



## Overall

*Benign interest rate and bond outlook, and high single-digit equity returns.*

- The central case for 2005 will be a mild deceleration in global growth rather than a serious slowdown.
- Short term rates could go somewhat higher in the US and stay flat in the eurozone.
- The bond market environment to be benign in the eurozone.
- Given the economic and market backdrop, Eagle Star currently expects, global equities to deliver high single-digit returns.
- Possible shock events such as a dollar collapse, a Chinese currency revaluation or ECB intervention could induce considerable volatility in asset markets.

## Economic Growth

*Mild deceleration in global growth.*

- The central case for 2005 should see a mild deceleration in global growth rather than a serious slowdown.
- The lagged impact of the one-third surge in oil prices, combined with the rate hikes in the US and UK in 2004, should have a slowing effect on the global economy in 2005.
- Europe ended 2004 with weakened economic momentum and this is set to play out further over coming months.

## Equity Markets

*High single digit equity returns.*

- Analysts foresee global profit growth slowing from 26% in 2004 to around 14% in 2005. This would be in line with the assumed slowing in the pace of the global economy.
- In those regions which have seen profit margins reach high levels, there is also an expectation that cost cutting and productivity improvements have peaked and that margins will contract slightly.
- As a result of a reasonable profits picture in Europe, European equity markets still look attractively valued versus the US with 2005 price/earnings ratios of just under 13 for Europe versus just under 17 for the US.

## Interest Rates & Bonds

*Benign outlook.*

- Markets are expecting a further 1% increase from the Fed in 2005, which would leave rates at 3.25%, still a relatively low level.
- In the eurozone, investors now anticipate a small increase at year end but that expectation could be further delayed if significant dollar weakness or lower economic growth materialise in coming months.
- Even possible shock events, such as a dollar collapse and sharp rises in US long-term rates, may not be sufficient to alter a reasonably benign eurozone bond environment, enabling eurozone bond yields to fall further below US yields.

## Currency Markets

*Continued dollar weakness.*

- All eyes are on the dollar again in 2005. Since the dollar floated in the early 70's it has not fallen against major currencies for four years in a row. Could this year be the exception, however?
- A point to note is that China and other Asian central banks are resisting dollar weakness, thereby putting added stress on the floating currencies of the euro, sterling and Swiss franc.
- Like 2004, it is unlikely to be a one-way market but overall the dollar downtrend seems intact.