

The & Letter

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Completed in July 21st 2010

EDITORIAL



Surpluses of all kinds

Having faked the discovery of surplus private debt in 2007, lenders have now been thrown into a panic by reading the public-sector balance sheets which, for their part, are in exceedingly poor shape. In the face of past surpluses, the measures that have been adopted are extraordinary, with short-term rates close to zero, the triggering of quantitative monetary policies and an extraordinary swelling of budget deficits. These remedies have resulted in various interpretations that have caused violent market reactions. There is a risk that such excessive volatility will continue in the months to come, because a return to the norm continues to be embedded in mindsets when it is economic and financial change that needs to be properly understood. We must not hide the fact, however, that it is more exciting to discuss a surplus of solutions, even though lately there has only been a surplus of worries.

Romain Boscher,
Chief Investment Officer

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Asset Management

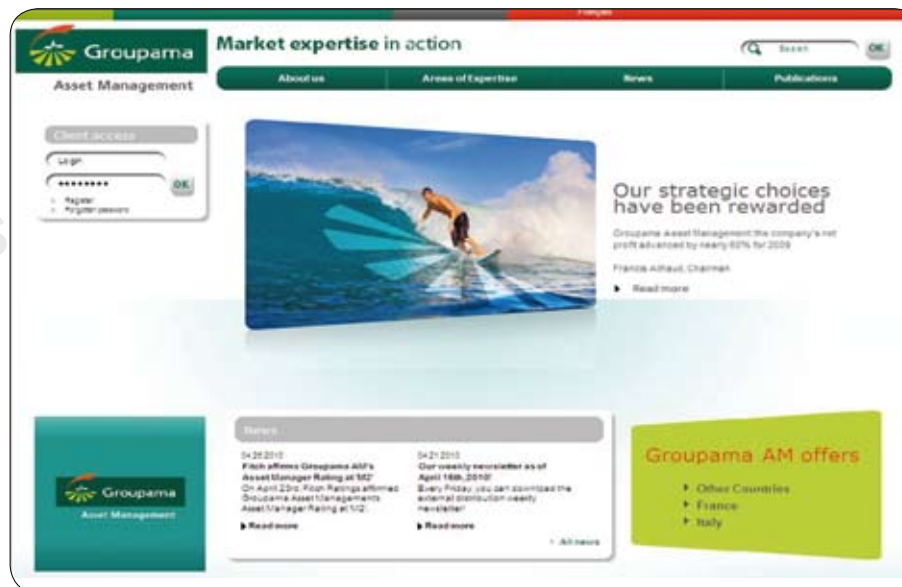
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Funds
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Tendance

Projection



Anticipation
Projection
Tendance

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Anticipation

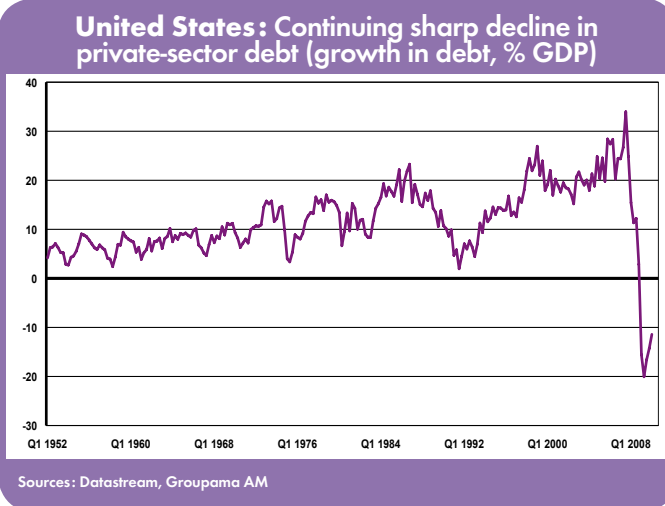
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View the entire range of our funds, their presentation, features, and of course performances.
You will also find all the news and our downloadable publications.

ECONOMIC ENVIRONMENT

United States

STUCK DUE TO THE NECESSARY REDUCTION OF PRIVATE DEBT

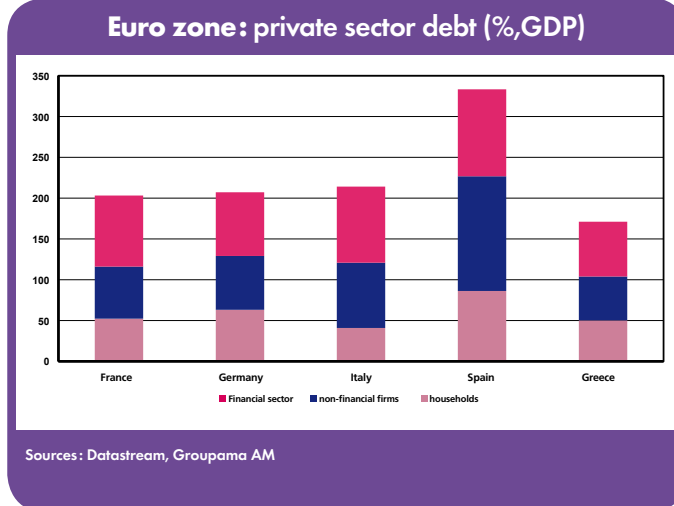
The sharp decline of 3.5 points in the ISM manufacturing index in June alone, returning to its level of 6 months ago, is no surprise: off-season inventory growth remained weak at 0.9% in the first quarter, a rate towards which it would be expected to fall in the second half once the growth phase of the inventory cycle is complete. Although world trade is slowing, the US economy remains hampered by a decline in the leverage effect of the banking system and any form of lending: financing conditions remain difficult for all borrowers, with the exception of large companies, for which massive bond issuances benefit from structurally strong demand by US institutional investors, given the ALM problems. By contrast, households are being forced to reduce their debt at an annual rate of 3% of income. For that reason, the residential property market fell heavily after the tax incentives expired, and the savings rate, which was 4% in May, has not yet stopped climbing, a result of sales of household financial assets, which financed consumption earlier in the year. Nevertheless, the government may still count on a high level of investor confidence in US public debt if it has to boost the economy again.



Euro zone

EUROZONE SUPPORTIVE OF BUDGETARY RIGOUR, REGARDLESS OF THE VERY DIFFERENT PRIVATE DEBT PROBLEMS FROM COUNTRY TO COUNTRY

GDP is expected to accelerate in the second quarter due to exports, the inventory cycle and a rebound in the construction sector, after the harsh winter earlier in the year. However, growth will then end in the second quarter because of a weakening of domestic demand. Following the announcement of budget-consolidation measures, the economic climate grew worse: the reversal of household expectations presages a continuation of the drop in consumption after an already significant contraction in the first quarter, resulting from the high unemployment rate (10%) and a correction in the automobile market after sales incentives expired. Out of all the countries in the entire Eurozone, Spain is currently the most worrisome, not because of its public debt trend, which in our view is of little concern, but rather because of its inappropriate economic policy. Indeed, Spain is currently suffering from a considerable surplus of private debt, the indispensable absorption of which is already depressing domestic demand. However, the forced reduction of the budget deficit, specifically through salary reductions, is amplifying the debt reduction process, although it will be difficult for the population to accept these sacrifices, as it has already been affected by severe unemployment, which is at an historic high of 20% and will continue to worsen. Spain is entering a very turbulent period, during which the risks weighing on the system are high.

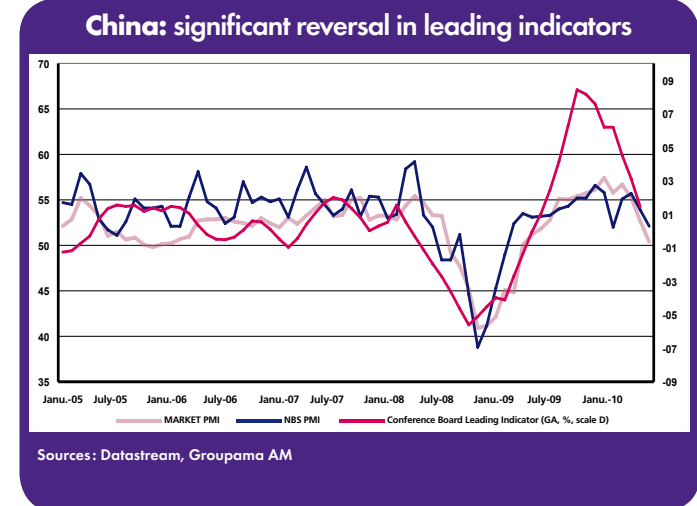


China

SEEKING TO PREVENT A REAL ESTATE BUBBLE

Leading indicators show a more marked slowing than we anticipated. A return to more reasonable growth in household consumption, as measured by both retail sales and new car registrations, is not inspiring any concern. In fact, consumer prospects are good, especially given the continuing strong growth in the jobs market, which is evenly distributed among the various provinces. By contrast, the sharp decline in loan production, which was sought by the Chinese authorities and is quite inadequate in their eyes, is problematic. This is because although total loans outstanding are indeed slowing, with repercussions on growth and particularly on investment by companies and provinces, real estate loans outstanding are continuing to accelerate, inflating the real estate bubble, which will significantly reduce long-term growth in China, according to the authorities. Consequently, as long as real estate speculation persists and the real estate market remains turbulent, the monetary authorities will continue to apply a tight monetary policy and reduce bank liquidity, at the risk of excessively softening interest rates on the Chinese markets and causing a severe slowing of their economy.

Laurent Berrebi,
Chief Economist



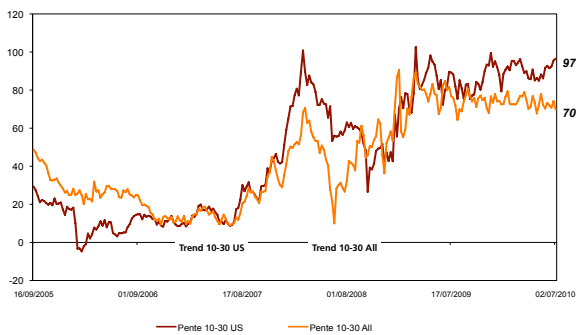
FIXED INCOME MANAGEMENT

Eurozone

SHORT RATES

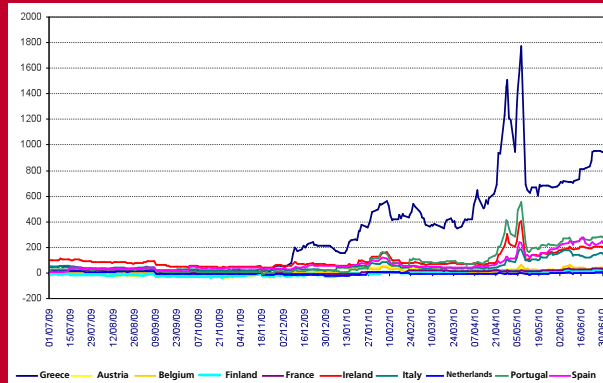
The BCE meeting on 10 June, unlike the previous one, fully reassured the markets. Of course, this was not because of concerns as to the refi rate, which is soundly anchored to the 1% mark and for which expectations of upward movement are very low. It was because liquidity at the beginning of the end of the long-term refinancing had engendered so much discussion the previous year. In fact, all the analyses show that the market's excess liquidity is currently due to the Central Bank alone, and that inter-bank exchanges remain anaemic, hence the markets' attention to the forthcoming refinancings. Investors were fully reassured by both the speech and the measures that were implemented, but particularly by the major test on 1 July. Indeed, this was quite successful, with a drop of €440 billion in the one-year refinancing and a renewal level considerably lower (€160 billion), and specifically lower than expected (>€200 billion). All of that is in line with our expectations and projections, which we therefore maintain unchanged.

Change in 10-30 yr slopes for Germany and the United States



Source : Bloomberg

Evolution of 2 year interest rate spreads in the eurozone *



Source : Bloomberg

* The rates used are generic rates, a change in the benchmark obligation could result in an increase in yield

LONG RATES

With Moody's lowering of Greece's LT rating, the emergence of slightly worse economic indicators and increasing concerns about Spain, risk aversion remains quite high on the bond markets. Thus, German bond yields returned to their previous low points, and peripheral sovereign debt saw risk premiums jump sharply, some to beyond their previous high points at the beginning of May. The reassuring factor that limited this increase was that the new government bond issuances occurring during the month, led by Spain, continued to be well received and accepted by the market, signalling very attractive yields. What is more, announcements by the various Treasuries offered indications of the completion status of their refinancing plans, which overall are quite advanced, with a few exceptions. We do not anticipate any major changes over the next few weeks in terms of either market psychology or macroeconomic environment, which is even expected to deteriorate in the second half. We therefore maintain a defensive country

positioning, under-weighting peripheral debt and overweighting that of core countries. We are also keeping our portfolios neutral with regard to rate sensitivity, in the belief that in the short term, yield trends are expected to remain within a very narrow range, centred on current levels. Thus, we project short-term rate stability at, for example, 3% for the 10-year OAT, with very slight 12-month tension at 3.50%, down from our previous targets.

Inflation indexed

Once again this month, the continuous decline in core or global inflation figures and risk aversion have had an impact on the asset class. Indexed assets thus under-performed their nominal counterparts over the past month on all markets, with the exception of Japan, which benefited from direct purchases by the Finance Ministry. Given our expectations as to the market situation, as described above, there is no reason why the market is improving in the short term in this class of assets. We are therefore maintaining a zero weighting in our aggregate funds and a cautious position in our indexed funds.

FIXED INCOME MANAGEMENT

United-States

SHORT RATES

At the last FOMC meeting, Mr. Bernanke sent an important cautionary signal regarding the US economic recovery. Expectations of increases in the Fed Funds rates were then once again put to rest. The first increase is now expected in the summer of next year. Nevertheless, dissent remains among the governors with a vote that continues to push for normalisation of the curve, both to restrict the creation of a bubble in certain assets, and to give the Fed further room for manoeuvre in the context of potential asset sales. We acknowledge this change of tone, however, and are therefore revising our 12-month target to 0.75%.

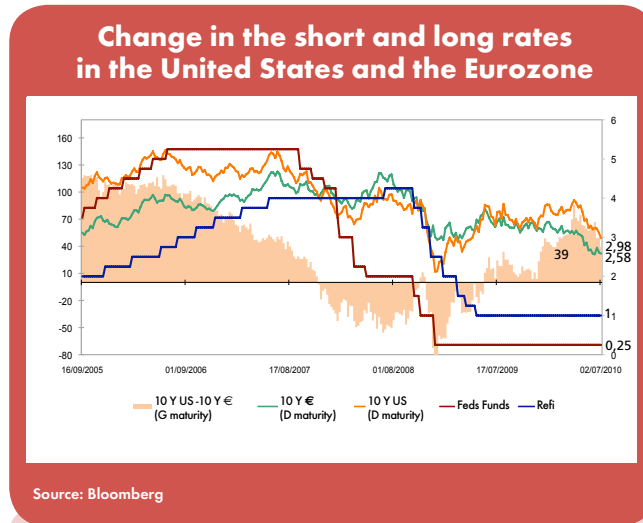
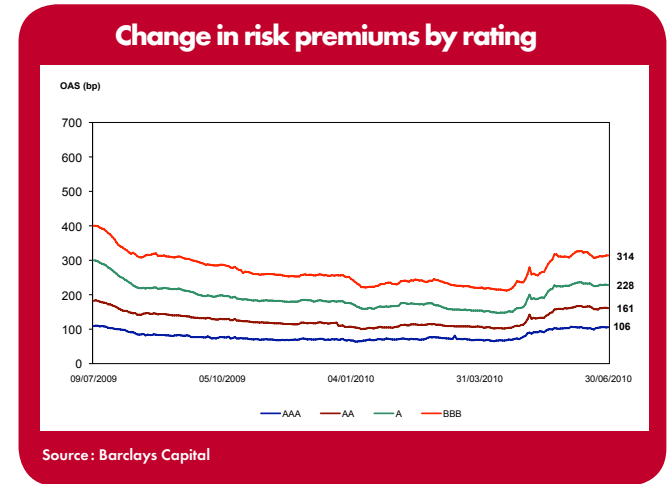
LONG RATES

In an environment favouring a flight to quality, US bonds have clearly benefited from their status as a safe haven. Thus, bond yields have continued their almost steady downward trend that began on 4 April, from 4% for 10-year rates to a low of 2.88% at the beginning of July. The publication of macroeconomic figures showing lower income also contributed to this rally. The contribution of this aversion to the risk of declining yields is expected to be gradually mitigated. However, we believe that the US recovery could be weaker, which will limit tensions. We therefore see a short-term target in line with the current 3%, and a 12-month target limited to 3.75%.

Lending

The most subordinated debts, in particular, have suffered from the environment described above, and the asset class as a whole saw its risk premiums rise slightly over the entire period. It is clearly not issuers' fundamentals that are the source of these trends – rather, these are quite good for the time being, and with a peak in default rates that now appears to be behind us – but rather the general environment and concerns about sovereign debt. We saw a slight easing of the primary market, giving us a bit of breathing space, but it

was narrow in scope and of short duration. The asset class continues to be supported by an appetite for yield that is undeniable and that limits sharp increases in risk premiums. The banks' stress tests could be catalysts for a welcome return of confidence; unfortunately the lack of coordination in defining these tests and the current lack of transparency sharply limit this reassuring aspect. By contrast, our expectations of a future decline in the global economic environment, and our fundamental worries regarding the financial sphere in the second half, appear to be of greater concern and compel us to show greater restraint towards the assets class as a whole, and specifically to lighten up on the financial sector, especially subordinated debt. Even if these concerns do not materialise immediately, the liquidity criteria for these assets have convinced us to begin this lightening process immediately.



Past performance is not a reliable indicator of future performance.

Philippe-Henri Burlisson,
Core Management Director





Results forecasts and evaluation of the markets

PROFITS OUTLOOK

■ Projected results: increase is slowing

- The consensus continues to revise its 2010 earnings projections upwards for all regions except Japan, but less in 2011, hence a decline in 2011 growth.
- In the United States, despite estimates of higher growth in 2010 earnings, we note for the first time since 2009 that more than half of all companies saw their earnings revised downwards over a month (negative net-up).

■ Very attractive valuations: declining markets remain a contrast with earnings expectations. Whom should we believe?

- Valuations are therefore very attractive and do not appear to take earnings expectations into account.
- The US and Europe reported declines in the historic valuation levels of 2003-2007, and are approaching the 2009 low points.

OTHER FACTORS

■ Liquidity:

- Significant withdrawals in US and European equity funds, we are seeing a reversal of this trend since the start of the year.
- Some mergers and acquisitions, particularly in Spain.

Performance of the main indices since the start of the year

	08/07/10	Var. 2010 in euros
DJ Euro Stoxx 50	2 666	-10%
SBF 250	2 564	-8%
CAC 40	3 538	-10.1%
FTSE 100 (UK)	5 105	0.2%
S&P 500	1 070	8.6%
Nasdaq	2 175	8.5%
Topix (Japan)	861	12.9%

Source : Datastream

EQUITY MANAGEMENT

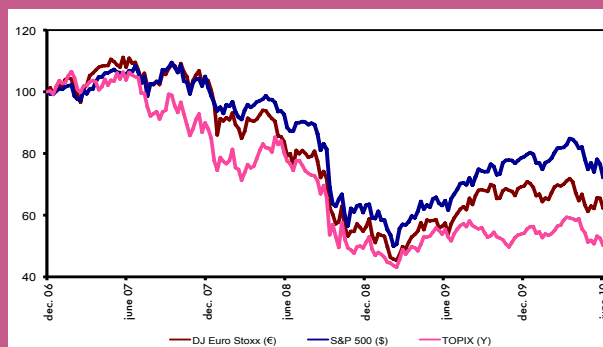
■ Small caps: 2010... still a year of out-performance?

- Current problems are specifically concentrated in financial securities, which hardly exist in this class of assets
- Sharper improvement in earnings
- Major proving ground for under-valued issues.

■ Graphic analysis: return to a bear market

- Markets are trending slightly downwards, breaking through significant levels and largely positioning themselves under the long-term (200-day) moving averages
- Beyond the very short-term rallies corresponding to "over sold" periods, the trend remains downwards in the months ahead. For now, signs of accumulation prevent us from envisaging any reversal in this trend.

Performances of international stock market indices

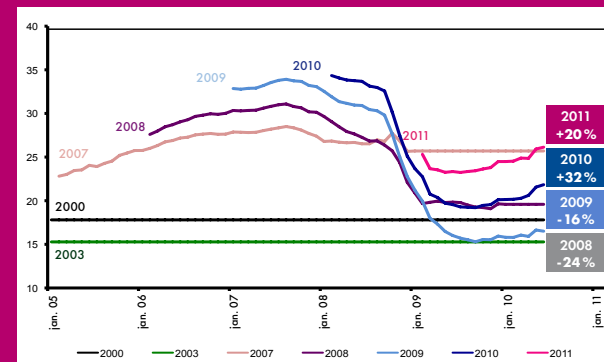


Source : Datastream



Claire Chaves d'Oliveira
Head of Equity Management

Profits forecast by the consensus on Euro Stoxx



Source : IBES

Market outlook

■ Prospects: turbulent summer in prospect...

The micro-macro battle mentioned last month is continuing, with earnings still upgraded (although momentum is tailing off) and stock markets are once again being impaired by the financial crisis. Still fearing the effect of the multiplication of austerity plans (pressure on consumption, fiscal pressure, risk of deflation, higher net-equity requirements for financial companies, etc.), we have not changed our growth prospects for companies, which are still far below analyst consensus, particularly for 2011 when we anticipate growth close to zero.

The only strong point for European export companies is the euro's weakness against the dollar, but this favourable trend seems to be resulting in a pause.

However, company Q2 results, which are scheduled to appear in the next few days, are expected to remain solid: the primary challenge will be the tone of the prospects communicated by company management.

Our short-term as well as long-term objectives therefore remain unchanged, with high volatility expected during the summer, around levels close to current ones. We maintain our preference for the US market (still protected from austerity plans) and the Japanese market, over the European and Asian markets, which are suffering from a turning point in the growth rate.

GLOBAL BALANCED PORTFOLIO MANAGEMENT

Trend

Two weeks of intense decline in the stock markets followed by one week of record appreciation: traders are still suffering from the bracing hot-and-cold treatment. Questions are currently focused on two items deemed to be of particular concern: the possibility of a double-dip recession for the global economy - or at least for the so-called emerging economies? -, and the ability of European banks convincingly to pass the stress-test cap.

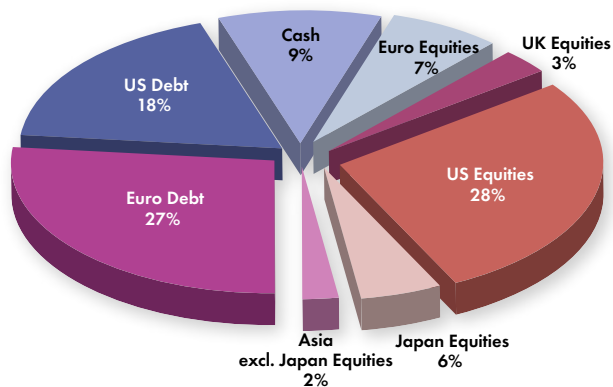
As for the first item, for the time being, a (slight) breeze of optimism seems to be blowing, even though a good number of analysts still projects almost zero growth in the US during the third quarter, given an unfavourable inventory effect. In this regard, remarks by WTO General Director Pascal Lamy concerning the negative effects of debt on European and US growth have fuelled the pessimists' fire. To be precise, concerning sovereign debt, particularly in Europe, we must acknowledge that tensions remain for the weak links, and that the positive effects of the financial stability plan are not immediately

apparent: rates of over 11% on Greek loans with maturities of 3 to 7 years do not appear to be a tangible improvement over the initial situation.

Regarding the stress tests of the European banks, the period before their 23 July publication will necessarily inspire a number of computations. The remarks by J.C. Trichet, however, prepared the ground rather well, with certain listeners being particularly creative in their thinking and even finding a way to use the European Financial Stability Fund to assist in the necessary recapitalisation of banking establishments in difficulty.

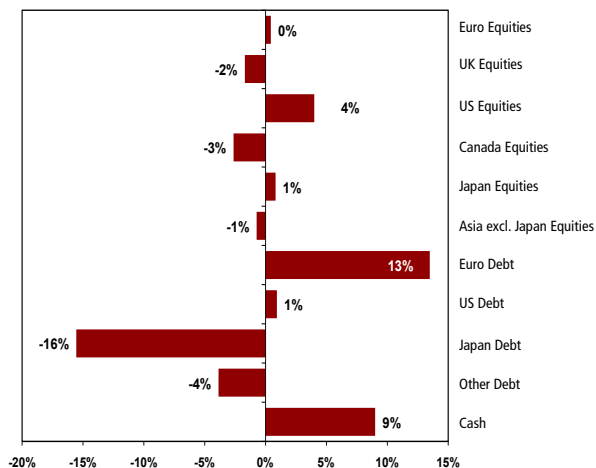
However, until that fateful date of 23 July, earnings reports in the US will have a ripple effect during trading sessions before they can truly give the "okay"; since they are expected to be satisfactory, they should offer a some respite to participants who are feeling somewhat beleaguered.

Model portfolio



% difference

BETWEEN BENCHMARK AND MODEL PORTFOLIO



Portfolio closed on 10/07/2010. Benchmark composed of 50% JPM global hedged + 50% MSCI world. Source: Groupama AM

Allocation

OVERALL ALLOCATION

Equities 46%-fixed income 45%-money market 9%
We have marginally increased the weight of equities in the portfolio by increasing the weighting of Japanese stocks financed by using a portion of available cash.

EQUITY MARKETS (46%) +1%

USA (=): we are keeping our exposure unchanged: the dollar's response is a positive factor offsetting our fears at the somewhat unusual fact that during the past month, over half the companies in the S&P revised their earnings downwards.

EUROPE (=): we still remain under-exposed: despite the German economy's good results, we are concerned at the effect of the "fiscal consolidation" plans on the region's companies.

ASIA (+1): we are strengthening Japanese equities, which are expected, at least for exporters, to benefit from the yen's slight weakening due to political uncertainties. By contrast, we remain underexposed to Asia excl. Japan, as the Chinese situation, in particular, does not appear to be particularly transparent.

FIXED INCOME MARKETS (45%) =

USA (=): US bonds out-performed during the period, playing their role as a safe haven during a period of sharp decline in risk assets; we maintain our slight over-exposure.

EUROPE (=): more than ever, the bund remains a safe bet, despite levels that are not particularly encouraging. We maintain our position.

JAPAN (=): little interest.

MONEY MARKET (9%) -1%

The cash reserve was reduced slightly after the allocation of shares.

Jean-Louis Autant,
Head of Global Balanced Management



IN THE BLINK OF AN EYE

Our strategy

		Current level 06/07/2010	Short-term objective	1 year objective
United States	Fed Funds	0.25	☹️	☹️
	10 yr T-bill	2.95	☹️	☹️
Eurozone	Refi rate	1.00	☹️	☹️
	10 yr OAT	2.94	☹️	☹️
Japan	BOJ rate	0.10	☹️	☹️
	10 yr JGB	1.14	☹️	☹️

Sources: Groupama AM, Bloomberg

Our model portfolio in € 06/07/10

BENCHMARK	EURO MTS GLOBAL
Sensitivity	☹️
Inflation indexed allocation	☹️
Curve choice	
1 - 3 yr	☹️
3 - 5 yr	☹️
5 - 7 yr	☹️
7 - 10 yr	😊
10 - 15 yr	😊
15 yr +	😊

Sources: Groupama AM, Bloomberg

Conclusions of the equity markets committee 06/07/10

	Indices 06/07/2010	Forecasts Groupama Asset Management	
		short term (< 3 months)	a 1 yr
France (CAC 40)	3 332	☹️	😊
Euroland (DJ)	241	☹️	😊
United-Kingdom (FTSE 100)	4 824	☹️	😊
United-States (S&P 500)	1 023	☹️	😊
Japan (Topix)	837	☹️	😊
MSCI Asia free ex-japan	456	☹️	😊

Sources: Groupama AM, Bloomberg

😊😊 Positive 😊 Positive neutral ☹️ Neutral ☹️ Negative neutral ☹️☹️ Negative

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