



8th September 2014

The week gone by

Global **equities** were up for the fourth 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 15.8X and the 2015 P/E at 14.1; albeit equities remain better value relative to other asset classes.

The global index (in euro terms) rose by 1.8% last week giving a total return year-to-date of 14.5%. Most of the major equity **markets** were up in local currency term last week led by Europe (+2.8%) and Hong Kong (+2.0%). The bellwether US market was in positive territory (+0.2%). The main theme of the week, which was supportive to equities, was the surprise cut in ECB interest rates from 0.10% to 0.05% and the cut in ECB bank deposit rates from minus 0.1% to minus 0.2%.

Eurozone **bond** prices were flat last week but are up a staggering 15.3% year-to-date led by Spain (+21.5%) and Italy (+17.9%). The German 10-year bond yield rose slightly to 0.93% from its all-time low of 0.89% the previous 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 rose from 2.34% to 2.46%. **Commodity** prices in general were down by 2.0% (in dollar terms) last week and remain well off their mid-June highs.

	Index	1 Week Return 29.08.14 to 05.09.14		Year to Date Return 31.12.13 to 05.09.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	1.8	1.8	14.5	14.5
US	S&P 500	0.2	1.7	8.6	15.7
Europe	FT/S&P Europe Ex. U.K.	2.8	2.8	4.6	4.6
Ireland	ISEQ	3.6	3.6	9.1	9.1
UK	FTSE 100	0.5	0.3	1.6	6.5
Japan	Topix	1.2	1.7	-0.7	5.9
Hong Kong	Hang Seng	2.0	3.5	8.3	15.4
Australia	S&P/ASX 200	-0.5	1.4	4.6	17.0
Bonds	Merrill Lynch Euro over 5 year	0.0	0.0	15.3	15.3

The week ahead

- It is projected that US August headline retail sales (Friday) rose by 0.3% month-on-month (last: 0.0%). The markets expect a modest increase in the initial reading of the University of Michigan's index of consumer confidence (Friday) from 82.5 to 83.0.
- It is forecast that euro area July Industrial Production (Friday) increased by 0.5% month-on-month (last: -0.3%).
- In the UK it is expected that July Industrial Production growth (Tuesday) was 0.2% (last: 0.3%).
- Geopolitical tensions in Ukraine, Syria and Iraq will be monitored closely.

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. We remain overweight equities and underweight bonds.

United States

- S&P Index spent most of the week above the 2000 level and held it over the weekend. Although current valuations show equities are not cheap, positive earnings revisions are evident against a favourable backdrop of a strong macro environment and strong USD. Fears over margin sustainability thus far appear unfounded. Firms operating at peak margins have generated an above-average EPS beat rate in the latest round of earnings, easing concerns around sustainability. M&A activity and IPO activity continues to be buoyant. Tax inversion buyouts remain one of the motivations for M&A activity but synergies and scale remain key drivers. Share repurchases are still at high levels, however, the efficacy of repurchases wanes as share prices rise.
- The timing and intensity of rate hikes by the Fed remain a key focus and these concerns could alter the trading path of equities from now until year end.

Europe & UK

- Equity markets were lifted this week on the back of Draghi's interest rate cuts and the hope of further easing in the region. Economic data points remain weak in the region but incremental good news came in the form of easing geopolitical concerns and a weaker Euro, which could provide some uplift to revenue and earnings.
- 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. The Scottish referendum creates additional risk given many businesses are not fully prepared for such changes.

Rest of World

- The Yen has weakened in anticipation of an announcement on further monetary easing by the BoJ. 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.
- Despite the low level of the US 10 year yield, confidence remains in the economic recovery and its sustainability. Sentiment remains positive, but not overdone. The labour force participation rate remains a key focus particularly the debate over secular vs cyclical drivers.
- The ECB cut deposit and Refi rates by another 10 bps to -0.20% and 0.05% respectively causing the Euro to weaken. Draghi noted the decision to cut rates was not unanimous and conventional policy tools were seen as exhausted. The ECB remains prepared to take further action if necessary going beyond their current liquidity injections (TLTRO and ABS purchases). Equity markets should be supported by the potential for further easing, and the anticipated impact of the ABS program. However, the ABS program is unlikely to encourage banks to lend given the credit risk still stays with the bank.
- Draghi's 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. 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 had expected. The strength of UK economy has exceeded market expectations and unemployment has fallen faster than 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, with BoJ Governor Kuroda stressing the importance of a larger and sustained rise in nominal wages.

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.

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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