

Investment Perspective

JULY 2010



Inside view

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Over recent months 'bond vigilantes' have demonstrated to politicians what real power looks like, bringing Greece and other European fiscal miscreants to account. The central issue is the solvency of governments, typically regarded as safe 'lenders of last resort', and is profoundly more complex when it relates to 16 members of a single currency. Any resolution will involve some members 'winning' and others 'losing', a very different political equation from the relatively benign environment of the early years of the euro. This drama will be long-lasting and far-reaching, needing to address the solvency of both governments and banks. How harsh will the required write-downs of sovereign debt be, or how robust are the capital ratios of banks? The €750bn bazooka fired by the IMF and European Central Bank has bought some time, but has not resolved any of the fundamental issues.

The wider issue for investors is whether fiscal tightening in Europe and elsewhere will prematurely choke the momentum of a nascent global recovery. While the balance of risks has clearly shifted, there is momentum behind both the US and Asian recoveries, with ample liquidity and the prospect of sustained low interest rates to support them. The stakes are high – the US must maintain its historic role as the prime engine for global growth and China's role in setting the pace in Asia has never been more critical. Tension about the outcome – 'double dip' or sustained recovery – is evident in many ways and most obvious in the debate between deflation proponents and those who argue that inflation is the greater threat, a theme picked up by Carl Astorri in this quarter's 'Global Perspective'.

While happy to grant the US some 'extra time' during the current pressure on euro members, the bond market will at some point also demand that the US puts its fiscal house in order. This threat explains the pre-emptive fiscal consolidation delivered by the new British government late in June. We believe that high-quality corporate debt is where investors will find value in global bond markets, not sovereigns, a theme detailed by Stefan Muheim in a feature article in this issue.

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EQUITIES

FTSE 100	4,917
S&P 500	1,031
Eurostoxx 50	2,573
Nikkei 225	9,383
Swiss Market Index (SMI)	6,128

INDEX

4,917
1,031
2,573
9,383
6,128

BONDS (10YR)

UK Gilts	3.36
US Treasuries	2.93
Japanese Government Bonds	1.09
Swiss Government Bonds	1.48
German Bunds	2.58

YIELD %

3.36
2.93
1.09
1.48
2.58

COMMODITIES

Gold (\$/ounce)	1,242
Oil WTI (\$/barrel)	76

PRICE

1,242
76

Accelerated fiscal tightening to intensify deflation forces



CARL ASTORRI, ASIP
Global Head of Economics
and Asset Strategy
Based: London

Deflationary pressures already facing the global economy have intensified in the wake of Europe's fiscal crisis, making deflation a greater risk than inflation in the next two to five years. Such a large amount of excess capacity was built up during the recession that it would take two years of substantially above-average growth to erode it and stabilise core inflation. Unfortunately, the major developed economies are unlikely to grow that fast over the next couple of years, especially given the severity of fiscal austerity measures being unleashed.

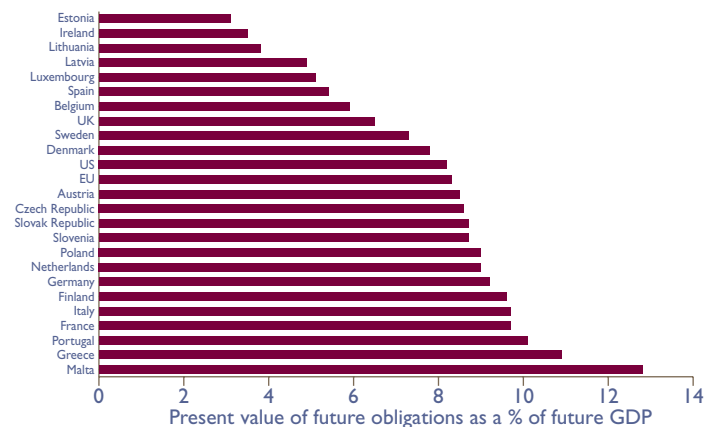
The new age of austerity

After years of credit-fuelled excess, the priority for most consumers is saving not spending, banks are more focused on rebuilding their capital bases than driving lending growth and governments have to accelerate their fiscal tightening plans. The fiscal crisis in Greece is forcing other European governments to bring forward and increase the severity of their fiscal tightening plans to avoid a run on their own sovereign debt. Governments used fiscal stimulus to head off the global recession and brought substantial liabilities from their banking systems onto their balance sheets. Many of the major developed economies also face a major structural issue – retiring baby boomers who are living longer and fertility rates that are below population replacement levels. Spending on retirement and healthcare benefits for the elderly will increase, but there will be fewer workers to pay for these benefits.

As a result, these countries have large unfunded liabilities – the difference between the projected cost of continuing current government programmes and expected tax revenues. Although these countries remain publicly committed to restoring fiscal discipline, large portions of their government budgets are funded on a pay-as-you-go basis. No real resources are set aside and invested each year to pre-fund these future expenditures. For example, to pre-fund its commitments the average European Union country would need to have more than 4.3 times its current annual GDP in the bank earning interest, or put aside 8.3% of GDP every year. Otherwise, and unless they reform their health and social welfare programmes, these unfunded obligations would have to be met by substantially increasing taxes. The UK fiscal imbalance is a little smaller, given a younger population.

The US, with a fiscal imbalance of 8.2% of GDP, would need to save and invest an equivalent amount every year from now on to pay expected future benefits without future tax increases. It would take a doubling of payroll taxes on employers and employees to close the gap. Alternatively, spending on nearly four out of every five dollars would have to be cut on programmes other than social security

Fiscal imbalances



As at 18 June 2010

Source: Gokhale 2009 "Measuring the Unfunded Obligations of European Countries"

and Medicare, eliminating most discretionary spending on education, national defence, environmental protection and welfare – forever. Neither of these solutions looks politically palatable.

Political and economic 'mission impossible'

Governments typically do not slash entitlements or grow their way out of severe fiscal trouble without first defaulting or letting their currencies depreciate. While we see deflation as clearly the bigger threat for now, the longer-term risk is that inflation will also form part of the policy solution to the fiscal crisis among the major developed economies. Governments faced with a debt crisis usually compel central and commercial banks to hold their debt, restrict overseas investment, default on commitments to politically weak groups and foreign creditors and condemn bond investors to negative real returns by unleashing inflation. However, as the experience of Japan over the last two decades shows, even when you print money it is extremely difficult to break a debt-deflation cycle.

So what are the asset allocation implications of the inflation outlook? In the next two to five years we believe deflationary forces will cause conventional government bonds to outperform inflation-linked bonds and industrial commodities, while limiting the upside for equities. Consequently, we reduced our holding of index-linked bonds in client portfolios earlier in the year following their outperformance of conventional government bonds. Longer-term, if inflation is indeed part of the solution to the fiscal mess, it will be beneficial to overweight index-linked bonds, equities and gold.

— **Carl Astorri** is responsible for our views on all major asset classes, including equities, bonds, commodities and property. He has 15 years' experience as a strategist and economist, and holds a Masters degree in Economics and Finance from Bristol University. Carl is also an associate member of the Chartered Financial Analyst Institute.

Key Points

- Fiscal tightening will result in sub-par growth at time when already lots of spare capacity – put downward pressure on prices near term.
- Deflation remains bigger threat for now, but longer-term inflation is tempting tool in struggle with excessive debt.

Focus on yield in the UK equity market



ALAN HIGGINS, CFA
Head of Investment Strategy, UK
Based: London

With interest rates below inflation and bond yields not far off, the search for yield continues. Historically, when FTSE 350 average dividend yields move above government bond yields, it has been a buy signal for equities. At 3.6%, the current FTSE 350 dividend yield provides only a slightly better yield than 10-year gilts for the added risk. But why buy either when inflation is enough to erode most of it? We believe there are good opportunities within the FTSE 350 to buy companies with above-average dividend yields and plenty of scope to keep up the payments.

Larger companies often dominate index averages, blinding us to potential opportunities. A better approach would be to look at the percentage of companies that have a dividend yield greater than the government bond yield. On this measure, currently 32%, income stocks look attractive. It may be down from last year's highs of 63%, but it is well above the 20-year average of 11%. The FTSE 350 High-Yield Index, which is made up of those stocks with an annual dividend above the index average, currently has an average yield of 5.5%.

Of course, equities come with an element of risk, particularly in the high-yield sphere. There are two key questions, especially in periods of uncertainty: 'Does the company have the ability to pay the dividend?' and 'How vulnerable are equities generally?' Individual companies may still pay their dividend, but capital losses could challenge investors' patience in the short term if equity markets in general extend their recent correction. In volatile markets, it is worth keeping in mind that a large proportion of total long-term equity returns come from dividends. For example, the average annualised price return of the FTSE 350 over the past 20 years is 6%, compared with an average annualised total return (including dividends) of 10% over the same time period.

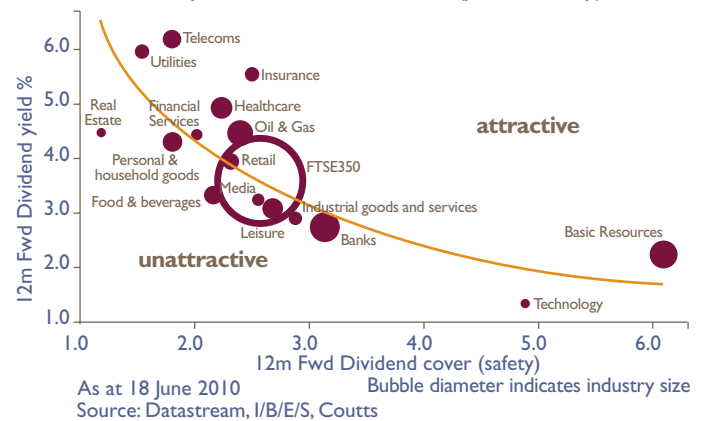
Yields are higher because perceptions of risk have increased

Yields have increased as a result of falling equity prices, which reflect the heightened risk and negative sentiment associated with equities, and cast doubt on the ability of many firms to pay such high dividends (relative to their price). A useful metric to gauge this ability is to look at how many times the net profits of a firm could pay the dividend (dividend cover). A drop in this cover below 1.5 could call into question the company's ability to sustain its dividend and continue to invest for future growth.

Our analysis, when comparing dividend cover versus dividend yield, suggests that the healthcare, telecoms and oil & gas sectors have adequate dividend cover and yields above that of inflation. However, nearly a third of the oil & gas sector is made up of BP, which on 16 June announced it would halt its dividend as part of a settlement with the US in the wake of the Gulf of Mexico oil spill.

Yet excluding BP only slightly lowers the dividend yield of the sector, while boosting the dividend cover, so the rest of the sector remains attractive.

Forecast dividend yield versus dividend cover (yield vs safety)



In turn, food & beverage, industrial goods & services and banks have adequate dividend cover, but their yields are below current consumer price inflation.

A word of warning – high yielders are volatile

The top 30 stocks of the FTSE 350 Index, all with an annual dividend yield above 6%, tend to be extremely volatile during periods of economic uncertainty. Their average decline during the credit crisis was a remarkable 74%, against the 38% average for the index as a whole. Stocks with dividend yields of 4.5-6%, which fell an average of 42%, have a similar performance to the Index – and offer a safer alternative to the highest yielders.

Overall, we believe that income stocks are attractive, particularly in light of their high yields relative to government bonds. The best opportunities are in the oil & gas, healthcare and telecoms sectors, in those companies with above-average yields (although not too high) and good dividend cover:

— **Alan Higgins** is responsible for the management of UK-based discretionary managed portfolios and contributes towards our global investment strategy for the major asset classes. Alan has over 20 years' experience in portfolio management. Prior to Coutts & Co, he worked at Morgan Stanley Wealth Management where he specialised in asset allocation and alternative investments.

Key Points

- Low cash rates and relatively high inflation driving quest for yield.
- Income stocks attractive, with oil & gas, healthcare and telecoms offering best opportunities.

Will banks be the next victims of Europe's debt crisis?

We believe a restructuring of Greece's roughly €310 billion of debt is likely at some point, adding to the euro-zone banking sector's existing burden of losses from corporate and consumer lending. While there have been some positive recent developments, we expect the sector to struggle over the longer term.

Our outlook is for the euro-zone to muddle through with stagnant growth over the next couple of years, but this is dependant on containing the fiscal crisis in the periphery. This view assumes that Greece will delay any restructuring for a year or two, while other highly-indebted governments use this window of opportunity to push through tough austerity measures.

In this scenario, Greece's eventual restructuring would cause some damage to the euro-zone banking sector's capital base, but not a wider contagion to other government bond markets. German and French banks in particular have substantial exposure to Portugal, Italy, Ireland, Greece and Spain (the PIIGS countries), both in absolute terms and as a percentage of their banking system assets.

Bank exposure to PIIGS as % of total sector assets

Exposure to	US banks	German banks	French banks	Italian banks	Spanish banks	UK banks
Greece	0.1%	1.1%	1.0%	0.2%	0.0%	0.2%
Ireland	0.5%	4.6%	0.8%	0.6%	0.5%	2.0%
Italy	0.5%	4.7%	6.5%	n/a*	1.5%	0.8%
Portugal	0.0%	1.2%	0.6%	0.2%	2.8%	0.3%
Spain	0.5%	5.9%	2.8%	0.9%	n/a*	1.2%
Total	1.6%	17.5%	11.7%	n/a*	n/a*	4.5%

As at 31 March 2010

Source: Courtts, BIS, Bloomberg. *BIS data not available for Italy, Spain

Although we view it as less likely, the possibility does exist of further contagion if the political will is lacking for tough austerity measures, or if the measures are blocked by civil unrest. There is even a small risk of a break-up of the euro-zone stemming from a failure to agree on terms for emergency funding. These possibilities highlight the importance of political risk over the next few months, especially in Spain.

Reasons to be positive in the short term

Over the short term, macro-economic issues will dominate and could continue to weigh on the banking sector. However, we also see some positive developments that could provide the basis for a short-term rally.



JEAN-MAURICE LADURE, CFA
Head of Investment Strategy, Switzerland
Based: Zurich

Asset quality has improved earlier than expected, with the provisions for bad loans having peaked in the third quarter of last year; while the formation of non-performing loans has also slowed in recent quarters. Capital positions have improved through the reduction of risky assets on balance sheets. We believe the trend of industry consolidation will spill over to German Landesbanken, and this should contribute to some stabilisation in the banking system.

Longer-term struggles for the banking sector

However, our longer-term view is that the financial sector will struggle as a result of tighter regulation, the need to boost capital ratios and a slower economic recovery in Europe. Reduction in risky assets, higher capital ratios and lower leverage all imply a lower return on equity, lower earnings growth and lower dividend growth for European financials. Overall we remain cautious on the financial sector within equities.

In the case of both equities and credit, we would be cautious and selective in the banking sector in general. For the insurance sector, we believe that the exposure to high-risk sovereign debt is manageable and solvency ratios should provide a sufficient buffer even in the case of more significant write-downs.

Equity performance in the European Union (total return)



Banking sector bonds offer a way for investors to move up the capital structure and reduce risk while maintaining exposure to the industry. In an environment of weak growth, we believe high-quality fixed-rate assets will make more attractive investments. As discussed in Stefan Muheim's 'Credit Perspective' article elsewhere in this issue, low government bond yields will also inevitably force investors seeking higher yields to move into risk assets.

— **Jean-Maurice Ladure** is primarily responsible for making investment recommendations within managed portfolios. He has over ten years' experience as a strategist, quantitative analyst and portfolio manager. His particular areas of expertise include modelling the interactions between economics and financial assets, assessing equity market valuations and capturing investor sentiment effects on markets. Jean-Maurice is a CFA charterholder and a French actuary.

Key Points

- Greece likely to restructure, adding more losses to Europe's banking sector as it copes with bad debts from consumers and businesses.
- Banking bonds offer lower-risk exposure to industry, but we would be cautious and selective in the sector in both equities and bonds.

China's balancing act

China's efforts to deflate a real estate bubble and cool inflation through policy tightening have not sat well with investors concerned about their impact on economic growth. Shanghai-listed A-shares, for example, have fallen by more than 20% this year. On the surface, this looks like previous boom-bust cycles, but a closer look at the data, as well as the policy action itself, suggests that policy has been both sufficiently measured and proactive enough to avoid a hard landing for the Chinese economy.

Although China has begun with its typical response to accelerating asset prices – raising reserve requirements – the 100 basis points (bps) move in this cycle has been modest compared to the 1,000 bps seen in 2007-08. This is in spite of the fact that annual growth in home prices in Beijing and Shanghai has matched the peaks of the 2007-08 cycle, which saw appreciation of 12-15%.

In line with its historical response to rapid rises in real estate prices, this tightening cycle has included a focus on administrative measures to incrementally tighten credit, including raising minimum down payments on purchases and limiting speculative (second home) purchases, as well as tightening loan-to-value limits and collateral requirements on purchases.

Learning the lessons of the past

Such similarities to previous policy responses have provided ammunition to those fearing another boom-bust cycle. Yet there are also notable differences in policy action that suggest China has learned the lessons of the past. In combination with a moderate slowing in credit growth, 2010 has seen China implement supply-side measures and strengthen its banking system against the fallout of 2009's rapid credit expansion.

During the 2006-07 rise in property prices China's Ministry of Land and Resources released 50-70,000 hectares of land for residential property construction, a level similar to the amounts released through the 2005 and 2008 troughs in the property market. However, in response to the price acceleration of 2009, an above-average amount of almost 80,000 hectares was released, with over 180,000 hectares slated for 2010 (see chart opposite).

Taking steps to assure a smoother transition

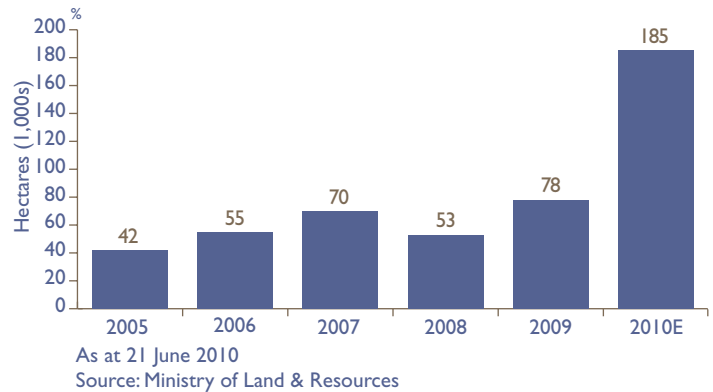
Recognising that its fiscal and monetary expansion had the potential to create a bad debt problem for its banking system, policy-makers ensured stability in the sector as they began tightening by encouraging



NORMAN VILLAMIN

Head of Investment Strategy, Asia
Based: Singapore

China land supply to residential property



capital raising. With loan-to-deposit ratios in the 60-75% range and tier I capital ratios for Chinese banks of 8-10% at the end of 2009, these capital raisings combined with more moderate balance sheet expansion should strengthen a still relatively unleveraged system.

Questions about whether China can stop short of more aggressive tightening measures have been raised recently as wage pressures increase. Minimum wage rises of 15-30% have been implemented or proposed in major cities, and high-profile labour issues at electronics manufacturer Foxconn and car maker Honda have led to increases of 24-30% in base wages, according to press reports. However, in the context of growth in productivity and industrial production in China, such increases do little to change overall unit labour costs.

Put another way, Chinese labour is now participating more fully in the rapid revenue growth of Chinese companies. This trend should help drive a rebalancing of growth within the economy, boosting household consumption, while restraining profit growth for the industrial sector and exporters.

In the near term, with leading indicators pointing to a moderation in Chinese growth in coming quarters, the prospects for a relaxation of tightening measures appear to be growing. Given a more responsive, sustainable and broader policy framework compared with previous cycles, and efforts to boost consumers' contribution to growth, we believe growth in the Chinese economy should be more balanced and sustainable beyond 2010.

Key Points

- Chinese policy action contributed to past boom-bust cycles; fears of repeat have knocked over 20% off Chinese equities in 2010.
- This time, more responsive, measured approach, using broader set of tools should ensure broad-based and sustained growth beyond 2010.

— **Norman Villamin** is responsible for the management of the US-dollar-based discretionary managed portfolios and contributes towards our global investment strategy for the major asset classes. Norman has over 17 years' experience managing wealth on both an advisory and discretionary basis. He holds a Bachelors degree in Business Administration from the University of Michigan and a Masters in Business Administration from the University of Chicago.

The time is still right for corporate bonds

An economic environment of low but positive growth, which remains our central view for the major developed world, could be 'just right' for corporate bonds. The fresh bout of risk aversion in the face of the continuing fiscal crisis in the euro-zone, combined with a low interest rate environment and a consequent search for yield, bode well for investment-grade corporate bonds. We believe they will remain the low-risk asset of choice for some time.

The corporate sector in general is underpinned by strong balance sheets and healthy cashflow. A lack of refinancing needs should also be supportive in the short run – except for banks, which face a continuous need to replace expiring debt. While healthy, cashflow is not so strong as to tempt corporate management or shareholders (in particular private equity investors) to be overly-enthusiastic about the outlook. This suggests that they will retain a cautious stance with regard to balance-sheet management or replacing equity with debt.

Attractive yield premiums over government bonds add to the appeal of the asset class in an environment of ultra-low rates. Although far away from the once-in-a-lifetime levels of two years ago, valuations generally remain attractive on a relative basis. The super-low yields on safe-haven government debt will inevitably force investors to move back into risk assets. For one to three-year euro-denominated corporate debt, the current yield spread of more than two percentage points over equivalent German bunds seems compelling, without a dramatic increase in risk. Recent weeks have seen the spread of corporate over government yields widen some 60 basis points (bps) for dollar-denominated debt and about 70 bps for euro-denominated bonds.

'Too-big-to-fail' bank bonds look attractive

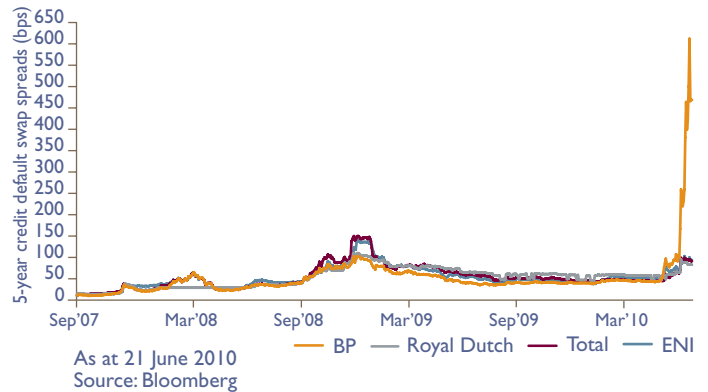
The best opportunities are in large banks, which continue to benefit from basically unlimited government support around the globe for the time being. Shorter-dated and lower-quality investment-grade bonds (one to five years and A- to BBB-rated) from stable sectors like consumer staples, telecoms and food retail also have relatively attractive yields.

Before the oil spill disaster in the Gulf of Mexico, the oil & gas sector across Western Europe and the US was very expensive as a result of the sector's robust balance sheets and strong cash flows. The whole sector has now cheapened considerably in the wake of BP's problems, and we believe is offering good value. The oil & gas sector in emerging markets appears similarly attractive, particularly in Russia.



STEFAN MUHEIM, CFA
Fixed Income Research Analyst
Based: Zurich

Risk perception rising for oil & gas sector



While we believe large banks offer good value at the moment, small and mid-sized banks, especially those in southern Europe, generally look less attractive. We expect that future European bank losses will be more of a problem for the regional than the global banking sector, as opposed to the situation during the credit crisis when the larger, global banks were hardest hit.

The overwhelming majority of corporate borrowers have taken advantage of the favourable market last year to 'pre-fund' this year's or even next year's needs. We can therefore expect many companies to only opportunistically tap the market again to issue new bonds, and for supply to be limited. The situation is different in the banking sector. Banks have a constant need to issue new debt in order to refinance maturing liabilities. But since the sovereign crisis has roiled the global bond markets, the new issue market has virtually closed down, leading to significant pent-up supply of new bank debt. With new bonds being offered at a significant discount over outstanding bonds, prices in the whole secondary market could potentially adjust lower. This could lead to an underperformance of old versus new issues, and investors should hence prefer new issues over outstanding ones once the primary market reopens.

We believe the super-strong, high-quality, safe-haven type of corporate bonds in the consumer staples area are over-bought, with potential to substantially underperform in the medium term. With dividend yields much higher than debt costs, there is a strong incentive for management to replace equity with debt, which would favour shareholders over bond holders.

Key Points

- Economic environment of low but positive growth should benefit corporate bonds, as well as positive fundamentals.
- Best opportunities are in large banks, which benefit from government support. Some shorter-dated, lower-quality bonds in stable sectors also look attractive.

— **Stefan Muheim** is primarily responsible for the analysis of fixed income markets and recommendations on a sector and security-specific basis. He has over 14 years' experience as a fixed income strategist and analyst, a fixed income mutual fund portfolio manager and private banking advisor. He holds a Masters degree in Economics from the University of Fribourg in Switzerland, and is also a CFA charterholder and financial planner.

Finding the best ballast in stormy markets



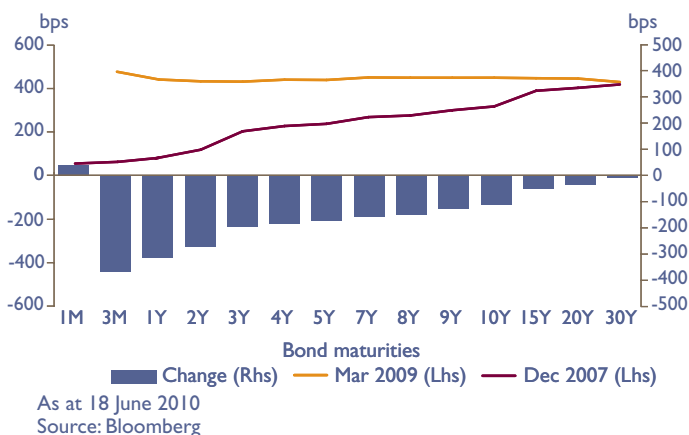
PABLO BALAN, CFA

Global Head of Portfolio Risk and Analytics
Based: London

With volatility on the rise again, the quest for an effective hedge against commonly-held risk assets has taken on increased urgency. While government bonds have traditionally provided this ballast, they face a number of challenges in the current environment. In recent major bear markets managed futures, or CTAs, have been an effective tool and could provide a good hedge against any continuation of recent equity weakness.

The traditional role of government bonds reflects their historic risk-free status and strong performance in difficult market conditions for risk assets. However, it is apparent from the graph below that the significant move in yields seen in the 2007-09 bear market was in short-dated bonds, while longer-dated yields were broadly unchanged. In order to capture this move, bond holdings would have had to be concentrated at the short end. However, the lack of duration (price sensitivity to changes in yield) meant only modest capital gains. But that is just part of the problem. The current level of short-dated yields does not leave much room for further falls, with yields ranging from around 0.4% in Germany to 0.8% in the UK.

UK yield change in credit crisis



Clearly, it is important to take into account the current economic and financial market climate when considering which assets or strategies may act as a hedging tool. Given the escalation in sovereign debt concerns, we believe that longer-dated government bonds could be a sub-optimal hedge against risk assets.

The difficulty is exacerbated by the tendency for long-term correlations between asset classes to become less meaningful during periods when equity markets are falling. What is important is the conditional correlation. For example, if equities fall by more than

10%, how are other assets correlated in this specific environment? In particular, is the correlation negative and are the returns of the hedging strategy high enough to at least partly offset the impact on the portfolio from falling equity markets?

The only sure method of hedging equities at all times is a constant short sale via a futures overlay, or continuous purchase of put options. However, this strategy is doomed to negative returns in the long run as the transaction costs and option premium eat into returns. In reality, there are no clever options strategies which can provide long-term positive returns while hedging against losses, as investors in Madoff's hedge fund sadly found to their cost.

CTAs (commodity trading advisors) are a potential hedge alongside gold (see table below). This style of investment management is typically systematic and seeks to capture up and down trends in a variety of markets. The table below shows the performance of various risk assets and strategies over the last two major bear markets for equities. In simple terms, CTA managers will aim to capture an up or down trend in equities, currencies, commodities or interest rates (i.e. 'momentum investing').

In the previous edition of *Investment Perspective* we wrote in the behavioural finance section about the tendency of investors to wait until a trend has become long established before investing, allocating substantial assets towards the top of the market, and to sell at the bottom, a strategy doomed to failure. In contrast, CTA managers typically use sophisticated technology in an effort to generate returns by capturing market trends very early and getting out of them just as they are finishing.

Of course, what has worked before may not work as well going forward. However, we believe CTA managers have the potential to provide an effective hedge and to produce positive real returns in the context of current market dynamics. We have historically included CTA managers as part of diversified hedge fund of fund holding, but in the current environment it is worth considering increasing this exposure, potentially through the addition of a dedicated CTA fund.

Asset Class Returns (%)	Tech bubble (Q2/00-Q2/03)	Credit crisis (Q4/07-Q1/09)
Equities	-43.4	-47.7
Short-dated govt bonds	23.6	11.1
Long-dated govt bonds	32.9	25.0
Gold	20.9	23.6
CTA Managers	22.9	16.5

As at 18 June 2010

Source: Bloomberg, JPMorgan. *Asset classes represented by S&P 500, 2-Year Treasury, 10-year Treasury, Gold spot price and Barclays Trader Indexes CTA, respectively.

— **Pablo Balan** is responsible for the risk management and quantitative analysis of client portfolios and investable assets. He holds a Bachelors degree in Physics from Amherst College in the US, a Masters degree in International Affairs from Columbia University in the US and a Masters of Science in Mathematical Finance from Cass Business School in London. He is also a CFA charterholder.

Key Points

- With volatility back on the rise, the search for effective hedge against traditional risk assets has intensified.
- Government bonds, the traditional hedge, may prove ineffective in current markets. We see CTAs as better potential hedge.

Global Strategy Team

The Global Strategy Team, comprised of highly experienced investment professionals, researches and analyses macro-economic and market data with a view to making investment recommendations on all the major asset classes. It is also responsible for running discretionary managed portfolios. The team is headed up by Carl Astorri in London, but its global credentials – with members also based in Zurich, Hong Kong and Singapore – ensures its global insight is based on local knowledge.

If you would like further information on any of the topics discussed or would like to find out how to access some of the potential opportunities outlined in this issue of *Investment Perspective*, please find the contact details of the team below.

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Twelve-month Asset Class Outlook

The table below provides a summary of our current views on each asset class.

Asset Class		Outlook
EQUITIES	Developed market equities	The combination of historically fair valuations and the need for the market to adjust to more realistic growth and earnings expectations points to low but positive returns.
	Emerging market equities	Have come through the developed-economy-focused crisis of the past couple of years with their superior long-term return potential intact.
FIXED INCOME	Government bonds	The need to keep rates low for longer to offset fiscal tightening will underpin bond prices.
	Index-linked government bonds	Looking expensive, although still offer a way of protecting against the tail risk that fiscal deficits are inflated away.
	Emerging-market bonds	Offer higher yields with, in many cases, less fiscal risk than the major bond markets.
	Investment-grade corporate bonds	Expected to advance in a positive but sluggish growth environment, and as investors search for yield.
	High-yield bonds	As the recovery becomes more broad-based and default rates fall, spreads could narrow further, providing the opportunity for capital gain, as well as yield pick-up.
CASH	Three-month cash rates	In stark contrast to emerging markets, the combination of large output gaps and large fiscal deficits will keep short rates low in major developed economies.
COMMODITIES	Oil	Oil tends to be one of the best-performing commodities at this stage of the cycle but weakness of the recovery will limit upside.
	Gold	Still offers a hedge against the depreciation of FX majors to boost export growth.
PROPERTY	UK commercial property	Offers an attractive yield in a low rate environment but capital gains will be moderate due to a lack of lending to this sector.

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