Market Comment

Issued on 10th February 2003

Overview

Unsurprisingly, the main preoccupation on investment markets last week continued to be the Iraqi situation. All eyes were on US Secretary of State, Colin Powell, as he delivered a hi-tech presentation to the United Nations Security Council on Wednesday. His speech, however, did little to negate the uncertainty that hangs over investors at the moment. Rather, equity markets suffered a fourth week of negative performance.

On the economic front, most of the major indicators released this week in the US were better than expected, though overshadowed by the geo-political events outlined above. The Institute for Supply Management released two figures during the week, one covering the manufacturing sector and the other the services sector. The former came in at 53.9, suggesting the industrial sector is still expanding, albeit slowly. Economists, however, were encouraged by the new orders component of the index. The non-manufacturing figure on Wednesday showed a 12th consecutive monthly figure of expansion. Finally, at the end of the week, there was a very strong non-farm payrolls figure, showing a rise of 143,000 for January, way above expectations of 50,000. The US unemployment rate fell from 6% to 5.7%. On this side of the Atlantic, the biggest story was the surprise cut in UK interest rates by the Bank of England, from 4% to 3.75%, the lowest level in 48 years, and the first move for 14 months in UK rates. The ECB left eurozone rates unchanged at its meeting.

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

Table 1

Market	Index	% Return 31/01/2003 to 07/02/2003	
		Local Currency	Euro
US	S&P 500	-3.0	-3.7
US	NASDAQ	-2.9	-3.6
Europe	FT/S&P Europe Ex. UK	-4.0	-4.0
Ireland	ISEQ	-3.8	-3.8
UK	FTSE 100	0.9	-0.8
Japan	Topix	2.2	1.2
Hong Kong	Hang Seng	-1.2	-1.8
Bonds	Merrill Lynch Euro over 5 year	0.4	0.4

Equities

The FTSE 100 was one of the few indices to end the week in positive territory, having enjoyed a very strong Monday, when it rose 3.4%. This was driven by an announcement from the Financial Services Authority that life assurance companies could apply for a waiver if the value of their assets risked falling below a minimum regulatory level. Friends Provident rose 11% on the day. Standard Life, however, cut bonuses on some policies for the third time in little more than a year. On the same day, Ericsson, the giant Swedish telecoms equipment manufacturer, fell 11.7%, forecasting another year of falling demand ahead.

On Tuesday, AIG, the world's largest insurer, announced a $1.8 billion charge to cover old liability claims. Unsurprisingly, the market took a dim view and AIG's price fell 7%.

On Wednesday, Elan broke records for an Irish company, for all the wrong reasons, by reporting a net loss of $2.4 billion for 2002. The losses mainly related to write-downs in the value of its investments in other bio-tech companies and charges related to its recovery plan. The share fell sharply.

Bonds

The Merrill Lynch over 5-year euro government bond index gained 0.4% on the week as investors bet that the ECB will soon follow the Bank of England's lead in cutting interest rates. Continuing uncertainty in the equity markets has been supporting bonds on an ongoing basis, as has the parlous state of the main European economies.

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 should fall further in the Eurozone. The UK cut rates by 0.25% to 3.75% last week, citing concerns on the global economic outlook.
- 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. But in the near term, the Iraq crisis continues to impact negatively on market sentiment.
- Our current overall portfolio stance is overweight bonds and neutral equities versus the manager average. On a geographic basis, the funds continue to have a preference for the Pacific region on a valuation basis and as a low cost producer. The weightings in the UK and Europe have been moved to neutral from underweight following recent heavy falls.