

## Monthly Report for August 2010

Fund manager's strategy report

### Sustainable upswing or relapse into recession?



Seldom have opinions about the future of the economy and the financial markets been as divergent as they are today. This may seem problematic for some investors due to the extreme difficulty of making clear projections under these conditions as a basis for sound investment decisions. However, the situation is positive in that a euphoria-fed bubble is unlikely to form. The experience of the last several years also seems to have made market participants a bit more critical, albeit (for some) at a very high price on the stock market. But, as they say, you live and you learn. The question now is whether these lessons will remain in the short-term or long-term memory banks. Judging from past experience, one cannot but fear that such vital experience will once again have only a short-term impact on market player behavior. For asset managers like us, who assume that market participants will not always act rationally but highly emotionally in certain periods, this information is of crucial importance. In highly efficient markets, it would be extremely difficult for active asset managers whose investment decisions are not tied to an index to generate consistent returns in excess of the market. However, the current mixed sentiment in the market with regard to future performance, particularly that of the Western economy, appears completely and appropriately rational.

#### The Optimists

On the positive side are primarily those companies that delivered highly encouraging figures in the second quarter of the current year and who have also expressed optimism about the future. As expected, business analysts have extrapolated these positive figures into the future, thus expecting a continued rise in profits. However, maximum skepticism must be maintained when it comes to analysts' opinions. Their goal is often not to issue the best possible projections for their own clients, but to increase their own earnings by increasing trading activity. ARVEST asset managers thus rely primarily on their own research in making investment decisions. In fact, research is one of the most important activities within the ARVEST group, as we firmly believe that our own, independent research is the most important requirement for successful asset

management. It also helps to emancipate oneself from market opinions at crucial moments.

As with analysts, one must be equally cautious with politicians, who, in their efforts to be reelected, must spread optimism constantly. Timothy Geithner's assertion that the US economy will not fall back into recession despite numerous early indicators of declining momentum in economic growth is to be interpreted accordingly.

#### The Pessimists

The weakening of economic dynamism is not lost on US Federal Reserve Chairman Ben Bernanke. In his opinion, the risks faced by the US economy have once again risen so sharply that their future development is "extraordinarily uncertain." In other words, for the time being he would like to see the government's low interest rate policy, aimed at supporting the economy, remain in place, as the upswing is not yet self-supporting but based largely on extraordinary economic stabilization measures. Yale economist Robert Shiller is a bit more blunt on the topic. In his view, the probability of a relapse into recession is over 50%. David Rosenberg, former chief economist at Merrill Lynch, goes even further than Shiller, with a (however calculated) 66% recession probability. Rosenberg's pessimism is based on factors such as the ECRI index (see chart), which can serve as an early indicator of future economic development and which has been falling continuously for several weeks. The downturn in US consumer confidence does not contradict the latter scenario.



#### Conclusion

The difference between optimistic analyst opinions and weakening early indicators could lead to dangerous tension, the easing of which would be not without consequence for the stock market. Unfortunately, at this time I am unable to express unconditional optimism, even if every communication expert would strongly advise a monthly report author to do so.

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ARVEST Funds AG,  
Beyzade Han, Fund Manager