Monthly outlook – August

The price of wheat goes through the roof!

Equities performed extremely well in July, as the S&P500 index rose by 6.88% in dollar terms and the BUX by 5.77% in the local currency, while the USD-denominated MSCI EM Equity Index, which represents emerging markets, rose by 8%.

Share prices rose mainly on the back of favourable macroeconomic figures and news, such as the announcement by the International Monetary Fund at the start of the year of an improvement in its global-growth forecast for 2010 from 4.2% to 4.6%, while China showed year-on-year GDP growth in the second quarter of 10.3% combined with an easing of inflationary pressure.

The US economy expanded by an annualized 2.4% in the second quarter, which, although representing a slowdown compared to the figure of 3.7% for the previous quarter, appears to have been sufficiently convincing for investors, especially in light of earlier declines, to further increase their exposure to equities.

At the beginning of August, however, the markets began a correction, and even the persistently favourable surprises of the corporate reporting season were unable to prevent the decline. From the firm resistance levels of 1120-1130 points, the S&P 500 index took a sharp downward turn, accompanied by substantial trading volumes, in the direction of the X axis of the graph. At the same time, the good news for investors keeping their savings in Hungarian forints was that the forint was able to remain relatively stable despite the fall in international risk-taking propensity, holding at levels of 280 forints to the euro.

On the commodities market, which is less keenly followed by small investors, wheat futures do not present such an erratic or varied picture, as the line on the graph that shows the price has shot upwards at an angle of almost 90 degrees, indicating a 36.98% price increase during the month.

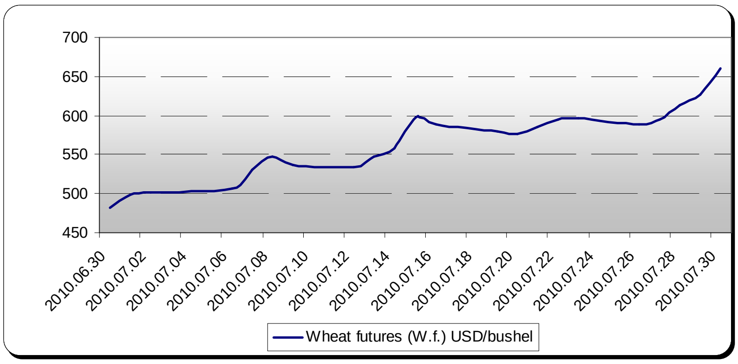
This extreme movement in price can be explained primarily by the drought in Russia, of a severity unseen for centuries, which has been responsible for forest fires over vast areas and is also having a negative impact on the country's grain production.

A temporary export embargo declared by the Russian president applying to grain and similar products is expected to enter into effect on 15 August. Given that the ban applies to the world's third largest exporter of grain, as only the US and the EU deliver more of this type of commodity abroad than Russia (which last year exported more than 18 billion tons of wheat), it is a measure with the capacity to affect prices at the global level.

The seriousness of the Russian situation is indicated by the fact that Russian Prime Minister Vladimir V. Putin has pledged 10 billion roubles in subsidies and 25 billion roubles in credit to the agricultural sector.

Below is a list of the countries most dependent on Russian exports, based on data of the International Grains Council (IGC) applying to the period between July 2009 and June 2010 (in thousands of tons), as well as a graph showing the development of the wheat futures price in the month of July.

Egypt	6 062
Turkey	2 410
Syria	1 030
Iran	834
Libya	674
Israel	629
Jordan	610
Yemen	584
Iraq	470
Lebanon	276
United Arab Emirates	150
Tunisia	114

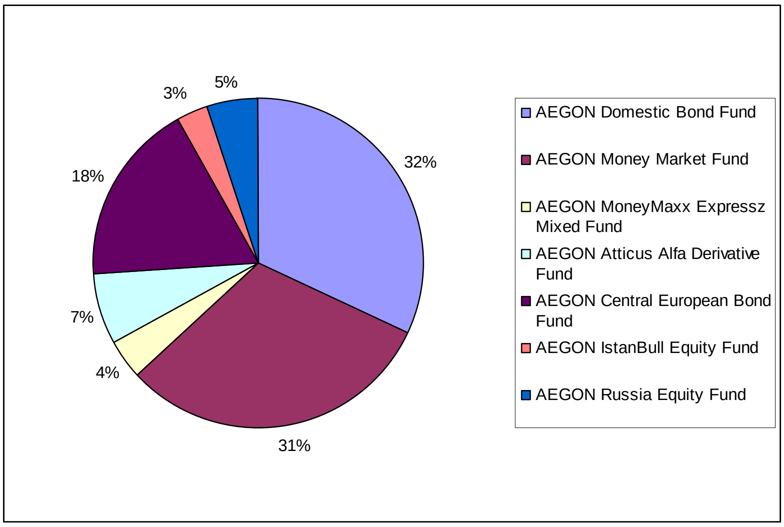


Brisk business by speculators also plays a role in changes in the price of this commodity market product. According to the summary of filed futures contracts (Commitments of Traders Report) regularly issued by the Chicago Board of Trade, short-term investors, who account for the major share of such transactions, had concluded a total of 199,852 purchase and 24,463 sale contracts as of 10 August, indicating that the overwhelming majority of players were betting on an increase in price. At the same time, commodities market traders believe that the danger of a price bubble forming – which would typically be followed by a heavy wave of selling – has seriously increased due to the sudden soaring of the price and to measures that are having a distorting effect on the market.

The question thus arises of what kind of investment portfolio might be appropriate for providing a balanced yield for investors at a medium level of risk in an environment where equity prices are fluctuating wildly and bond prices are soaring, while commodities are luring investors to enter on the buy side. There are few investment funds on the market in Hungary which might help small investors take advantage of the yield potential inherent in commodities while simultaneously being able to enjoy the benefits of spreading risks across various asset classes.

The AEGON Smart Money Investment Fund of Funds is an excellent vehicle for helping investors to do exactly this: it aims to assemble a medium-risk, balanced portfolio which could also increase the value of invested capital by exploiting the yield opportunities inherent in commodities markets. In view of the present investment environment, we have made the following strategic asset allocation decision this month:

Name of the Fund	Weight (%)
AEGON Domestic Bond Fund	32%
AEGON Money Market Fund	31%
AEGON MoneyMaxx Expressz Mixed Fund	4%
AEGON Atticus Alfa Derivative Fund	7%
AEGON Central European Bond Fund	18%
AEGON IstanBull Equity Fund	3%
AEGON Russia Equity Fund	5%



In making the decision, we raised the fund's beta – buying the Russia and IstanBull equity funds in place of the International Equity fund – and thus aim to exploit the higher potential returns arising from more favourable pricing levels in these regions. We have continued to favour regional bond markets over domestic bonds, and have thus further raised the proportion of Central European bond funds in our model portfolios.

In view of the favourable trends in the commodities market, our AEGON Atticus Alfa Fund, with its less restricted investment policy, may be the fund capable of profiting from price movements given that it is able to take up both short and long positions in almost all asset classes. Since corn may to some extent be used for substituting wheat, and that this substitution – particularly in the case of food production – can be implemented within a short space of time and is economical above a certain price level, the AEGON Atticus Alfa Derivative Fund has been accumulating long positions in corn futures since the beginning of July.

Prepared by AEGON Global Asset Management / AAM CEE
Ádám Halóka – Investment expert