

GENERAL INVESTMENT CLIMATE

The Economy

The final quarter of the year was again a difficult one for the financial sector. Banks continued their reluctance to loan to each other because of the uncertainty of their exposure to the American mortgage market. Meanwhile, the situation on the American house market continues to deteriorate: both prices and volumes decline month after month. The stock of unsold homes continues to increase as more Americans default on their mortgage. At the current pace of sales, it would take eleven months to sell this inventory. Therefore, there are no signs that the situation in the market will improve in the near future. The prices of newly built houses have suffered as well: compared to the fourth quarter of 2006, prices have gone down by 13%.

The fall in house prices has made the American consumer feel less rich. This is reflected in the consumer confidence indexes, which are currently at levels comparable to September 11th 2001. However, the statistical link between consumer confidence and consumer spending is quite weak. Consumption expenditure increased year-on-year by 6.3% in November (excluding automobiles even +7.2%). When excluding the effect of increased gasoline prices, consumption growth still exceeds 5%. It currently looks like the consumer will spend “less more” rather than less. The labour market still is relatively healthy. The pace of new job creation has decreased, but there still is a net creation of new jobs. Unemployment has increased somewhat, but remains at a low level.

In the Eurozone, the economy stabilizes at a high level. Economic growth in Eurozone is currently at +2.7% year-on-year. Even though, sentiment-driven indexes show that the European consumers and producers are generally becoming less optimistic, this is not yet visible in the hard figures. An exception to the negative sentiment indicators is the German industrial sector, which has become more optimistic on its export potential, despite the strong Euro. The order intake of the German manufacturing sector increased by 10% compared to November of 2006. The German labour market also continues to strengthen: unemployment has decreased again and the number of vacancies is historically high. Outside of the Eurozone, the Bank of England surprised the market in December by cutting rates by 25 basis points to 5.5% despite the strength of the British economy. Unemployment decreased in the UK to a new low of 2.5%. Consumption growth, however, is weakening.

In Japan, the industry has recovered some more and unemployment remains low, but consumption expenditure and sentiment remain depressed.

The oil price continued the strong upward movement that started in the third quarter. At the beginning of January, the symbolic \$100 level was briefly crossed.

Money markets and exchange rates

The Federal Reserve lowered its reference rate twice by 25 basis points to 4.25% during the fourth quarter: once in October and again in December. A further rate cut in January is considered to be almost certain, but for the rest of the year, opinions differ. Forward prices show that the market expects the federal funds rate to drop to 3.40% by the end of 2008, while analysts predict that the Fed might stop after one or two further cuts to keep inflation under control. The increase in producer prices in the US in November reached the highest level of the last two decades: the PPI increased by 7.2% compared to the previous year.

The European Central Bank has not changed its rates since July 13th 2007. It is generally expected that the ECB refinancing rate will remain at 4% for the time being. On the one hand, there is the persistently precarious situation on the interbank market and the signs of a slowdown of the rate of growth. On the other and, a decrease in interest rates would be very unlikely since inflation has increased to its highest level in six years. In November, Eurozone inflation was 3.1% compared to the same month in 2006. During the December press conference, ECB President Trichet admitted that some members were in favour of a rate hike to control inflation.

In December, the ECB, the Bank of England and the Fed undertook massive interventions in the money market. The inter-bank money market had dried up; because of the lack of trust between the banks, they were not prepared to provide loans to each other. This caused interbank interest rates to rise far above central bank interest rates. On December 18th, the ECB injected a record amount of €350 billion in the market to allow the banks to bridge the end of the year.

The American long-term interest rates decreased sharply near the end of the year (from 4.64% to 4.34%). The lead of the US rates over the European rates, which has been the case since 2004, has disappeared during the fourth quarter. The European 10-year rate (4.355%) even ended the year above its American counterpart (4.336%). The short term interest rates have developed according to a similar pattern. The 3 months USD libor decreased from 5.17% to 4.64% while the 3 months EURO libor only decreased from 4.79% to 4.78%.

Until the end of November, the US dollar was rapidly on its way to break the 1.5000 barrier. However, the dollar decline stopped just short of this symbolic level (1.4966). In December, the dollar appreciated again and finished the year at 1.4590.

Stock Markets

The stock markets had their second difficult quarter this year: the AEX and the BEL20 closed the year with declines of 4.66% and 4.57% respectively. The US indexes posted similar declines. The DAX again was the best performing European index with an increase in the fourth quarter of 2.62%. Because the same big German shares weigh heavily in the Eurostoxx 50, this index was also able to end the quarter with a small gain.

Once again, mid- and smallcaps strongly underperformed the blue chip indexes in the fourth quarter. The Dutch AMX and ASCX lost 7.3% and 10.8% respectively and the German small-cap index SDAX dropped 9.5%.

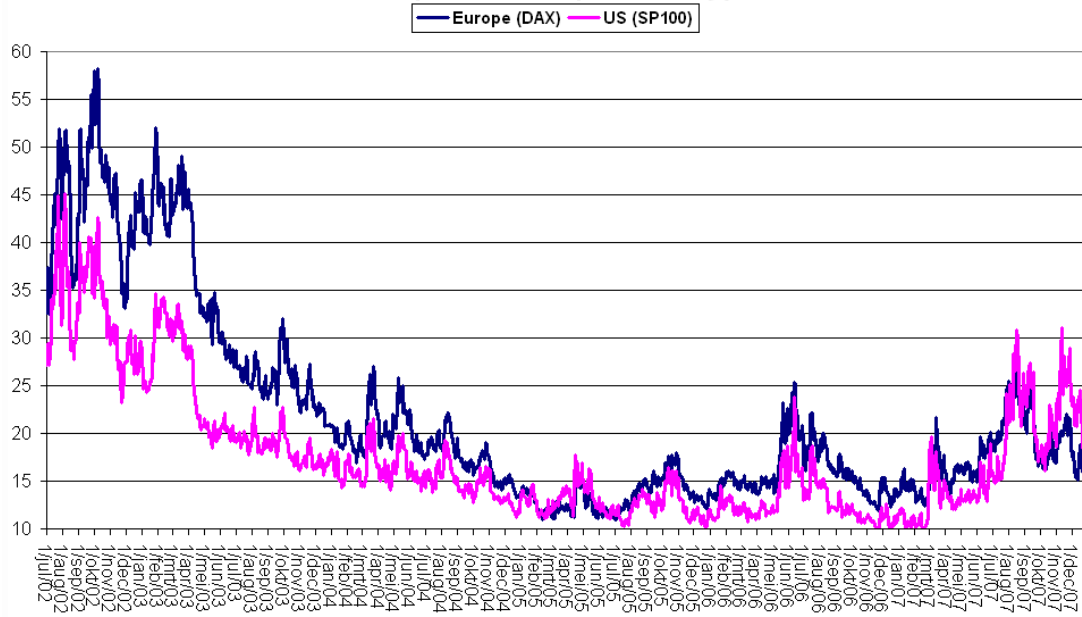
Table 1.1 - General

	31/dec/07	30/sep/07 - 3 mth	30/jun/07 - 6 mth	31/mrt/07 - 9 mth	29/dec/06 - 12 mth
AEX	515,77	-4,66%	-5,92%	1,03%	4,12%
BEL20	4127,47	-4,57%	-11,03%	-7,70%	-5,95%
DAX	8067,32	2,62%	0,75%	16,63%	22,29%
EU50	4399,72	0,41%	-2,01%	5,23%	6,79%
DJ	13264,80	-4,54%	-1,07%	7,37%	6,43%
SP500	1468,36	-3,82%	-2,33%	3,34%	3,53%
Nasdaq	2652,28	-1,82%	1,88%	9,52%	9,81%
EUR/USD	1,459	2,26%	7,74%	9,26%	10,54%
EUR 3 maanden	4,6840	-0,1080	0,5090	0,7600	0,9590
EUR 10 jaar	4,4070	-0,0120	-0,2000	0,3200	0,4340

Implied volatility

The increase in volatility at the start of the credit crisis during the summer had almost disappeared again by the end of the third quarter. In November however, large writedowns by mainly American banks caused rise to surge again. This second surge of volatility was stronger in the US than in Europe, which has pushed the American volatility index VIX significantly above the European VDAX for the first time in several years.

Table 1.2 Development of the implied volatility jul 02 - dec 07



Long-term development

The AEX broke through its long-term moving average and has remained there for a significant period for the first time since 2004. The trend line is still increasing, but is flattening out. Because of the strong declines in the prices of mainly small- and midcaps, the valuations of these companies now appear to be very attractive again.

Table 1.3 Long-term development AEX jan 02 - dec 07

