

Market Comment

Issued on 31st January 2002

Overview

The key feature of the week was the release yesterday of US Commerce Department figures on GDP growth. The nation's gross domestic production of goods and services grew in the last quarter of 2001 by 0.2%, whereas it had been expected to contract by over 1%, following a 1.3% drop in the third quarter. The surprise rise in output resulted from a burst of consumer spending, aided by heavy price discounting, and a large rise in government spending following the events of September 11th. The news heralded the first clear sign that the US economy may be coming out of recession and follows other positive signals earlier in the week, such as lower jobless claims, higher home sales and, significantly, growth in demand for business equipment. The latter, combined with evidence that stocks of unsold goods have fallen, indicates that companies may be feeling more confident about the outlook for future activity and that growth could resume in the manufacturing sector.

The good news on GDP growth was accompanied by a decision by the Federal Reserve (Fed) to leave interest rates unchanged. This decision was well anticipated, and indeed a decision to cut rates was likely to have been adversely received by investors as the eleven rate cuts in the last year are perceived to be having the desired stimulative effect on the economy and any further move could be de-stabilising. Nonetheless, since the recovery is not yet firmly established, the Fed has kept open the possibility of making a further cut if the recent rise in growth is not sustained.

Market Performance

Table 1 below shows the movements in selected markets since last week's comment and from the beginning of the year.

Table 1

Market	Index	% Return 23.01.2002 to 30.01.2002		% Return 01.01.2002 to 30.01.2002	
		Local Currency	Euro	Local Currency	Euro
US	S&P 500	-1.3	0.6	-3.0	-0.1
US	NASDAQ	-0.5	1.5	-1.9	1.0
Europe	FT/S&P Europe Ex. UK	-0.8	-0.8	-3.7	-3.7
Ireland	ISEQ	-5.3	-5.3	-8.5	-8.5
UK	FTSE 100	-1.8	-0.5	-2.4	-2.1
Japan	Topix	-1.1	2.1	-6.5	-4.5
Hong Kong	Hang Seng	0.0	1.9	-5.6	-2.8
Bonds	Merrill Lynch Euro over 5 year	-0.7	-0.7	0.8	0.8

Bonds

Bond prices eased in recent days as the improvement in US economic prospects heralded an end to the cycle of interest rate cuts. Normally, higher growth will lead to higher inflation and, ultimately, higher interest rates, which then cause bond prices to fall. However, in the current cycle, the likelihood of a shift from higher growth to higher inflation is less clearcut as statistics in the US and the other major economies are indicating a complete absence of inflation and many commentators believe there are strong risks of deflation (falling prices). The lack of inflation has balanced the negative impact on bond prices arising from the turn in the US growth cycle and has helped European bond prices to rise by almost one percent in the month.

Equities

Equity markets have had a more difficult week, the good news on the US economy being tempered by the continued fallout from the collapse of Enron, the Texas based energy trading company. The Enron experience has caused commentators to focus on corporate accounting practices and companies considered to have unusual practices were sold heavily. The impact was felt particularly strongly in Ireland when an article in the Wall Street Journal on Wednesday questioned the accounting practices at Elan, causing the stock price to fall by 30%. In Europe, telecom stocks also had a bad week dogged by concerns about their high debt levels.

The run on markets caused by accounting worries indicates the fragility of markets which are likely to remain jittery until the economic recovery is more firmly established.

Market Outlook

- The Federal Reserve performed a dramatic easing of monetary policy during 2001, with interest rates cut to below 2%, a forty-year low. Other central banks also lowered rates; moves which were possible due to subdued inflation pressures globally.
- Lower interest rates are helping to reflate the major economies. However, the recovery could also appear patchy at first, as many sectors still have an overhang of capacity built up during 1999/2000.
- Currently it is felt that we are at the low point for the global economy and close to lows on interest rates.
- Given the extent of the stimulus we have seen, especially in the US, equity investors should sit through negative earnings' reports in anticipation of a recovery in corporate profits in the second half of 2002.
- A neutral stance in equities is warranted at present; but it is likely that equity positions will be increased as the economic picture becomes clearer.

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