Forum Finance Group

since 1994

January 2013

Investment Perspectives 2013

INVESTMENT PERSPECTIVES 2013

Table of contents — Pages

	Pages
EXECUTIVE SUMMARY	1
2012: REVIEW OF OUR INVESTMENT THEMES	2
2012: ECONOMIC DEVELOPMENTS	3-6
2012: THE FINANCIAL MARKETS	7-12
Equities	7-8
Commodities	9
Debt instruments, currencies	10-11
Hedge funds	12
2013: ECONOMIC OUTLOOK	13-15
2013: FINANCIAL MARKETS' OUTLOOK	16-18
2013: ASSET ALLOCATION	19-23
Debt instruments	19
Equities	19
Commodities	20
Gold	20
Hedge funds	20
FFG portfolio construction	21
Single hedge fund managers/structured products	22
Asset allocation grid	23

EXECUTIVE SUMMARY

- In 2012, ***considerable progress was made in the Euro zone***. The ECB's commitment to buy troubled debt proved to be a turning point, with rates in Italy and Spain dropping to non-stressed levels. ***The risk of a breakup has decreased*** and Greece has been given more time. The improvement of the housing sector in the United States has contributed to higher levels of consumer confidence while the Chinese economy has avoided a hard landing. Finally, the ***political landscape has become clearer*** following the change of leadership in China and elections in the U.S. and France. In particular, the dynamic of the Franco-German axis has been impacted by the election of the new French President, François Hollande.

- The financial markets were characterized by ***strong demand for all types of debt instruments*** and ***low volumes in the equity markets***. The ***best risk-adjusted performances were recorded by assets within the fixed-income space.*** During the first half, ***U.S. equities were resilient*** while ***European ones were under selling pressure***. These trends reversed from June onwards, with European equities outperforming. Volatility in foreign-exchange markets was also high, even though ***year-on-year variations were small for the main parities***.

- ***Global economic growth will remain modest in 2013***. Austerity programs will continue to impact economic activity in the Euro zone even if it should have to face ***lesser headwinds***. The ***prospects for the United States appear more encouraging*** but, even if an agreement on the fiscal cliff has been reached, the pace of growth will be below trend. The global economy can ***no longer rely on elevated growth rates of emerging economies*** as the latter have not been immune to the issues faced by the more developed economies.

- ***Monetary policies will remain very accommodative*** in the developed economies. The Federal Reserve has asserted its intention to maintain ***interest rates close to zero*** for an extended period and to ***support the housing market*** by buying mortgage-backed securities. The European Central Bank will continue to provide ***liquidity to the banking sector*** and is committed to ***purchase peripheral sovereign debt*** under certain conditions. The central banks of emerging economies are also likely to maintain their accommodative stance by ***extending their looser monetary policies.***

- We recommend a ***more dynamic positioning*** of the portfolios at the beginning of 2013. The significantly tighter credit spreads of Investment Grade corporate bonds has reduced their attractiveness while the receding tail risks are more ***supportive for risky assets***.

- For the beginning of 2013, we recommend ***reducing the exposure to investment-grade credit*** and continue to exclude any investments into G-7 government bonds. We also recommend ***increasing the exposure to convertible bonds***, while the current allocations into ***high-yield and emerging market debt are maintained***.

- Our exposure to equities will favour ***high-quality dividend stocks***. We also like the shares of ***international companies with strong brands***, especially those with ***growing emerging markets exposure***. From a regional perspective, our assessment is that ***European and emerging market equities*** should outperform those of the United States.

2012: REVIEW OF OUR INVESTMENT THEMES

- Our preference for ***assets providing income*** over those dependent on price appreciation proved to be a good choice. ***Investment grade corporate and high-yield bonds*** produced returns well above their longer term averages, while also providing stability to the portfolios. Our exposure to ***emerging market debt*** was another strong contributor and the ***absence of exposure to the safest government bonds*** (US Treasuries and German Bunds) did not detract from our performance. Our lack of exposure to ***peripheral sovereign debt***, while preventing us from benefiting from the second-half rally, helped us to limit the volatility of the portfolios.

- Our ***cautious outlook on equities*** and our ***emphasis on income-generating strategies*** at the beginning of 2012 led us to adopt a neutral positioning into this asset class, but with an ***overweight into U.S. stocks*** and into those ***paying high dividends***. U.S. stocks initially outperformed but were later caught up by those from other regions. Investments into ***high dividend paying*** stocks represented one of our favourite strategies within the asset class and generated robust returns. On the other hand, the performance of ***gold mining equities*** was very disappointing, especially when considering the appreciation of the price of gold.

- 2012 was another testing year for the hedge fund industry. While some ***Funds of Hedge Funds*** produced good risk-adjusted returns, many others struggled to cope with the difficult conditions. The numerous and unpredictable policy interventions have ***restricted the ability of certain strategies to perform*** and this environment is unlikely to change much in 2013. Market conditions have also become ***less supportive for structured products***, hence our decision not to replace some of the products that matured during the year.

- Our core ***5% allocation to physical gold*** produced another positive contribution even if the behaviour of its price proved to be quite volatile. The main driver of gold remains the policies of the major central banks and ***the monetary stimulus measures*** taken by the Federal Reserve and the ECB in 2012 ***helped gold to move higher***.

- ***Global commodities*** produced modest negative returns in 2012. Whereas the ***prices of agricultural commodities moved higher***, the price of ***oil remained under pressure for most of the year*** following an initial rise. Our commodity exposure through a certificate on a global commodity index produced a small negative contribution.

- The parities of most of the ***major currencies*** did not record significant variations in 2012 even though intra-year movements were at times noteworthy. Our slight ***preference for the dollar over the Euro*** proved to be a good call during the first half of the year due to the on-going concerns surrounding the sustainability of the euro zone. This trend then gave way to a stronger Euro following the ECB's decisive announcements. As expected, the Swiss National Bank ***successfully defended the 1.20 Euro-Franc floor*** by expanding its balance sheet, in particular during the first quarters of 2012.

2012: ECONOMIC DEVELOPMENTS

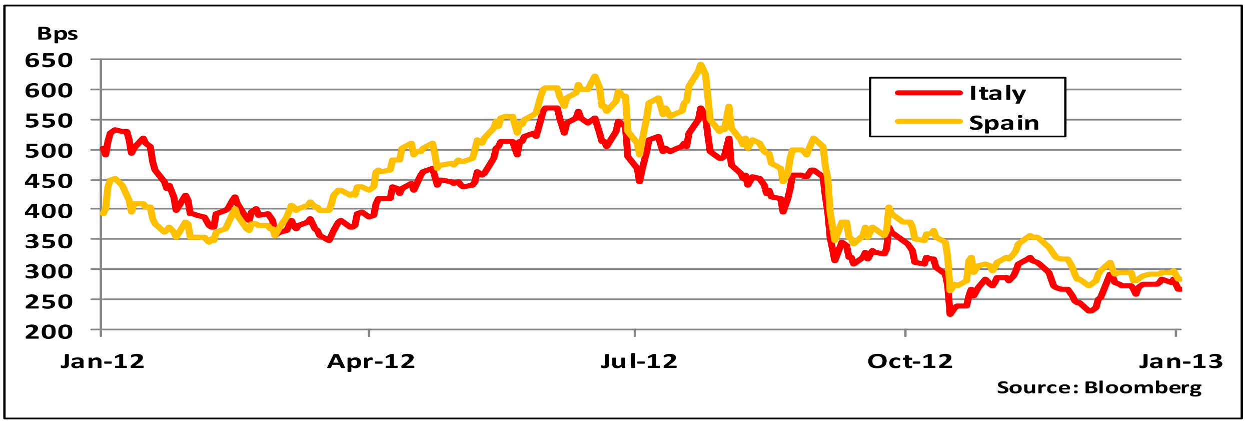
The year of the European Central Bank

2012 was another eventful year for the sovereign debt markets in the Euro zone. The year got off to a positive start after the ***ECB added much-needed liquidity to the banking sector*** through its Long Term Refinancing Operation (LTRO) program. The first tranche of this program, announced in December 2011, offered banks ***three-year loans at a discount*** against a wider-than-usual range of collateral and was followed by a second tranche in February 2012. During the same month, Euro zone finance ministers agreed on a ***second bailout package for Greece*** including 130 billion Euros in new loans and a haircut for private investors. For financial markets, this plan allayed the fears of a near-term Greek exit from the Euro as well as an uncontrolled default of payment

From March onwards, market sentiment turned negative due to ***concerns about Spain's ability to meet its deficit targets and risks related to its banks***. The fragility of the whole Spanish banking sector and escalating sovereign refinancing costs put Spain under intense pressure, especially as the country's third biggest lender, Bankia, had to be nationalised at a total cost of EUR 23.5 billion. In May, the inability of any of the main Greek parties to form a coalition government meant that voters had to return to the polls in June. This outcome only added more uncertainty to a ***potential exit of Greece from the Euro zone*** and yields on peripheral sovereign debt continued to rise until the decisive intervention of the ECB President, Mario Draghi, in late July.

Investors were impressed by the strong rhetoric of Draghi who expressed his commitment to do all that would be needed to protect the Euro. In August, he reaffirmed his intentions by mentioning the possibility for the ECB to purchase ***unlimited quantities of sovereign debt*** of up to three years in maturity. This plan, called ***Outright Monetary Transactions*** (OMT), would be available to the countries asking for help from the European Stability Mechanism (ESM) and promising to make certain economic reforms. Markets were also buoyed by the November decision of European finance ministers to ***ease the conditions on aid for Greece*** in order to keep the euro-area intact and to clear Greece to receive a 34.4 billion-euro loan instalment in December.

European sovereign debt CDS USD spreads



The chart above shows that the sovereign 5-year CDS spreads of Italy and Spain substantially widened during the second quarter. The strong commitments of the ECB from July onwards lead to the subsequent tightening of spreads, reflecting investors' belief ***that real progress had been made*** and that the ***risks related to a breakup of the Euro zone*** had receded.

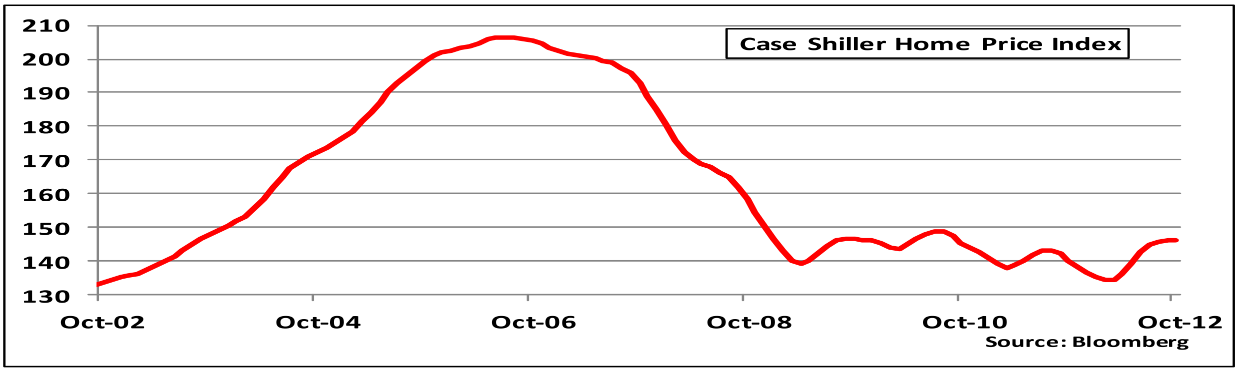
The Federal Reserve launches QE3

The U.S. Federal Reserve maintained its very accommodative stance through 2012 as it ***extended its Operation Twist*** program in June and later announced a ***third round of quantitative easing*** (***QE3***). Policy makers took these measures as they deemed the improvement in the labour markets to be insufficient and in order to limit the risks related to the European debt crisis and the prospects of severe fiscal tightening in the U.S.

As expected, the U.S. central bank decided to continue its Operation Twist program to ***extend the maturities of assets on its balance sheet***. This was carried out by selling $267 billion of shorter-term securities and buying the same amount of longer-term debt in a bid to ***reduce borrowing costs*** and stimulate the economy. The Federal Reserve also extended its commitment to keep ***short-term interest rates near zero*** through at least mid-2015, compared to 2014 previously.

In September, the Federal Reserve announced its ***QE3 program***, consisting of the ***purchase of $40 billion in mortgage-backed securities per month*** for an unlimited period. The bank's objective is to cap bond yields and to lower mortgage rates to support the housing market.

The recovery of the U.S. housing market



As shown in the chart above, the U.S. housing market has been showing signs of improvement as prices have bounced off the bottom. Even if the weight of the housing market in the American economy has decreased (2.5% of nominal GDP in 3Q2012 compared to 6.3% in 4Q2005), a re-acceleration of housing activity would be encouraging since it would positively affect the psychology of all economic agents.

The Swiss National Bank defends its franc cap

The Swiss National Bank ***successfully defended the franc ceiling at 1.20 per Euro*** it had introduced in September 2011. The SNB had to act decisively from April through September by purchasing large quantities of Euros. During that period, the size of its balance sheet increased from $326 billion to $525 billion, the equivalent of approximately ***80% of the country's GDP***. In those terms, the SNB's balance sheet is significantly larger than those of the major central banks.

The Swiss franc lost some ground against the Euro in December after Credit Suisse and then UBS said they would set ***negative rates for franc cash balances*** above a certain threshold. This measure intends to dissuade investors from seeking refuge into the franc, but is unlikely to have much effect if the Euro zone were to enter into another period of severe turbulence.

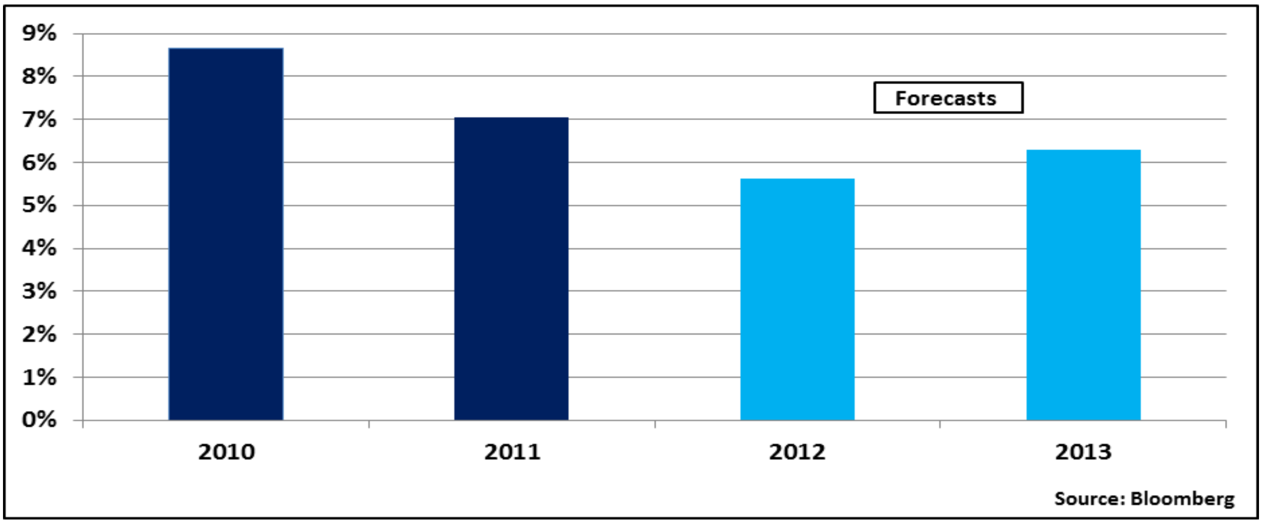
BRIC's slowing growth

During 2012, the pace of growth of the so-called BRIC countries (Brazil, Russia, India & China) ***continued to decelerate*** from the higher rates of the previous years. Taking into account the BRIC's much ***larger share of global GDP***, the slowdown of their economic activity was much more ***detrimental to the world economy*** than it would have been in the not so distant past. The most important reason for their slowdown of growth is the worsening economic situation in Europe, but it would be ***wrong to attribute all of the blame to external factors***. These countries are also facing distinct issues and structural problems of their own, which vary from one country to another.

In China, the sustained tightening measures taken in 2011 to ***cool the property market*** were a big drag on growth through 2012, especially at a time when ***export growth was being badly affected by the problems in Europe***. These issues lead to rising inventories, falling corporate earnings and weaker output growth. The ***drawn-out political transition of the Chinese leadership*** was mostly to blame for the lack of an early policy response. Given that growth in China is highly driven by infra-structure investment, political uncertainty had an especially restraining effect on economic activity.

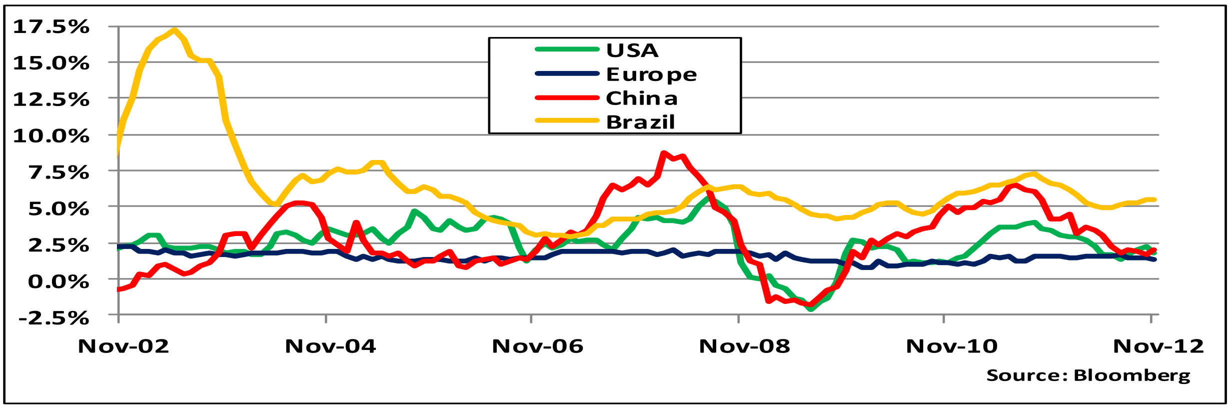
India's growth has also been impacted by external forces and monetary policy tightening, but the ***lack of structural reforms*** is also to blame. Decision making has been hampered by political gridlock and administrative obstacles. ***Key supply side reforms have not been rolled out*** fast enough in recent years and this has increasingly constrained growth. The lack of reliable power supply is a good example of these problems. The slowdown has been evident across all sectors of the economy, but the ***main drag has been from manufacturing***. Exports have risen as a share of GDP and the slowdown in the US and Europe, adding up to 50% of India's goods and services exports, has had an impact on both the manufacturing and services sectors.

BRIC GDP growth



In nominal terms, the ***BRIC's share of global GDP increased from 6% in 2000 to nearly 20% in 2011*** and since the financial crisis in 2008, its ***contribution to global growth has been above 50%***, compared to an average of 27% between 2000 to 2007. These statistics explain why their lower rates of growth (shown in the chart above) are having such an impact on the global economy.

Inflation across the world (2001-2012)



As shown in the chart above, ***inflation across the world continued to moderate***, in particular in the larger emerging economies such as China and Brazil. This enabled those countries' central banks to ***ease monetary policies*** to offer some support to their economies. The overnight SELIC rate controlled by Brazil's central bank was cut from a peak of 12.5% in July 2011 to 7.25% in November 2012, while China lowered the Required Deposit Reserve Ratio for the country's banks.

Conclusions

The role of the major central banks remains paramount and the ***decisive role played by the European Central Bank has proven to be a game changer***. The ***risks associated with a breakup of the Euro zone have receded*** and the ***conditions in the sovereign debt markets for the peripheral countries have improved considerably.*** The latest decision by European Union finance ministers to put the ECB in charge of all euro-area lenders is ***another step towards more financial stability in Europe***. Under the agreement, the European Stability Mechanism (ESM) fund could be used to recapitalize banks directly instead of having to go through national governments.

In the US, the Federal Reserve maintained its ***very accommodative stance*** through 2012 and announced at its December 12 meeting that it would ***add $45 billion of monthly Treasury purchases*** to its existing program. The additional purchases will follow the expiration of Operation Twist (end 2012). As a result, the size of the Fed's balance sheet will ***expand to almost $4 trillion by the end of 2013***. For the first time, the Fed ***linked their interest rate outlook to economic thresholds***, saying that ***short-term rates would remain exceptionally low*** as long as the unemployment rate remains above 6.5% and one to two years projected inflation is below 2.5%.

In conclusion, ***world economic growth is not expected to accelerate much in 2013***, but the risks appear lower than a year ago. ***Economic activity has bottomed in the larger emerging countries***, even though one should not anticipate a strong rebound. ***Inflation does not represent a threat*** at this stage and the major central banks will continue to maintain their ***interest rates at levels close to zero***.

2012: THE FINANCIAL MARKETS

The ECB and the FED drive the markets

2012 turned out to be a much better year for financial assets than most market forecasters had predicted. This was largely due to the ***reduction of systemic risk in the Eurozone*** and the ***successful strategy of the ECB to steer sovereign debt yields to more sustainable levels***. Debt instruments produced the best risk/return adjusted performances as investors continued to search for higher-yielding alternatives to government bonds. Companies took advantage of borrowing costs at all-time lows to issue a close-to-record amount of corporate bonds.

2012 performances

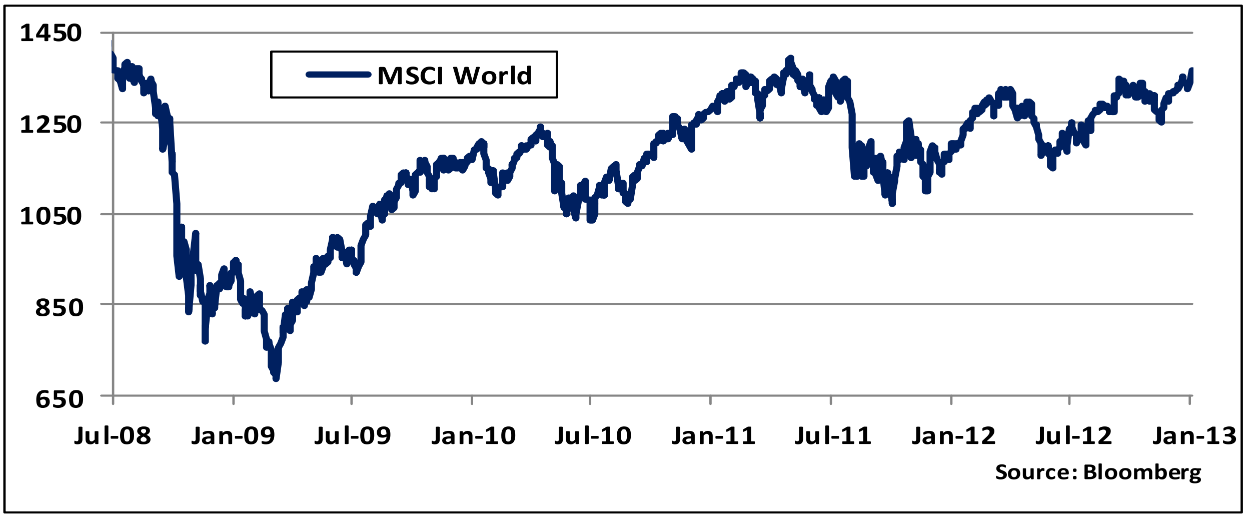
	End 2011	*End 2012*	*2012 performance*
Equities			
S&P 500	*1257.6*	*1426.2*	*+ 13.4%*
Euro Stoxx 50	*2316.6*	*2635.9*	*+ 13.8%*
MSCI EM	*916.4*	*1055.2*	*+ 15.1%*
Yields			
UST 10-year	*1.88%*	*1.76%*	*- 12bps*
Bund 10-year	*1.83%*	*1.32%*	*- 51bps*
BBB EU	*4.80%*	*2.98%*	*- 182bps*
Currencies			
EUR/USD	*1.296*	*1.319*	*+ 1.8%*
USD/CHF	*0.938*	*0.915*	*- 2.4%*
GBP/USD	*1.554*	*1.626*	*+ 4.6%*
USD/JPY	*76.91*	*86.75*	*+ 12.8%*
EUR/CHF	*1.217*	*1.208*	*- 0.7%*
Commodities			
CRB Index	*305.3*	*295.0*	*- 3.4%*
Oil, WTI	*$ 98.8*	*$ 91.8*	*- 7.1%*
Gold	*$ 1564*	*$ 1675*	*+ 7.1%*

Equities

Equity markets started the year on a good note in the wake of the ***liquidity offer*** made by the European Central Bank in late 2011. This positive trend lasted until March. Despite the release of better-than-expected first-quarter earnings, equity prices were impacted by ***renewed stress in the Eurozone and signs of a slowdown in China***. While US equities corrected by some 10% during the second quarter, European and emerging equities dropped by twice as much.

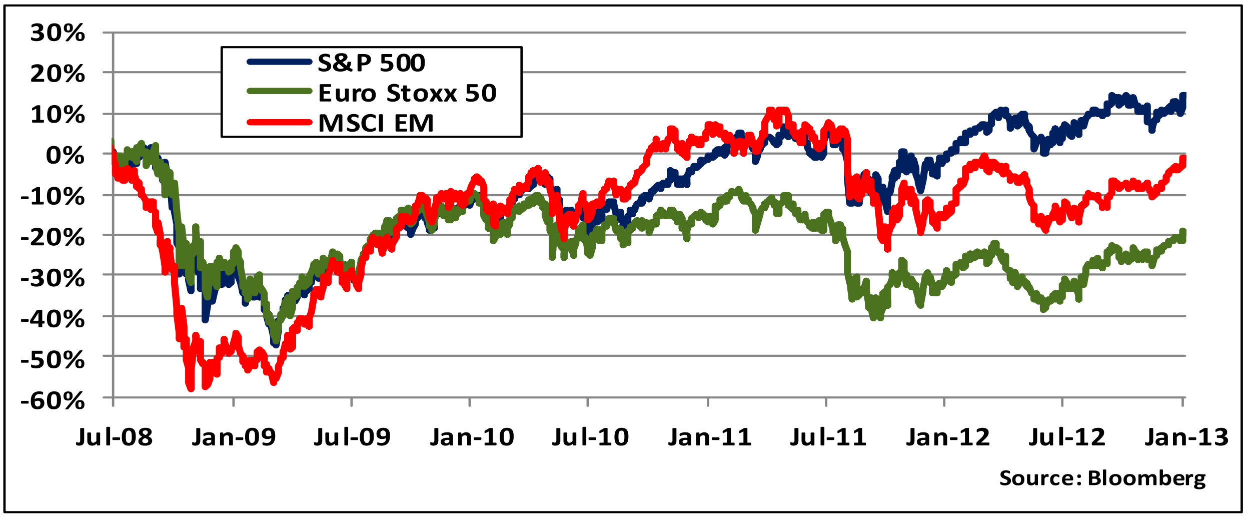
From June onwards, global equities started to move higher and, in retrospect, the ***promise by Mario Draghi to do all that would be needed to protect the common currency proved to be a pivotal moment***. Equities continued to rally as the ECB announced a plan consisting of the purchase of unlimited quantities of short-term sovereign debt (OMT) and the Federal Reserve announced its mortgage-backed securities purchase program.

MSCI World (2008 - 2012)



Global equities recorded a 13.2% gain in 2012 due to a strong performance during the second half, as shown on the right side of the chart above. From a regional perspective, the outperformance of US equities over European ones, observed since June 2010, started to unwind from June onwards.

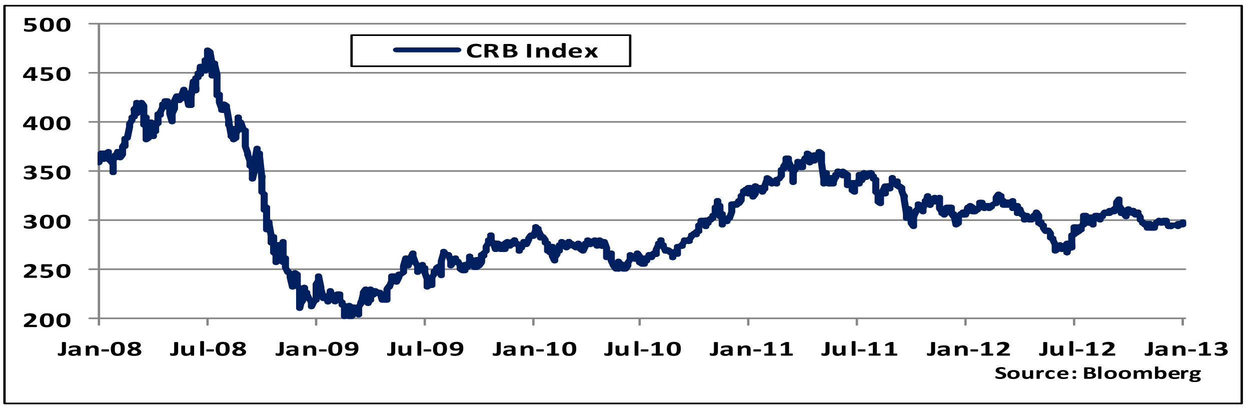
S&P 500 - MSCI Emerging Markets - Euro Stoxx 50 (2008 - 2012)



For the whole of 2012, the performances of the major equity indices, in local terms, ***turned out to be quite similar*** despite a strong outperformance of US equities during the first five months. The S&P 500 Index, the EuroStoxx 50 Index and the MSCI Emerging Market Index ended the year with respective gains of 13.4%, 13.8% and 15.2%. Once again, the ***Chinese equity market underperformed***, with a modest 3.2% gain for the Shanghai Composite Index. In Europe, all the indices ended in positive territory, with the exception of the Spanish IBEX, which dropped by 4.7%. The best performance was recorded by the German DAX Index, up by 29.1%, while the UK FTSE 100 Index and the Italian MIB Index produced smaller respective gains of 5.8% and 7.8%.

Commodities

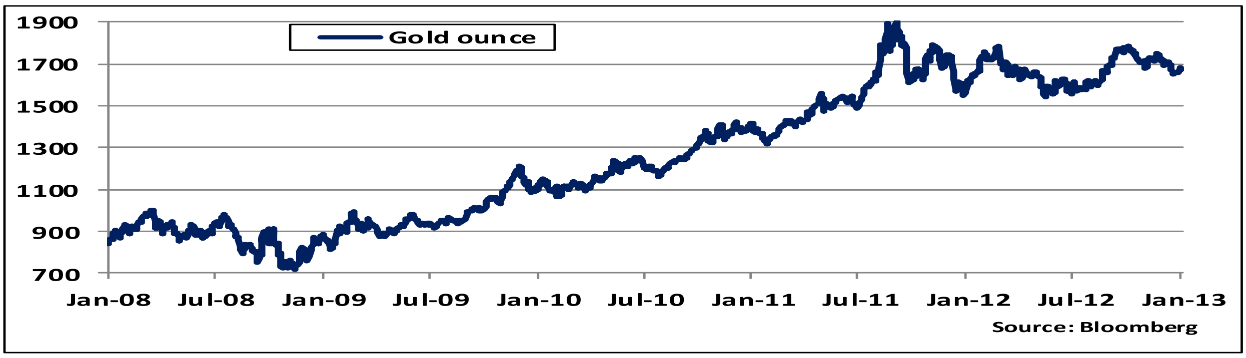
CRB Index (2008 - 2012)



Global commodity indexes recorded slightly negative performances in 2012. Following an initial rise, the ***prices of energy and industrial metals dropped steeply during the second quarter*** due to the slowdown of economic activity in China and renewed tensions in the Eurozone. The price of WTI oil plunged from $110 a barrel to $78 with Brent oil experiencing a similar drop. During the second half of the year, the ***price of Brent oil recorded a stronger rebound*** than WTI oil due to fears of a supply disruption caused by the tensions between Iran and Israel. For the whole of 2012, the price of WTI oil decreased by 7.1%, while Brent oil ended the year 3.5% higher.

The best performing components of the commodity space were agricultural commodities. The ***S&P GSCI Agricultural Index***, comprised essentially of wheat, corn and soybeans ***climbed by 40%*** in June and July, due to the effects of one of the worst droughts in the United States for decades. Prices retreated from their peak during the second half of the year, leaving the ***S&P GSCI Agricultural Index*** with a 3.9% gain for 2012.

Gold price in $ (2008 - 2012)

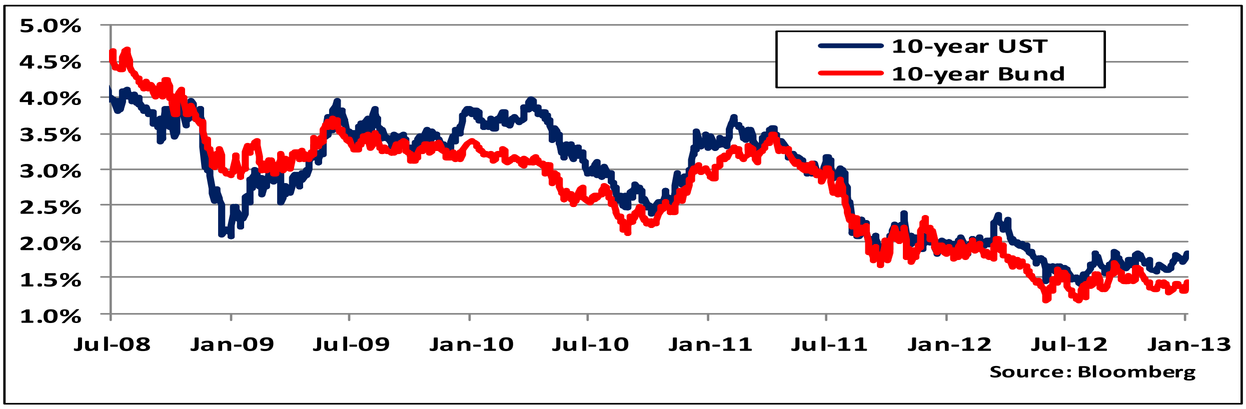


The price of gold appreciated by 7.1% in 2012, its ***twelfth consecutive year of gains***. The correlation of gold with other financial assets has been constantly evolving and, for most of the past year, ***gold moved in tandem with European equities***. Following an initial 14% rise to $1'784 per ounce, in the wake of the ECB's offer of liquidity (LTRO), the price of gold then dropped to $1'540. From July onwards, gold performed well on the back of the measures announced by central banks. However, since it reached $1'790 in early October, gold has been unable to hold onto its gains due in part to a ***shift out of safe haven assets***, reflecting investors' higher level of confidence.

Debt instruments

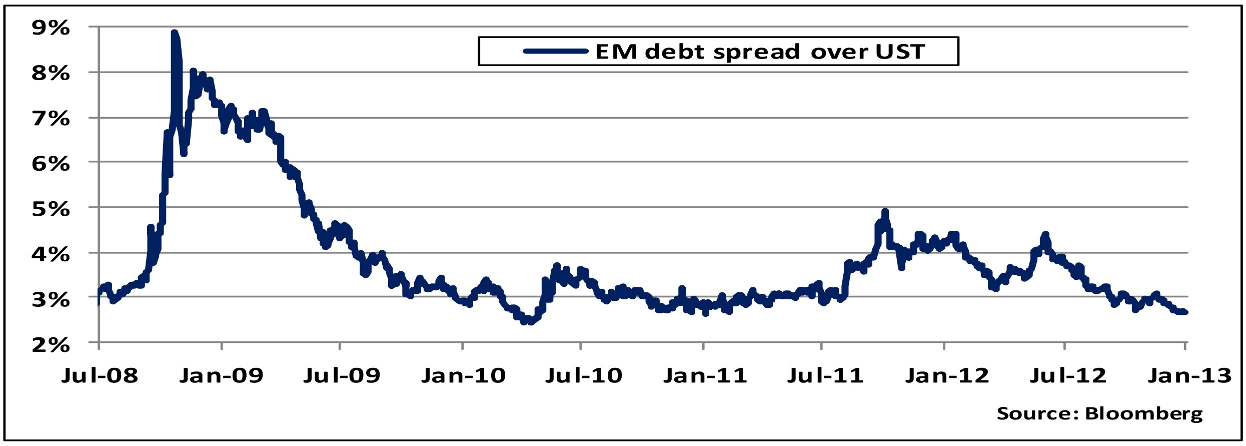
The ***bull market for G-7 government bonds extended well into 2012*** as yields collapsed to all-time lows during the second quarter. In the case of a certain number of countries (Germany, Finland, Austria, Netherlands & Switzerland), ***yields on shorter term sovereign debt even turned negative***, meaning that investors were actually paying these countries for the privilege of lending to them. Even though these yields did not rise much from July onwards and some remained negative, investors clearly shifted their exposures towards ***higher-yielding debt instruments*** such as investment-grade corporate credit, high yield and emerging market debt.

10-year US and German government bond yields



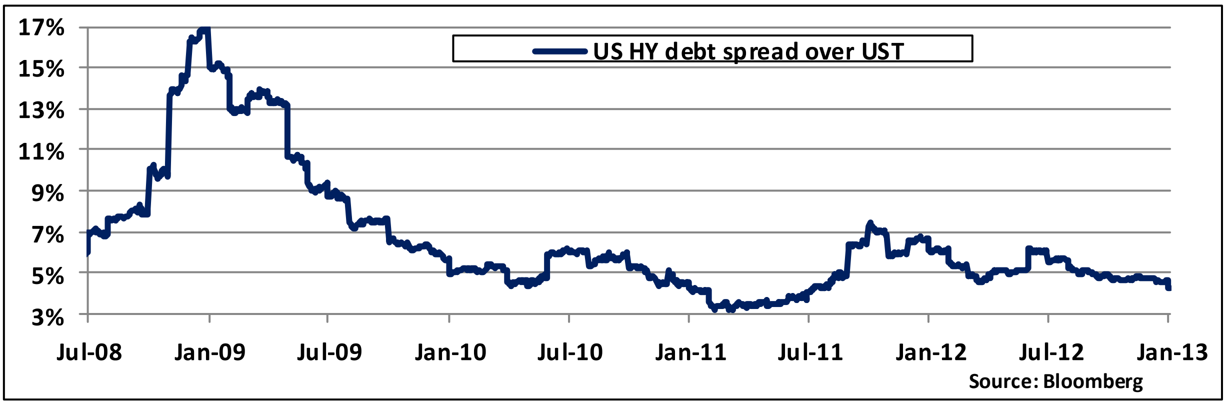
The yields on the benchmark 10-year U.S. Treasuries and German Bunds initially climbed from 1.88% and 1.83% at the end of 2011 to ***year-highs of 2.38% and 2.05%*** before declining to ***all-time lows of 1.39% and 1.17%*** at the end of July. Yields have since drifted higher but still ended the year at levels well below those observed twelve months earlier.

Emerging Market Debt spread (2008 - 2012)



Since the end of 2011, the spread of emerging market debt yields over U.S. Treasury yields (JPMorgan EMBI Global Spread Index) has narrowed from 4.3% to the current level of 2.7%. This tighter spread is due to the ***on-going search for assets offering yield*** and a reflection of the ***strong fundamentals of emerging economies*** as well as their ***ability to repay their debt***.

U.S. High Yield spread (2008 - 2012)



The spread of U.S. high yield debt over risk-free debt, as measured by the difference between the Citigroup HY Index and U.S. Treasuries, ***narrowed from 6.2% to 4.3% in 2012***. The prices of high-yield bonds were impacted by the ***return of an aversion to risk during the second quarter*** and spreads widened significantly from a year-low of 4.5% to 6.2%. In Europe, this move was even more severe as the spread of the Itraxx Crossover index increased by 248 basis points from 505 bps in March to 753bps, before ending the year at a much tighter level of 484bps.

The ***investment-grade credit space proved to be a resilient asset class throughout 2012*** and spreads tightened considerably. This was reflected by a decrease of the Itraxx Europe A to AA 5-year Index, which measures the performance of the most liquid credit default swaps for investment grade credits, from 174bps in January to 117bps at year-end, while the equivalent US Index tightened from 120bps to 95bps.

Debt instruments' market performance in 2012 (USD)

World Government Bond Index	+ 1.7%
U.S. Credit AAA	+ 6.0%
U.S. Credit BBB/BB	+ 14.4%
Global Emerging Market Sovereign	+ 17.7%
U.S. High Yield	+ 15.2%

Currencies

Even if ***periods of instability*** were observed in the foreign-exchange markets throughout 2012, most of the major parities ended with ***limited year-on-year changes***. The ***Japanese yen was the exception*** as its ***value depreciated by 12.8% against the dollar***, due to more quantitative easing by the Bank of Japan and election results which raised the likelihood of more aggressive policies to fight against deflation. The EUR/USD parity initially climbed from 1.30 to 1.35 before collapsing to a low of 1.21 in July. Thereafter, the ***Euro recovered most of these losses to end 2012 at a 1.32 parity***, a gain of 1.8%. The EUR/CHF parity remained within a tight range as the Swiss National Bank defended its policy of ***capping any appreciation of the Swiss franc beyond 1.20 per Euro***.

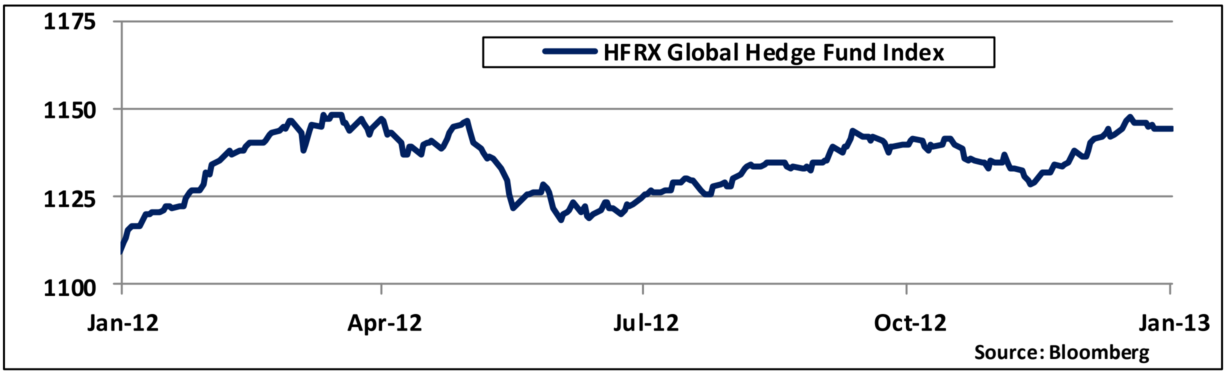
Hedge funds

2012 was another disappointing year for the hedge fund industry. The ***returns of most strategies have lagged those recorded by traditional assets***, while the ***performances of core strategies such as Global Macro and Systematic CTA have been weak***. In an environment that remains more driven by central bank and government policies than fundamental data, it has been ***difficult for Global Macro managers to anticipate market movements*** and to add value. The ***frequent trend reversals and range-bound trading across the various asset classes*** have negatively impacted systematic trading strategies, which have suffered drawdowns in 2012.

The poor performance of certain hedge fund managers can be partly explained by a fear of taking on too much risk, which has lead to an ***under-utilisation of their risk budget***. Another factor could be that ***risk models built before the financial crisis are less adapted to deal with the current market conditions***, which are characterized by lower volumes and wider price fluctuations.

Nevertheless, some strategies performed well during the past year. ***Credit managers produced strong returns*** as they benefited from the search for yield and the tightening of credit spreads. ***Strategies providing liquidity also continued to take advantage of the withdrawal of banks*** from activities such as market making and mortgage refinancing.

HFRX Global Hedge Fund Index (2012)



Hedge Fund strategies market performance in 2012 (end of November, USD)

HFRX Global Hedge Fund Index	+ 3.2%
HFRX RV FI Convertible Arbitrage Index	+ 7.1%
HFRX Multi-Emerging Markets Index	+ 10.9%
HFRX RV FI Corporate Index	+ 8.0%
HFRX Equity Hedge Index	+ 4.4%
HFRX Macro Multi-Strategy Index	+ 5.2%
HFRX Event Driven Index	+ 5.5%
HFRX Equity Hedge Short Bias Index	- 18.0%
HFRX Macro Systematic Diversified CTA Index	- 7.4%

2013: ECONOMIC OUTLOOK

All through 2012, the global economy staggered along at a slow pace but managed to avoid the biggest pitfalls that could have pushed it back into recession. It is obvious that the world is still facing many serious problems, but ***sufficient progress has been made on several issues*** for us to feel ***more confident about the economic outlook for 2013***.

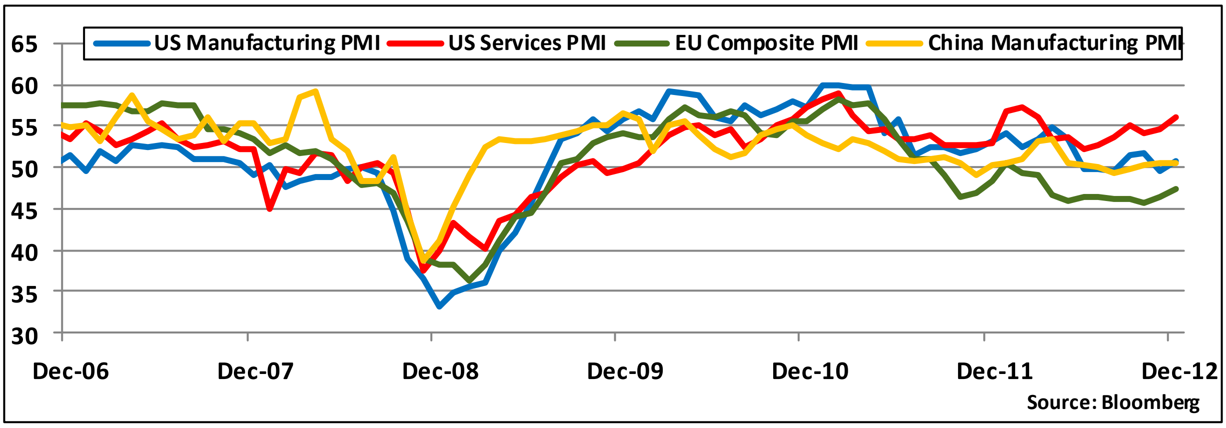
In Europe, the ***threat of a systemic banking seizure has been averted*** and, even if European banks are still greatly under-capitalized, ***the risks from the sector are much lower than a year ago***. The significant drop in bond yield spreads indicates that the ***sovereign debt part of the crisis***, while still not resolved, ***has been brought under control*** thanks to the commitment of the ECB. Finally, major fiscal adjustments have already been made in the periphery and growth should sooner or later benefit from ***reduced fiscal drag***.

The ***economic outlook is also looking more positive for the larger emerging economies***. In China, money and credit growth have stabilized and there is increasing evidence that the economy is set for a ***soft landing***. Other emerging economies should also improve in the coming year as ***a number of growth-reducing forces will tend to diminish***.

Finally, the economy of the United States is expected to continue growing around 2% in 2013 despite the impact of some fiscal tightening. Several areas of the economy are improving and there is scope for higher levels of capital spending by the corporate sector.

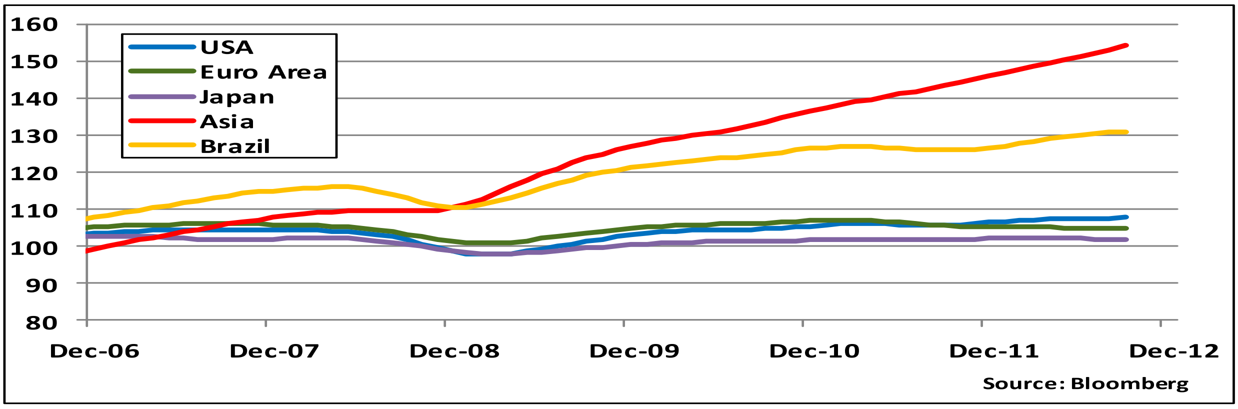
Leading economic indicators

Purchasing Manager Indexes



Purchasing Managers Indexes are showing ***slightly stronger signals*** across the different regions. The latest data in the ***U.S.*** are showing an improvement of the non-manufacturing index from its summer lows and ***manufacturing activity has returned above the 50 threshold***, indicating an expansion. In ***Europe***, the services and manufacturing composite index appears to have bottomed in October and is trending higher. Finally, ***China's manufacturing index*** has climbed above 50, indicating a ***modest expansion of activity***.

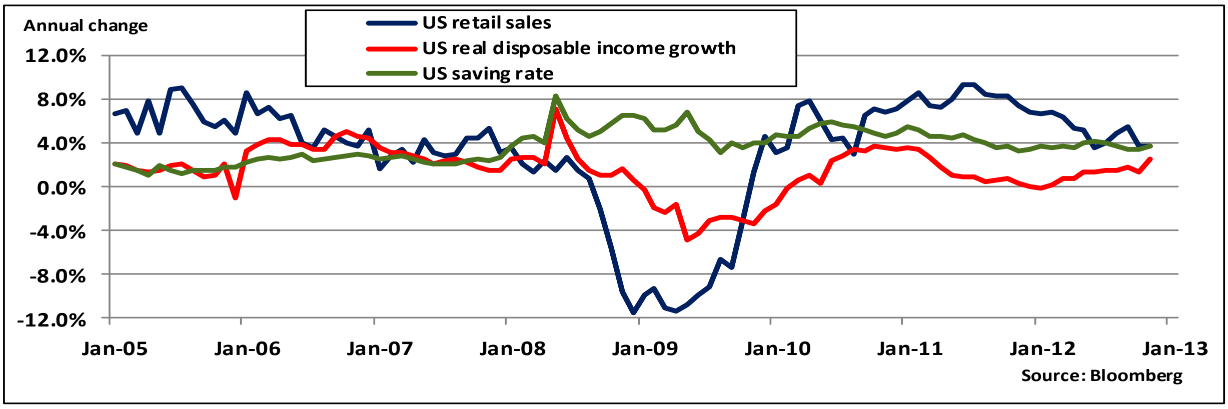
OECD Composite Leading Indicators



The chart above shows the ***divergence of economic conditions*** in the various regions. The ***resilience of Asian economies*** is reflected by a continuous rise of the region's OECD Leading Indicators throughout 2012. The outlook appears to be improving for the U.S. and also for Brazil, which experienced much lower growth in 2012. In contrast, the Leading Indicators for Europe and Japan are signalling that ***economic activity is likely to remain weak throughout 2013***.

Consumer spending

U.S. retail sales/income growth/saving rate (year on year net change)



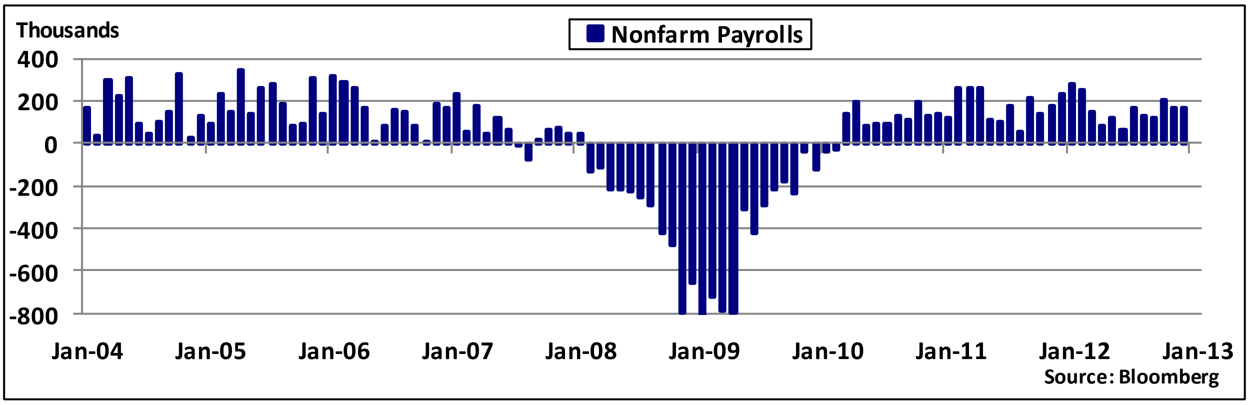
The chart above shows that ***consumer spending in the United States continued to grow in 2012 but more modestly and inconsistently*** than during the previous year. This slower rate can be attributed to ***mixed consumer fundamentals***. Some fundamentals are weak, including high unemployment, weak wage growth, low home equity and limited credit availability. Others are quite strong, including dramatically reduced debt burdens, pent-up demand, modest core inflation and rising house prices.

Looking ahead, the agreement on the U.S. fiscal budget has removed some of the ***prevailing uncertainty related to tax increases.*** However, the key drivers for higher levels of consumer spending are a ***stronger job market*** and the ***continuation of rising home prices***.

Job markets

Overall conditions in the labour markets of the western economies ***have diverged*** throughout 2012. The latest numbers show that ***unemployment in the Euro zone has reached a new record,*** rising from 10.7% to 11.8% at the end of November. Given the financial difficulties of the Euro zone and continuing job losses in the public sector due to spending cuts, ***unemployment levels are likely to carry on rising***. In the United States and in the U.K., the ***unemployment rates have respectively decreased from 8.5% and 8.4% to 7.8% and 7.9%.*** In the U.S., this is partly due to a decline in the share of working-age people in the labour force from 64% to 63.6%.

U.S. Nonfarm Payrolls (month on month net change)



In the U.S., ***conditions in the labour markets***, as measured by the number of nonfarm jobs created by the private sector, ***have stagnated*** over the last twelve months. An average addition of 158'000 jobs per month in 2012 remained well below the 250'000 to 300'000 additional jobs per month required to regain the number of jobs lost during the economic downturn.

Conclusions

In the light of the above indicators, it appears that one can expect some ***modest improvement of the world economy in the year ahead***. The ***crisis in the Euro zone has somewhat abated*** and it seems that the ***fiscal drag*** due to severe austerity measures ***has peaked*** even though it will continue to ***hinder growth***. Due to a lack of reforms, ***France could present one of the biggest risks*** in the Euro zone. France is the largest consumer of German goods and any unexpected weakness of its economy would negatively impact the main growth engine of Europe.

In the U.S., the last-minute agreement reached by the Democrats and the Republicans on the so-called fiscal cliff has averted a near-term recession, but there is still a lot of work to be done to bring the budget deficit to a more sustainable level. Economic growth will remain below long-term trend, but the ***housing sector is expected to improve further*** and the ***corporate sector*** might feel more comfortable to ***invest some of its vast reserves of cash***.

The Chinese economy has been showing signs of improvement and ***fears of a hard landing should continue to fade***. Following a significant slowdown in 2012, the ***economic growth rates of India and Brazil should pick up*** even if they will remain well below their previous highs.

2013: FINANCIAL MARKETS' OUTLOOK

Compared to a year ago, ***market sentiment has substantially improved***. The decisive role played by the European Central Bank has ***lowered the risk of a break-up of the Euro zone*** and ***yields of peripheral sovereign debt are no longer at stressed levels***. Considering the stellar performances of debt instruments in 2012 and the expectations of much lower future returns, the ***most pressing issue facing investors is how to reallocate their overweight towards this asset class***.

During the fourth quarter, we have progressively been shifting the positioning of our portfolios by ***increasing our allocation to equities and convertible bonds***. We therefore recommend a more ***dynamic asset allocation*** heading into 2013 as we expect the ***relative valuations between asset classes*** to take on a bigger role for allocation decisions. The yields offered by certain debt instruments should be largely protected by the ***extension of central banks' loose monetary policies***, aiming to maintain interest rates around record low levels. That explains why we are maintaining our exposure to debt instruments such as high-yield and emerging market debt.

It is important to stress that the recommended asset allocation takes into account the ***evolution of the portfolios' various assets*** since our mid-year review. It also reflects the ***changes*** that have already ***taken place within the portfolios during the second half of 2012***. These investment decisions have been explained in detail in our monthly Newsletters.

Debt instruments' outlook

G-7 government bonds offer very little value and, at this stage, we exclude holding any significant exposure to this segment of the fixed-income markets. ***Investment grade bonds have lost a lot of their appeal*** as the potential for tighter credit spreads is restrained and because their very ***low yields offer only limited protection in case underlying rates were to rise***. A rise of rates is not our core scenario, but we must keep this risk in mind. We also anticipate inflows to be less supportive as it is likely that ***investors will migrate out of safe haven into riskier assets.***

High-yield corporate debt remains one of our ***favourite exposures within the debt instruments asset class.*** This segment offers a more compelling risk-return profile than investment-grade. The current ***spreads are pricing in default rates well above projected ones*** and the yields on offer are sufficient to absorb the negative impact of an unlikely rise of underlying interest rates. At this stage, we feel comfortable holding on to our exposure to ***emerging market debt denominated in local currencies.*** The asset class should continue to be supported by solid fundamentals, declining inflation and a benign supply outlook.

We have been increasing our allocation to ***convertible bonds*** due to robust technical factors and historically low yields in other asset classes. The returns of convertible bonds should be driven by ***underlying equity returns, income and some spread compression***. Convertible bonds should also benefit from a ***gradual shift into equities from credit***, given their upside participation and the universe's majority composition of high-yielding bonds. The structure of convertible bonds has improved over time as they now ***include dividend protection*** to capture the upside in dividend-supported stocks as well as ***change of control protection*** in the case of takeovers.

Equity outlook

Our more ***positive outlook for equities*** in the first half of 2013 is due to receding tail risks, the lack of alternative assets with reasonable yields and a modest pick-up of global economic activity. ***Aggressive monetary policy measures have reduced the systemic risks*** and the decisive role played by the European Central Bank has taken away some of the political risks. ***Asset performance is less likely to be driven by macro developments*** and more by the relative valuations of each asset class. On this basis, equities offer ***a risk premium which appears to be excessive***. The improving level of confidence should reduce this risk premium demanded by investors and boost demand for higher-yielding assets.

A year ago, we wrote about our scepticism for a reversal of the massive money flows that had been invested into the bond markets. We now believe that ***inflows into equities will increase at a faster pace than those into safe haven assets***. Recent data is indicating that this trend is already under way, with a bias towards equities from Europe, emerging markets and China.

Despite the appreciation of the price of gold in 2012, the gold mining sector has performed poorly and ended the year with a disappointing drawdown. However, we believe there are many ***good reasons to be allocated into gold mining equities***. Their valuations relative to gold are close to extreme lows, market sentiment is negative and gold companies are focused on improving their profitability and distributing more dividends. These different elements explain why we have opted to remain exposed to the shares of gold companies.

Alternative investments

Alternative investments add value to portfolios due to their ability to ***exploit market inefficiencies, reduce portfolio volatility, bring diversification*** and ***provide access to complex strategies.*** Some of our current focuses are on ***quantitative strategies*** and on those which can benefit from the ***deleveraging of the banking sector***.

For certain strategies, it has become increasingly difficult to replicate returns of the past, but their real value resides in their ***capacity to protect part of the portfolios' investments*** in the case of prolonged market drawdowns, hence our perseverance with these kind of strategies.

Our exposure to funds investing into other hedge funds (FoHFs) has been reduced due to disappointing performances and unfavourable liquidity terms. Some of the managers of these funds have ***been unable to adapt their models to the prevailing market conditions*** and further consolidation is most likely within the fund of hedge funds industry.

Compared to a year ago, our ***allocation into structured products has diminished*** as several products which had matured were not replaced. This was the result of ***less supportive conditions***, essentially due to lower volatility, tighter credit spreads and rising markets. We are not expecting the conditions for structured products to improve in the short term.

Gold outlook

Gold has recently lost some of its luster due to disappointing price action, slower buying of exchange-traded products and rumours of liquidation by hedge funds. It also seems that investors have become less inclined to use gold as a hedge against US fiscal cliff risks given its ***positive correlation with other risky assets through 2012***.

Despite all the above, ***gold should remain an integral part of most investment portfolios***. The longer-term supportive environment has not changed as ***real interest rates are at their lowest for many years*** and central banks are still in an ***aggressively reflationary mode***. The prospect of easier monetary policy could lead to potentially large moves in 2013. Also, even if tail risks are receding, they have not disappeared and ***gold represents an insurance*** against the more extreme scenarios.

Currency outlook

The major currencies ended 2012 at parities close to those observed a year earlier as they ultimately ***neutralised each other due to their inherent weaknesses***. However, these various currency pairs evolved within relatively wide ranges and for 2013 we expect these ***ranges to be tighter*** as the ***prospects for big surprises appear more limited***.

The situation in Europe has improved considerably and the focus is now on the Spanish application for ESM/ECB support. An approval of this application and a fiscal compromise in the U.S. should translate into more risk taking and bring ***further short term support for the Euro*** against the dollar. However, stronger growth in the U.S. and the risks of a protracted recession in Europe should ***prevent the Euro from appreciating much***. It is also possible that at some stage the ECB will need to do more to support economic activity and look for ways to ease financial conditions, which should then drive the Euro lower.

The Swiss National Bank has ***successfully defended the 1.20 cap*** it has set for the franc against the Euro. The most likely scenario for the EUR/CHF parity in 2013 is to remain in a ***tight range***. The central bank will continue to prevent the franc from appreciating above the 1.20 cap and should take advantage of a stronger Euro to unwind some of its considerable FX reserves. In the case of unexpected Euro strength, ***the SNB might decide to fix a higher cap***.

The Japanese Yen was the only major currency that experienced a significant change of its value, as it depreciated by 12.8% against the dollar. The newly-elected LDP leader Shinzo Abe wants the Bank of Japan to act more aggressively and ***move its inflation target from 1% to 2%***. The adoption of much looser monetary policies should continue to ***weaken the Japanese currency***.

Over the longer term, we remain convinced that ***emerging market currencies*** should appreciate against the major currencies, in particular due to higher levels of growth, healthier fiscal positions and the monetary policies of the major central banks. We are exposed to these currencies through equity positions and emerging market debt denominated in local currencies.

2013: ASSET ALLOCATION

Debt instruments

- As explained previously, we have become ***less constructive towards certain debt instruments***. We recommend ***reducing the exposure to investment-grade credit*** which offers limited upside and extremely low yields. Inflows into low-yielding bonds are likely to ebb as investors feel increasingly confident to ***move away from the safest assets***.

- ***Conditions remain supportive for high-yield bonds*** as their spreads are wide relative to current and projected default rates. Companies have largely been able to refinance at attractive borrowing costs, hold strong balance sheets and the maturity of their debt has been extended. The on-going demand for income-related investments should continue to support this asset class.

- We recommend ***increasing the allocation to convertible bonds***. We have recently invested into a new fund dedicated to emerging market convertible bonds and also into Euro-denominated convertible bonds. ***Convertible bonds are an optimal alternative to a direct equity exposure*** as they benefit from bond-like downside protection and a participation in the upside of equities.

Equities

- Over the last quarter of 2012, we progressively increased the risk in our portfolios. This is reflected by our ***recommendation of a higher allocation*** into equities. At this stage, we believe that the ***reduction of tail risks*** and the ***rich valuations of the safest debt instruments*** make equities a more attractive asset class.

- Equity prices should benefit from the ***partial unwinding of overweight allocations into low-risk asset classes*** due to improving investor confidence and low exposures to equities. Extremely accommodative monetary policies around the world, high cash balances and a slightly better growth outlook for 2013 should also support higher prices of equities.

- Under the current conditions, we still like ***high quality dividend paying stocks***. We also like the shares of ***international companies with strong brands***, especially those with ***increasing exposure to emerging markets***.

- From a regional perspective, our focus will be more on ***European and Asian equities. European equities are largely under-owned*** and the suppression of tail risks has made their valuations more compelling. We also like ***Chinese equities*** which appear to be well positioned to make up for some of their underperformance over the last years.

Commodities

- The ***structural support for commodities appears to be fading*** and 2012 has been a difficult year for the asset class. ***Commodities prices*** have fallen for most of the last quarter but they ***could well start the new year on a stronger note*** due to subsiding tail risks, an improving outlook on China's economic activity and investors' under exposure to the asset class.

- However, our ***outlook for commodities is muted*** as we find it difficult to identify broad-based tailwinds for commodity prices in 2013. The asset class is complicated due to its many different individual commodities and we prefer to focus on other assets.

- We do not intend to increase our exposure to the asset class, but we will maintain our on-going exposure to a ***well-balanced commodity index*** with weightings of 20% in energy, 20% in precious metals, 20% in base metals and 40% in agricultural commodities.

Gold

- We continue to ***recommend maintaining the current 5% allocation to physical gold*** due to its long-term defensive nature. The main reasons for investing into gold are to protect against ***monetary debasement*** and to ***insure part of the portfolios against unpredictable events***.

- Furthermore, the low or negative real interest rate environment means that there is ***no opportunity cost in holding gold***. The major central banks are extending their reflationary policies and gold will keep its ***safe haven characteristic*** in foreign currency reserves and as a ***hedge against future inflation***.

Hedge funds

- Despite their relatively disappointing performance in 2012, hedge funds will continue to play a key role in the portfolios. The ***active management approach*** of hedge funds contributes to the ***diversification of investors' portfolios*** and their ***returns are less correlated*** to those from traditional assets.

- The risk-on and risk-off market conditions have been very difficult for systematic strategies which seek to capture price momentum. Even if a sudden change of the trading environment appears unlikely, we ***continue to retain an exposure into our fund of Commodity Trading Advisors (CTA) funds***. We view this position as an uncorrelated source of return that should bring ***protection to the portfolios in the case of negative market developments***.

FFG PORTFOLIO CONSTRUCTION

- The construction of an investment portfolio and the selection of its individual components are the result of a ***well-defined investment process***. This process begins with the determination of the ***client's investment profile***, which then leads to the tactical positioning of the portfolio within strategic asset allocation ranges for each asset class.

- The ***determination of the allocation to the different asset classes*** is the ***main driver*** of the portfolio's performance and serves as the keystone around which the other investment decisions are taken. The role of your investment manager at the Forum Finance Group is to build portfolios based upon all the relevant information and through the ***selection of investment products from a pre-determined investment universe.***

- Each individual investment has a specific role to play and the selection of any product is based on both its ***inherent features*** as well as its ***complementary properties*** within the portfolio. It is necessary to fully understand each investment product in order to be able to predict to a large extent its behaviour depending on different market scenarios and to better ***evaluate its purpose in relation to the other assets***.

- Therefore, the performance of any specific investment cannot be measured against its peer group without taking into consideration the remainder of the portfolio. Typically, the ***portfolios' risk budget*** will be spread across ***directional assets*** such as ***equities, commodities and high-yielding debt***. The portion of the portfolios ***dedicated to the preservation of capital*** will be invested into ***assets less correlated to market trends***, such as ***funds of hedge funds, highly-rated bonds and certain structured products***.

SINGLE HEDGE FUND MANAGERS

- From a historical perspective, the Forum Finance Group investment managers have always invested into the hedge fund space via ***Funds of Hedge Funds***, essentially in order to comply with mandate directives and for portfolio diversification purposes, but also to limit risks associated with single manager funds.

- Since the June 2009 corporate merger with IWM Independent Wealth Management (IWM), ***investments into single managers*** are also taken into consideration for those clients having signed an appropriate mandate. We view these types of investments as ***genuine alternatives to the traditional asset classes***, providing access to outstanding fund managers and improving the risk-return profile of portfolios.

- Whereas Funds of Hedge Funds will continue to be classified as a separate asset class, the ***majority of single manager hedge funds will be classified within the traditional asset classes***. Therefore, as an example, the allocation to equities will not only include the direct equity positions and the investments into equity funds, but may also include strategies such as Long/Short equities or Event Driven equities.

STRUCTURED PRODUCTS

- From our point of view, ***structured products*** also provide an alternative way of investing into traditional asset classes such as equities, debt instruments and commodities. The different structures of these products vary considerably and the selection of a specific structure is not only a function of the prevailing market conditions and the outlook for the underlying asset, but also a function of the capacity of the product to ***mitigate risk*** within the global portfolio.

- ***Structured products are classified within the most relevant asset classes*** at any defined moment. This allows us to better analyse the overall levels of risk of each asset class than if structured products were classified separately. Structured products are, by nature, hybrid instruments and the evolution of their different components will determine whether it becomes necessary to ***reclassify*** a particular structured product into a different asset class.

ASSET ALLOCATION GRID 2013

For our balanced accounts, we recommend the following grid:

	Allocation	January 2013
Short-term deposits	**0 – 20%**	**6%**
Debt instruments	**15 – 40%**	**30%**
Investment grade bonds	5 – 30%	10%
EM & high-yield bonds	5 – 20%	8%
Specialist bonds	5 – 15%	12%
Equities	**20 – 50%**	**42%**
Developed markets	10 – 30%	28%
Emerging markets	10 – 30%	14%
Commodities	**0 – 15%**	**7%**
Physical gold	0 – 5%	5%
Other commodities	0 – 10%	2%
Hedge funds	**10 – 30%**	**15%**
		100%

CONTACT

The Forum Finance Group S.A.
6, rue de la Croix d'Or
P.O. Box 3649
CH-1211 Geneva 3
Switzerland

Phone : +41 22 311 8400
Fax : +41 22 311 8465
E-mail : info@ffgg.com
Web : www.ffgg.com