HDF OUTLOOK

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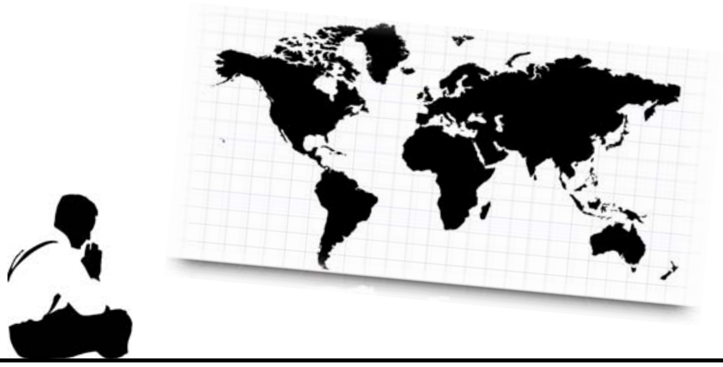

THE ECONOMIST'S VIEWPOINT

The beginning of stabilisation

The crisis is not over. The first anniversary of the Lehman Brothers bankruptcy allows us to review the initial lessons of this exceptional event and the challenges that lie before us.

1- Which economic scenarios?
The positive figures for economic activity in the second quarter of 2009 in France, in Germany, in Japan…have once again (but this time in a positive sense) surprised the experts. This was due to a raft of factors: a faster rebound of China and the resilience of other large emerging markets (India for example) when faced with the crisis, the first impact of the growth plans, the positive impact of the drop in inflation on purchasing power and consumption…
But, capital investment by companies has dropped significantly as a result of the low visibility on the medium to long-term economic climate. Unemployment continues to grow in most countries. Rather than extrapolate the second quarter results, one needs to consider that the most advanced countries have entered a stabilisation phase with growth close to 0% on an annual basis, which could last until the end of 2009 or beginning 2010. This could mean that we have come out of this exceptionally severe recession that has lasted a year, without talking about an upturn or coming out of the crisis. For the upturn, it will be necessary to await 2010, even if the second quarter of 2009 does provide positive surprises, for instance due to the restocking awaited in a number of sectors after months of destocking.

Even under this rather optimistic scenario, unemployment will go on rising for months to come as it will take time for companies to restart their capital expenditure programmes. Some of them, especially small and middle market companies, are facing tough cash-flow and financing challenges. In France, the decline in bank credit for the private sector (both companies and retail) in July 2009 (year-on-year) is a signal worth considering. The bank support contributed by Governments has given them liquidity enabling them to meet their credit commitments. They should not hold back, since the credit crisis is likely to delay any genuine recovery.

2- Lessons from the crisis for banking and financial regulation
The world banking crisis is only partly over. A number of financial institutions still have considerable toxic assets on their balance sheets which have not yet been digested. All the same, the rebuilding process should not be postponed. It has rapidly become obvious, in respect to most of the issues in banking and finance, that what is required is a global response, at the risk generating new and harmful distortions to competition. The Pittsburgh G-20 summit should confirm member states' convergent interests on a number of points including the campaign against tax havens (having already achieved a breach in the Swiss de-fences), the principle of spreading traders' bonuses over a number of years (and basing them on medium- to long-term performance), the central role to be given to the IMF within the framework of the new World Governance to be established, the capital requirements for banks and the need to better adapt these to the risks undertaken.
On other issues convergence is far too difficult or nonexistent, whether with respect to capping bonuses or the right balance between self-regulation (by boards of directors, audit and compensation committees) and regulation, amongst other concerns.
Europe, the principal force behind the G-20 proposals, cannot impose its point of view worldwide unless it unites and speaks with one voice — a condition that is far from being met at several points in the debate. It needs to go beyond the rather astonishing call in August by Lord Turner, chairman of the UK's Financial Services Authority (FSA), for a tax on financial transactions (with an even wider reach than the so-called Tobin tax) which would, at a single stroke, wipe out the ideological frontier separating 'Anglo-Saxons' from 'continental Europeans'.

3- The major challenges
Social issues will continue to exist in 2010 with the likely continued growth in unemployment, in particular amongst the youth. In order to contain this phenomenon, resources will need to be devoted to employment policy.

Energy risks continue to be present and very difficult to anticipate, even though, at mid-September 2009, the price of oil is modest at around US$68 per barrel in comparison to the prices seen in the first half of 2008. Even if the slow return to economic growth does not provoke a rapid price increase back to US$150 per barrel, the impact of geopolitical uncertainties should not be underestimated.

Inflation risks? Some are already arguing for the return of inflation as the result of the over-abundance of liquidity, as a relatively painless way of correcting the over-indebtedness of Governments, that have in the crisis replaced the over-indebtedness of the private sector. My conclusions are significantly different. I do not believe in a return to inflation in service goods (retail and wholesale prices) over a two-three year horizon, for at least two reasons: (1) globalisation will not be threatened by the crisis. In any case we have to believe this, since a return to protectionism would harm us even more… Globalisation means more competition in all sectors and reduced ability for companies to pass on in price increases due to increases in costs (the experience of the first half of 2008 confirms this..). (2) Increases in unemployment limit the ability of employees and unions to transform an initial price shock (oil prices, primary goods) into salary based inflation. A return to the 1970s is not on the agenda. This means that inflation and deflation will continue to impact asset values rather than goods and services, as has happened over the last fifteen years. We will continue to pass from one bubble to another, the current bubble being in US Treasury Bonds, and sovereign bonds from countries that still have strong credibility and therefore a good credit rating.
The day this bubble on sovereign bonds bursts, we can expect a dramatic increase in interest rates on those bonds, even if central banks maintain, as is probable, their interest rates at levels close to zero in 2010.

A dollar risk? I fear that in 2010-2011 the greenback will sag under the weight of US budget deficits. It is true that US households have started to save again (with a savings rate of 5-6% in contrast to negative or zero rates seen previously) and the US commercial deficit has had a tendency to go down. But this last tendency will probably stall, since the increase in the budget deficit (approximately 12% of GDP in 2009 and maybe the same in 2010) cannot be "balanced" by domestic factors and will therefore lead to an increase in the commercial balance of payments deficit. Dollar weakness is a threat for Europe. Since if the dollar falls in 2010, many countries, China for one, will want to follow suit, for competitivity reasons, and the euro is likely to be the only significant currency to rise, weighing on the competitivity of companies and the rebound in Europe. The international monetary issue may return rapidly to the G20 agenda.

4- Implications for stock markets
Our preferred base scenario leads to several conclusions. Stabilisation and then the moderate growth forecast for 2010, despite inevitable short term volatility, explains the performance of the markets over the last months. Are financial markets too optimistic? If one considers the profits announced by large companies and the monetary policies that will keep interest rates close to zero in 2010, stock markets still have margin for growth compared to actual levels. The relatively good performance of stock markets will be helped by the abundance of liquidity and the risks existing in real estate and the potential risks in fixed income. In addition, the hypothesis made here on inflation that it stays under control over the next two-three years leads to a not very attractive view of gold as an asset class over the medium-long term.

In reality, investors will remain prudent given the continuing uncertainty. They will continue to give preference to liquid and short term assets. They should continue their return to equities while taking appropriate precautions: (1) rather than invest in global stock market indices, remain selective, targeting sectors and companies in each sector, (2) benefit from the growth of emerging markets by staying partially invested in their financial markets, combining sectorial and geographic diversification.

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Sent to press on September 15th, 2009

THE ASSET MANAGER'S VIEWPOINT

For the last six months, large amounts of still uncommitted funds, renewed optimism over the economy, and extremely accommodating monetary and budgetary policies have enabled risky assets to appreciate.
In terms of the economy, we moved from a sudden plunge in activity, to slower erosion in activity, to the present as we witness the first shoots of modest growth. The level of global activity, however, remains weak and it will be many quarters before 2007's levels are reached again.

The good news is mainly as follows:
1/ To start with, the resilience of growth and a range of leading economic indicators.
With emerging market growth rates (China in particular) sustained at a high level, and positive growth figures coming from many other countries in the second quarter (France, Germany and Japan among them), it seems that the worst recession since the Thirties is now behind us and that we may have synchronous growth in all major economies in the third quarter of 2009. Indeed, given the severe stall in the second half of 2008 it is easy to understand why business should rebound, even rather strongly.
2/ Corporate earnings are promising, too
Companies have reported better-than-expected earnings above all because they have slashed their operating costs and capital expenditure very aggressively. They have drawn down their inventories to meet demand. The banks, meanwhile, have benefited from the positive financial market performance, high profit margins (since there is less competition), the large volumes of business on the primary markets (new issues) and the more flexible scope given them in valuing certain assets on their balance sheets.
3/ And the US real estate market.
After tumbling over 32% from the high reached in July 2006 on the Case-Shiller index, prices seem to have steadied, rising two months in a row and posting a recovery in transaction volume. But the situation remains shaky. Almost a third of home loans still show residual debt that exceeds the market value of the homes they finance. What's more, the supply of homes for sale is not reducing, and it is possible that the recent hike in prices is attracting additional sellers to the market.

Despite all this good news — which is indeed welcome — unresolved issues are impacting the strength and sustainability of this growth and the possible resurgence of inflation.
Robust and lasting growth cannot take place without the consumer participating. Inventory rebuilding can sustain production over the short term, but it would rapidly run out of steam if final demand does not kick in. It is still difficult to get a good fix on the potential rebound in demand. The problem is that household concerns (mainly in the United States, Canada, Britain and Australia) will largely be focused on debt reduction for the next few years. All the more so as they cannot count on strong growth in income (in the United States nominal annual wage growth has been negative for months, thanks to company cost control programmes) and the unemployment level will spur them to build their savings for a rainy day.
On the corporate side of the equation, the current rebound is being fuelled by the need to rebuild inventories and the impact of various plans to kick-start the economy (such as schemes to save the automobile industry or help first-time home buyers). Once this is over, it is not likely that companies will throw themselves enthusiastically into capital expenditure projects. But a recovery in productive investment, like that in household spending, is indispensable for any sustained recovery in growth.
Regarding inflation, it should be recalled that in the period from 2007 to 2008, world industrial production fell by 12.5% over one year or so. No return to the activity levels prevailing before the recession is conceivable for several quarters. This will keep up the pressure on employment levels, production capacity utilisation and pay. Inflation is therefore unlikely to be fed by wages in the near future, leaving central banks with large margins of manoeuvre when it comes to maintaining liquidity in their economies. Until the economic recovery is under way and they are redeployed, such funds can find their way into other financial asset classes and so trigger strong market movements.

What conclusions can we draw for the financial markets?
Over the long term — provided there is no inflation — equities are likely to outperform other asset classes, particularly government bonds and real estate. However, over the short and medium term, uncertainties and volatility will remain high as a number of factors will conflict and upset the markets. These are the principal elements:
1- Even if we consider inflation to be under control at present, given the low level of economic activity, it will remain a major concern for the financial markets thanks to the sheer scale of the funds that have been injected into the economies.
2- Fiscal and budgetary policies cannot be sustained at their current levels. The reduction in bank balance sheets and household debt in the English-speaking world will, at one moment or another, come into conflict with the determination of the authorities to make a gradual adjustment. Remember that we have not yet experienced an exit from a global debt crisis.
3- Every country would like to improve its external competitive edge at low cost by depreciating its currency.
4- Based on past data, leading indicators are predicting a 'V'-shaped crisis exit (which current financial market performance seems to confirm). But will the first semester of 2010 upset this forecast?

What conclusions can we draw for our portfolio management?
For the last few months we have seen financial markets operating closer to normal, with more discretion and respect for the particular fundamentals of each asset class. This strengthens our interest in alternative strategies based on a more fundamental approach, while maintaining a large proportion of highly reactive discretionary trading strategies.
For the next semester we will be targeting strategies such as Long/Short equity, Global Macro and Long/Short Fixed Income, as well as Systematic strategies (with a preference for the short and medium term ones). We are highly confident in the opportunities currently available on the markets, and in our ability to generate performance that is largely uncoupled from their directional dynamics.

We are available to answer any questions you may have, and we thank you for the trust you place in us.

Christophe Jaubert - Eric Debonnet - David Gilleron - Thierry de Rycke
HDF Finance – Sent to press on September 23rd, 2009

	PERFORMANCES AS OF SEPTEMBER 18, 2009 IN EURO	Target	Rating S&P	2009 YTD	5 YEARS	10 YEARS
MULTI STRATEGY	HDF Multi Alternatives Class A EUR	Absolute gain	AA	8.31%	18.96%	61.82%
	HDF Xiphias Investissement *	Absolute gain		10.58%	34.12%	124.66%
	HDF Capital Appreciation Class A	Absolute gain		7.84%	18.97%	67.85%
	MSCI World Index [a]			*24.07%*	*-1.13%*	*-23.36%*
MULTI STRATEGY LOW VOLATILITY	HDF Arbitrage Low Vol Class A	Absolute gain		4.41%	12.52%	42.12%
	HDF Global Arbitrage	Absolute gain		4.18%	12.11%	(1)
	HDF Fixed Income Alternative Class A EUR *	Absolute gain		7.28%	12.30%	51.84%
	EONIA Index			*0.67%*	*15.10%*	*35.91%*
TRADING	HDF Trading Class A *	Absolute gain		6.72%	34.23%	(1)
FIXED INCOME LONG-SHORT	HDF Optimix Class A *	Absolute gain		5.17%	3.60%	(1)
	Avg. of the Morningstar "International Bonds" category			*7.41%*	*9.22%*	*-*
LONG-SHORT EQUITY	HDF Global Opportunities Class A EUR	Absolute gain	AA	7.00%	21.25%	77.21%
	HDF Global Long/Short *	Absolute gain		7.89%	22.58%	(1)
	HDF Xiphias International Class A EUR *	Absolute gain		6.18%	22.05%	89.18%
	HDF Europe Long/Short *	Absolute gain		10.20%	25.14%	(1)
	HDF Eurovest Class A EUR *	Absolute gain	AA	11.88%	24.22%	(1)
	HDF Amerivest Class A EUR *	Absolute gain		1.52%	12.38%	(1)
	HDF Asiavest Class A EUR *	Absolute gain		1.68%	15.42%	(1)
	MSCI World Index [a]			*24.07%*	*-1.13%*	*-23.36%*
EQUITY	HDF Global Equity Class A EUR	Relative gain	AA	23.47%	27.53%	51.12%
	MSCI World Index [a]			*24.07%*	*-1.13%*	*-23.36%*
	HDF Europe Equity Class A	Relative gain		25.37%	35.67%	68.93%
	MSCI Europe Index [a]			*30.53%*	*15.18%*	*-0.44%*
	HDF Emerging Markets Equity Class A EUR	Relative gain		35.57%	71.77%	118.02%
	MSCI Emerging Mkt Free Index [b]			*59.03%*	*64.82%*	*60.98%*

* Estimated performance. Monthly NAV. [a] With dividends. [b] Without dividends. (1) Track record too short for the period.

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