Analyst Investment Management Plc

Market Insight October 2011

Greece is the Word

Highlights

Highlights is probably not the best description of events this month, lowlights though were plentiful; even Gold lost it's apparent invincibility as it was sold down over $250 on snowballing fears that Greece will default and that the resulting contagion would cause the break up of the Euro and create another banking crisis. This against a backdrop of growing fears of a double dip recession.

Investment Strategy

Equities
Expect further volatility
Buy on Dips

Currencies
Preference for USD over Euro
GBP works as refuge
Swiss National Bank Caps CHF/Euro

Bonds
Corporates continue to suffer as Treasuries prosper

Commodities
Oil Range bound
Gold trading buy at current levels

MACRO REVIEW

Pressure mounts from around the globe on 'dithering' Euro Politicians as politicians from across the pond also fail to outshine.

With all paths apparently leading back to Greece's troubled door step and the lack of action by Euro leaders, even potentially positive attempts at stimulus from the Fed, which announced 'operation Twist' did little to lift spirits. Their plans were over shadowed by what was seen as their surprisingly gloomier economic outlook at a time when the markets expected, or at least hoped the Fed would offer something positive to rally the troops (what happened to think it don't say it?). Now though sentiment is proving more positive

	GDP	Jobless	Infl.	Rates
US	1.60%	9.10%	3.80%	0.25%
EU	1.70%	10.00%	3.00%	1.50%
UK	0.70%	7.90%	4.50%	0.50%
Spain	0.70%	20.89%	3.00%	1.50%
France	1.60%	9.60%	2.20%	1.50%
German	2.70%	7.00%	2.40%	1.50%
Italy	0.80%	8.00%	2.80%	1.50%
China	9.50%	4.10%	6.20%	6.56%
Russia	3.40%	6.50%	9.00%	8.25%
Brazil	3.10%	6.00%	7.23%	12.00%
India	7.70%	9.40%	8.43%	7.25%

it starts to filter through.

US

As President Obama tours the US to promote his $447bln jobs creation plan it appears the country needs more convincing. Consumer spending and confidence remain in the doldrums, a plunging stock market does little to inject a positive outlook and without evidence of a better jobs market concerns over the economy will remain. The initial reaction to the Feds latest stimulus plan with a 'Twist' was grim, giving the stock markets their worst performance in years. The reality however maybe different, according to a report out last week in the Wall St. Journal the view is changing and analysts now believe the programme will

Europe

Whilst European leaders have received moral support form around the globe, the same leaders from China to the US and the UK, made it abundantly clear that decisive action needs to be taken to resolve the crisis in Europe. There was much speculation regarding the vote in Germany and speculation of a lack of enthusiasm for the Greek bailout fund, but this proved unfounded following a resounding yes from the German Parliament. If the majority of media reports were to be believed in the run up to this vote, then Merkel was in trouble, in reality she won by 390 votes to 72. This may seem a trivial point but it does not help sentiment for the man in the street who feels the backing is not there. This is also the case for any argument as to whether Greece remains within the Euro, as if Greece could just simply be asked to leave or walk away. Greece in our view and most others will default. At present under the Euro constitution they cannot be pushed out by another state and it would be an economic disaster, not just for them but for all Euro states should they withdraw. In Germany it would cost 25% of GDP in year one, there would be a run on banks throughout the region with aftershocks being felt around the global economy. It does not make sense to consider a Eurozone without Greece, but decisive and costly action is needed.

UK

Consumer Confidence rises

The UK's troubles have almost slipped under the radar on the global stage, and now it appears the British consumer is gaining in confidence for the first time in four months according to the latest report. Wage growth remains at almost half that of inflation and with the BOE hinting at further stimulus plans on concerns over the recovery cooling, this would seem to be a welcome but unconvincing shot in the arm for the UK retailers.

China

Mixed Signals

China has taken a back seat in terms of priority for most investors, but the jury is still out over whether we hit a soft or hard landing. Inflation remains the main concern but Chinese policy makers appear to have had success in slowing growth without cutting off domestic demand. Manufacturing slowed for a third month and this will concern exporters across the globe but so far evidence suggests no severe setback domestically. That said the property market still raises concerns as developers did not get their 'Golden September', traditionally a strong period, with sales down 13% from August.

Brazil

An encouraging report from the Brazilian Central bank showed positive results for Brazil's banking sector, including stress and solvency tests which showed strong capitalization and a diversified funding base. Without doubt the sector looks in good shape but we would suggest a slight element of caution, limited as it maybe, in case of any aftershocks or fallout from Europe.

Brazil is not without out its problem's, hence the unexpected cut in rates last month as industrial output rose by just .5% in July and the IMF revised their growth forecast for 2011 & 12 down by .5%, a sharper downward revision than anywhere else other than Japan. Inflation remains an issue with consumer demand still strong and unemployment at record lows the Central Bank will have to find a balance.

Brazilian Inflation

Russia

Austerity top of the agenda for President Putin.

This assumes that the new President will be Putin (highly likely). Putin in announcing his decision to run for President has laid out plans for austerity measures to balance the government's budget. The departure of finance minister Alexei Kudrin has sparked concerns about the Russian economy; Kudrin was popular both in Russia and with investors abroad, being seen as someone to help curb government excesses whilst helping secure financial stability. Rising standards of living have helped Putin's domestic popularity but in the wake of the financial crisis a report out this week shows the amount of people living under the poverty line increased from 21.1mln to near 23mln from a year ago. Putin will not want political distractions as he tries to keep the economy on track.

EQUITY MARKET

Accumulate

- **Continued volatility**
- **Buy on dips**

Investment Strategy

- **Overweight BRICS** (Brazil, Russia, India, China)
- **Long DAX** (German Leading Equity Index)
- **Long US**

Equities

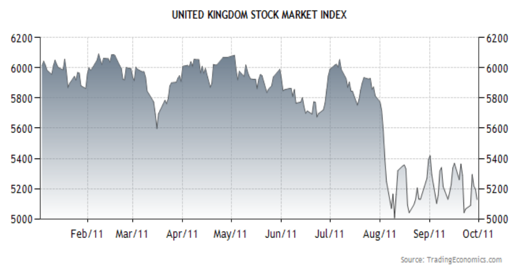
Another miserable month for equities gave the STOXX 600 its biggest drop since 2008 down 17% for the third quarter. There is very little else to say other than Greece and its well documented issues amid concerns of default and any possible resulting contagion across the globe; despite the Euro-leaders calls for support decisive action has been sadly lacking. As we head into more upcoming corporate earnings analysts have started revising downward there estimates for year end levels for global equity indices. Even with these downgrades equity valuations remain at their cheapest for over two years and earnings are expected to recover, albeit at a slower pace than previously predicted.

Euro Stoxx 50 year to date

After losing close to a third of their value Banks remain under pressure and despite repeated reassurances news from the sector has not helped, UBS's apparent inability yet again to keep its house in order as a rogue trader costs it $2.5bln, and news that Dexia in Belgium faces a possible bailout are not helping confidence in the sector.
The FTSE has lost over £218billion this last quarter with mining stocks having played a significant part of the loss. Commodities prices have been knocked back reflecting concerns that China, the worlds top metals consumer, will have shrinking demand. Again we would argue the sector looks oversold and slower growth is already priced in and the markets have overreacted, but there are not many investors prepared to put their heads up above the parapet for long at the moment.

DAX year to date

FTSE year to date



FIXED INCOME

Investment Strategy

- **Look for opportunities in European and High yield credits following the recent sell off.**
- **Hold high yield emerging market bonds**

Treasuries

Another good quarter for Treasuries at the expense of almost all else with their best performance in three years, and with the Fed embarking on its buy programme for longer term treasuries and Europe's woes, this looks unlikely to change for the moment. The feds 'Operation Twist' policy to buy short term bonds to roll into longer dated bonds is designed to bring down longer term rates, and despite the initial criticism early signs are it appears to be working. That said according to an ICAP brokers survey money managers are turning more bearish on treasuries but we would argue we are not there just yet.

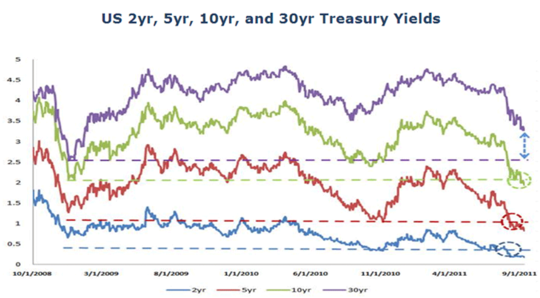
Corporates & Emerging market bonds

As with treasuries German government bonds enjoyed an excellent quarter returning 7.9% as investors looked for safe haven assets. However there appeared no hiding place this month for corporate's as they were hit again. Whilst the Euro zone crisis and talk of the world falling into the abyss continue to circulate there will be few signs of a rally. With little leadership or signs of an adequate solution in Europe, or questions of political leadership over in the US, institutional investors have shut down on risk across the corporate bond arena.

The flight to safety was evident last week as outflows from emerging market bonds hit $3.2billion vs $692million the previous week. In the US, bond offerings fell in the third quarter to $192bln from $314.7bln in the previous quarter.

Investment Actions

- **Berlian Laju Tanker 7.5% 2014 bonds. Rated CCC. Barclays released a sell recommendation which saw the bonds marked down to near its all time low at around $35 having traded near $85 earlier in the year.**
  Hold to sell into strength



(Source: Bloomberg LP)

CURRENCIES/COMMODITIES

Currencies

- **Prefer USD over Euro**
- **Prefer GBP over Euro**
- **CHF capped vs Euro**

Euro

Prefer USD and GBP

In view of the worsening crisis in the Eurozone we see no reason to be buying the Euro and expect further falls against the USD and GBP, even in the event of further stimulus from the BOE or the Fed's 'Twist' adding the predicted stimulus.

GBP

Relative safe haven

Despite a minor rally Sterling continued its weak performance against the USD over the quarter, largely inline with speculation for further monetary easing and no real change in sentiment for Sterling. We remain with our view of GBP over Euro as a safe haven against any further Eurozone instability.

CHF

SNB Controls

Following the Swiss National Banks announcement that they would have to live with a stronger CHF they promptly took the extraordinary step of capping the CHF against the Euro at 1.20, which was indirectly seen as a vote of confidence for the Euro but more importantly was seen as decisive action to curb speculation on its own currency and help the Swiss economy and its exporters. The SNB has vowed to defend the CHF robustly by buying 'unlimited quantities of foreign currency. This position is unlikely to change any time soon.

Commodities

- **Oil range bound**
- **Gold remains solid**

Oil

Price succumbs to poor global outlook

Oil did not get any further boost from last months encouraging Chinese PMI as it heads for its worst quarterly drop since 2008. Its poor performance was inevitable given the global outlook and China's, the world's second largest consumer, slowing demand. We don't anticipate much to change in oil on the upside over the coming weeks, and would expect it to remain range bound.

Gold

Amongst the onslaught of grim news even Gold let slip its aura of invincibility as uncertainty, normally its bread a butter for a rally, saw Gold sold down from above $1800 to close to $1500, heading straight through what was considered a support level of $1750 without looking back. This was down as much to profit taking and had gained momentum as investors needed to pay for losses elsewhere. Last month we had suggested taking profits at around $1800 or trading from the short side, this month we believe there will be opportunities to trade from the long side as demand for Gold is still in evidence and Gold is still widely tipped to hit $2000 by year end.