AEGON Asset Management

Monthly outlook – November

Walking the high wire without a safety net?

It's not worth going against the wishes of the IMF, although there are exceptions

Take your seats for a spectacular production, which for the time being is only showing in our neighbouring countries, Ukraine and Romania. One year ago, almost to the day, on 10 November 2008, just like Hungary our north-eastern neighbour, Ukraine, was granted a hefty, USD 16.4 billion loan by the International Monetary Fund (IMF). Here the purpose of the lifebelt, as elsewhere, was to assist the government in its work by bolstering confidence, and to restore economic and financial stability, thus avoiding a landing so hard as to be indistinguishable from a crash. There was certainly an urgent need for this assistance in the case of what was then the latest victim of the global economic crisis, since the liquidity crisis and fall in raw materials prices, especially the price of steel, had also caused severe problems in Ukraine. This was accompanied by the annual "cat and mouse" game between Russia and the Ukraine, otherwise known as "Gas Wars", which is a key issue for the whole of Europe due to Ukraine's strategic position in the gas supply chain. And last, but by no means least, the central and eastern European banks (and thus the economies of their home countries), are tied by a myriad of strands to the former Soviet republic through their Ukrainian subsidiaries.

The IMF determines the quotas of member nations on the basis of their weight in the world economy, and the size of the quota is definitive in determining the size of the loan. Under normal circumstances, a given country can borrow up to 300% of its quota. In the light of the reasons described above, it is perhaps unsurprising that there wasn't, and still isn't, any question of abandoning Ukraine to her fate, because this would set off a domino effect with unforeseeable consequences. Accordingly, the credit line that was granted amounted to 800% of Ukraine's IMF quota. Dominique Strauss-Kahn, managing director of the International Monetary Fund, said that Ukraine's stability was of key importance, and this justified such a sizeable loan.

Despite this massive amount of credit, the Ukrainian economy lies in ruins. According to a forecast made at the end of October (and subsequently reaffirmed) by the World Bank's leading economist, Ruslan Piontkivsky, the country's gross domestic product (GDP) will fall by 15% in 2009; although he has upgraded the 2010 GDP growth projection from 1% to 2.5%. The latter is primarily due to the fact that as the world economy recovers the country's export prospects could improve (although it will still take several years for exports to reach pre-crisis levels), and this will have a positive impact on GDP. The situation is further exacerbated by high inflation (CPI), which according to the forecasts could be 14% in 2009, and may still be 11% in 2010. The World Bank believes that the budget deficit continues to represent the main threat to economic stability, since tax discipline in Ukraine has deteriorated substantially. There is an urgent need for a balanced budget, in which expenditure needs to be slashed as outgoings remain extremely high and their true level is underestimated (e.g. pension payments). The 2010 budget deficit target of 4% of GDP is unattainable without the imposition of austerity measures. Indeed, if no changes are made, all this could result in an 8% deficit, which carries a serious risk in terms of the country's financing potential.

However, the real slap in the face only came on the weekend of 7 November, when the IMF announced the suspension of its cooperation with Ukraine, since the country's authorities and political bodies have neither the will nor the ability to fulfill even the most elementary conditions of the agreement concluded with them. The international organisation also clearly indicated that substantive negotiations could not be recommenced until after the presidential elections, so at the end of January at the earliest. What does all this mean in the light of the figures? Ukraine will not receive the next, USD 3.8 billion instalment of the IMF loan, due for disbursement this month, because it went against the wishes of the IMF and pushed through a 20% raise in the statutory minimum wage.

Romania is the second country to be made an example of by the International Monetary Fund. Similarly to Ukraine, the next USD 1.5 billion dollar instalment of the standby loan will not be disbursed until a stable government is formed in Bucharest.

On first reading, these measures come across as very severe, but while the punishment is genuinely unpleasant for Romania, the situation is not so clear-cut in the case of Ukraine. Indeed, the latter is perhaps the best example of how the **"too big to fail" principle holds true even for entire countries**, as the EU has rapidly cobbled together a EUR 610 million loan package, which can be drawn down virtually unconditionally, and the almost USD 500 million Russian gas bill was eventually paid from Ukraine's SDR facility also kept at the IMF.

As the above events also go to illustrate, the autumn of 2007 marked the beginning of a new era in which everything, or even its complete opposite, may happen. Investors have experienced, at their own cost, the unexpected nosedive and the subsequent soaring – currently regarded as V-shaped – that is being driven by fiscal and monitory economic stimulation measures. While all this was going on, very few have succeeded in amassing great fortunes, because the majority either didn't get out in time, or, lacking faith in the upturn, were late in getting back in. Naturally there are exceptions, since it is in times of crisis that you can gain (or lose) the greatest wealth; but most investors have an increasingly urgent need for total return investment funds, which aim to achieve a positive yield in excess of that attainable on risk-free investments. The various funds that pursue a total return policy also allow scope for a certain degree of "fine tuning", by selecting the risk/return ratio that best suits the investor's needs. The chosen fund could be the very low-risk AEGON Ózon Capital Protected Derivative Fund, or the euro-dominated AEGON EuroExpress Investment Fund, which competes with the benchmark interest rate of the European Central Bank. Also available are the medium-risk AEGON MoneyMaxx Expressz Mixed Investment Fund, or the AEGON Smart Money Investment Fund of Funds, launched barely two months ago, which also carries a medium-risk. If you have your sights set on an even higher yield, then it's worth taking a closer look at the AEGON Atticus Alfa Derivative Fund, which is classed as riskier than the other total return funds described above, or its even higher-risk "big brother", the AEGON Atticus Vision Derivative Investment Fund.

12-month performance of AEGON's total return investment funds

Name of fund	12-month yield*
AEGON Atticus Vision Derivative Investment Fund (HUF)	29.23%
AEGON Atticus Alfa Derivative Investment Fund (HUF)	21.65%
AEGON MoneyMaxx Expressz Mixed Investment Fund (HUF)	15.72%
AEGON Smart Money Fund of Funds (HUF)	This fund was launched on 15.09.2009
AEGON Ózon Capital Protected Derivative Fund (HUF)	7.81%
AEGON EuroExpress Investment Fund (EUR)	7.13%

Source: BAMOSZ
*Shows the performance of the fund in the period ending 31.10.2009

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