

Market Comment

Issued on 29th May 2002

Overview

Investor sentiment remained shaky this week as indicators on the US economy presented mixed signals on the strength of the recovery and political tensions heightened, with fears in the US of further terrorist attacks and increasing concerns of nuclear conflict between India and Pakistan over Kashmir.

On Thursday (May 23rd), figures on US durable goods orders were sharply higher than expectations, reflecting strong demand for machinery and electrical equipment. This was followed, however, by a downward revision to the annualised figure for first quarter GDP growth, from 5.8% to 5.6%. Investors returned from the US Memorial Day holiday weekend to further mixed signals with consumer confidence figures rising slightly but expectations retreating. In Europe, economic indicators gave some grounds for optimism, with a higher than expected rise in the Ifo Index of German business sentiment and a fall in German producer prices. This should take some of the pressure off the European Central Bank to raise interest rates. A survey of European investors also revealed a majority view that market conditions would improve.

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

Table 1

| Market | Index | % Return 16.05.2002 to 23.05.2002 | |
|-----------|--------------------------------|-----------------------------------|------|
| | | Local Currency | Euro |
| US | S&P 500 | -2.0 | -2.6 |
| US | NASDAQ | -2.7 | -3.3 |
| Europe | FT/S&P Europe Ex. UK | -0.1 | -0.1 |
| Ireland | ISEQ | -0.4 | -0.4 |
| UK | FTSE 100 | -2.0 | -2.2 |
| Japan | Topix | -0.5 | -0.7 |
| Hong Kong | Hang Seng | -0.4 | -1.0 |
| Bonds | Merrill Lynch Euro over 5 year | 0.1 | 0.1 |

Equities

The main market weakness was in the US where trading activity was restricted by the long holiday weekend and conflicting economic news combined with political worries which drove stock prices lower. The high valuations of US technology stocks gave further cause for caution as investors took the view that a substantial economic recovery would be required to drive earnings up to the level of expectations. A fall of almost 3% on the NASDAQ reflects the level of concern in this sector. In the Far East, there was some profit-taking in Japan after its recent strong run and the market was marginally lower. There is a growing level of optimism that the Japanese economy may be experiencing a modest export-led cyclical upswing. Europe was unchanged on the week.

Bonds

European bond markets moved sideways this week, as the improvement in economic sentiment, which would tend to raise interest rate expectations, was tempered by a better inflation outlook. A fall in oil prices to the \$25 per barrel level, lower German producer prices and strong demand for the euro all helped to allay fears that the ECB would implement an early rise in interest rates.

Outlook

- An ongoing improvement in global economies remains the central scenario, although there are some doubts about the durability of the US consumer, given high personal debt levels.
- While the current monetary background is supportive of growth, investors have begun to focus on how quickly US rates will increase from the artificially low levels of post September. Additionally, the ECB has signalled that it is leaning towards a tightening bias.
- In any event, rates increases globally are likely to be modest given the continued benign outlook for inflation. Many companies continue to report a lack of pricing power.
- Overall, the environment supports a mildly positive stance on equities, as markets await the earnings recovery. Geographically we prefer markets in Asia and Europe while we remain biased towards cyclical and financial stocks and underweight technology stocks.

© Copyright 2002 Eagle Star Life, Eagle Star House, Frascati Road, Blackrock, Co. Dublin.

Eagle Star Life Assurance Company of Ireland Limited is regulated by the Irish Financial Services Regulatory Authority.