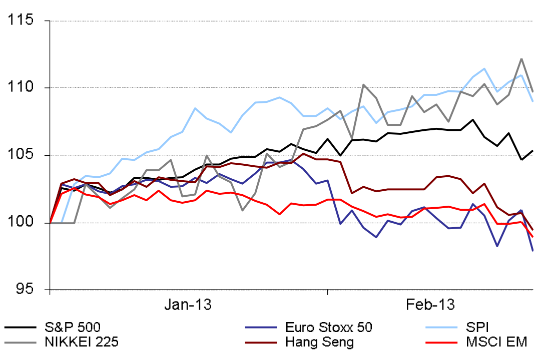
Volatility ahead – medium-term outlook remains positive
Gold prices about to collapse?

The bullish market mood of January cooled significantly after European economic data indicated that recession might last longer than anticipated and will not end before Q2 of this year. The US Congress is unlikely to prevent the full spending cuts specified under the Budget Control Act, which will make for softer US economic data in the coming quarters. In addition, the Italian elections have resulted in a deadlock situation with a long period of political bargaining and potential re-elections ahead of us. The only thing certain seems to be that Italy is very unlikely to follow the austerity path of Monti's government, which re-established a great deal of credibility last year. Despite these negative points, we remain positive on the medium-term outlook and still see value, especially in equity markets. However, we are very worried about the recent gold price movements and outflows out of gold investment funds.

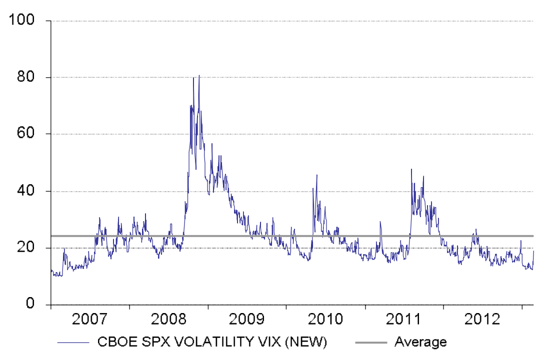
The Japanese Nikkei and the Swiss SPI equity market indices continued to outperform in February, while other major equity markets remained flat or even weakened. Especially eurozone and emerging markets equities underperformed (see fig. 1). The implied volatility index VIX, which traded at very low levels from the beginning of the year, has risen steeply in the last several days (see fig. 2). At the same time, commodities have sold off sharply while the USD has recovered strongly (see fig. 3).

Fig. 1: Major equity markets in 2013



Source: Thomson Reuters Datastream, Blue Horizon Wealth Partner

Fig 2: VIX index - S&P500 implied volatility



Source: Thomson Reuters Datastream, Blue Horizon Wealth Partner

Gold prices about to collapse?

We have serious doubts as to whether gold can provide real safety and security if monetary systems should collapse. In the past, especially under the Bretton Woods system between 1944 and 1973, gold was used as a monetary anchor, but it is unlikely to serve that purpose in the future. Still, in the last 10 to 13 years gold prices have risen almost ten-fold on the back of economic crises and unprecedented monetary expansion. We understand how concerns aroused by those factors have been a major driving force for the recent gold price rally. Moreover, we fully appreciate the diversification value of gold in a portfolio context.

Nevertheless, gold cannot, in our opinion, be considered a safe haven asset. First, gold has a history of strong multi-year rallies followed by sharp sell-offs and periods of sluggish price movements. Second, the gold price is highly volatile and can move sharply up and down. Third, demand depends very much on central-bank and investment buying, and this demand can be as high as or

Fig. 3: EUR-USD exchange rate

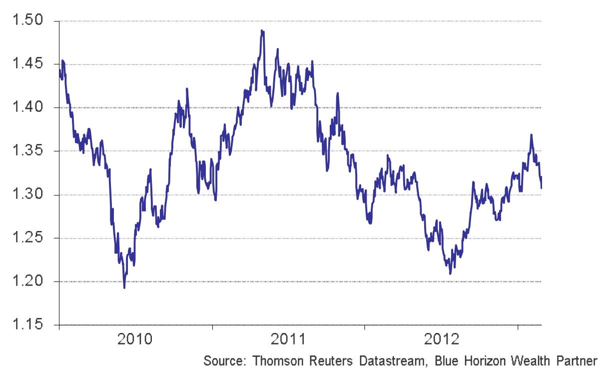


Fig 4: Real interest rates still negative but bottomed

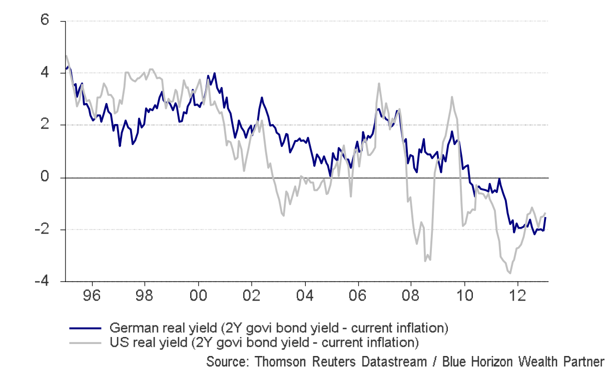


Fig. 3: Gold price development

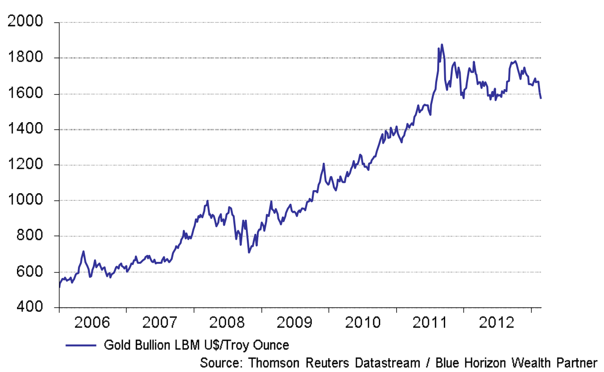
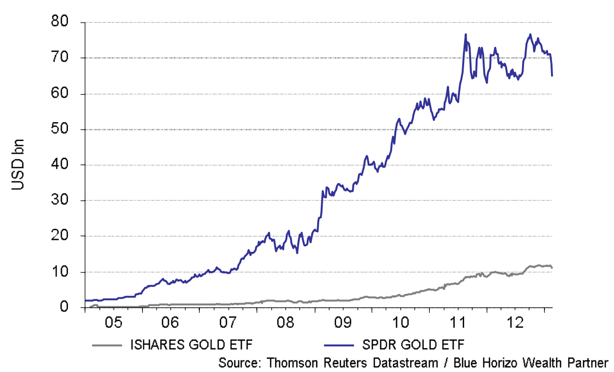


Fig 4: Gold ETF outflows



even higher than commercial demand. Therefore, if gold were to fall out of investors' favor, there could be very sharp sell-offs.

We are becoming increasingly concerned about the current state of the gold market. Economic activity has slowly but surely picked up, which suggests that monetary expansion is going to slow down sooner or later. We already see that real interest rates are starting to rise again, and equity markets have been performing very well for the last 12 months. As a result, the opportunity costs of holding gold, which is a non-interest-bearing asset, have begun to climb. On top of that, investors' demand has started to slow. Gold ETFs (see fig. 4) are already experiencing significant outflows. In addition, influential investors like George Soros and Louis Moore Bacon have announced that they have cut their stakes in gold. Such dynamics can easily lead to accelerated gold selling and a further fall in gold prices.

Outlook

As discussed above, we see the economy on the road to recovery, although it will continue to be a long and bumpy ride. Our optimism is based on several observations. First, a number of economic indicators have been improving over the last couple of months. Second, we continue to believe that the monetary support provided by central banks will continue to bolster markets for risky assets and will, over time, exert positive effects on the real economy. Third, equity market valuations still look attractive. Dividend yields exceed interest rates by historically high margins, and price earnings ratios, based on IBES 12 months earnings forecasts, are clearly below long-term averages.

Fig. 5: Dividend yields vs 10Y government yields

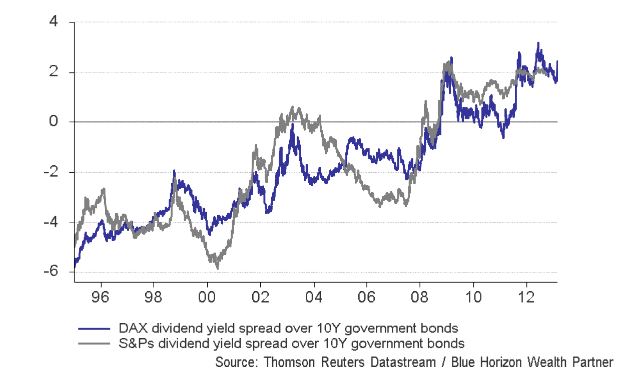
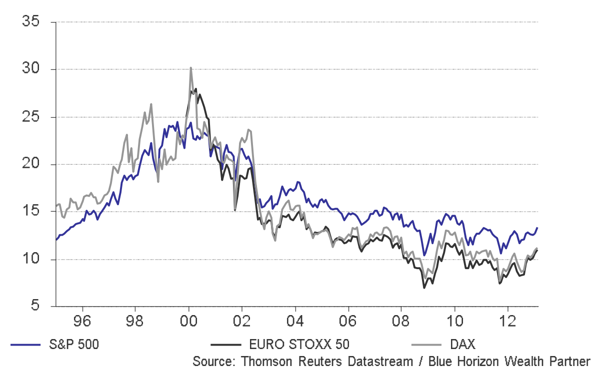


Fig 6: 12M Forward PEs (IBES estimates)



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