NEWSLETTER

Bedrock

December 29th, 2006

www.bedrockgroup.ch

The year of 2006 will be over in a few trading hours. We hope and trust that our weekly views and thoughts as expressed in our newsletters helped you in finding some value in this year!

We did benefit from strong Global Equity Markets, narrow trading bands for bonds, rising short-term rates and therefore improving returns on cash. Currencies continued to confuse everyone as trends which started turned into blips, broadly accepted expectations fizzled and others never came to be. The Weak Dollar remained steady, the undervalued Yen remained just that, consensually undervalued. Commodities in general performed well, rising for most of the year into our expectations, oil remaining finally in a narrow band on historically high grounds, whilst lower than some analysts had hoped for.

For those of our Readers who followed our advice and invested in various Emerging Market Country ETF's a word of caution: Some of these ETF's paid significant dividends into the year end with correspondingly sharp price declines: Example- the Korea Fund went Ex Dividend on the 27th for US$7.12 and lost a similar amount on the open. Net flat, but then, the cash comes in only in two weeks. So if you noticed BIG declines, its probably from an equivalent distribution. Do consider reinvesting as this reduces exposures into the future

We must now concentrate on 2007. We believe that we are facing another year much like 2006 with strong equity markets, within which Europe and Emerging Markets to be the front-runners, whilst the US, strong as it may well be, the laggard,
Fixed income markets will continue to privilege cash, as its returns will remain at or above that of longer duration fixed-income instruments. Although it seems possible that the US will lower its short rates sometime in 2007, it is unlikely to spark a meaningful rally in its bonds. At Bedrock we prefer the steady rates outlook for the USA whilst expecting rises in Europe and Japan.

Currency wise, we maintain our expectation for a stronger Japanese Yen and a slowly declining US Dollar.

What else? Weakening US Dollar and strong global economies bode well for commodities in general and oil in particular. We remain over-weighted into the New Year.

Happy New Year!

Currencies

- **The EURUSD pair looks to have stabilized in the 1.31 to 1.32 range and we believe this should hold through the thin trading into the New Year.**
- **The JPY just cant seem to get out of its own rut, reaching historic lows against the Euro and slipping towards 119 against the US$**

We continue to recommend buying the JPY, especially against the EUR and CHF.
If you didn't do it yet, you were smart and lucky, but we may be right (at last) into 2007!?

We like long dated Call options on the JPY vs. the Swiss Franc, as in this pair the "carry cost" is minimal.

Fixed Income

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- **US Treasury Yields traded around 4.60% give or take ten basis points. We do not expect any significant moves away from this level in the near future.**
- **We also believe that the Japanese Government Bonds are headed down in price and up in yields, (although this is proving to be a frustrating theme) on the back of a continuing economic expansion.**
- **European long term yields have also picked up this week and we expect further moves in this direction into the New Year.**

We continue advising holding only up to 3 Year US Bonds as it does not pay to be in the longer part of curve. We have a firm view that it does not pay AT ALL to hold bonds, in any of the G3 economies!

Equities

- **Global equity markets turned skittish into the low liquidity of year end. Not very meaningful albeit slightly up.**

We maintain our positions.

Emerging Markets

- **Emerging Market shares continued their upwards momentum.**
- **We continue to overweigh Emerging Markets as we believe that we are experiencing what is tantamount to an economic tidal-wave.**

We keep our core positions in Emerging Markets in general, with particular emphasis in Russia, Asia (China/India) and Brazil.

Commodities

- **Oil prices traded down to the $60.00 - $60.50 range. As we can see, the oil producing countries do not want to see oil prices below $60.00 We continue to believe in higher future prices due to core global demand and little new supplies or viable alternatives.**
- **We also believe that the oil industry as a whole is trading at a discount to their current and expected future earnings, implying that energy related equities are cheap within what we believe to be still relatively inexpensive markets overall!**
- **Gold and Silver prices steadied with Gold rallying through $634 and Silver over $12.80 into a soft US$,**
- **Soft agricultural commodities have significant upside in the long term.**

We like having a broad diversification in the commodity sector, and allocate to different sub-themes (Energy-Base Metals-Precious Metals-Water and Soft Commodities).
It is our long standing view that these exposures are appropriate in most all portfolios.

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