



ALPHACAPITA (Switzerland) SA Global Asset Management

OCTOBER 2011 NEWS LETTER

“STONG COMPANIES—WEAK GOVERNMENTS”

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Outlook

It is once again time to take a look at the last quarter's developments in the financial markets, and what a quarter it has been having experiencing volatility not seen since the financial crisis of 2008. We have seen risk premiums for insurance on stocks at levels over 40 (normal we trade VIX between 14-20) and CDO spreads on Greece, Portugal, Italy and Spain jumping to new records. Likewise we have experienced the funding markets for the banks tightening. All clear signs that the financial markets are in a distressed situation. So what has brought this into the market? Well it will not come as a big surprise to anyone who has followed the news lately, that the main reason for this is the expanding of the debt crisis in the EU. The other big problem is in the U.S agreeing to expand the debt ceiling and their long term view on how to deal with the expanding deficit problem.

During Q3 we have seen new attempts to quell the uncertainty. Firstly the EU came up with the possibilities for the rescue fund to buy bonds from the peripheral EU countries. Secondly like Italy, Spain and Greece came out with new spending cuts. All news which in normal circumstance, would have

taken some of the uncertainty out of the financial markets. But at the same time in the U.S we witnessed maybe one of the most embarrassing political fights seen in a very long time. The Republicans and the Democrats were not able to come to an agreement for lifting the debt ceiling before the eleventh hour. By having this fight with no consideration to the fact that they were only hours away from creating a meltdown in the financial markets they spread another portion of uncertainty into the markets. This resulted in a down grade of the US which once again only added more risk to the market. Likewise we again experienced uncertainty as the first honest spending cuts in Greece seemed to be enough and could go through the parliament. This is still the big questions which needs an answer fast.

So what is going to make the market change from its negative bias right now? In our mind there is no doubt politicians have to put aside their political agendas and try to work together. This is a mutual task for both sides of the Atlantic. By bringing confidence from the politician's sides with some unilateral agreements will in turn bring the financial markets confident. Solutions,

not quick fixes, are what will show the way for the future. Is this then a possibility? Yes, in our minds it is. The latest key figures show the economy is stalling but not reversing. This is an important note, the world economy is still growing but not at the same pace as before. We normally would not see a straight growth line up after a slow downturn and is important again to notice that the financial crisis had the potential to be even bigger than the depression of the thirties. So it is only natural after an impressive return to growth that we will experience a period of lower growth, but still growth none the less. Corporate earnings are still good and they are mostly having low debt ratio and are generating high cash flows. This will make companies ready to use this period to invest in new employees, new equipment and M&A if the right political environment will appear. However in the very short term we still expect to see a lot of uncertainties. The markets have now priced in a lot of bad news to come, and in our minds this is a bit overdone. We are today seeing Germany DAX trading at P/E levels under 2008 crisis and 10 year US yield less than 2%. If anything, we can only say there is a big bubble in the bond market.

With that said, we of course also use a lot of time to see what can go wrong. First and most importantly it is not the bankruptcy of Greece as this is more or less priced into the market, and a bankruptcy of Greece is, in our opinion, not going to happen now. It is first going to happen when the new EU rescue Fund has been approved in EU parliaments, as this Fund, 440 billion Euro, would be able to be used for securing the bank's balance sheets. It is not the bankruptcy of Greece itself which

**STANDARD
& POOR'S**





Outlook continued

is the big problem, it is how it's going to impact on Italy and Spain. This is why we must hope that Greece does not default before the afore mentioned countries are in a more secure economic position themselves. Our next big worry right now is if we see profit warnings from companies with bad earning report. This question will soon be answered as Q3 earnings which starts at the end of September beginning of October. We also have to look at Spain and Italy as imminent spending cuts are going to be introduced to secure their finances for the future, but still with some solution for bringing the unemployment rate down especially in Spain's case. Understandingly this is not an easy case taking on both of this problems at the same time, but never the less this is the task they have. Last but no less important, are the U.S capable of finding a sensible solution for their debt problem and getting more workers into employment? All these questions have to be confronted and dealt with very soon to avoid a market that is behaving like it was in 2008. Whilst we do not have an answer to the above we are going to experience high levels of volatility and lower equity prices. Our portfolio has of course been impacted by the current market and brought down the year to date performance to -14.41% of which we have seen -8.96% in Q3 alone for the balanced portfolio and -22.1% for the aggressive of which we have seen -15.42% in Q3. We of course never like to see negative figures, but we keep on with our long term strategy, even it hurts on the short term.

Strategy

As mentioned above Q3 has been a dreadful quarter, at the time of writing S&P 500 is down year to date by 9% and just in Q3 -13,50%. For the DAX (Germany 30 stocks index) year to date performance has been -28% and for Q3 alone it is -28%. In the end of July we sold out of our position in BMW, Siemens and Walker & Dunlop. For BMW & Siemens this was done with a 25% profit and a small loss -2% on Walker & Dunlop. The reason for doing this was we did not know how the market would react to the negotiation regarding the raising of the US debt ceiling.

In the middle of August we implemented our current hedging strategy in dealing with high volatilities. In the current market situation, the day to day volatility is so high 3%-4% change during one session. So we are defending the portfolios with strategically placed stops to basically catch a falling market. This strategy has worked very well lately.

In the turmoil of the current situation it is once again very important for us to stress, that the strategy we have is long term, and we still very much believe in our stock, bond & currency selection. We see no reason to change the asset allocation right now with around 1/3 split equally in equity, Government bonds and Corporate Bonds. We have added a bit more to the cash account just to be able to move if we see the right offer. It is also important to note that even if the markets look bad and the risk is much higher, this is normally times for the long term investor to buy into quality stock at very favourable levels. And as no one can say if we are trading at the bottom or if we still have further bear markets to come, we have taken the strategy of using these levels to add more into the stocks, corporate bonds that we like. Yes, this strategy can in the short term reflect a negative return to the portfolio, but on the longer term (history also supports this strategy) this will add extra performance to the portfolio. We cannot help quoting our times most successful investor Warren Buffet whose still famous words are: ***"Be fearful when others are greedy, and be greedy when others are fearful"***

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Warren Buffet





ON CURRENCY

This quarters most important news on the currency front was SNB, The Swiss Central Banks decision to bind the CHF at level 1.20 against the EURO. This move made the CHF weaken from a 1.12 level to 1,21 in split second, without doubt putting a lot of currency traders on the wrong side. The reason behind this move was, as many probably have experienced recently, with a very strong CHF, so strong that we actually at one

point had the EURCHF down trading at almost "pair 1", a price level never seen before and maybe never seen again. And why was the CHF so strong? This had once again to do with investors uncertainty about the equity markets and the move for safe havens. A Swiss franc at this level would without any doubt strangle the Swiss economy over time and this is the reason for the SNB to make a move as drastically as they did. The obvious trade would be buying Swedish and Norwegian Kroner, as they are both very strong countries with very healthy economies, we also did see this move as both currencies strengthened against EUR with around 5 to 6 %. But it has stopped there and our explanation for this is that both currencies are not very big, having a global weight of around 0,50%, compared with CHF which has a weight of around 3,2%. So investors need to keep a close eye on the liquidity in these currencies before buying. At the same time both Swedish and the Norwegian



"Chart showing EURCHF spot"

central banks signal that they expect rate hikes to be put on hold for the time being, and this again had the impact of a weakening of both currencies. So this bring us back to the main theme in AlphaCapita, and that is that no matter how we look at it, if everything goes wrong there is only one global reserve currency in the world and that is USD. We therefore keep our exposure to the USD, currently we have a weight of around 28%.

ON STOCKS

After selling the above mentioned stocks at the end of August we re-bought BMW and Siemens at a level 58 and 70, 30% under our selling price, as we still very much like the story behind BMW and Siemens - they are both very well driven companies with a good management. Both have high exposure to Emerging Markets and are today trading at very favourable prices as well as giving us important and nice dividend. The rest we have allocated to our EFT fund in Asia. The reason for adding more exposure to the ETF Asia, is because Asia is probably today the only area which has enough capital to introduce stimulus if needed. We also still like the growth scenario in Asia. We like all investment cases mentioned here over the long term.

On our UK Stock we have added more into Vodafone. Again the reason for this

move is we like the dividend yield and prefer to take the risk here compared with buying a Government Bond for less than 2% yield. Vodafone is also a so called defensive stock which has lived up to this as it has shown a very steady price range. Likewise we have bought more into Barclays as we firmly believe that the Banking sector has been too hard hit and at the moment Barclays are trading well below price to book level, which cannot in our wildest imaginations be a long term fair value.

In the Q2 newsletter we gave information regarding our new stock in the portfolio, Entropic Communication. This stock has as many other stocks been hit hard, but especially small stocks like Entropic Communication have had hard time. Entropic Communication at the time of writing has a negative performance in the market of 50%,





STOCKS - continued



"Entropic Communication has performed with a 20% gain"

however we still very much like the case around the stock. Entropic Communication is selling chips for the broadband industry, and during Q3 has started selling their chip into the European market through their new corporation with "InCoax Network, Netherland". This move has been made to close the gap from the lagging Euro-

pean chip market in comparison to U.S. development. We therefore welcome the new strategy to include Europe in their sales strategy as they have more or less sold over 50 mill chips in a very short period in U.S. So if the picture is going to be the same as in the U.S they have a great potential for growing their earnings. We have therefore added a bit

more into Entropic Communication at \$4.24 taking the average buying price down to \$7.50 a share. After the news came out at the start of September Entropic Communication has performed with a 20% gain which in this market condition is very impressive.

ON BONDS

As mentioned in the beginning of this newsletter the U.S credit rating was put down from AAA to AAa. This news was not a surprise but it added more jitters with regards to the U.S economy. In this case it is important to note, that a down grade from S&P is only one institutions opinion, and we cannot help stating that S&P had an AAA rating on subprime loans before it all went downhill in 2008. That said, we find the down grade in line with the economy and also a important nudge to the politicians of U.S to come up with a long term solution for solving the debt situation. The downgrade also made the FED come out with a not ever seen before statement as they promised to hold yields at the current level for the next two years. In our minds

this again seems like a desperate action, the decision, was also for one of the first times in the FED's history not voted through unanimously.

All the uncertainty has made investors run for safety by buying U.S and German Government Bonds. This has taken the yield on the 10 year U.S bond to under 2%. In our opinion this might be one of the biggest bubbles ever seen. With these levels and deducting inflation the investor will only see a negative yield.

Our move to the above situation was to sell out of our Spanish Government bonds due to the fact that the risk reward premium in our mind was no longer in place. Instead we have reinvested a small part of this revenue back into the ETF that will benefit from a higher U.S 20 year

yield. We do believe this will be a wise move, especially right now as we have done this at very low levels. Again this can give us some head wind on the short term, but we strongly believe this will make us make much better returns in the longer term.

"S&P had an AAA rating on subprime"



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