ZURICH

1st September 2014

The week gone by

Global **equities** were up for the third week in-a-row last week continuing the strong 2014 run which began in February. The global index hit a fresh all-time-high on Friday. Euro currency weakness has been a major feature in 2014 market returns (see table below). 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 15.6X and the 2015 P/E at 14.0; albeit equities remain better value relative to other asset classes.

The global index (in euro terms) rose by 1.3% last week giving a total return year-to-date of 12.5%. There was a mixed bag of returns amongst the major equity **markets** ranging from plus 2.0% in Europe to minus 1.5% in Hong Kong. The bellwether US market was in positive territory (+0.8%). The main themes of the week were stronger US economic data, speculation of further loosening for monetary policy by the ECB and geopolitical tensions in Ukraine.

Eurozone **bond** prices were up again last week (+1.1%) and are up a staggering 15.3% year-to-date led by Spain (+20.2%) and Italy (+16.7%). The German 10-year bond yield fell to a fresh all-time low of 0.89% last week. Prices have been supported by ongoing deflationary concerns as well as speculation that the ECB may introduce some form of QE. Equivalent US yields fell from 2.40% to 2.34%. **Commodity** prices in general were up by 1.4% (in dollar terms) last week and are up 4.5% so far this year, albeit well off their mid-June highs.

	Index	1 Week Return 22.08.14 to 29.08.14		Year to Date Return 31.12.13 to 29.08.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	1.3	1.3	12.5	12.5
US	S&P 500	0.8	1.6	8.4	13.8
Europe	FT/S&P Europe Ex. U.K.	2.0	2.0	1.7	1.7
Ireland	ISEQ	1.9	1.9	5.4	5.4
UK	FTSE 100	0.7	1.7	1.1	6.3
Japan	Topix	-0.6	0.1	-1.9	4.2
Hong Kong	Hang Seng	-1.5	-0.6	6.2	11.5
Australia	S&P/ASX 200	-0.3	0.7	5.1	15.5
Bonds	Merrill Lynch Euro over 5 year	1.1	1.1	15.3	15.3

The week ahead

- Little US corporate news is expected during the Labour Day holiday-shortened week although a small number of Industrial and Consumer companies with late reporting schedules are expected to post quarterly results. In the August employment report (Friday), It is projected that non-farm payrolls rose by 220k (last: 209k) and that the unemployment rate declined to 6.1% (last: 6.2%).
- At the September ECB meeting (Thursday), the markets do not expect any policy change or the launch of QE, even if the probability of QE has materially increased following President Mario Draghi's speech at Jackson Hole.
- In the UK, at the September MPC meeting (Thursday), it is expected that support for a rate increase before year-end will grow further.
- Geopolitical tensions in Ukraine, Syria and Iraq will be monitored closely.

Global Outlook 01st September 2014…..

- 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. We remain overweight equities and underweight bonds.

United States

- S&P closed above the 2000 level ahead of the Labour Day weekend in the US. Year to date, equities have defied the expectations of many by continuing to rise, despite geopolitical concerns. Earnings growth has been respectable and fears over margin sustainability are thus far unfounded. Firms operating at peak margins have generated an above-average EPS beat rate in the latest round of earnings, easing concerns around sustainability. Economic data points continue to come in strong with the Chicago PMI data rebounding strongly from its July levels. M&A activity and IPO activity continues to be buoyant. Tax inversion buyouts remain one of the motivations for M&A activity (per Burger King's acquisition of Tim Horton's) but synergies and scale remain key.

- The outlook is positive given home sales and consumer spending data are showing an upward trend and higher compensation is likely if the broad-based strength continues. These factors will support earnings but could also heighten concerns around the timing and intensity of rate hikes by the Fed. These concerns could alter the trading path of equities from now until year end.

Europe & UK

- Draghi's speech at Jackson Hole has lifted European equity markets early last week, despite the weak economic data reads of late. The ECB's indication of additional monetary stimulus in the region was taken well. However, the timing of action remains unclear and the upcoming ECB meeting will likely not produce much news. Economic data points remain weak, creating more downside risk. In August, PMI data and business confidence continued to exhibit softness and inflation ran at 0.3%, down from 0.4%. EMU GDP growth in Q2 was flat weighed down by the inventory cycle and investment spending. Given equity valuation multiples had re-rated materially since 2012 and earnings growth is not providing any upside surprises, it is optimistic to expect major gains form the region in the near term with such a weak economic back drop. Negative headlines from Italy (recession), Portugal (Banco Espirito) and Russia (geopolitical) continue to weigh on sentiment.

- In the UK, a deceleration in growth is expected in the balance of this year, however, there is still some momentum left in the economy. MPC Policy tightening may impact equity markets on announcement but is already well expected.

Rest of World

- The Nikkei 225 continues to recover since its pull back earlier this month. Economic data is coming in strong with PMI data ahead of expectations and the components of PMI suggesting a possible continuation of growth acceleration. The Yen weakened following Jackson Hole speeches from key Central Bank leaders, given Japanese exports should benefit as other major economic regions grow. The recovery trend remains intact in Japan, broadly and is supported by the continued expansion of the monetary base.

- 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 more signs of more positive policy co-ordination.

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 expected to withdraw some of their policy accommodation whilst the ECB and BoJ continue with easy policy.

- In the US, 10 year US Treasury yields are below 2.4%, despite robust economic data and Yellens comments at Jackson Hole. Despite the low level, there is still confidence that the economic recovery is sustainable and sentiment remains positive, but not overdone. Chair Yellen's speech on Friday at Jackson Hole appeared to re-affirm her views and the tone of her speech was slightly more hawkish, as expected. The labour force participation rate remains a key focus particularly the debate over secular vs cyclical drivers.

- Draghis speech at Jackson Hole marked a shift in ECB rhetoric as he called for European governments to accelerate the pace of structural reform and deepen fiscal co-ordination across the region. He once again reaffirmed the ECB are prepared to take further action if necessary going beyond their current liquidity injections (TLTRO and ABS purchases). Blackrock Investment Managers have been retained by the ECB as consultant on their ABS purchase program. The impact of this program will take some time to be felt but equity markets in the mean-time should be supported by Draghi's comments on further easing, and the anticipated impact of the ABS program.

- Italy and France are just two of the countries that have failed to embrace structural reform in the region. The situation remains more difficult in France with an apparent lack of appetite or urgency to change. Economic data has been weak across the region, with weak PMI reads the latest disappointment.

- The governor of the Bank of England has signalled that interest rates in the UK will rise sooner than the 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, although, inflation is still far from the 2% target level. There are continued expectations that the Bank of Japan may announce further stimulus in 2014 as a measure to sustain the trajectory. Economic data points continue to be broadly positive. The BoJ Governor Kuroda stressed the importance of a larger and sustained rise in nominal wages, a key data point for the BoJ.

Positioning

- Zurich Life funds are 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, neutral Ireland, Europe and Asia and overweight North America.

This outlook does not constitute an offer and should not be taken as a recommendation from Zurich Life.
Advice should always be sought from an appropriately qualified professional.

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