Global Markets Strategy Report

October 2011

Rank: From weakest to strongest in ascending order:

Strong Underweight	Underweight	Slight Underweight	Neutral	Slight Overweight	Overweight	Strong Overweight

Please note that the rank is indicative and may not sum to equilibrium.

This report outlines Pioneer Investments' view on the current macroeconomic situation and specific asset classes. It covers the key markets of Europe, the US, Japan, Asia and Emerging Markets.

Macro and political situations still dominate

→ The latest economic data point to weak growth but hardly a recession. However, the latest policy action is impressive. Economic summits are devoted to the euro sovereign-debt crisis. Moreover, the joint provision of extraordinary funds to banks by the European Central Bank (ECB) and US Federal Reserve (Fed), suggests that the troubled euro Banking sector is seen as potentially damaging for the global economy. This mobilisation should avoid an outcome such as that seen in the aftermath of Lehman Brothers' collapse three years ago.

→ The US Federal Reserve worsened the economic outlook of late when it announced new measures to stimulate the US economy. Citing "significant downside risks" to growth may appease some political detractors of its overly loose policy but this unexpected alarm may also be a consequence of the euro debt crisis, which has become the main risk scenario.

→ On a more hopeful note, outside intervention should eventually urge EU officials to take the firm action needed to address the crisis. However, on the issue of Greece, the penchant for muddling through still prevails over tough decision-making. Therefore, it is up to unelected bodies, such as the ECB, to deal directly with the crisis, to then be followed by the new bailout facilities.

→ In this risk-averse environment we should focus on risk control rather than picking up seemingly cheap assets in battered equity and credit markets. We believe that a scenario of extended weak growth is not fully priced into US stocks at current valuations and as a result we have cut the overweight in this asset class.

How we are positioned

→ Some of the gloomiest assumptions about the debt crisis are being built into European equity prices, notably into stocks (and bonds) issued by euro banks, which in our view are able to sustain stressful events such as an orderly default of Greek government debt. As the market slump became broad-based it affected sectors deriving most of their earnings from outside the euro area, notably from sales in fast-growing regions where the economy slowed down but is not at risk of recession.

PIONEER Investments®

→ However, macroeconomic data should take priority and override investment selection criteria based on corporate balance sheets. When market conditions become less volatile, conventional metrics such as price-to-earnings ratios or price-to-book ratios are likely to regain a key role, and European equities should have more upside than other markets in this friendlier environment.

→ Our strategy's decision to add to European equities in exchange for the cut in US equities should not make our portfolios more volatile and prone to multiple risk scenarios, which have Europe (especially the eurozone) in the foreground. With this in mind, we refrained from selling US dollars and buying euros as a result of our move. We believe the US dollar has become a cheap hedge against a further exacerbation of the euro sovereign-debt crisis.

→ Global co-operation to solve the euro crisis is welcome and can restore investor confidence in the economy (and in risky assets) if the macroeconomic outlook brightens. Policy mistakes will keep financial markets on edge and maintain the case for holding safe-haven assets.

→ Safe-haven assets are expensive, notably in the few core bond markets left (USA, Germany) where yields barely cover current inflation and are attractive only if we envisage an outright recession and the ensuing sharp decline in inflation.

→ The credit market provides plenty of higher-yielding opportunities (all the more so after recent credit spread widening, which has been driven by extreme risk aversion) whereas government bonds from the euro periphery should be selected more carefully.

Our Investment Phazer*

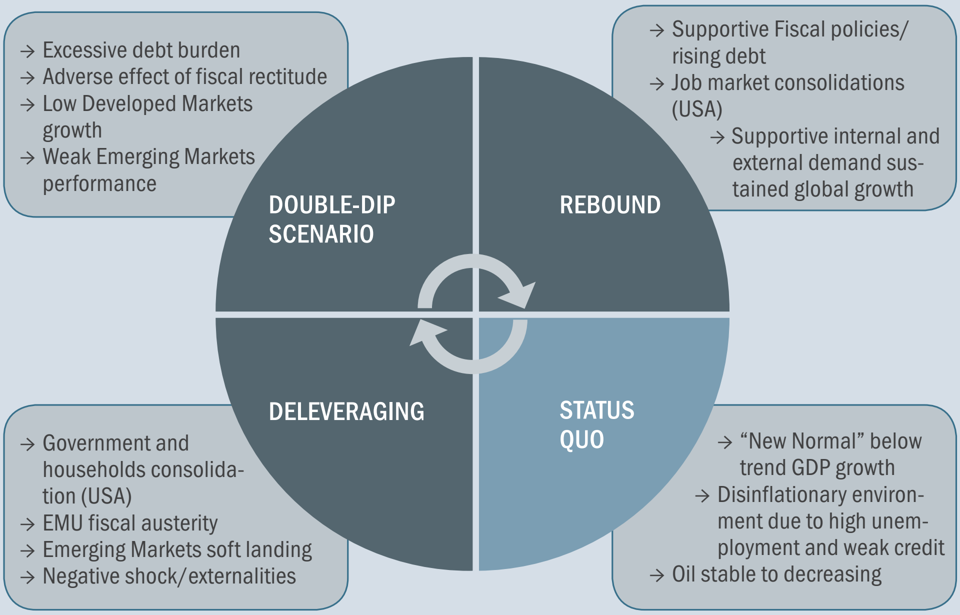
Confirmed growth in earnings per share and low inflation expectations favour cyclical assets.

Earnings growth

Solid earnings growth has been confirmed by each round of corporate quarterly reports since the first quarter of 2009, even before the economic recession (GDP) officially ended, and has been little affected by the current economic slowdown, which is also reducing inflation expectations.

Cost-cutting still on top

Cost-cutting accounts for much of earnings growth in the early stages of an economic upturn and a large number of companies are still wary of bold expansion plans. Sales revenues increased last year but are very sensitive to the economic cycle and their contribution is likely to recede.



(*) Data on US Earnings Growth and US Inflation are analysed by a proprietary statistical model to get four different economic phases. Source: Pioneer Investments Asset Allocation Research as of 31 August 2011.

Implied Strategy

Based upon 30 years of observations, when above-trend operating earnings combine with below-trend inflation expectations, risky assets (equities and corporate bonds) have provided the best returns over a 12-month horizon. However, risk factors may lead to a lower risk profile, notably on global equities, in times of turbulence, whereas corporate bonds are more supported by prudent policies.

Alternative Scenario

We do not anticipate a double dip thanks to emerging markets' support to global growth, but the need for debt reduction (deleveraging) by both households and governments in developed regions may hold back economic growth for quite some time. This makes the case for a tactical exposure to safe-haven assets.

Asset Class	Double Dip	Deleveraging	Strength	Rebound
Equity	Sell	Sell	**Buy**	Buy
Core Government	Buy	Buy	**Sell**	Sell
Credit	Sell	Buy	**Buy**	Sell
Cash				Buy

Global Scenario

Outside pressure to solve the euro crisis

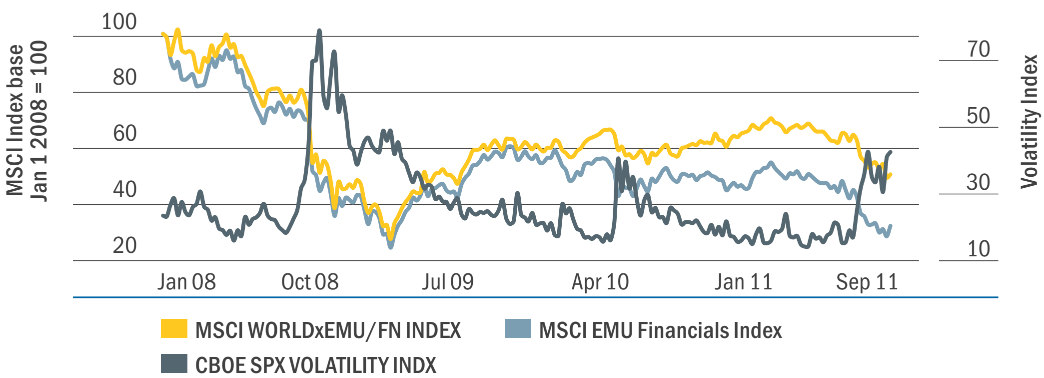
Investors are often relieved by central banks' cooperation. In the latest chapter of the euro debt crisis, the ECB provided additional loans in US dollars to european banks in conjunction with the Federal Reserve. Burdened by losses on holdings of government bonds issued by financially stricken countries, most European banks were finding it difficult to obtain US dollar loans. The money provided had to fill the gap opened by the withdrawal of US money-market funds, on which European banks have long relied for dollar funding.

This global cooperation reminds us of what happened after the collapse of a major US investment bank about three years ago, and highlights the risk that Europe's debt problems could affect the global financial system and lead to the recession now feared by financial markets. A more benign view is that EU officials will act more firmly to resolve the crisis at the urging of other key players. The commitment shown by the latest G20 meeting is being seen constructively by financial markets but the recent rebound in risky assets may prove short lived as those we have already seen in this troubled third quarter.

In fact the risk of policy mistakes is still high as the onus is on the European Union to find solutions to its own crisis despite the entry of external parties onto the scene. The issue of Greece started the euro debt crisis more than a year ago and is still to be defined as divisions remain over the key point of write-downs to private creditors' holdings. The Greek economy accounts for a small fraction of euro-wide GDP but resolving the issue has become an important test of politicians' ability to manage a broader crisis. While a Greek debt restructuring is all but announced, the question is how to make it a "soft" process (much like those regulated by domestic commercial law) and remove the uncertainties over banks' losses (as heavy as the "haircut" will be). A lack of agreement risks triggering a "hard" default (chaotic and unregulated).

As politicians put off decisions and the risk of an uncontrolled Greek default is not dispelled, it is up to unelected bodies such as the ECB to deal directly with the crisis, notably by buying the government bonds of other stricken countries. The ECB used to be reluctant to take up this role but may be less so in the future, as "orthodox" economist are replaced by "crisis managers" on the executive board (see the recent resignation of the German chief economist). The ECB's charter cannot be easily changed and inflation will thus remain at the centre of its policy, but a closer look at global trends and what other major central banks are doing should become regular practice. We do not expect policy rates to be cut as soon as this October but unwinding this year's policy normalisation would be part of this new attitude.

EMU Banks Under Close Scrutiny

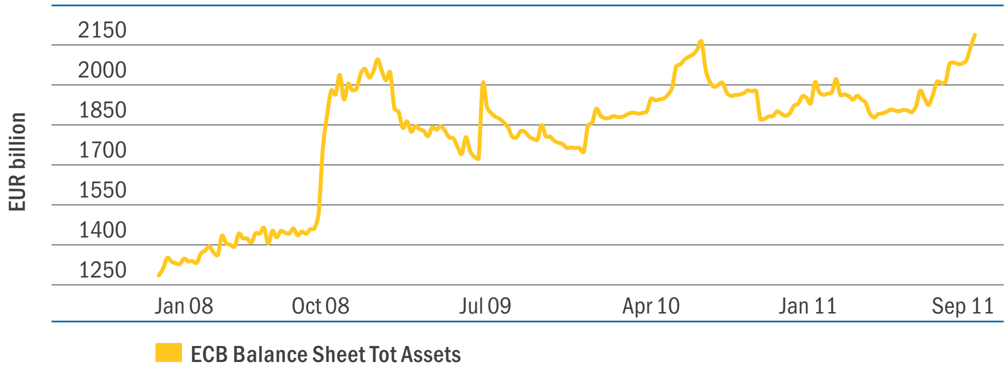


Source: Bloomberg data as of 30 September 2011

The role of permanent crisis manager will be taken up by the facilities created by the crisis itself. As a first step, the German Parliament has duly approved the expansion of the European Financial Stability Fund ("EFSF"). The EFSF was originally charged with releasing aid money to financially stricken countries, but it soon had to take on other crucial duties (such as purchasing bonds to stabilise secondary markets). This passage was needed to avoid another market meltdown but is unlikely to dispel all concerns. The additional powers granted to the facility are the least one could expect in these challenging conditions and the amount of extra money available is finite (a weak point against massive speculation if the crisis deteriorates).

A catalyst to change the prevailing mood is hard to identify in the short term. A further enhanced version should allow the EFSF to issue "Eurobonds" jointly backed by all member states rather than by single states in proportion to their GDP. Unsurprisingly, Germany is not willing to join (Standard & Poor's warned that it could be downgraded if the EFSF was expanded further) unless it dictated fiscal policy to all member states. They are unlikely to find a euro "fiscal union" politically feasible, but financial market pressure may prompt them to accept a devolution of powers.

Government Bond Purchases Inflate ECB Balance Sheets



Source: European Central Bank, Bloomberg data as of 30 September 2011

The Economy

United States

The Federal Reserve sounds another growth alarm

The US central bank is once again showing its commitment to economic growth as the 27 September policy council announced new stimulus measures. "Operation Twist" seems like a soft version of quantitative easing (QE) as the Fed will buy US$400bn of long-maturity government bonds in exchange for a corresponding amount of short-term notes instead of newly-printed money as was done in the two previous rounds of QE.

The main reason why investors did not welcome the announcement is probably because the Fed quoted "significant downside risks" to growth as the rationale behind the new measure. This is a more downbeat view of the economy than when QE started and made Operation Twist appear inadequate (the traders' preferred jargon is that the Fed fell "behind" expectations). In fact, the Fed governor went to great lengths to explain to sceptical politicians that another stimulus package was needed. The Federal Reserve may have exaggerated the current economic slowdown in order to counter the criticism of those who want to curtail its powers (and even abolish it altogether).

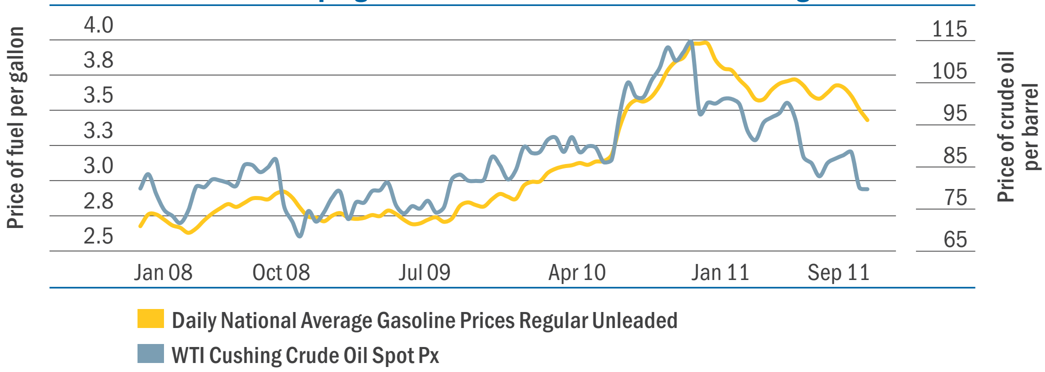
Based upon the latest macro figures, there has been no dramatic change compared to a month ago in the most closely watched economic sectors. Home prices continued to decline from a year earlier (July update) in the 20 main cities but less than forecast. Investigations into the foreclosure practices of banks may have led to delays in processing and keep prices from falling further. For its part the labour market confirmed a pattern of slow growth. Weak data released by the Federal Government were affected by one-off factors, such as the recent strike at a large provider of telecom services. However, corporate surveys show a regular monthly increase in private-sector jobs and no losses.

The Fed can claim that low inflation allows monetary policy to remain exceptionally loose. Core inflation, which excludes the impact of food and energy prices and is the Fed's favourite gauge, has been rising steadily this year and in August reached 2% from a year earlier (a 3-year high), offsetting the recession-induced downturn. However, analysts anticipate a decline in inflation next year as economic growth slows down. We expect the headline index (which includes food and energy items) to fall by about a full percentage point to less than 2% from a year earlier as GDP growth remains below the long-term average (1.7% in 2011 and 1.6% in 2012 compared to 3% last year).

We do not expect the fiscal drag to undermine the growth outlook. The bipartisan parliamentary committee appointed after the August debate on the debt ceiling is working on budget consolidation and will unveil its proposals towards year-end. However, spending cuts are likely to be mild as policy action is still focused on how to stimulate the economy (the White House's plan to spur employment growth is a case in point).

Household spending could even regain some speed thanks to falling oil prices, which in the US feed through almost immediately to fuel prices due to the low rate of sales taxes. Crude oil prices are down by about 15% from this year's highs posted in early May and since then retail prices for unleaded petrol have declined by 12%, in spite of seasonal patterns, and this is likely to raise real disposable incomes again.

Lower Fuel Prices Helping to Restore US Households' Purchasing Power



Source: Bloomberg data as of 30 September 2011

Europe

A new-look ECB

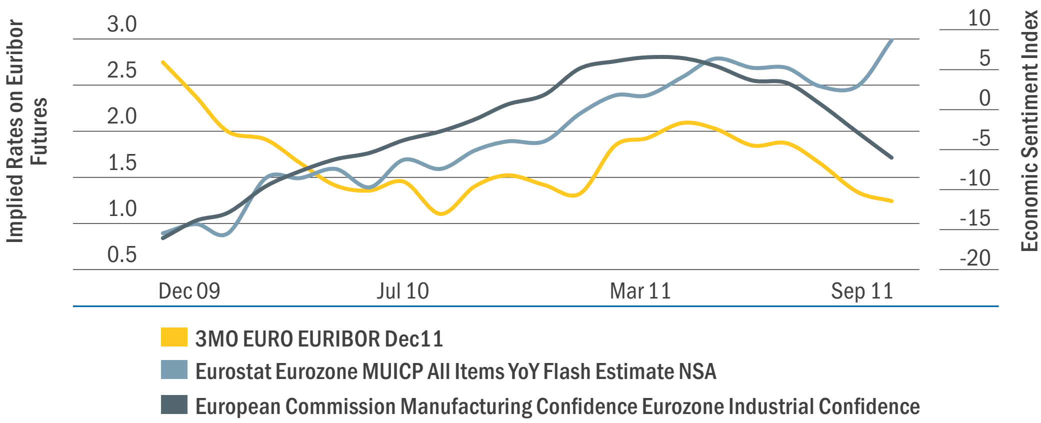
Speculation is growing that the two moves made this year by the European Central Bank to normalise its monetary policy may soon be unwound. Admittedly, the first increase in policy rates, back in April, was partially supported by signs of rising inflation with no worrying evidence for the economy. The second rate hike, in July, hardly looked justified as the ECB chairman struggled to reconcile the upside risks to inflation with a sovereign-debt crisis that was back to the fore and posing downside risks to economic growth. Quoting both risks has probably not enhanced the Central Bank's reputation.

Its efforts to differentiate itself from the too growth-oriented US Federal Reserve may have backfired. Pending the start of operations by the EFSF, the ECB has been given a key role in managing the crisis through the purchase government bonds of distressed countries (Italy and Spain first). The unexpected resignation in August of the German executive-board member (and chief economist) may mark the beginning of a changeover at the ECB, as its strict mandate towards price stability inherited from the German Central Bank becomes more flexible and when there are downside risks for the economy it should follow the Federal Reserve's approach.

Altering the ECB's original mandate would be fraught with legal controversy, but the anticipated decline in inflation may make things easier. The average increase in consumer prices should stay above the 2% comfort zone this year but is likely to fall below that threshold next year as the fiscal drag of the severe austerity plans enacted by several governments (accounting for half of overall GDP) curbs household spending.

The transition to the new Head of the ECB is likely to be very smooth. Germany's attitude towards a new-look ECB, in which crisis management and normal (statutory) policy are barely distinguished, is mixed. However, the euro-friendly lobby may be accidentally bolstered by a sharper-than-expected economic slowdown. Euro-wide GDP growth fell to 1.6% in the second quarter (from 2.4% in the first quarter) but the effect of a global slowdown was more visible for an export-driven economy, such as Germany, amid reduced demand from fast-developing emerging countries.

Inflation Above Target, but The ECB Turns to Evidence of a Weak Economy



Source: European Union Commission, Bloomberg data as of 30 September 2011

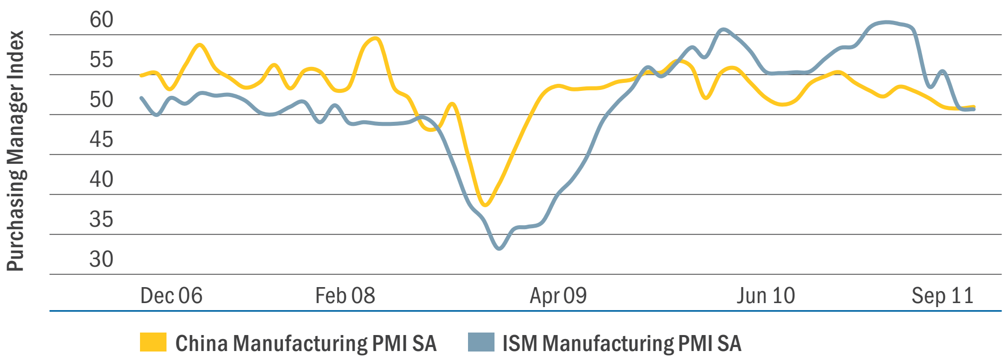
Asia

Calling inflation's cyclical peak

China's inflation eased in August from a three-year high and industrial output growth moderated, adding to evidence that higher interest rates and lending restrictions are cooling the world's second-largest economy. For fast developing economies like China, the slowing may help contain inflation and allow a soft landing. Other Asian policy makers may pause or even stop monetary tightening as an extended period of weak growth in developed countries threatens exports. Policy rates were left unchanged in South Korea and Indonesia, which are two of the larger economies in East Asia, and this action suggests that they are giving less priority to restraint and more to economic growth.

China's money-market rates have declined lately on speculation that the Central Bank (the People's Bank of China (PBOC)) will refrain from announcing more tightening. GDP grew 9.5% in the second quarter from a year earlier, which is slightly less than in the first three months and most analysts expect it to slow further in the second half of the year. The PBOC has raised rates five times over the past year and repeatedly boosted banks' reserve ratios for the biggest lenders. This policy is slowly bringing loan growth back to normal levels and without disrupting economic activity as the mild decline in manufacturing indices shows. These patterns look consistent with a soft-landing scenario. For its part a key survey of Asian large manufacturers, such as Japan's TANKAN, has regained positive territory in the third quarter, as companies restore operations after last March's powerful earthquake. It could have remained below zero for longer if weakening global demand (along with a strong yen across the board) had curbed exports.

Manufacturing Activity Still Expanding In Both China and the US



Source: Blooomberg data as of 30 September 2011

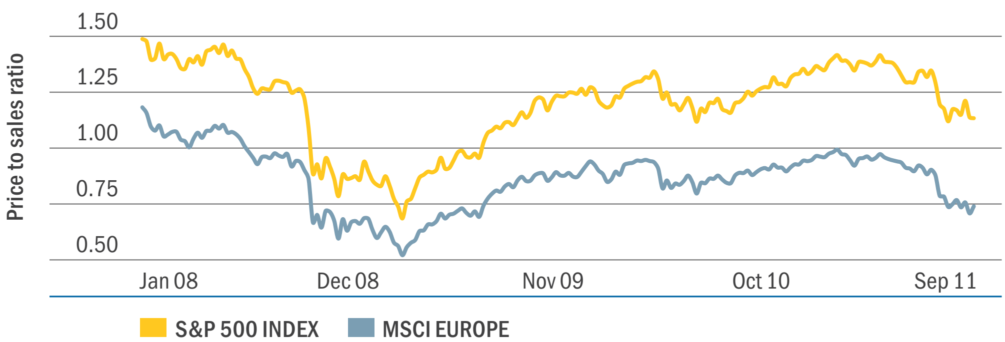
The Markets
US Equities

High hopes for central bank stimulus

Analysts believe that about half of the earnings made by US companies in the S&P 500 Index are made overseas and that fast developing emerging markets account for an increasing stake. Demand for both industrial and consumer goods from those regions grew less strongly than last year as domestic policy makers raised interest rates and took other restrictive measures in order to pare down excess growth in bank lending and keep inflation from rising. A global economic soft landing may be the result of this policy action. The case for applying more brakes looks less compelling and earnings made by highly cyclical export-driven companies may resume soon.

Companies whose profitability relies mainly on domestic sales have actually performed better than the broad market in spite of all the concerns about an impending recession. Speciality retailers, even in the supposedly cyclical Apparel sector, have often reported better-than-expected revenues. The same goes for makers of other durable consumer goods, notably in Information Technology. In this scenario our US portfolio managers maintain an overweight to cyclical sectors.

Estimated Sales at US Companies are Well Above the Last Recession



Source: Standard & Poor's, Bloomberg data as of 30 September 2011

Our strategy has instead cut the long-held overweight not on fundamental grounds but rather on concerns regarding investors' over-reliance on the Federal Reserve's action. The announcement made on 21 September of a bond-purchase programme in exchange for short-term debt rather than newly-printed money was deemed inadequate, as the Fed worsened the economic outlook at the same time. This reaction suggests a fragile market, which has not fully discounted a scenario of weak growth for an extended period (let alone a recession). For bottom-up stock pickers like Pioneer Investments the current attention to technical indicators is also a matter of concern.

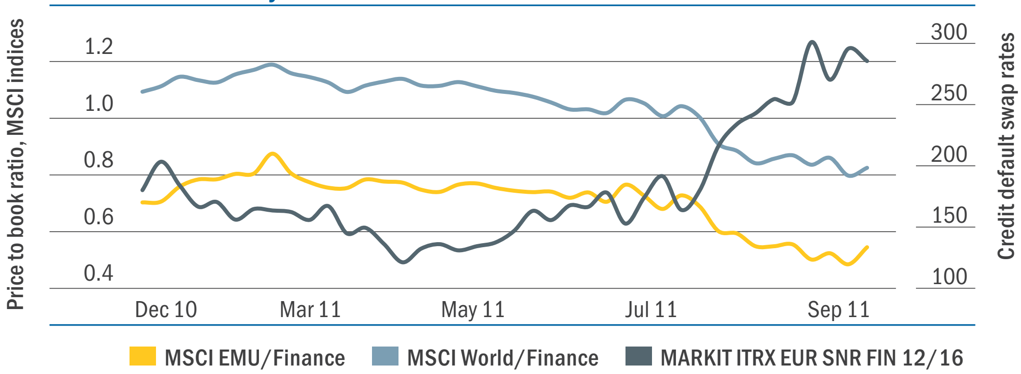
European Equities

The overriding macro picture

The macro climate is holding sway with markets responding swiftly to evidence of a deteriorating economy. Policy mistakes are also affecting market behaviour. This is likely to remain the case for the moment. The top-weighted Financial sector epitomizes the fall of European equities as it bears the brunt of the sovereign-debt crisis. Many banks are being forced to strengthen capital levels but capital markets cannot be successfully accessed under current adverse conditions. Asset disposals raise cash reserves but may detract from future earnings if the unit sold operates in profitable non-core businesses. The profitability of core business is also impaired by the need to accumulate additional money instead of lending it to companies and households.

We can ask ourselves how much this gloomy scenario is built into recent market valuations. The average price-to-book ratio for eurozone banks (based upon the cap-weighted MSCI Index) fell as low as in the midst of the recession and stands at about 0.50, as if most banks were not valued as a "going concern" (commonly defined as a firm that will be in existence far and beyond a foreseeable future). Only when markets regain some poise will bottom-up will stock pickers enjoy the fruits of buying companies at deeply discounted prices, with the ability to perform over the medium-term. We believe that investors will turn back to traditional valuation metrics, such as price-to-earnings and price-to-book ratios, under more settled conditions. Banks and other financial firms (such as insurers) account for about 20% of broad market capitalisation in Europe. The rest is made up of industry groups whose revenues are made largely outside the eurozone where economic growth is set to continue, albeit at a slower pace. From a portfolio perspective, this is key to our investment case. Our dedicated portfolio managers continue to favour companies with global exposure versus more domestically-oriented companies. Since the recovery began in early 2009, European companies have derived sales and earnings from structurally higher growth in developing countries (notably in East Asia) and may again exploit this advantage on receding concerns about an economic hard landing.

Emu Banks Mostly Below Book Value as Debt Crisis Boosts Credit Risk



Source: Bloomberg data as of 30 September 2011

Asia and Emerging Markets Equities

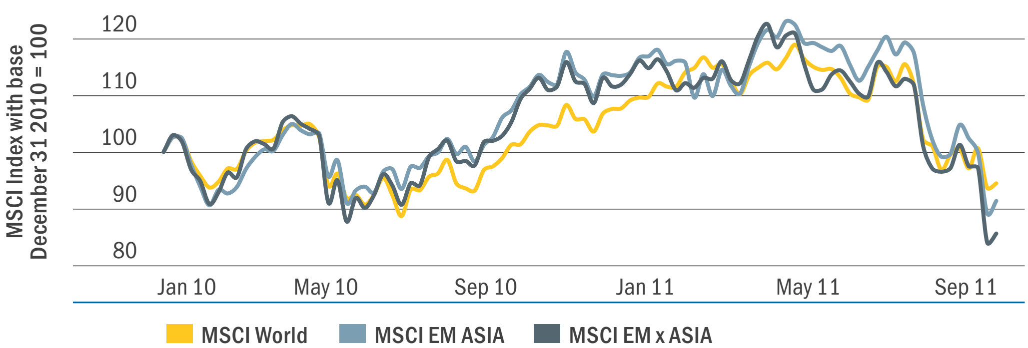
Reasons for a high correlation

Emerging economies, notably in East Asia, retain much stronger growth potential than most developed countries thanks to domestic demand but they are also closely linked with the global economy via trade flows. China could be sheltered to some extent from the ups and downs of developed economies if it allowed its own currency to strengthen and increased the contribution of household spending to overall growth as a result. For now, exports and fixed investments account for a large stake of GDP and most emerging economies tend to share China's growth model.

This may explain why emerging equity markets are hurt at present by fears of a recession in developed countries, having been quite resilient to higher interest rates and other domestic measures to curb economic growth. Investors were confident that those policies would hold inflation in check and lead to an economic soft landing. The fact that emerging equity markets fell even more sharply than most developed markets over the last couple of months suggests that the soft-landing scenario is being replaced by a much gloomier situation with emerging countries importing the recession of developed countries.

The consensus view is that emerging economies can grow driven by domestic demand and are not so reliant on global trends. This asset class should then reduce the volatility of global portfolios, but instead the latest market action shows a high correlation. In fact, we should be able to distinguish between emerging economies and markets (notably in equities) whose sharp decline was probably accelerated by factors such as corporate governance and investment flows.

Emerging Markets Follow the World Index Sharply Down



Source: Bloomberg data as of 30 September 2011

Corporate governance has improved compared to the past when investors were aware of the risk and saw emerging markets as a "frontier" investment case, although reported cases of corruption in BRIC countries (notably in India and Russia) is not helpful in turbulent times.

Flows into emerging markets are still dominated by western investors, who in times of turbulence and deep risk aversion often withdraw money from riskier assets and invest in safe havens, such as US Treasuries, German Bunds and Gold. Emerging equity markets experienced these outflows when the euro sovereign-debt crisis started in May last year but were able to regain steam pretty quickly and resume an upward trend.

The reliance on foreign flows is reminiscent of when emerging markets were not seen as a mature market. However, flows can still have an impact due to the development of exchange traded funds, which have become retail investors' preferred access to emerging equity markets (as shown by the impressive size of assets under management).

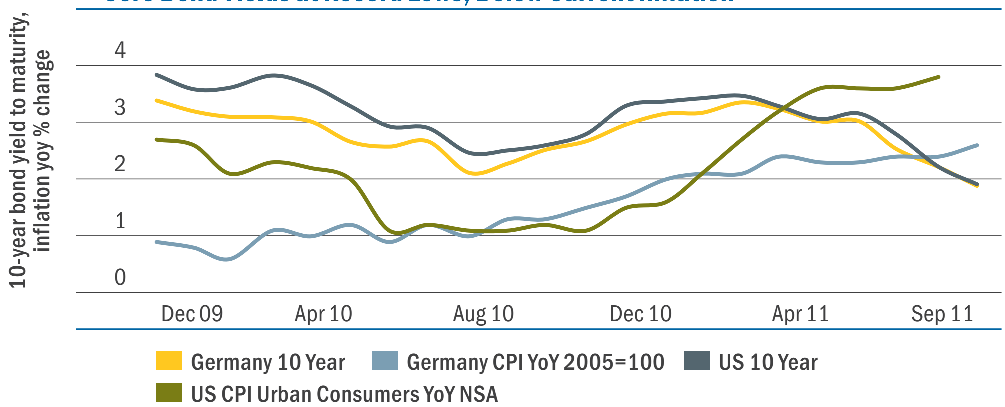
Unlike most developed regions where the fiscal drag may curb growth on a structural basis, emerging countries are mostly debt-light and can revive the economy with stimulus packages as they did after the 2008 global downturn. Another support is likely to come from less expensive currencies as a result of reduced expectations of higher interest rates.

Bonds

Core bond yields suggesting a recession

We hardly see any value in the few core bond markets surviving the sovereign-debt crisis. Yields on German and US government debt barely cover the current level of inflation and look attractive in anticipation of a sharp decline in consumer prices (which may come as a result of outright recession or a Japanese-style deflation). German Bund futures are enjoying safe-haven value in the current euro crisis as yields broke through the recession-induced lows of early 2009. However, the decline in US Treasury yields was also sharp during the third quarter in spite of the August debt downgrade by a major rating agency. This suggests a high risk of recession in the US, on concerns that an extended period of sub-par economic growth will eventually lead to the worst case scenario. In fact, the situation may unfold differently this time, as households' debt reduction process continues and keeps long-term growth more subdued than in the past. GDP growth of 5% year-on-year would be very hard to achieve in this scenario, while growth in the region of 2% should become the norm rather than an abrupt deceleration anticipating a recession.

Core Bond Yields at Record Lows, Below Current Inflation



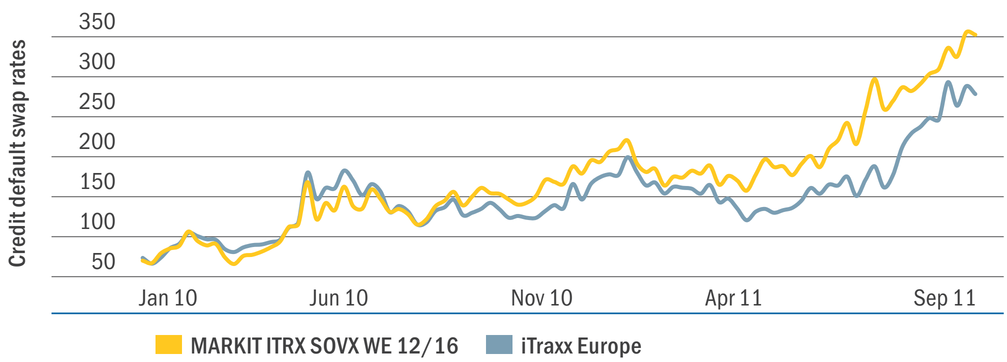
Source: Bloomberg data as of 30 September 2011

The risky end of credit markets: euro non-core government debt

If core markets are poor value, identifying better high-yielding opportunities is not so easy and not only because the sovereign-debt crisis has greatly enlarged the credit market universe. Expectations about inflation and interest rates are barely relevant in this field and other macro indicators affect this market very differently than in the past. GDP growth estimates are a case in point, as the prospect of a structurally low or non-existent growth is a negative for bonds issued by governments of the euro periphery, which will find it very hard to improve their finances and their credit standing.

The market perception of government credit risk as a result of Greece's troubles has led to some extreme situations of late. When the cost of insuring Italy's credit default soared to 500 basis points and borrowing costs rose above 6%, investors seriously took into account an international bailout. For all the uncertainties surrounding Italy's austerity plan, such concerns seem overdone and may provide some buying opportunities. Spain may be upgraded for more fundamental reasons, as the cooperation between the outgoing and the (probably) incoming government ensured a smooth parliamentary approval of the austerity plan and a few much needed economic reforms (not to mention the balanced-budget amendment now enshrined in the basic law). The recovery of Irish government bonds reflects an improved outlook for the economy, which went through the housing crisis very bruised but still well equipped to grow apace (unlike the euro periphery area in Southern Europe).

Credit Risk of Sovereign and European Banks Moving in Tandem



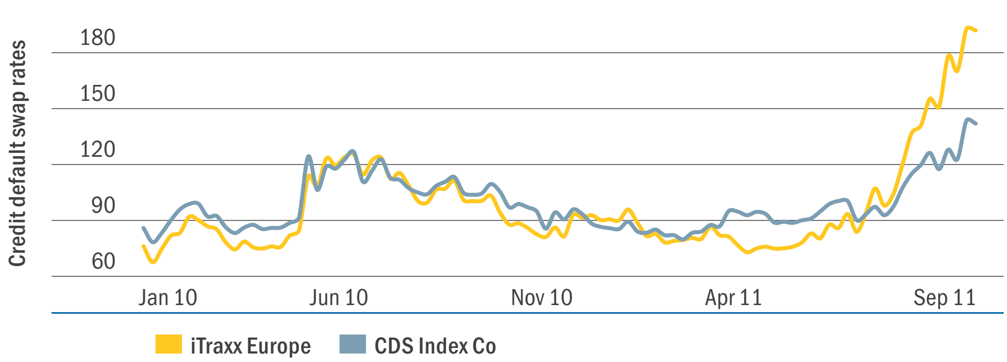
Source: MARKIT, Bloomberg data as of 30 September 2011

Opportunities in corporate bonds pricing high default rates

Any investment in credit markets is selective, but we can find more opportunities in corporate bonds. Spreads have not been very resilient in this summer's "epidemic" of risk aversion. The cost of insuring against a corporate default rose so sharply that the iTraxx Europe Index is back to the recession-induced record highs of early 2009 (of about 200 basis points). The Financial sector's weight accounted for much of the upward pressure amid the sovereign-debt crisis. We believe that some large banks can withstand the losses, which may be incurred on holdings of distressed government debt (including Greece's in case of an orderly default). The selling was as indiscriminate as in the midst of the last recession and risk premiums should now provide a reasonable hedge against the worst case scenario and this also holds true for subordinated bank bonds.

Companies operating in other (non-financial) sectors have retained most of the conservative policies that were badly needed to overcome the recession. Holding costs down and keeping abundant cash flows was reassuring enough for bondholders and spreads rose moderately despite widespread risk aversion. Credit risk rose sharply for non investment-grade issuers in anticipation of a recession-led increase in defaults. As we do not envisage such a gloomy situation, we can find several buying opportunities in this asset class.

US Corporate Credit Risk Less Affected by Financial Sector's Woes



Source: MARKIT, Bloomberg data as of 30 September 2011

Currencies

One-way bets against the US dollar become less profitable

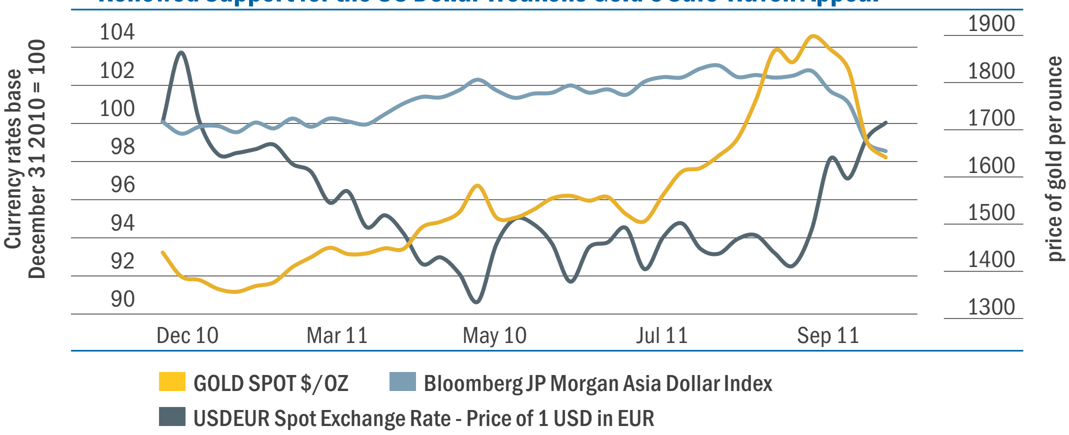
The Federal Reserve's new measures to stimulate the economy may be supportive for the US dollar. Unlike the previous two rounds of quantitative easing, "Operation Twist" announced on 21 September does not add to money supply and that was enough to stem the US dollar's slide across the board. The US currency appreciated by some 4% in trade-weighted terms in September, probably in anticipation of a change in monetary policy (still loose, but with self-imposed limits at last).

As speculative carry trades were unwound, the US dollar recouped almost all of this year's losses against a basket of Asian currencies, although the weakness of the euro accounted for much of the dollar's appreciation. It took a long time for the sovereign-debt crisis to have an impact and speculation about the ECB suddenly changing its stance and cutting policy rates soon may create additional pressure. The ECB was also forced to reverse a rate hike three years ago in the wake of Lehman Brothers' collapse but may find itself in a more embarrassing situation this time for unwinding a wrongly-timed tightening of monetary policy as the debt crisis becomes more severe again.

We are holding on to our EUR underexposure despite buying European equities in exchange for US equities. Thanks to a less extreme Federal Reserve policy, the US dollar seems to be regaining some of its safe-haven appeal. This may explain the recent slump in gold prices, which have halved their year-to-date gain after a 14% drop in September (coinciding with the US dollar's rebound).

Using currencies as hedges has its risks, notably when their supposedly inflated value prompts central banks to intervene. Admittedly, the Bank of Japan's efforts to weaken the yen have rarely been successful, but the Swiss central bank managed to convince investors that it is committed to maintaining the currency below 1.20 against the euro (which is about 10% weaker than market prices implied right before the announcement made on 6 September).

Renewed Support for the US Dollar Weakens Gold's Safe-Haven Appeal



Source: Bloomberg data as of 30 September 2011

Tactical Asset Allocation Summary

Global Equities: Underweight

The base case for economic strength favours cyclical asset classes and equities among them, as evidence of strong earnings growth should overcome recurrent risk factors. We are increasingly concerned, however, that the euro sovereign-debt crisis may undermine the outlook for global economic growth amid rising political risk. Valuations look compelling but we give more priority to capital preservation by cutting our equity exposure.

USA: Neutral

The Federal Reserve's unconventional policy measures are keeping government bond yields low against dividend yields. We are mindful, however, about the market's excess reliance on Fed policy and believe that an extended period of weak growth is not fully built into market prices. That is why we reduced our holdings.

Europe: Underweight

Banks account for a large stake of the broad market and investor concerns about their financial health will not disappear as policy mistakes delay any solution to the sovereign-debt crisis. Other sectors are conveniently exposed to fast-growing regions and retain more upside potential when fears of a global recession recede.

Japan: Underweight

Economic growth is recouping what it lost as a result of last March's earthquake but exports account for most of overall GDP growth and will still be curbed by a strong currency and weak demand abroad (notably US).

Pacific ex Japan: Neutral

Markets in this area are highly reliant on China, where efforts to cool down inflation may eventually succeed and avoid the risk of a hard landing for the economy.

Emerging Markets: Overweight

Most of these regions retain a strong potential for domestic growth, with East Asia standing in the first tier. The global economic slowdown may help inflation to recede and make tight monetary policies less compelling. Moreover, most emerging countries are light in debt and can revive the economy with looser fiscal policies.

Global Bonds: Underweight

Government bonds in core markets are barely attractive as yields fall below inflation rates. Such levels are consistent with an impending recession, which would bring inflation down sharply. We do not envisage a recession but core bonds are supported by their safe-haven appeal and may remain so for quite some time as the euro sovereign-debt crisis is far from resolved and the risk of policy mistakes remains high.

Euro Government: Underweight

The ECB is likely to reverse its policy and cut interest rates amid concerns about the sovereign-debt crisis, as well as a sharp economic slowdown in Germany. Record-high credit spreads within the euro area may provide excellent buying opportunities in peripheral countries. However, they need to enact economic reforms alongside austerity plans in order to structurally improve government finances.

Euro Corporate: Overweight

Banks account for a good proportion of issuance in the euro market and their exposure to the sovereign-debt crisis is significant. Investors' fears about this have pushed credit up sharply and we believe there are several buying opportunities. Outside of the Financial sector, companies are still committed to sound budget policies and the default rate implied in current spreads looks excessive.

US Government: Neutral

Economic growth should remain below-par for an extended period of time and that will keep inflation expectations subdued. The debate over the debt ceiling may lead to budget consolidation and a less expansionary fiscal policy, which should support the market on a fundamental basis.

US Corporate: Neutral

US businesses are largely committed to cost cutting so the recent rise in risk premiums is the result of very high risk aversion. The lowest-rated (high-yield) bonds have been excessively hurt by the tough environment and are likely to provide selective buying opportunities.

Emerging Markets: Neutral

Credit spreads held reasonably well in the face of the euro sovereign-debt crisis as major emerging countries also pursue the right economic policies in difficult circumstances. Local-currency issues should not be overly affected by international investment flows and prove less volatile as a result. Another support may come from receding inflation expectations as the economy slows down.

Tactical Asset Allocation Summary

Global Summary Table

Asset Class	Recommendation
Equity	Underweight
Government Bonds	Underweight
Corporate Bonds	Overweight
Liquidity	Neutral

Regional Summary Table

Asset Class	Recommendation
Euro Cash	Underweight
2yr Euro Corp	Overweight
Total Liquid Assets	**Neutral**
Euro Bond	Underweight
US Bond	Neutral
Japan Bond	Neutral
Government Bonds	**Underweight**
US Corporate	Neutral
US High Yield	Overweight
Euro Corporate	Overweight
Euro High Yield	Neutral
Emerging Market Bonds	Neutral
Corporate Bonds	**Overweight**
North America Equity	Neutral
Europe Equity	Underweight
Japan Equity	Underweight
Global Emerging Mkts	Overweight
Pacific Ex Japan	Neutral
Equity	**Underweight**

Foreign Currency Exposure

US Dollar	Overweight
Euro	Underweight
Yen	Underweight
Other	Neutral

FROM WEAKEST TO STRONGEST IN ASCENDING ORDER:

Strong Underweight | Underweight | Slight Underweight | Neutral | Slight Overweight | Overweight | Strong Overweight

Please note that the rank is indicative and may not sum to equilibrium.

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