



Summary and investment conclusions

- The global economy is in the throes of a deep recession which is affecting developed and emerging economies alike.
- The myriad monetary and fiscal stimulus packages should avert a global depression and deflation.
- We expect to see the first signs of an economic recovery towards the end of 2009 and the beginning of 2010. The financial markets normally discount this some 6 to 9 months ahead.

Bonds	We will be investing primarily in corporate bonds with a sound rating and a short maturity of 2 to 4 years. For new investments, our focus will essentially be on investments in defensive sectors.
Equities	Even though valuations are low, equity prices remain under pressure from falling earnings expectations. We remain underinvested for the time being and will increase our investment level should calm be restored to the market.
Private equity	Net asset values (NAVs) will likely have to be corrected further downwards both this year and next. At 40% to 90%, average discounts are at multi-year highs. We remain underweighted and will be investing primarily in public partnerships.
Hedge funds	Despite the difficult market environment, hedge funds managed to generate positive returns in the first quarter. Nevertheless, we remain underweighted for the time being as hedge funds will face further redemptions.
Currency	We are leaving the reference currency allocation of 70% to 80% unchanged. US dollar exposure will be largely hedged going forward.

Macroeconomic environment

The global economy is in the throes of the most severe recession since the end of the Second World War. The economic downturn has affected not only the developed economies, but also the emerging economies in Asia, South America and to an even greater degree in the Eastern European states. The global economic downturn can clearly be seen in the data available for the USA. US gross domestic product (GDP) contracted by 6.3% in the fourth quarter of 2008, the sharpest contraction since 1953. The number of unemployed had risen to over 5.5 million by mid-March 2009 and the unemployment rate is expected to increase to over 10% by the end of the year. No country or region has managed to sustainably decouple itself from the negative real economic growth of the world's most important economic nation. The economic data coming out of Japan, Great Britain and Germany has been extremely negative since the beginning of the year. Financial market developments in the past quarter were not only affected by the global recession but also by the ongoing international banking crisis. And in February, the dire situation at US insurance company AIG in particular led to increased uncertainty about the stability of the global financial system.

Despite overall negative economic conditions, we see the first clear signs that a global economic depression can be averted and that a collapse of the global banking and financial system is increasingly unlikely.

• **Stabilization of the US banking system:** On 23 March, US Treasury Secretary Timothy Geithner published the US government's concrete catalogue of measures to resolve the banking crisis in the USA. Under the plan, the bulk of the "toxic assets" are to be shifted off the banks' balance sheets with the help of private investors. As soon

Real economic growth and growth expectations
(annual percentage change)

	2008E	2009E	2010E
World	2.9	-1.2	2.8
Industrialized Countries	0.9	-3.0	1.2
USA	1.1	-2.9	1.8
Japan	-0.6	-6.1	0.6
Euro zone	0.7	-3.0	0.6
Great Britain	0.7	-3.0	0.7
Emerging countries	5.8	1.9	4.8
China	9.0	6.7	8.0
India	6.4	5.1	6.5

Source: Median of IMF, Morgan Stanley, Goldman Sachs, UBS, Barclays Capital, JP Morgan and Deutsche Bank, March 2009

as initial details of the plan were released on 9 March, the US S&P 500 stock market index rallied by 18%. Besides the USA, other countries in Asia and Europe that play an important role in the international financial system have meanwhile also taken decisive measures to stabilize the global banking system.

• **Monetary measures:** Besides conventional fiscal measures, the central banks of the USA, Japan, Great Britain and Switzerland have also resorted to "unconventional" monetary instruments to increase the money supply (so-called quantitative easing). Only the European Central Bank (ECB) is reluctant to go down this path. These measures, we believe, will counter the risk of deflation.

• **Fiscal measures:** Following the sharp drop in private investment and consumption expenditure, even skeptics of government economic measures concede that the risk of a prolonged global depression can only be countered with a substantial increase in public spending (expansionary fiscal policy).



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China will spend around USD 590 billion and the USA around USD 787 billion on government spending programs. Japan and the states of the European Union (EU) have also passed massive economic stimulus programs.

As a result of the packages of measures outlined, the likelihood of a scenario of depression and deflation is relatively low. Rather, we assume that the global recession will bottom out in the fall of this year and the first signs of an economic recovery will become apparent at the end of this year and the start of 2010. The latest data from the US real estate market, which shows that house prices are firming to some extent, also supports this scenario.

Bonds

In the USA and Europe, yields on 10-year government bonds have risen slightly since the beginning of the year and recovered from their recent historical lows. At times, 10-year US government bond yields increased to over 3% on fears over the financing of the budget deficit. However, after the Federal Reserve's surprise announcement of a further expansion of the program to purchase government and agency bonds, yields fell back again - at times by more than 50 basis points - to stand at 2.68% at the end of the first quarter. In Germany, by contrast, the yield curve has become steeper, reflecting increased risk aversion and rate cuts by the ECB. In Switzerland, the yield curve is also steeper due to lower rates at the short end.

With the exception of the euro zone, we do not expect any of the leading central banks to move further on interest rates. Due to the severity of the global recession, we do not expect inflation expectations to rise in the coming months and therefore rates at the long end of the yield curve are likely to remain relatively stable. We anticipate that yields on 10-year US government bonds will move between 2.6% and 2.9% over the next three months, while yields in the euro zone will range between 2.8% to 3.0%. Clearly, the risk to our forecast for yields is an increase in inflation expectations as a result of the highly expansionary monetary policy worldwide and thus in a sharp rise in yields.

We will be investing primarily in bonds with a sound rating and a short maturity of between 2 to 4 years. For new investments, our focus will essentially be on bonds from solidly financed companies in defensive sectors.

Stock markets

Stock markets lost further significant ground during the first two months of the year amid the global recession and continued tightness in the credit markets. However,

Performance of the major stock market indices

Index performance in % and local currency				
	Index	-1 month	-6 months	2009
USA (Dow Jones)	7'609	7.7	-29.7	-13.3
USA (S&P 500)	798	8.5	-31.3	-11.7
USA (Nasdaq Composite)	1'529	10.9	-26.1	-3.1
Europe (DJ Euro Stoxx 50)	2'071	4.8	-32.5	-15.4
Germany (DAX)	4'085	6.3	-29.7	-15.1
France (CAC)	2'807	3.9	-30.8	-12.8
Switzerland (SMI)	4'927	5.0	-26.8	-11.0
Great Britain (FTSE 100)	3'926	2.5	-20.8	-11.5
Brazil (Bovespa)	40'926	7.2	-17.8	9.0
Russia (MICEX)	773	16.0	-24.0	24.8
India (Sensex)	9'682	8.9	-25.8	0.4
China (Shenzhen)	802	21.8	30.7	45.0
Japan (Nikkei 225)	8'322	10.0	-26.8	-6.1
Hong Kong (Hang Seng)	13'437	4.9	-25.4	-6.6
Taiwan (Taiex)	5'314	16.6	-7.8	15.8
Singapore (Straits Times)	1'696	6.4	-28.1	-3.7

Source: Bloomberg, Data as at 1 April 2009

since 9 March, following the announcement of the US government's stabilization measures as well as positive news from Citigroup, there has been a reversal of trends, with the markets staging a significant recovery. Whether we are seeing a bear market rally or whether a trend reversal has already taken place is difficult to say at the current point in time. However, we assume that the prevailing uncertainty in the global equity markets about real economic growth (top-down) and future corporate earnings growth (bottom-up) will continue to dominate market events over the months to come and that volatility will continue to stay high.

In spite of the positive trend over the past few weeks, the fact remains that current market valuations are still very low in historical comparison. The dividend yield on US equities, for instance, is higher than the yield on 10-year US government bonds for the first time in over 50 years. Also based on the ratio of price to book value many stock markets are valued at historically low levels.

We believe that clear signs that the banking and credit sectors as well as the US real estate market are stabilizing are required before a sustained recovery in the world's equity markets can occur. We basically intend to increase our current investment level in equities of around 70% over time. If, counter to our main scenario, the economic situation were to deteriorate significantly, coming after the recent rally this would trigger renewed losses and prompt us to reduce our positions.

Our focus remains on large-capitalized companies with low valuations, solid balance sheets and high, stable dividend yields. We take a closer look at large caps on the last page of this edition of Investment Outlook.

Investment Outlook

Second quarter of 2009

Currencies

Up to mid-March, the US dollar continued to appreciate due to increased risk aversion and the significant deterioration of the economic situation outside the USA. The lower oil price also had a positive effect on the greenback. The acceleration in monetary expansion (quantitative easing) announced by the US central bank on 18 March, however, had a negative impact on the US currency.

Changes in exchange rates

Exchange Rates	31.03.2009	-1 month	-6 months	2009
EUR/USD	1.318	4.8%	-5.9%	-15.6%
USD/CHF	1.146	-2.5%	1.8%	13.2%
EUR/CHF	1.510	2.2%	-4.2%	-4.5%
GBP/USD	1.428	1.6%	-19.3%	-27.7%
USD/JPY	98.82	1.4%	-6.5%	-3.0%

Source: Bloomberg, data as at 1 April 2009

The Swiss franc was supported by the continued high levels of uncertainty in the markets and in the current environment it is likely to retain its status as a safe haven currency. The Swiss National Bank, however, announced that it would be intervening in the foreign exchange market to prevent the Swiss franc from appreciating further against key currencies. The stabilization of the financial markets will tend to have a negative impact on the Swiss franc in the longer term and cause it to depreciate against the euro.

We are leaving the reference currency allocation of 70% to 80% unchanged. Since we expect a weaker US dollar in the medium term, our exposure but for about 5% will remain hedged for the time being. The Swiss franc is likely to continue trading in a relatively narrow range against the euro (1.47-1.57).

Listed private equity

The negative share price development of the listed private equity sector continued through the first quarter of 2009. Besides the broadly negative stock market trend, sector-specific factors such as uncertainty over NAV pricing (lagged NAV adjustments), increased leverage ratios, high overcommitment levels and negative market sentiment towards private equity caused further share price losses.

UK-listed fund of funds are currently trading at an average discount of between 70% and 90%, their highest in many years. However, this should be relativized to a certain extent as the general expectation is that the NAVs will have to be adjusted downwards further during the course of this year. We nevertheless consider the recent share price development of certain individual companies to be a clear overreaction by the market, though this, in turn, will generate considerable investment opportunities over the coming months.

For the time being, we will also remain underweighted in listed private equity securities with a target investment ratio of 50%-70%. We will focus primarily on investments in public partnerships. Caution is still urged for fund-of-funds investments because so far these companies have only partly written down their NAVs. We have completely cut our exposure to business development companies (BDCs) because the risk of BDCs failing has increased. Our focus remains, as before, on liquid securities.

Hedge funds

After a negative performance over the course of a number of months, hedge funds kicked off the year with slight gains. As at 23 March, the HFRX index showed a return of +1%. In the year to date, convertible arbitrage, event driven and relative value arbitrage strategies have been the best performers, and equity market neutral and distressed strategies the laggards with negative returns.

2009 will bring radical change to the hedge fund industry as only half of all hedge funds are expected to survive. Established managers that survived the difficult past year and manage to return to normality as quickly as possible will be among the profiteers. On the other hand, there are attractive investment opportunities in the market that can be realized without the use of leverage. Moreover, there is less money following the same volume of investment opportunities as before the crisis. The reason for this is, inter alia, that investment banks have had to cease trading for their own account.

Despite the attractive investment opportunities, we are maintaining our high cash allocation and remain underinvested. We anticipate that hedge funds will face further redemptions. For risk reasons, we still primarily prefer selected fund of funds and managers with a low equity exposure (long/short managers). We also continue to favor global macro managers, which have a low direct equity market risk. Our investment ratio will be anywhere between 40% and 60%.

Returns on investable hedge fund strategy indices (HFRX)

Daily - 03/31/2009	2009	2008	2008		2007
			Draw Down	Total	
HFRX Index	YTD, %	YTD, %	June 30 - Dez 30	H1 2008	Total
HFRX Global Hedge Fund Index	0.7%	-23.1%	-22.1%	-1.0%	4.2%
HFRX Global Hedge Index (in Euro)	1.1%	-23.6%	-23.0%	-0.6%	2.7%
HFRX Convertible Arbitrage Index	9.4%	-58.2%	-51.5%	-6.7%	-1.0%
HFRX Distressed Securities Index	-5.2%	-27.6%	-24.2%	-3.4%	4.0%
HFRX Equity Hedge Index	0.8%	-25.7%	-24.5%	-1.2%	3.2%
HFRX Equity Market Neutral Index	-2.5%	-0.7%	-2.7%	2.6%	3.1%
HFRX Event Driven Index	2.3%	-22.3%	-18.3%	-4.0%	4.9%
HFRX Macro Index	-0.6%	6.2%	-5.2%	11.4%	3.2%
HFRX Merger Arbitrage Index	1.7%	3.4%	1.0%	2.4%	4.9%
HFRX Relative Value Arbitrage Index	1.5%	-37.6%	-29.7%	-7.9%	5.8%
Credit Suisse Inv. Tremont Managed Futures	-0.2%	20.1%	8.1%	12.0%	4.5%

Source: Hedge Fund Research, 25 March 2009

Investment Outlook

Special topic – large caps

Favoring large caps over small and mid caps during the crisis

From the end of the 1990s until the beginning of 2006 small and mid caps significantly outperformed large caps. In the current global recessionary environment, by contrast, investors place more weight on stable defensive investments, which is why the large, established stocks are currently to be preferred over smaller stocks.

In the current uncertain market environment, marked by investors' continued moderate appetite for risk, besides fundamental considerations, such as better marketability and often a more transparent and comprehensive duty to disclose information, a number of factors support the case for investing in large cap stocks, including the following points:

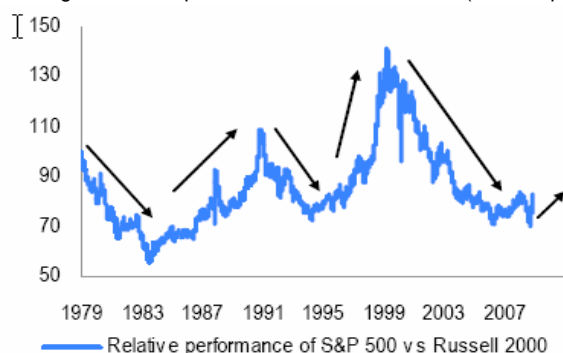
- relative valuation
- broader diversification
- lower volatility
- higher dividend yields / greater dividend security
- readier access to the credit market
- moderate economic recovery after the crisis.

Relative valuation

After having produced a better share price performance over the course of several years, there has, since 2006, been a change in the relative performance of small and mid caps in the USA. However, valuation differentials have so far not narrowed significantly. Based on the price-earnings ratio, the equities in the S&P 500 are still around 30% cheaper than those in the Russell 2000. Given that small cap stocks outperformed for seven years (1999 to 2006), the opposite trend is also likely to last several years. Indeed, in the past, such trends have tended to extend over longer periods of time, as shown in the diagram below.

Relative performance of S&P 500 vs Russell 2000

Rising curve = outperformance of S&P 500 (large caps)
Falling curve = outperformance of Russell 2000 (small caps)



Source: Bloomberg and UBS WMR

Diversification and volatility

Large caps are often more broadly diversified in terms of geography and sector than small caps, which due to being focused on individual regions and/or sectors are more vulnerable to any fluctuations within them. This broader diversification is a particular advantage during difficult times. In addition, large caps hold up better during periods of high market volatility than smaller caps. After experiencing record levels of volatility in the fourth quarter, share price have now stabilized somewhat, but volatility is still exceptionally high.

Dividend yields and the credit market

In economically difficult times, it must generally be assumed that dividends will be cut. Besides the fact that large caps tend to have higher dividend yields than small caps, dividend security is, as a rule, greater at large established companies than it is at smaller, less diversified companies.

Since mid-2007, the investors' flight to quality has led in the financial and credit markets to a significant widening of the yield differential between the different quality segments. Given the increased aversion to risk, it is currently virtually impossible for smaller and less well-known borrowers to raise money in the capital markets, or if so then only at considerably less favorable conditions than established borrowers.

Only moderate recovery expected after the crisis

Over the past weeks and months, growth expectations for most countries have been revised downwards. An economic recovery is not expected to begin until 2010. The upswing is expected to be no more than moderate. This is significant in as far as small-cap stocks tend to be more cyclical than large caps and, as a rule, profit during the initial stages of economic recovery. This is likely to be much less the case in the next economic cycle.

Investment case

In the current economic environment, large cap companies are to be preferred over the overall riskier small and mid caps not only due to the safety aspects, such as marketability and diversification, but also on the basis of valuation and market cycle factors in particular. Thus, our focus in terms of equities is on large caps with attractive dividend yields.

Baar-Zug, 8 April 2009

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