



### Policy action key to restoring growth and confidence

Governments around the world are intensifying their efforts to deal with the financial crisis by taking sizeable measures not only to rescue banks that are heavily exposed to toxic assets, but also to prevent the credit crunch from engulfing the rest of the economy. The plans are not always consistent, yet they underscore an unconditional commitment to fight the current disruption and should eventually create a set of conditions for a future recovery in confidence. For these reasons, we stand by our view that a deep and long global recession may yet be avoided and we reiterate our preference for global equities and for corporate bonds.

#### Policy response: Timely intervention is key

We acknowledge that in 2009 the major global economies will all experience recession, but we do not share the negativity of some investors who predict a deep and long (1930s-style) depression. Reducing global leverage may take time, but global policy efforts may restore investor confidence before the real economy actually returns to growth. This is a key difference with the 1930s when protectionist measures made conditions worse.

All governments in developed countries are showing a **thorough commitment to set their economies on a recovery path**. For now, they are fighting an uphill battle to allay investors' fears. All risky assets, from equities to corporate and emerging-country bonds, are suffering amid an unprecedented flight to safety. However, the steps being taken to contain the global downturn are also unprecedented. In this respect, some governments are taking a very aggressive stance. The US is employing all available measures to prevent recession turning into depression. Some may question the effectiveness of initiatives such as flooding money markets with cash, taking stakes in banks and extending guarantees on deposits or other bank debt amid a flurry of weak economic data. Yet in spite of this, priorities are clearly set.

*Timely intervention is key.... global policy efforts may restore investor confidence before the real economy actually returns to growth*

## 2009 Financial Markets Outlook

**Equity markets** are nervous as we move into 2009, but this sentiment may reverse over the coming year. Major stock indices have recently fallen to five-year lows; much of these falls can be explained by the fact that stockmarkets remained the only fully functioning and liquid markets throughout the recent crisis. Stockmarkets suffered, as investors who could not liquidate other asset classes, 'oversold' equity allocations instead. Relative equity valuations are now very attractive when compared to risk-free assets, as stock prices are already reflecting an expectation of a prolonged recession and sharp declines in earnings.

We believe that it is up to developed countries, starting with the US, to restore confidence through well devised rescue plans for the financial sector, which will benefit the rest of the economy. The new US administration has appointed a competent team to deal with a tough crisis, and may still succeed in preventing recession from turning into a deeper slump. European governments have yet to pursue a clear coordinated policy, and this fragmented approach, along with a late switch to an easing mode by the ECB, may delay recovery in the euro area. Against this backdrop, **US equities may outperform in the year ahead.**

**Government bond** yields in major markets moved lower through 2008, as inflationary concerns gave way to fears surrounding the credit crisis, which triggered a flight to safe-haven sovereign debt. Ten-year government bond yields are now at their lowest levels since the credit crisis began in the US and in Germany. However, bailout policies may have a large impact on the future issuance of government bonds, especially in the US and the UK, thereby boosting yields. **Therefore, we see more value in euro-area government debt, where the ECB has more room to cut key rates and where new bond issuance may be somewhat constrained by EMU rules.** Globally, risk aversion remains widespread and has also affected sovereign emerging-market bonds, which were previously considered something of a safe haven, thanks to commodity exporters' healthy budgets.

**Corporate bond** spreads also reached record highs during the credit crisis. Spread levels suggest rising fears of a dramatic increase in overall defaults, which we believe is exaggerated in light of recently enhanced government guarantees on bank debt. Against this backdrop, **we maintain our overall preference for credit markets (both investment grade and high yield).**

**In currency markets**, the euro and sterling recently weakened against the US dollar, amid sharply reduced economic growth estimates and doubts surrounding the effectiveness of European governments' plans to deal with the banking crisis. However, fundamentals have not driven all market trading, as the yen has strengthened despite Japan's recession. The ongoing global deleveraging process has seen the unwinding of many previously popular carry trades, which has led to a sharp appreciation in the yen against higher-yielding currencies. **We confirm our current overweight in yen, while at recent levels in the €/€ 1.25 area, we see reduced upside for the US dollar against the euro.**

## 2008 Market Review

### Equity Market Performance as at 30 November 2008

Index	Performance (Euro)	Performance (US dollar)
MSCI World (All Countries)	-35.39%	-43.80%
MSCI North America	-30.64%	-39.67%
MSCI Europe	-41.30%	-48.94%
MSCI Japan	-26.27%	-35.86%
MSCI Asia Pacific ex. Japan	-33.52%	-42.17%
MSCI Emerging Markets	-51.36%	-57.69%

Source: Bloomberg, MSCI, 31.12.07 - 30.11.08. Performance calculated on a price return basis.

In 2008, global equity markets suffered their worst year since 1970. Longer-term comparisons show the S&P 500's 2008 performance decline was equivalent to its returns in 1932, during the 'Great Depression'. Emerging Markets held ground well during the first half of the year, but started to underperform during the worst of the financial crisis, as commodity prices fell sharply.

### Fixed Income Market Performance as at 30 November 2008

Index	Performance (local currency)	Spread (31 Dec 07)	Spread (30 Nov 08)
JPM Euro 3 Months	5.15%	-	-
JPM Global Gov Bond (USD)	4.62%	-	-
ML US Investment Grade (USD)	-12.17%	206	647
ML Euro Investment Grade	-16.62%	120	421
ML US High Yield (USD)	-31.56%	592	1988
ML Euro High Yield	-43.92%	491	2182
JPM Emerging Markets Bond (USD)	-18.14%	261	740

Source: Bloomberg, Merrill Lynch and JP Morgan, 31.12.07 - 30.11.08.

Performance calculated on a local currency total return basis.

Spreads represent the basis-point spread over the risk free rate (option adjusted).

Government bonds were the only asset class offering positive returns over the eleven months to end-November, with yields ending 2008 at their lowest levels since the credit crisis began. As a consequence, spreads on all classes of Corporate bonds rose dramatically, forcing the performance of Investment Grade, High Yield and Emerging Market bonds into negative territory in 2008. The increase in corporate spreads reflects high risk aversion among investors and important technical factors such as a lack of liquidity in markets for these securities. Importantly, however, spread widening does not necessarily imply a fundamental deterioration in the financial position of all issuers.

## 2008 Market Review Continued

### Currencies and Commodities as at 30 November 2008

	31 Dec 07	30 Nov 08	Change (%)
<b>Currencies</b>			
USD/EUR	1.459	1.269	-13.02
USD/JPY	111.77	95.57	-14.50
EUR/JPY	163.04	121.22	-25.65
<b>Commodities</b>			
Crude Oil	93.85	53.50	-42.99
Gold	833	818	-1.80
CRB Commodities Index	358.71	242.2	-32.5

Source: Bloomberg, US Federal Reserve, London Metals Exchange, 31.12.07 - 30.11.08.

After reaching an all time high of €/£ 1.59 in July, the euro subsequently lost ground to the US dollar when investors bought dollars to fund purchases of US government paper as the credit crisis intensified. The yen benefited from the global deleveraging process, which saw many carry trades unwind. Commodities also took a major hit during the second half of the year, and the CRB Commodities Index has fallen 33% year-to-date. Gold, however, has slipped only 2% when measured in US dollar terms, and has appreciated when measured in many other weaker currencies.



## 2008 Timeline of Emergency Government Interventions

*Since policy action is key to fighting the financial crisis and restoring confidence, we provide an overview of some of the unprecedented steps taken by governments and central banks around the world to deal with the financial crisis during the course of 2008:*

March

→ Bear Stearns, the fifth largest US investment bank, is acquired by JPMorgan Chase in a deal backed by the US Federal Reserve.

July

→ US officials rescue America's two largest mortgage lenders, Fannie Mae and Freddie Mac. As owners or guarantors of US\$5 trillion worth of home loans, they are crucial to the US housing market and authorities agree they can not be allowed to fail.

September

→ Having let Lehman Brothers fail, the US Federal Reserve announces an US\$85bn rescue package for AIG, the country's biggest insurance company, to save it from bankruptcy. AIG secures the loan in return for an 80% public stake in the company.

→ The credit crunch hits Europe's banking sector as the European banking and insurance giant Fortis is partly nationalised to ensure its survival. Dexia is next to be bailed-out as the credit crisis deepens.

→ The UK government takes control of mortgage lender Bradford & Bingley. It also plans to raise the protection on guaranteed bank deposits from £35,000 to £50,000.

→ The Irish government says it will guarantee all deposits in the country's main banks for two years.

→ In the US, lawmakers reach a bipartisan agreement on a rescue plan for the US financial system. The package, to be approved by Congress, allows the Treasury to spend up to US\$700bn buying bad debts from ailing banks.

→ Germany announces a 50bn euro (US\$68bn; £38.7bn) plan to save distressed bank Hypo Real Estate.

October

→ The UK government announces details of a rescue package for the banking system which amounts to a de-facto nationalisation. Then it announces plans to pump billions of pounds of taxpayers' money into UK banks: Royal Bank of Scotland, Lloyds TSB and HBOS are the main recipients.

→ The US government unveils a plan to purchase stakes in a wide variety of banks in an effort to restore confidence in the sector. President Bush says the move will help return stability to the US banking sector.

November

→ China sets out a two-year US\$586bn economic stimulus package designed to help boost the economy by investing in infrastructure and social projects and by cutting corporate taxes.

→ The US government announces a US\$20bn rescue plan for troubled banking giant Citigroup.

→ The US Federal Reserve announces it will inject another US\$800bn into the economy in a further effort to stabilise the financial system and encourage lending. About US\$600bn will be used to buy up mortgage-backed securities; while US\$200bn is being targeted at unfreezing the consumer credit market.

→ The European Commission unveils an economic recovery plan worth 200bn euro to stimulate spending.

## 2009 Economic Outlook

### Global View: Policy actions will be key

Governments around the world are intensifying their efforts to deal with the financial crisis by taking sizeable measures not only to rescue banks that are heavily exposed to toxic assets, but also to prevent the credit crunch from engulfing the rest of the economy. The plans are not always consistent, yet they underscore an unconditional commitment to fight the current disruption and should eventually create a set of conditions for a future recovery in confidence.

The credit crisis began in the US and authorities there are duly employing all available measures to prevent recession from turning into depression. Some may question the effectiveness of initiatives such as flooding money markets with cash, taking stakes in banks and extending guarantees on deposits or other bank debt amid a flurry of weak economic data. Yet in spite of this, priorities are clearly set. One of the most compelling measures announced to date permits the US Federal Reserve to draw from a special fund to buy commercial paper in an effort to restore a vital funding facility heavily used by corporations.

European governments' actions look shy in comparison. The fragmented nature of the plans announced so far may not convince markets that this cross-border crisis is being managed effectively. Germany's determination to adhere to EMU fiscal parameters is in stark contrast to the more flexible approach adopted by other countries (led by France). For its part, the ECB is taking an active part in global easing, but key lending rates are being cut more aggressively elsewhere (notably in the UK). However, lower benchmark rates are gradually moving interbank lending rates down across the eurozone.



# 2009 Economic Outlook Continued

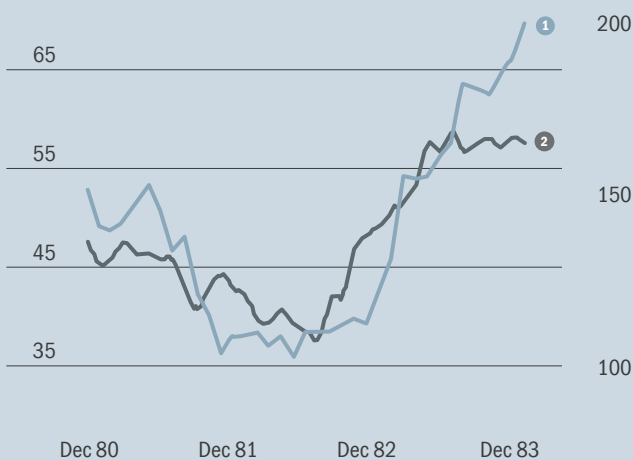
Against this backdrop, we expect Europe's potential recovery to be more limited than any recovery in the US. This should force further rate cuts from the ECB, if inflation further stabilises. We see more downside for US Treasuries, since Washington's commitment to revive its economy will put huge upward pressure on America's budget deficit and, once economic conditions eventually improve, will fuel inflation. Corporate bonds stand to gain the most from better conditions as current emergency policies seek to improve corporate solvency. Equities will also benefit from the end of turbulence.

*Governments around the world are intensifying their efforts to deal with the financial crisis... these plans underscore an unconditional commitment to fight the current disruption*

Some leading indicators are worth tracking closely to spot turning points. One of them is America's ISM Manufacturing index, a key gauge of a highly cyclical sector, which fell through the key 50 threshold (suggesting a threat of recession) in September, but plunged lately to levels last seen during the recession of the early 1980s. At that time, lower interest rates helped the economy slowly return to growth with the ISM Manufacturing index correctly anticipating a rally in the S&P500 index (see charts below). Since the current downturn is closer to the 1980s experience (and not the 1930s), this predictive pattern may yet repeat itself.

We believe that this recession will not become another Great Depression, thanks to an effective monetary and fiscal policy response. We expect, nonetheless, very subdued growth for most of 2009, while global deleveraging continues.

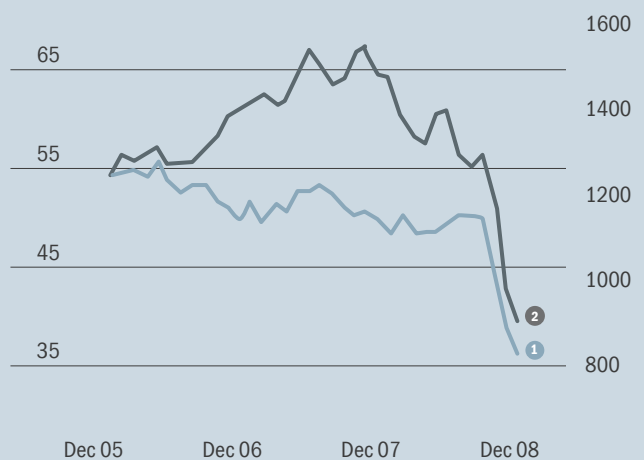
**US recession in 1982**



- 1 ISM Manufacturing Index
- 2 S&P 500 Index (rhs)

Source: Bloomberg. Data from December 1980 to December 1983.

**US recession now**



- 1 ISM Manufacturing Index
- 2 S&P 500 Index (rhs)

Source: Bloomberg. Data from December 2005 to December 2008.

## United States

The US economy contracted by an annualised -0.5% in the third quarter of 2008 and we now expect a further contraction in the fourth quarter of -2.8%, as consumers cut spending, companies reduce investments and net exports decrease. Looking into 2009, the outlook for the US economy is mixed as economic growth faces contrasting forces:

### Headwinds are expected to come from:

- Weak consumer spending
- Declining corporate investment
- Fading contributions from net exports

### Tailwinds should come from:

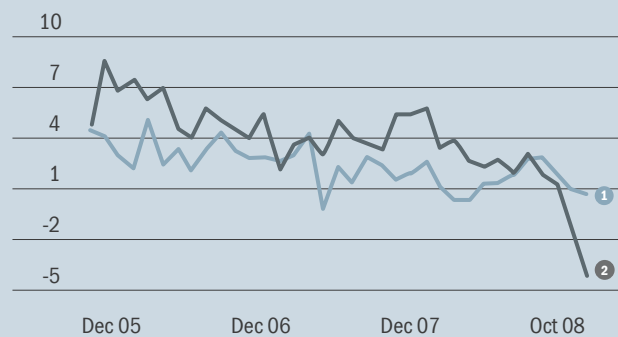
- A second tax-cut package
- An easing of financial conditions
- Substantially lower energy costs
- Lower mortgage rates
- The new Administration in place in January

As a result, US GDP in the year ahead should contract for the first one or two quarters, prolonging the technical recession. **For 2009 as a whole, we predict flat growth in the first quarter will be followed by a weak improvement during the year, prompting an overall GDP decline of -0.4%.**

The US Congress has already approved a massive plan to purchase distressed assets from banks and other financial institutions in order to strengthen their balance sheets. The crisis has reshaped the whole financial sector, with the demise of independent investment banks and a thorough consolidation process. Ailing carmakers may be poised to get some help and avoid bankruptcy, but support for banks remains key as Citigroup's government bailout in November clearly shows.

The appointment of NY Fed Chairman Timothy Geithner as US Treasury Secretary in the new Administration adds to the quality of the new economic team. Against this emergency backdrop further US Federal Reserve easing is unavoidable, even though key lending rates are already back to lows (1%) recorded in the last recession. The need to keep rates at Japanese levels underscores the risk of deflation, as the Fed acknowledged in recent market communications. With banks unwilling to expand credit, the US Federal Reserve has now become involved in direct lending to struggling companies, as well as to private borrowers.

### US consumer spending on a weak trend



1 Johnson Redbook Index Same Store Sales

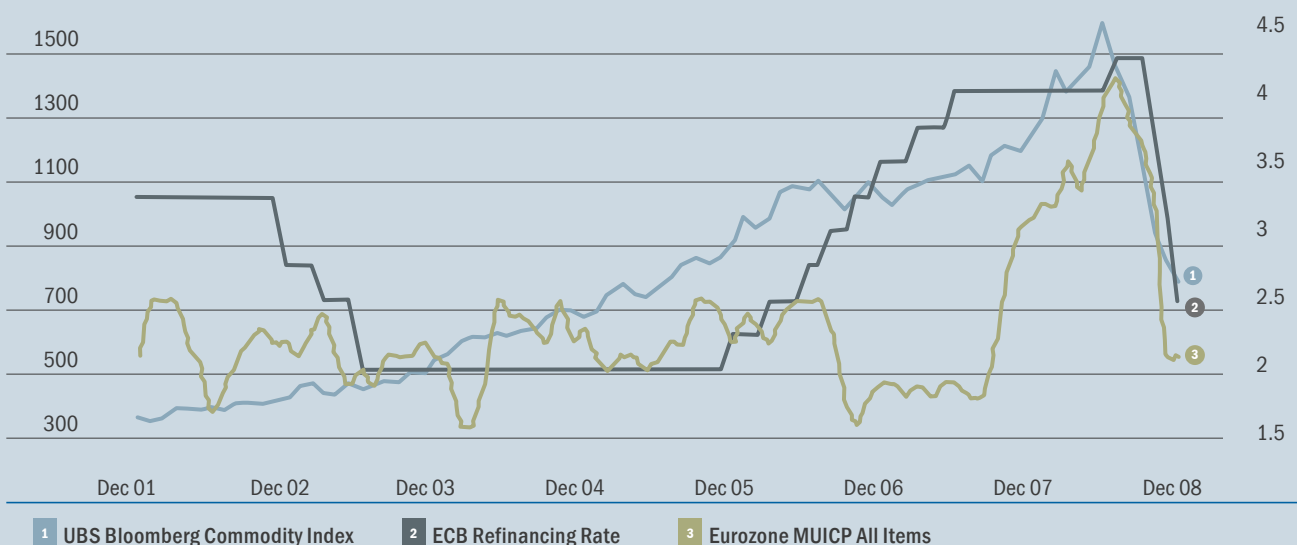
2 Retail Sales YOY % Change

Source: Bloomberg. Data to 31 October 2008.

Governments have come to the rescue of the banks hardest-hit by the credit crisis, in an effort to avoid a confidence crisis and avert bank-runs. Massive capital injections with taxpayers' money and increased deposit guarantees underscore the efforts being made to avoid a systemic disruption. A more flexible approach to fiscal parameters, such as deficit/GDP ratios mandated by EMU rules is on the cards as euro member countries resort to tax cuts and/or increased expenditure to support their economies. The ECB recently made its third rate cut in three months, acknowledging that downside risks to growth topped the agenda. Further moves are widely expected, probably starting in January with a further half-point easing. The historical floor for ECB lending rates at 2% was reached between May 2003 and November 2005, but the severity of the current crisis may suggest an even more aggressive approach is required. The US Federal Reserve will likely cut rates to zero soon, and other European central banks seem far from ending their stimulative policies. Inflation data are likely to strengthen the case for lower rates. Average consumer-price inflation has already halved from its July peak, but with oil and other commodity prices on a sharp downward trend, there is room for eurozone inflation to undershoot its 2% target, providing the ECB with a fundamental reason to continue its current policy. Downbeat business surveys, notably Germany's IFO index and purchasing managers' indices in major countries, may add to the case for further cuts. GDP growth is also being revised downwards.

Beyond the single currency area, a severe recession has hit Britain, where the consequences of the housing market crisis are being widely felt. The UK government played a very active role in bailing out the credit industry by announcing tax cuts and a comprehensive recapitalisation package. The Bank of England acted very aggressively and cut key lending rates from 5% to 2% since the crisis intensified in early October.

### More aggressive easing in Europe as inflation falls



Source: Bloomberg. Data to 4 December 2008.

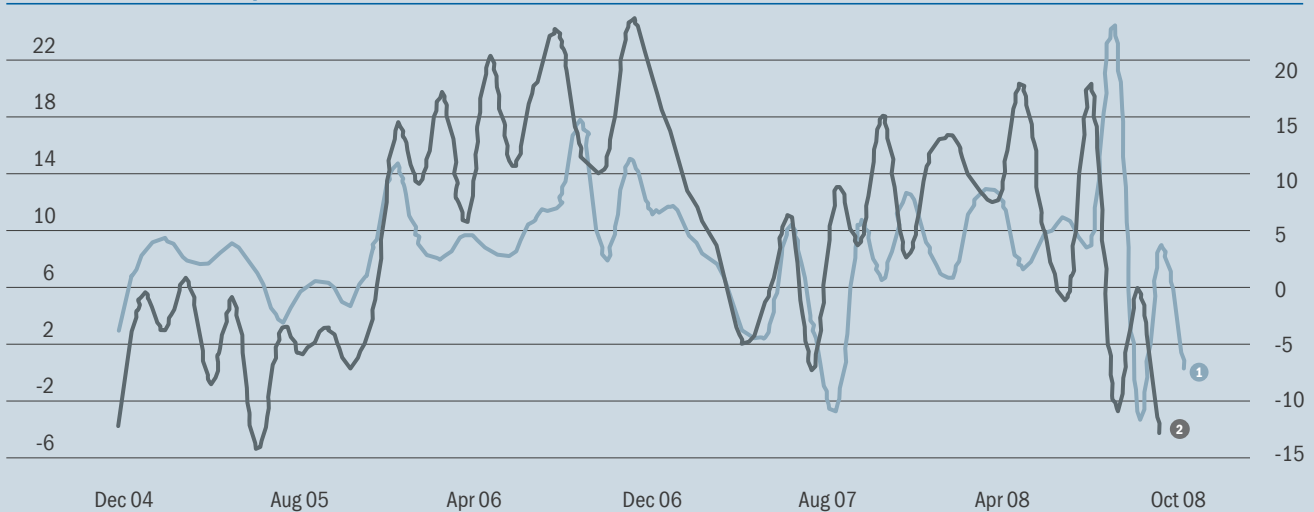
**Japan**

Global deleveraging made the yen much stronger over the year. Domestic spending remained structurally weak and as the cost of exports increased in-line with the appreciating yen, the world's second largest economy fell into recession. Japanese car exports were hardest-hit, but other industrial enterprises highly dependent on demand from other Asian countries, have also been forced to cut their investment plans.

Japan's interest rates are the lowest among major developed countries, although there is very little room for further easing in nominal terms. The Bank of Japan cut its target rate to 0.30% from 0.50% in late 2008. For its part the government is seeking to use fiscal expansion despite sky-high debt levels in an effort to revive household spending. This is an uphill battle, as wage growth has not risen throughout the expansion and has recently entered negative territory. However, unlike the US and Europe, no massive plan to save distressed financial institutions is required.

For 2009, Japanese GDP is expected to contract at -0.7% year on year. Internal demand will be negatively affected by lower household labour income and weak corporate profitability. Moreover, the deterioration in corporate profits and sluggish exports are expected to negatively affect capital investment growth, and downward pressure on exports is likely to continue due to weak overseas demand and yen appreciation.

**Weak auto sector in Japan**



**1** Japan Vehicle Production YOY

**2** Japan Vehicle Exports YOY

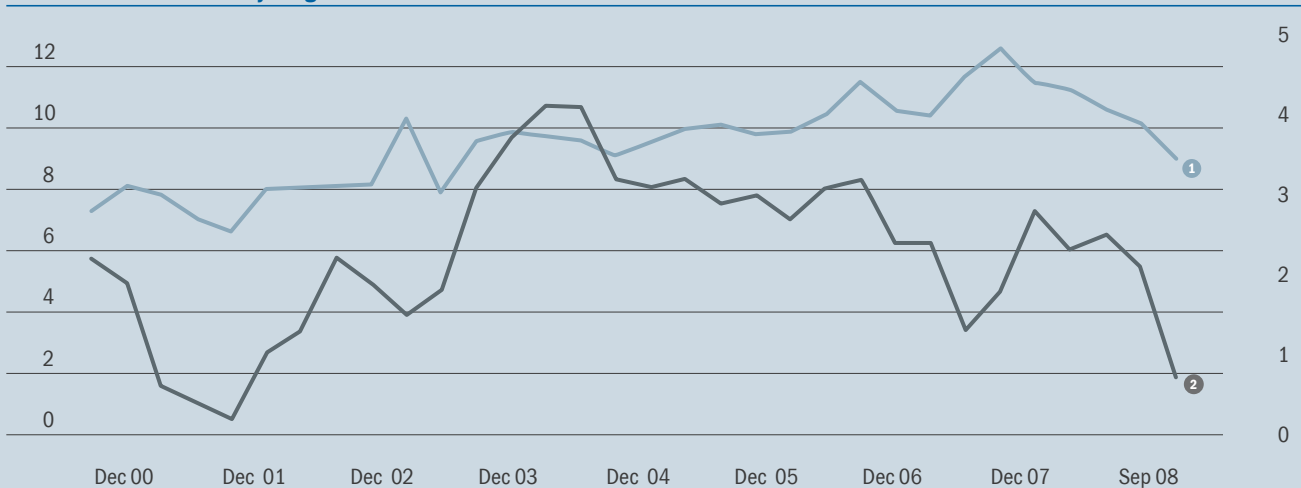
Source: Bloomberg. Data to 31 October 2008.

The early stages of the global credit crisis did not have any significant impact on emerging markets, as investors believed that strong domestic growth would shelter them from a recession in the US or other developed countries. Rising commodity prices provided some good reasons for this optimism amid strong demand for raw materials from countries such as China and India.

Yet a sharp and sudden reversal in the commodity markets from late July stalled the decoupling theory. Hardest-hit are countries that are net exporters as a period of high oil prices and other raw materials, which left them with sizeable foreign-currency reserves, was reversed. On the other hand, net importers of raw materials such as China and India are reaping the benefits in terms of lower inflation. However, falling commodity prices also underscore a weaker demand amid an economic slowdown. As China's growth fell into single-digit territory, officials turn to expansionary policies: key lending rates are cut, bank reserve requirements are lowered and a substantial stimulus package aimed at boosting domestic consumer demand (in the face of flagging export markets) is quickly enacted.

The current economic and investment environment does not invalidate many of the long-term drivers of growth inherent in emerging-market economies before the start of the crisis. To begin with, these countries learned a lot from past crises and are now more financially independent than in the past. Most regional governments have multiple levers on hand to absorb shocks and support growth. Thanks to abundant cash reserves and prior fiscal discipline, a number of countries are now better equipped to deal with challenging conditions and are well-positioned to emerge relatively stronger once the crisis abates.

**US slowdown eventually weighs on China**



**1** China GDP Constant Price YOY

**2** US GDP Chained 2000 YOY

Source: Bloomberg. Data to 30 September 2008.

## 2009 Financial Markets Outlook

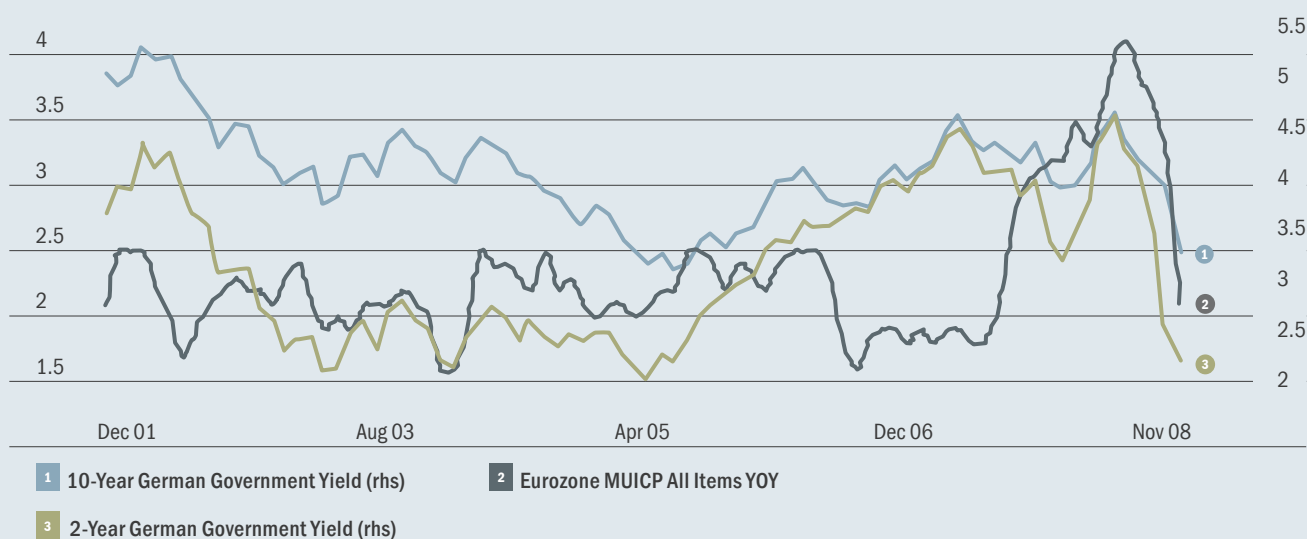
## Global Government Bonds

German government bond yields ended 2008 at their lowest levels since the credit crisis began, amid growing worries that any recession will be deeper and longer than earlier anticipated. After the latest ECB cut on 4 December, two-year German yields stand at 2%, which is a half-point less than current ECB rates, and suggests the market believes the ECB has further to cut. 2% is also the historical trough for ECB rates, when the euro-area economy was struggling to recover from a much shallower downturn. The current crisis is definitely more serious, which suggests that there is room for further rate cuts in Europe and further price appreciation in euro sovereign debt.

Other than Germany, euro countries have seen credit spreads widen of late – to a very small extent when compared to the corporate market meltdown, but visibly for government euro debt standards. This trend may be explained by the looser fiscal policies being implemented to fight the crisis, but can also be understood in terms of the risk aversion now affecting what used to be perceived as an absolutely safe market.

US Treasuries are more at risk of budget profligacy. The size of the various packages already enacted or soon-to-be discussed may eventually account for 5%-10% of US GDP. This is a huge commitment that will put strong upward pressure on the budget deficit. The risk of a deep and long recession, closer to the 1930s depression than to the severe downturn of the early 1980s, is currently dominating investors' minds, but once macroeconomic conditions show a modest improvement, dormant concerns about budget deficits may re-emerge.

### Inflation and bond yields sharply declining



Source: Bloomberg. Data to 30 November 2008.

## 2009 Financial Markets Outlook

## Global Credit Markets

Despite focused attention on banks' balance sheets, the sharp increase in risk premiums has been broad-based, suggesting that risk aversion is actually the main market mover. In late 2008, non-financial companies felt the direct effects of the crisis, with credit spreads for carmakers (which account for a large part of the overall US market) dramatically rising. After the latest sell-off investors seem to be pricing the risk not only of a deep and long recession but also of a 1930s-style depression.

We do not subscribe to this gloomy view. Credit markets stand to benefit even more than equities from measures aimed at restoring corporate solvency. Our view extends to include both Investment Grade and High-Yield paper, in the US as well as in Europe and Emerging Markets, where spread widening came later and was triggered by plunging commodity prices.

We believe that selected developing countries are better placed to weather a global downturn thanks to prior fiscal discipline and rich cash reserves. With more room for fiscal expansion, some countries may yet be able to invest in domestic infrastructure and revive domestic growth, partly offsetting the negative impact of foreign capital outflows.

### Carmakers' woes weigh on corporate spreads



1 ITRAXX Europe Industrials Index

2 ITRAXX Europe Index

Source: Bloomberg. Data to 28 November 2008.

## 2009 Financial Markets Outlook

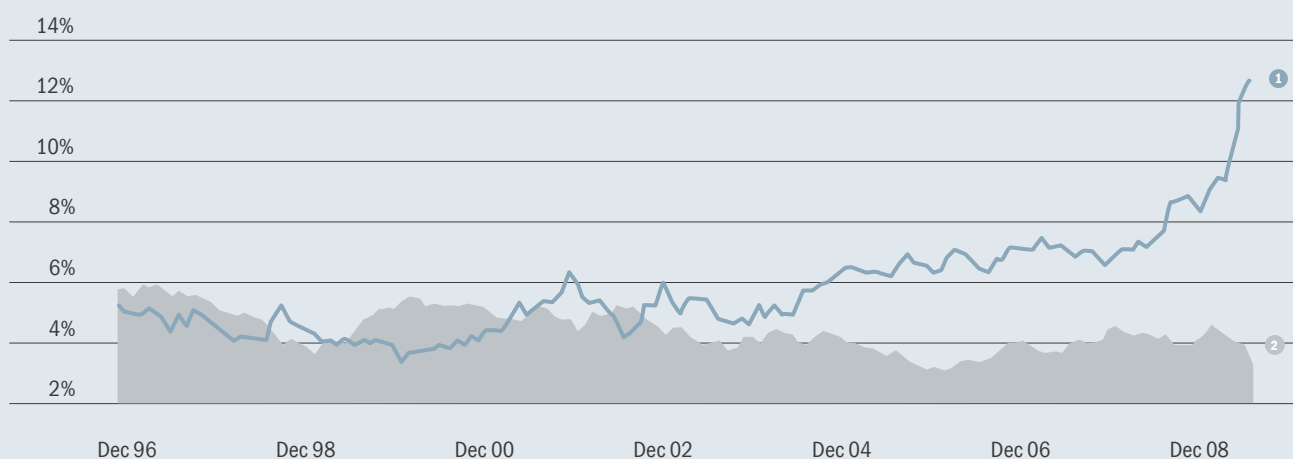
## European Equities

Valuations are increasingly compelling across industry groups, and inter-bank lending rates are declining on the back of repeated rate cuts by central banks, but there is uncertainty about the effectiveness of government bailout plans to restore growth. Germany's latest concerns about the UK's budget deficit suggest that EMU fiscal orthodoxy is still too entrenched.

On the other side, there is a genuine commitment to save the real economy from the credit crunch, notably by restoring normality to the vital inter-bank lending market. LIBOR 3-month rates have declined by almost 2% since early October, and despite trading stubbornly above key lending rates, the slow but steady downtrend will allay markets' worst fears about a recession in Europe extending for most of next year.

European equities will benefit from improving global conditions, although other areas such as the US and parts of Asia may offer more value at present. The US is at a more advanced stage in dealing with the crisis, while Japan offers better valuations and lower exposure to the risk of further asset write-downs.

### Relative valuation MSCI Europe



1 MSCI Europe Earnings Yield

2 10-Year Bund Yield

Source: Bloomberg. Data to 30 November 2008.

## 2009 Financial Markets Outlook

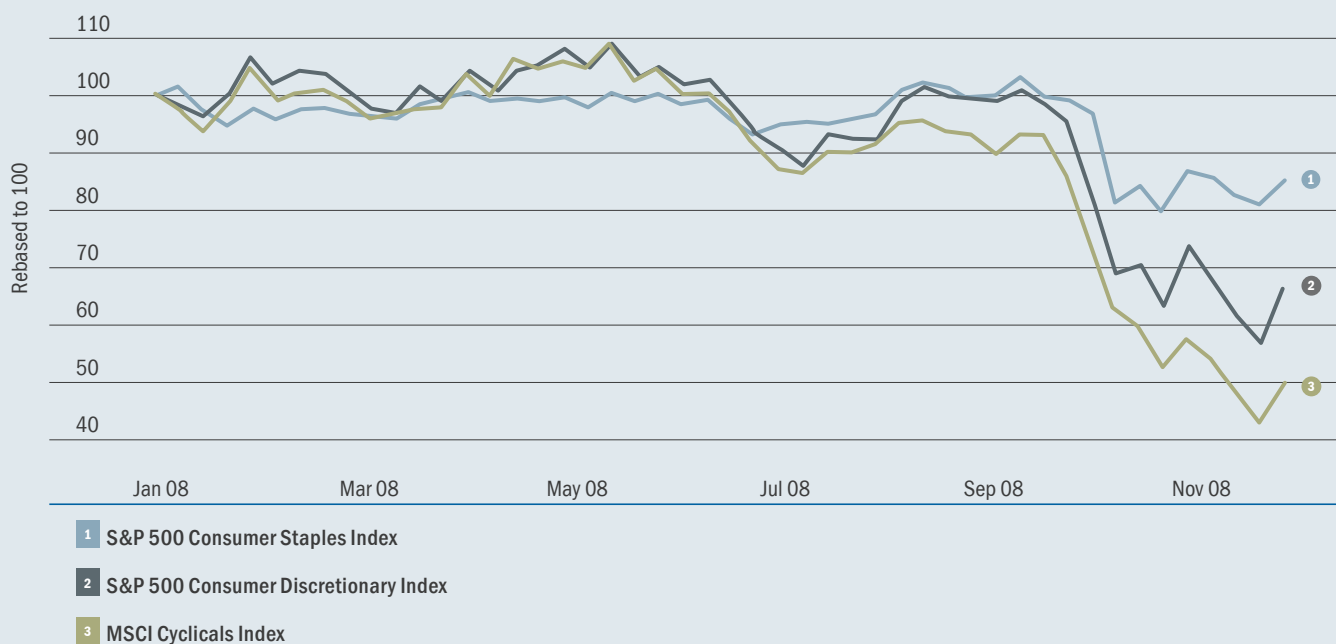
## US Equities

Optimism about the new Administration's plans to revive the economy are providing renewed support, but with a closely-tracked volatility index staying at record highs, it is still premature to attempt to pick sectors and stocks. Announcements can cause euphoria, but the real effectiveness of the plans will only become apparent over time.

Reasons to be cautious are also provided by sector breakdowns. Cyclical stocks are still under severe pressure and are reacting badly to downbeat economic releases, while earnings' estimates are being aggressively cut.

The good news is that some measures may prove very effective: the Fed's purchase of assets from money-market funds and of commercial paper to fund non-financial businesses may well prove more effective than a blanket asset-recovery plan like the TARP. In general, the convalescence period following this crisis is likely to be longer than expected, but the US is ahead of other hard-hit areas such as Europe.

### Cyclical sectors most hurt by recession



Source: Bloomberg. Data to 28 November 2008.

## 2009 Financial Markets Outlook

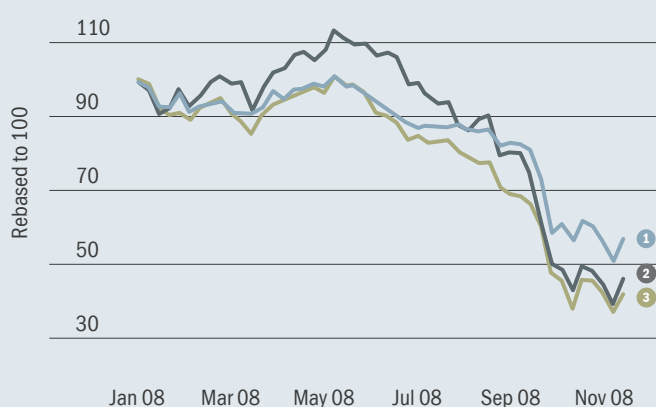
## Asian (ex-Japan) and Emerging Market Equities

China's growth rate fell into single-digit territory in the third quarter, which by past standards makes this a quasi-recession. However, room for policy expansion does exist. The Chinese central bank took part in global monetary easing and reduced domestic banks' reserve requirements. Moreover, China's currency is not strengthening against the US dollar any further. For its part, the government has duly announced a massive fiscal plan to revive domestic growth. Admittedly, China has some breathing space to use fiscal policy to revive growth. Furthermore, there is no huge provision needed to rescue stricken financial institutions.

In spite of all these efforts, Asia's biggest economy is highly dependent on global growth. Plunging commodity prices help importing countries such as China (and India) to contain inflation but they also signal further weakness in demand for raw materials.

Emerging Markets are considered high-beta economies thanks to their leading role in the manufacturing and trade of major industrial goods. These countries economic growth trends were big beneficiaries of the credit expansion. As the 'credit bubble' is deflating, the stockmarkets of the higher-beta economies tend to underperform. For this reason we are cautious of these markets as we move into 2009.

### Plunging commodities weigh down on EM equities



- 1 MSCI World Index
- 2 MSCI World Materials Index
- 3 MSCI World Emerging Markets Index

Source: Bloomberg. Data to 28 November 2008.

### Emerging Markets back at a discount



Source: Bloomberg. Data to 30 November 2008.

## 2009 Financial Markets Outlook

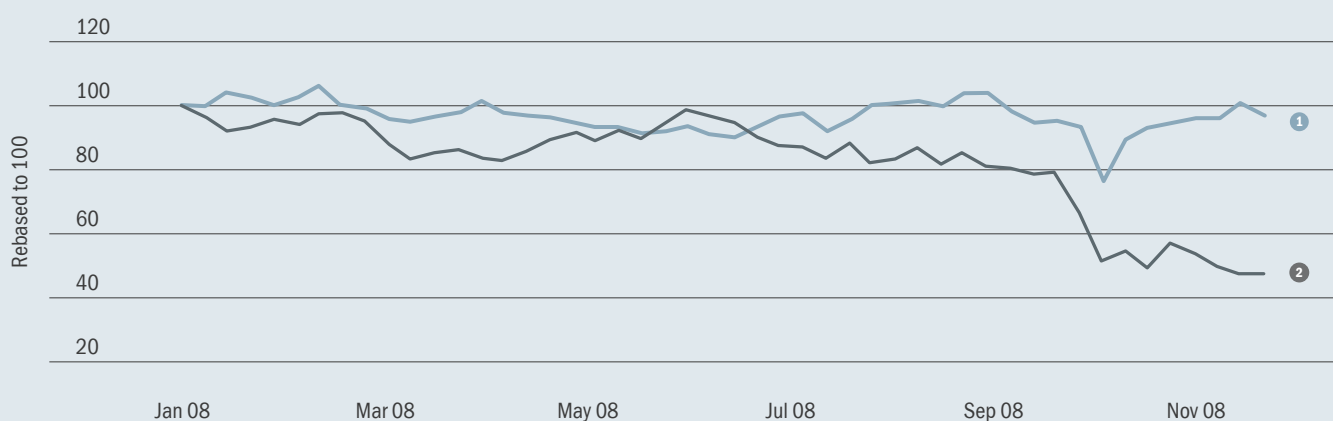
## Japanese Equities

When risk aversion prevails, only very defensive sectors such as utilities can escape indiscriminate selling. Manufacturers accounted for much of the recent market sell-off as a stronger yen, cut export-related revenues, while domestic demand also weakened.

Against these challenges, there are, however, supporting factors. For example, the Japanese banking sector has minimal exposure to housing-related 'toxic' assets, with Japanese banks much less affected by the global credit crisis than American and European counterparts. Some major banks could even afford to buy stakes in distressed US institutions over the course of 2008.

The thorough commitment of the Japanese central bank and government officials to restoring growth gives further confidence. Moreover, valuations look more compelling than elsewhere, with a sizable part of market capitalisation accounted for by companies' cash holdings.

### Utilities sheltered by strong yen, not so carmakers



1 Topix Electric Power Index

2 Topix Transportation Equipment Index

Source: Bloomberg. Data to 28 November 2008.

## 2009 Financial Markets Outlook

## Currencies

The main European currencies have been steadily losing ground against to the US dollar since mid-July, on rising concerns about global recession and governments' plans to deal with it. However, we believe that US economic figures will not improve soon and do not see further significant upside for the US dollar against the euro. However, we do believe the yen will receive ongoing support from global deleveraging in 2009.

### Japanese yen up on deleveraging



- 1 Australian Dollar
- 2 Euro
- 3 US Dollar

Source: Source: Bloomberg. Data to 12 December 2008.

### Emerging currencies devalue against US dollar



- 1 South Korean Won
- 2 Brazilian Real
- 3 Mexican Peso

Source: Bloomberg. Data to 28 November 2008.

#### Important Information

Unless otherwise stated all information contained in this document is from Pioneer Investments and is as at 17 December 2008.

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