EAGLE STAR

Market Comment

Issued on 25th August 2003

Overview

Further strong gains on most of the world's leading stock markets last week pushed many indices to highs not seen in well over a year. A notable feature was the widespread nature of the rise, with western and eastern markets alike rising on continuing optimism about economic recovery. While volumes were relatively light in the US and Europe, possibly exaggerating the movements slightly, those in the Far East were exceptionally heavy for the time of year. Investors have been active in the region on expectations that Asian exporters will benefit disproportionately from US economic recovery.

Last week's growth figures in Japan, suggesting annualised growth of 2.3%, continued to exert a powerful influence on the market there. Up 5% on the week at one stage on Thursday, and closing above the 10,000 level during the week for the first time in a year, the Nikkei index eventually closed the week up over 4%.

In the US it was a relatively quiet week for corporate news but the two big economic indicators released during the week showed a slight fall in the University of Michigan confidence number - largely ignored - and a large fall in the Initial Jobless Claims figure - greeted as a sign of an improvement in the labour market.

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

Table 1

Market	Index	% Return 15/08/2003 to 22/08/2003	
		Local Currency	Euro
US	S&P 500	0.2	3.7
US	NASDAQ	3.7	7.3
Europe	FT/S&P Europe Ex. UK	2.4	2.4
Ireland	ISEQ	2.4	2.4
UK	FTSE 100	-0.5	1.6
Japan	Topix	4.1	9.1
Hong Kong	Hang Seng	3.2	6.8
Australia	S&P/ASX 200	1.2	3.0
Bonds	Merrill Lynch Euro over 5 year	0.0	0.0

Equities

Japanese equities enjoyed a very strong week. The Nikkei closed above 10,000 on Monday and did not relinquish that level, despite a slight fall off on Friday. The biggest gainers have been the banks, boosted by optimism over the positive effect of rising share prices on their balance sheets, and stocks likely to benefit from domestic economic recovery, in the light of last week's upbeat growth figures. Elsewhere in the Far East, the Hong Kong, Singapore and Korean stock markets also closed at their highest levels for a year or so.

Closer to home, European markets have been helped by the current weakness of the euro against the US dollar. The euro fell to a four month low against the dollar last week, boosting exporting stocks in particular, with car makers being notable beneficiaries. The German Dax Index hit its highest level since September 2002 during the week, up an impressive 61% from its March low. The Irish market mirrored its European counterparts, rising 2.4%

Bonds

Following several weeks of rising yields, US and European bond markets steadied up last week with longer dated yields recouping a small amount of their recent losses. Japanese yields continued to rise though, finishing the week at their highest level in over a year. The Merrill Lynch over 5-year index finished flat on the week.

Outlook

- Economic activity has strengthened in the US but its sustainability remains questionable. Globally, inflation pressures are low.

- Investors are already discounting a swifter pace of US economic 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.
- 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.
- 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 neutral bonds and slightly overweight equities versus the manager average on a tactical basis. 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.