

2007

investment outlook



Overall

Corporate earnings backdrop and more attractive valuations favour equities over bonds.

- The central case for 2007 is for some moderation in global economic growth although a 'soft landing' in the US is most likely. Other economies are likely to perform reasonably well.
- Slowing growth and housing market pressures argue for lower interest rates in the US. Eurozone rates are likely to peak close to 4%.
- Inflation and inflation expectations are to remain contained.
- The prospect of peaking interest rates and reasonable valuations (especially against other assets) support global equities but expect volatility over the next 12 months.
- Currency trends are uncertain although an imminent US dollar collapse is unlikely. However, some further weakness in the dollar is possible.

Economic Growth

Global growth to moderate.

- Global economic growth accelerated in 2006 despite the surge in oil prices and higher interest rates.
- For 2007 the consensus sees global growth declining moderately from last year's robust growth of around 4.8% real GDP.
- China and India should continue to expand strongly, increasing their share of global GDP.

Interest Rates & Bonds

A more settled environment.

- Global short-term interest rates are close to peaking, partly because inflation has remained contained despite the surge in economic growth and commodity prices.
- 2007 may see some divergence in central bank policy with markets forecasting a modest rise in eurozone rates and a similarly modest fall in US rates.
- Given this backdrop, the outlook for bond markets is likely to be a modestly positive return.

Equity Markets

High single digit returns.

- Continued global growth in 2007, albeit weaker than in 2006, should translate into further profits expansion but at a more moderate pace.
- Global earnings growth is pencilled in at 10% versus 14% in 2006. This represents a continued positive backdrop for global equities.
- The US market has been a laggard for a number of years and may get more attention from investors as the year progresses.
- In Europe, equity markets have room for further gains given the reasonable valuations and the strong degree of M&A activity. Interest rates, although having further to rise, are likely to peak at moderate levels.
- Pacific Basin markets should continue to perform well although there is over-exuberance in some of the China related stocks.

Currency Markets

Still a dollar story.

- The slow and deliberate rate of appreciation of the Chinese currency means that its huge trade surplus continues to be re-cycled into the US dollar.
- Global capital flows continue to be attracted to the US dollar, providing a significant offset to the worryingly large US trade deficit.
- The yen may continue to struggle until the path for higher Japanese interest rates becomes more definite.

This outlook of potential investment market developments in 2007 does not constitute an offer and should not be taken as a recommendation from Eagle Star. Advice should always be sought from an appropriately qualified professional.

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