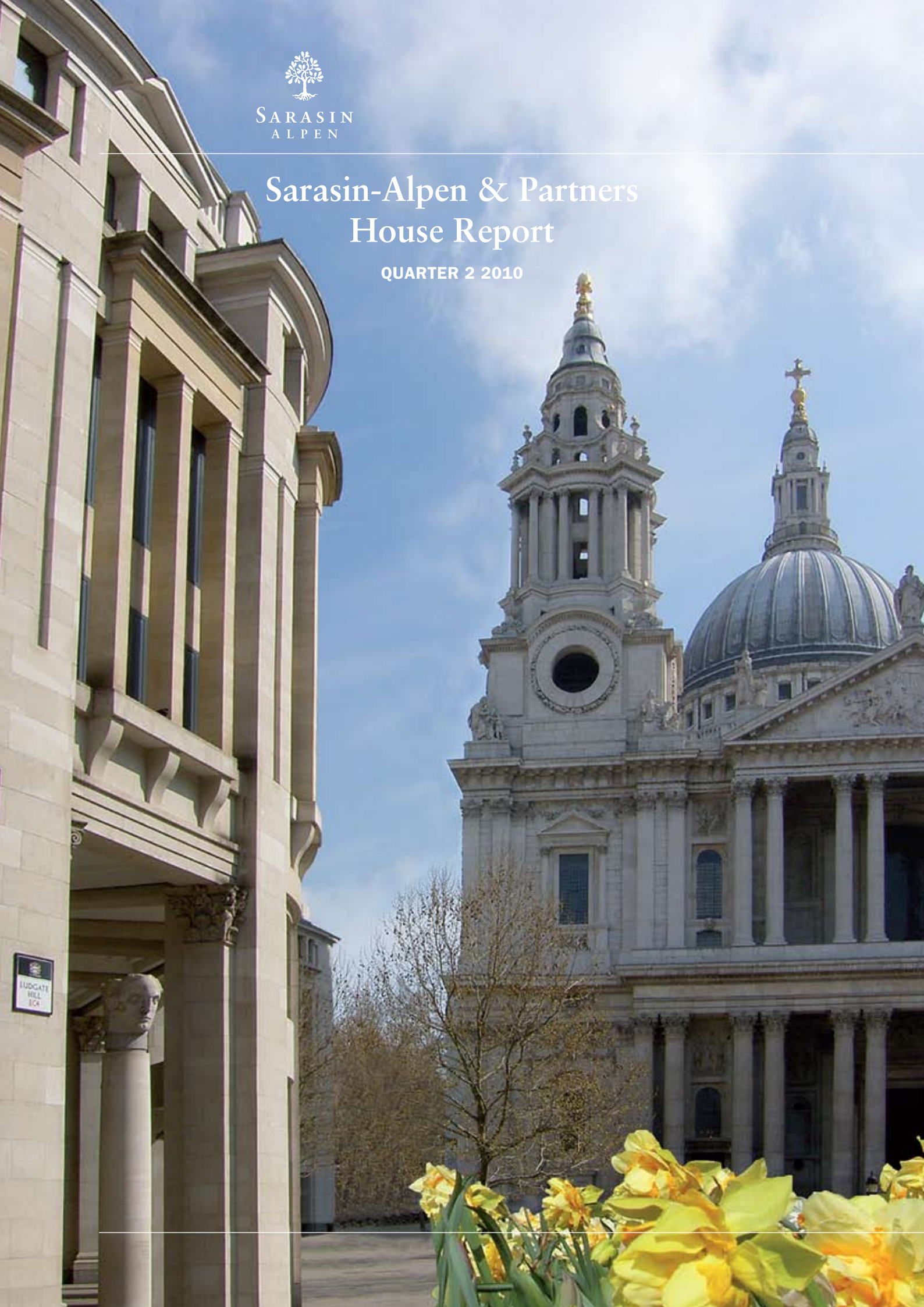




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Sarasin-Alpen & Partners House Report

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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 seventh 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.

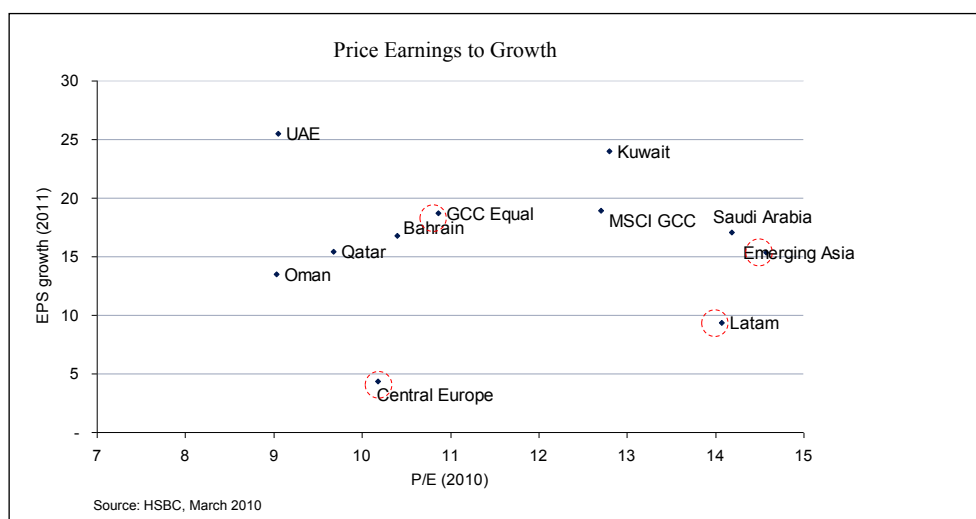
I am also pleased to include a short comment on the petrochemical industry. The full report on the Gulf Petrochemicals Industry from Alpen Capital is available on request. However, before this and before Guy discusses the outlook for financial markets in 2010, a few words from me on the risks & opportunities of investing in this region.

The first quarter was an excellent period for investors. Admittedly, local equity markets were due for a bounce after a poor end to 2009, but the 13% rally was welcome nonetheless. A number of factors contributed to the move; not least a better than expected outcome from the Dubai World restructuring process. Although a number of uncertainties remain about this and the status of other Dubai-related entities, the broad thrust of the proposal was positive and, crucially, appears to have been accepted by the major international creditors.

As important as this news was, it was not entirely responsible for the strong performance of the market. For this, I believe we must thank the improving economics and the low valuation of the market. This combination makes the region one of the most compelling investment opportunities available today...without exception.

The process of economic diversification that started in Dubai has been adopted with enthusiasm throughout the Gulf. This was apparent from the 2010 budget process, which saw a 35% increase in government spending in Kuwait, a 25% increase in Qatar and a 14% increase in Saudi Arabia. These are extraordinary numbers by any standards but they are even more remarkable when compared to the cuts in spending which must be implemented in the developed world.

Strong economic growth in the Gulf is therefore



all but assured. But unlike other fast growing parts of the world, investors here don't have to worry about higher interest rates spoiling the party. Normally, the positive effect of strong economic growth is offset by the negative impact of higher interest rates, as central bankers tighten monetary policy to prevent inflationary forces from building. However, the Gulf won't be troubled by higher interest rates because by pegging their currencies to the US Dollar they have effectively outsourced their monetary policy to the US and US rates aren't going anywhere.

It is this combination of low interest rates and strong economic growth that makes the region so interesting. If you add the fact that the equity market is cheap then the story becomes even more compelling.

There are various ways of measuring value. One of the most popular metrics is to compare the multiple of earnings (the price earnings ratio) with the growth in earnings - known as the PEG ratio (Price Earnings to Growth - shown above). According to HSBC, the six countries of the GCC are trading on an average PEG ratio of just 0.58. By way of comparison, Emerging Asia & Latin America have PEGs of 0.99 & 1.47 respectively. In other words, you are required to pay 40% less for growth in the Gulf than you are in Asia.

While, inevitably, investing in the region is not without risk it is important to take a step back and look at the big picture. If you do, you will see that the Gulf offers a uniquely attractive investment opportunity; it is the only part of the world to enjoy the prospect of low interest rates and strong economic growth. It has a young and fast growing population, 40% of the world's oil & gas reserves and governments committed to economic diversification on a massive scale. It is situated between Europe and Asia with an educated workforce and a high quality infrastructure able to attract and retain the best people from around the world. And its equity markets are cheap!

I'm pleased to say that this is finally being recognized by international investors. The GCC outperformed other emerging markets by 10% in the January-March period, with net outflows from international investors in Q4 last year turning into net inflows in Q1 this year. The investment case for the larger emerging markets is clearly less compelling now - they are expensive and they suffer from the prospect of higher interest rates. International investors have started buying here and the good performance makes it likely that others will follow. With limited liquidity the potential for substantial gains is obvious. The Gulf remains our favoured region in the emerging world.

A reversal of fortune...



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

For most investors, who remember previous recoveries, today's economic data describes a rather unfamiliar, almost "upside-down" world. Accelerating industrial production, improving trade balances and very low inflation coupled with soaring productivity, feels like the sort of 'Tiger Economics' of Emerging Asia, rather than an enfeebled G7. By contrast, rising inflation, spiralling labour costs and central banks reluctant to tighten policy or allow currency appreciation, reminds one of the problems and dilemmas faced by Western economies in a rebound. All of this confirms our strategy for 2010 of broadly holding currency and short-dated bonds in the Emerging World, and large global growth stocks (our 'Nifty-Fifty' strategy) and high-quality real assets in developed markets. As this 'reversal of fortune' flows through markets over the coming year, it will offer a raft of asset allocation, thematic and stock selection opportunities for global managers, which we examine in more detail below.

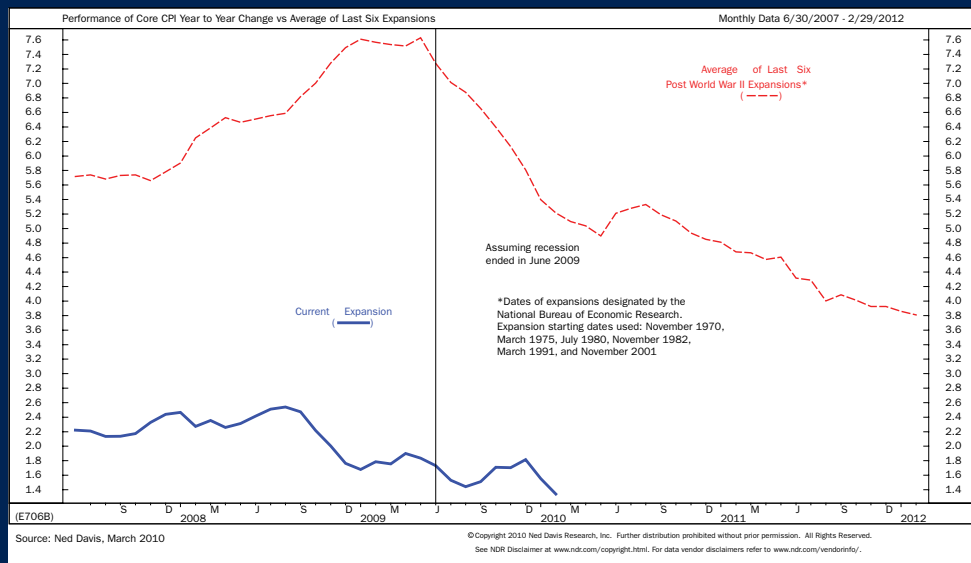
A re-learning exercise for global economists

The astonishing rebound in industrial production across the globe is beginning, not unsurprisingly, to expose pockets of inflation across the emerging world. Guangdong for example, the heart of the Chinese export machine, will lift its minimum wage by 20% to counter what it identifies as rising living costs and increasing labour shortages. These trends are already impacting China's trade balance, which turned negative (albeit temporarily) for the month of March.

Meanwhile in India, industrial production growing at an extraordinary 17.6% has pushed headline inflation to 16.2% last month, a level Prime Minister Manmohan Singh described as 'deeply worrying.' Vietnam has also seen inflation more than double in just four months to 9.5%.

By contrast, the picture in the West could hardly be more different. Driven lower by a collapse in home-owner and rental costs, US core inflation fell on a monthly basis in January, for the first time since 1982. These trends are reverberating across developed economies. In Japan, the GDP deflator is at all time low, while the Eurozone is recording core inflation of just 0.8%. This continued trend of an 'inflation-less' recovery in the developed world (see Chart 1) supports the decision by the Federal Reserve to leave rates at between 0 and 0.25% for a still 'extended period.' Even more extreme anti-deflation measures have been introduced in Japan with the Bank of Japan's new 20 trillion yen (\$222 billion) bank-credit programme, and the unexpected announcement by the Swiss National Bank that currency intervention may

Chart 1: US core-inflation is so far below the levels in previous recoveries, allowing US rates to remain "lower for longer"



again be used to avoid 'excessive' currency appreciation. In other words, despite the extraordinary economic rebound of the last six months super-loose money policy and special liquidity measures appear to remain very much with us - the comparison with Asia and the emerging world could hardly be more extreme.

Stubborn and outmoded currency structures suddenly seem very much out of step with the global trade, labour and capital flows...

Even as the global recovery broadens and deepens, the world economy remains distorted by rigid currency structures that continue to drive trade and capital flows. The largest of these remains China's undervalued dollar peg that generates vast trade surpluses which have been amassed into a war chest of reserves (\$2.5 trillion). While such excessive surpluses would typically cry out for a revaluation, heated politics and a nervous export lobby ostensibly remain in the way. The China Council for the Promotion of International Trade showed that the most labour intensive export sectors only had margins of 3%, and anything but a notional appreciation would cause many to close.

China's mercantilist behaviour distorts not just US-China bilateral trade but has wide ranging repercussions across the broader emerging market world that is terrified of losing competitiveness to it. Although most emerging markets have more flexible currency regimes that allow them to 'normalise' interest rates, they have delayed their moves for fear of attracting more capital that will put upward pressure on their currencies. In essence, roughly 58% of the world is stuck in direct or indirect dollar pegs that drive, in an increasingly distorted manner, trade and capital flows.

A further 14% of the world is tied into the Eurozone, where a similarly rigid currency arrangement drives a disparate economic region. Like China, Germany has an implacable export drive that is hollowing out the periphery, which needs painful wage and price deflation to match Germany's super-competitive position. While we have (finally) seen a €45 billion package for Greece, the resurgence of political turmoil in Latvia (which just a year ago faced a Greece-like choice of devaluation or austerity) shows the danger of longer-term

political instability that comes from remaining in a rigid currency arrangement. Unpopular austerity measures have bred public discontent, exacerbating splits in the governing coalition and threatening to derail the IMF-led loan agreement. The issue for Greece is not today's funding crisis, but the longer-term political instability that will accompany the austerity measures that are now being implemented.

So what does this mean for global liquidity?

For the moment it means that global liquidity will remain exceptionally generous indeed. Ben Bernanke's check list before he considers lifting the Fed Funds rate, remains substantial. The list is even longer for central bankers in the Eurozone (including resolving real estate and funding crises in peripheral Europe) and in Japan (reversing headline deflation across the economy).

Ben's To-Do List

1. Stop buying securities ✓
2. Close down special lending facilities ✓
3. Get unemployment down
4. Restore health of regional banking system
5. Drain excess reserves
6. Raise Federal Funds rate

In addition, Janet Yellen has emerged as the front runner among the candidates for the Federal Reserve's Vice Chairman post after the surprise resignation of Donald Kohn. Having previously served on the FOMC, she has established a reputation of being a "dove" focused on employment and growth. More recently, she has particularly argued that the economy still needs the support of "extraordinarily low" interest rates. Policy, as

we have argued, should first be tightened in the emerging world and particularly in Brazil, China and India - but only the latter has done so, and perhaps they simply had to act (in the face of colossal inflation). For China and perhaps Brazil, politics, fear of acting first and almost two decades of export lead growth make it difficult to encourage the currency appreciation and tighter money which comes a necessary responsibility of being the locomotive at the front of the world economic train.

The implications for global bonds...

Despite lots of tough talk about re-establishing fiscal credibility in Europe, we simply cannot see Germany pouring petrol onto the Greek fires or the smouldering problems in Spain and Portugal by arguing for tightening monetary policy in the Eurozone. Bond markets are starting to notice - despite credit downgrades outnumbering the number of upgrades by almost 4 times in 2009, credit spreads have rallied from their widest point (+672bps in March 2009, Merrill Lynch Sterling Corporate Index) to their current level of +200bps. With Moody's predicting that the US will spend 11% of 2011 tax revenue on servicing its debt, moving the US 'substantially' closer to being downgraded from its AAA rating, it is perhaps not too surprising to see the debt of some high grade corporates, for example Johnson and Johnson and P&G, trade with yields close to, or on occasion, below those available on US Treasuries, much as we predicted.

Supranational bonds denominated in emerging markets currencies offer a sound alternative. They allow investors to have access to appreciating and high-yielding currencies but with limited sovereign risk. European Bank for Reconstruction and

Development (EBRD) 2013 in Brazilian Reais yields 9.25% or an EBRD 2013 in Indonesian Rupiahs yields 5.7%. We have a positive view of the underlying Brazilian and Indonesian economies, which hold solid domestic demand and relatively more sustainable fiscal positions. This 'Reversal of Fortune' means a reordering of investment policy priorities.

As we have indicated in previous reports our core strategies expect:

- 1. Further currency and interest rate rises across the emerging world.*
- 2. Further equity market increases in the developed markets, lead by a new 'Nifty Fifty' selection of global, large-cap growth stocks with superior cash flow and dividend growth potential.*
- 3. Underperformance of emerging world equities driven by tighter local credit conditions, rising real wages and lower international fund flows.*
- 4. Further 'blow-ups' in structurally distorted regions (peripheral Eurozone) as they struggle to implement radical restructuring without currency or interest rate flexibility. Despite some distinctly better economic data, the UK economy remains vulnerable to any sort of interest rate shock alongside of course heightened political risk.*
- 5. Japanese deflation is now an absolute political priority, regardless of the longer-term economic outlook, which implies a materially weaker Yen and rising asset prices.*
- 6. Corporate cash flow continues to be extraordinarily strong (US corporate cash balances last quarter were a record 13.8% of nonfinancial company net worth).*

Summary

As we set strategy today we worry most about pent-up pressures in the inflexible and outdated currency structures that now cover so much of the global economy.

That change will eventually come in the form of Chinese currency revaluation, tighter money and stronger currencies for much of the rest of the emerging world and an enhanced fiscal union across the Eurozone is inevitable. But, the timing is hard to predict as domestic and international politics are the real drivers of the reform schedule. There is also a risk that when change comes, it will be disorderly or chaotic and that extreme currency volatility lifts overall market volatility. The more likely result though is a gradual and evolutionary change but with some symbolic moves (a potential very modest loosening of the Chinese peg) likely in the run up to the G20 summit in Korea in June. While we wait though, we will continue to see the active use of special liquidity instruments (Japan and potentially the UK if the QE programme is renewed), currency intervention (Switzerland) and currency pegs, that contribute to what we see as abnormal liquidity conditions which will remain very generous, with the downside risks to asset markets limited. Against this backdrop, high quality, global growth stocks, with super-normal cash flow and accompanying dividend growth will continue to perform. This "Nifty Fifty" core to portfolios will be focused primarily in the West, while the risk of regional asset bubbles, particularly in China, remains. By contrast, accounts will add to their holdings of emerging markets currency and bonds, while retaining defensive weightings in physical gold.

The Gulf Petrochemicals Industry Research Report by Alpen Capital

The Gulf Petrochemicals Report is the sixth report published by Alpen Capital after the launch of its industry research services in early 2009. The report caters to investors looking for investment opportunities in the Gulf petrochemicals industry. The focus of the report is on emerging trends and it explores various facets of industry development in the region. We have limited our study to basic petrochemicals.

Investment Rationale

The Gulf petrochemicals industry is at an inflection point - the region has enormous capacity expansion plans, which are set to change the global petrochemicals industry landscape. Most of the leading global petrochemicals firms are evaluating options of entering or expanding their activities in the Gulf through subsidiaries, joint ventures, or other innovative operating models.

In 2007, a rapid surge in oil prices led to a corresponding rise in input cost for petrochemicals firms across the globe. This played into the hands of the Middle East players, who used ethane (gas-based) as the major input rather than naphtha (oil-based). This advantage magnified with the rise in oil prices and led to global petrochemicals leaders shifting their focus from west to east for expanding their petrochemicals production bases. The Middle East was chosen because of the input advantage and because of its proximity to large and growing end-market.

Investment Positives

Significant cost advantage: Feedstock and logistics are the top two cost components of petrochemicals products; the Gulf enjoys an advantage over Asia and Europe on both accounts. First, feedstock cost is lower in the Gulf owing to its rich oil and gas reserves. The GCC countries procure ethane at US\$ 0.75-1.5 per million BTU (mmbtu), compared with

a minimum US Dollar 3.20/mmbtu in Europe and the US. As ethane is expensive and scarce, Asian and European firms use naphtha as a major feedstock. Secondly, the GCC's closeness to demand clusters - specifically India and China - offers a significant logistic cost advantage (second largest cost component after feedstock).

These cost advantages, coupled with increasing environmental regulation of petrochemicals companies in the west and rising margin pressure globally, offers a congenial environment for petrochemicals industry growth in the Gulf.

Strong government intent: In order to diversify economies away from oil, governments in the Gulf are taking initiatives in the petrochemicals space, particularly downstream. They are encouraging a shift from export-oriented petrochemicals production to manufacturing of value-added specialty chemicals for supply to domestic industries; automotive, appliances and consumer products. Moreover, significant tax advantages are offered to foreign partners to act as catalyst for capacity expansions and product diversification.

Investment Negatives

Project delay and cancellation: Some petrochemicals projects are behind schedule due to delays in project funding, feedstock shortages and subdued demand. If the global economic situation worsens, delays could

prolong further, although it is unlikely that projects will be shelved.

Growing ethane shortage: The region is experiencing a shortage of natural gas due to increased domestic consumption. Gas demand in the Gulf is estimated to grow at about 6.6% per annum, compared with yearly growth of 2.2% for oil. The concern is that new plants and higher production capacities may not be matched by sufficient ethane supply.

Political and regulatory hurdles: Iran faces the threat of international sanctions, including a trade embargo, due to its nuclear technology development. If sanctions are applied on Iran, petrochemicals projects, involving JVs with foreign firms, could be delayed or cancelled.

Further, the Gulf petrochemicals industry is under significant threat from new protectionist tariffs (anti-dumping) in key markets, such as India and China. India is contemplating enforcement of an anti-dumping duty on polypropylene imports from Saudi Arabia, Oman and Singapore, while China plans to impose anti-dumping charges on methanol imported from Saudi Arabia, Malaysia, Indonesia and New Zealand.

Industry Outlook:

The Gulf emerges a clear favourite for investment in the petrochemicals sector. The pace of growth will depend on downstream sector growth, the global economic recovery and new supply initiatives overcoming feedstock, technical and human skill-set constraints.

Here are a few trends:

Massive capacity expansion: The global petrochemicals industry is facing an avalanche of new capacity for ethylene and

polyethylene over the next six years (2010-15) from an estimated 139 mmt and 90 mmt respectively in 2009.

Major clustering in the Gulf: The majority of the world's petrochemicals capacity growth over the next six years will be concentrated in the Gulf specially Saudi Arabia.

Demand outlook moderate in short term, gaining momentum from 2011

Alpen Capital forecasts global ethylene demand to grow at a CAGR of 4.7% over the next six years. The key emerging markets - China and India - remain the focus of petrochemicals demand growth.

Demand-capacity mismatch to deepen

Over the next six years, capacity growth will outpace demand growth, leading to a widening of the supply demand gap. The gap is likely to widen over the next two years and then gradually reduce as demand growth picks up. Excess capacity may peak in 2012 - 2013. This is bad news for marginal cost producers, but not necessarily so for Gulf producers with low cost advantage.

High capital intensity and strong cyclicality are key characteristics of the petrochemicals industry.

In order to access the complete report, please visit Alpen Capital's Industry Reports section under Media Relations on the website:

www.alpencapital.com or email
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