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Market Commentary, March 2012

"It is well enough that the people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning."

Henry Ford (1863 – 1947)

"Price is what you pay. Value is what you get."

Warren Buffett (famous US value investor)

"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are unknown unknowns – the ones we don't know we don't know."

Donald Rumsfeld (Ex-US Secretary of Defence)

"I may be able to calculate the path of the stars in centimetres and seconds, but not what the madness of people can do to a stock exchange price!"

Sir Isaac Newton (1643 – 1727)

Is it possible to make a boiled egg runny again? After the continuing flooding of the markets, can the FED, and now also the ECB, ever get back to the path of sustained monetary stability with limitless and cost-free liquidity alone? Do they even want to do that? The answer to all three questions must probably be "no" – they are all equally improbable.
In our opinion, in the past few months we have experienced the beginning of a new level of paper money devaluation. It should be noted that since Mario Draghi took office, the European Central Bank is also using the US remedy of unrestrained money printing. For the politicians, the danger of a European wildfire simply seems too great. The same men and women who otherwise advocate the social market economy as a social form without any alternative are now suspending the rules of the market economy entirely. The "social" element is also falling by the wayside – in the coming years ever larger parts of the less affluent population will fall victim to the misguided central bank policy. Anyone without assets will be unable to avoid the money devaluation and is exposed without protection to the creeping reduction in purchasing power.

The effects of the unsuccessful attempt to postpone the official bankruptcy declarations of Greece, Portugal and perhaps Ireland are wiping out assets all over the world and exacerbating the scale of the inevitable market reactions. What's more, they are putting social stability at risk all over Europe. In the medium term, the gap between rich and poor will widen and thus weaken Europe as a location for business and industry. Greece will possibly be kept "on a drip" until the debt extensions, due in 2012, in Italy and Spain are exhausted, whereupon the patient will presumably be left to his fate.

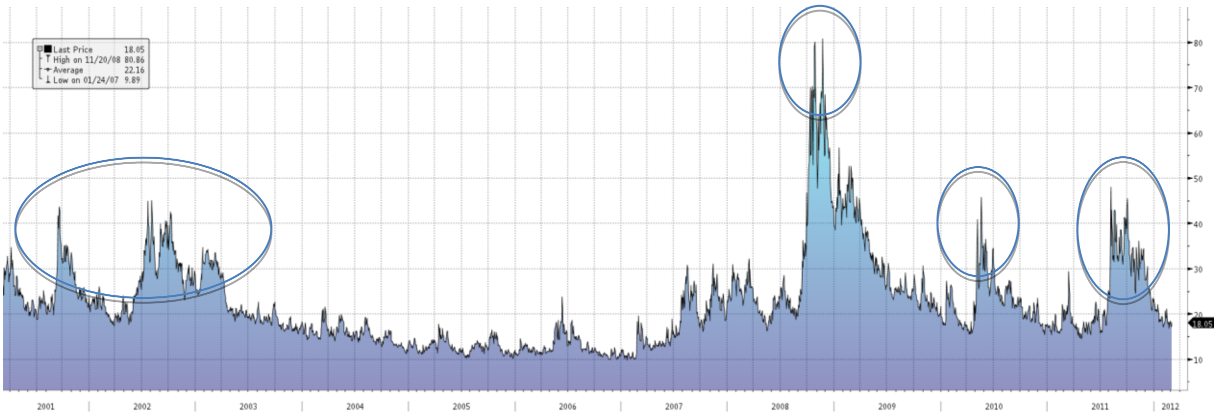
Trends in 2012

1.) The actual drama and the fact that the numerous rescue measures have no benefits for the real economy will be even more clear as soon as it is recognised that virtually none of the hundreds of billions of euros or dollars is flowing into people's real purchasing power. Growth in real purchasing power has been stagnating in the developed economies for years. Also, consumer prices in the eurozone have increased by 7.30% since February 2008, according to official figures!

It may be argued that "it's better than inflation". In many countries we are actually rather seeing deflationary trends in the short-term. The pressure of competition combined with a weakening economy is currently still limiting the inflationary price upsurge. Unfortunately we are also unable to give the all-clear in this respect, quite the contrary. It is highly likely that inflation will make a detour via producer prices. Flooded with cheap money, the banks act rationally – they invest in (besides bonds and shares) supposedly high-yield assets such as oil, energy, basic commodities, raw materials, agricultural products, land and woodland. The increases in their prices must ultimately be passed on by the producers to consumers. The current trading margins of the producers are simply too small to subsidise such price increases in the long term. The logical consequence is that more and more extensive wage claims will be made by employees to enable them to at least partially cover their increased living expenses. This would be the **beginning of a dangerous wage/price spiral**. We believe that this scenario is highly likely over the next 36 months and are adjusting our management mandates accordingly.

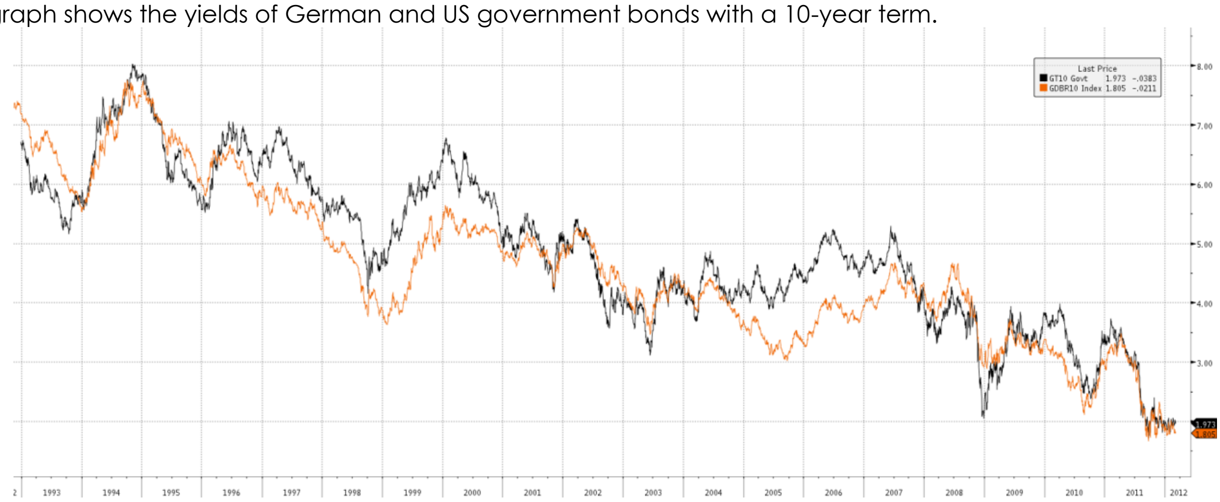
2.) As mentioned above, as a result of the central banks being flooded with money and the resulting speculative purchases made by the banks, in our opinion the prices of many forms of investment (including shares, bonds and raw materials) have significantly deviated from their fundamental values. Referring back to the quotes at the beginning of this commentary, this does not necessarily mean that "good sense" and sound economic management will immediately gain the upper hand again (as Sir Isaac Newton knew over 350 years ago!). However, these "tensions" on the capital market will in our opinion lead to a **considerable increase in volatility (fluctuation) on the markets** for shares, pensions and raw materials. For prudent investors, so-called volatility strategies, whose positive performance is directly tied to an increase in fluctuation margins, may be a good option.

The following graph shows the considerable fluctuations in the US S+P 500 share index in the context of strong negative market movements.



3.) Under the assumption of the irrational price trend referred to in section 2.), the German **federal bonds (bunds) and US government bonds (T-bills)** will certainly play a special role. When real returns are "less than zero", those investments actually are not a useful investment but rather provide short-term asset protection in a highly nervous market environment. In view of the huge new debt mountains, the current prices of those bonds seem much too high. After another short reduction in returns, for the second half of **2012 and not later than 2013 we expect a significant relative increase in the risk premiums (yields)** for these forms of investment. This would obviously involve appropriate price reductions for those securities (see Warren Buffet's quote!). Furthermore, as a result of the banking system being pumped full of money, the current risk of bankruptcy of many institutes is being reduced for the time being, which means that "safe havens" will generally have to be resorted to less frequently, at least until 2013. Investors can therefore position themselves in solutions which participate in price reductions for the above-mentioned securities. This can be done both for passive protection and also for active optimisation of returns.

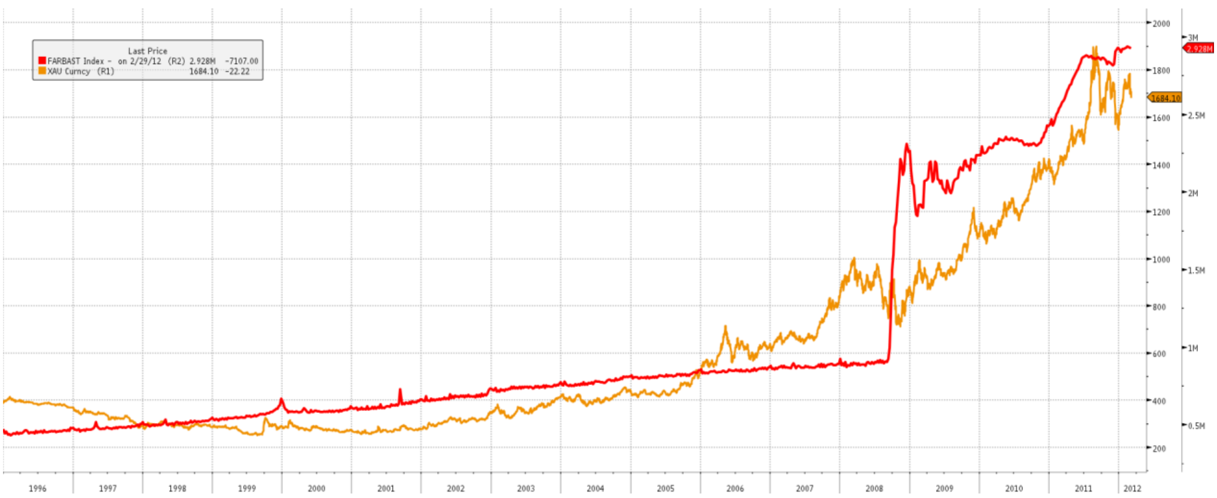
This graph shows the yields of German and US government bonds with a 10-year term.



4.) We are often asked: **"What about shares? Should I buy?"** We will try to sum up our opinion in a single sentence: **Many shares are more expensive than they seem, but are absolutely essential as a high quality addition to a portfolio**. Participation in productive capital with a good balance sheet and a solid and sustained share in profits is a key building block for real capital preservation after taxes and inflation. Shares offer a certain degree of protection against inflation because the value of the company does not depend on the value of the currency. The currency price of the company's assets (buildings, land, rights, machines, etc.) increases with declining purchasing power. However, please be aware of the above-mentioned Achilles heel of "consumption or investments", without which no company can generate sustained profits. Unfortunately, companies' balance sheets also increasingly include items that no longer represent any real value (e.g. virtual values of taken over companies), which are not written off and are included in the market valuation without differentiation. On the other hand, real future burdens from pensions or other liabilities are often insufficiently taken into account. **So please be careful and consult experts!**

5.) It has become virtually an endless mantra, but we still consider it very important **not to give up a single gram of existing gold or precious metal positions**. As we have explained in numerous market commentaries, gold and silver are an extremely efficient money substitute and portfolio protection and are not an investment for the purpose of profiting from returns. Also, the price of gold is not increasing – the purchasing power of money is decreasing, so quite simply a larger amount must be spent to purchase a unit. Unsure investors should be aware that the Chinese Central Committee and many international central banks are on their side. In August 2011, the largest gold purchases in 40 years by international central banks and investors were noted.

The following graph illustrates the "explosion" in the US Fed's balance sheet after the beginning of the rampant money printing and the simultaneous acceleration of the increase in the gold price.



6.) Subjects that we focused on in 2011 are still current in 2012. In the next few years, banks and insurance companies will have to further adjust and rearrange their capital structure. Under the more rigorous EU regulations under "Solvency II" and "Basel III", **certain instruments are no longer permitted as a substitute for equity capital**. Such securities, with an above average rate of interest and a right of termination of the debtor and whose current prices are often below par, offer attractive opportunities in 2012 too.

To sum up: 2012 will be another challenging year in that, in our opinion, the forecasts of key developments can be made more reliably than in 2011.

Our capital market forecast which is most likely to occur is as follows:

- The central banks' monetary policy will continue to be expansive; excessive money supply will prevent the necessary structural adjustments in the banking system and lead to more price bubbles in investment classes;
- The risk of bank failures with relevance for the system will continue to rapidly decrease;
- The downside risk of the large share markets is limited by medium-term inflation risks and huge liquidity;
- Upside opportunities are also limited due to the geopolitical risks, the restrained consumer spending in the industrial nations and the increasing raw material and energy prices;
- In our opinion, above average fluctuations in the share markets should be expected;
- Greece (80% probability) and Portugal (30% probability) will leave the euro in 2012; the euro itself will remain stable against the USD and even appreciate slightly;
- Gold and silver will increase further with fluctuations and reach new peaks;
- The corporate bonds still favoured by many investors in 2011 will become relatively less attractive;
- The yields of German federal bonds and US government bonds will increase in the second half of the year by a considerable percentage, contrary to the current majority view.

Conclusion: As you can see, we are by no means optimistic regarding economic development in 2012. However, we are optimistic in our expectation that, with our restrained strategic market assessment, we can also make a substantial positive contribution to your assets in 2012. Capital (sound corporate interests, precious metals and real estate), yields (foreign currency bonds, subordinate bonds of insurance companies) and intelligent hedging strategies in the volatility and interest area are particularly attractive.

Finally, we would like to draw your attention to an article in *Wirtschaftswoche* magazine of 13 February 2012, in which **350 leading asset managers in the German-speaking countries were tested**. Only four asset managers achieved positive overall performance in the period January 2011 to January 2012. Although we do not yet participate in these comparisons, with many mandates BPM would have again been at the top of the rankings (top 5).

We would like to thank you for your loyalty and look forward to further successful cooperation. We also thank the many clients who have contributed to BPM's continued organic growth through active friendly recommendations. Please do not hesitate to contact us directly as before with any questions or requests that you may have. You can also use the existing contact form at www.berlin-pm.com for this.

Yours,

Uwe Günther Sven Marzahn

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