

● In the short and medium term, earnings are the main driver for equity markets

● In the long term, consumers hold the key to a sustainable recovery

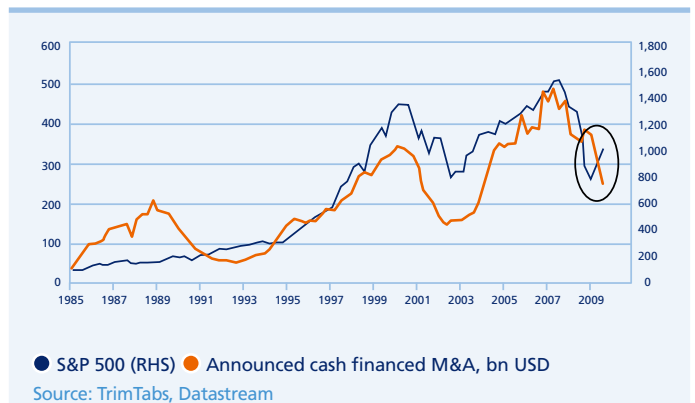
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Monthly Investment Newsletter

M&A: next driver of equity markets?

- Global M&A (mergers & acquisitions) is still down from the record level of USD 4,400 billion in 2007, but this is changing fast. Recent takeover bids by, among others, Kraft Foods, Xerox and Abbott in the US indicate the start of a new period of M&A.
- The current environment is perfectly suited for M&A; funding has become cheap again and equity and corporate bond markets are very willing to provide new capital.
- As long as companies can buy competitors with a stable business model and with a free cash flow yield that is higher than the corporate bond yield which they have to pay themselves, M&A makes sense.
- For listed companies, it is very favourable that equities are now slightly more attractively valued than corporate bonds, a reversion of the situation of late 2008.
- Furthermore, there is no lack of viable, cash generative targets out there, because companies in general have behaved prudently during the past recession.
- All in all, as long as corporate bond yields remain low (which may be for quite a while) M&A activity is likely to boom again. That would not be a moment too soon.
- After all, financial markets need a new impulse to drive them higher. Upside surprises in earnings and economic data are likely to become scarcer given the increased expectations and potential lack of upside in consumer demand.

- Besides, valuations have normalised and therefore lost some of their appeal. M&A may thus provide the icing on the cake in this mature phase of the recovery play.
- Each deal will generally be good for the equity holders and potentially bad for the bond holders.
- Targets will tend to have high free cash flow generation. They can be found in all sectors, but are overrepresented in the more defensive parts of the investment universe.

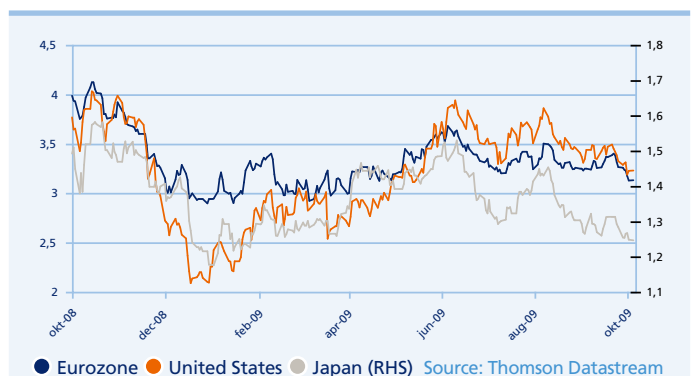


M&A should pick up as the market continues to rise

Asset Allocation

We are neutral equities versus bonds

- Markets are in a sweet spot: economic growth and corporate earnings are recovering, inflation is declining and monetary and fiscal policy remain accommodating. Such an environment is favourable for risky assets.
- For the next 6-9 months economic data will continue to improve and loose policy could remain until Q2'10. Earnings growth will be a main driver for equity markets in the near term.
- Sustainability of earnings is a key concern in a sub-par growth environment which we expect beyond mid-2010. Deleveraging needs to continue, cost cutting effects will fade, policy will be reversed and households will remain under pressure.



10-Year Bond Yields

Equities

Consumer is key for sustainable recovery

- Equity valuations have returned close to their long-term average. However, the end of the re-rating does not mean that equity prices have no upside potential anymore.
- Main driver will be the earnings development. Earnings have bottomed; six months earlier than expected thanks to aggressive cost cutting and lower interest charges.
- Earnings growth of 20% or even more in 2010 is realistic, thanks to further cost containment, productivity gains and a small increase in top-line revenues.
- It will be difficult though to sustain growth beyond 2010, in particular because of continuous concerns about consumer spending. Income growth remains subdued, unemployment keeps on rising and household deleveraging will continue, especially in the US.
- Future consumer spending needs to be income driven. Because of tighter credit standards and debt reduction priority by banks, households can rely less on credit to fund spending.

- The consumer represents 60% to 70% of most developed economies and is therefore critical for the sustainability of any economic uplift.

Regional equities: we overweight emerging markets

- Overweight emerging markets. Earnings growth is higher, valuations are attractive, fundamentals are solid (low debt levels, resilient domestic demand).
- Overweight Europe. Relative valuation is attractive. European equity risk premium is still well above long term averages.
- Underweight US. Stabilization of global economy reduces the need for a safe haven. US valuation premium is substantially higher than average.
- Underweight Japan. Weakest economic fundamentals among developed regions. Strong yen hurts exports.

Size & Style

- Overweight Large Caps. Earnings momentum is better for large caps. Valuations of large caps are more attractive.
- Overweight Value vs. Growth. Earnings recovery is supportive for value strategies. We remain positive about High Div.

Fixed Income

We diversify our credit exposure

- With depression risk out of the way, strengthening macroeconomic momentum and no policy tightening in sight, investors are tempted to continue to climb up the risk curve.
- In the short-term, this is likely to remain a support for risky assets. As this whole environment is accompanied by ongoing underlying disinflation in the developed world, there is no large risk for government bonds either.
- However, the risks in the short-term are more balanced for government bonds as they will at least be partially used as a funding source

for more risky allocations of investors.

- Looking into next year, the road looks bumpier. Valuations are no longer excessive, with the possible exception of European ABS, and both macroeconomic and liquidity conditions will almost certainly not continue to improve to the same extent as they have done over the last six months.
- In some areas the pace of improvement will not only slow, but at least partially go in reverse. It seems likely therefore that volatility will rise again next year and risk premiums could well stop to tighten further.
- In this environment, a somewhat more diversified risk allocation seems justified, while paper with higher ratings and more implicit government backing is likely to offer better risk adjusted return perspectives over the next couple of months.

Equities		
		change
Energy	+	
Materials	=	
Industrials	-	▲
Consumer discretionary durables	-	
Consumer discretionary services	-	
Consumer staples	-	
Health Care	+	
Financials	=	
Information Technology	+	
Media	=	
Telecom Services	+	
Utilities	=	▼

Fixed Income		
10-year Bond Yield (3 month forecast)		change
US	3.0%	
Eurozone	3.0%	
Japan	1.3%	
Investment Grade Credits	+	
High Yield Credits	=	▲
Emerging Market Debt		
Hard Currency	=	
Local Currency	+	
Asset Backed Securities	+	

⊕ positive ⊖ neutral ⊖ negative

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