



Current challenges facing the World Economy – A consideration of a chosen few scenarios

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Agenda

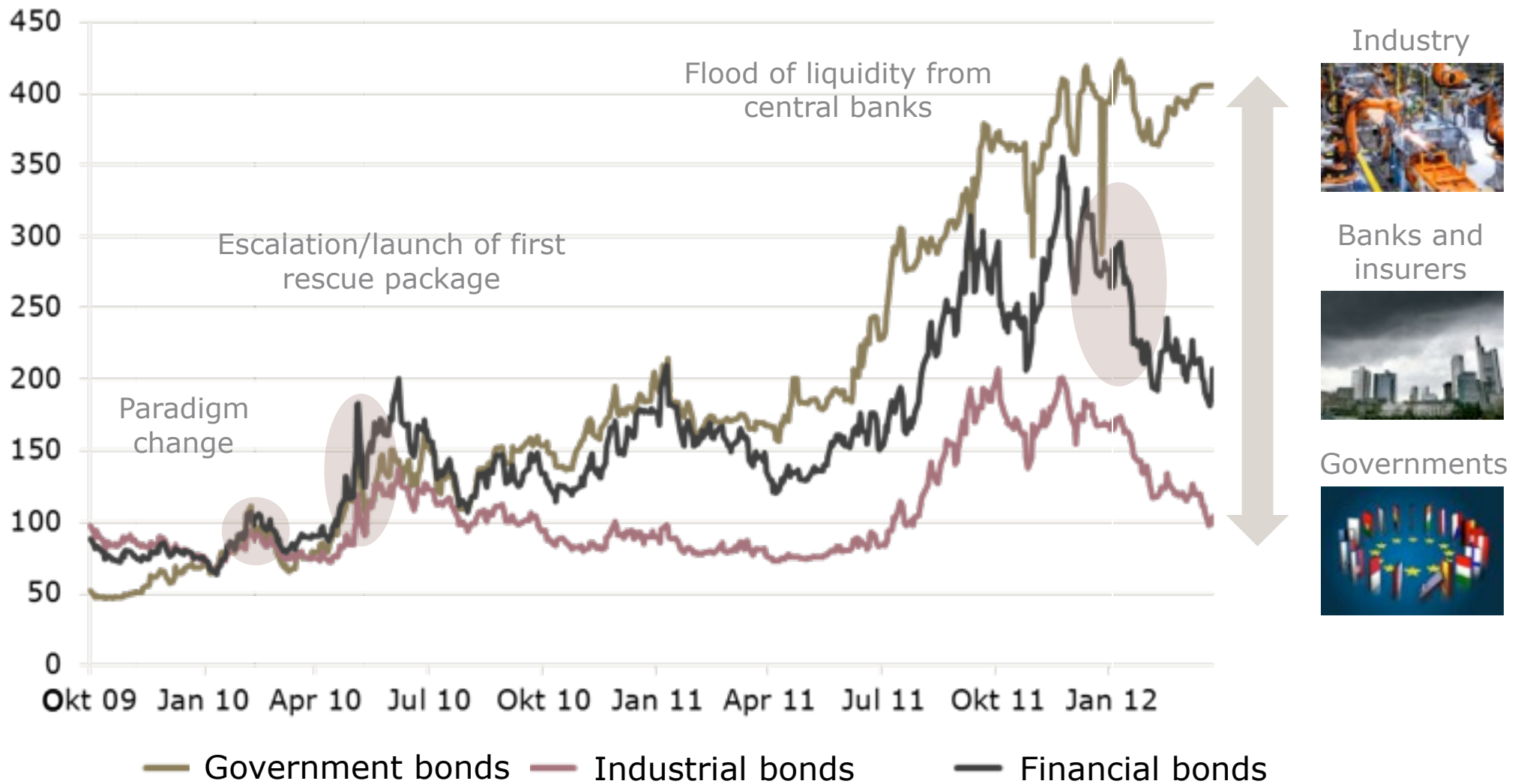
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- Introduction
- Overview of Scenarios
 - Painful Adjustment
 - Stay on the Sidelines
 - Steady Coping
 - Golden East
 - Red Abyss
- Scenario Probability and our Assessment

Too soon to give the all-clear...

...but industry is in good shape

Comparison of European credit default premiums



Industry



Banks and insurers



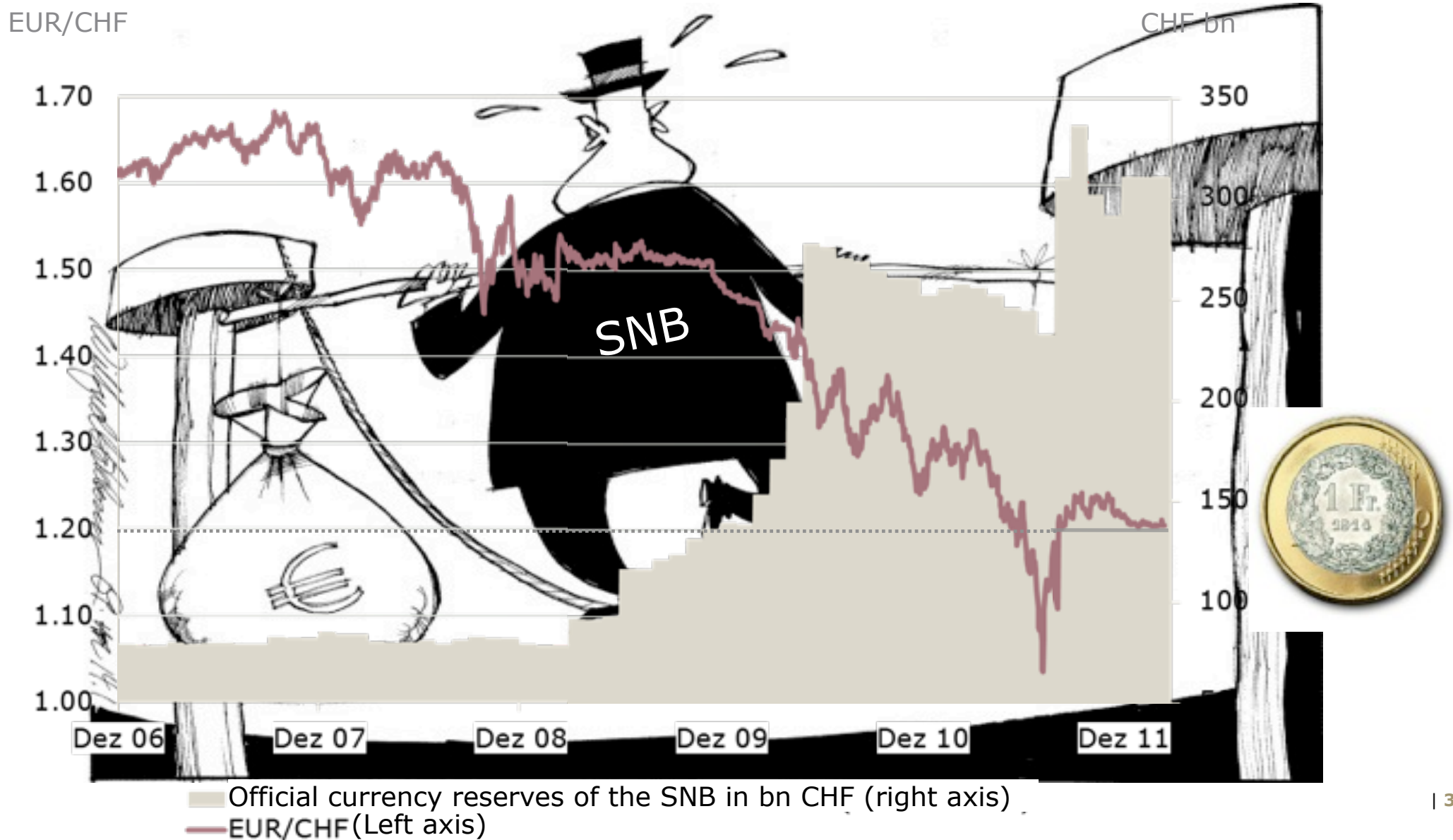
Governments



Dilemma for the Swiss National Bank

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Is the Swiss franc turning into a "quasi euro"?

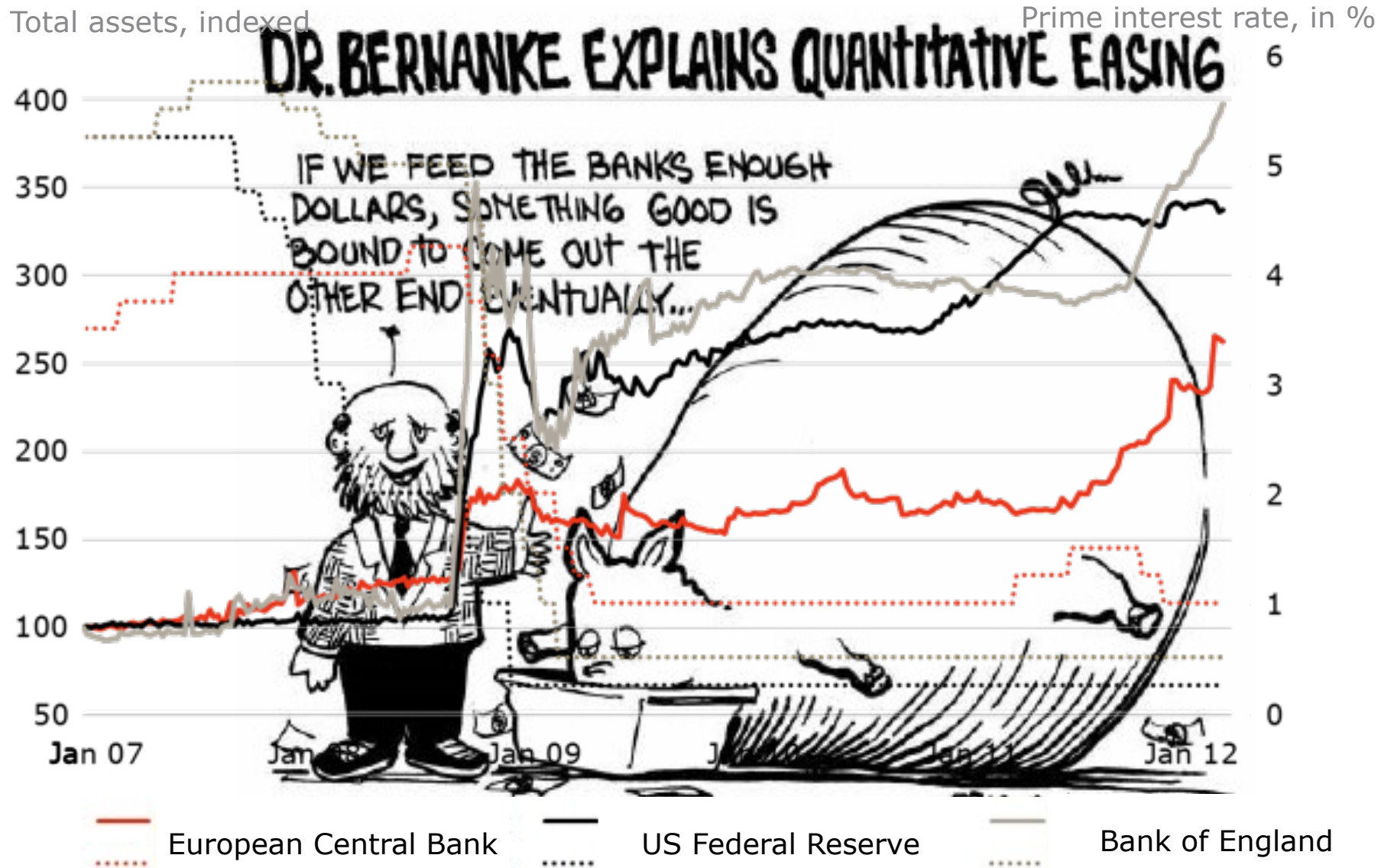


No end in sight to the flood of liquidity

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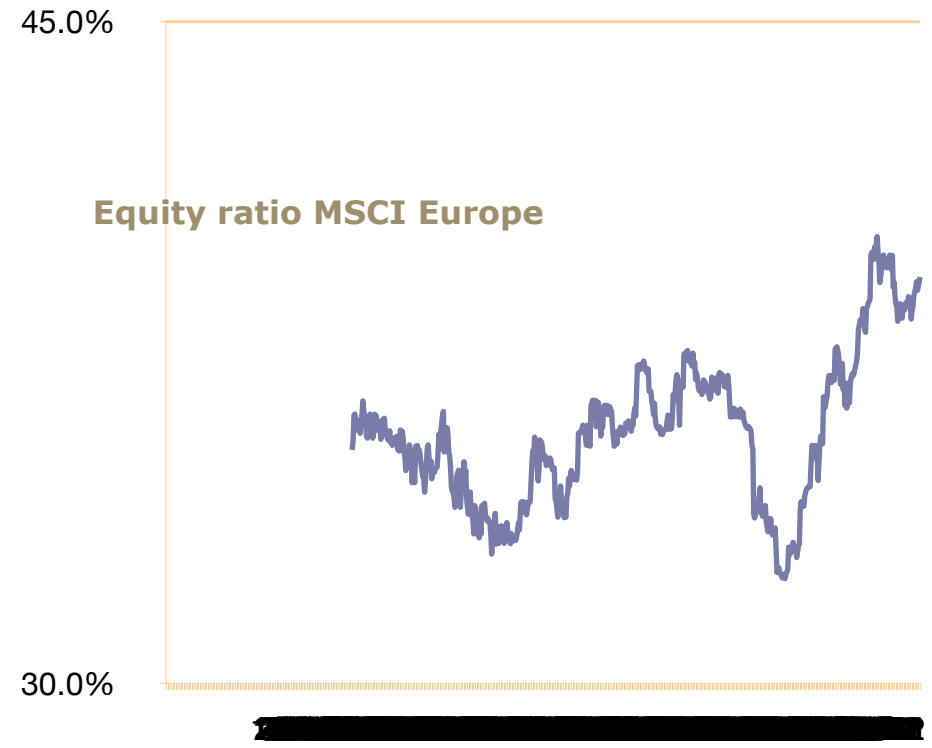
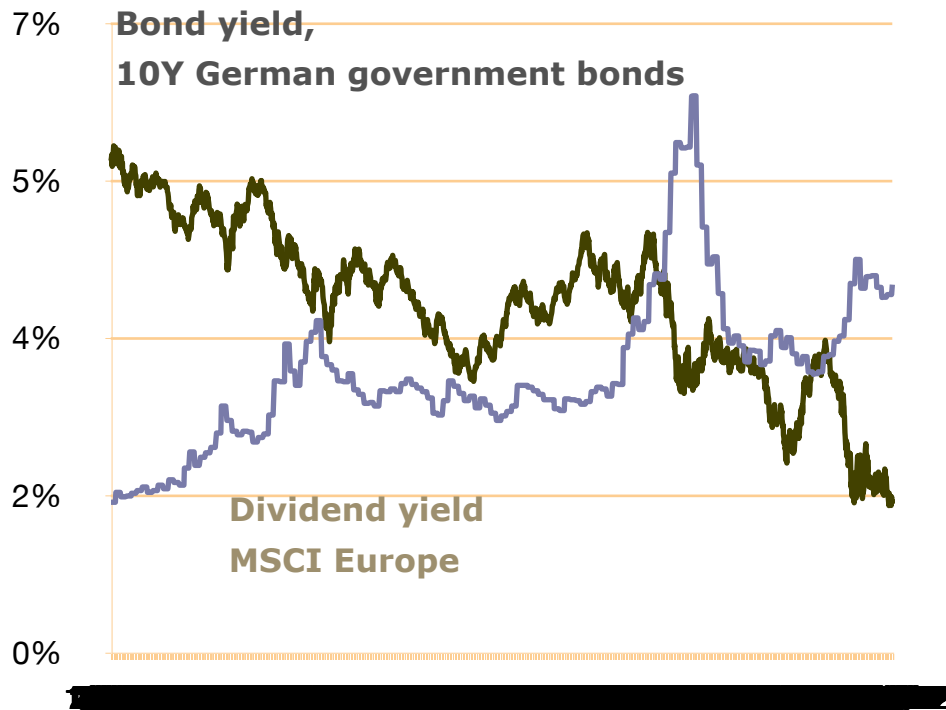
Central banks continue to balloon...

...while key interest rates are stuck at historically low levels



Attractive share valuations

Dividend yields and historically high equity yields support equity investments



We continue to think in scenarios...

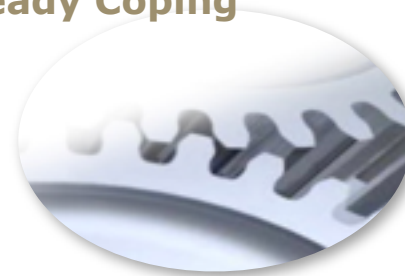
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...and to set our compass accordingly

Stay on the
sidelines



Steady Coping



Painful
Adjustment



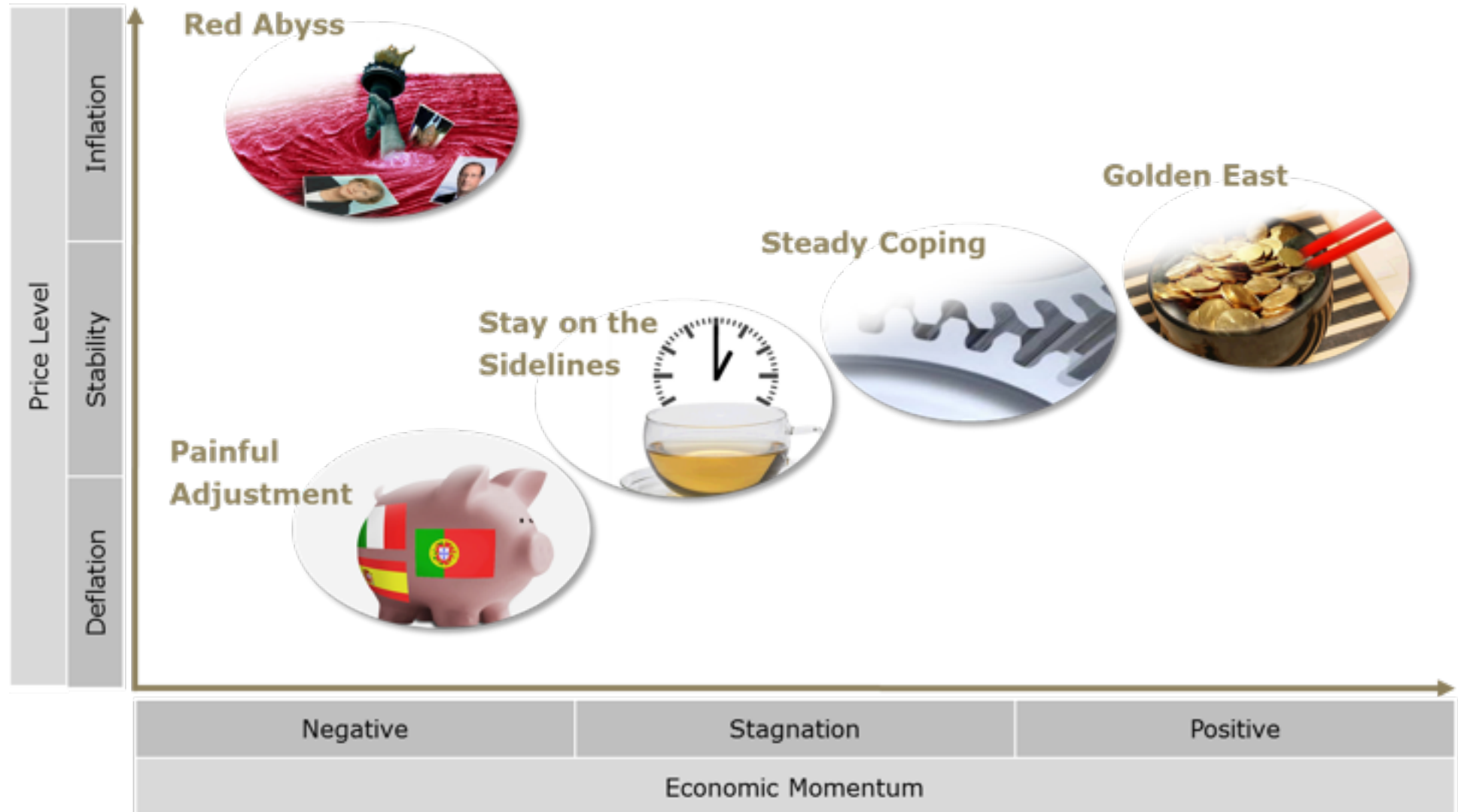
Golden East



Red Abyss



Overview of scenarios



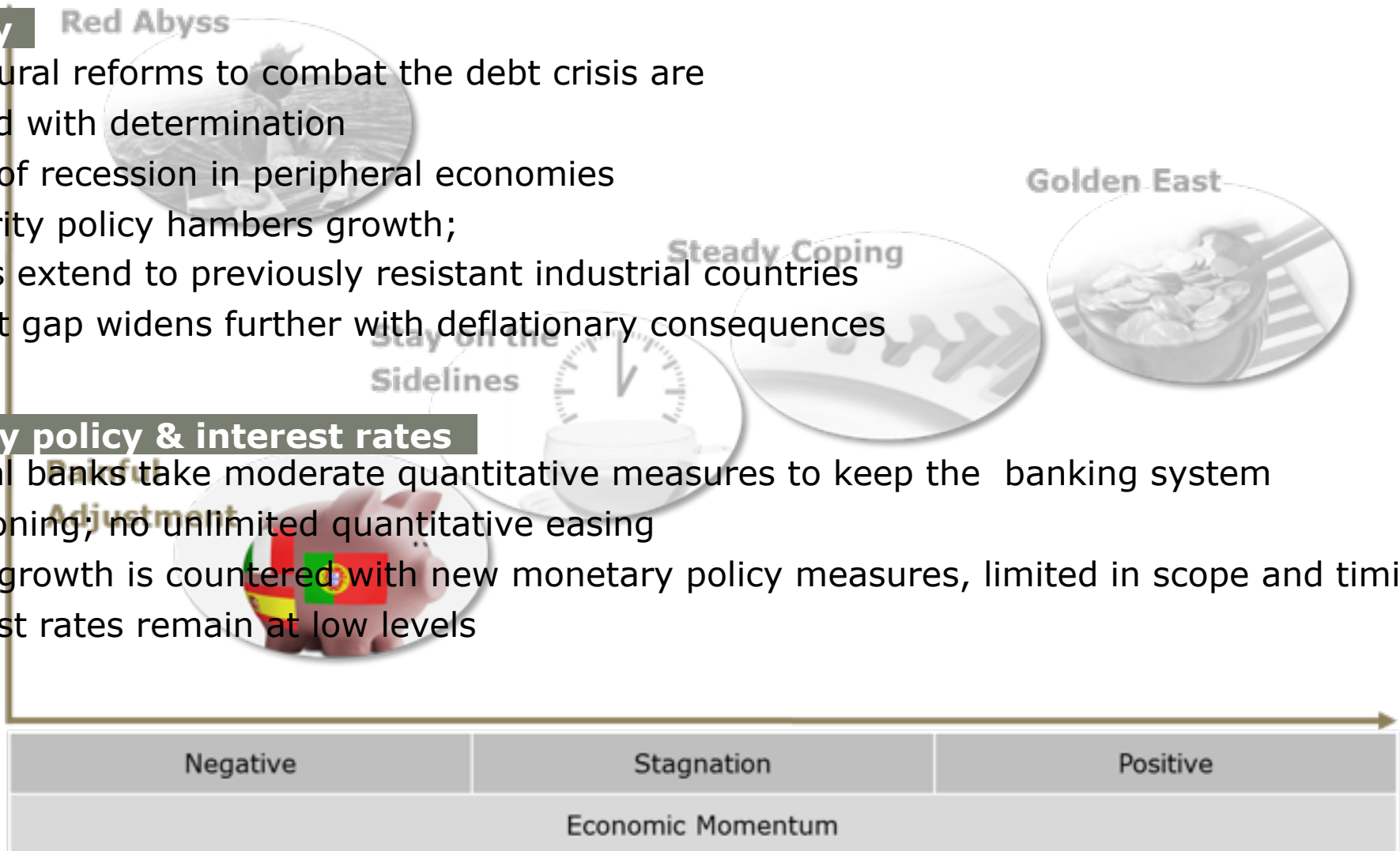
Impact on the economy and monetary policy

Economy

- Structural reforms to combat the debt crisis are tackled with determination
- Years of recession in peripheral economies
- Austerity policy hampers growth; effects extend to previously resistant industrial countries
- Output gap widens further with deflationary consequences

Monetary policy & interest rates

- Central banks take moderate quantitative measures to keep the banking system functioning; no unlimited quantitative easing
- Weak growth is countered with new monetary policy measures, limited in scope and timing
- Interest rates remain at low levels



Painful adjustment

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Effects on asset classes

Equities

- Below-average returns

Bonds

- Ongoing demand for government bonds from AAA-rated countries

Currencies

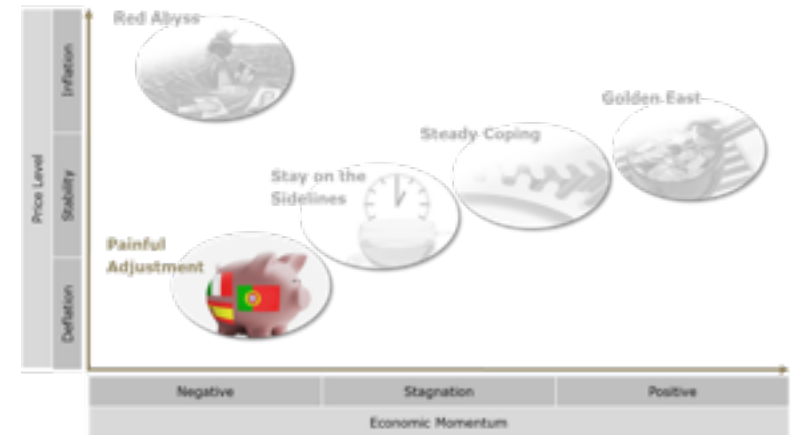
- Currencies of structurally sound countries appreciate (SEK, NOK)
- After a weak phase, USD appreciates as the debt problem is finally addressed
- Cyclical currencies trend softer

Gold

- No direction (low real interest rates, but diminishing stimulus from monetary policy)

Real estate

- Prices ease in Switzerland and Germany
- Market returns to a healthy equilibrium in the medium term



Painful adjustment

Stagnation thanks to middle course?

Merkel Heads For Debt Showdown With Hollande At EU Summit

François Hollande and Angela Merkel: the body language

Formal handshakes – none of those awkward kisses that the German leader and Sarkozy used to lavish on each other



Can Hollande, Merkel find middle ground?

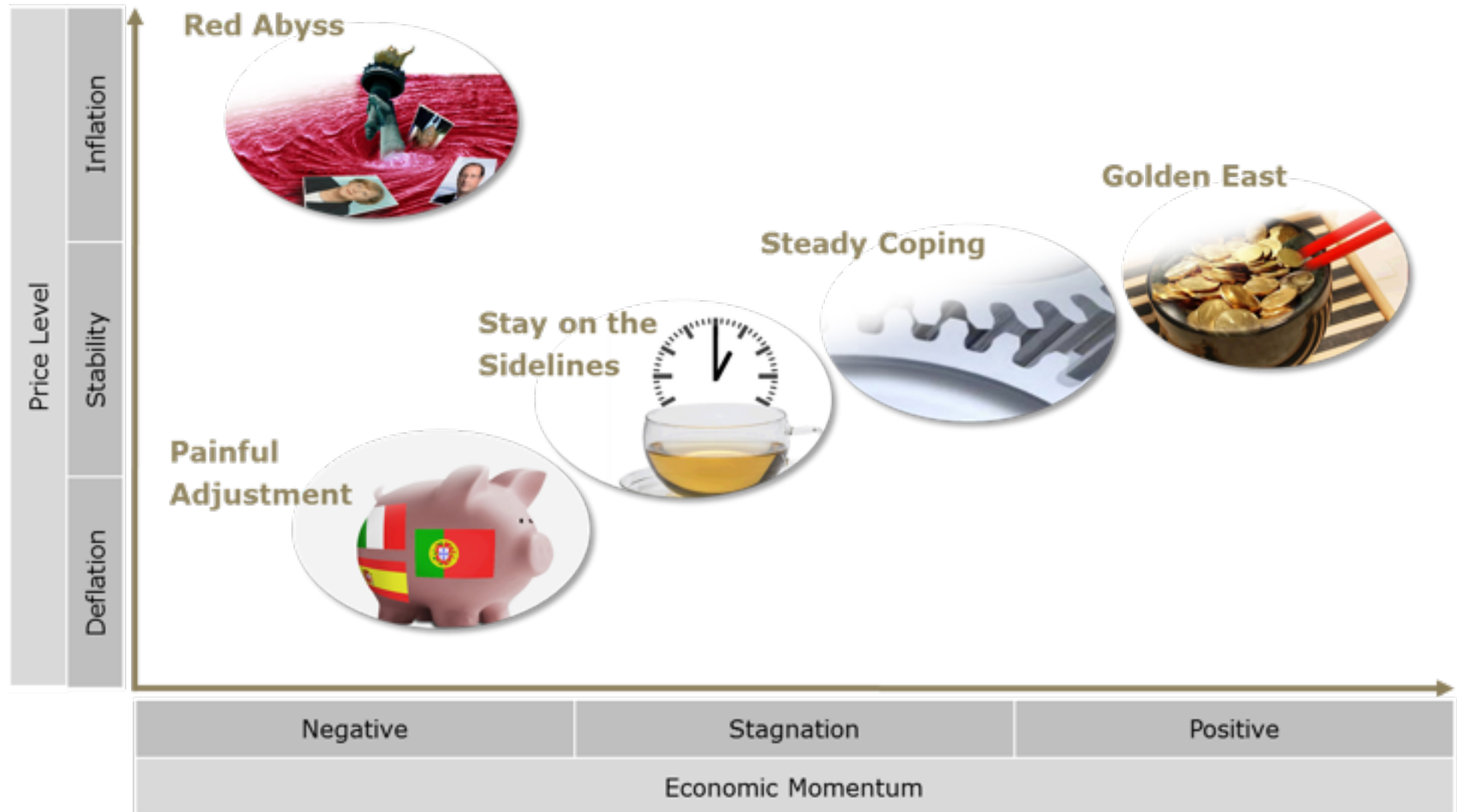
Merkel, Hollande pledge to find common ground on European growth

French President François Hollande and German Chancellor Angela Merkel held the first of many meetings yesterday, discussing proposals for augmenting austerity with stimulus measures.

Hollande turns tide against Merkel's austerity

Hollande Meets Merkel to Start a Delicate Balancing Act

Overview of scenarios



Impact on the economy and monetary policy

Economy

Red Abyss

- Global economy stop & go; frequent, brief up- and downswings
- Only the strongest countries (Germany, Switzerland) post positive growth rates
- Mild recession in peripheral countries; debt crisis continues to flare up; EMU remains intact
- Sluggish consolidation of structural deficits, high risk premiums within the EMU
- European bank landscape recovers slowly, lending remains cautious
- Spotlight on US debt crisis
- Continuation of the macroeconomic trends of the last years

Golden East

Steady Coping

Stay on the sidelines

Adjustment

Monetary policy & interest rates

- No departure from extremely accommodative monetary policy
- Weak growth is countered with new monetary policy measures, limited in scope and timing
- No inflationary effects
- Long-term interest rates remain under equilibrium level

Negative

Stagnation

Positive

Equilibrium level

Stay on the sidelines

Effects on asset classes

Equities

-High volatility; above average returns; significant regional differences

Bonds

-Ongoing rally in AAA government bonds

Currencies

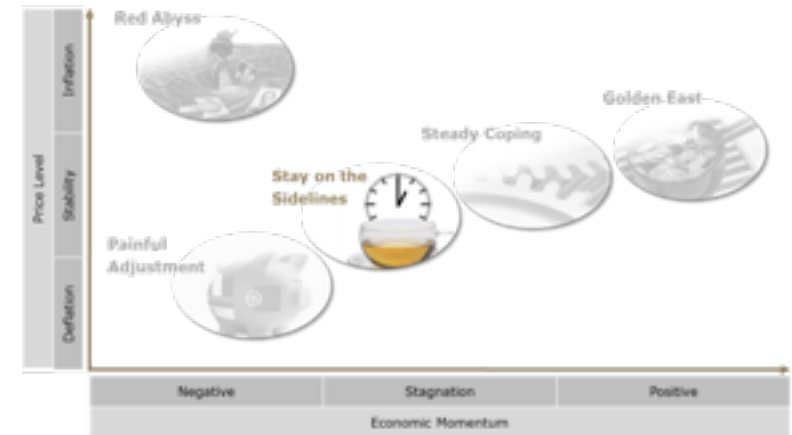
-CHF and JPY remain strong
-EUR/USD stabilises, broad sideways trend
-Currencies of fundamentally strong emerging market countries appreciate

Gold

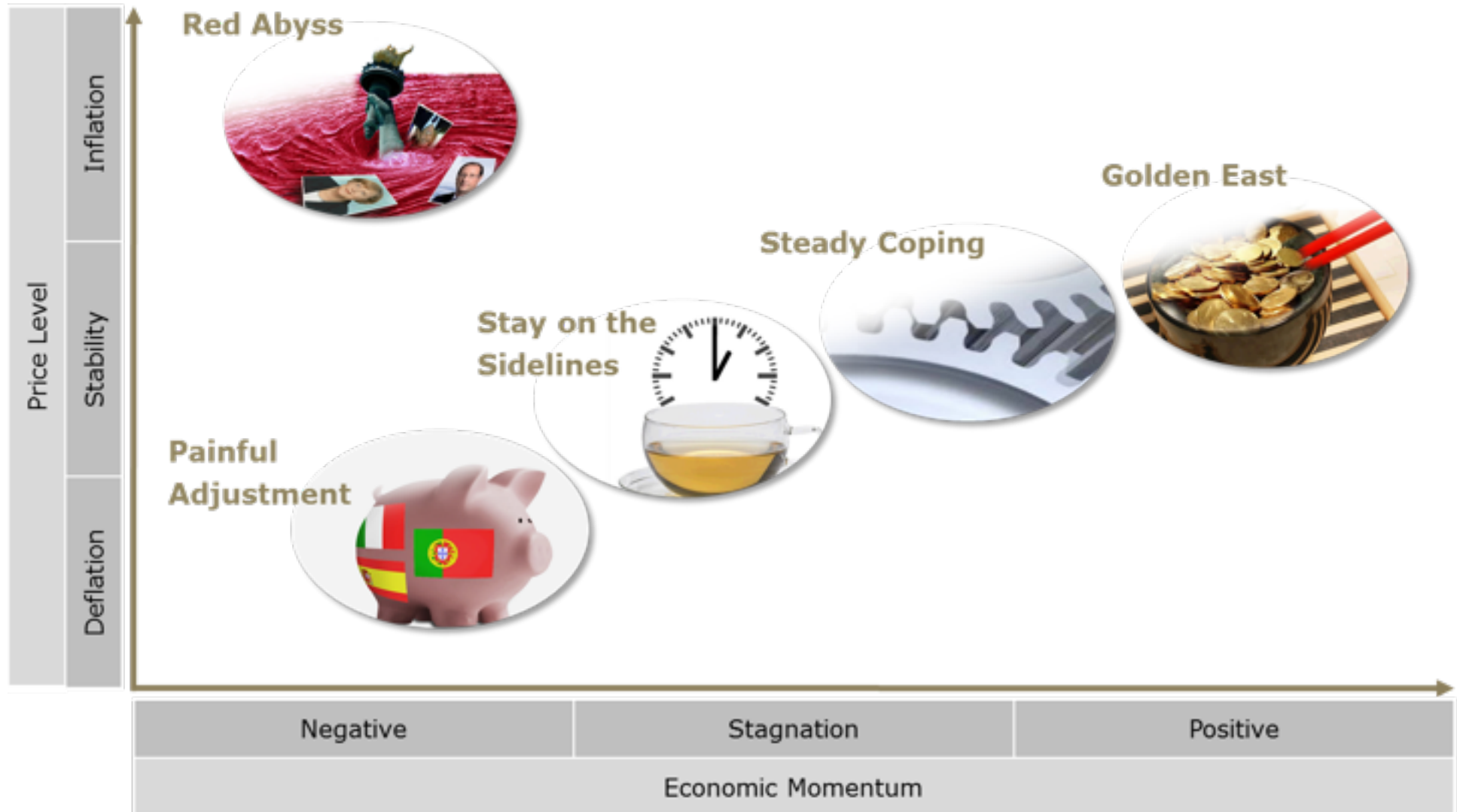
-Uptrend remains intact due to low real interest rates

Real estate

-Further expansion of CH real estate bubble, prices continue to rise in Germany
-Ongoing correction in euro periphery



Overview of scenarios



Impact on the economy and monetary policy

Economy

- EU debt crisis stabilises
- Combination of structural reforms to stimulate growth and measures to reduce debt
-> stimulating effect on the global economy
- Much of the global economy posts (above) average growth
- EMU remains intact, risk premiums on government bonds decline
- Bank balance sheets cleaned up, lending revives

Red Abyss

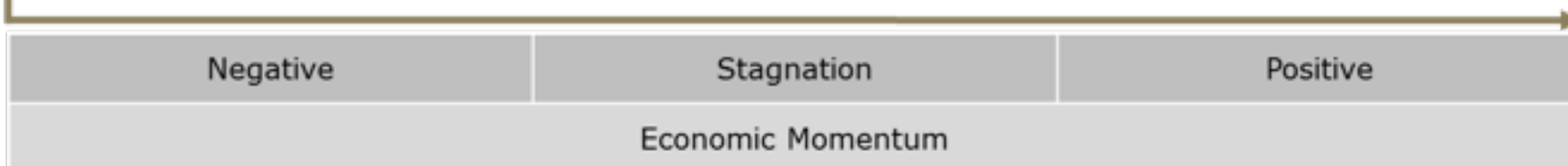
Golden East

Steady Coping

Painful Adjustment

Monetary policy & interest rates

- Monetary policy remains extremely accommodative – no quantitative limit
- No inflationary effects
- Long-term interest rates rise to equilibrium levels on the back of healthy economic situation



Steady coping

Effects on asset classes

Equities

- Stock market rally
- PIGS countries post high outperformance

Bonds

- Rally in government bonds diminishes
- Bonds from peripheral countries have massive potential to catch up

Currencies

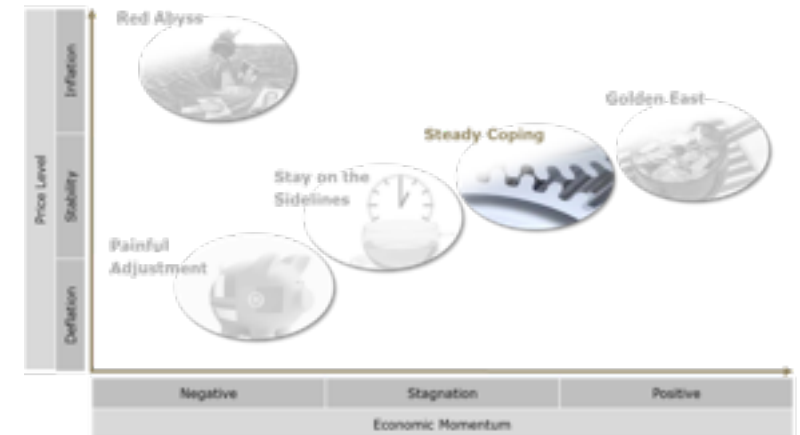
- Fundamentally strong G10 currencies (AUD, CAD)
- Emerging market currencies appreciate; USD weak, EUR/USD recovers
- CHF remains strong; decline in CHF minimum exchange rate to EUR

Gold

- Loses appeal and moves into a sideways trend

Real estate

- CH real estate bubble expands, comes closer to bursting
- Ongoing correction in the euro periphery, closer to stabilisation



Steady coping

Forecast rising income for blue chip companies

Company	income (in billion)			
	2010	2011	2012 est.	2013 est.
Nestle SA	88.02	83.77	90.13	95.78
<i>Change (%)</i>		-4.82%	7.60%	6.26%
Zurich Insurance Group AG	67.82	52.98	56.79	58.40
<i>Change (%)</i>		-21.88%	7.19%	2.84%
Novartis AG	50.62	58.57	57.88	58.65
<i>Change (%)</i>		15.69%	-1.16%	1.32%
Roche Holding AG	47.47	42.53	44.63	46.46
<i>Change (%)</i>		-10.41%	4.94%	4.10%
ABB Ltd	31.59	37.99	40.19	42.97
<i>Change (%)</i>		20.26%	5.80%	6.91%
Holcim Ltd	21.65	20.74	21.80	23.09
<i>Change (%)</i>		-4.20%	5.11%	5.92%

Steady coping

Forecast rising profits for blue chip companies

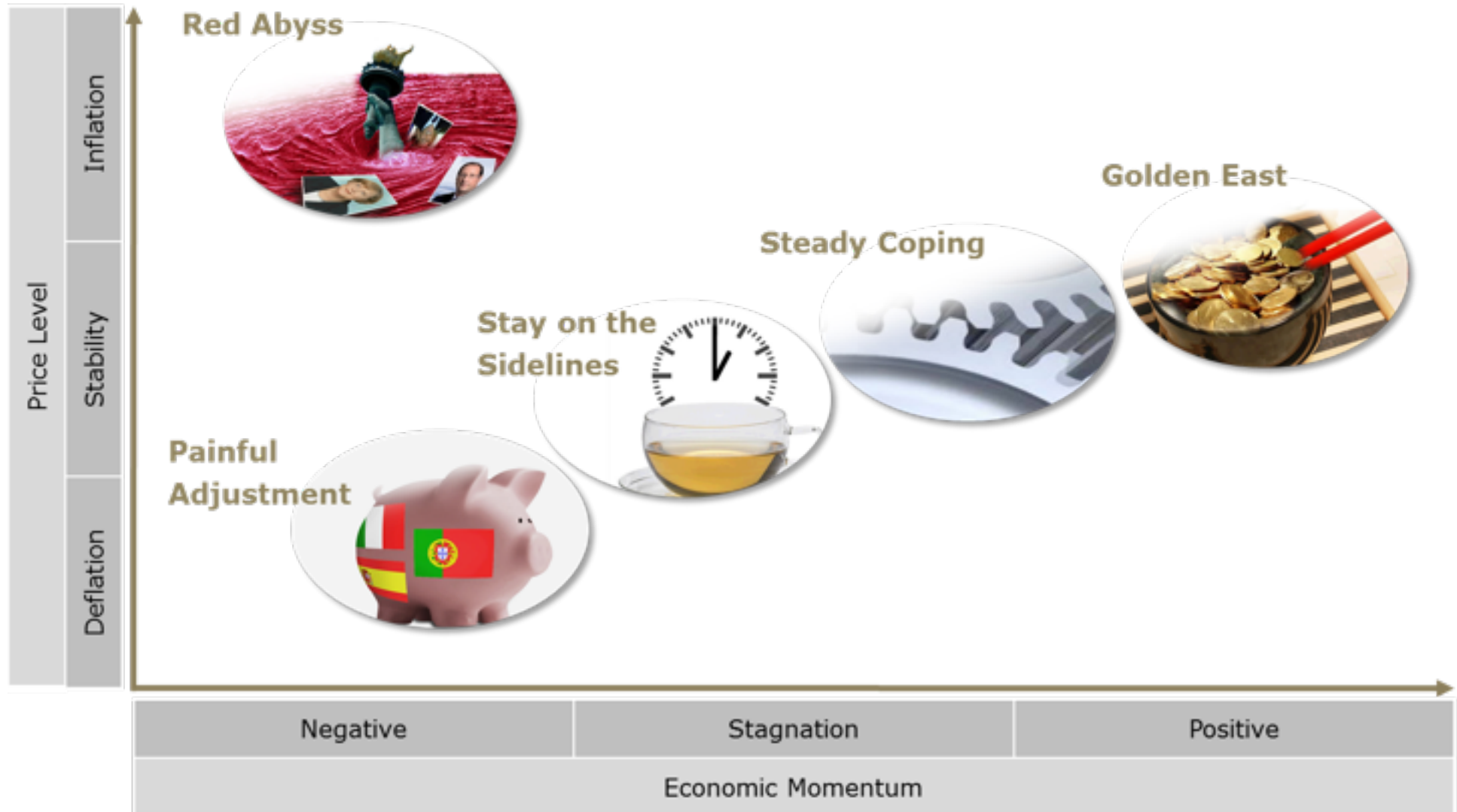
Company	gross profit (in billion)			
	2010	2011	2012 est.	2013 est.
Nestle SA	43.24	39.64	43.25	46.32
<i>Change (%)</i>		-8.32%	9.10%	7.10%
Zurich Insurance Group AG	4.92	5.58	5.84	5.99
<i>Change (%)</i>		13.46%	4.75%	2.47%
Novartis AG	36.14	39.58	40.89	41.41
<i>Change (%)</i>		9.54%	3.29%	1.27%
Roche Holding AG	34.18	30.59	33.92	35.35
<i>Change (%)</i>		-10.51%	10.88%	4.22%
ABB Ltd	9.53	11.43	12.02	13.01
<i>Change (%)</i>		19.99%	5.15%	8.20%
Holcim Ltd	9.27	8.53	9.48	10.21
<i>Change (%)</i>		-8.04%	11.21%	7.62%

Steady coping

Forecast rising EPS for blue chip companies

Company	adj. EPS			
	2010	2011	2012 est.	2013 est.
Nestle SA	3.24	2.97	3.32	3.60
<i>Change (%)</i>		-8.33%	11.78%	8.43%
Zurich Insurance Group AG	7.21	6.38	10.51	5.49
<i>Change (%)</i>		-11.51%	64.73%	-47.76%
Novartis AG	5.18	5.57	5.45	5.72
<i>Change (%)</i>		7.53%	-2.15%	4.95%
Roche Holding AG	12.78	12.30	13.63	14.79
<i>Change (%)</i>		-3.76%	10.81%	8.51%
ABB Ltd	1.22	1.38	1.46	1.66
<i>Change (%)</i>		13.11%	5.80%	13.70%
Holcim Ltd	3.69	2.68	3.42	4.27
<i>Change (%)</i>		-27.37%	27.61%	24.85%

Overview of scenarios



Impact on the economy and monetary policy

Economy

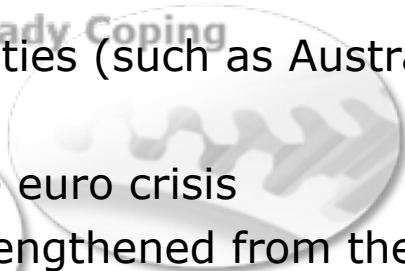
Red Abyss

- Soft landing achieved in China; Asia becomes the motor of global economic growth
- Above-average growth in the emerging economies of South America (especially Brazil)
- Countries with strong exports or rich in commodities (such as Australia and Canada) profit from high demand in emerging markets
- Emerging market countries help to overcome the euro crisis
- EMU remains intact – the euro zone emerges strengthened from the crisis
- Lower refinancing costs for peripheral countries

Golden East



Steady Coping

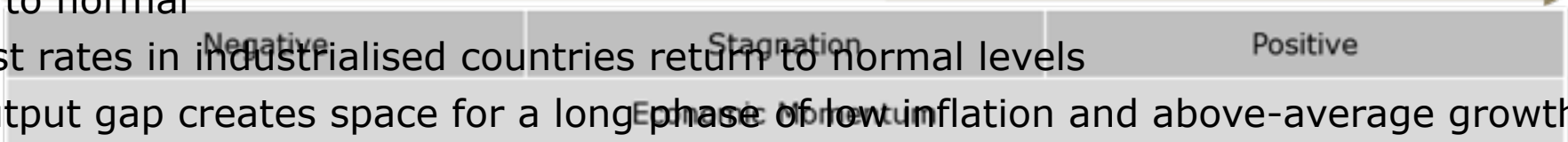


Adjustment



Monetary policy & interest rates

- Monetary policy gradually becomes less accommodative; central bank balance sheets slowly return to normal
- Interest rates in industrialised countries return to normal levels
- The output gap creates space for a long phase of low inflation and above-average growth



Golden East

Effects on asset classes

Equities

- High returns, especially in emerging markets and Europe

Bonds

- Weaker performance by AAA government bonds
- Bonds from peripheral countries and emerging markets perform well

Currencies

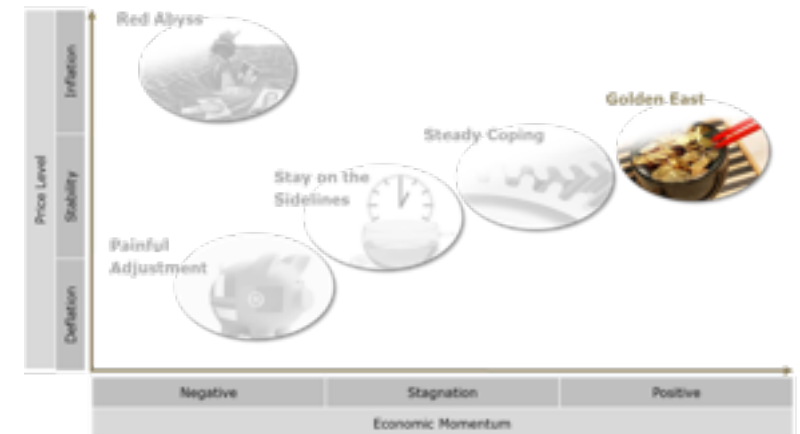
- Excellent environment for carry trades
- The weakest currencies are USD and JPY
- EUR stabilises while CHF remains relatively strong
- Emerging market and commodity currencies appreciate

Gold

- Loses its appeal do to higher interest rates and diminishing risk aversion

Real estate

- CH real estate bubble expands further
- Bursting depends on the rise in interest rates



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Economic growth in India

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Golden East

Economic growth in India

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Golden East

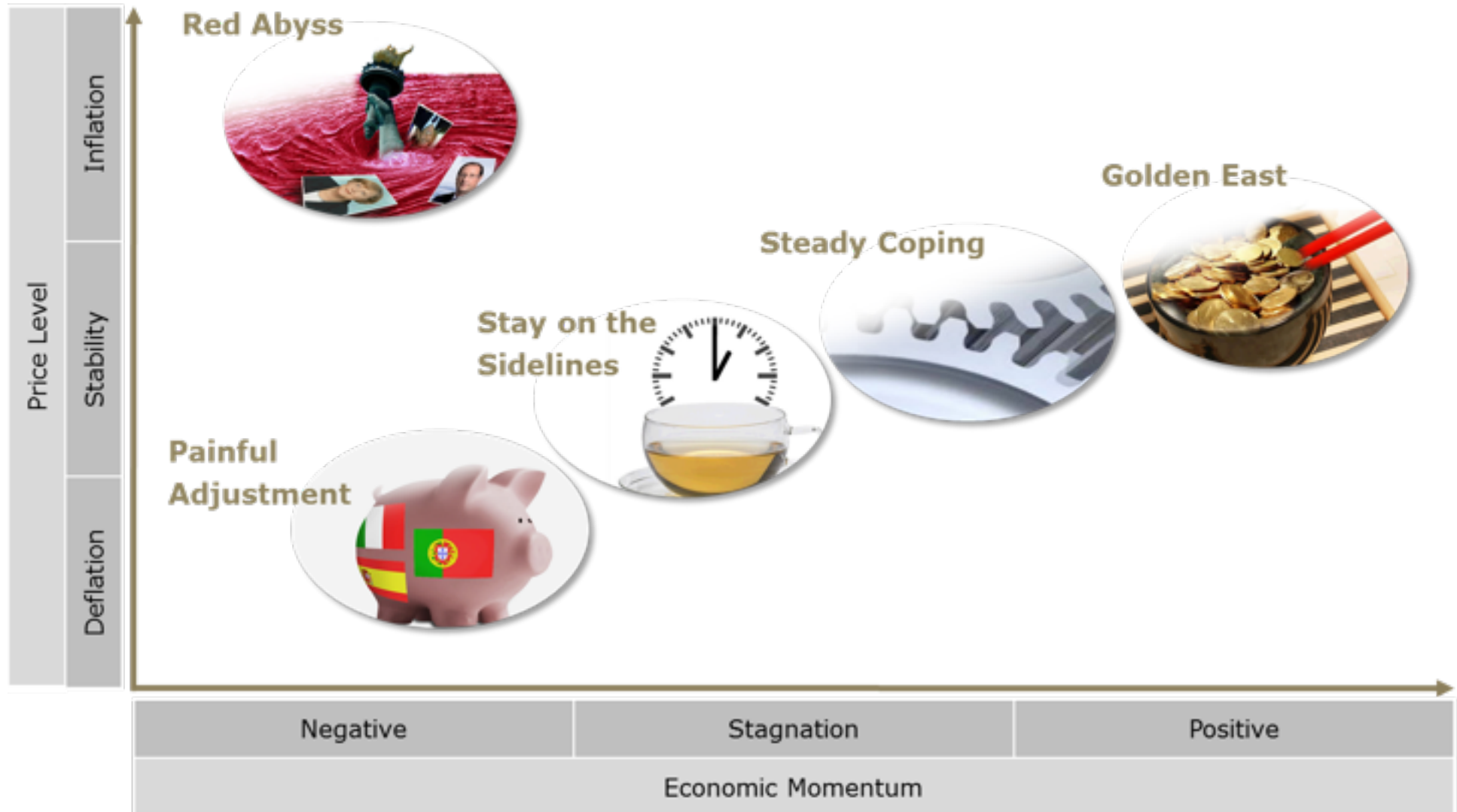
Economic growth in India



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Overview of scenarios



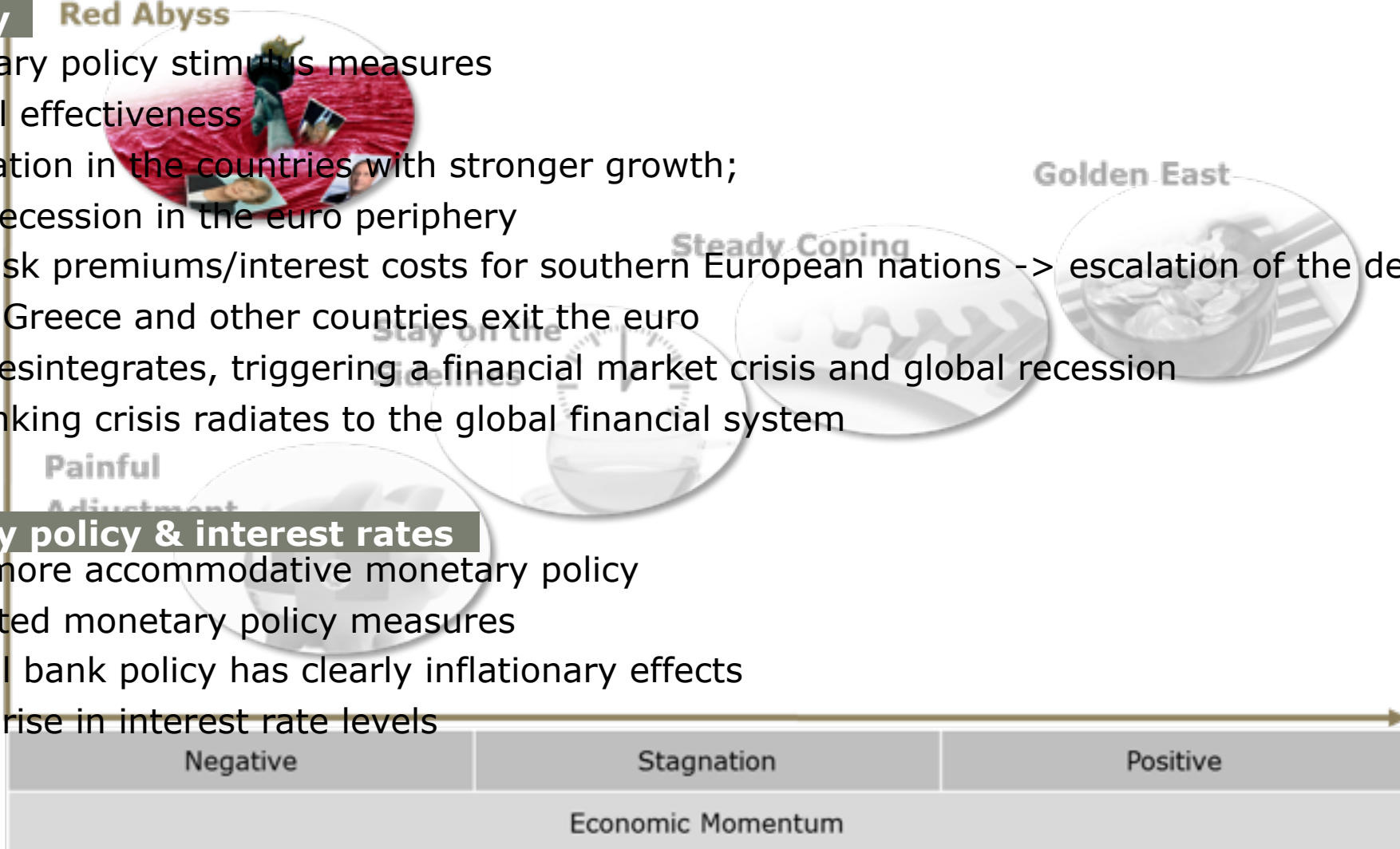
Impact on the economy and monetary policy

Economy **Red Abyss**

- Monetary policy stimulus measures lose all effectiveness
- Stagnation in the countries with stronger growth; deep recession in the euro periphery
- High risk premiums/interest costs for southern European nations -> escalation of the debt crisis; Greece and other countries exit the euro
- EMU desintegrates, triggering a financial market crisis and global recession
- EU banking crisis radiates to the global financial system

Monetary policy & interest rates

- Even more accommodative monetary policy
- Unlimited monetary policy measures
- Central bank policy has clearly inflationary effects
- Sharp rise in interest rate levels



Red Abyss

Effects on asset classes

Equities

-First a sharp drop in prices, then recovery?

Bonds

-Rise in interest rates provokes massive price losses

Currencies

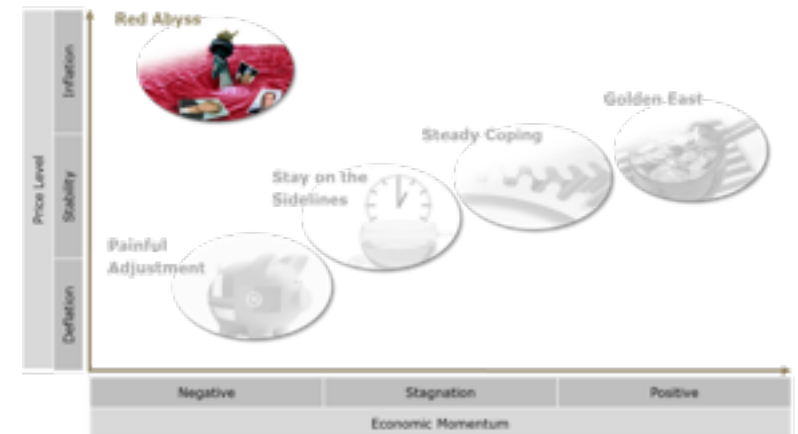
-Flight to USD; CHF and JPY remain stable
-EUR and alternative currencies weaker
-Emerging market currencies depreciate

Gold

-Sustained demand for gold as a hedge against inflation

Real estate

-CH real estate bubble expands further, then bursts due to rising interest rate level
-Correction continues in euro periphery

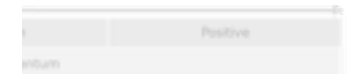


Red Abyss

Debt-to-GDP Ratio



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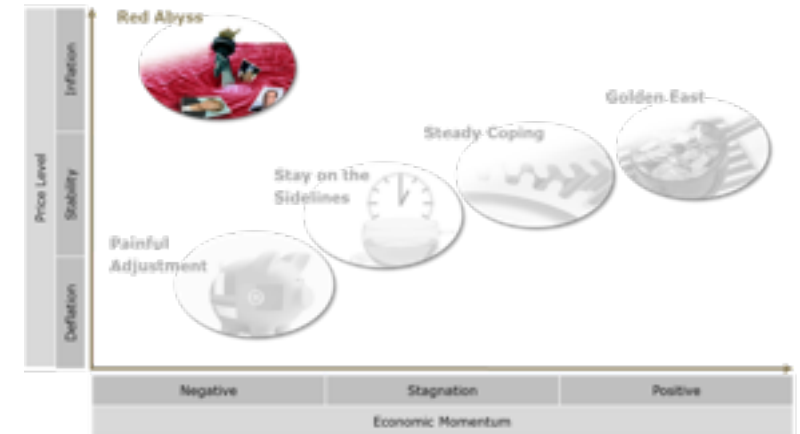
Maastricht rule:
Total debt not to
exceed 60% of
GDP

Red Abyss

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Ratings

Country	S&P-Rating
Luxembourg	AAA
Sweden	AAA
Denmark	AAA
Finland	AAA
Netherlands	AAA
Germany	AAA
UK	AAA
Austria	AA+
France	AA+
Belgium	AA
Estonia	AA-
Czech Republic	AA-
Slowenia	A+
Slowakia	A
Poland	A-
Malta	A-



Country	S&P-Rating
Spain	BBB+
Ireland	BBB+
Italy	BBB+
Bulgaria	BBB
Lithuania	BBB
Latvia	BBB-
Cyprus	BB+
Hungary	BB+
Romania	BB+
Portugal	BB
Greece	CCC

Stable stagnation

Golden East



**rather
unlikely**

**Stay on the
Sidelines**



**very
likely**

Steady Coping



**rather
likely**

Red Abyss



**rather
unlikely**

Painful Adjustment



**very
likely**

Scenario probability for industrialised countries

- **Economic growth** remains muted in developed countries. Developing and emerging market countries make further gains in importance
- **Risks in the government and bank segments** persist
- Central bank **monetary policy** remains highly accommodative – interest rates remain low
- Rethinking of **currency diversification** – Swiss franc remains a "quasi euro"





Thank you for your attention



Adrian Künzi, 1973, Dr. oec. HSG, MPhil

Dr Adrian Künzi was appointed CEO of Notenstein Private Bank Ltd in January 2012. From 2007 to 2012 he was a Managing Partner with unlimited liability of Wegelin & Co. Private Bankers. He established the bank's presence in French-speaking Switzerland and built up the business with institutional clients and family offices. Previously he was Head of the Investment Office at Wegelin & Co. From 2001 to 2003 he was with Goldman Sachs (Frankfurt) in investment banking. Adrian Künzi earned a doctorate in Finance at the University of St. Gallen and also holds a master's degree in Economics from the University of Cambridge (UK).