

Eagle Star Investments

Weekly News

22nd December 2008

Global Overview

Equity markets remain mainly stable to positive

Equity markets rebounded early in the week after the US government confirmed details of a rescue plan for the car companies and the US Federal Reserve decided to cut interest rates to virtually zero. Some of the gains were lost in the next couple of days, but despite this, most markets registered modest gains over the week.

US economic data

The US Federal Reserve slashed interest rates from 1% to almost zero, highlighting deep concern among policymakers over the severity of the economic crisis. The US central bank surprised markets as it lowered its overnight lending target rate to between 0% and 0.25%, taking it to the lowest level in decades.

European data

The minutes of December's Bank of England Monetary Policy Committee meeting reflected a unanimous decision to cut rates by 1%, taking interest rates to 2%, and that a more aggressive move had even been considered. Elsewhere, the German Ifo institute index registered 82.6, confirming that business confidence is at its lowest since 1982.

Commodities

Oil prices sank under \$34 a barrel for the first time since April 2004, in spite of OPEC's latest effort to reduce output by 2.2 million barrels a day (7% of the cartel's output quota). In currency markets, sterling weakened to a record low on fears that further UK interest rate cuts are in store. The €/£ rate reached a high of 0.96 on Thursday, whilst £/\$ rate finished the week at 1.49. Elsewhere, the dollar hit a three-month low against the euro after the US Federal Reserve cut interest rates close to zero, and the €/£ rate finished the week at 1.39.

Index		Year to Date Return 31.12.07 to 19.12.08		1 Week Return 12.12.08 to 19.12.08	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-39.5	-36.5	0.9	-2.9
US	NASDAQ	-41.0	-38.0	1.5	-2.4
Europe	FT/S&P Europe Ex. U.K.	-45.1	-45.1	0.5	0.5
Ireland	ISEQ	-65.8	-65.8	-5.4	-5.4
UK	FTSE 100	-33.6	-47.7	0.2	-4.2
Japan	Topix	-43.5	-25.9	2.6	0.5
Hong Kong	Hang Seng	-45.6	-42.5	2.5	-1.4
Australia	S&P/ASX 200	-43.0	-53.7	3.0	1.6
Bonds	Merrill Lynch Euro over 5 year Govt.	9.9	9.9	2.1	2.1

Global Equities



United States

Overview

US stocks rose, extending the second straight weekly advance, as President's Bush's rescue plan for carmakers alleviated concern that a collapse of the industry would result in massive job losses.

Auto sector – General Motors and Chrysler will receive up to \$17.4 billion in short-term loans from the US government as part of an aid package to the troubled auto industry. According to details of the plan, the package involves \$13.4 billion in short-term refinancing from the first \$350 billion tranche of the troubled asset relief programme (TARP). An additional \$4 billion will be made available in February, although it will be conditional on drawing down the remaining \$350 billion of the TARP.



Europe

Overview

Despite equity market volatility, European markets finished the week gaining marginally by 0.5%.

BNP Paribas – the French bank announced that its investment banking division had registered a loss of €720 million (\$1.03 billion) for the first 11 months of this year. This bad news also coincided with the bank admitting to a possible \$464 million exposure to the alleged fraud of Bernard Madoff in the US.



Ireland

Overview

It was another volatile week on the ISEQ as banking stocks in particular continued to suffer steep declines, with the index ending the week over 5% lower.

Anglo Irish Bank – Anglo Irish Bank Chairman Sean Fitzpatrick announced his resignation last week, after it emerged that he had failed to disclose personal loans, totalling €87 million, that he had with the bank. Whilst failure to properly disclose the loans is not illegal, the practice adopted was inconsistent with the bank's corporate governance policy. As the story unfolded, resignations by Lar Bradshaw, a non-executive director with Anglo, and chief executive David Drumm followed swiftly, resulting in the share price tumbling as low as 19 cent at one point.

Irish government steps in to recapitalise three main Irish banks – The Irish government stepped in over the weekend to partly recapitalise the three main Irish banks, Anglo Irish Bank, Bank of Ireland and AIB Bank through the use of taxpayers' funds totalling €5.5 billion. Anglo Irish Bank is to receive €1.5 billion and in exchange the State will take an effective 75% controlling stake in the bank. The investment will take a form of preference shares, with an annual fixed dividend of 10%. Bank of Ireland and AIB are each to receive €2 billion of capital in return for preference shares that will pay a return of 8% per year to the State.



Asia Pacific

Overview

Expectations that the Bank of Japan would cut interest rates at the weekend helped markets to make moderate gains as banking stocks rallied. As forecast, Japan's central bank cut its key interest rate to 0.1% and comes after the government lowered its economic forecast for the fiscal year to March, w from 1.3% to -0.8%. Both the Topix and Hang Seng indices rose by 2.6% and 2.5% respectively over the week.

Bonds

The decision by the Fed to lower rates close to zero and its statement that it is considering buying long-term US government bonds, plus some weak German data caused bonds to gain significantly over the week. The Merrill Lynch over 5 year government bond index gained 2.1% on the week.

Global Outlook

- Global policymakers continue to address the most fragile economic situation for 70 years through 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. Growth and employment are certain to be sharply lower in 2009 but the aim is to get some stability in the forward looking indicators during the next few months.
- There is ample evidence of how the global banking crisis has spread into the real economy where companies, their suppliers and customers are credit-constrained and the bad debt cycle is deteriorating further. There are some signs that efforts to revive the money markets and banking system have been successful - risk spreads in these markets have fallen significantly in recent weeks - but much more needs to be done.
- Global short rates will continue to be lowered over the coming weeks and months. Despite the ECB downplaying expectations of a January rate cut, it will still likely drive rates closer to 1% before this cycle is over. Rates are now close to zero in the US and the Fed is focused on driving down other interest rates, such as the level of rates that companies have to pay in order to raise debt financing. Further unconventional policy responses will be seen there and in other countries over coming months.
- With some markets priced for the deepest slump since the Great Depression, government bonds have received strong safe haven flows, with bond markets experiencing the strongest conditions in decades. Prices may suffer periodically as governments step-up their borrowings substantially and profit-taking is always a risk but the economic backdrop continues to demand a low level of short and long term interest rates.
- Equity markets have clearly discounted a pretty weak economic picture going forward but the vicious cycle of bad debts and unemployment has not been stabilised yet. The new unconventional policies of the Fed and some optimism around further fiscal stimulus measures from the new US administration may inject some near term stability in the markets. But the key to any sustainable rally remains 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 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.

This outlook does not constitute an offer and should not be taken as a recommendation from Eagle Star/Zurich. Advice should always be sought from an appropriately qualified professional.