EAGLE STAR

Market Comment

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Overview

It was another bad week for equity markets, as corporate concerns combined with economic and geo-political fears to push sentiment lower.

The previous week had seen some good news on US retail sales which helped to steady investor nerves, but this was followed by a higher than expected rise in business inventories and lower industrial production. Later in the week, figures on initial jobless claims were above expectations and housing starts were lower, all serving to fuel fears of a 'double dip' recession, in which consumer sentiment and spending power would tumble and companies would find it increasingly difficult to push through price increases - a typical deflationary situation.

These fears obscured the positive economic impact of historically low interest rates which have dramatically reduced borrowing costs for companies and allowed consumers to re-finance mortgages at lower rates and borrow for car purchases (with US auto manufacturers offering zero interest deals). This week, the Federal Reserve is due to make a decision on interest rates with the majority of commentators expecting no change at this meeting. The Conference Board's consumer confidence survey is due out on Tuesday.

Table 1 below shows the movements in the main markets since last week's comment.

Table 1

Market	Index	% Return 13.09.02 to 20.09.02	
		Local Currency	Euro
US	S&P 500	-5.0	-5.8
US	NASDAQ	-5.4	-6.2
Europe	FT/S&P Europe Ex. UK	-7.1	-7.1
Ireland	ISEQ	-2.4	-2.4
UK	FTSE 100	-3.7	-4.4
Japan	Topix	2.0	0.0
Hong Kong	Hang Seng	-3.3	-4.1
Bonds	Merrill Lynch Euro over 5 year	0.7	0.7

Equities

With the exception of Japan, equity markets fell substantially, with European markets particularly badly hit. A close run election in Germany, added to already weak sentiment, pushed the Dax index of German shares to a five year low. A profit warning from the giant financial company, JPMorgan Chase, hit financial shares across the board, including the Irish banks, which were lower on the week although to a lesser degree than their larger European counterparts. The technology sector was hit by a significant cut in forecast earnings from Electronic Data Systems, the computer management and services company. In Japan, banking stocks staged a brief rally as the Bank of Japan stated that it planned to buy shares directly from the banks to limit their exposure to equity market volatility. However, a lack of detail in the plan renewed scepticism that the authorities would take the appropriate action to sort out the ailing financial system and the market fell back. The yen also weakened, which should benefit Japanese export stocks such as autos, electronics and pharmaceuticals.

Bonds

Government bond prices gained from the weak economic indicators, continuing concerns about war with Iraq and falling equity markets. The Eurozone over 10 year index rose 0.7% as the US economic reports on jobs and housing helped keep prices rising. A series of warnings on corporate profits also caused investors to remain in the safe haven of bonds until firmer economic news can give some support to equity prices.

Outlook

- Economic recovery remains the central scenario, supported by generally accommodative monetary policies. However, risks of a double dip recession have re-emerged.
- Current investor sentiment remains negative, with concerns stemming from relatively high US valuations and geo-political tensions.
- These events have obscured the underlying improvement in US profitability, which has occurred over the past few months. However, we remain

underweight in the US on valuation grounds, marginally underweight Europe, which has failed so far to de-couple from the US and overweight Asian markets and the UK. At the sectoral level, we remain biased towards basic materials and financials and underweight technology stocks. Healthcare and telecoms have been moved from underweight to neutral on valuation grounds.

- Overall, our stance is overweight bonds, slightly underweight equities. An end to the two and a half year fall in equities will come about when the markets are convinced that the excesses of the 1990's, and especially the TMT bubble, have been fully worked off.