

The old weather adage that “if March comes in like a lion, it goes out like a lamb” resonated with events on global equity markets in March. After plunging to new lows in the first week, markets gathered upward momentum as investors grew more confident about the potential of government actions to stem the economic decline.

Global equities post best gains in months...

- US and emerging markets tended to provide the best equity returns in a strong month for nearly all stock markets. The banking sector made a rare reappearance at the top of performance tables as investors warmed to news that many banks had made a profitable start to 2009.
- Central banks in the US, UK, Japan and Switzerland each turned to non-traditional monetary policy measures to boost struggling economies. The European Central Bank maintained its measured response to the downturn with a standard interest rate cut.

Markets surge on improved sentiment...

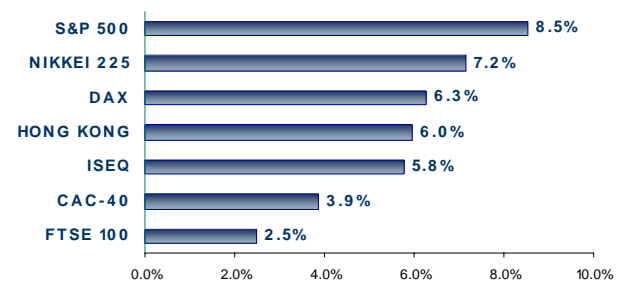
Equity markets nursed some green shoots of relatively positive data and government action into a full-blown rally in March. It would be a significant stretch to describe US housing market data releases that showed a modest improvement from record lows, as being upbeat. However, as a signal to investors that the economy might be bottoming out, it presaged a higher appetite for risk. That manifested itself in a preference for cheap, economically sensitive stocks that had been heavily sold over the previous year.

Mining, technology and industrial stocks rallied amid hopes that the massive inventory correction was closer to an end. Industrial production had fallen off a cliff as companies worked through surpluses amid contracting demand. The pick-up in commodity prices in the month may be a further confirmation of this, with rising hopes that the Chinese economy is in robust health. The corollary of this is that ‘defensive’ stocks - typically in utilities and telecommunications sectors - broadly underperformed.

The banks’ rally had its roots in a combination of cheap valuations, the US Treasury Secretary’s Public-Private Investment Program (PPIP), and the move towards ‘quantitative easing’ (QE). The PPIP aims to remove toxic assets from bank balance sheets in order to promote new lending. QE has the same end goal, and the Bank of England pledged to buy £75 billion of gilts in the next three months, with the US Federal Reserve following with a US\$300 billion package to purchase longer-term Treasury securities.

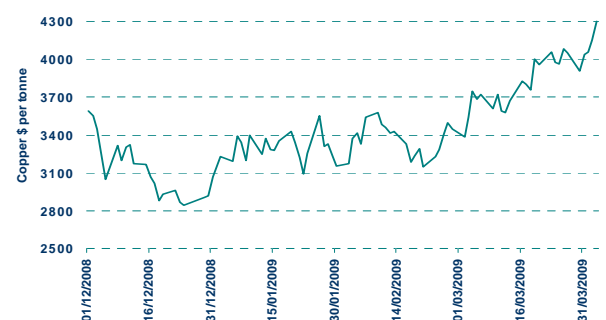
Irish banks participated in the rally, with the ISEQ financials index surging 69%. The rebound was sustained even as the government finances worsened further ahead of a tough budget and Standard & Poors downgrading of Ireland’s debt rating from AAA to AA+.

Equity market returns – March 2009



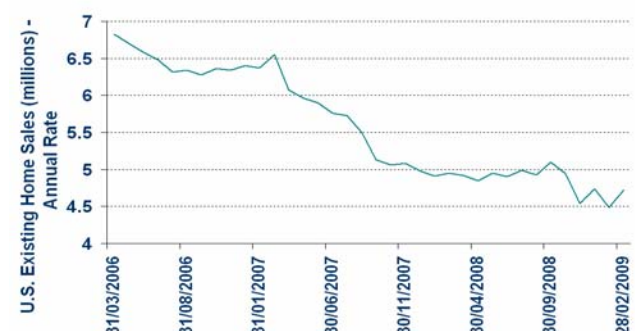
Source: Bloomberg. Capital returns in local currency.

Copper prices maintain upward trend...



Source: Bloomberg.

US house sales bounce from lows



Source: Bloomberg.

Bond markets make gains...

Bond markets generally posted positive returns as central banks loosened monetary policy further. As we've seen in recent months, bonds of Eurozone countries no longer behave as cohesively as before. In March, Irish bonds outperformed those of Germany as investors weighed up relative values. Irish bond yields briefly rose after the S&P rating downgrade, but over the month 10-year yields fell 21 basis points to 5.29%.

The 'quantitative easing' measure announced by the Bank of England resulted in an immediate drop in bond yields. This clearly encouraged the Federal Reserve to follow suit in its efforts to lower mortgage rates. The actions had the desired effect and UK and US bond markets outperformed in the month.

The European Central Bank cut rates to 1.5% in March (and again to 1.25% in early April), but the structure of the euro area makes it difficult for the bank to buy up government debt. However, there is speculation that the ECB may increase the duration of its loans to banks beyond the current six-month period.



10-year bond yields

	31-Dec-08	28-Feb-09	31-Mar-09
US	2.22	3.02	2.67
UK	3.02	3.62	3.17
Germany	2.95	3.11	2.99
Japan	1.17	1.28	1.35

Source: Bloomberg.

BIAM Outlook

- While there has been some positive economic news recently in the form of better-than-expected US housing market and durable goods data, the overall tone is one that points to a very weak economic outlook. The Organisation for Economic Co-Operation and Development downgraded its 2009 global economic growth forecast to -2.7%, with its 30 members experiencing a contraction of 4.3%. Where some of the US and Pacific (ex Japan) numbers may be showing some signs of bottoming out, the data in Europe and Japan continue to career downwards. The IFO German Business Climate Indicator remains weak, touching a 26-year low as collapsing trade hurts its large export-driven manufacturing base.
- Fears of prolonged deflation have subsided as the amount of money being pumped into the US and UK economies will ultimately have an inflationary impact. Since consumer activity fell off the proverbial cliff in the latter months of 2008, industrial production has fallen everywhere and a massive inventory adjustment is taking place. This has meant factory closures and job losses as companies attempted to halt the build-up of inventories. Ultimately there will be a rebound once stock levels have been sufficiently depleted, which will in turn result in a pick-up in manufacturing, albeit at a slower pace than before. Overall, while leading indicators show some signs of stabilising, we are not yet at a recovery phase.
- In terms of equities, the eternal question revolves around what is in the price. While we acknowledge the poor state of the global economy and the probability of a dreadful earnings season ahead, we do not share the more apocalyptic visions of the future and choose to focus on compelling corporate valuations, as and when they arise. We have been easing the defensive bias that has been a feature of the portfolio in the past year to take advantage of particularly cheap valuations in more cyclical names. We do not expect markets to rise unhindered, but believe an opportunity exists to make long-term investments at cheap prices.