The Letter
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SUMMARY

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EDITORIAL

After the reprieve.

Faced with the reality of Greece's insolvency, the European Agreement reached on 21 July is a compromise between German public opinion, the rating agencies, Greece's private creditors and the ECB. It contains its share of potentially very stabilising advances (strengthening the role of the EFSF), as well as uncertainties over the terms of application (effective participation of the private sector) and ambiguities as to the size of the EFSF and the efficacy of its rapid intervention in a crisis. Optimists and pessimists alike will find something to bolster their views on the future and stability of the eurozone. The real judge will be the region's ability to resume a path to growth. But that's something that Brussels can't decree, even if decisions made there can help it along.

Antoine de Salins,
Chief Investment Officer
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The Actively Responsible Asset Manager

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Laurent Berrebi,
Chief Economist

United States

THE SLOWDOWN CONTINUES; A NEW RECESSION IS LESS UNLIKELY

The rebound of the ISM manufacturing index, by 1.8 points to 55.3, creates no illusions: The leading economic indicators haven't ended their slide and are expected to be driven lower by weakening world trade and domestic demand. Domestic shipments of capital goods confirm the marked slowdown in corporate capital expenditure. Moreover, due to the sharp downturn of durable goods purchases—particularly automobiles—household consumption has been contracting since March. In a context of continued household deleveraging, the nosedive in developers' confidence (despite lower mortgage rates), low job creation, flat wage income and the sharp rise in underemployment are all factors likely to lengthen the duration of the slowdown—which could even degenerate into recession. We are nevertheless maintaining a scenario of rekindled growth by the end of the summer, driven by higher consumption as household purchasing power gets an expected boost from falling energy inflation. We've lowered our growth forecast, from 2.5% to 2.2%.

Euro zone

CONSUMPTION FALLS

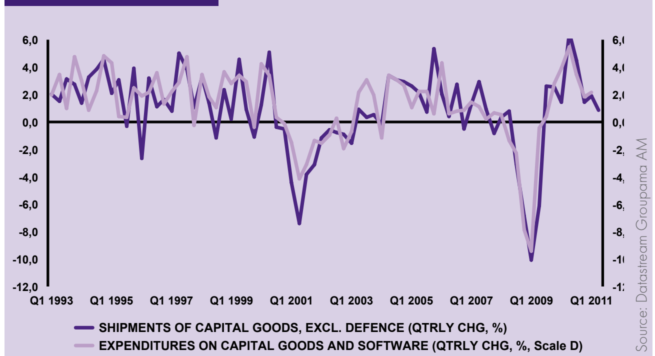
Leading indicators continue their sharp downturn in the industrial sector, which is being hurt by the global slowdown: The annual growth rate of new German export orders fell to 5%, its lowest level since late 2009. The PMI services index also strongly deteriorated, especially in France and Italy, pointing to a significant slowdown in domestic demand. Business expectations plunged to a two-year low, joining investor confidence, notably illustrated by the ZEW index. More importantly, after holding up well through the first quarter due to the sharp drop in the savings rate, household consumption is falling: Retail sales are plummeting everywhere. Given a too-low savings rate, changes in consumption will have to depend solely on the determinants of purchasing power, which are misdirected. Employment was steady in the first quarter and is expected to fall with the sharp slowdown in activity. Average wages posted a weak increase of 1.5% due to the high level of unemployment, which will persist. Only the drop in inflation projected from the end of Q3 will serve to revive purchasing power and consumption.

China

MONETARY POLICY CONTINUES TO TIGHTEN

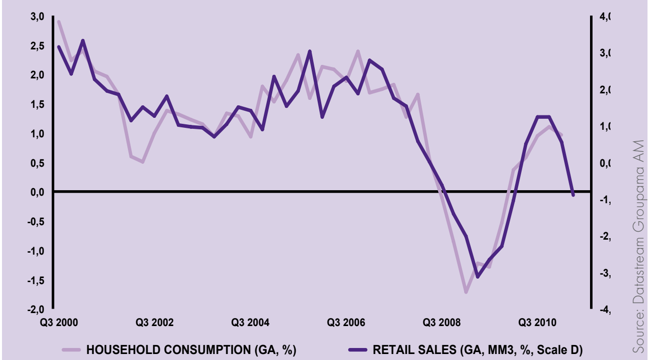
Growth weakened slightly in the second quarter, from an annual rate of 9.7% to 9.5%. In effect, while industry is impacted by the slowdown in exports and retail sales, which are being hurt by rising inflation and reduced support for the automobile industry, the services sector remains dynamic, and the construction sector is being buoyed by a large-scale programme of social housing construction carried out by local governments. Meanwhile, inflation continues to climb due to the sharp rise in housing costs, a reflection of the real estate bubble that the authorities are trying to combat. Monetary policy should thus continue to harden: The legal reserves ratio has been raised six times since the beginning of the year, to 21% for large banks, a historical high, and benchmark rates were again raised in early July, by 25 basis points. However, the credit difficulties of SMEs, the failure of several real estate developers and, more generally, the importance of the industrial slowdown presage a shift in the monetary policy from tight to neutral during the third quarter.

United States: corporate investment continues its sharp slowdown



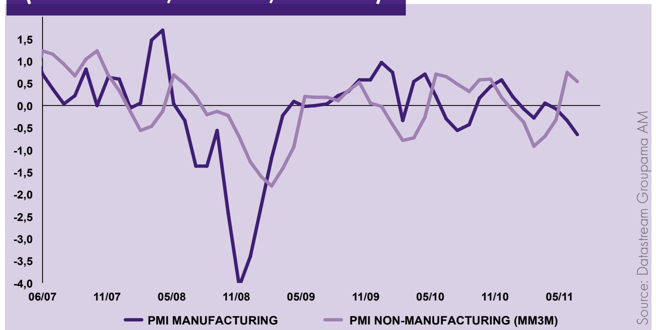
Source: Datastream Groupama AM

Euro Zone: consumption falls



Source: Datastream Groupama AM

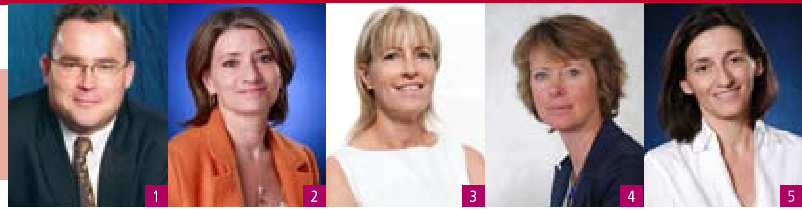
China : Activity slows sharply in the manufacturing sector but speeds up in the non-manufacturing sector (PMI indices, centred, normed)



Source: Datastream Groupama AM

Summary

CORE MANAGEMENT



Money Market Management

Stay the Course!
As sailors well know, when the wind blows and the seas are rough—as with today's extreme market conditions vis-à-vis the eurozone crisis—it is vital to remain vigilant and avoid getting carried away. One must stay the course and remain flexible in order to capture or counter short-term movements. We remain convinced that a political solution will be found, albeit one that is long and difficult. We will be watching the next round of results, but we continue to factor in the fundamental support provided by the good health of companies and the quality of their profits. In short, we are staying the course. We are maintaining our market targets, which, given the extreme movements on the markets, has led us to marginally raise our exposures.

P-H.B

CENTRAL BANKS

The summer will be a hot one!

As expected, the ECB raised its interest rate by 25 bps, to 1.50%.
In [President] Jean-Claude Trichet's message, the term "strong vigilance" was replaced by "closely monitoring", which means there should not be a rate increase in the next month.
The ECB again warned against a default by Greece—even a selective one. That possibility has provoked negative expectations on the other peripheral countries, in particular Italy, and Italian banks are under heavy attack. On the eve of the results of stress tests on European banks, this situation is raising the spectre of the liquidity crisis of 2007.
In the U.S., discussions on raising the debt ceiling are in full swing, and the possibility of a QE3 by the Fed is re-emerging.

A WORD ABOUT THE INVESTMENT STRATEGY

Management policy

The portfolios remained highly liquid in view of the quarter's end. We are maintaining a variable rate bias in anticipation of significant volatility in the Eonia and the money market in coming weeks.

Completed on July 18th 2011 D.B

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Head of Equity Management
5- Claire Bourgeois
Head of Equity & Fixed Income ALM

Corridor,refinancing Rate & EONIA
Average EONIA of 30/06/11 : 1,133 %

History of peripheral debt purchases by the ECB

Fixed Income Management

LONG RATES

■ After many twists and turns in Greece over the parliamentary vote on the new austerity plan, it was finally passed, allowing the fifth tranche of the initial bailout plan to be released. This offered a glimmer of hope to the market, reinforced by France's proposal on the private sector's involvement in outlining a new financing plan.

This new optimism lasted just a short time, however, crushed by the actions of the rating agencies. Standard & Poor's deemed the French proposal a 'selective default' on Greek debt and Moody's downgraded Portuguese and Irish debt to junk status.The contagion reached Italy and all debts saw their risk premiums widen against the German Bund.

The discordance that currently prevails in the eurozone amongst the political authorities is fuelling the extreme volatility that we have seen in recent days.

If reaching an agreement still seems hard to imagine—such is the level of disagreement between the states—the spreading of the crisis to Italy reinforces the need for a lasting solution for the markets. We remain convinced that a political solution will emerge in the coming weeks, calming the extreme risk present in the markets.

Fundamentals are deteriorating on both sides of the Atlantic; inflation figures remain high, and are not expected to slow until autumn. Current rate levels, however, seem to us to assume much more than a weakening of fundamentals, and have been driven by the flight to quality which has benefited German and American obligations.

We are maintaining our 3-month target at 3.3% for the U.S. 10-year rate, and at 3.5% for the 10-year French rate.

CREDIT

■ The climate of extreme risk aversion is driving risk premiums higher in a very illiquid market.

Widening spreads are mainly affecting BBB-rated debt, subordinated financial debt and utilities (highly correlated with sovereign risk).

After a small issuance window in early July, the primary market quickly closed due to the actions of rating agencies, and is expected to remain sluggish over the summer.

The recent widening of risk premiums makes valuations attractive on certain sectors and issuers, pending a favourable political solution in the coming weeks.

We will take advantage, with great discretion, of valuation levels that are considered attractive to begin adding some credit exposure (beta), especially to core countries.

INFLATION-INDEXED

■ Recent performances of inflation-indexed assets are highly disparate between the geographical regions. Outperformance is notable in the United Kingdom and the United States. In the eurozone, their performance is in line with that of nominal bonds. The summer's unfavourable carry trade and the risk aversion driving the markets are negative factors for euro-indexed assets, to which we prefer those that are U.S.-indexed.

A WORD ABOUT THE INVESTMENT STRATEGY

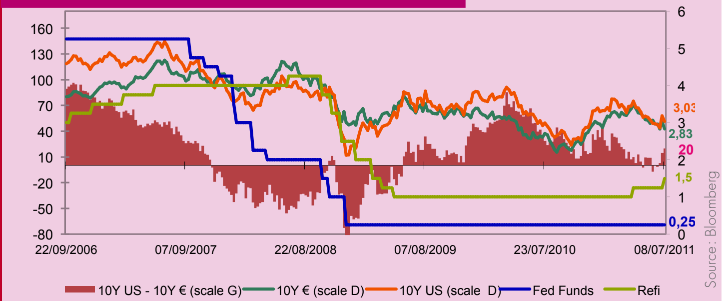
■ The uncertainty and volatility driving the markets in the very short term militates for maintaining a neutral stance on exposure to interest rates.

The flattening of the 2-10 year segment is still likely, given the level of the 2-year German rate below that of the Refi rate.

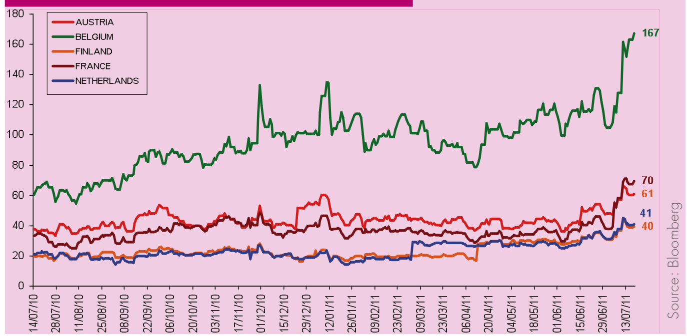
We are maintaining our bias for core countries, pending the announcement of a political resolution. Our country allocation continues to exclude the three countries which called for European assistance and maintains a neutral positioning on Italy and Spain. We are maintaining credit exposure at 100%, and asset allocation at 95%. In the medium term, we will increase the portfolios' beta in order to take advantage of valuation levels that are considered attractive.

Completed on July 18th 2011 G.M

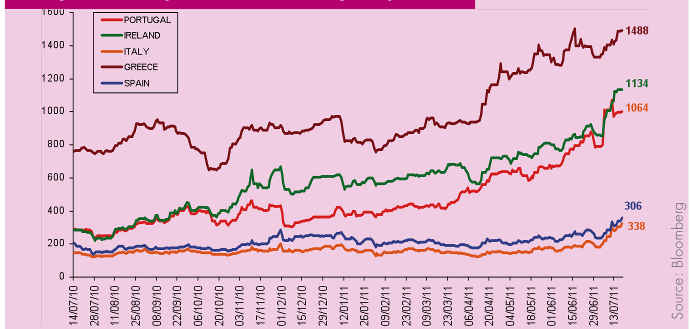
Change in the short and long rates in the United States and the Eurozone



10 year Core Sovereign Spreads



10 year Peripheral Sovereign Spreads



Equity Management

PROJECTED RESULTS AND VALUATIONS

■ **Profit warnings are multiplying** on the eve of earnings reports, particularly for firms exposed to consumption and construction, and those unable to quickly pass on higher costs to their customers.

■ The consensus has revised its 2011 profit estimates downward for all regions, even the U.S., which previously had seen only upward adjustments.

■ Earnings-revision momentum is now negative for the United States.

■ The recent trend in the equity markets is stabilising valuations at an intermediate level.

■ Europe is pulling away from the U.S. and offers more attractive valuations.

OTHER FACTORS

■ **Flows: Resumption of withdrawals from U.S. equity funds...**

• ... and modest subscriptions in Europe

• Reduced appetite for financial transactions: delays of some IPOs, slower M&A activity.

■ **Graphic analysis: European markets testing support levels.**

• The S&P 500 continues to trend within a broad corridor and remains blocked by the upper bound; the European indices are weaker, as illustrated by the CAC, which has breached short-term support levels.

• No weakening of medium-term configurations which, for now, remain positive and offer key support between 5% and 10% below current levels.

OUTLOOK

■ **Will corporate earnings measure up?**

• For almost two years, in a challenging macroeconomic climate, corporate earnings have provided continuously solid support to equity markets.

• However, for several months we've been underlining the excessive optimism of the consensus, with corporate margins at an all-time high and struggling to improve.

• We haven't altered our earnings growth expectations, which are still below those of the consensus. But we are keeping a close watch on second-quarter earnings reports, which could disappoint under the combined pressure of higher commodity costs and weak demand.

• On the macroeconomics side, the eurozone is experiencing a new peak in the crisis, as European authorities take more time than expected to put a lasting solution in place. This crisis is driving a fresh bout of undue risk aversion and rising volatility.

• Despite these concerns, and in light of the challenges, we believe that the crisis will ultimately be resolved, and have therefore not changed our level targets, which reflect positive expectations at 3 months, as well as at 12 months (Europe). However, these expectations are highly dependent on corporate earnings, and we would have to revise them in the event of significant disappointments in the coming days.

A WORD ABOUT THE INVESTMENT STRATEGY

■ **The sectoral strategy emphasises the protective pricing power of results.** As such, we are maintaining our exposure to the automobile sector and increasing that to consumer goods, with a focus in both cases on luxury shares. In respect of financial shares, we are closing our short bet on diversified financials, though we remain cautious on banks.

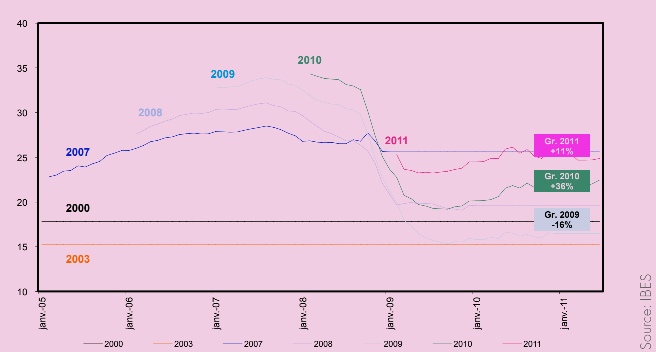
Completed on July 18th 2011 C.CO

Performance of the main indices since the start of the year

	13/07/11	Var. 2011 in euros
DJ Euro Stoxx 50	2715	-2,78 %
SBF 250	2815	0,52 %
CAC 40	3793	-0,30 %
FTSE 100 (UK)	5906	-2,58 %
S&P 500	1318	-0,74 %
Nasdaq	2797	-0,12 %
Topix (Japan)	861	-6,92 %

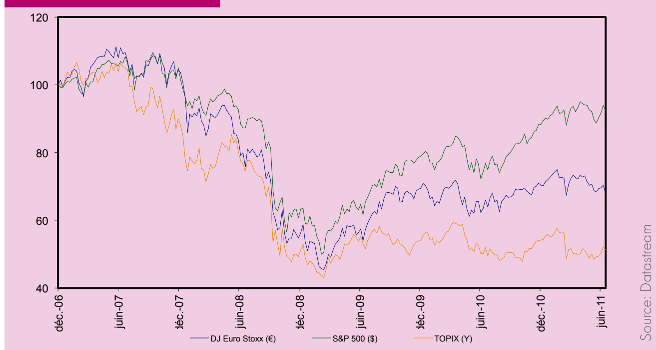
Source: Datastream

Profits forecast by the consensus on Euro Stoxx



Source: IBES

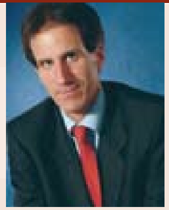
Performances of international stock market indices in local currency



Source: Datastream

GLOBAL BALANCED PORTFOLIO MANAGEMENT

Jean-Louis Autant,
Head of Global Balanced Management



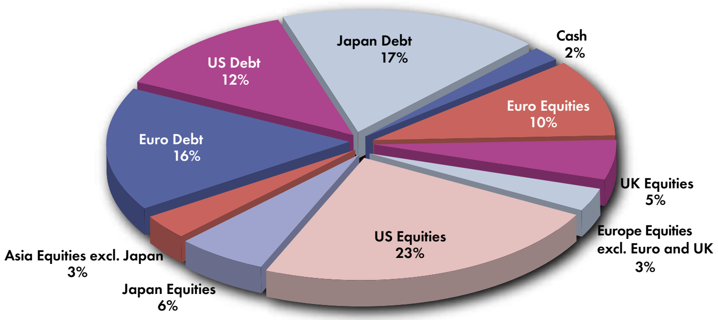
Trend

Anticipating a summer truce!
Of the usual seasonal entertainments offered to market participants, three activities have stolen the show: arm wrestling, pitting prominent personalities of the eurozone against those of the U.S.; dominoes, loved by Europeans; and Liar's Poker, preferred by Americans. But the game is now over in Europe, and the markets are finally breathing easier. Until the fateful date of 21 July, the dominoes wobbled ominously, of course, but the weakest of them was kept from falling, thus preserving the delicate balance. At present, it is hard to establish a precise summary: between public bailouts (new or left over from the previous overall rescue plan), the nature of the generous donors (EFSF, ESM, IMF…), the exchanges, rollovers and sundry buybacks of old debts, it is hard to sort it out, but an air of optimism is blowing nonetheless. Determining the winner of the arm-wrestling showdown is also a delicate issue . Is it Nicolas Sarkozy--never better, it is said, than in the throes of a crisis? Angela Merkel, satisfied at having widened the circle of voluntary donors? or Jean-Claud Trichet, so happy to be able to count on a new buyer of doubtful debt (the EFSF) that he can't for one minute imagine a single selective default decreed by rating agencies? In what may well be the summer's most popular series, the likelihood that the party will be spoiled by rating agencies seems significant, since their role in the parallel resolution of the U.S. crisis will be crucial as well.

In the U.S., the game of Liar's Poker between Republicans and Democrats over raising the debt ceiling will no doubt go on until the deadline on 2 August. But despite the pressures observed on U.S. credit default swaps (CDS), it is clear that the U.S. markets are maintaining a certain calm, backed up by quarterly earnings reports that are up, and even exceed expectations. But even if an agreement on the debt is reached, and ratified in extremis, the loss of the U.S.'s AAA rating appears increasingly likely since the agencies, in seeking to preserve some credibility, will have to demonstrate a certain fairness of treatment between the United States and an old Europe which has thus far been mistreated.

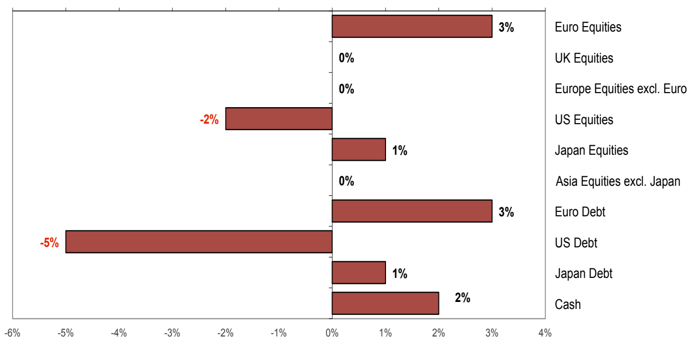
But for now, we can hope for a period of rest : will we finally see a summer truce?

Model portfolio



% difference

BETWEEN BENCHMARCK AND MODEL PORTFOLIO



Portfolio closed on 14/07/2011. Benchmark composed of 50% JPM global hedged + 50% MSCI world. Source: Groupama AM

Allocation

GLOBAL ALLOCATION

Equities 53% / Rates 45% / Cash 2%

We are taking advantage of the bear trend in the Euro equity markets to invest some of our cash holdings. This month we are overweighting equities, with a strong return to the eurozone. We are also increasing our underweight in bonds following the rally on German and U.S. interest rates.

EQUITY MARKETS (53%)

- **USA (=):** The U.S. stock market remains the most resilient year-to-date with a performance of nearly 10% for Dow Jones. The strong results of Q2 call for continued investment in this region.
- **Europe (+2.5):** Given the strong commitment of Member States to stem the risk of contagion in the eurozone, we believe that the macro risk premium is too high and that it is timely to overweight the region in the short term.
- **Asia (=/+ 2.5):** We remain neutral on Asia excluding Japan, preferring to reinvest in Japan which is benefitting from the revival of its economy—witness the rebound of industrial output in May. A reconstruction plan is in the works and a supplementary budget of €18 billion has already been passed, 40% of which has been allocated to rebuilding.

DEBT MARKETS (45%)

- **USA (=):** The U.S. interest rate markets are holding up remarkably well despite the recent end of QE2 and uncertainties related to the AAA rating of U.S. debt. The rate levels recently reached do not inspire us to return to this asset class and we remain underweight by 2 points.
- **Europe (-1):** The list of countries seeing an increase in their risk premium is growing, notably including Spain and Italy. Only the German Bund still retains its safe haven status. We continue to stay away from the peripheral countries.
- **Japan (-1):** We are taking profits following the downward movement of rates in Japan and remain underweight.

MONEY MARKETS (2%)

Overweighting equities led us to reduce our cash holdings to 2%.

IN THE BLINK OF AN EYE

Our strategy

		Current level 14/07/11	Short-term tarjet	1 year tarjet
United States	Fed Funds	0,25	😐	☹
	10 yr T - bill	2,84	☹	☹
Eurozone	Refi rate	1,50	😐	☹
	10 yr OAT	3,31	☹	☹
Japan	BOJ rate	0,10	😐	😐
	10 yr JGB	1,11	😐	☹

Sources : Groupama AM, Bloomberg

Our model portfolio in € 14/07/11

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 12/07/11

	Indices 12/07/2011	Forecasts Groupama Asset Management short term (<3 months)	a 1 yr
France (CAC 40)	3808	😐	☺☺
Euroland (DJ)	268	☺	☺☺
United-Kingdom (FTSE 100)	5929	😐	☺
United-States (S&P 500)	1319	😐	☺
Japan (Topix)	870	😐	☺
MSCI Asia free ex-japan	574	😐	☺☺

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

☺☺ Positive ☺ Positive neutral 😐 Neutral ☹ Negative neutral ☹☹ Negative

COMMERCIAL CONTACTS

Summary

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