- Illegal: Unprofitable breach of contract
- Inscrutable: Rescue facility on watchlist
- Irrational: Disappointing utilities

part

partners' view

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

swisspartners

Politics and business

Surprisingly robust labor market figures in the USA. Deflation trend continues in Switzerland. North Rhine-Westfalia cold-shoulders Minister of Finance Schäuble.

While Europe is preoccupied with getting the latent debt problems more or less under control, the USA is reporting reassuring economic data. Both the labor market (newly created jobs, jobless rate) and the most important purchasing managers indices were remarkably robust. Thus, the US unemployment rate surprisingly dropped to 8.6 percent, the lowest level in a long time (see graph).

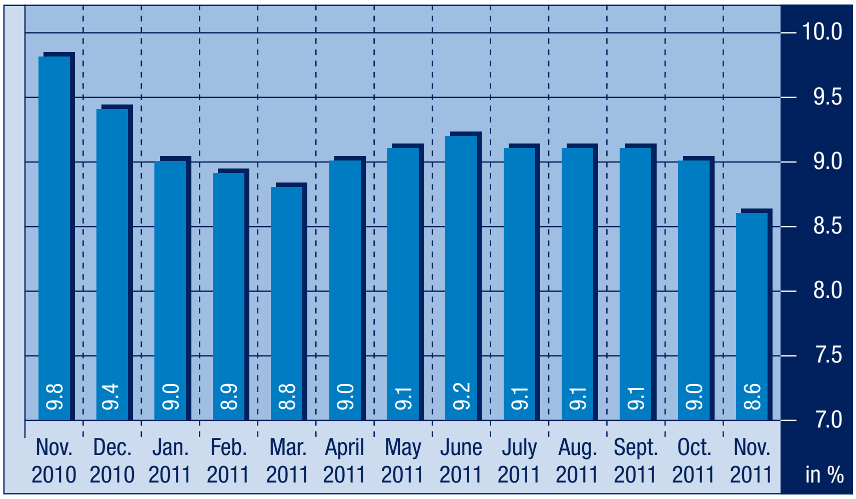
Deflation

The decline of prices for Swiss consumer goods that have been anticipated for next year unexpectedly took hold this November, even though projections had suggested a slight increase. The deep discounts offered to buyers of automobiles (euro rebates) account for most of the 0.2 percent deflation. This is further increasing pressure on the Swiss National Bank (SNB) to weaken the Swiss franc because inflation associated with an expansion of the money supply would be tolerable. It could weaken the franc by further raising the minimal EUR/CHF foreign exchange rate. There are many reasons for such a move: deflationary trend, increased unemployment (now at 3.1 percent), shift of export-industry jobs to low-wage countries, and exchange-rate-related losses in the quarterly results of many businesses. What is more, the SNB can rely on full political support for an intervention of this kind. So it is absolutely conceivable that the SNB will already have been active when this issue of partners' view is distributed. The timing would be perfect, because the year-end rate of the euro will also be applied in corporate balance sheets to translate foreign-exchange reserves into francs.

Unprofitable breach of contract

When Switzerland and Germany signed a joint tax treaty, the German side agreed not to leverage and/or purchase stolen financial data. Although the treaty has not yet been ratified, the clauses that waive the prosecution of bank employees and the purchase of data CDs are already valid. Obviously, this is of little interest to the government of North Rhine-Westfalia, because it is considering the purchase of a CD with stolen data implicating clients of Swiss banks. For several different reasons, this is not a wise decision. First of all, the state is snubbing Wolfgang Schäuble, its own Minister of Finance, whose signature seals a moral obligation for all of Germany, including all of its states, and he is the individual who will ultimately distribute to the German states the tax revenues received on the basis of the treaty. Secondly, experience with the last instances of stolen tax data confirms that the tax revenue collectible with this method is even lower than what the treaty signed by Schäuble will generate with no extra effort whatsoever. So even from the monetary perspective, the breach of contract makes no sense.

US unemployment rate



Source: US Department of Labor, Bureau of Labor Statistics

Currencies and interest rates

No added value with the Norwegian krone in 2011. Yet again, rating agencies provoke outrage. Merkel and Sarkozy as euro debt solution developers.

Although the Norwegian krone (NOK) recently gained somewhat versus the Swiss franc, the true barometer is the euro, not the franc. The NOK is more attractive than the EUR in every respect, but the diversification into NOK bond did not really generate any added value. Today, its value versus the euro and the Swiss franc is at the same level as at the beginning of the year. Nonetheless, it has considerable potential, given the Eurozone's pending problems.

Is S&P politically active?

The euro and its member nations should be rescued under all circumstances. The objective is to curb financial speculation aimed at Southern Europe (Italy, Spain, Portugal, Greece) and to open the rescue umbrella so broadly that the indebted nations can borrow money at more favorable terms. For months now, US rating agencies have been thwarting such attempts. But in many cases, their activism is impenetrable, especially as regards the timing of their announcements. For instance, Standard & Poor's placed no fewer than 15 Eurozone countries on the watchlist with a negative outlook, only two days prior to a seminal meeting of EU political leaders at the Euro Summit in Brussels.
If the US rating agency intended this to be a downgrade threat to force a sustainable solution at the summit, it overestimated its own role. The purpose of a rating agency is to assess the financial soundness of bond issuers and not to assume roles in politics. The reform process in which the Eurozone countries are involved is being repeatedly torpedoed and delayed by the rating agencies because the response to such announcements is higher risk premiums (meaning higher debt servicing costs).

It's sink or swim

Germany's Chancellor Angela Merkel and her French counterpart President Nicolas Sarkozy regularly get together as a political "outpost" ahead of important meetings of Euro member nations. They are, so to speak, the trailblazers of solutions that must then be unanimously ratified by all members of the Eurozone. This approach has its downsides because among others, euro heavyweights France and Germany convene at these meetings with pre-worded contracts that automatically impose sanctions on member nations with excessive deficits. So for the deficit-ridden countries, these are not jointly developed solutions, they are warnings: either they accept the drafts negotiated in advance by Germany and France or they forego their eligibility to receive financial support. In view of the contractually defined and thus unavoidable unanimity for council resolutions, this could soon backfire for Germany and France.

Perpetuum mobile

Next year, the capital market will have to pass an acid test. In 2012 alone, the USA and the Eurozone have to refinance nearly five trillion (5000 billion) US dollars in debt. This represents 200 to 450 percent more capital than was needed this year! Who has the funds to buy these bonds apart from the central banks (ECB and FED), or perhaps surplus-generating Japan and China? And, more importantly: at what terms? The European Union wants to solve this problem with the permanent European Stability Mechanism (ESM) and, in parallel, the temporary European Financial Stability Facility (EFSF). These two repositories are to be endowed with guarantees and leverage mechanisms allowing them to fund European bonds worth up to two trillion (2000 billion) euros. Rating agency Standard & Poor's has already implied that this perpetuum mobile is not to everyone's liking: It placed the EFSF bonds on the watchlist as a candidate for a downgrade from their current AAA rating.

"In 2012, the USA and Europe will have to refinance a huge amount of debt."

Financial markets

Critical review of recommendations. Corporate capital requirements result in capital increases and divestment.

The buy thresholds suggested in the October issue for ABB (15.50) and Holcim (48.00) were attained only three weeks later. This illustrates how volatile the equity markets are – even for blue chips.
The markets are nervous in both directions: Investors either missed the upswing and are buying, or they own too much stock in the downswing and are selling. Both approaches are trend accelerators. For the time being, this scenario will not change.

Rear-view mirror

In this last issue for 2011, a critical look back at the year's investment recommendations is appropriate. The great disappointment this year, with hindsight, were shares in companies focused on renewable energy. Not just the nuclear catastrophe in Fukushima, but also the growing appetite of Asian economies for energy would have been reason enough to secure sustainable profits for this industry. But its annual performance was exceptionally poor, because of surplus capacities, competition from low-cost producers in China, and the abolition of government incentives. Nonetheless, or now all the more: the future of renewable energy never looked rosier. Consequently, our recommendation: ride it out!
The roster of big losers also includes European utilities. Despite dividend yields of up to ten percent, French stocks like Suez, Veolia, EDF, or Germany's RWE and E.On have been punished by between twenty and fifty percent this year. Electricity, water, and waste management remain products with a future. Moreover, writedowns in conjunction with the nuclear phase-out (E.On, RWE) have likely been digested in the meantime.

Capital requirements

The year 2012 could become a challenge, not only for the bond market with respect to capital requirements. The stock market might also be poised for a wave of capital increases. German utility RWE played a pioneering role by raking in two billion euros with stock placements. The market reacted with a price plunge of twelve percent. Financials are facing further stress tests, which could also lead to further capital increases, depending on the capital adequacy results. Divestitures are another source of capital. Net debt can be reduced by selling activities that are outside the scope of a company's core business. French utility Veolia Environnement, for instance, announced its intention to raise a total of five billion euros by spinning off business units.

Last but not least

"Markets are like parachutes:
they only work when they're open."
Former German Chancellor Helmut Schmidt

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Robin F. Amacher
Kristian Bader
Marthe Ballet
Yves Baumann
Johan Buckert
Herman Buhl
Christ Johann Collenberg
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