

Market Comment

Issued on 27th January 2003

Overview

Investment markets suffered sharp falls last week as geopolitical tensions and cautious outlooks from a number of corporations continued to sour market sentiment. The week started off on a quiet note as US markets were closed on Monday for Martin Luther King Day. However, investors returned in selling mood as the possibility of a US led military attack against Iraq heightened. This unease continued for the remainder of the week and today markets are awaiting the preliminary report from UN weapons inspectors on their findings in Iraq.

Bond markets benefited from the weakness in equity markets and continued their positive run. Investors searching for safe havens for their funds are switching to fixed interest investments and cash. Gold prices have risen to their highest levels in six years.

On the economic front, the housing market in the US remains solid. Housing numbers showed that the construction of new homes in the US has reached record levels. The sector is supported by the lowest mortgage rates seen for thirty years in the US. There was some mild relief for Germany when the ZEW economic expectation survey for January rose for the first time in seven months.

Investors have much to focus on this week with the UN announcement on Iraq today and the State of the Union Speech by President Bush to Congress tomorrow. On Wednesday, the US Federal Reserve meets to decide on interest rates but is not expected to move to a loosening bias at this stage. Friday brings a meeting between UK Prime Minister Tony Blair and President Bush to discuss the situation in Iraq.

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

Table 1			
Market	Index	% Return 17/01/2003 to 24/01/2003	
		Local Currency	Euro
US	S&P 500	-4.5	-6.1
US	NASDAQ	-2.5	-4.1
Europe	FT/S&P Europe Ex. UK	-5.5	-5.5
Ireland	ISEQ	-1.8	-1.8
UK	FTSE 100	-5.7	-6.3
Japan	Topix	0.3	-1.3
Hong Kong	Hang Seng	-1.6	-3.2
Bonds	Merrill Lynch Euro over 5 year	1.3	1.3

Equities

It was a dismal week on equity markets world-wide, the UK market leading the downward trend. The FTSE 100 made history on Friday as it recorded its tenth consecutive day of declines. Concerns of forced selling by some institutional investors and a weak dollar both contributed to the sell-off on the FTSE 100. Europe and the US also posted heavy falls as investor nervousness over Iraq prevailed.

The corporate earnings results season continues, the common theme being subdued outlooks from chief executives. Infineon Technologies, the German chipmaker, warned that market conditions in the future would be difficult. Nokia, the telecoms company and Citigroup, the financial services giant, also revealed cautious outlooks.

AT&T stock fell 19% after it forecast a fall in 2003 telecom spending.

Bonds

Bond markets rose again this week underpinned by uncertainty over Iraq and weakness on equity markets. European government bonds continue to outperform helped by the ongoing decline in the US dollar. The European Central Banks monthly bulletin was released last week and lent further support to European bonds. It said that there were still risks to growth in the Eurozone and that inflation is likely to ease. This led to speculation over the possibility of further interest rate cuts in Europe. The Merrill Lynch over 5-year bond index gained 1.3% on the week.

Outlook

Forward indicators for the major economies suggest that growth will remain relatively subdued, particularly in the first half of 2003.

- ▶ Renewed geo-political tensions have seen oil prices rise by 35% since the low of last November. If sustained at these levels, economic growth forecasts could be reduced further.
- ▶ With growth below trend in all the major economies, interest rates are likely to stay low in the US and could fall further in the Eurozone and possibly even the UK.
- ▶ The US dollar will remain under scrutiny in 2003 with further downward pressure likely.
- ▶ For sustained rises in equities we need to see a more robust economic and earnings environment.
- ▶ However, shifting war fears will continue to have an impact on the economic and market outlook in the short term.
- ▶ Our current overall portfolio stance is overweight bonds and neutral equities versus the manager average. On a geographic basis, we are underweight equities in the UK and Europe. We are broadly neutral in Ireland and slightly overweight in the US. We continue to have a preference for the Pacific region on a valuation basis and as a low cost producer.

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