



1. Summary

Energy and commodities were the leading asset classes in the 1st quarter, followed by U.S. equities and High Yield, measured in USD. But taking the fall of the U.S. Dollar into account, only commodities and energy made positive returns in EUR. Even Gold did not show a positive return in EUR this quarter. The return of the MSCI World index was -1.4% in EUR and this despite evidence that risk appetite has returned to the markets. Japan was one of the worst performing equity markets.

Lower risk investments such as government bonds or investment grade credits did little to protect capital with negative returns in EUR. The upward move in long bond interest rates continued in the 1st quarter.

Despite the tragic earthquake and tsunami event in Japan and the MENA (Middle East North Africa) political situation, world economic growth should maintain its strong growth momentum in 2011 as evidenced by the strong recovery of world trade volumes and the rapid employment growth in emerging economies, including in the U.S. and Germany. Germany is the star performer with strong industrial production increasing to its highest level since reunification.

The IMF recently confirmed its medium-term view that the world economy can grow by an average of 4.6% a year until 2015. Yet the levels of growth between emerging economies and advanced economies remain highly divergent. The

IMF suggests that emerging economies will be 33% larger than they were at the start of 2007, while developed economies are likely to have expanded by only 3% during the whole period.

Yet we believe there are risks that may compromise the global outlook.

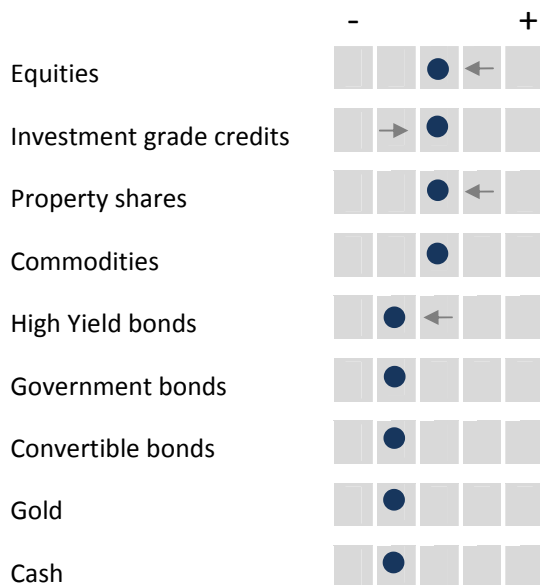
- The effect of rising oil prices threaten to squeeze incomes of the consumer of advanced economies and exacerbate inflationary pressures in emerging economies.
- Risk can also come from policy errors. The divide in monetary policies between the hawkish ECB and the more dovish Bank of England and the Fed suggests the difficult choice central banks have to make between fighting inflation or deflation. The timing and pace of the exit from super expansionary monetary policies will be a major challenge for central banks.
- The main potential source of core inflation remains employees gaining more wage bargaining power. However, the current output gap is still high. Robust economic data in Germany suggest increased pressure on higher wages. Emerging economies are most at risk for both higher core and headline inflation (example India).
- The eurozone debt crisis presents dark clouds ahead. The periphery of the eurozone economies will suffer and time will tell how effective budgetary measures

will be. The future of the EUR is at stake. As a result of budget cuts, the UK is one of the weakest advanced economies. The continuing political wrangling over deficit reduction in the U.S. does not bode well.

- In the years ahead, the growing imbalances between emerging and advanced economies should continue and tensions are likely to increase.

Our base case scenario for the 2nd Quarter has changed in as much that we believe that risks have increased materially. We expect markets to enter into a consolidation phase at best and we believe it is therefore prudent to take a more defensive stand to investments.

Recommended asset allocation – balanced



2. Economy

Despite the tragic events in Japan (it is expected that this event may influence world GDP growth by a negative 0.5%), MENA and the likely end of QE2, most forecasts still point to solid 4% global GDP

growth in 2011, only slightly down from the 4.3% estimate in December 2010. But more importantly, the number expected for 2012 is higher at 4.9%. In particular, growth in emerging economies and the U.S. will likely be responsible for most of the world growth this year and next.

The global recovery in consumption and investment has come on the back of the unprecedented monetary and fiscal policy stimulus over the last two years. As today's real global interest rates (interest less inflation) are still negative, current policies continue to boost global aggregate demand.

However, early economic indicators, such as the Institute of Supply Management (ISM) new manufacturing orders, container shipments and steel production suggest that world economic momentum has probably peaked in January this year.

China

Private sector consumption in China is still growing at a healthy pace, despite the recent tightening measures. Moreover, while credit growth may have been slowed down, it is still expanding at a rate of 17.7% YoY.

Wage inflation in China has been phenomenal compared to most other countries since the crisis, providing a much needed boost to domestic demand.

As a result of strong domestic growth, China's current account is finally starting to shrink. China's long term growth outlook should remain intact while the economy is moving away from an export oriented to a more sustainable domestic led economy.

Part of this policy is the controlled appreciation of the Remnibi against the USD. Since 2007, the nominal exchange rate has appreciated by 12% against the USD.

Europe

European GDP growth is under pressure from fiscal tightening, higher oil prices and a stronger EUR (which together could take 1.2 percentage points of GDP growth). In addition, the ECB seems poised to allow rates to rise in 2011, which should hurt the periphery of the eurozone where it is most vulnerable, having most of the eurozone's excess leverage and most of its floating-rate debt.

The economic outlook in the UK, Greece, Portugal and Ireland is grim considering a background of massive budget cuts, high unemployment and lower fiscal receipts. A double dip economic scenario in some of these countries is likely.

USA

Economists have started to downgrade U.S. growth forecasts due to the unusually severe winter conditions and higher gasoline prices. Also, data from ISM new orders suggest payroll rises may have peaked, despite March payrolls rising by about 200,000 for the second month in a row. However, Morgan Stanley and Credit Suisse still expect U.S. GDP growth to come in between 3-3.5%, still significantly outperforming Europe (around 2.0% growth). Growth engines are exports and capital spending which are strong. But the housing market generally remains weak and budgets cuts from the state and local governments are offsetting growth from healthy sectors.

Critically, the U.S. job's market shows positive signs; wage inflation on the other hand remains low.

Middle East

Current events in the Middle East are of great concern because this historic troubled region could even become more unstable, threatening global oil supplies.

The nature of the economic and financial risks largely come from two sources: (a) the potential for oil prices to rise sharply if supplies are disrupted and (b) the potential for rising political tensions to cause a general flight out of risk assets.

Libyan oil production accounts for only 2% of global oil output. However, current oil inventories are low and Libya is a major supplier of sweet crude to Europe that cannot be easily replaced by other producers. Moreover, oil prices are already moving up because of tight demand/supply conditions. Other oil producers such as Algeria (1.6% of global production), Bahrain and Yemen are relatively small, but if Iran would become embroiled, another 4.6% of global supplies would be at risk. The threat to oil transportation through the Straits of Hormuz cannot be excluded.

Despite the fact that oil prices have moved up in the past two years, they have not caused a problem to the global economy. On the other hand, economic models suggest that if crude prices were to increase to \$150 per barrel, global economic growth would reduce by 1%. This would be bad news considering the weak recovery in the advanced economies.

Inflation

The policy mix of large fiscal deficits and highly stimulative monetary policies in the advanced economies appears inflationary.

However, there is currently no excess monetary growth (too much money chasing too few goods) and the pass-through from higher commodity prices is weak given the ongoing slack in the advanced economies.

While commodity and oil prices cannot be ignored, the more important issue is what happens to unit labour costs. Wage growth in advanced economies is at a record low. Companies have kept a lid on wage growth and productivity gains have been healthy. There are no signs that western companies are going to grant large wage increases (except perhaps in Germany).

The current output gap in the eurozone, a proxy of spare capacity, is still very high (at 3.8% of GDP, this year on OECD estimates) suggesting that companies can produce more before labour can put in higher wage demands.

Most of the Asian emerging economies are in a very different position. There is excess money growth and the absence of spare capacity implies that higher commodity and energy costs will push up wage demands and the overall prices of goods and services. Thus far, inflation is edging higher, not spiralling out of control. However, policymakers of emerging economies need to get ahead of the curve by raising rates and, where necessary, allowing exchange rates to appreciate.

The higher emerging market inflation develops the more chance of it going into higher export prices to advanced economies. As the world economy is global,

the inflation outlook may be therefore less benign than currently assumed.

Interest rates - ECB

Following the 25bp hike to 1.25% by the ECB on 7 April this year, the market believes that the ECB will raise interest rates two more times through the remainder of this year and that the Bank of England will raise rates twice through 2H11. The Fed is expected to stay on hold this year, however.

We suggest the recent 25bp rate increase by the ECB is more symbolic and should not imply the start of a classic tightening cycle. The economic situation in the eurozone is too delicate to start serious tightening. However, it is an indication that we are at the beginning of the end of super low interest rates.

We expect 10Y-rates of Bunds and Dutch government paper to rise to 3.7% respectively 4% this year, from currently 3.3% and 3.6%.

In this cycle, policy tightening is likely to occur via fiscal rather than monetary policy. The IMF estimates fiscal tightening in the eurozone to be equivalent to 1.2% of GDP on a cyclically-adjusted basis this year.

Other factors that quasi restrict liquidity:

- The strong EUR. Each 10% of EUR appreciation takes about 1.5% off nominal GDP growth (and 0.8% off real GDP growth)
- A form of monetary tightening is being imposed de facto by virtue of the new Basel 3 rules and individual countries imposing even stricter capital rules on banks.

Furthermore, decisions by the ECB on liquidity measures are more important than a symbolic hike in rates. It is critical that the ECB continues to provide ample liquidity. Indeed, over the past 18 months when the ECB suggested it would reduce its liquidity provision, we have typically seen increasing volatility in the EUR exchange rate.

Equally important is the role of the ECB in purchasing peripheral eurozone debt. It is estimated that the ECB currently has purchased around €77bn of peripheral eurozone debt – and we believe it is critical that in the case of renewed tensions, the ECB stands ready to provide further support.

Interest rates – the Fed

Interest rate policies by the Fed are more keenly followed by the market than decisions by the ECB. For the global economic outlook, the Fed holding interest rates at current levels is key. With the current fragile status of the economy, we anticipate the Fed to hold rates stable at least until 2012.

We expect that Fed officials will acknowledge rising inflation expectations either by directly strengthening their language on tolerance or by increased talk about exiting quantitative easing.

We do not believe the data coming out of the U.S. economy would justify new quantitative easing measures and we do not anticipate the Fed to launch QE3.

On the contrary, the likely end of QE2 in June this year is a sign of turning monetary policies in the US. This is a very delicate situation and we anticipate market volatility to return during that period.

Usually, the start of a new rate hike cycle traditionally prompts a six-month period of moderate market weakness and a rotation into more defensive sectors.

3. Fixed income

Government bonds

EU government bond prices from “core” countries have significantly corrected in the 1st quarter this year. We generally expect eurozone interest rates to continue moving higher. A new eurozone crisis may push interest of Bunds lower, however.

Credits (corporate bonds)

Excess liquidity conditions should continue to drive investment grade credit spreads tighter. However, returns will be significantly lower than in 2010.

High Yield

HY bond prices are now a point away from all-time highs of \$105 (CS High Yield index), a level they have never breached in this market’s 25 year history. HY yields are near historical lows, even after several weeks of increased market volatility. As pricing tightens to historical lows, issuers are beginning to push for low quality deal structures, including weaker covenants, shorter and less requirements. This means that risks are rising for buyers of HY paper.

4. Equities

Global equities have rallied significantly since two years on the back of huge liquidity provided by central banks. Also, the lack of good alternatives has given support to buying and holding equities.

The recent hike by the ECB may, however, be the first signal for more caution.

Also, high oil and commodity prices give warning signals that the equity markets could be in for a correction.

On the other hand, equities may find support from healthy corporate balance sheets, still ample liquidity support from central banks of advanced economies and the declining risk of a double dip and deflation.

Companies indeed continue to improve their balance sheets as net debt-to equity has fallen to the lowest level since 1993. Armed with high levels of cash and low leverage, companies are well-positioned to expand their capital expenditures and take advantage of improving economic conditions.

Current valuations of equities are not stretched to historic levels and we expect companies will continue to improve their earnings in 2011. In the absence of a recession, we believe it is difficult to be bearish on equities.

Trading off the positives and negatives against each other, a repositioning towards more defensive stocks seems wise.

U.S. and European cyclicals have become relatively expensive and vulnerable to slowing economic growth. Lead indicators like the German Ifo and eurozone PMI have already started to come off their highs, which historically has been a drag on cyclical stocks. On the positive side, the outlook for European banks has started to improve and if bank stocks rally after the ECB starts to raise rates, this would send a powerful and positive signal to the rest of the equity market.

The major dangers for the equity markets in general continue to be higher oil prices, lower liquidity, exiting of monetary stimulus.

The prospect of higher commodity prices and rising inflation favors energy and companies with pricing power that can pass along higher input costs.

Emerging markets

Despite some underperformance relative to developed markets in the 1st quarter, our outlook has become more positive compared to our views expressed in our last Investment View.

Over owned, high valuations, and rising inflation weighed on EM equities since late 2010, but we believe these pressures have faded. A peak in inflation – particularly in China – would provide confidence that EM policy-makers have properly addressed the inflationary pressures without derailing the growth story. A peak in oil prices would also improve the outlook for the EM consumer, one of our favorite growth themes.

5. Currencies

We have been surprised by the strength of the EUR this quarter (+6% vs USD). We had expected the EUR to weaken until there would be more clarity about policy decisions with regard to the rescue operations of certain eurozone countries and the stability mechanism.

Perhaps it was the expected rise in interest rates that has been behind the EUR strength?

We believe the EUR is too expensive both on a purchasing power basis and based on the uncertainty risk that there will be no eurozone solution for the foreseeable future.

Indeed, the lack of leadership to address the economic mismatch between various eurozone members is a concern.

The peripheral eurozone members have not been able to become competitive despite huge financial efforts by the richer members states. Indeed the question is if the peripheral eurozone countries can change their policies and become “good” euro citizens. We are a bit sceptic at this stage.

It is clear that most peripheral eurozone members need more time to implement new policies and to reduce debt further. In the meantime liquidity is being provided by the ECB and the stability mechanism. However, international investors are not buying peripheral eurozone government debt and bond prices are going down by the day.

The stronger eurozone members, under the leadership of Germany, have introduced the idea that the debt of certain peripheral eurozone members must be restructured. Were this to happen, this would simply mean that investors would have to accept a write down on certain of their peripheral eurozone government holdings. A “voluntary” write down is being discussed.

Writing off debt would indeed give more breathing time, but does it really solve the fundamental issues?

We do not believe that it is realistic that the eurozone would break up into two camps. This would imply a devaluation of currencies by members leaving the present euro block. The effect would be devastating for the European financial, political and economic system.

U.S. economic momentum remains slightly positive relative to that of the eurozone and with the USD usually being a cyclical currency, the eurozone crisis should benefit

the USD. However, the USD fundamentally remains a weak currency. Although the U.S. economy seems to be coming out of the woods, the long term debt picture is a dark cloud hanging over the future of this country.

We continue to believe that the Swiss Franc should maintain its safe haven status resuming its upward trend.

Commodity currencies should continue to do relatively well amid a better macro outlook and increasing interest rates.

6. Commodities

Energy remains one of our favourite investments. In part, because the geopolitical situation in the MENA has resulted in a significant oil supply shock at a time demand is expanding.

Still, once higher oil prices start to slow down demand and the lost supplies from Libya come back on line, we may see the price of oil heading back down, which would be good for the economy in general.

We have been positive on base metals during the past two years. However, downside risks to the strength of metals demand have risen on the back of higher oil prices as oil supply shocks often have a dramatic impact on metals demand.

Global economic health is critical for industrial metals, which tend to show a close relationship with GDP growth.

We had anticipated that in 2011 Gold's current momentum would give way to more fundamentally-based assets like equities. This has only been partly true. The powerful combination of higher risk, an oil supply shock and rising inflation expectations has provided support to Gold prices (USD) so far.

Further upside pressures on oil prices and eurozone volatility may create the recipe 2

The response of key central banks to rising inflation expectations should ultimately determine whether Gold continues to go higher. Negative real interest rates encourage Gold purchases by turning cash holdings into a negative carry position. Negative carry costs can currently be found across major reserve currencies such as the USD, the GBP and the EUR. Unexpected rate hikes in those currencies should impact Gold negatively.

7. Conclusion

Our base case scenario for the 2nd Quarter has changed in as much that we believe that risks have increased materially.

We expect markets to enter into a consolidation phase at best and we believe it is therefore prudent to take a more defensive stand to investments in general.

Although we have become more defensive, equities are still our preferred asset class, as it provides the best value and it represents a better hedge against inflation than most other asset classes.

We expect weakness from the EUR in the coming months and currency protection should be envisaged by buying forward contracts in Swiss Francs.

We like the following investment ideas: U.S. international banks, German small and mid cap industrials, oil exploration and services, mining equipment, strong international franchises with pricing power, domestic emerging market companies.

The Investment Committee

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Ranked Performance of Various Indices, Q1 2011

Barrel of Oil in \$	+23.58%
Rogers International Commodity Index in \$	+9.73%
MSCI USA in \$	+5.46%
High Yield bonds in \$	+3.89%
MSCI China Free in \$	+2.93%
MSCI Emerging Markets in \$	+2.16%
Gold \$ per Ounce	+0.81%
Convertible Bonds in €	+0.59%
Barclays CTA Index	+0.52%
HFRX Global Hedge Fund Index \$	+0.40%
MSCI Latin America in \$	+0.40%
JP Morgan Cash Index 1M in €	+0.18%
MSCI Europe	-0.09%
Investment grade Credits in €	-0.73%
JP Morgan Global Gvt. Bonds in €	-0.88%
MSCI World in €	-1.41%
Copper in \$ per Lb.	-2.45%
MSCI Japan in JPY	-3.83%



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