

Market Comment

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Overview

Investment markets suffered sharp falls in the last week as corporate accounting scandals continued to sour market sentiment. The US pharmaceutical company, Merck was the latest major company to fall victim to queries regarding its accounting practices. However, while Merck had recorded €14 billion in revenues from its pharmacy benefits management unit between 1999 and 2002 that were never collected, it had not inflated its earnings as it had recorded equivalent amounts as costs.

The US President, George Bush delivered a much anticipated speech on the need for reform in corporate America on Tuesday. His initiatives to double jail sentences for corporate fraud and to provide the Securities and Exchange Commission with greater funding did little to boost markets. However, news that US producer price inflation figures were subdued last week was welcomed as it allows the Federal Reserve to keep interest rates on hold.

The euro toyed with parity against the US dollar yet again during the week. The euro reached \$0.9952 at one point and it is expected to make the break through over the next number of weeks. The Japanese yen continued to strengthen against the US dollar leading to losses on the Topix Index as fears persist regarding the effect of these currency movements on Japanese exporting companies.

Table 1 below shows the movements in the main markets since the last market comment.

Table 1

Market	Index	% Return 05.07.2002 to 12.07.2002	
		Local Currency	Euro
US	S&P 500	-6.8	-8.4
US	NASDAQ	-5.2	-6.7
Europe	FT/S&P Europe Ex. UK	-7.7	-7.7
Ireland	ISEQ	-1.9	-1.9
UK	FTSE 100	-8.5	-8.4
Japan	Topix	-2.3	-1.0
Hong Kong	Hang Seng	-1.5	-3.1
Bonds	Merrill Lynch Euro over 5 year	1.2	1.2

Equities

It was a dismal week for equity markets world-wide. The UK market was particularly badly hit, as investors weary from weeks of US corporate scandals pushed the FTSE 100 index down to levels not seen for five years. News that US authorities had launched investigations into Qwest, the US telecommunications Company and Bristol-Myers, the pharmaceutical company, encouraged markets to remain on edge.

Last week saw the beginning of the US earnings reporting season for the second quarter and there was some respite for investors on Friday as Dell, the world's second largest PC maker, raised its second-quarter earnings targets. Juniper Networks also helped to alleviate investor jitters somewhat when it announced earnings that beat analysts' expectations.

Bonds

Bonds had a positive week taking their lead from weak conditions on equity markets. Poor consumer confidence data and benign inflation figures also supported bond markets. The monthly bulletin of the ECB, while still expressing some concerns regarding inflation, was more balanced in its assessment than the previous two months and pointed out the uncertainty present in the economic outlook. The Merrill Lynch over 5 Year Government Bond Index rising 1.2% on the week. The Eagle Star Active Fixed Interest Fund is up 4.2%, year to date.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies.
- Recent indicators suggest that the Fed may delay any rate hikes a bit longer while the ECB may do likewise, given the recent strength in the euro.
- Current investor sentiment remains negative, with concerns stemming from high US valuations and a series of investigations into US corporate accounting this year.
- These events have obscured the underlying improvement in US profitability which has occurred over the past few months. However, we remain underweight in the US on valuation grounds, underweight in Europe, which has failed so far to de-couple from the US and overweight in Asian

markets. At the sectoral level, we remain biased towards cyclicals, basic materials and financial stocks and underweight in telecoms, technology and healthcare stocks in our portfolio.

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