- Asia: Economic clout with new free-trade zone
- Switzerland: Consumer price index misleading
- Buy recommendation: Eyes open on Novartis

partners' view

January	February	March	April	May	June	July	August	September	October	November	December
1/10	2/10	3/10	4/10	5/10	6/10	7/10	8/10	9/10	10/10	11/10	12/10

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Politics and business

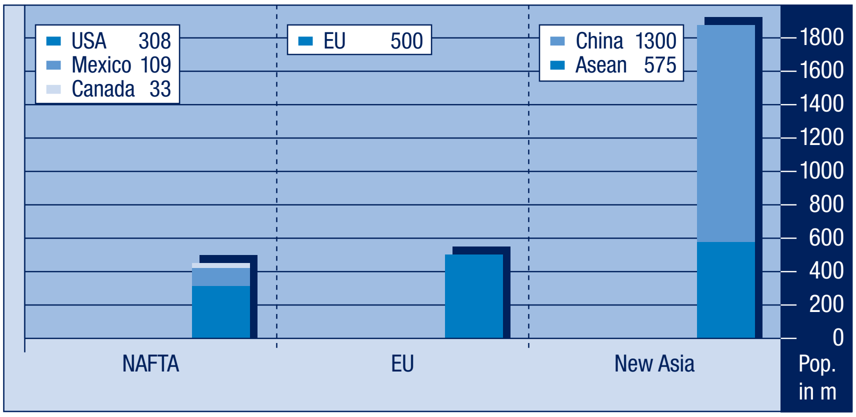
Soft ground for American homes. Thanks to a free-trade zone, Asia becomes a new economic power.

The American housing market, which triggered the global economic crisis, has still not bottomed out. The most recent figures show a totally surprising trend: imminent property sales declined by another 16 percent. One of the reasons is the expiry of the government's fiscal incentive for home buyers which amounted to USD 8000 per property. On the other hand, banks whose assets were poisoned by subprime mortgage products have risen from the ashes. Most government loans have been repaid and the lending countries either booked end-of-year profits in exchange for their support (Switzerland, UBS) or had to invest considerably less than was originally budgeted (USA).

New economic power

The free-trade agreement between China and the ten Asean nations (Indonesia, Brunei, Malaysia, the Philippines, Singapore, Thailand, Laos, Vietnam, Cambodia, and Burma) went into force on January 1, 2010. This new economic bloc with a population of 1.9 billion people will primarily boost intra-Asian trade. One of the key measures is the abolishment of 90 percent of all import duties. For suppliers domiciled in the countries that ratified the free-trade agreement, this is a massive advantage over their European or American competitors. The new zone also acts as a shield that sets up a barrier between the Asian growth markets and the rest of the world and leverages growth stimuli largely within the region. This form of modern protectionism which provides key trade partners with a bonus over rivals will not fail to have an impact.
The central bank of China tightened capital adequacy requirements and also increased the interest rate for one-year bonds. These restrictive measures must be observed very attentively because the Western world knows relatively little about the health of Chinese banks.

Three distinctive economic blocs



The German employment wonder

The German labor market is picking up steam. In December, the number of jobless people declined by 3000 and the unemployment rate stabilized at 8.1 percent, about 2 percent less than in the USA. This is an astounding trend, especially when looking back to the recent past. In 1999, about ten years ago, nearly 12 percent of the working population in Germany had no job, as opposed to about 4 percent in the USA at that time. So while the number of job seekers has more than doubled in the USA since then, unemployment in Germany declined by about 30 percent. However, Spain faces the biggest problems as regards job cuts. In the southern part of Europe, 19.3 percent of the employable population is jobless, one in five people!
There couldn't have been a worse time for disappointing labor market statistics to surface in the USA. In December, another 85,000 jobs were lost, much more than expected. This is especially serious because the slump broke the positive momentum. After all, economists have become accustomed to hearing upbeat news about the US job market.

Currencies and interest rates

The euro is ailing and the Norwegian krone looks promising. The Swiss consumer price index is misleading.

The euro, Europe's unified currency, is becoming more and more unstable. The burden of high debt (Greece, Italy, Ireland, Belgium), the enormous unemployment rates (Spain, Slovakia), and the latest expansion towards the East (Bulgaria, Romania) are having a negative impact on the exchange rates versus the Swiss franc and even the US dollar.

Total return is decisive

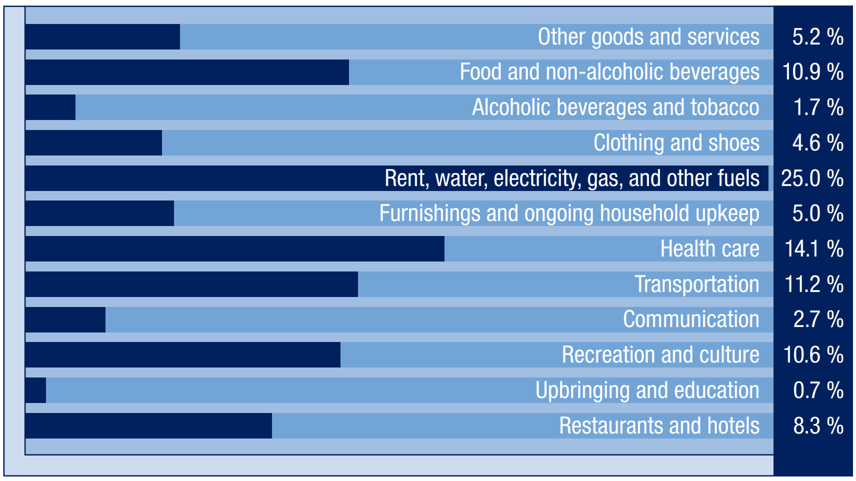
The risk premiums for credit default swaps (CDS) declined considerably last year, after a steep rise at the turbulent beginning of the year. The returns available to holders of corporate bonds dropped by the same margin. Once again, it must be pointed out that high risks associated with corporate bonds are not worthwhile at the moment. In 2010, the total return in bonds, composed of interest income, price gains, and currency translation differences, will not by any measure match the attractive advances in 2009. The Norwegian krone has the potential to perform well in the total-return analysis. Short-term bonds issued by top-rated borrowers (further interest rate hikes are expected in Norway) currently yield about 3.5 percent. Because of the very solid metrics of Norway's economic output, it is fair to expect the country's currency to appreciate.

Discount wars

People who are currently browsing show windows can see the wide-open gates to paradise. Liquidation sales and predatory discounting suggest that inflation – an increasing consumer price index – is far away. But those who analyze the weighting of the goods basket used to calculate the national index of consumer prices will note that the item "Clothing and shoes" only accounts for 4.6 percent (see graph). And the obvious price cuts in home electronics (booked under "Recreation and culture") only make up about 3 percent. Also, the assumption that the increase in "Health care" is attributable to higher premiums for health insurance is wrong. These expenditures, which impose a heavy burden on the budgets of most households, are not even included in the consumer price index (see also partners' view 7/09).

United in direction, disparate in timing – that would be a fitting description of the opinions of economists regarding global interest rate policies in the current year. Most experts agree that the large economic blocs – the USA and Europe – are poised to abandon the accommodative strategy and raise interest rates this year for the first time. A year has 12 months and there are almost as many proposed deadlines for these first interest rate steps. If the economy continues to improve at last year's encouraging pace, this event will happen just before mid-year. If we see setbacks in the rebound, interest rate hikes will be delayed until the end of the year.

Swiss consumer price index (LIK) – basket and weighting



Source: BFS

Financial markets

Invest in Asia according to the motto "Better late than never." Making money is getting more difficult. Eyes open with Novartis.

The free-trade agreement in Asia (see "Politics and business") is a veritable reason to be invested in Asia. The best way is via an investment fund specialized in this region ex Japan. Even though prices have rebounded vigorously since their latest lows, investors looking for equities can hardly ignore this market. "Better late than never" is arguably an adequate motto.

The aftermath

This year, the Federal Reserve Bank (FED) will announce its first interest rate hike. It has been statistically corroborated that stock markets trend briskly twelve months before an interest rate increase, in our case the year 2009.
But in the months after the first hike, the music plays in minor. Nonetheless, 2010 is bound to be a demanding year that initially could be very friendly because of all the liquidity that needs to be parked. The pre-hike period will soon be over and then, from a purely statistical point of view, it will be harder to earn money. Due to the buoyancy that prevailed last year, investors could buy almost anything, but in 2010, profits will depend on judicious stockpicking.
The start into the corporate earnings season – some call it the "confessionals period" – was rather downbeat. Alcoa, traditionally the first S&P 500 equity to show its hand, disappointed analysts and was punished with an 11 percent price erosion. It is obvious that after a good year in stocks, investors are hoping that their ambitious expectations will be fulfilled. This also supports the thesis that this year, selectivity will be much more important than previously.

Eyes open!

The market penalized the total takeover of Alcon by Novartis with a massive stock price slump. Although the transaction was already announced in 2008, it still caught investors on the wrong foot. The Basel-based pharma giant complemented its ophthalmology portfolio (lenses, eye surgery, instruments, and medication) with Alcon and is merging it with its own "Eye Care" division consisting of Ciba Vision (contact lenses and lens care products) and the ophthalmic operations of Novartis' Consumer Health Division. Given the strategic rationale of the decision and the unjustified market response, it is high time to cast an eye on Novartis.

Last but not least

"People can't stand a blowhard, but they'll always listen to him."
Muhammad Ali

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Marthe Ballet
Yves Baumann
Jörg O. Blickensdorfer
Johan Buckert
Christ Johann Collenberg
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