Henderson Global Investors

Economics & Strategy

8 December 2008

Weekly Economic & Market Update

Highlights

- The US labour market deteriorated sharply in November.
- G7 leading economic indicators are declining at an alarming pace.
- The monetary transmission mechanism remains impaired.
- Brent crude oil briefly fell below $40 a barrel last week.

Views

- US non-farm payrolls fell 533,000 in November and are expected to continue to decline by 300,000-400,000 a month for the next six months.
- The global PMI hit its lowest level on record in November and until monetary transmission re-normalises, leading indicators are likely to continue declining.
- Commercial banks continue to raise cash levels on their balance sheets at the expense of household and corporate sector lending. Central banks have a number of additional policy options available to them to combat the credit crisis.
- It appears as if speculators may increasingly be participating in the oil sell off.

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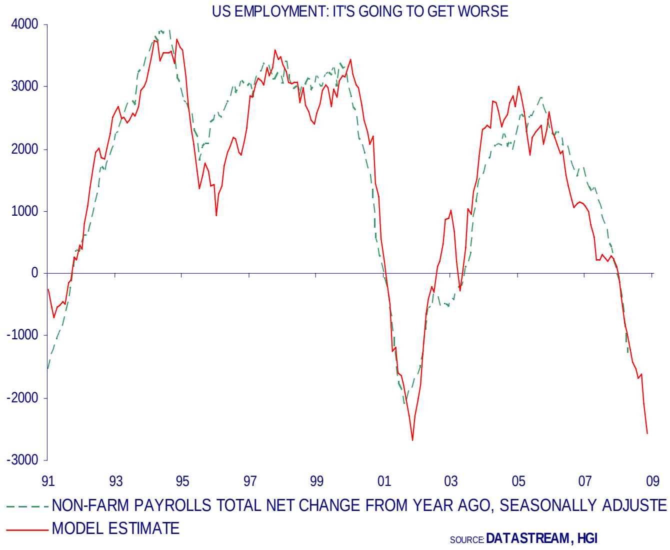

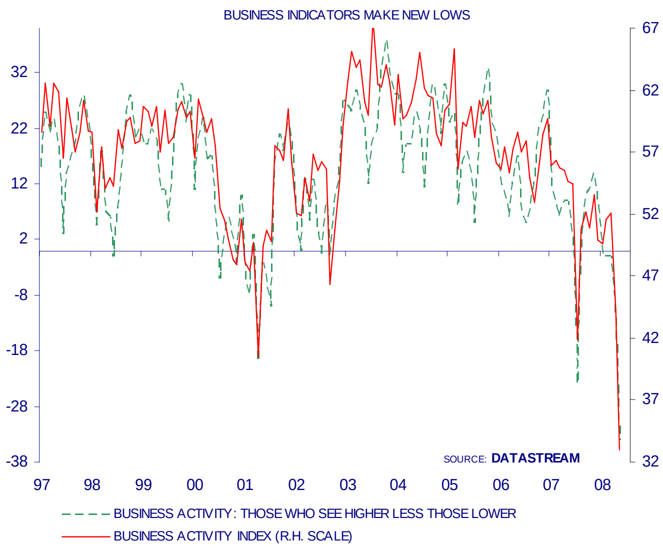

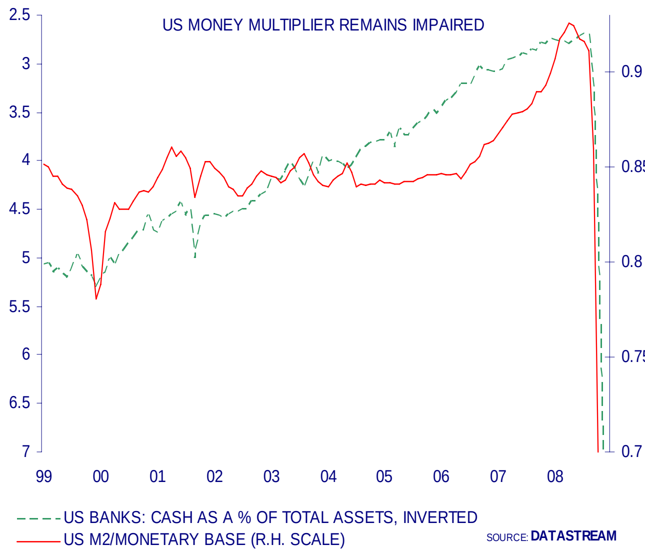

- US employers shed 533,000 jobs in November, the largest monthly decline this cycle. Despite being a significant deterioration, comparisons to previous recessions, such as in the 1970's, are somewhat misleading given today's larger labour force.
- The decline was broad-based. Service sector job losses accelerated sharply to 370,000 in November from 153,000 the previous month. The part-time sector, usually a good leading indicator for trends in the overall labour market, accelerated its staff reductions as well.
- Our model points to payroll declines of 300,000-400,000 a month over the next 6 months which will open up a considerable amount of spare capacity and put further pressure on wages.
- Global purchasing manger's indices plunged in November as both business and consumer confidence continued to deteriorate. The composite global PMI fell to 35.4, the lowest level ever in its brief history.
- The US composite PMI declined to 37 as the services index fell to its lowest level ever. The UK composite PMI faired no better as it declined to 39 in November which was also an all-time low.
- Despite government efforts aimed at restoring some semblance of normality to lending markets, many firms continue to indicate that lack of financing remains one of their most serious problems.
- Commercial banks continue to decrease the amount of credit made available to both the household and corporate sectors.
- The money being created by central banks is ending up on commercial banks' balance sheets as they continue to try and improve their capital positions.
- This behaviour has lead to a collapse in the money multiplier, otherwise known as the rate of transmission of monetary policy through the banking system. As long as monetary transmission remains impaired, confidence surveys will continue to decline.

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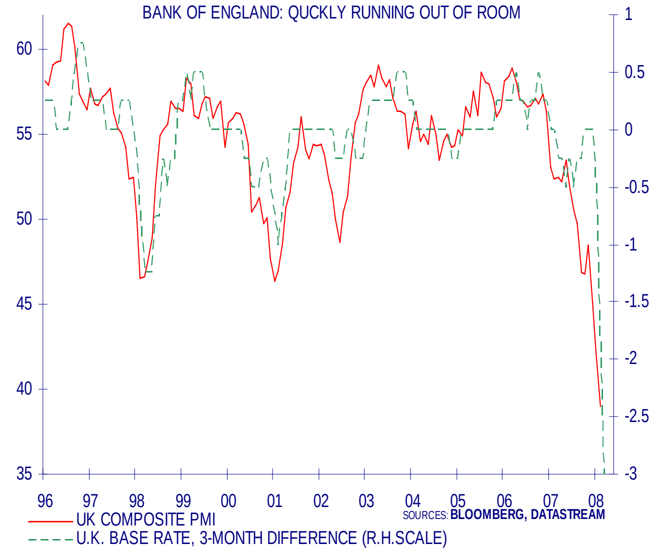

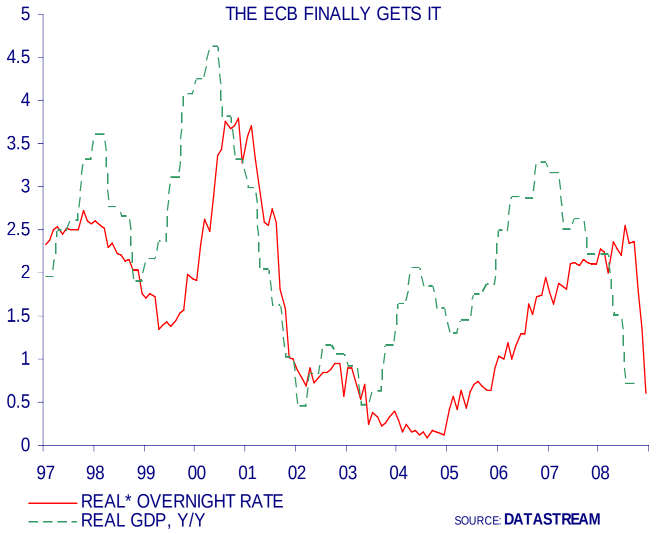

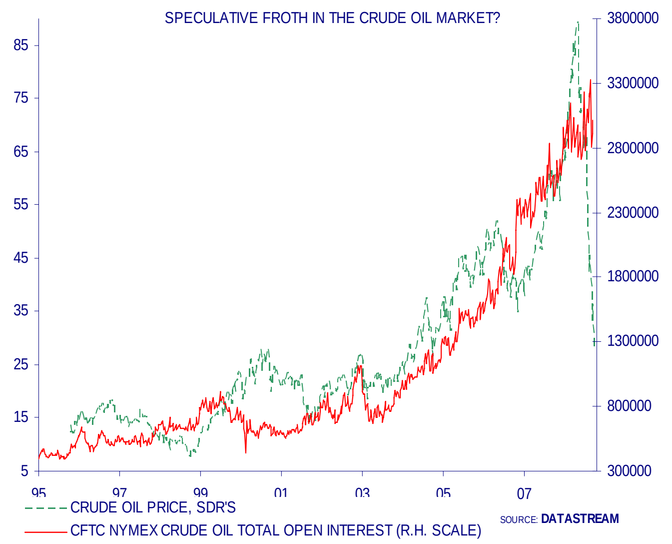

- The Bank of England cut its target for the Bank rate by 100 basis points to 2% last week and committed to further rate cuts if they are needed.
- As mentioned above, it's not the price of credit but its availability that's the problem in most countries.
- However, policymakers have many options available to them beyond monetary policy, including: targeting lower long-term interest rates by purchasing government bonds, lending directly to private non-financial enterprises and expanding the scope of purchases of financial assets such as corporate bonds, to name a few.
- As interest rates approach 0, central banks are likely to increase their use of such policies.

- The ECB cut its target rate by 75 basis points, the largest single cut in the central bank's history. In keeping with tradition President Trichet gave no indication of future rate moves but confirmed that the ECB will 'continue to keep inflation expectations firmly anchored in line with its medium-term objective'.

- Trends in resource utilisation and leading indicators seem to suggest that the ECB is now running the risk of undershooting its inflation target of below but close to 2%.

- However, in the last two months, the ECB has acknowledged the significant downside risks to growth and has aggressively lowered real rates to reflect the future trajectory of real growth.
- Brent crude oil briefly fell below $40 a barrel last week as poor economic data continued to weigh on the commodity complex.

- When the price of oil peaked back in July, open interest in the oil futures market pulled back sharply giving the appearance that speculators were closing positions.

- Open interest has recently spiked up in line with the fall in oil giving the impression that speculators are, once again, active in the market but this time on the short side.

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28/11/08 to 05/12/08	Index	Local Returns % Week	Local Returns Year to Date	Sterling Returns % Week	Sterling Returns Year to Date	US Dollar Returns % Week	US Dollar Returns Year to Date
FTSE All Share	2014	-5.6	-38.7	-5.6	-38.7	-10.4	-55.2
FTSE 100	4049	-5.6	-37.3	-5.6	-37.3	-10.3	-54.1
S&P 500 Composite	876	-2.3	-40.3	3.0	-18.5	-2.3	-40.3
NASDAQ Composite	1509	-1.7	-43.1	3.5	-22.3	-1.7	-43.1
Toronto S.E 300 Composite	8117	-12.4	-41.3	-12.0	-39.1	-16.4	-55.5
Dow Jones Euro Stoxx	206	-7.1	-50.2	-2.3	-41.0	-7.2	-56.8
Dax 30	4381	-6.2	-45.7	-1.3	-35.7	-6.3	-52.9
SBF 250	2096	-8.0	-47.0	-3.2	-37.2	-8.1	-54.1
Milan Comit General	887	-8.5	-51.8	-3.8	-42.9	-8.6	-58.2
Madrid S.E. General	908	-4.5	-44.7	0.5	-34.5	-4.5	-52.0
Netherlands - CBS All Share	229	-9.2	-55.5	-4.4	-47.3	-9.2	-61.4
Swiss Market Index	5531	-4.9	-34.8	-0.5	-17.5	-5.5	-39.6
Topix	786	-5.9	-46.7	2.6	-11.7	-2.6	-35.4
FT/S&P World Pacific Basin ex Japan	213	-5.0	-48.7	-1.1	-43.5	-6.1	-58.6
ASX 200	3490	-6.7	-45.0	-4.1	-45.5	-9.0	-60.1
Hang Seng	13846	-0.3	-50.2	5.0	-31.6	-0.3	-49.9
FTSE Singapore All Share	396	-3.4	-56.4	0.7	-43.7	-4.4	-58.8
Kuala Lumpar Composite	838	-3.2	-42.0	1.5	-27.9	-3.6	-47.3
Korea S.E. Composite	1028	-4.5	-45.8	0.2	-52.9	-4.9	-65.5
Taiwan S.E. Weighted Index	4225	-5.3	-50.3	-1.2	-34.5	-6.2	-52.1
Bangkok S.E.T.	393	-2.2	-54.2	2.7	-40.9	-2.5	-56.7
Mexico IPC (Bolsa)	20082	-2.2	-32.0	-0.7	-26.2	-5.7	-46.0
Brazil Bovespa	35347	-3.4	-44.7	-10.3	-48.1	-14.8	-62.0
Argentinian Merval	1005	1.1	-53.3	3.8	-41.9	-1.5	-57.4
US Treas. Benchmark Bond - 30Yr	3.11	5.9	23.5	11.5	68.7	5.9	23.5
US Treas. Benchmark Bond 10 Yr	2.65	2.4	14.3	7.9	56.1	2.4	14.3
UK Benchmark Bond 10 Yr	3.42	2.5	11.2	2.5	11.2	-2.7	-18.6
Japan Benchmark Bond 10Yr	1.37	0.2	2.5	9.2	69.9	3.7	24.4
German Benchmark Bond - 10 Yr	3.00	2.1	14.2	7.4	35.3	2.0	-1.0
FTA British GVT IL 5% Infl. Over 5 Yrs	1.55	1.7	-5.8	1.7	-5.8	-3.4	-31.1
US Treas. Index Linked Bond > 5 Yrs	3.48	5.8	-3.2	11.4	32.3	5.8	-3.2
Lehman US Credit Agg A	7.95	1.8	-10.8	-	-	1.8	-10.8
Lehman US Credit Agg AA	6.24	1.4	-2.0	-	-	1.4	-2.0
Lehman US Credit Agg AAA	3.61	1.3	6.1	-	-	1.3	6.1
Lehman US Credit Agg BAA	9.63	0.7	-13.8	-	-	0.7	-13.8
Merrill Lynch UK All Stocks	8.43	1.6	-9.2	1.6	-9.2	-3.5	-33.5
Merrill Lynch UK Credit A	9.49	1.7	-13.5	1.7	-13.5	-3.4	-36.7
Merrill Lynch UK Credit AA	7.03	1.7	-4.6	1.7	-4.6	-3.5	-30.2
Merrill Lynch UK Credit AAA	6.16	1.6	-1.4	1.6	-1.4	-3.5	-27.8
Brent Oil ($/Barrel)	39.2	-	-	-14.9	-42.9	-19.2	-58.2
Gold Bullion $/ Troy Oz	748	-	-	-3.1	22.2	-7.9	-10.5
Economist Commodity Index ($)	151.7	-	-	1.6	-5.7	-3.6	-31.0
Currencies	***vs $***	***vs £***					
¥	92.0	134.1		9.0	65.8	3.5	21.4
$	-	1.46		5.3	36.6	-	-
Euro	1.268	0.870		5.2	18.5	-0.1	-13.3
Aus $	0.64	2.29		2.8	-1.1	-2.4	-27.6

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Economic Outlook

GDP growth (%)	2007	2008*	2009*
US	2.0	0.3	-2.0
Japan	2.0	0.2	-1.2
Euro-area	2.6	0.9	-1.0
UK	3.0	0.6	-2.5
G7	2.1	0.3	-1.0
Asia ex Japan	8.9	7.0	5.0
World	5.0	2.3	0.8

Plunging business and consumer confidence suggest the US, UK, Euro-zone and Japanese economies will experience a severe recession. Lower oil and food prices and cuts in interest rates may allow a recovery to commence in the second half of 2009 but growth could struggle to reach trend rates until 2010.
Asia will not be immune to the global slowdown but may avoid recession.

Inflation (%)	2007	2008*	2009*
US (core)	2.3	2.3	1.3
Japan	0.1	1.5	-0.5
Euro-area	2.1	3.2	0.5
UK	2.3	3.7	0.7
G7 (headline)	2.2	3.0	0.5
Asia ex Japan	4.5	6.7	4.5
World	4.1	5.9	2.5

Recessions and periods of de-leveraging are almost always associated with falling inflation pressures. Thus, weaker economic growth is likely to lead to a fall in core inflation in developed economies.
The risks of headline deflation have increased substantially.

Interest rates (%)	05 Dec 08	May 2009*
US	1.00	0.50
Japan	0.26	0.30
Euro-area	3.25	1.50
UK	2.00	1.50

The rapid deterioration in the economic outlook for Europe and the UK is likely to lead to more interest rate cuts in coming months.
The Federal Reserve may also ease policy again in response to weak growth and continued problems in the financial system.

Currencies	05 Dec 08	May 2009*
Yen/$	92	108
$/euro	1.27	1.15
£/euro	0.87	0.70
$/£	1.46	1.80

The US dollar may extend its recent gains against sterling and the euro if interest rates are cut in the UK and Europe.
The yen is likely to be volatile while leveraged investors are unwinding trades.

* Henderson Global Investors' forecast

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Financial Market Outlook

Govt 10-year bonds (%)	05 Dec 08	May 2009*
US	2.65	3.25
Japan	1.37	1.00
Euro-area	3.00	3.25
UK	3.42	3.50

Bond yields could drop in the near future if central banks cut short-term interest rates and the growth outlook worsens.
Except in the worst scenarios, bonds are not good value on a medium-term perspective and yields could be rising by the second half of next year.

EPS growth (%)	2007
US	-4
Japan	7
Euro-area	15
UK	8
Asia ex Japan	45

Weaker global growth and the effect of buoyant commodity prices on margins are likely to combine to produce disappointing earnings growth in 2008.
Any recovery in earnings in 2009 will probably be modest, in line with expectations for output growth.

P/E ratios	2007
US	11
Japan	9
Euro-area	7
UK	8

Equity markets appear cheap but valuation is playing no part in the current environment. Investors fear large earnings downgrades and cuts in dividends and will only return to valuation when the economic outlook is more certain.

Equity markets	05 Dec 08
US (S&P 500)	876
Japan (Topix)	786
Euro-area (DJ Eurostoxx)	206
UK (FT All Share)	2014
MSCI Asia x Jap US$	255
MS emerging markets US$	498

Equity markets are likely to remain volatile in the short-term and could fall even further on forced selling and fears about the financial sector and the global economic outlook.
By the second half of next year, assuming the outlook for 2010 is brighter, equities might be staging a sustainable recovery.

* Henderson Global Investors' forecast