



## Investment Outlook - Third quarter of 2010

### • Global macroeconomic outlook

Despite the agreed EUR 750 billion rescue package, the European debt crisis is likely to continue to cast a shadow over international financial market developments over the coming months.

Positive corporate results are being overshadowed by concerns about stability of the Euro, the European Monetary Union and European banks as well as the sustainability of the economic recovery.

We expect a subdued global economic recovery, with some downside risk in the short term; however, we do not expect this to trigger a return to global recession.

### • Traditional investments

- **Currencies** Anticipated trading range for USD/CHF: 1.08 – 1.15 (USD/EUR: 1.18 – 1.24) and for EUR/CHF: 1.30 – 1.40; increased exchange rate volatility and continued Euro weakness expected.

- **Bonds** We continue to prefer corporate bonds to government bonds; targeted term to maturity is 3 years; our focus: companies with stable, predictable cash flow.

- **Equities** Earnings have been revised upwards on the back of generally positive corporate results for the first quarter. In the run-up to the release of the half-year results, macroeconomic uncertainty is likely to dominate the markets, which is why we expect increased market volatility.

### • Listed alternative investments

- **Private equity** Net asset value (NAV) development is expected to remain largely positive in the second half of 2010, which should see the asset class outperform equities.

- **Infrastructure** The asset class is characterized by low cyclicality, above-average earnings visibility and lower market volatility compared to stock market indices; increased regulatory risk increases the need for greater selectivity.

- **Commodities** Concerns about the economic recovery and growth momentum (China) caused prices to fall in the second quarter of 2010, producing selective buy opportunities.

- **Real estate** The real estate boom in parts of China and Europe's debt are weighing down on the outlook in most regions; the risks will continue to dominate through the 2nd half of 2010.

## Market data

<b>GDP Growth %</b>	<b>Country</b>	<b>2009</b>	<b>2010E</b>	<b>2011E</b>
Industrialized Countries	USA	-2.4	3.4	3.3
	JPN	-5.2	3.3	1.7
	EMU	-4.0	1.4	2.2
	UK	-4.9	1.5	2.7
	Switzerland	-1.5	2.5	2.1
Emerging countries	China	8.7	10.1	9.0
	India	6.6	8.3	8.5
	Brazil	-0.2	6.7	4.5
<b>Exchange rates</b>	<b>30.06.10</b>	<b>% -1 M</b>	<b>% -3 M</b>	<b>% YTD</b>
USD/CHF	1.074	-7.72	1.85	3.61
EUR/CHF	1.3184	-7.23	-7.41	-11.14
GBP/CHF	1.6102	-4.08	0.62	-3.81
USD/JPN	88.43	-3.10	-5.39	-4.93
<b>3 month Libor</b>	<b>30.06.10</b>	<b>-1 M Bp</b>	<b>-3 M Bp</b>	<b>YTD Bp</b>
CHF	0.11	0.3	-13.5	-14.0
USD	0.53	-0.2	24.2	28.3
EUR	0.71	7.3	12.9	5.1
<b>Government (10y)</b>	<b>30.06.10</b>	<b>-1 M Bp</b>	<b>-3 M Bp</b>	<b>YTD Bp</b>
CHF	1.48	-6.0	-40.1	-48.3
USD	2.93	-35.4	-89.5	-90.6
EUR	2.57	-8.2	-57.3	-86.7
<b>Stock market</b>	<b>30.06.10</b>	<b>% -1 M</b>	<b>% -3 M</b>	<b>% YTD</b>
SMI	6128.06	-2.98	-11.04	-6.38
S&P 500	1030.71	-3.74	-12.51	-7.57
Nikkei	9382.64	-3.95	-15.40	-11.04
FTSE-100	4916.87	-4.77	-14.41	-9.16
DJ EURO-STOXX 50	2573.32	-1.28	-13.60	-13.21
MSCI Emerging Markets	344.956	0.30	-8.28	-6.17
<b>Commodities</b>	<b>30.06.10</b>	<b>% -1 M</b>	<b>% -3 M</b>	<b>% YTD</b>
Gold oz/usd	1242.25	2.14	11.59	12.25
Oil (WTI)	75.63	2.24	-8.18	-4.70
Copper (Spot)	6483.5	-6.19	-16.44	-11.69
Nickel (Spot)	19679	-7.51	-21.16	6.65

Source : Bloomberg M.St, GS, UBS, DB, Barclays, BofAML, JPM,  
Asset Mgmt Partners 06/2010

## Editorial

What had been sparked by Greece temporarily set off a broader conflagration in (southern) Europe in the second quarter. Doom-mongers in the United States and Asia have since been prophesying the demise of the European Monetary Union. Alternatively, some countries have been named as potential candidates for ejection or exclusion. At the current time, it can be said that the Euro area and its currency are not a haven of stability, and Germany and France are supporting the survival of the European Monetary Union, despite coming at a high cost. The restructuring of Greece's debt will, however, probably be inevitable.

Rising recession fears following the debt crisis are misplaced. We believe that a double-dip scenario is unlikely and expect a weaker-than-average economic recovery. Positive corporate results have meanwhile exceeded market expectations, but have been barely reflected by the market.

Given the recent developments in Europe, national and regional differences are bound to widen. Dividing the world up into "emerging" and "developed" economies though is likely to be too simplistic going forward. This will also affect our investment decisions.

We take a closer look at this issue of growing economic divergence and its ramifications in our special topic section on page 4.

*Your Asset Management Partners Team*

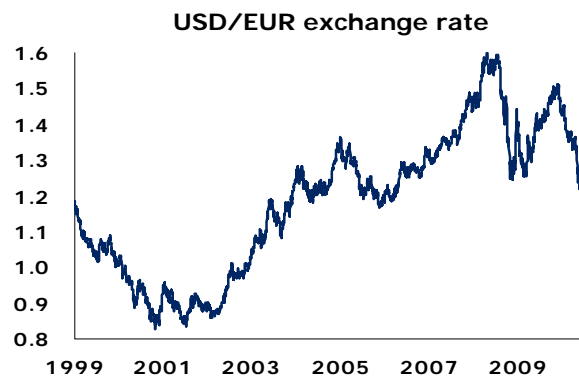


## Macroeconomic environment

In the second quarter, international financial market developments were primarily dominated by the escalating crisis over high public debt in parts of the Euro area. Despite a massive EUR 750 billion rescue package for the troubled southern European states, the financial markets could not initially be calmed. At the beginning of the third quarter, a number of risk factors were dominating global economic and financial market developments.

### Doubts about the stability of the Euro and the European Monetary Union

The future of the European Monetary Union's currency, the Euro, is increasingly being questioned, especially by US and Asian investors. The main scenarios are that either the highly indebted countries, such as Greece, exit from the Euro or the more solid, competitive countries from northern Europe, such as Germany, leave the currency union. While such scenarios cannot be ruled out, the probability of the Euro failing over the next few years is very low. The political and economic ramifications for any country that were to leave the currency union would be incalculable.



### Doubts about the stability of European banks

Following the debt crisis in Europe, the stability of numerous European banks is also being called into question. Besides a number of German and French commercial banks that have relatively large holdings of Greek government bonds, there are particular concerns over the health of Spanish banks. The financial markets have come under significantly increased strain and the European Central Bank (ECB) has had to intervene increasingly in the money market. Prices of credit default swaps on European banks have nonetheless widened significantly in recent weeks. We do not expect the crisis to escalate any further as we anticipate that the ECB will secure refinancing for banks that can no longer raise funds in the money and capital markets.

### Doubts about the sustainability of the economic recovery

The sharp rise in public debt is not a problem that is limited to the Euro area. On the contrary, going by the data, the United States' and Great Britain's deficit figures are worse than that for the Euro area as a whole. Many countries have decided to improve the state of their public finances - not least due to pressure from the financial markets - through spending cuts and, in some cases, tax increases. Some analysts fear that these savings measures could choke off economic recovery in those countries. But we feel these fears are overstated. However, the pace of economic recovery is likely to slow down during the second half of the year. A positive point is that due to the Euro crisis the leading central banks will be following expansionary monetary policies with low key interest rates for longer than we had anticipated.

### Our economic scenario is confirmed

In the previous edition of "Investment Outlook", we indicated our expectation for a moderate economic recovery in the Western industrialized nations. Although the risks that we have described herein have increased the potential for another setback in the short term, we do not expect the global economy to go back into recession (a double dip). The announcement that the exchange rate of the Yuan, the Chinese currency, would be made more flexible is a positive sign that the large global imbalances can be reduced in the medium term, removing one of the causes of the recent economic and financial crisis.

## Traditional investments

### Bonds: Unchanged strategy

We are sticking to our "short maturities, cautious about government bonds" strategy and targeting an average term to maturity of around 3 years for the portfolios. In the second half of the year, we will look at a position in inflation-linked bonds as a possible expansion of this strategy. We will also hold convertible bonds in our portfolio for yield reasons.

The debt crisis and the uncertainty in Europe have caused yields to fall further compared to the end of 2009 - US 10Y: 3.25% (Dec. 3.84%); EU 10Y: 2.66% (Dec. 3.38%). We do not expect any of the major central banks (i.e. the US Federal Reserve, the Bank of England, the Bank of Japan, the ECB and the Swiss National Bank) to raise their key rates over the next three months.

Consensus estimates put the yield on 10-year US government bonds at 3.9% and that on 10-year European government bonds at 3.4% at the end of 2010. Yield expectations in the United States continue to be below the average for the last 10 years.



**Preference for corporate bonds**

We remain cautious towards Euro-area government bonds. For corporate bonds, we favor defensive sectors with stable cash flows coupled with high earnings visibility. We generally take positions in solid companies with a good rating (A-/BBB issuers or better), low event risk and predictable earnings. Positions in cyclical sectors (with a single A/BBB rating) where a rating upgrade is on the cards look particularly attractive. The precarious debt burden of some European states – especially the so-called “PIIGS” countries (Portugal, Ireland, Italy, Greece and Spain) – is likely to cause the yield differential between corporate bonds in Europe to widen still further.

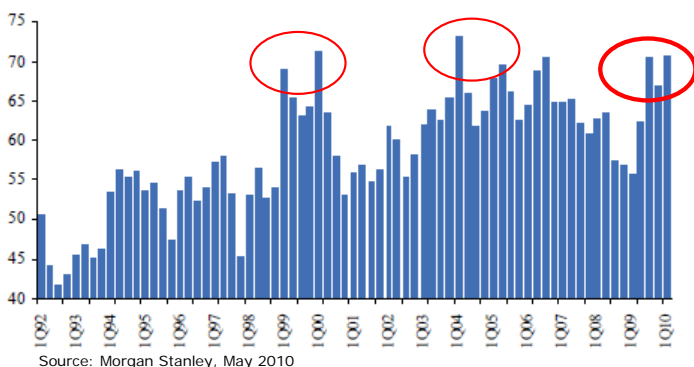
**Equities: Increased volatility will likely be temporary; valuations look attractive**

Global equity market weakness in May has since been partly corrected such that the S&P 500 is meanwhile down by over -13.7% from its April high and the Euro Stoxx 50 and the MSCI EM (Emerging Markets) are down by -17.5% and -12.6% respectively.

The approval of a support package for European countries had a positive effect on equities, triggering something of a rebound (SMI: +7%; Euro Stoxx 50: +11%) at the beginning of June. Based on 2010E P/Es (SMI: 11.4x, S&P: 12.9x, Euro Stoxx 50: 9.8x), equities look moderately priced. The return on equity (ROE) in the European markets is currently around 10-11%, which implies no earnings growth this year. Based on the positive first-quarter results, we do not expect this to be the case. Despite being attractively priced, the situation on the stock markets remains fragile and ahead of half-year results being announced from mid-July onwards (starting with Alcoa on 12 July), stock markets are likely to be shaped by macroeconomic developments.

The fear that the European countries’ debt burden could have an adverse impact on the momentum of future earnings is understandable. This is the reason why the positive first-quarter corporate earnings results received little attention and were overshadowed by the escalation of the Greek debt problem. The stock market sell-off occurred against the positive backdrop of earnings upgrades for 2010/11. What is more, the majority (around 70%) of companies beat market expectations significantly, as shown in the chart for the S&P 500 below.

**Percentage of companies reporting positive earnings surprises (1992 to date, quarterly)**



We remain cautious of the risk of a further downturn in stock markets and have thus reduced our investment level somewhat. Initially, we assume that cyclically-oriented sectors (energy, industry, raw and basic materials) will continue to make gains, but then we will gradually rotate into more defensive investment themes in the third quarter. The half-year results in July will provide a first indication. In the meantime, we will be focusing on quality stocks with a solid balance sheet, attractive dividend yield or growth (including share buybacks and special dividends). We will be increasingly looking at companies’ international orientation and share of sales generated in emerging markets. The defensive orientation of the SMI heavy-weights is becoming more in line with our reduced appetite for risk.

**Performance and volatility of SPI from 2007 to date**



**Listed alternative investments**

**Listed private equity: Continuing to trade at a discount of around 30% to the NAV**

Sound corporate results have led to net asset value (NAV) figures being adjusted upwards again. Fund of funds and business development companies (BDCs) saw particularly strong price gains. Listed private equity remains attractive, trading at an unchanged discount of around 30% to the NAV.

**Private infrastructure: High earnings visibility; increasing regulatory risk**

High expected earnings visibility together with attractive dividends underline the defensive nature of the asset class. In the current environment, we regard this as advantageous. Increasing regulatory risk - especially in indebted regions - could dampen earnings prospects in the medium term as capital expenditure plans could be threatened.

**Commodities: Asymmetric trends**

We expect that once fears of a double dip recede and the European debt situation eases, gold prices will retreat. Industrial metal prices are now lower than at the beginning of the year. The price slide was triggered by uncertainty about future demand in China as well as about the economy. Low inventories and, in our opinion, excessive price correction mean that prices should trend higher. The low correlation of agricultural commodities to equities and structural changes in the emerging markets make agricultural products an attractive medium-term investment.



# Higher national debts and growing economic divergence bring regional aspects back into focus

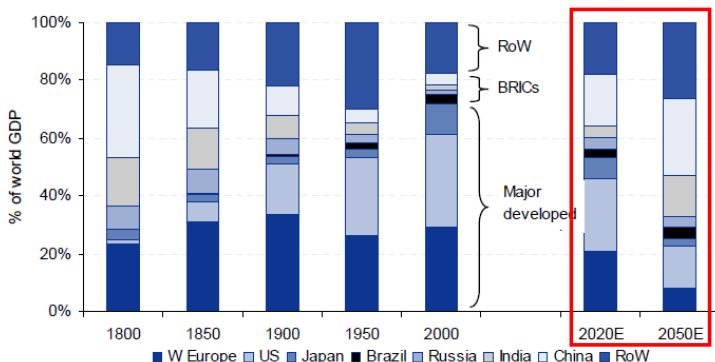
## Rising debt burden weighs on markets

The debt crisis in Europe, the risk of overheating in the emerging economies (e.g. China), the increased regulatory risk in various sectors (financial industry, energy) and the widening of regional disparities are currently shaping financial market development significantly. Fear of rising fiscal deficits in Europe is starting to cast a shadow over the anticipated economic recovery. We assume that rising fiscal deficits – as discussed in the special topic section of the previous edition of Investment Outlook – could well affect the momentum of growth in the Western world.

## Growing economic divergence

Growing economic divergence in Europe reflects that the debt of the northern European states is lower than that of the southern European states. Stock selection along sector lines appears inadequate and needs in future to incorporate regional aspects to a greater degree. The reasons for this are clear: states with very high debt will try to increase the tax burden of generally solidly financed companies or to introduce new regulations. This could affect the earnings momentum of companies in southern Europe for some time to come. By contrast, the earnings momentum in northern Europe within the economic and monetary union should gain further traction due to continued low interest rates and a weak Euro. At company level, the North should benefit as a quasi free-rider from the South's problems, with the common monetary policy providing advantageous conditions.

## Contribution to global GDP over time and expected changes by 2020 & 2050



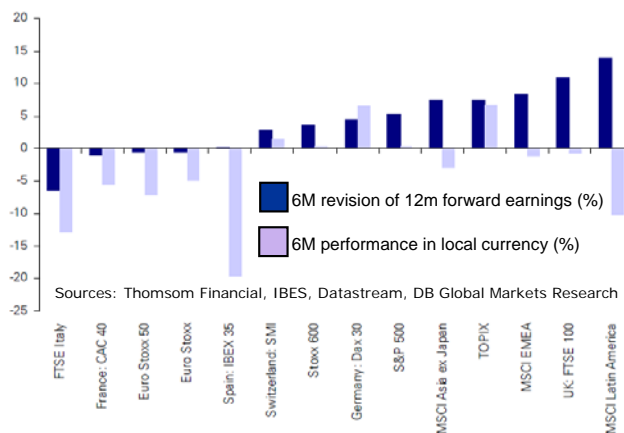
Sources: OECD, Goldmann Sachs Global ECS Research, 2009/2010

The global economic balance is shifting at the global level. The financial crisis will probably quicken this shift in the medium term in favor of the emerging markets. Current expectations for GDP share by country in 2020/2050 are shown in the chart above. Growth expectations for 2010 for the emerging markets (+7.1%) continue to be significantly higher than for the developed economies (+2.6%). For companies, gaining a good foothold in growth markets is therefore becoming increasingly important.

## Emerging Markets showing positive earnings momentum

Positive first-quarter corporate results have led to an improved earnings outlook, especially in the emerging markets. The chart below compares market performance with earnings revisions based on first-quarter figures. Market valuations do not fully reflect the difference in earnings momentum.

## Performance versus earnings revisions



Sources: Thomson Financial, IBES, Datastream, DB Global Markets Research

Besides the emerging markets' performance, the United Kingdom's (FTSE 100) positive performance also stands out. While Germany should receive a fillip from a weak Euro and a high export ratio, the FTSE 100 is basically benefiting from high overseas earnings (overseas: 65%; thereof, emerging markets: 20%) and thanks to the British pound is also enjoying fiscal and monetary policy advantages over the Euro area.

## Conclusions

We believe that 1) when it comes to selecting stocks and bonds regional aspects will gain in importance, 2) given the debt crisis in Europe, the earnings momentum in the emerging markets is then more sustainable, 3) stock market valuations appear on the whole attractive, but 4) the better long-term outlook for the emerging markets is not fully reflected in current market valuations, and 5) equity markets should ultimately then continue to trend higher on the intact - if long in coming - cyclical upswing.

The need of many countries to explore new sources of financing is obvious. Hence there is a risk of increased regulation, which would adversely impact expected earnings growth.

At company level, a global network and a foothold in growth markets will be decisive success factors going forward. An ideal revenue split would be, for example, like that of BMW or VW, companies that have already made China their "second home market". Such companies are already profiting from the impressive growth rates in the emerging markets.

Baar-Zug, 30 June 2010

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