

Market Commentary

6th of October 2011

The sovereign debt crisis in Europe coupled with weaker macro economic numbers and fears of a hard landing in China resulted in a very turbulent third quarter for financial markets. Investors fled equities and bought corporate bonds instead. Initially gold was considered a safe haven and the gold price rose well past USD 1900 before a sharp correction in September brought it back under USD 1600.

We had started to reduce the equity exposure of our clients in April this year and held cash instead of further increasing our exposure to bonds which we believe to be expensive. We also sold the more cyclical holdings and retained the more defensive ones. Our positions in the Swiss Franc, Gold and American multinational companies were also beneficial. Therefore, even though the average European equity market is down more than 20% this year, our client portfolios are down 3-6% depending on the currency and risk profile.

SOVEREIGN DEBT ISSUES

Though some progress was made in the past couple of weeks towards a solution to the sovereign debt crisis in Europe, there is no concrete plan in place yet and this continues to weigh on market sentiment. Even though the US debt situation is not in focus at the moment, their tackling of the deficit reduction plan also leaves a lot to be desired. There are too many conflicting opinions being voiced by the various vested interests in Europe and America which increases uncertainty for investors. However, as there has been indiscriminate selling of equities, the present situation has opened up opportunities to buy equities of some very solid companies at very reasonable valuations.

RECESSION FEARS

Despite all the recent developments, we do not believe that we are heading for a global recession. In fact recent data from the US and China with regard to GDP and PMI has been more positive than expected even though they are not at the levels that would provide substantial comfort to the markets. The Chinese have been worried about the level of inflation for over a year and had tried to slow down growth to combat it. Recent statistics indicate that Chinese inflation has peaked and the drop in commodity prices over the past month should encourage the Chinese government to shift their focus back to growth especially in light of the weak economic conditions in the west.

However, we believe that a slowdown is in place and that analysts and economist have only recently started to revise their numbers downward. Therefore the probability of further near term losses on the equity markets is high.

OUR VIEWS

Last month, we wrote that we were expecting a correction in Gold and the Swiss Franc. Though both of these have taken place as expected, the speed of each move surprised us as it indicates the level of leverage behind market positions. Investors have moved away from equities and into bonds in the past quarter and we believe this move is overdone. However, though we do not wish to increase bond exposure, we have retained a high level of liquidity.

Traditionally investors fled from equities to treasuries when they were risk averse. As the financial crisis started, this is exactly the move we saw. Now corporate bonds are being favoured over equities. However, as we have repeatedly emphasised most companies outside of the financial sector have strong balance sheets and what investors are doing by buying their bonds is to provide cheap capital with which they can make their shareholders rich in the medium term.

Investor sentiment is at very low levels and even small bits of good news can cause very strong rallies as most market participants are very underexposed to equities. In fact we have seen such moves over the past two weeks. Timing entry points is very difficult at the best of times and therefore we believe it is important to build positions slowly rather than attempting to make all or nothing decisions.

We are pleased that our clients have provided us with very positive feedback regarding our approach to these difficult markets and look forward to making good use of the opportunities that such markets reveal.

Gillian Hollenstein