

## Weekly Economic & Market Update

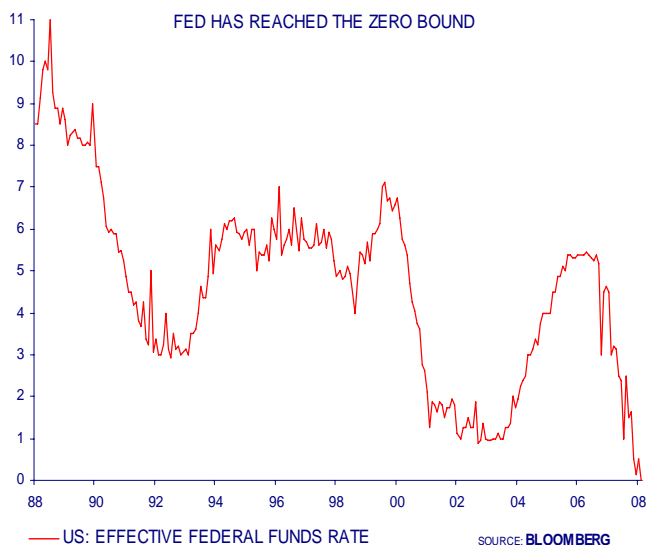
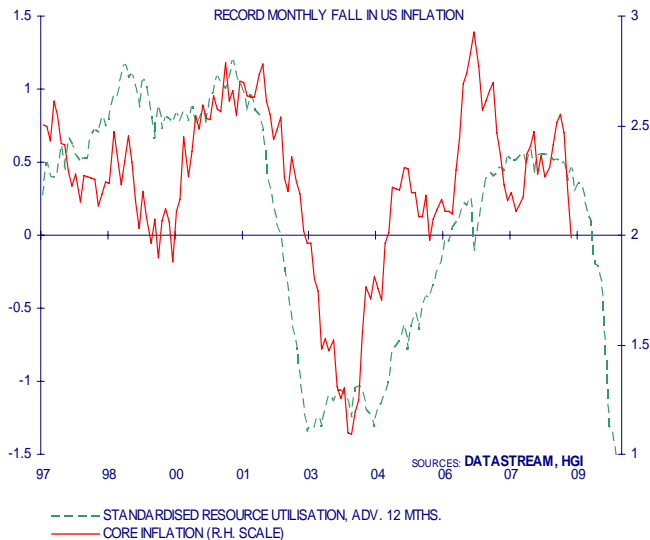
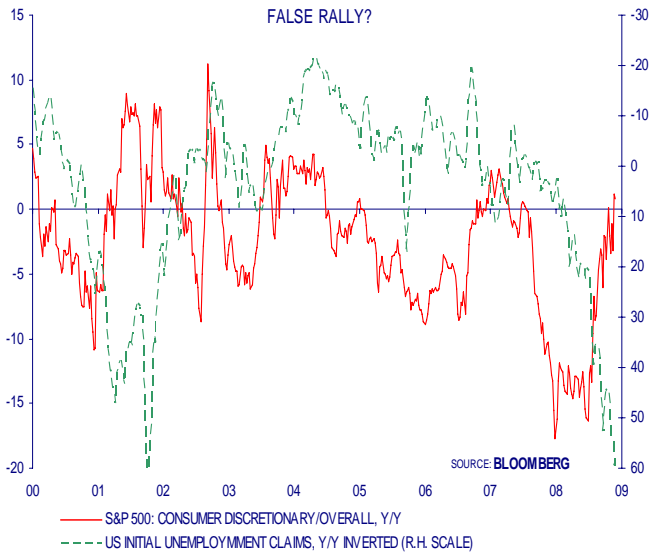
### Highlights

- Global equities have made gains in three out of the last four weeks.
- US consumer prices experienced their largest monthly decline on record in November.
- The US Federal Reserve (Fed) lowered its target for the overnight interest rate to a range of 0 to 0.25%.
- There are signs that the plunge in high frequency leading indicators of activity may be abating.

### Views

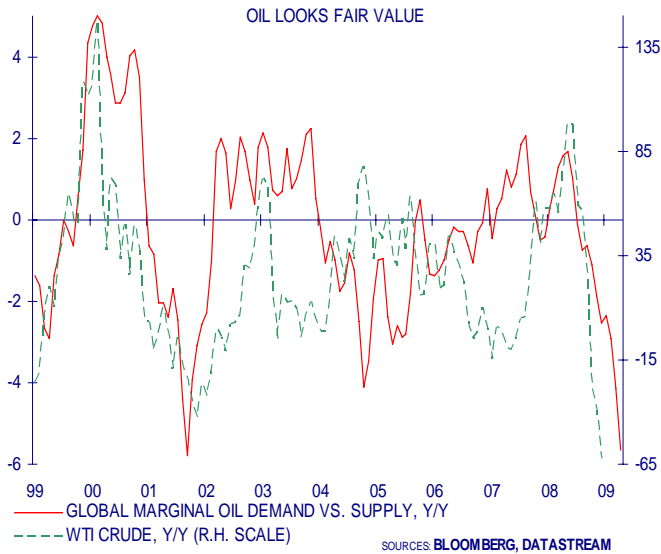
- The bounce in equities appears to be more technical in nature rather than fundamental.
- US core inflation is expected to fall to around 1% and headline prices are likely to deflate for 6-9 months in 2009.
- Having reached the zero bound in interest rates, the Fed's main tool for affecting monetary policy is now quantitative easing. Appropriately, the Fed noted that 'the committee is also evaluating the potential benefits of purchasing longer-term Treasury securities'.
- The November Philadelphia Fed index and advance December Eurozone PMIs both saw their rate of decline slow whilst the US ECRI index (an important US leading indicator) and the Baltic dry index of global shipping activity actually bounced.

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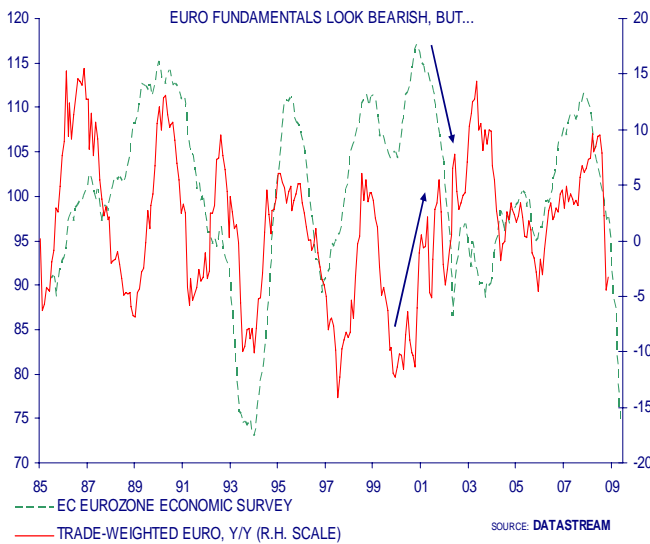


- Global equities have made gains in three out of the last four weeks. However, the bounce in equities appears to be more technical in nature rather than fundamental.
- The rally has been lead by consumer discretionary stocks at a time when global unemployment is on the rise. Such rallies have proved unsustainable in previous bear markets.
- Given this price action, a retest of the cyclical lows in equities looks probable. Once labour market conditions stabilise, interest rate sensitive sectors, such as consumer discretionary, should indeed lead the rally as they did in mid 2003.
- US consumer prices experienced their largest monthly decline on record in November. The headline CPI fell 1.7% on the month and core was flat.
- Energy contributed to most of the fall in the headline measure but there has been no sequential inflation in the other 90% of the CPI basket (core) in the last two months.
- Going forward core inflation is expected to fall to around 1% and headline prices are likely to deflate for 6-9 months in 2009.
- The US Federal Reserve (Fed) lowered its target for the overnight interest rate to a range of 0 to 0.25% and indicated that it would remain there for 'some time'.
- The Fed also reiterated its commitment to purchasing agency debt and mortgage-backed securities 'in large quantities' and indicated that it 'stands ready to expand its purchases...as conditions warrant'.
- Importantly the Fed noted that 'the committee is also evaluating the potential benefits of purchasing longer-term Treasury securities'. Despite having already rallied significantly, 30-year treasury yields fell another 23 basis points following the Fed announcement.

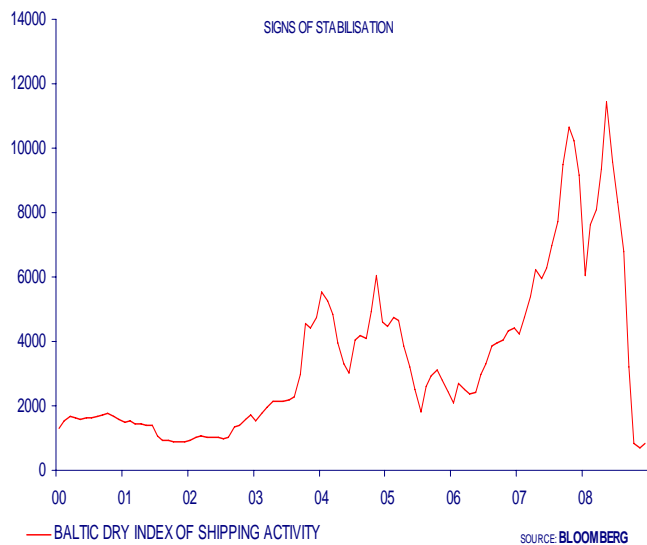
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- The crude oil price is down 75% from its peak reached less than six months ago. Despite large cuts in OPEC production and statements that more are to come oil continues to decline.
- Thus far, the decline in oil prices appears to have been in line with fundamentals (chart). However, net open interest in the futures market has surged into the selloff indicating that speculators are likely to be heavily involved. This opens up the prospect for a sharp profit taking rally which could quickly become a 'short squeeze'.
- Nevertheless, as long as leading indicators of economic growth continue to decline, a sustainable rally in any commodity price is unlikely.



- The euro has been one of the strongest performing currencies globally in December, and certainly the strongest against the majors.
- Market participants find the euro strength difficult to explain as it seems unlikely that the eurozone economy will be stronger than any other region or that the ECB will have to cut interest less than any other central bank.
- However, euro strength during an ECB cutting cycle has precedent. The trade-weighted euro rallied as the ECB cut its target rate during the 2000-2003 period.
- Thus, notwithstanding that the euro looks expensive against the majors, the rally could continue.



- Global output is expected to contract sharply in the fourth quarter of this year and the first in 2009. However, the visibility beyond six months is somewhat mixed. Certainly, a return to trend growth isn't expected until at least 2010.
- However, there are signs that the plunge in high frequency leading indicators of activity may be abating.
- Examples include: the November Philadelphia Fed index and advance December Eurozone PMIs both saw their rate of decline slow whilst the US ECRI index (an important US leading indicator) and the Baltic dry index of global shipping activity actually bounced. It's early days, but these are all positive signs nonetheless.

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11/12/08 to 18/12/08	Index	Local Returns		Sterling Returns		US Dollar Returns	
		% Week	Year to Date	% Week	Year to Date	% Week	Year to Date
FTSE All Share	2163	-1.1	-34.2	-1.1	-34.2	1.6	-49.3
FTSE 100	4331	-1.3	-32.9	-1.3	-32.9	1.3	-48.3
S&P 500 Composite	885	1.3	-39.7	-1.3	-21.8	1.3	-39.7
NASDAQ Composite	1552	3.0	-41.5	0.3	-24.0	3.0	-41.5
Toronto S.E 300 Composite	8425	0.4	-39.1	0.5	-34.6	3.2	-49.6
Dow Jones Euro Stoxx	223	-1.1	-46.4	5.4	-31.1	8.2	-46.9
Dax 30	4756	-0.2	-41.0	6.4	-24.2	9.2	-41.6
SBF 250	2261	-2.1	-42.9	4.3	-26.6	7.1	-43.4
Milan Comit General	950	-1.4	-48.4	5.1	-33.7	7.9	-48.9
Madrid S.E. General	985	0.7	-40.0	7.3	-22.9	10.1	-40.6
Netherlands - CBS All Share	250	-1.9	-51.6	4.6	-37.7	7.3	-52.0
Swiss Market Index	5515	-3.8	-35.0	5.3	-9.9	8.1	-30.6
Topix	839	-1.2	-43.2	-1.0	-7.7	1.6	-28.8
FT/S&P World Pacific Basin ex Japan	238	0.5	-43.7	1.2	-36.7	3.9	-51.2
ASX 200	3581	-0.5	-43.5	1.7	-41.1	4.4	-54.6
Hang Seng	15498	-0.7	-44.3	-3.3	-27.2	-0.7	-43.9
FTSE Singapore All Share	430	0.9	-52.7	2.3	-38.0	5.1	-52.2
Kuala Lumpur Composite	881	2.3	-39.1	2.7	-24.5	5.4	-41.8
Korea S.E. Composite	1176	1.9	-38.0	4.6	-42.2	7.3	-55.2
Taiwan S.E. Weighted Index	4695	0.8	-44.8	0.8	-28.4	3.4	-44.9
Bangkok S.E.T.	452	6.4	-47.4	5.9	-33.0	8.7	-48.4
Mexico IPC (Bolsa)	22347	4.4	-24.3	1.5	-18.9	4.2	-37.5
Brazil Bovespa	39536	2.6	-38.1	0.3	-39.3	3.0	-53.2
Argentinian Merval	1108	1.7	-48.5	-0.9	-38.3	1.7	-52.4
US Treas. Benchmark Bond - 30Yr	2.55	8.0	31.6	5.2	70.8	8.0	31.6
US Treas. Benchmark Bond 10 Yr	2.08	4.3	18.7	1.6	54.1	4.3	18.7
UK Benchmark Bond 10 Yr	3.17	3.0	12.9	3.0	12.9	5.7	-13.0
Japan Benchmark Bond 10Yr	1.26	1.3	3.4	1.6	67.9	4.3	29.5
German Benchmark Bond - 10 Yr	2.97	1.8	14.6	8.5	47.3	11.4	13.5
FTA British GVT IL 5% Infl. Over 5 Yrs	1.14	5.0	-0.7	5.0	-0.7	7.8	-23.5
US Treas. Index Linked Bond > 5 Yrs	2.90	5.4	1.5	2.7	31.8	5.4	1.5
Lehman US Credit Agg A	7.24	4.3	-6.0	-	-	4.3	-6.0
Lehman US Credit Agg AA	5.57	3.0	1.8	-	-	3.0	1.8
Lehman US Credit Agg AAA	3.18	2.3	9.0	-	-	2.3	9.0
Lehman US Credit Agg BAA	9.01	3.9	-9.8	-	-	3.9	-9.8
Merrill Lynch UK All Stocks	8.37	1.7	-9.0	1.7	-9.0	4.4	-29.9
Merrill Lynch UK Credit A	9.51	1.8	-13.6	1.8	-13.6	4.5	-33.4
Merrill Lynch UK Credit AA	7.00	1.3	-4.5	1.3	-4.5	4.0	-26.4
Merrill Lynch UK Credit AAA	5.78	2.2	-0.1	2.2	-0.1	4.9	-23.0
Brent Oil (\$/Barrel)	41.4	-	-	-11.0	-42.7	-8.6	-55.9
Gold Bullion \$/ Troy Oz	850	-	-	0.3	31.9	2.9	1.6
Economist Commodity Index (\$)	150.6	-	-	2.1	-11.1	4.8	-31.5
Currencies	<b>vs \$</b>	<b>vs £</b>					
¥	89.2	136.8		0.2	62.4	2.9	25.2
\$	-	1.53		-2.6	29.8	-	-
Euro	1.448	0.944		6.6	28.5	9.4	-1.0
Aus \$	0.71	2.17		2.2	4.3	4.9	-19.6

## Weekly Economic & Market Update

### Economic Outlook

<b>GDP growth (%)</b>	<b>2007</b>	<b>2008*</b>	<b>2009*</b>
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	-2.0
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. Emerging markets growth appears to have slowed sharply in November.

<b>Inflation (%)</b>	<b>2007</b>	<b>2008*</b>	<b>2009*</b>
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.

<b>Interest rates (%)</b>	<b>19 Dec 08</b>	<b>May 2009*</b>
US	0.25	
Japan	0.20	0.10
Euro-area	2.50	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 however quantitative easing has now become its most potent policy tool.

<b>Currencies</b>	<b>19 Dec 08</b>	<b>May 2009*</b>
Yen/\$	90	108
\$/euro	1.39	1.15
£/euro	0.93	0.70
\$/£	1.49	1.80

Euro strength appears to have gone too far against both the US dollar and sterling. The Bank of Japan has expressed its displeasure with recent yen strength. It appears as if JPY/USD 90 is the the BOJ's comfort level.

\* Henderson Global Investors' forecast

## Weekly Economic & Market Update

### Financial Market Outlook

Govt 10-year bonds (%)	19 Dec 08	May 2009*
US	2.08	3.25
Japan	1.23	1.00
Euro-area	2.97	3.25
UK	3.17	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	9

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	19 Dec 08
US (S&P 500)	885
Japan (Topix)	834
Euro-area (DJ Eurostoxx)	223
UK (FT All Share)	2163
MSCI Asia x Jap US\$	302
MS emerging markets US\$	590

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

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