

Quarterly Outlook

SAXO
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Welcome to our quarterly outlook for the Global economy

The economy is continuing to deteriorate dramatically, but the pace of decline is petering out. Leading indicators are still pointing lower and the money supply figures are not a cause for celebration. Stocks will continue to suffer from earnings revisions and downgrades. We maintain that stocks could go significantly lower and our target for S&P500 is 500 within 2009. The Fed, SNB and BoE have begun on Quantitative Easing programs, but the experience from Japan is not impressive and we do not expect these activities to have any lasting impact on the interest rates.



DAVID BAKKEGAARD KARSBØL
CHIEF ECONOMIST

David Karsbøl is Chief Economist and Head of the Saxo Bank Strategy Team. He is responsible for the overall macroeconomic views of Saxo Bank. He has a Master's degree in economics (cand.polit.) from the University of Copenhagen, where he specialised in finance, statistics and monetary economics. His master's thesis was about the pricing of gold since 1971 and he is known for his contrarian thoughts. He is available for comments on the macroeconomic situation and forecasts.

David Karsbøl concentrates on Business Cycle Analysis and subscribes to the reasoning of the so-called Austrian School of Economics (Menger, Schumpeter, von Mises, von Hayek etc.). He believes that understanding debt cycles is integral to understanding the general business cycle.



CHRISTIAN TEGLLUND BLAABJERG
CHIEF EQUITY STRATEGIST

Christian Tegllund Blaabjerg grew up in Kolding, Denmark, and has a broad educational background ranging from a Masters in Political Science from University of Aarhus to a degree in finance from ASB, Aarhus School of Business. Prior to joining Saxo Bank in 2007 Christian was a quantitative analyst in Danish company Novozymes A/S within sales and marketing.

Christian works with equity analysis both on single company and equity markets level. His primary focus is to develop trading models using various approaches based on statistics/econometrics. Mr. Blaabjerg is available for comments on major companies as well as equity markets in general.

Christian Tegllund Blaabjerg appears regularly on major financial news networks and printed media, commenting on single stocks and stock market developments.



JOHN HARDY
CONSULTING FX STRATEGIST

John Hardy graduated from University of Texas at Austin (graduated with high honours). John is Consulting FX Strategist for Saxo Bank. John has developed a broad following from his popular and often quoted daily Forex Market Update column, received by Saxo Bank clients and partners, the press and sales traders.

John is a regular guest and commentator on television networks, including CNBC and Bloomberg. He also writes regular ad-hoc commentary focusing on the major currencies, Central Bank policies, macro-economic trends and other developments and is one of the authors of the Saxo Bank Yearly Outlooks and 10 Outrageous Predictions.

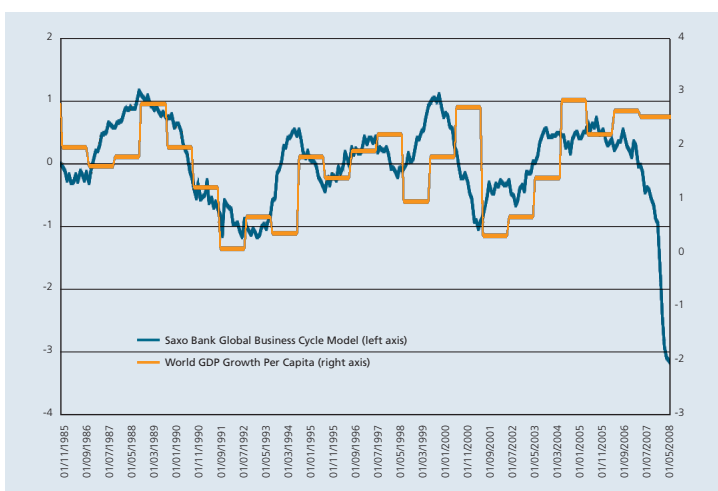


JENS BALLEGÅRD CHRISTENSEN
MARKET ANALYST

Mr. Christensen joined the Saxo Bank Strategy team in February 2009 as Market Analyst. He started his career in Saxo Bank in March 2007, initially as student assistant and later as intern in the London office. From January 2008 Mr. Christensen held a position in Saxo Asset Management. He holds an AP Degree in Financial Management.

MACRO: FURTHER DETERIORATION OF ECONOMIC ACTIVITY

The overall level of economic activity has continued the rapid deceleration observed in late 2008. Our Global Business Cycle Indicator only recently (the last two months), began declining at a slower pace and is now suggesting that 2009 World GDP per Capita growth will be around -2.5%. For the most export oriented countries (Japan, Germany and China), this slowdown is hitting them hard and will lead to severe recessions with even more negative growth rates.



Leading Indicators give no hope for a near-by recovery. Some of them – especially for the US – have actually edged higher in the past two months, but that is exclusively due to an explosion in the Base Money Supply, which is leading to an increase in M2 Money Supply (35% of US Leading Indicators). However, the Base Money is sitting idle on the balance sheets of the banks and non-M2 Leading Indicators are pointing decidedly lower. Furthermore, lending activities, New Orders, Factory Orders (both down by 25-30 percent YoY across the board) and Exports are all pointing in the same, gloomy direction: deeply lower.

Global Capacity Utilisation is also in a free fall, which is indicating massive over-capacity in the manufacturing industry. This is deflationary and we are maintaining the forecast of 2009 as a year of deflation. This is especially priced-in in the US and Japan, where deflation over the next two years according to Break-Even Inflation Rates is expected around -2% per year. 5-year inflation rates are still positive in most countries with Japan expected to be worst off (-2.5%), and US (+0.36%), UK (+0.95%) and Germany (+0.71%) still expected to have rising prices.

We still believe that writedowns from Eastern Europe and Chinese deceleration will be the primary drivers for negative growth and deflation for the rest of the year. That should lead to lower interest rates, but the fact that the Obama-administration plans to roll and issue around \$6.3T of debt in the next twelve months alone poses a huge risk to the interest rate outlook, if the Chinese and Japanese are getting tired of rolling their debt at less than 70 bps. The stakes are high and they are not getting smaller as we head further into 2009. Fix your borrowing costs now, if possible.

EQ: EARNINGS TO CONTINUE DECLINING

Earnings expectations have been slashed during the first quarter of 2009 as the outlook for equities in 2009-2010 turned more and more bleak on the back of weakening fundamentals. We are still negative on equities due to that our base scenario for the economy is deflation and we do not find that equities are outright cheap currently.

Despite bailout packages of companies, housing market stability packages and growth packages our macroeconomic team still sticks to our originally posted deflationary scenario. Combined with the fact that we are now facing negative growth across the globe we believe that equities still will experience headwinds in the coming quarters.

We do not expect the market to begin pricing in a sustainable recovery in Ex-financials until we get closer (maybe only one quarter out) to the earnings through, which on our quarterly expectations will not occur until 1st quarter of 2010. Prior we believed this would occur in the 4th quarter of 2009, but due to the development in the global economy we no longer find this likely.

EARNINGS ESTIMATES FOR 2009

We revise our original estimates for earnings growth in the Yearly Outlook on the back of our macroeconomic view. We are especially concerned on the development in Europe and Japan, as we see the growth in the overall economy here contracting more than originally expected.

FIGURE 1

Earnings estimates (ex. Financials) for 2009.

	Europe	US	Japan
Old Expected Earnings Growth (ex. Financials)	-36%	-30%	-41%
New Expected Earnings Growth (ex. Financials)	-40%	-33%	-47%

As can be derived from figure 1 we are lowering our earnings expectations growth for 2009 with 13% for Europe, 14% for Japan and 8% for US.

TARGET VALUATIONS FOR INDICES

As a consequence of our lowering earnings expectations for Europe and Japan we are also lowering our target for the stock indices which are shown in figure 2.

FIGURE 2

Equity Index Targets based on DDM simulations.

	18 March 2008	Lows 2009 based on DDM Valuation (old)	Lows 2009 based on DDM Valuation (new)
DJ Stoxx600	171	189	164
S&P500	794	610	500
Nikkei225	7972	5350	4600

FX: THE EFFECTS OF MONETISATION

The main theme that has taken over the currency market as we head into the end of the first quarter is one of competitive devaluation: a race to the bottom by major central banks who are increasingly taking up ever more aggressive, non-traditional monetary policy measures in an effort to revive their economies and stave off the risk of deflation now that rates are reaching the zero bound. The weakening effect on the currency from these non-traditional measures is often considered a helpful byproduct for the economy. The BoE has even commented on this on several occasions in recent months as it happily ushers the pound into the basement.

To take a brief look at where we have come from, we must remember that the Fed had already fired the first warning shots for its intent to go all out in a war against deflation late last year, when it first mentioned the idea of debt monetization, a move that sent EURUSD rocketing above 1.4500 briefly before it traded all the way back down to 1.2500 again by early March as the market was still in the older, simpler risk aversion/global deleveraging mode and could see that many other central banks were increasingly headed the way of the Fed and rate spreads versus US rates sharply narrowed. But then the Bank of England kicked off the competitive devaluation theme in earnest by moving to outright money printing by debt monetisation (direct buying of Gilts), suddenly leap-frogging the Fed's monetary aggressiveness.

Now on the cusp of a new quarter, the US Fed performed its own one-upmanship with a shocking opening of the monetary spigots via outright debt monetisation as well and a massive expansion of mortgage buying. Many had speculated that the FOMC might hem and haw on the money printing via treasury buying issue (i.e., debt monetisation, the most direct way to print money) for some time before actually going down this rout, but Bernanke and company obviously felt that the deterioration in US employment and activity was becoming too alarming and that it was safer to err on the side of too much rather than too little stimulus to credit markets. The Fed's moves pushed the greenback through the floor across the board, particularly against the Euro and the Yen and could set up further weakness in the near term.

So what is the outlook for the major currencies now at the end of the 1st quarter as the new competitive devaluation theme has taken hold and the old "global deleveraging" trade that terrorised markets in Q4 of last year seems to have faded? Our main macro view is that the market still does not appreciate how low equities and risk appetite can still go before we see any chance of stabilisation, so we see a significant risk that the market will be forced into risk aversion trades and the idea that things could get worse before they get better. Also very interesting to watch will be the attempts by the G20 and other international organs to bail out the world's trouble spots and rejigger global capital markets for a brave new financial world.

EUR: the Euro's success is the Euro's failure. The Euro is strengthening as the ECB has always had a philosophical distaste for the hyper-expansive measures and is clearly far less concerned about deflation. But Europe has its own peculiar problems that are still festering and must give the single currency further stress in the coming quarters: first, the strength of the currency itself will have a crippling effect on the EuroZone economy, particularly its traditionally strongest members like Germany. Second, the financial sector is still a huge worry as there is no credible plan to clean up European banks and their gigantic exposure to Eastern Europe, nor a credible plan to roll over the mounds of corporate debt that must be refinanced in the coming year. Third, there is the pressure on individual countries like Greece, Spain and Ireland who are suffering horribly under the yoke of the single currency and who will require a very expensive bailout if they are to avoid the path of threatening an exit from the monetary union.

USD: a goner or readying for a last hurrah? To be fully USD bearish, we would have to see the USD continuing to sell off as we see risk appetite declining. We can't help but think that the USD move lower as we head into the end of March is as much allied with the general and mystifying rally in risk appetite as it is about worries over the trajectory of the hyper-expansionist Fed monetary policy. Yes, in the long run, the USD must devalue for the obvious reasons recounted ad nauseum elsewhere, but the world still has a tendency to return to greenback as a safe harbor when risk aversion is at its worst, and we don't think we've seen the worst just yet. We still think there are a reasonable odds for a last hurrah in the dollar this year.

JPY: the deleveraging trade seems to be over - is JPY strength done for good? The Yen thrived best as the world launched into forced deleveraging mode last fall. As with the greenback, however, the new theme of competitive devaluation means that many fear aggressive new non-traditional monetary policy from the Bank of Japan due to its jaw-dropping economic weakness from the global trade meltdown and the effects of a strengthening currency. Since January, we have thus seen JPY weakness rather than strength, associated first with a rise in interest rates as the market has worried about the affects on the long end of US bonds, for example, and then by the general rally in risk appetite in March. With the Fed's new efforts aimed at smashing especially longer rates lower, the JPY has come storming back versus the dollar and could have bouts of strength for the rest of the year as the bond vigilantes may be a bit too premature here and as risk aversion returns. Still, we are unlikely to see the kind of strength and velocity from the Yen as we saw in the white knuckle panic last fall.

GBP: GBP has been the biggest "winner" in the race to the bottom. GBP has been a basket case for many good reasons as it was at the epi-center of the fall of world finance. At the same time, the country has a terrible fiscal position and is therefore one of the least able to afford the massive stimulus efforts it has announced. The weak pound is therefore a must and will help cushion some of the blow on the UK economy as it has become so cheap that the UK is now incredibly competitive. When things stabilise perhaps later this year, the pound could be in for a rebound, especially if the EuroZone problems see EURGBP finding resistance.

CHF: The SNB is on a war path. The SNB's approach to competitive devaluation was to make good on verbal intervention with the real kind. This has effectively removed the EURCHF trade as the classic risk barometer for now - at least on the downside. We suspect that CHF will not move much vs. the EUR as our call for a return to risk aversion will mean that CHF will be under pressure to strengthen, but few market participants will have the heart or the deep pockets to take on the SNB. Still, one might look to sell EURCHF on occasion in the coming quarters as a range trade whenever the market Pollyannas are singing the loudest.

AUD: Economic deterioration is taking hold quickly Down Under. Australia has avoided the worst of the financial sector meltdown as its banks were far better positioned than elsewhere, but it still must fight the typical "Anglo-economy" problem of an overleveraged consumer and particularly the weakness in its commodity industries. As we expect at least one more big round of risk aversion in the coming months, this could mean another round of weakness for the Aussie, particularly if hopes of a resilient China prove unfounded (reasonable odds for this in the short term). Further out, Aussie may be a bargain versus the likes of the Euro.

CAD: Canada's economy is making a remarkable "effort" to catch up with the US economic deterioration with the natural resource and manufacturing sectors now quickly imploding due to the weakness of its neighbor to the south. The best thing Canada has going for it in the long run was its fiscal and regulatory prudence while the times were good, meaning that it has a far superior starting point than the US as it entered the crisis. Still, the country needs a global recovery to get back on track economically, and its robust banks could mean some degree of capital outflows on vulture trades in which resources and companies abroad are snapped up at liquidation prices, so another round of CAD weakness could be in the cards for the loonie before things improve.

NZD: The kiwi will have a tough time strengthening in an environment of risk aversion due to its poor liquidity. But the weakness of the currency should eventually be a boost for the economy even if it hasn't shown up much in the trade balance so far with the collapse in commodity prices. But somewhere further down the road, the first commodities that are likely to stabilise and rebound are food commodities, which are vital for New Zealand's trade picture. So when things look the worst for the world economy and the S&P500 is trading at around 500, a short EURNZD trade might be an idea.... looking for a resurgent Asia somewhere in 2010.

NOK: nothing wrong with this currency, which should be one of the star performers, even if/when risk aversion resumes. With enormous resources built up over years of reaping gains for its fabulous oil exports, there is no reason to expect instability for Norway, which can sail through a couple of years of global economic carnage without much stress. Long NOK trades vs. EUR and CHF are worth a look in coming months.

SEK: this currency moves in close correlation with risk appetite. It reached a climax of weakness versus the Euro on over-played fears of its exposure to Eastern Europe and as the equity market hit the skids in early March. The krona has since rebounded, but could see another bout of weakness on continued worries over Eastern Europe exposure and risk aversion as well as its incredibly rapidly shrinking trade balance, but we would look for resilience against the Euro on any reapproach to the old highs in EURSEK

SPECIAL PIECE: NO LASTING IMPACT FROM QUANTITATIVE EASING

On Wednesday, March the 18th 2009, the Fed caught most market participants off guard by announcing the beginning of Quantitative Easing (QE) by buying longer-term Treasury securities together with a significant expansion in its purchases of Agency MBS and Agency debt. The Fed will purchase up to \$300bn in Treasuries over the next six months, which will be concentrated on the 2-10 year sector of the nominal curve. The market was clearly not anticipating the Fed's move with the US 10 year bond future up almost 5 points immediately after the announcement, pushing down the yield more than 40 basis points.

Since the beginning of the current crisis, the Fed has come up with several programs in an effort to encourage banks to lend more to the private sector and thereby stimulate a recovery of the economy. These initiatives have so far been termed as 'credit easing' opposed to 'quantitative easing', since they have been targeting asset purchases in markets where it was believed most needed. However, the Fed's balance sheet has increased from \$0,88T in August 2008 to \$1,88T last week through the purchase of private sector financial assets, and the difference between credit and quantitative easing must be seen as a question of merely semantics. The confusion between analysts has come to an end - what we are seeing now is a straight Zimbabwean-style monetisation of fiscal spending.

The concept of Quantitative Easing is fairly new and has not been conducted by many central banks in the past couple of decades, but the Fed only needs to look to the UK and BoE to get an idea of how it will work. As the Fed, the BoE has recently committed itself to purchase Gilts and executed the first operation on Tuesday with a bid-to-cover ratio of 7.35. That is, for every bond bought by the BoE, 7.35 were offered. This number is very high and a clear sign that the market is punishing the BoE for overpaying for the bonds it promised to buy. The problem is that the market already had priced the Gilts according

to yields that the market deemed a fair valuation - the BoE's purchases do not change this. The market will drive up yields on bonds again as soon as the buying pressure fades, which in turn will force the BoE - and now the Fed - to further purchases.

To make matters worse, the trade surpluses and therefore intervention-induced reserves are stalling in China and Japan, the two biggest buyers of US Treasuries. Thus the demand for Treasuries is set to decline significantly from here. This comes at a time where the US has to re-finance more than \$6T of debt over the next 12 months, which would imply a doubling of the M1 money supply if the Fed were to purchase 25% of this amount. Yesterday's new money will not help much to fill the gap.

The logical destination of this exercise will be that the central banks will end up owning all of its government's debt in order for the QE policy to work. The worst case scenario of this will be a destruction of the private capital market for sovereign debt - the best case scenario will have no effect.

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