

Market Outlook

Investing Themes for Q1 - 2012



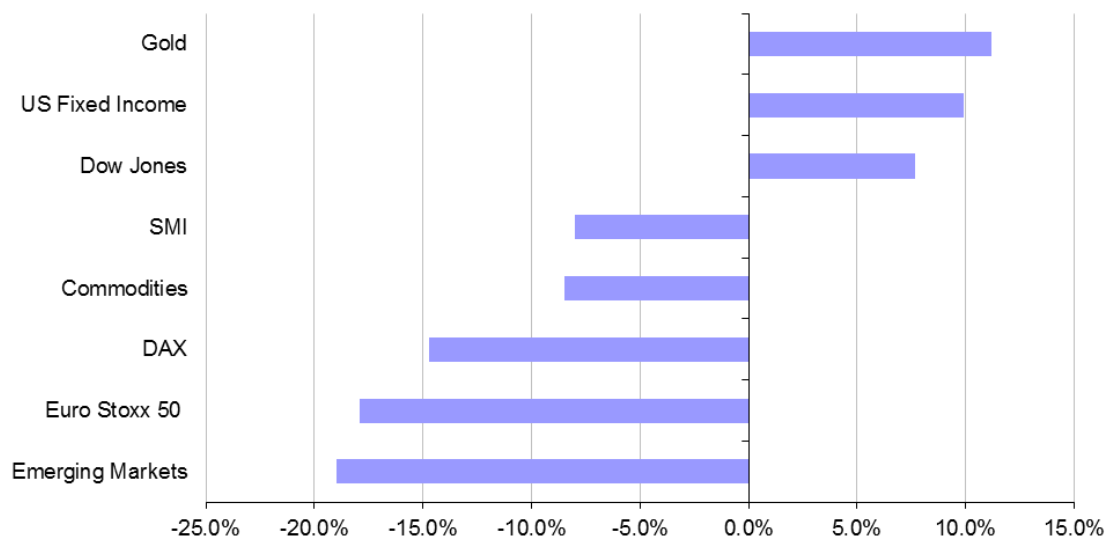
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I. Market review and outlook

2011 was characterized by very nervous financial markets and an extremely difficult year for investors. Spring saw the tsunami in Japan which triggered a serious incident at the Fukushima nuclear power station as well as revolutions in North African countries which constituted the Arab Spring. Around the middle of the year, poor economic data in the US renewed fears of recession. As the US economy started to make up ground in the second half and as the situations in Japan and North Africa eased, the on-going debt crisis in the euro zone became the dominant theme for many investors. The EU held one summit after another. However, the market's lack of trust in European politicians' ability to overcome the debt crisis has, if anything increased. With this in mind, it is no wonder that risk assets such as equities were generally avoided. International investors preferred to take refuge in "safe havens" such as German and US government bonds. Demand for gold was particularly high. Despite the correction in the latter months of the year, a troy ounce of gold increased to USD 1,576 by the year end. This implies an 11% yearly gain, putting gold once again ahead of the major asset classes in terms of investment return. Overall, equities were among the loosing asset classes in 2011; Emerging Markets shares as well as Blue Chips in Euroland lost between 15% to 20%. On the other side, the Dow Jones Index managed to post some modest gains.

Performance (in local currency) 31.12.2010 - 31.12.2011



On the back of debt crisis in Europe, the high level of uncertainty in financial markets is set to continue. At the same time a significant economic downturn in most Eurozone countries has to be expected. The mood among companies and consumers has noticeably deteriorated – not least because of the worsening debt crisis - and economic growth in the euro zone has slowed considerably. Over the winter, the monetary union

is set to slide into recession and there is a great danger that it will be more severe and prolonged than anticipated. The outlook is better on the other side of the Atlantic. Indicators show that the economic recovery is set to continue – albeit at a moderate pace. However, the US economy is still in a fragile state, meaning there is a high risk that growth will be markedly weakened by external factors. For example, there is a risk that the increasing turbulence in global financial markets may have a negative effect on the real economy in the US. Political strife in the run-up to the Presidential elections could also depress the mood among companies and private households and may lead to a reluctance to spend and invest.

With the established industrial nations ailing, hopes now rest on emerging economies, particularly China. 2012 is the "Year of the Dragon" and it remains to be seen whether this will bring the Chinese economy any good luck. Only one thing seems certain: that the pace of economic growth will continue to slow. However, we do not anticipate a severe downturn, as there is enough room for manoeuvre in Chinese monetary and fiscal policy to stimulate the economy if required.

In summary, 2012 promises to be another challenging year for investors. As risk appetite among market participants is still low, the bond havens should remain in demand. Low interest rates and a weak economy represent a positive environment for gold. For equities – as with all other asset classes – a focus on quality is particularly important in an uncertain environment such as this.

In these difficult times, we wish all of our readers a happy and successful year and hope it brings them good fortune so far as their investment activities are concerned.

I. Asset Allocation Views

1. Interest Rate and Fixed Income

At the start of the year, downward revisions of growth and inflation forecasts together with persistent uncertainty in global markets will result in risk-free yields continue to stay at their current depressed levels. In anticipation of a brightening picture for the European debt crisis and associated ECB action, we expect markets to once again be driven by fundamentals. With negative real interest rates in the US and Germany, we see little value in holding government bonds of longer duration in 2012, with US government bonds in particular likely to see significant yield rises.

How to invest: Overall we are still neutral for bonds. We avoid government bonds and prefer corporate bonds of investment grade quality (i.e. little default risk, cash rich companies in defensive sectors). We generally prefer short maturities. To maintain a maximum level of flexibility we suggest holding above average cash reserves.

2. Global growth and Equities

Our view on euro zone growth remains pessimistic. We cannot rule out a recession in most of countries of the European Area. This time around, almost every country in the euro zone is now in the middle of an austerity drive to a greater or lesser extent. In other words, the fiscal policy of the euro zone as a whole is actually pursuing a restrictive course in the face of recession. The only conceivable way of dampening this effect would be for the more stable countries in the north of the euro zone to counter the negative economic consequences of austerity drives in the south by pursuing a less severe fiscal course in the short term. However, it is unlikely that any such scenario will unfold in the current political climate, as the urgent need to make savings in public sector has now become a Europe wide mantra. However, the example of Greece provides a crystal clear example of how cutting expenditure too rapidly and too drastically can actually produce precisely the opposite result to that which was intended. After all, if a country's economy shrinks at a faster rate than its debt mountain is cut, the debt ratio actually rises!

In view of the above, we expect a mild recession in the Eurozone in 2012. As a result of these developments and a more favourable comparative basis for energy prices, the inflation rate should remain low over the coming months. The ECB can therefore leave its key rate at the current level of 1% for the foreseeable future. The greatest element of uncertainty in this context is the astonishing stability of the price of Brent crude, which is still trading above 100 US dollars a barrel despite economic uncertainties around the world. However, the risk remains that improving economic data or tensions in the Middle East could lead to a renewed surge in the oil price, which in turn would halt the decline of the inflation rate and weigh on the economy.

In 2012, the US economy is only likely to accelerate at a modest rate. Despite the anticipated recovery, the US economy remains fragile. Once again, capital investment is likely to prove the key growth driver. For one thing, the climate for investment is currently favourable given the low interest rate environment. By contrast, consumer spending is again likely to develop only moderately in 2012. A positive influence here is the fact that consumer purchasing power is likely to be strengthened by the anticipated decline in inflation. Consumer spending will also be supported by the ongoing – albeit very sluggish – recovery of the labour market. On the other hand, private households will also be preoccupied with tackling their debt burdens in 2012, and this will have the effect of restraining consumer spending. We are not expecting any growth stimuli of note to come from the export side. On the other hand, government

expenditure can be expected to shrink once again, which of course will be holding back economic growth.

We continue to anticipate slowing but still robust growth rates in emerging markets in 2012. Although momentum should slow once again, growth rates for these economies will remain far above those of the industrialized nations.

How to invest: We have become cautious on equities at this stage and expect rising volatility until at least the middle of 2012. We favour defensive, cash rich and dividend paying stocks over cyclical sectors. Since summer 2011 the market turned in favour of defensive stocks (healthcare, telecoms, consumer staples, and utilities), while more cyclical sectors (construction, consumer discretionary, financials, industrials, materials, and technology) were left behind. Against the backdrop of substantial macroeconomic risks this trend is likely to continue into the coming year. Some exposure to the oil sector may hedge against renewed tensions in the Middle East and a sudden increase in economic activity and subsequent inflation fears.

3. Commodities and Gold

Financial market turbulence and negative real interest rates in Western economies boosted the price of gold in the first half 2011, while commodities that are tied to the economic cycle lost ground. Hardest hit were soft commodities and industrial metals. Energy, however, held up supported by relatively tight oil markets. 2012 looks like being another difficult year for the commodity market, if our scenario of weakening growth worldwide unfolds. Gold, however, should continue to do well and outperform other metals.

How to invest: We remain overweight in Gold and gold mining stocks. Precious metals in general are an important hedge against macroeconomic risks. However volatility in Gold has increased. In the last quarter 2011 gold prices corrected almost 20% from their peaks and we expect volatility to remain high. We would increase gold holdings during a correction phase. Large cap gold mining stocks look particularly interesting. For the first time some companies have started to pay dividends and with low valuation persisting we anticipate M&A activities to pick up in 2012. We also remain invested in energy and commodity stocks though we would not add to the positions. The long-term structural themes behind the case for investing in agricultural commodities remains compelling, such as a growing world population, climate change, emerging market diet development and planting competition with biofuels.

4. Currencies

Sentiment in financial markets may remain depressed as progress in the euro sovereign debt crisis will be slow and macroeconomic data may start to disappoint in 2012. Further easing by central banks – lower key rates, and where appropriate, quantitative easing – will compress interest rate differentials and strengthen the safe haven currencies JPY and USD. However we expect the USA and Japan to intervene in order to keep their currencies low. If this trend continues it could spark global competitive currency devaluations as well as tariff wars. To begin with, China has already increased tariffs on German and US luxury cars in December 2011. There might be more to come in 2012.

How to invest: To hedge against currency risks most of the asset should be invested in the reference currency. For diversification and hedging purposes we keep long positions in the US dollar in coming months. Avoid the Euro and keep an overweight in the US\$ for the time being. Continue to accumulate Gold.

Recap – Asset Allocation (January 2012)

Cash	Positive
Bonds	Positive on corporate bonds Negative on Government bonds Overall short duration, good quality
Equities	Neutral
Commodities	Neutral
Precious metals	Positive, especially Gold
Currencies	USD (new!)

The above ranking represents a general guide and the actual weight in our Multi asset portfolios will depend on portfolio objectives and restrictions.

Established by

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