



Our Market Update of September 2005 is still valid. Further developments and considerations must include the following:

1. **Energy prices** and developments in the U.S. should drive the economic outlook for the U.S. and as a result also globally. High energy prices have in the meantime decreased the demand for gasoline but not for natural gas in the U.S. Natural gas prices have gained more than 150% y-o-y and much higher prices are expected for the winter heating season.
2. Energy prices and **rising interest rates** in the US seem to gain the upper hand over deflationary factors. This will result in corporate **earnings pressures** to increase.
3. For the same reasons **consumers' spendable income** is affected increasingly: Much higher energy bills, growing prices for agricultural products and other daily necessities affected by higher energy prices, the expansion of the Alternative Minimum Tax to which 20 mio Americans will be subjected in 2006 compared to about 4 mio in 2005. In addition, rising interest rates will increase the debt servicing burden of consumers as well as of public debtors. An economic downturn in the U.S. and as a result for the rest of the world in the next 6 months is likelier than ever.
4. For the time being, as a result of higher short-term interest rates and the growing rate differential to other currencies, the **USD** may gain more in strength.
5. In the next weeks, the **U.S. budget deficit** should attract again more attention. The unbudgeted for cost for Katrina and Rita should exceed USD 100 bn if not reach USD 200 bn. This will translate in additional interest liabilities of USD 6-12 bn / yr. Congress shows great difficulties in cutting other budget items to compensate for these additional expenditures.
6. IMF and other sources have recently more or less said openly, that the **U.S. budget** was out of control. This combined with an eroding political clout of the current U.S. administration may eventually create a loss of confidence of investors in the U.S. and the USD. When is unclear.
7. The **US trade deficit** seems to be slated to grow: Energy imports become ever so costlier, exports may shrink under a stronger USD. Further down the road, imports may shrink due to lower spendable income of consumers while essential imports may remain at the same level at least in monetary terms. As the USD starts to weaken, prices for USD denominated commodities may start to be raised in line. From an economy point of view, this is not a desirable scenario at all.
8. Higher oil prices create a huge increase in **Petrodollars** for all parties involved in the production and distribution process. This liquidity seeks investment opportunities. Short-term, these funds may just take advantage of somewhat higher US interest rates.
9. Already now, but with a higher likelihood in a few months, such Petrofunds may seek a **safe haven** in gold, silver, and in currencies of commodity rich countries (hard assets). Already in the last few weeks, prices of gold and silver have moved up, this time around not only in USD but also in all other major currencies. A disconnect between USD and gold price has manifested itself, at least temporarily (both are getting stronger). While short-term consolidations at various price levels have to be expected, an upward trend seems to be there.
10. Of all other aspects, **Iran** represents an unknown to be considered (introduction of their own EUR based oil exchange in Q1 2006, cutback of oil sales, attack by the U.S.). Other events may potentially happen as well. One of which could be represented by the credit **derivative market** that might at some point implode. The Financial Times reported recently of a huge matching backlog of outstanding credit derivatives that has become a significant source of

worry for central banks: “The total notional value outstanding of credit derivatives rose to \$12,430bn in June up 48 per cent from January according to the International Swaps and Derivatives Association.”

Investment View:

1. The **oil and gas investment case** remains strong for 2 reasons: It covers the upside from better than expected economic development and it benefits from potential supply shortages and disruptions. The upside potential seems to outweigh the downside potential by far for the time being.
2. The **alternative energy** including the uranium **investment case** remains intact but may be subject to higher volatility due to its long-term investment horizon. In the case of uranium such investments would lose immediately as a result of a (unlikely) nuclear accident or terrorist event. Partial profit taking may be advisable with a possible reentry at lower levels.
3. **Gold and silver** investments remain the strongest investment case not only from the point of view safe haven, but also because of supply issues. Careful selection is needed due to adverse production cost developments for the mining industry.
4. **Commodities** (soft and hard) should remain within investor’s sight.
5. **Bonds** continue to lack attractiveness, “risk free” cash returns are improving.

For all of the above reasons as well as for the recent index gains a correction of financial markets must be expected. It may be that a next downturn is of temporary nature only. Eventually, we expect the markets to experience a more severe and longer lasting downturn. Medium and long-term, precious metals, commodities and energy remain most attractive.

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