

## Market Comment

Issued on 26th August 2002

### Overview

It was a better week for equities overall as most markets moved forward to end the week in positive territory. European markets were among the best performers. The FT/S&P Europe Ex. U.K. Index recorded a rise of 3.8%. European equities had been underperforming US markets and the rally in Europe last week was in part a case of European stocks catching up on their American counterparts. Better than expected earnings figures from Swedish banks and a more positive outlook for European insurance companies also helped investor sentiment in Europe. Data released last week showed that inflation is below the crucial 2% mark in Europe, which enables the European Central bank to keep interest rates at their current low levels.

In the US, sentiment was lifted by inflows into mutual funds. There had been high levels of redemptions in US mutual funds in July and this had contributed to investor jitters. Investor confidence was also helped by a sharp slowdown in directors' selling of their own stock, which now roughly balances purchases. Selling had dominated purchases by 4:1 over past weeks.

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

**Table 1**

| Market    | Index                          | % Return 16.08.2002 to 23.08.2002 |      |
|-----------|--------------------------------|-----------------------------------|------|
|           |                                | Local Currency                    | Euro |
| US        | S&P 500                        | 1.3                               | 2.6  |
| US        | NASDAQ                         | 1.4                               | 2.7  |
| Europe    | FT/S&P Europe Ex. UK           | 3.8                               | 3.8  |
| Ireland   | ISEQ                           | -0.7                              | -0.7 |
| UK        | FTSE 100                       | 1.4                               | 1.5  |
| Japan     | Topix                          | 0.2                               | -0.3 |
| Hong Kong | Hang Seng                      | -0.2                              | 1.1  |
| Bonds     | Merrill Lynch Euro over 5 year | -0.3                              | -0.3 |

### Equities

It was a positive week for equities as European stocks recorded strong gains, while the US, UK and Japanese markets all recorded rises. Upbeat comments from US Federal Reserve officials lent support to equity markets. The president of the Federal Reserve Bank of Philadelphia said that company profits were improving. He also commented that they do not expect a double-dip recession leading to speculation that further interest rate cuts may not be imminent.

Insurance companies were among the top performing stocks in Europe bringing some welcome relief to the beleaguered sector. Axa, the French insurer, rose 5.5% after reporting a smaller than expected fall in profits for the first half of the year. Swiss Life, the Swiss life and pension insurer, also rose over 5%.

In the US, Home Depot, the world's biggest home improvement retailer, released strong quarterly earnings figures. The company beat analysts' expectations when it reported earnings of 50 cents a share for the second quarter.

### Bonds

Positive comments on the US economy from Federal Reserve officials affected bond prices on both sides of the Atlantic this week. Investors interpreted the comments to mean that the Federal Reserve is unlikely to ease interest rates in the short-term and the futures markets are now only pricing in a small chance of a rate cut at the next meeting of the Federal Reserve. This is down from a 50% chance last week. The Merrill Lynch over 5-Year Government Bond Index fell 0.3% on the week. The Eagle Star Active Fixed Interest Fund is up 6.4%, 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.

© 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.