

Market Comment

Issued on 9th September 2003

Overview

The rally in equity markets continued this week, underpinned by further positive economic data from the US. Markets were closed in the US on Monday for the Labour Day holiday but activity picked up considerably for the remainder of the week.

The Institute of Supply Management in the US released particularly good figures. The index on manufacturing activity rose to 54.7%. However, the labour component of the index continued to contract underlining the jobless nature of the recovery so far. These concerns were reinforced on Friday when non-farm payroll data was weaker than expected in the US. However, economic data on balance is strengthening and investor sentiment has markedly improved. Second-quarter productivity was revised upward to 6.8 per cent while the Federal Reserve said in its Beige Book survey that US economic activity continued to improve in August.

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

Market	Index	% Return 29/08/2003 to 05/09/2003	
		Local Currency	Euro
US	S&P 500	1.3	0.2
US	NASDAQ	2.6	1.5
Europe	FT/S&P Europe Ex. UK	2.7	2.7
Ireland	ISEQ	0.7	0.7
UK	FTSE 100	2.3	2.0
Japan	Topix	2.4	0.9
Hong Kong	Hang Seng	2.4	1.2
Australia	S&P/ASX 200	0.4	-0.8
Bonds	Merrill Lynch Euro over 5 year	-0.7	-0.7

Equities

It was a good week for equities as upbeat economic data continued to provide evidence of a strengthening economy. European markets put in a good performance with insurance stocks continuing their recovery following upgrades from a number of investment brokers.

Technology stocks across the globe gained further ground despite concerns over valuations. SAP, the German software group gained when both Morgan Stanley and Credit Suisse First Boston upgraded the stock. Technology companies such as Cisco Systems and Intel fuelled investor sentiment about the sector with the release of cautiously better outlooks for their future earnings prospects.

Asian equity markets were strong as exporters benefited from the upturn in investor sentiment. In Japan, electronics exporters gained from improved manufacturing data. The Australian market under-performed due to the defensive nature of the market.

Elan, the pharmaceutical company based in Athlone, ended weeks of uncertainty about its accounts when it filed its 2002 accounts with US regulators on Friday. The battered share price rose over 20% as a result.

Bonds

Bond markets fell back early in the week before recovering somewhat on Friday following the release of weak employment data. Comments from Federal Reserve officials suggest that the Fed is unlikely to raise interest rates in the near future due to low inflation. However, improved economic data has kept bond investors wary and the Merrill Lynch euro over 5 year government bond index lost 0.7% on the week.

Outlook

Economic activity has strengthened in the US and sentiment has improved greatly

regarding the rest of the globe; inflation pressures remain 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.
- ▶ Central banks have stated that interest rates are likely to stay low for a considerable period of time.
- ▶ Given current valuations in equities and the sharp rally in markets since March, a continuous rise in equities will need a sustained, robust, economic and earnings environment.
- ▶ Recent sharp 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 underweight bonds and 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 and Latin America due to more attractive valuations and better economic growth potential. The funds are overweight European equities and underweight US equities on a tactical basis.

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