

Market Comment

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Overview

The recent upturn in equity markets came to an end last week as markets worldwide fell back on profit taking, mixed economic data and renewed geopolitical concerns. The week started with the emergence of data in the US that showed a sharp rise in new home sales. This was followed by news of a strong increase in durable goods orders in the US, which rose 8.7% in July.

However, profit taking on gains made in previous sessions stopped markets moving forward and news that consumer confidence in the US had fallen did not help equities. The confidence figure fell to 93.5 in August; which was lower than expected, and highlights some weakness in US consumer spending. Consumer spending constitutes 70% of the US economy and is watched closely by investors as an indication of how the economy is holding up.

There was also nervousness on markets as geopolitical concerns over Iraq and the Middle East re-emerged. Dick Cheney, the Vice President of the United States, made a speech endorsing a pre-emptive strike on Iraq.

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

Table 1

Market	Index	% Return 23.08.02 to 30.08.02	
		Local Currency	Euro
US	S&P 500	-2.6	-3.5
US	NASDAQ	-4.8	-5.6
Europe	FT/S&P Europe Ex. UK	-3.7	-3.7
Ireland	ISEQ	-1.5	-1.5
UK	FTSE 100	-3.7	-2.8
Japan	Topix	-2.3	-2.3
Hong Kong	Hang Seng	-2.0	-2.8
Bonds	Merrill Lynch Euro over 5 year	0.7	0.7

Equities

It was a poor week for equities as investors took a cautious stance on mixed economic data and geopolitical tensions. In the US, concerns over valuation levels persisted as experts continued to reassess earnings expectations for 2003, leading to speculation that US stocks may be still overvalued.

Technology stocks on both sides of the Atlantic led markets down. Downbeat news from Intel, Nortel and Sun Microsystems weighed heavily on the sector. Intel, the world's largest chipmaker, warned that third quarter growth would be modest while Nortel Networks, the Canadian equipment maker, lowered its revenue forecasts and announced 7000 job cuts. Sun Microsystems also fell back as analysts at Goldman Sachs estimated that the company would report losses in excess of forecasts.

The ISEQ index held up relatively well, supported by good performances from financial stocks such as Bank of Ireland and Anglo Irish Bank. Oil stocks posted positive returns as tensions in the Middle East and concerns over inventories in the US pushed prices up. However, an agreement from OPEC to increase supply caused prices to ease somewhat as the week progressed.

Bonds

Bond prices moved higher last week as mixed economic data and weak stock markets helped to attract investors into fixed interest markets. European bonds gained as Otmar Issing, head of the European Central Bank, made cautious comments on the outlook for the European economy. News that the German Ifo survey on business sentiment fell for the third consecutive month also helped fixed interest markets to make ground. The Merrill Lynch over 5-Year Government Bond Index rose 0.7% on the week. The Eagle Star Active Fixed Interest Fund is up 7.6%, year to date.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies. However, risks of a double dip recession have re-emerged.
- Current investor sentiment remains negative, with concerns stemming from relatively 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, marginally underweight Europe, which has failed so far to de-couple from the US and overweight Asian markets. At the sectoral level, we remain biased towards basic materials and financials and underweight technology stocks. Healthcare and telecoms have been moved from underweight to neutral on valuation grounds.
- Overall, our stance is overweight bonds, neutral equities. 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.

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