The Letter
Funds & Strategy

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SUMMARY

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EDITORIAL

Risks and Uncertainties

The present time confirms, if confirmation were needed, that investors and asset managers are faced with different challenges in confronting risk and uncertainty, as shown by Frank Knight, Professor of Economics at the University of Chicago, in his book, Risk, Uncertainty and Profit (1921). Risk (the second-round potentially inflationary effects of rising crude oil prices, for example) is measurable, quantifiable and often "hedgeable". Conversely, uncertainty cannot be reduced to attempts to quantify it, and its significance is especially hard to assess. In short, uncertainty leaves us largely unprepared for the unknown, without the slightest point of reference provided by statistics or any precise information to lean on. That's what we're living today in a particularly intense fashion: the political and economic consequences of the "Arab Spring" and the disaster in Japan are having an aggregate impact on overall uncertainty worldwide. Humility requires the admission that it is difficult to distinguish between the signal and the noise of such events.

Antoine de Salins,
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The Actively Responsible Asset Manager

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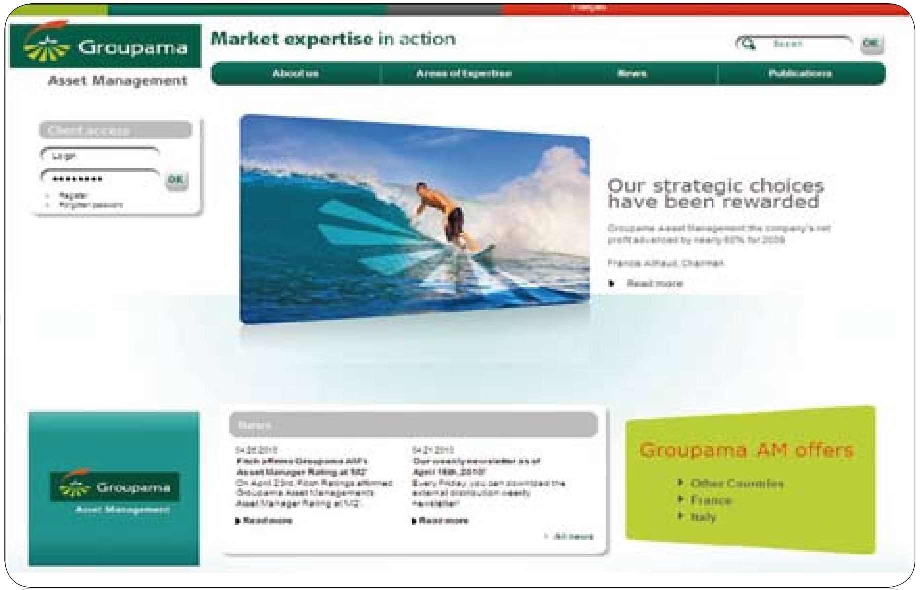

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ECONOMIC ENVIRONMENT

Laurent Berrebi,
Chief Economist

United States

AFTER A SOLID FIRST QUARTER, THE ECONOMY WILL BE HURT BY RISING INTEREST RATES AND SOARING OIL PRICES

The first-rate ISM indices, derived from surveys of major groups, are too rosy this month, and thus offer a distorted picture of the American economy. Growth, revised downward in the fourth quarter from 3.2% to 2.8%, remains moderate. The indicators for SMEs are weak. Global leading indicators (Conference Board, OECD) reflect a slowdown even after a solid first quarter 2011 buoyed by exports and inventories. The rise in long interest rates will prompt another decline in sales and drive prices lower in the housing market which is still distressed by the fragility of the banking system: the small reduction in the default rate does not justify the steep cuts in loan loss provisions made recently by the banks.

After a 4% increase in the fourth quarter of 2010, consumer spending should slow in the first quarter of 2011. Following its 0.1% contraction in January, it should return to a 2% annualised growth rate, consistent with a pace of 200,000 new jobs a month. It will likely slow even further in the second quarter, following the 20% jump in oil prices per barrel in recent weeks and the fall in consumer confidence. Inflation is expected to rise by 0.7 points in the next few months.

Euro zone

CONTRACTION OF DOMESTIC DEMAND, ROBUST EXPORTS

Growth held steady at 0.3% in the fourth quarter, lifted only by foreign trade. In contrast, final domestic demand (excluding inventories) was down in almost all countries except Germany, where it was flat, and France, where it was strong. The recession persists in all peripheral countries except Spain (+ 0.2%), saved by exceptionally strong exports (+ 4.5%).

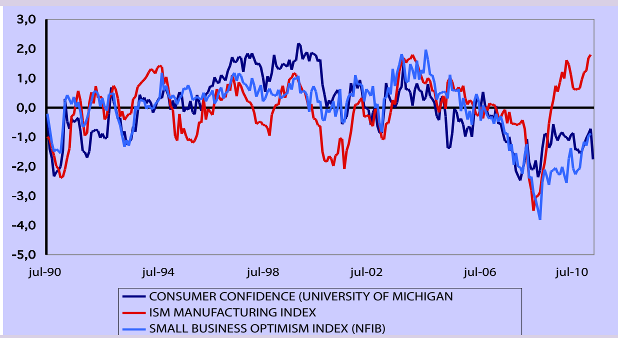
Growth will be stronger in the first quarter owing to a rebound in world trade, a recovery in construction after the previous quarter's storms, and restocking in France which saw massive inventory depletion owing to strong demand for vehicles before the end of the car-scrapping incentive. But the recession will linger in the peripheral countries. The continued rise in long rates despite advances in European cooperation and the recent surge in oil prices are deepening our concerns about growth, which will increasingly be impacted by budget austerity. Inflation is expected to rise by 0.5 points in the next few months and will reduce consumer purchasing power accordingly. Core inflation remains stable at 1% but could fall still further due to potential reduction in consumer demand.

Japan

MORE TROUBLE

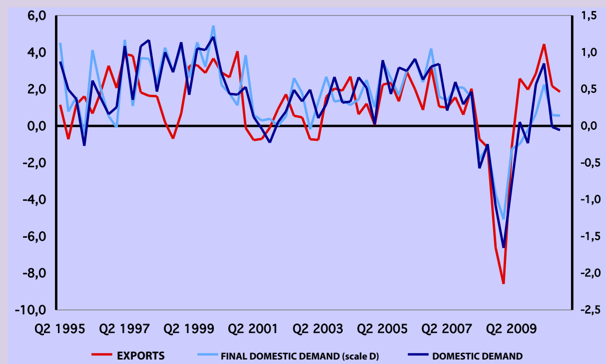
On 11 March 2011, an unprecedented earthquake shook five Japanese prefectures representing 8% of the country's GDP. But the tsunami that followed devastated the entire region, leaving thousands dead and missing. Several nuclear plants were damaged: 11 of Japan's 55 reactors have been shut down, when nuclear power provides nearly one-third of electricity generation. Several businesses have closed due to power failures and disruptions in the supply chain. Lastly, the nuclear accident at the Fukushima nuclear plant brought more adversity, especially for Tokyoites who account for 40% of the country's GDP, as they deal with radioactive contamination and the earthquake's aftershocks: household spending and business investment are expected to plummet. Overall, if the Fukushima plant can be rapidly brought under control, Japan's GDP should contract sharply in the second quarter, but growth thereafter should be buoyed by spending on reconstruction. The negative impact would thus be temporary for Japan and minor for the rest of the world. Indeed, the world should benefit from the negative energy supply shock impacting Japan, whose energy policy is likely to be called into question. On the other hand, the persistence of nuclear risk in the coming weeks is likely to cause a radical change in the expectations of private operators worldwide and lead to a significant weakening of global growth.

United States: big companies confident, SME'S less so, and consumers lose confidence .



Source: Datastream Groupama AM

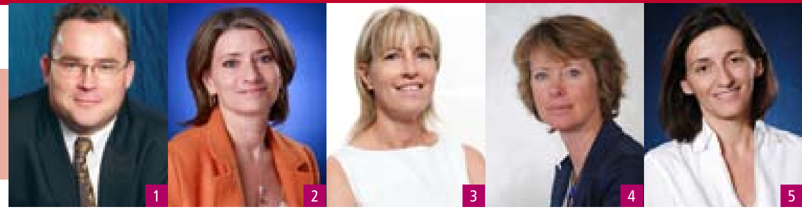
Euro zone: demand (% QTR CHG)



Source: Datastream Groupama AM

Japan's nuclear energy plants

Source: Datastream Groupama AM



Money Market Management

Caution is key.
The debt crisis in the Eurozone improved after the first weekend of the EU summit. Geopolitical risk in the Gulf appears to be waning—not for democracy, but for the price of black gold. The markets relegated these two risks to second place as all eyes focused on Japan. Beyond the tragedy it represents for the Japanese, this catastrophe with have a three-fold consequence: a slowdown in the global economy, an imbalance in financial flows due to the repatriation of Japanese assets and, lastly, the anxiety that nuclear risk engenders for all operators. We do not doubt the negative import of all of these factors, but it is still too early to measure their magnitude. We are therefore taking a defensive stance, but without considering the worst-case scenario.

P-H.B

CENTRAL BANKS

■ The central bank gets tough!

At the last meeting of the European Central Bank, Jean-Claude Trichet did some straight talking and announced a probable rate hike in April.
This decision reminds the European political authorities that the ECB has left them time to resolve the problems of the peripheral countries and it is time now for the bank to return to its primary mandate: fighting inflation. Mr Trichet said that the expected increase of 25bp should not be the start of a cycle of monetary tightening. Assuming that's so, we're somewhat baffled by the urgency of this move to combat an imported inflation that has little sensitivity to interest rate levels.
Meanwhile, the British central bank, dealing with an inflation rate that is much higher than the Eurozone's, is holding rates at 0.5% so as not to weigh on growth.
Mr Trichet has sharply outlined the difference between monetary policy and extraordinary measures for bank liquidity. One-week, one-month and three-month refinancing operations for unlimited amounts are being continued which will ensure ample liquidity until at least the end of the first half of 2011.

The combination of still-low rates and unlimited liquidity argues for an EONIA rate that is below the refi rate. Volatility continues to be high since the start of the year.
Year-to-date, the EONIA has averaged 0.65%, well above the average for 2010.

A WORD ABOUT THE INVESTMENT STRATEGY

■ Fund strategy.

Spreads on peripheral countries have once again widened.
In money-market portfolios, we expect short rates at significantly attractive levels to place Spanish, Portuguese and Italian bonds.
Following Mr Trichet's pronouncements, we expect the refi rate to rise 25 bps in April, but we do not believe in an isolated increase; instead, we expect a second rate hike by the end of the year. The disaster in Japan and its impact on the world economy in coming months are some of the reasons that could lead Mr Trichet to offset an increase in rates. In fact, at a time when politicians are proposing to provide assistance to Japan by purchasing the Japanese debt, a rise in rates in Europe could be poorly perceived.

D.B

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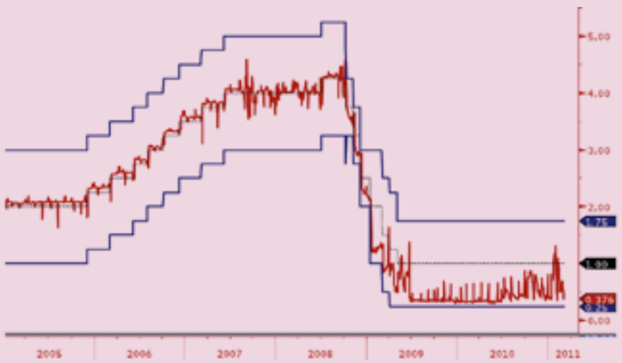
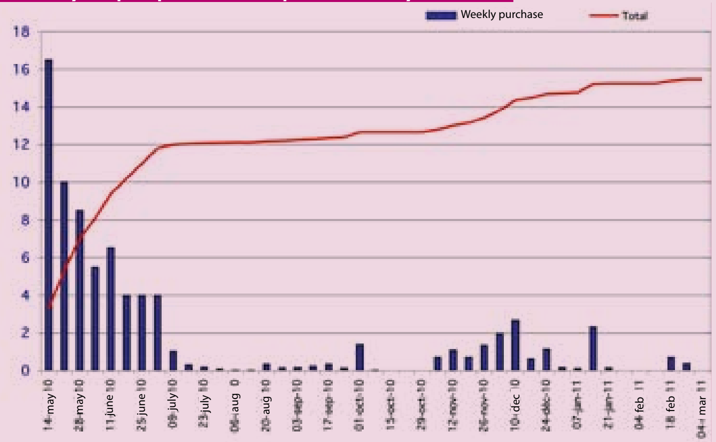
3- Gaëlle Malléjac
Head of Fixed Income Management
4- Claire Chaves d'Oliveira
Head of Equity Management
5- Claire Bourgeois
Head of Equity & Fixed Income ALM

Corridor,refinancing rate & EONIA
EONIA average capitalised over 2010: 0.43%



Source: Bloomberg

History of peripheral debt purchases by the ECB



Source: Groupama AM - Bloomberg

Fixed Income Management

LONG RATES

Recent events - the disaster in Japan and emerging geopolitical risk - phave led to rising volatility and the return of a "flight to quality" in the markets.

The Libyan crisis halted rising yields in the U.S. and pushed the U.S. 10-year rate down.

In the Eurozone, the markets reacted mainly to the impact of the crisis on the price of oil per barrel, prompted by Jean-Claude Trichet's speech focusing on inflationary pressures.

The arrival of disaster in Japan in recent days and the nuclear risks it engendered swept aside most rate hike expectations in the Eurozone and caused yields to tumble.

This news has overshadowed the management of the sovereign debt crisis, yet the timetable for the coming days is no less packed or significant.

The current discussions aim to reach a consensus between countries on the competitiveness pact and the European Stability Mechanism. Progress is expected so that an agreement can be presented at the EU summit on 24-25 March. It seems optimistic to assume that all will be resolved by that time, but initial statements have been positive.

Beyond the sovereign crisis, the markets will remain focused in the short term on developments in Japan and on the nuclear risk.

The flight to quality will continue to take precedence over fundamentals. Inflationary pressures, fuelled by the high price of oil, will be relegated to second place.

CREDIT

Corporate debt has proven very resilient in this climate of risk aversion. It has maintained its outperformance year-to-date, although some sectors have lost ground in recent days, primarily utilities and insurance. While fundamentals are still buoyant, growing risk is prompting us to reduce our credit allocation and our credit sensitivity, and to adopt a defensive bias.

INFLATION INDEXED

Inflationary pressures are persisting. The coming inflation figures are expected to show a further rise in inflation driven by continued high oil prices. Nevertheless, the resurgence of risk aversion and volatility are factors that penalise the asset class, so we are returning to a neutral stance.

A WORD ABOUT THE INVESTMENT STRATEGY

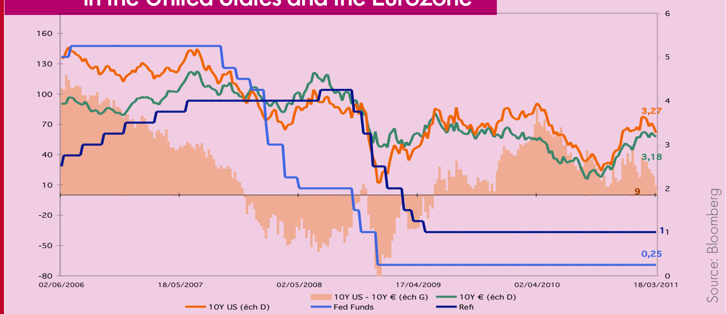
The continued flight to quality expected in this climate of high uncertainty is leading us to return the portfolios' interest rate exposure to neutral and to remove our bias on the flattening of the 2-10 year segment.

Our country allocation is still underweight on countries with significant solvency issues (Greece, Portugal and Ireland), neutral on Spain and Italy, and still gives pride of place to the «core" countries.

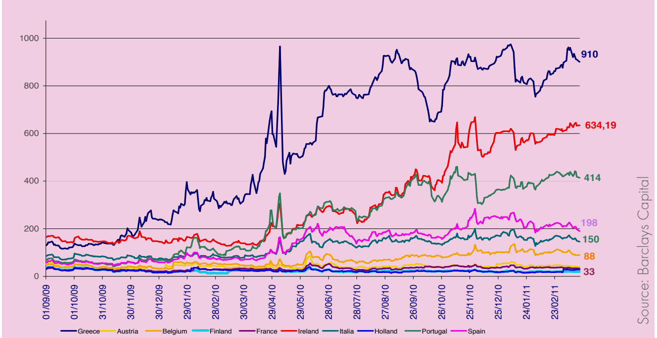
On credit, we're taking a defensive stance in the portfolio by decreasing credit sensitivity and establishing a liquidity pocket.

G.M

Change in the short and long rates in the United States and the Eurozone



2-year country risk spreads in Eurozone



Equity Management

EARNINGS GUIDANCE AND VALUATIONS

■ Earnings guidance: positive earnings surprises are declining.

• We note that this time positive surprises mainly concerned revenue, and not earnings (higher costs).

■ Valuations: the rebound in valuations is fading... they remain attractive.

• While earnings expectations are stabilising, interest rates and equity market movements are offsetting one another and valuations remain attractive.

OTHER FACTORS

■ Liquidity and flows: inflows are increasing into U.S. and European equity funds

• We are also seeing an acceleration of IPOs ($26 billion worldwide in two months)

• Return of corporate takeovers, completed or being planned

■ Small Caps should extend their strong performance

• The M&A cycle is favourable, as illustrated by recent transactions on Bulgari, Tognum and SGL Carbon.

• More robust growth

• A large pool of undervalued securities

■ Chart analysis: a return to support levels

The expected correction finally happened, taking European and U.S. indices down to major support levels. There is "normally" a high probability of a rebound. However, this decline is probably the beginning of the process of a larger-scale weakening that we've been expecting for spring. The Japanese market is in an obviously different configuration now, and such a sharp deterioration obscures all visibility.

MARKET OUTLOOK

■ Increasing uncertainty

• Macroeconomic data confirm the upturn, as do the latest corporate earnings, particularly in terms of revenue... but with the start of a compression of margins.

• Geopolitical uncertainties and their impact on oil prices are weighing on most companies' margins, which we already feared would narrow, hence our positioning below the consensus on earnings growth expectations.

• Added to these concerns is the disaster in Japan, for which we can't yet measure all the consequences, but which will undoubtedly impact the psychology of the markets and global growth.

• In addition, the European debt crisis remains unresolved, although governments acted efficiently in early 2011. Spring maturities could see market fears resurface.

• Against this backdrop we are significantly reducing our exposure to Japanese equities. On western markets, the current dip could turn into an opportunity to buy, provided that the nuclear spectre is effectively eliminated. Over the longer term, our targets are likely to be lowered.

A WORD ABOUT THE INVESTMENT STRATEGY

■ The theme of rising commodities costs, including oil, remains critical, prompting us to raise our exposure to energy.

• Events in Japan have led us to further reduce our holdings of luxury shares, and to emphasise certain defensive sectors (food processing, telecoms).

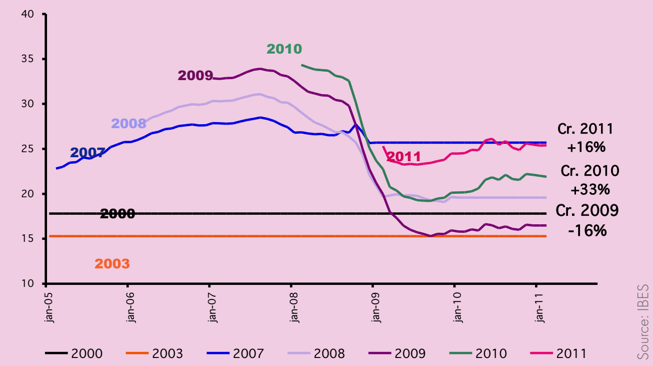
C.CO

Performance of the main indices since the start of the year

	08/03/11	Var. 2011 in euros
DJ Euro Stoxx 50	2945	5.5 %
SBF 250	2945	5.2 %
CAC 40	4016	5.5 %
FTSE 100 (UK)	5975	0.9 %
S&P 500	1322	1.4 %
Nasdaq	2766	0.6 %
Topix (Japon)	939	-1.1 %

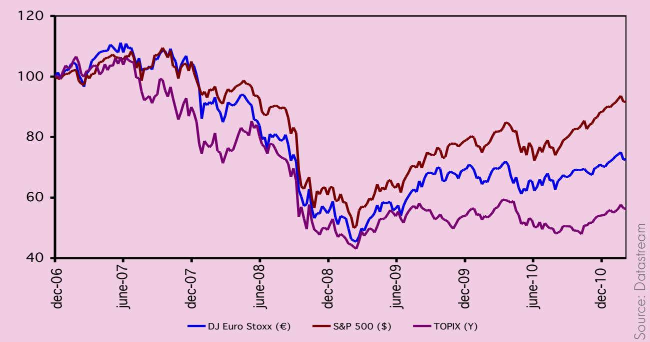
Source: Datastream

Profits forecast by the consensus on Euro Stoxx



Source: IBES

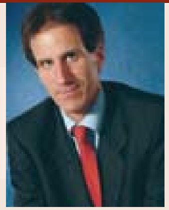
Performances of international stock market indices in local currency



Source: Datastream

GLOBAL BALANCED PORTFOLIO MANAGEMENT

Jean-Louis Autant,
Head of Global Balanced Management



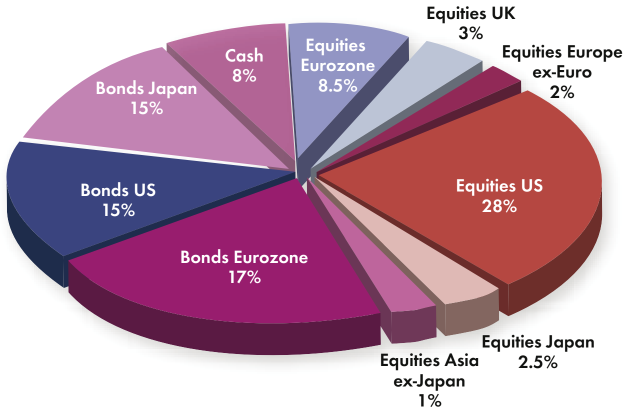
Trend

The consensus that the equity markets were looking for a way to consolidate their brilliant run of recent months is now a fait accompli. Forgotten are the cheers that had greeted the S&P's impressive, nearly 100% rebound since its low 2009 low point! Obviously affected by a disaster of this order, an expected healthy consolidation turned into a severe correction. Pre-earthquake, however, the horizon had already darkened considerably, as investors dealt with persistent pressure on energy prices caused by the turmoil in North Africa and the Middle East, tried to estimate the extent of money tightening to come in the Eurozone, or worried about the impact on peripheral sovereign spreads of the downgrade of Spanish debt.

Post-quake, and although it is obviously hard to thoroughly analyse a situation that is still far from stable, it is evident that visibility remains low. We can, however, note two important phenomena that occurred during this violent sell-off: the major role that hedge funds appear to have played in abandoning Japanese risk assets, and the brutal unwinding of carry trades which caused a sudden surge in the yen. This latter movement, largely unforeseen, created another problem for the Japanese government which it could well have done without. For now, joint intervention by the world's central banks has succeeded in curbing the soaring yen, but the dollar's subsequent plunge risks gradually leaving the euro alone to face the crisis.

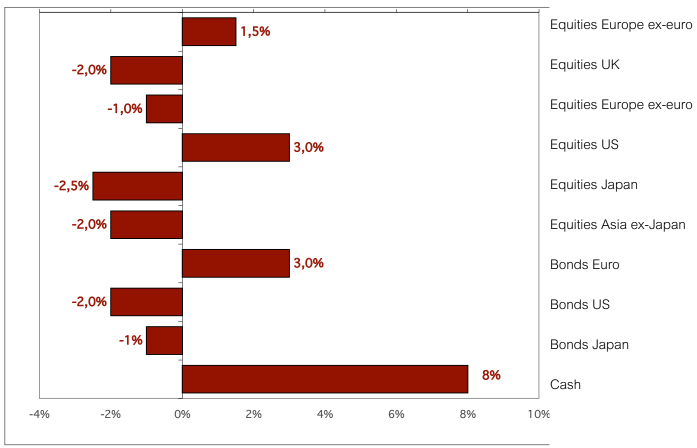
In this tense environment, investors are nonetheless sorely lacking in dependable alternatives for their equity investments. Indeed, the bond markets are not a particularly reassuring refuge, whether in the Eurozone, where they appear directly threatened by the developing phase of money tightening, or in the U.S., where they could be weighed down by the repatriation of Japanese capital and uncertainty about the government debt ceiling. This lack of alternatives is a weighty factor which presages a stabilisation of the equity markets over the next few weeks.

Model portfolio



% difference

BETWEEN BENCHMARCK AND MODEL PORTFOLIO



Portfolio closed on 14/03/2011. Benchmark composed of 50% JPM global hedged + 50% MSCI world. Source: Groupama AM

Allocation

GLOBAL ALLOCATION

Equities 45% / Fixed Income 47% / Cash 8%

EQUITY MARKETS (45%)

■ **USA (28%):** U.S. stock exchanges have largely outperformed the other financial markets, both during the retracing phase and in the current correction phase. In this extremely tense environment, they continue to seamlessly play their role as a refuge for investors. In addition, earnings season has confirmed substantial corporate profits and the resulting plethora of cash will allow U.S. business—once past the phase of stress—to resume share buybacks and M&A transactions. This remains our preferred region.

■ **Europe (13.5%):** After enjoying a positive trend, the European indices are holding at levels close to solid resistance, which, here again, appear difficult to overcome. We're holding steady here, too.

■ **Asia (3.5%):** There is little reason in this context to favour Japanese equities; we are maintaining half of the benchmark's exposure. Other than a technical rebound in the short term, we believe that the performance of Japanese equities will remain behind that of its counterparts. The industrial base has been severely damaged and the massive injections of cash by the Bank of Japan seem insufficient to counteract this negative impact. We are also continuing to lighten our holdings in the Asia-excluding-Japan region.

BOND MARKETS (47%)

■ **USA (15%):** Fears related to Japanese capital repatriation and the U.S. government debt ceiling are leading us to trade off much of our exposure in favour of Japanese bonds.

■ **Europe (17%):** The various European summits appear to have calmed concerns (in the short term) about the sovereign debt crisis.

■ **Japan (15%):** We are rebuilding substantial positions on Japanese debt: the investments made by repatriated capital should buoy the markets despite their still very low absolute levels.

MONEY MARKET (8%)

Increased due to the paring back of equities.

IN THE BLINK OF AN EYE

Our strategy

		Current level 16/03/11	Short-term objective	1 year objective
United States	Fed Funds	0.25	😐	😐
	10 yr T - bill	3.20	☹	☺
Eurozone	Refi rate	1.00	☹	☹
	10 yr OAT	3.43	☹	☹
Japan	BOJ rate	0.10	😐	😐
	10 yr JGB	1.21	☺	☹

Sources : Groupama AM, Bloomberg

Our model portfolio in € 16/03/11

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 16/03/11

	Indices 16/03/2011	Forecasts Groupama Asset Management short term (<3 months)	a 1 yr
France (CAC 40)	3 697	😐	☺
Euroland (DJ)	267	😐	☺
United-Kingdom (FTSE 100)	5 598	😐	☺
United-States (S&P 500)	1 257	😐	☺
Japan (Topix)	818	☹	😐
MSCI Asia free ex-japan	539	😐	☺

Sources : Groupama AM, Bloomberg

Sector Outlook

Energy	☺	Consumer Products - Cosmetics	☹
Basic Materials	☺	Health Care Equipment	😐
Capital Goods	😐	Pharmacy & Biotech	☹
Industrial and Commercial Services	😐	Banks	😐
Transportation	☺	Diversified Financials	😐
Automobile	😐	Insurance	😐
Consumer Durables	☹	Real Estate	☺
Hospitality & Leisure	😐	Software & Computer Services	☺
Media	☺	Technological Equipment	😐
Non-Food Retail	😐	Semiconductors	☺
Food Retail	☹	Telecoms Operators	☺
Food Processing	😐	Utilities	😐

Sources : Groupama AM

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☺☺ Positive ☺ Positive neutral 😐 Neutral ☹ Negative neutral ☹☹ Negative

Summary

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