TEMPLE BAR INTERNATIONAL

MARKET UPDATE

Week In View: 7th – 14th July 2006

Market Review

US stocks closed firmly in the red last week, as escalating conflict in the Middle East saw oil prices setting fresh highs and the Q2 earnings season kicked off to an uninspired start. In addition, a US$280m fine from European regulators for Microsoft saw the technology sector sell-off, resulting in the NASDAQ's worst week since April 2005; the tech-heavy Index falling 4.4%. **The broader S&P 500 Index fell 2.3%.**

Market Movements

Markets	14 Jul 2006	% Change
S&P 500	1236.20	-2.31
NASDAQ	2037.35	-4.35
TSE 1st Section	1521.71	-3.27
FTSE/S&P World Europe	359.80	-3.19
FTSE All-Share	2898.49	-3.12
DAX	5422.22	-4.57
Hang Seng	16135.71	-1.97
Citi World Govt Bond Index All Mats	477.71	0.53
Bonds*	**14 Jul 2006**	**07 Jul 2006**
US	5.06	5.13
Japan	1.85	1.96
Germany	4.00	4.08
UK	4.58	4.64
Currencies	**14 Jul 2006**	**07 Jul 2006**
USD/Euro	1.26	1.28
GBP/Euro	0.69	0.69
JPY/USD	116.33	114.00
USD/GBP	1.83	1.85
JPY/GBP	213.38	210.98
Commodities	**14 Jul 2006**	**% Change**
Oil (Brent Crude)	76.14	2.59
Commodity Futures (CRB) Index	393.97	1.22
Gold	666.85	5.54

The Bank of Japan (BoJ)'s nine-member board voted unanimously to raise interest rates on Friday for the first time in nearly six years, ending a lengthy period of zero interest rates aimed at breathing life back into the economy. Equity markets had already priced in the change and **the Nikkei 225 appeared more sensitive to raging oil prices, falling on Friday to end the week down 3.0%.**

European shares fell heavily across the board as oil prices rose and geopolitical concerns heightened in the Middle East. Predictions that crude oil could move above US$80 a barrel this week is likely to prey on sentiment too. **Against this background, the German Dax Index fell 4.6%.** UK stockmarkets followed their European counterparts lower, with Wall Street's rocky opening on Friday only serving to exacerbate the week's negative performance. **The FTSE All-Share Index ended down 3.1%**.

Asian stocks fell for the second week in a row, following the decline of the US NASDAQ, general worries about earnings, higher oil prices and the latter's potential impact on world economic growth. Major export stocks led declines as almost all regional markets fell, while **Hong Kong's Hang Seng Index closed down 2.0%.**

In emerging markets, **Mexico gave back gains from the previous week to end as one of the largest fallers; down 7.6%.** The rest of Latin America wasn't far behind, with **Brazil's Bovespa down 2.1% and Argentina's Merval falling 2.9%**.

With little economic data to go on, the **US Treasury market found support** by way of a flight to quality amid another bout of global equity selling and tension in the Middle East. However, gains were capped by concerns that record oil prices may fuel inflation. **Eurozone bonds also gained**, supported by risk aversion that swept through global financial markets, as yields reached the highest levels since September 2004, **while the JGB market rebounded** as investors covered short positions ahead of the BoJ's hike in interest rates that heralded an historic change in policy.

Following a weaker-than-expected US non-farm payrolls figure, **the US dollar traded modestly lower**. However, as political concerns escalated in the Middle East, and oil prices rose, lost ground was recovered. In Japan, **the yen was unchanged** as the BOJ announced its expected rate decision, despite a relatively dovish statement.

Crude oil prices continued to set fresh highs, hitting US$76 per barrel, as Middle East tensions took hold. Israel continued its offensive in Lebanon, while key oil producer Iran remained defiant in the face of Western pressure to rein in its nuclear ambitions. **Safe-haven gold bullion soared back through the US$660-per-ounce mark** in response to geopolitical tensions.

Comment

Geopolitical tensions rise: what next for markets?

Investor confidence remains fragile against a backdrop of escalating geopolitical tensions. Fears that the violence in Israel and Lebanon could spark off a wider regional conflict have driven oil prices up to fresh peaks. At the same time, gold is benefiting from its traditional safe haven status, with the price of gold hitting a two-month high as the crisis has deepened. Markets are likely to remain nervy in the week ahead, particularly given the number of significant data releases due. A key focus will be Fed chairman's Ben Bernanke's policy testimony on Wednesday. Bernanke may keep markets guessing about what the Fed will do in August. Markets are expecting a further hike, though we continue to believe that we are nearing a peak in US rates, particularly given recent signs of a moderation in US growth. Meanwhile, the Q2 earnings season starts in earnest this week, with initial earnings announcements (particularly in the IT sector) suggesting some numbers may come in below expectations. A slowdown in earnings growth has been widely expected and should not be viewed as a major threat to equity market prospects. Slower earnings growth does, however, suggest that the exceptionally strong gains in equity markets in recent years are unlikely to be repeated. A lower return environment (with higher volatility) is more probable.

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