

## Market Comment

Issued on 30th June 2003

### Overview

Equity and bond markets gave up some of their recent gains last week, largely reflecting investor disappointment at the size of Wednesday's 0.25% cut in US interest rates. Profit warnings from major blue chip companies also triggered some profit taking on equity markets, which have moved up sharply over the last three months from their lows of mid-March.

The Federal Reserve cut the Fed funds interest rate to 1%, its lowest level since 1958, citing risks of lower inflation as the prime reason for the cut. In its accompanying statement, the Fed said that "a slightly more expansive monetary policy would add further support for an economy which it expects to improve over time"; market expectations had been evenly balanced between a quarter point cut and a half point cut.

Bond investors reacted badly because there was no indication that the Fed would make any further cut or that it would take any other steps to keep bond yields low. Equity investors were slightly disappointed with the scale of the cut and there was profit taking following the strong advance seen since March.

Prior to the interest rate announcement, economic statistics were continuing to point to a generally subdued US economic environment, with US durable goods orders weaker than expected. However, on Thursday, there were signs of less negative labour market conditions with initial jobless claims falling from 421,000 in May to 404,000 in June. This was followed on Friday by a better than expected University of Michigan Consumer Confidence index, which bounced from 87.2 to 89.7. There was also some positive news on the Eurozone economy with the German Ifo business sentiment index rising from 87.6 in May to 88.8 in June, beating forecasts.

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

Table 1			
Market	Index	% Return 20/06/2003 to 27/06/2003	
		Local Currency	Euro
US	S&P 500	-2.0	-0.4
US	NASDAQ	-1.2	0.4
Europe	FT/S&P Europe Ex. UK	-1.9	-1.9
Ireland	ISEQ	-2.2	-2.2
UK	FTSE 100	-2.2	-1.5
Japan	Topix	0.5	1.0
Hong Kong	Hang Seng	-2.8	-1.2
Australia	S&P/ASX 200	-1.3	-0.1
Bonds	Merrill Lynch Euro over 5 year	-1.0	-1.0

### Equities

European food and beverage stocks fell during the week following profit warnings from food giant, Unilever, and brewer, Heineken. Unilever warned that, due to destocking in the US, sales would fall short of its target this year, although earnings would be within target. The news led to a number of broker downgrades on the stock and pushed the share price down over 11% on the week.

The beverage sector was hit by a warning from Heineken that earnings in the first half of 2003 would be no higher than last year due to slower economic growth, the war in Iraq, and the SARS virus in Asia. Heineken was down over 8% on the week.

In Ireland, there was more bad news for Elan, which fell over 30% on Thursday when it announced that it faced technical default on its debt because of delays in a filing to its US regulator.

### Bonds

Eurozone bonds succumbed to some profit taking as the Fed move on interest rates was less than many market participants expected. Signs of improved US consumer confidence and a pick-up in German business conditions also pushed yields upwards as did a rise in the dollar to a five week high against the euro. The over five year Eurozone government bond index ended the week down 1%.

## 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 should stay low in the US - as central banks attempt to boost economies further. Hopes of a continued support from monetary policy, together with technical factors, have driven equities higher over the past three months.
- ▶ 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 to marginally overweight 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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