



20th October 2014

## The week gone by

Global **equities** (in euro terms) fell back for the fourth week in-a-row. Euro currency weakness has been a major feature in 2014 (see table below) hiding much poorer local currency returns. All of the major markets, with the exception of the US, are now in negative territory year-to-date in local currency terms. Whilst certainly acknowledging the feeling of panic stations in some markets in the first half of the week, there is general consensus that the US economy, at least, is in a fairly strong position. Equities continue to be supported by the expectation of reasonably strong corporate earnings' growth and low interest rates. In addition, equities remain better value relative to other asset classes.

The global index (in euro terms) fell by 1.9% last week giving a total return year-to-date of plus 7.0%. With the exception of Australia, all of the major equity **markets** were down in local currency terms last week led by Japan (-5.3%). The bellwether US market was down 1.0%. Equities have struggled as to how to best gauge global economic health amidst the myriad of economic data in the last few weeks. Market volatility, as measured by the VIX index, has picked up significantly.

Eurozone **bond** prices were down by 0.6% last week but are up an impressive 15.2% year-to-date led by Spain (+21.8%). The German 10-year bond yield fell from 0.89% to 0.86%, a fresh weekly-closing all-time low. Prices have been supported by ongoing deflationary concerns and speculation that the ECB may introduce some form of QE. Equivalent US yields fell from 2.28% to 2.19%. **Commodity** prices in general fell by 1.1% (in dollar terms) last week and have now lost all and more of their strong gains in the first half of the year.

	Index	1 Week Return 10.10.14 to 17.10.14		Year to Date Return 31.12.13 to 17.10.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	-1.9	-1.9	7.0	7.0
US	S&P 500	-1.0	-2.0	2.1	10.2
Europe	FT/S&P Europe Ex. U.K.	-0.8	-0.8	-5.4	-5.4
Ireland	ISEQ	-0.1	-0.1	-1.1	-1.1
UK	FTSE 100	-0.5	-1.3	-6.5	-1.9
Japan	Topix	-5.3	-5.2	-9.6	-3.7
Hong Kong	Hang Seng	-0.3	-1.3	-1.2	6.6
Australia	S&P/ASX 200	1.6	1.1	-1.5	4.5
Bonds	Merrill Lynch Euro over 5 year	-0.6	-0.6	15.2	15.2

## The week ahead

- Third quarter earnings' results will continue apace this week with the majority of announcements expected from Industrials, Discretionary and Financial sectors. It is forecast that September headline CPI inflation (Wednesday) rose by 0.1% (last: minus 0.2%) month-on-month.
- At the EU Summit (Thursday), government leaders will address the economic situation in the EU and discuss budgetary policies of member states.
- In the UK, it is likely that any rate hike has been pushed back by a number of months due to market turmoil and global uncertainties. It is projected that Q3 GDP (Friday) grew by 0.7% quarter-on-quarter (last: 0.9%).

# 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. We view market weakness as an opportunity to add to positions.
- Equity markets remain attractive on a relative basis. Cash and 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 moved only 1.02% on aggregate over the 5 trading days last week; however, the spike in the Vix index (a measure of future volatility) better reflects the true market movements that were more pronounced at the sector level. A lot of volatility has been driven by sentiment and investor positioning. News headlines on the spread of Ebola and oil price declines fed fears of growth deceleration, on top of concerns around the growth slow-down from other major economic regions spilling over into the US. Clarity on corporate outlooks for 2015 is not yet being provided. However, fundamentally, the US growth story appears robust, with company Q3 earnings reports coming in slightly ahead of expectations so far, which should help stabilise the market in the coming days and weeks. Although only 26% of S&P 500 companies have reported so far, the positive start bodes well for sentiment. Economic data has been mostly positive. The outlook on consumer spending in the back half of the year remains favourable, given low gas prices, low unemployment, wage rises in certain states and lapping of fiscal headwinds from year ago. Comments from the Federal Reserve have been supportive, reiterating their pledge to keep rates low "for a considerable time" post end of QE, and the timing of the reinvestment phase-out being economic dependent. Company balance sheets remain in healthy condition.

## Europe & UK

- Equity markets remain weak as economic data from the EU region continues to be poor. Euro area Industrial Production fell markedly in August, and business surveys point to a further loss in industrial momentum, which could weigh on GDP growth even further. Inflation expectations continue to decline as low energy prices offset the inflation lift the weaker Europe provides. Fiscal budgets for 2015 are currently being reviewed in Brussels. Merkel made clear her tolerance for allowing flexibility in fiscal budgets is low, while preliminary drafts show the risk of non-compliance by France and Italy is high. The upcoming European Summit could give insight on how the EU intends to balance austerity versus the need to stimulate economic growth.
- Price/Earnings multiples expanded in 2013 and early 2014 in the hope of seeing positive earnings revisions on stronger growth levels. This has been reversing as expectations for growth are lowered and earnings revisions remain negative. Catalysts to lift equity markets include news of QE by the ECB, although this is heavily data dependant and German opposition creates difficulties, or credible policy reform from France and Italy. Expectations are low in terms of the TLTRO program's effect on growth. Banks appear unwilling to lend until conditions improve, however, an improvement is partially predicated on the extension of credit, creating a difficult situation.
- In the UK, a deceleration in growth is expected in the balance of this year, merely a cooling from strong levels. There appears to still be some momentum left in the economy with strong business and consumer confidence levels. MPC Policy tightening may impact equity markets on announcement. The MPC actions remain data dependant, with wage growth a key focus.

## Rest of World

- The Yen remains weak, a positive for inflation and exports in Japan. 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, namely US. 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, relatively, and earnings revisions have turned positive.
- 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.

## 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 as they look to stimulate growth and inflation.
- 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. The tone of their latest meeting minutes was dovish citing concerns on slower global growth affecting the US.
- In Europe, Draghi has signalled he is prepared to instigate a QE program (similar to the US) with a targeting balance sheet asset level of \$3tn. However, ABS program is unlikely to encourage banks to lend given much of the credit risk still stays with the bank. Political hurdles, namely German opposition, create uncertainty on the trajectory and magnitude of the possible QE program.
- 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](http://www.zurichlife.ie)

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

Intended for distribution within the Republic of Ireland.

