

# KRAEMER, SCHWAB & CO. AG

## Investment Management

### REVIEW AND OUTLOOK – SEPTEMBER 2005

#### Emerging Markets Debt

Interest rates in general have remained at very low levels worldwide. The emerging country bonds have performed very well over the last few years. The two largest debtor countries, Brazil and Colombia, have greatly improved their financial position by pursuing conservative financial policies and running surpluses in the balance of trade. Brazil is politically in the midst of a hefty controversy because of alleged vote buying by the governing Labor Party. The political crisis has so far only marginally affected the economy but could erode confidence anytime. In Colombia there is some progress in the dissolution of the right wing paramilitary forces, but the left wing rebels have vowed to continue fighting. Unfortunately yield premiums have also declined. Among the other emerging countries the Philippines are struggling to constrain debt and increase revenues. Thanks to the high remittances by Philippine workers living abroad the country should be able to muddle through the crisis.

#### High Yielding Corporate Bonds

Amazon is in the process of repaying its debt early. We see no problem there, they have ample cash. Automobile companies on the other hand face serious problems: overcapacities, arrival of low cost competitors from the East, pricing pressures due to high and inflexible labor costs including expenses for underfunded pensions and increased medical costs. Our bonds are short term and will be repaid over the next two years, which should keep us out of trouble. Rhodia is a French fine chemical company that was split off the drug company Aventis. After a rough start it is now about to break even. ISS is a big Danish cleaning company that has been taken over by Goldman Sachs and an affiliate of the Wallenberg family in Sweden. The bonds have been downgraded out of fear that the new owners will borrow heavily to finance the acquisition and thereby push the company's debt into speculative territory. Recently management has confirmed that it will not undertake additional borrowing and the bond price has stabilized.

... / ...

# **KRAEMER, SCHWAB & CO. AG**

## **Investment Management**

### **Stocks**

Profits so far have progressed satisfactorily and the economic outlook is not unfavorable. But, after two good years in the stock market, uncertainties are growing. High energy prices, low growth, devastating natural catastrophes, big current account deficits by the US and a volatile political situation in the Middle East are weighing on the markets. We are not pessimistic but cautious and we prefer favorably priced value stocks to high priced growth stocks. They normally offer good yields, some upside price potential and are attractive holdings even in a difficult period. Among them we count financial and insurance stocks. The latter sector is negatively affected by the big natural catastrophes, which cost them dearly, but at the same time they lead to new demand for insurance and higher premiums. In addition these companies will profit from higher interest returns on their investment portfolios once rates move higher. In the meantime they are inexpensive and have good dividends. As contrarians we love to buy them when they are unpopular. The same holds true for banks. They too are out of the limelight. Some consumer goods companies, after a long consolidation, begin to look attractive. We will add to our stock holdings should they decline.

### **Outlook**

We strive to invest cautiously and with a margin of safety as political and economic uncertainties are growing.

Roland Schwab

September 6, 2005