Check-Up

Reichmuth & Co Private Bankers Client Newsletter
Integral Investment Management | September 2018



Editorial

I have been at Reichmuth & Co for exactly 10 years. Initially, I was able to help in Zurich with the establishment of our branch. I am delighted to see how successfully the team and the branch have been performing. Read more in the interview with Urs Beck on page 8.

Just how much the world has changed over these 10 years becomes apparent in the lead article. Many of these topics and the resulting uncertainty should give food for thought. They are part of our discussions we hold with our clients and we take many lessons from this.

Nobody knows how the future will turn out – but we nevertheless have an idea of what the future might look like and this helps us to prepare for it.



Remy Reichmuth,
General Partner

A WORLD IN UPHEAVAL

How investors should prepare themselves

The world in 2018 looks extremely different than it did 10 years ago. As globalisation was accelerating at full speed, value chains were being transformed, and labour-intensive jobs were being outsourced to lowwage countries. The financial crisis brought this to an abrupt halt.

Bailouts by the largest central banks were needed to save the financial system from collapsing. These efforts proved to be the highlight of global cooperation, and the world economy appeared to be on the slow road to recovery. Only Southern Europe still languished in a recession due to high debt and restrictive EUR limitations. However, Brexit and the election of Donald Trump as the President of the United States ushered in the first signs of a new world order – one of upheaval. Today, politicians on the left and right are no longer pushing for their own interests; it is now a fight between those who are for or against globalisation.

Regional interests dominate

Regional and national interests are once again the top priority. Donald Trump is the most obvious manifestation of this. The US President is certainly no moral authority, nor is he a good example for people to whom relationships are more important than deals. Who can even tell what he really wants? The only thing that seems consistent is that the US administration wants to lower the large US trade deficit.

Higher USD as well?

If the administration is successful, foreign companies will be able to export less to the US. This means that they will earn less USD from their operational business. If they also hold debt in USD, they may have to buy USD just to service their debt, which would bolster the USD. At the same time, the US wants to attract new investments, i.e. capital imports. Both of these forces could temporarily put a halt to the notorious downward trend of the USD against the European "hard currencies", in particular the CHF.

Continued on the next page

Agenda
3rd Trimester 2018

"2019 Market Outlook" Our traditional annual outlook

KKL Lucerne:	6 November, 5.30 p.m. & 14 November, 6.30 p.m.
Hotel Einstein, St. Gallen:	8 November, 5.30 p.m.
Burgbachsaal, Zug:	5 November, 6.30 p.m.
WIDDER Hotel Zurich:	12 November, 5.30 p.m. & 19 November, 6.30 p.m.
Germany:	21 November, Schloss Hugenpoet, Düsseldorf
	26 November, Vier Jahreszeiten, Munich

Further events that Reichmuth & Co supports:

Reichmuth & Co Lecture No. 10 from the University of Lucerne with Dr Axel A. Weber on the topic of: "This time around everything is different – including fiscal policy? Financial crises, fiscal policy and feasibility belief" (23 October, 6.15 p.m., University of Lucerne)

Investors should keep an eye on how this scenario unfolds. In any case, the USD is no longer truly positive for investors in the long term, since America is too complacent about accepting somewhat higher inflation. This is also another reason for the long-term weakening of the US currency.

Europe at a standstill

There is less activity going on in Europe. The EU remains stubborn in its negotiations with the United Kingdom and Switzerland. The ECB wants to keep the EUR together at any cost and is maintaining its zero-interest policy. The new Italian government wants to boost the country's economy by means of additional fiscal policy measures and is aiming for more redistribution from north to south and is exerting pressure by flirting with the idea of leaving the EUR. Germany is hardly making any progress towards giving up national interests in order to enable this redistribution. Furthermore, Germany, the key European economic motor, is hitting a rough patch due to trade conflicts. German exporters are likely to feel this headwind, along with suppliers such as those from Switzerland.

Wanted: a vision for Europe

There is simply a dearth of forward-looking ideas for what is actually a large and strong region in the world. It would be far better if Europe were to put the spotlight on free trade in the common European economic area and not tie the issue to the free movement of persons. This would be more in keeping with the diversity and differences between the countries in Europe and would also offer the United Kingdom, Switzerland, and even embattled Turkey new possibilities for shared interests.

Is the trade dispute a negotiating tactic?

Some dogs' barks are worse than their bite. The US President's sharp rhetoric with its about-turns and pirouettes is certainly entertaining, but what is the point? Is he only using it to set up deals? If the trade dispute is really a mere negotiating tactic to achieve more free trade with fewer tariffs worldwide, then an inflationary boom could be expected thanks to generous cash flows, resulting in increased growth on the stock markets. If not, then traditional export companies are at greater risk than globally positioned companies, which we still prefer.

Technology – boom under threat?

The technology sector is also likely to attract more attention in the future, as the US is currently the industry leader and China wants to assume this position. Value chains are being reinvented – but it is now thanks to possibilities afforded by digitalisation rather than outsourcing to low-wage countries. If the trade dispute continues its shift to the technology sector, then the largest US indices will come under threat. This would in turn rapidly change the relatively relaxed mood on the financial markets.

Base effect key for long-term investment success

This is why we must bear in mind an important rule: we want to keep the asset base as high as possible, particularly in the face of challenging markets. This is best achieved by ensuring a widely diversified portfolio that takes into consideration a variety of developments. Unfortunately, the alternatives are still less than attractive. A shift from equities to bonds really only makes sense within the USD allocation. Faced with an expensive US stock market, investors can move part of their US stocks to USD corporate bonds, which are still yielding around 3% per year even with short maturities. Unfortunately, in Europe we do not have the luxury of such an option. Stocks are still the main focus here, although classic export assets are under greater threat from the trade dispute than globally active companies that only have their headquarters in Switzerland, for example. In our view, it also makes sense to increase the allocation for active and flexible managers, such as hedge funds, for example. As well, this is a way of safeguarding investments and being able to respond in the course of potential disruptive developments.

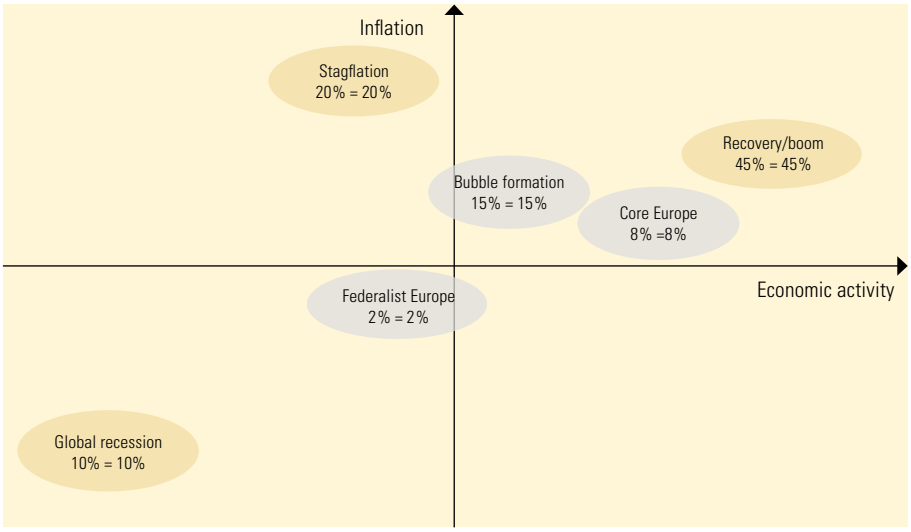
We would be delighted to look over your portfolio with you to ensure that, depending on the scenario, it still matches your investment goals and your risk tolerance.



Christof Reichmuth, General Partner

HEALTHY ECONOMY – HEAVY-HANDED POLICY

Protective tariffs still not affecting real economy



Yellow = the scenarios described below

Summary

- Economic outlooks are good, primarily in the US, somewhat weaker momentum in Europe.
- Although inflationary pressure is increasing, central banks are continuing to take considerable time with rate hikes.
- Political squabbling regarding a trade war still has no significant effect on real economy.

Recovery/boom – US economy moving at full speed

The global economy is performing well. Companies' confidence is resulting in new investment projects. Trump is making a breakthrough with his trade policy. Tariffs are being reduced and market access for US firms abroad is being improved. Fears of a global trade war are diminishing. Thanks to strong growth, central banks can cautiously wind down their purchase programmes and hike interest rates gradually. Thanks to significant investments in research and technology, China is continuing to move up the value chain. Progress is being made with its transformation from an export to a consumption model. In Europe, a forward strategy is also being adopted.

45%
Probability
3–6 months

Investment ideas

- Overweight shares (more and more cyclicals)
- Avoid fixed-income investments
- Overweight foreign currencies

Stagflation – protective tariffs stifling global trade

Trump's poker player diplomacy with respect to US trade policy is proving to have an enormous boomerang effect. Protective tariffs and retaliatory measures are being introduced in broad fashion and are stifling growth. The US is isolating itself further, and its image has sunk to a new low. Higher budget deficits are weakening the USD and fuelling an inflationary spiral. The US Fed is faced with a dilemma: lower interest rates due to the economic downturn or raise interest rates to fight inflation. Savers and employees who lose their jobs are the biggest losers when it comes to negative real interest rates. In Europe, the Southern European countries are once again under pressure due to the economic downturn.

20%
Probability
3–6 months

Investment ideas

- Underweight shares from industrial countries
- Overweight hedge funds
- Underweight USD
- Overweight gold

Global recession – downturn and debt crisis

We currently see three possible triggers: 1) The Fed raises key interest rates too quickly, leading to more defaults and increasing risk premiums. 2) The new populist government in Italy escalates matters. As this is met with little understanding by the other EUR member states, Italy declares overnight that it will leave the EUR, leading to a new banking crisis. 3) Debt levels in China exceed the critical level. An abrupt slowdown is followed by currency devaluation as a final resort, which has a catastrophic impact on the global export industry. Rising real interest rates and credit spreads see the central banks increasingly fall into the deflationary trap.

10%
Probability
3–6 months

Investment ideas

- Overweight cash
- Underweight equities (put options)
- Overweight fixed-rate (high-quality)
- Gold

IS THE US EXPANDING ITS HEGEMONY?

Diverging economic performance



Patrick Erne,
Head of Research

The global economic outlook has weakened somewhat. The diverging development between the US and the rest of the world could increase even more. Whereas the US economy is showing signs of overheating, growth momentum in the rest of the world is threatening to cool off.

The US job market is tightening further, with more vacant positions available than unemployed workers. This highlights the skills shortage, and wages should rise more sharply in the future as a result. US trade policy remains a factor driving uncertainty. It is questionable whether Donald Trump and his escalation politics will achieve the hoped-for deals within a reasonable time. The longer the escalation period lasts, the greater the uncertainty will be and its dampening effect on the investment climate. In our main scenario, we are still convinced that a negotiated solution with individual trade partners will be found in the coming months and the current economic growth will not be extinguished abruptly. The relationship with China plays a key role. We are more sceptical about this because the heart of the dispute – technological supremacy – extends beyond trade relationships.

Global challenges that remain

The leading indicators in Europe have weakened. Europe needs open export markets, and the longer the uncertainties remain for global trade, the more susceptible the economy will be to a down-turn. The political trouble spots in Europe (Italy, Brexit, migrant crisis) are still unresolved and are straining the investment climate. The weaker EUR continues to shore up the economy. China's economy is currently undergoing a long-term restructuring as it strives to transform itself from the workshop of the world into a leading tech nation. This fact, along with the unresolved trade dispute with the US, has recently put the brakes on the economic momentum. As a result, the government is increasingly utilising stimulus measures in order to shore up the economy.

GDP growth expectations	GDP current growth	Growth expectation 2018
United States	2.8%	3.0–6.5%
Europe	2.1%	1.5–2.0%
Switzerland	2.2%	1.5–2.0%
Japan	1.0%	1.0–1.5%
China	6.7%	6.0–6.5%

Rising US key interest rates

The US Fed is continuing its strategy. Two further interest-rate hikes are planned for the second half of the year and are already reflected in today's market expectations. In 2019, however, only one further rate hike is expected. A risk scenario for the financial markets would be a faster rise in terms of inflation, which would push interest-rate expectations upwards. In our view, there are some indications that US inflation will rise further over the target of 2% set by the Fed. If so, the US Fed would have to raise interest rates higher than forecasted. The USD liquidity shortage is already making itself felt in some emerging markets with budget deficits and high foreign debt. As a result, currencies in some countries (e.g. Turkey) have fallen drastically over the past weeks. This development could lead to an economic crisis in individual countries (see box).

No interest-rate normalisation in sight for Europe

The ECB's bond-buying programme is expected to end at the close of the year, but rate hikes are not expected until the summer of 2019. The question remains whether the economic and political situation will improve considerably by the summer of 2019 and if the ECB will be given the necessary leeway to raise interest rates. Even though the interest-rate differential compared to the USD has already reached historically high levels, a further widening is probable in the short term. The USD is thus likely to profit from further capital flows and will continue to be more attractive than the EUR. The room to manoeuver for the SNB remains limited.

Will the US yield curve become inverted?

Central banks in Europe (including Switzerland) and Japan remain cautious. A rate hike has been postponed for now. The interest-rate differential should keep the appetite for US interest-bearing securities high and maintain long-term US interest rates significantly under the nominal growth of 5% of late. The US yield curve has flattened as a result and could even become inverted if the capital flight to safe havens increases due to geopolitical uncertainties. An inverted yield curve would be a warning signal of a future recession.

Interest rate expectations	3-m rate (Libor)	Expectation in 3–6 m	10-year swap	Expectation in 3–6 m
United States	2.3%	rising	3.0%	rising
Europe (D)	–0.4%	stable	0.9%	rising slightly
Switzerland	–0.7%	stable	0.4%	rising slightly
Japan	0.1%	stable	0.4%	rising slightly

Record-high share buybacks

Despite high growth expectations, the large majority of companies recently reported impressive profit statements. US companies, in particular, recorded significant boosts in profits thanks to tax reforms and have recovered a great deal of capital from abroad. A substantial portion of these funds is flowing into share buybacks, thereby increasing the demand for shares. The year 2018 may be a record year in this regard. These are one-off effects, however, and cannot be repeated at will.

Record-high US margins

In recent years, lower inflation pressure enabled many companies to increase their margins. Margins for US companies, in particular, are at historic highs. In a climate with rising interest rates and full capacity, however, certain sectors are likely to find it harder to maintain those margins. Higher capacity utilisation requires more investment, and wages should slowly rise as well. Despite solid growth in earnings, some margin pressure could become pronounced for the first time in the coming months and cause disappointment. A stronger USD could also create some headwind for US companies, especially those with high exposures abroad.

Slight decrease in equity allocation

Overall, equities continue to be more favourable than fixed-rate investments. The focus remains on globally active quality stocks with stable cash flows. The ongoing price corrections in some markets (e.g. certain emerging markets) offer buying opportunities for long-term investors. At the same time, however, we are hedging a portion of the equity allocation with put options to cover the overall increased risk.

International share valuations and expectations

Market	Index level (23.08.2018)	Price / earnings	Price / sales	Price / book value	Div. / yield	Expectation 3–6 months
S&P 500	2857	20.7	2.2	3.4	1.8	sideways
DAX	12366	14.4	0.9	1.7	3.1	sideways
SPI	10804	12.8	1.8	2.0	3.1	rising
TOPIX	1698	13.5	0.8	1.3	2.1	sideways
China H-Shares	10815	8.1	0.9	0.9	4.3	rising

DÉJÀ-VU?

Is Turkey facing a "twin crisis"?

In our book "Déjà-Vu?", which was published in 2012, we analyse and examine the lessons from different crisis situations. A twin crisis is the combination of a currency and banking crisis. Such constellations often lead ultimately to a debt crisis ("triplet crisis"). This combination can result – at least in the short term – in a massive increase in (imported) inflation. Countries with a significant budget deficit are particularly vulnerable. As long as deficit countries maintain robust growth, a healthy fiscal policy and sustained high capital inflows, budget deficits are not a cause for concern. However, such phases often end abruptly and plunge countries into a crisis. A twin crisis is becoming increasingly apparent in Turkey. Following a currency devaluation, equity investments in such countries offer attractive upward potential. This could turn into an appealing opportunity over the next few months.

INVESTMENT POLICY OVERVIEW

Still no recession in sight despite American "anxiety disorder"

Asset class	Positioning	Change since the last Check-Up
	Min. — – 0 + ++ Max.	
Bonds		
United States		Focus on good quality US corporate bonds.
Europe		No peripheral countries or bank bonds.
Switzerland		Trapped in the European morass.
Emerging markets		Increasing pressure on emerging-market bonds.
Equities		
United States (partially hedged)		Opportunistic partial hedging.
Europe		Profit-taking within cyclical sectors.
Switzerland		Acquisition of SMI-securities
Japan		Abenomics favours equities in Japan.
Asia/emerging markets		Market correction offers chances for India and Vietnam.
Alternative investments		
Hedge funds		Focus on active strategies.
Insurance-linked securities		Clear skies ahead for decorrelated investments.
Raw materials incl. gold/silver		After a weak period for gold, prospects are now increasingly positive.
Real estate		High interest-rate sensitivity urges caution.
Currencies		
USD		Overall a balanced currency exposure with no clear favourites. Temporary (at least until mid-term elections) solid support for USD, which reflects the relative economic strength, among other things.
EUR		
CHF		
Other		



If any of our clients 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 at nadine.vonwyl@reichmuthco.ch.

PENSION SCHEME WITHOUT CROSS-SUBSIDISATION

Interview with Dr Guido Schüpfer, Lucerne Cantonal Hospital

Dr Schüpfer, the Lucerne Cantonal Hospital decided some years ago to restructure its pension fund. What were the reasons behind this step?
We had always been affiliated with the Lucerne Pension Fund. However, it had an upper limit for insurable salaries. The hospital council and executive board wanted to remove this unfair element and thus decided together with management to join the non-mandatory PensFlex collective foundation.

Did you feel the existing solution had any disadvantages?
Yes, the disadvantages of a large pension fund such as cross-subsidisation of existing pensions by the active contributors and the formation of collective equalisation reserves. Even our management were barely aware of such disadvantages at the time.

What decisive advantages do you see in the new, split solution?
Within the hospital we expect our management staff to work independently and act responsibly. We now have a modern pension-fund solution for a clearly defined group of people: the basic coverage will continue to be provided by the Lucerne Pension Fund, where the assets are administered collectively for all of the employees together. With the non-mandatory management pension scheme, each insured individual can determine their own investment strategy. In addition, we strive to be an attractive employer in order to create long-term loyalty among our employees.

Why did you choose the PensFlex collective foundation?
Our insured employees can benefit directly from the personalised attention of the PensFlex insurance consultants when it comes to insurance, pension, and taxation issues, as well as from the investment specialists provided by Reichmuth & Co, who advise on individual investment strategies. The fact that this solution removes the need for cross-subsidisation and/or co-financing from collective equalisation reserves in the future was a very positive element for us.

Were there any other reasons for making this change?
Many employees realised, and rightly so, that PensFlex also offers an opportunity for tax optimisation and retirement planning.

And for you personally?
The tax-deductible purchases that I can make from my securities account as well as the diversification of the pension fund formats were key factors for me. On the one hand, I can reduce my taxable income, and on the other I can expand my retirement provision. Since I chose a savings plan with the highest contributions, my retirement provision increases more rapidly and my income-tax situation is also optimised.

What advantages do you experience with your PensFlex securities account?
The personal securities account statement makes the growth of my assets very transparent. Additionally, my client relationship manager at Reichmuth & Co reviews my investment profile in the securities account and matches it to the private wealth allocation.

How does that work?
I sit down with the PensFlex pension consultant and the investment specialist from Reichmuth & Co for an annual tax planning session and we examine the possible purchases and the strategy for the pension fund capital.

Have you already heard about the possibility of a mortgage loan through PensFlex?
Yes, the mortgage solution from PensFlex is an attractive investment idea, especially in today's low-interest environment. It is risk-free, not subject to risks from rate changes and has a stabilising effect on the investment portfolio. The credit note for the tax-free interest, currently at 2.55% p.a., is extremely interesting. Coupled with the higher write-off option for tax purposes, I get double the benefits with it.

How flexible and innovative do you find this structure?
Both the foundation and Reichmuth & Co are open to input, ideas and new investment models. We developed the mortgage solution together, for example.

luzerner kantonsspital
LUZERN SURSEE WOLHUSEN

As a main regional hospital, the Lucerne Cantonal Hospital ensures that comprehensive medical care is available close to home for those living in central Switzerland. The LUKS is the largest regional hospital in Switzerland. Thanks to four locations and a high level of medical expertise, its almost 7,000 employees, 856 beds and 46 operating theatres and birthing rooms provide care to patients as close as possible to their home, family and relatives.



Dr Guido Schüpfer
MBA HSG, PhD, Senior Physician KAIRS & Medical Chief of Staff

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10 YEARS OF REICHMUTH & CO IN ZURICH

Challenging and interesting – a look back and ahead

The Zurich branch will celebrate its 10th anniversary on 1 October. What comes to mind when you think back to when it opened?
In 2008, the financial markets were rocked by a storm that made our first steps a challenge – it was an interesting and exciting time. And looking back, it is amazing to see how the banking landscape has transformed itself in the meantime.

Why did Reichmuth & Co choose Zurich as a location?
Thanks to our clients from Zurich, we knew that our integral approach would be unique here as well. It is also an economically strong region with many entrepreneurs and SMEs at home here, and based on our experience as an owner-managed bank, they share the same values as we do. Finally, the close proximity to the airport is also a key factor for our international clientèle.

What were the main reasons behind your decision to join Reichmuth & Co?
As is so often the case, people were the main reason. I sensed that everything was focused on client satisfaction: "No company can keep going if its clients are not satisfied. However, if our clients are satisfied, this will also benefit our company in the long term." I have never stopped believing this. I was also impressed by the fact that there are no budget targets. Furthermore, it was apparent to us all that this compact and owner-managed family company offers a scope of activity worth aspiring to.

How did the expansion go? Were you able to gain a foothold quickly?
Was 2008 an ideal time to make this move? Yes and no! On the one hand, investor uncertainty was high and time was needed to build trust with new contacts. On the other hand, many clients from other banks were very dissatisfied. All in all, we made a solid start and grew steadily during the first few years. I was particularly pleased by the excellent continuity we had in our team – other than a few changes we are still the same group we were that first day 10 years ago! A few new employees have joined us, and both their expertise and personality traits have been the right match. Over the past few years, we have thus been able to grow even further and enjoy pleasing levels of new client acquisitions.

Where is this growth coming from?
From a real cross-section. Firstly, there is our individualised, personal approach. It is unique, especially at a time when many banks are standardising their services and optimising process efficiency. Secondly, we have the pension fund division with retirement planning, and our individualised pension solutions. Thirdly, on the investment end of things, there are niche solutions such as infrastructure or alternative investments, which in our opinion really strengthen a portfolio. And finally, there are always those satisfying recommendations from existing clients – this display of trust never fails to motivate us further.

Is there anything you would do differently today?
I don't believe I would do very much differently – even though at times I thought differently. However, at Reichmuth & Co, we have found the environment that moved us to change. With patience and perseverance, we also convinced our contacts that Reichmuth & Co was not only the right choice for us, but for them, too.

What are the focal points and targets for the future?
Firstly: keep our focus on the integral approach. This holistic view is the only way to ensure that we are on the best possible path for the future. This is particularly important because I believe that the financial markets could become more turbulent once again. Secondly: despite the flood of regulations, avoid letting that affect the individuality in client relationships. We have succeeded in this over the past years but we must not let our guard down. And thirdly: digitalisation. It offers tremendous opportunities, both for clients and the bank. I'm referring to such things as developing new solutions for the clients themselves as well as utilising those from external partners when it makes sense to do so. The past 10 years have been challenging and interesting. I'm convinced that the next 10 years will not be any less so – and I look forward to the challenge.



Urs J. Beck
Head of Zurich branch, Partner