Eagle Star Investments

Weekly News **27th July 2009**

Global Overview

Equity markets continue to make strong gains

Global equity markets extended their recent run of form, as encouraging economic data and continued optimism about the earnings season boosted risk appetite, on hopes for an economic recovery. Tentative signs of stabilisation in the US housing market, along with news that US corporate lender CIT appeared to have avoided bankruptcy after securing a $3bn short-term finance package, led some markets to their highest levels of 2009.

US economic data/indicators

Investors got a boost from upbeat economic data, with existing home sales' numbers showing continued signs of improvement, rising by 3.6% in June. Meanwhile, the VIX index of US equity volatility fell below 24, its lowest level since before the collapse of Lehman Brothers last September.

European economic data

The German Ifo business sentiment index rose for a fourth consecutive month in July to 87.3, its highest level since October 2008, compared to 85.9 in June. Also, on a positive note, the rate of contraction in European manufacturing and service slowed by more than expected with the composite index rising to 46.8 in July, from 44.6 in June.

Oil and currencies

On commodity markets, the oil price traded higher in line with equity markets, on hopes that an economic recovery would fuel demand. The oil price rose by 7% over the week, ending above $68 a barrel. In currency markets, the €/$ rate ended the week at 1.42, as the safe-haven demand for the dollar currency diminished in response to an improvement in risk appetite.

	Index	Year to Date Return 31.12.08 to 24.07.09		1 Week Return 17.07.09 to 24.07.09	
		Local Currency %	Euro %	Local Currency %	Euro %
US	S&P 500	8.4	6.4	4.1	3.5
US	NASDAQ	24.7	22.3	4.2	3.6
Europe	FT/S&P Europe Ex. U.K.	8.5	8.5	4.4	4.4
Ireland	ISEQ	19.6	19.6	3.8	3.8
UK	FTSE 100	3.2	14.1	4.3	4.2
Japan	Topix	7.1	0.6	4.8	3.3
Hong Kong	Hang Seng	38.9	36.3	6.3	5.6
Australia	S&P/ASX 200	9.9	25.0	2.2	3.5
Bonds	Merrill Lynch Euro over 5 year Govt.	0.7	0.7	0.1	0.1

Global Equities

United States

Overview

US equity markets reached their highest levels of 2009 on upbeat economic data releases, along with the majority of corporate earnings reports exceeding expectations.

Coca Cola – The beverage maker reported a 43% increase in second-quarter profit, exceeding analysts' estimates. For the three months ending 3rd July, the company posted a gain of $2.04bn, up from $1.42bn, a year earlier. The company noted that rapid overseas growth had more than offset weak domestic volumes.

Caterpillar Inc – The world's largest maker of machinery reported stronger-than-expected earnings and raised its full-year forecast.

Morgan Stanley & Wells Fargo – The two companies bucked the corporate earnings trend, with disappointing second-quarter results due to higher expenses and surging bad debts respectively.

Europe

Overview

European equities gained 4%, taking them to their highest level in 2009, as hopes for an economic recovery in the US delivered renewed optimism to most sectors.

GlaxoSmithKline – The pharmaceutical company posted a 12% rise in second-quarter net profit, to £1.43bn, after currency benefits offset sales lost to generic versions of some of its drugs. The company has forecast increased orders for its anti-flu drug Relenza and huge pre-orders for the H1N1 vaccine that the company expects to have ready later this year.

Ireland

Overview

The Irish market finished the week almost 4% higher, led by banking, construction and resource stocks.

Ryanair – The airline posted a profit for the first three months of its financial year of €136.5m, compared to a loss of €90.5m for the same period a year earlier, as a result of a 42% fall in the cost of fuel.

Asia Pacific

Overview

Asian markets followed the rest of the world higher as investors digested more upbeat economic releases, better-than-expected second-quarter earnings reports and evidence that stimulus plans are working. Both the Topix and Hang Seng indices made healthy gains, ending the week up 5% and 6% respectively.

Bonds

With equity and commodity markets gaining sharply, investors opted away from the perceived safety of government bonds. Comments from Ben Bernanke, the chairman of the Federal Reserve, attempted to assuage investor worries about the US central bank's intention to exit from its accommodative monetary policies. Mr. Bernanke emphasised that any change to this policy was still some time off, owing to the vulnerability of the economic recovery. The Merrill Lynch over 5 year government bond index gained 0.1%.

Global Outlook

- Economic data has stabilised after being in freefall earlier this year, and GDP forecasts are currently being revised higher. Leading indicators of future activity have improved considerably from their worst levels. Signs of less stress in the financial system have bolstered this process although, outside of China, bank lending is moribund and this remains a concern. China's positive growth story definitely helps sentiment although it is not really helping the rest of the world, while Asia's growth is still dependent on exports to a weakened US consumer sector.
- The scale and scope of policy initiatives to save the banking system and offset the collapse in private sector demand have been unprecedented. Because of the scale of the global crisis, the ultimate success of these efforts - or their unintended consequences - is still far from certain. Put another way, whether the outlook is inflationary or deflationary, and which comes first, remains an open question.
- Short rates have likely reached their cyclical lows in the major economies, at somewhere between 0% and 1%. The major central banks feel in a quandary, however, trying to keep policy easy while talking about exit strategies from their various initiatives, including their partially-successful quantitative easing (QE) policies. As a result, investors' expectations of the timing of rate hikes have gyrated wildly over the past couple of months but have been more stable in the past couple of weeks, pricing in modest increases in most short rates early next year.
- It looked like bonds were in a more constructive phase but they have been hit as sentiment has swung heavily in favour of equities. Although many commentators continue to speculate on the long-term inflation risks from the current policy mix, inflation indicators are still pointing downwards. In the eurozone, peripheral bond markets, such as Ireland, have been helped by improved funding positions, although budgetary concerns are still evident. The near-term outlook will be determined by how risk assets behave, although, adjusted for inflation, bonds are at attractive levels.
- Developed equity markets have embraced recent earnings' data and the continued surge in China's equity indices. The caveats - that China's equity market now has bubble characteristics, that final demand remains weak and that earnings have been boosted by cost control - are interesting in themselves but secondary to the more bullish sentiment now evident. Technically, the equity markets have broken out of recent ranges and this normally sets the stage for further gains. Investors will therefore watch near-term price action very carefully.
- Currently, the funds are neutral to overweight equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology, and underweight industrials and utilities. Geographically, the funds have an underweight position in Ireland and the US, are closer to neutral in Japan and the UK, and are overweight in the Pacific Basin and Europe.

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