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IRISH LIFE INVESTMENT MANAGERS (ILIM)

Monthly Mindshare - August 2015

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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 end of July
- Investment Asset watch
- Market developments in July
- 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

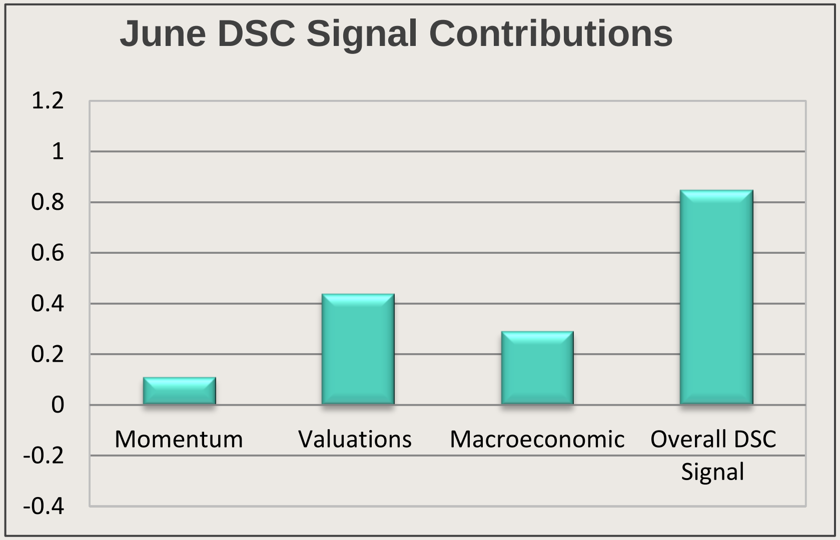
This month we examine…

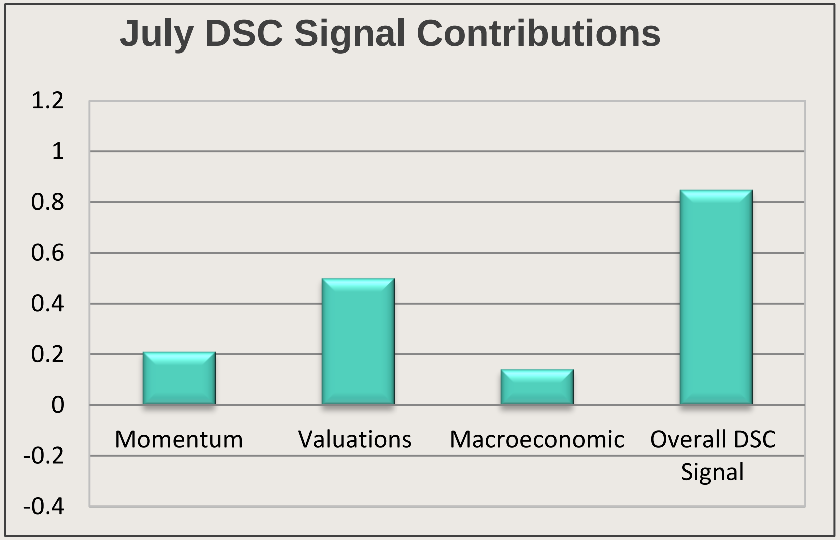
- Which factors were driving the DSC process in July and how the DSC signal was impacted as a result.
- What has been going on in the major economies around the globe through July.

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 JUNE





- The overall ***DSC*** signal remained essentially unchanged through July – it moved from 0.85 at the end of June to 0.86 at the end of July so remains in overall positive territory. All DSC related funds continue to be fully invested in their Developed Market Shares. Valuations is still the major contributor of the three factors as can be seen above.

- The **Momentum** category increased over the month as markets rose with the response to Greece agreement in principle.
- There was no material change in **Valuations** category over the month.
- The **Macroeconomic** category reduced somewhat with global economic growth more sluggish than expected.

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. When rate tightening cycles finally begin in the US and UK, they are expected to be gradual. 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 few 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 medium 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 around 6%, 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 JULY

- The clear majority 'No' vote in the Greek referendum was an apparent rejection of terms being offered by creditors and was seen as significantly raising the possibility of a Greek exit from the Euro and contributed to weaker equity markets and wider Eurozone peripheral bond spreads in early July
- The subsequent agreement in principle between Greece and creditors for a €82/86bn bailout programme restored calm and led to a rebound in equities and narrowing of peripheral bond spreads as risks of an imminent Greek exit from the Euro were removed
- Earnings reporting seasons surprised positively with results to date approx 4% ahead of forecasts in the US and 2% in Europe which supported equity markets
- The US Fed appeared to suggest a September interest rate rise was possible when indicating it only needed to see some further improvement in the labour market before raising rates. Subsequent weaker than expected wage inflation data however pushed expectations for the first rate rise back out to January 2016
- Commentary from members of the Bank of England policy committee and minutes from the July meeting suggested and earlier UK interest rate raise than previously expected with expectations being pulled forward to early 2016
- Continued upbeat comments on the economic and inflation outlook from the Bank of Japan, an apparent change in the definition of core inflation and higher than expected actual inflation readings all suggested the potential for additional monetary easing in Japan has been significantly reduced
- Brent oil fell -17.9% due to expectations of increased Iranian supply post the signing of the nuclear agreement, continued increases in supply of oil from OPEC and increased oil rig counts in the US
- Global equities rose 1.7% (1.7% in €). Eurozone > 5 year bonds rose 3.5% on narrowing peripheral spreads and a fall in German 10 year yields to 0.64% as inflation pressures eased with lower oil prices. The Euro fell slightly against the US$ to 1.105 as ECB QE related trades were re-established post the removal of Greek uncertainties. Commodities fell -14.1% (-13.4% in €) on deteriorating demand/supply dynamics and concerns over Chinese growth

MARKET SIGNPOSTS

Markets In July		
	Local Returns	Euro Return
Ireland	5.6	5.6
UK	2.6	2.7
US	2.0	2.8
North America	1.9	2.6
Europe	5.1	4.5
Japan	1.8	1.4
Pacific	-0.8	-2.9
Emerging Markets	-4.3	-6.1
World	1.7	1.7
EMU Govt Bonds >5yr	3.5	3.5
Commodities	-14.1	-13.4

Markets YTD		
	Local Returns	Euro Return
Ireland	27.1	27.1
UK	4.5	14.5
US	3.5	13.4
North America	3.4	12.5
Europe	16.2	19.2
Japan	19.0	26.2
Pacific	2.4	6.0
Emerging Markets	1.3	5.2
World	6.6	13.9
EMU Govt Bonds >5yr	1.1	1.1
Commodities	-9.5	-0.9

Equity Markets Rebound on Greek Deal

Brent Oil Declines on Supply Concerns

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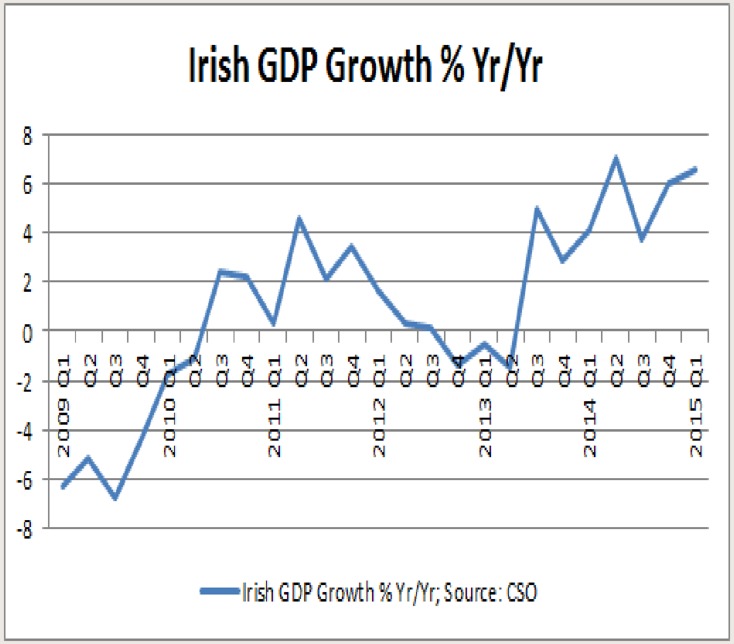
IRELAND ECONOMY REVIEW

Economy

- Economic releases generally remained positive.
- Q1 GDP grew 1.4% q/q and 6.5% y/y. 2014 GDP growth was revised up from 4.8% to 5.1%
- In Q1, consumer spending rose 1.1% q/q and 3.8% y/y. Investment fell -3.1% q/q due to volatility in aircraft orders but was up 4.0% y/y. Exports rose 2.3% q/q and 14.3% y/y. Imports rose 0.6% q/q and 14.7% y/y
- Seasonally adjusted numbers on the Live Register fell 2,300 to 344,900
- Retail sales fell -3.9% m/m but rose 5.4% y/y; core sales ex autos rose 0.4% m/m and 5.8% y/y; consumer confidence fell -3.1 to 99.7
- Industrial production remains volatile, falling -6.9% m/m
- The seasonally adjusted monthly trade surplus fell to €3,973m from €4,600 but was still the third highest reading in two and a half years
- The composite PMI rose 0.1 to 60.9; manufacturing PMI fell -2.4 to 54.6; services rose 1.9 to 63.3
- National residential property prices rose 0.1% m/m and 10.7% y/y. Dublin prices fell -0.3% m/m but rose 10.5% y/y. Prices outside Dublin rose 0.4% m/m and 9.7% y/y
- CPI rose 0.3% m/m and was down -0.1% y/y
- Exchequer returns to the end of June remained strong. Revenue for the half year was approx €1bn ahead of target with tax revenues and PRSI ahead but excise duties were behind. Expenditure was approx 0.2% below target, mainly due to lower debt service costs. Exchequer returns to date suggest the target of a fiscal deficit of 2.3% of GDP in 2015 will be beaten

Irish Economic Growth Remains Strong



EUROZONE ECONOMY REVIEW

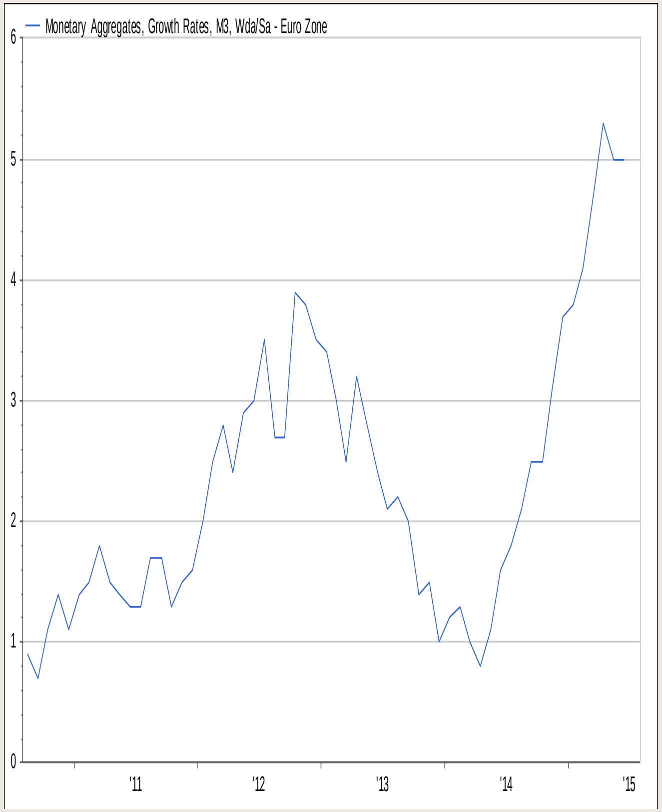
Economy

- Data generally remained consistent with growth of around 1.5%
- The composite PMI fell -0.5 to 53.7; ZEW expectations fell -11.0 to 42.7; Sentix business sentiment rose 1.4 to 18.5
- Industrial production fell -0.4% m/m ; construction output rose 0.3% m/m; retail sales rose 0.2% m/m; consumer confidence fell -1.5 to -7.1; M3 money supply growth was unchanged at 5.0% y/y
- CPI was unchanged at 0.2% y/y; core inflation ex food and energy rose 1.0% y/y from 0.8% y/y previously
- The German composite PMI fell -0.3 to 53.4; the IFO business climate rose 0.6 to 108.0; ZEW expectations fell -1.8 to 29.7; retail sales fell -2.3% m/m; consumer confidence was unchanged at 10.1; industrial production was flat m/m; factory orders fell -0.2% m/m
- The French composite PMI fell -1.8 to 51.5. Business confidence rose 2 to 99; consumer confidence fell -1 to 93; consumer spending rose 0.4% m/m; industrial production rose 0.4% m/m
- In Spain, Q2 GDP rose 1.0% q/q; the composite PMI fell -2.5 to 55.8, industrial production rose 3.4% y/y; retail sales rose 2.3% y/y
- The Italian composite PMI rose 0.3 to 54.0; industrial production rose 0.9% m/m; retail sales fell -0.1% m/m; business confidence fell -0.3 to 103.6

Interest Rates

- The ECB did not make any changes to monetary policy
- The ECB reiterated it intends to fully complete the current €60bn per month asset purchase programme out to September 2016
- It indicated it is continuing to monitor financial markets and the impact of current monetary policy and would use all instruments within its mandate if unwarranted tightening of monetary policy becomes evident
- The ECB increased the amount of Emergency Liquidity Assistance support to Greek banks a number of times in the month to just under €91bn in total
- The ECB' s economic outlook was generally positive, expecting the recovery to broaden further, supported by monetary policy measures already undertaken

Eurozone M3 Money Supply Growth Remains Strong



U.S. ECONOMY REVIEW

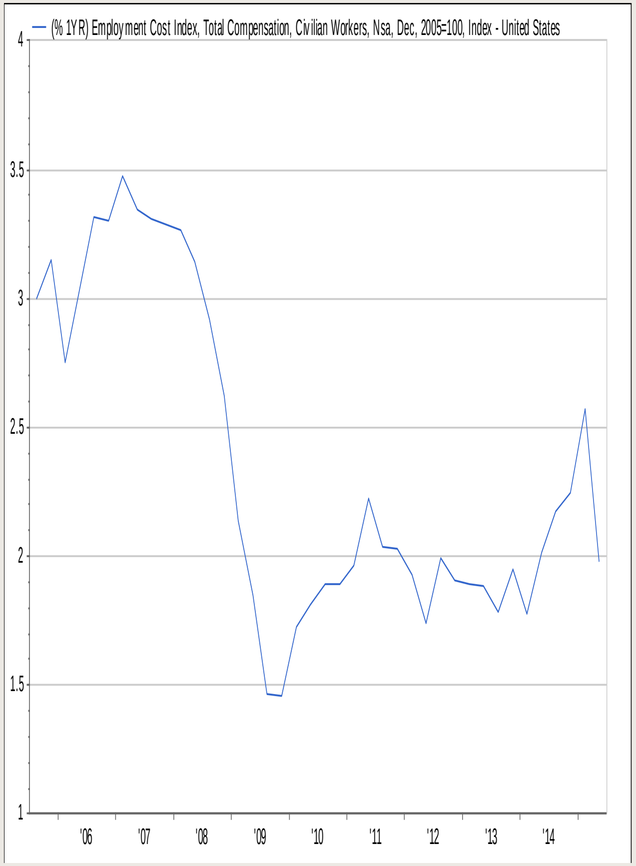
Economy

- US economic data was slightly disappointing
- Q1 GDP was revised up from -0.2% to +0.6% annualized. Q2 GDP was slightly below expectations at 2.3% annualized, supported by a high inventory build
- ISM manufacturing rose 0.7 to 53.5; services rose 0.3 to 56.0; the composite PMI rose 0.6 to 55.2; small business confidence fell -4.2 to 94.1
- Non-farm payrolls rose 223,000, slightly below expectations; unemployment fell 0.2% to 5.3%; average hourly earnings fell to 2.0% y/y; industrial production rose 0.3% m/m; factory orders fell -1.0% m/m
- Headline retail sales fell -0.3% m/m; consumer confidence fell -8.9 to 90.0
- CPI rose 0.3% m/m and was up 0.1% y/y. Core CPI ex food and energy rose 0.2% m/m and 1.8% y/y
- Durable goods orders rose 3.4% m/m; orders ex transport rose 0.8% m/m; capital goods shipments fell -0.1% m/m
- House prices in the top 20 cities fell -0.2% m/m but rose 4.9% y/y; housing starts rose 9.8% m/m; building permits rose 7.4% m/m; new home sales fell -6.8% m/m while existing home sales rose 2.2% m/m

Interest Rates

- The Fed left interest rates unchanged
- The tone of the statement was more optimistic on growth but displayed less conviction on inflation by removing a reference to the stabilization in oil prices
- The Fed suggested a September rate rise was possible when indicating a rate rise would be appropriate on only some further improvement in the labour market
- However expectations for the first rate rise were pushed out to January on lower than expected wage inflation data

U.S. Wage Inflation Eases



U.K. ECONOMY REVIEW

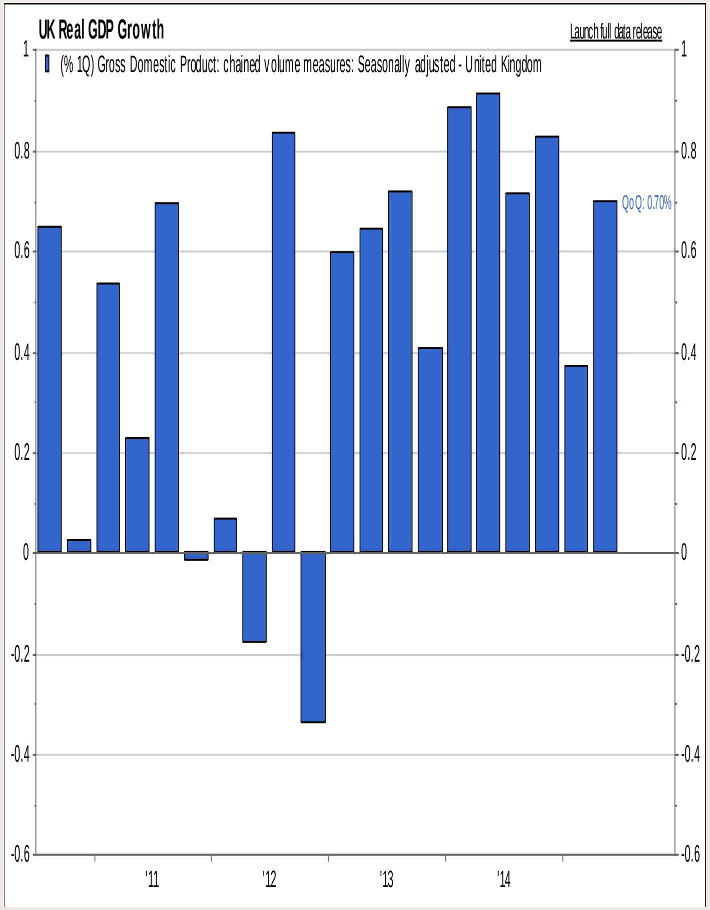
Economy

- UK data was mixed but slightly disappointing overall
- Q2 GDP rose 0.7% q/q and 2.6% y/y. Excluding the volatile oil and gas sectors, it grew 0.5% q/q. Services grew 0.7% q/q
- The composite PMI rose 1.6 to 57.4; manufacturing fell -0.6 to 51.4, services rose 2.0 to 58.5; construction rose 2.2 to 58.1
- Core retail sales ex autos and fuel fell -0.2% m/m but rose 4.2% y/y; consumer confidence fell -3 to 4
- Unemployment rose 0.1% to 5.6%; numbers employed fell -67,000 over three months from 114,000 previously; average weekly earnings ex bonuses rose 2.8% annualised over 3 months from 2.7% previously
- Industrial production rose 0.4% m/m and 2.1% y/y; construction output fell -1.3% m/m but rose 1.3% y/y
- The Halifax house price index rose 1.7% m/m and 9.6% annualised over 3 months
- CPI was flat at 0.0% both m/m and y/y

Interest Rates

- The BoE unanimously agreed to leave policy unchanged
- Global risks and uncertainties, particularly in Greece, were cited as making the decision more clear cut
- A number of members described the rate decision as finely balanced, up from two who had previously done so
- The minutes highlighted increasing divergence in views regarding the risks of increasing inflation and thus the possible need to raise rates relatively quickly
- Expectations for the first UK interest rate rise were pulled forward to early 2016 when BoE Governor Mark Carney commented the decision on when to raise rates is likely to come into sharper focus around the turn of the year
- Another committee member, David Miles, previously considered a ‘dove’ also indicated the case for raising rates was stronger than at any stage over the last 6 years and that a more rapid pace of increases than previously suggested by the BoE might also be necessary

U.K. Headline Q2 GDP Improves



ASIAN ECONOMY REVIEW

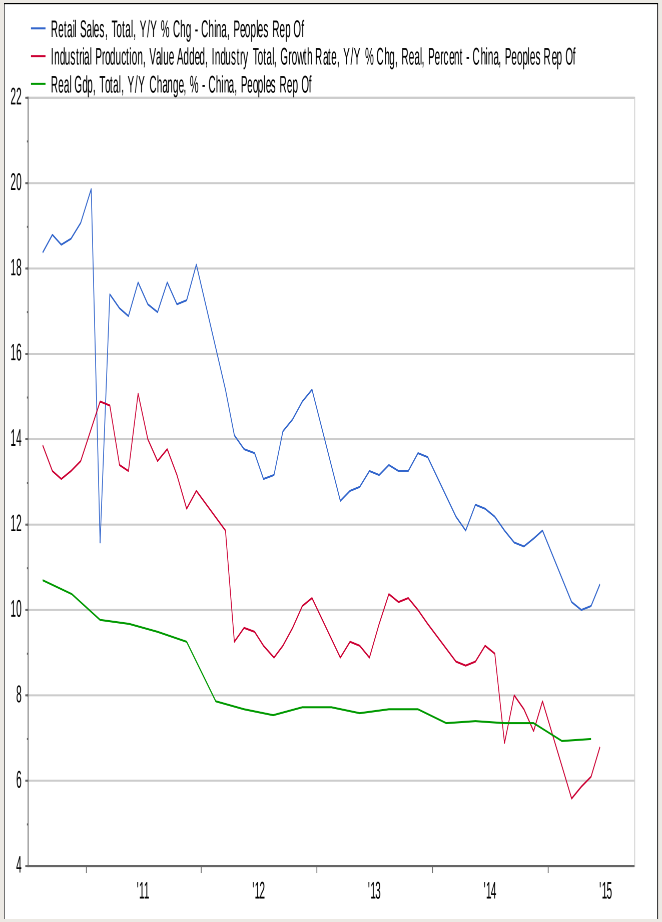
Japanese Economy

- Economic releases were mixed but point towards a contraction in Q2 GDP
- Industrial production rose 0.8% m/m; machine orders rose 0.6% m/m; retail sales fell -0.8% m/m; consumer confidence rose 0.3 to 41.7; exports rose 9.5% y/y and imports fell -2.9% y/y; the composite PMI fell -0.1 to 51.5; the Economy Watchers survey current reading fell -2.3 to 51.0 while the outlook reading fell -1.0 to 53.5; the Tankan business survey generally improved with large manufacturer's sentiment reading rising 3 to 15 while services rose 4 to 23; bank lending growth was unchanged at 2.6% y/y; the tertiary index fell -0.7% m/m; headline CPI rose 0.4% y/y; core CPI ex fresh food and energy rose 0.8% y/y from 0.7% y/y previously
- The Bank of Japan (BoJ) left policy unchanged. Despite lowering its fiscal year 2015 GDP forecast to 1.7%, the BoJ remains confident the economy will continue to recover and inflation will increase due to the pick-up in employment and wages. Investor expectations for additional monetary easing were reduced as the BoJ changed the definition of core inflation and actual inflation surprised to the upside

Chinese Economy

- Chinese data continued to show some signs of stabilization despite a deterioration in some PMI's
- Q2 GDP rose 1.7% q/q from 1.3% in Q1 and rose 7.0% y/y
- Exports rose 2.8% y/y; imports fell -6.1 y/y
- Retail sales growth improved to 10.6% y/y from 10.1%; industrial production growth improved to 6.8% y/y from 6.1%; fixed asset investment growth was unchanged at 11.4% y/y; Industrial profits fell -0.3% y/y from 0.6% previously
- Monthly new lending figures were ahead of expectations and rose Rmb 378.3bn to Rmb 1279.1bn
- The Caixin (formerly HSBC) manufacturing PMI fell -1.2 to 48.2; services fell -1.7 to 51.8; Official manufacturing PMI was unchanged at 50.2; services rose 0.6 to 53.8

Further Stabilisation in Chinese Economic Data



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