

Market Comment

Issued on 14th February 2002

Overview

Investors' nerves were restored somewhat over the last week as a positive trend in the economic fundamentals and favourable corporate earnings announcements dispelled some of the gloom engendered by the Enron affair.

The outlook for the US economy received a boost from statistics showing that retail sales excluding the auto sector had experienced their biggest rise in two years. A reduction in auto sales had been expected following the discontinuance of deep discount and zero interest financing deals. Thus the 1.2% rise in sales of other items was interpreted as a positive indicator for the economy, particularly as it followed earlier statistics showing a reduction in unit labour costs (which is good for productivity and corporate profits), and a smaller than expected rise in unemployment.

On the corporate front, concerns about unorthodox balance sheets and debt exposures remained in the foreground, but were tempered by a view that the pessimism of the previous week may have been overdone. Strong results from a number of companies, particularly in the auto and drugs sectors, also helped restore confidence.

Market Performance

Table 1 below shows the movements in selected markets since last week's comment and from the beginning of the month.

Table 1

Market	Index	% Return 06.02.2002 to 13.02.2002		% Return 31.01.2002 to 13.02.2002	
		Local Currency	Euro	Local Currency	Euro
US	S&P 500	3.2	2.8	-1.0	-2.6
US	NASDAQ	2.6	2.1	-3.9	-5.4
Europe	FT/S&P Europe Ex. UK	2.3	2.3	-1.7	-1.7
Ireland	ISEQ	1.9	1.9	-8.1	-8.1
UK	FTSE 100	1.6	2.3	-0.2	-0.5
Japan	Topix	6.6	6.5	1.2	0.4
Hong Kong	Hang Seng	2.3	1.8	1.0	-0.5
Bonds	Merrill Lynch Euro over 5 year	-1.1	-1.1	-0.4	-0.4

Equities

Equities rose across the board, helped by good corporate results and better economic expectations. In the US, Hewlett Packard announced a surge in demand for PCs in the first quarter while Applied Materials, which is the biggest micro-chip equipment maker, exceeded analysts' profit estimates and said it believed the industry had bottomed out.

European markets gained from strong results in the auto and pharmaceutical sectors, with Renault, Peugeot and Aventis each surprising analysts with stronger than expected results and upbeat statements on the future. Eagle Star funds are strongly positioned in these sectors with Peugeot held across all our equity portfolios.

In Ireland, the shock waves created by AIB and Elan in the previous week receded and AIB clawed back 11% of its 16% loss. Elan was up over 8% but still has a long way to go to regain the 65% drop of recent weeks.

The favourable trend in markets is mirrored in the performance of Eagle Star equity based funds. In the 6 day period from 7th February to 13th February (the latest available price), the Five Star Five Fund is up 1.9%, while the International Dynamic and Dynamic Funds are up 1.4% and 0.7%, respectively.

Bonds

Reflecting the improvement in the US economic outlook, there was some profit taking on bond markets and prices fell on expectations that the next move in US interest rates could well be upward. A rise in oil prices and a higher than expected increase in UK inflation also pushed prices lower.

Market Outlook

- The Federal Reserve performed a dramatic easing of monetary policy during 2001, with interest rates cut to below 2%, a forty-year low. Other central banks also lowered rates; moves which were possible due to subdued inflation pressures globally.
- Cutting interest rates will help to reflate the major economies. However, the recovery could also appear patchy at first, as many sectors still have an overhang of capacity built up during 1999/2000.
- Currently it is felt that we are at the low point for the global economy and close to lows on interest rates.
- A neutral to underweight stance in equities is warranted at present, given the current uncertainty over the degree of economic recovery and accountancy standards concerns. However, it is likely that equity positions will be increased as the economic and corporate earnings' picture becomes clearer.

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