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Financial Markets Research

US relatively strong; EU pushed into action

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Highlights

- Forward-looking indicators are pointing to a modest acceleration of the US economy. But the rest of the world is slowing. An escalating European debt crisis is pushing the ECB into more monetary easing and EU countries into better governance for the eurozone. This will not address southern European countries' lack of competitiveness.

- During the last month, we upgraded our view on equities to neutral. We no longer believe that the risks of a further decline outweigh the likelihood of a rebound. We expect the ECB to take on a larger role in fighting the worsening debt crisis, thus staving off a depression in the eurozone. But with the region in recession and with moderate growth elsewhere, we do not forecast strong returns for stocks.

- The outlook for real estate closely resembles the one for equities. Access to funding will remain an important issue for the foreseeable future.

- We are inclined to take a positive view on investment grade and high yield bonds relative to their government counterparts for 2012. In the short term, however, we maintain a neutral view. We need more clarity on policymakers' choices.

- The strong uptrend in defensive equity sectors has ended. In recent months, performance has been mixed. But we prefer to take a wait-and-see stance before retreating from our positive view on defensives.

- We believe the current low yields on government bonds—Germany's are still close to their lowest level for more than 200 years—do not reflect the inflation risks in the medium- to long term. However, the low inflationary risks in the short term must be taken into account.

- Gold is the subject of our monthly special. All the gold on the planet is worth 37% of the total capitalization of global equity markets. That is exactly in line with the historical average over the 1970-2011 period, but above the 23% median. As elevated uncertainty around the economy will continue for a while, we believe it is too early to anticipate a correction in the gold market.

Summary

Forward-looking indicators are pointing to a modest acceleration of the US economy. But the rest of the world is slowing. An escalating eurozone debt crisis is pushing the ECB into more monetary easing and EU countries into better governance for the eurozone. This will not address southern European countries' lack of competitiveness.

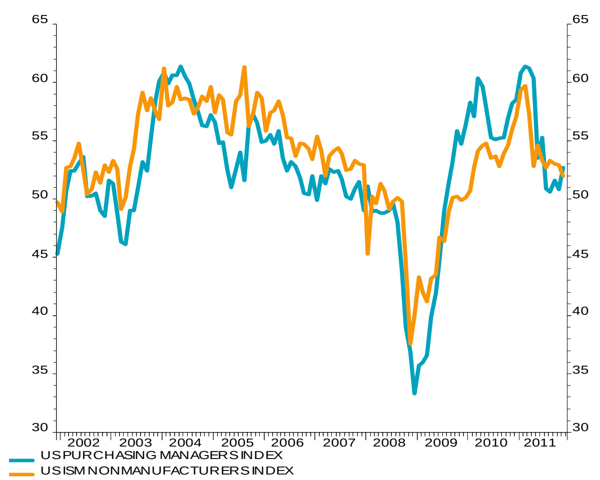
Macroeconomic view

The world economy—with the exception of the US—is generally showing signs of a slowdown. The euro area is being pushed towards a solution of sorts to the ongoing debt crisis. This will not, however, address the southern European countries' lack of competitiveness, nor turn the EU into an optimum currency area. Neither a sovereign debt restructuring by one or more countries nor the departure of one or more countries from the eurozone can be ruled out. In any case, Italy and Spain are too big to fail and will have to be bailed out at some point.

North America

For the moment, the US economy seems to be defying gravity. The index for hours worked is showing solid gains. Post-Thanksgiving shopping was surprisingly enthusiastic. The savings rate has fallen again from around 5.0% at the beginning of 2011 to 3.5% in November, which is remarkable in an environment in which deleveraging is supposed to be taking place. The inability of the Super Committee to reach a budget compromise looked to be a threat to growth because of supposedly automatic spending cuts, but Congress has indicated that the payroll tax cut will be extended for another year, as will the emergency unemployment benefits. The US economy is thus heading for decent growth in the first quarter of 2012. Talk of a double dip is dying down rapidly. The pressure on the Federal Reserve for additional monetary stimulus is weakening. That said, growth in 2012 will probably continue to be below trend.

ISM MANUFACTURING AND NON-MANUFACTURING INDICES



Source: Thomson Reuters Datastream

Europe

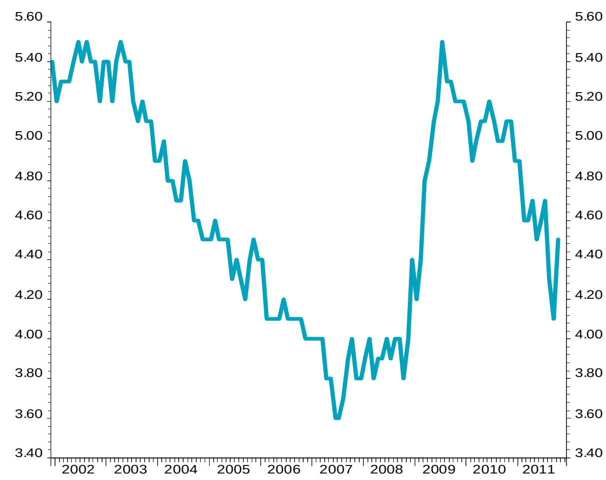
The UK economy grew by 0.5% in the third quarter on a quarterly basis. The outlook is subdued. The likelihood of a drift into a new recession has risen. The UK government is determined to deliver on budget discipline and has announced additional tightening measures. Monetary policy is currently on hold, as the Bank of England is waiting to see what policy measures will be introduced to counter the eurozone debt crisis.

Forward-looking indicators suggest that the whole eurozone is drifting into a recession, although macroeconomic data for Germany remains relatively strong. In November, the unemployment rate there declined again, falling to 6.9%, after the up-tick in October. The ECB has reversed its two earlier hikes and—in line with expectations—eased its collateral criteria and provided longer-term lending facilities for European banks. Although the ECB refused to lower the refi rate below 1% in the post-Lehman environment, additional rate cuts cannot ruled out at present. But even if the ECB keeps official rates at 1.0%, actual money market rates will be brought close to 0%. The longer-term measures being implemented by European governments to ensure budgetary discipline fall short of being a quantum leap to fiscal union. The ECB is therefore reluctant to act as a sovereign lender of last resort. The EU's bazooka—in the form of the EFSF, its successor the ESM and a loan from the IMF—is probably too small to bail out Italy and Spain. Pressure on the ECB is therefore set to increase. In any event, the ECB will prevent a speculative attack on Italy and Spain; these two countries are simply too big to fail. The ECB will prevent a disorderly default at all costs. But an orderly default cannot be ruled out. After elections in Greece, which are likely to take place in the first quarter of 2012, a second Greek debt restructuring is likely. As for Portugal and Ireland, it remains to be seen whether they can endure the current recession without restructuring and/or leaving the euro area. For the weaker euro countries, it comes down to a cost/benefit analysis. In the current poker game, the ECB is reluctant to show its hand too early. Tensions in European government bond markets are expected to flare up from time to time.

Pacific

The Australian economy slowed in the third quarter, with qoq growth dipping to 1.0% from the second quarter's revised 1.4%. On 6 December, the Reserve Bank lowered its benchmark interest rate by a modest 25 basis points. More cuts are set to follow in the coming months: the external climate is worsening, the government is determined to deliver a budget surplus in the next fiscal year and inflation is falling.

JAPANESE UNEMPLOYMENT RATE (%)



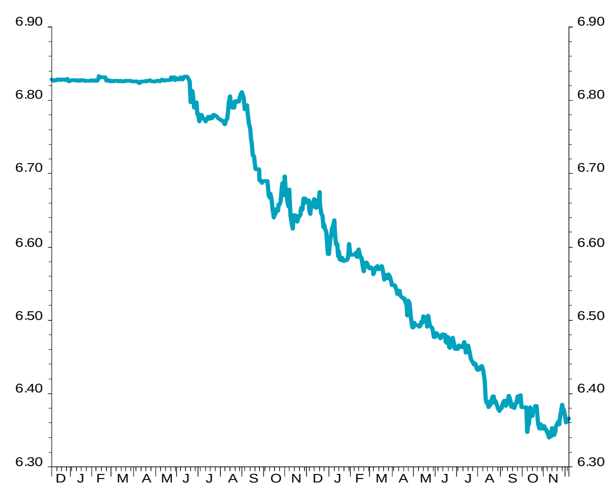
Source: Thomson Reuters Datastream

The Japanese economy is slowing. Exports have weakened, thanks to the strong yen. The flooding in Thailand is negatively affecting supply chains. Declining core machinery orders highlight a fall in investment. Even so, the Japanese economy should see decent growth in 2012, in part due to the ongoing public spending on the reconstruction of the broader Fukushima area. A hike in VAT has been postponed until at least the third quarter of 2013. Unemployment rose unexpectedly in October, fortunately reflecting a return of discouraged workers. Moreover, the Japanese economy remains vulnerable to external shocks, such as a potential deepening of the eurozone crisis.

Emerging markets

In emerging markets as a whole, growth is generally weakening, while inflation is becoming less of a problem. Further monetary loosening should be expected.

CHINESE YUAN VS US DOLLAR



Source: Thomson Reuters Datastream

The Chinese economy is slowing. Domestic consumption is resilient, but exports and investment are weakening. Inflation is coming down, reaching 5.5% in October. By lowering the reserve requirements for Chinese banks, the central bank has made a first loosening move. Further gradual moves are set to follow, enabling growth of at least 8% in 2012.

Indian GDP growth dipped below 7.0%—to 6.9%—on a yearly basis for Q3, down from 7.7% in Q2. Inflation remains stubbornly high, with the benchmark wholesale price index at 9.7% on a yearly basis in October. The weakening of the rupee will increase upward inflationary pressure. Progress on reform is lacking. The prime minister, Manmohan Singh, hastily retreated on a plan to open up the country's retail industry to foreign investment (Wal-Mart), probably his boldest reform proposal since 2004, after protests from all sides.

The Brazilian economy came to a standstill in the third quarter. Inflation is slowing, though the 7.0% reported on a yearly basis in October is still above the 6.5% upper limit of the central bank's target range. The central bank lowered interest rates in August and this policy will be continued.

Russia was the only BRIC nation to report accelerating GDP growth in the third quarter, with a 4.8% rise on a yearly basis. Nevertheless, it is generally accepted that a downturn is underway. Unfair elections raised political tensions, disconcerting investors further. Inflation is falling, reaching 6.8% in November. The central bank should be able to lower interest rates in the course of 2012 if the European economy continues to weaken.

GDP GROWTH BY REGION (%)

	2010	2011	2012	Δ -1M 2011	ROBECO*
US	3.0	1.8	2.1	0.2	=
EUROZONE	1.8	1.6	0.4	-0.1	-
UK	1.8	1.0	1.1	-0.2	-
JAPAN	4.1	-0.4	2.1	0.1	=
CHINA	10.4	9.1	8.5	0.0	=
INDIA	8.5	7.4	7.7	-0.1	-
BRAZIL	7.5	3.2	3.5	-0.4	-
RUSSIA	4.0	4.1	3.5	-0.1	=
WORLD	3.9	2.6	2.6	0.0	-

* INDICATES WHETHER WE EXPECT A HIGHER (+), MATCHING (=) OR LOWER (-) GROWTH RATE THAN THE CURRENT CONSENSUS ESTIMATE FOR 2012
SOURCE: CONSENSUS ECONOMICS, ROBECO

CPI BY REGION (%)

	2010	2011	2012	Δ -1M 2011	ROBECO*
US	1.6	3.2	2.1	0.1	=
EUROZONE	1.6	2.7	1.8	0.1	=
UK	4.7	5.3	3.3	0.2	=
JAPAN	-0.7	-0.3	-0.2	-0.1	=
CHINA	3.3	5.4	3.8	0.1	=
INDIA	10.4	8.3	7.2	0.3	+
BRAZIL	5.9	6.5	5.5	0.1	+
RUSSIA	8.8	7.1	6.8	-0.2	=
WORLD	2.3	3.4	2.4	0.1	=

* INDICATES WHETHER WE EXPECT A HIGHER (+), MATCHING (=) OR LOWER (-) CPI THAN THE CURRENT CONSENSUS ESTIMATE FOR 2012
SOURCE: CONSENSUS ECONOMICS, ROBECO

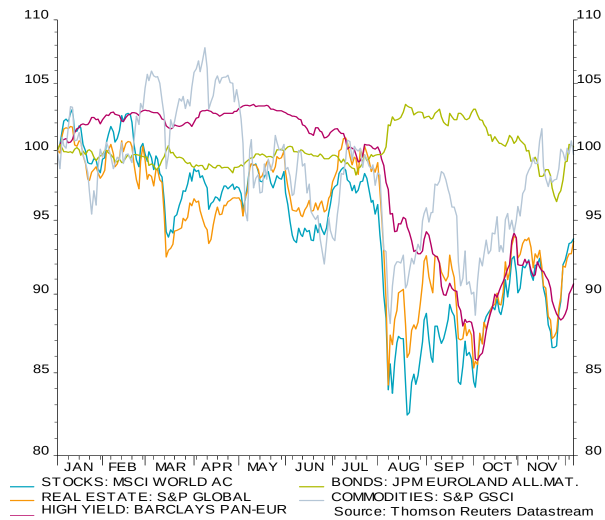
Outlook financial markets

Asset mix

Last month's review

With the moment approaching that the eurozone would collapse without the ECB taking on a bigger role, markets anticipated a green light from Germany. A red light would result in a depression and an extensive series of defaults. Stocks and commodities recently set new four-month highs. Stocks were the best performing asset class over the last month and a quarter. Even so, returns for equities so far in 2011 are -6%. High yield and real estate also made gains. Last month, the German ten-year interest rate rose from 1.8% to 2.1%, while peripheral spreads declined. Eurozone bonds were thus roughly flat. The euro itself weakened by three cents to USD 1.34. Oil and gold hardly changed. The VIX index remains at elevated levels, and is still trading around 30. It has remained above 20 for four months in a row.

PERFORMANCE OF ASSET CLASSES (TOTAL RETURN EUR)



PERFORMANCE OF ASSET CLASSES (TOTAL RETURN IN EUROS)

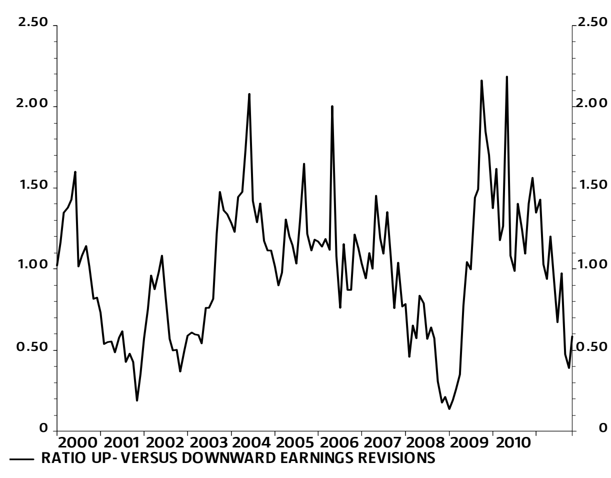
	-1M	-3M	-6M	-12M	-3Y	-5Y
STOCKS (MSCI AC WORLD)	1.9%	6.6%	0.1%	-3.4%	49.8%	-4.9%
REAL ESTATE (S&P GLOBAL REITS)	0.0%	1.1%	-2.2%	-2.8%	72.1%	-21.9%
HIGH YIELD (BARCLAYS PAN-EUR)	-1.5%	-2.1%	-11.5%	-8.8%	63.7%	-17.3%
BONDS (JPM EUROLAND ALL MAT.)	0.3%	-2.4%	0.3%	-0.1%	6.1%	16.4%
COMMODITIES (S&P GSCI)	1.5%	2.2%	2.9%	3.7%	25.7%	-16.1%

SOURCE: THOMSON FINANCIAL DATASTREAM

Equities

During the last month, we upgraded our view on equities to neutral. We no longer believe the risk of a further decline outweighs the likelihood of a rebound. The debt crisis has worsened, reaching the point where the ECB has to decide whether it is willing to take on a larger role. As argued above, in our baseline scenario we expect it to agree to such an expanded role. This should prevent a depression in the eurozone. But with the eurozone in a recession and with moderate growth elsewhere, we do not forecast strong returns for stocks. In addition, earnings leave some room for disappointment, while valuation is neutral.

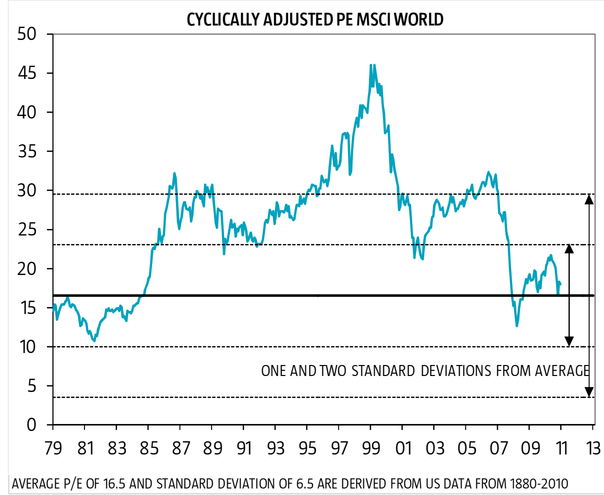
UPWARD VERSUS DOWNWARD EARNINGS REVISIONS (x)



Earnings have impressed during the economic recovery. From mid-2009 to the second quarter of 2011, analysts' upward earnings revisions have outnumbered their downward revisions. US profit margins are rather high when viewed in a historical perspective. Using a trend line of the MSCI World index's real earnings as an indicator of earnings potential suggests there is limited upside. Currently, earnings are 17% above their trend. Our bottom-up analysts and portfolio managers generally share our view that earnings margins around the globe are high. We are therefore skeptical about the projected earnings growth of 10% in 2011 and 11% in 2012. On a more positive note, analysts are downgrading their earnings estimates massively: realism is on its way.

We believe that stocks are neutrally valued at present. For the MSCI AC World index, the Shiller P/E is in line with what we believe to be a normal valuation level, as shown in the graph to the right. We want to emphasize that valuation is of limited importance for short-term investment horizons and that over- or undervaluation of up to 20% is fairly common. On longer-term horizons (of a few years and more), valuation is a very important driver of returns. This implies that above-average returns in the medium- to long term should not be expected. That said, the headwinds from valuation have disappeared. On balance, we have a neutral view on equities for the months ahead.

VALUATION OF EQUITIES (x)

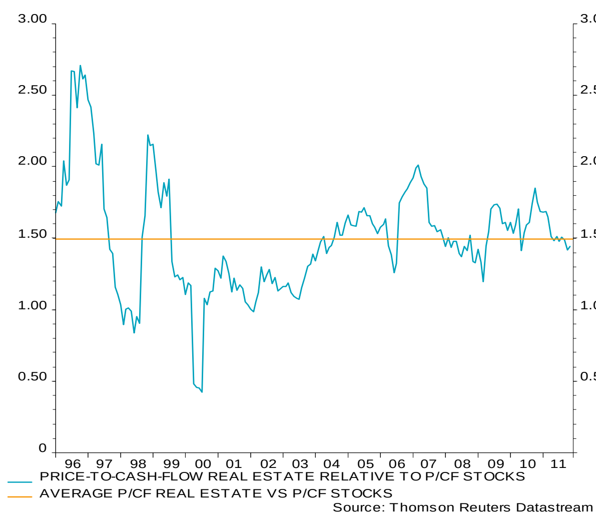


SOURCE: DATASTREAM

Real estate

The outlook for real estate closely resembles the one for equities. In the event that moderate economic growth around the world continues, real estate will probably continue to benefit from its defensive characteristics. But if the eurozone debt crisis deteriorates further, funding problems are likely to dominate the asset class. In such a scenario, real estate will probably underperform equities. The balance sheets of real estate companies have improved. The ratio of net debt to total assets is declining, but it is still high from a historical perspective. From a valuation perspective, we believe there is no significant difference between equities and real estate. The asset classes are highly correlated and, based on the price/cash flow ratio, their valuations hardly differ. The current price/cash flow ratio for real estate is 1.5x the one for stocks. That is in line with the historical average.

VALUATION REAL ESTATE VERSUS EQUITIES (x)

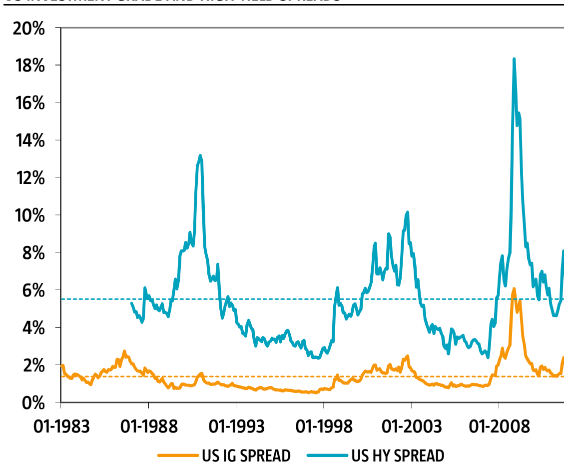


SOURCE: BARCLAYS, ROBECO

Corporate bonds

Investment grade and high yield bonds appear to be factoring in a recession. Spreads in the US market are high in a historical perspective. On the one hand, one could argue that spreads have risen too far, given that corporate balance sheets are healthy and loaded with cash. On the other hand, the graph to the right shows what happens when the market becomes really worried about a credit crunch, as happened in 2008. But a situation like 2008 is rather extreme. We are inclined to take a positive view on investment grade and high yield bonds relative to their government counterparts for 2012. In the short term, however, we maintain a neutral view. We need more clarity on policymakers' choices.

US INVESTMENT GRADE AND HIGH YIELD SPREADS

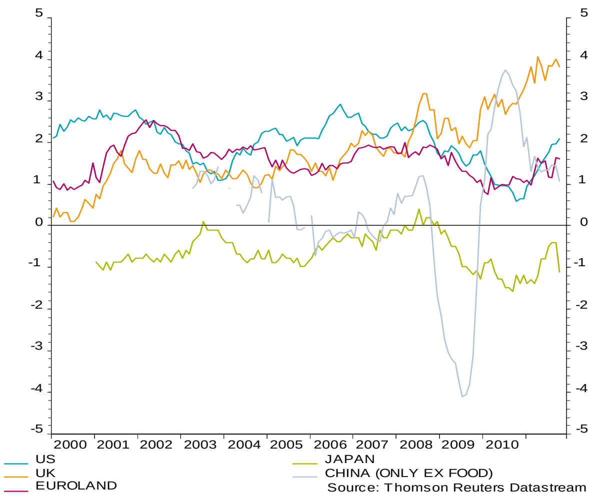


SOURCE: BARCLAYS, ROBECO

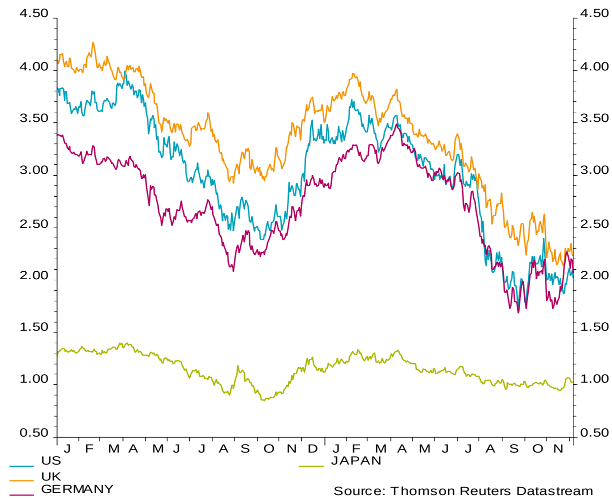
Government bonds

We believe the current low yields—Germany's are still close to their lowest level for more than 200 years—do not reflect the inflation risks in the medium- to long term. But the low inflationary risks in the short term must also be taken into account. Core inflation is clearly on the rise in the US, the UK and Japan, as the chart below left illustrates, but our Inflation Monitor indicates that short-term inflation risks are falling. Furthermore, the high uncertainty surrounding the eurozone debt crisis is by no means diminishing. Finally, short-term interest rates should remain low during 2012, and possibly also in 2013.

INFLATION RATES (%)



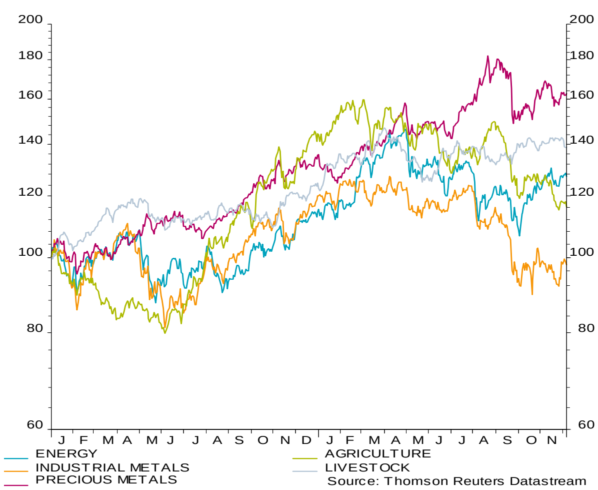
TEN-YEAR INTEREST RATES (%)



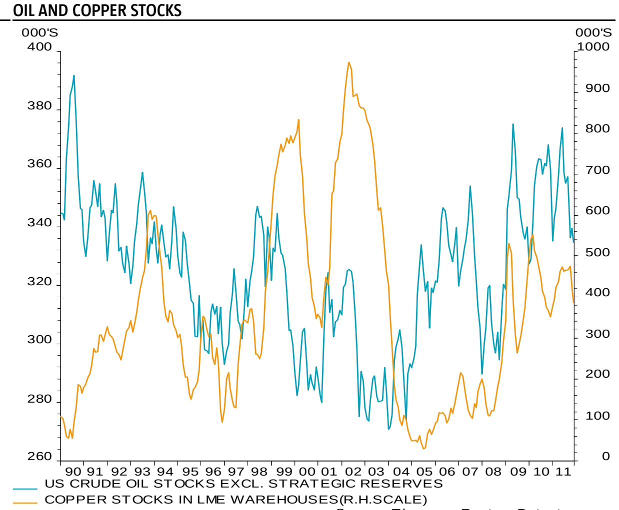
Commodities

The outlook for commodities is currently being affected by the global slowdown and the debt crisis. But as the slowdown of the Chinese economy is likely to conclude in a soft landing, we expect a further rise of commodity prices in the medium term, given that the commodity market continues to be characterized by capacity constraints on the supply side. In the short term, the mild recession in the eurozone is a risk, as it has the potential—if the debt crisis lingers—to drag other developed regions into recession. Because of this risk, for now we maintain our neutral view on the asset class.

GSCI COMMODITY SPOT PRICES (USD)



OIL AND COPPER STOCKS



Regional mix

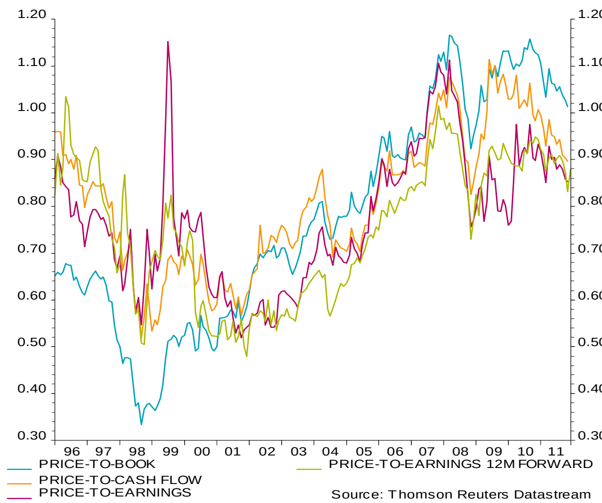
PERFORMANCE OF REGIONS (MSCI AC WORLD; UNHEDGED TOTAL RETURNS IN EUROS)

	-1M	-3M	-6M	-12M	-3Y	-5Y
NORTH AMERICA (50%)	2.7%	9.4%	7.4%	3.5%	49.8%	1.2%
EUROPE (24%)	1.5%	6.3%	-9.6%	-8.3%	41.1%	-19.0%
PACIFIC (13%)	2.4%	3.8%	1.9%	-7.8%	37.0%	-12.5%
EMERGING MARKETS (13%)	-0.4%	0.0%	-7.4%	-13.1%	97.5%	21.6%
AC WORLD (100%)	1.9%	6.6%	0.1%	-3.4%	49.8%	-4.9%

SOURCE: THOMSON FINANCIAL DATASTREAM

Within equities, emerging markets remain our favorite region. We expect emerging markets to pick up their ten-year trend of outperformance, for fundamental reasons as well as from a valuation perspective. First, from a fundamental point of view, we see four positives. To start with, emerging markets do not have the government-debt and budget-deficit challenges faced by many of their developed markets counterparts. Furthermore, their banking systems also seem to be less vulnerable. Next, we expect some more years of high labor-productivity gains. Finally, domestic retail sales are still growing at a decent rate. From a fundamental point of view, then, emerging markets remain attractive. Second, from a valuation point of view, there is some room for a revaluation relative to the broader market (see graph right). Emerging markets should therefore find some support from relative valuation levels. The expected earnings growth in 2011 and 2012 is in line with the growth for the broader market.

VALUATION MEASURES EMERGING MARKETS RELATIVE TO MSCI AC WORLD INDEX



EARNINGS AND VALUATION DATA OF REGIONS (MSCI AC WORLD)

	EARNINGS GROWTH (%)			ST.DEV. ESTIMATES (%)		EARN. REV. INDEX		P/E ON 12M FWD EARN.	
	FY1	FY2	12M	CURRENT	10Y AVG.	3M	1M	CURRENT	10Y AVG.
NORTH AMERICA	16.6	10.3	10.7	7.5	5.5	-18.4	-14.7	11.2	14.9
EUROPE	1.8	9.4	9.3	14.2	13.0	-40.6	-34.3	9.1	13.1
PACIFIC	7.9	17.8	14.6	1.2	0.8	-41.3	-37.0	11.3	16.6
EMERGING MARKETS	9.5	10.9	10.7	15.2	10.3	-40.6	-39.5	9.1	10.8
AC WORLD	10.1	11.0	10.8	2.7	2.1	-32.0	-31.2	10.3	14.2

THE EARNINGS REVISIONS INDEX IS CALCULATED AS THE DIFFERENCE BETWEEN THE NUMBER OF UP- AND DOWNWARD REVISIONS RELATIVE TO THE NUMBER OF TOTAL REVISIONS.
SOURCE: THOMSON FINANCIAL DATASTREAM

Sector mix

PERFORMANCE OF SECTORS (MSCI AC WORLD; UNHEDGED TOTAL RETURNS IN EUROS)

	-1M	-3M	-6M	-12M	-3Y	-5Y
ENERGY (12%)	1.8%	9.7%	2.3%	2.7%	58.6%	14.0%
MATERIALS (8%)	-0.8%	-1.9%	-8.2%	-14.5%	97.5%	16.5%
INDUSTRIALS (10%)	2.7%	7.9%	-3.6%	-6.9%	55.1%	-2.3%
CONSUMER DISCRETIONARY (10%)	2.0%	7.6%	2.8%	-2.9%	81.0%	1.5%
CONSUMER STAPLES (10%)	4.1%	8.0%	9.2%	9.2%	53.3%	41.7%
HEALTH CARE (9%)	3.5%	6.2%	3.6%	8.8%	35.2%	9.8%
FINANCIALS (19%)	1.7%	4.1%	-8.6%	-13.8%	25.4%	-44.7%
IT (12%)	1.1%	12.1%	8.2%	0.3%	76.8%	9.6%
TELECOM SERVICES (5%)	1.6%	5.1%	3.8%	1.7%	34.5%	12.5%
UTILITIES (4%)	1.3%	5.7%	3.4%	-2.7%	12.1%	-7.1%
AC WORLD (100%)	1.9%	6.6%	0.1%	-3.4%	49.8%	-4.9%

SOURCE: THOMSON FINANCIAL DATASTREAM

The strong uptrend in defensive sectors is no longer in place. Over the last few months, performance has been mixed. But we prefer to take a wait-and-see approach before retreating from our positive view on defensives. Clearly, the debt crisis has been the main driver of the huge underperformance of financials and the moderate underperformance of cyclicals, as well as the decent relative performance of defensives. But Europe has fallen into a recession in the meantime, which has contributed to numerous earnings downgrades. As earnings downgrades for defensives are still better than for financials and most cyclicals, we stick to our positive view on defensives. We also maintain our negative view on financials.

EARNINGS AND VALUATION DATA OF SECTORS (MSCI AC WORLD)

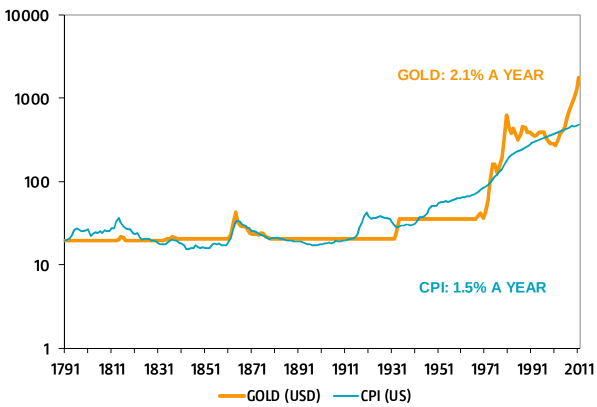
	EARNINGS GROWTH (%)			ST.DEV. ESTIMATES (%)		EARN. REV. INDEX		P/E ON 12M FWD EARN.	
	FY1	FY2	12M	CURRENT	10Y AVG.	3M	1M	CURRENT	10Y AVG.
ENERGY	23.8	3.7	3.5	3.4	2.7	-24.6	-10.0	8.9	11.9
MATERIALS	27.9	11.5	11.1	4.1	2.7	-54.0	-55.9	8.9	12.9
INDUSTRIALS	11.4	11.2	11.2	1.1	0.8	-37.7	-33.7	10.8	15.1
CONSUMER DISCRETIONARY	11.9	19.7	17.0	0.9	0.7	-16.7	-13.2	11.8	16.4
CONSUMER STAPLES	7.1	9.8	10.0	0.4	0.3	-26.3	-10.2	14.1	16.0
HEALTH CARE	5.5	4.6	4.6	0.5	0.3	-4.5	-10.4	10.8	15.6
FINANCIALS	3.9	14.7	15.1	0.9	0.9	-46.0	-49.5	8.4	11.7
IT	7.0	11.7	11.8	0.6	0.4	-27.6	-40.1	11.7	19.3
TELECOM SERVICES	0.9	6.8	6.6	0.5	0.5	-26.6	-27.2	11.1	19.1
UTILITIES	-7.3	22.4	19.3	1.1	0.8	-29.8	-16.0	13.2	13.3
AC WORLD	10.1	11.0	10.8	2.7	2.1	-32.0	-31.2	10.3	14.2

THE EARNINGS REVISIONS INDEX IS CALCULATED AS THE DIFFERENCE BETWEEN THE NUMBER OF UP- AND DOWNWARD REVISIONS RELATIVE TO THE NUMBER OF TOTAL REVISIONS.
SOURCE: THOMSON FINANCIAL DATASTREAM

Special: Gold, double or bubble?

Over the past ten years, gold has managed to eke out an annualized return of around 20%. Looking at the parabolic rise of the gold price, this may feel like a one-way bet. Nevertheless, numerous sizeable—though temporary—corrections have taken place over the past decade. The most pronounced was the 30% sell-off in 2008, when a flight to quality pushed all risky assets deep into negative territory. Despite that sell-off, gold still managed to close the year with a 6% positive return, prompting many to claim that gold was the next bubble. Subsequently, however, the gold price has more than doubled.

GOLD AND CPI IN THE LONG RUN



SOURCE: ROBECO

NOMINAL AND REAL GOLD PRICE (USD)

SOURCE: THOMSON REUTERS DATASTREAM, ROBECO

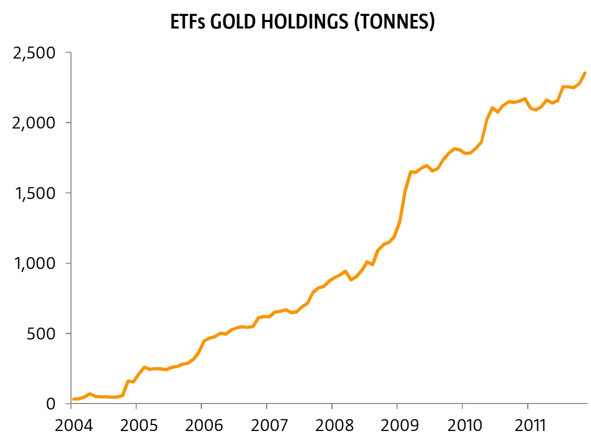
Static supply leads to high price volatility. One of the key characteristics of the gold market is its rigid supply structure. Roughly 2,600 tonnes of new gold are mined each year, which is equivalent to around 1.5% of the existing gold stock. This new supply has risen somewhat in recent years. But based on the state of existing mines, the level of investments made by mining companies and the discovery of new fields (not impressive), it looks like not too much upside should be expected. Other supply comes from recycling, either from jewelry or old fabricated products. Although higher gold prices should boost the re-use of gold, it appears that annual recycling peaked at 1,700 tonnes in 2009; it has not risen following the huge price spike seen in 2010-11. This seems to suggest that there is limited room for supply to match a rise (or a fall) in demand. In such an environment, prices are known to show explosive moves.

So are we looking at a bubble? In the case of gold, only around 11% of demand is linked to industrial usage. The remaining demand comes from more elusive sources. About half of demand is linked to jewelry, with emerging markets such as India and China the main drivers for the continued growth. One would expect higher prices to have dented the demand for jewelry, but so far this has been more than neutralized by the rising wealth in these countries. The remaining demand comes from what the World Gold Council calls "investments".

Over the last three years, gold reserves at central banks have been increased by 200 to 300 tonnes a year. This has reversed a multi-decade trend of declining gold reserves. Furthermore, there has been ongoing demand from ETFs that ranges from 200 to around 300 tonnes a year as well, though 2009—when there was a jump of 600 tonnes—was an exception. ETFs' holdings are currently equivalent to a year's gold production. Both factors have played a significant role in the ongoing rise of gold. Both factors can also be linked to the current conditions in the global economy. The risk of sovereign defaults has clearly risen, while increasing inflation is another concern. After all, inflation could be spurred by printing money to prevent defaults. Either way, gold acts as a safe haven. As these risks will be around for a while, there seems to be no economic reason to expect a correction, even though the gold price is close to a new high in real terms.

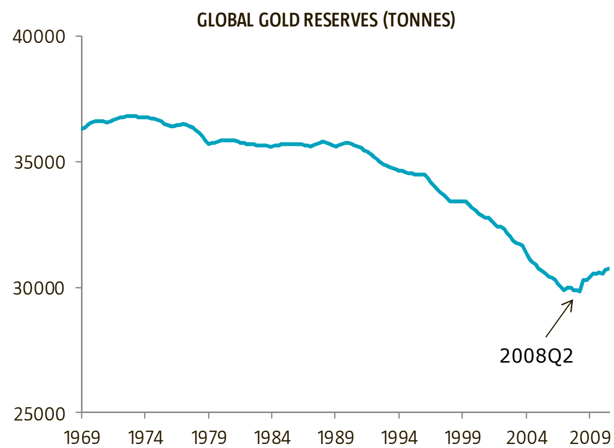
At the same time, there are also a couple of negatives to put forward. First, as seen in 2008 and again in September 2011, gold is not a very reliable hedge for a possible crash in financial markets. Second, there is always the risk of regulation. Famously, US president Franklin Roosevelt signed an order that seized all gold in the US back in 1931. There is no reason to expect any such drastic measures this time around—gold is not part of the currency system as it was back then—but the high level of regulation does pose a potential threat. Third—and most important—investing in gold only makes sense if there are enough investors who believe there is no bubble yet.

PHYSICAL GOLD HELD BY ETFs (TONNES)



SOURCE: WORLD GOLD COUNCIL, ROBECO

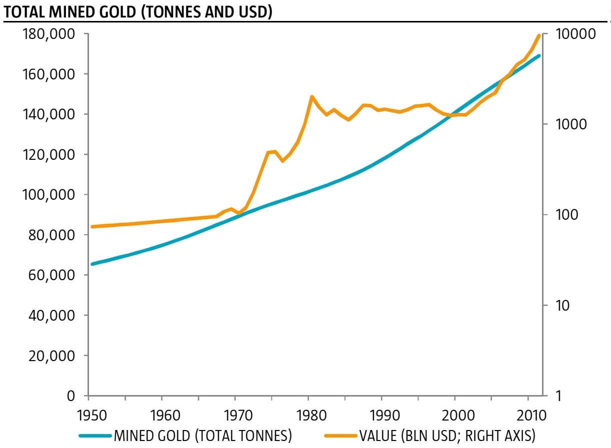
GLOBAL GOLD RESERVES (TONNES)



SOURCE: WORLD GOLD COUNCIL, ROBECO

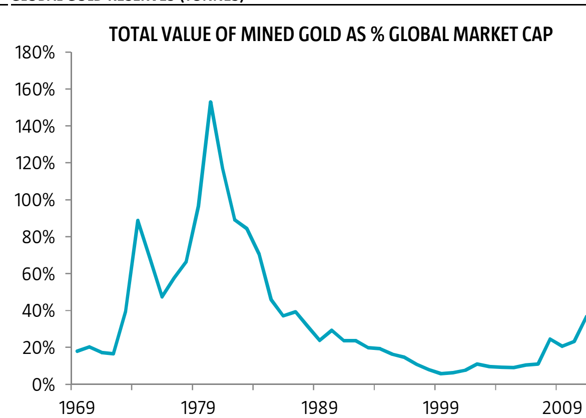
That brings us to the following analysis. One way to address the question of whether gold is at ridiculous levels is to examine whether the buying power of gold in financial markets is at extreme levels. For this purpose, we have constructed a time series of the value of all the gold that has been extracted from the ground. We then used the time series of the value of the listed companies around the world, as measured by the market capitalization of the MSCI AC World Index. By dividing the first series by the second, we arrive at the percentage of listed companies that could be bought in return for all the gold in the world. One can interpret this ratio as a kind of risk indicator. As shown in the chart below right, the value of all the gold above ground exceeded the value of listed companies in 1980. At that time, gold was worth 153% of the global market cap. In 1999, there was a low of 6%. Now, the level is 37%, exactly in line with the historical average over the 1970-2011 period, but above the median of 23%. This provides support for the view that gold has much further to run if the global situation deteriorates badly. But if the situation gradually normalizes from here, using the median of 23% as guidance for a normal valuation, there could be a significant correction. In our baseline scenario, we expect a gradual realization that the ECB will pick up the bill for the debt crisis. As such, elevated uncertainty about the economy is set to continue for a while. As a result, we believe it is too early to anticipate a correction in the gold market. Finally, we would like to point out a timeless argument: one can hold gold for purposes of diversification. It is a kind of insurance policy that you hope not to collect on.

TOTAL MINED GOLD (TONNES AND USD)



SOURCE: WORLD GOLD COUNCIL, ROBECO

GLOBAL GOLD RESERVES (TONNES)



SOURCE: US GEOLOGICAL SURVEY, MSCI, ROBECO

Closing date tables 08 December 2011, text 12 December 2011.
In our text and data tables, we do not refer to calendar months but look back from this closing date.

Important information