EAGLE STAR

Market Comment

Issued on 9th September 2002

Overview

Equity markets worldwide retreated last week as economic data and continuing geopolitical concerns played havoc with investor sentiment. Markets in the US were closed on Monday for the Labour Day Holiday and investors returned on Tuesday in favour of bonds. Investors remained cautious as President George W Bush initiated talks with world leaders and the United Nations in order to gain support for the US stance on Iraq. Equity markets are likely to remain volatile until after the first anniversary of the September 11th terrorist attacks this Wednesday.

The Institute of Supply Management in the US released figures on manufacturing on Tuesday, which were weaker than expected. The key manufacturing figure was unchanged at 50.5 while the new orders figure was 49.7, below the important 50 mark which indicates expansion. There was also disappointing figures from the eurozone purchasing managers index, which came in at below expectations.

However, the week ended on a positive note as good news on the employment front helped to bolster investor confidence. The labour department in the US reported that the unemployment rate dropped to a five month low in August suggesting that the labour market is holding up well. This is significant as consumer spending and confidence is largely dependent on the perceived state of the jobs market.

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

Table 1

Market	Index	% Return 30.08.02 to 06.09.02	
		Local Currency	Euro
US	S&P 500	-2.4	-2.7
US	NASDAQ	-1.5	-1.8
Europe	FT/S&P Europe Ex. UK	-3.2	-3.2
Ireland	ISEQ	-4.8	-4.8
UK	FTSE 100	-2.8	-2.5
Japan	Topix	-5.0	-5.1
Hong Kong	Hang Seng	-3.2	-3.5
Bonds	Merrill Lynch Euro over 5 year	1.4	1.4

Equities

It was a dismal week for equities as markets posted further falls and question marks persisted over the likely strength of the economic recovery. Investor confidence remained fragile in anticipation of the anniversary of the September 11th attacks and continuing geopolitical concerns.

The Japanese market led the falls and shares in the Tokyo index reached 19 year lows as confidence in the economy and proposed government reforms collapsed. There was some respite on Friday when a top official said that the government was likely to propose another anti deflation package this week. However the long-term outlook for the Japanese economy is not favourable.

The ISEQ index fell sharply when IFG announced disappointing results for the first six months of the year. AIB fell after analysts said that it was now unlikely to join the Dow Jones Euro Stoxx 50 Index as had been predicted.

Intel, the world largest chipmaker, released its much anticipated mid-quarter update on Thursday. Although the company lowered its revenue forecast slightly, fears that the company would considerably cut its targets failed to materialise. Market analysts welcomed the news.

Bonds

Bond prices moved forward last week on poor German economic data and weak equity markets. German manufacturing orders and weak retail sales both fell leading to speculation that the ECB might cut interest rates going forward, while concerns over Iraq continue to work in favour of fixed interest markets. The Merrill Lynch over 5-Year Government Bond Index rose 1.4% on the week. The Eagle Star Active Fixed Interest Fund is up 9.0%, 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 geo-political tensions.
- 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, marginally 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. 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.