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Weekly Report

Stay overweight stocks on improving economic environment

In anticipation of increasing liquidity drainage by various central banks we slightly reduced our equity exposure end of last year. Indeed, monetary authorities have raised the rhythm of liquidity absorbing moves or announcements since the start of the year, which was received by stock markets lukewarm at best. Importantly though, a substantial correction was avoided so far, indicating that investors perceive these actions as phasing out of emergency measures rather than strict tightening moves. In the latter circumstances, credit conditions would be seriously impaired. With the exception of China, where measures are indeed targeting more reasonable loan growth, credit facilities for consumers and businesses are currently not in the focus of central banks policies. Meanwhile, investor sentiment towards riskier asset classes, such as stocks has cooled down and markets on a global basis are definitely no longer overbought. Fundamentally though, company reports published until now suggest an improving environment, which should lead to strong corporate profit growth. We consider the current uncertainty as an opportunity to establish a small position in equities of emerging markets, except for low risk strategies. While we continue to expect central banks in emerging markets to take further measures in order to prevent overheating and subsequent pricing pressures, reduced visibility in respect to the strength of domestic activity seems not to lead to abrupt moves. Under the angle that economic growth seems sustainable, which would lead to corporate profit growth well in the double digit area, we stay overweight in equities.

Foreign Exchange

The USD further strengthened versus most of the major currencies following the increase of the discount rate. It is indeed our scenario that the USD will benefit over time from more attractive yield differentials, particularly against the EUR. After the strong move and the insistence of Fed members that the benchmark rate will remain low for an extended time period the USD may take a breather, though. The Congressional testimony by Fed chairman Ben Bernanke will most likely not change that picture. One of the currencies that could defy suction of the impetuous USD move was the CAD. This oil-price sensitive currency strengthened in line with the commodity. Next to the general notion that energy demand will increase if economic growth turns out to be sustained the Iran situation is increasingly worrisome. Last week, IAEA inspectors raised concerns over the rising stockpiles of enriched uranium and the possibility of a nuclear missile design. We expect the CAD to continue to strengthen on a very short-term basis, but anticipate a subsequent weakening to the 1.07 level.

	Short-term trend	Last
EURUSD	→	1.3615
USDCHF	→	1.0754
USDJPY	→	91.374
GBPUSD	↑	1.5489

Fixed Income

The rise in the US discount rate only shortly increased market volatility as market participants had been well prepared for such a move: End of January, former Fed Governor Larry Meyer first pointed to a higher rate, followed by comments from Ben Bernanke. Not only the interest rate level, but also the maximum maturity of the credit will be changed to overnight from 90 days previously. The authorities used all available instruments to emphasize that this step was intended to normalize the Fed's lending facilities and would not alter the outlook for monetary policy. This has also been the main reason why the increase occurred in between regular FOMC meetings. Importantly, the modifications are not expected to lead to tighter financial conditions for households and businesses. But depositary institutions are now encouraged to borrow in private markets rather than from the Fed. While monetary policy may not immediately be changed, the Fed Board recently issued an advisory urging banks to strengthen their management of interest-rate risk. The absorption of liquidity leads to higher rates even if inflation remains on target.

	Forecast end 10	Last
US 10y T %	4.80	3.79
Fed funds	2.25	0-0.25
Bund 10y %	4.00	3.28
ECB rates	1.50	1.00

Stocks

Several of the stocks we hold have reported results that exceeded consensus expectations, including ABB (ABBN VX), BNP Paribas (BNP FP), Swiss Reinsurance (RUKN VX), Nestle (NESN VX), Kingfisher (KGF LN) and Analog Devices (ADI). ABB demonstrated that margin pressures can be offset by lower sourcing and manufacturing costs. The ~50 % emerging market exposure and the prospects of its energy efficient products offer above-average growth potential. BNP Paribas is well-diversified with attractive positioning in retail, European fixed income as well as global equity derivatives. Investment banking was off to a strong start in 2010 and the management is hopeful that the peak in loan losses has passed. Good cost control and synergies from Fortis offer additional upside. Kingfisher expects to beat profit forecasts. Gross margin should indeed benefit from reduced promotional activity, an improved sales mix and efficiency gains. Strong cash generation is anticipated to lead to dividend growth, debt reduction and international expansion. ADI should continue to benefit from strength in industrial and communication.

	Forecast end 10	Last
S&P 500	1230	1109
NASDAQ	2450	2242
DJ STOXX 600	270	250
SMI	7000	6687