

PRESS RELEASE

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PONDERING THE NEW YEAR - ECONOMIC GROWTH LIKELY TO EXCEED EXPECTATIONS IN 2010

Commenting on the outlook for 2010, Bechara Madi, Head of Macro at Matrix Money Management says:

For a year now, our forecast envisaged an end to the global recession around mid-year 2009. Whilst this was far from consensus for most of the year, it is now widely accepted that a global recovery is taking hold and spreading. As was the case in previous turnarounds, the early stages of the recovery have been driven by a mix of factors, namely the support from policy stimulus, the turnaround in the inventory cycle and especially important for exporting economies, the revival in world trade. The overwhelming message from the economic data is that the growth recovery in many economies is likely to exceed expectations over the next few quarters.

Deflation, and not Inflation, Remain the Key Concern through 2010 and even 2011

Despite our expectation of strong growth over the next 12-18 months, we continue to believe that the risks of deflation remain far greater than those of inflation. This view is based on the amount of capacity that exists in the key developed markets, as well as the world at large.

Monetary Policy: Divergence is a Key Theme for 2010

Whilst the market is increasingly obsessed with the timing and mechanism of the exit from quantitative easing and the normalisation of interest rates, we continue to believe that there is very little room for rate normalisation in G4 before Q4 2010 at the earliest for reasons detailed above and in attached document. When defining the likely path of monetary policy, we believe that the decision-making over the 12-18 months is likely to remain heavily skewed against a premature withdrawal of stimulus. In simple terms, it is far easier for central banks in highly-leveraged economies to deal with inflation than to deal with deflation. Hence, deflation is to be avoided at all cost even at the risk of keeping rates too low for too long.

2010 GENERAL MARKET OUTLOOK

We believe that the market outlook for 2010 will continue to be dominated by the economic recovery. Broadly speaking, we believe that the rationale for owning assets that benefit from growth (equities, credit, commodities and emerging markets) remains intact. The trade is in fact reinforced by the policy of asset reflation. Cash is the lowest yielding asset in the world, and the main reason to hold it, which is uncertainty, is fading. The flow out of cash is lifting most asset prices. This will end only when G4 central banks start hiking interest rates or investors have become underweight cash. We are far from either scenario. For the reasons described above, we are not expecting the major central banks to remove the punch bowl any time soon. Even when policy is tightened, the fact remains that monetary policy has simply been a catalyst to encourage private money (excluding financial institutions) into riskier assets (by making

cash expensive to hold) rather than providing the liquidity itself. It will take significant interest rate hikes to make cash a competitive asset class again.

Bond Markets: The divergence of policy rates between G4 and peripheral markets has key implications for the respective bond markets. In the peripheral markets, the expected tightening of policy means suggests a bear market with a flattening of the curve. In G4, for the reasons detailed above, we strongly believe that rate hikes are unlikely before Q4 2010 and we therefore disagree with the current market pricing (Chart 10 of the attached presentation). If true, with short-term interest rates anchored by official rates, yield curves should remain steep as the medium-term uncertainty on inflation validates a risk premium. Furthermore, the expected issuance to fund the widening public deficits should lead to additional upward pressures on long-term yields. This is more so in the absence of additional Quantitative Easing to mop up some of the new issuance. In short, with uncertainty regarding the global crisis easing, G4 bond yields have to rise much more to improve their attractiveness relative to higher yielding assets.

Equities: Once again, equity markets correctly led the economic recovery. History, as gauged by the last six US recoveries, shows that equities rally reliably during the last 3 months of a recession and the first 3-4 months of a recovery. The equity rally since 9th March has fitted this pattern perfectly. Given our economic forecast and given that equities have been the most visible and most common expression of the bet on growth,, we see no reason for a halt in the equity rally. This view is further supported by expectations of continued earnings growth in 2010 (although we are not pinning a lot of hope on a pick-up in dividends any time soon). Admittedly, the reward to risk in equities is less attractive than it was six months ago however the remaining uncertainties in the market are strong enough to hold back most investors from moving down the liquidity curve into cheaper but less liquid assets. Therefore, we expect equities to remain a favourite asset class to express the growth theme, hence widening the valuations relative to the less liquid asset classes.

Credit: We prefer Credit over Equities as the exposure to the corporate sector. This is for the following reasons: Firstly, Credit offers defensive characteristics against market corrections in risky assets. Secondly, Credit benefits from a positive carry in the form of a coupon (unlike equities where the dearth of dividends is likely to continue), in addition to capital appreciation. Last but not least, Credit should benefit from flows from institutional investors – insurers and banks – who are being forced to move along the risk curve in search for yield and carry. That said, the Dubai crisis was a timely reminder that the legacy of the global credit crunch might remain evident in some highly-leveraged entities. Hence, the need to be more selective within the Credit asset class.

Emerging Markets: We believe EM to be one of the best asset classes to express the growth theme. Most Emerging Markets are exiting the crisis relatively unscathed and structurally and financially sounder than the main developed markets. This suggests medium-term outperformance of EM equities, credit and FX, although an underperformance in local sovereign bonds as monetary policy is tightened early in response to the cyclical recovery. The need to be selective and differentiate within EM was also highlighted by the Dubai crisis. In our August update, we detailed a framework to analyse the EM universe and we split them into three broad groups: (1) The larger economies that have sufficiently large populations to generate growth led by domestic demand. China is the leader in this group, as well as India, Indonesia, and to a lesser extent Brazil. (2) The resource exporters. Brazil also falls into this group, as well as most Latam countries, South Africa and the Gulf oil exporters. (3) The processing economies, which effectively represents the resource-short export-oriented economies of Asia and Central Europe. Of the three, we would pick the second group of countries on the basis of the quality and composition of their growth.

Commodities and commodity currencies: We continue to believe that Commodities would be a key beneficiary from the global recovery and as such are also one of our

favourite expressions of the growth theme. Within the class, Gold has been one of the best performers this year however it is beginning to display characteristics associated with bubbles. Specifically, Gold is supported by arguments for both inflation and deflation. It seems that there is no scenario imagined which is bad for Gold. That is worrying.

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NOTES FOR EDITORS

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