

## Weekly Report

### Will investors get hit a third time ?

Never before has the sequence of “booms and busts” been so intense than over the last decade. The tight dimensionality in thinking and acting might have been caused by the benchmarking of investments, an excessive level of greed and fear as well as a shortened horizon (hopefully more in action than spirit). After excruciating experiences first in conjunction with the technology sector in 2000 followed by the housing market shortly afterwards, the majority of investors now are opting for capital preservation. This flight for safety caused yields to plunge to record – low levels, not seen by professional investors in their life time. While market participants argue that this seems to be the right level for a long-lasting “slow growth” economic environment with extremely low inflation (if not deflation) potential, we are rather afraid that these “perceived safe” bond investments represent yet another investment trap. After all, we are currently close to the long-term growth in the US and the prospect to undershoot the 2-4 % very long-term average growth band is extremely low. Additionally, the elevated level of unemployment, which has currently taken the center stage of all discussions, has to be put in perspective: We all know that the “natural rate of unemployment” is not a constant and has been changed some ten years ago for the last time. We think that the FOMC will abstain from bond purchasing and even not reinvest the proceeds of maturing mortgage-backed assets, which will severely disappoint currency and bond investors. Interest rates as low as they are can only be justified in an environment of depression and deflation.

### Foreign Exchange

Some may wonder why the JPY currency is so strong. Of course, low interest rate differentials to other currencies and flight to safety have traditionally favored the JPY. But more recently, another important factor has been detected: China reportedly increased its holding in Japanese bonds this year, which was also the case in June. This seems to represent a change in strategy, as Chinas was a net seller of Japanese bonds last year. The fact that mostly short-term papers have been acquired and medium- to long-term bonds have been sold is indicative of China using Japanese investments rather as a currency diversification than anything else. We consider the JPY as unattractive.

We generally still like the USD. We do not agree with the scenario of further monetary easing. During the Senate Banking Committee, Ben Bernanke was pushed to answer the question of further measures and answered that monetary policy was already quite stimulative. We expect a clear USD strengthening this week.

	Short-term trend	Last
EURUSD	↓	1.3249
USDCHF	↑	1.0422
USDJPY	↑	85.691
GBPUSD	↑	1.5943

### Fixed Income

Extraordinary low interest rates for an extended period of time represent a risk, which should not be underestimated: They have played a major part in the housing bubble and now seem to lead to dangerous distortions, where yield differentials between high and low risk are not sufficiently elevated to bear the venture. Additionally, it is striking to observe that equities and commodities are rising at the time Treasuries seem to signal meager growth or even a double-dip with deflationary trends. Some bond holders repeatedly criticize stock investors for their “sleepiness” in respect to economic trends. But this time even comrades in bond investing, the ones which deal with corporate and inflation-linked bonds, seem to question the deflation-scenario the Treasury market is predicting. This is truly remarkable. One of the worst bond investments has been to short Treasuries. While we have been considering this strategy as interesting for quite some time, we think it represents probably the best investment idea in the bond market at these levels, given our scenario of bottoming core inflation and solid economic growth.

	Forecast end 10	Last
US 10y T %	4.00	2.83
Fed funds	0.25	0-0.25
Bund 10y %	3.20	2.52
ECB rates	1.00	1.00

### Stocks

The positive trend in the reporting season continued with the majority of companies comfortably beating the expectations, including Lanxess which also raised its earnings outlook, citing the recovery in the global economy with emerging markets leading the way; Givaudan raised its FY sales growth in local currency to 5 % versus 4 % previously; NovoNordisk reported significantly better than expected results and sensibly increased its FY sales guidance to 15-16 % versus 10-13 % prior; Bellway signaled higher sales prices and a normalization in cancellations; Henkel strongly raised its 2010 EPS growth guidance to more than 25 % versus above 15 % previously; Swatch reported a blow-out quarter and kept a positive outlook for 2H; Arkema, BMW, Deutsche Post and in the US Kraft, which lifted its cost savings target for the Cadbury deal to \$ 70 million; Perkin Elmer grew double-digit top- and bottom-line; Emerson Electric reporting strong results and mentioning recovery in later cycle businesses with associated margin performance; Pfizer benefiting from a diversified product portfolio and DTV from strong ARPU growth.

	Forecast end 10	Last
S&P 500	1200	1125
NASDAQ	2400	2299
DJ STOXX 600	250	262
SMI	6700	6392