

Market Comment

Issued on 8th July 2002

Overview

There was a strong rebound on equity markets on Friday, following a difficult start to the week. The fallout from the Worldcom scandal continued to weigh on markets and concerns over corporate accounting practices crossed the Atlantic, as questions arose over a number of European companies.

However, there were further indications of an improvement in economic conditions in most parts of the world. In the US, the Institute of Supply Management's manufacturing activity index rose to 56.2 in June. A figure greater than 50 indicates expansion in the economy. There was positive news for manufacturing in Europe also, The Reuters Purchasing Managers' Index rising to 51.8. In Japan, the Tankan survey on business confidence showed its biggest improvement since the survey began in 1974. In Germany, industrial orders were stronger than expected, suggesting that Europe's largest economy might be starting to recover.

The European Central Bank left interest rates unchanged on Thursday, as fears regarding inflation were dampened by the strengthening euro. The euro has been on an upward trend and the consensus remains that it is only a matter of time before it reaches parity with the US dollar. In the UK, the Monetary Policy Committee also left interest rates unchanged on the back of poor manufacturing data.

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

Table 1

| Market | Index | % Return 28.06.2002 to 05.07.2002 | |
|-----------|--------------------------------|-----------------------------------|------|
| | | Local Currency | Euro |
| US | S&P 500 | -0.1 | 1.6 |
| US | NASDAQ | -1.0 | 0.7 |
| Europe | FT/S&P Europe Ex. UK | 0.4 | 0.4 |
| Ireland | ISEQ | -4.8 | -4.8 |
| UK | FTSE 100 | -0.9 | 0.4 |
| Japan | Topix | 1.8 | 3.0 |
| Hong Kong | Hang Seng | 2.0 | 3.7 |
| Bonds | Merrill Lynch Euro over 5 year | -0.2 | -0.2 |

Equities

Independence Day dominated equity markets in the US, last week. Investor jitters over possible terrorism attacks on the 4th July holiday, led markets lower earlier in the week. Meanwhile, worries over the prevalence of corporate accounting issues also contributed to the general nervousness. The day passed without incident and when markets reopened on Friday they powered ahead buoyed by the positive sentiment.

In Europe, Vivendi Universal, the media giant generated much of the week's headlines. On Tuesday it rose over 9% on the news that its chairman, Jean-Marie Messier had agreed to resign, while on Wednesday it plunged some 25% on a suggestion that its accounts were not in order. The company responded to the claims by stating that the US Securities and Exchange Commission had not voiced any objections to its accounting practices. The company was not helped by downgrades from both Moodys and Standard and Poors. However on Friday, the stock rose 16%, as European equity markets rallied, making up the losses of earlier in the week.

Bonds

Bonds markets had a good start to the week on the basis of poor equity market performance. Investors continued to transfer funds from equity markets, to the less volatile environment of government bonds. However, they fell back on Thursday and Friday as stock markets rallied and the Merrill Lynch over 5 year bond index ended the week marginally lower. Year to date, the Eagle Star Active Fixed Income fund is up 3.2%.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies.
- Recent indicators suggest that the Fed may delay any rate hikes a bit longer while the ECB may do likewise, given the recent strength in the euro.
- Current investor sentiment remains volatile, with concerns stemming from high US valuations with a series of investigations into US corporate accounting this year.
- These events have obscured the underlying improvement in US profitability which has occurred over the past few months. However, we remain

underweight in the US on valuation grounds, more neutral Europe and overweight Asian markets. At the sectoral level, we remain biased towards cyclicals, basic materials and financial stocks and underweight telecoms, technology and healthcare stocks in our portfolio.

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