EAGLE STAR

# Market Comment

**Issued on 13th June 2002**

## *Overview*

In a week of further positive economic news, equity markets continued to slide as investors remained concerned about the outlook for corporate profits. While the economic outlook has improved, confidence remains fragile while the release on Wednesday of the Beige Book of indicators from the Federal Reserve district offices confirmed that the recovery is still very patchy. Overall economic activity expanded at a moderate pace in April and May, though the tone was uneven, with some major sectors showing signs of improvement while others softened or remained weak. Manufacturing production was generally higher, as was activity in the services sector, though labour market conditions remained slack and price increases were subdued. However, some manufacturing input prices, such as steel and energy, were sharply higher, while at the same time, manufacturers have found it very difficult to pass on higher input costs.

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

## *Table 1*

| Market | Index | % Return 05.06.2002 to 12.06.2002 | |
|---|---|---|---|
| | | Local Currency | Euro |
| US | S&P 500 | -2.8 | -3.6 |
| US | NASDAQ | -4.8 | -5.5 |
| Europe | FT/S&P Europe Ex. UK | -2.8 | -2.8 |
| Ireland | ISEQ | -2.2 | -2.2 |
| UK | FTSE 100 | -2.8 | -2.7 |
| Japan | Topix | -2.0 | -3.6 |
| Hong Kong | Hang Seng | -2.2 | -3.0 |
| Bonds | Merrill Lynch Euro over 5 year | 0.4 | 0.4 |

## *Equities*

While the slide in equity markets is disconcerting, valuations in certain regions and sectors, notably in Europe and Asia, are at reasonable levels relative to bonds and to historic values. Conviction in the future strength of the US economy in particular in capital spending is needed to buoy the market. In the meantime, any negative corporate news is sending markets downward. In the past week, the battered technology and telecom sectors were joined by pharmaceuticals in a sharp markdown of prices. Pharmaceuticals fell heavily as Abbott Laboratories in the US issued a profits warnings and concerns mounted on the threat to earnings on branded drugs from generic products.

Eagle Star's managed funds are currently slightly underweight equities and have a strong sectoral and regional bias towards areas that are more insulated from the current volatility in markets. For example, we are overweight in basic material stocks, which have been more successful than others in pushing through price increases on their products.

## *Bonds*

Reflecting our equity markets positions, Eagle Star funds are slightly overweight bonds which have seen further price rises as investors look for a safe haven for their funds. Bonds have also gained from reduced expectations that central banks will push up interest rates as long as economic growth remains modest. European bonds have also gained from a sharp rise in the euro exchange rate, which rose above 95 cents to the dollar on Wednesday, a 17 month high.

## *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, and we are still awaiting a pick up in capital spending.
- While the current monetary background is supportive of growth, investors had begun to anticipate US rates increases from the artificially low levels of post September, but pressures for rate increases have eased somewhat.
- In any event, interest rate 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 neutral 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 while underweight technology stocks.