

# Chief Economist's Comment

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## Peak has been reached

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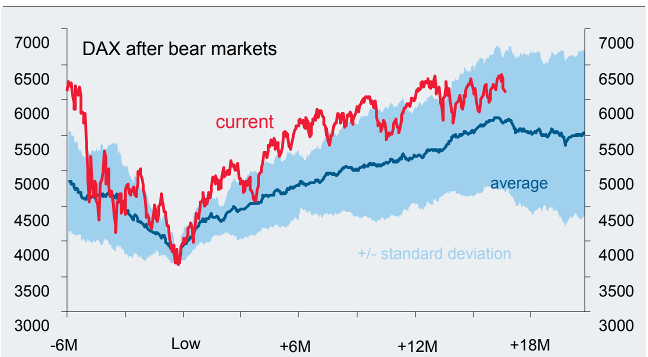
The German economy grew in the second quarter by 2.2 % over the previous quarter, or by 9 % using the American, annualized notation. Exports reached record levels, and German businesses are suffering from a shortage of skilled workers. If one combines these two components, this sounds like a boom and rising stock prices. In this environment, how can one explain why stock markets have pulled back noticeably over the last few days?

### Stock markets lead the way

Stock markets have the unpleasant habit of reacting not to past data, but anticipating future developments. That is why a look at the current numbers often gives rise to the presumption that stock markets have nothing to do with reality, but merely engage in irrational, wild movements. One should recall, for example, the spring of 2009, when fear of a slide into a global depression dominated the public discussion. The initial, fragile recovery trends among leading indicators were largely ignored, and market participants pointed out that the background conditions were so poor that no recovery was possible for the foreseeable future, and if it were possible, the feared credit crunch would quickly stifle any recovery.

Model cyclical upswing

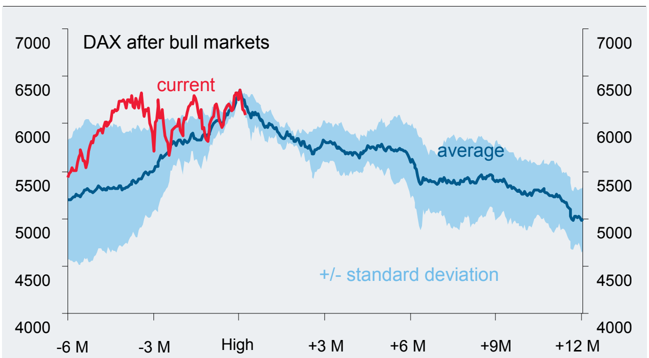
Indexed to the stock price low of March 3, 2009




Sources: Bloomberg, Helaba Research

Phase of weakness ahead

Indexed to the stock price high of August 9, 2010




Sources: Bloomberg, Helaba Research

### Model course

Things turned out differently, though. The DAX, but also stock markets around the world, posted a pronounced, dynamic recovery, which from our perspective can certainly be described as exemplary. From the low in March 2009, the German key index rose by 73 % to the high on August 9, that is, within seventeen months. The historical average is 71 % with a recovery duration of 18 months. This cyclical rally was thus nothing out of the ordinary. The trio of good growth and export figures and a strong demand for workers reported above confirms precisely the scenario that the stock markets had already anticipated.

### No further peak in sight

At the peak, the probability for a further rise is virtually nil – unless one finds a mountain that was previously unknown. Translated into financial language: if the cyclical stock price drivers do not improve further, which is already apparent with nearly all indicators, the stock markets can post further gains only if cyclical factors are joined also by positive structural factors.

### Structural strains

The fundamental environment, however, has rather tended to deteriorate recently. In an environment of increasing regulation, not only will the returns of the banks be limited, experience tells us that the so-called real economy will also move onto a flatter growth path. The era of new risk awareness, which I had already pointed to as far back as 2007, is not yet over.

### No new wealth effects

Even if the real estate markets around the world – with the exception of Germany – have undergone a severe correction since 2007 and a few markets are now showing slight recovery trends, this is surely not the prelude to a new boom, which means that no positive wealth effects can be expected from this for the foreseeable future.

### Sovereign debt as a negative factor

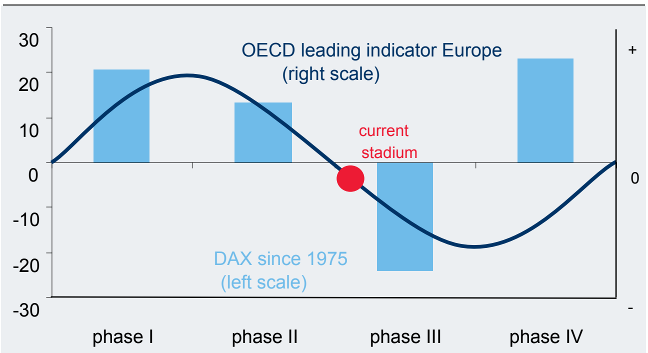
One must not forget sovereign debt, which is surging in most countries of the world and argues rather for a more restrictive fiscal policy over the next few years.

### Prospects more on the gloomy side

As a result, the prospects for stocks are more on the gloomy side from both a cyclical and structural perspective. Moreover, the valuations are anything but favourable for dividend-paying stocks.

Economic phase argues against stocks

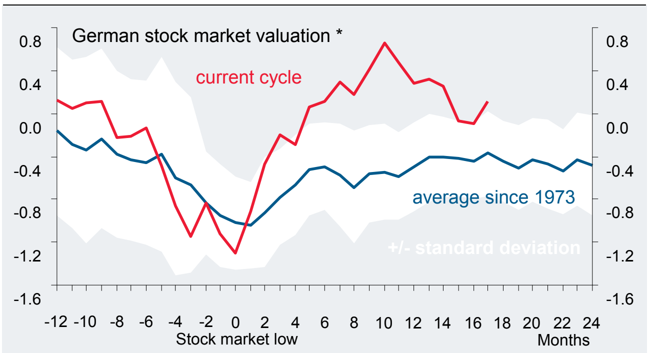
annualized performance, % stylized change over prior month




Sources: Datastream, Helaba Research

Stocks not really cheap

number of standard deviations




* Mean value from z-standardized PE, price/cash flow ration, price/book value and inverse of dividend yields

Sources: Datastream, Helaba Research

## Improvement of the labour market continues

Although the German indicators, like the ifo Business Climate Index or the Purchasing Managers' Index EMI, rose once again most recently, globally there are already signs of a slowdown in growth, which will also have repercussions in Germany in the second half of the year because of that country's strong dependence on exports. Because of the strong competitive situation of German industry, which is further boosted by the weakening of the euro, this pace should be sufficient, however, to lead to a further improvement in the labour market. Even if the stock markets will disappoint more likely than not, we should expect that the unemployment rate will continue to fall. A decline to 2.5 million in 2011 is quite realistic, also because of the demographic trend.

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