



17th November 2014

The week gone by

Global **equities** (in euro terms) rose for the fourth week in-a-row (albeit marginally) reaching a fresh all-time-high on Tuesday. Euro currency weakness has been a major feature in 2014 (see table below) hiding much poorer local currency returns. 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 despite the rise in price earnings multiples.

The global index (in euro terms) rose by 0.1% last week giving a total return year-to-date of 16.2%. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from 2.7% in Japan to minus 1.7% in Australia. The bellwether US market was up 0.4%. Markets have reacted positively in recent weeks to a good US Q3 earnings season as well as increased monetary expansion (QE) in Japan.

Eurozone **bond** prices were up by 0.5% last week and are up an impressive 16.5% year-to-date led by Spain (+20.8%). The German 10-year bond yield fell from 0.82% to 0.78%, 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 rose marginally from 2.30% to 2.32%. **Commodity** prices in general fell by 1.4% (in dollar terms) last week and have now lost all and more of their strong gains in the first half of the year. Oil prices were down around 4% on the week.

	Index	1 Week Return 07.11.14 to 14.11.14		Year to Date Return 31.12.13 to 14.11.14	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World	0.1	0.1	16.2	16.2
US	S&P 500	0.4	-0.3	10.4	21.6
Europe	FT/S&P Europe Ex. U.K.	0.0	0.0	-1.4	-1.4
Ireland	ISEQ	-1.7	-1.7	4.5	4.5
UK	FTSE 100	1.3	-0.5	-1.4	2.7
Japan	Topix	2.7	0.6	7.5	7.2
Hong Kong	Hang Seng	2.3	1.6	3.4	13.9
Australia	S&P/ASX 200	-1.7	-1.0	1.9	10.0
Bonds	Merrill Lynch Euro over 5 year	0.5	0.5	16.5	16.5

The week ahead

- With nearly 90% of the US S&P 500 having reported third quarter earnings, retailers comprise the majority of the remainder. In the October FOMC minutes (Wednesday) it is expected that continued labour market progress meant that the committee was comfortable ending its asset purchasing program.
- It is expected that euro area November 'flash' composite PMIs (Thursday) to remain broadly stable. Such an outcome would be consistent with a scenario of modest Q4 GDP growth of c0.2% quarter-on-quarter.
- In the UK, it is expected that October CPI (Tuesday) remained constant at 1.2% year-on-year. It is likely that October retail sales (Thursday) rose by 3.8% year-on-year (last: 2.7%).
- Japan's Q3 real GDP figure was announced overnight at minus 0.4% quarter-on-quarter (+2.2% had been expected). This is likely to trigger a general election on 14th December which the incumbent prime minister, Shinzo Abe, is expected to win.

Global Outlook



- Equity markets remain attractive on a relative basis. Cash and bonds are still not compelling on a relative basis. We remain overweight equities and underweight bonds and maintain our regional allocations.

United States

- Fundamentally, the US growth story appears intact and our outlook remains favourable. Company Q3 earnings reports were solid, with earnings surprising to the upside, but revenues only coming in in-line with expectations, with commodity pricing and FX acting as headwinds. Company balance sheets remain in healthy condition, with low debt and high cash spending power. Valuations still appear reasonable versus historical standards and on a relative basis (earnings yields on equities still materially exceed 10 year bond yields). Economic data has been positive for the most part. Markets anticipate that the Fed will commence tightening in mid-2015, albeit at a slow pace. The October FOMC statement has a slightly more hawkish tone, however, and the initiation of rate hiking could cause equity market volatility if announced sooner than expected. GOP achieved control of the Senate in the US. Although an improvement on the prior situation, it is unlikely to markedly change legislative progress materially but is an incremental positive given their pro-business policies. The outlook on consumer spending for the remainder of 2014 appears favourable, given low gas prices, low unemployment, wage rises in certain states and lapping of fiscal headwinds from year ago. 2015 should see accelerated fiscal expenditure pre-elections in 2016. The dollar is expected to remain strong. Further strengthening cannot be ruled out given expansionary monetary policy in other major economic regions.

Europe & UK

- Economic data remains soft. Q3 Euro area GDP came in at 0.2% slightly ahead of expectations with France and the Netherlands driving the incremental favourability. Consumer spending drove the GDP growth rate into positive territory, offsetting the negative contribution from investment which continues to decline on aggregate across Euro area. The surprise in France is unconvincing given the contribution from consumer spending was very modest and most of the upside was driven by more transitory components, unlikely to be sustained. Low energy prices offset the inflation lift the weaker Euro provides. Fiscal budgets for 2015 have yet to be finalised. 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.
- Catalysts to lift equity markets include credible policy reform in France and Italy or news of QE by the ECB. Implementation of QE could prove difficult with speculation of escalating tensions and Draghi facing a number of opponents including Germany, Luxembourg and Holland. 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, some deceleration in growth is expected for the remainder of this year, but this will merely be 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 additional monetary expansionary measures announced by the BoJ in recent weeks will involve annual purchases of a size equivalent to 15%

of the Japanese economy. The Yen should remain weak as the BOJ implements its monetary easing, a positive for inflation and exports in Japan. 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, relatively, and earnings revisions have turned positive. In figures released over the weekend, Japan's real GDP contracted 1.6% q/q saar in Q3 in contrast to expectations of a +2.2%. The downside surprise was mainly due to inventory investment which has been a volatile component of GDP since the beginning of this year and also due to private imports. Excluding these two components, final demand added 1.5pp to real annualized growth, broadly in line with expectations.

- 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 will 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 announced their targeting of balance sheet asset levels of \$3tn, from current balance sheet levels of \$2tn. The ECB left the policy rates and the ABS and TLTRO programmes unchanged. The balance sheet expansion was unanimously supported by the Governing Council.
- 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 in early 2015.
- Japanese monetary policy is expected to remain loose for some time to come given the latest announcement of further QE. Abe's efforts have broken the two-decade cycle of deflation, although, inflation is still far from the 2% target level and this was cited as one of the reasons for the additional measures.

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.

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