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14th April 2014

The week gone by

Global **equities** overall fell out of bed last week. Stocks started to roll over as sell-offs in aggressive growth sectors spilled into the broad market. The Q1 earnings' results season, which has just kicked off, will be critical. Equities continue to be supported by the expectation of strong corporate earnings' growth and low interest rates. Valuations, however, are no-longer attractive.

The global index (in euro terms) fell by 3.3% last week giving a total return year-to-date of minus 1.2%. Many of the major **markets** were in negative territory in local currency terms last week led by Japan (-6.7%) and Europe (-3.5%); the global index moved below its 50-day moving average but remains well above the key 200-day moving average.

Eurozone **bond** markets rose by 0.2% last week and are up an impressive 6.3% year-to-date led by Spain (+9.5%) and Italy (+8.1%). The German 10-year bond yield fell further from 1.55% to 1.50% last week; its 2013 low was around 1.2%. Equivalent US yields are at 2.62%. Eurozone bonds have benefited from deflationary concerns and speculation that the ECB may introduce unconventional measures to boost growth. Commodity prices in general rose by a further 1.5% last week; commodities remain one of the best performing asset classes so far this year (+10.4%).

	Index	1 Week Return 04.04.14 to 11.04.14		Year to Date Return 31.12.13 to 11.04.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	-3.3	-3.3	-1.2	-1.2
US	S&P 500	-2.6	-3.9	-1.8	-2.4
Europe	FT/S&P Europe Ex. U.K.	-3.5	-3.5	1.2	1.2
Ireland	ISEQ	-3.5	-3.5	8.8	8.8
UK	FTSE 100	-2.0	-2.3	-2.8	-2.5
Japan	Topix	-6.7	-6.4	-12.9	-10.4
Hong Kong	Hang Seng	2.2	0.9	-1.3	-2.0
Australia	S&P/ASX 200	0.1	-0.1	1.4	6.0
Bonds	Merrill Lynch Euro over 5 year	0.2	0.2	6.3	6.4

The week ahead

- The US Q1 corporate earnings season gets into full swing this week. It is forecast that March CPI (Tuesday) rose 0.1% month-on-month and 1.4% year-on-year (last: 0.1% and 1.1% respectively).
- In the UK, it is likely that March CPI (Tuesday) edged down to 1.6% year-on-year (last: 1.7%).
- In Japan, it is estimated that the index of tertiary activity (Friday) fell 0.1% in February, which would be the first decline in two months.
- Chinese Q1 GDP growth (Wednesday) is forecast to slow to 7.3% year-on-year (last: 7.7%).

Global Outlook

- The general economic backdrop for 2014 still continues to necessitate a reasonably loose monetary policy in several of the major regions. Central Banks are generally neutral in their stance.
- Despite fund flows and investor positioning causing a dip in the S&P and Eurostoxx indices over the past week, the fundamental outlook for the US and Eurozone for the year remains unchanged. De-risking and sector rotation were seen over the past week, evident in a shift away from higher beta to lower beta stocks. Sectors that had been strong year to date were heavily sold. The fundamentals for stocks and sectors punished heavily in the rotation have not changed. Appetite for risk still remains. However, investors appear to be reviewing positioning.
- Strategists continue to favour equities over bonds, based on relative valuation. Equity markets valuations are at more normal levels and are expected to continue to perform strongly into 2014, despite recent volatility, as long as growth expectations continue to be met. The broadly positive equity market outlook for 2014 is driven largely by expectations for earnings growth, as valuation multiples in many sectors and many markets are relatively high. We view market weakness as an opportunity to add to positions.
- In the US, consensus expectations continue to be for the Fed to end over half a decade of QE by Sep 2014. Yellen is perceived to weigh unemployment more heavily than inflation in the Fed goals. Therefore expectations are for rates to remain low for an extended period beyond the end of QE. Although Yellen's suggestion of an initial rate hike in spring 2015 remains possible, the Fed is still likely to remain data dependant ahead of taking any action, which is supported by the dovish tone of the most recent Fed minutes. These comments should provide US$ strength. US growth is still sub-par by historic standards but, importantly, it is stable with signs of improvement. Inflation remains below target levels and core CPI (ex energy and food) is still relatively benign. However, confidence appears to remain in the US growth story, with GDP to be buoyed by accelerated consumer spending and capital expenditures.
- There is some caution built into estimates given market valuations appear to be fair, the S&P 500 had reached record highs during Q1. Fed tapering could eventually cause a pull back but appears so far to be well baked into expectations causing little reaction to date.
- Export led Emerging markets may see some benefit from an accelerating US economy; however, this will be overshadowed by the headwinds facing Emerging markets, including rising US interest rates, a stronger US$ and negative sentiment around China. This may keep emerging market equities out of favour in the near term.
- The Japanese market remains volatile with some weakness in recent weeks. A stabilisation in the exchange rate is sought ahead of seeing Japan outperform. There are continued expectations that the Bank of Japan may announce further stimulus in 2014, but the impact of the increase in domestic consumption tax may need to be assessed by the BoJ ahead of taking any action.
- Expectations are for more stable debt markets across the EU, given the ECB's credible commitment to preserving the Euro by buying periphery bonds. This was evident in the Ireland and Greek 5 year bond auctions last week. Focus remains on growth and inflation expectations, which remain low. Bond markets remain vulnerable to upside growth surprises. Confidence in the ability of the ECB and policymakers to manage the peripheral debt situation remains high. In particular the trajectory of Eurozone inflation is of paramount importance. The ECB has reiterated their commitment to managing inflation through use of unconventional policy tools if necessary. Their unambiguous language in relation to forward guidance also underlined their intentions to maintain accommodative monetary policy going forward. However, there are still many challenges to be negotiated in peripheral countries as credit growth remains challenged.
- Zurich Life funds are close to neutral in bonds versus the manager average with a slight overweight in equities. The funds are underweight energy and tech stocks and overweight industrials and consumer services. Geographically, the funds are underweight the UK and Asia Pacific region, neutral in the US and Japan, overweight Ireland and slightly overweight Europe.

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