Eagle Star Investments

Weekly News 9th August 2010

ZURICH

Global Overview

Equity markets trade higher

The release of solid corporate earnings results, in particular from European banks, pushed markets higher early in the week. Fresh unease about the strength of the US recovery, along with disappointing US employment data, eroded some of these gains later in the week, but equity markets still managed to end the week in positive territory.

US economic data

New claims for jobless benefits jumped by more than expected, adding to the uncertainty surrounding the US labour market. US non-farm payrolls and housing data also disappointed.

Central Bank meetings

As expected, the Bank of England and ECB both left interest rates unchanged at 1% and 0.5%, respectively.

China plans property "Stress Tests"

Chinese regulators have demanded stress tests on loans to a range of industries including cement and steel, whose results are closely tied to property markets. These tests form part of a wider investigation into the banks' ability to withstand falls in house prices.

Currencies

Increasing worries that the Federal Reserve will have to take further steps to stimulate an economic recovery in the US caused the dollar to come under renewed pressure last week. The €/$ rate ended the week at 1.33.

Commodities

Wheat prices grabbed the headlines as they raced higher, after Russia announced it would temporarily stop grain exports. Elsewhere, initial optimism over the global recovery helped oil trade $2 higher, at $81 a barrel. However, worries that US economic recovery would be slower-than-expected, caused it to slip back to end the week at just under $81 a barrel.

	Index	Year to Date Return 31.12.09 to 06.08.10		1 Week Return 30.07.10 to 06.08.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	0.4	8.3	1.6	0.4
US	S&P 500	0.6	8.7	1.8	0.1
US	NASDAQ	0.9	8.9	1.5	-0.2
Europe	FT/S&P Europe Ex. U.K.	-0.1	-0.1	1.3	1.3
Ireland	ISEQ	-1.4	-1.4	0.6	0.6
UK	FTSE 100	-1.5	5.2	1.4	1.4
Japan	Topix	-5.1	12.0	1.4	1.1
Hong Kong	Hang Seng	-0.9	6.9	3.1	1.4
Australia	S&P/ASX 200	-6.3	3.1	1.6	1.1
Bonds	Merrill Lynch Euro over 5 year Govt.	6.4	6.4	1.7	1.7

Global Equities

United States

Overview

Despite the latest economic data releases casting doubt over the US economic recovery story, US equities recorded healthy gains over the week as the majority of corporate earnings continue to be strong.

Earnings releases – Pfizer reported better-than-expected quarterly earnings. The company announced that its full-year profit will be at the upper end of its forecasts, due to cost savings from its recent merger with Wyeth. Conversely, however, Procter & Gamble reported that net income in its most recent quarter fell by 11% as consumers switched to cheaper non-branded alternatives.

Europe

Overview

Better-than-expected corporate earnings results, notably from European banks, helped drive markets over 1% higher.

BNP Paribas – The French bank reported that lower provisions for bad loans and strong retail banking helped its second-quarter net profit surge to €2.11 billion ($2.7 billion), up 31% from €1.6 billion in the corresponding period a year earlier.

HSBC – The bank announced that its half-year profit more than doubled from a year ago, as bad debts fell to their lowest level since the start of the financial crisis.

Ireland

Overview

The Irish market followed the rest of the world higher, gaining marginally over the week.

AIB – The bank recorded a pre-tax loss of just over €2 billion for the first half of the year, with bad debts increasing over the period. It warned it will need continued support from the Government and called for an extension to the State Bank Guarantee Scheme.

Asia Pacific

Overview

Despite the latest Chinese PMI data showing further signs of a slowdown in the growth of manufacturing activities for July and concerns over China introducing property "stress tests", both Hong Kong's Hang Seng and the Japanese Topix Index gained over the week.

Suzuki Motor – The Japanese car-maker recorded its highest quarterly operating profit in two years, boosted by its presence in the fast-growing Indian market.

Bonds

Despite equity markets finishing the week in positive territory, bond markets made healthy gains last week. Peripheral bond markets, in particular, benefited amid worries regarding the outlook for the US economy and the possibility of further quantitative easing announcements in the US. The Merrill Lynch over 5 year government bond index rose 1.7% over the week.

Global Outlook

- Economists expect the global economy to expand by around 3.5% this year, although weak bank lending and financial market volatility add to downside risks for this forecast. Inflation pressures globally remain modest, reflecting weaker data in the US, Europe and Japan and stronger readings in emerging economies and Asia. Exports are very strong from some European economies but domestic demand remains subdued and concerns linger about whether the private sector in Europe and the US can grow without continued government support.
- The eurozone debt crisis had reawakened worries about sovereign creditworthiness, the long-term consequences of the credit burst and the unintended consequences of a myriad of policy actions – factors which periodically increase the risk concerns of equity investors. Investors have not been focusing on such concerns of late, however.
- Central banks continue to set interest rates at emergency levels in Europe and the US, although they have risen somewhat in some of the stronger economies such as Canada, India and China. By extension, 2011 rate expectations remain very close to their cycle lows in the US, UK and eurozone. Investors, therefore, expect that low rates will persist for some time, a view reinforced by the recent testimony from Federal Reserve Chairman, Ben Bernanke.
- These low short-term interest rates, combined with disinflation concerns, continue to be of general support to the major bond markets such as Germany, the US and Japan. Peripheral bond spreads in the eurozone have narrowed of late, with the general situation much calmer since Greece has fallen out of the investment grade universe. However, it is clear that the longer-term success of the euro project will require a more centralised fiscal framework than we have currently and it is likely that this issue will come to the fore again at some stage.
- Global equities are flat so far this year but this masks very substantial volatility - four 7%+ falls, one 14% recovery and the recent 9% rally. Low interest rates certainly provide some forward support to risk markets and the reaction to the strong US earnings' season and European bank stress tests has been more on the positive side than the negative. Also, investors seem to believe that the Fed will soon embark on another quantitative easing policy ("QE2"). Sentiment and market action are positive and further gains are possible, although the pattern of the market this year makes us slightly cautious still.
- Currently, the funds remain underweight equities and overweight bonds, versus the manager average. Within equity sectors, the funds are reasonably balanced, with a slight overweight in technology and an underweight in consumer goods. Geographically, the funds are underweight in Ireland and the US, are neutral in Japan, the UK and the Pacific Basin and are overweight Europe.

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