Eagle Star Investments

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ZURICH

Global Overview

Equities rally

It was a good week for equities as economic data worldwide and moves by the European Central Bank to help ease the debt crisis gave markets a boost.

European Central Bank meeting

The ECB held interest rates constant at its latest policy meeting. In the press conference announcing its decision, Jean-Claude Trichet challenged political leaders to do more to fix their budgets. Spain was the latest country to announce measures. It plans to raise tax on tobacco and set a date for a pensions' overhaul.

US data

The unemployment rate jumped to 9.8% in November as payroll growth slowed to 39,000, down from 172,000 in October. There was positive data elsewhere though, as manufacturing data continued to point to expansion in the economy and retail sales rose by the most in eight months.

Currencies

The euro rose against the dollar for the first week in a month after data worldwide boosted the appeal of higher-yielding assets. The €/$ rate ended the week just below 1.34, a gain of 0.9% over the week.

Oil

Oil prices rose over 6% last week, as economic data in Europe and China pointed to increased demand. The effect of a weaker dollar, boosting the appeal of commodities as an alternative investment, also contributed to the gain.

	Index	Year to Date Return 31.12.09 to 03.12.10		1 Week Return 26.11.10 to 03.12.10	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	8.3	17.4	2.3	1.9
US	S&P 500	9.8	17.7	3.0	2.0
US	NASDAQ	14.2	22.4	2.2	1.3
Europe	FT/S&P Europe Ex. U.K.	4.4	4.4	2.1	2.1
Ireland	ISEQ	-7.9	-7.9	2.8	2.8
UK	FTSE 100	6.1	10.9	1.4	1.2
Japan	Topix	-3.1	16.9	1.4	2.0
Hong Kong	Hang Seng	6.6	14.2	1.9	1.0
Australia	S&P/ASX 200	-3.6	13.7	2.1	3.7
Bonds	Merrill Lynch Euro over 5 year Govt.	2.3	2.3	-0.5	-0.5

Global Equities

United States

Overview

US stocks produced good returns for the week following upbeat economic data, most importantly in the manufacturing and retail sectors. Elsewhere, the ECB's efforts to stem the region's debt crisis and data out of China also supported markets.

Abercrombie & Fitch – The clothing group announced that sales surged 22% in November, well exceeding expectations. Shares finished the week 16% higher.

Home Depot – Shares in the largest home-improvement retailer rallied 8% over the week. This followed data which showed that construction spending rose in October.

Europe

Overview

European markets posted their first gain in four weeks as the ECB held rates constant and bought some Irish, Greek and Portuguese bonds to try to help ease the debt crisis.

Basic resource stocks – Metal prices rallied on the back of upbeat economic data and a weakening dollar. ArcelorMittal, the world's biggest steelmaker, rose by 8% during the week.

Ireland

Overview

The Irish market pared some of its 2010 losses when it rose almost 3% last week. Upbeat construction data in the US contributed to CRH rising over 6%, rebounding from its previous week's fall.

Basic resource stocks – Bank of Ireland and Irish Life soared, recouping large losses from previous weeks, as Irish banks will receive as much as €35 billion of EU/IMF aid to stabilise and recapitalise the financial system.

Asia Pacific

Overview

After three weeks of declines, Asian markets rose in line with the rest of the world. Key reasons for the rise included the improving data in the US, which is seen as boosting demand for products from Asian companies, and a slight easing of the European debt crisis. Inflation and the possibility of monetary tightening in China still remain in investors' focus though.

Bonds

Eurozone bonds fell for another week as investors speculated as to what other options are open to the ECB if the crisis worsens. These include boosting the size of the temporary rescue fund, cutting interest rates on bailout loans or issuing joint bonds for the euro nations. The Merrill Lynch over 5 year government bond index finished the week 0.5% 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. The global economy continues to be quite lopsided and the underlying strength of private sector demand in parts of Europe and in the US remains a key concern for policymakers. Inflation pressures overall 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 been increased in some of the stronger economies such as Canada, India and China. In the US, UK and eurozone, 2011 rate expectations are still only 0.3% above their cycle lows. The ECB is obviously keen to normalise monetary policy as quickly as possible. That is part of the reason why it changed its stance so abruptly on Irish banks in the last few weeks. However, 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 0.5% to 0.8% from recent record or near-record levels; in the short-term, with rate expectations falling again, bond yields are unlikely to rise much further from here. Irish 10-year bond spreads versus Germany are now at 5.3%, a fall of 1.3% from the recent wides. This followed the EU/IMF loan package but, more importantly, some reasonably sized purchases of Irish bonds by the ECB. The Greek experience has tempered investors' reactions to such moves; certainly one would expect the authorities to have learned from this experience and continue to try to narrow Irish spreads. Things are unlikely to run as smoothly as that, however. The EU institutions have been very reactive in this period, responding to crises rather than getting ahead of events. It is unlikely that we will get through this peripheral country debt situation without a full scale, long dated, ECB- funded mechanism.
- In what has been a year of high volatility, global equities have gained around 8% so far and, in local currency terms at least, markets have just made a high for this year. In the short-term, markets may just have run their course. We have had a strong recovery from the low point of the year and some of the sentiment measures are quite high. Nonetheless, we are entering what is generally a seasonally positive time for equity markets, when investors will be looking to extrapolate the most recent trend into the new year.
- Currently, the funds are neutral equities and overweight bonds, versus the manager average. Within equity sectors, the funds are overweight technology and underweight financials with other positions reasonably balanced. Geographically, the funds are underweight in Ireland, the US and Europe, neutral in the UK and Japan and overweight in Pacific Basin.

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