

Market Comment

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Overview

The US Federal Reserve meeting on Tuesday dominated markets last week. The committee decision to leave rates unchanged, at a forty year low of 1.75 %, had been anticipated by most investors. Policymakers acknowledged that corporate governance concerns had caused uncertainty for investors and weakness in financial markets and they changed their stance on interest rates to an "easing" bias. This indicates that they are more likely to cut interest rates going forward.

The deadline in the US for chief executive officers to personally sign off on their companies' financial statements came on Thursday. The majority of companies met the Securities and Exchange Commission's criteria and had their documents submitted on time. Markets reacted favourably, as the day passed off without any major surprises.

There was mixed news on the economic front this week. Consumer prices rose less than expected, indicating that inflation remains under control. Figures released on retail sales showed that there was a 1.2 per cent rise in July sales in the US, indicating that consumer spending is holding up. However, figures for housing starts activity fell from previously high levels, even though mortgage rates are low.

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

Table 1

Market	Index	% Return 09.08.2002 to 16.08.2002	
		Local Currency	Euro
US	S&P 500	2.2	0.8
US	NASDAQ	4.2	2.7
Europe	FT/S&P Europe Ex. UK	-0.4	-0.4
Ireland	ISEQ	4.8	4.8
UK	FTSE 100	0.2	-0.3
Japan	Topix	-2.0	-1.1
Hong Kong	Hang Seng	2.5	1.1
Bonds	Merrill Lynch Euro over 5 year	-0.2	-0.2

Equities

Equity markets had a positive week overall, as the US and Hong Kong markets bounced back from the sharp falls of recent weeks. European markets and the FTSE 100 in the UK moved within a limited range while the Japanese market fell back after a long period of relative out performance.

The week began with news that US Airways had filed for bankruptcy protection. The airline, the seventh largest in the US, is the first to file for bankruptcy since the September 11th terrorist attacks. The US Airways share price fell 79% on the news and other airlines stocks such as Delta Airlines and Continental, also fell back.

Intel, the giant semiconductor company, revealed its plan to produce the next generation of micro transistors. The new chips will be faster and smaller, yet much cheaper. The announcement gave a much needed boost to the technology sector. On Thursday, Dell reported good second quarter earnings figures. The Nasdaq index rose 4.2% on the week.

Hong Kong ended the week higher helped by a strong move in the two big telecom stocks, China Mobile and China Unicom.

Bonds

Fixed interest markets fell marginally this week. Longer dated bonds held firm on news from the Federal Reserve that economic weakness is likely to continue in the short term. An upturn in mortgage refinancing activity, as borrowers renegotiate their mortgages to take advantage of lower rates has helped longer dated bonds. Tame inflation conditions world-wide also continue to work in favour of bond investors. The Merrill Lynch over 5-Year Government Bond Index fell 0.2% on the week. The Eagle Star Active Fixed Interest Fund is up 7.5%, year to date.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies. However, risks of a double dip recession have re-emerged.
- Current investor sentiment remains negative, with concerns stemming from relatively 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 Europe, which has failed so far to de-couple from the US and overweight Asian markets. At the sectoral level, we remain biased towards basic materials and financials and underweight technology stocks. Healthcare and telecoms have been moved from underweight to neutral on valuation grounds.
- Overall, our stance is overweight bonds, neutral equities; although a continued bear market rally in equities is possible after the heavy declines in July. An end to the two and a half year fall in equities will come about when the markets are convinced that the excesses of the 1990's, and especially the TMT bubble, have been expunged.

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