EAGLE STAR

Market Comment

Issued on 15th December 2003

Overview

Most equity markets made further gains on the week, although the rise was marginal in some regions. In the US, the Dow Jones Index moved above the significant 10,000 barrier for the first time in 18 months, giving a technical boost to sentiment. A rise in retail sales also helped confidence and was particularly positive for the automobile sector.

On Tuesday, the Federal Reserve announced that it would hold US interest rates at their current level for the foreseeable future, even though it perceived that the risk of deflation had diminished. This helped underpin equity market sentiment and offset the negative impact of a further decline in the dollar and some lacklustre economic statistics released towards the end of the week. Initial jobless claims were higher than in the previous week, whereas they had been expected to decline, and the University of Michigan index of consumer confidence dropped from 93.7 to 89.6, well below an expected level of 96.

Movements in the main markets since last week's comment

Market	Index	% Return 05/12/2003 to 12/12/2003	
		Local Currency	Euro
US	S&P 500	1.2	0.0
US	NASDAQ	0.6	-0.6
Europe	FT/S&P Europe Ex. UK	0.1	0.1
Ireland	ISEQ	0.2	0.2
UK	FTSE 100	-0.4	-0.4
Japan	Topix	-2.1	-3.2
Hong Kong	Hang Seng	2.3	1.1
Australia	S&P/ASX 200	-0.5	-0.7
Bonds	Merrill Lynch Euro over 5 year	0.5	0.5

Equities

In the US, the S&P 500 added 1.2% helped by strong performances from autos, while the technology sector under-performed as the high level of valuations triggered some profit taking.

In Europe, strong performances from oils and autos helped sustain market momentum. Oils were boosted by the continued strength of oil prices with the French giant, Total Fina, adding 2.8%. German car-makers performed well; Daimler-Chrysler gaining 4.4% and Volkswagen adding 2.1%. Telecommunications stocks performed well as analysts focussed on cash flow generation potential for the sector in 2004. Clothes retailers were hit by a profits warning from Inditex, owner of the Zara brand, which fell 10% on Friday.

In the UK, the cruise company Carnival, which is held in the 5*5 Fund, had a strong week, rising by 6.9% as analysts upgraded their bookings and earnings forecasts.

Japan had a poor week, despite better economic numbers. The Tankan business survey revealed that Japanese business sentiment was at its best level in over six years. Machinery orders were also higher. However, continued strength in the yen, despite considerable foreign exchange intervention by the Bank of Japan, was a negative for exporting stocks.

Bonds

In the US, the Federal Reserve's continued pledge to maintain accommodative policy for a considerable period, along with minutes from their October meeting indicating a lack of concern about inflation resulted in a positive performance by US bond markets. European bonds also rose on the week.

Outlook

- Forward indicators point to strong or strengthening economic growth in all major markets.
- As confidence in the global economy has improved, investors have begun to anticipate the turn (upwards) in the US and Eurozone interest rate cycle. The ECB and the Federal Reserve have indicated no rush towards higher rates however.
- This environment is one in which bond markets should remain on the backfoot, despite the relatively supportive inflationary background currently being experienced.
- The economic picture remains a more positive one for equity markets, although valuations are once more an issue in certain markets and sectors. Historically equity markets have continued to be supported even in the initial stages of tighter monetary policy.
- Our current overall portfolio stance remains overweight equities and underweight bonds versus the manager average. The funds continue to be underweight 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 are also overweight Europe on valuation grounds. The funds continue to have a sectoral bias toward cyclical stocks although some defensive sectors such as pharmaceuticals have been moved from underweight to neutral.