

## Market Comment

Issued on 21st July 2003

### Overview

Corporate earnings reports from the technology and banking sectors dominated equity markets last week. However, while the overall impression veered towards the slightly positive, most markets failed to make any significant moves. The Chairman of the US Federal Reserve, Alan Greenspan delivered his testimony to the US Congress on Tuesday. He said that the Federal Reserve could keep interest rates low for a considerable length of time to spur US economic growth and that there was even room for further rate cuts if necessary. Mr. Greenspan was relatively more upbeat on the economic outlook than in his previous speeches.

Economic data released last week was generally positive. The US Philadelphia Fed's manufacturing index rose to 8.3 in July indicating acceleration in manufacturing activity. The housing market in the US also continues to hold up well. New housing figures in June were better than expected rising to 1.8 million. The University of Michigan confidence index also rose although it was not as strong as anticipated. In the UK, unemployment fell to its lowest level in two years.

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

Table 1			
Market	Index	% Return 11/07/2003 to 18/07/2003	
		Local Currency	Euro
US	S&P 500	-0.5	-0.3
US	NASDAQ	-1.5	-1.3
Europe	FT/S&P Europe Ex. UK	0.1	0.1
Ireland	ISEQ	1.5	1.5
UK	FTSE 100	0.4	-2.2
Japan	Topix	-1.3	-1.8
Hong Kong	Hang Seng	2.3	2.5
Australia	S&P/ASX 200	1.3	-0.6
Bonds	Merrill Lynch Euro over 5 year	-0.9	-0.9

### Equities

In the US, positive results from financial giants, Citigroup and Bank of America helped to get the week off to a good start. Bank of America posted a 23% rise in quarterly profits while Citigroup raised its dividend. Intel, the world's biggest chipmaker, raised its earnings guidance and posted higher than expected revenues. However, IBM, the computer giant, disappointed the market when it indicated that it saw little hope of a rebound in IT investment by its customers. Technology stocks fell on the back of the report stalling a run that has seen the NASDAQ rise almost 28% year to date.

In Europe, Nokia, the Finnish telecoms equipment maker, fell more than 15% after it predicted that industry conditions are unlikely to improve over the next few months. SAP, Europe's largest software producer, reported less than expected software revenues, causing stock prices to fall.

The Irish market outperformed due to a strong return from pharmaceutical company, Galen. The stock rose sharply when the company announced that it was in preliminary discussions regarding a take-over offer. However, at time of writing, the company has indicated that the talks have since terminated.

In Asia, the Hong Kong market put in a good performance due in part to the H-share index, which lists Chinese rather than Hong Kong based stocks. This index rose to a five year high. Singapore was also strong as funds continued to flow into the region.

### Bonds

Bond markets had a difficult week as prices in both the US and Europe fell following a relatively upbeat testimony from Alan Greenspan, chairman of the Federal Reserve in the US. While Eurozone bonds continue to outperform their US counterparts, they came under pressure on two fronts. Firstly, there was a sharp rise in a German business confidence index. The ZEW survey rose to 41.9 in July, well above market expectations. Secondly, comments by Ernst Welteke, president of the German Bundesbank, that further interest rate cuts were unlikely in the short term also held bonds back.

### Outlook

- ▶ Global economic activity remains well below trend and looks likely to remain so for the next six months at least. Inflation pressures are low and could easily fall further.
- ▶ US growth is tepid despite massive policy stimulus. Investors, however, are already discounting a swifter pace of activity in H2 of 2003. Eurozone growth is very weak and forward indicators suggest no near term improvement is on the horizon.
- ▶ Further rate cuts are likely in the eurozone and US interest rates - at 1% - are likely to stay low for a considerable time. While policymakers in the major economies view the chances of negative inflation, or deflation, as quite low, the Fed has partly justified its last cut as insurance against such an eventuality.
- ▶ Given current valuations in equities, and the sharp rally in markets since March, a continuous rise in equities will need a more robust economic and earnings environment.
- ▶ Bond yields are low in all major markets but have been underpinned by low inflation expectations and a supportive short rate background. From here yields are vulnerable - in both directions - to changes in perceptions regarding growth and short rate directions. Ultimately, however, a successful reflationary effort by global policymakers would mean a negative environment for bond markets, and a more positive one for equities.
- ▶ Our current overall portfolio stance is overweight bonds - given the ongoing disinflationary backdrop - and overweight equities versus the manager average. The funds are slightly underweight in Europe due to weak economic fundamentals and a strong currency and overweight Asia (ex-Japan) due to more attractive valuations and better economic growth potential.

© Copyright 2003 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.