

September /October 2009 Markets & Stocks

ANALYST: Giles Rowe

Cash drag

27th October 2009

SAMPLE

US retail investors are still sitting on \$3.3 trillion of cash in money market funds, having watched the fifth biggest six month rally in 300 years go ahead without them. Back in March the S&P 500 Index broke out of the downward trend channel, at which we increased our equity asset allocation. We will remain just above neutral equity weight unless or until the S&P500 breaks beneath its new channel. Concerns about increasingly positive investor sentiment, leading stocks and indices losing momentum, the rally now reaching nearly 50% of 2008's decline and Bill Gross of PIMCO calling a top have given the market a pause.

As usual, economic indicators are mixed too, though the leading ones support the view that we are at or near the beginning of the recovery the market has just foreseen. But credit concerns remain, focussed now on irresponsible governments. The CPS* note 'The Hidden Debt Bombshell' estimates UK

public debt at £2.2 trillion, 157% of GDP. So equities are overshadowed by fears of currency instability and inflation alongside expected tax hikes, spending cuts and unemployment.

The UK's Quantitative Easing was intended to force institutional cash into equities, not to bolster the banks. This implies some degree of artificial stimulus behind the rally, assuming similar government stimuli in other markets. But high levels of cash remain in Asian and private hands, despite minimal cash returns.

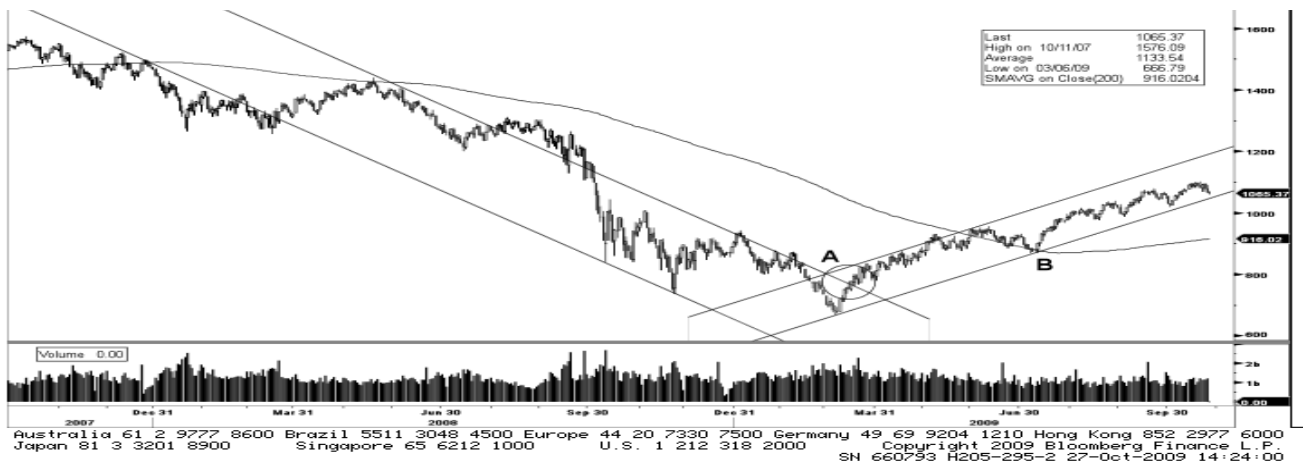
This contrarian sign is a factor underlying our neutral to positive stance, though substantial risks abound. We can still find stocks with attractive valuations, and company results have surprised on the upside. Asset allocation remains a better defence than market timing and we continue to seek profit opportunities on a fundamental basis, without simply mirroring indices, as set out inside. We have already sold Spirax and Ingenico which have hit their targets.

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S&P 500 primary uptrend intact

The chart shows the S&P 500 from the 2007 peak to date with the bear's down and the current up channel marked. It broke out of the down channel at A, and its failure to break below the 200 day moving average at B triggered the next leg up. Will the trend continue, break down or consolidate?



Sources: Bank of England, *Centre for Policy Studies, Financial Times, Bloomberg

Ingenico (INGFP) **SAMPLE BUY**

Buy Range €13.6 to €15.3 Down/Upside Review €13/€19

Date: 31/07/2009

Profile:

- Ingenico SA produces financial transaction systems, including the hardware, software and services for integration in new secure transaction systems, such as Europay, Mastercard and Visa. Ingenico also does consulting, integration and design and deployment of their electronic funds transfer projects.
- Ingenico's H1 statement cleared up uncertainty about the year's outlook, with an indicated flat H2 guiding to up to an -8% decline for the year. Not surprising in these conditions. The interesting features are that a) 44% of Ingenico's business is in China, b) It is now fabless, therefore more flexible and able to maintain c) what the market sees as pretty robust margins at c. 11%. Operating cash conversion has been above 100% the last three years, and historic cash flow yield before capex is 15%. Annualised sales growth has been 14% p.a., including acquisitions, over the last 10 years, and EPS growth 5%.

Risks and Key Issues:

- Ingenico has done well to muscle in on markets dominated by much larger players like Thales. Can it keep up the pace against its scale disadvantages?
- Consumer demand growth has been a significant contributory driver, mainly in Europe followed by the Americas. There is a question mark over near term sustainability.

Value:

- Powerful operating cash flow offset by finely balanced growth outlook. Zero gearing and a well covered dividend reduce the impact of any downside risks.

Catalysts:

- The main catalyst is the recent outlook statement, and any improvement in background conditions should accelerate enhancement to the valuation.

BASIC STATISTICS
Share Price €14.61

Market Cap €659m

Enterprise Value €82m

Bloomberg INGFP

Gearing 0%

12 month High €20.32

12 month Low €8.74

Sector IT

Next Results 20th August 2009

Website www.ingenico.fr
Consensus Rating 3.7 (Buy)

Riskgrade™ 186

PRICE CHART

Jul 03 to Jul 09



Year End	12 / 8 Act	12 / 9 Est	12 / 10 Est
EV/Sales	0.8 x	0.8 x	0.8 x
EV/EBITDA	6.4x	6.4 x	5.6 x
PER (GAAP)	18.2 x	14.2 x	11.4 x
Yield	1.7%	1.7%	2.1%
Dividend Cover	3.3 x	4.1 x	4.3 x

Data sources: Ingenico, Bloomberg, Reuters,
 Chart source: Bloomberg

Reckitt Benckiser (RB/ LN) BUY

Buy Range 2670p to 2950p Down/UpSide Review 2600p/3300p

Date: 04/08/2009

Profile:

- Reckitt Benckiser's results showed resilient H1 growth across most areas mainly due to volume growth, at +8% excluding FX effects, with diluted EPS +30% in Q2 and 33% in H1.
- It is seeing difficult conditions but focusing on 17 'Powerbrands' such as Nurofen, Strepsils, Airwick, Harpic, Dettol, Veet and Vanish. Q2 gross margin was up +0.8% to 59.1%, and adjusted operating margins were +110bp to 21.6%. Input costs reduced, for instance Q2 media buying rates fell -4% to 11.4% of net revenue, and there is no squeeze on commodity supply.
- Reckitts is raising FY 2009 targets: net revenue growth is now projected at +5 to 6% (was +4%), and net income growth +10 to 11% (was +8 to 10%) at constant FX rates. Very consumer focused, but there has been a return to brands from own-label. Net working capital is negative (-£1,222m), reducing financing costs, and net debt reduced -£571m from £1,096m in December to £525m in June, on shareholders' funds of £3,216m, even after a £341m dividend payment. H1 operating cash flow was £884m on operating income of £819m. The business has doubled in size the last five years, doubling income in three years. ROE is c. 35%.

Risks and Key Issues:

- All consumer stocks are subject to variations in disposable incomes, and Reckitt's end markets have not seen the worst, with unemployment and credit restrictions yet to bite. However, Reckitt's marketing strength does not seem to be reflected in current value.

Value:

- Formidable market positions underwrite growth prospects and cash flow outlook drive our conservative 3300p DCF based upside.

Catalysts:

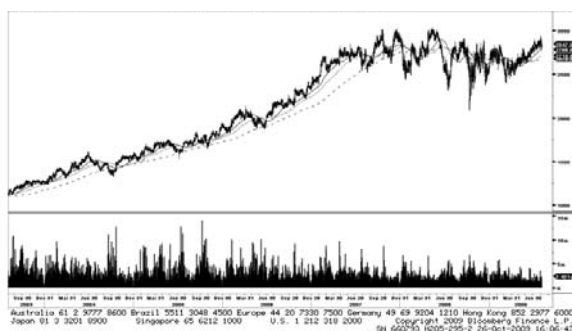
- Rapidly disappearing gearing, dividends twice covered and cash flow conversion over 100% are complemented by respectable growth.

BASIC STATISTICS

Share Price	2812p
Market Cap	£19,981m
Enterprise Value	£21,067m
Bloomberg	RB/ LN
Gearing	17.8%
12 month High	2945p
12 month Low	2097p
Sector	Consumer Cyclical
Next Results	27th October 2009
Website	www.reckittbenckiser.com
Consensus Rating	3.8 (Buy)
Riskgrade™	82

PRICE CHART

Aug 03 to Aug 09



Year End	12 / 8 Act	12 / 9 Est	12 / 10 Est
EV/Sales	3.2 x	2.8 x	2.8 x
EV/EBITDA	13.1 x	10.9 x	11.2 x
PER (GAAP)	18.2 x	14.4 x	14.9 x
Yield	2.8%	3.4%	3.4%
Dividend Cover	1.9 x	2.1 x	2.0 x

Data sources: R&B, Bloomberg and Reuters, NTT
 Chart source: Bloomberg

Bonduelle (BON FP) **BUY**

Buy Range €60 to €70 Down/UpSide Review €59/€80

Date: 28/08/2009

Profile:

- Bonduelle claims to be the world's leading processor of vegetables. It offers a range of national brand and private label products, with industrial processing of vegetables in 33 production sites globally. Bonduelle grows many of its own crops in good agricultural regions, close to customers, but can source from diverse areas as well. 64% of the group's €1,490m revenues are from outside France, and 2008 saw operating income reach €100m. Cash conversion is above 100%, ROE 13.9% and EBITDA margin 11%, gradually increasing from 6.7% over the last 10 years, in which sales have grown from €840m by 6.6% p.a. and EPS by 16% p.a.. Cash flow yield before capex is 11% and after capex 3.8%.
- The business is 60% family owned (Christophe Bonduelle is chairman and CEO) and growth has been funded by own resources and debt, with gearing now 111% and issued shares constant at 8m. Debt is primarily long term, with 12 year bonds issued in 2000 and 2004 to US investors, and 7 year bonds with redeemable share subscriptions and/or purchase warrants in 2007.
- Bonduelle expanded into Eastern Europe in 1991, Latin America in 1994 and North America in 1998, so revenues are equally split between France, other Eurozone and Rest of World.

Risks and Key Issues:

- Gearing is high at 111%, having financed growth without diluting the family.
- Market cap is €488m, but with family holding 60% the free float is only €200m, so there may be small cap liquidity issues.

Value:

- Our target is very conservative compared to our DCF valuation of over €100. Interest cover is 3.5x, dividend cover 3.7x and valuation undemanding on most bases.

Catalysts:

- Undervalued but performing well, with good growth potential and potential for increasing institutional holdings.

BASIC STATISTICS

Share Price	€63.85
Market Cap	€488m
Enterprise Value	€902m
Bloomberg	BON FP
Gearing	111%
12 month High	€68.95
12 month Low	€48.69
Sector	Consumer Non Cyclical
Next Results	6th October 2009
Website	www.bonduelle.com
Consensus Rating	4.0 (Buy)
Riskgrade™	130

PRICE CHART

Aug 03 to Aug 09



Year End	12 / 8 Act	12 / 9 Est	12 / 10 Est
EV/Sales	0.6 x	0.6 x	0.6 x
EV/EBITDA	5.5 x	5.4 x	5.3 x
PER (GAAP)	9.6 x	13.3 x	8.2 x
Yield	2.3%	2.3%	2.5%
Dividend Cover	4.5 x	3.2 x	4.8 x

Data sources: Bonduelle, Bloomberg and Reuters,
 Chart source: Bloomberg

Danone (BN FP) **BUY**

Buy Range €36.5 to €40 Down/Upside Review €5/€6

Date: 28/08/2009

Profile:

- Danone describes itself as selling ‘global concepts centred on health benefits’. It distributes its products to a million outlets globally, independent local vendors contributing 40% of growth. They give Danone better pricing power than it would have with the supermarket majors alone. Marketing is driven by constant new product introductions and health based campaigns backed up by R&D and quality control.
- For example, since 1994 Actimel has now had 24 scientific studies into its impact on natural defences, 8 of which took place in 2008. R&D programmes focus on interactions between bacteria and the human body, as well as modelling the gastrointestinal systems of adults and children.
- 2008 sales were split as follows: Dairy 57%; Mineral Water (e.g. Volvic, Evian, Badoit) 19%; and as a result of the acquisition of Numico, two new activities: Baby Nutrition (e.g. Aptamil) 18% and Medical Nutrition (e.g. Fortimel) 6%, which are as reliant on R&D as is the base business.

Risks and Key Issues:

- 2008 growth came primarily from Asia (+16.3%) and RoW (+13.2%), with two thirds of markets static.
- Many of Danone’s products are low priority medically. Is bottled water as genuine a health product as Danone claims?

Value:

- Danone has stable 12 to 15% operating margins, around 100% cash conversion, 128% gearing and 4.4x interest cover. Capex is greater than depreciation by 33% and net working capital is –5% of sales, so the high level of debt seems supportable. Free cash flow is consistently €1bn, and our DCF comes out at €56, a 45% uplift.

Catalysts:

- Low valuation, stable revenues and margins.

BASIC STATISTICS

Share Price	€38.38
Market Cap	€20,130m
Enterprise Value	€31,185m
Bloomberg	BN FP
Gearing	128%
12 month High	€1.54
12 month Low	€1.22
Sector	Consumer Non Cyclical
Next Results	23rd October 2009
Website	www.danone.com
Consensus Rating	3.9 (Buy)
Riskgrade™	97

PRICE CHART

Aug 03 to Aug 09



Year End	12 / 8 Act	12 / 9 Est	12 / 10 Est
EV/Sales	2.0 x	2.1 x	2.0 x
EV/EBITDA	11.5 x	10.8 x	10.3 x
PER (GAAP)	15.4 x	26.2 x	14.3 x
Yield	2.8%	3.1%	3.2%
Dividend Cover	2.3 x	1.2 x	2.2 x

Data sources: Danone, Bloomberg and Reuters,
 Chart source: Bloomberg

Spirax Sarco (SPX LN) **BUY**

Buy Range 925p to 1020p Down/Upside Review 905p/1150p

Date: 28/08/2009

Profile:

- Spirax Sarco produces boiler, pressure and temperature controls and other industrial process products like pumps. It is world leader in industrial steam and peristaltic pumping.
- Spirax has historically been a very stable business, is currently ungeared and has grown sales and EPS at c. 8% p.a. over the last 10 years.
- Yielding 3.4% and at a PER of 13.0x Spirax is not an exciting company, but is regarded as reliable.
- Yet while August 20th interims showed sales up 5%, profits were down 25% to £30m due to customer spend slowing, not surprising in current markets.
- This is a niche business that is close to its markets and manages to consistently defend margins against a number of larger competitors. However, the level of R&D and capex required in this industry is not intense, and current demand conditions apart, profitability is generally stable.
- Spirax has a broad range of end markets and customers for whom Spirax' products, services and engineered packages reduce costs, increase efficiency and enable them to meet increasingly stringent regulations.

Risks and Key Issues:

- Spirax' revenue is primarily maintenance rather than new build, which makes it resilient. But despite the range of end customers it is still a narrow industrial exposure, as has been seen in the last quarter.

Value:

- Operating cash flow cover is regularly over 100%, and capex runs at the same level as depreciation. Spirax neither borrows nor issues equity, and has grown equity at 10% p.a. over the last 10 years while growing sales at 7%. Our DCF target is 1150p

Catalysts:

- Opportunity to buy well run small company at a good price. But at our target it may look fully valued.

BASIC STATISTICS

Share Price	974p
Market Cap	£743m
Enterprise Value	£728m
Bloomberg	SPX LN
Gearing	0%
12 month High	1195p
12 month Low	741p
Sector	Industrial
Next Results	9th March 2010
Website	www.spiraxsarcoengineering.com
Consensus Rating	3.0 (Buy)
Riskgrade™	125

PRICE CHART

Aug 03 to Aug 09



Year End	12/ 08 Act	12/09 Est	12/10 Est
EV/Sales	1.4 x	1.4 x	1.4 x
EV/EBITDA	7.2 x	7.5 x	7.2 x
PER (GAAP)	12.5 x	13.4 x	12.7 x
Yield	3.4%	3.5%	3.7%
Dividend Cover	2.3 x	2.1 x	2.1 x

Data sources: Spirax Sarco, Bloomberg, Reuters
 Chart source: Bloomberg

Gazprom (OGZD LI) **BUY**

Buy Range \$21 to \$25 Down/Upside Review \$17/\$40

Date: 30/09/2009

Profile:

- Gazprom's London listed ADR is equivalent to 4 shares, and is priced in US\$.
- Gazprom, the successor to the Soviet Union's state owned gas company, has a monopoly on the Russian Federation's gas exports, a point reiterated for at least the medium term on 29th September 2009 by Putin when promising more domestic liberalisation to a banking conference.
- It also extracts, transports and stores natural gas, and is noted for using its considerable muscle whenever required, regularly pressurising the Ukraine and latterly Poland when they object to its price tariffs or try to levy their own. The EU is striving to set up alternative supply routes, such is Gazprom's dominant position in Europe.
- It is seeking to start supplying Asia as well and on 30th September announced an intention to expand in North American gas and electricity markets.

Risks and Key Issues:

- European energy demand is down 20% this year according to Bloomberg, and Gazprom is slashing capex and investment by over 30% to 760bn Rubles as demand falls sharply, particularly within the FSU. Budgeted revenues have been cut from 3.7tn Rubles to 3.3tn Rubles.
- Gazprom could well come into conflict with Europe over 'take or pay' provisions in long term contracts if demand stays low.
- Investors in Russian stocks face additional political and governance risks including outright theft.

Value:

- Gazprom had 300bn Rubles (£6.4bn) Free Cash Flow in 2008, after 900bn Rubles (£19.2bn) investment cash outflow, effectively a 7.2% cash flow yield to Gazprom's market cap. Our DCF is slightly above our \$40 target.

Catalysts:

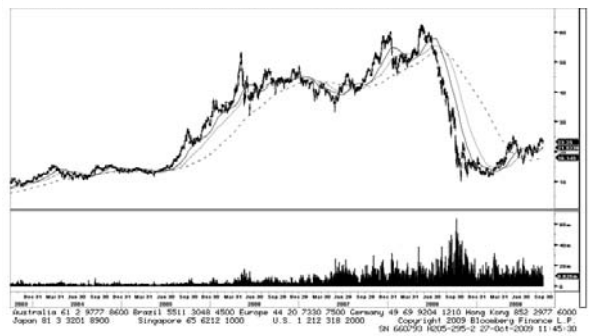
- Both Gazprom and Natural Gas look cheap. Gazprom's growth strategy, building on dominant positions in two continents, is interesting.

BASIC STATISTICS

Share Price	\$23.59
Market Cap	\$138,033m
Enterprise Value	\$171,312m
Bloomberg	OGZD LI
Gearing	22%
12 month High	\$31.7
12 month Low	\$10.55
Sector	Energy
Next Results	2nd November 2009
Website	www.gazprom.com
Consensus Rating	4.5 (Buy)
Riskgrade™	n/a

PRICE CHART

Sep 03 to Sep 09



Year End	03/09	03/10	03/11
	Act	Est	Est
EV/Sales	1.7 x	1.6 x	1.5 x
EV/EBITDA	3.5 x	4.5 x	4.5 x
PER (GAAP)	6.3 x	6.4 x	6.2 x
Yield	0.0%	0.6%	1.1%
Dividend Cover	n/a	24.7 x	14.5 x

Data sources: Gazprom, Bloomberg, Reuters
 Chart source: Bloomberg

Diageo (DGE LN) BUY

Buy Range 910p to 1,000p Down/UpSide Review 890p/1,150p

Date: 08/10/2009

SAMPLE

Profile:

- Diageo is one of the leading global alcoholic beverage groups, with 100 brands selling in 200 countries. Its key assets are number 1 brand positions like Johnny Walker, Smirnoff, Captain Morgan and Gordons. These are very actively managed. Top line growth will probably flatten this year, but margins are likely to improve after currency impact. Basically very stable, but with significant chunks of opportunity from portfolio realignments, and isolated but significant changes such as if India conforms to WTO requirements removing a 600% excise duty. The breadth of the portfolio permits Diageo to steer customers from one Diageo product to another. These strategies help customers move from low price to higher margin premium brands. While its 48% ROE is the main rationale for buying Diageo, there is some bid speculation. This is unlikely, but the 14x PER and 3.9% yield are pretty cheap for Diageo's kind of steady profitability.

Risks and Key Issues:

- Diageo has built its strategy on 'premiumisation'. Will this work in a low growth world?
- There is little room to grow in spirits without regulatory control, but how long can Diageo maintain static growth without decline?
- Diageo has returned £24bn to investors since 1997.

Value:

- Diageo's cash flow has been suppressed by an increase in investment in Whisky stocks over the last three years, but is now levelling off. I expect this to increase cash flow yield to c 6.5% from 5% at today's price and restore cash conversion from 65% to c 100% over the next couple of years. Gearing is high at 242%, but given the strength of its brands, Diageo's intangible assets should arguably be valued much higher than the current £4.6bn.

Catalysts:

- Clear valuation story, 20% upside potential.

BASIC STATISTICS

Share Price	960p
Market Cap	£23,844m
Enterprise Value	£31,644m
Bloomberg	DGE LN
Gearing	242%
12 month High	1,003p
12 month Low	727p
Sector	Consumer Non Cyclical
Next Results	2nd February 2010
Website	www.diageo.com
Consensus Rating	4.1 (Buy)
Riskgrade™	90

PRICE CHART

Oct 03 to Oct 09



Year End	03/09	03/10	03/11
	Act	Est	Est
EV/Sales	3.4 x	3.3 x	3.2 x
EV/EBITDA	11.6 x	10.3 x	9.8 x
PER (GAAP)	14.8 x	13.9 x	13.1 x
Yield	3.8%	3.9%	4.1%
Dividend Cover	1.8 x	1.8 x	1.8 x

Data sources: Diageo, Bloomberg, Reuters,
Chart source: Bloomberg

Dell (DELL US) **BUY**

Buy Range \$14.50 to \$16.0 Down/Upside Review \$14.1/\$22.0

Date: 21/10/2009

Profile:

- This is a great turnaround story but with significant risks. Will the Vista induced corporate buying freeze be sufficiently thawed by Windows 7 to benefit the entire Microsoft ecosystem, or will continuing economic weakness prevail? Another issue is that Dell's strategy is changing rapidly, with the \$3.6bn cash acquisition of Perot part of a deeper shift into services, as well as an aggressive targeting of healthcare. At the same time it will be launching a smartphone for AT&T next year.
- Chairman Michael Dell has himself replaced his hand picked CEO, Kevin Rollins, after a period of underperformance and weak governance. He is attacking rejuvenation with vigour, with numerous senior departures, arrivals, plant closures and strategy changes.

Risks and Key Issues:

- Dell's new CFO reports finding weak systems for a company of Dell's size. This is no surprise given the range of customer and governance problems raised recently.
- In 2007 a legal case claimed Dell took kickbacks from Intel, falsified sales figures to manipulate the share price, and senior figures sold stock at the peak. The same year the New York Supreme Court ruled that Dell had "engaged in fraud". In 2009 the Taiwanese Consumer Protection Commission fined Dell \$30,000 for putting false prices on its website and charging the 'correct' price. In short, a big clean up is required.

Value:

- It is probably conservative to assume revenue growth such that Dell's sales get back to 2009 levels by 2014, and if it does, then even without a large margin recovery our DCF is around \$22.
- The acquisition of Perot has reduced Dell's cash pile from 23% of market cap to 11%.

Catalysts:

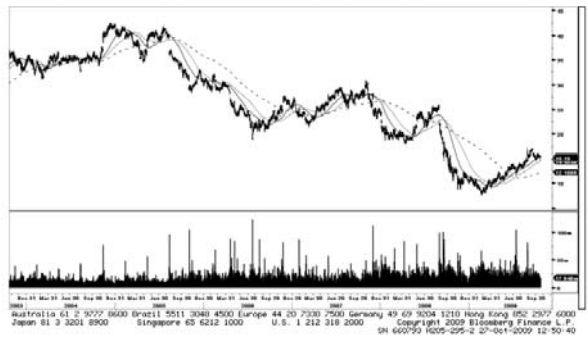
- Dell is not loved, has lost its way, but still has a 33% ROE and great turnaround potential. It is undervalued even in its current shape.

BASIC STATISTICS

Share Price	\$15.35
Market Cap	\$30,433m
Enterprise Value	\$27,085m
Bloomberg	Dell US
Gearing	0%
12 month High	\$17.26
12 month Low	\$7.84
Sector	IT
Next Results	19th November 2009
Website	www.dell.com
Consensus Rating	3.7 (Buy)
Riskgrade™	158

PRICE CHART

Oct 03 to Oct 09



Year End	01/09	01/10	01/11
	Act	Est	Est
EV/Sales	0.4 x	0.5 x	0.4 x
EV/EBITDA	5.9 x	6.9 x	5.7 x
PER (GAAP)	12.3 x	14.3 x	11.6 x
Yield	0.0%	0.0%	0.0%
Dividend Cover	n/a	n/a	n/a

Data sources: Dell, Bloomberg, Reuters
 Chart source: Bloomberg

Henderson Rowe Limited

25 Grosvenor Street,
London W1K 4QN

Phone: 0207 907 2200

Email: admin@hendersonrowe.com

Investment Managers:

CEO: Charles Aram

CIO: Giles Rowe

Patrick Donovan

Adam Hayek

William Lawes

Finlay Maclennan

Ben de Rivaz

Darren Winstone

John Wick

Dominic Wright

Derivatives:

Ben Gregory

Andrew Powell

Operations:

Jolin Yang

Malean Vuong

Non-executives:

Ch: The Rt Hon the Lord Parkinson

Kieran Mohally

SAMPLE

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in equities, bonds, funds and CFDs,

with an international asset allocation framework.

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Henderson Rowe is using Risk Metrics' measure of risk, the Risk Grade™, to assess the risk of investments. This is an open and transparent benchmark to measure the risk of financial assets. It is widely used by financial institutions. One key benefit is that it is a standardised measure of volatility allowing "apples-to-apples" comparisons of investment risk across all asset classes and regions. Thus we can say that a stock with a Risk Grade™ of 600 is six times as risky as a fund with a risk grade of 100. However it is based strictly on historical data and does not predict future performance in any way.

Risk Grades range from zero for cash to over 1000 for IPOs and early stage technology stocks. The illustration at left gives an idea of the levels of Risk Grade™ for certain broad categories of investment in normal conditions (current volatilities are lower than normal). It is important to bear in mind that these are backward looking measures, and do not necessarily indicate future volatility.

