

Investment Outlook 2009

Overall

Valuations and unprecedented policy response make strong equity gains possible

2008 was a horrendous year for the global economy and equity markets. However, the global policy response to date has been enormous and unprecedented and this should allow for an improvement in confidence. With equity markets reasonably valued, this could provide the platform for an equity market recovery. These recoveries have traditionally happened in advance of the bottom of the economic cycle, so it would not be unusual to see continued grim economic data at the same time as an equity market rebound.

Economic Growth

Backdrop is grim; policymakers aim to stabilise the negative downward spiral

- As the new year gets underway, the economic situation remains fragile. Policymakers have attempted to prevent a deflationary slump through aggressive interest rate reductions and extraordinary interventions in the financial markets.
- Growth and employment are certain to be sharply lower in 2009 but the aim is to get some stability in the forward-looking indicators during the next few months.
- Much of the effort of policymakers has been directed at trying to support the banking system, reduce the funding costs of banks and to get credit flowing back to the real economy. Further supportive actions can be expected but there is still a risk that some countries, in their own perceived self-interest, might pursue policies that could undermine global growth and cooperation.
- The collapse in oil and other commodity prices would ordinarily be a significant positive for the global economy.

Equity Markets

Strong gains possible if policy action is successful

- Economic data is grim and arguably still deteriorating, but traditionally equity markets rally in advance of the turn in the economic cycle.
- There is some optimism that the unconventional policies of the Fed, further US fiscal stimulus and measures from other large economies may support markets.
- On some measures, equity valuations are at multi-decade lows and, thereby, offer strong support to the markets in the event of an improvement in confidence.
- Markets will remain volatile and the direction uncertain until credit markets begin to return to normality; there are some indications that this is beginning to happen.
- Any recovery is likely to be good for the Asian (ex Japan) markets, whose long-term fundamentals are superior to Europe and the US.

Interest Rates & Bonds

Further cuts in short rates ahead; backdrop still supportive for bonds

- Global short rates will remain exceptionally low or fall even further in the first quarter.
- The ECB is still likely to drive rates closer to 1% before this cycle is over. And while US rates are now close to zero, the Fed is focused on driving down other interest rates, such as the level of rates that companies have to pay in order to raise debt financing.
- Government bond prices have risen appreciably in recent months due to falling short rates and slumping equity and corporate bond markets.
- Although prices may suffer periodically as governments step up their borrowings substantially – and profit-taking is always a risk – it remains the case that the economic backdrop should be bond supportive for a while to come.
- Ultimately, the level of short-term and long-term rates may be seen as "emergency" levels and hence may not be sustainable.

Currency Markets

Likely to be a key focus during 2009

- The dollar has performed well in the face of the economic slump and reduction of interest rates to zero. Its valuation cushion against the euro has been eroded somewhat, but there has been some improvement in the trade deficit, which is a positive. Longer-term concerns remain, but the markets' focus has been on shorter-term developments.
- The strength of the euro against some of the other European currencies, such as sterling, has led the single currency into extreme territory and vulnerable to negative data from the eurozone.
- It would probably take an improvement in the global climate before China reverts to its prior policy of currency appreciation. This, in turn, would permit other Asian economies to let their currencies rise against US and European currencies, which is seen as a necessary part of the rebalancing of global growth.

This outlook of potential investment market developments in 2009 does not constitute an offer and should not be taken as a recommendation from Eagle Star/Zurich. Advice should always be sought from an appropriately qualified professional.

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