

Market Comment

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Overview

Equity markets rose strongly on Monday as further details of George W. Bush's economic stimulus package for the US emerged. The \$670 billion, 10 year plan proposes the abolition of personal tax on dividends. Investors focused on this dividend yield story on Monday. However, enthusiasm waned on Tuesday, as official details were unveiled. Investors re-assessed the potential impact of the plan and turned their attention back to the weak dollar and geopolitical concerns.

The potential conflict with Iraq continues to hang over equity markets. A declaration from UN arms inspectors that they had found no "smoking guns" seems to have done little to calm tensions. Oil prices have risen to around €32 a barrel as a result of this and a general strike in Venezuela, one of the world's major oil producers. At an emergency session yesterday, OPEC agreed to increase its output quota by 1.5 million barrels per day, to 24.4 million barrels. However, continued movement of US troops into the Gulf is likely to curb any potential decline in prices.

After the positive manufacturing survey data of the previous week, last week's service sector data, while positive, was weaker than market forecasts. The week closed on a downbeat note as disappointing employment figures were released in the US. The data showed that the US economy lost 101,000 jobs in December. Economists had been forecasting modest gains. The major losses were in the manufacturing and retail sectors.

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

Market	Index	% Return 03/01/2003 to 10/01/2003	
		Local Currency	Euro
US	S&P 500	2.1	0.7
US	NASDAQ	4.4	2.9
Europe	FT/S&P Europe Ex. UK	-0.8	-0.8
Ireland	ISEQ	0.7	0.7
UK	FTSE 100	-0.8	-2.1
Japan	Topix	-0.7	-1.7
Hong Kong	Hang Seng	1.4	0.0
Bonds	Merrill Lynch Euro over 5 year	0.8	0.8

Equities

Last week saw the beginning of the corporate earnings announcement season for the fourth quarter of 2002. Alcoa, the world's largest aluminium producer, reported poor results while Gateway, the computer maker, warned of losses due to weak holiday sales. However, there were better outlooks/results from EMC, the data storage company, and SAP, the German software producer.

US markets, led by technology stocks, held on to the gains made early on in the week on the back of the Bush economic stimulation package. The US market outperformed Europe and Asia on the week. There was further evidence of weakness in the German economy as November retail sales fell 6% year-on-year. The Dutch airline, KLM, issued a profit warning, citing worsening economic conditions and fears of war with Iraq as the reasons. Most European airline stock fell on the news.

The UK market had a flat week as the defensive nature of the FTSE 100 prevented it from making any major moves. The index, which consists mainly of financials, pharmaceutical and oil stocks, has underperformed as investors moved into technology and telecoms.

Bonds

European bonds moved forward overall on the week, supported by weak economic data in Europe and faltering European equity markets. As expected, the European Central Bank left rates unchanged when the committee met last week. However, futures markets have priced in another 0.25% interest rate cut by the European Central Bank. US bond prices under-performed their European counterparts as investors anticipated that the US government would be forced to increase supply to fund the economic stimulus package.

Outlook

- ▶ Forward indicators for the major economies suggest that growth will remain relatively subdued, particularly in the first half of 2003.
- ▶ Renewed geo-political tensions have seen oil prices rise by 25% since the low of last November. If sustained at these levels, economic growth forecasts could be reduced further.
- ▶ With growth below trend in all the major economies, interest rates are likely to stay low in the US and could fall further in the Eurozone, while the UK may be reluctant to change rates despite the strength of the housing market.
- ▶ The US dollar will remain under scrutiny in 2003 with further downward pressure likely.
- ▶ For sustained rises in equities we need to see a more robust economic and earnings environment.
- ▶ However, shifting war fears will continue to have an impact on the economic and market outlook in the short term.
- ▶ Our current overall portfolio stance is overweight bonds and neutral equities versus the manager average. On a geographic basis, we are underweight equities in the UK, Europe and Japan. We are broadly neutral in Ireland and marginally overweight in the US. We continue to have a preference for the Pacific region on a valuation basis and as a low cost producer.

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