Irish Life Investment Managers

Monthly Mindshare November 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…

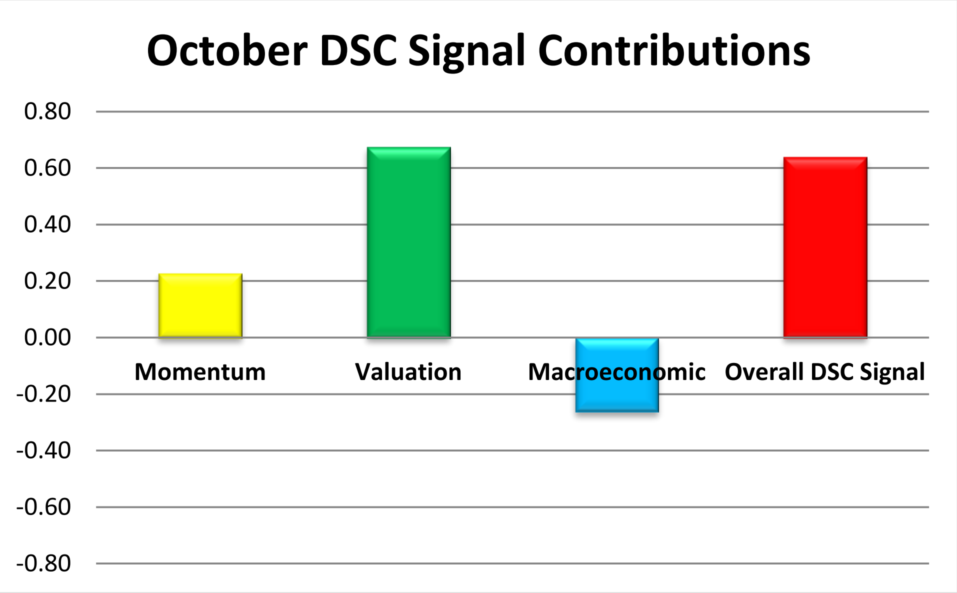
- Which factors were driving the DSC process in November and how the DSC signal was impacted as a result

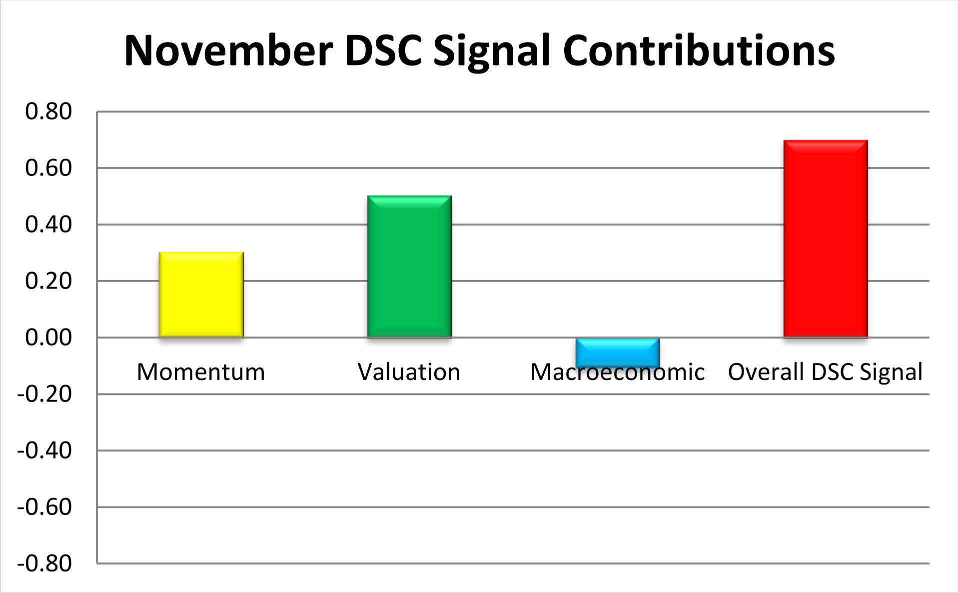
- What has been going on in the major economies around the globe through November

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 November having picked up slightly from October to finish the month at +0.70, up from +0.62. All MAPS 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 in particular remains positive and is increasing month on month.
- The **Valuation** category weakened slightly on continued rising prices while earnings have failed to keep pace
- The **Macroeconomic** category saw the biggest change again as energy prices continue to weaken.

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 but remain sensitive to any ECB policy announcements.

- **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 November

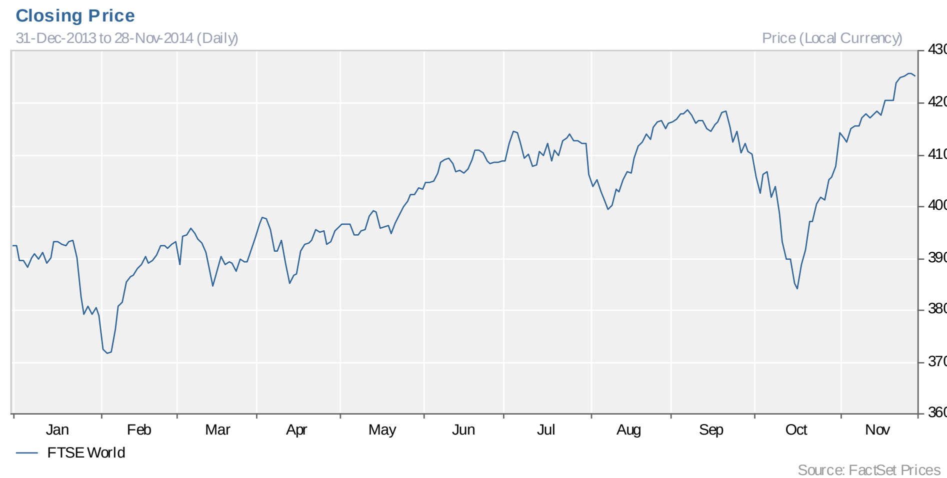
- Both equity and bond markets reacted positively to the continued support provided by accommodative policies from global central banks
- The Japanese equity market in particular and other global equity markets were supported by the late October decision by the Bank of Japan to increase asset purchases to Y80trn pa
- The ECB reiterated that its balance sheet is expected to increase by €1trn to €3trn and that there is unanimous agreement to use other unconventional measures if required. Expectations for further policy announcements, particularly a sovereign bond purchase programme, rose as President Draghi indicated inflation levels and expectations were excessively low and a rapid response is required to achieve its 2% inflation target, to which it is committed. He suggested the pace, size and composition of asset purchases could be adjusted to ensure targets are met
- The People's Bank of China reduced interest rates for the first time in over 2 years in response to weaker Chinese economic data
- Elsewhere, global economic data generally improved. US Q3 GDP was revised up to 3.9% annualised while the labour market remained firm and retail sales were strong. European Q3 GDP surprised positively, up 0.2% q/q and many business sentiment surveys improved although the widely followed PMI's did fall to 12/18 month lows.
- Tensions in Ukraine continued to rise
- Oil prices continued to fall with Brent down -18.3% as OPEC failed to cut production levels in an effort to protect market share and reduce prices to levels where production for US shale producers becomes unprofitable
- Global equities rose 2.8% (2.3% in €). Eurozone >5 year bonds rose 2.2% with German 10 year yields falling to new all time lows of 0.70% and peripheral spreads narrowed further due to continued low inflation at 0.3% y/y and increased speculation of a sovereign bond purchase programme from the ECB. The Euro also weakened slightly to 1.247 against the US$ due to speculation of increased monetary stimulus although it strengthened against the yen and sterling. Commodities fell -10.7%, led lower by the fall in the oil price

Market Signposts

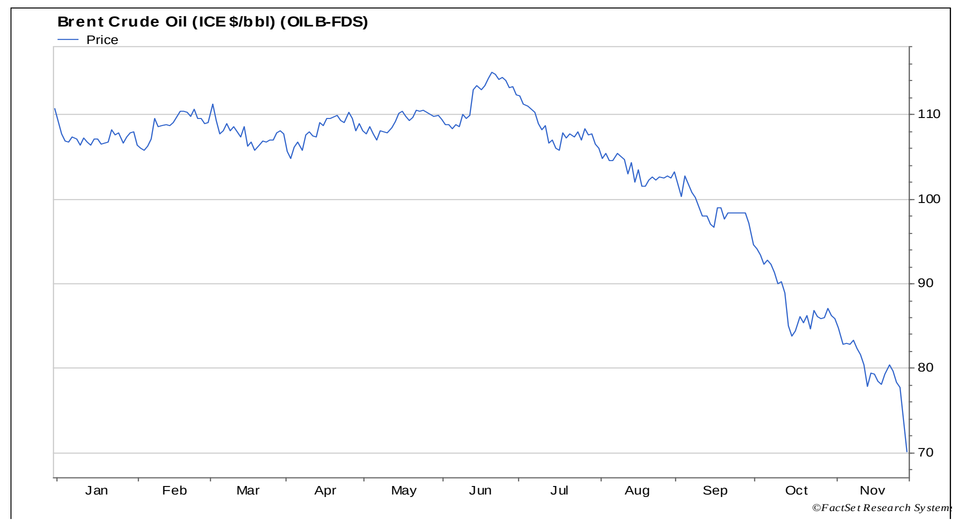
Markets In November	Local Returns	Euro Return
Ireland	6.5	6.5
UK	3.0	1.3
US	2.6	3.1
North America	2.6	3.0
Europe	4.1	4.1
Japan	6.2	0.8
Pacific	-0.3	-1.9
Emerging Markets	1.1	-0.6
World	2.8	2.3
EMU Govt Bonds >5yr	2.2	2.2
Commodities	-10.7	-10.2

Markets YTD	Local Returns	Euro Return
Ireland	13.4	13.4
UK	2.8	7.5
US	13.7	25.6
North America	13.6	25.0
Europe	9.8	9.8
Japan	10.6	8.2
Pacific	5.2	12.4
Emerging Markets	8.2	13.7
World	10.9	18.0
EMU Govt Bonds >5yr	18.5	18.5
Commodities	-23.8	-15.7

Equity Markets Continue to Recover From October Lows



Oil Price Continues to Fall as OPEC Fails to Cut Production



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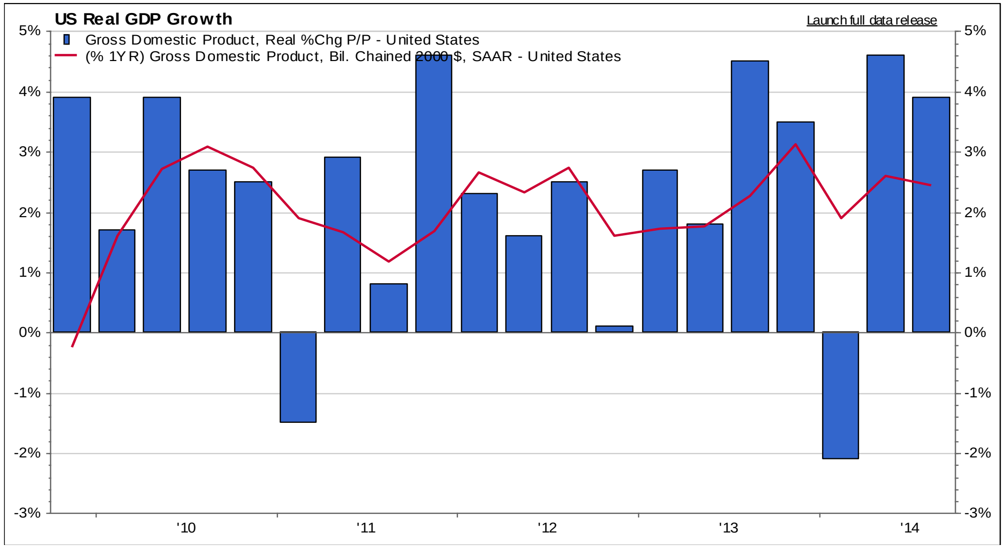
US Economy Review

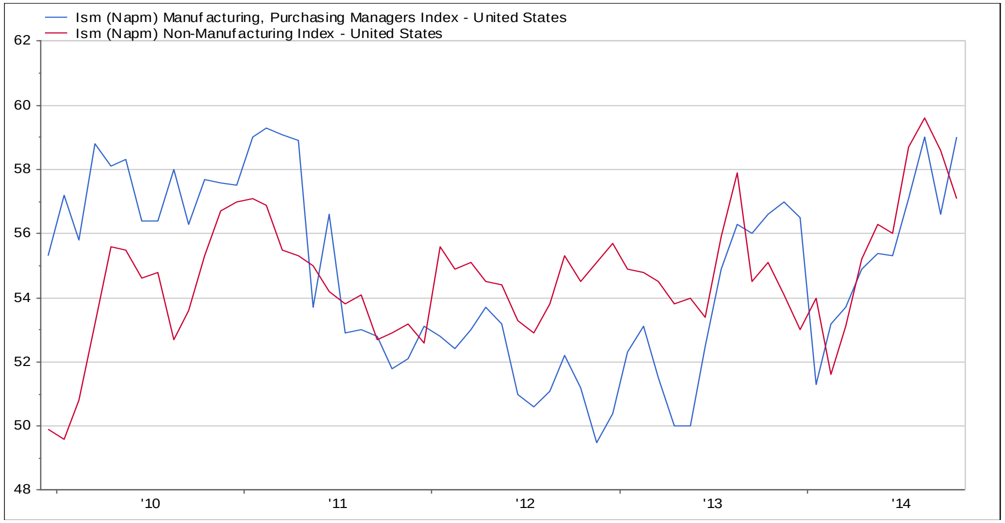
- **Economy**
  - Data was generally better. Q3 GDP rose 3.9% annualised with consumption up 2.2% and business fixed investment up 7.1%; inventory build was revised from $63bn to $79bn
  - ISM manufacturing rose 3.0 to 59.0; services fell -1.5 to 57.1; the composite PMI fell -1.8 to 57.2
  - Non farm payrolls rose 214k from 248k previously; unemployment fell 0.1% to 5.8%;
  - Industrial production fell -0.1% m/m
  - House prices in the top 20 cities rose 0.3% m/m and 4.9% y/y from 5.6% previously
  - CPI was unchanged at 1.7% y/y

- **Interest Rates**
  - There were mixed messages from the Fed minutes but the overall interpretation by investors was slightly dovish
  - Concerns were expressed over falling inflation expectations with a need to remain attentive to further changes; concerns over global growth risks and increased financial volatility were excluded from the October post meeting statement due to concerns over how markets might interpret such comments
  - There was agreement that rate rises are data dependent

US Q3 GDP Revised Higher



ISM Manufacturing and Services in Expansionary Territory

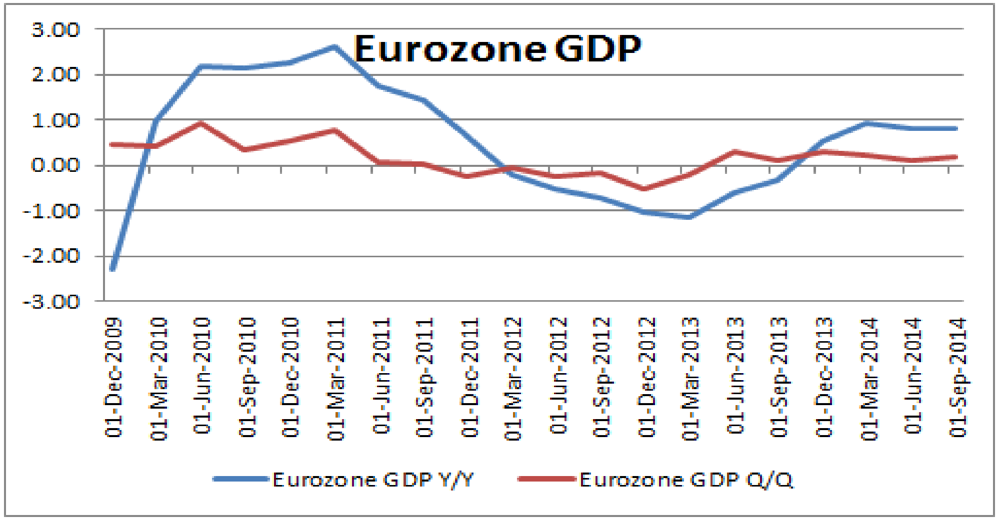


Eurozone Economy Review

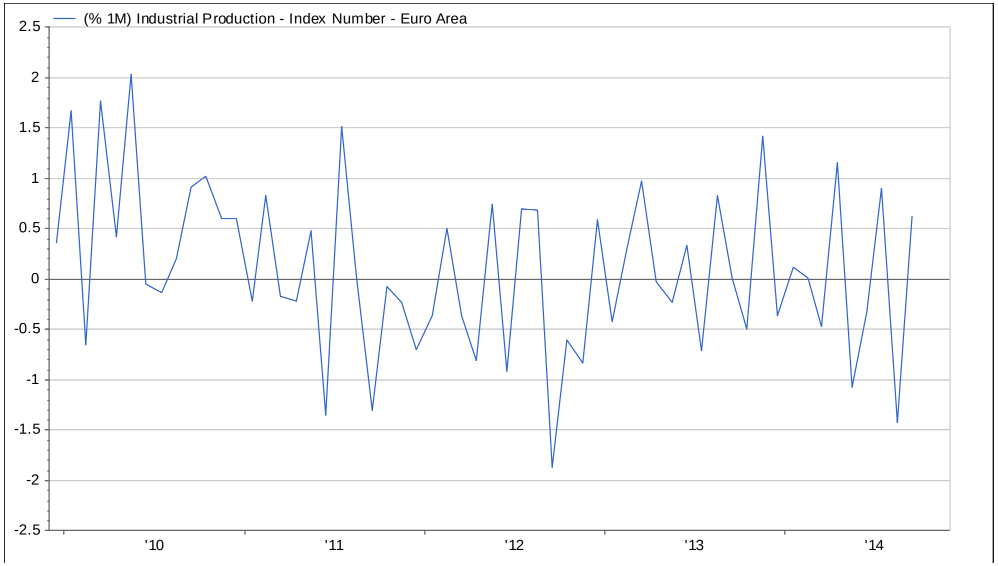
- **Economy**
  - Data was slightly better although the growth outlook remains modest. Eurozone Q3 GDP surprised positively, up 0.2% q/q with Q2 revised up to 0.1% q/q.
  - Most sentiment surveys improved with Sentix business sentiment up 1.8 to -11.9; ZEW expectations up 6.9 to 11.0; PMI's however fell to 12/18 month lows with the composite PMI down -0.7 to 51.4
  - Industrial production rose 0.6% m/m
  - German data was better. Q3 GDP rose 0.1% q/q;
  - French Q3 GDP rose 0.3% q/q; the composite PMI rose 0.2 to 48.4; business confidence rose 3 to 94
  - Spanish retail sales rose 1.0% y/y from 1.1% previously; industrial production rose 1.0% y/y from 0.6%; Italian Q3 GDP fell -0.1% q/q; unemployment rose 0.6% to 13.2%

- **Interest Rates**
  - There were no new policy announcements by the ECB although commentary was dovish
  - ECB President Draghi indicated the balance sheet is expected to grow by €1trn to €3trn and that there is unanimous agreement to use other unconventional measures if required
  - Subsequently Draghi indicated inflation levels and expectations are excessively low; that the ECB needs to act quickly to bring inflation back to 2% and is committed to achieving the 2% inflation target and will do everything in its power to do so

Eurozone Q3 GDP Surprises Positively/Q2 Revised Higher



Eurozone Industrial Production Rebounds

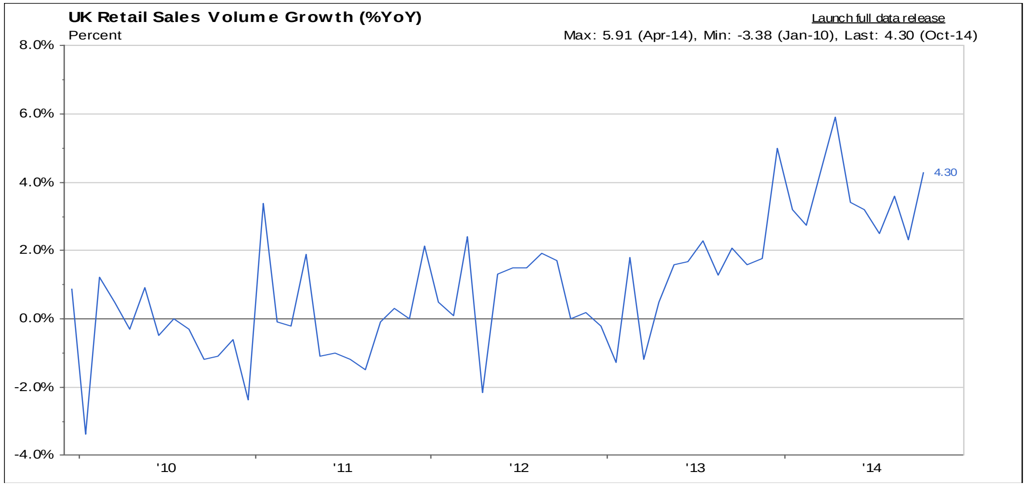


UK Economy Review

- **Economy**
  - Economic data was better although the Q3 GDP mix disappointed
  - Q3 GDP was confirmed at 0.7% q/q and 3.0% y/y.
  - Core retail sales ex autos rose 0.8% m/m and 4.6% y/y; consumer confidence was unchanged at -2
  - Unemployment was unchanged at 6.0%
  - Industrial production rose 0.6% m/m and 1.5% y/y; construction rose 1.8% m/m and 3.5% y/y
  - Halifax house prices fell -0.4% m/m but rose 8.8% annualised over 3 months from 9.6% previously
  - CPI rose to 1.3% y/y from 1.2%

- **Interest Rates**
  - BoE left policy unchanged, again in a split vote of 7:2
  - The minutes suggested differences of opinion remain with some concerned about potentially higher wage inflation and price inflation as the impact of the stronger sterling begins to dissipate
  - The majority felt the level of spare capacity in the economy was greater than previously thought and that inflation pressures remain subdued
  - There were also some concerns over signs of slowing global growth and weakening in domestic housing data
  - These comments pushed expectations for the timing of the first UK rate rise out to late Q3/early Q4 2015

UK Retail Sales Remain Strong



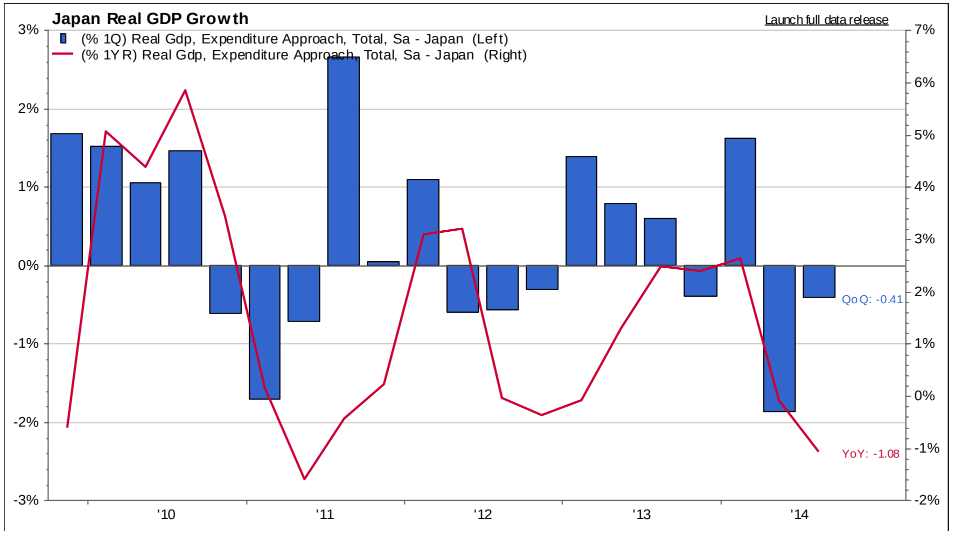
UK Average Earnings Rise

Asian Economy Review

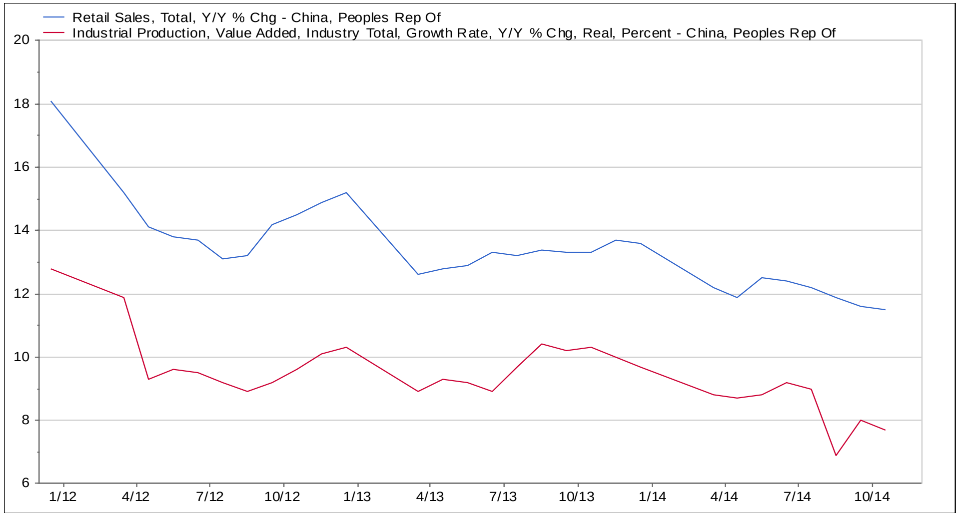
- **Japanese Economy**
  - Releases were mixed but generally better although Q3 GDP disappointed
  - Q3 GDP fell -0.4% q/q or -1.6% annualised.
  - Industrial production rose 0.2% m/m;
  - The Bank of Japan (BoJ) left policy unchanged in an 8:1 vote. The overall assessment of the economy was unchanged and described as recovering at a moderate trend. Inflation is expected to remain around current levels for the time being. The minutes showed the October increase in asset purchases was mainly due to downward pressure on inflation from oil prices and that purchases should be increased as much as possible to avoid a deflationary mindset developing

- **Chinese Economy**
  - Chinese data disappointed after some recent improvement
  - The HSBC composite index fell -0.6 to 52.9; manufacturing fell -0.4 to 50.0; services fell -0.6 to 51.7. Official manufacturing PMI fell -0.3 to 50.8; services fell -0.2 to 53.8
  - Industrial production growth slowed to 7.7% y/y
  - Exports rose 11.6% y/y from 15.3% previously; imports rose 4.6% y/y from 7.0% previously
  - Following the weaker data, the People's Bank of China reduced interest rates for the first time in over 2 years as the 1 year lending rate fell 0.4% to 5.6% and the 1 year deposit rate fell 0.25% to 2.75%

Japanese Q3 GDP Disappoints



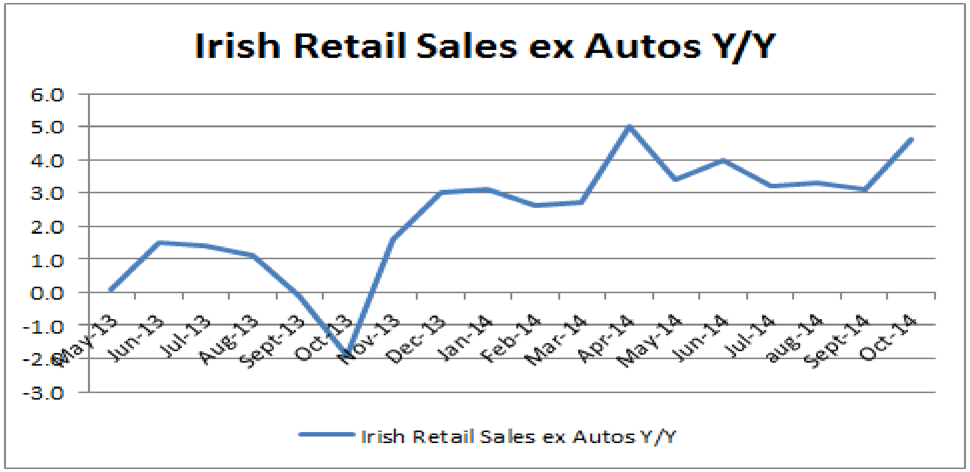
Chinese Retail Sales/Industrial Production Growth Slow



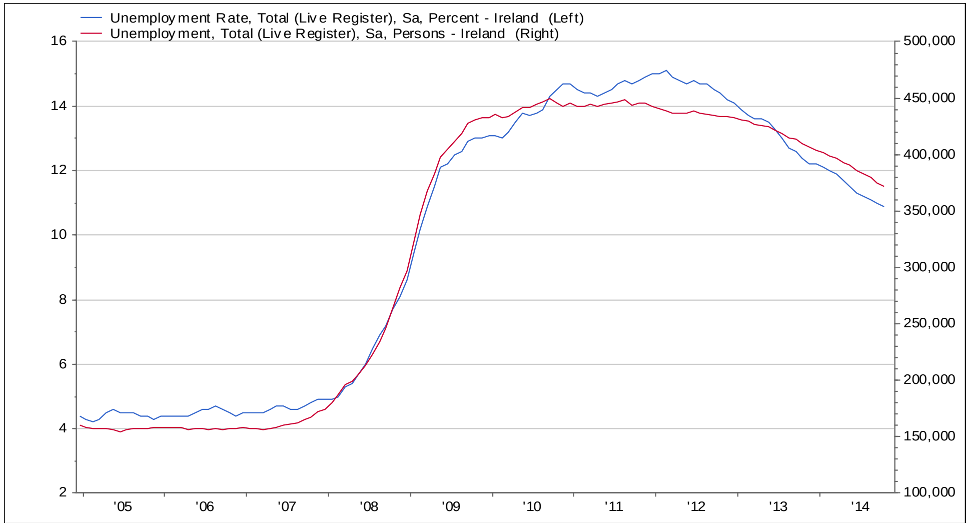
Ireland Economy Review

- **Economy**
  - Economic releases generally remained positive
  - Retail sales fell -0.7% m/m but rose 5.6% y/y. Core sales ex autos rose 0.3% m/m and 4.6% y/y
  - Employment grew for an eighth consecutive quarter, up 0.5% q/q and 1.5% y/y. Numbers on the Live Register fell 3,500 to 371,400 and unemployment fell 0.2% to 10.9%
  - Industrial production rose 4.1% m/m and 20.7% y/y
  - The composite PMI rose 0.2 to 60.2; manufacturing rose 0.9 to 56.6; services fell -1.0 to 61.5
  - National residential property prices rose 2.9% m/m and 16.3% y/y. House prices in Dublin rose 3.3% m/m and 24.1% y/y. Residential prices outside Dublin rose 2.8% m/m and 8.3% y/y
  - Exchequer returns remained positive with the deficit for the first ten months €1.7bn ahead of target at €8.9bn, suggesting the governments estimate made at the time of the budget for a deficit of 3.7% of GDP in 2014 will be beaten. Tax revenues are €1.1bn ahead of budget, non tax revenue is €0.4bn ahead of target while lower interest payments have also saved €0.4bn. Gross voted current expenditure has overrun by approx €0.5bn while gross voted capital expenditure is approx €0.1bn inside budget

Irish Core Retail Sales Remain Strong



Irish Labour Market Continues to Improve



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