Eagle Star Investments
Weekly News
12th January 2009

Global Overview

Markets end lower as fear returns

After a few weeks of gains on equity markets, investor sentiment turned negative last week as poor economic data worldwide resurrected fears that the global recession was worsening. This comes just before the start of what most analysts are expecting to be one of the worst earnings seasons in years.

US economic data

US manufacturing and non-manufacturing activity continued to contract in December, but this was overshadowed by a large jump in US job losses in December. 524,000 jobs were lost, bringing the total for 2008 to 2.6 million, the biggest annual slide since 1945. The unemployment rate now stands at 7.2%.

European data

Data released last week supported expectations of a rate cut from the European Central Bank, when it meets this week. Industrial output in the largest countries of the single currency economy and the first rise in German unemployment since 2006 added to the calls for an interest rate cut, especially as eurozone inflation is currently under the ECB target.

UK interest rates

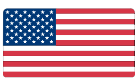
As expected, the Bank of England cut rates by a further 0.5%, to 1.5%, to bring rates to the lowest level since the BoE was founded in 1694.

Commodities

Oil prices rose to over $50 early in the week as concerns were heightened by the conflict between Israel and Hamas. However, signals of further economic contraction and a large increase in stockpiles caused it to slump, finishing the week at just over $40 per barrel.

Index		Year to Date Return 31.12.08 to 09.01.09		1 Week Return 02.01.09 to 09.01.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	-1.4	2.1	-4.5	-1.5
US	NASDAQ	-0.3	3.2	-3.7	-0.8
Europe	FT/S&P Europe Ex. U.K.	2.6	2.6	-0.3	-0.3
Ireland	ISEQ	14.6	14.6	11.0	11.0
UK	FTSE 100	0.3	8.1	-2.5	5.4
Japan	Topix	-0.5	3.7	-0.5	3.9
Hong Kong	Hang Seng	-0.1	3.4	-4.4	-1.6
Australia	S&P/ASX 200	0.4	4.1	0.6	-3.7
Bonds	Merrill Lynch Euro over 5 year Govt.	-0.7	-0.7	-1.0	-1.0

Global Equities



United States

Overview

Just before what analysts expect to be an extremely tough earnings season, US equity markets slipped into negative territory for 2009 as job losses in December came in at the elevated level most had expected.

Wal-Mart – The consumer staples sector was hit hard after the world's biggest retailer, Wal-Mart, issued a profit warning, cutting its fourth-quarter earnings forecast. It finished the week almost 10% lower. This led many other consumer stocks lower, in a sector that can usually weather a slowing economy.

Europe

Overview

Fears for the global economy, along with weak eurozone economic data, caused European markets to finish the week in the red.

Commerzbank – Shares in the German bank slumped after it was announced that the German government would take a 25% stake in the bank, in order to help cover its acquisition of Dresdner Bank from the insurer Allianz. Its share price was 30% lower over the week.

Oil sector – Oil prices fell more than 11% over the week, reversing some of the previous week's gain, on the back of disappointing US inventory data. Oil stocks finished the week lower as a result.

Ireland

Overview

The Irish market finished the week 11% higher with Irish Life & Permanent, Anglo Irish Bank and Elan leading the way.

Elan – Renewed hope for Tysabri and speculation about a €4bn bid from Pfizer helped Elan gain by 40% over the week.

Asia Pacific

Overview

Early week optimism about the potential US stimulus plan was offset by weak economic data showing economies worldwide are continuing to contract, affecting the export-reliant Asian markets heavily.

Bonds

Eurozone bonds fell last week as supply continues to rise with governments continuing to pursue fiscal measures to help protect economies. The Merrill Lynch over 5 year government bond index fell 1% on the week.

Global Outlook

- As the new year gets underway, the economic situation remains fragile, with the employment picture likely to remain extremely bad throughout the year. Policymakers have attempted to prevent a deflationary slump, through aggressive interest rate reductions and extraordinary interventions in the financial markets, aiming to get some stability in the forward-looking indicators during the next few months.
- The crisis of confidence in the global banking system means that companies, their suppliers and customers continue to be credit-constrained and, at the same time, 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, to reduce the funding costs of banks and to get credit flowing back to the real economy. There has been some partial success in this area - funding costs, for example, have begun to fall - but there is much work still be to be done on this front.
- Global short rates will remain low or fall further over the coming weeks and months. Despite the ECB trying to downplay expectations of a rate reduction this week, the data in the eurozone has been so weak in the past month that rates are more-than-likely to be cut. In any event, rates will probably get 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, with some commentators wondering 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. It is true that ultimately the level of short and long-term rates may be seen as "emergency" levels and, hence, not sustainable but that is not within the markets' time horizon yet.
- Global equity markets have rallied since mid to late November and, in that time, have weathered an onslaught of dreadful economic news and employment data. That gives some support to the idea that markets have discounted a very weak economic picture going forward. There is some optimism surrounding the new unconventional policies of the Fed and further fiscal stimulus measures from the new US administration and other jurisdictions. As before, 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 the direction uncertain until those markets begin to return to normality.
- Currently, the funds are slightly overweight equities and bonds, versus the manager average. Within equity sectors, the funds are overweight healthcare and technology 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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