

## Weekly Report

### Obama: Oh-banca!

The banking sector must be regulated. It is however highly problematic when politicians take the lead. It even becomes dangerous and potentially system-relevant if this crucial topic merely seems to serve as diversion from other difficulties, in this case healthcare reform and if changes occur to the will of politicians that flee into populist rhetoric. Barack Obama's support by former Fed president Paul Volcker does not bode well either: the latter stated the only beneficial innovation in the financial industry over the last 25 years has been the introduction of ATMs. The rigorous implementation of president Obama's plan would imply that some large banks had to divest proprietary trading investment banking units, hedge funds and private equity investments in order to operate as commercial banks. Ironically, some of these banks have virtually been ordered at the peak of the crisis to acquire institutions active in this field. Others, such as Goldman Sachs and Morgan Stanley, which only registered in 2008 as commercial banks, would have to give up their current status to continue some of their traditional activities. Most curiously, neither the proprietary trading nor hedge funds and private equity have caused the crisis. True motives, such as an expansive monetary policy, unsound mortgage lending practices and most importantly, politicians that strived to maximize the homeownership over quasi-government owned institutions like Fannie Mae and Freddie Mac are kept silent. Soul-searching on these topics is, of course, highly unpopular with politicians. Hopefully, regulators rather than politicians will have the final say.

### Foreign Exchange

Risk aversion seen last week on concern over the prospects of further monetary tightening in China, Obama's plan on financial regulation and the uncertain situation in Greece benefited the USD. But indications that fiscally troubled Greece may find strong demand for its 5-year EUR 3-5 billion syndicated bond issue helped the EUR today. Tactically, we see a sideways move in the EUR, but fundamentally, we expect a weakening. Uninspiring household consumption will hold the economic recovery back. Additionally, tensions in the Eurozone due to widely varying yield spreads of various countries should continue until fiscal discipline will be improved. The new European Union's commissioner for currency issues, Olli Rehn, is expected to address this issue when he releases his first statement on Tuesday. The ECB is anticipated to keep interest rates lower for a longer time frame than other central banks, which should therefore pressure the EUR. The GBP is trending higher on expectations that 4Q GDP will finally show a positive reading.

	Short-term trend	Last
EURUSD	→	1.4146
USDCHF	→	1.0406
USDJPY	→	90.10
GBPUSD	↑	1.6232

### Fixed Income

One way to avoid that market participants benefit from low interest rates is simply to raise them. Former Fed Governor Larry Meyer stated that the FOMC was considering increasing the discount rate. Traditionally, the discount window of the Fed is considered the source of fund of last resort. This is the reason why the discount rate is normally held 100 bps above the fed funds target. During the crisis, the FOMC narrowed the spread to 50 bps over the fed fund rates to promote the restoration of orderly conditions in financial markets. At that time, it was stated that the changes would remain in place until the Fed determined that market liquidity had improved materially. Should the central bank decide to increase this rate, which will probably occur between planned FOMC meetings sometimes in February, it signifies the phasing out of another liquidity program. On the corporate bond side, it seems that spread contraction has come to a halt. With risk appetite waning, investors may demand a premium, particularly for new issues of riskier names. Improved covenants and higher interest payments are also requested.

	Forecast end 10	Last
US 10y T %	4.80	3.63
Fed funds	2.25	0-0.25
Bund 10y %	4.00	3.23
ECB rates	1.50	1.00

### Stocks

We have been selling United Technologies (UTX) and Chevron (CVX) as we have reached our price targets and switched into Johnson & Johnson (JNJ). With this move we are now overweighting the healthcare sector. Uncertainty in respect to the overhaul in this field pressured the stocks in this sector since last March. Additionally, more cyclical names were favored in light of the economic recovery. As the passage of the health care bill in a strict form faces certain difficulties after the Democrats lost their supermajority in the Senate and nervousness in the stock market increased due to uncertainties related to exit strategies of central banks, we chose to overweight healthcare. Johnson & Johnson's pharmaceutical pipeline remains strong as the company launched products recently and upcoming drug introductions are anticipated. In the Medical Devices & Diagnostic segments JNJ holds no 1 or no 2 positions in key segments, has a strong track record of financial performance and competes in attractive categories. A broad restructuring will offset costs of recent acquisitions. We consider the stock as attractively valued.

	Forecast end 10	Last
S&P 500	1230	1100
NASDAQ	2450	2215
DJ STOXX 600	270	248
SMI	7000	6451