Crèdit Andorrà Asset Management

Fourth quarter
Date of Report: 27th September 2013

Quarterly Report

Our View on the Markets

INDEX

Europe makes a comeback

The old continent has been a hotbed of tension over the past few years, engulfed by doubts regarding the survival of a project spearheaded by a currency with a short history and too many analysts predicting an even shorter future. Following its longest recession ever, Europe is back in the limelight. This time, finally, its comeback is underpinned by positive factors.

European macro data – even in peripheral countries – has surprised an audience accustomed to never-ending downturns. Recession had already been registered for seven consecutive quarters and the old continent was only a source of bad news. Until recently, numerous catastrophic forecasts counted the days to an inevitable breakup of the Eurozone. OMT began to unwind the hopes of those aiming to become the new "Roubini" (the NYU professor who predicted the burst of the US real estate bubble and – by the way – has continued to foresee one disaster after another, a lot less successfully for the time being). The old continent's economy was bent on remaining in a recession which was scaring away the investors.

Yet nothing lasts forever, not even recessions. Besides the invaluable collaboration of the ECB, other factors led us to believe that it was time to be more optimistic. The habit of inflicting "self-punishment" with austerity measures has become less prevalent over the past few months. In fact, authorities are now extending deadlines for meeting established deficit targets, which – moreover – are defined in structural terms (reducing their anti-cyclical impact). In the peripheral countries, current account deficits have improved spectacularly – in many cases they are now even surpluses –, exports are rising, banks are gradually recapitalising, previously unthinkable reforms are being approved, and lost competiveness is being regained at an accelerating pace. Six years of crisis have left internal demand in the doldrums, affected by the scourge of unemployment, but has also allowed for a partial clean-up of previous years' excesses. In short, it was a question of time...time bought by the ECB (mainly) and (small but vital) steps taken towards European integration.

The good news is that leading indicators point to the fact that the economic improvement has only just begun and should continue. We harbour no illusions, but rather expect the recovery to be lukewarm, with practically all economic agents still much busier reducing debt than anything else. With neither inflation nor substantial growth, the ECB should continue to lend a hand for a long time. What can be expected from fixed income? Very low interest rates look like a sure thing. However, we must be careful: 2% is a low rate for the Bund, but so is 3%. We must bear in mind that recent levels are an historical anomaly and, sooner or later, must be corrected. With the Fed trying to find a formula for reducing stimuli, risk is more asymmetric than ever and maintaining short durations looks like the most reasonable choice. In particular, the US central bank's new attitude, which is distancing it from policies of its European counterpart is likely to end up affecting the Euro. If one asset should benefit simultaneously from both the ECB's easing and the improving European macro scenario it is old continent equities. Investors didn't have them on their radar screens, implying that there are a vast number of potential buyers. Earnings are still depressed and, therefore, have great room for improvement, and this is not yet discounted by still very low valuations. All the above has to be taken with due caution as we do realize the fragility of the recovery. However, it does seem that Europe has made a comeback, and this time in a positive way.

David Macià, CFA
Head of Research and Strategy

Strategy

Asset Allocation (3-month view)

Monetary	→
Government Fixed Income	↓
Corporate Fixed Income	→
Equities	↑

Fixed Income

Governors' waltz

GOVERNMENT:

U.S.	↓
Eurozone	↓

CORPORATE:

U.S.	↓
Eurozone ("Core")	↓
Periphery	→

Equities

The wind is blowing in Europe's direction

U.S.	→
Eurozone	↑
Spain	↑
Emerging Markets	→

Commodities

Gas for Europe

Oil	→
Gold	→
Metals	→

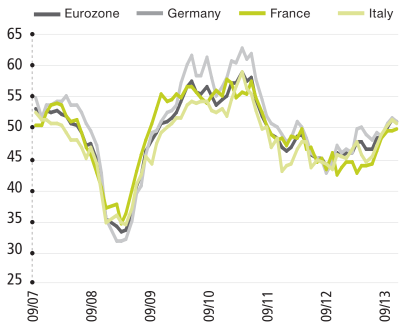
Currencies

Give me dollars

EUR/USD	↓

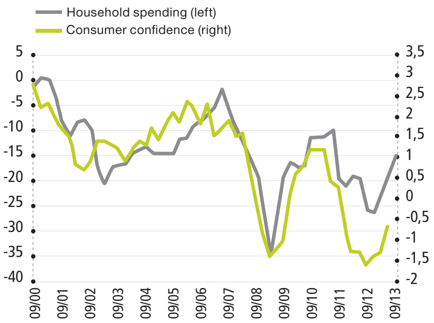
Macroeconomic View

Eurozone Manufacturing PMIs



Leading indicators, such as PMI's indicate that the recovery should be sustained in the coming quarters. The last reading again exceeded the level of 50. Not only do core countries improve but so does the periphery.

European Consumer confidence and household spending



Consumer confidence improves and reaches levels not seen in more than two years. Consumers seem to have played a role in these early signs of recovery.

Consensus economic forecasts

Yearly

	2013	2014	2015
GDP (YoY%)	-0.4	1	1.4
CPI (YoY%)	1.5	1.5	1.5
Unemployment (%)	12.2	12.2	12

Quaterly

	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14
GDP (YoY%)	0.4	0.8	0.8	1	1.15
CPI (YoY%)	1.4	1.4	1.55	1.5	1.5
Unemployment (%)	12.2	12.2	12.2	12.1	12.1

Let's grade the Eurozone's recovery

The tail end of the summer brought new signs of acceleration of the Eurozone's recovery. The combination of second quarter GDP and leading indicators – particularly PMIs and confidence indicators – outpacing forecasts injected a strong dose of optimism into the outlook for the remainder of 2013 and 2014.

An "A" in the subject of credibility: This is a key catalyst for attracting or frightening away stable and sustainable investment flows which help to create wealth. Months have gone by since the headlines were catastrophic for Europe and it looks like homework done by the ECB and many EU member countries has restored foreign investor confidence.

A "B" for growth: Although the figure is nothing to write home about (+0.3% q-o-q), the fact that second quarter GDP growth is positive this year puts an end to seven consecutive quarters of downturns. It was the longest recession ever suffered by the Eurozone. Consumers are spearheading this modest recovery and – based on signals emitted by leading indicators such as PMIs or confidence indicators – it should continue in upcoming quarters. However, we would keep a close eye on global growth. Foreign trade has been a great help – particularly in Germany, which is still the main driver of European growth – and should continue to underpin future growth. However, risk of a slowdown of emerging markets, including China, could raise doubts regarding the outlook for European growth.

A "C" for the ECB and fiscal policy: At its meeting in September, the ECB reiterated that interest rates should remain at current levels - or even decline - for a long time, this forward guidance was applauded by the market. Although a further interest rate cut doesn't look likely (unless macroeconomic data worsens), we wouldn't rule out new monetary policies aimed at encouraging lending. Amortisation of LTROs reflects greater confidence of financial markets, but implies a decline in aggregated liquidity. This factor, together with the recent rebound in monetary rates, spurred Draghi to warn at the September meeting that the ECB is prepared to take further action if necessary. Markets also approved the improvement in fiscal policy and delays in deadlines for meeting public deficit targets. However, the latter isn't an expansionary measure although it isn't as tight, which should help affected countries recover growth sooner.

A "D" for the labour market and banking union: Even though the number of unemployed people has declined over the past two months, this has not pushed down the unemployment rate which remains high and is the aggregate of some extremely different situations: e.g. 6.8% in Germany and 26.3% in Spain. The banking union project also gets a bad grade: in spite of moving forward, the pace is much slower than foreseen and, therefore, it isn't a catalyst for exiting the recession right away albeit should help over the medium-term.

Macroeconomic data indicate that the European economy is gaining ground, although it's true that everyone isn't ploughing forward at the same speed. However, structural reforms carried out by the majority of peripheral countries should underpin a correction of imbalances and more flexible economies which encourage growth. Moreover, fiscal adjustments should be reflected by healthier public accounts, thereby reducing risks of new bouts of sovereign crises with their resultant impacts on the financial sector. Reform of this sector in many countries, together with timid progress towards a banking union, should help to restore lending to the private sector. Overall, we would give Europe a good grade and are expect upcoming quarters to continue to bring positive surprises.

Susanna Torrent, CAIA
Fixed Income Senior Manager

Fixed Income

Governors' waltz

European interest rates have been dancing to the tune of Draghi's speeches and those of the governors of the other main central banks. Like all good orchestra conductors, they have managed to direct investors' movements up until now. However, the upbeat waltz to which traditional fixed income assets have been dancing for the last 30 years may be about to turn into a requiem.

The text books we studied when pursuing our economics degrees told us all about equilibrium interest rates. Over the years different economic models have arisen which explain what these interest rate levels should be, but they all tend to be based on variables such as expected growth, forecast inflation in coming years, etc. However, today's and recent years' extremely low interest rates are not explained by any of these theoretic models: the explanation lies with the highly expansionary monetary policies carried out by the main central banks in an attempt to solve the financial crisis.

Are traditional models no longer useful for forecasting long-term interest rates? Sincerely, we are unable to come up with a convincing reply. We are, indeed, convinced that – sooner rather than later – central bank measures will become less effective and no longer have as much influence on interest rate levels. We aren't alone in this view. For quite some time, certain voices are raising questions such as: whether or not Draghi's words can continue to influence markets financial *in eternum*, if sovereign rates of central countries should also include credit risk premiums (given the extraordinary levels of financial leverage which have been reached), if inflation of financial assets triggered by monetary policies might be generating another bubble, etc.

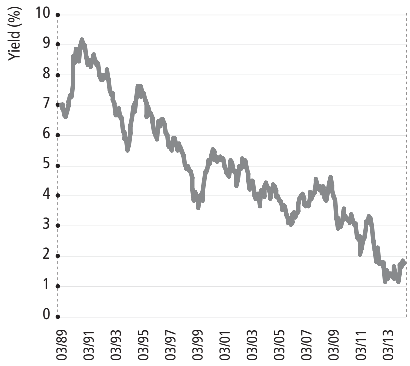
We also firmly believe that – in spite of the improvement of some economic indicators in recent months – the European economy is by no means perfectly healthy. A sharp rebound in long-term interest rates which occurs too rapidly could put at risk any nascent recovery. The Governor of the ECB's latest speech was along these lines, warning that it is necessary to remain watchful of any possible rebound in interest rates and indicating his willingness to use all available weapons...if necessary. Nevertheless, we believe that we are unlikely to see the lows registered during May 2013 (10-year German bund: 1.16%) again. Under a best-case scenario, we think minimal corrections over the short-term should be followed by modest but persistent rebounds of interest rates over the medium term.

> "Under a best-case scenario, minimal short-term corrections should make way for a modest but steady rise in interest rates over the medium term"

As a result, the outlook isn't encouraging for traditional fixed income investors accustomed to holding stable bond portfolios. We believe the best-case scenario which might occur over the medium term would be a lack of aggressive rises in long-term interest rates, thereby preventing major capital losses due to unfavourable swings in bond prices. Yet, we also expect gains to be minimal. If an investor wants to avoid high risks, he/she is only likely to manage to capitalise current levels of interest rates: a 10-year yield of 1.83%! As we commented previously, we are confronting an historical anomaly: such investors won't even be able to maintain purchasing power in real terms – discounting inflation –. Given this situation, we unceasingly recommend that our customers opt for a more active than ever management of both interest rate risk (via dynamic hedging) and credit risk (via intensive selection and monitoring of issuers) in their fixed income portfolios.

Meritxell Pons, CAIA
Fixed Income Director

10 yr German bond yields



After 30 years of positive performance, lon term sovereign bond yields have reached such low levels that the risk of a traditional fixed income investor is totally assymetric.

Official Rates: Consensus Forecasts

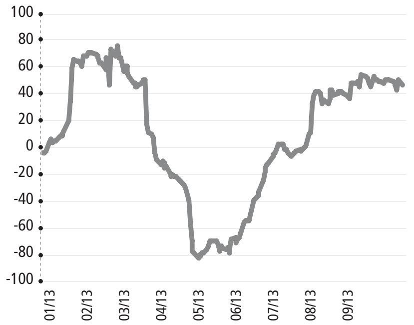
	30/09/13	Q4'13	Q1'14	Q3'14
Euro-Zone	0.50%	0.50%	0.50%	0.50%
U.S.	0.25%	0.25%	0.25%	0.25%
United Kingdom	0.50%	0.50%	0.50%	0.50%

Interest Rates: Changes

	30/09/13	Last 3 months	Last year
Euro-Zone			
3-month Euribor	0.23%	0.007	0.005
10-year Bund	1.78%	0.051	0.337
U.S.			
3-month U.S. Libor	0.25%	-0.024	-0.110
10-year U.S.	2.61%	0.124	0.977
United Kingdom			
3-month GBP Libor	0.52%	0.007	-0.079
10-year Gilt	2.72%	0.278	0.994

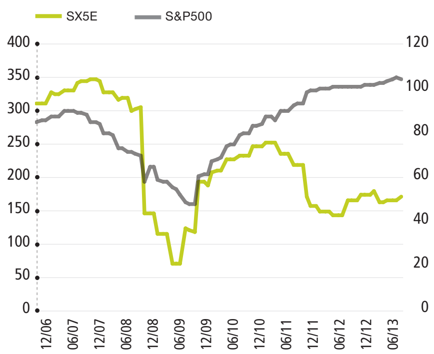
Equities

Citigroup Surprise Index Eurozone



Since last May, the improving macroeconomic data has caught investors by surprise

EPS S&P500 vs EuroStoxx50



US earnings (trailing 12 months) reach new highs while European company earnings remain very depressed, far below historic highs.

			Q3 %	YTD %
USA	S&P500	1,682	4.69%	17.91%
	DJ Indus. Avg	15,130	1.48%	15.46%
	NASDAQ 100	3,218	10.61%	20.94%
EUROPE	DJ Euro STOXX 50€ Pr	2,893	11.16%	9.76%
	France (CAC 40)	4,143	10.82%	13.80%
	Spain (Ibex 35)	9,186	18.34%	12.47%
	UK (FTSE 100)	6,462	3.97%	9.57%
	Germany (DAX)	8,594	7.98%	12.90%
	Switzerland (SWISS)	8,023	4.42%	17.59%
	Italy (FTSE MIB 30)	17,435	14.41%	7.14%
	Netherlands (AEX)	375	8.80%	9.40%
JAPAN	TOPIX	1,194	5.31%	38.88%
	NIKKEI 225	14,456	5.69%	39.06%
EMERGING MARKETS	Mexico	40,185	-1.08%	-8.06%
	Brazil	52,338	10.29%	-14.13%
	Argentina	4,784	60.73%	67.60%
	China	2,175	9.88%	-4.16%
	India	19,380	-0.08%	-0.24%
	Korea	1,997	7.17%	0.00%
	Russia	1,463	9.95%	-0.81%

The wind is blowing in Europe's direction

After years of European equities spurring more animosity than anything else, they may be set to become the protagonist once more. This time though in a positive way, as investors are faced with increasingly less attractive alternatives, which leads them to this asset class.

Investing is increasingly difficult. Much of the attractiveness of fixed income assets – the main object of desire for years – has disappeared. The Fed is searching for the best way to begin to reduce stimuli – a task that will certainly prove more difficult than running the monetary printing presses at full speed – which should provoke, at the very least, an increase in the volatility of this asset class. There may be additional side effects: the major bull market of the past three decades might already be in its final stages. It is time to search for new paths and equities are recovering fans. In fact, during the last week for which we have data –mid-September –, net inflows into equities were at an historic high.

Helping to pave the way, most of the obstacles present at the beginning of the month have disappeared (although some only temporarily): what looked like an inevitable military attack on Syria ended up being just a scare, the Fed surprised markets by postponing its much-feared "tapering", and Summers – who was not favoured by markets – ruled out himself as a candidate to replace Bernanke in January. Other worries included whether or not the Chinese macro situation would continue to flounder and if the summer sell-off of emerging market stocks might turn into a stampede. Neither has panned out, for the time being. What about German elections? Merkel will have to govern in coalition with a left-wing party, more pro-Euro than the FDP with which she previously governed. It looks like there are only two remaining clouds on the horizon: Berlusconi, who poses a permanent threat to Italian government stability; and US negotiations to renew the state budget – the fiscal year ended in September – and raise the debt ceiling. Unfortunately, the latter is not really news. It's a scenario which has been repeated over and over again and the budget always ends up getting approved at the very last minute. In 1995, Clinton had to shut down the government for a few days, a scenario which may be repeated now. In any case, the economic impact should be minimal since a government shutdown would probably last only a few days and – once activity is started up again – any pending receivables must be paid-off retroactively.

Equities are therefore in the cards, but where? US equities are at historic maximums and any upside at this point would probably be via expansion of multiples. What about emerging markets? Investors haven't yet gotten over last summer's scare. Since 2010, average inflows were USD1Bn, and only a minimal portion has been withdrawn (around USD254Bn). If fears regarding China or the Fed's "tapering" reappear (the latter is only a matter of time), the possibility of getting one's fingers burnt is not small. What about Europe? Not too long ago, nobody even wanted to touch it with a ten-foot pole. It looks like this situation is beginning to change. In the first half of 2013 US investors' purchases were higher than ever since 1977. The second quarter of this year broke the negative trend of the previous seven quarters and both European PMIs and confidence indicators are signalling that the recovery should be here to stay. It's likely to be a very timid recovery, so that the ECB has no choice but to up the dose of monetary policy given to its patient. It's atasty cocktail for investors, which is also accompanied by quite reasonable valuations. Taking into account the low starting point of earnings - and high operating leverage - in Europe, it isn't too bold to expect to see improving results released at upcoming quarterly presentations.

On an imaginary meteorological map, for years Europe was expected to remain stormy. Now, at long last, it looks like there's an anticyclone on the horizon.

David Macià, CFA
Head of Research and Strategy

Commodities and Currencies

COMMODITIES

Gas for Europe

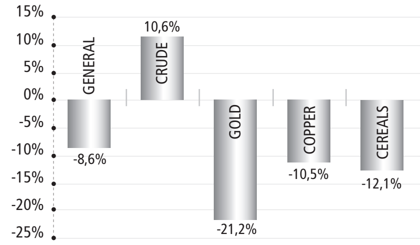
Currently, natural gas accounts for 25% of energy consumed in Europe. Usage is still predominantly on the retail side. However, in the future it is expected to become the main source of energy, together with other renewable energies, to generate cleaner energy and partially substitute the usage of oil and coal by industrial and transportation sectors. Therefore, the subject of natural gas also encompasses topics such as Europe's industrial costs and competitiveness. If Europe had access to this type of energy at US prices – USD4 per each USD10 paid in the "old world" – its energy bill would be cut by over 10%.

It's being said that the US may be energy self-sufficient by the end of this decade precisely thanks to the shale gas boom. To the contrary, Europe – which clearly suffers a deficit – is overly dependent on imports from Russia and Norway. This is precisely why far-reaching and truly controversial decisions must be made in the energy arena such as usage of nuclear energy or "fracking" to access shale gas reserves. Parliamentary debates in the UK and the Netherlands regarding whether or not to grant a green light to gas extraction using this new technology are currently under way. Other measures also under way include construction of gas pipelines (from Russia, the Ukraine, the Middle East, and Africa) and renegotiation of long-term contracts in order to decouple gas and oil prices.

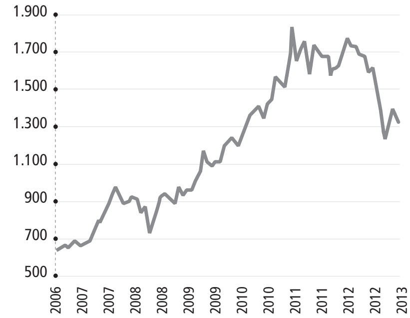
From a financial point of view, we need to focus on the US market, which is the only place where natural gas contracts can be negotiated. In that market, although this depends on weather conditions (an average winter is foreseen), we believe that increases in supply and demand are likely to move in tandem, without spurring price fluctuations in the upcoming months.

David Rabella
Head of External Funds and Alternative Investments

Performance DJ UBS TR commodities YTD



Gold



CURRENCIES

Give me dollars

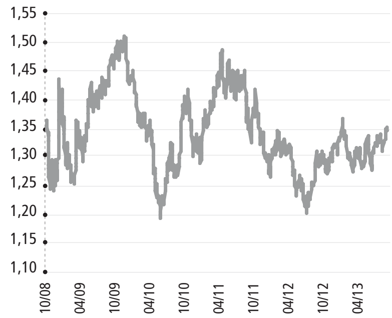
Daily currency trading volumes amount to the equivalent of USD5.3Trn. Volumes keep on rising (they have multiplied by four thus far this century). However, one thing never changes: the US dollar is absolutely the dominating currency, the counterparty of 87% of all trades. Nothing manages to overshadow the USD: neither the launch of the Euro, nor the resurgence of emerging countries, nor the return of interest in the Yen (even though as a sell), nor anything else. In fact, the Euro – the second most important currency in terms of its share of total trades – barely comprises 33.4% of transactions.

Therefore, the role of the worldwide reference currency is unquestionable. Zero interest rates and the Fed's extremely dovish stance also allowed the USD to be the "funding currency": investors requested dollar loans in order to invest funds in other currencies at higher interest rates or with more promising growth dynamics. Nobody was surprised that emerging markets were the predominant destinations. Now, however, with Bernanke thinking about how to begin to unwind stimuli, it's a different story. Once it begins to be confirmed that US monetary policy has changed its tune, the huge earlier-mentioned positions are likely to be unwound, with capital being repatriated towards the US. This summer we had a little taste of this scenario, with violent corrections of emerging market currencies and massive sell-offs of underlying assets (both stock and debt). The Euro came away unscathed.

For the time being, the famous "tapering" (slowdown in the pace of expansion of the Fed's balance sheet) has been postponed. However, it is only a matter of time. Meanwhile, the ECB will have no other alternative but to invent some way to help the Eurozone even more – its economy is too weak and deflation and tight credit are predominant in the South. Moreover, with its internal demand so weak, Europe is depending on foreign trade to pull it out of the crisis. A weaker Euro would be extremely helpful. More expansionary measures in Europe and fewer in the US over the next few years are the main ingredients of a recipe for cooking up a weaker Euro and a stronger US Dollar.

David Macià, CFA
Head of Research and Strategy

Euro vs dollar



The Euro has held up well against the dollar during the whole crisis.

Exchange rate $/€

% change:	1 month	3 months	1 year
	2.48%	4.04%	5.09%
Consensus Forecast:	2013	Q1'14	Q2'14
	1.32	1.30	1.29

Latin America

Exodus or round trip?

Recent flows of funds out of the region and currency corrections have revived fears of a new emerging market crisis. However, we believe the region is better positioned to face this situation than in previous crises.

Since the Federal Reserve announced the possibility of gradually reducing current monetary stimuli, assets in the region have suffered sharp corrections. These declines took place even in spite of improving global macroeconomic data, particularly in the case of developed countries, with Europe finally putting the recession behind it. Countries with the largest current account deficits such as Brazil or Peru – with imports in USD surpassing exports – have registered the greatest corrections of their currencies. This situation distorts future forecasts since inflationary pressures might return to the forefront (since imports are more expensive), with inflation already at the top of desired ranges in some countries such as Brazil. In order to put a brake on this spiral, Brazilian authorities are raising interest rates and have announced an aggressive currency market intervention plan (USD60bn through YE 2013e). These circumstances make it difficult to recover more solid growth rates.

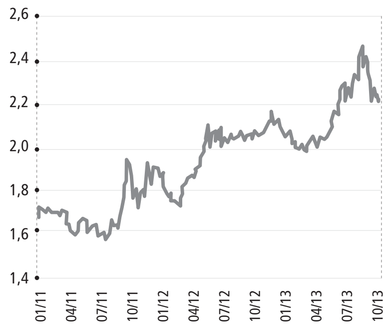
We would also point out that the role of certain factors which lent support to the positive performance of assets in this region has reversed and they are now obstacles. In particular, China is currently growing at a slower pace and raw materials prices are losing steam. These circumstances are driving the exit of funds from the region which has revived fears of possibly having to confront a new "emerging market crisis" since crises of the past 30 years were largely triggered by substantial outflows of funds and depreciation of local currencies. Among other aspects, balance sheets of many companies – which have taken on debt in USD but generate revenues in local currencies – were put under pressure.

However, **we think the region is better positioned than in previous eras**. Currency exchange rates are now flexible, so they can better adapt to fluctuations of inflows and reduce their impact. Moreover, foreign currency reserves are at higher levels than in previous crises and local bond markets are much more developed and liquid, which has helped decrease levels of debt dollarization (thereby reducing possible imbalances). Therefore, we would venture to say that currency depreciation no longer has the pernicious effect that it had in other eras, when the bulk of debt was denominated in USD. Yet, the fact that the region is better prepared to face a massive flight of capital doesn't imply that we are not about to face a likely future slowdown in growth. Leading indicators of manufacturing activity and consumer data point in this direction. Furthermore, recent weakness underlines structural problems such as the region's low productivity. Any change in global liquidity makes the situation more delicate and negative impacts are sharper in emerging markets than in developed countries.

It is tempting to invest in Latam assets given valuations which look attractive following recent corrections. However, we believe that it is still too soon to raise our exposure, especially taking into account growth and inflation forecasts for this region. We need to see currencies and raw materials prices stabilise, as well as solid evidence of reacceleration of growth in China, before wholeheartedly placing our bets on emerging markets.

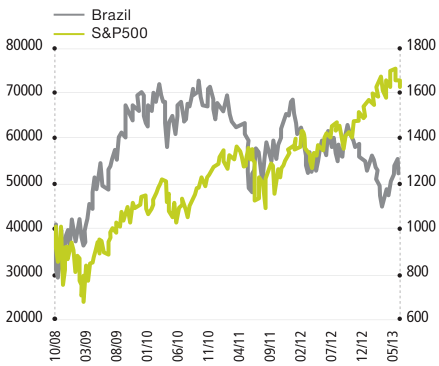
Noelia Povedano
Vice-President of LatAm
Markets and Strategy

Brazilian Real Trend



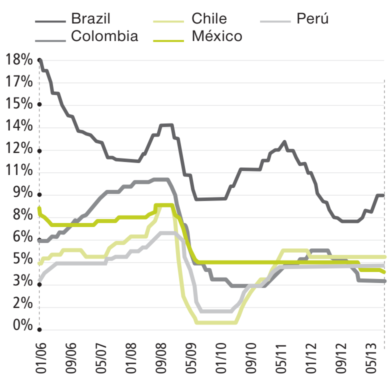
The outflows in the region have caused strong corrections in the majority of latin american currencies against the dollar and especially in those countries with larger current account deficits like Brazil. These corrections have fueled fears of a possible emerging market crisis.

S&P500 vs Bovespa



The fear of tapering by the U.S. Federal Reserve has led to strong corrections of the regional stock exchange indices. Brazil's Ibovespa index has dropped a -21.15% YTD compared to a rise of 19.79% for the S&P500.

Reference Interest Rate Trend



Corrections in the currencies of the region could create additional inflationary tensions. Countries such as Brazil, where price indices are already above the desired levels, have continued to increase interest rates in order to curb this trend.

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