

### Interest rates/Bond markets

#### Rewinding emergency measures

##### USA

- Ongoing debates about sovereign risks in the Euro Area periphery leave marks in bond markets worldwide
- The Federal Reserve prepares the ground for a cautious withdrawal of monetary stimulus by raising the discount rate
- Credit markets suffer from the general drop in risk appetite – spreads should continue to widen modestly

##### Euro Area

- Fears surrounding the Greek fiscal crisis have lessened somewhat and the spreads of peripheral countries' paper to German Bunds have tightened
- Given the sovereign risk debate, the ECB will likely keep rates lower for longer
- Macro data point to stronger economic activity

##### Japan

- The Japanese economy is mired in deflation still – ultra easy monetary policy does not help to activate price dynamics
- Real GDP growth in the fourth quarter 2009 benefitted from the deep plunge of the deflator

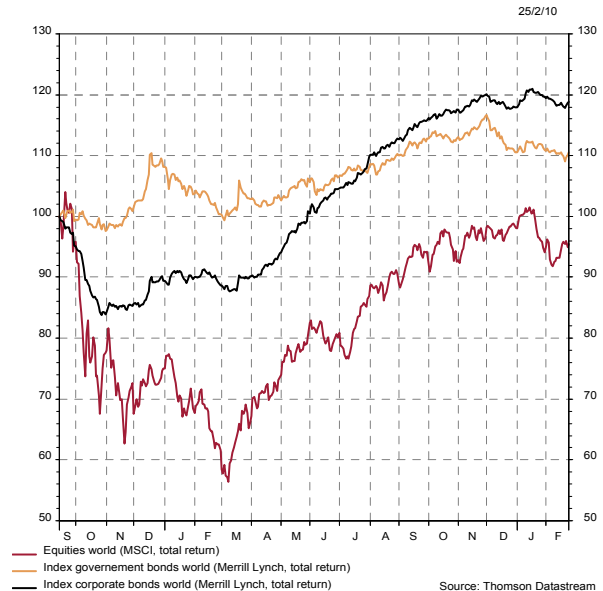
##### United Kingdom

- The BoE makes an unusual strong commitment to leave the benchmark rate untouched for an extended period of time
- Temporarily high inflation rates should calm down again over the coming months

##### Switzerland

- Swiss National Bank continues to intervene in currency markets if Swiss Franc appreciation goes too far
- The yield on a 10 year government bond remains at ultra low level as domestic demand for this asset class continues to be high

### Asset class performance since Lehman collapse



Markets remain hyper-sensitive towards potential exit strategies of central banks. The latest move of the US Federal Reserve to rewind emergency measures, namely the hike of the discount rate, caused markets to temporarily reprice. Although such a move was commonly expected, the timing of the decision caught some market participants on the wrong foot. In our opinion 10-year yields in the US have reached the upper boundary and should retrace this increase over the month to come. Yet in his latest testimony to Congress, Fed chairman Bernanke reaffirmed that an expected backdrop of low rates of resource utilization, subdued inflation, and stable inflation expectations is consistent with a low for long stance on policy interest rates. Bond markets in the Euro Area, on the other hand, had to struggle with debates surrounding sovereign risks in the peripheral countries and potential contagion into core Europe. The early March ECB meeting and the mid March ECOFIN meeting are key dates to see whether any support measures are granted by the Euro Area to the problematic countries such as Greece. Concerted bilateral aid consisting of loans and guarantees, coordinated by the European Commission, seems a likely form of support that could be made available to Greece, if needed. In the meantime, we expect long rates to edge slightly higher.

### Stock markets

Recovering from a temporary setback

#### USA

- Sound earnings season had limited market impact
- Equity markets have recovered in February confirming our view that setback at the start of the year was only temporary
- We expect higher stock prices over one month as the signs of an economic recovery are increasing

#### Euro Area

- Euro Area stock markets lost out versus other regions so far this year
- Higher realised and expected corporate earnings result in even more attractive valuation metrics
- We think that the negative investors' sentiment is a contra-indicator and thus see current levels as a positive signal

#### Japan

- Japanese stocks performed comparably poorly in the last month as fears related to monetary tightening in China weighed on the market
- As our regional allocation model is based on trend following concepts its current positioning recommendation is to underweight Japan

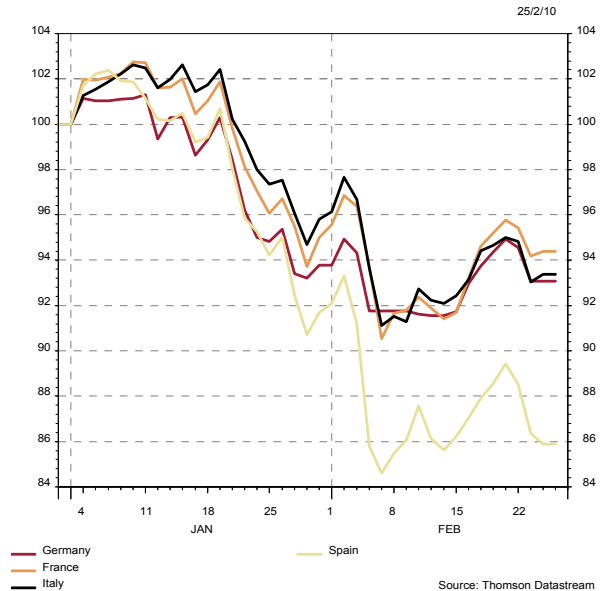
#### United Kingdom

- As the economy recovers and the Bank of England promises to keep rates low for a prolonged period of time, the fundamental environment remains favourable for stocks in the UK
- In a global equity portfolio, UK stocks should be kept overweighted

#### Switzerland

- Our regional allocation model suggest an overweight of Swiss equities
- Fundamental valuation measures remain supportive for Swiss equities with the price to cash-flow ratio approaching its longterm average levels
- Rising earnings expectations will result in even more attractive valuations metrics

### Euro Area equity markets in 2010



With both the S&P 500 and Euro Stoxx 50 moving up approximately 6% from their lows this year reached at the beginning of February, we reiterate our view that the latest setback was in line with the numerous ones that occurred since the cyclical low of March 2009. Macro- and micro momentum are still intact. After the latest correction and considering the healthy outlook for corporate earnings, equity valuations have certainly gained in attractiveness as compared to other risky assets such as corporate bonds. While the credit rally of the past quarters brought spreads back to levels that they had reached before the Lehman collapse, equity indices have not yet climbed above pre-Lehman levels. Furthermore, the Euro Stoxx index has corrected relatively much as compared to other stock indices on the back of the sovereign risk crisis in the European periphery. As signalled by the volatility spread between the Spanish index and the EuroStoxx50, investors already seem to bet on a contagion of the debt crisis into core Europe which obviously limits the downside risk from here. The latest Fed hike of the discount rate is not a game-changer to us but rather signals that the financial crisis has been largely digested justifying an end to emergency measures introduced by the Fed. We stick to our belief of a continuation of the bull market.

### Currencies

Euro weakness is overdone

#### USA

- In the mid-term, the USD has room to appreciate further versus European currencies
- 2-year swap rate differentials indicate further upside potential against the Euro

#### Euro Area

- Current EUR/USD level is in undershoot territory
- Net short speculative positions in Euro are at record levels, reflecting extremely negative sentiment
- This recation is overdone and we expect the Euro to recover against Swiss Franc until end of the year

#### Japan

- If risk sentiment stabilises further, the Yen should weaken against other major currencies
- The deflationary outlook for the Japanese economy plus the rich valuation of the Yen call for weakness in our view

#### United Kingdom

- Dovish Bank of England displays a growing inflation tolerance despite the recent overshooting of the inflation target
- We remain constructive for the Sterling as the housing market recovery and strong purchasing managers surveys suggest that the economic recovery is a fact

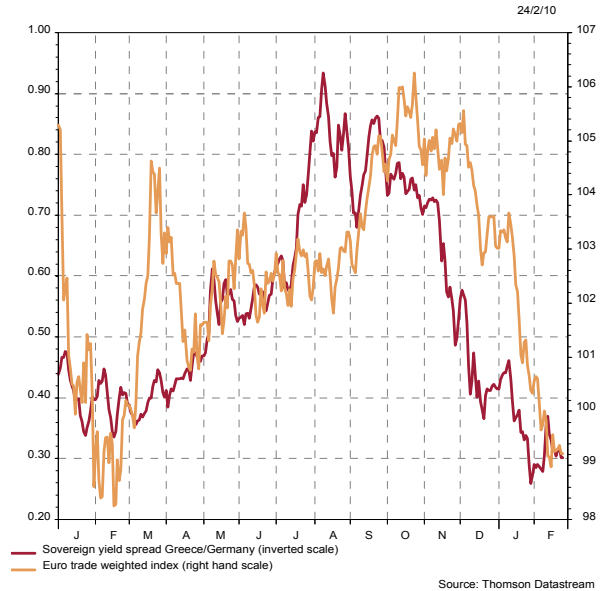
#### Switzerland

- SNB vice chairman Jordan restated the central bank's interventionist stance
- We think that the Swiss National Bank has an exchange rate of 1.47 against the Euro in mind as the floor to defend
- Due to widening rate differentials to other regions, we expect the Swiss Franc to weaken mid-term

#### Released and approved by the Economics Department

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### Greek tragedy weighs on the Euro



Looking at our simple rate differential model, which takes the economic divergence theme into account, the recent strengthening of the Dollar seems justified. However, the market reaction with respect to the EUR/USD exchange rate, aggravated by the Greece issue was overdone in our view. Until the end of the year, we expect the Euro to recover against the Swiss Franc to levels of around 1.50. For the time being, we believe that the Swiss National Bank will maintain their interventionist stance when it comes to defend the Swiss Franc from appreciating further relative to the Euro. We think that their current line of defense is drawn around 1.47. Since our last investment process, our call for a stronger British Pound has become less convincing as the Bank of England has displayed very little willingness to start a monetary tightening cycle earlier than its central European peers. Although inflation has surpassed the upper limit of the Bank of England's target band, officials of the bank repeated that interest rates will be kept at very low levels for an extended period of time. We nevertheless remain constructive on the Sterling over the coming month as we think that positive macroeconomic fundamentals will be the dominant market driver in the short-term.