



## Media release

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# Sarasin's Strategy Outlook: Global blue chips stand out as Europe's bailout unravels

As continents vie for the world's largest bailouts, the faltering and indecisive European offering looks unimpressive when compared to the US bank rescue plans post-Lehman or the Chinese emergency fiscal package last year, says the latest Strategy Outlook issued by the Sarasin Group. However, it adds, in the long term, the effects should be the same: more money printed, greater public sector involvement in the economy and lower interest rates for longer. In contrast, the corporate world – with a record quarter for profits, the most “cash on balance sheet” in 50 years and dividend growth well in excess of inflation – seems “reassuringly” dull and solid. With yields considerably above government bonds and balance sheets often stronger than those of the national governments under which they operate, the opportunity for a strong recovery across our “Nifty Fifty” style global equities is clear.

### **Guy Monson, Chairman of the Investment Policy Committee**

“We are experiencing a hesitant, uncertain and mildly chaotic start to the fiscal consolidation needed globally, but the fact that it is not perfect is probably helpful; a terrible ‘Shift to Thrift’ could derail the nascent recovery we are now seeing. Financial markets will slowly but surely come to recognise this; we see interest rates remaining at or close to zero, and bond yields will stay near to Japanese levels, while the euro finally regains its competitiveness – not a bad environment for the largest European exporters and our ‘Nifty Fifty’ style equities around the globe, especially when the EURO Stoxx 50 index yields a full percentage point more than French and German government bonds.”

### **Burkhard Varnholt, Chief Investment Officer**

“Despite the ongoing fiscal consolidation, European equity markets now look particularly cheap, thanks to a weaker euro, stronger overseas growth and lower valuations. One has to be cautious, however, as the risks of a self-fulfilling prophecy remain elevated: the collapse of equity markets on the back of fears about a global slowdown could actually trigger a fall in business confidence and ultimately in global activity. Our belief is that bailouts backed by central bank intervention are ultimately effective, however, that in Europe's case, political and longer-term solvency issues as well as extraordinary levels of academic and economic criticism mean that markets will take some convincing.”

Sarasin points out that the key failing of the IMF-led EUR 750 billion programme to rescue Greece is that, while it provides plenty of liquidity, it does nothing to address the longer-term structural issues. These are only likely to be solved with a strong federal budget and an effective Stability and Growth Pact which has penalty powers. However, it warns that simultaneous belt tightening by different members of the euro zone could reduce total demand and savings, potentially triggering an economic contraction that could leave the economy in a more vulnerable state than in the beginning. The “Shift to Thrift” is at risk of becoming a global phenomenon, as can be seen in the IMF summary of “Fiscal Rules“, which are steadily becoming enshrined in statute.

The Sarasin Strategy Outlook goes on to say that the euro crisis could be a remarkable opportunity to improve the efficiency of the public sector, setting up a “right-sized” government that uses scarce

tax revenues more effectively; in the 1980s, Denmark, Finland and Ireland all successfully used this template to bring about an economic recovery at the same time as fiscal consolidation. The problem is not the aggregate amount of debt but rather the distribution of the government debt. Hence, from an economic point of view, core eurozone can (in theory) continue to finance transfer payments to the periphery for a long time. Perhaps the trend towards thrift in the periphery, matched by extended private sector consumption in the core, is the ultimate goal.

### Global Investment Strategy Implications

With US inflation rising at an annual rate of 0.6% in the first quarter of 2010, the slowest pace since records began in 1959 (according to a Commerce Department report of April 30, 2010) and core inflation in Europe remaining weak with a whiff of deflation, Sarasin indicates that, in the near term, bonds continue to provide diversification benefits and a protection against another deflationary shock. Increasingly Sarasin prefers cash plus real assets (gold and blue chip equities) over finding portfolios locked into longer-term government issues.

Sarasin's general view that "Nifty Fifty" style, Western blue chips would outperform higher beta emerging and mid/small cap indices has also proved broadly correct with global equities remaining the preferred asset class. Since January 1 this year the exception has been in Europe, where the collapse in the currency and relative equity weakness has produced an extraordinary 29% decline for US dollar-based investors, some 23% worse than the S&P. Sarasin thinks that this is not enduring, and that US dollar-based and GCC investors should be steady buyers of high-yielding European blue chips no matter how counter intuitive this may feel.

### "Nifty Fifty"

The 50 most favourite stocks by institutional investors. Companies in this group are characterized by consistent earnings growth and high P/E ratios. Examples include Roche, Cisco and Intel.

The quarterly Strategy Outlook is available from [media@sarasin.ch](mailto:media@sarasin.ch) or visit [www.sarasin.com](http://www.sarasin.com)

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