

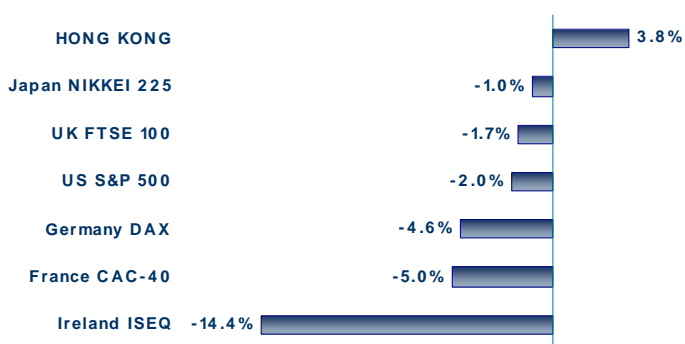
The seven-month equity rally faltered in October despite the third-quarter earnings season generally providing more upbeat corporate performances than anticipated. While the first half of the month saw the US Dow Jones Industrial Index rise above 10,000 for the first time in a year, the pick up in oil prices above US\$80 per barrel dampened enthusiasm for economically-sensitive stocks as the month progressed. Scepticism about prospects also wavered amid a mixed batch of US economic data releases that weighed on sentiment.

The setback was more of a developed economy phenomenon, with the US S&P 500 Index down 2%, while the French and German stockmarkets declined by close to 5%. Ireland's ISEQ Index slumped 14% as bank shares retreated amid speculation that further government support may be required. Further afield, China's Shanghai Composite Index generated a gain of 8%, pulling Hong Kong stocks along in its wake. Investors rotated towards more 'defensive' stocks in the latter part of the month, with consumer staples and healthcare sectors tending to outperform. European banks were weaker as the European Commission pushed Dutch bank ING to sell off its insurance operations as the price of approval for its government bailout.

## BIAM Strategy and Outlook

- Estimates for GDP growth in 2010 are improving, although wide regional differences exist: the US economy is expected to grow by about 2.5%, while the UK, Eurozone and Japan are likely to see more modest expansions.
- The turnaround in growth expectations has been driven by the continued improvement in leading indicators that point to a significant upturn in real economic activity. Upward earnings revisions and continued tightening in corporate credit spreads are notable positives. Consumer spending has picked up, while house prices in the US and UK are recording increases. The slowdown in inventory destocking and the eventual rebuilding of stocks will be positive for growth, while wage growth declines, fading fiscal stimulus and household deleveraging will provide headwinds.
- The sell-off experienced by equity markets at the end of October was accompanied by a pick-up in volatility. As stated here before, we are conscious that equity valuations are no longer as attractive as a few months ago. If earnings growth fails to meet expectations, then markets may begin to look overpriced.
- However, we believe corporate earnings can remain buoyant and see evidence of this at an individual stock level. Although not as abundant as before, we are finding opportunities to rotate out of strong performing stocks into more attractively rated quality stocks.
- Despite the global economic improvement in recent months, government bond yields remain close to historic lows in a number of markets. Bonds have been supported by private sector deleveraging, low inflation and interest rates and outright purchases by some central banks engaged in quantitative easing policies. Commercial banks looking to reduce balance sheet risks have also been notable buyers. We believe that these activities will prove to be temporary, and are running a modest short duration position in portfolios based on a fundamental view that bonds are expensive.

### Equity market returns – October 2009



Source: Bloomberg. Capital returns in local currency.

### Movement in 10-year bond yields

	31-Dec-08	30-Sep-09	31-Oct-09
US	2.22%	3.31%	3.39%
UK	3.02%	3.59%	3.62%
Germany	2.95%	3.22%	3.22%
Japan	1.17%	1.30%	1.42%
Ireland	4.27%	4.67%	4.70%

Source: Bloomberg.