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9th March 2015

The week gone by

Global **equities** (in euro terms) rose for the fifth straight week reaching a fresh all-time-high on Friday. Today is 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 significantly enhanced returns for eurozone investors in 2015 (see table below). 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 1.5% last week giving a total return year-to-date of a strong 13.8%. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from plus 1.1% in Japan to minus 2.7% in Hong Kong. The bellwether US market was down 1.5%, reacting negatively on Friday to strong employment data which increases the chances of an earlier hike in interest rates than previously expected.

Eurozone **bond** prices overall were down by 0.2% last week but are up 4.5% year-to-date. Markets have reacted positively year-to-date to the announcement of QE which begins today. The German 10-year bond yield rose from 0.33% to 0.39%, still close to its all-time low of 0.30%. Equivalent US yields rose from 1.99% to 2.24%. The gap between the German and US 10-year yield is now at its highest level since German re-unification. **Commodity** prices in general were down by 1.8% (in dollar terms) last week and are down 4.3% so far in 2015.

	Index	1 Week Return 27.02.15 to 06.03.15		Year to Date Return 31.12.14 to 06.03.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	1.5	1.5	13.8	13.8
US	S&P 500	-1.5	1.6	0.6	12.1
Europe	FT/S&P Europe Ex. U.K.	0.7	0.7	15.7	15.7
Ireland	ISEQ	0.7	0.7	15.2	15.2
UK	FTSE 100	-0.5	0.1	5.3	13.4
Japan	Topix	1.1	3.3	9.5	20.9
Hong Kong	Hang Seng	-2.7	0.4	2.4	14.1
Australia	S&P/ASX 200	-0.5	1.4	9.0	14.8
Bonds	Merrill Lynch Euro over 5 year	-0.2	-0.2	4.5	4.5

The week ahead

- In the US, it is expected that February retail sales (Thursday) will rise by 0.4% month-on-month (last: -0.8%). The March University of Michigan consumer sentiment index (Friday) is likely to be broadly flat at 95.6 (last: 95.4).
- At the Eurogroup meeting (Monday), the focus will be on the Greece, with the country fast running out of cash. It is expected that euro area January industrial Production (Thursday) edged up by 0.2% month-on-month (last: 0.0%).
- In the UK, it is expected that January Industrial Production (Wednesday) grew by 0.2% month-on-month (last: -0.2%).
- The second release of Japanese Q4 real GDP growth (Sunday) is likely to revise down the preliminary reading to 1.5%.

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 as job gains and lower commodity prices underpin consumption. Whilst the adverse weather and US West Coast port strikes could cause noise in economic data points for February, the trend in the labour market data suggests slack in the labour force continues to diminish with the latest non-farm payroll numbers showing 295k added to payrolls in February, beating expectations well. Signs of wage growth are encouraging as higher labour compensation can drive corporate earnings growth.
- However, the unemployment rate came in at the higher end of Feds target range, average hourly earnings growth was weak, January payrolls were revised downwards and the overall labour force contracted 178k and participation rate fell. Prior to the latest non-farm payroll read, year to date economic data points have been mixed. PMI data has been somewhat weak and retail sales remain lacklustre broadly. 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 as capital expenditures are cut.
- S&P 500 earnings expectations for FY 2015 have been meaningfully reduced since the start of the year, mostly driven by energy sector earnings expectations. 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.

Europe & UK

- ECB announced a sizable, open ended Quantitative Easing program. From today, 9th March, 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 fails to pick up during the next year. The move should re-anchor inflation expectations and fears of deflation should be curbed. January data showed lower unemployment in the Eurozone which should support consumption near term consumption levels
- 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.
- 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

- 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 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 prices would bring CPI inflation back to a 1% trend. The impact from the oil price creates a transitory disruption to the longer term story.

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. However the latest non-farm payroll numbers has caused the market to bring forward expectations on timing of the initial interest rate hike.
  - ECB announced an open-ended quantitative easing program starting 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 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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