HOVING & PARTNERS S.A.
WEALTH MANAGEMENT

Quarterly Investment View

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1. Summary

The second Quarter 2011 was volatile, dominated by the April revolution in some Arab countries, Souvereign debt issues of the peripheral euro-zone countries, and Greece in particular, the flight to safety in Bunds and Dutch government bonds, the move by investors into the Swiss franc, the disruption of manufacture supplies from Japan following the tragic Tsunami and generally the slowdown in world economic growth.

Inflation turned higher in emerging markets. Interest rates climbed with the result that emerging market stocks showed some of the largest declines compared to world stock markets. China in particular took strong measures including rate hikes and record-high bank reserve requirements to slow down the economy.

Not surprisingly, commodity and food prices corrected as a result of lower imports and destocking effects.

In Europe, the élan of the German economy was impressive. While the peripheral EU economies were contracting, the stronger Nordic EU economies fared reasonably well.

European bond markets were dominated by the EU Souvereign debt crisis. Liquidity poured out of troubled EU peripheral countries to considered safer EU countries.

This unstoppable flow caused interest rates to soar in the weaker euro-zone countries for government borrowings.

The US stock market did quite well in local currency (+5.5%), but was down measured in euro. The European stock markets showed a mixed picture, but some markets like Germany, France and even Spain made gains in H1. The Tokyo stock market suffered, post the traumatic Tsunami event. The MSCI World equity index posted a gain of +2.24% in local currency, but was down in euro.

Oil prices were strong, but corrected when the International Energy Agency (IEA) decided to intervene by destocking strategic oil reserves. The lack of oil supplies from Libya caused more disruption than initially anticipated.

The USD was weak against the euro, declining by about 8% in the first six months of the year.

Our views for H2, 2011

We suggest that with the exception of Greece and the peripheral euro-zone Souvereign debt crisis, the first global economic signs for the better are around the corner.

First, most forward looking global growth data are improving, surprising on the upside.

Second, we do not expect that the ECB will abandon its responsibility for financial stability across the euro-zone countries. The ECB will stand firm to convince politicians that a possible default of Greece could engulf larger euro-zone economies.

Third, the issues around the US debt ceiling are expected to be addressed in time.

Fourth, certain leading indicators in the US promise better times. QE3 may not have to be put in place by the Fed.

Fifth, although Chinese leaders are still focussed on politically sensitive inflation, there is evidence from manufacturing and service sector surveys that the Chinese economy is slowing. Chinese Premier Wen Jiabao expressed confidence that the government will be able to keep prices "firmly under control". Sustainable growth seems back on top of the policy priority list. The return of China as growth engine would be good news.

Sixth, prices of oil and food have come down, giving more breath to the world consumer.

Conclusion

The main risk to markets in general remains a default of Greece. Letting this happen would result in financial chaos. It is the responsibility of euro-zone governments to avoid this scenario. The position of the ECB is clear and we expect that the credibility of the ECB will remain intact.

We suggest the consolidation phase of equities to be near the end and we anticipate that investors will be paid for the risk of taking a higher equity exposure in 2H. However, we would advise to buy on dips as markets are likely to remain volatile due to remaining uncertainties.

2. Economy

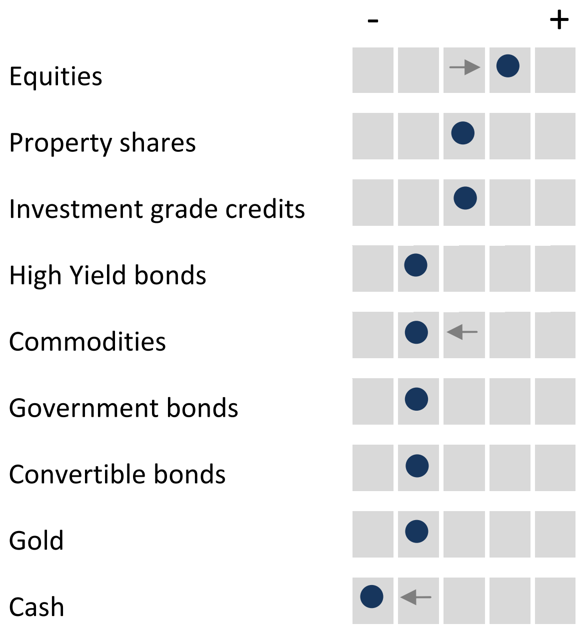
Despite multiple shocks to the global macro economy in 2011, the basics did not change in the last six months: global GDP growth at 4%, emerging markets at 6% and developed markets at a modest 2% growth.

Economic indicators have corrected sharply over the past three months, with the US leading indicator of Institute of Supply Management (ISM) new orders series, in particular, showing in May its biggest monthly fall since October 2001. But, the recent US Purchase Manager Index number of June was above expectations.

We believe that the world economy "soft patch" has touched bottom around May/June this year.

Key economic leading indicators such as Copper, Aluminum US Gasoline/Jet fuel demand and the Baltic Dry Index stabilized or were positive in June, the first time since three months.

Recommended asset allocation – balanced



Production in Japan rose 5.7% in May. This does suggest an acceleration of the recovery from parts disruptions. Japan may see a V-shaped bounce in 2H from its quake-induced deep recession.

US production and orders should bounce in July (vehicle production expected to be +23% in July) and the US soft patch in 1H should give way to reacceleration in 2H.

We see the latter driven by (1) a rebound in auto production as supply disruptions ease; (2) relief for consumers from gasoline prices falling 15% from their peak, (3) a revival in bank lending starting to trickle down to the crucial small business sector; and (4) stronger capital expenditures due to amortization tax incentives agreed in November 2010 and the re-industrialization of the US that follows from global rebalancing.

For Europe, with a stronger than expected start in the year, most forecasts are for GDP to grow around 2.0% this year. In contrast, for 2012 we expect the euro bloc economy to slow meaningfully to just 1.2% GDP growth on the back of earlier than expected ECB rate hikes, ongoing tensions in the eurozone periphery and a still expensive euro.

A major positive for Europe is that the German consumer seems to increase spending (after ten years of limited growth). The strong job market has resulted in German unemployment reaching a generational low, well below the euro bloc average and the rate prevailing in the US.

This is not only good news for Germany, but also for the eurozone periphery. After all, German consumer spending amounts to around 15% of EU area GDP, almost the size of the euro-zone periphery countries.

Strong German domestic demand helps the euro-zone periphery in exports. Ireland exports over one third of its GDP in goods and services to core Europe, followed by Portugal and Spain, which export around 10% of their respective GDPs to the core, while Greece exports nearly 6%. A buoyant Germany and importantly, strength in core Europe, are therefore vital to the euro-zone periphery countries.

China

The official Chinese Production Manufacturing Index (PMI) has continued to weaken for the fourth month running, There is also an important element of seasonality in the series which typically troughs in July.

Most economists already forecast lower growth for Chinese GDP of around 8.5-9% in 2011 (compared to a 30-year trend growth rate of 10% p.a.). We see, however, a few positive signals:

1) Inflation seems to be near a peak. The price component of the PMI continues to fall and this leads core inflation by four months – and is now consistent with core inflation falling to close to 1% (from the current 2.9%).

2) Growth in China is clearly slowing. This slowdown is desirable, given that output is still currently around 1% above potential, on the People's Bank of China numbers. The magnitude of the slowdown is not yet worrying, with the PMI still above 50 and still consistent with GDP growth of about 9%. Recall, we have had twelve rises in the reserve requirement and five rises in interest rates!

China remains with two critical issues, however: over-investment in fixed assets and leverage.

The over-investment in fixed assets (given an investment share in GDP of 47% in

China) puts the economy in a vulnerable position should this trend reverse.

China's debt

Credit Suisse calculates that total private sector credit-to-GDP is almost 20% above trend – and highlights that, according to the BIS (Bank of International Settlements), a figure above 10% should be considered problematic. However, a significant part of that debt build-up in this cycle has been due to projects that would count as "government spending" in other economies. Lastly, the total debt-ratio for the economy (consumer, corporate and government) is in line with that for Malaysia and Thailand (economies where the private sector credit-to-GDP is quite similar).

The Chinese economy can be kick-started quickly if necessary: the budget deficit is just 2% of GDP, government debt-to-GDP is just 18% and above all, the sharp squeeze on corporate cash-flow (corporate cash-flow has fallen by 15% yoy between Q3 2010 and Q1 2011) could be reversed if lending conditions were to be eased.

Inflation, is it coming back?

A new global development is that core inflation is inching higher, not just in the stronger emerging market economies, but in the slow-healing economies of Europe and the US as well.

The BIS said in its 81st Annual Report, published last week, that "tighter global monetary policy is needed in order to contain inflation pressures and ward off financial stability risks" and warns that "central banks may have to be prepared to raise policy rates at a faster pace than in previous tightening episodes".

This analysis goes against the Fed's current assessment that inflation pressures in the US are likely to be transitory and interest rates can thus remain low for an extended period of time, as reiterated by Chairman Bernanke last week. It also contrasts with the Bank of England's stance.

Expected US core CPI, excluding food and energy, should rise 1.5% this year and 1.7% next year. Looking ahead, clearly many businesses want to raise prices and housing rent has significantly increased (due to foreclosures). On the other hand the weak US labour market and slow growth of wages should keep a lid on US inflation.

In Europe, inflation has likely peaked at 2.8% in April and should gradually ease towards 2% in early 2012. While headline inflation depends on imported commodity prices, core inflation (salaries and rent) remains subdued.

In emerging markets, output gaps have closed, adding to the pressure from abundant liquidity and strong commodity prices. Headline inflation is expected to continue to work its way into the core as workers successfully negotiate partial cost of living adjustments, especially in Asia.

Monetary tightening in emerging markets and the recent stabilisation of commodity prices bode well for an easing of headline inflation pressures in 2H. If so, fears of a hard landing in China and elsewhere in emerging markets should dissipate and give way to a more benign view of emerging market and global growth during 2H.

In today's post-bubble world with high and persistent unemployment, financial fragility and high and rising public debts, inflation, by contrast, does not seem to be high on most people's worry list, despite the BIS concerns. Therefore, many major central banks are unlikely to follow the BIS call; global policy rates are likely to stay low for longer. However, we concur with the BIS analysis and believe global inflation pressures look set to rise over the medium term.

The ECB and the Souvereign debt problems

The ECB raised their main policy rate from 1.25% to 1.50% to keep inflation in check and signaled that more rises are likely despite the escalating debt crisis and more evidence of slowing growth in much of the euro bloc. Central banks in other major economies are taking a more cautious approach to protect fragile recoveries.

The approval by the Greek Parliament in June to accept deeper austerity measures in return for a €12bn payment initially led to unwarranted hope. This hope evaporated when Moody's, a rating agency, downgraded Portugal's credit rating to "junk" status. In reaction, the yields on Portuguese, Greek and Irish bonds rose strongly, reflecting that investors no longer belief that the crisis can be contained, as did selling by investors who cannot hold junk bonds. The ECB took immediate steps to protect Portugal's banking system, suspending rules that require at least one investment grade rating in order to accept government bonds as collateral for ECB loans.

Moody's downgrade was highly criticized by senior European officials. It is true that credit downgrades risk to be self-fulfilling and it complicates fixing the crisis (buying time), but objectively it is hard to argue that Greece or Portugal should still be investment grade.

Following Portugal, Italy, long a bystander to the euro-zone's debt woes, was suddenly thrust into the eye of the storm, when investors fled Italy's Souvereign bonds. In one week, Italy's 10Y Souvereign bond yield increased by 100 basis points to a record high of 285bp, against 10Y-German Bunds.

Investors have become frustrated that European leaders are still at odds over a second aid package for Greece. There is no consensus how to share the burden of a new Greek bailout with private-sector creditors.

At the heart of the issue is that credit rating companies have made it clear that making private creditors feel the pain (plans by French and German banks to roll over Greek debt) would be treated as a debt default by Greece.

This would mean that Greek banks would no longer be able to use their government bonds as collateral for their liquidity-providing operations (about €100bn). The country's banking system would collapse.

ECB officials and the ECB President Jean-Claude Trichet have made it clear that letting this happen is unacceptable.

A Greek default would lead to further downgrades and raise funding costs in Italy and Spain to dramatic levels. The euro-zone governments need to recognize that its efforts to insulate other countries from a Geek default has failed.

Global euro-zone Bonds, a solution?

There is a solution to restore access for the weaker EU members to the bond markets, but it would involve the issuance of euro-zone bonds based on the European Financial Stability Facility (EFSF) which is guaranteed by euro bloc member states.

The global euro-zone Souvereign debt would be pooled like the US Treasury bond market. Debt to GDP ratios would become an average of all euro-zone countries and although still high, its level would be below the US.

But very importantly, interest rates of the troubled euro-zone countries would come down strongly enabling these countries to grow again and come out of recession.

It would mostly mean that countries would lose some of their sovereign privileges, a highly political issue. The idea of a united Europe in economic terms with a single currency can only work with further political integration. This seems a stumble block in Germany, in Finland and recently In the Netherlands.

Interest rates and debt – US

As inflation starts to get closer to the Fed's "2 percent or a little below" target, Fed officials are likely to persist and keep policy accommodative as the slow recovery grinds along. Further upside surprises to inflation would however significantly complicate the Fed's policy decisions.

The Fed has learned from its mistakes made in the handling of the Great Depression when rates were tightened too quickly.

Today, the Fed knows that an expansion of reserves is only inflationary if it prompts a boom in bank lending. The Fed understands it has to move carefully to exit of low rates because the recovery in the US economy has been slow.

The situation on the fiscal front however is more precarious. Today, as in the mid 1930s, fiscal fatigue has set in. The debate has shifted from keeping the recovery going to removing fiscal support. Remember that fiscal policy is set to automatically tighten next year. All told, programs comprising more than one percent of GDP are set to expire, including the payroll tax cut and extended federal unemployment benefits.

It is important to recognize that the debate about fiscal austerity can hurt the US economy before the cuts kick in. Most people understand that a major austerity lies ahead, but they have little idea of where the cuts will hit. Setting a clear budget plan in motion would reduce uncertainty and help people plan for the future.

At one extreme, politicians could agree to disagree and refuse to raise the debt ceiling before the cash runs out on August 2nd. This would prompt either an immediate cut in government spending equivalent to seven percent of GDP or a default on the debt. At the other extreme, politicians could agree to a large, front-loaded cut in spending.

Our baseline view is that the near-term uncertainty shock will abate with a last minute extension of the debt ceiling. The best policy outcome, in our view, is modest upfront spending cuts with a commitment to deal with long-run structural deficit concerns after the Presidential election in 2012.

US 10Y-Treasury yields are expected to rise in the absence of quantitative easing and generally on the back of a better than expected performing US economy.

3. Fixed income

Review

US 10Y-Treasury and 10Y-Bund yields both moved up by about 13bp in the first six months this year.

US 10Y-Treasury yields peaked on 8 February with a high of 3.74% and had a low of 2.86% on 24 June, finishing at 3.16% on 30 June. German 10Y-Bunds had their high of 3.49% on 11 April and a low of 2.83% on 24 June, finishing with 3.02% at 30 June.

Credit spreads generally widened in the 2nd Quarter as investment grade corporate bonds failed to keep up with rallies in underlying bonds of core EU countries.

High yield bonds performed reasonably well supported by lower bankruptcies. Emerging market debt suffered from higher interest rates.

We believe that EU core government bonds are expensive and do not compensate for inflationary risks. The flight to safety status may continue for a while, but the interest rate picture in the euro-zone core countries will definitively change when a European solution is found for the Souvereign debt crisis. Was this to happen, we expect interest rates to rise in euro-zone core countries. On the other hand, Bunds or Dutch Souvereign bonds continue to be a good hedge against equity market volatility.

Within corporate bonds, we prefer high yield credit over investment grade. Default activity has been minimal and, as we expect, is likely to remain low. Investors should therefore be rewarded for the additional risk.

It is too early to come back to emerging market bonds as anti-inflation measures still prevail. A good example is Turkey with its unsustainable growth of 11%.

4. Equities

We tactically reduced our equity positions when we became more defensive in mid-April on economic growth worries, the end of quantitative easing (QE2) and higher oil prices. Since that decision, main European equities came down by 6%, but recovered around 4% from their lows by the end of June (the last three days).

These negative factors should play less of a role in 2H. We look for global growth of 4% this year and for US growth to reaccelerate to 3% in 2H 2011.

While US house prices could drop further, affordability and rental yields have improved, paving the way for a housing recovery.

Emerging market inflation seems to be peaking and the completion of QE2 is expected to have little impact.

Hence, we reverse part of our tactical downgrade and suggest increasing equities, making further additions in 2H, should markets fall further.

The buy case for equities:

(a) Equities offer relative value: the equity risk premium (ERP) is 6.3% versus a historical premium of 4.5-4.9%

(b) Equities hedge investors against rising inflation, until inflation rises above 4% (currently inflation expectations are 2.4%)

(c) Corporate margins remain strong. Analysts forecast around 10-14% US EPS growth this year and 9% next

(d) Equities are still under-owned, investor sentiment is not bullish

Although US equities are more expensive, their earnings outlook is stronger than their European counterparts.

We also look to start rotating back into emerging markets where valuations are more reasonable now.

Emerging markets

Most emerging markets had a bad first six months period mostly because of interest rate concerns and lower growth. However, some of these countries, and in particular China, are further ahead in the tightening cycle.

The good news is that we are getting closer to foreign investor capitulation in emerging markets. According to Bank of America Merrill Lynch there has been almost USD 4bn worth of outflows over the last six weeks from emerging markets. We believe South Korea and domestic China are a Buy.

5. Currencies

The euro appreciated by +8.3% against the US dollar in the first six months 2011, despite the eurozone Souvereign debt crisis. The Swiss franc was somewhat weaker against the euro, losing a surprise -2.6% in value over the same period.

US monetary policy is likely to remain accommodative and this will result in an interest rate differential dynamic that is unhelpful for the US Dollar. Also, the euro-zone debt crisis has not really benefited the US Dollar, from which we conclude that the underlying trend is weak. Stronger 2H world economic growth could spur more risk taking which could pressure the US Dollar further down.

We continue to believe the euro is fundamentally overvalued because the eurozone economy (with the exception of Germany) is still fragile. The potential ECB rate hikes may underpin the euro further into this year, however.

Will the Swiss Franc lose its safe haven status? This will depend on the outcome of policy decisions by euro-zone governments. While there are solutions with global euro-zone bonds, we anticipate that this will take some time. Delays should continue benefiting the Swiss franc. Buy Swiss francs on weakness.

Finally, we expect UK economic growth to remain poor and inflation to remain stubbornly high. We therefore continue to take a negative view on the Pound Sterling versus the euro.

6. Commodities

As we expect stronger growth rates in 2H commodities should rerate.

Steel is considered the real world indicator of the true industrial supply demand balance given its non-speculative properties. Steel prices are set to rally as China’s two-year destocking exercise seems nearly over and the first signs of recovery in the ex China market can be observed.

In contrast, after a hectic 2nd Quarter, our view is that energy and grain prices will remain volatile, but moving sideways to down over the remainder of the year.

Global oil demand has slowed from an unsustainable 4% growth pace in January to 1.0%-1.4% in May. Analysts forecast slightly lower oil-demand growth in the OECD, with non-OECD members taking a larger share in overall oil demand.

Following high demand, Brent and WTI crude oil prices moved sharply up in the beginning of the year, reaching their peaks of respectively $126.65 and $113.93 in April.

Following this peak, prices started to decline finishing the first six months of the year at $112.48 and $95.42 respectively.

The International Energy Agency (IEA) announced a co-ordinated strategic oil reserve release “to offset the Libyan oil supply disruption” seemingly in response to the failed OPEC meeting of June 8.

Historically, previous IEA releases had a big immediate impact on both price level and structure, although the effectiveness of interventions in the market on the long run has shown to be limited.

Saudi Arabia recently expressed concerns about the direction of the global economy and pledged to expand output substantially over the summer months. But, increasing output so soon seems a technical issue.

We suggest that the IEA measure is a form of QE3 providing immediate relief to oil dependent consumers taking away a significant headwind for the world economy.

But in almost every scenario for the next five years, limited global oil supply growth will likely mean higher-for-longer prices. So if Libya doesn’t come back on line soon, the price of oil is expected to move up again.

Physical Gold increased in value by +5.6% in USD, but declined by -2.7% in euro. Gold as an asset class has protected capital value in the last few years, but it is doubtful that physical gold prices would move much higher from here, unless the European Souvereign debt crisis would get out of hand.

7. Conclusion

The main risk to markets in general remains a default of Greece as politicians continue to blunder. Was this to happen, financial chaos is to be expected.

We suggest the consolidation phase of equities to be near the end and we anticipate investors will be paid for taking the risk of a higher equity exposure. Buy-on-the-dip seems to be the best tactical approach.

We believe that the asset mix of balanced portfolios should reflect a higher exposure to equities in general in 2H 2011.

Fixed income remains an important asset class in 2H 2011 to counterweight adverse equity volatility.

As an asset class per se, fixed income should not return more than the current yield as lower interest rates are not expected (euro or USD).

High yield remains attractive as a sub-class of fixed income.

Souvereign bonds of the eurozone core countries are only attractive in a crisis scenario, Credits are otherwise preferred.

The Investment Committee

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Ranked Performance of Various Indices Q1, 1H 2011	Q1	1H
Barrel of Oil in €	+16.67%	+9.35%
JP Morgan High Yield bonds in €	+3.16%	+3.62%
JP Morgan Global Gvt. Bonds in €	-0.88%	+0.86%
Investment grade Credits in €	-0.73%	+0.61%
JP Morgan Cash Index 1M in €	+0.18%	+0.45%
Convertible Bonds in €	+0.66%	-1.24%
MSCI Europe	+0.09%	-1.26%
MSCI Daily Net TR World Free €	-0.93%	-2.58%
Gold $ per Ounce in €	-5.04%	-2.72%
MSCI USA in €	-0.66%	-3.12%
Rogers International Commodity Index in €	+3.35%	-6.82%
MSCI Emerging Markets in €	-4.21%	-8.30%
MSCI China Free in €	-3.05%	-8.45%
BB CTA Index	-5.66%	-9.11%
HFRX Global Hedge Fund Index €	-5.43%	-9.83%
Copper in $ per Lb. in €	-7.24%	-10.48%
MSCI Latin America in €	-5.43%	-10.88%
MSCI Japan in €	-13.00%	-11.29%

Negative performance in past quarter

Positive performance in past quarter

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