



V A L B Y

Market Update

December 2011

Macro Economic Comments

After a very turbulent year in the markets, December turned out to be much calmer. No news regarding the European debt crisis was delivered during December. Instead, American macroeconomic data was given more attention, which resulted in the equity markets ended the year on a high note. The most important news from the US was among others the improved data regarding employment and the number of purchased homes. Simultaneously the US, Australia and China showed improved Purchase managers index (PMI), which further improved the end to 2011. The sum of these improvements has led to that the US GDP is expected to rise by 2,5 % in 2012.

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If we turn our heads towards Europe, the markets finally showed faith in the political decisions regarding the debt crisis taken during the fall. Several bill auctions took place during December and all of them resulted in lower interest for distressed countries like Spain and Italy compared to the previous month.

Going into 2012 there are still many unanswered questions from 2011. The United States are in a complicated and locked political situation which is blocking important political and economic decisions in Washington. In Europe, one of the most important issues during 2012 will be how the politicians resolve the current economic crisis and how this will impact the global economy. One beacon of light in the economic darkness is the fact that industry production, corporate cash flows and supply of liquid assets look better today than during the financial crisis in 2008. 2012 will continue to be characterized by both political and economic uncertainty, both in Europe and in the rest of the world.

BONDS

During the days leading up to European Unions meeting in the beginning of December, the rating agency Standard & Poor announced that many countries in the Eurozone were at risk for being downgraded on their credit rating. During all of December, both the ECB and FED bought vast quantities of government securities to keep the interest rates low. The fact that even Italy and Spain were able to get lower interest rates shows that the political actions taken have shown some merit.

FOREX

The Euro depreciated in comparison to almost all other currencies despite the fact that good result from the European bill auctions. Even though the central banks have taken liquidity measures there are still doubts about the future of the Euro which results in other currencies being

preferred as safe harbors.

Like equities, currencies had a slower month than we have seen during the fall.

COMMODITIES

Industry metals continued to be under pressured following the general speed reduction in the economy. Zinc was the metal which had the greatest problems and fell almost 10 % during December. Precious metals, especially gold and silver also suffered heavy losses during the year's last month.

Oil prices continued to rise, which concludes the fact that oil prices have now risen for three straight months. Today the price of a barrel of crude oil is around 110 dollars. Stock levels are declining but are still above average and the impact of geopolitical risks will become even bigger for the price going forward.

The broad commodity index RJ/CRB fell 1,84 % during December.

EQUITIES

The stock market had a calmer month than during previous months this fall. During the first two weeks of December the markets showed a small decline only to rally as the new year came closer. The rally can largely be traced to the improved macro economic data from the US. The same pattern was noticed on the Stockholm Stock Exchange which finished the year with a big bump resulting in a result of -14,5% for the year.



On a global scale only ten of the 91 national indexes fished in black. The Dow Jones was one of these and finished the year + 8 %-. As we know, the BRIC countries had a tough year due to lower economic growth and rising inflation. Brazil dropped 25 % during the year and India plummeted by 35 %.

VALBAY ASSET MANAGEMENT

During December the equity markets in the US showed a continued strength in comparison to almost all other global regions. Our global equity allocation had an exposure of 20 % against the US equity market, which can be compared to the world index which has an exposure of 43% against the US markets. This means that we had a smaller exposure towards the US than the broad world index. We have since some time had a larger exposure

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towards emerging markets since we see better yield potential there than in other regions. Many of the emerging markets showed a very poor development during 2011 in light of risk aversion and concerns about India, Brazil and China's growing pains resulting in high inflation. Concerns regarding the Chinese real estate market have also contributed to dampen the development in the Chinese stock market.

Going into 2012 we continue to be optimistic about the emerging markets. Inflationary pressure is declining, which allows monetary stimulants which in turn could help the equity markets in these countries. Due to our beliefs we have not made any reallocations in our equity exposure during December. Our course is still cautiously positive as we head into 2012.

Within our bond allocation we increased the share of money markets funds to 50 % from 30 %. The proportion of so called High Yield (bonds with high risk) is unchanged at 12,5 % and the so called Investment Grade (bonds with low risk) is also unchanged at 25%. We see a substantial risk of severe losses in bonds with long maturity, which has resulted in our reallocation.

In 2012 the financial markets will probably continue to be characterized by the debt crisis in the western world. This due to countries, companies and consumers needing to

further pay off their loans resulting in fewer investments. Austerity packages will inhibit the economic growth, especially in Europe. During 2012, some of the world biggest economic powers including, the US, China, France, Russia and India will face elections which could add to the current turmoil in the financial markets.

of positive factors which leads us to be cautiously positive going into 2012:

The rebound in the US economy is stable, a number of economic indicators point up again and employment is rising. We see signs of the American real estate market finally turning around after years of decline.

Both the ECB and the FED have used very expansive monetary policies, which means that both banks are adding or supplying large quantities of liquidity. At the same time many other central banks have started lowering interest rates and reducing reserve requirements.

The European politicians are taking measures to tighten the budget discipline, build rescue funds and integrate in order to retake confidence and save the European Monetary Union. This work will be instrumental for the development of Europe in 2012.

To summarize we can say that the market climate is grim and so are the expectations. With such an environment small changes can give big outputs.

We are in for an exciting year!

We at Valbay want to wish you all a Happy New Year!



Against the known negative powers there are a number

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