

Global Perspectives – n°43

Markets have been volatile recently. Are there reasons to worry ?

Of course there are ! There are always reasons to worry !

But ... **CapitalatWork** tends to worry more when other people don't worry a lot and we tend to worry more about things that are NOT KNOWN than about things that are KNOWN.

Our point today is that almost everybody worries (a lot) about things that are

1. ***well-known***
2. ***known for quite some time (6 to 18 months)***
3. ***known by a lot of people.***

So, what do we know for sure ?

We know as facts that,

- short and long rates all over the world have gone up significantly (1% to 3%) from the multi-decades lows of three years ago,
- for the last 12 to 18 months, the US residential real estate market has been in a downturn,
- over the last 6 to 12 months, credit-related problems have surfaced,
- these credit-related problems are not limited to the credit-originators but have spread through
- the markets to all sorts of different risk-holders, some of which are leveraged.
- these credit-related problems are not limited to mortgages but have spread to different areas as credit spreads on corporate bonds have widened (non-investment grades spreads have surged)
- and securitization of LBO-credits have become more difficult,
- some high-profile defaults have happened and have been widely-publicized.

We also know as facts that,

- credit-originating standards have been tightened,
- risk-management and audit departments are on high alert,
- provisions are being taken and are being announced on a daily basis but especially during earnings-reporting season, which is now.

What don't we know ?

Obviously there are a lot of things we do not know but, related to the above credit-related issues, essentially HOW FAR, HOW DEEP and HOW LONG will the damage spread.

But again, we DO KNOW that a lot of people worry about these three questions and that all sorts of scenarios, from the most optimistic to the most pessimistic, are being discussed and are thus at least partially discounted in the current prices.

That is a fact ! Just listen for an hour to CNBC or go through the 30 last copies of the WSJ and you will see what I mean.

So, in all modesty, we tend not to worry too much about the by now famous "subprime crisis". Time will tell whether we were right or wrong not to worry because so many people have been worrying so much for such a long time.

Another thing we know as a fact is that **most of our companies have continued to perform very well on an operating basis** as we can see from their recent revenues and earnings announcements. This obviously relates to the recent past.

St Gobain, ArcelorMittal, Comcast, LVMH, United Technologies, Siemens, Vinci, Moody's ... just to name a few of our holdings have announced results in line or exceeding our estimates. What we do not know and therefore have to estimate is how they will perform in the future and if current valuations are as reasonable as we think they are.

Again, time will tell.

As a conclusion, let me repeat what we said one month ago, in our Global Perspective of June07

Because of higher interest rates all over the world, the relative attractiveness of the different asset classes (cash, bonds, equities) has become more balanced.

Two years ago, we saw a lot of value in equities and little or no value in cash or bonds.

Today, because of higher real rates there is again value to be found in the fixed-income area and, because of higher prices and valuations a bit less value in equities.

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