



## ECHO FROM THE ALPS

### Half-time report 2009

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We are happy to provide you with our July 2009 market newsletter, which we have finally given an official name, "Echo from the Alps". "Echo from the Alps" is a reference to the place we live and work: Switzerland. Our country is home to the Alps, one of the biggest mountain formations in the world. We call our newsletter "Echo from the Alps", because we are top-down "global macro" style investment managers, looking at economic developments from the top. Our focus is on structural changes in the global economy and the value drivers created thereof. Despite today's difficult economic environment, we believe there are always good investment opportunities. Locating these opportunities today, however, requires a truly global view. Standing on an alp affords one the view to survey the lower lands. Our periodic investment updates can therefore be seen as an "Echo from the Alps", which explains how we see the world and how investors should position themselves. We will continue to issue our market updates on a quarterly basis or, if market movement requires it, more often.

This "half-time" report comes at an ideal time. After seeing a relatively strong recovery from the March lows, market sentiment has lost a bit of momentum recently as the outlook for the global economy seems more uncertain than ever. However, the recovery of global markets has helped us to deliver a year-to-date performance of +12.14% (in USD) for our main strategy, the Alpine Atlantic Global Offshore Portfolio.

Some people see the current environment as a huge long-term buying opportunity while others think this is just a "dead cat bounce" and that things will only get worse from here. The market has not even made up its mind as to whether deflation or inflation will be the real danger in the next 12-18 months. I think the market often has a one dimensional view on things and the question of whether we should be worried about deflation or inflation can only be answered by having a two dimensional view.

People who are following our newsletters know that we tend to be more worried about inflation longer-term and actually think we could see some very strong inflationary pressure developing in the next two years. In the short-term, I think it is unlikely that we will see inflation and actually think that the current process of deleveraging and restructuring will have a deflationary impact. Yes, there was an enormous amount of liquidity pumped into the global financial system, but, unless we see some increasing lending activity, we don't think that inflation will be a concern near term. However, the move from the currently mildly deflationary situation to the point where we are starting to see some serious inflationary pressures could be a relatively short one. We currently anticipate inflation to reemerge within the next 12-18 months. Our forecast has recently moved more to the back end of this estimate, but we think inflation will come and in a big way.

Now that most financial institutions have restructured their balance sheets and reduced their leverage, their willingness to lend will increase soon. This seems especially likely when one considers the fact that many of the big banks are considered "too big to fail" and therefore do have access to easy capital if needed. Also, due to the fact that many banks can refinance themselves at very low rates, their interest rate margins have risen strongly. However, once the velocity factor of the money flow starts to increase and the economy is showing further signs of recovery, then I think we will see a huge spike in yields, especially at the longer-end of the curve. Text book economics tell us that in an environment of slow economic growth and very low capacity utilization it is almost impossible for

inflation to emerge. However, in today's world, global factors play a crucial role. We feel global economic growth will reemerge, lead by Asia, but that the recovery in the U.S. will be much slower than elsewhere. We expect commodity and energy prices to rise sharply over the next 12-18 months and therefore to add external inflation pressure on the U.S. at a time that could not be worse. Corporate earnings will be very weak for the time being, although we might see some positive surprises as well. The uncertainty and volatility that remains in the markets will, nevertheless, make it almost impossible for P/E valuations to expand further in coming months. So, if the multiples are not rising and corporate earnings remain weak, it is unlikely that most major equity markets will recover much further short-term. In our May newsletter we projected global equity markets to recover by 10%-20% until the end of the year. We stick with our forecast made back in May, however, part of the projected price increases have occurred already but a 10% (for most major markets) to 15% performance (especially emerging markets) is still possible.

Our forecasts are as follows:

- **Global equity markets to recover a further 5-15% until the end of the year**
- **Global recovery will be lead by emerging market countries**
- **Further, possibly significant, split of the U.S. Dollar**
- **Increasing growth signals out of Asia, eventually spreading globally**
- **Positive fundamentals for "commodity backed" and "surplus" currencies**
- **Yield curves to remain very low at short end, but rising at long end**
- **Oil prices to move towards \$100 again by the end of the year**
- **Commodity prices to rise again after temporary consolidation**
- **Gold to break the \$1,000 mark and move toward \$1,300 in the next 12 months**

**"The sun is rising in the east"... indeed...**

In our March 2009 update "The sun is rising in the east", we projected that Asia would be the first region to experience a

## Market update



### PRICES AS PER JULY 20<sup>TH</sup> 2009

Global Equity Indices	Last Close	YTD %
Swiss Market Index	5625.0	1.64
Swiss Performance Index	4826.0	5.80
Eurostoxx 50	2496.0	5.71
German DAX Index	504.0	4.55
FTSE 100	4638.0	-1.22
CAC40 Paris	3255.0	1.18
Standard & Poors 500	940.0	4.09
Dow Jones Industrials	8711.0	-0.75
Nasdaq 100	1527.0	26.09
Nikkei	9395.0	6.05
Topix	878.0	0.34
Hang Seng	19502.0	35.55
All Ordinaries	4044.0	10.64

Government Bond Yields 10Y	Last Close	YTD %
USA	3.6	46.77
EUROPE	3.4	-9.60
U.K.	3.9	14.07
SWITZERLAND	2.2	-13.90
JAPAN	1.3	7.60

Libor 3 Months	Last Close	YTD %
USA	0.42	-65.00
EUROPE	0.94	-67.00
U.K.	0.96	-48.74
SWITZERLAND	0.36	-45.00
JAPAN	0.42	-49.00

Exchange Rates	Last Price	YTD %
US Dollar / Swiss Franc	1.0700	0.56
Euro / US Dollar	1.4050	1.79
US Dollar / Japanese Yen	94.4600	3.92
Euro / Swiss Franc	1.5220	2.01
Pound Sterling / Swiss Franc	1.7665	12.51

Commodities	Last Price	YTD %
Crude Oil	63.5	37.16
Gold	946	8.56

Alternative Investments	Last Price	YTD %
Tremont Hedgeindex	376	6.21
Goldman Sachs Commodities	430	19.77
LPX Private Equity	55.93	17.25
Global Property	295	15.47

significant increase in economic activity and that the recovery of the global economy would thus start in Asia. I think there is now increasing evidence of this and the latest economic data confirms this view. Not only are real estate prices starting to recover, but, also sales of cars and freight rates are trending upwards. This is starting to have a positive effect on companies in the west already. For example, Swiss watch makers are starting to see a gradual improvement of business conditions in Asia and commodity producers are also experiencing stronger demand from Asia and other emerging markets. We think that the recent outperformance of emerging markets is more than just a temporary development. The trend will likely be fueled further as an increasing level of global capital, seeking real economic growth opportunities, will flow into these markets.

### **The central role of foreign currency management in global wealth management**

We can't repeat often enough how important managing foreign currencies is in the context of managing a globally diversified investment portfolio. Despite this, we are often surprised how many people, among them many so called investment experts, do not have any clue about this issue. About ten years ago, I was working as a foreign currency manager for one of the biggest U.S. firms. The company had huge foreign currency positions and even bigger operational money flows in those currencies. In order to protect corporate margins, it was crucial to carefully manage the currency exposures. The impact from currency movements on the performance of a global investment portfolio is terribly important. U.S. investors and asset managers often overlook this factor, since they have a very strong home or U.S. Dollar bias. This practice can be quite dangerous, however, since we live in a world that is becoming increasingly "multi-polar" and where more and more money and power shifts to emerging economies. Further to this, there is a growing trend among the major central banks (on whole the largest holders of U.S. dollars) to restructure currency holdings in order to increase the diversification of their currency reserves. This will most likely add further selling pressure on the U.S. Dollar in coming years. What is a 5% investment return in U.S. Dollar worth when it is measured on a global scale? It is probably much less today versus the last few years. This is especially so if we see increasing inflation and a weakening of the U.S. Dollar versus other major currencies. We believe that global diversification of investments and therefore investments in a range of non-U.S. Dollar currencies, is going to be a key driver of portfolio performance in coming years.

### **Alpine Atlantic's Patronus Investment Program**

Alpine Atlantic has recently launched its "Patronus" Investment Program (Patronus = Latin for protector), a portfolio strategy which seeks to protect and preserve the real value of investments from a possible upcoming spike in inflation. The huge creation of money by global central banks is slowly working its way into the global money flow, eventually leading to an increase of prices. The strategy focuses on investments in the area of precious metals and commodities, which should do well in an environment of rising prices. We offer this investment program as a "Turnkey solution", which means that it includes the coordination of the opening of a Swiss bank account as well as ongoing investment reporting through our online reporting tool. Please visit our homepage for more detailed information on this investment program.

### **The "U.S. vs. UBS case" and the bigger story behind it**

The ongoing case against UBS by the U.S. government is making big headlines at the moment - again. Although the outcome of this case is unclear at this moment, the chances that UBS and the IRS will reach a settlement are rising after the court decided to give the process some more time. The respective governments will be using this additional time to help work towards an eventual settlement. One thing is very clear, both parties have an interest to settle the case. While UBS has a lot at risk, there is a lot at stake for the U.S. as well. Not only is UBS a very important employer in the U.S. but also a bank that in many areas can be regarded as system critical. At a time when so many jobs have been lost and the global financial system is so fragile, it would be especially stupid to crush a player like UBS. In our view,

it is just a matter of agreeing on ‘price’ before a settlement can be made. That being said, the case itself is not our affair and there is limited value to extended commentary on it – enough has been said.

The bigger story for us, and one that almost seems forgotten in the current debate about UBS, is that the U.S. government seems intent on making U.S. people scared of investing abroad. Beyond that, they are also trying to make it very difficult and more cumbersome for foreign banks and investors to invest money in U.S. securities. This is essentially just another way of implementing hidden protectionist measures. This is in and of itself a very dangerous game since the U.S. is so dependent on foreign investment and capital. Combined with other measures, such as the excess money printing, such actions make foreign investors more and more worried and are decreasing their willingness to lend money to and invest in the U.S. This will also have a negative impact on the value of the U.S. Dollar. So, while it might seem to make sense to make an example of UBS in the short-term, the longer-term impact of the underlying policies illustrated in this case is going to be counter productive. Such actions will hurt the U.S. market and should give investors who are thinking about diversifying globally an even higher incentive to investigate that option.

**Gold and the Dollar – what’s next?**

The question that seems to be the most common among investors lately asks what is going to happen with Gold and the U.S. Dollar. We would like to address this question in a combined context. Since the spot price for one ounce of gold is normally quoted in U.S. Dollars, a further weakening of the U.S. Dollar would cause the price of gold to increase, all other things being equal. Maybe that equation is simplified, but essentially for our analysis it’s sufficient. The U.S. Dollar has been trading in a very narrow range against major currencies and the volatility has been decreasing steadily. This is most obvious when one looks at the price graph EUR/USD below:



The price of EUR/USD has moved back towards the 1.40 level which means the U.S. Dollar is weakening again and is now forming a new price floor around current trading levels. In our view, this is a very negative sign for the U.S. Dollar. It shows that when financial markets are performing well, and therefore showing increasing optimism in the outlook for the global economy, the U.S. Dollar tends to fall. The correlation on this is actually very high and stable. This highlights the fact that the U.S. Dollar is the most liquid currency and used whenever investors seek liquidity temporarily. However, as financial markets and global economic conditions are expected to normalize (which does not necessarily mean improve), capital is flowing away from the U.S. Dollar.

This comes on top of the fact that the U.S. economy has significant structural weaknesses and heavy debt burden which will take a long time to improve. Thirdly, there is also a “chronic” sales pressure which might emerge as global investors and central banks will look to increase their foreign exchange holdings and currency reserves away from the U.S. Dollar. Currently, around 62% of global currency reserves are invested in U.S. Dollar, we think that number could drop to less than 50% in the coming three years. Further confusion is caused by statements from politicians and foreign central bankers who have, on many occasions, stated their preference for a strong U.S. Dollar. We think these statements are political whitewash and that there is an official version and an unofficial version here. All of these players have significant U.S. Dollar reserves which they look to lower in coming months. It’s understandable that they do not want the U.S. Dollar to weaken before they had a chance to lower their exposure. Therefore our view on the U.S. Dollar remains negative and we expect a further devaluation in coming weeks and months.

This will of course also have a direct impact on the gold price, which would reflect a weakening U.S. Dollar and therefore show a higher U.S. Dollar price indication. In the introduction to this newsletter we talked about the uncertainty of investors, not knowing whether deflation or inflation is the more likely risk in coming months. We think that the market’s focus could shift quickly from a deflationary scenario to a discussion about emerging inflation pressures. In such a case, gold would certainly benefit as it seems an ideal hedge against a weakening U.S. Dollar - as well as inflation. Therefore it makes sense for investors to hold some gold in their portfolio for strategic reasons.

For the U.S. Dollar and Gold we expect the following:

- **U.S. Dollar to break out of its current trading pattern and to weaken further**
- **Increasing selling pressure from strategic investors looking to diversify**
- **Gold to move towards \$1,000 level in coming weeks and months**
- **Temporary price corrections very likely but long-term uptrend to continue**
- **Increased demand for gold as a strategic hedge and normalizing trade demand**
- **Gold to move towards \$1,300 level in 2010**
- **U.S. Dollar to move toward 1.50/1.60 versus Euro**

### About Alpine Atlantic Global Asset Management AG

[www.alpineatlantic.com](http://www.alpineatlantic.com)

The company is an independent asset management company located in Zurich, Switzerland. The company offers “turnkey solutions” for offshore asset management, asset protection and banking, helping its clients to diversify assets globally.

Daniel Zurbrügg is the Managing Partner of the company. In his 20 year long career he managed assets for the Philip Morris Group and Compagnie Financière Richemont. Prior to joining Alpine Atlantic he was the head of asset management for Zurich based private bank “Bank Frey & Co. AG”.