EAGLE STAR

Market Comment

Issued on 17th June 2003

Overview

Equity markets extended their rally through most of last week but succumbed to profit-taking on Friday when weak US consumer confidence figures raised fresh doubts about economic prospects. Bonds took up the slack and made strong gains on the week.

In the early part of the week, equity market momentum remained buoyant, helped by lower interest rate prospects and strong liquidity flows. A drop in US wholesale inventories was also supportive as it suggested that demand was picking up. However, subsequent economic data put a damper on sentiment, particularly a big drop in consumer confidence. The University of Michigan Index for June, released on Friday, revealed a drop to 87.2 from 92.1 last month, a big reversal of the expected figure of 93. This news followed on poor employment data the previous day, which showed a lower than expected drop in new jobless claims and a rise in continuing claims.

It is not surprising that the markets should have paused for breath, as they have had a fairly continuous run from their low point of mid-March; the S&P 500 Index is up 23% from its March low, while the Europe ex UK Index is up 29%.

While the signals on the economy remain mixed, there is an underlying expectation that, against a background of very low inflation, both the Federal Reserve and ECB will lower interest rates further, and this is a key support for both the equity and bond markets.

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

Table 1

Market	Index	% Return 06/06/2003 to 13/06/2003	
		Local Currency	Euro
US	S&P 500	0.1	-1.0
US	NASDAQ	-0.1	-1.1
Europe	FT/S&P Europe Ex. UK	0.3	0.3
Ireland	ISEQ	-1.6	-1.6
UK	FTSE 100	-0.4	-1.2
Japan	Topix	1.3	1.5
Hong Kong	Hang Seng	1.7	0.6
Australia	S&P / ASX 200	1.3	1.3
Bonds	Merrill Lynch Euro over 5 year	2.0	2.0

Equities

Most of the corporate news on the week consisted of pre-announcements for Q2 earnings. In the technology sector, Texas Instruments took a hit, falling 9% on Wednesday when it announced that lower sales of semi-conductor chips would cause earnings to be at the lower end of earlier guidance.

Mobile phone makers also disappointed, with Motorola cutting its second quarter sales and earnings targets and Nokia, which lost 5% on the week, warning that revenues would fall below the lower end of earlier forecasts.

European markets remained firm, helped by strong performances in the banking sector where there have been rumours of merger and acquisition activity. Insurers also extended their recovery on the back of stronger equity markets.

Asian markets put in the best performance of the week as the SARS issue is no longer a factor and investors focussed on the positive impact of a weaker dollar on export sales. The Tokyo market was also boosted by the global pick-up in equity markets.

Bonds

With government bond yields continuing to make record lows, European bonds had another buoyant week, the euro over 5 year index rising 2%. The President of the ECB, Wim Duisenberg, hinted in an interview that he was prepared to cut interest rates further from the current level of 2%. The stronger euro has had a significant impact on eurozone inflation, giving the bank additional room to manoeuvre on interest rates. Its preparedness to do so has also been influenced by the negative effects of the stronger euro on Eurozone exports. Deflation fears were a further factor in the strength of bond prices as statistics on the week revealed a further dip in US producer prices.

Outlook

- Forward indicators for the major economies suggest that growth will remain relatively subdued for the rest of 2003.
- Further interest rate cuts are likely in Europe and the US as central banks attempt to boost economies further. Hopes of such cuts, together with technical factors, are currently driving equities higher.
- However, given current valuation levels, a continuous rise in equities will need a more robust economic and earnings environment.
- Our current overall portfolio stance is overweight bonds - given the ongoing disinflationary backdrop - and neutral equities versus the manager average. The funds are underweight in Europe due to deteriorating economic fundamentals and a strong currency and overweight Asia (ex-Japan) due to more attractive valuations and currency considerations.