EAGLE STAR

Market Comment

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Overview

The third quarter corporate earnings season got underway last week and results were generally better than expected, which helped underpin equity market values. The broad indication is that earnings are about 20% ahead of the same period last year. The US technology sector wobbled a little as IBM results disappointed, but the overall response of investors was that the improvement in corporate earnings justified the current level of valuations. Most markets made further gains on the week.

US economic news was also positive and fuelled optimism that the recovery in corporate profits can continue. September housing starts were higher than the previous month and above expectations, as was the University of Michigan index of consumer sentiment. On the manufacturing front, the Empire index of manufacturing activity in New York State jumped from 18.3 in September to 33.7 in October, whereas it had been expected to decline to 16. Retail sales for August were also revised upward to an annual growth rate of 1.2%. Analysts are now indicating that the growth rate of the US economy in Q3 will be in excess of 6% and that the momentum of the economy will remain strong for the fourth quarter.

Movements in the main markets since last week's comment

Market	Index	% Return 10/10/2003 to 17/10/2003	
		Local Currency	Euro
US	S&P 500	0.1	1.7
US	NASDAQ	-0.2	1.4
Europe	FT/S&P Europe Ex. UK	1.4	1.4
Ireland	ISEQ	1.6	1.6
UK	FTSE 100	0.8	2.8
Japan	Topix	1.9	2.7
Hong Kong	Hang Seng	0.9	2.3
Australia	S&P/ASX 200	1.1	2.7
Bonds	Merrill Lynch Euro over 5 year	-0.6	-0.6

Equities

In the US, the first batch of Q3 corporate results saw Intel, Motorola, Bank of America, Merrill Lynch, MBNA, Ford, Johnson & Johnson, and General Motors beat earnings expectations, with Merrill Lynch coming in more than 20% better than expected. Not surprisingly, the good results helped financials out-perform on the week. While the Intel and Motorola results were good news for semi-conductor stocks, the technology sector in general suffered from downbeat results from IBM and e-Bay and under-performed on the week.

In Europe, results also beat expectations, with the German software group SAP increasing profits by 25% on cost-cutting. Nokia reported third quarter net income 35% higher than a year ago and announced that sales of handsets were stronger than expected. The initial market reaction to Nokia's news was negative as investors remained concerned at falling handset prices, but by Friday the share price had recovered. Financials also had a strong week, helped by bid speculation, although an announcement of a rights issue by Munich Re put a cap on some gains.

Bonds

Bond yields drifted upwards as the positive economic and earnings news continued to favour equities. Eurozone bonds also slipped back as the dollar reversed some of its losses and reached a two week high against the euro. While this was counter-balanced to some extent by a drop in oil prices in reaction to prospects of a resumption of Iraqi oil production, the over 5 year eurozone bond index fell 0.6% on the week.

Outlook

- Economic activity has strengthened in the US and investors have begun to anticipate a synchronised global recovery; inflation pressures remain low.
- Equity markets have risen sharply since mid-March; increased growth optimism could extend this rally further although valuations are a constraint in certain sectors and markets. Additionally, investors still have some concerns about the sustainability of growth improvements.
- Central banks have re-stated their commitment to keeping interest rates low and recent inflation data have supported this stance.
- 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 equities and underweight bonds versus the manager average. The funds are underweight in the UK equity market due to its defensive characteristics and overweight Asia and Latin America due to more attractive valuations and better economic growth potential.