EAGLE STAR

# Market Comment

**Issued on 12th May 2003**

## *Overview*

Investor focus was fixed firmly on policy makers in the US, Europe and the UK last week. The US Federal Reserve left interest rates unchanged. In a significant move it expressed concerns about further falls in the current low level of inflation. Further falls in inflation would be a worrying development for equity markets because it hampers the ability of corporations to increase prices and profits. The European Central Bank also kept rates on hold prompting market analysts to conclude that there will almost certainly be an interest rate cut during the summer. As expected, the Bank of England also kept rates stable at 3.75%.

There was more disappointing economic data released in the US and Germany last week. On the US unemployment front, while weekly unemployment claims fell, the four-week moving average rose to its highest level in over a year. US retail sales figures were weak in April as many of the big retailers reported sales that came in below expectations. In Germany, April unemployment figures released last week were the highest since after the Second World War. Factory orders in Germany were also down sharply.

On currency markets, the euro surged to four-year highs against the US dollar. The euro has gained about 9% against the dollar in the last six weeks. It ended the week at $1.15. In Japan, the yen reached ten-month highs against the US dollar.

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

**Table 1**

| Market | Index | % Return 02/05/2003 to 09/05/2003 | |
|---|---|---|---|
| | | Local Currency | Euro |
| US | S&P 500 | 0.4 | -1.9 |
| US | NASDAQ | 1.2 | -1.2 |
| Europe | FT/S&P Europe Ex. UK | -0.2 | -0.2 |
| Ireland | ISEQ | 0.6 | 0.6 |
| UK | FTSE 100 | 0.4 | -1.8 |
| Japan | Topix | 2.4 | 1.6 |
| Hong Kong | Hang Seng | 3.1 | 0.8 |
| Australia | S&P/ASX 200 | -0.7 | -0.8 |
| Bonds | Merrill Lynch Euro over 5 year | 1.2 | 1.2 |

## *Equities*

Most equity markets ended the week marginally ahead. In the US, technology stocks outperformed despite a downbeat sales forecast from technology giant Cisco. Most companies, however, have reported better earnings then expected for the first quarter. Retailers had a difficult week as many of the larger names posted weak store sales. Walmart, the world's biggest retailer, JC Penny and Sears Roebuck all saw their stock decline.

Despite the recent strong rally, European equities remain under pressure from weak economies, a strong euro and lack of policy action from the ECB. There was better news from the pharmaceutical sector as German pharmaceutical companies Bayer and Altana both posted earnings results that were higher then expected.

The Irish market held onto gains last week, its safe-haven status and defensive qualities attracting some international investors away from volatile markets elsewhere. Financials are the main movers with Bank of Ireland up 14.2% year to date and AIB up 10.7%. The ISEQ index overall is up 7.2% year to date.

Asian markets had a good week, as concern over the SARS virus dissipated with news that the number of new cases is declining and this supported a 3.1% rally in the Hang Seng index.

## *Bonds*

Bond markets moved forward last week supported by weakening economic indicators, low inflation and the low interest rate environment. The US Federal Reserve's decision to move to an easing bias was also favourable. Eurozone bonds moved ahead on high expectations of a cut in interest rates by the ECB in the next couple of months. Continuing uncertainty in equity markets has been supporting bonds on an ongoing basis, as has the fragile state of the main European economies. European bonds have also been underpinned over the last six weeks by the sharp rise in the euro/dollar rate to $1.15.

## *Outlook*

- Forward indicators for the major economies suggest that growth will remain relatively subdued for the rest of 2003.
- Central banks were anticipating a recovery in confidence post an Iraq war. Now they will be monitoring developments closely to see if economic activity stages even a partial rebound. Our central scenario remains that further rate cuts will be necessary, especially in Europe.
- Given current valuation levels, a sustained rise in equities will need a more robust economic and earnings environment.
- Our current overall portfolio stance is overweight bonds and neutral equities versus the manager average. The funds are underweight in Europe due to deteriorating economic fundamentals and a strong currency.