Blue Bridge
Wealth Management Consultants Inc.

BULLETIN
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The climate and forecasting

The special edition of "The Economist", The World in 2010, was insightful, as those editions usually are, but not overly upbeat. Even on the cover, the only smiling face was the one of Shakira. On just about every issue, extreme views almost balance each other, thus who is to know which side will win out in 2010. It seems that we are pulled into every direction, and thus have become directionless. Climate change is a prime example of this.

On page 148 is the article entitled "On thin ice" which explains the disappearance of the Artic ice cover, a process which seemingly is accelerating beyond expectations. A European satellite should be able to tell us this year, based on measures of the thickness of the ice, how long the Artic ice has left. Will it be that the Arctic will be ice-free by 2010 or will this happen around 2050 only? When it happens, it will be disastrous, the article states, because ice will no longer reflect sunlight into space, hence global warming will then go into overdrive.

On page 153 is the article entitled "Where have all the sunspots gone" which explains the observations of scientists that sun spot activity has declined over the past couple of decades and that "if this carries on, solar magnetic fields will become too weak to form sunspots, which will vanish completely in 2015". Sunspot activity changes over time, and a decline in activity is not uncommon. This said, such a decline is expressed in bitterly cold winters in Europe and North America and there is ample historical data to prove this.

So what will it be, melting ice which will flood low-lying areas around the globe, or will we soon fondly remember the years of relative warmth? This is not a debate for this newsletter, but it is worth pointing out that we cannot predict major trends in climate changes with certainty.

While the hype about global warming gets the front pages, less attention is paid to reports that the Atlantic Ocean has been cooling down for a number of years. The hurricane activity this year was about 50% of the long-term trend, and while this may be an aberration, it should not go unnoticed, for maybe there is a message in this.

30 years ago we discussed ways to warm up our planet, for talk centered on the coming of a new ice age. Could it be that today we rely too much on climatic short-term observations and not enough on long-term trends? Come to think of it, that almost sounds like forecasting the stock market! Have a happy 2010!

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The Dollar and the Deficits

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C. Fred Bergsten is of the opinion that the adaptation of a global currency system less centered on the US dollar is not just a US economic imperative, but a foreign policy and national security one as well. He blames much of the recent economic crisis on the huge inflow of foreign capital into the US, which resulted in low interest rate, excess liquidity and loose monetary policies. And he states that the large external deficits and the resulting currency dominance are no longer in the US national interest.

We know that future US budget deficits will exceed everything we have known or thought possible. Estimates are that by 2030, the US will transfer 7% of its yearly economic output to foreigners to service its debt. Already today the fate of the US is largely in the hands of China, Japan, Russia and several oil-exporting countries.

Yet countries calling for a non-dollar based monetary system need to be concerned of the outcome. Reducing the US external deficits means hardship for the next three largest economies, China, Japan and Germany, all of them export oriented. According to Bergsten, a central goal of US foreign economic policy must be to prevent and counter deliberate currency undervaluations which keep the dollar overvalued and harm US competitiveness. He singles out China's efforts to prevent the renminbi from rising and Switzerland's aggressive intervention to weaken the Swiss Franc, despite the country's huge current account surpluses. He adds that the upward bounce of the dollar during the height of the crisis wiped out almost half the gains in US competitiveness of the previous six years.

Currently the US dollar represents about 65% of national currency reserves and the Euro 25%. Each remark by a major central bank that it intends to diversify is reserves sends shockwaves through the markets. To stabilize currency markets and give everybody a more equal chance, Bergsten advocates the greater use of Special Drawing Rights (SDRs) which, thanks to the G-20 decision in April 2009 have moved from 1% to about 5% of global reserves. He suggests that the IMF should create substitution accounts into which monetary authorities could exchange unwanted dollars in return for SDRs without affecting global markets.

The problem of the rising US budget deficits is that it promotes higher trade and current account deficits. The increase in domestic demand exceeds the potential domestic output and as long as financing is available, the US lives beyond its means. Over time the additional debt increase interest rates, which in turn attracts capital inflows, and a higher US dollar and reduced competitiveness are the result. The entire mechanism is highly complex and is understood by few. When you hear that the US dollar MUST decline in 2010, do not assume that this is a foregone conclusion, for no country desires to have a higher currency.

A look at investing

Looking back at the financial markets during 2009, we can only be impressed by the recovery of the global equity markets. From its low on 9th March 2009 to the end of last year, the S&P 500 Index reported a rise of +65%, at the same time the MSCI World Index and the MSCI Emerging Market Index rose respectively by +70% and +104%.

Similarly, the bond markets enjoyed staggering performances, driven mainly by corporate bonds that recovered from 2008, the year of the Lehman Brothers collapse. This is illustrated by the Barclays Capital Credit Investment Grade Index, which reported a performance of +19% in 2009.

As mentioned in the previous newsletter, these rallies resulted primarily from the combined effects of the massive public interventions, lower interest rates, the deleveraging of companies and financial markets recovering a sense of normalcy.

Despite the various signs implying that a recovery of the global economy should be on its way, the market consensus is that it is very unlikely that we will witness a repetition of these historical performances in 2010. One of the practical conclusions that we can reach from this anticipated change of environment is in terms of asset allocation.

If 2009 was favorable to "long only" managers who buy and hold securities (for example equities or bonds) with the hope that their market prices will rise, we believe at Blue Bridge that 2010 will offer an environment more favorable to hedge fund managers. The main reason comes from the fact that hedge fund managers have at their disposal more strategies than simply relying on the rise of a market price. Having more tools in their "tool box" should play to their advantage in 2010, which is expected to be a bumpy year.

Now that we have explained briefly why we currently overweight hedge funds, we have to recognize that alternative strategies are heterogeneous. Therefore, at the time of this writing the strategies we favor are the ones that should be able to take advantage of volatility spikes. Similarly, we have interest in strategies that may benefit from less liquidity, as in erratic markets investors may be prone to remain in safe investments. Finally, as not all companies will fare well in these challenging environments, we favor hedge fund managers who have the tools to take advantage of the winners and losers.

By Gwenolé Le Blevennec
Lepercq, de Neuflize & Co

European news

"Rotten assets were the detonator of this crisis, which is unprecedented since the Second World War" Jean-Claude Trichet, President of the European Central Bank (ECB), stated recently. He added: "I would say that the problem continues, but it is not the main problem. The real problem is that the recession itself caused a certain number of additional losses…on loans that had been granted to the productive sector as a whole. This all has to be absorbed by the financial sector, taking into account all the measures that have been taken." Mr. Trichet again urged banks to strengthen their capital base. "The recovery is going to be difficult, even chaotic in some regards," he said. The ECB decided to maintain its key rate at its historically low level of 1%.

Source: lemonde.fr

Selection of Financial & Economic Indicators

Index	DJ I	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
January 29-10	10067.33	3895.48	2147.35	1073.82	11107.95	1119.54
Monthly var.	-3.46%	-4.98%	-5.37%	-3.70%	-5.24%	-4.19%
Year-to-date	-3.46%	-4.98%	-5.37%	-3.70%	-5.24%	-4.19%
Year-over-year	25.83%	31.35%	45.44%	30.02%	27.75%	33.46%

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
January 29-10	5188.52	5608.79	3739.46	6440.72	10198.04	2776.83
Monthly var.	-4.14%	-5.85%	-5.00%	-1.61%	-3.30%	-6.39%
Year-to-date	-4.14%	-5.85%	-5.00%	-1.61%	-3.30%	-6.39%
Year-over-year	25.04%	29.28%	25.74%	21.75%	27.57%	24.13%

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
January 29-10	1080.00	303.70	72.80	474.00	248.50	265.43
Monthly var.	-1.46%	-9.17%	-8.83%	-13.54%	6.65%	-6.69%
Year-to-date	-1.46%	-9.17%	-8.83%	-13.54%	6.65%	-6.69%
Year-over-year	16.47%	106.81%	74.66%	-17.99%	67.79%	20.45%

Currencies	$CA	¥	€	£	$AU
January 29-10	1.0700	90.3000	1.3865	1.5989	0.8845
Monthly var.	-2.20%	3.01%	-3.24%	-1.15%	-1.50%
Year-to-date	-2.20%	3.01%	-3.24%	-1.15%	-1.50%
Year-over-year	12.94%	-0.42%	8.22%	9.97%	38.72%

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