

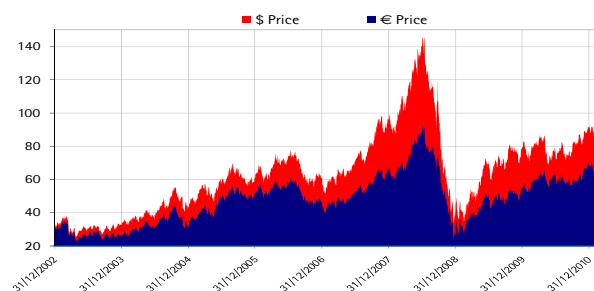
## Market Themes

May– 2011

- The US dollar continued to weaken over the month, falling by 3.9% on a trade-weighted basis, while the euro strengthened against most major currencies (+4.6% versus the US dollar, +2.2% versus the Japanese yen and +3.7% versus the Chinese yuan).
- Continued strength in oil prices (+6.8% over the month) added further to inflationary pressures. This is leading to rising concern at the ECB, with the first interest rate hike of 25 basis points delivered in April. In the US, the Federal Reserve is taking a more sanguine view, describing the moves as temporary in nature and insisting that interest rates will remain low for "an extended period". Thus the interest rate differential continues to favour euro strength versus the US dollar.
- Sovereign debt issues in Europe remain focused on the smaller peripheral debt markets of Greece, Ireland and Portugal, with so far no apparent contagion to Spain and Italy from Portugal's application for aid. Debt issues are clearly not confined to Europe, as demonstrated by the recent downgrading by S&P of the outlook for it's US AAA rating and Japan's AA- rating.
- Global economic momentum remained positive over the month. The global equity market in euro terms was 0.6% lower over the month.

At a sector level, Healthcare was the best performer, rising by 2.2% in euro terms (-0.4% ytd), followed by Consumer Staples (+0.9% on the month, -4.4% ytd) whilst Financials (-1.3% on the month, -3.9% ytd), Technology (-1.3% on the month, -4.9% ytd) and Telecoms (-1.7% on the month, -2.2% ytd) lagged. Energy performed poorly despite the strong oil price, falling by 2.8% over the month (+4.0% ytd).

**OIL PRICES**



At a regional level, the ISEQ was the best performer, rising by 4.5% over the month (+4.2% ytd), followed by the EuroStoxx (+3.1% over the month, +6.8% ytd) and the UK FTSE (+2.0% on the month, -0.8% ytd). Japan again fared badly in euro terms, falling by 4.6% on the month (-14.9% ytd).

## Strategy Changes

- We remain overweight equities in our balanced portfolios.
- At a sector level, portfolios remain overweight in Basic Materials, Industrial and Energy related sectors and underweight in Consumer Staples, Utilities and Telecoms.
- At a regional level we maintain an overweight position in Japan, with significant hedging of the yen exposure.
- We remain underweight bonds in our balanced portfolios. Within our bond portfolios, we remain overweight core bond markets and underweight peripheral bond markets.

## Market Outlook

- Global earnings momentum stalled during April however the Q1 earnings season in the US had a very encouraging start. The number of companies beating consensus earnings and sales estimates so far has been significantly higher than the number of companies missing estimates.
- Strong commodity prices have driven headline inflation rates significantly higher over the last year, with a notable acceleration in the last six months. The fear of deflation appears well passed, as core inflation rates are also rising steadily. Global central banks are responding, with the cycle of interest rate increases already commenced in many regions (Eurozone, Sweden, Norway, Canada, China, Australia).
- Economic data, particularly for global manufacturing, points to continued albeit modest global growth.
- Unemployment rates in Germany are at 20 year lows on the back of strong core European economic growth and despite the strength of the euro. However, there are some concerns that rising interest rates and euro strength will eventually create some headwinds for economic activity in Europe.