Eagle Star Investments

Weekly News

5th January 2009

Global Overview

Equity markets end the year on a positive note

Despite persistent concerns about the outlook for the global economy, along with dismal economic data releases, equity markets experienced an end-of-year rally, with the widening of the bailout package for US carmakers being well received.

US economic data

According to the US Institute for Supply Management, factory activity fell to a 28-year low at 32.4 in December with the manufacturing category continuing to contract at an accelerated pace. Elsewhere, the S&P/Case-Shiller home-price index of 20 cities fell by a record 18% in October from a year earlier.

European data

European manufacturing contracted in December at its fastest pace on record, signalling that the recession is deepening. The Purchasing Managers Index (PMI) slumped to 33.9 in December, a low not seen in the survey's 11-year history and well below the forecast of 34.5. Slumping production in eurozone factories increases the pressure on the European Central Bank to cut interest rates further this year, with investors betting it will do so as early as January.

Commodities

Oil prices rose to over $46 a barrel over the week as concern over the conflict between Israel and Hamas in the Middle East outweighed the economic downturn. In currency markets, sterling weakened to a record low against the euro, with the euro threatening to hit parity against sterling, due to heightened expectations that the Bank of England is poised to cut interest rates at its policy meeting next week. The €/£ rate reached a high of 0.98 on Tuesday, its strongest level since the launch of the single currency in 1999, falling back later on in the week to stand at 0.96. Elsewhere, the €/$ rate finished the week just over 1.25% weaker, at 1.39.

	Index	1 Week Return 26.12.08 to 02.01.09	
		Local Currency %	Euro %
US	S&P 500	6.8	8.1
US	NASDAQ	6.7	8.0
Europe	FT/S&P Europe Ex. U.K.	3.0	3.0
Ireland	ISEQ	3.5	3.5
UK	FTSE 100	8.2	7.9
Japan	Topix	1.5	2.0
Hong Kong	Hang Seng	6.1	7.4
Australia	S&P/ASX 200	3.7	8.9
Bonds	Merrill Lynch Euro over 5 year Govt.	0.3	0.3

Global Equities

United States

Overview

In spite of continuing disappointing data releases, optimism about the effectiveness of fiscal initiatives, along with the widening of the bailout package for US carmakers, lifted sentiment, causing markets to gain by nearly 7%.

GMAC – The Federal Reserve confirmed last week that it will provide $6 billion to strengthen GMAC's finances. The Treasury will buy $5 billion worth of preferred shares in GMAC as part of the $700 billion financial rescue known as TARP, and it will lend $1 billion to General Motors, which, in turn, will invest $1 billion in GMAC. The financing affiliate of General Motors immediately announced that it will loosen its criteria for vehicle loans in an attempt to draw consumers back into dealerships.

Europe

Overview

With all equity markets enjoying an end-of-year rally, European markets finished the week up by 3.0%.

Credit Suisse – the Swiss banking giant announced that it has sold part of its Global Investors business to Aberdeen Asset Management in return for a 25% stake in the UK fund manager. The share-based deal is worth approximately £250 million and comes only a month after Credit Suisse revealed its intentions to cut more that 5,000 jobs in a bid to save 2 billion Swiss francs, after it sustained further losses due to the financial crisis.

Ireland

Overview

The market reacted positively to news that the Irish government is investing €5.5 billion in preference shares in AIB (€2 billion), Bank of Ireland (€2 billion) and Anglo Irish Bank (€1.5 billion), ending the week with a healthy gain of 3.5%.

Asia Pacific

Overview

Despite the constant flow of weak economic data suggesting that a recovery may be some time off, Asian markets responded optimistically to the stimulus packages announced by governments in the US, Europe and across the Asian region. Both the Topix and Hang Seng indices enjoyed the end-of-year rally, rising by 1.5% and 6.1% respectively.

Bonds

Eurozone bonds registered small gains last week as equity markets rallied. The Merrill Lynch over 5 year government bond index gained 0.3% on the week.

Global Outlook

- As we enter the new year, the economic situation remains fragile. Policymakers have attempted to prevent a deflationary slump through aggressive interest rate reductions and extraordinary interventions in the financial markets. 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.
- The crisis of confidence in the global banking system has meant that companies, their suppliers and customers have become credit-constrained and the volume of banks' bad debts has risen appreciably. This is why much of the effort of policymakers has been directed at trying to support the banking system, reduce the funding costs of banks and to get credit flowing back to the real economy. Some of these efforts have begun to yield results - funding costs, for example, have begun to fall - but so far the results have been mixed and there is much work still to be done on this front.
- Global short rates will remain low or fall further 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 likely be seen there and in other countries over coming months.
- Government bond prices have risen appreciably in the last few months due to falling short rates and slumping equity and corporate bond markets. Some commentators have begun to wonder whether government bonds have now entered a bubble period. While it is likely that prices may suffer periodically as governments step-up their borrowings substantially - and profit-taking is always a risk - it remains the case that the economic backdrop should be bond-supportive for a while to come. Ultimately the level of short and long-term rates may be seen as "emergency" levels and, hence, not sustainable but that has not been the focus to date.
- Equity markets have clearly discounted a pretty weak economic picture going forward but the vicious cycle of bad debts and unemployment has not yet been stabilised. There is some optimism surrounding the new unconventional policies of the Fed and further fiscal stimulus measures from the new US administration, which may inject some near-term stability in the markets. Bounces to date have been short lived because the key to any sustainable rally remains the unfreezing of the money markets and the re-opening of the corporate bond markets. Markets will remain volatile and their direction uncertain 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.

Print Ref: CSA63

Eagle Star Life Assurance Company of Ireland Limited
Eagle Star House, Frascati Road, Blackrock, Co. Dublin, Ireland.
Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurich.ie

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