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Investment Policy

Massive fiscal and monetary efforts show limited impact

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- Asset allocation: Amid the severest economic and financial crisis since World War II, we are compelled to remain defensive and underweight risky assets.
- Economics: Dismal newsflow across the board, but speed of contraction has started to slow.
- Equities: rangebound; downgraded US equities to neutral, UK to underweight as momentum fades.
- Fixed income: High-grade, inflation-linked and government-guaranteed bank bonds offer value.
- Currencies: US dollar is set to decline in very volatile forex markets.
- Alternative Investments: As deleveraging continues, the focus is on assets/strategies that apply low leverage and have non-cyclical exposure.

Asset allocation

With the start of the new year, it has become increasingly clear that we are in the midst of the most severe global economic and financial crisis since World War II. The newsflow from the US housing market, labour markets around the world, consumers and companies is discouraging and continues to deteriorate. For example the US labour market showed the biggest loss of jobs since December 1974. World equity markets, however, offer value after suffering steep declines in 2008. Since October 2008 a sideways-trending market has been established, and this may indicate that a lot of bad news is already priced in.

Although there is room for sharp bear market rallies, we clearly do not have enough reasons to believe in a prolonged and sustained rally in equities and other risky assets. For this to happen, the negative momentum of the news-flow has to diminish while confidence in the financial markets as evidenced in corporate spreads or the interbank money markets, for instance, has to increase further. Furthermore, usually the process of forming a market bottom includes several attempts to retest the market lows we witnessed in November 2008.

Our stance at a glance – Asset allocation (relative positions to the investment boundaries of Classic Mandates) – For details please contact your client advisor.

Asset Class	Rating		Overweight	Underweight
Cash	Overweight			
Bonds	Neutral	Duration (=)	Neutral in EUR and USD (3-5 years)	
		Segments	1-5 year corp. bonds focus on financial bonds, USD Inflation linked bonds	High Yield, Single Emerging Market Bonds
Equities	Underweight*	Regions	Switzerland, Brazil, EM Asia	Eurozone, UK
		Sectors	**Health Care**, Energy, Telecom, Consumer Staples,	**Consumer Discretionary**, Industrials, Financials
		Styles	EUR large cap, USD Value	EUR small cap, USD Growth
Alternatives	Underweight	Commodities	Agriculture, Gold	Industrial metals, Energy
		Hedge Funds	Global Macro, Event Driven/Distressed	Equity Hedge, Relative Value
		Real Estate	US REITS, Asian real estate	Continental Europe
Forex			JPY, CHF, NOK, AUD	USD, RUB, ZAR

* excluding convertible bond positions booked in the bond quota

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Source: Julius Baer

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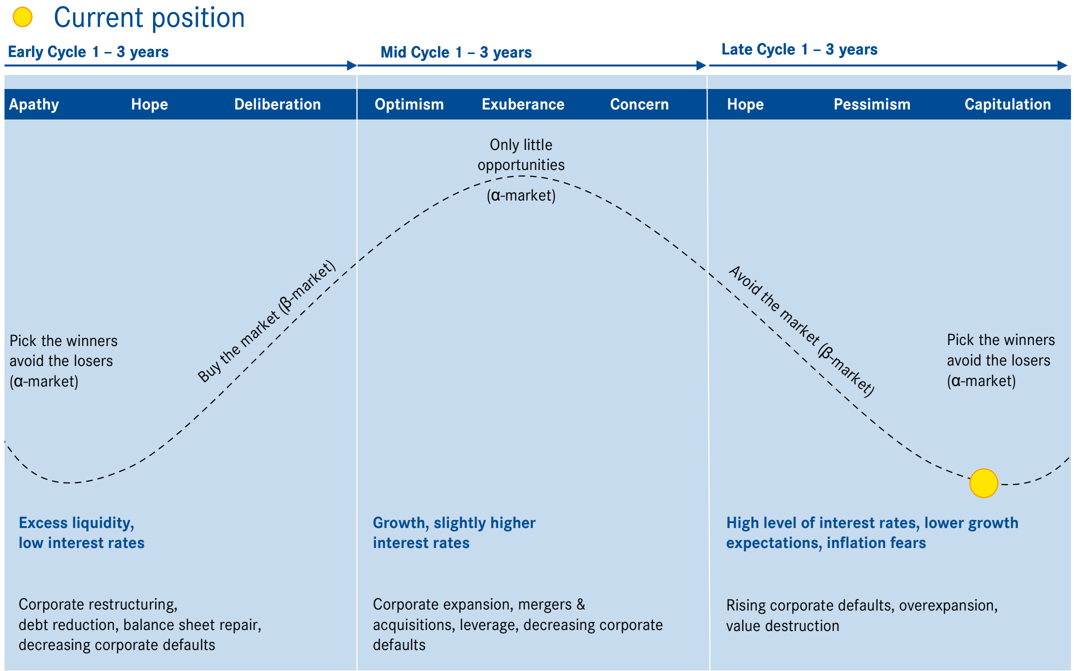
Evolution of the capital market cycle – opportunities and risks



Source: Julius Baer

In the multi-asset portfolios we remain defensive and underweight in risky assets. Within equities we recommend staying underweight but using setbacks within the trading range to slowly accumulate positions. We see opportunities in Asia and select cyclical areas. Bonds are an attractive asset class to invest in for the time being, as interest rates are expected to remain low and interesting valuations can be found in short term financials, convertibles and inflation-linked bonds.

Matthias Ramser, Head Strategy Funds

Economics – Positive signs are few and far between

The economic backdrop remains catastrophic, with activity indicators around the globe continuing to collapse. In order to find at least some signs of easing, you have to look at the speed of the contraction, which, according to the December readings of the Purchasing Managers' Indices, has started to slow. The most recent round of negative surprises calls for renewed downward revisions of the global, US and European growth outlook, in particular for the last and the current quarter. However, we maintain our more positive view for the second half of the year. Efforts to stimulate activity using both fiscal and monetary policy are continuing and even intensifying. At the same time, lower crude oil prices continue to prop up consumers' purchasing power, creating another powerful support for growth in the second half of the year. There remains a risk that these stimulating factors will only be successful later rather than sooner, pushing a recovery into 2010. Inflation should disappear completely in next six to twelve months given the growing economic slack. Central bank rates will converge towards the 0-1.5% range.

David Kohl, Deputy Chief Economist

Equities – Likely to remain rangebound

Lead by cyclical sectors, equity markets rallied from the end of November 2008 until early January 2009 providing a return of more than 20% (MSCI World index). With markets remaining in the rangebound pattern, momentum indicators tell us to expect more short-term consolidation going forward.

Although defensive sectors have massively outperformed cyclical stocks in the past few months, we do not think now is the right time to switch out of defensives, as the macroeconomic outlook and the overall environment in equities still shows continued uncertainty. Therefore we leave our defensive sector allocation unchanged. Nevertheless, we do recognize that the sector positioning may need changing later in the year.

In regional terms we have downgraded US equities to neutral as valuations now look somewhat stretched. Further along, the relative performance vs. global equities will start to lose momentum. Additionally we have reduced UK equities to modest underweight as most of the GBP weakness now is in the price and base rates have only limited room for further declines.

Christoph Riniker, Senior Strategist

Fixed income – Financials remain attractive

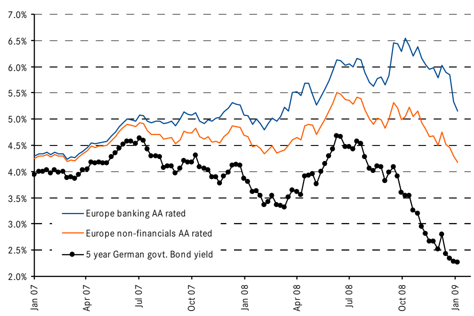
Global bond market conditions are normalising. Our chart shows the downtrend of bond yields since October, most pronounced for government bonds but also visible for European bank bonds and non-financial bonds. In an environment of negative growth, erosion of profit margins, volatility of input prices and ultimately rising corporate default rates, we will focus on high-grade investments and continue to underweight high-yield bonds.

Within the high-grade segment, we maintain our preference for bank bonds. Newly-issued bank bonds explicitly guaranteed by the German, UK and US governments combine the advantage of the highest credit rating, a decent liquidity, and a yield advantage over government bonds. The credit rating is lower but the returns are higher on bonds of banks without an explicit government guarantee.

Investors should still focus on systematically important banks only.

US inflation-linked bonds (TIPS) remain attractive despite the outlook for a negative inflation rate. Investors should keep in mind that the return on the TIPS is determined by the level of the real bond yield they lock in for the full lifetime of the bond investment and the inflation index. The inflation index is expected to creep upwards in 2009 and beyond, even though the annual rate of change could slow for statistical reasons. Given the complexity of single TIPS investments, investors should focus on TIPS funds.

Yield advantage of AA-rated EUR financial bonds over non-financials and 5-year German government bonds



Source: Merrill Lynch, Datastream

Markus Allenspach, Head of Fixed Income Research

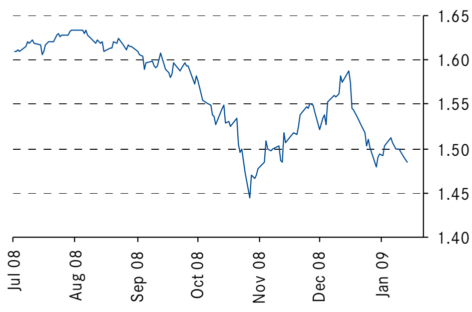
Currencies – US dollar amid historically high market volatility

The US dollar trend continues to point downward. Over the last few weeks, the greenback has traded between an intra-year peak of 1.25 versus the euro to 1.47 and back to 1.35. Basically, worries about the Federal Reserve Bank's monetary policy resulted in renewed US dollar weakness. But the US currency has received some help since it is clear that the stubbornness of some members of the European Central Bank will not persist and that policy makers will have to agree on further sharp interest rate cuts in Euroland.

All this contradictory news together resulted in high volatility, which, measured in historical terms, is at extreme levels. Nevertheless, we expect the US dollar to resume its downtrend in the first half of 2009.

The Japanese yen and the Swiss franc both look strong and could move up even more from current levels. They both benefit from their status as safe-haven currencies. Moreover, broad-based interest rate convergence in most G-10 countries leaves them with almost no disadvantage from the funding side. We still favour both currencies as hedges against the potential for further disruption in the financial markets.

Swiss franc as a safe haven



Source: Bloomberg

**Philipp Ackermann,
Head of Currencies & Commodities**

Commodities – Be patient!

As was expected, a rebound took place at the turn of the year amid very low volume. Energy prices moved up by more than 30% in a context of geopolitical tensions (Gaza and Ukraine) and a cold snap in Europe where temperatures fell below average for the season. Yet the rebound was short-lived and at the time of writing crude oil prices are facing renewed downward pressure. Index rebalancing by the two majors, S&P GSCI and DJ-AIG, has also underpinned petroleum products and industrial metals against agricultural commodities. Nevertheless, fundamentals further point to very weak global demand for energy and metals, leading to a strong build-up in inventories. Within this context we still favour the agriculture sector due to its less cyclical characteristics and low inventories. We favour gold as well for its safe haven status in an uncertain environment. Gold is further underpinned by ongoing strong investor demand, which more than compensates for weak demand from jewellers. Moreover a potentially weaker US dollar adds to the attractiveness of gold.

Fabien Weber, Senior Portfolio Manager, Commodities

Real estate – Look for low leverage and resilient cash flow

As we enter the new year, the key themes remain leverage and refinancing. This will lead to dilutive equity raisings and more liquidations. Forced sellers will then accelerate price declines. Therefore, low leverage and resilient cash flow yield within defensive sub-sectors will remain key factors for outperformance.

US: The valuation of companies with balance sheet strength and therefore low dilution risk looks attractive for long-term investors. As the retail sector is going to be affected by accelerating store closings in 2009, therefore putting pressure on occupancy and rental growth, we increase our focus on Healthcare such as nursing homes and medical office buildings.

Asia: Asian real estate companies continue to trade at significant discounts to their net asset values. However, a convincing re-rating of the stocks will take place once there is greater confidence in real estate values and the regional economies turn around.

Europe: The European property sector faces a mixture of dividend cuts, property sales and equity issuances as the companies deal with the effect of falling values on balance sheets.

Overall also in Europe lowly-geared property companies should continue to outperform. Regionally the earliest stabilisation of property prices might occur in the UK, as it was the first market to lead the downturn.

Markus Puck, Alternative Investment - Head of Real Estate

Hedge funds – Is the industry polarising?

As we look back on the worst year ever for hedge funds, a number of questions will decide the future shape of the industry:

1) Are hedge funds an asset class?
2) Will there be a new transparency and regulatory framework?
3) Will access methods to hedge funds change?

The asset class issue is important for the larger institutional investors. As hedge fund correlation with traditional assets was not satisfactory, institutional interest might decline for some time to come. After a prominent fraud scandal towards the end of the year, calls for transparency and regulation can be expected to increase even though the regulatory supervision proved ineffective in that particular case.

Funds providing access to hedge funds will also come under scrutiny. Many funds of funds failed to avoid the fraud scandal, raising questions about the quality of the very expensive due diligence process.

Given all these questions there is a possibility that the industry could polarise. The first polarisation could be between longer term-oriented institutional investors and the retail market. A second polarisation could occur between liquid and illiquid products and strategies. And finally large investors might shy away from pooled investments, preferring managed accounts with additional transparency. Although the usefulness of hedge funds in general may be questioned at the moment, investors will eventually benefit from a more differentiated approach to the use and abuse of hedge funds in their portfolio.

Sassan Zaker, Head of Hedge Funds

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