



Investment Market Commentary [Nov 2011]

US – Corporate M&A and a late rally fail to push US stocks into the black

Review:

- U.S. equity markets rallied sharply in October due to recent economic releases suggesting the country is not headed towards a recession as well as European policymakers taking a bolder step to stave off a potential sovereign debt crisis.

Outlook:

- In the U.S., economic releases have been better than expected, GDP forecasts have been revised slightly upward and there are even hopes that the Super Committee may actually come up with an agreement to cut at least USD1.5 trillion from the deficit. However, a failure to reach that goal could cause investors to worry about further U.S. downgrades.
- We continue to believe there is potential upside for the U.S. equity markets. However, we also expect volatility to persist. While the intensity of macro concerns may have receded they do remain elevated.

Europe

Review:

- In October, the MSCI Europe returned 7.8% in euro terms as sentiment was lifted ahead of the European Union summit on hopes that a new deal to contain the Eurozone debt crisis would be announced. The summit produced a credible package but it was not as substantial as markets had hoped.

Outlook:

- In early November, political chaos in Greece raised doubts over the ability of European leaders to provide a viable solution to the Eurozone debt crisis. With much of the Eurozone either in or heading for recession, the European Central Bank cut interest rates by a quarter point to 1.25%.
- Many investors hope more cuts will follow as without economic growth the debt crisis is only likely to worsen, no matter how much austerity governments implement

Asia

Review:

- Asian markets recovered some of their recent losses from September, reflecting renewed optimism on a resolution to the Eurozone debt crisis, and decent corporate results out of Asia and the U.S. Defensive stocks funded the October rally, Asian currencies appreciated, and liquidity flew back to equities. In Australia, currency rallied despite the expectation of interest rate cut. In Hong Kong and China, the materials and industrial sectors were boosted by the Chinese government hinting that monetary policy may be eased in some areas. In Korea, foreigners returned as net buyers, but Taiwan lagged, as did the ASEAN region as a whole. Indonesia had a surprise rate cut as inflation numbers came in more benign than expected. In contrast, India hiked rates but signaled inflation should moderate from December, implying a possible pause in their tightening regime going forward.



Thailand held up despite the heavy flooding during the month. Japan underperformed as a strong yen hurt exporters, leading the BOJ to intervene in the currency market in an attempt to weaken the yen towards month end.

Outlook:

- Short selling turnover was about 5-6% of total market turnover on the Hong Kong Stock Exchange in 2010 and Q1 of this year. However, this short selling turnover ratio jumped to 9.2% in August, 10.2% in September and stayed high at 9.2% in October. Despite the strong market rally in October, short-sellers have not gone away and any short-covering in the future should provide more upside for the Hong Kong and China markets.
- China inflation has peaked and pork prices have already fallen by 15%. There are already some expectations in market that Chinese government will fine-tune its monetary policy to become more accommodative and to allow some increase of bank loan quota.

China

Review:

- Chinese equities rose sharply due to a combination of easing worries over an uncontrollable European sovereign crisis and some hints of a peaking in government tightening in China. The MSCI China index rebounded strongly after the sharp sell-off in September as the moderately less hawkish tone from various government officials led to short-covering across Hong Kong-listed stocks and a rebound in mainland Chinese markets. The National Development and Reform Commission expects inflation pressure to ease further and reiterated that the country's consumer prices have stabilized. The MSCI China index has just rebounded off its historical trough price-to-book level and will likely remain volatile with the mixed news flow

Outlook:

- While markets may continue to gyrate as a result of news coming out of Europe, we believe the point of maximum stress may have passed. Given the skepticism about Chinese corporates and worries about a policy-driven hard landing in the economy (starting with real estate), valuations are attractive across MSCI China companies.
- Overall, CPI pressure should ease off and we expect the government to continue the "fine-tuning" policies (or selective/targeted easing), which should reduce China's hard landing risks.

Japan

Review:

- The TOPIX index rose slightly in October, finishing the month at 764. In USD terms the market underperformed the S&P 500 and MSCI AC Asia excluding Japan.
- In general, the market mean reverted from defensives towards cyclicals with the best performing sectors being mining, electrical appliances, and non-bank finance, while precision instruments, pulp and paper, metal products performed the worst.

Outlook:



- The market is undervalued trading on a 12 to 13 times price-to-earnings ratio based on 2012 earnings forecasts and below one times price-to-book.

Emerging Market

Review:

Review:

- Risk assets rallied in October, as global macro concerns receded temporarily. European policy-makers began to engineer a plan to refinance peripheral debt and recapitalize the banks. U.S. economic data surprised on the upside and China reported data consistent with a soft landing.
- Emerging market equities rebounded sharply in October, gaining 13.3% (in USD terms), marking the best monthly performance since May 2009

Outlook:

- Although markets remain news driven, aggressive easing by central banks across emerging markets would make us progressively more optimistic. Valuations are cheap, consistent fund outflows have begun to moderate and softer commodity prices will alleviate inflationary pressures justifying monetary easing. Our long-term assessment of corporate profitability is positive.
- Using leverage as a prop to offset lower margins or falling productivity from poor investment decisions is neither needed, nor widespread. However, we do expect earnings expectations to fall further as revenue growth is marked down due to cyclical factors. This may act as a short-term headwind to equity market performance.

Global Resources

Review:

- October witnessed a rebound in commodity prices and commodity-related equities. In China, PMI data surprised to the upside, lending credence to the 'soft landing' thesis. Base metal prices increased markedly from recent lows on improving sentiment regarding the Chinese economy. October was a very strong month in absolute terms and relative to the comparator

Outlook:

- Despite a sharp rebound in resource equities in October, there remains a lot of value in the sector

Bonds

Review:

- Global government bond markets ended the month weaker as investors were encouraged by the outcome of the EU summit. An agreement in principle was reached to write down the level of Greek sovereign debt held by the private sector. Eurozone leaders also agreed to expand the European Financial Stability Fund to €1 trillion and to recapitalize banks which have exposure to countries at risk of default.

Outlook:



- Investors have been defensively positioned in recent months against a backdrop of generalized risk aversion relating to problems in the Eurozone. As risks from this region begin to dissipate, we expect major government bond markets to reverse their recent strength as investors sell safe haven assets. Despite these developments, we remain cautious on peripheral European markets given their low levels of growth, high levels of debt and lack of competitiveness. Details of the Euro plan have yet to be clarified, and whilst the policy response from European leaders has so far been supportive for riskier markets, we expect further volatility as details emerge.



Risk/Return Profile of Zurich Funds:

Secure (♠): Low Risk / Return Potential

- Zurich US Dollar Money Fund

Stable (♠♠): Moderate Risk / Return Potential

- Zurich International Bond Fund
- Zurich US Dollar Bond Fund

Growth (♠♠♠): High Risk / Return Potential

- Zurich American Growth Fund
- Zurich Emerging Market Bond Fund
- Zurich Global Allocation Fund
- Zurich High Yield Bond Fund
- Zurich European Bond Fund
- Zurich European Growth Fund
- Zurich Global Equity Fund
- Zurich Strategic Bond Fund

Aggressive (♠♠♠♠): Very High Risk / Return Potential

- Zurich ASEAN Frontiers Fund
- Zurich Asian Equity Plus Fund
- Zurich China Growth Fund
- Zurich Eastern Europe Fund
- Zurich Global Resources Diversified Fund
- Zurich Gold Fund
- Zurich Hong Kong China Fund
- Zurich Japan Growth Fund
- Zurich Latin America Growth Fund
- Zurich Taiwanese Equity Fund
- Zurich Asia Growth Fund
- Zurich BRIC Fund
- Zurich China Opportunities Fund
- Zurich Global Emerging Market Opportunities Fund
- Zurich Global Resources Fund
- Zurich Healthscience Fund
- Zurich Indian Equity Fund
- Zurich Korea Fund
- Zurich Middle East Fund
- Zurich UK Growth Fund

(♠♠♠♠) stands for the highest risk/return profile. This profile is based on the subjective comparison by Zurich Life Insurance Company Limited among the above unitised funds.