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How does the global equity landscape look for 2003?

What sectors do you see outperforming/underperforming in the coming year?

What are the prospects for economic recovery for 2003?

What is the overriding strategy in global fixed income?

There is a lot of talk about a weak dollar; can you discuss some foreign exchange themes for 2003?

Investment Perspectives 2003: The Year Ahead

Globally, investors are still trying to understand the deterioration of the world “peace-dividend” and the excesses of the late 1990s. The combination of these two, along with other structural factors, have led to an extended environment where economic and corporate profits growth continue to be sluggish. Investment returns for the foreseeable future are likely to stay below their long-term average. Our Investment Strategy teams in many regions around the world, including the U.S., believe investors should prepare for a longer period of single-digit returns in the major asset classes. In many cases, expectations for future earnings growth and stock market valuations still appear too high. Furthermore, if the global economy, starting with U.S., recovers better than expected in the next year, the volatility of returns is likely to be much higher than normal. Therefore, we believe investors need to be more prepared, perhaps more than ever before, when managing their wealth and developing an investment strategy. Lower than average investment returns coupled with higher than average volatility will create a challenging environment for investors and wealth managers. Investors who maintain realistic expectations and are properly diversified across and within all major asset classes will be the most successful in the years to come. In the discussion that follows, we briefly outline Merrill Lynch Research’s current investment strategy thoughts. Our macro strategy views should be considered when developing an investment strategy for the year ahead.

How does the global equity landscape look for 2003?

In our opinion, 2003 and beyond should be a year of high volatility, and global asset returns should continue to be below average as economies become more disconnected and central bank rates diverge somewhat. Volatility in asset prices should remain with global equities and fixed income in a competitive battle for the marginal investment dollar. We would watch the capital spending and credit cycles closely to determine if 2003 progresses into a year of further sluggishness or a year of the “replacement cycle.” For now, we are still cautious.

In the U.S., Richard Bernstein, our Chief U.S. Investment Strategist, still believes the market is in speculative mode. Some of the things that suggest this include: the fact that investors are ignoring the “unpredictability of earnings per share (EPS) and geopolitics;” high beta stocks are selling at higher relative valuations than during the bubble;

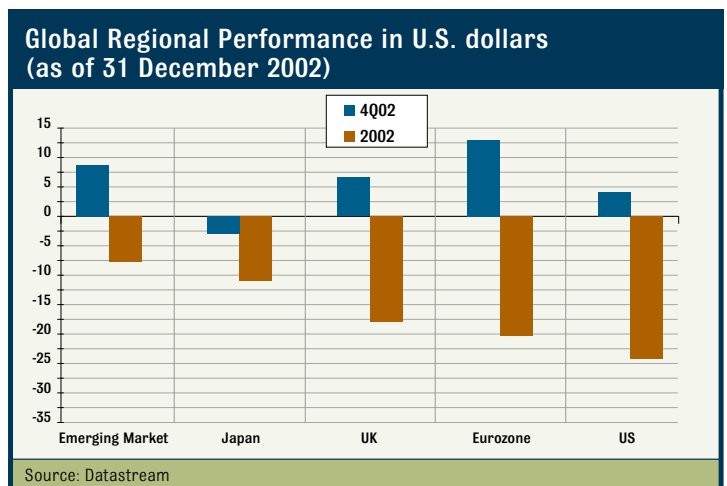
momentum investing is still popular; and the “Greenspan Put” seems alive and well. All of this leads our U.S. Investment Strategy team to maintain their high-quality, conservatism, and diversification stance into 2003.

In Europe, which was the worst performer in 2002—down more than 30% in local currency and down about 20% in U.S. dollars—our European Economics and Strategy team believes there may be further easing in the new year as the region continues to show signs of very weak growth. The themes our investment strategists continue to emphasize into 2003 are restructuring, realism, and reflation. They are still overweight in energy, staples, utilities, and telecoms. In our view, continental Europe may, at least, “feel recessionary” in coming quarters as corporate restructuring is slow and Germany seems to be experiencing a credit crunch. We do not forecast a repeat of equity’s extremely poor performance in 2002, but Europe’s valuations remain too high to forecast a bull market.

We are more positive on the U.K. equity market. We still believe the U.K. market will outperform in the coming months as investors continue to play the “search for yield theme” around the world. We expect higher rates to mix with a strong global economy, which should lead to a re-balancing of growth away from consumption and towards the industrial sector, capital expenditures, exports, and government. We believe the U.K. has the most attractive yield characteristics of the major markets.

In Japan, our strategists forecast a volatile fluctuation pattern for the Nikkei 225 before rebounding to around 11,000 by year-end, based on positive government policy initiatives and expectations for an economic turnaround in 2004. The Japan strategy team believes the domestic economy will continue to go through a cyclical slowdown and recurring profits will decline about 10% year-on-year in fiscal year 2003/2004. Many challenges remain for Japan in 2003.

CHART 1



Until reform is fully in place, we are less favourable on the market and maintain our underperform rating in a global portfolio.

Lastly, the Emerging Markets, the best performer in 2002 (down approximately 5% in dollar terms), still look inexpensive, in our view. As domestic demand in some emerging economies becomes a more important driver, our strategists feel comfortable forecasting that perceived long-term growth prospects of the global emerging markets will rise relative to the growth prospects of the developed markets. This will allow the sizeable price/earning (P/E) gap to close. We also believe this will take time and will not be absent of volatility. For the emerging markets to continue their out-performance in 2003, the global economic upswing that most economists are looking for in the second-half of the year must show signs of staying on track in the first quarter.

CHART 2

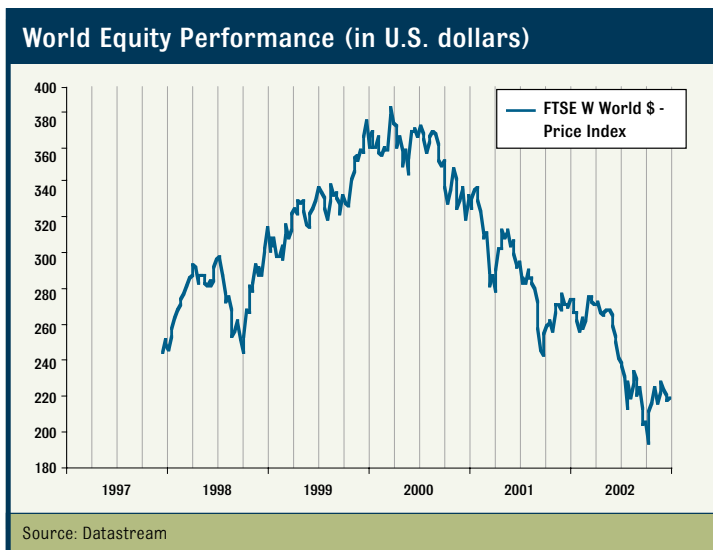
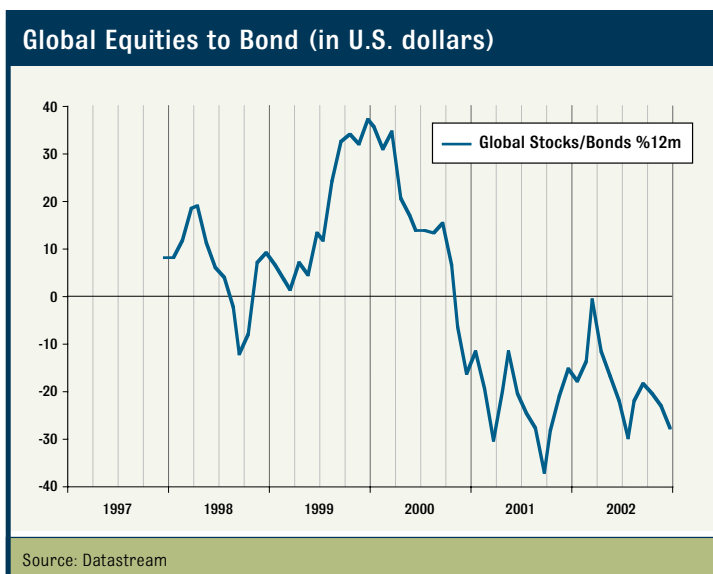


CHART 3



What sectors do you see outperforming/underperforming in the coming year?

Globally, we continue to emphasize four specific investment themes: 1) high quality; 2) balance-sheet restructuring; 3) yield; and 4) diversification. Therefore, we currently believe the sectors that will outperform in 2003 will be consumer staples, energy and utilities. These three sectors contain most of the characteristics of our four investment themes. Additionally, we believe the pharmaceutical industry group is particularly attractive in the U.S. due to its compelling valuation relative to the overall market place. In contrast, we are still concerned about the fundamentals for financials, technology and cyclical consumer goods in general. There are still some questions about U.S. consumer spending continuing at its current pace as well as the timing of a pickup in business capital spending. Until we see more positive information, we believe financials, technology and, in particular, the auto group will underperform. Finally, in terms of size and style, considering our cautious stance for 2003, we have a preference for large capitalization over small capitalization stocks and value over growth. However, we recognize that as the economy strengthens in the second-half of the year, our stance may have to shift by mid-year.

CHART 4

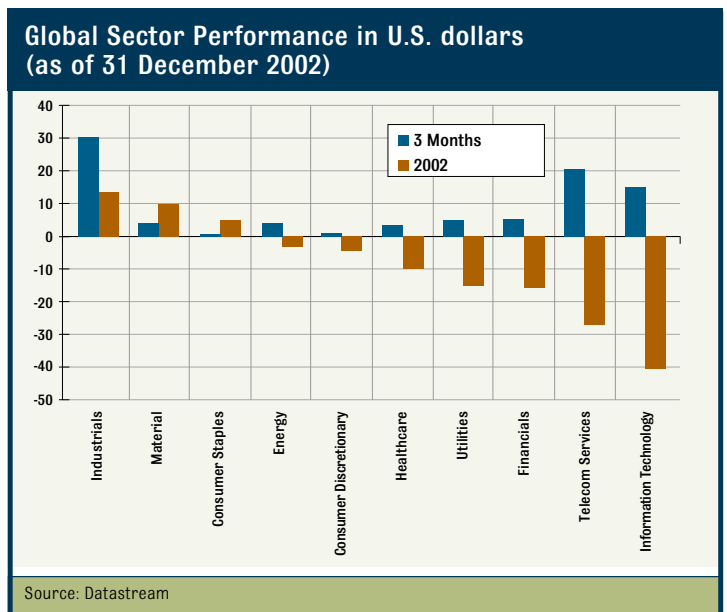
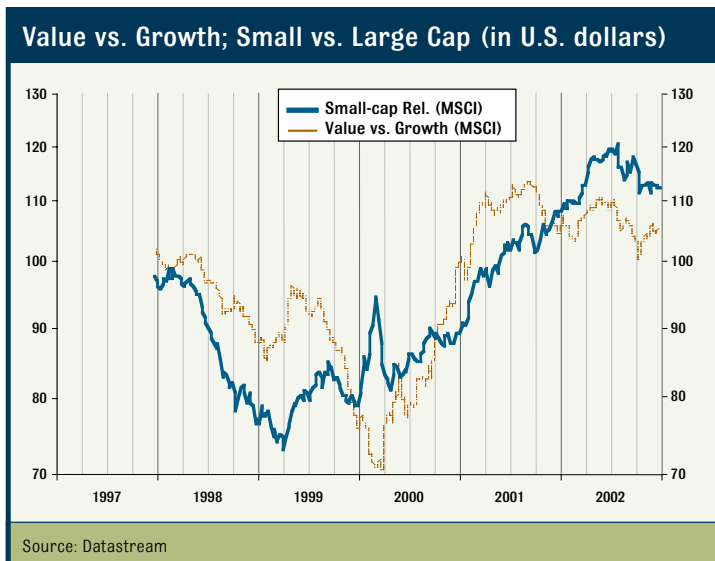


CHART 5



What are the prospects for economic recovery for 2003?

According to the Chinese calendar, 2003 is the year of the sheep. For the U.S., it will be more like the year of sheepish recovery in terms of the economy. We are looking for real gross domestic product (GDP) growth of 2.6% (4% nominal GDP growth) in 2003, a marginal improvement over 2002 with the same erratic quarterly growth pattern. We believe economic momentum will build towards the latter half of the year. With the bottom-up consensus looking for roughly 15% EPS growth for 2003—almost the same projection at this time last year for 2002—earnings disappointments are likely to once again dominate upside surprises.

Moreover, we believe that the risks are high that the dollar continues on its weakening path and that the U.S. goes to war, most likely in the first quarter. The one upside risk to our forecast is the extent to which the U.S. Congress can pass a tax-cutting package in the coming months. Fiscal stimulus should provide key support for the economy, but we remain skeptical that it will be enough to push the economy back to its potential growth rate this year – though we are hopeful for 2004. The good news is that capital spending is showing decisive signs of bottoming-out and in some sectors, returning to growth. Once households follow the corporate sector in terms of balance-sheet repair, look for a much better year in 2004 where we have an initial forecast in GDP growth of 3.6%.

We are less optimistic on the macro economic outlook of Europe, however. We expect Eurozone growth to surprise on the downside in 2003. We forecast 1.2% GDP growth, well

below potential. In contrast, strong U.K. growth of 2.8% is forecasted. A strong Euro will be a negative trend for Eurozone earnings, with the British pound largely unchanged. Lastly, given the bleak economic outlook, we expect European equity markets to be flat at best and volatile over the next twelve months.

In terms of Japan, we are cautiously optimistic on 2003 economic prospects, but predict a sharp contrast between a first-half recession and a gradual second-half recovery. After zero growth in 2003, we forecast 1.5% real GDP growth in 2004. Japan remains ensnared in a complex transition, with the cutting of excess debt and excess capacity, but we are hopeful that an aggressive stance on deflation will be launched in 2003.

In the Pacific Rim, we think three themes should contribute to growth in 2003: 1) a U.S. recovery in capital spending; 2) a turnaround in Asia technology; and 3) a boost in export production based on demand from China. In all, the stop/start global economy seems to be starting again, and the recovery should resume in Asia ex-Japan.

TABLE 1

Global Economic Growth Outlook (% change year-on-year)			
	2001	2002F	2003F
World	1.0	1.8	2.5
United States	0.3	2.3	3.0
Euroland	1.5	0.8	1.2
Germany	0.7	0.2	1.5
France	1.8	1.0	1.9
Italy	1.8	0.3	1.8
Japan	-0.2	-0.3	0.0
United Kingdom	2.0	1.7	3.0
Canada	1.5	3.4	3.0
Asia ex-Japan	4.0	5.4	5.6
Latin America	0.1	-1.1	2.5

Source: Merrill Lynch Global Economics

What is the overriding strategy in global fixed income?

Given the likelihood that the U.S. Federal Reserve and Bank of England (BoE) are nearly finished with the current easing cycle, and with the European Central Bank (ECB) just beginning, we believe there is foundation for a meaningful outperformance of European fixed income markets versus the U.S. and Gilt markets, according to our Chief Global Fixed Income Strategist, Tom Sowanick. On the back of these thoughts—and the fact that a weaker dollar and more fiscal stimulus are likely—our Global Fixed Income team recently reduced exposure to the U.S. Treasury market and shifted funds into Europe.

There are three key themes that should be anticipated for the year ahead. First is the risk that yields may converge between the U.S. and Eurozone. This would prompt a combination of declining yields in Europe with stable to modestly higher short-term yields in the U.S. The second key theme is the risk of a yield curve divergence between the Eurozone, U.K., Japan, and the U.S. Lastly, we believe investors should view the weakness in the U.S. dollar as a forewarning of trouble to come – mainly in the Treasury market and specifically at the front-end of the yield curve. In conclusion, in the short-term, our Global Fixed Income team believes differing economic cycles, varying central bank rate cycles, and the weaker dollar could cause a significant shift in relative market performance over the early months of 2003.

In the U.S., the fixed income markets should produce another fascinating and challenging year. In our view, investors should limit their exposure to the short end of the Treasury market. We believe investors should maintain only a modest overweight in corporate bonds as we head into the new year. We still have some concerns regarding the excessive moves made by corporate bonds when equity prices rallied off of the October 2002 lows. In addition, investors should watch the dollar closely. If a weak dollar policy is chosen by policy makers, then rates may rise sooner and further than expected – hurting treasuries, but benefiting corporates.

In Europe, our European Fixed Income team believes European debt markets will continue to be range-bound in early 2003. They still maintain a 4.25% call for 10-year yields by the end of 2002, but with a cautious directional view for 2003. They also believe the ECB is likely to continue easing rates next year. Our Fixed Income team is forecasting a 2.5% repo rate by March 2003, and more cuts may have to be delivered after that. An important development to watch in early 2003 is that the ECB may find itself in a similar position to where it was in December 1998, when a coordinated rate cut by national central banks of the Eurozone was deemed to be insufficient by the markets.

TABLE 2

Merrill Lynch Global Government Bond Indices as of 11 December 2002

	Total Return in U.S. Dollars		
	Month-to-Date	Qtr-to-Date	Year-to-Date
U.S.	1.371	-0.664	10.318
Canada	1.461	2.582	9.682
New Zealand	1.016	7.172	29.94
EMU	2.232	3.088	22.483
U.K.	2.209	-0.47	16.788
Denmark	2.306	3.189	22.973
Sweden	1.254	4.043	25.685
Japan	-0.716	-0.382	9.93
World	1.198	0.909	15.284

Source: Merrill Lynch

There is a lot of talk about a weak dollar; can you discuss some foreign exchange themes for 2003?

Our Foreign Exchange (FX) Strategy team believes a weaker dollar is likely for 2003—even in the face of an economic backdrop that should prove to be more fruitful in the U.S. relative to others in the Group of 3 nations. Our expectations of a weaker dollar are tied to a correction in external imbalances, namely the large and growing current account deficit. The critical issue is why the external imbalances are going to matter next year. We believe there are three critical considerations in that regard. First, we are living in a FX world dominated by bond flows. This weighs on the dollar through two channels: the rising cost of servicing external debt and the fact that real rates in the U.S. are expected to remain low. Second, foreigners are funding the government. Yields in government bonds are far less attractive than in credit. Finally, valuation matters. We are in the midst of a valuation adjustment, and the connection between economic activity and the currency will be dampened as a result. In sum, we believe the next weak point in the dollar is upon us. After closing the year at an exchange rate of 1.03, we see the EUR-USD cross-rate rising to 1.05 in the first quarter on the way toward 1.12 at year-end.

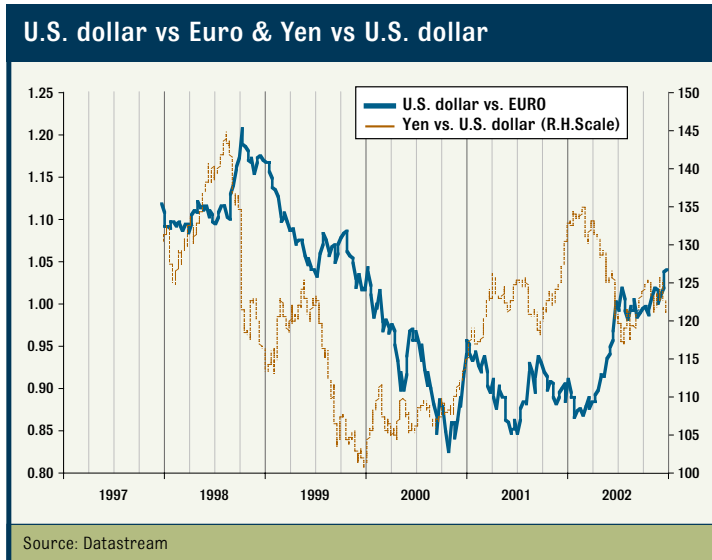
Furthermore, we expect the downturn in the dollar to support a significant strengthening in the euro. There are two considerations that lead us to believe that officials will have to accept a stronger currency. First, the euro is undoubtedly starting from an undervalued position. Second, Euroland officials may not like a stronger euro, but they will certainly not find consensus among the international community to intervene and support a weaker exchange rate.

The Japanese yen continues to trade in a range, and we expect it to stay in the stronger-end of that range through the first quarter of 2003. In addition to dollar weakness, the yen is likely to benefit from expectations of repatriation by financial institutions ahead of its year-end, in March 2003. However, we expect the dynamics for a weaker yen to begin around the end of the fiscal year when we believe banking reform will begin in earnest. We believe that the transition of reform will generate a substantial weakening in the yen,

even more than the U.S. dollar. We forecast a cross-rate of 118 yen/dollar in three months with a move to 130 yen/dollar in twelve months.

Other themes our FX strategy team sees developing in 2003 include: stronger North Asian FX versus the yen due primarily to robust Chinese demand; continuously climbing commodity currencies (NZ, CAD, AUD); and a rise in the Brazilian real.

CHART 6



In conclusion, confusing economic data, worries over dollar weakness, war, and sluggish earnings growth will continue to dampen investment returns. We strongly believe that certain outlying trends do not last for an extended period of time. This is true for any region of the world – not just the U.S. Volatility will most likely continue to be abnormally high and active management will be paramount.

Investors should focus on high quality, diversification, and yield-driven themes within the investment marketplace. Those who are disciplined in their approach to asset allocation and re-balance when necessary should prove to be more successful in the years ahead.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	18	23.08%	Buy	4	22.22%
Neutral	47	60.26%	Neutral	12	25.53%
Sell	13	16.67%	Sell	2	15.38%

Investment Rating Distribution: Global Group (as of 30 September 2002)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1301	45.39%	Buy	464	35.66%
Neutral	1369	47.77%	Neutral	343	25.05%
Sell	197	6.87%	Sell	44	22.34%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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