EAGLE STAR

Market Comment

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Overview

The sharp rises in equity values recorded over the previous two weeks came to an abrupt end last week as it became clear that the war in Iraq was likely to take a lot longer than originally anticipated. Investors retreated to the safer haven of bonds as the allies met stronger resistance from Iraqi forces and oil prices again rose above $30 per barrel on supply concerns.

Economic news was not particularly favourable to equities either, as figures on US consumer spending showed no growth in January and February, despite rises in personal income. Consumer confidence also remained weak, and new home sales recorded their largest two-month decline since 1982. On the business front, US factory orders for durable goods fell by 1.2% having recorded a rise of 1.9% in January. While some of the weakness in economic indicators may be attributable to severe weather conditions in the US in February, there was nothing in last week's data to instil sufficient confidence that the economy would rise above the current uncertainties engendered by the war.

Meanwhile, industrial and consumer sentiment indicators confirmed that the eurozone is stuck at below trend growth rates. The Ifo index of German business confidence, for example, came in below expectations at 88.1, a drop on the previous month's already low level of 88.9.

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

Table 1

Market	Index	% Return 21/03/2003 to 28/03/2003	
		Local Currency	Euro
US	S&P 500	-3.6	-6.0
US	NASDAQ	-3.7	-6.1
Europe	FT/S&P Europe Ex. UK	-4.8	-4.8
Ireland	ISEQ	-2.5	-2.5
UK	FTSE 100	-4.0	-5.7
Japan	Topix	1.3	0.2
Hong Kong	Hang Seng	-3.4	-5.8
Bonds	Merrill Lynch Euro over 5 year	1.1	1.1

Equities

Equity investors turned cautious last week after two consecutive weeks of spectacular gains as they began to price in the likelihood of a long drawn out war and further volatility in oil prices. In the US, the S&P 500 index shed 3.6%, about a third of its gain of the previous few weeks. Worries over the German economy, allied with war nerves, caused the German Dax Index to fall over 7% last week, a significant factor in the 4.8% decline in the Europe ex UK index.

At a stock level, there was little variation across sectors, energy stocks proving the most resilient as they were helped by higher oil prices.

In Asia, concerns about the mystery pneumonia outbreak hit market sentiment as factories closed in an effort to contain the virus. The Hong Kong and mainland China markets fell back, although the Japanese market recorded a positive return on the week, helped by a strong performance by the telecommunications company, NTT Docomo.

Bonds

Last week, investors scurried into the shelter of government stock in response to the deteriorating situation in Iraq. In addition to the prospect of a long drawn out war, bonds gained from the downturn in equity values and a continued lack of good news on the economic front. The rise in oil prices partly fuelled by the Iraq situation, but also by the impact of unrest on Nigerian oil supplies had no negative impact on eurozone bond prices. The possible inflationary effect was counterbalanced by renewed weakness in the dollar, which saw the euro rise to just under $1.09.

Outlook

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

- Developments in Iraq will dominate news in the short-term. Further violent moves in either direction are quite possible over coming days.
- It remains the case that a sustained rise in equities will need a more robust economic and earnings environment. The markets may have discounted too quick a resolution to the Iraq situation and an ensuing lift to industrial and consumer confidence that translates into higher economic activity.
- Central Banks will be monitoring these developments to evaluate any likely change in the underlying weak economic fundamentals.
- Our current overall portfolio stance is overweight bonds and 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 and the UK on valuation grounds. The funds are underweight in Europe due to deteriorating economic fundamentals.