Market Themes

January 2012

- Financial markets faced many challenges in 2011, the primary one being the sovereign debt crisis in the euro-zone. Additional challenges included the Japanese earthquake, concerns about global growth in general and US growth in particular, European bank funding concerns and a downgrade of US sovereign debt by one of the main rating agencies.

- The sovereign debt crisis in the euro-zone took centre stage in the latter part of the year, with bond spreads for Italy, Spain, France and Belgium widening dramatically.

- There were many measures taken by the world's leading central banks aimed at stemming the crisis, including the reintroduction of US dollar swap lines by the Federal Reserve (to alleviate dollar funding concerns for euro-zone banks), interest rate cuts from the ECB (reversing the rate hikes from earlier in the year) and the unprecedented introduction of an unlimited 3 year long-term refinancing operation (LTRO) by the ECB, aimed at alleviating liquidity concerns for eurozone banks.

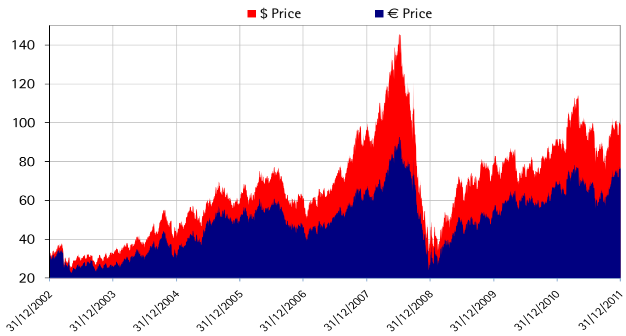
- Economic data over the year confirmed a slow-down in US economic growth, with a subsequent rebound in the final quarter. Data from the euro-zone however is consistent with a renewed recession. Chinese data continued to moderate over the year, which has added to concerns about global economic growth.

- Global earnings estimates have been revised down significantly over the latter part of the year.

- The global equity market ended the year down 3.4% in euro terms.

- At a broad sector level, the basic materials sector was the worst performer, falling by 21.6% over the year, followed by financials (-17.6%) and industrials (-9.8%). Healthcare was by far the best performer, rising by 9.4% over the year, followed by consumer cyclical (+0.9%) and consumer staples (unchanged over the year).

OIL PRICES



- At a regional level, the euro-zone was the worst performer, the DJ EuroStoxx falling by 17.7% over the year, followed by emerging markets (-16.3%), Australia (-11.6%) and Japan (-11.9%). The US was the best performer, the S&P 500 Index rising by 3.1% in euro terms, followed by the ISEQ, which rose by 0.6% over the year.

Strategy Changes

- We increased our equity exposure during the quarter, targeting German, US and Japanese equities on a regional basis, and basic materials and energy on a sectoral basis.

- At a sector level we are overweight basic materials and energy while underweight consumer staples. We have reduced our overweight in healthcare (but remain overweight) and reduced our underweight in financials (but remain underweight).

- Within our bond portfolios, we have reduced our underweight in periphery bonds (where we are now neutral). We remain overweight Norwegian bonds and underweight German bonds.

Market Outlook

- Despite efforts by the ECB to alleviate liquidity concerns about euro-zone financials, the crisis is far from over. We remain in an era of increased uncertainty, and hence increased volatility in financial markets. We expect this to remain a feature of financial markets for some time.

- Economic data in the US continues to suggest a rebound in growth, with more recent data indicating a further gain in momentum. European data remains weak and consistent with recession.

- Using various valuation measures, all equity markets are trading at significant discounts to recent history. Regionally, Japanese and Asian markets are the most compelling in valuation terms as they are currently trading at the greatest valuation discounts relative to recent history.

- The technical outlook for the market deteriorated significantly in late summer with a number of long term indicators giving negative signals. As we approached year end however, investor sentiment had reached levels of extreme negativity which would normally coincide with some short term relief recovery in risk assets.