

Neue Privat Bank

Euro crisis stirs up fears of a new economic collapse Swiss National Bank has shot all its powder

- Despite the massive EU rescue package, the Euro crisis has not yet passed. In the prices of Greek government bonds, a partial moratorium is already, de facto, included. The situation is also particularly critical in Spain which is caught up in a vicious circle with high unemployment, falling real estate prices and wobbling savings institutes.
- The Swiss National Bank has shot all its powder and is no longer in a position to intervene against an increase in the value of the Swiss Franc without further raising the balance risks.
- The massive savings plans of numerous European states have led to fears that the economy is going to collapse again. The consequence is that investors are fleeing from risky investments such as equities.
- We believe that after the rapid economic recovery of recent months, the economic dynamism is likely to calm down. However, we regard a new slide into recession as rather improbable. If this scenario is confirmed in the next few months and the Euro crisis is somewhat eased, shares at their current levels and particularly with a view to the high growth of profits appear to be under-valued.

Under the curse of the Euro crisis

For investors on the international capital markets, the second quarter of 2010 was fully characterised by the Euro crisis. Due to growing doubts with regard to the financeability of the overflowing state debts of a few southern European countries, Europe saw itself compelled to put up an enormous rescue package of EUR 750 billion to prevent national bankruptcy for Greece and an infection of further EU member nations. Spain is turning out to be a very much heavier problem-child for the EU, appearing to be caught up in a vicious circle of unemployment at a record level, collapsing real estate prices and wobbling savings institutes because of distressed mortgages. Even though quite a lot is being done behind the scenes to strengthen the capital basis of the sickly "Caixas" by means of mergers and other measures, trust on the markets has taken a hard knock. Even the two big banks, Santander and BBVA, are struggling with more difficult financing conditions, even though they are among the world's best managed and financed institutes. Although the problems in Spain are hanging like a Sword of Damocles over the markets, one can assume that politics and the European Central bank will do everything possible to secure refinancing of the state debts and prevent the crisis from slopping over into other countries. As a large number of European banks and particularly insurance institutes are holding massive positions in European government bonds, the task, in the final analysis, is nothing less than securing the international banking and financial system.

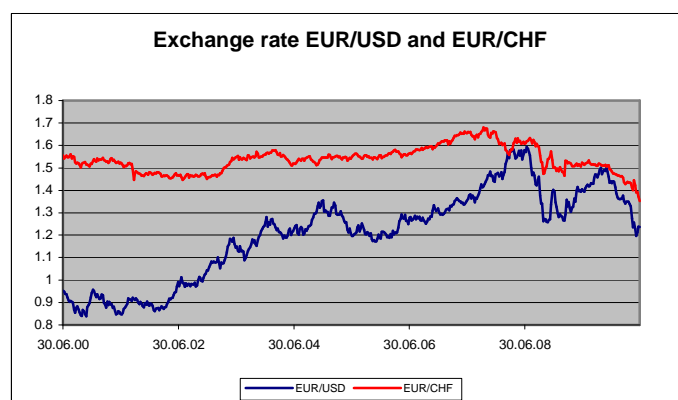
Even if time for consolidation of the national households was bought with the massive rescue package, the structural problems of the Eurozone are still not solved. The main problem isn't the absence until now of a sanctioning system but more in the varying development of productivity in the individual countries. While the German export industry is recording high increases in productivity, a few southern European nations are falling behind more and more in industrial development. The economic gap is therefore opening further all the time, without the escape-valve of exchange rate adjustments being available. This fundamental drifting apart was, as one example, concealed for a long time in Spain by a booming real estate market. Now that the bubble has burst, the structural problems are moving to the forefront, without any sight of a fundamental solution to them.

Overestimated economic skid-marks

Whether or not overcoming the Euro crisis is successful depends in particular on whether most of the exposed nations can swallow the bitter pill of a credible financial policy which brings the budget deficits more or less back into balance. The associated cuts in expenditure are unavoidably combined with lower state investments and - as a consequence of salary

reductions for government personnel - a negative impact on consumption. In this regard, fears are awakened that the skid-marks of the Euro crisis would inevitably lead to a clear weakening of the economy or even a global collapse of economic growth.

Apart from the fact that the economic upswing has developed a dynamism of its own, particularly in the emerging nations as well as the USA and therefore seems to be self-carrying, one must also take into consideration that the economic braking effects of the Euro crisis through the weakening of the Euro are, to a certain extent, globally distributed. In the economically stronger core nations of the EU (Germany, Holland, France, etc.), there are many exporting companies that are benefiting massively from the weaker Euro. Conversely, a few export-orientated Swiss companies that hardly have any factories abroad will have to deal with a massive reduction in their margins. In this sense, Switzerland, as an economic role-model, will be unable to avoid bearing part of the burden of the Euro crisis in a global economy. We therefore believe that economic growth is going to slow down in the next few months and the forthcoming year, but that an economic collapse can be avoided.



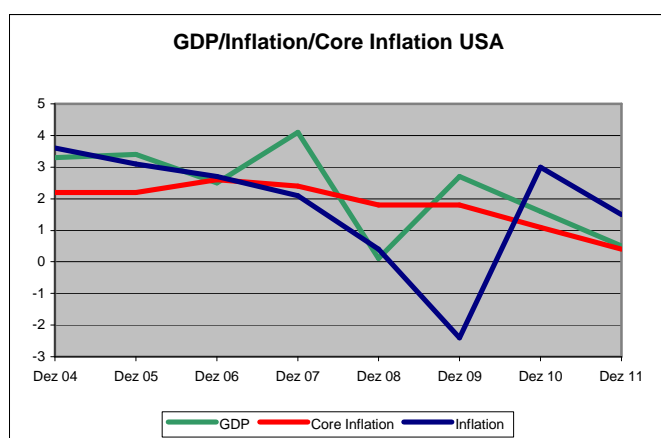
Graph 1, Source: Bloomberg

Swiss National Bank has shot all its powder

The Euro crisis and its weakening impact on the global economy has once again restricted the leeway for central banks to increase interest rates. It must consequently be expected that the current phase of low interest rates will have to be lengthened and initial, moderate raises in the USA and Europe will only come next year. Nevertheless, fears of inflation appear to be premature. High capacity reserves worldwide will keep the pressure on margins and

salaries. This picture of very moderate inflation is supported by the fact that the core inflation in the USA and other nations has been tending downwards for a long time now.

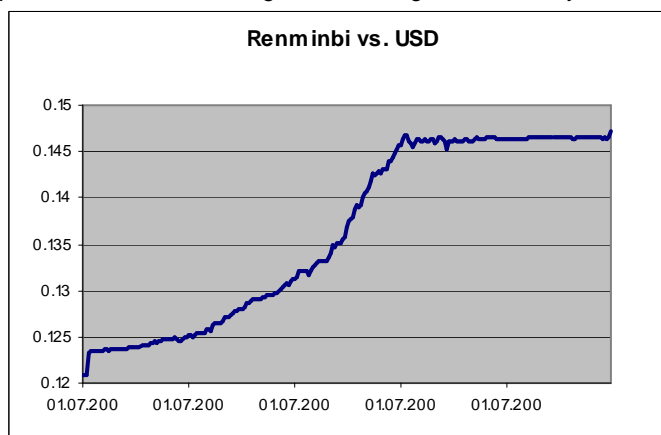
In the prevailing circumstances, the hands of the Swiss National Bank (SNB) are also largely bound although here in Switzerland there are early signs of overheating in the construction industry and the real estate markets. If the SNB were to raise interest rates, it would lead to a further appreciation of the Swiss Franc against the Euro with all the negative consequences for the export business. The SNB also has to watch the Franc appreciating further without being able to do anything to counteract it because after the massive interventions in favour of the Euro, it has shot all its powder. A further massive increase in foreign currency positions in the balance sheet of the SNB, which has inflated its currency reserves since the end of 2009 from CHF 95 billion to CHF 230 billion at the end of May, would certainly be associated with a risk of loss that could no longer be justified. One must therefore expect that the upward pressure on the Franc will remain intact.



Graph 2, Source: Bloomberg (estimates for 2010, 2011)

More flexibility for the Renminbi as a glimmer of light?

As in the earlier upswing, hopes are once again pinned on China which, shortly before the G20 summit, indicated that it is going to allow more currency flexibility in future vis-à-vis the Dollar. Even if an appreciation of the Renminbi will develop very slowly, the willingness of the Chinese to show more flexibility could have positive effects in the long term on the global economy.



Graph 3, Source: Bloomberg

In order to cushion the economy-dampening effects of a stronger Renminbi, Chinese politics will almost certainly undertake simultaneous measures to strengthen the purchasing power of domestic consumers. That would reduce the massive current account balance surpluses with the USA and build back one of the fundamental global imbalances which was one of the

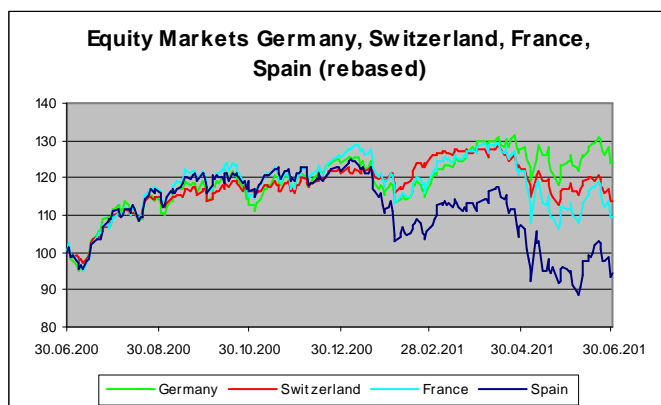
causes of the loose granting of credit in the USA and the financial market crisis that it triggered.

Equities with a high risk premium

In the past two months, the stock markets have come under heavy pressure due to the Euro crisis and the renewed economic fears. Most of the European listed shares suffered particularly, whereby German shares were a great deal better than those of southern Europe. As the profits of most companies are developing better than expected, the fundamental valuations have, in the meantime, fallen way below the multi-year averages. That equities are currently inexpensive is also reflected in the high dividend yields of numerous shares which are partly very much higher than the yields on bonds.

Conversely, the moderate valuation of equities means that investors are currently demanding a very high risk premium for holding shares. This is due primarily to the fact that the nerves of many investors are in tatters because after a financial crisis that isn't yet quite overcome, the next debt crisis is already on the horizon, with an uncertain outcome. We believe that the valuation of equities will remain under pressure until there are signs that the savings programmes initiated by numerous governments start showing success and the budget deficits can be sharply reduced. A further strain on stock markets in the near future could also be the latest economic figures which - as is normal after an initial phase of recovery - could show a flattening of economic growth. An example here is that for the first time in a long time, the number of jobs in the USA fell in the past month, and even the eternal economic high-flyer, China, is showing the first signs of tiredness. Correspondingly, one must expect that the widespread fears on the markets of an economic double-dip will not dissipate quickly.

Things look a great deal less negative if one takes into consideration the profit expectations of companies. Even if economic growth slows down, the European companies included in the EuroStoxx50, as one example, can be expected to achieve profit growth of around 25% to 30% for the next 12 months. That equates to an anticipated price-earnings ratio of 9, a value that, from a historical point of view, is well below the average. A particular increase in profit can be expected for strongly export-orientated companies in the Eurozone. An example is that analysts have calculated for the French liquor manufacturer Pernod Ricard a profit increase of about 12 million Euro for every percentage point of depreciation of the Euro against the Dollar. In the current circumstances, we therefore recommend above all shares of European exporting companies as well as shares with a high, secured dividend yield. Globally leading technology shares continue to be interesting because their profitability is hardly diminished by a slowdown in growth. Due to the oil spill in the Gulf of Mexico, a large number of oil companies have been punished on the stock markets, even though there are examples like the American Hess which primarily have onshore oil reserves.

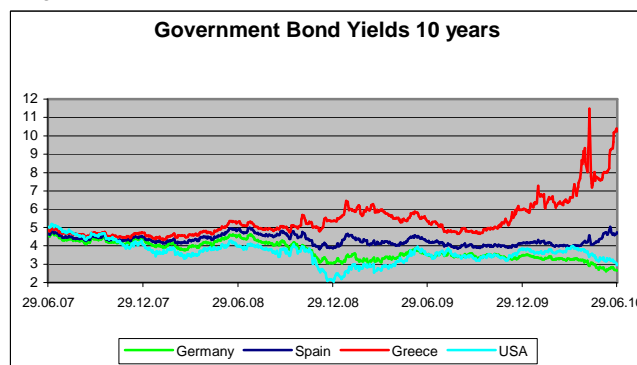


Graph 4, Source: Bloomberg

The gap in government bonds continues to widen

The high aversion to risk on the capital markets has led to a situation in which the interest rate differences on the bond markets have sharply widened. Whilst the yield from 10-year US treasury bonds has sunk to under 3% for the first time since April 2009, the yield on German government bonds with the same term has even fallen to a low for the year of 2.56%. At the other end of the scale, the risk premiums for Greek bonds have reached a higher level than before announcement of the EU rescue package, whereby the current yields indicate, with about a 75% probability - national bankruptcy for Greece.

The very strong pressure on Greek government bonds at the moment also has technical reasons and could be of a temporary nature. As the Hellenic bonds are thrown out of most of the bond indices, index providers are practically forced to liquidate an estimated EUR 20 billion of those bonds. That a partial moratorium for the Greek state is also more or less a fact is reflected by the situation in which a bond that runs with variable interest until 2034 can be bought for about 32% (!) of its nominal value.



Graph 5, Source: Bloomberg

MR/30.06.10

Recommendation for investment fund: NPB Asia (ex. Japan) equity fund

Product description

A good seven years ago, the NPB launched an equity fund for Asia (without Japan). Prior to the launch, suitable management with corresponding expertise and an existing track-record, plus preferably a permanent domicile directly in Asia, was sought. In an intensive and very strict selection process, we were finally convinced by Pheim Asset Management PTE Ltd. from Singapore. The following reasons led us to this decision:

- Headquartered in Singapore and therefore in the same time-zone as the companies in which investments are made;
- The central location in Asia enables visits to companies within short periods of time without long travelling times;
- Presence in Asia enables direct insight into politics and business and therefore the early recognition of trends;
- Investment philosophy (value approach) corresponds to the investment style preferred by the NPB;
- Existing track record.

The focus of the fund's management is primarily on small-capitalised companies in the whole of Asia (without Japan). Through broad diversification over numerous countries, industries and companies, price fluctuations are minimised. As at the end of June, the fund is invested in 72 different companies. Detailed information on the current positioning is published in each monthly report. It can be downloaded from the Internet (www.npb-bank.ch) or ordered from us.

Performance

The fund has achieved the following results as at 30.06.10:
 Since launch: +161.96%
 2010: + 0.28%

Outlook

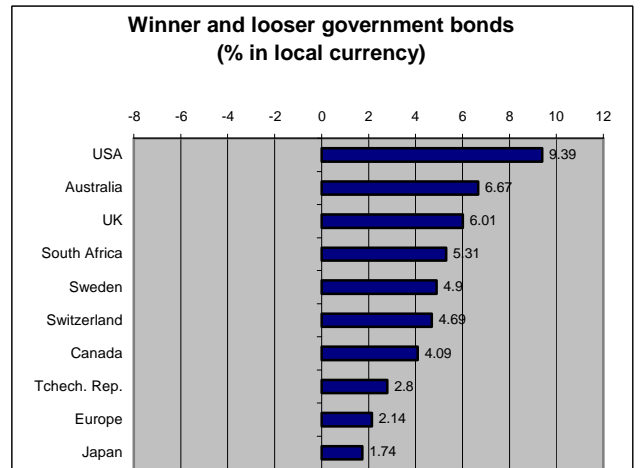
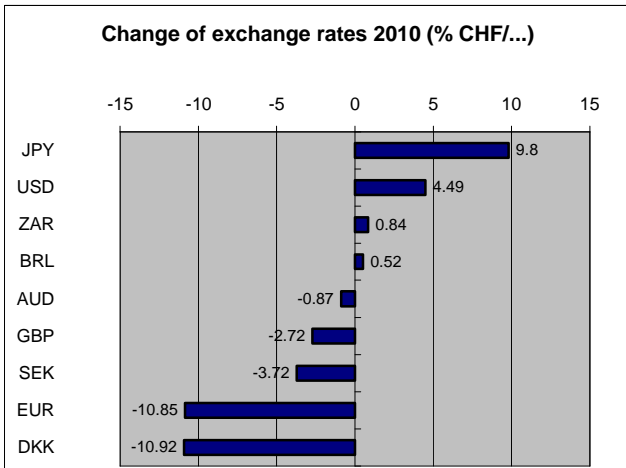
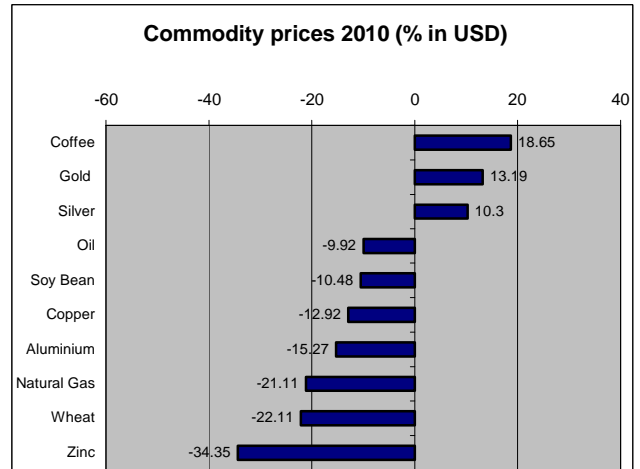
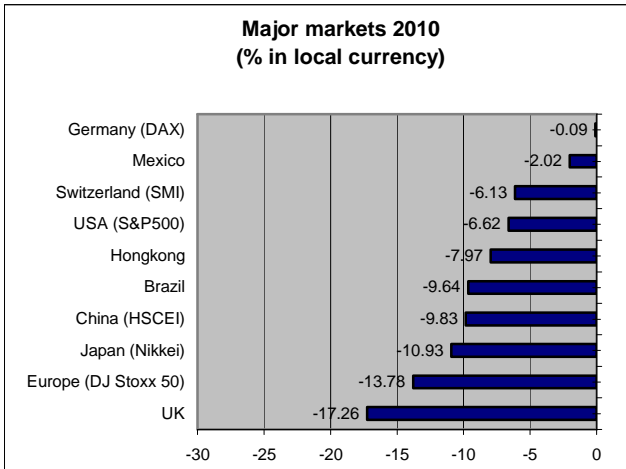
Asia was also affected by the crisis, but recovered very quickly. Asia is not particularly affected by the current turbulence in Europe because numerous companies are heavily involved in trade with each other in the region. This has the advantage that dependence on business activity in the USA or Europe is, in the meantime, significantly lower than it was just a few years ago. A much greater influence on the entire Asian region stems from economic growth in China. After a setback, this has strengthened again and is well ahead of comparable figures in the established economies. Most companies in Asia are benefiting from those strong figures, whereby other countries too (e.g. Indonesia) are developing very positively. Due to the difficulties in Europe and the limited growth in the USA, we expect Asia to have the biggest opportunities and the NPB Asia (ex Japan) fund to record further positive results.

Key details of the fund

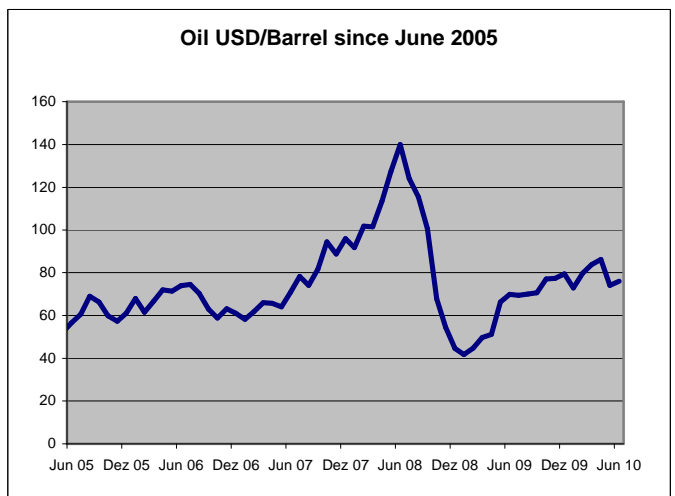
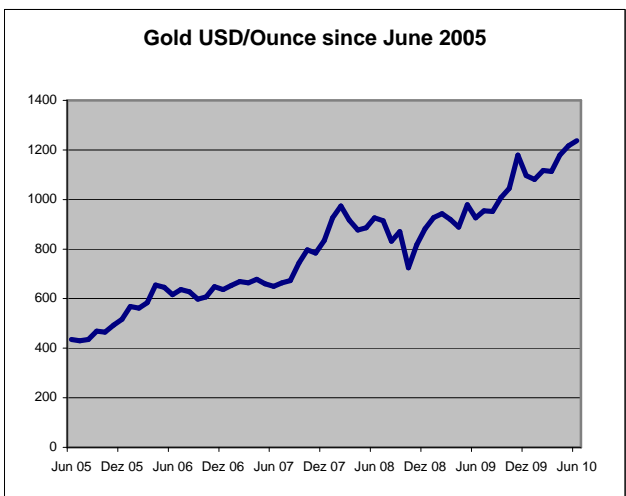
Launch:	7.01.2003
Initial issue price:	USD 100.-
Current price (30.06.10):	USD 261.96
Liquidity:	daily
Fund management:	NPB (SICAV)
Manager:	Pheim Asset Mgmt (Asia) Ltd.
Deposit bank:	DZ Bank International AG
Representative/Payment agency CH:	NPB Neue Privat Bank AG
Auditors:	KPMG

MW/30.06.10

Development of markets in 1st half of 2010



Interesting charts



Source: Bloomberg