

## Market Comment

Issued on 16th May 2002

### Overview

Equity markets made solid gains in the past week, largely in response to further confirmation of economic recovery in the US. In the previous week, statistical releases confirmed significant rises in productivity, allied to further falls in unit labour costs. These trends are very positive for future growth in corporate profits and consequently gave a strong fillip to equity markets. This week, retail sales figures for April confirmed that the consumer sector remains buoyant, a further positive indicator for future demand. The April data showed that US retail sales were up 1.2% on the previous month, compared to a rise of 0.2% in March, and well above the expected increase of 0.6%. Crucially, the higher figures apply across the board, whereas previously car sales, which have held up well throughout the downturn due to heavy price discounting, accounted for a large component of consumer spending.

Table 1 below shows the movements in the main markets since last week's comment.

**Table 1**

Market	Index	% Return 09.05.2002 to 16.05.2002	
		Local Currency	Euro
US	S&P 500	1.7	1.7
US	NASDAQ	4.6	4.6
Europe	FT/S&P Europe Ex. UK	1.6	1.6
Ireland	ISEQ	1.2	1.2
UK	FTSE 100	1.2	1.0
Japan	Topix	-0.4	-0.1
Hong Kong	Hang Seng	1.2	1.2
Bonds	Merrill Lynch Euro over 5 year	-0.2	-0.2

### Equities

Equity markets around the world responded well to the positive economic trends emerging from the US. The battered technology sector got a strong boost from an announcement of better than expected earnings by Applied Materials, which supplies semi-conductor equipment to computer chip-makers, such as Intel. Sales were boosted by higher orders from Asian foundries, which are the lowest cost chip producers. The results augur well for recovery in the broader technology sector and fuelled an advance of 4.6% on the NASDAQ index on the week.

European markets responded well to the firmer US trend. We expect Europe to benefit to a greater degree from any improvement in equity market sentiment as European company valuations are at lower historic and relative levels than in the US. Likewise, the Pacific region is attractive due to its strong very sensitivity to any pick-up in the world economy. Reflecting these views, Eagle Star's funds are overweight in the European and Pacific regions relative to our competitors. Within the US, a continued economic upturn is more likely initially to benefit smaller, more aggressive companies than the very large stocks, although the former are inherently more risky.

### Bonds

Bond markets faltered this week due to stronger economic signals and some concerns on rising inflation. This is particularly worrying for Europe, as the ECB has hinted at the possibility of interest rate rises to counter the higher inflationary trend.

### Outlook

- Central banks eased policy significantly in 2001 in order to counteract recessionary conditions and reflate the major economies. The most dramatic easing was in the US where rates fell below 2% - a forty year low.
- Economies have begun to recover over the past four months and markets have already anticipated that central banks will take back some of the "insurance" cuts they performed post September 11th.
- Any change in interest rates would not be very substantial, however. There are still some lingering concerns regarding the durability of the recovery and inflation pressures are still fairly contained, notwithstanding the impact of oil price spikes such as we are currently experiencing.
- While equity valuations are still a periodic cause for concern, at present a neutral to slightly overweight equity stance is warranted, given the improvement in the economic environment.

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