MAXIMUS CAPITAL

WEALTH MANAGEMENT

Maximus Capital S.A.

Global Outlook

January , 2012

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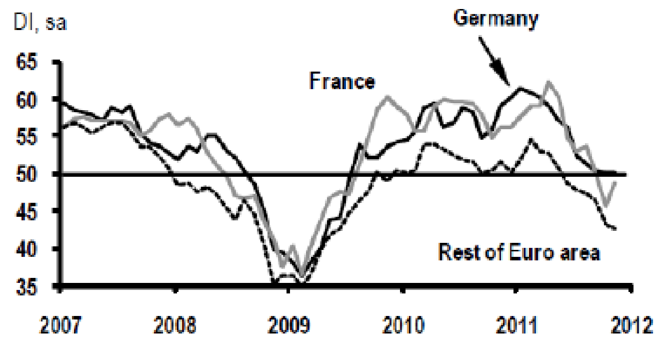
2011 was a year that most investors would like to forget. Even though equity markets are essentially flat year to date, the S&P 500 saw a 300-point range – a 9% rally followed by a 22% drop, followed by a 20% rally). Multiple events contributed to this: Japan floods, Arab spring, Peripheral Europe, and U.S. AAA downgrade. This year has truly been a "macro market" year, full of uncertainty and volatility. Investors looking for a respite from this type of market may be disappointed, as many of the same macro issues are likely to loom in 2012.

The outlook for the global economy in 2012 is clear, but unfortunately it isn't pretty: recession in Europe, anemic growth with significant downside risks at best in the United States, and a slowdown in China and in most emerging-market economies, because Asian economies are exposed to China; Latin America and Russia are exposed to potentially lower commodity prices (as both China and the advanced economies slow); Central and Eastern Europe are exposed to the eurozone. And turmoil in the Middle East is causing serious economic risks elsewhere – as geopolitical risk remains high and thus high oil prices will constrain global growth. One of the major advanced economies, the United Kingdom is double dipping, as front-loaded fiscal consolidation and eurozone exposure undermine growth In Japan, the post-earthquake recovery will fizzle out as weak governments fail to implement structural reforms.

Eurozone:

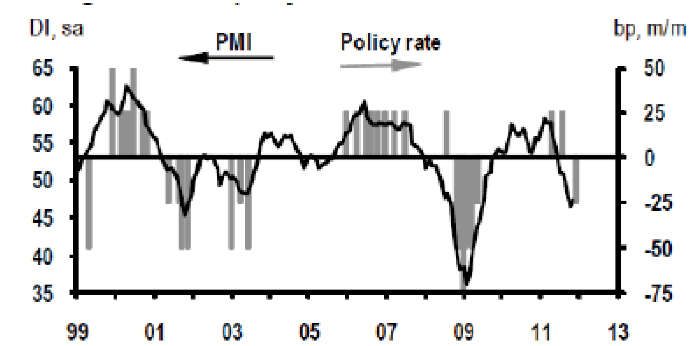
At this point, a eurozone recession is certain. While its depth and length cannot be predicted, a continued credit crunch, sovereign-debt problems, lack of competitiveness, and fiscal austerity imply a serious downturn. Standard&Poor`s said on Dec. 5 that Germany and France may be stripped of their AAA credit ratings as the region's crisis prompted the New York firm to put 15 euro nations on review for possible downgrade.

Figure 17: Euro-Area PMIs Point to Recession . . .
From "Global Data Watch" dated 11/25/11



Source: J.P. Morgan.

Figure 18: . . . And Likely Further Cuts by ECB
From "Global Data Watch" dated 11/25/11



Source: J.P. Morgan.

Eurozone GDP, at USD12.2trn, is not much smaller than the US's (USD14.5trn) and, as Europe is a more open economy, it represents a higher share of global trade. If Europe falls into recession, it will affect trading nations around the globe.

USA:

The US — growing at a snail's pace since 2010 — faces considerable downside risks from the eurozone crisis. It must also contend with significant fiscal drag, ongoing deleveraging in the household sector (amid weak job creation, stagnant incomes, and persistent downward pressure on real estate and financial wealth), rising inequality, and political gridlock. While recent data suggest that the economy is doing better – all signs are that GDP will have expanded at a 3% annual rate in the fourth quarter of 2011 – it is important not get carried away. Fiscal support for the expansion will continue to be withdrawn. And, while the housing market shows some signs of stabilizing, prices will remain weighed down by the large shadow inventory of homes in foreclosure and held by banks. Also 2012 year present additional risks to US economy. The first risk relates to spillovers from the economic and financial crisis in Europe. Around 20% of U.S. exports are destined for Europe, and the economic contraction will surely impact demand from that market. The second risk is tightening of domestic fiscal policy. The recession produced an unprecedented fiscal policy response, as the federal deficit increased to 10% of GDP. The political tolerance for such large deficits has lessened recently, and several temporary fiscal stimulus measures are set to fade in 2012, which could subtract one to two percentage points from GDP growth next year.

China:

China should grow by 7.5-8% in 2012. This is muddling through, considerably slower growth than the double-digit rates of the past. We are more pessimistic than institutions like the World Bank and International Monetary Fund, which anticipate Chinese growth in 2012 of 8.5-9% – forecasts that do not take into account the sharp cooling of China's housing market. Although weakening housing demand has not yet shown up in lower prices, the volume of transactions has fallen off dramatically. And where volumes lead, prices eventually follow. Flaws in China's growth model are becoming obvious. Falling property prices are starting a chain reaction that will have a negative effect on developers, investment, and government revenue. The construction boom is starting to stall, just as net exports have become a drag on growth, owing to weakening US and especially eurozone demand.

Markets Outlook

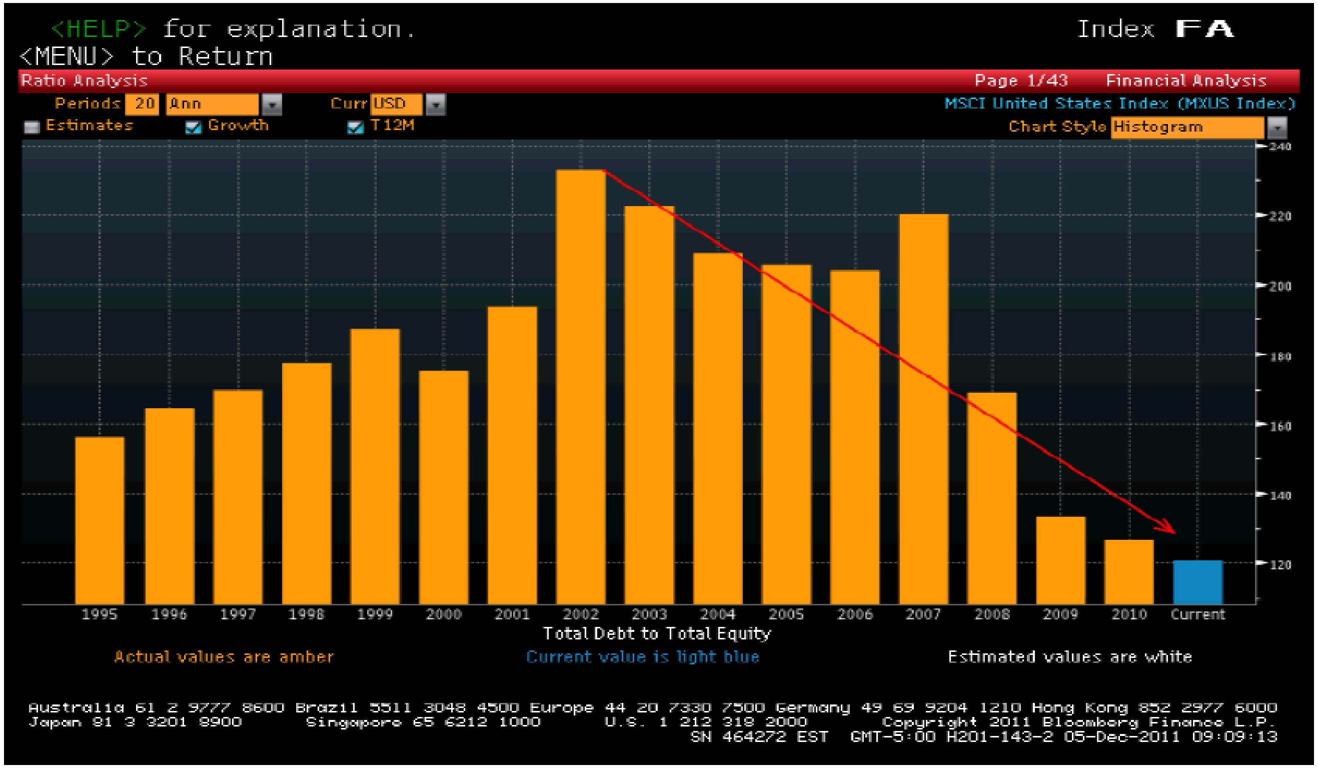
We expect uncertainty and volatility to remain high well into 2012. The US market is likely to remain in the best position. The US stock market has now outperformed the BRIC markets for four years. Surprisingly few investors seem to know this fact. Chart 1 shows the performance of the S&P 500 and the MSCI BRIC index beginning December 31, 2007. The US stock market not only provided protection relative to the BRIC markets during the bear market (whatever happened to those stories of emerging market economies "de-coupling" from the developed world?), it has maintained that outperformance during the bull phase.

Chart 1: S&P 500 vs. MSCI BRIC

Source: Bloomberg

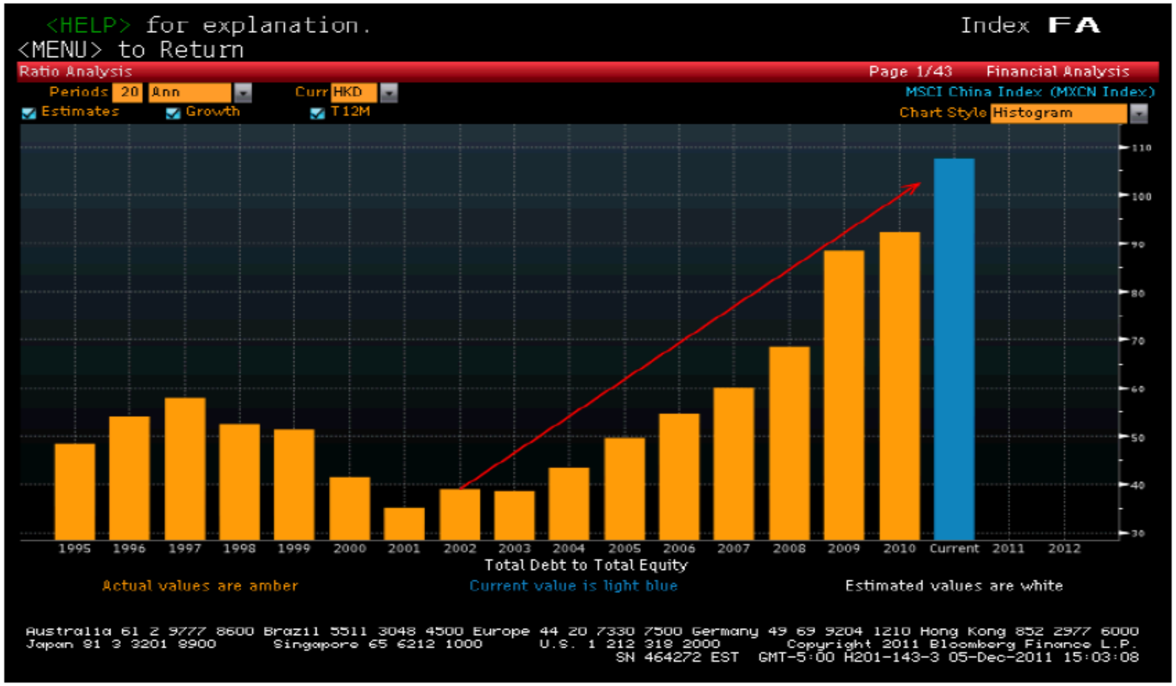
The US appears to have the strongest corporate sector in the world right now, and US corporations have produced their strong earnings while actually de-levering their balance sheets. Charts 2 and 3 show the trends in the US and Chinese corporate sectors' debt/equity ratios. Whereas US companies have been reducing during the past decade their reliance on debt to boost profitability, Chinese companies have increasing debt. Chinese debt/equity ratios are now on par with those in the US, but Chinese earnings dynamics have been weaker. It seems also that Chinese companies would have to increase leverage given the supposed strong growth in the Chinese economy.

Chart 2: US Debt/Equity



Source: Bloomberg

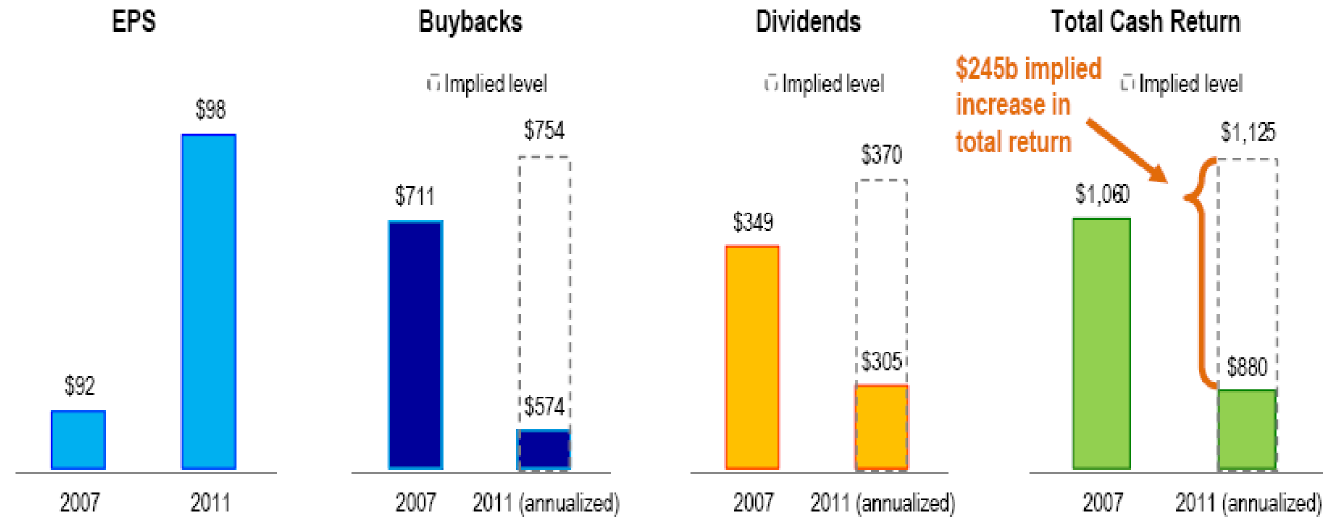
Chart 3: China Debt/Equity



Source: Bloomberg

Also if we compare cash return statistics this year and 2007 (when S&P 500 profits were last near this level), we can see that dividends totaled $349bn in 2007 and are only $305bn currently. But to true up to the 2007 implied level, dividends would need to increase by 21% to $370bn.

2007 vs. 2011(annualized), $bn where applicable



Source: FactSet.

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For 2012 our base case assumption is for the S&P 500 to form a 1,350 - 1,100 trading range. It will be difficult for equities to sustain back above the 1,300-1,350 trendlines, as long as the European sovereign debt crisis and recession lurk in the background. Similarly, it will be tough to move below strong 1,075-1,100 clustered support, as long as the U.S. avoids an economic recession, earnings stay elevated, and investors remain defensively positioned. However, there is a big downside risk (Euro-area crisis morphs into a systemic bank crisis; US economy slip into recession; China hard landing; oil at $150 from Middle East tension) and small upside risks for this range, and market can test 950-1000 somewhere in next year. A more optimistic Equity case for 2012 would necessitate several of the following fundamental and policy outcomes: positive resolution of the European crisis, ECB quantitative easing, upward revisions to the economics forecast, U.S. fiscal policy stimulus, Fed QE3, and a China soft landing. We estimate a likelihood of only 15% for this outcome.

Commodities:

Real assets, in general, tend to perform well during periods when a currency is depreciating and inflation expectations are rising. Critically, this is not happening within US dollar markets, and actually has not been happening for quite some time.

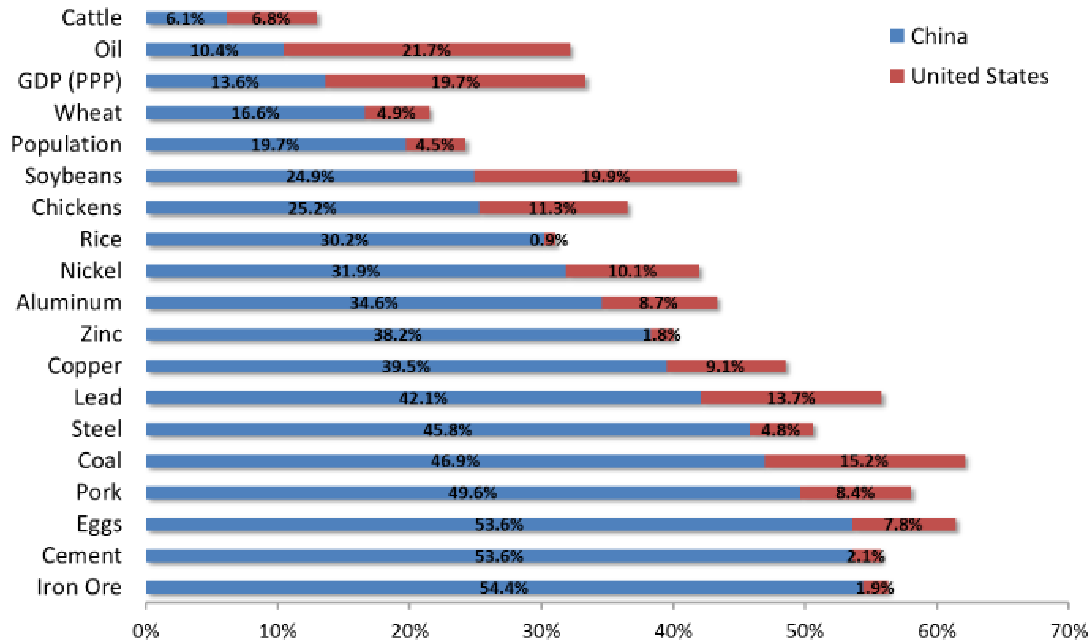
Chart 4 shows the Thomson Reuters/Jeffries CRB Index. Most investors still do not appreciate that commodities (when priced in US dollars) peaked in 2008. One could point to individual commodities that have performed well, but the asset class as a whole has not met many investors' return expectations. This underperformance makes sense because commodities are an inflation hedge and excessive credit typically generates excessive inflation. The credit bubble did indeed lead to the highest inflation rate in the US in nearly 18 years (5.6% in July 2008). However, as credit has been curtailed, so have inflation rates, and so have the prices of commodities and other real assets.

Chart 4: The ThomsonReuters/Jefferies CRB Index

Source: Bloomberg

Also, the chart below gives a good sense of what might happen to global demand for various commodities if Chinese growth slows down. Take iron, for example. If Chinese demand declines by 10%, this would represent a reduction in global demand of nearly 5%.

Table 1: China's share of total global demand for a selected list of non-food commodities:



Gold:

Gold posted a stellar performance this year, outpacing all major asset classes, and posting a positive return for the 11th year running. Looking back into the past decade, gold delivered average annual returns of nearly 20%, compared to an average CPI of 2.5%. Can the yellow metal do it all over again in 2012? We are long-term bulls on gold, however, a decline in EUR real rates and EURUSD will temper gold price gains.

Currencies:

Global slowdown in 2012 suggests that high-beta currencies will underperform. The traditional safe havens of JPY and USD will be the outperformers of 2012, in our view. Persistent problems in the eurozone, economic deleveraging and declining global yields should keep USD supported, especially when other safe havens like CHF are at intervention risk. In general, when the rest of the world is not outperforming, 'bad news' in the US will be more supportive for USD in the flight to safety. The major risk for USD next year is the potential for another round of QE from the Fed, though USD's sensitivity to monetary stimulus is lower in an environment of broad global easing. Also the impact of QE2 was less USD-negative than QE1, and the price action around QE3 may be even more muted.

While some investors seeking the safe haven in Scandinavian currencies, especially the NOK, given their relatively sound fiscal position, they are not immune from the impact of the global deleveraging and the resulting growth slowdown. Sweden is particularly exposed to the global growth outlook given its high level of exports to GDP at 50% and its exposure to the Eurozone in particular given that 40% of Sweden's exports are directed at Europe.

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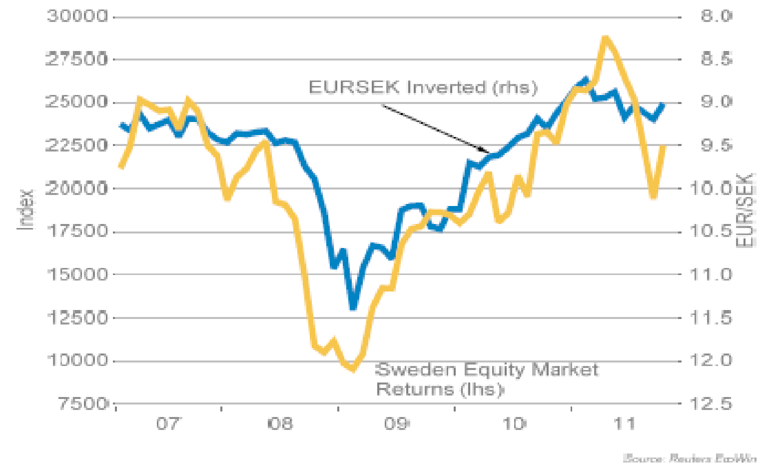
SEK Re-establishing Correlation to Equity Market



Source: Reuters Ecowin

SEK Trades in Line with the Global Export Cycle …

Source: Reuters EcoWin.

The key risk for NOK lies with oil prices. While they remain firm, risks are skewed to the downside on the back of a potential weakening of demand as global growth slows. Due to Norway's heavy reliance on commodity exports, deteriorating oil prices would rapidly hurt the country's terms of trade, which would in turn likely lead to lower profitability, wages, spending and demand. Such a scenario would therefore hurt growth and also likely prompt a change in stance from the Norges Bank.

Conclusions:

- We are into a completely different set of post-recession realities than what we were accustomed to through the post-WWII era. The prior 10 recessions before the epic 2007-09 downturn were nothing more than brief and small corrections in real GDP in the context of what was a generational secular credit expansion — an expansion that went asymptotic from 2002 to 2007. But make no mistake — this was a multi-decade debt boom and will take years to mean revert.
- Market volatility is part and parcel of every post-bubble deleveraging cycle. This means an ongoing focus on long-short relative value strategies that have little directional exposure with the overall market but take advantage of the inherent mispricing across sectors during these periods of heightened volatility.
- Deflation trumps inflation as the primary trend in a deleveraging cycle. This means an emphasis on defensive sectors with earnings stability and predictability characteristics. It also means a focus on squeezing as much income as possible out of the portfolio.

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- In this post-bubble environment, policy rates will remain near the floor for years.
- Keeping policy rates low means that real rates will remain negative. Even if the CPI turns negative, the central banks around the world will de facto ease policy by printing money. In this sense, the secular bull market in gold bullion remains intact and, as such, dips should be bought.
- Global deleveraging cycles almost invariably bring on heightened geo-political tensions. This is why the oil price has such a high floor established underneath it. Protectionism will continue to emerge as a new normal, as part of the globalization trend gets reversed.
- Investors must focus on safe yelds:

    1) High-quality corporates (non-cyclical, high cash reserves, minimal refinancing needs). Corporate balance sheets are in very good shape.

    2) Equities - focus on reliable dividend growth/yield

    3) Alternative assets - allocate significant portion of asset mix to strategies that are not relianton rising equity markets and where volatility can be used to advantage.

    4) Precious metals - a hedge against the reflationary policies aimed at defusing deflationary risks,money printing, rolling currency depreciations and heightened trade frictions.

12, rue Jean-Calvin
1204 Geneva
Switzerland
Phone +41 22 311 05 46, + 371 67783600
Fax + 371 67783602
swiss@maxcapman.com
www.maxcapman.com