EAGLE STAR

Market Comment

Issued on 1st March 2004

Overview

Equity market returns were in the main rather subdued last week, although Japan was a notable exception with a bounce of 2.2% fuelled by positive economic data and corporate news.

Marginal changes in equity market indices masked a considerable degree of activity in certain industry sectors spurred by earnings and merger/take-over news.

For Irish investors, the big news item of the week was AIB's results, where disappointment at the level of interest margins pushed the stock down on the release of results on Tuesday. There was some recovery subsequently but the stock ended the week down 6.8% as investors remained concerned about guidance on margins going forward.

On the economic front, US statistics confirmed continued economic strength with fourth quarter GDP growing at an annualised 4.1%, slightly higher than the advance estimate of 4% and higher than an expected 3.8%. The University of Michigan consumer confidence index was revised upwards to 94.4 from 93.1, while figures on new home sales were also revised upwards. Any concern that these positive trends might accelerate an interest rate rise was allayed by employment data, which showed a rise in new jobless claims. Additionally, durable goods orders for January were weaker than expected.

Movements in the main markets since last week's comment

Market	Index	% Return 20/02/2004 to 27/02/2004	
		Local Currency	Euro
US	S&P 500	0.1	0.2
US	NASDAQ	-0.4	-0.3
Europe	FT/S&P Europe Ex. UK	-0.5	-0.5
Ireland	ISEQ	-0.7	-0.7
UK	FTSE 100	-0.5	0.1
Japan	Topix	2.2	2.4
Hong Kong	Hang Seng	0.3	0.3
Australia	S&P/ASX 200	0.5	1.7
Bonds	Merrill Lynch Euro over 5 year	0.9	0.9

Equities

In the US, there was some rotation out of highly valued technology stocks into more defensive sectors, causing the NASDAQ to under-perform the broader S&P 500 Index. Energy and basic material stocks out-performed and retailers gained from improved earnings from Gap, Kohl's and Home Depot.

In Europe, there was considerable activity in the telecom and financial sectors. France Telecom announced a €3.5bn offer to buy out the minority stake of Wanadoo, the internet service provider, pushing the Wanadoo price up 15.5% on the week.

UK mobile phone operator, MMO2, fared even better, with a rise of 16.6% as the previous week's failure of Dutch telecoms group, KPN, to agree a take-over fuelled speculation of further bids. Eagle Star funds are overweight MMO2.

In the European financial sector, German bank, HVB announced a long awaited rights issue of €3bn. and net losses for 2003 of €2.6bn. The stock fell 4.9%. Italian banks had a better week, with take-over speculation fuelling rises in Capitalia and Banca Nazionale del Lavoro.

In Asia, Japan was the region's strongest market as economic releases including exports, industrial production and household spending all proved to be better than analysts' expectations. Domestically exposed sectors such as construction, retail and finance all moved higher. Additionally, Yamanouchi Pharma and Fujisawa Pharma announced plans to merge. A weaker currency, following a period of protracted strength, was also a positive factor for the market.

Bonds

Interest rate expectations remained subdued, allowing further rises in bond prices. A weakening of the euro against the dollar was counter-balanced by a fall in the German Ifo business sentiment index, its first decline in 10 months, and by a low inflation number from the eurozone. The ECB is due to meet on Thursday this week and, while no immediate change in rates is expected, the Bank's statement is likely to be closely watched for any hint that a cut is under consideration.

Outlook

- The global economy, led by the US, continues to display good momentum.
- The Fed is using low inflation as justification for maintaining US interest rates at their current ultra-low levels, although investors are highly sensitive

to remarks/data that could alter the status quo.

- The ECB had also been keen to persist with unchanged rates. Recent data and persistent euro strength against the dollar could soften this stance however. Markets are now pricing for an additional ECB rate cut over coming months.
- This environment is one in which bonds should remain less favoured than equities, albeit supported by a low inflationary background and low short rates.
- 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 due to more attractive valuations and better economic growth potential and are slightly overweight Japan. The funds have moved from overweight to closer to neutral in European equities. The UK exposure has been moved from underweight to neutral. The funds continue to have overweight sectoral positions in financials and general industrials.