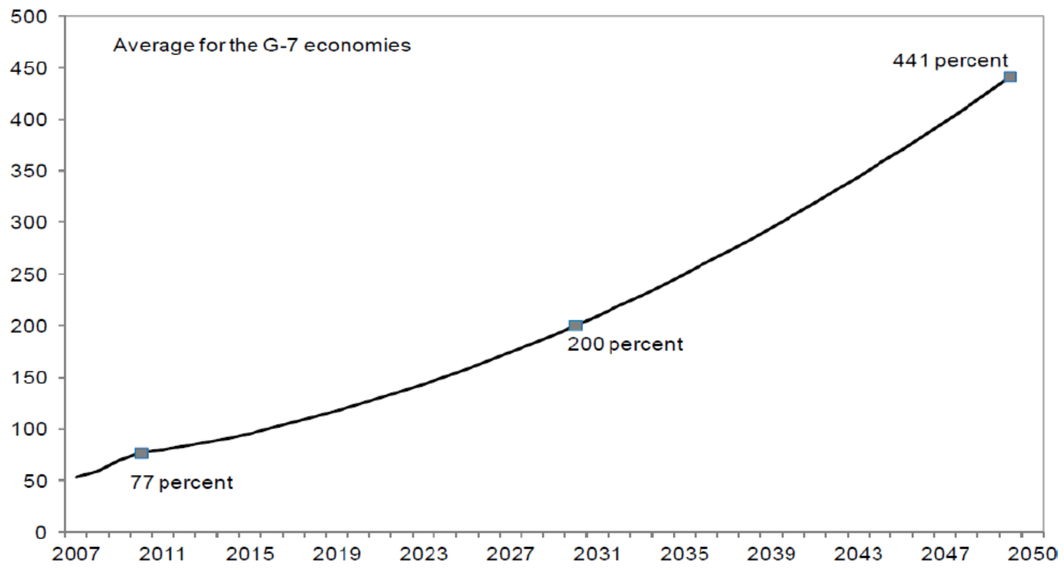
Global Perspectives

July 2011

What have we, **Capital*at*Work**, been saying for the past few years, months and weeks?

1.
If you have attended some of our presentations or read some of our Global Perspectives, you will have been made more than aware of the huge fiscal challenge most countries of the world are facing with.

Figure 11. General Government Net Debt Scenario Under 2010 Policies
(In percent of GDP)



Sources: IMF *World Economic Outlook* July 2010 Update, and IMF staff calculations and estimates.

You will hopefully recognize the above graph, which is conveying an über-important message:
if the current state of public finances is far from brilliant, without major corrective measures, the future debt situation will be far worse !

We have been saying for years that the retirement age should be raised gradually but significantly as the greying of the population, with the accompanying pension and healthcare costs, is THE major societal problem, and opportunity, we are facing.

The lack of urgency, governments, all over the world, are showing in the face of this problem is of course mind-boggling but one cannot be surprised as this is unfortunately how some democracies tend to work.

Most important is not so much being right but being well prepared.

We have therefore been very selective and very conservative.
We do NOT own € government bonds of the European Periphery (we sold our Italian bonds) and are therefore focused on the stronger European core, Germany, Netherlands & Finland and DO own some € bonds from Canada, 22% supra nationals and 15% Norwegian Kröner.

2.
Deleveraging (the reduction of debt levels) will be a predominant theme for some years to come.

This is most probably DISINFLATIONARY at best, DEFLATIONARY at worst. When inflation is low, stays low or goes even lower ==> you have to own long-duration assets.

Cash is definitely NOT king in such an environment.

3.
The worries with regards to public finances obscure two simple facts:

1. corporations are, in general doing well,

and 2. corporate assets are cheap; equities more in particular.

During the 1Q of 2011, based on renewed economic optimism, interest rates were going up strongly AND stock prices were going up, with quite an adverse effect on equity valuations, (equity premia going down) which led us to some caution.

During the 2Q, exactly the opposite happened. Because of disappointing economic growth, stock prices, commodity prices and interest rates came down with a very positive effect on equity valuations.

On average, European Equity valuations are in the 10x to12x 2011 Exp EPS range and in the 12x to 14x 2011 Exp EPS range for the US.

One of the most common mistakes when investing is to focus to much on growth, on a micro level and on a macro level.
Growth usually does not come cheaply and also growth usually does not come without problems like inflation and higher interest rates.

Today the contrast between the deleveraging, slow-growing and ageing welfare states with ultra-easy monetary conditions and the high-growth, young countries with tight monetary policies are unprecedented.

Paradoxically, we continue to think assets of the low-growth world will outperform assets of the high-growth world.

4.
With regards to currencies, many people seem to be worried about the Euro and rightly so.

Let us nevertheless not forget that,

1. a low-inflation currency is usually a strong one,

and 2. owning some foreign currencies, like we do, is warranted. If you have 20% to 40% Non-Euros, and the Euro were to go down, you will do quite well, in Euro, of course.

So, let's keep our heads cool by being well prepared for the challenges to come,

Capital*at*Work Foyer Group, the 12th of July 2011.

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