

Weekly Report

Emergency Plan: Short term stabilization, long-term ...?

For the first time since the crisis started, European authorities reacted forcefully. The massive new loan program, which may top EUR 750 billion, seems therefore to stabilize markets. The package consists of EUR 60 billion in emergency lending, which could be accessed quickly and of EUR 440 billion set up as a special purpose vehicle for new loans, which would take several weeks until activation. The IMF contributes an additional EUR 250 billion. The ECB finally agreed to debt purchases. Interestingly it does not only consist of government, but also private issuers. Lastly, the Fed will restart its emergency currency-swap tool by providing the US currency to European central banks, including the BoE and the SNB. As impressive as the emergency plan appears, it does not eradicate the root of the problem: The EUR continues to be a political currency rather than an economic currency. The success of the current plan is therefore dependent on the political will and assertiveness of its member countries. For the fiscally challenged countries this signifies adherence to austere conditions. It is far from certain that the concerned countries have the staying power to bear years of lower standard of living conditions, high unemployment and a weak economic environment. In Germany, which will bear the brunt of the payments, a surge of anti-European sentiment could be observed during the recent elections. Furthermore, the president of the Bundesbank openly expressed disapproval with the possibility of the ECB buying troubled bonds. To address the EMU problems on a sustainable basis, a transformation from a political to an economic union would be needed.

Foreign Exchange

The reaction of the massive bail-out plan on the EUR could best be described as "volatile stabilization". The uncertainty in respect to the adherence of troubled countries to the austere measures and the still missing ratification of the contract by the member states were main elements in the mitigated market reaction. The notion that the EUR is a "political" currency could not be dispersed. This fact will most likely weigh on the currency for years to come. We consider it most improbable that the EUR can be transformed to an economic-driven currency. The anticipated sluggish development of GDP growth within the Eurozone will additionally disfavor the EUR versus other currencies. We therefore would refrain from investing in this currency even after the gigantic package, which was presented. We received many enquiries in respect to the sensitivity of the CHF to recent events in the Eurozone. We would highlight that the SNB has done a fabulous job so far. While Switzerland is very dependent on export towards the Eurozone, its main counterpart is Germany. We favor CHF over EUR.

	Short-term trend	Last
EURUSD	↓	1.2801
USDCHF	→	1.1089
USDJPY	↑	93.195
GBPUSD	↑	1.4878

Fixed Income

Statements from the ECB are increasingly contradictory to the point that the credibility of the institution is at risk. Last week, the acceptance of Greek bonds, even if declared as not investment grade, refuted prior declarations. At the ECB meeting last Thursday, J-C Trichet stated the ECB's governing council had not discussed the option of buying government bonds and gave no signals that other measures were under consideration. Just three days later, the ECB not only agreed to purchase government bonds, but also private issuers. This could be considered by markets as direct financing of excessive fiscal deficits, which could even be interpreted as a breach of the ECB mandate as the central bank could get involved on the fiscal side. Ironically, Mr. Trichet specifically explained during the last ordinary meeting that the ECB was responsible for the M=Monetary side within the EMU. The E was taken care of by the governments of the different member states. Very intelligently, he did not comment on the U= Union. By stating that the bond purchases would be sterilized this additionally points to deteriorating quality of ECB holdings.

	Forecast end 10	Last
US 10y T %	4.80	3.55
Fed funds	2.00	0-0.25
Bund 10y %	4.00	2.95
ECB rates	1.00	1.00

Stocks

Stock markets reacted very positively on the bail-out plan. We like to caution, however, that much of the strong action seems short-covering activity. European banks, which have been considered particularly endangered by the sovereign crisis due to their holdings of fiscally challenged countries and due to possible liquidity issues, jumped over 20 %. The orchestrated plan may allow banks to sell sovereign positions, thereby lowering the risk profile. Since many questions in respect to the feasibility of the plan remain open, we would concentrate on other sectors and prefer US financial institutions over their European counterparts. We would highlight Citigroup (C), Bank of America (BAC) and MasterCard (MA). We still favor technology and industrial companies, such as Autonomy (AU/ LN), ASML (ASML NA), Intel (INTC), Microsoft (MSFT), Applied Materials (AMAT), EMC (EMC) in the technology sector and ABB (ABBN VX), Alstom (ALO FP), Schneider (SU FP), Siemens (SIE GY), 3M (MMM), General Electric (GE), United Technologies (UTX), Illinois Tool Works (ITW) and United Parcel Services (UPS) in the industrial sector.

	Forecast end 10	Last
S&P 500	1230	1151
NASDAQ	2450	2356
DJ STOXX 600	270	254
SMI	7000	6482