

The inauguration of Barack Obama as President of the United States provided some optimism in a month when economic data releases detailed a global economy caught in a deepening downturn. After a bright start to 2009, global equities tumbled – even as central banks continued to lower interest rates.

The new year begins with further equity losses...

- After a positive first few days of 2009, global equity markets retreated under a barrage of weak economic data and forecasts. Investors were also unnerved by a renewal of banking turbulence as a number of governments increased the level of state investment in the industry.
- The International Monetary Fund cut its forecast for global economic growth for 2009 from 2.2% in November to just 0.5%. The US economy contracted by 3.8% in the fourth quarter. Although better than consensus estimates, it still represents the worst performance in over 16 years.

Bank stocks under renewed pressure in January...

In the middle of January, bank share-price movements akin to those seen last September and October were in evidence as the issue of bank capitalisation requirements was reignited. Earnings announced by a number of banks were worse than expected, with losses at Bank of America and Citigroup triggering new US government investment.

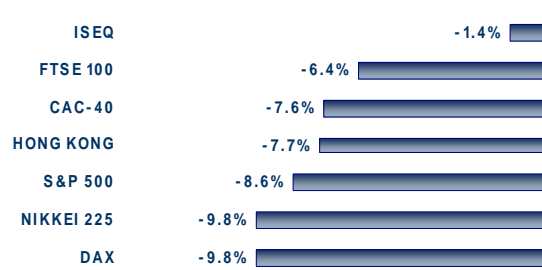
On this side of the Atlantic, the UK government swapped its preference shares in Royal Bank of Scotland for ordinary shares, increasing its stake in the bank to 70%. Closer to home, Anglo Irish Bank was nationalised by Finance Minister Brian Lenihan following "serious reputational damage". The share prices of Bank of Ireland and Allied Irish Banks (AIB) were sold off in the following days as investors fretted about their possible fate. In the month, Bank of Ireland and AIB fell 22.1% and 29.5%, respectively.

Banking stocks' influence on the overall ISEQ Index has become more muted as their market weights declined in the past year. CRH now accounts for over one-third of the Irish market, making it by far the biggest single influence on the ISEQ Index. CRH gained 2% in the month, benefiting from news that the new US administration intends to spend US\$30 billion on a federal road-building program.

For Irish and Eurozone exporters, there was some relief in the decline of the euro, which lost close to 9% against both the US dollar and British pound. The euro's relative weakness had its roots in a number of sovereign-debt downgrades during the month.

In broad terms, defensive sectors outperformed in January with the healthcare sector's relative strength aided by a couple of high-profile mergers and acquisitions. Financials generally lagged equity market returns.

Equity market returns – January 2009



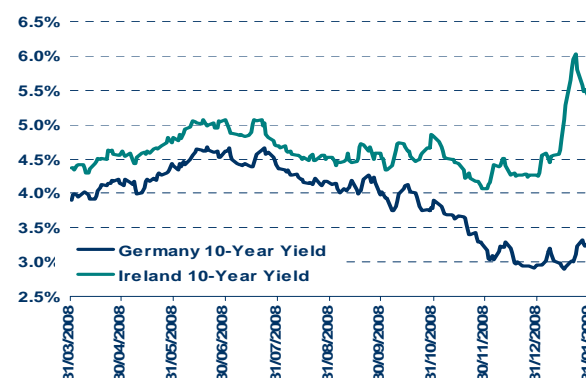
Source: Bloomberg. Capital returns in local currency.

US consumer sentiment hits record low...



Source: Bloomberg – US Conference Board.

Cost of Irish government borrowing rises...



Source: Bloomberg.

Bonds post negative returns in January...

Bond markets gave up some of the gains of 2008, amid worries about the amount of debt governments plan to issue this year to fund various stimulus packages. This had a bigger impact on the longer-dated part of the curve and we saw a renewed steepening in Eurozone bond yield curves as expectations persisted that the European Central Bank will continue to lower interest rates.

The severe financial market dislocation, and accompanying economic distress, prompted widespread speculation about the possibility of a eurozone sovereign bond default and/or a country leaving the eurozone. Yields on Irish, Greek, Portuguese and Spanish bonds rose more than German yields, following credit rating outlook downgrades as government finances deteriorated.

At the end of January, the yield on a 10-year German bund stood at 3.30%. The comparable yields on the others were: Ireland (5.46%), Greece (5.77%), Portugal (4.48%) and Spain (4.31%). Irish 10-year bond yields rose more than 100 basis points in January, with the Anglo Irish Bank nationalisation a contributory factor.



10-year bond yields

	31-Dec-07	31-Dec-08	31-Jan-09
US	4.03	2.22	2.84
UK	4.51	3.02	3.70
Germany	4.31	2.95	3.30
Japan	1.51	1.17	1.30

Source: Bloomberg.

BIAM Outlook

- With leading economic indicators falling at an unprecedented pace, it becomes increasingly difficult to foretell the turning point in the economic cycle with any precision. This, in fact, is always true – but the nature of the current downturn leads us to conclude that macro-forecasting is even more hazardous than usual. There may be no analytical tools available to call the turn of this particular cycle. What we do know, now, is that it is bad and has been going on for at least a year. Given the global policy response, and the in-built self-correcting tendencies of economies, we might be tempted to conclude that the cyclical low should be in 2009. If this assumption is correct, stocks are cheap on current valuations.
- Defensive sectors, such as healthcare and consumer staples, have outperformed over much of the past year. We are aware that the sharp falls in the valuations of other more cyclical stocks have thrown up some interesting opportunities. In recent times, we have reduced the 'defensive' tilt of our portfolios to take advantage of these changes, although we continue to have a defensive bias. The near-term newsflow on corporate earnings and the economic backdrop will continue to be poor, which could restrict any significant sustained advance.
- Interest rates came down further in January with the Bank of England (BoE) and European Central Bank (ECB) reducing their respective rates by 50 basis points. We expect this trend to continue, although the ECB has intimated that it will not lower rates as far as the near-zero level of the US and Japan and targeted by the BoE. Interest rates have also come down sharply in the previously-booming Asia Pacific region, which will help to stabilise tumbling consumer and business confidence levels.