

## Market Comment

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### Overview

The last of the second quarter earnings reports came out last week and investors turned to economic news for direction. Most markets had a strong start to the week but profit taking led to a pullback on Friday.

Economic data overall was mixed on both sides of the Atlantic. In the US, there was a sharp decline in consumer confidence figures. The Conference Board's index fell to 76.6 in July from 83.5 in June. The figure came as a surprise to the market as most analysts had predicted an improvement. However, the release of the Chicago Purchasing Managers' Index on Thursday showed the figure rising to 55.9 in July, well ahead of expectations. Markets also welcomed the news that the annualised second quarter gross domestic product had grown to 2.4 per cent from 1.4 per cent in the first quarter. There was also an improvement in durable goods orders in the US. In Europe, the latest monthly reading of Germany's Ifo institute business climate index recorded its third consecutive gain. However, the index failed to meet market expectations.

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

Market	Index	% Return 25/07/2003 to 01/08/2003	
		Local Currency	Euro
US	S&P 500	-1.9	0.4
US	NASDAQ	-0.9	1.4
Europe	FT/S&P Europe Ex. UK	1.0	1.0
Ireland	ISEQ	2.1	2.1
UK	FTSE 100	-0.8	0.7
Japan	Topix	-0.3	1.1
Hong Kong	Hang Seng	3.1	5.5
Australia	S&P/ASX 200	1.4	1.9
Bonds	Merrill Lynch Euro over 5 year	-1.4	-1.4

### Equities

Economic news was in the spotlight in the US last week. However, there were still some corporate earnings reports for investors to digest. Proctor & Gamble, the consumer product manufacturer, saw its stock rise when it posted a 5 per cent rise in profits. Xerox, the electronics manufacturer beat market expectations but the company revenues declined.

In Europe, the two big stories came from ABB, the Swiss engineering group and France's Alcatel, the telecommunications equipment manufacturer. Both stocks have seen severe declines in the past number of years. ABB stock rose when it reported that it would return to profit this year. While Alcatel announced a modest operating profit and said that the company would breakeven on the full year. Numerous brokerage houses upgraded their recommendations on both companies.

Hong Kong rallied on the back of a stronger property market. The government indicated that it hopes to unveil new measures to support the real estate market.

### Bonds

It was another volatile week for bonds as the market in the US and Europe absorbed economic data releases and searched for indicators regarding an economic recovery. There was relief on the US bond market when the Treasury's refunding auction did not go above \$60 billion. The US government will sell a record amount of new debt but there had been speculation that the amount would be billions greater. Eurozone bonds also took some heart from the news, but investors chose to focus on the positive economic data from the US and this resulted in a sell off on bond markets.

### Outlook

▶ Global economic activity still remains below trend. Inflation pressures are low and could easily fall further.

- ▶ US growth is currently tepid despite massive policy stimulus. Investors, however, are already discounting a swifter pace of activity in H2 of 2003 and into 2004. Eurozone growth is weak but markets now expect a better outlook, as a delayed reaction to improving global growth prospects.
- ▶ Further rate cuts are still possible in the eurozone and US interest rates - at 1% - are likely to stay low for a considerable time.
- ▶ Given current valuations in equities, and the sharp rally in markets since March, a continuous rise in equities will need a more robust economic and earnings environment.
- ▶ Bond yields are low in all major markets but had been underpinned by low inflation expectations and a supportive short rate background. Recent increases in bond yields especially in the US reflect greater optimism about future growth prospects. From here yields are vulnerable - in both directions - to changes in perceptions regarding growth and short rates. Ultimately, however, a successful reflationary effort by global policymakers would mean a negative environment for bond markets, and a more positive one for equities.
- ▶ Our current overall portfolio stance is overweight Eurozone bonds - given the ongoing disinflationary backdrop in the Eurozone - and overweight equities versus the manager average. The funds are underweight in the UK equity market due to its defensive characteristics and overweight Asia (ex-Japan) due to more attractive valuations and better economic growth potential.

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