ECHO FROM THE ALPS

1st Quarter 2011 Investment Update
By Daniel Zurbruegg, CFA / Alpine Atlantic Global Asset Management AG

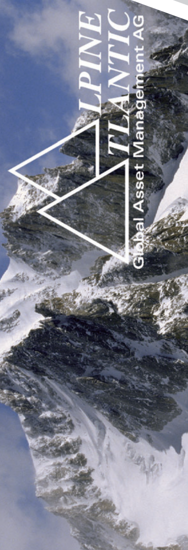
LIQUIDITY DRIVEN MARKET MOMENTUM TO WEAKEN

First of all, we would like to wish all our readers a happy and prosperous New Year; we hope you all had a good start. About one month after we celebrate the New Year in the western world, the Chinese are going to celebrate their New Year at the beginning of February. 2011 is the year of the rabbit, which is following the year of the tiger. The Chinese believe that the year of the rabbit will bring a general consolidation in life, a time to calm down and recover. It is a time that is good to make things more stable, to focus on life and quality time with friends and family and also a year to be patient and not to "push the river". In Chinese traditions, the rabbit is the sign of the moon, while the peacock is the sign of the sun, together they are the Yin and Yang of life and anyone making supplications for wishes to be fulfilled are certain to get what they want in the year of the rabbit. Don't worry, our newsletter has not changed its focus from economics to philosophical issues, but, given the volatility of financial markets and the overall global economy in the past few years, I certainly think we could use a year of stabilization. And, while we hope for another good year, we certainly think it is better to rely on independent thinking and a sound, well thought out investment strategy. If, however, we get a bit of extra help from the Chinese rabbit, we certainly wouldn't mind.

The performance of global financial markets certainly gave investors a chance to earn decent returns but it required proactive action, especially on the currency front, to generate profits. Most major equity markets finished the year strong with index levels rising between 5% and 10% just in the last quarter of 2010. This came as a surprise to many investors, especially given the turbulence encountered in the fourth quarter of 2010, such as the European sovereign debt problems or the increased tensions on the Korean peninsula. Given the outlook for continued moderate economic growth in most parts of the world, it is clear that the rally has been driven by excess liquidity which needed to be invested. Many, especially large institutional investors, are forced to put some of their cash to work and it is therefore not surprising that we saw global equity markets finishing the year strong despite the above mentioned problems. We had already discussed the chances for a year-end rally in our last update in late October and we are therefore pleased to see that this rally has indeed taken place. The need to invest excess cash was also the main driver behind the strong start to the New Year and it seems that an increasing number of investors have become more positive with regards to the outlook for global equity markets.

While we think that there is a realistic chance to finish the year 2011 with higher equity markets, we are strongly convinced that a simple buy and hold strategy will not result in optimal performance and we think the right timing will be crucial in 2011. This means that investors should be prepared to hedge their investment exposure in anticipation of a potential market selloff and use a potential correction to take advantage of attractive investment opportunities.

We expect the liquidity driven rally to gradually weaken in coming weeks as markets look for additional catalysts to support further price increases. One primary focus area is corporate profits for Q4/2010 and for Q1/2011. We think that it will become increasingly



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difficult for companies to generate substantial profit growth, given that the basis for comparison will be 2010 when we already realized a significant jump in corporate profitability from very weak 2009 levels. In our view, it is highly doubtful that companies are able to match the high expectations that the market has and we feel that the risk is significantly skewed to the downside. In combination with other negative factors such as renewed sovereign debt fears and possible geopolitical events, such as a further increase of tensions on the Korean peninsula, we think the risks for a broader market correction are significant during the later phase of Q1 and early Q2 and we think it is wise to be ready to hedge market exposures.

There are clear signals from central banks around the world that they plan to continue their expansionary monetary policies, that have clearly supported equity and bond markets in the last couple of months. The Federal Reserve made it very clear that they plan to do whatever is needed to bring the economy back on track and will add further stimulus if needed. This places the U.S. among the group of countries which are expected to raise rates at a relatively late point in the current economic cycle. The very low yield levels in the U.S. combined with fears about further increased monetization of debt have pushed the U.S. Dollar to new lows versus most major currencies.

We are strongly convinced that the economic problems seen in 2010 will not go away anytime soon and that we will have to deal with sovereign debt issues for a long period of time, these problems are not reversed overnight. The excess spending in the welfare states, as we have today in many countries, is indicative of systematic overspending by many governments. In the future, the fact that changing demographics, due to an aging population in most countries will make the situation even worse, is a real concern to us and we are worried that many countries may seek to solve the debt problem by creating inflation. So far inflation does not seem to be a big problem, but, the excess liquidity is certainly there and will eventually find its way into the economy. To make the story worse, we are concerned that once the economy gains some momentum, that the increase in the velocity of the money flow will push inflation significantly higher. Don't count on the central banks to withdraw this excess liquidity on time. History repeats itself and history teaches us what this could lead to.

Despite the challenges that remain, may you all have a great 2011, the Chinese year of the rabbit. We hope you enjoy reading this newsletter.

Thank you & and Gruss from Switzerland

Daniel Zurbrügg, CFA

Market Update

PRICES AS PER FEBRUARY 2011

Global Equity Indices	Last Close	YTD %
Swiss Market Index	6'495.20	0.9
Swiss Performance Index	5'827.21	0.6
Eurostoxx 50	2'965.50	6.2
German DAX Index	7'100.05	2.7
FTSE 100	5'881.37	-0.3
CAC40 Paris	4'015.07	5.5
Standard & Poors 500	1'276.34	1.5
Dow Jones Industrials	11'823.70	2.1
Nasdaq 100	2'270.51	2.4
Nikkei	10'360.34	1.3
Topix	910.08	1.2
Hang Seng	23'447.00	0.0
All Ordinaries	4'850.00	0.1
Government Bond Yields 10Y	**Last Close**	**YTD%**
USA	3.34	23.7
EUROPE	3.16	22.5
U.K.	3.66	16.6
SWITZERLAND	1.82	28.2
JAPAN	1.22	27.1
Libor 3 Months	**Last Close**	**YTD%**
USA	0.30	130.8
EUROPE	1.06	82.8
U.K.	0.77	42.6
SWITZERLAND	0.17	-5.6
JAPAN	0.18	50.0
Exchange Rates	**Last Price**	**YTD%**
US Dollar / Swiss Franc	0.9407	1.0
Euro / US Dollar	1.3711	2.4
US Dollar / Japanese Yen	82.02	1.4
Euro / Swiss Franc	1.2897	3.4
Pound Sterling / Swiss Franc	1.4976	2.9
Commodities	**Last Price**	**YTD%**
Crude Oil	89.34	-2.2
Gold	1331.95	-6.3
Alternative Investments	**Last Price**	**YTD%**
Tremont Hedgeindex	461.9	4.7
Goldman Sachs Commodities	335.3	11.5
LPX Private Equity	984.1	5.8

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INVESTMENT PERFORMANCE AND GLOBAL MARKET UPDATE

Our global macro strategy delivered a positive performance of +16.14%, up strongly from the performance reported at the end of the third quarter of 2010. We are pleased with this result, especially given the fact that we have had a slightly negative performance for the first six months. Our investments positioning really started to pay off in the second half of the year, with global markets rising and the U.S. Dollar weakening versus most major currencies. The returns achieved in the past two years, however, are above our long-term return expectations for our global macro strategy. While global equity markets have recovered strongly the past two years, we certainly do not anticipate a similar performance for the next two years and therefore our return expectations are going to be closer to our expected, long-term return target, which is between 8%-10% in an environment of low interest rates and about 10-12% in times of higher interest rates, which we expect in coming years.

Our investment allocation has been very good for the past two years, with little or no exposure to sectors such as financial stocks or real estate and also low exposure to the U.S. Dollar and the Euro, which have both fallen significantly. We wish we had a slightly longer duration with our bond investments, that would have improved returns even more, but we just did not think that rates could fall so much and remain at such low levels for a prolonged period of time. However, we think that the oversupply of liquidity that currently exists in a lot of western markets will eventually be very costly and cause interest rates to rise sharply. We are already looking at rising prices, primarily driven by higher energy and food costs and we expect the excess liquidity to finally cause inflation to rise sharply. This might happen in two steps, the first one being an asset price inflation (again), similar to the housing bubble we have seen in the first couple of years of this century. We think the first bubble can already be seen in the bond market and we expect this to be reversed eventually. We are especially bearish for U.S. and European government bonds, but, also think that the U.S. municipal bond market will see large corrections.

We have held most of our positions unchanged for the time being but are planning some changes in coming weeks. We feel that the most important decision is to be ready to hedge market exposures in equities and foreign currencies. Our long-term outlook has not changed, we still think the U.S. Dollar and the Euro are going to be structurally weak for quiet some time to come, but, a potential correction in equities or the bond market could cause the U.S. Dollar to move higher temporarily as it did in 2008. In such a situation, market flows are more powerful than long-term factors and it can therefore result in price moves that contradict the basic fundamental expectation.

"OUTLOOK AND FORECASTS FOR 2011"

We expect the following market trends / economic developments for 2011:

- Continued, strong growth in emerging markets, but moderate growth for the U.S. and Europe (with the exception of a few export oriented countries)
- Equity prices to rise marginally until the end of the year (5-10%), but risk for a temporary selloff around late Q1/early Q2, with emerging markets outperforming once again
- USD and EUR to remain structurally weak but downside potential now limited for the time being (5% to 10%)

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- Commodity prices to remain firm and trend higher, although lower than initially thought. Oil prices to break USD 100/barrel mark

- Gold to consolidate at levels of around USD 1'300, probably only moderate performance early in the year, in the absence of any new catalysts, but worth keeping in anticipation of higher future inflation

- Interest rates in western markets to remain low but stronger upward pressure in second half of the year.

The key in our view is to keep a well-diversified portfolio in 2011 but take appropriate measures to hedge the downside risk. The basis of our global macro investment strategy are our four building blocks for our portfolios:

- **Cash in foreign currencies:** To hedge against a further devaluation of USD and EUR

- **Global currency bonds:** To generate attractive income stream in hard currencies

- **Global equities:** To generate long-term capital gains

- **Alternative investments:** Primarily precious metals and commodities to hedge against future inflation and preserve purchasing power

"MACROECONOMIC UPDATE / 2011 - STABILIZATION NOT NORMALIZATION

The events in global economics last year were highly alarming, the sovereign debt crisis in many countries have worsened significantly and we are facing a situation today where a large number of governments, countries and individual states are facing technical bankruptcy. Of course, central banks and the IMF can put together bailout programs, the Fed can engage in further quantitative easing programs but all of these measures will come at a price. It would be outright foolish to believe that all this liquidity can be created out of thin air without real economic consequences. These consequences do not come overnight but actually might take 2-3 years until we see the negative impacts. It is understandable that today's central bankers are highly concerned about the reemergence of deflation and its destructive effects on the economy. One only needs to look at the situation in Japan, where the economy has been in deflation for most of the last 20 years. A bit more than 20 years ago, Japan's leading equity index, the Nikkei, stood at 39'000 points and it has only recently gone back up over 10'000 points. Two decades of devastating losses in equity markets, this tells us that structural problems can take a very long time to correct. Another example are U.S. equity markets, where market indices are pretty much back to the levels seen in the year 2000. This is not only a lost decade of flat performance, but, once the decreasing value of the U.S. currency is taken into consideration, an outright shocking loss that highlights the true dimension of the problem. We believe that many western nations have entered a prolonged period of deep structural change that will take many years to be completed. For decades western nations have enjoyed increasing prosperity and that resulted in a steep increase of government spending and a never ending increase in the build-up of welfare states. This has resulted in the huge amounts of government debt in many major economies today and the problem is now made worse by changing demographics, chronic overregulation and the wrong economic incentives. The large debt burden faced by many

countries is in sharp contrast to the very healthy balance sheets of many large corporations and this has led to a situation in which many large multinational corporations' bonds are perceived to be safer than government paper of individual countries. This is fascinating and shows us the limits of text book economics as we know it. Wasn't the yield on government bonds considered the benchmark for the risk free return? Didn't they tell us that over a long period of time equities should outperform bonds? Well, tell that to someone who was invested in Japanese equities for the past 20 years and the chances are that they do not agree with textbook economics anymore.

But let us go back to the basics of today's situation. The world economy is expected to grow at a rate of about 6% this year, after a strong recovery of almost 7% last year. That's not a bad number you might say. The problem is that global growth is spread very unevenly these days, with an ever growing share coming from emerging markets such as China, India and Brazil, while western markets are only experiencing anemic growth. While new emerging markets present very attractive opportunities for large international companies, it means that export oriented businesses in saturated western economies should do reasonably well and therefore outperforming firms with a focus on domestic business. Here a big problem for the U.S. and the European Union becomes obvious as many companies do not have a high enough focus on exports. Take for example the European Union and compare France and Germany. It is very clear that Germany is much better positioned to take advantage of the export opportunities that these new emerging markets present. Just think of cars like Mercedes, Volkswagen or BMW, they are market leaders in most of these emerging countries. Now think about the French carmakers for a moment…think a bit harder…do you even now the names of these producers…Renault, Citroen and Peugeot, but these producers are all significantly less successful in those new markets.

GOLD UPDATE – IT'S NOT A ONE-WAY STREET

In our last update in October 2010 we said that gold prices might start to enter a period of consolidation and that the market would start to look for new catalysts to support the next upward move in gold. Now, three months after we made that statement, gold prices have moved down to around USD 1'330, which is about 6% lower than when we wrote our last report and almost 10% lower than the highs seen in November. Given the correction in gold, it is important to review the investment case for gold and decide whether the current price correction is indeed just a consolidation or whether a larger correction is in the cards. What is obvious right now is that there is lower demand for gold and volumes have been relatively thin. We saw a first wave of profit taking in late December and, since the start of this year, we have been seeing lower buying interest and lower volumes. We believe there are a number of factors responsible for the current price consolidation. The main reason is that gold had an incredible bull run the past two years and an increasing number of investors want to lock in the gains. Also, buying activity in Asia has been very low and will probably not increase until after the Chinese New Year (early February) when market participants are finally back at work. Another reason in our view is that the general fear about future inflation and possibly hyper-inflation caused by money printing world wide has diminished somewhat. Don't get me wrong, we still believe we have laid the groundwork for future inflationary pressure, but it might take longer for it to materialize. Since this is not a new topic, people have gotten used to it and, when things become old news, people usually don't show much reaction anymore; that's just how the mind of the market is working. Another factor that needs to be kept in mind is the recent increase in longer-term interest rates that has made it more costly for investors to hold gold relative

to other assets, since it is not paying any interest. However, as long as the short-end of the yield curve remains at very low levels, the impact on gold prices should be moderate. The recent downward move in prices to levels around USD 1'310 is nothing more than a reversion to mean, or a reversion to the long-term upward trend as can be seen from the chart below. After unsuccessfully testing upper limits a couple of times, the prices are now moving to the lower end of the trading band in the absence of larger buying interest.

In our view, gold will only be able to move to fresh highs once the market receives real news that is currently not priced in. This could come in the form of a sudden spike in inflation, announcements of further measures to provide liquidity (QE3?) or a sudden market sell-off caused by external factors such as a worsening of the sovereign debt crises or a military conflict (Korea, Iran). In our view, the recent consolidation is not the start of a larger correction in gold prices but we might see gold in range trading for another couple of months. The longer the price can stay above important support levels and therefore forming a new base, the better the downside is protected. In any case gold remains an important part of our core holdings for the time being.

RARE EARTHS – UPDATE

The investment theme "Rare Earths" has received a lot of attention since we wrote about these investment opportunities last year in our October issue. Remember, the term "Rare Earths" refers to a group of metals, minerals, chemical elements with exotic names like scandium, yttrium, lathanides or lutetium just to name a few. These elements are used in a number of applications and devices, such as mobile phones, TV's and microprocessors. With China dominating the market with about 90% market share in rare earths mining, it is obvious that China has the power to control prices and has recently begun to use its dominant market position politically and strategically. The recent tensions between China and Japan were the first example of this. China pretty much stopped the export of rare earths to Japan, which presents a big problem for Japanese manufactures that depend heavily on this supply. China states that it is implementing these export restrictions to secure the supply for their domestic market and that this export control measure is not targeted at foreign competitors. China has recently announced further reductions in their exports of rare earths which means that prices might continue to soar. The basic investment case hasn't changed since last year and we think that there is going to be a lot more investment activity in the sector in order to increase the ex-Chinese supply of rare earths. Eventually, since they are not as rare as the name suggests and can be found in many other places in the world, the increased exploration activity will bring prices down to a new equilibrium price.

We believe that the sector continues to offer an attractive investment opportunity for the next 12 to 24 months as a growing number of companies want to secure ex-Chinese supply of rare earth minerals. It remains to be seen whether the sector represents a longer-term investment perspective, but that will depend on the future development of rare earths prices when more supply will eventually come to market.

CHINA – OPPORTUNITY OR THREAT

The recent visit to the United States by Chinese president Hu Jintao got a lot of attention and coverage in international media and the fact that so many important people showed up for this meeting shows how important it was for both sides. For China this visit was important, not only for political reasons, but also for building its prestige on the global stage. From an economic point of view, they are able to act from a position of strength. President Hu Jintao said a few days before the visit that (quote)…"the Dollar dominated currency system is a product of the past"…at the same time, he said that the Chinese Yuan is not yet ready to takeover as the new world reserve currency. It remains to be seen what "not yet ready" means according to the Chinese definition but we think China will make a number of very significant changes in coming years that could have a lot of consequences for the West.

The strategy of China for the last 30 years has been to keep its currency artificially low in order to promote exports and the country has been extremely successful in doing so. However, this has resulted in significant imbalances in the world economy that sooner or later need to be reversed. China has been accumulating huge amounts of foreign currency reserves and a lot of it was reinvested to buy U.S. treasuries, therefore financing "America Inc." and other countries which are now running large deficits. Let's be clear, China has a number of very serious problems, different problems compared to Europe or the United States but equally challenging. The growing imbalance between the booming cities and rural areas continues to drive more and more people to the big cities. This growing imbalance is increasing socioeconomic tensions and coupled with strong inflationary pressure makes it increasingly difficult for people to make a living, especially in more rural underdeveloped areas. There is also a large infrastructure and pollution problem in China and these problems need to be solved in coming years. The key advantage that China has is that it is not a democratic system and that the ruling party can make and implement much needed changes quicker than most other countries. That should help China to continue to grow their economy and keep adding jobs for many millions of people. I think we are at a very important turning point in the history of China. For the past few decades, the focus was on producing and exporting goods and at least in that context, China has been very successful. Going forward China needs to focus more on securing a stable supply of energy, commodities and technology and therefore its interests are not so heavily biased towards keeping a strong currency anymore. Imports are growing faster than exports, currently at a rate of about 25%, compared to export growth of only about 17%. The overall trade surplus of China has fallen about 9% from the previous year and about 34% from 2009. There is another factor that needs to be considered, China needs to deal with its inflation problem and we think it will tackle it from two sides. They will continue to hike interest rates further and therefore control domestic growth and prevent the economy from overheating, at the same time, they will change their currency policy by allowing Chinese companies to hold large foreign currency balances abroad and use them for investment purposes. That will help the Chinese central bank because it is no longer forced to buy foreign currency reserves and issue cheap domestic currency, which had in turn caused further inflationary

pressure in the past. I think that this will help the Chinese central bank to bring inflation under control and will probably allow them to keep further interest hikes moderate and diminish the risk of them over-tightening, which should also be positive for Chinese stock prices. So even a small, controlled appreciation of its currency will help them eventually to bring growth and inflation at home under control. That's why we think that China will let their currency appreciate, but, as always they will do it when it serves their purpose and that might now be sooner not later. At the same time, the effects from such developments would be negative for the west. In a time when western governments are so dependent on countries like China to buy their debt, we expect the purchase of government paper to decrease in coming years, which will make it a lot harder and more costly for troubled governments to issue debt. This will eventually lead to higher interest rates in the west and that would come at a time when inflation is already on the rise because of rising commodity and energy prices. Central banks in the west will probably try to keep short-term rates low for as long as possible in order to stimulate their domestic economies, but the longer-end of the yield curve could experience a significant increase in yields. We feel that adding further exposure to Chinese Yuan and possibly other Asian currencies is the right thing to do going forward and also caution investors to hold bonds with long maturities.

ESTONIA AND THE EURO – JOINING A SINKING SHIP?

Estonia has recently become the 17th member of the Euro currency zone. Given Estonia's relatively small size, with only 1.3mln citizens, this might not be big news, but Estonia is the first ex-Soviet state to adopt the Euro and it comes at a time when many doubt the future of Europe's single currency. Despite the recent problems in Europe with the Greek bailout, the crisis in Ireland and the possibility of further countries needing bailouts, polls show that a majority of people in Estonia support the recent move to become a member of the Euro. Of course, people are worried that prices will rise but it is for many the final proof that they have fully arrived in the west. The measures taken to cut spending and deficits in order to fulfill the entry criteria for the Euro zone brought GDP down more than 10 percent and caused the unemployment rate to soar to 16%. While the country is the youngest and poorest member of the Euro club, it is also among the ones with the lowest debt and deficit levels. But how promising is the perspective of joining the Euro given its recent difficulties and the potential for further nations to become financial emergencies that need to be dealt with? "We will never let the Euro down…", these were the words that French president, Nicolas Sarkozy used in his recent speech at the World Economic Forum in Davos, Switzerland. Since politicians in Europe certainly don't have much choice other than talking-up the Euro, the question is whether their opinions really reflect the views of their people. An increasing number of people in Germany and France feel that they would be better off having their own currencies back. While this is certainly understandable for Germany, given the fact that they make the largest financial contributions to the Euro zone, it is somewhat surprising that we see a similar development in France. Recent polls show that there is a growing number of people who support the Front National, which is considered a far right wing party, formerly headed by Jean-Marie Le Pen who was recently succeeded by his youngest daughter Marine. Marine Le Pen is becoming increasingly popular among French people and also an increasing number of conservatives are supporting her ideas. Marine Le Pen could become a real opponent for president Sarkozy in next year's elections. One of the main priorities on the agenda of Front National is the exit from the European Union and the Euro zone. Similar tendencies can be observed in countries such as Italy and the Netherlands and should this trend continue then this could become a real danger for the European Union in the years to come.

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AUSTRALIAN FLOODING – LAND UNDER WATER IN DOWN UNDER

The devastating flooding in Queensland/Australia has caused record damages of up to USD 8bln. What the true long-term damage is still remains to be seen. Short-term, the consequences are rising prices for agriculture and commodities and a reduction of Australia's GDP by about half a percent in 2011. While the flooding has mainly caused immediate disruptions to certain industries such as the coal business, it has certainly caused long-term damages to farming in general. It is not only the delay in wheat harvest and actual damage to this year's wheat crop, but the much bigger problem is that the flood washed away layers of fertile soil, which will cause a true long-term damage to agriculture production in the area. Under normal market circumstances such an event would cause prices to rise sharply at first and then move lower, the risk of seeing prices at much higher levels for a prolonged period of time are very significant. The flooding in Australia is only another event in a string of natural disasters we have seen in the recent past. This comes at a time when the market for agriculture commodities is already dealing with a very tight supply/demand situation and with record amounts of financial investments having driven prices up strongly. Australia's prime minister is proposing a new tax of an additional 0.5% on all incomes over AUD 50'000/year and 1.0% for incomes over AUD 100'000/year. The government also wants to cut back on other investments to help and support people that got hit hard by the flooding. We think that the investment case for Australia hasn't changed at all despite the devastating flooding. The future for Australia looks bright, given its unique position as being one of the world's richest commodity areas and its close proximity to the fast growing emerging markets.

INVESTING IN BANK STOCKS – FINALLY A LIGHT AT THE END OF THE TUNNEL?

Investors in banking stocks such as Citibank, UBS and many others certainly have had a hard time in recent years. Many stocks have fallen by 60 percent or more and investors lost a lot of money. The financial sector has also been the weakest market sector in the past few years. Given the very disappointing performance of such stocks, it is not surprising that the broader market indices have not been able to make any meaningful advance in the past few years, keep in mind that the Dow today still stands at pretty much the same level we had ten years ago. The banking sector has been without doubt heavily leveraged in the past and the recent financial crisis has shown how quickly liquidity problems can spread when most major banks are undercapitalized and therefore overleveraged. It remains to be seen whether the recent regulatory changes, which will make it necessary for banks to hold more capital, are sufficient. What is certain is that troubled and undercapitalized banks will need to increase capital significantly, either by holding back profits and/or by selling new shares.

But are there any interesting investment opportunities or are all banks bad investments? While we remain sceptical for many large banking organizations and would not consider making any investments there, we are starting to see some real opportunities in the sector. We like banks that have been relatively conservative in the past and have therefore weathered the storm of the financial crisis relatively well and without any bailout programs. At the same time, a bank has to have growth opportunities such as emerging markets and the capital necessary to fund such expansions. That is why we like certain banks in Canada and Australia that have healthy balance sheets, attractive dividends, moderate valuations and significant potential to grow their businesses in the years to come, especially through their activities in emerging markets.

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The chart above compares some of the largest banks in Australia and Canada (red and blue line) with with some of its US and European competitors (yellow and green lines).

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