BPM BERLIN PORTFOLIO MANAGEMENT

Market commentary September 2011

"The markets are never wrong, opinions often are."

Jesse Livermore (American trader at the beginning of the 20th century)

"When purchasing a share I always remember that the seller usually has a reason for selling."

Thomas Voges (UniCredit)

"When I talk to a stock exchange colleague, no matter how brilliant he may be, after two sentences I can already notice that he studied economics. His arguments and analyses are squeezed into a corset that he can't get out of."

Andre Kostolany (stock exchange expert)

"All truth passes through three stages: First, it is ridiculed. Second, it is violently opposed. Third, it is accepted as being self-evident."

Arthur Schopenhauer (German philosopher)

Today, there are many examples of a well-known pattern repeating itself - after a two-year rise in global share prices, the start of August this year brought about a historic wave of selling in the markets. Historic not because of its compelling logic; historic because of its size. This time too, we must be careful not to confuse the cause and the trigger as the first wave of selling was only initiated by a few, albeit multi-billion, sale orders by institutional investors. Yet, by the second week of August the downhill dynamic had already widened as banks, insurers, funds and asset managers were forced into further sales when they reached their risk limits.

Please understand us correctly: It is not our intention to say "what we think will happen". No one can predict the future. Rather, we continue to make it our concern to listen to the range of market signals without bias, assess and evaluate their influence on investor trades and, as a result, derive the future market trends with the highest relative probability in the various asset categories.

As you know, we were already forced to paint a rather gloomy picture of the medium-term economic and stock market development in our last market commentary. The burden of negative factors was simply too overwhelming to derive a sustainable net economic growth and resulting sufficient consumption capacity and willingness to consume by households.

Our assessment of a strongly growing threat of inflation remains, even if we can now envisage a short deflationary period resulting from the influence of the dramatic reduction in growth. The imminent introduction of a new injection of liquidity by the FED and ECB will unfortunately once again reinforce the medium-term risks. This renewed artificial flood of liquidity may stabilise share markets for a limited period and thus confirm many investors in the false assumption that the correction has passed! The fact that at least 50 per cent of past market price increases are based on the investment of cheap central bank funds rather than on the organic investment of profits is not yet sufficiently well known to private investors. Unfortunately even this central bank liquidity instrument is increasingly wasted as strikingly attested by the large amount of data on strongly declining medium-term net inflows in direct company participations and funds.

Why have numerous advisers - especially at banks - once again been calling for an entry into the broad stock market since mid-August? We encounter essentially three main arguments which are worthwhile examining further:

- ***"The historic valuation of many market-leading companies is currently extremely cheap. In addition, numerous companies have enormous liquidity reserves."***

  Both are relatively correct if one considers that the current low valuations were seen as entirely normal in the 1960s, 70s and 80s. The liquidity situation of companies may be an indication of their ability to survive - however, it is not proof that product sales will be successful in the future. It seems important that we once again point out that the projection of the current business situation and cyclically higher growth dynamics into the future are regularly doomed to fail.

- ***"There are always setbacks. They have also always been a good opportunity to enter cheaply into the market."***

  Here, the argument is skillfully sold to directly connect with the experience of many private investors. It is correct that analytical behaviour is a prerequisite for obtaining above-average yields. Firstly, however, in our opinion, a sufficiently high capitulation sentiment is currently missing. Secondly, the level at which the market sufficiently factors in the existing economic, political and global risk is still entirely open-ended.

- ***"Despite phases of exaggeration (like now), prices have always reverted back to their fair value."***

  This is of course fundamentally correct. However, the fair value is not a constant and therefore not suitable as a target! You can easily see that analysts tend to describe current conditions and use mainly key economic figures at the company level for - usually positive - valuations. Historic data is usually selected to support their own scenario. It goes without saying that, as a result of understandable economic interests, analysts employed by banks tend to lean to more positive scenarios than independent economists and asset managers. In any event, the motives for the purchase (or non-purchase) of securities for private investors are often assumed to be different than for banks. Life experience, risk sensitivity, political events or exchange and discussion with friends are often more decisive than balance sheet analyses of industrial companies.

(Despite the knowledge that the majority of our clients have not completed any economic studies, the economic basics of the "complete economic cycle" is nevertheless referred to here. In whose logic the consumption capacity of private households and the country plays a central role (as an essential basis for future company profits). It is precisely at this point that we see considerable potential for further disappointment for many, if not all, companies based on the dramatic national debts and the restraint in consumer spending. If you are interested in knowing more, please talk to us or an independent adviser on this issue.)

A short summary

After a phase of increasing divergence between the global realities and market prices (in particular the share market) there was an abrupt, strong correction. We currently find ourselves in the "price establishment" phase on the part of the market and the forced, retroactive adjustment of growth estimates by most analysts. However, despite this, these analysts continue to assume that this relates to a "big mistake" by the market which it will soon recognise... we find this view rather strange!

Yes, today many shares and bonds are indeed significantly cheaper than two months ago without any dramatic change to the **current** state of most companies and debtors in this short period. If the securities market were a supermarket, this discount action would regularly provoke buyer stampedes. Assets that were purchased at higher prices only weeks ago are now, sometimes wrongly, avoided.

How does this all fit together? You know the answer, we have all read and heard it again and again: The security markets act on the expectations of future development, not the current situation! Therefore, orienting the strategic portfolio structure to the most probable future developments continues to apply and -very importantly- independently of current events.

What is the strategic positioning of BPM?

1. **Shares**

   Strategically, in the future shares will increase significantly in value as asset security instruments in comparison to government bonds. Their fundamental value is a useful protection against inflation and, in many cases, a reliable source of dividends. Our strategic recommendation continues to concentrate on the areas of utilities, telecom, commodities, foodstuffs and pharmacy. We continue to avoid stocks sensitive to economic trends. Please note: After the valuation discount of gold and silver mines compared to the respective metal prices rose to extremely attractive levels we will, for the first time, establish strategic positions within the scope of the management mandate.

2. **Bonds**

   From our point of view, government bonds are totally overvalued or will effectively only be repaid with freshly printed "paper money". The real yield is currently already negative, i.e. an investment directly destroys your buying power! However, the influx of "freshly printed" central bank funds in government bonds is expected to continue in order to at least guarantee the preservation of the nominal capital. Corporate bonds of good debtors and attractive foreign currency bonds are clear holding positions. In places where quotas have not been exhausted, bonds of excellent debtors (in Canadian dollars, Turkish lira, Brazilian real, South African rand, Australian dollars or also in Norwegian kroner) offer buys. Variable interest bonds of good-quality banks or with "system relevance" should be held. In some cases, additional purchases remain attractive.

3. **Commodities and precious metals**

   Over the past few years our favourites, gold and silver, have contributed considerably to the stabilisation of managed assets - and will continue to do so. We would use corrections of 10-20% (gold) and up to 35% (silver), which are always possible, as opportunities to further increase positions and/or to reach the target quota. For many years, gold was discredited as a purely speculative investment by the mainstream investor community; now we hear in the street: "we probably would invest, however, the entry level is deemed much too high." It will be interesting to see how public opinion continues to change (in the sense of Arthur Schopenhauer).

   Our long-term, extremely positive assessment remains: Gold is no typical investment - gold is "only" better money! Widely diversified commodity investments should be held. Copper is of interest and is being intensely monitored by us. Based on the weakening economic dynamics, additional purchases in energy and industrial metals are currently not a priority.

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Further unique special solutions for our mandates, which we cannot delve into here for reasons of space, reinforce the immunity of management mandates against strong market shocks and are actively used by us.

We, as the responsible manager of your assets, will also pursue a value and distribution-oriented strategy in the future. As a result of the expansion of our personnel capacities, this year we will acquire further mandates. **At the beginning of each new relationship is the hypothetical question: „ If you could have your whole wealth in cash – would you invest it in the same way as now?"**

Our main concern remains offsetting extreme, negative market movements through diversification to non-correlating asset classes without foregoing positive asset development. This is, of course, an established approach – but the strict independence from banks and the "How" make the difference! The success of the BPM strategy is now becoming clear to more and more investors.

We thank you once again for lending your trust. Please do not hesitate to contact us for further in-depth information and discussions.

Uwe Günther Sven Marzahn

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