Weekly Investment News

ZURICH

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The week gone by

Global **equities** overall moved slightly higher last week but only in euro terms. The world index was up for the seventh week-in-a-row, hitting a fresh all-time high on Tuesday. Stocks were adversely affected later in the week by the deteriorating situation in Iraq. Equities continue to be supported by the expectation of reasonably strong corporate earnings' growth and low interest rates. Valuations, however, are now considered to be 'fair' or at normal levels with the global 2014 price earnings (P/E) multiple trading at 15X.

The global index (in euro terms) rose by 0.5% last week giving a total return year-to-date of 7.5%. Many of the major **markets**, however, were in negative territory in local currency terms last week including the UK (-1.2%), the US (-0.7%) and Europe (-0.5%).

Eurozone **bond** markets fell by 0.2% last week but are up an impressive 9.5% year-to-date led by Spain (+14.6%) and Italy (+12.1%). The German 10-year bond yield rose marginally from 1.35% to 1.36% last week; its 2013 low was around 1.2%. Equivalent US yields were steady at around 2.6%. Eurozone bonds have benefited in the last number of weeks from deflationary concerns and the further reduction in ECB rates. Commodity prices in general rose by a further 1.5% last week due mainly to the rise in oil prices (+4%) on the back of Iraqi situation; commodities remain one of the best performing asset classes so far this year (+10.6%).

	Index	1 Week Return 06.06.14 to 13.06.14		Year to Date Return 31.12.13 to 13.06.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	0.5	0.5	7.5	7.5
US	S&P 500	-0.7	0.1	4.8	6.8
Europe	FT/S&P Europe Ex. U.K.	-0.5	-0.5	5.9	5.9
Ireland	ISEQ	-2.3	-2.3	7.9	7.9
UK	FTSE 100	-1.2	0.6	0.4	4.8
Japan	Topix	0.8	2.1	-4.5	0.4
Hong Kong	Hang Seng	1.6	2.4	0.1	2.0
Australia	S&P/ASX 200	-1.1	0.4	1.0	8.3
Bonds	Merrill Lynch Euro over 5 year	-0.2	-0.2	9.5	9.5

The week ahead

- In the US, it is likely that the Federal Reserve (Wednesday) will taper asset purchases by a further $10bn per month, evenly divided between Treasury and agency MBS. This would bring the monthly purchases down to $35bn. It is expected that May Industrial Production (Monday) rose 0.5% month-on-month (last: -0.6%) while headline CPI (Tuesday) increased by 0.2% month-on-month (last: 0.3%).
- In the UK, it is expected that the Monetary Policy Committee minutes (Wednesday) showed that members voted unanimously to keep policy on hold, with the Bank Rate at 0.5% and asset purchases at £375bn.
- It is likely that euro area final May HICP and core inflation will be confirmed (Monday) at 0.5% and 0.7% year-on-year respectively.

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 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.
- The broadly positive outlook for equity markets in the US has been somewhat in conflict with the behaviour of the US 10 year treasury yield over recent weeks. US bond yields (10 yr) have dropped from 3% at the beginning of this year to 2.6%, despite continued tapering in asset purchases by the Fed, an improving economic outlook and the consensus expectation for rate rises in 2015. However, low inflation and inflation expectations are a possible explanation. The level of yields could support a bearish growth outlook for the US. If yields remain low, there is a risk of more volatility across styles and sectors.
- So how do we reconcile the recent performance of the US 10 year and the outlook or equities? A slow climb in the 10 year UST yield and a re-bound in inflation towards its 2% level is needed to help support equity markets over the coming months. With little slack left in the labour force, wage pressure should help lift inflation. An increase in the participation rate would also be helpful in boosting consumer spending power.
- 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.
- Peripheral bond yields have resumed their downward trend, post the recent policy actions by the ECB. The ECB has reduced interest rates. The second initiative has been the introduction of a targeted LTRO which is aimed at reducing the cost of funding for Eurozone banks provided they lend to the corporate sector. The ECB's aim is to reduce corporate funding costs especially those in the peripheral economies. In addition, the ECB indicated that they are looking at further monetary easing to combat weak lending in the Eurozone and very low inflation.
- The governor of the Bank of England, Mark Carney signalled last week that interest rates in the UK will rose sooner then market expected. The strength of the UK economy has exceeded market expectations and unemployment has fallen faster then expected. Official interest rates may arise in the UK before year end.
- The Nikkei has outperformed in the last few weeks in parallel with a small weakening of the Japanese's currency. 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.
- Zurich Life funds are slight overweight in equities and close to neutral in bonds versus the manager average. The funds are underweight energy and financials and overweight consumer goods and tech stocks. Geographically, the funds are underweight the UK and Asia Pacific region, neutral Europe, overweight North America and overweight Ireland.

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