



Global Overview

Equity markets tumble

Global equity markets endured a turbulent week, falling sharply in the wake of a steep sell-off in the Chinese market on Tuesday.

Further complicating factors

The spotlight also fell on growing problems in the US subprime mortgage lending sector and some pessimism about US economic prospects. Comments from ex Fed Chairman Alan Greenspan suggesting that it was possible that the US economy would experience a recession before 2007 is out and a surge in the value of the yen, which rose 3.6% on the week, also added to the uncertainty.

Yen strength

Super-low interest rates in Japan have allowed investors to borrow money cheaply there to fund the purchase of assets, including equities, in other markets. A strengthening yen means that such investors may be forced to sell assets to repay their loans before the yen gets even stronger. This is known as the carry trade.

Flight to safety

With riskier assets being sold off, many investors appeared to move to the safe haven of bonds, which rose on the week.

| Market | Index | Year to Date Return 31.12.06 to 02.03.07 | | 1 Week Return 23.02.07 to 02.03.07 | |
|-----------|--------------------------------------|---|-----------|---------------------------------------|-----------|
| | | Local Currency % | Euro % | Local Currency % | Euro % |
| US | S&P 500 | -2.2 | -2.2 | -4.4 | -4.6 |
| US | NASDAQ | -2.0 | -2.0 | -5.9 | -6.0 |
| Europe | FT/S&P Europe Ex. U.K. | -0.9 | -0.9 | -5.1 | -5.1 |
| Ireland | ISEQ | -1.6 | -1.6 | -6.6 | -6.6 |
| UK | FTSE 100 | -1.7 | -2.3 | -4.5 | -5.5 |
| Japan | Topix | 2.4 | 4.5 | -5.1 | -1.8 |
| Hong Kong | Hang Seng | -2.6 | -3.1 | -6.1 | -6.3 |
| Australia | S&P/ASX 200 | 2.1 | 1.4 | -4.1 | -5.4 |
| Bonds | Merrill Lynch Euro over 5 year Govt. | 0.9 | 0.9 | 0.9 | 0.9 |

Global Equities



USA

Overview

US stocks fell sharply on the week, suffering their steepest one-day fall since 2001 on Tuesday. The fall reversed the year's gains.

Key Movers

Construction sector – Companies that are more vulnerable to swings in the economy, such as materials and homebuilders, saw some of the steepest declines. The building sector was not helped by an unexpectedly sharp drop in new home sales.

Investment banks – Anxiety about the strength of financial markets hit investment banks hard, Lehman Brothers and Bear Stearns both falling over 8%.



Europe

Overview

European markets could not escape the fallout on global markets, with nearly all national markets down somewhere between 4% and 6%.

Positive performers – German software group, SAP, added 1.5% on the week following reports that Silver Lake, the US investor group, was to buy a significant stake in the company. Swiss Re also stood out after it reported impressive full-year results, including a doubling in net profit.

UK – The FTSE 100 suffered its worst week since March 2003 as it fell 4.5%.



Ireland

The Irish market fell a little more than the European average, reflecting the strong start it had made to the year. The leaders were all affected with Bank of Ireland down 8%, AIB down 7.5%, CRH down 5% and Anglo Irish Bank down 7%.



Asia Pacific

China – The Shanghai market plunged 8.8% on Tuesday, sparking world-wide falls in equities that continued throughout the week. The fall was blamed on rumours that the authorities were to clamp down on speculative activity. By week end, the market had recovered slightly, down 5.6%, but the damage was done.

Other markets – Other Asian markets did not escape the adverse winds from China. Japan fell over 5%, while Hong Kong was down over 6% and Australia 4%.

Bonds

European bond markets gained, as they often do at times of turbulence in the equity markets, as investors looked for a safer home for their money. The Merrill Lynch >5 year Bond Index rose by 0.9% over the week.

Global Outlook

- There were no so-called fundamental data to drive last week's fall in global equity markets, although ex-Fed Chairman Alan Greenspan was reported to have warned of a US recession by year end. While the consensus expects growth to moderate this year, a US recession is very far from current economic data trends. Indeed, policymakers' concerns continue to be focused on strong global growth momentum and the cyclical inflation pressures that have emanated from that.
- More plausible is the age-old story of excessive risk positions and complacency during a period of one way trends; in this case, a four-year uptrend in global equities assisted by trades financed by super-low Japanese interest rates and a weak Japanese currency. All of this has encouraged lots of risk-taking behaviour from investors. Additionally, those who borrow to finance speculative market positions - such as hedge funds - are more vulnerable to sharp market movements and this tends to produce a domino impact after the initial fall. The fact that all of the main markets fell by almost the same amount backs up the theory of position unwind or risk reduction, rather than any more precise reason.
- Last weeks 4.8% fall in global equity markets was the largest weekly fall since the current equity market uptrend began in March 2003. There have been six other weekly corrections of 3% or more during that time:

| <u>Week Ending</u> | <u>FTSE All-World Equity Index</u> | <u>Week Ending</u> | <u>FTSE All-World Equity Index</u> |
|--------------------|------------------------------------|--------------------|------------------------------------|
| 09/6/06 | -3.6% | 12/3/04 | -3.0% |
| 19/5/06 | -3.3% | 26/9/03 | -3.7% |
| 30/4/04 | -3.0% | 28/3/03 | -3.4% |

We have referred to likely periods of volatility in equity markets for some time now. Our assessment at the moment is that the current moves are shaking out investors with excessive geared positions, thereby removing some froth from a complacent market, just as happened in the above moves. Therefore, we have generally maintained current equity positions and geographic weightings, albeit with some selective stock-switching within markets and also some selective additions to overall equity contents, where appropriate.

- It will be interesting to see if the ECB comments on recent equity market falls when it meets this week. Bond markets had been better-behaved of late - and we had added to positions during this period - and gained further on the back of safe-haven demand last week. However, it has generally been trends in short rates that have dominated bond markets in the last few months. In that regard, investors have fully anticipated a further 0.25% rise in rates to 3.75% but will be looking for clues as to any future moves.

This outlook does not constitute an offer and should not be taken as a recommendation from Eagle Star.
Advice should always be sought from an appropriately qualified professional.

EAGLE STAR HOUSE FRASCATI ROAD BLACKROCK CO DUBLIN IRELAND TELEPHONE 01 283 1301 FAX 01 283 1578 WEBSITE www.eaglestarlife.ie

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