

Dear Investor

A Publication by Solidinvest of Switzerland.

Economic trends, equity markets, and investment scenarios.

July 2010

Esteemed reader of Dear Investor:

It was 1985, 25 years ago, when I founded Solidinvest. In this specially designed issue that commemorates the occasion, please let me acquaint you with the thoughts of two authors with whom Solidinvest entertains close contacts:

- **Dr. Klaus W. Wellershoff**, the former UBS senior economist who is highly respected not only in Switzerland but also around the world, expresses his optimism as regards the future of Switzerland as a financial services center.
- **Dr. Burkhard P. Varnholt**, Chief Investment Officer at Bank Sarasin, introduces the “Kids of Africa” children’s village that he sin-

gle-handedly established at Lake Victoria in Uganda. The project is supported by Solidinvest.

Since the scope of our publication should not exceed the normal framework, I have taken the liberty to condense my assessment of the securities markets in this special edition.

Please let me thank you for your long-standing loyalty as a reader of our publication. As always, I welcome any suggestions you might have that can help improve it.

Dr. Robert Lebrecht

Chairman of the Board of Directors

THE SWISS FINANCIAL CENTER: AN OPTIMISTIC PERSPECTIVE

Dr. Klaus W. Wellershoff, CEO/Partner of Wellershoff & Partners Ltd, Zürich

Switzerland is the global market leader in private asset management services. This was true long before Solidinvest was founded 25 years ago and this status is not likely to change despite competition from the Far East and the Gulf region. More than anywhere else, the challenges of the 2008/2009 financial crisis triggered a self-critical and pragmatic process of renewal in Switzerland.

Switzerland's successful asset management model is simple but difficult to copy. Its strong points are professional client support provided by banks and asset managers as well as the country's political stability. But the significance of Switzerland as a hub of private banking is also being leveraged by the Swiss franc, meanwhile nearly fully gold-backed again, and by declining public-sector debt.

In the coming years, private asset managers face three critical challenges: enormous government debt, rising interest rates, and a paradigm change

in the way society rates the significance of privacy.

Let us first look at government debt, a topic that started to dominate global headlines when the Greek crisis erupted in April 2010. On average in the OECD community of nations, the ratio of government debt to national income was 97 percent in 2010, nearly 30 percentage points higher than ten years ago. Because of exorbitant deficits, this quota will continue to worsen. Unless the major industrialized nations want to share this fate with Greece, they will have to massively reduce their deficits. Otherwise, government debt will become a never-ending issue. This means that taxes will have to rise in the coming years. **The ability to tax-efficiently invest declared assets will become a key competitive advantage.** Switzerland's long-standing tradition in cross-border asset management will inspire the Swiss financial center to devote its attention to this topic and develop benchmark solutions.

Furthermore, it is reasonable to expect that interest rates will rise again in the coming years, regardless whether this is a consequence of heavy government debt or extremely expansive monetary policy. For asset managers, stagnating interest rates have

the same serious consequences as rising rates. Both scenarios shift the emphasis toward asset preservation in bonds, equities, and real estate. In asset management, this will result in a separation of the wheat from the chaff. **As long as the markets trend firmly, it is easy to manage assets. It becomes difficult in volatile markets, as we have seen since the beginning of the new millennium.** In this context, Switzerland's traditional form of asset management, which has always focused on the preservation of wealth, should be ideally positioned to distinguish itself.

Switzerland is also relatively well positioned as regards the globally changed attitude toward privacy. In the past years, the borderline between the public and private domains has shifted dramatically. Be it Facebook or Twitter, the routine reports by German banks to the internal revenue services, automatic data exchange, or security cameras in public spaces: no one seems to be bothered by this massive intrusion of the state in private affairs. The contrary is true: people who don't get at least 20,000 hits when they google their names are nobodies in our media society.

Needless to say, there are trends in Switzerland

that point in the same direction as well. But for many Swiss citizens, the protection of the individual against government surveillance appears to be a prized value: which other country in the world would seriously consider amending its constitution to cover banking secrecy? The issue is not an amendment that would protect foreign tax evaders as is often erroneously portrayed abroad – it is delineation of private and public interests. Safeguarding the private sphere in the era of the Internet is a precious entitlement in a free society. It would be fatal if Switzerland were to lose its moral compass in this respect. Observers who understand the political concept of direct democracy as practiced in Switzerland know that the electorate – the country's voters – would never tolerate any restrictions of the citizen's right to privacy.

No matter how we look at it: the financial crisis has clearly enhanced the attractiveness of Switzerland as a financial center. This also applies particularly to its political stability. In a world of low growth rates, high government debt, and increasing fiscal protectionism, further international conflicts are inevitable. It doesn't take a lot of imagination to envision that bank disclosures to fiscal authorities and mandatory approval processes might ultimately

be turned into rigid protectionist measures. Against this backdrop, there will likely be a renaissance of Switzerland's neutrality as a financial center in the perception of international investors.

The conclusion derived from these considerations for asset management in Switzerland is unequivocal: the demand for management services will remain high and probably even continue to grow.

This should also sustain competitiveness in the market, especially for declared assets. Thus, in addition to leveraging tradition and experience, asset managers will be called upon to continually optimize their deliverables. These are excellent perspectives for clients.

For asset managers, this doesn't make doing business easier, because innovative and tax-efficient services impose stricter requirements on transparency. The expected increase in regulatory density will trigger a consolidation among smaller and very small providers. Only few large asset management banks will benefit from this development because in the past, they failed to prove that size is a pivotal advantage in servicing private clients.

Switzerland will have to contend with the fact that

slower growth of wealth and margin pressure will narrow the contribution of financial services to its gross domestic product. At the same time, it is fair to assume that the economically significant industry will continue to experience brisk demand. In addition to political stability, the large community of medium-sized, highly professional asset managers is one of the main competitive advantages at the international level. Moreover, Switzerland has not lost its faculty for pragmatic self-criticism, so the basic prerequisites for preserving its good competitive position are intact. **As long as the country's liberal values are preserved as well, Switzerland stands a good chance of remaining the market leader in private asset management during the coming decades.**

STATUS QUO IN THE SECURITIES MARKETS

Dr. Robert Lebrecht, Chairman of the Board of Directors, Solidinvest AG

In mid-2010, the markets sent out signals of such disparity that it is difficult to plausibly outline which course the journey might take in the coming months.

A review of the first half of 2010 shows that first of all, the equity markets were exceptionally volatile, and second, that the changes of direction took place abruptly and were hardly predictable. When the bourses started to pick up momentum in April, the Greek crisis escalated. Although it was never a secret, the exorbitant government debt accumulated by many countries in southern Europe suddenly turned the markets sour. It was only when the European Union (EU) joined forces with the International Monetary Fund (IMF) to craft a rescue package worth over 750 billion euro that the equity markets bottomed out. Starting in mid-May, they nearly rebounded to pre-crisis levels. But then in June, the trend suddenly reversed because of fears that the economic recovery might not be sustainable. **Which economic facts are relevant today when the issue is to define, with a reasonable degree of confidence, the direction in which investors should steer in the near future?**

ECONOMIC BASELINE CONDITIONS

**ECONOMIC TREND / INFLATION / DEFLATION
/ INTEREST RATES / CURRENCIES**

In the wake of the economic crisis that erupted in 2007, the most vigorous rebound of the past 30

years got underway starting in March 2009. This positive trend began to stutter in the second quarter of 2010, and on that note, fears of a renewed recession (double dip) quickly emerged. What's behind all this?

Indeed, troublesome factors have been identified that are jeopardizing the continuation of the upswing. For instance, a whole bouquet of weak metrics from the USA has been worrying investors, including the perceptible decline in consumer sentiment, the faltering recovery of the labor market, and the slump of the ISM's manufacturing report, a key leading indicator. **In America, the leading indicators suggest a weaker economic pace but not a relapse into a recession.**

The concerns about the economic slump are also being fueled by the debt crisis in Europe. The pressure exerted on governments to rehabilitate their households is considerable, even in countries like Germany or France. The markets are still skeptical as to whether or not the EU/IMF aid package will prevent the bankruptcy of certain euro countries. In this context, it must be emphasized that the goal of the rescue program was not just to avert the downfall of Greece and of the European currency union. Yet

again, it was to protect the banks and insurance companies against the consequences of their risk-fraught deals.

Although the weakness of the euro in connection with the European debt crisis occurred somewhat unexpectedly, it not only helps Germany as the world's export champion but also benefits all other EU countries in the eurozone as an economic stimulant.

In the first quarter of 2010, the Chinese economy grew by 11.9%. This prompted the authorities to take preventive measures against overheating. The country's currency was flexibilized and interest rates tightened, resulting in the intended slowdown of runaway growth that cannot be sustainable in the longer term. Given the wage pressure that has recently emerged in China, it seems unreasonable to assume that China and other newly industrialized countries might forfeit the economic momentum that is so important to the Western economies. This would not be tolerated by the political class.

In the current economic environment, which is still quite fragile after the sharp recession and the vigorous but nonetheless only one-year-old recovery, the central banks of the industrialized nations

are not under pressure to abandon their expansive monetary policy. In other words, the markets can continue to expect generous liquidity injections, and interest rates will remain historically low well into the coming year. Despite government austerity efforts, stimulation will not be stopped because there are no signs of inflation.

The exchange-rate fluctuations so far this year have been exceptional. The massive depreciation of the euro versus the Swiss franc produced an undervaluation of at least 10 percent. The franc again assumed the role of a safe-haven currency. As soon as the markets return to normalcy, a longer-term countermovement is likely. Versus the US dollar, the post-collapse euro seems to be fairly valued. The parity of the euro in relation to other currencies is hardly likely to experience further pressure even though the European Central Bank (ECB) has lost credibility as a truly autonomous central bank.

If we weigh the positive and negative factors, there is no reason to assume that the American and European economies will fall back into a recession (double dip). But a slower growth phase extending into the year 2011 seems probable. This also confirms the fears that economic recovery in the

industrialized nations will take a lot of time, given the severe recession in combination with the 2007/2009 financial crisis. “Back to normal” is still far away at the moment.

EQUITY MARKETS / INVESTMENT OUTLOOK

Since a phase of weaker economic growth is more likely than a recession, the equity markets will remain volatile. Looking at the late-June price trends with significant cuts in some instances, the equity markets appear to be favorably valued with respect to all conventional criteria. Another severe correction is therefore hardly probable, even though nervous players on the security markets will continue to overreact when they hear bad news while tending to ignore positive signals.

The expansive monetary policy and the reassuring corporate results published in the first quarter of 2010 also speak against a continued bear market. The imminent reporting period for half-year results should bring further calm to the markets if earnings, as expected, at least match first-quarter levels.

On the other hand, it is not realistic to assume that the cyclical highs of April 2010 will soon be

reattained on the equity markets. It is not yet possible to fully assess the impact of government debt on the global economy.

Thus, our investment policy remains cautious and in the best case, our weighting of equity exposures will stay neutral. Since the emerging markets (EmMa) have hardly been affected by the debt crisis in Europe, they have become more appealing for stock purchases.

KIDS OF AFRICA – A CHILDREN’S VILLAGE IN UGANDA

Dr. Burkhard P. Varnholt, Chief Investment Officer,
Bank Sarasin & Cie AG, Zürich

“Kids of Africa” is a very personal story. About five years ago, Burkhard Varnholt established a village for orphans in Uganda, East Africa. In the meantime, Kids of Africa is considered to be one of the model projects for sustainable development aid. SOLIDINVEST is committed to Kids of Africa. The project matches our values in an ideal manner.

Mr. Varnholt, what's behind "Kids of Africa"?

About ten years ago, a Ugandan asked me to help finance his and his siblings' education. He responded to my donation with a touching letter of gratitude. That's when I decided to get acquainted with the family that I was supporting. So I flew to Uganda, and this created a bond of friendship that remains strong to this very day. After they had graduated, the young adults could not find gainful employment. This prompted the idea to create a children's village where they could accrue occupational experience. The village itself was built in record time at a location on Lake Victoria where no electricity and running water were available. In the meantime, our village already consists of 10 buildings that accommodate our foster children.

Which children does "Kids of Africa" support?

We admit orphans that can be placed neither with relatives nor with a local foster family as well as children rejected by other organizations because their mortality risk is too high. That's why we are so delighted that all children admitted so far are in good health.

For how many children does the village offer a home?

Currently, just under one hundred children live there. Because it is so compact and surveyable, it is also financially efficient. We can assure that donations are allocated directly to the project without any deductions.

What about relations with the community?

For us, it is extremely important that the village be embedded in the social fabric. Among other facilities, we run a primary school for 350 pupils. And successfully, too: for the first time, two of our children ranked among Uganda's top 100 scholars this summer.

We regularly organize sports events, offer training positions, and actively support the local authorities. Our management team has an excellent reputation.

How do you manage to reconcile your daily workload with your commitment to "Kids of Africa"?

We have a very dedicated management on site. I personally visit the village six times a year, sometimes

with my family. We've even celebrated Christmas in the village – a great experience.

Which projects are currently ongoing?

Quite a few! We have to plan ahead, especially for the older children. At the moment, we are building a carpentry and metalworking shop. Then, we are considering opening a secondary school because our region lacks such educational institutions at this level. In the coming years, it is quite likely that teaching will be at the top of our agenda anyway. We also want to do much more in sports: it's the best way to inspire kids to learn.

Who else supports “Kids of Africa”?

A husband-and-wife team of doctors who are close friends as well as my brother and my wife have been committed to the children's village since its inception.

It has been most gratifying to have a company like Solidinvest as an ally for “Kids of Africa”! We are dependent on and motivated by this kind of spontaneous support.

INVESTMENT STRATEGY

Comments

In comparison with the situation at the end of March, we have only marginally changed our strategic direction. For the time being, we have stopped investing in the Japanese equity markets and are also avoiding expensive and hardly profitable real estate funds.

Our exposure in equities remains weighted with a maximum of 50 percent, but in many cases, this quota is not exploited because of the continued volatility of the markets. The equity quota also includes structured (hybrid) products. Fundamentally, we only invest in structured products when we can influence their risk profiles. We are increasing the weighting of investments in emerging markets (EmMa) but only within the scope of the specified quota.

In fixed-income paper (bonds), the focus is on medium durations. Selectively, we are still holding bonds of top-rated issuers in stable local currencies (real, zloty, ruble and now also Turkish lira), because yields in comparison with the so-called hard currencies are such that more income can be generated with a tolerable forex risk.

1. European investors

1.1. Asset allocation

- Bonds	up to 50%
- Stocks: Switzerland, Eurozone, USA	up to 50%
- Emerging markets	up to 20%
- Alternative investments	up to 10%
- Commodities incl. precious metals	up to 20%
- Cash	up to 20%

1.2. Currencies

- CHF, EUR	up to 80%
- Other, incl. local currencies	up to 40%

2. USD investors

2.1. Asset allocation

- Bonds	up to 50%
- Stocks: USA, Eurozone, Switzerland	up to 50%
- Emerging markets	up to 20%
- Alternative investments	up to 10%
- Commodities incl. precious metals	up to 20%
- Cash	up to 20%

2.2. Currencies

- USD	up to 80%
- Other, incl. local currencies	up to 40%

Editorial deadline

July 8, 2010

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