

Toward trust throng all, to trust cling all, yes, all!¹

„Kehraus“, literally translated as a clean sweep, is defined in Wikipedia as the carnivalesque dance towards the end of the foolish goings in Carnival time as well as more generally (albeit dated), as tidying-up or finishing-off. As far as the calendar is concerned, carnival's climax is currently as far off as can be. With a view to financial markets however, harebrained goings-on could be witnessed at liberty everywhere during the course of these past weeks.

Figuratively too, investors were practising “Kehraus” by sweeping equities as well as, towards the end of September, precious and non-ferrous metals out of their portfolios with a big broom, almost as if they had to disengage from all risky assets as soon as possible. It goes without saying that the global investor's risk appetite plummeted to levels last seen in 1981, according to Credit Suisse.

Mood worse than actual situation

Towards its end, the dramatic and widespread slump, which only bonds of impeccable nations and high-quality companies managed to avoid, displayed all the symptoms of a full grown panic. Daily swings of equity indices (not just single stocks!) of in excess of five or more percent on either side prompted volatility meters to reach seldom seen high readings. The Swiss SMI, for example, registered rolling five-day-swings not witnessed during any of the crises of the past 20 years, which also included a number of rather drastic events.

The reasons for the negative trend are quite apparent: The never-ending Greek debt and budget tragedy, which now also includes a menacing Italian, Spanish and Portuguese act, is weighing heavily on sentiment. The ongoing state of shock in the American as well as the Japanese economy is equally increasingly defeatist. In the maelstrom of the manifold problems, previously halfway-tepid growth expectations for the industrialised nations cooled rapidly to freezing temperatures, which is now also gradually rubbing off negatively onto emerging economies. At least that is the interpretation of the stock exchanges. However, one cannot help but get the impression that the mood is worse than the actual situation.

In Switzerland, the strength of the Swiss Franc was the dominating topic. At times, the Euro traded at par to the Swiss Franc, the US-Dollar could be had for just over 70

cents. Just a short time later, the Swiss National Bank's announcement to unconditionally defend a limit of 1.20 Francs to the Euro led to a sharp retracement. The fact that the European currency has not undercut this line since, much rather is trading slightly above it, illustrates the markets' respect for this measure. Three questions remain unanswered, however. Firstly, will tiny Switzerland be able to neutralise the vast global flight into the Franc if the Euro problems worsen? Secondly, will this defence reaction not be followed by an equally damaging wave of inflation in a few years time? And finally, how will the Swiss National Bank, currently engaging not only in pure monetary policy but also in exchange rate policy, be able to bow out of this one day?

Politics forfeiting trust

Speaking of politics: On the international stage, politics have proved unable to reassure markets. American congress's bickering over the debt-ceiling, Europe's tug-of-war over stabilisation issues as well as unconvincing ventures like selective bans on short-selling, new taxes on financial transactions or the leveraging of the European rescue package (EFTS) were unsuited to building trust. Quite to the contrary, all that has been aired by different camps gives rise to the fear that politics has run out of cures and that the medicine chest is empty.

Average **growth and inflationary forecasts** from „The Economist's“ September poll of economists:

	Real GDP Growth		Inflation	
	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>
Germany	3.0%	1.6%	2.4%	1.9%
Euroland	1.7%	1.0%	2.6%	1.9%
United Kingdom	1.2%	1.6%	4.3%	2.7%
Japan	-0.4%	2.5%	0.0%	0.1%
Switzerland	2.0%	1.5%	0.7%	1.0%
USA	1.6%	2.0%	2.9%	1.8%

¹ Adaption from Goethe's Faust „Toward gold throng all, To gold cling all, Yes, all!“

Economic forecasts scaled down

Growth expectations for the current as well as the following year were scaled back across the board during the third quarter, at times significantly so. The hoped-for economic recovery has in the meantime degenerated into a corrosive paralysis. Above all however, and this is what rankles with financial markets nowadays, the recovery after the last recession is taking a lot longer than in previous cycles. In the USA for example, indexed Gross Domestic Product (GDP) reached its pre-recession-level on average four and a half quarters after the onset of recession. Not only has the current slump been much more pronounced than before, the recovery is taking much longer too. Even now, twelve quarters after the recession's onset, the level of GDP in 2007 has not yet been re-attained.

Change in **Equity Markets since beginning of the year:**

		<u>Dec.2010</u>	<u>Sept. 2011</u>	<u>Change²</u>
Asia ex Japan	DJ STOXX A/P	491.3	394.3	-19.8%
Germany	DAX	6'914.2	5'502.0	-20.4%
Europe	DJ STOXX 600	275.8	226.2	-18.0%
Japan	TOPIX	898.8	761.2	-15.3%
Switzerland	SPI	5'790.6	5'006.5	-13.5%
USA	S & P 500	1'257.6	1'131.4	-10.0%
World	MSCI World Index	330.6	280.6	-15.1%

Equities downright cheap

Equities have put a dreadful quarter behind them. Whereas at mid-year green performance figures here and there gave rise to hope, during the course of the past three months these have massively turned to shades of red everywhere. This in spite of equities being, fundamentally seen, attractively valued, as evidenced by price/earnings ratios of between 10 and 16 or dividend yields in a range from 2.3 to 4.4 percent. In comparison with bonds, equities present themselves as downright cheap.

The **equity funds employed by us** achieved the following returns in the year³:

Aberdeen Asia Pacific (USD)	-17.1%
Invesco Asia Infrastructure (USD)	-21.0%
Nomura ETF Topix (Yen)	-15.4%
Performa Asian Equities (USD)	-22.3%
Black Rock Swiss Small & Midcap Opp. (CHF)	-22.8%
Raiffeisen Futura Swiss Stocks (CHF)	-17.6%
CIIM European Stock Portfolio (EUR)	-12.4%
Performa European Equities (EUR)	-19.2%
Performa US Equities (USD)	-15.8%
Perkins US Strategic Value (USD)	-12.7%

Other funds employed by us developed as follows:

BlueBay High Yield Bond Fund (EUR)	-6.3%
Lyxor ETF Euro Corp. Bond Fund (EUR)	1.0%
New Capital Wealthy Nations Bond Fund (EUR) ⁴	0.8%
New Capital Wealthy Nations Bond Fund (CHF)	-0.3%
New Capital Wealthy Nations Bond Fund (USD)	0.7%
Pictet CH-CHF Bond Fund	4.1%

Commentary on Asset Allocation

At its meetings, the investment committee decided upon the following changes to the asset allocation for medium-risk balanced Swiss Franc portfolios not subject to client's restrictions:

Money Market: Compared to our strategic allocation, we are currently overweight in the money market. Amongst other reasons, this has to do with us not replacing maturing bonds on a one-to-one basis at the moment, but instead placing parts of it in cash. The position is meant to enable us to selectively add to our equity allocation by exploiting weakness (see following paragraphs).

² Development of index in local currency. Exceptions DJ STOXX Asia/Pacific ex Japan and World in USD.

³ Performance in fund currency, Source: Bloomberg.

⁴ Performance in all currencies incl. re-invested dividends

Bonds: Sometimes it is difficult to understand the logic: The USA loses their Standard & Poor's top credit rating (which did not really come as a surprise to anyone) which immediately prompted the run on US treasuries and the associated decline in yields continues (which did come as a surprise). At least the Old World's bond markets played it by the book. Here bad news on Greece, Italy and Portugal led to falling prices and as a consequence, rising yields.

In the corporate bond sector, where we have the major part of our exposure, bonds of good borrowers have now reached yield levels so low as to discourage any further purchases. For this reason, we are channelling redemptions into money markets for the time being instead of reinvesting in bonds. The special position in High Yield Bonds experienced a harsh reversal during the course of the global dampening of risk appetite. Bonds of particularly rich nations (as implemented with the Wealthy Nations Bond Fund) also had to pay tribute to poor market sentiment.

Since the beginning of the year, **yields on 10-year government bonds** have declined in some instances massively:

	<u>Dec.2010</u>	<u>Sept. 2011</u>
Switzerland	1.7%	0.9%
Europe	3.0%	1.9%
United Kingdom	3.4%	2.6%
USA	3.3%	2.2%
Japan	1.1%	1.0%

Swiss Equities: At the end of August we decided to use a potential setback in equity prices to increase the Swiss equity position by five percentage points for Swiss Franc-based portfolios. Limit orders were placed in the market to this extent but were not filled by the end of the quarter. The Swiss Stock Portfolio launched earlier this year did not get off to a good start (-17.6 percent since start versus -13.5 percent for the SPI Total Return Index). We remain convinced, however, that in the long-term the value approach applied will prove positive in Swiss stocks too.

European Equities: Analogous to our action on Swiss equities, we also placed limit orders in the market for our Euro referenced mandates to buy European quality stocks. Four fifth of these limits were reached and filled, so that the equity allocation

in Europe increased step-by-step and selectively by about four percentage points. Our European Stock Portfolio at -15.5 percent is currently slightly ahead of its benchmark (DJ Stoxx 600 Total Return Index) at -15.8 percent.

Measured on the **price/earnings ratio**⁵ using the last 12 months earnings, all equity markets have become more attractive (green) since beginning of the year:

	<u>Dec. 2010</u>	<u>Sept. 2011</u>	<u>Change</u>
MSCI World Index	15.6	11.6	-25%
DAX Index/DE	14.4	9.8	-32%
DJ STOXX 600 Index/EU15.3	15.3	10.5	-31%
S & P 500 Index/USA	15.8	12.4	-22%
SPI Index/CH	14.9	13.6	-9%
TOPIX Index/JPN	16.3	16.2	-1%

US Equities: At -10 percent, the US equity market does not look too bad in comparison with other markets in the year to date. As the US Dollar gained against the Swiss Franc recently, this segment presents itself less ugly than other markets. US companies outside the financial sector did their homework and are teeming with strength. With 5.5 percent of their balance sheet totals in cash, liquidity is at levels not seen since the nineteen-fifties. We are neutral weight US equities.

Asian Equities: Asian equities suffered a dramatic setback during the past quarter as investors got increasingly worried about the exports from this region. We remain overweight in Asia, as we are convinced of the long-term growth potential of this increasingly important region.

Non-traditional Investments: We currently have no engagements here.

⁵ Source: Bloomberg

Summary of our current **asset allocation**⁶:

Investment Category

Money Market	overweight
Bonds	underweight/short Duration
Equities Switzerland	underweight
Equities Europe	underweight
Equities USA	neutral
Equities Asia	overweight
Equities Japan	neutral
Non-traditional assets	no position

Price / Book and **Dividend Yield** of major equity markets:

	<u>Price / Book</u>	<u>Div. Yield</u>
MSCI World Index	1.5	3.0%
DAX Index/DE	1.2	4.4%
DJ STOXX 600 Index/EU	1.3	4.2%
S & P 500 Index/USA	1.8	2.3%
SPI Index/CH	1.7	2.5%
TOPIX Index/JPN	0.9	2.4%

And to finish, one more thing

The living legend Warren Buffett – also known as the Oracle of Omaha – is apparently bullish or at least is trying to set a positive signal. At least, this is what the announcement of his holding company, Berkshire Hathaway (BH), to buy back its own shares on the exchanges, leads one to believe. The repurchase is tied to two conditions. Firstly, liquid assets of the company are not to decline below USD 20 billion as a result (BH held USD 48 billion at the end of June and has since spent about USD 15 billion on other acquisitions). Secondly, purchases will only be made up to a price of a maximum of 110 percent of book value of the shares. The latter restriction was immediately after the announcement as BH's shares rallied almost met, making it

likely that a large chunk of the cash will remain untouched in the company's till unless the stock declines again.

What do we learn from this? When there is trust, often a single word is enough to precipitate an improvement. If trust is lacking, however, neither a dictionary nor a check book is enough to help recovery.

We wish you many golden autumn days and thank you for the trust placed in us.

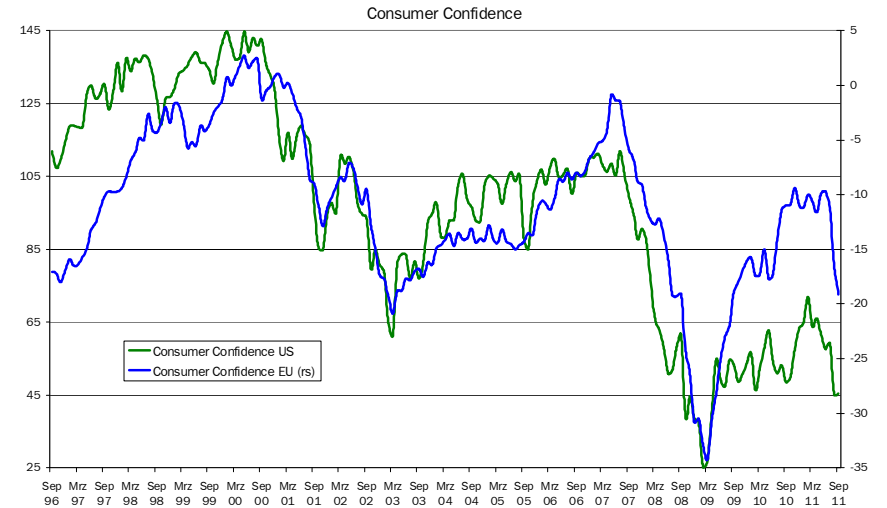
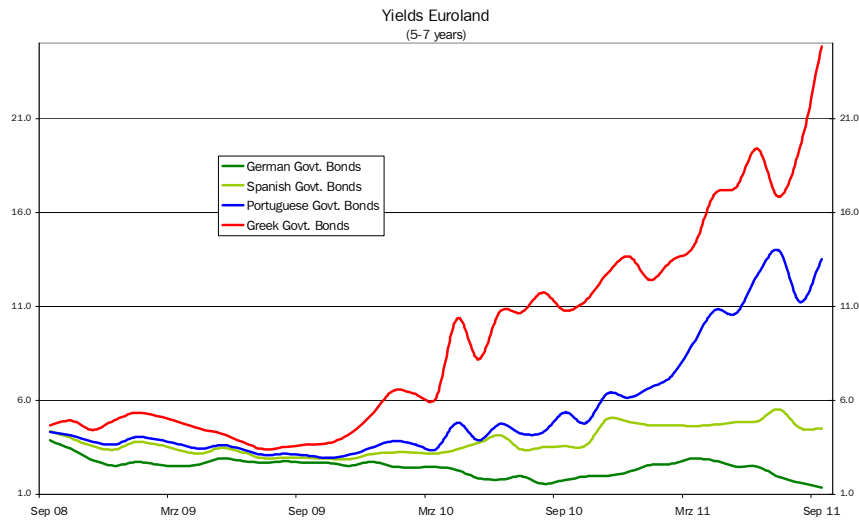
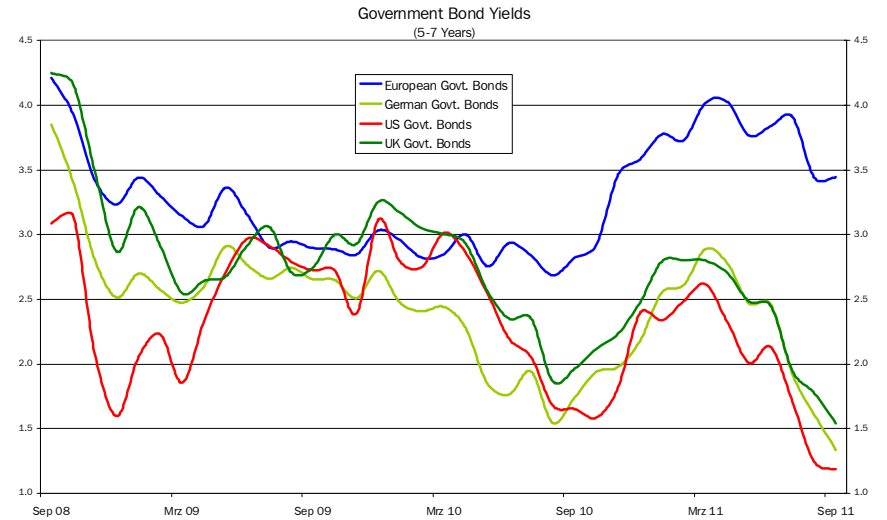
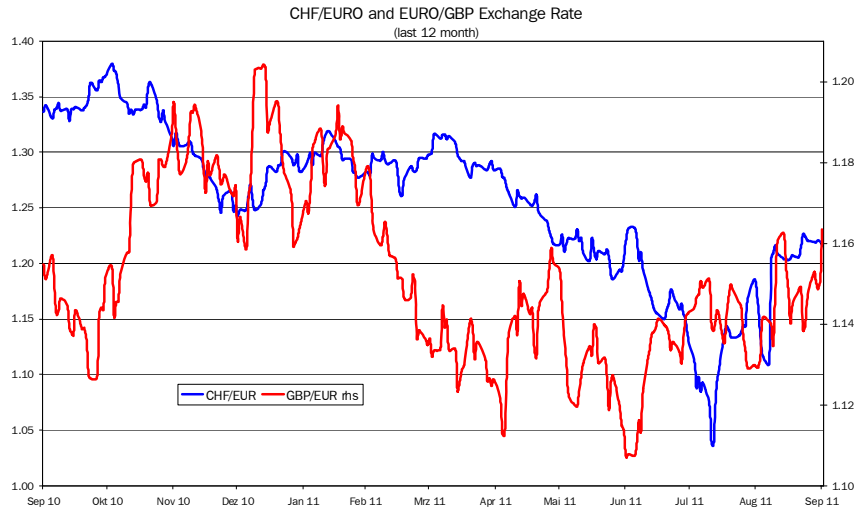
Alfred Ernst

Vaduz/Zurich, 30th September 2011

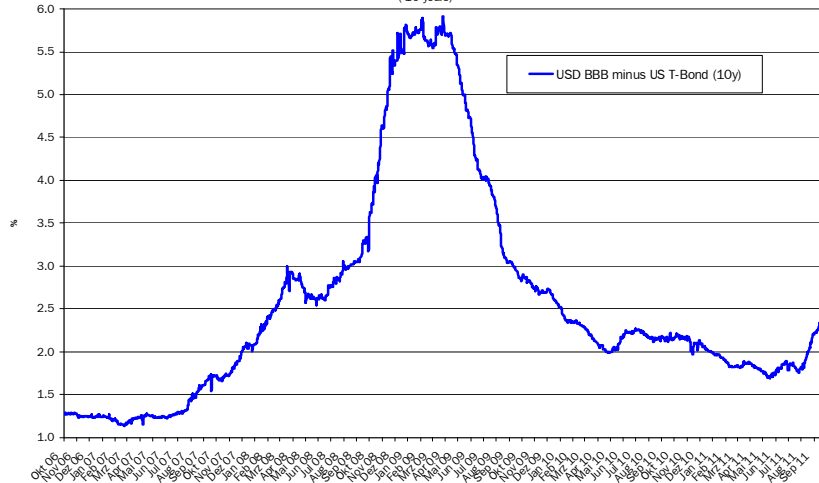
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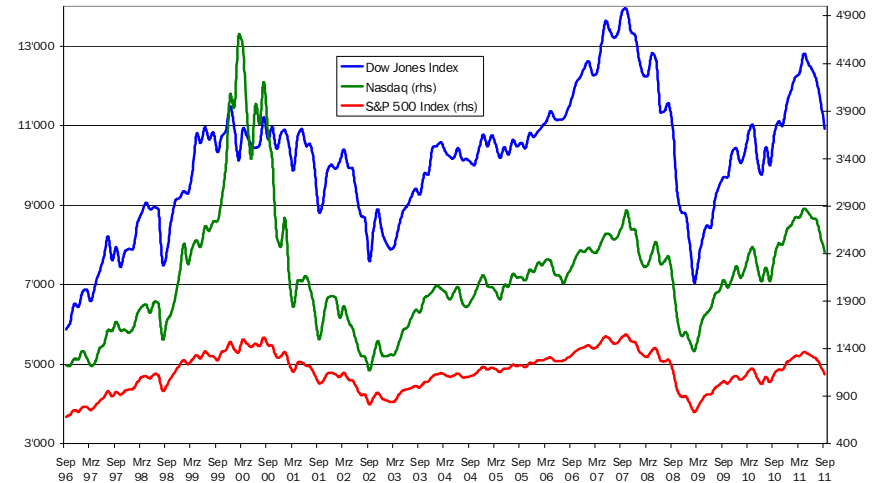
⁶ For a Swiss Franc referenced portfolio.



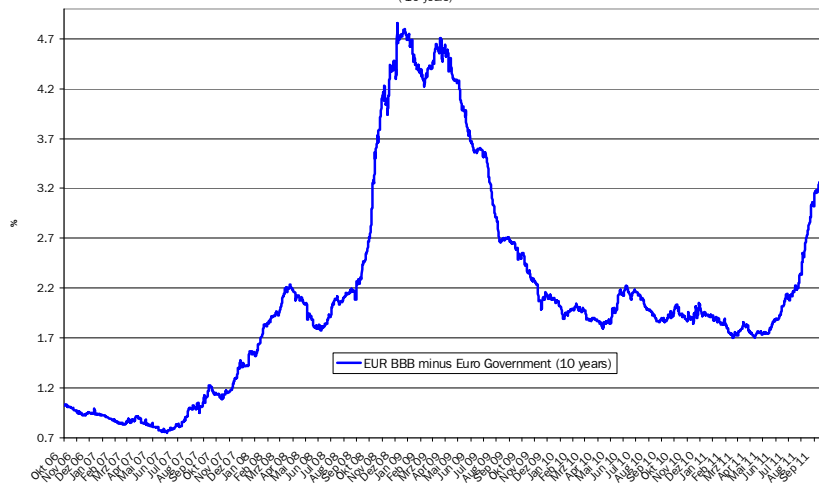
Credit Spread US
(10 years)



Equity Markets USA



Credit Spread EU
(10 years)



Equity Markets Europe

