

H2 09 in a nutshell...

30th June 2009

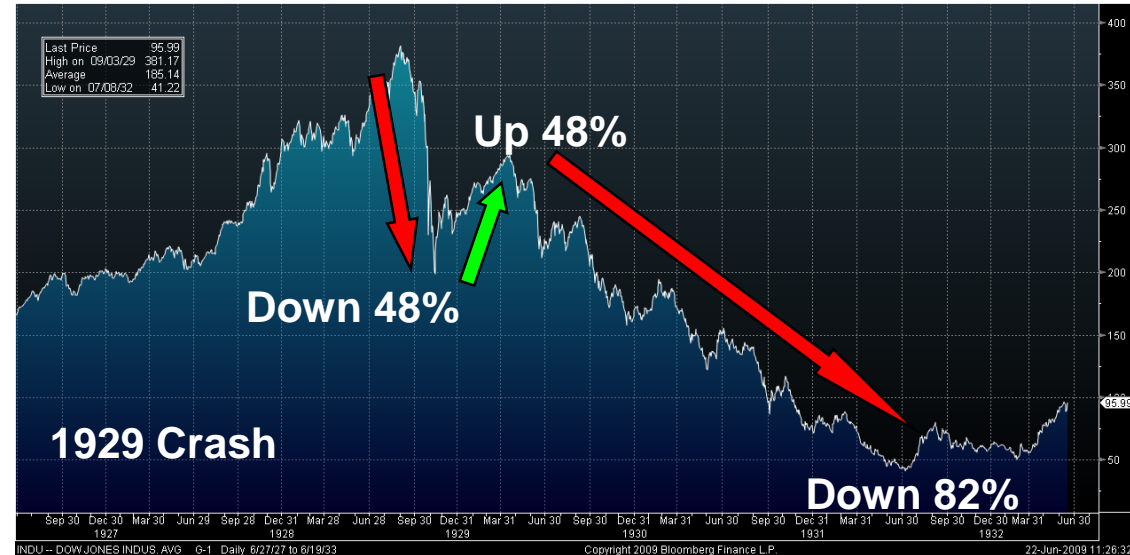


Summary

- Stock markets and sentiment have clearly improved in recent weeks, but not so concerning the fundamentals. There is little room for positive surprises in the second half, but a lot of risk for deceptions. We remain cautious and **underweight** stocks. For the moment, key support of the S&P 500 index lies around 875-885. As long as it holds, there is still a chance that this bear market rally extends further. Those who are still overweight can therefore still try to ride the rally, but should place a (mental) stop below 875. We prefer not to try.
- **Silver** is the most promising “currency” and **Natural Gas** offers a trading opportunity.
- For the rest, we maintain our 2009 forecasts, regarding **Equities** (“forget the “buy and hold” strategy, “buy and sell” will be the name of the game in 2009. Any rallies will be bear market rallies”), the **USD** (“the greenback will sooner or later pay the price for massive reflation. EUR/USD will return back above 1.40 ... at least – done), **Oil** (“can go anywhere short term, but should re-enter a “fair value zone” of 80-100 USD/barrel within 6-12 months”) and **Gold** (“an absolute must have. Minimum target for 2009 is 1000 USD an ounce. Minimum target for 2010 is 1500 USD an ounce”).

Comparing 1929 with 2008

It is true that the 1929 crash cannot be compared with the one seen last year because authorities learned the lesson and have this time flooded the system with huge amounts of liquidity. Still, we find it interesting – and scaring – to have a look at what happened to the Dow Jones index in 1929 ... after a 48% bear market rally. After all, we don't have experience with the secondary effect of massive reflation, because never before in history have so many major economies printed so much money.



Sentiment has improved, but ...

... most leading economic indicators in the U.S. and Europe continue to deteriorate. A majority of economists believes that the 3rd quarter 2009 will mark the end of this recession, which explains why the median year-end forecast for the S&P 500 lies at 970, and only one economist sees it below 900 (as contrarians, we have a lot of sympathy with Barry Knapp of Barclays Bank). This leaves little surprise potential to the upside, but a lot to the downside, for example if this recession persists beyond Q3.

On the following pages, we will show you a few charts of key economic figures which make it difficult to explain where the positive sentiment comes from. These charts are self-telling and don't need to be commented.

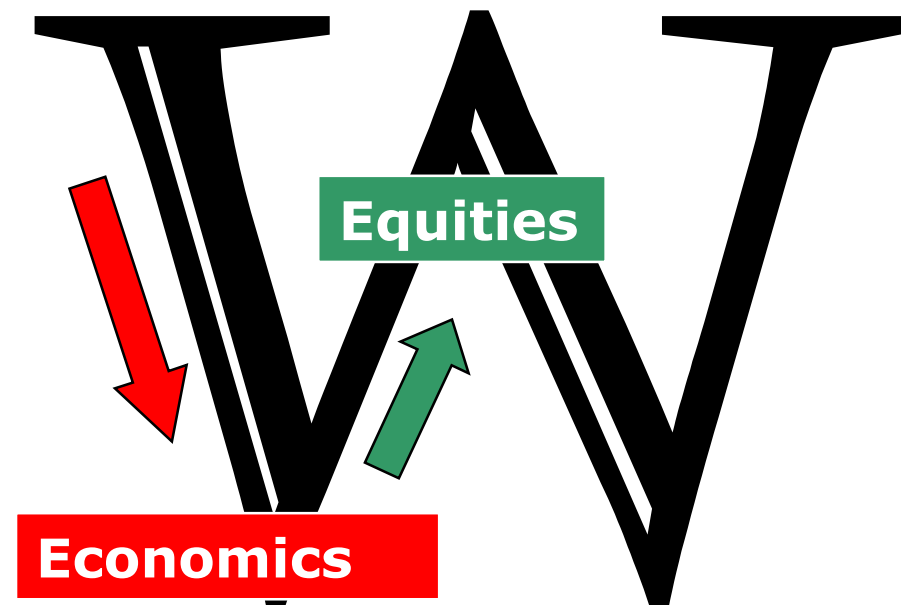
Firm	Strategist	2009 Close	2009 EPS
=====			
Bank of America -a	David Bianco		
Bank of Montreal-b	Ben Joyce	1,050	\$53.00
Barclays	Barry Knapp	757	\$41.00
Citigroup -c	Tobias Levkovich	1,000	\$51.00
Credit Suisse	Andrew Garthwaite	920	\$49.00
Deutsche Bank	Binky Chadha	1,060	\$48.80
Goldman Sachs	David Kostin	940	\$40.00
HSBC	Kevin Gardiner	900	
JPMorgan	Thomas Lee	1,100	\$57.00
Morgan Stanley	Jason Todd	900	\$51.00
RBC -d	Myles Zyblock	1,050	\$58.00
UBS -a			\$51.00

Mean		968	\$49.98
Median		970	\$51.00
High		1,100	\$58.00
Low		757	\$40.00

W-hat Shape – L, U, V or W

There is a lot of talk about what shape this recession will have. Will it be an L, U, V or W ... it's usually with the X where the fantasy of the economists finds its limits. Looking at economic figures, all the 4 officially recognized letters remain possible, since we are still in the very first leg of the movement. Equity markets however are already discounting a V or a W shape.

It is true that equity markets tend to be 3-9 months ahead of the curve, but until economic figures start turning around, we cannot even know if there will be a curve ... around the corner. We find it difficult to believe that this crisis is already behind; exclude the V and consider the W as the most positive outcome.



U.S. Capacity Utilization since 1979



U.S. Unemployment since 1979

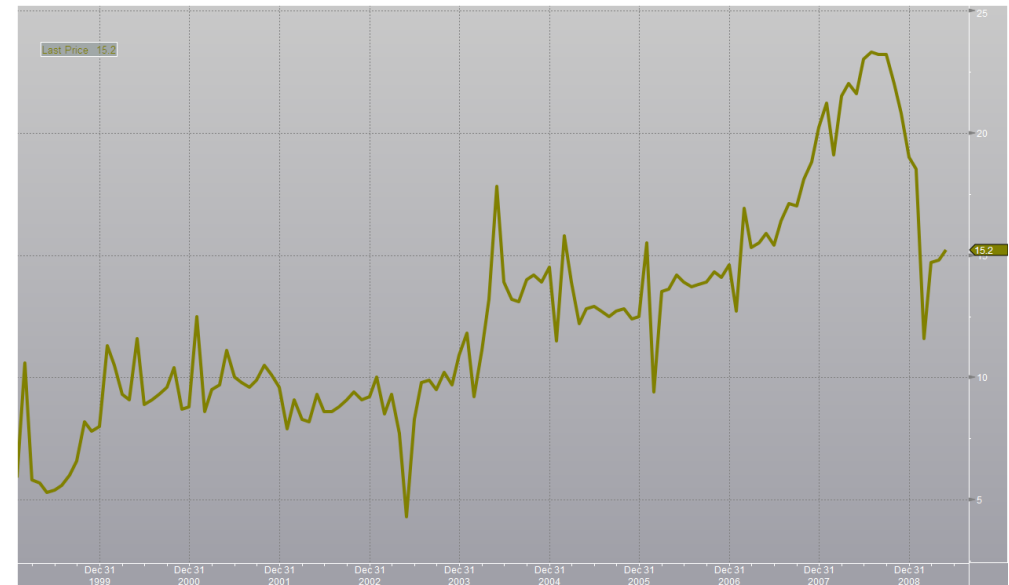


Industrial Production since 1985



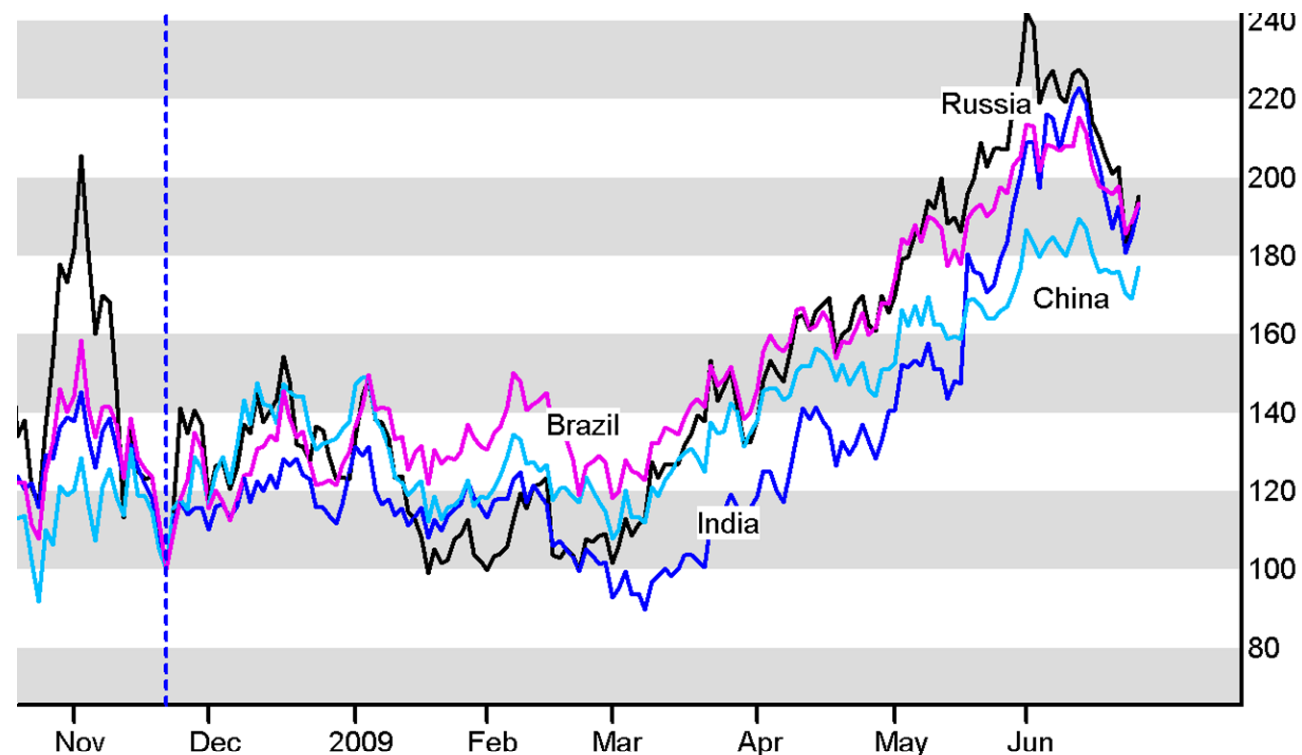
Not all is bleak and weak, but ... (cont.)

Emerging markets have done very well in recent weeks, and some of this performance can be explained by an improvement in economic indicators, such as **Chinese Retail Sales Year-on-Year** (chart above) or **Brazilian Industrial Production** (chart below). However, as shown on the next slide, the rally in emerging market stocks has become parabolic, which is one of the most difficult patterns to exploit, because parabolic rallies (or crashes) can go very far – beyond anything reasonable – but always correct very sharply behind.



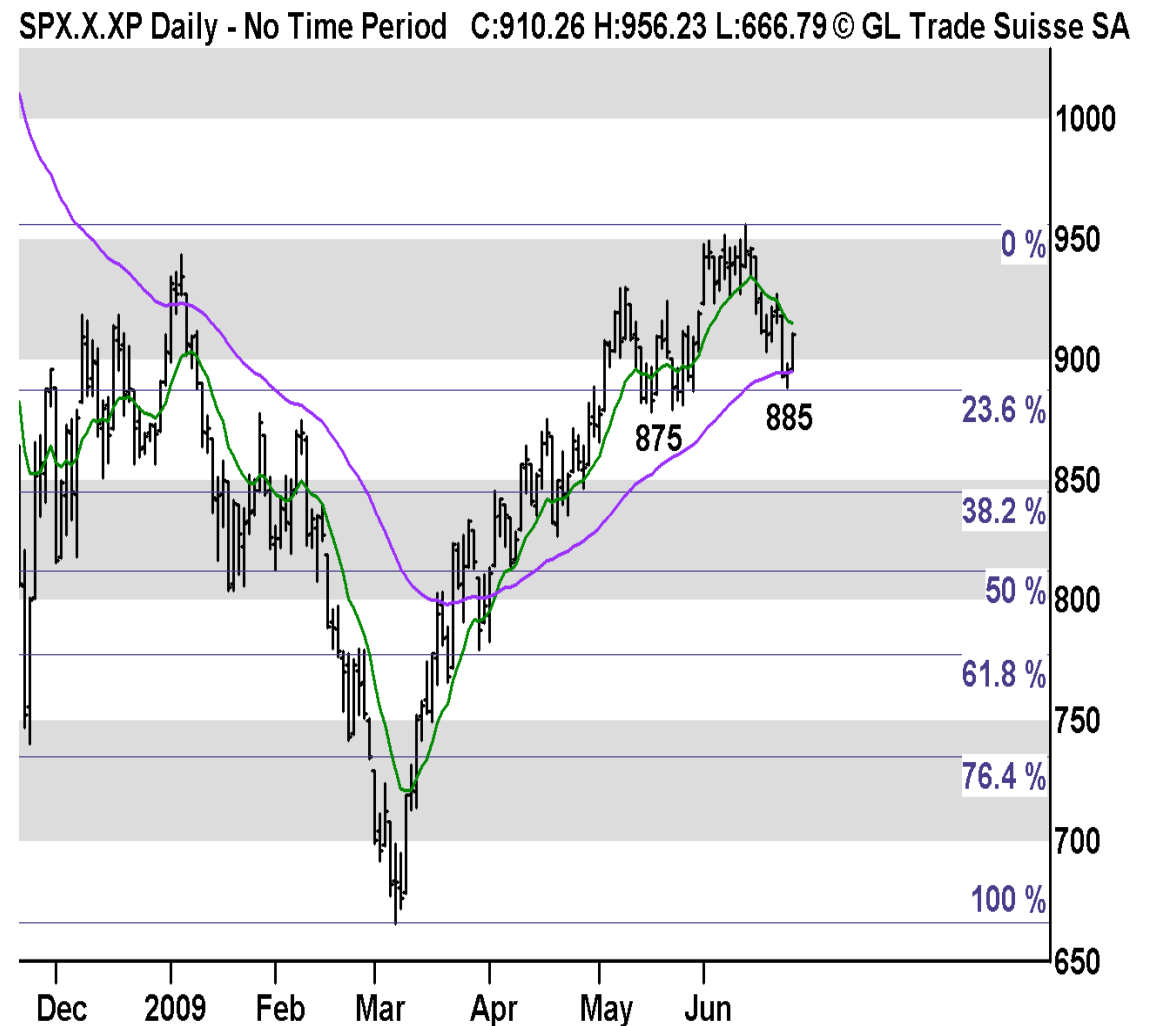
... the good news for BRIC's seem discounted

The chart below shows the performance of the largest BRIC ETF's (which also include the performances of the respective currencies). They all have more or less doubled in the past 3-6 months, indicating that the good news for these economies are already discounted, leaving again more surprise potential to the downside.



S&P 500 – 875-885 Pivotal Support

From a technical perspective, there is still a chance (!) that this bear market rally extends further, beyond the recent highs of 956. The critical and pivotal key support to watch lies between 875 (multiple low in May) and 885 (minimum Fibonacci Retracement). A clear break below there will tell us that we will finally see what we expect for some time, i.e. the next major move ... to the downside. We remain underweight equities.



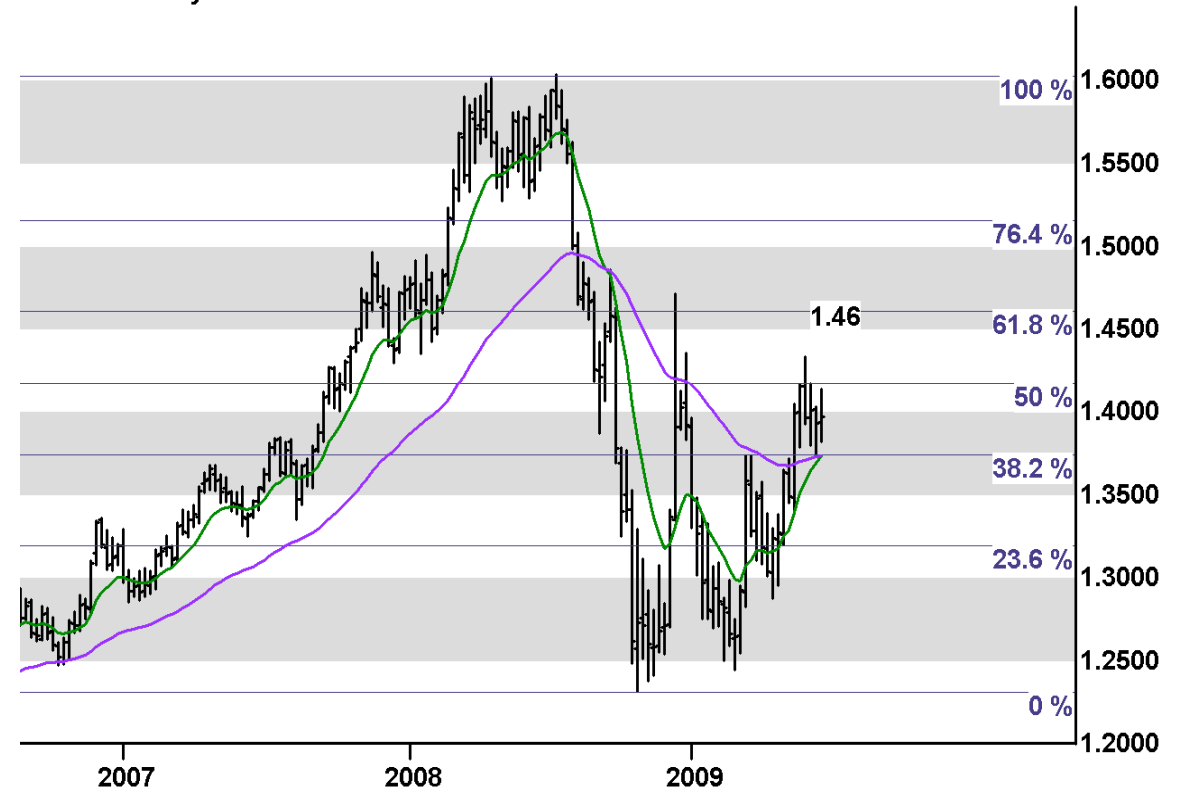
USD weakness to persist longer term

Over the past six weeks, EUR/USD is consolidating inside the 1.37-1.43 range, gradually building down overbought signals it reached early May. If risk aversion increases again – say if stocks tumble – we may see a temporary USD relief rally, which can send EUR/USD to as low as 1.30, but not below!.

A sustained break above 1.46 will open the door for a re-test of 1.60 ... and higher.

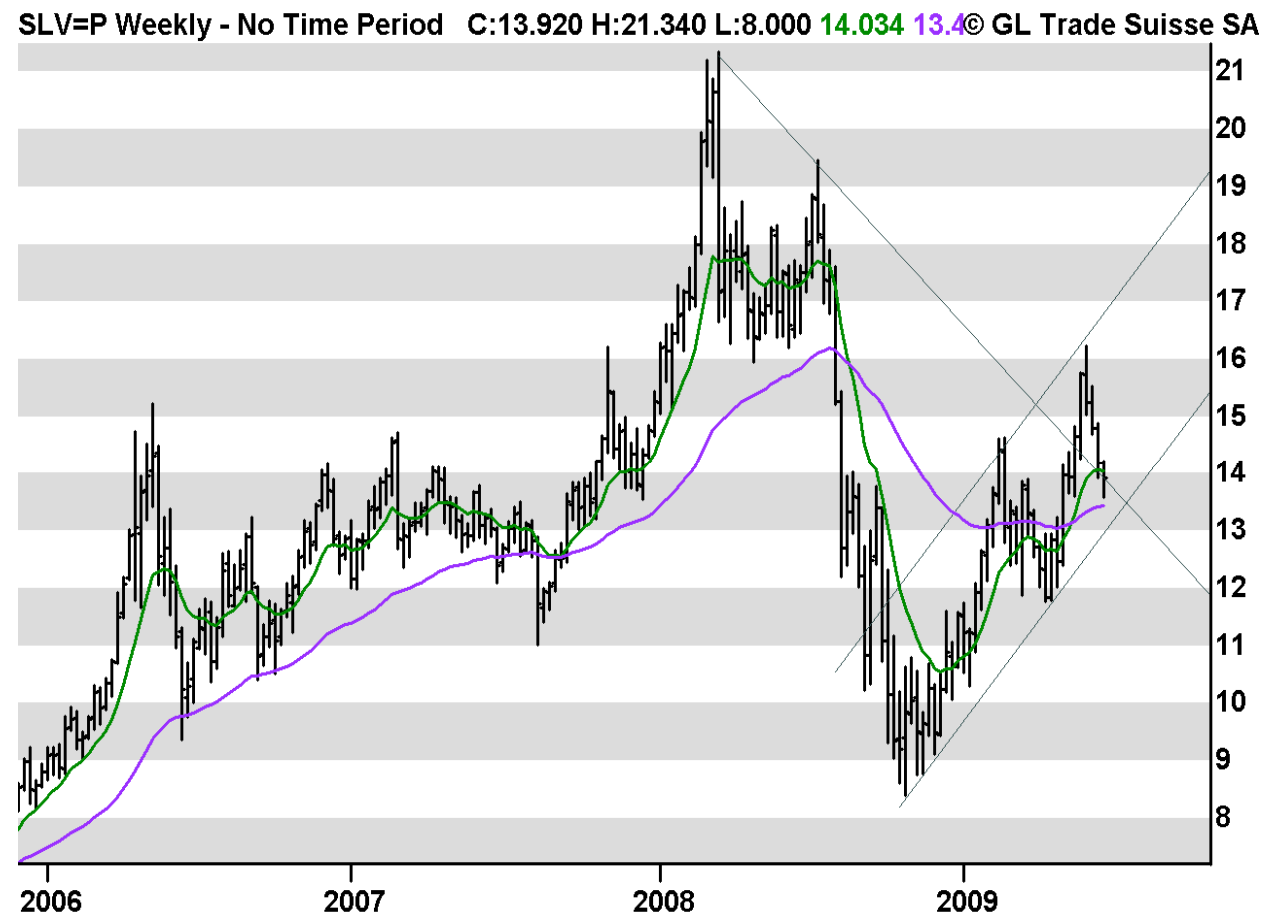
Investors should be underweight USD and sell more on any relief rally. The question is not IF 1.46 gives way, but only WHEN it gives way.

EUR=P Weekly - No Time Period C:1.3970 H:1.6038 L:1.2327 1.3735 1.3© GL Trade Suisse SA



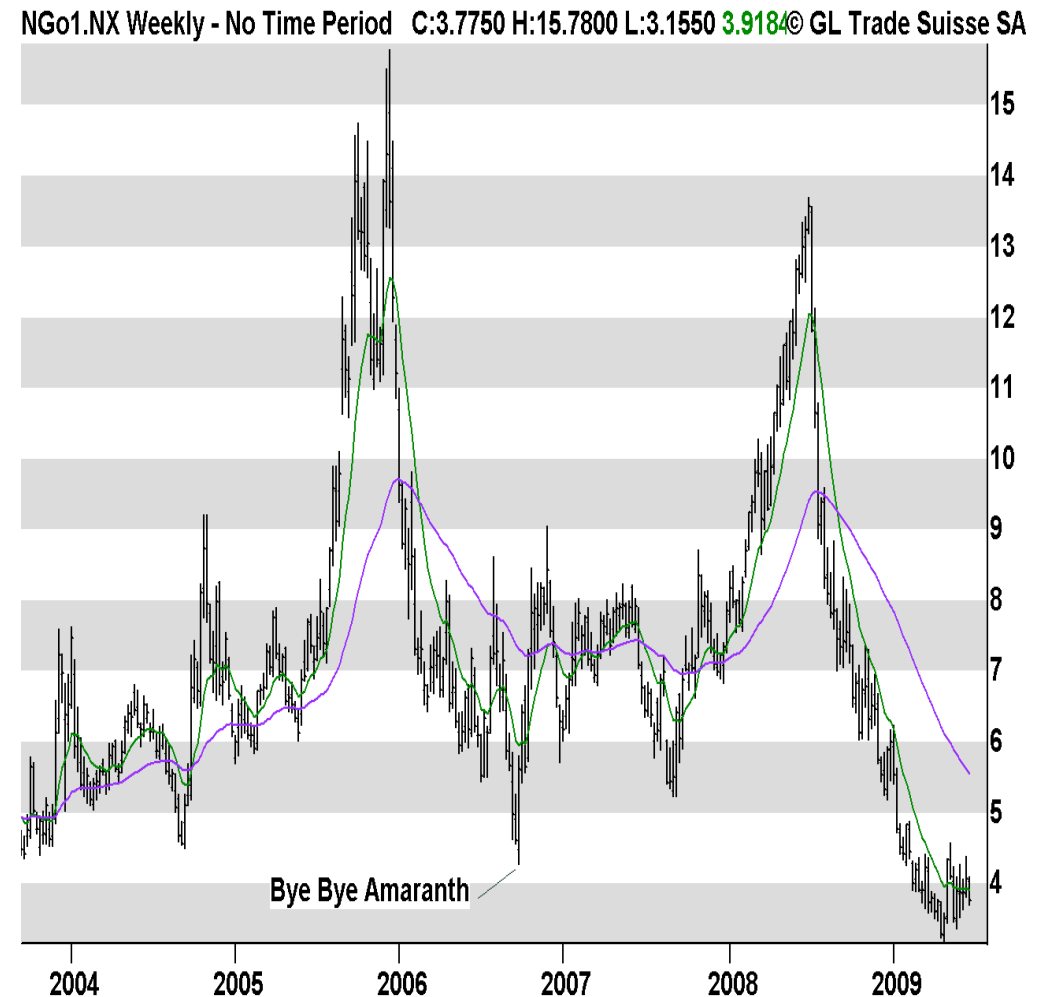
Silver – our favorite currency

From a technical point of view, Silver is the most promising “currency”. The correction from the peak seen early June, around 16 USD/ounce, is nothing else but a buying opportunity. We don't think that Silver will drop again below 13 USD/ounce. Thus, anything below 14 is a strong buy.



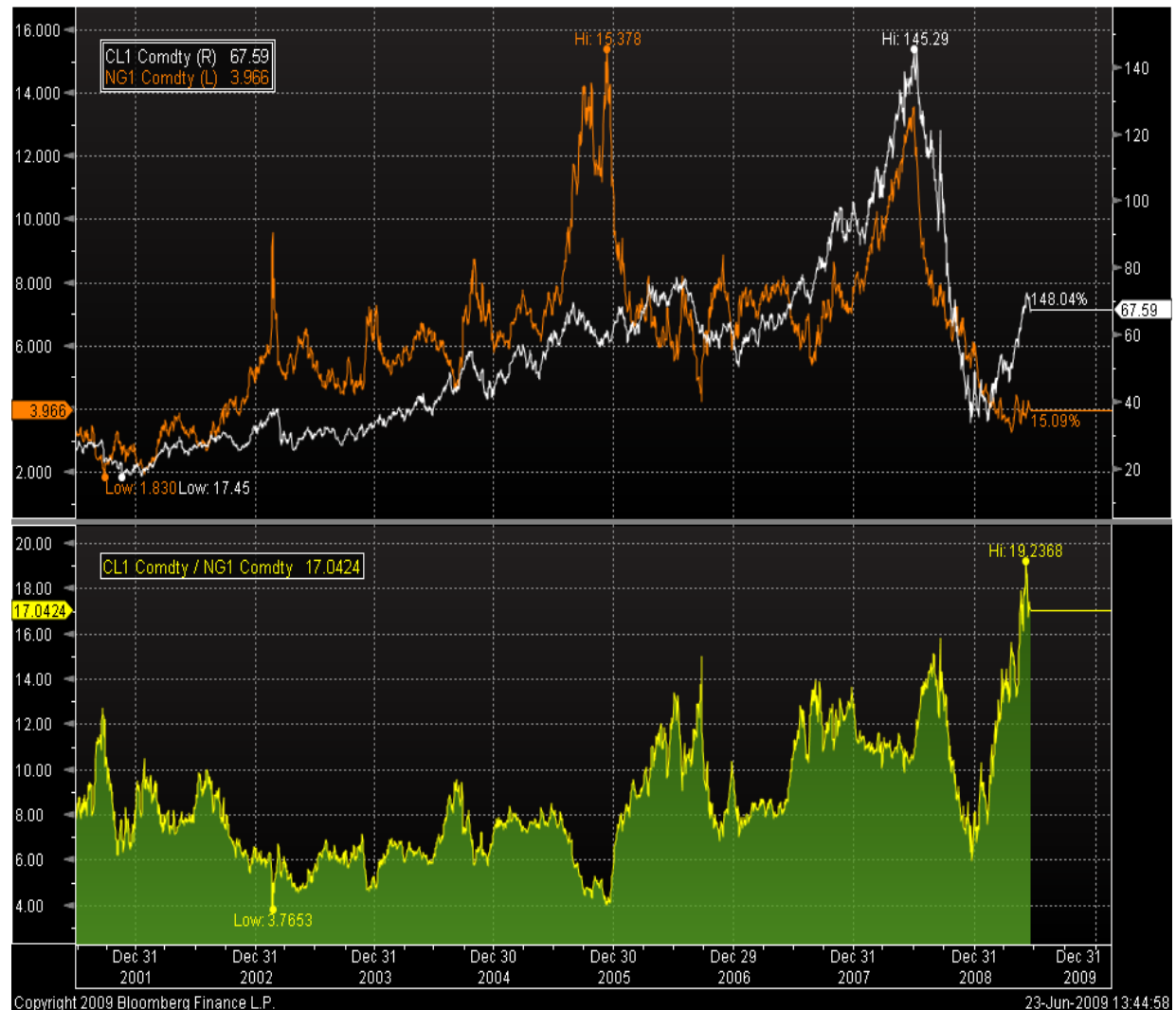
Natural Gas – a trading opportunity

Natural Gas currently trades at a 7-year-low. Investors or traders who are familiar with futures trading – and only those (!!!) – can build up a long position in Natural Gas futures, ideally in September 09 or longer contracts, around 4.00 USD and below. Natural Gas can be extremely volatile. The kneejerk correction from 8 to 4 and back to 8, in September 2006, led to the collapse of Amaranth Advisors LLC, an American multi (?) strategy hedge fund, after losing roughly 6 billion USD on natural gas futures.



Gas compared to Oil

The chart on the top is an overlay of oil and gas prices since 2001. The chart on the bottom shows the ratio between oil and gas during the same period. Both charts demonstrate that gas is currently extremely cheap compared to oil.

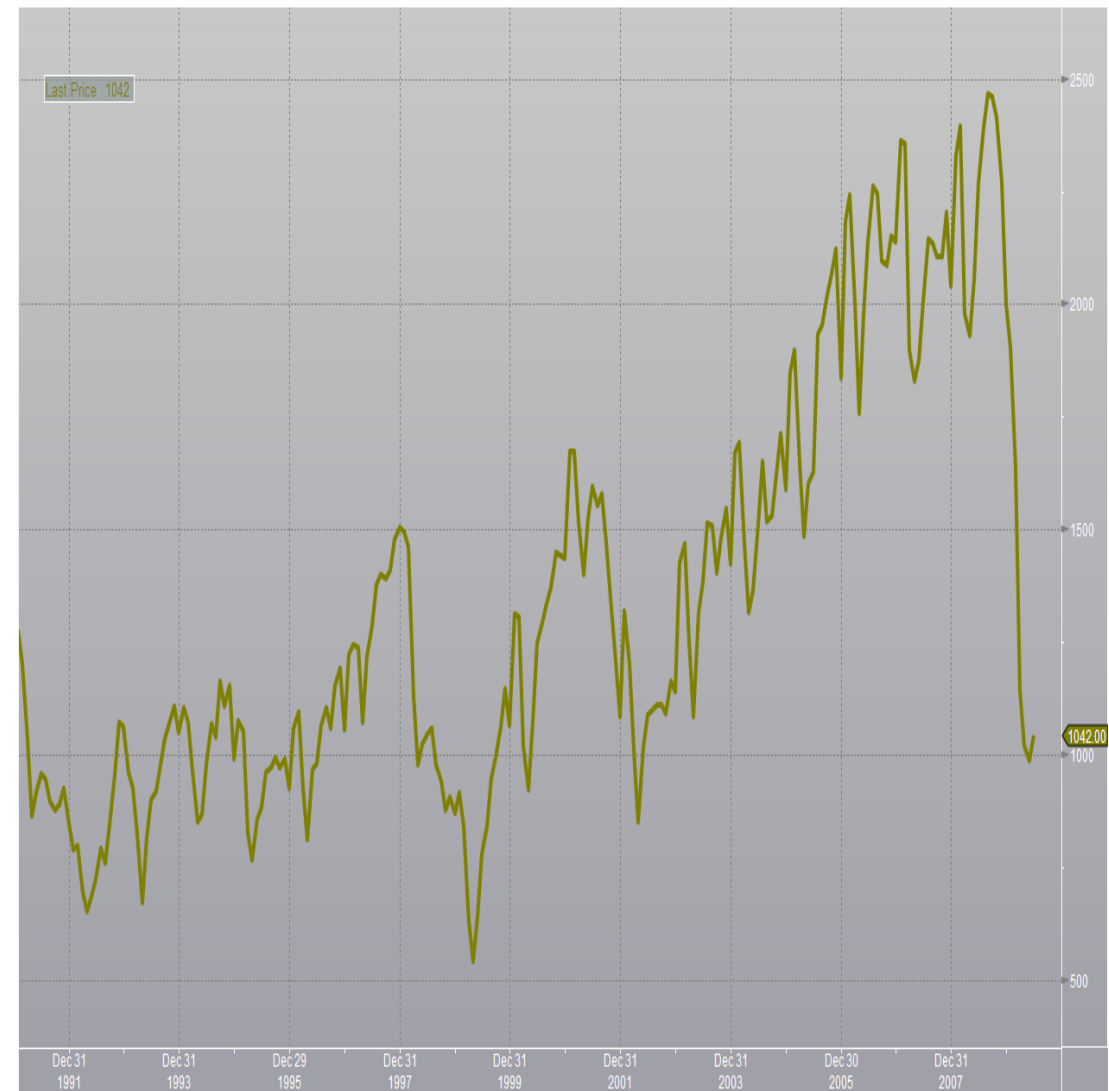


North America Rig count (as of June 19, 2009)

The number of rigs currently drilling for gas is 822 less than last year's level of 1'514 rigs – that's a heavy 54% drop. Oil can be bought anywhere, gas has to be bought next door (ask Ukraine).

The least we can say is that drillers have adapted to a decrease of demand, eventually overreacted.

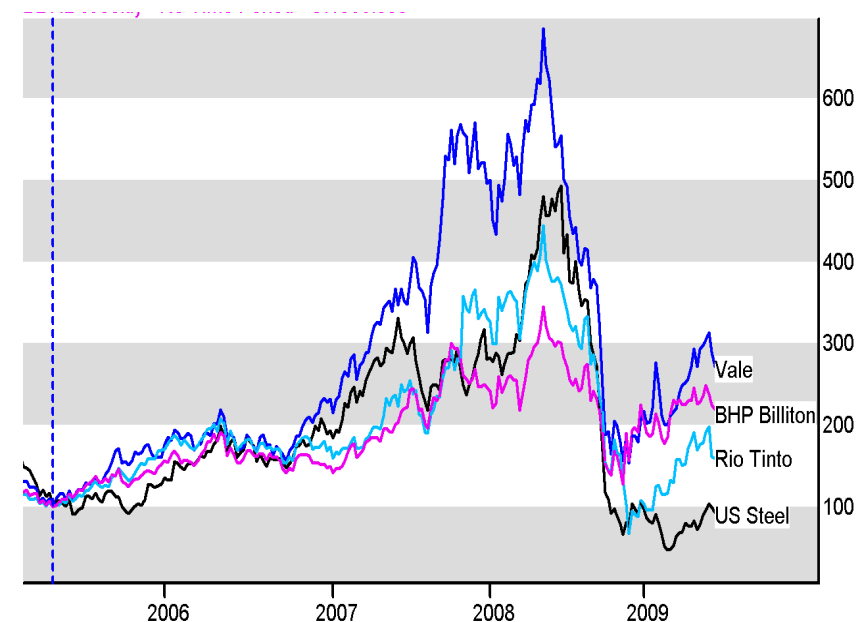
Again, this is nothing for investors with heart or tension problems.



China Steel ! – US Steel (X US)?



China is not the World, and US Steel even less so. But when comparing the iron ore imports of China (chart on top) with US Steel which produces in the (cheap) USD room, we have the impression that this is an opportunity, at least for those who patiently and gradually build up positions with long term potential.



Conclusions

- “In 1929, the S&P 500 index managed a bear market rally of 49% - we all know what happened thereafter. If the S&P index can make the same performance this time, it will reach 990, i.e. our major resistance level. We cannot exclude such a final rally, but think that it is unlikely and expect the S&P 500 index to cap in the 930-940 zone. Thus, we recommend (clearly) underweighting stocks”.

That’s what we wrote on May 12, 2009 (N.Y. close at 906). Although in the meantime it capped a touch higher, at 956, we don’t see any reason to change our statement.

- Technical analysis is not a science. Unfortunately, it does not function 100% ... as any other approach. But when looking at all charts of the main indices and currencies, Silver is definitely the hottest one – thus, worth a try.
- Natural Gas looks promising too, but more from a fundamental and historic high/low point of view.

Asset Allocation Guidelines

Asset Allocation Guidelines (for "Balanced Portfolios")

Cash	5%
Government Bonds (short term, top names*)	30%
Corporate Bonds (medium term, high grade)	15%
Equities	15%
Hedge Funds	25%
Precious Metals**	10%
Total	100%

*U.S., Germany, France, Netherlands, Switzerland

**5% physical gold, 5% gold mining stocks

Currency Exposure Guidelines

Currency Exposure Guidelines (for "Balanced Portfolios")

Base Currency	USD	EUR	CHF
USD	75%	0%	0%
EUR	10%	80%	10%
CHF	5%	5%	80%
Gold*	5%	5%	5%
Others	5%	10%	5%
Total	100%	100%	100%

*physical gold only, does not include exposure to gold mining stocks

Sources – Disclaimer - Opinions

Sources

We read many publications, from many banks, brokers and independent consultants, and spend a lot of time analyzing analysts, but almost no time analyzing balance sheets. Thus, our comments are often based on several sources, making it impossible to mention all – and be it only for the risk of missing and offending one of them. We therefore only cite our independent consultants, The Institutional Strategist (tis@tisgroup.net) and BCA Research (clientservices@bcaresearch.com) ... and thank all the other, unnamed ones for their valuable contribution.

Disclaimer

We take it as a given that the readers of our publications know how a disclaimer looks like (although they never read one) and that they are professional enough to take our recommendations as what they are: our actual views on markets, and subject to change without further notice.

Before following our advice, investors should consider that we run a higher risk than others of being wrong, because ... **“We rather have a wrong view than no view”**,

Opinion

We like to know your opinion, not only regarding our comments. If you have any suggestions, ideas or questions, please send a mail to loic.schmid@bbh360.ch