The Letter
Funds & Strategy

Number 107
September 2011

SUMMARY

Completed in September 26st 2011

EDITORIAL

Aporia

Philosophers are familiar with the concept of "aporia". It describes a hopeless situation or logical reasoning leading to an insoluble contradiction, and it comes to us, of course, from Greece…. It is a fairly accurate description of what we feel we've been living for the past two months. If they really want to re-stabilise the financial system and prevent the gradual choking of the engines of growth, the political authorities of the eurozone must now cut the Gordian knot (Greece again!) of the balance between the level of solidarity in refinancing public debt and the legitimate counterparties that provide unequivocal budgetary discipline. This knot is that of State sovereignty. It is therefore a sensitive decision to be taken by the very people who are responsible for leading these States. Faced with an apparently hopeless situation, isn't courage the only attitude possible?

Antoine de Salins,
Chief Investment Officer
Groupama Asset Management

The Actively Responsible Asset Manager

Groupama Asset Management - Communication department:
58 bis, rue La boétie - 75008 Paris - Tel.: +33 (1) 44 56 79 18 • Fax: +33 (1) 56 59 40 93
www.groupama-am.fr • Numéro ISSN :1634-9032

Groupama Asset Management

www.groupama-am.com

Expertises
Performance
Economic analysis
Anticipation

Funds
Economic analysis
Tendance
Projection

Anticipation
Funds
Projection
Tendance

Projection
Tendance
Economic
Anticipation
Economic analysis

Find the full presentation of our products on our website **www.groupama-am.com.**

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

Laurent Berrebi,
Chief Economist

United States

CRISIS OF GOVERNANCE, CONSUMER CONFIDENCE DOWN, BUSINESSES "WAIT AND SEE"

Two major events have upset our scenario of a recovery in consumption that began to emerge in July. First, the downward revision of growth figures discredited the effectiveness of the quantitative monetary policy conducted so far by the Federal Reserve, and convinced investors of a modest long-term economic outlook in the U.S., triggering a significant market correction. Then, the open conflict between the Obama administration and the Congress, responsible for the downgrading of U.S. government debt by the S&P, highlighted a level of debt and a budget deficit that are unsustainable in the minds of Americans. Households, the sharp decline in whose expectations since early August is already reflected by a significant decrease in their investment spending, could now reduce their consumption in order to smooth the impact of an inevitable increase in taxes made apparent by the crisis in governance. If consumer pessimism were to be confirmed in the coming months, consumption would fall, triggering a new recession. For now, the stabilisation of ISM indicators above 50 refutes that possibility. Companies are simply creating fewer jobs to adjust to a weaker rate of growth.

Euro zone

SHARP DETERIORATION OF EXPECTATIONS, DUE TO THE CRISIS OF EUROPEAN GOVERNANCE

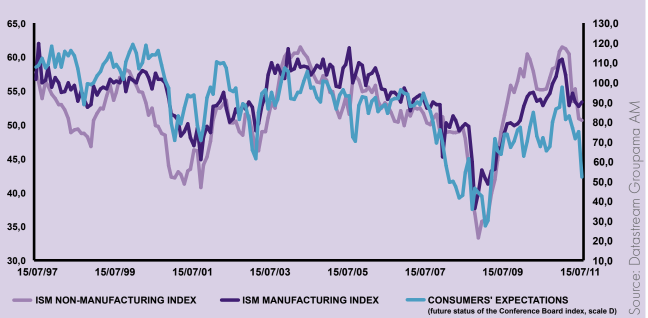
Growth was weak in the second quarter across the entire eurozone (+0.16 % Q/Q), still buoyed by exports, but impacted by a contraction in domestic demand for the first time in a year. The slowdown was sudden in Germany (+0.1 %, after +1.4 %) and France (0 %, after +1.0 %), due to the sharp drop in consumer spending, which was adversely affected by the termination of the car-scrapping incentive in France and the severe decline in purchasing power in Germany. Since the beginning of the summer, business and consumer expectations have fallen off sharply, especially in Germany, most likely because of the crisis of European governance. Industrial companies throughout the eurozone, increasingly frustrated over their production plans, will likely slow their activity and halt their investment momentum. Purchasing managers' indices (PMI), which suggest an industrial recession, are not, however, pointing to a global recession. The decline in both overall inflation and underlying inflation make it likely that the European Central Bank (ECB) will soon reduce key interest rates.

Japan

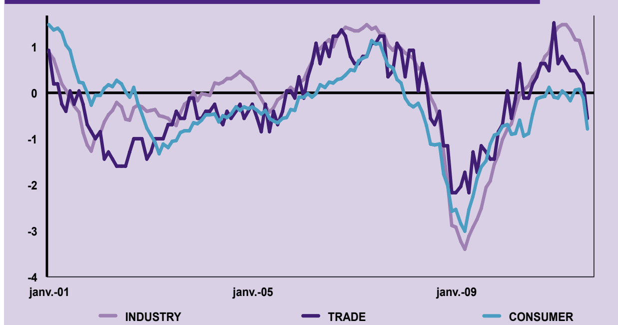
THE V-SHAPED RECOVERY EBBS AWAY

GDP contracted 0.5 % in the second quarter due to the sharp reduction in exports which, following the nuclear disaster and the tsunami, were hurt by the disruption of economic channels. But domestic demand—in investment and consumption—appear stable, and completely spared: Growth figures should be revised significantly downward to be more coherent, as indicated in particular by the plunge in investment spending revealed in surveys of large companies. Leading indicators continue to show a V-shaped recovery, driven by exports and spending on reconstruction in the energy sector to restore production capacity, and in residential real estate to relocate the inhabitants of devastated areas. However, companies do not appear to be restoring their destroyed production capacities on Japanese territory. This V-shaped recovery will nevertheless be hindered by the downturn in the global cycle of business investment, and the strong yen, which should lead Japanese manufacturers to reduce their margins.

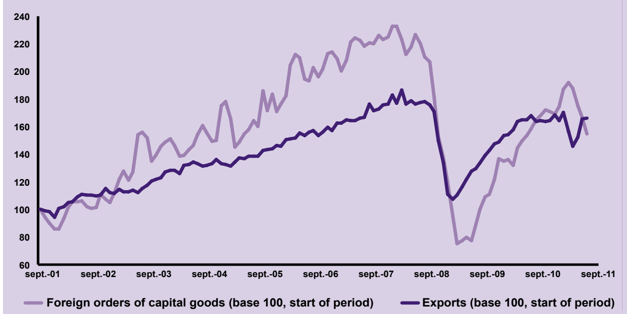
United-States: Business expectations steady, sharp deterioration of consumers' expectations



EURO ZONE: Sharp fall-off in both business and consumer confidence (consumer confidence indices, centred, normed, standard deviation points)

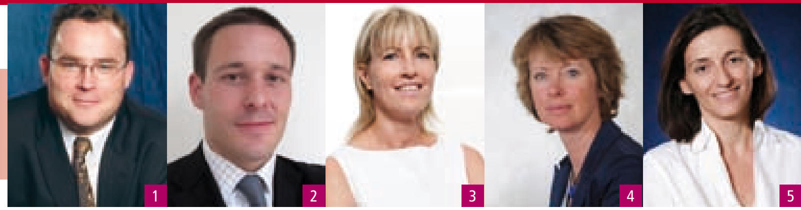


Japan: V-shaped recovery in exports halted by global slowdown



Summary

CORE MANAGEMENT



The fundamental equilibrium-restoring forces are present, but for the moment without effect.

The fundamental equilibrium-restoring forces are present, but no one is paying attention right now. The markets were, in effect, in extreme mode for a large part of the summer, reaching irrational levels that are more indicative of investors' stress than of economic reality. This applies for the valuation of equities, for the drop in nominal rates pulling a fair number of real rates into negative territory, and for credit risk premiums that implicitly anticipate unrealistic, double-digit default rates. The markets are focused on the resolution of the sovereign crisis in the eurozone, on the implementation of the plan of 21 July and on the progress of possible alternatives. The situation could drag on, because the markets are no longer "paying to watch" but are expecting concrete and coordinated solutions to be implemented. Our central scenario remains that of "soft" growth and depends on the ability of policy makers and central bankers to make good use of the limited flexibility left to them to stabilise an environment that is rife with risks.

P-H.B

1- Philippe-Henri Burlisson
Core Management CIO
2- Thomas Prince
Head of Money Market Management
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

Money Market Management

CENTRAL BANKS

Central banks hold centre stage.

Central bankers on both sides of the Atlantic continue to hold centre stage. In the U.S., we hoped for a bit more visibility on an eventual QE3, but there was none forthcoming. However, the Fed's authority is as important as ever and it is impressive to see how the market incorporated permanently low short rates with a collapse of Fed Funds rate expectations. For its part, the ECB continued in "fire fighter" mode, relaunching the SMP programme by buying peripheral debt—particularly Italian and Spanish—to avert a spike in risk premiums following disappointments with the implementation of the plan of 21 July. The next step, after the handover from Mr Trichet to Mr Draghi, will probably be a gradual shift in direction. The situation, in our view, justifies a gradual drop in the refi rate of 50 bp. Meanwhile, this stalemate and a certain exacerbation expressed in the U.S. and British media were not without consequence to the banks and their financing: We thus witnessed a gradual freezing of the interbank market. The central banks' joint announcement of Thursday, 15 September threw oil – not on the fire, but on the system. In this environment the EONIA continues to be very volatile, fluctuating between 0.6 % and 1.5 % since mid-July.

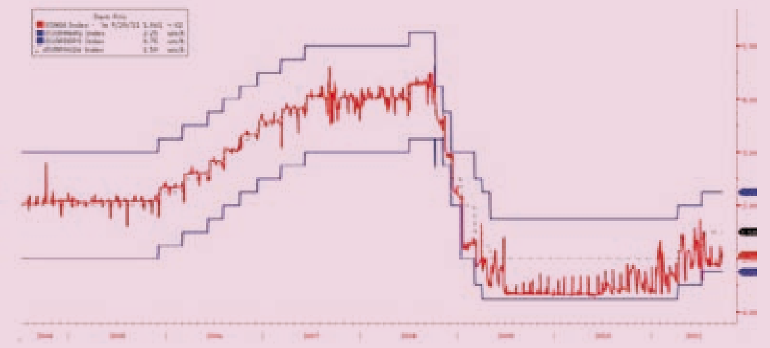
A WORD ABOUT THE INVESTMENT STRATEGY

Investment strategy:

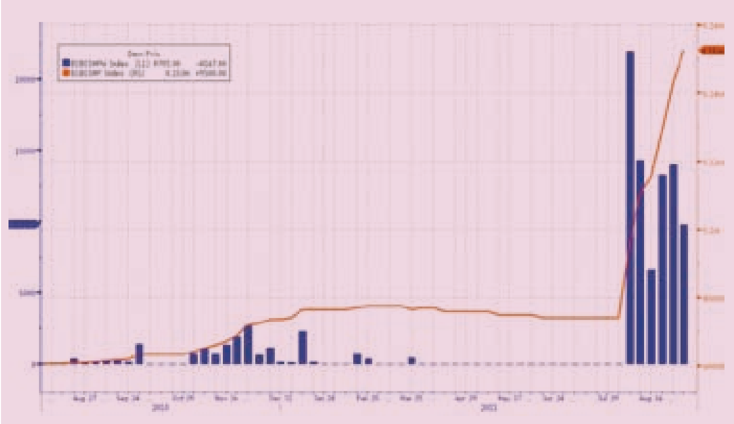
In this context our investment strategy is to remain ever vigilant about issuers in the portfolio and to slightly favour fixed rates to floating rates in anticipation of lower interest rates, which are certainly already widely anticipated by the market.

P-H.B

Corridor,refinancing Rate & EONIA
Average EONIA in august: 0.906 %;
from the begining of the year: 0.883 %



History of peripheral debt purchases by the ECB



Fixed Income Management

LONG RATES

The exposure of weak economic fundamentals on both sides of the Atlantic, along with the issue of sovereign debt, drove the markets toward extreme levels of risk. The events of the summer reinforced the markets' concerns about the growth profile of developed countries, illustrated by the United States' revision of growth figures for the past several years. In the eurozone, the sovereign debt crisis took on a new dimension. Despite the European political will to find solutions to the Greek problem, the responses presented on 21 July were not enough to reassure the markets, given the complexity of the measures to be put in place.

The ECB then intervened in the secondary market, in the context of the SMP, by buying Italian and Spanish debt in order to contain the interest rates of these two countries.

The dissensions between the eurozone's member states and Greece's lack of rigour in implementing austerity plans revived fears of Greek default and led to expectations that Greece would exit the eurozone.

Markets are now waiting for strong political decisions towards more coordination and economic governance, and greater credibility of the eurozone countries in implementing the adopted and necessary measures of austerity plans.

In the short term, the uncertainty surrounding the fate of Greece and the contagion to other peripheral countries -with no immediate solution in sight- is driving continued flight-to-quality, with the primary beneficiaries being U.S. and German debt and, to a lesser degree, French debt. In this environment, reinforced by the continuing global economic slowdown, we expect a further rate cut and are posting a 3-month target of 1.75 % for the U.S. 10-year rate, and 2.4 % for the 10-year French rate.

In the longer term, the eurozone economy is likely to be further weakened by the succession of austerity plans, without falling into recession, and will thus maintain a low rate environment. The liquidity premium (linked to the flight-to-quality phenomenon) will be mitigated by future policy decisions and steps towards greater integration. Overall, we expect a 10-year French rate of around 2.75 %.

CREDIT

The major stress that has affected the markets for several weeks is having a very significant impact on the credit market, which is seeing the massive widening of spreads in an illiquid market. The financial sector once again bore the brunt of the losses, particularly French shares.

The valuation levels of some sectors and companies look attractive from a fundamental point of view.

However, the lack of visibility over the short term and continued erratic movements argue for caution vis-à-vis the asset class.

INFLATION-INDEXED

The last few weeks have been very negative for inflation-indexed assets. Inflation break-evens fell sharply and are not expected to find support levels in the short term despite very attractive valuations. Real rates have fallen to very low and even negative levels in some geographic regions. They should remain low in view of trends in the economic environment.

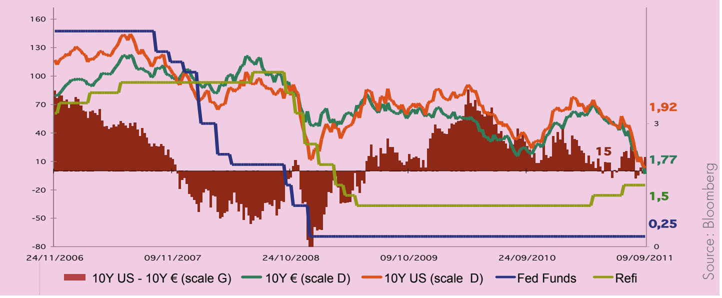
A WORD ABOUT THE INVESTMENT STRATEGY

The lack of visibility on a short-term solution in the eurozone calls for conserving a neutral position on exposure to rates. The strategy of flattening on the 2-10 year segment is maintained, as the rate cut by the ECB that we are expecting has already been anticipated by the markets. The flight-to-quality movement is expected mainly on 10-year rates.

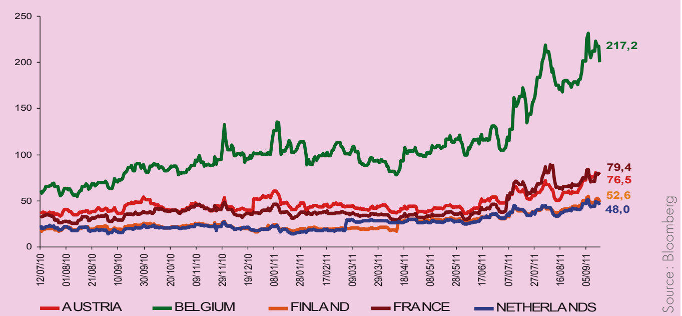
We are reinforcing our bias for the core countries, and increasing our exposure to Germany at the expense of Spain and Italy, on which we are now underweight; France is now neutral, from overweight.On credit, we are maintaining an asset allocation of 95 % and are initiating several hedges to reduce the impact of high volatility on our portfolios.

G.M

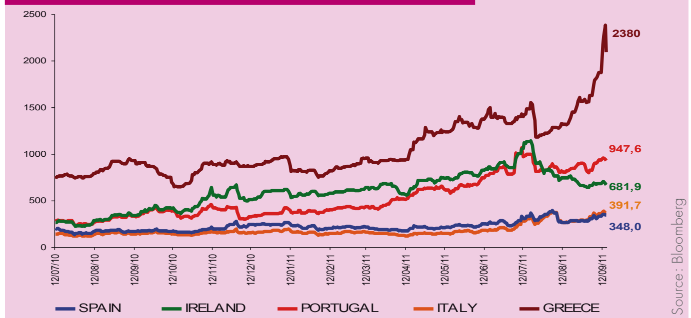
Change in the short and long rates in the United States and the Eurozone



10 year Core Sovereign Spreads



10 year Peripheral Sovereign Spreads



Equity Management

PROJECTED RESULTS AND VALUATIONS

Projected earnings: more adjustments to come?

• The analysts' consensus revised its outlook sharply downward for earnings growth in the eurozone in 2011, from 9 % in July to 5 % currently. For our part, we've revised our expectations to 4 %.

• The consensus expects double-digit growth for 2012, which seems highly uncertain.

Valuations: Collapse in valuations

• The extreme levels of the crisis have again been reached, even taking into account a downward trend in earnings revisions which has just begun.

OTHER FACTORS

Flows: Significant withdrawals from equity funds

• In June and July withdrawals in the U.S. reached their highest level since October 2008.

• But low prices are attracting predators and leading to a spate of M&A activity and share buybacks.

Chart analysis: The bear market is still with us

• The main markets are following a negative trend which could quicken into a sell-off in the very short term. For a sustainable rally to occur, the markets will first have to be stabilised.

• Deterioration in the medium and long term remains troubling and confirms that we are still in a bear market.

OUTLOOK

Levels at point of entry, despite all else…

• Since last summer, the equity markets have had to choose between the plague (risk of recession in the U.S., without a budgetary escape hatch) and cholera (eurozone sinking deeper into the sovereign crisis with diminishing clarity on the possible outcome).

• Of course, we have no visibility in either case. While the economic indicators are for now pointing more to a slowdown than a recession, the panic of last summer could be self-fulfilling, with businesses adopting a "wait and see" attitude and consumers one of worry. The bond situation in the eurozone holds even more uncertainty.

• That said… Some elements should play their role of restoring equilibrium. Valuations are incredibly attractive, even with our assumptions on earnings growth, which are very conservative and well below the consensus. Indicators of sentiment are in the panic zone, a usually contrarian signal.

• The markets' current levels therefore represent a point of entry under a long-term perspective, even if the timing is uncertain: our 3-month targets, slightly higher than current prices, do not rule out new periods of stress. Our 1-year targets for the euro zone imply multiples of 10.8x on 2012 profits, down 7 % from 2011, which seems a very conservative assumption.

• In this context, we are focusing on Asian markets whose potential for economic growth—and therefore earnings growth—is higher than that of developed countries, as well as the Japanese market which is expected to continue its post-tsunami catch-up.

A WORD ABOUT THE INVESTMENT STRATEGY

We continue to avoid financial shares and are taking profits on the automotive and food processing sectors. We are maintaining our bias for shares related to emerging consumption.

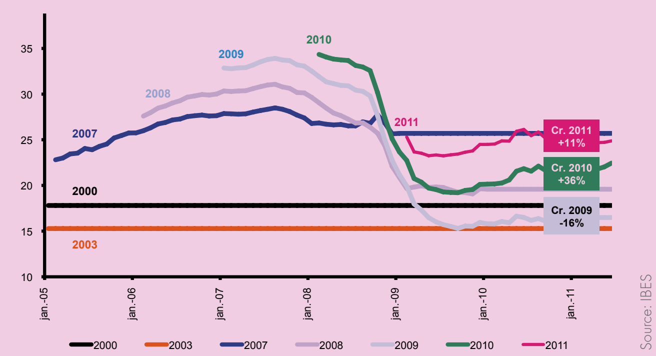
C.CO

Performance of the main indices since the start of the year

	13/09/11	Var. 2011 in euros
DJ Euro Stoxx 50	2037	-27,08 %
SBF 250	2180	-22,15 %
CAC 40	2895	-23,91%
FTSE 100 (UK)	5174	-13,25%
S&P 500	1173	-8,53 %
Nasdaq	2535	-6,38 %
Topix (Japan)	750	-13,68 %

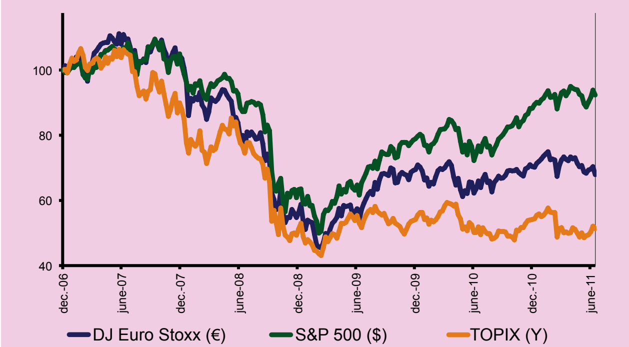
Source: Datastream

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

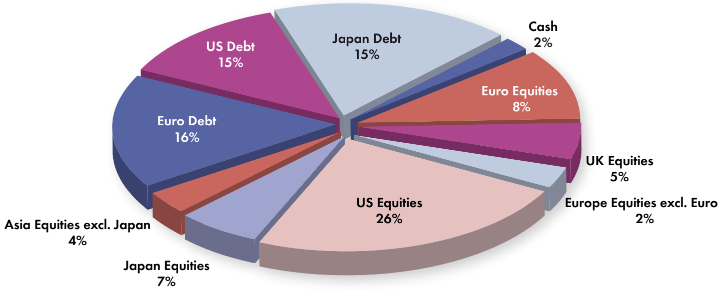
Jean-Louis Autant,
Head of Global Balanced Management

Trend

Summer was brutal and autumn shows no signs of being more merciful: as a result, the trend is towards widespread stress. Authorities under pressure are trying to somehow regain control, but as we've seen before, politicians' timing is not always that of the markets. Nonetheless, finding themselves in the eye of the storm, these same authorities, out of sight since the summit of 21 July, finally emerged: Through the magic of technology, the now famous three-way videoconference between Merkel-Sarkozy-Papandreou led to a temporary drop in pressure on the markets (while it climbed in Athens). The display of France and Germany's willingness at all costs to prevent Greece's exit from the eurozone allowed the stock markets to stage a rebound from their lows.
Meanwhile, the main central bankers (ECB, Fed, BoE, BOJ and SNB), for their part, performed the of work of restoring 3-month dollar liquidity-providing operations: a real boon for European banks (especially French if we are to believe the rumours) being slowly asphyxiated by their refinancing difficulties in greenbacks.

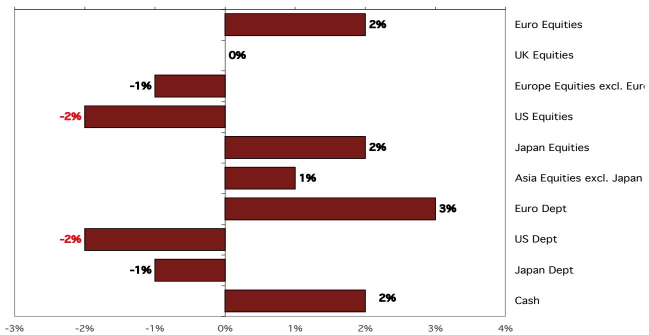
While the pressure is undoubtedly on the eurozone, there is worry that the situation in the U.S. might not be much brighter (with all due respect to T. Geithner, come to proffer his advice to the Europeans). Disappointments at the macroeconomic level are such that QE3 (which does not yet have a name) is increasingly likely in order to avoid an eventual "double dip". It will take until the next FOMC to know which way the wind is blowing: After the "twist" of short bond maturities in favour of long maturities, direct aid measures for still-distressed mortgage holders are expected, not to mention the famous "Buffet Tax" on billionaires.
In this highly toxic environment, M&A activity is continuing, albeit at a slightly slower pace, and share buyback programmes are being re-established for substantial sums: all signs that entrepreneurs have not, unlike market participants, finally given up.
Taken together, the valuations of European equities at rock bottom and record levels of risk aversion make the re-weighting of portfolios in risky assets (equity and credit) seem tempting. We will tackle them gradually and selectively.

Model portfolio



% difference

BETWEEN BENCHMARCK AND MODEL PORTFOLIO



Portfolio closed on 13/09/2011. Benchmark composed of 50 % JPM global hedged + 50 % MSCI world. Source: Groupama AM

Allocation

GLOBAL ALLOCATION

Equities 52 % / Rates 46 % / Cash 2 %

The return of equity markets to levels near their annual lows incites us to re-weight our portfolios in equities with a medium-term perspective; in the short-term, in fact, further deterioration obviously cannot be ruled out, but we think that now is the time to start buying (we hope) on the cheap.

EQUITY MARKETS (52%)

■ **USA (26 %):** US markets ultimately weathered the summer sell-off and remain in a state of near-equilibrium. We are maintaining our slight underweight.
■ **Europe (1,5 %):** We remain slightly above the weight of the benchmark, mechanically taking into account the market effect which leads us to buy at levels near the annual lows.
■ **Asia/Japan (11 %):** This is the geographical region that we currently favour; Japan in particular has been bolstered: recovery plans could be further augmented which should buoy the market. Asia excluding Japan is maintaining some dynamism even if inflation fears remain pervasive.

INTEREST RATE MARKETS (46 %)

■ **USA (15 %):** Excessive pessimism drove the 10-year rates to extremely low levels, well below 2 %. Despite these very weak levels, the fact that long rates should be supported by the famous "twist" is a positive element.
■ **Europe (16 %):** Core bonds are preferred in a clearly defensive short-term objective; obviously, a rate of 1.80 % over the Bund rate can only be a temporary investment.
■ **Japan (15 %):** The prospect of a stimulus by the Japanese government could weigh on Japanese bonds; we are thus paring back holdings.

CASH (2%)

We are maintaining a defensive cash portfolio

IN THE BLINK OF AN EYE

Our strategy

		Current level 13/09/11	Short-term tarjet	1 year tarjet
United States	Fed Funds	0,25	😐	😐
United States	10 yr T - bill	1,91	☺	☹
Eurozone	Refi rate	1,50	☺	☺
Eurozone	10 yr OAT	2,53	☺	☹
Japan	BOJ rate	0,10	😐	😐
Japan	10 yr JGB	1,00	☹	☹

Sources : Groupama AM, Bloomberg

Our model portfolio in € 13/09/11

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 13/09/11

	Indices	Forecasts	
	13/09/2011	Groupama Asset Management	
		short term (<3 months)	at 1 yr
France (CAC 40)	2855	☺	☺☺
Euroland (DJ)	202	☺	☺☺
United-Kingdom (FTSE 100)	5130	☺	☺☺
United-States (S&P 500)	1162	☺	☺☺
Japan (Topix)	750	☺	☺☺
MSCI Asia free ex-japan	488	☺☺	☺☺

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

Crédits photo : Philippe Abergel, Jean-François Labat, Jean Ber,. Stéphane Michaux - Conception : adcreations.fr Imprimé par Groupama Asset Management sur papier recyclé.

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

Summary

COMMERCIAL CONTACTS

Business Development Managing Director:
Jean-Marie Catala / 01 44 56 79 18 / jmcatala@groupama-am.fr
International Business Development Managing Director:
Arnaud Ganet / 01 44 56 56 61 / aganet@groupama-am.fr
Institutional Investor Relations:
Jacques Bontet / 01 44 56 57 76 / jbontet@groupama-am.fr
Bruno de Solms / 01 44 56 75 43 / bdesolms@groupama-am.fr
Jérôme Guittet / 01 44 56 57 22 / jguittet@groupama-am.fr
Barbara Flogny / 01 44 56 75 62 / bflogny@groupama-am.fr
Valérie Rapoport / 01 44 56 56 45 / vrapoport@groupama-am.fr
Gaspard Theysset / 01 44 56 66 65 / gtheysset@groupama-am.fr
External Distributor Relations:
Alexandre Jaeglé / 01 44 56 89 17 / ajaegle@groupama-am.fr
Anne-Laure Mugnier / 01 44 56 56 21 / almugnier@groupama-am.fr
Matthieu Painturaud / 01 44 56 77 72 / mpainturaud@groupama-am.fr
Group Relations:
Corinne Foucoin / 01 44 56 79 07 / cfoucoin@groupama-am.fr
Eric Mathieu / 01 44 56 57 64 / emathieu@groupama-am.fr
Network Group Relations:
Luc de Corainville / 01 44 56 77 65 / ldecorainville@groupama-am.fr
Sabine Peter / 01 44 56 77 09 / speter@groupama-am.fr
Didier Oms / 01 44 56 56 74 / doms@groupama-am.fr
Jérôme Larsonneur / 01 44 56 56 20 / jlarsonneur@groupama-am.fr
SRI development:
Michel Lemonnier / 01 44 56 66 36 / mlemonnier@groupama-am.fr