

A tough climb ahead

Key investment views

Amid a tentative recovery and building structural risks to the global economy, we continue to recommend that investors proceed with caution. We have identified investment opportunities that we believe will either benefit from strong long-term underlying fundamentals or that remain at valuation levels that are inconsistent with the recovery phase of the business cycle.

Corporate bonds continue to offer attractive value

We think that investment grade corporate bonds will be able to earn solid returns and perform better than government bonds for the remainder of the year. Of course, the credit rally is unlikely to continue at its recent pace, but we still recommend building corporate credit exposure. The focus should be on higher quality, investment grade debt, as the potential for further outperformance in lower quality, high yield corporate bonds is more limited amid elevated default risks.

US dollar to weaken structurally

The US has built up a large quantitative easing program, which increases the risk that longer-term inflation there will be much higher than in countries with more sustainable monetary and fiscal policies. As the economy recovers, market participants will increasingly focus on how to pay for the policy measures employed to combat the crisis. This alone should place structural pressure on the US dollar to weaken. In addition, we also think the currency will offer a low yield, as policymakers will likely wait a long time to become more restrictive.

Emerging market economies to lead the upturn

The slowdown in the larger emerging market economies has been less dramatic than generally feared. Domestic demand is holding up comparatively well, especially in Brazil, China and India. In addition, a massive fiscal stimulus package in China will support growth in the Asian region in the second half of 2009. Although emerging market equities no longer trade at a material discount to global equities, we think they will continue to perform well thanks to strong underlying business cycle momentum and longer-term economic growth potential.

Energy stocks take support from oil prices

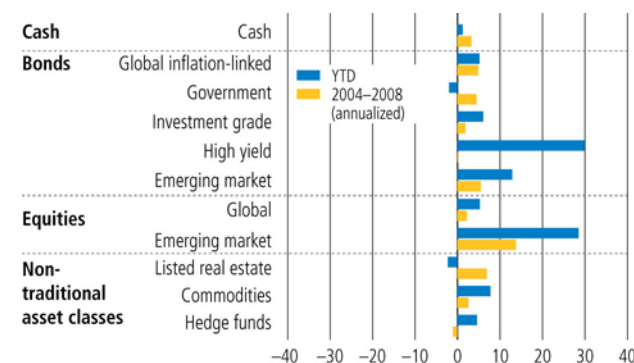
The energy sector has hardly reacted to the doubling of the oil price since the start of the year. In addition, analyst earnings expectations for the sector remain depressed and do not adequately reflect the recent upswing in oil prices, in our view. From a valuation perspective, energy stocks trade at a significant discount to the overall market and at a 25% discount to their historical average. Therefore, we expect energy stocks to outperform the overall market over the next several months.

Take profits in equities on further strong gains

We look to take profits in stocks on further strength and expect better entry points to emerge for those looking to build up exposure to equities. While we do not expect any major economic setbacks within the next three months, it will likely become more difficult for economic indicators to lift sentiment now that a recovery has become more widely anticipated. Evidence suggesting that the economy might be heading into a double-dip recession (which some also refer to as a W-shaped recovery) would only begin to emerge toward the beginning of 2010, although equities might anticipate such a potential downturn in advance.

Performance of main asset classes

Total return in %



Note: Information through June 22, 2009. Returns over five years are annualized. Source: Bloomberg, GPR, HFR, JP Morgan, Merrill Lynch, MSCI, Thomson Financial, UBS WMR

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Published in English, German, French, Italian, Spanish, Chinese traditional, Chinese simplified and Russian.

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