

Investment Outlook 2008



EAGLE STAR

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Overall

Moderate returns for equities; mixed returns for bonds

- The central case for 2008 is for further moderation in global economic growth, although a 'soft landing' in the US remains the most likely outcome. Asian (ex-Japan) economies are likely to perform reasonably well, although a slower global economy will impact.
- Slowing growth and housing market pressures argue for further interest rate cuts in the US. Current eurozone rates are likely to be at their peak, although they may not be cut until towards the end of the year.
- High food and energy prices have caused headline inflation numbers to rise. This may limit the scope of rate cuts, especially

in the major economies.

- The prospect of lower short rates and reasonable valuations supports global equities, although there are concerns about the health of the banking sector and the overall earnings' outlook. Expect further volatility over the next twelve months.
- The US dollar remains the primary focus of currency markets. After last year's weakness, the US dollar now has valuation support versus European currencies. The slow pace of Chinese currency appreciation is likely to persist.

Economic Growth

Global growth to moderate further

- Global economic growth should slow under the weight of prior rate rises, higher oil prices and the workout of the dislocation in credit and money markets.
- For 2008 the central scenario is for a 'soft landing' in the US, despite growing talk of a more serious downturn.
- China and India should continue to expand strongly in absolute terms, although the risks in both are probably skewed to the downside.
- Developments in the oil and commodity markets and how they impact on inflation will continue to complicate decisions for policy makers - especially in Europe and Asia.

Equity Markets

Valuation support suggests moderate gains

- Valuations of equities remain attractive, especially against other assets, but slowing economies are likely to put pressure on earnings' growth. Volatility may persist, especially in the earlier part of the year.
- Consensus earnings are currently forecast to rise by 13% in 2008 versus 9% in 2007. However, there are concerns as to the transparency of profits, especially in the banking sector, and earnings' forecasts are likely to be cut back more aggressively in some sectors as the year progresses.
- The US market may continue to get more attention from investors in 2008, not least because of the declining interest rate environment.
- Europe still has valuation support relative to the US but other factors - such as a high currency and hawkish ECB - may limit its performance.
- Asian markets continue to have positive long-term prospects. However, after such strong absolute performances and the elimination of the valuation discount versus other markets, near-term performance may be more volatile.

Interest Rates & Bonds

Further rate cuts

- Declining global short-term interest rates and moderating economic growth should provide some support to bonds.
- However, headline inflation has increased significantly due to food and energy price rises. This has complicated the picture for policy makers who might otherwise reduce rates further and faster in the face of the credit and money market disruption that started in 2007.
- Given this more complex backdrop, the outlook for bond markets is mixed.

Currency Markets

Still a dollar story

- The US trade deficit is finally beginning to improve from dire levels, partly alleviating one of the fundamental negatives for the US dollar.
- The euro, Swiss franc and sterling have taken much of the strain of US dollar weakness because Asian authorities have been slow to appreciate their currencies.
- Fundamentally, the dollar's decline against European currencies should be close to an end, although momentum is still against it. With economic risks globally to the downside, Asian policy makers, including the Chinese, are unlikely to make any bold moves in 2008.

This outlook of potential investment market developments in 2008 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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