ZURICH

21st July 2014

The week gone by

Global **equities** recovered most of the previous week's losses to continue the long upward 2014 run which began in February. Overall, the bull market is now into its 65th month, the 4th longest bull market in history. Equities continue to be supported by the expectation of reasonably strong corporate earnings' growth and low interest rates. Valuations, however, have crept up with the 2014 price earnings (P/E) multiple now trading at 15.4X and the 2015 P/E at 13.8X; albeit equities remain better value relative to other asset classes.

The global index (in euro terms) rose by 1.2% last week giving a total return year-to-date of 9.0%. All of the major **markets** were up in local currency terms last week by roughly the same amount. The bellwether US market has been the top performing market so far this year.

Eurozone **bond** market prices were up again last week (+0.8%) and are up a staggering 11.5% year-to-date led by Spain (+14.9%) and Italy (+13.0%). The German 10-year bond yield fell from 1.20% to 1.15% last week equalling its 2013 low. Prices were supported by ongoing deflationary concerns and geo-political tensions in Ukraine. Equivalent US yields fell from 2.52% to 2.48%. **Commodity** prices in general were flat on the week (in dollar terms) and remain up 6.2% so far this year, led by livestock and soft commodities.

	Index	1 Week Return 11.07.14 to 18.07.14		Year to Date Return 31.12.13 to 18.07.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	1.2	1.2	9.0	9.0
US	S&P 500	1.2	-1.2	7.0	9.2
Europe	FT/S&P Europe Ex. U.K.	0.4	0.4	1.7	1.7
Ireland	ISEQ	0.9	0.9	3.5	3.5
UK	FTSE 100	0.9	1.3	0.0	5.1
Japan	Topix	0.7	1.2	-3.0	2.7
Hong Kong	Hang Seng	1.0	1.6	0.6	2.7
Australia	S&P/ASX 200	0.8	1.5	3.4	10.9
Bonds	Merrill Lynch Euro over 5 year	0.8	0.8	11.5	11.5

The week ahead

- The US Q2 earning results season is now in full swing with the emphasis this week on industrials and technology names. It is projected that June CPI (Tuesday) rose by 0.3% month-on-month (last: 0.4%) and 2.1% year-on-year (last: 2.1%). Existing home sales (Tuesday), new home sales (Thursday) and durable goods orders (Friday) are other key announcements.
- It is expected that euro area July 'flash' PMIs to move slightly upwards with the composite PMI (Thursday) inching up to 53.1 (last: 52.8).
- In the UK, it is estimated that Monetary Policy Committee members (Wednesday) voted unanimously to maintain policy on hold. It is expected that Q2 GDP grew by 0.8% quarter-on-quarter, consistent with 3.1% annual growth.
- It is forecast that China's July HSBC PMI improved to 51.0 (last: 50.7).

Global Outlook

- Strategists continue to favour equities over bonds, based on relative valuation. Equity markets have performed strongly year to date in most regions. Expectations are for markets to hold these higher levels/trading ranges, 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.
- Equity markets look reasonably valued, although not cheap, but alternatives such as cash or bonds are still not compelling on a relative basis. Volatility across most markets remains low. We continue to reflect our view by being overweight equities and underweight bonds.

United States

- The growth story in the US looks robust, with healthy economic momentum and share buy backs and M&A helping S&P maintain its current range close to its peak. Earnings remain a key focus. Second quarter earnings reports from companies have looked robust thus far with strong early reads from the financial sector, boding well ahead of a heavy earnings week this week. M&A activity and IPO activity continues to be buoyant. Tax inversion buyouts from the US into Europe are ongoing and often a cited driver of M&A.
- 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. If yields remain low, there is a risk of more volatility across styles and sectors, given the low level of yields could imply low future growth prospects.

Europe & UK

- In Europe, economic data points have been disappointing and expectations for earnings are low given companies are facing challenges still in most core regions, making the region less compelling. Geopolitical risk will continue to weigh on markets and investor sentiment near term. There are few catalysts to spur investor confidence in Europe and more visibility is required to change this. The UK market has been bolstered by M&A activity

Rest of World

- The Nikkei has remained strong in recent weeks in parallel with economic data looking healthier.
- Export led Emerging markets may see some benefit from an accelerating US economy and easy monetary policy 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.

Central Bank Watch:

- Whilst the general economic backdrop for 2014 still continues to necessitate a reasonably loose monetary policy in several of the major regions, the Fed and BoE are withdrawing some of their policy accommodation whilst the ECB and BoJ continue with their aggressively easy policies.
- In the US, the Fed is still on course to end over half a decade of QE by Sep 2014 and given Yellen's dovish tone, expectations are for rates to remain low for an extended period beyond the end of QE which the market is pricing in. The forward rate implied by the market is lower than the Fed's median member forecast, despite, expectations of rate rises in 2015, as the market remains focused on Chair Yellens continued dovish tone.
- A key focus for the Fed is wage inflation, seeking nominal wage growth ahead of price inflation ahead of actioning rate rises. Typically there is a lag between price inflation and wage inflation, however, the much discussed participation rate and productivity levels are key factors affecting the trajectory of wage inflation.
- The ECB's aim in holding current low interest rates and the targeted LTRO initiative 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. Although the emerging issues at Espirito caused some risk shift, the situation is not expected to take the Eurozone back to its crisis days. Weak economic momentum and inflation levels remain a focus.
- The governor of the Bank of England, Mark Carney has signalled that interest rates in the UK will rise sooner then market expected. The strength of UK economy has exceeded market expectations and unemployment has fallen faster then expected. Official interest rates may arise in the UK before year end.
- Japanese monetary policy is expected to remain loose for some time to come. Abe's efforts have broken the two-decade cycle of deflation. There are continued expectations that the Bank of Japan may announce further stimulus in 2014 as a measure to sustain the trajectory. However, economic data points are coming in favourably and the BoJ may potentially push QE out further as long as the data remains strong.

Positioning

- Zurich Life funds are slightly overweight in equities and neutral to slightly underweight in bonds versus the manager average. The funds are underweight energy and financials and overweight consumer goods and industrials. Geographically, the funds are underweight the UK and Asia Pacific region, neutral Europe, overweight North America and overweight Ireland

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