EAGLE STAR

Market Comment

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Overview

With the fourth quarter earnings reporting season in full swing, corporate news dominated markets last week. Generally, results were above expectations, allowing equities to make further gains. Bonds also had a good week as investors became more confident that interest rates would stay low for a considerable period.

It was a short week for US markets with the Martin Luther King holiday on Monday and there was relatively little in the way of economic news. Any figures that were released were neutral to supportive of equities. Housing starts and building permits for December were ahead of the previous figure and beat expectations; jobless figures were also better than expected with initial jobless claims lower than the previous month's downwardly revised figure; the index of leading economic indicators released on Thursday was up a marginal 0.2%, the same as the previous month.

The dollar lost half of its previous week's gains against the euro as European finance ministers expressed concern about excessive currency moves but gave no indication of plans to deal with the euro's rise. This was despite signs that German business expectations have diminished as the stronger currency takes its toll on competitiveness.

Movements in the main markets since last week's comment

Market	Index	% Return 16/01/2004 to 23/01/2004	
		Local Currency	Euro
US	S&P 500	0.2	-1.7
US	NASDAQ	-0.8	-2.6
Europe	FT/S&P Europe Ex. UK	0.8	0.8
Ireland	ISEQ	0.4	0.4
UK	FTSE 100	-0.6	-1.0
Japan	Topix	1.7	0.5
Hong Kong	Hang Seng	4.4	2.5
Australia	S&P/ASX 200	1.4	2.5
Bonds	Merrill Lynch Euro over 5 year	0.5	0.5

Bond Markets

Bond prices moved upward as monetary policy was eased in some regions and expectations of higher US and eurozone interest rates receded a little. In Canada, rates were cut by 0.25% as its central bank attempted to limit the rise of the Canadian dollar against the US dollar. In Japan, the monetary authority eased policy even further by pumping more funds into the banking system. Europe was noteworthy for inaction by the ECB, but the renewed slide in the dollar was sufficient to attract interest in eurozone bonds and the over 5 year eurozone bond index gained 0.5%. Conversely, in the UK, strong economic data on GDP and retail sales prompted expectations of higher UK base rates in February causing both equity and bond prices to underperform.

Equity Markets

Banking stocks dominated the news on both sides of the Atlantic as strong results and merger speculation kept them in the limelight. US giant Citigroup, the world's largest financial services company, announced net profits of almost $5 bn. in the fourth quarter, which was ahead of expectations, helping it to gain 2% on the week. JP Morgan Chase and Merrill Lynch also reported ahead of expectations, while the previous week's announcement of a takeover of Bank One by JP Morgan Chase fuelled analyst speculation on further merger activity in the sector.

Merger speculation also dominated the financial sector in Europe due to suggestions of a friendly takeover of Capitalia by ABN Amro, its largest single shareholder which were subsequently denied. There was also continued speculation of a link-up between giant German banks, HVB Group and Commerzbank.

European pharmaceuticals also experienced enhanced interest on merger prospects. Aventis shares rose over 7% on the possibility of a bid by Sanofi-Synthelabo, while an increase by Novartis of its holding in its rival Roche, underpinned both stocks.

Technology stocks under-performed, largely due to profit-taking and valuation concerns, causing the NASDAQ to decline 0.8%. This was despite good earnings results and a positive outlook from the technology giant Microsoft.

Asian markets, especially Hong Kong, performed strongly ahead of the Chinese New Year holidays on Thursday and Friday. Property stocks in both Hong Kong and Singapore led the rally as the sector reacted positively to the low interest rate environment with property prices rising further after years in the doldrums.

Outlook

- The global economy, led by the US, continues to display strong momentum.
- As confidence in the global economy has improved, investors have begun to anticipate the turn (upwards) in the US and Eurozone interest rate cycle,

although the strength of the euro may keep the ECB on hold for longer. The Fed is using low inflation as justification for maintaining US interest rates at their current ultra-low levels.

- This environment is one in which bonds will remain less favoured than equities, 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 stance is overweight equities and neutral bonds versus the manager average. The funds continue to be overweight Asia and Latin America due to more attractive valuations and better economic growth potential and underweight in the UK equity market due to its defensive characteristics. The funds are also overweight Europe on valuation grounds. The funds continue to have a sectoral bias toward cyclical stocks although some defensive sectors have been increased with pharmaceuticals being moved from underweight to neutral.