ZURICH

20th July 2015

The week gone by

Global **equities** (in euro terms) rose strongly, reacting positively to the latest Greek bailout and good US Q2 earnings' results. Euro currency weakness has significantly enhanced returns for eurozone investors in 2015 (see table below) and this was once again a major feature last week. Equities continue to be supported by the low interest rate environment. 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) rose by 5.1% last week giving a total return year-to-date of a strong 17.3%. Technically, the Index moved above its 50-day moving average and is now 9% above the critical 200-day moving average. All of the major equity **markets** were up in local currency terms last week ranging from 5.0% in Japan to 1.5% in the UK.

Eurozone **bond** prices were up strongly (1.7%) on the week, a knee-jerk reaction to the Greek bailout with core and peripheral markets rising by about the same amount. Overall, eurozone bonds are down by 0.6% year-to-date and remain well-off their mid-April peaks. The German 10-year bond yield fell from 0.90% to 0.79% last week; it had hit an all-time-low of 0.06% in April. Equivalent US yields fell from 2.40% to 2.35%. **Commodity** prices in general were down by 1.7% (in dollar terms) last week and are down 6.7% so far in 2015.

	Index	1 Week Return 10.07.15 to 17.07.15		Year to Date Return 31.12.14 to 17.07.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	5.1	5.1	17.3	17.3
US	S&P 500	2.4	5.0	3.3	15.1
Europe	FT/S&P Europe Ex. U.K.	3.9	3.9	18.4	18.4
Ireland	ISEQ	3.2	3.2	24.1	24.1
UK	FTSE 100	1.5	5.0	3.2	15.3
Japan	Topix	5.0	6.6	18.2	27.2
Hong Kong	Hang Seng	2.1	4.6	7.7	20.1
Australia	S&P/ASX 200	3.2	5.3	4.8	5.6
Bonds	Merrill Lynch Euro over 5 year	1.7	1.7	-0.6	-0.6

The week ahead

- The US Q2 results season continues with financials dominating the earnings tape. It is projected that June new home sales and existing home sales (Friday) increased by 540k and 5.4m units, respectively (last: 546k and 5.35m).
- In Europe, it is estimated that the July euro area flash composite Purchasing Managers' Index (Friday) will moderate to 53.9 (last: 54.2).
- In the UK, it is expected that the June MPC minutes (Wednesday) will revel unchanged votes (9-0) on rates.

Global Outlook

United States

- Chair Yellen noted the more momentum, less slack, and reduced uncertainty over the outlook in her testimony before congress this week. Although incrementally less dovish in her tone, the market still expects just a single hike from the Fed this year. The Fed remains heavily data dependent. The range of expectations varies from Sept 2015 to early 2016. We look for a late 2015 hike with the potential for the Fed to wait until 2016 if inflation is stalled by factors such as a strengthening US$ or weakening oil price, amongst others. The latest data from the US was mixed, with retail sales disappointing, manufacturing IP unchanged, and CPI coming in broadly as expected with housing-related data looking healthy.
- Although early in the earnings season, Earnings Surprises Ratio has been positive with 73% of the S&P 500 coming in above expectations and only 24% below expectations. S&P 500 Index has rebounded well in the past week of trading having been sluggish in the wake of China equity market volatility and the uncertainty in Europe over Greece. Although early in the season, Q2 earnings reports may be a potential catalyst to boost earnings outlooks marginally if growth is stronger than expected. Earnings expectations were cut significantly year to date mainly energy related and FX related and the US underperformed World Equity Indices. Positive earnings revisions or a stronger USD could cause flows into the US. Some caution remains given the expansionary monetary policies within Europe and Japan helping boost equity markets (similar to the impact the S&P experienced with over the 5 years with the now completed quantitative easing). Both regions are earlier in their "recovery cycles" versus the U.S making them relatively more attractive.

Euro Area, Europe & UK

- The Greek parliament passed a package of measures as part of its agreement with the institutions. Subsequently, the ECB kept haircuts on collateral unchanged and increased the ELA ceiling allowing banks to re-open, albeit with capital restrictions still in place.
- Although the probability of Gr-exit has waned substantially, the Greek saga will remain a risk factor for some time. Much uncertainty remains on factors such as the mechanics of the bridge financing and the health of the banking system. However, it is not likely to cause any meaningful contagion at this point.
- Elsewhere in the European region, 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 lacklustre 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, the resulting weaker Yen and stronger economic data reads. Growth in private consumption (60% of GDP) should pick up throughout 2015, supported by data showing a rise in real wages recently. There have been fluctuations in export data and industrial production but the economy is recovering on firmer trends in consumption and capital expenditures. Equity valuations in the region look attractive, relatively.
- 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. China posted stronger Q2 GDP data versus expectations pointing to potential stabilization in growth.
- Recent equity market volatility poses some downside risk still, given the financial services sector is a meaningful contributor to growth. The equity market is not a major source of corporate financing in China with bank lending the main source of funds. Therefore the corporate sector is somewhat less impacted by the leverage-fuelled equity market volatility of late.

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. Yellens testimony last week may have sounded incrementally less dovish versus recent statements however remains key is their unchanged forward guidance in terms of the Fed remaining heavily data dependent. The trajectory of hikes is more important than the timing of the first move and the path of hikes will be gradual.
- 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 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. Negotiations with Greece remain the focus of the ECB member states and the market.
- The MPC have not changed their stance of late. BoE's and remain focused on labour force slack. There was a suggestion from one BoE member that rate hikes are coming "soon" and he emphasized the risks of waiting too long before hiking support an unchanged policy stance at the moment.
- Japanese monetary policy is expected to remain loose for some time to come. The BoJ cut its FY15 GDP and FY15-17 CPI forecasts, but said its price target remain achievable. Inflation still remains well below 2% target at present.

Positioning

- Zurich Life funds are overweight in equities and underweight bonds versus the manager average.
- Zurich Life funds favour 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.

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.

Zurich Life Assurance plc

Zurich House, Frascati Road, Blackrock, Co. Dublin, Ireland.

Telephone: 01 283 1301 Fax: 01 283 1578 Website: www.zurichlife.ie