Helaba **Research**

Capital Markets Briefly

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Pronounced Recession Fears

- In this crisis environment, the **US Dollar** is benefiting as a safe haven currency. Over the short term there is further appreciation potential. However, a countermovement should begin in 2009, and the Euro-Dollar exchange rate should recover.
- The by now extremely pronounced pessimism and the favorable valuations should limit the risks of setbacks in **stocks.** All in all, the chances that the stock market will find a stable bottom are not bad.
- To prevent an extended economic crisis in the Euro zone, the ECB is likely to cut its key interest rate to 2 %. The decline in yields in the **Euro bond market** will continue for the time being not least due to a noticeable drop in inflation.

Financial markets at a glance:

	Performance			Forecast horizon at end...		
	year to date	1 month	current*	Q4/2008	Q1/2009	Q2/2009
	(%)		(cross rate)			
EUR-USD	15,6	3,5	1,26	1,23	1,30	1,28
EUR-JPY	33,2	6,8	122	117	132	135
EUR-GBP	-12,9	-7,3	0,84	0,83	0,84	0,82
EUR-CHF	8,9	-0,9	1,52	1,48	1,54	1,55
	(in local currency, %)		(index)			
DAX	-43,2	-4,3	4.579	5.200	5.400	5.700
Euro Stoxx 50	-45,7	-8,0	2.390	2.700	2.800	3.000
Dow Jones	-36,5	-6,7	8.425	9.500	9.700	10.300
Nikkei 225	-45,6	-10,5	8.328	9.500	9.800	10.500
	(in Bp)		(in %)			
3M Euribor	-53	-82	4,15	3,70	3,30	2,80
3M USD Libor	-249	-162	2,22	1,80	1,70	1,50
10y Bunds	-66	-29	3,65	3,80	3,50	3,80
10y Pfandbriefe	-40	-26	4,35	4,40	4,10	4,40
10y Treasuries	-49	-21	3,53	3,70	3,50	3,80

* 11.18.08; Numbers in German Notation

Sources: Bloomberg, Helaba Research

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Christian Apelt

Currencies: The Air for the Dollar is Getting Thinner

US Dollar profiting from turbulences

The sharp slide of the Euro is slowing down. The Euro-Dollar exchange rate is stabilizing around 1.25. Uncertainty and risk aversion continue to prevail in global financial markets, even if a slight easing has taken place in a few areas. This environment is fundamentally positive for the US Dollar. Repatriations and forced liquidations of international investments, as well as the settling of Dollar debts, could give the Greenback a further boost.

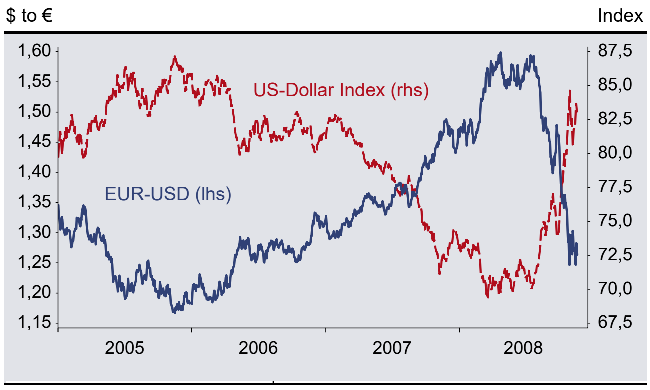
Deep US recession, but growth in the Euro zone hardly better

The upheavals have led to a stronger appreciation in the Dollar than the fundamental picture would currently justify. The US economy is in recession. Economic growth should be especially negative in the winter half-year. The financial crisis is making itself increasingly felt in the real economy. At least inflation will slow markedly, thanks to declining energy prices. That is also why the Federal Reserve cut the Fed Funds Rate to 1.0 % and could even take it down to as low as 0.5 % in the near future. However, the weakness in other currency regions mitigates what is a negative environment for the Dollar. The economic downturn is leading to sizeable interest rate cuts also in the Euro zone. While the interest rate advantage of the Euro is shrinking, it remains intact.

EUR-USD: Countermovement in the first half of the year, weakness in the second half

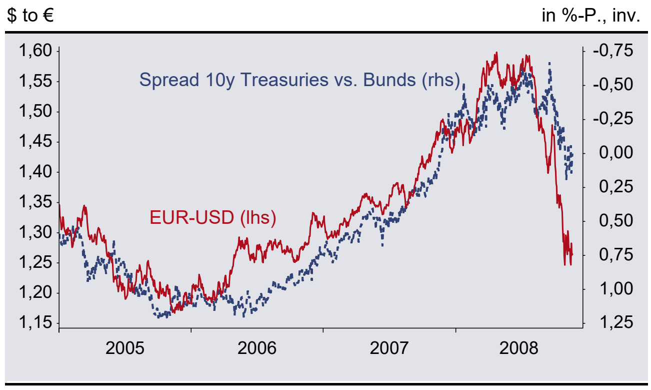
An easing in financial market tensions in the first half of 2009 should hurt the Greenback first of all. The Euro-Dollar exchange rate should correct its overshooting on the downside and rise back to at least 1.30. In the second half of 2009, however, other positive factors for the Greenback should become more important. The US current account deficit, a long-term problem, will shrink because of weak domestic demand. The capital needs of the US will thus decline, and the US currency should benefit from this. Moreover, the Euro has lost a bonus in the wake of the crisis. A policy that lacks uniformity in some parts and the vulnerability of individual countries within or at the periphery of the Euro zone point to structural problems in the common currency. As a result, the Euro-Dollar exchange rate should go back down to 1.20 in the second half of the year.

US Dollar makes up losses of two years



Sources: EcoWin, Helaba Research

Short-term exaggeration of the Euro-Dollar weakness



Sources: EcoWin, Helaba Research

Pound remains weak for the time being, Yen and Franc will give back some of their gains

Following the generous interest rate cut by the Bank of England to 3.0 %, the British Pound has come under noticeable pressure. The expectation of further cuts down to 1.5 % argues against a sustained recovery by the British currency in the next few months, that is, the Euro-Pound exchange rate should trend around 0.84. Only when the British economy stabilizes over the course of 2009 will the Pound Sterling recover vis-à-vis the Euro in the direction of 0.78. Analogously to the Green-back, the Japanese Yen is profiting from greater risk aversion and reduced interest rate differential. Further upside potential cannot be ruled out over the short term. As capital market tensions ease in 2009, the Yen will presumably give up some of its gains again, and the Euro-Yen exchange rate should rise to 140. Much the same holds for the Swiss Franc. The Franc, too, will lose some of its exchange rate gains against the Euro, especially since Switzerland cannot disconnect itself from the Euro zone in the development of either the economy or interest rates.

Markus Reinwand, CFA

Stocks: Chances for a Bottom Formation

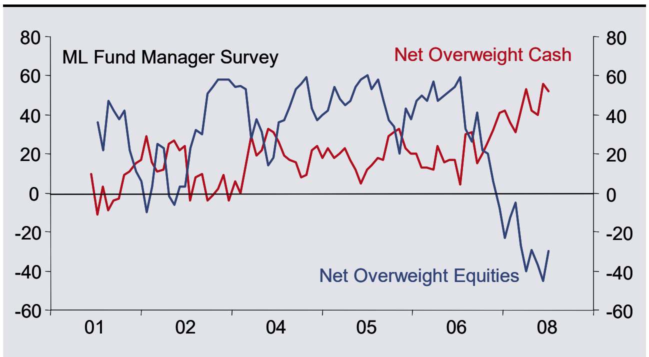
Lows for the year put to the test

The mood among investors continues to be marked by an extreme risk aversion. The implicit stock volatility – a classic yardstick for measuring uncertainty in the markets – is remaining stubbornly at historically high levels. Accordingly, all attempts at a recovery have proved decidedly short-lived so far. Instead, most of the leading international indices are heading for the October lows. However, experience from previous sell-off phases shows that a test of salient lows is the rule rather than the exception before the market embarks upon a sustained recovery.

Extreme pessimism

Given this technically still very fragile situation, restraint is still indicated for the time being. Any breach of the previous lows would presumably trigger another wave of selling. On the other hand, the unwinding of risk stocks has progressed quite far in many investment portfolios. As a result, stocks are by now clearly underrepresented. The loss of importance of dividend-paying stocks is not only the inevitable consequence of the massive decline in stock prices. Over the past few months there have also been extremely pronounced net outflows of funds from stock funds. In the sense of a contraindication, this would suggest that the bottom has been gradually reached. Similar signals come from a number of important sentiment barometers, which reveal an excessive pessimism among stock market investors.

Stocks already clearly underrepresented



Sources: Merrill Lynch, Helaba Research

Deep recession anticipated

Sources: Datastream, Helaba Research

Favorable valuation

If there was too much optimism about growth at the beginning of the financial crisis, it would appear that by now the opposite extreme has been reached. That is also indicated by the most recent, enormous downward dynamic in the revised growth forecasts for next year. In spite of continuing weak economic data, the potential for negative surprises in the stock markets should be limited, given the noticeably scaled-down expectations. The same is suggested by the fact that stocks have anticipated an economic drought period, both with respect to the magnitude of the correction and in terms of the valuation ratios. Thus, P/E ratios on the basis of already reported results are by now noticeably lower – especially for European stocks – than they were during the last two recessions in 2001 and 1991. In fact, they have now even reached the level of the serious recessions in the middle of the 1970s and at the beginning of the 1980s.

Attractive upside potential in stock prices

During previous stock market cycles, the combination of extreme pessimism and low valuation usually proved to be an attractive buying opportunity for investors with a medium-term horizon. Possible phases of weakness should therefore be used selectively to enter the market. However, given the extraordinarily high fluctuations in the prices of even blue chips, strong nerves are called for.

Ulf Krauss

Bonds: Interest Rate Low has not been Reached Yet

Europe is sliding into a recession

Euro land is in recession: in October, the Purchasing Managers Index dropped by 7 points to a new historical low of 41.3. Following the commodity price shock from last summer, uncertainty about the state of the global financial system is having a growing effect. The hope that the emerging markets would prove resilient has been dashed. This puts pressure on the export nations in the Euro zone. On the other hand, concerns about bank collapses have waned. The risk of a serious credit crunch has eased thanks to extensive state guarantees. At the same time, economic stimulus programs in the Euro region offer the chance that the emerging recession will remain contained.

Inflation in retreat

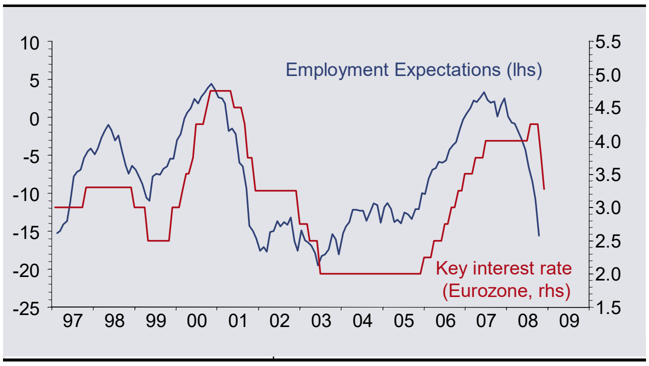
According to preliminary estimates, inflation in the Euro area dropped to 3.4 % in October. It will drop below the 3 % level in November, and presumably below the 2 % level in May 2009. Since the middle of the year, the CRB Commodity Index has lost 40 % of its value. Crude oil prices have even dropped by more than 60 %. Still, consumer confidence in the Euro area has dropped to the lowest level in fifteen years. The restraint of consumers, which is already noticeably in the automobile sector, should spread to other areas of consumer spending. Discount actions will presumably be the order of the day next year. In some areas we could even see deflationary tendencies.

ECB remains challenged

The ECB has responded to the transformed fundamental environment with two rate cuts of 50 basis points each. Although this will not avert a recession, the ECB should be eager to prevent a long and sustained economic crisis in the Euro zone. To that end, the ECB will presumably lower the refinancing rate to 2 % next year. That level existed once before, between 2003 and 2005. The ECB will have no lack of arguments in favor of an expansionary monetary policy: the growth of credit in the Euro zone is already weakening noticeably. Inflation expectations are very low. For the financial system, the easing means a steeper yield curve and more favorable refinancing conditions.

Recession puts ECB under pressure

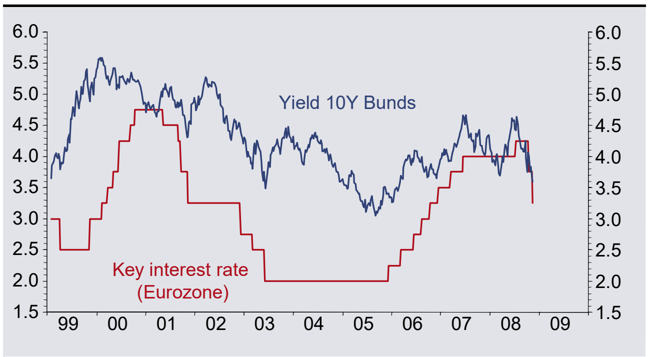
EU businesses survey %



Sources: Datastream, Helaba Research

Key interest rates and yields in free fall

%



Sources: Datastream, Helaba Research

Cyclical low in yields will be plumbed in 2009

The yield curve has by now assumed a normal form. The yield differential between two-year and ten-year German treasury bonds was most recently at 1 ½ percentage points. The return of German treasury bonds rose again sharply in October and has thus posted a growth of more than 8 % since the beginning of the year. The performance has been only half as good for Italian government bonds, which are suffering from higher risk premiums. The yield low in the Euro bond market will presumably be reached in the first half of 2009. However, the question about the financing of the state bailout packages and economic stimulus programs should prove as much a drag as the year goes along as a gradual brightening in the economy. ■