



# Quarterly Report - March 31, 2009

## Economic Environment

### Review - Outlook

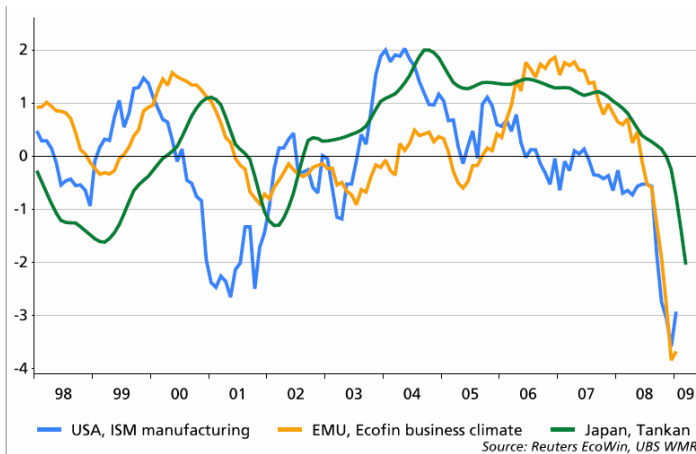


Figure No. 1: Sentiment among companies

Consumer confidence in the economy fell to new historic lows worldwide in Q1 2009 as the jobless rate rose sharply. The mood at companies brightened slightly from their previous gloom thanks to massive government intervention. Retail sales dropped less than expected in February following an unexpected increase in January. The growth in retail sales can be traced to price discounts at companies, which are reducing their inventories dramatically.

Orders for durables rose unexpectedly in February after declining to a record low in

January for the sixth consecutive month. In terms of general observations, economic indicators have declined less drastically since the start of the year or have recovered slightly from their historic lows. If the leading indicators continue to gain ground over the next two or three months, we can confidently say that the economy has bottomed out.

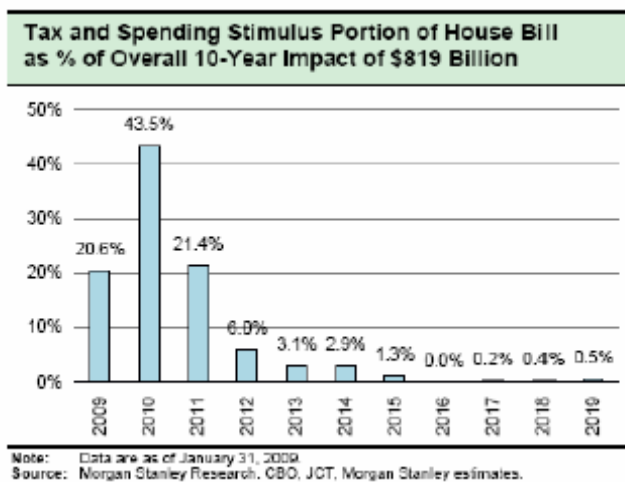


Figure No. 2: Year-by-year impact of US stimulus programs

What we cannot yet predict is the extent to which the global economy will benefit, in spite of economic stimulus packages of historic dimensions. Most of these will not begin having an impact until next year. And it is questionable whether all these stimulus packages can be financed. The high level of government debt is making investors skeptical about government bonds. A recent prominent example is the failed sale of 2.5 billion euros' worth of 10-year British government bonds. Unlike inflation, a deflationary environment causes debt to appreciate. That would break the

government's neck. The governments and the Fed will therefore do everything in their power to prevent deflation. It is questionable, however, whether the steps the Fed has taken (reduced interest rates, easing



of the monetary supply) will really have any long-term benefits. Banks continue to show restraint about extending loans and demand for loans is inexistent due to the excess debt carried by consumers. Governments around the world will do their utmost to ensure that the economy does not slide into a years-long recession or depression. The economy could see a short-term recovery as a result. Economic stimulus from governments on such a huge scale is not long-lasting, as past experience indicates. For an economic recovery to materialize, the upward trend in the leading indicators must persist over the next three months. Two further prerequisites are that real estate prices do not decline and the banking system starts functioning again.

## Bonds

### Review - Outlook

Is this safe haven still safe? After the massive rush into US Treasuries by investors, fear of a major correction arose. That is even true of 30-year bonds, whose price has dropped since early 2009 from a good 140 points to around 127. The United States is threatened with a huge deficit that will swell from the

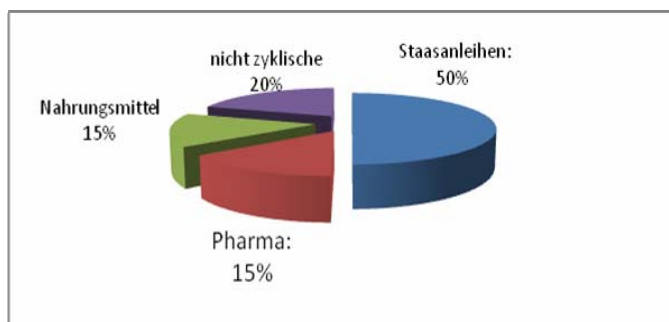


Figure No. 3: Model bond portfolio

economic stimulus package and could lead to a widespread sell-out of government bonds. That is why the US Treasury Department is struggling to sell its government bonds to investors. Other countries have keenly felt the effects of investors' growing skepticism of government bonds. A recent prominent example is the failed sale of 10-year British government bonds worth the equivalent of 2.5 billion euros. The Brits' failed auction is a sign that governments will also have an increasingly difficult time financing their billions in spending

programs. Meanwhile, Standard & Poor's have downgraded Spanish, Greek, Portuguese and Irish government bonds from their top rating of "AAA" to "AA+" in response to the mounting debt of these countries. Austrian government bonds came under pressure because of the high level of debt in Eastern Europe. Austrian banks have EUR 230 billion in outstanding loans in Eastern Europe, the equivalent of 75% of the Austrian gross domestic product.

The ratings of government bonds will continue to suffer from the financing of stimulus packages, causing prices to decline as well. We therefore continue to prefer short-term corporate bonds from defensive sectors (foods, pharmaceuticals) with solid cash flows and a low level of debt. (See the Quarterly Letter of December 31, 2008). The prices of these bonds are also quite attractive right now from an historical standpoint.





## Equity Markets

### Review – Outlook

Bad news about the economy, corporate profits and the financial sector had a depressive effect on equity markets up to mid-March. Estimated profits for 2009 in the relevant equity markets were slashed by double-digit amounts in some cases (USA: -10%; Europe: -18%; Japan: -26%; emerging markets: -10%).

country	index	performance 12.31.08 -03.31.09
<b>World</b>	MSCI World	-11.86%
<b>North America</b>		
USA	Dow Jones	-12.48%
	S&P 500	-14.90%
	NASDAQ	-2.79%
Canada	SPTSX	-2.00%
<b>Europa</b>		
EU	DJ Euro Stoxx 600	-9.58%
Germany	DAX	-15.08%
France	CAC	-12.69%
Switzerland	SMI	-9.57%
<b>Aisa</b>		
Japan	Topix	-9.06%
Hong Kong	Hang Seng	-4.28%
Australia	S&P/ASX 200	0.38%
<b>Emerging Markets</b>		
China	Shanghai Composite	29.48%
Taiwan	Taiwan Taiex Index	13.55%
India	Sensex 30 Index	0.74%
Russia	Russian RTS	10.27%
Hungary	Budapest Stock Exch.	-9.89%
Czech Republic	Prague Stock Exch.	-12.64%
Argentina	Argentina Merval	4.39%
Brazil	Brazil Bovespa Stock	8.99%
Mexico	Mexico Bolsa	-12.41%

Then in mid-March the public-private investment program of the Obama Administration gave the equity markets a powerful boost. With his new plan, Treasury Secretary Geithner intends to buy up toxic assets from the banks. Several banks also surprised the market with a strong outlook for the coming year. All these factors helped equity markets to recover robustly from their price lows in mid-March. Equity markets cannot recover without healthy banks, however, and they remain the Achilles' heel of the economy. But can we still even trust the forecasts that banks give us? Anyone who has placed his trust in banks over the past 18 months has lost a bundle of money. The banks say they have written off 70% of their bad loans. As the recession unfolds, private and corporate customer lending business is sure to come under massive pressure, which would be

Figure No. 4: Worldwide stock yields Q1 2009

akin to a loss of EUR 75 billion. It also still unclear how the Administration intends to implement the public-private investment program it has proposed.

The 10-year average P/E ratio (Benjamin Graham) for the S&P 500 is currently at 11.9, down from 14.8 just one year ago. Yet in recessions, the P/E ratio is known to reach a level of 7 to 9. Analyzing the equity markets based on P/E ratios is problematic, because the state will intervene on a massive scale in economic events and rekindle investors' hopes of price gains.

In past crises, state intervention has always triggered strong and quite sustained positive counter-movements in the equity markets despite the poor environment. After all, market trading is more about expectations than facts. That could be the case now too, because the markets are heavily oversold. Investor confidence indicators have hit the lowest levels since economists began recording them. At that point, a few positive headlines are all that is needed to set off stock-price fireworks in the markets. The past has also shown that these gains on stock markets following government intervention are not permanent.





## Commodities

### Review - Outlook

On commodity markets, prices hit their lowest levels since the 1970s. The recession dampened prices on the commodity markets and caused deflation. In mid-March the commodity markets were able to recover, thanks to news of better-than-expected global economic performance. Production in certain commodity markets was cut back so drastically that the buildup of inventories was at least slowed down. Our investment strategy focuses on markets with minimal surplus inventories. Given the low prices, farmers are likely to plant less than last year and inventories are currently at their lowest levels since the 1960s. If environmental damage occurs, prices for agricultural commodities could shoot up again.

On the supply side, certain commodities are finite, and the marginal production costs are increasing by a disproportionate amount. This is true in the oil sector, for example. There, production costs for major reserves that have not yet been exhausted, e.g. oil sands in Alaska, are estimated to be USD 60 to USD 90 a barrel and even higher for the new Brazilian reserves. All this comes against the backdrop that maintaining the oil supply up to 2030 will require additional oil reserves equivalent to six times the current production capacity of Saudi Arabia. It is preferable to build up commodities positions in portfolios when commodity prices are below marginal production costs and investments in new production and transport infrastructure are uneconomical for market participants.



Figure No. 5: Rogers International Commodity Index



## Currencies

### Review - Outlook

Uncertainties in the market set the US dollar rising sharply against other currencies like the euro up to mid-March. The US dollar has proven to be a safe haven during crises in the past. The exchange rate trend for the dollar in the weeks ahead will depend on investors' need for security and on the assessment of



Figure No. 6: Euro to US dollar exchange rate

economic prospects for the US being somewhat more optimistic than for Europe and Japan. A correction is probable if the financial markets calm down. And if the US government again takes on the role of global economic powerhouse, a major depreciation of the dollar is likely in the long term. The euro suffered in the financial crisis mostly because of the problems in Eastern Europe. Another adverse factor for the euro has been that the crisis is a test of the monetary union as a whole. Expectations range from a collapse to the view that the monetary union is serving as an anchor in the storm for the small national economies. The markets are sure to notice any signs of member states drifting apart. The support loans needed for the new member states are a further burden on the euro. Given the persistently weak economic data for the euro area, the latest interest rate cuts by the ECB will not suffice to jump-start the economy. Further interest rate cuts by the ECB would cause the euro to come under greater pressure because the interest rates in the other countries are close to zero.

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