

The last quarter of the year was very eventful. It ended notably with new trends that might extend into 2010.

At the macroeconomic level, the publication of the GDP figures confirmed that the major economic areas had already moved out of recession in Q3, while the confidence indicators made further progress. The phase of falling prices came to an end when the inflation rate returned to positive figures in both the United States and Europe. The monetary authorities, for their part, re-oriented their position: whereas some central banks (such as *Norges Bank* or the *Reserve Bank of Australia*) began to raise their interest rates, the European Central Bank, the Swiss National Bank and the Federal Reserve announced a gradual withdrawal of the emergency measures. The first concrete signs of a reversal on the US labor market, which appeared at the beginning of December, heightened the anticipations of an interest-rate hike by the FED.

The expectations that a still-very-accommodative monetary policy would be re-oriented thus characterized the trend on the financial markets at the end of the period under review. The dollar picked up at the end of the year, while gold finally corrected by about 10% after having reached an all-time high at more than USD 1,200 per ounce.

Speculation over the forthcoming decisions to be taken by the central bankers penalized fixed-income securities, which went through a difficult quarter, in particular on the longest maturities. The situation was compounded by the fact that the last part of the year was marked by a revival of the worries over the quality of sovereign debt. As for the stock markets, they continued their positive trend, although the rate of increase of the main indices faded slightly after a very fine summer.

ECONOMY

United States

The published news definitively pointed to a recovery of economic activity. The move out of recession became official with the Q3 GDP data, which turned out to be up by +2.2% following four quarters of negative growth. The statistics for industry corroborated this sentiment: whereas industrial production continued its upward path, engendering a slight rise in the rate of production capacity utilization, the leading indicators of economic activity further improved. The good news also concerned consumption, as was borne out by the increase in retail sales.

The recovery of the real-estate market, in contrast, proved more complicated. The rebound of activity during the summer was not confirmed at the end of the year. Sales of new houses fell again, while the increase in sales of existing houses was supported by the forced sales of seized properties and by tax credits for first-time buyers.

But it was the employment report for the month of November, which turned out to be much better than expected (a considerable slowdown in the rate of job losses and a drop in the unemployment rate from its peak at 10.2%), which marked the news in Q4. Since the revival of the labour market was the missing link in the recovery chain, the economic forecasts in the United States suddenly improved, increasing the probability of an interest-rate hike by the Federal Reserve in 2010, despite the still-very-cautious line being taken by the monetary authorities. In this respect the rebound of the inflation rate, which returned to positive figures following a phase in which prices fell for eight months, was due mainly to the mechanical effect connected with the fluctuation of energy prices.

Euro zone

The euro zone as a whole also moved back into growth (the GDP figures revealed an increase of +1.6% at an annualized quarterly rate in Q3). This trend is likely to continue over the next few quarters, as is suggested by the improvement in the various leading indicators of economic activity. However, the national data show a degree of heterogeneity: Germany and France are clearly on the road to recovery, Spain is still in convalescence while the forecast for Greece is very guarded.

In the meantime the ECB began to exit from its quantitative monetary policy, announcing a gradual withdrawal of the liquidity injection measures put in place during the crisis, but without signalling the slightest intention to raise interest rates. Particularly as the disinflation process continued, despite a consumer price index that has become positive once again: core inflation in fact continued to slow down.

Europe outside the euro zone

Unlike its two principal fellow institutions, the Bank of England did not appear to be in a hurry to re-orient its monetary policy. Quite the contrary, it even announced a GBP 25 billion expansion of its securities repurchase programme (to a total of 200 billion), in order to take the inflation rate down to its target level of 2% and to reduce the surplus unused capacity in an economy that is having difficulty pulling out of recession.

The economic recovery continued in Switzerland. The rebound in activity was boosted by the increase in exports, which were stimulated by a recovery of the global economy that more than compensated for the handicap caused by the strength of the Swiss franc. Finally, *Norges Bank* took the lead by raising its interest rates on two occasions during the past quarter (from 1.25% to 1.75%).

Japan

Hindered by the risks of a new deflationary spiral, put under pressure by the strengthening of the yen and requested by the government to take action, the Bank of Japan announced additional lending facilities for the banks totalling USD 114 billion. The world's second-largest economy confirmed its double face. The industrial rebound, which was boosted by the boom in exports to China, was not accompanied by an increase in the inflation rate, which remained well in negative figures.

Emerging economies

Apart from the difficulties encountered by Dubai, submerged by debts amounting to billions, the economic environment for the emerging countries further improved during the last quarter of the year with the return to growth of the developed countries and the increase in commodity prices. Furthermore China's soundness benefited the whole of Asia, as was borne out by the dynamism displayed by countries such as South Korea and Indonesia. In Brazil, the recovery of private consumption was reflected in a further decrease in unemployment.

MARKETS

Equities

Following a dazzling summer rebound, the stock markets moved in a narrow band between October and December. The year ended on a positive note, however, with the final trading sessions taking the principal indices to record highs for the year. Although the macro-economic news was favourable, the operators wondered about the possibility of a premature interest-rate hike. At the same time, some unfavourable news about the financial health of the Greek State and the Emirate of Dubai revived some unpleasant memories. In terms of sectors, we observed a good performance by the defensive sectors like the food and beverages sector. Mining and chemical shares also stood out. Conversely, the banking sector lost some of its shine, posting a decrease over the period.

The *MSCI World*, in local currencies, rose by +4.1% over the quarter (+22.8% in 2009). The European and U.S. stock markets again ran neck and neck with the *DJ Stoxx 600* ending the period at +4.7% and the S&P 500 at +5.5% (+28.0% and +23.5% respectively over the last 12 months). It is worth pointing out the remarkable performance of US technology stocks, as

exemplified by the rise in the *Nasdaq* between October and December: +6.9% between October and December and +43.9% over the past year. The emerging markets (*MSCI Emerging Markets*) recorded an excellent performance (+6.9% in local currencies over the last three months and +58.7% in 2009). In contrast, the Topix continued to suffer, posting a decrease (-0.3% between October and December) over a very mixed year (+5.6%).

Bonds

The path followed by the bond portfolios was, to say the least, tortuous over the last three months of the year. The long part of the interest-rate curve suffered from the improvement in the economic panorama, which raised somewhat the inflation expectations. The explosion of public debt did the rest, in particular for the government bonds of English-speaking countries, whose economies – flooded by liquidity injections – were, in addition, suffering from a negative current-account balance. The speculation over an early interest-rate hike by the FED, which was fuelled by the prospect of an imminent improvement in US employment, also exerted tensions on short-term interest rates. At the end of the day only bonds denominated in CHF and EUR succeeded in posting globally-positive performances.

In general, the *Global Govt Bond Index* in local currencies fell by -0.2% in Q4 (+0.7% over the year 2009).

Exchange rates

The US employment report, which was published at the beginning of December, also marked a turning point for the dollar's exchange rate. After having declined since March with the decrease in risk aversion, the greenback had exceeded 1.51 against the euro at the end of November before rebounding (to 1.43) on the anticipations of an improvement in the United States' economy, which finally turned out to be sounder than expected. The strengthening of the dollar was coupled with a weakening of the euro, at a time when the worries about the budgetary situation of certain European states (in particular Greece) weighed on the exchange rate of the single currency. Benefitting from very sound fundamentals, in particular for its public finances, the Swiss franc in turn served once again as a safe haven, strengthening from 1.51 to 1.48 against the euro over the last two weeks of December.

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