Weekly Investment News

ZURICH

24th August 2015

The week gone by

Global **equities** (in euro terms) fell sharply during the week reacting adversely to weak Chinese economic data and the subsequent impact on commodity prices. Markets continue to focus on the timing of upcoming US interest rate rises – there is now between a 30% and 40% chance of lift off in September. Euro currency weakness has enhanced returns for eurozone investors in 2015 (see table below), although there was a reversal last week. Equities remain better value relative to other asset classes despite the rise in price earnings multiples in some markets.

The global index (in euro terms) was down 7.51% last week giving a total return year-to-date of 2.37%. Technically, the Index fell back below its 50-day moving average recently and has now broken below the critical 200-day moving average. The index is also now almost 14% off its 2015 high made in April. All of the major equity **markets** were down in local currency terms last week with Hong Kong (-6.59%) being the weakest. The Australian market was the strongest albeit with a -2.65% return.

Eurozone **bond** prices rose by 0.18%. Bonds have been performing well recently in reaction to Chinese and global growth worries. Overall, eurozone bonds have given a return of 1.14% year-to-date but prices remain well-off their mid-April peaks. The German 10-year bond yield fell to close at 0.564% last week; it had hit an all-time-low of 0.06% in April. Equivalent US yields fell from 2.20% to 2.04%. **Commodity** prices in general were down by 3.35% (in dollar terms) last week and are now down 16.79% so far in 2015.

	Index	1 Week Return 14.08.15 to 21.08.15		Year to Date Return 31.12.14 to 21.08.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	-7.51%	-7.51%	2.37%	2.37%
US	S&P 500	-5.77%	-8.06%	-4.27%	1.94%
Europe	FT/S&P Europe Ex. U.K.	-6.29%	-6.29%	6.04%	6.04%
Ireland	ISEQ	-5.32%	-5.32%	18.17%	18.17%
UK	FTSE 100	-5.54%	-7.51%	-5.76%	1.19%
Japan	Topix	-5.49%	-6.06%	11.76%	17.24%
Hong Kong	Hang Seng	-6.59%	-8.80%	-5.06%	1.14%
Australia	S&P/ASX 200	-2.65%	-5.83%	-3.63%	-7.78%
Bonds	Merrill Lynch Euro over 5 year	0.18%	0.18%	1.14%	1.14%

The week ahead

- On Thursday revised US GDP growth figures are expected to move upwards with a consensus of 3.2% quarter on quarter growth expected. It is estimated that the August consumer confidence index (Tuesday) will rise with a consensus projection of 93.0 (up from 90.9).
- In Europe, German Q2 final GDP is expected to be confirmed at 0.4% (quarter on quarter) on Tuesday, whilst Greek quarter on quarter GDP growth (Friday) is projected at 0.8%.
- In the UK, it is forecast that year on year GDP growth (Friday) will come in at 2.6%, with private consumption and investment figures also due out on Friday.

Global Outlook

United States

- US markets are 7% off their 2015 highs and last week saw the S&P 500 break through important technical levels to dip below 2040 and close the week at 1970, last seen in October 2014. Energy, Technology and Financial sectors led last week's decline and high Beta stocks saw profit taking as investors de-risked. The Fed's failure to give clarity on interest rate hikes and dovish tone drove volatility in financials space. Timing of Fed Liftoff is one of the most discussed and debated. Consensus is still that the Fed will hike before year end, however, the probability of a September hike is now reduced due to the dovish tone of the Fed minutes released last week. The Chinese Yuan (CNY) depreciation, combined with heightened fears over Chinese growth, following a weaker than expected manufacturing report, have also contributed to the spike in equity market volatility.
- Domestically macro data doesn't show any material sign of deterioration, with unemployment low, housing market recovering steadily and consumers benefitting from low gas and potential wage hikes as labour force slack erodes. Housing recovery is key to continued economic strength. Demand, supply, affordability & credit all augur a rejuvenation of the housing cycle. Residential investment still languishes at 3% of GDP vs. the longer term average near 5%. Reconciling the economic data with the volatility of US equity indices of late, the movement appears to be an index price correction and does not reflect expectations for an economic recession in the US.
- Sentiment remains at bearish-to-neutral levels, having been at such levels for a while. While a short-term bounce could occur in the coming days, key technical levels should be watched to determine whether this is merely a short term correction or the beginning of a cyclical downturn in equity indices.

Euro Area, Europe & UK

- August data for Eurozone showed robust manufacturing survey numbers and an improvement in consumer confidence. Although exports up to June 2015 have been robust, the recent devaluation of the CNY and strengthening of the Euro is a meaningful headwind. Given the export-driven growth model of the Eurozone, this means downside risk to Euro Area GDP. It is estimated that a 200bp slowdown in China (with a fixed exchange rate) could lead to approx. 10-15bp decline in Euro Area growth. The ECB meeting minutes highlighted the fragility of the Euro Area recovery, weak inflation and, despite an incrementally more optimistic tone, still see the balance of risks to the downside. Commodity prices, the emerging market slowdown and exchange rate developments will shape the inflation outlook for the region.
- The Greek Parliament approved the third bail out from the Troika with the support of 222 MPs. Risk around Greece has not waned given;
    - Weakening position of the government, the announcement of a new political movement by the leader of Syriza's leftist platform and the very high probability of a party split and snap election.
    - Execution of the bailout program terms will be challenging in itself
    - Banks recapitalisation process will also be a tough process.
- Inflation in the UK showed a pick up recently, but the BoE are unlikely to shift their stance on rates given low commodity prices (including the continued slide in Oil) should see inflation continue to trend lower in the near term and wage growth is decelerating. Whilst the MPC have been focused on domestic data (wage growth, inflation) they are drawn towards external risks, currency levels and real interest rate levels. Monetary conditions have tightened in the last two years due to the strengthening currency and higher real interest rates (as inflation remained low, exacerbated by oil price weakness). A rebound in inflation would mean lower real interest rates and help to offset some of the monetary tightness. However the BoE are unlikely to tighten any time soon given weak inflation and a strong GBP. A slowdown in the Chinese economy is a headwind, further supporting the case for no hike.

Rest of World

- Risky assets remain under pressure and core bonds are being bid up in a flight to safety. The PBoC has taken action to stimulate the Chinese economy by depreciating the CNY versus the USD. Following the USDCNY fixing, Asian currencies and other China-related assets are experiencing volatility. The PBoC have highlighted the bigger role of the market in determining the equilibrium exchange rate. The IMF welcomed the move. A key market concern is that this does not de-risk the China story - Chinese economic data has been weaker than expected in recent months – and this stimulatory measure is not a quick fix.
- The iShares Emerging market TETF is now 26% off its April 2015 highs with commodity weakness and Dollar strength broadly persisting. USD strength keeps the USD denominated debt burden of many emerging markets at high levels.
- Labor market and tax receipts reports were broadly positive, however, a drop in Q2 real GDP intensifies pressure on the BoJ to announce further stimulation. Falling commodity prices and a strong Dollar could push the trade balance higher, despite the obvious risk to exports from China related weakness. The 3-month average trade deficit edged up due to exports to the US and Europe rising materially over the past two months.

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 likely before year end. 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 until from March to end-September 2016 at least.
- The MPC have not changed their stance of late. BoE's and remain focused on labour force slack.
- 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 Asia ex Japan
    - Overweight Ireland, Europe ex UK 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.

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