



6th October 2014

The week gone by

Global **equities** (in euro terms) fell back for the second week in-a-row last week but remain in a strong upward trend which began in February. Euro currency weakness, however, has been a major feature in 2014 (see table below) hiding poorer local currency returns. 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 15.3X and the 2015 P/E at 13.7; albeit equities remain better value relative to other asset classes.

The global index (in euro terms) fell by 0.5% last week giving a total return year-to-date of plus 13.2%. Most of the major equity **markets** were down in local currency term last week led by Japan (-3.7%), Hong Kong (-2.6%) and Europe (-2.5%). The bellwether US market was also in negative territory (-0.7%). The main theme of the week was the negative reaction to ECB President Mario Draghi's lack of clarity on outright purchases of ABSs and covered bonds. Friday saw a sharp rebound for equities, off the 50-day moving average, on the back of stronger than expected US payroll data.

Eurozone **bond** prices were up by 0.4% last week and are up an impressive 15.6% year-to-date led by Spain (+21.2%) and Italy (+17.8%). The German 10-year yield fell from 0.97% to 0.92%; its recent all-time low was 0.89%. Prices have been supported by ongoing deflationary concerns and speculation that the ECB may introduce some form of QE. Equivalent US yields stand at 2.43%. **Commodity** prices in general fell by 1.4% (in dollar terms) last week and are well off their June highs.

	Index	1 Week Return 26.09.14 to 03.10.14		Year to Date Return 31.12.13 to 03.10.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	-0.5	-0.5	13.2	13.2
US	S&P 500	-0.7	0.6	6.5	16.9
Europe	FT/S&P Europe Ex. U.K.	-2.5	-2.5	-0.3	-0.3
Ireland	ISEQ	-0.7	-0.7	5.5	5.5
UK	FTSE 100	-1.8	-2.2	-1.5	4.8
Japan	Topix	-3.7	-2.8	-1.5	3.8
Hong Kong	Hang Seng	-2.6	-1.3	-1.0	8.6
Australia	S&P/ASX 200	0.1	0.4	-0.6	6.1
Bonds	Merrill Lynch Euro over 5 year	0.4	0.4	15.6	15.6

The week ahead

- A relatively quiet week in the US ahead of the start of the Q3 earnings' results season the following week.
- It is expected that German August Industrial Production (Tuesday) fell by 1.5% month-on-month (last: +1.9%).
- In the UK, at the BoE Monetary Policy Committee (Thursday), it is expected that the committee will leave interest rates and asset holdings unchanged at 0.50% and £375bn respectively. Rates may, however, increase before year-end.
- 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 some strategists seeing further equity upside. Equity market gains in most regions are predicated on earnings growth given many regions have seen P/E expansion in anticipation of an improvement in earnings or expectations of continued earnings favourability. We view market weakness as an opportunity to add to positions.

- Equity markets remain attractive on a relative basis. Asset classes such as cash or bonds are still not compelling on a relative basis with equity earnings yields higher than 10 years bond yields in all major regions. We remain overweight equities and underweight bonds.

United States

- S&P 500 has been more volatile in recent weeks. The Vix index rose sharply, from depressed levels, as fears of global growth slow-down spilling over into the US and the end of QE create uncertainty. Much of the volatility is driven by small cap stocks in the US as they are underperforming their large cap peers, given the disproportionate impact small cap equities would experience should a slowdown in US materialise. However, the economic backdrop remains favourable, Q2 GDP came in at a strong 4.6%, and the economic data readings have been strong with Non-Farm payrolls beating expectations last week. Fears over margin sustainability thus far appear unfounded. 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 of M&A activity. Share repurchases are still at high levels, however, the efficacy of repurchases wanes as share prices rise.

- The US dollar has strengthened materially in recent weeks. The strength of the dollar is typically does not define the direction of the equity market. However, the impact on sectors varies. Commodity sensitive sectors and those with more international exposure (consumer staples sector) are typically worst affected by a strengthening dollar. However, earnings remain the most crucial determinant of equity market direction.

- 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 remain weak as economic data from the EU region continues to be poor and earnings are revised downwards. Final PMI figures were revised downwards hitting a 10 month low. Forward looking components of the PMI look weak, indicating a near term pick up is unlikely. There are no signs of credit growth which is needed to support a recovery, stimulate economic activity and get earnings revisions trending upwards. Banks appear unwilling to lend until conditions improve, however, an improvement is partially predicated on the extension of credit, creating a difficult situation. Although the ECB is feeding money to banks for targeted lending, the ECB will not assume any credit risk.

- In the UK, a deceleration in growth is expected in the balance of this year, a cooling from strong levels. There appears to still be some momentum left in the economy. MPC Policy tightening may impact equity markets on announcement but is already well expected.

Rest of World

- The Yen remains weak, a positive for inflation and exports. The Yen should remain weak on the expectation for further monetary easing by the BoJ, although this may not materialise until 2015. 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. Valuations in the region look attractive.

- 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 with rate rises on the horizon, 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. Fears of the global growth slow-down spilling over into the US are contributing to keeping yields low. The level of slack in the U.S. labour force participation rate remains a key focus of the Fed, particularly the debate over secular vs cyclical drivers, and expectations around the timing of rate rises feed off this.

- In Europe, Draghi has signalled he is prepared to instigate a QE program (similar to the US) should the current liquidity injections (TLTRO and ABS purchases) prove fruitless. Equity markets should be supported by the potential for further easing. However, as noted earlier, 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.

- 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 or early in 2015.

- 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 utilities and energy and overweight consumer goods and industrials. Geographically, the funds are underweight the UK and Europe, neutral Asia Pacific, slightly overweight Ireland and overweight Japan and 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

Zurich Life Assurance plc is regulated by the Central Bank of Ireland.

Intended for distribution within the Republic of Ireland.

