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RETAIL INVESTMENT OUTLOOK 2015

Irish Life Investment Managers are part of the Great-West Lifeco group of companies, global leaders in financial services, and have over €40 billion* in assets under management on behalf of our Irish and International clients. We strive to combine our expertise and experience with diligence and dedication, to continually meet your evolving needs.

*Source: ILIM, correct as at 21/1/2015.

European Pensions AWARDS 2014
WINNER
Equities Manager of the Year

European Pensions AWARDS 2014
WINNER
Passive Manager of the Year

Irish Pensions AWARDS 2013
WINNER
Innovation Award

Irish Pensions AWARDS 2013
WINNER
Investment Manager of the Year

Irish Pensions AWARDS 2013
WINNER
Communication Award

With another positive year for investment markets behind us, we look back on the year that was and how it looks for markets in the year that will be. Following another successful year for the flagship Irish Life MAPS (multi asset portfolio's), where performance was strong and assets under management increased more than fivefold, we share some valuable insights from our investment team on how the property, bond, alternative and equity markets contributed to performance and examine where the opportunities and speed bumps may lie for investors on the journey into 2015 and beyond.

CONTENTS

SECTION 1

INTRODUCTION

In the last edition of the Retail Outlook, I suggested that it would be unreasonable to expect global stock markets to perform in 2014 the same way they did in 2013. It turns out that was unreasonable and they didn't. However, the performance across most asset classes in 2014 proved once again to be very resilient with equity markets up mid to high single digits, sovereign bond market yields across the globe falling and property (in the case of Ireland) going from strength to strength. Indeed, the only major asset class to produce lower returns than the previous year was cash – a trend that is unlikely to reverse in 2015. However, it was also more apparent last year over previous years, how the gains are not being spread equally by geography reflecting the rate at which different economies are emerging from the impact of the financial crisis. Although nearly seven years on from its peak, the results of measures taken, or not taken, are very clearly starting to manifest themselves in 'multi-speed' economies. The US is leading the charge and is poised for interest rates increases in mid-2015 while other economies are still dependent on central bank policies maintaining low rates for some time to come. It makes for an interesting, and challenging environment for all investors.

One could debate the merits of how investors could or should capitalise on opportunities in current markets but commentators who suggest that cash is the place to be are thin on the ground at this stage. Certainly on this side of the Atlantic, net cash returns to investors are set to remain at or close to zero and in some cases even negative. While the global economy is not out of the woods yet, and with several tests ahead in 2015, it is still hard to see the merit in staying in cash over the medium to long term. Election years always have the capacity to unsettle markets and the UK, Greece and Spain all go to the polls over the coming 12 months. There is chatter amongst the investment community about short term oil shocks and the threat of deflation. There are even those talking up the fear of wars, between countries or even currencies, but nobody appears to be predicting another global crisis. As such, the relatively benign backdrop has increased investor confidence at a time when capital guaranteed products have all but disappeared, deposit rates continue to fall, bond prices are rising and stock market returns have been positive.

Hence, the number of investors abandoning cash as an investment strategy in the search for better returns continues to rise. In 2014, global retail equity mutual funds saw inflows of over $115bn worldwide. The world's largest pension fund, the Government Pension Investment Fund in Japan, announced it was moving the equity holdings in its €1.3trn fund from 25% to 50% weighting. Indeed, the Irish Life multi-asset funds, MAPS, saw funds under management rise more than five-fold in 2014 alone. Investors are on the move.

Despite the strong performance of global equities in recent years, valuations are still within fair value range and as such, are capable of delivering reasonable mid to high single digit returns again in 2015. Bonds continue to perform, reflecting their perceived safe haven status in relatively stable but still recovering global markets. In Europe, the German 10yr bond yield continues to set new all-time lows but the potential for further gains, in the event of a European Central Bank led quantitative easing programme or further interest rate cuts for example, still exists. In the US, Treasury yields are higher in the expectation of rising interest rates in mid-2015. On a local basis, commercial property continues to see sustained buyer interest from a wide range of domestic and international buyers while high quality supply remains constrained in the short term. On a global basis, falling oil prices are impacting on global inflation, lowering it by 0.3% in 2014 but boosting global GDP by approximately 0.4%. There is a lot going on...and that is before attempting to ascertain the impact of any elections or indeed the potential for unforeseen events like wars. So all in all, we think 2015 is likely to be another positive year for investors but given the nature, size and uncertainty of the macro events to unfold, it could be a ride bumpier than more recent years.

Change brings opportunity and 2015 should present plenty of both. ILIM are committed to providing investors with innovative and relevant investment solutions based on our award winning investment capabilities. Our focus is to help investors make informed and beneficial investment decisions.

Wishing you a successful 2015,

David Haslam
Head of Retail, ILIM

IRISH COMMERCIAL PROPERTY

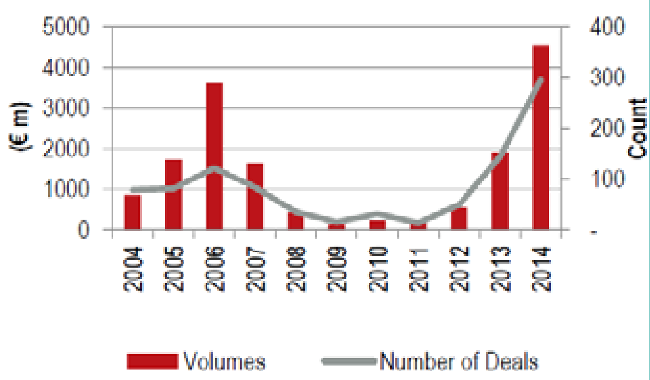
SECTION 2

IRISH COMMERCIAL PROPERTY

A RECORD YEAR FOR IRISH COMMERCIAL PROPERTY IN 2014

2014 was a record year for liquidity in the Irish property investment market with transaction volume of direct property investments of €4.5bn, ahead of the record set at the peak of the last cycle in 2007. Additional loan sale activity exceeded €20bn. 2014 also proved to be one of the highest levels of annual capital growth on record, with market value change set to exceed 30% for the year. The strength and speed of the recovery has surprised on the up side. This has been driven by a combination of falling yields, rental growth and value-add at property level. The total return for the market is expected to come in at approx. 37% with the income return component at approx. 7%.

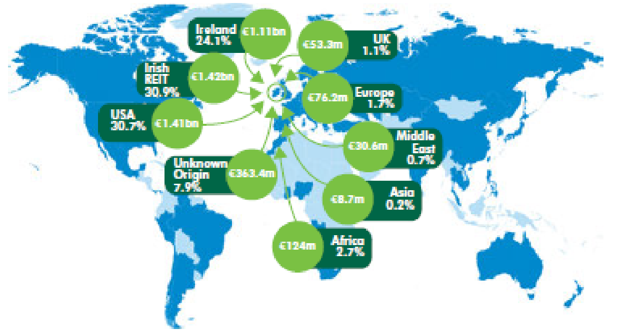
INVESTMENT VOLUMES AND NO OF DEALS



Source: ILIM, November 2014

The significant variation in sector returns continued the trend of recent years with offices again leading the way with capital growth of approx. 37%. Dublin city centre locations were particularly strong again with suburban and provincial centres seeing more constrained growth. Retail saw significant improvement in value growth at approx. 25%, mainly through the second half of the year, while the industrial sector continues to lag at approx. 5% for the year, with industrial value improvement limited to properties with long term secure income in good locations.

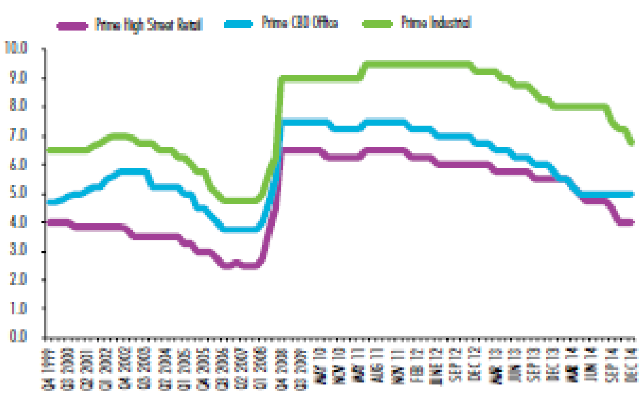
IRISH INVESTMENT SPEND 2014



Source:CBRE Research

The strong weight of both overseas and domestic capital has generated further significant reductions in yields, underpinned by low bond yields and in anticipation of further capital and rental value recovery and growth. Offices continued the yield trend of the preceding 18 months with the prime office yield reducing by c.0.75% over the year to sub 5%. Prime retail experienced the strongest yield change following a significant pickup in the volume of retail stock brought to the market and aggressively bid during the second half of the year. The prime high street yield now sits at 4%, with prime shopping centres at sub 7%. Industrials have also seen yield improvement from 8% to sub 7% despite a relatively low level of transactions.

IRISH INVESTMENT SPEND 2014



Source:CBRE Research

An exceptional level of rental growth from Dublin city centre offices has distinguished it from other sectors and locations during 2014. The combination of a supply shortage of quality stock and strong occupier demand has seen office rents increase from €30 per sq. ft. to €45 per sq. ft. over the last 12 months. Quarter 4 2014 has been the strongest quarter ever recorded, with take-up reaching 1 million sq. ft. The dramatic increase in take up resulted in overall take up for the year of 2.3 million, an increase of 20% from 2013. As a result, the vacancy rate also saw a change with a further reduction to an overall vacancy rate of c.12% with even tighter supply levels in specific locations including Dublin 2 where the vacancy rate is now at 7% and prime grade A at significantly lower levels. The outlook for continued rental growth in central Dublin over the short and medium term is very strong, with good suburban office locations set to see improvement in take up and rental levels given the shortage of supply in Dublin's city centre.
The shortage of quality office space and limited development pipeline is leading to a high level of office refurbishment, which is generating significant value add in many cases. Most valuers are now valuing older office properties on a future refurbishment basis with a provision for capital expenditure and a rental value assuming refurbishment. While long term secure income properties remain in demand from investors, shorter income duration and vacant office properties in the right locations have seen the strongest pick up in values given the strong letting and rental growth prospects.
Retail values have stabilised in the prime retail streets during the second half of the year but positive retail rental growth is still limited to the best shops with large floor plates. Retailer demand for small or irregular units and secondary locations is still limited. Industrial vacancy rates have reduced significantly due mainly from sale of vacant properties but availability levels remain high with rental levels showing a level of improvement.
The outlook for the Irish commercial property sector is positive. There remains a significant amount of property to be brought to the market through loan and direct property sales from NAMA and the other banks. 2015 is also expected to see the resale of property by early acquiring short term opportunistic buyers. Acquisition activity by long term buyer is likely to persist and new entrants from overseas will continue to arrive and seek participation in the recovery. While the first phase of value recovery through yield compression has generated substantial value growth, property yields still look attractively priced in the current low bond yield environment. Capital values still remain significantly below peak values and there remains strong potential for value growth based on rental growth.
While there are risks to the sector including domestic and international economic growth and sustained investor appetite for the sector, current property occupier and investment fundamentals and wider investment market pricing, support further growth from the sector, with rental income continuing to be an important albeit lower contributor to returns.

Martin O'Reilly
Head of Property, ILIM

EQUITY MARKETS

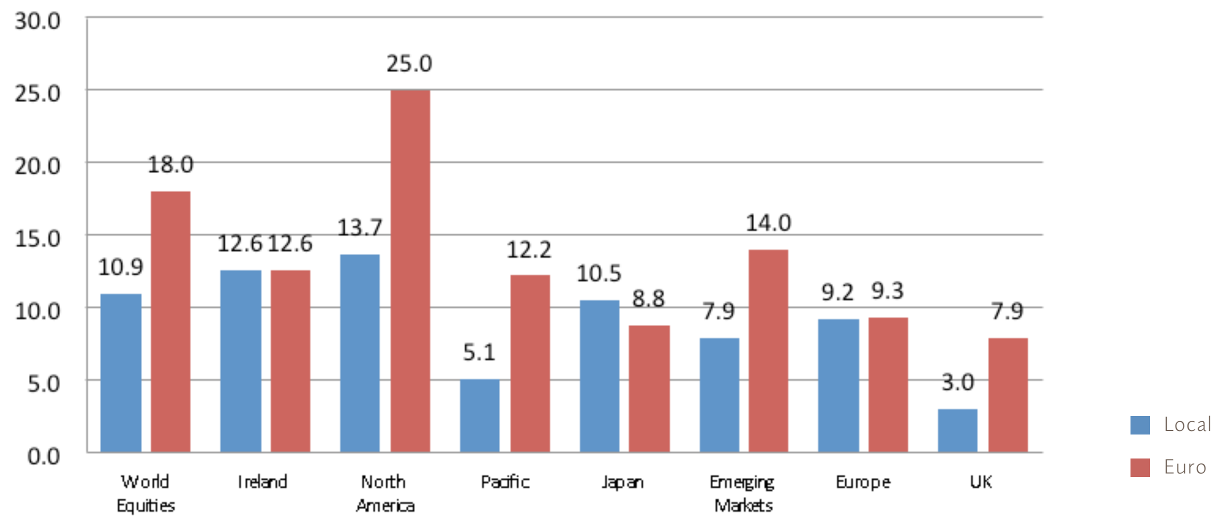
SECTION 3

EQUITY MARKETS

VALUATIONS KEEPING US KEEN...

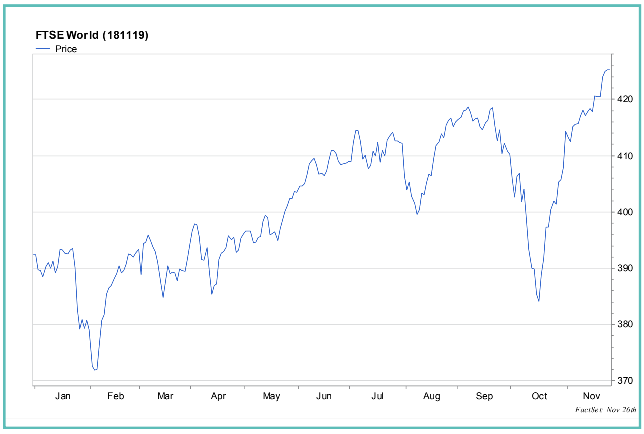
Equity markets have performed well in 2014, rising 10.9% in local currency terms by late November or 18.0% in Euro terms following weakness in the Euro from May onwards on the back of additional monetary stimulus measures announced by the ECB. Equities have been supported by a modestly improving, although bumpy, global economic backdrop, solid corporate earnings reporting seasons, supportive global central bank policy measures, attractive valuations relative to other asset classes, ongoing focus on shareholder value by companies and evidence of continued flows into equities from both investors and corporates via M&A (mergers and acquisitions) which globally are up 45% year on year and are at 7 year highs.

MARKET RETURN YEAR TO DATE (AS AT 25TH NOVEMBER 2014)



Source: Factset, December 2014

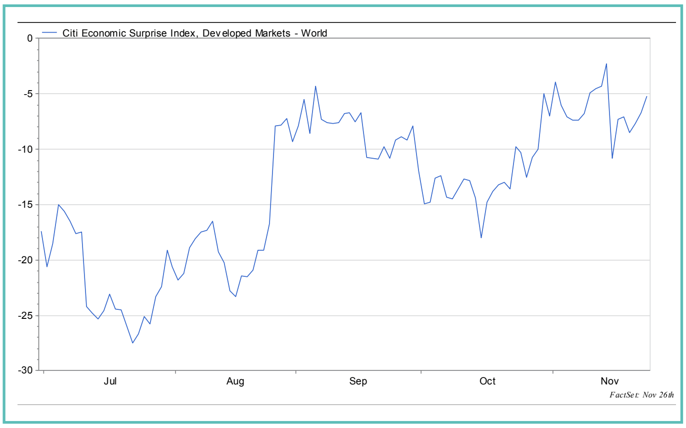
The above chart masks some of the recent moves in equity markets as shown below where all the year to date gains temporarily disappeared in mid-October given concerns over a slowdown in global economic growth following a number of softer economic releases, in particular a sharp fall in German industrial production and disappointing US retail sales. Most leading indicators however suggested that the weaker data points related to a mid-cycle economic soft patch as opposed to a significant slowdown and that activity would rebound. Subsequently, economic releases have generally improved since the middle of October and resulted in equity markets recovering, moving back again to new highs for the year.



ECONOMIC BACKDROP

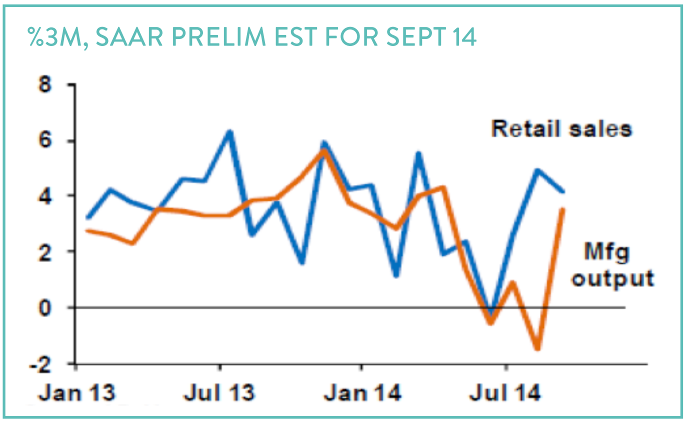
Growth Slowdown Fears

While there were fears over a global economic slowdown evident in October, these fears have subsided as economic data has improved over recent weeks as highlighted by the upward move in the Citi Economic Surprise Index for developed markets below.



Source: Factset, November 2014 2014

In particular, global retail sales remain strong, helped by improving labour markets and lower levels of inflation which historically tend to be negatively correlated with retail sales. Much of the concerns over global growth in October emanated from disappointing industrial production data through the autumn. Historically global retail sales and industrial production levels are quite closely correlated as shown in the chart below. With global retail sales growing approx. 4.5% annualised and expected to remain strong, aided by low levels of inflation, global industrial production activity should improve in coming months following the disconnect with retail sales in early autumn and has already begun to do so as activity levels catch up with the strong retail sales performance. This suggests the concerns over global growth in October were overdone with production levels expected to rebound and remain stable at growth rates of around 4/5%.



Source: JP Morgan, November 2014 2014

Recent Economic Releases

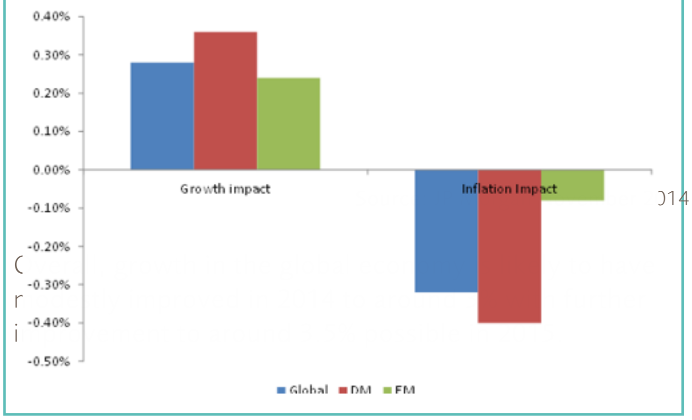
With regards to other economic news flow, in the US, Q3 GDP grew 3.9% annualised, the fastest pace of growth over a six month period since 2003. Strength in retail sales, consumer confidence, ISM manufacturing and service indices and the labour market suggest GDP growth of 3%+ is likely in 2015. In the UK, Q3 GDP was slightly softer than Q2 but still strong in absolute terms. While activity and sentiment surveys have pulled back slightly, sentiment readings remain at relatively high levels. Combined with a healthy consumer backdrop, strong retail sales, an improving labour market and a strong housing market, this suggests that GDP growth of slightly below 3% is still likely in 2015. Economic data has generally disappointed in the Eurozone although Q3 GDP surprised positively.

The recent policy announcements from the ECB, reduced fiscal austerity, a weaker Euro and improving global backdrop should all contribute to better growth in 2015 although it will remain modest at around 1%/1.5%. Chinese economic data has fluctuated through the year but has shown some recent tentative signs of stabilisation in response to a number of targeted mini stimulus packages which have been announced and should result in GDP growth settling around 7% in 2015. In Japan, distortions from the 3% sales tax rise in April are still evident with Q3 GDP falling more than expected. However, some of this was due to inventories which should reverse in Q4 with the increased level of monetary stimulus from the Bank of Japan likely to boost growth in coming quarters. In addition, the government has called an early election in December and if the incumbent government wins as expected, their mandate for pro-growth monetary and fiscal stimulus policies will be strengthened, increasing the likelihood of further fiscal and monetary policy announcements through 2015 which would be supportive of growth and could result in GDP growth of 1.5%/2% in 2015.

Positive Impact of Lower Oil Prices

In addition to the above developments, global economies are set to benefit from the sharp fall in oil prices which has been evident through 2014. Despite tensions in the Middle East, oil prices have fallen approx. 25% since the middle of the summer as supplies have remained plentiful, facilitated by the continued growth in shale oil production in the US, the reopening of facilities in Libya and the refusal of OPEC to cut production in an effort to protect market share. The fall in oil prices has boosted consumer spending power as petrol/gasoline prices have fallen and is estimated to improve global GDP growth by approx. 0.3% and developed market growth by approx. 0.4% over one year. Similarly lower oil prices have also contributed to lower levels of inflation, reducing global annual inflation by approx. 0.3%

IMPACT OF 20% DECLINE IN OIL PRICE



GLOBAL CENTRAL BANKS

Central Banks Balance Sheet Expansion

Policy measures implemented by global central banks have been one of a number of key drivers of equity markets over the last number of years. In recent months there have been notable developments on this front with significant changes announced in the policy stances being adopted by major central banks. In the US, the Federal Reserve, as expected, announced in October that asset purchases under QE3 were ending having previously been gradually reducing the level of monthly purchases since January 2014 as they believed the economic recovery was now on a sustainable footing. The Fed however has indicated that monetary policy will remain accommodative as interest rates will be maintained at their current historic low levels for a considerable period of time. While the cessation of asset purchases by the Fed reduced the level of stimulus being provided by global central banks, this has been offset by announcements elsewhere.

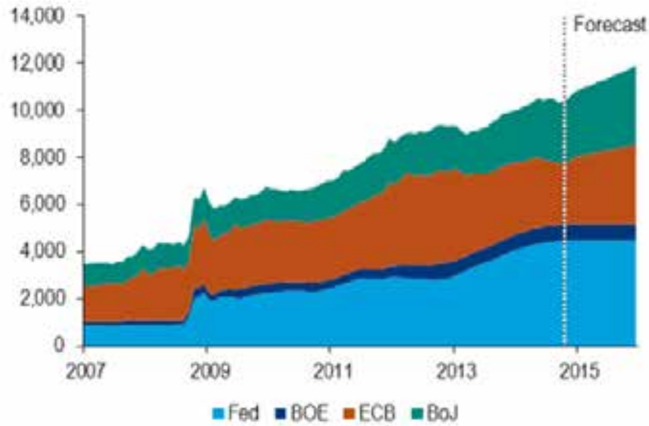
In Japan, given the slower than expected economic recovery from the 3% sales tax rise in April and the risks to the Bank of Japan's 2% inflation target following a slide in inflation back down to 1% (excluding the impact of the sales tax rise), the Bank of Japan in late October announced an increase in its asset purchase programme from Y60/70trn pa to Y80trn pa.

In Europe, the ECB has announced a number of policy measures over the last six months and has indicated it intends to expand its balance sheet by €1trn to €3trn through a combination of cheap loans to banks via Long Term Refinancing Operations (LTRO's) and asset purchase programmes. It has already begun buying Asset Backed Securities (ABS) and covered bonds with speculation that it could soon announce plans to buy corporate bonds. ECB President Draghi has recently indicated that in his view, inflation levels and inflation expectations are already excessively low and the ECB needs to act quickly to raise both measures and prevent deflation occurring. He has stated, as the Fed did when launching QE3, that the pace, size and composition of asset purchases should be adjusted to ensure that its inflation mandate is achieved and he has said the ECB will do whatever is required to ensure the 2% inflation target is reached.

These comments have increased speculation that the ECB will announce a sovereign bond purchase programme early in 2015.

On the basis of the additional measures already announced by both the Bank of Japan and the ECB, the balance sheets of G4 (US, UK, Japan, Europe) central banks will actually increase by approx. 15% in 2015 despite QE3 in the US having ended. Thus the positive impact of central bank balance sheet expansion on global economies and equity markets will remain a feature in 2015 although the expansion will have shifted from the US to Europe and Japan.

G4 CENTRAL BANK BALANCE SHEETS US$BN



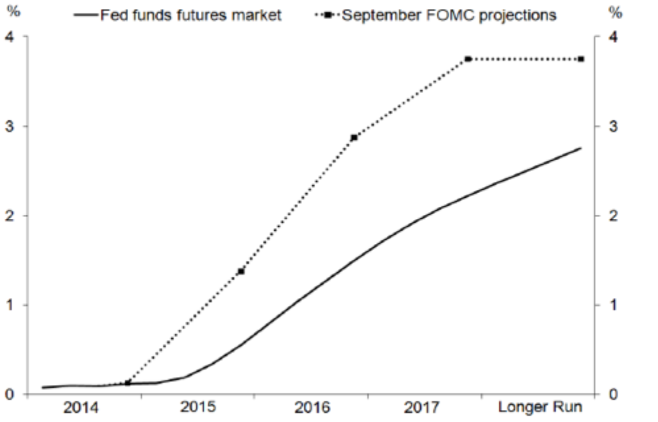
Source: BofA Merrill Lynch, November 2014

Timing of Interest Rate Rises

While global central banks' balance sheets will continue to expand in 2015, expectations on the timing of the first interest rate rises have also been pushed out in recent months while the People's Bank of China recently cut interest rates for the first time in two years.
At the time that global growth concerns were evident in October, commentary from both the Fed and Bank of England became quite dovish and there was an apparent willingness on the part of both central banks to allow investor expectations on the timing of rate rises to drift well into the second half of 2015. In the November Inflation Report, the Bank of England indicated that inflation was expected to be still below its 2% target at the end of 2017 while it was noted that there was an increasing possibility that inflation could fall below 1% through the first half of 2015. Despite the recent split votes of 7:2 in relation to interest rate decisions at the Bank of England, these comments have pushed markets expectations for the first rate rise in the UK out from Q1 2015 to late Q3/early Q4 2015. Similarly in the US, despite the Fed raising its forecast in September for the level of the Feds Fund Rate to 1.38% at the end of 2015 and 2.88% at the end of 2016, by the middle of October the market was expecting the rate to be only 0.41% at the end of 2015, well below the official forecast by the Fed. While a series of better US economic data releases have increased market expectations for the Feds Fund Rate to approx. 0.7% by the end of 2015, market expectations

over the timing and pace of rate rises are much more sanguine than the Fed's official forecasts, as shown below.

FED FUNDS RATE: FEDERAL RESERVE PROJECTIONS V'S MARKET EXPECTATIONS



Source: Deutsche Bank, November 2014

While general economic data and labour conditions in the US have improved, commentary from leading Fed members suggests that the markets expectations regarding the timing of interest rate rises may be closer to the actual eventual outcome than the Fed's own official forecasts. In early November, New York Fed President Dudley argued for the need to be patient regarding the timing of US rate rises given that the risks of tightening too early were seen as greater than those associated with tightening too late, the Fed was still seen as undershooting its employment and inflation targets while he also suggested there was room to allow the economy to run above trend for a period to facilitate the reduction of long term unemployment. Compared to the middle of 2014, expectations for the timing of the first US rate rise have now been pushed out a couple of months to July/August 2015 and, as in the case of the UK, have been facilitated by the continued low levels of inflation.

Impact of Interest Rate Rises on Equity Markets

While not necessarily being a negative for equity markets over a 12 month period, particularly if rates are rising because the economic growth backdrop is improving, the longer rate rises are delayed, the more accommodative monetary policy is. That in turn is supportive of equity markets. History shows that even when interest rates do rise, typically, equity markets are still up around 10% twelve months after the first rate rise, supported by the better economic environment which usually contributes to the decision to raise rates in the first instance as shown in the table below which shows historic changes in UK equities 3, 6 and 12 months after the first rate rise in rate tightening cycles in the UK since the 1970's. Similar trends have been evident in the US in rate tightening cycles there.

UK EQUITIES POST INTEREST RATE RISES

	3m	6m	12m
Jun 72	7.9	7.4	-6.7
Apr 76	-8.5	-28.7	5.3
Nov 77	-2.0	0.3	7.5
May 84	-2.3	16.7	29.4
Feb 88	4.1	9.6	19.7
Sept 94	-6.3	-6.8	11.1
Nov 03	1.9	4.2	9.2
Average	-0.7	0.4	10.8

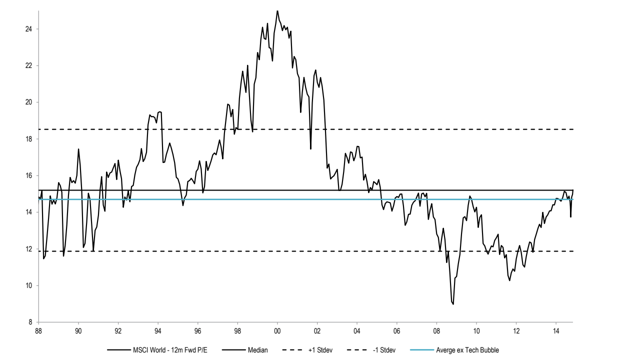
Source: Bloomberg, December 2014

EQUITY MARKET OUTLOOK

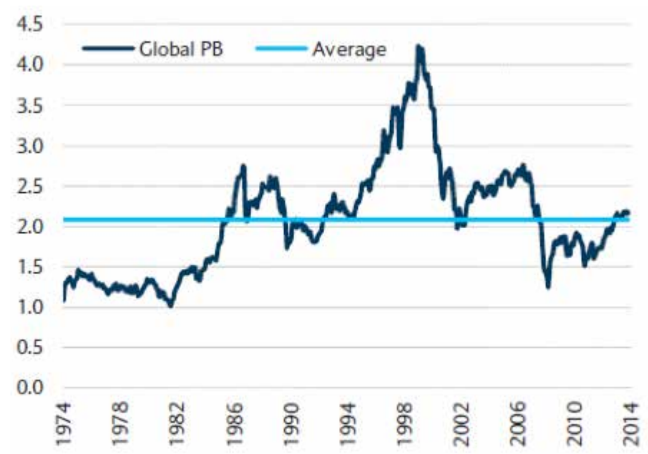
Valuation

On a valuation basis, global equity markets are around fair value and are not stretched, beingneither extremely cheap nor expensive when looking at historic price to earnings multiples and price to book multiples as shown below.

GLOBAL EQUITY 12 MONTH FORWARD P/E MULTIPLE



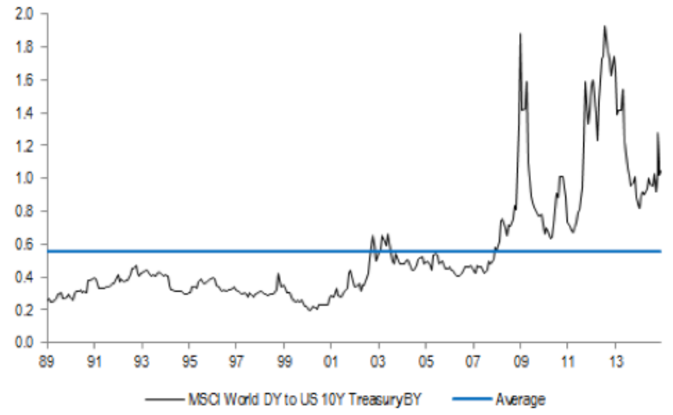
Source: JP Morgan, December 2014



Source: Barclays, November 2014

On a relative valuation basis, global equities remain extremely attractive relative to bonds. The chart below compares equity valuations relative to bonds by dividing the global equity dividend yield by the yield on US 10 year treasuries (a proxy for global bonds). Currently the relative yield on equities remains attractive compared to the yield on bonds and is significantly above the average relative yield between the two assets over the long term, highlighting the relative attractiveness of equities versus bonds.

GLOBAL EQUITY DIVIDEND YIELD V'S BOND YIELDS



Source: JP Morgan, December 2014

With global earnings forecast to rise approx. 9% in 2015 and with an improving economic backdrop and relatively low levels of inflation and interest rates providing potential for valuations to move somewhat higher, equity markets remain well underpinned with potential for further upside in 2015.

Earnings

In terms of earnings, recent earnings reporting seasons have surprised positively in the US and Japan and ex financials have also surprised positively in Europe. The improving economic backdrop with scope for margins to improve, particularly in Europe where margins have yet to significantly recover from the crisis lows, provides a solid backdrop for earnings growth over the next year. The tables below highlight the average historic change in margins and earnings growth in the US, fo example, for given ranges of GDP growth. With US GDP of 3%+ expected in 2015, margin expansion of 51/55bps and EPS growth of around 8% is possible in 2015 on the basis of historical outcomes for growth of similar levels.

US GDP	Profit Margins change bps y/y	S&P 500 EPS % change y/y
<-3%	-16	-85%
-2% to -1%	-84	-6%
-1% to 0%	10	-4%
0% to 1%	44	-40%
1% to 2%	0	8%
2% to 3%	55	8%
3% to 4%	51	15%
4% to 5%	20	16%
>5%	76	23%

Source: JP Morgan, December 2014

Monetary Support

Equity markets have benefited in recent years from the monetary stimulus being provided by global central banks. As mentioned earlier, with global central banks' balance sheets continuing to expand in 2015 despite the ending of QE3 in the US and with interest rate rises being potentially delayed compared to earlier expectations, monetary policy is likely to remain accommodative and supportive of equities.

Equity Flows

Flows to equities remain positive. Year to date, global retail equity mutual funds have had inflows of approx. US$115bn. M&A activity is at seven year highs and is up 45% year on year. In late October, the Government Pension Investment Fund (GPIF) in Japan, the world's largest pension fund at approx. US$1.3trn, announced it intends to double its holdings in equities from 25% to 50% with other funds in Japan expected to follow the GPIF's lead and also announce plans to increase their equity holdings. Flows into equities are thus likely to remain positive and continue to support markets over the next year.

Summary

Equity markets continue to be supported by a number of factors. Fundamentals in terms of a modestly improving global economic environment and rising earnings remain positive. Equity valuations are not stretched and are around fair value based on historic averages although the economic, inflation and interest rate backdrop provide scope for some further rise in valuation multiples. Equities remain extremely attractive relative to other asset classes, particularly bonds. Monetary policies remain accommodative with central banks' balance sheets continuing to expand even after the ending of QE3 in the US while expectations for the timing of interest rates rises are being pushed out, facilitated by the ongoing low levels of inflation. Flows into equities have been positive and are expected to remain so given switching by investors into what is seen as an attractive asset class which should continue to benefit from improving fundamentals and better growth while corporates remain disciplined and maintain a focus on shareholder value. Further gains of around high single digit returns from global equities are possible in 2015 and if the Euro continues to weaken, gains could be higher in Euro terms. Markets however could be more volatile than they have been in recent years, with issues such as the exact timing of rate rises in the US and UK, political uncertainties and election cycles across the Eurozone and the UK, the outlook for growth in China and perceived risks of deflation if inflation expectations fail to rise potentially giving rise to periods of anxiety and volatile movements in markets from time to time.

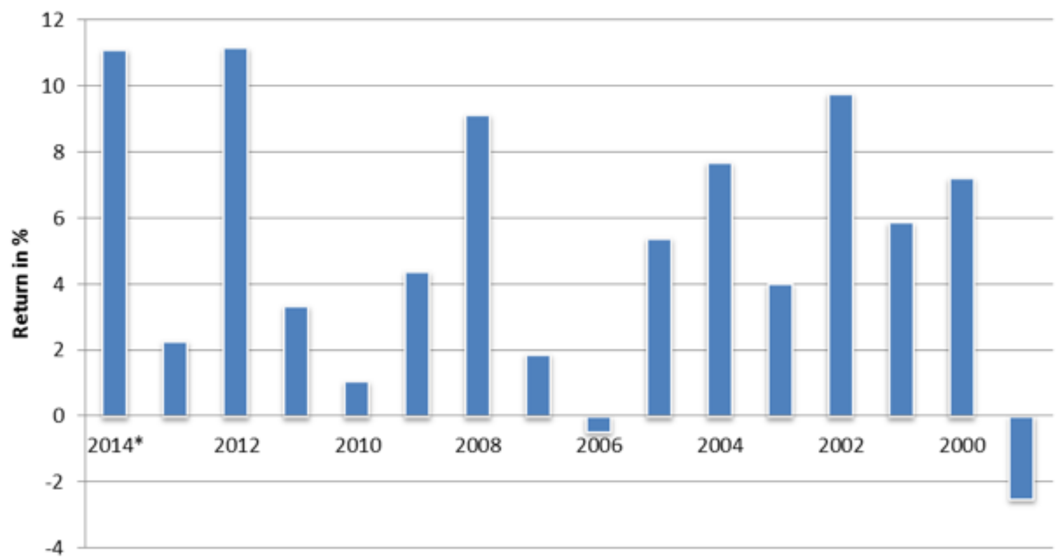
Lenny McLoughlin
Chief Economist, ILIM

BOND MARKETS

IS THE GAME UP FOR BONDS?

Against most initial expectations 2014 turned out to be one of the best years for European Government bond markets since the inception of the Eurozone in 1999.

MERRILL LYNCH EUROZONE GOVERNMENT BOND INDEX
(ANNUAL RETURNS IN %) *2014 UP TO END NOVEMBER



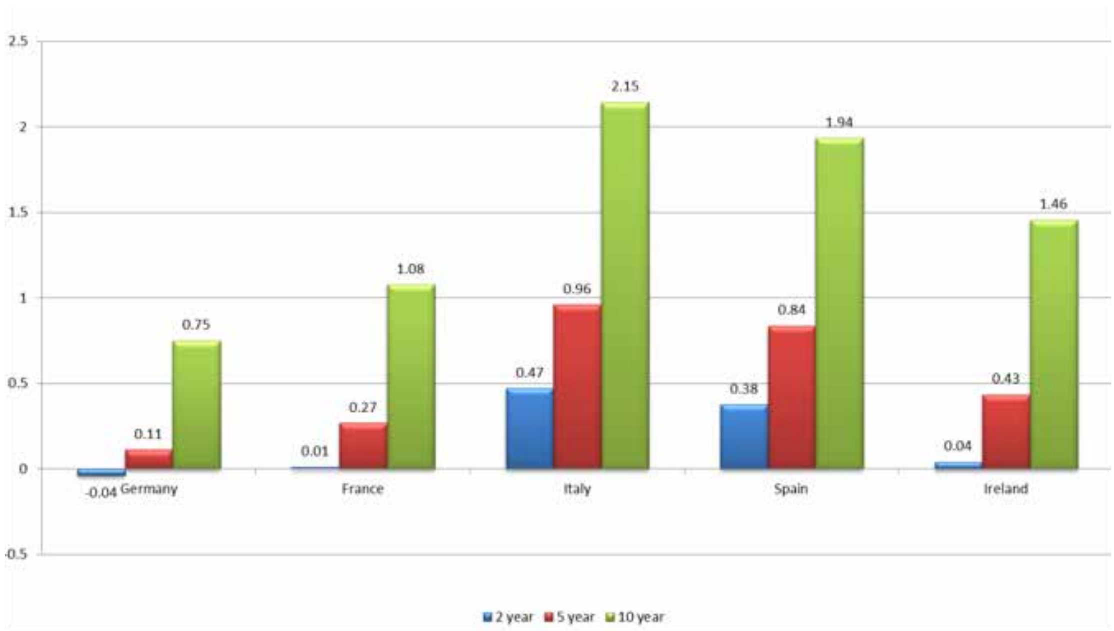
Source: Factset, November 2014

2015 OUTLOOK

As of end 2014 the market is again trying to guess when and by how much the US Federal Reserve will hike rates in 2015. Optimists have begun to predict rates hikes to be postponed until 2016 while mid to late 2015 looks a more realistic forecast based on latest US economic data. However, the outlook for Eurozone Government bonds remains constructive even after the impressive returns posted in 2014 across all markets, 2015 will mark a year of transition though. The hunt for yield will remain the dominant force and correlations between semi-core countries and large peripheral increasingly resemble the pre-crisis period. The impact on convergence trades versus German Bunds will be less linear than in 2014 though as the tightening trend matures and the underlying drivers shift. While investors are getting used to negative yields and 2% handles in 10y peripherals yields, spreads versus German Bunds have been range-bound over the past months. Another catalyst hence seems required to push spreads tighter from current levels. With the macro outlook unlikely to improve materially and the return of foreign investors to peripheral debt markets set to slow down, the ECB will once again be required to trigger the next leg lower in spreads. Indeed, the ECB-view to an overwhelming degree determines the spread outlook in 2015. With ECB quantitative easing now a fact and large scale asset purchases are in effect over the coming months, new spread lows are in store next year. Total returns are thus still reasonable even after this year's rally. Curves will continue to flatten as the yield grab intensifies. We therefore stick to our strategic convergence and flattening recommendations in semi cores and peripheral countries. ECB-inaction accordingly represents a key risk for Eurozone Government spreads. The overall impact would be different for each Eurozone country. While core and semi-core countries will be protected by persistent negative yields and the resulting hunt for positive returns, peripheral country bond yields are biased to further widening as lower growth and lower inflation could bring debt sustainability concerns back on the agenda and support the rise of populist forces. The latter could represent the biggest risk for spreads. General elections will be held in Greece, Portugal and Spain with anti-establishment parties currently leading the polls, while even core countries experience a political rise in extremist parties on the left and right. Active country selection will therefore remain one of the most important tools for Fixed Income management in 2015. As of time of writing we intend to enter the New Year with an overweight in peripherals Spain, Italy and Ireland while maintaining a marginal overweight in duration.

Downside surprises for economic growth and lower than expected global inflation closed the window for US and UK Central Banks on potential rate hikes in 2014, while further support measures were being implemented by the ECB and Bank of Japan. With official ECB interest rates at 0.05% and negative deposit rates already in place, the ECB was forced into further action in Q4-2014 with the outright purchases of Covered Bonds and Asset Backed Securities. Given that the Eurozone economies are struggling to avoid recession and deflation, the market strongly started to price in a full blown QE with purchases of Eurozone Government bonds as early as Q1-2015. As a result bond yields reached new lows with the 10 year German bond yield at 0.7% only about 0.3% above its Japanese counterpart. The following chart gives an overview of bond yields in late 2014:

EUROZONE BOND YIELDS



Source: Factset, November 2014

The story of 2014 was the remarkable recovery in the peripheral bond markets with Italy (+13%), Spain (+14.4%) and Ireland (+12.8%) showing strong performance. A recovery in economic growth in Ireland and Spain and improved political stability in Italy helped to regain investor confidence. By year end Ireland was in the position to repay a €9bn loan to the IMF with an impressive refinancing in the bond markets.

Max Plapp
Head of Bonds, ILIM

INDEX PERFORMANCES AND MARKET DATA

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Equity Markets (%)	2010	2011	2012	2013	2014	2015 YTD
ISEQ	-3.0	0.6	14.7	35.8	16.8	4.6
FTSE 100	9.0	-5.6	6.0	18.7	0.7	4.1
Euro Stoxx 50	-0.1	-17.7	13.4	21.5	4.0	7.5
S&P 500	12.8	0.0	12.4	32.4	13.7	-0.3
Nasdaq	16.9	-1.8	14.1	36.9	14.8	0.5
Nikkei	-3.0	-17.3	16.24	59.4	7.1	0.3
MSCI Emerging Markets	16.4	-20.4	13.8	-2.3	5.6	3.2
MSCI World	17.2	-7.62	12.1	26.3	10.4	0.9

Sovereign 10yr Bond Yields (%)	2010	2011	2012	2013	2014	2015 YTD
US	3.3	1.9	1.7	3.0	2.2	1.8
German	3.0	1.8	1.4	1.9	0.5	0.4
UK	3.4	2.0	1.9	3.0	1.9	1.5
Japan	1.1	1.0	0.7	0.7	0.3	0.2
Ireland	9.1	8.4	4.5	3.4	1.3	1.1
Italy	4.8	7.1	4.6	4.1	2.1	1.5
Greece	12.5	31.7	12.7	8.2	9.6	8.7
Portugal	6.6	13.4	6.9	6.1	2.7	2.2
Spain	5.5	5.1	5.4	4.1	1.6	1.4

Central Bank Rates (%)	2010	2011	2012	2013	2014	2015 YTD
ECB	1	1	0.75	0.25	0.05	0.05
Bank of England	0.5	0.5	0.5	0.25	0.50	0.50
US Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25

Foreign Exchange Rates	2010	2011	2012	2013	2014	2015 YTD
Dollar/Euro ($/€)	1.34	1.30	1.31	1.37	1.21	1.12
Sterling/Euro (£/€)	0.86	0.83	0.81	0.83	0.78	0.75
Dollar/Sterling ($/£)	1.56	1.55	1.61	1.65	1.56	1.50

IPD All Property Return (%)	2010	2011	2012	2013	2014	2015 YTD
Ireland	-2.4	-2.4	3.1	12.7	TBC	TBC
UK	14.5	8.1	2.7	10.7	TBC	TBC
US	14.8	14.5	5.3	11.4	TBC	TBC

* Information correct as at 23/1/2015

** Equity market returns are total returns

Source: Bloomberg

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ILA 10062 (REV 02-15)