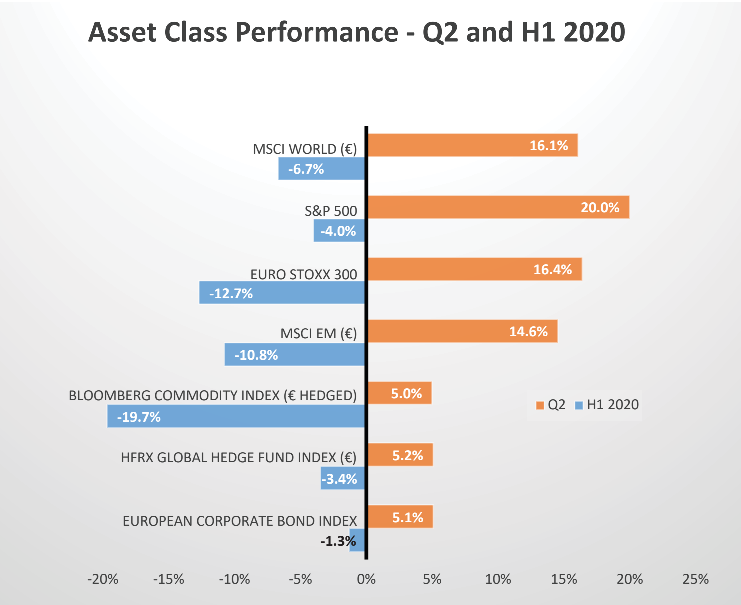
QUARTER 2 2020 INVESTMENT MARKET REVIEW AND OUTLOOK

AIB PRIVATE BANKING



Morgan Stanley Capital Index (MSCI); Hedge Fund Research (HFRX)
Source: Refinitiv Datastream.

While Quarter 1 saw the fastest equity bear market since the Second World War, Quarter 2 saw the quickest rebound in equity markets in over 20 years. The recovery, which started towards the end of March, continued strongly into April and positive momentum remained for the rest of the quarter with solid gains in markets during May and June. This resulted in overall returns for the period that were well into double digits (see chart above) although nearly all major indices still remain lower than at the start of 2020. Other asset classes also performed satisfactorily, albeit not as strongly as equities, with mid-single digit gains recorded in fixed income, commodity and hedge fund indices. Commodities, after an extremely challenging Q1, saw a good bounce back in a number of sectors with oil particularly buoyant, up over 90%. Defensive assets such as European Sovereign and Investment Grade Corporate Bonds also delivered gains with peripheral Eurozone bond indices among the stronger performers. Hedge Funds also benefited from the general recovery across asset classes with the HFRX index up c.5%.

Quarter 2 started favourably as equity markets built on the strong momentum from the end of Q1 which had seen global indices gain c.14% in the last week of March. Investor sentiment was also helped in April by evidence of a fall in new coronavirus infection rates in many developed and emerging countries (Italy, Germany, South Korea, etc.) and plans to re-open some economies. Another key driver was the announcement by Governments and Central Banks of further large monetary and fiscal stimulus programmes designed to reduce the economic damage of the COVID-19 related lockdown measures. Global equity indices rose c.11% (in € terms) in April.

The same supportive themes, coupled with some hopeful news on the development of a COVID-19 vaccine, continued to help markets in May with mid-single digit gains across many Developed Markets. Emerging Markets (EM) underperformed, with the main EM index broadly flat, as tensions between the US and China increased following China's decision to pass a controversial national security law in respect of Hong Kong. Global indices strengthened further in June helped by some strong economic data, particularly in the US and also increased fiscal and monetary stimulus measures, notably in the Eurozone where the European Central Bank (ECB) increased and extended its Pandemic Emergency Purchase Programme (PEPP). Overall global equity indices rose c.2% (in € terms) in June, resulting in a gain of over 16% in the quarter.

On a regional basis, while all equity indices registered strong gains, US markets continued their theme of outperformance particularly versus Europe, with the S&P 500 and NASDAQ rising 20% and 31% respectively. Markets were assisted early on in the quarter by the aggressive levels of monetary and fiscal stimulus measures put in place by the Federal Reserve (Fed) and Trump administration. The Fed also committed to unlimited government bond purchases and signalled its support for corporate markets with purchases of individual company bonds along with corporate bond Exchange Traded Funds (ETFs). Finally, better than expected economic data and Q1 corporate earnings, particularly in the Information Technology and Healthcare sectors (i.e. Microsoft, Apple, Johnson & Johnson, etc.), helped bolster index returns. US small cap stocks also rose strongly (25%) as they benefited from the significant stimulus measures and the plans announced by President Trump to quickly re-open the US economy.

European and EM indices generally underperformed the US with markets in the UK, Spain, France and China registering gains of c.7 to 12%. European equities were impacted early in Q2 by concern over the economic impact of the coronavirus especially given the already fragile state of many European economies. Performance rallied notably in June helped by the agreement of a €750bn European Union (EU) recovery plan and a comprehensive re-opening schedule put in place by most countries. EM and Japanese markets also lagged with the former impacted by Sino/US tensions over Hong Kong and the latter affected by weak economic data. The main Japanese index (Topix) and China's equity index (Shanghai) rose c.10% and c.9% respectively. At a sectoral level, there was a continuation of the theme of strong outperformance of growth over value with returns in the quarter of c.26% and c.12% respectively. The IT sector was the top performer with a gain of c.30% as a combination of generally favourable Q1 earnings and a view that the industry was better able to cope with the economic effects of the coronavirus contributed to outperformance.

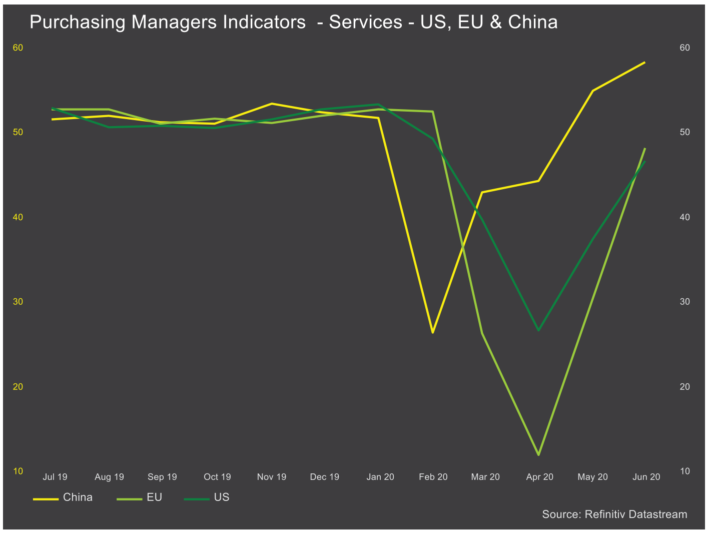
Despite the risk-off environment, Eurozone sovereign bond markets also experienced a positive quarter as they were supported by increased Quantitative Easing (QE) and the prospect of lower interest rates and inflation for longer. This was particularly evident in periphery countries such as Italy and Spain where, after a spike in April on government funding requirement concerns, yields subsequently fell sharply in May and June helped by the announcement of new stimulus measures totalling €1.35tn by the EU and ECB. Italian and Spanish yields both fell c.0.3% in the quarter to 1.2% and 0.4% respectively while there was also a reduction in core yields. German 10 year bund yields fell slightly to -0.5% while Irish bonds also performed well with yields declining c.0.1% to close to zero. As a result, the Eurozone short dated bond index rose 0.2% in the quarter. European corporate bonds also had a favourable quarter as the combination of lower sovereign yields, improved stock market sentiment and increased QE helped the index deliver a return of c.5%.

Commodities had a mixed quarter with the energy and precious metal sectors performing well. Gold continued to perform well (up 11%) helped by the weaker US$, low interest rates and concerns over the ongoing high number of coronavirus cases particularly in the US. Crude oil prices rose strongly (c.92%), despite significant volatility in April where some West Texas Intermediate (WTI) future prices turned negative on oversupply concerns. Prices were subsequently helped by strong production cuts by OPEC and improved demand. The agri and industrial metals sectors had more muted returns due to excess supply concerns, although some industrial metals such as copper performed strongly (c.22%). The overall commodity index rose 2.2% (on a euro hedged basis).

Hedge Funds recorded a positive quarter as favourable equity and fixed income markets helped contribute to a return of c.5% in the index. Eurozone cash rates remained well anchored in negative territory with three month interbank rates finishing at c.-0.4% which was in line with the previous quarter end.

Investment Market Outlook

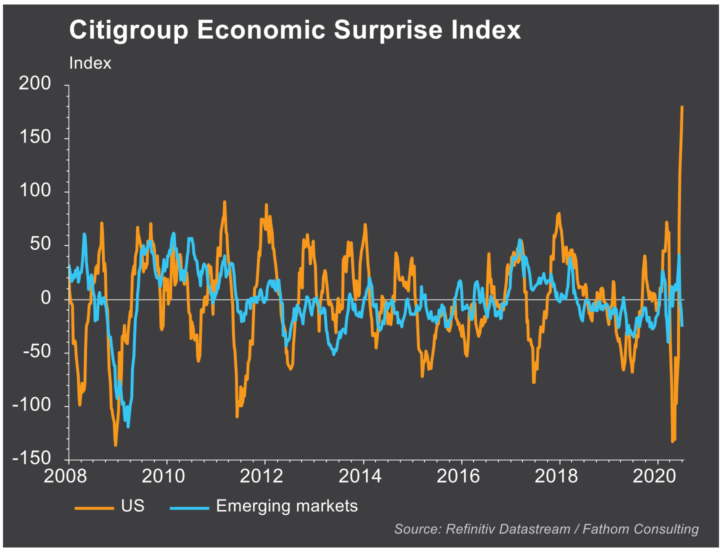
In our Q1 2020 Outlook we highlighted that markets would be influenced by a number of factors including global Central Bank/Government actions and the success or otherwise of countries in reducing the spread of COVID-19 and normalising economic activity. In this regard we saw positive progress over Q2 (see chart below) and this contributed to markets delivering strong returns in the period. Looking out over the short to medium term, Central Bank and Government policy measures are likely to remain supportive with macro-economic data also expected to continue to improve which should be beneficial for markets and may allow them push higher. However investors have now gone a long way in assuming a V-shaped growth recovery which leaves asset prices vulnerable to volatility and potentially a pull-back in the event of any disappointing developments on the economic, earnings, pandemic or geo-political front.



Source: Refinitiv Datastream

Despite having experienced the deepest economic contraction in 90 years, it is thankfully now expected to be the shortest, as strongly improving and better than expected economic data (see 'Surprise Index' chart) point to a second half rebound in activity and earnings. While the outlook looked bleak in March with much of the world's economy in lockdown, we have seen the accelerated partial re-opening of many developed economies particularly in the last month and a clear timetable for a fuller re-opening during Q3. In the case of certain emerging economies this has been even more progressed with countries like China and South Korea in particular nearly fully re-opened. In China, consumer demand is now more than 90% of what it was last year and industrial activity has recovered back to normal levels. This re-opening of economies has also been achieved, in most cases, with a minimal effect on virus transmission with some local outbreaks in certain countries (China, Germany, etc.) being contained relatively quickly.

One exception to this is currently in parts of the US with transmission rates having picked up recently in a number of important states (Texas, California, etc.), due in part to higher testing volumes, which has caused a pause or reversal in re-opening plans in these areas. While this may cause economic data in the US to wobble a bit in the short term, the outbreaks appear to have galvanised the Trump administration and the individual states themselves into taking containment measures more seriously which may ultimately allow for a greater chance of increased normalisation of economic activity. These containment actions could also be important as it would allow the world's largest economy rebound more sustainably and securely while lowering the risk of a significant "second wave" that could occur possibly during H2 2020. Encouragingly in the US at a broader economic level, recent data have pointed to a very strong rebound in employment, housing and consumer confidence levels which augurs positively for a continued recovery.

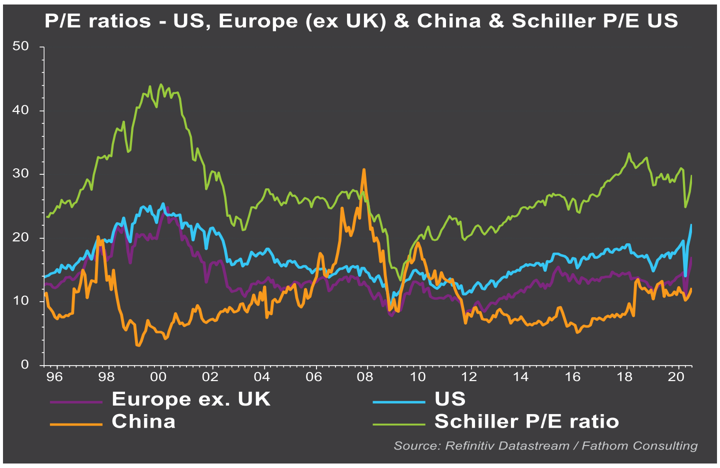


Source: Refinitiv Datastream / Fathom Consulting

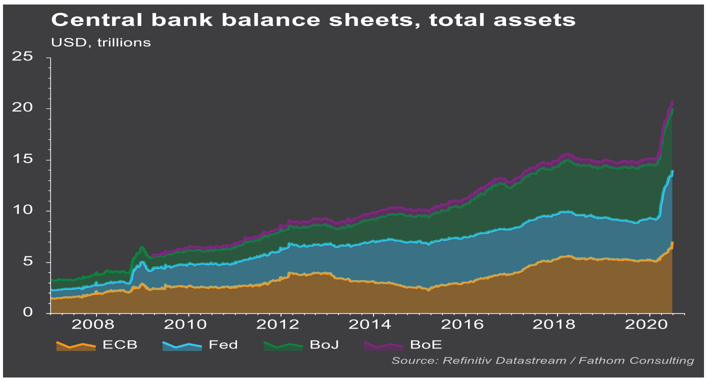
A further factor that is being closely watched is the development of a coronavirus vaccine with currently c.38 candidates in the process of being trialled/researched. However while there has been some encouraging preliminary news, any definitive results are still some time off and even a fast-tracked vaccine development process would likely take c.12-18 months to be available. Similar to last quarter the level of new coronavirus cases will continue to be closely monitored, particularly in the major economies of the US, China and the Eurozone as it is likely to determine the shape of the recovery particularly as lockdown and mobility measures are removed. It is quite possible that in the event of a material spike in cases and notwithstanding government policy, many consumers and businesses will change their habits and voluntarily adopt their own form of lockdown. This would severely strain the positive recovery scenario that many investors are expecting.

At a corporate level, attention will soon turn to US Q2 earnings. While expectations are extremely weak (c.40% projected fall in the US in Q2 (year on year) and c.60% in Europe) which reflects the timing of the lockdown period and also particular earnings downgrades for the energy and transport sectors, the good news is that this is expected to represent a low in the cycle with the pace of downgrades decelerating rapidly. The more severe fall in expected European company earnings in Q2 reflects in part the quicker and more extended nature of the lockdown measures adopted by many countries in the region. The tone of company outlook statements will also be particularly closely scrutinised. With valuations stretched following the strong rebound in markets since end March (see chart overleaf), investors will look for comfort around the expected recovery in earnings that should begin in Q3. Overall the current consensus is that earnings in the US and Europe will decline in 2020 by c.20% and 30% respectively but experience a sharp rebound of c.30% in both markets in 2021.

Markets should also continue to gain support from global stimulus measures. Fiscal stimulus has recently been stepped up with additional budgets in Japan, Germany and France and total global measures are now estimated at around 4% of the world economy. The finalisation and implementation of the EU's €750bn Recovery Fund will also be very important given that most of this fund will be in the form of grants to peripheral EU countries which have been impacted most by the coronavirus. Resistance remains however from several countries which may see it watered down somewhat



although there is a hope that it will be finalised over Q3 and ready for implementation by year end. In the US the US$2.2tn CARES Act (the largest piece of rescue legislation in US history) expires at the end of July and pressure is on to extend it as it will be a key support to those currently unemployed and also to small businesses. Finally monetary support from Central Banks which has been significant in 2020 (see graph below) should also continue to be positive given the message of "no limit support" by the Fed and ECB.



In relation to other factors that may influence markets, support should continue to come from the relative attractiveness of equities compared to sovereign bonds and cash rates with the rates for the latter now expected to remain lower for longer. Institutional positioning is also low still with high cash levels in the wings that can be invested although on the negative side corporate buy-backs will be much less in 2020 and may be only c.50% of the US$700bn spent in 2019. The US election in November may also start to come into more focus in the minds of investors. Joe Biden is currently leading in the important swing states (Florida, Michigan, etc.) and has indicated an intention to reverse part of Trump's corporate tax cuts. While this would make markets nervous it may be offset by a less aggressive trade policy toward China and the EU. On the less positive side, geo-political concerns remain in relation to the US and China, particularly around Hong Kong, with Brexit also still to be finalised although we would consider this to less of a concern to global markets.

In relation to the outlook for other asset classes, Eurozone sovereign bonds, following the fall in yields across most core and periphery markets in Q2, are at expensive levels. While events like a global second wave of coronavirus cases could see core yields go lower, peripheral yields could widen on investor concern over economic stability. Short term support however should come from very low inflation expectations (see 'Inflation expectations' chart) and also increased buying by the ECB as it raised its buying programme by €600bn to €1.35tn in June which will be conducted through to June 2021. Corporate bond markets should also benefit from this programme, with current purchases of c.€10bn per month, although the outlook for corporate earnings and default expectations will also be important.

The outlook for commodity markets is mixed. Following their strong rebound oil prices may still have scope to strengthen in the medium term on a combination of demand recovery as economies re-open and continued production restraint from the major oil producers. A renewed return of US shale production remains a risk however. Gold prices may also have scope for further appreciation helped by ongoing investor nervousness concerning the coronavirus impact and the expected lower for longer environment for cash, bond and inflation rates. Some industrial metals (e.g. copper) have a positive outlook on improving economic normalisation particularly in China although others (e.g. aluminium) may be negatively affected by a positive supply backdrop which may also be a feature for many agri commodities.

In the short term, markets will continue to be largely influenced by evidence of economic normalisation and also success in reducing coronavirus cases, particularly in the US. As efforts to fully re-open economies are unlikely to be smooth, markets will remain wary and therefore volatile. Global central bank and government measures will continue to be an important market support particularly as further stimulus measures may be required to manage and assist the economic recovery.

Faced with this current unpredictable investment environment, diversification remains important. We continue to believe that holding the appropriate mix of investment assets can help mitigate the effects of significant market volatility while providing the opportunity for satisfactory risk adjusted returns over the long term.

Listen to Conor English, Head of Investments in Private Banking discuss the latest quarterly bulletin in depth with John Fahey, AIB's Senior Economist and Jane Kavanagh, Corporate Treasury on the AIB Market Talk channel on any of the podcasts apps for iOS or Android. Listen and subscribe today.

Note: The information contained in this report has been compiled from sources that AIB Wealth Solutions deem reliable. Whilst all reasonable care has been taken to ensure that the facts stated are accurate and that the opinions and commentary given are fair and reasonable, AIB Wealth Solutions does not hold itself responsible for the completeness or accuracy of the information provided. Any opinions expressed herein are subject to change without notice. This document is not an offer to sell or a solicitation to buy any security. This publication is for information purposes only and is not an invitation to offer, buy sell or deal.

WARNING: All forms of investment involve some degree of risk. If you do not understand the nature and extent of your exposure to risk you should not invest.

WARNING: The value of your investment may go down as well as up and you may not get back all or any of the capital you invested.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The return on investments denominated in non-euro currencies may be affected by changes in exchange rates.

Allied Irish Banks, p.l.c. is regulated by the Central Bank of Ireland.