

- **BIAM's view on peripheral Eurozone Government bond markets**

BIAM's view on the so-called peripheral government bond markets (Ireland, Italy, Greece, Spain & Portugal) is modestly positive and we hold a small overweight position to reflect this. Our view is driven by attractive yield spreads (the excess dividend yield generated by peripheral government bonds) versus Germany combined with the strong indications from Eurozone politicians that defaults within EMU will not be allowed (as the core countries will financially support the weaker states should it become necessary). There are obvious flaws in the European Monetary Union (the lack of economic/fiscal coordination) but a crisis is often the catalyst for change. The European Commission "recommendations" to the Greece government regarding its fiscal policy along with the close monitoring that will take suggest that the deeper economic integration may be the long-term result of this crisis.

Individual countries in order of preference (our current position within the Government bond funds in brackets);

Ireland (overweight)

The uncertainty surrounding ultimate losses on NAMA and the costs of recapitalising the banks remains a headwind for Irish government bonds, but even a conservative outlook suggests net government debt to GDP will actually remain below the Eurozone average over the coming years. The government has shown a willingness to tackle the structural deficit and markets have responded positively. The government suffered a collapse in revenues due to overreliance on property-related taxes but Ireland did not enter the crisis with the high debt levels and poor demographics of Greece and Italy.

Italy (small overweight)

While Italy does have a huge debt/GDP ratio, the private sector does not have excessive debt levels and the banking system is relatively strong. The deficit in Italy did not deteriorate rapidly in the recession as it has done in Ireland and Spain and it is not heavily reliant on external capital to fund its deficit. There are longer-term issues regarding the competitiveness of the economy and the costs of an aging population but in the short-medium term strong domestic demand for Italian government bonds is likely to continue to support the market.

Greece (small overweight)

Greece undoubtedly is in the worst position of the Eurozone countries due to its high debt/GDP ratio, high deficit and high reliance on foreign capital. Nonetheless the flight from Greek government debt in the past month or so has left them trading at attractive dividend yields and we therefore prefer Greek bonds to Spanish or Portuguese (where the problems may not be as serious but the significantly lower yields offset this).

Spain (small underweight)

Spain has suffered from a property bust similar to Ireland and has seen a drastic deterioration in its public finances. Like Ireland it entered the crisis with a low debt/GDP ratio which is a positive but it is a much more rigid economy than Ireland's and much less export-oriented. This suggests that Spain will find it more difficult than Ireland to grow in the coming years.

Portugal (small underweight)

Like Greece, Portugal is heavily reliant on foreign capital and like Spain the outlook for economic growth is quite bleak. With Portuguese bonds yielding less than Ireland's we do not believe they offer sufficient reward for the risk involved.

Continued...

- **BIAM reduces non-Government bond holding**

The BIAM Fixed Income Team has decided to reduce the strategic over-weight position held in corporate bonds (broad credit).

Corporate bond spreads (the excess dividend yield generated by corporate bonds over government bonds) have tightened significantly over the past year and are now back to pre-Lehman Brothers default levels.

Corporate bonds outperformed substantially in 2009, as it became clear that the default risk levels being priced into them were extreme and indiscriminating. The index for the broad credit strategy* generated a total return of 10.6% in 2009 thereby delivering excess returns of 6.9% versus equivalent Government bonds.

Excess return momentum has been petering out in recent months, suggesting that further gains may be harder to earn as spreads are now quite tight.

There is still some upside potential in owning credit, but the preference for corporate debt has become something of a crowded trade and the risk of a correction carries relatively more risk.

We will continue to maintain an allocation to senior bank credit established in April/May 2008. This allocation was made primarily as a buy and hold strategy with our intention to earn the carry (income) for the portfolio over time. This senior bank credit is all high-ranking debt of leading banking names.

Bank of Ireland Asset Management
February 2010

*Merrill Lynch EMU Large Cap Non-Sovereign Index - EXLO

Bank of Ireland Asset Management Limited is regulated by the Financial Regulator. Incorporated and registered in Ireland at 40 Mespil Road, Dublin 4. Registered number 145221. Member of the Irish Association of Investment Managers. Past performance may not be a reliable guide to future performance. Mention of specific securities should not be taken as a recommendation to buy or sell these securities. Performance numbers are quoted gross of management fees. This document is solely for distribution within BOI Group and not externally.