ALPINE ATLANTIC
GLOBAL ASSET MANAGEMENT AG

ECHO FROM THE ALPS | 2/2013

AUGUST 2013 INVESTMENT UPDATE

By Daniel Zurbrügg, CFA and Thomas Merrick, Alpine Atlantic Global Asset Management AG

THE GLOBAL REBALANCING

Dear Readers,
Making decisions is never easy. This is true for financial and business investments but making decisions in other areas of life is also a difficult process. Weighing pros and cons against each other is challenging enough but eventually making a decision is often the hardest part of the process. Once a decision has been taken and a proper long-term plan has been established, ones focus moves to executing and monitoring. Executing a long-term plan or strategy naturally involves a regular critical review of the process. Measuring progress is often difficult, there are times when things go very positively and smoothly, but sometimes progress is slow and momentum negative. We all have experience with that in our own lives. These moments and the decisions taken during times of difficulty are often the ones that yield the greatest returns and benefits; this is true for life in general and for financial investments in particular. Consider for example an athlete, let's say a marathon runner. Preparing for a marathon means investing a lot of time, energy and discipline. During the preparation period, there will be good days and bad days, but just because progress might be slow sometimes, a good athlete never quits. Instead they are critically reviewing training and making slight modifications along the way. The parallels to financial investing are obvious; also in this area we need discipline and focus on a long-term goal. This helps us to deal with challenges that will come up over time and these challenges will come for sure, sooner or later.

Runners at the Jungfrau Marathon Switzerland; despite challenges they keep their focus in order to make it to the finish line.

The last couple of years have brought enormous challenges to the world economy and the global financial system. What started as a housing boom in the United States more than a decade ago, eventually became a worldwide problem when the housing bubble burst. With the collapse of the U.S. housing market, a lot of banks were sitting on bad loans and the stability of the global financial system was at risk, especially after the bankruptcy of Lehman Brothers, which sent shock waves across global markets. The result was a global banking crisis and banks almost stopped lending to each other because everybody was concerned with counterparty risk. We all know the consequences this had in the last few years. Governments eventually jumped in to bail out banks and financial institutions that were becoming insolvent. This caused finances of many governments to turn from bad to worse. In an attempt to stabilize the global financial system, and with it the global economy, central banks around the world have been providing liquidity like never before, which is now visible in the massively enlarged balance sheets of these central banks. Governments on the other hand have been taking on more and more debt since it is very difficult for them to cut costs given the often inefficient dynamics of politics. This has led to an intense debate about whether or not spending cuts and austerity measures are the right way out of this misery.

The current debt burden of many nations is very problematic but in order to assess whether a debt problem might become unsustainable, we need to put it in the right context and also compare it to the GDP of a given country and the net assets/ wealth of its households. Some countries can afford a higher debt level, since they have more wealth and higher economic profitability or per capita GDP. Over the last twelve months, the global sovereign debt crisis has been the main market theme. Going forward the main question is whether those concerns intensify again or whether markets come to the conclusion that the world is finding a way out of this debt trap. In this issue we are going to highlight a new debt story that worries us even more than the international sovereign debt situation and that is the situation in the municipal bond market in the U.S. The recent bankruptcy of Detroit is just one example of this huge problem and more cities are likely to follow Detroit. We think there could be a real storm coming in the municipal bond market and we think investors have to be very careful. We are going to look at Detroit's bankruptcy and its implication later in this issue.

One of the major market stories in recent months has been the drop in gold prices to levels around USD 1200/ounce. In recent weeks the price moved back up to prices around USD 1300/ ounce. The correction seen in the previous quarter was caused by large scale liquidation of gold positions, especially by funds/ETF's as well as by speculative investors. At the same time the intense discussions and speculation about a possible end of the Fed's asset purchase program caused more downward pressure on gold prices. With market prices having moved to levels not too far away from average global productions costs (USD 1050), the downside looks to be better protected. It is not unusual to find a market where prices can temporarily fall below production costs, but in the long-run this is not sustainable. We take the recovery of gold prices back up to levels above USD 1300 as a sign that the supply/demand situation is about to change, shorting precious metals and commodities has been a very popular trade in recent months but it looks as if this is coming to an end. It looks to us as if gold is currently trading in a trendless range without many drivers out there that can move it back up to the levels we had. So what is ahead for precious metals in coming months? We are going to review this later in this investment update.

Growth in China is slowing and currently the economy is growing at a rate of 7.5% per year. While this is still very good by western standards, it represents the weakest growth rates in China in several years. The effects of this can be felt across markets already and especially the commodity markets where most prices have corrected sharply. The Chinese government seems to be determined to keep growth at current levels, however, the main story is that the structure of the Chinese economy is changing. There is a clear trend and an even clearer commitment from the government to move the economy towards a more sustainable model where consumption is becoming an increasingly important driver of the economy.

We live in a world that is trying to rebalance from the many imbalances we have built up in the last couple of decades. It is very critical that investors understand this development and the opportunities created thereof.

We hope you enjoy reading our latest investment update.

With the very best regards from Switzerland,

Daniel Zurbrügg

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GLOBAL ASSET MANAGEMENT AG

MARKET UPDATE

PRICES AS PER AUGUST 8TH, 2013

Global Equity Indices	Last Close	YTD%
Swiss Market Index	7'977.34	16.9
Swiss Performance Index	7'553.74	20.1
Eurostoxx 50	2'736.45	6.2
German DAX Index	8'338.31	9.5
FTSE 100.28	6'583.39	11.6
CAC40 Paris	4'076.55	12.0
Standard & Poors 500	1'691.42	18.6
Dow Jones Industrials	15'425.51	17.7
Nasdaq 100	3'118.57	17.2
Nikkei	13'615.19	31.0
Topix	1'140.91	32.7
Hang Seng	21'807.56	-3.7
All Ordinaries	5'038.80	8.0

Government Bond Yields 10Y	Last Close	YTD%
USA	2.50	59.2
EUROPE	1.68	28.2
U.K.	2.48	40.9
SWITZERLAND	1.06	112.0
JAPAN	0.75	7.1

Libor 3 Months	Last Close	YTD%
USA	0.26	-15.0
EUROPE	0.15	-19.8
U.K.	0.51	-1.0
SWITZERLAND	0.02	66.7
JAPAN	0.16	-8.9

Exchange Rates	Last Price	YTD%
US Dollar / Swiss Franc	0.9222	0.8
Euro / US Dollar	1.3344	1.1
US Dollar / Japanese Yen	96.22	10.9
Euro / Swiss Franc	1.2306	1.9
Pound Sterling / Swiss Franc	1.4297	-3.7

Commodities	Last Price	YTD%
Crude Oil	105.97	15.4
Gold	1313.3	-21.7

Alternative Investments	Last Price	YTD%
Dow Jones Hedge Index	502.6	3.7
Goldman Sachs Commodities	634.7	-1.8
LPX Private Equity	1289.2	23.7

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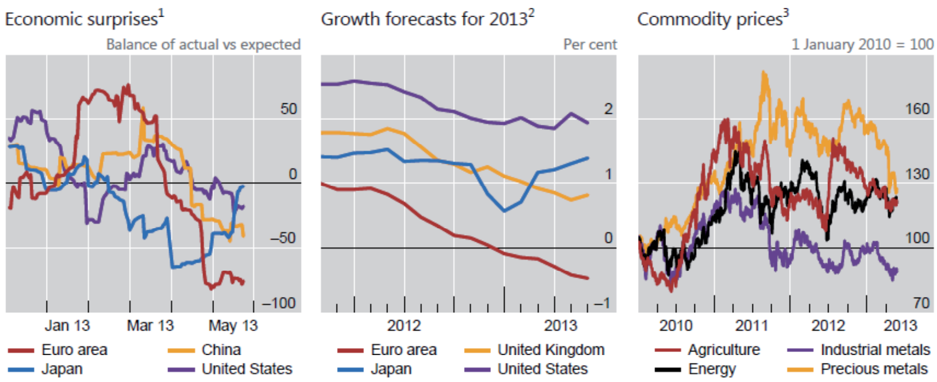
GLOBAL MACROECONOMIC & MARKET UPDATE

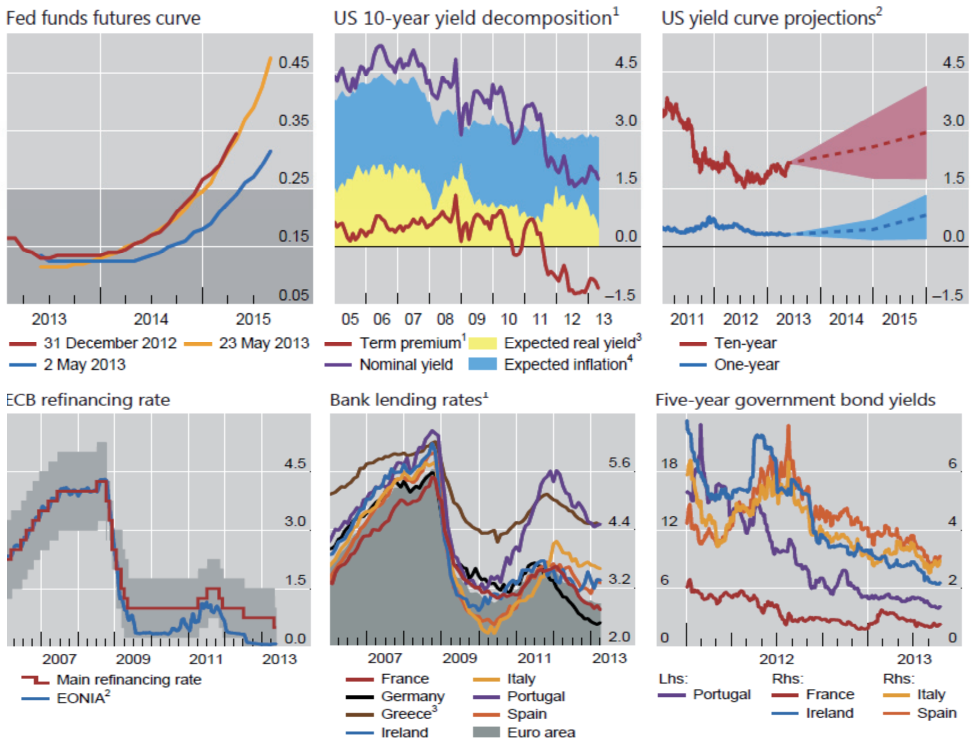
The sovereign debt crisis has been the main headache of global financial markets for the past two years and hardly a week passed by without more news regarding the financial problems of Greece, Portugal, Spain or the U.S., just to name a few. Still today, many fear that a debt related financial and economic collapse is on the horizon. The popular argument is always the same: Too much debt.

We remain concerned about the debt problems of many nations and believe that it will take several years to improve this situation. However, in our view, the current discussion is too much focused on the debt side of the equation. Yes, too much debt is not good, but what makes it even worse is when there are no assets and income to cover and support the debt. In that sense, looking at a country is not much different from reviewing a company and analyzing its financials; just what financial analysts do the whole day. Interestingly, in the discussion about sovereign debt the comparison between nations is often done based on an overly simplistic view. There is one aspect of the comparison that is a lot different when reviewing the financial standings of a nation. Unlike a private company, a nation with its own central bank can determine the value of its currency by “printing” more money if needed. This is for example the case in the U.S. where the Federal Reserve has been engaging in a large scale asset purchase plan (quantitative easing). Skeptics often refer to this as “printing money out of thin air” and they see this as a first step towards high inflation, possibly even hyperinflation. This is not wrong, but also not fully correct. It depends what the newly created liquidity does and if it finds its way into the real economy. What we are seeing in today’s situation is that most of that new liquidity isn’t doing much at all, the main effect has been that the banks deposit more money back at the central banks. This in turn is helping the banks to earn risk-free profits so they don’t have to actually lend money to somebody which would actually increase the risk for the banks. Since the actual money flow is not increased, the risk for inflation is well contained and as long as there is not a real pick up for credit from households and businesses, it is very unlikely that we see a sharp spike in yields in most major economies. Despite some encouraging signs in recent weeks the actual velocity of the money flow remains very slow. Velocity is an indication of the speed at which money is flowing in the financial system. Increasing velocity is an indication of improving economic activity, something that has not really happened so far. Also, given the fact that commodity prices have fallen sharply in the past months (see chart “Commodity prices” below), the risk of seeing a sharp increase in inflation is almost zero.



The chart above clearly shows the slowing growth momentum that is currently seen in most major economies. Slower growth has direct implications on the commodity market where prices have moved sharply lower in the recent past. Charts from BIS

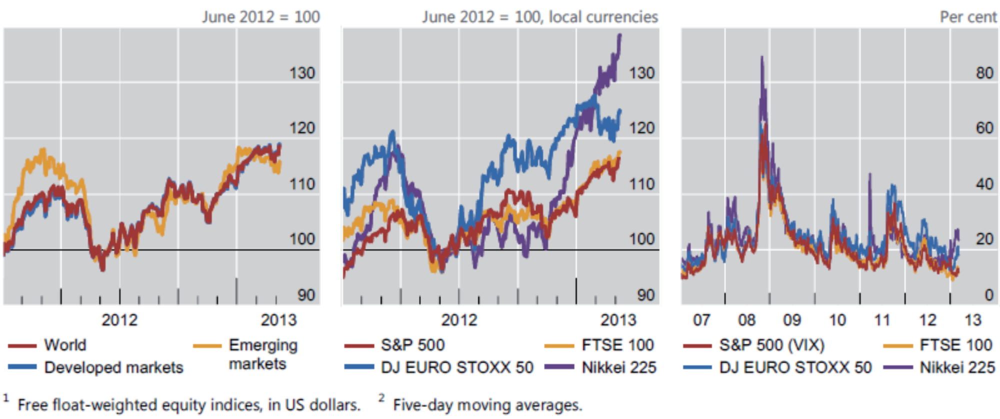
Actually, the risk of seeing negative inflation rates in many economies is significantly higher. Central banks see this and since most of them fear deflationary tendencies, they will all keep loose monetary policies. In a global context it does not even make much of a difference if the U.S. Federal Reserve is going to reduce its asset purchase program eventually. Other central banks, especially the Bank of Japan, have already started to make up for that. "QQE", quantitative and qualitative monetary easing as the Japanese program is called is even more aggressive than the Fed's program. It aims to almost double the monetary base within the next two years (!!) and buy back bonds and other securities on a very large scale. The goal is to reduce yields across the whole yield curve, especially at the longer end and by doing so to encourage consumption and investments. What is different with the program in Japan is that the government is also planning to increase investments, this in sharp contrast to the U.S. and Europe where governments are actually cutting back their spending.



The charts above show the effects of central bank intervention and how this impacts interest rates, despite a small increase in the last couple of weeks, interest rates in many markets are still near record lows, with expected increases not coming before mid 2014

It remains to be seen which is the better way and for different countries different strategies might be right. Japan has very high levels of debt but it also has a high level of domestic savings, so it looks like this is sustainable. In the U.S. the situation is slightly different due to the lower savings rate. Just cutting spending is not going to solve the problem. What is needed are public investments that make sense and that have real economic returns. So the discussion should be which strategy is appropriate for a given country. With regards to Japan and the U.S. there needs to be a more forward thinking strategy. For the European countries, this is a slightly more challenging issue. Countries such as Italy, Spain or Greece are not poor countries, actually these governments own some very valuable assets, the problem is that those countries need to make more reforms and increase privatization of state owned assets and this is something that is much harder to do in Europe. Reforms take time and they are usually only done under pressure; the liberalization of the job market in Europe is a good example of that. However, the current economic situation is creating the pressure needed to jump start reforms.

Monetary and fiscal policies are also impacting financial markets, especially stock markets. Lower yields typically increase the present value of stock investments, but this is only one influence. Equity prices also react to interest rates because the lower these rates are the less attractive the bond market is and the more attractive equities are on a relative basis. The chart below illustrates this very clearly. Stocks have been doing much better than other investments (such as bonds and commodities). We expect interest rates are going to remain supportive for stocks for quite some time to come. Yields might go up slightly but on a relative basis they still remain exceptionally low.



Low interest rates are making equity investments more attractive on a relative basis again. With yields remaining low for longer, the chances for a continuing outperformance of stocks versus bonds and precious metals seems very likely

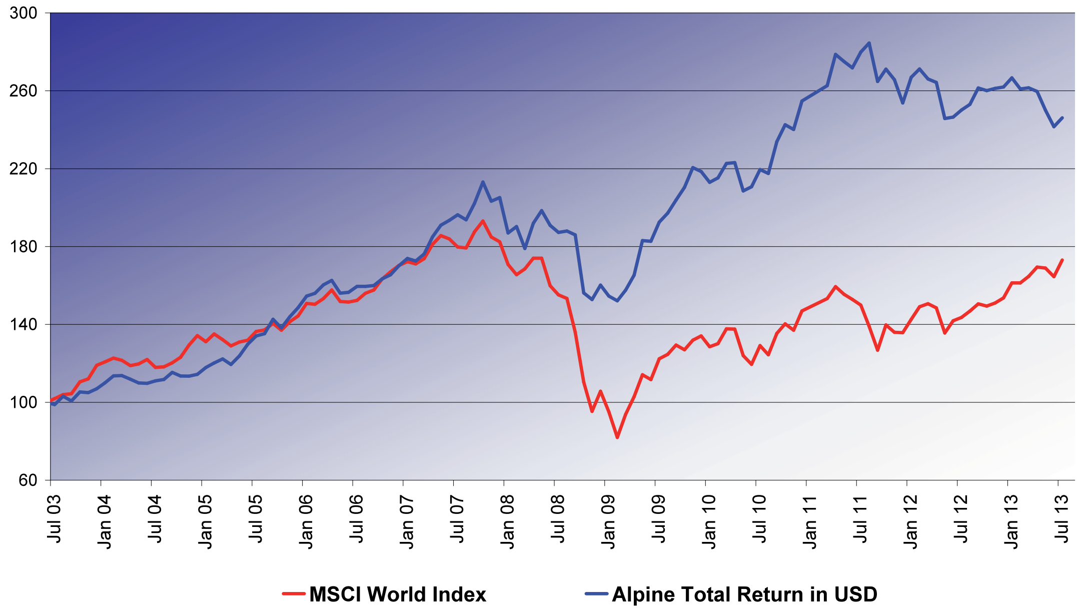
We regard the current discussion and speculation about when the Federal Reserve is going to stop its asset purchase program as a non event. In our view it makes no difference and it is not changing the fact that rates are going to remain at very low levels. A sudden and sharp increase in yields would put the current, already fragile, recovery at risk. Also other markets are going to see very low interest rates for probably years to come. For many central banks price stability is not a very important goal anymore as other measures such as GDP growth or employment numbers are the main focus.

INVESTMENT PERFORMANCE AND GLOBAL MARKET UPDATE AUGUST 2013

Our Global Macro strategy is down 5.87% (as per August 5, 2013) mainly because of two factors. Our large allocation to non USD currencies has hurt us in the last couple of months, a time during which the greenback moved up 5-10% versus most major currencies. Despite the currency hedges that we implemented, we were not able to fully neutralize this development. In our view the move in USD was mainly caused by large outflows from the Yen as a direct consequence of the new QEE program announced by Japan. The other factor causing us headwinds was the sharp correction in precious metals. Despite having liquidated about half of our precious metals positions last year we still keep about 10% of physical gold in our portfolio. In sharp contrast to precious metals and foreign currency allocations, our equity positions performed quite well. Some of the newly added positions, such as in healthcare, performed very strongly.

While we have made smaller modifications to our model as well as the implementation of hedges (currencies, precious metals) we do not anticipate making larger modifications to our strategy and stick with our long-term game plan. Precious metals seem to be fairly priced at the moment especially given the sharp correction this year and the fact that market prices have moved close

Alpine Global Macro Model Portfolio Return in U.S. Dollar



This is for information purposes only and not an offer to buy any securities, past performance is not guarantee for future performance

to actual production costs. Also, we do not anticipate a change to our strategic asset allocation with regards to currencies. While we have temporarily hedged some foreign currencies (currently about 40% of NAV), we do not see any reasons to change our strategic allocation. This is based on our view that the rebound of the U.S. Dollar was more caused by external factors, rather then internal ones. The speculation about a possible end of the Fed's quantitative easing program has certainly not helped but in the last couple of weeks the Dollar has lost a lot of momentum again.

Looking ahead, our plan is to add more equity exposure to our portfolio. We continue to find good value in many areas. We think that because of the recent underperformance of emerging markets there are a lot of good entry opportunities. We also think that the planned transformation of the Chinese economy will offer exciting prospects for companies with exposure to growing consumption spending in China.

Despite the recent increase in longer term yields (especially in the U.S.), we are not changing our fixed income strategy in any meaningful way.

Our durations are very low and credit quality is very high, therefore, we should not see much of a negative impact even if rates eventually rise. We are seeing more interesting opportunities again in bonds with a remaining duration of 3-5 years and we look at those opportunities very selectively.

OUTLOOK AND FORECASTS FOR Q3 & Q4 / 2013

We expect the following market trends / economic developments for the remainder of 2013:

- Slight improvement in global economic activity, improved market sentiment
- Profit growth to remain moderate, but expansion of market multiples (possible turning point of long-term trend)

- Improved market equilibrium in most markets, therefore low volatility to persist
- Continued outperformance of stocks versus bonds and precious metals, emerging markets starting to outperform
- Precious metals to stabilize around current levels (USD 1300), range trading between USD 1200 and USD 1400
- Energy prices to stay firm in anticipation of faster global GDP growth
- Interest rates in most major economies to remain very low, slight move to the upside at the longer end of yield curves.

CHINA - A GIANT IN TRANSFORMATION

For more than a decade now, the western world has been depending on China to pull things along. With most major economies growing at a very slow pace or even contracting, China has been one of the few bright spots on the global landscape. China has experienced strong growth rates in recent years mainly because it was the main manufacturing engine for the world. This is beginning to change and growth rates in China have been slowing to around 7.5% a year. This is the official growth target rate of the Chinese leadership and they do not seem to be too concerned about the recent slowdown. The new five year plan that was laid out recently calls for a gradual transition of the Chinese economy to a more sustainable model. Currently investors feel comfortable with this and have accepted that growth might "only" be in the 7%-8% range in coming years. In our view, however, this is not very realistic and we expect growth in China to move gradually lower in coming years towards maybe 5% or even lower. This does not mean that we are highly concerned with it, but it looks impossible to us that an economy can grow at 7% plus for very many years. Let's not forget the base effect of such a situation. Every year China's economy is getting bigger and bigger and even as the growth rate slows, the absolute size of the growth of an economy can still be very significant. In the case of China it means that China is getting bigger and bigger in terms of its economy and it's getting bigger fast.

What hasn't changed in our view is that China will become more and more important for the global economy and this will continue to have effects in other areas such as politics. What is changing in our view is the structure and the composition of its economy. Currently, it is still mainly an investment/production driven economy but we expect this to change over the next decade. Only around 35% of China's GDP is coming from consumption. This is in sharp contrast to more advanced economies where usually 60-70% is coming from consumption. This is a big challenge for China in the future as it needs to transition its economy to a more sustainable model. While investments and production still play a crucial role, domestic consumption has to become more important. People will only consume more if the overall living standards and average incomes continue to improve.

We think this transition is much harder to achieve then many people think. In our view, growth rates have to come down further, given the fact that the investment based growth in the past was driven by an unsustainable pace of credit expansion. While this outlook clearly highlights some risks for companies being exposed to investment spending in China, the transition to a more consumption oriented economy offers very attractive opportunities for companies active in this area.

Therefore, the question is not so much whether or not to invest in China and other emerging markets, but maybe more how to invest in those opportunities. There are certainly some local companies that look very attractive; however, we are concerned about corporate governance and transparency. We prefer international companies with a strong focus on emerging markets and going forward, especially companies exposed to growing consumptions in emerging markets.

PRECIOUS METALS UPDATE NEW PRICE EQUILIBRIUM TO HOLD FOR THE COMING MONTHS

Gold and silver prices have moved sharply lower during the second quarter and have only now found some new support. With gold trading around USD 1300/ounce and silver trading slightly below USD 20/ounce the obvious questions is when are prices turning around? Is there more downside to come? And more importantly, has the long-term outlook for precious metals changed?

drive precious metals. Clearly, sliding prices in recent months developed some kind of self dynamics. The lower prices moved, the more speculative money left precious metals. This becomes obvious when one looks at in-/outflow statistics for a lot of the ETF's and funds. The downward correction was made even worse with some huge selling from large institutional players. However, in recent weeks, it seems that selling pressure has subsided.

This is also confirmed by looking at the physical gold market where demand is relatively stable and has even improved lately, a clear confirmation that a lot of fast moving money was driving the decline in prices.

Long-term gold price (since 2003), current transition period, with 1350 and 1400 being the main resistance points.

The price correction seen in gold and silver in the last couple of months was very significant, no doubt about that. In the meantime it looks as if prices have entered a consolidation/support phase with relative trendless trading around USD 1300 for gold and USD 20 for silver. Since there are always several factors driving prices, it is worth reviewing the individual factors that usually

Another factor that has had a negative impact on gold is the change in the risk premium that was priced in. This became obvious in the last year for example in connection with the break up fear surrounding the Eurozone. After ECB's Draghi pledged full support for the European Union last year and to do "whatever it takes" to hold things together. In the months following the announcement, the credit spreads for most major European countries, especially the problem countries such as Italy and Spain, started to contract significantly. This in turn also reduced the risk premium which is part of the gold price. We believe we could see smaller spikes of risk premiums again in the coming months that would also support gold at least temporarily. Generally, volatility and risk premiums are currently very low; maybe too low for our taste. We think there is a good chance that we might see an increase again, which would also support precious metals prices.

Inflation is also not a concern for investors right now. Central banks are not worried about it so why should investors be? Not long ago, many investors were worried about higher inflation and even scenarios of hyper inflation were making the round. Today this is much less of a concern and the decrease of inflation expectations has been another negative impact on precious metals prices. However, in our view this is also a factor that can't go much lower anymore and we even feel that this might be at a turning point, with more people expecting higher inflation again as the global economy is gathering momentum.

Last but not least, we should not forget about the fundamental supply and demand situation. Gold and silver prices have come down to levels that are not much above actual productions costs. The lower prices are already causing huge problems for companies with higher production costs. Short-term, we think it is possible to have prices at or even below production costs, longer-term we expect prices to be above those levels. This would mean that prices are currently not far away from fair value and therefore at a turning point.

To sum this all up, we continue to feel comfortable with our precious metals position. They represent about 10% of our portfolios and we consider it a strategic holding going forward. We are not too concerned about further downside at the moment, but believe that prices for gold even below the USD 1200 mark are possible short-term. However, we stick with our positions, since they also give us a hedge against higher future volatility and possible external shocks. Therefore our allocation to precious metals has a very important function with regards to our overall portfolio strategy and risk diversification.

A PERFECT STORM COMING FOR THE MUNI MARKET?

About two years ago, Jefferson County/Alabama filed for bankruptcy; it was at that time the largest such case with debt of around USD 4 billon. In July, the city of Detroit filed for bankruptcy and in our view this will have further negative implications for the municipal bond market. Jefferson County was a relatively small problem, Detroit is a whole different case since the size of open dept is close to USD 20bln (!!). Detroit was once the fourth largest city in the U.S. with almost two million people living there. Today only about 700'000 are left. That was in the 50's and 60's when the car industry was booming. What makes the Detroit bankruptcy special is not the fact that this is a very large bankruptcy but the fact that the holders of GO Bonds (General Obligation bonds) might lose up to 60 or 80% of their investments.

This category has so far been regarded as relatively safe and many investors are holding such positions with the idea that this is a very low risk investment with good after tax returns. One rule of capital markets is that there is no free lunch, not even in the muni market and increasing problems in this market could mean that this is really going to shake capital markets, especially in the U.S.

The U.S. muni market is very large with almost USD 4000bln of debt outstanding of which so called GO bonds make up about a quarter. So it is potentially a very large problem that touches a large number of individual investors and the fever curve is going up. The yield of the GO20 Muni Bond Index has gone up significantly in the past few weeks touching almost the 5 percent level. Last year at the same time the yield was about 1.2% lower. Compared to the levels seen at the end of last year, there has even been a jump of 1.6%. With the yield levels that many muni bonds have reached, the illusions that many investors had are gone. This is a market that is in structural change and the finances of many cities and communities in the U.S. are deteriorating despite the fact that some are experiencing slightly higher revenues (mainly because of higher taxes). What has brought Detroit down is going to bring down more cities in the coming years. Many of them have accumulated unsustainable amounts of debt. There are a number of reasons causing the financial problems but many cities have simply overspent in the past. Almost all of them have huge unfunded pension liabilities. For example in the case of Illinois, the future annual liabilities for pension payments is eventually going to be twice as much as the tax revenues. Chicago is already feeling the heat, just recently the city had to fire more than 2000 teachers because of rapidly rising costs.

The municipal bond market is one of the most decentralized segments of the capital markets and one where risks have not really been priced correctly. Holders of GO bonds, so far considered to be a very safe place, might be at risk. The fact that also holders of such bonds might lose money is something really new, something that might change the landscape of this market. Claims of pensions might have priority over GO bonds, not only in the Detroit case but maybe for future city bankruptcies as well. That is the reason why investors need to critically review the credit quality of such bonds, specifically looking at problems such as unfunded pension liabilities.

It looks like the next large bankruptcy in this area is just a matter of time. Detroit has been the biggest so far but more might follow. This will cause investors in such bonds to reconsider the risk of such investments in comparison with other financial investments. The recent increase in risk spreads confirms that this process has already started and will make it harder for certain muni issuers to raise money. A situation that can be compared to Europe, where the different countries also trade at different yield and yield spread levels.