Market Comment

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Overview

Investors faced turbulent equity market conditions last week as economic concerns took a back seat to the unfolding situation in Iraq. There were mixed signals early on in the week as efforts were made to keep the United Nations diplomatic process alive. The US and the UK struggled to win the support of the UN Security Council members. However, St. Patricks Day brought an end to the months of speculation as President Bush told Saddam Hussein and his sons to flee Iraq within 48 hours or face military attack. Iraqi officials have made it clear that Saddam Hussein will not be leaving Iraq. Stocks markets rose on the news as the uncertainty of recent weeks came to an end and expectations of a short war dominated market sentiment.

In the UK, investors had a rollercoaster week. On Wednesday stocks fell by almost 5% while on Thursday the index recouped these losses as the FTSE 100 recorded the largest percentage gain since 1987. Tony Blairs pro American stance and the split in the British cabinet over the war in Iraq is contributing to investor nerves.

On the economic data front, industrial production was marginally better than expected in February, but US retail sales for February were worse than expected. US jobless claims fell but still remain at worrying levels while an important gauge of US consumer confidence fell more than forecast. The US Federal Reserve meets today to decide on interest rates but is now expected to leave rates unchanged.

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

Table 1

Market	Index	% Return 07/03/2003 to 14/03/2003	
		Local Currency	Euro
US	S&P 500	0.5	2.9
US	NASDAQ	2.7	5.1
Europe	FT/S&P Europe Ex. UK	4.0	4.0
Ireland	ISEQ	2.0	2.0
UK	FTSE 100	3.2	4.3
Japan	Topix	-1.3	-0.6
Hong Kong	Hang Seng	0.6	2.9
Bonds	Merrill Lynch Euro over 5 year	-1.4	-1.4

Equities

Equity markets ended the week in positive territory as the situation in Iraq finally came to a head and investors anticipated that the market might soon be able to move out from under the shadow of the geopolitical uncertainty.

In Europe, there were better than expected results from Fortis, the Benelux insurance group. The company maintained its cash dividend and announced that its solvency ratio was 81% above the required legal minimum. In its mid-quarter update, Nokia made reassuring comments concerning the handset market.

Boston Scientific won an expedited review for one of its drugs from the Federal Drug Administration in the US, which means it should get earlier than expected approval. Defence stocks in the US gained; Lockheed Martin rose after the company was awarded a six-year defence contract worth €4 billion by the Pentagon.

Japanese stocks fell back as tensions rose after North Korea launched the second test missile into the Japanese sea in two weeks. Fears of instability in the Korean peninsula together with the war in Iraq led to declines in the Topix index.

Bonds

Bonds lost ground last week as equities rallied on expectations of a quick war in Iraq. The likelihood of an interest cut in the US on Tuesday has faded despite weak economic data. The Federal Reserve has not indicated that it intends to cut interest rates. In the Eurozone, prices came under further pressure from a €7 billion auction of five-year German bonds. The outcome of the sale was disappointing and the Finance Agency withheld €2.9 billion of the securities.

Outlook

- Forward indicators for the major economies suggest that growth will remain relatively subdued, particularly in the first half of 2003.
- Developments in Iraq will dominate news in the short-term. Further violent moves in either direction are quite possible over coming days.
- It remains the case that a sustained rise in equities will need a more robust economic and earnings environment. The markets may now be discounting a quick resolution to the Iraq situation and an ensuing lift to industrial and consumer confidence that translates into higher economic activity.
- Central Banks will be monitoring these developments to evaluate any likely change in the underlying weak economic fundamentals.
- Our current overall portfolio stance is overweight bonds and underweight equities versus the manager average. On a geographic basis, the funds continue to have a preference for the Pacific region on a valuation basis and as a low cost producer and the UK on valuation grounds. The funds are underweight in Europe due to deteriorating economic fundamentals.