ZURICH

2nd March 2015

The week gone by

Global **equities** (in euro terms) rose for the fourth week in-a row, reaching a fresh all-time-high on Thursday, and are now approaching the sixth anniversary of the current bull market. European equities have led the way so far this year. As during most of 2014, euro currency weakness has again flattered returns for eurozone investors in 2015. 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 1.7% last week giving a total return year-to-date of a strong 12.1%. Most of the major equity **markets** were up in local currency terms last week led by Europe (+2.7%). The bellwether US market was down 0.3% on profit-taking. Markets have been supported by continued loose monetary policy, with quantitative easing (QE) beginning in the eurozone next Monday, along with better than expected economic data in Europe. A temporary resolution of the Greek crisis has also helped.

Eurozone **bond** prices overall were up by 1.3% last week and are up 4.7% year-to-date. Markets have reacted positively year-to-date to the announcement of impending QE. The German 10-year bond yield fell from 0.37% to 0.33%, close to its all-time low of 0.30%. Equivalent US yields fell from 2.11% to 1.99%. **Commodity** prices in general were down by 0.3% (in dollar terms) last week and are down 2.5% so far in 2015.

	Index	1 Week Return 20.02.15 to 27.02.15		Year to Date Return 31.12.14 to 27.02.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	1.7	1.7	12.1	12.1
US	S&P 500	-0.3	1.5	2.2	10.5
Europe	FT/S&P Europe Ex. U.K.	2.7	2.7	14.9	14.9
Ireland	ISEQ	3.6	3.6	14.4	14.4
UK	FTSE 100	0.5	2.5	5.8	13.3
Japan	Topix	1.6	2.5	8.3	17.1
Hong Kong	Hang Seng	0.0	1.8	5.2	13.6
Australia	S&P/ASX 200	0.8	2.3	9.6	13.3
Bonds	Merrill Lynch Euro over 5 year	1.3	1.3	4.7	4.7

The week ahead

- In the US, it is expected that non-farm payrolls (Friday) will increase by 240k (last: 257k) and the unemployment rate will fall to 5.6% (last: 5.7%).
- It is projected that the ECB (Thursday) will keep interest rates unchanged at 0.05% but will likely release the execution details of its asset purchasing programme (QE). It is forecast that euro area Q4 GDP (Friday) to be confirmed at 0.3% year-on-year.
- In the UK, it is expected that rates and asset purchases (Thursday) to be on hold at 0.50% and £375bn respectively.

Global Outlook

We believe that equity markets are fairly valued versus history and they look attractive compared to cash and bonds. Volatility in markets may increase through 2015 as divergent Central Bank policies are implemented in major global regions.

United States

- Fundamentally, the US growth story appears intact. Domestic strength continues to pull against the global weakness. Economic growth should continue throughout 2015. The trend in the labour market data suggests slack in the labour force continues to diminish. We see scope for economic growth to continue for the next year. Company balance sheets remain in healthy condition, with low debt and high cash levels. Profit margins remain high.
- However, year to date, economic data points have been more mixed indicating growth may have moderated somewhat. Retail sales remain lacklustre but employment levels remain strong with some signs of wage growth (Wal-Mart announced wages rise last week). Oil price volatility and FX headwinds prevail. Capital expenditure intentions are falling within the energy sector, heightening concerns over unemployment levels rising in the space.
- Q4 CY2014 Company earnings reports show earnings grew approx 5% YoY on aggregate for S&P 500 companies. Approx 90% of S&P 500 companies, by market cap, have reported earnings so far. Excluding Energy and Financials, the two biggest negative contributors, earnings grew approx. 12% yoy. Healthcare and Tech sector earnings beat expectations by the greatest amount, with Tech beat driven mostly by Apple. Earnings came in approx. 2.5% ahead of analyst expectations (although typically earnings come in ~3% ahead of expectations so results were "in-line"). The Fed raising rates ahead of market expectations or fears of deflation, driven by low oil prices and cheap imports and a weaker demand environment, could drive further market volatility, along with the oil price volatility and USD$ levels. S&P 500 earnings expectations for FY 2015 have been meaningfully reduced since the end of 2014, mostly driven by energy sector earnings expectations.

Europe & UK

- ECB announced a sizable, open ended Quantitative Easing program. From March 2015, the ECB will commence buying €60bn of private and public sector securities every month until end-September 2016 at least. President Draghi said the programme will "*be conducted until we see a sustained adjustment in the path of inflation which is consistent with (our) aim of achieving inflation rates below, but close to, 2% over the medium term*". The programme will represent at least €1.1tn of asset purchases, possibly more if inflation and growth fail to pick up during the next year. The move should re-anchor inflation expectations and fears of deflation should be curbed once the oil price stabilises. Equity markets have reacted favourably thus far given the scale and the open ended nature of the program, the level of detail given, which was more than expected, and the unanimous support of the Council members. However, it remains to be seen whether real growth can be generated across the region. Depreciation of the Euro should help growth rates across the EMU as exports become more competitive.
- Further catalysts to lift European equity markets include credible policy reform in France and Italy. Interest rates are expected to stay low for an extended period. If QE does stimulate growth in the region, this should see banks easing credit standards over time driving momentum in growth. Political risk prevails in Europe with Greece requiring fresh financial aid to avoid default. However, the risk of a Greek exit from EMU remains high.
- The move by the ECB increases the likelihood of other central banks in other small, open economies in Europe – primarily the Scandinavian economies - will ease policy as well. The impact will vary depending on their monetary policy frameworks. Sweden recently set its main policy rate below zero, joining the ECB, Denmark, and Switzerland in extraordinary monetary policy.
- The UK government is approx. half way through the required fiscal cuts creating a headwind for the UK economy. Strong business and consumer confidence levels indicate some momentum is left in pockets of the economy. However, overall consumer debt levels remain high. Wage growth remains a key focus of the MPC but is still absent. Headline inflation is decelerating, weakened by low energy and food prices.

Rest of World

- People Bank of China cut deposit and lending rates by 25 and 40 bps respectively in late 2014, the first cut since 2012. Equity markets reacted favourably and further rate cuts throughout 2015 are expected as the PBOC look to stimulate the economy.
- Australia GDP is adversely impacted by the falling capital expenditures, mostly in the mining sector, with weak commodity price environment. Consumer spending has remained below average, despite a significant increase in wealth levels, keeping capex in non-mining sectors at bay.
- Emerging markets are heavily influenced by the macro environment and still face headwinds of slower growth in China and Euro Area, lower commodity prices (a negative for commodity dependant economies), the prospect of rising US yields and US dollar strength.
- The additional monetary expansionary measures announced by the BoJ in late 2014 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. JPY depreciation, narrowing domestic output gap, and a continued rise in service prices since 2013 would bring CPI inflation back to a 1% trend. The impact from the oil price creates a transitory disruption in the longer term story.

Oil Price

- Oil price volatility remains high. OPEC countries have not cut production, leaving it to the non-OPEC nations to adjust their output.

Central Bank Watch:

- The general economic backdrop for 2015 still continues to necessitate a reasonably loose monetary policy in several of the major regions. Policy is broadly unconventional in most regions. Some divergence is evident, with the US leading the change.
- In the US, the Fed is expected to withdraw some of their policy accommodation with rate rises on the horizon. Yellens tone remained dovish in her latest testimony, meaning interest rate rises are unlikely at the next two Fed meetings. The market continues to push out expectations on timing of the initial interest rate hike.
- ECB's announced an open-ended quantitative easing program starting in March 2015 by buying assets of €60bn per month up until at least the end of 2016 expanding their balance sheet by at least €1.1tn. The Program will focus on EGB's (€45 of the €60bn monthly purchases approx.). It will also include debt issued by certain agencies and international and supranational institutions. The program was unanimously supported by the Governing Council, helped by the structure of risk sharing in the event of losses on sovereign bond purchases.
- Wage growth remains a key focus of the MPC in the UK, but is still absent. The MPC now unanimously support an unchanged policy stance, causing the market put push out expectations in terms of rate rises.
- 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.

Positioning

- Zurich Life funds are overweight in equities and neutral in bonds versus the manager average. In equities, the funds are underweight UK and Asia, neutral North America, slightly overweight Ireland and Japan and overweight Europe. The funds are underweight utilities and energy and overweight consumer goods and industrials.

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