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Weekly Report

Credit agencies: ECB no longer cares!

During long hours of senate hearings, one of the crucial questions repeatedly turning up was: How should regulators reform the credit agency mechanism? Over the Atlantic, the ECB was forced to find an immediate solution after the S&P rating agency assessed Greek debt as "junk" and the two other institutions (Moody's and Fitch) risked to follow. Such a downgrade to "below investment grade" threatened the eligibility of Greek bonds as collateral for ECB loans. This would have been a catastrophe, notably for Greek banks. We all should know by now that banks represent the bloodstream of any economic system. A high level of thoughtfulness and proficiency should therefore be applied when changing parameters. The ECB found a surprisingly simple solution: Ignore credit agencies altogether! Officially, the Governing Council of the ECB defined it as "suspension until further notice". Interestingly, certain politicians also suggested already last week that large financial institutions should rather act on internal know-how when assessing the risk in respect to sovereign issuers than on the rating mechanism of agencies. What seems reasonable and logical in theory represents a massive problem in the real world. All serious asset managers have to succumb to regulations. These stipulate not to invest in vehicles rated "below investment grade". This implies ironically that parties still capable to invest in Greece are mainly the non-regulated ones, exactly the ones, which politicians seem so keen to repress. What has become crucial to the ECB is as important for all asset managers and countries: Define the role of rating agencies!

Foreign Exchange

Politicians may be surprised by the market reaction today as the EUR failed to benefit from the massive EUR 110 billion rescue package. What they could learn from this experience is: 1) Never play with markets, 2) time is money, 3) credibility and practicability are crucial. What we learned is: keep away from situations, which are determined by politicians and ratings agencies. This combination means unpredictability and grave disconnection from reality. Importantly, the power plays over recent weeks have put in danger the monetary union. The EUR will therefore certainly not replace the USD as a reserve currency for a long time. Additionally, given all the difficulties in the Eurozone, the ECB will keep interest rates low for a longer time than previously thought. This will put the EUR in a relative negative position to other currencies. Elsewhere, the Australian government has formally proposed the adoption of the 40 % mining profit tax, which would become effective in 2012. The proposal has not yet been approved by the parliament. We are cautious on the AUD.

	Short-term trend	Last
EURUSD	↓	1.3166
USDCHF	→	1.0881
USDJPY	↑	94.555
GBPUSD	↑	1.5229

Fixed Income

At the peak of the Greek crisis, authorities were quick in calling for a ban on short selling of sovereign bonds. Yet, in many instances, the accelerated selling pressure last week was no longer caused by "shorts" but by "forced" sellers when S&P officially declared Greek bonds as junk. Interestingly, asset managers were not only scrutinized by risk departments in respect to their Greek positions, but the exposure to PIS (PIGS minus-G) seemed of equipollent interest. While the enormous EUR 110 billion bail-out appears to have saved, at least temporarily, Europe's Achilles heel, the situation of the remaining fiscally challenged countries could now be questioned as a strategy in their respect has not been formulated. In our assessment, the indecisiveness, the lacking leadership and the missing conviction of European authorities have already led to an irreparable damage. Additionally, the success of the bail-out plan is far from certain as it demands grave sacrifices from the Greek population and discipline seems not exactly the forte of this nation. The recession will last longer. We expect the ECB to keep interest rates at 1.00 % in 2010.

	Forecast end 10	Last
US 10y T %	4.80	3.70
Fed funds	2.00	0-0.25
Bund 10y %	4.00	3.06
ECB rates	1.00	1.00

Stocks

As a further sign of the stabilization in the housing market, D.R. Horton (DHI) reported better than expected results. The home-builder achieved profitability for the second consecutive quarter by delivering a record 103 % of its beginning backlog and improving homes sales gross margin to 18 % (+ 470 bps y-y, + 90 bps sequentially). A further gain in margins is expected. The management continues to anticipate the strongest deliveries and net income in the June quarter as a substantial portion of the current backlog and April sales are scheduled to close by June. Net sales orders for 2Q increased 55 %, which is well above its peers. It was accomplished primarily due to improved absorptions. The average selling price increased approximately 1 % y-y and the cancellation rate was 21 %. DHI is positioned to take market share this year. We keep the position. Details of the United Parcel Service (UPS) report showed a continuation of the improvement in its international package business. Domestically it benefits from significant cost reductions. Profit margins are anticipated to ameliorate over the next several quarters. Price target \$ 77.

	Forecast end 10	Last
S&P 500	1230	1197
NASDAQ	2450	2490
DJ STOXX 600	270	261
SMI	7000	6608