September, 2010

Macro Strategy: G3, emerging markets and commodities

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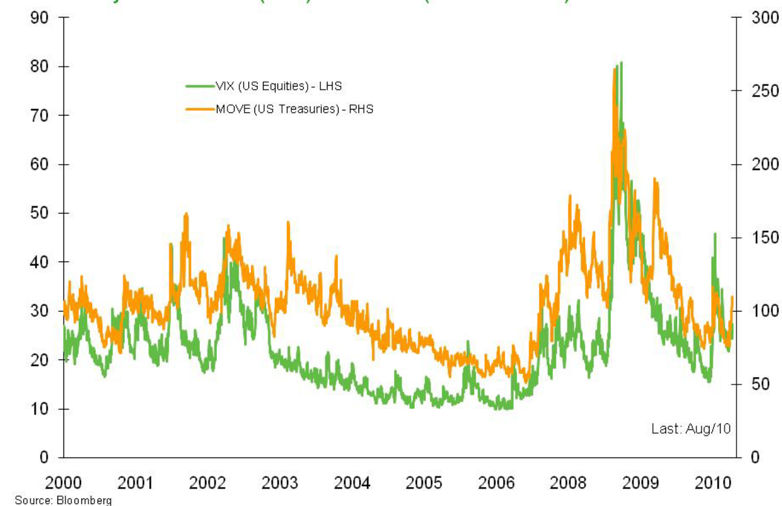
Refer to important disclosure on page 17

Themes	Outlook
Global resilience to a US-led deceleration: Is the global economy losing momentum?	“Deceleration & Disinflation” vs. “Double Dip & Deflation” We expect the former scenario to carry on into 2011 and see potential upside for global growth from Asia-Pacific and Latin America in 2H10.
Risk in Europe	Speed of events slowed after the Greek bailout, the EUR750bn EFSF, and the stress tests. German-led recovery and gradual achievement of fiscal targets in the peripheral Euro markets limited the possibility of larger contagion from the US-led risk scenario during the summer. We reiterate the view that no country in the Euro area is expected to seek financial assistance in the next 12 months.
Monetary policy: More extended liquidity and potential QE2	G3 economies: we forecast subpar growth and subpar inflation in 2011 to extend excess liquidity until 2012. Markets questioning the rebound in the US present further challenges to G3 central banks and means flattened yield curves will likely prevail in 2H10. US yield curves strongly flattened in Aug/10 and the Fed option to deploy QE2 may add further flattening in Sep/10.
FX Markets: Extended USD weakness	Most of the weakness in the USD looks priced in if the Fed disregards the need for QE2. The central banks of Japan, Switzerland and the Euro area have limited options to intervene individually if the USD weakens further. A flattened yield curve and unusually low short-term interest rates may push markets to seek returns through some diversification: non-G3 developed markets and fast-growing emerging economies.
Commodities & Alternative Markets: Re-coupling with emerging markets in 4Q	A corporate-led recovery in developed markets and the resilience of emerging economies’ consumer markets are creating a backdrop for the re-coupling of commodities to fundamentals of medium to long-term demand and are reducing the risk of contagion from prolonged weakness in the US.
Equities & Credit: Lower corporate risk vs. slower economy	High liquidity in corporate balance sheets triggered consolidation through M&A activity in the 1H10. We expect strong earnings in 2Q to ease in 3Q and to pick up the pace again in 4Q. In the next stage, debt and equity markets are likely to see decent demand with “extended liquidity” in treasury markets.

Resilience in the global economy:
US “Deceleration & Disinflation” vs. “Double Dip & Deflation”

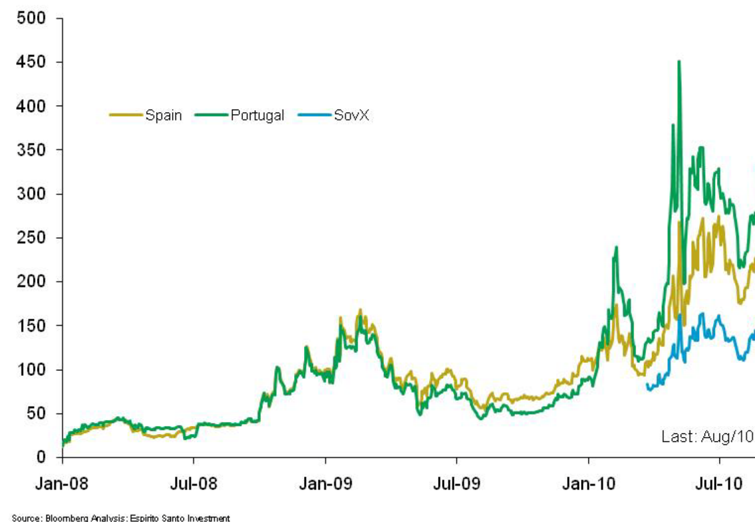
- The summer break was marked by a reinforced perception of larger than expected deceleration in the US economy.
- Globally, emerging economies, mainly China, eased the pace in response to policies adopted by governments to curb the above-par expansion in the 1H10, but continue to maintain a solid growth outlook for the 2H10.
- Risk aversion on the Euro area fiscal crisis eased as there was no need to activate the EFSF and Greece passed the test of the first quarterly report to the EU-IMF-ECB. Ireland’s rating downgrade was mostly a non event: 1 notch by S&P to AA- and negative outlook. However, the renewed US-led risk scenario contributed to a widening of credit spreads for the Euro peripheral markets at the end of Aug/10.
- Downside risks for the global economy are, again, subject to the size of the US deceleration since no major disappointment has been observed elsewhere. Global markets rallied in the view that the US recovery was “V” shaped, but now there are widespread concerns that a “W” double dip could be on the horizon. We are facing the prospects of an anemic US economy prolonging the subpar performance until the end of 2011 with limited fiscal and monetary policy tools to stimulate its own economy.
- We believe any attempt to further stimulate the economy seems inappropriate when the predominant topic among G3 economies will remain subject to the medium to long-term need to reduce fiscal deficits. Although politically tempting to create a fiscal and monetary package to balance the risk of a prolonged recession or the “second dip”, the performance of the fiscal and monetary bailout in 2008-2009 proved to be limited compared to the legacy of the large fiscal and liquidity skeletons.
- Since the willingness of governments to act aggressively looks limited, and benchmark interest rates will remain at historical lows, markets will likely find little space to rally in the G3 economies and may seek opportunities of taking risk in other asset classes and regions.

US Volatility trackers: VIX (S&P) and MOVE (US Treasuries)



Source: Bloomberg

Sovereign risk spreads (5yr CDS): Portugal; Spain; and W. Europe (SovX)



Source: Bloomberg Analysis: Espirito Santo Investment

Resilience in the global economy:

US "Deceleration & Disinflation" vs. "Double Dip & Deflation"

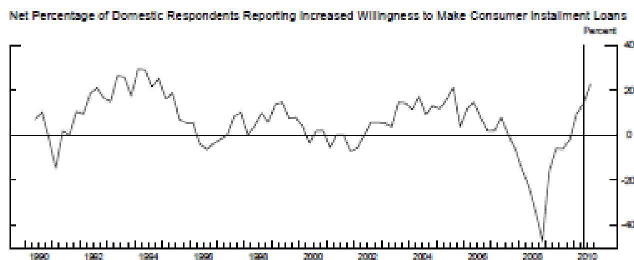
- The risk that the deceleration and the disinflation for the US economy will be more severe will pressure authorities to look for some additional (marginal) measures in both fiscal and monetary policies to offset the downside bias.
- Consumer credit continues to suggest a challenging outlook while the level of unemployment remains at a recessionary level (above 6%). Despite the recent improvement in the credit markets, according to the Fed's survey of banks loan officers, the willingness to lend remains subject to higher consumer credit scores. In the absence of significant expansion in consumer credit, we believe the US economy is likely to grow by only 2% to 3% in the next decade (closer to 2% until 2015).

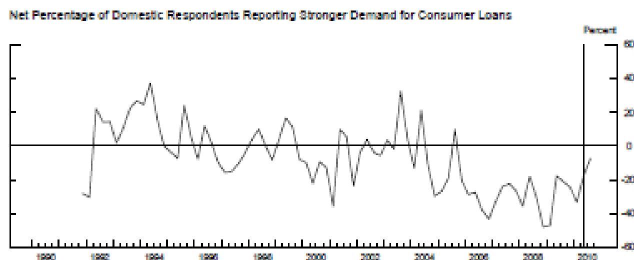
US GDP measured by the impact of consumer spending - Selected years cumulative change (%)

	1980-1989	1990-1999	2000-2007	2008-2010 (1H10)
GDP	34.8%	38.6%	21.3%	-1.3%
ex-housing	34.6%	36.7%	21.9%	0.0%
ex-durable goods spending	29.6%	31.7%	16.6%	-0.9%

Source: Bloomberg Analysis: ES Investment

Measures of Supply and Demand for Consumer Loans





Source: US Federal Reserve

Fed's Senior Loan Officer Survey (July, 2010)
Fact: US banks are willing to lend.
But: the same banks continue to impose tight lending standards.

d. Minimum required credit score (increased score=tightened, reduced score=eased)

	All Respondents		Large Banks		Other Banks	
	Banks	Percent	Banks	Percent	Banks	Percent
Tightened considerably	0	0.0	0	0.0	0	0.0
Tightened somewhat	3	8.6	0	0.0	3	18.8
Remained basically unchanged	30	85.7	17	89.5	13	81.3
Eased somewhat	2	5.7	2	10.5	0	0.0
Eased considerably	0	0.0	0	0.0	0	0.0
Total	35	100.0	19	100.0	16	100.0

e. The extent to which loans are granted to some customers that do not meet credit scoring thresholds (increased=eased, decreased=tightened)

	All Respondents		Large Banks		Other Banks	
	Banks	Percent	Banks	Percent	Banks	Percent
Tightened considerably	0	0.0	0	0.0	0	0.0
Tightened somewhat	4	11.1	0	0.0	4	25.0
Remained basically unchanged	31	86.1	19	95.0	12	75.0
Eased somewhat	1	2.8	1	5.0	0	0.0
Eased considerably	0	0.0	0	0.0	0	0.0
Total	36	100.0	20	100.0	16	100.0

ESPIRITO SANTO Investment

Resilience in the global economy:
US "Deceleration & Disinflation" vs. "Double Dip & Deflation"

- The potential downside risks for the US economy are largely owing to its heavy reliance on consumer spending (70% of GDP) and the limited resources to restore growth in the face of a prolonged recovery in employment levels. At this moment it is most likely that the needed contraction in terms of employment and income is already consolidated. We forecast a further contraction in the housing market to be offset by consumer spending, mostly related to essential products and services.
- The weakness of the USD will likely continue to provide some support to growth, especially if the expansion in emerging markets accelerates in the 4Q10.
- According to the latest edition of the Philadelphia Fed's survey of professional forecasters (sample of 36 forecasters), the potential for negative GDP readings on a quarterly basis will remain significant until 3Q11, but less than 5% of the forecasters see a risk of deflation in the same period.
- Any further contraction in US GDP would likely confirm that this is still the 'Great Recession' that started in December 2007*. We believe that if a second dip occurs, it would be less pronounced than in 2009, not coupled with deflation but with prolonged sub-par inflation.

	Real GDP (%)		Unemployment Rate (%)	
	Previous	New	Previous	New
Quarterly data:				
2010:Q3	3.3	2.3	9.6	9.6
Q4	2.8	2.8	9.5	9.6
2011:Q1	2.7	2.3	9.3	9.4
Q2	3.2	3.1	9.1	9.3
Q3	N.A.	3.0	N.A.	9.0
Annual average data:				
2010	3.3	2.9	9.6	9.6
2011	3.1	2.7	8.9	9.2
2012	3.2	3.6	8.0	8.2
2013	2.9	2.6	7.1	7.3

Risk of a Negative Quarter (%)		
	Previous	New
Quarterly data:		
2010:Q3	9.8	14.0
Q4	12.3	16.8
2011:Q1	14.1	16.5
Q2	14.8	15.0
Q3	N.A.	14.9

Short-Run and Long-Run Projections for Inflation (Annualized Percentage Points)

	Headline CPI		Core CPI		Headline PCE		Core PCE	
	Previous	Current	Previous	Current	Previous	Current	Previous	Current
Quarterly								
2010:Q3	1.8	1.4	1.4	1.4	1.7	1.3	1.2	1.1
Q4	1.8	1.6	1.5	1.2	1.6	1.5	1.3	1.1
2011:Q1	1.9	1.8	1.5	1.2	1.8	1.7	1.4	1.4
Q2	2.0	1.6	1.6	1.4	1.7	1.5	1.5	1.4
Q3	N.A.	1.9	N.A.	1.6	N.A.	1.7	N.A.	1.5
Q4/Q4 Annual Averages								
2010	1.6	0.9	1.0	0.9	1.4	1.2	1.2	1.1
2011	2.0	1.8	1.6	1.5	1.8	1.7	1.6	1.5
2012	2.4	2.1	2.0	1.9	2.0	1.8	1.8	1.7
Long-Term Annual Averages								
2010-2014	2.19	2.00	N.A.	N.A.	1.80	1.82	N.A.	N.A.
2010-2019	2.40	2.30	N.A.	N.A.	2.15	2.11	N.A.	N.A.

Source: Federal Reserve Bank of Philadelphia
*Business cycles are dated according to the US NBER; http://www.nber.org/cycles/april2010.html

Monetary Policy:
Disinflation and the possibility of Fed's QE2

- According to the latest speech of the Fed Chairman Ben Bernanke, the FOMC considers three options to prevent the downside risk to growth and inflation: (1) conducting additional purchases of longer-term securities, (2) modifying the Committee's communication, and (3) reducing the interest paid on excess reserves. He also considered a fourth strategy, proposed by several economists, that the FOMC increase its inflation goals.
- Despite the sequence of disappointing data on the US economy pushing the yield curve to test historical lows and increasing the market's expectation of some action from the Fed, some factors will limit the possibility of a second quantitative easing cycle at the September 21 FOMC meeting:

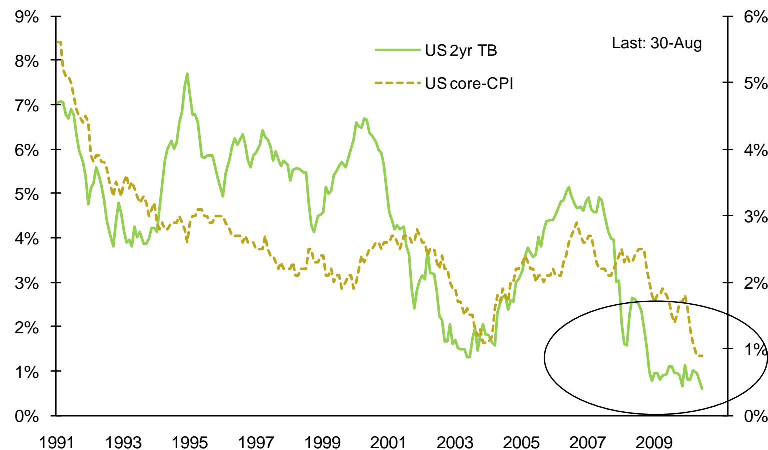
1. Fed's forecasting models take into account the survey of professional forecasters (no relevant risk of deflation by Jul/10).

2. Fed's Chairman Ben Bernanke continues to consider that expectations are anchored (no deflation perceived by consumer inflation expectations).

3. There will be three of the seven seats on the board of the FOMC vacant at the September 21 meeting. Nominations are on hold, depending on US Senate approval of current nominees of the Federal Administration. Bernanke may deploy the available tools if necessary but with limited board structure, he would be facing the risk of later be questioned on the legitimacy of taking a critical decision.

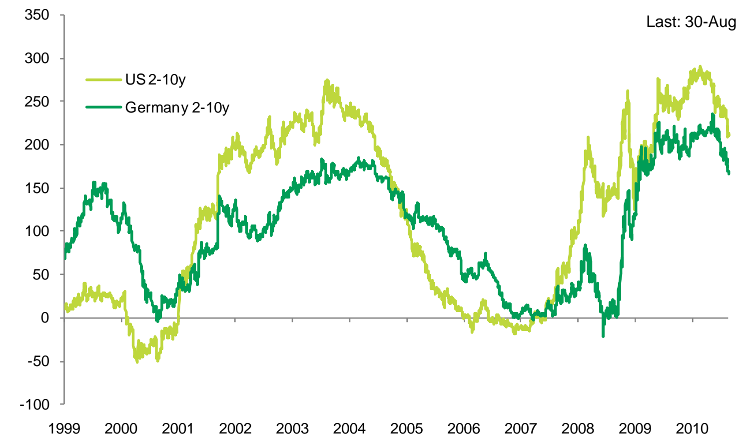
4. All the mentioned factors and the limited set of additional economic data available until the next FOMC meeting in Sep/10 suggest to us that the possibility of a move will be on the instrument of communication which may pave the way for the adoption of QE2 in November 3 or December 14.

US 2 year Treasury and Core Inflation



Source: Bloomberg, Analysis: ES Investment

Spread 2-10y – US Treasury vs. German Bund



Source: Bloomberg, Analysis: ES Investment

Monetary policy

US led disinflation in the short-run

- Term structure of the US treasuries yield curve flattened further in Aug/10 and the spillover was broad based in most of benchmark curves in Europe. In the absence of supportive data which could offset the additional risk of "double dip & deflation" in the US, the flattening will likely prevail in a narrow range bound trend by end of 3Q10.
- Our view is that US treasuries are likely to trade in the range of 0.40% to 0.70% for the 2yrs and in the range of 2.40% to 2.80% for the 10yrs.
- Meanwhile, German bunds will remain exposed to both US flattening and the risk of flight to quality moves from eventual disappointment emerging on the Eurozone's path to fiscal stabilization. Historically low rates of the 2yrs Bunds trading in the range of 0.50% to 0.70% and 10yrs at 2.40% to 2.80% may prevail in the current short-term scenario.

Inflation Forward Curves — 30-Aug

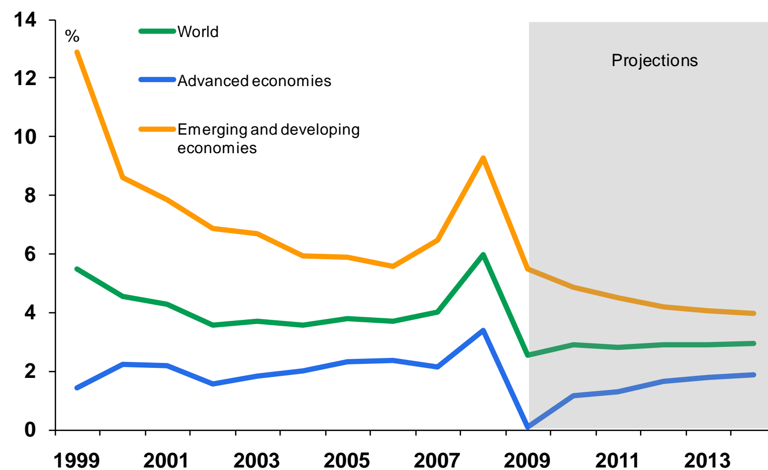
		1 YR	2 YR	3 YR	4 YR	5 YR	6 YR	7 YR	8 YR	9 YR	10 YR	12 YR	15 YR	20 YR	25 YR	30 YR
US Fed Target 1%-2%	Bid	0.66	0.86	1.13	1.30	1.45	1.62	1.75	1.86	1.96	2.01	2.13	2.22	2.28	2.32	2.35
	Ask	0.66	1.01	1.23	1.40	1.53	1.70	1.83	1.94	2.03	2.09	2.23	2.32	2.38	2.42	2.45
	Mid	0.66	0.94	1.18	1.35	1.49	1.66	1.79	1.90	1.99	2.05	2.18	2.27	2.33	2.37	2.40
Euro ECB Target 2%	Bid	1.30	1.29	1.31	1.34	1.37	1.43	1.50	1.55	1.62	1.67	1.74	1.81	1.87	1.94	2.06
	Ask	1.40	1.33	1.35	1.38	1.41	1.47	1.54	1.59	1.66	1.71	1.78	1.85	1.91	1.98	1.98
	Mid	1.35	1.31	1.33	1.36	1.39	1.45	1.52	1.57	1.64	1.69	1.76	1.83	1.89	1.96	1.96
UK BoE Target 2%	Bid	3.98	3.26	3.03	2.95	2.90	2.91	2.91	2.99	3.02	3.06	3.14	3.23	3.36	3.46	3.48
	Ask	4.28	3.31	3.08	3.00	2.95	2.96	2.95	3.04	3.07	3.11	3.19	3.28	3.41	3.51	3.53
	Mid	4.13	3.29	3.06	2.98	2.92	2.93	2.93	3.01	3.05	3.08	3.17	3.25	3.38	3.48	3.50
Japan BoJ Target 1.5%	Bid	-0.68	-0.64	-0.61	-0.58	-0.58	-0.51	-0.48	-0.44	-0.41	-0.37	-0.31	-0.23	-0.14	-0.09	-0.06
	Ask	-0.48	-0.44	-0.41	-0.38	-0.34	-0.31	-0.28	-0.24	-0.21	-0.17	-0.11	-0.03	0.06	0.11	0.14
	Mid	-0.58	-0.54	-0.51	-0.48	-0.46	-0.41	-0.38	-0.34	-0.31	-0.27	-0.21	-0.13	-0.04	0.01	0.04
Sweden Riksbank Target 2%	Bid	1.38	1.30	1.30	1.30	1.11	1.15	1.19	1.24	1.40	1.32	1.35	1.36	1.39	1.39	1.39
	Ask	1.88	1.80	1.80	1.80	1.61	1.65	1.69	1.74	1.90	1.82	1.85	1.86	1.89	1.89	1.89
	Mid	1.63	1.55	1.55	1.55	1.36	1.40	1.44	1.49	1.65	1.57	1.60	1.61	1.64	1.64	1.64
Spain ECB Target 2%	Bid	1.37	1.28	1.26	1.26	1.27	1.30	1.34	1.38	1.44	1.48	1.52	1.58	1.63	1.70	1.76
	Ask	2.80	2.61	1.76	1.76	1.77	1.80	1.84	1.88	1.94	1.98	2.02	2.08	2.13	2.20	2.25
	Mid	2.09	1.95	1.51	1.51	1.52	1.55	1.59	1.63	1.69	1.73	1.77	1.83	1.88	1.95	2.01
Australia RBA Target 2%	Bid	2.73	2.55	2.48	2.45	2.45	2.47	2.58	2.59	2.60	2.54	2.54	2.53	2.53	2.52	2.52
	Ask	2.93	2.75	2.68	2.65	2.65	2.61	2.69	2.61	2.62	2.74	2.74	2.73	2.73	2.72	2.72
	Mid	2.83	2.65	2.58	2.55	2.55	2.54	2.64	2.60	2.61	2.64	2.64	2.63	2.63	2.62	2.62

Source: Bloomberg

Monetary Policy and Inflation

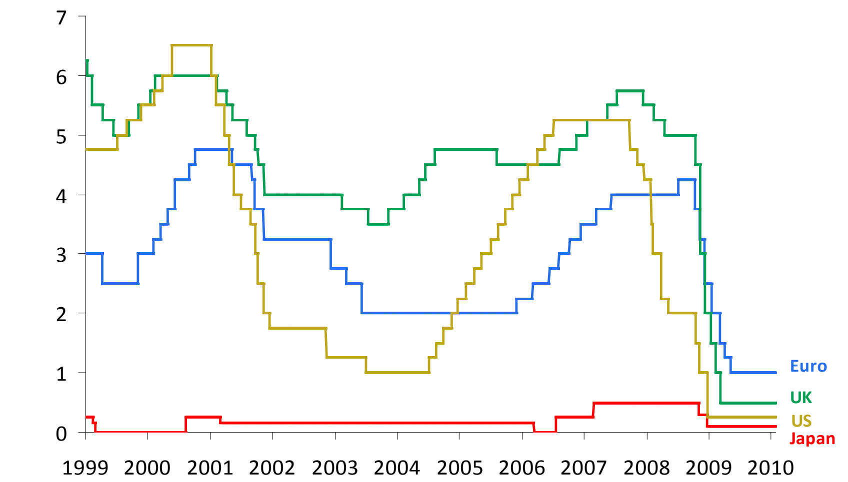
- Central banks' interest rate decisions in Sep/10 will be an interesting way to validate our view that some markets are decoupling from the risk in the US economy on the decision to normalize monetary conditions with the strengthening of their macro-fundamentals.
- From our list of fast growing high grade markets (see page 12), Sweden (9/2), Canada (9/8), and South Korea (9/9) are expected to raise their benchmark rate by 25bps, according to market consensus' estimates (Bloomberg), as growth fundamentals continue to advance. New Zealand (9/5) is also expected to make the same move. Other central banks like Norway (9/22), Brazil (9/1) and Australia (9/7) are expected to keep the speech of stronger economic activity leading to the possibility of additional moves in the 4Q10.
- These monetary policy decisions will be also reinforcing our view that the risk of a global scale deceleration will be limited in the 2H10 and that an outperformance of Asia will create an upside bias for the economies with stronger correltation with the region in the 4Q10 and 1H11.

Inflation: World, Advanced and Emerging Economies (CPI %)



Source: IMF Analysis: Espirito Santo Investment

Monetary Policy: US, UK, Euro and Japan



Source: Bloomberg

Risk factors

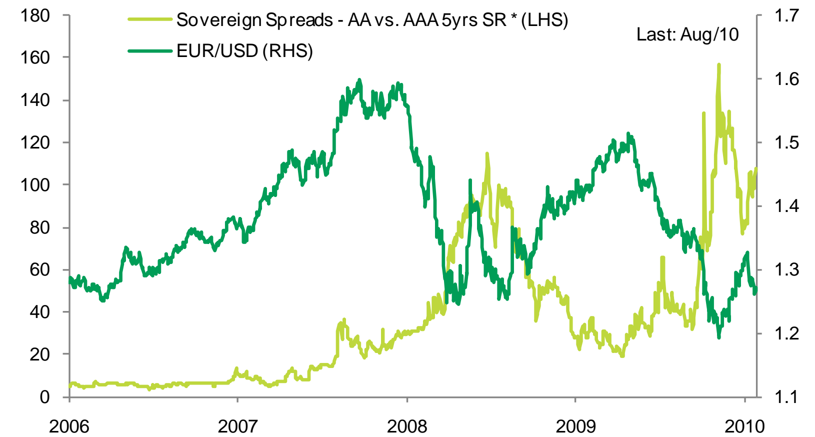
Global risk continue to penalize governments in the Euro area

- Despite the absence of negative events (the downgrade of Ireland's rating by S&P was mostly a non-event), two factors worked against the possibility of spreads narrowing in the Euro peripheral markets in August: reduced liquidity and the strong advance in German bunds. The risk aversion in the US which led to the strong decline in its treasuries yields was extended into the benchmark curves in Europe, especially German bunds.
- All peripheral Euro governments issued debt in the markets in August, continuing to build a liquidity cushion for 2011. Spreads remain close to historical highs, but nominal yields of these securities of 3.0%-3.5% for 2yrs bonds and 4.0%-4.5% for 5yrs of the Portuguese Republic, for example, are far from levels that would typically be associated with countries at risk of imminent need of financial assistance. So far, economic and fiscal figures are performing in line with the targeted levels; this has historically led to a gradual improvement in confidence and subsequently translates into a robust decline in risk spreads.
- The transition from the 3Q10 to the 4Q10 will remain marked by adverse conditions in a global context and negative bias for growth in G3 economies. However, in the case of the Euro area, excess risk aversion of the 2Q10 was replaced by a more realistic view that economic conditions did not deteriorate and governments will be able to refinance debt maturing in the next 12 months, at least. It reinforces our view that the EFSF will not be activated in 2010 .

	Moody's		Standard & Poor's		Fitch	
Investment Grade	Aaa	Spain (-)	AAA		AAA	
	Aa1		AA+		AA+	Spain
	Aa2	Italy/Ireland	AA	Spain (-)	AA	
	Aa3		AA-	Ireland (-)	AA-	Ireland/Italy/Portugal (-)
	A1	Portugal	A+	Italy	A+	
	A2		A		A	
	A3		A-	Portugal (-)	A-	
	Baa1		BBB+		BBB+	
	Baa2		BBB		BBB	
	Baa3		BBB-		BBB-	Greece (-)
Speculative Grade	Ba1	Greece	BB+	Greece (-)	BB+	

(-) Negative Outlook

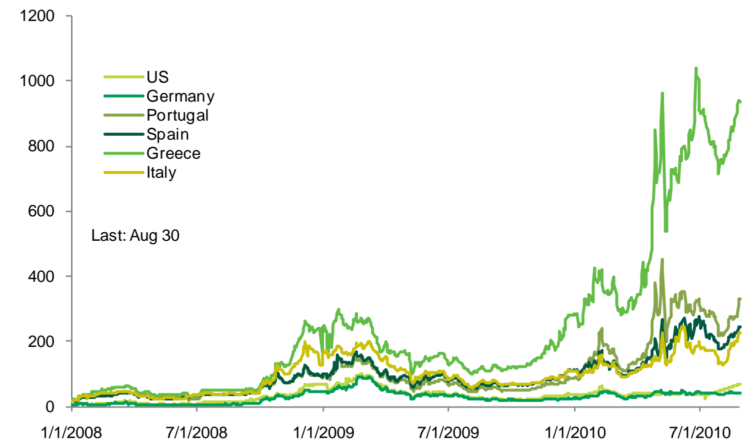
Sovereign risk premium in the Eurozone (AAA vs. AA) and EUR/USD



Source: Bloomberg, Analysis: ES Investment

*Sovereign bond rates differentials

Risk spreads (bps) :CDS market sovereign risk (SR 5yrs)



Source: Bloomberg, Analysis: ES Investment

FX markets:

Concerns about a second dip in the US leading to weaker USD

- While the EURUSD lost momentum in Aug/10, the JPY and the CHF appreciated to uncomfortable levels for central bankers in Japan and Switzerland who remain hampered by limited structural instruments to avoid further FX appreciation if acting individually. A coordinated action seems less likely since the recent USD has had a mixed effect and the cost of intervention is not attractive for central banks' balance sheets.
- Current central banks' approach of trimming the excess of markets' moves suggests that JPYUSD may slow the pace to break the 80 level but the prevailing USD weakness in the 2H10 will eventually test JPY highs of more than 15 years before "normalizing" in the range of 85-95 by the end of the year.
- The EURUSD in the range of 1.25 to 1.30 will be biased to test the support level in the case of negative events related to Euro area peripheral markets (mainly on risk of rating actions).
- Non G3 growing markets (CAD, SEK, NOK, and AUD) will remain coupled with the prospects of sustained growth and diversification outside USD, JPY, GBP and EUR. Emerging market and commodities-related currencies showed resilience to milder Chinese growth and a drop in energy and industrial commodities prices in July-August. Excess liquidity in G3 markets and diversification continues to favour flows to EM and commodity currencies.

Last:27-Aug						USD Forwards (mid curve)						USD Consensus - year end				
	Spot	MTD	YTD	12 months	24 months	1 Month	3 Months	6 months	1 Yr	2 yrs	5 yrs	2010	2011	2012	2013	2014
EURUSD	1.270	-2.67%	-11.29%	-11.37%	-13.42%	1.28	1.28	1.28	1.28	1.28	1.30	1.24	1.24	1.35	1.35	1.30
GBPUSD	1.553	-1.04%	-3.98%	-4.67%	-14.74%	1.55	1.55	1.55	1.55	1.55	1.55	1.51	1.52	1.58	1.58	1.57
JPYUSD	84.770	2.01%	9.73%	9.85%	28.35%	85.06	85.00	84.89	84.62	83.69	78.10	92.00	97.00	100.00	103.00	103.00
CADUSD	1.053	-2.24%	-0.01%	3.85%	0.99%	1.03	1.03	1.03	1.03	1.04	1.04	1.05	1.05	1.06	1.11	1.09
SEKUSD	7.392	-2.45%	-3.12%	-3.69%	-12.72%	7.34	7.35	7.37	7.41	7.46	7.48	7.69	7.88	7.18	7.07	6.98
CHFUSD	1.025	1.56%	0.98%	3.30%	7.41%	1.03	1.03	1.02	1.02	1.01	0.97	1.10	1.12	1.15	1.16	1.14
CNYUSD	6.803	-0.42%	0.35%	0.40%	0.54%	6.80	6.78	6.75	6.69	6.59	6.52	6.67	6.37	6.41	--	--
BRLUSD	1.754	0.06%	-0.54%	7.21%	-6.98%	1.76	1.78	1.82	1.90	2.06	2.46	1.76	1.80	1.75	1.80	1.85
RUBUSD	30.688	-1.57%	-2.13%	3.60%	-19.69%	30.72	30.88	31.14	31.83	33.33	38.19	30.38	29.75	27.78	--	--
INRUSD	46.915	-1.08%	-0.83%	4.07%	-6.35%	47.02	47.45	47.94	48.79	50.55	53.93	45.50	43.50	41.00	40.00	40.00
PLNUSD	3.132	-1.97%	-8.59%	-8.74%	-27.49%	3.12	3.13	3.15	3.19	3.25	3.11	3.20	3.17	2.79	2.59	--
AUDUSD	0.897	-0.81%	-0.09%	6.28%	4.56%	0.89	0.89	0.88	0.86	0.83	0.75	0.88	0.86	0.90	0.81	0.79
NZDUSD	0.710	-2.26%	-1.83%	3.58%	1.30%	0.71	0.71	0.70	0.69	0.67	0.61	0.71	0.70	0.68	0.65	0.64
ZARUSD	7.318	-0.29%	1.09%	6.27%	5.28%	7.34	7.41	7.52	7.73	8.16	9.57	7.64	8.00	7.70	6.90	6.90
CLPUSD	497.930	4.68%	1.91%	11.19%	3.05%	500.64	501.77	504.41	510.65	524.93	565.89	510.00	500.00	--	--	--
MXNUSD	13.098	-3.46%	-0.05%	2.02%	-21.46%	13.05	13.13	13.26	13.53	14.12	15.76	12.25	12.15	12.00	--	--
KRWUSD	1192.150	-0.79%	-2.36%	4.76%	-8.66%	1194.50	1197.80	1202.33	1209.70	1224.10	1258.10	1140.00	1102.00	1090.00	1050.00	--
HKDUSD	7.779	-0.16%	-0.32%	-0.37%	0.32%	7.78	7.77	7.77	7.76	7.74	7.69	7.77	7.75	7.75	--	--

Source: Bloomberg

						EUR Forwards (mid curve)						EUR Consensus - year end				
	Spot	MTD	YTD	12 months	24 months	1 Month	3 Months	6 months	1 Yr	2 yrs	5 yrs	2010	2011	2012	2013	2014
EURGBP	0.818	-1.64%	-7.61%	-7.03%	1.55%	0.82	0.82	0.82	0.82	0.83	0.84	0.81	0.80	0.79	0.78	0.78
EURJPY	107.692	-0.71%	-2.66%	-2.64%	11.12%	108.61	108.52	108.36	107.95	106.91	101.70	113.00	117.00	125.00	122.00	123.00
EURCAD	1.206	-0.44%	-11.28%	-14.65%	-14.27%	1.24	1.24	1.24	1.24	1.23	1.25	1.18	1.18	1.27	1.22	1.19
EURSEK	9.390	-5.05%	-14.06%	-14.64%	-24.44%	9.38	9.39	9.41	9.45	9.54	9.74	9.30	9.20	8.98	8.83	8.68
EURCHF	1.302	-1.15%	-10.43%	-8.45%	-7.00%	1.31	1.31	1.31	1.30	1.29	1.26	1.34	1.37	1.40	1.47	1.48
EURBRL	2.228	-2.61%	-11.77%	-4.98%	-19.46%	2.25	2.28	2.33	2.42	2.63	3.21	2.18	2.23	2.36	2.43	2.41

Source: Bloomberg

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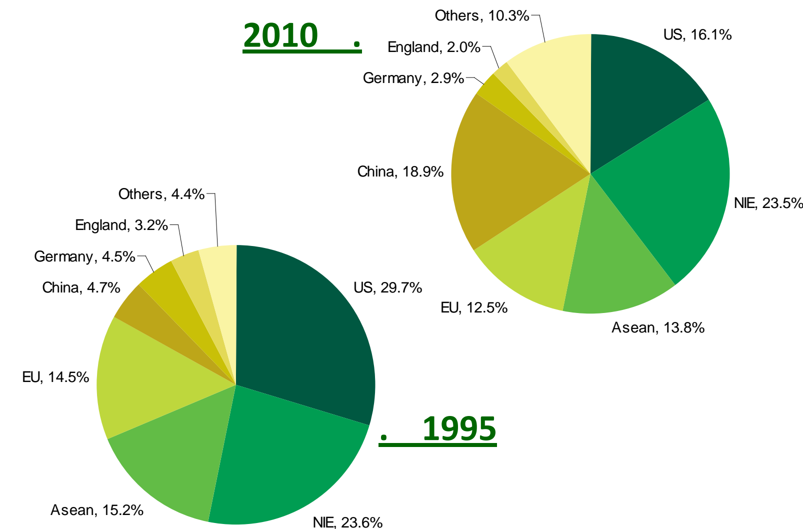
The recent moves in the USDJPY:
Is there a case for the intervention of BoJ?

- As a consequence of the risk-averse sentiment, the yen is currently trading at historically high levels against the dollar, staying under USDJPY100 barrier since April 09.
- The Bank of Japan has been under pressure to intervene in the FX market, given the potential downside to the Japanese exporting sector (which accounts for almost 13% of the national GDP). Japan's largest manufacturers said in a survey released February that they "can remain profitable as long as the yen trades at 92.90 per dollar or weaker".
- The parallel with 1995, when the dollar-yen reached 80.63, is often referred to. However, the profile of the Japanese exports has considerably changed. As seen in the charts to the right, if the US once was the main trade partner of Japan, its importance has considerably faded, in favor of other Asian countries (being clearly surpassed by China, for instance).
- As of now, not only did the yen not appreciate as much as before, the destination of exports is much more diversified, meaning the impact is smaller and less localized.

Main destination of the Japanese Exports



Source: Bloomberg;
Notes: NIE stands for "New Industrialized Countries", comprising South Korea, Hong Kong, Taiwan and Singapore.

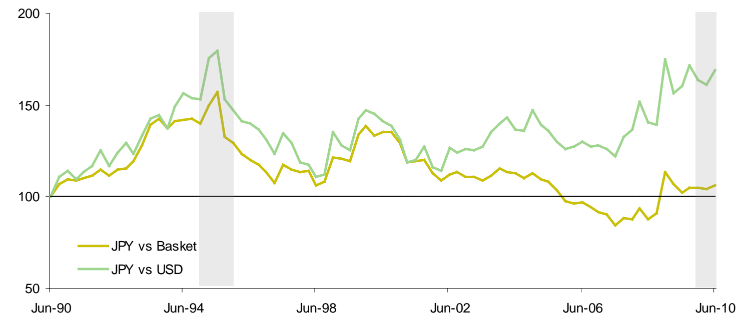
JPY appreciation against the currencies of its main export partners

	USD	NIE	ASEAN	EU	CH	GE	UK
Jan95 - Jul95	21.0%	14.9%	22.9%	-1.5%	18.1%	1.2%	16.9%
Jan10 - Jul 10	12.3%	14.9%	12.0%	28.1%	11.0%	28.1%	17.3%

Source: Bloomberg; Analysis: ES Investment

Notes: For the economic blocks, a basket of the currencies of the member countries was created, weighted by the exports of Japan to each country within the block. Concerning the EU, a theoretical Euro (Bloomberg ticker: THEOEURO Index) was used for the 1995 period. As for Germany, the 95 values concern the appreciation of the Yen against the German mark, and the 2010 value the appreciation against the Euro.

JPY Real Exchange Rate appreciation (Jun90=100)



Source: Bloomberg, BoJ; Analysis: ES Investment
Notes: "Basket" is a currency basket weighted by the trade importance of each currency to Japan, as of 1993.

- The yen has appreciated over 10% against all the export partners considered here. However, despite this rally in the currency, we note the positive performance of the main Japanese exporters in this 2Q earning season, consistently topping analysts' expectations, and the improving reports on the economy.
- We take a look at the evolution of the real exchange rate of the yen since 1990. While it can be seen that, back in April 95, the yen valued on real terms was highly overvalued both in dollars and against the basket of other currencies, as of now, the real exchange against the basket is at the same level as that of 20 years ago (see graph to the right)
- Given that the yen is overvalued mostly against the dollar, its overall impact on trade terms is contained. Thus, considering the high costs of an intervention and the apparent lack of support of other central banks to do so, our opinion is that it is not likely that the BoJ will directly intervene to correct the JPY (as seen in 2003-2004).

Fast growing 10 high grade markets and BRICs:
Milder but healthy growth in 2H10

- Disappointment in Chinese and US economies led to the consensus revision of a milder expansion in the global economy during the 2H10. However, some regions continue to post economic indicators suggesting that no significant contagion is in place or even the possibility that Asia, including China, is facing the risk of a larger deceleration.
- In fact, the Chinese economy seems to be just taking a quick pause for breath in the 2Q and 3Q before picking up the pace in the 4Q10 as some evidence of heating economic conditions emerged from exports and manufacturing activity of Chinese trade partners such as South Korea and Australia (both economies continued to move above expectations in Jul/10).

2009 GDP (Current USD bn)

G3 + UK	33541
US	14256
Eurozone	12033
Japan	5068
UK	2184

BRICs	8948
China	4909
Brazil	1574
Russia	1229
India	1236

10 Alternative High Grades	6190
Canada	1336
Mexico	875
Australia	997
Korea	833
Taiwan	379
Poland	430
Sweden	405
Norway	383
South Africa	287
Thailand	264

Source:IMF

Last: 23-Aug

	Annual change in GDP (%)*									S&P Rating	FX rate (1yr % Chg)***	CDS Spreads (5yrs bps)****	Equity index (1yr % Chg)*****
	Avg. 1999-2008	2009	1Q10	2Q10	*2010*	*2011*	*2012*	*2013*	*2014*				
Australia	3.3	0.7	**2.7**	**2.7**	***2.0***	*3.3*	*3.4*	*3.2*	*3.0*	AAA	6.4%	55	6.5%
Canada	2.9	-2.5	**3.1**	**3.8**	***2.1***	*3.6*	*3.3*	*2.5*	*2.1*	AAA	4.2%	--	8.2%
Chile	3.8	-1.6	**1.5**	**6.5**	***-1.5***	*4.7*	*6.0*	*4.8*	*4.6*	A+	10.2%	29	37.1%
Mexico	3.0	-7.3	**4.3**	**7.6**	***3.3***	*4.9*	*5.5*	*5.3*	*4.9*	BBB	2.7%	131	11.0%
Norway	2.4	-1.9	**-0.8**	**1.4**	***1.3***	*1.8*	*1.9*	*2.0*	*2.1*	AAA	-3.9%	25	16.1%
Poland	4.2	1.0	**3.0**	3.2**	***2.2***	*4.0*	*3.9*	*3.9*	*4.0*	A-	-8.7%	161	10.4%
South Africa	3.9	-2.2	**1.6**	3.0**	***1.7***	*3.8*	*4.3*	*4.5*	*4.5*	BBB+	6.4%	171	5.7%
Korea	5.3	-1.0	**8.1**	**7.2**	***3.6***	*5.2*	*5.0*	*4.7*	*4.5*	A	4.8%	135	9.5%
Sweden	2.8	-4.8	**3.0**	**3.7**	***1.2***	*2.5*	*3.0*	*3.5*	*3.9*	AAA	-3.6%	38	9.6%
Taiwan	3.8	-4.1	**13.7**	**12.5**	***3.7***	*4.2*	*4.8*	*5.0*	*5.0*	AA-	2.8%	--	13.7%
Thailand	4.8	-3.5	**12.0**	**9.1**	***3.7***	*4.5*	*5.0*	*6.0*	*6.0*	BBB+	8.7%	135	38.5%

Source: IMF; Bloomberg Analysis: Espirito Santo Investment

* YoY(%) ** Bloomberg Consensus *** FX vs. USD **** CDS and *****Local currency (Jul-10)

ESPIRITO SANTO Investment

Commodities:

Weakness in the short-run is not a trend for the 4Q10

- Slower trade across the majority of asset classes in Aug/10 led commodities markets to follow the US centered risk scenario, except for agricultural products owing to a series of supply shocks in grain markets.
- Precious metals advanced with the diversification of inflows seeking seemingly safer assets that are an alternative to the US or German low yielding treasuries securities and the JPY and CHF FX rates. They may still have the upside bias of emerging markets' growth to extend its legs into the 4Q10, with our view that gold will be testing USD1250-1300 in the short-run.
- Despite the negative US outlook, crude oil seems to be sustaining the trading range of USD70-75/barrel if risk aversion persists in Sep/10. Higher demand in Asia (secular trend) and lower inventories at the end of the hurricane season in the gulf of Mexico (Oct-Nov) continue to support our view that oil will move to the range of USD80-90/barrel by the end of 2010.
- Industrial metals have different individual stories in the short-run, but the strength of copper prices continues to reinforce the prospect of gains in the 4Q10. The end of 3Q still looks challenging for industrial commodities as markets will continue to test the risk of a "second dip" in the US.

Baltic Dry Index

Source: Bloomberg

Last: 30-Aug

		Spot	MTD	YTD	12 months	24 months
Crude Oil	Brent	75.950	-2.98%	-1.62%	4.92%	-32.18%
	WTI	74.480	-5.66%	-6.15%	2.39%	-35.49%
S&P GSCI Index	Total Return	4108.100	-3.40%	-9.40%	-4.32%	-52.28%
	Agriculture	609.921	2.92%	-0.91%	9.65%	-27.74%
	Energy	879.049	-5.69%	-13.50%	-10.19%	-63.25%
	Industrial Metals	1617.427	-0.59%	-5.24%	10.16%	-16.81%
Precious Metals	Gold	1237.350	4.77%	12.80%	29.57%	48.87%
	Silver	19.006	5.53%	12.63%	29.06%	39.65%
Industrial Metals (LME 3 mo)	Aluminum	2058.000	-5.38%	-7.71%	9.24%	-25.57%
	Copper	7459.000	2.23%	1.14%	18.96%	-2.50%
	Steel	515.000	0.00%	39.19%	24.10%	-33.55%
	Zinc	2095.000	3.46%	-18.16%	14.42%	13.30%

Source: Bloomberg

US Equities: 2Q earnings season

Testing the consensus vs. actual reports

- The 2Q earnings season came out extremely positive, with US companies topping analysts expectations*. Results were sustained across sectors, with Financials being the greatest surprise.
- The miss in the forecasts may be explained by a difficulty to grasp a better than expected economic performance in the 1Q, along with analysts possibly underestimating the higher efficiency of the companies' cost structures in the aftermath of the difficulties faced in 2009.
- Another interesting note is that while *Cyclical* and *Non-cyclical Consumer Goods* increased above expectations, *Basic Materials* fell relative to the 1Q. This may be taken as an indication that companies are being unable to pass cost increases onto consumer lines.
- It is also worth noticing the trend of smaller companies posting the greatest increase in earnings, and the fact that, in overall terms, revenues coming from emerging economies grew faster than those from developed ones.

A snapshot of the 2Q earnings season

	Results
Earnings' Surprise (1Q)	15.0%
Expected Change on Earnings (2Q)	2.5%
Earnings' Surprise (2Q)	11.5%
Actual Change on Earnings (2Q)	13.2%

Source: Bloomberg; Analysis: ES Investment

Notes:

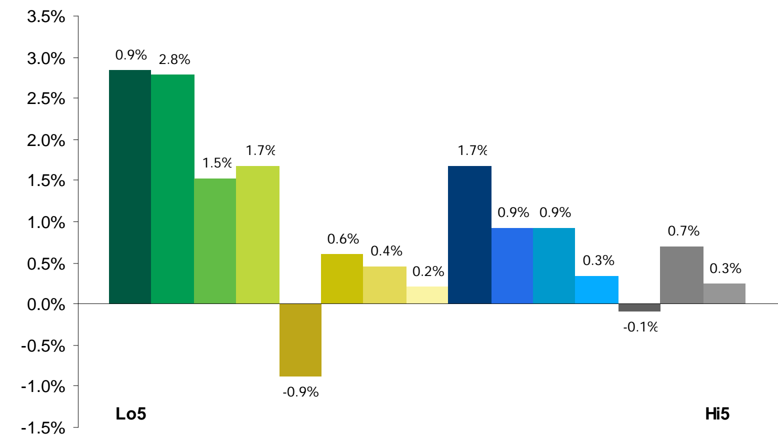
- Earnings' surprise is computed as the % change of actual EPS against analysts' estimates.
- Expected Change on Earnings is computed as the % change of analysts' estimates for this period's EPS against the previous quarter EPS.
- Actual Change on Earnings is computed as the % change of the current period's EPS against the one from the previous period.
- All of the values are presented as a weighted average of market cap.

The 2Q Earnings Season by Industry Sector

	Expected Change on Earnings	Earnings' Surprise	Actual Change on Earnings
Basic Materials	-0.1%	0.2%	-0.1%
Communications	-0.5%	0.6%	-0.2%
Consumer (C)	0.0%	0.5%	0.5%
Consumer (NC)	1.6%	1.1%	2.5%
Energy	0.8%	0.4%	2.5%
Financial	-2.6%	7.5%	1.4%
Industrial	2.5%	1.9%	4.2%
Technology	0.8%	2.4%	2.5%
Utilities	-0.2%	0.3%	-0.1%

Source: Bloomberg; Analysis: ES Investment

Change on Earnings (2Q vs 1Q) by Market Size



Source: Bloomberg; Analysis: ES Investment; Notes: 150 companies divided in 15 buckets with 5 companies each.

* Bloomberg consensus

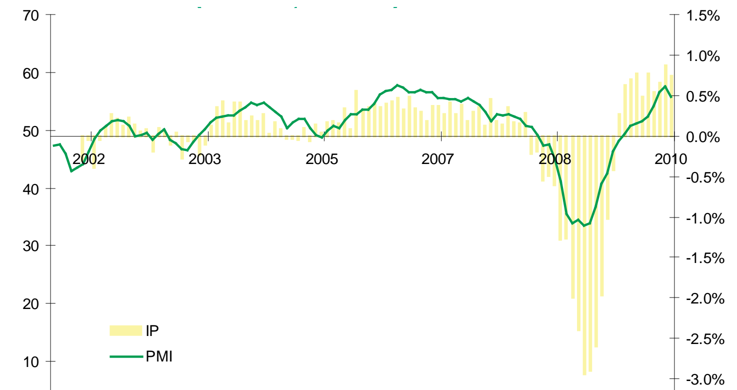
Note: This study comprises the top 150 companies listed in the US, sorted by market size.

Industrial production in the US vs Eurozone

- The Purchasing Managers Index (PMI) is closely correlated to the evolution of the Industrial Production (IP) Index, as the former reflects the managers' expectations of the economic performance in the coming 6 months.
- The correlation between these two indicators is strong enough for us to manage to derive estimates for the IP Index based on the PMIs (as the latter are released in advance).

- Comparing these two indicators, our model suggests that, in the **US**, managers' expectations seem to be **overvalued by 2.6%**, with respect to the actual IP values.
- By contrast, in the **Eurozone**, managers seem to be more cautious with their predictions, **understating the IP Index in 0.6%.**
- Based on the result of our study, estimates for the upcoming IP values for both areas are shown below.

PMI vs IP (% MoM, 6m MA) - Eurozone



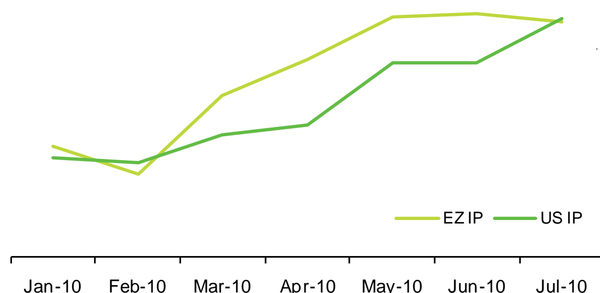
Source: Bloomberg, Analysis: ES Investment

Estimates of Industrial Production for the remaining of 2010

	Sep	Oct	Nov	Dec
EZ	2.2%	0.9%	-1.6%	-0.2%
US	1.2%	0.3%	-0.3%	-1.4%

Analysis: ES Investment

Industrial Production of the US and Eurozone (Jul09=100)



Source: Bloomberg, Analysis: ES Investment

- Intuitively, a faster pace of the Eurozone Industrial Production may be expected given these figures. Not only does this seem to be a future trend, it also has been increasing at a faster rate for the past six months (see bottom left graph).

- Therefore, based on this major driver of economy growth, it is not clear why Europe has been outperformed by the US since the beginning of 2009 (return of the MSCI US vs. MSCI Europe is 3.36% (p.a.); return of the EUR/USD is -36.4%).
- For an international investor, this has special relevance if we take into account the fact that exports account for just 11.0% of the US economy, against 19.6% for the European economy.

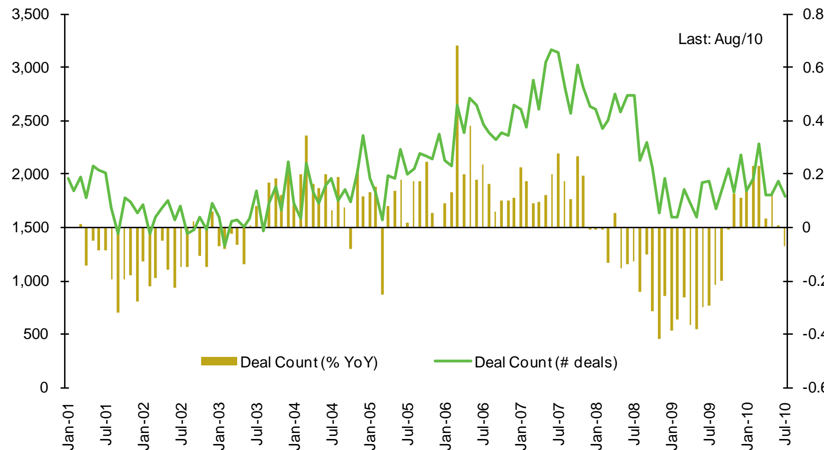
- It is thus advised to underweight the exposure to the US economy in favor of Western Europe markets (with higher selectiveness in sectors less exposed to governments of peripheral Euro economies).

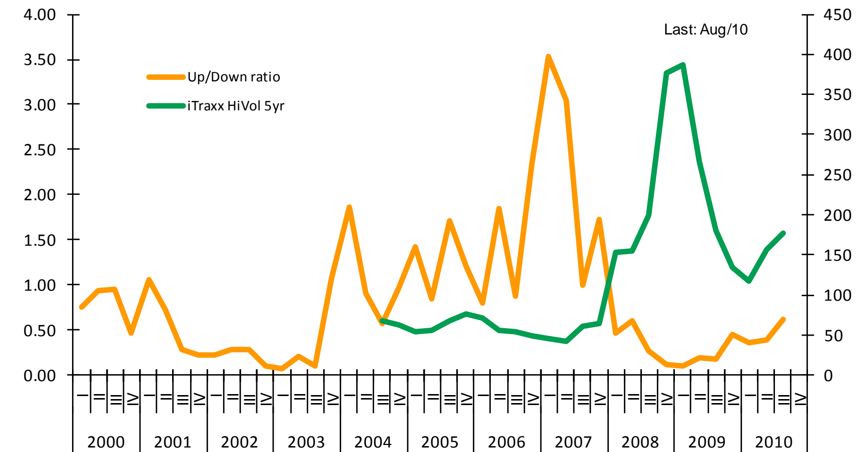
Note: All values and analysis as of July 2010.

Credit markets

Extended period of contagion in the credit markets

- Supply conditions are seasonally weak in August, but Aug/10 was even worse with the restrictive conditions of wide spreads observed in Euro peripheral government bonds.
- Lower benchmark rates in US treasuries and German bunds were coupled with the flattening of market curves which may favor higher activity by issuers at the beginning of Sep/10.
- Credit spreads followed the same pattern as spreads of government bonds in the Euro peripheral markets: there was some widening in yields and a larger move of German bunds and the swap curve in response to the sharp rally by US treasuries.
- With short-term rates at historical lows on both sides of the Atlantic, some appetite for higher yields may favor corporate credit, with our expectation of decoupling of rating fundamentals between sovereign and corporate bonds over the remainder of the year. Last but not least, consolidation through cash led M&A is expected to be gradually replaced by some leverage in debt markets with the expected rebound of the global economy in 2011.





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