Irish Life Investment Managers

Monthly Mindshare
December 2014

David Haslam

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

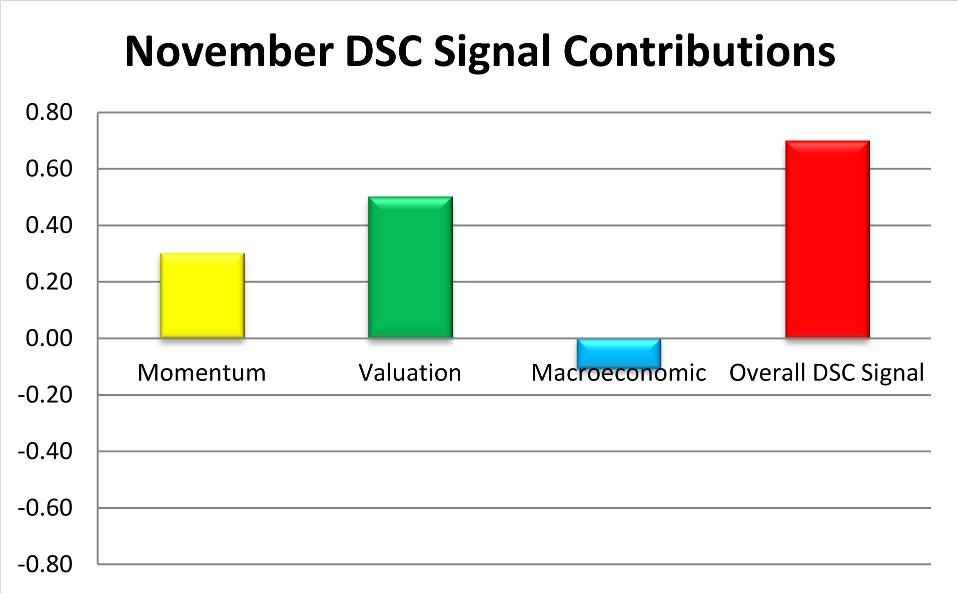
This month we examine…

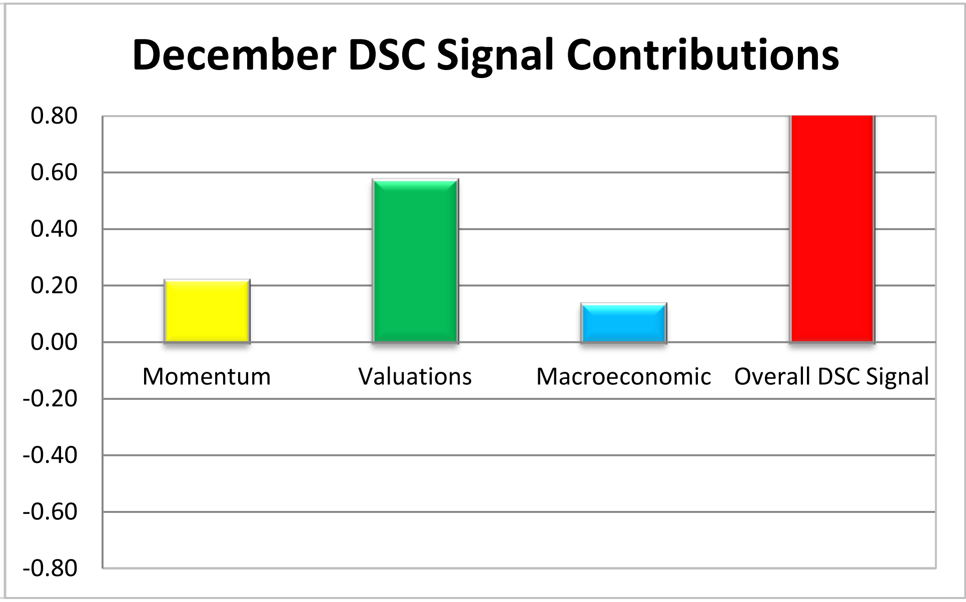
- Which factors were driving the DSC process in December and how the DSC signal was impacted as a result
- What has been going on in the major economies around the globe through December

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 Jan 2015

- The ***DSC*** signal rose in December and remains in overall positive territory at the end of December. It finished the month and the year at +0.93 up from +0.70. 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 weakened slightly as pricing in stock markets eased as successive highs were reached over the course of 2014.
- The **Valuation** category strengthened again as valuations improved and is still the largest overall contributor to the signal.
- The **Macroeconomic** category saw the biggest change and is now contributing positively to the signal as oil prices continue to weaken, bond yields fall and financing rates are lower.

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 occasional soft patches. The improving backdrop is positive for the companies profit outlook. Global central banks remain supportive, committing to keep interest rates low for some time yet, facilitated by low levels of inflation. While market supports 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 in terms of sovereign bond purchase programme probably cap upside in core yields and support further reduction in peripheral country bond yields in the short term. As has occurred in other markets, the ultimate commencement of sovereign bond purchases is likely to cause yields to move higher at some point during 2015 probably resulting in flat returns from the Eurozone > 5 year benchmark 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 November

- The ECB have formally announced a sovereign bond purchase programme as President Draghi said the ECB would be acting illegally if it failed to pursue its price stability mandate and said it would do what was required to raise inflation expectations as soon as possible. It was indicated any decisions in this regard could be taken by majority and did not require unanimity to implement.
- The potential Greek general election weighs on market sentiment with anti EU and Troika programme parties winning the election and potentially pulling Greece out of the Euro and defaulting on debts led equity markets and core bond yields lower
- Russia faced an economic crisis as an increase in interest rates to 17% failed to stabilise the currency and gave rise to fears of possible default on foreign exchange denominated corporate borrowings. Combined with continued weakness in oil prices and ongoing economic sanctions, concerns grew over a possible severe recession in Russia and potential contagion elsewhere
- Brent oil fell another -18.3% following the decision by OPEC not to cut production in an apparent effort to squeeze shale oil producers in the US by allowing prices to fall to levels where production is unprofitable for these operators
- The Fed slightly lowered its forecasts for inflation and the pace of interest rate tightening for coming years. The Fed suggested this did not represent any change to its previous guidance that rates would not be raised for a considerable period
- Equities began to recover in the second half of the month as 'firewalls' and protections now in place in the Eurozone were viewed as potentially limiting any contagion from a worst case scenario of a Greek default and exit from the Euro
- Global equities fell -0.9% (+1.2% in €) but were higher than their mid month lows. Eurozone >5 year bonds rose 1.7% with German 10 year yields falling to new all time lows of 0.53% and peripheral spreads continued to narrow as speculation mounted over an ECB sovereign bond purchase programme as inflation remained at 0.3% y/y with the potential to fall further in coming months due to lower oil prices. The Euro also weakened further to 1.210 against the US$ due to speculation over additional ECB stimulus. Commodities fell -13.3%, led lower by the fall in oil prices

Market Signposts

Markets In December

	Local Returns	Euro Return
Ireland	3.0	3.0
UK	-2.2	0.3
US	-0.3	2.7
North America	-0.3	2.6
Europe	-2.0	-2.3
Japan	-0.2	1.8
Pacific	-1.0	0.2
Emerging Markets	-2.4	-1.7
World	-0.9	1.2
EMU Govt Bonds >5yr	1.7	1.7
Commodities	-13.3	-10.6

Markets YTD

	Local Returns	Euro Return
Ireland	16.8	16.8
UK	0.6	7.8
US	13.3	29.0
North America	13.2	28.2
Europe	7.6	7.4
Japan	10.3	10.1
Pacific	4.2	12.6
Emerging Markets	5.6	11.8
World	9.9	19.3
EMU Govt Bonds >5yr	20.6	20.6
Commodities	-33.1	-23.8

Equity Markets Were Volatile Again

Euro Continues to Weaken on Expectations of ECB Policies

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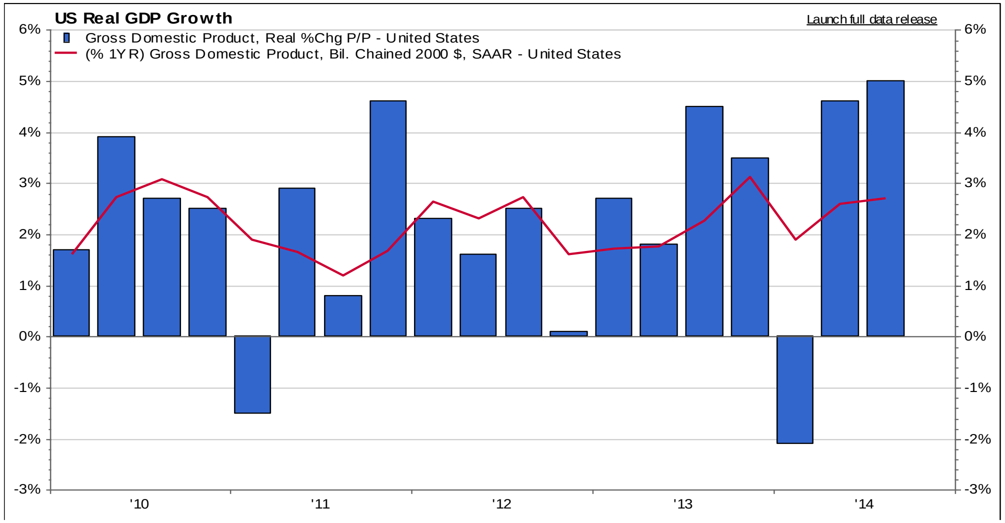
US Economy Review

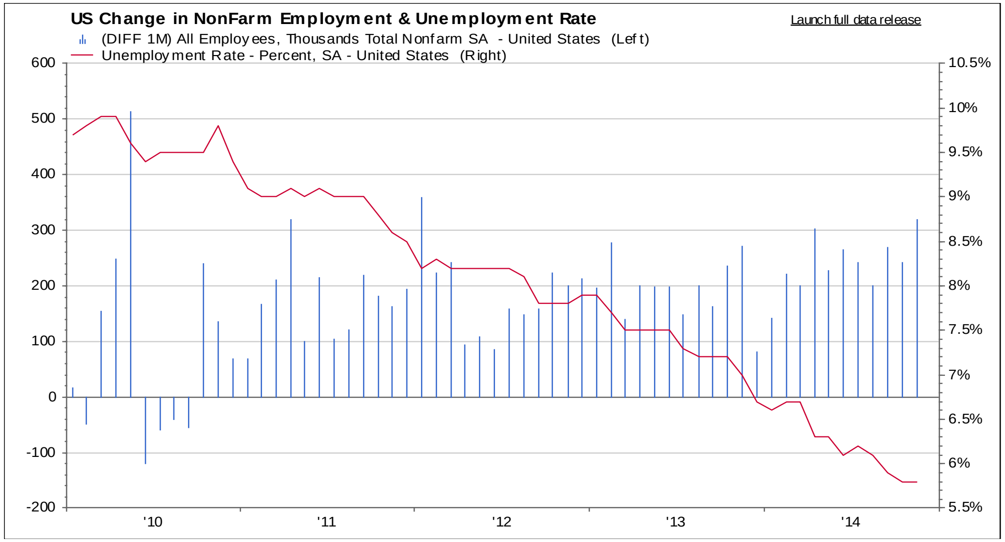
- **Economy**
  - Data was generally positive. Q3 GDP was revised up to 5.0% annualised
  - Non farm payrolls rose 321k; unemployment was unchanged at 5.8%; core retail sales rose 0.6% m/m; consumer confidence rose 3.9 to 92.6
  - Industrial production rose 1.3% m/m;
  - House prices in the top 20 cities rose 0.8% m/m
  - CPI fell to 1.3% y/y from 1.7% previously

- **Interest Rates**
  - The Fed altered interest rate guidance by saying it would be patient before raising rates with any decision being data dependent. The Fed said this was consistent with previous guidance that rates would not be raised for a considerable period
  - The Fed's forecasts for inflation and the pace of rate rises in coming years were revised down slightly, It forecast the Fed Funds rate at 1.125% at the end of 2015, 2.5% at the end of 2016 and 3.625% by the end of 2017 compared to the current target of 0/0.25%

US Q3 GDP Revised Significantly Higher



US Labour Market Remains Strong



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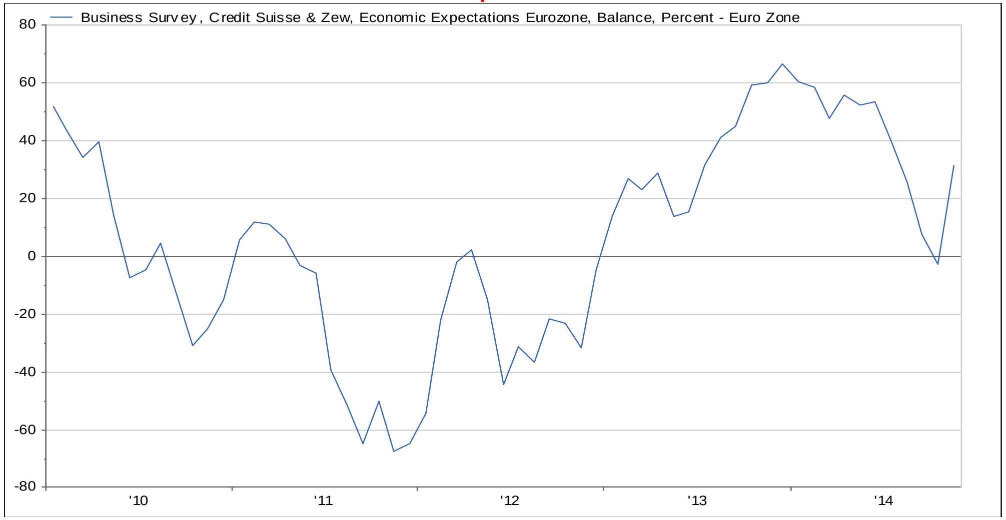
Eurozone Economy Review

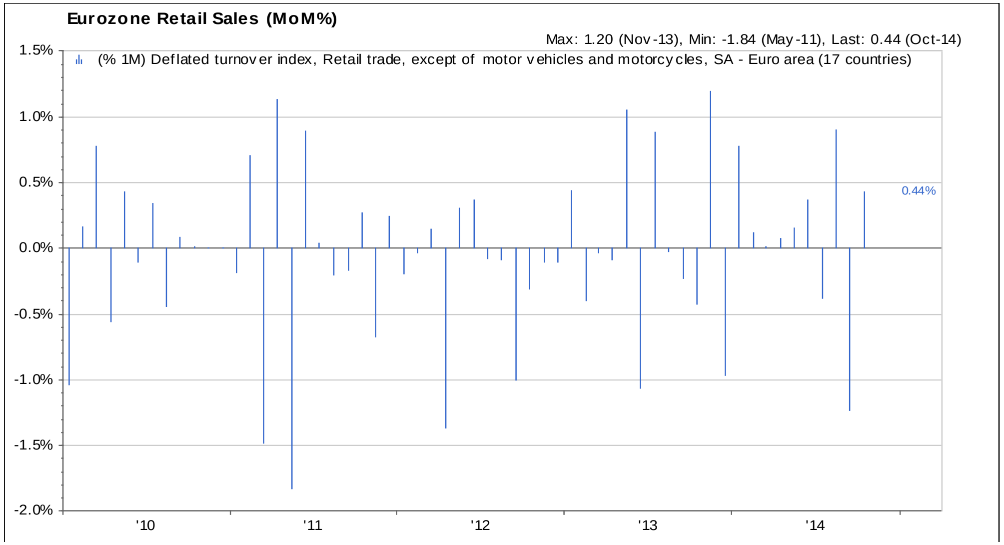
- **Economy**
  - Data was generally better although the growth outlook remains modest.
  - Industrial production rose 0.1% m/m; construction output rose 1.3% m/m; retail sales rose 0.4% m/m; consumer confidence rose 0.7 to -10.9; employment grew 0.2% q/q and 0.6% y/y; inflation was unchanged at 0.3% y/y
  - German data was better. The composite PMI fell -0.3 to 51.4 although manufacturing rose above 50 to 51.2.
  - The French composite PMI rose 1.2 to 49.1; consumer spending rose 0.4% m/m; industrial production fell -0.8% m/m
  - Spanish composite PMI fell -1.7 to 53.8; industrial production rose 1.2% y/y; retail sales rose 1.9% y/y;

- **Interest Rates**
  - The ECB committed to announcing additional stimulus
  - President Draghi said the ECB would be acting illegally if it did not pursue its price stability mandate
  - The ECB indicated it will not tolerate significant deviations from its 2% inflation target .
  - Any policy decision could be taken by majority and did not require unanimity, thus avoiding inaction due to disagreements
  - Lowered inflation forecasts of 0.7% in 2015 and 1.3% in 2016 were recognised as being out of date given weaker oil prices

Eurozone ZEW Expectations Rise



Eurozone Retail Sales Improve



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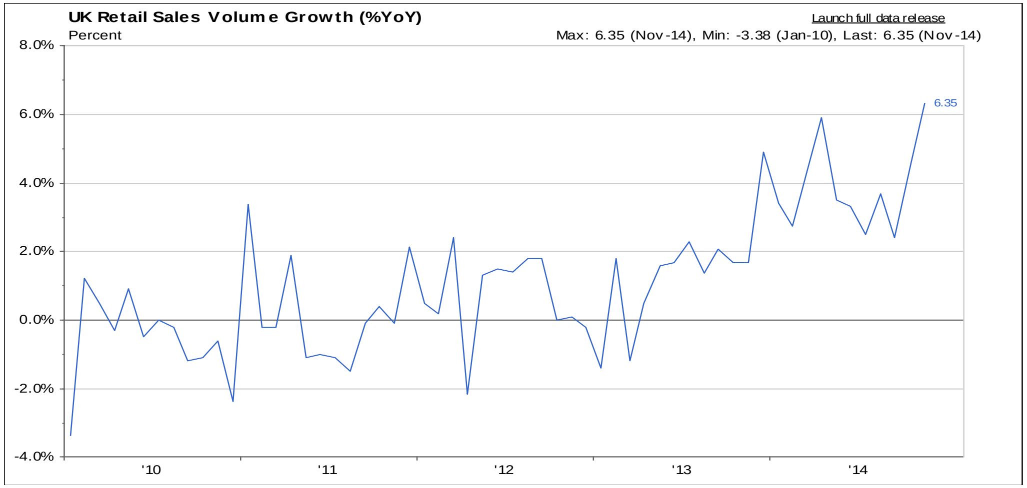
UK Economy Review

- **Economy**
  - Economic data was mixed with most releases in line with expectations although historic GDP data was revised down
  - Q3 GDP was confirmed at 0.7% q/q
  - Retail sales rose 1.6% m/m and 6.4% y/y; consumer confidence fell -2 to -4
  - Unemployment was unchanged at 6.0%
  - Industrial production fell -0.1% m/m
  - The Halifax house price index rose 0.4% m/m and 8.2% annualised over 3 months from 8.8% previously
  - CPI rose 1.0% y/y from 1.3% previously

- **Interest Rates**
  - The BoE left policy unchanged, again in a split vote of 7:2
  - The all in oil prices was the most significant recent development and was viewed as a positive for growth given the boost to spending power
  - Combined with lower long term real interest rates this was seen by some as potentially adding to inflationary pressure in the medium term
  - There is still a lot of debate and disagreement among members relating to the level of slack in the UK economy and the risks of higher inflation

UK Retail Sales Remain Strong



UK Average Earnings Rise

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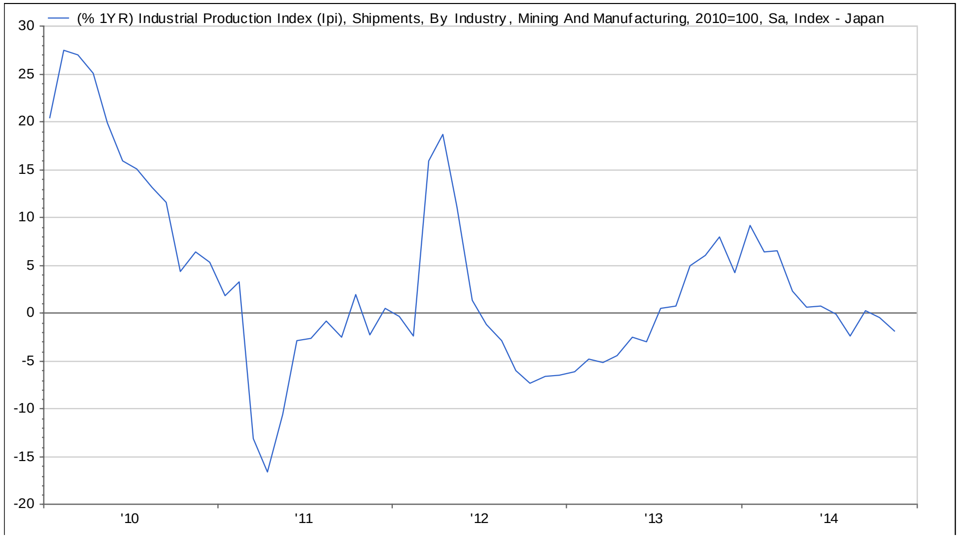
Asian Economy Review

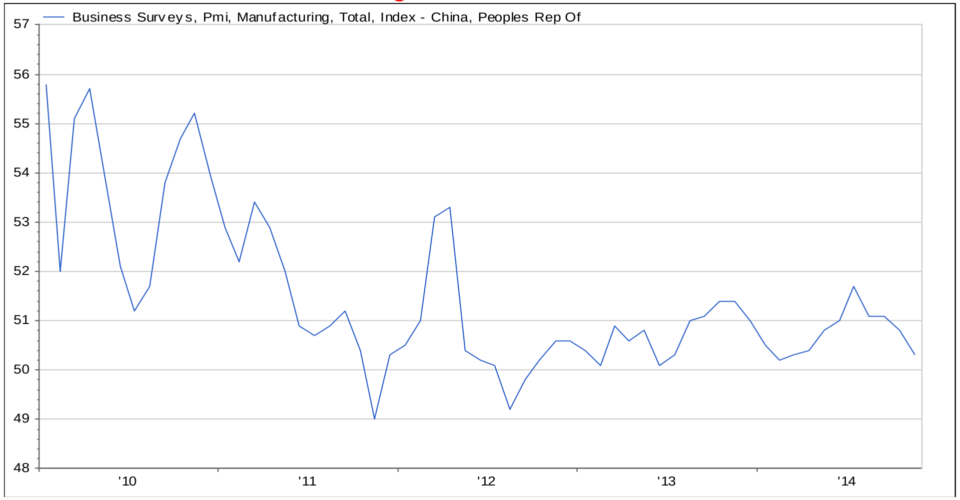
- **Japanese Economy**
  - Releases were disappointing
  - Q3 GDP was revised down to -0.5% q/q
  - Industrial production fell -0.6% m/m and -3.8% y/y; retail sales fell -0.3% m/m but rose 0.4% y/y; consumer confidence fell -1.2 to 37.7; exports rose 4.9% y/y from 9.6% previously while imports fell -1.7% y/y;
  - The Bank of Japan (BoJ) left policy unchanged in an 8:1 vote. The economy was described as recovering moderately with some weakness remaining, particularly in production. It was believed a positive cycle from income to spending is underway in the household and corporate sectors with employment and wages rising. These are expected to contribute to a general economic recovery in coming quarters with recent weakness expected to dissipate gradually

- **Chinese Economy**
  - Chinese data disappointed
  - The HSBC composite PMI index fell -0.6 to 51.1;
  - Official manufacturing PMI fell -0.5 to 50.3; services rose 0.1 to 53.9
  - Industrial production growth slowed to 7.2% y/y from 7.7%;
  - Exports rose 4.7% y/y from 11.6% previously; imports, a leading indicator of domestic demand and production, fell -6.7% y/y from +4.6% previously

Japanese Industrial Production Deteriorates



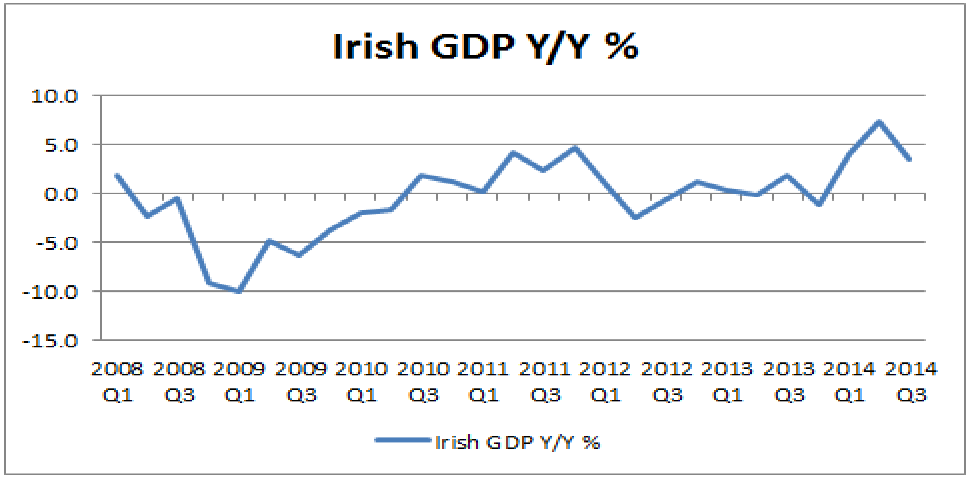
Chinese Manufacturing PMI Continues to Slide



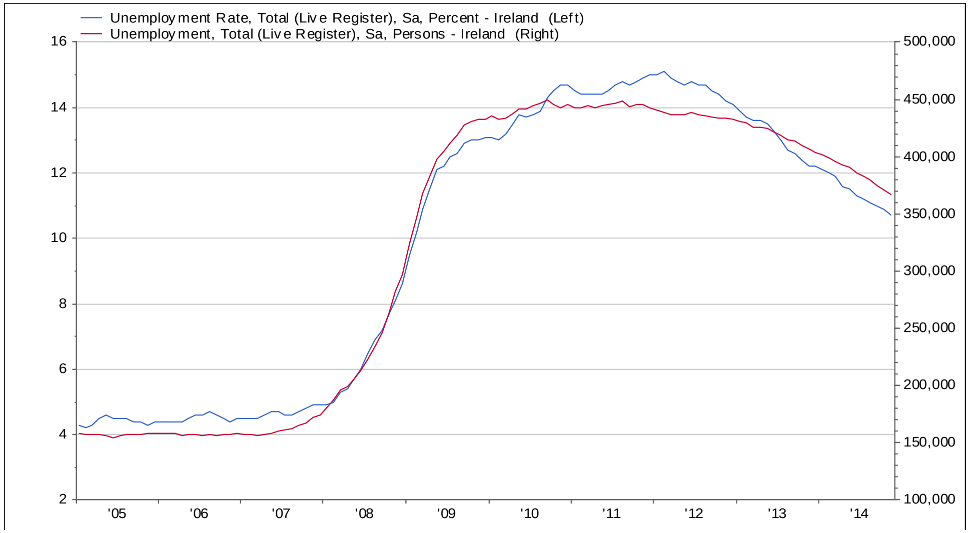
Ireland Economy Review

- **Economy**
  - Economic releases were more mixed but were generally positive
  - Q3 GDP was slightly disappointing, up only 0.1% q/q and 3.5% y/y compared to the downwardly revised 7.3% y/y in Q2. Domestic demand grew 1.1% y/y and 2.3% y/y
  - Numbers on the Live Register fell 4,300 to 367,100; unemployment fell to 10.7%, the lowest since February 2012
  - Industrial production remained volatile, rising 8.9% m/m and 38.2% y/y
  - Manufacturing PMI fell -0.4 to 56.2; services rose 0.1 to 61.6
  - National residential property prices rose 0.5% m/m and 16.0% y/y. House prices in Dublin fell -0.1% m/m, the first fall since February, but were up 22.4% y/y. Residential prices outside Dublin rose 1.2% m/m and 9.6% y/y
  - November Exchequer returns remained positive with tax revenues 0.6% ahead of budget for the month resulting in the annual deficit being €1.7bn ahead of target ytd. Revenues were 4% ahead of budget for the year with expenditures approx 0.5% over budget, mainly due to overspending in health and small overspends elsewhere

Irish GDP Remains Strong but Slightly Below Expectations



Irish Labour Market Continues to Improve



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Irish Life Investment Managers
Beresford Court
Beresford Place
Dublin 1

Tel 353 (0)1 7041200
Fax 353 (0)1 7041918