



Media Release

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Sarasin's Strategy Outlook: Goldilocks scenario continues to fan equity markets – the rise of equities buoyed by generous liquidity

The combination of nervous central bankers and frightened politicians is adding up to ever more generous liquidity conditions, despite evidence of an accelerating world economic recovery. Global equities should continue to rise despite recent gains, as investors flee near-zero yields on cash, according to Sarasin Group's latest Strategy Outlook. Investor sentiment is further buoyed by central bankers' reluctance to turn off the stimulus taps, note authors Burkhard Varnholt, Chief Investment Officer, and Guy Monson, Chairman of the Investment Policy Committee, at Sarasin.

As a result, one of the most powerful rallies in risk assets in recent market history, predicted in Sarasin's July Strategy Outlook, is being fuelled by extremely low interest rates and promising economic data. Export-led economies are experiencing a soaring inventory-led bounce, while unemployment in much of the world has not been as severe as economists forecast. There are still areas of concern – the US housing market remains too dependent on government support, while debate continues on the record levels of spare production capacity across global economies. These issues have increased the nervousness of policy makers about acting too soon to withdraw stimulus programmes and repeating the errors of the Bank of Japan in the mid-nineties.

Guy Monson, Chairman of the Investment Policy Committee

"The Goldilocks scenario – where growth is strong enough to lift earnings but too fragile for Central Bank tightening – that we dared to put forward in our last Strategy Outlook now dominates our strategy. As we expected, investors now have the confidence to escape near-zero cash yields. These yields are also encouraging investors to revisit equities given bonds' low yields. We are now taking a tactical approach given the unique up- and downside risks evident in the global economy."

Burkhard Varnholt, Chief Investment Officer

"Since the Goldilocks scenario has become a reality, we need to look out for the three bears. The first is the emerging markets questionable ability to offset a drop in US consumption, should this fall dramatically. The second is the inability of global economic powers to address the exchange rate regimes at the heart of global imbalances. The third is therefore a disorderly fall in the value of the US dollar as the currency loses its status as a global reserve currency and becomes a global "carry trade" or funding currency."

Two key risks threaten global economic recovery

Sarasin see two key risks to global economic recovery. The first is that while consumption in the emerging markets will grow, it may not offset a fall in consumption in the US as saving rates rise there. While the easiest adjustment mechanism would be a revaluation of emerging market exchange rates, which would raise domestic purchasing power and productivity among thrifty consumers, this is unlikely. Sarasin therefore expects the dollar bloc to be bound by unsustainable exchange rates, leaving the G20 central bankers challenged by inflationary drivers that are contradictory and beyond their control. The second risk is a disorderly fall in the US dollar as the American currency moves from the role of a global reserve to that of a global 'carry trade' or funding currency (perhaps usurping the role the yen has played for much of this decade).



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Global Investment Strategy Implications

While an exclusively reflation-based asset allocation stance is tempting, Sarasin recommends a broader, more tactical approach given the scale and duration of the rally to date, the rise in asset valuations and the existence of some unique up- and downside risks. Sarasin recommends a gentle reduction in corporate bond holdings, with long-term strategic opportunities in emerging market debt driving the use of sovereign issues and third-party EM bond funds. We will be launching our own dedicated funds in 2010. Sarasin has also moved from a China-centric EM strategy to include South America, Eastern Europe, the Gulf, and, where appropriate, Africa. In China, Sarasin will focus on domestic growth themes, particularly related to consumer demand, education and healthcare. Sarasin recommends a considerable exposure to equities, particularly financial stocks appropriate to our “Corporate Restructuring” theme. Sarasin also recommends an increase in physical gold positions, and the additional of global real estate holdings.

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