ZURICH

28th July 2014

The week gone by

Global **equities** were up again last week, continuing the long upward 2014 run which began in February, and hit a fresh all-time-high on Thursday. 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 15.5X and the 2015 P/E at 13.9X; albeit equities remain better value relative to other asset classes.

The global index (in euro terms) rose by 0.9% last week giving a total return year-to-date of 9.9%. All of the major **markets** were flat or up in local currency terms last week led by Hong Kong (+3.3%), which reacted positively to stronger Chinese economic data. The main theme of the week was the plethora of generally positive US Q2 earnings' figures.

Eurozone **bond** prices were up again last week (+0.4%) and are up a staggering 11.9% year-to-date led by Spain (+15.6%) and Italy (+13.7%). The German 10-year bond yield remained constant at 1.15% last week, equalling its 2013 low. Prices have been supported by ongoing deflationary concerns and geo-political tensions in Ukraine. Equivalent US yields fell marginally from 2.48% to 2.47%. **Commodity** prices in general were up by 0.3% (in dollar terms) last week and are up 6.5% so far this year, albeit well off their mid-June highs.

	Index	1 Week Return 18.07.14 to 25.07.14		Year to Date Return 31.12.13 to 25.07.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	0.9	0.9	9.9	9.9
US	S&P 500	0.0	0.7	7.0	9.9
Europe	FT/S&P Europe Ex. U.K.	0.5	0.5	2.2	2.2
Ireland	ISEQ	0.3	0.3	3.9	3.9
UK	FTSE 100	0.6	0.7	0.6	5.8
Japan	Topix	1.4	1.7	-1.6	4.4
Hong Kong	Hang Seng	3.3	4.0	3.9	6.7
Australia	S&P/ASX 200	0.9	1.8	4.3	12.9
Bonds	Merrill Lynch Euro over 5 year	0.4	0.4	11.9	11.9

The week ahead

- US Q2 earning results continue in force this week. Industrials, healthcare and energy sectors are expected to be in focus. At the July FOMC meeting (Wednesday), it is likely that we will see modest upgrades to the committee's assessment of the economy and labour markets and it is expected that the committee will taper purchases by another $10bn.
- It is expected that euro area July 'flash' HICP inflation (Thursday) will be constant at 0.5% year-on-year. It is forecast that the euro area June unemployment rate (Thursday) will remain stable at 11.6%.
- In the UK, it is expected that June mortgage approvals and consumer credit (Tuesday) increased slightly to 63k (last: 61.7k) and £0.8bn (last: £0.7bn) respectively.
- In Japan, it is forecast that June Industrial Production (Tuesday) fell by 1.2% month-on-month (last: 0.7%).

Global Outlook

- Strategists continue to favour equities over bonds, based on relative valuation and many strategists seeing further equity upside. 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. Capex spending has accelerated, consumers continue to spend on durables, autos and employment numbers continue their positive trend. M&A provides further upside. So far, US company earnings look healthy, particularly in Tech (boding well for productivity) and Healthcare sectors, with companies comprising over half the market cap of the S&P already after reporting. M&A activity and IPO activity continues to be buoyant and speculation has lifted valuation for many companies. Tax inversion buyouts remain one of the motivations for M&A activity but synergies and scale remain key drivers.

- 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.

Europe & UK

- In Europe, expectations for earnings are low given companies are facing challenges still in most core regions and the early read of company earnings supports this. Macro-economic data, whilst slightly better as seen in the strong PMI read, is not showing enough of an acceleration to bolster investor confidence. Geopolitical risk remains an overhang. More visibility is required for the region before confidence and interest in the region picks up again. The UK market has already de-rated somewhat reflecting higher rate expectations. It has been bolstered by M&A activity and speculation. The past week saw a spike in deals. The GDP read had a muted reaction as it failed to surprise to the upside. GBP is expected to remain strong versus the Euro.

Rest of World

- The Nikkei has remained strong in recent weeks in parallel with economic data looking healthier and less volatility in FX and interest rates. Earnings season has not provided much of a reaction so far with expectations muted.

- 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 easy policy.

- In the US, 10 year US Treasury yields shifted up closer to 2.5% level on strong economic data reads through the week, but remains at a low level. 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.

- The Fed is still on course to end over half a decade of QE by Sep 2014 and expectations are for rates to remain low for an extended period beyond the end of QE which the market is pricing in. A key focus for the Fed is wage inflation, seeking nominal wage growth ahead of price inflation ahead of actioning rate rises.

- ECB are expected to hold rates at low levels for a number of years. The strength of the bund over the past few months suggests continued disappointment in the Eurozone growth rate and the expansion of the ECB balance sheet to combat low growth, low inflation and stimulate lending in the region. Recent strong consumer sentiment read from Germany was overshadowed by geopolitical concerns and lower expert expectations.

- 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 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.

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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