Investment Management Market Report
Source: Deutsche Bank Offshore, 01 October 2001

Global Overview
The recent terrorist attack on America comes at a time of pronounced instability in the world economy. Quite clearly, market expectations and forecasts have been discarded and future expectations are clearly tainted with the increasing likelihood of continued military retaliation by the United States.

Prior to the destruction of the World Trade Centre, we were of the opinion that investment markets would begin to show recovery in the fourth quarter, led by surprisingly resilient consumer spending in the US, and the long awaited impact of the monetary easing adopted by the US, having a positive effect on company earnings. In turn, we believed that we were close to the bottom of the interest rate cycle, and that the US economy would not slip into recession, and that we could expect interest rates to turn during 2002.

As a direct consequence of the terrorist attack, interest rates around the globe are likely to continue falling, and indeed we have already witnessed swift action by the Federal Reserve, the European Central Bank, and the MPC in the United Kingdom in this respect, in an attempt to bolster the falling markets. In addition, there has been a commitment from the US Administration that public monies will be available to support those industries that suffer most in the wake of this atrocity.

A degree of uncertainty hangs over the market, in that it is unclear as to what form or duration any reprisals will take, early attacks suggest military targets as a priority. Expectations for investment growth will have to be scaled back substantially, as it is a central expectation that the struggle against terrorism will continue for some time, and we believe that the economic and financial policies that will ultimately emerge from this period will remain with us for some time to come.

Near term, the focus will be on the stability of Pakistan, and its relations with Afghanistan and others in the region. The Pakistan government has already urged that the reprisals are not long drawn out, as there has already been strong condemnation of the early attacks. We believe the near term deterioration in economic conditions in the US will in time be overpowered by a massive fiscal stimulus. Our expectations would also include a substantial increase in defence spending and a continuation of an accommodative monetary policy, until such time as the economy shows signs of sustainable growth.

The US Economy is now in recession, and will pull the rest of the global economy down with it. Global growth is expected to slip to 2.2% this year from 4.7% in 2000, the lowest since 1992. Central bankers in all major economies will be reducing interest rates further, in order to provide some stimulus for growth. We believe that growth in the main economies will be heading back to trend by the end of 2002, through a combination of fiscal and monetary stimulus.

In anticipation of interest rates falling further, bond markets have already responded, with short dated issues offering an attractive short term safe haven for investors. Arguably however, these returns will look less attractive if inflation picks up, which could be a very real consequence as a result of the risk of a substantial increase in the price of oil, as witnessed in previous military conflicts. Much depends on the scope and duration of the forthcoming US military operations, and the most immediate risks appear to be on the downside.

The outlook could brighten considerably if consumer confidence and spending holds up more robustly than we expect in the face of recent events. We should also consider the possibility that the recent strike in Afghanistan credibly reduces the immediate terrorist threat, and this would give sentiment a considerable lift. The Gulf war was won more easily, and at a lower cost than many had feared. We would however have to concede that the chances of a surprise in that direction seem unlikely on this occasion.

One final risk concerns US Dollar exchange rates. Our baseline forecast sees the Dollar depreciating further in the near term, especially against the Euro, but then deriving some strength later next year from a pick up in the economy. A sharp decline in the Dollar would be a plus for the US Economy via increased net exports, and would mean that the Federal Reserve could change course on interest rates sooner than expected.

In conclusion the continued uncertainty that hangs over US military reaction is causing anxiety in investment markets. Whilst it is true that we believe there are some very cheap stocks on offer, it is unlikely that there will be any marked or sustainable rebound whilst military considerations prevail. Notwithstanding this, we do not believe that there is a great deal of downside from current levels. It should be remembered that the low point for equity markets was actually marked by the commencement of military activity during the Gulf war, and thereafter markets moved in an upward direction.

We recognise that this is an anxious time for investors and should you wish to discuss matters in more detail, please do not hesitate to contact either Ryan Harrison or Jason Jones on + 44 1534 889270, for further comment.