



“The scale of the Irish stock market’s underperformance in July is partially accounted for by the sharp decline in Elan’s share price. In a month of volatile share price movements, the extent of the fall of the ISEQ index’s largest stock was still significant.”

Leona Nicholson, Head of Irish Equities & Global Equity Product

Highly volatile month for financial markets...

- July was something of a month of two halves with equities selling off in the first two weeks amid renewed concerns about the health of the global financial system and the general economic malaise. In Europe, this was copperfastened by an increase in the official European Central Bank rate to 4.25% from 4%.
- The second-half saw equities rebound as a pull-back in the oil price from \$145 per barrel provided a catalyst. In general though, most stock markets finished the month in negative territory with Ireland’s ISEQ a notably poor performer.

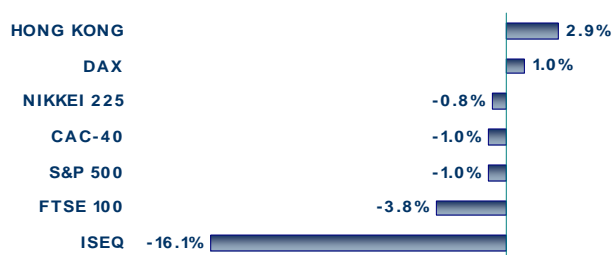
Irish equities lag behind in July...

The Irish stock market was hammered in the first half of the month as the country’s economic outlook dimmed and bank earnings forecasts were cut. The slide in bank stocks was reflected in AIB shedding nearly 30% in the first two weeks before moderating that loss to 19% for the month. By comparison, Bank of Ireland recorded a relatively robust 3.1% drop. Although banks rebounded from mid-month lows, the Irish market was then hit when the ISEQ’s largest stock, Elan, dropped over 40% following a setback in its Alzheimer’s drug trials. This was followed by a further 45% drop on the first day of August amid worries about the safety of its Tysabri multiple sclerosis drug.

The US mortgage market remained in focus as US regulators stepped in to take control of IndyMac - the third largest bank failure in US history. Following persistent speculation about the viability of mortgage agencies Fannie Mae and Freddie Mac, Treasury Secretary, Henry Paulson, secured approval to buy unlimited equity stakes in the firms. By month-end, the financials sector was the strongest performer as better-than-expected quarterly earnings, from the likes of Wells Fargo and JPMorgan Chase, triggered renewed confidence in the sector.

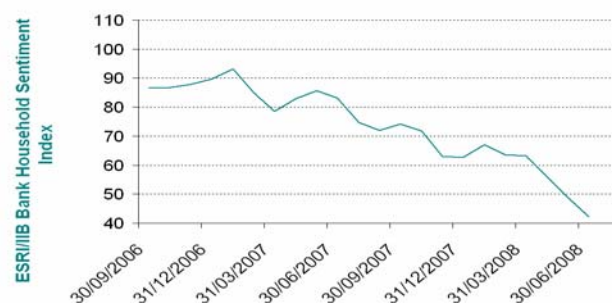
The drop in the price of commodities (oil, metals, crops) was reflected in the relatively poor returns generated by energy and mining sectors and by stock markets in commodity-rich countries. Canada (-6%), Brazil (-8.5%) and Norway (-7.9%) were among those that lost ground. Notwithstanding Ireland’s Elan experience, the pharmaceutical/healthcare sector outperformed in most markets during July as stocks with ‘defensive’ qualities were favoured. In this vein, the consumer staples sector also outperformed the broader market in the month.

Equity market returns – July 2008



Source: Bloomberg. Capital returns in local currency.

Irish consumers become less confident...



Source: Bloomberg

US employment situation worsens...



Source: Bloomberg.

Bonds rise as economic data worsens...

Bond markets rallied as the drop in commodity prices, and deteriorating economic outlook, eased concerns about inflation and the likelihood of significantly higher interest rates. Eurozone bonds gained as Jean Claude Trichet stated that he had “no bias” on further rate moves following the early July hike.

Measures of manufacturing, services, and retail sales all declined in the region, while confidence levels plummeted against the backdrop of rising inflation and unemployment. The IFO survey of German business sentiment fell the most since September 2001. Irish consumer confidence weakened to a new low in July as the live register revealed significant levels of job losses.

Bond yields fell across the curve, with the greatest moves at the short-end leading to a steepening of the yield curve.

10-year bond yields

	31-Dec-07	30-Jun-08	31-Jul-08
US	4.03	3.97	3.95
UK	4.51	5.13	4.81
Germany	4.31	4.62	4.36
Japan	1.51	1.60	1.54

Source: Bloomberg.



BIAM Outlook

- The outlook for the US economy remains weak with consensus estimates for 2009 GDP growth still declining. While the US has so far avoided a recession, at least in the technical sense of negative real growth for two or more successive quarters, the prospect of a prolonged slowdown seems likely. The more frequently published economic data imply a modest rate of growth of about 1%. The prospects for the European economy have also deteriorated recently, and while Asia would appear to be holding up relatively well, there has been some evidence of a slowdown in export activity.
- Results announced by US companies appear to be consistent with this lower rate of growth: domestic earnings have been weaker while overseas earnings have been stronger as export markets have been more resilient and the benefits of a weaker dollar feed into corporate profits. In the current results season, almost half the S&P 500 companies have reported results with 67% recording numbers above (already reduced) consensus expectations. Having considered the gloomy economic situation and earnings forecasts, the question now is how much of this is already in the price of equities? Forward price-earnings multiples are currently below 10 in many European markets, while the US P/E multiple for next year is below 12. The long-term average P/E for the US market is around 16 times.
- While we continue to cast a prudent eye across equities, attractively priced opportunities have emerged following recent weakness. These include financials, consumer discretionary and sectors with a lower degree of financial leverage. Falling oil prices will help restore some of the lost purchasing power and ease inflationary concerns, which in turn might allow central banks the flexibility to lower interest rates to combat weak economic growth.