



**“Sentiment among investors ebbed lower in June, as inflation pressures grew and economic and corporate earnings growth estimates were reduced. Expectations of higher interest rates dampened equity and bond markets in the month.”**

**Cora Hughes — Head of Consumer Research**

### Economic woes consume markets...

- Stock markets tumbled in June, as an escalation in the oil price to US\$140 per barrel exacerbated concerns about the pace of economic activity. Inflation worries stoked the sell-off on bond and equity markets, with the European Central Bank (ECB) committing to raising interest rates in July.
- With unemployment rising, house prices falling, and fuel prices going up, the Irish stock market accepted the forecast that the economy would contract in 2008 by sending bank and building shares sharply lower.

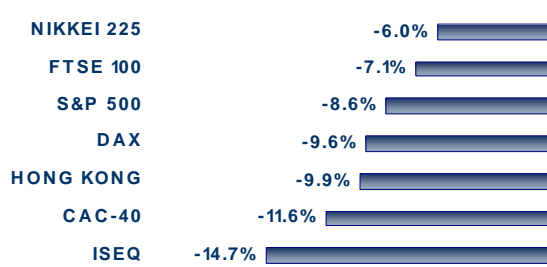
### Torrid month for stock markets...

The rebound in stock market fortunes — which started back in mid-March — faltered as interest rate expectations shifted in early June amid rising inflationary pressures. Governments and central banks grappled with unpalatable choices: slowing economic growth prospects favour the use of interest rate cuts; while rapidly rising inflation should dictate a diametrically opposed strategy. The ECB's signal of a rate increase in July took financial markets by surprise and contributed to the equity sell-off — particularly for financials.

The Economic and Social Research Institute issued a report forecasting that the Irish economy is now entering recession for the first time in 25 years. It expects economic activity to fall by 0.4% this year, and disposable income by 2.6%. It forecast that unemployment will hit 7% in 2008, and that net emigration will return as people leave the country to find work. With global financials already weak, this contributed to a further slide in bank fortunes. Since the beginning of the year, the financials segment of the ISEQ has lost over 40% of its value.

The Dow Jones Industrial Average dropped 10.2%, for its worst June return since 1930, capping its poorest first half in over three decades. This reflected the weakness of economically-sensitive stocks during a month in which US consumer confidence hit a 16-year low and corporate earnings estimates showed signs of the credit crunch biting. Energy and mining stocks continued to outperform on strong demand for commodities, while utilities also performed well.

### Equity market returns – June 2008



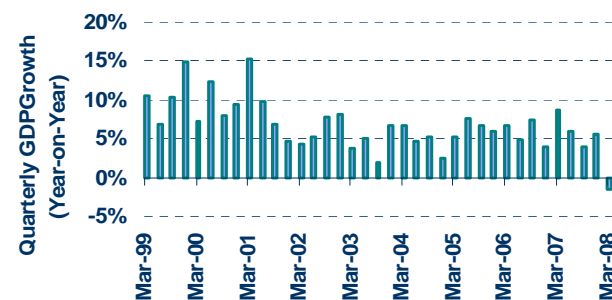
Source: Bloomberg. Capital returns in local currency.

### Oil price climb accelerates in June...



Source: Bloomberg.

### Ireland GDP contracts in first quarter...



Source: Bloomberg, Central Statistics Office.

## Volatile month for bonds...

Bonds performed poorly for much of the month, as yields jumped sharply in response to revised interest rate expectations and increasing inflation. Curves flattened as the short-end was dramatically sold off — the yield on a 2-year Treasury bond jumped 50 basis points in the space of 24 hours to its highest level in five months, before falling back.

Longer-dated US yields finished the month lower, as equity markets sold off and economic data worsened. Although European bonds pared losses towards the end of the month, 4% inflation and a likely rate hike in July meant bonds nursed losses for the month.

## 10-year bond yields

	31-Dec-07	31-May-08	30-Jun-08
<b>US</b>	4.03	4.06	3.97
<b>UK</b>	4.51	4.99	5.13
<b>Germany</b>	4.31	4.41	4.62
<b>Japan</b>	1.51	1.76	1.60

Source: Bloomberg.



## BIAM Outlook

- The global economic outlook is increasingly dependent on what happens to oil prices. A pull-back would ease inflation concerns and allow central banks to ease their recently established hawkish positions. If oil prices stay high, it's difficult not to see a significant slowdown in global growth. The notion of emerging economies avoiding the fall-out of a prolonged slowdown in the West is increasingly unlikely.
- Financial sector problems have been more persistent than we had anticipated. Although US subprime difficulties are largely priced in, the focus has now shifted to more generalised bad debt problems as consumers feel the strain of rising unemployment, the higher cost of everyday living, and collapsing home equity. We are convinced that many banks offer attractive long-term value but, in the absence of a catalyst, it is difficult to determine when that value will be unlocked. Weak sentiment appears to be keeping investors on the sidelines at present.
- Slower growth is certainly in the price of many assets, particularly equities, but valuations can be described as 'attractive' only if the slowdown does not extend beyond 2009. As such, we believe it is prudent to keep risk at a minimum, until the outlook becomes clearer. Among the few areas of the market that have been performing well in this difficult period, some energy and mining stock valuations are beginning to look stretched, given the weakening economic outlook, and we will continue to monitor this closely.