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EUROPEAN MARKET COMMENT: URSA MINOR OR URSA MAJOR

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Ursa Minor or Ursa Major?

World markets are in the midst of a synchronised slowdown more severe than has occurred at any time since the 1930s. In the United Kingdom, by September 21, the FTSE 100 fell into double bear territory, categorised by two consecutive 20% declines in the FTSE 100 from its peak. The FTSE 100 first fell into bear territory when it dropped 20% in March, and in the third week of September it fell more than 20% below the March level, dipping below 4,600 for the first time since October 1998. There are those who believe that we could be entering the worst bear market since the 1970s, but comparisons are difficult to gauge since each bear market has resulted from different structural causes. In the 1970s there was a severe credit squeeze, in 1990 the Gulf crisis pushed already weak economies into recession, and in 1998 the bear market was triggered by the debt default in Russia and the collapse of Long-Term Capital Management. History has shown that equities have always bounced back, but the length of time to recovery has varied substantially, ranging from as long as 12 years following the 50% peak-to-trough decline in the 1930s bear market, and as brief as five months following the 1974 peak-to-trough decline of 59% and the 1998 decline of 25%. (See exhibit on the following page — "Past and Present U.K. Bear Markets.") The present downturn is the most significant market decline since 1987, when the market fell 36.6% from its previous high, and comes amidst economic weakness in many major markets. In addition, valuations entering into this bear market were at historical extremes, and the gap between the optimistic future growth rates implied by market valuations and economic reality for the TMT sector has yet to be bridged.

In relative terms the United Kingdom has suffered less than has Europe, where the plunge in equity prices was even more precipitous. France's CAC-40 closed on September 21 down 47% from its peak in September 2000, and Germany's DAX 30 was down 53% from its all-time high in March 2000. Shares rebounded slightly between September 21 and month end, with the CAC-40 rising by 11.7%, and the DAX 30, 13.8%.

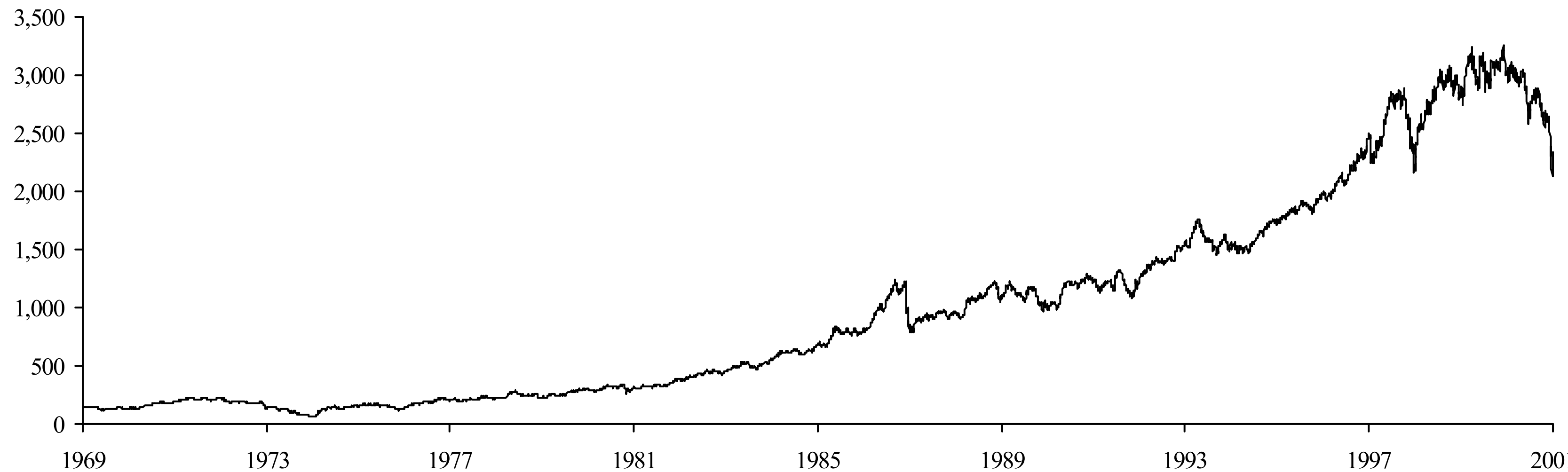
While investors cheered the rebound, the longer-term outcome for equities remains uncertain. The risk of recession is higher in continental Europe than in the United Kingdom because of deteriorating economic fundamentals in the region. Industrial production in the euro-zone dropped by 1.1% for the 12 months ending 31 July 2001, declining at a faster rate than during the last global financial crisis in late 1998. In addition, the rate of decline in employment accelerated in September—a worrying indication that euro-zone manufacturing woes might spill over into the wider economy. Britain appears to be in better shape, with annualised GDP growth for the second quarter of 2.3% reflecting faster growth in the services and construction industries.

With recent surveys showing that Europe's consumers seem to share the American public's pessimism, weakening consumer confidence could reinforce a downward trend. Investors have already digested a welter of corporate disappointments, profit warnings, and a sliding share market. Against this, there is a little noticed accounting measure that has the potential to send shivers through the market. The Accounting Standards Board's FRS17 requires all companies to value pension assets at the market price on the balance sheet date. The recent fall in world stock markets has the potential to push plans into a funding deficit, which will lower distributable reserves and increase gearing levels as plan sponsors will need to make contributions for the first time in years. The accounting change may hit reported earnings hard at a time when the market is particularly vulnerable to bad news.

Further interest rates cuts by the European Central Bank and the Bank of England may comfort equity markets in the short term, but pumping extra liquidity into the economy may not be enough. Low interest rates alone cannot encourage nervous corporations and consumers to invest and spend. Throughout the 1990s equities flourished, as the benefits of prolonged peace were priced into the market after the conclusion of the cold war and the success of the Gulf War. Now that the world appears to be much more dangerous, the natural reaction is to batten down the hatches. The crisis may force cautious policymakers to cast aside fears about inflation and to pursue more aggressive monetary and fiscal easing.

PAST AND PRESENT U.K. BEAR MARKETS

FTSE All-Share Price Level: 31 December 1969 - 30 September 2001



Bear Market Years	1970	1973	1974	1976	1987	1990	1998	2001
Percentage Off High	-25.33	-38.65	-58.87	-32.64	-36.64	-21.58	-24.92	-30.12
Number Of Months To Bottom	4.4	11.1	11.4	8.9	3.8	8.6	2.5	7.7
Number Of Months Back To Peak								
Nominal Terms	11.0	44.7	5.1	4.4	44.6	6.4	5.2	
Real Terms	11.1	44.7	5.7	3.3	44.6	7.4	5.2	

Source: Datastream International.

Notes: All return data are in Sterling (£). Percentage off high data represent the percent change from the high to the low for the year.