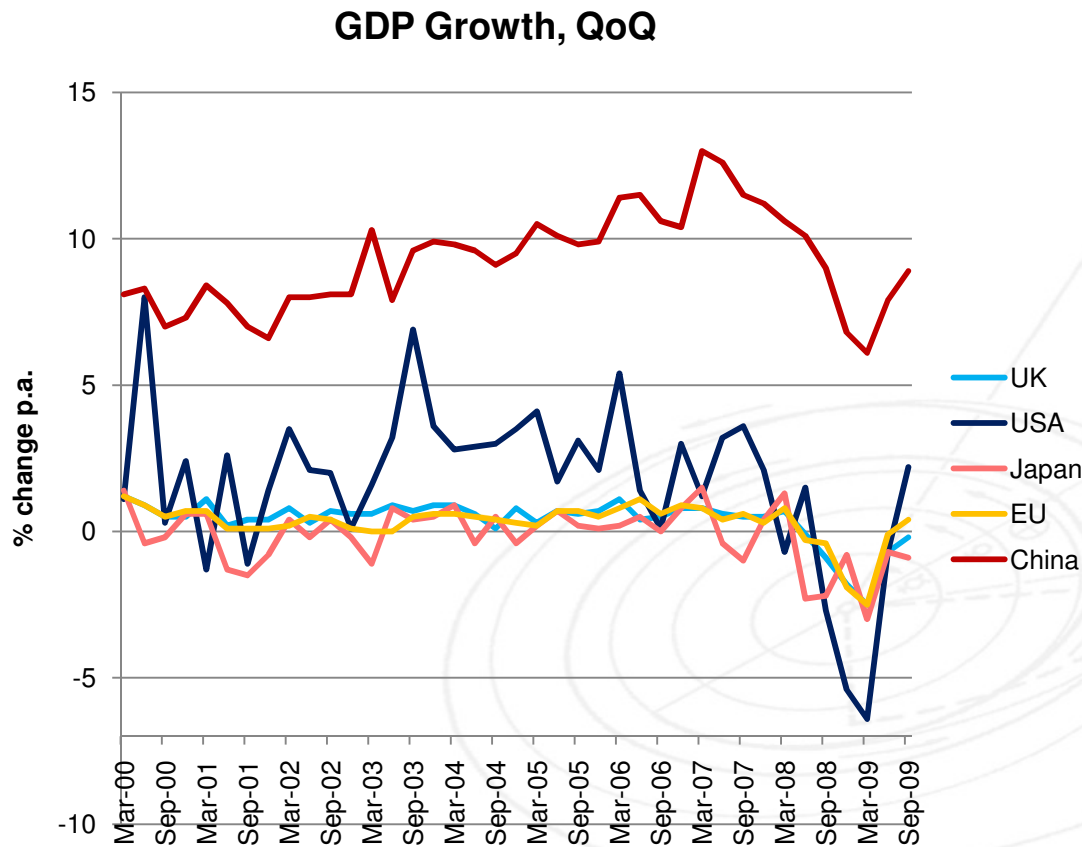




# Economic Growth – Slow Recovery

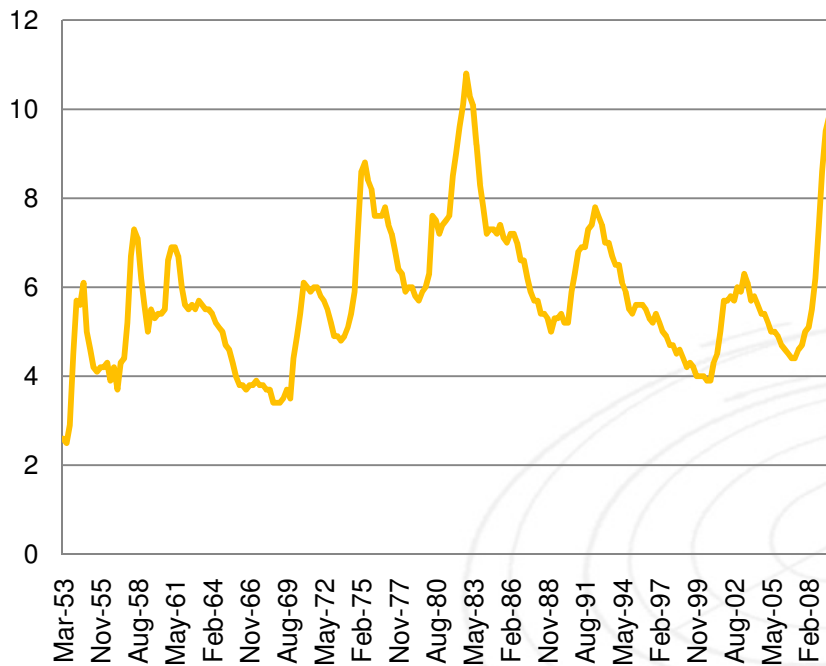


- ❑ The recession has ended and the upturn should be sustained
- ❑ Labor market is slowly stabilizing and the inventories are slowly building
- ❑ IMF: Economic cycles combined with banking crisis create deeper downturns and weaker upturns
- ❑ Every country will likely reduce stimulus and rise rates at its own pace

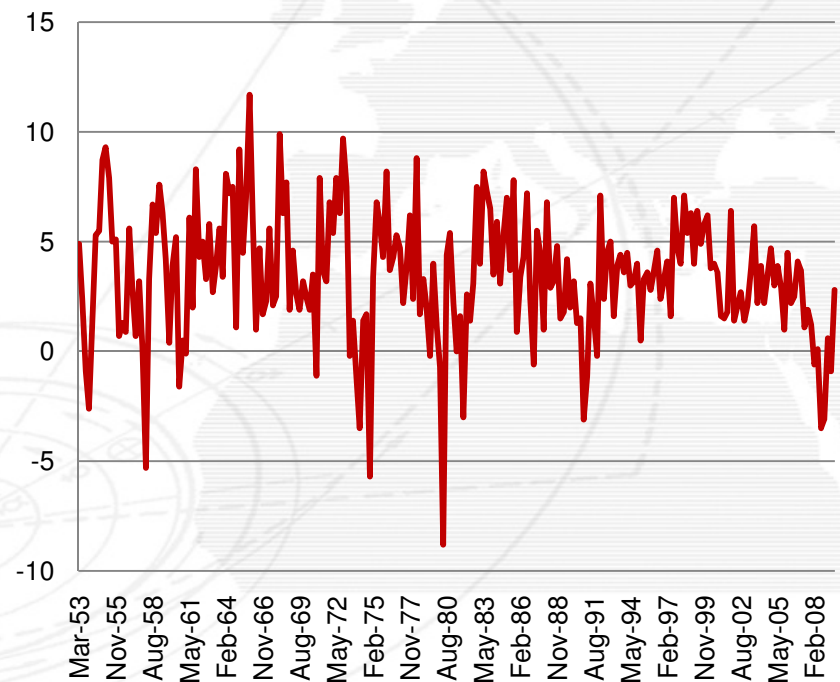
Source: Bloomberg

# Households – Still Under Pressure

US Unemployment %



US GDP Consumption %



- The US unemployment rate is stabilizing @ 10-10.5%, and should start to recover this summer
- This is limiting wage growth and consumption
- Consumer spending stopped contracting in Dec-09
- Statistics about the consumption are mitigated

# Debt Super Cycle – Global Rebalancing Needed



## Developed Countries

- High level of debt (debt super cycle)
- Fiscal restraint needed
- Weaker growth

## Emerging Markets / BRICS

- Consumer and business debt low
- Need to invest into infrastructure
- Property ownership low
- Need to put money aside for education, health and pension

Global rebalancing is needed, and it already started but it may have a violent end.

# What should happen when interest rates will go up?

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## Market Expectations:

Region	Actual Jan 2010	Consensus est. Q4
US	0.25%	0.75%
Euro zone	1.00%	1.50%
UK	0.50%	1.00%
Switzerland	0.25%	0.75%
Japan	0.10%	0.10%

## Impact on Asset Classes:

- Strengthen the domestic currency
- Bonds with high durations (long maturity, low coupon) will go down
- High equity multiples will not be justified anymore and could trigger a correction
- Gold will be less attractive since it does not pay interests
- Banks will make less money on the carry trade

# Equities

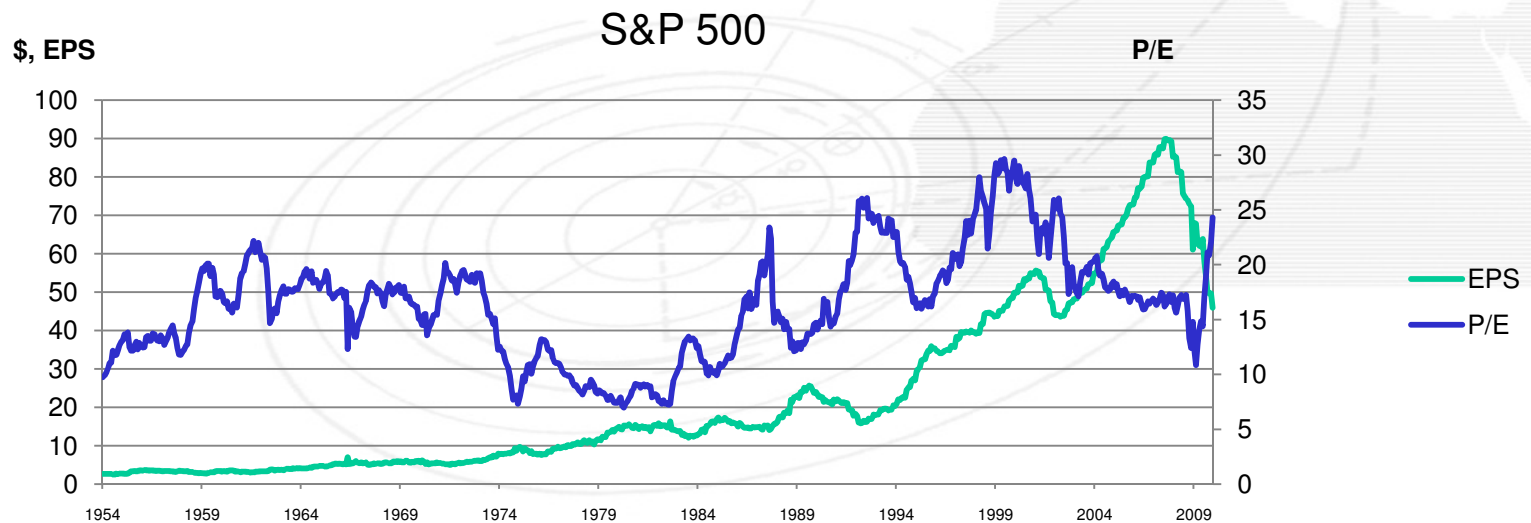
P/E

- ❑ Historically the S&P 500 averaged a P/E of 14-17
- ❑ In 2009, S&P 500 P/E increased from 10 to 25 to reflect the expected earnings recovery and low interest rates
- ❑ During a bear market, the P/E can reach 6-8x at its bottom\* and 8-13 during the consolidation

➔ **The S&P 500 multiple is high and go down if interest rates rise**

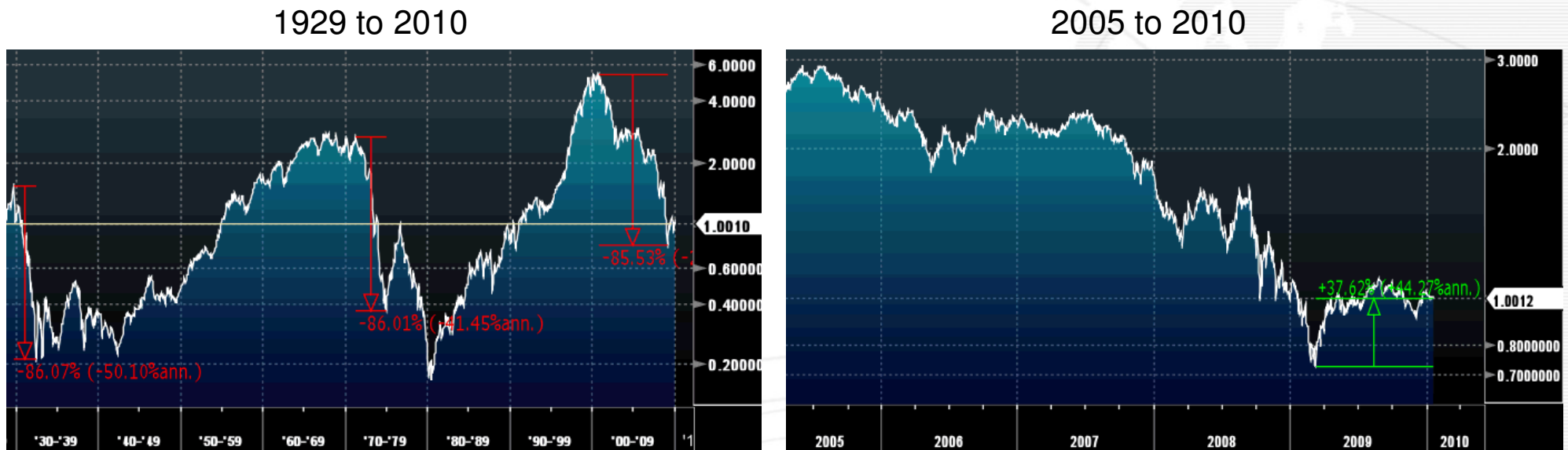
Earnings

- ❑ 1Q-3Q 2009 corporate earnings were better than expected, mostly based on cost-cutting
- ❑ 4Q09 earnings will need increase in revenues this time



\* Professor Robert Shiller on cyclicity of financial ratios

# Financial Markets' Cycles – S&P 500 Measured in Gold



This chart shows equity market cycles as defined by the Real S&P 500 in gold instead of USD. A few **interesting observations**:

- ❑ The value of the S&P 500 measured in gold and ex-dividends was the same in January 1929, 2009 and 2010.
- ❑ In the prior two secular bear markets, both stopped going down when they reached the -86% level. **This rule has been precisely right this time again.** Historically, the recovery has been **W-shaped**, not V or L.

## Implications For Portfolio Management at Huet & Cie

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- ❑ **Fixed Income:** We can take more credit risk but reduce the duration of our bonds. The credit analysis will become more important. The allocation to fixed income will be reduced.
- ❑ **Equities:** Earnings should continue to recover like the economy. High multiples will be difficult to sustain. Stock selection will become more important than last year.
- ❑ **Hedge:** Currently, the equity volatility is low (VIX: 18%) but it is likely to change. Puts look cheap and are an attractive way to hedge the equity risk.
- ❑ **Interest Rates:** Short-term interest rates will have to rise and the stimulus will be taken out. It is unlikely to happen in the first half of 2010. This event will trigger significant changes in the assets valuation.
- ❑ **USD:** China and foreign central banks are still buying USD securities, because it is not in their interest to have a weak USD. This situation is not sustainable in the long-term. The implications are unclear but we are likely to see a strengthening of the USD in the short-term, followed by a weakening.