

## Strategy and economic research

## Market Insights

### KEY TOPICS

#### Lessons from the World Cup

Markets, like soccer, can surprise us. Betting on a rise in long yields looks the most reasonable long-term strategy. But given the prevailing mood of uncertainty, which is affecting European governments in particular, a slow-motion bond market correction cannot be ruled out. In the weeks ahead, therefore, close attention should be paid to the initial results of stress tests, which could affect the direction of market and the volatility

Page 2

#### Ukraine's New Normal

Significant change has come to Ukraine during 2010, starting with the election of President Viktor Yanukovich and the formation of a new (seemingly stable) parliamentary coalition allied with the new President. After the previous 2-3 years of non-stop political turbulence, a certain degree of political calm has returned to the country. As far as investors are concerned, however, the single most important development is the re-establishment of an IMF program. Officials are meeting with investors this week and next as Ukraine seeks to sell its first foreign currency bond since 2007. Whether or not Ukraine is able to place a USD bond this month at a price that makes sense to the new government, investors are increasingly focused on local opportunities in the Ukrainian market.

Page 3

#### Market Data

Page 4

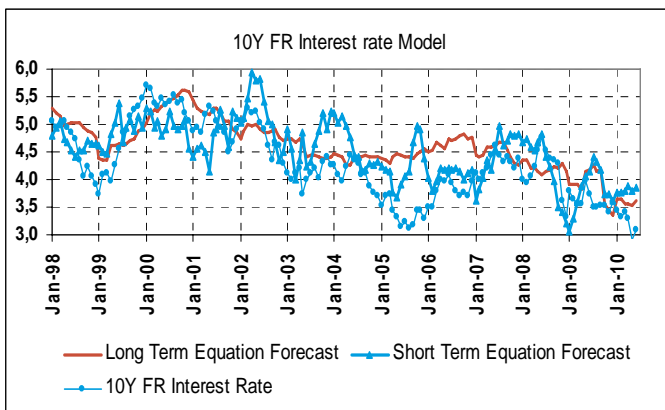
Lessons from the World Cup

> Soccer teaches the virtues of diversification

The first World Cup to take place in Africa reminded us that diversification is still crucial to good portfolio asset allocation, in life as well as in soccer (think Uruguay). Diversification offers protection against events that, while unlikely, do arise from time to time. Who would have bet on a first-ever final between Spain and the Netherlands? Not many, except for maybe Paul, the octopus oracle.

> The conventional bond market

Markets, like soccer, can surprise us. Over the past decade, long yields have gradually sunk to previously unthinkable lows. Even today, from a strictly fundamental standpoint, bonds appear expensive, notably for countries like France and Germany. As a result, betting on a rise in long yields appears to be the most reasonable long-term strategy. However, the graph below shows that the speed at which long yields revert to their fundamental value can vary over time, and that yields can remain overvalued for extended periods, as during the “conundrum” of 2004 and 2005. Given the prevailing mood of uncertainty, which is affecting European governments in particular, a slow-motion bond market correction cannot be ruled out. What to do in the meantime? A directional position on the yield curve’s shorter maturities, which present the lowest risk, is one option. Another possibility would be to make short-term plays based on more “tactical” factors such as momentum or inflows, rather than on macroeconomic views, while keeping in mind that this is a riskier route.



Source Datastream, Amundi Strategy

> Conventional bonds vs. linkers

The inflation-linked bond market may offer another way to diversify performance in the months ahead.

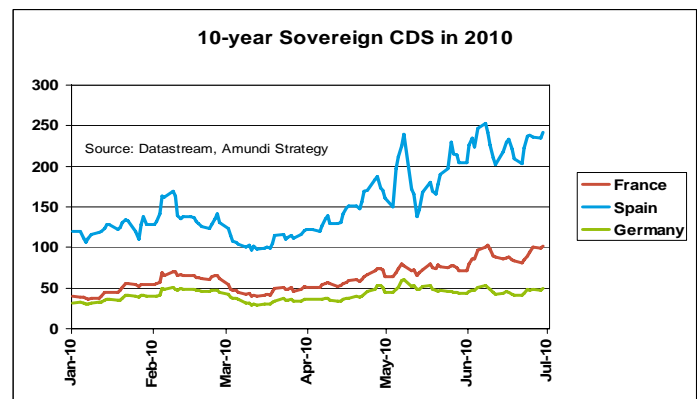
From January to end-June, European and US ILB indices underperformed their conventional bond counterparts. Breakeven inflation rates are lower than long-term inflation expectations on both sides of the Atlantic. The downward movement has been accompanied by a drop in real interest rates to the lowest levels of last year. At present, we find the scenario of significantly greater inflationary pressure in the long term unlikely. And for this reason, we prefer not to recommend choose between inflation-linked bonds and conventional bonds. But other factors such as carry, flows and/or seasonal inflation trends are worthy of attention, because they could make arbitrage between the two markets temporarily attractive.

Performances	Nominal Bonds* - Europe	Linked-Inflation Bonds - Europe	Nominal Bonds* - USA	Linked-Inflation Bonds - USA
January-June 2010	8,2%	4,4%	5,7%	3,8%

\* Barclays Indices matched for duration

> Upcoming news to watch

Spain has hoisted the World Cup trophy and managed to forget its troubles for a night. It even hopes to succeed on the financial front. For now, CDS continue to price in a very high likelihood of default – possibly too high unless markets are counting on the euro zone to implode. We will have to pay close attention in the weeks ahead to the initial results of stress tests – and not just for Spain. These results could significantly affect the direction of market and the volatility.



Source Datastream, Amundi Strategy

Ombretta Signori

## Ukraine's New Normal

Significant change has come to Ukraine during 2010, starting with the election of President Viktor Yanukovich and the formation of a new (seemingly stable) parliamentary coalition allied with the new President. After the previous 2-3 years of non-stop political turbulence, a certain degree of political calm has returned to the country. The strong relationship between Yanukovich and Russian leaders has also boosted investor confidence in Ukraine's stability, as the Kremlin has moved quickly to support Ukraine's new government via a reduction in gas prices, direct financial support, and political support for increased Russian private sector investment in the country. Officials are meeting with investors this week and next as Ukraine seeks to sell its first foreign currency bond since 2007. The roadshow follows Ukraine's one-notch rating upgrade by Fitch, and last weekend's announcement of a new Standby Agreement with the IMF. Ukrainian asset prices have moved slightly higher this week, but not by much – implying that these positive developments were already priced in.

### > IMF Agreement Renews Investor Confidence

As far as investors are concerned, however, the single most important development is the re-establishment of an IMF program, after the previous program ran off the rails last autumn when Ukraine's highly fractious political groups couldn't agree on either fiscal targets or structural reforms heading into the January and February 2010 presidential election. Now, with the presidential contest settled and parliamentary elections not required until September 2012, there is an important window of opportunity to govern the country. The agreement, which still requires ratification by the IMF's Executive Board, will be worth USD 14.9bn to be disbursed over 2½ years between August 2010 and February 2013. While many key details and macro assumptions of the IMF program remain unknown, investors will expect the Fund to keep close tabs on Ukraine's budget performance while enforcing long overdue structural reforms. On the fiscal side, the IMF and Ukraine have already agreed that the budget deficit should not exceed 5.5% of GDP in 2010 and 3.5% of GDP in 2011. The Ukrainians hope to cut this year's deficit below 5%, and reduce government spending by around USD 2bn in the next few months to accomplish this goal. Slightly longer term, the IMF program commits Ukraine to making a series of structural reforms to its tax and pension systems, the customs service, and the judiciary. All of these areas have needed overhauling for many years, so while we wish the Ukrainians well, we take a wait-and-see attitude in this respect.

Another area where the previous IMF program floundered was in the area of gas price liberalization. During 2009, the previous government repeatedly failed to deliver on promises to raise gas tariffs on the population (companies and households). The new government says that it will boost local gas tariffs by 50% before the end of this year. While the government has a large enough

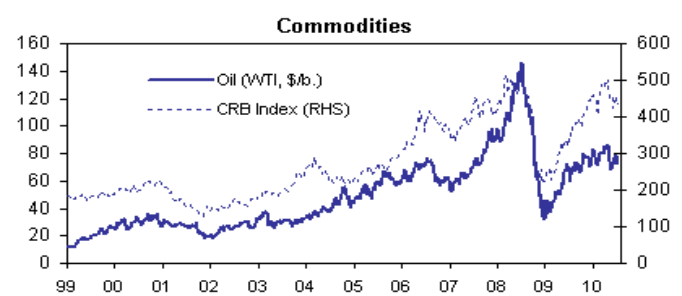
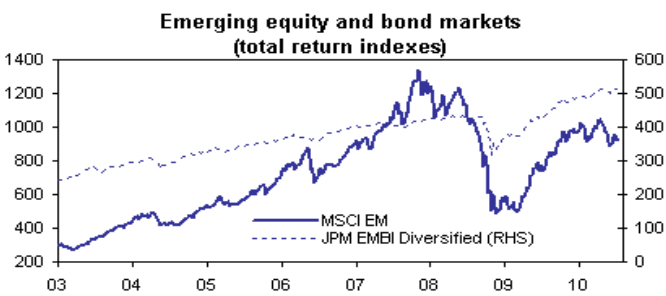
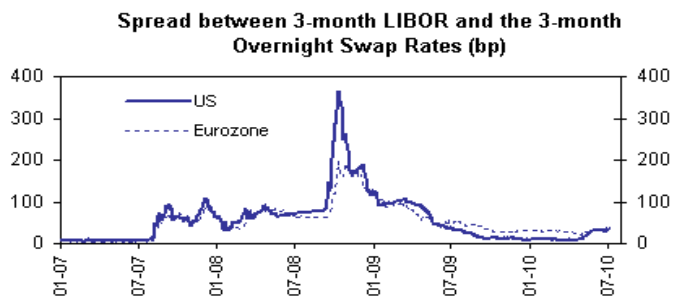
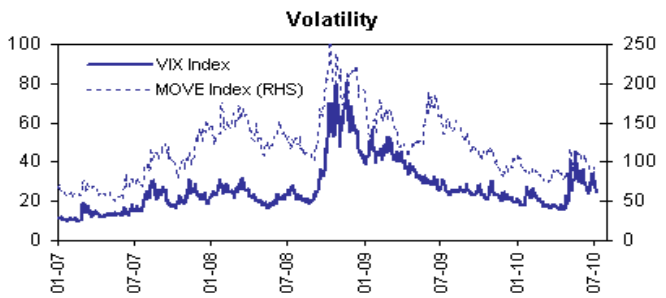
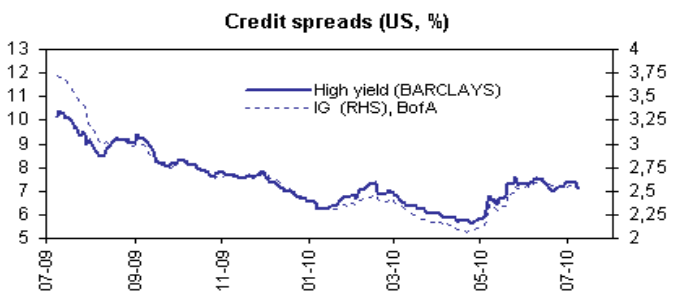
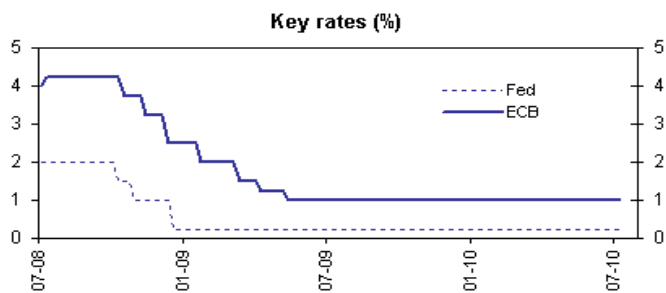
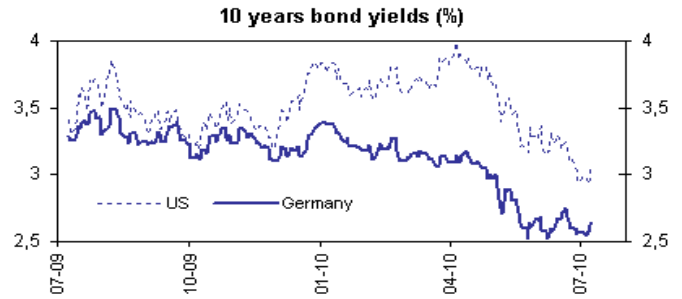
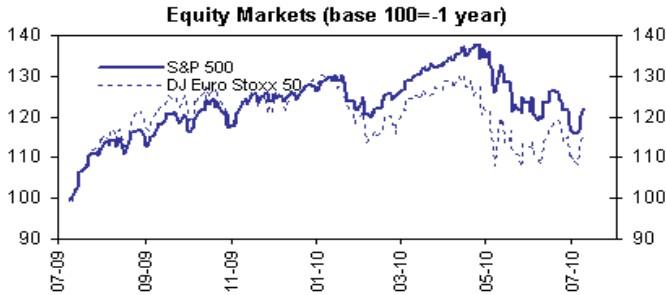
majority in parliament to actually deliver, there will be an inevitable backlash that investors simply must monitor. Helping Ukraine to cope with the long-standing mismatch between what it pays for Russian gas and what it charges domestic customers is this year's agreement with Russia/Gazprom to provide significant price discounts. This agreement, which has enabled Ukraine to pay 27% below the prevailing market rate for Russian gas during 2010, is open-ended and very much dictated by political relations between the two countries. Maintaining this price discount is essential to meeting a key requirement of the new IMF program, which calls for limiting the financing gap of Naftogaz (Ukraine's gas distribution monopoly) to 1% of GDP in 2010. As the IMF program further commits Ukraine to completely eliminating the Naftogaz financing gap in 2011, there is a very strong need to maintain good relations with Russia in the medium term.

Whether or not Ukraine is able to place a USD bond this month at a price that makes sense to the new government, investors are increasingly focused on local opportunities in the Ukrainian market. In particular, there is considerable anticipation regarding a large tranche of VAT bonds that is expected shortly. These 5yr bonds are being issued (in lieu of cash) to compensate the country's exporters who were entitled to (but did not receive) rebates on Value Added Taxes that were assessed to them during the global financial crisis. The total stock of these government arrears has been estimated around USD 2.5bn. The country's exporters have reluctantly accepted a very low coupon (5.5%) on these VAT bonds, and local economists and bankers expect these cash-hungry firms to dump these notes very quickly into the secondary market – at presumably steep discounts. For investors who are comfortable with currency's (UAH) medium-term outlook, these bonds are likely to trade at rather appealing yields. Officials do not believe that the one-off supply of these VAT bonds will compromise the Treasury's ability to sell domestic debt in the weeks and months ahead – even though UAH 18bn is equivalent to 75% of total domestic debt issued during the first half of this year.

Ukraine wouldn't be Ukraine, of course, without some political noise – and amidst all of the positive newsflow over the past week, word leaked out that the City of Kiev might need to restructure its three US dollar bonds (due 2011, 2012 and 2015) valued at \$700 million. Leaving aside the wisdom of Kiev ever selling bonds denominated in FX, the municipal government's balance sheets do appear rather strained at present (given the magnitude of last year's mammoth recession), and we are hard-pressed to see how Kiev can avoid a debt restructuring at some point in the next 12 months unless it gets bailed out by the sovereign. Of course, the timing of Kiev's statements raised significant questions about the relationship between the City's political leadership (a holdover from Ukraine's "Orange" period) and the new national government (which is "Blue"). When financing pressure mounts, however, Kiev's communication with the national government should improve as city officials seek sovereign support.

*Blaise Antin*

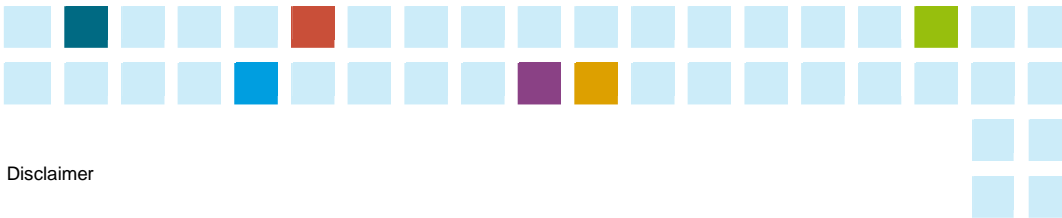
Market Data



Select Global Exchange Rates (July 12, 2010)

	F/X Rate	% Ch. WoW	% Ch. YTD	End year			
				2009	2008	2007	2006
USD/EUR	1,26	0,7%	-12,3%	1,44	1,39	1,47	1,32
USD/GBP	1,51	-0,6%	-6,8%	1,62	1,46	2,01	1,96
GBP/EUR	0,84	-1,3%	6,2%	0,89	0,95	0,73	0,67
JPY/USD	88,51	-1,1%	4,4%	92,43	90,64	112,04	119,16
JPY/EUR	111,9	-1,8%	19,1%	133,2	126,1	164,9	156,9
CHF/USD	1,05	1,0%	-2,4%	1,03	1,07	1,12	1,22
CHF/EUR	1,33	0,3%	11,3%	1,48	1,49	1,65	1,61

Sources: Strategy and Economic Research Amundi Group, Datastream and Bloomberg.



Disclaimer

Chief editor: Pascal Blanqué

Editors: Patrick de Fraguier, Michel Martinez

This document may not be reproduced, fully or partly, or communicated to third parties without our authorisation.

Published by Amundi a joint stock company (société anonyme) with a registered capital of 578 002 350 euros. An investment management company approved by the French Securities Authority (Autorité des Marchés Financiers - "AMF") under No.GP04000036. Registered office: 90, boulevard Pasteur 75015 Paris - France. 437 574 452 RCS Paris.

The information contained in this document is not intended for distribution or use by any person or entity in a country or jurisdiction where such distribution or use would be contrary to legal and regulatory provisions, or which would require Amundi and its affiliated companies to comply with the registration procedures of said countries.

All of the products and services may not be registered or authorized in all countries or available to all clients. The data and information in this document is provided solely for information purposes. None of the information contained in this document constitutes an offer or appeal by any member of the Group Amundi to provide investment advice or services or to buy and sell financial instruments.

The information contained in this document is based on sources that we deem to be reliable, but we cannot guarantee that it is exact, complete, valid or relevant, nor should it be considered as such for any purpose whatsoever.

## Correspondents

### Editors

Patrick de Fraguier (Paris)  
+33 1 76 33 91 59  
Michel Martinez (Paris)  
+33 1 76 37 23 84

### Paris

Marc-Ali Ben Abdallah  
Didier Borowski  
Marie Brière  
Bastien Drut  
Clémentine Gallès  
Delphine Georges  
Julien Marcilly  
Nathalie Navarre  
Florian Roger  
Ombretta Signori  
Ibra Wane

### Los Angeles (TCW)

Blaise Antin  
Marcela Meirelles  
Brett Rowley  
Jean Charles Sambor

### Milan

Sergio Bertoncini

### Mumbai

Nidhi Chawla

### Tokyo

Masanaga Kono  
Akio Yoshino

### Assistentes

Hélène Leconte (Paris)  
Josseline Materne (Paris)  
Hélène Reto (Paris)  
Myrella Suarez (TCW)