WEALTH MANAGEMENT
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Marcuard Heritage: Quarterly Asset Allocation Outlook

1st Quarter 2012

A retrospective view on 2011 Q4

The fourth quarter did not give investors a pause as the rollercoaster environment of the markets prevailed. Sudden drops in the stock markets which stopped out some investors were followed by sudden rallies. This happened also in December which supported buy-and-hold investors much more than active investors who were essentially whipsawed.

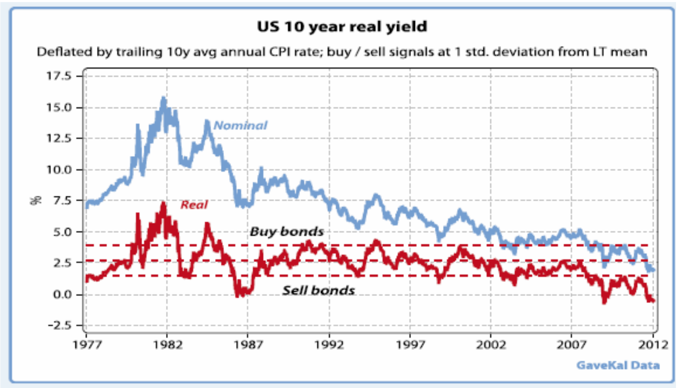
Table 1: 2011 the Year when Gold, US and German Government Bonds excelled

Equity Markets	2011	Dec (%)	Nov (%)	Oct (%)	Sept (%)
MSCI World Gross USD	-8.0%	-0.6%	-3.2%	9.8%	-8.7%
S&P 500	0.0%	0.9%	-0.5%	10.8%	-7.2%
MSCI Europe Gross	-10.9%	2.0%	-1.4%	7.8%	-4.6%
MSCI AC Asia Pacific	-17.3%	0.3%	-6.7%	7.6%	-9.5%
MSCI BRIC	-24.9%	-2.3%	-8.0%	15.6%	-16.8%
Fixed Income & Credit					
BarCap Global Aggregate Index (USD Hedged)	5.4%	1.5%	-0.5%	-0.1%	0.6%
JPM GBI EMU AAA TR USD	4.0%	-0.6%	-4.4%	2.4%	-4.9%
Global Gov Bond Index All Maturities (USD)	3.7%	0.5%	-1.3%	-0.2%	-1.6%
Bloomberg EFFAS **US** Gov Bond 3-5 Years	3.9%	0.2%	-0.1%	0.0%	-0.2%
Bloomberg EFFAS **US** Gov Bond 10+ Years	23.9%	2.6%	1.4%	-3.1%	9.3%
Bloomberg EFFAS **EURO** Gov Bond 3-5 Years	-2.1%	2.8%	-2.5%	-1.3%	-0.3%
Bloomberg EFFAS **EURO** Gov Bond 10+ Years	-2.2%	6.0%	-4.3%	-4.1%	1.4%
Bloomberg EFFAS German Bonds 1+ Years	6.4%	2.9%	-0.8%	-0.9%	2.2%
Markit iBoxx Global EM LC Bond Index	-3.2%	-0.9%	-3.0%	3.8%	-8.8%
CS High Yield Index	5.5%	2.5%	-1.8%	4.5%	-1.2%
Alternatives & Commodities					
HFRX Global Index	-8.9%	-0.4%	-0.9%	0.8%	-3.0%
HFRI Fund of Funds Composite Index	-5.5%	-0.3%	-1.0%	1.1%	-2.8%
Dow Jones Credit Suisse Core Hedge Fund Index	-7.6%	-0.6%	-1.0%	1.9%	-4.2%
DJ-UBS Commodity Index	-13.4%	-3.8%	-2.2%	6.6%	-14.7%
Gold	10.1%	-10.5%	1.8%	5.6%	-11.0%

Source: Bloomberg

While gold had to face selling pressure in the last quarter of 2011 which more than halved the otherwise splendid annual performance, government bonds, notably of the US and Germany, had a very strong though somehow unlikely run. As table 1 shows, while gold prices appreciated by more than 12% for the year, US government bonds with maturity above 10 years returned more than 23%(!) while German bunds on average returned more than 6%. This is remarkable as we remember that one part of the ongoing current crises is related to governmental debt issues of many developed markets which led to a succession of credit rating downgrades all through the year. One consequence, though, are the negative real yields for "safe(r)" governmental debt in the more stable countries of the developed world.

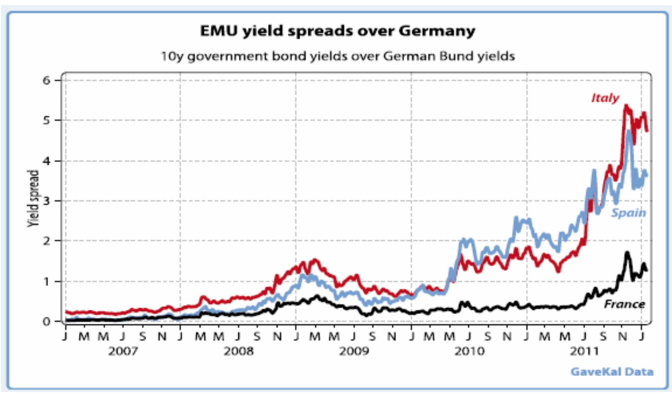
Chart 1: Real Yields have become negative for "safe(r)" Bonds



Source: GaveKal

The demand for "safe(r)" bonds caused also a further widening of the spreads across the EU members (see Chart 2). These spreads will not narrow until confidence in the Euro-zone set-up is restored. Finally, corporate bonds were supported well by a combination of healthy corporate balance sheets and demand for yield by the investors. For instance, high yield bonds returned about 5.5% for the year as shown in Table 1.

Chart 2: The EU Confidence Crisis prevails as Spreads remain high



Source: GaveKal

Also, stock market volatility came back significantly by the end of December as economic data in the US was constructive while Euro-zone's crisis management seemed to have satisfied the markets for the time being.

Interestingly, while the US stock markets came back strongly, e.g. the S&P 500 ended with a flat performance for the year, the other stock markets of the developed world did recover only partially but stayed in the negative territory. More surprisingly, the emerging markets including the BRIC were hit much harder, proving once more that financial decoupling is still a premature assumption.

Hedge Funds in general had a difficult year as their often fundamental approach did not work in times of ongoing exogenous policy shocks. Fortunately, the Hedge Fund manager selection by Marcuard Heritage was superior to the respective indices.

What to expect for 2012?

2012 will not be an easy year. Macroeconomic events will again dominate the headlines, the markets and sentiments. The global economy will face a slowdown and some economies will likely enter into a recessionary territory. This is particularly true for Europe. The EC members need to figure out how to achieve budgetary discipline with effective controls. As long as the markets' lack of conviction prevails on how the EC will manage its national debts and avoid a systemic banking crisis there is the danger of a negative feedback loop as the skeptical investment sentiment aggravates the situation. It will be interesting to watch how the ECB will position itself as the pressure will be mounting that it should become much more supportive through monetization similar to the quantitative easing programs in the US, i.e. to become the lender of last resort.

Having said this, and despite all rhetoric, just before Christmas, the ECB extended its Long Term Refinancing Operation (LTRO) which offers banks three-year loans at a discount against a range of collateral, from 12 months to 36 months. Banks jumped on this facility and acquired about EUR 489bn. This action removed the liquidity risk in the banking sector and potentially avoided multiple bank failures. With this action the ECB did, in fact, a QE in disguise!

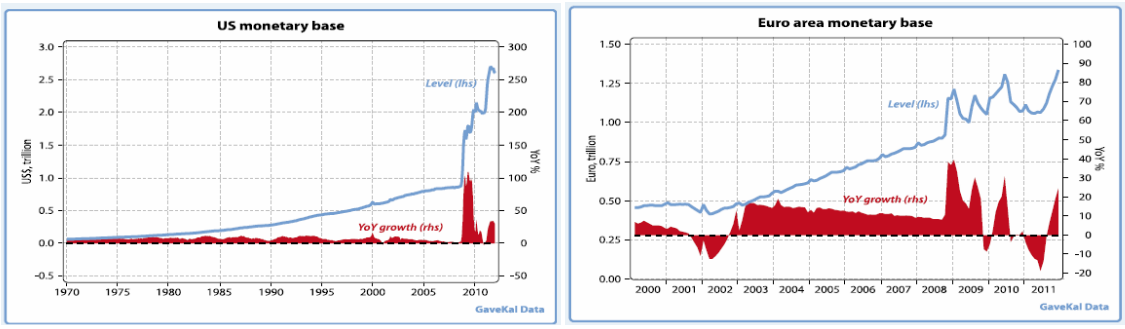
March will be a critical time when Greece will go through another phase of debt restructuring, i.e. with bond redemptions totaling approximately EUR 16bn. We are cautiously positive that policy makers will avoid a Euro break-up and that banks are successfully supported to muddle through. However, the verdict is out how much fiscal integration the Euro-zone will have achieved by the end of 2012.

Unfortunately, the EU woes will potentially affect the rest of the world again as it did last year when EMs' and BRIC's stock market suffered even more than the European one's. Generally, the developed markets will continue their effort to de-lever their economies which will not leave much space for positive impulses to the global economy.

As GaveKal puts it: "While Asia's structural growth rate is higher than that of the West, Asian countries' export dependence means that the economic growth cycles follow the cycles of the Western countries that provide the final demand. These cycles are amplified for Asian assets, as foreign liquidity flows exacerbate any reaction to changes in growth expectations."

Just before last Christmas, investor sentiment seemed to have changed. Despite the ongoing concerns, more investors believe that all the bad news is adequately reflected in the asset prices and that the odds for positive surprises have significantly risen. This mood swing was accentuated thanks to the string of positive economic news from the US and from some countries in Europe, notably with respect to Germany. Also, the majority of investors reckon that the ECB will ultimately follow the Fed as it will become more active to stimulate the European economy. The afore-mentioned LTRO operation might have been a taste of more to come. Chart 3 shows that the ECB has already supported the European economies over the last years including an accelerated expansion of the monetary base in the last year. Nevertheless, in comparison with the Fed, the ECB's actions were so far rather timid.

Chart 3: The Monetary Bases of the US and Eurozone

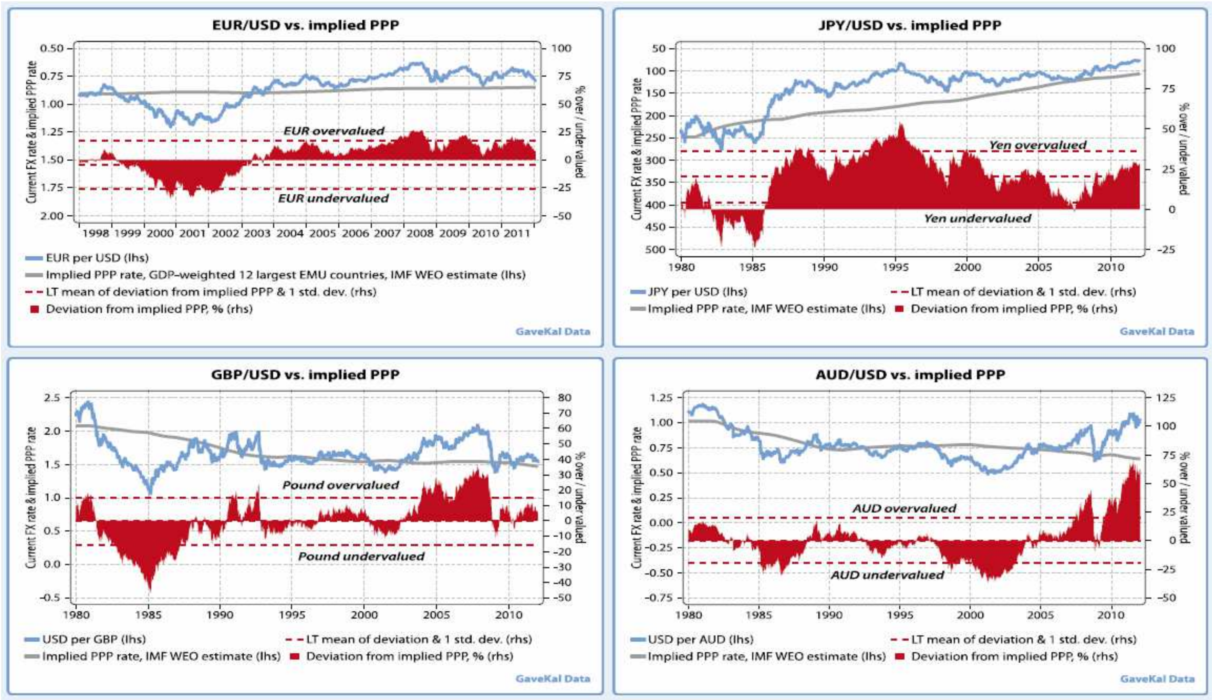


Source: GaveKal

Thanks to these expansionary measures we expect that the short end of the yield curves will remain extraordinarily low which per se should prove to be supportive for the equity markets. At the long end of the yield curves we would expect no upward movements as long as there are no inflationary signals emerging. As the reputation of government bonds as risk free assets has been shaken and US Treasuries and German Bunds had faced a tremendous demand in 2011, we prefer to focus on investment grades and the high yield sector. Corporate balance sheets continue to be generally healthy and the bad market sentiment over the last months may have distorted the risk perception regarding these instruments. For instance, the spread implied expected default rates of B and B+ are currently around 10% as compared to a historical rate of around 5% according to Moody's.

The mood swing back to more optimism has provided a convenient tailwind for the equity markets which since then have performed well. Markets like the German stocks appear to be completely oversold. Obviously, a slowdown of major economies in 2012 will impact the corporate earnings as well. Nevertheless, the first weeks in January indicate that investors have started to correct their assessments which supported equities. We do not believe that the recovery will continue seamlessly given the overall macro picture and therefore rely more on Long/Short managers than on pure beta plays.

Chart 4: Currencies – the EUR under Pressure while the Australian Dollar is still overvalued



Source: GaveKal

In 2011 the EUR had a strong run versus the USD despite its fundamental overvaluation. Only by end of 2011 the EUR gave finally in and depreciated significantly as the ECB put more money in the market via LTRO. We expect that the pressure on the EUR will continue.

The price for gold faced a strong correction in Q4 after it peaked just below USD 1800. However, as long as the structural issues of the developed world will prevail, gold remains attractive for many investors and a potential rebound towards the USD 2000 level over the next quarters is not an implausible assumption.

The Marcuard Heritage Model Portfolio Positioning

We started to re-deploy cash and thereby reduce significantly the temporarily high level of cash in the portfolio. At the current stage of the cycle we decided to raise our credit exposure with funds specialized in the short-term high yield space and complemented with Credit Long/Short.

Generally, we stick to our shorter duration position at this stage and we continue to favor exposure into fixed-income enhanced instruments.

In the current risk-on phase, we added to certain long-only, short and medium duration fixed income exposure. We did also build up again a small position in convertibles.

We maintain significant exposures with respect to Equity L/S. Although, we prefer active managers who are able to generate alpha from both the long and the short book, we will complement with exposure to value stocks with stable high dividend payments.

Our exposure to insurance-linked securities will continue to add to the diversification of the portfolio and remains a source of independent return generation.

Gold remains a valid component in the portfolio as a kind of insurance component despite its strong price advances and corrections during 2011. As the bearish sentiment will prevail the gold price should be supported.

We continue to use alternative investments such as CTAs and selected global macro funds to complement our exposures as they provide a degree of insurance components due to their favorable correlation qualities vis-à-vis the main asset classes.