INVESTMENT STRATEGY

2013 Q3

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Executive Summary

Economic Outlook

Although fiscal drag increased massively in the United States, the US economy remained quite resilient. This resilience stands in stark contrast with the continuing recession in the European Union but possibly also with slower growth in Asia, and in particular in China. We expect growth to remain moderate in the United States as the fiscal drag is likely to persist through 2013. If the recovery in the United States is to appear sustainable, the Federal Reserve might first decrease the rate of liquidity injection, and subsequently - but only very gradually - reduce liquidity. As a result we do not expect interest rates to significantly increase globally. It is to be seen of course, how more vulnerable economies will face higher financing costs, in particular European periphery economies, but plausibly also some emerging markets.

Stocks

Stocks have come under pressures as uncertainties about the slowdown of the US economy, alternated with concerns about QE tapering by the Federal Reserve. As we will move through 2013, QE tapering concerns will become the main concern, as the US housing sector will continue to improve. The change in monetary policy is likely to prevent very strong rises in equity markets. Yet, equity markets should recover earlier than bond markets from the change in monetary policy direction. As yields stabilise, we would expect equity prices to move up again sometime after the summer, albeit at a more moderate rate as we had during the first part of 2013.

Commodities

Prospective monetary tightening in the United States, as well as a secular globally deflationary trend, do not bode well for commodity prices.

Gold will remain under pressure as emerging markets suffer less inflation, and their current account surpluses continue to shrink. Smaller current accounts mean that these countries, which over the last years have been important buyers of gold, will reduce their demand for this precious metal. If yields continue to rise, this could act as a drag on gold prices as it loses relative appeal compared with bonds.

In a global low growth environment, industrial metals are unlikely to pick up meaningfully. This is even more relevant because the biggest consumer of industrial metals, China, will continue to grow at rates that are significantly lower than the double-digit rates we were used to in the previous years.

Given this current economic slow-down, oil prices are also expected to remain subdued. However, as long as uncertainties in the Middle East persist, oil prices are unlikely to go significantly below 100 US dollar the barrel. If uncertainties are able to translate into an effective rise of tensions, for instance the nuclear energy standoff between Iran and the US, we would not exclude a sharp rise in the oil price.

Executive Summary

Bonds

The steady pace of economic growth in the US has, as we had expected, ensured a continuation of the current upward trend in bond yields. This has been further exacerbated by new economic projections by the Fed which makes tapering of the QE program more likely. German yields have also increased, albeit at a lower pace due to continued weakness in the periphery of Europe. The massive increase in Japanese yields reflects, for now, that markets are taking the BoJ's inflation targets seriously.

We expect global yields to rise a little further but to stabilise sometime towards the end of 2013. Although recent movements in yield suggest an end in the 30 year bull market, more evidence is required for this to be conclusive.

Currencies

Whilst US yields have thus far risen more than yields in Europe, the euro has remained remarkably resilient. In fact, whilst many currencies - in particular commodity currencies and the yen - have suffered against the US dollar, the EUR/USD exchange rate has not changed significantly. As real reforms in Europe are likely to deliver results only very gradually, and as significant fiscal stimulus appears politically unfeasible, we would expect the European Central Bank at some point to deliver more stimulus through some sort of unconventional liquidity injection. In other words, we expect the European Central Bank to catch up with other major central banks. As that happens, and as the Federal Reserve will start tapering QE, we expect the euro to weaken versus the US dollar. Likewise the yen will also weaken as the Bank of Japan is likely to further step up stimulus through 2013. We also believe that commodity currencies, such as the Australian dollar, will continue to suffer against the US dollar because of less demand for raw materials from China.

Major Risks and Opportunities

The "sequester" might still derail the US recovery in 2013. This would clearly force the Federal Reserve to protract rather than unwind Quantitative Easing. Paradoxically, unless the slowdown in growth is violent, such a situation could lengthen, rather than undo, the current upswing in equities. Again, under the scenario of a violent slowdown safe-haven flows would strengthen the US dollar, the yen and the Swiss franc versus the Euro and Sterling. If the slowdown is more moderate, currency implications would be less straightforward as the continuing expansionary stance of US monetary policy might stall the upward trend of the greenback.

We consider fiscal consolidation in the Euro-zone as a special risk factor. In fact, social hardship in the periphery might well undo continuing political support for austerity. To overcome this type of risk, more progress on the banking union and more relaxation on austerity would be welcome. This is, however, unlikely to happen before the German elections in September. As such, recurrent spikes in spreads and downward pressures on the Euro and periphery equity markets are not to be excluded.

China may face political economy issues as it moves away from an export-driven growth model to a more domestically driven growth model. Internal political problems might also aggravate external territorial tensions with its neighbours. Further more the People`s Bank of China have taken a hard line regarding credit expansion due to its rapid rise in the first quarter. If this stance by the PBoC continues, the implicaions for the overvalued real estate market and GDP growth in general could be dire.

The major risk countries right now are still Egypt, Syria and Iran. Recently also Turkey seems to question its political destiny. Further political destabilisation in the region might lead to a simultaneous increase in USD and in oil prices. Historically the solution of political problems in the Middle East, or the prospect thereof, have often led to tailwinds for equity markets.

Outlook Summary

Asset	Price as of 27-06-2013	Target for end of Q3	Commentary
Equity markets			
S&P 500	1603	1580	Ongoing discussions about the planned tapering of QE and the extent of the actual pick up in yields could act as a drag on the US equity market. Towards the end of Q3 we are expecting a stabilisation at a lower level before resuming the bull trend in Q4.
DAX	7791	7500	The German economy is actually sliding towards recessive levels. A level of 7000 should not be passed on the downside and we are expecting to retest the recent historical high and potentially beyond.
FTSE MIB	15430	14500	The Italian stock market is highly dependent on the level of sovereign yields which have increased substantially during the last weeks. We are expecting to see prices lower in a range between 13,800 and 12,300. A pick up towards year end is highly probable and should reach levels of 17,000.
SMI	7672	7100	As Switzerland is acting as a safe haven, money is flowing into their capital markets and especially into the stock area, as long as yields are low. We see a probability for further downside towards the area near 6600, which would reflect a 50% retracement. Longer term we are expecting a new leg higher to test the previous highs.
Topix	1099	1050	The up trend is damaged but still in place and the the difference between the actual price level and the 200 day moving-average has decreased form 40% to 26%. A further down trend towards 1000 is highly likely.
SHComp	1950	1850	The Chinese equity market is negatively affected by the weakening economic situation. The real estate market and credit markets are in a bubble and the People`s Bank of China is fighting against a further expansion in credit volume.

Outlook Summary

Asset	Price as of 27-06-2013	Target for end of Q3	Commentary
Commodities			
Gold	1201$	1100	If yields pick up further, the Gold price should be affected negatively. The major down trend is still in place and we might possibly reach levels between 1000 and 1100 within the next quarter.
Industrial Metals	255.95	230	We have to be particularly vigilant about the Chinese economy because China is the biggest commodity purchasing country world wide. Unfortunately China's economy is weakening and has serious problems to maintain its growth path. As a result we are expecting a further down trend in Q3 towards 220.
Brent Oil	102.82	95	The economic situation is not supporting the oil price. If we are able to break the recent low at 99.67 we see a potential downtrend towards the region of 90.

Outlook Summary

Asset	Price as of 27-06-2013	Target for end of Q3	Commentary
Bonds			
US T-Note	2.4721	2.25	Long-term we see an upward trend, but recurring bouts of uncertainty are determining short-term reversals.
Japan 10-year	0.838	0.77	Low yields are already pricing in massive monetary easing.
Italian 10-year	4.566	4.25	Yields should revert to pre-crisis levels. Yet, as long as political uncertainty does not dissipate, we might see recurring spikes.
Eurozone: Bund	1.725	1.60	Long-term we see an upward trend, but recurring bouts of uncertainty are determining short-term reversals.

Outlook Summary

Asset	Price as of 27-06-2013	Target for end of 2013	Commentary
Equity markets			
US Index	82.902	87.00	We remain longer-term bullish, viewing the price action over the last 8 years as forming a large base. We thus eventually seek a break over 88.71 to cement this base in place.
USD/CHF	0.9453	0.99	We are faced with an economy that is continuing to have strong GDP growth and low unemployment. It is thus difficult not to think of the boy that cried wolf when assessing the Swiss economy.
GBP/USD	1.5249	1.50	The general economic environment has improved since our last quarterly report, indicating that the UK economy may have passed its low point. For this reason, we do not expect to see a large depreciation in cable over the quarter.
AUD/USD	0.9275	0.82	We anticipate a continuation of the long overdue repricing of the Australian dollar, particularly considering the vast current account deficit that has been built up over the last 30+ years.
EUR/USD	1.3038	1.24	Euro zone PMI readings continue to under-perform their US counterparts, suggesting that the growth dynamic is still heavily tilted towards the United States.
EUR/CHF	1.2321	1.2550	Swiss exports have remained surprisingly stable to all destinations, not just Germany. For this reason we see no real reason why the Franc should depreciate substantially versus the Euro.
USD/JPY	98.53	103.00	We remain wary of the long-term ability of the Japanese authorities to simultaneously increase the money supply and also keep government bond yields contained.

Economics / GDP - Growth

USA GDP/ISM

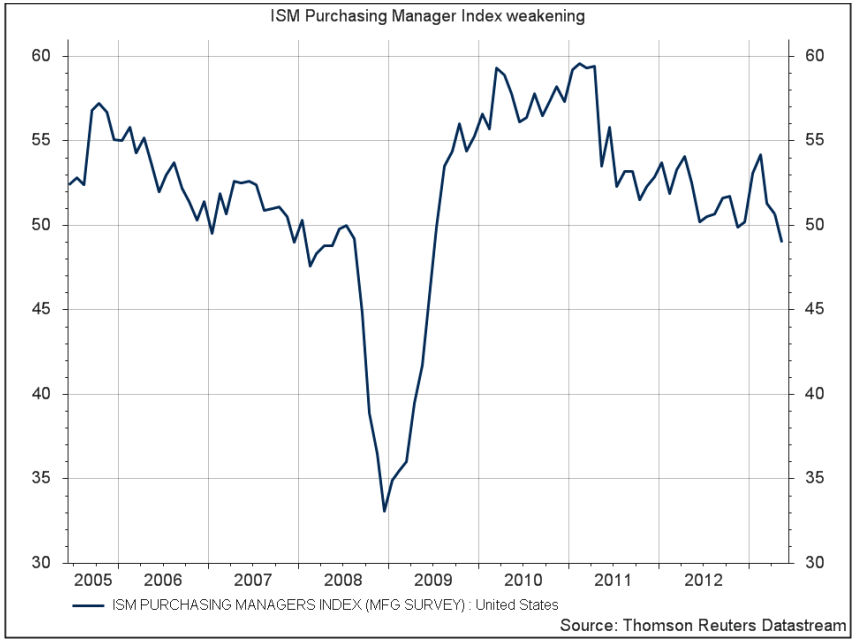
The US economic data set remains a mixed bag, with positive and negative data alternating one another. The point to make, of course, is that - compared to other countries - US government agencies provide a lot of data. As such, the scope for contradictory data is higher.

Going beyond the endless distinctions between new housing starts, existing home sales, new homes sales, new mortgage applications, it appears clear, however, that the housing market, as reflected in price and confidence indices is still in an upward trend. This remains the key factor in sustaining the labour market, and allowing the economy to weather the ongoing "sequester".

US companies are showing some concerns as to the sustainability of the current upswing. A lot of this concern is related to the increased fiscal drag in the context of the ongoing weak recovery. We continue to stress that growth will remain markedly below the levels to which we were used before the 2008 financial crisis. Industrial confidence indicators inevitably suffer in this environment.

As for now, the ISM Purchasing Manager Index has just dropped below the 50 threshold level, indicating the possibility of a contraction. Gradually ebbing fiscal pressure should, however, determine a reversion of this trend. The US cycle might well weaken but is unlikely to fall into outright recession.





Economics / GDP - Growth

USA Further Statistics

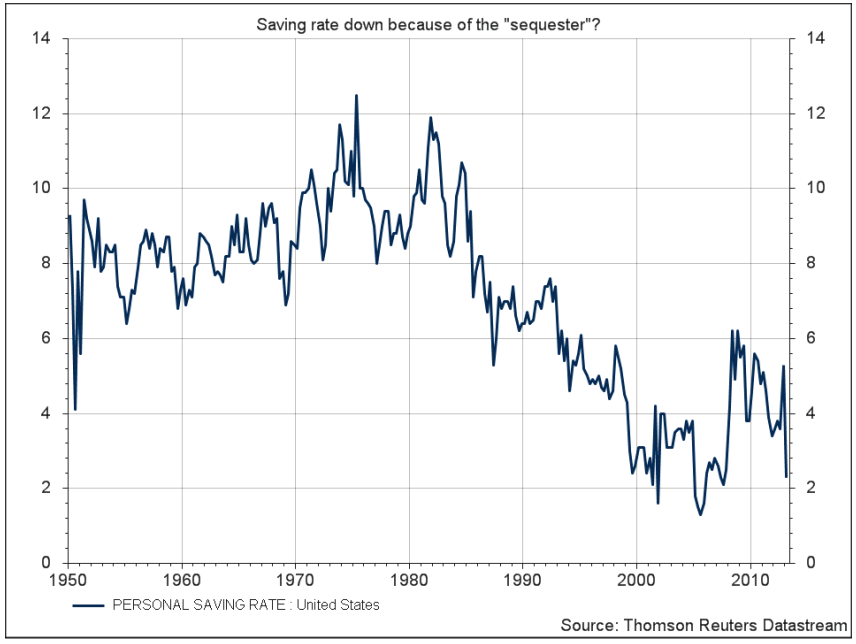
Curiously, while industrial confidence is sliding consumer confidence remains in an upward trend and is currently at its highest level since the 2008 financial crisis.

True, as a leading indicator, consumer confidence tends to be less useful than industrial confidence. On the other hand, the current level is from an historical viewpoint very low and, as such, it tells us two things: 1) there is an huge upside potential in the event of positive external shocks (such as e.g. new energy opportunities); 2) US families remain overall inclined to reduce their debts and maintain relatively high savings rates.

Is the significant drop of the Q1 savings rate, close to the pre-crisis levels around 2%, able to provide an additional boost for GDP growth? For sure reduced private savings are currently compensating for the increased fiscal drag. Decreased savings might even indicate that households are confident that the increased drag is temporary and that the economy will continue to grow through 2014.

It is, however, premature to argue that the US households deleveraging cycle is over. It is more correct to argue that the savings rate might stabilise at a higher level even if the chart leads us to believe that we are stabilising at lower levels. We see this as being a function of the sequester. This means that the US growth rate will remain moderate for the next years to come.





Economics / GDP - Growth

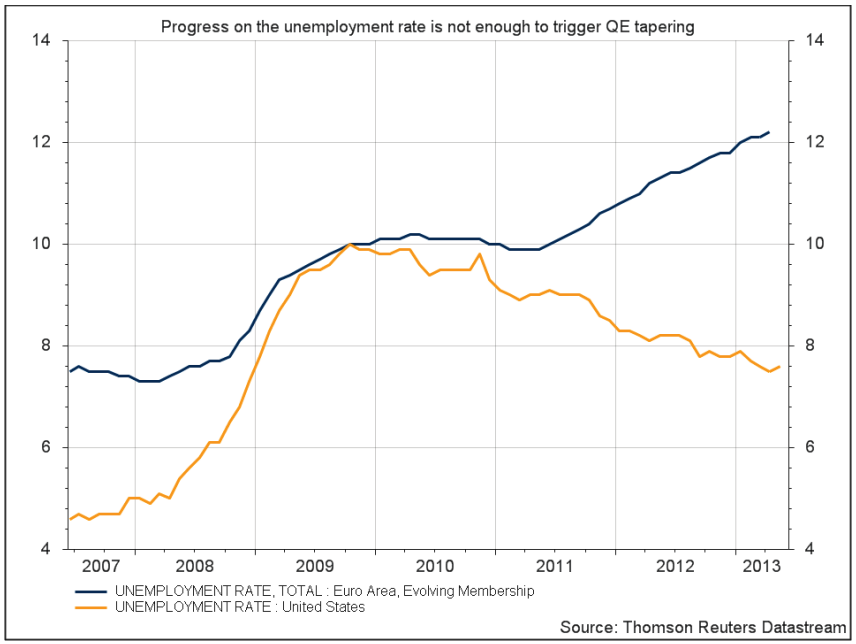
USA Unemployment

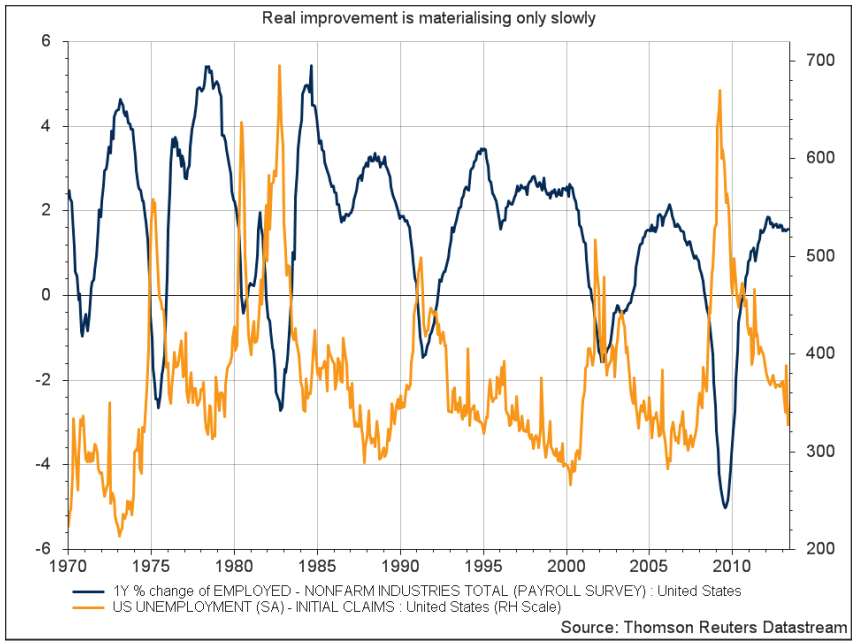
It is true that the labour market has now become a formal target of monetary policy. The Federal Reserve Open Market Committee went so far as indicating that interest rates will not be raised before the unemployment rate reaches the 6.5% level. At the current growth pace, such a level will not be reached before the end of 2014.

The Federal Reserve is now indicating that it could gradually start exiting (tapering) QE3. We believe that this will occur only gradually and that, as such - and in spite of recent yield spikes - bond markets will remain well behaved. Indeed, the mere reduction of the unemployment rate is not enough to start tapering. To be sure that the recovery will be sustainable, the Federal Reserve will also look at other data, such as the overall labour force and monthly payrolls.

A permanent stabilisation of initial jobless claims would be one important indicator of progress for Mr. Bernanke. A monthly annual employment level change around 2% would also be helpful. This would mean that the labor market creates every month around 250'000 new jobs.

Over the last six months the labour market has gone close to that average. Yet, since the 2008-2009 recession there have often been reversals in the speed of job creation. As such, the Federal Reserve will remain prudent before certifying a "substantial improvement in the employment outlook". The point is, we have still not reached these targets.





Economics / GDP - Growth

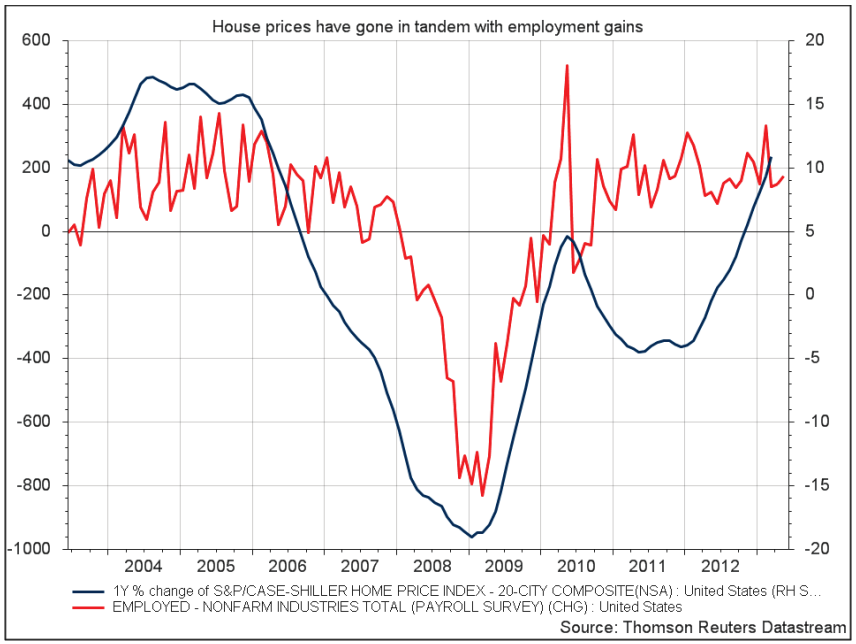
USA Real Estate

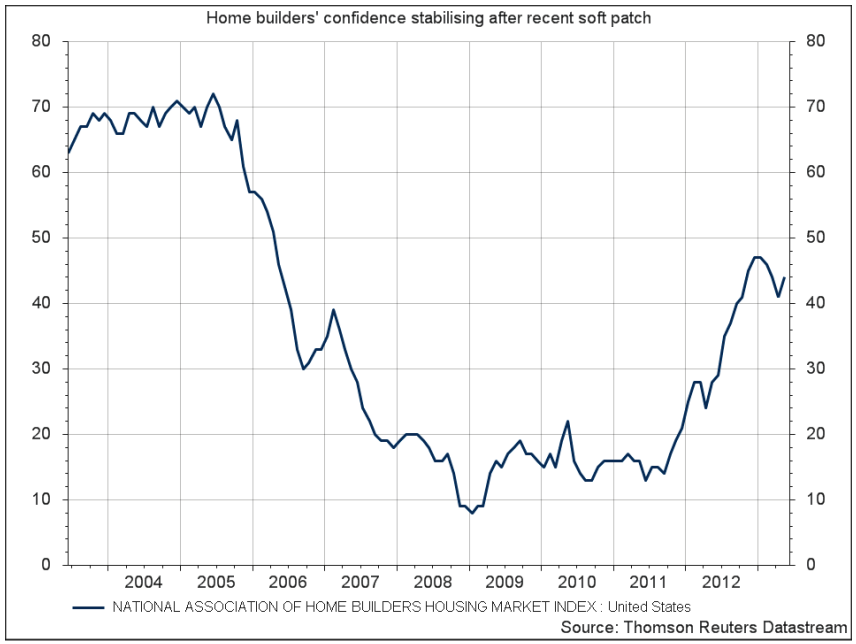
The improvement in house prices, although from a low level, is truly encouraging. In fact, without a corresponding pick-up in prices, the current upswing in housing construction would not rest on a solid basis.

The housing sector today constitutes only 2% of GDP, compared to 6% before the financial crisis. Yet, housing is highly cyclical and could thus make a major contribution to further improving the labour market, even if its weight is no longer what it used to be.

Unfortunately, the NAHB Housing Market Index has stalled its massive 2012 rise. It needs pointing out however, that after the soft patch registered since the beginning of the year, the index is now showing signs of stabilisation.

This improvement is clearly also a function of the continuously positive trend in house prices, which would be compatible with a further rise in confidence. Clearly, the NAHB Housing Market Index has become an increasingly important leading indicator, not less so than the more often quoted ISM and Chicago Purchasing Manager indices.





Economics / GDP - Growth

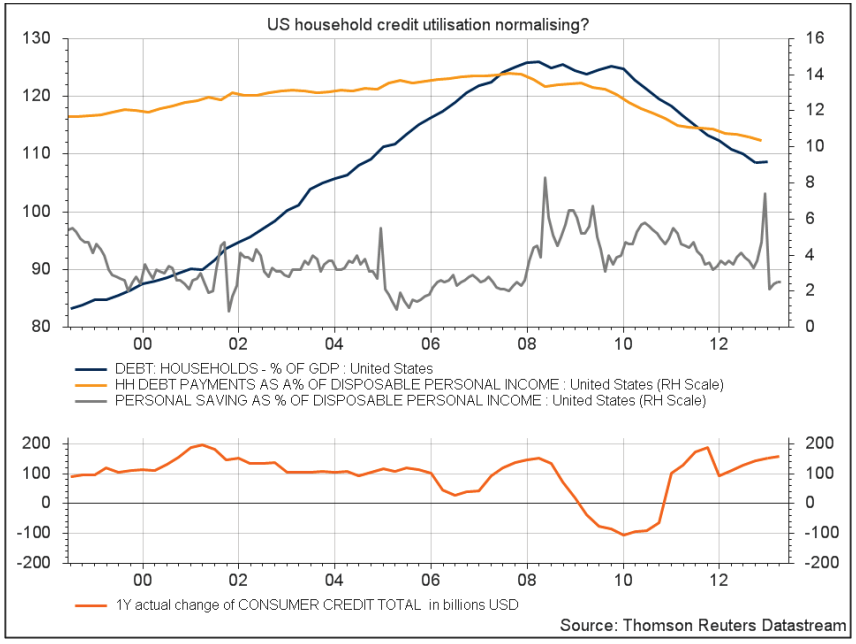
USA Further Statistics

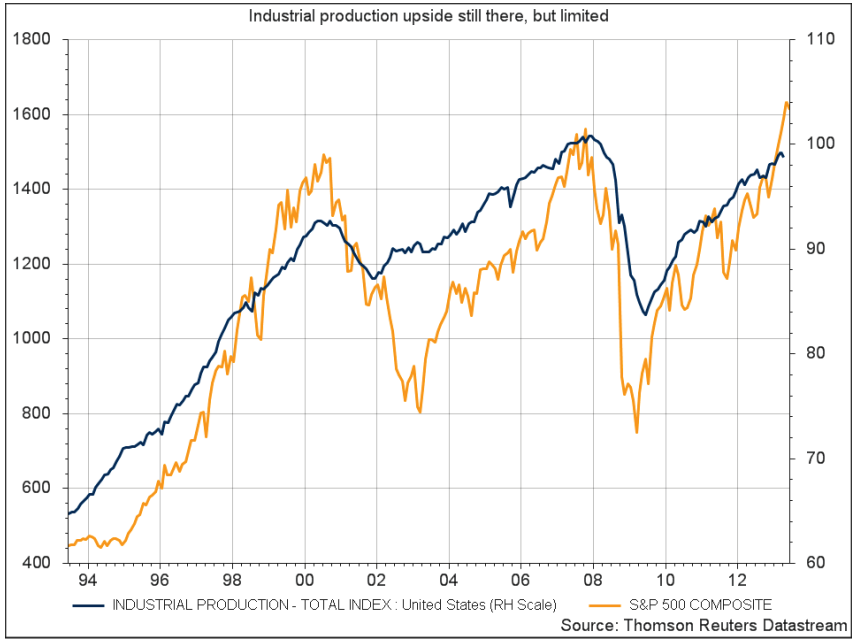
US household debts have staged a spectacular reduction as a share of GDP. This successful development can be attributed to two factors. First, and in spite of the recent drop discussed on page 10, the savings rate has permanently moved up from the record low levels between 2005 and 2008. Second, quantitative easing has decisively repressed deflationary expectations, although recent downward inflation trends are raising some concerns. As such, the savings rate's increase, while stable, has not been extreme and the economy has continued to grow, albeit at relatively low levels. Also, because of moderate inflation the real value of the debt has gone down.

US household deleveraging has, however, not come to an end. It is more likely to continue at the current moderate pace. As a result, growth will also remain moderate.

There is still some upside to industrial production. Key drivers of industrial production in the US are the housing sector, the shale energy revolution and the car industry.

There is also increasing evidence of some degree of repatriation of manufacturing activities previously outsourced to developing countries, in particular China. This phenomenon is a function of China's increasing wages, as well as overall cheaper factor conditions in the United States.





Economics / GDP - Growth

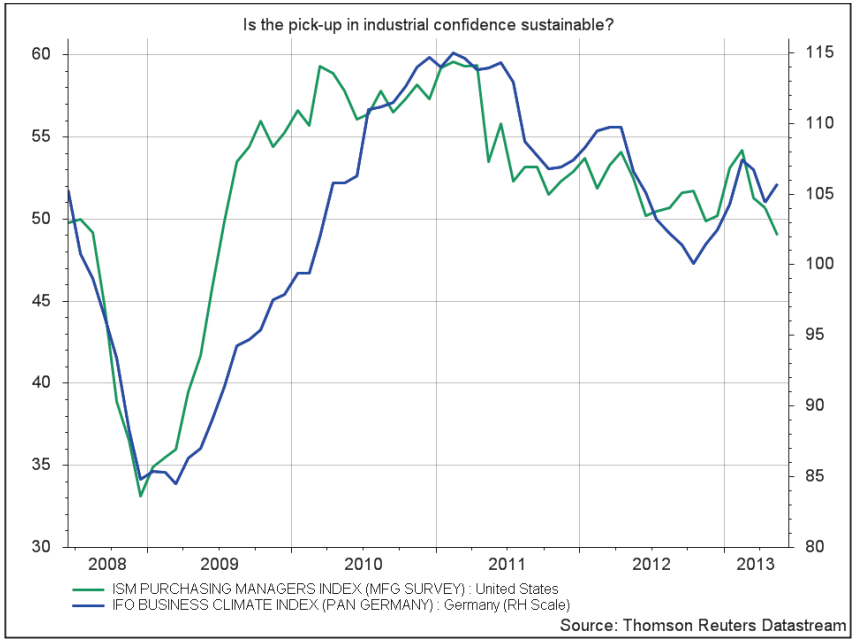
Europe German IFO-Index

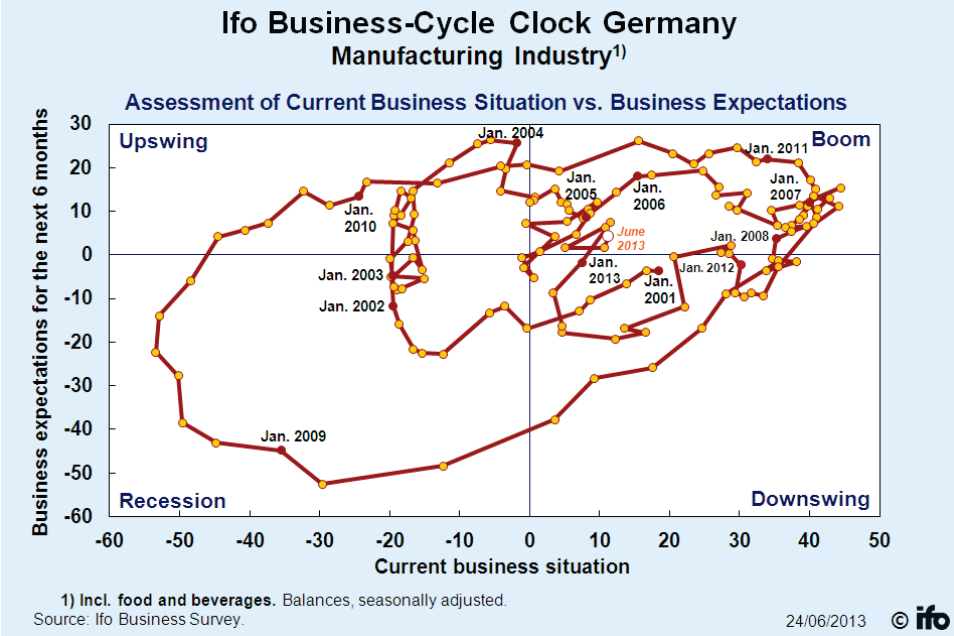
Finally the important German business confidence indicator IFO has improved. Healthy demand from Germany, Europe's biggest economy, is very important if the periphery economies are to emerge from recession.

The key question is, of course, the sustainability of the pick-up in the IFO. The IFO reflects confidence in the manufacturing industry. Given the dire state of Europe's economies, such confidence can only come from export demand out of Europe. It is thus critical that the ISM (the "American IFO"), reverses its recent decline. We would expect that to happen some time later this year. In the meantime, however, there is a good chance Germany's economy slows down again, and the IFO with it.

The Ifo Business-Cycle Clock has always exhibited a remarkably stable pattern. Clearly, the circular movement from upswing to boom to downswing, recession and back to upswing, does not recur with exactly the same regularity as that of a Swiss clock. Yet, it is clear that the German business cycle is currently hesitating between the continuation of a moderate upswing, or a further retrenchment in line with Europe's generally sober mood.

It is likely that Germany's economy, and with it the Euro-zone as a whole, will avoid to remain in 2013 in negative territory. However, growth will remain extremely sluggish and the overall situation in Europe will be more ugly than beautiful.





Economics / GDP - Growth

Europe Further Statistics

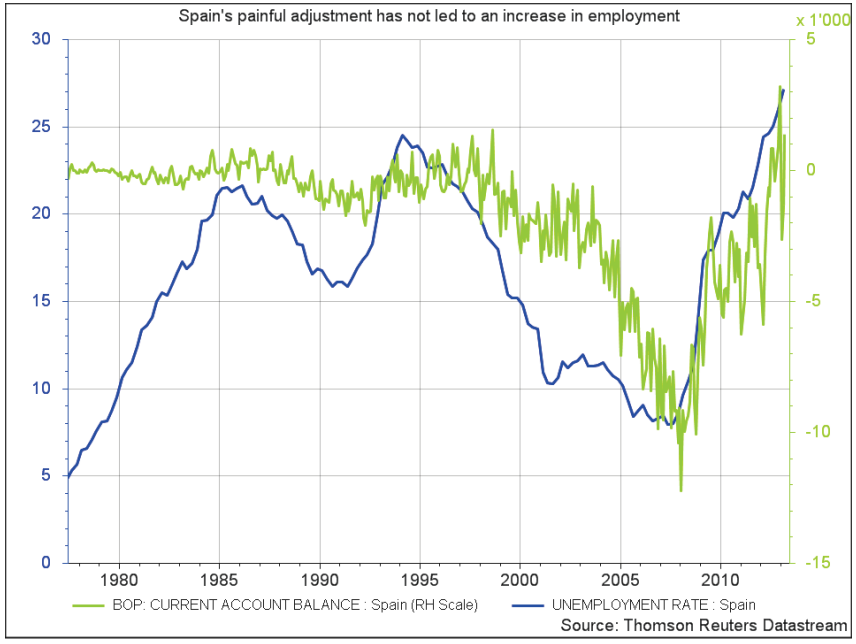
Germany is not only dependent on the pick-up of demand from the United States. Critically important German export items - such as for instance luxury cars - depend heavily on demand from the growing middle class in China.

Thus the structural slowdown in demand from China reflects a real long-term problem for the German economy. A closer look at China's trade volumes show that they are closely associated with manufacturing confidence both in Germany and the United States. It sheds additional doubts on the sustainability of the recent up-tick in manufacturing confidence in Germany.

Spain has been among periphery economies plausibly the most successful in pursuing "internal" devaluation. The reduction in labor costs is, in fact, reflected in the improvement of the country's current account (which is, however, also partly determined by reduced demand).

It is important to observe that austerity and the reduction of labor costs have so far only been able to adjust periphery economies' external accounts. They have not been able to reignite growth. As such, demands for more progress on banking union will continue. The core countries are likely to very slowly accept such progress, but with additional demands for - and controls on - reform.





Economics / GDP - Growth

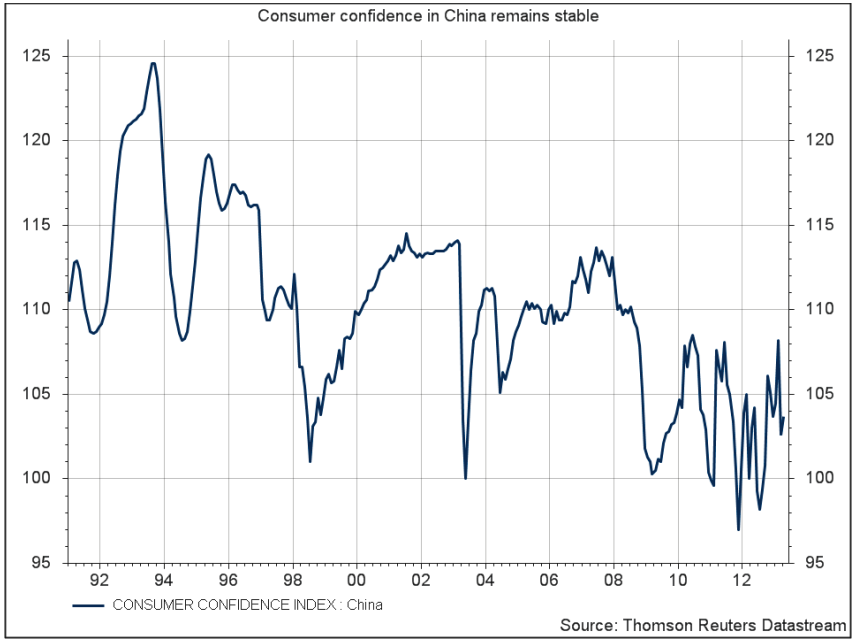
China Cons.Confidence/GDP

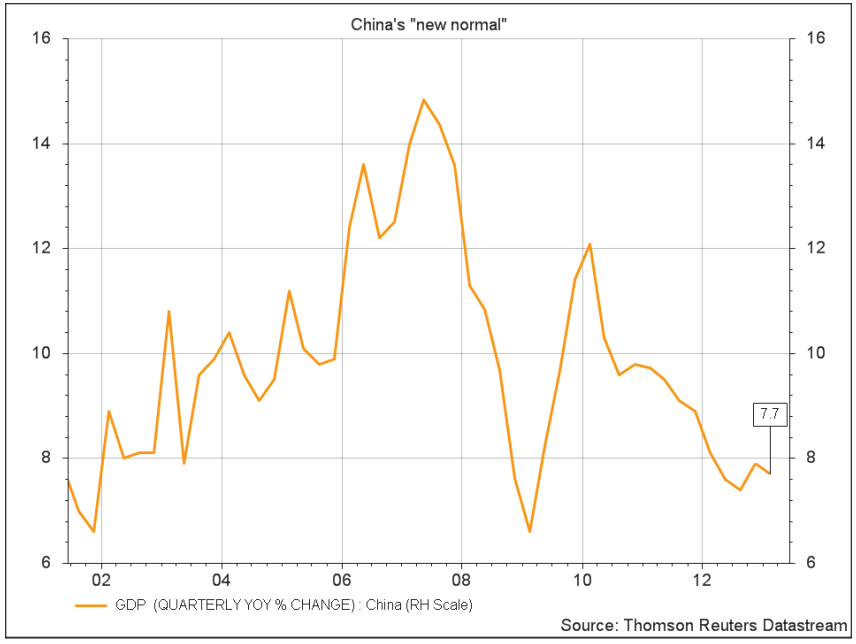
The transition to a new leadership has been relatively rocky. Yet, the fact that the Communist Party of China ultimately managed to pull it off again, may be another factor that has contributed to the recent improvement in consumer confidence.

Growth has recently stabilised, which also plays an important role. However, it should be pointed out that Chinese consumer confidence, volatile as it is, has been on a steady downward trend since the crisis. This trend clearly reflects an incapacity of the system to accommodate the rising expectations of Chines families. China, indeed, still struggles to satisfactorily increase domestic consumption and reduce its reliance on exports and investments.

The impact of the mini-stimulus, announced in September, has now run its course, and China is stabilising at its "new normal" growth rate, below 8%. Unfortunately the economy remains focused on the export sector and real estate (see also next page), and less on consumption spending.

Given higher internal wage levels and subdued growth in advanced economies, China is very unlikely to return to double-digit growth levels.





Economics / GDP - Growth

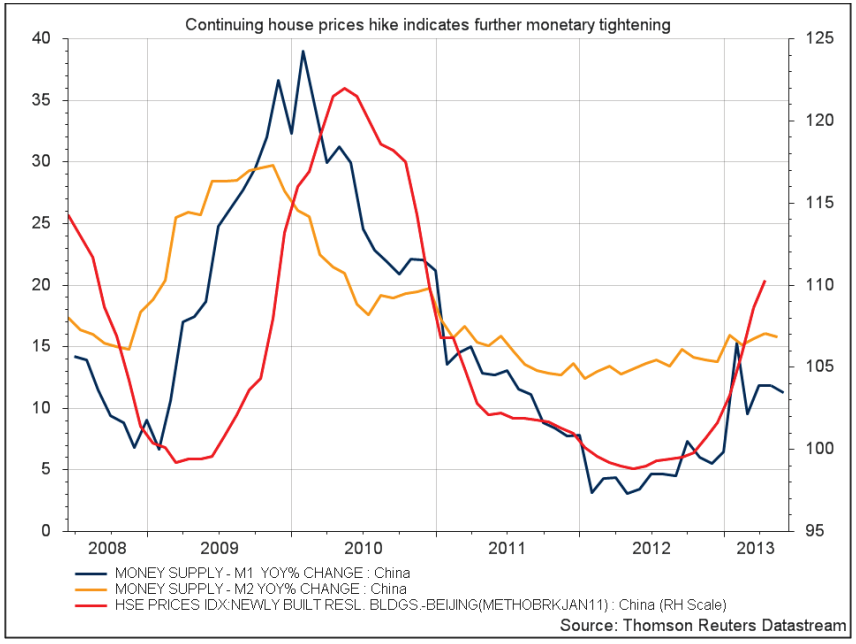
China Further Statistics

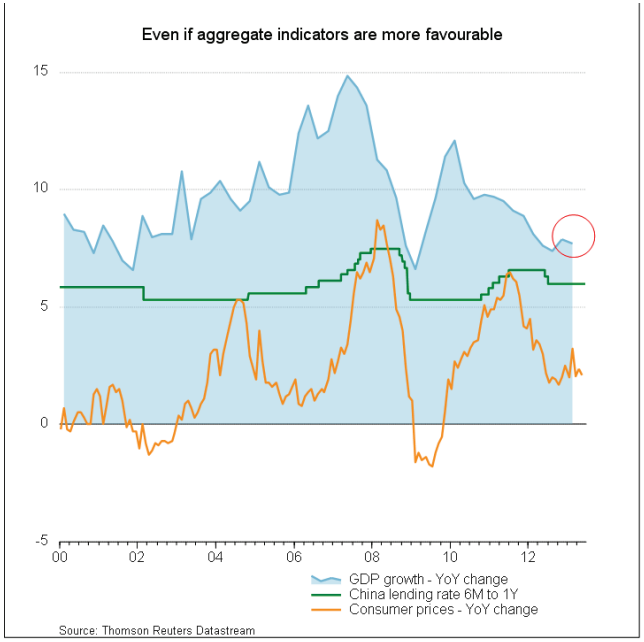
Historically when China manages a mini pick-up in activity, real estate prices exhibit maxi upswings. Speculation in the real estate sector remains a key concern for the Chinese government.

The recent spike in housing prices, plausibly the authorities' biggest economic concern, is likely going to lead to increased tightening, be it through administrative measures, be it - as can be seen below - through a reduction of the monetary base.

In spite of continuous expressions of concern by the Governor of the People's Bank of China (PBoC), inflation has remained generally subdued, in line with moderate economic growth.

Yet, while prices of goods and services remain well-behaved, the same cannot be said for house prices. Thus the PBoC might go slow when it comes to raising interest rates. It will act fast in different ways to combat rising house prices. These alternative actions are likely to keep the annual growth rate below 8%. And a further slowdown can no longer be ruled out.





Economics / Inflation

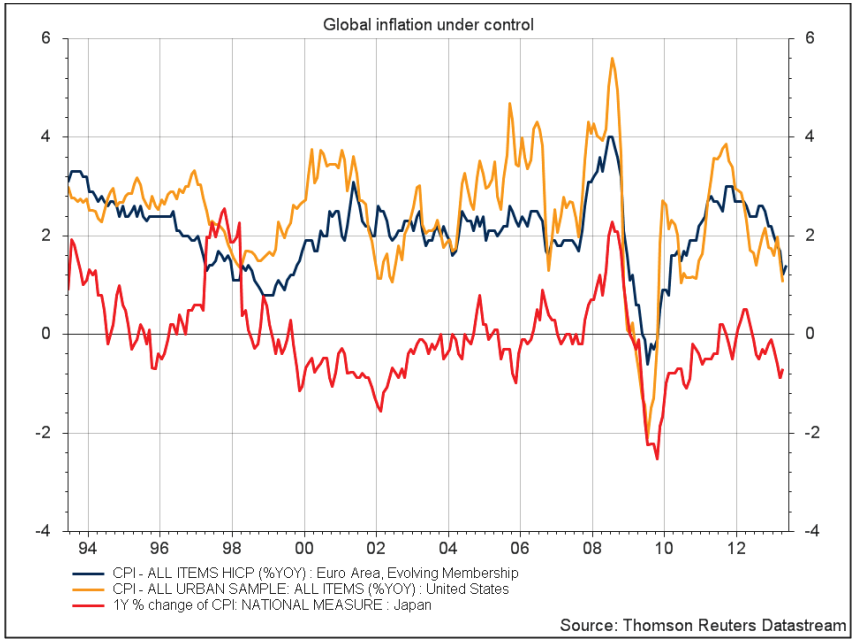
CPI

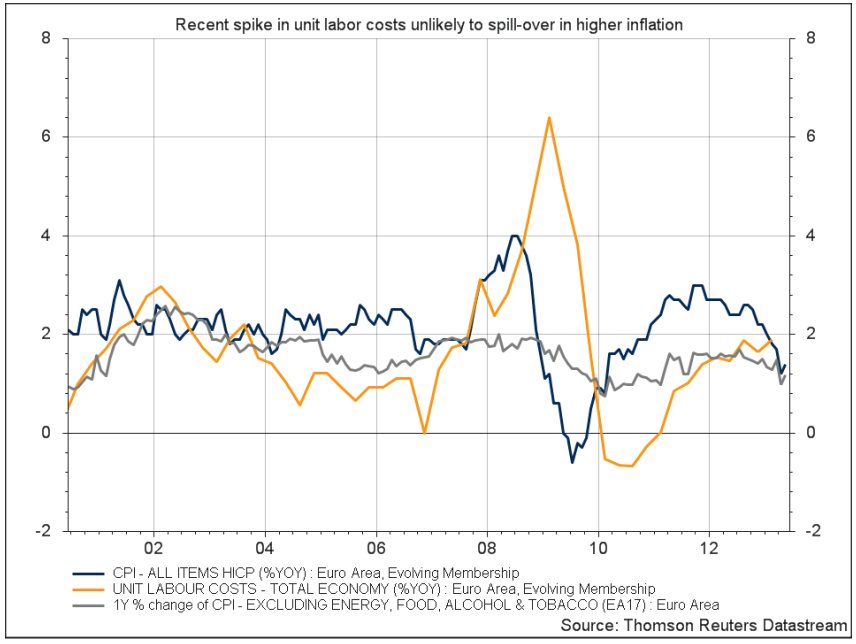
Inflation is globally under control. This ensures that central banks in advanced countries can, for the moment, pursue their policies of massive liquidity injection.

The clear risk, of course, is a repeat of the 2005-2008 experience: in the absence of goods and services inflation, asset inflation develops. We expect that, amongst major central banks, the Federal Reserve will be the first to gradually reduce liquidity. The ECB might be forced to add liquidity some time later this year.

Inflation in Europe is particularly subdued. The recession, in fact, is having a chilling impact, not only on prices of goods and services, but also on wages.

This makes it easier for the ECB to further reduce its reference rate. It must be said that, given currently low rate levels, such a move might not necessarily do a lot to stimulate more credit in Europe's troubled periphery. Yet, it might have the advantage of putting further downward pressure on the euro versus the US dollar. If the situation in Europe remains sluggish, another rate reduction is on the cards.





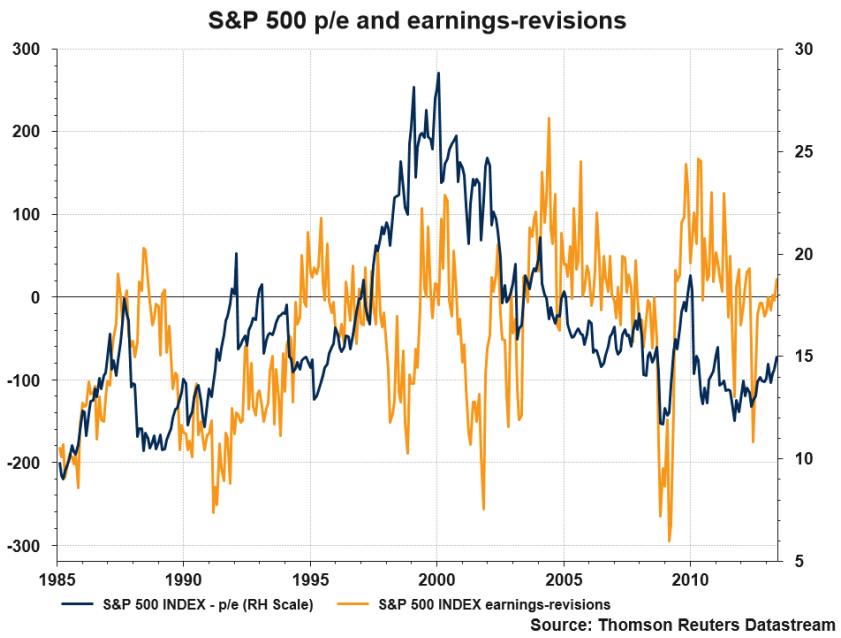
Asset Class Expectations / Stockmarkets

USA: S&P 500

1580

Fundamentals:
Ongoing discussions about the planned tapering of QE and the extent of the actual pick up in yields could act as a drag on the US equity market. The recent rise in yields is expected to stall due to a continued fragile global economic environment. There is however potential for upside surprises given the strong domestic US economy.
The valuation of the US equity market with a p/e ratio of about 15 is at its long term average.
Downside earnings revisions look like they are coming to an end and we are expecting upward revisions. That should support the equity market.

Technicals:
The bull trend in US equities, which has been in place since November 2012, stalled in May 2013 and has broken its up trend in the middle of June 2013.
We are expecting a further correction towards 1500 in the S&P 500. This would reflect a 50% correction in an existing long term upward trend. Additionally this would constitute a return to the 200 day moving-average.
Towards the end of Q3 we are expecting a stabilisation at a lower level before resuming the bull trend in Q4.





Asset Class Expectations / Stockmarkets

Germany: DAX

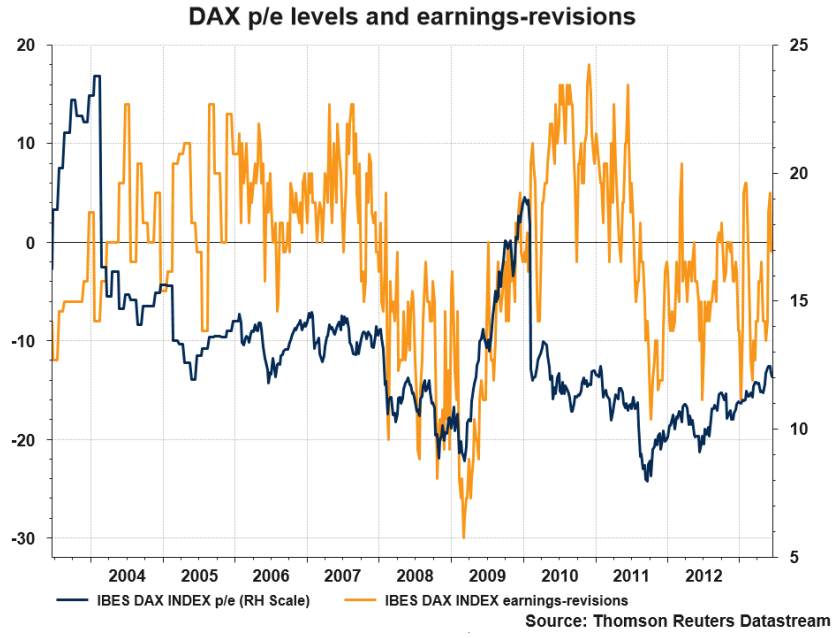
7500

Fundamentals:

The German economy is actually sliding towards recessive levels.
If Germany were to get back into recession, this could significantly affect the German equity market negatively.
With a p/e ratio of around12, the valuation of the DAX Index is in the lower to midrange of the valuation levels that we have seen in the last ten years. Earnings revisions are likely to have a positive impact on the market because there is a bias towards revising earnings higher.

Technicals:

Since September 2011, the German equity market has gained 72% starting at 4963, reaching 8557. This strong rally was only interrupted by two short corrections in February 2012 and March 2013.
Having made a new historical high in May 2013 at a level of 8557 a turn around pattern has been created. Since 28th of May the market has lost roughly 10%.
We are expecting further downside but it should be limited. A level of 7000 should not be passed on the downside and we are expecting to retest the recent historical high and potentially beyond.





Asset Class Expectations / Stockmarkets

Italy: FTSE MIB 14500

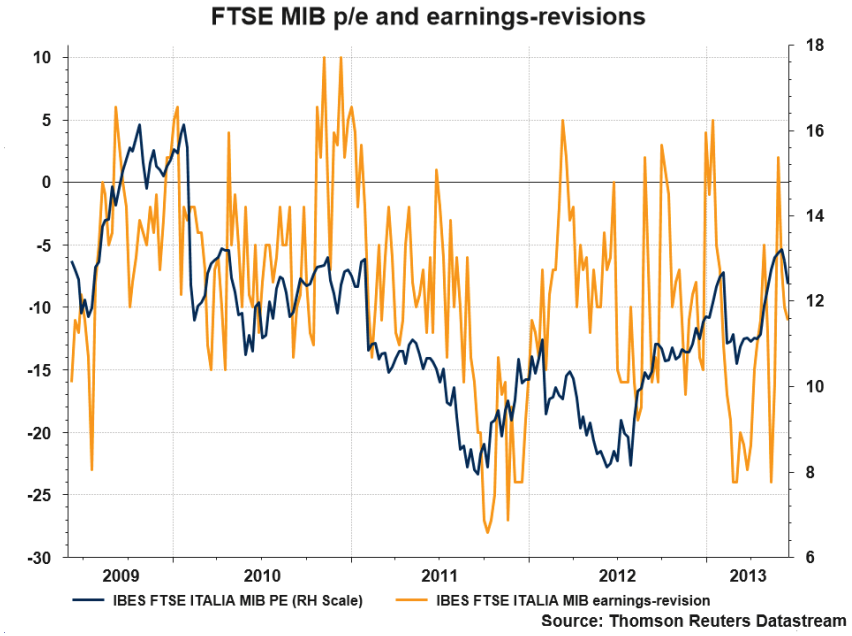
Fundamentals:

The Italian stock market did not pick up substantially in line with other major equity markets such as the S&P 500, DAX or Nikkei.
The Italian economy being in a recession and political uncertainty during the spring have been the main reasons for this situation.
The p/e ratio of around 12.5 is at an average level. Earnings revisions are very erratic and unstable.
The Italian stock market is highly dependent on the level of sovereign yields which have increased substantially during the last weeks.

Technicals:

The FTSE MIB has pushed below its important support at around 15,000. The historical low is at 12,300 which is not that much lower. There is a high probability to test this level again.

We are expecting to see prices lower in a range between 13,800 and 12,300.
A pick up towards year end is highly probable and should reach levels of 17,000.





Asset Class Expectations / Stockmarkets

Switzerland: SMI

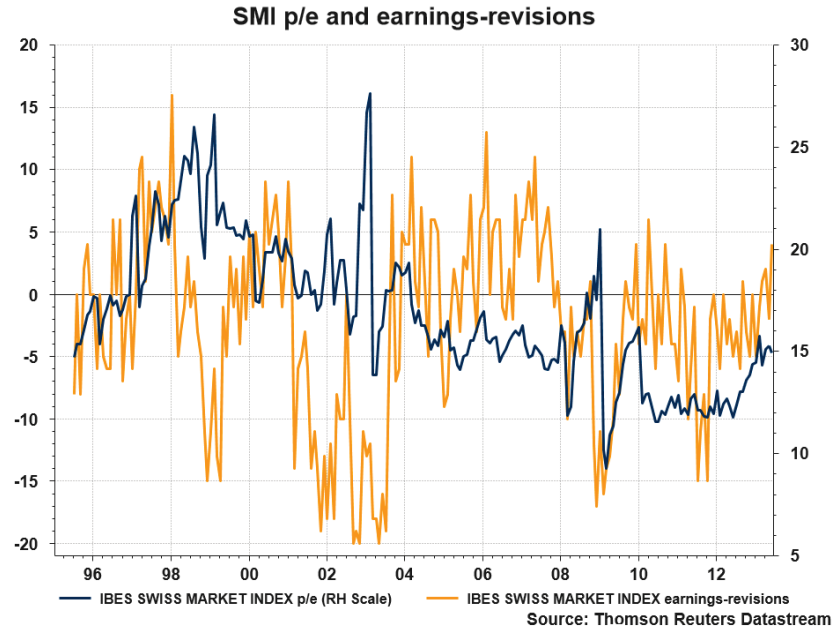
7100

Fundamentals:

The Swiss economy is one of the few economies which has reasonable economic growth rates. As Switzerland is acting as a safe haven, money is flowing into their capital markets and especially into the stock area, as long as yields are low (or even negative).
The p/e level is in the lower mid to average range and has to be judged as inexpensive. Despite a strong Swiss franc Swiss corporations are able to cope with this environment. We see a trend reversal in earnings expectations. The downtrend in earnings-revisions recently turned to an up trend, which supports the equity market.

Technicals:

The long term up trend has been broken but the 200 day moving-average line could still support.
As the up trend has been broken we see a probability for further downside towards the area near 6600, which would reflect a 50% retracement of the long term up-trend.
Longer term we are expecting a new leg higher to test the previous highs or even test the historical highs from 2007.





Asset Class Expectations / Stockmarkets

Japan: TOPIX

1050

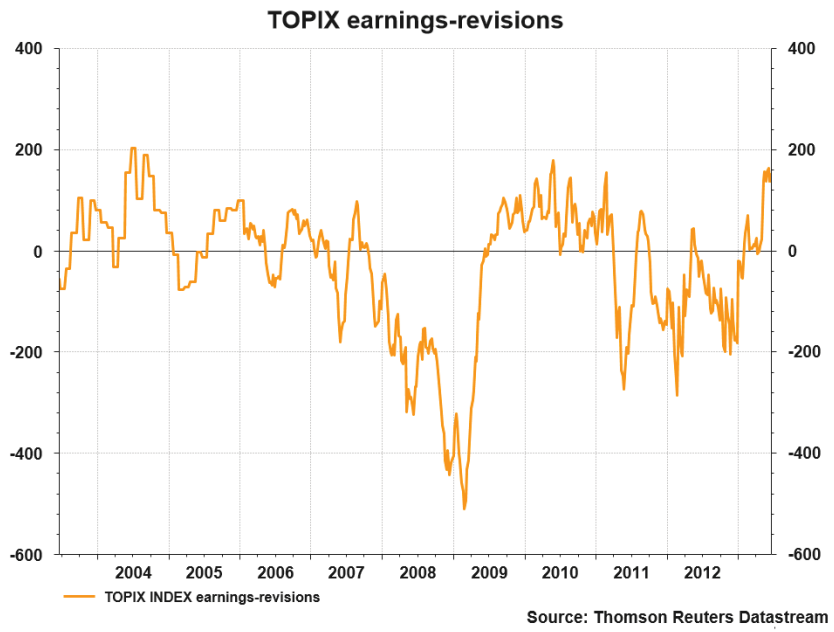
Fundamentals:

Between November 2012 and May 2013 the Japanese equity market went up by around 80%. However, Since 23 May the TOPIX has lost around 20%.

This uncertainty was based on a global yield pick up which has negatively affected the Japanese bond market. Additionally investors are concerned about so called Abenomics, especially the third arrow, where structural reforms have to be implemented.
The recent pick up in earnings-revisions is good sign for Japanese equities.

Technicals:

After the huge pick up we recently saw a pull back towards the area of the 38% retracement. Thus, the up trend is damaged but still in place and the the difference between the actual price level and the 200 day moving-average has decreased form 40% to 26%.
Technically speaking a further down trend towards 1000 is highly likely.



Source: Thomson Reuters Datastream



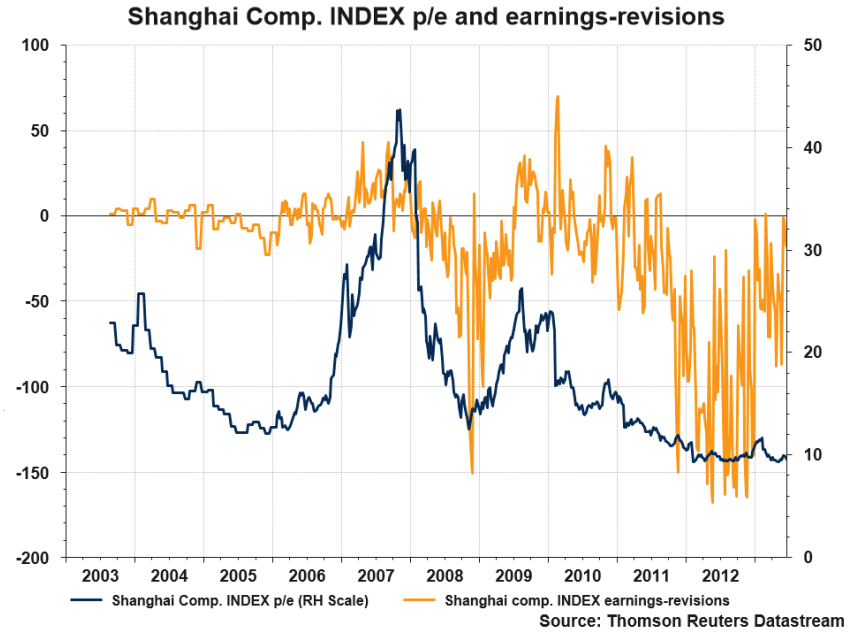
Asset Class Expectations / Stockmarkets — China: SHCOMP — 1850

Fundamentals:

The Chinese equity market is negatively affected by the weakening economic situation. The real estate market and credit markets are in a bubble and the People`s Bank of China is fighting against a further expansion in credit volume. Therefore interest rates are expected to increase. China is confronted with the risk of a credit crunch which would have a negative impact on the economy.
The valuation of the equity markets is quite low and earnings-revisions are in an upward trend. Despite these valuation metrics we currently see no evidence of support.

Technicals:

The Shanghai Composite Index has recently broken its important support level at 1950.
Chinese equities are in a major downtrend since July 2009.
The next support level from October 2008 is at 1664.
This level is expected to be tested. Of course it will not go down in a linear way, therefore we are expecting huge volatility with pull backs.





Asset Class Expectations / Commodities

Gold: 1100

Fundamentals:

The Gold price is highly influenced by the financial industry, especially from the ETF sector. Actually there is demand from several central banks but we believe that the influence of central banks is fading as many central banks from emerging countries are now confronted with current account deficits. Recently India`s authorities raised taxes on purchases of Gold, adding further downside pressure. Another important factor is the influence of yields. If yields pick up further, the Gold price should be affected negatively (see chart below). However, if the economic situation, especially in the US, were to surprise us negatively and yields were to come down significantly, gold could potentially enter into a "renaissance" and pick up substantially.

Technicals:

After the important push below the support level at 1525 USD, we saw a massive draw down towards 1321. This draw down was followed by a consolidation phase of two months. On the 20th June this consolidation phase was broken to the downside. At the time of writing, we are at 1225.

The major down trend is still in place and we might possibly reach levels between 1000 and 1100 within the next quarter.





Asset Class Expectations / Commodities

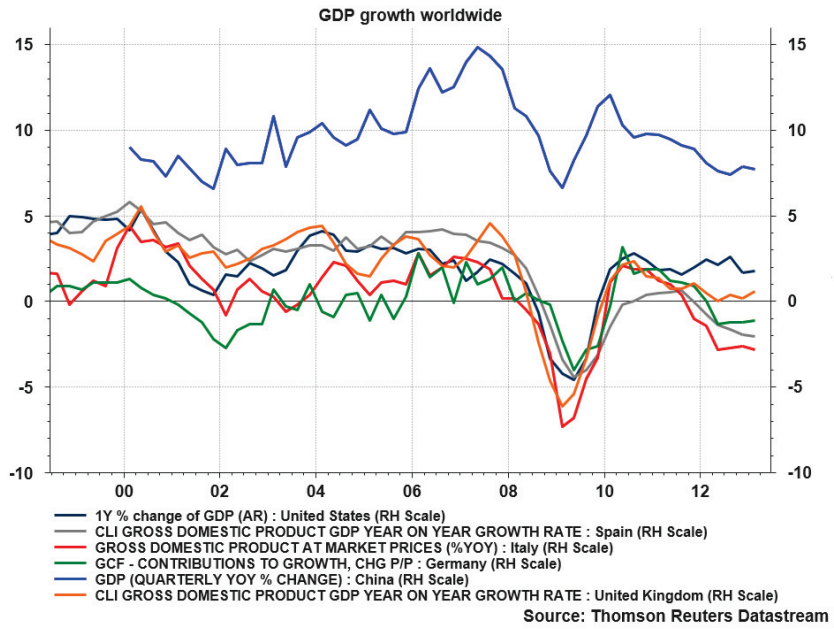
Industrial Metals: 230

Fundamentals:

Industrial metals are usually more related to the real economy, therefore it is very important to follow economic trends quite carefully.
Globally speaking we are in a slow growth environment. We have to be particularly vigilant about the Chinese economy because China is the biggest commodity purchasing country world wide. Unfortunately China's economy is weakening and has serious problems to maintain its growth path.
As a result we are expecting a further down trend in Q3 towards 220.

Technicals.

Since the beginning of 2011 industrial metals are in a long term down trend. As expected industrial metals have ended the quarter close to our Q2 target of 250 (27 June at 255).
We recently pushed below the retracement level of 262. The next support level is now around 175.
The 200 day moving-average line is falling suggesting further weakness.





Asset Class Expectations / Commodities

Brent Oil: 95

Fundamentals:

The economic situation is not supporting the oil price. Additionally we have to take into account the additional supply from the US shale oil industry , which is not seen in global oil supply (the exception is oil exports to Japan). However, it affects the demand side negatively, therefore Brent Oil will face headwinds.
It is remarkable that the spread between WTI oil and Brent oil decreased since February from 23 to 6 US$, at a time where geopolitical tensions in the middle east e.g. Syria, Iran etc. are still ongoing.

Technicals:

Brent oil is actually trading within a corrective trading corridor between 100 US$ and 107 US$. It came down from 120 in February.
If we are able to break the recent low at 99.67 we see a potential downtrend towards the region of 90.



Asset Class Expectations / Bonds

USD Bonds: T-Note

2.25

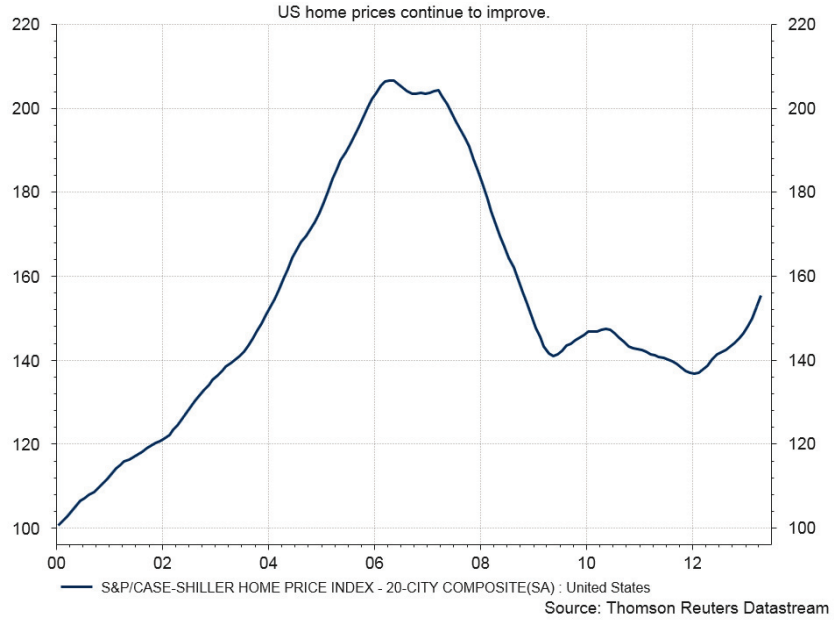
Fundamentals:

As mentioned later in this report, there has been a dramatic improvement in the US annual budget deficit rising from -10% in 2009 to only -4% now. If we combine this with the improving unemployment situation and the clear pick up in the housing market, we are led to believe that the US economy is in a relatively robust economic state.

Thus, although it is too early to call an end to the 30 year bear market in yields, we anticipate that there is likely to be support at lower levels, closer to the 2.250% region. Even though a mild downturn is expected over the next months we expect this to be swiftly discounted and thus lower yield levels should have a floor near the 2.000% level.

Technicals:

US 10 year yields had been trading in a daily rising channel until the end of June. The violent break higher that followed next targets the falling trend-line off 5.323% currently at 2.745%. We would need to see a sustained break over this trend-line to suggest that we are forming a base and that the 30 year bear market in yields is indeed drawing to a close.
In the meantime we favour a short-term test of the aforementioned falling trendline, followed by a relapse lower towards the 2.250% region, where a degree of support would be anticipated, in line with the evolving recovery structure seen since 1.379%. Back under 1.612% (01/05/2013 low) is required to negate our current bullish stance.





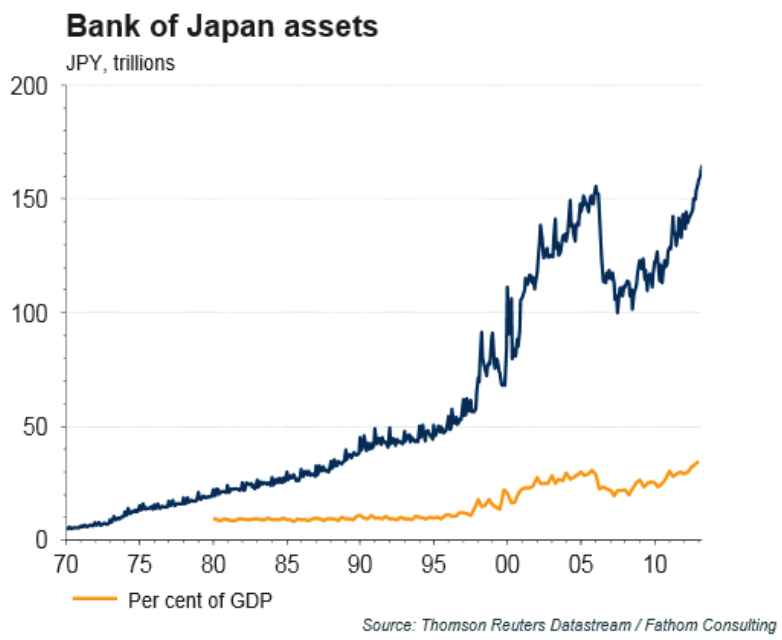
Asset Class Expectations / Bonds

Japan 10-yr: 0.77

Fundamentals:

The BOJ has entered into an asset buying frenzy of epic proportions. Although some short-term benefits are anticipated which may lead to a perception of a more stable economy, the longer-term benefits are questionable. This is particularly pertinent given the inflexible labour market and poor demographic back drop.

Given our time horizon of one quarter it is anticipated that yields will remain stable, but contained on the downside, in line with a generally buoyant global yield environment. For this reason we target an end of Q3 level of 0.800%.



Source: Thomson Reuters Datastream / Fathom Consulting

Technicals:

Japanese yields have risen dramatically after reaching the support of a multi-year falling channel. The subsequent push back over the 200 day moving average also led to a piercing of the channel resistance reaching 0.996% so far this year. The consolidation that has followed this break higher has been contained by the 200 day moving average. Although a push back down towards 0.650% cannot be ruled out, ultimately a fresh attempt at a return towards 0.996% is favoured.

In line with our expectations in other markets, that higher yields will not be maintained, we are targeting an end of quarter yield of 0.800%.



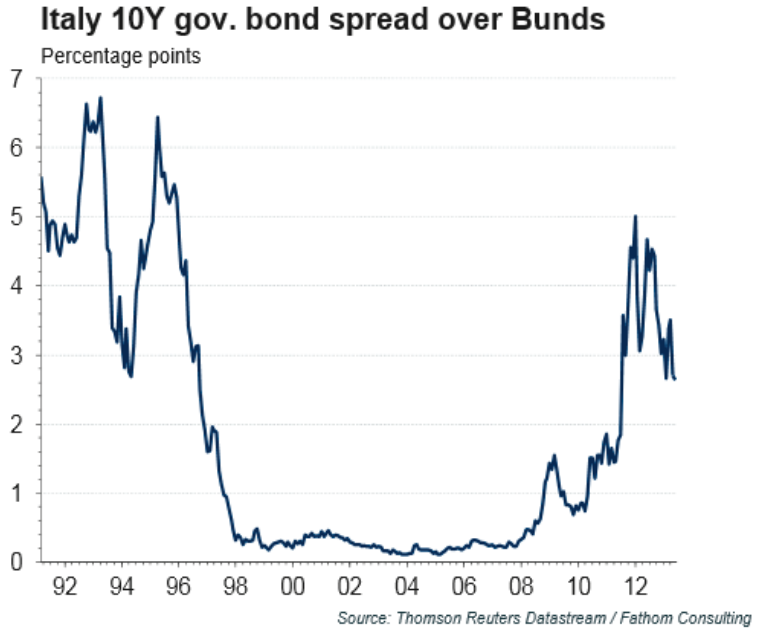
Asset Class Expectations / Bonds

Italian 10-yr: 4.25

Fundamentals:

After peaking at a spread of near 5% the risk relative to Bunds has been falling ever since. This is in part associated with the efforts of the ECB president to do whatever is deemed necessary to stop a disorderly rise in yields in the periphery.

However, although the spread to bunds has been improving we are sceptical about the ability of nations like Italy on the periphery of the Eurozone to undergo the economic shifts that are necessary if the outright yield in the 10 year maturity rises or remains elevated in line with the US 10 year. For this reason we anticipate a larger corrective phase in Italy with scope for an end of Q3 target near 4.200%.



Technicals:

Since the middle of 2012 Italian 10 year yields had been declining and in doing so the price pattern formed a daily falling channel. However, since creating a low at 3.676% (03/05/2013), the subsequent recovery has broken over channel resistance and also broken back over the 200 day moving average.

We anticipate a fall back down to the 200 day moving average ahead of a further swing higher. Bigger picture, the rise from 3.676% is currently seen as a correction higher, with scope for an eventual relapse down to lower levels. With this in mind we see the end of quarter yield level nearer 4.200%.Technicals:



Asset Class Expectations / Bonds

Eurozone, Bund: 1.60

Fundamentals:

As a widely recognised exporting nation, the health of the German economy is highly dependent on the demand for their products. Exports are close to contracting on a annualised basis (See chart below). This has the potential to have a detremental affect on GDP which is anticipated to put a degree of downside pressure on yields going forward. However, the influence of the US 10 year cannot be under-estimated. Thus although there may be a short term fall in yields, any such pullback is anticipated to be contained by the 200 day moving average. We thus anticipate an end of quarter yield below current levels.



Source: Thomson Reuters Datastream / Fathom Consulting

Technicals:
The Bund yield appears to be in a long term bottoming process. We anticipate that this process will continue as the 30 year bull market in bonds draws to a close. In particular we note the formation of a rising channel which has now been broken to the upside reaching 1.852% thus far. We are inclined to view this as a false break and look for a move back down to the 200 day moving average, currently near 1.459%, from where a further recovery in yields would be expected to begin.

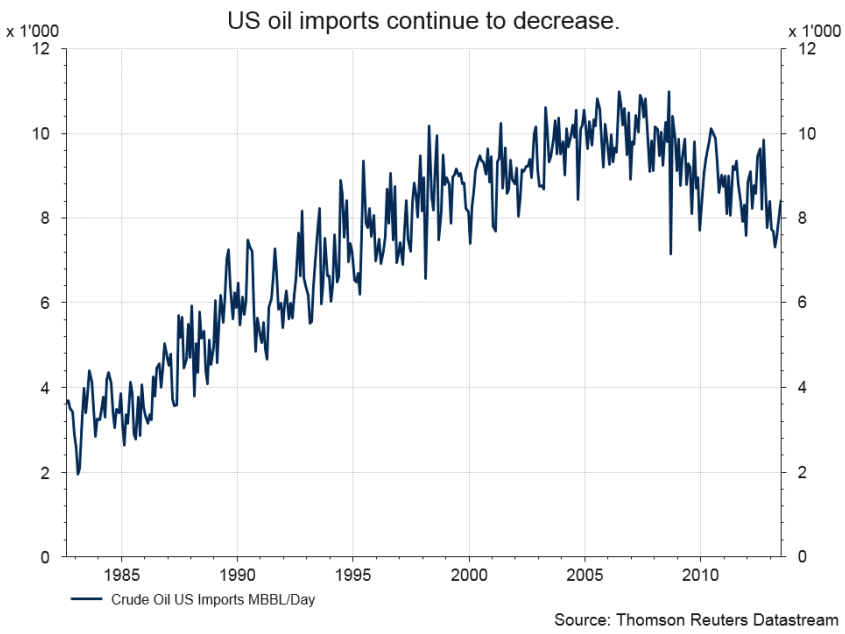
In any case, a higher low is anticipated versus 1.152% for a return to 1.852%. However, in line with our fundamental view we see an end of quarter yield at 1.800%, as part of a larger base building process.



Asset Class Expectations / Currencies

USD Index: 87.00

Fundamentals:
US oil imports are continuing to fall giving us direct evidence that the impact of shale gas is now having a real effect. We anticipate that shale gas volumes will continue to increase providing US industry with an energy advantage and also likely leading to a positive outcome when viewed from a current account perspective.
Furthermore we have seen substantial improvements in the US federal budget deficit. The annual budget deficit has been improving since reaching -10% in the fiscal year of 2009. Last year saw an improvement to -7%. Current estimates for 2013 are for a deficit of around 4%. This suggests a much stronger underlying economy then may at first be visible in coincident economic statistics. This supports our expectation of further strength in the US Dollar over the medium-term.



Source: Thomson Reuters Datastream

Technicals:
Contrary to our expectations at the beginning of last quarter, the USD Index has failed to break out of the large triangular consolidation pattern that has been developing over the last 8 years. However, we view the recent set-back from 84.50 as being a pullback in an evolving rising trend. With this in mind we expect the 78.60 level to contain the current correction, with a higher low anticipated for a fresh swing to retest the annual high at 84.50 (23/05/2013).

We remain longer-term bullish, viewing the price action over the last 8 years as forming a large base. We thus eventually seek a break over 88.71 to cement this base in place. Only a push back under 72.70 will lead us to change our long-term bullish bias.



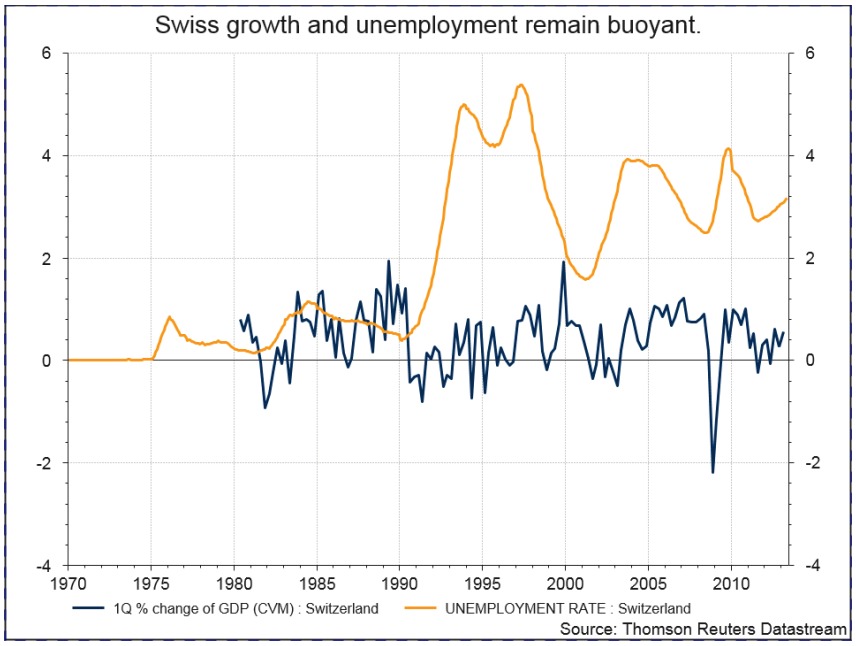
Asset Class Expectations / Currencies

USD/CHF: 0.99

Fundamentals:
The Swiss economy is heavily orientated towards its export markets making the Swiss economy particularly susceptible to a strong currency. The SNB also continues to vocally remind the market that it remains ready to defend its exchange rate, referring to the floor that has been placed in EUR/CHF at 1.2000. Furthermore, the negative interest rates available to foreigners on Swiss Franc holdings is still in place.
However, despite all of the above we are faced with an economy that is continuing to have strong GDP growth and low unemployment. It is thus difficult not to think of the boy that cried wolf when assessing the Swiss economy. For this reason the Swiss Franc is anticipated to depreciate against the US dollar, but potentially at a slower rate than many of its peers.

Technicals:
The recent failure to make a swift return to the annual high at 0.9839 coupled with the break under 0.9207 suggests that we remain within the midst of a larger corrective phase with scope for a retest of the 0.9022 area. Should this region be tested again, strong support would be anticipated, for a substantial recovery higher.

Longer term a return to 0.9839 is anticipated in line with our expectations for the USD Index. Failure to remain above the 0.8568 key low (27/10/2011) would suggest a considerable weakening of the current bullish structure, leading us to neutralise our bullish bias.



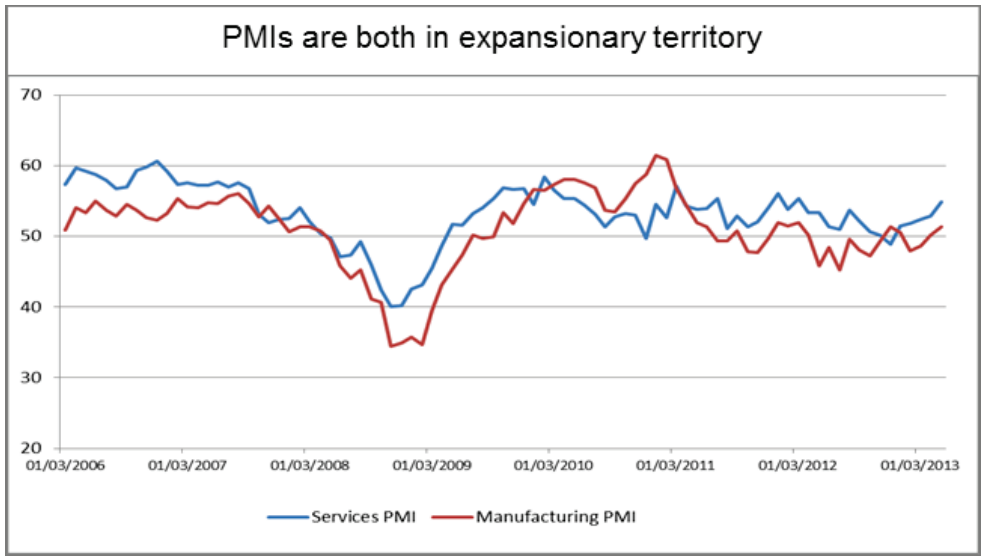


Asset Class Expectations / Currencies

GBP/USD: 1.50

Fundamentals:
We remain of the view that the large depreciation in Sterling versus the US Dollar has already taken place, back in 2008. The appointment of Carney as the BOE governor is not anticipated to dramatically change this. However, given our general view of the US Dollar, weakness is anticipated to return to cable.

The general economic environment has improved since our last quarterly report, indicating that the UK economy may have passed its low point, as can be seen in the recent PMI readings in the chart below. For this reason, we do not see a large depreciation in cable over the quarter, leading us to an end of period price level of 1.5000.



Technicals:
Cable saw a break out of a multi month convergent consolidation pattern, at the beginning of the year, reaching 1.4832 thus far. The recovery that has followed has tested the 200 day moving average, currently at 1.5696.

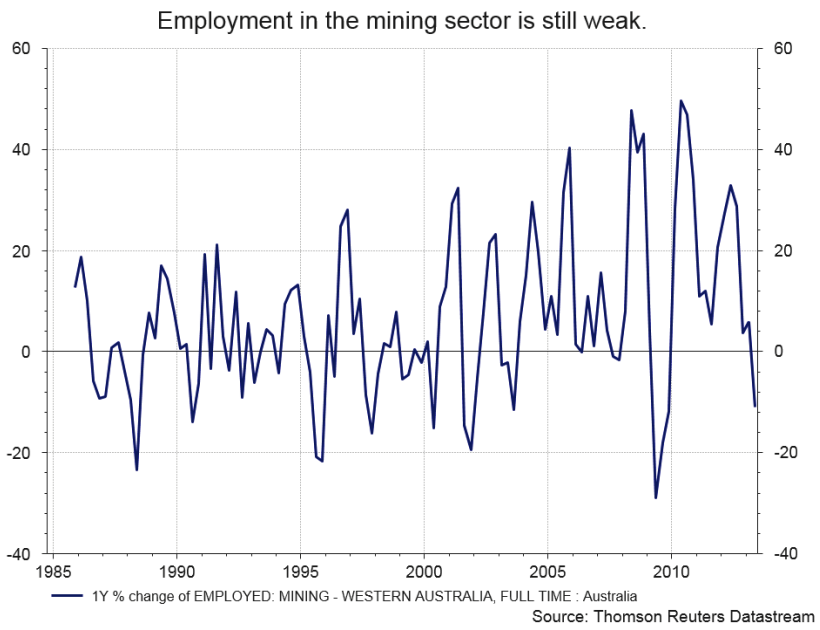
We now favour the initiation of a fresh medium-term weakening phase from the current region. However, the rate of sterling depreciation is not expected to be as severe as that which is anticipated elsewhere. Thus, despite the breakout of the consolidation pattern , we think a mildly bearish bias is warranted, in line with the weekly bearish channel detailed in the chart below.



Asset Class Expectations / Currencies

AUD/USD: 0.82

Fundamentals:
Over the last two decades the Australian economy has become heavily orientated towards the resources industry and has in recent years become dependent on demand from the Chinese growth story to justify its investment in plant and machinery. As the Chinese economy has slowed this investment is now perceived as a mis-allocation of capital with other sectors of the economy suffering as a result.
This is likely to lead to a swift and long overdue repricing of the Australian dollar, particularly considering the vast current account deficit that has been built up over the last 30+ years. Combined with an overvalued housing market, our long held analogy of comparing the Aussie to Sterling back in 2007/8, remains valid. With this in mind we also expect a swift move lower to mimic the collapse of cable back in 2008.



Technicals:
Our expectations of weakness in AUD/USD have come to fruition, with a large multi-month top now likely in place. As can be seen from the weekly chart below, we have seen a break out of the long standing triangular consolidation, coupled with a push under long-term trend line support from 0.6010 (2008 low).
The current short-term bounce from the 0.9150 region is deemed to be a corrective phase ahead of a fresh leg to the downside. It is also worth highlighting the 0.9388 level as it ties in with major highs and lows from 2009, 2010 and 2011. For this reason we now anticipate substantial long-term weakness, with potential for a swift move towards the 0.8067, 2010 low. Should the current corrective phase persist, we view the 0.9800 region as being a good strategic entry point for shorts.



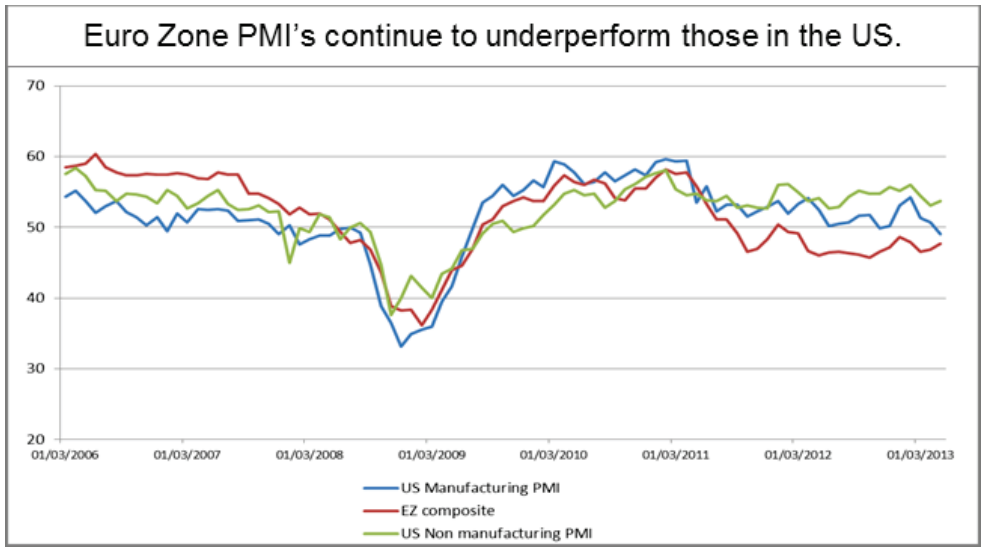
Asset Class Expectations / Currencies

EUR/USD: 1.24

Fundamentals:
Euro zone PMI readings continue to under-perform their US counterparts, suggesting that the growth dynamic is still heavily tilted towards the United States. It is also important to reiterate the swift improvement that has been seen in the US budget deficit over recent years.
This compares with a Euro zone that is still seeking to create a fiscal union of sorts, with initial steps taken towards a banking union. It is our view that the whole process is back to front; logically, a fiscal and banking union should be the first step towards a single currency region, not the final step. Evidence also suggests that the policy steps taken in the US are reaping some initial rewards where as the Euro zone remains mired in a low growth environment.

Technicals:
Given the dependence of the USD index on EUR/USD, our technical views in both of these assets are naturally going to be similar. Thus we see the recent rise from 1.2746 as a correction. With this in mind we would anticipate a lower high under 1.3711 in coming weeks, for a fresh swing to the downside, to initially retest 1.2746 and 1.2043 thereafter.

Assuming a break over 1.3711 does not materialise over the forecast period it is anticipated that progress will be made back towards the support of the multi-year falling channel, currently near 1.0700. With this in mind we target an end of quarter value at 1.2400.



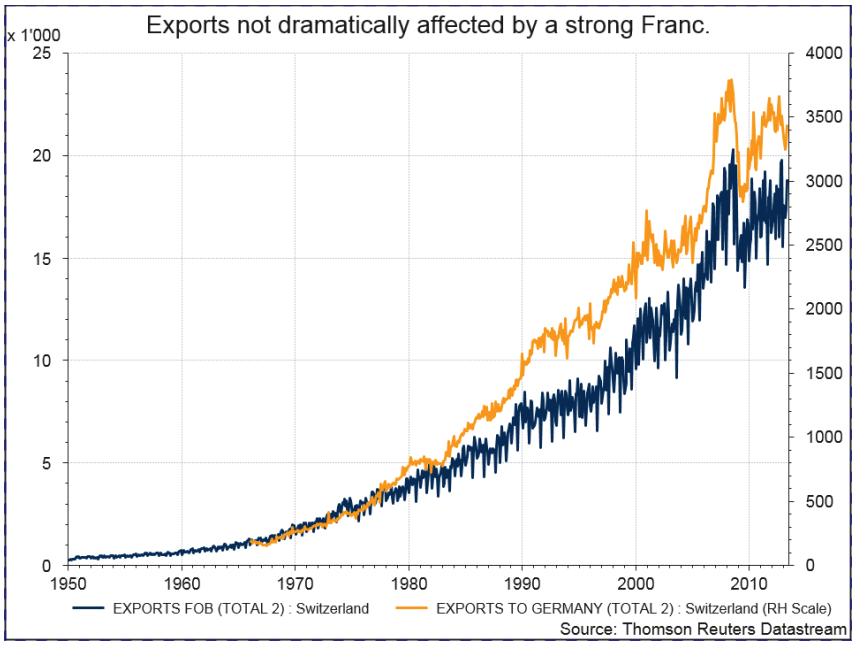


Asset Class Expectations / Currencies

EUR/CHF: 1.2550

Fundamentals:
Switzerland's largest trading partner is Germany. As can be seen in the chart below, the value of exports from Switzerland does not appear to have been dramatically affected by the strengthening of the Swiss Franc versus the Euro. In fact exports have remained surprisingly stable to all destinations, not just Germany. For this reason we see no real reason why the Franc should depreciate substantially versus the Euro.

Infact, should financial markets experience a severe dislocation in the coming quarter it is still anticipated that the Franc would act as a safe haven, even if less so than on previous occasions. For this reason we see limited upside, targeting the recent highs during the quarter and then falling back lower.



Technicals:
Our expectation of an end of Q2 price at 1.2300 has proved to be largely correct.

Although mildly bullish on this pair we have yet to see any dynamic price swings higher. The 1.2185 level remains key to further gains, with a push under this level negating hopes of further near-term upside. So, provided a foothold can be maintained above 1.2185 a fresh swing higher towards 1.2650 is anticipated over the next quarter.

Under 1.2185 will likely lead to a retest of the key 1.2000 level. We are targeting an end of quarter level at 1.2550. The scenario in mind is a return to the recent annual high followed by a relapse lower.



Asset Class Expectations / Currencies

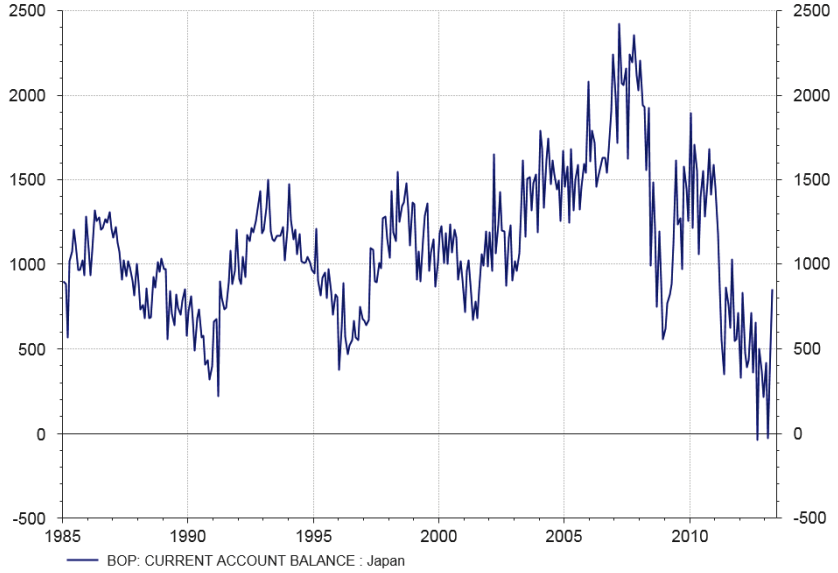
USD/JPY: 103.00

Fundamentals:
The so called three arrows behind Abenomics are having an initial impact on the profits of large scale manufacturers in Japan, with Japanese exports up by 10.1% in May when compared with the same month last year. However, if we drill down into the numbers we see that this is purely a function of a weaker Yen leading to non domestic sourced revenues converting to greater Yen values when repatriated. Volumes are in fact lower for the majority of these manufacturing companies. Given the above export analysis it is a matter of time before the Japanese try to increase market share via price cuts. This may yet trigger a true currency war.
We remain wary of the long-term ability of the Japanese authorities to simultaneously increase the money supply and also keep government bond yields contained.

Technicals:
In line with our expectations from the last report, USDJPY has indeed seen a substantial pullback. As preempted in the Q2 report, we view price levels close to the recent low at 93.79 as a good opportunity to reinstate long positions. In fact the key low at 92.57, which lies close to the 38.2% retrace of the 75.53 - 103.74 rise, is expected to offer substantial support, if tested. Failure here would see a re-test of the 200 day moving average, currently at 89.68.

In any case, we would expect a higher low versus 77.13, between 92.57 and 89.68, for a fresh swing back towards 103.74 initially and then onto our end of quarter target at 103.00.

Depreciation in the Yen is returning the current account to surplus.



Source: Thomson Reuters Datastream



**It's not about predicting the future
but rather about being prepared for it.**

Pericles, Athens 450 bc.

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