BNP PARIBAS
INVESTMENT PARTNERS

INVESTMENT STRATEGY

May 12, 2010

May 10

Contents

A shock that is likely to leave its mark

Over the past few weeks we have seen considerable concern in financial markets about the crisis in the euro zone's peripheral countries followed by a vigorous rebound when European authorities presented their rescue plan. Yet given the nature of the risks involved (sovereign default and the collapse of the euro) and the magnitude of the movements observed, markets could soon see more turbulence. Some of the most extreme scenarios seem highly unlikely however, for three reasons. For one thing, despite contagion to other asset classes, this shock is not a widespread sovereign debt crisis but is limited to the euro zone's peripheral economies, with the sovereign yields of the major advanced economies even falling. Furthermore, the euro-zone member countries have demonstrated a particularly vigorous political response, with a plan that was intended to send a clear message that they are determined to defend monetary union. We continue to believe that there is very little chance at this point that a euro-zone country will default or abandon the euro. Lastly, the global economic environment is less worrisome than it was in 2007 and 2008.

Over the medium term however, this crisis could leave its mark on the riskier asset classes. There are two reasons why we doubt that what we have seen recently is simply consolidation in a bull market.

The first is that our economic scenario of slower growth in the developed economies (and especially in the US) in the second half of the year still holds, and this day is approaching. The second reason has to do with how markets will react to the threat of public debt, a risk that has been out of the spotlight since March 2009, when investors began to focus on the decline of systemic risk in the financial sector, the recovery of global growth and rising corporate earnings. This "storyline", which is favourable to risky assets, now seems likely to reverse. For one thing, the recovery is expected to be weak. Secondly, the problem of high public debt and its negative impact on government funding, public spending and therefore economic activity is widespread throughout the developed economies and will not go away overnight.

We therefore continue to reduce our portfolio's risk and in May returned to a more neutral position in developed equity markets, investment-grade credit and agricultural commodities.

ASSET ALLOCATION

Allocation decisions

- We continue to reduce our portfolio's risk exposure.
- Exposure to developed equities is being trimmed to neutral, with a slight preference for emerging equities.
- Our position in investment-grade credit was also reduced to neutral.
- Less exposure to oil and agricultural commodities and more to gold.

Developed equity markets

- We remain overweight in the US.
- Underweight in the euro zone trimmed after substantial underperformance.
- Slight overweight now in Japan.

Emerging equity markets

- We continue to prefer Korea.
- Now slightly overweight in Russia.
- Still neutral to slightly underweight in the other BRIC countries.

Typical diversified model portfolio – Institutional clients

The model portfolio holdings below are measured against cash and may be transposed into any other portfolio whether benchmarked or not.

MULTI-ASSET CLASS[1]

	Alpha	Current weight	*Previous weight*
EQUITIES			
Developed Equities	0.02	0.2%	*0.8%*
Emerging Equities	0.08	0.6%	*0.7%*
FIXED INCOME			
Government Bonds	0.00	0.0%	*0.0%*
Investment Grade	0.00	-0.1%	*1.0%*
High Yield	0.08	1.7%	*1.1%*
COMMODITIES			
Brent Oil	0.00	0.0%	*0.2%*
Base Metals	0.03	0.3%	*0.5%*
Gold	0.06	0.5%	*0.3%*
Agricultural	0.00	0.0%	*0.3%*
Cash Euro		-3.4%	*-5.0%*
Module Total		0.0%	*0.0%*

PORTFOLIO STATISTICS

Target Ex-ante Volatility	1.00%
Real Ex-ante Volatility	0.74%

1-Hedged in Euro, 2-Local Currency

EQUITIES: DEVELOPED COUNTRIES[1]

	Alpha	Current weight	*Previous weight*
US	0.32	2.4%	*2.5%*
Canada	-0.12	-0.7%	*-0.3%*
Euroland	-0.12	-1.0%	*-2.6%*
Japan	0.26	1.2%	*0.1%*
UK	0.08	0.7%	*2.5%*
Switzerland	-0.13	-0.9%	*-1.3%*
Australia	-0.29	-1.7%	*-0.8%*
Module Total	0.0	0.0%	*0.00%*

BOND COUNTRIES SOVEREIGN[1]

	Alpha	Current weight	*Previous weight*
US	-0.6	-7.0%	*6.7%*
Euroland	0.4	6.4%	*-0.5%*
Japan	-0.4	-4.8%	*-0.5%*
UK	0.0	-0.7%	*-5.2%*
Switzerland	0.6	6.1%	*-0.5%*
Module Total	0.0	0.0%	*0.00%*

EQUITY EMERGING COUNTRIES[2]

	Alpha	Current weight	*Previous weight*
Brazil	-0.1	-0.5%	*-0.5%*
China	0.0	0.0%	*0.0%*
India	-0.1	-0.5%	*0.0%*
South-Korea	0.2	1.2%	*1.2%*
Taiwan	0.1	0.3%	*0.5%*
Russia	0.1	0.4%	*0.0%*
South Africa	-0.2	-1.1%	*-1.3%*
Turkey	0.0	0.1%	*0.0%*
Module Total	0.0	0.0%	*0.00%*

ECONOMIC OUTLOOK

Viewpoint

Central banks return to the front lines

Monetary normalisation has begun...

Size does matter. A divergence was observed last fall between the "large" central banks (the Fed, ECB, BoE and the BoJ) and their "small" counterparts, which began their tightening cycle because they felt their economies were sufficiently strong. Although this divergence has intensified, the raising of policy interest rates has been limited by international considerations. The Bank of Norway, which just increased its policy rate to 2%, has indicated that recent events throughout Europe could adversely affect the country's economy. After pausing briefly early in the year, the RBA resumed its tightening of monetary policy, raising its key rate to 4.50% on May 5, for the sixth 25 bp increase since October. As for the BoC, in April it stopped saying that it would keep its interest rates on hold until the end of the second quarter. Several central banks in the emerging countries have already begun to tighten monetary policy, either by increasing interest rates (as in India and Brazil) or by adopting stricter reserve requirements, as in China. These measures are intended to prevent inflation and/or asset bubbles, particularly in property markets.

...but not in the United States nor in the euro zone

Will the US save the day? In the United States, most of the exceptional measures to refinance banks and purchase securities have been completed according to schedule and procedures for withdrawing liquidity are currently being tested. And yet Ben Bernanke seems to be in no hurry to actually start tightening monetary policy, by raising the interest rate on reserves and the fed funds target and reducing excess reserves. The very sharp reaction to the 25 bp increase in the discount rate in February has confirmed that investors are watching the Fed's every move. Therefore, even though the economic outlook is steadily improving and a zero interest rate policy may pose problems over the longer term, particularly by damaging the central bank's credibility, the Fed is likely to wait until next year before raising its policy rates. The lack of inflationary pressure affords the central bank this luxury.

The ECB will be purchasing securities

In response to the "Greek crisis" and after some hesitation, the ECB has abandoned many of its principles. In early May, after Greek sovereign debt was downgraded to junk status, it indicated that it would accept Greek bonds as collateral regardless of their rating. Then, a few days after the meeting of the central bank's Governing Council, which apparently "had not discussed this possibility", the decision to purchase both public and private debt securities was announced, under the European emergency rescue plan revealed on May 10th. Even though the Federal Reserve, the BoE and to a lesser extent the BoJ had already implemented similar programmes, the ECB had been more reluctant to follow their example and simply made limited purchases of covered bonds while concentrating its efforts on refinancing the banking system. Lastly, the ECB reactivated its unlimited auction mechanism, which it had been gradually winding down. Europe's central bank has strayed quite far from monetary orthodoxy and is likely to keep its refinancing rate at 1% for about another year.

Consensus Forecasts: Growth & Inflation

	GDP y.o.y %									Inflation y.o.y %								
	2009	2010				2011				2009	2010				2011			
M= Mean; H= High; L=Low		M	H	L	-1M	M	H	L	-1M		M	H	L	-1M	M	H	L	-1M
Developed Economies																		
USA	-2.4	**3.2**	3.9	2.5	[3.1]	**3.1**	4.4	1.5	[3.0]	-0.3	**2.1**	3.0	1.6	[2.2]	**1.9**	3.9	0.8	[1.9]
Canada	-2.6	**3.2**	3.4	2.5	[2.9]	**3.0**	3.6	2.3	[3.2]	0.3	**1.9**	2.2	1.5	[1.8]	**2.2**	2.6	1.7	[2.2]
Euro zone	-3.9	**1.2**	1.8	0.6	[1.1]	**1.5**	2.6	1.0	[1.5]	0.3	**1.2**	1.5	0.8	[1.1]	**1.4**	1.8	0.7	[1.4]
UK	-5.0	**1.3**	2.2	0.9	[1.4]	**2.3**	3.2	1.4	[2.3]	2.2	**2.7**	3.6	1.8	[2.6]	**1.7**	3.6	0.3	[1.7]
Switzerland	-1.5	**1.8**	2.5	0.9	[1.5]	**1.9**	2.8	1.1	[1.8]	-0.5	**1.0**	1.3	0.7	[0.8]	**1.1**	1.7	0.8	[1.1]
Japan	-5.2	**2.2**	2.8	1.5	[1.9]	**1.6**	2.9	0.9	[1.6]	-1.4	**-1.1**	-0.6	-1.6	-[1.1]	**-0.2**	0.6	-0.7	-[0.3]
Australia	1.3	**3.3**	3.8	2.6	[3.1]	**3.4**	4.3	2.7	[3.4]	1.8	**2.6**	3.0	2.2	[2.5]	**2.8**	3.3	2.6	[2.7]

Source: Consensus Forecasts as of 12/04/2010

ECONOMIC OUTLOOK

Developed economies

Don't expect current growth to last

US "core" domestic demand (excluding inventories) grew at an annualised 2.2% in Q1 2010, as in the second half of 2009...

...and is not likely to accelerate this year

After the current phase of restocking, US GDP growth should decline from its Q1 rate of 3.2% to a "core" rate (i.e. excluding inventories and external demand) of about 2.2%, where it has been since mid-2009. As expected, household consumption was solid in the first quarter, rising from 1.6% to 3.6%, and business investment is picking up, mainly as firms replace their IT resources. Both the residential and commercial property sectors remain depressed. Although not grim, since there is very little chance of a relapse into recession, the outlook for the coming quarters is not very encouraging either. In the current recovery employment is still the biggest unknown. Job figures for April are rather upbeat, with net job creation in the private sector (of about 120,000 a month since January) and public-sector employment receiving a substantial but brief boost from census-related hiring. The high jobless rate of 9.9% is likely to subside only gradually and will thus weigh on wage income for some time. The tax reductions for households and firms allowed under the government's $787 billion stimulus package gathered steam in the first quarter and at this pace the total $288 billion in tax cuts will be exhausted by the end of the second. Growth – which has been supported by these measures and the decrease in the saving rate from 4% at the beginning of the year to 2.7% in March – can therefore be expected to slow, particularly since the manufacturing cycle as peaked. Japan is benefiting from dynamic growth in Asia and there are increasing signs that domestic demand is strengthening. Nevertheless, the BoJ is still concerned about deflation and is not planning to withdraw its support from credit markets.

Large discrepancies in the euro zone

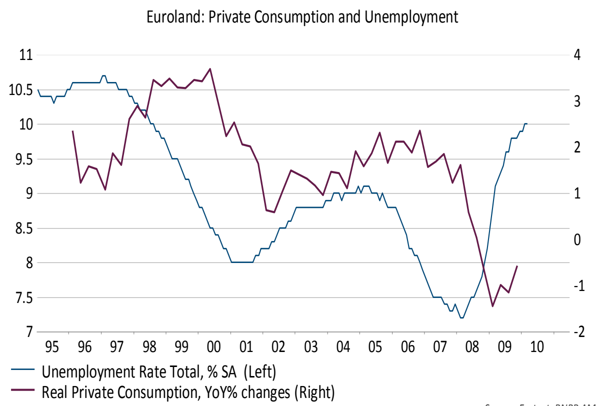
An awkward period for the UK economy

Recent survey data for the euro zone are encouraging, as the euro's weakness strengthens business conditions. After an initial estimate of only 0.2% growth in the first quarter we expect economic activity to improve, particularly given the signs that credit markets are returning to normal. Yet household consumption remains depressed and the economic outlook is mixed – although manufacturers in Germany and France are planning to increase their investments, this is not the case in Spain and Italy. In the United Kingdom, the cyclical recovery is losing steam, inflation continues to rise and the country will have to face severe budgetary constraints. The coalition government of conservatives and liberal-democrats resulting from the May 6 election could complicate this situation, including for the BoE.

US – ISM survey data still positive

Source: Factset, BNPP AM

Euro zone – consumption is sluggish



Source: Factset, BNPP AM

ECONOMIC OUTLOOK

Emerging economies

Growth has probably peaked

Emerging economies still growing strongly

Emerging economies are still growing robustly and the consensus of forecast revisions is positive. In its most recent report in April, the IMF raised sharply its growth forecast for the ASEAN countries, Brazil, India and eastern Europe. The institution is expecting GDP growth of 6.3% and 6.5% in 2010 and 2011 respectively. Judging from the strength of consumer confidence, the outlook for domestic demand is bright, as suggested by the rapid growth of retail sales, particularly in Asia.

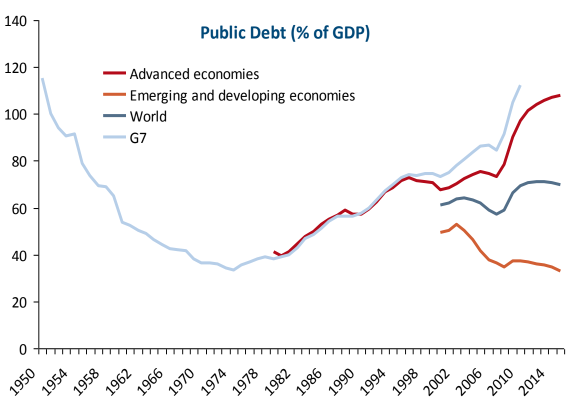
Unlike the G7 countries, the emerging economies have very little debt

The growth cycle has probably peaked in the major economies. China is determined to deflate its property market bubble through targeted monetary measures, while Brazil and India have simply raised their policy rates. These are cyclical measures, since there are no signs that inflation is getting out of hand and it is in fact decreasing in Russia and India. Given the amount of excess capacity we even expect inflation to decline over the longer term, which will make it possible to maintain abundant liquidity. Unlike the G7 countries, the emerging economies have very little debt, with credit default swaps less expensive for Asia than for the euro zone. Nevertheless, by reducing exports and increasing risk aversion, problems in the advanced economies may adversely affect their emerging counterparts.

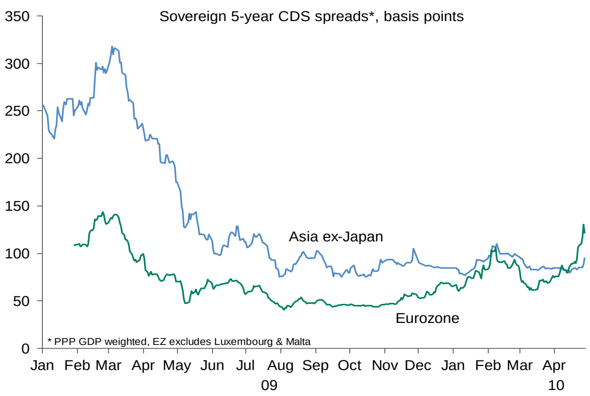
Chinese authorities are determined to prevent property speculation

Chinese authorities are taking strong action to prevent speculation in property markets by exercising strict control over bank lending and through various administrative measures, such as raising mortgage interest rates sharply and requiring higher down payments. As a result, property sales have plunged, which could pose a threat to economic growth given the construction sector's weight in Chinese GDP and its substantial contribution to provincial governments coffers. The crisis in Europe is also not good for China, since the euro's depreciation decreases the value of the country's foreign-exchange reserves of roughly $2.6 trillion and Europe is China's largest export market.

EM debt outlook improves



Asia ex-Japan – emerging and less risky



BOND MARKETS

Government Bonds

Greek crisis plays havoc with market

Sovereign risk continues to drive the market

With government bonds behaving so divergently during the current crisis it is impossible to speak of the bond market in general. The yield on the debt of some of the euro zone's peripheral countries, and that of Greece in particular, **have skyrocketed from fears of a sovereign debt crisis** that has sent investors scrambling for "safer" assets.

The main risk in this sort of environment is that panic-driven markets will overreact. Just one weekend and a few important decisions later and the sovereign spreads of these countries have tumbled back down while the yield of 10-year US Treasuries and German bunds are up almost 20 basis points.

So is the crisis over? Not really, but things have calmed down for now. **Over the medium term however the problem will remain** and not just for some euro-zone countries. Indeed, as we have already pointed out, other major economies like the United States and the United Kingdom will also need to get their public finances back into shape. This is why we believe that sovereign debt will remain a key investor concern for quite some time.

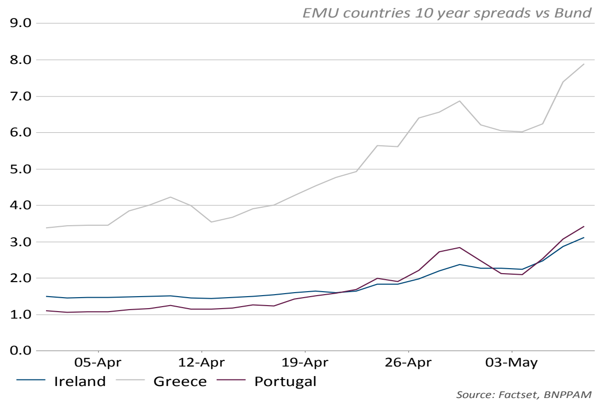
In terms of fundamentals little has changed. **Concerns about debt have obscured the fact that economic activity continues to accelerate.** As for inflation, it remains tame, although still relatively high in the UK.

We are therefore staying neutral in government bond markets.

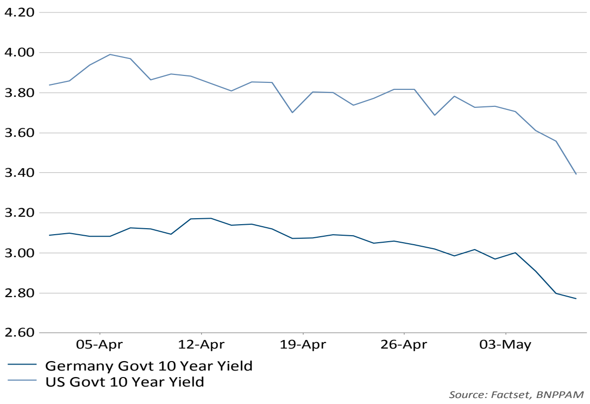
No longer long US/short UK

We are making a few relative plays however. Just before the British election, we have closed our long US/short UK position. After the sharp drop in yields, which affected the US market in addition to the euro zone, we now prefer to short the US and Japan and go long on Germany and Switzerland, which among other things offer relatively more attractive valuations.

Rising yields in Greece...



... caused investors to look for "safety"



BOND MARKETS

IG and HY credit

There is smoke but fire is somewhere else

Fundamentals take a back seat to sovereign risk

Can rising sovereign debt risk increase borrowing costs for firms, just as the economic recovery is enabling them to strengthen their balance sheets? This is a legitimate question considering that credit spreads did not increase when concerns about Greece began to mount. In fact, it was only when fears intensified considerably and Greek sovereign yields surged spectacularly that credit investors started to get jittery.

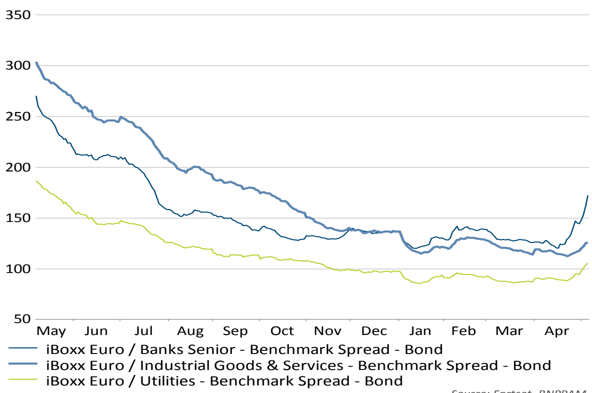
However, **in the investment-grade universe the overall impact was "on average" more modest** as the correction of spreads did not generally bring with it a significant increase in yields. The "average" however hides the different impact for issuers in countries that were exposed to concerns about their public finances. **Investment-grade spreads rose most sharply in the financial sector**, in both the cash and CDS segments. Although recent memories have naturally compounded the fear that the financial system could break down again, we must keep in mind the substantial means that central banks are employing to prevent another crisis. The ECB's new measures therefore come on top of the central bank's already highly favourable monetary conditions. Although it is also true that the prospect of regulatory change is a source of uncertainty for the financial system. High-yield credit has also corrected a bit, but continues to be **supported by favourable investor flows** that are absorbing the high issuance.

Monetary conditions remain favourable

If fundamentals continue to improve and if the economy does not relapse, credit should continue to appeal to investors given the low yields available in other debt markets. Yet recent events have reminded us just how fragile the recovery is and that **substantial structural problems are far from resolved**. These will weigh on credit by limiting the market's upside potential and increasing its volatility.

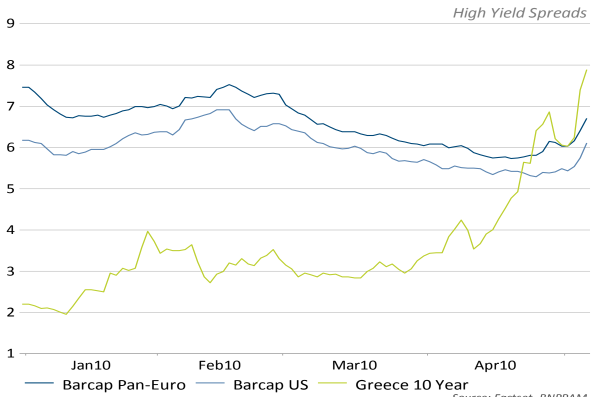
We are reducing our IG position to neutral but keeping our HY overweight for now.

IG yields up more sharply on financial issues



Source: Factset, BNPPAM

High-yield debt has been quite resilient



Source: Factset, BNPPAM

CURRENCY MARKET

We expect the euro to weaken against the dollar over the medium term

Concerns about euro-zone governance as well as speculation

Over the past few weeks currency traders have been focusing mainly on news from the euro zone about the "Greek crisis". The **EUR/USD** exchange rate has fallen from 1.35 in mid-April to 1.25 on May 6, its lowest level since March 2009, before the first news of the European rescue plan pulled it briefly back up above 1.30. Despite the magnitude of the measures announced and the clear determination of EU authorities to defend the euro, it quickly fell back. Since the beginning of the European sovereign debt crisis, the euro has rebounded only moderately and briefly in response to the announcement of apparently favourable decisions. Europe's currency seems to have been deeply affected by what the crisis has revealed about the difficulty that European authorities have in responding rapidly with a single course of action. But we may see the euro bounce back soon, given the level of speculative positions against the currency and the recent measures to prevent the euro zone from collapsing. This appreciation of the euro would also no doubt come with higher volatility. Over the longer term, the euro could be hampered by Europe's dimmer economic prospects in comparison with those of the United States and the anticipation of monetary policy measures. We expect the EUR/USD rate to average between 1.20 and 1.25 for the rest of the year.

Concerns about public finances could weigh on the pound

British debt does not augur well for a stronger pound. The fears sparked by the high sovereign debt levels of several euro-zone countries could rapidly spread to the United Kingdom, given its high 2010 budget deficit and public debt of 12% and 80% of GDP respectively. The political uncertainty resulting from the May 6 election may further weaken the currency, even though all political parties are committed to doing everything possible to preserve the country's AAA rating. As a result, the **GBP/USD** rate has declined since the election, although the pound has been strengthening against the euro since March and is likely to continue to do so.

Intervention to weaken the yen is still a possibility

Yen should gradually weaken. Japan's very low interest rates and above all the likelihood that the BoJ will keep them low over the foreseeable future should revive yen-financed carry trades and therefore weaken the currency when risk aversion eases a bit. Indeed, the BoJ will probably be one of the last central banks to tighten its monetary policy. Furthermore, Japan's minister of finance would like to see a weaker yen and once again made this known when **USD/JPY** plunged to 88 in response to the sharp drop in EUR/JPY on May 6. The yen subsequently slipped to 94 when the BoJ announced that it would inject 2,000 billion yen into the country's banking system.

FX Rate Forecast Summary (Major Currencies)

End of Period		2009	07-May-10	2Q 2010 Min	2Q 2010 Max	3Q 2010 Min	3Q 2010 Max	4Q 2010 Min	4Q 2010 Max	1Q 2011 Min	1Q 2011 Max
USD Block	EUR / USD	1.43	1.2651	1.25	1.35	1.25	1.30	1.20	1.25	1.20	1.25
	USD / JPY	93	91.03	95	100	95	100	100	105	100	110
	USD / CAD	1.05	1.0499	0.95	1.05	0.95	1.05	1.00	1.10	1.00	1.10
	AUD / USD	0.90	0.8832	0.87	0.92	0.85	0.90	0.85	0.90	0.82	0.87
	GBP / USD	1.61	1.4684	1.45	1.55	1.50	1.60	1.50	1.60	1.45	1.55
	USD / CHF	1.03	1.1120	1.08	1.12	1.08	1.12	1.10	1.14	1.14	1.18
EUR Block	EUR / JPY	134	115.15	124	130	121	128	128	134	123	135
	EUR / GBP	0.89	0.8615	0.85	0.90	0.80	0.85	0.80	0.85	0.80	0.85
	EUR / CHF	1.48	1.4067	1.40	1.45	1.38	1.43	1.40	1.45	1.40	1.45

Source: BNPP AM as of 7/5/2010

EQUITY MARKETS

Developed markets

From cyclical recovery to sovereign risk: we reduce our exposure to neutral

Sovereign risk hangs over equities like a sword of Damocles

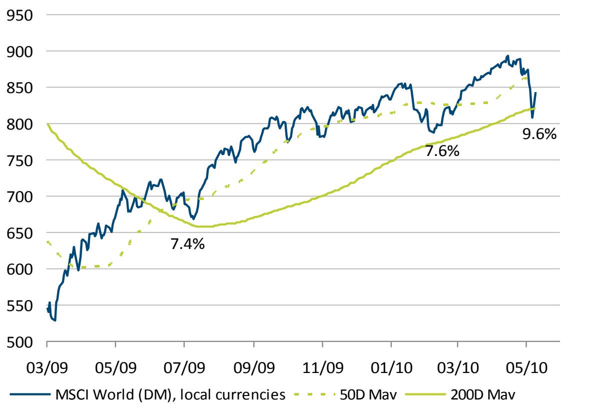
The "Greek debt crisis" and growing fears of contagion to other European countries have caused equity prices to drop worldwide. This is the strongest correction since the rebound of March 2009, with the MSCI World index falling almost 10% in local currency terms. The scale of the concerted response of European governments, the IMF and the ECB to the "Greek crisis" is unprecedented. In doing so, European authorities have affirmed that the very low interest rates and abundant liquidity that have been the main drivers of the rebound in risky asset prices since March 2009 would be extended. This crisis and the risk that it may spread have however drawn attention to the importance of reducing public debt levels even though economic recovery in the advanced economies is fragile (supported in part by restocking and temporary fiscal stimulus) and despite the considerable structural challenges that lie ahead. Meanwhile, the dynamism of the emerging markets, which are leading the global recovery, is threatened by the need to tighten monetary policy in response to rising inflation and signs of overheating. A sharper slowdown of China's economy than currently anticipated would cast further doubt on the sustainability of global growth.

We therefore believe that even though near-term fundamentals are still relatively positive for equity markets, recent events in Europe could bring them to a standstill. After the improvement in the economy and earnings, the slower growth that we expect in the second half of the year and sovereign risk (which will require fiscal retrenchment to at least stabilize public debt) are likely to make investors more risk averse. We are therefore further reducing our portfolio's risk exposure and our position in developed equity markets to neutral.

Near-term fundamentals still positive

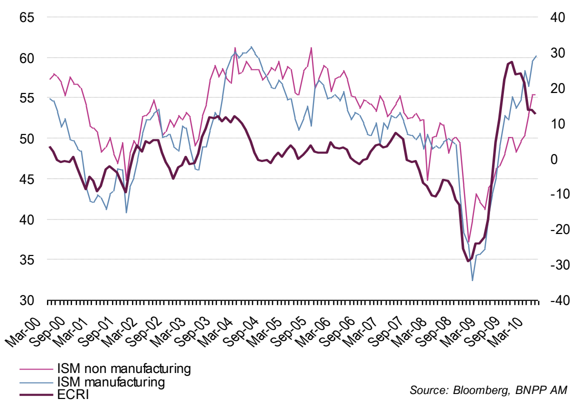
The strong and steady improvement in leading economic indicators since the end of 2008 suggests that economic recovery will continue to be fairly robust in the first half of the year. In the United States, the ISM manufacturing index has for the past nine months been above 50 (which implies that output is expanding) and in April reached its highest level since the previous cyclical peak of mid-2004.

The MSCI World index



Source: Factset, BNPP AM

The first signs of a slowdown?



Source: Bloomberg, BNPP AM

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EQUITY MARKETS
Developed markets

However, some early indicators, such as the ECRI, are beginning to weaken, suggesting that economic activity could begin to slow in the second half of the year. This trend reversal should mean weaker gains and greater volatility.

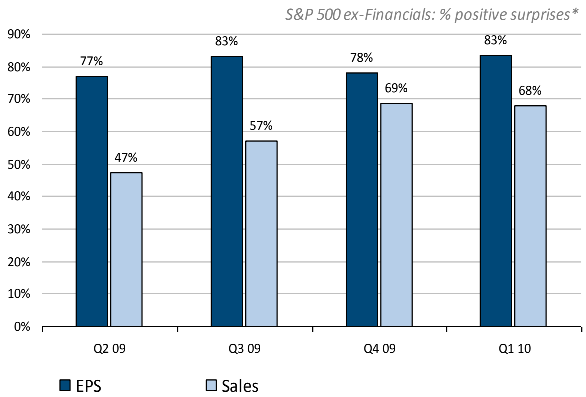
Strong earnings growth in 2010 but expectations for 2011 may be overoptimistic

The stronger economic environment has brought with it upbeat forecasts of EPS growth, with 31% expected for the MSCI World index in 2010 and 20% in 2011. The earnings revision trend also continues to be positive and should remain so over the next few weeks, given the strength of earnings reported for the first quarter, which like sales were better than expected. However, we are a bit more sceptical about the earnings growth forecast for 2011 and believe that the revisions trend will slow over the next few months. Future fiscal tightening is likely to gradually weigh on sales and there is less and less potential to improve margins. With the MSCI World's 12-month P/E at 13.9, equity markets are reasonably valued, as long as the outlook for earnings growth remains credible.

We prefer the United States, Japan and, to a lesser extent, the UK

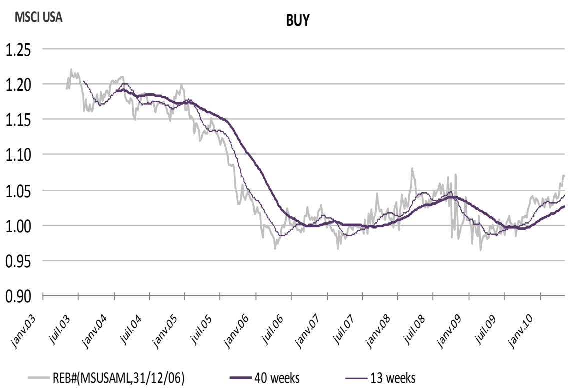
Among the developed markets we still have a strong preference for the United States, which will continue to benefit from a favourable earnings outlook and highly accommodative monetary and fiscal policies, while enjoying a relative advantage from the heightened risk aversion. We are also overweighting the Japanese market, mainly for tactical reasons in addition to its attractive valuation and positive earnings momentum. We have trimmed our overweight in UK equities significantly in view of the risks that lie ahead for the domestic economy. However, the pound's weakness and the country's highly accommodative monetary policy will continue to be two strong supporting factors. The depreciation of the euro and the announcement of the European rescue plan have encouraged us to add to our position in the euro zone, while maintaining an underweight in light of the region's structural weaknesses and the impending fiscal retrenchment that is soon likely to hamper growth. We remain underweight in Canada and Australia given the dimmer outlook for commodities and the monetary tightening underway in Australia and soon in Canada most probably.

Another good earnings seasons



Source: Bloomberg, BNPP AM

The relative momentum of US equities



EQUITY MARKETS

Emerging markets

Supports weaken

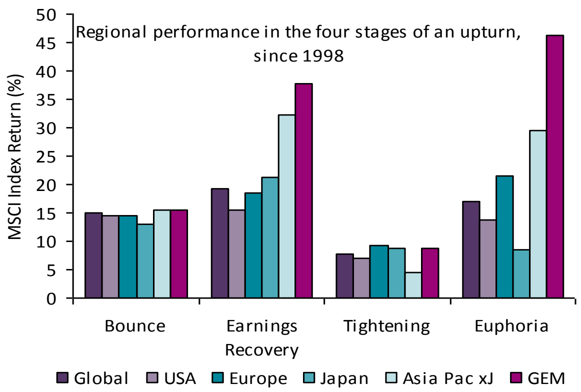
Tighter monetary policy and weaker leading indicators

Monetary conditions continue to tighten in the BRIC countries, except for Russia. The very aggressive administrative measures that China has taken to stop real-estate speculation have caused investor confidence to plunge. Brazil finally raised its policy rate, by 75 bp, while India pursued its tightening cycle with a second increase in April. Although these measures may be seen as normalisation against a background of economic recovery, they accelerate the reversal of leading indicators and weigh on the earnings revisions trend. The proportion of upward earnings revisions has become quite modest and is no longer supporting equity markets. The normalisation of interest rates and the decline of leading indicators, which are likely to continue for a few more months, will considerably limit the upside potential of emerging equity markets. The main risks are exogenous, and most notably rising risk aversion that could cause investors to repatriate their funds.

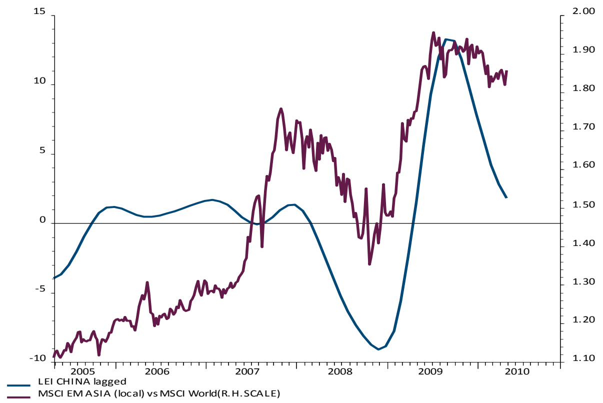
Lower prices or a lower risk premium will be necessary to make emerging markets more attractive

Now that the earnings revision trend is stabilising and there is a moderate risk of inflation, the only thing that can make emerging markets more attractive are lower prices or a lower risk premium. It would seem that both of these conditions have been met since emerging markets have fallen 12% from their mid-April peak and were briefly in oversold territory, while emerging market risk as measured by CDS prices is declining rapidly in comparison to developed equity markets. It is true that emerging economies do not have the same budget deficit and debt problems as do the euro-zone countries. In terms of P/E ratio, emerging markets are 15% cheaper than their developed counterparts. Considering their growth potential this discrepancy is increasingly hard to justify. We should keep in mind that emerging markets offer higher returns on equity and operating margins and have greater structural potential for growth. These factors explain why we have a slight preference for emerging markets.

Performance slumps as interest rates rise



Leading indicators head downward



Source: DATASTREAM

EQUITY MARKETS

Emerging markets

The dollar's appreciation will not be good for Asian equities

History shows that when the dollar appreciates against the euro this is not good for Asian equity markets, due to their exposure to export sectors. This is especially the case of those markets most exposed to global trade, such as Singapore, Korea and Taiwan, where the negative correlation exceeds 70%. In the event that the euro does fall substantially, the performance of Asian equity markets relative to "world" stock indices will form a major resistance level that will probably not be breached. Still there is little downside potential since monetary conditions will remain loose and macroeconomic fundamentals are solid once again.

Within Asia we continue to prefer peripheral markets that are less exposed to monetary tightening and are more attractively valued. The main two examples are Korea and Taiwan, which are both showing strong earnings growth for the year and are likely to benefit from the large volume of new orders from the United States (according to the ISM survey) and their exposure to technology sectors.

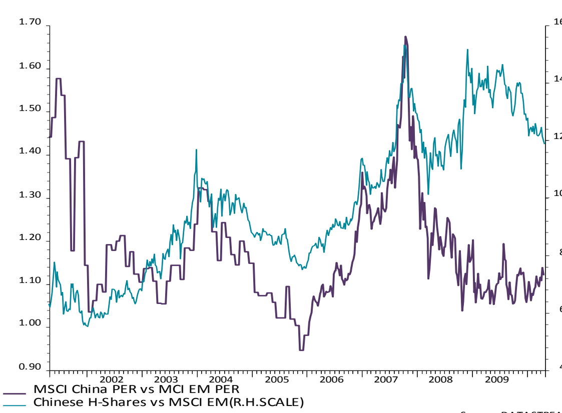
We are still wary about the Chinese market

We are still cautious about China, where fundamentals continue to be unfavourable. Growth is slowing, leading indicators are declining, credit is being severely tightened in the property market and the trend for both earnings and equity prices is negative. Investors are clearly pessimistic and we do not expect leading indicators or liquidity to improve over the near term. Lastly, the latest economic data show that China's economy is beginning to feel the effects of the recent austerity measures and suggest that monetary restrictions should be eased.

Valuations and monetary cycle explain underweight in Brazil

We remain underweight in Brazil, due to its relatively high valuations and monetary tightening cycle. Furthermore, the country's dependency on commodities exposes it to a downturn in the global economic cycle, particularly since commodities has been one of the best performing sectors over the past few months. We have also reduced our position in the Indian market, which will be faced with higher interest rates and dimmer earnings prospects over the next few months and whose valuations are among the highest of the emerging universe.

Valuations are reasonable but no momentum



Source: DATASTREAM

Brazil – Watch out for commodities

Source: DATASTREAM

ALTERNATIVE STRATEGIES

Commodities

Oil and grain exposure is gradually returning to neutral

After the crisis, the rebound in commodities will probably be driven by the strength in fundamentals

After reaching a new year-to-date high, crude oil prices corrected sharply as risk aversion intensified. Although this correction may be excessive, since the "Greek crisis" has no direct repercussions on fundamentals, the previous increase in oil prices was in our view more the result of strong economic data than improving fundamentals. Indeed, although Chinese demand remains strong, US oil stock levels are sending a mixed signal as refiners have increased fuel production in anticipation of recovery. Given these factors, **we recommend reducing an overweight position in oil when the likely price rebound occurs**.

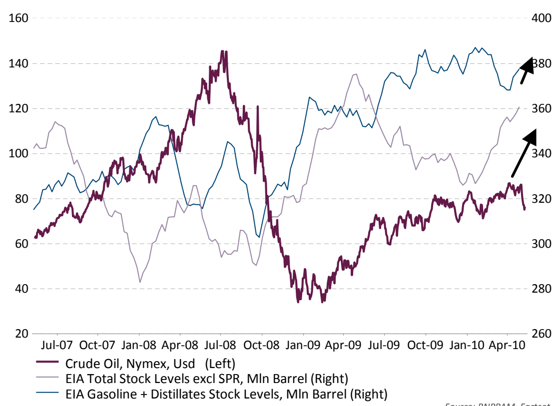
We are keeping a slight overweight on base metals, since fundamentals suggest that the market has overcorrected. Indeed, demand should continue to be firm as manufacturers rebuild their inventories and metal stock levels continue to steadily decline. Hence we expect prices to recover when risk appetite returns and the US dollar pauses.

Investment demand should continue to underpin the price of gold

While heightened risk aversion and a stronger dollar are weighing on commodity prices, gold has benefited from its status as a safe-haven investment. Concerns about sovereign debt risk in the developed countries have made the yellow metal a more attractive investment, particularly in the form of ETFs that invest in physical gold and which have exceeded the record levels achieved in December 2009. Given the favourable monetary environment and the likelihood that investment demand will remain strong, gold has the potential to return to its record prices of 2009. **We have therefore added to our overweight position** in gold and other precious metals.

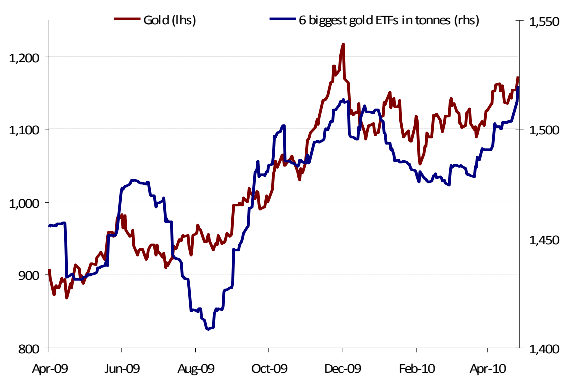
We have returned to a neutral position in grains. Although demand fundamentals look set to improve over the medium term, stock levels are high after two years of abundant harvests and the dollar's strength is likely to continue to weigh on export demand. Therefore, unless there is a severe weather event, we see little near-term upside potential for grains.

Oil stock levels are rising



Source: BNPPAM, Factset

Gold shines again for investors



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