Check-Up

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



Editorial

COVID-19 has decelerated everyday life and accelerated existing trends. Neither the USA nor China has been putting on a good show in 2020. China failed by covering up the coronavirus outbreak and its handling of the Hong Kong issue. The USA has shown itself to be less than inspiring – whether it is dealing with the pandemic or the presidential candidates on offer. For once, Europe might be able to reclaim some of its shine. The most prominent poles of the new world order are drifting further apart, and Europe appears to be stuck in between trying to take advantage of the coronavirus crisis to install the mechanisms for a fiscal union.

It is a challenging environment for investors. What is our assessment of the current situation? How should we be positioning ourselves? Keep reading to find out.



Remy Reichmuth,
General Partner

"JAMAIS VU"

Explosive global, fiscal and monetary policy

How is it possible to bolster the economy if you are simultaneously constricting it because of the coronavirus? A seemingly insurmountable task. The USA's strategy is to give consumers direct support, while in Europe people are being fed and can work thanks to loans and subsidies. The trend towards more government intervention is gathering momentum.

Neither fiscal nor monetary policy can solve the problem of new growth in the current phase. What may help to maintain stability in the short term may endanger prosperity in the long term. We can only hope that the virus weakens or that an effective vaccine becomes available soon.

Getting as close as possible to full employment

Ultimately, the aim of every government is to enable as many people as possible to find a job. To accomplish this, John Maynard Keynes used government spending policies to manage economic cycles. When this stopped being effective in the 1970s – both inflation and unemployment were high – the US Federal Reserve under Paul Volcker began to focus on low, stable inflation instead. This was meant to form the basis for a more efficient economy. Efficiency rather than income equality became the new goal. As a result, short-term interest rates instead of fiscal policy became the focus for managing economic growth. However, this approach has not been working effectively either since the 2008 banking crisis, and now the coronavirus has complicated things even more.

Are we facing the imminent merger of fiscal and monetary policy?

"Jamais vu" refers to the phenomenon of experiencing a situation that you recognise on some level but that nonetheless seems novel and unfamiliar. It remains impossible to decisively categorise the situation since we are in the middle of a

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period of reflection with an ongoing battle of opinions. Some players want to keep to the same course, with central banks continuing to print money and hold securities on their own balance sheets (QE). Others are calling for an expansionary fiscal policy in the form of increased spending or tax cuts. Such measures are to be funded by debt, which central banks would facilitate with zero interest rates. And progressives are demanding the abolition of physical money. They want a digital currency so that interest rates can be pushed further into negative territory.

Money not ideal for storing value

We currently find ourselves following the second recommendation, and preparations are underway to embrace the third, e.g. in China, but such ideas are prominent in Europe as well. In view of this development, it is no wonder that precious metals are shining with even more lustre. Money admittedly works well as a means of payment and as a measure of value, but its function as a store of value is sacrificed in favour of system and structure preservation.

Can we draw any analogies with the past?

In 1918, workers in the Ruhr area in Germany were paid for their resistance against the French with newly printed money. "Money for nothing" was followed by hyperinflation. At that time, however, production output was pushed to the maximum, whereas today there are practically no shortages anywhere. During the Great Depression from 1929 onwards, highly expansionary monetary and fiscal policies were also pursued. Inflationary pressure appeared only years later, which was countered with price controls. This accommodative monetary policy led to stagflation in the 1970s. Such a scenario seems possible once again, particularly if the world divides itself into blocs and fiscal and monetary policy are merged.

An analogy to 2000 is most likely to be found in the sharp growth among tech stocks. During the dot-com bubble, tech stocks were trading at absurdly high prices. Back then, however, there were also several investment alternatives, such as real estate and bonds with 5% interest. It is the widespread belief that digitalisation changes everything that is reminiscent of the tech bubble.

The year 2008 is not a fitting analogy. When the over-extended financial world collapsed, affecting the real economy, the authorities all over the world came together to solve the resulting problems. We have the exact opposite occurring in 2020. The highly efficient global economy was broadsided by the measures to stop the spread of a virus – with knock-on effects for the financial world. And global cooperation is no longer trending.

Is a crash coming?

Granted, stock exchanges have recovered surprisingly quickly in the wake of the sharp slump in the spring. Nevertheless, stock markets make a strong distinction between growth stocks, stable companies and cyclical industrial companies. One lesson from the tech euphoria of the 1990s is this: if the digital sector does not do as well as expected, its shares will correct themselves – and non-technology shares will also suffer. Not all stocks are expensive.

Based on our discussions with company directors, we have noted that companies in the non-digital sector are the ones most cautious about the future. They are reducing rather than expanding their output, and projects are being postponed. Once the pandemic is over, this will be the basis for positive future development.

Resilience and ability to act

In uncertain times such as these, conventional risk measures such as volatility are of little use. Resilience is what is in demand now. It should be possible to withstand difficult market conditions without sustained adverse effects. For their part, companies are complementing efficient "just in time" supply chains with "just in case" capacities. For investors, resilience means maintaining their ability to act at all times, with the focus on liabilities. We recommend having as little outside capital as possible and reserving two years of cash to cover your living expenses. Now that stock markets are trading at the same levels as at the beginning of the year despite the weak real economy, even three to four years of cash reserves would be appropriate.

Resilience for investors could also mean making investments that are not connected to the stock markets. Unfortunately, bonds are no longer an option, but precious metals or more illiquid niche products still are. Carrying out a resilience test makes sense to us. How would your portfolio do in a bear market similar to that of 2000–2003 and would you still have the ability to act?

Inflation and gold as key indicators

We are sticking to our original advice: overweight equities, supplemented with precious metals and niche products. Bonds remain less appealing. We keep an eye on the two key indicators of gold and inflation because they act as a seismograph, recording the state of the financial system. The price of gold has already risen sharply due to the high levels of uncertainty, but market expectations for future inflation are still very low. Financial markets are expecting only 1.5% inflation per year for the next 30 years in the USA. However, should inflation forecasts rise alongside precious metal prices, we would expect a strong reaction on equity markets – with a move away from highly valued growth stocks and towards neglected value stocks. Of course, long-term bonds would then become "expropriated assets".

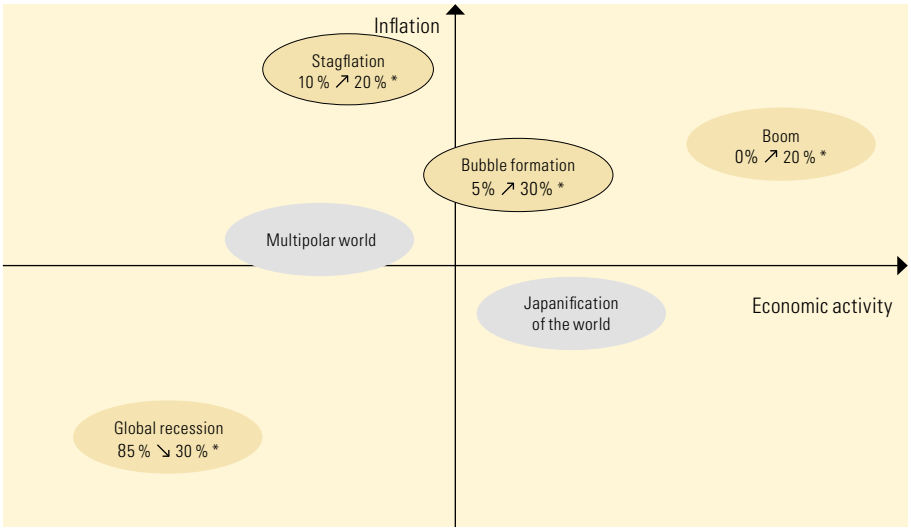


Christof Reichmuth, General Partner

OUR SCENARIOS

Silvan Betschart and Cajetan Bilgischer

Monetary policy remains in place – but fiscal policy is now in charge



Political scenarios *Scenarios described below* ** Estimated probability of occurrence (latest publication vs today)*

Summary

- Pandemic's progress and fiscal policy set the pace
- Western monetary policy adopts Japanese approach
- Market signals eternally low interest rates
- US default cycle speeds up
- Excessive stimulus measures and supply chain problems increase risk of stagflation

Bubble formation – the party's far from over

The global economic engine has been tinkered with and souped up so much in the last decade that accepting a recession as a means of recovery seems too risky. Central banks are adopting ultra-expansionary policies in an attempt to cushion the economic slump caused by the pandemic. Key interest rates will remain low for years to come, and negative real interest rates will fuel investors' appetite for risk and further exacerbate bubble formation in growth stocks. Given the current high degree of uncertainty, companies are putting planned investments on hold. After a brief pause, stabilisation measures will be resumed by means of share buyback programmes, and increasing numbers of retail investors will become equity specialists. Bubble formation enters its final phase.

30 %
Probability
3–6 months

Investment ideas

- Overweight shares (prefer growth stocks)
- Stable dividend stocks attractive
- Real assets attractive (gold, real estate and infrastructure)

Stagflation – a combination of inflation and an economy in the doldrums

Despite the massive stimulus measures, potential global growth will not be achieved because the newly created money is not entering the real economy to the degree it should. Capacity utilisation remains below average. The irreconcilable differences between the USA and China will affect international trade. Higher production costs due to supply chain disruptions will lead to lower margins and reduced economic performance. Expansionary monetary and fiscal policies fail to have an impact. As a result, economic growth will weaken, while unemployment increases and inflation takes off.

20 %
Probability
3–6 months

Investment ideas

- Overweight hedge funds
- Underweight USD
- Inflation-linked bonds
- Overweight gold

Out-of-the-Box: "Crack-up boom" phenomenon – are we facing the ultimate bull market?

The term "crack-up boom" was coined by economist Ludwig von Mises. It describes the unwelcome situation when inflation spirals out of control. What would happen if the current combination of expansionary monetary and fiscal policies were to lead to such a situation? Economic actors would rapidly lose confidence in the currency as a result of monetary expansion combined with excessive fiscal programmes. They would part with their nominal assets and flee to the already overbought stock market, where prices would continue to rise. Nominal assets would become worthless. The resulting currency collapse would lead to a global currency reform in which gold and/or cryptocurrencies play a central role. During this process, however, a real threat would exist of capital controls and restrictions on cash movements, including limitations on trading in gold. Fiat currency would be replaced by another monetary system as it would no longer be able to perform the tasks intrinsic to its very creation – a medium of exchange, unit of account and store of value.

THE BIG SECTOR ROTATION?

Cyclical stocks with catch-up potential



Patrick Erne,
Head of Research

Markets will undergo a reality check in autumn. Following the decline in March, stock markets have risen sharply, and profit expectations for 2021 are high. Even if expansionary monetary and fiscal policies remain the main drivers of rising share prices, much will depend in the short term on whether an effective vaccine is approved this autumn or not. A vaccine would strengthen confidence in the economic recovery and favour a sector rotation from COVID-19 winners to cyclicals.

Hopes for a vaccine

Even though we are still in the midst of a raging battle with the COVID-19 crisis, the worst of the global economic slump is behind us. A look at mobility data shows that activity levels in Europe and Asia are already approaching pre-crisis levels. Although Europe experienced a sharper economic downturn than the USA, it is ahead in terms of economic recovery. The rapid approval of a vaccine this autumn is crucial to maintaining current confidence and ensuring economic recovery. Nevertheless, even with vaccination in place, it will take several years before we return to pre-crisis trend growth levels. The number of bankruptcies worldwide will continue to rise, reaching a possible peak in 2021 at the earliest. Consolidation will take place in certain sectors, and highly indebted companies in particular could fall victim to it. Higher unemployment and increasing credit defaults are usually deflationary. However, output capacity in some industries will be at risk of disappearing. If demand for those specific products rises faster and more robustly during the economic recovery, this could then lead to temporary price increases due to capacity bottlenecks.

Ballooning budget deficits and yield curve control

Fiscal policy has become the most important tool for governments during a crisis. The enormous aid packages bring short-term stability, but the longer-term outlook is rapidly becoming more uncertain. Tackling a debt problem by going even deeper into debt buys you at the most a little more time. In Europe, the main focus is on the possible consequences of redistribution from north to south. In the short term, the eurozone should emerge stronger from this stability pact, and the yield differential between Germany and Italy should narrow in the coming months. In the USA, we are already flirting very heavily with helicopter money since consumers are being supported directly with payments from the government. The current economic crisis is affecting less-qualified workers above all, and the gap between the wealthy and the non-wealthy has widened. There is growing pressure on politicians from voters to convert the stimulus packages – originally intended as temporary aid – into longer-term income support or a guaranteed basic income.

The central banks will be concentrating on controlling the yield curve. The short end of the curve (up to the five-year range) is likely to remain almost unchanged, while the long end should rise slightly as the economy begins to grow again. As long as confidence in monetary policy and government institutions remains high, yields pose little danger. Conversely, this also means that the yield potential of quality bonds has been largely exhausted.

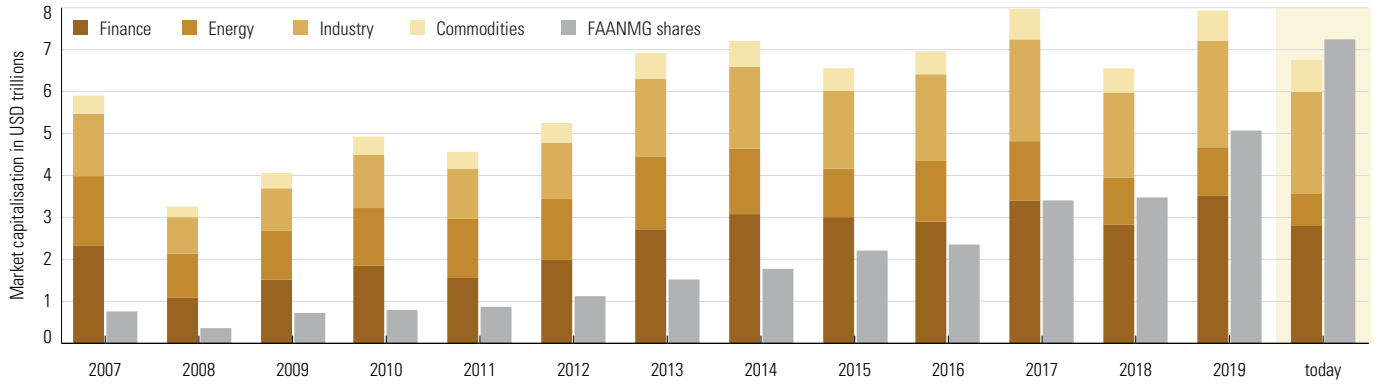
Gold is the most attractive "currency"

Interest-rate differentials between the USD and the other major currencies have narrowed during the crisis. As the economy rebounds, inflation figures will recover over the next 12 months. Real interest rates in most regions will remain deeply embedded in negative territory. Given such an environment, we consider foreign currencies to be less than desirable. In the short term we would prefer the EUR over the USD due to the slightly rosier short-term economic outlook, but upward potential remains limited as no one wants a strong currency. As a result, the fundamental factors are all pointing to further price increases for gold. Investors should not let themselves be rattled by short-term fluctuations in the price of gold due to extreme positions and instead continue to keep physical gold stocks in their vaults.

Cyclical sectors with catch-up potential

On stock markets, prices for certain sectors and stocks have varied quite significantly during the COVID-19 crisis. Many healthcare and technology shares were among the beneficiaries of the crisis. Due to their high weighting in the indexes, tech stocks are benefiting from an increased cashflow into passive investment vehicles. Cashflow-oriented business models, which have also grown in popularity during the recent economic crisis, continue to favour these stocks. However, some of these companies' valuations have risen to dizzying heights. And in our view they are too high when compared to the overall market. The market capitalisation of the six major technology stocks (Facebook, Amazon, Apple, Netflix, Microsoft and Google) is

Six tech monopolies with higher capitalisation than all cyclical sectors put together



Source: Bloomberg (as of 14.08.2020)

currently higher than the total market capitalisation of all of the cyclical sectors in the USA (see chart). With an economic recovery, a normalisation of inflation expectations, and further stimulus programmes, we foresee improved yield prospects for some cyclical sectors in the coming months. Due to the high weighting of techn shares on the US stock indexes, this could also lead to an underperforming US stock market compared with Europe, at least temporarily. If an effective vaccine is available by autumn, this rotation could gain even more momentum. We therefore recommend that sector allocation should not lean too one-sidedly towards "crisis profiteers" and that cyclical value stocks should be purchased selectively.

Emerging markets benefit from weaker USD

From a structural viewpoint, we have a positive outlook for Asia. However, with the populist-led US election campaign in progress, focus on the rivalry between the USA and China is increasing once again. Nonetheless, the opening up of the Chinese financial market remains a long-standing issue, and its importance on the global equity index will continue to grow. Emerging markets in particular benefit from a weaker USD because many companies and governments hold debt in USD and their debt burden shrinks as a result. We would therefore recommend capitalising on downturns caused by current political discussions to further increase Asian allocation in the long term.

As there is little to suggest a sharp decline in the price of gold based on the low real interest rates and weak USD, we see further potential in gold-mining stocks for risk-oriented investors. Overall, we are positioning ourselves somewhat more cyclically for the third trimester, but without increasing our equity exposure and favouring the European market.

US elections – Initial positioning and possible consequences

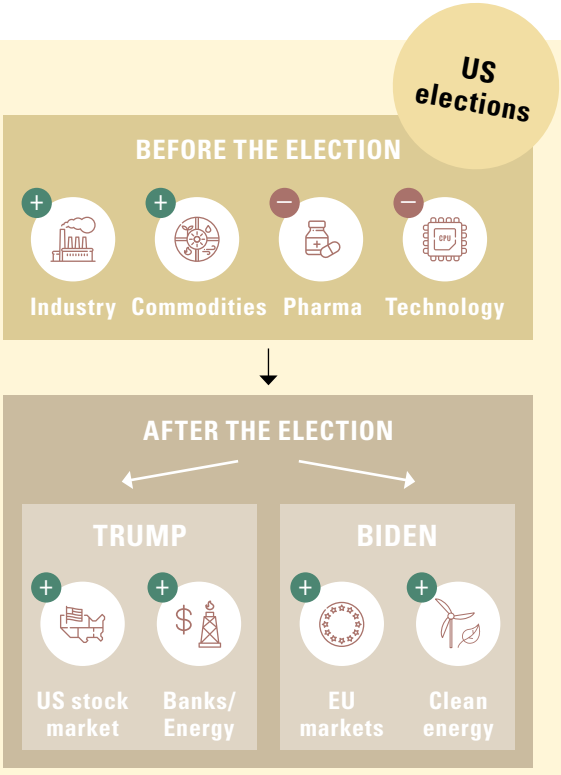
The outcome of the US presidential election will affect markets. In the run-up to the elections, we are focusing on sectors where consensus prevails. Higher infrastructure spending is good for industry and commodities. Prescription drug prices are a key campaign issue and putting pressure on global pharma companies.

Trump – Republican

Business-friendly policies favour domestically oriented companies. Trump will represent the interests of US companies abroad and resist more regulation. This will put US stock markets at an advantage over their European counterparts and bodes well for the banking and energy sectors, as well as technology.

Biden – Democrat

More redistribution and higher taxes will put pressure on US companies' profit margins. Technology companies will come under greater regulatory scrutiny. We expect stock markets in Europe to do better compared with the US stock market. The boom in renewable energies will be strengthened, which will help this industry.



ASSET ALLOCATION

Cajetan Bilgischer

Pandemic's progress and supportive fiscal policy set the pace

Liquidity



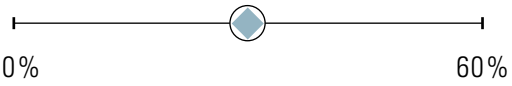
Liquidity ratio falls further due to share purchases.

Bonds



We expect central banks to keep interest rates low for a long time so that governments and companies can continue to service or pay off their debts. We consider a possible resurgence of inflation as the greatest risk to high bond prices, meaning there is limited potential for further price increases.

Equities



Switzerland	=
Europe	=
USA	=
Emerging economies	=

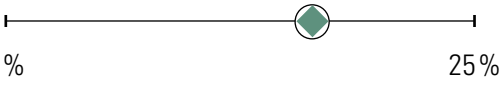
Although two important stock market drivers of recent years have disappeared with the reduction in the number of share buyback programmes and steep dividend cuts, the equities asset class still offers better yield prospects than bonds – even in the aftermath of the pandemic shock. Furthermore, the probability has increased that as part of their quantitative easing programmes the Fed and the ECB will follow the Japanese example by entering the stock market as major investors.

Real estate



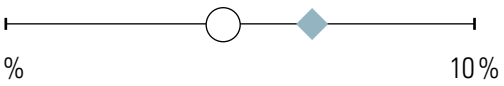
Given the prospect of low interest rates for a very long period, real estate remains an attractive portfolio diversification. However, demand for office and retail space is likely to remain low for some time. We favour property sectors where cashflow is reliable, and we are keeping the home bias high.

Alternative investments



Proactive and flexible hedge fund managers are encountering good conditions due to the massive shift in asset prices. We consider adaptable long/short strategies and dedicated distressed strategies to be promising.

Gold



The heavily overbought market situation, which reflects the widespread increased interest in gold during a crisis, led to a consolidation in August. This creates opportunities to boost the existing gold allocation.

○ 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.

SECURING BENEFITS WITH PENSION PLANNING

What needs to be considered early on?

Taking the right steps at the right time can have a significant impact on your third stage in life. "I kept putting it off until it was almost too late." This type of statement is heard all too often. To avoid such a situation, take the necessary time now to address all the important issues beforehand without feeling pressured by time in any way.

What are the decisive factors to consider?

The closer you get to your planned retirement date, a huge number of questions regarding your financial security will become more pressing. When should I start preparing for retirement? Should I opt for a lump-sum payment or regular pension withdrawals from the pension fund? How high will my living expenses be after I retire? What will change in terms of the taxes I have to pay?

The three most important points to keep in mind are:

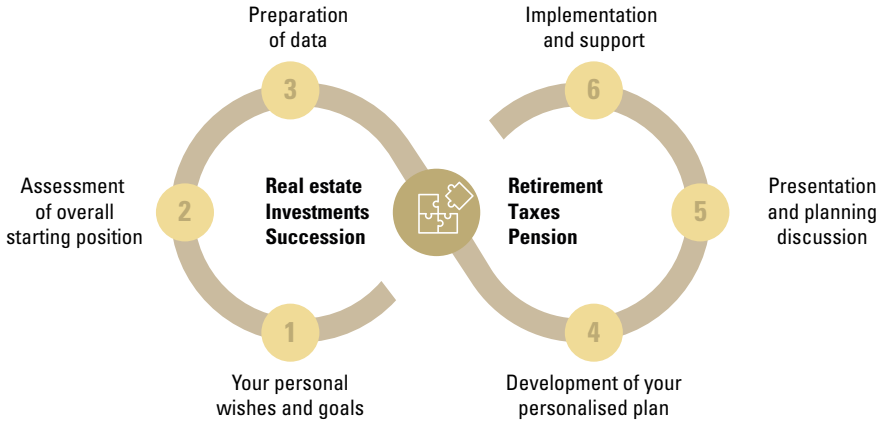
1. Start planning early
2. Make a budget for your living expenses
3. Optimise your tax situation

Experience shows that far-sighted planning can achieve considerable financial added value, particularly in the final 10 years before your planned retirement.

Taxes, taxes, taxes

The greatest potential for optimisation lies in the area of taxes. With the right planning for pension benefit purchases, substantial tax relief can be achieved over the years. In addition, after determining your current living expenses, you can also make an informed decision as to whether you should opt for regular pension benefits from the pension fund or whether a capital withdrawal makes more sense. Of course, a combination of these two options can also offer advantages.

Pension planning with a holistic approach



Own presentation

Withdrawal of pension assets

Additional significant optimisation can be realised by withdrawing pension assets. In this case, it is important to spread out the individual pension asset withdrawals over several years in order to reduce progressive taxation and keep your lump-sum benefits tax as low as possible. Withdrawals from different pension pots must always comply with the corresponding cantonal regulations.

For example, whereas in Zurich you may make a maximum of two withdrawals from the 2nd pillar, Lucerne allows you to make three.

Planning and implementation are a matter of trust

And now we come to the last and probably most important question for you. Whom should I trust to help me plan and implement my retirement goals? Your individual wishes and goals need to be the focus of an integral, holistic planning approach. The resulting plan and measures will ensure the greatest benefits for your retirement years.

We would be happy to work with you to develop an ideal customised concept so that you can look forward to a worry-free, enjoyable retirement. Contact us so that we can explain the advantages and opportunities available to you. As the Chinese philosopher Lao Tzu once said, "Only those who know their destination will find the way."

These five points give you the greatest added value

1. Tax-conscious purchases into the pension fund during your employment
2. Pension and/or capital withdrawal upon retirement
3. Staggered withdrawal of pension assets
4. Structuring for financing home ownership (affordability, amortisation, etc.)
5. Plan investments beforehand



Marcel Roos,
Financial Planner and Tax Expert

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LESSONS FOR YOUR FINANCIAL INDEPENDENCE

Interview with Jürg Staub

2020 is turning out to be a special year. What has your experience been like so far?

Personally, I'm grateful that no one around me has been seriously ill with COVID-19 and that my children, including of course my wife, have handled homeschooling well. I'm also thankful that our banking operations could continue safely and without incident despite many of our employees having to work from home. When I think about how other people around the world have been affected, then I have absolutely no right to complain.

What is your take on the situation from the perspective of a private banker?

It bears repeating, "Fear and greed are never good advisors." The important thing is to ensure that the investment strategy is robustly aligned with the individual client goals and that clients are actively supported during a crisis – with a greater reliance on digital media as well. In my opinion, we have successfully achieved both of these objectives thanks to our close proximity to our clients. Our client feedback proves this, along with the fact that we were able to acquire new clients during the first half of the year. We also have a strong balance sheet with more than three times the equity that is required. This is especially crucial in periods of uncertainty.

What kind of conclusions can you draw from an investor perspective?

With regard to the monetary policy response, it's "more of the same". This helps in the short term, but worries me even more in the long term. Low interest rates may drive asset prices higher, but the mountain of debt continues to grow. That's just asking for trouble. It was also telling to see once again how the heavy turbulence revealed the weakness of some investment models.

Could you provide us with a concrete example?

Five years ago, for instance, a client asked us to evaluate a new, rule-based approach. Academic evaluations and the recalculated time series since the 1990s shored up the theory that a newly established risk indicator could identify future tail events and prevent major price slumps. We had our doubts that managing risk solely by using a formula based on historical data could generate sustainable returns. With the arrival of the novel coronavirus, a tail risk has now occurred for the first time, which the risk model in question should have been able to identify at an early stage. In reality, however, during the bear market in the spring, equity risk was reduced and the rebound after the panic was largely missed. Instead of keeping calm in the midst of the worst upheaval, book losses were suffered pro-cyclically during the prevailing market weakness. We're convinced that the weighting of risk factors must be continuously scrutinised, which requires a future-oriented and scenario-based approach.

What is your current advice to your clients?

A zero interest rate environment means that investors must accept price fluctuation risks in order to achieve positive returns, making it essential to consolidate and diversify risk management within the investment structure. It is equally important that the risks contained in a portfolio match the client's risk tolerance. To verify this, we test portfolios based on historical crises. What book losses would my portfolio have suffered? I also have serious doubts about the long-term intrinsic value of nominal money. Scenarios such as stagflation, hyperinflation or even a "restart" with currency reform must be considered. This will protect us against being affected by nervousness and short-term trends during panic phases. It often helps to think in terms of different "pots" as well.

Which pots?

- "Short-term liabilities": This type of capital should be held with as little risk of default and fluctuation as possible and should be liquid.
- "Value retention": Price fluctuations must be tolerated for capital with a longer-term horizon and a focus on value retention. This is the only way that assets can be preserved over time.
- And "seize opportunities" when sufficient capital resources are on hand: The aim is to generate active added value in the medium term. This can be done through the opportunistic use of mispricings of certain investments, as is currently the case in the distressed sector, or investments in innovative business models, such as by start-ups.

This will ensure that you are well prepared for the greater uncertainty. We strive at all times to support you with practical assistance and advice to achieve and maintain your financial independence. Thank you for placing your trust in us.



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