

PATRIVALOR

SOCIEDAD GESTORA DE CARTERAS, SGC

Global economic framework

9 de Mayo de 2012

Inde

PATRIVALOR

SOCIEDAD GESTORA DE CARTERAS, SGC

Global Economic Framework

New Orthodoxy: dollar, interventionist & free generatrion of money.

Autonomy of Structural Costs (Energy & Labor)

Commercial Imbalances

Autarchy in Instrumental Costs (Financial & Fiscal)

Fiscal and Monetary Imbalances

Market Situation

Investment Strategy

New Orthodoxy

Since the Smithsonian Agreement and the abolition of the dollar-gold convertibility (1971-1973)

Dollar: means of local and international payment (one offer, two demands). End of fixed parity and free floating of exchange rates between currencies according to their purchasing power parity (relative depreciation due to inflation) and their current account balances.

Interventionism: Each state promotes **wellbeing** (redistribution of income), regulates the factors which influence **employment** (the cost, the types of interest and the financial assets) and maintain the commercial and financial transactions according to the **free market** (“administrative” floating by the BC).

Free creation of money: each BC is independent in its policy of control of inflation (free generation of money), of supervision of the balances of their banks and the adjustment of the national and international payment flows (in coordination with their public treasure).

The markets are adopting a new function: Vigilant and Deterrant

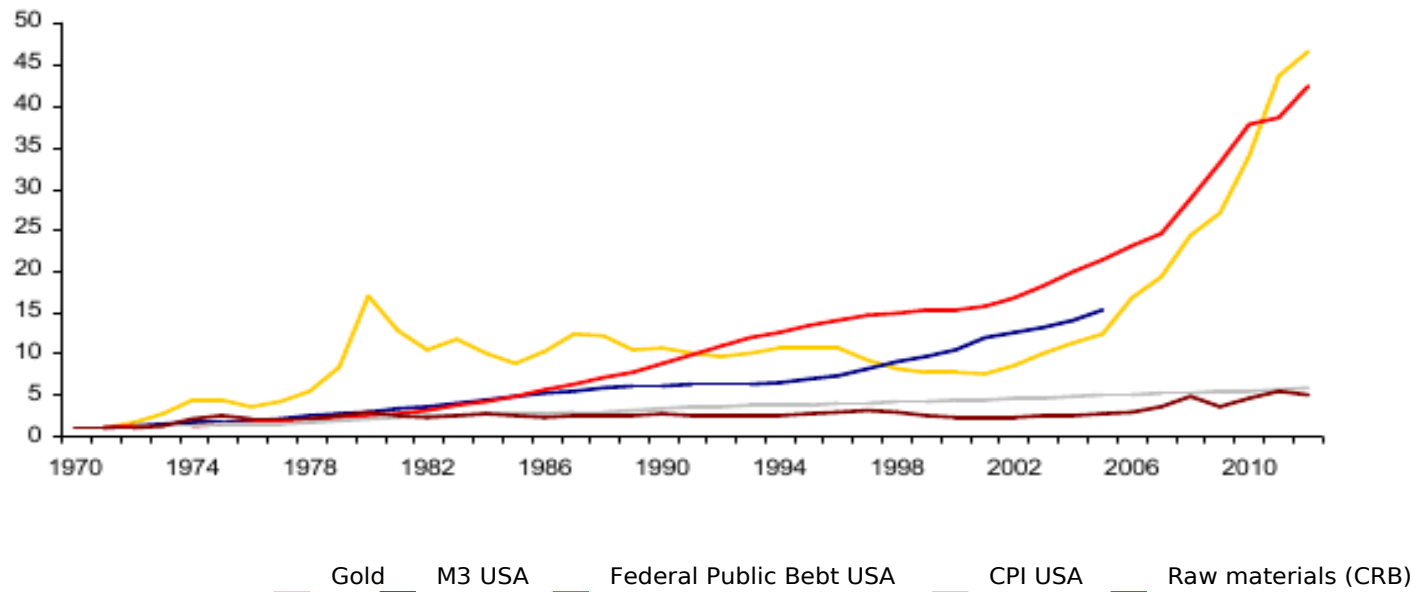
Given the deterioration of the means of payment and debt that lead to a market where everything is unstable, the large invaders collect huge speculative sums and act suddenly and coordinate to correct situations of imbalance.

In every episode of crisis, their intervention (reinforced by communiqués from supranational bodies, international banks, rating agencies and audits) serves to create a level of unbearable pressure on the respective public, which gives in and accepts the remedies with recourse to the financing of the IMF or the BC of the G-7 (now in addition to those of the G-20)

Free Monetary Generation

The price of gold reflects the deterioration of the means of payment...

Comparison Gold vs. Monetary erosion
USA USA (1970 =1)



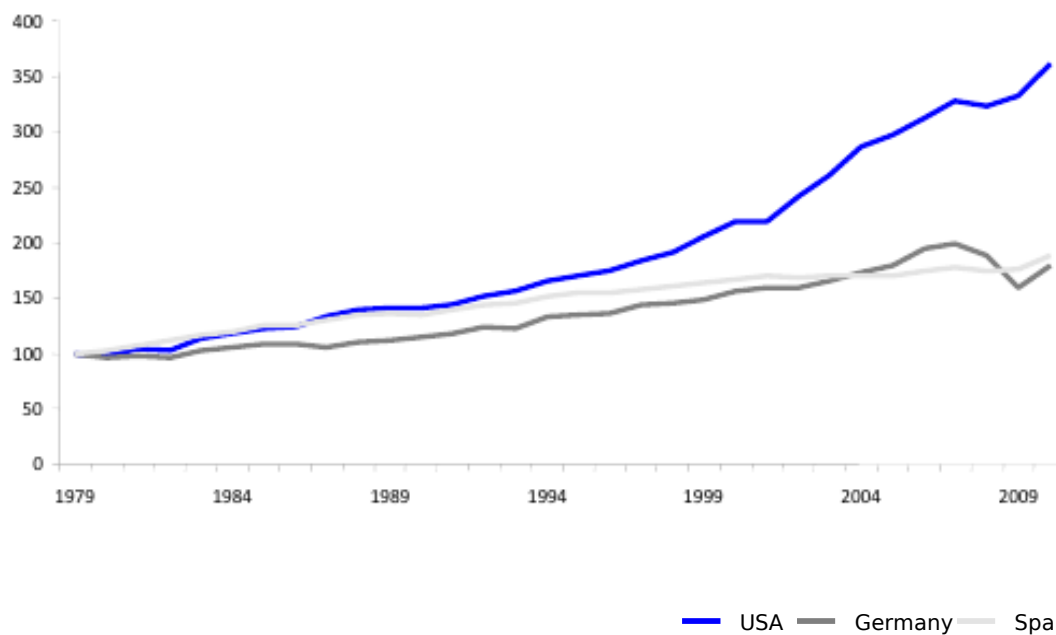
M3 ceases to be published by the Fed in March 2006 claiming that it was not a relevant measure

The M3 stops being published by the Fed in March 2006, claiming that it was no longer a relevant measure.
Source: Bloomberg, Patrivalor

Commercial Imbalances

... deterioration is evident if you compare it with the increase in productivity....

Production by employment 1979-2010



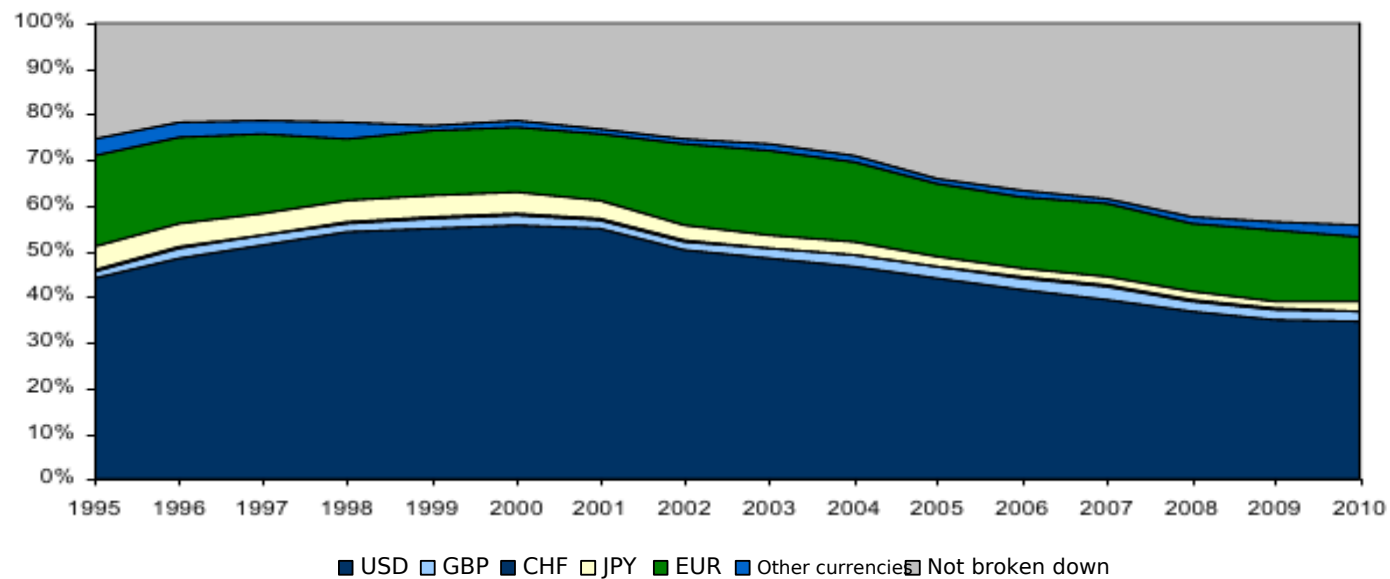
The USA has increased its productivity throughout the past 30 years at an annual rate of 4,2%, practically double of Spain (2%) or Germany (1,9%)

Source: US Bureau of Labor Statistics, Patrivalor

Free Monetary

... and that drags down the international demand for dollars.....

Mayor currencies World Reserves



Source: IMF COFER, Patrivalor

Global Economic Framework

Since the Smithsonian Agreement and de abolition of the dollar-gold convertibility (1971-1973)

Current problems in the system

Persistent US current deficit, and its counterparts: huge own public debt and, in other countries, huge current surplus that needs to be recycled.

Fragility of the Euro, affected by the perspectives of amplification of its members (“from Tenerife to Vladivostod, with 44 nations”), its lack of undated legitimacy; and the largest imbalances between Germany and the rest (different levels of productivity)

Degradation due to excessive growth of money and debt: the solution implies deflation (recapitalization and starting from an acceptable activity, without possible devaluations).

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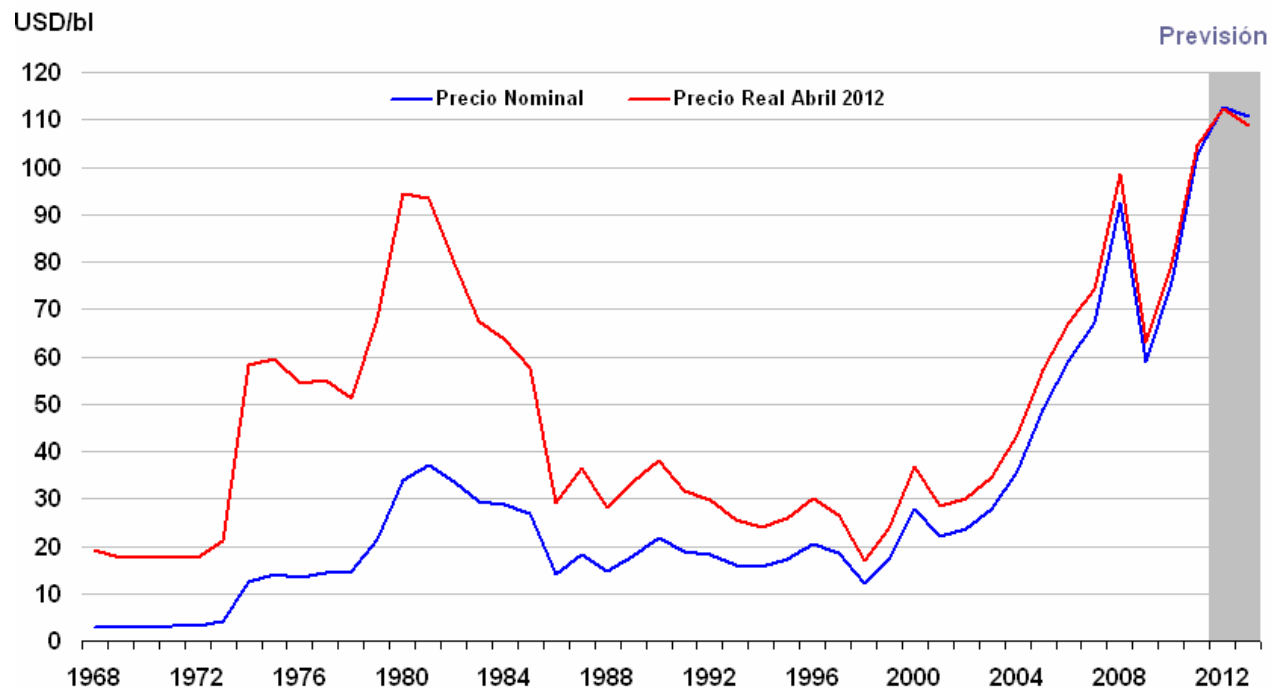
Structural Energy

- **In October 1973**, and under the pretext of the Arab-Israeli war, OPEC (countries that controlled 50% of world oil production and 90% of exports at the time) was formed to try to isolate Israel from its allies (through oil supply embargoes, reduction of oil production and increase in the price of crude oil). **Oil goes from \$ 2.47 per barrel (one ton has approximately 7 barrels) to \$ 11.65** in one year (371.6% more). It is currently around \$100.
- **Dependent economies have to reduce their energy consumption** from a certain price level, which induces a recession which, in turn, destroys the demand for oil until it allows prices to fall to bearable levels.
- **Current global energy consumption** is distributed between **oil (36%), coal (28%), natural gas (24%), nuclear (6%), hydroelectric (5%) and wind and solar renewable (1%)**; both oil, coal and natural gas are not renewable, so the mere annual production decreases the total available

Structural Energy Costs

The price of crude experiences nominal increase by the monetary erosion.

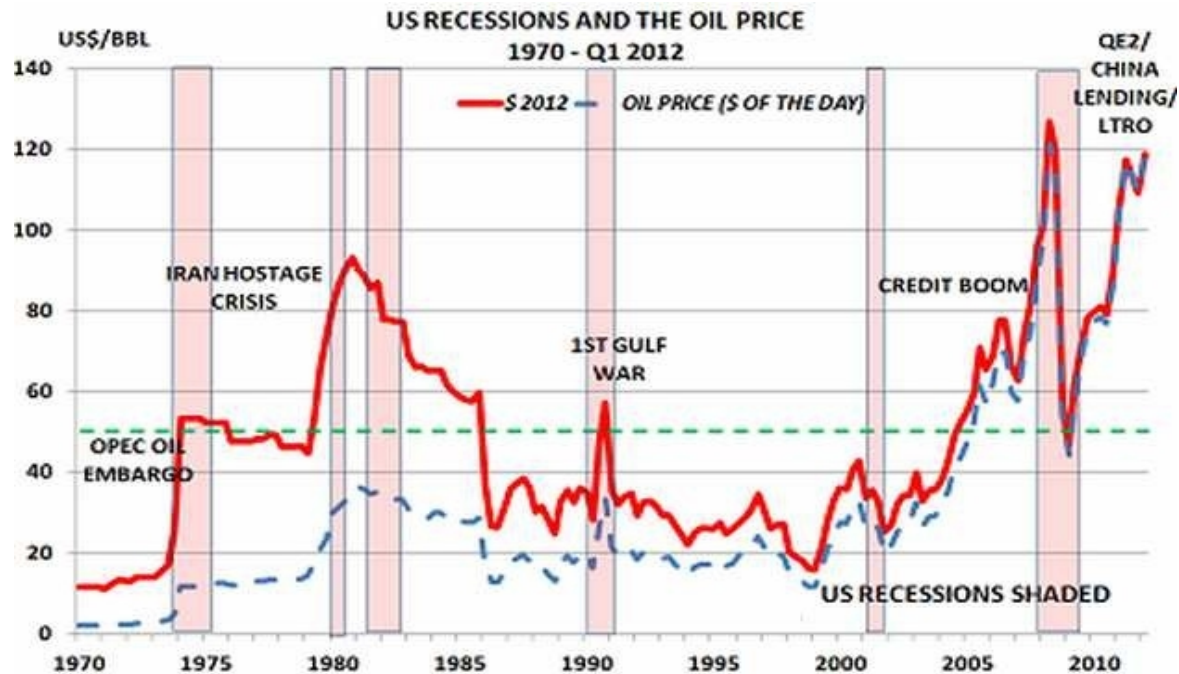
Annual Price of Imported Crude USA



Source: IEA, Patrivalor

Structural Energy

Starting from a determined price level, the deficit countries could enter into a recession.

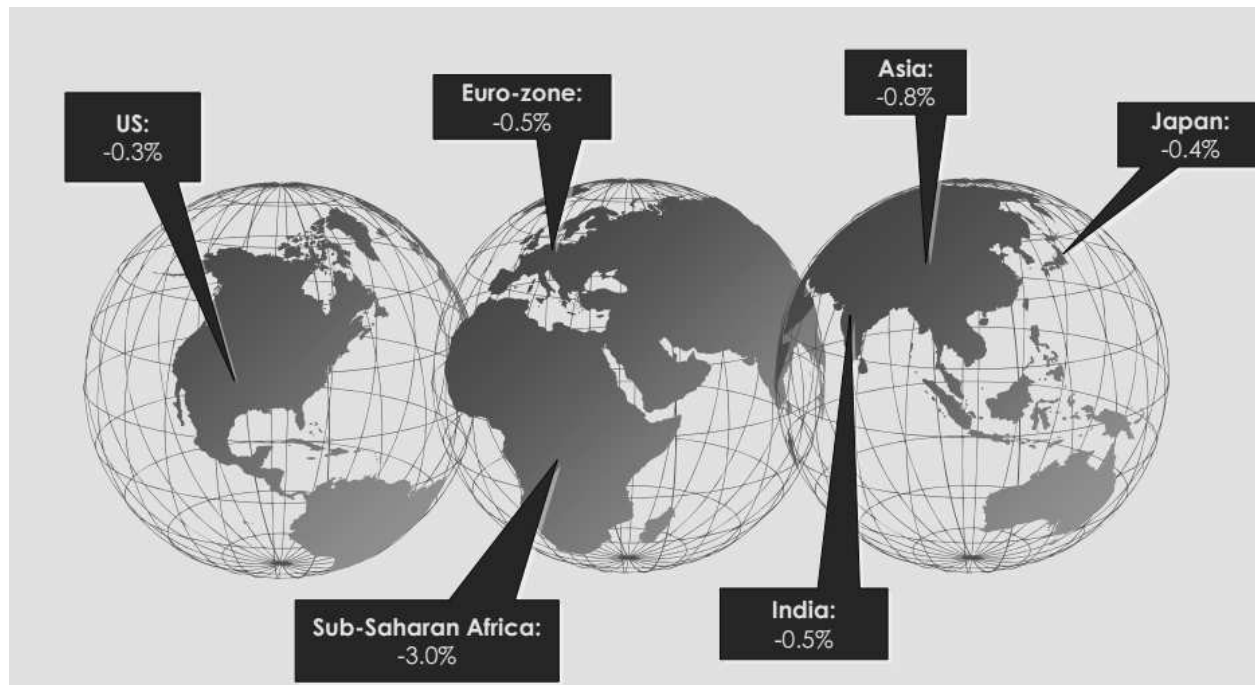


Source: Citigroup

Structural Energy

... due to the generalized impact on costs.

Impact in the GDP of increases of \$10 in the price of a barrel.

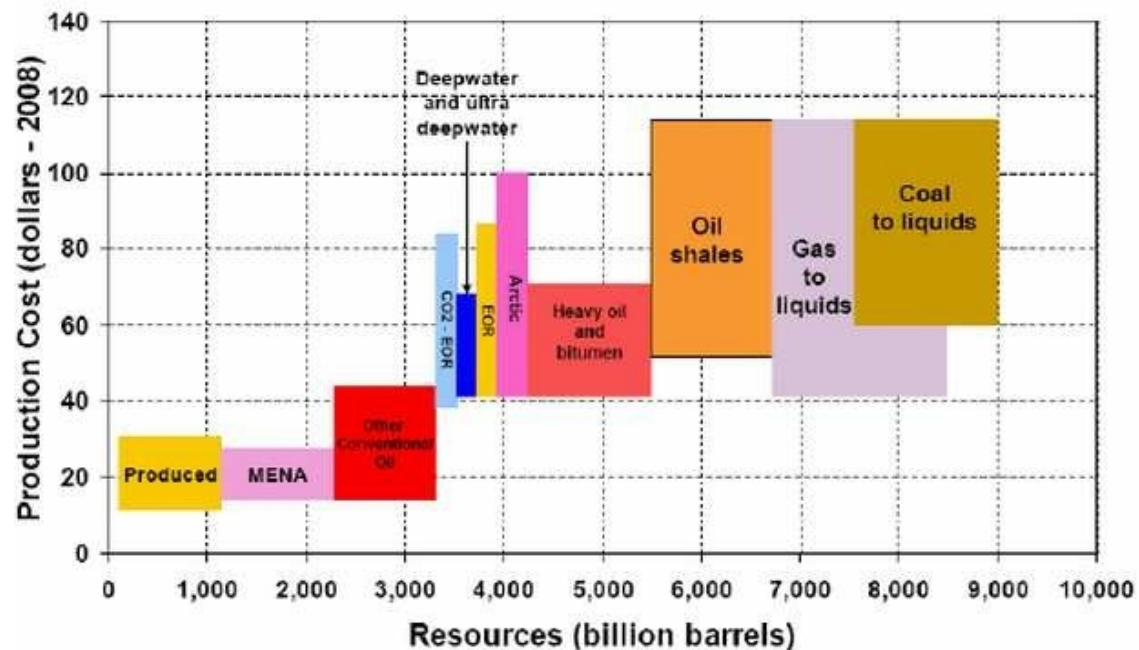


Source: IEA, Analysis of High Oil Prices on the Global Economy (2004)

Structural Energy Costs

And the difficulty of the reposition implies, in turn, future structural increases.

Cost of production by energetic resource



Source: Citigroup

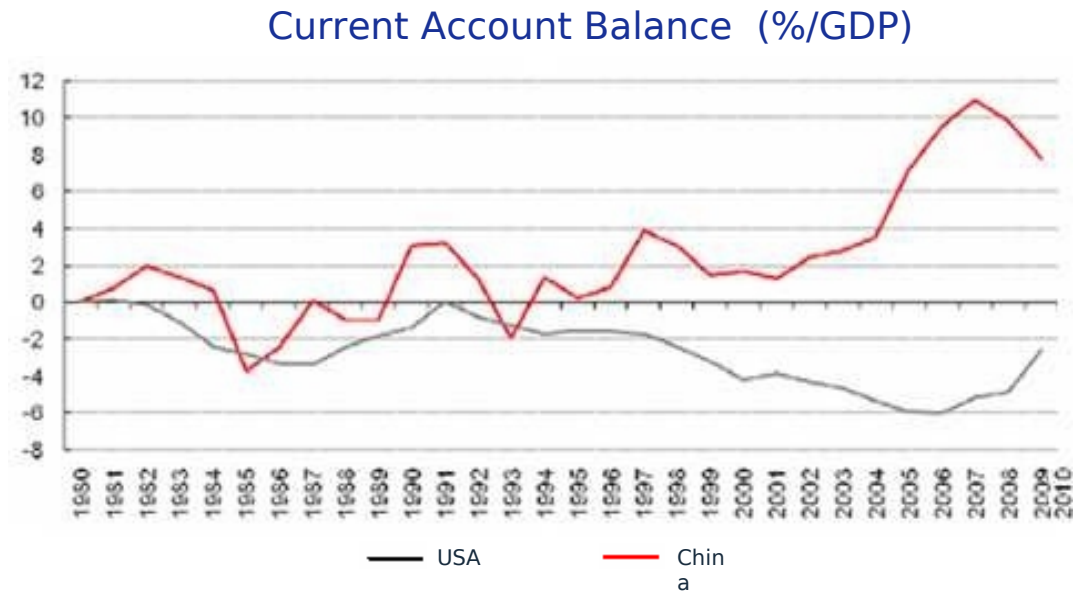
US-China: the political path of factory relocation, or the new era of multinationals

- 1972** Nixon visits China in "**the week that changed the world**": objective, **offset rising energy costs with low labor costs.**
- 1979** Carter recognizes that there is only one China (and that Taiwan forms a part of the same)
- 1989** Inflation, unemployment and corruption bring peaceful protesters to Tiananmen Square, crushed by tanks (5 months before the fall of the Berlin wall).
- 2000** Clinton and Bush II help with the **incorporation of China to the WTO.**
- Now** Bergsten and others propose the **G-2**, as both nations are:
- The two largest economies, with the highest international trade and the highest environmental pollution
 - Complementary in their balance of payments

Structural Labor

- Leaders of each group of nations (developed and emerging)

China accesses the US markets....

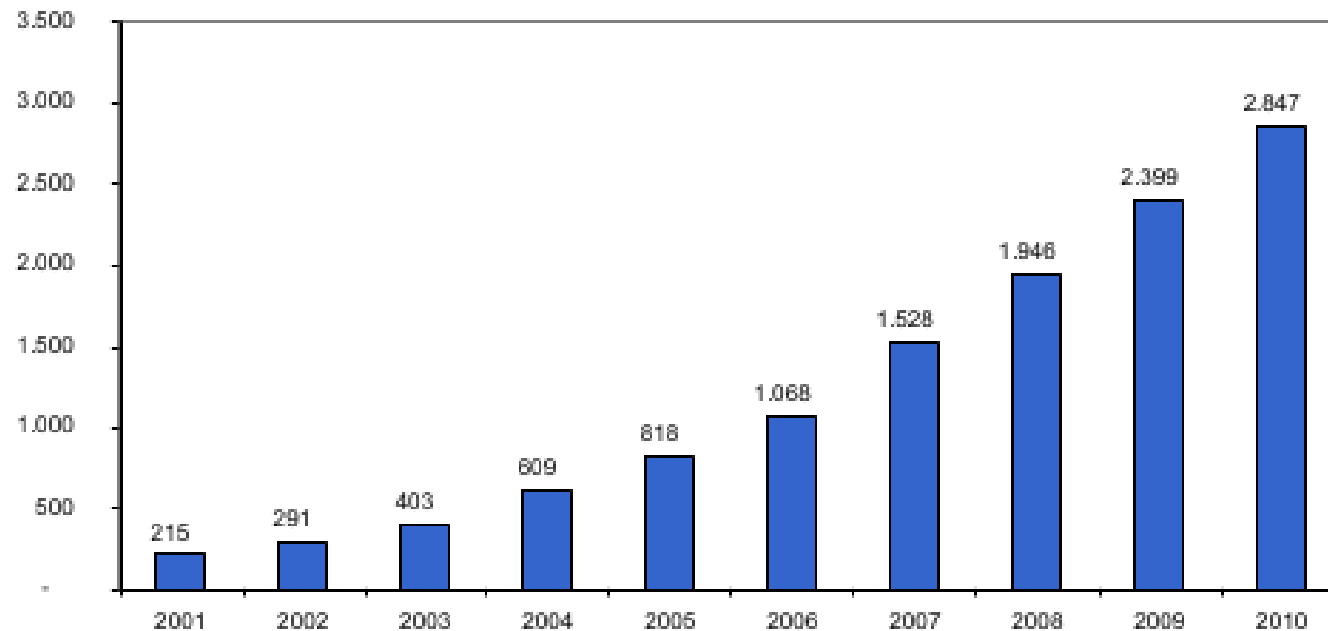


Source: IMF, Pativalor

Structural Labor

... and, in return, should finance the deficit of the USA.

US debt accumulated by China (USDbn)



Fuente: US Department of Treasury, Patrivalor

US-China relations are the most visible part of "globalization", epoch in which the dual national economy prevails:

A.- International party, in structural crisis due to progressive relocation of production centers (trade deficit increases, reserves and currency parity fall, unemployment increases - aggravated by the disorientation of unions and governments-)

B.- Autarchic or territorial part (public sectors, infrastructures, real estate ..., **currency consumers** –for energy and technology-) **reactivated to offset the effects** of the international decline, but **in structural crisis** when it depletes foreign exchange and debt renewals.

Transfer of activity, employment and income of the developed countries to emerging countries

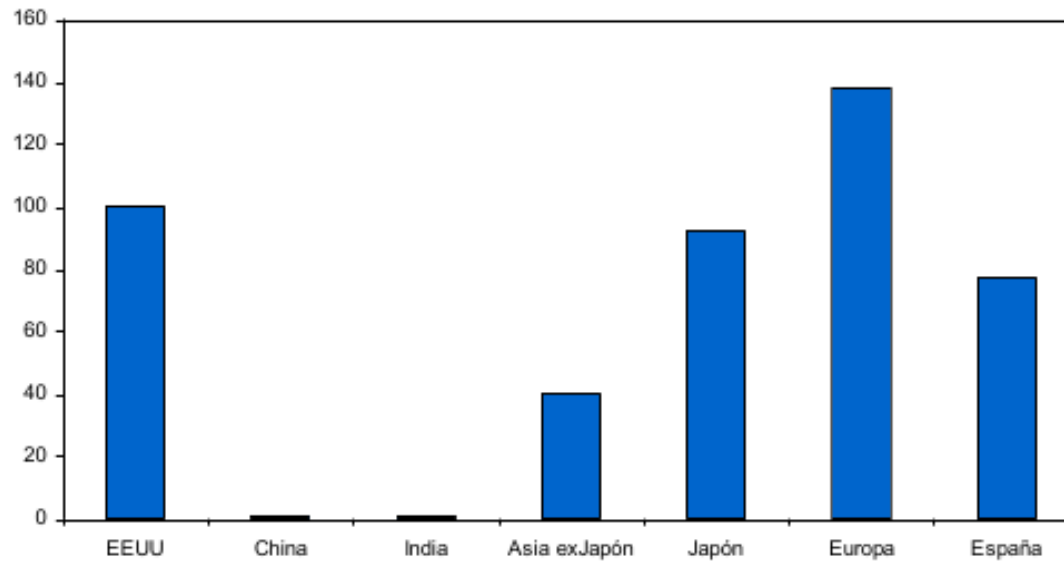
Like this the emerging countries are a strong competitor in the

Estructural Labor activities of low productivity.

Comparison of Labor Costs

Compensation for Hour Worked (2010)

USD34.7
=100

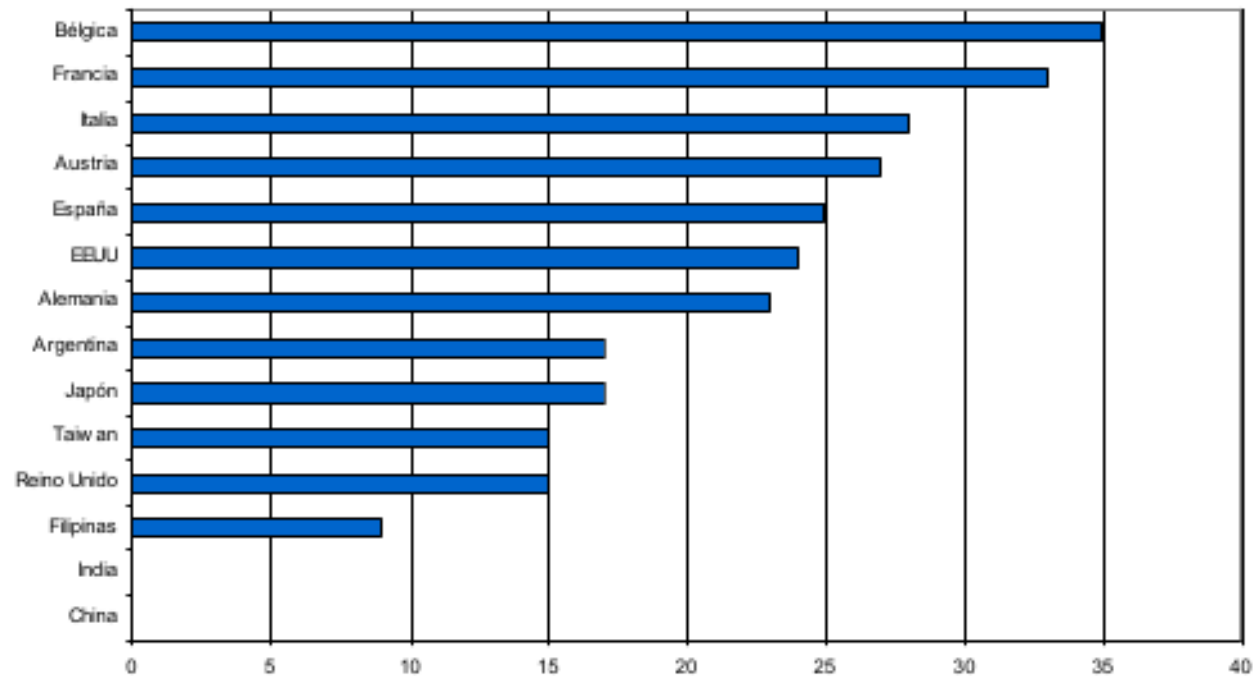


Source: US Bureau of Labor Statistics, Pativalor

Structural Labor Costs

... and more the don't compete in the same conditions ("*dumping social*")

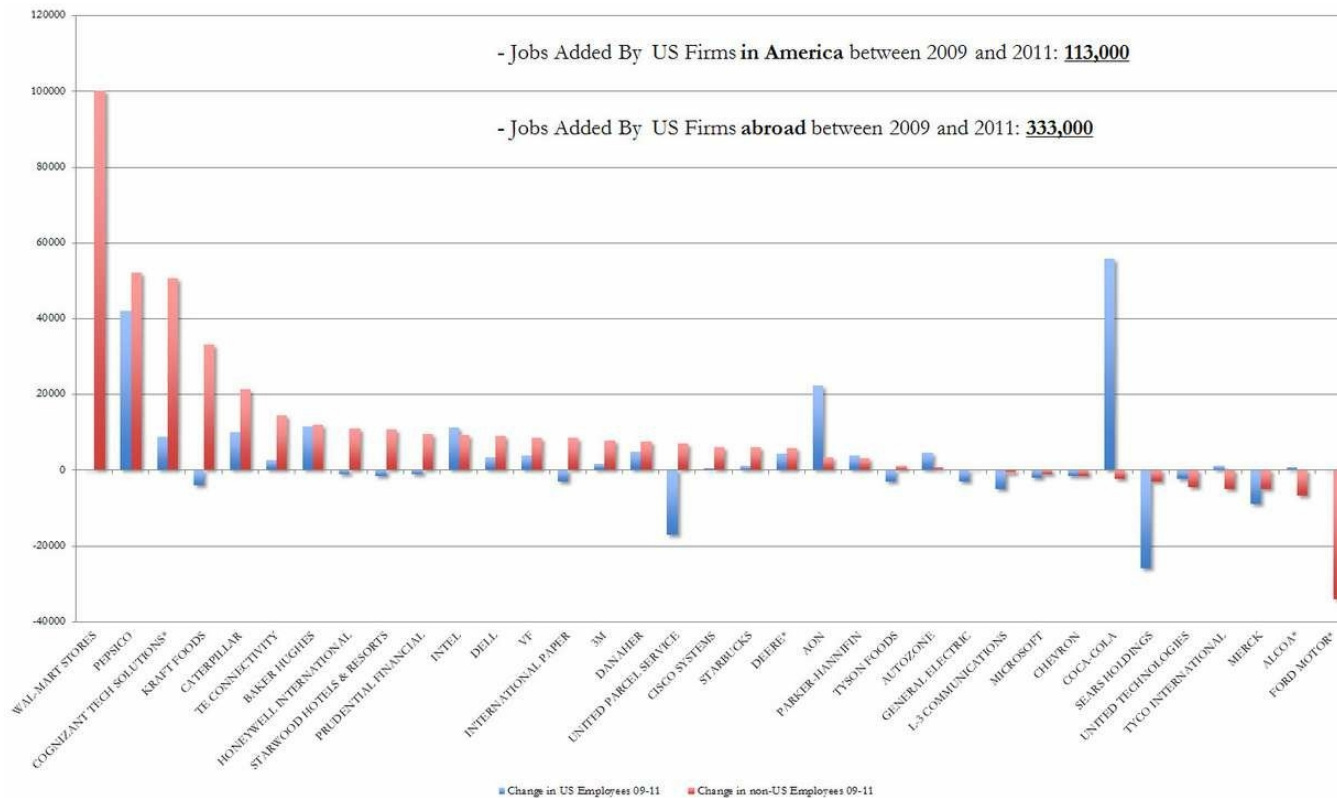
Social Benefits a percentage of Labor Cost



Source: US Bureau of Labor Statistics, Patrivalor

Structural Labor

This disloyal “comparative advantage” permits them to absorb work positions...



Source: Wall Street Journal

Structural Labor

... so, until 2030, only the middle class will grow in the emerging countries



Social: European Union Institute for Security Studies Global Trends 2030, Kharas & Gertz (2010: 5)

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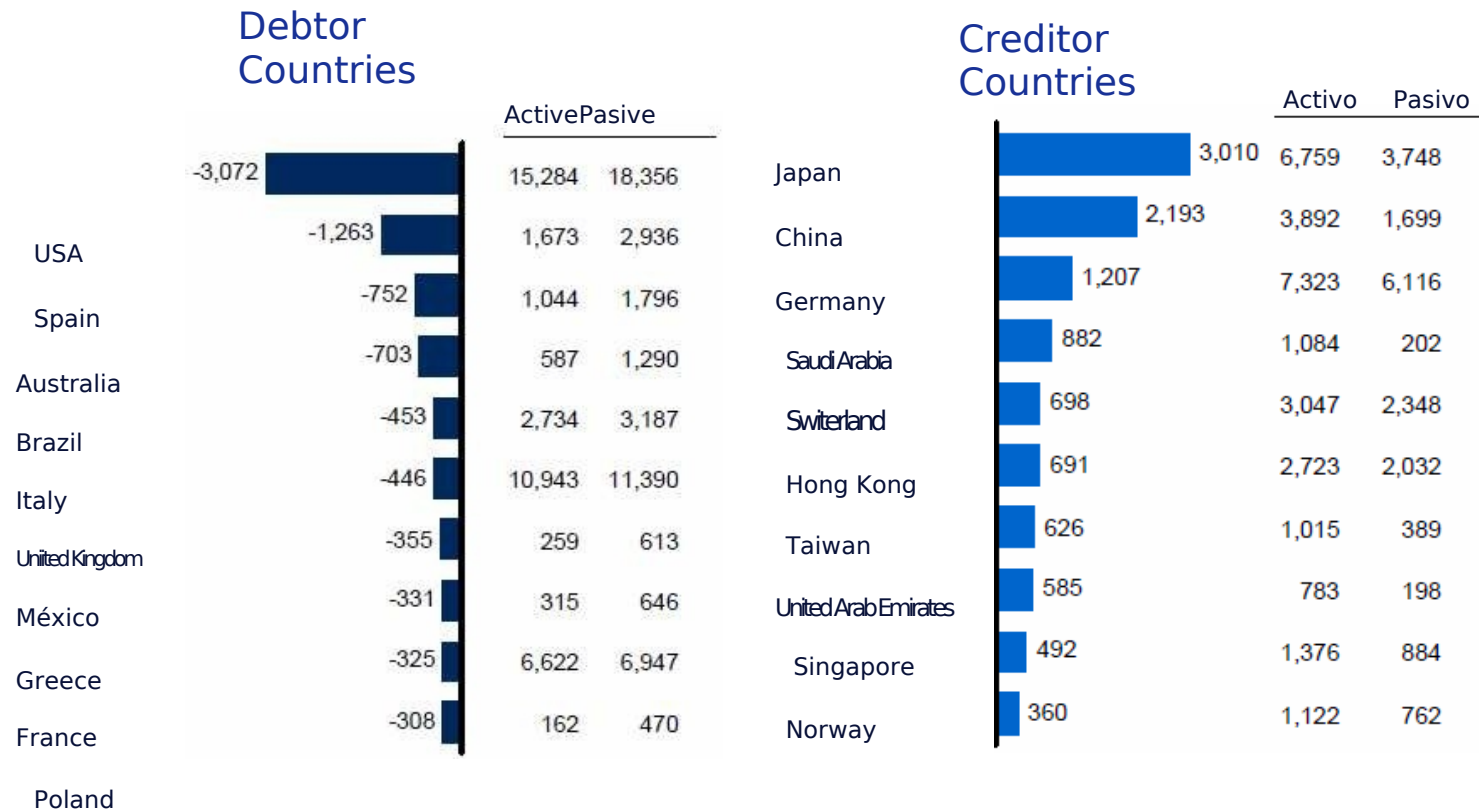
Fiscal and Monetary Imbalances

Market Situation

Investment Strategy

Commercial

Comercial imbalances



Source: IMF, Pativalor
Foreign Investment minus Foreign Debt

Summary of current account balance imbalances:

Surplus countries:

oil exporters (Middle East)

technology exporters (Japan, Germany and Switzerland)

cheap labor exporters (China and Asia)

Deficit countries:

The United States (with international currency status, delays its inevitable local adjustment) and most of the developed nations that or they don't have oil,

or they are not competitive in manual labor

or they are not competitive in technology

and that they can't delay your local business adjustments

Gradual routes to equilibrate the deficit balances.

Accounting, through **income in the capital balance** (difficult due to the amount of accumulated balances and the expectations of zero growth and return)

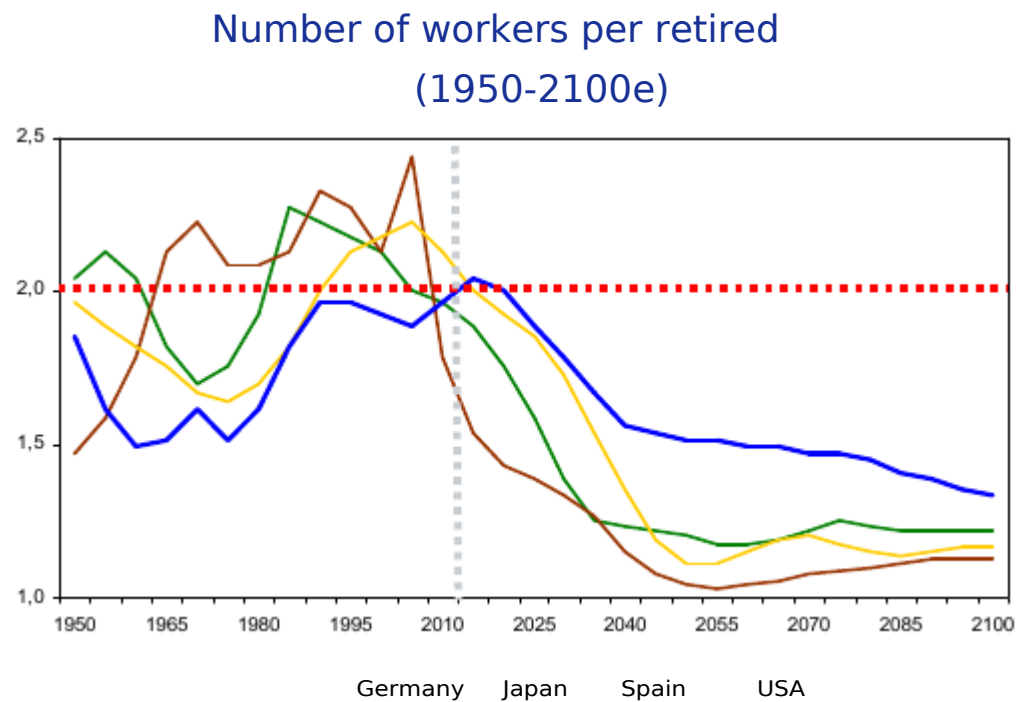
Exchange rate, through **devaluation of deficit currencies** until a competitive exchange rate is set (difficult due to the resistance of surpluses and the United States)

Commercial, by **setting tariffs** that take into account social dumping and the different levels of sectoral productivity (a more reasonable solution, but rejected by the surpluses and the United States)

Executive route to equilibrate the deficit balances

Drastic adjustment of the standard of living of deficit countries (deflation, unemployment) through **episodes of acute crisis** that make it seem inevitable and acceptable to public opinion.

In these conditions, the state of wellbeing is becoming unviable.



Inverted dependency ratio: population of working age divided by population over 65

Source: Department of Economic and Social Affairs of the United Nations, Patrivalor

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Instrumental Costs

- Historically, **banking and state are instrumental sectors to real activity**, given the consideration of financial cost (interest and commissions) and **fiscal cost** (taxes) that they have in the annual results of companies
- The banking system has a **guarantee coefficient** or "**percentage of own resources that must be maintained to guarantee the success of the deposits and foreign resources received**", in addition to other coefficients whose mission is to ensure that financing flows and that there is a good diversification of the uses of the total funds. **The moral hazard prevails: no bank is "too big to fail"** and if any bankruptcy is liquidated with the deposits covered by the guarantee fund.
- **The Basilea I agreement of 1988 completely changed the guarantee coefficient, determining that "each asset must be weighted by its respective risk and the sum of these weighted risks is the required equity"**. This way of measuring collateral assumes that banks must use "**consumption of own resources**" in the most profitable way possible; the bank is "**freed from its instrumental task**" and becomes yet another company that only seeks to maximize its profit (and salaries and bonuses related to it).

Instrumental Costs

1988 – Basilea I: Own resources on assets held by a risk according to the category of the counterparty (0%, 10%, 20%, 50%, 100%) with a minimum of 8%.

2004 – Basilea II: Development of the criteria of credit quality in the holding of assets (through ratings and or internal models of the own entity).

2010 – Basilea III: Increase the minimum (tier 1 is 6%, adding a 2,5% of anticyclical provisions and up to another 2,5% discretionary) and puts special emphasis on the liquidity coefficient, but maintaining the credit quality ranking.

Covered by regulations, total assets can grow up to 50 times their own resources if assets are chosen: the banking sector transfers the high-weighting risks from its balance sheet to its clients (securitization, investment funds, subprime, others) so that it can consume its own resources in the most profitable way.

The ratios of capital consumption privilege the autarchical territorial sectors (public and private with real guarantee) and underestimate the concentration of risks contracted: hyper-financed sectors reach saturation and bankruptcy.

The bank balances, poorly diversified and managed, stopped receiving the impact of the unpaid of the sectors in crisis.

Credit is directed towards the privileged territorial sectors...

Instrumental Costs

	Basilea I	Basilea II estándar simplificado	Basilea II basado en ratings	Otr
Gobiernos / Bancos Centrales	0%	0%		
De AAA a AA-			0%	
De A+ a A-			20%	
De BBB+ a BBB-			50%	
De BB+ a B-			100%	
Menor a B-			150%	
Otros sector público	0-50%	0%		
Entidades de crédito	20%	20%	<90 días	
De AAA a AA-			20%	20'
De A+ a A-			20%	50'
De BBB+ a BBB-			20%	50'
De BB+ a B-			50%	50'
Menor a B-			150%	150'
Mercado Hipotecario	50%	35%	35%	
Retail	100%	75%	75%	
Corporativo & RE comercial	100%	100%		
De AAA a AA-			20%	
De A+ a A-			50%	

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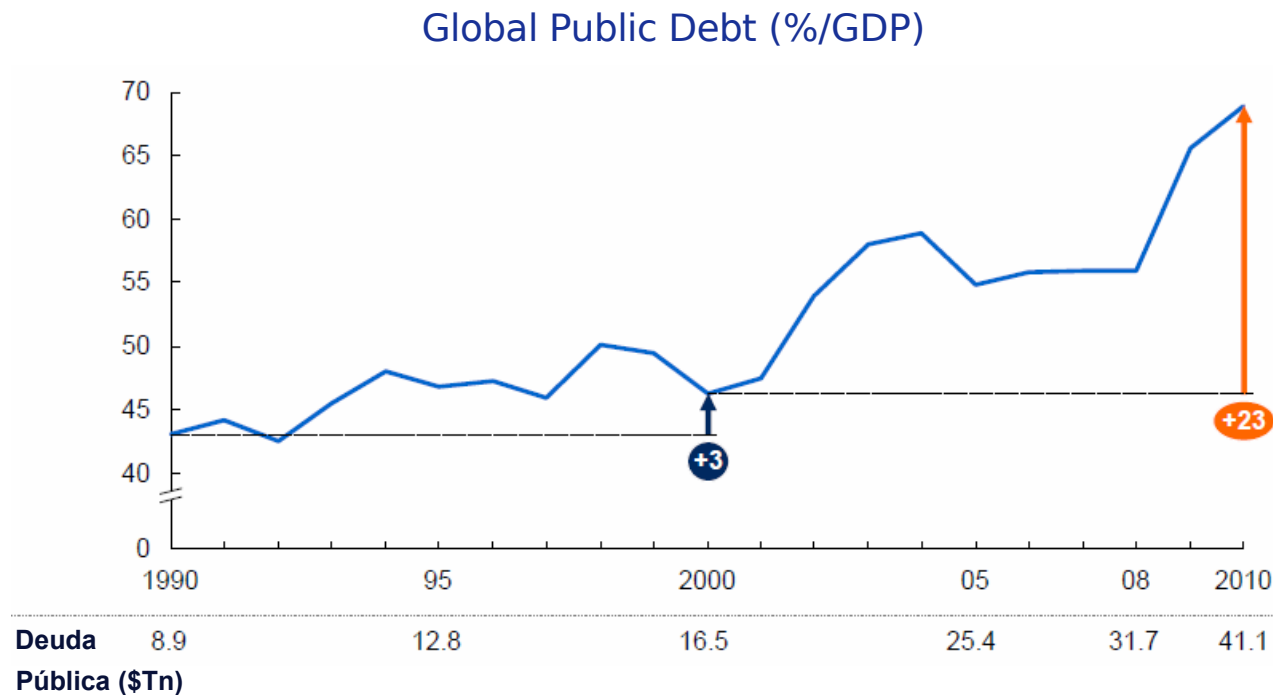
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The commercial and pre-budgetary imbalances bring inmeasured public doubt

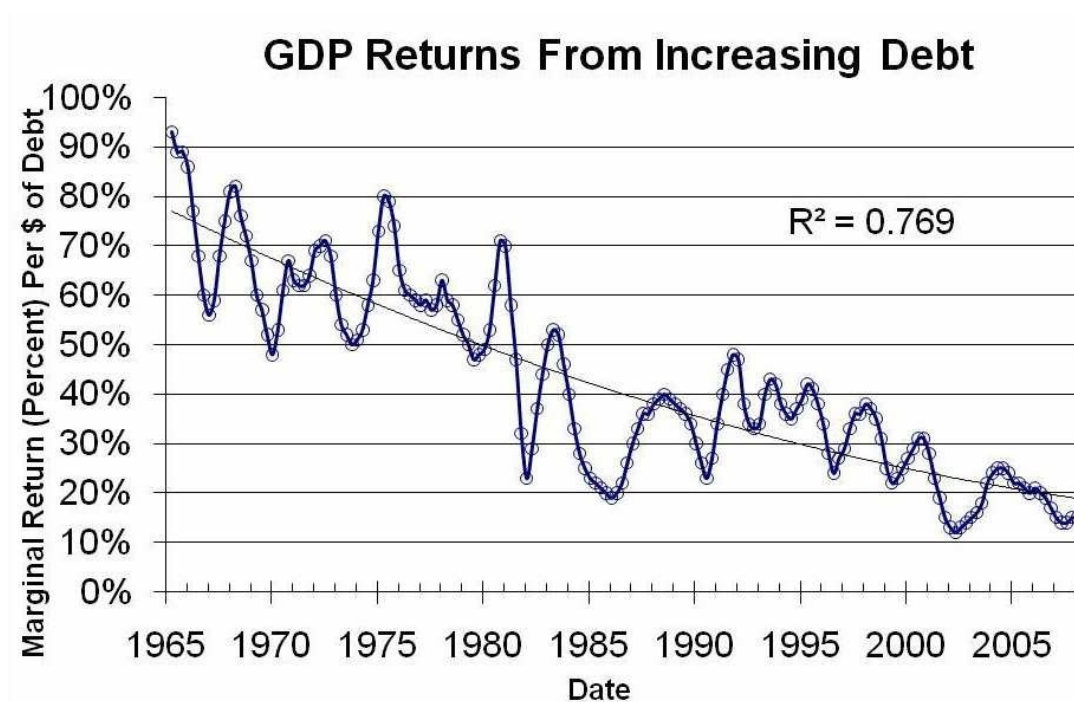


Source: BIS, McKinsey Global Institute

Fiscal and Monetary Imbalances

... a debt which loses marginal utility progressively with its increase

Marginal Growth of GDP by Additional Unit of Debt

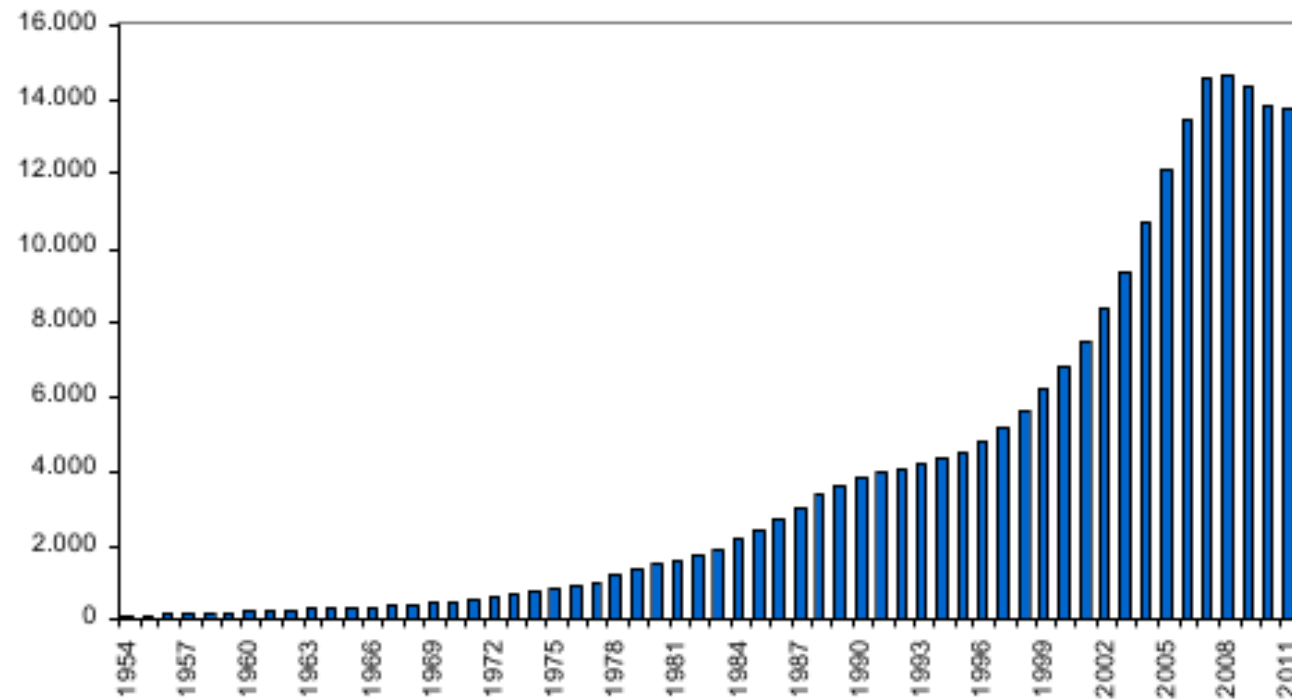


Source: Intermountain Institute for Science & Applied Mathematics, Professor Antal Fekete

Fiscal And Monetary Imbalances

There are also sectoral financing imbalances (mainly real estate activity)

Evolution of Mortgage Credit USA (USDbn)

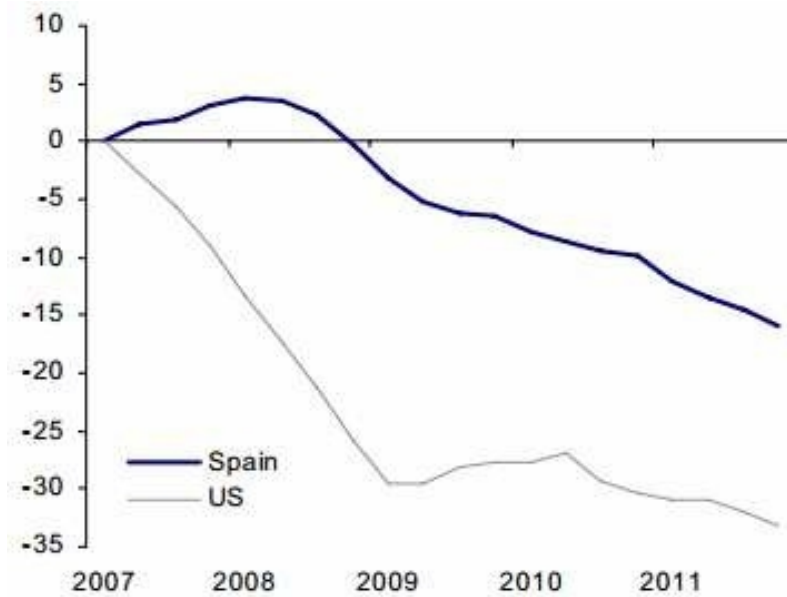


Source: US Government GPO, Patrivalor

Fiscal and Monetary Imbalances

...whose resolution will take time (somo more than others)

Real estate prices Spain vs USA since 1Q 2007

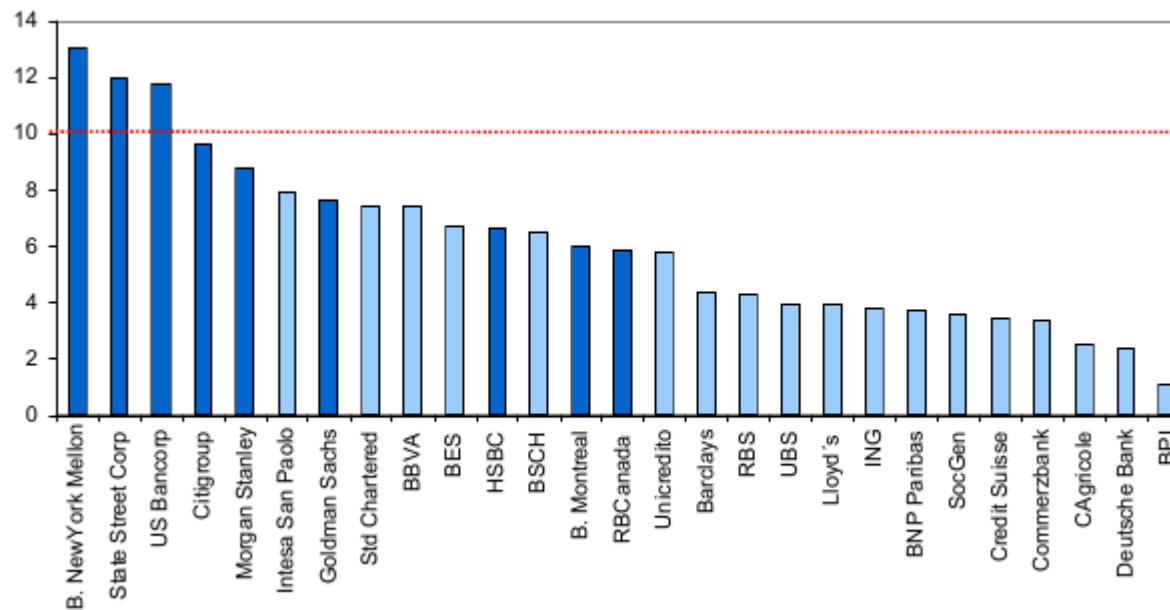


Source: Haver Analytics

Fiscal And Monetary Imbalances

All of this affects the bank balances, in general crisis and recapitalization necessities.

Capital ratio

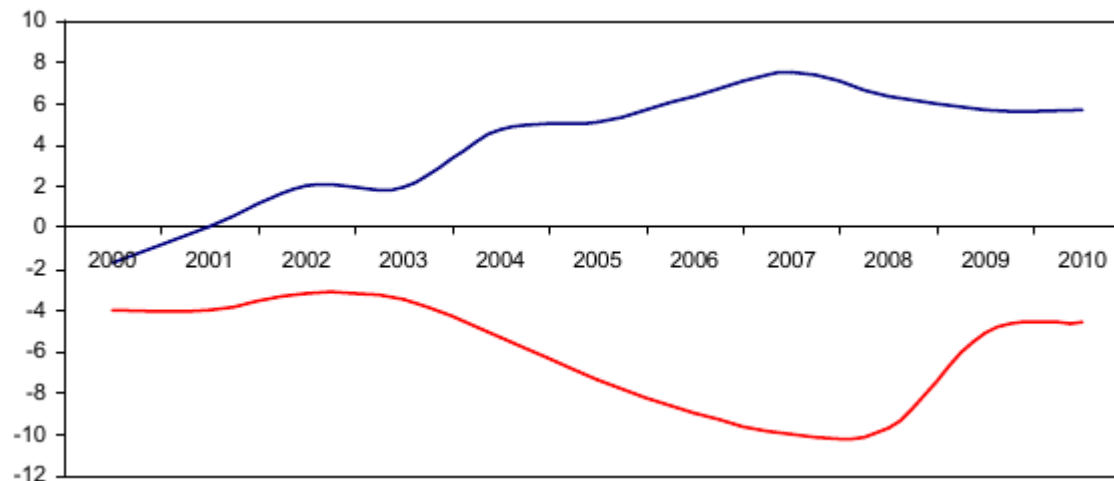


Capital ratio calculated as ex-minority PR and hybrid instruments over total AR
Source: Compañías, Patrivalor

Fiscal And Monetary Imbalances

At the macro level, Germany (similarly to China with the US) will have to finance Spain and the other European countries affected by its policy ...

Current Account Balance (%/GDP)



Fiscal And Monetary Imbalances

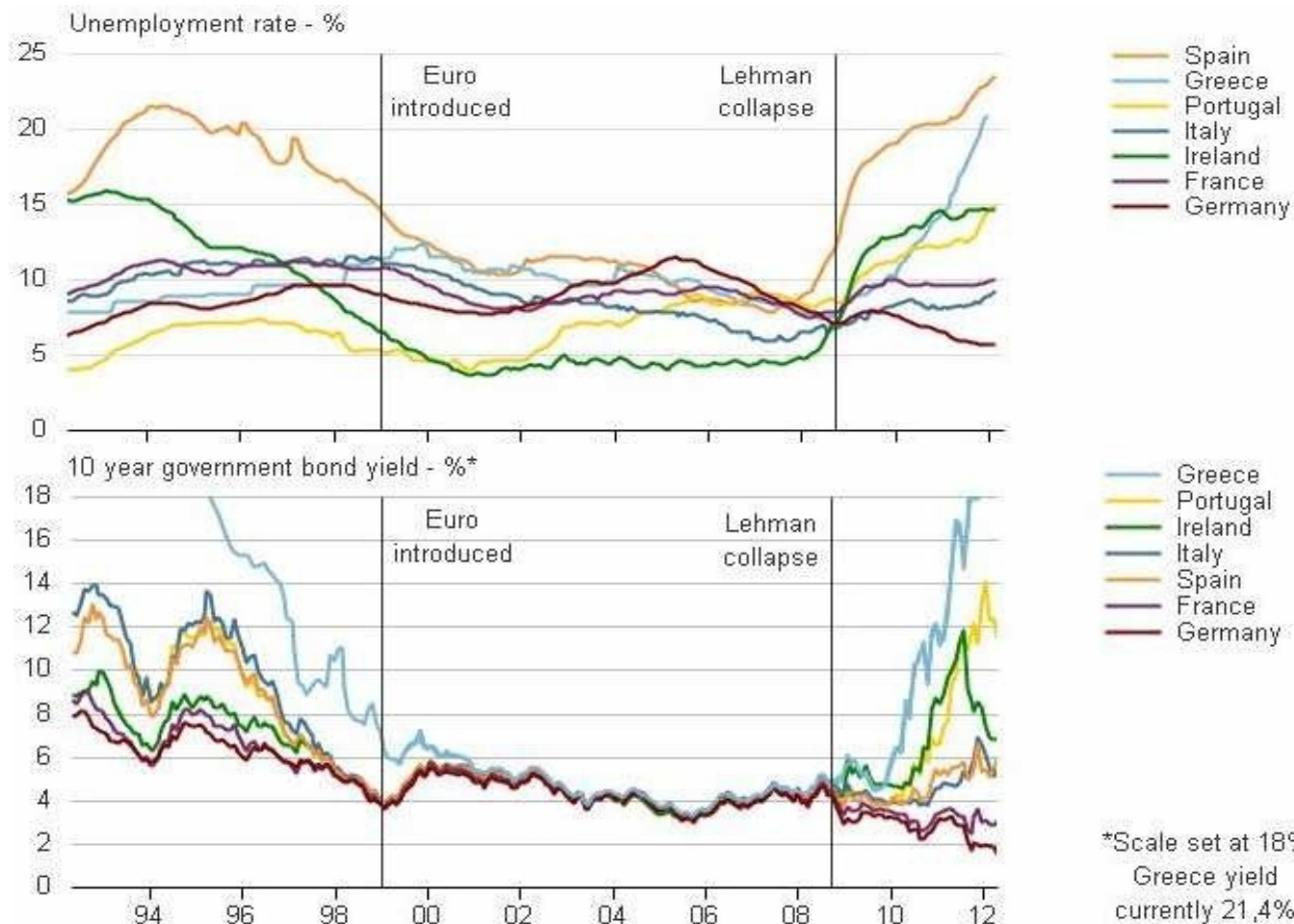
— Germany — Spain

Source: IMF, Pativalor

Fiscal and Monetary Imbalances

... because all of the European model has begun to be questioned....

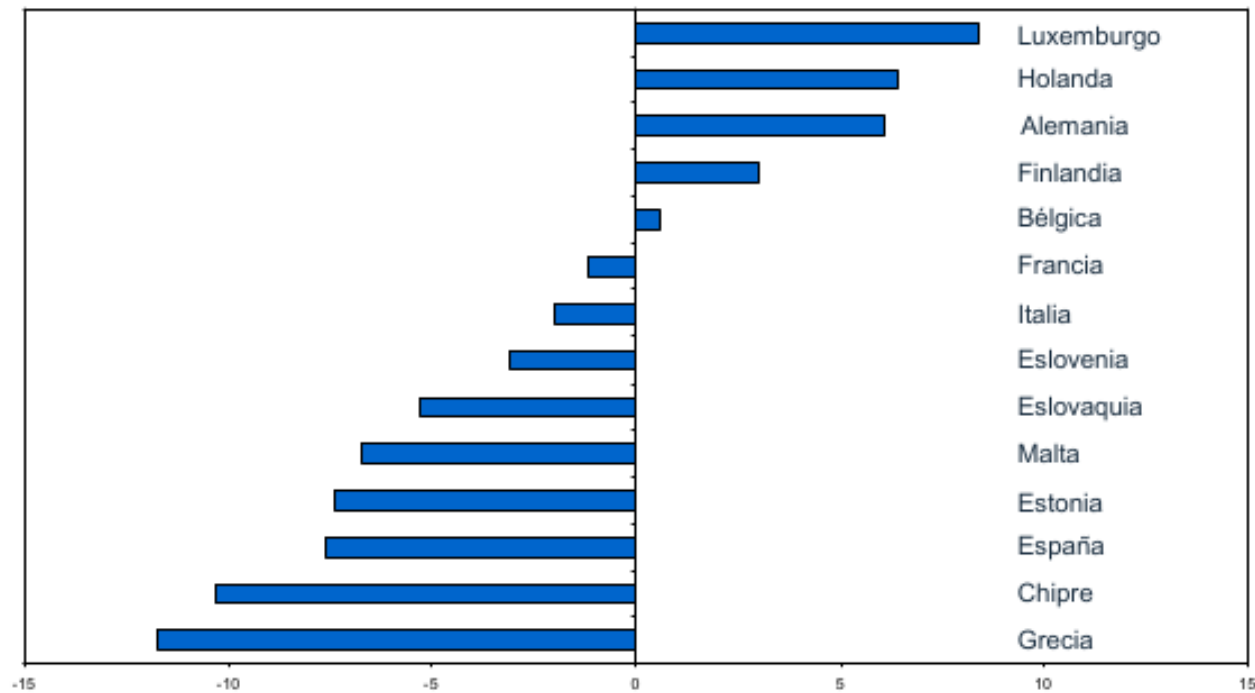
Unemployment rate and public debt yields 10 years



Fiscal And Monetary Imbalances

... to not permit the necessary internal devaluations...

Change in the Current Account Balance 2005-2010 (%of GDP)

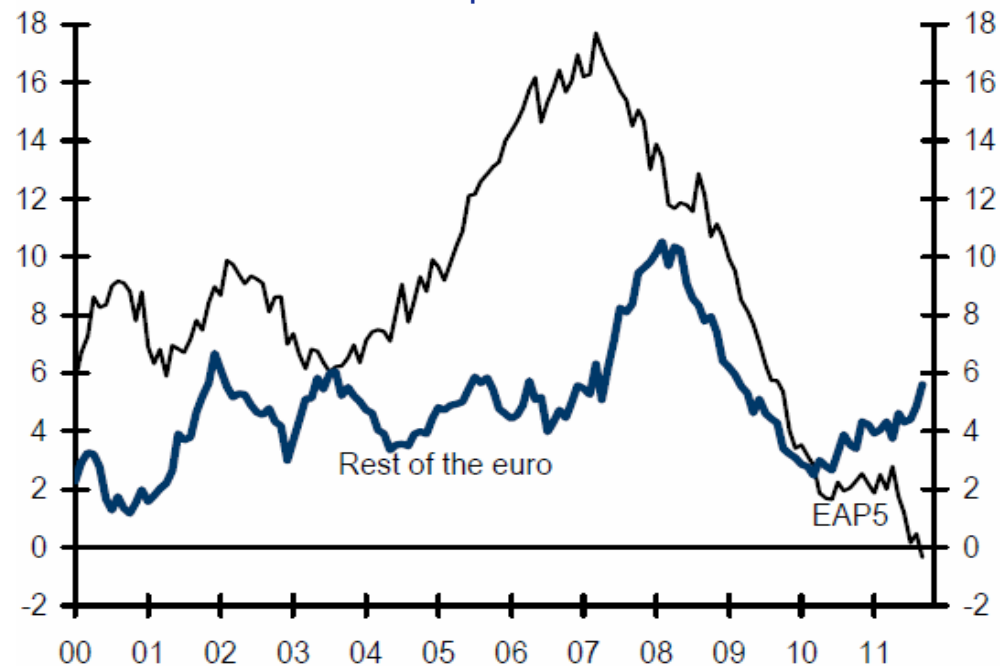


Source: Eurostat, IFO Institute, Patrivalor

Fiscal And Monetary Imbalances

Proof of the crisis, money moves from the periphery to the nucleus (I)

Growth of the familiar and corportative deposits in EAP5 vs the rest of Europe



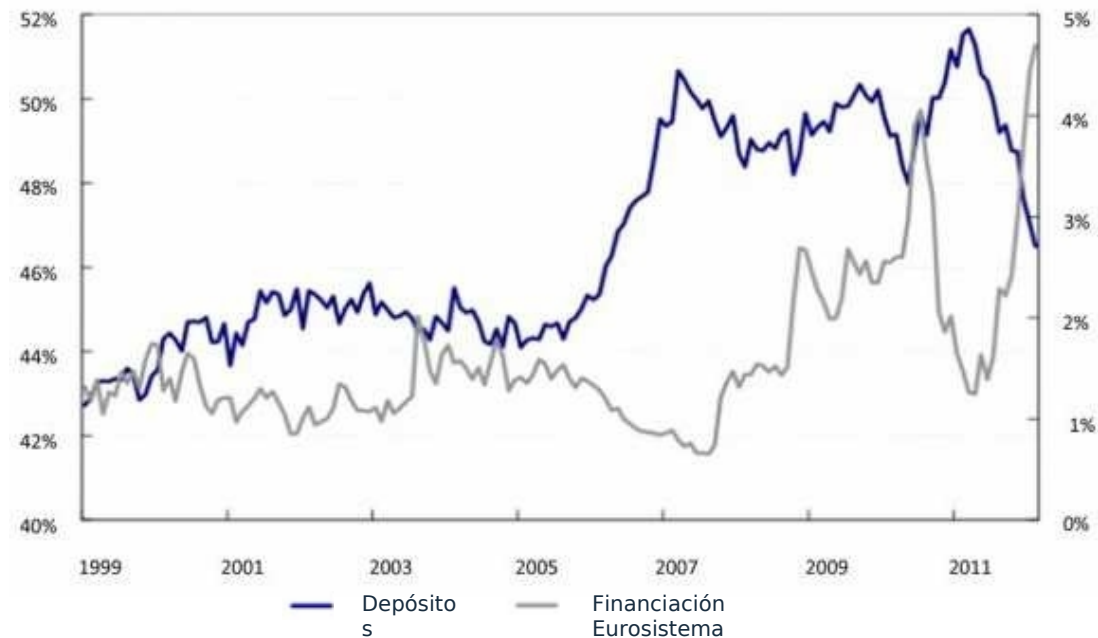
EAP 5: Italy, Spain, Ireland, Portugal, Greece

Source: ECB y Credit Suisse

Fiscal and Monetary Imbalances

Proof of the crisis, money moves from the periphery to the nucleus (II)

Growth of deposits vs Euro system Financing in Spain



Source: Banco de España, ECB (Open Market Operations), Patrivalor

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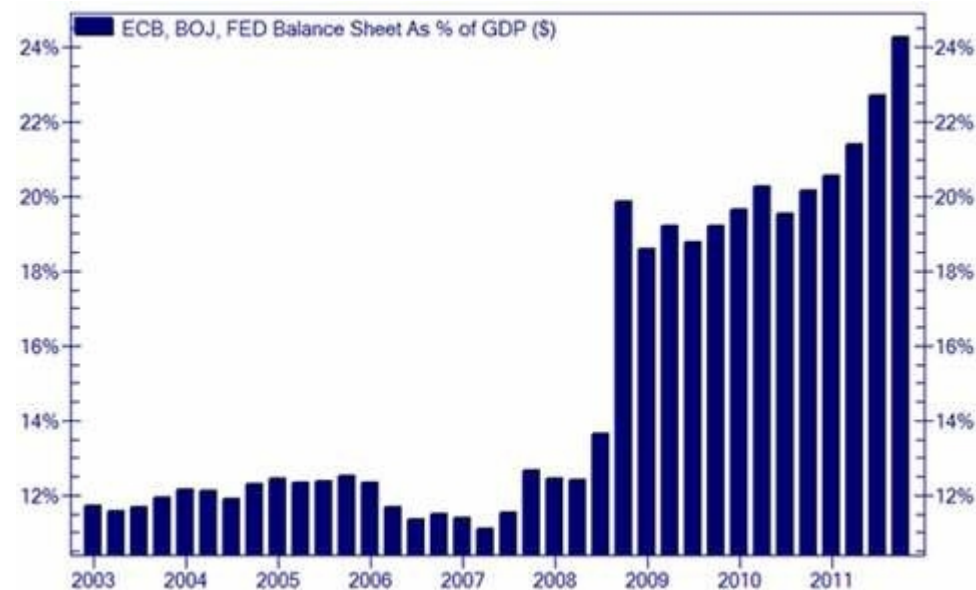
Market Situation

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Market Situation

The **general situation is sustained thanks to the coordinated intervention of the BC** that has accelerated since 2008 due to the systemic banking situation (the new rise in gold coincides with this phase)

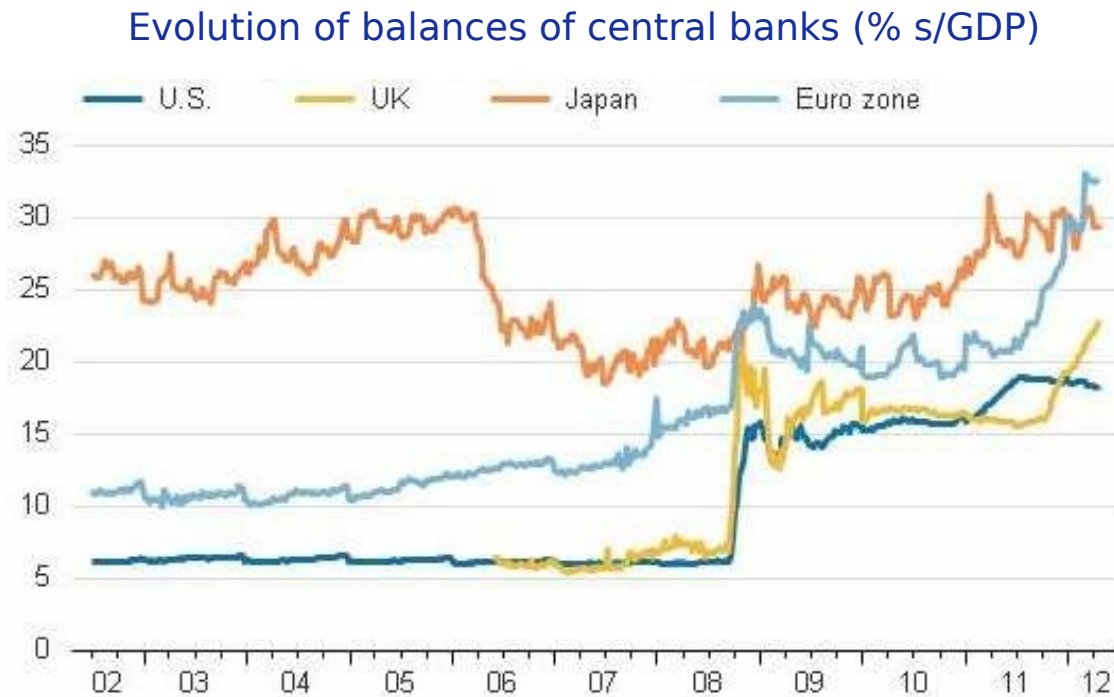
BCE, Fed, and BoJ Balance Sheet (%/GDP)



Source: Bloomberg y BoJ

Market Situation

In increase relative to balance, BCE has been more aggressive than Fed, BoE y BoJ...

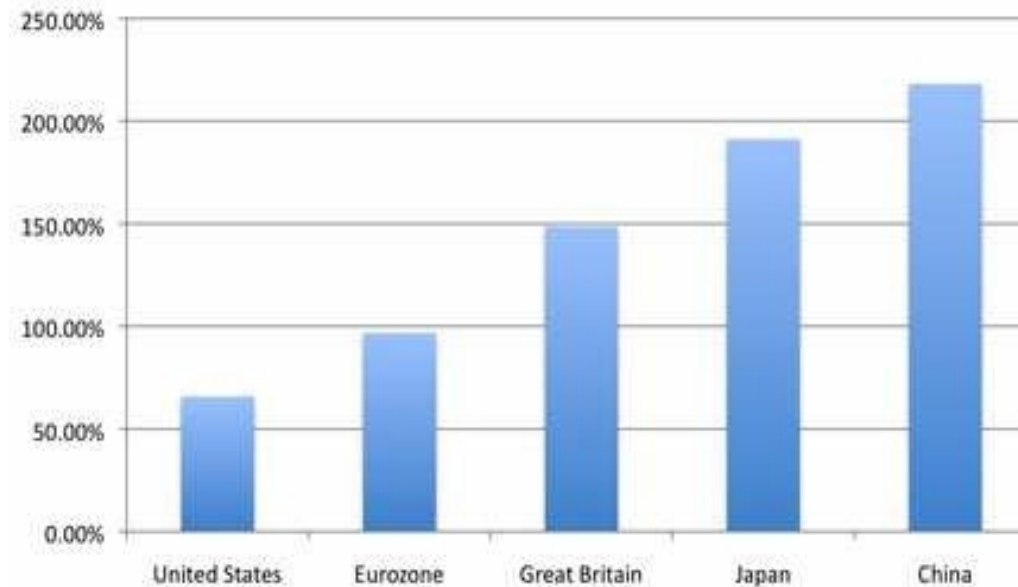


Source: Bloomberg y BoJ

Market Situation

... but in monetary terms, Japan and China increased the most...

Monetary offer over GDP

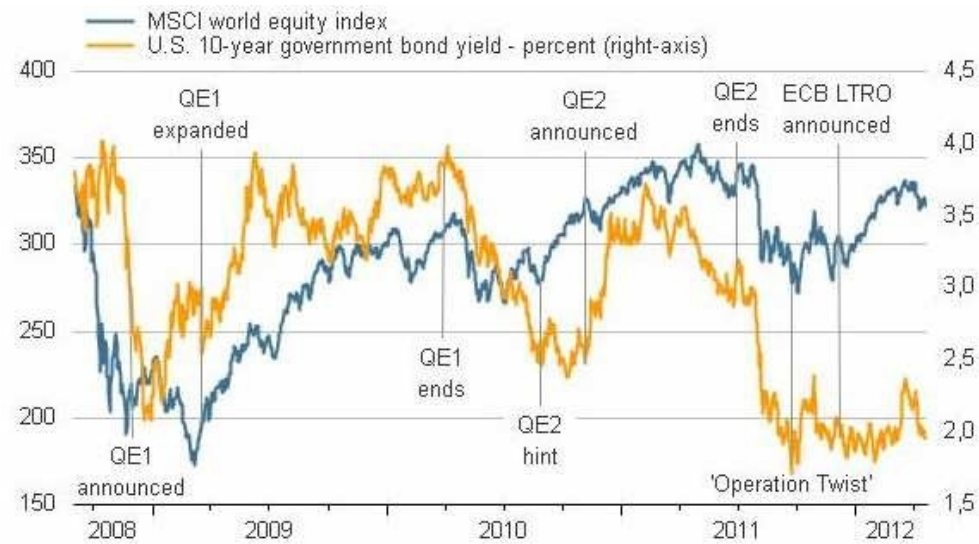


Source: CQCA Business Research

Market situation

CB interventions support the fixed and variable income markets ...

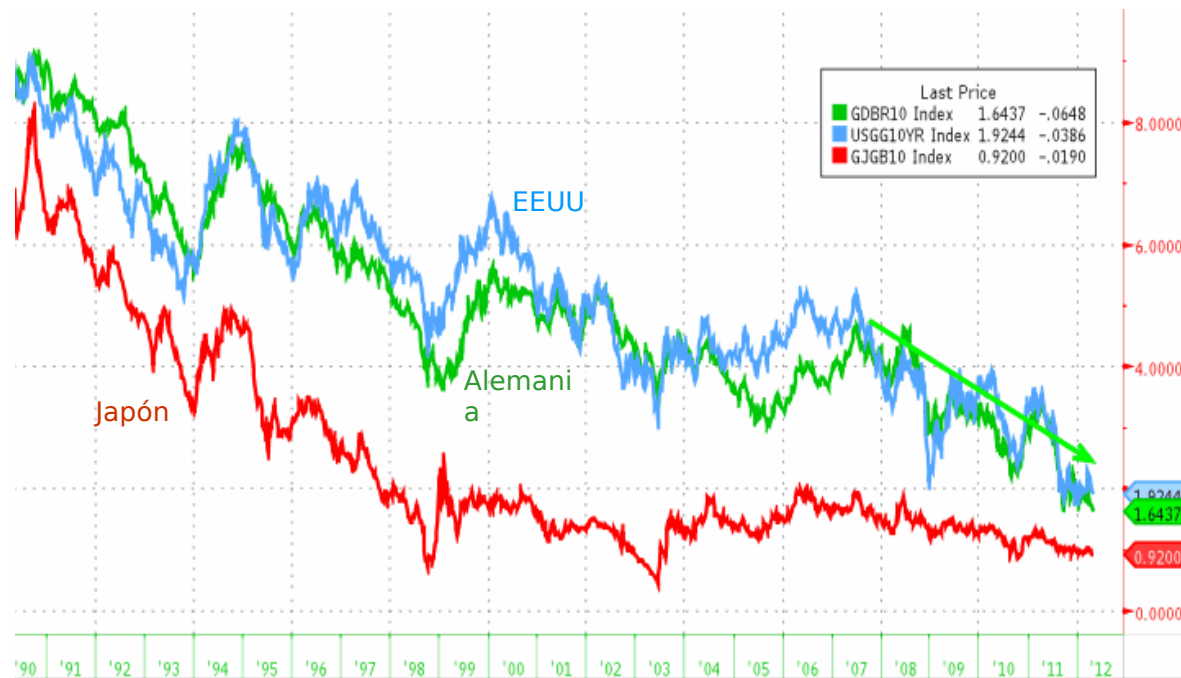
Reactions in Equities and in Fixed income a QE and LTRO



Source: Bloomberg

... and control the evolution of the types of interest...

Evolution of Bond yields 10 years USA, Germany and Japan



Source: Bloomberg, Patrivalor

Market Situation

...maintaining the market in levels of risks aversion before the crisis

Historical evolution of VIX

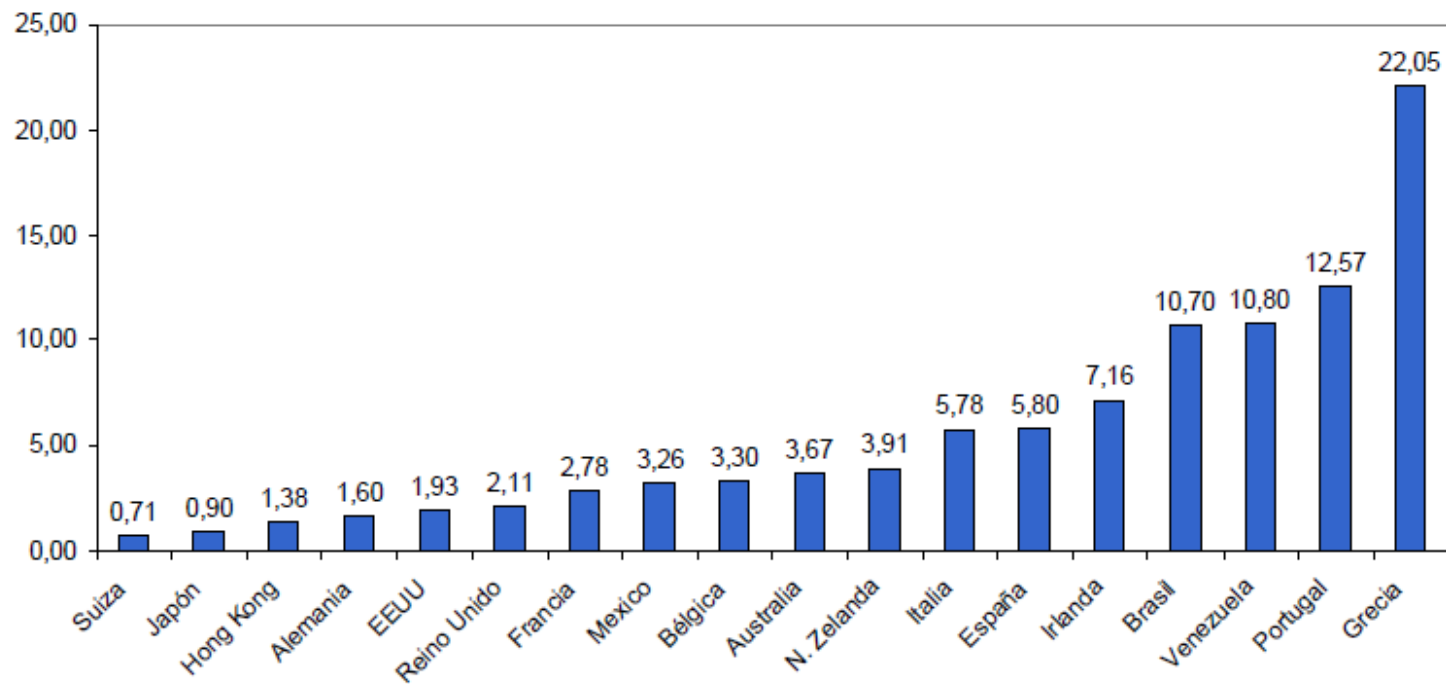


Source: Thomson Reuters Datastream

Market Situation

Although the cost of financing continues to depend on the quality of the issuer and the confidence of investors

TIR 10 years of governmental debt



Source: Bloomberg, Patrivalor

Market Situation

So, low interest rates... until when?

Evolution of 10-year bond yields USA

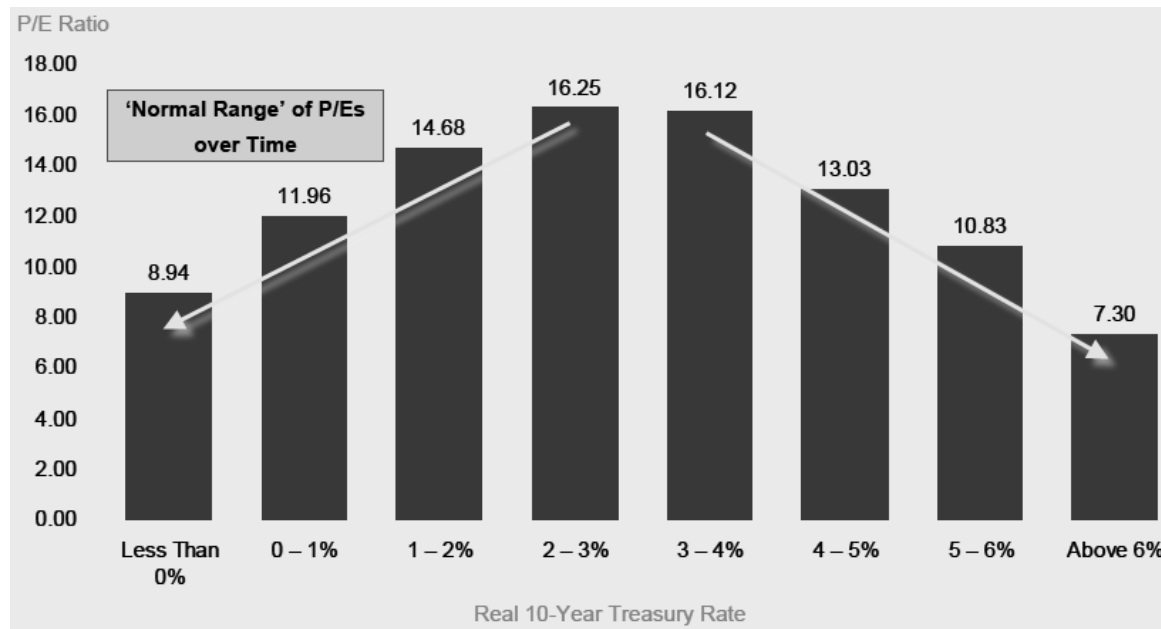


Source: Bloomberg, Patrivalor

Market Situation

... and this question is important because of its high impact on profit valuation.

PER vs 10-year bond yield USA

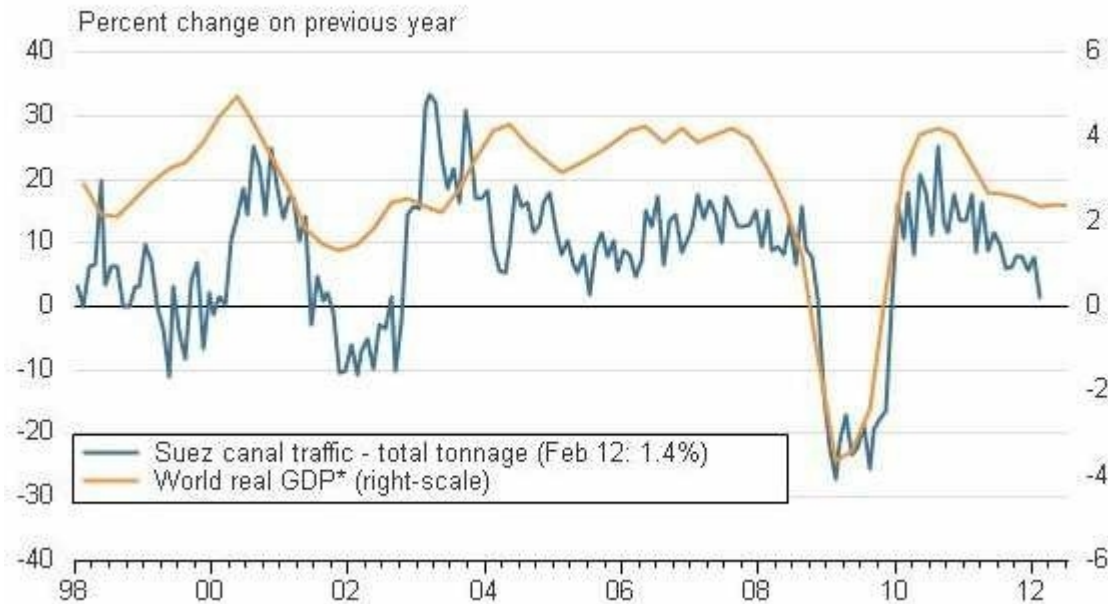


Source: Morgan Stanley

Market Situation

At a macro level, the real economy grows in a lateral, fairly fragile range.

Global GDP vs Suez Canal Traffic

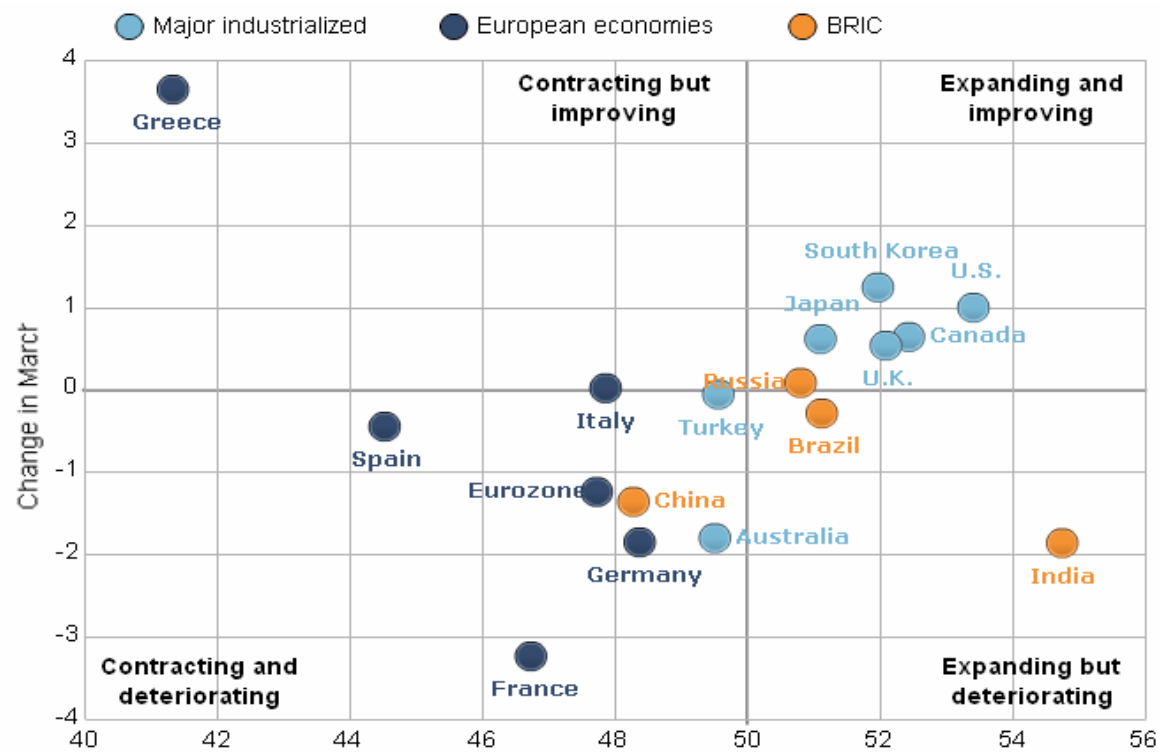


Source: Thomson Reuters Datastream, Oxford Economics Forecast

Market Situation

At a global level, few countries can save this fragility

PMI's Manufacturers

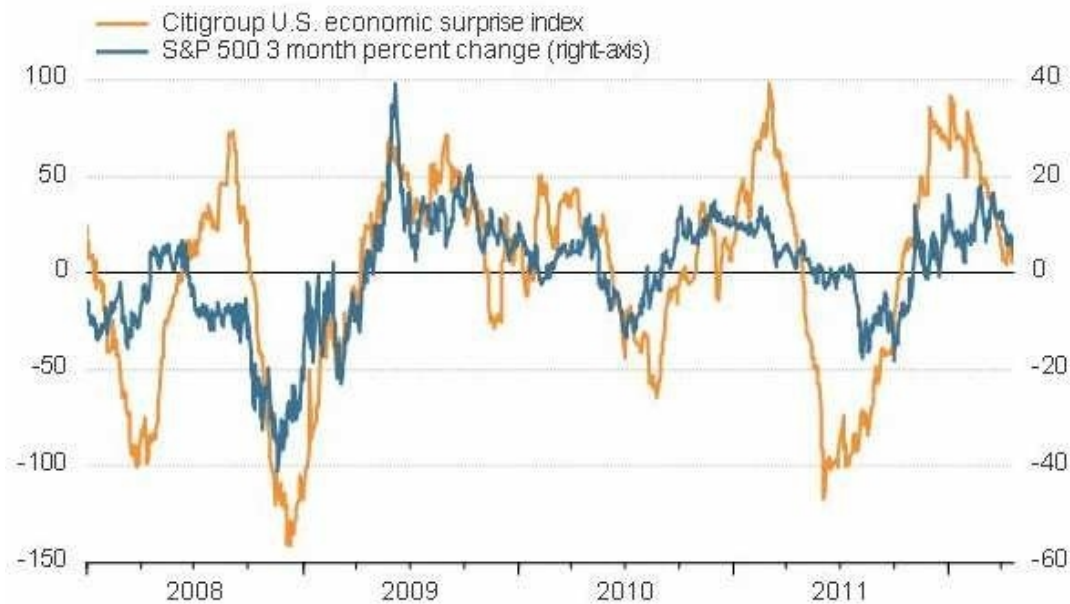


Source: Institute for Supply Management, Markit Economics

Market Situation

...and although the momentum is losing strength in the US

Leading indicators US vs S&P rolling 3M

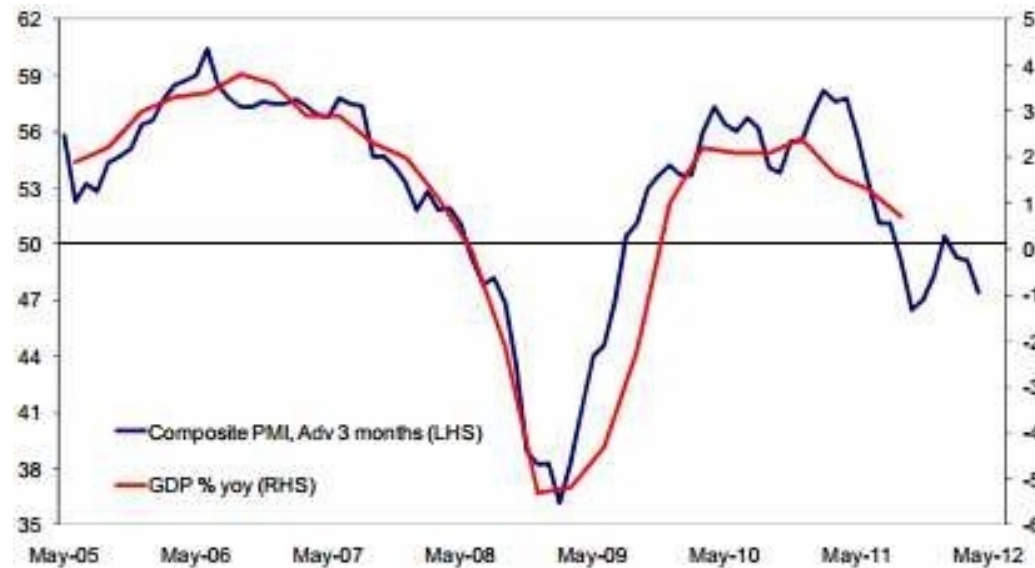


Source: Thomson Reuters Datastream

Market Situation

... it is still better than in Europe

PMI Euro zone vs GDP Euro zone

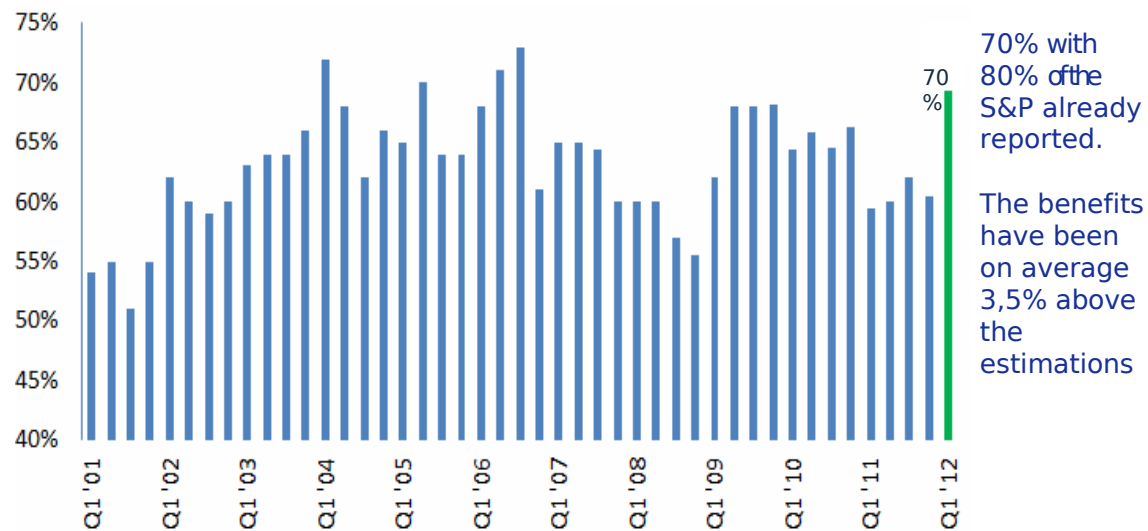


Source: Haver Analytics

Market situation

At the micro level, the profits of US companies, among which are many of the global ones, continue to grow

Percentage of companies of the S&P with benefits higher then the market consensus (2001-present)



Source: Reuters

Market Situation

... maintain their maximum margins

US business benefits over GDP

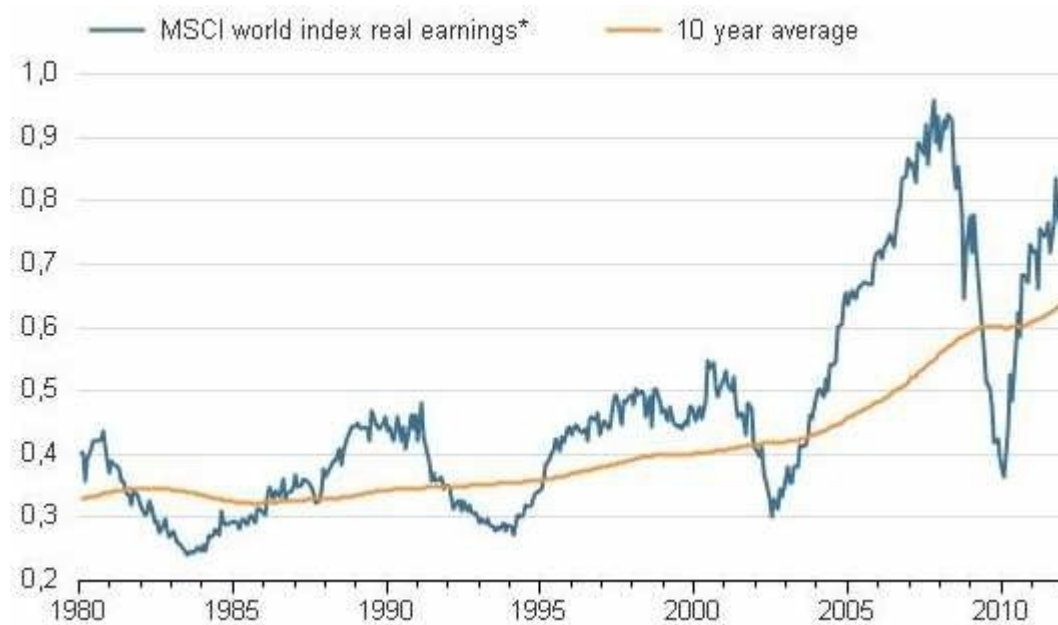


Source: Deutsche Bank

Market Situation

... or, from another point of view, their benefits are above the average

Business benefits vs average past 10 years



Source: Thomson Reuters Datastream

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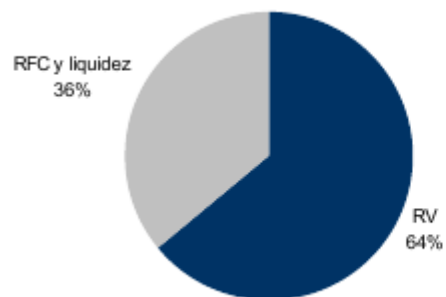
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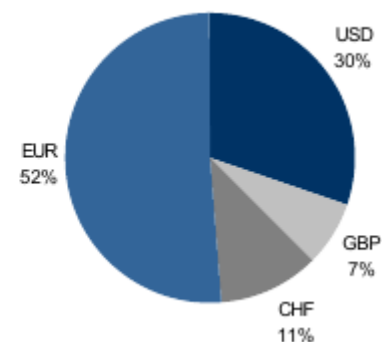
Market Situation

Investment Strategy

Distribution by asset class



Distribución by currency



Principal statistics of the portfolio of equities

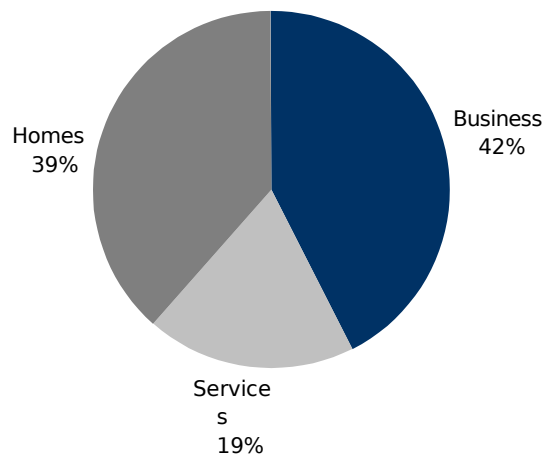
Earnings Yield	7.38%	ROE	20.46%
Dividend Yield	3.47%	D. Neta/ total assets	11.81%
Beta	0.83	Number of inverted securities	35

Principal ratios in the portfolio of equities

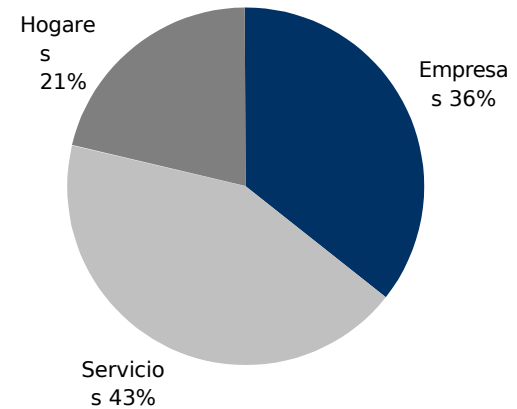
% peso	Sector	EY (%)	DY (%)	Beta	DN / AT	DN / Fact	Mgn Neto	ROE	Bº / Empleado
7,7%	Energy	8,26	2,65	1,03	8,11	18,10	30,10	17,07	406.876
3,4%	Materials	3,83	1,06	0,83	-1,29	-6,67	17,67	7,10	354.487
11,1%	Industrial	7,04	2,62	0,88	16,26	25,76	68,60	18,17	23.454
5,2%	Technology	7,09	1,89	1,01	-21,54	-44,65	9,94	23,19	147.226
27%	Business								
3,1%	Communications	9,69	6,47	0,71	42,72	72,46	105,76	28,70	94.948
3,5%	Utilities	8,65	4,32	0,70	22,36	64,13	12,48	14,34	212.654
5,3%	Infraestructures	8,34	6,29	0,79	42,41	175,50	12,73	20,67	220.347
12%	Services								
14,1%	Health	6,98	2,89	0,69	-8,84	-13,89	18,74	21,57	81.980
10,3%	Consumption	6,54	3,04	0,83	6,08	6,27	31,16	33,34	35.485
24%	Homes								
64%	Total RV								
	Average	7,38	3,47	0,83	11,81	33,00	34,13	20,46	175.273

Patribond Analysis

Sectoral Distribution of RV of the portfolio (base 100)



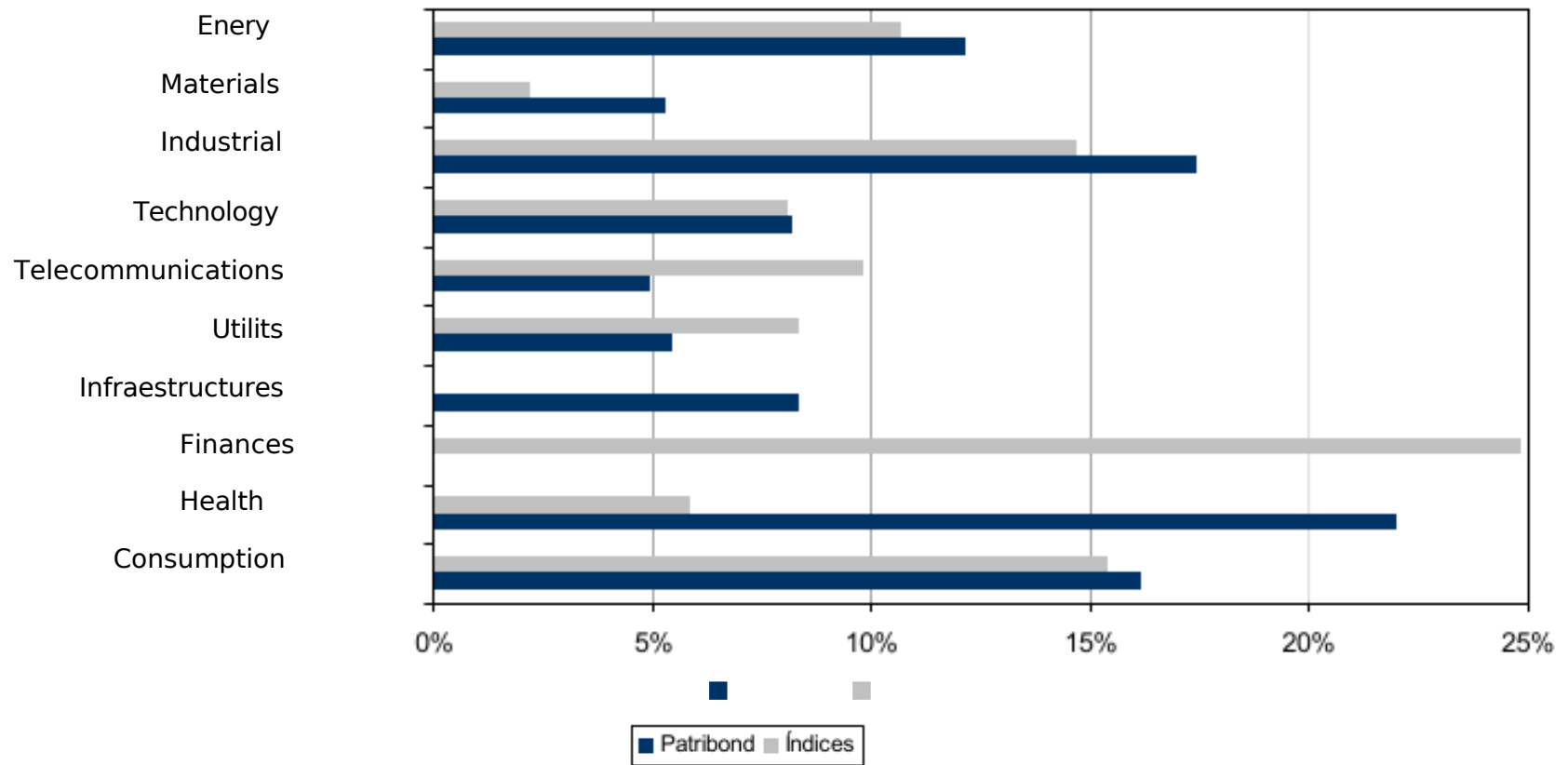
Sectoral distribution of RV average global indices



Patribond Analysis

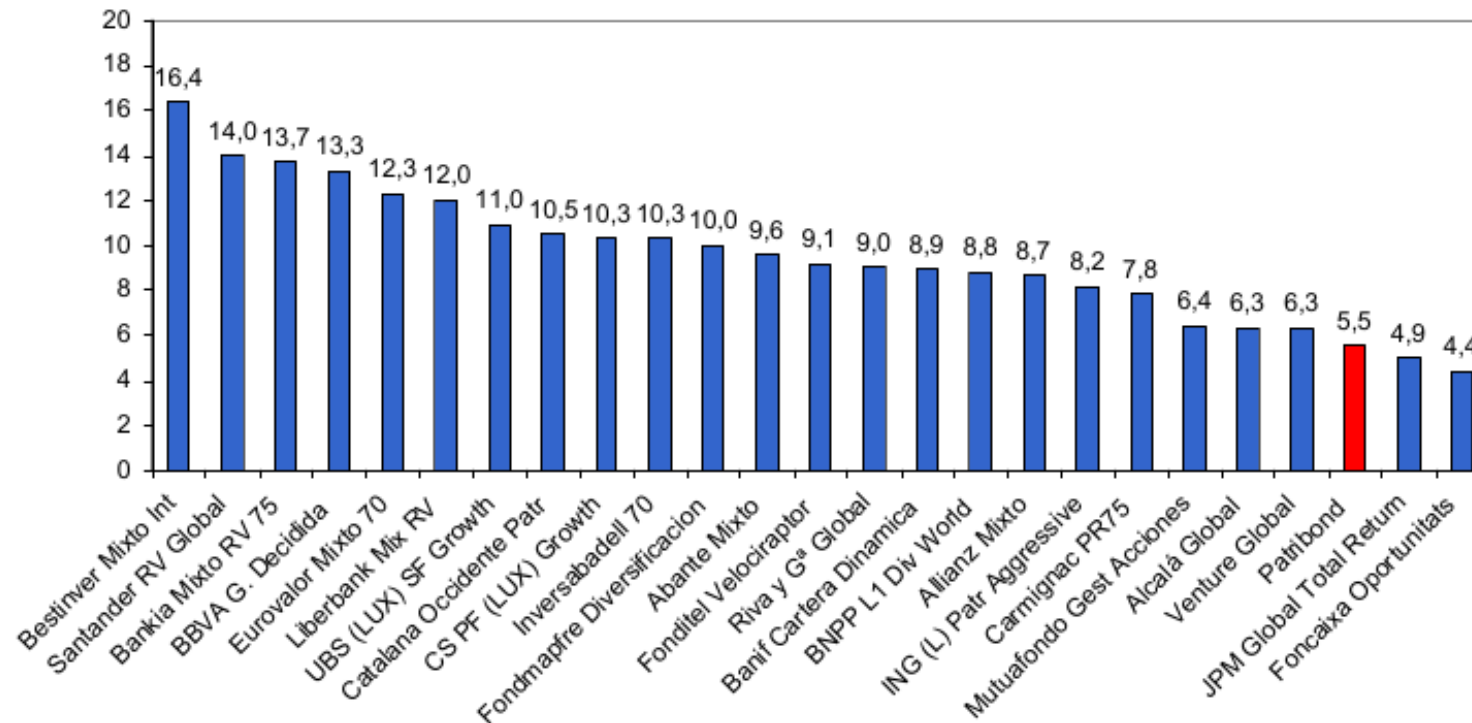
Patribond

Sectorial Distribution vs indices



Great stability in the portfolio (low volatility)

Average volatility past three years



Source: Morningstar

Patribond Analysis

Low volatility even in periods of uncertainty and periphery volatility



Source: Morningstar

Patribond Analysis

Value generation in the long term



Source: Morningstar

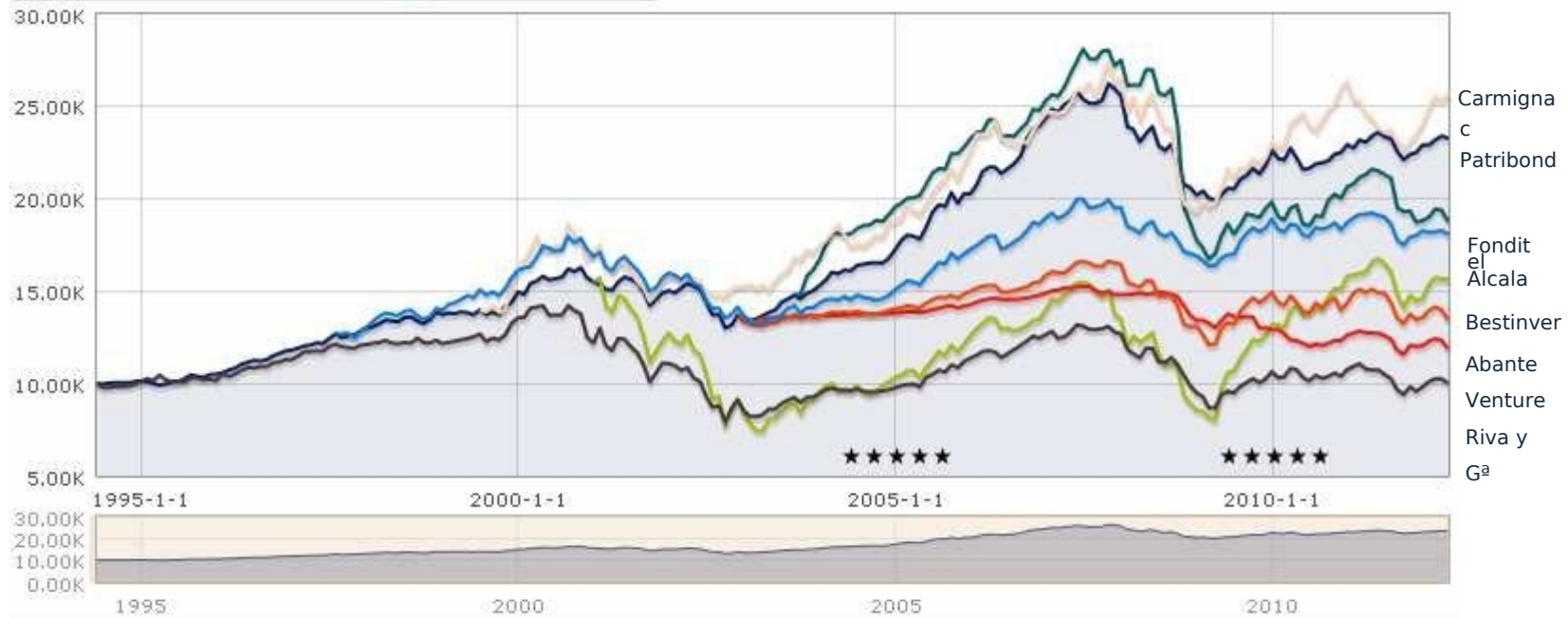
Patribond Analysis

Comparisons

03/05/1994 - 30/04/2012

1m 3m 6m Año 1a 3a 5a 10a **Máx**

- Patribond FI Acc
- Bestinver Mixto Internacional FI
- Riva y García Global FI
- Venture Global FI
- Abante Mixto PP
- Fonditel Velociraptor FI
- Carmignac Profil Réactif 75
- Alcalá Global FI



Source: Morningstar
www.pativalor.com

Patribond Analysis

Comparisons

03/05/1994 - 30/04/2012

1m 3m 6m Año 1a 3a 5a 10a **Máx**

- Patribond FI Acc : 16.03K ● Eurovalor Mixto 70 FI : 16.48K
- Liberbank Mix RV FI : 14.00K ● Bankia Mixto Renta Variable 75 FI : 11.85K ● Inversabadell 70 FI : 16.71K
- Banif Cartera Dinámica FI : 5.26K ● BBVA Gestión Decidida FI : 14.09K
- Santander Renta Variable Global PP : 9.86K ● FonCaixa Oportunitats FI : 6.82K



Patribond Analysis

Comparisons



Source: Morningstar

Patribond Analysis

Comparisons



Fuente: Morningstar

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