EAGLE STAR

Market Comment

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Overview

Equity markets recovered some of their losses of the previous week, despite mixed economic signals and currency uncertainty in advance of the weekend meeting of the G7 group of finance ministers. The uncertain trend of economic indicators was helpful for bond prices and Eurozone bonds gained almost 1% in the week, helped also by a further rise in the euro to 1.27 against the dollar.

US manufacturing sentiment in January was slightly ahead of the previous month but below analysts' expectations. The index of services sector sentiment was more positive, jumping from 58 in December to 65.7 in January and was well above expectations, while factory orders were up 1.1% after a 0.9% decline in December. Combined with further solid corporate earnings reports, the news helped the S&P 500 Index gain 1% on the week, notwithstanding the release of disappointing labour market figures on Thursday which recorded a rise in new jobless claims. The NASDAQ was weaker as US technology stocks experienced some profit-taking, in the wake of a cautious comment on the outlook for technology spending from the chief executive of Cisco Systems.

Movements in the main markets since last week's comment

Market	Index	% Return 30/01/2004 to 06/02/2004	
		Local Currency	Euro
US	S&P 500	1.0	-1.0
US	NASDAQ	-0.1	-2.1
Europe	FT/S&P Europe Ex. UK	0.3	0.3
Ireland	ISEQ	-0.1	-0.1
UK	FTSE 100	0.3	-0.4
Japan	Topix	-2.0	-3.6
Hong Kong	Hang Seng	0.2	-1.8
Australia	S&P/ASX 200	0.0	-1.1
Bonds	Merrill Lynch Euro over 5 year	0.9	0.9

Equities

While the Cisco statement gave technology stocks a knock and caused the Cisco share price to fall 9% on Wednesday, the actual results from the company were broadly in line with expectations. However, investors took it as an opportunity to take profits in the sector and rotate into more defensive areas such as consumer staples and healthcare. This helped companies such as Wal-Mart, the giant retailer, gain almost 6% on the week after announcing strong January sales.

On this side of the Atlantic, the Swedish giant, Ericsson, which is the world's largest supplier of mobile telephone networks, announced better than expected fourth quarter profits and gave a positive outlook for 2004, helping the stock to rise 15.2% on the week. UK mobile phone operator, MMO2, also had a good week, rising 4.9% as it announced the addition of 855,000 new customers in Q3 and a rise in its average revenue per user in Germany, the UK and Ireland. Also in the UK, life insurers had a good week as Aviva raised its forecast for full year profits.

In Ireland, Ryanair recovered a little of the previous week's 30% drop, rising 6.7% to €5.20, despite a ruling by the European Commission that it must repay part of the subsidies it had received to operate out of Belgium's Charleroi airport.

In Asia, the Tokyo market was weakened by the impact of dollar weakness on exporting stocks, while buoyancy in property stocks helped insulate the Hong Kong market from the effect of the Avian flu scare. The latter helped to push the Thai market down by 7% at the end of January; however, its effects there diminished last week as the market rose by almost 2%.

Bonds

Eurozone bonds had a good week, the over 5 year index gaining 0.9% as the euro once again rose to 1.27 against the dollar and the ECB made no move at its monthly meeting on Thursday to change interest rates. The weaker trend in US labour market statistics was also supportive, as were indicators on Eurozone manufacturing sentiment, which came in slightly below expectations. The UK authorities raised base interest rates by 0.25%, to 4%, on Thursday in response to continued strength in consumption and the housing market, but the move was widely anticipated and had little market impact.

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 underweight bonds versus the manager average. The funds continue to be overweight Asia 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 have been increased with, for example, the underweight in pharmaceuticals being reduced.