Investment Outlook – September 2008

Global Equities

During September significant volatility and market risks entered the market, following the collapse of Lehman Brothers and the Fed takeover of the 2 US mortgage giants Freddie Mac and Fannie Mae.

The contagion in the US spread worldwide with similar bailout and rescue plans being put into action across Europe. Liquidity and inter-bank lending has effectively dried up causing concern that we are entering a deep recession that will last through 2009 and possibly well into 2010. In the US almost 1 million jobs have been lost since the beginning of the year.

The MSCI World Index fell 11.9%, for the month, while the Eurozone lost 11.4% in local euro terms. The rest of the World (non US) - as measured by the MSCI EAFE Index lost 14.7% for the month and is down 31.1% for the year to date in US$ terms.

However the strengthening dollar played havoc with foreign market returns when translated into US$ terms. Emerging markets were particularly hard hit in this regard including Brazil, Russia, India and South Africa. Fears of significant global contraction sent other commodity linked currencies down including the Australian and Canadian dollar.

By early October the euro had lost upwards of 12% against the US dollar in the past 2 months, while the British Pound had retreated by approximately 10%.

The Pacific region also suffered against a strengthening US$ losing 13.7% for the month in $ terms. (MSCI Pacific Index). It is now down 27.7% for the year.

North America as measured by the MSCI US benchmark lost 9.2% and remains down 19.6% for the year to date.

Increasing worries over real estate write downs, lack of bank liquidity and esoteric financial instruments have created fear in the markets. The S&P 500 is now at levels last seen 10 years ago. The investment banking model has been called into question globally. Major sell offs of banking shares are expected during September.

It is clear the US financial system will continue to see failed banks and the real estate meltdown will persist for another 12-18 months – when prices are expected to bottom out. Housing prices have already fallen approximately 20-25% across most US markets.

Global Bond outlook

Following the unprecedented global coordinated central bank rate cuts in early October bond prices have shown recent gains. Given the worldwide credit crunch and lack of liquidity further rate cuts are expected – with the Fed leading the way.

Although the ECB remains steadfast fighting inflationary risks in the Eurozone given the deflation experienced by falling equity and housing prices – further eurozone rate cuts and UK cuts are expected.

Given recessionary fears there is a flight to government bond and other highly rated fixed income instruments. The European Government Bond Index rose 0.60% for the month (euros), although due to the stronger dollar, the World Government Bond was marginally down at 1.2% for the same period.

Dollar strength has removed a concern the Fed may have had concerning lowering rates further.

The US housing slump continues and fears of a weak recessionary environment are expected to exist through the end of 2009. Manufacturing data and recent jobless claims show the US is likely already in recession and expectations are much of the developed world will suffer a similar fate. With the government bailout of Freddie Mac and Fannie Mae along with the credit crises – this translates into US mortgage origination effectively drying up. Opportunities for refinancing have been very limited at the long end, with 30 year fixed loans on larger homes remaining around 6.5% levels at the end of July. A steepening yield curve has ensued.