Check-Up

Client Newsletter of Privatbankiers Reichmuth & Co
Integral Investment Management | May 2017



Editorial

Financial markets are shrugging off an increasingly ambivalent political order in the world, and remain in pleasing form. Our main concerns on the political front revolve around the longer-term implications. The globalization megatrend has delivered considerable prosperity but it has also brought problematic effects in terms of income inequality. The resultant resentment is now surfacing in elections, and a countertrend has taken hold. That said, there is no stopping the process of globalization, partly because it is now being bolstered by another megatrend that is gathering pace: digitalization.

Digitalization is something we are addressing both in selecting promising investments and seeking to harness its potential for our clients. One example of the latter is our e-Connect platform, which we delv into on page 8. Amid all these developments, one thing remains constant: the most important aspect of integral investment management is connecting with our clients. That will never change.



Jürg Staub,
General Partner

IDEAS OLD AND NEW

Now there is an alternative

Freedom means being able to choose freely between a range of options. We therefore welcome the fact that politicians' well-worn argument that there is no alternative has run its course. Wherever there are problems, it is essential to consider all of the options, weighing up the pros and cons. There are always alternatives, and the events of 2016 put paid to the myth that there are not.

New ideas for Europe?

There are signs emerging in Europe that Brexit has had an impact on the self-conceived identity of the EU in Brussels after all. Although the tone set in the EU's draft guidelines for negotiations with the UK is far from uplifting, even European Commission President Juncker has now presented a white paper with five possible scenarios for the EU going forward. Europe's future will likely be decided at the ballot box this year. The most probable outcome would appear to focus on the core concept of a peace project and common economic area. From our perspective, this would be an optimal scenario, one that would also open up prospects for non-EU states, as well as perennial accession candidates such as Turkey. Political and national differences would no longer have to be reduced to the lowest common denominator. Europe's diversity would be retained, and yet still be integrated in the economic area. In a few years we may even be thanking the British for having saved Europe's diversity from oversimplistic uniformity.

Elections in France

The far-right politician Marine Le Pen has made it to the final round of voting, but has little chance of moving into the Élysée Palace. The only potential for a surprise in this regard would be if the center were to splinter. Le Pen would unquestionably spell trouble both for Europe as well as the economy and financial markets. Meanwhile, Macron would likely join with Germany in developing the EU towards a 'European core'. A victory for the left would make another

continued on next page

five years of French malaise a certainty. However, France is unlikely to be the tipping point for the euro's viability as a single currency – we still believe this will hinge on developments in Italy.

The US with new and old ideas

Donald Trump's first 100 days have not been a success story. Given how they are presented, it is difficult to take his ideas seriously. That said, some of his statements provide food for thought. Until Trump raised the issue, who knew about the NATO agreement obliging members to spend 2% of their GDP on defense? Who was aware that China's import duties are far higher than those in the US? In our view, the most important conundrum at present is the Border Adjustment Tax (BAT). This is a form of value added tax that treats profits generated domestically and abroad differently. As with everything else, it has its pros and cons. It would heavily favor domestic producers over their foreign counterparts. Meanwhile, shifting profits to low-tax countries such as Ireland would become irrelevant. This change in the tax system would entail complex implications, should it prove feasible. One consequence would likely be a stronger USD. Another would be the dismantling or restructuring of certain bureaucratic behemoths. The OECD's efforts on Base Erosion and Profit Shifting (BEPS) and the corresponding regulations would be rendered obsolete.

US wants lower trade balance deficits

The BAT would be a big step in this direction. One of the consequences in our view would be a stronger USD, another that the importance of the USD as a reserve currency would wane somewhat. A lower trade balance deficit would reduce the amount of USD being exported around the world. Although this could be offset by foreign currency purchases by the US Federal Reserve, that would in turn entail highly complex consequences that are far from clear. Historically, the USD has been a weak currency, due to the high balance of trade and budget deficits, but also because US inflation having been higher than in Europe or Japan. In terms of purchasing power parity, the USD is rather expensive, but we are holding it nonetheless since there are few attractive alternatives and there is the possibility of the USD overshooting on the upside.

Japan and China

Japan has massive debts, but only to its own citizens. Government debt is like a deferred tax. This deferral mostly comes at a cost, although this is not currently the case. A country that is in debt to its own people has no debt at all, but its tax revenue has a different duration. If interest rates are high, debt rises; if they are at zero, it does not. It is a similar story in China, where the debts are also domestic. While Japan cannot grow itself out of the situation, China is seeking to do so with a policy aimed at nominal growth roughly in line with credit growth. Given that the debt is above all in the private sector, this could be a successful path.

Turnaround in monetary policy

Based on this assessment of the situation, our assumption is that the period of extraordinary central bank measures is coming to an end. The Fed has not bought any new government bonds since 2015, although it is replacing those that expire. It has also raised interest rates from zero to 1%. Added to this, it wants to reduce its bloated balance sheet by no longer replacing maturing bonds. This will likely bring back the market pricing US Treasuries. Somewhat later, in the course of the coming year, the ECB will follow suit and abandon its ruinous negative interest rates. This will allow the SNB to do the same. We therefore see the next twelve months as essentially being a phase for resolving the systematic error of negative interest rates. Interest rates will likely be determined by the market again toward the end of the decade, i.e. 2019/20. Market prices can also exaggerate, it is still a far more efficient pricing mechanism than for governent officials doing it.

A positiv overall picture – but a rocky road ahead

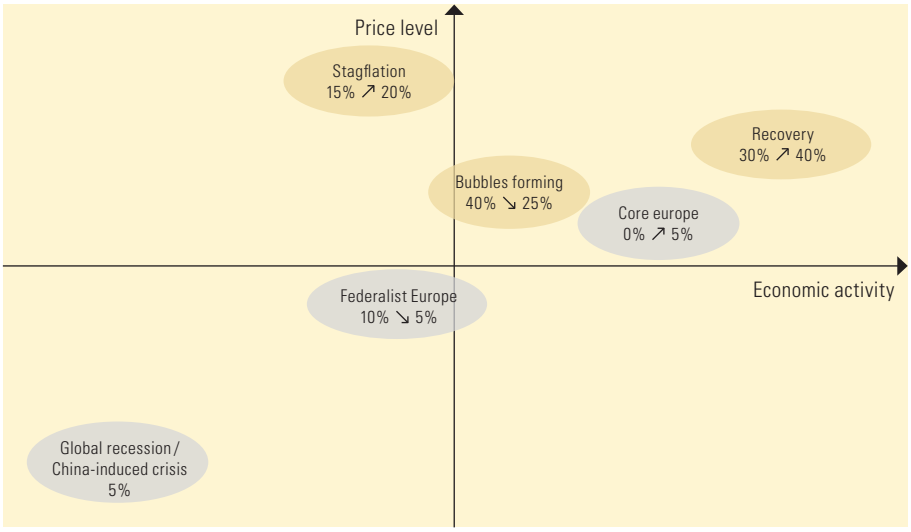
We are therefore looking to the future with optimism. That said, the transition back to a world shaped more strongly by market forces will be bumpy. The risk of permanent losses will likely come into play first in the case of long-term bonds. A 1½% Confederation bond is currently trading at 132% and being repaid at 100%. Avoiding a permanent loss is the primary task of any good asset manager, while temporary fluctuations in prices are to be tolerated on occasion in the interests of long-term returns. Equities therefore remain the heavyweight in our investment strategy, but we are becoming more cautious. The less willing an investor is to take corrections in their stride, and the shorter their time horizon, the more consideration should be given to reducing or partially hedging their equity exposure. We are avoiding long-term bonds, and are seeking to ensure broad portfolio diversification with various sources of yield. Talk to our relationship managers about your personal wealth situation, your goals, and what is on your mind. We will be happy to tell you what we would do in your position.



Christof Reichmuth, General Partner

EARLY INDICATORS POINT TO RECOVERY

Our take on the future



Yellow = the three scenarios described below

Summary

- Good economic data in the US and in Europe make economic recovery more likely.
- A Europe with a strong core and flagging periphery will crystallize after the elections.
- Stagflation risks have risen in the US, owing to full employment and the associated pressures on wages.

Recovery – global pick-up in growth

The threatened protectionist plans come to nothing, with the focus centering on business-friendly reforms. Coupled with positive consumer sentiment and major infrastructure projects, supports growth. Interest rates have turned around. The tight labor market drives rising wages, but inflation remains in check. There are signs of an economic recovery in Europe, which makes it through the election-packed year without a pronounced shift to the right. In China, the transformation from an export-based to a consumption-based model progresses. Confidence returns, companies embark on new capital spending projects, and global economic growth picks up.

Investment ideas:

- Overweight equities (tactically: cyclicals)
- Avoid fixed income
- Foreign currencies are attractive

40% probability 3 – 6 months

Bubbles forming – loss of confidence in central banks

(Geo)political trouble spots provide heightened uncertainty and prevent a global economic upswing. Share buyback programs and higher distribution yields are given preference over capital spending. Takeover activity remains high. Despite the solid US labor market, the Federal Reserve raises interest rates only tentatively. Elsewhere, central banks continue their expansionary courses, keeping interest rates low or negative. Helicopter money is used. Amid the dearth of alternatives, investors crowd into anything offering returns. The formation of bubbles moves into the final and most extreme phase. Doubts mount over the intrinsic value of nominal assets (bonds, paper money).

Investment ideas:

- Overweight equities (Focus on equities)
- Underweight fixed income
- Overweight USD & gold
- Real estate

25% probability 3 – 6 months

Stagflation – inflation rates overshoot

The US labor market reaches full employment. Reduced regulation, tax cuts, and infrastructure projects cause the labor market to overheat and increase pressure on wages. However, tariffs introduced on foreign goods and other barriers to trade quickly nip growth in the bud, and inflation overshoots the 2% target. Real interest rates in the US fall into negative territory. The USD weakens, with a positive impact on certain emerging markets. Europe continues to toil with competitiveness problems, and the resurgent EUR brings new pressure to bear on the peripheral EU states.

Investment ideas:

- Overweight hedge funds
- Underweight USD
- Overweight precious metals

20% probability 3 – 6 months

SIGNS OF MONETARY POLICY EXIT

Extraordinary measures nearing an end



Patrick Erne, Head of Research

The economic outlooks are solid, and the leading indicators are pointing to further growth. The direction taken by the markets in the coming months – in the short term at least – will be determined by the elections in France and the political debates on US tax reform and the planned spending on infrastructure. The uneasy calm on the markets could give way to heightened volatility in the foreseeable future.

Growth despite political imponderables

The forecasts for economic growth brightened further in Q1. The leading indicators – which are mostly based on surveys – are pointing to a pick-up in growth in all the major economic areas. Even in Europe, the outlook for growth have improved markedly of late. Driven by the export powerhouse Germany, the Eurozone posted its highest current account surplus for the past 20 years, and is benefiting overall from the weak EUR. The decisive question in the coming months will therefore be whether these positive survey findings actually translate into capital investment and higher consumer spending. The global growth scenario could gather further pace if the fiscal policy stimuli in the form of tax relief and infrastructure spending are pushed through in the US. However, the potential for surprises on the political front remains high, making the current upswing unpredictable. Donald Trump's unconventional style of government is doing little to generate trust, there are pivotal elections in the offing in Europe, and China is preparing for the National Congress of the Communist Party in the fall. Despite the political risks, we expect to see a slight acceleration in the global economy over the next three to six months.

GDP growth expectations	Current GDP growth	Growth expectation (12 months)
United States	2.0%	2.0 – 2.5%
Europe	1.7%	1.0 – 1.5%
Switzerland	1.0%	1.0 – 1.5%
Japan	1.6%	1.0 – 1.5%
China	6.9%	6.0 – 7.0%

Monetary policy & interest rates: exit signs

In the US, the economic data have improved to such a degree that in addition to the announced interest rate hikes there is talk for the first time of reducing the central bank's balance sheet. Although the Fed stopped buying additional government bonds some time ago, it still replaces bonds on its balance sheet when these expire. Bonds worth a total of nearly USD 1,000 billion are due to mature in the next two years. If the Fed begins to stop or curtail reinvestments with a view to shrinking its balance sheet, this could send interest rates shooting back up at the long end. We expect to see a slight rise in US interest rates across all maturities by the end of 2017. The other regions will follow the Fed's lead with some delay. The divergence of international monetary policy is therefore likely to reach its peak in the course of this year. In Europe, expansionary monetary policies have resulted in pronounced market distortions in the case of interest rates. Germany is booming, has a record-high current account surplus, unemployment is at its lowest level since reunification, and the real estate market is threatening to overheat. Despite all that, rates fell to fresh lows in Q1. This is in part a consequence of the QE program, and the security-driven mindset of many investors in Europe who are fleeing into negative-yielding Bunds. Against a backdrop of rising inflation, this is particularly risky in our opinion.

Interest rate expectations	3m rate (Libor)	Expectation in 3 – 6m	10y swap	Expectation in 3 – 6m
United States	1.2%	rising	2.2%	rising
Europe (Germany)	–0.4%	stable	0.7%	rising slightly
Switzerland	–0.7%	stable	+0.0%	rising slightly
Japan	+0.0%	stable	0.2%	unchanged

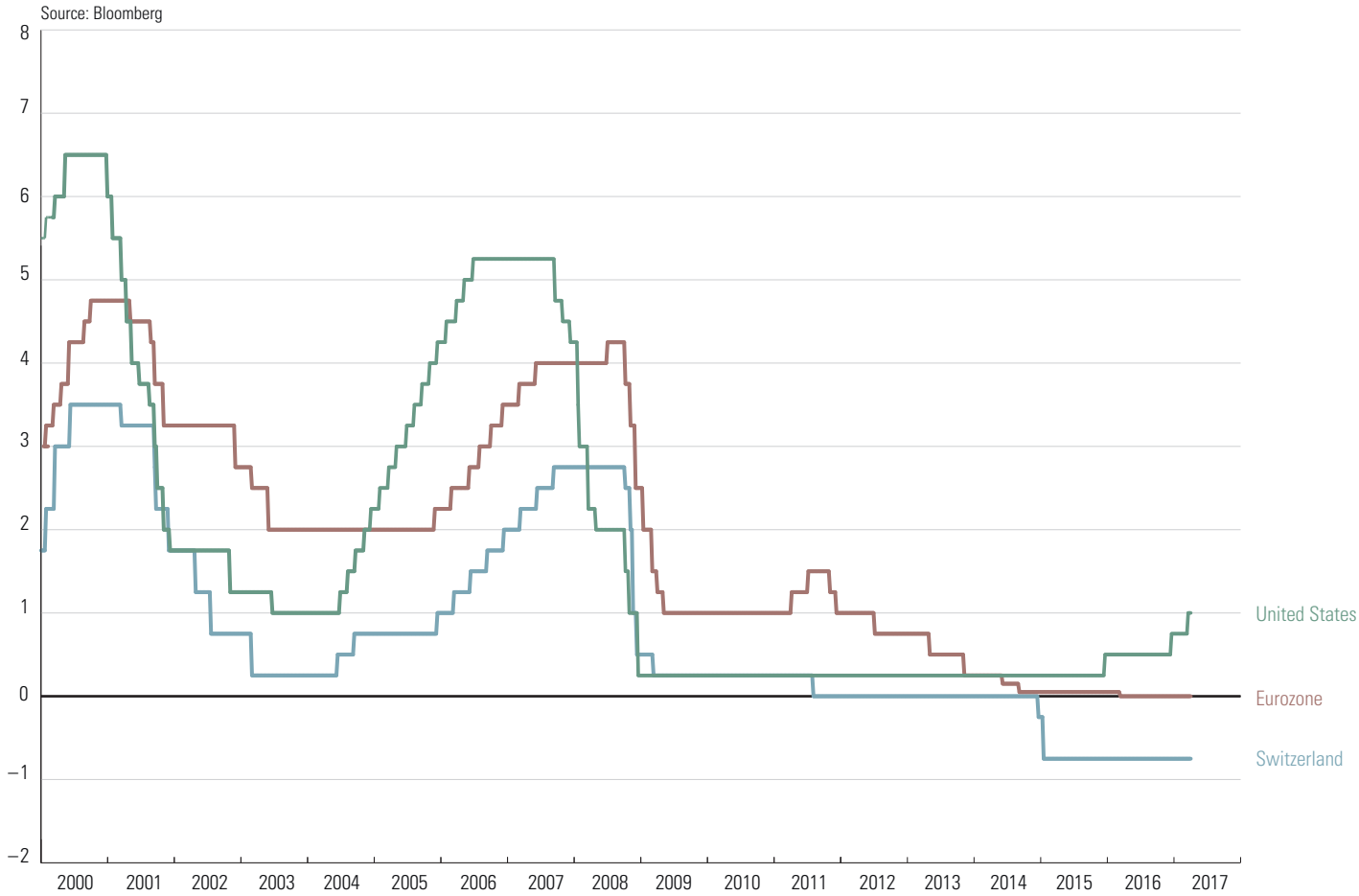
Equities – trend positive, but expectations high

Equity markets have risen again in recent months on the back of the broad-based economic recovery narrative, and much of the earnings growth is now priced in. Should Donald Trump fail to bring together the divided Congress and push through the promised tax cuts, infrastructure programs, and reduction in regulation in a timely manner, the current expectations of US equity market are probably too upbeat. A consolidation in equity markets hence appears likely. However, if these domestic policy obstacles were to be cleared and the promised measures introduced in short order, there would be further upside potential for US equity market, and in particular in cyclical sectors. International investors are largely steering clear of Europe's equity markets, this despite the fact that economic growth is picking up somewhat, while deflationary fears have been dispelled and ECB policy remains expansionary. It is therefore no surprise that the European stock markets are trading at a discount to their US counterparts. Barring any major upsets in the French elections, share price performance could therefore deliver a positive surprise. Emerging markets would be the main beneficiaries of a recovery in developed countries. Earnings growth is stronger in the former, while valuations are lower by comparison. In a recovery scenario, we continue to view emerging markets as the biggest winners.

Equity valuations and expectations worldwide

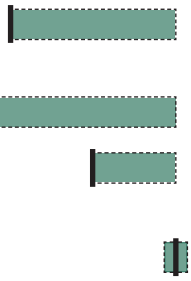
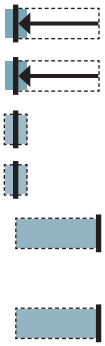
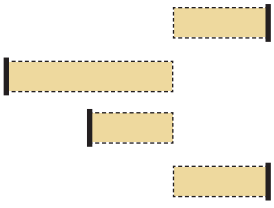
Market	Index level 21.04.2017	P/E	P/S	P/B	D/P	Expectation 3 – 6 months
S&P 500	2 356	18.3	2.1	3.1	2.0	sideways
DAX	12 031	13.7	0.9	1.8	2.6	sideways
SMI	8 554	17.4	2.1	2.5	3.4	sideways
TOPIX	1 489	13.5	0.8	1.2	1.9	rising
China H Shares	10 050	8.1	0.9	1.0	3.6	rising

Key interest rates heading for normalization



OVERVIEW – ASSET CLASSES

Somewhat more cautious, and diversify broadly

Asset class	Positioning	Change since last investment decision
	Min. –– – 0 + ++ Max.	
Bonds		■ We are sticking to the clear underweighting of bonds, focusing on short maturities. ■ 1/3 of the emerging market bonds in local currency; supplemented with MXN bond
Government bonds		
Corporate bonds		
Emerging markets		
Equities		■ Sale of defensive stocks from the consumer & telecom sectors. ■ Partial hedging via put options on S&P500 & EuroStoxx50 ■ Added investment in mid caps in Europe ■ Among emerging markets, preference given to China, India, Vietnam, and Russia.
United States		
Europe		
Switzerland		
Japan		
Asia / Emerging markets		
Alternative investments		■ Added investment in hedge funds in the segments macro, event-driven (in particular mergers & acquisitions). ■ Expansion of silver positions; we recommend approx. 4% gold and 1.5% silver.
Hedge funds		
Insurance-linked securities		
Commodities incl. Gold/Silver		
Real estate		
Currencies		■ Our currency rankings remain unchanged: 1. USD, GBP, XAU, NOK, SEK 2. CHF, CAD, AUD 3. EUR, JPY
USD		
EUR		
CHF		
Other		

previous current change

Please note:
If you would like to receive a copy of our Investment Policy publication with detailed market assessments, please contact your relationship manager or register with Nadine Vonwyl (nadine.vonwyl@reichmuthco.ch).

REICHMUTH BOTTOM FISHING

Philipp Murer

Our fund specializing in fallen angels offers an attractive addition

For some time now we have been recommending globally positioned companies with solid business models and recurring cash flows as the basis for our equity investments. In a market environment where growth and interest rates are low, quality stocks are attractive and have performed correspondingly well. The economic outlook has now brightened, interest rates are rising in the US, and the situation in Europe should also ease. Accordingly we are increasingly seeking carefully selected opportunities among companies that have come under considerable pressure of late and are deemed to have promise from a contrarian perspective. In light of heightened price risk of certain stocks, we recommend implementing the Reichmuth Bottom Fishing, which has successfully pursued a contrarian and anti-cyclical strategy since its launch 15 years ago.

Volatile but good performance



Source: Bloomberg

INTEGRAL CIRCLE: PENSION PLANNING

The right road map

«Integral Circle» **Events** Fall 2017

Occupational pension planning is a pivotal aspect in preparing to stop work, whether through early or regular retirement, a business handover, or succession arrangements. Some of the measures necessary should be addressed years before your working life draws to a close.

Many discussions on this issue center on having a plan that maps out the route to the ideal tax outcome.

1. What needs to be taken into account with regard to the 1st pillar (OASI)?
2. Do voluntary contributions to the pension fund make sense?
3. Do I need to watch deadlines to take advantage of tax benefits?
4. When is the ideal time to stop working?
5. How will my assets, income, and outgoings develop in the final phase through to retirement?

Individual stories

You will receive specific, bespoke recommendations for making the optimal arrangements in terms of pensions, taxes, financing, and investment.

We would like to invite you to join us at one of our four events in the fall to discuss these issues further.

- **Wednesday, September 6, 2017, 11.30am in Lucerne**
- **Tuesday, September 12, 2017, 11.30am in Zurich**
- **Thursday, September 14, 2017, 5.30pm in Zurich**
- **Wednesday, September 20, 2017, 5.30pm in St. Gallen**

We would be delighted if you could take part. If you have any questions or would like to register, please contact our relationship managers, who will be happy to help you.



Marco Danelli

WITH E-CONNECT, YOU ALWAYS HAVE ACCESS

Dionys Berwert on the new electronic platform e-Connect

Digitalization is the word on everyone's mind at the moment. Is this also an opportunity for Reichmuth & Co?
Connecting with clients at all times is an essential part of what our relationship managers do, and we therefore consciously do not want the personal contact or implementation of the investment strategy to be digitalized. After all, our individual approach is something our clients greatly appreciate. That said, technology does open up new opportunities, and people are now used to accessing information at any time using a wide range of devices. Our new e-Connect platform allows them to do so, and also provides other modern means of communicating with relationship managers.

What does the new e-Connect offer clients?
e-Connect is a state-of-the-art platform which provides a clear overview of assets, accounts, and portfolios, as well as analyses broken down by asset class and currency. The easy-to-use navigation allows clients to find specific positions, transactions, and performance data. e-Connect also offers clients secure channels for contacting and exchanging information with their relationship manager, and checking their statements online. Another popular feature is the e-mail notification service informing clients about transactions that have been executed, as well as delivering electronic versions of our regular in-house publications (Check-Up & Investment Policy).

What is special about e-Connect?
We have also incorporated our philosophy of integral investment management in the e-Connect platform, simply and pragmatically. At a glance, clients have a consolidated overview of all the assets held in the accounts they have with us, with asset classes and currencies aggregated. As well as their private wealth, we are thus also able to show pension vehicles, real estate, and other assets. If desired, we can even show portfolios the client holds with third-party banks if this information is shared with us.

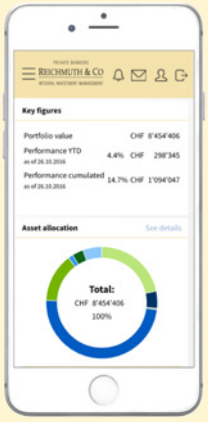
How much of a benefit does this new platform offer clients?
Clients who want to use the new platform can access key information whenever they like, 24 hours a day, i.e. also outside office hours and on their mobile devices. Those who are environmentally conscious are also happy to do without hard copies of account statements by post. On e-Connect clients can find all the information that they would otherwise receive on paper.

Who is e-Connect suitable for?
e-Connect is available to all clients, and we are convinced that many will use and appreciate this new platform. For fund clients, we would tend to recommend monthly delivery of the fact sheets coupled with an annual statement.

But the Internet is not safe and security is what I'm looking for in a private bank.
As one of the few private banks run by general partners with unlimited liability, security is sacrosanct for us. We are not an online bank, and therefore deliberately do not offer the possibility of entering stock exchange or payment orders in e-Connect. Our solution is based on the latest technological standards, and everything is carried out via a secure, encrypted connection. Only authorized users can gain access to e-Connect, and they have to go through several security measures to do so, including using a personal access code sent by text message. Of course, it is important that users protect their devices from being accessed by third parties, and make sure that their antivirus programs etc. are kept up to date.

What else is in the pipeline?
We are constantly looking for new technologies that would offer an added benefit for clients, and ways to integrate them quickly and easily in the platform. Examples may include digital contracts, archive services, automatic monitoring of investment restrictions, and online solutions with regard to our pensions offering.

new
e-Connect
2017



**e-Connect –
digital platform for clients**
With e-Connect you have a complete overview of your assets at all times. You can also keep up to date with our investment policy, and much more besides. We would be delighted if you were to choose to use this new communications channel, and your relationship manager will be happy to help you.