Group Pension Managed Funds Update to 31st December 2005

Summary

Group Pension Managed Funds ended 2005 with yet another positive month. The final quarter of the year saw funds return 4.9% on average. Over the year, the average fund return was an excellent 21.6%, the best yearly return since 1997. Over the three years to 31st December 2005 the average fund return has been 14.7% per annum. In the five-year period ended 31st December pension managed funds have, on average, returned a less robust 2.8% p.a. However, the ten year period to the end of December saw an average return of 10.0% 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

2005 was an excellent year for equity markets. Notable events included the continuing rise in US interest rates, a substantial increase in the price of oil, significant corporate activity and strong economic news. One of the driving factors influencing equity markets during 2005 was the price of oil. The oil price rose 45% to $61 per barrel over the year as a whole, although at one stage during the year the price reached a high of over $70 per barrel (from $42 per barrel at the beginning of the year). Unusually cold weather increased demand for oil products, while the hurricanes in New Orleans during the summer damaged oil refineries, reducing oil supplies. Commodities had a very good year, with the prices for gold, copper and zinc reaching record high levels during 2005.

Irish equities rose 21.7% over the year. Financials outperformed the market as a whole, returning 25.6%. One of the biggest stocks making headlines during the year was Elan. At the beginning of the year, Elan represented 9.4% of the ISEQ index. On 28th February it was announced that Elan's groundbreaking Multiple Sclerosis drug Tysabri had been linked with the death of two patients. The drug was immediately withdrawn from the market and the stock price fell 70%. Subsequently, Tysabri was granted priority status by the FDA and the share price rallied. Elan represented 5.1% of the index at year end. Having begun the year with a price of €19.60, by 31 December the share price was €11.40, a fall of 42%. However, this return masks a very volatile year for this most controversial of Irish stocks. Over the year, mergers and acquisitions activity was strong. Jurys Doyle hotel group was bought out, Eircom (+14%) purchased Meteor (and was itself the target of an aborted bid by Swisscom), CRH (+26%) made several acquisitions in the US and Grafton Group (+15%) purchased Heiton's, Davies and Garvey's.

UK equities also had a good year. The rising prices of oil and commodities boosted the market, which has an above average exposure to these sectors. Also beneficial was a cut in interest rates by the Monetary Policy Committee in August. However, slowing demand from consumers, rising levels of unemployment and stagnant house prices hindered the market and the economy as a whole. Terrorist attacks in London on July 7th had no lasting impact on equity markets. Corporate activity also supported the market during the year. The most noteworthy takeovers were Telefonica's purchase of O2, Holcim's takeover of Aggregate Industries, Aviva's buying RAC, William Hill's purchase of Stanley Leisure's retail betting outlets, P&O's takeover of Dubai's DP World and the sale of building's provider BPB to their French peer St. Gobain.

US equities did not fare as well other markets. However, the dollar strengthened 15% against the euro over the year, considerably boosting the return on dollar denominated assets for Irish investors. The Federal Reserve raised interest rates 8 times during the year, bringing short term rates up from 2.25% at the end of 2004 to 4.25% at the end of 2005. The US trade deficit reached historic levels. Although economic data was weak in the first half of the year, the economy showed signs of improvement in the latter months. Generally, corporate earnings were strong and, as elsewhere, corporate activity was rife. Some of the most notable transactions included; Proctor & Gamble's friendly takeover of Gillette, Johnson & Johnson's merger with Guidant, Bank of America's acquisition of MBNA and Addidas' takeover of Reebok. However, some notable names struggled in 2005. Pharmaceutical company Merck had a difficult year, with continuing troubles surrounding its Arthritis drug Vioxx, and unfavourable patent rulings over another drug Fosamax. Meanwhile, it was a very bad year for one of America's corporate giants, General Motors. In February GM had to pay $1.6bn to Fiat to avoid having to buy its loss making car division. In March, the company issued a significant profit warning as it struggled with falling US car sales and the burden of rising healthcare and pensions costs. In April, the company's debt was downgraded to junk status (as was Ford's). June saw things improve somewhat for GM as they announced aggressive cost cutting measures, and Kirk Kerkorian raised his stake in the company. However, in October, former GM subsidiary Delphi filed for bankruptcy leading to fears that GM might have to take on the burden of Delphi's $11bn pensions liability. Then in November it was announced that GM would have to restate its 2001 earnings. In December, Standard & Poor's warned that a bankruptcy filing might be the only way for the company to escape its financial predicament. GM fell 48% during 2005.

European equities had a very good year. Interest rates remained at historically low levels, with the ECB increasing rates just once, by 0.25% in December. Corporate restructuring and improved productivity began to filter through to company earnings, which were strong. Insurers had a difficult year, as the impact of floods in Central Europe during the summer and the hurricanes in the US Gulf Coast increased claims. The outcome of the German election was seen as disappointing, as the coalition is likely to find it difficult to agree on the substantial reforms necessary to raise the economy from the doldrums. The availability of cheap debt encouraged corporate activity. Swiss cement maker Holcim acquired Aggregate Industries, Pernod Ricard bought Allied Domecq, Novartis purchased Hexel and Eon Labs, Unicredito and HVB Group merged, KPN acquired Telfort and France Telecom purchased an 80% stake in Amena. As mentioned earlier Telefonica, took over British mobile phone operator O2, while St. Gobain bought BPB.

The Japanese equity market was the star performer of the year. Despite a poor first quarter, the market rallied strongly to rise almost 44% by year end. Strong economic news flow and improving corporate confidence led to a belief that the economy's 16 year slump has finally come to an end. The most significant development occurred when reformist Prime Minister Koizumi dissolved parliament and called early elections after parliament refused to support his plans to privatise Japan Post. Koizumi won a significant victory in the subsequent elections, giving him a mandate to push forward with his plans to reform the economy. This was widely welcomed by investors, both domestically and internationally. The best performing sectors were real estate and banks.

Asian markets also fared well, rising on the back of Japan's improving situation and continuing strong economic growth in China. Australia benefited from the surge in commodity prices. South Korea was boosted by fiscal reforms and the ending of North Korea's nuclear programme. Hong Kong fared well as property prices surged, despite rising US interest rates. Singapore's high yields and defensive characteristics sustained the market during a turbulent year. Taiwan's improving relations with China helped the market there, although the market was not as strong as some others in the region. The announcement by China in August that it was removing the renmimbi's dollar peg supported currencies in the region.

Eurozone bonds underperformed relative to equities, but still returned a healthy 7.9% as yields continued to fall despite improving economic data and rising interest rates.

Tables

1. Group Pension Managed Fund Returns to 31st December 2005

	Investment Returns to 31st December 2005				
	3 Months %	**1 Year %**	**3 Years % p.a.**	**5 Years % p.a.**	**10 Years % p.a.**
AIB Investment Managers	5.2%	22.0%	14.6%	1.3%	8.8%
Bank of Ireland Asset Management	4.6%	18.0%	13.2%	4.3%	10.6%
Canada Life/Setanta	3.1%	21.7%	14.5%	1.8%	8.9%
Eagle Star	4.8%	23.1%	15.5%	4.0%	10.6%
Friends First/F&C	5.5%	22.3%	15.3%	2.8%	10.3%
Hibernian Investment Managers	5.1%	19.5%	14.4%	2.9%	10.2%
Irish Life Investment Managers	5.3%	23.0%	16.7%	4.3%	10.1%
KBC Asset Management	5.9%	22.2%	13.6%	0.5%	8.9%
Montgomery Oppenheim	3.9%	20.6%	14.4%	3.4%	12.8%
Standard Life Investments	6.1%	23.9%	15.4%	3.1%	9.0%
Average	***4.9%***	***21.6%***	***14.7%***	***2.8%***	***10.0%***

2. Equity Market Index Returns to 31st December 2005

Region	**3 Months**		**12 Months**	
	Local Ccy	***Euro***	***Local Ccy***	***Euro***
Ireland	8.2%	8.2%	21.7%	21.7%
UK	3.5%	2.7%	21.1%	24.7%
North America	2.4%	4.6%	7.3%	23.8%
Eurozone	4.5%	4.5%	25.9%	25.9%
Rest of Europe	8.3%	8.0%	35.7%	34.3%
Japan	16.2%	14.0%	43.9%	44.0%
Pacific Basin	5.1%	6.9%	24.5%	39.7%