

## **GENERAL INVESTMENT CLIMATE**

### **The Economy**

In October, it soon became clear that the impact of the financial crisis on the real economy is bigger than expected. In an unprecedented manner, the economy came to an abrupt standstill, due to a rapid build-down of inventories by the companies. The Eurozone and Japan showed negative growth in the second and third quarter, whereas it appeared from reviewed figures that the US are already in recession since December 2007. Even in emerging countries such as China, India and Russia, growth is slowing down considerably; only Brasil seems to be able to withstand the economic downturn. In 2009 most industrialised countries should face negative growth. No improvement is expected before the second half of 2009, or even 2010 according to some analysts.

Many large industrial companies in the automotive industry in particular were forced to stop their production for several weeks or even months. This obviously had its repercussions on the suppliers, such as the steel producers and the chemical industry. Especially the American car manufacturers (GM, Chrysler and to a somewhat lesser extent Ford) are facing huge problems, forcing them to apply for government aid. But European and Japanese manufacturers are also cutting back their production.

The housing market in the US continues to decline; the number of new houses fell by 33% in 2008, the number of houses sold reached its lowest level in 17 years in November, and the prices also keep falling. A large number of other economic indicators, such as the Purchasing Managers Index of the ISM (32.4 in December, its lowest level since 1980) and the retail sales, suggest further economic weakening ahead.

In view of this continuous flow of negative news, it comes as no surprise that the unemployment in the US rose to 6.7% in December, the highest level in 15 years. Two million jobs disappeared during the past year; in Europe (temporary) employees are sacked en masse as well.

In Europe, the growth of retail sales is negative since the beginning of 2008, while the German export came to a nearly complete standstill in the fourth quarter. The continuous fall of consumer and producer confidence promises little good for the upcoming months. In order to stop this negative spiral, central banks made use of the interest weapon, and governments rediscovered Keynesian policies. The president elect Barak Obama announced a stimulation package for the American economy of \$700 billion (5% of GDP), China of \$600 billion (15% of GDP). In the Eurozone the measures would only represent 1.5% of GDP.

The financial crisis reached another climax at the beginning of October with the near bankruptcy and dismantling of Fortis and the fall of Iceland.

The G7-meeting of 10-11 October was the turning point of the financial crisis. A consensus was reached that after Lehman Brothers no other financial institutions would be allowed to collapse. Other large banks were rescued thanks to state guarantees and capital injections. Iceland received multi-billion euro loans from the IMF, Russia and the Scandinavian countries. Belarus, Ukraine, Estonia and Hungary also had to call upon the IMF for aid.

Oil prices continued their spectacular dive during the last quarter of 2008. In the wake of the economic downturn, oil prices fell as low as \$34 per barrel, before recovering slightly, to finish the year at \$45.

## Money markets and exchange rates

The European and American central banks reacted to the serious deterioration of the economic outlook by aggressively easing monetary policy, hereby helped by the fact that inflation pressure faded away completely. The ECB lowered its basic interest rate in three steps with 175 basis points to 2.5%. The Federal Reserve also cut its basic interest rate, twice in October (50 basis points each) and once in December to a range of 0-0.25%, the lowest level ever. This is also the case in the UK, where the Bank of England cut its basic interest rates with unprecedented leaps (150 and 100 basis points) to 2%.

The interbank markets relaxed considerably after the announcement of economic stimulation packages in the US and several European countries; the 3-month interbank rates fell sharply from 5.3% to 2.9%.

The fall of the British pound was the most noticeable event on the exchange markets; during the last quarter, the pound lost more than 20% of its value against the euro, finishing the year at 1.037 euro. Parity with the euro is within sight. The strong recovery of the US\$ proved to be relatively short-lived; after reaching temporary highs of 1.23, the US\$ weakened again, to finish the fourth quarter nearly unchanged at 1.40 dollar the euro. On an annual basis, the euro lost 4% against the dollar. The strong performance of the Japanese yen in 2008 also caught the eye (+19% against the euro).

## Stock Markets

Table 1.1 - General

	31/dec/08	30/sep/08 - 3 mth	30/jun/08 - 6 mth	31/mrt/08 - 9 mth	31/dec/07 - 12 mth
AEX	245,94	-25,80%	-42,26%	-44,41%	-52,32%
BEL20	1908,64	-28,57%	-39,76%	-48,69%	-53,76%
DAX	4810,2	-17,51%	-25,06%	-26,39%	-40,37%
EU50	2447,62	-19,44%	-27,00%	-32,54%	-44,37%
DJ	8776,39	-19,12%	-22,67%	-28,43%	-33,84%
SP500	903,25	-22,56%	-29,43%	-31,71%	-38,49%
Nasdaq	1577,03	-24,61%	-31,22%	-30,80%	-40,54%
EUR/USD	1,3973	-0,85%	-11,31%	-11,50%	-4,23%
EUR 3 months	2,8920	-2,3850	-2,0550	-1,8350	-1,7920
EUR 10 year	3,5460	-0,7990	-1,2650	-0,5770	-0,8610

The stock markets ended their “annus horribilis” on a low. The major indices on both sides of the ocean lost another 20-30% in the last quarter of 2008. Hence, annual losses mounted to 34% (Dow Jones) over some 40% (DAX, SP500 and Nasdaq) to more than 50% (AEX and BEL20).

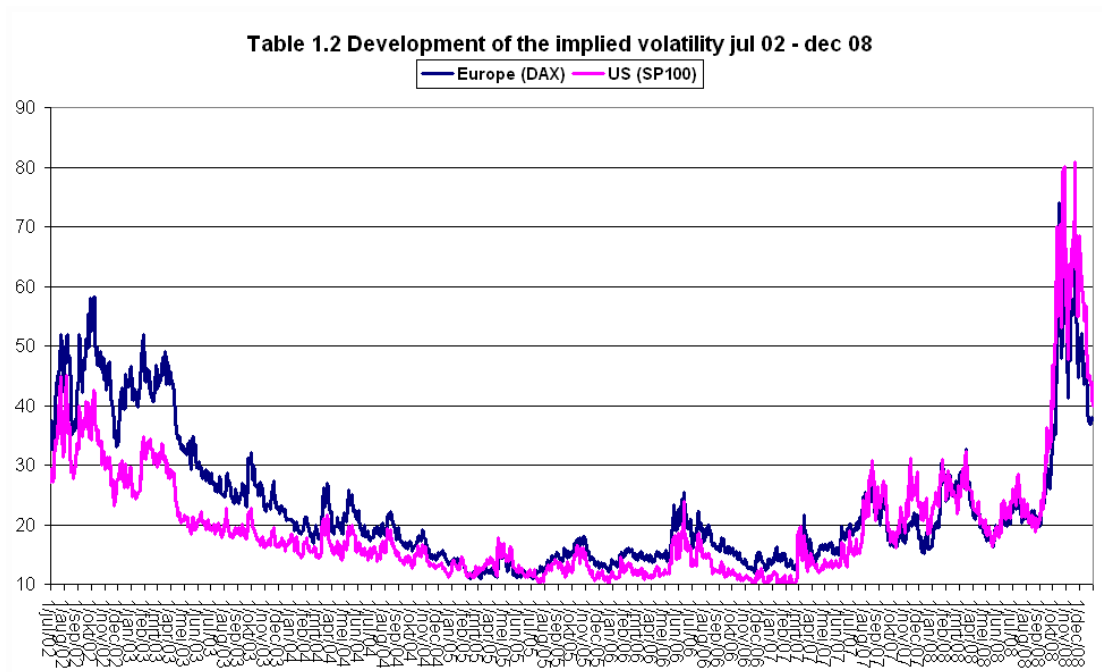
Thereby, 2008 was the worst year for the stock markets since 1931.

The small- en midcap indices performed even worse than the main indices in the fourth quarter, especially the AMX (-36%) and the ASCX (-32%). The SDAX (-18%) and the MDAX (-19%) were able to somewhat limit the damage.

As the stock markets didn't subside on the very bad economic figures that came out in December, most of the bad news now seems to be priced in the market.

### Implied volatility

During October and November, stock market volatility reached unprecedented heights. The VDAX rose to 75% in October, the American VIX even reached heights of 80%. The worsening of nearly all important economic indicators caused huge uncertainty at the financial markets. Towards the year-end, volatility fell back towards 40%.



### Long-term development

The downward trend continued. On November 21<sup>st</sup>, the AEX reached its lowest level in five years time (222.93), hereby nearly falling through the lowest point of March 2003. The index stabilised somewhat in December around 250 points, albeit some 55% below the top of July 2007.

