Outlook 2012

December 2011

By Thomas Fischer

JYSKE GLOBAL ASSET MANAGEMENT

2011

According to the Chinese Zodiac the year of 2011 was the Year of the Rabbit. According to Chinese tradition, the Rabbit brings a year in which you can catch your breath and calm your nerves. Wow did the rabbit get that wrong!, we have just experienced one of the most difficult years in the financial industry. European banks have been in the eye of the storm throughout 2011, and as in a real life storm the "eye" acts as the vortex that feeds humid air and cloud formation into the force of the storm. The investment world watched nervously how developments unfolded in the eurozone with almost daily reports about the debt crisis and a shaky currency foundation. Banks world-wide are exposed at different levels to the eurozone countries but within the eurozone exposure remains high, forcing banks to "slim" the balance sheets. We entered 2011 as cautious optimists but in the early summer we realized that the politicians in the U.S. and Europe would not be able to calm the waters but rather make a bad situation even worse. We therefore reduced risk in our portfolios by limiting our exposure to bonds and equities. We enter 2012 with an underweight position on bonds, underweight position on equities, neutral and overweight on alternatives and overweight cash.

The Investment Committee of JGAM met recently outfitted with reports from our research partners and a crystal ball, we tried to look into the future and will in this article try and give our view for 2012 and the threats and opportunities facing investors.

2012

According to the Chinese Zodiac is the Year of the Dragon signifying success and happiness, is rather murky. We believe that the world is facing many dangers and that we will have yet another year with high uncertainty and increased volatility. We are very nervous about the world economy and we cannot rule out that history will repeat itself and give us another dose of depression last seen in the thirties. We hope however, that politicians will wake up and realize the grave dangers before we reach the "tipping point" and turmoil. In such an uncertain environment, we believe it is important to construct "All Weather Portfolios" that can withstand the storms and hurricanes that in our opinion will occur throughout 2012. We have identified the following as major themes that will affect the world economy and the investment world:

- The eurozone debt issues and the future of the euro
- U.S. in an election year
- China's growth
- Geo political tensions

Eurozone

In the eurozone politicians and technocrats have to begin to deploy proper long lasting initiatives and policies to address the sovereign debt issues. The introduction of "eurobonds" and a European Central Bank (ECB) actively involved as a "lender of last resort", would probably calm investors' nerves, and give the European politicians time to address the underlying euro problem namely a lack of integrated fiscal policies. The solutions sounds pretty easy, but with 17 countries involved in the process and Germany a staunch opponent of granting the ECB a greater role, it will be an uphill struggle to empower the ECB. Without a proper unified strategy, the eurozone will keep making haphazard solutions, thus further exacerbating the tension in the eurozone. The future of the euro is now really an issue and a breakup of the currency is not as far-fetched as once believed. The threat to the euro can come from both inside and outside the union. In the 17 country eurozone, tensions are already running high, as Germany wants all the other countries to behave like Germans. However, the last thing low growth, high unemployment countries like Greece, Ireland, Spain and Portugal need is strict austerity measures. Outside the eurozone, but within the EU 10 countries resides, some have begun to question their membership. In the UK euro skepticism is rising and some politicians have expressed concerns about a eurozone acting against the interest of other EU members.

U.S.

In the U.S. the politicians from both parties have to work together to fight high unemployment and increasing debt levels. They struggled in 2011 with raising the debt ceiling and in November the "Super Committee" could not agree on austerity measures and the stalemate triggers automatic spending cuts of USD 1.2 trillion. In 2012 the "federal extended unemployment program" will expire and 2 million unemployed workers will lose unemployment insurance, unless Congress renews the extended unemployment program before expiring on December 31. The social security payroll taxes were reduced in 2011 and the cuts will expire at the end of the year, unless the U.S. Senate agrees to renew the tax cuts. Democrats and Republicans already have clashed over the issue and in an election year co-operation could become even more difficult.

China

With recession looming in the background, both in Europe and the U.S., all eyes are now on the emerging markets in general and China in particular. The emerging markets however, are export driven and growth is depending on customers (read: Europe and the U.S.) willing and able to continue spending money. In Europe governments are cutting spending aggressively, in order to satisfy creditors and thus keeping interest rates at a sustainable level. The banks are simultaneously scaling back their assets and tightening credit standards. The EU is the largest market for many Asian exporters representing 11% for Korean exporters and 19% for Chinese exporters. The U.S. accounts for about 17% of Chinese exports so continued deleveraging in Europe and the U.S. will have a huge impact on the emerging economies. According to our research partner Bank Credit Analyst (BCA) Singapore, an extremely open economy, has witnessed a dramatic deterioration in overseas sales and exports collapsed by 16% in October from a year earlier. Sales to Europe fell by 31% and exports to the U.S. fell 51%. The contraction in exports are similar to what happened after the Lehman collapse. China has not (yet) seen such developments, but Singapore could be the canary in the coalmine. China however, may already be preparing for a global recession, and could be shifting to a crisis fighting mode. According to BCA capital spending financed by the Chinese state budget will probably increase substantially in order to protect growth.

Politics

2012 is an election year. We kick off with elections in Taiwan in January and the current president Ma Ying-jeou, who is running for re-election. He is seen as a supporter of closer ties to China. The opposing party The Democratic Progressive Party however is more reluctant to closer ties and a victory for them could increase the tension between China and Taiwan. Finland, who demanded collateral in order to sign the Greece rescue package, has its presidential election on January 22. According to a recent opinion poll the conservative candidate Niinistö is favorite to win the election with the euro skeptic "True Finns" candidate in second place. Russia has its presidential election in March and Putin is the favorite. As president Putin will probably continue to use Russia's resources (oil and gas) to gain political influence outside of Russia. In May the French voters are asked to elect their president. The choice is between the current president Mr. Sarkozy and the socialist Francois Hollande. The election could affect the French attitude towards the eurozone and the help to the peripheral countries. The election year concludes in November when the U.S. has to elect its president for the next 4 years.

Tension over Iran's nuclear program could also escalate in 2012 as Israel has said it will strike Iran if they achieve nuclear weapon capabilities.

Conclusion

We believe that the many unresolved issues will lead to increased volatility and uncertainty and require a well diversified "All Weather Portfolio". We will focus on regions, sectors, commodities and currencies best suited to cope with any of the above threats. In times of turmoil, gold, the US dollar (USD) and the Japanese yen (JPY) are still considered safe havens. In a low interest rate environment cash has a very low yield but we will be looking for opportunities with investment graded corporate bonds. Dividend paying stocks and consumer staple stocks also offer some protection in a volatile environment. China with its focus on growth will probably also offer some interesting equity opportunities. Oil could benefit from the Middle East tension and Putin's wish to use oil as a strategic weapon to gain political power outside of Russia. We hope the Dragon will live up to its name and deliver success and happiness, but it will for sure be a bumpy road, with many road blocks, but we will be prepared and ready to act as events unfold.

"Money it's a crime
Share it fairly but don't take a slice of my pie
Money so they say
Is the root of all evil today
But if you ask for a raise it's no surprise that they're
giving none away"

Pink Floyd

Disclaimer

This disclaimer covers all publications by Jyske Global Asset Management (JGAM). JGAM is supervised by the Danish Financial Supervisory Authority in Denmark and registered with the Securities and Exchange Commission in the United States. Registration with the SEC does not signify in any manner whatsoever that an adviser is sponsored, recommended, or approved, or that its abilities or qualifications have in any respect been passed upon, by the SEC or by any other agency of the United States or any officer thereof.

This publication is based on information, which JGAM finds reliable, but JGAM does not assume any responsibility for the correctness of the material nor any liability for transactions made on the basis of the information or the estimates of the publication. The estimates and recommendations of the publication may be changed without notice. The publication may not be copied without permission from JGAM.

JGAM has prepared a "Policy for Handling Conflicts of Interest" and introduced procedures to prevent conflicts of interest. Read more about JGAM's "Policy for Handling Conflicts of Interest" on www.jgam.com/terms.

Investments on the basis of this publication are subject to risk. The price of and return on securities may fall as well as rise. Past performance is not a guide to the future, and investors may not get back the full amount invested. The price of emerging-market securities can be extremely volatile.

When an investment is denominated in a currency other than the investor's base currency, the investor must be warned that changes in exchange rates may have an adverse effect on the value and price of or return on an investment.

Bond investment involves risk. Many factors, including the country's credit quality, willingness to pay, liquidity, social conditions and economic developments may affect the price of a bond. Indirect factors may also affect the price of a bond, for instance global economic factors, global risk tolerance and geopolitical risks.

Equity investments are associated with risk. Movements in the equity market, the sector and/or news flow, etc. regarding the company may affect the price of the equity. In connection with an ADR or similar papers, the foreign exchange risk exists relative to the currency in which the underlying equity trades.

Alternative investments (including commodity investments) involve risk. Movements in the credit market, the sector and/or the news flow, etc. regarding the issuer may affect the price of an alternative investment.

Leveraged investments are very risky, exposed to all the above mentioned factors as well as a fall in the value of collaterals combined with an increase in the value of the loan currencies. Leveraged investments are only recommended for investors with a suitable risk profile.

All of the above mentioned risk factors should not be regarded as exhaustive.