ZURICH

15th June 2015

The week gone by

Global **equities** (in euro terms) fell back again as markets continued to focus on the Greek debt situation and higher bond yields. Euro currency weakness has significantly enhanced returns for eurozone investors in 2015 (see table below) despite a partial reversal in the last few weeks. 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 and bond yields.

The global index (in euro terms) fell by 0.8% last week giving a total return year-to-date of a plus 12.3%. Technically, the Index remained below its 50-day moving average but is still well above the critical 200-day moving average. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from minus 0.9% in Japan to plus 0.9% in Australia.

Eurozone **bond** prices fell again (-0.6%) last week, and are now down by 2.4% year-to-date, hurt by comments from ECB president Mario Draghi the previous week that 'we should get used to periods of higher volatility'. Bond prices in Europe are now down by over 7% from their recent peak. The German 10-year bond yield was virtually flat last week ending at 0.83%; it had hit an all-time-low of 0.06% in mid-April. Equivalent US yields fell marginally from 2.41% to 2.39%. **Commodity** prices in general were up by 0.4% (in dollar terms) last week but are down 2.8% so far in 2015.

	Index	1 Week Return 05.06.15 to 12.06.15		Year to Date Return 31.12.14 to 12.06.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	-0.8	-0.8	12.3	12.3
US	S&P 500	0.1	-1.2	1.7	9.2
Europe	FT/S&P Europe Ex. U.K.	-0.2	-0.2	13.3	13.3
Ireland	ISEQ	1.8	1.8	18.9	18.9
UK	FTSE 100	-0.3	0.2	3.3	10.7
Japan	Topix	-0.9	-0.5	17.3	22.3
Hong Kong	Hang Seng	0.1	-1.2	15.6	24.1
Australia	S&P/ASX 200	0.9	1.1	2.5	4.3
Bonds	Merrill Lynch Euro over 5 year	-0.6	-0.6	-2.4	-2.4

The week ahead

- In the US, at the FOMC rate decision (Wednesday), the markets are looking for clarity on the committee's views on the causes of first-quarter weakness in activity, especially consumption, and thereby guidance on the timing of the first rate hike.
- At the Eurogroup meeting (Thursday), the focus will be on Greece. A revised proposal from the Greek government is expected ahead of the meeting. It is estimated that euro area May final headline and core HICP inflation (Wednesday) rose by 0.3% year-on-year and 0.9% year-on-year respectively.
- In the UK, it is not expected that the minutes of the MPC (Wednesday) will show any change in stance or votes.

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.

- Economic data is showing incremental signs of improvement. Strong retail sales numbers last week followed strong non-farm payrolls in early June, showing the US consumer is more resilient than feared. Stronger data should reduce the Fed's concerns about economic momentum, but not enough to warrant rate hikes in June. The course the Fed will take remains unclear. Historically the Fed push through a series of rises following an initial hike. However, this economic cycle has followed an atypical recovery pattern, versus history so may be warranted in this instance.

- S&P 500 movements continue to be heavily influenced macro-economic news including economic data releases and, to some extent, the outcome of the ECB/IMF/Greece negotiations. 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.

Euro Area, Europe & UK

- Q1 national account details show Euro area investment activity has picked up considerably in early 2014. German 10 year Bund yield is at 80bps having ended May close to 50bps as bond investors unwind their positions and take profits. Although the ECB increased their 2015 inflation forecasts from 0.0% to 0.3%, this was mainly due to the oil price rebound seen lately and the sharp move in European bond yields was not a result of any change in economic data.

- Greece's negotiations with the ECB, IMF continue to drive volatility in European markets. The consensus appears to be that a compromise will be reached eventually but the risk remains that the Syriza government opt to hold a referendum on leaving the euro. Although markets are choppy, the EURO STOXX Index has pulled back almost 10% since its April high and valuations appear more reasonable at this juncture given fundamentals are also incrementally better.

- Aside from resolution of the Greek situation, 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.

- Inflation in the UK remains lackluster and Q2 inflation expectation was revised lower. The outlook for the back half of the year looks for a pick-up in inflation and the gradual oil price recovery will help.

Rest of World

- The gradual recovery continues in Japan, broadly, and is supported by the continued expansion of the monetary base and weaker Yen. Growth in private consumption (60% of GDP) should pick up throughout 2015, supported by data showing a rise in real wages recently. Equity valuations in the region look attractive, relatively. Earnings revisions have been trending flat in recent weeks and the latest economic data paints a positive picture of the economy.

- Emerging markets remain weak and range bound for the most part. Weaker commodity prices are a headwind and weaker currency means the USD denominated debt burden has risen, increasing the riskiness of these markets further.

Central Bank Watch

- The general economic backdrop for 2015 still continues to necessitate a reasonably loose monetary policy in several of the major 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 is around September 2015.
- Earlier in 2014, ECB announced an open ended Quantitative Easing program. The ECB will commence buying €60bn of private and public sector securities every month until from March to 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.
- The MPC unanimously support an unchanged policy stance at the moment. The BoE downgraded its growth forecast but maintains its expectation on labor force slack. Fiscal policy is expected to be a headwind to GDP growth as the Conservatives' implement a more restrictive fiscal policy.
- 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.
- Zurich Life funds favor Irish and Spanish over German and Belgian bonds.
- In equities, we are
  - underweight UK, North America
  - neutral Europe ex Ireland, neutral Asia ex Japan
  - Overweight Ireland and Japan

  (All the above are relative to the manager average)
- Sector weights (at aggregate level) are: underweight energy and utilities, and overweight consumer goods and industrials.

Zurich Life Assurance plc
Zurich House, Frascati Road, Blackrock, Co. Dublin, Ireland.
Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurichlife.ie