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Irish Life | 75 Years of Experience

Monthly Mindshare
March 2015

Seán Haverty
Irish Life Investment Managers

IRISH LIFE INVESTMENT MANAGERS

- **Only Irish winner at 2014 European Pension Awards and**
- **Only Investment Manager to win two awards**
- **Irish Pension Awards 2014 – ‘Investment Manager of the Year’ and ‘Alternatives Investment Manager of the Year’**

CONTENT

- Overview of DSC in MAPS
- Factors driving DSC
- DSC Factor update for February
- Investment Asset watch
- Market developments in February
- Market signposts
- Economic review - Ireland, Eurozone, U.S., U.K. and Asia

DYNAMIC SHARE TO CASH IN MAPS

In May 2013, Irish Life Assurance launched their Multi Asset Portfolio range (MAPS) featuring the proprietary **Dynamic Share to Cash (DSC)** process designed by Irish Life Investment Managers.

Using a blend of market signals from three broad categories, the **DSC** aims to identify changes in long term market trends and reduce equity market exposure where signs of impending stress are indicated.

The three broad categories the process tracks are:

(1) Momentum - shorter term trends
(2) Valuations - ongoing, well established and defined market measures of value
(3) Macroeconomic - a top-down global economic perspective on markets

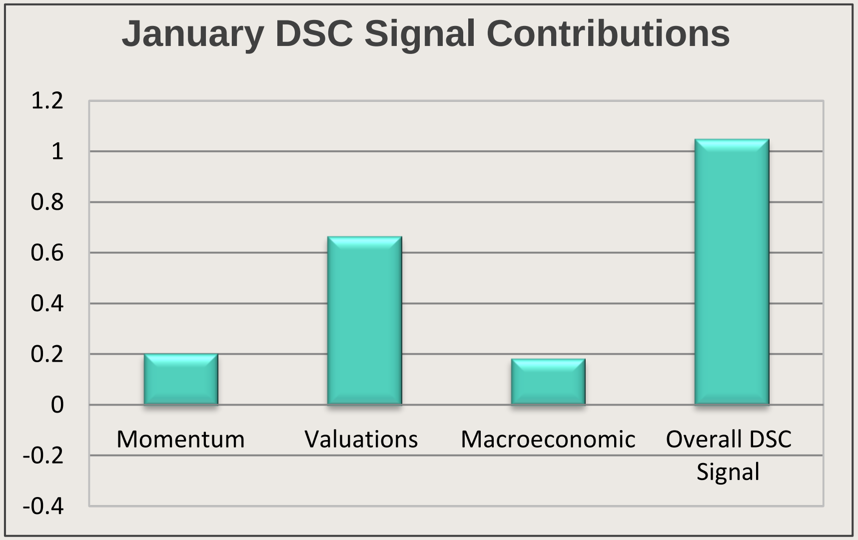
This month we examine…

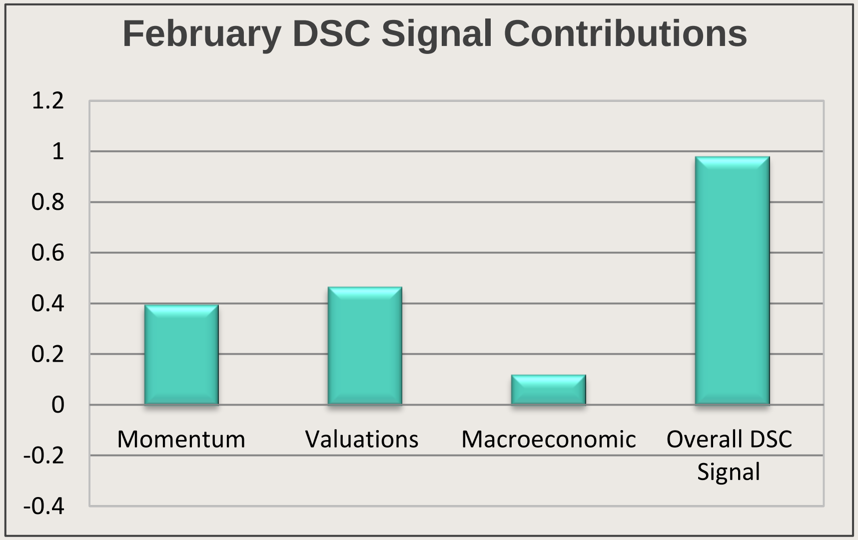
- Which factors were driving the DSC process in February and how the DSC signal was impacted as a result.
- What has been going on in the major economies around the globe through February.

DYNAMIC SHARE TO CASH - FACTORS

FACTOR CATEGORY	OBJECTIVE	INDIVIDUAL FACTOR EXAMPLES
1 MOMENTUM IN MARKETS	Take account of trends in shares	• 12 month share market momentum • 200 day moving average
2 VALUATIONS	Take account of the long-term valuation of shares	• Long-term share values • Earnings quality • Earnings yield • Earnings revisions
3 GLOBAL MACROECONOMICS	Take account of the influence of global economics on shares	• Real GDP growth rate • Bond yield curve slope • Energy price levels

DYNAMIC SHARE TO CASH – FACTOR UPDATE FOR FEBRUARY





- The ***DSC*** signal dropped slightly over February to 0.98 so remains in overall positive territory. All DSC related funds continue to be fully invested in their Developed Market Shares. The largest contribution is still being driven by the Valuations component.

- The **Momentum** category picked up over February with strong equity market returns.
- The **Valuation** category weakened because of higher valuations caused in the main by the above equity market returns.
- The **Macroeconomic** category also reduced slightly because of a modest recovery in energy prices.

ASSET WATCH

- **Equities**

  The global economic growth outlook, while modest compared to levels evident pre-crisis, is slowly improving, despite periodic concerns over potential slowdowns related to mid cycle soft patches. The improving macro backdrop is positive for the global earnings outlook. Global central banks remain supportive, committing to keep interest rates low for some time yet, facilitated by low levels of inflation. While asset purchases under QE3 in the US have ended, both the ECB and Bank of Japan have increased the level of stimulus and asset purchases they are undertaking. Flows into global equity markets have been positive over the last two years and are expected to continue. Valuations remain supportive of global equities, particularly relative to other assets, providing upside for further gains in equity markets. While mid to high single gains in equities are expected in 2015, greater volatility is likely to be evident as political events and economic and monetary developments give rise to fluctuations in markets from time to time.

- **Bonds**

  While absolute levels of yields in core Eurozone markets are low, policy initiatives from the ECB, including the recent sovereign bond purchase programme, probably cap upside in core yields and support further narrowing of peripheral spreads in the short term. Continued low levels of inflation and supportive ECB policy measures could enable the Eurozone > 5 year benchmark to generate marginal positive returns in 2015.

- **Property**

  The Irish property market has been strong with activity at record levels, which are expected to remain high given the weight of buyer interest. Yields have compressed led by offices and has been supported by the yield gap against bonds. Prime office yields are expected to begin to stabilise with further falls expected in the retail and industrial sectors. Rental growth has been strong in the office sector due to limited supply and is expected to continue while rental growth can recover in the retail and industrial sectors after recent signs of stabilisation. With an overall sector yield of 6/7%, Irish property is expected to return 8/10% pa over the next three years.

- **Cash**

  Cash returns are expected to remain low through 2015.

MARKET DEVELOPMENTS IN FEBRUARY

- Global equities rose 5.7% (6.2% in €). Eurozone >5 year bonds rose 1.1% with peripheral yields falling ahead of the implementation of the ECB's asset purchase programme in March and easing of tensions in Greece. The Euro fell marginally to 1.122 against the dollar as policy paths between the Fed and ECB diverge. Commodities rose 8.1% (8.8% in €) led by the rebound in oil prices

- The positive investment market response to accommodative central banks policies continued. A number of central banks announced further loosening of monetary policy with interest rate cuts in Australia, China and Sweden amongst others with the latter also announcing its own Quantitative Easing programme

- Commentary in the Fed minutes and in testimony by the Fed Chairperson Janet Yellen to Congress pushed expectations for the timing of the first US rate rise out to September 2015

- In contrast, expectations for the first UK rate rise were pulled in to Q1 2016 following forecasts by the Bank of England that inflation would rise to 2.1% by the end of 2017 and the estimated remaining slack of 0.5% in the economy would be eroded by the middle of 2016

- Greece applied for a four month extension of the existing bailout programme which eased fears of a Greek exit from the Euro and possible negative contagion to other peripheral markets. The extension provides more time for an ultimate compromise to be reached in relation to the Greek fiscal situation

- A new ceasefire agreement was signed in Ukraine which also helped ease uncertainties

- Earnings reporting seasons surprised positively against previously downgraded forecasts. Earnings forecasts for 2015 continued to be lowered, mainly in the energy and materials sectors

- Brent oil rebounded 18.1% as the US rig count fell almost 30%

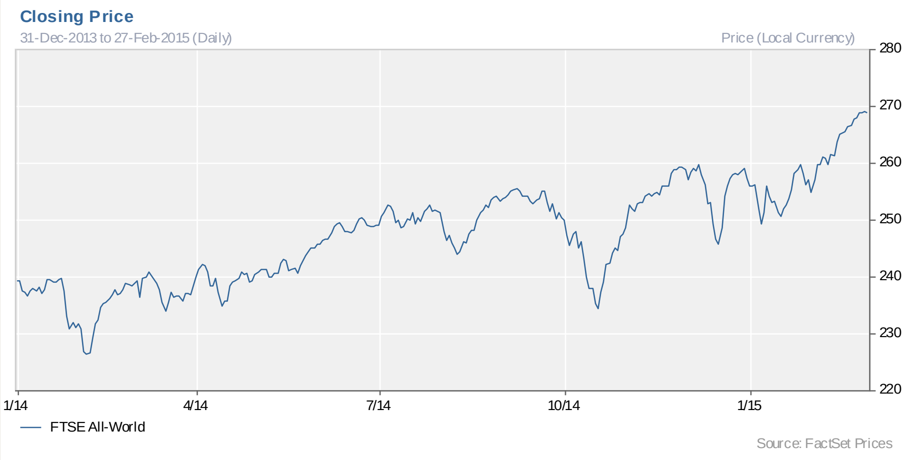
- Global economic data was mixed with softer US data partly offset by better data elsewhere, particularly in Europe

MARKET SIGNPOSTS

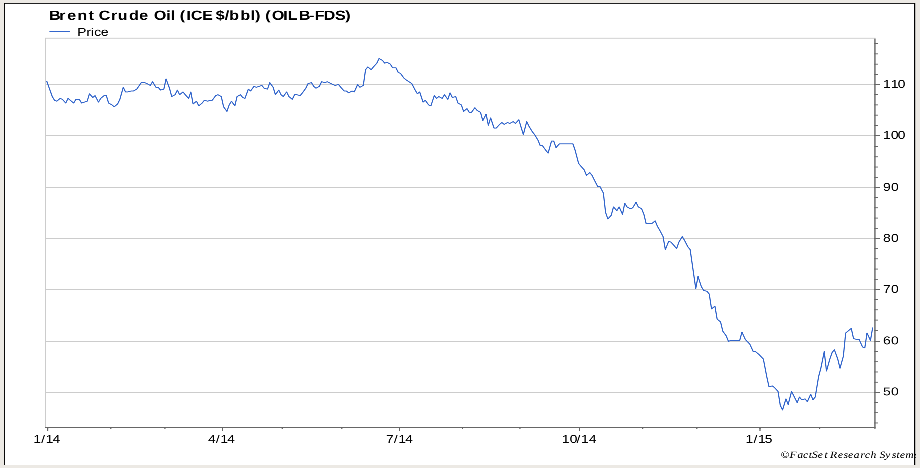
Markets In February	Local Returns	Euro Return
Ireland	9.9	9.9
UK	3.5	7.2
US	5.8	6.5
North America	5.7	6.5
Europe	7.2	6.7
Japan	8.0	6.7
Pacific	3.1	4.0
Emerging Markets	3.3	3.7
World	5.7	6.2
EMU Govt Bonds >5yr	1.1	1.1
Commodities	8.1	8.8

Markets YTD	Local Returns	Euro Return
Ireland	15.2	15.2
UK	6.5	13.8
US	2.8	10.9
North America	2.9	10.5
Europe	11.7	14.8
Japan	8.5	17.4
Pacific	5.7	12.2
Emerging Markets	4.8	11.9
World	5.3	12.2
EMU Govt Bonds >5yr	4.7	4.7
Commodities	0.7	8.7

Equity Markets Continue Higher in 2015



Brent Oil Price – Some Rebound



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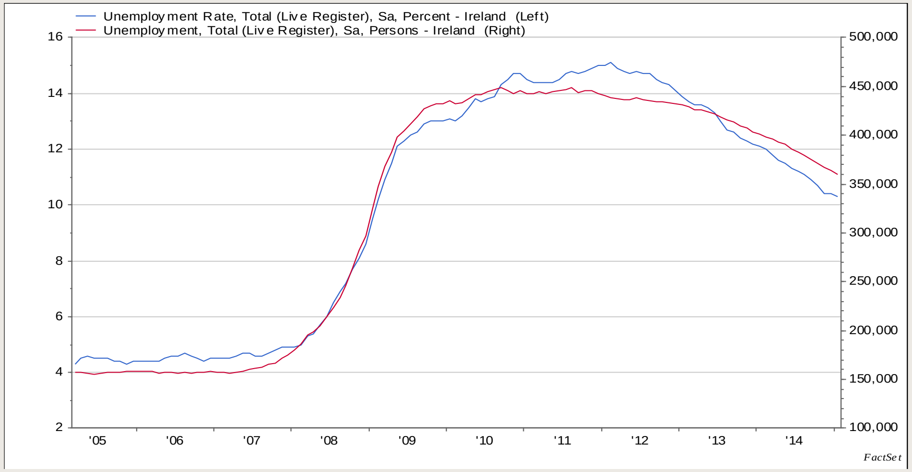
IRELAND ECONOMY REVIEW

Economy

- Economic releases generally remained positive
- Numbers employed in 2014 rose 1.5% or 29,100 to 1,938,000
- Numbers on the Live Register fell 3,700 to 360,200; unemployment fell 0.1 to 10.5%
- Retail sales rose 3.3% m/m and 8.8% y/y; core sales ex autos fell -0.1% m/m but rose 4.8% y/y
- Industrial production remained volatile, falling -12.4% m/m but rose 15.0% y/y
- National residential property prices fell -1.4% m/m but were up 21.7% y/y. Prices in Dublin fell -0.9% m/m but rose 21.7% y/y. Prices outside Dublin fell -0.9% m/m but were up 9.3% y/y
- CPI (Inflation) fell -0.8% m/m and -0.6% y/y
- January Exchequer returns were strong with a budget surplus of €781m v's a deficit of €1,142m in January 2014. The improvement excluding the impact of the introduction of the Single European Payments System (SEPA) in 2014 is estimated at around €680m. Tax revenues ex the SEPA impact were up 12.3% y/y while net voted current expenditure was down 6.3% with debt servicing costs down 22.4%

Irish Labour Market Remains Strong



Irish Retail Sales Continue to Rebound

EUROZONE ECONOMY REVIEW

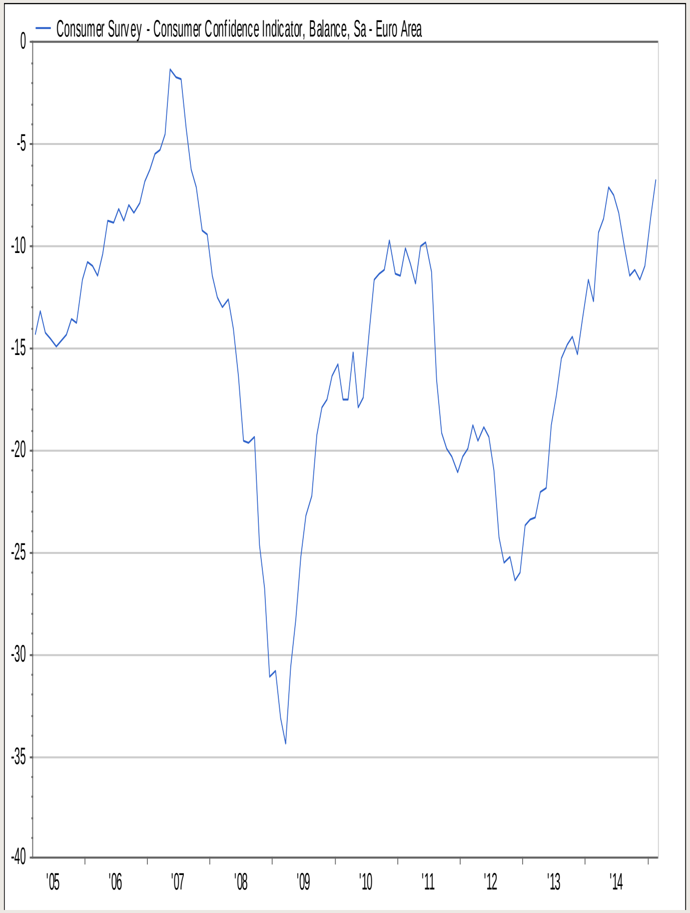
Economy

- Data continued to improve. Eurozone Q4 GDP surprised positively, rising 0.3% q/q. Industrial production was flat m/m; retail sales rose 0.3% m/m and 2.8% y/y; consumer confidence rose 1.8 to -6.7, a seven year high
- CPI (Inflation) fell -1.1% m/m and -0.6% y/y
- German data was better. Q4 GDP rose 0.7% q/q; industrial production rose 0.1% m/m; factory orders rose 4.2% m/m; retail sales rose 0.2% m/m; consumer confidence rose 0.4 to 9.7
- French Q4 GDP rose 0.1% q/q; consumer spending rose 0.6% m/m; industrial production rose 1.5% m/m
- Spanish industrial production slipped to -0.9% y/y; Italian Q4 GDP was flat, industrial production rose 0.4% m/m; retail sales fell -0.2% m/m; consumer confidence rose 6.9 to 110.9

Interest Rates

- The ECB surpassed expectations with a €60bn per month asset purchase programme - it will mainly consist of sovereign bonds but also includes existing ABS and covered bond purchases, inflation linked bonds and supra national issues and will be operational from March 2015 to September 2016
- In effect it is open ended as the ECB indicated it will continue until inflation moves sustainably back towards its 2% target
- Purchases will be undertaken by individual national central banks

Eurozone Consumer Confidence Recovers



US ECONOMY REVIEW

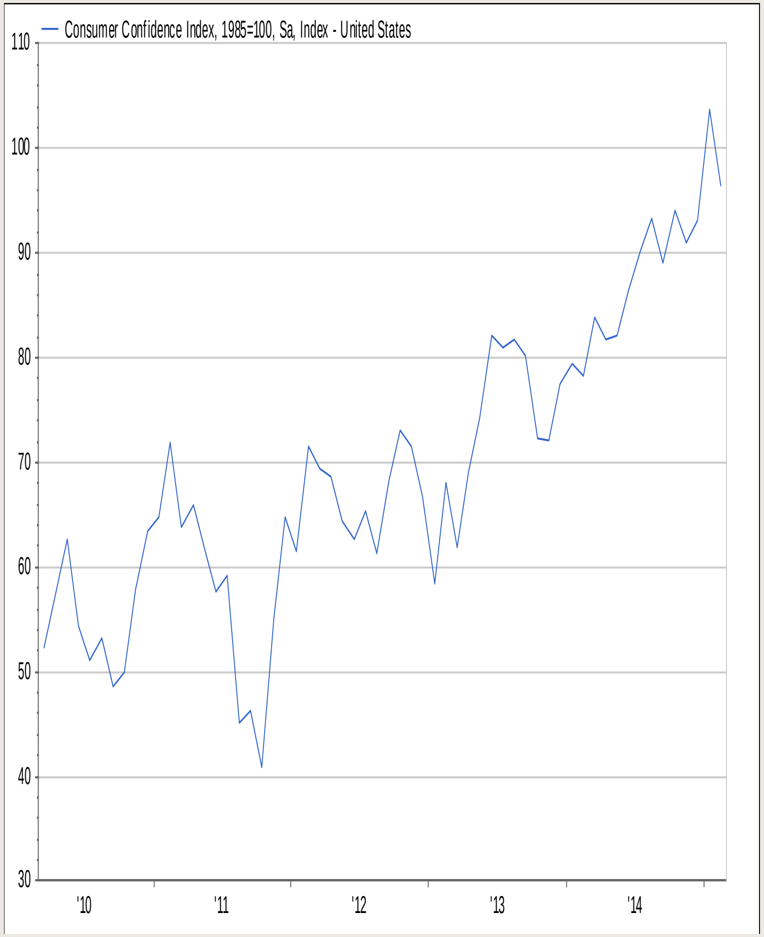
Economy

- Data was generally softer. Q4 GDP was revised down to 2.2% annualised from 2.6% mainly due to lower inventory build which reduced the GDP estimate by -0.7%
- Non farm payrolls rose 257k with upward revisions to previous figures; unemployment rose 0.1% to 5.7% due to a higher labour participation rate
- Industrial production rose 0.2% m/m; factory orders fell -3.4% m/m; retail sales fell -0.8% m/m; consumer confidence fell -6.5 to 96.4; headline durable goods orders rose 2.8% m/m; capital goods shipments fell -0.3% m/m
- House prices in the top 20 cities rose 0.9% m/m and 4.5% y/y from 4.3% previously; new and existing home sales fell -0.2% m/m and -4.9% m/m respectively
- CPI (Inflation) fell -0.7% m/m and -0.1% y/y

Interest Rates

- There was no Fed meeting during the month
- The January minutes showed many participants inclined to maintain current rates for a longer time.
- In testimony to Congress, the Chair of the Federal Reserve, Janet Yellen indicated that while significant progress had been made in the labour market, room remained for further improvement and the jobs market and inflation outlook still warranted a high degree of policy accommodation

US Consumer Confidence Falls



UK ECONOMY REVIEW

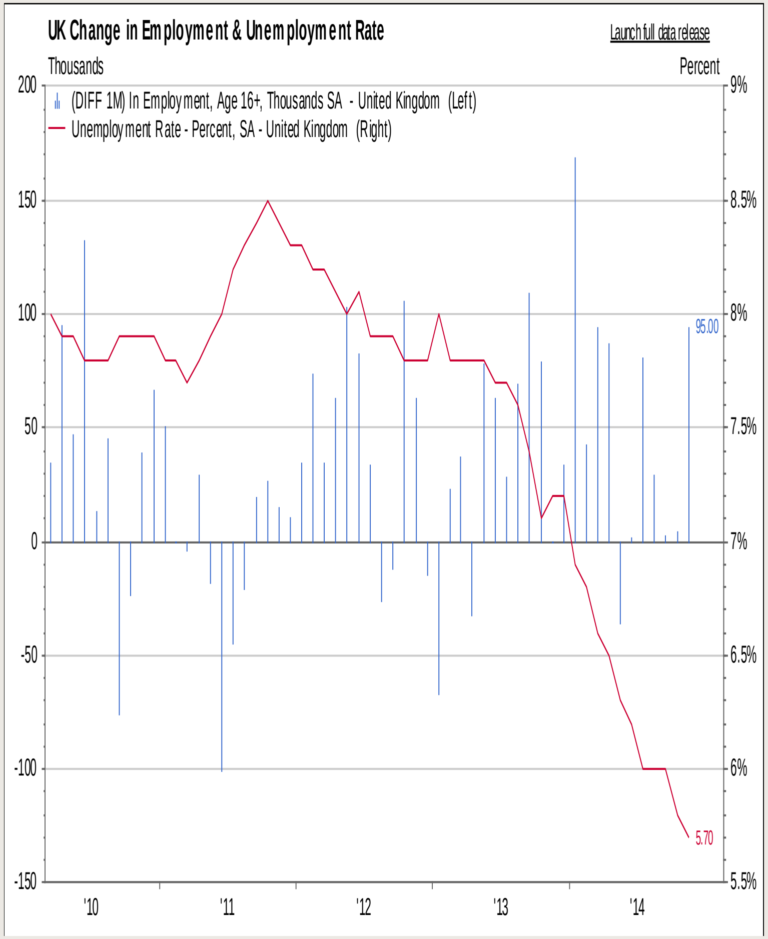
Economy

- UK data was mixed but modestly better, mainly relating to sentiment surveys
- The mix of Q4 GDP was disappointing. Net trade contributed 0.6% to growth, household consumption contributed 0.3% while gross capital formation took -0.2% off growth
- Retail sales fell -0.3%m/m but rose 5.4% y/y; consumer confidence was unchanged at 1
- Unemployment fell 0.1 to 5.7%; average earnings ex bonuses rose 1.7% annualised
- Industrial production fell -0.2% m/m; construction output rose 0.4% m/m
- The Halifax house price index rose 2.0% m/m and 8.5% annualised over 3 months from 7.8% previously
- CPI (Inflation) fell -0.9% m/m and rose 0.3% y/y

Interest Rates

- The BoE unanimously agreed to leave policy unchanged
- The prospects of both higher inflation and the persistence of low inflation expectations were discussed. Overall however it was judged that current inflation expectations were consistent with the 2% inflation target
- The Inflation Report indicated the Bank of England expects inflation to be 2.1% by the end of 2017, slightly above the 2% target. The more aggressive tone in the Inflation Report pulled forward expectations for the first UK interest rate rise to Q1 2016
- The estimated remaining slack in the economy of 0.5% was forecast to have been eroded by the middle of 2016

UK Labour Market Remains Strong



ASIAN ECONOMY REVIEW

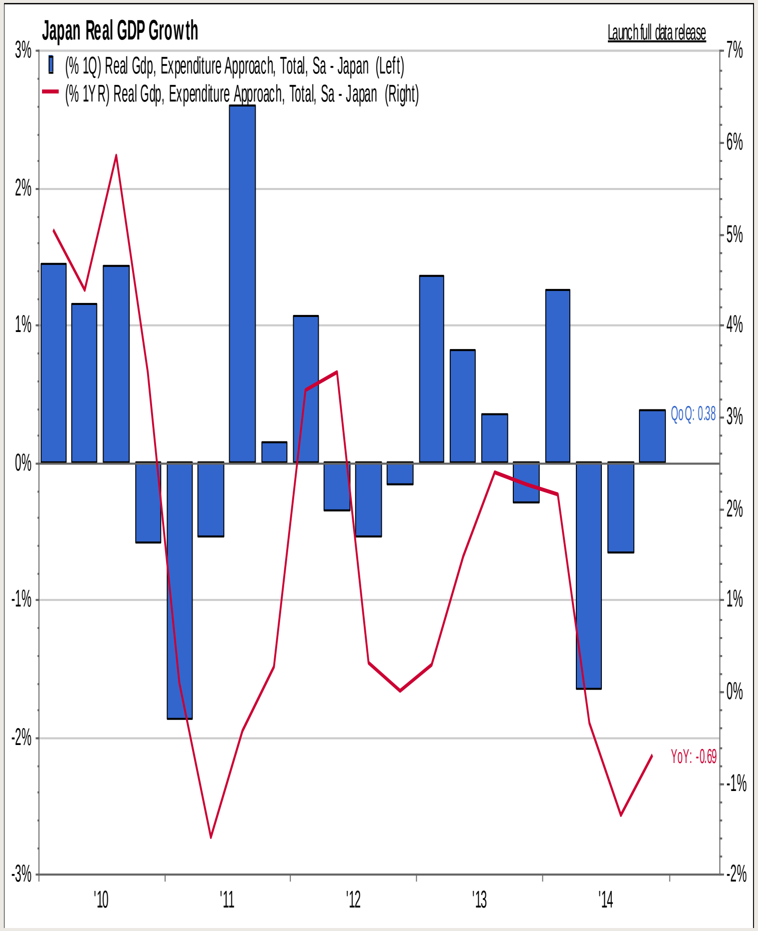
Japanese Economy

- Releases were mixed but overall were slightly better
- Q4 GDP was positive at 2.2% annualised after two quarters of contraction but was below expectations. Industrial production rose 4.0% m/m; machine orders rose 8.3% m/m; retail sales fell -0.3% m/m; consumer confidence rose 0.3 to 39.1; exports rose 17.0% y/y while imports fell -9.0% y/y; core CPI (Inflation) slipped to 2.2% y/y and excluding the April sales tax rise, fell to 0.2% y/y; bank lending slipped to 2.6% y/y from 2.7% previously
- The Bank of Japan (BoJ) left policy unchanged. The economic assessment was unchanged with the recovery described as moderate. It was admitted the rate of increase in inflation could slow in the short term although it is believed inflation expectations will rise in the long term. It was emphasised that the BoJ would not hesitate to adjust policy if necessary to achieve the 2% inflation target

Chinese Economy

- Chinese data was mixed but distorted by the timing of Chinese New Year
- Exports fell -3.3% y/y from +9.9% previously; imports fell -19.7% y/y from -2.3% previously
- The Peoples Bank of China reduced interest rates for the second time in three months by 25bps

Japanese Q4 GDP Rebounds After Two Negative Quarters



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Irish Life Investment Managers
Beresford Court
Beresford Place
Dublin 1

Tel (01) 704 1200
Fax (01) 704 1918
Web: www.ilim.com