Bank of Ireland
Asset Management

July 2009

Market Review & Outlook

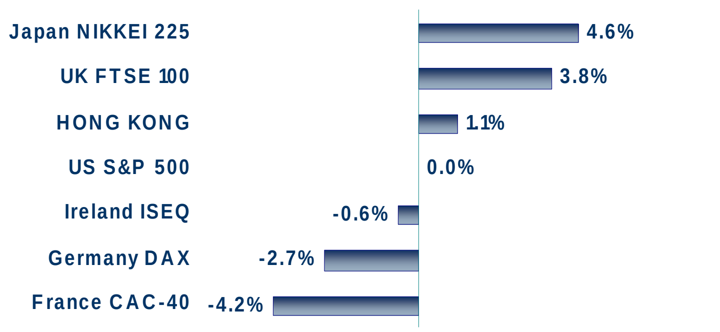
At the half-way point in 2009, global stock markets are looking considerably more healthy than they did in early March, with most now exhibiting positive returns for the year-to-date. The turnaround was remarkable, and it is not hugely surprising that equities experienced some profit taking in recent weeks. For the month of June itself, returns were mixed with many Asian markets maintaining their advance as European equities slipped back amid continued economic weakness. The momentum behind commodities faltered as the month progressed as weak economic conditions raised questions about the sustainability of demand to justify higher prices.

In broad terms, the best performing sectors in June were those with a defensive bias (utilities, healthcare, telecoms) as investors took profits on more economically-sensitive sectors, such as industrials, materials and energy. Technology, which outperformed as earnings expectations were raised amid signs of better order books than anticipated. The technology-heavy US Nasdaq Index climbed 3.4% in June.

BIAM Strategy and Outlook

- The tentative signs of recovery suggested in leading economic indicators have progressed from mere upticks into more fully fledged gauges of a recovery. Data released in June, such as the ISM New Orders Index, point to a v-shaped rebound in the US. Bank lending standards, although still tight, are also improving. A similar pattern is emerging in some European countries: the German IFO Business Climate Survey has rebounded sharply, as have expectations for retail sales volumes and general economic output in the UK. Increasing UK mortgage approvals and a second month-on-month pick-up in UK house prices suggest that the UK consumer is growing less bearish.
- Wage growth remains subdued in most regions with the noticeable exception of China, which continues to do well on a number of fronts. Export market share is rising (admittedly in a shrinking export market), and the country is running a budget surplus. Low levels of government debt provide the means to maintain its fiscal expansion.
- The US$442 billion provided to banks by the European Central Bank at 1% in June; its one-year term; and the breadth of accepted collateral are seen as very positive steps for Eurozone banks. It allows them to rebuild capital through the traditional yield curve carry trade i.e. borrow at low short-term rates and lend at higher long-term rates.
- Earnings estimates for the S&P 500 have been raised in recent weeks and a continuation of this trend would be welcome for stock markets. Scepticism about the durability of the economic rebound needs to be balanced against the improving momentum in earnings. There has been a wide dispersion of stock returns and that presents stock selection opportunities for bottom-up stock pickers like us.
- The world economy still faces headwinds, not least high debt levels in the US and UK (and Ireland). High debt, falling asset values and rising unemployment constrain consumer spending and we expect that central banks will hold interest rates at current low levels for an extended period. We expect Continental Europe to lag any recovery due to structural rigidities, over-dependence on exports and a less aggressive policy response. Consequently, we expect Eurozone government bonds to outperform those in the UK and US, although upside appears very limited.

Equity market returns - June 2009



Source: Bloomberg. Capital returns in local currency.

Movement in 10-year bond yields

	31-Dec-08	31-May-09	30-Jun-09
US	2.22%	3.46%	3.54%
UK	3.02%	3.75%	3.69%
Germany	2.95%	3.58%	3.39%
Japan	1.17%	1.49%	1.36%
Ireland	4.27%	5.45%	5.73%

Source: Bloomberg.

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