

## Group Pension Managed Funds Update to 31<sup>st</sup> May 2006

### Summary

Following strong first quarter growth and flat returns in April, group pension managed funds experienced a significant correction during May. Over the month, the average managed fund return was -4.2%. This brings the return for the first five months of 2006 to 0.9% on average, eroding much of the gains made earlier in the year. Over the past twelve months, the average fund return was a strong 15.6%. Over the three years to 31 May 2006 the average fund return has been a healthy 14.6% per annum. In the five-year period ended 31 May pension managed funds have, on average, returned a less robust 2.8% p.a., reflecting the equity bear market of the early 21<sup>st</sup> century. In contrast, however, the ten year period to the end of May saw an average return of 9.2% per annum. When considering these returns it is important to remember that the investment horizon of most pension schemes is generally over 25 years, and that equities have historically provided significantly higher returns over the long term than bonds, property or cash, although at the cost of greater volatility.

### Market Review

Last month got off to a reasonably strong start, as investors focussed on strong corporate earnings, while oil and commodity prices continued to rise. However, markets subsequently experienced something of a correction mid-month. Rising interest rates, inflation concerns, a weak dollar, slowing economic growth, falling demand from China (and a subsequent fall-back in commodity prices), all led to a rash of profit taking in equity markets and a rotation out of economically sensitive sectors into non-cyclical stocks and also into bonds. This increased demand drove bond prices higher (and therefore bond yields lower), which exacerbated the impact of the markets' performance on pension scheme funding levels. It is worth noting, however, that the market rallied somewhat during the final week of May. This may imply that the performance of markets over the month was merely a case of investors becoming nervous and wanting to lock in the considerable profits earned over the past 18 months. Whether this is a blip or a long term change in the direction of markets remains to be seen.

The Irish equity market lost almost 4% during May, following the trend in global bourses. Inflation data reached a 3-year high, fuelled by rising oil prices and increased mortgage costs. The weakening of the dollar against the euro impacted on domestic stocks with exposure to the US market. Elan had a good month, as the path seems clear for a relaunch of the controversial Multiple Sclerosis drug Tysabri in the US next month. European approval of the drug seems likely to follow soon after. At the end of May, Elan represented 6.5% of the ISEQ. Financials underperformed the market as a whole, as rising interest rate expectations impacted on the sector.

May began brightly for equities in the UK, driven by bid speculation and rising oil and commodity prices. However, a slowdown in demand from China soon hit resource stocks while a drop in the oil price saw investors move out of stocks such as BP and Royal Dutch Shell. These sectors rebounded somewhat towards the end of the month, as their lower prices made them more attractive. Exporters were hurt by the weakening dollar. Overall, the FT UK index fell 4.7% in sterling terms over the month.

US equities were the best performing during May, falling just 2.9% in dollar terms. Unfortunately, the weakening of the dollar against the euro further reduced the performance of US equities for Irish investors - to -4.7%. Over two-thirds of the S&P 500 companies reported first quarter earnings ahead of expectations. However, as the month progressed, higher than anticipated inflation figures and another interest rate hike by the Federal Reserve dampened investor enthusiasm. The sharp mid-month decline in commodity prices knocked resource stocks. Continuing high oil prices have finally impacted on consumer confidence, which had been a major support to the US economy in recent years. Technology stocks fared poorly, as both Dell and Cisco announced disappointing results. Autos and retailers outperformed the rest of the market, on the back of broker upgrades and strong results respectively. Towards the end of the month, weaker than expected GDP figures reduced concerns over future interest rate increases, and the market recovered some of its losses.

Eurozone equities fell back 4.4% over the month, while the Rest of Europe returned -6.0% (in local currency terms). The European Central Bank kept interest rates on hold once again, but indicated that rates would be increased in June. Speculation rose that this increase might be as much as 0.5%. The ongoing battle for control of steelmaker Arcelor saw Mittal Steel raise their bid by a third, topping the offer by Arcelor's management to buy back the company's shares at a premium. The increased bid saw Arcelor's shares rise, and Mittal's fall. Improved economic data from Germany boosted markets towards month end.

The Japanese equity market was the worst performer over the month, falling 8.0%. This brings the return for the first five months of the year to -2.1%. Japan is the only major market to be in negative territory year to date. The weakening of the dollar had a negative impact on export stocks, while falling commodity prices hampered steel stocks. Banking stocks also struggled, as earnings are forecast to decline.

Pacific Basin equities fell back 5.7% during May. A weak dollar, falling commodity prices, slowing economic growth and rising interest rate expectations combined to slow the markets of the region. In addition, nervous foreign investors rotated out of the region, which is perceived as highly risky compared to western markets.

Despite rising interest rate expectations and higher inflation, bond yields fell during May as investors moved into bonds seeking a safe haven from the volatility of equity markets.

## Tables

### 1. Group Pension Managed Fund Returns to 31<sup>st</sup> May 2006

	Investment Returns to 31 <sup>st</sup> May 2006					
	1 Month %	5 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.
AIB Investment Managers	-4.5%	0.7%	16.2%	14.5%	1.1%	7.9%
Bank of Ireland Asset Management	-4.6%	-1.0%	10.3%	12.3%	3.6%	9.6%
Canada Life/Setanta	-3.8%	0.5%	12.9%	13.9%	2.2%	8.0%
Eagle Star	-4.2%	1.9%	17.6%	15.5%	4.3%	9.8%
Friends First/F&C	-4.4%	0.7%	16.3%	14.7%	3.0%	9.4%
Hibernian Investment Managers	-4.1%	1.6%	15.4%	14.5%	3.0%	9.6%
Irish Life Investment Managers	-4.0%	0.6%	16.8%	15.9%	3.6%	9.4%
KBC Asset Management	-4.5%	1.1%	16.1%	13.9%	0.3%	8.2%
Oppenheim Investment Managers	-4.4%	1.6%	16.5%	14.5%	3.7%	11.7%
Standard Life Investments	-3.8%	1.1%	17.8%	15.7%	3.0%	8.1%
<b>Average</b>	<b>-4.2%</b>	<b>0.9%</b>	<b>15.6%</b>	<b>14.6%</b>	<b>2.8%</b>	<b>9.2%</b>

### 2. Equity Market Index Returns to 31<sup>st</sup> May 2006

Region	1 Month		5 Months	
	Local Ccy	Euro	Local Ccy	Euro
Ireland	-3.9%	-3.9%	4.3%	4.3%
UK	-4.7%	-3.8%	3.7%	3.8%
North America	-2.9%	-4.7%	2.7%	-5.4%
Eurozone	-4.4%	-4.4%	5.7%	5.7%
Rest of Europe	-6.0%	-5.7%	3.0%	3.2%
Japan	-8.0%	-8.1%	-2.1%	-5.4%
Pacific Basin	-5.7%	-7.9%	4.3%	-1.2%