

## New World – Old World

China (new world) has announced changes to its exchange rate policy, to the delight of Europe's equity markets. The demand for cars is increasing in the new world, and in the old world manufacturers are switching almost seamlessly from short-time working to full-time work. While government debt is falling in the new world, it continues to rise in the old world, also as a result of the financial crisis. In some cases, such as Greece and a few other European countries, governments have even had to provide support packages.

In recent weeks, this interaction between "old" and "new" has almost perfectly mirrored developments in the equity and currency markets. Furthermore, it also sets the trends on which we will be focusing during the months and years ahead:

- In the long term, a key issue will be the rebalancing of trade balances as well as many state budgets. The G20's efforts (aimed at preventing new financial crises) should be viewed in this context, since real economy imbalances ultimately lead to fiscal imbalances, and vice versa.
- In the medium term, government debt will have to be reduced, especially in the old world. This may even trigger

growth momentum in the longer term, since public investment tends to crowd out private investment. Initially however, the savings measures will have a detrimental impact on growth as this demand stimulus turns negative.

- In the short term, we are in an economic transition scenario, and it remains to be seen to what extent growth momentum from the new world will transfer to the old world as the latter's monetary and fiscal stimulus packages expire. Some main indicators, especially those issued by the OECD, are already pointing to a slowing of momentum.

We must therefore expect volatility to continue. The focus will shift even more to the real economy indicators, and a return to risk aversion cannot be ruled out. Equity markets however will continue to be bolstered by moderate valuations and liquidity.

Wishing you a balanced world,

Hans-Jörg Naumer



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Equity Indices	Status
FTSE 100	5,064
DAX	6,071
DJ Euro Stoxx 50	2,638
S&P 500	1,077
Nasdaq	2,223
Nikkei 225	9,694
Hang Seng	20,691
KOSPI	1,730
Bovespa	64,824

### Interest Rates %

USA	3 Months	0.53
	2 Years	0.65
	10 Years	3.14
Euroland	3 Months	0.75
	2 Years	0.54
	10 Years	2.60
Japan	3 Months	0.39
	2 Years	0.14
	10 Years	1.11

FX	Status
USD/EUR	1.229

### Raw Materials

Oil (Brent. USD/Barrel)	76.6
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# Markets in Detail

## Tactical Allocation, Shares & Bonds

- We cannot expect to see a new bull market before profits return to a sustainable upward trend. Until then, our scenario of a volatile sideways movement should continue.
- The favourable valuations should provide sufficient support for a possible return to risk aversion, as the money market still appears to be tight despite the EMU/IMF emergency measures, although a liquidity crisis seems to have been averted.
- In terms of “match strategy”, it should be helpful to play inoffensively, score goals as quickly as possible and then strengthen the defence. In other words, the neutral equity/debt allocation can be maintained

The arrows are indicating the advised weighting of segments inside the individual asset classes (Regions, Sectors, Bonds).

### Germany

- For the most part unaffected by the European “debt crisis”, Germany’s real economy data remain solid. Its labour market – as a trailing indicator – is performing very favourably.
- The German economy with its strong focus on exports benefits from two factors in particular: the high economic growth outside Europe and the recently weak Euro, which provides companies with additional windfall profits.
- The overweighting of German equities within the European investment segment should be maintained.

### Europe

- Europe is still benefiting from the cyclical recovery. However, the pressure to consolidate government finances and the resulting obstacles to growth are greatest here.
- The economic recovery in the United Kingdom is weak and likely to suffer as a result of government spending cuts.
- Germany should therefore remain the European favourite.

### USA

- Compared to Europe, the United States is still enjoying profit advantages, both in terms of cost and turnover.
- Increasing inflows into US equity funds appear to underscore the attractiveness of this market, which also seems to be reaping the benefits of the loss of confidence in the Eurozone.
- For international investors, US dollar appreciation might spell an improvement in performance.

### Japan

- Japan is benefiting from the global cyclical recovery via its export sector.
- Monetary policy efforts are still being stepped up, against the global trend. As a result, the yen might soon see its strength decline.
- International flows of funds point to an increased interest in Japanese securities. However, foreign investors are best advised to enter into currency hedges.

### Emerging Market

- Latin America (especially Brazil) is likely to continue to benefit from the demand for commodities.
- Asia is expected to remain a long-term “growth story”.
- The Eastern European countries present a very mixed economic picture. In addition to the existing currency risks, the economic recovery has remained weak.
- Valuations have fallen following the correction. Signs of overheating in the equity markets are now mostly a thing of the past in this investment segment.

### Sectors

- In terms of sectors, we continue to back both interesting cyclical sectors (industry and the “restructuring winner” technology) and defensive sectors such as health and telecommunications.
- Pharmaceuticals look interesting given their healthy balance sheets, high dividend yields and attractive valuations.

## Investment Theme: Active Management

- Where inefficient markets are concerned, active management is surely the order of the day. This seems to apply to an even greater degree in volatile sideways markets.
- The index developed by our equities fund manager RCM, which examines “stock-picking” versus “sector-picking” based on volatilities, is currently showing a “stock-picker” market.
- Even if the selection of individual securities were to boost performance, this can be supplemented by the aforementioned “barbell” strategy in relation to sector allocation.

## Euro Bonds

- The still smouldering fiscal crisis in the Eurozone has in recent weeks seen a continuation of the “flight towards the safe haven” of German federal bonds as well as new historical record lows in terms of yields.
- The “safe haven” inflows towards German federal bonds should cease in the coming weeks. For the remainder of 2010, a gradual yield increase to pre-crisis levels (10-year federal bonds >3%) could then be expected.
- The duration should continue to be reduced by an overweighting of the 2- to 3-year maturity segments.

## International Bonds

- Short term, there is little likelihood of a significant change in the established yield range of US treasuries.
- In our view (not least due to the historically steep yield curve), the criteria for higher long-term yields in the medium term are still rising short-term yields, based on an anticipated first Fed rate move in Q1 2011.
- US government bonds may be interesting for Eurozone investors, although they would entail an exchange rate risk.

## Emerging Market Bonds

- While the industrialised countries are battling increasing government debt, many emerging markets are managing to reduce their debts in relation to GDP.
- On balance, the segment continues to appear attractive even compared to corporate bonds, owing to its higher risk premium narrowing and thus price gains potential.

## Corporate Bonds

- In terms of valuation, corporate bonds should remain well placed in the medium term. Implicit default rates continue to move at above-average levels. In our view, the attractive yield mark-up compared to government bonds offers a sufficient risk buffer for the coming months.
- A worsening of the fiscal crisis might cause systemic risks to re-appear.
- Yield-seeking investors should therefore favour the emerging markets bonds segment.

## Currencies

- While the US dollar might manage a slight correction versus the Euro based on large long positions, we expect the Euro to remain weak over the long term. The main pressures on the common currency are the loss of confidence in fiscal discipline, growth momentum and the independence of the ECB in the Eurozone.
- The yen is overvalued. A correction might begin if the foreign exchange markets price in a widening of the interest rate spread between the US and Japanese currencies.

## Imprint

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