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Management Report
2nd Quarter 2007

Economic trends during the second quarter of 2007

The expected downturn of the US economy happened more slowly than expected. On the whole, US growth did in fact fall off considerably, but this was due to very negative net exports (difference between exports and imports), which are unlikely to persist as a factor in view of the robustness of the global economy. The US domestic economy – important from the point of view of inflation - picked up surprisingly on the other hand. The basic rate of inflation continued to decline in fact, helped by the lower growth of unit labour costs. But the quickening pace of the economy could curb this trend, which would not be to the liking of the US Federal Reserve.
In the euro zone, most of the forward-looking economic indicators pointed to a flattening out of the high economic growth rate. In addition, the expansion of the inflation-relevant M3 monetary aggregate was greater than ever before after eight interest rate hikes. However, the core rate of inflation came close to the 2% monetary policy pain threshold. And the situation was similar for Switzerland, although the rise in core inflation without further monetary countermeasures is still to come.
In Japan, the picture was mixed. Whilst the figures for real economic growth in the first quarter were good, the index of forward-looking indicators showed signs of weakness. The falling rate of employment and productivity growth points in the same direction. At the same time, unit labour costs declined again, if somewhat less than before. Given the circumstances, deflationary trends reappeared.
The level of economic growth was also high on the most important emerging markets. The threat of inflation therefore also grew in this group of countries and required appropriate monetary countermeasures.

Financial market trends

Worldwide, bond markets suffered from the strong economic situation in local currency during the 2nd quarter. In the US, the markets have been gearing up for economic slowdown and interest rate reductions by the Fed since mid-2006. The stronger than expected economic conditions, however, put paid to hopes of a reduction in interest rates by the US central bank. Long-term USD-denominated securities lost much of their attractiveness and the interest on 10-year government bonds rose substantially.
In view of the good state of the economy, the European Central Bank (ECB) continued its series of interest rate rises. And the Swiss National Bank (SNB) raised the official target range.
All the main currencies – with the exception of the Japanese yen - appreciated against the Swiss franc during the 2nd quarter. The yen suffered from the low Japanese interest rate compared with other countries, stimulating carry trades that tend to keep the currency rate low.
The equity markets were buoyant worldwide and produced value gains that again appreciably outdid the negative performance of the bond market. Of the mature markets, the Far East led the rankings, followed by Europe and the US. Japan and Switzerland were bottom of the class, with share price gains of around 4%. A few of the emerging markets, such as Poland, Korea and Mexico, achieved even greater increases in value.
During the 2nd quarter, there were marked differences between the various segments. Clear front runners were the growth-sensitive energy, commodities and industrials sectors. Technologies and telecoms service providers occupied the middle field. The weakest performers were healthcare stocks and financials. These suffered particularly from the spreading uncertainties about sickly subprime loans on the US mortgage market.

In the 2nd quarter 2007, the value of the A-share rose by 1.86%, from CHF 249.44 to CHF 254.07, and in the same period the B-share fell by -0.17%, from CHF 210.26 to CHF 209.90.