

# Our Point of View, June 30<sup>th</sup> 2009

2	A summer without swallows	The phenomenon of the markets' upturn
4	Maybe we're heretics	A contrary view to the current consensus
5	Printing presses and other threats	The central bank printing presses are running flat out
8	Where is the enemy?	What's on the horizon – deflation or inflation?
10	We risk repeating ourselves	China is the answer
12	Conclusion in brief	Opportunism is called for

Burgauer Huser Aman & Partner AG  
Investment Managers and Consultants  
Stockerstrasse 14  
8002 Zürich

Mailing address:  
P.O. Box, CH-8027 Zürich  
Telephone +41(0)44 206 22 33  
Telefax +41(0)44 206 22 44  
info@bhapartners.com  
www.bhapartners.com

---

 Statistics of leading stock markets
 

---

<b>A) Year to date</b>		in US dollar	in local terms
Switzerland	SMI	- 4.75 %	- 2.86 %
Germany	DAX Xetra	+ 0.51 %	- 0.70 %
France	CAC 40	- 1.80 %	- 2.74 %
U.K.	FT-SE 100	+ 8.46 %	- 4.36 %
Sweden	OMX	+ 20.05 %	+ 19.12 %
Europe	STOXX 50	+ 0.54 %	+ 0.20 %
USA	S&P 500	+ 1.73 %	+ 1.73 %
	Nasdaq	+ 16.56 %	+ 16.56 %
Japan	Nikkei	+ 5.00 %	+ 10.43 %
Morgan Stanley World Equity Index		+ 4.73 %	n.a.
Bloomberg Effas US\$ Bond Index (5-7 years maturity)		- 4.50 %	n.a.
Balanced Mandate Index *		- 13.83 %	n.a.

<b>B) Over five years</b>		in US dollar	in local terms
Switzerland	SMI	+ 10.39 %	- 4.33 %
Germany	DAX Xetra	+ 36.28 %	+ 17.86 %
France	CAC 40	- 3.05 %	- 16.16 %
U.K.	FT-SE 100	- 13.47 %	- 5.00 %
Sweden	OMX	+ 10.56 %	+ 12.44 %
Europe	STOXX 50	- 1.69 %	- 14.98 %
USA	S&P 500	- 19.45 %	- 19.45 %
	Nasdaq	- 10.23 %	- 10.23 %
Japan	Nikkei	- 6.46 %	- 16.71 %
Morgan Stanley World Equity Index		- 9.29 %	n.a.
Bloomberg- Effas US\$ Bond Index (5-7 years maturity)		+ 31.67 %	n.a.
Balanced Mandate Index *		+ 11.19 %	n.a.

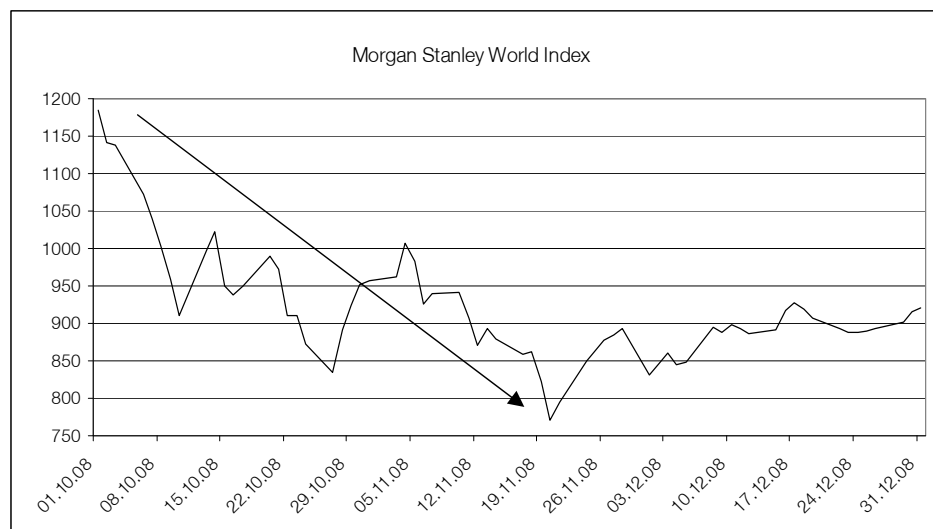
\*50 % Morgan Stanley World Equity Index and  
50 % Bloomberg Effas Bond Index (5-7- years maturity)

# A summer without swallows

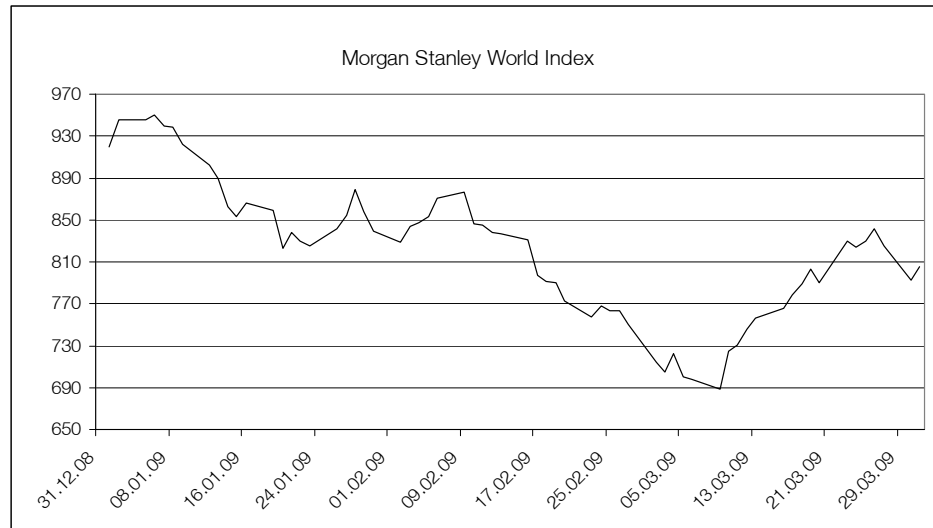
The phenomenon of the markets' upturn

The first half of 2009 was a real roller-coaster ride: a nightmare of a first quarter and an apparent acceptance of fate between April and June. But suddenly there's a new expression continually popping up in the financial press – "green shoots". This botanical term symbolises the annual miracle of spring and growth starting afresh. We are now entitled to ask if the many financial journalists, analysts and experts are right in their interpretation that the green shoots on the stock markets are foretelling an economic upturn, the system is saved and everything is hunky dory. Let's take a quick look at this abrupt swing in sentiment:

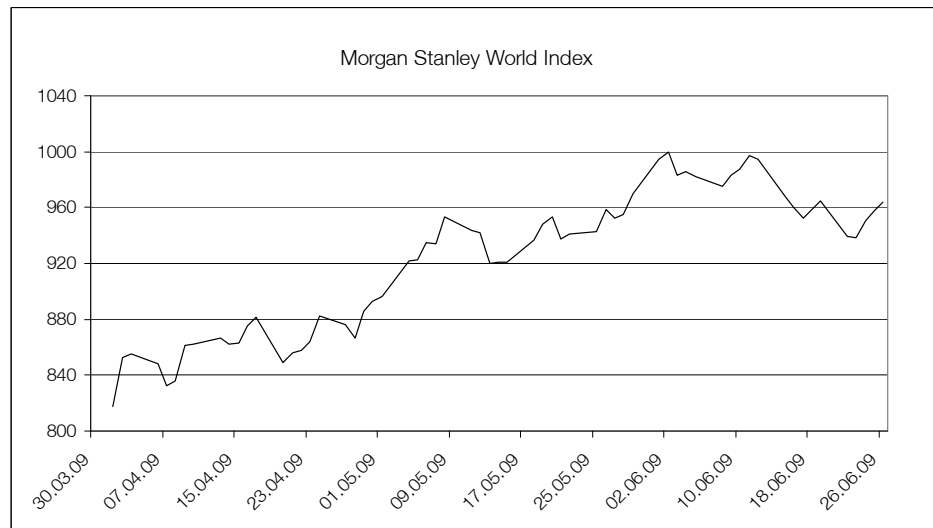
Firstly, the final quarter of 2008: End of the world



First quarter of 2009: Hope of a turnaround has quickly evaporated



Second quarter of 2009: The sudden turnaround



A downturn usually ends with a bottom-finding phase and repeated testing of a cyclical low. It may well be that this March's low in sentiment was a kind of confirmation of last November's lows in prices. Despite this, it is

strange that, from April, stock markets executed a sustained turnaround en masse, rather than technical recoveries correcting market exaggerations. Everything had been heading south – good and bad, great and small, rotten and respectable – in uninterrupted, unprecedented fashion – and suddenly, almost overnight, came the trend reversal. But the reality was that this reversal set in first and only afterwards did the analysts duly come up with their rosy scenarios for economic recovery in 2010. People put the cart before the horse and cleverly concluded that a positive trend forecast did not entail overmuch risk if the stock markets continued steaming away so impressively from their lows. The “green shoots” theory was quickly hauled out from the recesses of the analysts’ toolbox. The systemic crisis was apparently defeated, and the new upturn was in sight.

## Maybe we’re heretics

A contrary view to the current consensus

---

You have to be an opportunist at times in our business. We increased our equities exposure in the second quarter, because there is only one genuinely true rule of investment, namely that the market is always right and it is madness to try to fight a trend.

However, the main reason we increased our equities exposure was not because we believed it was reasonably apparent that a trend reversal was on the cards. The world today is far too opaque for that. It is totally impossible to predict even roughly what this or that company will earn at the end of 2010 – but that is precisely what today’s share prices are attempting to factor in. So are we being stupid and is everybody else indecently clever, as we seem to be the only ones who don’t dare to even tentatively forecast corporate earnings for 2010? Well, at risk of being a little cheeky and self-important we are going to answer our rhetorical question straightaway: no, we are not more naïve than our competitors,

but we think they are currently probably right for the wrong reason. The markets are not in reality rising in anticipation of a return to economic growth in 2010. So why are prices climbing left, right and centre?

Below we set out our theory and the reasons why the current consensus view that the green shoots are here may be completely wrong:

## Printing presses and other threats

The central bank printing presses are running flat out

---

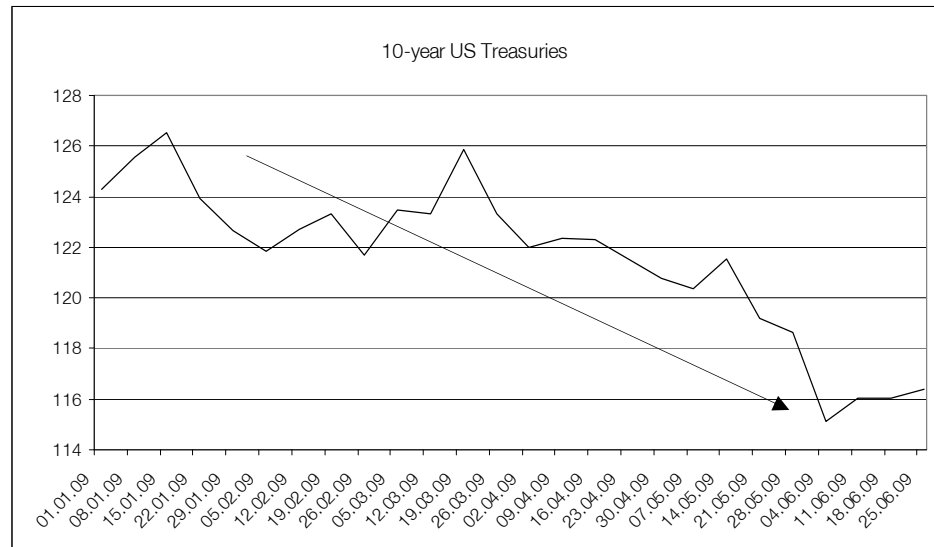
Politicians are crafty devils. They never spell things out, catching out gullible citizens and decent taxpayers time and again with this tactic. So our Swiss politicians call new taxes, for example, “incentivisation levies”, “environment charges” or, cheekily, the “noise levy”. In plain language they’re all new stealth taxes which the politicians don’t want to refer to as such.

The central bankers of this world – led by the United States – have come up with another deceitful term from the box of tricks of economic theory. They no longer refer to printing money as such, but instead call it “quantitative easing”. That sounds intelligent and reasonably academic, so the world accepts this course of action as a great feat without questioning. However, the truth – and please note this is only our opinion – looks a little different.

This is what is happening here as regards quantitative easing. The US government, for example, needs trillions upon trillions of new money to finance its horrendous deficits and at least equally horrendous stimulus packages. The logical consequence of such gigantic fund-raising operations would be higher interest rates, but they would be untenable in the dire current economic environment. A buyer is therefore appointed that

is in a position to buy up unlimited quantities of this government paper, namely the central bank or the US Treasury in the case of the USA. It is now purchasing these US government securities in almost unlimited volumes. But that's not all. It is also buying junk bonds and practically everything the market is spurning. The central bank includes the stuff in its balance sheet and pays cash – newly created money. A central bank can create as much money as it – and the politicians – want. The intention is to liquefy the market, to avoid a credit crisis and, above all, to keep interest rates ultra-low through the flood of money. This is currently called quantitative easing, but we think the proper term is cranking up the printing presses. And not just gently; no, at full speed. It's red-hot. And if we think that McDonald's burgers, soft drinks and violent films are all that find their way from the USA into the rest of the world, we are massively mistaken. The UK and obedient Switzerland are also already going in for quantitative easing on a huge scale, and the European Central Bank will before long reconcile itself to using this miracle tactic, despite the grumbling from German Chancellor Merkel. As if the eurozone did not have enough problems round its neck with the ailing currencies of the Baltic states and other eastern European countries. Oh for the days of the good old German mark.

Short-term interest rates everywhere are dutifully poised ready to dive, i.e. in the region of 0%. Bond yields also fell initially when quantitative easing (printing money) began, but not for long. The market is not as stupid as politicians think. Lately, to the chagrin of the central banks, bond yields have risen pretty sharply, which was definitely not what those in charge of the printing presses intended. Just look at the trend for 10-year US government bonds, where investors have lost a great deal of money this year:



Anyway, in the USA and Europe money is being printed furiously to prevent deflation and spur consumers into action with cheap money. The only problem is that the only customers getting new bank loans are those who don't need any money. This is in fact an old rule of banking, which every now and then is ignored. A somewhat cynical comment, but nevertheless part of the basics of banking. The flood of money has begun. There is no shortage of credit facilities, but the banks have no desire to make new loans to highly indebted consumers – which means that a great deal of money is sloshing around the world and increasing daily. And what shall we do with it? Bond yields are far too low for it to flow into bonds and the money markets offer nothing – costs eat up most of the yield. So where shall we put it?

Yes, you're right, into the stock market it goes. Many blue chips have dividend yields of 4% or above and offer good opportunities to enter the market after the awful slump. So, in our view, there is a vast amount of money flowing into the equity markets as a result of quantitative easing, that is to say, the windfall created by the central banks. That is not what the politicians intended, but people do not always follow these high-handed individuals' prescriptions. Usually that is a good thing, but today

it's dangerous to let oneself be lulled into a false sense of security and think that rising stock market prices herald an economic turnaround. We believe the stock markets are rising due to the printing of money – the immense flood of money created by the politicians. That is not by any means to say that one should not join in the fun, especially after many valuations plunged so sharply in March. However, the likelihood that the upbeat market sentiment is the precursor to a clear economic recovery in 2010 is based on extremely fragile, if not unrealistic, foundations. So for you and us that means “long live opportunism” but, above all, maintaining a sense of reality. The green shoots could wither away and what would be left would be a gigantic pile of newly printed money.

## Where is the enemy?

What's on the horizon – deflation or inflation?

---

At the moment there is no sign of inflation anywhere. Correction: no sign of *official* consumer price inflation, which, we now all know, is being well and truly fiddled and largely strips out the “volatile” energy and food components – i.e. those components which are essential for human survival. However, quantitative easing – through which money supply in various countries has recently been massively expanded – is quite clearly inflationary. The value of countries' money is being diluted. The prime, albeit extreme, example at present is Zimbabwe, where so much new money has been printed that the paper on which the notes are printed has become worth more than all the zeros on the notes themselves. Central banks are united in the opinion that a calculated measure of inflation is a lesser evil than deflation. We definitely agree with this view. Deflationary periods are disastrous in our consumer society, after all, who is going to buy anything if prices look virtually certain to keep falling?

The problem we *must* focus on today is the issue of what then happens to the central banks' artificially created windfall once economic activity really does pick up again, whenever that may be. The politicians tell us that the financial assistance – quantitative easing, or printing of money – will then be neutralised, absorbed or in some other way magicked away. That sounds very plausible, but we question how that can be achieved without an explosion in interest rates. In recent months the central banks have already had trouble keeping interest rates stable while it rained money, but we are supposed to believe in all seriousness that the trillions can be recouped without adversely affecting interest costs. Sorry, but we don't buy it; that just looks totally impossible to us. This means that in all likelihood most of the quantitative easing windfall will remain in the system, because – given that they naturally want to be re-elected – no politician will dare argue in favour of an approach that would triple interest rates. There are therefore two possibilities. The first is that the green shoots are indeed the precursor to an economic upturn. That would be nice, but we would then have to brace ourselves for a new bubble, as there would be too much money in circulation. The vast amount of money sloshing around available at almost zero interest would have a kind of leveraging effect on demand. So we believe quite significant inflation is inevitable if the green shoots really do herald a fresh upsurge of growth.

We are ambivalent as to whether this will occur but are covering ourselves by investing in assets such as physical gold and other investments that are generally linked to commodity prices, such as industrial metals and food.

The second possibility is that the pumping of money into the system will fail to kickstart the economy, and a mildly deflationary phase will set in. Under this scenario, the sustained uptrend on the stock markets since April has been driven purely by printing money, and not by economic activity. Consequently, it is merely a technical uptick engendered by the central banks. This would call the new bull market into question (is it really a bull market?) and make the selling off of medium to long-term bond holdings a mistake, especially as interest rates would remain low for longer than expected.

The central banks are completely unequivocal in their view that the “inflation” option is preferable. We agree, since deflation is the ultimate destroyer of consumption. But we don’t believe the central bankers can neutralise the newly printed trillions so easily, without immediately choking off the nascent growth. We therefore tend towards the view that a new bubble has been created, a vast amount of money is floating around the world, banks are being stingy in granting loans and there is an investment crisis, which points pretty clearly towards investment in equities. This means equities are being bought for the wrong reason; investors are primarily choosing to do so not because they are convinced the companies whose stocks they are buying will post significantly higher earnings in the foreseeable future but because of a lack of alternatives and because many dividend yields are massively outperforming returns on time deposits and bonds. But the green shoots are nonetheless stronger in one corner of the world than elsewhere: in Asia and the greater China region.

## We risk repeating ourselves

China is the answer

---

Investing in Chinese equities is not for the faint-hearted. Volatility is considerable, and that is really saying something nowadays. But after all the sceptics in this world, who have never travelled further east than Vienna, prophesied the end of the Chinese miracle last year, China stands out once more as the golden child of the world. No talk of shaky 5% growth; we’re getting closer to more like 9% again, and although this is lower than we’ve seen in the past few years, it is still miles ahead of the rest of the world. China has deployed its reserves very cleverly and most notably, quite unlike western countries, has absolutely no subprime skeletons that need clearing out. In response to the slump in exports, public money has been used to launch gigantic infrastructure projects. That is to say that China’s reserves have not been unproductively

squandered (à la General Motors), with every yuan from the government's coffers instead being used to boost demand, and this policy is still being pursued. In contrast to the way in which cash is used in the West to plug holes, in China such government aid has a clearly productive outcome. This cushioning has evidently borne fruit, and soon we will all once again be marvelling at how successfully China is turning its export-driven industry into a consumer-based economy. This metamorphosis is in full swing. China is well aware of its vulnerability in terms of its dependence on the cycle in the West and is not just talking about changing things, but putting it into practice. Decision-making paths are short, because in the Chinese parliament there's no need to grapple with a multi-party system. Granted, China is not a free-market economy in the western sense; it is not a democracy, justice is lacking in some regards, and frequently little respect is paid to human rights. But can we in the West really criticise China? Is our democracy really all it's cracked up to be? Hardly. In the UK, members of parliament have been helping themselves at the public's expense, corruption is widespread in the West, and the USA is mired in hypocrisy, breaching fundamental human rights and wanting to improve the world with missionary zeal, while ethics and morality sink in a morass of cynicism at home. So let's be cautious about condemning foreign systems. We think it is extremely positive that China is quietly and slowly working towards a free-market economy. Many things that are "directed" work much better than they do here. The West still needs to stop navel-gazing and realise once and for all that the world does not revolve around it. It needs to learn that it cannot preach justice, morality and ethics while ignoring and abusing these standards itself. Degenerate tendencies are incomparably smaller in Asia than in the West, the motivation to achieve overwhelming, and the desire and striving for a better life enormous and, last but not least, in the coming centuries many hundreds of millions of people will carve out a standard of living we have long since taken for granted. Let's hope that cultural life is not a casualty as in the West. McDonald's is not needed!

Chinese growth numbers will deliver further surprise the next few quarters. Critics will dismiss this as communist-manipulated trickery. Let them say what they want. But they will learn they were wrong about one thing, of that we are sure: one cannot afford not to be invested in the greater China region. It simply doesn't make sense to have 2% of one's assets invested in a stock such as Siemens, ABB, Royal Dutch or some other western blue-chip company and then daringly invest the same amount in the giant Chinese economy. That defies common sense. The writer of these comments feels that investing even half one's equity content in this part of the world is quite sensible. Excessive diversification substantially dilutes long-term investment performance. In other words, you have to stand by your convictions. And here the facts logically dictate that the greater China region must be one of the pillars of an equity portfolio. One should guard against prejudice. Especially in our profession.

## Conclusion in brief

Opportunism is called for

---

We don't have much more to add here. But perhaps there are some very busy readers of these lines out there who like to keep their volume of reading under control by cutting straight to the chase. For them, the heart of our message is as follows.

The transformation of the stock markets since the nightmarish period up to March this year must be treated with ambivalence. It is very possible that the positive trend reversal is due chiefly to the massive windfall from the central banks and not actually to an imminent economic turnaround in 2010. As always, we think that investors must be proactive, and instead of deploying traditional strategies, they must focus on seizing opportunities.

Secondly, it is impossible to predict whether we will have to endure a period of deflation without growth or whether inflation will flare up again as a consequence of the flood of money released through quantitative easing. Purely on the basis of logic, we tend towards the latter view.

However, it must be noted that the central banks' vast stimulus packages will not automatically bring about an economic recovery, so investors must be on the look-out for opportunistic exposure.

Thirdly, fixed-income investments have little to offer – unless, of course, we are heading for deflationary times. Time deposits offer virtually zero returns, and relevant rates can only rise. Bonds are risky, and yields are no longer very attractive. They harbour fundamental price risks, and investors should concentrate on short maturities.

Fourthly, the logical consequence of these thoughts is that only equities and commodities have genuine upside potential. However, as the fundamental economic prospects are extremely opaque and our system is now entirely dependent on the unprecedented interventions of the central banks, investments must be made on an ultra-pragmatic basis. Quantitative easing is a theory which is now being put into practice worldwide for the first time (with the possible exception of Japan in the 1990s). That is to say that the global economy has effectively been put in a test tube at the central bank laboratories. That may sound grossly exaggerated, but the truth is that quantitative easing does not equate with what practical experience teaches. It is in reality an *attempt* to restore normality. It remains to be hoped that the daring measures set in motion are appropriate to correct the nonsense perpetrated by the bankers over recent years. But there is no guarantee of that whatsoever.

Rest assured that we will stay on the case and move fast if required.

MAB

*“I always think that Federal Reserve sounds like a  
dodgy brand of Scotch whisky”*

(Sandi Tostvig on the BBC Radio show “The News Quiz” 10/10/08)