Eagle Star Investments

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ZURICH

Global Overview

Mixed picture for equities

Equity markets experienced a mixed week, finishing mostly flat in Europe and the US, while Asia Pacific markets fell. Ireland and Japan were the obvious exceptions, both rising strongly.

Ireland's bailout

After days of speculation, Ireland finally issued a formal application for financial aid to the EU/IMF over the weekend. Details are still scarce, but the facility is commonly expected to be in the region of €80-90 billion.

US data

The US domestic economic picture continued to show some signs of improvement, with strong retail sales in October and a marginally better employment picture. However, a record-low CPI number showed the economy still flirting with deflation.

China

The People's Bank of China increased its banking reserve ratio for the fifth time this year, to a record high of 18%, in a bid to cool exuberant lending and also announced measures to stabilise prices, particularly in the food sector.

Currencies

The €/$ ended the week more-or-less unchanged as the Irish financial aid story dominated the headlines. It ended the week just above the 1.36 mark, having weakened to 1.34 midweek.

Oil

Oil prices retreated for another week, following China's move to increase its banking reserves, which investors believe will slow growth in the country. Oil finished the week at $81 a barrel, a fall over 4%.

	Index	Year to Date Return 31.12.09 to 19.11.10		1 Week Return 12.11.10 to 19.11.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	7.2	13.9	0.4	0.3
US	S&P 500	7.6	13.0	0.0	0.2
US	NASDAQ	11.0	16.5	0.0	0.1
Europe	FT/S&P Europe Ex. U.K.	4.1	4.1	0.6	0.6
Ireland	ISEQ	-5.9	-5.9	4.6	4.6
UK	FTSE 100	5.9	9.9	-1.1	-2.0
Japan	Topix	-4.2	12.2	2.7	1.6
Hong Kong	Hang Seng	7.9	13.3	-2.5	-2.4
Australia	S&P/ASX 200	-5.0	9.5	-1.4	-1.1
Bonds	Merrill Lynch Euro over 5 year Govt.	3.6	3.6	-1.2	-1.2

Global Equities

United States

Overview

In the week that GM returned to the market with a higher-than-expected issue price of $33, the US market overall was flat. In corporate earnings news, Q3 was the sixth-straight quarter that over 70% of companies have beaten expectations.

Caterpillar – The world's largest maker of construction equipment agreed to buy Bucyrus, which is primarily a drilling equipment company, for $7.6 billion. Shares in Caterpillar rose almost 4% over the week.

Europe

Overview

While the UK market continues to struggle with falling commodity prices and poorly-performing bank stocks, other European exchanges rose, with Germany leading the way, up 1.6%.

Basic resources – The effect of Chinese policy was felt on the metals market also, with copper falling on the week. BHP Billiton (-1.3%) and Rio Tinto (-2%) led basic-resources stocks lower.

Ireland

Overview

The Irish market was the standout performer (+4.6%) as stocks rallied in anticipation of the country being granted financial aid in order to help deal with its debt crisis.

Allied Irish Banks – Despite the bank announcing that deposits have shrunk by 17% this year, the equivalent of €13 billion, its share price rose 13% over the week, but this has been given back in this mornings trading.

Asia Pacific

Overview

Asia Pacific stocks were mostly down last week as the Chinese authorities introduced further measures to cool the domestic economy, while Korea also raised interest rates. However, Japan outperformed for the second week in a row, with more evidence of foreign buyers and a strong end to the earnings season.

Bonds

Eurozone bonds suffered last week as talks about a financial aid package for Ireland continued through most of the week. Irish bond spreads versus Germany narrowed over the five days, as Bund yields moved higher, the first time this has happened since early October. The Merrill Lynch over 5 year government bond index finished the week 1.2% lower.

Global Outlook

- Global growth forecasts for next year remain fairly healthy although, at the margin, they are being revised lower at the moment. Asian economies are still strong; indeed, parts of China's economy are still too strong for the authorities there. However, the global economy continues to be quite lopsided and the underlying strength of private sector demand in Europe and the US remains a key concern for policymakers. Inflation pressures globally remain modest, reflecting weaker data in developed economies and stronger readings in emerging economies and Asia.
- 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. In the US, UK and eurozone, 2011 rate expectations have risen between 0.3% and 0.5% from their recent cycle lows, with the ECB keen to normalise monetary policy as quickly as possible; witness its abrupt change of policy on funding Irish banks, with its new policy of trying to transfer Irish bank risk from the ECB's balance sheet to the Irish State and the EU/IMF. Given the precarious state of some of the peripheral economies, we would expect the ECB to stay on hold for some time to come; for different reasons, the same conclusion applies to the Fed.
- German and US long-term interest rates have risen by 0.4% to 0.5% from recent record or near-record levels. Irish 10-year bond spreads versus Germany are now at 5.3%, a fall of 1.3% from the recent wides. Note that Greek spreads are not far from the wides that prevailed before its rescue package was put in place. Ireland's application for EU/IMF loans has not produced a sudden dramatic reduction in Irish bond yields: the Greek experience has tempered investors' reactions and investors need to consider whether this move is sufficient to address Ireland's problems and whether Portugal can avoid the same fate. Thus, the situation is likely to drag on for some time to come. Ultimately, a full scale, long-dated ECB-funded mechanism will likely be needed.
- Global equities have gained 7% this year but it has been a period of very high volatility with several large gains and falls over that time. Low interest rates certainly provide some forward support to risk markets and earnings' expectations have been managed well by companies. The net impact of the Fed's further quantitative easing policy ("QE2") has been neutral, but markets and sentiment had been strong in the anticipation of such moves and the break into new ranges appears to have been a false one. The fuel for further gains may be limited in the very short term, but investors anticipate a more positive seasonal sentiment thereafter.
- Currently, the funds are neutral equities and overweight bonds versus the manager average. Within equity sectors, the funds are now reasonably balanced. Geographically, the funds are underweight in Ireland, the UK and the US, overweight in Europe, further overweight in Pacific Basin and closer to neutral in other markets.

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