



“ When plunder becomes a way of life for a group of men living together in society, they create for themselves in the course of time a legal system that authorizes it and a moral code that glorifies it.

– *French economist, statesman and author Frederic Bastiat (1801-1850)* ”

It's not just the US that may have a new leader, the world's second largest economy, China, will most certainly have a new leader as the political cycle in the two economies coincides next week. While the market has been focused on Europe all of this year, what happens in the US and China post-elections, will dominate the agenda over the coming months. Policy gridlock in US and a policy vacuum in China will likely give way to new announcements and new actions in both countries. Despite the macro risks overhang this year, Equities have done well and the rally has come to be known "the most hated rally." The reason for the rally is simple - liquidity trumps. The recent decline that we have seen in the S&P 500 came when the vast majority of economic data were all better than expected. Fiscal policy uncertainty is likely to keep things volatile but I have little doubt that the "fiscal cliff" will be averted regardless of who is in the White House come January 2013. The fears of a hard landing in China have proven unfounded, economic indicators suggest China's economic plans are on track and the "stimulus" powder is still dry, if it needs using. Any EUR rally is likely to get capped at the 1.35 level. Gold is a long term buy; however trading 10% rallies and sell-offs could still bring returns from an asset which moves higher in spurts and could be range bound for months.

Obama vs. Romney: Down to the wire...

At the turn of the year, the global economy faced three main risks – a Chinese "hard landing", a double-dip recession in the US, and a Eurozone collapse.

What we've seen to date, looks like a "soft landing" in China and no risk of a US recession, Christmas cancelled. The 3Q US GDP number of +2% growth QoQ, is an improvement from the +1.3% of last quarter but all of the +0.7% increase can be accounted for by increased government spending. Uncertainty about government policies is the key reason for weaker private capital spending and weaker consumer confidence, two key factors that drive GDP growth.

As for the third risk – the survival of Euro, I am more inclined to believe "Daylight Savings" is a bank than to believe that the Euro's future has been secured for the long term.

The US Presidential campaign is coming to an end (yawn) and next week we shall learn whose narrative prevails. This election is the start of something new – a generational struggle between retiring baby boomers (hands off my pensions and healthcare, more income and less inflation) and the twenty- something graduates (where is my job and my house; I am in student debt, get me out of here).

Both Democrats and Republicans see history on their side. Gallup (the polling company) noted that with the

exception of President Truman, all incumbent Presidents who successfully sought re-election in the post-World War II era had approval ratings that averaged 50% or higher in the year in which they ran. President Obama's approval rating has averaged below 50% all of this year. On the other hand, no Republican has ever won the White House without winning Ohio. Romney still trails in Ohio. There is always a first time for everything.

A Romney victory would very likely be greeted with a cheer and a rally (long US Financials is the trade) as Obamacare is repealed and maybe parts of the Dodd/ Frank framework disbanded. Small businesses are likely to be the focus of a Romney administration i.e. a start of spending and hiring again thus driving business activity and lowering unemployment. As with all Commanders-in-Chief, President Romney will have his "honeymoon" period of favourable ratings and positive sentiments.

President Obama has had his "honeymoon" and is unlikely to secure a second. An Obama victory would likely be treated with more caution than cheer by the Equity market due to the threat of continued gridlock. Having said that, I am very hopeful, that Congress and President Obama, having failed to dislodge each other, will have no other option but to become more conciliatory.

Whatever the outcome of the US election, I am not overly concerned about the prospect of the market Equity for the rest of this year and early next year. Volatile, yes, but the market will continue to do well and GDP growth will

increase steadily once a long term plan for deficit reduction has been put in place in the US, and next year we will see that plan.

It's not just the US that may have a new leader, the world's second largest economy, China, will most certainly have a new leader too as the political cycle in the two economies coincides next week. While the market has been focused on Europe all of this year, what happens in US and China post-elections, will dominate the agenda over the coming months. Policy gridlock in the US and a policy vacuum in China will likely give way to new announcements and new actions in both countries.

A 'New' and 'Improved' Can

If there were a 'phrase of the year award' it would most certainly go to – "kicking the can down the road." It is not a reference to a game of kicking the can but a reference to Europe's procrastination in coming up with a solution for the continent's sovereign debt crisis. Bearish investors clearly underestimated the length of the road and Draghi's PUT (the ECB plan to buy peripheral countries' bonds) made the road even longer and wider. This 'New' and 'Improved' can has kept the risk of a break-up at bay and seen the stresses in Europe ease.

The importance of the ECB's OMT (outright monetary transaction) should not be under-estimated. It has the ability to ease financial market stress significantly (as it already has even before it is implemented), to boost economic growth (we have yet to see this), and to lead to institution building (a work in progress) in the Euro area for the Union's survival.

November marks the one year anniversary of Mr Draghi ascension to the helm of the ECB. His stay at the ECB has engendered an S&P 500 rally of over +20% and two +20% plus rallies in the Eurostoxx 50. So what is next?

The novelty has certainly worn off, but Draghi's promise "to do 'whatever it takes'" lives large, keeping short sellers of both the EUR and peripheral sovereign bonds at bay. However, for the European economy, the improvement in financial market conditions is still failing to lift the real economy. The Euro area composite PMI (an indicator of economic activity) still languishes in the contraction zone of sub 50 (45.8 the current reading). Germany's growth is flat, France's growth worrying and the periphery still in recession. In its latest quarterly Bank Lending Survey published Wednesday, the ECB said 11% of banks that took part in the survey made it harder for companies to borrow in the second quarter, while only 1% eased their rules. The net balance of 10% was up from the 9% in the first quarter. Expect the ECB to deploy more unorthodox

monetary policy and cut rates further, if credit availability tightens further.

In an encouraging sign, the Bundesbank Target 2 balances (money that other Eurozone central banks owe the Bundesbank) have started to decline, from €751bn in August to €695bn in September i.e. bank deposits in the periphery have started to increase and this should improve liquidity and lending to peripheral economies. The ECB's OMT program should reduce concerns surrounding the liquidity needs of sovereigns and 2013 should bring a modest recovery in Europe.

On the policy front, there has been a notable change within Germany's policymakers with a renewed willingness to support Greece. IMF head Christine Lagarde is travelling around Europe trying to broker a deal to re-structure Greek debt. Greece is likely to get both more time and more money. Recent polls in Europe (Holland and Finland) indicate the radical nationalist objections to Europe are beginning to recede, at least for now.

Equities

Despite the macro risks, equities have done well and the rally has come to be known "the most hated rally". The S&P 500 index is up +12.6% YTD and the Emerging Markets Index up +8.26%. Regular readers will recall, that apart from a period of caution in late summer, we have been positive Equities for the whole year and have recommended a long position in US Equities and, more recently, European and Emerging Market (EM) equities too. I continue to hold this view for the rest of the year.

The reason for the rally is simple - liquidity trumps. Central banks have provided the liquidity all year and reduced the incidence of "tail risk". As US housing data continues to improve, it will be another boost to US consumption and in turn to Equities and other risk assets.

The recent decline of -4% that we have seen in the S&P 500 came when the vast majority of economic data – US manufacturing, US auto sales, US jobs report, US Retail sales and US Housing were all better than expected. Last week's FOMC meeting in the US delivered further reassurance (if anyone needed it) that policy will remain accommodative until the economic recovery is well established.

Fiscal policy uncertainty is likely to keep things volatile but I have little doubt that the "fiscal cliff" will be averted regardless of who is in the White House come January 2013. A mix of tax increases and spending cuts, will follow as compromises are made and the gridlock broken.

The sectors I prefer to be long - Technology (XLK), financials (XLF), Industrial (XLI), Energy (XLE) and Consumer Discretionary (XLY).

To play the US housing recovery, I prefer XHB as an ETF and in single stocks Lennar Corp (LEN UN, Home Builders), Pultegroup (PHM UN, Homebuilders), Emerson Electric (EMR UN, Electrical component & equipment), Owens Corning (OC UN, Building Material) and Stanley Black & Decker (SWK UN, Hand/Machine Tools).

While the US has seen disappointment on revenue front, in the case of Europe and the DJStoxx600, both EPS and revenues are so far posting positive surprises, making a further case for a higher allocation to European equities in the portfolio. I would largely have the same cyclical sector biases in Europe— Industrial (Vinci), Energy (Total), Consumer Staple (Danone, Nestle), and Consumer Discretionary (BMW). European financials (not the sector as a whole but specific stocks) are looking attractive as their business models go through a change to reflect their core strengths. UBS is my favourite financial stock in Europe. I am not convinced by UK banks yet, and would stay away from RBS and Lloyds.

The EM case will get even better post the leadership change in China. The fears of a hard landing in China have proven unfounded and economic indicators suggest China's economic plans are on track and the "stimulus" powder is still dry, if it needs using at all. The economic slowdown is bottoming out and strong labour market conditions prevail. China's PMI reading, though still in the contraction zone, rose to 49.1 from 47.9. China GDP growth for Q3 2012 was a healthy +7.4% year-on-year. A leadership change next week will end the uncertainty for the next ten years; and will lead to new actions and perhaps stimulus too.

For EM equities exposure, I would recommend the MSCI Asia Pacific x Japan Index, either through an ETF, or a call spread on the Index.

Currencies

From a one-month view, I like long USD/JPY, long GBP/USD, long EUR/USD, and long AUD/USD.

GBP is being supported by better than expected GDP data, the BoE's (Bank of England) bond buying and a Chancellor who is rowing back from his extreme austerity talk. The EUR is supported by anticipation of the ECB's action. I don't see these positives going away over the coming months. However any EUR rally is likely to get capped at the 1.35 level. The EUR benefits from the

ECB's commitment to help but suffers from a lack of growth in the economy. Therefore, expect the EUR to rally if Spain asks for a bailout and the ECB steps in to buy bonds. Thereafter the EUR should weaken and go to mid-1.20 levels to reflect the economic reality and disparity between the US and the European economies.

Though I expect AUD (Aussie Dollar) to weaken over the longer term, I do see that it could go all the way to 1.05 before signs of weakness. The news out of China aids a strong AUD. Higher inflation will keep the RBA (Reserve Bank of Australia) on hold from a rate cut.


Commodities

The last couple of weeks have been difficult for commodities with both Gold and Brent declining between 4-5%. The slide eventually stemmed for Brent when US GDP data surprised to the upside. If this is a sign of global growth bottoming out (and I think it is), Brent should not be in a down trend. The better than expected PMI number from China lends further support.

Gold has seen a slide from \$1795 back to \$1700 due to - weak US corporate earnings, uncertainty around US Federal Reserve Chairman Bernanke's tenure and technical selling. However, having tested the low, it bounced back to \$1714. I expect this bounce to go higher with the Hindu festival of 'Diwali' coming up on November 13. For Gold to really break \$1800 and beyond, the inflationary fears have to settle. There is no doubt we will have inflation, but it won't be in the short term.

Therefore, I believe Gold will continue to trade in the range of \$1600 to \$1800, with buying on a 10% correction and selling on a 10% rally being the strategy. Since September 2011, when Gold reached giddy highs of \$1900, there have been three corrections of 13-15% followed by three rallies of 12-15%. This could easily continue and therefore even though Gold is a long term buy, trading 10% rallies and sell-offs could still bring returns from an asset which moves higher in spurts and could be range bound for months.

Best wishes,



Manish Singh, CFA

Important Information

This document is provided to you for your information and discussion only. It is not a solicitation or an offer to buy or sell any security or other financial instrument. Any information including facts, opinions or quotations, may be condensed or summarised and is expressed as of the date of writing. The information may change without notice and Crossbridge Capital (UK) Limited, Crossbridge Capital Merchant Banking LLP and Crossbridge Capital LLP (together "Crossbridge Capital") are under no obligation to ensure that such updates are brought to your attention.

The price and value of investments mentioned and any income that might accrue could fall or rise or fluctuate. Past performance is not a guide to future performance. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income. This document and any related recommendations or strategies may not be suitable for you; you should ensure that you fully understand the potential risks and rewards and independently determine that it is suitable for you given your objectives, experience, financial resources and any other relevant circumstances. You should consult with such advisor(s) as you consider necessary to assist you in making these determinations. Nothing in this document constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you.

Crossbridge Capital does not advise on the tax consequences of investments and you are advised to contact a tax advisor should you have any questions in this regard. The levels and basis of taxation are dependent on individual circumstances and are subject to change.

This document may relate to investments or services of an entity/ person outside the UK, or to other matters which are not regulated by the FSA, or in respect of which the protections of the FSA for retail clients and/or the UK Financial Services Compensation Scheme may not be available. Further details as to where this may be the case are available on request in respect of this document. This document has been prepared from sources Crossbridge Capital believes to be reliable but we do not guarantee its accuracy or completeness and do not accept liability for any loss arising from its use. Crossbridge Capital reserves the right to remedy any errors that may be present in this document.

Crossbridge Capital its affiliates and/or their employees may have a position or holding, or other material interest or effect transactions in any securities mentioned or options thereon, or other investments related thereto and from time to time may add to or dispose of such investments. Crossbridge Capital may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment to any company or issuer mentioned. Some investments referred to in this document will be offered by a single entity or an associate of Crossbridge Capital or Crossbridge Capital may be the only market maker in such investments.

This document is intended only for the person to whom it is issued by Crossbridge Capital. It may not be reproduced either in whole, or in part, without our written permission. The distribution of this document and the offer and sale of the investment in certain jurisdictions may be forbidden or restricted by law or regulation.

Crossbridge Capital LLP and Crossbridge Capital Merchant Banking LLP are authorised and regulated by the Financial Services Authority for the conduct of investment business in the United Kingdom. The registered addresses of Crossbridge Capital (UK) Limited, Crossbridge Capital LLP and Crossbridge Capital Merchant Banking LLP are 9 South Street London W1K 2XA respectively. If you have any questions regarding the document, please contact your RM.

United Kingdom

9 South Street
London W1K 2XA
United Kingdom

Singapore

One Temasek Avenue
23-05 Millenia Tower
Singapore 039192

Visit our website:

crossbridgecapital.com

 @CrossbridgeViews