EAGLE STAR

Market Comment

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Markets

In the US, evidence that the authorities are determined to do everything to reflate the economy continues to emerge. US mortgages tend to be fixed-rate rather than variable-rate and the fixed rate is determined largely by the yield on long-dated US government bonds. Since the beginning of the year, the yields on long-dated US government bonds have not fallen as much as on short-dated bonds and this may be a contributory factor to last week's reported slowdown in housing sales. Sales of new homes were at their lowest level since August 2000, estate agents reported a drop in the sale of previously-owned homes and mortgage brokers reported a drop in mortgage applications. Growth in the housing market had been a significant source of growth in the economy in the past year or so. But the US Treasury has taken action in cancelling the sale of long-dated bonds paving the way for cheaper mortgage finance and cheaper corporate lending. Going forward, low mortgage rates and the demographic profile of the US population are likely to keep housing sales strong.

Consumer confidence, crucial to the timing and strength of the US economy recovery, fell in October to its lowest level since February 1994. But we shall have to wait for consumer expenditure data to see the impact of the fall in confidence on spending. There is some evidence that spending has shifted more toward discount stores and somewhat away from more up-market stores as seen in the strong results from Wal-Mart relative to GAP. In addition, mortgage refinancing, which increases consumers' disposal income, is near an all-time high in the US.

Inflation remains subdued allowing the Federal Reserve to continue its policy of lowering interest rates to stimulate consumer demand and capital expenditure in the economy. All of the potential indicators of inflationary trends are showing no sign of inflation re-emerging as a barrier to interest rate cuts in the short term. Oil prices remain stable at the $20 - $21 per barrel level, commodity prices remain low, producer prices are showing no sign of any significant increase and wage demands are being tempered by layoffs.

Table 1 below shows the movements in the selected markets in recent days (market close on 23rd October to close on 31st October) and in the period since the terrorist attacks on the World Trade Centre (close on 10th September to close on 31st October).

Table 1

Market	Index	% Return 23/10/01 to 31/10/01		% Return 10/09/01 to 23/10/01	
		Local Currency	Euro	Local Currency	Euro
US	S&P 500	-2.3	-3.6	-3.0	-3.3
Europe	FT/S&P Europe Ex. UK	-2.6	-2.6	-0.6	-0.6
Ireland	ISEQ	-2.6	-2.6	-6.4	-6.4
UK	FTSE 100	-3.0	-2.0	+0.1	-0.3
Japan	Topix	-3.3	-4.4	+0.3	-1.3
Hong Kong	Hang Seng	-1.4	-2.8	-2.8	-3.1
Euro Bonds	Merril Lynch Euro over 5 year	1.9	1.9	4.5	4.5

Equities

Equities lost ground over the last week as investors took profits following the strong gains over the previous month. Companies continued to report poor earnings, but reactions were muted as large falls had been expected due to the deteriorating global economy, exemplified by US data showing the first quarterly decline in the economy in eight years. The major corporate news of the week was the awarding of the biggest-ever military contract to Lockheed Martin of the US. The deal, which entails building the most advanced military plane yet, is estimated to be worth up to $200 billion.

Bonds

The big news in the period under review, 23rd to 31st October, was the announcement by the US Treasury that long-bond issuance is to end. The prospect of a lack of supply at the long-end of the maturity spectrum pushed up the prices of long-dated US government bonds and consequently yields dropped. The yield on the US benchmark long-bond fell from 5.2% to about 4.9%. Bond prices continued to be supported by a lack of evidence of inflation and global economic weakness.

Outlook

The swift round of interest rate cuts by global Central Banks has been positive for markets and more cuts are expected. Inflation remains subdued and permits the US policy of lower interest rates and higher government spending to continue until growth re-ignites in 2002. Corporate earnings remain a negative in the near term but equity markets are historically cheap on valuations relative to bonds.

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