



21st September 2015

## The week gone by

Global **equities** (in euro terms) had seen significant volatility during August on the back of economic growth concerns in China and the emerging markets. Last week, however, saw some further stability return to markets. Investors continue to focus on the timing of the upcoming US interest rate rise. Comments from the Federal Reserve following last Thursday's FOMC meeting were dovish in nature – with concerns raised about weaker global growth and a stronger US dollar – pushing out lift-off until December 2015 or Q1 2016. Equities remain well valued on a yield basis compared to cash and bonds whilst price/earnings multiples have contracted somewhat.

The global index (in euro terms) fell by 0.3% last week giving a total return year-to-date of plus 2.7%. Technically, the Index remains well below the critical 200-day moving average but is over 5% higher than the recent low on 24<sup>th</sup> August. There was a mixed bag of returns from the major equity **markets** in local currency terms last week ranging from minus 1.2% in Japan to plus 2.0% in Australia. The influential US market was flat on the week, losing earlier gains following the FOMC meeting.

Eurozone **bond** prices were ahead by 0.5% on the week, reacting to the Fed's concerns on global growth. Overall, eurozone bonds have given a return of plus 0.9% year-to-date although prices remain well-off their mid-April peaks. The German 10-year bond yield rose marginally from 0.65% to 0.66% last week; it had hit an all-time-low of 0.06% in April. Equivalent US yields fell from 2.19% to 2.13%. **Commodity** prices in general were down by 1.3% (in dollar terms) last week, despite a 3% rise in the gold price, and are down by 15.6% so far in 2015.

	Index	1 Week Return 11.09.15 to 18.09.15		Year to Date Return 31.12.14 to 18.09.15	
		Local Currency %	Euro %	Local Currency %	Euro %
Global (euro)	FTSE World (total return)	-0.3	-0.3	2.7	2.7
US	S&P 500	-0.1	0.2	-4.9	1.9
Europe	FT/S&P Europe Ex. U.K.	-0.6	-0.6	3.7	3.7
Ireland	ISEQ	0.3	0.3	23.8	23.8
UK	FTSE 100	-0.2	0.8	-7.0	-0.7
Japan	Topix	-1.2	-0.3	3.9	11.1
Hong Kong	Hang Seng	1.9	2.3	-7.1	-0.5
Australia	S&P/ASX 200	2.0	3.7	-6.3	-9.9
Bonds	Merrill Lynch Euro over 5 year	0.5	0.5	0.9	0.9

## The week ahead

- In the US, it is forecast that the third estimate of Q2 real GDP (Friday) will be unchanged at 3.7% quarter-on-quarter. It is likely that the September final University of Michigan consumer sentiment index (Friday) will be revised up to 87.0 (last: 85.7).
- Euro area September 'flash' composite PMI (Wednesday) is likely to edge down to 54.0 (last: 54.3).
- In Japan, it is forecast that August core CPI (Thursday) fell by 0.1% year-on-year (last: 0.0%).

# Global Outlook



## United States

- The S&P 500 Index was flat last week after gains earlier in the week were reversed on Thursday evening upon the Fed's announcement that they are keeping rates unchanged. The Fed remains dovish in their tone and the reaction of the equity market seemed to indicate the Fed had taken a slightly different approach vs the markets in terms of weighing positive news on US growth and labor markets with concerns about financial market turbulence and global growth. The Fed's concern that EM weakness and the strong USD could restrain US growth seemed heightened vs previous statements and Yellen did not express any confidence around inflation returning to target 2%. Most Committee members still expect a rate hike before year end and the Median Member Forecast for rates fell.
- The key question is whether we have seen the low or just a low. The S&P 500 index failed to break through the key technical resistance level of 2000 for the second time since the pullback. Technology, Energy and Healthcare are amongst the best performers also since the S&P 500 pullback in last August. Consumer discretionary stocks have been some of the most resilient throughout the market volatility (past month) which speaks to the strength of the US consumer and domestic economic situation. Timing of Fed Lift off remains one of the most discussed and debated topics amongst investors.
- 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. Domestically macro data doesn't show any material sign of deterioration, with unemployment remaining low. The August non-farm payroll report was robust, despite the lackluster headline figure, as revisions were positive some wage inflation was evident. Housing market recovering steadily and consumer benefitting from low gas and some wage inflation as labor 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%

## Euro Area, Europe & UK

- The ECB revised their outlook for real GDP growth for 2015, 16 and 17, primarily due to lower external demand owing to weaker growth in emerging markets. The Eurozone is one of the most exposed DM regions to EM's, given its export-driven growth mode. The ECB is therefore more sensitive to inflation and currency dynamics. The ECB highlighted that risks to Euro Area growth remain on the downside. Although exports up to June 2015 have been robust, the recent devaluation of the Chinese Renminbi and strengthening of the Euro is a meaningful headwind. Commodity prices, the emerging market slowdown, and exchange rate developments will shape the inflation outlook for the region.
- Regarding growth within the Eurozone: Given continued high structural unemployment and low potential output growth in the euro area, the ongoing cyclical recovery must be supported by effective structural policy reform in key member states. This includes product and labor market reforms and enhancing of the business environment. Loan growth has shown some improvement but the dynamics of loans to non-financial corporations remain subdued.
- Robust private domestic demand is expected, despite the continuing fiscal consolidation and modest global growth. The near term outlook for inflation is muted given falling energy prices. The continued strength of the GBP is a drag on import prices and continues to push down inflation posing further downside risk. Some wage growth is expected, which should counterbalance the drag to inflation from Oil and GBP appreciation.
- 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). 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.

## Emerging Markets

- Emerging market growth fears were central to the turbulence seen in markets during August. Emerging market currencies have depreciated substantially against G4 and global oil prices and the G4 bond yields have

been falling. Confidence in global growth is low as sub-par emerging market

- Growth concerns remain despite recovering developed markets. A demand boost from the US and China would be the catalyst to help Emerging Markets recover but with the recent activity data in China being a disappointment, concerns have become heightened and Brazil remains in recession. The US and other developed markets are posting solid growth numbers (as seen in positive revisions to Q2 GDP estimates recently). However, economic growth in the major developed economies is driven in a large part by services, thus having limited impact on Emerging Markets.
- Emerging market private-sector debt levels remain high (JPM estimate levels at around 130% of GDP). The risk of disruptive de-leveraging combined with FX headwinds, reduced growth expectations, reduced pricing power for goods and commodities leaves Emerging Markets in a difficult position.
- In China, increased fiscal and monetary easing measures are being instigated by policy makers but risk remains to the downside.

## Central Bank Watch:

- It appears that the G4 Central Bank policies are being affected by EM growth concerns and financial market developments. The heightened risk awareness could point to them taking a somewhat more dovish policy stance for a little longer than previously expected.
  - In the US, timing of rate rises remains the focus. Although many believe early 2016 is likely, the consensus is still for a move prior to 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 from March to end-September 2016 at least. The ECB may increase the size of the program or bring forward some buying depending on economic data, inflation.
  - When the BoE does raise rates, they are expected to do so gradually and to a lower level than in recent cycles, given the likely persistence of the headwinds weighing on the economy.
  - 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 favor Irish and Spanish over German and Belgian bonds.
- In equities, we are
  - Underweight UK
  - Neutral Asia ex Japan and North America
  - 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.

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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