Asset
Management
Partners

Investment Outlook - Fourth quarter of 2010

• Global macroeconomic outlook

Aggressive liquidity creation by the leading central banks has so far prevented the Western world from slipping into deflation; we do not expect a double-dip recession.

In the medium term, the stability of the financial system as a whole and the debt problems of European countries (PIGS) besides Japan and the United States pose the greatest risks to a sustained economic recovery.

Global gross domestic product (GDP) is forecast to grow by 4.6% this year and 4.0% next year; the key drivers of growth in 2010 (2011) will be the emerging markets with an expected growth rate of 7.1% (6.3%), as opposed to the developed economies 2.4% (2.3%).

• Traditional investments

- Currencies USD: Anticipated trading range for USD/CHF: 1.00 – 1.10 and for EUR/CHF: 1.30 – 1.40; increased exchange rate volatility; limited USD/CHF and EUR/CHF recovery expected.

- Bonds We continue to prefer corporate bonds to government bonds; targeted average term to maturity is 3 years; our focus: companies with stable, highly predictable cash flows, complemented by convertible bonds and emerging market bonds.

- Equities We remain positive towards equities and expect share prices to have moved higher by the end of the year. Good corporate results for H1 2010 make earnings expectations for 2010 look reasonable; earnings growth should remain positive in 2011 despite slowing momentum.

• Listed alternative investments

- Private equity Positive NAV development should continue into H2 2010 and be the prime driver behind the expected price gains.

- Infrastructure Attractive risk-return profile and moderate valuations are positive; inflation-linked tariffs are a key feature of this asset class in the current environment.

- Commodities Weather-related crop failures have lent soft commodities additional momentum; industrial metals face rising demand and low inventories as double-dip fears recede; going forward, higher opportunity cost of holding gold.

- Real estate US housing indicators remain weak, indicating that the situation in the housing market is still fragile; persistent excess supply situation (excluding the emerging markets).

Market data

GDP Growth %	Country	2009	2010E	2011E
Industrialized Countries	USA	-2.6	2.7	2.7
	JPN	-5.2	2.9	1.3
	EMU	-4.1	1.5	1.5
	UK	-4.9	1.5	2.3
	Switzerland	-1.9	2.7	2.2
Emerging countries	China	9.1	10.0	9.0
	India	7.4	8.5	8.3
	Brazil	-0.2	7.5	4.2

Exchange rates	30.09.10	% -1 M	% -3 M	% YTD
USD/CHF	0.980	-3.62	-8.04	-5.59
EUR/CHF	1.340	2.87	0.96	-10.75
GBP/CHF	1.544	-1.71	-4.13	-8.44
USD/JPN	83.46	-1.17	-4.96	-11.45

3 month Libor	30.09.10	-1 M Bp	-3 M Bp	YTD Bp
CHF	0.18	1.3	6.7	-7.3
USD	0.29	-0.6	-24.4	3.9
EUR	0.85	1.8	14.1	19.3

Government (10y)	30.09.10	-1 M Bp	-3 M Bp	YTD Bp
CHF	1.40	18.0	-14.0	-49.7
USD	2.51	-1.8	-42.1	-132.7
EUR	2.28	14.5	-30.2	-111.2

Stock market	30.09.10	% -1 M	% -3 M	% YTD
SMI	6296.33	-0.57	5.26	-3.81
S&P 500	1141.2	5.64	11.08	2.34
Nikkei	9369	6.18	-0.14	-11.16
FTSE-100	5548.62	3.39	15.46	2.51
DJ EURO-STOXX 50	2747.9	1.20	9.10	-7.32

Commodities	30.09.10	% -1 M	% -3 M	% YTD
Gold oz/USD	1308.35	4.88	5.32	19.27
Oil (WTI)	79.97	7.05	5.74	0.77
Copper (Spot)	8006	7.81	23.48	9.04
Nickel (Spot)	23406	13.37	18.94	26.85

Sources: Bloomberg M.St, GS, UBS, DB, Barclays, BofAML, JPM, Asset Mgmt Partners 09/2010

Editorial

So far this year, macroeconomic factors and currency fluctuations have been shaping the financial markets. Markets fell in reaction to the debt crisis in Europe as well as on fresh fears of a recession. Companies' good half-year results did not therefore receive the kind of attention that they should have. We expect companies to post good results for the third quarter, going some way to making 2010 a positive year for stocks in the end.

The market, as we know, is "always" right. Bond markets, in contrast to stock markets, are indicating slowing economic growth ahead (see Diagram 1). As things stand, stock markets seem the more realistic and make us optimistic. We expect that bond markets – though with something of a lag – will soon stop sending recessionary signals. The strong, unbroken growth momentum in the emerging markets supports this thesis.

The financial crisis has strengthened the position of the emerging markets over the "old world". But are we aware that the emerging markets' share of GDP has increased disproportionately and several regions have now in fact already emerged? Does our tactical asset allocation sufficiently reflect these facts? We discuss our intentions and strategies in terms of implementing this in our special topic section on page 4.

Your Asset Management Partners Team

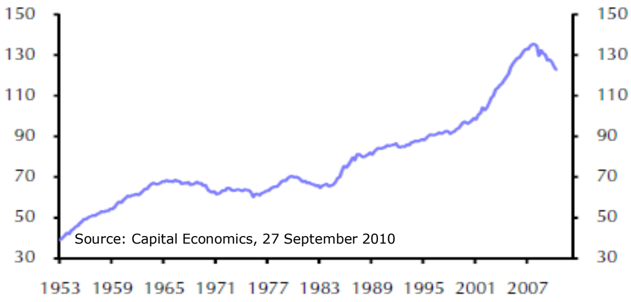
Macroeconomic environment

In the third quarter, softer leading economic indicators gave rise to fresh fears of a double-dip recession in the United States. Given the sorry state of public finances and the extremely low interest rates in the Western industrialized nations, many economists and investors are now asking themselves whether monetary and fiscal policies have reached their limits and a "Japanese scenario" with falling national income and falling prices (deflation) is inevitable for the United States and Western Europe. In our opinion, though fears of a double-dip are overdone, economic growth in the United States can be expected to remain weak for the time being. Only in the emerging countries will the rate of economic growth be high in the foreseeable future.

USA: High household indebtedness

All available macroeconomic indicators confirm the picture of a marked slowdown in the pace of economic recovery in the United States. Given the record-low interest rates and fiscal stimulus packages, this development is somewhat unexpected. In our view, the main reason for this below-average economic recovery is the persistently high level of household debt. Even though US households have reduced their debt levels over the past 18 months, the level of indebtedness remains historically very high at 123% of disposable income. It is impossible to determine what the "right" level of indebtedness is in the long run. Household deleveraging is likely to continue for some time yet and affect private consumption despite record-low interest rates.

Indebtedness of US households as a % of disposable income



European decoupling improbable

In contrast to the United States, the latest growth figures for Europe provided a positive surprise. This is especially true for Germany and Switzerland. Both countries managed to lift their exports, in particular to the emerging economies, significantly. Germany benefited from government stimulus measures and the depreciation of the euro as a result of the Greek crisis, which made German exports much cheaper. We are skeptical that economic development in Europe can lastingly decouple itself from the low economic growth rates in the United States, as business investment and private consumption have contributed only little to the current upswing. Nor can it be ruled out that the debt problems in the so-called PIGS (Portugal, Italy, Greece and Spain) may lead to prolonged recession in these countries. In recent communiqués, the Swiss National Bank also pointed out the risks to the Swiss economy over the coming quarters of the strong appreciation of the Swiss franc.

Economic momentum slowing slightly in the emerging markets

While the developing countries staged an impressive recovery in the second half of 2009, their growth rates have slowed slightly during the past six months. We see this as a positive development as this slowdown should counteract any economic overheating in the regions in good time. Our outlook for the emerging economies in Asia (especially China) and South America (especially Brazil) remains positive.

Summary

Economic recovery in the Western industrialized nations remains highly uncertain. Even though the risks are considerable (e.g. high government debt, financial sector beset with problems, risk of protectionism, currency crises), we believe that it should be possible to prevent the leading industrial nations slipping back into recession. The economic outlook for the emerging economies, on the other hand, remains positive.

Traditional investments

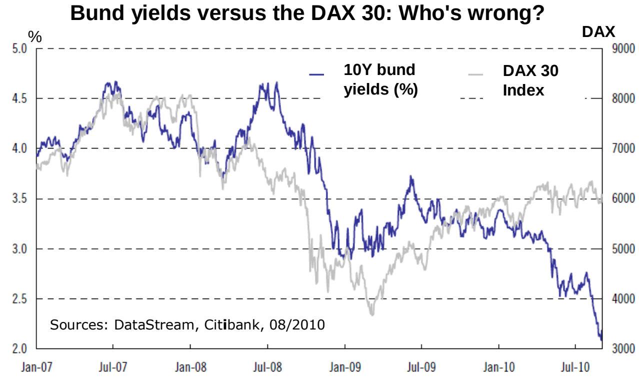
Bonds: No rise in yields before 2011

Compared to the beginning of the year, the debt crisis, the economic uncertainty in Europe and fears of a double-dip recession in the United States have led to a further drop in yields over the end of 2009. As per the end of August, the yield on 10-year Swiss government bonds fell to the year's low of 1.09% and on 10-year US Treasuries to 2.41%. Swiss government bonds are currently yielding 1.41% (consensus forecast 1.54%) and US Treasuries (10Y) a modest 2.51% (consensus forecast at 31/12: 2.58). The discount over the average yield of the last five years (USA: 3.96%; CH: 2.43%) remains substantial.

Bond markets are assuming falling price levels and weakening economic growth. This contradicts the signals coming from the equity market (see Diagram 1 on page 3). We anticipate that before long yields in the bond markets will rise from recessionary levels. In other words, the signals that the stock markets are emitting correspond more closely to our expectations – at least as long as corporate earnings do not collapse. Consequently, we are still sticking to our "short maturities, cautious about government bonds" strategy.

The average term to maturity in the portfolios remains unchanged at approximately 3 years. For yield reasons, we have taken positions in convertible bonds and also new in emerging market bonds in local currencies. This positioning is based on better economic data and forecasts than in the developed economies as well as widening spreads.

Bund yields versus the DAX 30: Who's wrong?



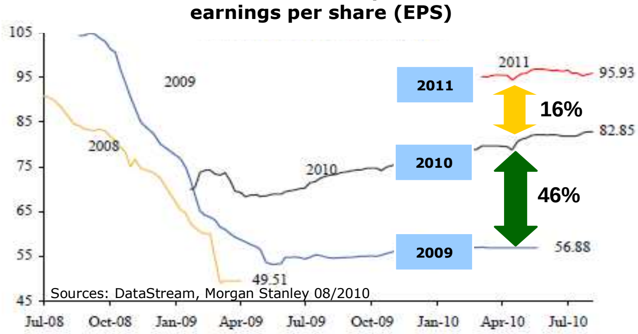
Sources: DataStream, Citibank, 08/2010

Equities: Environment remains constructive

We are maintaining the view expressed at the beginning of the year and expect equity markets to move higher by the end of the year. Our constructive outlook is based on a number of factors: 1.) This year macro factors have been shaping stock market developments. The European debt crisis and growth concerns have played a major role. And as a result 2.) companies' solid mid-year results did not receive as much attention as they should have and as a consequence 3.) stock markets remained by and large moderately priced (P/E 2010E for Euro Stoxx 50: 10.5x; S&P 500: 13.7x; SMI: 12.3x). This is especially true of the emerging markets, which because of an advantageous macroeconomic starting position (government debt/GDP, growth, demographics) hold considerably more potential. You will find more on this in our special topic section. Finally, 4.) is the fact that earnings expectations for 2010 are very likely to be met or exceeded by a majority of companies.

Positive earnings momentum 2010 should continue into 2011

S&P 500: Consensus expectations for earnings per share (EPS)



Sources: DataStream, Morgan Stanley 08/2010

With over 70% of S&P 500 companies and 42% of MSCI Europe companies having exceeded earnings expectations by mid-year, a look ahead is in order. For the S&P 500, the current forecasts for earnings growth in 2010 and 2011 are 46% and 16% respectively.

Earnings growth is expected then to weaken markedly in the coming year, though growth rates should remain positive (see Diagram 2). With global GDP growth forecasts for mature economies being lowered from 2.6% to 2.3% for 2010, current market expectations could be disappointed and expected earnings for 2011 could be revised downwards.

For the third quarter, however, we expect very good corporate results again and targets for 2010 to be met, which will likely support the markets. That companies are now overall net buyers of their own stocks is also positive. The high levels of free cash flow (Euro Stoxx: FCF yield: >8.0%) being currently generated also act as a support. Besides continuing to reduce debt levels (degearing), we expect increased shareholder payback by means of (special) dividends and share buybacks.

Listed alternative investments

Listed private equity: Outperforms stocks (MSCI World) by 10%

Private equity managed to partially decouple from the financial markets thanks to the general improvement in the environment (good exit and investment opportunities) and ongoing deleveraging. Good corporate results should lead to a further improvement in net asset values (NAVs). In the current environment, we do not expect a sustained narrowing of the discount to the NAV, which is around 30% and well above the historical average of 13%.

Private infrastructure: Remains attractive thanks to high earnings visibility and dividend yields

This asset class looks particularly attractive in the current environment with an average dividend yield of 4-5% and with highly predictable cash flows. Regulatory risks in indebted regions, however, require greater selectivity in choosing investment instruments.

Commodities: Gold "overshoots" due to low interest rate environment

Gold prices have risen further. Gold has become relatively more attractive in the low interest rate environment and given the uncertainty about economic growth against the background of expansionary monetary policy. The gold price was supported further by low opportunity costs. We expect the price of industrial metals to rise further on the back of positive demand and low inventories. The temporary price correction in the middle of the year was the result of mounting fears of a double-dip recession. Going forward, we expect prices to trend higher. Soft commodities (e.g. wheat, cotton) benefited from natural events and saw above-average gains. The positive long-term price trend should remain intact.

Real estate: Ongoing consolidation ex. EM

Real estate shares continue to trade sideways. In the United States, indicators suggest that the US housing market is not recovering quickly. The situation for commercial real estate in many places is one of excess supply and therefore requires a selective approach.

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The emerging markets are no longer just a niche investment

Increased attractiveness over time

The emerging markets exhibit the following characteristics: high economic growth (2010E: 7.7%; 2011E: 6.3%), rapidly expanding companies, low government debt compared to GDP, intact current account balances often coupled with undervalued currencies, growing credit availability and an advantageous demographic structure compared to the developed economies.

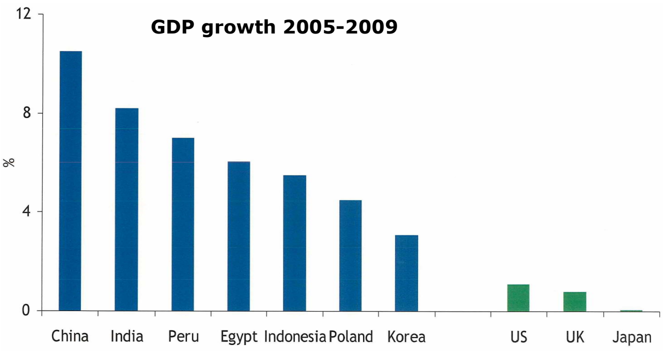
The following figures underline the long-term attractiveness of the emerging markets. According to the International Monetary Fund (IMF, 10/09), the emerging markets now:

- represent 86% of the world's population
- represent 75% of the world's land mass
- hold 68% of the world's foreign exchange reserves
- account for 54% of the world's energy consumption
- account for 50% of the world's GDP

Following the Tequila crisis of 1994/95, the Argentinian crisis of 1998-2002, the Asian crisis of 1997/98 and Russia's declaration of bankruptcy of 1998, it is clear that lessons have been learned by the nations affected. While the ratio of debt to GDP stands at 90.6% for the developed economies, the BRIC countries are in a more favorable position (Brazil <75%; Russia <15%; India <75%; China <70%) (source: GS, 05/2010 & M.St. 10/2010). Debt levels, especially in the United States and Europe, are likely to initially rise further on account of planned fiscal measures.

Current weighting in MSCI World

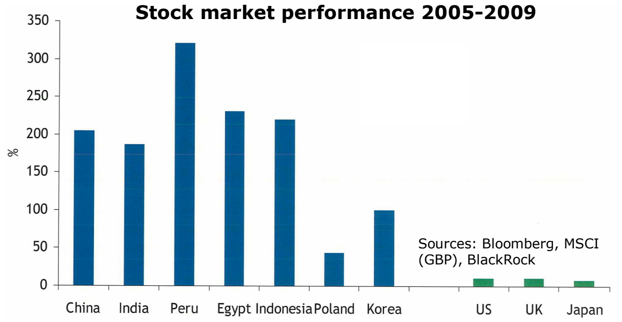
At the end of 2009, the emerging markets had an approximately 13% weighting (22 countries) in the MSCI All Country World Index. In 1989, they still had a modest 2% weighting (8 countries). This is a six-fold increase in just 20 years. Growth momentum in the BRIC countries should continue, far outpacing the developed economies. The forecasted growth differential is 4.7% for 2010 and 4.0% for 2011.



Sources: IMF, BlackRock, 2010

More performance, but also more volatility

Investments in these regions are rightly still perceived as "risky" and exhibit greater volatility. The diagram below clearly shows that in certain regions the stock market performance was unquestionably better over the past five years and adequately reflected the above-average economic growth.



At company level, an analysis of performance over the past ten years also turns out in favor of the emerging regions. Currently, emerging market stock are trading at a P/E 2010E of 11.8x against 12.6x for the developed economies (S&P 500: 13.7x). A comparison of return on equity (ROE) and earnings per share (EPS) is as follows:

MSCI	World	Global EM	EM Europe
Earnings per share, 10Y CAGR*	3.6%	12.2%	16.7%
Return on equity, 10Y average	12.3%	13.7%	15.2%

Sources: Citigroup, 07/2010, BlackRock; *) CAGR: Compound annual growth rate

Consequences: Increase positions

These facts raise certain fundamental questions such as the equity orientation of the portfolio. Do we have the necessary risk tolerance given the higher volatility? What is the correlation to other existing positions (S&P 500: 48% of sales are generated in the emerging markets)? In which markets is direct exposure possible or meaningful? And what are the currency risks?

Our current approach is to primarily increase our asset allocation to country-specific passive investments or funds in the emerging markets. We are also consciously investing in stocks that generate a large share of their shares in the emerging markets ("indirect way"). Company names to mention in this context include Texas Instruments (share of sales: ca. 63%), Suzuki Motors (46%), Richemont (33%) and Holcim. In the case of Holcim, the share of sales was 53% but accounted for over 75% of profits (EBIT level) due to favorable margins in the emerging markets.

A balanced approach to both ways of investing seems most appropriate to increasing our emerging market position, not least for diversification reasons.

Baar-Zug, 30 September 2010

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