BPM Berlin Portfolio Management

Market Comment March 2011

In recent weeks, the world community has witnessed events that will shape our future life in many ways and change it in substantial areas. The effects and consequences on the political balance of power, the security situation in many countries and, ultimately, continued economic and business development, are today at best unpredictable. In a few weeks, questions which today have not even been formulated must be discussed and answered.

The following is a brief and by no means comprehensive summary:

1. Starting with the riots in Tunisia, almost the entire North African region has become destabilised. The contradictions in this region have been exacerbated to such an extent that many countries are in the medium term more and more ungovernable by their former leaders. How the situation will develop and the political orientation are currently unpredictable.

2. Movements of refugees between Africa and Europe are increasing. Thousands of people fleeing from hunger and hopelessness are landing in Italy and this, in our opinion, is only a foretaste.

3. China has at the same time sharpened its approach to critics of the system and the international press, fearing a spillover of the unrest.

4. The rating agency Moody's is again downgrading (perhaps partly for political reasons) countries in the euro periphery. Greece is now rated as being less solvent than Egypt!

5. The $3000 billion market for U.S. municipal bonds is in a disastrous state. If the U.S. government does not continue its expired "Build America Bond" Program (the government took over 35% of the interest for BABs), many municipalities and states will operate in short-term insolvency.

6. The manager of the world's largest mutual bond fund (Bill Gross of PIMCO) has sold all U.S. government bonds in his funds.

7. The global oil price is rising above $100 per barrel. The United States is opening the strategic petroleum reserve, which can ensure a supply for approximately 60 days.

8. The developments in Saudi Arabia are particularly noteworthy. Destabilization here would, in our opinion, lead to an entirely new geopolitical level of escalation.

9. The strongest earthquake ever measured in Japan, the third largest industrial nation in the world, is shocking the country and the whole world. Shortly afterwards, parts of the country were hit by a tsunami, bringing havoc causing billions of dollars of damage. A nuclear incident is under way in nuclear power plants, leading to the release of radioactive material into the atmosphere. There is a high danger of a meltdown.

10. Silver, gold and other metals are reaching new multi-year highs.

11. The inflation trend in many countries indicates further steep rises.

12. Finance ministers from the ECB are holding further summit meetings to discuss what action to take to ensure the stability of the euro. Final decisions are on their way. However, in any event further unilateral demands will be made on support from the EU (Germany, France, the Netherlands…).

The list of important events that have occurred in the recent past can certainly be continued. As those responsible for the assets of our clients, we are required to make the right assessments and decisions in this situation. It is obvious that the forecast uncertainty of future developments has increased greatly. However, a sober and critical assessment shows that essential elements of our current strategy have been confirmed.

Our medium-term scenario, with the highest relative probability, assumes a weakening of the above-average growth in Europe, low single-digit growth in the U.S. and a worsening of the outlook in Asia in the near future. We currently do not believe that the reconstruction work in Japan could indeed lead to a resumption of growth. Rather, we expect that the debt will again rise significantly over the 200% of GDP mark due to the new need for expenditure on infrastructure, and further intensify the fiscal problems. This, combined with the simmering bubble in the Chinese real estate market and an inevitable appreciation of the Yuan, is currently leading to an unattractive risk / reward ratio for investors in this region.

We stand by our expectation of inflation higher than the market consensus. Do you remember the deflation debate of a few months ago? What matters for us now is not so much the argument of price pressure from rising asset prices but rather the extreme global money supply growth.

Both in the euro and particularly in the U.S. dollar we expect a further flattening of the yield curve in the short and medium range based on rising money market rates. The U.S. dollar seems to still be at risk in the medium term of devaluation in relation to other hard currencies. USD positions should be hedged, and leveraged investments in USD nominated securities should, as an absolute necessity, be in the same currency.

Further increases in food and oil prices are dramatically exacerbating the political tensions between the people and the governments of many countries. As mentioned above, hunger, hopelessness, failure to share in social wealth and a very young population can overthrow any government.

Conclusion: There is currently a clear preponderance of potentially negative factors. There is therefore no surge in aggressive new investments in various asset classes. For a long time now, the direction of the "smart money" has clearly been towards precious metals, stocks and high yields:

A. There has been a switch from government bonds and money market investments to physical, material and real assets (stocks, commodities, real estate, water, wood and art).

B. Safe and continuous cash flows have become of increasingly high strategic value and are still relatively cheap (utilities, Telco's, basic materials).

C. Income in income securities is being maximised as the second pillar of the immunisation strategy (customised notes, discount strategies, hybrid capital).

D. The proportion of variable interest-bearing corporate bonds (floaters) is increasing.

E. There is greater "asymmetrical" diversification under exclusion of the "flop" asset classes.

F. There is successive building up of liquidity in order to buy quality "cheaply" in sell-out phases.

The latest developments are in part (unfortunately) precisely the kinds of turbulence which we had to prepare you for in our comments in the last few quarters. The assets managed by us are therefore oriented in line with such kind of developments, within the framework of the defined investment guidelines. Strategic action is not currently necessary. We will contact you without delay if changes in the situation in the short-term give rise to any changes in our assessment.

Our thoughts are with the victims and casualties of the natural disasters and the innocent civilian victims of the unrest in North Africa. We wish them a swift transition towards democratic market economy structures.

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