

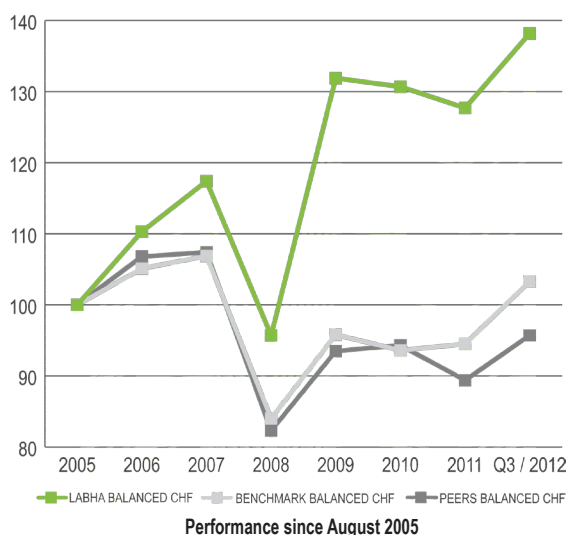
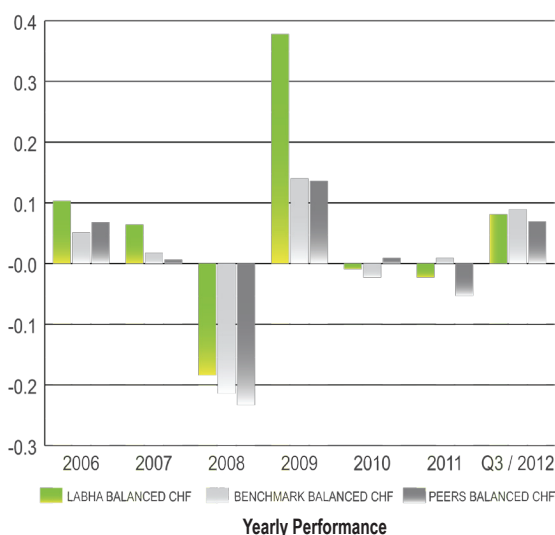
# Quarter Report CHF

Q3 / 2012

The third quarter of 2012 turned out to be a lot more positive than most market participants were expecting. Equity markets rallied 6.7% on average this quarter, performing better than commodities for the year and equaling the price appreciation in gold for the first three quarters of 2012.

Last quarter our market view was as follows "After the recent sell off in Europe, European equity markets look attractive again and we have started to add to positions." We believe that equities should outperform bonds over the next few years as they are better value at current levels. Therefore, even though we have booked profits and retained cash we are looking for opportunities to use market volatility to increase equity exposure. We believe that the long awaited transition from bond heavy asset allocation in investor portfolios towards a more neutral bond-equity positioning should start to take shape over the next two quarters." For the first three months of 2012 equities have produced more than twice as much performance as bonds.

Due to our above stated opinion, we added to equity positions especially in the cyclical sectors and emerging markets during the months of June and July and this opportunistic rebalancing has once again been very positive for client portfolios. The average performance of the CHF Balanced portfolios for the three quarters of 2012 was 8.1%, which is substantially ahead of the average of our peers at 6.9%. We have produced this return even though we have taken less than average risk in our client portfolios. This is a very important fact because if we had disregarded all the issues in Europe completely and taken above average risk to achieve this performance then our result would be due to luck. However, in this case it is due to good stock and bond picking. In Switzerland, Syngenta (+30%), Zurich Insurance (+21%) and Holcim (+24%) were some of the strong performers for the year. In the Euro area, the same is true for Allianz (+27%) and in the Emerging markets Larsen&Tobro (+30%).



The performance depicted above is the average of performance achieved for CHF balanced portfolios managed by LABHA. Past performance is not necessarily a guide to future expectations. Benchmark: 50% MSCI World Equity in CHF(Net) and 50% J.P. Morgan Global Aggregate Bond Index in CHF. Peers: Balanced Strategy Funds quoted in CHF (source: Bloomberg).

In September the ECB President Mario Draghi, announced that the ECB was willing to purchase unlimited amounts of Spanish and Italian bonds based on certain conditions being met. He stated that the ECB wants this to be perceived as a fully effective backstop to preserve the Euro area. This announcement boosted market sentiment substantially and was very positive for equity performance.

The following week the FED announced Quantitative Easing 3 (QE3) pledging purchases of mortgage backed securities at the rate of USD 40billion a month for an unlimited period. During the month of September the German Constitutional court approved the European Stability Mechanism (ESM). This

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removed one more insecurity from markets. However, in order for the ECB to buy Spanish bonds the Spanish government has to apply for a bail out from the ESM and accept all stipulated conditions. The Spanish Prime Minister Mr. Rajoy has been reluctant to make this formal application as he feels it will not be well received by the Spanish people. The ECB announcement caused Spanish yields to drop below 6% so Mr. Rajoy feels he has no immediate need to apply for a bailout despite a worse than expected budget deficit and disappointing results in the Spanish Banking stress test. There are further potential roadblocks for financial markets in October. Greek creditworthiness and future payments to Greece were to be discussed by the TROIKA in September. As Greek politicians were trying to insist on better terms and conditions and talks were not advancing, the whole matter has been postponed to October. There will be several meetings and summits of European leaders during the month of October at which they hope to reach consensus on important details regarding the use of ESM funds and possible European Banking supervision by the ECB etc. All of these events make October a month when volatility could rise again. We have therefore reserved some cash in all client portfolios to take advantage of this volatility. We are not expecting a major setback but believe that after the very strong rally some consolidation is inevitable.

Equities in emerging markets have been underperforming all year. However their bonds have done very well and now their currencies are beginning to appreciate as well. We had increased positions in emerging market bonds for our client portfolios at the end of last year. The reason we did this is because emerging markets had been raising interest rates for the bulk of 2011 and their currencies had also depreciated substantially. We were therefore positioning ourselves in advance of a rate reduction cycle with possible currency appreciation as an extra bonus. This positioning has paid off very well for our clients this year. We now believe that it is time to start increase the emerging market equity exposure in client portfolios. The emerging markets have reduced interest rates and announced infrastructure, reform and stimulus packages over the past six to nine months. It usually takes about three to six months for such measures to show results. Therefore a positive trend for growth in these markets should become evident in the fourth quarter of 2012. We have gradually increased exposure to emerging markets, commodities and related themes during the third quarter and will continue to do so on dips.

We remain underweight bonds in the developed markets and overweight in the emerging markets and are slightly underweight equities with a bias towards increasing allocation on dips. We currently hold about 7% of balanced portfolio assets in gold and intend to add to the positions as opportunities arise.

Your views and questions are always welcome and we look forward to continued success with our positioning of your portfolios for future market moves.

*Gillian Hollenstein*

#### **Important Disclosures**

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