Newsletter No.27

December 2012 Alvine Capital Newsletter

Stay fully invested

Key issue: with the world economy stabilised and even the euro crisis subsided, central bank activity will maintain ultra-low interest rates.

Key recommendation: risk assets will continue to climb a wall of worry. Investors should maintain a healthy asset appetite especially for yield.

It is an extraordinary myth amongst many commentators and investors, that today's financial markets are inherently volatile. Unless asset prices can be persuaded to increase in an orderly, smooth path, then the bull market is not to be trusted. These are some of the recent scare stories that perhaps understandably, spook the public.

Faber: Expect Re-Election to Send S&P Down 20%

http://www.cnbc.com/id/49802535/Marc_Faber_Prepare_for_a_Massive_Market_Meltdown

Nouriel Roubini sticks to 'perfect storm' in 2013 prediction

http://www.telegraph.co.uk/finance/financialcrisis/9408062/Nouriel-Roubini-sticks-to-perfect-storm-in-2013-prediction.html

We should still give the irrepressible Nouriel the benefit of the doubt, as we are not yet into the New Year, but the latest of Marc Faber's doom laden predictions seems already a trifle absurd. All bull markets climb a wall of worry, and will always exhibit **violent swings.** With stock prices now coming up to four years from their 2009 lows, it is surely time to confirm an ongoing bull trend. Many investors have become side tracked by the scaremongers, and significantly underweight risk assets, especially equities. Higher prices will eventually force greater participation.

The Euro crisis—the dog that did not bark

How many words, articles, broadcasts, fulminations have been made over the **EURO DEBT CRISIS!** It has been especially tempting for Anglo-Saxon pundits to cry—we told you so, and with great glee predict imminent disaster. It did not happen in 2012, much as it had only flared but not exploded since the inception of the story in 2010. The Euro was a political creation (as is the EU), and will only be killed off by a reversal of the mixture of romanticism, expedience and ingrained bureaucracy still very much alive on the continent. Germany has found itself too deeply enmeshed by the spider, and the costs of breaking up incalculable; it has been easier for **Merkel to carry on playing the game.**

With **Mario Draghi in control** the crisis phase has passed. It is hard to see this problem doing any more than rumble on into 2013.

Fiscal cliff/Arab spring/Chinese hard landing/North Korea/German elections/European recession/Japanese sclerosis etc, etc.

Maybe it sounds like a long list of problems, and after all these are only the known ones. For political pundits and journalists (and financial strategists!) who need to make a living, and for the ever present 24 hour media, these stories and pithy catch phrases need to be kept alive. But for investors trying to make intelligent long term decisions, we should try and stand back and decide if any, or all, of these crises have the power to fundamentally change markets?

Our opinion is that more important long term trends in **earnings** (high and rising), **globalisation** (ongoing and transformational), **technology** (connecting people and markets), global **interest rates** (low-and falling), and **demographics** (one to watch—but not yet) are paramount in understanding and forecasting investment returns. Let others be paralysed by the noise.

Central bankers—rule the roost

The UK got its man—the next **high profile** governor

There have been three phases of central bank 'ultra' activity since the onset of the financial crisis in 2007. The first was disaster management, recognising the scale of disaster, early unprecedented interventions at RBS, AIG and others literally saved the world's banking system. This was accompanied by slashing most interest rates to near zero, plus the onset of QE.

The second phase, which is still largely in progress, can be characterised by fighting possible deflation. With the ECB's LTRO programmes, and the BOE and the Fed embarking on various mass QE, government benchmark interest rates have been forced down. In depressing the yields on these assets it is hoped that a strong message is passed to markets, and hence assisting economic stability. We have been assured that not only are these policies consistent with the mandates, but that the process can and will be reversed at the appropriate time in the future.

Ben Bernanke coined this process 'portfolio channel balance', as he explained **'the Federal Reserve's purchases of longer-term securities affect financial conditions by changing the quantity and mix of financial assets held by the public'** (source: www.businessinsider.com 9/9/12).

How exactly this filter's into the real world is less relevant for investors, **we call this a type of market ramp.**

The size and prolonged nature of intervention is the dominant factor in market movements—this has become **Bernanke's infamous helicopter.**

Third phase—welcome to 'Abenomics'

The return to the premiership of Japan for Shinzo Abe has been presaged by a tub thumping election promise to galvanise the economy by extreme monetary steps. These include increasing the inflation target to at least 2%, and the direct issuance of government bonds to provide infrastructure spending. **This is money printing in its crudest form.** While Japan's two decade long slump may justify this egregious action, other parts of the world are questioning the straight jacket of existing central bank mandates.

As Mark Carney has already speculated **'if yet more stimulus were required, the policy framework itself would likely have to be changed'** (source: FT.com 11/12/12). As the 'something must be done' bandwagon gathers steam (with abundant support from the IMF amongst others) in our democracies, it seems the monetary authorities are prepared to manipulate, or abandon what are perceived to be old fashioned constraints of inflation targeting.

Expect more intervention for many years to come.

Global interest rates falling fast

As the global slowdown gathered pace in the back half of 2012, many other countries cut interest rates to forestall flagging demand. In contrast to 2011 when much of the emerging world was hiking, this new phenomenon has led to a truly **worldwide hunt for yield**.

Over bought territory?

Hindsight is a wonderful thing, and can make a mockery of us all. Even the greatest modern investor Warren Buffet was wrong to call the top in the bond market in 2009 when interest rates looked incredibly low (the ten year was around 3.3%) now a seeming bargain!

Buffett says U.S. Treasury bubble is one for the ages:

http://uk.reuters.com/article/2009/02/28/uk-berkshire-buffett-bubbles-sb-idUKTRE51R1Q720090228

While not wishing to seriously embarass the world's most famous, and successful, investor the point of this now four year old story is to demonstrate just how low bond yields have become and how much more of the bull market in fixed income was to come.

We feel the same point can be applied to equities, and many other yield bearing assets such as credit. While it would have been nice to have picked the absolute market lows of March 2009, there is still plenty left on the table. With interest rates anchored by central bank activity it is now dividend yields that represent such value, surpassing there fixed equivalents for may corporate names.

'Stocks are the new bonds' Peter Oppenheimer chief global equity strategist at Goldman Sachs (source: CNBC.com 18/12/12).

Conclusion: stay FULLY engaged

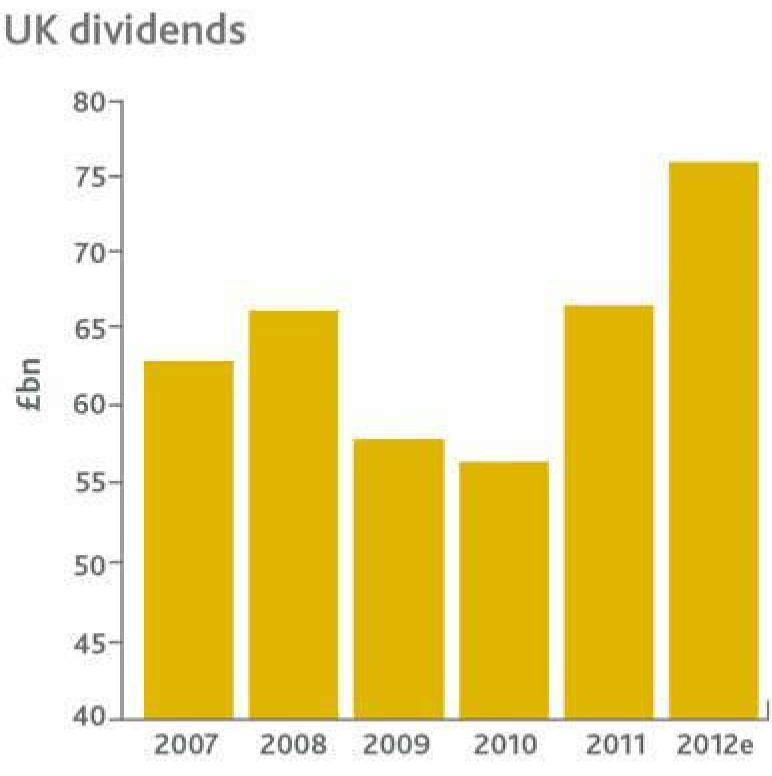
A few stories around the globe caught our eye recently.

'The Reserve Bank of Australia's move to lower its offical cash rate to 3%' (source: FT.com 4/12/12).

'Brazil's central bank has cut interest rates to an all time low of 7.25%' (source: FT.com 4/12/12).

These moves have been followed worldwide, from Korea to Sweden.

The trend for ultra-loose monetary policy is the **sina qua non** of investing. As was seen in the incredible 30 year bond market rally, unprecedented low interest rates represent the most easy financial conditions imaginable. **Dividend yields are the ultimate duration play.**



Payouts at likely record levels in the UK (source: Investor Chronicle 25/7/12).

Market forecasts for 2013 at year end

S&P 500: 1600

US Ten year treasury: 2.0%

$/euro: 1.22

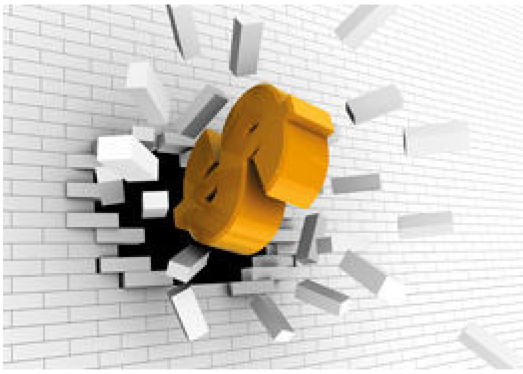
$/£: 1.50

Gold: 1800$

Brent spot: $105

Post script

A word of caution on recent US $ weakness. We see recent 'risk on' rallies in the euro as not representative of long term trends. With the economic cycles of Europe and the US at clearly different stages. The US economy's performance in 2013 is unlikely to race away, much good work has been done in restoring it's long term health. Europe has only just begun the long road of healing it's financial mess. For this reason, despite liking financial assets, we would look for a fading of the european currency strength into the New Year.



The US dollar represents the best store of long term value amongst the major currencies.

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