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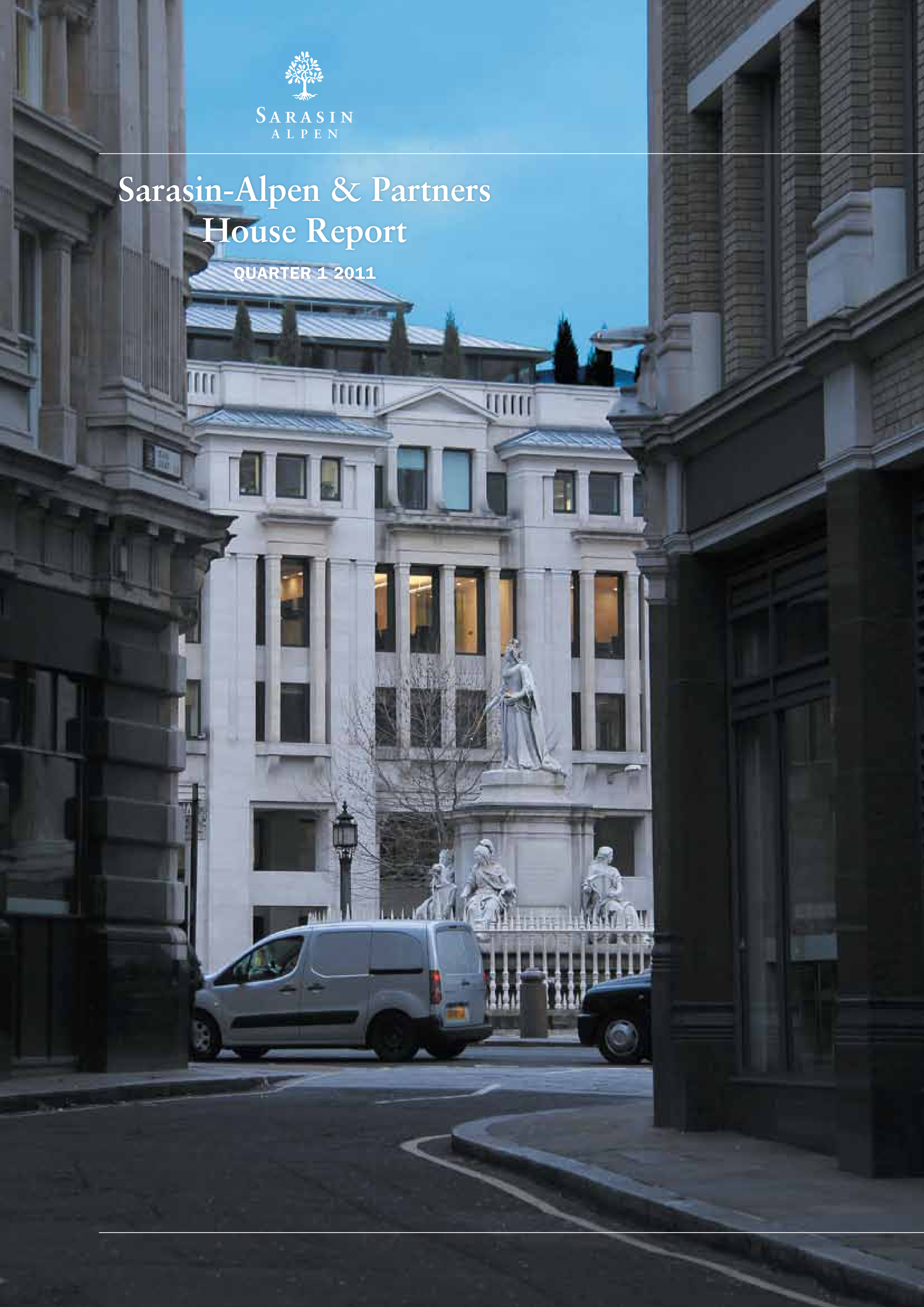
Sarasin-Alpen & Partners House Report

QUARTER 1 2011



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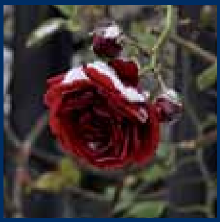


SARASIN-ALPEN & PARTNERS HOUSE REPORT
is a quarterly publication providing informed analysis
and advice on topics of interest for the private client
and institutional investor.

Introduction

Paul Cooper
Managing Director, Sarasin-Alpen & Partners Ltd.

It is with great pleasure that I enclose the tenth edition of the Sarasin-Alpen & Partners Quarterly House Report. The main body of the report is once again written by Guy Monson, Chief Investment Officer of Sarasin & Partners; the UK subsidiary of Bank Sarasin. Guy's ability to explain some of the most complex financial issues has made his "Market View" essential reading for clients and friends of the Sarasin Group.

I am also pleased to include a short piece on our newly launched Sarasin Nifty Fifty India Equity Fund. Before this, though, a few words on the risks & opportunities of investing in the Gulf.

As we look back on 2010 I believe we have much to be grateful for. It was always going to be a challenging year; the 1st full year of recovery after the deepest recession in 80 years. Many questions remained unanswered and yet the answers would likely determine the direction of asset prices for many years to come. Would the extraordinary measures undertaken by the world's leaders be sufficient to generate sustained growth? Had they done too much and would inflation be the result?

How would equities react to the threat of higher interest rates in the strong growth scenario and disappointing earnings in the low growth scenario?

Considering these challenges I suspect that politicians and central bankers will be quietly satisfied with the way the year has progressed. That's not to say the crisis is fully behind us, but rather that the economy has responded in a way that provides some grounds for optimism. Indeed, the International Monetary Fund (IMF) now predicts growth for the global economy in 2010 (compared to -0.6% in 2009 and 2.8% in 2008). The fact that 12 months ago they expected 3.1% shows the extent to which the economy exceeded expectations in 2010. Within this, however, the developed world has been sluggish (though still better than expected), while growth in the emerging world has been stellar.

This meant that even though interest rates in the developed world stayed low, corporate profitability exceeded expectations (on the back of strong global growth). In other words, neither of the earlier scenarios "played out". Instead we saw low interest rates and strong earnings growth - an excellent combination for equities.

Closer to home, the MENA region (Middle East North Africa) is expected to have grown by a respectable 4.1% in 2010. However, it starts to get interesting when you look forward to 2011. Although growth is expected to slow in the advanced economies from 2.7% to 2.2% (as fiscal policy is gradually tightened) and from 7.1% to 6.4% in the emerging economies (as interest rates are raised and other measures to tackle inflation are implemented), growth in the MENA region is expected to accelerate from 4.1% to 5.1%. Global growth next year, at 4.2%, remains healthy by historical standards, but momentum is shifting towards the Gulf.

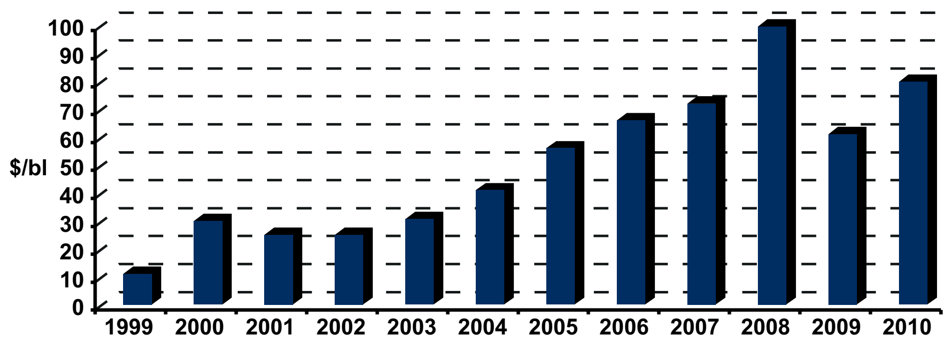
Although the outlook for 2011 is by no means uniform across the region, higher oil prices will improve liquidity and help kick start lending in the banking sector, supporting the government's investment program. As an illustration, the Saudi Arabian Ministry of Finance announced last month that it expected a 2010 budget surplus of $29bn (7% of GDP) rather than the projected deficit, despite spending 16% more than originally envisaged. Revenue for the year was 56% higher than budgeted thanks to an average oil price of almost USD 80. High oil prices makes the region's financial position the envy of the world.

2010 was not a bad year for the region's equity markets either, rising by 13%. This was similar to the performance of global developed and emerging markets. However, given the improving fundamentals & strong oil price, the inability to make up for the region's underperformance in 2009 was disappointing. For example, while global emerging markets have risen by 103% since the beginning of 2009 (and oil prices have doubled) the GCC market is up just 24% (source: Bloomberg, price indices).

Performance since the demise of Lehman Brothers on September 12, 2008 is equally extraordinary. The MSCI World Index, covering 24 countries in the developed world, finally returned to its pre-Lehman level on December 29, 2010, while the MSCI Emerging Market Index reached this level as early as August 2009 (and is now 35% higher). The Bloomberg GCC 200 index on the other hand is down 27%, which is even worse than the MSCI World Financials Index (-20%), the constituents of which wrote off $1.7 trillion over the same period (source: Bloomberg).

However, I believe that this is about to change. As mentioned above, economic momentum is shifting to the region and the equity market has started to perform well. Strong government finances, low interest rates and a high oil price all support the investment case. The equity market is cheap and with improving fundamentals it offers significant upside potential. 2011 should be the year in which the strengths of the GCC are finally recognized.

2010 was the 2nd best year EVER for the oil price (WTI)



The Sarasin Nifty Fifty India Equity Fund

Sarasin-Alpen & Partners is delighted to announce the launch of its 2nd equity fund - the Sarasin Nifty Fifty India Equity Fund. The Fund aims to achieve long-term capital growth by investing in some or all of the stocks in the S&P CNX Nifty Index, containing India's 50 largest companies.

The Economic Rationale

- The Republic of India is the seventh largest country in the world by geographical area and the second most populous with 1.2 billion people. In 2010, India's nominal GDP stood at USD 1.3 trillion, which made it the eleventh largest economy in the world. In terms of purchasing power, India's economy is the fourth largest.
- With an average annual GDP growth rate of 5.8% for the past two decades, India has been one of the fastest growing economies in the world. Growth in 2010 should reach 9.7%.
- A 2007 Goldman Sachs report projected that from 2007 to 2020, India's GDP per capita would quadruple and that its economy would surpass that of the United States before 2050.

The Investment Opportunity

Investors in the Indian equity market have been handsomely rewarded in the recent years. USD 1 million invested in the Nifty Index ten years ago would be worth USD 6.1 million today versus just USD 1.2 million for an equivalent investment in the S&P 500 Index. This equates to a return of 19.7% p.a. for the Nifty compared to just 1.4% p.a. for the S&P.

Although this performance is impressive, reflecting India's rapid development over the period, the country is at the beginning of its "journey" not the end. Income per capita of USD 1,176 leaves it ranked 137th in the world, just behind the Solomon Islands and Yemen (source: IMF, December 2010). It is the prospect of continued economic progress and wealth creation that makes India such an interesting long-term investment opportunity.

Investing in India

Our process capitalises on the momentum characteristics of the Indian equity market. Momentum is one of the most popular and recognisable investment styles, applied in portfolios all over the world. Indeed, its importance is probably understated as momentum is often seen to creep into portfolios that claim to operate differently. Stocks are said to be trending when their returns move consistently in the same direction. The momentum investor believes that more money can be made by "buying high and selling higher" than in buying underpriced stocks and waiting for the market to re-evaluate them.

Most portfolios are benchmarked to, and their performance compared against, an index. This can lead to a highly concentrated portfolio. For example, the eight largest companies in the Nifty Index make up for more than half of it. An alternative approach, known as "equal weighting", invests the same amount in each stock, regardless of its size. With the Nifty Index, each stock would represent just 2% of the portfolio, reducing considerably the concentration and hence stock risk.

Our Proposition

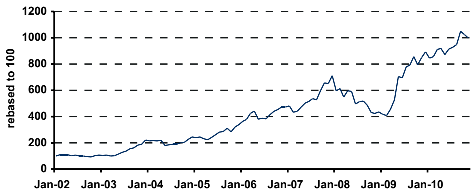
Our concept is simple but effective; it seeks to combine the momentum approach with the equal weight approach to deliver superior returns with lower volatility.

- Stocks are bought if, as well as being members of the S&P CNX Nifty Index, they have positive momentum. When they no longer have positive momentum (or when they are no longer in the index) they are sold.
- Stocks with positive momentum are equally-weighted, with position sizes of 100%/N, where N is the number of stocks with positive momentum. The maximum position size is 5%, so if fewer than 20 stocks have positive momentum the balance will be held in cash. Cash can be as high as 100% which reduces the risk of substantial losses in downward trending markets.

Back-Testing the Investment Process

Back-tested results should be treated with caution. Nevertheless, they provide an illustration of what might have been achieved if the process had been applied during the period shown.

We are pleased to report that the back-test generated a return of 32% p.a. over the period with a volatility of just 26%. This compares to a 25% p.a. return with volatility of 28% for the S&P CNX Nifty Index.



The above chart is a result of back-testing historic data which we believe to be accurate. The results obtained are for illustrative purposes and demonstrate what we believe would have been the outcome; but they should not be construed as an indication of future performance and they are not guaranteed. Returns are shown before management fees but including transaction charges.

Source: Sarasin-Alpen & Partners - January 1, 2002 to November 30, 2010. Please read the Fund Prospectus for a full description of the risks of investing in this fund.

Conclusion

The Sarasin Nifty Fifty India Equity Fund offers investors an opportunity to access some of the world's fastest growing companies in a disciplined and robust manner.

Benefits for investors

- Exposure to up to 50 of India's leading listed companies.
- A disciplined stock selection process that ensures the Fund is only exposed to companies with a positive momentum.
- Less stock concentration than the Nifty index.
- The ability to hold up to 100% cash in downward trending markets.

May we live in less interesting times...

Visit www.sarasin.co.uk to access a special webcast, presented by our Chief Investment Officer Guy Monson, released for this House Report.

Guy Monson
Chief Investment Officer, Managing Partner
Sarasin & Partners LLP, UK

I am hoping that 2011 will not be another year of records. I would certainly like to say goodbye, even by a margin, to the world's largest peacetime deficits in the West, and also to the lowest core inflation rate in the US for fifty years. I hope it will soon be farewell to the biggest central bank bond purchases by the UK and US since Weimar Germany, and I am sure that even in China the authorities would like to forget the stimulus-driven growth records of 2009/10, with all the inflation and credit problems left in their wake. Every emerging economy must be praying that we do not see new highs in food prices after the stratospheric moves in soft commodities last year (cotton broke a post US civil-war price record over New Year after rising 99% in 2010), and I know from my Asian travels that every emerging world exporter is hoping to see the last of the record gains in local currencies as Bernanke's newly minted dollars flow from Washington to Mumbai and Rio…

In fact, investors across the globe are wearying of today's unnatural, stimulus-driven world of money printing and emergency economics. A return to more honest, rather duller, less headline-grabbing economics, with a real consolidation of public finances in the West and more balanced, domestic-led growth in the East suddenly seems rather attractive. 2011, I am glad to say, offers a few tentative signs that this just might be where economies are heading – December, for example, saw China's PMI (Purchasing Managers Index) hit a three-month low of 53.9, while Chicago's PMI touched its highest level since 1988. With the Federal Reserve embarking on another round of government bond purchases, and President Obama signing into law an $858 billion package of tax breaks and extensions, the US recovery should continue to surprise even if labour growth remains the laggard. Holiday retail sales appear to have posted their strongest gains in five years, service industries are booming, and, yes, even Goldman Sachs has joined the relatively bullish fray…

China – from export dragon to middle-class consumer

Key to this is a change in the behaviour, and indeed perception of China as the authorities struggle to control inflation while still safeguarding growth. With soaring commodity costs and rising wage demands across the region, more rate rises as we saw on Christmas Day will surely be necessary – a policy cocktail that will remain broadly negative for China's equity markets but broadly positive for its currency (gains of say half a percent per month as witnessed in 2006-8). By contrast, global investors – and particularly those in Europe – will see a more investment-friendly China in terms of its impact on global markets. After a rise of more than 11% last year against the euro, the accusation of currency 'protectionism' is being replaced by a more positive view of China as a compelling export opportunity, from auto to aerospace to luxury goods. Steadily, more of the benefits of Chinese (and indeed wider EM growth) may now be accruing to the West. In response, 2010 saw significantly lower equity returns in some of the BRIC markets than in their Western equivalents with, for example, double-digit declines in local Chinese indices and a near zero return from Brazilian equities, compared with 17% rise in NASDAQ. An even more dramatic contrast was seen in the fortunes of investors who bought Western companies selling into Asia, rather than investing in the local stocks themselves; with a weak currency, Europe's exporters have made fortunes exporting to the brand and luxury goods hungry new consumers of Asia. 2010 returns from our holdings of BMW (+87%), the luxury goods conglomerate Richemont (+53%) and the European shipping and cargo group AP Moller (+38%) are just some examples of profiting from growth in the East through the companies of the West - a strategy we will continue to follow this year.

Expect a string of emerging world entrepreneurs to focus their attention on 'cheap' trophy assets in the West

So, 2011 will likely see more decisions like that of Mukesh Ambani, CEO of Reliance Industries, who has indicated that he will invest up to $12bn over the coming years, not in Asia, but in US energy projects. The Financial Times quotes one of his executives as saying "He has done his asset accumulation and now wishes to de-risk. One way of doing that is to go offshore." Similarly, over Christmas, the Royal Bank of Scotland completed the sale of the Grosvenor House Hotel in Mayfair to the Indian billionaire Subrata Roy, who owns media conglomerate Sahara India Pariwar. Expect more entrepreneurial money to flow back from the East to the West, taking advantage of low valuations, cheaper currencies and, ultimately, economic turnaround stories.

While Japan will likely be back on the investment calendar…

This may just be the year when investors talk more about the returns from investing in Japan than they do of China. Much of it will be negative, as Japan's government wrestles with 20% approval ratings and central and local government debt, estimated by the Wall Street Journal to be over $11 trillion (or near to a world-beating 200% of GDP). If a realisation of the simple unsustainability of this situation triggers a fall from last month's record highs for the yen, it might mean a collapse in the bond market, but also an extraordinary windfall for Japan's super-competitive exporters (especially if the Chinese currency were to continue to climb). There would, of course, be a host of other 'aftershocks' from this sort of seismic financial event in other markets and asset classes, but it is a scenario of such market significance that we are now simulating portfolio strategies.

Stock and theme selection will matter more than market direction in 2011

If 2009 was the year of crisis management across the global economy, and 2010 the year of stimulus economics, then this could be the year of consolidation. If we are right, then what will be the key attributes of successful equity selection in 2011?

1. **Operational excellence** will be the key driver of equity outperformance and alpha, as opposed to the 'risk on, risk off' mentality of 2010, where macro-driven surges in futures and indexed products swamped individual stock performance. Indeed, corporate performance is extraordinary; in the US car market, for example, sales are still almost a third fewer than the 16.8 million annual average of 2000 to 2007, but all three major manufacturers are now profitable. Ford will likely reclaim the No. 2 spot for U.S. sales, which it lost to Toyota in 2007 after 76 years, while Chrysler (to which our thematic funds are exposed through holdings in Fiat Auto) look to have increased sales 9.3% (Bloomberg), and have kept their main Detroit plant (normally closed during the Christmas holiday) open to meet demand for the Jeep Grand Cherokee. A similar story of turnaround and transformation is evident in many other of our holdings as companies and governments need to 'get more from less' – a key theme in our restructuring holdings in 2011.

2. Sometime around the end of this year or the beginning of 2012, we should see the seven billionth person born on planet Earth (the six billion mark was reached in 1999). This, along with **strong economic growth in many 'new markets',** is allowing companies like Proctor and Gamble to boast that they will aim to add an extraordinary one billion new customers by 2015. Key to achieving this will be aggressive innovation, the introduction of all product lines to all countries, a focus on a two-tier product range for affluent and "starter markets", and pushing sales into rural and less affluent areas across existing markets. It is a powerful agenda, backed by global demographics and rising spending. New, emerging world brands will be among the winners, as will Asian banking and insurance services – all part of our focus on Asian consumer behaviour. These trends may also draw us to some early investments in Africa, where the continent as a whole is now in its 15th year of consecutive per capita growth (GDP averaged 4.9% p.a. between 2002 and 2009) and where domestic demand has become a key driver in contributing 30% to GDP.

3. **Disruptive events and technologies** are suddenly very real with the torrential rains in Queensland currently halting an extraordinary 48% of the international coking coal trade (Source: World Coal Assoc). Similar weather-related issues have pushed Colombian coffee to a 13-year peak after the wettest rainy season on record, with Arabica coffee up 80% since mid-June. Wheat and corn prices have seen similar weather/harvest-related issues, contributing to a new all-time high in the FAO benchmark agricultural index. Investments across the food spectrum (distribution, irrigation, fertilisers and equipment) will continue to be key parts of our portfolios in 2011. Disruptive technologies will also be in the personal computer arena, with Morgan Stanley predicting that two thirds of Dell's revenue and half of its operating income are at risk from declining PC and server growth in 2011, as iPad-like tablets and other smart mobile devices, typically with Arm-based processors (held in our UK funds), dominate sales. With no need for a mouse,

keyboard or packaged software, desktop virtualization and cloud-based applications will be dominant. Opportunities will be clear in new mobile data pricing models (Virgin Media, Korea Telecom), mass storage (Cisco) and, increasingly, in media (Pearson). Remote robotics from post-BP sub-sea robots, remote operations of trains and iron ore mines by Rio Tinto, and even cross-border surgery will also be part of our focus on automation and global data flows across our thematic funds.

Summary

In summary, global equity markets in 2011 will continue to be underpinned by the lessening of double-dip risk, continued growth in emerging economies, and generous liquidity conditions globally. The price to pay will be higher inflation, driven by food, energy and emerging world labour costs, which will be hard for any single country to control.

For emerging economies this is potentially dangerous, as many of their stock markets seem ‘priced almost for perfection’ and are naturally more vulnerable to food and energy shocks – once again, we expect the companies of the developed world selling into the emerging markets to deliver superior risk-adjusted returns.

Rising inflation and a mountain of sovereign and bank issuance leaves us nervous of further capital losses across Western bond markets – index-linked holdings and short-dated emerging market bonds (primarily to capture currency appreciation) are our favoured fixed income solutions.

For our UK investors, a strong showing from the PMI at the end of last year indicates that the manufacturing and export sector recovery should continue to offset the impact of much of the government’s 2011 fiscal tightening. Remember though, that this policy mix is highly experimental and potentially vulnerable, either to a precipitous sell-off in UK gilts, or to political instability within the coalition – the hard-won market credibility achieved by George Osborne may yet be challenged.

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Chief Economist and Partner

  

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