



25th May 2015

## The week gone by

Global **equities** (in euro terms) rose sharply helped by a recovery in European equities. Comments by the ECB's Benoit Coeure that July and August QE would be partly front-loaded in May and June checked the bond market sell-off and supported equities. The US S&P 500 Index notched a fresh all-time-high on Thursday. Euro currency weakness has significantly enhanced returns for eurozone investors in 2015 (see table below) and this was again the case last week. 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 3.6% last week giving a total return year-to-date of a strong 17.1%. The Index moved above its 50-day moving average again and remains well above the critical 200-day moving average. Almost all of the major equity **markets** were up in local currency terms last week led by Europe (+2.5%) and Japan (+2.5%).

Eurozone **bond** prices overall rose by 0.2% last week halting a sharp decline of the previous four weeks. Markets had suffered on the back of some stronger economic data as well as a bout of profit taking. The German 10-year bond yield fell marginally from 0.62% to 0.60% last week; it had hit an all-time-low of 0.06% a month or so ago. Equivalent US yields rose from 2.14% to 2.21%. **Commodity** prices in general were down by 2.5% (in dollar terms) last week and are down 1.9% so far in 2015.

	Index	1 Week Return 15.05.15 to 22.05.15		Year to Date Return 31.12.14 to 22.05.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	3.6	3.6	17.1	17.1
US	S&P 500	0.2	4.1	3.3	13.5
Europe	FT/S&P Europe Ex. U.K.	2.5	2.5	17.1	17.1
Ireland	ISEQ	1.4	1.4	20.1	20.1
UK	FTSE 100	1.0	3.5	7.1	17.0
Japan	Topix	2.5	4.6	17.1	26.8
Hong Kong	Hang Seng	0.6	4.6	18.6	30.3
Australia	S&P/ASX 200	-1.2	0.0	4.7	10.2
Bonds	Merrill Lynch Euro over 5 year	0.2	0.2	1.2	1.2

## The week ahead

- In the US, it is expected that the second estimate of Q1 GDP growth (Friday) will be revised down to -0.9% quarter-on-quarter (last: 0.2%). The May Chicago PMI (Friday) is likely to increase to 53.0 (last: 52.3). We expect that the May Conference Board's consumer confidence index (Tuesday) to remain constant at 95.2.
- It is projected that euro area April M3 growth (Friday) improved by 4.9% year-on-year (last: 4.6%).
- In the UK, it is expected that Q1 GDP growth (Thursday) will be revised up to 0.4% quarter-on-quarter (last: 0.3%).

# Global Outlook



## United States

- Macro data remains the focus of US investors who seek clarity given the mixed economic data year to date and timing of Fed rate hikes.
- The S&P 500 Index recent advance towards new highs showed a broadening in participation across sectors, typically a bullish signal. However, trading volumes have been low and investor sentiment remains heavily neutral. The breadth of positive earnings revisions has increased for S&P 500 companies (positive earnings revisions now exceed negative revisions) indicating the heavy earnings downgrades seen year to date are bottoming out (the vast majority of earnings downgrades were energy or FX related).
- Economic data remains mixed and is not painting a particularly robust picture of the US economy. The Fed remains dovish in their tone. Expectations are for a rate rise in late 2015 and a slow trajectory thereafter, with potentially a substantial period before a second rise is instigated. Earnings growth in Q1 2015 was around 10% yoy for S&P500 Ex Energy companies. Although this seems a robust number, aggregate EPS growth, inclusive of energy was up only 2.4% yoy and sales growth came in below expectations. Sales growth ex Energy was a mere 2% yoy. Gross margin expansion drove much of the growth in EPS yoy, indicating cost savings and/or lower commodity prices are driving EPS growth.
- The S&P 500 will continue to be dominated by macro-economic news. The market will likely continue to reward more scarce sales growth. 2H 2015 could see a relative improvement in economic growth, compared to a weak 1H, assuming a drop in the volatility of oil and USD. The stronger US dollar is less of an incremental headwind yoy for companies in 2H 2015 (since the dollar spot index started strengthening in mid-2014) and the lagged effect of the pick-up in employment may be reflected in accelerated consumer spending (which has also disappointed thus far in 1H). The level of confidence in the US economic recovery being sustained is lower and until there is more clarity, the S&P500 may continue to trade within a range. Oil price, although recovered from March lows, is still down > 40% yoy and creates uncertainty in terms of the economic impact given the lagged effect it could have on unemployment and capital expenditures.

## Euro Area, Europe & UK

- European Equity markets have taken a breather from their strong rally that peaked mid-April and more recently made a lower high. The relative attractiveness of the market stems from ECB's quantitative easing program (in its early stages) and fewer currency pressures, with the weak Euro working in favor of exporters in the region. However, given the +22% move from January to mid-April, valuation looks full at current levels. P/E ratios are well above their 10 year average. This is not unexpected at the beginning of a significant QE program and in anticipation of acceleration in growth. However, earnings revisions, although positive, have been of a small magnitude in comparison to the large moves in valuation.
- 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 the growth. Political risk prevails in Europe. With the fiscal policy changes Syriza intend to implement, its unlikely Greece will achieve the previously targeted reduction in Debt (as % of GDP) from current c.174% to < 120% by 2020. With the Conservatives success in UK elections, a 2017 (or likely earlier) referendum is likely on the cards on Britain's membership.

## Rest of World

- 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 gradual recovery continues in Japan, broadly, and is supported by the continued expansion of the monetary base. Growth in private consumption (60% of GDP) should pick up throughout 2015. Equity valuations in the region look attractive, relatively. Earnings revisions have been trending flat in recent weeks. JPY depreciation, a narrowing 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 and better industrial production data. Economic surprise index spiked to a 2 year high in May. Japanese corporate profits are helped somewhat by the weaker yen allowing currency uplift to earnings and also the weaker oil price. China posted disappointing economic data in April and so far in May. With weak real activity data, weak PMI's and subdued inflation levels, there are no clear signs of stabilization.

## 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 being closest to tightening policy.
- In the US, the Fed is expected to withdraw some of their policy accommodation with rate rises on the horizon. Consensus timeline for a Fed Funds rate hike moved from June out to late 2015 with possibly only one rate hike and a substantial period before the second is implemented.
- 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 program 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 program 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.
- The MPC unanimously support an unchanged policy stance, causing the market to push out rate rise expectations. The BoE downgraded its growth forecast but maintains its expectation on labor force slack and inflation. Fiscal policy is expected to be a headwind to GDP growth, given the election outcome as the Conservatives' implementing a more restrictive fiscal policy focused on debt reduction.
- 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 underweight bonds versus the manager average.
- We have a preference for Spanish and Irish over German and Belgian bonds.
- In equities, we are
  - underweight UK, North America and Europe ex Ireland,
  - neutral Europe including Ireland, neutral Asia (ex Japan),
  - Overweight Ireland and Japan.
- Sector weights (at overall level) are: underweight energy and utilities, and overweight consumer goods and industrials

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