Check-Up

Reichmuth & Co Private Bankers Client Newsletter
Integral Investment Management | January 2020



## Editorial

As 2019 draws to a close, we can look back on a very satisfactory financial year. We now find ourselves at the beginning of a new decade. What will it bring?

The last few years have been marked by the emerging new world order, the accelerating technological revolution, and daring experiments in monetary policy. Together, they have created a new narrative, a story that most people believe. It will accompany us during the '20s and sounds something like this: "Interest rates will remain low forever, climate change must now be combated as quickly as possible, and the state must play a more important role."

In this Check-Up, you can read how we are preparing for this narrative. We wish you all a happy and successful new year.



*Jürg Staub,*
*General Partner*

# WHAT WILL THE '20S BRING?

## Low interest rates, bigger state, fight climate change

*After decades of fighting for a bigger state, the left is receiving support from an unlikely ally, namely the European Central Bank (ECB). It is "threatening" not to raise interest rates unless fiscal policy now assumes the main burden of stimulating the economy.*

Expansive fiscal stimuli could be implemented quickly and effectively through tax cuts. Unfortunately, however, the same ECB has virtually robbed politicians of this option with its extremely low interest rate policy. That is because its negative interest rate policy has led to the inflation of assets, which in turn feeds the left-wing argument that the rich just keep getting richer. Politicians are pleased with the ECB's call for an expansive fiscal policy, but who dares to implement it by cutting taxes? As a result, we must expect expenditure increases. This is not a recipe for sustained healthy growth, but rather for a sustained increase in the public spending ratio.

### Decarbonisation of the economy

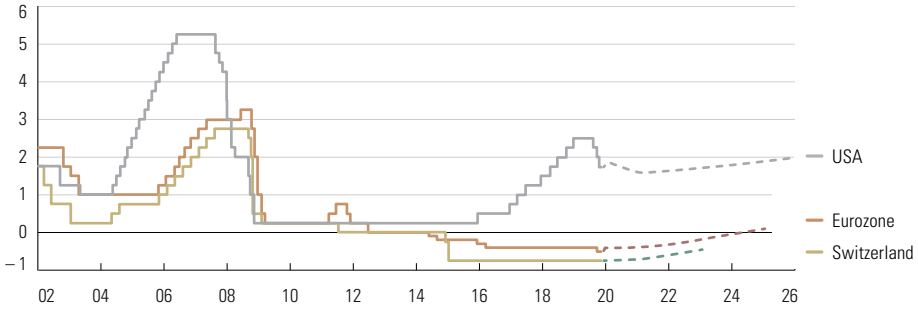
The core of economic activity is almost always the "conversion of energy". Human-induced climate change is therefore the flip side of the coin of economic success resulting in a significant increase in prosperity. So, if economic activity heats up the atmosphere by releasing previously locked-up $CO_2$ too quickly, we simply must find better solutions. This can be managed centrally or with a market-oriented and liberal approach. With the current low $CO_2$ price, it is almost impossible to develop viable business models for new technologies. A steering tax, which would be paid back in full to the citizens themselves, would be a liberal and market-friendly solution. The result would be a boom in new technologies that are not based on fossil fuels. With technology-neutral regulations, the best solution would prevail.

### More directives

Unfortunately, it is more likely that the EU will continue to operate with even more

*Continued on the next page*

**Market expectations for central bank interest rates**




Source: Macrobond, Bloomberg (As of 13/12/2019)

political influence, subsidies, direct interventions and bans. The European Investment Bank (EIB) is also anticipating a new role and positioning itself accordingly. It wants to lend its voice in support of decarbonising the economy on favourable terms, financing it with bonds which, thanks to their top creditworthiness, can then be monetised again by the ECB through bond purchases. The carousel continues to turn...

## Permanent low interest rates

Meanwhile, almost everyone now believes that it is nearly impossible for interest rates to rise any more. The central banks have cemented them at virtually zero. Nevertheless, everyone is also now realising that permanent negative interest rates are a stupid idea with more negative than positive effects. It seems to me that it is only a matter of time before governments try to move away from this approach to save face. Stock prices have reacted to this low interest rate environment and have risen despite falling profit expectations. In other words, stock markets have become more expensive.

## Are we facing a crash?

Stock market booms end either because of an unexpected event or because a recession is imminent – or because nobody worries any more and markets simply become too expensive. Examples of unforeseeable developments include the rapid deterioration of the social and economic situation in Latin America and Hong Kong. A global recession is not yet foreseeable, but the probability of the third scenario taking place – that markets become too expensive – is increasing. At the moment, it does not look like a severe slump is looming. However, a correction of 20% is always possible and must be taken into account in the portfolio structure.

## A US flu going around?

The upcoming US presidential election will cause uneasiness in the new year. If the economy continues to hum along and President Trump survives the impeachment process, his chances for a second term in office are good. If not, and depending on who wins the Democrats' candidate election, the US stock markets could face a sharp correction. Elizabeth Warren, for example, is still too far to the left, but her focal points address the current mood. She wants to introduce a wealth tax, put financial institutions on a tighter leash, regulate pharmaceutical prices and break up tech companies. It is quite possible that these topics will also catch on in the USA.

## What if interest rates suddenly shoot up?

From today's perspective, short-term interest rates in Europe are not expected to rise above zero. Long-term interest rates need to be closely monitored, especially once they are able to establish themselves again free of market interventions. They could rise as a result of a higher supply of government bonds but also due to higher inflation and growth figures. As soon as this becomes foreseeable, today's bond replacement instruments such as non-cyclical consumer stocks with healthy dividends will come under some pressure.

## What will 2020 bring?

There is reason to be thoroughly optimistic when it comes to the real economy. Not only will interest rate and monetary policy remain expansionary, but fiscal policy should also have an impact on demand. We therefore remain positive for equities, even though valuations are high and fluctuation risks are increasing. We also remain positive for precious metals, even though we no longer expect lower negative interest rates. At zero interest rates, gold remains an instrument that provides the portfolio with some stability in bear markets. Precious metals have no returns, but bonds barely have any either, which is why we remain underweight in bonds. Their only role is to help stabilise the portfolio. Since no presidential candidate as of yet wants a strong USD and because the interest rate differential against the EUR is tightening, we are becoming somewhat more cautious vis-à-vis the USD. The portfolio can be supplemented with investments that grow more independently of the interest rate or stock market, not least because a price is not available daily. Determining which products are right for you and finding the best mix both form part of our personal conversation with you. We are looking forward to it.

*Christof Reichmuth,*
*General Partner*



**"Abyssus Abyssum Invocat"**

Watch our 2020 Market Outlook in a recording at the KKL Luzern on 25 November 2019:

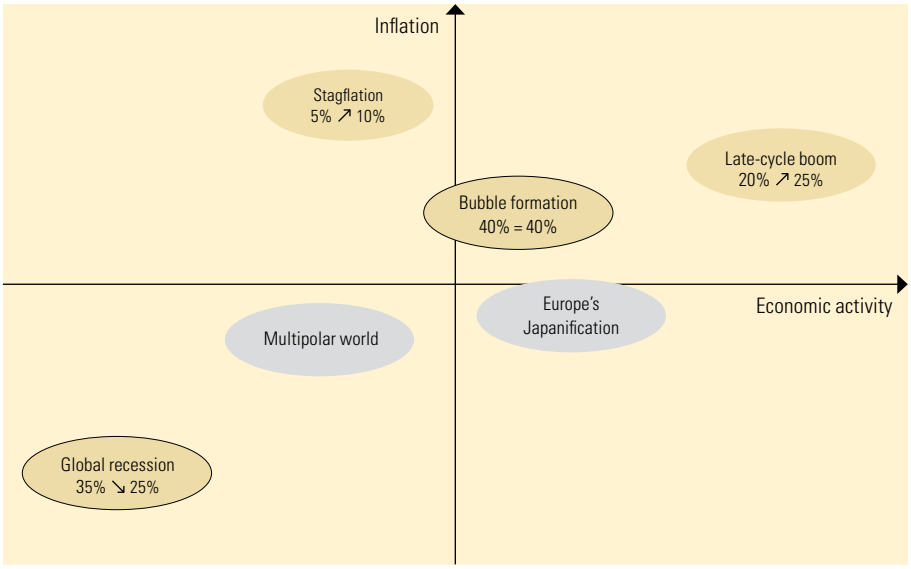
**www.reichmuthco.ch**

**New video**

# OUR SCENARIOS

*Silvan Betschart and Cajetan Bilgischer*

## Economic stabilisation with no prospect of a strong recovery




*In bubbles = described scenarios  Yellow = economic scenarios  Grey = political scenarios*

**Summary**

- Equity-friendly strategies remain highly weighted
- Recession risks have diminished despite political uncertainties
- Stabilisation of manufacturing industry at a low level
- Policy of open monetary floodgates ad infinitum
- Fiscal policy becoming increasingly important

### Bubble formation – Open monetary floodgates ad infinitum

Central banks are aware of the high level of global debt and respond to any stock market correction by further lowering interest rates. Balance sheet normalisation is completely off the table, and QE4 is making the rounds. Inflationary pressure remains low despite the good labour market situation. Companies invest less in growth and push share buyback programs. Political pressure on the central banks remains high. Higher inflation becomes increasingly probable to solve the problem of public debt. Amid a lack of alternatives, investors flock to anything that offers returns. Doubts about the intrinsic value of nominal investments such as bonds and paper money grow. Bubble formation enters its final and most extreme phase.

**40%**
Probability
3–6 months

**Investment ideas**

- Overweight shares, focus on equities
- Overweight real assets
- Underweight commodities
- Gold
- Overweight real estate

### Global recession – The calm before the storm of the negative spiral

Although a partial settlement in the trade dispute will temporarily stabilise the economy and boost private consumption, the fragile economy is exposed to many adversities worldwide. In addition to the "tug of war" over world domination taking place between the USA and China on many different fronts, these also include rampant populism with unforeseeable consequences. Investments are being held back, and the pressure on margins is increasing. Massive interventions are undertaken too late and are inadequately coordinated. Popular uprisings and the rejection of globalisation do not bode well for the world economy.

**25%**
Probability
3–6 months

**Investment ideas**

- Overweight cash (CHF and gold)
- Underweight equities (hedges)
- Overweight fixed-income investments

### Out-of-the-Box – The stepping stone for the future of financial repression has been laid

Debt problems can be solved in three ways: 1) Failure & restructuring, 2) Saving & growing out of it or 3) Redistribution & inflation. This is reminiscent of post-war debt management, in which the yield curve was temporarily frozen despite high inflation rates, with savers and holders of nominal value investments suffering enormous losses in purchasing power due to negative real interest rates. On the other hand, US stock market investors were actually able to increase their purchasing power. At that time, it was possible to significantly reduce the debt ratio by unconventional means. What options are available today with modest growth rates? For politicians, only the third option (redistribution and inflation) seems feasible at present. Although inflation is currently not widely discernible, it is considered one of the most underestimated risks in today's environment – which is one of the main reasons why we see gold as an essential portfolio component.

# GROWTH STABILISATION

## Bottom formation in the manufacturing industry



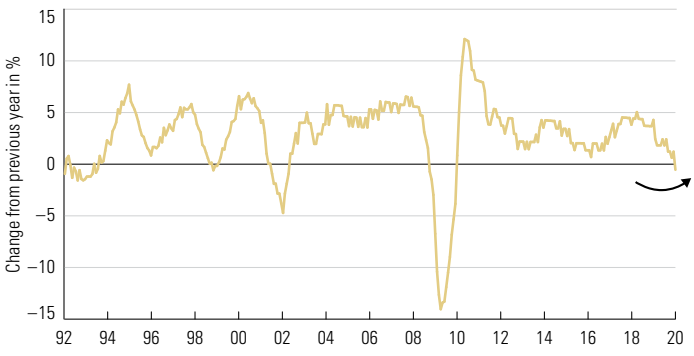
*Patrick Erne,*
*Head of Research*

The economic cycle has found firmer footing. A rapid slide into recession is not unlikely in the coming months. Even if political uncertainties remain high, we expect a favourable environment for equities in the first trimester. Following the significant share price increases in 2019, however, the same high growth rates can no longer be expected. The focus for Swiss investors remains on high-dividend equities.

### Decline in manufacturing industry stabilises

Global economic growth returned in 2019, but it should level off in the first half of 2020 – although at significantly lower levels compared with the previous year. The weak growth in 2019 was particularly noticeable in the manufacturing sector. In some industries, it is now becoming apparent that inventories are gradually returning to normal levels, and that a new order cycle could begin. In some key sectors, such as technology, the launch of 5G also means new product cycles are on the horizon, which should support this trend and increase capacity utilisation once again. The picture is somewhat less clear in the automotive sector, which is undergoing structural change and putting a particular strain on the German economy. The weightier service sector posted relatively stable growth worldwide in 2019 and hardly weakened, especially in the USA. This trend is supported by ultra-expansive monetary policy. This means that high-quality companies are benefiting from further reductions in refinancing costs. In some Asian countries, fiscal programs were also expanded to support the economy. In China and India, for example, taxes were lowered, and in Japan an additional expenditure package with various new elements was adopted. While tax cuts provide an immediate stimulus, infrastructure projects take much longer to inject money into the economy. In Europe, the demand for more fiscal spending has been on the agenda for some time. However, concrete measures are still lacking, and reaching a political consensus is difficult. Consensus seems to prevail only in the area of investment incentives for achieving a sustainable climate policy. As welcome as these measures may be, overall they are unlikely to succeed in making a very significant positive impact on economic growth in Europe.

### Global industrial production turning around?




Source: Macrobond, Bloomberg (As of 06/12/2019)

### Low interest rates – Excess in credit markets

The US has abandoned its cycle of interest rate hikes early and has already cut interest rates three times. Most other central banks have also lowered interest rates recently. Monetary policy continues to be ultra-expansive for the time being and will remain so in the coming months. In some regions, the long end of the yield curve has recovered slightly from the lows of August. With the market showing signs of recovery, this trend is likely to continue for a while, but overall long-term interest rates will also remain low for the time being. Inflation expectations remain moderate, despite full employment in many parts of the world. Fixing the long end of the yield curve cannot be ruled out. This has already happened in Japan in the past, but could also be utilised in other regions, as described in the Out-of-the-Box scenario on page 3.

Credit markets are showing increasing divergence between the worst segment and better-quality debt. While the credit spreads for bonds are being downgraded to a single B rating as a result of investors' hunger for returns, there has been a significant increase in the lowest quality. This applies above all to companies in cyclical industries such as energy. Although default rates for this segment are on the rise, the majority of companies continue to enjoy access to extremely cheap capital, and refinancing is not a problem. This contrasts sharply with the steep rise in corporate debt as shown in Chart 2. However, as long as the economy stays reasonably stable and corporate cash flows do not come under pressure, credit premiums will remain low. Although this corresponds to our baseline scenario for the coming months, we would not make any major compromises on quality. We are adding a number of emerging market bonds to complement our fixed income business. Although credit spreads

have also fallen in this segment, they are still attractive compared to US-treasuries.

### Low credit spreads despite rising indebtedness




Source: Macrobond, Bloomberg (As of 06/12/2019)

### Equities remain a favourite

With the global economy stabilising, monetary policy remaining ultra-expansive and few attractive alternatives available, equities remain the preferred investment category. Since the valuation gap between defensive and somewhat more cyclical business models has widened considerably in recent years, we see further upward potential for companies that are somewhat more sensitive to the economic cycle. Regionally, we continue to hold a substantial portion of our share quota in quality and dividend equities in Switzerland, where the yield differential between dividends and risk-free interest rates remains very high. We prefer Asia over Europe. Although both markets are dependent on exports, the domestic market in Asia is many times larger. Even though growth rates in China continue to decline slightly, companies in the consumer, healthcare, technology and internet sectors are still offering above-average growth potential. Barring any further escalation in the trade dispute, our attitude toward Japan is also more positive now. Thanks to its proximity to China, Japan benefits from inter-Asian trade. In addition, in recent months Japanese companies have been increasing their efforts to align their corporate culture more closely with that of their shareholders (corporate governance). The public debate on making index membership in the future dependent on transparency, corporate structure and free float has contributed to this trend. This could significantly improve the recovery potential for the return on equity of Japanese stocks in the medium term.

Political events will continue to have a significant impact on stock markets in 2020. In addition to the trade dispute, the US-election in particular is likely to affect the stock market. While taxes were reduced under Trump and will remain low, the opposite may be expected if the Democrats win. Higher taxes and tighter regulation in individual sectors (e.g. technology, pharmaceuticals and energy) would clearly have a negative impact on the profit expectations of US-companies. Although it is too early for any reliable election forecasts, we consider the outlook for equity markets outside the US to be more attractive, at least as long as there are signs of growth stabilisation.

***In short***

### The best investment ideas for 2020

Virtually all asset classes performed positively during the past investment year, including Swiss equities. Even though Swiss dividend stocks are once again among our favourites in 2020, we recommend diversifying the equity portfolio geographically and across sectors. We will be weighting nominal investments, in particular bonds, low in 2020 due to the expected stabilisation of growth and the already extremely low interest rates. Our most preferred investment ideas for the new year are:




**High-dividend stocks**

Swiss dividend stocks remain popular in a negative interest rate environment. We recommend a basket of robustly financed companies in Switzerland that is diversified across various industries. The selection of good companies is considerable and extends far beyond the three index heavyweights Nestlé, Roche and Novartis.



**Gold**

Rising government deficits and the central banks' commitment to expansive monetary policy over a longer period of time are pushing real interest rates deep into negative territory. In this environment, gold remains in demand and offers good portfolio protection against unexpected rises in inflation or geopolitical risks.




**Asian equities including Japan**

These stock markets have upward potential if things settle down in the trade dispute. Due to political uncertainties, these stock markets have been underweighted by international investors in recent years and are valued relatively cheaply.



**Infrastructure**

"Cash flow is king". Real-asset investments with regular significant distributions promise stable and attractive returns even in an environment of low economic growth.



**Alternative investments**

In the reinsurance market, insurance premiums are on the rise after two years of catastrophic losses (2017/18). Higher returns and a low correlation with traditional investments make insurance-linked securities attractive as portfolio additions.

# INVESTMENT POLICY OVERVIEW

*Cajetan Bilgischer*

## The mood is positive for equities – even in a US election year

| | Min. | Max. | |
|---|---|---|---|
| **Liquidity** | 0% | 10% | Tactically, we are keeping some liquidity in order to be able to react flexibly to changes in our market view. |
| **Bonds** | 20% | 60% | The majority of quality bonds are yielding negatively, which makes a long-term investment in this asset class unappealing. Even investments in inferior bonds are not being compensated adequately. Emerging market bonds offer the most attractive yield potential. |
| **Shares** | 20% | 60% | Swiss shares, especially dividend stocks, are among our favourites in the current negative interest rate environment. The emerging stabilisation of the manufacturing sector makes cyclical stocks in Asia (including Japan) attractive. The catch-up potential of these stocks will be accentuated by any signs of easing in the trade dispute. The closer we get to the US presidential election date and the more likely it looks that Donald J. Trump will be re-elected, the more constructive we will become for US equities, despite the high valuations. |
| **Real estate** | 0% | 15% | The attractive distribution yields will also be maintained in 2020 with rental income. We consider the potential of the properties themselves to appreciate further to be limited. We prefer office and industrial properties over residential and retail properties. |
| **Alternative investments** | 0% | 25% | In the area of alternative investments, we favour targeted investments with no or very low correlation to the financial markets (e.g. insurance-linked securities) in addition to strategies that exist for adverse scenarios. |
| **Gold** | 0% | 10% | We regard this precious metal as an essential portfolio component, whether to hedge any setbacks on the stock markets or to protect against surprises on the inflation front and counter current elevated and growing geopolitical risks. |

| | |
|---|---|
| Switzerland | ++ |
| EU | – |
| USA | 0 |
| Emerging economies | + |

● Our strategy's neutral position ◇ Current weighting

**Our clients can request our detailed investment policy with thorough market estimates from their client relationship manager or register for it themselves by contacting nadine.vonwyl@reichmuthco.ch.**

# OUR SOLUTION SECURES PROVEN ADVANTAGES

## New FIDLEG legislation come into effect on 1 January 2020

**Focus on investor protection**

The financial crisis was followed by calls for increased regulation of the financial sector and improved investor protection. One consequence of this was the MiFID2 investment guidelines, which have been in force in Europe for the past year. However, this was not only a cause of joy among banking clients, as it entails a great deal of additional administrative work, and investors sometimes felt that they had been "disenfranchised". Fortunately, with the new Financial Services Act (FIDLEG), the "Swiss finish" is much more practice-oriented and the client's personal responsibility is not eliminated to such an extent. FIDLEG enters into force on 1 January 2020. Swiss financial institutions have two years to implement the new standards.

**The "Reichmuth & Co finish" adds to the "Swiss" one.**

Convinced by fundamental values such as personal responsibility and individuality, along with a more liberal, critical view of the state, we began engaging with FIDLEG at an early stage. Our aim was to ensure that, within the scope of the additional laws and regulations, there continues to be sufficient room to exercise the individuality and personal convictions that our clients value. It was all the more satisfying when we realised that the new regulations offer an additional differentiating factor! The experiences reported by and with our clients – who also maintain securities portfolios at other banks – showed how impersonally and uncharitably laws can be implemented when it comes to client contact. This was especially true when the focus was primarily on the legal framework – and not on the clients.

**What does FIDLEG mean for you in concrete terms?**

The bank is now obliged to check that its services are appropriate and suitable for its clients. With regard to appropriateness, it is necessary to verify that clients have the required expertise of the financial instruments. If not, we will of course be happy to provide more detailed information to our clients. During the suitability test, it must be determined if the chosen investment strategy also fits a client's financial circumstances and risk preferences. These verification obligations can vary depending on the type of mandate chosen. In this context, we have also revised our mandate forms and aligned them to optimally meet the needs of our clients (see overview).

**"Opting-out" as an additional simplified implementation**

FIDLEG is oriented towards different client segments, which regulates the level of investor protection. Private clients with a high net worth have the option, subject to certain conditions, of being classified as "professional clients" and making use of the "opting out" procedure. The above-mentioned checks must then be carried out to a limited extent only or can be dispensed with entiretly in certain cases. The voluntary "opting-out" is therefore appealing to those clients who prefer a straightforward approach and wish to emphasise their own responsibility.

We are very pleased to use our solutions to continue to work for you within the FIDLEG parameters in a very individualised and unique manner. If you have any feedback, please do not hesitate to contact us. Our client relationship managers will be happy to answer any questions you may have.

**Overview of our mandate forms**

| Asset management | "Portfolio" investment consulting | "Transaction" investment consulting | Self-management |
|---|---|---|---|
| **The premium package for achieving your individual goals** | **Self-determination with a professional sparring partner** | **The principle of dual control before the final investment decision** | **Identification with the values of genuine private bankers** |
| You delegate the management of your assets to Reichmuth & Co. Together we will define an investment strategy tailored to your personal needs to achieve your goals. Personal aspects and your integral asset situation can be taken into account on a completely individual basis. Your investment portfolio is actively managed and also continuously monitored with regard to risk management. | You will have an expert and professional sparring partner at your service. Your client relationship manager will actively support you in achieving your desired portfolio structure and proactively monitoring your assets, including regular portfolio health checks. You decide how often and to what extent we should provide you with support – as well as handling effective implementation in your portfolio. | For you, taking responsibility for portfolio structuring is the most important issue. However, before making a final investment decision, you appreciate input from your client relationship manager. "Transaction" investment consulting is a condensed version of "Portfolio" investment consulting, yet you do not want to forego an independent second opinion. | You appreciate the structure and values of genuine private bankers, but want to make truly independent investment decisions. You follow the events on the financial markets completely independently and appreciate a personal partner who ensures the efficient and flawless processing of your stock market orders. |



*Remo Hegglin,*
*Client Relationship Manager*

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# "INDEPENDENCE IS A CORE VALUE"

## Interview with Christof Reichmuth on strategic orientation

**Christof Reichmuth, what is your view of Reichmuth & Co at the turn of the decade?**
I see us as a robustly healthy, solid and growing private bank with loyal and forward-looking clients. We have already experienced significant ups and downs on the financial markets with many of them. The mutual trust we have is a key factor, especially in difficult times. I was also very pleased about the active support of our employees as we prepared this year's strategy revision. They completed important future-oriented projects and surprised me in a positive way.

**Where do you see the greatest challenges?**
The greatest challenges in recent years have been regulation and negative interest rates. The regulatory frenzy is slowly abating, and the final bureaucratic hurdles such as FIDLEG now have to be implemented in a client-friendly manner. The enormous challenge of negative interest rates has also passed its peak. As private bankers, the most important challenge for us is to identify both the current and future needs of our clients. We want to meet or – even better – exceed their expectations. And of course, the market situation and retaining high-calibre employees who live our culture are a continuous challenge for a private bank.

**Digitalisation and sustainability are not included in your list?**
Those are major trends that we are trying to make the most of. For example, where and how new technological solutions can be implemented sensibly. They offer advantages, especially in communication, but personal interaction remains irreplaceable. Sustainability is a much-discussed topic, with a lot depending on one's personal point of view and with a great deal of room for interpretation. Because the issue is evolving rapidly, we're taking a step-by-step approach. We currently implement ESG criteria according to client preferences or exclude certain segments completely.

**How would you describe the bank's strategy in one sentence?**
We pursue a prudent and profitable growth strategy to help our clients achieve and maintain financial independence. Independence is not only an absolutely critical value for us as a company. Independence is also a central value for almost all of our clients.

**And who are your clients?**
For years we have enjoyed a steadily growing client base. The unifying element is most likely that they view the world similar to the way we do. This means that they share our liberal values, think for themselves and appreciate autonomous solutions. However, our clients' requirements are very different. Private individuals and families want to preserve, increase and pass on their wealth. Executives often want to derive the greatest possible benefit from wealth accumulation. They are always amazed at the added value that our pension coaches can offer them thanks to creative solutions. Business owners, on the other hand, value our services as their own "private financial manager" or take advantage of the more entrepreneurial offers, such as in the infrastructure sector. Most notably they are always contributing new ideas, which we implement for our broader client base. Infrastructure solutions, for example, are currently also in high demand among institutional clients.

**Why do you want to continue growing?**
Nothing ever stays the way it is. Only those who strive for growth remain agile and innovative. Above all, however, we can see that our services and solutions are achieving success for us. We don't grow by advertising a mass-market product. We grow because our clients trust us and recommend us to others.

**Why do you still assume unlimited liability for your company when many private banks have moved away from this position?**
Yes, we're sticking with it. Unlimited liability essentially relates to the bank's balance sheet, i.e. the clients' account balances. We maintain a very cautious balance sheet policy, but unlimited liability is even more important as a sign of how we understand risk. This is a common feature of all of our activities and is greatly valued.

**What will your clients experience from your strategic direction?**
We hope that our clients will sense that we really identify with them and their objectives at all times so we can achieve their goals together. The most important assets for us are long-standing clients to whom we can offer integral consulting over many generations. And in such a way that they are not given a new point of contact at the bank every two years. At the same time, we want to ensure that we keep the necessary dynamism that every company needs in order not to be left behind. This helps both current and future clients. If we succeed, we should be able to grow through recommendations and referrals in the future as well.