



## Nurturing Wealth Together

November 2010

Dear Investor,

As you recall from the September report we have become more positive on the economic turnaround, founded on the view that notwithstanding the high level of global unemployment (we still remain concerned on this front), other global economic indicators are in general turning positive (more on this below). In our view, this coupled with cheap equity valuations and massive liquidity that needs to find returns better than inflation, equity prices will be higher over the next 12 and 24 months. November turned into the month of material events, with investors once again being spooked just as the markets were recovering from their recent volatility in May, June and August. The biggest concerns were debt issues in Euroland (Ireland, Portugal and potentially Spain), China raising interest rates twice in the month, and the possibility of war as North Korea shot missiles into South Korea.



The Ireland debt issue led to a massive sell-off in the Euro (-9.2% for the month) and Italian, Portuguese and Spanish bond yields amid concerns that the European debt crisis is worsening and spreading to other neighbouring countries. This risk is real and is likely to remain on the horizon for the next 12-24 months as these 'rogue' euro-countries on the periphery are forced to implement austerity measures (raise taxes, cuts pensions, and less spending by government) to rescue their dire over indebtedness. Spain remains the key concern given its massive absolute level of debt in

excess of US\$1 trillion. While its debt relative to its GDP (60%) is not a concern, it would be very difficult to rescue Spain on an absolute level should the contagion spread.

Companies like Anheuser-Busch Inbev which has high levels of debt, fell 13% during the month notwithstanding that its fundamentals remain strong. Other companies that fell during the month included: Abbott Laboratories (-9.5%) on concerns of a competitor to its main product Humira, Deutsche Bank (-6.4%, we sold this when concerns of Ireland emerged) on concerns of the European debt issue, and Exxon Mobil (-6.3%), Xstrata (-6.3%), Rio Tinto (-4%) all fell on lower commodity prices, which fell due to US dollar strength and concerns over China hiking rates. The MSCI world index fell 2.4% for the month while the average hedge fund that has reported to date fell 1.5%.

**RISK IS WHAT YOU BUY RETURN IS WHAT YOU GET.**

## So Where to From Here?

Country	Monthly Returns				Compound Annual Returns (p.a.)				
	Month	3 Mth	6 Mth	YTD	1 yr	3 yr	5 yr	10 yr	
<b>Developed (Local Cur)</b>									
MSCI World Large Cap (USD)	-2.7%	5.4%	9.8%	0.6%	1.9%	-10.0%	-0.9%	-0.9%	
MSCI World (USD)	-2.4%	6.1%	10.5%	2.1%	3.8%	-9.5%	-0.6%	-0.1%	
MSCI World (Local)	-0.5%	5.3%	6.4%	2.2%	5.8%	-9.4%	-2.2%	-1.7%	
Germany	1.3%	13.1%	12.1%	12.3%	18.9%	-5.3%	5.2%	0.5%	
UK	-2.6%	6.3%	6.6%	2.1%	6.5%	-4.9%	0.4%	-1.0%	
France	-5.8%	3.5%	2.9%	-8.3%	-1.9%	-14.0%	-4.6%	-4.8%	
US (Dow)	-1.0%	10.0%	8.6%	5.5%	6.4%	-6.3%	0.4%	0.6%	
US (S&P 500)	-0.2%	12.5%	8.4%	5.9%	7.8%	-7.3%	-1.1%	-1.1%	
Japan	8.0%	8.6%	1.7%	-5.8%	6.3%	-14.1%	-7.7%	-3.8%	
Hong Kong	-0.4%	11.0%	16.4%	5.2%	5.4%	-7.0%	9.0%	5.1%	
Singapore	0.1%	6.3%	14.2%	8.5%	15.1%	-3.7%	6.5%	4.9%	
Australia	-1.2%	4.3%	5.0%	-4.2%	-0.8%	-10.8%	0.4%	3.8%	
<b>Developing (Local Cur)</b>									
India	-2.6%	8.3%	15.2%	11.8%	15.3%	0.3%	17.3%	17.2%	
China	-5.3%	6.3%	8.8%	-13.9%	-11.7%	-16.7%	20.7%	3.1%	
Brazil	-4.2%	5.4%	7.4%	-1.3%	1.0%	2.4%	16.2%	17.7%	
Israel	-0.9%	9.3%	13.8%	7.9%	14.8%	0.6%	7.8%	9.3%	
Taiwan	1.0%	8.2%	13.5%	2.3%	10.4%	-0.8%	6.2%	4.8%	

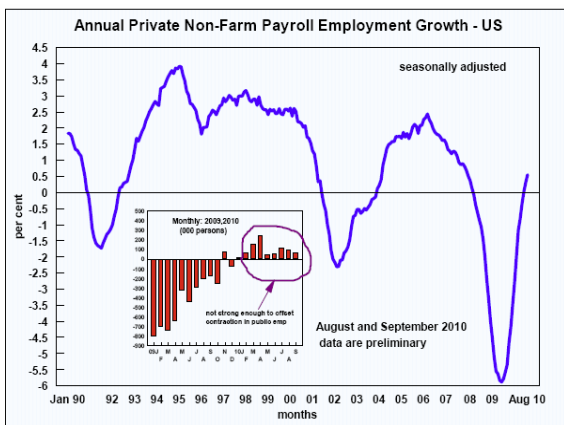
Source: 613 Capital LLC

We remain confident in the turnaround in the global economy with many economic data releases now exceeding expectations. This does not imply that economic growth returns to pre-crisis levels but rather that corporate profitability, which is now forecast to exceed the heights reached in 2007/08, will expand even further.

## Risks

### 1. Unemployment

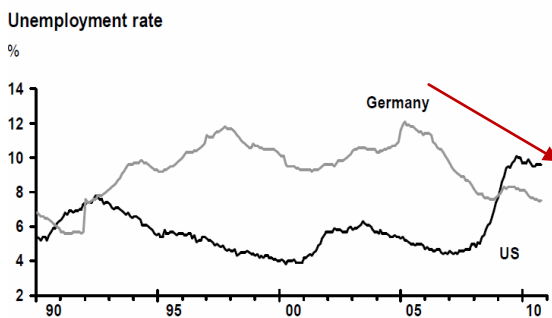
The real bug-bear remains the weak employment numbers on a global basis and housing in the US and parts of Europe. We expect unemployment in the US to increase during the first half of the year. This however is not because companies will not be hiring, but rather that they will not be hiring enough. The calculation for unemployment includes those people still looking for jobs, and excludes those that have given up. So as the numbers of those who have given up looking for work decide to come back into the market place in search of jobs, they are included in the numbers again and hence are a drag on the unemployment calculation. This is more about maths and rules than reality!



Source: Bankwest

In addition to the above, while non-farm payrolls reflect hiring, the level of job creation (average 150k) remains too low (needs to be above 450k) to impact the unemployment rate which the government estimates at 9.8% (as of 3 December 2010). In reality, if we were to return to a participation rate (the % of people employed as compared to the total population – see right hand graph above), closer to the levels in December 2006, unemployment would be sitting closer to 15%-18%.

What is interesting to note is the level of unemployment in Germany as compared to the US. Due to incentives implemented by government in the early 2000's, Germany's unemployment rate has steadily been falling and is now at 15 year lows, with the latest data showing unemployment having contracted to 6.7% from 7.5% a year ago.

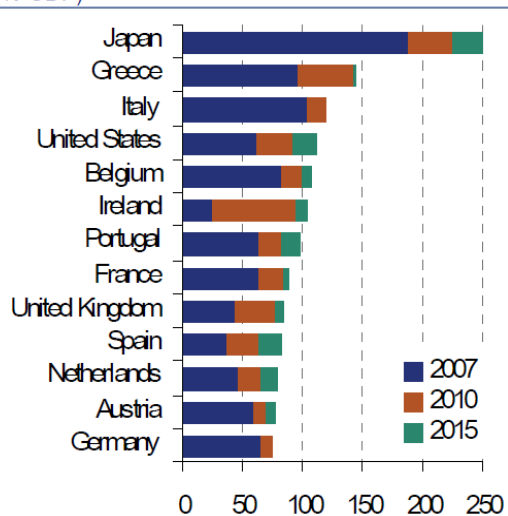


Source: Citigroup

Unemployment in the rest of the euro zone remains weak and continues to weaken due to austerity measures. Latest stats for October showed average unemployment at 10% for the EU27, its highest level in more than 12 years. While the 10% average looks on par with US, it hides the likes of Spain (4<sup>th</sup> largest euro zone economy) at 20.7%, Latvia at 19.4% and Lithuania at (18.4%), France at 9.8%) and Belgium (9.9%).

## 2. Euro zone Contagion / Collapse.

**Chart 26: Gross general government debt (% GDP)**



Source: IMF World Economic Outlook, October 2010 and BofA Merrill Lynch Global Research

Ireland, swamped by the bursting of a decade-long real-estate bubble, became the second country after Greece to require financial support from the IMF and European Union who committed to support Ireland with a €85 billion package. While the problem did not initially revolve around Irish sovereign debt levels (currently 64%), the inability of the government to raise sufficient funds to rescue its banking system spooked investors. The banking indebtedness will now ultimately be transferred to the government who will see its debt to GDP ratio peak at 117% in 2012.

Investor concerns regarding Germany's patience to continue to rescue peripheral euro zone members remains high. Germany demanded a "permanent" system as of 2013 that would enable fiscally troubled countries to restructure their debts, by forcing bond holders to be responsible for their own losses. While this ultimately is the correct path as risk takers should have to deal with potential losses, this is not what the market wants to currently hear. Fortunately, Germany has softened its stance and agreed to give the International Monetary Fund a role in determining losses on a case-by-case basis. The new proposal would introduce "collective action clauses" for debt sold post 2013, enabling fiscally hard-hit governments to renegotiate bond contracts.

**Table 9: Size of fiscal austerity packages**

	2010	2011	2012	2013	2014	2015	2010-2011	2010-2015
Greece	-6.2	-4.9	-2.2	-1.9	-1.6	n.a	-11.1	-16.8
Ireland	-1.8	-4.3	-2.9	-1.5	-2.0	-1.4	-6.1	-13.9
United Kingdom	-1.8	-2.9	-2.1	-2.3	-1.6	-0.9	-4.7	-11.7
Spain	-2.9	-3.1	-1.7	-1.6	-0.7	-0.6	-6.0	-10.6
Portugal	-1.2	-2.9	-0.8	-0.7	n.a	n.a	-4.0	-5.5
Italy	-0.3	-1.2	-1.4	-0.3	n.a	n.a	-1.5	-3.2

Notes: The table shows the estimated change in the cyclical adjusted primary balance to GDP ratio. Source: IMF, Governments Budgets' plans and BofA Merrill Lynch Global Research

debt, it would be a massive undertaking to try and support the fourth largest country in the Euro zone. This is the key 'fat-tail' event that needs to be monitored carefully and hedged against using out the money option strategies.

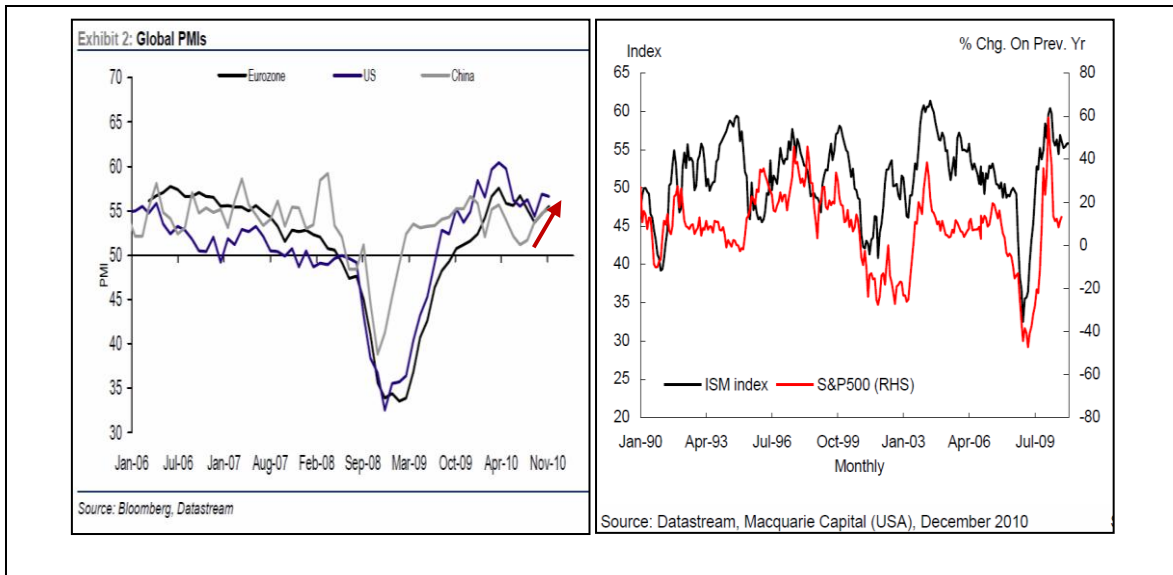
This risk is likely to remain for the foreseeable future as austerity measures put material pressure on GDP growth and unemployment rates. The real risk though is that this spreads to Spain, who not overly indebted, but has a material unemployment problem and weak economic growth. With over €1 trillion in

To counter the potential contagion, the European Commission needs to get ahead of the game rather than responding retrospectively all the time. This however goes against their natural personality. They are more likely to consider: implementing further quantitative easing, raising the size of the €750 trillion rescue fund, forcing tighter fiscal union and monitoring in the euro zone, and in a worst case scenario kicking out ill-behaved countries from the Euro zone.

**Positives**

Improving economic data points, massive liquidity, low equity valuations, strong balance sheets and lean corporations will see earnings continue to surprise to the upside in the coming 12 months. This will ultimately lead to higher share prices as investor sentiment recovers from the shocks of the past three years.

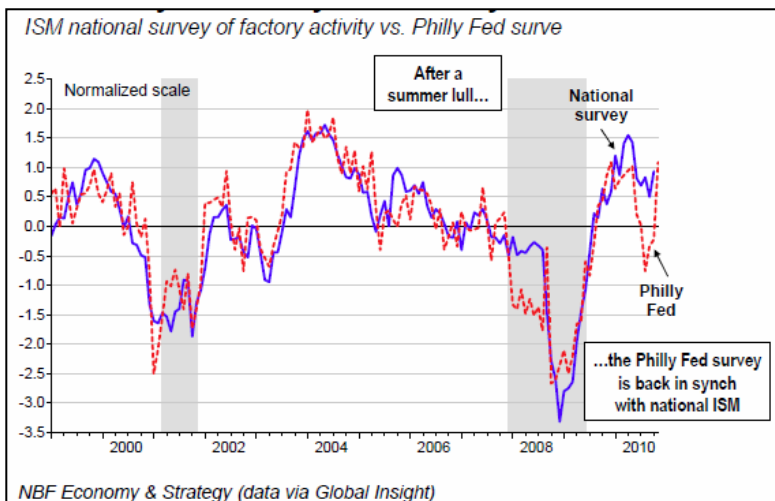
**3. Global Purchasing Managers Indices (PMI) are Rising**



The Institute for Supply Management (ISM) in the US was flat, but remained at high levels, dropping slightly in October. While the index showed a drop, it was ahead of expectations. The standout sub-component was supplier deliveries, which rose to 57.2 in November from 51.2 in October. The employment component was essentially flat at 57.5 from 57.7 in October, which is broadly consistent with 150,000 jobs creation from private sector employment.

The graph to the right shows the relationship between the ISM and the S&P 500. The ISM (black line) indicators are starting to rebound, indicating potential further increases in the S&P 500 (red line).

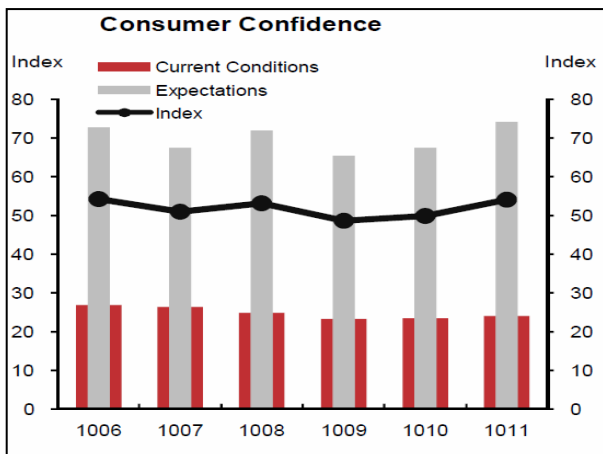
**4. US – PHILADELPHIA FED surprise to the upside**



Surveys conducted by interviewing manufacturers in Philadelphia showed a sharp turnaround during November, rising to 22.5 from 1.0 in October. The 21.5-point surge in the headline was one of the largest on record and a clear sign that the soft patch in the Philadelphia region is receding.

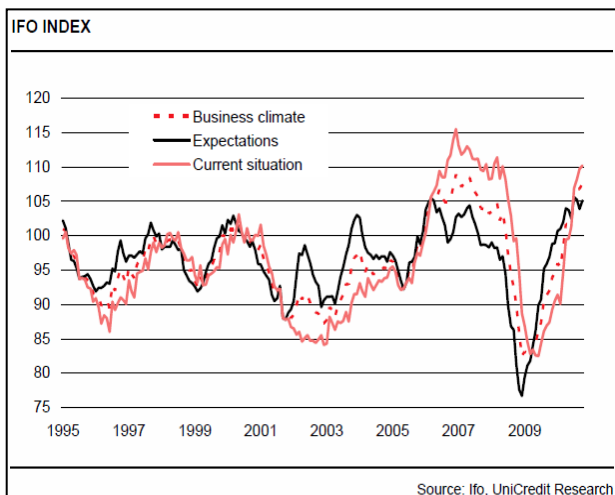
Strong rebounds were recorded in key components such as new orders, employment, employee workweek, and shipments.

## 5. US Consumer Confidence and German IFO surprise to the upside



Confidence among U.S. consumers rose in November to the highest level in five months and a gauge of business activity unexpectedly climbed. This gives support to a recovery taking hold in the US during 2011. The Conference Board's sentiment index rose to 54.1. The increase was led by the "expectations" component of the report, which is a good leading indicator for future activity.

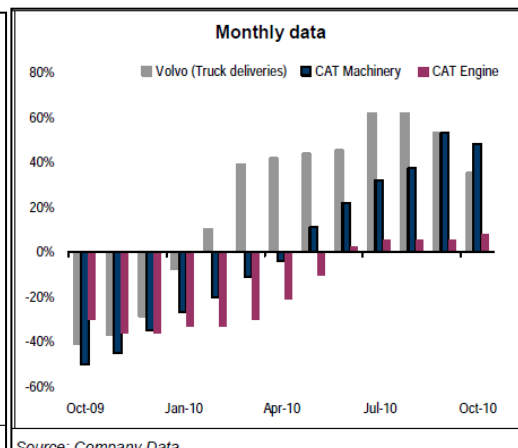
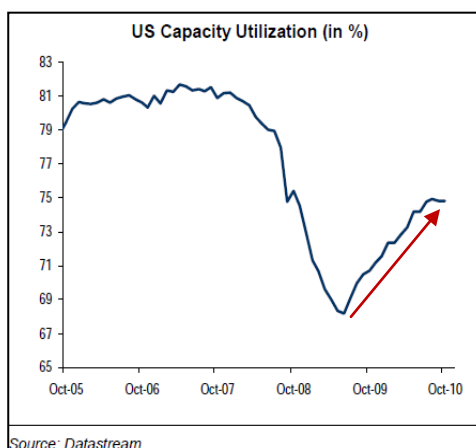
Assessments of the present situation rose incrementally (24.0 vs. 23.5), while future expectations increased more sharply (74.2 vs. 67.5). The labor component of the survey showed mixed signals as jobs plentiful rose slightly, while jobs hard-to-get also rose. This probably relates to different sectors of the economy hiring while others are not, reflecting a slow and moderate improvement in labor conditions.



The increase in Germany's November PMI was confirmed by its increase in the IFO business climate, which covers a wider range of the economy. The index jumped to 109.3 from 107.6 with both the current assessment and future expectations improving strongly. While some analysts remain sceptical on the renewed rise of the index given the deteriorating environment in the euro zone, it is not totally unexplainable. Germany is an export lead economy that continues to benefit from a weaker Euro. Aligned to this is the US and the Chinese PMI numbers for November which rose strongly. Industrial activity in these countries is relevant for German export growth. The fall in the unemployment rate, also plays a major role as more jobs signifies more consumption which leads to more production requirements.

## 6. Other out the box indicators – truck orders and capacity utilisation

Capacity utilization has been rising from its lows reached during 2009, although was recently flat in October 2010. At this stage it would appear that for now, the current utilisation is aligned with the current level of economic demand. Confirming this view is the machinery and engine orders from Caterpillar and Volvo which also appear to have shown strong improvement over the past 24 months, but have recently moderated.

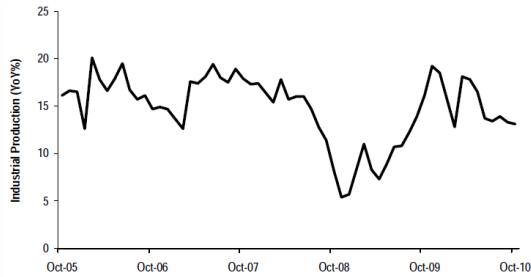


Source: Credit Suisse

## 7. China

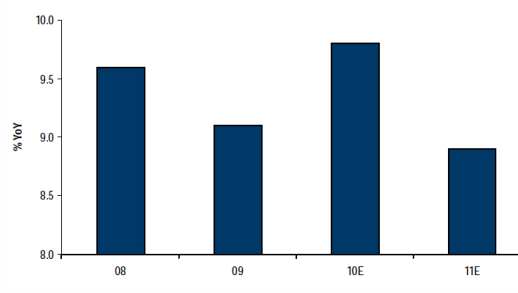
The Chinese economy continues to power ahead with exceptionally strong growth across most sectors of the economy. This strength, combined with rapid rises in property prices and loan extensions in China has seen the government implement measures to try and curb potential bubbles and inflation.

**Exhibit 6: China Monthly IP YoY%**  
%, unless otherwise stated



Source: Datastream

**Exhibit 7: China Annual IP YoY%**  
%, unless otherwise stated



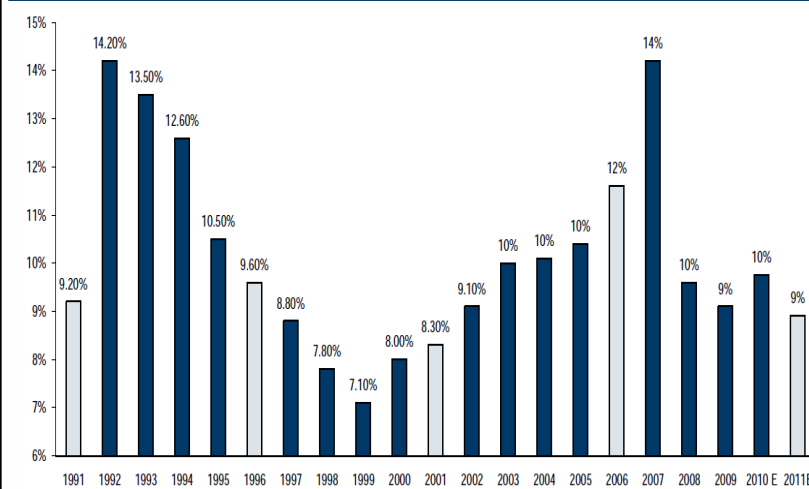
Source: Datastream, Credit Suisse estimates

China's multi-decade long growth in GDP shows no sign that this is likely to pause, with the government now focusing on developing Central China's 'Tier 2 and Tier 3' cities. This will see the development of new cities within Central

China and requires the governments of six provinces to finish detailed plans by the end of December.

**Exhibit 9: China GDP Growth YoY% (starting years of 5-year plans highlighted)**

%, unless otherwise stated



Source: Datastream, Credit Suisse estimates

These plans will contain details on: food production, energy and raw material production, equipment manufacturing, transportation systems (airports, waterways, roads, and railway), four economic zones (including six megalopolis and a traditional industrial zone), schools and policy changes needed to drive form and economic openness

A risk to Chinese growth remains inflation and the government policies implemented to manage a 'soft' landing in this regard. Rising food inflation, wages, commodities and energy costs are all driving an increase in CPI which is forecast to rise above 6% for 2011.

In conclusion, we are becoming more confident in the likelihood of a good year from equities during 2011, notwithstanding the low growth economic environment. We remain cautious with respect to the current issues taking place in the euro zone and expect volatility will remain high during 2011. We however continue to see value in equities on a 12 month forward looking basis and will take opportunities as they arise. The key will be to remain vigilant in managing risk and nimble enough to lock in gains when appropriate.

As always we welcome your feedback and questions.

**RISK IS WHAT YOU BUY RETURN IS WHAT YOU GET**



## APPENDIX

### Thematic Research Background

**'Ageing Demographics'** focuses on the global ageing population and the industries that will benefit from this. This includes the healthcare sector (pharmaceuticals, medical equipments manufacturers, laboratory testing, age care facilities etc.). We are particularly excited about this theme in the pharmaceutical industry where a second theme 'patent expirations' will also be a strong tail wind for generic drug manufacturers. Drug patent expirations will exceed \$150bn over the next 5 years. It also provides the opportunity to invest in large drug manufacturers who, while losing revenues to patent expirations, (until replaced by new drugs) are trading at low valuations and high dividend yields for those patient investors.

**'Peak Oil'** acknowledges the current cyclicity of oil, but also looks to a future where this cyclicity will reduce materially as demand exceeds supply. At current estimates, discovered reserves are around 1.3 trillion barrels, with current annual consumption around 36 billion barrels per annum. This equates to approximately 36 years left of oil at current levels of demand (will be less as China and India come on board). While there are other discovered reserves, they require a higher oil price to make them economically viable, so either oil prices rise and remain high or the supply of oil continues to fall. A risk to this theme and ultimately where the future lies is substitution. The world has reached a tipping point with respect to high oil prices and will seek to employ new technologies that can replace oil. These include natural gas, electrification of motorised travel, and nuclear power generation. Ironically, coal will also be a material beneficiary of Peak Oil, although environmental pressures will force cleaner technologies to be invented. Part of this theme is to look at global utility companies, which are likely to be the future petrol companies as people 'fill-up' by plugging in.

**'Technology Giant Cash Machines'** while a more risky and cyclical theme, this focuses on quality technology companies that dominate their market position and have material cash on balance sheet and continue to produce huge amounts of cash annually as compared to their market capitalisation. Many of these companies are trading at cash yields above 8% and continue to grow cash earnings at greater than 10% per annum. As it is always difficult to predict when a new technology can become disruptive and materially damage the market position of a technology company we will manage this risk through appropriate position size while remaining focused on quality.

**'Legalised Addiction'** focuses on consumer monopolies in the carbonated-beverages, coffee, tobacco, telecommunications and gambling industries. We continue to search for companies that are strongly cash generative, have high return on shareholder's equity and can protect their competitive market positioning. With the exception of gambling (too cyclical and which we are not invested in) and a material economic slowdown, these companies will continue to grow ahead of developed world population growth rates and GDP, and represent a conservative way to invest in the long term growth prospects of a rapidly growing emerging market middle class.

**'Emerging Middle Class'** focuses on the huge surge in the number of middle income earners coming from emerging markets over the next 40 years. As the economic growth of Brazil, Russia, India, China, South Korea and Vietnam continues to outstrip the developed world by a factor of 2-3x's, GDP per capita is expected to follow.

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