

The & Letter

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EDITORIAL



Between convalescence
and relapse

Our macro-financial scenario for the coming year is one of caution: a soft recession in Europe; U.S. growth below the consensus (1.1% versus 2.2%) as personal consumption ceases to be supported by a decline in the savings rate; and corporate earnings guidance that is more restrained than this same consensus. Economic support for the markets—which will remain volatile due to the sovereign debt crisis in Europe—will therefore be modest. The strategy of “baby steps” led by the eurozone authorities to navigate this crisis will only stabilise the markets in the months ahead if tangible results are seen on four points: i) adoption of the Greek PSI in January; ii) finalisation in March of a credible EU “golden rule” Treaty incorporating fiscal discipline rules; iii) development of a eurozone growth strategy in the coming months that supplements fiscal austerity measures; and iv) throughout the period, the effectiveness of the LTRO as an implicit support mechanism for fragile sovereign debt markets via the banks. That’s what will make the difference between convalescence and relapse.

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United States

RESURGENCE OF INDUSTRY IN A STILL-FRAGILE ECONOMY

Growth is driven by consumers' need to replace durable goods, which has been on hold for the past three years. Non-existent gains in purchasing power, however, portend the end of this resurgence. Revenues could even deteriorate if falling inflation, countered by newly rising oil prices, fails to offset the imminent weakening of the creation of jobs, expected to drop to 50,000 versus an average of 150,000 over the last quarter. In effect, the wait-and-see attitude businesses are showing in their capital expenditures should soon be seen in their hiring behaviour; employment will also likely suffer from the sluggishness of the past four months in consumer services, which households need to finance their craving for durable goods. Finally, the significant decline in household wealth in the third quarter should halt the decline in their savings rate. In sum, we expect consumption and growth to be flat in the first half of the year.

The improvement seen recently in residential property concerns only the rental investment market in collective housing (buildings), fuelled by the need to relocate households that have lost their primary residence to foreclosure. In contrast, the single-family home market remains mired in a slump as consumers are forced to continue deleveraging

United States: Personal consumption (Volume, Base 100 at beginning of period), a plethora of durable goods at the expense of services and nondurables



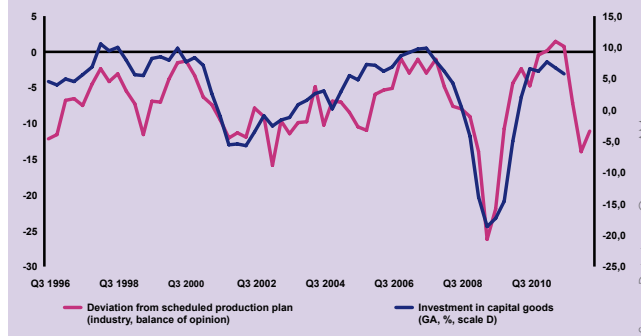
Euro zone

A PAUSE IN THE DECLINE OF LEADING INDICATORS

GDP is expected to decline by about 0.5% in the fourth quarter, impacting Italy and Portugal in particular, but sparing neither France nor Germany (-0.3%). This decline will be mainly driven by investment: Business capital expenditure has suffered from the crisis of confidence in the euro, especially in Germany, while consumer spending has been hurt by the sharp fall-off in new mortgages, with the notable exception of France, where the property market has benefitted from the programmed end of tax relief on mortgages, before a sharp correction in 2012. Consumption is also expected to fall, albeit much less than investment.

The decline of leading indicators took a pause over the last month, in parallel with the stabilisation of economic indicators and the lull in the debt crisis following mainly from the decisions of the EU summit of 9 December, and the actions of the ECB. It is only a pause, however: The pace of the contraction in activity is expected intensify in the first quarter of 2012 as businesses adjust their capital expenditure and payrolls to weaker activity. Only Germany is safe, with particularly strong fundamentals for both consumers and businesses, including historically low unemployment and favourable corporate profitability and debt levels.

Euro Zone: Businesses must adjust their capital expenditure to lower-than-expected activity

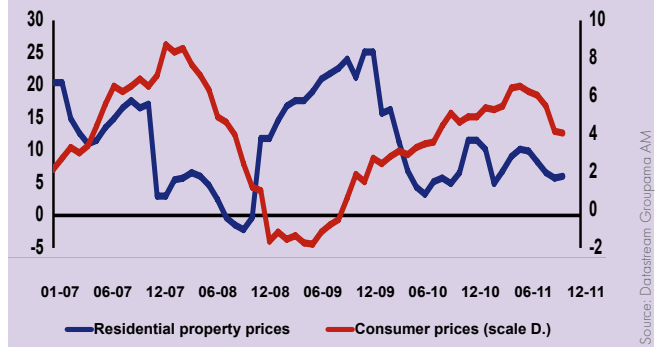


China

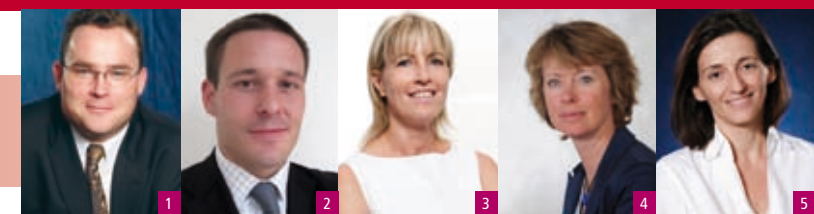
ACHIEVING A SOFT LANDING

While exports continue to slow, activity indices are no longer deteriorating: Household consumption is being boosted by the decline in inflation, which fell from 5.5% in October to 4.1% in December, and by the ensuing gains in purchasing power. Property investment should continue to fall, and property prices continue to decelerate. The faster-paced growth of debt observed recently should impel authorities to maintain pressure on key interest rates and to put off reducing mandatory reserve ratios for now, despite the decline in inflation. Conversely, fiscal policy should remain very active, in the form of subsidies to SMEs and fiscal transfers to local governments hurt by the sudden drop in land sales, while social programs could be curtailed. China appears to be achieving a soft landing. Growth should slow to 8% in 2012, in line with the authorities' objective.

China: Prices (% GA), Soft Landing



CORE MANAGEMENT



Money Market Management

Cautiously positive

These words could sum up our outlook for 2012. We are excluding the possibility of a eurozone break-up from our central scenario. It will be long and challenging, with a year in two phases punctuated by political action, but we should make it through. Sovereign risk premiums are thus expected to ultimately fall, and nominal core rates to rise moderately. The ECB will also continue to flood the markets with liquidity in a European version of quantitative easing. We therefore no longer anticipate a credit crunch either, which would lead us from an economic contraction into a veritable recession. Corporate profits will decline as a result, but the restoring force of valuations should ensure that the equity markets do not follow suit, and healthy balance sheets should allow the debt markets to hold steady. This 12-month scenario does not rule out some sensitive junctures, requiring continued caution.

P-H.B

CENTRAL BANKS

Liquidity, convergence and solidarity

Nothing much new in the U.S., where the Fed is putting the finishing touches on its communications policy on interest rates, which are still at historic lows. It remains, nevertheless, attentive to statistics, with plans being considered for eventual growth-support measures. In Europe, while the situation in Hungary is worrying, the liquidity injected by the ECB with its LTRO¹ of December is slowly starting to work its way through the system. Despite still record-level deposits with the ECB, peripheral sovereign bank spreads have begun to come down...at least to the 3-year mark. The reduction of mandatory bank reserves and the LTRO of February should nevertheless completely flood the market in the short term. At its January conference, the ECB left its rate unchanged at 1%, but it remains very cautious on the economic situation in the eurozone. It affirms, however, that it is seeing the first signs of LTRO liquidity being transferred to the real economy. Yet again, the ball is in the court of the politicians, who will have their work cut out for them in 2012 to transform the decisions taken

in 2011 into action. Like Mr Monti, we hope for "A Europe that is more communitarian, in which the Member States undertake to comply with mandatory rules and submit to common controls...[But also a Europe] ... of increased solidarity."

¹LTRO: Long Term Refinancing Operation

A WORD ABOUT THE INVESTMENT STRATEGY

Investment strategy:

In this environment, we are maintaining a long-term investment horizon and continuing to seize opportunities, particularly on the spreads of bank issuers.

T. P.

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Head of Fixed Income Management

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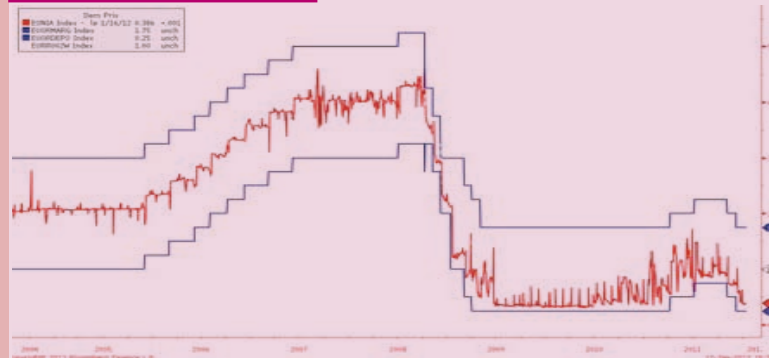
Head of Equity Management

5- Claire Bourgeois

Head of Equity & Fixed Income ALM

Corridor, refinancing Rate & EONIA

Average EONIA in december: 0.61681%;
and in 2011: 0.86975%



History of peripheral debt purchases by the ECB



Fixed Income Management

LONG RATES

■ **2012 is underway with continued uncertainty surrounding the progress** of the sovereign debt crisis in the eurozone.

Investor sentiment had nevertheless improved somewhat in recent weeks thanks to the success of the ECB's three-year refinancing operation (VLTRO¹) of 21 December, which helped to ease tensions. Its announcement in early December, followed by the ECB's massive injection of liquidity into the banks, triggered a sharp drop in sovereign risk premiums on short maturities and senior bank debt.

But the stalled talks on the Greek PSI (private sector involvement plan) and the S&P's intervention on European government bonds reminds us that the road ahead appears long and steep for months to come.

Indeed, the risks are still significant in the short term. First, Greece must reach an agreement with its private creditors to be eligible for aid from international authorities before March. In addition, European governments must refinance their debt on the market in very large amounts, and reach an accord on the new EU Treaty, all in a context of continued pressure by agencies on their credit ratings.

Volatility is therefore expected to remain high with significant movements in risk premiums. Interest rates in core countries of the eurozone will be pulled between economic data, which is stabilising

(particularly in Germany), and the sovereign debt crisis, which should finally be resolved in the medium to long term. Core sovereign rates should thus change within the recent range before gradually tightening, leading to narrower risk premiums.

In France, the risk premium should hover around an average of 160 bp in the coming months given the electoral context, persistent risks on fiscal targets, and continued pressure from rating agencies (this does not exclude a return to levels of ~200 bp).

In the peripheral countries, caution is still in order, and our preference remains for the AAA countries of the eurozone.

CREDIT

■ **The breathing space provided by the success of the ECB's** three-year refinancing operation allowed the credit market to rise in recent weeks, albeit in weak volumes. The massive injection of liquidity into banks reassured investors facing the risk of refinancing these institutions in early 2012.

However, risks are still present concerning the debt crisis and the expected persistence of volatility militates for continued caution on this asset class. Despite the reopening of the primary market at the start of the year, liquidity remains very limited.

INFLATION-INDEXED

■ **The asset class once again found favour with investors**, supported by trends in sovereign risk premiums (and the increase of Italy's), and by the announced increase of the VAT in France. While inflation-indexed assets may not escape the expected volatility in the markets, they still offer attractive valuations and positive carry.

A WORD ABOUT THE INVESTMENT STRATEGY

■ **In our portfolios, while our preference in country allocation still favours the core countries of the eurozone**, their order has been slightly revised this month.

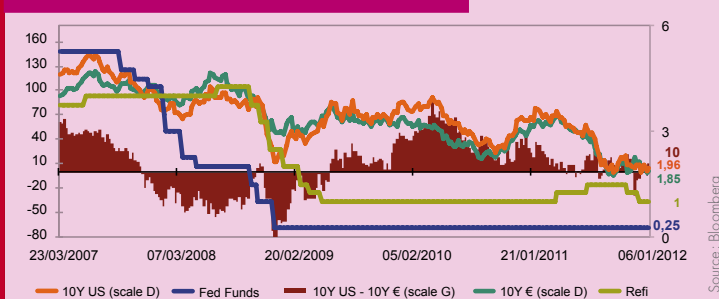
Austria was downgraded to neutral, less for rating reasons than for the risks inherent in Hungary's problems, and we reduced the overweight in Germany given the levels of its absolute rates.

In credit, caution is pushing us to maintain an underweight in the asset class and under-sensitivity in the portfolios. Changes were made in the finance sector, where we are reducing our underweight in senior bank debt and paring back our overweight in subordinated debt. In corporates, we are maintaining our overweight in BBB issuers.

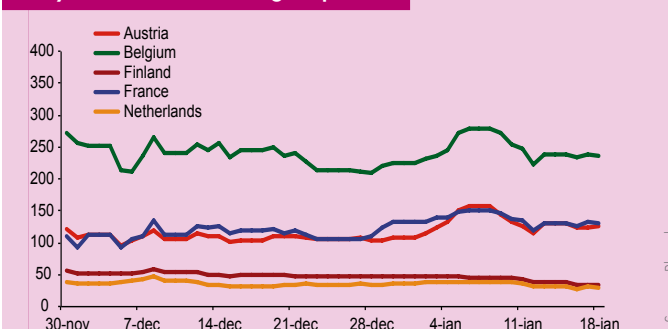
G.M

¹VLTRO: Very Long Term Refinancing Operation

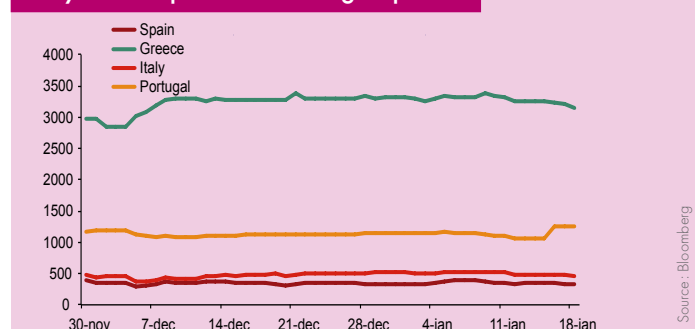
Change in the short and long rates in the United States and the Eurozone



10 year Core Sovereign Spreads



10 year Peripheral Sovereign Spreads



Equity Management

PROJECTED RESULTS AND VALUATIONS

■ Earnings forecasts: a pause in the decline or the start of a recovery?

- A slowdown in the deterioration process during the holidays.
- We are still somewhat cautious on the strength of profits in the context of a global slowdown.

■ Valuations remain attractive and stable, but the extremely low levels must be seen in context.

- The year-end rally in the equity markets was counterbalanced by the decline in interest rates.

OTHER FACTORS

■ Cash and banks: higher withdrawals from European equity funds.

- Further withdrawals from U.S. equity funds in November and December.
- Weak recovery in the M&A market, but the market's rise creates an opportunity for some equity offer.

■ Chart analysis: a welcome rally but worries persist for 2012.

- The trend remains positive for early 2012, but the potential appears limited.
- The deterioration of long-term charts continues to stoke fears of a bearish downturn in 2012.

OUTLOOK

■ Outlook: despite some positive economic signals, many uncertainties remain.

- The macroeconomic data of the past weeks reflect stronger-than-expected activity, particularly on the part of U.S. consumers.
- Another reason for relief: while the ECB did not deliver the Quantitative Easing hoped for by the markets, the three-year unlimited bank financing operation (LTRO) is still good news. It at least avoids the massive refinancing of banks in 2012, and leaves room for governments to fund themselves through the bond market.
- The weakening of profits expected by the analysts' consensus stabilised over the holidays, but the profit warnings stacking up as the year starts should revive the trend. We haven't altered our profit forecasts, which are still far below the consensus.

- The risk appetite, still far behind the usual norms, continues its slow rise, and is now out of the "panic" zone.
- The most important point, however, remains the huge uncertainty about the resolution of the European debt crisis: the early months of 2012, interspersed with major elections, should continue to be buffeted by opposing winds, whether in the short term (important maturities for peripheral countries), or in the longer term (fiscal and budgetary integration still awaiting a framework). The crisis is not likely to be resolved before the second half of the year.
- We are not altering our expectations for the financial markets, which are slightly negative at 3 months and positive at 1 year, and are maintaining a preference for Asia and the United States.

A WORD ABOUT THE INVESTMENT STRATEGY

- **We remain bullish on consumer cyclicals**, boosted by the consumption of emerging countries and technology shares. We are staying clear of financial shares, which are highly dependent on EU debt, although we would not hesitate to return to the sector in the event of good news on the Greek PSI.

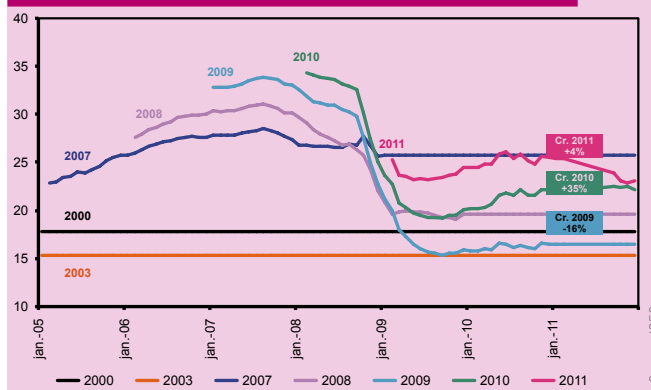
C.CO

Performance of the main indices since the start of the year

	11/01/12	Var. YtD in euros
DJ Euro Stoxx 50	2339	0,99%
SBF 250	2380	1,51%
CAC 40	3205	1,42%
FTSE 100 (UK)	5671	2,89%
S&P 500	1292	5,16%
Nasdaq	2711	6,47%
Topix (Japan)	733	3,03%

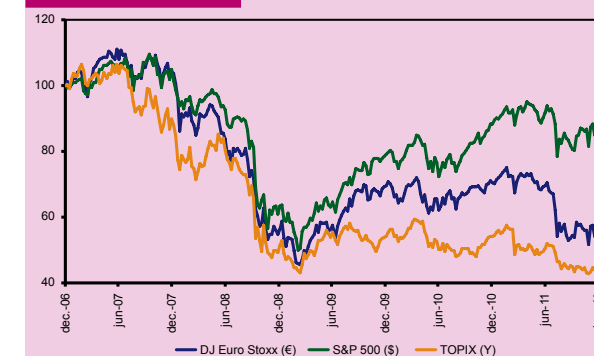
Source: Datastream

Profits forecast by the consensus on Euro Stoxx



Source: IBES

Performances of international stock market indices in local currency



Source: Datastream

GLOBAL BALANCED PORTFOLIO MANAGEMENT

Jean-Louis Autant,
Head of Global Balanced Management



Trend

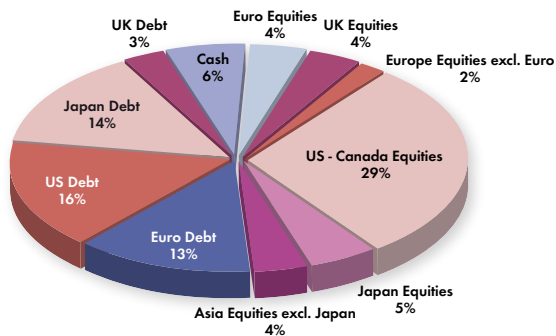
Excessive enthusiasm?

"Anticipating 2012" is how we titled these same columns last month, following an umpteenth European summit which left participants still hungry for answers. It's now clear, a month later, that those same investors seem to be regaining some of their appetite (their full appetite will take more time) for risk assets, and eurozone equities in particular. Certainly, January is traditionally a good month for portfolio reallocations that favour the equity markets. This is especially true at the start of this year: liquidity is abundant and the risk-free markets are still fairly stingy in terms of yields (on that subject, we should salute the altruism of investors who went after negative yields on German 6-month bills). Does the calendar alone, then, explain the rush into risk assets? We should point out, and hail, the clearly encouraging newsflows, especially from the United States where macroeconomic data and initial earnings releases for Q4 boosted investor sentiment, which in the end suffered little from the flat performance of equities in 2011.

The news from China is also seen as reassuring, with the Cassandras who predicted a hard landing having evidently been proven wrong by figures showing some resilience in the economy. Given this improvement, the eurozone—not surprisingly—ultimately remains the focal point of all problems. Mario Draghi is generally seen to have succeeded in his debut at the head of the central bank, but as long as the 500 billion euros that he decided to inject into the banking system keep finding their way back onto the ECB's books, the problem as a whole will remain. Confidence has certainly not returned to the European banks, and until they know how they are going to be treated as private investors in the Greek situation, there is little hope that they will put the mountains of cash at their disposal to more productive use.

Despite a clear improvement in overall sentiment, uncertainties related to the fate of the Greek debt are such that it seems foolhardy to be very aggressive in the use of risk assets.

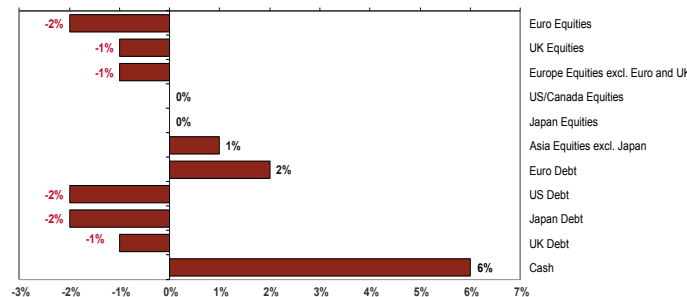
Model portfolio



Portfolio closed on 13/01/2012. Benchmark composed of 50% JPM global hedged + 50% MSCI world. Source: Groupama AM

% difference

BETWEEN BENCHMARK AND MODEL PORTFOLIO



Allocation

GLOBAL ALLOCATION

Equities 48% / Rates 46% / Cash 6%

EQUITY MARKETS (48)

■ **USA (=):** We are maintaining our allocation in the U.S. stock market in line with its weight in the indices. In macroeconomic terms, the data are surprisingly positive (even if it's too early to talk about a decoupling) and, in parallel, the initial quarterly earnings releases appear to be strong.

■ **Europe (=):** We remain underexposed: The zone's difficulties (especially the problem of Greek debt) are still a sword of Damocles hanging over risk assets and the near-universal downgrade initiated by the S&P will do nothing to resolve them even if the damage is minimal for now. As a reassuring element, the ECB is strategizing, and its activism is commendable. Still anticipated is a movement in the key interest rate; this seems likely before summer and will be appreciated by investors.

■ **Asia/Japan (=):** We are maintaining an underexposure on the region. Asia excluding Japan, in particular, is benefiting from the improved outlook on Chinese growth. This soft landing (well-managed by the authorities) is reviving interest in investment in the region. Japan should benefit in this environment, even if the yen's strength is weighing on its economy.

INTEREST RATE MARKETS (46)

■ **USA (-1):** We have no major worries about U.S. bonds, as the on-going Twist operation is unquestionably a positive element. We are, however, taking profits on an asset class that has performed well, and using them to buy eurozone bonds.

■ **Europe (+1):** The easing of the stress over sovereign spreads resulting for the most part from the ECB's actions is leading us to marginally increase our allocation (mainly for the carry trade relative to U.S. bonds).

■ **Japan (=):** We are maintaining a slight underexposure to Japanese rates, as the bond market there provides little reason to favour it.

CASH (6)

Our cash portfolio remains unchanged.

IN THE BLINK OF AN EYE

Our strategy

		Current level 12/01/12	Short-term tarjet	1 year tarjet
United States	Fed Funds	0,25	😊	😊
	10 yr T - bill	1,90	😊	😞😞
Eurozone	Refi rate	1,00	😊	😊
	10 yr Bund Fr/Germ Spread	1,83 120bp	😞	😞😞
Japan	BOJ rate	0,10	😊	😊
	10 yr JGB	0,96	😞	😞

Sources : Groupama AM, Bloomberg

Our model portfolio in € 12/01/12

BENCHMARK	EURO MTS GLOBAL
Sensitivity	😊
Inflation indexed allocation	😊
Curve choice	
1 - 3 yr	😊
3 - 5 yr	😊
5 - 7 yr	😊
7 - 10 yr	😊
10 - 15 yr	😊
15 yr +	😊

Sources : Groupama AM, Bloomberg

Conclusions of the equity markets committee 12/01/12

Indices	Forecasts	
	Groupama Asset Management	
	short term (< 3 months)	at 1 yr
France (CAC 40)	3211	😊
Euroland (DJ)	230	😊
United-Kingdom (FTSE 100)	5697	😊
United-States (S&P 500)	1292	😊
Japan (Topix)	733	😊
MSCI Asia free ex-japan	471	😊😊

Sources : Groupama AM, Bloomberg

Sector Outlook

Energy	😊	Consumer Products - Cosmetics	😊
Basic Materials	😊	Health Care Equipment	😊
Capital Goods	😊	Pharmacy & Biotech	😊
Industrial and Commercial Services	😊	Banks	😊
Transportation	😊	Diversified Financials	😊
Automobile	😊	Insurance	😊
Consumer Durables	😊	Real Estate	😊
Hospitality & Leisure	😊	Software & Computer Services	😊
Media	😊	Technological Equipment	😊
Non-Food Retail	😊	Semiconductors	😊
Food Retail	😊	Telecoms Operators	😊
Food Processing	😊	Utilities	😊

Sources : Groupama AM

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😊😊 Positive 😊 Positive neutral 😊 Neutral 😞 Negative neutral 😞😞 Negative

📄 Summary

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