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## **Interest rate, currency and equity market prospects in the USA, Europe and Japan**

### **U.S. equity market**

Given the ongoing deceleration in the economy it is at first glance surprising that the S&P 500 has not yet shown any signs of weakness. A more detailed analysis of the companies, however, indicates that they are considerably better positioned today than they were around five years ago. Most have also improved their capital ratio. We anticipate that despite the slight slowdown, the majority of companies will be able to successfully generate earnings without any major problems. The positive trend in cyclical stocks in recent months also points towards a likely upswing in U.S. equities again this quarter. As a result of the sheer size of the U.S. equity market, from today's perspective there will probably only be moderate rises in the major leading share indices (S&P 500, Dow Jones).

### **USA: interest rates, bond market and the currency**

The weak phase in the U.S. economy is set to continue. Economic growth rates could decline even further, although a recession seems unlikely at the moment. The main argument behind our outlook is the need for further consolidation in the real estate market, and this will have a curbing effect on a range of sectors in the macroeconomy. The labour market, which has been in good shape until now, will also finally start to feel the effects and will therefore trigger a turnaround in monetary policy. We are expecting the first cut in interest rates around the middle of the year. The bond market in the USA should benefit from this situation and we are anticipating a slight fall in yields in the coming months. Forecast lower U.S. interest rates are likely to adversely impact and weaken the dollar, although it appears unlikely that the currency will fall below the lows against the euro at the end of 2004 on a sustained basis.

### **European equity market**

In addition to good corporate fundamentals, macroeconomic indicators are also giving grounds for optimism with the prospect of further price gains on the European equity markets. Despite the rise of recent years, company earnings continue to offer potential for a sustained upward trend and this in turn generates opportunities to improve the return on equity. Dynamic growth in Eastern Europe provides enterprises with both a boost and chances for longer-term expansion. The valuation of European equities is still highly attractive and there is considerable upside potential.

### **Eurozone: interest rates and the bond market**

Economic growth in the Eurozone proved to be surprisingly robust in Q1 2007. Neither the increase in VAT in Germany nor the economic slowdown in the USA put a stop to the upswing and the outlook for the year as a whole is now significantly more positive. The key drivers here are investment and sharp growth in employment figures. The considerable improvement in the labour market points towards faster growth in private consumption from H2 2007 which should carry over into 2008. We are expecting a moderately positive contribution from exports and the companies are well positioned in the markets, particularly in the growth markets of Eastern Europe and Asia. Against this backdrop, money market rates are likely to rise again in June. For the second half of the year we expect interest rates to remain unchanged although the risk of a further hike remains. In the bond market, short and medium-term maturities are attractive, while long-term bonds will probably show losses again in Q2 in the face of strong economic growth.

### **Japanese equity market**

We believe that the outlook for the equity market in Tokyo is in principle positive. The economic recovery looks set to continue and is now extending to domestic market sectors. Many companies are emerging successful from the restructuring processes of recent years and there is nothing to prevent an upturn in the equity market in the medium term. As a result of the slight slowdown in growth in company earnings and the uncertain currency components, our sector allocation focuses on domestic consumption, real estate and banking.

### **Japan: interest rates and the currency**

Following the spurt in the economic upturn in Q4, the overall performance of the Japanese economy in H2 2006 was positive although growth in private consumption was flat. Early indicators for Q1 2007, however, point to a recovery in this sector and we believe this is likely to continue over the course of the year as developments in the labour market are set to remain positive. Overall, the pace of economic growth should pick up in 2007 compared to 2006. To date, inflation data has scarcely reflected the long-year uptrend in the Japanese economy. We are only expecting a very slow rise in inflation, which in turn will lead to only very moderate rate increases by the Bank of Japan. We anticipate that positions financed in yen will become less attractive and this should ultimately lead to a firming of the undervalued Japanese currency.