

Market Comment

Issued on 3rd March 2003

Overview

Concerns about the US and European economies weighed heavily on equity markets last week, as did some disappointing corporate news, and prices fell back. On Tuesday the well-regarded US Conference Board released its index of consumer confidence, which registered a large drop to a ten year low of 64, from 79 the previous month. While war jitters were a factor in the decline in consumer sentiment, fears of rising unemployment and higher oil prices also contributed. Investors were unnerved by the size of the fall, as the index had been expected to decline to 77. The news triggered a bout of profit-taking on Wall Street following two weeks of gains. Prices fell further on Wednesday following disappointing earnings results from the computer giant, Hewlett Packard.

The later part of the week saw a welcome recovery, as investors responded to more upbeat economic signals. Durable goods orders jumped 3.3%, well above an expected 1% rise, while on Friday the University of Michigan confidence index rose from 79.2 to 79.9, also above expectations. This helped equity prices to pick up somewhat, and the US S&P 500 was just marginally down on the week.

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

Table 1			
Market	Index	% Return 21/02/2003 to 28/02/2003	
		Local Currency	Euro
US	S&P 500	-0.8	-0.8
US	NASDAQ	-0.8	-0.8
Europe	FT/S&P Europe Ex. UK	-2.4	-2.4
Ireland	ISEQ	-3.6	-3.6
UK	FTSE 100	-1.9	-1.9
Japan	Topix	-2.5	-2.0
Hong Kong	Hang Seng	-1.4	-1.3
Bonds	Merrill Lynch Euro over 5 year	0.2	0.2

Equities

Technology stocks were the worst performers of the week following the downturn in earnings at Hewlett-Packard, although they recovered some ground on Friday, in response to an analyst's upgrade of earnings prospects for the chip maker, Intel.

In Europe, the already fragile tone of the market was rocked by the disclosure of accounting irregularities at the US subsidiary of Ahold, the Dutch retailer. Ahold is the world's third biggest retailer and generates almost two-thirds of its profits in the US. The news caused a collapse of over 60% in the share price and also had a knock-on effect on some European insurers who would have significant exposure to Ahold in their investment portfolios. The Eagle Star funds have no exposure to the stock.

It was also a bad week for the German chemicals group, Bayer, which fell sharply on fears of litigation regarding its anti-cholesterol drug, Baycol. However, elsewhere pharmaceutical stocks out-performed, notably in the US where Pfizer advanced on approval by the European Commission for its takeover of Pharmacia.

Energy stocks gained from the continued rise in the oil price, which was up 3% on the week and by news of a merger between US groups, Devon Energy and Ocean Energy. Eagle Star funds are overweight the energy sector which has out-performed so far this year.

Bonds

Eurozone bonds moved further ahead in expectation of an early cut in interest rates as the European Central Bank governor, Wim Duisenberg, stated that he did not expect the Eurozone economy to recover this year. The ECB is due to meet this week and analysts are expecting a rate cut of at least 0.5%. The US bond market also improved following the news of weaker US consumer confidence and growing conviction that a US war with Iraq is inevitable.

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. The funds are underweight in Europe due to deteriorating economic fundamentals.