Eagle Star Investments

Weekly News 13th September 2010

ZURICH

Global Overview

Equities finish higher, volatility remains
Fresh concerns about the health of the European banking system, along with worries that July's "stress tests" had understated some lenders' holdings of potentially risky assets, weighed heavily on investor sentiment early in the week. As the week progressed, however, better-than-expected US data releases boosted investor confidence and most equity markets recorded modest gains for the week as a whole.

US economic data
Latest initial jobless claims dropped by 27,000 to 451,000, the lowest level in almost two months. Also on a positive note, latest trade data reflected a narrowing trade deficit and went some way to reassuring investors about the pace of the economic recovery.

Eurozone region
Eurozone countries stepped up borrowing to fund their economies with a renewed round of sovereign debt issuance, adding to investors' concerns over the region. Elsewhere, fears were heightened by reports that Germany's ten largest banks may need an extra €105 billion.

Bank of England interest rate decision
The Bank of England left its benchmark interest rate unchanged at a record low level of 0.5% and announced no new quantitative-easing purchases.

Currencies
Concerns regarding the methodology behind the European banking sector stress tests, weighed on the euro currency earlier in the week. The €/$ rate ended the week at 1.27, a fall of 1%. Elsewhere, the Australian dollar reached a record high against the euro as stronger-than-expected domestic employment data raised expectations of a rate hike next month.

Oil & Gold
Despite choppy trading, heightened risk appetite combined with upbeat economic data, bolstered commodities' prices and the oil price ended the week above $76 a barrel, a 2% weekly gain. Elsewhere, gold came within striking distance of the $1,265 record level in June, before easing back to $1,244.

	Index	Year to Date Return 31.12.09 to 10.09.10		1 Week Return 03.09.10 to 10.09.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	0.3	12.1	0.8	1.8
US	S&P 500	-0.5	12.1	0.5	1.8
US	NASDAQ	-1.2	11.3	0.4	1.7
Europe	FT/S&P Europe Ex. U.K.	1.4	1.4	1.4	1.4
Ireland	ISEQ	-6.5	-6.5	-0.7	-0.7
UK	FTSE 100	1.6	9.0	1.4	2.2
Japan	Topix	-8.1	14.5	1.2	2.8
Hong Kong	Hang Seng	-2.8	9.3	1.4	2.7
Australia	S&P/ASX 200	-6.4	8.7	0.4	2.8
Bonds	Merrill Lynch Euro over 5 year Govt.	6.8	6.8	-0.6	-0.6

Global Equities

United States

Overview
Despite low trading volumes in a week shortened by the Labor Day Holiday, better-than-expected jobs and trade data helped lift optimism about the economic recovery.

National Semiconductor – The Company reported better-than-expected profit of $89 million, for the quarter ending 31 August. However, it revised down its sales forecast for the next quarter as companies reduce inventory levels.

Europe

Overview

European stocks rose by 1%, after a report showed fewer-than-estimated Americans applied for jobless benefits.

Information Technology sector – This sector was one of the strongest performers over the week, rising almost 3% on upbeat global data.

Ireland

Overview

The Irish market put in a weaker performance than those of its European counterparts, declining by almost 1% on the week.

Anglo Irish Bank – The Irish government announced a solution for winding down beleaguered Anglo Irish Bank. The bank will be split in two, one part becoming a deposit only bank and the other part being wound down over a number of years.

Allied Irish Banks – The bank announced it will boost capital by €2.5 billion through the sale of its Polish unit to Spain's Banco Santander.

Asia Pacific

Overview

The Japanese Topix Index along with Hong Kong's Hang Seng Index, both recorded healthy gains over the week as investors responded to better-than-expected US payroll numbers.

Bonds

The deterioration in sentiment triggered a sell-off in peripheral eurozone government bonds with the spread between German and Irish 10-year government bonds widening to a record 372 basis points. This narrowed somewhat, however, after Ireland announced it would wind down troubled Anglo Irish Bank and the European Central Bank stepped in to purchase peripheral eurozone debt. The Merrill Lynch over 5 year government bond index fell 0.6% over the week.

Global Outlook

- Global growth forecasts are quite healthy enough for this year and next (3.6% and 3.3%). However, weak bank lending and financial market volatility add to downside risks to both forecasts and there have been some concerns over a double-dip in the US economy. Inflation pressures globally remain modest, reflecting weaker data in developed economies and stronger readings in emerging economies and Asia. Indeed, further disinflation is a greater near-term concern than inflation. Exports are very strong from some European economies but domestic demand remains subdued and the global economy is still very lopsided. The key concern is whether the private sector in Europe and the US can grow without continued government support.
- 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 have reached new cycle lows in the US, UK and eurozone, in many ways an extraordinary situation which is at odds with the expectations for recovery.
- Low short-term interest rates, combined with disinflation concerns, have been a support to major bond markets such as Germany, the US and Japan, and long-term interest rates have recently fallen to levels that have concerned many risk investors and policymakers. Bond prices have since retreated from their recent highs as stronger economic data have somewhat allayed fears of an imminent slide towards recession. Peripheral bond spreads in the eurozone have also narrowed from recent wides, including in Ireland, where spreads over Germany have retreated from recent cyclical wides of 3.75% to 3.40% currently. Some of this recent Irish weakness had been due to illiquid trading conditions, with a sense that Ireland's fiscal measures have been swamped by its banking woes. It is quite possible that the rescue mechanism in place for eurozone countries will be further tested in the months ahead.
- Global equities are only modestly lower this year but this masks very large gyrations: we have had four 7%+ falls, one 9% and one 14% rally. Related to this is that investors' convictions are very low and holding periods very short. Low interest rates certainly provide some forward support to risk markets. Additionally, investors seem to believe that the Fed will ride to the rescue with further quantitative easing policy ("QE2"), although the Fed's recent comments do not suggest anything new is imminent. Sentiment and market action have turned mixed again and bond market developments are a concern for equity markets as they suggest that the macro environment is deteriorating; caution is probably warranted still.
- Currently, the funds are neutral equities and slightly overweight bonds, versus the manager average. Within equity sectors the funds are now reasonably balanced. Geographically, the funds are underweight in Ireland and the UK, overweight Europe and closer to neutral in other markets.

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