

Weekly Report

Europe: Why not consider options?

Statements by European authorities are ambiguous: On the one hand they praise the solidity of the euro area and emphasize that its situation compared very flatteringly with a number of other industrialized countries. On the other hand, various parties stated that no support from the community could be expected. Why are options, such as the help from the IMF, bilateral loans from other EU countries or a "Euro loan" not considered at this stage? Strategically it would send the wrong signal. Fiscal discipline is of paramount importance to the Eurozone: the non-bail out clause in the Maastricht Treaty implies that all individual countries bear the responsibility in respect to their deficits. Ironically, the first countries to break this rule were France and Germany in 2003, thereby signaling to other countries that a certain flexibility in respect to deficit levels seem to exist. The current situation is more delicate as the peripheral countries now in focus have private sectors considered as non-competitive and "artful" book-keeping practices by Greece dishonored to a certain extent the credibility of statistical data from the Eurozone. A firm hand is needed. The ECB together with the European Commission take over this role. The acceptance of a loan from the IMF would reflect a weak union, which is incapable of solving the problem itself. Market participants have no patience for this power game. They simply ask for a higher premium, thereby mounting the pressure on the parties involved. Importantly, all the governments are still successful in raising capital, which was demonstrated by Greece and also Portugal. In the worst case, a bail-out will occur.

Foreign Exchange

"Spend now-save later" was the mantra of the Group of Seven finance ministers. This seems somewhat counterintuitive given the harsh measures which are imposed on Greece and other south European countries. More importantly, it rises the question to what extent economies still need to be substantially supported by governments. Is it not rather time to address rapidly worsening public finances? The official statement warns indeed that G-7 members should set clear, credible and consistent plans to strengthen their budget. Delay in doing so would lead markets to begin questioning the commitment to sound policy frameworks, resulting in higher interest rates. Details of the exit strategies by the various central banks will indeed determine the course of currencies in 2010. We still expect the UK and the US to surprise with a more pro-active approach than market participants now are anticipating. This explains our positive outlook for the USD and GBP in the medium term. Short term, the USD seems somewhat overbought and a technical reaction may occur.

	Short-term trend	Last
EURUSD	→	1.3689
USDCHF	→	1.0706
USDJPY	→	89.361
GBPUSD	↑	1.5645

Fixed Income

Greek Treasuries seem opportune at this stage. The EUR Sovereign bond of the Hellenic Republic maturing in March 2012 currently yields approximately 6.5 %, which we consider highly attractive. We would also like to address the perceived T-Bill auction difficulties of Portugal: It indeed just raised EUR 300 million rather than the EUR 500 million planned. But it is crucial to note that the issue was bid for EUR 1.195 billion. The decision to borrow just a fraction was based uniquely on price. As the current crisis is, in our opinion, a liquidity rather than a solvency issue, the above mentioned distinction is highly significant. Future auctions will therefore be watched very closely. We are confident that announced measures, the oversight by the European Commission and the ultimate support by the ECB will result in a positive outcome over time. In the US, the employment report failed to surprise on the upside. It is however interesting to note that details reveal some encouraging trends: hours worked and part-time workers increased further, jobs have been lost in construction and on state level and hourly earnings rose 2.5 % y-y.

	Forecast end 10	Last
US 10y T %	4.80	3.59
Fed funds	2.25	0-0.25
Bund 10y %	4.00	3.14
ECB rates	1.50	1.00

Stocks

Companies, which reported solid results/outlook last week and we still consider attractive include: Autonomy (AU/ LN), Syngenta (SYNN VX), Roche (ROG VX), Aixtron (AIXA GY), ARM Holding (ARM LN), Cisco (CSCO), Clorox (CLX), DR Horton (DHI), Archer-Daniels (ADM), Emerson Electric (EMR) and UPS (UPS). The operating income at Autonomy might at first sight not appear particularly appealing. But the organic revenues growth was truly impressive, particularly when adjusted for mega deals, which is currently the focus point of the market. We keep our position given the improving demand environment and a strong product line-up. Syngenta sees volume growth starting in 2Q10. As 2009 price increases should be maintained, accelerating volume are expected to lead to profit growth this year. Pre-season is very encouraging. Shares of Roche reacted negatively to the quarterly report as EBIT looked light at first sight. Importantly, when results are normalized for inventory destock and divestments, operating results would have exceeded expectations. We expect management to increase its 2010 guidance when they report 1Q.

	Forecast end 10	Last
S&P 500	1230	1066
NASDAQ	2450	2143
DJ STOXX 600	270	239
SMI	7000	6347