

# Trends



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# Washington Comic Book

PATRICK SÉGAL

We wrote in our last column that the credit rating agencies were watching America's financial situation through a well-polished rear-view mirror. Thus we had no insider tip on the scathing condemnation issued by Standard & Poor's. If the US does not start putting its financial house in order within the next two years, it will be stripped of its AAA credit rating. That's quite the threat.

China's Dagong Credit Rating Co. downgraded the US government to a much more realistic A+ several months ago. After Greece, Ireland and Portugal it is now America's turn to be pilloried for its budget deficit and national debt, respectively running at 10% and 100% of GDP. Despite these dire numbers and the hysteria that gushed from Democrats and Republicans on TV during this year's marathon

budget debate, the outcome actually made the whole business seem more a comic book: the \$38 billion in spending cuts are a bad joke compared with the overall deficit of \$1.5 trillion. President Obama won't hear of slashing social expenditure with unemployment still rampant, and the Republicans want new tax breaks for their supporters. The 2012 election campaign has kicked off, and everything will now be dictated by awareness of it.

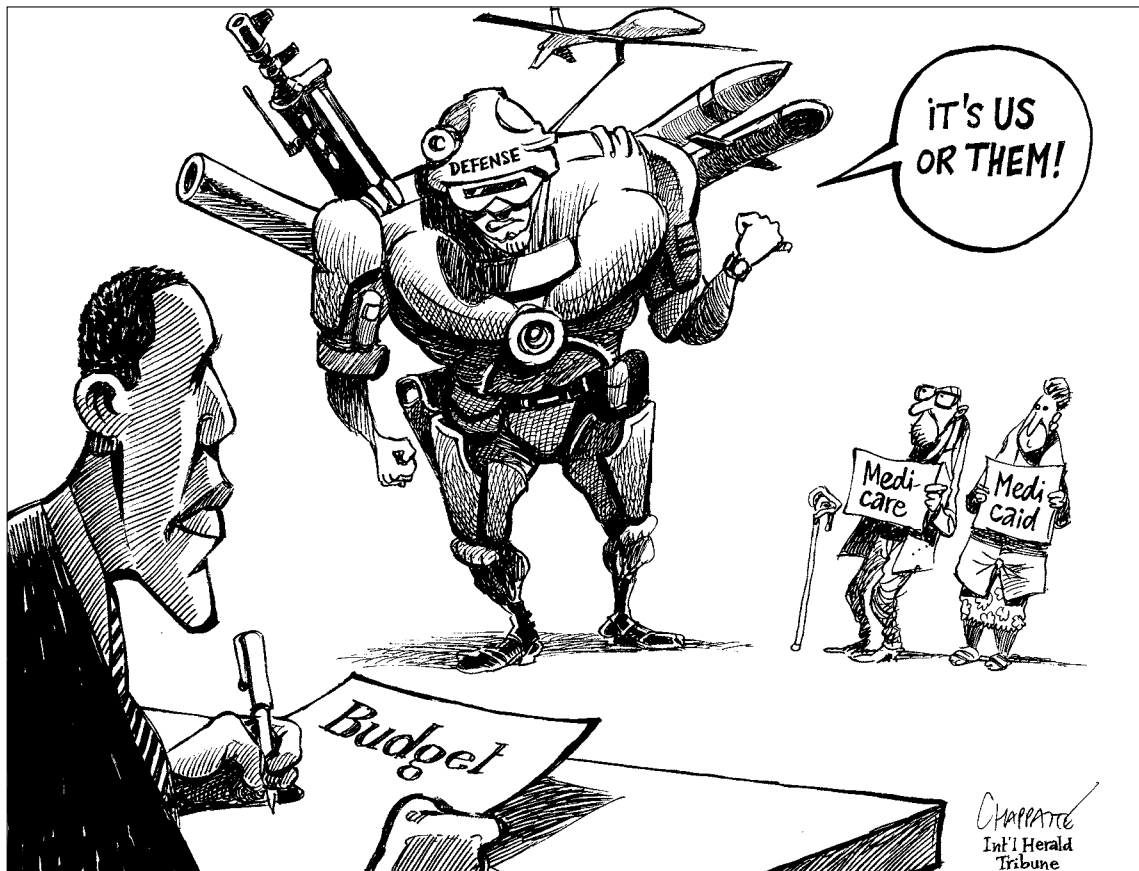
We were hoping the press conference that followed the last Federal Open Market Committee meeting would bring a bit of order and sobriety to all this frantic political posturing. Even a faint signal that the Fed was moving towards a semblance of monetary discipline could have given pause to the markets, to commodity speculators and to carry



## Standard & Poor's worried about US Debt



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### US Federal budget

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traders. But no such signal was forthcoming. Bernanke said that the Fed would implement QE2 in full, buying \$600 of Treasury bonds, and that it would not budge on interest rates for some time to come. Keeping the fed funds rate near zero, a strategy backed by the idea that a negative cost of money will help bring down unemployment, can only breed more uncertainty. US mortgage rates have already increased substantially, so who would want to buy 10-year government securities at a third less than the going rate? And who, for that matter, would want to buy dollars if they continue to be printed in countless numbers? Small wonder that investors are bidding up hard assets like gold, silver, oil and property instead, to escape from currency devaluation. Silver is back up to the level it reached in 1980 when the Hunt brothers, from Texas, were trying to corner the market. This time however it is being used by Indian and Asian billionaires as a hedge against currency debasement.

America's recovery is still struggling to gain traction for a fairly simple reason. In 1960 there were 15 million factory workers and 8.7 million civil servants

in the US. Now there are only 11.5 million manufacturing jobs left, thanks to productivity gains, but the number of government employees has more than doubled to 22 million. As in many other industrialised countries, downsizing the public sector has become crucial to trimming the deficit. The only realistic way out of the debt crisis lies in redeploying resources massively towards sophisticated services and in streamlining the civil service to reduce its weight in overall GDP. Sweeping tax reforms are urgently needed as well. The elimination of tax niches and loopholes would help bolster tax revenues immensely. American companies have war-chests in other countries that are not taxed in the US until they are brought home. Wall Street outfits like Paulson, Caxton, Renaissance, SAC and Citadel are used to paying next to nothing in taxes, so to counter Obama's planned increase in the levy on capital gains they have started amassing a huge campaign contribution for the future Republican candidate. Donald Trump, twice ruined and now a billionaire for the third time, thinks he has a chance. Washington lobbyists are in for a good year.

In the emerging countries, the inflation sought by the US Federal Reserve is giving rise to an explosion of discontent over soaring petrol and food prices. Rising wages are adding the cost-push spiral. While peoples around the Mediterranean basin take to the streets, in China lorry drivers are blocking Shanghai harbour and the mood of workers is turning ugly. Higher interest rates will slow the growth of production capacity across the emerging regions. Diminishing purchasing power will slow the growth of their domestic consumption.

Our wish list had included a small dollar comeback on the back of a Fed message with more backbone. This hope was dashed by the decision to exercise the whole QE2 option and maybe even consider a QE3. Although quantitative easing has merely lined the pockets of rough-and-ready traders while doing nothing for industry and the economy at large, the Fed continues to steer towards a balance sheet with \$3 billion of assets. How will it get out of this mess? Nobody knows! The authorities themselves admit they are in «uncharted territory». They have already incurred heavy losses in the bottomless real estate market. Waiting too long before coming back to reason could be all the more painful.

Meanwhile the dance of the damned continues, with investment banks, hedge funds and traders all trying to grow their fortunes in currencies that are

worth less and less. With no rules or vision to guide them and with no taxes to cough up, speculators have swarmed into the dark tunnel of vacuous Fed strategy.

After predicting the demise of the euro, many market participants are now saying it is over for the US dollar. But like all exaggerated claims, this one makes little sense. The greenback, by a broad definition, represents 80% of the money circulating

## *All trying to grow their fortunes in currencies that are worth less and less*

worldwide. John Connally, Nixon's treasury secretary, said «the dollar is our currency but your problem». Raymond Barre, the great French economist and politician, pointed out less bluntly and more shrewdly that the only fundamental dictating the dollar's exchange rate was confidence in the United States. It went up, he said, when people were optimistic about America's future and down when they were worried. For Barre, psychology offered a better explanation than economics for the dollar's movements

To fight the Fed's chloroform, we recommend taking refuge in sturdy assets that have always weathered the worst crises. In the meantime the Golden Calf is drawing more worshippers than ever.



*“Oh, darling, you shouldn't have  
—soybeans!”*

# When Macro met Micro, or when investing equals stock-picking

PIERRE-YVES BRACK

We all know what is pinning the market back, and this prevents us from tipping into a mood of out-and-out euphoria. But as well as the dangers and doubts, the constraints also offer opportunities.

The economic picture is made up of losers who have fallen victim to conditions and winners enjoying a whole new outlook.

Everything boils down to analysing companies: identifying those that may fall short of market forecasts while picking those with potential to beat estimates through niche positions and competitive edges.

## Plenty of pressure from the outside ...

As we spelt out in last month's commentary, companies' top lines are coming under pressure from various quarters, touted in the media:

- Tighter monetary policy in emerging markets to ward off overheating in economies.
- Anticipations for a sea change in US monetary policy in June, as QE will probably be discontinued.
- The tight grip on public spending in advanced economies as reflected by government austerity drives.
- Widespread pressure on sourcing costs (including softs).
- Political and social tensions in Arab countries, giving rise to fears of disruptions in oil and gas supplies.
- Likely disruptions to supply chains in industries where Japan is pivotal (e.g. electronic appliances and cars), possibly leading to under-use of production facilities.

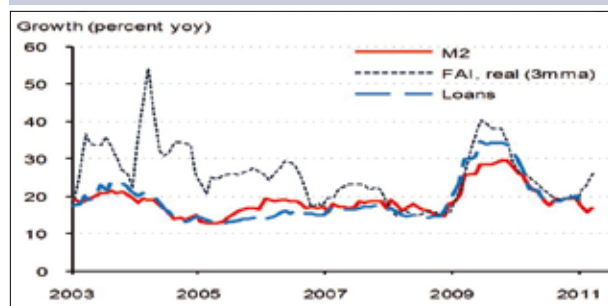
## ... but not everyone can be tarred with the same brush

Despite these observations (which should stop investors getting carried away on the upside), it should be stated that these various factors will not all hit companies in the same way. While some business sectors will be placed at a disadvantage, others will actually flourish under these conditions.

**Tighter monetary policy in emerging markets.** Take China, for example. There can be no doubt that authorities are working to keep a lid on inflation

### Investment has remained strong.

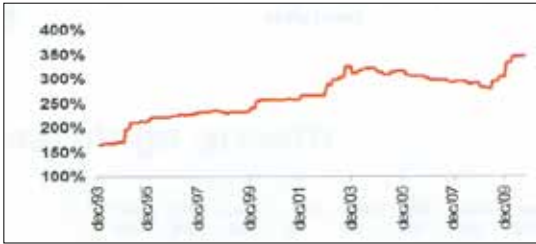
Source: CEIC, World Bank staff estimates.



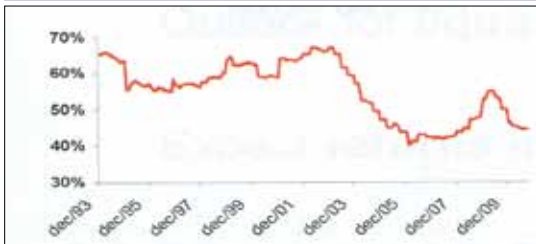
and speculation in the financial/property domains. At the same time, however, the government is allocating a huge amount of funds to its new five-year plan, which includes the fast-paced development of the country's hinterland and second-tier cities. So on balance, if consumer spending is slowing, investment expenditure is picking up — including in the property arena by way of a huge construction programme for subsidised housing (10 million units per year in 2011 and 2012). Thus, while some are losing out, others are sitting pretty.

**Public finances under pressure.** This may be the case, but corporate coffers have never been so full, with free cash flow covering current capital expenditure 3½ times over and indebtedness at rock bottom. This has given rise to huge investment potential — but not necessarily within the confines of the nation's borders. The mining industry is a clear-cut example. Companies — propelled upwards by record commodity prices — are in turn investing on a large scale. Groups such as BHP, Rio Tinto and Vale are each planning to invest USD 80-90bn over the next five years, with the companies next on

Free Cash flow / Capex



AverageNet debt / Equity non-financials



the pecking order also spending significant sums. Naturally, finding untapped resources means travelling to other parts of the globe. That poses no problem to the industry's equipment makers, who follow their customers in order to continue meeting their specific needs. Whenever a new site springs up, you can be sure that equipment supplied by Caterpillar, Joy Global and Bucyrus has already ground into action.

The strong finances boasted by corporations have at the same time rekindled acquisition-driven growth and share buybacks, which are automatically supporting share prices.

**Widespread pressure on commodity supply costs.** This is obviously problematic for commodity buyers but represents a windfall for suppliers and those who supply them with goods and services: it is important to see both sides of the coin.

**Fears (valid or otherwise) of supply disruptions** resulting from the three-way catastrophe that hit **Japan along with political and social tension in Arab countries.** Clearly, some companies are suffering through loss of contracts or markets, higher costs and under-use of production facilities, for example. But others are gaining in a variety of ways: gains in market share after certain producers have been unable to meet demand (e.g. Gazprom taking the place of some Libyan suppliers), a shake-up in priorities (e.g. alternative energy sources) and reconstruction needs in terms of materials and equipment.

**The economic picture is made up of losers who have fallen victim to the conditions and winners with a whole new outlook. Everything**

**boils down to analysing companies: identifying those that may fall short of market forecasts while picking those with potential to beat estimates through niche positions and competitive edges.**

These more immediate factors should not make us lose sight of the supportive long-run trends. Population growth and urbanisation, along with environmental issues and increasingly hard-to-get-at natural resources, represent genuine opportunities for several industries (e.g. agriculture, infrastructure, renewable energy and pollution clean-up equipment, etc.).

**Scope for margin appreciation**

Those companies able to reap the benefits will also gain from low operating leverage, after having cut costs to the bone during the most recent economic downturn.

Nominal growth of 4% or more in the US and 6% or more on a global scale will enable those winning market share to deliver top-line growth nudging double figures. This would obviously erase all cost-related pressure and send profit margins rising to new record highs.

S&P 500 net profit margin

Source: Compustat, I/B/E/S, FirstCall and Goldman Sachs  
Global ECS Research



**Some favourites in these conditions**

It is impossible to «reinvent the wheel» every four weeks. Our recommendations have thus not changed markedly.

To seize the opportunities coming to the fore in these troubled times, our preference lies with companies with gold-plated finances — we are not enticed by those gearing up. **Strong financ-**



**es** often means higher shareholder returns. More than ever, **dividends** have become pivotal to overall performance.


All else being equal, Japan's reconstruction will boost demand inside the country for **natural resources** (including coal and gas, to compensate for nuclear generation). At the same time, investment and residential construction are picking up pace in China. Copper, iron ore and coal remain out favourites.

**Platinum and palladium** have priced in a sharp slowdown in automotive output worldwide. To our mind, the decline is overdone for these metals (which have base and precious usages) given

the production shortages and the introduction of tighter environmental standards around the globe. **But gold remains the ultimate safe haven.**

**Rare earths** are extremely attractive (though very volatile). Chinese export quotas have been slashed due to a surge in demand, without mentioning likely strategic stockpiling in the US for defence applications (missile guidance systems, night sights, etc.) or «green» applications (catalytic converters, electric car batteries, and wind/solar power).

Lastly, **agriculture** is on an uptrend. In the US, sowing areas are set to increase by 3-4% this year to meet rising demand — much to the benefit of seed and equipment producers.



# “Courage is the mean with regard to fear and confidence”

Aristotle

PHILIPPE LEDERREY

Irrespective of their resilience to a number of exogenous shocks recently, European markets may turn their focus to more structural considerations once the quarterly earnings season winds down. Indeed, conditions appear ripe for an upsurge in market tensions. More than half of companies broadly beat estimates (top line, operating figures and earnings), but corporate guidance for the rest of the year is nevertheless cautious owing to high commodity prices and currency effects. We still feel that the next few months are likely to be a transition period characterised by abrupt, uneven movements. In terms of investment themes, we obviously like exposure to emerging markets, but we are highly wary of a number of segments that have captured investors' attention recently. The key to all this in the coming days will be oil prices. They fell by 14% in just one day and could enter a consolidation period that would have a major impact on sector rotation.

## European markets calm, reassured by the Fed

European markets were solid in April (+2.9%, already evaporated in early May), driven in part by Ben Bernanke's reassuring comments. Mr Bernanke announced that the Fed would not raise rates quite yet and, importantly, that the Fed would not draw down market liquidity even after the current phase of exceptional measures ends. Taken together, these promises increased investors' willingness to take on risk. Still, we are surprised by the market's ability to withstand so many exogenous shocks this year: geopolitical turmoil in the Middle East, nuclear risk in Japan following a massive earthquake, the growing risk that Greece's debt will be restructured, the possible rating downgrade on US debt, and sharply rising commodity prices. Once the quarterly earnings season comes to a close, investors may turn their attention back to structural considerations: sovereign debt, divergent monetary policy between Europe and the USA, and the effects of a falling dollar. Clear signs of overheating in emerging-market countries (cf. surprise rate hike in India) and the foreseeable slowdown observed in developed countries are likely to accompany a decline in risk appetite, at least in the next few months.

## Return-to-normal implies a stock market consolidation

The OECD's composite leading indicators (designed to anticipate turning points in economic activity relative to trend) were highly and unexpectedly positive but are now starting to head downward.

Adding to this the nascent rise in rates in Europe and the inevitable reduction in liquidity worldwide (e.g. once central banks' rock-bottom interest rate policy and highly accommodating monetary policy come to an end as planned and when the exceptional measures expire), we see that the necessary conditions for renewed market tension are indeed present. Some would argue that European markets have weathered similar conditions in the past. We disagree, since we are now emerging from a period of highly exceptional measures that have little in common with a «classic» mid-cycle situation.

## Quarterly earnings: surprises still positive, but less than before

With just under three fourths of European companies having published their figures so far, just over half (58%) beat expectations in terms of their top line, operating figures and earnings. This figure is significantly lower than the one from the past two quarters (and lower than in the USA: 70%) but still remains slightly above the long-term average. In their outlook for the rest of the year, companies have focused on themes that reflect prudence: rising commodity prices (especially energy) and the growing impact of currency effects. Some companies plan to raise prices in order to offset pressure on margins, but they admit that the hikes can only be temporary. Another interesting factor further supports our strong conviction on overweighting the healthcare sector: margins appear to already be heading upwards, catching analysts off guard (83% of companies have beaten revenue estimates).



### M&A theme suddenly resurrected

The M&A theme played a much greater role at the start of the year than we could have imagined, even in the absence of the normal structural factors that trigger such activity. The number of deals over the first four months of the year was up by over 60%, with some offers reflecting spectacular premiums. We can draw two conclusions from recent deals. First of all, most of them have taken place in sectors showing the most favourable margin situation or the best free cash-flow generation (healthcare, telecoms, luxury products, mines and chemicals). We have also observed a marked increase in deal premiums, especially when the buyer is a heavy-weight player. At these prices, it is likely that sector leaders making acquisitions will not be able to deliver on their ROI promises and will end up destroying shareholder value. Sectors most likely to see M&A activity include capital goods, luxury products and cosmetics, semiconductors and oil services.

### Transition period calls for caution

■ We still feel that the next few months are likely to be a transition period characterised by abrupt, uneven movements. That said, we do not have the conviction that the European markets are headed for a major and prolonged correction. This phase of challenge and uncertainty will probably need to be digested before we can hope for growth to resume a more linear path.

■ We therefore still advise overweighting defensive sectors. This includes healthcare, where companies – despite being hit by the rise in generics and cuts in public spending – still have significant room to cut costs and reorganise their manufacturing processes for increased efficiency.

■ Regionally, we are obviously continuing to steer clear of countries still facing sovereign-risk or private-debt problems (Greece, Ireland, Portugal and Spain). We are also still wary of a number of countries considered solid but with limited visibility on long-term equilibria (typical of France). On the other hand, countries known to have problems but with fairly healthy fundamentals could provide a positive surprise (such as Italy). At this stage, our preferred countries for equity investors are generally in northern Europe. They show higher growth and are driven by the strength of their export markets and accelerating domestic demand.

### China: solid investment theme or red herring?

We obviously like exposure to emerging markets but are highly wary of a number of segments that

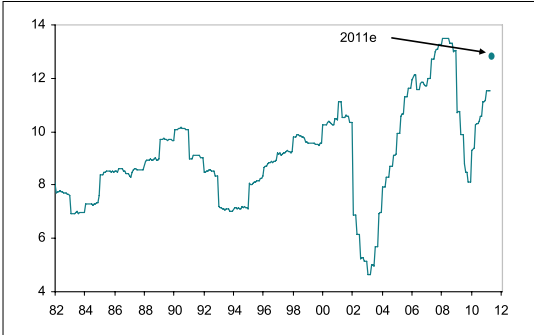
have captured investors' attention recently. Let us take the example of European investors' blind attraction to any sort of capital expenditure in China. We make a distinction between segments that can still conceivably benefit from this exposure (such as consumer goods and healthcare), and those that already face head-on competition in China (chemicals, telecoms equipment makers, electricity transmission and renewable energies). The situation of solar energy equipment makers is telling: there were few if any Chinese competitors 15 years ago, but they accounted for half the market in 2009 and two thirds at the end of 2010. The reason is simple: their competitive price advantage exceeds 30%. Some may doubt the real negative impact of Chinese competition on western industry, but they would do well to remember the impact Japan had on the auto industry 50 years ago: that country exported 100,000 cars in 1965, 1.8m ten years later and 4.4m twenty years later. The consequences for most non-Asian companies (especially mass-market cars) were often quite devastating. Apart from this question of competition, a large number of European companies point out that the advantages of low personnel expenses are dwindling. Also, the Chinese government's legitimate desire to gradually expand domestic consumption will inevitably undercut the competitive advantage related to labour costs.

### Oil prices again in the forefront

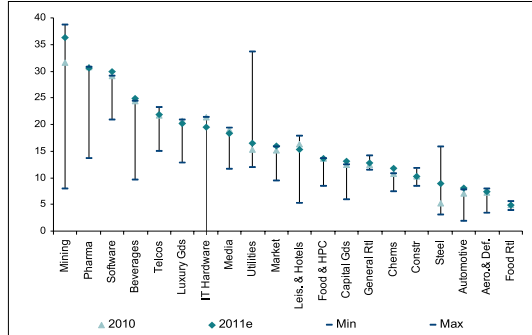
The key economic factor in the coming days is very likely to be oil prices. They fell by 14% in just one day, and the direction in which they now head may have serious consequences. We feel it necessary to draw a clear line between the relatively short-term tactical approach and the longer-term strategic approach.

■ The speculative aspect is particularly important in the short term. We still do not understand how finance and oil industry professionals cannot see the importance of this factor, which they consider secondary at best. It is difficult to believe that the 77% drop in crude oil prices between July and December 2008 was driven exclusively by the (very static) fundamentals of the oil industry. And again, on 5 May 2011, when the new rules on daily fluctuations in futures contracts triggered the sharp one-day decline mentioned above. It is of course difficult to gauge short-term movements, but the speculation-driven technical correction does not appear to have exhausted the downside. Many other short-term considerations also justify downward pressure. They include high levels of excess production capacity, extensive inventory levels, declining emerging-market demand following central banks' initial anti-inflationary measures, and a broad decline in global de-

Could European corporate margins really be hitting record levels despite intense upward pressure on costs?



In this respect, several segments are especially risky (such as auto, retail and food)



mand owing to recent price hikes. Oil prices could plausibly drop below USD 100 (or even USD 90) per barrel..

Longer-term concerns centre around geopolitics. Numerous Middle Eastern countries have experienced popular uprisings against their governments, with the notable exception of Qatar and Saudi Arabia. For how long will the royal family in this major oil-producing country be able to contain the ambitions of the people? The answer to this question could drive oil prices up by more than 50% in just a few weeks – or let prices continue to correct.

In the longer term, with energy demand that will inevitably expand and a supply that will sooner or later erode, prices will gradually rise in the coming years. And there is another wild card at play. If the current governments in major Middle Eastern coun-

tries (which account for 70% of future reserves) are replaced, the incoming leaders could conceivably adopt a pricing policy aimed at controlling production quotas much more closely – and thus limiting the supply. This would translate into further pressure on prices.

Looking at the correlation of European sector performance with the performance of oil, we see that some segments will benefit the most from consolidating oil prices: healthcare, food, tobacco, telecommunications and utilities. Sectors that stand to suffer the most include energy of course (especially services and extraction companies), mining companies, transport companies and manufacturers. This oil-related approach thus also leads us to favour defensive plays and avoid cyclical ones. And it favours countries like Switzerland and Germany while penalising both northern and southern ones.

# Our view on technology following Japan's disaster and our trip to Silicon Valley

GÉRALDINE GUYON

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From March 14th to 18th we were in San Francisco and Silicon Valley, where we visited 20 companies. These included not only giants like Apple, Cisco, Juniper and Hewlett Packard but also players such as MIPS, Finisar, Seagate, KLA Tencor, Flextronics and AMAT that may have a lower profile but are highly renowned by tech watchers and investors.

Our visit was very enlightening. Despite the risks overhanging supplies of Japanese components, the mood of US tech executives is upbeat. Corporate America has no other choice than to follow the crowd when it comes to cloud computing, server virtualisation or data storage. A looming war will pit the two leading chip-makers, Intel and AMD, against ARM. Finally, M&A activity is back and could heat up further if the Obama administration decided to exempt technology companies from the requirement to repatriate earnings from abroad.

## No worries despite a more uncertain environment?

All the semiconductor manufacturers we met were sanguine about the consequences of Japan's disaster. They have about two months of stock to draw from and their contacts in Asia believe that things will return quickly to normal. We would like to share their optimism, but we cannot. Japan ranks among the world's top chip-producing areas along with South Korea/Taiwan and northern California. A quick review of indispensable components points up the difficulties facing high tech. Japanese firms churn out 35-40% of the flash (NAND) memories used in smartphones, laptops and tablets. They make 13% of DRAMs and 85% of the BT resin that sticks chips to silicon circuit boards. They make HDI mother boards, lithium-ion batteries and flat screens for computers and TV. One missing part shuts down a whole assembly line. As proof, Peugeot has stopped production in France because of an indispensable component that cannot be shipped from Japan. When we visited Apple the representative said he was not worried, but a few days later the company was snapping up all the NANDs it could lay its hands on in the market (Apple buys 20% of the global output), causing NAND prices to leap 13% in a single day! The same woe-some tales are heard about BT resin. The upshot is that Cisco, Alcatel-Lucent, HP, STM, Apple and others will be confronted with component shortages in the coming weeks. Inevitably this will impact their forecasts.

The other main conclusion from our visit was that a war is developing between chipmakers Intel and AMD on the one hand, and ARM and its open architecture (CPU+GPU) model on the other. Intel and AMD showed us their latest innovations, which will come onto the market this summer and are likely to excite investors (Bulldozer for AMD and Sandy Bridge for Intel). More importantly, we realised that a major technological issue is currently developing in Silicon Valley. Intel's x86 platform and its closed vertical manufacturing process is being challenged by the open-architecture approach used by ARM and MIPS Technology.

These two companies are competing with Intel by offering an alternative to chipmakers like Nvidia, Qualcomm and Texas Instruments. They design processor architecture in return for a royalty on each chip sold. Their chips are used in PCs, smartphones and mobile phones, and their designs give end-users longer battery life. Over the long term, this development could threaten Intel's supremacy. In mobile devices such as telephones and tablets, ARM dominates the market with an 80% market share. ARM and Nvidia, through the 64-bit Denver project, are now targeting the PC and server market, which has so far been Intel's stronghold. Rumours are circulating that Apple could switch to ARM architecture for its next generation of Macbooks. Google could also enhance its Android 3.0 (Honeycomb) operating system by adopting solutions developed by ARM or MIPS. In our meetings,



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we learnt that Nvidia's quad-core Tegra 2 chip represents a technological revolution because of its low power consumption (1w), while Intel's Atom dual-core x86 chip is much too power-hungry for mobile phones.

As a result, a war is developing in Silicon Valley. MIPS is the only alternative to ARM in the open-architecture segment, and is a potential target for Intel since there is no risk of objection from the antitrust authorities. The market is therefore speculating about a tie-up between MIPS and Intel.

**The semiconductor sector will see increased demand because of fears of shortages, and this will push up component prices. The increase in inventories that took place before the Japan earthquake will quickly be eliminated, since there are large numbers of customers hurrying to place orders. We believe that the Japan disaster could delay the expected slowdown in the semiconductor sector by six months.**

**Today's main themes are data storage, batteries, virtualisation and cloud computing.**

PC manufacturers like HP have told us that they expect very strong PC demand from companies, but weaker demand from consumers, due to low sales in China and tough competition from tablets. More and more companies are giving their staff

tablets instead of laptops. The nascent tablet market is likely to feature one big winner, i.e. the iPad2, and many losers, since all the new tablets being launched are similar, and often more expensive than the original.

Cloud computing remains a common theme, and is becoming the new standard for manufacturers. The same is true in software virtualisation and peripherals, according to VMware, the world's leading virtualisation company. Virtualisation has only a 20-25% penetration rate in servers, and is only at the start of its growth phase. Sales are expected to rise by 20% per year for the next 3 years. SMEs are now following large corporations in migrating their IT infrastructure to the internet cloud.

The telecoms hardware manufacturers we visited told us that network hardware demand remains strong. Current resources are insufficient given the number of internet users (according to Juniper and Cisco), the explosion in online video use (according to Finisar) and growing demand in emerging-market countries. Orders are also being supported by the roll-out of 4G networks in USA and Europe, and 3G networks in China.

Heavy investment is being made in fibre-optics, as in the late 1990s / early 2000s according to Finisar. Finisar's CEO brought back memories of 10 years ago and the internet bubble, when the share prices of companies like JDS Uniphase surged massively.



Our conversations also revealed that Cisco, currently the world's leading network hardware producer, is being attacked by an increasing number of rivals, such as Juniper and Alcatel-Lucent. Other manufacturers that are absent from the network hardware business, like HP, have also been taking business away from Cisco by providing a cheaper service.

**We are big fans of the telecoms and IT hardware segments because of their technological innovation, along with growing client demand for improvements to their IT hardware and networks. However, we will take a cautious approach due to uncertainties about possible shortages and delayed deliveries of some components. The other concern relates to margins, since producers may have to pay more for components from other suppliers.**

### Conclusion:


After our visit to Silicon Valley and the Japan earthquake, we adjusted our recommendations. We advise focusing on and overweighting the semiconductor segment, taking a more cautious stance on the IT and telecoms hardware segments – which could suffer from component shortages – and favouring the software segment, which is not affected by Japan's problems.

### Two months after the earthquake and halfway through the quarterly earnings season, how is the tech sector faring?

Initial results in the tech sector have been broadly positive, although there have been disappointing figures from some companies, such as MIPS, Logitech, SAP and Nokia. The semiconductor segment, which is our favourite within the tech sector, has delivered strong results and solid guidance, despite the risk of component shortages. The major producers (Intel, Infineon, Sandisk, Texas, ASML etc.) have confirmed that **their Japanese plants are not at full production** and that they could see **some difficulties in meeting client demand** on time, but that **they are keeping their full-year forecasts unchanged**. The market has reacted positively to these results, and the segment has been popular with investors.

Judging by these initial quarterly results and forecasts, the situation in Japan no longer seems to be a problem, and companies are as optimistic as they were two months ago.

Their forecasts are a little surprising, since some high-tech retailers are starting to be concerned about future deliveries and about a possible increase in prices. They are even advising customers to buy PCs for the next school year now, instead of waiting until the autumn.



## Economic forecasts

GDP growth and contributions to global expansion (BPER estimates)

Country	GDP 2010	GDP 2011 BPER Estimates	GDP 2012 BPER Estimates	Country weights	Contribution 2011
<b>United States</b>	<b>2.8%</b>	<b>3.1%</b>	<b>2.9%</b>	<b>19.7%</b>	<b>0.61%</b>
<b>Euro Area</b>	<b>1.7%</b>	<b>1.7%</b>	<b>0.8%</b>	<b>14.6%</b>	<b>0.24%</b>
<b>China</b>	<b>10.3%</b>	<b>9.0%</b>	<b>8.0%</b>	<b>13.6%</b>	<b>1.22%</b>
<b>Japan</b>	<b>3.9%</b>	<b>1.4%</b>	<b>2.0%</b>	<b>5.8%</b>	<b>0.08%</b>
<b>India</b>	<b>10.4%</b>	<b>8.2%</b>	<b>7.8%</b>	<b>5.4%</b>	<b>0.44%</b>
<b>Russia</b>	<b>4.0%</b>	<b>4.7%</b>	<b>4.5%</b>	<b>2.9%</b>	<b>0.14%</b>
<b>United Kingdom</b>	<b>1.3%</b>	<b>1.1%</b>	<b>0.6%</b>	<b>3.0%</b>	<b>0.03%</b>
<b>Brazil</b>	<b>7.5%</b>	<b>4.5%</b>	<b>4.5%</b>	<b>2.9%</b>	<b>0.13%</b>
<b>Mexico</b>	<b>5.5%</b>	<b>4.5%</b>	<b>4.0%</b>	<b>2.1%</b>	<b>0.09%</b>
<b>Canada (IMF estimates)</b>	<b>3.1%</b>	<b>2.8%</b>	<b>2.6%</b>	<b>1.8%</b>	<b>0.05%</b>
<b>Others (IMF estimates)</b>	<b>5.2%</b>	<b>4.7%</b>	<b>4.9%</b>	<b>28.2%</b>	<b>1.31%</b>
<b>WORLD</b>	<b>5.0%</b>	<b>4.4%</b>	<b>4.1%</b>	<b>100%</b>	<b>4.4%</b>

### Comments

- The GDP growth rates shown above are final for 2010. Projections for 2011 and 2012.
- Each country's weighting has been translated into US dollars and is based on the principle of purchasing power parity, which takes account of differences in prices and standards of living.
- The countries are ranked by the size of their economy, in decreasing order.
- Contributions to global growth are calculated as follows: the GDP growth of each country is multiplied by its size, with the total adjusted to the aggregate weighting of the countries listed. The sum of the contributions works out to 4.4%, a good estimate of global GDP growth for the current year.
- The list is limited to the 10 countries that contribute most to world economic expansion.

# Tactical allocation (%)

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## CHF PORTFOLIO

Asset class	Switz.	Europe	UK	USA	Japan	Asia/other emerging regions	Commod.	Precious metals	Sundry or global	Total
Short-term	14									14
Fixed income	14	2								16
Equities	8	2		2	3	5				20
Directional hedge funds		7								7
Nondirectional hedge funds	23									23
Property	3								7	10
Commodities, Precious metals							3	7		10
<b>Total</b>	<b>62</b>	<b>11</b>	<b>0</b>	<b>2</b>	<b>3</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>7</b>	<b>100</b>

## EUR PORTFOLIO

Asset class	Switz.	Europe	UK	USA	Japan	Asia/other emerging regions	Commod.	Precious metals	Sundry or global	Total
Short-term		17								17
Fixed income		14							2	16
Equities	3	7		2	3	5				20
Directional hedge funds		5		2						7
Nondirectional hedge funds		23								23
Property									7	7
Commodities, Precious metals							3	7		10
<b>Total</b>	<b>3</b>	<b>66</b>	<b>0</b>	<b>4</b>	<b>3</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>9</b>	<b>100</b>

## USD PORTFOLIO

Asset class	Switz.	Europe	UK	USA	Japan	Asia/other emerging regions	Commod.	Precious metals	Sundry or global	Total
Short-term				17						17
Fixed income				16						16
Equities		4		8	3	5				20
Directional hedge funds				7						7
Nondirectional hedge funds				23						23
Property									7	7
Commodities, Precious metals							3	7		10
<b>Total</b>	<b>0</b>	<b>4</b>	<b>0</b>	<b>71</b>	<b>3</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>7</b>	<b>100</b>

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