PRIVATBANKIERS
REICHMUTH & CO
INTEGRAL INVESTMENT MANAGEMENT

# CHECK-UP

CLIENT INFORMATION OF PRIVATBANKIERS REICHMUTH & CO, INTEGRAL INVESTMENT MANAGEMENT

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## EDITORIAL

*The worst of the financial crisis is over, and yet the after-effects will be felt for years to come in the financial world as well as in the real economy.*

*Increasing legal uncertainty is cause for concern. Recent experience has shown that countries' sovereign legal systems come under increasing pressure from a «might is right» mentality in times of crisis. We can only hope that this trend will be stopped in its tracks in good time. Even in an economic war, there can only be losers. The settlement reached recently between the US and Switzerland is an encouraging sign, but one battle without casualties does not signify an outright victory.*

*The lasting prosperity of both the real economy and the financial system hinges on a stable and reliable legal system.*



*Jürg Staub*
*General Partner*

# STABILIZED FINANCIAL SYSTEM

## WHEN WILL THE SAME BE TRUE FOR THE REAL ECONOMY?

Job done! The rescue packages put together by central banks and governments have stabilized the financial system. This is clearly reflected in the insurance premiums for major banks' bonds, known as credit default swaps, which have fallen sharply and are now back below one percentage point. The risk premiums for highly leveraged companies, known as high-yield spreads, have also dropped from panic levels in excess of 18 percentage points to less than eight percentage points. This explains why banking and low-quality stocks, which had taken a dramatic beating in 2008, have performed so well.

### No sign of renewed growth yet

This development is hugely important for the financial markets and the world economy, yet it is not enough to signal sustained growth just yet. This would require a further fall in risk premiums and (just as importantly) a lot of new money in consumers' pockets. The latter has not materialized so far and cannot be expected for the foreseeable future. Hence, companies are adjusting their capacities in line with lower demand levels. This is causing a steady rise in unemployment, which is set to remain very high in many countries. Until this trend comes to a halt, short-term interest rates will stay close to zero.

### Who will replace the government stimuli?

The inventory cycle and government stimuli are helping to stabilize economic growth, which will in fact pick up a little following the recent slump. Next year, however, consumer demand will have to replace state-sponsored measures as the driving force behind economic activity. If growth in consumer and/or capital spending does not bounce back, governments will have to create fresh stimuli, and these will have to be on an even greater scale than the present ones if they are to have a positive impact on the economy. This is hard to imagine, given the desolate state of Western governments' finances. Budget deficits for 2009 are expected to be about 12% of gross domestic product in the US and 6% in Europe, respectively.

### Who is financing the government deficits?

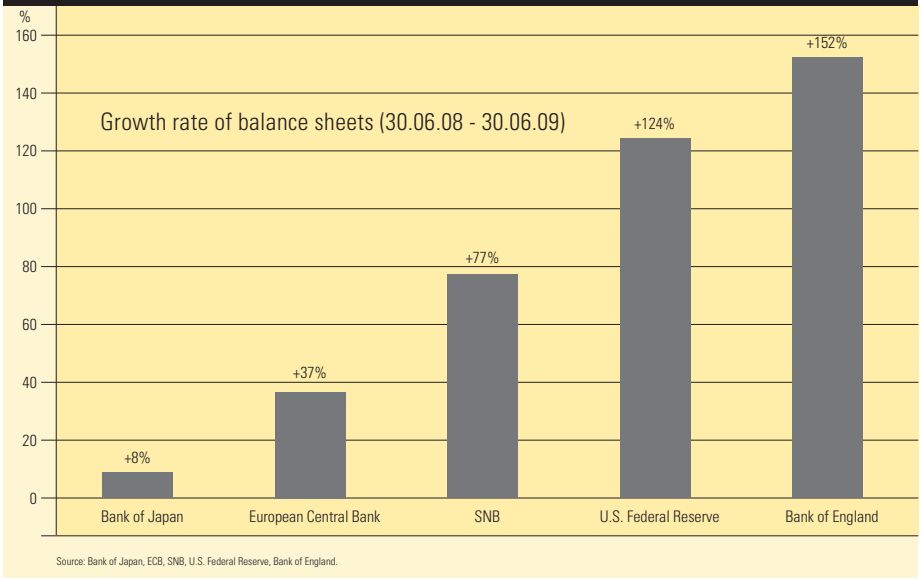
The State finances its spending by levying taxes, borrowing or – in extreme ca-

continued on next page

## CONTENT

3 The Big Picture
3 Portfolio of the Future
4 Investment Policy
5 Market Outlook
6 Is the time still right to buy Stocks?
7 Inflation is the only Remedy for the System
8 Our Clients are always our Priority

**EXPLOSION OF THE CENTRAL BANKS' BALANCE SHEETS**




Source: Bank of Japan, ECB, SNB, U.S. Federal Reserve, Bank of England.

ses – printing new money. In times of recession, however, tax revenues fall, while spending rises due to increased social security payments and the cost of stimulus packages. That is why deficits are so high at present and why governments are taking on new debts to cover them. Lots of new government bonds are being issued, and they need buyers. If there are too few buyers in the market, the central bank can buy the bonds using newly printed money. The UK and the US have already resorted to this direct monetarization of government debt.

### Immense money supply growth

Central banks' balance sheets have thus expanded on a huge scale, but all the new money has done little to boost demand. Instead, banks have used it to increase their cash reserves. Unfortunately, this has already caused the currencies concerned to depreciate. In the future cash will be even less effective as a means of preserving value. Its earning power is already negligible. Everything is likely to rise against cash over the next few years: asset prices, consumer prices and investment prices.

### Supply and demand

Every market price is determined by supply and demand. The supply of equities was enormous from September 2008 to March 2009. Many were forced to sell, others were keen to sell. Hardly anyone dared buy stocks. This oversupply came to an end in March and has since given way to a demand surplus. The trend spreading very quickly on the stock markets is also emerging, albeit with a time lag, in the real economy. The slump in demand at the end of last year was set against an oversupply of goods. Capacities have since been scaled back, and demand is now settling at a low level.

### What does this mean for interest rates?

Interest rates are also affected by supply and demand. As long as unemployment is rising, central banks' short-term interest rates will stay close to zero. As regards long-term rates, on the other hand, central banks can only exert a temporary influence. It is hard to believe that enough investors can be found right now who are prepared to lend the US government money in USD for ten years at just 3.5% interest and thus absorb the high level of Treasury issuance. Therefore, we expect long-term rates to move higher before their short-term counterparts. This will be a further setback for the real economy.

### How is the real economy performing?

The global recession should be over before the end of this year, thanks first and foremost to the basis effect. From September onward, the year-back comparison base is very weak. Added to this is the inventory effect. Inventories were reduced heavily after the system crisis in September 2008 and now need to be stocked up again. The recovery will be a slow one, starting out from a rather low level, and it will be years before economic output returns to the levels seen during the boom years.

### What does this mean for investors?

Interest rates will remain low for the time being, making high current yields attractive. These are not to be found on the money market or among prime bonds, although these two asset classes can help to reduce portfolio volatility. Top-rated stocks with high dividend yields and attractive valuations are more appealing. A selection of these can be found on page 6. Hedge funds, too, continue to offer an attractive risk/return profile, but they are only suitable for medium-term investors who do not need their investments to be tradable on a short-term basis. As far as currencies are concerned, we would steer clear of the USD and GBP because the respective governments have chosen to finance their debts by printing money. We recommend a high weighting of domestic currency, supplemented with Asian currencies and those of commodity-rich countries like the CAD and NOK. We remain bullish with regard to precious metals.



*Christof Reichmuth*
*General Partner*

# THE BIG PICTURE

## OUR SCENARIO ANALYSIS IN A NUTSHELL

| CONSENSUS | NEW BUBBLES | STAGFLATION | FISCAL CRISIS | GROWTH |
|---|---|---|---|---|
| The financial crisis is over. The economic crisis is not, but it is close to bottoming out, and the global economy recovers slightly toward the end of 2009 and in 2010.<br>Central banks maintain an expansionary stance.<br>Government deficits remain extremely high.<br>Inflation remains low.<br>Margins remain good. | The central banks' expansionary monetary policies cause new bubbles to form. Surplus liquidity is not absorbed due to the weak real economy. This leads to inflation in asset prices but not in prices for goods and services. New bubbles arise, perhaps in equities, gold, oil or commodities. Growth remains modest | The central banks' extremely expansionary monetary policies undermine confidence in the stable value of cash. The economy recovers in nominal terms, yet real growth is still close to zero. Unions demand compensation for inflation, which gradually results in an inflationary spiral. | Governments' rescue packages only served to buy time. The economy fails to recover, and credit defaults increase. New packages are put together for the financial system and the economy. Government debts rise rapidly. Faith in the all-powerful State evaporates. Fears of government defaults rise. A flight out of nominal assets takes hold. | Government and central bank action has overcome the financial crisis, and the real economy recovers faster and more markedly than could have been expected.<br>Central banks take the surplus liquidity out of the system in good time, and inflation remains relatively low. |
| INVESTMENT IDEAS<br>«Bread and butter» portfolio of blue chips and bonds<br>Riding the market's ups and downs | INVESTMENT IDEAS<br>Blue chips<br>Emerging markets<br>Commodities<br>Gold and silver | INVESTMENT IDEAS<br>Inflation-linked bonds<br>Stocks with pricing power, high dividend yields, and low P/E ratios<br>Stocks with cheap long-term debts and high intrinsic value (e.g. real estate companies)<br>Gold and silver | INVESTMENT IDEAS<br>Cash in domestic currency<br>Government bonds in the first phase, thereafter no more exposure to treasuries<br>Stocks that pay stable dividends<br>Real estate in stable countries<br>Real physical assets<br>Gold and silver | INVESTMENT IDEAS<br>Stocks of all kinds, including capital goods and high-beta companies<br>Emerging markets<br>Inflation-linked bonds |
| High Yield Spreads: 800 bps | High Yield Spreads: 400 bps | High Yield Spreads: 600 bps | High Yield Spreads: 1500 bps | High Yield Spreads: 300 bps |
| Probability 6 months: 50% | Probability 6 months: 30% | Probability 6 months: 10% | Probability 6 months: 5% | Probability 6 months: 5% |
| Probability 18 months: 10% | Probability 18 months: 15% | Probability 18 months: 50% | Probability 18 months: 20% | Probability 18 months: 5% |

# PORTFOLIO OF THE FUTURE

## DIVERSIFIED AND FUTURE-ORIENTED – ADJUSTED TO PREVAILING MARKET CONDITIONS

| EX. | BUILDING BLOCK | IMPLEMENTATION | RETURN* | VOLATILITY* |
|---|---|---|---|---|
| 35% | Fixed Income | Money Market<br>Short duration bonds of companies with stable cash flows<br>Inflation linked government bonds | 2-5% | 5% |
| 5% | Structured Products | Asia FX against EUR and USD | 8% | 8% |
| 30% | Equities | Scale in – Scale out concept<br>Stocks with high dividend yield and low valuation<br>Food, health care, energy and electricity infrastructure<br>Asia ETF and sector ETF actively managed | 9% | 15% |
| 5% | Real Estate Stocks | 1/2 Switzerland, 1/2 Asia Reits | 5-10% | 15% |
| 20% | Alternative Investments | Reichmuth Matterhorn 3 or third-party instruments<br>Reichmuth Himalaja | 8-10%<br>10-15% | < 5%<br>< 10% |
| 5% | Precious Metals | Gold and silver physical | 8-10% | 10% |
| | | **Total** | **5-9%** | **approx. 6%** |

*Expected average return and volatility over the next 5 years – no guarantee

# INVESTMENT POLICY
**SEPTEMBER 2009**

| BASIS | CH | EU | USA | J | CHINA |
|---|---|---|---|---|---|
| **Purchasing Power Parities** | | | | | |
| Ned Davis Research | | 1.54 | 1.15 | 1.12 | |
| | | | | | |
| **GDP Growth** | | | | | |
| actual | -2.4% | -4.7% | -3.9% | -6.4% | 7.9% |
| 6 months | → | ↗ | ↗ | ↗ | → |
| 3 years | ↗ | ↗ | ↗ | ↗ | → |
| | | | | | |
| **Inflation** | | | | | |
| actual | -1.2% | -0.7% | -2.1% | -1.8% | -1.8% |
| 6 months | ↗ | ↗ | ↗ | ↗ | ↗ |
| 3 years | 4.0% | 5.0% | 6.0% | 3.0% | 7.0% |
| | | | | | |
| **Stock Markets** | **SPI** | **DAX** | **S&P 500** | **TOPIX** | **HSCEI** |
| Price/Sales | 1.4 | 0.6 | 1.1 | 0.5 | 1.8 |
| Dividend Yield | 2.4 | 3.9 | 2.6 | 2.1 | 2.4 |
| Price/Book | 1.9 | 1.4 | 2.1 | 1.2 | 2.3 |
| Price/Earnings actual | 36 | 35 | 19 | n.a. | 18 |
| Price/Earnings estimate | 15 | 16 | 17 | 42 | 15 |

| FORECAST | CH | EU | USA | J | CHINA |
|---|---|---|---|---|---|
| **Money Markets (3 months)** | | | | | |
| actual | 0.3% | 0.9% | 0.4% | 0.4% | 1.7% |
| 6 months | → | → | → | → | ↗ |
| | | | | | |
| **Swap Rates (10 years)** | | | | | |
| actual | 2.5% | 3.5% | 3.6% | 1.4% | 3.2% |
| 6 months | → | → | → | → | n.a. |
| 3 years | ↗ | ↗ | ↗ | ↗ | n.a. |
| | | | | | |
| **Currencies** | | | | | |
| actual | | 1.52 | 1.06 | 1.13 | 6.3 |
| 6 months | | → | → | → | → |
| 3 years | | ↘ | ↘ | → | ↗ |
| | | | | | |
| **Stock Markets** | **SPI** | **DAX** | **S&P 500** | **TOPIX** | **HSCEI** |
| actual | 5'250 | 5'400 | 1'010 | 950 | 11'450 |
| 6 months | → | → | → | → | → |
| 3 years | ↗ | ↗ | ↗ | ↗ | ↗ |
| | | | | | |
| **Real Estate Market** | → | → | → | → | → |

Legend: ↗ = increasing → = neutral ↘ = decreasing as of: August 21, 2009

# MARKET OUTLOOK
**3rd TRIMESTER 2009**

## CURRENCIES

**Exchange rates are more or less holding steady as the imbalances between key economic factors have eased.**

The relative strength of the EUR is attributable to the fact that the European Central Bank has cut money-market rates somewhat less aggressively than most of its counterparts and that the latter are steadily increasing the EUR's weighting in their currency reserves at the expense of the USD. This, in addition to the general economic downturn, is putting extra pressure on European exports. The EUR is now rather richly valued in terms of purchasing power parity, especially as regards the weaker countries of the euro zone. The slight uptrend in the EUR over the past few months is thus unlikely to continue. The Asian currencies, especially the JPY and CNY, have remained flat relative to the USD. With current account imbalances declining but still significant, the pressure on these countries to revalue their currencies is becoming ever greater. Over the long term, therefore, higher exchange rates for the JPY, CNY, HKD, SGD, TWD, and KRW can be expected – not only versus the USD, but also versus the European currencies.

The commodity currencies CAD, AUD, and NOK, which depreciated sharply when the oil price slumped in the fall of 2008, have all but recouped these losses in recent months.

The CHF has been quite steady versus the EUR at an exchange rate just above CHF 1.50 since the Swiss National Bank's intervention in March 2009. No new trend can be expected over the short term. Over the long term, meanwhile, the CHF will firm up against the EUR, especially if inflation returns, since the SNB expressly stated that the aim of its intervention was to prevent deflation in Switzerland.

## INTEREST RATES

**Interest rates are set to remain extremely low by historical standards for some time to come.**

The worst of the global financial crisis is past, but the downturn in the real economy will not reach its lowest point until a few months' time. It will be a while before growth rates return to their long-term potential levels, i.e. about 2% on average for the industrialized nations. Central banks will thus be in no hurry to hike rates again as this would strangle a nascent economic recovery. With inflation virtually absent, long-term yields will also remain low for the time being. Inflation rates, which are in fact negative in many countries due to the base effect, will move back into positive territory over the next few months, but a sustained inflationary trend is not on the cards because high and still rising unemployment will keep wage costs (and therefore the prices of the goods and services in the index basket) low. There is a risk that the huge money supply created by the central banks could inflate the value of other assets such as precious metals, certain segments of the equity market or other asset classes, real estate, etc. as soon as the money starts to circulate.

Risk premiums on corporate bonds have fallen but remain much higher than their normal levels from before the financial crisis. Since a sharp increase in defaults is to be expected in the near future, meaning that trust among banks is unlikely to be restored soon, risk premiums will stay higher than average.

## STOCK MARKETS

**Stock markets have risen continually from their March lows and are now much higher than they were at the start of the year. A consolidation or a slight countermove can be expected in the months ahead.**

Following a sharp rise in stock prices, much of the hoped-for economic upswing is now priced in. The signals from the real economy are still far from suggesting that the recession has clearly bottomed out. Growth in many countries has risen slightly but remains negative, pointing to a merely temporary rebound in the economy. Therefore, we can hardly expect the uptrend to continue unchecked over the next few months. A consolidation or a slight correction seems more likely.

Stocks are certainly trading at fair levels in terms of the usual multiples. Those from non-cyclical industries with high and relatively stable dividend yields such as pharmaceuticals, food, and energy/communication utilities are looking attractive. Those from cyclical industries, some of which have experienced virtually unprecedented falls in sales, order intake, and profit margins, entail very high risks. Even with prices at very low levels from a historical perspective, therefore, investments should be restricted to companies with an ample capital base that will be able to weather the crisis and profit from the recovery.



*Dr. Max Rössler*

# IS THE TIME STILL RIGHT TO BUY STOCKS?

## WILL THE RALLY SOON BE OVER?

The stock markets have bounced back strongly from their lows in March. Many investors were unwilling to buy stocks in the spring after the financial crisis of 2008 and asked themselves if it was the right time to get on board.

### Stocks are not expensive, but only selectively cheap

The stock markets are no longer especially cheap by historical standards. Cyclicals, in particular, have recouped much of their big losses recently. A recovery in the real economy is very much priced in. The defensive sectors, on the other hands, are still attractive.

### Money burning holes in people's pockets

Central banks continue to make cheap money available. Money-market rates are close to zero, and many market players are sitting on large cash holdings. They are looking for alternatives to the unsatisfactory yields on money-market paper. There has also been an improvement in market psychology. Cautious optimism is the order of the day, albeit still at modest levels. Too much optimism would in fact be a counter-indicator, pointing to falling stock markets, and vice versa.

### High yields in a low interest rate environment

In an environment of low interest rates, high yields are attractive. This is especially the case if these stem from well-run companies whose valuation is fair. Such firms should, in principle, overcome both possible economic scenarios, fiscal crisis as well as stagflation.

### Dividend stocks are attractive

In the current market environment there are still a number of first-class defensive stocks with solid balance sheets and high dividend yields. When selecting such stocks one must strive to find such stocks where the dividend yields surpasses the government bond yield by a wide margin and where the P/E ratios is below 10. Usually, the dividend yield offers a certain protection against market corrections.

### Equities belong in a portfolio geared to real value

For portfolios geared to real value, we advise individually to allocate a higher proportion of the portfolio to real assets (stocks, real estate and commodities). The following selection list contains a number of stocks that we currently view as attractive.



*Silvan Betschart*

**SELECTION OF DIVIDEND STOCKS**

| | Currency | Price 18.08.2009 | YTD (in%) 2009 | Dividended Yield (in %) | | Price/Earnings | | Price/Book Ratio | Price/Sales Ratio |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Current | 2010 E | Current | 2010 E | Current | Current |
| UTILITIES | | | | | | | | | |
| RWE AG | EUR | 58.7 | -7.7 | 7.7 | 6.5 | 8.6 | 8.5 | 2.7 | 0.7 |
| E.ON AG | EUR | 27.1 | -4.3 | 5.5 | 5.9 | 19.0 | 9.0 | 1.4 | 0.6 |
| TELECOM | | | | | | | | | |
| SWISSCOM AG | CHF | 350.5 | 3.2 | 5.4 | 6.7 | 9.4 | 9.9 | 3.4 | 1.5 |
| DEUTSCHE TELEKOM AG | EUR | 8.8 | -17.9 | 8.8 | 8.8 | | 12.8 | 1.1 | 0.6 |
| FRANCE TELECOM SA | EUR | 17.1 | -14.5 | 8.2 | 8.5 | 11.4 | 9.1 | 1.6 | 0.9 |
| ENERGY | | | | | | | | | |
| ROYAL DUTCH SHELL PLC | EUR | 18.4 | -1.8 | 6.7 | 6.9 | 12.3 | 7.9 | 1.2 | 0.5 |
| ENI SPA | EUR | 16.0 | -4.8 | 8.2 | 7.2 | 11.9 | 7.8 | 1.4 | 0.6 |
| TOTAL SA | EUR | 37.6 | -3.0 | 6.0 | 6.3 | 12.6 | 8.2 | 1.6 | 0.7 |
| PHARMACEUTICALS | | | | | | | | | |
| NOVARTIS AG | CHF | 48.0 | -8.9 | 4.2 | 4.9 | 13.3 | 10.3 | 2.0 | 2.5 |
| SANOFI-AVENTIS | EUR | 44.8 | -1.2 | 4.9 | 5.5 | 14.1 | 7.2 | 1.3 | 2.1 |
| NON-CYCLICAL CONSUMPTION | | | | | | | | | |
| NESTLE SA | CHF | 42.2 | 1.3 | 3.3 | 3.7 | 8.6 | 13.1 | 3.1 | 1.4 |
| PROCTER & GAMBLE | USD | 52.4 | -15.1 | 3.2 | 3.4 | 14.3 | 13.9 | 2.5 | 2.0 |
| UNILEVER NV | EUR | 19.2 | 11.2 | 4.0 | 4.3 | 12.6 | 13.6 | 5.4 | 1.3 |
| INSURANCE | | | | | | | | | |
| ZURICH FINANCIAL SERVICES AG | CHF | 220.0 | -3.1 | 5.0 | 5.7 | 17.9 | 7.5 | 1.2 | 0.7 |
| MUENCHENER RUECKVERSICHERUNGS AG | EUR | 99.9 | -10.3 | 5.5 | 5.8 | 15.8 | 7.1 | 0.9 | 0.4 |
| ALLIANZ SE | EUR | 74.1 | -1.0 | 4.7 | 5.6 | 9.4 | 6.9 | 1.0 | 0.4 |

Source: Bloomberg

# INFLATION IS THE ONLY REMEDY FOR THE SYSTEM

## CENTRAL BANKS UNLIKELY TO APPLY BRAKES IN TIME

The key question for long-term investors is this: «Will we see inflation or deflation going forward?» Inflation rates are negative at the moment, i.e. we have deflation. We see this as a cyclical and thus temporary phenomenon caused by the demand shock in the wake of the financial crisis. It will be followed by a period of low real growth and rising inflation, a scenario termed «stagflation».

**What is inflation?**

Inflation comes from the verb «to inflate», meaning to expand or blow up. Everyone is familiar with the consumer price index. It tracks the price of a typical basket of goods as bought by the average consumer. However, inflationary trends may also arise in specific areas, for example in the price of commodities or other assets. These have a delayed impact on consumer price inflation.

**Stable, low inflation is best**

Stable inflation is more important for companies than very low inflation, since they want to be able to plan ahead with some degree of certainty. A stable, low inflation rate – as has largely prevailed over the past 15 years – is best. When this is the case, interest rates are also low, and low interest rates mean high asset values because they increase the capitalization factor (the price/earnings ratio in the case of stocks). Deflation is bad because cash gains value, demand falls in anticipation of lower prices, and the economy falters.

**Key factors affecting inflation**

Inflation arises when the money supply is too large relative to the supply of goods. Aside from wages, commodity prices and productivity are key factors influencing the inflation rate. Companies are currently adjusting their capacities in line with lower demand, which is causing unemployment to rise, which in turn is putting pressure on wages. This adjustment process should be nearing its end soon.

**Deflation triggered by demand shock**

The inflation of the 1970s started with a supply shock. The current phase of deflation, meanwhile, reflects the demand shock in the wake of the financial crisis. As soon as overcapacities have been eliminated, price levels will stabilize. The money supply is growing on a vast scale. In the future regulatory and protectionist measures will have an increasing effect on inflation, which will differ from country to country.

**Can central banks prevent inflation?**

In theory yes, if they take decisive action to use up the large amount of new money. They have a large arsenal of effective weaponry at their disposal for this purpose. Central banks usually put the brakes on economic growth by raising their headline interest rates, but this is not their goal amid high unemployment. During the financial crisis, central banks expanded their balance sheets by leveraging or buying assets and thereby poured money into the system. If they sell these assets on the market, for example, this will take money out of the system. At a time when governments are issuing lots of new bonds, this increased supply of government paper would meet with insufficient demand. Long-term yields would unavoidably rise, and this would trigger the next recession. That is not what anyone wants at the moment. Therefore, we doubt that the central banks will use their anti-inflation weapons effectively. They are much more likely just to talk about it and perhaps apply further creative mathematics to make consumer price inflation look lower than it really is for most consumers.

**What would the alternative to inflation be?**

The alternative to inflation, further deleveraging through bankruptcies and reorganizations, is actually more of a threat. Today's highly leveraged financial system could not cope with it. The banking crisis showed what happens when borrowers attempt to solve their debt problems by not paying back debts. Assets are destroyed, liabilities remain, balance sheets become skewed, and faith in the financial system evaporates. The large amount of new government debt could also test people's faith in the all-powerful State and its creditworthiness. The next crisis – a fiscal one – would then be upon us. That, however, is likely to be some years away for now.

**Inflation helps nominal systems and penalizes savers**

Practically all nominal systems come under pressure in deflationary phases. In Switzerland, for example, these include not only banks and insurers but also pension funds. How can they cover capital guarantees and politically determined minimum interest rates when there is no money to be earned on either the money market or risk-free government bonds? Or, worse still, if borrowers default? Higher interest rates due to inflation would certainly help. While pensions would lose value in real terms as a result, the system would at least be saved from collapse.

**How can we invest during periods of inflation?**

In inflationary times, the important thing is to preserve the real value of assets. Real value is typically lost on

continued on page 8

# OUR CLIENTS ARE ALWAYS OUR PRIORITY

## INTERVIEW WITH KARL REICHMUTH

*Things escalated on the international financial markets about a year ago. What is the situation today?*

The after-effects of the financial crisis have not yet been overcome. We think the sector will see a few more changes yet. The tax discussions with the US are one example. Other markets, too, are increasingly resorting to protectionist measures, and the financial crisis has also hit the real economy. From an investor's point of view, therefore, the market environment remains challenging.

*Where does Reichmuth & Co stand at present?*

Thanks to our autonomous investment policy, the assets entrusted to us suffered smaller losses than the market average in the catastrophic year that was 2008. More importantly, all but a small number of clients stayed loyal to us. We are even attracting some excellent new ones. The Zurich branch we opened last year is performing especially well. It is regrettable, on the other hand, that our Matterhorn fund of hedge funds was affected by the Madoff fraud.

*How did clients react to that?*

Here we have to distinguish between the Matterhorn investors who also bank with Reichmuth and those who do not, whom we do not know by name. Many of our banking clients were naturally very disappointed, as were we, that our name appeared in the headlines in connection with this story. For the most part, however, they were able to put it into perspective. Clients who had followed our asset allocation benefited from a broadly diversified portfolio with no cluster risks.

*But what about the other Matterhorn investors?*

Many of them are professionals, and they got over it quickly. Matterhorn outperformed many rival products and the fund of hedge funds index last year in spite of the Madoff-related write-downs. Further, the returns of Matterhorn have fared very well in a multi-year comparison. What was a problem, however, was that we were hardly able to establish direct contact with fund investors who are not our banking clients in order to explain what had happened. We have learned our lesson from this and in the future we will offer our investment solutions only to people we know rather than to a broader public.

*How do you see yourself in the fraud story?*

It is interesting to note that this is less a scandal concerning the much-maligned hedge fund industry than a one-off case on a massive scale on the highly regulated US financial market. When it is discovered after the fact that a state-regulated broker such as Madoff was able to create false transaction advices and account statements, it is clear that the supervisory apparatus has failed miserably.

*How will Reichmuth & Co set its priorities in the future?*

As a relatively small bank, we can only be successful if our clients are as well. We have no other priorities. We have to earn our clients' trust on a daily basis, be close to them, understand their needs, and be an open and proactive partner for them. As regards investments, we want to add value for our clients as a buy-side provider and deliver stable, above-average performance as we have over the past 12 years.

*You previously mentioned the tax discussions. What is your stance on the Swiss banking secrecy?*

In terms of protecting privacy, the law on bank-client confidentiality has great significance for a Swiss private bank with traditional values like Reichmuth. We stand by this, come what may. Being a young bank, however, our business model has never been geared to untaxed wealth, which is why the tax discussions only affect us peripherally.



*Karl Reichmuth*
*General Partner*

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continued from page 7

long-term nominal investments such as government bonds. Where inflation was merely a regional problem, the currencies of the countries affected depreciated. In these cases, it made sense to hold real estate and stocks against credit and keep assets in a currency not hit by high inflation. If the US were to enter a phase of high inflation, the USD would be a currency to avoid, whereas US equities would be of interest. It would be preferable to hold them via futures as this would involve neither holding USD assets nor taking on a counterparty risk.

*Christof Reichmuth*
*General Partner*