Eagle Star Investments

Weekly News 20th September 2010

ZURICH

Global Overview

Mixed week for equities
Most equities finished the week higher following upbeat economic and earnings releases, along with government interventions in the currency market. Fears surrounding the budget deficit of a number of eurozone countries intensified, curtailing some of the markets' gains.

Eurozone growth
The European commission revised its growth estimate for 2010 upwards, after seeing strong growth in Q2. It said the economy may grow 1.7%, almost double its previous estimate.

Irish bond spreads
Rumours that the Irish government would require financial aid from the ECB or IMF caused the spread between German and Irish 10-year government bonds to widen to a record 388 basis points towards the end of the week. The spread is the extra yield investors demand to hold Irish instead of German debt.

US economic data
Consumer sentiment fell to a one-year low on fears that personal income taxes, for households with incomes above $75,000, would increase next year.

Japanese intervention
After remaining at a 15-year high, the Japanese government intervened in the market by selling yen reserves in order to weaken the currency of the export-led economy.

Oil & dollar
The unexpected drop in consumer sentiment was a factor in the price of oil declining during the week, as investors speculated that demand would weaken as a result. The price ended the week below $74 a barrel, a weekly decline of 4%. The decline in the €/$ rate to 1.30, reducing the appeal of commodities as alternative asset, also impacted on the oil price.

	Index	Year to Date Return 31.12.09 to 17.09.10		1 Week Return 10.09.10 to 17.09.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	1.4	11.1	1.1	-0.9
US	S&P 500	0.9	10.8	1.4	-1.1
US	NASDAQ	2.0	12.1	3.3	0.6
Europe	FT/S&P Europe Ex. U.K.	0.7	0.7	-0.7	-0.7
Ireland	ISEQ	-9.0	-9.0	-2.7	-2.7
UK	FTSE 100	1.8	8.2	0.1	-0.7
Japan	Topix	-6.1	12.0	2.2	-2.2
Hong Kong	Hang Seng	0.4	10.1	3.4	0.8
Australia	S&P/ASX 200	-4.8	9.2	1.7	0.5
Bonds	Merrill Lynch Euro over 5 year Govt.	6.0	6.0	-0.8	-0.8

Global Equities

United States

Overview
US markets rose for the third week running as industrial production increased and headline inflation figures continued to increase slightly, easing the fear of a deflationary spiral.

Technology – The tech sector led the way as Cisco announced it was going to start paying a dividend, while Microsoft is planning a debt sale to pay for dividends and Oracle posted expectations-beating results.

Europe

Overview

European stocks came off their four-month highs, as German investor confidence fell more than forecast and fears surrounding the budget deficits of some countries in the region dragged markets lower.

Carrefour – The French retailer unveiled ambitious targets on sales and margins to analysts at its meeting in Lyon, causing the stock to rally over 6% on the week.

Ireland

Overview

The Irish market got significant attention last week, following a report from Barclays that said the country 'may need to accept external assistance, if there are additional financial-sector losses or the economy worsens'. Financials were hardest hit.

Allied Irish Banks – The bank finished the week 13% lower on rumours of an additional €3bn of capital being required in order to meet the regulator target of €7.4bn Tier 1 capital. Further to this, it was hit by technical-selling after it was removed from a number of FTSE indices.

Asia Pacific

Overview

Asian stocks rose for another week, helped mainly by Japan's intervention in the currency market and a positive economic report from China showing growth in industrial output. Export-reliant companies, including Sony, Honda and Canon, all saw shares rise on the back of the currency intervention to make the yen weaker.

Bonds

Eurozone bonds fell for the third successive week as the appeal for risk assets increased. This followed signs that the global economy may avoid a double-dip recession as growth gains momentum once again. Fears that some countries in the region, most notably Ireland, would fail to narrow their budget deficits still exist, though. The Merrill Lynch over 5 year government bond index fell by 0.8% 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 remained under widening pressure, including in Ireland, where spreads over Germany made new wides of 3.9%. 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 in Europe and closer to neutral in other markets.

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