



The US sub-prime crisis that began in August 2007 reached a crescendo in 2008, setting the scene for an extraordinary and volatile year in global financial markets and the world economy. In the fallout, annual investment returns were the worst in recent years while the global economy fell into recession for the first time since 1990/91. Felix Stephen, Senior Investment Strategist at Investment Solutions, shares his outlook for 2009 and explains why he thinks that the worst appears to be behind us, and 2009 looks set to see some optimism restored, with markets expected to show positive, albeit modest, returns.

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The outlook for 2009 is cautiously optimistic. Global central banks and governments have been quick to act in their efforts to try to stem the fallout from the US sub-prime crisis. Interest rates are at or near historical lows, and authorities vow to do whatever is necessary to restore confidence in the financial system. Government stimulus plans are in place and are constantly being expanded. The impact of these measures is very likely to be felt by the middle of 2009.

Global growth is anticipated to be around 2% in 2009, from an estimated 3.7% in 2008. Emerging economies will be the key drivers of growth, growing at around 3.7% for the year. Advanced economies are expected to lag behind, contracting at -0.7%. For Australia, growth is expected to be a modest 1.3%.

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Financial Market Outlook

Australian shares

The ASX 200 Australian equity market index is expected to trade within a 3,400 to 4,300 range, with a fair amount of volatility during the first six months of 2009.

We expect the market to shift into a higher 4,300 to 5,000 range during the second half of 2009 as global and domestic growth traction becomes more visible. There is a strong possibility that the index could move into a 5,100 to 5,900 trading range around early to mid-2010 as global growth accelerates, thanks to strong policy initiatives implemented by the authorities.

International shares

We anticipate the US S&P 500 index trading in a range between 800 and 1,100 over the next six months and an eventual upside breakout to shift the index to trade in a 1,100 to 1,450 range. A similar pattern is likely to be established in most major global equity markets. On a regional basis, it is expected that the European stocks are likely to outperform the US. The weaker Sterling Pound is likely to support UK stocks relative to European stocks while Japanese stocks should move in tandem with the US market initially and then gather upward momentum with economic growth traction being gained in the Asian emerging economies. Emerging market countries with financial flexibility and policy credibility, such as China and Mexico, should perform well while Central Europe, Korea, India and Indonesia are likely to be laggards.

Diversified listed property trusts

It is likely the global listed property market will offer relatively good value for investors in the short to medium term due to the relatively attractive distribution yield on offer. However, there could be concern that the subdued economic outlook and the increased cost of capital will have a negative impact on the asset class. While an equity market rally will no doubt be supportive of listed property securities, declining direct property values and the



Margin Lending

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increased cost associated with rolling over existing credit facilities will eventually have a heavy negative impact on the asset class.

Global property securities should offer better value relative to domestic listed property through efficient diversification and country allocation that results from uneven economic growth and varying earnings outlook across the world.

Studies show that commodities are a good hedge against inflation and against geopolitical risks

International bonds

We expect global sovereign bond yields to move higher sometime during the second half of 2009, taking the US bellwether 10-year note to around the 4.0% to 4.25% levels during the sell-off. A rise in yields of around 2.0% to 2.25% from present levels is consistent with similar moves in the past. Most global bond markets are likely to suffer when safe haven capital flows that have been parked in Government bonds are reversed, particularly when financial institutions add risk to their asset base or banks recommence extending credit to their customers.

Australian bonds

Australian bonds, such as global sovereign bonds, are vulnerable to a sharp sell-off sometime during the second half of 2009. The Australian 10-year bond may reach the 5.0% to 5.50% level during this sell-off. It is possible that the bond curve to “Bear Steepen” while the spread of 10-year US Treasuries may narrow from the present 2.0% level to around 1.5%.

Alternative assets

Broadly, absolute return, multi-strategies, market neutral equity strategies, equity long/short, global infrastructure, convertible arbitrage, credit long/short and fixed income arbitrage, etc, would fall within this category.

These strategies have the capacity to deliver “alpha” that is not usually correlated to other major asset classes and are excellent risk diversifiers. However, we are cautious on this asset class and would urge investors to be ultra vigilant when employing such strategies, ensuring that such strategies are liquid, transparent and that they are managed by institutions with strong balance sheets.

Commodities

The view on the commodity complex in the medium to long term remains positive. We expect that once global economic growth gains some traction and growth visibility emerges from the prevailing doom and gloom, commodity prices should accelerate higher. The prevailing commodity prices could be a good entry point to this asset class or, if already invested, it is an asset class that should be re-weighted higher. On specific sectors, agriculture and livestock should perform well in the short term to be joined by energy and industrial materials in the medium to long term.

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Currencies

Broad weakness in the US Dollar would imply that the Australian Dollar is most likely to appreciate against the US Dollar and even against the Euro and the Japanese Yen. Watch for a modest depreciation against the Sterling Pound from current levels. It is likely that the Australian Dollar will remain modestly strong against emerging market currencies in the early part of 2009 and then gradually depreciate against them as the emerging economies gather strength.