

Market Comment

Issued on 23rd June 2003

Overview

Equity markets moved further ahead last week, helped by some positive US economic data. The gains were mainly in the earlier part of the week and were followed by some profit-taking on valuation concerns and fears that the better economic news might mean an interest rate cut from the Federal Reserve this week of only 0.25%. As a result, some markets were only marginally up on the week. Bond markets were also hit by interest rate concerns and succumbed to some profit-taking.

After a big drop in US consumer confidence at the end of the previous week, investors were buoyed on Monday by signs of an improvement in manufacturing conditions. The Federal Reserve Bank of New York's Empire State Index for the sector leaped to 26.8 in June, from 10.6 the previous month. The housing market index also recorded a strong advance, from 56 to 62, well above an expected 58.

Further positive statistics were released later in the week - higher housing starts and a 1% rise in leading indicators. The only weakness was in the Philadelphia Fed's index of business conditions, released on Friday. While the index recorded a rise of 4% after a negative 4.8% last month, expectations had been for a stronger rise following the leap in the Empire State Index earlier in the week.

In the eurozone, official figures confirmed the continued moderation of inflation pressures; but ECB comments suggested no immediate need to reduce interest rates further.

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

Table 1			
Market	Index	% Return 13/06/2003 to 20/06/2003	
		Local Currency	Euro
US	S&P 500	0.7	2.8
US	NASDAQ	1.1	3.2
Europe	FT/S&P Europe Ex. UK	2.6	2.6
Ireland	ISEQ	1.2	1.2
UK	FTSE 100	0.6	2.4
Japan	Topix	2.0	3.2
Hong Kong	Hang Seng	0.8	2.9
Australia	S&P/ASX 200	0.1	2.2
Bonds	Merrill Lynch Euro over 5 year	-1.7	-1.7

Equities

At the start of the week, firmer economic statistics buoyed the US S&P 500 Index initially, but fears on the interest rate front led to some profit-taking and the index ended the week only marginally ahead. In the corporate sector, Morgan Stanley, the investment bank, fell 6% on Wednesday after reporting a 25% fall in income during Q2. Kodak, the photograph equipment maker, fell 9% on warning that Q2 profits would be less than half earlier forecasts because of the impact of the SARS virus on sales in Asia.

In Europe, a strong performance by pharmaceuticals helped the index record a rise of 2.6%. Sanofi Synthelabo, Aventis and Novartis were boosted by announcements of, or expectations of, drug approvals. EADS, the aerospace company, gained from expectations of higher sales of the Airbus aircraft.

In the Far East, exporting stocks gained from better US economic indicators. Japanese car makers were buoyed by overseas buying and helped the Topix Index record a 2% gain on the week.

Bonds

Bond markets were hit by a bout of profit-taking after the strong advance in prices of previous weeks and also in reaction to the slightly better US economic news. Doubts about the size of the week's Fed cut and the timing of any further ECB moves also hit prices. Some strengthening in the dollar on the back of an improving US economy was also a negative for eurozone bonds.

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.

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