Zurich Life
Weekly Investment News

15th August 2011

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Global Overview

Volatility continues

Equity markets gyrated violently, but a recovery late in the week masked the wild swings. This rebound, helped partly by the Federal Reserve's comments and economic data, saw markets bounce from recent lows and finish the week only marginally lower.

US

At its latest meeting, the Fed announced it would keep interest rates at emergency lows until at least mid-2013. Elsewhere, following some disappointing data recently, markets got a boost from jobless claims and retail sales being better-than-expected. Consumer sentiment, however, fell to a thirty-year low.

Short selling ban

In order to try to restore order to markets, France, Italy, Spain and Belgium imposed a short selling ban on financial stocks for the next couple of weeks. Short selling is the practice where an investor makes money from an asset when the price of it declines.

Bank of England

The BoE's Inflation Report showed that it expected GDP growth to be lower than previously estimated. Inflation expectations were also downgraded, giving the BoE some reprieve from the high inflation/low growth environment since the turn of the year.

Currencies

The euro traded in a range against the dollar last week and the €/$ rate ended the week unchanged at 1.42. The main news on currency markets involved the Swiss franc. The Swiss franc rose almost 8% against both the dollar and the euro, following the market sell off of financials early in the week. The Swiss National Bank injected liquidity and this helped the Swiss Franc to give up most of its gains.

Oil & gold

The oil price (West Texas) rebounded in line with equity markets late in the week, to finish at $85 a barrel, a fall of 1.7%. Gold ended the week 5% higher at $1,739, yet another record high.

	Index	Year to Date Return 31.12.10 to 12.08.11		1 Week Return 05.08.11 to 12.08.11	
		Local Currency %	Euro %	Local Currency %	Euro %
Global	FTSE World	-9.2	-12.1	-1.3	-1.6
US	S&P 500	-6.3	-12.0	-1.7	-1.6
US	NASDAQ	-5.5	-11.2	-1.0	-0.9
Europe	FT/S&P Europe Ex. U.K.	-15.3	-15.3	-1.4	-1.4
Ireland	ISEQ	-12.6	-12.6	0.6	0.6
UK	FTSE 100	-9.8	-11.6	1.4	0.9
Japan	Topix	-14.5	-15.3	-4.1	-2.0
Hong Kong	Hang Seng	-14.8	-20.2	-6.3	-6.1
Australia	S&P/ASX 200	-12.1	-16.6	1.6	0.2
Bonds	Merrill Lynch Euro over 5 year Govt.	3.4	3.4	2.8	2.8

Global Equities

United States

Overview

US stocks fell for a third straight week on fears the reduction of the nation's credit rating and Europe's debt crisis would cause the global economy to falter. The S&P 500 traded in a 7.7% range during the week.

Stocks – Walt Disney sank 6% after posting disappointing quarterly studio revenue. Financials were among the worst-performing stocks with Bank of America, one of the weakest, falling 12%.

Europe

Overview

European markets ended the week 1% lower as fears surrounding a global economic slowdown were added to the continued debt problems in the region. In particular, France came under fresh pressure to convince turbulent markets it can deliver on debt targets and maintain its prestigious triple-A rating.

Commerzbank – The German bank's second-quarter profits were all but eliminated by €760 million in impairments on Greek sovereign debt.

Ireland

Overview

The ISEQ was one of the few equity markets to buck the trend and deliver a positive return for the week.

Bank of Ireland – The Bank reported an underlying loss before tax of €723 million for the first half of this year, down from a loss of €1.32 billion the same time last year.

Asia Pacific

Overview

Japan's Topix and Hong Kong's Hang Seng staged a sharp retreat, ending the week down 4% and 6% respectively. Latest inflation data from China showed that CPI came in higher-than-expected at 6.5%, with food prices still the main driver. Elsewhere, Japan's economy shrank by a less-than-expected 1.3% in the second quarter, compared to market expectations of a 2.7% contraction.

Bonds

Eurozone bonds made substantial gains during the week due to their relative safe-haven status and the volatile trading environment for equities. In an effort to prevent France and Italy from being drawn into the debt crisis, the ECB purchased €22 billion of government bonds. This resulted in the narrowing of peripheral spreads. The Merrill Lynch over 5 year government bond index rose 2.8% last week.

Global Outlook

- Current and forward indicators of economic activity suggest that global growth rates have likely peaked for the moment. Investors are now concerned that this is more than a mid-cycle pause and is, perhaps, something more significant. Inflation has been more of a regional or country-specific concern for investors, particularly in some Asian countries, but there are some shared global concerns, such as energy and food prices. However, some of these could dissipate if growth moderates further. So far, there are no major countries actively seeking currency strength, a key indicator that central banks are not concerned about inflation.
- Official interest rates remain at emergency levels in the US and, given last week's explicit statement from the Fed, investors expect this situation to persist for another two years; two-year US rates have just reached a new low of 0.19%. The balancing act facing the ECB is very problematic, with the peripheral economic position a considerable complication to its decision-making. Rates are very low in the eurozone, despite recent increases, and future rate expectations have flipped over now with some small reduction now expected before year end. This may be a little premature but the change of direction seems correct and validates the idea that the current hiking cycle would be very short.
- The ECB buying of Italian and Spanish bonds has had a positive impact but the ECB's commitment to this buying is a subject of some debate, both inside the ECB and elsewhere. Investors are impatiently waiting for the next anticipated development – a jointly guaranteed eurobond – but it is unclear whether this is politically possible. The situation remains fluid and sentiment fragile. The US debt ceiling debacle has resulted in a temporary fix that could come back quickly to investors' attention and the downgrade by S&P complicates matters. However, US treasuries are likely to continue to receive flows amid equity market volatility and continued uncertainty in Europe. Overall, it appears that long-term interest rates in the US and Germany remain on a neutral to downward trend and that further falls are likely over the coming weeks, but perhaps not immediately. More EU action is likely but it remains to be seen whether the peripheral debt crisis has been fully addressed.
- In what has been a volatile year, global equities are down around 12% in euro terms, although the vast bulk of that fall happened in the past two weeks. Valuations are reasonable but investors are now questioning the path of future corporate profits, given renewed economic growth worries. The consensus expectation for gains during this year has taken a battering recently, although a lot can happen between now and the end of the year. Currently, we remain concerned that further slow-down concerns have yet to be fully discounted by investors despite recent negative price action. However, in the short term, markets could rebound somewhat given the recent sharp sell-off which has put them into oversold territory.
- Currently, the funds are closer to neutral in equities (having added exposure last week) and neutral bonds versus the manager average. Within equity sectors, the funds remain underweight financials and overweight technology. Geographically, the funds are underweight in Ireland and the UK, neutral in Japan, neutral to overweight in Europe and the US and overweight in the Pacific region.

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