EAGLE STAR

Market Comment

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Overview

Equity markets posted modest gains last week, ending over four weeks of negative returns. The Iraqi situation continued to dominate as investors became unnerved by the growing chasm between the United States and Europe. A concession from Baghdad to allow U-2 surveillance flights over Iraq went some way to easing tensions on stock markets across the world. On Friday, a cautious but mildly optimistic speech by UN chief weapons inspector, Hans Blix, also helped to delay the immediate threat of war. However, equity markets are unlikely to make significant ground while the situation in Iraq continues to overshadow investor sentiment. In the UK, security was stepped up considerably as intelligence reports suggested an increased likelihood of possible terrorist attacks by Al-Qaeda.

On Wednesday, the chairman of the Federal Reserve in the US, Alan Greenspan delivered his testimony to the Senate Banking Committee. He said "uncertainties created by a possible war with Iraq posed formidable barriers to business spending and clouded the economic outlook". This cautious outlook was expected by the market and had little impact.

There were further indications of weakness in the German economy last week as industrial production fell 2.6% in December. In the UK, the Bank of England cut its forecast for UK economic growth and warned that the risk of war could hit the housing market. In the US, the University of Michigan's consumer confidence figure fell to 79.2 in February from 82.4 in January, signalling weakness in the consumer outlook. However, retail sales were stronger than expected. Industrial production also rose, pointing to some improvement in the manufacturing sector.

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

Table 1

Market	Index	% Return 07/02/2003 to 14/02/2003	
		Local Currency	Euro
US	S&P 500	0.6	0.9
US	NASDAQ	2.2	2.5
Europe	FT/S&P Europe Ex. UK	1.9	1.9
Ireland	ISEQ	1.7	1.7
UK	FTSE 100	0.4	-0.4
Japan	Topix	2.3	2.5
Hong Kong	Hang Seng	0.6	0.8
Bonds	Merrill Lynch Euro over 5 year	0.2	0.2

Equities

There was a long awaited improvement in equity markets last week. The Japanese market made the biggest gains as bargain hunting brought investors back to the market. In yet another bid to turn the Japanese banking sector around, the Bank of Japan is to appoint a new governor this month. However, investors remain sceptical as radical changes have been mooted many times before.

It was a difficult week for car manufacturers. France's Renault delivered a bleak message regarding the outlook for European car sales while in the US General Motors stock fell on a downgrade from Bank of America Securities.

Pharmaceutical stocks came under pressure on news that the New York attorney general had filed lawsuits against GlaxoSmithKline and Pharmacia. He is accusing them of allegedly inflating their prescription drug prices. There was good news from computer giant, Dell, when it posted strong revenue growth.

Bank of Ireland helped push the Irish stock market forward. The bank announced on Wednesday that it had bought back 275,000 shares and planned to buy back more in order to boost its earnings per share.

Bonds

Bonds recorded marginal gains last week as an improvement on equity markets dampened the rally of recent months. The US Treasury auctioned $42billion of five-year and ten-year notes, holding bonds back somewhat. Eurozone bonds held up well on increased expectations of an interest rate cut from the ECB. In the medium term, fixed interest investments continue to receive support from low interest rates, mixed economic data and investor concerns over Iraq. The Merrill Lynch over 5-year bond index gained 0.2% on the week. The Active Fixed Income Fund is up 2.4 % year to date.

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 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 to slightly underweight 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.