MAVEST SPECIAL REPORT

Is this the end of the game – that we call Disneyland?

The United States of America are facing the loss of economic importance. A mixture of higher inflation and a depreciation of the U.S. dollar may bring relief for only a short time. In the long run, the United States should look for a more sustainable growth model, because debt as an economic driving force is not working anymore. This task of strategic change has not begun since the financial crisis and is expected to run extremely painful in decades. In essence, the business model "Disneyland" is on the way out.

To date, enough foreign investors played the Disneyland game to finance the United States. Economists say usually: Global investors rely on the stability and strength of the U.S. economy. They exchanged goods with the U.S. dollar facing the Americans, that every day bought more goods than they sold. In average the United States imported goods for two and a half billion U.S. dollars more than they exported over the past years. In February, the deficit was 45.8 billion U.S. dollars. This phenomenon is reflected in the persistent trade deficit. For the American economy this concept of debt was quite attractive. The trading partners accepted again and again printed U.S. dollars as payment. The U.S. market was important for them because of its size. Currently a worldwide change takes place, it could be dramatic.

The U.S. economic model is based not only on performance but at least two decades, more and more on "consumption on credit." A desired side effect is a decline in the value of their currency: the U.S. dollar. We call the U.S. concept internally Disneyland.

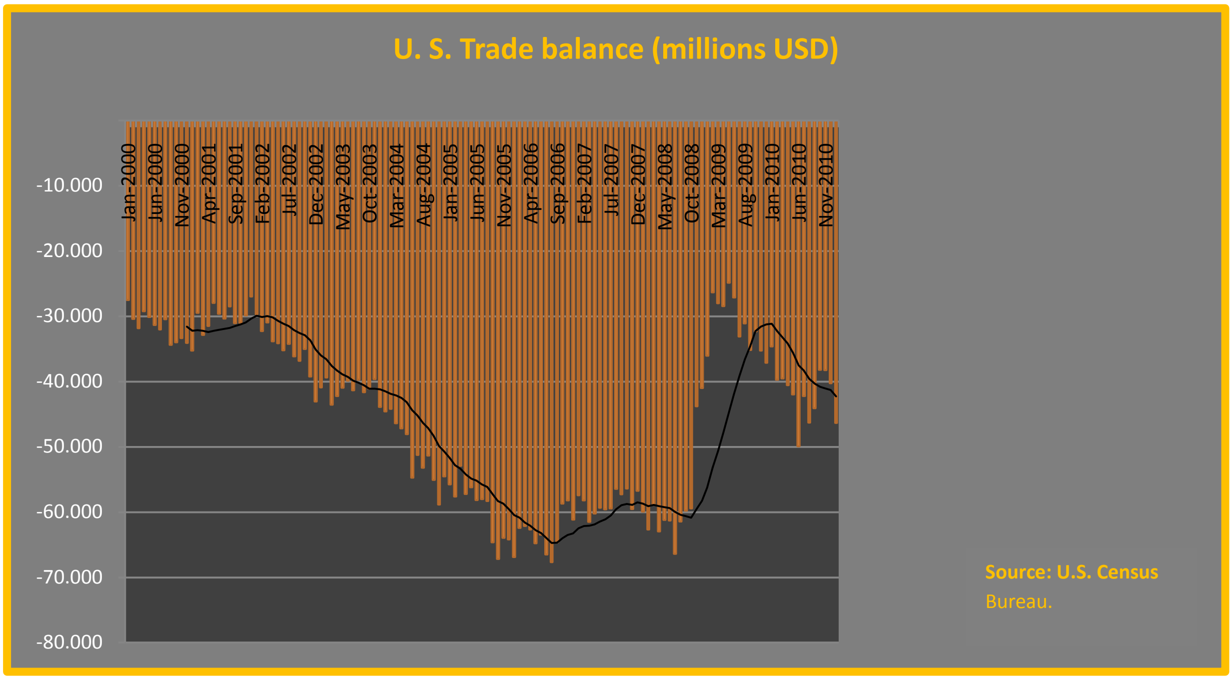
The situation

The trend of wealth speaks for some time against the United States, such as the Global Institute, McKinsey (MGI), a company's internal think tank, said: Born in 1960, Americans in 40 years increased per capita income of 254 percent recorded. In 2000, babies can hope for an average growth of 163 percent over the next 40 years. Productivity in the last decades has been improved especially at the expense of employment. The country that did so well in the past is technologically not on the top anymore, there is a lack of competitiveness. Another problem is the lack of jobs for lower-skilled, like Nobel-laureate Paul Krugman in his column in The New York Times once complained. In the view of McKinsey only growth can bring the solution. That is not even half of the truth, because the U.S. is a debt-financed (leveraged) economy that can hardly outgrow the problems. Asia passed by in relation to the dynamics of economic development and presumably unassailable. The 1-million-dollar question is: How to achieve higher growth rates in a country where two-thirds of economic output is related to credit financed consumption?

In our view even these simple facts describe the complexity of the tasks of re-vitalization of the U.S. economy. Although MAVEST with its market exposure in FX is never committed long term, but our traders have been observing for years with concern the economic development of the United States. Some of the key long-term determinants we present for this special report. We will briefly discuss them separately.

Disneyland (I) - Trade balance

The reality of the U.S. economy: Since 1998, the U.S. trade balance every month is at least by a double-digit billion in deficit. Since 1992 we have not seen a single year in plus. The U.S. model is one of the leading causes of global trade imbalances. Identifiable demand fell after the first months of the financial crisis, but this development was not a consequence of deeper insight into their own faulty economic model, but it was the temporary abandonment of private consumption and decline of investment. Thereafter the economy stabilized by the U.S. government trillions stimuli. The total debt is now not lower because a change of guarantors happened. At best, perhaps the financing for the entire economy will be cheaper.



Since both the government and the private spend more than they earn we speak of a U.S. model. We name this concept Disneyland[1].

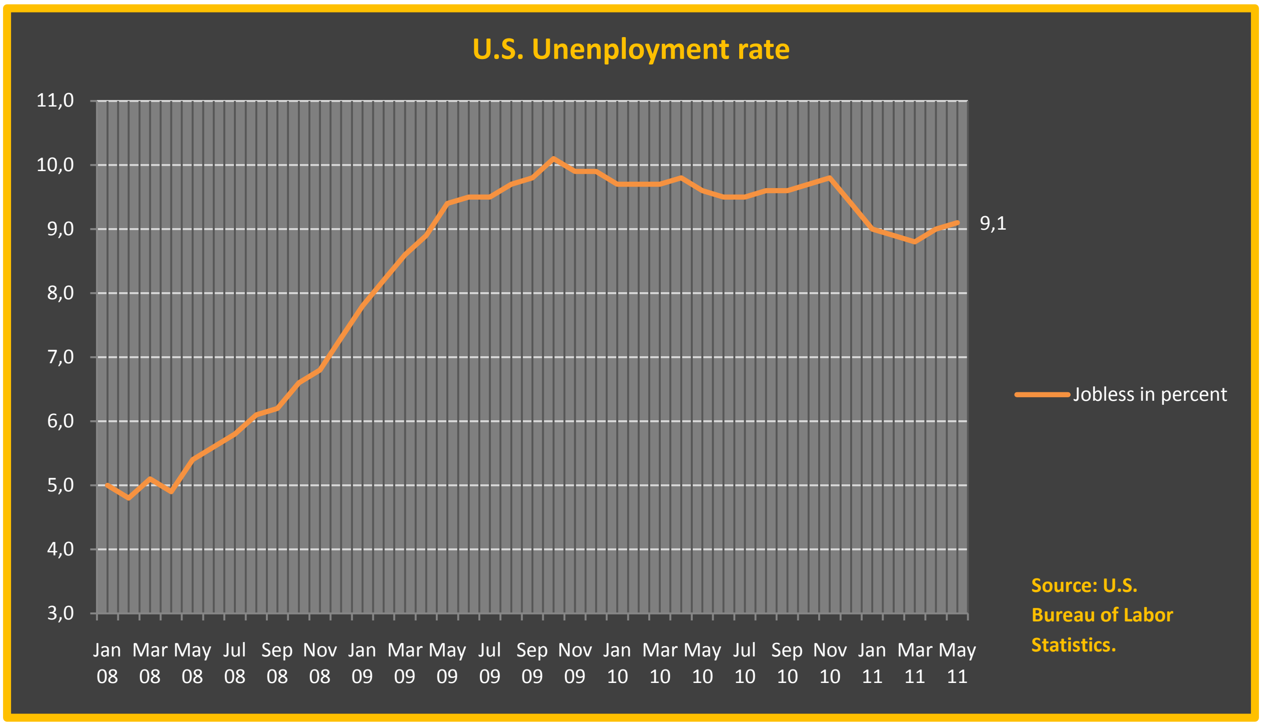
Disneyland (II) - Credit-financed private debt

Rising interest rates in a "leveraged" economic have consequences that we have seen in the last few years in the mortgage sector. There are now about 11 million mortgage holders actually insolvent, since real estate had lost about 50 percent of "value". But banks search for sufficient collateral for loans. It starts a dangerous cycle of collective insolvency. The house of cards collapses, if the monthly charges rise strongly. Recently Yale Professor Stephen Roach described in a comment the average U.S. consumer as a "zombie". The government's wants to support homeowners in distress and take billions of dollars in the hand - 150 billion U.S. dollars some say. The result: A new illusion, for the victims continue to live on credit, of course without solving the underlying problem.

The five largest U.S. mortgage banks and some foreign banks are currently under pressure. They should have forced homeowners into foreclosure in the fast track. Obviously something went wrong and the institutions try now to solve their problems with the U.S. government. The concern is that the mortgage loans could be restricted in future. Without too much detail: The United States use anyway bizarre rules such as "bell letters", just because of this banks in Europe should have stayed on a side in the U.S. house market. The private game works like this: You live in a one or two sizes too big house, hoping for rising property prices. If it runs well, someone else pays your house and the mortgage, then you start the game again. Absurd: Banks were driving the mortgage game with ads that recommended homeowners to borrow against their homes and put money into shares. The consequences are known. Another negative highlight of the financial crisis, called the Pulitzer Prize winner Jake Bernstein and Jesse Eisinger in a report as "incest" trading - a term that we did not know yet as traders. Air was sold back and forth through front companies and that in fact in the

[1] This report is not against Walt Disney that is a fantastic company.

institutions themselves, to earn high premiums. This further weakened the financial system. The state then saved the U.S. financial sector with 700 billion U.S. dollars.



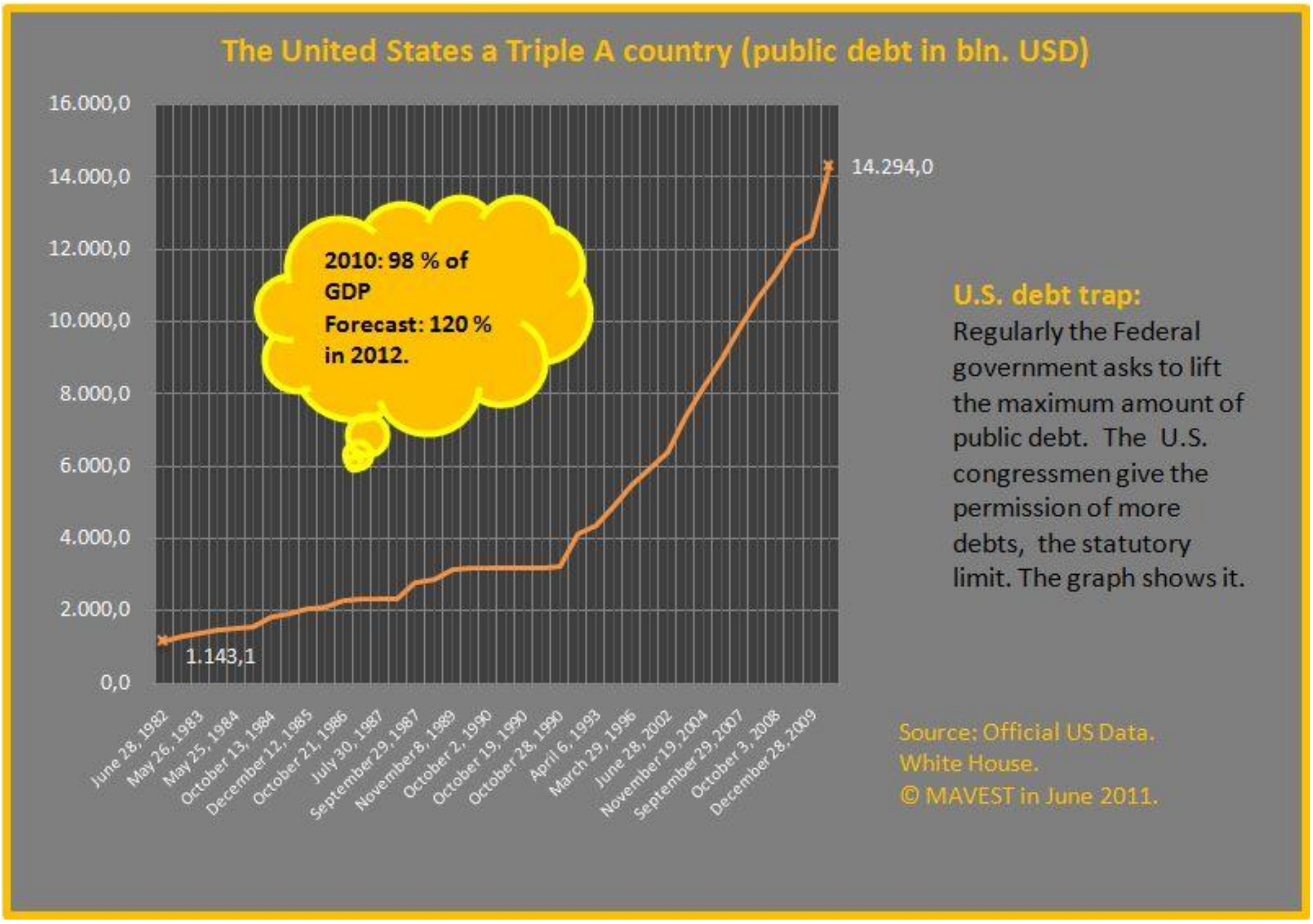
In this situation with U.S. zombie banks (Krugman) and U.S. consumer zombies (Roach) the U.S. Federal Reserve has to operate their monetary policy. The dilemma: Rising interest rates would overwhelm consumers even more than the tense situation already does. The equity markets and the balance sheets of banks and asset managers will be shaken again. In any case U.S. banks will be confronted with shocks and bad debts. So the Fed actually keeps quiet and hopes. But what they hope for? The scope for turning is low. Unemployment in the U.S. skyrocketed and remained at a high level. This development is surprising, since so far everybody thought that a very flexible labor market not only quickly degrades jobs, but also builds up when economy rises again. The graph shows that there are serious problems: The effects of leveraged economy that is now in the process of "de-leveraging". In addition, long-term unemployment is increased - an economic phenomenon that was said to be an exclusive problem of the more regulated economies of “Old Europe”.

We still remember very well the discussions over the past two years, as Wall Street put a deflationary scenario on the wall. Japan was the nightmare scenario - with an economy with zero growth at low interest rates. Meanwhile, we also see in the United States again rising prices - inflation is in discussion now. Everybody knows how to handle rising prices. Of course, now Wall Street argues that the actual recovery is too fragile. Similar arguments can be heard from the UK. The European Central Bank (ECB) ventured this year the first step and raised interest rates taking some criticism for it. It is argued that the prices are just too high because of increased food and energy prices. But there is no guarantee that this price high will vanish again.

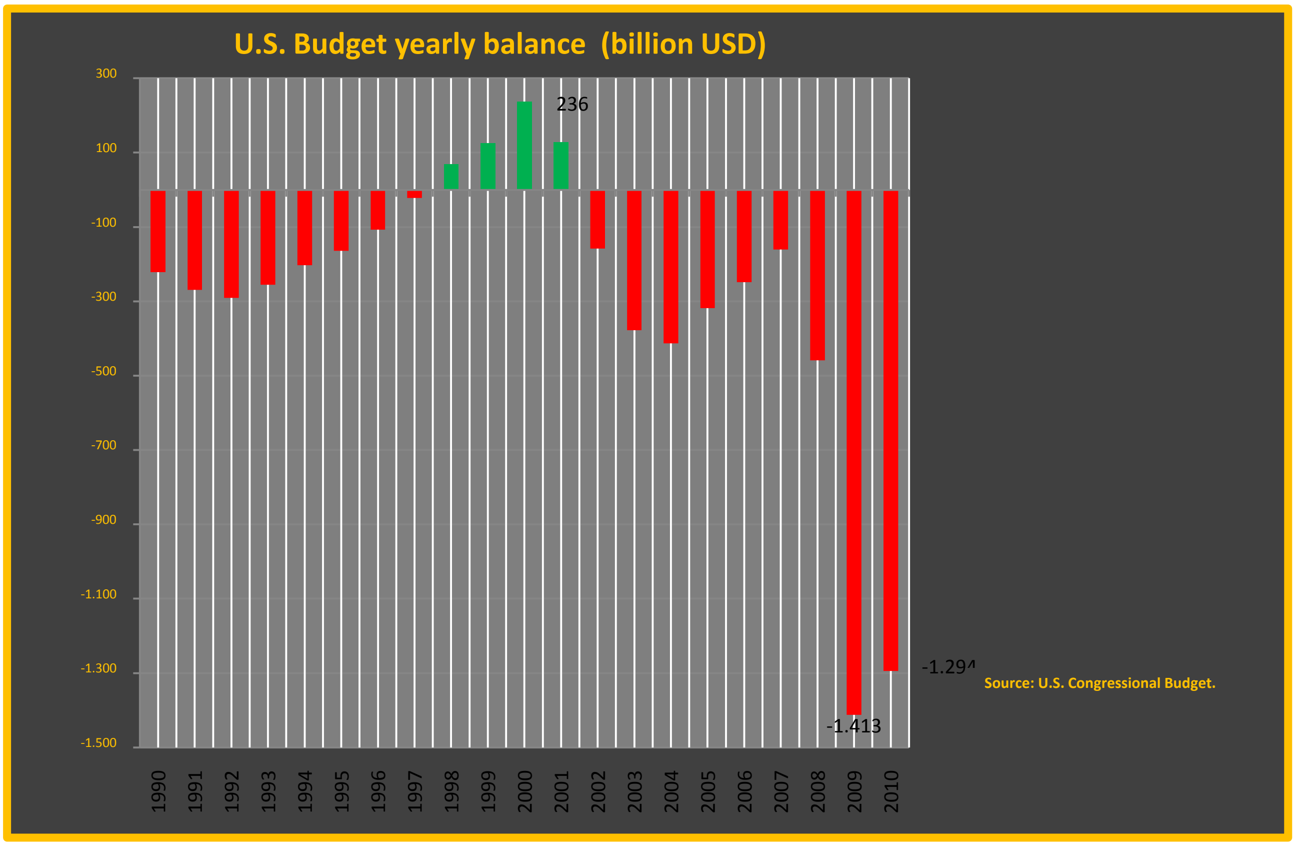
Disneyland (III) - U.S. government debt

We don´t see towering debt of the United States too critical, because the country had to tackle a violent shock. The Obama administration billion debt we cannot blame. In our view we criticize the U.S. mentality of debt. The total debt piled up by the federal government, U.S. states and municipalities are in any case considerably. In this situation the wrong pre-crisis political philosophy of the Republicans block the country. We remember a showdown in April when a deadlock in the House almost meant insolvency. This now happens every month.

California, according to figures the eighth largest economy in the world, faced under former “Governator” Arnold Schwarzenegger a budget crisis and is now under life support from Washington. U.S. credit rating agencies where wrong in evaluating U.S. debt in the past. They are in critics now especially when you compare the U.S. rating to some downgraded European municipal bonds. In this respect, the United States benefited so far from low - Bond investors say too low - interest payments.



In April, Obama presented a medium-term plan, annual government expenditure of 4,000 billion U.S. dollars to reduce debt in twelve years. The Republicans want to save even 6,000 billion. However, republicans want to cut somewhere else. That is U.S. politics about in these days. It seems to be absurd to extend tax breaks to wealthy Americans, which the philosopher George W. Bush invented. The U.S. government lost about 1,100 billion U.S. dollars in tax revenue. A compromise line in the budget debate between the U.S. president and the majority in the House of Representatives launched an extension of tax privileges. Meanwhile many commentators suggest the U.S. president should not agree for the tax privilege that was limited in time. That does not sound like political leadership on the one hand and lack of accountability on the other.

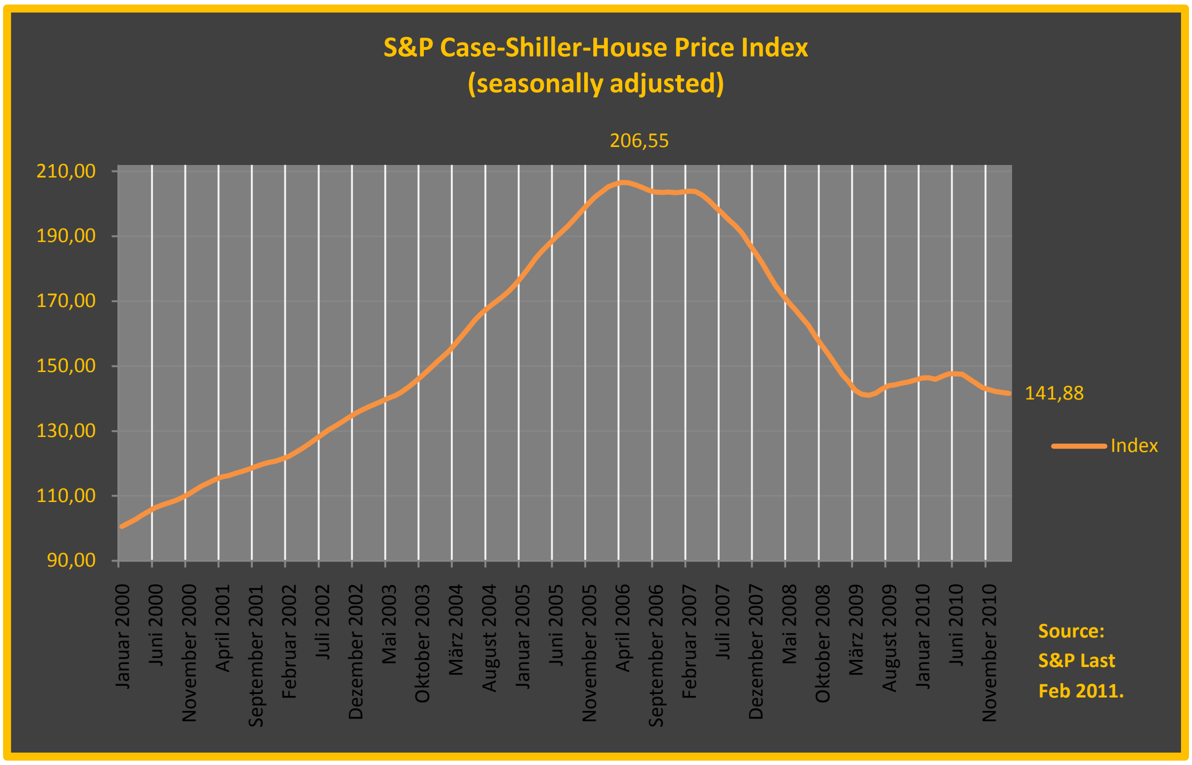


Disneyland (IV) - Concepts and leverage economy

The United States are a bad example in another way: The shadow banking system was the most successful international export good. By moving and packaging risks in the outsourced units this system helped financial institutions to inflate their balance sheets and to avoid regulation. Meanwhile there are similar trends in China already, as the British Economist recently reported. Also in Europe we saw this questionable development: A former head of government from the north of Germany said that German regional banks, much of the state owned, ran their own shadow systems to save taxes. Wow – that is big: Public enterprises cheated the state supervision controlled by elected representatives.

In any case the banking system turned to large wheels as a result of the shadow banking system and even insiders in-house understood nothing. In 2008 the financial crisis created distrust in the banking sector.

Meanwhile, the United States develops elsewhere a new instrument of leverage: in the insurance sector a shadow insurance system. U.S. states are competing for insurance money that mean jobs for lawyers and income for the state. We remember the insurance giant American International Group (AIG) that was saved with 180 billion U.S. dollars by the U.S. government in the crisis. Lehman would have been nothing against its default. The sky gets dark.



The housing market is another piece of the puzzle in the U.S. house of cards: The unsound mind, to fund equity investments by mortgage loans makes real estate market to a kind of key market for the U.S. economy and the financial system. Falling prices in the property sector are difficult to handle because the other investments of U.S. citizens come under pressure, starting a negative cycle.

In the U.S. the stock markets are more connected to the systems than in any other country: Pension funds promised more than U.S. workers now get. U.S. universities such as Yale, that for years has been very successful in the financial markets, faced cuts into their budgets during the crisis. Meanwhile, with the stock markets back again the problems are smaller. Nevertheless, the unilateral commitment to the stock market of almost all systems and budgets in the United States is a significant social risk factor.

Record-total debt - the U.S. in de-leveraging mode

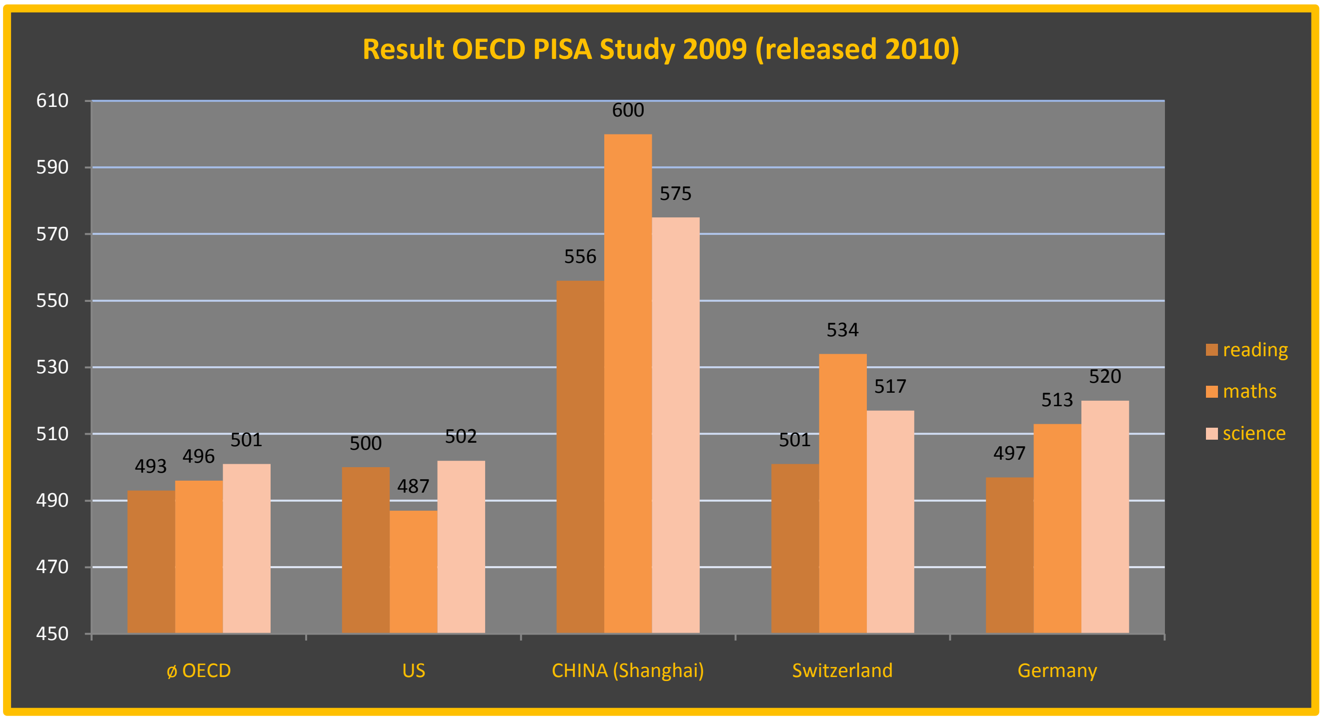
After the crisis the United States replaced the first crisis-induced collapse in domestic demand through additional government demand stimulus. With regard to total debt of the U.S. economy here just debts were "repotted", but the problem of high overall debt of the government, enterprises and people could not be resolved in the short term. The total debt measure is already long time well over 300 percent of annual gross domestic product (GDP). The total debts add up off the debt of households, the national debt, the debt of companies and financial institutions. The total debt has been in Q4 at a dangerously high figure of 354.2 percent of GDP and is the direct result of the Disneyland model. During the Great Depression in the 30s of last century total debt reached a peak only at a value of about 275 percent of GDP. Yet this comparison is probably too simple. The world has changed and a higher debt ratio is now created in the system. Nevertheless, the use of a high leverage is a national economic stability risk.

Certainly raises the question of why international investors have looked away for as long and have made it so simple for the United States. Ultimately, it is a case of market failure, the risk premiums of U.S. borrowers were for decades too low. Other nations profited in delivering goods to the United States and have to participate in the re-dimensioning of the U.S. economy now. However such processes are not the outcome at negotiation tables, but require decades of adjustments.

The impact of U.S. trade policy were rising U.S. currency reserves with the central banks of exporting nations. In the simple logic of interest-driven U.S. trade policy the problem of high imports is the Chinese Renminbi (Yuan) that is kept under control in the currency exchange. As a company in currency trading, MAVEST is in principle against this Chinese policy. On the other hand, we understand Chinas position, as the Asians have had bad experiences in the 90's with the release of currencies. A release of the Yuan would probably result in a rapid appreciation. This effect could be a large shock for the Chinese economy - without helping the U.S. in equal measure.

Long-term competitiveness

China is on the track with all power and high speed. If we take the results of the largest education comparison study as a benchmark, then the U.S. and even some European countries are behind. Although the reading skills significantly differ in China by region, the results in mathematics and scientific interest suggests that China will outpace the United States significantly. The United States performed worse than Switzerland and Germany. We think that some elite universities are not sufficient to be able to compete internationally in the long run.



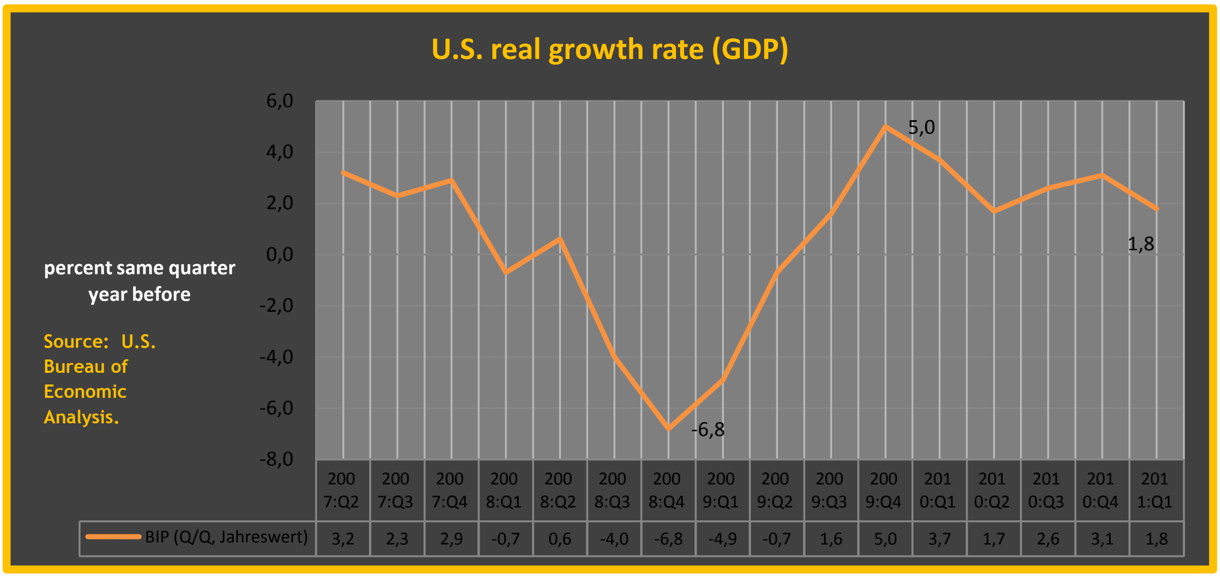
As described before the infrastructure of the United States is rather backward. With broadband Internet connections the United States are not the front, as one might suspect. Before Barack Obama was elected he addressed this topic several times. The infrastructure in the country of Silicon Valley's lost in last decade from rank 7 to rank 23. The World Economic Forum reported for 2010/2011 that Switzerland is the country with the best infrastructure. Austria finished in 6th place, Germany ranks 9th, Portugal and Spain rank 14 and 22 even ahead of the U.S. The MGI recommends an expansion of infrastructure. That sounds great. Who is funding?

U.S. growth

The crisis caused a slump in growth, as everywhere in the world. For the following discussion we should mention that the U.S. statisticians like annual growth rates presenting quarterly figures.

A few months ago we were really surprised by a message: U.S. America grows just because health costs are rising constantly and the country has an exorbitantly expensive health care system. In fact 16 percent of annual economic output flows to that sector OECD says. By comparison, the OECD average is nine percent and most European countries give ten percent of their economic output to health. In the United States traditionally government has little influence on the health system. It should be noted: Private is economically more expensive.

The national debt burdens the growth of a country and who is the creditor also plays a role: The U.S. economist Kenneth Rogoff and his colleague Carmen Reinhart in 2010 presented an examination and analyzed 3,700 national budgets in completely different economic cycles. The researchers found that from a budget deficit of 90 percent of GDP the economic output growth is reduced. If the external debt exceeds 60 percent GDP, this leads to lower growth.



A few months ago we were really surprised by a message: U.S. America grows just because health costs are rising constantly and the country has an exorbitantly expensive health care system. In fact 16 percent of annual economic output flows to that sector OECD says. By comparison, the OECD average is nine percent and most European countries give ten percent of their economic output to health. In the United States traditionally government has little influence on the health system. It should be noted: Private is economically more expensive.

The national debt burdens the growth of a country and who is the creditor also plays a role: The U.S. economist Kenneth Rogoff and his colleague Carmen Reinhart in 2010 presented an examination and analyzed 3,700 national budgets in completely different economic cycles. The researchers found that from a budget deficit of 90 percent of GDP the economic output growth is reduced. If the external debt exceeds 60 percent GDP, this leads to lower growth.

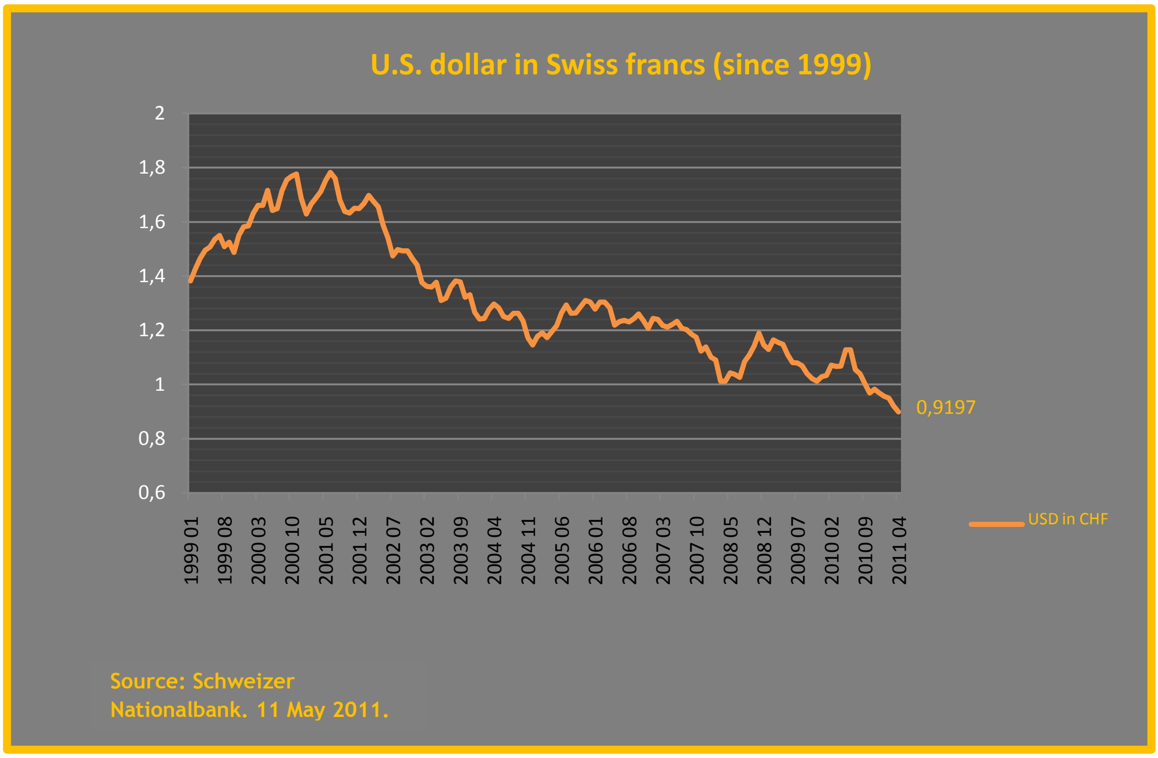
The U.S. dollar

Let us turn to our main theme: A popular and easy way to apparent recovery could be sustained depreciation of the dollar. This idea is not new and since the Great Depression in the last century actually the constant exchange policy principle of the United States. However, the foreign financing of Americans could suffer, because nobody gives even a loan with the perspective of getting back only a fraction of the international purchasing power. China alone holds foreign currency reserves of currently more than 1,200 billion U.S. dollars. Another major creditor is Japan with about 900 billion U.S. dollars.

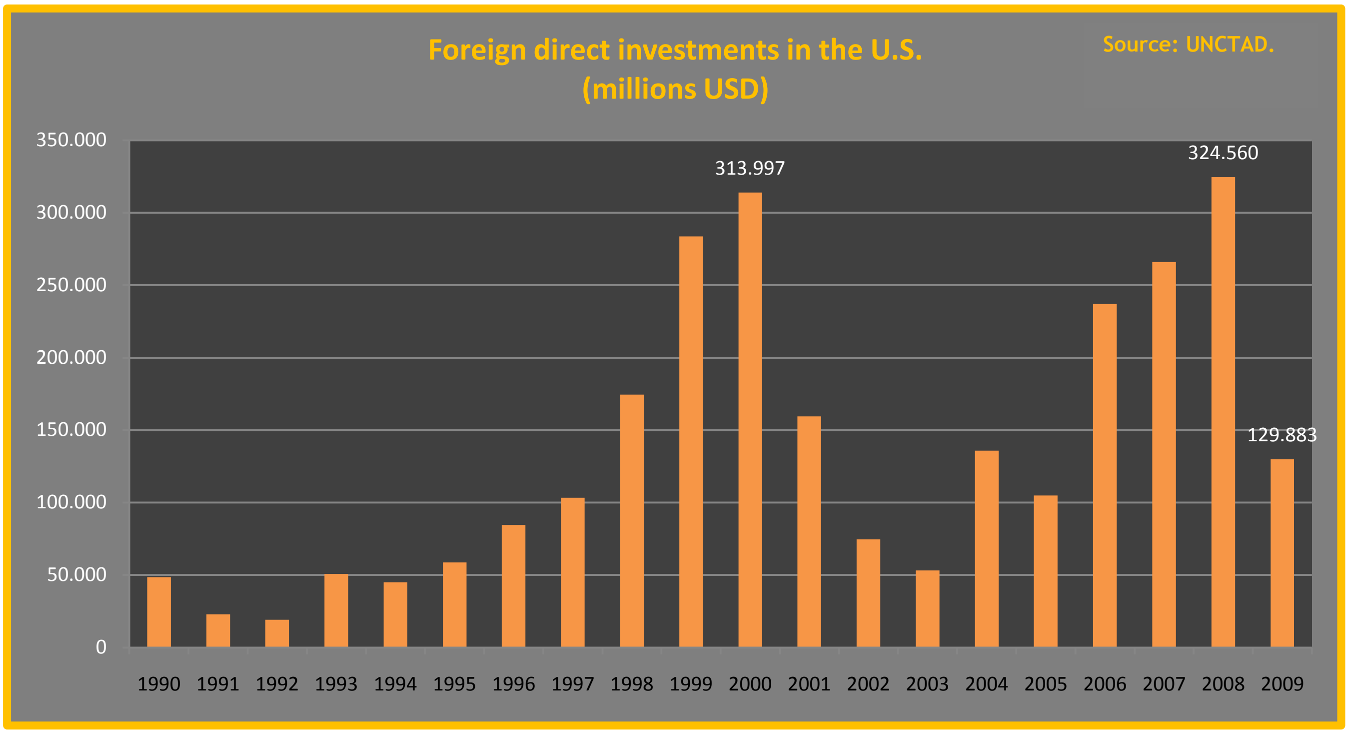
The U.S. is demanding for years a revaluation of the Chinese Yuan. The Chinese currency is not subject to free forex trading. The U.S. is begging for an international monetary liabilities section. China defends itself against this simple method of debt relief and asks officials how the United States wants to pay back their debt. This is a kind of stalemate.

Central banks trust no longer so much on the U.S. dollar as reserve currency as before, and prefer to buy gold. Mexico made in recent years 100 tons of gold to the depot. Officially it is not distrust of the dollar, but an attempt to diversify.

The monetary policy of Federal Reserve chief Alan Greenspan gets increasingly under fire in hearings about the financial crisis. Greenspan himself, who was known as a magician, sees his former decisions more critical than before. "Helicopter" Ben Bernanke is now actually flooding the country with U.S. Dollars. However, the idea of "quantitative easing" is now stretched to their limits. The balance sheet of the U.S. central bank is now inflated to Lehman crisis levels – 2,700 billions of U.S. dollars. Up to June the central bank will buy more U.S. government bonds - it has up to 70 percent of the issued government securities purchased and spent fresh money for it. A typical market process could be that the U.S. must offer higher interest rates in the medium term to investors. Additional the stimulus by the U.S. government will be back down in the near future.



Consider the U.S. dollar in a longer-term perspective; it is not surprising to see how the U.S. currency gave way. In the last decade, exchange rate of the U.S. dollar against the Swiss franc almost halved. Means: Investments in the U.S. were from Swiss perspective because of the exchange rate, a financial disaster. The example shows very well the importance of the expectations of international investors. If investors expect a weak foreign currency, we see no incentives for the transfer of capital. In order to absorb the quantities of capital the United States needs investors in Europe and more in Asia are increasingly important.



The United States depends not only because of their trade deficit on a drip of the world but the country is also dependent on foreign direct investment. In 2008 the consultants from McKinsey called for more international cross-border money flows. Who collected our little international funding, was considered suspended. Meanwhile, Brazil is fighting with government surcharges against too strong cash flows. Emerging markets came after the financial crisis first under pressure as foreign capital was withdrawn. The financial crisis shows the dependence of the U.S. on foreign countries, because it runs an economic model without own strength. Germany but also Switzerland, are not preferred recipient countries of FDI. Ironically, Warren Buffet searched after the financial crisis for German medium-sized enterprises.

For international investors, there is currently little reason to invest with a high U.S. dollar exchange rate risk. Also, there are no incentives for other central banks, copying the U.S. interest rate policy. If you follow the majority view of economists, then capital flows to other regions with higher returns. That brings headache to U.S. officials.

The "right" economic model

From today's perspective the lack of saving in the U.S. indicates the vulnerability of the U.S. economic system. Still in the report on the financial market in 2008 the McKinsey Global Institute of (MGI) criticized, that the German detention of investment in the equity markets is a problem. Now we know: This is an erroneous understanding of the system of the consultants expressed. Bad timing. The crisis wiped the apparent knowledge of the implications and benefits of cross-border risk taking completely away.

The German banking sector understood its business like a risky hedge fund as the head of Commerzbank in an interview admitted once. This is the reason why risk-averse Germans were shaken from the financial crisis. Even Switzerland, a stronghold of economic soundness was under pressure because of its two globally active banks. These mistakes of single banks do not change the view on the more sustainable European economic model. Critical to a prosperous economy are direct investments, own stability and not the grade people participate in the equity markets.

Even the system of social security in Europe stabilized the economy in crisis. The U.S. pension funds with their equity portfolios lead to high volatility and force the Fed to support the stock markets in order to obtain a total system that is over the top now.

What others think

Pacific Investment Management Company (PIMCO), the largest pension fund company in the world, and a subsidiary of Germany's Allianz, positioned itself loudest. In February 2011, PIMCO total return fund, led by PIMCO founder William (Bill) Gross, quit from all U.S. government bonds. In March, the billionaire fund began with the establishment of short positions in U.S. government bonds. In May, the company announced that it had increased its short positions by three to four percent. PIMCO, criticized for months, the low-partly negative - real interest rates, which an investor gets for the purchase of U.S. government securities. Gross has never embarrassed in his column for strong language and compared the approach with a "ponzi scheme". Gross suggested that the U.S. needs fundamental reform, but probably would rather go the easy way out of inflation and devaluation of the dollar. His April column is titled "Skunked".

The rating agency Standard & Poor's committed a sacrilege: the U.S. Company announced on 18 April 2011 to have reduced the outlook for the credit of the United States. While the U.S. retains the grade "AAA", however, the probability of a downgrade in the next two years is at 30 percent.

Criticism comes also from other countries. In May, Brazil spoke up. The country is one of the largest producers of commodities and now has to handle the international money flows. The Secretary of Finance of Brazil, Guido Mantega, criticized, the liquidity policy of the Fed and ECB, which flood the market with euros and dollars. Similarly, China argued for months.

A few years ago the editors of the British business magazine The Economist decided, that it was time to open an Asian comment column. Arguing growth in the global economy would take place in Asia. Now, even the permanently optimistic Americans believe in the supremacy of China in the business world. It is certainly not yet. However, the growth model of the United States no longer is a blueprint for others. Recently The Economist advised the Americans to learn from the Europeans. Certainly not meant was Britain, but Old Europe. It must have cost a great effort for the editors to write this, because the magazine railed for years against regulation and calls for a lack of flexibility in continental Europe.

In its spring report the International Monetary Fund urged to greater fiscal discipline.

Final evaluation

(1) We would like to clarify that this Special Report is not directed against the United States or its citizens. We love and appreciate the United States Hollywood films (mostly), iPod and iPad, the American optimism, the current president, the New York Times column by Paul Krugman - even if we are not always follow his opinion - and much more.

(2) We do not know if the Dow Jones Industrial Average in the next few years, is doubling or lying down half first. We do not know if U.S. citizens need to pay two bucks for one euro first, or we see before the parity. But we are pretty sure that the American business model of Disneyland cannot continue to function. Presumably, international lenders will no longer be available accepting global payment by the U.S. currency to the same extent as far.

(3) If a medium-term abstention from consumption in the United States will not be politically feasible, then probably for the next financial and economic crises the term "tsunami" may no longer be sufficient.

(4) Another long-term risk factor with potential for crisis is the export of the United States: the leveraged economy. If the shadow insurance system penetrates further, it is more a question of when and not if we will see a new financial crisis.

(5) For investors in continental Europe strategic investments in the United States give high risk of currency changes. Capital flows from Europe are unlikely in this environment. We will watch more often money flows from Europe to Asia and in emerging countries - or vice versa.

MAVEST TEAM

Our approach

The idea of MAVEST is not the strategic investment, but the short-term trading. Our traders look about current market developments and news. We do never forecast. However, we are always close to the markets and observe changes in the institutional environment of financial markets. Such longer-term observations, we describe in Special Reports on various topics that might be relevant in the future.

For us market moves are pure quantity effects. In the long term for us the question is, where and in which direction does the capital of institutional investor flows. Such strategic shifts do not influence our short-term trading, but could impact long term on our trading strategies.

MAVEST GmbH

Churerstrasse 35

CH-9470 Buchs SG

FON: ++41 81 511 01 81 FAX: ++41 81 511 01 87

Register: CH-320.4.068.620-6

www.mavest.ch