



FALCON PRIVATE BANK

SWISS PRIVATE BANKING

Falcon Perspectives



WAITING FOR THE ECONOMIC RECOVERY

The environment on the financial markets has significantly improved since the beginning of March. Stocks have rallied on hopes that the US recession might end this year. The oil price has spiked nearly 60% from its February low. Corporate bonds advanced nicely whereas government paper, considered as a safe-haven investment, suffered losses. Investors have started to take on more risks. It is just the opposite from what has happened in 2008. Are these positive trends going to continue? After all, we have had several bear market rallies in 2008 and each of them has petered out fairly soon. Is it different this time?

Falcon Private Bank is optimistic. In our view, the market has probably reached bottom in March, but volatility will remain high over the next few months. We believe that the US economy will turn around in 2010, as the powerful mix of expansive monetary and fiscal policy will eventually bear fruit. We have increased the equity allocation in our balanced investment strategies as of late, but we remain slightly underweight in stocks: After such a strong rally, a consolidation is due at some point; more importantly, the market's upturn so far was based on less worse than expected – but not good - economic data. For this rally to be sustainable, hard economic data has to confirm the improved expectations. After all, plenty of things could go wrong on the way to a global recovery.

Revival of riskier asset classes...

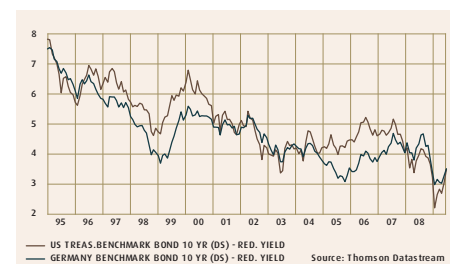
Investor's sentiment has changed significantly in the last months. Trends, which have been in place since 2007, have started to turn around. Global markets gained between 30% and 40% from their March lows. The sharp reversal is striking, but has to be seen in relation to a record drop in equity prices in quite a short period of time: All major indices lost nearly 60% (!) of their value in only 18 months or so, the most since the Great Depression in the thirties of the last century. The damage that the financial crisis and the global recession have done to stocks is huge! Other riskier asset classes such as commodities or corporate bonds registered hefty gains, too. On the other hand, investors switched out of safe-haven investments such as government bonds and sent their prices lower. Whereas 2008 was characterized by a flight to quality, we have experienced a flight from quality since the middle of March. Investor's risk appetite has increased.

...in expectation of an economic recovery

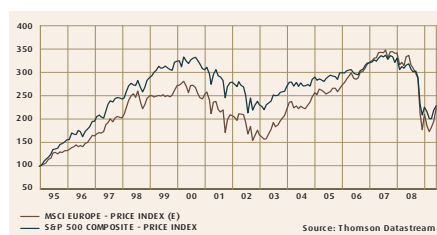
After a long and painful period, when the US economy went from bad to terrible since the beginning last fall, March 2009 finally brought a series of improved reports that have fuelled hopes that the country could be stabilizing. Surveys of businesses and households showed increased confidence. Even though first quarter GDP fell by another 6.1% (-6.3% in Q408, annualised figures), there were signs that the weakness is fading: After declining over four percent in the second half of 2008, consumer spending rose 2.2% in the first three months of this year. A record drawdown in inventory could bode well for production later this year. ISM data (Institute of Supply Management) has risen in April for the fourth month in a row. Historically this has been one of the best leading indicators for the economy. Some important indicators seem to have turned around in Europe and Asia, too. The IFO Indicator, Europe's most powerful economic gauge, has risen for a few months after bottoming in December. To be sure, the world's major industrialized countries are still in a deep recession, but the downtrend seems to have abated somewhat.

government bonds, have narrowed markedly. Higher yielding paper from companies with low credit quality enjoyed the best price advances. On the other hand, investors withdraw from safe government bonds. US longer-term interest rates for example rose over one percentage point since the beginning of this year. The yield of the 10-year Treasury bond stood at 3.40% at the end of May, compared to 2.20% in early January. Yields in Europe and Japan also rose, but to a much lesser extent, as these blocs are lagging the US economic cycle.

US Treasury and German Bund yields



S & P 500 vs. MSCI Europe



Investors have started to capitalize on these "green shoots", as Federal Reserve Chairman Ben Bernanke called these early signs of recovery. Equities, commodities and corporate bonds rallied. Credit spreads, that is the yield difference between corporate and

Are investor's increased risk appetite and the positive trend for equities going to last? What are the implications for the major asset classes and for Falcon Private Bank's investment strategies?



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Turnaround in corporate earnings

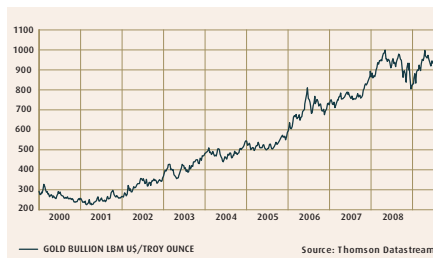
We think that the US economy will find bottom this year and turns around in 2010. The excessive monetary and fiscal policy is likely to impact real economic activities positively. First tentative signs of a recovery are evident, but much more is needed. We expect the US economy to grow some 2% in 2010 after an estimated contraction of 3% this year. Statistics also offer some encouraging clues that the current recession might come to an end soon. US post-war recessions lasted on average about 10 months. The current recession is already 17 months old and about to match the so far most severe economic downturns after World War II in 1997/3/74 and 1981/82, which lasted 18 months. A turnaround in America will help other major industrialised countries, too. After their GDP is likely to shrink between 4% and 7% this year, Japan, Germany and the UK should experience a zero-growth period in 2010.

The better economic outlook will help bolstering corporate earnings, the most important driver for equity prices. There are positive indications, too. After nearly all companies of the S&P 500 Index have reported first quarter profits, 67% surprised positively. This figure is not only slightly above the historical average, but it was also the first upside surprise since profits began declining in 2007. To be sure, the absolute figures are still bad as the first quarter 2009 marked the seventh consecutive three-month period with negative earnings comparisons. EPS of the S&P 500 Index is down 36% from last year's first quarter. For all 2009, earnings are likely to shrink some 10%. But investors hope that earnings comparisons will switch direction in the fourth quarter 2009 and rise in 2010.

Consolidation ahead?

After a run of 30-40% from their lows, the national equity markets' upside is limited in the short-term, though. Investors have been easy to please in past months. They started to push up stock prices as the US economy was getting worse at a slower than expected pace, as a financial system meltdown could be avoided and as a longer-lasting deflation period has become rather unlikely. What's more, the markets have been quite resilient to negative economic news from the consumer, the labour and the housing sector as well as to talks about a possible negative credit outlook for the US after the rating agency Standard & Poors warned that the UK could lose its triple-A credit rating. But investors won't be pleased so easily any more going forward. They want to see hard data that an actual economic improvement is coming. Less worse than expected data won't be enough, real growth has to emerge. But that could take some time. Also, occasional setbacks cannot be ruled out. In fact, as recessions are ending (or starting), it is quite typical that positive and negative economic data alternate frequently. Hence, we will wait until we eventually continue to increase the allocation to equities in our investment strategies.

Price of gold



Opportunities in corporate bonds

Given the improved economic outlook, we remain positive for commodities, a main beneficiary of a global recovery and the emerging market's increasing hunger for raw materials. Gold is attractive as it serves as a good hedge – or an insurance - in case of an eventual financial or economic setback and in the event that the US Dollar comes under more pressure: The Fed is pursuing an aggressive monetary policy and negative inflation implication can not be ruled out. After the turbulence in recent months and the distortions in many asset classes, there are plenty of opportunities for hedge funds and their medium-term prospects look bright.

Despite a rally on the credit markets, especially in the area of higher yielding paper, we like continue to like corporate bonds. This is because credit spreads are still at historically high levels. We recommend papers with A and BBB ratings. But one has to look at every single issue and issuer specifically. The financial sector for example carries more risk – but potentially higher return – than paper from more defensive names. Government bonds on the other hand remain unattractive. Long-term interest rates are still very low by historical standards and governments are issuing huge amounts of debt in order to finance their rapidly rising public deficits, arising from the various stimulus programs and lower tax income. We expect yields to rise from current levels.

RECOMMENDED ASSET ALLOCATION

FALCON PRIVATE BANK BALANCED STRATEGY USD			
ASSET CLASS	ALLOCATION	CHANGE	COMMETNARY
Cash	17%	-2%	elevated position as we expect opportunities from a market consolidation
Bonds	33%	0%	focus on corporate bonds; government paper offers poor value
Equities	44%	0%	underweight as good economic data still has to materialize
Alternative Investments	6%	2%	increase commodities by 2%; 4% allocation to a fund-of-hedge-fund

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