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Irish Life Investment Managers

Monthly Mindshare
October 2014

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Dynamic Share to Cash

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

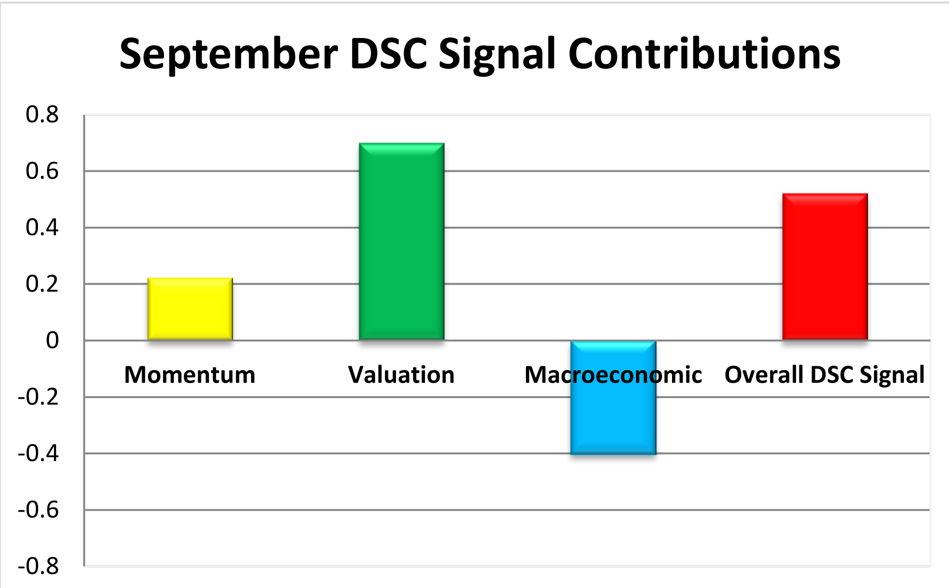
This month we examine…

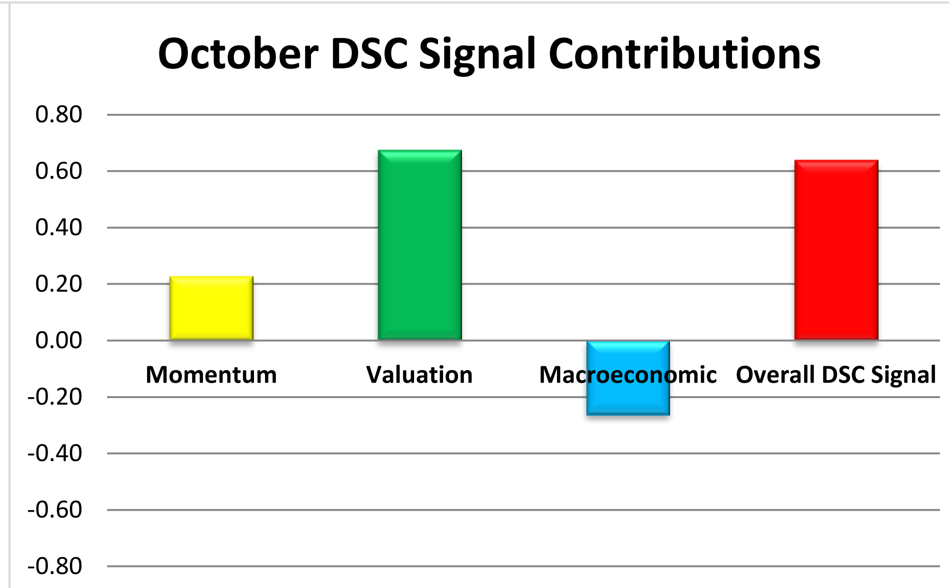
- Which factors were driving the DSC process in October and how the DSC signal was impacted as a result
- What has been going on in the major economies around the globe through October

Dynamic Share to Cash

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





Source: ILIM Nov 2014

- The ***DSC*** signal remains in overall positive territory at the end of October having fallen intra month in response to the weak markets experienced during that time. It finished the month at +0.62, up from +0.58 at the end of Sep. All MAPS funds continue to be fully invested in Global shares. The largest contribution is still being driven by the Valuations component.
- The **Momentum** category in particular has recovered and is slightly higher month on month.
- The **Valuation** category weakened slightly on rising prices.
- The **Macroeconomic** category saw the biggest change as low energy prices look supportive and long bond yields have tightened.

Asset Watch

- **Equities**
  - The global economic growth outlook, while modest compared to levels evident pre-crisis, is slowly improving, despite some recent concerns over a potential slowdown which seem to relate to a mid cycle soft patch in Q3 2014 as opposed to anything more severe. 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. While asset purchases under QE3 in the US have ended, both the ECB and Bank of Japan have recently increased the level of stimulus and asset purchases they are undertaking. Market risks have reduced in recent years post policy initiatives although geo-political issues remain a potential overhang. Flows into global equity markets have been positive over the last two years and are expected to continue. Valuations remain supportive for global equities, particularly relative to other assets, providing upside for further gains in equity markets.

- **Bonds**
  - While absolute levels of yields in core Eurozone markets are low, the recent policy initiatives from the ECB probably cap upside in core yields and support further narrowing of peripheral spreads. As a result, Eurozone > 5 year bonds are expected to be about flat for the remainder of the year.

- **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 2014 and 2015.

Market Developments in October

- Markets were extremely volatile with equity losses in the first half of October being recovered by month end while sharp falls in global bond yields were also partially reversed into month end
- Global growth concerns became evident post continued deterioration in European sentiment surveys, a very weak industrial production figure of -4.0% m/m in Germany, softer US housing and consumer confidence readings in late September and weaker US retail sales
- Markets began to stabilise as central banks remained supportive and dovish comments pushed out expectations on the liming of the first rate rises in the US and UK to Q4 2015 and mid 2015 respectively
- Strong US labour market, consumer confidence and GDP data, a modest improvement in Eurozone PMI readings and stronger economic releases in China also eased earlier fears of a global slowdown during the second half of the month
- In Europe, the ECB bank stress tests were relatively well received and added to the recovery in markets. While 25 banks failed and were required to raise €25bn of capital based on end 2013 data, 12 have already addressed their capital shortfalls and the remainder currently need to raise only an additional €6/7bn which should be easily achievable for most of the banks in question
- A surprise increase in Bank of Japan asset purchases from Y60/70trn pa to Y80trn pa in an effort to dampen risks of a deflationary mindset developing also supported markets as did the announcement by the Japanese Government Pension Investment Fund, the worlds largest pension fund, that it was planning to double its domestic and international equity holdings to 25% in each
- Global equities rose 1.1% (1.5% in €). Eurozone >5 year bonds rose 0.6% with German 10 year yields falling to 0.82% after earlier reaching an all time low of 0.71% on the back of falling inflation expectations and the concerns over growth. The Euro fell to 1.253 against the US$ as further monetary stimulus is expected from the ECB in coming months while the Fed was slightly more hawkish than expected at its end October meeting. Commodities fell -6.0% on weaker oil prices as OPEC members initiated a price war in an effort to protect market share and OPEC production levels rose to their highest level since November 2012

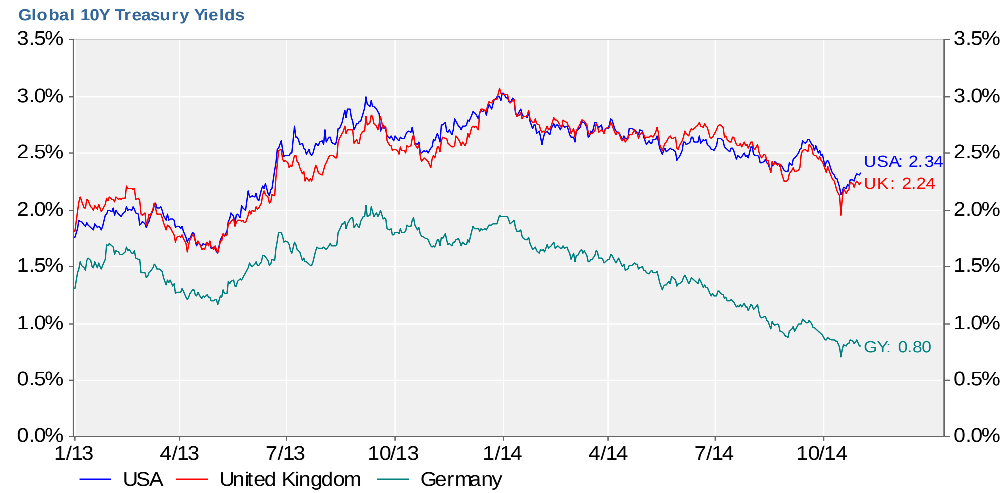
Market Signposts

Markets In October	Local Returns	Euro Return
Ireland	-2.2	-2.2
UK	-0.9	-1.4
US	2.4	3.2
North America	2.1	2.9
Europe	-1.7	-1.8
Japan	0.8	-0.6
Pacific	2.3	3.0
Emerging Markets	1.4	2.0
World	1.1	1.5
EMU Govt Bonds >5yr	0.6	0.6
Commodities	-6.0	-5.3

Markets YTD	Local Returns	Euro Return
Ireland	6.5	6.5
UK	-0.2	6.1
US	10.7	21.8
North America	10.7	21.3
Europe	5.5	5.5
Japan	4.1	7.4
Pacific	5.5	14.6
Emerging Markets	7.0	14.3
World	7.9	15.3
EMU Govt Bonds >5yr	16.0	16.0
Commodities	-14.7	-6.1

Equity Markets End a Volatile Month Higher

Global Bond Yields Fall on Growth Concerns Though off Lows



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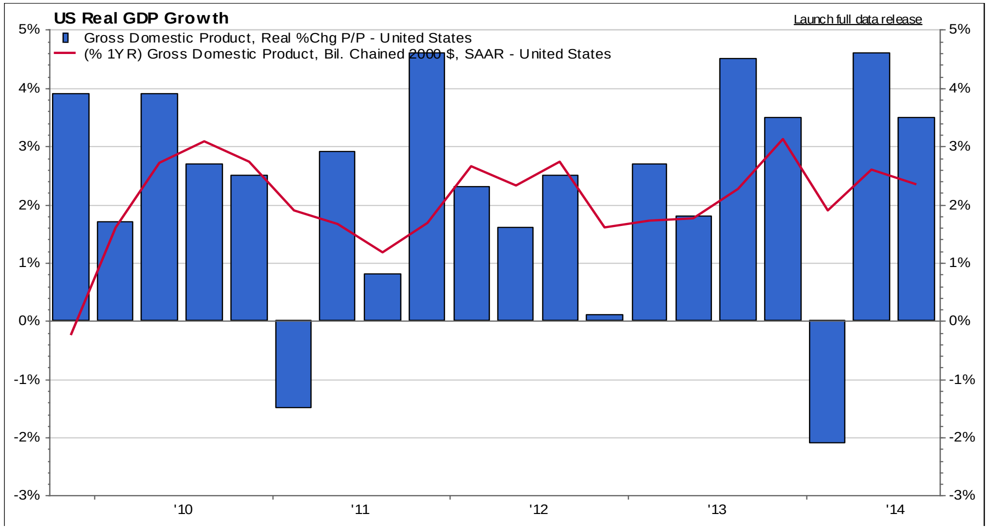
US Economy Review

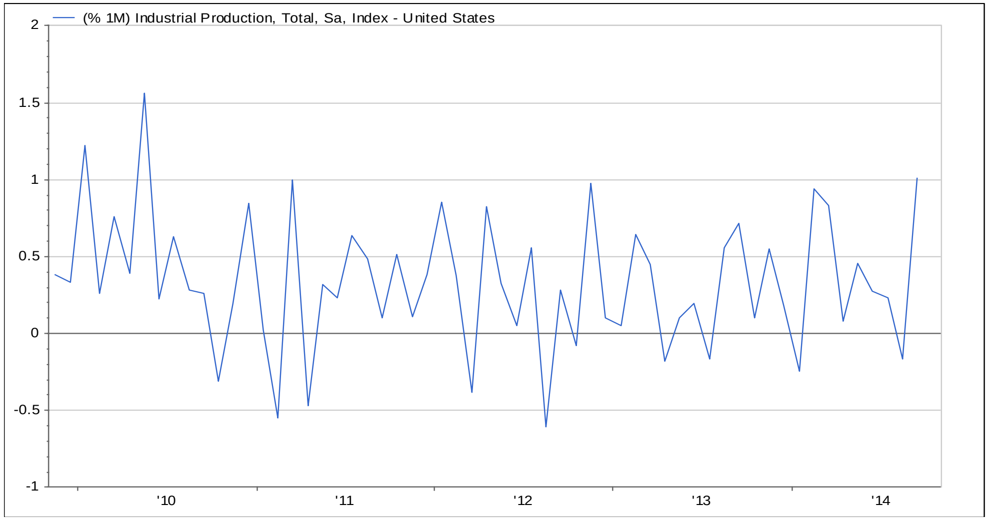
- **Economy**
  - Data was mixed but generally positive.
  - Non farm payrolls rose 248,000; unemployment fell to 5.9%; initial unemployment claims fell to a 14 year low
  - ISM manufacturing fell -2.4 to 56.6; services fell -1.0 to 58.6; the composite PMI fell -0.7 to 59.0; industrial production rose 1.0% m/m; capacity utilisation rose 0.5% to 79.3%
  - Retail sales fell -0.3% m/m; consumer confidence rose 5.5 to 94.5, a seven year high; CPI was remained at 1.7% y/y
  - Housing data remained mixed as house prices in the top 20 cities fell -0.2% m/m

- **Interest Rates**
  - Fed commentary was mixed. Minutes for the September Fed meeting indicated a willingness to be patient regarding rate rises and highlighted risks to the economy from a higher US$ and weaker overseas economies, pushing expectations for the first rate rise out to Q4 2015
  - At the late October meeting, asset purchases under QE3 were finally ended. The statement however was more hawkish as the underutilisation of labour resources was said to be diminishing and there was less concern over the recent fall in market inflation. This pulled expectations for the 1st rate rise back into Q3 2015

Stronger Than Expected Q3 US GDP



Strong Rebound in US Industrial Production



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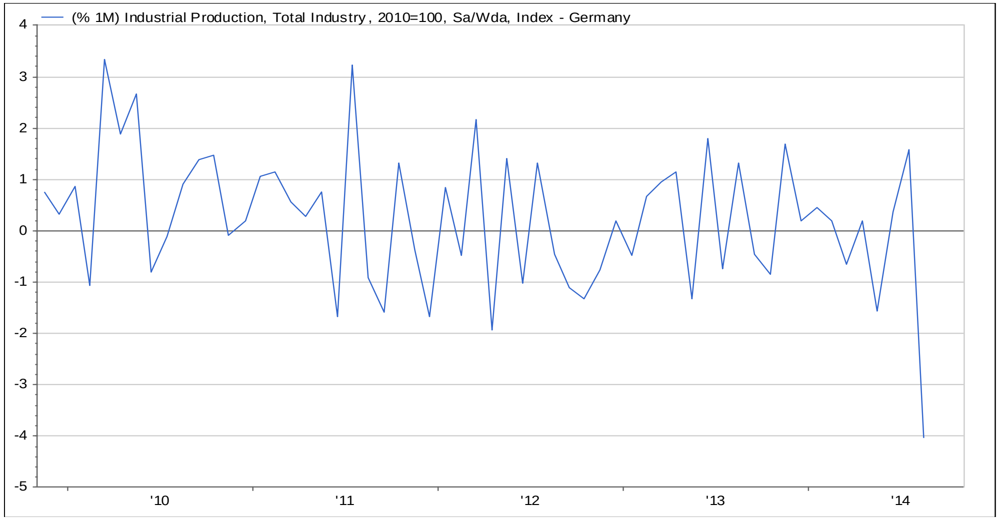
Eurozone Economy Review

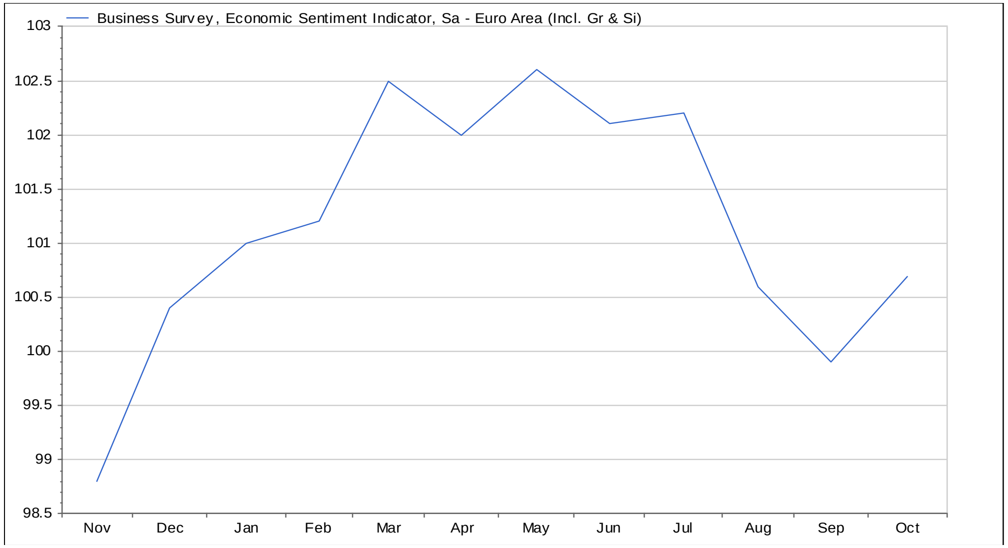
- **Economy**
  - Data generally disappointed although improved towards month end.
  - German data was weak as August industrial production fell
  - French data was also weak as consumption fell -0.8% m/m; consumer confidence fell 1 to 85; composite
  - Spanish data was better as Q3 GDP rose 0.5% q/q and 1.6% y/y; retail sales rose 1.1% y/y; unemployment fell -0.8% to 23.7%; composite PMI fell -1.6 to 55.3

- **Interest Rates**
  - There were no new policy announcements by the ECB
  - There was disappointment at the lack of detail on the asset purchase programme with no clear indication as to its potential size. There was an emphasis that the gauge of success of policies would be on whether inflation gets back to 2% rather than focusing on a target level of asset purchases
  - It was reiterated that if existing policies fail to raise inflation expectations, there is unanimous commitment to use other unconventional measures beyond what has already been agreed to help achieve the ECB's objectives
  - Covered bond purchases under the asset purchase programme began and amounted to €1.7bn in the first week. Asset Backed Security purchases are scheduled to begin in November

Sharp Fall in German Industrial Production due To Auto Sector



Eurozone Economic Confidence Rebounds



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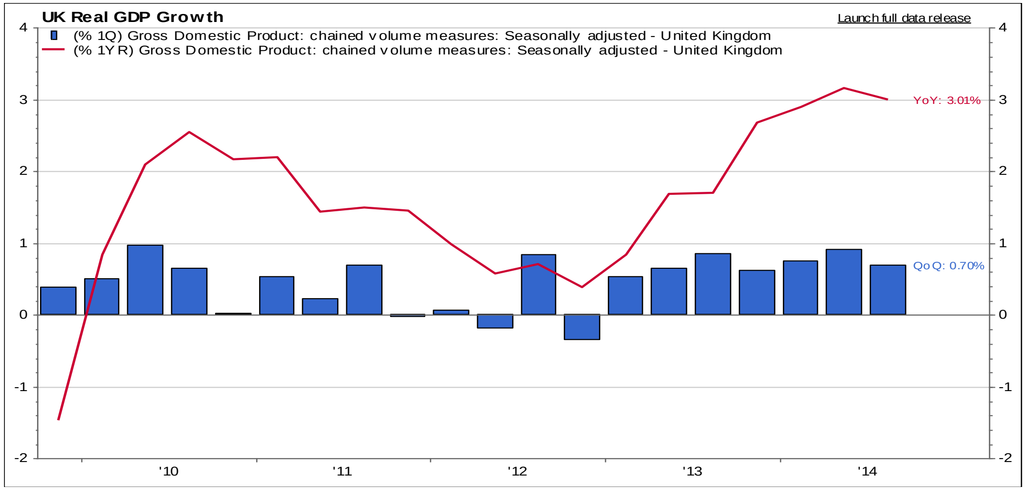
UK Economy Review

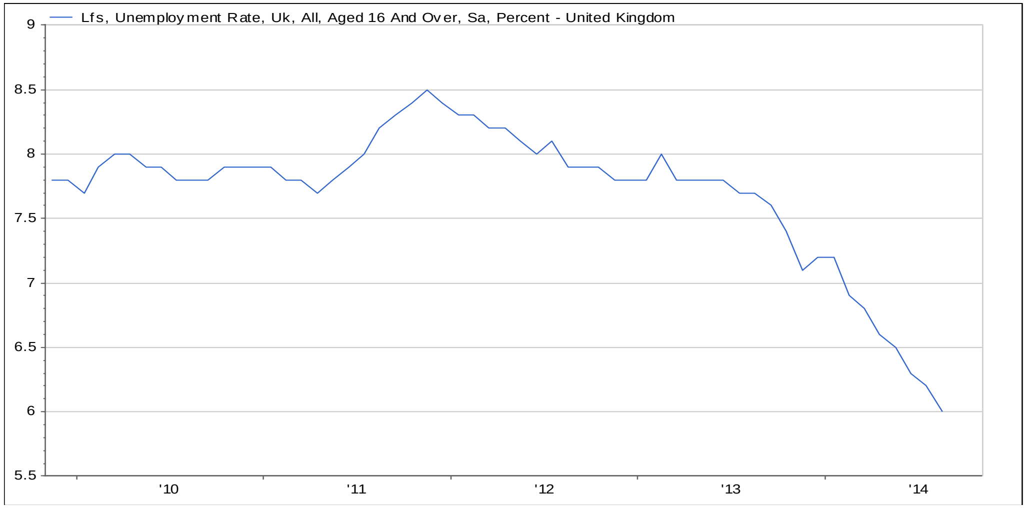
- **Economy**
  - Economic data was somewhat softer but still consistent with strong growth
  - Q3 GDP rose 0.7% q/q and 3.0% y/y compared to 0.9% q/q and 3.2% y/y in Q2
  - Unemployment fell 0.2% to 6.0%;
  - Retail sales fell -0.3% m/m but rose 2.7% y/y; consumer confidence slipped 1 to -2
  - CPI fell to 1.2% y/y from 1.5%
  - The Halifax house price index rose 0.6% m/m and 9.6% annualised

- **Interest Rates**
  - BoE left policy unchanged, again in a split vote of 7:2
  - The tone of the minutes was more dovish with concerns expressed over the global economy and an easing in domestic growth
  - Uncertainty remains over the amount of slack in the economy
  - The two members voting for a rate rise were concerned that falling unemployment could lead to a sharp pick up in wage growth and that recent low inflation was due to a higher exchange rate and lower fuel prices which should be looked through and discounted

UK Q3 GDP in Line With Forecasts but Below Q2



UK Unemployment Rate Continues to Fall



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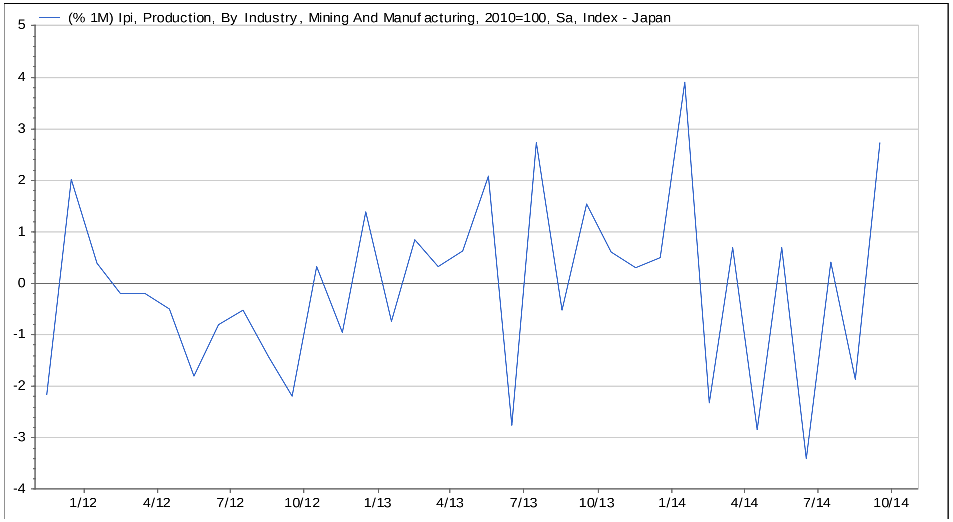
Asian Economy Review

- **Japanese Economy**
  - Releases were generally better although CPI continued to slip
  - Industrial production rose 2.7% m/m and 0.6% y/y; the composite PMI rose 2.0 to 52.8 with manufacturing up 1.1 to 52.8 and services up 2.6 to 52.5; retail sales rose 2.7% m/m and 2.2% y/y; consumer confidence fell 1.3 to 39.9;
  - The Bank of Japan (BoJ) surprised markets announcing an expansion of its asset purchase programme to Y80trn pa from Y60/70trn pa in an effort to ensure its 2% inflation target is met and to dampen the risks surrounding a return to a deflationary mindset. The BoJ expects the economy to continue to grow at a rate above its potential trend over the next two years with consumption improving gradually as wages steadily rise

- **Chinese Economy**
  - Chinese data was mixed but generally improved
  - Q3 GDP was 0.1% better than expected at 7.3% y/y although down from 7.5% in Q2
  - The HSBC manufacturing index rose 0.2 to 50.4 although services fell 0.6 to 53.5.
  - Industrial production rose 8.0% y/y from 6.9% previously. Export growth rose to 15.3% y/y from 9.4% while imports, a leading indicator of domestic demand and production, rose 7.0% y/y from -2.4% previously

Japanese Industrial Production Rebounds

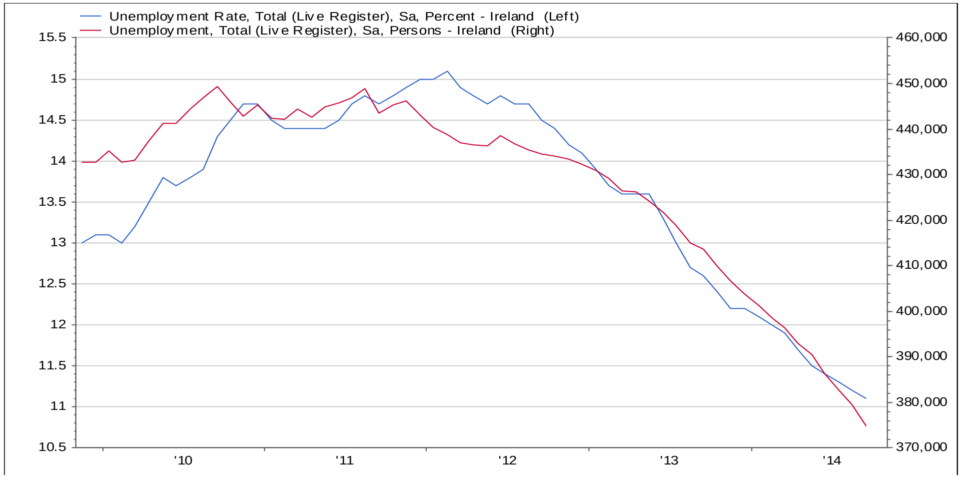


Chinese Industrial Production Growth Rebounds

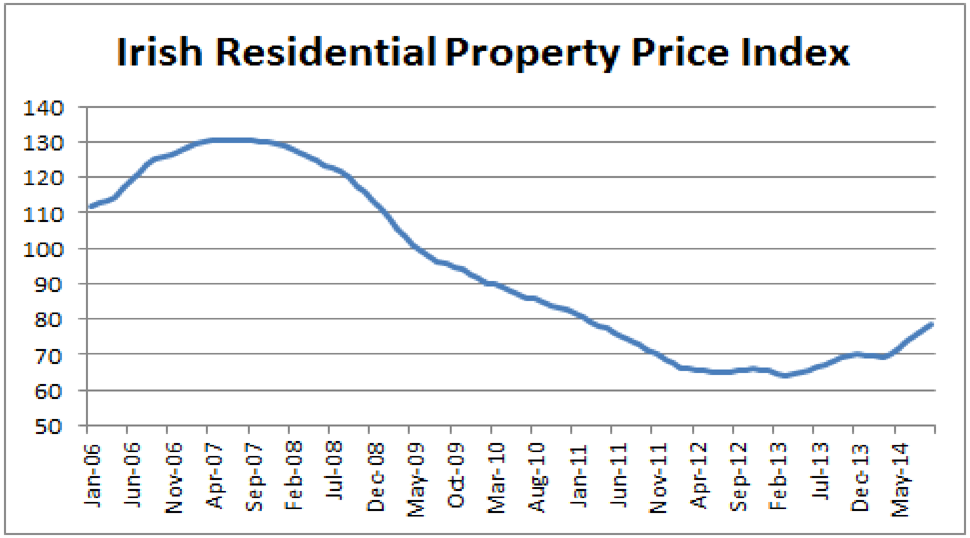
Ireland Economy Review

- **Economy**
  - Economic releases generally remained positive
  - Retail sales rose 0.1% m/m and 5.9% y/y;; consumer confidence rose 5.7 to 92.8, an eight year high
  - Industrial production remained volatile, falling -1.6% m/m but up 19.7% y/y. Numbers on the Live Register fell 4,700 to 374,800, the lowest since March 2009 with unemployment down 0.1% to 11.1%
  - National residential property prices rose 1.8% m/m and 15.0% y/y. Dublin prices rose 2.5% m/m and 23.4% y/y. Prices outside Dublin rose 1.1% m/m and 7.0% y/y
  - CPI fell -0.2% m/m and was up 0.3% y/y from 0.4% previously
  - The composite PMI fell 1.8 to 60.0 with manufacturing down 1.6 to 55.7 and services up 0.1 to 62.5
  - Following the better than expected exchequer returns year to date, the government announced an expansionary budget instead of the €2bn adjustment which had been planned at the beginning of the year. The various measures announced were forecast to boost GDP growth by 0.3% in 2015 to 3.9% while the fiscal deficit was forecast to be 2.7% of GDP in 2015, below the 2.9% target

Irish Labour Market Continues to Improve



Irish Residential Property Prices Continue to Recover



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