

## **XYZ Eurozone Fund**

Fund update for Fourth Quarter 2003

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During the final quarter of 2003, government bond yields in the Euroland region edged higher across the yield curve in response to improving global economic fundamentals. However, yields closed the quarter well below their highs, as resurfacing geo-political tensions, the prospect of a prolonged period of low US interest rates and emerging concerns over the impact of the strong euro on the region's nascent economic recovery caused government bonds to rally once again. At the beginning of the quarter we shortened duration (i.e. the fund's sensitivity to changes in interest rates) from neutral to below benchmark, in expectation that government bond yields would be driven higher by more concrete signs of a global economic recovery. As yields began to retrace some of their earlier rises, we briefly exited this position at the end of October before again adopting a short duration strategy in early November. However, after trading in a range for much of November yields again rallied lower, as cautious investors sought the relative safety of the government bond markets in the face of weaker-than-expected US labour market data and mounting fears of a further terrorist attack. This, due to our short duration strategy, had a negative impact on the performance of the fund. Looking ahead, Euroland business sentiment surveys seem to point towards a further acceleration in economic growth during the early stages of 2004. In addition, the stronger euro does not, for now at least, appear to be having an adverse impact on growth. In fact, export expectations actually increased during December. In this environment, we expect government bond market participants to refocus on improving economic fundamentals, with the result that yields should rise further. Under this scenario, we would expect to retain a short duration strategy in the near future.