PRIVATBANKIERS
REICHMUTH & CO
INTEGRALE VERMÖGENSVERWALTUNG

# CHECK-UP

CLIENT INFORMATION OF PRIVATBANKIERS REICHMUTH & CO, INTEGRAL INVESTMENT MANAGEMENT

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## EDITORIAL

*In view of the latest developments in the global financial markets, a fundamental examination of the financial world, concerning the «old and new economy», is called for. After the well-known excesses at the turn of the century, a sobering shake-out in favour of the «old economy» has taken place in the stock market.*

*«Everything is different now», some would say. Others believe, «history repeats itself». Both views are right. Information technology is rapidly changing our daily life. The human nature in the investment process although remains always the same.*

*Wisdom is a matter of emphasising – and this is different for every individual client. It is shaped from an enthusiastic search for opportunities weighed against a fearful avoidance of imprudent risk. Only an integral investment management approach can encompass both. Turmoil always bring opportunities along for those who set their investment compass for a more distant time horizon. That is what this CHECK-UP is about.*

*Karl Reichmuth*

# STRONG START INTO THE YEAR 2000

## FUTURE CHANCES FROM THE INVESTOR'S POINT OF VIEW

The start of the new millennium is witness to world-wide success in the real economy. Almost the entire world is expressing optimism for the state of economic development. The new communication technologies and possibilities of the Internet have led to a powerful set-off full of fantasies and ideas. The nineties are over and the previous anxiety about restructuring and job security has gone with them. People have accustomed themselves to life-long education and flexibility and have learned to cope with future unknowns much better than expected. At the same time, there are many encouraging signals that the new era will be seen as an opportunity.

### New «Entrepreneur-Ship»

For a long time, many students dreamed of the secure government job, a comfortable position in a large company or in a consultant firm with precise, hierarchical career planning. Today, this is no longer the case. In contrast, the appeal of growth companies or even start-up companies is the ability to move forward with one's own ideas. Lower barriers to entry are not the least responsible. Quickly changing firms and the total transparency on the Internet have resulted in dramatic disintermediation. There are many niches to be found, into which young innovative firms with equally young and idea-rich entrepreneurs are willing to venture.

This momentum is leading to more confidence and courage to spring into «entrepreneur-ship». Most business sectors of the future are less capital intensive. The result of this newly found entrepreneurial courage are prosperous economies world-wide.

### Economic Boom does not equal Stock Market Boom

Despite this optimistic scenario, we are not euphoric about the stock market outlook. The biggest stock market gains will be «worked out» by falling interest rates and restructuring. The interest rate cycle has been running a long time without dampening the euphoric investor mood. We must, in this case, stand by a more conservative investment policy.

*continued on the next page*

## CONTENT

### From Crisis Investment to Opportunity Investment

In the summer of 1998, we called on crisis investment. The interest rates were near to nothing, the profit margins historically high and, on the stock market, the P/E ratios were very optimistic. Due to the overvaluations that existed in the market, we moved to a minimal share position. Since then, interest rates are on the rise and, ironically, so are investment opportunities. Related opportunities can be found in this Check-Up.

### Switzerland is Attractive Again

Along with the regain of independence of the SNB, the opportunities for investments in Switzerland are again on the rise. We still see attractive possibilities with small and medium-sized companies in Switzerland. After the two-year fall back by the Blue Chips, we consider a partial re-entry into these stocks as justifiable. In combination with previous assessments, we see attractive prospects in the Swiss real estate market. During the next weeks, we will be preparing recommendations for our customers in this sector.

### Optimism also in Europe

Our optimism in relation to Europe is confirmed. Like the Swiss boom of past years, the same scenario is emerging in Euroland. Discussions with business people confirm and even surpass our expectations. In combination with the tax recommendations of the German government, which help domestic companies, and the support of an attractive EUR relative value, we still favour German shares on the second line (MDAX). In addition, we find true value shares in Europe under large-cap names which we further recommend.

### Different Alternatives in the USA and Japan

We see potential in the Japanese and Asian stock markets. We are advising our customers to invest in capital-protected investments or funds. In the USA, there are a number of well-known firms that are still much cheaper to buy than just a short time ago. In spite of this, we are maintaining a very low exposure in the US market. The USA is presently on the highpoint of an expansion phase. Therefore, investments in USD money markets with interest rates around 7% appear more attractive.

### Hedge Funds for all Seasons

For about three years, it has been our opinion that hedge funds are an investment class of their own. Although we are aware that the present hedge fund boom is a product of the bull market, we consider hedge fund investment as sensible. Our primary investments are with less volatile fund managers who are running real businesses. Of course, with the backdrop of the Sword of Damocles «Crash», we see that this hedging strategy is not foolproof.

### Scepticism concerning Technology Stocks

After the latest drop in technology stocks, the question of entering this seductive category arises. With a portion of scepticism, we compare the historical evaluation models to current prices. In our opinion, the winners of the technology revolution are going to be those companies that understand how to use the new possibilities in their core business. In addition, the stable logistical companies can develop into «fulfilment» companies. Therefore, it is worthwhile to pursue the relatively low-priced shares of Metro, Karstadt and other service companies. Hardware manufacturers and service companies that supply the high world-wide demand for this hardware will also profit. Mind you, these stocks have certainly been fully valued by the market for some time now.

your RIF team

## MDAX

### MEDIUM-SIZED GERMAN COMPANIES

The MDAX encompasses 70 German businesses and is set-up as a performance index, i.e. dividends and rights issues are taken into account. The weight on the index is based on equity and not stock market capitalisation. The P/E ratios have an average value of 16-18x, approximately 40% below present DAX levels. The MDAX is still 20% below the level of mid 1998.

From the tax reforms in Germany above all the MDAX firms should benefit. These reforms will lead to a transformation in Germany from «poor-mouthing accounting» to «profit maximisation accounting». In addition, Germany is at the commencement of an upswing in the economy. The weak EUR, in comparison to the USD and JPY, should additionally help the export-oriented domestic companies.

Marco Buck

# «NEW COMPENSATION» IS A HALLMARK OF «NEW ECONOMY»*)

## MULTIFOLD EFFECTS OF OPTION PLANS

Today, the expression «New Economy» is often quoted. Most of the time, it refers to an economy that is new, changing and improved…

The fact is that option plans for the management are enjoying widespread practice. Through option plans, enterprises can relieve some of the pressure off their earning statements and maintain salaries at a lower level since monetary compensation for the employee is transferred to the expected rise in value of employee stock options.

**Equalising Salaries through Private Credit**

From the point of view of John Smith, representing all option holders, the options are additional compensation for his work. As long as the options are not «in the money» or still blocked, John is on a tight budget because of his relatively low salary. But, using his options as collateral, John can utilise private credit to supplement his income and pay back the loans when the options are executed, or so he thinks.

From the company's point of view, only the annual salary is booked as an expenditure. The options are shown as a footnote. Of course, this has a strongly positive effect on the declared profits. The firm's managers know that the options are the core of John's salary pakkage, but they are only concerned with good numbers on their earning statement. However, the actual compensation must be in accordance with the true employment costs. Otherwise, the shareholders or the Johns of this world, or both, are making a huge mistake.

*) Based on a memorandum from David A. Levine, 22. 12. 1999

**One Instrument, Double Booking**

Also in official statistics, option plans do not appear under the heading of employment costs. Therefore, a substantial rise in the employment cost index (ECI) has not been witnessed despite a long ongoing economic boom in the USA. The non-cash component of compensation is remunerated for additional consumption by way of private credit with the mental assurances of expected capital gains on options. Thanks to option plans, a high earnings growth can be reported concurrently with negligible growth of employment costs. And that is exactly what leads to still higher valuation of every option, one instrument, double booking.

**Option Plans are Negative Dividends**

Share buy-backs are a customary tax-advantaged substitution for dividends (see Check Up No. I/2000). Those who use share buy-backs to shore up the earnings per share (EPS), should lead to a rising share price corresponding to the number of shares repurchased. If share buy-backs count as substitutions for dividends, then, logically, option plans should be considered negative dividends. In this case, it concerns itself with the issuance of additional shares.

**Magical Earnings Growth**

The quality of earnings will likewise deteriorate. A simplified example should bear this out.

Due to the earnings growth exhibited until now the market will assign a P/E ratio to the firm of 50x. With an oncoming of more difficult times, the management asks their employees to forgo 25% of their salaries in lieu of double the amount in shares. They gladly accept. The earnings of the firm increase 50% to 1.5 mio. as a result of the cooperation of the employees. Subsequently the P/E remains at 50x and the market price of the shares lifts 50% to 75 mio.

| Example (in millions) | 1st year | 2nd year | |
|---|---|---|---|
| Sales | 5.0 | 5.0 | |
| Salaries, Wages | 2.0 | 1.5 | -25% |
| Other expenses | 2.0 | 2.0 | |
| Net Profit | 1.0 | 1.5 | +50% |
| P/E | 50x | 50x | |
| Market Capital. | 50 | 75 | +50% |

Salaries cannot drop to zero! But, maybe suppliers are willing to accept shares as compensation instead of cash….

**Option Plans – also Remedy for Lower Inflation**

Management groups, about 20% of the non-agricultural private work force, are not represented in US national wage statistics. If wages do not increase, cost of sales remains low and price pressures fall away. That holds the measured inflation rate down.

**Pay Attention to Quality of Earnings**

The all too often observed rule in politics, that a measure fails to function after a period of time if the economic explanations are not available, is also applicable to the stock market. Therefore, we advise investors to focus on businesses with high quality of earnings. Admittedly, these businesses are associated with a more moderate appreciation potential, but lower price volatility.

*Christof Reichmuth*

# PRIVATE PUMP PRIMING
## ECONOMIC EXPANSION IN THE USA

The great economist, John Maynard Keynes, advocated federal deficit spending to lead the economy out of the 1929 Depression. Keynes said that the economy needed «pump priming» (injection of liquidity) to increase aggregate demand. Today, however, due to strong economic expansion and stock market capital gains, the USA is at the moment experiencing a budget surplus. The private sector has taken over the role of priming the pump. Household and corporate debt has never been higher.

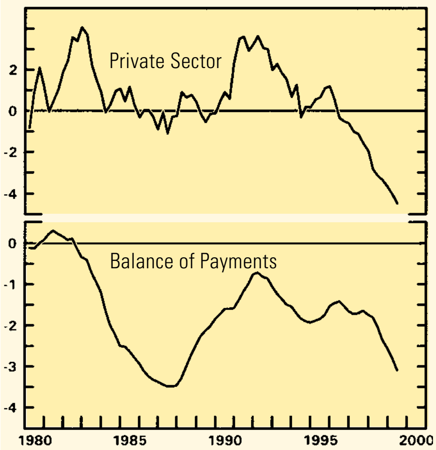
Americans wholeheartedly believe in the new information technology which is manifested by the rampant buying of IPO's with little sales and no foreseeable profits in the near term. An interesting business model is enough for private investors to go into debt by way of margin and home loans to purchase these shares. This phenomenon is called the «private pump priming».

Above all, the Internet euphoria results in an all-encompassing belief in the economic future. From a socio-political perspective, this is surely to be welcomed. As investment professionals, we must ask ourselves, «How long can this deficit spending without inflation last?» Sooner or later, this virtual financial world will leave its marks on the real economy.

**First sign of transition from the Financial to the Real World**

One example of the grip of the financial world on the real world is Tim Koogle. He is the largest individual shareholder of Yahoo, an internet business with a turnover of 590 million USD and market capitalisation of 67 billion USD. Tim Koogle contributes, to cultural charities, hundreds of millions of dollars each year. As an opera fan, he buys entire opera houses. Most of the deficit spending by governments goes to transportation, steel factories or other basic industries. Private donations go more in the direction of culture and research. In the end, both types of deficit spending have the same effect: an upswing to the economy and also inflation.

**NEW DEBT AS % OF GDP**



Source: Bank Credit Analyst

Karl Reichmuth

# SWISS STOCKS ARE BACK TO FAIR LEVELS
## TIME FOR A PARTIAL BUILD-UP OF A BLUE CHIP PORTFOLIO

Based on value assessments, we have been sceptical for about two years concerning the high capitalisation and value saturation of Blue Chip stocks. Since then, many of these large firms have diminished in worth. The following Swiss Blue Chip firms have lost up to 51% of their value in the last two years. The present upward tendency of interest rates, unfortunately, is not conducive for buying aggressive Blue Chip Portfolios. On the other hand, we consider it to be sensible to begin gradually building up a long-term Blue Chip portfolio at these lower and fairer levels. Similar and analogous positions should also be considered in Europe and in the USA.

| Name | Jul 98 | Apr 00 | Difference | P/E 01 |
|---|---|---|---|---|
| Ciba | 210 | 103 | -51% | 15 |
| Sair Group | 510 | 300 | -41% | 9 |
| Clariant | 1050 | 635 | -40% | 14 |
| UBS | 650 | 430 | -34% | 13 |
| Swiss RE | 4140 | 2800 | -32% | 13 |
| Zurich | 1150 | 750 | -35% | 12 |
| CSG | 385 | 300 | -22% | 14 |
| Nestlé | 3520 | 2955 | -16% | 20 |
| Novartis | 2750 | 2350 | -15% | 21 |
| Alusuisse | 1190 | 1060 | -11% | 12 |
| Holderbank | 2100 | 1950 | -7% | 15 |

*Alessandro Pelli*

# RIF MARKET OUTLOOK
**2. TRIMESTER 2000**

## INTEREST RATES
**World-wide economic boom leads to increase in short term interest rates**

The positive mood in the world economy carries onward. After years of accommodative and expansive policies, central banks are now moderately applying the brakes to counter the unintended strong effects on the economies. In the USA, as well as in Switzerland and the EU, shortages are arising for highly-skilled personnel required for continual non-inflationary growth in the «knowledge economy». This calls to mind the situation in the late eighties.

The monetary policy primarily affects the demand-side of the economy. The U.S. Federal Reserve Chairman, Alan Greenspan, will remain restrictive until the growth in demand slows to below 4%. The market is responding to his efforts with lower long-term interest rates, but extremely high credit spreads. The spreads are higher than they were during the Russian economic crisis in the Autumn of 1998. At the same time, the default rate is twice as high as it should be during a normal expansion phase. The market expects a recession, or at least, accompanied by lower inflation.

In Europe, the interest rate curve currently remains steep. The task of the ECB, to carry out a unified monetary policy for politically distinct sovereign states, will become increasingly difficult. While higher interest rates are called for in Ireland and Spain, such steps could possibly impede economic expansions in Germany and France.

We expect a worldwide economic expansion with higher real interest rates and climbing inflation premiums.

## CURRENCIES
**The USD is a favourite value benchmark, a good trading currency, but is lacking the quality as a store of value**

The USD has maintained its strength much longer than the fundamental indicators would have predicted. The best explanation is the one-sided positive support of the EUR by financial pundits.

The EUR has been a seemingly stable currency. Despite import price inflation, it has not led to an overall increase of the inflation rate in the eurozone. Externally, the EUR is very weak against the JPY and USD. This has accelerated a rebound of the European economy. As soon as this fact is reflected by economic indicators, the EUR will strengthen against the USD requiring rapid restructuring steps in Euroland. Until now, the weak EUR has ensured Europe's competitive ability.

The Swiss National Bank is equally aware of the situation. The completely exhausted labour market, a shortage of highly skilled workers and a positive consumer confidence is alarming the caretakers of the currency. A slow increase in the value of the CHF against the EUR will be tolerated. Therefore, the CHF is once again a good store of value. If the USD should go through a crisis, it may return to its previously held role as the safe haven of currencies, also vis-à-vis the EUR.

We recommend a very low allocation to the USD with a slight overweighing of the EUR.

## EQUITY MARKET
**Opportunities in Value and Mid Caps. For the last two years, Large Caps have been in a bear market.**

Since April 1998, the majority of stocks have gone down. The ratio of advances to declines is very negative. The share values for many large capitalised companies are at a two-year low and causing them to lose weight in the Index. Only a small number have been able to increase their weight in the Index through extreme price appreciation. This has lead to an unprecedented divergence between winners and losers in the market. The present prices for numerous large capitalised companies are at a fair level. The defensive stance over the last two years is now showing its merit. We have plenty of liquidity at our disposal and are employing it during the current weakness to accumulate the first part of a «Blue Chip Value» portfolio.
As could be expected, investment bankers are producing plenty of paper to justify the high demand for growth IPO's. The most recent correction on the stock market will attenuate the demand for these stocks and leave an overhang of paper in the pipeline. Supply will outweigh demand.
Also in Europe, the technology, media and telecom (TMT) sector has attracted the most attention in the stock markets. However, we are concentrating on mid-size caps which will profit the most from restructuring, tax reforms and the weak EUR.
In Japan, the Nikkei average rose further to 18'500 points. The battle against a high JPY continues, but the economy is showing clear signs of improvement. We are holding to our prediction of 25'000 by the year 2002 accompanied by high volatility.

# RIF INVESTMENT POLICY

## 2. TRIMESTER 2000

| BASIS | CH | EU (D) | UK | USA | J |
|---|---|---|---|---|---|
| **Purchasing Power Paritiers** | | | | | |
| PPP (NDR) | 1,36 | 1,19 | 1,64 | 1 | 108 |
| | | | | | |
| **GDP Growth** | | | | | |
| actual | 3,0% | 3,1% | 2,9% | 6,9% | 0,3% |
| 6 months | ↗ | ↗ | ↗ | ↘ | ↑ |
| 3 years | ↗ | ↗ | → | ↘ | ↑ |
| | | | | | |
| **Inflation** | | | | | |
| actual | 1,6% | 2,0% | 2,3% | 2,7% | -0,9% |
| 6 months | ↗ | ↗ | ↗ | ↗ | ↑ |
| 3 years | 3% | 4% | 4% | 4% | 2% |
| | | | | | |
| **Stock Market** | | | | | |
| Steady State FV-Potential | 11% | -20% | -30% | -40% | 40% |
| P/E 2001 | 18 | 25 | 20 | 24 | 28 |
| EPS Expectation 2001 | ↗ | ↗ | → | → | ↑ |

| CONCLUSION | CH | EU (D) | UK | USA | J |
|---|---|---|---|---|---|
| **Money Market (3 month)** | | | | | |
| actual | 2,8% | 3,7% | 6,0% | 6,1% | 0,1% |
| 6 months | ↗ | ↗ | → | ↗ | → |
| | | | | | |
| **Money Merket (10 years)** | | | | | |
| actual | 3,9% | 5,2% | 5,2% | 6,0% | 1,8% |
| 6 months | ↗ | ↗ | ↗ | ↗ | ↗ |
| 3 years | ↗ | ↗ | ↗ | ↗ | ↑ |
| | | | | | |
| **Currency** | | | | | |
| actual | | 1,58 | 2,64 | 1,67 | 1,58 |
| 6 months | | → | ↘ | ↘ | ↘ |
| 3 years | | → | ↓ | ↓ | → |
| | | | | | |
| **Stock Market** | | | | | |
| actual | 7.370 | 7.160 | 6.240 | 1.435 | 18.500 |
| 6 months | → | divergent | → | divergent | ↗ |
| 3 years | ↗ | ↗ | → | ↘ | ↗ |

Legend:
↑ = very positive
→ = neutral
↓ = very negative

divergent = different market expectations for value and growth stocks

Prepared: 23.04.2000

# RIF GLOBAL LIST

## MAY 2000

| | SECTOR | W | THEMES | «TIMING-PORTFOLIO» | «GRANDCHILDREN'S PF» | SELL |
|---|---|---|---|---|---|---|
| DEFENSIVE | Consumer | | Defensive | PARMALAT | NESTLÉ | |
| | Staples | + | Health | SAKS | PHILIP MORRIS | |
| | | | Lifestyle | | UNILEVER | |
| | Utilities | 0 | Liberalization | ENDESA | RWE / CKW | |
| | | | Deregulation | VEBA | PACIFIC GAS | |
| INTEREST SENSITIVE | Banks | | Concentration | HSBC | UBS | DT BANK |
| | | – | Higher | BANC ONE | SOGENAL | COMMERZBANK |
| | | | Interests | | | |
| | Insurances | | All Finance | FORTIS | SWISS RE | |
| | | – | Capital | ZURICH | ING | |
| | | | Gains down | | | |
| GROWTH | Pharma | + | Process of Concentration | SCHERING PLOUGH | NOVARTIS | MERCK |
| | | | Lifestyle Tabs | | BAYER | |
| | Technology | | Digitalisation | XEROX | HONEYWELL | ABB |
| | | – | Need of Investment | ALSTOM | SIEMENS | |
| | | | | | PHILIPS | |
| | Telecom | – | Wireless Network | ATT | SIEMENS | |
| | | | Mobile Process | MCI/WORLDCOM | BELL ATLANTIC | |
| CYCLICAL | Oil | 0 | Doubling of Oil Price | ENI | ELF / TOTALFINA | |
| | | | Concentration | TEXACO | REPSOL | |
| | Chemicals | + | Process of Concentr. | DSM | EASTMAN KODAK | |
| | | | Specialists | CLARIANT FIP) | AKZO | |
| | | | Tournaround | THYSSEN | PECHINEY | |
| | Basic Industrials | + | of Pricetrend | METSA SERLA | RIO TINTO | ALUSUISSE |
| | | | World Demand | STORA ENSO | ANGLO AMERICAN | |
| | Auto / | | Plattform-Concept | RENAULT | DAIMLERCHRYSLER | |
| | Parts & | + | Overcapacity World | VW | GEORG FISCHER | |
| | Equipement | | | | MICHELIN | |
| | Real Estate | 0 | Settlement of Structure | | ST GOBAIN | |
| | Building | | Restructuring Estates | | HOLDERBANK | |
| | Machinery | 0 | Innovation | STORK FIP) | SULZER | |
| | | | Management | SCHINDLER | LINDE | |
| | Various | | | | DAX/MDAX | |
| | Conglomerates | | | | NIKKEI | |
| | | | | | REAL ESTATE CH | |

Timing-Portfolio: Interesting opportunities  Grandchildren's Portfolio: buy-and-hold-titel - basic investements  FIP = Fall in Place (special move expected)  RP = realise profits

# THE CURRENCY DILEMMA

## EUROPEAN INTEGRATION LEADS TO AN IMBALANCE

Recently, a newspaper reported that the Italian government is fighting against inflation by forbidding price increases in state and state-sponsored businesses.

This message explains the main confidence problem with the new European currency system. Politically independent states with individual fiscal policy have been robbed of control of independent monetary policy.

The individual governments in Euroland no longer have control over their own money and interest rate policies. Therefore, one is less able to simply order a «stop» to inflation. Different paths of development in individual countries will eventually lead to a dangerous imbalance. The resulting integration pressure will demand that workers become more mobile and flexible. This adjustment will be much more difficult in Europe, with its language barriers and diverse mentalities, than in the USA. The USA is already

*continued on the next page*

# RIF INVESTMENT STRATEGY
## 2. TRIMESTER 2000

### PENSION PORTFOLIO
**Currencies**
- EUR slightly overweighed, USD reduce to minimum
- 5-10% commodity currencies (AUD, CAD)

**Categories**
- Slight shift from money market instruments to short-term bonds
- Alternative investing in 1-2 year guaranteed return of investment (Groi) vehicles (long DAX, short SPX)
- CHF and USD maturities: around 2-3 years
- EUR maturities: around 4 years
- Avoid equity risk

### HARVEST PORTFOLIO
**Currencies**
- As Precautionary (above)

**Categories**
- Stand-by funds or Groi (short SPX)
- Selective additional purchase in Blue Chip value sector
- Continued conservative allocation to shares
- Small and mid caps CH and D (MDAX)
- Japan/Asia exposure through instruments offering capital protection about 5-10%
- 10-20% alternative investments
- around 5% accumulation in real estate investment vehicles CH

### SPORTING PORTFOLIO
**Currencies**
- Short USD
- Stand-by funds in EUR

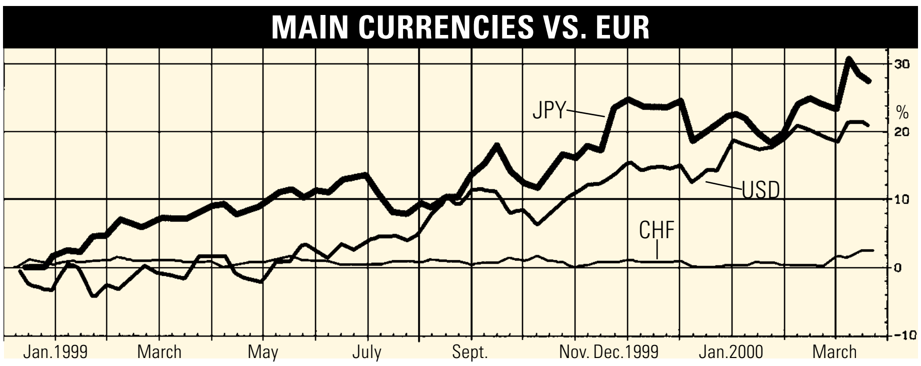
**Categories**
- Long Europe (MDAX/ Small and mid-cap counters)
- Accumulate strongly depreciated Blue Chips
- Accumulate Biotech Basket
- JGB short
- Nikkei long
- S&P or Nasdaq short (Bear Collar or short Future with short Put Position)
- 30-40% alternative investments

The recommendations are dependent on movements in the market and are subject to change without notice. Further information including the RIF World, RIF Small-and-Mid-Cap List and the current Bond List are available from Mr. Alessandro Pelli or Mr. Stefan Ulrich at +41-41-249 49 29.

a «melting pot» of different nationalities. Such thoughts might be the reason for the undervalued EUR in comparison to the USD. The temporary situation leaves no real alternatives. The only three choices are: invest in a clearly overvalued USD, an unsightly constructed EUR or a manipulated JPY.

**Opportunities and Dangers for the CHF**
The CHF plays only an ancillary role in the large world currency exchange system. This is opportunity and danger at the same time. As a small currency, the CHF is vulnerable to the gigantic flow of currency, and yet, it offers higher stability. The latest measures of the Swiss National Bank show its will to maintain the current situation.

Therefore, the currency allocation must be defined by the individual portfolio levels. For speculative investors, we recommend EUR long / JPY short. Because of interest rate differences and after about a 30% correction in exchange rates, the risk to reward ratio looks attractive.





*Sven Schupp*