Eagle Star Investments

Weekly News

15th December 2008

Global Overview

Equity markets remain under pressure

The fate of US car manufacturers dominated markets last week, as initial optimism about a $14 billion bail-out plan for the struggling industry turned to gloom when the US Senate stalled on agreeing a rescue package. Despite this, equity markets stayed in positive territory on the week, with some markets registering decent gains.

US economic data

Worries about the potential fall-out from a collapse of the three car manufacturers raised concerns over further job losses. Elsewhere, news such as US initial jobless claims rising to a 26-year high at 573,000 and the trade deficit widening unexpectedly in October, reinforced recent dire economic releases.

European data

ECB Governing Council members, Axel Weber and Yves Mersch, cast doubt about the extent of future eurozone rate cuts, suggesting that aggressive interest rate cuts might be off the agenda. In an interview over the weekend, ECB President, Jean-Claude Trichet, warned that European policymakers must exert fiscal discipline and not tear up the rule book when launching emergency economic rescue packages.

Commodities

Oil prices sank below $45 a barrel after concern that a prolonged recession will significantly reduce fuel demand. However, oil prices rallied towards the end of the week with markets expecting OPEC to announce a cut in output of between 1 and 1.5 million barrels a day. In currency markets, sterling weakened to a record low and the €/£ rate reached a high of 0.89. £/$ traded at 1.50 with markets remaining convinced that the Bank of England will continue cutting interest rates. Elsewhere, the dollar weakened with the €/$ rate finishing the week at 1.33.

Index		Year to Date Return 31.12.07 to 12.12.08		1 Week Return 05.12.08 to 12.12.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-40.1	-34.5	0.4	-4.8
US	NASDAQ	-41.9	-36.5	2.1	-3.2
Europe	FT/S&P Europe Ex. U.K.	-45.3	-45.3	5.4	5.4
Ireland	ISEQ	-63.9	-63.9	1.0	1.0
UK	FTSE 100	-33.7	-45.4	5.7	2.5
Japan	Topix	-44.9	-26.3	3.5	-1.1
Hong Kong	Hang Seng	-46.9	-41.7	6.6	1.1
Australia	S&P/ASX 200	-44.6	-54.4	0.6	-0.6
Bonds	Merrill Lynch Euro over 5 year Govt.	7.6	7.6	-2.7	-2.7

Global Equities

United States

Overview

The market suffered fresh volatility as investors focused on the future of the US auto industry which teetered nervously between bailout and bankruptcy.

Auto sector – Just as the failure of the US car industry seemed inevitable, the US Treasury performed a U-turn over the weekend, signalling that it is ready to step in with funds to rescue the car makers. This bailout plan is likely to be in the form of a short-term loan which will tide them over until Congress decides on the next step.

Dow Chemical – One of the world's largest chemical groups, is to cut 5,000 jobs (11% of its workforce), to close 20 plants in the US and Europe and leave idle 180 in an effort to reduce capital expenditure and withstand the global economic downturn. The proceeds from this aggressive cost-cutting plan will be used to pay for the $15.3 billion all-cash takeover of Rohm & Haas, a speciality chemicals manufacturer.

Europe

Overview

European markets recovered from the previous week's losses to close the week 5.4% higher.

HBOS – Shareholders in the British bank overwhelmingly approved the bank's takeover by Lloyds TSB and a £11.5 billion cash injection from the government. The vote came after HBOS, which owns Halifax and Bank of Scotland said that bad debts would jump to £8 billion this year, mostly from corporate lending, which was higher than analysts' expectations.

Ireland

Overview

Despite the volatility within global financial markets, the Irish market closed the week with a small gain, finishing the week 1% higher.

Recapitalisation of Irish banks – Over the weekend, the Irish Government announced that a fund of up to €10 billion is to be made available for recapitalising Irish banks and Building Societies. This Fund will be made up of money from the National Pension Reserve Fund, private investors and existing shareholders. The state will be able to underwrite an issue of new shares by lenders or take shares in banks under the plan.

Asia Pacific

Overview

Early in the week, President-elect Barack Obama's announcement of an increase in the level of infrastructural expenditure boosted Asian markets. However, falls in global equity markets were echoed across Asian markets on Friday, erasing some of the strong gains made earlier in the week. Despite this, both the Hang Seng and Topix Indices rose by 6.6% and 3.5% respectively over the week.

Bonds

Eurozone bonds retreated following recent strong gains as investors took profits in thin December markets. The Merrill Lynch over 5 year government bond index fell 2.7% on the week.

Global Outlook

- Global policymakers continue to address the most dangerous economic situation for 70 years, with aggressive interest rate reductions and extraordinary interventions in the financial markets. Policy action is intended to stabilise the banking system and prevent the global recession from becoming a prolonged deflationary slump.
- Efforts to revive the money markets and banking system - the lifeblood of the real economy - have been slow to work and in the meantime the banking crisis has rapidly spread into the real economy where companies, their suppliers and customers are credit-constrained. A more rapid improvement in the money markets is vital if further deterioration in economic activity is to be forestalled.
- Despite current rates being at extremely low levels, further falls in official short term interest rates will be seen in a host of countries over the coming weeks and months. The ECB will probably have to lower rates by at least another 1%, to 1.5% and UK rates will likely fall below 1%. In the US, even with rates now at 1%, investors expect rates to fall to 0.5% or lower at this week's meeting. With rates at these levels, the Fed is likely to be preparing more unconventional interest rate policies - such as trying to actively lower longer term interest rates. It is a longer than normal meeting this week and they are likely to be discussing this issue.
- With some markets priced for the deepest slump since the Great Depression, government bonds have received strong safe haven flows. Bond prices may suffer periodically as governments step-up their borrowings substantially, but the very weak growth and very low inflation backdrop will continue to underpin the market.
- The shattering loss of confidence in corporate bond markets is also manifest in equity markets, where investors have become almost inured to the huge volatility, the seemingly random price action and large price falls. Co-ordinated policy action is intended to arrest that fear and set the stage for the return of some confidence into the banking system, the real economy and equity markets. History suggests that powerful rallies can occur in the midst of severe bear markets - such as we have experienced this year - especially when sentiment is totally shattered, as it has become in the past two months. The key to any sustainable rally however is the unfreezing of the money markets and the re-opening of the corporate bond markets. Expect volatility and uncertainty to persist until those markets begin to return to normality.
- Currently, the funds are close to neutral in equities and overweight bonds, versus the manager average. Within equity sectors the funds are overweight healthcare and underweight basic materials and financials. Geographically, the funds have an underweight position in Ireland and Japan, and are slightly overweight in the US, the UK, Europe and the Pacific Basin.

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