

Monthly Investment Analysis

May 2010



Global market overview

Market attention on Greek debt problems intensified over April. Greek bond yield spreads over German bunds widened to record levels and credit default swaps (CDS) rose. Standard and Poor's decision to cut Greece's sovereign rating to junk status heightened concerns. Downgrades to Portugal and Spain reinforced the view that euro-area problems aren't just confined to Greece; periphery asset prices fell. As market fears of a Greek default escalated, the EU was forced to outline details of its aid plan. Loans of up to €30bn from EMU member states were announced along with an IMF loan of up to €15bn. Greece finally requested funds towards the end of the month as its asset prices plunged further. This provided some market relief, but uncertainty still remained over the approval process for the loans, notably in Germany.

The long risk trade struggled to gain momentum. Equity markets hit fresh 18-month highs, but then fell as Greek debt worries escalated. Data and Q1 earnings, however, were solid overall, particularly from the US. This reinforced the view that the global economic recovery is gaining some momentum. The Fed showed no sign of moving nearer to policy tightening after maintaining its 'extended period' language. The mix of upbeat data and Greek worries saw a mixed performance from the US dollar. US 10 year Treasury yields ground lower, within a 3.65-4.00% range, suggesting that Greek contagion had failed to spread outside of the euro area over the month.

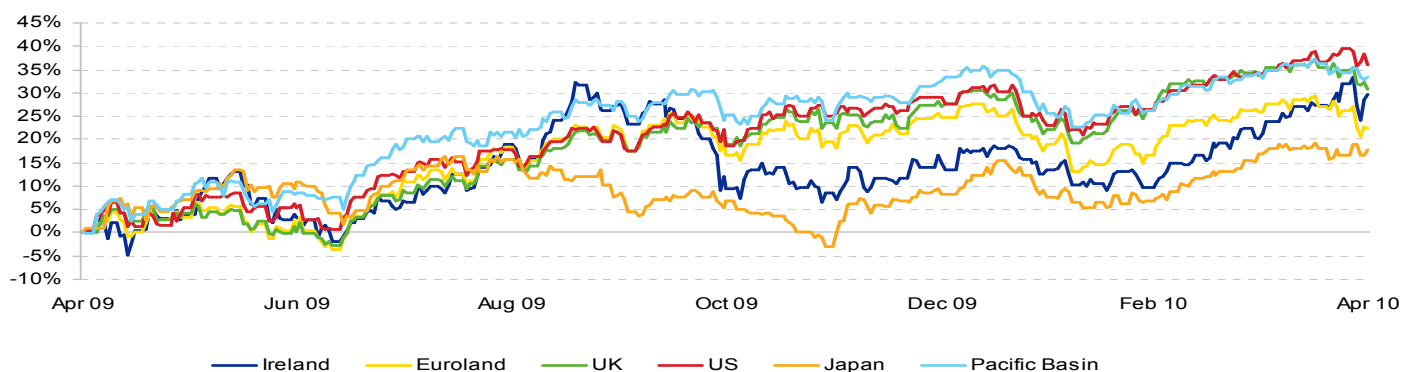
The election was the main focus for UK asset markets. The televised leaders debates had a significant impact on the polls and risks of a hung parliament increased. Data and monetary policy took more of a back seat, but Q1 GDP did disappoint, showing only a 0.2% quarter-on-quarter pace of growth. Together with higher-than-expected inflation, another large decline in employment and sluggish retail sales, this reinforced the view that the UK is experiencing a distinctly frail emergence from recession. There was slightly better news on public finances, but worries about cutting the large deficit continued.

Source: Fund Manager's Monthly - RBS 30 April 2010

	MSCI World	ISEQ	Dow Jones Euro Stoxx	Dow Jones Europe Stoxx	FT 100	S&P 500	NASDAQ	Topix	FT Pacific (ex Jap)
Index Level 30/04/2009	85	2,622	220	200	4,244	873	1,717	838	265
Index Level 31/12/2009	105	2,975	275	254	5,413	1,115	2,269	859	354
Index Level 31/03/2010	115	3,178	277	264	5,680	1,169	2,398	979	353
Index Level 30/04/2010	117	3,397	269	260	5,553	1,187	2,461	987	354
1 Month Return	1.8%	6.9%	-2.8%	-1.4%	-2.2%	1.5%	2.6%	0.8%	0.2%
Year to Date Return	11.6%	14.2%	-2.0%	2.4%	2.6%	6.4%	8.5%	14.9%	0.0%
1 Year Return	37.3%	29.6%	22.3%	29.8%	30.9%	36.0%	43.3%	17.8%	33.4%

Source: Bloomberg 30 April 2010 (All Index Levels & Returns are in Local Currency terms with the exception of the MSCI World, which is expressed in € terms)

The graph below highlights performance from the major stock market indices over the twelve months ending 30 April 2010:



Source: Bloomberg 30 April 2010

Monthly market watch

Ireland

The ISEQ index rose 6.9% in April, significantly outperforming its international peers and against a backdrop of a declining European market. Three significant events dominated. Airlines suffered with Ryanair and Aer Lingus giving up ground following the Icelandic ash cloud disruption. Banks benefited from improved sentiment around NAMA transfers and greater certainty on capital raisings following Bank of Ireland's capital restructuring announcement.

Europe

The Dow Jones Europe Stoxx (-1.4%) had a negative month, underperforming the FT 100 (-2.2%) and S&P 500 (+1.5%) on a constant currency basis (euro). Forestry & paper (+10.5%), Automobiles (+7.4%) and Engineering (+4.2%) were the strongest-performing sectors in Europe. The laggards included Insurance (-8.8%), IT Hardware (-7.7%) and Mining (-6.7%).

UK

UK equity markets retreated marginally last month as a decision by Standard & Poor's (S&P) to reduce the credit ratings of Greece, Portugal and Spain led to deepening concern that several indebted European nations were moving closer to default. The FTSE All-Share index, having hit a 20-month high in March, returned -1.4 per cent. Fears that the UK election would deliver no clear winner; thereby making it that much harder for a new government to reduce the country's huge budget deficit, further weighed on the market.

US

The US equity market rose for a third successive month as evidence that the world's largest economy is making the necessary transition from a government-policy-induced recovery to a self-sustained expansion, continued to accumulate. Aside from robust economic data, resurgent merger and acquisition activity and a strong earnings season underpinned the positive tone, although stocks came off the boil towards the end of the month amid mounting concern over Europe's debt crisis.

Japan

Japanese stocks fell in line with the majority of other developed markets. A measure of Japanese business confidence rose for an eleventh consecutive month while

other economic indicators suggested that Japan's economy is beginning to recover. Energy stocks were the best performers while utilities lagged as investors switched out of defensively oriented stocks into more economically sensitive areas of the market.

Pacific Basin

Asian stocks advanced, bucking the weaker trend seen elsewhere, as investors shrugged off concern over Europe's sovereign debt crisis, opting instead to focus on the relatively rosy economic picture in Asia. Indonesia, Korea and Malaysia were among the best performing markets while Chinese stocks sold off. Economically sensitive sectors such as technology, materials and industrials, all rose while financials reacted badly to events in Europe.

Bond and currency levels and returns

	Merrill Lynch Euro 1-3yr Bond Index	Merrill Lynch Euro >5yr Bond Index	Merrill Lynch Euro >10yr Bond Index
Index Level 30/04/09	417	628	809
Index Level 31/12/09	425	649	836
Index Level 31/03/10	429	669	867
Index Level 30/04/10	427	664	863
1 Month Return	-0.6%	-0.8%	-0.4%
Year to Date Return	0.4%	2.3%	3.3%
1 Year Return	2.3%	5.7%	6.7%

	€/\$	€/£	€/¥
Currency Level 30/04/09	1.328	0.896	130.350
Currency Level 31/12/09	1.441	0.892	133.080
Currency Level 31/03/10	1.348	0.890	125.880
Currency Level 30/04/10	1.331	0.869	125.770
1 Month Return	-1.2%	-2.3%	-0.1%
Year to Date Return	-7.6%	-2.6%	-5.5%
1 Year Return	0.2%	-3.0%	-3.5%

Source: Factset / Bloomberg 30 April 2010

The Eurozone in Crisis!

The whole Euro project came under enormous pressure last month as the Greek fiscal crisis reached its zenith, spilling over to other peripheral bond markets like Spain, Portugal and Ireland. Also the Euro came under extreme selling pressure as the Euro authorities procrastinated in taking the definitive action needed and Greek default/Euro breakup seemed a very real risk. However, on Sunday May 9th the EU came up with a sizeable and far-reaching plan.

The total cash amount potentially available is €750B or 8.2% of 2010 Eurozone GDP, €250B of which coming from the IMF. It would take the form of conditional loans through (1) the EU budget and (2) a special purpose vehicle (SPV).

The European Commission will increase its balance of payments facility by €60B to €110B of capital. The IMF will add €60B. This facility will be available for the first time to Eurozone countries and is likely to be available rapidly, although governments can make bridge loans on a short-term basis should imminent funding needs arise.

The Eurozone countries also reached an intergovernmental agreement, which will set up an SPV. The SPV will work through loan guarantees. Any payouts will be tied to strong conditions, acting together with the IMF. The total amount is of up to €440B with an additional IMF contribution of at least €220B. Looking at this facility relative to the funding needs of the periphery, it covers either the funding needs of Spain, Portugal and Ireland together up until well after the end of 2013.

In addition, the ECB Governing Council decided to conduct interventions in the euro area public and private debt securities, subject to commitment by governments on their fiscal plans. No amounts were announced, which leaves the ECB with complete freedom to act. Also the ECB will not only buy public sector paper but also private sector, a major development. Unsurprisingly, the ECB will sterilise these operations to avoid any impact on the monetary base and so on inflation. The ECB also reopened swap and term operations

This plan shows a belated sense of solidarity by the Eurozone governments and institutions, along with the IMF. It is a major backstop facility for Eurozone sovereigns and will provide ample breathing space to implement fiscal consolidation measures, which are expected to be stepped up over the coming weeks. A word of caution, though, the longer term requirement for extreme fiscal action to reduce the debt burdens of the periphery will be tough, with much interference now by the EU and IMF. There will be negative second order effects on growth, implying an arduous path to recovery. Ireland thankfully took early steps to rein in the deficit, but this is a multi-year process.

Important Information

Warning: The value of your investment may go down as well as up. Past performance is not a reliable guide to future performance.

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