

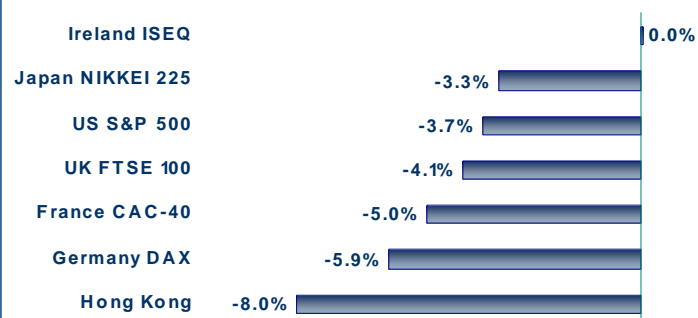
2010 got off to something of a shaky start for global equity markets, with most indices recording losses in January. Many markets were in positive territory early in the month, before US President Obama's proposals to impose a levy on large banks in order to recoup "every single dime" of taxpayer money spent to bail out the industry offset positive bank profit news. Obama's follow-up call that banks be banned from engaging in proprietary trading activities further hit sentiment and unsurprisingly, bank stocks were among the weaker performers in the month. News that the Chinese authorities were restricting lending by the country's banks also exercised investor minds, while worries about Greece's ability to tackle its financial difficulties mounted, as indicated by rising debt costs.

Although the trend in economic and corporate news flow was largely positive in the month, the best performing sectors tended to be those with a less economically sensitive bias. Hence, we saw consumer staples and healthcare stocks outpacing returns from materials and technology sectors. On a geographic basis, Ireland was among the few developed countries to eke out a positive gain, although some Eastern European markets bucked the weak trends with relatively strong returns. The threat of tighter Chinese monetary policy weighed on many Asian stockmarkets.

BIAM Strategy and Outlook

- While US leading indicators still point to a sharp rebound in activity, some indicators appear to have peaked, albeit at high levels still consistent with solid economic growth. GDP growth of 5.7% in the latest quarter was considerably ahead of estimates. US consumer and housing-related indicators remain more subdued; the recent decline in housing activity was disappointing but not unexpected given the planned expiry of the first-time buyer incentives.
- In Europe, the German IFO business sentiment index continues to point to solid growth, while the real economy remains somewhat sluggish. The UK emerged from recession in the fourth quarter, but quarterly growth of 0.1% after six quarters of contraction was disappointing. Nonetheless, we believe the UK outlook may not be as poor as forecasted by some commentators. China's economy grew 10.7% in the last quarter and authorities moved to dampen the threat of a credit bubble by raising bank reserves.
- Fourth-quarter earnings season has proved to be robustly positive with profits running ahead of expectations, particularly in the banking space. In the US, positive earnings surprises have outnumbered disappointments by about 4-to-1. Cost-cutting has been a significant driver of earnings surprises as margins expanded with notable productivity gains. This gain helped bring about the 5.7% GDP growth in the latest quarter. We do not expect companies to be able to grow profits indefinitely from cost cuts, but the potential for further earnings growth from any pick-up in revenue growth could be substantial.
- Bonds generally generated positive returns as investors were more cautious, but Greece's bond experience was significantly different. Added to its fiscal issues, Greece has a credibility problem after falsifying public finances data and this drove bond yields higher. The European Commission is likely to demand deep spending cuts in return for assistance.
- Interest rate expectations remain dulled by such fiscal difficulties, alongside high unemployment and the absence of inflation pressures. It is difficult to envisage any notable interest rate moves in the US, UK or Eurozone in 2010.

Equity market returns - January 2010



Source: Bloomberg. Capital returns in local currency.

Movement in 10-year bond yields

	31-Dec-08	31-Dec-09	31-Jan-10
US	2.22%	3.84%	3.59%
UK	3.02%	4.02%	3.91%
Germany	2.95%	3.39%	3.20%
Japan	1.17%	1.30%	1.33%
Ireland	4.27%	4.84%	4.85%
Greece	5.23%	5.77%	6.85%

Source: Bloomberg.