EAGLE STAR

Market Comment

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Overview

Equity markets remained in negative territory last week despite a cautiously optimistic testimony before the Senate's Banking Committee by the chairman of the Federal Reserve, Mr. Alan Greenspan. There are now some signs that the markets have entered a capitulation stage with broad based selling across sectors and high levels of redemptions in US mutual funds. Mr. Greenspan praised the resilience of the US economy and acknowledged the improvement in fundamental economic conditions. However, he also commented that corporate accounting scandals have undermined the credibility of corporate America and caused uncertainty about the immediate future. The consensus among analysts is that it is highly unlikely that there will be any change in interest rates before 2003.

On Tuesday, driven by doubts over US corporate governance, the euro moved above parity with the US dollar for the first time since February 2000. The dollar continued to lose ground and on Friday it hit a two-and-a-half year low against the euro and a 27-month low against sterling.

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

Table 1

Market	Index	% Return 12.07.2002 to 19.07.2002	
		Local Currency	Euro
US	S&P 500	-8.0	-10.3
US	NASDAQ	-4.0	-6.4
Europe	FT/S&P Europe Ex. UK	-6.3	-6.3
Ireland	ISEQ	-1.8	-1.8
UK	FTSE 100	-3.0	-3.6
Japan	Topix	-2.9	-4.5
Hong Kong	Hang Seng	-3.0	-5.4
Bonds	Merrill Lynch Euro over 5 year	0.4	0.4

Equities

It was a miserable week for equity markets as positive earnings results from a number of companies failed to lift investor sentiment. Companies such as Electrolux, Atlas Copco Citigroup and Ford all delivered good news. Some 79 per cent of the 500 or so companies that reported between Monday and Thursday met or beat analysts' expectations.

Markets retreated heavily worldwide on Friday when Johnston & Johnston confirmed a New York Times report that a FDA investigation had been launched into one of the company's factories in Puerto Rico. Siebel and Sun Microsystems share prices tumbled as they scaled back their estimates for upcoming quarters.

On Sunday, the board of Worldcom agreed to file for bankruptcy, surpassing Enron as the biggest insolvency in US history. The telecommunications company, reeling from a $3.9 billion accounting fraud last month, is trying to restructure its finances and filing for bankruptcy provides the company with protection from its creditors while it does so.

Bonds

European bond prices moved in a tight range last week, as investors were naturally reluctant to make any move into equities. Bonds have earned safe haven status due to the continued volatility in markets. The fortunes of bond markets have been heavily linked with those of equity markets during the last number of weeks and economic conditions have had less of an effect on bond movements. The Merrill Lynch over 5 Year Government Bond Index rose 0.4% on the week. The Eagle Star Active Fixed Interest Fund is up 4.2%, year to date.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies.
- Recent indicators suggest that the Fed may delay any rate rises until 2003 while the ECB may hold back also, given the recent strength in the euro.
- Current investor sentiment remains negative, with concerns stemming from high US valuations and 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, underweight in Europe, which has failed so far to de-couple from the US and overweight in Asian

markets. At the sectoral level, we remain biased towards cyclicals, basic materials and financial stocks and underweight in telecoms, technology and healthcare stocks in our portfolio.

- Overall, our stance remains overweight bonds, underweight equities although a bear market rally in equities is not unlikely given the technically oversold level of many share prices. An end to the two and a half year fall in equities will come about when the markets are convinced that the excesses of the 1990's, and especially the TMT bubble, have been expunged.