EAGLE STAR

Market Comment

Issued on 19th August 2003

Overview

Strong economic data helped to push equity markets firmly into positive territory last week. Retail sales figures in the US were unexpectedly robust. Sales in July rose by 1.4% while June's sales growth was revised upwards to 0.9%. Increased purchases of cars and household goods were the main drivers behind the figure. A bigger than expected rise in industrial production also proved supportive. The US Federal Reserve decided to leave short-term interest rates on hold on Tuesday. The market had largely anticipated the decision and the accompanying statement said that rates would not increase for a "considerable" period. There was a dramatic end to the week as the eastern coast of the US suffered a power blackout (partly due to decades of under-investment) on Thursday evening resulting in low trading volumes on Friday.

Asian markets had a particularly strong week as the prospect of global economic recovery led to fresh investor interest. Gross Domestic Product figures from Japan showed that the economy grew 2.3% on an annualised basis, beating analyst expectations.

Oil prices reached their highest levels since the war in Iraq in March. Concerns over Iraqi oil supplies pushed prices up.

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

Table 1

Market	Index	% Return 08/08/2003 to 15/08/2003	
		Local Currency	Euro
US	S&P 500	1.3	1.8
US	NASDAQ	3.5	4.0
Europe	FT/S&P Europe Ex. UK	3.0	3.0
Ireland	ISEQ	1.3	1.3
UK	FTSE 100	2.4	2.0
Japan	Topix	5.2	5.5
Hong Kong	Hang Seng	4.8	5.3
Australia	S&P/ASX 200	0.0	1.5
Bonds	Merrill Lynch Euro over 5 year	-1.0	-1.0

Equities

US markets had a good week on the back of upbeat economic data. Economically sensitive sectors such as basic materials and machinery stocks led the market up. The last of the second quarter earnings reports also emerged and there were no unwelcome surprises.

In Europe, it was a good week for financial and insurance sectors. Axa, France's biggest insurance group, released its half-year results and outlook statement. While net profits were down on the previous year, the company indicated that it is well positioned for an economic upturn. Swiss Re stock also moved ahead after JP Morgan upgraded its rating on the stock to neutral.

In Japan, export oriented stocks were lifted by brighter prospects in the US. Japanese carmakers put in a strong showing following the release of upbeat retail sales data in the US. The Australian market under-performed because of its defensive nature.

Bonds

Bond prices fell again last week pushing yields to one-year highs. In Europe, news that Germany had dipped into recession did little to support bond prices as investors focused instead on a statement from the European Commission saying that eurozone growth is likely to pick up towards the end of the year. Mortgage related hedging activity sent prices lower in the US. Trading was quiet towards the end of the week due to a power blackout in New York. The Merrill Lynch over 5-year index fell 1% on the week.

Outlook

- Economic activity has strengthened in the US but remains below trend. Globally, inflation pressures are low and could 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 neutral bonds and slightly overweight 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.