Irish Life

Market Review - December 2016

Asset Watch

- **Equities**
  - The global economy is experiencing moderate growth with this being lower than is typically seen in a cyclical recovery. In 2017, global GDP growth seems set to be at the higher end of the 2.5/3.0% range of recent years. Hopes for an uplift to growth from increased fiscal stimulus have grown in recent months, particularly after the election of Donald Trump as US President. In this environment earnings growth of high single digits seems likely. Relative valuations remain supportive of global equities, particularly against cash and bonds, providing support to equity markets. Uncertainties relating to political elections in Europe, Brexit negotiations between the UK and EU, ultimate policy announcements under the new Trump administration in the US, potentially higher global bond yields and reduced monetary accommodation all represent potential risks to equities. In 2017, with global growth remaining positive and improving, possibly boosted by increased fiscal stimulus, positive earnings growth should be generated, enabling equities to generate gains of mid single digits during the year although increased volatility is likely to remain a feature.
- **Bonds**
  - Absolute yields reached new all time lows in 2016 but have since risen as growth and inflation have picked up. With continued upward pressure on US yields with further reflation expected in 2017, aided by increased fiscal spending, global and European bond yields are also expected to be pulled higher during the year. However continued ECB bond buying, lack of fiscal stimulus across Europe and lack of sustained rise in Eurozone inflation given large output gaps in European economies should cap the rise in European bond yields with the Eurozone 5 year+ benchmark expected to provide a return of approx -2% in 2017.
- **Property**
  - The Irish property market has been strong with activity close to record levels. Foreign interest remains high, potentially boosted by Brexit related interest in Dublin. Rental growth is expected as supply remains restricted but is likely to be more evident in the retail sector than in the office space. Yields have already compressed significantly in the office space but there is scope for further yield compression in retail and industrial areas, Property remains supported by the relatively high gap between property yields and Irish bond yields with Irish property expected to produce mid single digit returns in 2017.
- **Cash**
  - Cash returns are expected to remain low through 2017.

Market Developments in December

- The equity market rally post the election of Donald Trump as US President continued through December while there was also a rebound in Eurozone sovereign bonds over the month. The Euro also continued to weaken against the US dollar while commodities rallied further on the back of additional gains in the oil price.

- Eurozone >5 year bonds rose 1.0% with German 10 year yields declining to 0.21% in a late year rally as the ECB committed to extending asset purchases to at least December 2017. Peripheral spreads against Germany narrowed as the Italian senate reform referendum passed without negative fallout and also on the back of the extended ECB asset purchase programme. Italian 10 year spreads fell to 161bps and Spanish spreads declined to 117bps.

- In the US, while the Fed raised interest rates by 0.25% as had been expected, it surprised investors by raising its forecast for the number of rate rises in 2017 from two to three with some Fed members citing increasing risks of fiscal stimulus for the change in rate expectations.

- In Europe, the ECB surprised investors by announcing that the size of asset purchases would be reduced from April onwards from €80bn per month to €60bn although purchases will be extended from the previous scheduled end date of March 2017 to at least December 2017. Other minor changes were also made to rules related to bond purchases which help address the scarcity issues being faced by the ECB within the purchase programme.

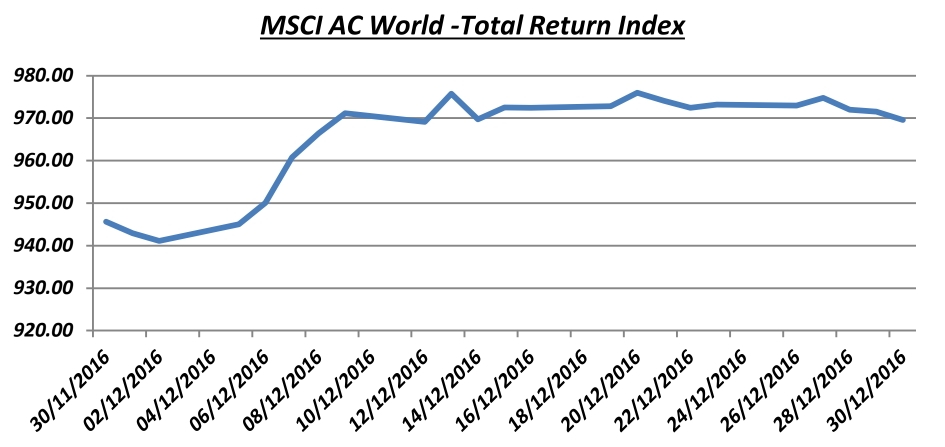
- The rejection of the Italian senate reform referendum failed to lead to any turmoil in either equity or peripheral bond markets with the quick appointment of a new Prime Minister and no calling of an early general election helping to calm markets.

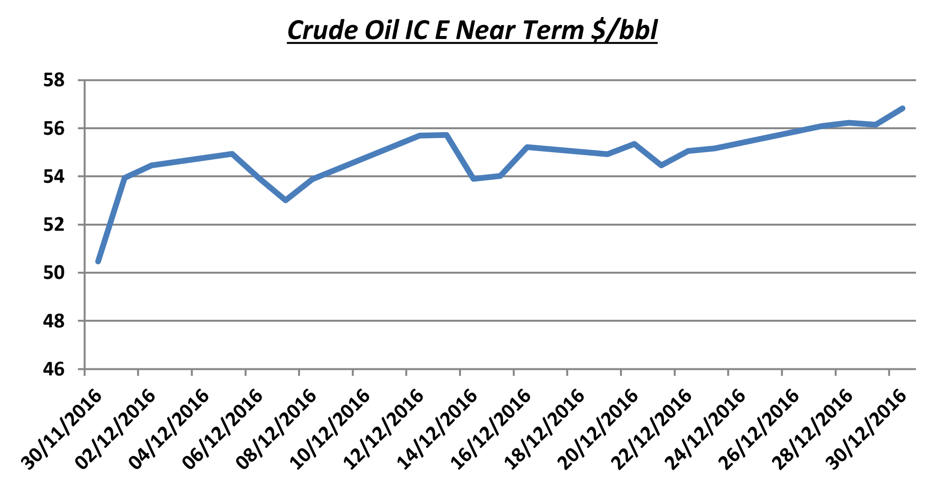
- Global equities rose 2.5% (2.8% in €)

- The Euro fell slightly to 1.052 against the US dollar on indications of a faster pace of US Fed rate rises in 2017 and the extension of asset purchases by the ECB for at least another nine months.

- Commodities rose 5.7% with Brent oil up 8.2% following indications by Saudi Arabia that it would cut oil production levels by more than it had previously indicated in November.

Market Signposts





Markets in December

	Local Returns	Euro Return
Ireland	4.8	4.8
UK	5.3	4.7
US	1.9	2.5
North America	1.8	2.4
Europe	6.0	6.3
Japan	3.4	1.6
Pacific	0.8	0.1
Emerging Markets	0.2	0.9
World	2.5	2.8
EMU Govt Bonds >5yr	1.0	1.0
Commodities	**5.6**	**6.2**

Markets YTD

	Local Returns	Euro Return
Ireland	-4.0	-4.0
UK	19.2	3.0
US	11.6	14.9
North America	12.1	15.7
Europe	3.2	3.3
Japan	-0.4	5.8
Pacific	8.5	11.2
Emerging Markets	10.1	14.9
World	9.7	11.7
EMU Govt Bonds >5yr	4.9	4.9
Commodities	**27.8**	**31.6**

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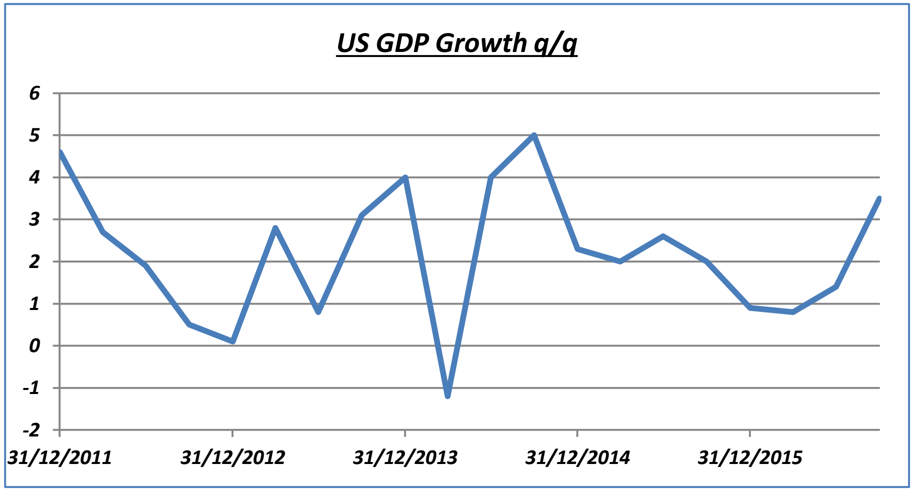
US Economy Review

Economy

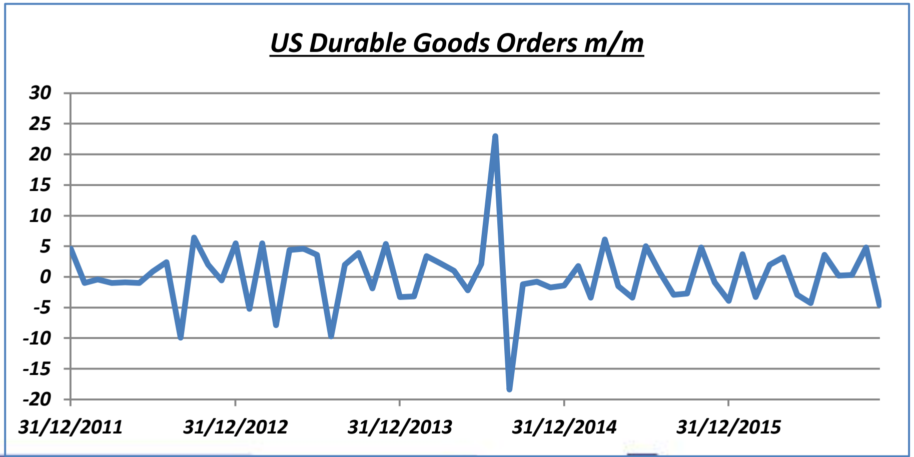
- US economic data was mostly positive this month, supported by the hope of increased public spending.
- Q3 GDP was revised upwards from 2.9% q/q, growing 3.5% q/q vs the previous quarter's growth of 1.4%.
- ISM Manufacturing increased by 1.3 to 53.2; Industrial production decreased by -0.4%; factory orders grew by 2.7% m/m;
- Non-farm payrolls slipped modestly to 178,000; unemployment fell -0.3% to 4.6%; average hourly earnings rose 2.5% y/y
- Headline retail sales grew 0.1% m/m; consumer confidence grew to 113.7 from 107.1 previously.
- CPI rose 1.7% y/y; core CPI ex food/energy rose 2.1% y/y
- Durable goods fell -4.6% m/m; orders ex transport grew 0.5% m/m; capital goods shipments grew 0.2% m/m
- House prices in the top 20 cities grew by 0.4% m/m; new home sales decreased by -1.9% m/m; existing home sales grew 5.2% m/m

Interest Rates

- The Federal Open Market Committee (FOMC) raised interest rates by 25bp as expected, but surprised by shifting the dots higher and forecasting a fed funds rate of 1.375% for 2017.
- This implies that the Fed now expects to raise rates three times in 2017, with the trajectory remaining the same for 2018 and 2019, leaving the median forecast for the fed funds rate 2.125% and 2.875%, respectively, for 2018 and 2019.
- Fed Chair Yellen stated that the Fed is currently operating "under a cloud of uncertainty at the moment", and this was obvious as the very marginal changes to the economic forecasts entails that most FOMC participants did not make significant changes to their fiscal policy assumptions when revising their outlooks while others did.



US Durable Goods Orders slip



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Eurozone Economy Review

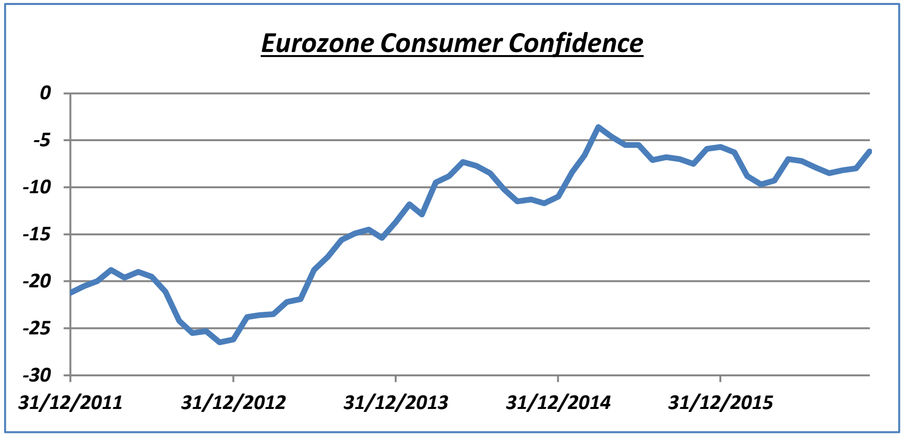
Economy

- European data has remained mixed but is still holding up better than expected.
- The Q3 GDP figure was confirmed at 0.3% q/q
- The composite PMI increased to 53.9; ZEW expectations rose 2.3 to 18.1; the business climate reading fell -0.14 to 0.42; economic confidence moved up 0.1 to 106.5
- Industrial production fell -0.1% m/m; construction grew 0.8% m/m; retail sales grew 1.1% m/m; consumer confidence rose 1.8 to -6.2; M3 money supply growth grew by 0.2% to 4.6% y/y
- CPI rose 0.6% y/y; core inflation ex food and energy rose 0.8% y/y
- In Germany the composite PMI rose to 0.1 to 55.0; The IFO business climate grew during the month, moving 0.6 to 111.0; retail sales grew 2.5% m/m; consumer confidence rose 0.1 to 9.9; Industrial production fell 0.3% m/m; factory orders grew by 4.9% m/m
- French composite PMI fell 0.9 to 51.4; business confidence increased by 3 to 105; consumer confidence was flat at 98; industrial production fell -0.2% m/m; consumer spending increased by 0.4% m/m
- In Spain industrial production grew 0.1% m/m; Retail sales increased to 3.3% y/y
- In Italy industrial production was flat at 0.0% m/m; retail sales grew 1.2% m/m

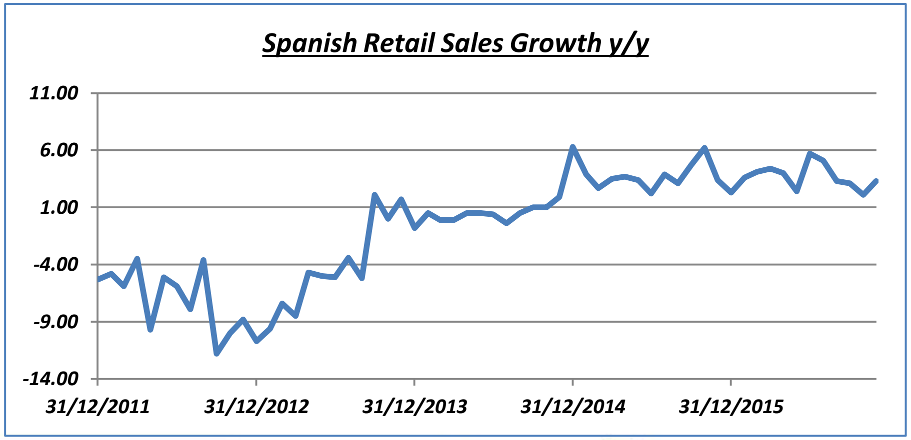
Interest Rates

- Most market participants expected a continuation of the ECB's asset purchase programme until at least September 2017, but like their US counterparts they elected to throw somewhat of a curve-ball by announcing an extension of the programme until December 2017 while simultaneously announcing a decrease in the monthly pace of asset purchases to €60bn a month beginning in April.
- Two other main changes were presented that will ensure that the purchases continue until at least the end of 2017, the first to the minimum maturity for eligible purchases and the second to the purchases of assets yielding below the deposit rate.

Eurozone Consumer Confidence continues on path of recovery



Spanish Retail Sales Rebound



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UK Economy Review

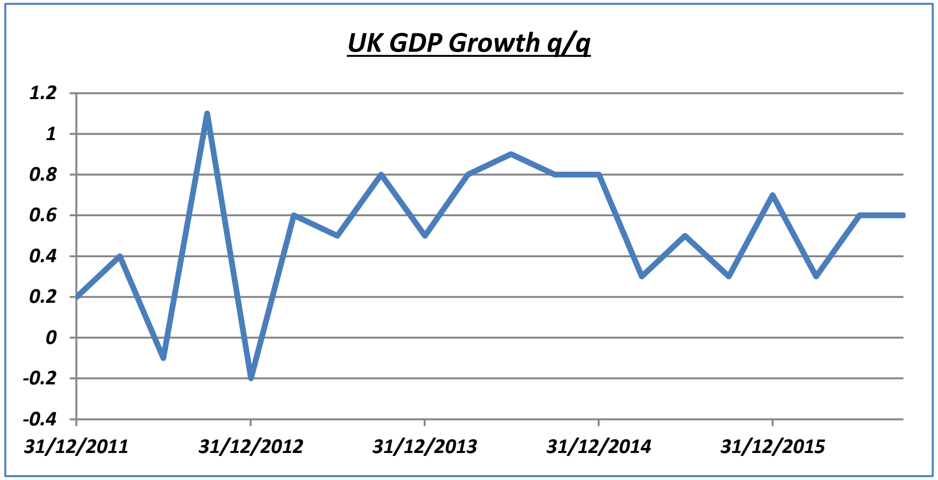
Economy

- UK showing continued resilience, but data has become softer
- Q3 GDP was shown at 0.6% q/q and to 2.2% y/y with household consumption up 0.7% q/q and business investment down -2.2% y/y.
- CBI survey trend selling prices were up 7 to 26 while CBI reported retail sales rose 9 to 35.
- Headline retail sales grew 0.2% m/m with a 5.9% growth y/y; consumer confidence rose 1 to -7
- Unemployment fell to 4.8%; numbers employed fell -6,000 over three months from 49,000 previously; average weekly earnings ex bonuses grew to 2.5% y/y; the claimant count rate also remained at 2.3%
- Industrial production fell -1.3% m/m and was down -1.1% y/y
- The Halifax house price index grew 0.2% m/m and was up 6.0% y/y; mortgage approvals grew once again, going from 63,600 to 67,500
- CPI grew 0.2% m/m and was up at 1.2% annualised over the last quarter. Core CPI ex food and energy was up 1.4% y/y.

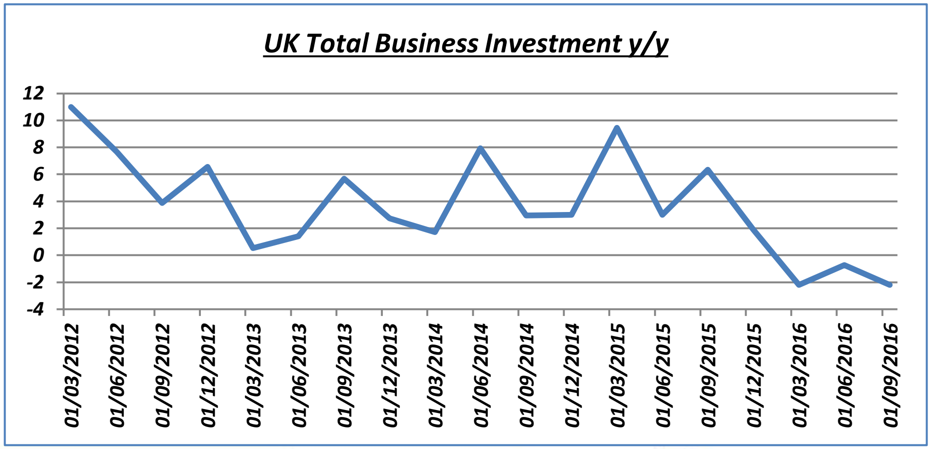
Interest Rates

- December's MPC meeting brought a unanimous vote in favour of unaltered policy settings, leaving the bank rate at 0.25% and the QE Gilt asset purchase target at £435bn.
- The December MPC Minutes acknowledged that there had been little news since the November policy meeting, but did state that their take on macroeconomic conditions remains cautious as "a slowdown in growth remained likely"
- Perhaps the most striking difference is that the 6% rebound in the currency has meant that policymakers are not fretting so much about the sterling going into a tailspin as the pound's appreciation implies "somewhat less of a boost to CPI inflation from imported costs than had been factored into the November projections".

UK Q3 GDP Growth remains positive



UK Business Investment at 5-year low



Asian Economy Review

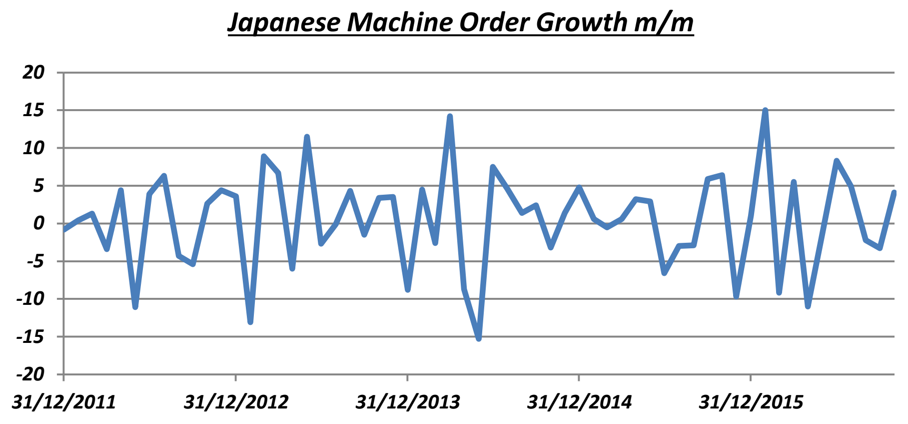
Japanese Economy

- Japanese data continued to be mixed throughout December. Q3 GDP was confirmed at a 0.3% q/q increase. Industrial production was flat at 0.0% m/m; machine orders rose by 4.1% m/m; retail sales grew by 0.2% m/m and were up 1.7% y/y; consumer confidence fell -1.4 to 40.9; the composite PMI increased 0.7 to 52.0; manufacturing PMI grew 0.3 to 52.0; the Economy Watchers survey current reading increased by 2.4 to 48.6; the outlook reading grew 0.1 to 49.1; bank lending growth increased remained at 2.4% y/y; the tertiary index was up 0.2% m/m; CPI grew 0.5% y/y; core CPI ex food and energy rose 0.1% y/y.
- The Bank of Japan (BoJ) maintained its current quantitative and qualitative easing programme with yield curve control at its monetary policy meeting in December, continuing to apply a negative interest rate of -0.1% on part of the current account deposits held at the bank and maintain its long-term JGP yield target at "around 0.0%". With economic data in the third and fourth quarters showing that the economy is returning to a path of recovery, the bank upgraded its economic assessment for the first time, stating that "Japan's economy is likely to turn to a moderate expansion".

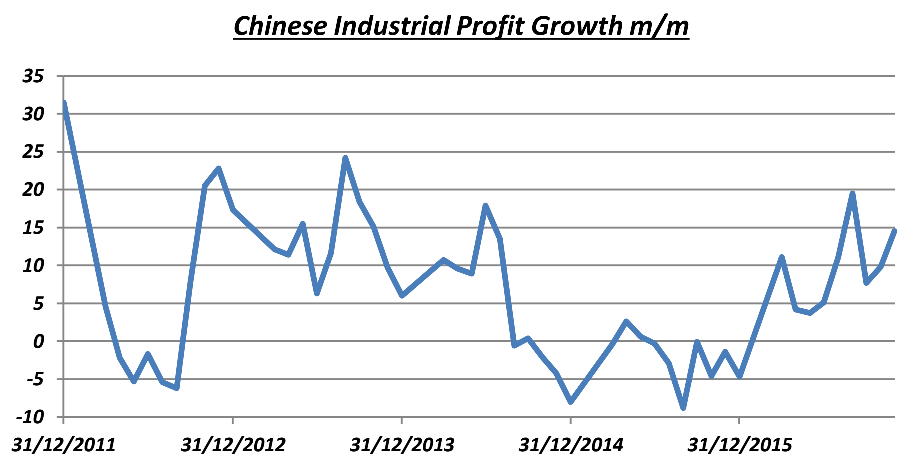
Chinese Economy

- Chinese data was generally firmer during November.
- Exports grew 5.9% y/y while imports grew 13.0% y/y
- Loan growth rose from Rmb651.3bn to Rmb794.6bn
- The Caixin manufacturing PMI fell to 50.9; services grew by 0.7 to 53.1; the composite PMI remained at 52.9. The official manufacturing PMI decreased by -0.3 to 51.4;
- Retail sales growth rose from 10.0% y/y to 10.8%; industrial production growth grew to 6.2% y/y; fixed asset investment growth was static at 8.3%
- Industrial profits were up 14.5% from 9.8% y/y during the previous month

Japanese Machine Orders rebound



Chinese Exports industrial profit growth rises



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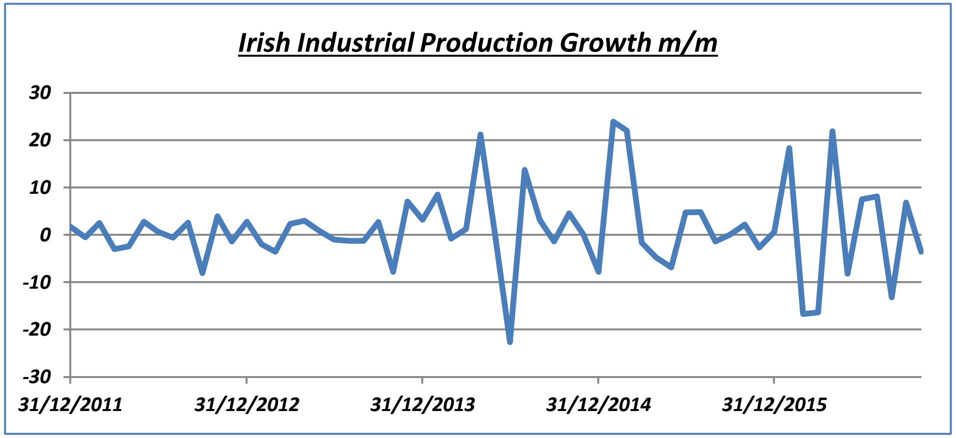
Irish Economy Review

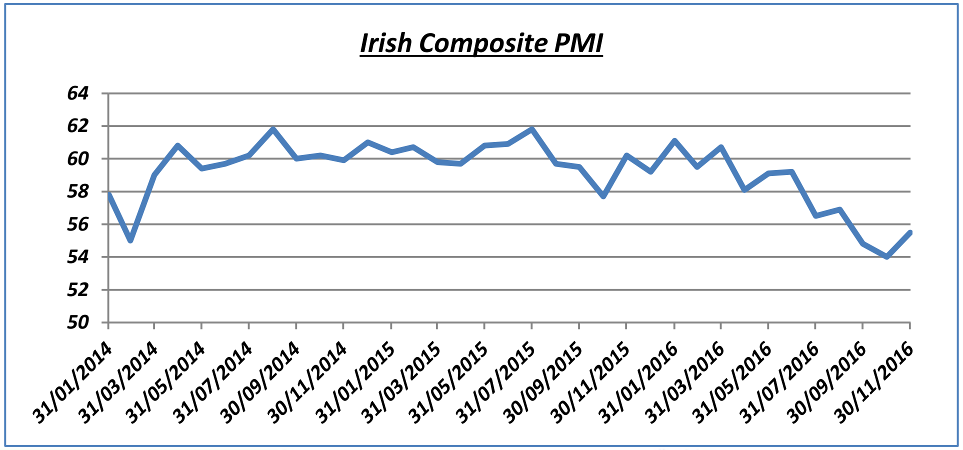
Economy

- Economic releases were generally positive
- Seasonally adjusted numbers on the Live Register fell 2,400 to 285,600. Unemployment fell to 7.3% with the previous months estimate having been revised to 7.5%
- Industrial production fell by -3.6% m/m and was down -6.4% y/y
- Retail sales slipped during the month by -0.3% m/m but were up 4.1% y/y. Consumer confidence rose 0.5 to 97.8
- The seasonally adjusted monthly trade surplus rose €1321m to €5091m; exports fell -4.4% m/m; imports rose 6.6% m/m
- The composite PMI rose 1.5 to 55.5; services also rose 1.4 to 56.0; manufacturing grew 1.6 to 52.1
- National residential property prices rose 1.3% m/m and were up 7.3% y/y. Dublin prices rose 1.1% m/m and 5.4% y/y. Prices outside Dublin rose 1.6% m/m and 11.0% y/y
- CPI fell -0.1% m/m and -0.1% y/y
- Exchequer returns in November were in line with expectations. Income tax revenues for the month were €157m above expectations, with the shortfall from VAT amounting to -€413m (-2.6%) as compared to expectations. For the year to date to end November, overall tax receipts are still €777m ahead of target.
- On the expenditure side, despite department of health related spending being €308m above budget, better than expected outcomes elsewhere have left total expenditure €510m below budget.

Industrial Production Growth falls



Irish Composite PMI Rises



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THANK YOU

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