EAGLE STAR

Market Comment

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Overview

With the earnings reporting season drawing to an end, economic trends were the main influence on markets last week. The news on that front was generally positive for equities, although early indicators of a turn in the interest rate cycle sounded a note of caution and sent bond markets lower.

Increasingly, US economic data have been pointing to a strong upturn in the economic cycle and statistics released last week confirmed the trend. On Friday, employment figures confirmed a rise of 126,000 in non-farm payroll numbers in October and an upward revision from 57,000 to 125,000 in the previous month's figure. The rise was mainly attributable to service sector employment, as manufacturing payroll numbers continued to decline. The unemployment rate also fell from 6.1% to 6% and initial jobless claims were less than expected, all helping to dispel fears of a jobless, economic recovery. Earlier in the week, the Institute of Supply Management index of manufacturing activity in October confirmed a significant upturn to 57, from 53.7 in September.

European economic news was also positive, with a survey of eurozone business activity in the services sector jumping in October to its highest level in three years. This was followed on Thursday by an announcement by the new ECB president, Jean-Claude Trichet, that eurozone interest rates would remain on hold, notwithstanding some stickiness in inflation, which hovers just above 2%. Nonetheless, market watchers are becoming increasingly convinced that the interest rate cycle is turning and decisions by the monetary authorities in the UK and Australia to increase interest rates by 0.25% to control frothy housing markets only served to reinforce that view.

Movements in the main markets since last week's comment

Market	Index	% Return 31/10/2003 to 07/11/2003	
		Local Currency	Euro
US	S&P 500	0.2	0.9
US	NASDAQ	2.0	2.6
Europe	FT/S&P Europe Ex. UK	2.4	2.4
Ireland	ISEQ	0.1	0.1
UK	FTSE 100	2.1	1.3
Japan	Topix	0.2	1.5
Hong Kong	Hang Seng	0.2	0.8
Australia	S&P/ASX 200	-0.7	0.2
Bonds	Merrill Lynch Euro over 5 year	-1.1	-1.1

Equities

Expectations of a strong global economic recovery further boosted equity market sentiment and most markets made further gains on the week, although profit taking left the advance fairly muted in some regions. Technology stocks made the strongest gains, reflecting their high sensitivity to economic growth. They also received a boost from a positive earnings report and optimistic outlook from Cisco Systems. Semiconductor stocks were marked up significantly in response to an upbeat forecast by the US Semiconductor Industry Association, which anticipated earnings growth of almost 16% in 2003 and 19% in 2004.

European equities were particularly strong on the week, helped by strengthening business confidence and a "no-change" interest rate stance by the ECB. Technology stocks also led the European advance, with SAP, the German business software company, jumping 7% on the back of Cisco's strong results. The Dutch retailer, Ahold, was one of the best performers of the week, rising 11% on the announcement of a rights issue and major restructuring plans.

Bonds

Eurozone bonds fell back in response to the UK and Australian interest rate decisions and to a weakening of the euro against the dollar which will make it slightly more difficult for Eurozone inflation to stay within the ECB target range. Strong US economic growth has boosted the dollar somewhat from earlier weaker levels and fuelled expectations that the next interest rate moves in both the US and Europe, while they may be some time away, will definitely be upward. In this environment, it is not surprising that bond prices have been under pressure.

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.
- Interest rates have been kept low for some time, but markets have already priced for both the Federal Reserve and ECB beginning to increase rates next year.
- Ultimately, 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 remain 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. The funds have a sectoral bias toward cyclical stocks.