

PRESS RELEASE

Portfolio strategy recommendations for 2008

Equities more attractive than bonds – Dax and commodities stocks are top picks

Frankfurt am Main, 26 November 2007. Equities offer greater potential than bonds over the medium term – this is the assessment of BHF-BANK’s analysts. According to Chief Investment Officer Kai Franke, the low interest rates do not offer adequate compensation for the growing risk of inflation. The equity markets, meanwhile, are benefiting from the sustained strength of the global economy and an attractive earnings yield. “Although the subprime crisis has triggered a strong correction, the key parameters suggest that prices will be back on the increase in the course of 2008,” explained Roland Ziegler, BHF-BANK equity strategist.

Asset allocation and equity market strategy in 2008

The bank’s analysts expect to see a further albeit less dynamic rise in profits. In Europe, their top picks for 2008 include the German DAX index and the commodities sector. The Japanese stock market is also back at a promising valuation level. “German blue chips are attractively valued in international terms. With their strong position on the global markets, they will enjoy above-average earnings potential in 2008, too,” equity strategist Kai Franke said. “The economic prospects are expected to brighten in the medium term, giving renewed impetus to the DAX. The pronounced weakness of the US dollar, however, is a risk factor.”

BHF-BANK’s equity experts believe that the commodity-intensive growth of the emerging markets will fuel the “basic resources” sector. Despite the outperformance of European commodities stocks in recent years, they are still trading at a discount to the overall market. European commodities equities benefit from a weaker US dollar. For the bank’s experts, the highly oil price-sensitive travel and leisure sector might well recover in the next few months. “The gloomy sentiment on the stock markets at the moment therefore represents an attractive investment opportunity,” equity expert Roland Ziegler explained. With a market discount of more than 10 per cent and a dividend yield of 3.7 per cent, the energy sector provides a sound basis in valuation terms. In the medium to long term, BHF-BANK’s analysts expect oil prices to rise further. “If the seasonal decline in energy prices we expect to see over the coming months materialises, we will use this favourable opportunity to reinvest in this sector,” Roland Ziegler added.

BHF-BANK's model portfolio provides for an equity weighting of 50.9 per cent, a bond weighting of 27.7 per cent and a cash position of 21.4 per cent. For the bank, the most promising sectors include oil & gas (4.6 per cent), utilities (3.2 per cent), basic materials (3.4 per cent), industrials (6.7 per cent), services (3 per cent), consumer goods (3 per cent), healthcare (3.7 per cent), financials (13.2 per cent), technology (4.4 per cent) and telecommunications (5.7 per cent), with individual stocks such as Goldman Sachs, BG Group, MAN, Telefonica, TomTom, EDF and Rio Tinto.

International bond markets – a defensive outlook for 2008

“The futures markets have priced in further interest rate cuts by the US Federal Reserve until mid-2008, not least due to the billions of credit risks thought to be lurking in bank balance sheets,” reported Annette Pacl-Schneeweis, BHF-BANK bond analyst. With the disinflationary effect of globalisation becoming less influential and the trend towards higher food prices continuing, a structural increase in inflation rates would come as no surprise.

“In all likelihood, the ECB will fail in its attempt to keep inflation below two per cent,” said Ms. Pacl-Schneeweis. “There is a significant risk of inflation on the one hand, and considerable risks to growth on the other.” Exchange rate trends, higher money market rates as well as tighter lending standards are already having a restrictive effect. “That is why the ECB will maintain a steady hand for the time being and leave the main refinancing rate at 4 per cent,” the bond expert explained. Rising inflation rates are likely to lead to higher inflation premiums and long-term interest rates.

The crisis on the financial markets is causing spreads to widen on the mortgage bond (*Pfandbrief*) market as well. “Short-dated mortgage bonds are particularly attractive at the moment due to their high yield premium. New issues also offer a slightly higher yield than papers already in circulation. Emerging market bonds denominated in euros and US dollars are anything but a bargain at the current spreads,” said Ms. Pacl-Schneeweis. On the bond markets, BHF-BANK recommends a weighting of 14.3 per cent in government bonds (Republic of Ireland, The Netherlands, the German federal state of Hesse), 11.3 per cent in mortgage bonds (HypEssen, Depfa, DG Hyp) and 2.1 per cent in corporate bonds (BASF, Suez).

Economic outlook

BHF-BANK's economists forecast global economic growth of 4.7 per cent for next year. While the industrialised countries will expand by 2.8 per cent, growth momentum will again mainly stem from the emerging markets, which are expected to grow by 6.6 per cent. In the United States, the purchasing

managers' indices suggest that the economy will weaken noticeably. As regards the frailty of the US dollar, a trend reversal is not yet in sight.

The business climate indicators of the European Monetary Union (EMU), too, point to slackening momentum – growth will decline from the previous year's 2.4 per cent to 1.3 per cent, and the risk of inflation will increase. The analysts forecast that inflation will continue to pick up pace, reaching up to 3 per cent at the beginning of the year. Towards the end of the year, inflation is expected to be in the lower 2 per cent range again. "The ifo business climate index is showing slackening economic growth in Germany as well," Chief Investment Officer Kai Franke said. The German economy is expected to grow by +1.4 per cent compared with 2.4 per cent in the previous year mainly due to the sharp downturn in consumer spending and investments.

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