



23rd March 2015

The week gone by

Global **equities** (in euro terms) rose for the seventh straight week reaching a fresh all-time-high on Thursday. As during most of 2014, euro currency weakness has again significantly enhanced returns for eurozone investors in 2015 (see table below). Last week, however, saw the euro strengthen somewhat. 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 0.6% last week giving a total return year-to-date of a strong 16.6%. All of the major equity **markets** were up in local currency terms last week led by the UK (+4.2%) and Australia (+2.8%). The bellwether US market was up 2.7%. Markets reacted positively to Federal Reserve Chairwoman Janet Yellen's more dovish comments on Wednesday concerning the timing of future interest rate rises, with the first move now likely in September or October.

Eurozone **bond** prices overall were flat last week but are up 6.8% year-to-date. Markets have reacted positively year-to-date to the announcement and implementation of quantitative easing (QE). The German 10-year bond yield fell further from 0.25% to 0.18%, a fresh all-time low. Equivalent US yields fell from 2.11% to 1.93%. The gap between the German and US 10-year yield is close to its highest level since German re-unification. **Commodity** prices in general were up by 1.6% (in dollar terms) last week but are down almost 7% so far in 2015.

	Index	1 Week Return 13.03.15 to 20.03.15		Year to Date Return 31.12.14 to 20.03.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	0.6	0.6	16.6	16.6
US	S&P 500	2.7	-0.4	2.4	14.5
Europe	FT/S&P Europe Ex. U.K.	1.5	1.5	19.1	19.1
Ireland	ISEQ	-0.5	-0.5	18.4	18.4
UK	FTSE 100	4.2	2.5	7.0	14.7
Japan	Topix	1.3	-0.6	12.3	25.4
Hong Kong	Hang Seng	2.3	-0.6	3.3	15.4
Australia	S&P/ASX 200	2.8	1.5	10.4	17.6
Bonds	Merrill Lynch Euro over 5 year	0.0	0.0	6.8	6.8

The week ahead

- In the US, it is expected that the third estimate of Q4 GDP growth (Friday) will be revised up to 2.4% quarter-on-quarter (last: 2.2%). It is projected that February headline CPI (Tuesday) will increase by 0.2% month-on-month (last: -0.7%). It is expected that the final reading of the March University of Michigan consumer sentiment index (Friday) will print at 91.8 (last: 91.2).
- The March euro area 'flash' composite Purchasing Managers Index (PMI) (Tuesday) is likely to remain broadly stable at 53.6 (last: 53.3).
- In the UK, it is projected that February CPI (Tuesday) will decline to 0.1% year-on-year (last: 0.3%).
- In China, we look for the March HSBC 'flash' manufacturing PMI (Tuesday) to decline slightly to 50.4 (last: 50.7).

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

- Release of the FOMC minutes was the key investor focus in the US last week. Consensus timeline for a Fed Funds rate hike moved from June out to September or early Q4 2015 given Yellens' dovish tone, with concern on the strength of the dollar delaying Fed action. Fundamentally, the US growth story appears intact. However, mixed economic data and a strong USD are key concerns for investors. With looming rate rises, there are concerns P/E multiples will suffer. However, the Fed appear patient and a rate rise should indicate confidence in the persistency of US economic growth, lowering equity risk premiums somewhat to offset any P/E compression.
- Economic data points have been mixed year to date with PMI data weak and retail sales lacklustre. Some of this can be deemed noise due to "one-off" events in Q1 (West Coast port strikes, extreme cold weather). However, any further weakness in data into Q2 could cause market volatility on heightened fears over the health of the economy. Employment data is the only bright spot in economic data reports with the outlook for consumer spending broadly positive. The magnitude and speed of the US dollar appreciation has caused consternation. Earnings downgrades continue for companies with international exposure and GDP growth is dampened due to declining exports as US competitiveness is eroded. One third of S&P 500 sales and 40% of its profits are from abroad, but only ~25% of its profits are earned in foreign currencies (as many contracts with foreign customers are USD based). Thus, every 10% appreciation in the dollar vs. major currencies hits S&P EPS by 2.5% or \$3.

Euro Area, Europe & UK

- European Equity market has been outperforming the S&P500 year to date. The relative attractiveness of the market stems from ECB quantitative easing, fewer currency pressures (weak euro enhances global competitiveness and European companies with international exposure see earnings upgrades from the generating revenue in appreciating non euro currencies, the opposite effect to what is seen in the US) making Europe a popular (consensus) play. However, valuations are at lofty levels given P/E ratios are well above their 10 year average. This is not unexpected at the beginning of a QE program and potential recovery however, earnings estimates are not moving upwards quite yet.
- 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

- 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. Economic activity is seeing a pick up due to increased exports ~(on weaker Yen), increased industrial production. Japanese corporate profits are helped somewhat by the weaker yen allowing currency uplift to earnings and also the weaker oil price.

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. The Fed's tone remained dovish in their latest FOMC minutes release given the dollar strength. The market now expects Fed Funds initial rate hike around Sept 2015. June had been consensus prior to the release of FOMC minutes last week.
- 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.
- 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, overweight Ireland, Japan and Europe. The funds are underweight utilities and energy and overweight consumer goods and industrials.

This outlook does not constitute an offer and should not be taken as a recommendation from Zurich Life. Advice should always be taken from an appropriately qualified professional.

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