



Bond & Currency Weekly

Julius Baer Economic & Fixed Income Research
25 July 2013

Economics: When regulators become the bond investors' best friends

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US regulations are tightening conditions for banks and shadow banking, reducing the pressure on the Federal Reserve to lift interest rates. There is room for some consolidation or correction of capital market rates in the 3 to 5-year bracket. Peripheral debt should benefit from the outlook of positive growth for the euro area in H2 2013.

Currencies: CNY provides stability in volatile emerging market space

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Beijing unveiled new measures to support growth after falling purchasing managers' indices signal that the slowdown is hitting the job market. Keeping the CNY stable and not letting it appreciate further is among these measures. The CNY has support from large, stable foreign direct investment inflows, which protect the currency from depreciating significantly

Currencies: Turkey's central bank defends its currency

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The Turkish central bank increased its headline interest rate in order to defend the slumping Turkish lira. Falling risk appetite and political turmoil led to massive capital outflows, adding pressure to the balance of payments. Attractive carry and sound fundamentals should regain appeal among foreign investors

Corporates: Freeport McMoran reported solid Q2 results

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The results include a month of operations of PXP and MMR after the acquisitions closed in June. Guidance for the full year was slightly lowered and a deleveraging target set at USD12bn by 2016.

Latin America: Brazil facing internal and external pressures

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Growth continues to be moderate. The central bank should continue to fight inflation. The government faces pressure from international investors as well as from its own citizens.

Asia: China – one step closer to interest rate liberalisation

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China's central bank has removed the regulated floor for lending rates. The impact is likely to be limited in the near term due to the tight lending conditions. In the long run, this is negative for banks, but could be positive for some large property developers.

Julius Baer Fixed Income and Economic Research thank you for your interest in our publication. We would like to inform our readers that we are taking a summer holiday break next week and that the next issue of the Bond & Currency Weekly will be on 8 August 2013.

Strategy at a glance

Background: China remains in the spotlight

The main question at this juncture is whether the Chinese government will allow growth to fall to 7.5%, to 7% or even to 6.5%. We note that Beijing implements supportive measures in small doses whenever signs of economic weakness emerge. Nevertheless, Chinese growth is far from the levels of the last decade and our commodity specialists maintain their call that global supply will rise faster than demand, implying a continuation of the structural downtrend of commodity prices. Disinflationary forces will thus remain in place in the USA and Europe, despite more positive manufacturing data recently. We expect the Federal Reserve (Fed) to issue a more balanced statement next week and thus maintain our call for exposure to 3-year to 5-year bonds where rates could decline in the USD, EUR and CHF segments. Given the muted global growth outlook, we stay cautious on emerging market bonds, except for those denominated in CNH since they will benefit from the internationalisation of the currency.

USA: Fed likely to be more balanced

When the Fed began to openly debate the schedule for exiting the quantitative support programme, US consumption seemed to be resilient to the fiscal headwinds. In the meantime, most indicators surprised to the downside, and we expect a more balanced Fed outlook to be published next week. Therefore, we stay with low-investment-grade bonds in the 5-year bracket and USD high-yield bonds.

EUR: Still disappointing loan numbers

While some cyclical indicators turned positive for Q3 2013, loan supply remains a major concern for the euro-area economies. Indeed, the latest loan officer survey of the European Central Bank (ECB) again painted a picture of more credit restrictions and a continuation of the credit crunch in peripheral economies. We thus maintain our call for more action from the ECB and maintain our medium-term recommendation for EUR high yield and peripheral debt.

CHF: Housing market overheating

We see short-term room on the downside for rates in the USD and EUR segments, which will allow CHF rates to drift lower. The latest data from the Swiss housing market, however, points to a reacceleration of prices and unbroken loan growth. Seemingly, the self-regulation of the banking industry is not sufficient to stop banks from lending more aggressively. We sense that the Swiss National Bank will use any CHF weakening to allow rates to trend higher and stick to our forecast for higher yields in the medium term.

Convertibles: Never change a winning team

We still see more upside for convertible bonds and recommend switching out of emerging market (EM) bonds into convertible bond funds.

Performance review

25.07.2013

USD performance	-1 week	-1 mth	-3 mth	-6 mth	-1 year
Money market	0.01	0.04	0.10	0.21	0.53
US 5-year Treasury note	-0.29	0.55	-2.68	-1.94	-2.27
US 10-year Treasury note	-0.81	-0.15	-6.69	-4.80	-7.14
US TIPS	-0.84	1.80	-8.06	-7.40	-6.75
Corporate master	-0.10	1.63	-4.06	-2.61	-0.20
A-rated financials	0.06	1.75	-2.72	-1.10	4.05
BBB-rated industrials	-0.07	1.70	-4.57	-3.15	-0.31
US High-yield bonds	0.37	3.39	-0.15	1.99	10.94
Emerging market	0.38	6.29	-6.86	-6.97	-0.26
EMBI Asia	1.83	7.96	-7.05	-6.58	-3.00
EMBI Europe	-0.13	5.37	-5.68	-6.07	2.94
EMBI Latin America	0.25	6.37	-7.69	-7.86	-1.23
ELMI Total	0.14	1.75	-2.09	-2.22	4.16
ELMI Asia	0.02	0.76	-2.37	-2.33	1.26
ELMI Europe	0.69	2.63	-0.17	-2.66	9.13
ELMI Latin America	-0.32	3.51	-3.77	-1.55	5.90

EUR performance	-1 week	-1 mth	-3 mth	-6 mth	-1 year
Money market	0.00	0.02	0.05	0.11	0.31
Germany 5-yr govt. bond	-0.57	1.09	-1.24	0.57	0.34
Germany 10-yr govt. bond	-0.76	1.82	-2.68	0.38	-0.80
Italy 5-yr government bond	0.97	2.99	0.01	1.50	19.06
Spain 5-year govt. bond	0.82	2.74	0.05	4.28	25.20
Ireland 5-year govt. bond	0.33	1.66	-0.29	3.18	24.72
Portugal 5-year govt. bond	3.56	0.47	-3.31	0.08	29.57
France 5-year govt. bond	-0.14	1.80	-1.40	0.43	2.11
AA-rated financials	-0.38	1.03	-0.79	0.76	3.24
BBB-rated industrials	-0.11	1.47	-1.00	1.37	5.90
EUR high yield	0.67	2.81	0.70	2.81	17.70

CHF performance	-1 week	-1 mth	-3 mth	-6 mth	-1 year
Money market	0.00	0.01	0.02	0.03	0.09
Swiss 5-year govt. bond	-0.04	0.50	-0.88	-0.26	-2.68
Swiss 10-year govt. bond	-0.09	0.64	-3.60	-3.00	-3.07
AAA-AA foreign bond 1-3yr	0.00	0.30	-0.11	0.20	0.42
AAA-AA foreign bond 3-5yr	-0.01	0.84	-0.61	0.02	0.79
AAA-AA foreign bond 5-7yr	0.05	1.29	-1.35	-0.41	0.93

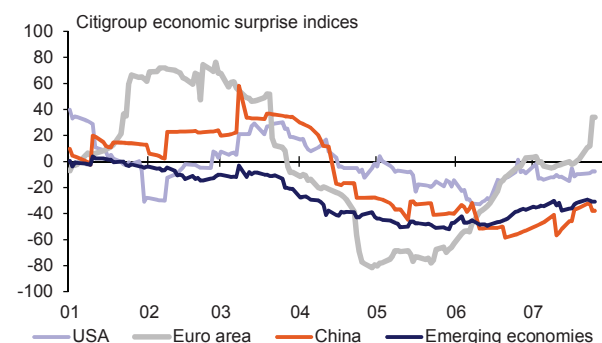
GBP performance	-1 week	-1 mth	-3 mth	-6 mth	-1 year
Money market	0.01	0.05	0.13	0.27	0.70
UK 5-year government bond	-0.41	1.81	-1.93	-0.34	-1.11
UK 10-yr government bond	-0.76	1.68	-5.16	-1.97	-5.37
A-rated financials	0.05	3.10	-2.63	0.59	9.46
BBB-rated corporates	0.17	2.04	-0.41	1.95	11.94
UK High-yield bonds	0.71	3.10	-0.01	3.31	24.16

Convertible bonds	-1 week	-1 mth	-3 mth	-6 mth	-1 year
Global convertibles	1.00	5.14	4.50	6.56	19.03
Europe convertibles	0.74	2.99	2.97	2.81	13.42

Source: Datastream, Bank of America Merrill Lynch, Julius Baer

Chart of the week: Emerging economies remain under pressure

The Citigroup Economic Surprise Index measures the difference between market expectations for economic indicators and the actual outcome. The EM index has been negative all the time since January, meaning that in the last six months, the actual outcome was on average much weaker than market expectations. We note that consensus expectations for EM growth have been reduced materially during this period. It is thus fair to say that the emerging economies even failed to meet lowered expectations.



Source: Datastream, Julius Baer

Economic forecasts

Exchange rates

	Spot	JB Forecast		Forward	
	25.07.13	+3mE	+12mE	3m	12m
EURUSD	1.32	1.27	1.31	1.32	1.33
USDJPY	99.7	105.0	104.0	99.7	99.4
GBPUSD	1.53	1.51	1.58	1.53	1.53
EURGBP	0.86	0.84	0.83	0.86	0.87
EURCHF	1.24	1.28	1.30	1.23	1.23
USDCHF	0.93	1.01	0.99	0.93	0.93
JPYCHF	0.94	0.96	0.95	0.94	0.94
GBPCHF	1.43	1.52	1.57	1.43	1.42
EURSEK	8.61	8.30	8.25	8.63	8.70
EURNOK	7.85	7.70	7.90	7.88	7.96
USDCAD	1.03	1.02	1.01	1.03	1.04
AUDUSD	0.92	0.88	0.91	0.91	0.90
NZDUSD	0.80	0.80	0.82	0.80	0.78

Source: Bloomberg Finance L.P., Julius Baer

Interest rates

Central Bank Rates

	-12m	-3m	Spot	+3mE	+12mE
US Fed Funds	0.25	0.25	0.25	0.25	0.25
ECB Main Refi. Rate	1.00	0.75	0.50	0.50	0.50
BoJ Overnight	0.10	0.10	0.10	0.00	0.00
UK Base Rate	0.50	0.50	0.50	0.50	0.50
SNB 3m CHF-Libor	0.07	0.02	0.02	0.00	0.00

10year gov't bond indices

	-12m	-3m	Spot	+3mE	+12mE
US 10y T-Notes	1.40	1.71	2.61	2.65	2.80
Euro 10y Bund	1.26	1.24	1.69	1.60	2.25
Japan 10y Gov't Bond	0.73	0.58	0.81	0.90	1.05
UK 10y Gov't Bond	1.46	1.73	2.42	2.35	3.00
Swiss Conf. 10y Bond	0.52	0.59	1.06	1.00	1.40

Source: Bloomberg Finance L.P., Julius Baer

Economics

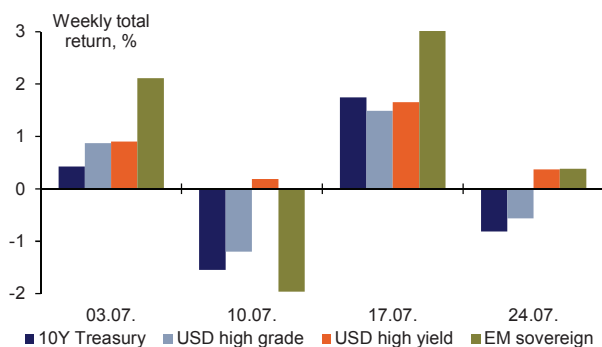
When regulators become the bond investors' best friends

- US regulations tighten for banks and shadow banking, reducing the pressure on the Fed to lift rates
- Room for some consolidation or correction of capital market rates in the 3-year to 5-year bracket
- Peripheral debt to benefit from the outlook for positive growth of the euro area in H2 2013

Treasury move still set the tone

The global bond market continues to trail the erratic moves of the US Treasury market. Yields of US government bonds were down slightly on a weekly basis, pulling down US high-grade debt along. There was some further correction of the emerging bond markets following the massive loss in May and June. The best performance year-to-date in the USD segment, however, was achieved with USD high-yield bonds and convertible debt.

The US Treasury market still sets the tone

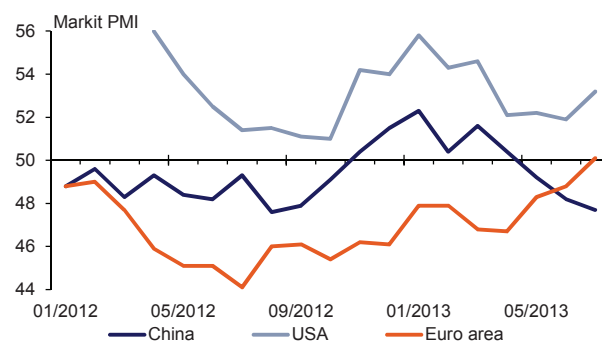


Source: JP Morgan, Bank of America Merrill Lynch, Datastream, Julius Baer

Mixed signals from the global economy

The slight increase in US bond yields mentioned above stands in contrast to the incoming economic data. Admittedly, the preliminary reading of the July purchasing managers' index as calculated by Markit, the private data company, surprised positively. The Markit purchasing managers' index (PMI) rose to 53.2 in early July from a final reading of 51.9 in June.

Purchasing managers' indices: China still struggling, euro area merely hits the break-even rate of 50

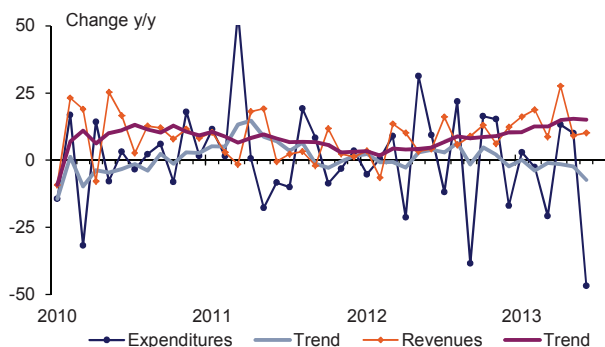


Source: Markit, Bloomberg Finance L.P., Julius Baer

FOMC to issue more balanced statement

The US Federal Reserve's (Fed) open market committee (FOMC) is expected to issue a more balanced statement next week. The increase of the Markit PMI index should not be over-interpreted. Markit has only been collecting the data since April last year and we have no clue how reliable the seasonally adjustment process is. Regional Fed indices of industrial activity continue to point to a sharp deceleration of economic activities in June and July, merely as a result of the automatic spending cuts. Investors will recall that up to 700,000 government employees will be on 20% mandatory unpaid leave in June, July and August. Federal spending declined by an impressive 46.8% in the year to June, while revenues rose 15% in the first six months of the year versus the same period a year ago.

Fiscal headwinds have accentuated in June; spending down 47%



Source: Datastream, Julius Baer

Still some room for lower rates

Capital market rates have some further room for consolidation. Incoming data for GDP due on 31 July 2013 is set to confirm the weakening trend of the US economy. Even with some of the fiscal headwinds alleviating in H2 2013, growth is not expected to return to trend anytime soon. Moreover, the housing market has reacted rather negatively to the increase of the mortgage rate in May and June. Taking into account the downtrend in inflation, we still see room for 3-year and 5-year government bond yields to trend towards the level of 0.75% and 1%, respectively.

USD swap rates: No reason for massive increase in an environment of disinflation and sub-trend growth



Source: Datastream, Julius Baer

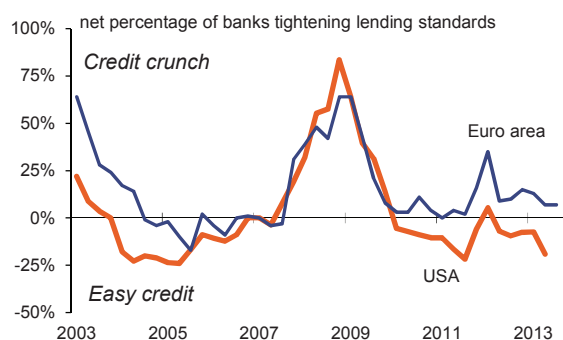
Regulation takes some arguments away for rate hikes

One topic has become of special interest to us: US financial regulation. The Fed has been warning time and again that it would not tolerate a re-leveraging of the US economy. As regular readers of our publications will know, it has been our central assumption earlier this year that the Fed is creating volatility on the bond market in order to slow carry trades, financial leverage and "the searching for yield and other forms of excessive risk taking" (Bernanke). Our central take is that the more regulation is introduced to slow the re-leveraging of the US economy, the more time the Fed has to keep rates down.

Banking regulation: Good for bonds

The US banking industry is up and running – very fast, in the eyes of the Fed. Therefore, it will welcome the introduction of the new Basel III capital requirements on 1 January 2014 and the idea of tighter leverage factors for banks. Loan growth has been rapid and unlike their European peers, US senior loan officers continue to ease the conditions for loans further. We understand that the new regulation will curtail loan growth and as such lower the necessity for the Federal Reserve to tighten. Hence, regulation is good for the bond market.

US loan officers are more generous than their European peers



Source: Federal Reserve, European Central Bank, Datastream, Julius Baer

Shadow banks: The new hot spot

Fed members had warned about REITs, real estate investment trusts, becoming the most vulnerable segment outside the regulated banking industry. REITs often conduct a maturity transformation, borrowing short-term to finance long-term assets. According to our understanding, the Fed has issued new regulations concerning the equity of REITs. Again, the faster the shadow banking industry gets better regulated, the less pressure the Fed will feel the need to raise rates.

USD summary: Waiting for more regulation

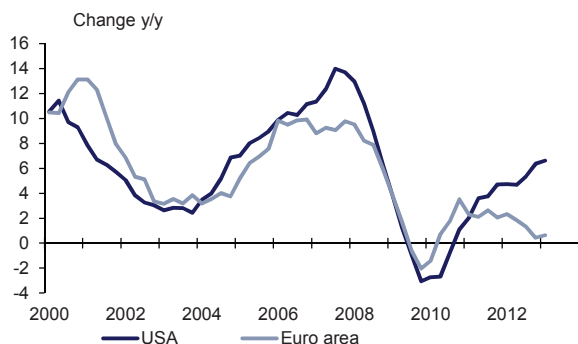
US lawmakers rushed through some bank regulations much faster than anticipated by the broad market. We reckon that massive re-regulation of the market materially lowers the risk

of an overheating on the credit market and thus lessens the need to tighten monetary reins.

Euro area: Banks are not lending

Europe's regulators face exactly the opposite problem. Loan officers are tightening lending standards, and loan growth remains absent. The lack of funding is a major problem in many of the smaller economies, and also in Italy and Spain.

Growth of loans to corporates: Up in USA, down in euro area

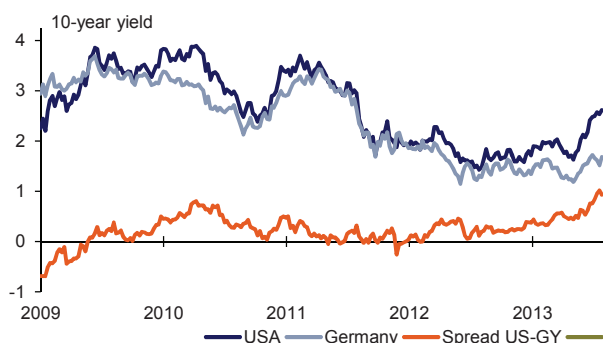


Source: Federal Reserve, ECB, Datastream, Julius Baer

Time for more forward guidance

The latest bank lending survey and incoming data on loan growth reveal that the European Central Bank (ECB) President Mario Draghi has not yet fulfilled his pledge to restore the monetary transmission mechanism. In fact, the fragmentation of the euro system is still increasing, not reverting. Against this backdrop, we believe it is of utmost importance for the ECB to keep rates down. Earlier this month, the ECB began to issue a forward guidance, which allowed the spread between US and German 10-year bond yields to widen to almost 1% from 0.7% in June and 0.5% in May. In order to maintain the spread, the ECB is under pressure to reiterate its forward guidance to keep rates down for an extended period.

10-year government bond yield: Can Draghi enforce more decoupling?



Source: Datastream, Julius Baer

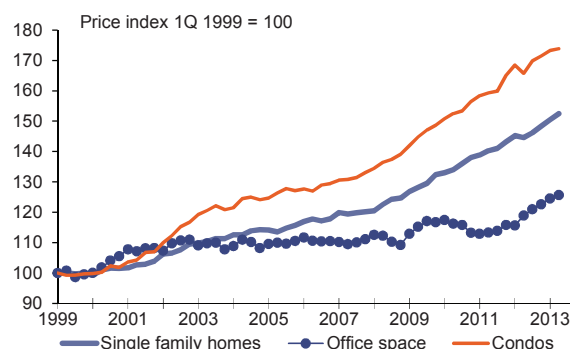
Europe's periphery still looks attractive

Incoming economic data is consistent with a return to positive growth in the second half of the year. We still see very favourable trade data published for Spain, and reckon that the Greek government is likely to receive the next tranche of the troika support. Portugal evaded new elections, which is positive for the bond market. After all, we still see room for more yield convergence in the euro area and recommend purchasing peripheral debt and EUR high-yield bonds.

Moral suasion has not helped much in Switzerland

The latest monthly report of the Swiss National Bank (SNB) shows another decent gain in the prices of Swiss houses and condominiums. A year after the banks promised to slow lending growth and to tighten lending standards, not much has happened on the price front. The next step will be the macroeconomic prudential measures due on 1 September 2013. The more we learn about the price development, the more likely it seems to us that the SNB must be tempted to use any weakening of the Swiss franc to allow rates to trend higher. We thus remain negative for Swiss bonds and recommend investing in EUR instruments instead.

Swiss real estate prices still rising strongly



Source: Swiss National Bank, Wüest & Partner, Julius Baer

Markus Allenspach

Currencies

CNY provides stability in volatile emerging markets space

- Beijing unveiled new measures to support growth after falling PMI signals that the slowdown is hitting the job market
- Keeping the CNY stable and not letting it appreciate further is among these measures
- CNY has support from large, stable FDI inflows, which protect the currency from depreciating significantly

Relatively stable CNY despite economic slowdown

The Chinese yuan (CNY) is among the rare emerging market currencies which remained broadly stable during the recent sell-off, since fears of an early tapering of the US Federal Reserve's (Fed) quantitative easing (QE3) emerged in late May. There has only been a small correction to USD/CNY 6.135 from the low around 6.12 reached at the end of May. This comes despite strengthening evidence of a renewed economic slowdown in China. However, part of this correction can also be attributed to the crackdown of massive illegal money flows. The People's Bank of China's (PBoC) foreign exchange policy still keeps volatility low despite efforts to become more market oriented. Going forward, we expect the CNY to remain stable as one part of the growth-supporting measures, which were announced yesterday by the state council. Nevertheless, sizeable foreign direct investment (FDI) inflows will continue to support the currency. Therefore, a marked depreciation of the CNY is very unlikely.

Government unveils new growth measures

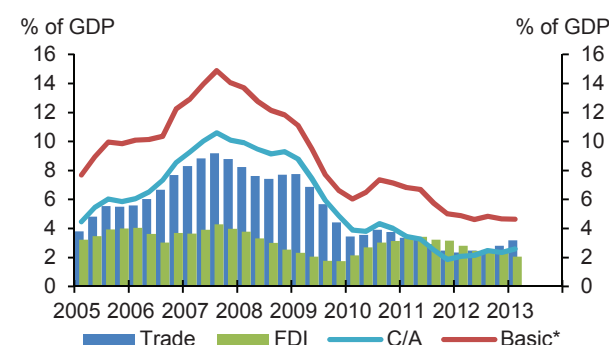
Chinese leaders yesterday announced new measures to support growth after the July HSBC manufacturing purchasing managers' index (PMI) fell further to 47.7 and signalled a continued slowdown. The slide of the employment component to 47.3 must have been particularly worrisome for Beijing. Moreover, it sees the need to keep growth relatively stable for the successful implementation of pending structural reforms. Therefore, the regime announced a slew of different measures to support the weakest links in the economy, such as small firms and exporters. Furthermore, private capital shall be allowed to be invested in the railway sector. The measures also include launching new projects - such as social housing, highways and railways -, tax rebates for small companies and exporters, as well as simplifying export procedures. In addition, the state council promised to keep the exchange rate stable to give more support to ailing exporters. We thus expect the CNY to

remain broadly stable in the coming months, albeit with a slight appreciation bias.

FDI inflows will remain sizeable and stable

We keep a slight appreciation bias due to the fact that inflows into the CNY still dominate. While capital outflows reached a massive USD292bn in 2012, they still remained below inflows recorded in 2012. For 2013 - which has already seen large inflows also in the more volatile parts of the balance of payments - outflows are likely to be smaller than in 2012. China's basic balance surplus still remains sizeable at around 5% of gross domestic product (GDP), supported from both a current account surplus and large, stable FDI inflows.

China's FDI inflows remain a sizeable, stable support for the CNY



* Basic balance = current account balance + FDI

Source: Datastream, Julius Baer

FDI inflows have been moderating somewhat over the last few quarters both due to increasing Chinese investment abroad and slowing foreign inflows. Nevertheless, foreign direct investment will remain a reliable source of large money inflows over the coming years due to the stability of such flows. Therefore, a market depreciation of the CNY from a structural point of view is hardly justifiable and thus highly unlikely in the coming year.

Susan Joho

Fixed Income – Currencies

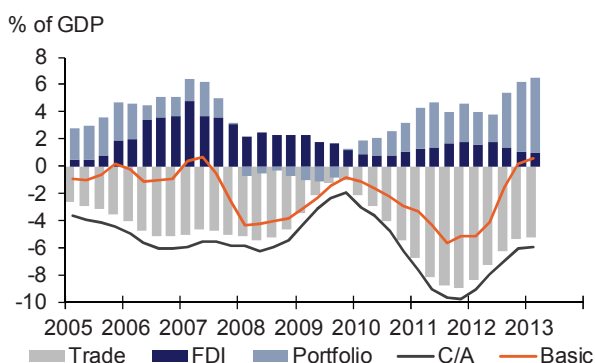
Turkey's central bank defends its currency

- The Turkish central bank increased its headline interest rate in order to defend the slumping Turkish lira
- Falling risk appetite and political turmoil led to massive capital outflows, adding pressure to the balance of payments
- Attractive carry and sound fundamentals should regain attractiveness for foreign investors

Central bank raised headline interest rate

On Tuesday, the overnight lending rate was raised by 75 basis points to 7.25%, after the lira dropped to a record low of USD/TRY 1.96 this month. It was the first time in two years that monetary conditions were tightened. Further rate hikes remain possible as inflation has risen back to a high 8.3% y/y in June. To support price and financial stability the Central Bank of the Republic of Turkey (CBRT) raised the upper band of overnight interest rates, which in terms of its use for monetary policy purposes by the CBRT may be compared with the federal funds rate. Overnight borrowing rate and one-week repo were kept unchanged at 3.5% and 4.5% respectively.

Current account and basic balance Turkey



Sell-off in emerging markets forces monetary tightening

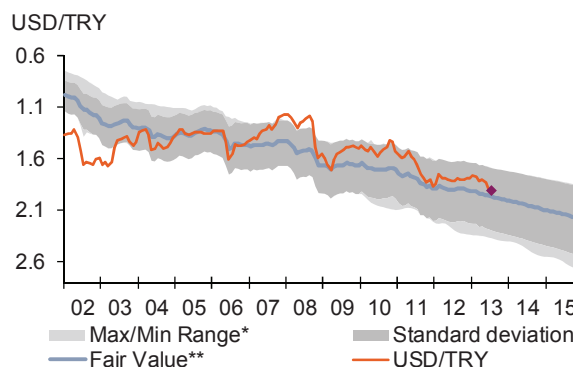
In the wake of the sell-off in emerging markets and recent political turmoil, the Turkish lira has suffered severely against major currencies. The ongoing weakness of its currency has put pressure on the balance of payments due to a large current account deficit. The situation forces the CBRT to act by hiking interest rates - as other central banks in Brazil, Indonesia and India have done in previous weeks. In the past Turkey has balanced its current account deficits mainly through continued growth in capital inflows. However, since risk appetite has been dropping due to the anticipation of higher yields in relatively low-risk-investments such as US high-yield bonds, capital outflows have been mounting. By

widening its overnight interest floor the CBRT sustains liquidity flexibility, while concurrently adding to yield attractiveness for foreign investors and curbing inflation.

Fundamentals point to TRY bottoming out

Overall, we share an optimistic view on Turkish growth prospects and the Turkish Lira. Inflation trend has been falling significantly in the last decade, albeit still overshooting the central banks' inflation target of 5%. The fiscal budget is well-anchored and rebounding growth should revive foreign direct investment (FDI). Moreover, prospects of premature rate hikes in the USA have been abating over the past days and the TRY offers an attractive carry, which should regain attractiveness to portfolio investors.

Valuation model for the Turkish lira



* Goldman Sachs Dynamic Equilibrium Exchange Rate; various PPPs including terms-of-trade adjustment

** Weighted average

Source: Goldman Sachs, Datastream, Julius Baer

From a fundamental perspective the TRY has been slightly overvalued for about some time. After its recent slump it is now again close to its fair value and with further central bank action in view, a bottoming out seems near. Although we still see the TRY depreciating, we are slightly more positive on the short to mid-term horizon than we have been before. We thus revised our three-month forecast to TRY 1.95 down from 2.00 against the USD. We leave the 12-month horizon unchanged at 1.95.

Stephanie Lindeck

Fixed Income – Corporates

Freeport McMoran reported solid Q2 results

- The results include a month of operations of PXP and MMR after the acquisitions closed in June
- Guidance for the full year was slightly lowered
- Deleveraging target set at USD12bn by 2016

Freeport-McMoran Copper & Gold reports Q2 2013 results

On Tuesday this week Freeport-McMoran C&G (Baa3/BBB/BBB, Buy/Opportunistic) reported results for Q2 2013. Revenues for Q2 2013 were USD4.32bn against consensus estimates of USD4.45bn. Production in Q2 2013 included 951m pounds of copper, 173,000 ounces of gold and 23m pounds of molybdenum. Operations were impacted by the roof collapse in the Grasberg mine resulting in 28 fatalities and a halt in production for six weeks until inspections were completed. Management slightly lowered the guidance for the full-year 2013 as follows: 4.1bn pounds of copper, 1.1m ounces of gold and 92m pounds of molybdenum, while for Q3 2013 it is expected to amount to 1.1bn pounds of copper, 330,000 ounces of gold and 22m pounds of molybdenum.

Freeport-McMoran completed its USD19bn acquisitions of Plains Exploration & Production (PXP) and McMoran Exploration Company (both not covered) within the quarter and the results also include PXP's operations starting 1 June and MMR's operations starting 4 June. Due to the acquisitions, debt on 30 June 2013 stood at USD21.2bn and consolidated cash stood at USD3.3bn.

The company's balance sheet is solid and liquidity appears adequate. Upon closing of the PXP acquisition, Freeport replaced its revolving credit facility that was scheduled to expire in March 2016 with a new USD3bn senior unsecured revolving credit facility, expiring in May 2018. As of end June 2013, the company had no outstanding borrowings and USD46m outstanding letters of credit.

Overall, the company will seek to reduce debt but it will need to prove that it has the capability to deleverage and meet its USD12bn debt target over the next three years. According to management, a broad set of natural resource assets will be used to provide financial flexibility and value to shareholders, and in addition capital cost reductions and divestitures will be pursued to ensure that the company maintains long-term growth prospects.

Potential risks to the business include the company's inability to deleverage and cut costs quickly, increased copper supply in the market and negative currency effects. We remain comfortable with the company's leverage and overall balance sheet and we maintain our positive view on Freeport-McMoran.

Source of credit ratings: Bloomberg Finance L.P.

Eirini Tsekeridou

Fixed Income – Latin America

Brazil facing internal and external pressures

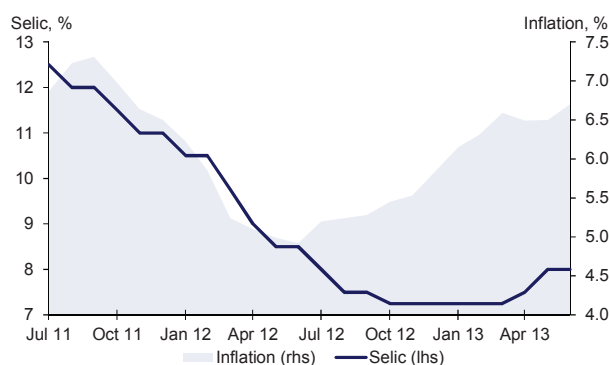
- Growth continues to be moderate
- The central bank should continue to fight inflation
- The government faces pressures from international investors as well as from its citizens

Growth

Initially thought to grow at 4% for 2013, Brazil has continuously disappointed analysts. In Q1 2013, gross domestic product (GDP) grew below expectations, printing a pace of 0.6% q/q, flat in relation to 0.6% q/q in Q4 2012. In addition, the most recent industrial production figure was quite weak, at -2% m/m, suggesting softer growth going

forward. Analysts across the financial industry have been downgrading y/y growth for 2013 to around 2.5% over the last few months. On the positive side, there has been a mild acceleration in investments in the economy, a good sign for mid-term growth. However most of these investments were financed by the government while private investors stayed on the sidelines.

Inflation is still on an upward trend since rate cuts in the past were overdone



Source: Bloomberg Finance L.P., Julius Baer

Fiscal situation

Between 2011 and 2012, the Brazilian central bank lowered rates aggressively. It was believed that lower central bank rates would reduce the financial costs of the government. In anticipation, Brazilian authorities took the chance to loosen their fiscal discipline by increasing spending. It did not take long until rating companies reacted. Standard & Poor's placed Brazil on negative outlook, adding pressure on the government to take measures to prevent a further deterioration in the country's finances.

Inflation

Price increases remain the main concern since they directly affect the relative competitiveness of the country. June's inflation stood at 6.7% y/y, above the central bank's target. We believe it will take a while until the monetary authority can tame inflation. It should take at least two more interest rate hikes of 50 bps to contain core inflation and put a break on the weakening BRL. Last week, the central bank's benchmark rate was raised by 50 bps to 8.5% and is expected to rise above 9% in the near future.

Protests

A new development worth highlighting in the recent past are the massive protests in Brazil. These were driven by inflation in transportation costs, corruption and deficiencies in education and healthcare. As a consequence, the popularity of the current administration has decreased significantly. We are still waiting for responses by the government to these new pressures. It is somewhat positive to see some boundaries on the administration, which has been sitting in power comfortably since the early stages of President Lula's term and has lost discipline after such a long time in power.

BRL

Returns	FX rate	1 Year	YTD	QTD	MTD
BRL (vs. USD)	2.25	-9.0%	-8.8%	-0.8%	-0.8%
BRL (vs. EUR)	2.97	-16.9%	-8.9%	-2.3%	-2.3%
BRL (vs. CHF)	2.40	-14.4%	-6.5%	-1.7%	-1.7%

Source: Bloomberg Finance L.P., Julius Baer

The BRL has been one of the main causes of headache for local-debt investors in emerging markets. The currency underperformed most of its peers as high inflation deteriorated the profitability of the corporate sector in the country. Furthermore, the low level of interest rates did not offer an interesting risk-return profile to fixed income investors. At the moment, the BRL seems to be somewhat more stable as the Brazilian central bank starts to hike rates more aggressively.

The BRL continues to sell off



Source: Central Bank of Brazil, Julius Baer

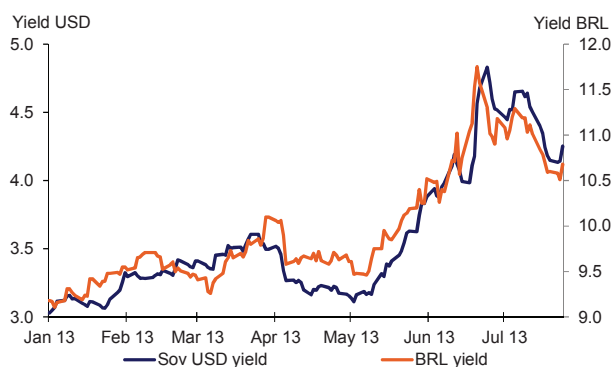
Bonds

Returns	Yield	1 Year	YTD	QTD	MTD
Sovereign	4.87	-6.42%	-10.09%	1.74%	1.74%
Credit	7.18	-2.49%	-8.16%	0.52%	0.52%
Local Currency	7.17	-4.11%	-6.10%	-0.75%	-0.75%

Source: Bloomberg Finance L.P., Julius Baer

After a massive sell-off in May and June, in anticipation of an eventual tapering of the stimulus injected by the US Federal Reserve, Brazilian debt has started to bounce in July. In several publications we highlighted that the level of liquidity is very low. Thus, it is likely that small news have a great impact on bonds (both to the upside and downside). At this stage we prefer hard-currency bonds since the volatility of the exchange rate of Brazil is too high.

Sovereign 10-year bonds recovering in July



Source: Bloomberg Finance L.P., Julius Baer

Conclusion

Brazil is going through a soft patch of lower domestic demand and limited industrial expansion. Commodity exports

are not as meaningful as before so internal dynamics are what count currently. Inflation is the main problem at the moment, which means that any chance of productivity growth is briefly erased by higher costs. As the government tries to contain inflation, for example through lower wage increases, discontent should prevail (as shown by recent protests). In the private sector, the labour market is softening, which could eventually help contain wage inflation and stabilise companies' earnings. We suggest that equity

and foreign exchange investors remain in wait-and-see mode. It will be interesting to see which policy responses the current administration will choose to provide comfort to both, its citizens and international investors. We believe it is critical to wait for a stabilisation of the profitability of the corporate sector before increasing exposure to BRL-denominated assets.

Emiliano Surballe, CFA

Fixed Income – Asia

China – one step closer to interest rate liberalisation

- China's central bank removed regulated floor for lending rates
- Impact likely to be limited in the near term due to the tight lending conditions
- Long-run negative for banks, but could be positive for some large property developers

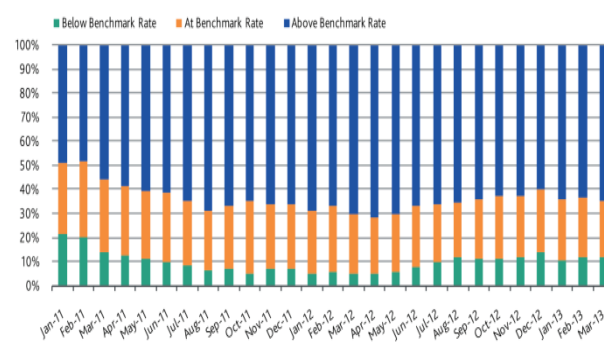
PBoC removed regulated floor for lending rates

Last Friday, the People's Bank of China (PBoC), China's central bank, surprisingly removed the regulated floor for lending rates, allowing financial institutions to set their own rates on all loans except mortgage loans. Mortgage rates will remain subjected to the existing floor, in line with the government's policy to curb speculative property investing. Prior to the announcement, China banks can offer a maximum of 30% discount to the benchmark lending rates (i.e. floor of 70%). The PBoC's benchmark lending rate is currently at 6.0%. In addition, the PBoC removed the lending caps on rural credit unions, as well as the control on pricing mechanism of discounted bills.

Immediate impact likely to be limited

However, given that current lending conditions remain tight, we believe that the impact from onshore borrowing costs and banking operations is likely to be minimal. As shown in the chart below, only a very small portion of loans (around 11.4%) are priced below the lending rate, and almost no banks offered loans near the 30% discount to the benchmark lending rate.

Few Chinese loans are priced below PBoC benchmark rates



Source: Moody's Investors Service, Julius Baer

Banks are also unlikely to engage in price wars given the tightened lending quota and regulatory caps on loan-to-deposit ratios. Moreover, top-tier state-owned enterprises (SOE) have long been able to tap the onshore corporate bond markets at comparative rates as substitutes to bank loans. However, lending rates could potentially see some declines should the central bank inject more liquidity into the interbank market or cut the reserve requirement ratios.

Symbolic step to China's financial reform nonetheless

Nevertheless, we believe that the current move is symbolic, since it signals the new administration's determination to forge ahead with capital market reforms and further liberalise its interest rates. Deeper financial overhaul could be in the offing given the benign inflation outlook, improved pricing capability of financial institutions and better financial infrastructure with the emergence of the Shanghai interbank offered rate (Shibor). In S&P's view, the acceleration in interest rate liberalisation over the past year or so may be

related to the rapid growth of off-balance-sheet and non-bank financing. S&P believes that the interbank market volatility in mid-June had likely slowed the growth in 'shadow financing', but the effects are likely to be temporary. The PBoC may thus have to retool to exert a more sustained and less disruptive control over the broader credit conditions.

In particular, the next steps of liberalisation will focus on the removal of the deposit rates ceiling, which would lead to a more conventional monetary policy framework by targeting money market interest rates. This would have a much bigger impact, by raising the financing costs for major banks while prompting lenders to allocate capital more efficiently. Low deposit rates have often been cited as a key reason for the low contribution from household consumption, as well as China's property bubble since savers seek higher returns than those bank deposits can offer. Currently, the PBoC controls deposit rates with a cap of 110% of benchmark rates of 3.0%. Nevertheless, as the PBoC has pointed out, no major moves on the deposit rate ceiling should be expected in the near term given the lack of certain conditions such as a deposit insurance scheme. We also note that the changing of the deposit rate is likely to face greater political pressure from various powerful bodies (such as SOEs and major banks) given the widespread impact. The PBoC would also have to introduce other sources of funding available to banks, such as the deregulation of onshore certificate of deposits.

Interestingly, we also note that a select group of observers seemed sceptical of the current move, saying that it reflects official concerns over the economic slowdown and a possible spike in non-performing loans. In their view, the move was a short-term relief for the heavily indebted SOEs, big private-sector employers and local government financing arm. While we are unable to verify such claims given the short time span, it would certainly be important to watch if any sector receives particular support following the policy tweaks.

Long-run credit negative on banks

In any case, we believe that in the longer run, the removal of the lending rate floor may allow borrowers with strong bargaining power to obtain cheaper funding, leading to a further decline in lending rates. This would benefit the top-

tier SOEs, but will eventually lead to an erosion of the banks' margins. In Moody's view, the four major state-owned banks will see the largest impact due to their relatively large exposure to large SOEs that could negotiate for lower lending rates. Hence, Moody's expects the Chinese banks to accelerate its expansion into more profitable businesses, such as loans to small and mid-sized enterprises (SMEs), to offset the margin pressure.

In our view, smaller institutions with lower contributions from non-interest income (i.e. lower earnings diversification) would see greater impact from any declines in lending rates. These banks could also see greater competition as major banks move to expand their footprint in the SME segment. Furthermore, should the liberalisation of deposit rate take place, smaller banks would also see greater margin pressures because these institutions usually attract deposits by offering higher rates. As such, we would prefer to stay with the major state-owned banks, with greater earnings diversity and stronger support from the government.

Long-run positive for major developers

Similarly to other corporates, we believe that most Chinese property developers are unlikely to benefit in the near term from the removal of the lending floor, given that the majority of them are unable to obtain bank financing below the benchmark rates. Among the major companies, only large SOE developers such as China Resources Land Ltd. and China Overseas Land and Investment Ltd. (both Buy/Opportunistic) are able to borrow at a 10% discount. Furthermore, developers are unlikely to benefit materially from higher mortgaged sales given that the range of mortgage rates has been left unchanged.

In the longer term, however, we believe that large developers with sound financial management and disciplined land bank acquisitions may be able to pay significantly lower interest rates for domestic bank financing. This would mean greater differentiation between the developers since this would eventually lead to stronger market-share gains.

Source of credit ratings: Bloomberg Finance L.P.

Magdalene Teo, Sok Yin Yong

Latest bond issues of Research covered 'buy' rated issuers list

ISIN	Issuer	Rating Mdy's*	JB Research Issuer Class.	Ccy	Cpn	Maturity	Ask Price Clean**	YTM	Spread over Government	Minimum
CH0217986378	KOREA NATIONAL OIL CORP	A1e	Quality	CHF	1.625	29/11/2018	100.95	1.44	106	5'000
CH0215275519	RABOBANK NEDERLAND	Aa2	Quality	CHF	1.000	26/06/2020	98.40	1.24	58	5'000
EUR										
DE000A1TNJ97	DAIMLER AG	A3	Opportunistic	EUR	2.000	25/06/2021	98.85	2.16	95	1'000
USD										
US166764AC43	CHEVRON CORP	Aa1	Quality	USD	0.889	24/06/2016	100.50	0.72	11	2'000
US166764AE09	CHEVRON CORP	Aa1	Quality	USD	1.718	24/06/2018	100.02	1.71	35	2'000
US166764AG56	CHEVRON CORP	Aa1	Quality	USD	2.427	24/06/2020	99.79	2.46	49	2'000
BE6254003252	BARRY CALLEBAUT SVCS NV	Ba1	Opportunistic	USD	5.500	15/06/2023	103.00	5.11	253	200'000
US166764AH30	CHEVRON CORP	Aa1	Quality	USD	3.191	24/06/2023	99.43	3.26	67	2'000
US87927VAF58	TELECOM ITALIA CAPITAL	Baa3	Opportunistic	USD	6.375	15/11/2033	94.08	6.92	379	1'000
Other currencies										
XS0945074051	RABOBANK NEDERLAND	Aa2	Quality	CAD	2.625	25/06/2018	99.54	2.73	90	1'000
XS0949742323	DAIMLER AG	A3e	Opportunistic	NOK	3.000	10/07/2018	99.83	3.04	116	10'000
XS0942787911	RABOBANK NEDERLAND AU	Aa2	Quality	AUD	4.125	19/09/2018	98.80	4.38	122	1'000
XS0942541912	LANDWIRTSCH. RENTENBANK	Aaa	Conservative	NOK	2.625	17/06/2020	97.88	2.97	76	10'000

Source: Bloomberg Finance L.P., * = Composite credit rating where available, or Moody's rating, for credit rating definitions see the table at the end of this document, ** = 04:30 pm, 25 July 2013.

Latin America bond information list

ISIN	Issuer	Currency	Rating*	Maturity	Coupon	Price**	Yield to maturity	Yield to call/put	Duration	Collateral type	Min Piece
REGULAR INFORMATION LIST											
Investment Grade											
USP14486AC11	BANCO NAC DE DESEN ECONO	USD	BBB	06.2019	6.500	111.0	4.4		4.9	Senior	100'000
USG2583XAA93	CSN ISLANDS XI CORP	USD	BB+	09.2019	6.875	98.5	7.2		4.8	Senior	100'000
USG9393JAA00	VOTO-VOTORANTIM O/S TRAD	USD	BBB	09.2019	6.625	108.3	5.0		5.0	Senior	100'000
USG08010BH52	BANCO BRADESCO (CAYMAN)	USD	BBB	09.2019	6.750	110.9	4.7		5.0	Subordinated	100'000
US46556MAA09	ITAU UNIBANCO HLDG SA/KY	USD	BBB-	04.2020	6.200	104.6	5.4		5.4	Subordinated	100'000
USG93932AA24	VOTORANTIM OVERSEAS IV	USD	BBB	06.2020	7.750	113.8	5.3		5.4	Senior	100'000
USL21779AA88	CSN RESOURCES SA	USD	BB+	07.2020	6.500	94.1	7.6		5.5	Senior	100'000
US91911TAL70	VALE OVERSEAS LIMITED	USD	BBB+	09.2020	4.625	100.8	4.5		5.9	Senior	2'000
USP3772WAB83	BANCO DO BRASIL (CAYMAN)	USD	NR	01.2021	5.375	99.0	5.5		6.1	Subordinated	100'000
USG0732RAF58	BANCO BRADESCO (CAYMAN)	USD	BBB	01.2021	5.900	102.5	5.5		6.0	Subordinated	100'000
US46556MAE21	ITAU UNIBANCO HLDG SA/KY	USD	BBB-	12.2021	6.200	102.8	5.8		6.5	Subordinated	200'000
US91911TAM53	VALE OVERSEAS LIMITED	USD	BBB+	01.2022	4.375	96.1	4.9		6.9	Senior	2'000
USG0732RAG32	BANCO BRADESCO (CAYMAN)	USD	BBB	03.2022	5.750	101.0	5.6		6.6	Subordinated	200'000
US46556MAF95	ITAU UNIBANCO HLDG SA/KY	USD	BBB-	03.2022	5.650	97.9	6.0		6.6	Subordinated	200'000
US46556MAH51	ITAU UNIBANCO HLDG SA/KY	USD	BBB-	08.2022	5.500	96.9	6.0		6.8	Subordinated	200'000
US05958AAJ79	BANCO DO BRASIL (CAYMAN)	USD	BBB	10.2022	3.875	89.3	5.4		7.4	Senior	200'000
US105756BU30	FED REPUBLIC OF BRAZIL	USD	BBB	01.2023	2.625	88.5	4.1		8.2	Senior	200'000
SUPPLEMENTARY BOND INFORMATION LIST (no coverage)											
Floating rate notes											
US05966UJ34	BANCO SANTANDER BRAZ CI	USD	BBB	03.2014	2.373	100.1	2.2		0.1	Senior	150'000
Investment Grade											
USG24419AA47	RAIZEN ENERGY FINANCE	USD	BBB-	02.2017	7.000	110.5	3.8		3.0	Senior	100'000
US12803X2A85	CAIXA ECONOMICA FEDERAL	USD	BBB	11.2017	2.375	93.5	4.0		4.0	Senior	150'000
US05971BAB53	BANCO BTG PACTUAL/CAYMAN	USD	BBB-	01.2020	4.000	88.5	6.2		5.5	Senior	200'000
USP9037HAL70	TELEMAR NORTE LESTE SA	USD	BBB-	10.2020	5.500	94.9	6.4		5.8	Senior	100'000
USP18445AG42	OI SA	USD	BBB-	02.2022	5.750	94.8	6.6		6.4	Senior	200'000
USP84050AA46	SAMARCO MINERACAO SA	USD	BBB	11.2022	4.125	90.8	5.4		7.4	Senior	200'000
US12803X2B68	CAIXA ECONOMICA FEDERAL	USD	BBB	11.2022	3.500	84.6	5.7		7.6	Senior	150'000
USP28610AA46	CIELO SA/CIELO USA INC	USD	BBB	11.2022	3.750	89.6	5.2		7.6	Senior	200'000
Non Brazilian											
US29245SAD45	EMPRESA NACIONAL DE ELEC	USD	BBB	08.2015	8.625	113.0	2.0		1.8	Senior	1'000
USG2523RAA52	BANCO CONT(CONT SR TRST)	USD	BBB	11.2020	5.500	104.0	4.8		5.9	Senior	500'000
USP0607JAE84	AES GENER SA	USD	BBB-	08.2021	5.250	102.2	4.9		6.4	Senior	1'000
USP37100AA51	EMPRESA DE ENERGIA DE BO	USD	BB+	11.2021	6.125	111.0	4.5		3.0	Senior	200'000
USP37110AG12	EMPRESA NACIONAL DE PETR	USD	BBB	12.2021	4.750	107.0	3.8		6.9	Senior	100'000
USC71058AB42	PACIFIC RUBIALES ENERGY	USD	BB	12.2021	7.250	114.0	5.2		3.0	Senior	100'000
XS0430799725	PETROLEOS MEXICANOS	GBP	BBB	06.2022	8.250	125.4	4.7		6.5	Senior	50'000
USP16259AH99	BBVA BANCOMER SA TEXAS	USD	BBB-	09.2022	6.750	108.8	5.5		6.8	Subordinated	150'000
US71656MAP41	PETROLEOS MEXICANOS	USD	BBB	01.2023	3.500	95.9	4.0		8.0	Senior	10'000
USP32133CG63	BANCO DE CRED E INVER	USD	A	02.2023	4.000	93.8	4.8		7.6	Senior	200'000

Source: Bloomberg Finance L.P., * = Composite credit rating where available, or Moody's rating, for credit rating definitions see the table at the end of this document, ** = 04:30 pm, 25 July 2013.

Asia bond information list

ISIN	Issuer	Currency	Rating*	Maturity	Coupon	Price**	Yield to maturity	Duration	Collateral type
Greater China									
XS0528404733	CHINA RESOURCES POWER HL	USD	BBB-	03.08.2015	3.750	103.33	2.05	1.90	SR UNSECURED
XS0758793342	CITIC PACIFIC LIMITED	USD	BB+	21.01.2018	6.875	102.84	6.14	3.81	SR UNSECURED
XS0493535966	CLP POWER HK FINANCING	USD	A	19.03.2020	4.750	106.68	3.61	5.61	COMPANY GUARNT
XS0643649956	ZIJIN INTL FINANCE CO LT	USD	NR	30.06.2016	4.250	104.73	2.56	2.73	SR UNSECURED
USG46726AA63	HUTCHISON WHAM INT 09/16	USD	A-	11.09.2015	4.625	106.50	1.49	1.99	COMPANY GUARNT
XS0536564981	PCCW-HKT CAPITAL NO4 LTD	USD	BBB	24.02.2016	4.250	105.82	1.92	2.40	COMPANY GUARNT
XS0728761726	LS FINANCE 2017 LTD	USD	BBB-	26.01.2017	5.250	107.07	3.10	3.19	COMPANY GUARNT
USG01198AC73	AGILE PROPERTY HLDGS LTD	USD	BB	14.11.2016	10.000	107.50	7.38	0.29	COMPANY GUARNT
XS0745169044	CHINA OVERSEAS FIN CAYMA	USD	BBB+	15.02.2017	4.875	106.68	2.88	3.19	COMPANY GUARNT
USG5635PAA78	LONGFOR PROPERTIES	USD	BB	07.04.2016	9.500	108.99	5.83	0.66	COMPANY GUARNT
Indonesia									
USY70902AA21	PT ADARO INDONESIA	USD	BB+	22.10.2019	7.625	105.28	6.58	1.14	COMPANY GUARNT
USN44658AA58	INDO INTGRD ENERGY II	USD	B+	05.11.2016	9.750	106.25	7.55	0.26	SR SECURED
USN44519AA99	INDOSAT PALAPA CO BV	USD	BB+	29.07.2020	7.375	109.58	5.70	1.86	COMPANY GUARNT
USN54360AB30	MAJAPAHIT HOLDING BV	USD	BB+	17.10.2016	7.750	111.68	3.85	2.82	COMPANY GUARNT
Malaysia									
XS0212370869	IOI VENTURES	USD	BBB	16.03.2015	5.250	105.20	1.99	1.54	COMPANY GUARNT
USY68856AG17	PETRONAS GLOBAL SUKUK LT	USD	A	12.08.2014	4.250	103.30	1.03	1.00	COMPANY GUARNT
XS0225936417	SARAWAK INTERNATIONAL	USD	A-	03.08.2015	5.500	107.26	1.80	1.87	COMPANY GUARNT
XS0602697772	HONG LEONG BANK	USD	BBB+	17.03.2016	3.750	104.71	1.90	2.48	SR UNSECURED
Korea									
US40963MAB81	HANA BANK	USD	A	30.10.2015	4.500	106.38	1.60	2.13	SR UNSECURED
USY4822WCR98	KOOKMIN BANK	USD	AA	14.05.2014	7.250	104.90	0.99	0.77	COVERED
US82460EAA82	SHINHAN BANK	USD	A	15.09.2015	4.375	105.97	1.51	2.01	SR UNSECURED
USY3815NAT82	HYUNDAI CAPITAL SERVICES	USD	BBB+	13.09.2017	3.500	103.18	2.68	3.78	SR UNSECURED
US50065KAA07	KOREA EXPRESSWAY CORP	USD	A+	23.03.2015	4.500	105.01	1.41	1.57	SR UNSECURED
USY4899GAQ65	KOREA HYDRO & NUCLEAR PO	USD	A+	16.09.2015	3.125	103.53	1.43	2.04	SR UNSECURED
US50065XAA28	KOREA NATIONAL OIL CORP	USD	A+	09.11.2015	2.875	103.27	1.41	2.19	SR UNSECURED
India									
XS0463466028	AXIS BANK/DUBAI	USD	BBB-	30.09.2015	5.250	105.41	2.66	2.02	SR UNSECURED
XS0498932721	BANK OF INDIA LONDON	USD	BBB-	30.09.2015	4.750	104.51	2.59	2.03	SR UNSECURED
USM5314BAE13	ICICI BANK LTD/BAHRAIN	USD	BBB-	25.03.2015	5.500	104.83	2.50	1.56	SR UNSECURED
USY81636AA39	STATE BANK INDIA/LONDON	USD	BBB-	27.07.2015	4.500	104.59	2.13	1.91	SR UNSECURED
XS0480289189	INDIAN OIL CORP LTD	USD	BBB-	22.01.2015	4.750	103.83	2.10	1.43	SR UNSECURED
USU75888AA26	RELIANCE HOLDINGS USA	USD	BBB	19.10.2020	4.500	99.71	4.55	6.03	COMPANY GUARNT
XS0648477593	NTPC LTD	USD	BBB-	14.07.2021	5.625	102.51	5.24	6.36	SR UNSECURED
Middle East									
XS0466365110	CBQ FINANCE LTD	USD	A	18.11.2014	5.000	105.11	1.03	1.26	BANK GUARANTEED
XS0497249341	NATIONAL BK OF ABU DHABI	USD	A+	25.03.2015	4.250	105.16	1.09	1.58	NOTES
USM28368AA21	DOLPHIN ENERGY LTD	USD	A+	15.06.2019	5.888	112.30	3.55	4.99	SR SECURED
XS0551313926	DUBAI ELECTRICITY & WATE	USD	NR	21.10.2016	6.375	111.82	2.53	2.90	SR UNSECURED
XS0527351570	QATARI DIAR FINANCE QSC	USD	AA	21.07.2015	3.500	104.42	1.23	1.91	GOVT GUARANTEED
XS0549116290	QTEL INTERNATIONAL FIN	USD	A	14.10.2016	3.375	105.00	1.76	3.01	COMPANY GUARNT
USM8222MAB83	RAS LAFFAN LNG 3	USD	A+	30.09.2016	5.832	107.50	3.32	2.85	SR SECURED
XS0717839525	TAQA ABU DHABI NATL ENER	USD	A-	13.03.2017	4.125	105.94	2.40	3.32	SR UNSECURED
XS0436725765	TDIC FINANCE LTD	USD	AA-	02.07.2014	6.500	105.34	0.68	0.90	COMPANY GUARNT

Source: Bloomberg Finance L.P., * = Composite credit rating where available, or Moody's rating, for credit rating definitions see the table at the end of this document, ** = 04:30 pm, 25 July 2013.

Next Generation - Growth

Asia bond information list

Julius Baer appraises the long-term growth potential of Asian economies what will materialize in the longer-term revaluation of their currencies. The list of CNH bonds serves as [information](#) for investors seeking exposure to this growing market. Please consult Julius Baer's "Chinese Currency Handbook: The offshore renminbi" for details about investment opportunities for foreign investors.

ISIN	Issuer	Currency	Rating*	Maturity	Coupon	Price**	Yield to maturity	Duration	Collateral type
Greater China									
HK0000110798	BANK OF EAST ASIA CHINA	CNY	NR	11.05.2015	3.650	100.77	3.20	1.70	SR UNSECURED
HK0000091832	ICBC ASIA LTD	CNY	NR	04.11.2021	6.000	104.50	5.32	2.93	SUBORDINATED
HK0000069283	BANK OF CHINA	CNY	NR	30.09.2013	2.900	100.05	2.57	0.17	SR UNSECURED
HK0000106150	EXPORT-IMPORT BANK CHINA	CNY	NR	07.04.2014	2.700	99.20	3.89	0.67	SR UNSECURED
HK0000106168	EXPORT-IMPORT BANK CHINA	CNY	NR	05.04.2015	2.900	98.70	3.70	1.62	SR UNSECURED
HK0000083714	BEIJING ENTERPRISES WATE	CNY	NR	30.06.2014	3.750	100.33	3.38	0.89	SR UNSECURED
HK0000083706	BEIJING ENTERPRISES WATE	CNY	NR	30.06.2016	5.000	100.62	4.77	2.68	SR UNSECURED
HK0000091105	CNPC GOLDEN AUTUMN LTD	CNY	A+	26.10.2013	2.550	100.08	2.20	0.24	COMPANY GUARNT
HK0000091113	CNPC GOLDEN AUTUMN LTD	CNY	A+	26.10.2014	2.950	100.00	2.95	1.20	COMPANY GUARNT
HK0000072485	CHINA RESOURCES POWER HL	CNY	NR	12.11.2013	2.900	99.98	2.96	0.28	SR UNSECURED
HK0000072493	CHINA RESOURCES POWER HL	CNY	NR	12.11.2015	3.750	100.42	3.56	2.16	SR UNSECURED
HK0000078540	HKCG FINANCE LTD	CNY	A+	11.04.2016	1.400	95.89	3.00	2.61	COMPANY GUARNT
Japan									
HK0000079068	SUMITOMO MITSUI BANKING	CNY	NR	22.04.2014	1.100	98.75	2.84	0.72	CERT OF DEPOSIT
RMB Synthetic bonds									
Greater China									
XS0576382229	EVERGRANDE REAL ESTATE G	CNY	B+	19.01.2014	7.500	100.45	6.49	0.46	COMPANY GUARNT
XS0576382492	EVERGRANDE REAL ESTATE G	CNY	B+	19.01.2016	9.250	98.01	10.18	2.15	COMPANY GUARNT

Source: Bloomberg Finance L.P., * = Composite credit rating where available, or Moody's rating, for credit rating definitions see the table at the end of this document, ** = 04:30 pm, 25 July 2013.

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Imprint

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Appendix

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Frequently used abbreviations

Abbr.	Description	Abbr.	Description	Abbr.	Description
FCF	Free cash flow	CFI	Investing cash flow	EBIT	Earnings before interest and taxes
CFO	Operating cash flow	FFO	Funds from operations	EBITDA	Earnings before interest, taxes, depreciation and amortisation
CFF	Financing cash flow	RCF	Retained cash flow		

Issuer rating change history as of 25/07/2013

Issuer	Rating	History
Freeport McMoran C&G	Buy	Since 29/09/2009
China Overseas Land & Investment	Buy (initiation of coverage)	Since 14/01/2011
China Resources Land Ltd.	Buy (initiation of coverage)	Since 13/06/2011

Rating system for Fixed Income

Buy	Within its risk category, the issuer is highly recommended due to its financial and business condition (strong balance sheet, income statement, cash flow and good position in the industry). Debt instruments of the issuer are regarded as an attractive investment from a risk/return perspective.
Hold	Maintain position based on stable credit fundamentals and/or average expected return characteristics within peer group.
Sell	The rating is changed to Sell, depending on a significant deterioration in the fundamental data of the issuer in relation to the industry peers. The investment is no longer justified from a risk/return perspective for the relevant category.

Fixed Income Research maintains an issuer list with the following four risk categories

Conservative	Incorporates supranational issuers, top-rated sovereign issuers and bodies that are directly and fully guaranteed by these institutions. These issuers are most likely to preserve their top rating throughout the business cycle.
Quality	Incorporates sovereigns and corporate issuers that are very likely to service and repay debt within a five-year credit scenario. They are likely to preserve their investment grade rating throughout a normal business cycle.
Opportunistic	Incorporates issuers that are quite likely to service and repay debt within the five-year credit scenario. Such issuers have an attractive risk/return profile in the current credit scenario but are subject to rating downgrade risk and, thus, might be exchanged periodically.
Speculative	Incorporates sub-investment-grade issuers in Europe and the USA as well as local issuers in emerging markets. Issuers are likely to service and repay debt in the current credit scenario. Investors must note that these issuers are subject to a higher downgrade and default frequency and that an active management of these positions is crucial.

Credit rating definition

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	Moody's	S&P	Fitch/I BCA	Credit rating definition
Investment Grade	Aaa	AAA	AAA	Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.
	Aa1	AA+	AA	Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.
	Aa2	AA	AA-	
	Aa3	AA-	AA-	
	A1	A+	A+	Obligations rated A are considered upper-medium grade and are subject to low credit risk.
	A2	A	A	
	A3	A-	A-	
	Baa1	BBB+	BBB+	Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.
	Baa2	BBB	BBB	
	Baa3	BBB-	BBB-	
Non-investment grade	Ba1	BB+	BB+	Obligations rated Ba are judged to have speculative elements and are subject to substantial credit risk.
	Ba2	BB	BB	
	Ba3	BB-	BB-	
	B1	B+	B+	Obligations rated B are considered speculative and are subject to high credit risk.
	B2	B	B	
	B3	B-	B-	
	Caa1	CCC+	CCC+	Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.
	Caa2	CCC	CCC	
	Caa3	CCC-	CCC-	
	Ca	CC C	CC+ CC CC-	Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
	C	D	DDD	Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

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