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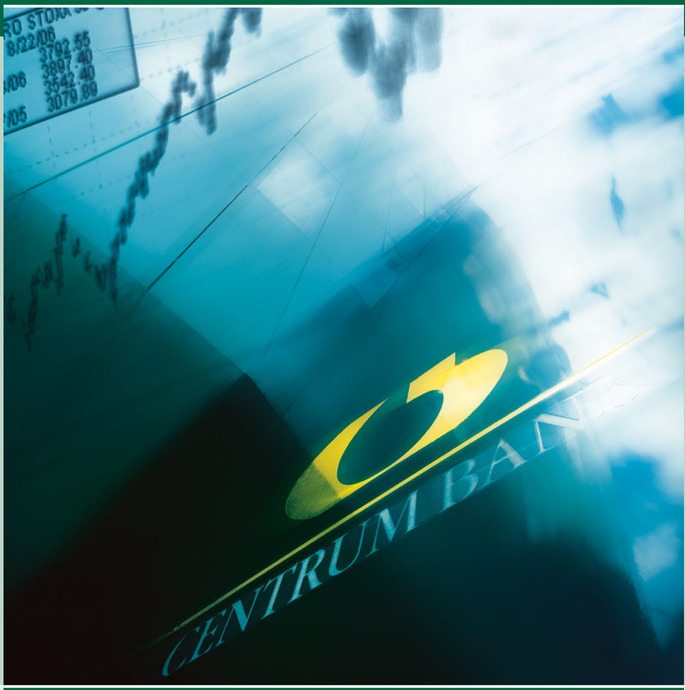

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Q1 2012

Global investment view

CENTRUM BANK

Viewpoint

Dr. Thomas Lips
CEO
Head of Asset Allocation

Dear Reader,

When European politics solemnly inaugurated the Euro more than 10 years ago, renowned economists drew attention to the construction errors of this artificial currency area. Politicians hoped that the joint currency would make the individual countries draw economically closer and enable a more parallel development. At the same time, Europe's political unity was to be promoted. As we have learned from the debt crisis, these hopes have failed. The economic and social policies of the different countries have not converged substantially. Europe has not become more mature for the political and fiscal union; to the contrary. The uniform currency has proved to be an obstacle to the economic progress in peripheral countries, as it is simply too strong. To Germany, it is a boon, offering a decisive advantage for Germany's export business in the global depreciation run. The Eurozone is drifting further apart, and the redistribution and solidarity policy of the Union is becoming increasingly unaffordable, giving rise to social tension, despite the assurance of politicians. As yet, there is no defined process regulating the exit of a country.

What developments must investors expect under these circumstances? Politicians are still eager to save the Euro in its current form. Until now, however, the announced measures have been unable to convince the markets. The facilities with the designated leverage mechanisms are more like a derivative product than a definite commitment of all countries – which is understandable from the perspective of the economically strong countries in the north.

Possible solutions: Firstly, the implementation of strict savings measures in the indebted countries, which would have a negative economic effect both on the countries themselves and on Europe as a whole. This would mean that prime EUR bonds would remain attractive, and shares of highly domestically oriented companies should be avoided. Secondly, the exit of the countries whose economies are not up to the Euro, most of all Greece, but also Portugal and possibly Italy and Spain. In such a scenario, investors would do well to avoid the nominal investments of debtors from these countries, i.e. money market and bond investments, as well as their shares. Thirdly, the ECB could start purchasing large amounts of EUR bonds by way of quantitative easing. In the medium run, this would result in a significant increase of the inflation in the Eurozone. Should this scenario materialise, all EUR bonds should be avoided, and the Euro exposure should be hedged.

In fact, there will hardly be any alternative. It appears likely that initially at least part of the savings programmes will be rolled out, with clearly negative consequences especially for the highly indebted countries. Given the unpopularity of such forced measures, these countries could consider an exit from the currency union to be more attractive from the political standpoint. What is more, the European Central Bank could feel forced to purchase great amounts of government bonds from those countries whose papers are under pressure resulting from fears of contagion, which could mean a risk of partly solving the problems by way of a higher inflation. All in all, this scenario would not make things easy for investors.

Dr. Thomas Lips

Global investment view

- **Risk of a recession phase in Europe**
- **High grade corporate bonds favoured**
- **USD to appreciate further against CHF, EUR and GBP**
- **Equity markets dominated by political decisions**
- **Continually cautious view for commodities – precious metals preferred**
- **Alternative investments – focus on low correlations**

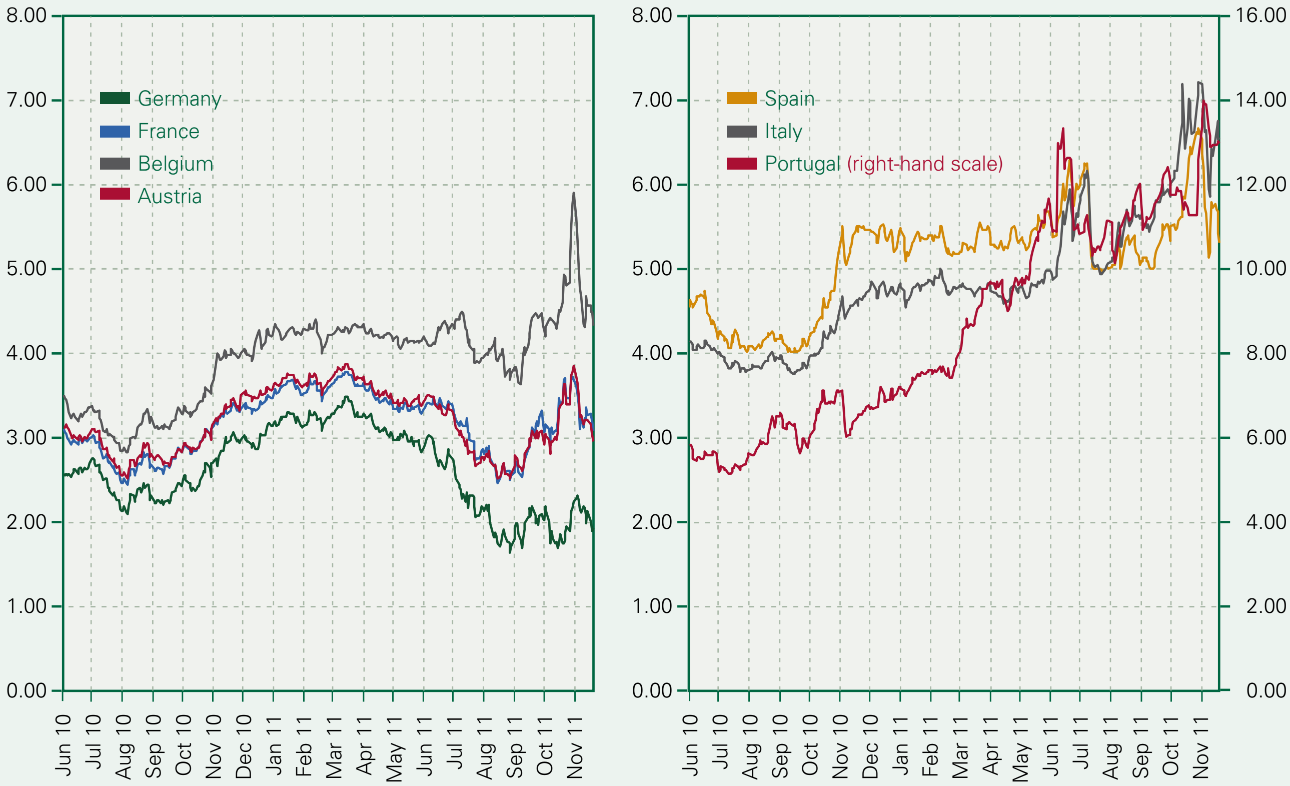
Risk of a recession phase in Europe

We anticipate a noticeable growth slowdown in 2012. Despite further EU summits, two successive reductions of the base interest rates and extensive liquidity measures by the ECB, the risks of a significant economic decline and prolonged economic contraction have further increased. Due to the debt crisis and the associated strict austerity course and needed structural reforms, our basic scenario predicts that next year will witness a recession in the Eurozone. The risks of further debt restructuring (PIIGS countries) and the banks' growing recapitalisation needs entails the danger of a contraction that could be more severe than expected. The current deleveraging process at banks is likely to go on for quite some time. This reduces the credit activity and encumbers the performance of the real economy.

Even in countries outside the Eurozone, e.g. in the United Kingdom, current economic data are pointing to an increasingly high likelihood of a recession. The Swiss economy is still burdened by the overvalued Swiss franc. Leading economic indicators signalise a risk of an at least slightly recessive development in Switzerland as well.

A noticeable slackening of the growth pace is noticeable in the emerging markets and especially in the BRIC countries. This is especially evident from the declining exports. Leading indicators such as the purchasing manager indices for China imply a further slowdown in the coming months. Latin America will be affected more by the dwindling commodity prices. The Brazilian central bank has already reacted by reducing the base interest rate thrice since August of this year, while China reduced the minimum reserve requirements for the banks in late November. Thanks to the lower commodity prices in recent months, the inflation development in China, for example, is already

Charts 1 and 2: Yield of 10-year EUR government bonds – stress symptoms in the core countries



Source: Bloomberg

showing clear signs of relaxation. The emerging markets have more leeway for interest rate reductions and, if necessary, much more expansive fiscal measures.

In the US, the current economic data have turned out to be generally better than expected in view of the confidence indicators. However, despite the recent slight recovery on the labour market, the economic performance has remained below average compared to previous cycles. At 8.6 %, the latest unemployment rate is still at a high level, and the real income is declining. Thus, the increased consumption in recent months has taken place at the expense of the savings ratio. For next year, negative effects from the fiscal policy must also be expected in the USA. The US economy is not likely to pass the globally weakening growth unscathed, and we expect economic growth to be generally lower next year.

Under consideration of the debt crisis and the associated uncertainties especially also in connection with politically viable solutions, there is a high risk of a greater-than-expected economic contraction. Compared to the opinion in the last quarter, our scenarios have not changed significantly in this respect:

Scenario 1:
Economic stabilisation in the Eurozone at a low level.

Further comprehensive steps are required to implement an EU fiscal union; quick development of the EFSF Eurobond market; controlled debt restructuring of Greece; support by the IMF; ECB as lender of last resort; increased purchasing programme for EUR government bonds due to the increasing maturities (probability: 10 %).

Scenario 2:
Main scenario – partial containment of the debt crisis.

A controlled debt restructuring of Greece takes place (however, even a debt haircut of 50 - 60 % will not be sufficient in the long run); further massively increased purchasing programmes for government bonds (especially Italy, Spain, Portugal, Ireland) by the ECB via EFSF/ESM and supported by the IMF. Global growth weakening and recession in the Eurozone due to the severe austerity policy. High political risks remain with respect to the long-term debt reduction or, in a first step, with respect to debt stabilisation. Growing recapitalisation need of banks (probability: 50 - 65 %).

Scenario 3:
"Worst-case scenario" – significant intensification of the debt crisis.

The intensification is fuelled by heightening political disputes and disagreements about debt restructuring measures. A possible uncontrolled default of Greece increases contagion effects: Surging risk/interest premiums for countries like Italy, Spain, as well as France, Belgium, Netherlands, etc. Increasing interest rates in the medium run also for US treasuries due to insufficient debt stabilisation. Relapse into an extended recession in Europe, contraction in the US. Weakening of the global economy due to receding trade flows, negative credit cycle (deleveraging of banks and consumers), and a confidence crisis in the financial system. High risk of deflation (probability 30 - 35 %).

In our main scenario, the debt crisis is not solved conclusively, and the austerity measures and structural reforms need to be stepped up considerably in many countries. Thus, we believe that the risk of intensification of the debt crisis is highly probable.

High grade corporate bonds favoured

As shown in the economic scenarios, high recession risks are on hand especially for Europe. The fiscal consolidation and the associating savings measures and tax increases hamper the growth perspectives, and even an expansion of quantitative easing measures by central banks will not solve the problems. Thus, governments and banks are in for further rating downgrades in the coming months and quarters.

At corporate level, broadly positioned large caps mostly operate very cautiously, with a clear focus on costs, cash flows and liquidity development. Among the allocations in the bond area, investment grade corporate bonds still offer interesting yield/risk perspectives. However, the deteriorating profit perspectives make it necessary to be very selective. In the banking segment, the current risk premiums are very high, as shown in chart 3. Yet, it is likely that the risks in the financial sector will not abate significantly in the medium run. In contrast, the banks and insurance companies are encumbered by higher financing costs, regulatory changes and thus lower profits.

In recent weeks, we have significantly increased the weightings in fixed-income investments in the respective reference currencies on the one hand and reduced equity allocations on the other hand in order to reduce portfolio risks.

From a strategic viewpoint, bonds of emerging markets remain an inter-

Chart 3: Interest spreads and default rates (iBoxx Euro swap spreads)

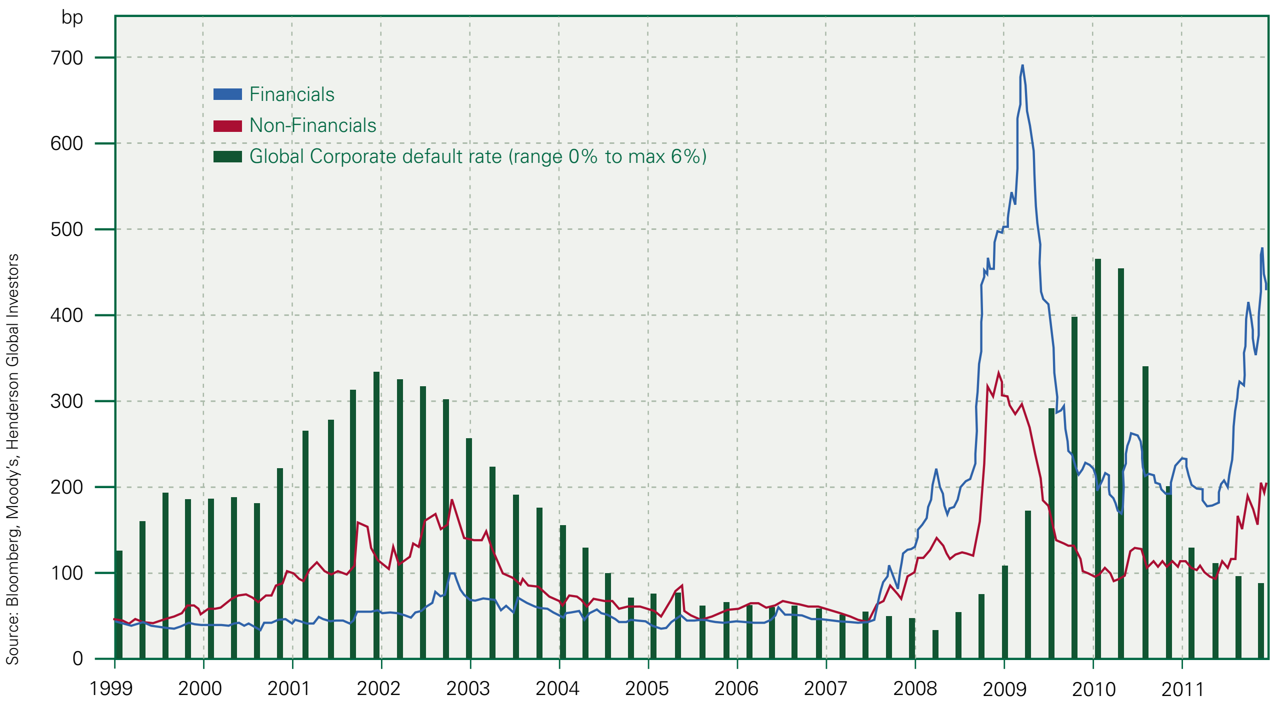


Chart 4: EUR/USD exchange rate (last 2 years)

Chart 5: EUR/CHF exchange rate (last 2 years)

Source: Bloomberg

esting investment diversification in the fixed-income area. However, the market turbulence experienced in recent months and the appreciation of the US dollar have caused corrections. We have decided to stick to our positioning. In the event of a more severe global economic weakening (towards scenario 3), increasing price fluctuations would have to be expected. Thus, we do not exclude the possibility of position reductions. A quick inflation decline would give central banks in the emerging markets leeway for interest rate reductions, which would increase the potential for bond price gains. On the other hand, increasing exchange rate fluctuations would have to be expected in this case. With respect to pure high yield engagements, we remain cautious due to the mounting macroeconomic risks.

USD to appreciate further (USD as refuge currency)

Following the market turbulence in September and the countermovement in October, the USD underwent a significant appreciation trend in the last two months. Increasing global economic risks could be associated with a further appreciation of the USD in the medium run. From the technical market perspective, this means that the EUR/USD exchange rate could test its low of 2010, at about 1.18. Structurally, the USD remains encumbered by the enormous national debt and the negative trade balance. In the medium run, factors such as the rela-

Chart 6: MSCI equity indices (in local currencies, indexed)

Source: Bloomberg

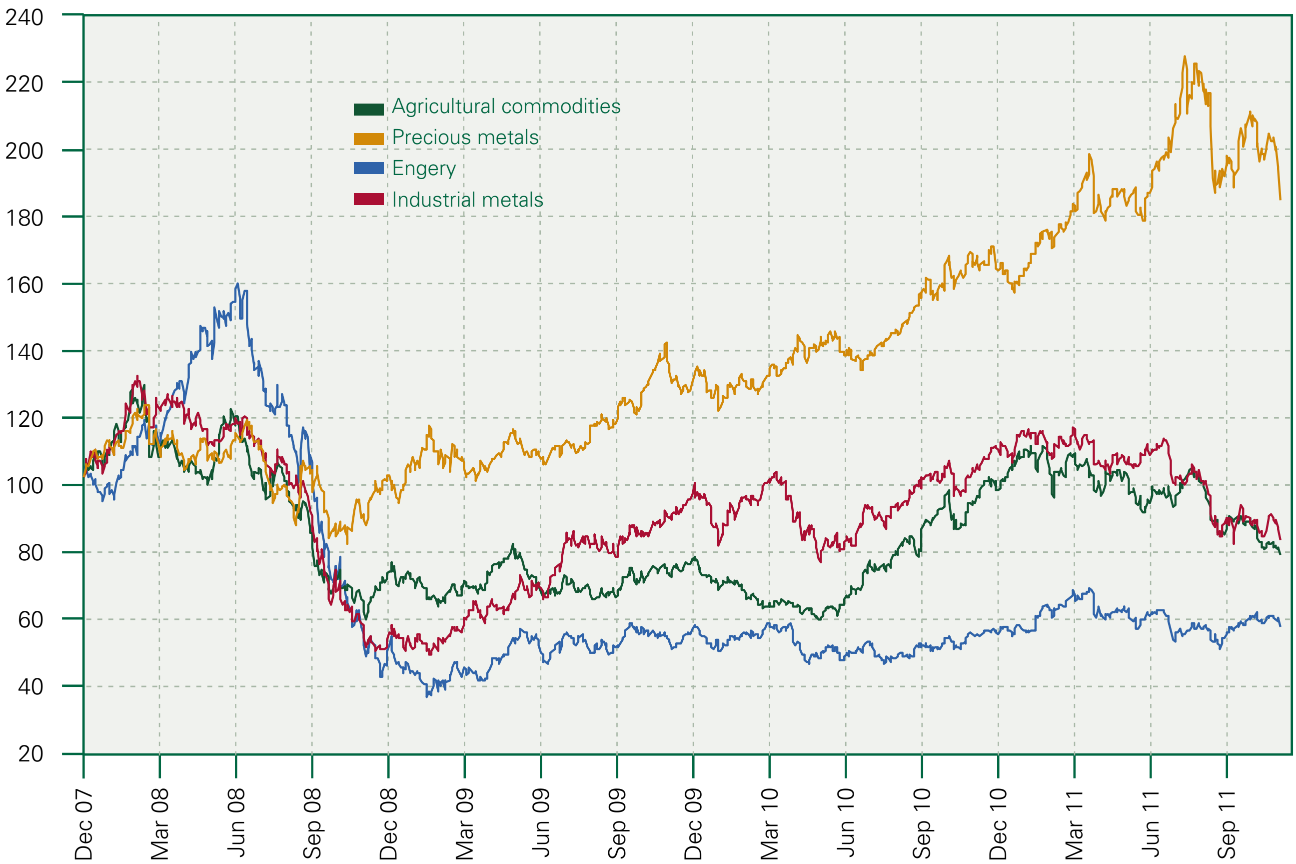
tively stronger economic performance in the US, the persisting undervaluation of the USD on the basis of the PPP, and sinking interest spreads speak in favour of the dollar. In contrast to the Fed, the ECB has limited its purchases of government bonds so far. Depending on the further development of the debt crisis and the potentially mounting political pressure on the ECB, the European Central Bank will probably also step up its quantitative measures considerably. This would greatly increase the depreciation pressure on the EUR.

So far, the pegged exchange rate of the CHF against the EUR, which was implemented by the Swiss National Bank (SNB), has proved successful. The clear communication of the SNB that it will make concerted efforts to enforce the minimum exchange rate has contributed to an exchange rate that has remained more or less stable. In view of the consistent position of the SNB and the remaining overvaluation of the CHF, the EUR/CHF exchange rate could weaken slightly to the range of 1.25 to 1.30.

Equity markets dominated by political decisions

Following the significant price slumps in August and September, the equity markets in general have been able to stabilise to a certain extent in the past two months. In relative terms, US equities experienced the most conspicuous recovery, supported by the mostly better-than-expected US economy data and the positive quarterly reports of companies. The Swiss market, too, was able to free itself from the depressed price levels in early August and underwent a continuous recovery phase.

Chart 7: Commodity sectors (S&P GSCI indices, indexed)



Source: Bloomberg

Compared to their historical values and the subdued long-term interest rates, equity valuations appear to be at attractive levels. However, further downward adjustments of company profits must be expected due to the global growth decline. In view of the general uncertainties, the usefulness of valuations as indicators is therefore limited. Actually, the development on the markets and the risk aversion are dominated by political decisions and the measures taken by central banks.

Based on our overall risk assessment, we have further reduced equity allocations in the Eurozone and partly also on the Asian markets in recent weeks. Despite the above-average long-term growth perspectives, the emerging markets are temporarily subject to greater fluctuation risks. We recommend investing primarily in the home market. The total allocation as a whole is significantly below the strategic equity weightings.

Our investment focus remains locked on to large caps with strong balance sheets and earnings. In contrast, we expect smaller and medium-sized companies to be impaired more severely by the weaker growth and restrictive refinancing conditions. As far as the industry allocation is concerned, we mainly concentrate on a combination of defensive industries (convenience goods, health) and internationally well-positioned companies in growth areas or with higher revenue shares in fast-growing economies (chemicals, industry, technology).

This year, financial securities have dropped drastically. We will remain cautious nevertheless.

Chart 8: Gold (spot price USD/ounce, last 5 years)

Source: Bloomberg

Continually cautious view for commodities – precious metals preferred

The looming growth slowdown and the appreciation of the USD have exerted significant pressure on commodity prices.

Since September, strong ongoing selling pressure has been evident in the field of agriculture. To a certain extent, this has priced in expected supply adjustments in the coming year. However, the price corrections have been intensified by an increasing risk aversion and the appreciation of the USD.

As to be expected, the development of industrial metals was closely correlated to equity markets; so far, the recovery from the annual lows in October has been limited. Due to the presented macroeconomic scenarios, we remain cautious in the field of commodities in the coming months and do not exclude the possibility of further corrections.

Recently, the energy sector and especially crude oil have performed relatively better. However, crude oil prices have again suffered price losses due to the official quota increase. The geopolitical risks in the Arab countries remain high. A potential escalation of events could trigger rapid price leaps and an increasing risk premium. On the other hand, the global growth perspectives have weakened in recent months, and energy prices are being countered by the stronger USD. For next year, we expect a generally reduced demand in the OECD countries, which will largely compensate the demand growth in the emerging markets. Barring the realisation of the geopolitical risks, this makes a price increase unlikely and could result in certain correction risks should growth slow down faster.

Chart 9: Silver (spot price USD/ounce, last 5 years)

Among precious metals, gold has developed much stronger than silver. In contrast, more economy-dependent precious metals like platinum and palladium have suffered noticeably from the increasing economic fears. Due to the unresolved debt issue in the industrial countries, gold remains an investment component. However, the expectations concerning a much more volatile price development of precious metals including gold have come true. Due to the ongoing risk aversion, we expect increased price fluctuations in the coming months as well.

Alternative investments – focus on low correlations

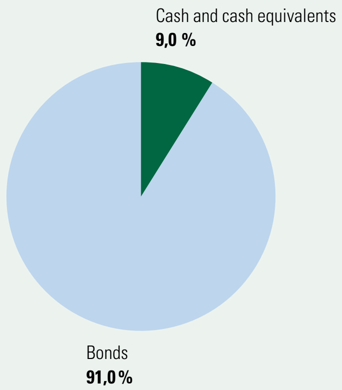
Among the alternative investments, the main focus is on strategies that are as weakly correlated as possible. As already in the prior quarter, the overall picture of hedge fund strategies in 2011 is sobering. For example, the HFRI Fund of Funds Composite index lost 4.9% until the end of November, and the DJ CS AllHedge index lost 5.6% until 12 December 2011. In the course of the year, we significantly reduced the hedge fund allocations and focused on defensive, weakly correlated areas such as global macro and managed futures. In the second half of 2011, arbitrate strategies like relative value also suffered from the increased market turbulence and increased interest spreads. Due to our cautious macroeconomic outlook and the potentially increasing liquidity problem that this might entail, we consider these less liquid strategies to be increasingly unattractive. Thus, a further intensified focus on defensive and liquid strategy areas is recommended.

Viktor Beck
19 December 2011

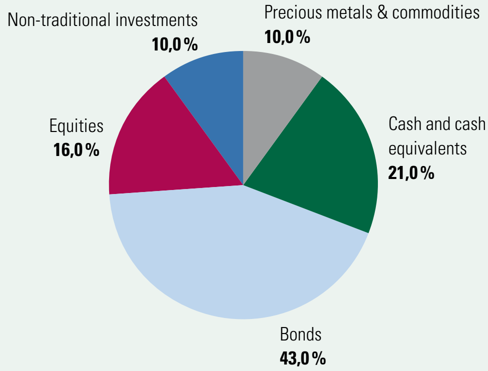
CHF-based discretionary mandates
Current asset allocation

Asset allocation of our CHF-based discretionary mandates for selected risk profiles as per December 19th 2011
(Portfolio break-up in asset classes)

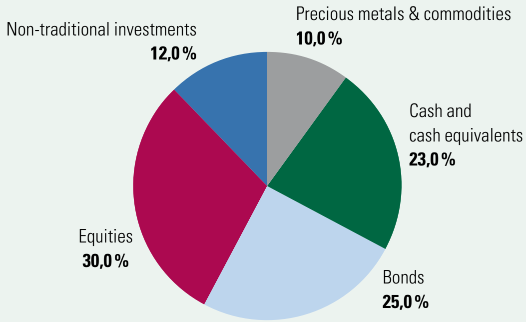
Risk profile "no equities"



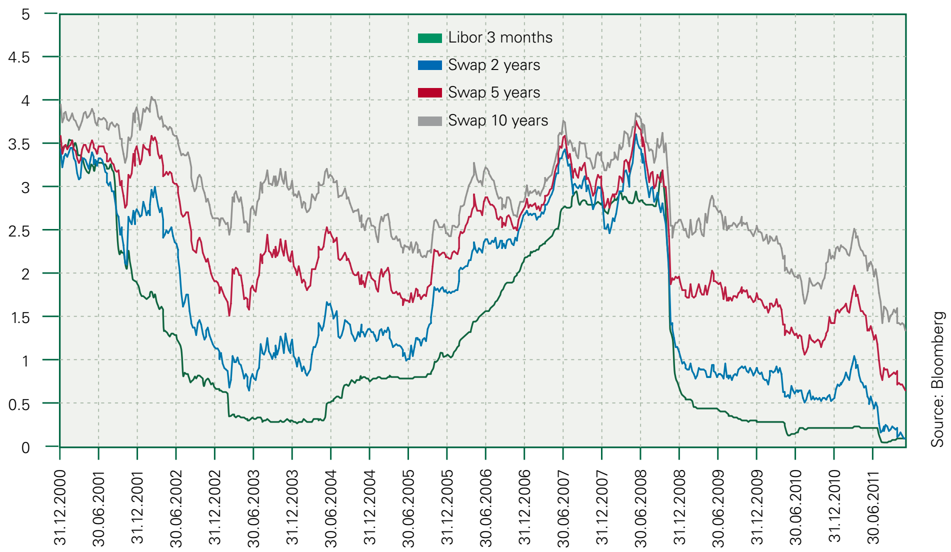
Risk profile "max. of 40% equities"



Risk profile "max. of 65% equities"



Interest and forward rates



Comment

Whilst the global economic situation seems to have deteriorated in the fourth quarter, bonds have continued to show price appreciation as the perceived safety of most government bonds has driven interest rates lower across the most curves.

Since Standard & Poors cut the credit rating of US Treasuries from AAA to AA+, on 5th August 2011, the yield on 10 year bonds has fallen from 2.56 % to the current level of 1.86 %. Government bond yields for Swiss Franc bonds have continued to grind lower with the 5 year rate at just 0.14 %, having started the year at 1.18 %.

Within Europe the yields are incredible disparate, which is an indication of how different the current situation remains for the common currency; as government leaders try to tackle the massive task of maintaining the currency, finally resorting to fiscal control and allignment against pressure from a disatisfied electorate. However whilst the 5 year yield on German government paper has fallen over the year from 1.84 % to 0.83 %, the yields on Italian and Portugese bonds have risen by 247 basis point and 10% respectively, whilst Ireland, France, Spain and Austria have seen yields fall by 4, 14, 24 and 57 basis points respectively. Clearly whilst there is a common currency, the fiscal and domestic bond markets have become visibly different.

Interest and forward rates

Swiss franc (CHF)	16.12.2011	Mar 2012	June 2012	Dec 2012
3 months	0.05	0.15	0.02	0.14
2 years	0.09	0.12	0.14	0.24
5 years	0.60	0.67	0.75	0.92
10 years	1.26	1.31	1.36	1.48

Euro (EUR)	16.12.2011	Mar 2012	June 2012	Dec 2012
3 months	1.43	1.95	1.38	1.21
2 years	1.36	1.37	1.32	1.41
5 years	1.81	1.88	1.93	2.11
10 years	2.46	2.51	2.55	2.66

US-Dollar (USD)	16.12.2011	Mar 2012	June 2012	Dec 2012
3 months	0.57	0.69	0.73	0.72
2 years	0.71	0.74	0.77	0.87
5 years	1.26	1.36	1.45	1.66
10 years	2.08	2.15	2.21	2.35

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