

Market Comment

Issued on 14th April 2003

Overview

The taking of Baghdad by coalition forces and the jubilant response of many Iraqi citizens to the end of Saddam Hussein's regime lifted equity markets early in the week. Subsequently, though, the focus returned to weak economic fundamentals and fears that corporate profits would undershoot expectations as the earnings results season gets underway this week. Traders were reluctant to take strong positions until a clearer picture of the impact of the war on corporate earnings begins to emerge.

US economic releases had been pointing to contraction in both manufacturing and services and rising unemployment. Statistics released last week were more upbeat, with a reduction in the US trade deficit and a fall in weekly jobless claims. On Friday, the University of Michigan consumer confidence index pointed to a rebound in sentiment with the index rising to 83.2 from a nine year low of 77.6 in March. March retail sales also jumped, by 2.1%, well above an expected rise of 0.6%. Investors reacted cautiously, however, as the figure was felt to have been inflated by delayed expenditure following the heavy snowfalls of February.

European economic data heightened fears of a slide into recession as German industrial output was reported to have fallen by 0.7% in February, while French inflation numbers were higher than expected, reducing the likelihood that eurozone interest rates would be cut.

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

Market	Index	% Return 04/04/2003 to 11/04/2003	
		Local Currency	Euro
US	S&P 500	-1.2	-1.6
US	NASDAQ	-1.8	-2.2
Europe	FT/S&P Europe Ex. UK	0.9	0.9
Ireland	ISEQ	0.9	0.9
UK	FTSE 100	-0.2	0.2
Japan	Topix	-1.7	-2.5
Hong Kong	Hang Seng	-2.0	-2.4
Bonds	Merrill Lynch Euro over 5 year	0.1	0.1

Equities

Markets remained volatile amid the conflicting influences of the prospect of an early end to the Iraq war, downbeat economic numbers (albeit with some recent positive data in the US) and corporate earnings fears. Many companies have issued profit warnings over the last number of weeks and this is making investors wary that the results announcements this week will be disappointing. Some have beaten estimates, however. On Monday, Alcoa, the world's biggest aluminium maker, announced better than expected earnings following a cost-cutting programme and the shares jumped 10% on the day. Later in the week, the giant conglomerate, General Electric, reported Q1 earnings down 8.5% year on year, in line with expectations.

European markets held up better than the US, largely due to a strong showing by insurers as Munich Re's rights issue was successfully placed and Goldman Sachs upgraded its recommendations on the company and on the other leading German insurer, Allianz. Asian markets continued to suffer from the fallout from the SARS virus, airline companies being particularly hard hit. Japan fell on the back of sales by foreign institutions in advance of structural selling of "large-caps" by domestic corporate pension fund managers.

Bonds

Bond markets moved sideways as the buoyant mood on progress towards ending the war was counterbalanced by economic concerns. German economic weakness helped eurozone bond prices to remain firm in the early part of the week, though prices slipped late in the week in response to the more positive economic news. The UK monetary authority decided on Thursday to leave the UK base rate unchanged at 3.75%.

Outlook

Forward indicators for the major economies suggest that growth will remain relatively

subdued for the rest of 2003.

- ▶ Developments in Iraq will be less dominant than before although geo-political tensions remain.
- ▶ Central Banks will be monitoring these developments to evaluate any likely change in the underlying weak economic fundamentals post the war in Iraq.
- ▶ It remains the case that a sustained rise in equities will need a more robust economic and earnings environment. The markets may be overly optimistic that a quick resolution to the Iraq situation will significantly boost consumer confidence.
- ▶ Our current overall portfolio stance is overweight bonds and slightly 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.

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