



MARKET COMMENT

Over the month world equities returned 1.7% (MSCI World Index) with daily volatility once again high. Earnings season kicked off for companies announcing their quarter two results, the Euro made strong gains reversing previous falls versus the Dollar and double-dip recession fears became the phrase of the month (see Viewpoint below).

Essentially, share prices have remained in a broad trading range for the last few weeks caught between a number of positive and negative forces. The list on the bullish side includes strong corporate earnings, reasonably cheap valuations, a low interest rate environment and increasing share buybacks and dividend payments. On the negative side, stocks are being hurt by slowing (but still positive) economic growth, weak credit growth and ongoing uncertainty surrounding issues such as the sovereign debt crisis, the Gulf oil spill and the legislative agenda in Washington.

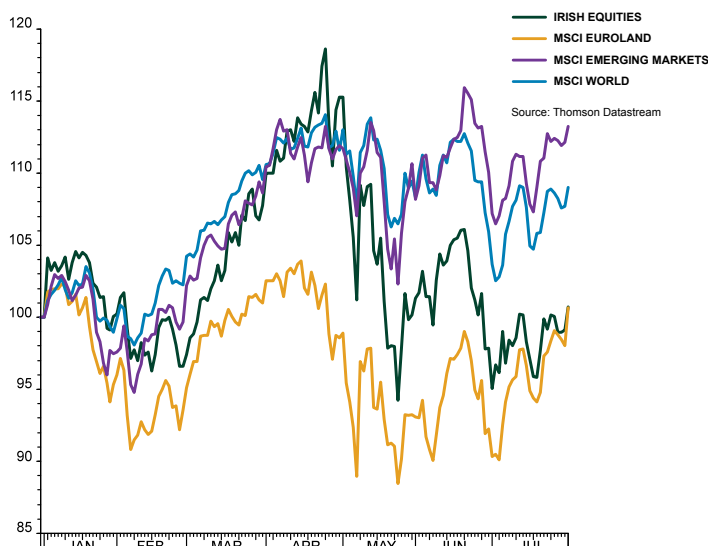
Second quarter corporate earnings season is now well under way, and even if the developed world economy is hitting some economic growth speed bumps, earnings results have continued to surprise on the upside. At this point, it looks like earnings growth will come in somewhere in the double digits yet again. As has been the case since the recession began, many companies have been growing their earnings through rigorous cost cutting measures. However, revenue growth has also been surprising to the upside in recent quarters. The rash of good news has caused expectations for the rest of 2010 to continue to rise. Many companies that have reported have exceeded their revenue expectations and the majority have beat earnings expectations.

The Euro gained strongly during the month finishing at \$1.30 and 7% higher than a month previous. This had an adverse effect on global

equity market returns for Euro investors. While the falling Euro in previous months led to the Euro investor being protected somewhat from global market falls in local currencies, in July Euro investors experienced low single digit gains while the US Dollar investor, for example, enjoyed a robust 8% return in the MSCI World Index.

The Eurozone bank stress tests were, as we expected, a non event with only seven of 91 banks failing, with five of these being Spanish savings banks, one Greek and one German. The most surprising part was that the overall shortfall of those seven banks was just €3.5bn. Market reaction was sceptical about the robustness of the tests but the results at least dampened immediate fears of financial contagion in Europe.

Year to date returns to 31 July 2010 (in Euro terms)



KBCAM's Outlook versus Benchmark Positions - 6 Month Time Horizon

	Ireland	Euro land	UK	Rest of Europe	US	Japan	Pacific Basin
Equities	□	□	□	↑	□	↓	↑
Bonds	↓	↓	↓	↓	↓	↓	N/A
Property	↓	□	↓	□	N/A	N/A	N/A

↑ = overweight
 □ = neutral
 ↓ = underweight

VIEWPOINT

Sometimes markets have a "here we go again" feel to them. After managing to get over the sovereign crisis experienced in May we experienced some "speed wobbles" in late June/early July on foot of what was termed "double dip" concerns. Since then some media commentators have continued vocalising about impending dangers. So are these "double dip" fears real?

Let's first of all examine the case of those who don't believe there is a high risk of a "double dip" recession. Growth advocates point to a steady economic recovery to date supported by very strong earnings recovery within a corporate sector that has taken significant steps to repair balance sheets. They point to a low inflation threat, improving consumer and corporate confidence and the evolution of emerging markets as an important economic block. They discount recent poor US housing numbers due to a technicality (a tax incentive deadline always artificially skews figures). Crucially they believe

that policymakers are doing a good job keeping economies ticking in the right direction using the instruments they have at their control including the Chinese authorities who have managed to steer their economy successfully through the recent global financial crisis. All of this is happening, they believe, in a world of undemanding equity valuations. Double dip advocates on the other hand point to austerity programmes in place in Europe and the U.S. as governments and consumers battle to correct deficits. They worry about more taxes, leading to less spending and weaker confidence, ultimately restricting industrial output and employment growth. They point to the lack of a sustained recovery in the US housing market and weaker recent economic numbers as well as the sovereign debt crisis in Europe. They also believe that emerging markets' growth cannot continue at this pace and that bond yields are telling us the future is not bright. Markets will continue to be influenced by short

term newsflow as both pro growth and double dip advocates seize on the latest indicators to justify their respective positions suggesting volatility will remain high. Whilst not denying that headwinds exist, we in KBCAM interpret current economic data as signalling that the subdued economic recovery remains on track. Markets will continue to move upwards in a volatile fashion in parallel with this recovery. We continue to believe the most likely outcome for the medium term is for equities to provide solid, if unspectacular, returns in the high single digit range, whilst bonds have the potential to underperform from here.

KBCAM FUND ACCESS

KBC Innovator, Alternative Energy and Water are available as fund choices through BOI Life savings, pensions and investment products. The KBC Managed Fund is available through the BOI Life Pensions products.

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