This section is brought to you by the Luxembourg based online broker Internaxx. Market analysis is provided by Fortis Investments, the asset management arm of the Fortis group

CEE markets to refocus on diversification, conservative products (source: Fortis Investments)
After rapid growth, central and eastern European financial markets plummeted in 2008 and many local currencies took a hit. The region saw investment outflows in all asset classes, even bond funds, which suffered from the high rates offered by banks chasing liquidity and rising market interest rates.

In spite of this, there is still potential, says Grzegorz Swietlik, head of the Warsaw representative office of Fortis Investments.
Falling interest rates should wean investors off their one-sided liking for term deposits and money market funds, which paid—and still pay—coupons well above the returns on, for instance, structured products. “Interest rates should slide further,” says Swietlik. This should benefit structured products. “Investors also forget that they will not be able to reinvest their money in deposits and money market funds at the same rate. Structured products have more to offer there.”

An appetite for better returns should encourage investors to look at international assets, resulting in more diversification across asset classes and countries. This would mean a shift away from local equities. Swietlik notes that the weakness of currencies such as the Czech crown or the forint could boost the sales of foreign funds in these denominations. But their returns are likely to suffer when these currencies strengthen again. “It is a case of buyer beware,” he comments.

Just like equities, foreign currency bonds might see inflows, but here too, the currency risk cannot be ignored. Thus, hedging should be an important feature for investors to look for when assessing equity and bond funds. “It would be wise to pick funds where the strengthening of these CEE currencies would have no or a limited impact,” says Swietlik.

As a result of the financial market rout, investors in central and eastern Europe are expected to develop an appreciation for safer investments with a more conservative approach and greater transparency. This could benefit the market for capital guaranteed funds, Swietlik says. Local bonds could also appeal to investors looking for safety. They already did well as interest rates came down, and with further monetary policy easing likely, should continue their positive run.

Deflation worries take hold, but equities tread water (source: Fortis Investments)
Equity markets have effectively moved sideways since November. All the doom and gloom has not pushed markets to below the lows of 20 November 2008, signalling that, apparently, a bleak scenario is discounted. We expect economic stabilisation in the second half of the year, which should be positive for equities, although we foresee a muted recovery. There is simply too much uncertainty to anticipate on such an improvement now. We remain neutral on equities.

Even the latest comments by the FOMC, the monetary policy committee of the Federal Reserve, could not turn the trend towards higher bond yields. It mentioned weak domestic and global demand and signalled interest rates would be kept low for a while. Demand for credit stayed weak. It did not mention deflation explicitly, but it is clear this risk is on its mind. Most important for bonds was a slightly greater appetite by the Fed to buy government bonds to lower yields. Eurozone economic sentiment and PMIs weakened further, while bank lending slowed. The flash inflation estimate for January was 1.1%. Although the ECB has been loath to cut rates further, we think it will be forced to do so.

Thus, many factors should support bonds, but instead, yields rose. The increase in the US was more pronounced than in Germany, indicating that investors are worried about the large US budget deficit. Although in our view these worries are reasonable, we do not see higher yields as sustainable. We have therefore stuck to a long duration position in the bond part of our model portfolio and to our flattening position for eurozone bonds in our tactical portfolios.

Inflation is falling rapidly around the world. This had been due mostly to falling commodity prices, which appear to have stabilised, but the continuing weakness in the global economy has now spread to non-energy prices. The latest US data had a distinct deflationary feel. The GDP deflator, the widest price measure, fell by 0.3% qoq annualised. Declines are extremely rare: the last time was in 1952. More deflationary data came in a report on consumer spending and prices. Income growth slowed sharply from 6% yoy in October 2007 to 1.4% in December 2008.

Other negative news came from US durable goods orders. They fell again in December, pointing to ongoing weakness in business investment. Other data showed new home sales so far have plunged by 76% from their peak, prices by 25%. Anything positive? The all-important ISM manufacturing index gained a few points for the first time since May, where it had been expected to be flat. The new orders component jumped. Although this is helpful, one has to bear in mind that the index remained firmly at recessionary levels.

Unemployment jumped from 4.1% to 4.4% in Japan in December. The ratio of jobs available for every applicant plunged to the lowest since November 2003. Household spending fell by 4.6% yoy in December, housing starts by 5.8% and industrial output by a staggering 20.6%. Plunging exports and a strong yen add to a toxic mix. With core inflation set to start falling, Japan is headed for another deflationary recession.
Joost van Leenders
Investment specialist investment strategy

Internaxx Top ten buys and sells –International Investors Activity summary

The 2008 Top Ten buys and sells are measured as the total number of trades carried out in each stock by Internaxx clients over the previous year. This report is not a recommendation to buy or sell these stocks

Top 10 January 2008

	Top 10 Buy	Top 10 Sell
1	Bank of America	BNP Paribas
2	Citigroup	Bank of America
3	AIG	Palm
4	BNP Paribas	Citigroup
5	Société Générale	Société Générale
6	Palm	Fortis
7	Fortis	
Arcelor Mittal		
8	Commerzbank	Nicox
9	Barclays	Merck
10	Deutsche Bank	Commerzbank