ZURICH

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The week gone by

Global **equities** pushed strongly ahead last week with the world index (in euro terms) hitting a new all-time high on Friday. International money flows continue to favour European equities although economic confidence in the euro area has receded following the publication of some weaker data. Global industrial confidence, however, has generally improved owing to upside surprises in the US and China. Equities continue to be supported by the expectation of strong corporate earnings' growth and low interest rates. Valuations, however, are now considered to be 'fair' or at normal levels.

The global index (in euro terms) rose by 1.5% last week giving a total return year-to-date of 4.8%. Most of the major **markets** were in positive territory in local currency terms last week led by Japan (+1.8%), the US (+1.2%) and Europe (+1.2%); the global index remained well above its 50-day moving average and remains significantly above the key 200-day moving average.

Eurozone **bond** markets fell back by 0.4% last week but are up an impressive 7.9% year-to-date led by Spain (+11.4%) and Italy (+8.7%). The German 10-year bond yield rose slightly from 1.33% to 1.41% last week; its 2013 low was around 1.2%. Equivalent US yields were unchanged at around 2.53%. Eurozone bond prices, although somewhat expensive, have benefited in recent weeks from deflationary concerns and speculation that the EBC may introduce some form of QE.

	Index	1 Week Return 02.05.14 to 23.05.14		Year to Date Return 31.12.13 to 23.05.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	1.5	1.5	4.8	4.8
US	S&P 500	1.2	1.8	2.8	4.0
Europe	FT/S&P Europe Ex. U.K.	1.2	1.2	3.4	3.4
Ireland	ISEQ	3.9	3.9	6.5	6.5
UK	FTSE 100	-0.6	-0.1	1.0	3.8
Japan	Topix	1.8	1.9	-9.4	-5.3
Hong Kong	Hang Seng	1.1	1.7	-1.5	-0.3
Australia	S&P/ASX 200	0.3	-0.6	2.6	7.5
Bonds	Merrill Lynch Euro over 5 year	-0.4	-0.4	7.9	7.9

The week ahead

- US corporate news is expected to be relatively light during the holiday-shortened week, with a handful of consumer and retail names comprising most of the earnings announcements. A rebound is expected in the University of Michigan's index of consumer sentiment (Friday) to 83.0 (last: 81.8).
- At the EU Summit (Monday & Tuesday) heads of governments will take stock of the results of the EU Parliamentary elections.
- In the UK, it is likely that the May consumer confidence index (Friday) improved further to -1 (last: -3).
- In Japan, it is estimated that the April nationwide core CPI (Friday) rose to 3.1% year-on-year (last 1.3%). Excluding VAT hike effects, that amounts to a 1.3% year-on-year rise.

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.
- 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.
- Despite recent volatility seen within the US and European indices, driven by sector/style rotation, the outlook for equity markets remains unchanged. Appetite for risk still remains.
- Volatility at the index level has actually been quite subdued, while within sectors a contrast to that is still somewhat evident at the individual stock level. Further style factor shifts will still contribute to volatility levels, however, to a lesser degree in the near term given a lot of this has passed for now. Lower correlation, greater dispersion, and higher volatility will likely continue to be seen in the near term.
- 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 which the market is pricing in as the Fed is still expected to remain heavily data dependant ahead of raising interest rates. US growth is still sub-par by historic standards but confidence appears to remain in the US growth story.
- Export led Emerging markets may see some benefit from an accelerating US economy and the speculated quantitative easing in Europe; however, this will be overshadowed by the headwinds facing Emerging markets, including rising US interest rates, a stronger US$ and negative sentiment and uncertainty around China. This may keep investors sceptical on emerging market in the near term. Uncertainty around China will persist near term, however, there are signs of more positive policy co-ordination which will impact financial markets favourably in the region. We don't expect major easing in the region.
- The Nikkei has been weak and remains volatile. A stabilisation in the exchange rate is sought ahead of seeing Japan outperform. Monetary policy is expected to remain loose for some time to come. There are continued expectations that the Bank of Japan may announce further stimulus in 2014, however, economic data points are coming in favourably and the BoJ may potentially push QE out further as long as the data remains strong. The latest consumer tax hike doesn't appear to have had a significant impact on inflation in the region to date.
- Expectations are for more stable debt markets across the EU. 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. The trajectory of Eurozone inflation is of paramount importance. The ECB's unambiguous language in relation to forward guidance underlined their intentions to maintain accommodative monetary policy going forward. The possibility of the ECB instigating further QE remains. However, there are still many challenges to be negotiated in peripheral countries as credit growth remains challenged.
- Zurich Life funds are slight overweight in equities and close to neutral in bonds versus the manager average. The funds are underweight energy and tech stocks and overweight industrials and consumer goods. Geographically, the funds are underweight the UK and Asia Pacific region, neutral to slightly underweight Europe, slightly overweight North America and overweight Ireland.

Zurich Life Assurance plc
Zurich House, Frascati Road, Blackrock, Co. Dublin, Ireland.
Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurichlife.ie

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