

Market Comment

Issued on 1st September 2003

Overview

After the previous week's strong performance on equity markets, the week under review was more notable for its inactivity than its level of activity. Starting with a Bank Holiday in the UK and building towards the Labor Day holiday in the US this week, volumes were low and big corporate stories thin on the ground.

The week's economic releases were generally positive, without any strong knock-on effect on stockmarkets. In Germany, the Ifo business climate index was up for the fourth consecutive month, though the Dax Index and the Europe ex. UK Index both finished down on the week.

Economic data in the US continued to support the view of a strengthening economy: consumer confidence figures from the Confidence Board showed a rise in August, durable goods orders data, which record purchases of goods with a life span exceeding three years, rose 1% in July and Gross Domestic Product numbers for Q2 in the US came in at 3.1% (annualised rate), against an expectation of 2.9%. The report also showed rises in consumer spending and business investment.

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

Market	Index	% Return 22/08/2003 to 29/08/2003	
		Local Currency	Euro
US	S&P 500	1.5	0.7
US	NASDAQ	2.6	1.8
Europe	FT/S&P Europe Ex. UK	-1.2	-1.2
Ireland	ISEQ	1.6	1.6
UK	FTSE 100	-1.5	-2.3
Japan	Topix	-0.2	-0.1
Hong Kong	Hang Seng	1.4	0.6
Australia	S&P/ASX 200	0.5	-0.5
Bonds	Merrill Lynch Euro over 5 year	-0.1	-0.1

Equities

In a quiet week for corporate news, Nokia provided a talking point by launching two new phones aimed specifically at fast-growing markets such as India and Russia. The CEO, Jorma Ollila, predicted that 800 million new customers would take up a mobile phone subscription in the next five years and that 80% of this growth would come from emerging markets. Nokia stock closed up 4.8% on the day and 17% in the previous fortnight, its best level since a profit warning six weeks ago when it fell 15% in a day.

One of Europe's largest companies, Munich Re, had a poor week, suffering a double blow. It reported its fifth consecutive quarterly loss, while Standard & Poor's cut its credit rating. The company responded by saying that the downgrade was unwarranted and that it would not raise funds simply to appease credit rating agencies. The stock closed down 5.4% on the day.

Ireland enjoyed a good week, the index rising 1.6%. There has been some renewed interest in the financials and this coming week is a big one for results with Kerry Group, CRH, Irish Life & Permanent and Grafton Group all releasing numbers.

Bonds

The eurozone government bond index finished the week virtually unchanged. A fourth, successive positive Ifo survey on Tuesday caused yields to rise a little, as it suggested that economic activity might be picking up a bit. However, yields fell again on Thursday, leaving the index down just 0.1% 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.

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