

# The & Letter

Funds & Strategy

Number **100**  
January 2011

## SUMMARY

<b>Editorial</b> .....	1
<b>Web site</b> .....	2
<b>Economic environment</b> .....	3
Global growth rebounds, but the horizon remains confused.	
<b>Core management</b> .....	4-6
Money-market management .....	4
ECB: back to basis!	
Fixed income management .....	5
More volatility to come.	
Equity management .....	6
The wind in their sails...but in troubled waters.	
<b>Diversified management</b> .....	7
Risk assets: the comeback	
<b>In the blink of an eye</b> .....	8

Completed in January 19<sup>th</sup> 2011

## EDITORIAL



Funds and Strategy newsletter celebrates its 100<sup>th</sup> issue!

For nearly nine years now, this newsletter has informed you every month about our outlook for the market, our new products and our fund performances, in the aim of guiding you, I hope, in choosing your investments. I am grateful for your loyalty.

At the beginning of this new year, I am pleased to announce that Antoine de Salins has been appointed Chief Investment Officer of Groupama Asset Management. In 2011, with the support of a robust group, and in a fast-changing environment, we aim to pursue growth, with emphasis on international growth, to improve our investment offering to better meet your needs, and to continue delivering high-quality performance over the long term.

Please accept my best wishes to you and your loved ones for this New Year 2011.

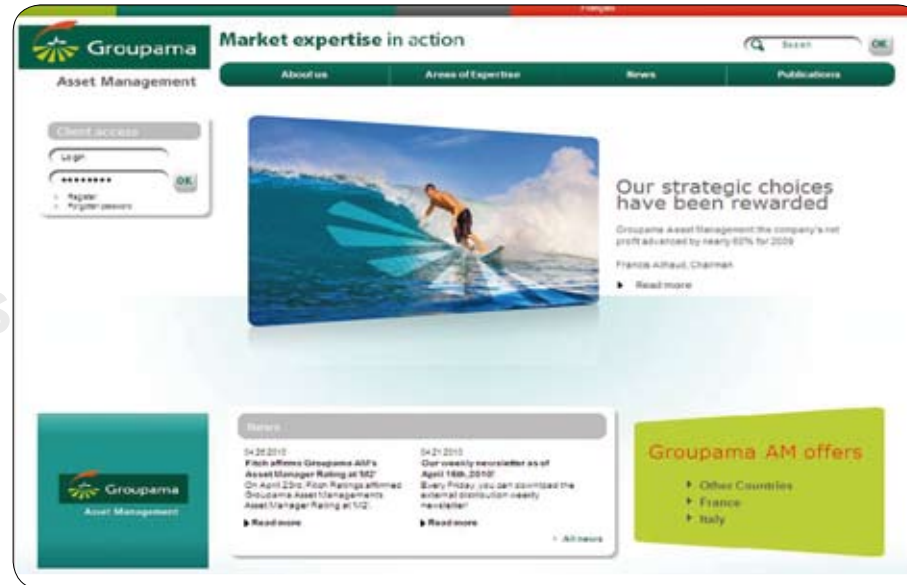
**Francis Ailhaud,**  
*Chief Executive Officer*  
*Groupama Asset Management*

## The Actively Responsible Asset Manager

**Groupama Asset Management - Communication department:**  
58 bis, rue La boétie - 75008 Paris - Tel.: +33 (1) 44 56 79 18 • Fax: +33 (1) 56 59 40 93  
www.groupama-am.fr • Numéro ISSN:1634-9032



**Asset Management**



Expertises  
Performance  
Economic analysis  
Anticipation

Funds  
Economic analysis  
Tendance  
Projection



Anticipation  
Funds  
Projection  
Tendance

Projection  
Tendance  
Economic analysis  
Anticipation

Find the full presentation of our products on our website [www.groupama-am.com](http://www.groupama-am.com).

View the entire range of our funds, their presentation, features, and of course performances.

You will also find all the news and our downloadable publications.



## United States

### LOWER INTEREST RATES BOOST CONSUMER SPENDING

Growing at a rate of 4%, unseen in nearly four years, consumer spending boosted economic activity in the fourth quarter. Spending was buoyed by the wave of mortgage refinancing brought on by the decline in long-term interest rates of the preceding two quarters. However, such a marked decline in the savings rate is temporary, as it is unwarranted by fundamentals: the level of household wealth justifies a savings rate of around 7%, households continue to reduce debt at a high rate of 2.4% of annual revenue, even as they see the jobs market continue to worsen. Consumer spending should thus return to a growth rate of 2%.

The rise in long-term interest rates should also lead to further declines in housing sales and prices, as indicated by the reduced long-term outlook for property developers. Finally, the pace of restocking, which exceeded \$120 billion per year in the third quarter, is expected to return to its "normal" level of around \$50 billion. Impacted by the inventory cycle's reversal and the rise in the savings rate and in long-term interest rates, growth should weaken beyond Q1. The brighter side in terms of fundamentals is the gradual loosening of the credit market for SMEs, along with the return of non-residents to the U.S. corporate bond market: reduced funding constraints should eventually lead to improved job creation and investment by SMEs.

### United States: consumer goods are driving the new acceleration in economic activity



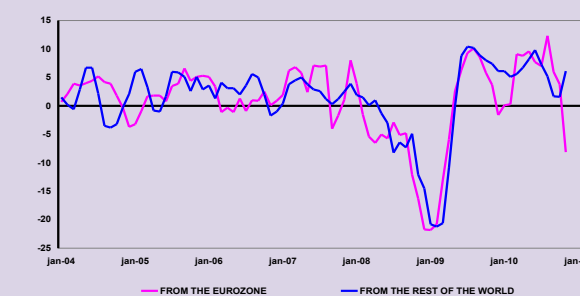
## Euro zone

### DESPITE GERMAN MOMENTUM, GROWTH REMAINS LACKLUSTRE

Growth was revised downward, from 0.3% to 0.2%, mainly due to consumer spending which in the end increased by a meagre 0.1% (instead of the 0.3% previously estimated), and in spite of rises of 0.4% and 0.5% in Germany and France, respectively. In the fourth quarter, domestic demand continued to be penalised by the peripheral countries, now in recession. German consumption shows no clear signs of recovery, suffering from low gains in purchasing power and continued debt reduction by consumers. France is one of the few countries where consumption has been strong, particularly due to the scheduled end of the car-scrapping bonus. Growth is expected to remain lacklustre, especially in the fourth quarter, as German foreign trade has slowed due the decline in demand from Europe's peripheral countries.

In the first quarter, European growth should benefit from the rebound in global growth, as evidenced by the strength of business indicators in the industrial sector. Beyond that, the outlook is clouded by austerity plans and higher long-term interest rates. The latter will have a significant impact on real estate, particularly in France, and Italy, where growth excluding inventory accumulation was already negative in the third quarter. Italian domestic demand is reversing, as shown by the sharp decline in business indices in services and construction, while the unemployment rate is rising.

### Germany: new manufacturing orders suffer from the recession in the peripheral countries (new export orders, qtrly chg, %)



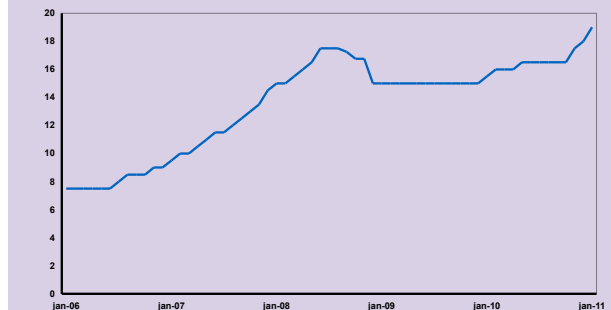
## China

### CALIBRATED MONETARY TIGHTENING TO TAME INFLATION AND CALM THE HOUSING BUBBLE

Activity remained strong in the short term due to restocking, but is expected to slow after the first quarter under the impact of tighter monetary policy with a twofold objective:

Firstly, even if an inflationary spiral is not in progress, the central bank will seek to curb inflation which is putting a brake on consumer spending, as households worry about soaring food prices. China could thus accept a higher appreciation of the yuan than the expected 5%. Secondly, the Bank of China wants to slow the flow of credit in order to calm the property market: a bursting housing bubble could have serious repercussions on the banking system. To dampen overheating in real estate, the government will also build 10 million public housing units. The continued rise in the required reserve ratio and prime interest rates, which were raised respectively by 350 and nearly 100 basis points in one year, will nevertheless be partly offset by the widening budget deficit: in 2010, the central government's fiscal deficit increased by one percentage point of GDP under the impact of higher social spending (education, health, transfers), which lowered rates of household saving as well as outlooks for consumption.

### China: sharp increase in required reserve ratios (%)



# CORE MANAGEMENT



## Money Market Management

### CENTRAL BANKS

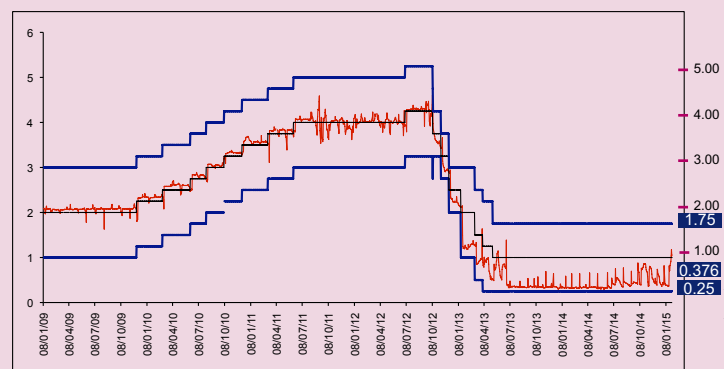
■ **The monetary policies of the central banks are firmly in place for a few more months.** Nevertheless, opposing issues are beginning to crop up. Given the recent surge in inflation (HICP at 2.2%), the ECB is beginning to distinguish between unconventional measures and monetary policy measures under its primary mandate, which is to deliver price stability over the medium term. In this context, the ECB is expected to adopt a new stance of combating any inflationary pressure, whilst pursuing its unconventional measures to inject liquidity into the markets. One question will concern its policy on buying up debt, in light of the success of recent auctions and future bond issues by the European rescue fund. Either it continues its tight-fisted purchases of debt at the same time as it issues bonds under the EFSF (at the risk of unnecessarily weighing down its balance sheet), or, in accordance with European authorities, it launches a real debt repurchase programme.

The Bank of England is in a slightly different position insofar as the risk of inflation is already quite real and further quantitative easing would risk driving inflation higher.

In the U.S., the QE policy will evolve according to economic statistics. We do not anticipate any change in 3- or 12-month rates.

P-H.B

Corridor, refinancing rate & EONIA  
EONIA average capitalised over 2010: 0.43%



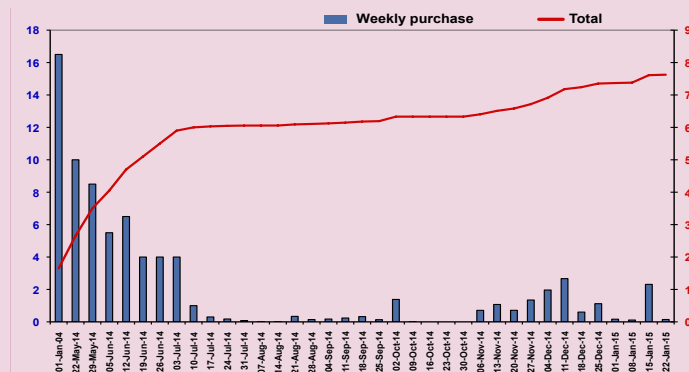
Source: Bloomberg

### A WORD ABOUT THE INVESTMENT STRATEGY

■ **Hopes of a normalisation of money market rates last summer led to a temporary rise in the EONIA,** which was quickly forgotten due to a persistent excess of liquidity. The spread of the European peripheral countries' crisis pushed expectations back during the third quarter. In order to respond to market movements, we modified the fixed rate and floating rate allocation in our portfolios. We are maintaining a 50/50 split which we feel is optimal. During the year, market expectations could change much more quickly than monetary policy itself, leading to high volatility in money market rates.

D.B

History of peripheral debt purchases by the ECB



Source: Groupama AM - Bloomberg

- 1- Philippe-Henri Burlisson**  
Core Management CIO
- 2- Diana Breton**  
Head of Money Market Management
- 3- Gaëlle Malléjac**  
Head of Fixed Income Management
- 4- Claire Chaves d'Oliveira**  
Head of Equity Management
- 5- Claire Bourgeois**  
Head of Equity and Fixed Income ALM

## Fixed Income Management

### LONG RATES

■ **Pressure on bond yields persisted in the U.S. at the year's end**, fuelled by surprisingly robust economic figures and the shunning of treasuries auctions by investors. The U.S. 10-year rate reached 3.48% during the final days of the year and since then has fluctuated between 3.30% and 3.5%. The speeding up of U.S. economic activity is expected to continue beyond end-2010 and to extend throughout the first quarter, sustaining a slight increase in U.S. yields as compared to current levels. For this reason we are revising our 3-month target upward, to 3.5%, for the U.S. 10-year rate.

■ **In the Eurozone, the sovereign debt crisis persists**, movements in risk premiums remain significant--most notably the risks weighing on sovereign debt refinancing, and numerous bond issues are expected as the year gets underway. Uncertainties about refinancing will continue to fuel volatility in the coming weeks. Rates in the Eurozone's "core" countries will be pulled between expected improvements in economic figures (mainly in France and Germany) and uncertainties over the sovereign debt crisis.

Interest rates in the core countries are thus expected to move within their recent range in the coming months. We are maintaining our 3-month target for the 10-year French rate at 3.30%.

### CREDIT

■ **The credit market ended the year on a slightly positive note overall**. Nevertheless, December witnessed a decorrelation between bank debt and corporate debt. The volatility and underperformance of the financial sector was largely led by regulatory uncertainties over the handling of bank failures (EU Commission directive) and the persistence of the sovereign debt crisis. These uncertainties primarily concerned senior and LT2 debt and have impacted their risk premiums in recent weeks. The lowest-ranking debt (Tier 1) was less impacted, as the market appeared to have greater visibility on its associated risks.

The divergence in the comportment of bank debt and corporate debt is thus expected to continue. The search for returns, always present in a very volatile climate for many asset classes, will favour corporate debt (whose fundamentals are improving).

### INFLATION INDEXED

■ **Inflation-indexed assets benefited from an environment of rising nominal rates** to post a significant outperformance for the month of December. They held up well against rising rates, supported by higher inflation figures in the Eurozone and fading fears of deflation in the U.S. The trend should continue in the short term with the expected impact of rising energy and food prices on inflation figures.

### A WORD ABOUT THE INVESTMENT STRATEGY

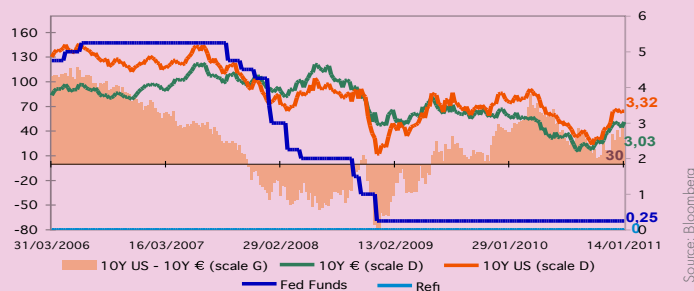
■ **Our bond portfolios have a slightly underweight duration exposure**, mainly notable on the shortest segments. In the current environment in the Eurozone our country positioning is still dominated by the states in the region that are still AAA-rated.

For credit market we remain cautious with exposures ranging from neutral to slightly underweight duration. We also still favour corporate debt from core countries with a BBB rating. In bank debt, regulatory uncertainty and possible new stress tests should continue to fuel volatility. Selectivity is the watchword.

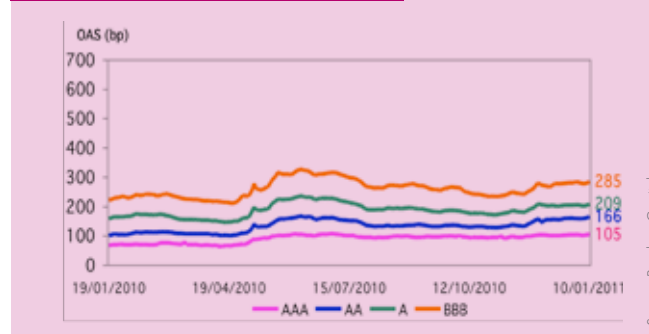
The inflation-indexed asset class should benefit from a more buoyant environment in the coming weeks, so we are slightly increasing the indexed assets allocation in our aggregate portfolios.

G.M

Change in the short and long rates in the United States and the Eurozone



Change in risk premiums by rating



## Equity Management

### EARNINGS FORECASTS AND VALUATIONS

#### Earnings: double-digit growth expected in 2011

- The consensus continues to upgrade earnings forecasts for 2010 across all regions except the Eurozone, where guidance continues to be lowered. The pace of earnings growth is expected to slow significantly in 2011.
- We are raising our 2011 growth expectations for the U.K., which should benefit from the boom in commodities.

#### Valuations are still attractive:

- Rising interest rates and markets are driving a rebound in valuations, while at the same time earnings expectations are stabilising in anticipation of the first announcements.
- The U.S. and Europe are still lagging behind the historic valuation levels of 2003-2007, however.

### OTHER FACTORS

#### Small Caps: As attractive as ever!

- The current M&A cycle is focused mainly on this asset class.
- More robust growth.
- A major source of discounted equities.

#### flow funds:

- Cash continues to flow into European equity funds, mainly German and British.
- M&A activity slowed at the end of 2010, but 2011 has already seen two takeover bids: DuPont's for Danisco and Johnson & Johnson's for Smith & Nephew.
- Between capital increases and IPOs, emerging markets took in nearly one-half of all capital raised worldwide in 2010, against just one-quarter in 2009.

#### Chart analysis: the positive trend is unbroken

- Divergence indicators point to a risk of correction in the coming weeks. However, the positive trend in the medium term is unbroken and should continue in 2011, at least until the second quarter.

### MARKET OUTLOOK

#### The wind in their sails... but the waters are troubled

- Once again, the equity markets are torn between competing forces: on the one hand, still-strong fundamentals, especially at the microeconomic level (attractive valuations, solid earnings, financial flows favouring equities, growing appetite of predators and rebounding M&A activity), and on the other, still-heavy uncertainty over sovereign debt in the Eurozone's peripheral countries.

- These factors are putting equity markets into an extremely unstable equilibrium, whereby the slightest positive or negative element could provoke violent swings, especially given the very low volumes of the recent weeks' rally, which makes it a weak one. Our indicators of risk appetite, however, have not crossed into extreme territory.
- Our outlook at both 3 and 12 months remains modestly positive, but this obscures the anticipation of heavy market volatility with repeated storm warnings coinciding with episodes of pressure on the bond markets. Over the long term, we are maintaining a preference for emerging and U.S. markets.

### A WORD ABOUT THE INVESTMENT STRATEGY

■ We are maintaining the high-growth theme of global consumption in our portfolios, but are taking profits in the automobile and food processing sectors. After a long period of underperformance, we are gradually coming back to energy sector. In respect of financial sector, our neutrality on banks allows us to absorb both positive and negative swings, but we are increasing our weightings in insurance and diversified financials.

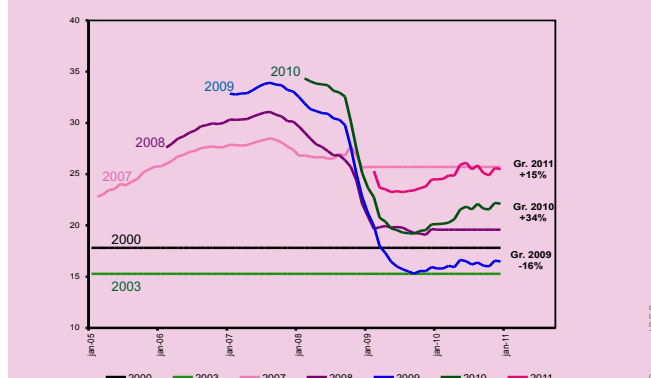
C.CO

### Performance of the main indices since the start of the year

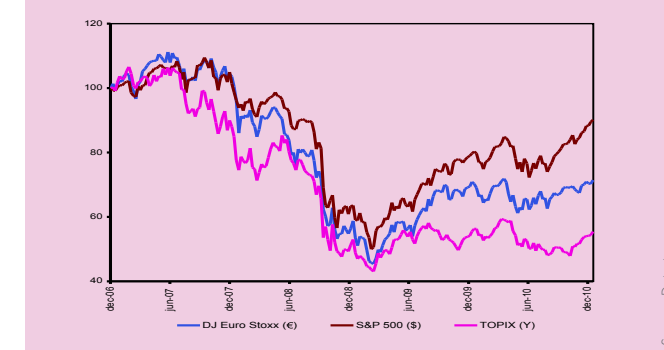
	14/01/11	Var. 2011 in euros
DJ Euro Stoxx 50	2920	4,6 %
SBF 250	2920	4,3 %
CAC 40	3983	4,7 %
FTSE 100 (UK)	6002	3,6 %
S&P 500	1293	3,2 %
Nasdaq	2755	4,3 %
Topix (Japon)	930	1,8 %

Source: Datastream

### Profits forecast by the consensus on Euro Stoxx



### Performances of international stock market indices in local currency



Source: Datastream

# GLOBAL BALANCED PORTFOLIO MANAGEMENT

Jean-Louis Autant,  
Head of Global Balanced Management



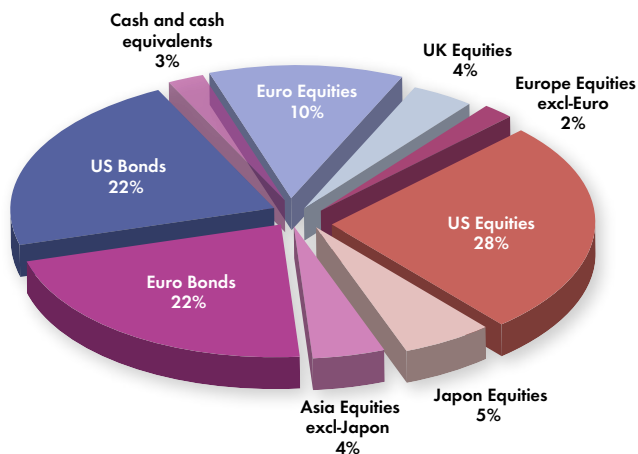
## Trend

Only yesterday investors seemed on the verge of a nervous breakdown: the eternal "evil speculators" were supposedly ready to blow up the Eurozone after inflicting the worst kind of torment on the so-called "Club Med" countries (to avoid overly-disparaging pig metaphors). One bond auction later—the altogether modest one of Portugal—and euphoria seems to have (definitively?) overtaken depression: Christian Noyer was all but accused of being a "Cassandra" for a speech, notable for its realism, in which he underlined an "environment characterised by great uncertainties" and the fact that «the crisis primarily reflects uncertainty and potential instability on a global scale". When at the same time Jean-Claude Trichet is pushing to increase the size of the European rescue fund and for a reform that would make the fund more flexible, it makes sense that caution should prevail. And if to European sovereign risk one adds the tense situations in many emerging economies confronted with currency and/or inflation problems, legitimate concerns should predominate.

Yet market participants now have a rosy view of 2011, convinced that once the Eurozone rescue is complete, ever-accommodative global monetary policy and the sweeping new U.S. tax package will be enough to maintain robust global growth.

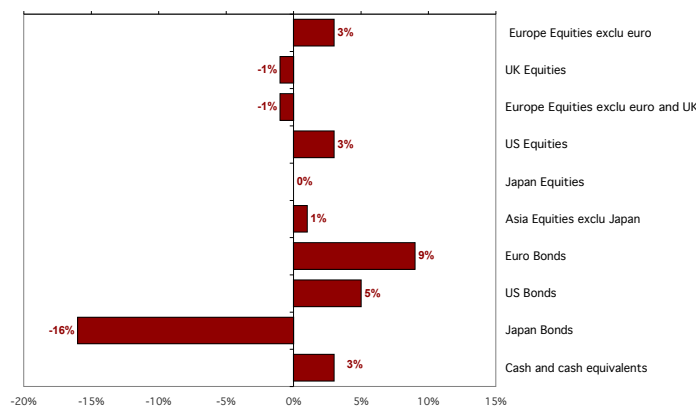
In this climate, investors continue to prefer risk assets, consistent with their allocation strategy established in late 2010; the only change is an abrupt sector rotation in favour those despised last year (utilities, financials, etc.). The consensus has rarely been so unified, and while we acknowledge that, we are still far from complacency.

## Model portfolio



## % difference

### BETWEEN BENCHMARK AND MODEL PORTFOLIO



Portfolio closed on 13/01/2011. Benchmark composed of 50% JPM global hedged + 50% MSCI world. Source: Groupama AM

## Allocation

### GLOBAL ALLOCATION

**Equities 53% / Fixed Income 44% / Cash 3%:** We continue to gradually take profits, slicing nearly two points off the equities allocation (taking into account the slide due to the portfolio's distortion from the market effect). At the same time, we are re-weighting the portfolio with fixed-income products, thus slightly reducing this underweight.

### EQUITY MARKETS (53%) -1

■ **USA (+1):** We continue to gradually re-weight U.S. equities in the portfolio: they seem the logical main beneficiaries of further fiscal stimulus and the substantial second round of quantitative easing. On the microeconomics side, earnings should meet expectations if we extrapolate from the first announcements.

■ **Europe (=):** We are maintaining our current allocation: though visibility is lacking on the central issue of sovereign debt, the proactive policy pursued by monetary and political authorities has succeeded for now in calming nerves (and speculation); reasonable valuation offers another reason for optimism.

■ **Asia (-2):** We are reducing our overexposure to the region: Japan has been pared back to neutral weight due to fears about the pace of its GDP growth. Excluding Japan, monetary tightening seems inevitable and destined to spread; we are therefore reducing our overexposure.

### BOND MARKETS (44%)+1

■ **USA (=):** U.S. bonds steadied to finish 2010 well ahead of their European counterparts: inflation is low, QE2 is still providing support, and interest rates will remain near zero; we are maintaining our allocation.

■ **Europe (+1):** Government debt seriously underperformed late in the year, a victim of speculation over the Eurozone's future and the return of investor appetite for risk assets. We are taking this opportunity to reinforce the allocation.

■ **Japan (=):** Absolute returns are still insufficient.

### MONEY MARKET (3%) =

The allocation remains unchanged.

# IN THE BLINK OF AN EYE

## Our strategy

		Current level 07/01/11	Short-term objective	1 year objective
United States	Fed Funds	0,25	😊	😊
	10 yr T - bill	3,32	😞	😊
Eurozone	Refi rate	1,00	😊	😊
	10 yr OAT	3,35	😊	😞
Japan	BOJ rate	0,10	😊	😊
	10 yr JGB	1,20	😊	😞

Sources : Groupama AM, Bloomberg

## Our model portfolio in € 07/01/11

BENCHMARK	EURO MTS GLOBAL
Sensitivity	😞
Inflation indexed allocation	😊
Curve choice	
1 - 3 yr	😞
3 - 5 yr	😞
5 - 7 yr	😊
7 - 10 yr	😊
10 - 15 yr	😞
15 yr +	😞

Sources : Groupama AM, Bloomberg

## Conclusions of the equity markets committee 07/01/11

Indices 07/01/2011	Forecasts Groupama Asset Management	
	short term (< 3 months)	a 1 yr
France (CAC 40)	3 866	😊
Euroland (DJ)	276	😊
United-Kingdom (FTSE 100)	5 984	😊
United-States (S&P 500)	1 272	😊
Japan (Topix)	926	😊
MSCI Asia free ex-japan	566	😊

Sources : Groupama AM, Bloomberg

## Sector Outlook

Energy	😊	Consumer Products - Cosmetics	😊
Basic Materials	😊	Health Care Equipment	😊
Capital Goods	😊	Pharmacy & Biotech	😞
Industrial and Commercial Services	😊	Banks	😊
Transportation	😊	Diversified Financials	😊
Automobile	😊	Insurance	😊
Consumer Durables	😊	Real Estate	😊
Hospitality & Leisure	😊	Software & Computer Services	😊
Media	😊	Technological Equipment	😊
Non-Food Retail	😊	Semiconductors	😊
Food Retail	😊	Telecoms Operators	😊
Food Processing	😊	Utilities	😊

Sources : Groupama AM

## COMMERCIAL CONTACTS

Alberico Potenza / +39 06 80 66 02 61 / apotenza@groupama-am.it  
 Fabrizo Salvi / +39 06 80 80 361 / fsalvi@groupama-am.it  
 Delphine Foucher / +39 06 80 66 38 41 / dfoucher@groupama-am.it

😊😊 Positive   😊 Positive neutral   😐 Neutral   😞 Negative neutral   😞😞 Negative

📄 Summary

Groupama Asset Management  
The Letter Funds and Strategy - N°100

8



Groupama Asset Management SGR S.P.A - Via Savoia, 23 - 00198 ROMA - ITALIA