EAGLE STAR

Market Comment

Issued on 11th August 2003

Overview

The emergence of upbeat economic news from the US met with a muted response from investors last week. Markets had discounted the improved data to a large extent already and most markets in Europe and the US traded sideways. The technology heavy NASDAQ index was the exception. Disappointing comments from Cisco saw the index lose some of its recent gains. Asia also fell back as a result of profit taking and worries over terrorism, following an explosion in Jakarta.

The Institute of Supply Management, in the US, reported its highest reading in service sector activity since the survey began in 1997. Employment data showed four week average jobless claims below 400,000 for the first time since February. Productivity data in the US was high and stronger than forecasts.

Concerns over oil supplies from Iraq caused oil prices to rise further. Fears regarding attacks on the infrastructure of Baghdad's oilfields drove prices up. However, this was offset by data showing that US crude oil stocks rose last week.

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

Table 1

Market	Index	% Return 01/07/2003 to 08/08/2003	
		Local Currency	Euro
US	S&P 500	-0.3	-0.7
US	NASDAQ	-4.2	-4.6
Europe	FT/S&P Europe Ex. UK	-0.9	-0.9
Ireland	ISEQ	0.9	0.9
UK	FTSE 100	1.2	0.9
Japan	Topix	-2.7	-2.3
Hong Kong	Hang Seng	-3.0	-3.4
Australia	S&P/ASX 200	0.3	-0.2
Bonds	Merrill Lynch Euro over 5 year	1.4	1.4

Equities

US equity markets fell back last week despite better economic news. Technology stocks were particularly badly hit following comments from the CEO of Cisco Systems, the data network equipment maker, who said that demand from corporations for routers and switches remains fragile. The retail sector performed well as Wal-Mart reported a sharp rise in July sales and provided a bright outlook for future sales figures.

In Europe, shares in Commerzbank, Germany's third largest bank fell as investors focused on an increase in its bad debt provisions rather than the increase in second quarter profits. Bayer, the German pharmaceutical company also produced disappointing results and an unimpressive outlook. However, there was positive news from Credit Suisse, one of Europe's top ten banks, which produced second quarter numbers that were well beyond expectations.

Asian markets fell back as foreign buyers who had recently supported the market engaged in some profit taking. Defensive markets such as Ireland, the UK and Australia held up better on the week.

Bonds

Bonds markets were dominated last week by the US Treasury's quarterly refunding auctions. There has been much volatility in bond markets over the past month. Yields rose, as investors became more upbeat about the economic outlook, especially in the US. The first auction of three-year notes had a poor response. However, there was a better reaction to the 5-year note auction on Wednesday and this had a positive effect on Eurozone government bonds also. The Merrill Lynch over 5-year index rose 1.4% on the week.

Outlook

- Economic activity has strengthened in the US but remains below trend. Globally, inflation pressures are low and could easily fall further.

- Investors are already discounting a swifter pace of US economic 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.
- 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.
- 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 nuetral bonds and equities versus the manager average on a tactical basis. 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.