EAGLE STAR

Market Comment

Issued on 9th December 2002

Overview

The two month advance in equity markets floundered last week as weak economic news and some disappointing corporate statements renewed concerns about earnings prospects. Bond prices advanced, aided by the trend in economic data which in Europe led the ECB to announce a 0.5% cut in eurozone interest rates.

Following the previous week's economic data showing Q3 GDP growth in the US of 3.8% annualised and improving consumer confidence, investors last week were anticipating further signals of economic strengthening. Initial indications were positive as retailers confirmed strong trading over the Thanksgiving holiday weekend, with the giant retailer Wal-Mart stating sales on Friday were 14% higher than the same day last year. However, continuing difficulties in the manufacturing sector were revealed in the Institute of Supply Managers' index, which came in below 50 for the third month in succession, indicating that the sector was still contracting. This bad news was compounded later in the week with the publication of disappointing US employment data. Total non-farm payroll figures fell by 40,000, whereas expectations had been for a rise of 36,000, and the unemployment rate rose from 5.7% to 6%.

Indicators in Europe were equally downbeat, with further bad news on the German economy. Unemployment figures were above expectations, while the November purchasing managers' index was weak and October retail sales fell below expectations. Against this background, there was little surprise at the announcement by the ECB on Thursday of a 0.5% interest rate cut, as anything lower would have been perceived as too little, too late to prevent a drift into recession.

Returning to the US, there was some positive news amid the gloom with figures released on Wednesday showing that growth in productivity was up from 4% to 5.1%, an indicator of the extent to which companies have been cutting costs. Activity in the services sector was also stronger than expected. The general view of analysts is that the US economy is stabilising but is some way away from a strong, steady growth path.

In addition, the US Treasury Secretary, Paul O'Neill, and the chief economic advisor, Lawrence Lindsey, resigned. O'Neill is likely to be replaced by John Snow, chief executive of CSX, who will be given the task of pushing Congress to cut taxes to bolster the sluggish economy.

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

Table 1

Market	Index	% Return 29/11/2002 to 06/12/2002	
		Local Currency	Euro
US	S&P 500	-2.6	-3.9
US	NASDAQ	-3.8	-5.1
Europe	FT/S&P Europe Ex. UK	-4.3	-4.3
Ireland	ISEQ	-4.4	-4.4
UK	FTSE 100	-3.7	-3.7
Japan	Topix	-3.6	-5.8
Hong Kong	Hang Seng	-1.0	-2.3
Bonds	Merrill Lynch Euro over 5 year	0.7	0.7

Equities

The eight week rally on equity markets ran out of steam amid renewed doubts about corporate profits and the economy. Some profit taking was inevitable after the strong advances in prices and it was not surprising that much of the selling was focussed on technology stocks which had run up strong gains in previous weeks. The NASDAQ Index had surged almost 30% over the previous two months, from over-sold levels, so a discouraging announcement from Hewlett Packard on 2003 market growth took its toll on sentiment. US retailers were hit by reports of disappointing overall sales in November, notwithstanding a strong Thanksgiving holiday period and heavy sales discounts. In Europe, the telecom sector was boosted by the announcement of a new debt management plan for France Telecom.

Bonds

Eurozone bond prices made steady gains, helped by weak economic indicators, a widely welcomed move by the ECB to cut interest rates and a strengthening of the euro against the dollar.

Outlook

- Forward indicators for the major economies suggest that growth will remain relatively subdued over the next few months.
- With growth below trend in all the major economies, interest rates are likely to stay low in the US, the UK and the Eurozone.
- Geo-political tensions have eased somewhat following the recent UN resolution on Iraq, allowing oil prices to fall by 12%. However, the possibility of military action has not completely disappeared.
- For further sustained rises in equities we need to see a more robust economic and earnings environment.
- Our overall portfolio remains neutral equities with a slight geographical bias towards Asian markets. Portfolios have become less defensive with overweight positions in financials, telecoms and healthcare. We have a preference for bonds over cash, given the low level of short term interest rates.