

Investing in 2009

Fixed Income

- Government bond yields (US, Eurozone, Japan) could decline further because of easing monetary policy and declining inflation expectations.
- Credit markets are pricing in a very dark economic scenario due to forced selling by leveraged investors. Hence, we see many dislocations which offer good opportunities.
- In 2009, we think forced selling will come to an end and liquidity will increase. Fundamentals will become the main driver again for credit markets.
- We see the best opportunities for corporate credits, both investment grade and high yield, mainly due to current extreme valuations.
- Emerging market debt is attractive as well, but is more vulnerable to a deteriorating outlook for the global economy.

Equities

- Equity markets will move in a broad trading range for most of 2009. We expect modest equity price increases. Meanwhile, dividends can provide a good carry.
- We expect an average dividend decline of 20%, more than in previous recessions. Nevertheless, dividend yields will be higher than government bond yields and interest on savings.
- Companies with high and sustainable dividends should outperform the market (mainly defensive sectors).
- Furthermore, we favour large caps with limited leverage and high cash flows.
- We prefer health care, food and beverages, telecom and the oil majors. We remain cautious on industrial cyclicals and financials.
- We prefer the US and Japan to Europe. We maintain our neutral stance on emerging markets.

Real Estate Equities

- Despite attractive dividend yields, we maintain our underweight in real estate equities.
- A recession may have a negative impact on the vacancy rate and on rental rates.
- Real estate equities remain expensive, both versus equities and credits.
- Due to the credit crunch, funding of real estate projects has become more difficult and borrowing costs have risen sharply.

Review 2008

- 2008 was one of the worst years in the history of equity markets (graph 1). Volatility reached extremely high levels (graph 2).
- Not a sector could escape price declines. Financials (due to the financial crisis) and Materials (due to strong commodity price declines, graph 6) were hit hardest.



- Not a region could escape as well. For a large part due to a stronger currency, US and Japanese equities performed relatively well (graph 3, 5). Emerging markets declined most, due to risk aversion among investors and plunging commodity prices (graph 6).
- Risk aversion caused downward pressure on government bond yields (graph 4).



- The euro declined sharply versus the US dollar and Japanese yen (graph 5). Reasons were the relative economic developments (US vs. Eurozone) and the strong increase of risk aversion (causing capital to pour back to the US and Japan).
- The oil price showed unprecedented strong fluctuations (graph 6). Due to the deteriorating global economic outlook, the oil price declined sharply in the second half of 2008.



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Source: Thomson Datastream (data as at 14 November 2008)



Outlook

2009

Outlook

Economy

- The credit crunch clearly spilled over into the real economy in 2008. We expect a severe global recession, but not a depression.
- Policy makers will mitigate rather than multiply (as they did in the 1930's) the negative impact of the financial crisis on the real economy.
- Nevertheless, the major economies (US, Eurozone, UK, Japan) will contract in 2009. A modest and gradual recovery can start as from the second half of 2009.
- We expect global GDP growth to slow to 2% in 2009. We foresee emerging markets growth of 3.5%. China GDP growth could fall back to 6-7% (from more than 10%).
- Due to strong commodity price declines and the slowdown of the global economy, inflation will not be an issue in 2009. Headline inflation rates could fall below zero temporarily.

2009 estimates

	US	Eurozone	Japan
GDP growth	-0.6%	-0.2%	-0.3%
Inflation rate (CPI)	1.9%	1.8%	0.8%
Central bank rate	0.5%	2.0%	0%
10-year bond yield	3.5%	3.5%	1.3%

Central banks and interest rates

- Central banks (together with governments) will continue to do whatever it takes to prevent the current financial crisis from creating a depression.
- Due to falling inflationary pressures, central banks have room to ease monetary policy further.
- Rate cuts and lower inflation expectations will cause government bond yields to decline further. We expect a steepening of the yield curve.

Equity markets

- Equity markets discount a global earnings decline of 40%, which is more than in recent recessions, but in line with our predictions.
- Equity markets tend to bottom at the beginning of a recession. Therefore, the trough in this bear market could be reached in this quarter (Q4'08).
- A sustainable recovery may only start late 2009, a few months before the bottom in earnings has been reached.
- Until then, equity markets will probably remain in a broad trading range with continuous high volatility. 2009 will be a year of 'treading water', waiting for the bottom in earnings.
- We forecast a 60% chance of higher equity markets in 2009.

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Euro/dollar, oil price

- We think the US dollar can strengthen further versus the euro. We estimate a EUR/USD of 1.15 by the end of 2009.
- Due to the gloomy global economic outlook, we do not expect a sharp rise in the oil price. The price could dip below USD 50, but not for long. Underinvestment in oil production provides strong upside once the economy recovers.

Where to invest in?

- High dividend equity strategies
- Large caps with high cash flows and strong balance sheets
- Health Care, Telecom, Consumer Staples, Energy
- US and Japanese equities
- High Yield and Investment Grade Credits

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