PRIVATBANKIERS
REICHMUTH & CO
INTEGRALE VERMÖGENSVERWALTUNG

CHECK-UP

CLIENT INFORMATION OF PRIVATBANKIERS REICHMUTH & CO, INTEGRAL INVESTMENT MANAGEMENT
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EDITORIAL

In 1998 we exposed ourselves in a lecture and in our «CHECK-UP» publication of that time on the topic «The financial world is distancing itself from the real world». In this «CHECK-UP» we write about the painful convergence of both these worlds – a convergence which has proven to be painful for many, but fortunately not for our customers.

Despite the market recovery that we have seen lately, a wise and experienced major investor recently said to me that the financial world is and remains perverted. Trading, and not investing, is today (too) often the aim of so-called investment advisors. In such a climate, hedge fund specialists would most likely be the ones to generate profits.

Luckily, ever since 1997, we have successfully been applying this investment style for our customers using our internal instrument. But now, at a time when everyone – especially the big players – seem to be jumping on this bandwagon, the time is probably once again ripe for profitable value investments instead of pure trading buys.

Karl Reichmuth
Partner with unlimited liability

EXPECTATIONS IN THE NEW DECADE

POSITIVE ECONOMY, LACKLUSTRE FINANCIAL MARKETS

By the end of last year it was clear to everyone that the bonanza of the Nineties was over. But what is to be expected in the new decade? A return to the strong growth of the Nineties with exceptionally good financial markets? Many experts are still struggling to come to terms with the «new world». It is tempting to make forecasts using positive historic data (especially data from the last ten to twenty years), however, the new potentials are still too unclear. There is much dust in the air and until this dust has settled, analysts prefer to hold on to the «rear-view mirror mentality». In our opinion, a new paradigm is emerging – a relatively positive development of the economy coupled with lacklustre financial markets.

Gravity – a principle that also applies to the economy?

Clearly, it is much simpler to achieve a 20% growth rate from a rather low starting point than from a very high starting point. Thus, in our view, financial markets, particularly highly capitalised stocks, continue to be expensive. This fact will make fundamental price increases highly unlikely.

Valuation drivers have run out of steam

As we keep on repeating, interest rates are by far the most important valuation drivers. It is by means of interest rates that the multiplier is determined (see Graph on page 2). Using modern valuation methods, such as the discounted cash flow method, lower discounting factors (determined by interest rates) increase the value of stocks (and vice versa). In times of stock market euphoria, this multiplier is psychologically supported or strengthened by positive investor's attitude towards risks (investor sentiment). Both together can lead to the known «valuation bubbles». When multipliers are as high as they are today, and, once the bubble has burst, sentiment drops to its normal level, it is predominantly profits which dictate how assets are valued. This is the situation which we find today.

What is the driving force behind profits?

Write-offs of record-high magnitude in the year 2001 caused profits for the S&P 500 companies to plummet by around 55%. From this low point, it is consider-

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- Should mortgage rates be fixed long-term?

ably easier to expect profit growth. If the financial industry manages to distract investors from this fact, this will temporarily ensure that current market prices are supported. Experience shows, however, that in the long-term profits will grow at the same rate as the GDP (see right-hand Table). In certain periods, such as in the Nineties, short-term deviations from this pattern may emerge, but in the long-term profit growth always converges towards the growth of the GDP.

EARNINGS: A TOTAL CHAOS!

EARNINGS GROWTH: 10% OR 120%?		
- SPX reported EPS 2001:	USD 24.–	–53%
- SPX consensus EPS 2002:	USD 52.–	+115%

A COMPARISON OF GROWTH RATES (1959 TROUGH 1999)	
- Nominal Gross Domestic Product	7.5% per annum
- Non-financial companies	7.5% per annum
- Total NIPA* after tax-earnings	7.4% per annum
- SPX earnings	6.9% per annum

PROFIT MARGINS ARE MORE IMPORTANT THAN TURNOVER		
- Pricing Power:	not in sight	neutral
- Productivity:	ev., temporarily higher	neutral
- Salaries:	no tendency to fall	neutral

*NIPA: National Income and Product Accounts / Quelle: BLA

Profit margin is the most important factor leading to company profits. This margin is determined by the ability to increase prices (pricing power), productivity and salaries. On the whole, salaries tend not to fall and productivity usually only increases temporarily towards the end of a recession. Thus, due to limited pricing power, there's only a slim chance that margins can be sustainably increased over a long period. Over-capacities and low trade barriers contribute, in addition, to the erosion in margins. Against such a backdrop, profit explosions appear highly unlikely. A healthy basis for long-term higher valuation of stocks seems to be lacking.

Positive performance of the economy

The above comments in no way imply that the economy must also suffer. Rather, the economy is currently reacting relatively calmly to exogenous shocks (e.g. wars or confidence crises). In a nutshell, the performance of the economy can be analysed in four sectors. Firstly, consumption (approx 70% of GDP), investments (approx. 15%), government spending (approx. 18%) and net exports (approx. –3%). Overall, in the Western world, these four sectors seem to be performing quite healthily.

Consumption – the ultimate hobby of US citizens

Since the Asian and Russian crisis the economy, and predominantly financial markets, are the marionettes of the Federal Reserve, and in particular of Alan Greenspan. The attempt to give the US economy a «kickstart» through a combination of higher fiscal spending (Keynes at its best), lower taxes (Reagan), and an extensive and cheap money supply (Greenspan), appears to be working. US consumption is once again rising to an extremely high level. The debt of private households has further increased. Thanks to rising US real estate prices (2001: +10%) accompanied by low interest rates, households were able to increase their mortgages in order to satisfy their consumption expenses. This trend is reaching an end. Already now, existing properties are traded with a factor that is 6 times greater than the number of new houses being built – a first indication of an overheated real estate market in the USA. Should interest rates rise, private households will be spending more on interest payments with the consequence that suddenly there will be less available income for consumption. The best-case scenario would therefore be stable consumption at a high level.

Investments – the driver behind the euphoria of the Nineties

It was thanks to a massive investment offensive, primarily in information technology, that the dream results of the Nineties became true. With the bursting of this IT bubble, investments collapsed. Many warehouses have now been emptied, but the over-capacities remain. The focus remains on cost reductions and not on sales growth. In a world driven by what is on offer, where all innovations are quickly imitated, competition remains extremely fierce.

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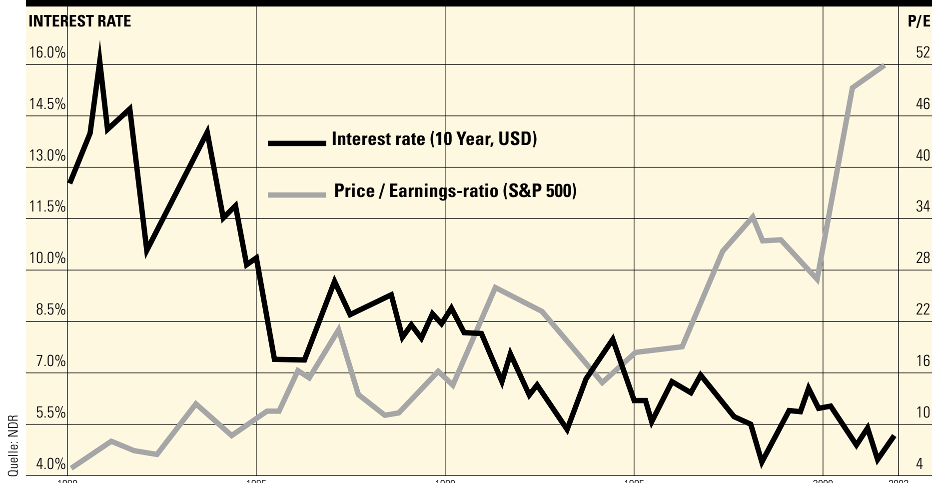


FALLING INTEREST RATES LEAD TO HIGHER MULTIPLES

It is highly probable that from this low point on, any increase in investments will be negligible.

Government spending – after Japan, now also increasing in the USA

For years, Japan has been trying to «sit out» the balance-sheet recession (overvaluation of assets on the balance-sheets), using massive fiscal stimulus packages. Due to these measures, the government debt of Japan rose to 140% of its GDP. The USA is currently following this pattern. Imminent drops on the financial markets are being countered with massive fiscal measures. The budget surpluses have been used up – and once again the US government is confronted with budget deficits. On the whole, a return to an expansive fiscal policy does have the effect of supporting growth - at least for the time being.

Net exports – protectionism places limits on globalisation

The USA's high net import ratio with the corresponding need for external financing is legendary. Every year, the USA requires a net cash inflow of around USD 400 billion. Should this fail to materialise, a sinking USD could once again help to correct the deficit in the trade balance. With the protectionist measures recently taken by the USA, namely imposing protective tariffs on steel imports, it was the leading nation itself that signalled its will to restrict world trade, and hence globalisation.

YALE-ENDOWMENT FUND-A SOPHISTICATED PIONEER

	YALE 1997	YALE 2001	REICHMUTH 2002
Cash	-0.7%	6.2%	5.0%
Bonds	12.1%	9.8%	40.0% 🡐
Domestic stocks	21.5%	15.5%	10.0%
International stocks	12.6%	10.6%	10.0%
Alternative investments	23.3%	22.9%	20.0% 🡐
Real estate	11.6%	16.8%	10.0% 🡐
Private equity	19.6%	18.2%	5.0%

A positive, but hardly a spectacular performance

To sum up, we conclude that financial markets and the economy will once again tend to converge in the new decade – brought about by a very healthy performance of the economy combined with very modest performance of financial markets.

Surprise potentials in our scenario

Exogenous shocks, such as a war, could throw this expectation into disarray. Any confidence crises and their effects on the financial markets are likewise not to be underestimated. In such a scenario, there could suddenly be increased demand for gold and the CHF – which is still de facto gold-covered. Normally, gold not only serves as an indicator of inflation, but much more as an indicator of confidence. A positive surprise, primarily for Europe, would be a growth shock thanks to increasing political stability in eastern Europe.

Positioning in the world of the new decade

Highly-capitalised stocks, the preferred playing field for institutional investors, are probably not the best investment class in this climate. Rather it is time to adjust yield-expectations in line with the new paradigm and shape portfolios correspondingly. As an example, we mention once again the «Endowment Fund» of the Yale University. For years, this institution has been the forerunner of a pro-active investment policy which is not oriented to annual benchmarks. In contrast to private investors, this institution can count on an «infinite time horizon». This, in principle, explains why there are differences between the Yale allocation and ours (see Table above).

In the EUR area, bonds with a yield of 5% seem attractive to us. For stocks, we continue to prefer secondary and value stocks, stocks with attractive dividend yields and our bottom-fishing strategy. In addition, we try not to orient ourselves towards benchmarks (e.g. stock market indices), and to generate added value for our customers by means of timing and selection. For alternative investments, we opt for the long-proven strategy. In addition to Mobimo as an income-producing real estate company, we also recommend direct investments in real estate.

Your RIF Team

RUSSIA, CHINA, ASIA AND INDIA

Russia, China, Asia and India are regions under much discussion for real growth. We are, in principle, of the same opinion. However, there are strong reasons in favour of limited allocations in these markets. Alongside the political risks, the huge risk of dilution in such growth markets must always be taken into account. Moreover, it is very likely that domestic investors reap the largest profits from these markets before international investors do. Since we lack the expertise in investing in these countries, we recommend specialized funds.

«FAMILY FUND»
AN APPEALING CONCEPT

With the Family Fund concept, Reichmuth & Co Investmentfonds AG is about to launch a Swiss innovation for managing large-scale family assets. The professional structure of the Family Fund with its high degree of transparency, security and flexibility solves the problems of double taxation applied to holding structures, and, in terms of administration, provides an attractive way of managing private assets.

Family Funds-the family «treasure box»
A Family Fund is a tailor-made investment fund under Swiss law for a specific group of people (e.g. a family). The result of this structure is that assets can be managed within a single fund, whereby the individual investors hold units of such fund. The Family Fund portfolio can include a very wide variety of financial assets (e.g. equities, bonds, fund units, derivatives, etc). At the wish of the investors it is also possible to furnish the Family Fund with material assets (so-called payments «in kind»).

All the advantages of a professional structure ...
An investment fund is no legal entity. Hence, the responsibility for an equal treatment of all unit holders lies with the fund management company, whereas custody of the assets is the responsibility of a custodian bank. Both the fund management company and the bank are supervised by the Swiss Federal Banking Commission (SFBC). The level of security is raised even further thanks to annual audits that are conducted by professional external auditors. In addition, the professional preparation of annual reports include other advantages. For example, the fund will claim withholding taxes, and the annual report can serve as a basis for private tax returns. Hence, the costs of completing these forms are reduced substantially.

... combined with tax benefits
The investor in a Family Fund is taxed in roughly the same way as a private individual. However, the investor benefits from the considerably greater certainty of not being classified and taxed as a «professional investor». Furthermore, the Family Fund is not liable to turnover tax or VAT, although the biggest advantage for the investor is the complete elimination of double taxation, which, for example, is applied to holding structures.

The table below show some of the most important factors to be taken into account when managing private assets, and how these factors compare when such assets are managed by a private individual, via a Family Fund or via a Personal Holding.

Requirements define the structure
In order to choose the suitable financial structure the individual requirements and needs of the investor must always be taken into consideration. For many of these requirements, the «family treasure box» can best be managed in the form of a Family Fund. In this sense, the Family Fund represents a logical further development of our integral approach to asset management. We would be delighted if we had the chance to discuss with you whether this innovative concept is a suitable solution for your needs.

Dr. Ricardo Cordero

FACTOR	BY PRIVATE INDIVIDUAL	FAMILY FUND	PERSONAL HOLDING
Legal structure	None	Investment fund	Limited liability company («Aktiengesellschaft»)
Incorporation	Not necessary	Very simple Contribution of material assets (payment «in kind») possible	Simple
Dissolution	Very simple	Very simple No fiscal consequences Redemptions «in kind» possible	Very costly Double taxation
Transparency	Transparent Relatively costly consolidation	Very transparent Very simple consolidation	Relatively transparent Limited consolidation
Taxes	Simple Risk of being taxed as professional investor	Simple Reduced risk of being taxed as professional investor No VAT No turnover tax	Complex Reinvestment of income possible Double taxation on dividend payments and on dissolution
Level of security	High	Very high Annual audits	High Annual audits
Supervision	None	SFBC (Swiss Federal Banking Commission)	None
Divisibility	Combersome	Very simple	Simple
Administration	Cumbersome	Fairly low cost	Very costly
Cost structure	Simple Not transparent	Very simple Very transparent	Simple Multy-layered

MARKET OUTLOOK
2nd TRIMESTER 2002

INTEREST RATES
Unspectacular economic recovery leads to a flattening of the interest rate curves with higher short-term and stable medium-term and long-term interest rates.

Thanks to a combination of one-off effects (lower taxes, higher government spending, inventory accumulation, property refinancing), the USA is reporting surprisingly good economic growth. However, boom effects are not on the horizon. The extreme money-supply growth, thanks to global reflationary competition, bears a certain potential for inflation. This will only materialize if it has an effect on demand. We expect liquidity to slowly level-off from its high levels, resulting in a decreasing inflationary potential. Short-term US interest rates are expected to rise towards 4% by the end of the year, whereas long-term rates are to be expected in a range of 5-6%.

Japan continues to be in a deflationary balance-sheet recession. It is not the savings ratio that is the problem here, but rather the lack of demand and the pressing need to write-off old debt. This clean-up process of the balance sheets will still take a few years. Despite a further fiscal stimulus package, a rise in long-term JPY interest rates is not in sight. Short-term interest rates will remain at approximately 0%.
Europe is and remains mediocre without strong growth. The EUR has tended to impair the flexibility of the European countries. There are no substantial structural reforms in sight. Only within Berlusconi's «Kingdom» the labour market is undergoing some first, yet radical, measures. Europe seems like a well-fed patient with no visions. Hence, we expect the lacklustre performance to continue, and short as well as long-term interest rates to remain stable.

In Switzerland, the economy seems on its way to a slow recovery. Restructuring measures are starting to take effect. Nevertheless, in contrast to the world-wide trend in interest rates, Swiss rates continued to fall as a consequence of the battle conducted by the SNB (Swiss National Bank) against a revaluation of the CHF. A war or a loss of confidence in the financial system could once again trigger the discussion whether the CHF should officially be linked to the EUR.
We recommend EUR bonds with yields of >5% and maturities of 4-6 years, as well as a portfolio of CHF corporate bonds of approx. 3-4 years' duration and yields of at least 4%.

CURRENCIES
Nothing new – USD is too expensive, EUR is too low, volatile JPY and over-important CHF.

The USD seems to be building a «top» against the EUR. But this development is very slow. Europe is too weak, confidence in the new currency too fragile, and the prospects are too vague. A sustained bearish stock market, and less than rosy prospects for US companies, will contribute to a decreasing inflow of funds from Europe to the USA, and, consequently, to a correction of the currency parity. If the current stabilisation of eastern Europe is no longer seen as a threat to the welfare of western Europe, but rather as a growth market with a stable climate, Europe could positively surprise even solid realists.
This year we expect a weakening USD, and the CHF to trade in a range of 1.45-1.52 towards the EUR (barring unexpected shocks). Concluding, CHF-based investors should aim for minimum USD exposure, normal EUR weighting and an overweight in CHF.

STOCK MARKETS
Over-valuations limit the up-side potential despite positive technical factors. Unspectacular side-way trend and a hidden bull market of value and secondary stocks continue.

The stock markets are currently at the top end of the side-way trend that we had expected. In the past quarter the recommended value and secondary stocks performed quite handsomely. We expect these shares to continue their rise, however, leading to a hidden bull market due to their low market capitalisation. As a consequence of overall side-way markets, timing and stock selection become key success factors. In this scenario, we continue with our strategy, whereby half a position is sold whenever a certain price target is reached, with a view to re-purchase this position once the price has dropped by approximately 10-15%. This strategy requires patience and discipline. In addition, it requires the will to overcome the fear of «not participating».

The US markets are fundamentally still around 30% too high. However, the extreme liquidity in money market funds (USD 2400 billion = 23% of the US GDP), coupled with negative real USD yields, continue to be provide strong technical support arguments for an over-inflated market.
The world-wide under-allocation in Japan is an argument that favour exposure to this market. We remain patient and continue investing with capital-protected instruments.

INVESTMENT POLICY

2nd TRIMESTER 2002

BASE	CH	EU (D)	UK	USA	J
Purchasing Power Parities					
Ned Davis Research	1,42	1,10	1,61	1,00	110
GDP Growth					
actual	1,0%	1,1%	1,9%	1,8%	-1,3%
6 months	↗	→	↗	↗	↗
3 years	↗	↗	↗	→	↑
Inflation					
actual	0,7%	1,9%	1,9%	1,5%	-1,2%
6 months	→	→	→	↗	↗
3 years	2,0%	2,5%	3,0%	3,5%	1,0%
Stock Market					
Price/Sale	1,5	0,6	1,5	1,6	1,0
Dividend yield	1,1	2,4	3,0	1,4	0,8
Price/Book	2,8	1,8	2,1	3,3	2,0
Price/Earnings 2002	19	27	25	22	n.a.
EPS Expectation 2002	↗	↗	↗	↗	↗

FORECASTS	CH	EU (D)	UK	USA	J
Money Markets (3 months)					
actual	1,6%	3,3%	4,2%	1,9%	0,0%
6 months	→	→	→	↑	→
Capital Markets (10 years)					
actual	3,7%	5,2%	5,3%	5,4%	1,4%
6 months	→	→	→	→	→
3 years	→	→	→	↗	↑
Currency					
actual		1,47	2,38	1,65	1,26
6 months		→	↘	↘	↘
3 years		→	↘	↓	↓
Stock Market					
actual	6.660	5.250	5.220	1.120	11.500
6 months	→	→	→	↘	→
3 years	→	→	→	→	↗
Real Estate Market	↗	↗	→	↘	n.a.

Legend: ↑ = very positive → = neutral ↓ = very negative as of: April 19, 2002

STOCK RECOMMENDATIONS

MAY 2002

	SECTOR	WORLD	SECONDARY	SPECULATIVE	SELL
BASE IND.	**Chemicals**		DSM Clariant Kemira		BASF
	Basic Resources	Anglo American	M-Real		Pechiney
CYCLICAL CONSUMER	**Automobiles**	VW Vorzüge Daimler Chrysler	Michelin		
	Retail		Charles Voegele	Fed Dep Store	
	Media		Tamedia	Wolters	
NON-CYCLICAL CONS.	**Food**	Philip Morris	Parmalat Südzucker		
	Various	BIC	Kali+Salz Emmi (Wandel)		Surveillance
ENERGY	**Energy**	TotalFinaElf Royal Dutch	ENI Repsol	Lukoil Transocean Gazprom	
	Utilities		Endesa CKW		
FINANCIALS	**Banks**	ING	LUKB SGKB	Commerzbank	
	Insurances	AXA Swiss Re Zurich	Baloise	Swisslife	
	Financial Serv				
HEALTH	**Pharmaceuticals**	Novartis Schering-Plough Roche	Bayer	Bristol-Myers Squibb	
	Biotech			RIM CC Bioscience Myriad	
INDUSTRIALS	**Building**	Holcim	Hunter Douglas Pilkington Dyckerhoff VZ		
	Machinery		Schindler	Stork Sulzer	MAN VZ Linde
TECHNOLOGY	**Hardware**	Philips Siemens Compaq	BB Medtech	Xerox	
	Software			Computer Assoc.	
TELECOM	**Telecom**			ATT Worldcom	Swisscom
	Equipment	Alcatel		Nortel Motorola	
CERTIFICATES	**Index**	DAX Japan Domestic	MDAX		
	Style		Pilatus	Bottom Fishing	

INVESTMENT STRATEGY

2nd TRIMESTER 2002

PERSONAL INSURANCE

Currencies

- EUR – normal weight
- USD at a minimum
- 0-5% AUD

Categories

- Maturities of 3 years in the CHF
- Maturities of 5 years in the EUR
- Up to 5% in real estate stocks
- Up to 5% in stocks with attractive dividend yields

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

CROPS / INHERITANCE

Currencies

- EUR – normal weight
- USD at a minimum
- 0-5% AUD

Categories

- CHF corporate bonds with yields >4% and duration of approx. 3 years
- EUR bonds with maturities of 5 years and yields of approx. 5%
- Hold stocks with attractive dividend yields
- Increase CH and D secondary stocks
- For European value shares, apply side-way market strategy with sale and re-purchase strategy of 50%
- 5-10% bear market strategy in the S&P 500 (capital-protected with GROI)
- 5-10% Japan bull market strategy (capital-protected)
- Up to 5% bottom fishing strategy
- 10-20% alternative investments
- 5-10% real estate stocks CH
- Up to 5% private equity instruments

Sport

Currencies

- Short USD/EUR
- Short JPY/EUR

Categories

- Long Europe (MDAX/secondary stocks)
- Bottom fishing strategy
- Nikkei/Topix long
- S&P short (bear collar)
- 30-50% alternative investments
- Up to 10% high yield investments
- Up to 10% private equity

SHOULD MORTGAGE RATES BE FIXED LONG-TERM?

Much uncertainty surrounding interest-rate forecasts

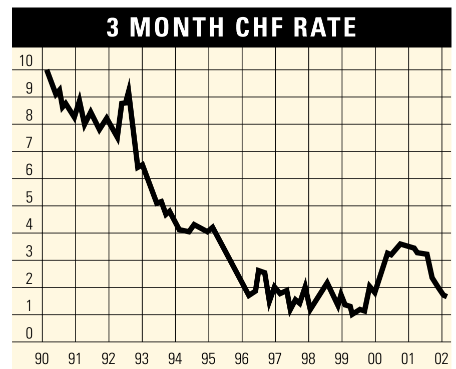
The turning point for interest rates seems to be upon us. That at least is the conclusion that the majority of experts draw from the more positive economic signals. This gives rise to the question of how best to finance real estate. Is a fixed-rate mortgage best in order to avoid surprises from a rise in interest rates? There is increasingly less demand for variable mortgage rates. The reason for that is that variable mortgage rates are currently less attractive than short-term roll-over and fixed-rate mortgages financed on the money market.

OVERVIEW OF MORTGAGE RATES

	Variable	3Y fixed	5Y fixed
Migros	3.75	4.125	4.50
CS	4.25	4.150	4.45
KB	4.0	4.25	4.55
Raiffeisen	4.0	4.25	4.625
UBS	n.a.	4.25	4.60
Coop	4.0	4.375	4.75

Quelle: www.comparis.ch 19. 04. 02

In Europe, we see a stable interest rate climate. It seems to us that compared with the USA, the inflationary potential in Europe and the pressure on higher interest rates continues to be minimal (lower money supply growth, stagnating economy). In Switzerland, the fight against a revaluation of the CHF is in full swing. It is probable that short-term interest rates will continue to remain low during this period. For this reason we consider short-term financing in CHF, currently at 2.6%, to still be advisable. Naturally, short-term financing is more aggressive than fixed-rate mortgages.



Therefore, in individual cases, depending on one's risk appetite, a mixed strategy should be pursued.

Cornelia Wyrsch