EAGLE STAR

Market Comment

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Overview

The corporate results season continued in earnest last week. Some 60 per cent of companies in the S&P 500 have released earnings numbers so far and of these, two thirds have beaten analyst expectations. However, much of the improvement is due to stringent cost cutting measures by companies rather then increasing sales. In the US, the weaker dollar has also had a positive effect on the overall earnings picture. Many companies were also fairly subdued in their statements about the outlook for the coming months. Consequently, the markets failed to gather substantial momentum in response to earnings data during the week.

It was a quiet week for economic news. In the US, unemployment claims released on Thursday were lower then expected. Durable goods' orders came in higher than forecast. However, the Conference Board in the US posted a negligible 0.1 percent gain in its index of leading economic indicators. In Europe, German inflation data fell below 1% again in July.

The deaths of Uday and Qusay Hussein in Iraq proved to be of minor interest to investors and markets in most countries traded sideways. However, oil prices fell some 5 per cent on the news as expectations for a pick up in Iraqi oil supplies mounted.

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

Table 1

Market	Index	% Return 18.07.03 to 25.07.03	
		Local Currency	Euro
US	S&P 500	0.5	-1.4
US	NASDAQ	1.3	-0.7
Europe	FT/S&P Europe Ex. UK	0.4	0.4
Ireland	ISEQ	-2.6	-2.6
UK	FTSE 100	1.4	1.3
Japan	Topix	1.3	-1.0
Hong Kong	Hang Seng	-2.0	-3.9
Australia	S&P/ASX 200	0.5	1.0
Bonds	Merrill Lynch Euro over 5 year	0.5	0.5

Equities

Corporate earnings reports dominated investment markets in the US last week. Merck, the US pharmaceutical giant, missed analyst forecasts and also lowered sales forecasts for some of its blockbuster drugs. AOL Time Warner, the media conglomerate released good earnings reports but these were overshadowed by lower subscribed additions.

In Europe, there was encouraging results from the pharmaceutical sector which helped to lift investor sentiment. Swiss company Roche saw its stock price rise some 5 per cent when its earnings matched expectations. Meanwhile, German pharmaceutical and chemicals company, Merck kGaA, posted a 35 percent rise in profits.

In Asia, the Hong Kong market fell as profit taking continued in the H-share index, which lists Chinese rather than Hong Kong based stocks. The index had risen to five years highs in recent weeks. However, the rally on the index seems to have run out of steam over the last number of days.

Bonds

It was another volatile week for bonds as the market in the US and Europe grappled with improved earnings data and speculation regarding economic recovery. However, cautious comments from senior officials at the US Federal Reserve and the European Central Bank helped bonds to recover somewhat from oversold levels later in the week. Bonds in Europe returned just under 0.5% on the week.

Outlook

- Global economic activity still remains below trend. Inflation pressures are low and could easily fall further.

- US growth is currently tepid despite massive policy stimulus. Investors, however, are already discounting a swifter pace of activity in H2 of 2003 and into 2004. Eurozone growth is weak but markets now expect a better outlook, as a delayed reaction to improving global growth prospects.
- Further rate cuts are still possible in the eurozone and US interest rates - at 1% - are likely to stay low for a considerable time.
- 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 had been underpinned by low inflation expectations and a supportive short rate background. Recent increases in bond yields especially in the US reflect greater optimism about future growth prospects. From here yields are vulnerable - in both directions - to changes in perceptions regarding growth and short rates. 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 Eurozone bonds - given the ongoing disinflationary backdrop in the Eurozone - and overweight equities versus the manager average. The funds are underweight in the UK equity market due to its defensive characteristics and overweight Asia (ex-Japan) due to more attractive valuations and better economic growth potential.