

Global Perspectives

June 2008

Recessions are never forever.

11 months ago (July 2007), we were about to enter one of the most disruptive financial storms ever, on the back of a downturn in the US residential real estate market, which actually started way back in 2006.

■ An unprecedented credit and liquidity crisis.

The surprise has come from **the extent** of the greed-induced **deterioration of credit standards**, and from **the extent** of the greed-induced meteoric rise in **leverage** in the banking system.

The credit-related problems which started in the by-now infamous sub-prime mortgage market, have spread to many other credit segments, with corporate credit spreads widening significantly.

From a simple problem of misallocation of funds to risky debtors at too low returns, we soon found ourselves in **a massive worldwide deleveraging phase**, with the epicentre obviously being in the US, more specifically in the US banking system.

As **banks have the highest and shortest-duration leverage**, that is where the panic started, that is where it spread and also where it stopped.

Stopped ?

Yes, the panic is over ! **The risk of a systemic domino-like collapse of the financial system is now close to zero.**

A dramatic monetary easing, the FED-induced acquisition of Bear Stearns by JPMorgan and the massive recapitalization of the banking system (more than 250 Bln Usd) has stopped the panic in its tracks.

■ Worries about a credit-crunch and a commodity-boom induced slowdown.

Many people will tell you we are not out of the woods yet. Some even say the worst is still to come.

We think that is rubbish !

The US and Europe are in a significant slowdown ! We can stop speculate about that as it is a fact. Whether the rest of the world will slow down too is now the hot topic.

At CapitalatWork we do not really worry, for two reasons.

1. Over the last 30 years, investors have almost systematically over-worried about the economy and underestimated its resilience. Free-market economies in a globalizing world have a host of global compensating forces at work for them.
2. Investors are always convinced economic slowdowns are bad times to invest. Actually the contrary is true, slowdowns are great times to invest.

Why ?

During slowdowns, many prices come down among which the price of money. Companies are under pressure and are forced to raise productivity.

Sooner or later economic activity picks up again and company profits along with it.

Economic slowdown ---> investors worry ---> lower stock prices ---> lower interest rates ---> higher cy productivity ---> Economic revival ---> higher corporate profits ---> high investment returns.

This time will be no different, now is a great time to invest !

- **All in all, a more prosperous and more peaceful Global Village**

We think the revival will come sooner rather than later because the rest of the world is still growing.

You have obviously heard a lot about China, India, Russia, Brazil , ... and for good reasons

More than 3 billion people yearning for increased living standards.

More than 3 billion people joining the race for food, energy, healthcare, ...

Think about the challenges, think about the opportunities !

The paradox is complete if you realize that **a slowdown in many of these emerging and overheating economies would actually be good news** (see The Economist May 24th).

So much so that emerging central banks would be well-advised to tighten monetary policy if the US and European slowdown does not slow down their economies. They would be well-advised to raise interest rates and/or let their undervalued currencies rise versus the Euro and the USDollar.

- **This time IS different !**

Of course some things are very different than in previous crises.

Some important prices have not come down at all. You obviously know what we are talking about. We are talking about most commodity prices and more in particular the price of oil which has more than quadrupled over the last three years and the price of agri-commodities which creates huge problems to feed the worlds' poor.

Again, the challenges are enormous and so are the opportunities.

We think that the credit-tightening will keep inflation in check in the US and Europe. As said higher Inflation is more a problem in emerging market economies which should also slow sooner or later.

Rightly or wrongly, inflation is again on everybody's lips. The best hedges against inflation are ...

* **inflation-linked bonds** in the fixed income space and, even better,

* **equity ownership of companies ...**

1. with a global presence,

2. which generate significant FCFs and are therefore not dependent on credit,

