

Global Strategy

Outlook International Financial Markets – 4rd Quarter 2008

Financial crisis not overcome yet

Continue to underweight shares

USA – Stocks: Risks outweigh opportunities
Economy: Stagnation

Europe – Stocks: Long-term attractive potential
Economy: Sustained economic slow-down

Japan – Stocks: Historically low entry levels
Economy: Continued weakness

USA

Stock market

Bleak market review

From a fundamental point of view the situation on the US equity market has further worsened. The crisis in the financial sector is showing no signs of letting off - in fact, quite the opposite is the case:

In a spectacular rescue mission, the distressed mortgage financiers Freddie Mac and Fannie Mae were placed under the administration of the Federal Housing Finance Agency (FHFA) and were thus de facto nationalised at the beginning of September. This step taken by the US treasury secretary will probably result in a few hundred billions of dollars of future costs to the budget. It is impossible to make a more accurate estimate at this point in time.

Whereas this step ensured that creditors' rights remained intact, shareholders had to absorb dramatic share price losses. One of the consequences of this misery is that risk capital investors will look twice at US financial shares next time before being prepared to assume high risks that are not justified by the potential return.

With the nationalisation of the aforementioned mortgage financiers the US Ministry of Finance also set a precedence which has rightly lead the potential capital investors to re-evaluate the situation. This was one of the reasons why the US authorities waited so long before taking this radical step.

The next shock followed suit in the US financial sector: The long-standing investment house Lehman Brothers became insolvent at the middle of September and had to file for protection from creditors. The dramatic fall of Lehman Brothers proved that distressed financial companies were having an ever more difficult time persuading shareholders into providing them with additional, badly needed funds for survival.

Almost at the same time as Lehman Brothers reported its insolvency, the takeover of Merrill Lynch by Bank of America was made public. Merrill Lynch also had to contend with the problem of illiquid assets that were difficult to value. In all likelihood, Bank of America did not agree to this takeover for economic reasons. The negative consequences will become apparent over the coming quarters in the form of falling profitability of Bank of America.

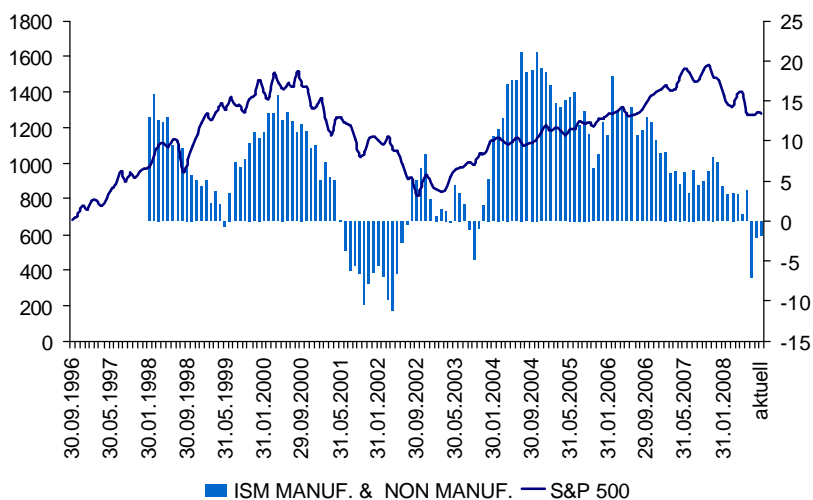
American International Group (AIG), the world's largest insurance company, was also faced with severe liquidity problems around mid-September, and the share price slumped by more than 80% within just a few days. The US government seems to be evaluating possible ways of bailing out AIG.

Due to the continued dire situation some financial houses have found themselves in, the S&P500 shed about 10% of its value in the third quarter. The substantial decrease in the oil price since the beginning of August has also put massive selling pressure on the companies commanding a comparatively heavy weighting, i.e. the oil and gas shares.

The most important economic data such as unemployment and industrial output were signalling the sustained weakness of the US economy. Given this downbeat set of indicators, the short yet sharp appreciation of the dollar in July and August came as a surprise to many market participants who were unable to explain this movement in its entirety with fundamentals. The necessity of repatriating liquid funds to the USA as well as the weak European economy were probably the driving forces behind the short-lived strength of the dollar vis-à-vis the euro.

The sentiment of the US purchase managers is only slightly negative (please refer to the chart below), a fact which can be considered positive in view of the difficult situation in the current economic environment.

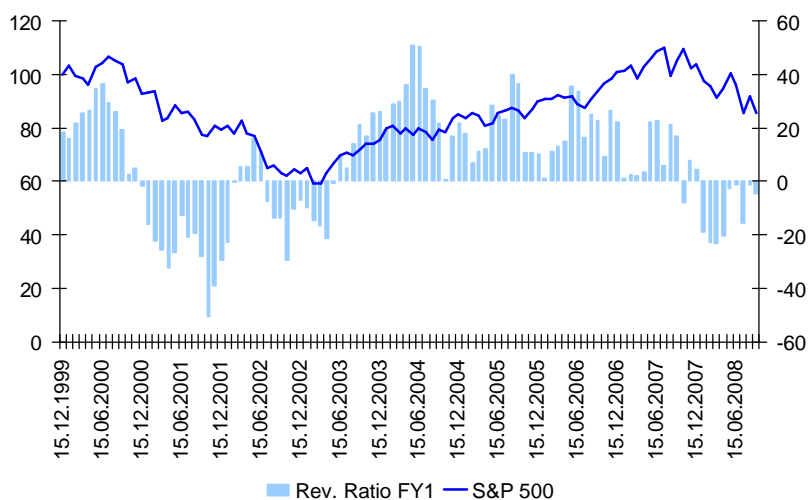
ISM-Index



Source: Bloomberg, own calculations

Unfortunately there is nothing to suggest the imminent recovery of the weak company earnings of US shares, in other words there are no facts that would support optimism yet. The S&P 500 revision ratio continues to indicate a clear overhang of negative earnings revisions, albeit less significantly so than in previous months. The following chart illustrates this scenario:

Revision Ratio S&P 500

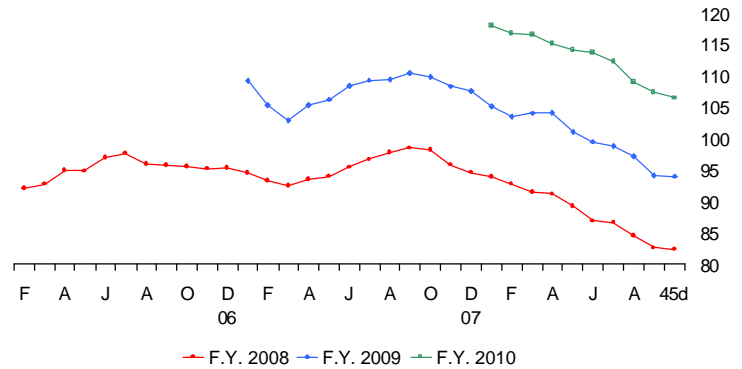


Source: Factset, own calculations

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The development of the estimated earnings indicates a further decline in company profitability. This should turn into a stress factor for the equity market in the coming months, since a number of important factors such as for example the aforementioned appreciation of the US dollar will have a more negative effect on the results of international companies than has been anticipated by many market participants so far.

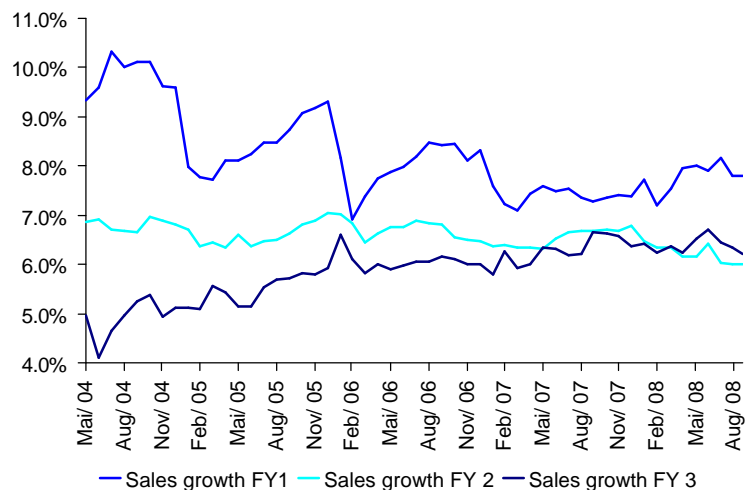
EPS-Forecast S&P 500 (in USD)



Source: Factset

Estimates put sales growth for the S&P 500 companies at 6% (see the chart below), and according to the consensus forecast growth rates should remain at this level over the coming years. These forecasts, however, seem only realistic if the dollar falls in due course. The US companies focusing on domestic business will certainly have a hard time trying to achieve these growth rates on average in the coming quarters. The still high and rising unemployment is an important factor that limits the upward potential of company earnings.

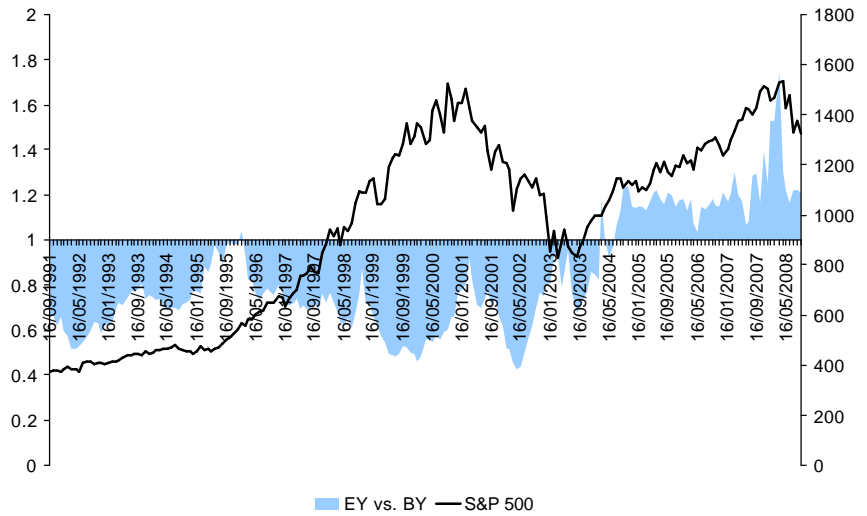
Sales growth S&P 500



Source: Factset, own calculations

The relation of earnings yield to bond yield (see the chart below) indicates that US shares are slightly more attractive than bonds. However, one has of course to bear in mind that the risk profiles of these two asset classes are very different.

S&P 500: US Stocks vs. Bonds

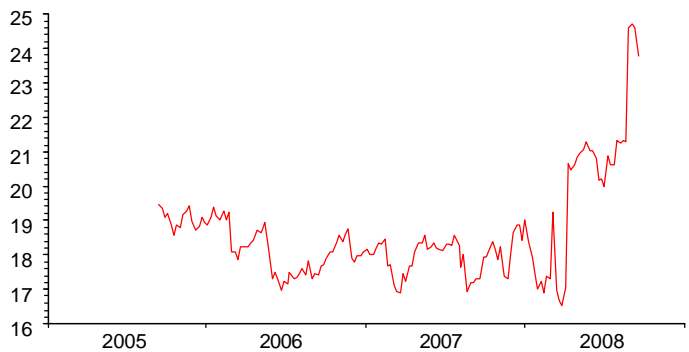


Source: Bloomberg, own calculations

Profit slowdown implies higher PE-ratio

The current P/E of 24x of the S&P 500 is very high; therefore long-term share return on this level is below average. This means that from a fundamental point of view there are many reasons to underweight US shares at the moment.

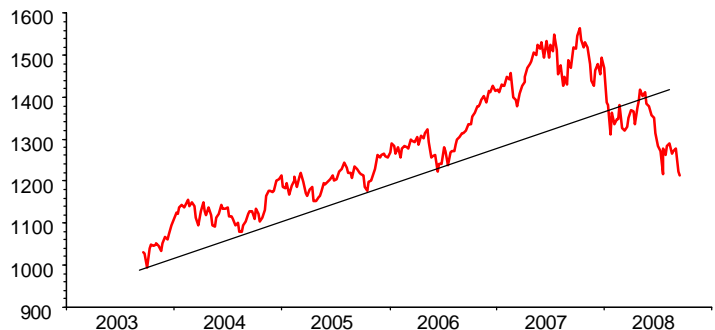
S&P 500: PE



Source: Thomson Datastream

Technical situation:

S&P 500



Source: Thomson Datastream

The main US index continued its downward trend in the past quarter. One particularly negative aspect is the fact that important upward trend lines have remained broken for months and that the few rebounds in the downward trend were not fuelled by increasing volumes.

Outlook

No signs of a trend reversal yet

Having seen our earlier expectations with regard to the development of the main US index come almost precisely true in the past quarter, we should now point out that the time is not yet ripe for a swift trend reversal. We have neither experienced a strong decline with high volumes nor weeks of sideways movement with strongly above-average levels of volatility in the S&P 500.

From today's perspective it is therefore obvious that the main US index remains in weak condition. It seems definitely too early for a year-end rally. We will issue a statement to this effect as soon as concrete signals begin to manifest themselves. The presumably weak development of company results will remain an important fundamental stress factor for US equities. We cannot see this situation change in the foreseeable future.

At the moment risks outweigh opportunities when it comes to shares, which is why we continue to recommend underweighting this asset class and in particular US shares. We also advise to avoid US financials, given that the cleansing of the market in this sector has only just started and will take numerous quarters to finish.

In terms of seasonalities caused by presidential elections, it is possible to establish a relationship between elections and the performance of equity indices.

The following table, which illustrates the development of the Dow Jones index in election years and thereafter (1900 - 2008), highlights the fact that the average performance of the index is at its peak in the third year after an election. This means that statistically speaking, the next peak performance can be expected for the year 2011.

Performance Dow Jones Index

	Election year			
	t=0	t+1	t+2	t=3
Mean (%)	8.3	5.3	3.0	14.0

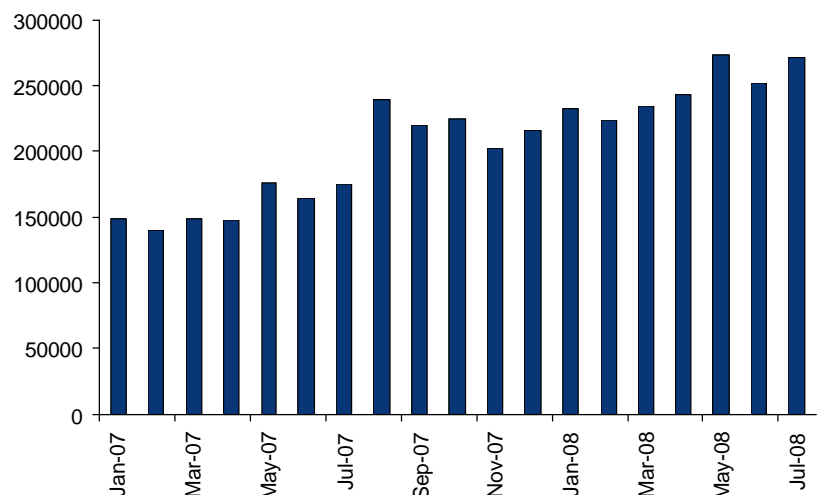
Source: Bloomberg, own calculations

Economy, interest rates, bond market and currency

Restrictive lending as biggest risk for the economy

The outlook for the US economy remains bleak. The factors weighing on the economy are not getting any lighter; in fact, quite the opposite is true. Creditor protection for Lehman Brothers and the urgent need for capital of the largest US insurance company, AIG, have marked a new peak in the financial crisis. At the same time, the property market shows no signs of improvement - but at least no deterioration either, except for the prices. Sales figures are stable but low, and inventories remain high. The foreclosures of insolvent debtors keep feeding new objects into the market, which means that the total number of unsold properties remains constant in spite of low construction activity. The only factor taking some weight off the economy is the massive decline in the oil price since the middle of the year. This should be enough to keep growth rates positive. The largest unknown is the question where and when the financial crisis will ultimately peak, and how this will affect the lending business. Whereas the US economy should be able to grow in spite of the correction on the property market, more restrictive lending would come with significant downside risks. The foreclosures of mortgage debtors should peak out this year, but the equity position of the financial sector is weak after a year of crisis. Although liquidity injections support lending by banks, the uncertainty over the future development will persist. Overall we expect the US economy to stagnate in the second half of the year.

Foreclosures of mortgages, in ths.



Source: Bloomberg

No changes to the interest rates, even if the data remain weak

After the most recent events (Lehman Brothers, AIG) the US central bank has been busy sorting out the problems on the financial markets, and has shown a steady hand in doing so. In the coming months the US economic data will be anything but good. Along with the weak demand indicators, the labour market will continue to deteriorate, i.e. the unemployment rate will react to the economic environment with its infamous time lag. This relationship is well known and should therefore not lead the central bank to change its policy. That said, the risk is certainly skewed towards a rate cut, since the environment is more likely to deteriorate than to improve for the time being. The fixed income market is currently dominated by "safe haven flows" which have pushed yields down by a significant margin. We do not expect the crisis sentiment to last and thus believe that yields should gradually start picking up again. However, this movement will be limited by the weak economic data.

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EURUSD expected to move sideways

After the summer rally we do not expect the dollar to appreciate any further against the euro. The strong EURUSD movement was on the one hand founded in the (record) valuation of the euro, and on the other hand in the economic slump of Euroland in the second quarter. We believe that the correction of the euro has come to an end for two reasons: First, the situation of the US economy is anything but supportive to the dollar, and the downside risks - as we have just seen again - are considerable. Second, the interest rate level on the money market is much higher in Euroland, and this situation is not likely to change for now. We therefore expect the EUR/USD rate to fluctuate around 1.45.

Euroland

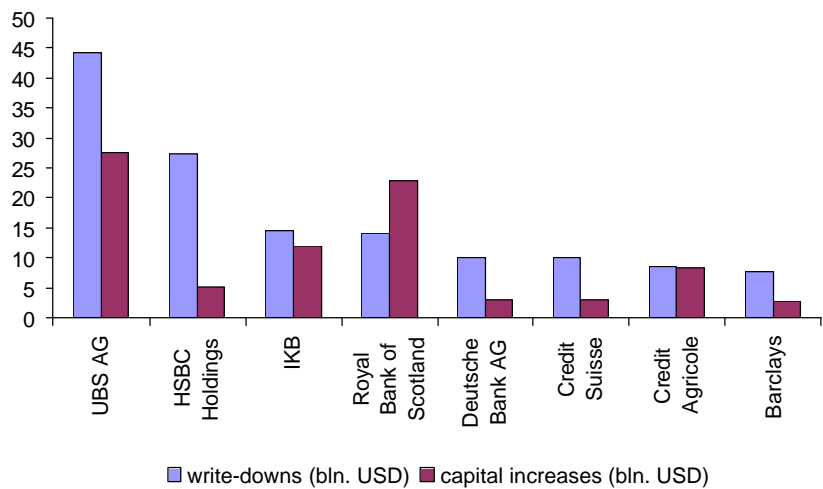
Stock market

Review of the last quarter

The European equity markets did not take the latest data about the economic slow-down and the bad news from the US financial sector lightly at all and continued their downward trend. Neither the lower oil price nor the weaker euro managed to lend much support to the markets. Some large banks such as the Swiss UBS or the British HBOS suffered heavy losses, even though their shares had already fallen way below their 2002 lows.

The following chart shows the current volume of write-downs of large European banks and their capital increases already executed.

European Banks: write-downs and capital increases

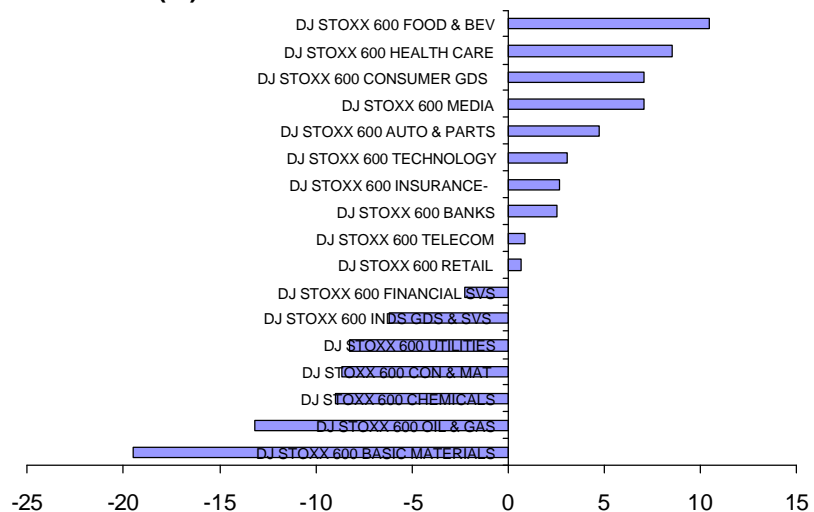


Source: Bloomberg

The onslaught of negative news from the US financial industry lead many investors to take refuge in defensive sectors such as food and beverages as well as healthcare.

The following chart highlights the different development of the most important sectors of the DJ Stoxx index within the course of the third quarter.

Sector performances (%)



Source: Datastream, own calculations

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Interestingly, equity indices that are heavy on the commodity side such as for example the Russian RTX or the Norwegian OBX have substantially underperformed the majority of the other European indices.

Sentiment indicator ZEW index receding

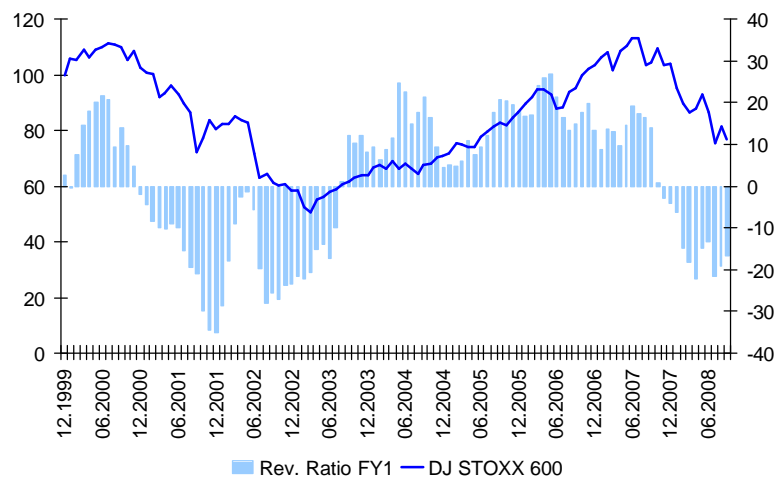
The ZEW index decreased from 17 to -9.2 (N.B. the consensus had expected a decline to 10). However, future expectations brightened: the consensus had expected -62 points, when actually the index improved to -55 points - a development probably caused by the falling oil price and the most recent weakness of the euro. Order intake in the industrial sector fell short of expectations, recording a yoy decline of 7.4%.

Revisions remain clearly negative

The earnings forecasts for the Dow Jones Stoxx 600 were again strongly negative at the end of the third quarter. Although the sentiment has somewhat brightened up, the picture remains the most pessimistic in five years. Interestingly, share prices were ahead of revisions yet again, whereas the European indices were already heading south in the summer of 2007, analyst estimates only followed with a time lag of numerous months.

Sector-wise, the most significant revisions have been seen in oil & gas, chemicals, and cyclical consumer goods. Classic defensives such as food, pharmaceuticals, and non-cyclical consumer goods, on the other hand, were relatively solid.

Earnings revision DJ Stoxx 600



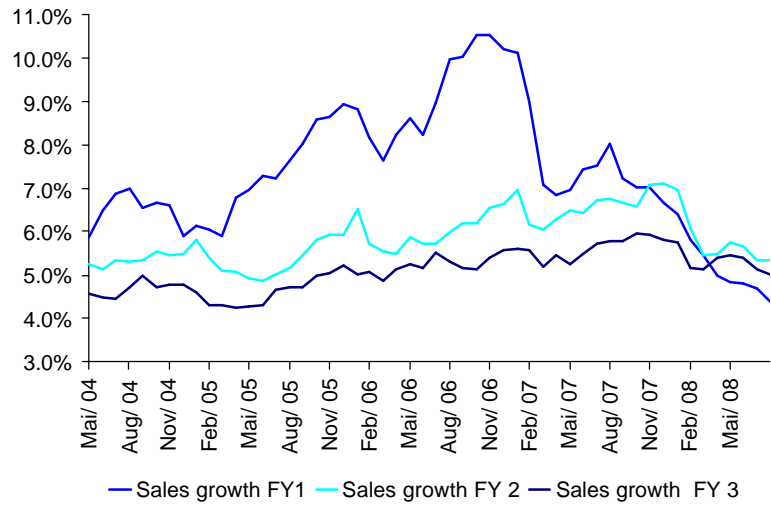
Source: Factset, own calculations

Still lower sales forecasts

After the recent substantial revisions of DJ Stoxx 600 sales forecasts, estimated growth rates in 2008, 2009, and 2010 are now on an almost constant level at close to 5%. Cyclical consumer goods such as in particular German carmakers have had to revise their sales forecasts downwards by a substantial degree. Both the (possible) recession in the USA and the weakening growth in Asia and Eastern Europe have recently shown a noticeable effect on sales figures. That said, weakening growth within the economic cycle is as normal as it is healthy.

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Sales growth

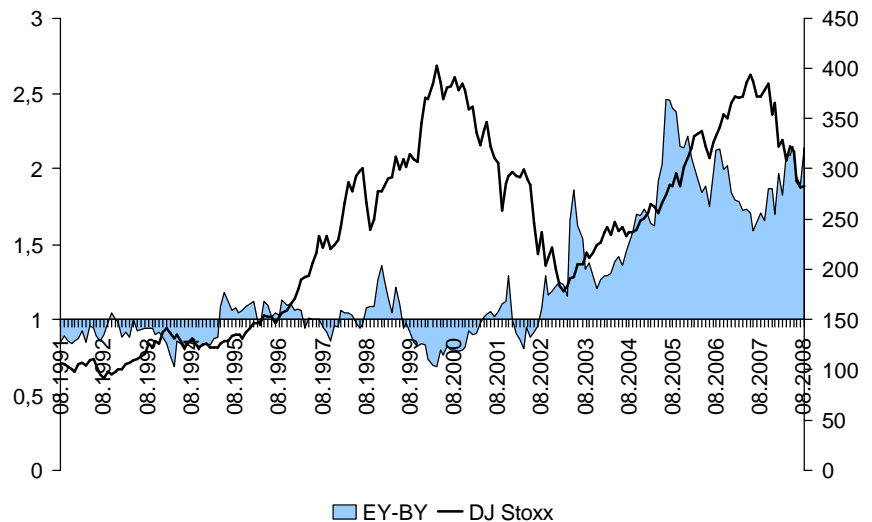


Source: Factset, own calculations

Earnings yield considerably higher than bond yield

The difference between earnings yields (i.e. inverse P/E) and bond yields is just one indicator highlighting the fact that European shares are currently traded at attractive prices. The following chart shows the current valuation of the Stoxx 600 according to this yardstick. Earnings yields are currently about twice as high as bond yields. This goes to underline the favourable valuation of European shares relative to European bonds, as well as the limited downside risk.

Earnings- vs. Bond-yield



Source: Datastream, own calculations

EuroStoxx50 still caught in a downward trend, momentum accelerating

The month of September has yet again lived up to its reputation of being the most volatile month of the year: the European blue-chips index, EuroStoxx50, is currently testing its year-low at high volumes and clearly above-average spreads. After a short-lived bear-market rally from mid-July, the index continued its downswing. The failure to clear the resistance at 3,400 points shows that the bears are still dominating the market. The upswing dynamics as signalled by the short-term overbought/oversold indicators have gradually come down and most recently the 50- and 200-days average has been sustainably broken on the way down.

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The other technical indicators (i.e. on-balance volume, MACD, RSI) support this bearish scenario: The MACD keeps indicating falling prices, and there are currently no signs of a trend reversal. The RSI would suggest going short and so does the momentum. The sentiment indicators (e.g. the put/call ratio) do not draw a more optimistic picture either.

EuroStoxx50 Index



Source: Bloomberg

The scenario is not much better in the strategically relevant monthly chart. The support at 3,000 to 3,100 points is currently in danger of being broken, with the nearest index target of the EuroStoxx50 situated at around 2,950 points. After that, the next support is only at 2,600 points. In a positive scenario, the index would stabilise in the support area of 3,000 to 3,100 and then rise to the Fibonacci projections of 3,370 or 3,541. However, given that the current downward trend is still intact, we consider this scenario as unlikely.

Outlook

We expect the speculation on interest rate cuts in Europe to eventually trigger a phase of stabilisation as well as the turn-around. In our opinion this should happen during the fourth quarter. Until then, we will have to overcome a few turbulent weeks; luckily the stronger season has just started at the stock exchange. The substantially lower oil price supports both companies and consumers. The stock exchange will realise this sooner or later - for the time being of course it is still pure fear over potentially even more banks and insurance companies going over Jordan that dominates the markets.

Overall we therefore recommend holding fundamentally and financially sound companies, where the lower prices have been caused by broad sell-offs rather than by specific problems. It is already very late for selling cyclicals seeing that the massive share price losses were recorded within a small time window, which is why prices are already very low now. The same is true for property shares, which have come to price in the worst-case scenario; in spite of the low prices, however, there are hardly any buyers in this category. It is only the financially unstable companies or those still commanding high valuations where we would advise to sell at this stage.

Given that the valuations of European equities are substantially more attractive than those of their American counterparts, there is also significantly more upward potential in the former. In our asset allocation we therefore recommend overweighting European shares since they will benefit above average from an improved economic environment during the next upswing. Overall, however, we are still upholding our advice to underweight equities.

Economy, interest rates and bond market

Economic growth continues to weaken

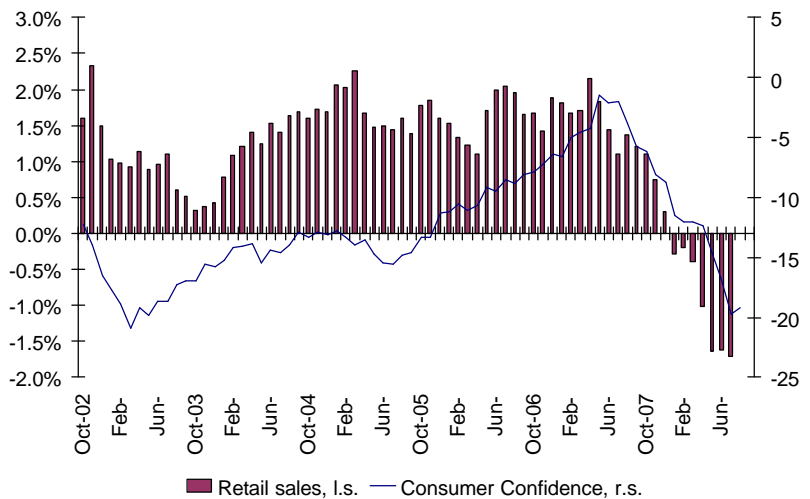
The anticipated weakening of economic growth has hit Europe harder than expected. Based on a shrinking second quarter we expect growth rates to remain in their current downward path (yoy) that may well take them into the first quarter of 2009. Only then we do envisage a moderate recovery.

The Euroland economy shrank by 0.2% in the second quarter with each one of the three most important economies, Germany, France, and Italy, recording declines. This shrinking can only partially be explained by the special effects (building of inventory, increased construction because of the warm winter) that caused the strong growth in the first quarter (+0.8%). The difficult environment has improved since July: the external value of the euro has corrected against the US dollar, and the oil price has declined substantially since mid-July. Given its increasingly comprehensive extent and its long duration the financial crisis seems to have taken the spot of inflationary concerns as no. 1 uncertainty factor.

Poor consumer and business sentiment

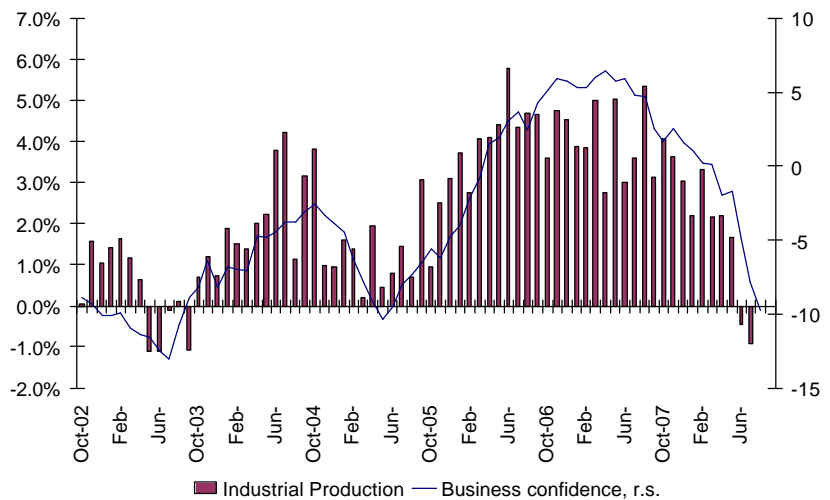
Many consumers are taking a wait-and-see stance with regard to purchasing durable goods (e.g. furniture, cars etc). Consumer sentiment is close to its all-time low, which does not bode well for a swift recovery of private consumption due to the losses in purchase power already suffered and the negative news flow (bank crisis, decline in economic growth). The industrial sector is faced with drastically lower numbers of order intakes, and industrial output exhibits shrinking dynamics. A lack of momentum in investment, consumption, and exports suggests a further slow-down in growth over the coming months. We do not envisage a distinctive recession, but the recovery that we expect to take hold from the second quarter of 2009 will only be a moderate one as well.

Euroland Retail sales (y/y) vs. Consumer confidence



Source: Datastream

Euroland Industrial production (y/y) vs. Business confidence, r.s.



Source: Datastream

Speculation on imminent interest rate cut too soon

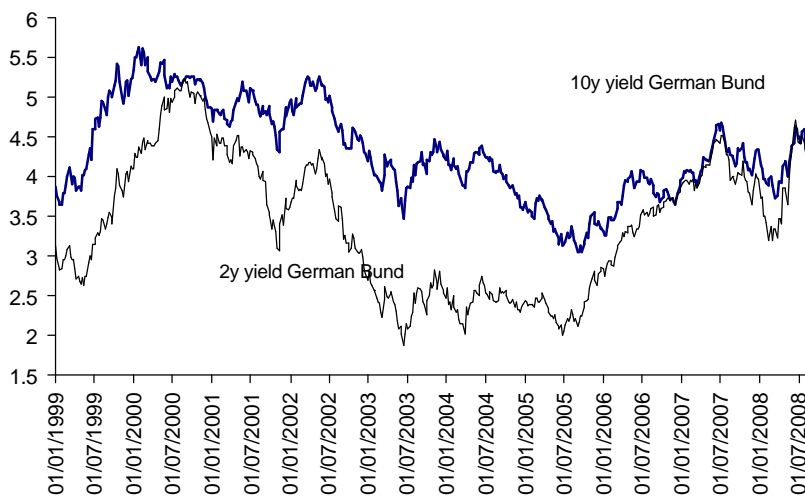
Total Euroland inflation passed its peak at the end of the second quarter, the oil price corrected substantially, and food prices have come down as well. The immediate danger of inflation seems to be contained, but the extent to which second-round effects will push up prices (e.g. by companies passing on increased costs and wage negotiations) remains yet to be seen. The ECB Governing Council has left rates unchanged at 4.25% and has issued a warning over out-of-line price increases on the back of broad based second-round effects and the resulting risk of inflation. We believe that the economic cooling-down and the bad consumer sentiment will prevent companies from passing on the increased costs in full. Workers' representatives will have to agree to a compromise in the upcoming wage talks. We expect inflation to gradually reduce to a range of 2 to 3%. In our scenario (oil price stabilisation, no comprehensive second-round effects, and weak economic environment) we envisage interest rate cuts by the ECB from the second quarter of 2009. We do not expect the ECB to react to the new climax of the bank crisis by hastening to cut its rates in any way.

Some potential for corrections at the short end

The realisation that the financial crisis and the economic downturn were here to stay for a bit longer has recently led to strong dynamics in government bonds. The yields of both 2-year and 10-year German government bonds have come down over the past weeks. In view of the still existing risk of inflation we expect 10-year yields to move sideways. The interest curve has steepened recently because the 2-year yields were highly susceptible to the negative news (e.g. Lehman), with 2-year government bonds apparently considered some sort of safe haven by investors. There is a chance that the short end may see a slight correction over the next three months.

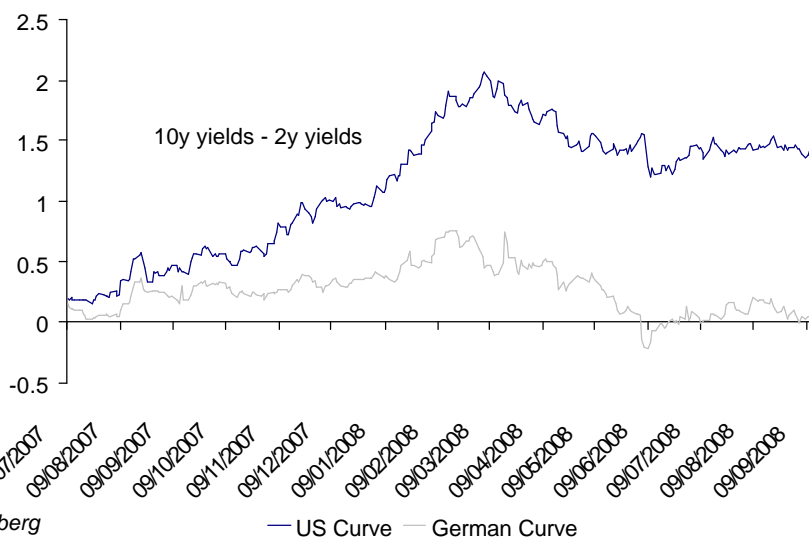
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German govt. Bonds (2y vs. 10y)



Source: Bloomberg

Interest rate curve slope German Bonds, US Treasuries in %-points



Source: Bloomberg

— US Curve — German Curve

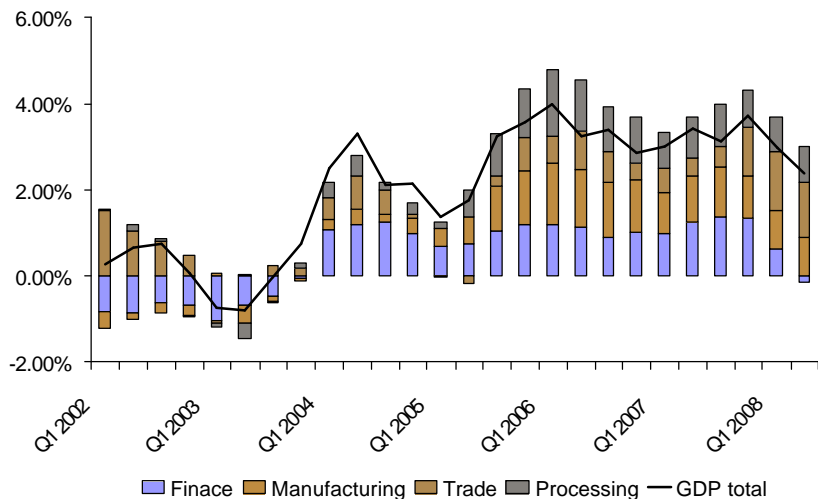
Switzerland

Economy, interest rates and currency

Further cooling down

Switzerland has shown a comparatively decent performance in international comparison. Although the GDP data of the second quarter indicated a further deceleration, they remained clearly positive.

Contributions to GDP growth y/y by sector



Source: Datastream, own calculations

Industrials as well as the processing sector such as pharmaceuticals reported good results, and the trade sector - spearheaded by retail - even improved its figures. With a view to the target markets, export-oriented companies are less optimistic about the future development due to the weak economy in the European Union than those focusing on the domestic market. Domestic demand has been stable so far, although sentiment indicators both by consumers and by the corporate sector suggest a decline.

Bank crisis still dominant

These relatively positive aspects have been overshadowed by the bank crisis, and we do not expect the all-clear any time soon. The financial sector generated a negative contribution to GDP growth, with banks leading the way; these recorded negative qoq growth rates for the second consecutive time. Given that over the past couple of years this sector has been responsible for one third of growth, the current situation weighs heavily on the economy. One can only hope that the effects on the real economy (for example on the labour market or consumer sentiment) will be limited. Overall we expect the picture to worsen further.

Falling oil price inspires hopes for a decline in inflation

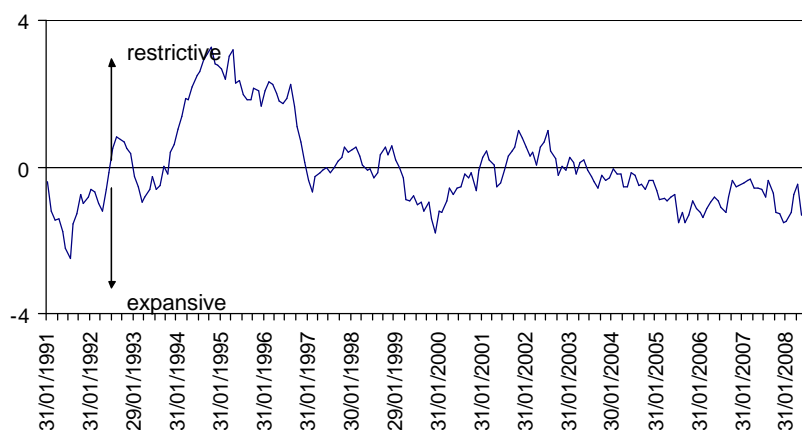
The increase in the oil price on global markets has led to a strongly rising inflation rate in Switzerland. Whereas average inflation of the ten previous years was below 1%, it increased to the record high of 3.1% this year (but eased off again in August). Price increases seem to have been passed on to a large degree in Switzerland, but it remains questionable whether given the current cooling-down second-round effects can appear in the wages. We expect inflation to settle at its average level in the long run, but this process may take a year.

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SNB observant

The Swiss National Bank left interest rates again unchanged in its September meeting. Given that inflation rates are already declining (thus confirming SNB President Jean-Pierre Roth's scenario), we do not expect a rate hike. At the same time the SNB did not join the ECB in its latest rate hike, which means that there is less reason to cut rates any time soon - even less so as the economy in Switzerland has been holding up better than in Euroland. The Swiss monetary policy is currently slightly expansive to neutral, which seems appropriate given the ongoing worries about the bank crisis. This is shown by the Monetary Conditions index; it measures the position of the monetary policy taking into account real interest rates and the real effective exchange rate. We expect the SNB to maintain its wait-and-see stance and keep rates unchanged for a while.

Monetary Conditions Index Switzerland



Source: Datastream, own calculations

Swiss franc sideways - likely to edge up

The Swiss franc has most recently left its sideways channel against the euro and appreciated slightly. The currency more or less abandoned its role as safe haven, as from May on it failed to exhibit a negative correlation to the equity markets - until the most recent events in connection with Lehman caused it to swiftly appreciate. In the long term we expect the franc appreciate by a moderate degree, but while turbulences last a sharp appreciation phase cannot be excluded.

Japan

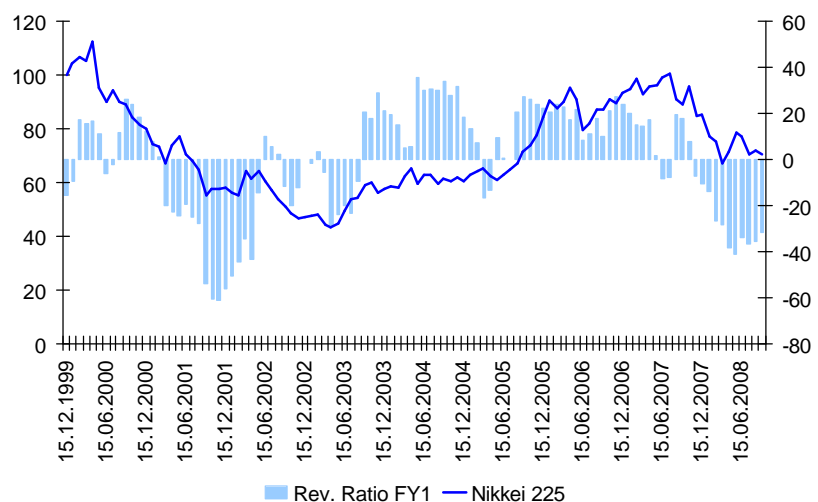
Stock market

Relative underperformance to international peers

The Japanese equity market has been underperforming its international peers since the beginning of July. Due to a massive amount of bad news (recessionary fears, disappointing company results, resignation of the prime minister, sustained strength of the yen) the broad Topix index fell by 9.7%. In euro terms, however, the index was only slightly negative at -0.98%.

Sector-wise, the biggest losers came from sea shipment (-27%), wholesale (-25%) and mining (-23%), whereas shares in plastics (+16%), paper (+8%), as well as the classic defensives, pharmaceuticals (+5.07%) and utilities (+4.50%), displayed relative strength.

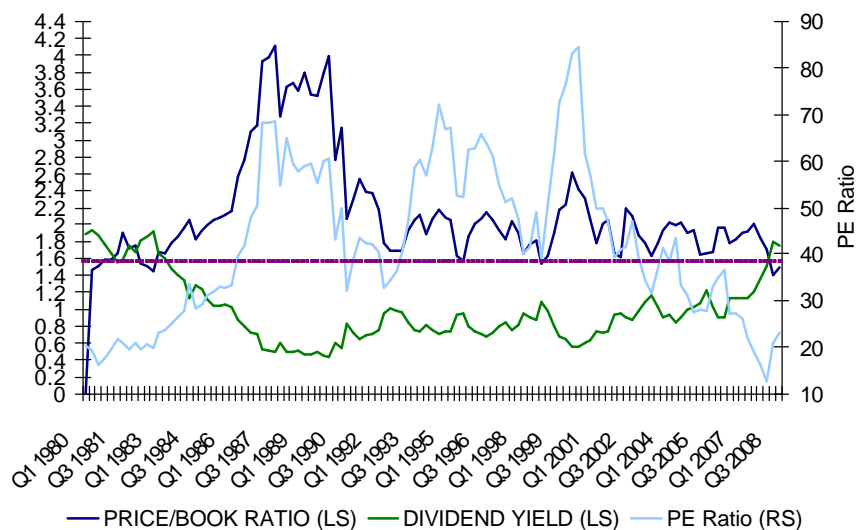
Revision Ratio Nikkei225



Source: JCF, own calculations

Revisions have been negative for the eleventh consecutive month. This means that more earnings forecasts have been revised downwards than upwards. Although the momentum has come down a bit in comparison with May 2008, analyst sentiment remains clearly negative. Sales revisions have shown a slightly better development, and the ROE forecasts are on the rise again as well. Current 2008 estimates suggest a minor weakening to 9%, whereas 2009 estimates put average ROE back at 9.23%. In addition we should point out that industrials and technology companies in particular have managed to increase the profitability of their core business by rates higher than those in the overall market.

Historical Valuations



Source: Datastream

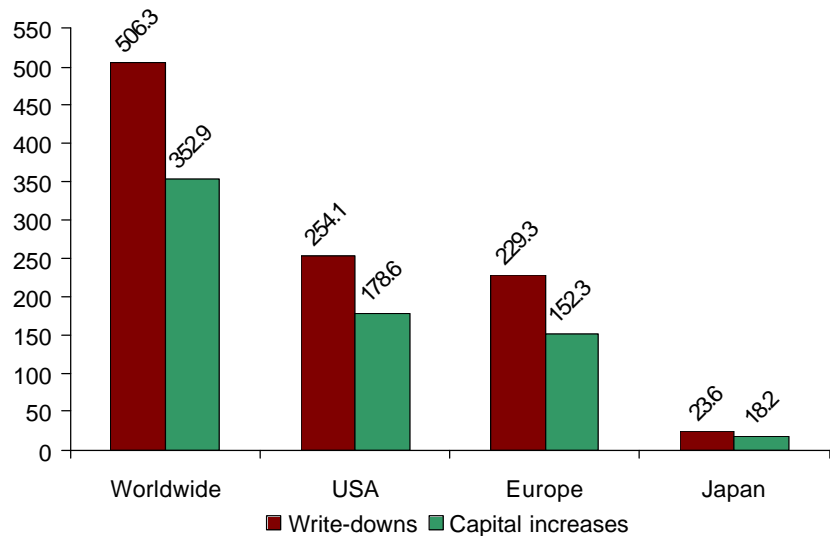
Due to the continued positive earnings development of Japanese companies and the most recent dip in share prices, the current valuations on the equity market are extremely attractive by historic comparison. The current PE-Ratio of the Nikkei represents a more than 20-years low, price/book value is currently at a 25-years low and dividend yield is back to its highest value since 1982. The above chart impressively underlines the extremely attractive valuation of Japanese shares in historic comparison.

Japanese shopping tour has started

Numerous Japanese companies have been keeping a very low profile while embarking on an international "shopping tour" the likes of which we last saw in the eighties. Whereas back then companies focused on prestigious property, the current capital expenditure seems to make more sense. At the moment the focus is on the acquisition of technology and the strengthening of existing positions in foreign markets. The wave of takeovers goes to show the good financial base of the Japanese companies, not the least in times of a global credit crunch.

Among the examples of said wave was the acquisition of Epcos by TDK, the one of Millennium Pharma by Takeda and the takeover of 50% of Bertelsmann by Sony BMG. Financials were quick in seizing the moment too: Mizho bought a stake in Merrill Lynch, Sumitomo Mitsui invested in Barclays and Mizubishi UFJ acquired the remaining shares in Union Bank California. The majority of acquisitions was funded by the companies' own capital resources and paid in cash. This shows that Japanese companies have gradually paid off their debt in recent years and that, after a couple of successive record years, they are more liquid than ever.

Write-downs and capital increases in international comparison (in USD bn)



Source: Bloomberg

Relatively little need for write-downs as major pro of the Japanese market

The above chart underpins the fact that the need for write-downs and for liquidity in the Japanese financial sector is substantially lower than that of their US and European competitors. We believe that this represents a major strength of the Japanese equity market at the moment. Therefore we do not share the scepticism that Japanese shares have to contend with and we do in fact believe that the massive underweighting of Japanese shares in institutional and also private portfolios should gradually reverse. We maintain our positive outlook for the Tokyo stock exchange due to the favourable fundamental valuation and to the relative strength of the Japanese corporate sector.

We expect the equity market to exhibit another phase of relative strength and therefore recommend the slight overweighting of the Japanese equity market within the context of our country allocation. As far as sectors are concerned, we continue to recommend a focus on the financial sector after the disproportionate slump it has gone through. We also expect relative strength in the technology sector and in cyclical consumer goods.

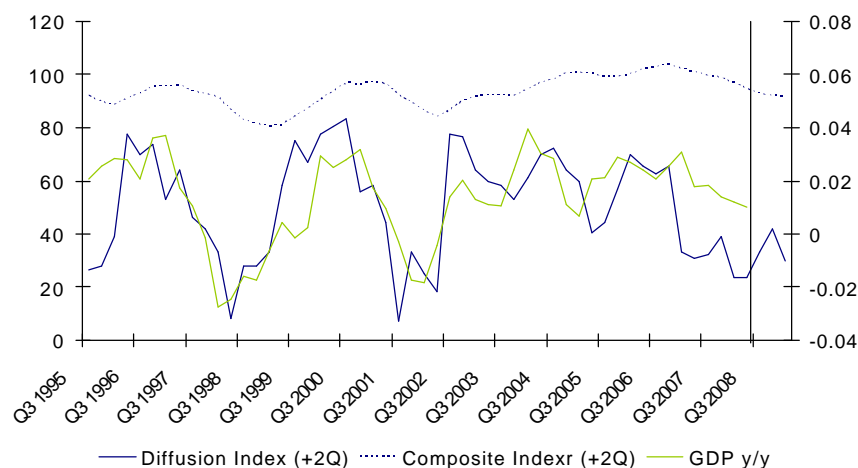
Economy, interest rates and currency

Trying to find a bottom

The Japanese economy is currently heading for the bottom of its trough. Exports fell sharply in the second quarter, which was due to the weak economy in the USA and Europe. China on the other hand stepped up the volume of goods imported from Japan and has thus replaced the USA as most important trading partner for the first time. Although this opens the chance to somewhat disconnect from the US economy, an economic slowdown in China would be all the more painful for Japan. Exports are Japan's traditional growth driver; hence economic growth will remain subdued until export figures are back up again. On top of that, losses resulting from price effects increased in the second quarter: export prices continued to decline and import prices (dominated by commodity prices) soared drastically. However, a trend reversal is on the horizon for both, and the outflow of purchasing power should slow down. It will nevertheless take a while for Japan to recover. Corporate and consumer sentiment have suffered sustainably.

Overall we do not expect the economy to recover on a long-term basis before mid-2009 - an opinion supported by the leading indicators of the Cabinet Office. The Diffusion index shows trend reversals two quarters ahead, and the Composite index indicates their extent. Both are still pointing downwards.

GDP and leading indicators



Source: Datastream, own calculations

Therefore the ability to pass on rising prices should remain limited as well (some have already been announced), and the inflation rate should fall again - albeit not to the original level.

Global Strategy

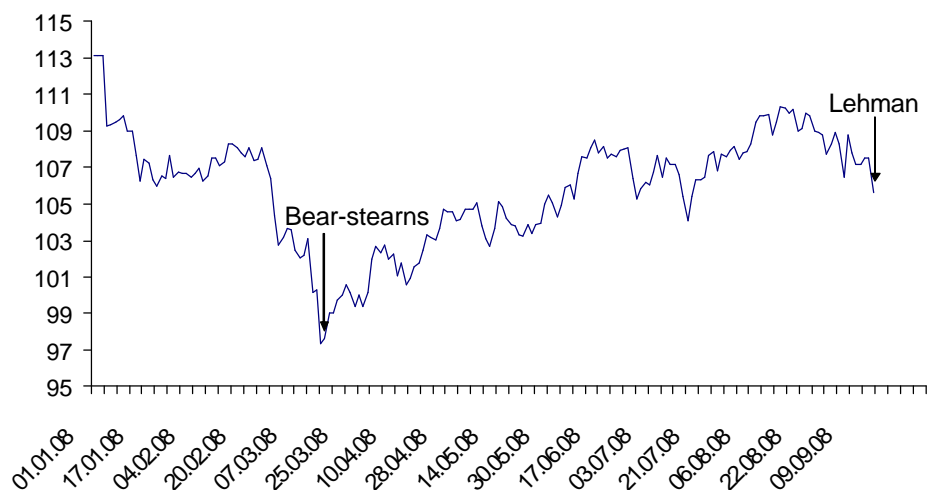
Interest rates unchanged

The Bank of Japan (BoJ) keeps its focus on the economy and believes that the rate of inflation will return to the target band of 0% to 2% soon. It has just reiterated this point of view in its most recent meeting. On top of that, we do not think that the BoJ will take the next step ahead of the Fed, not the least so as to prevent the yen from appreciating. This is why we do not expect any change in interest rates (a rate cut would not make sense at the current level of 0.5% anyway). The BoJ has in addition reacted to the recent turbulences by rising the disposable liquidity and stating "a careful monitoring" (September 16th). A spillover from the US could not be seen until now except for higher liquidity premia, as the Japanese banks have in the mean very limited exposure to the American market (except maybe Japans second largest bank Mizuho) - but if bad news add up we do not exclude turmoil.

Stronger yen

Since its low in 2008 (slightly above 110 USDJPY at the middle of August), the yen has re-embarked on an upward trend and is approaching 105 USDJPY. This may have been triggered by the current turmoil on the financial markets. This development was greatly amplified in relation to the euro: the weakening euro (11% in terms of EURUSD in one month) lead to the appreciation of the yen by 13% (EURJPY) within the same period. Fundamentally speaking, constant interest rate differentials and falling exports would not suggest a rising yen, but rather a sideways movement. However, in view of the persistent turbulences on the financial markets we regard a further appreciation of the yen as possible.

USDJPY



Source: Datastream

Economic Indicators

GDP growth	2006	2007	2008f	2009f
Austria	3.3	3.1	2.1	1.7
Germany	3.1	2.7	1.7	1.2
France	2.4	2.1	1.3	1.3
Italy	1.9	1.4	0.5	0.5
Spain	3.9	3.8	1.6	1.2
Netherlands	3.0	3.5	2.2	1.9
Euroland	2.9	2.6	1.5	1.2
USA	3.3	2.2	1.8	1.4
Japan	2.2	2.0	1.0	0.9
Switzerland	3.3	3.1	1.9	1.6

Inflation	2006	2007	2008f	2009f
Austria*	1.7	2.2	2.9	2.3
Germany	1.8	2.3	2.9	2.0
France	1.9	1.6	3.1	1.9
Italy	2.2	2.0	3.2	2.2
Spain	3.6	2.8	4.0	3.0
Netherlands	1.7	1.6	2.0	2.6
Euroland	2.2	2.1	3.2	2.2
USA	3.2	2.8	3.6	2.1
Japan	0.3	0.1	1.5	1.0
Switzerland	1.1	0.7	2.6	1.5

*national statistics

Source: Erste Bank estimates

Capital Market Forecasts

Exchange Rates

End of the month	current	Dec-08	Mar-09	Jun-09	Sep-09
EUR/USD	1.447	1.45	1.45	1.40	1.37
EUR/JPY	151.5	155	157	151	147
USD/JPY	104.7	107	108	108	107
EUR/CHF	1.583	1.60	1.58	1.57	1.57
USD/CHF	1.094	1.10	1.09	1.12	1.15

Money Market (3m)

End of the month	current	Dec-08	Mar-09	Jun-09	Sep-09
EURO	5.00	4.80	4.60	4.30	4.00
Japan	0.90	0.90	0.80	0.80	0.80
USA	3.20	2.60	2.50	2.50	2.60
Switzerland	2.78	2.75	2.75	2.75	2.75

Govt. Bond Yields (10Y)

End of the month	current	Dec-08	Mar-09	Jun-09	Sep-09
Germany	4.04	4.00	4.10	4.20	4.20
Austria	4.45	4.15	4.25	4.30	4.30
Spread to GE	0.41	0.15	0.15	0.10	0.10
USA	3.44	3.90	4.20	4.30	4.40

Source: Erste Bank estimates

International Equity Markets: EPS Growth and Valuation

	EPS Growth %			Price/Cashflow		
	2007e	2008e	2009e	2007e	2008e	2009e
USA	-3.9%	2.0%	24.4%	10.7	9.4	8.2
Euroland	4.7%	1.6%	11.1%	6.2	5.7	5.4
Germany	14.9%	-7.7%	18.2%	6.2	5.8	5.4
France	5.5%	10.0%	9.8%	6.4	5.9	5.5
Netherlands	4.5%	11.2%	3.1%	6.6	5.6	5.4
Switzerland	-19.1%	-8.9%	52.5%	11.4	11.2	10.0
Japan	3.1%	-5.0%	8.5%	6.0	6.1	5.7

Source: JCF

Emerging Markets: EPS Growth and Valuation

	EPS Growth %			Price/Cashflow		
	2007e	2008e	2009e	2007e	2008e	2009e
Brazil	16.6%	13.4%	24.5%	6.9	6.4	5.6
Argentina	-11.7%	23.7%	17.2%	5.5	n.a.	n.a.
Mexico	11.3%	3.7%	15.1%	8.1	7.8	7.1
	5.4%	13.6%	18.9%	6.8	7.1	6.3
India	20.5%	16.7%	17.1%	12.3	10.8	9.2
Malaysia	32.2%	5.7%	8.0%	6.8	7.1	6.6
Thailand	1.6%	19.6%	6.6%	6.2	5.9	5.3
Korea	8.3%	10.2%	12.6%	7.2	6.7	6.2
Hs China Enterprise						
Hong Kong						
	15.7%	13.0%	11.1%	8.1	7.6	6.8
Hungary	-8.6%	12.1%	4.1%	4.7	4.4	4.3
Poland	17.2%	10.7%	7.7%	7.2	6.0	5.7
Czech Republic	47.5%	9.9%	17.6%	9.0	7.4	6.6
Russia	53.9%	48.4%	3.9%	4.2	3.8	3.2
	27.5%	20.3%	8.3%	6.3	5.4	5.0

Source: JCF

Core-Investments: Strategic stock recommendations

USA/Canada	ISIN	Country	Sector
AGNICO-EAGLE MINES	CA0084741085	CN	Gold-Mining
JOHNSON & JOHNSON	US4781601046	US	Healthcare
WRIGLEY	US9825261053	US	Food-Confectionery
BOMBARDIER INC 'B'	CA0977512007	CN	Industrial
BURLINGTON NORTHERN SANTA FE	US12189T1043	US	Rail-Transport
BERKSHIRE HATHAWAY INC CL-B	US0846702076	US	Reinsurance/Holding
ORACLE CORP.	US68389X1054	US	Software
Europe	ISIN	Country	Sector
SIEMENS AG	DE0007236101	DE	Industrial
SOLARWORLD AG	DE0005108401	DE	Energy, Alternative
RWE AG	DE0007037129	DE	Utility
GAMESA CORP TECNOLOGICA SA	ES0143416115	SP	Industrial
WARTSILA OYJ-B SHARES	FI0009003727	FI	Industrial
SONOVA HOLDING	CH0012549785	CH	Medical Products
ROCHE HOLDING GENUSSCHEIN	CH0012032048	CH	Medical Drugs
VEOLIA ENVIRONNEMENT	FR0000124141	FR	Utility
HENNES & MAURITZ AB-B	SE0000106270	SW	Retail-Apparel
Asia	ISIN	Country	Sector
ZIJIN MINING GROUP	CNE100000502	HK	Gold-Mining
ESPRIT HOLDINGS LTD	BMG3122U1291	HK	Consumer, Cyclical
SONY CORP	JP3435000009	JP	Consumer, Cyclical
CHINA MOBILE LTD	HK0941009539	HK	Communications
JFE HOLDINGS INC	JP3386030005	JN	Basic Materials
CHINA CONSTRUCTION BANK	CNE1000002H1	HK	Financial
SANYO ELECTRIC	JP3340600000	JP	Electric Products
INFOSYS TECHNOLOGIES	INE009A01021	IN	Software
LENOVO GROUP LTD	HK0992009065	HK	Computer
PTT PLC	TH0646010007	TH	Oil Integrated

Asset Allocation Q4 2008

Portfolio	Weightings Erste Bank
Cash	Overweight
Bonds	Neutral
Stocks	Underweight
International Bond-Portfolio ¹⁾	
Europe	Neutral
USA	Slightly underweight
Japan	Neutral
Emerging Markets	Slightly overweight
International Equity-Portfolio ¹⁾	
Europe	Overweight
USA	Underweight
Japan	Slightly overweight
Emerging Markets	Neutral
FX-Allocation	
Dollar-Bloc	Neutral

¹⁾ Without consideration of currencies / markets in absolute terms

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