Bank of Ireland
Asset Management

February 2008

Month in Review

"Slowing economic growth and rising inflationary pressures — stemming from surging food, oil and metal prices — contributed to a mixed month for equity markets"

William Killeen
Head of Balanced Product, European Equities, & Energy & Materials Research

Credit market difficulties weigh on sentiment…

- The world's major stock markets failed to sustain a late-January rebound with flat-to-negative returns the order of the day. Concerns about a US recession, and further credit-related losses at financial institutions, dragged on sentiment. Against this backdrop, rising oil and commodity prices increased fears of a period of stagflation.
- Credit market woes persisted, amid reports of forced selling and ongoing worries about the viability of bond insurance firms — the so-called 'monolines'.
- On the interest rate front, the Bank of England cut 25 basis points off the base rate to 5.25%, while Ben Bernanke signalled further cuts are to come from the US Federal Reserve.

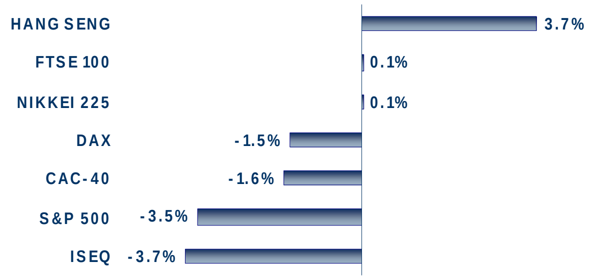
Equity markets struggle to regain momentum…

The S&P 500 Index declined for the fourth month in a row, as banks posted massive quarterly losses — UBS estimates that credit market losses could reach US$600 billion. Earnings season is nearly complete and fourth-quarter US corporate profits fell about 20% compared to a year ago, with financial sector earnings about 90% lower as a result of subprime-related losses. US telecom and utility sectors were also weak in the month.

Emerging markets generally produced good returns in February. Brazil's Bovespa Index was a notably strong performer. It rallied 6.7%, against a backdrop of historically low inflation (4.6%), record low interest rates (albeit at a rate of 11.25%), and rising retail sales. Brazil's economy is booming, aided by commodities such as oil, metals and sugar, which have recorded significant price gains. Markets in Taiwan, Hong Kong and South Korea were among other gainers. These economies enjoyed support as they are not expected to weaken notably from a US recession.

After a relatively strong start to the year, the Irish market saw a reduction in its year-to-date outperformance. Financials were weaker, amid ongoing concerns about the housing market. However, AIB reported full-year earnings growth of 15% and forecast low single-digit profit growth in 2008.

Equity market returns - February 2008

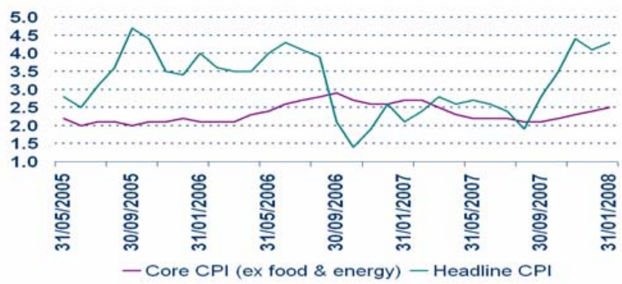


Source: Bloomberg. Capital returns in local currency.

Oil price stays above US$100 per barrel…

Source: Bloomberg.

…adding to US inflation worries.



Source: Bloomberg.

Continued overleaf

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Government bond yields grind lower…

Following the big moves on bond markets in January, amid feverish interest-rate speculation and plummeting stock markets, February was a relatively more sedate month — although still positive. An exception was at the longer end of curves where yields tended to rise modestly.

Inflation continues to be a feature, driven by rising commodity prices, but central banks in the US and UK are expected to reduce interest rates further, regardless. The European economy is performing more robustly, allowing the European Central Bank (ECB) to hold interest rates at 4%.

Credit markets remained weak, with spreads widening due to further selling pressures. This has not been confined to lower quality issues.

10-year bond yields

	31-Dec-07	31-Jan-08	29-Feb-08
US	4.03	3.60	3.51
UK	4.51	4.48	4.47
Germany	4.31	3.93	3.89
Japan	1.51	1.44	1.37

Source: Bloomberg.

Looking into the months ahead…

- The first two months of 2008 have been somewhat worrisome for equity investors, as the threat of a US recession appeared to increase and the credit crisis continued to result in mounting bank losses. The consensus view is that the US is either close to, or already in, recession. We believe this will be short-lived and followed by a gentle recovery. However, concerns remain in relation to further losses on subprime mortgages and other risk assets. Some of the more recent extreme estimates of risk asset losses could place a strain on the capital adequacy rates of US banks.

- The outlook for the broader economy becomes key in such an environment, and partly explains the heightened attention that macroeconomic data receives at present. Economic data has validated the pre-emptive response of the Federal Reserve (Fed) in cutting policy rates. We expect that the Fed will continue to cut rates aggressively, with a cut of at least 50 basis points likely in March. That could keep the US dollar under pressure, as the ECB is unlikely to be as active in lowering rates.