INVESTMENT STRATEGY

June 2008

Investment Strategy of 4 June 2008

Equity Markets	Last price	1M chg	3M chg	Ytd
(local currencies)	06/06/2008		*(% changes)*	
Stoxx 50	3 050	-6.5	-1.3	-17.2
EuroStoxx 50	3 597	-6.5	-0.6	-18.3
CAC 40	4 795	-4.9	2.5	-14.6
DAX	6 804	-3.0	3.2	-15.7
MIB	31 754	-7.4	-3.2	-17.6
Ibex 35	12 910	-7.8	0.8	-15.0
Footsie 100	5 907	-5.0	2.4	-8.5
SMI	7 386	-2.1	1.6	-12.9
S&P 500	1 361	-4.1	4.3	-7.3
Dow Jones Indus 30	12 210	-6.2	1.4	-8.0
Nasdaq	2 475	-0.4	11.4	-6.7
Nikkei 225	14 489	3.1	9.6	-5.3
Topix	1 428	3.7	10.9	-3.2
MSCI Emerging (USD)	48 617	-2.5	3.9	-5.7
Kospi composite	1 832	-1.4	7.9	-3.4
Bovespa	69 786	-0.6	10.8	9.2
Russia RTS	2 378	10.4	16.0	3.8
India BSE 30	15 572	-10.4	-5.9	-23.2
HS China - Red Chip (HKD)	5 196	-12.0	-0.1	-15.0

Bond Markets	Last yield	1M chg	3M chg	Ytd
	06/06/2008		*(changes in bp)*	
10-year US T-note	3.91	-1	31	-17
2-year US T-note	2.38	-1	82	-74
10-year Bund	4.44	31	65	12
2-year Bund	4.63	85	136	62
10-year Gilt	4.99	31	56	37
2-year Gilt	5.06	65	117	64
10-year JGB	1.80	14	44	30
2-year JGB	0.90	11	37	18
	Last spread	**1M chg**	**3M chg**	**Ytd**
			(changes in bp)	
Lehman Global High yield	587	17	-70	90
Lehman US High Yield	630	-4	-117	66
Lehman EUR High Yield	569	-29	-128	116
Lehman US Invest.grade	239	3	-24	42
Lehman EUR Corporate	161	-1	-6	41
JP Morgan EMBI+	254	5	-29	22

Currencies	Last	1M chg	3M chg	Ytd
	06/06/2008		*(% changes)*	
EUR/USD	1.57	1.2	2.5	7.0
USD/JPY	105.3	0.8	2.2	-6.9
GBP/USD	1.97	-0.3	-2.0	-1.2
USD/CHF	1.02	-2.3	-0.6	-9.4
EUR/JPY	165.7	2.0	4.7	-0.4
EUR/GBP	0.80	1.5	4.5	8.3
EUR/CHF	1.61	-1.2	1.9	-3.0

Commodities	Last price	1M chg	3M chg	Ytd
	06/06/2008		*(% changes)*	
Oil (WTI), $/bl.	138.5	13.7	31.3	44.3
Reuters/CRB index	460.6	-1.8	-4.1	7.5
Gold, $/oz.	901.4	3.0	-7.8	7.5

Source: Factset, BNPP AM

Less financial crisis...

The turmoil in financial markets over the past few weeks does not reflect a drastic change in sentiment on the part of investors, who are still convinced that the worst of the subprime crisis is over. Of course, they may expect more asset write-downs, and rumours of this have already weighed on the share prices of leading banks in both the United States and Europe in early June. Initiatives to provide banks with liquidity were in general well received, and a systemic crisis to the financial system is now no longer a threat.

Other concerns have appeared on the horizon, the main one being inflation and more specifically the effects of rising commodity prices on the global economy and how central banks will respond.

... but more “oil shock”

The scenario of a sharper than expected slowdown in growth after the latest "oil shock" seems to be taking shape. This has limited the rise of equity markets in May (only 1.2% for the MSCI World index) and triggered a 2% correction in the first week of June. Once again it is above all the lack of visibility that seems to be worrying investors and maintaining risk premiums at a high level. The dizzying increase in the price of crude oil, the causes of which are poorly understood, further adds to their concerns.

Our baseline scenario foresees little inflation other than that resulting from higher energy prices. In the current economic environment there seems to be little chance of a steady, substantial and sustained increase in core inflation, i.e. excluding food and energy. The situation is different than during the 1970s however, since this time we are not dealing with a "supply shock". We therefore believe that central banks will take moderate action that will not weigh heavily on growth.

Investors ignore fundamentals

With sentiment and near-term technical factors sending no clear signals, equity markets are likely to once again move more or less trendlessly, at the upper limit of the trading range observed since mid-January. As long as investor sentiment tends to fluctuate it will not be easy to make tactical bets within this range. Investor hesitation and indecision may be seen by the weekly variations in the S&P 500 over the four weeks between our last two Asset Allocation Committee meetings: +2.7%, -3.5%, +1.8% and then -2.8% during the week from 30 May to 6 June.

We believe this environment justifies a slight overweight position in equities. There seems to be little chance of a sharp correction in share prices since valuations are still a strong supporting factor. Furthermore, the very pessimistic outlook for earnings has already been largely factored in. However, volatility is likely to remain high over the near term since a consensus does not seem to be taking shape. The fog has not yet lifted. Waiting for summer!

9 June 2008

Contents

ASSET ALLOCATION

Typical diversified model portfolio – Institutional clients

The model portfolio holdings below are measured against cash and may be transposed into any other portfolio whether benchmarked or not.

MULTI-ASSET CLASS[1]

	Sharpe Ratio	juin-08 weights	mai-08 weights
EQUITIES			
Developed Equities	0.1	0.3%	0.5%
Emerging Equities	0.6	1.3%	1.5%
FIXED INCOME			
Government Bonds	0.0	0.0%	1.0%
Corporate Bonds	0.2	3.4%	1.8%
High Yield	0.2	1.1%	0.1%
Emerging Debt	0.0	0.1%	0.2%
COMMODITIES	0.0		
Brent Oil	0.0	0.0%	0.0%
Base Metals	-0.9	-2.0%	0.0%
Gold	0.1	0.6%	1.8%
Agricultural	0.6	1.1%	1.5%
Cash Euro	0.0	-6.0%	-8.6%
Module Total		0.0%	

1- Hedged in Euro, 2- MSCI hedged in Euro
3- MSCI in Euro, 4- JP Morgan GBI hedged in Euro,
5- Forwards to Euro investor
* Risk Budget (in bp),** VaR 99% 1 month,
***Net: Multi-Asset Class

EQUITIES: DEVELOPED COUNTRIES[1]

	Alpha	juin-08 weights	mai-08 weights
US	0.2	1.3%	1.0%
Canada	0.2	1.5%	1.1%
Euroland	-0.2	-2.1%	-2.0%
Japan	0.1	0.9%	0.1%
UK	0.0	0.2%	1.8%
Switzerland	0.0	-0.2%	-0.3%
Australia	-0.2	-1.5%	-1.8%
Module Total		0.0%	

EQUITIES: EMERGING COUNTRIES[3]

	Alpha	juin-08 weights	mai-08 weights
Brazil	0.2	0.5%	1.1%
Mexico	-0.2	-0.8%	-1.4%
China	0.1	0.1%	0.8%
India	-0.5	-1.4%	-0.7%
South-Korea	0.4	1.3%	0.7%
Taiwan	-0.2	-0.8%	-0.2%
Russia	0.4	1.4%	1.0%
Poland	-0.2	-0.6%	-1.4%
South Africa	0.1	0.3%	0.2%
Turkey	0.0	0.0%	0.0%
Module Total		0.0%	

BONDS: COUNTRIES SOVEREIGN[4]

	Alpha	juin-08 weights	mai-08 weights
US	-0.4	-10.3%	-2.5%
Euroland	0.3	10.7%	8.0%
Japan	0.0	-0.6%	-7.8%
UK	0.3	5.1%	-2.8%
Switzerland	-0.2	-4.9%	5.2%
Module Total		0.0%	

PORTFOLIO STATISTICS

Ex-ante Volatility	1.00%
Ex-ante Var*	0.67%
Excess Return over Cash at 84.1% conf.	0.46%
Conf. of beating Cash by 2%	29.5%
Risk of falling below Cash -0.5%	2.49%

Strategy overview

- Slight overweight in equities and preference for emerging regions maintained. Fears of sustained higher inflation have replaced the threat of a systemic crisis.
- Position in government bonds back to neutral. Despite the economic slowdown central banks are adopting a tougher stance on inflation and the risk of rising expectations.
- Exposure to high-grade debt increased, and also to high-yield issues, but to a lesser extent.
- Exposure to commodities was decreased, and in particular to metals, which are more vulnerable to the slowing global economy. We are wary of oil over the near term given the record prices reached. The removal of some or all price subsidies in Asia could slow demand somewhat.

Geographic equity allocation

- Preference for North-American markets maintained. Monetary loosening and fiscal stimulus measures will gradually revive the US economy in the second half of the year. Although the Fed is adopting a tougher stance on inflation it is likely to wait until the recovery is confirmed before taking action. The Canadian market is one of the few to show upward revisions in earnings forecasts.
- We have increased our exposure to the Japanese market, which offers attractive valuations and is benefiting from the return of foreign investors, despite the negative outlook for the economy and earnings.
- Exposure to the UK has been trimmed back to neutral. The rapid deterioration of the balance between inflation and growth has postponed expectations of interest rate cuts. Relative valuations are among the most attractive.
- We are maintaining our underweight position in the euro zone in light of the region's slowing economy, the euro's strength and the emergence of pressures on profit margins that will weigh on earnings growth, while the ECB stands ready to increase interest rates in July.
- We are still underweight in Australia, where relative valuations are high and a slowdown may be expected after the recent raising of interest rates.
- Among the emerging economies we prefer Brazil, South Korea and Russia. Valuation of the Russian market is attractive and lower taxes on oil revenues are expected, but inflation may pose a problem. We are reducing our exposure to the Brazilian market since it is now less attractively valued relative to our emerging universe.
- We have trimmed our overweight position in China, where pressure on profit margins is mounting, credit conditions are less favourable and valuations are stretched.

Government bonds

- We are underweight in the US, where inflation is high, monetary tightening is expected and the economy will recover gradually.
- We are overweight in the UK and the euro zone, where the recent rise in yields resulting from the sudden shift in investor expectations of ECB and BoE monetary policy has made relative valuations attractive.

ECONOMIC OUTLOOK

GLOBAL

Inflation situation much different than during the 1970s

The recent surge in oil prices has revived memories of the oil shocks of the 1970s. We see little resemblance however between the current situation and what happened over 30 years ago, particularly since the return of high inflation, the scourge of the 70s, seems very unlikely.

No wage-price spiral. The combination of forces that drove inflation upward in the G7 countries from 4.5% in mid-1972 to 14.8% at end-1974 and to 13.7% for core inflation (OECD data) no longer exists. During the 70s wages were often indexed on inflation and powerful unions were able to obtain substantial wage increases. Unions made their power felt not only in the manufacturing sector (which accounted for 30% of GDP at the time) but also in many service industries, such as transportation and utilities. According to the Bureau of Labor Statistics the number of workers in the US involved in work stoppages has decreased by a factor of 10. It would no doubt be a bit naive to think that this situation merely reflects less tension between management and labour.

In the past, the indexing of wages to prices, whether automatic or negotiated, sustained inflation. Hourly wages in the United States, which grew at an annual rate of 6% in 1970, were rising 8% at the end of the decade. In April 2008, year-on-year wage growth was only 3.4%, while inflation was 3.9%. Many similar examples may be found. In France, where the government's annual indexing of the minimum hourly wage was brought forward to May this year, studies show that increases in the minimum wage have done little to push up the wages of better paid employees and the gap between the lowest and median salaries is narrowing. The recent wage increases in Germany were mainly in the public sector, where wages had been stagnating for several years, or in highly productive manufacturing industries. Given labour's weak bargaining power and the limited spread and impact of wage increases we believe the "second-round" effects feared by the ECB will be minor.

Globalisation also relieves inflationary pressures. It is no secret that the increase in emerging economy exports is reducing the proportion of goods manufactured in the developed countries, and of course at a higher cost. The increasing complexity of the products that emerging countries are able to manufacture has considerably expanded the range of cheaper foreign imports since the 1970s.

How central bankers are responding. Monetary authorities in the emerging countries are not showing the same response to this commodity-driven inflation as their counterparts in the developed countries. Since emerging central banks are still building their credibility they cannot allow inflation to rise too far above their targets without taking action and have therefore started to raise interest rates. Central bankers in the developed economies can take a lighter hand in adjusting interest rates to keep inflation expectations under control. This of course is the case of the US Federal Reserve, whose main priority was first to deal with the financial crisis by massively cutting interest rates and which has only recently begun to adopt a more hawkish stance that emphasizes the risk of inflation. The Fed's credibility should be sufficient to keep a lid on inflation expectations. If necessary, the Fed may raise interest rates a bit, as the ECB plans to do.

There is therefore no longer a necessary link between rising oil prices, inflation, inflation expectations, wage demands, wages and more inflation, as was the case in the 70s. That is good news.

Consensus Forecasts: Growth & Inflation

	GDP y.o.y %										Inflation y.o.y %									
	2007	2008				2009				2007	2008				2009			
M= Mean; H= High; L=Low		M	H	L	-1M	M	H	L	-1M		M	H	L	-1M	M	H	L	-1M
Developed Economies																		
USA	2.2	1.3	1.9	0.8	[1.3]	1.9	3.3	0.5	[2.1]	2.9	3.8	4.1	3.0	[3.6]	2.4	3.6	1.5	[2.3]
Canada	2.6	1.3	2.2	0.8	[1.4]	2.2	3.0	1.4	[2.3]	2.2	1.7	2.4	1.3	[1.7]	2.0	3.0	1.4	[2.0]
Euro zone	2.6	1.5	1.8	1.3	[1.5]	1.6	2.1	1.1	[1.7]	2.1	3.1	3.5	2.6	[2.9]	2.1	2.5	1.7	[2.1]
UK	3.1	1.7	2.0	-0.1	[1.6]	1.6	2.3	-1.3	[1.7]	2.3	2.7	3.0	2.4	[2.6]	2.2	3.0	2.4	[2.0]
Switzerland	2.8	2.2	2.6	1.8	[2.2]	1.7	2.0	1.1	[1.7]	0.7	1.9	2.3	1.5	[1.9]	1.2	1.7	0.7	[1.3]
Japan	1.8	1.3	1.7	1.0	[1.3]	1.6	2.9	0.6	[1.7]	0.1	0.8	1.1	0.5	[0.7]	0.5	1.0	0.1	[0.5]
Australia	3.9	3.0	4.1	2.5	[3.1]	3.0	3.9	2.0	[3.0]	2.3	3.9	4.3	3.4	[3.4]	3.0	3.5	2.4	[2.8]

Source: Consensus Forecasts as of 12/05/2008; Asia Pacific Consensus Forecasts as of 12/05/2009; Latin American Consensus Forecasts as of 19/05/2008; Eastern European Consensus Forecasts as of 19/05/2009

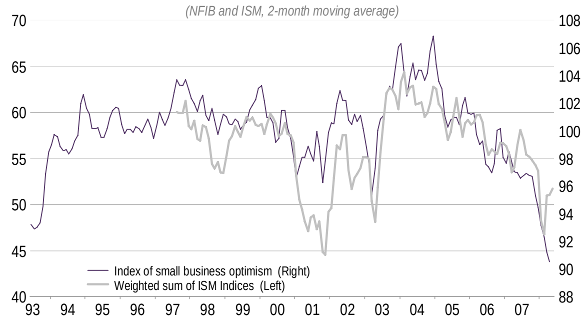
ECONOMIC OUTLOOK

UNITED STATES

A fragile improvement in spring

Economic indicators released over the past few weeks confirm our scenario of a slowdown but not a collapse in economic activity, with numerous statistics coming in above expectations, such as retail sales excluding automobiles, durable goods orders, ISM indices and even housing starts. Net job losses in May are estimated at 49,000, bringing the total over the first five months of the year to 324,000. The increase in the unemployment rate from 5% to 5.5% in May does not reflect rapid weakening of the employment situation, but rather the seasonal effect of the entry of many young people into the job market. None of the recent indicators are consistent with the levels normally observed during recessions, except for consumer and small business confidence. The sharp drop in confidence is a recent phenomenon that we believe does not reflect economic reality, nor even expectations, but rather the very depressed mood that prevailed early in the year. The opinions of purchasing managers in the largest companies are likely to be a more reliable indicator of the economic outlook than those of households and small companies.

ISM surveys do not show a collapse

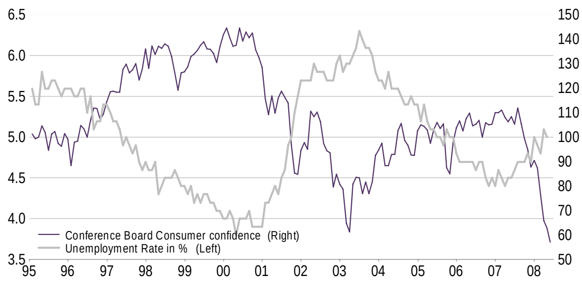


Source: Factset, BNPP AM

Fiscal stimulus should boost the economy. Under its fiscal stimulus plan the US government returned almost 100 billion USD (representing 1% of private consumption) to some 130 million households in May and June. For example, a family with two children and a adjusted gross annual income of $150,000 received a $1,800 check. According to a survey commissioned by the National Retail Federation, consumers plan to spend 40% of their tax rebate (vs. 30% during the 2001 stimulus plan), use 26% to repay their debts and save 19%. In addition to this, retailers are planning special "tax cut" incentives to encourage consumers to purchase cyclical goods rather than gasoline or other staples. We may therefore see a rebound in consumer spending in the second quarter, after modest annualised growth of only 1% in the first. The drop in consumer confidence (at its lowest level since October 1992) is not likely to weigh on spending.

The recent increase in crude oil prices has driven up the price of gasoline from $3 a gallon at the start of the year to almost $4. There is no doubt that this constitutes an "oil tax" on consumption. However, energy products now account for a much smaller share of total consumer spending than 30 years ago, thanks to more efficient energy use and substitute products. An oil "shock" will therefore have less impact on growth.

Consumer confidence plunges



Source: Factset, BNPP AM

Ben Bernanke puts his cards on the table. Since mid-March the Federal Reserve's chairman has been doing his best to convince commentators that he is no longer in "crisis management" mode and that monetary loosening is coming to an end. The central bank's comments point out the magnitude of the cuts made since the financial crisis first broke out last summer (325 bp for the fed funds rate) and the measures taken to inject liquidity into financial markets to get them back to normal. The Fed is also now stressing the increasing risk of inflation as economic data confirm that the slowdown is not likely to lead to a recession. The Fed's more hawkish stance is probably intended to anchor monetary policy expectations rather than signal an imminent increase in interest rates. Moreover, in Mr. Bernanke's opinion interest rates in early June were "correctly positioned" relative to the risks facing the US economy. We believe that interest rate futures reflect exaggerated expectations of monetary tightening before the end of the year.

ECONOMIC OUTLOOK

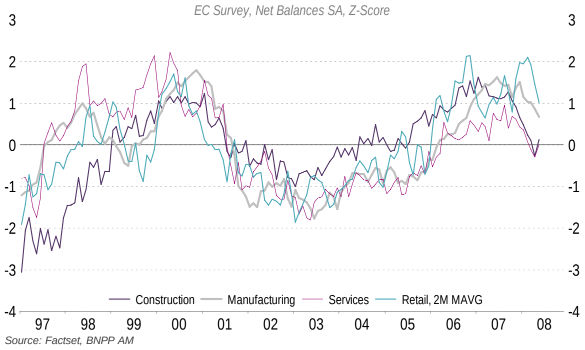
EURO ZONE

Do not expect another surprisingly good quarter like Q1

The pick-up in GDP growth in the first quarter masks increasing imbalances... Euro-zone GDP grew 0.8% q/q in the first quarter of 2008 (after 0.3% in Q4), for 2.2% growth year-on-year. This strong performance may be attributed to the robustness of investment, since private consumption growth was sluggish and net exports made only a very small contribution. But this apparent resilience of Europe's economy masks significant differences across countries, with Spain and Italy slowing sharply while Germany's economy grew an impressive 1.5% q/q. But there are also imbalances in the components of German GDP, with inventories making a large contribution and construction investment rebounding mainly due to favourable weather. The flipside of this may however be a sharp slowdown in economic activity in the 2nd quarter since there seem to be no new growth drivers, and German consumer spending can certainly not be counted on judging from the further drop in retail sales in April.

... and cannot be sustained in such a soft environment. The euro zone's strong economic performance cannot be sustained in the current environment and we expect GDP growth to slow from the second quarter. Business confidence surveys reveal a steadily deteriorating outlook in all sectors. The PMI composite index continued to weaken in May, slipping to 51.1, its lowest level since mid-2003.

Firms are starting to scale back hiring plans

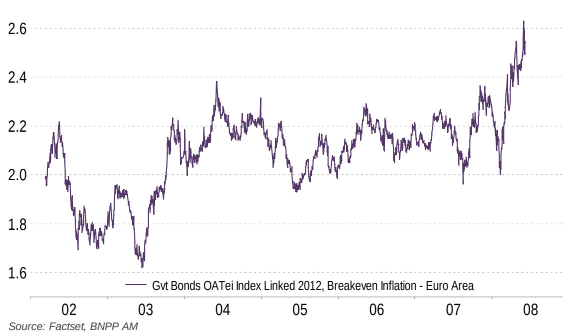


Source: Factset, BNPP AM

It is true that slowing global demand, the euro's strength, surging commodity prices, high inflation, tighter monetary and credit conditions and the sharp slowing of the property market in some EU countries will be a significant drag on growth over the coming quarters. In addition to the erosion of their purchasing power by fast-rising prices and the tightening of both mortgage and consumer credits, households will also have to face a steadily declining labour market over the next few quarters.

ECB adopts tougher stance much sooner than expected and says it is ready to raise interest rates as early as July to anchor inflation expectations. The ECB's main concern now is not the coming economic slowdown, but the mounting inflation expectations caused by rising prices, which rose at an annual rate of 3.6% in May according to Eurostat's flash estimate. This was the 7th straight month of over 3% inflation, well above the central bank's 2% target. The ECB is therefore worried about triggering a wage-price spiral, something it is determined to avoid at all costs in accordance with its mandate to ensure price stability. Hence Jean-Claude Trichet's statement at the ECB's press conference on 5 June, to almost everyone's surprise, that the central bank's governors could "*decide to move [their] rates by a small amount in [the] next meeting in order to secure the solid anchoring of inflation expectations, taking into account the situation. I don't say it is certain, I say it is possible*". After language like this, and considering the ECB's determination to anchor inflation expectations, it would now be extremely difficult for it to reverse its position without damaging its credibility. Axel Weber, the president of the Bundesbank, even went on to say that words would be followed by action. We take the ECB's statements seriously and have added a 25 bp rate hike in early July to our scenario, bringing the refi rate to 4.25%. Unless there is a considerable slowing or reversal of commodity prices over the coming months the ECB will remain hawkish.

Inflation expectations are rising



Source: Factset, BNPP AM

ECONOMIC OUTLOOK

UNITED KINGDOM & SWITZERLAND

United Kingdom:

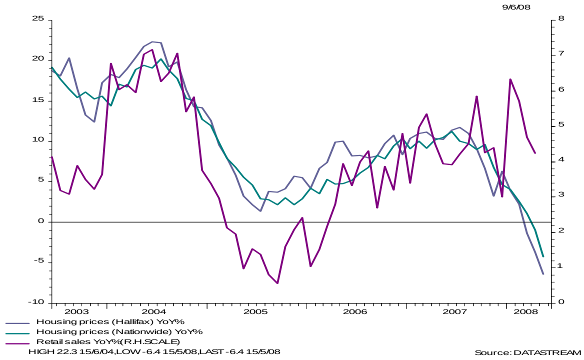
The slowing of the UK's economy is becoming increasingly apparent. House prices continue to fall, and even at an accelerated rate, and are now even down significantly year-on-year. With interest rates on mortgage loans still relatively high and loan approval rates still declining from an already historically low level, we do not expect the UK housing market to recover any time soon. Economic and confidence indicators are also weak. PMI indices continue to decline, particularly in the services sector, while consumer confidence, which is already quite low, further deteriorates. Retail sales are still robust, but given the above factors they are certain to slow, as all retail sector surveys suggest.

Given the marked economic slowdown that is taking shape, the recent surge in inflation puts the Bank of England in a very delicate position. We expect UK inflation to accelerate over the summer and then gradually slow as the base effects of commodity prices and foreign exchange rates and the ongoing economic slowdown begin to take effect. We continue to believe that the BoE will be compelled to loosen monetary policy further but that the next interest rate cut will not be until the end of the third quarter, since consumer inflation expectations are still quite high.

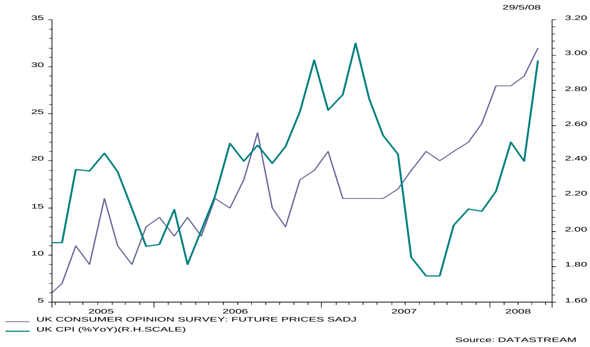
Switzerland

All indicators of economic activity and sentiment continue to weaken. The slowing of the euro zone, Switzerland's main trading partner, will make its impact increasingly felt over the next few quarters. Consumer spending, which has been robust until now, will also slow. Indeed, the jobless rate will increase and the global credit crunch's consequences on the financial sector and the jump in inflation to 2.9% in May are certain to weigh on consumer morale. Core inflation is also rising rapidly and consumer inflation expectations remain high. Under these conditions the SNB will certainly not lower rates before the fourth quarter. When we learn more about the central bank's position in June and what direction the Swiss franc is taking, we will be able to refine this scenario.

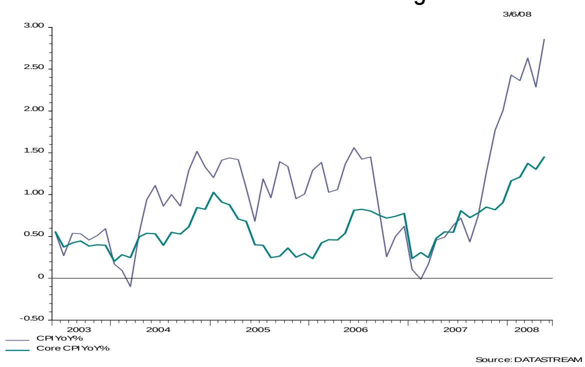
United Kingdom - falling house prices bode ill for retail sales



United Kingdom – inflationary pressures mount



Switzerland - inflation surges



ECONOMIC OUTLOOK

JAPAN

Still no recession... for now!

Momentum still negative. Japan's most recent economic statistics are not very reassuring and point to a slight acceleration of the current slowdown. Although GDP growth in the first quarter was certainly solid, based on the first estimates, we do not believe this pace can be sustained over the coming months. The strongest contributors to GDP were private consumption and exports, both of which are likely to weaken.

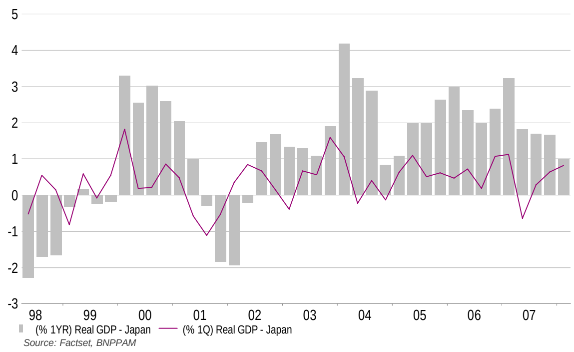
Foreign demand still crucial. We have been presenting foreign demand as the key factor that will prevent Japan from slipping into recession. Although we believe this is still the case, we acknowledge that the risks are high. Indeed, most recent figures show that global demand is slackening, even in Asia and we would not be surprised by a gradual and moderate decline.

The outlook for domestic demand is also not very good. Rising commodity prices are not only squeezing the profit margins of Japanese firms but also weighing on their investment plans. A deterioration of the labour market may be expected, and the recent weakening of the jobless rate and the ratio of job offers to applications is likely to continue.

Consumer spending will therefore feel the double impact of weaker employment and rising prices, particularly of energy and food.

The BoJ's dilemma. The Bank of Japan is confronted with the same problem as other central banks, i.e. how to deal with slowing growth when commodity prices are increasing. Although the BoJ is more concerned with inflation and its spread through the economy, the current level of inflation is in itself no cause for concern The core-core index, which excludes energy and food is still around 0%. Given these factors, we believe the BoJ is most likely to keep monetary policy on hold over the coming quarters.

GDP still robust in Q1 according to first estimates

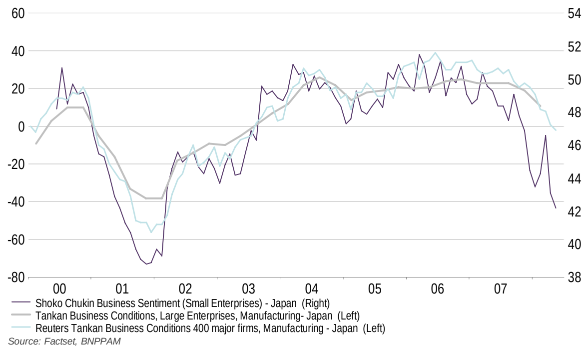


Source: Factset, BNPPAM

Exports and consumption will make smaller contribution

Source: Factset, BNPPAM

Business sentiment continues to weaken



Source: Factset, BNPPAM

ECONOMIC OUTLOOK

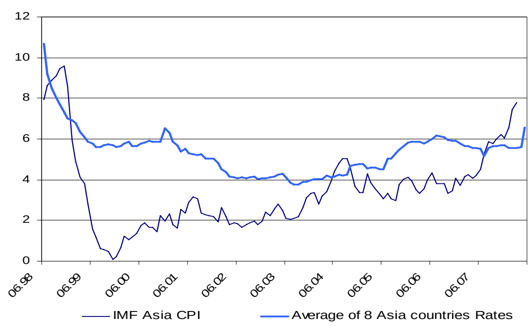
ASIA EX-JAPAN

Asia – high commodity prices are causing pain

Economic activity is still quite robust in Asia and not least in China and India. For example, bank lending rose 24.4% in Singapore last month while Chinese investments grew 25.7% over the first four months of the year. However, the disturbing rise of food and energy prices could push up interest rates everywhere and rapidly dampen growth. Indeed, energy and food expenditures represent a very large portion of Asian government and household budgets.

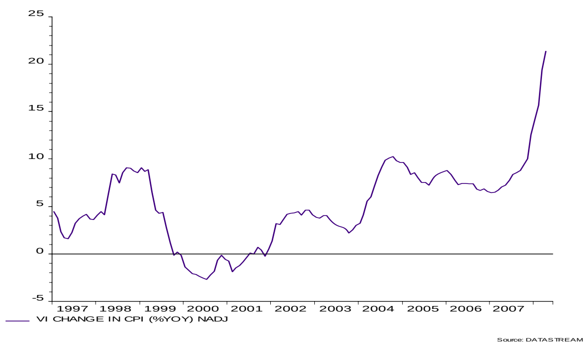
In many Asian countries the price of fuel is capped, with the government paying the difference between the subsidised price and the market price. These fuel subsidies may be considerable, and in the case of Malaysia exceed 8% of GDP. Although they greatly reduce the burden on consumers, they pose a substantial threat to government budgets when oil prices rise sharply. This is why some countries very recently have abandoned these subsidies. However, bringing the price of gasoline and other fuels in line with the market price represents in effect a consumption tax that will also push inflation sharply upward. It should be noted that this impact on inflation is mainly cyclical and limited to certain products.

Interest rates set to rise



Vietnam's economy is in crisis. The explosive growth of lending, the widening trade deficit and the massive inflow of foreign funds to finance local projects have resulted in a severe crisis that has driven prices at end-May 25.2% higher than a year earlier. This puts unsustainable pressure on the country's currency, which investors expect will drop 28% over the next 12 months. This pessimism has of course affected the performance of financial assets and caused share prices to plunge 60% since the beginning of the year and bond yield spreads to widen considerably.

Vietnam – an inflation crisis



India continues to grow at a disturbingly fast pace, with GDP rising much more than expected in the first quarter, by 8.8%. Although this growth is being driven primarily by domestic demand, particularly in technology services and construction, it is also generating high inflation and putting the country's central bank in a delicate position. The dilemma it must face is whether to raise interest rates and risk stifling the manufacturing sector, which is already heavily burdened with debt, or do nothing and accept the surge in commodity prices which may trigger social unrest. It must also decide whether to reduce fuel price subsidies, which could have disastrous social consequences, particularly with elections coming up.

China's PMI index for May was 54.7, which is still very high and suggests that business momentum will remain strong for the next quarter. Domestic demand continues to be the main growth engine, thanks in no small part to Olympics-related spending, as exports decline significantly in the wake of the global slowdown. Chinese firms are facing a difficult situation since their profit margins are being squeezed considerably. The prices of their production inputs are rising sharply and they are having a hard time passing higher costs on to their customers, as foreign demand slackens and the yuan's rise reduces their competitiveness. The most recent figures show that the Sichuan earthquake has had only a moderate impact on the national economy, since Sichuan province accounts for only 5% of China's GDP and the value of the property damaged is less than 0.25%.

ECONOMIC OUTLOOK

EMERGING EUROPE

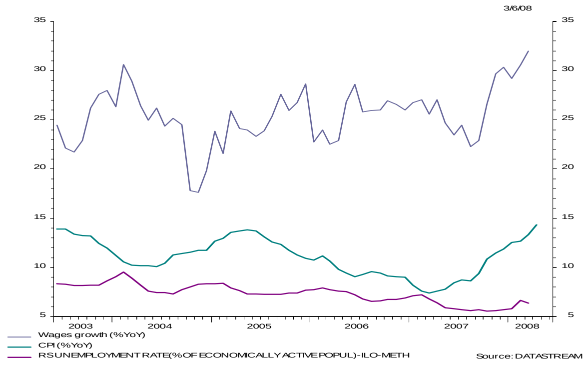
Emerging Europe

Russia

Despite a slight slowdown in wage growth and retail sales (which however are still rising at a very robust pace) inflation rose above 15% in May. Sharp increases in producer prices had much to do with this. Investment remains strong, even though foreign investment in the first quarter was softer than expected. The government's plans to stimulate production in the oil industry and develop infrastructure will however no doubt bolster foreign investment over the next few quarters.

To relieve inflationary pressures, the country's central bank will maintain its strong rouble policy, while also continuing to raise interest rates and increase bank reserve ratio requirements.

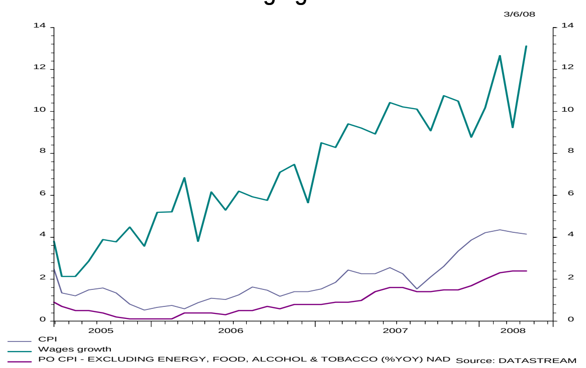
Russia – strong growth and rising inflation



Poland

Despite the threat of slowing exports, Polish GDP growth remains very strong, thanks in large part to consumer spending which continues to be underpinned by strong wage gains and steadily declining unemployment. Both headline and core inflation have however slowed somewhat recently. Although monetary tightening is certainly coming to an end, we may still see a bit more since Poland's central bank fears second-round effects and more upward pressure on wages.

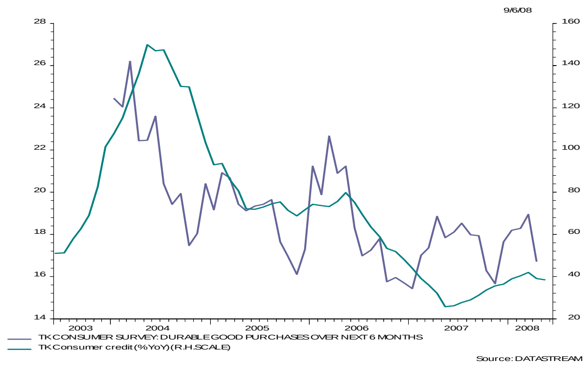
Poland – inflation should slow temporarily despite rapid wage growth



Turkey

The Turkish central bank raised interest rates by 50 basis points in May. We expect it to continue to tighten monetary policy over the next few months in order to keep stubborn inflationary pressures in check. Turkey's high dependence on foreign energy and the lira's sharp drop earlier in the year have continued to put upward pressure on inflation. Furthermore, this pressure will soon be accentuated as some government-controlled prices are increased. Core inflation is also accelerating, even though the already high jobless rate has increased. Under these conditions, consumer spirits are understandably quite low, particularly since there has been no improvement in the political and institutional situation.

Turkey – household consumption and lending still weak



ECONOMIC OUTLOOK

LATIN AMERICA

Latin America

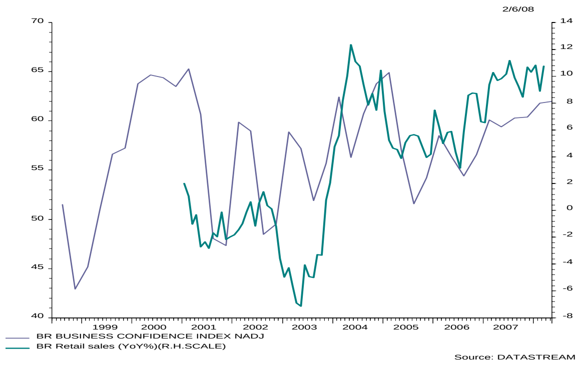
Brazil

Brazil's economy is still robust. Inflation continues to accelerate and therefore justifies further monetary tightening. Tighter monetary conditions have so far had only a limited impact on household spending, which has been bolstered by rising employment, and have not stopped credit from expanding.

Despite the strength of the real, exports continue to benefit not only from the strong demand for commodities and their high prices, but also from emerging country demand for manufactured Brazilian products.

We expect government spending and foreign capital inflows to maintain investment at a high level.

Brazil - consumption and business confidence

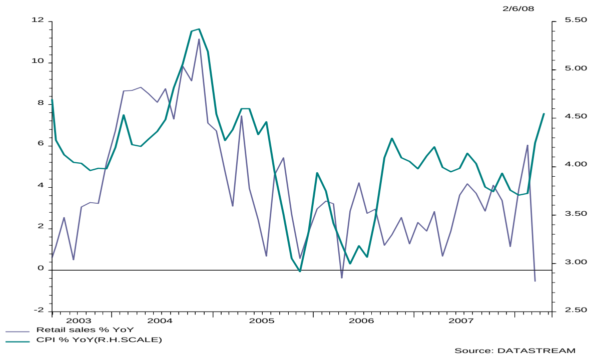


Mexico

First-quarter GDP and the latest retail sales figures were disappointing. Consumer confidence plunged recently as inflation rose and remittances from Mexican workers in the United States declined.

The slowing US economy also means that the outlook for the manufacturing sector is dimmer.

Mexico - retail sales and inflation



Consensus Forecasts: Growth & Inflation

	GDP y.o.y %									Inflation y.o.y %								
	2007	2008				2009				2007	2008				2009			
M= Mean; H= High; L=Low		M	H	L	-1M	M	H	L	-1M		M	H	L	-1M	M	H	L	-1M
Developing Economies																		
China	**11.4**	**10.0**	10.8	9.5	[9.9]	**9.3**	10.2	8.0	[9.3]	**4.8**	**6.3**	7.2	5.5	[6.0]	**3.8**	7.2	1.6	[3.7]
India	**8.6**	**7.7**	8.2	7.0	[7.7]	**8.1**	8.8	7.5	[8.2]	**5.9**	**6.1**	7.0	5.5	[6.0]	**5.5**	6.9	4.7	[5.4]
South Korea	**4.9**	**4.5**	5.0	3.6	[4.5]	**4.8**	5.7	3.2	[4.8]	**2.5**	**3.7**	4.5	2.9	[3.5]	**3.2**	3.6	2.3	[3.0]
Taiwan	**5.7**	**4.1**	5.0	2.4	[4.1]	**4.5**	5.2	3.4	[4.6]	**1.8**	**2.8**	3.8	1.9	[2.6]	**2.3**	3.7	1.4	[2.1]
Argentina	**8.7**	**6.8**	7.5	5.3	[7.0]	**4.5**	6.1	3.0	[4.9]	**8.5**	**9.5**	11.0	8.2	[9.7]	**10.2**	15.5	6.9	[10.6]
Brazil	**5.4**	**4.8**	5.2	4.5	[4.7]	**4.2**	4.6	3.7	[4.2]	**4.5**	**5.1**	5.5	4.5	[4.6]	**4.4**	4.7	3.4	[4.3]
Mexico	**3.3**	**2.6**	3.0	2.2	[2.5]	**3.1**	4.0	1.2	[3.2]	**3.8**	**4.2**	4.7	3.8	[3.9]	**3.5**	3.7	3.2	[3.5]
Poland	**6.5**	**5.3**	5.8	4.7	[5.3]	**4.9**	5.5	4.3	[4.9]	**2.5**	**4.2**	4.6	3.8	[4.1]	**3.4**	4.5	2.9	[3.3]
Russia	**8.1**	**7.3**	7.9	6.5	[7.2]	**6.7**	7.6	6.0	[6.7]	**11.9**	**12.3**	15.0	10.0	[11.5]	**9.6**	11.6	8.5	[9.6]
Turkey	**4.5**	**4.0**	4.6	2.9	[4.0]	**4.8**	6.0	3.7	[4.9]	**8.7**	**9.7**	10.5	8.3	[8.9]	**7.3**	9.0	5.6	[6.6]

Source: Consensus Forecasts as of 12/05/2008; Asia Pacific Consensus Forecasts as of 12/05/2009; Latin American Consensus Forecasts as of 19/05/2008; Eastern European Consensus Forecasts as of 19/05/2009

BOND MARKETS

Government bonds

ECB adopts a more hawkish tone. Although recent yield movements show that bond investors are indeed concerned about growth, they also reveal that their main concern is central banks and their policies. This explains why there was more pressure on European than US bond yields, which might not seem to make sense since both the euro zone and the US face similar inflation concerns. But although the growth gap does put greater pressure on European yields, the growth dynamic is quite different in the two markets, since the US has reached the end of its monetary loosening cycle and has a very accommodative policy, while the euro zone has not begun to lower interest rates although growth is slowing. The difference therefore lies in what the Fed and the ECB are saying, and in particular about the risk of inflation.

Valuations are mixed. Since the Fed has probably stopped loosening monetary policy, yields in the United States should be heading upward over the coming months. Since the economic recovery will take some time to get underway, the increase in yields should be gradual, but could accelerate if inflation fears intensify and encourage Fed officials to raise rates more rapidly. In any case, with yields at their current levels US bonds are too expensive and we recommend that investors stay away.

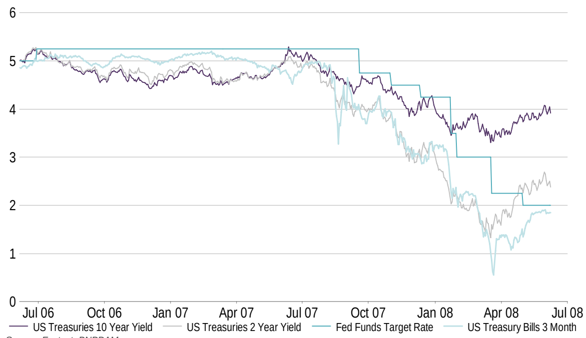
In Europe the situation is getting a bit more complex after Mr. Trichet's most recent statements, which now imply interest rates may be raised in July. What he has said has had a particularly strong impact on the short end of the yield curve and a more moderate one on 10-year yields, which however have drawn near 4.50%. This might seem to be a good time to get into the market considering its fundamentals (i.e. a slowing economy and no wage-price spiral) and now more attractive valuation. However, the ECB has made it clear to investors what its current priorities are and could continue to raise interest rates to forestall second-round effects. This position is likely to continue to weigh on longer maturities for a little while yet. Thereafter however we expect longer yields to stabilize at slightly lower levels.

In the United Kingdom a similar movement may be seen, with the BoE confirming its concerns about inflation expectations. The fact that the economic slowdown is more pronounced in the UK than in the euro zone makes the trade-off between growth and inflation all the more delicate. Unless inflation expectations get out of hand, we expect yields to stabilize slightly below their current levels.

All in all, we believe there are currently too many risks and uncertainties in bond markets and prefer to reduce our modest overweight position back to neutral.

Relative bets. Recent developments in government bond markets have changed relative technical configurations and valuations. We therefore recently reduced our exposure to markets that have been holding up relatively well recently, by increasing our underweight position in the United States and going underweight in Switzerland. Conversely, we are overweighting European and UK issues and increasing our exposure to Japan to near neutral.

US yields are edging back up



Source: Factset, BNPPAM

Interest Rate Forecast Summary : Major Markets

% End of Period		2007	05-Jun-08	2Q 08	3Q 08	4Q 08	1Q 09
US	Fed Funds	4.25	2.00	2.00	2.00	2.00	2.25
	10Y T-Note	4.03	4.04	3.75 - 4.00	4.00 - 4.25	4.00 - 4.25	4.25 - 4.50
EURO ZONE	Refi Rate	4.00	4.00	4.00	4.25	4.25	4.25
	10Y Bund	4.21	4.48	4.25 - 4.50	4.25 - 4.50	4.00 - 4.25	4.00 - 4.25
UK	Base Rate	5.50	5.00	5.00	4.75	4.50	4.25
	10Y Gilt	4.59	5.04	4.75 - 5.00	4.50 - 4.75	4.50 - 4.75	4.50 - 4.75
SWITZERLAND	Target Rate	2.75	2.75	2.75	2.75	2.75	2.75
	10Y Govt	3.07	3.28	3.00 - 3.25	3.00 - 3.25	3.00 - 3.25	3.00 - 3.25
JAPAN	O/N Call Rate	0.50	0.50	0.50	0.50	0.50	0.50
	10Y JGB	1.47	1.74	1.50 - 1.75	1.50 - 1.75	1.50 - 1.75	1.50 - 1.75

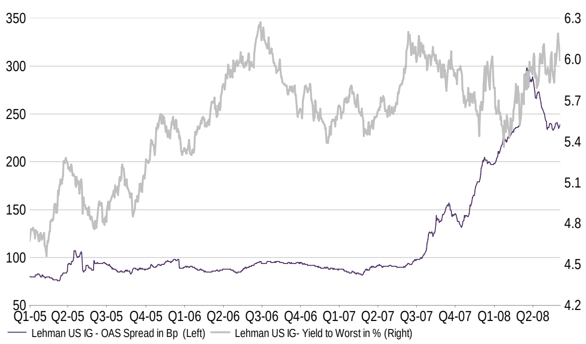
Source: BNPP AM as of 6/6/2008

BOND MARKETS

Bond diversification

High grade – market stabilizes in May. CDS and cash corporate bond spreads were more or less stable in May, with the Itraxx Main spread ranging from 70 bp to 80 bp and spreads on comparable US and European corporate bond indices tightening slightly. The beginning of June saw a slight increase in yields after the lowering of credit ratings on the main monoline insurers and the substantial recapitalization needs of bankers and brokers across the world became apparent. CDS spreads were very volatile but showed no clear trend. Despite the tightening of cash spreads, a further 20 to 30 bp rise in government bond yields made overall performance for the month slightly negative. The primary market was once again very active in May, while the secondary market continued to lack liquidity, particularly in Europe. May therefore saw the corporate credit market stabilize with a significant decline in volatility. This market's weaker performance was often more a problem of liquidity than issuer credit-worthiness. Despite the recent improvement in spreads, corporate bonds still offer considerable potential, particularly those of high-quality financial issuers, and this is also even true of securitizations of sound quality, such as AAA-rated European ABS.

Investment grade yields and spreads



High yield – at last a normal month. The HY market stabilized in May with Itraxx crossover spreads ranging from 400 to 450 bp. The cash bond market also benefited from the still only very partial decrease of the CDS/Cash basis. Cash bond indices thus posted a gain for the month, returning approximately the HY carry return. The deterioration of equity and fixed-income markets in early June caused spreads to increase slightly.

At their current levels, spreads are much higher than the default rate observed on HY issues or on loans on HY issuers. However, with credit conditions now less favourable and with many poor quality issues over the past few years, the default rate is likely to continue to increase and end the year at around 5% However, it would take a marked recession in the US and Europe for the default rate to rise much more than this. We doubt that this will happen and believe that after the roller coaster ride early in the year high-yield credit is likely to produce more stable returns, near its carry return of approximately 10%. We are therefore taking a slightly overweight exposure to this asset class.

Emerging debt - still resilient despite inflation concerns. Emerging debt spreads stabilized in April, with the EMBI+ index at about 250 bp. US Treasury yields were very volatile and trended slightly upward bringing performance for the month near the emerging debt carry return. Some non-investment grade countries, such as Vietnam, Pakistan and Sri Lanka saw their spreads do considerably worse. Other countries bolstered their currencies through intervention in forex markets. Such movements often reflect the tensions that build up when inflation accelerates in non-investment grade countries. It is also clear that emerging debt markets are relatively unaffected by the financial crisis stemming from the US subprime lending debacle and that they still enjoy strong global investment flows. Since Brazil's credit rating was raised to investment grade status by a second rating agency, its sovereign debt will now be included in the Global Aggregate indices. Moreover, over half of emerging market debt now has an investment grade rating.

Although fundamentals are still favourable overall, given the risks associated with the second-round effects of rising energy and food prices and the size of the yield gap vis-à-vis the high-yield market, we are maintaining near neutral exposure in emerging debt markets.

CURRENCY MARKET

To everyone's surprise, Ben Bernanke also claims stronger dollar is in the US's interest!

On 3 June, the Federal Reserve's chairman surprised market observers by using much of his speaking time at an international monetary policy conference in Barcelona to talk about the US dollar. Among other things he pointed out that the Fed was "carefully monitoring" foreign-exchange markets "in collaboration with the Treasury". Of course, Mr Bernanke did not fail to mention the "implications of changes in the value of the dollar for inflation and inflation expectations", in order to tie the dollar in with the central bank's monetary policy, which he feels "seems well-positioned to promote moderate growth and price stability over time".

Foreign-exchange traders got the message and EUR/USD immediately dropped from 1.56 to 1.545. Prior to this, the exchange rate had been fluctuating widely and mainly in response to Fed and ECB monetary policy considerations and economic data. But these two factors worked against each other: while the ECB's very hawkish and repeated comments on inflation dashed all expectations of a cut in interest rates and thus supported the euro, weak economic data (housing starts in France and weaker business confidence and retail sales in Germany) proved that the euro zone's economy was slowing, after stronger-than-expected GDP growth in the first quarter.

In this rather confusing environment, support and resistance levels played a key role, with EUR/USD bouncing off of 1.58 several times after comments by Jean-Claude Trichet and Axel Weber. If EUR/USD breaks through the bottom of 1.5290 reached after Mr Bernanke's statements we would expect a more marked drop.

As we anticipated, the growth differential between the United States and the euro zone is now the dominant theme in currency markets. Since we believe this is likely to work in favour of the dollar over the coming quarters, we are confirming our targets (*see table below*). Belief that the US economy may not slip into recession should enable the dollar to hold its ground against many currencies.

And what about the ECB? Jean-Claude Trichet's statements on 5 June implying that interest rates may be raised as early as July have of course strengthened the euro and quickly brought EUR/USD back to where it was before Mr Bernanke's statement. However, the euro's gain was rather modest in comparison with the ECB's surprisingly hawkish stance. We therefore did not think this was a good time to modify our positions in currency markets. It may be remembered that European authorities wanted to put the dollar on the agenda of the meeting of G7 Finance Ministers and Central Bank Governors held in Washington in early April. The Fed chairman's recent comments show that US public officials are ready to advance in this direction. The ECB often points out that it does not take the euro's strength or weakness into account when making monetary policy. Mr Trichet's words should therefore not be seen as a signal that the euro is set for a new phase of appreciation. On the contrary, fears of weaker growth in the euro zone could intensify and weaken the euro.

Dollar likely to strengthen. Since the beginning of the year the dollar has declined more or less uniformly against the currencies of the US' 12 largest trading partners, which together account for 87% of the dollar's effective exchange rate as calculated by the Fed. The only exception is the Korean won, which has lost 10% year to date and is at its lowest level since late 2005. The dollar therefore could regain ground over the next few months when it becomes clearer that the US economy is on the road to recovery. The return to more calm conditions in all financial markets should mean lower volatility, including for the major currencies. Against this background, we could see a pick-up in yen carry trades, since there is little chance that the BoJ will increase interest rates.

FX Rate Forecast Summary (Major Currencies)

End of Period		2007	05-Jun-08	2Q2008		3Q2008		4Q2008		1Q2009	
				Min	Max	Min	Max	Min	Max	Min	Max
USD Block	EUR / USD	1.46	1.554	1.50	1.55	1.46	1.51	1.40	1.45	1.36	1.42
	USD / JPY	111.7	106.1	100.0	105.0	102.0	107.0	110.0	115.0	110.0	115.0
	USD/ CAD	0.99	1.02	0.99	1.03	1.04	1.08	1.07	1.11	1.08	1.12
	AUD/ USD	0.88	0.96	0.88	0.92	0.90	0.94	0.90	0.94	0.88	0.92
	GBP / USD	1.99	1.95	1.84	1.96	1.79	1.90	1.72	1.83	1.72	1.83
	USD / CHF	1.13	1.04	1.04	1.08	1.07	1.10	1.11	1.14	1.12	1.15
EUR Block	EUR / JPY	163.3	164.9	150.0	163.0	149.0	162.0	154.0	167.0	150.0	163.0
	EUR / GBP	0.73	0.79	0.78	0.83	0.78	0.83	0.78	0.83	0.76	0.81
	EUR / CHF	1.66	1.62	1.59	1.64	1.59	1.64	1.58	1.62	1.55	1.60

Source: BNPP AM as of 5/6/2008

EQUITY MARKETS

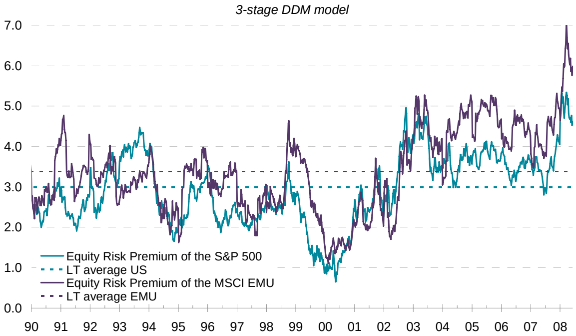
DEVELOPED MARKETS

Slight overweight maintained

From one crisis to another: fears of 1970s deja vu

The gains posted by equity indices since hitting bottom on 17 March have not been smooth sailing, to say the least. Once the fears of a systemic financial crisis and the worst-case scenario of a severe US recession had dissipated, investors were haunted by the return of the spectre of high and sticky inflation. The surge in energy and food prices has triggered concerns that the global economy will slow more sharply than expected, with potentially adverse political and social repercussions in some emerging countries. Investors are also fretting about how central banks will respond to this situation. But we believe it is not so much the prospect of stagflation triggered by the recent "oil shock" (as in the 1970s, although conditions back then were quite different in our opinion – see page 4), but rather the lack of near-term visibility that is holding equities back. Volatility and risk premiums in equity markets are therefore still very high.

Risk premiums still quite high



Source: Factset, BNPP AM Estimates

Not out of the woods yet

Over the near term, and until visibility is restored, equity investors may continue to respond skittishly to corporate earnings releases and economic data. Even though the US economy is expected to improve in the second half of the year, thanks to monetary loosening and the government's fiscal stimulus plan, the housing and labour markets are still weak and the rest of the global economy is slowing. Furthermore, Japan is on the brink of recession and Europe's economy is slowing sharply, with its traditional lag of two to three quarters behind the United States.

It should also be noted that just because investors' sentiment is that the worst of the subprime crisis is over does not mean we are out of the woods yet. The recent credit rating downgrades remind that we may see further asset write-downs. Nevertheless, banks are generally successful in rebuilding their balance sheets and a systemic crisis is no longer a threat.

Bottom-up consensus - Main Financial Indicators

	EPS Growth (%)				P/E				Dividend
(local currencies)	2007	2008	2009	12m fwd	2007	2008	2009	12m fwd	yield (%)
S&P 500	-5.2	9.7	18.5	14.1	16.8	15.3	12.9	14.1	2.3
DJ EuroStoxx	9.6	4.2	11.9	7.5	11.8	11.3	10.2	10.8	4.1
FTSE 100	6.9	6.4	8.5	7.6	12.3	11.6	10.7	11.2	4.3
SMI	-12.2	1.8	29.9	13.6	15.3	15.0	11.6	13.4	2.5
Topix	4.2	9.2	10.5	9.8	16.5	15.1	13.7	14.8	1.7
MSCI Emerging Free (usd)	18.8	14.8	15.7	17.5	15.3	13.3	11.5	12.5	2.0
EM Asia (usd)	18.1	13.4	15.5	18.5	16.4	14.5	12.6	13.7	2.0
EM Latam (usd)	16.6	15.1	14.7	15.0	15.6	13.4	11.7	12.6	2.5
EM Europe (usd)	21.9	14.5	13.1	14.6	12.4	10.8	9.4	10.1	1.6

Sources: IBES consensus as of 15/05/2008, Factset, BNPPAM

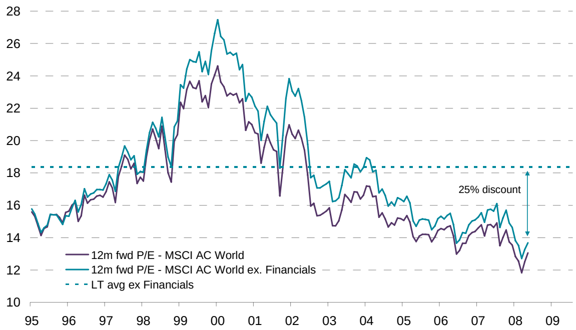
EQUITY MARKETS

DEVELOPED MARKETS

Solid support and signs of improvement

Valuations continue to strongly underpin equity markets. Depending on what multiples are used, valuations range from neutral to attractive. Even when financial sectors are excluded and a much lower 12-month forward earnings growth forecast is assumed than the overly optimistic 10.8% analyst consensus, markets are still not overvalued based on the forward P/E of the MSCI World. Relative to other asset classes, and to government bonds in particular, equities are very attractively valued compared to their long-term trend.

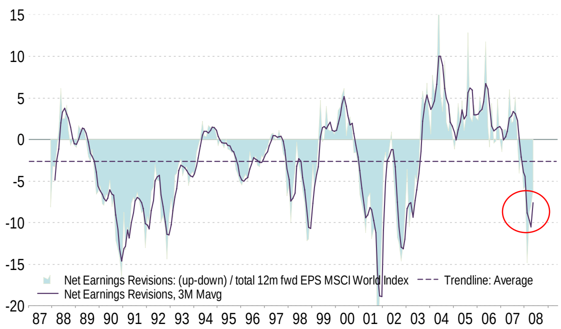
Valuation – forward P/E with and without financials



Source: Factset, MSCI, BNPP AM

Furthermore, very weak and even negative earnings growth expectations are already largely priced in. It should also be noted that the downward earnings revision process is already well underway and that the downward revisions momentum seems to be losing steam.

Downward earnings revisions trend has stalled



Source: Factset, BNPP AM

Conclusion

Given the relatively low valuations of the developed markets, fewer downward EPS revisions and favourable policy measures (and most notably those of the Federal Reserve and the US government) there is little chance that share prices will drop sharply. With near-term sentiment and technical factors sending no clear signals, equity markets could once again move trendlessly around the upper limit of the trading range observed since mid-January. We are maintaining a very small overweight in equities, with a preference for emerging markets.

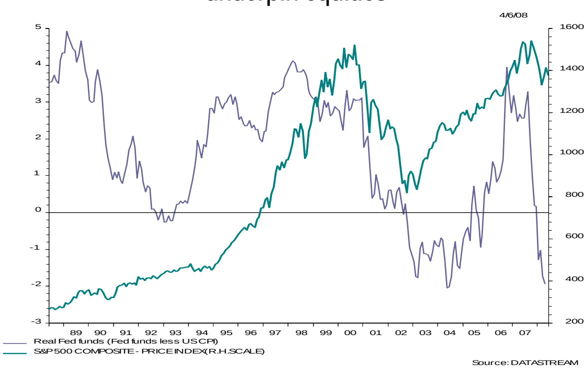
EQUITY MARKETS

DEVELOPED MARKETS

We still prefer North American markets, and now Japan

The US market is still the major developed equity market that offers the most favourable mixture of monetary conditions and fiscal policy. Although the Fed seems to have stopped loosening monetary policy, we do not think it will increase interest rates before the first quarter of 2009. The current level of 2% is extremely accommodative, in both nominal and real terms, since the real fed funds rate is likely to remain negative over the next few quarters. This will provide very solid support for equity valuation multiples and for the US economy in general. These monetary factors together with an aggressive fiscal stimulus plan may make it possible to avoid a recession, if only barely. Moreover, the most recent economic data confirm our belief that although there is little chance that growth will rebound strongly any time soon, we have certainly either almost reached the bottom of the business cycle or it is already behind us.

United States – negative fed funds rate will strongly underpin equities

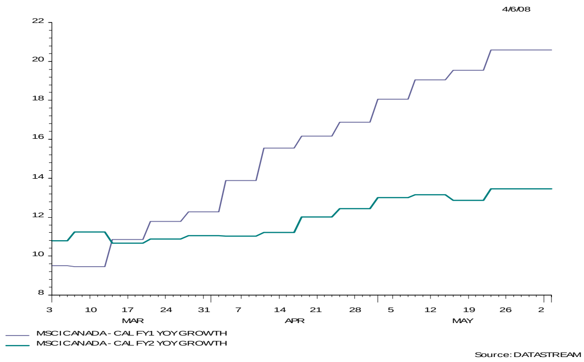


Although earnings growth revisions continue to trend downward, they are doing so at a slower pace. The market seems to have priced in most of the bad news about financials. However, more disappointing earnings releases and further downward revisions are still very likely in those sectors most exposed to the domestic economy. Nevertheless, the considerable exposure of S&P 500 firms to the global economy (via exports and foreign subsidiary revenues) and the dollar's weakness will continue to boost their earnings.

Lastly, we believe that US equity valuations, both in absolute terms and relative to other markets, will continue to be a supporting factor.

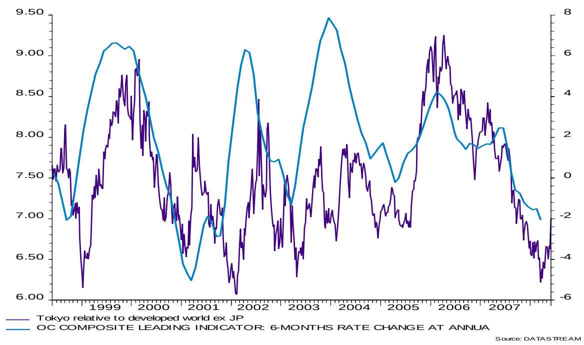
Canada's economy is likely to slow less severely than that of any other major developed country, due to its resilient domestic demand and high exposure to commodities. Although equity valuations are still expensive in relative terms, the momentum of earnings forecast revisions is very positive, both in absolute terms and in comparison to other markets. Although Canada's highly favourable situation may be attributed to the mining and energy sectors, further monetary loosening by the Bank of Canada (which is likely) will also be good for financial stocks, which make up a third of the Canadian stock market.

Canada – very positive earnings revisions momentum in 2008 and 2009



Since last month, when we became a bit more optimistic about Japan, momentum in the Japanese stock market has accelerated and a bullish trend is gradually taking shape. Given Japan's long battle with deflation, the prospect of moderate inflation tends to work to its advantage. The return of some inflation does encourage private consumption and makes it easier for firms to raise prices. Rising interest rates also increase the purchasing power of savings invested in cash assets, while encouraging a reallocation of bond investments toward equities.

Japan – a pro-cyclical equity market?



EQUITY MARKETS

DEVELOPED MARKETS

We are increasing our exposure to the Japanese market, since technical factors look positive over the near term. Investor sentiment is improving rapidly, particularly after the market's recent good performance. The success that activist shareholders have had in defying company directors with questionable performance has also bolstered investor confidence in corporate governance. Valuations are still reasonable, but the outlook for growth and earnings revisions continues to be negative.

Neutral in the UK

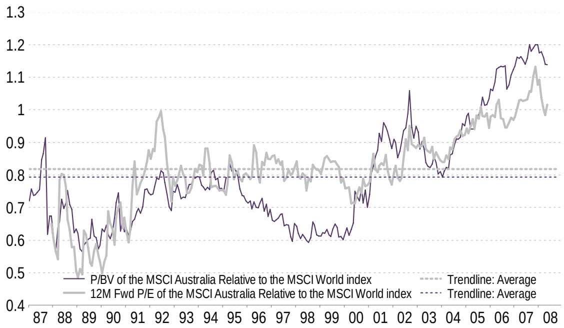
With energy and materials companies accounting for 40% of the UK equity market its earnings revision momentum has been favourable. However, earnings forecasts are clearly now being lowered for the financial sector, which accounts for a quarter of the country's equity index. We believe this is likely to continue, given the accelerated slowing of the housing market and investor scepticism that the BoE will continue to loosen monetary policy. However, much of this bad news has already been priced in, since valuations are very low by any criterion. We have therefore adopted a neutral position in the UK relative to the other developed markets.

Still cautious in the euro zone and Australia

The euro zone's equity markets are facing a particularly unfavourable combination of slowing economic growth and much more restrictive monetary policy than in the other developed countries, and which could be even further tightened very shortly. Earnings forecast revisions, which are already heading downward, will most likely continue to suffer from this situation, particularly given the euro's strength. Under these conditions, reasonable valuations will probably not be enough to prevent euro-zone equities from underperforming.

Australian equities are relatively expensive in comparison with other developed markets and no support can be expected from the slightly downward earnings revision trend. In addition, although monetary tightening has more or less run its course, the very high key interest rates will continue to weigh on the earnings of the financial sector, which accounts for 40% of the country's equity index.

Australia – relative valuations still very high in historical terms



Source: Factset, BNPP AM

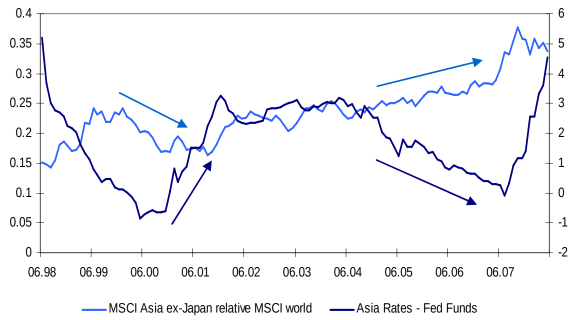
EQUITY MARKETS

EMERGING MARKETS

Asian equity markets – watch out for interest rates

Emerging Asian stock markets will perform less robustly over the coming months, as the global slowdown, and above all high food prices, weigh on the region's economy and earnings. Profit margins will be squeezed by rising commodity prices and especially the removal of price subsidies, while softer final demand weighs on sales. The direction of earnings and earnings revisions reflects these weakening fundamentals. Although valuations are reasonable, earnings forecasts are still too optimistic. When all is said and done, the region's higher inflation causes investors to demand a higher risk premium and reduces its relative appeal.

Asia – interest rates up, performance down



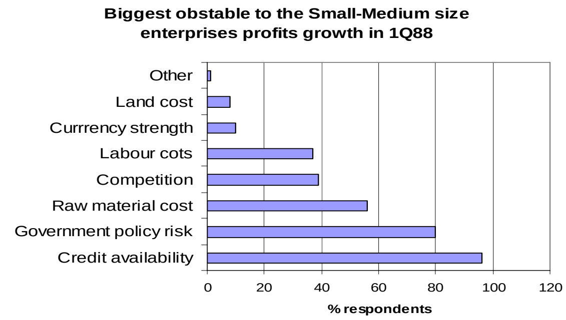
Although interest rates will continue to rise in response to inflationary pressures, there will not be a 1997-style crisis since current economic fundamentals are much more solid. The relative performance of emerging Asian equity markets has historically been negatively correlated with the spread between the region's interest rates and the fed funds rate. The prospect that this spread may widen therefore does not bode well for Asian equity markets. Global equity funds may be expected to sell the region's equities in favour of Japanese stocks, which they been neglecting.

Since mid-March there has been a steady flow of portfolio reallocations from emerging Asia to Japan. This may clearly be seen from the relative performance of the two markets. This makes sense since rising commodity prices will have a greater impact on the emerging countries who import these commodities than on Japan, whose more developed economy is less vulnerable to this inflation.

From a technical analysis perspective, the performance of emerging Asian markets peaked relative to global equities in late October 2007. Since they have reversed direction and are now clearly underperforming global equities, we have adopted a more prudent approach to this region. This same trend may also be observed if we compare emerging Asia to Latin America or Eastern Europe.

The Chinese equity market has not been as resilient as expected. This may mainly be attributed to the deregulation of the telecom sector which has weakened its performance and thereby that of the MSCI China index in general. We doubt that the market will fall below the trough reached in mid-March and believe that any further dips in share prices will be good buying opportunities. Although Chinese authorities have expressed their intention to support the equity market, weaker fundamentals will mean less upside potential than in the past. Tighter credit conditions and higher interest rates and commodity prices will be a drag on earnings.

Chinese firms feel pinch of tighter credit



EQUITY MARKETS

EMERGING MARKETS

Brazil – Despite inflationary pressures and ongoing monetary tightening, business and consumer confidence are still strong. Sentiment has been further boosted by Brazil's recent upgrade to Investment Grade status, since this will mean more direct foreign investment and lower funding costs. After the strong market gains of the past few months, the country's valuations are now in line with those of the emerging universe. However, we expect foreign investment flows into Brazil to continue.

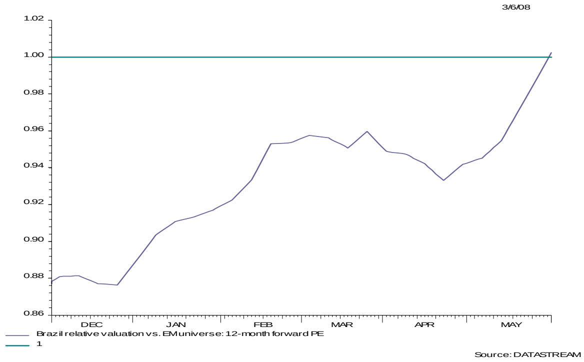
Mexico – The economic slowdown is beginning to make itself felt, as inflation continues to rise. This is likely to have a significant impact on the Mexican equity market, which is much more exposed to domestic consumption than to the oil sector. These concerns are reflected in the recent lowering of earnings forecasts. Valuations are now slightly above those of our emerging universe.

Russia – Although economic growth is still very strong, inflationary pressures are intensifying. However, the prospect of lower taxes continues to support the energy sector, which is still very inexpensive despite sharp upward revisions in its prospective earnings, which are considered to be relatively shielded from a drop in oil prices. The rouble will remain strong to reduce inflationary pressures.

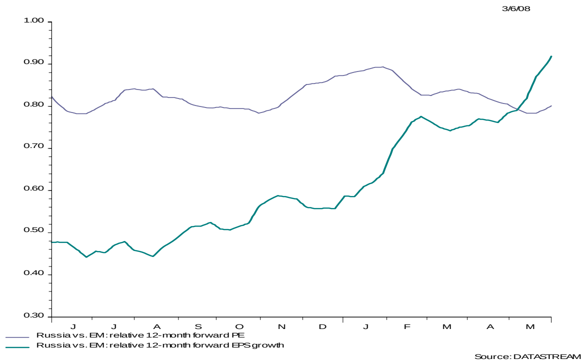
Poland – Although the Polish economy continues to grow at a very robust pace, high inflation has been declining slowly recently. However, fear of second-round effects may mean further increases in interest rates. This would weigh on the share prices of financial firms, which account for almost half of the market's capitalisation. The Polish market is valued less than the rest of our emerging universe, as analysts forecast stable but lower earnings growth.

Turkey – The country's political crisis continues while its economy still shows no signs of improving. The acceleration of inflation means that monetary tightening will continue. Although the market's extremely low valuations have already priced in this difficult environment, the earnings revisions trend is still slightly downward.

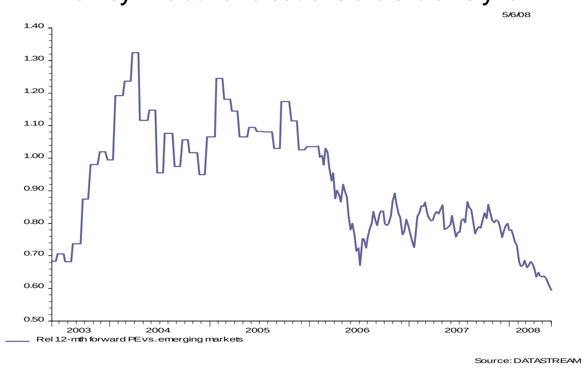
Brazil – valuations now in line with our emerging universe



Russia – valuations still attractive after recent rally thanks to stronger earnings growth



Turkey – relative valuations are extremely low



ALTERNATIVE STRATEGIES

COMMODITIES

Oil – even more expensive...and more volatile

The price of crude oil continued to rise in May, and despite some consolidation around $122/bbl at the end of the month, is now more than $138/bbl, a new record. This latest surge seems to follow an inverse relationship with the dollar's behaviour. Physical market fundamentals are solid, with most inventories being replenished, even though large imbalances may be observed between the various petroleum distillates, with too much gasoline and not enough diesel fuel, kerosene and gas-oil.

Measures in some emerging countries to reduce or abolish price subsidies on some petroleum products should start reducing global demand for oil over the medium term. Over the near term however, the market seems to be driven mainly by macroeconomic and financial considerations, making it very unstable. We are therefore maintaining a neutral position in oil.

Gold – dollar first

After falling back from its high last March of $1,040 an ounce, the price of gold stabilised in late April at around $900. Gold has basically been moving opposite to the dollar, rising back to up to $910 an ounce when the dollar slumped in early June. The prices of gold and crude oil therefore tend to move in the same direction over the very near term. Gold is still very cheap however relative to oil, since one ounce is currently worth 6.6 barrels of crude, compared to 19 barrels in the 1970s. We believe the divergence between gold and oil has become excessive. Although gold has of course temporarily lost its appeal as a hedge against market risk, it is still inherently the ideal financial instrument for hedging against inflation and monetary risks. This is why we are maintaining an overweight position in gold, even though we do believe the US dollar will gradually strengthen.

Base metals – still consolidating

After rising spectacularly early in the year, global base metal indices continued to decline in May, as they have been doing since mid-March. Zinc, nickel and lead are now at their lowest levels in at least a year. Copper, aluminium and tin however are still fairly near their highs. Except for zinc and nickel, inventories are still expanding. With global industrial output slowing, we have decided to adopt an underweight position in this asset class, even though China appears to have become a dominant player in base metals that is capable of turning the market around all by itself.

Agricultural commodities – consolidation then rebound

Agricultural commodity indices continued to consolidate in May, before rebounding briskly in the first week of June. The drop-off in May mainly reflects the decrease in wheat prices, which were about 40% below their high levels of March. Since then unusually rainy weather in the US Midwest has boosted corn, soy and wheat prices. The higher price of oil, which is a major expense for the agricultural sector (since it is used for both transportation and fertilizer), along with the dollar's decline contributed to this rebound, which drove corn and rice prices to record levels. In many countries, this food inflation resulted in emergency measures that included price controls and export taxes, and sometimes even led to rioting. Some consider biofuel crops to be mainly responsible for this situation, since they reduce the amount of land available for growing food crops. However, rising production costs, the lack of correlation with other financial markets due to the specific weather risks that farmers must face, and the increasingly limited supply of arable land are all good arguments in favour of this asset class in which we will maintain an overweight position.

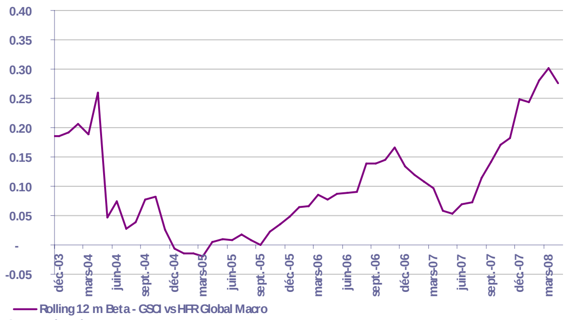
ALTERNATIVE STRATEGIES

HEDGE FUNDS

Global Macro

Global Macro managers, together with Commodity Trading Advisors (CTA), continued to be the strongest performers since the beginning of the year. We have been recommending this strategy for a while and continue to do so since it enables simultaneous exposure to several markets, and in particular those that may be subject to powerful trends, such as commodities or currencies. However, no trend lasts forever, and a market downturn can detract from performance before positions can be reduced. The advantage of Global Macro is that it may also be used to exploit a bearish trend. Traders must however be prepared to deal with periods when prices are going in no clear direction. This is why we recommend selecting managers who can also produce good returns over shorter periods through higher frequency trading.

Global Macro still exposed to commodities

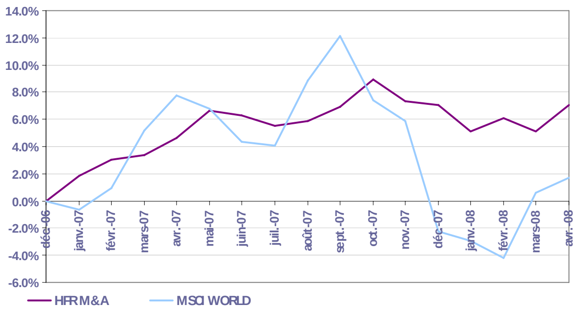


Source: Bloomberg, BNPPAM

Mergers & Acquisitions

There are several reasons we are still positive about M&A strategies. First of all, it should be noted that these managers did not post losses when equity markets were declining, and have even produced positive returns since the beginning of year, which shows that they knew how to manage their exposures. Secondly, the market still offers M&A opportunities, even though there are fewer than before the financial crisis. Thirdly, risk premiums continue to be high and thus offer the prospect of attractive returns.

M&A holds up well during equity market turbulence

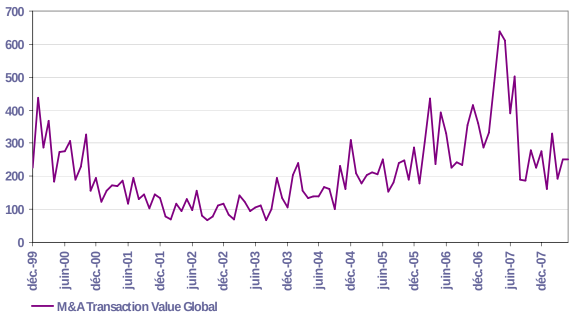


Source: Bloomberg, BNPPAM

Other Strategies

As we see no clear directional trend in equity markets, we still prefer to stay away from Long/Short with positive beta, since this strategy is likely to continue to be hindered by high volatility and trading ranges. However, as risk aversion gradually declines after the recent crisis, equity markets will once again be driven by more "fundamental" criteria. In this sort of environment, good stock pickers with relatively neutral exposures could be well positioned to take advantage of market opportunities.

Market continues to offer M&A deals, although fewer than last year



Source: Bloomberg, BNPPAM

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