PRIVATBANKIERS
REICHMUTH & CO
INTEGRAL INVESTMENT MANAGEMENT

CHECK-UP

CLIENT INFORMATION OF PRIVATBANKIERS REICHMUTH & CO, INTEGRAL INVESTMENT MANAGEMENT

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EDITORIAL

Target oriented mandates are our speciality. In this regard, our asset allocation is not rigid, but instead flexible in line with the market environment. We position our portfolios with a view to the future to enable us to achieve or exceed our target returns with the greatest possible security. In the slightly revamped investment section inside this issue of Check-Up you will find out which scenarios we are giving consideration and how we implement them in our modular concept of the «Portfolio of the Future».

Better returns with lower volatility – that is what we strive to achieve with such target oriented mandates. They are more broadly diversified than conventional portfolios and therefore also less risky. This concept has worked for many years, in difficult phases as well as in good periods. We expect the same in the current turbulent phase on financial markets, and are therefore already focusing on the new opportunities that will present themselves in due course.

Christof Reichmuth
General Partner

NORMALIZATION – NOT YET A CRISIS

RISK HAS A PRICE AGAIN

«The pitcher goes often to the well…» – was the title of the last issue of our Check-Up – «Threat of inflation and rising risk of a financial crisis». Has the crisis already arrived? No. What we're seeing at the moment is not more than a normalization of the exaggeration – not a crisis. However, the likelihood that one will occur has increased.

Solid global economy – with the exception of the US

The global economy is actually still in very good shape. Demand from Asia and Eastern Europe together with investments for replacements in the West is filling order books. Only the US is ailing, and almost at a point of a standstill. We do not expect a dramatic slump in the global economy, yet we are still considering all the possible scenarios. You can find a summary of presently conceivable scenarios on page 6. Short-term, the scenario expected by the market, i.e. the consensus view, is the most likely one. However, the risk of a recessionary development – as a result of a previous financial crisis – has risen once again.

Risk premiums – the appetite is waning

Risk premiums – the added costs borrowers with lower credit ratings have to pay – express investors' greed or fear. They fall when risk appetite rises, and rise when investors are afraid. Risk premiums have been very low for more than three years, indeed hitting record lows. This was made possible by the excessively generous supply of money by central banks after the stock market slump between 2000 and 2003. Whenever something lasts too long, an essentially healthy development is exaggerated and carried to extremes. This was most clearly noticeable in the US with the massive boom in the securitization of lower-quality loans and mortgages. It was only thanks to them that there was a major boom in the US real estate market in the first place, and, thereafter, also in the private equity sector. In our article on page 7, we outline how this was possible at all, taking subprime mortgages as our example. Incidentally, unlike most investors, we were prepared for this development, and in Reichmuth Matterhorn we even profit handsomely from it.

Alchemy in the financial sector?

In the past, people tried to manufacture

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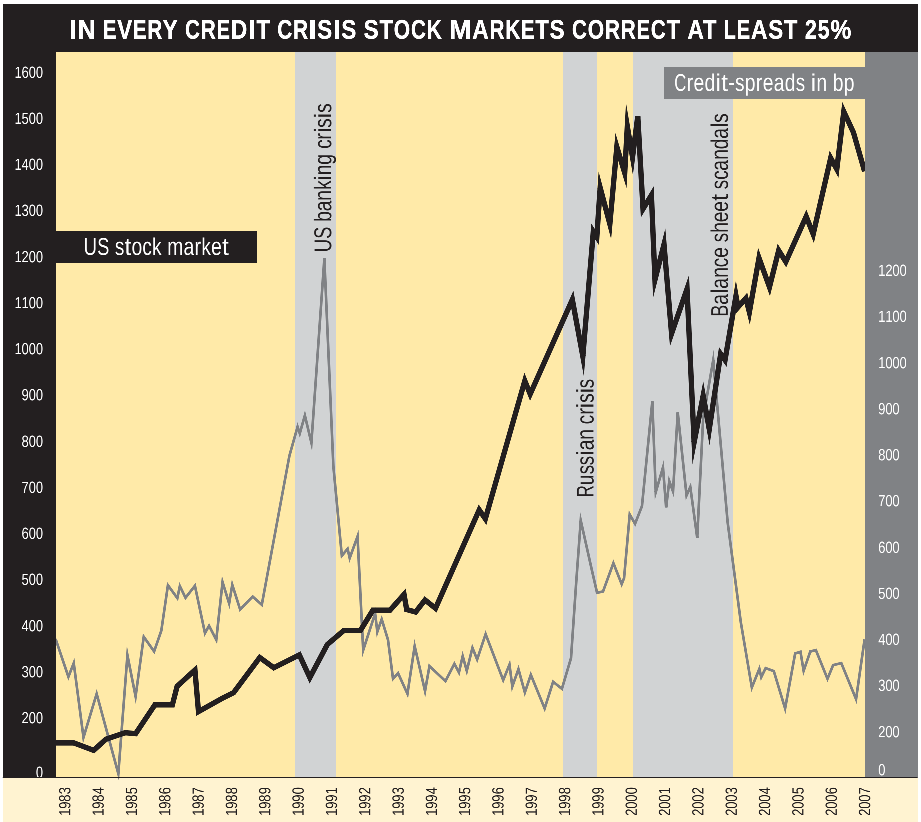


Source: NDR / Bloomberg

gold chemically. Many purely computer-based models these days are reminiscent of the same endeavor. We cannot understand the absolutely boundless faith in quantitative models. Admittedly, such models often work rather well for quite a while. Yet, at some point something happens that can no longer be tracked in figures and formulas. And it almost always comes to this point sooner or later. An investment always has a real underlying basis. Hence, using numbers and statistical values as the sole decision-making parameters always leads to errors. We place our trust in economic knowledge and good common sense, basing our investments on fundamental considerations and taking into account the dominating money flows over the medium term and the prevailing market sentiment in the short term.

What do higher risk premiums mean?

They mean a number of different things. For example, they mean that it will become more difficult for companies with lower credit ratings to raise capital. Therefore, the private equity boom is over for the time being. Secondly, they mean lower stock valuations, as the discount rates used to value companies are higher. The stock market is therefore likely to falter, despite a healthy real economy. Finally – and this is causing the most concern to us – they mean dwindling risk appetite. This in turn has a major influence on money flows and the consequences of this cannot be estimated at this stage. Under certain circumstances, it could lead to a phase of de-leveraging in the highly levered world of finance, which would almost certainly push prices down below fair value. However, this would subsequently open up excellent investment opportunities once again.

Credit crisis means a correction of at least 25%

There have been four major credit crises in the past 20 years, and each of them saw the global stock markets lose between 25% and 50%. While we do not expect a slump as seen after the tech bubble, we do regard a strong downtrend as being entirely conceivable. The key is to gear the portfolios towards this possibility.

Diversify defensively

Our modular concept is well diversified (see page 5). And within this concept, we now opt for a defensive allocation. In the case of equities, in addition to the heavy weightings in energy, basic materials and industry, we also recommend food and healthcare. In the strategy funds Reichmuth Alpin and Reichmuth Hochalpin, about half of the equity exposure is hedged via options, so as to cushion the effect of a possible slump. As already mentioned, thanks to our exposure in short credit strategies, we can profit from the current developments on credit markets via our alternative investments. This strategy has proven itself admirably thus far, as can be seen in the returns as of the end of July. Our strategy funds have again posted strong, above average performance, with gains of 6.3% (Reichmuth Alpin) and 8.1% (Reichmuth Hochalpin).

Currency allocation must not be neglected

At the moment, we're only experiencing a re-valuation of financial assets. What effect this will have on the economy, cannot be accurately predicted. In particular, the long overdue re-valuation in foreign exchange rates, may play a important role. Hence, we recommend a cautious stance in the currency allocation. We favor Asian currencies and we like Gold. The strong EUR has brought handsome profits to CHF investors. The time has come to secure these profits by hedging EUR exposure via forwards. Despite the fact that the USD is no longer expensive, we would still hedge USD exposure against European currencies. Eventually, even a short position against Asian currencies may be considered. Questions related to currency allocation should form part of our next dialogue with you. We look forward to the challenging times that lie ahead, and to our next meeting with you.

Your Reichmuth & Co Team

MARKET OUTLOOK
3rd TRIMESTER 2007

INTEREST RATES

Interest rates will continue to rise in Europe and Japan, while in the US they are set to remain unchanged or could drop slightly.

The good growth of the global economy has remained intact thus far. However, the risk that it could be increasingly hit by the crisis on the US securitized mortgage loans market is rising. The measures to cool the economy in China and the high dependency of the boom in Eastern Europe on imported capital, will also develop into a slowdown over time. Central banks are aiming their monetary policies primarily at maintaining the value of money. Given that they expect increasing inflationary threats, they will become even more restrictive, at least in Europe and Japan. However, the US Federal Reserve could shift to a more generous monetary policy, especially if there were to be a crisis on financial markets. Further interest rate hikes from the ECB and the Swiss National Bank are thus on the cards, and similar rate rises can also be expected on the money market in Japan.

Long-term yields continued to rise initially, but have corrected back down in recent weeks. They are likely to continue to follow the interest rate trend on the money markets in the coming months, albeit at a weaker pace, i.e. rising slightly in Europe and Japan and remaining practically unchanged in the US. Despite the relatively low level of yields by historical standards, long-dated fixed-income paper offer good real interest rates owing to low inflation.

CURRENCIES

The low-interest currencies JPY and CHF have remained weak, but a turnaround is in the offing. In the long run, the USD will continue its trend down, above all versus the JPY and the Asian currencies.

The weakening in the low-interest currencies JPY and CHF, stemming from the further increase in the volume of carry trades, continued in the past few months. However, a turnaround is now emerging due to uncertainty on financial markets triggered by the US mortgage market crisis, and this turnaround could strengthen over the near term. Aside from this, the fundamental imbalances in current accounts and purchasing power parity remain doggedly high, and have in some cases even increased. In the long-run, a reduction in these imbalances is inevitable. Correspondingly, we can expect a pronounced weakening of the USD, above all versus the JPY and other Asian currencies. The same applies, albeit to a lesser extent, in Europe, where we expect the CHF to appreciate and the GBP to depreciate clearly against the EUR over the long term.

STOCK MARKETS

Following the price declines in recent weeks, stocks are now fairly valued. If the mounting uncertainty on financial markets were to spill over into the real economy with recessionary tendencies, this could lead to a more protracted downtrend.

The stock markets have reacted to the US mortgage market crisis with falling prices and increasing volatility – particularly for financials, which are most affected. Based on fundamental criteria, in terms of their earnings – and provided the uncertainty on financial markets does not spread to the real economy – stocks are now fairly valued on average, and, in some cases even cheap. However, the erstwhile optimism of market participants has given way to heightened uncertainty and a prevailing loss of confidence. With financing becoming more difficult, there will also be a sharp drop in the volume of takeovers and the attendant demand for equities. Therefore, the uptrend seen thus far on stock markets is probably now broken for some time, and could in fact give way to a downward trend, particularly in the US.

As regards the individual markets, we are continuing to favor Japan and other Asian countries with fundamentally cheap valuations such as South Korea, Taiwan, Thailand and Singapore. Unlike the Western markets, price levels here are still well below historical highs. In terms of sectors, the financial sector is the most attractively valued. Despite this, we would avoid banks given the uncertain implications of the mortgage market crisis. However, we would consider investments in selected European insurers. Furthermore, the very volatile stock price environment at present will generally present a lot of attractive entry opportunities.

Dr. Max Rössler

INVESTMENT POLICY

3rd TRIMESTER 2007

BASIS	CH	EU	UK	USA	J
Purchasing Power Parities					
Ned Davis Research	1.22	1.24	0.64	1.00	106
GDP Growth					
actual	2.4%	3.1%	3.0%	1.8%	2.6%
6 months	→	→	↘	↘	→
3 years	↘	↘	↘	↘	→
Inflation					
actual	0.7%	1.9%	2.4%	2.7%	-0.2%
6 months	→	→	→	↗	↗
3 years	2.0%	2.5%	3.5%	4.0%	1.5%
Stock Markets	**SPI**	**DAX**	**FTSE**	**S&P 500**	**TOPIX**
Price/Sales	1.9	0.8	1.4	1.6	0.8
Dividend yield	2.1	2.6	3.9	1.9	1.3
Price/Book	2.7	1.9	2.3	2.8	1.7
Price/Earnings actual	14	13	12	17	20
Price/Earnings estimate	15	13	11	15	18

FORECAST	CH	EU	UK	USA	J
Money Markets (3 months)					
actual	2.9%	4.7%	6.6%	5.5%	1.0%
6 months	↗	↗	→	→	↗
Swap Rates (10 years)					
actual	3.4%	4.7%	5.7%	5.3%	1.8%
6 months	↗	↗	→	→	↗
3 years	↗	↗	→	↗	↗
Currencies					
actual		1.64	2.41	1.20	1.03
6 months		↘	↘	↘	↗
3 years		↘	↘	↘	↗
Stock Markets	**SPI**	**DAX**	**FTSE**	**S&P 500**	**TOPIX**
actual	7’130	7’500	6’210	1’465	1’580
6 months	→	→	→	↘	↗
3 years	→	→	→	↘	↗
Real Estate Market	→	→	↘	↘	→

Legend: ↗ = increasing → = neutral ↘ = decreasing as of: August 24, 2007

PORTFOLIO OF THE FUTURE
OUR FUTURE ORIENTED MODULAR CONCEPT

EX.	WHAT	HOW	IMPLEMENTATION	RETURN*	VOLATILITY*
5%	Commodities	Precious metals	Gold Forwards Gold Stocks ETF Gold physically	8-10%	10%
10%	Real Estate	1/4 Switzerland 1/4 Europe 1/2 Asia	Real Estate Companies Germany / Eastern Europe Singapore REITs / Vietnam	5-8%	10%
25%	Alternative Investments	Fund of Hedge Funds (diversified Instrument with clear return / risk targets)	Reichmuth Matterhorn or third party instruments Reichmuth Himalaja	8-10% 10-15%	< 5% < 10%
15%	Structured Products	Macro Ideas – implemented with partial capital protection	Japanese stocks capital protected Japanese small and mid caps with partial capital protection Bear market strategy on US stocks Asian currencies against the USD	10-15%	8%
20%	Equities	Diversified stock portfolio with an overweight in tail-wind sectors Implementation of «scale in – scale out»- concept	Energy (oil / gas) Infrastructure (power / traffic / railways) Basic materials (cement / suppliers) Asia (Singapore / Taiwan / Korea)	4-6%	15%
25%	Fixed Income	Money market and bonds as cushion and temporary liquidity reserve	Short duration in CHF and EUR SGD bonds with maturities up to 5 years	2-4%	4%
			Total	**5-9%**	**approx. 5%**

*Expected average return and volatility over the next 3-5 years

CURRENCY ALLOCATION – NOT TO BE NEGLECTED
JPY AND CHF UNDERVALUED – EUR AND GBP OVERVALUED

«You can do everything right – yet if you're currency allocation was wrong, you lose it all». This is a lesson we learned from a client many years ago. That's why we actively manage our currency allocation, normally by using currency forwards. In this respect it is important to view such forwards as a part of the asset allocation, and not as an isolated transaction.

From a CHF perspective, the last few years were characterized by two main trends: a very weak JPY (see chart) and a strong EUR. These trends are coming to an and. Ever since the JPY´s high in 2000, it has lost approximately 40% against the CHF. Currently, it is trading at almost historical lows. So called «strong currencies», such as the CHF and the JPY, should always be regarded against each other, and their ratio never goes to zero. Hence, any major deviation from the mean is especially interesting. Today, this ratio is so low, or the CHF so high, that within our currency allocation we consider the JPY to be highly attractive.

THE JPY IS ATTRACTIVE AND CHEAP AGAINST THE CHF

THE BIG PICTURE

OUR SCENARIO ANALYSIS IN A NUTSHELL

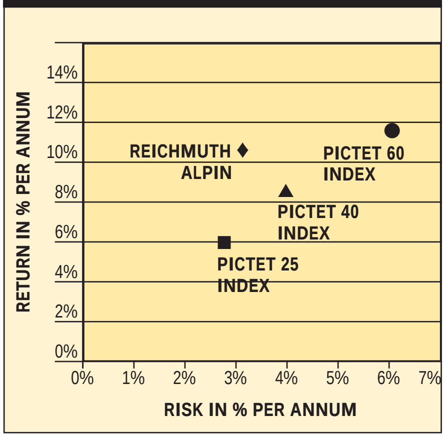
	MARKET	FINANCIAL CRISIS	RECESSION	INFLATION	EUPHORIA
	Worldwide economic growth remains positive, highest in Asia, lowest in the U.S. The imbalances on current accounts remain high. JPY and CHF stay undervalued because of carry-trades. Interest rates in Europe and Japan continue to increase whilst they are unchanged in the US. Equity markets tend to move sideward.	Potential triggers: 1) Credit crisis: An increase of defaults will lead to escalating risk premiums. Threat of potential chain reactions, especially with credit derivatives and credit structures 2) USD crisis : Imbalances cause strong depreciation of the USD (current accounts, carry-trades, FX reserves) 3) External Shock: Terrorism, war in the Middle-East, natural catastrophes	The restrictive monetary policy combined with stagnating or even decreasing real estate prices in the Anglo-American countries weakens economic growth and leads, first in the U.S. and later also in other countries, to a soft recession. Interest rates stop to increase. Equity markets start to crumble.	Central banks do not reduce liquidity overhang cumulated during recent years. Wages continue to increase. On a nominal view there is still growth, but in real terms we see a decline. Interest rates go up. Equity markets stagnate. Real estate, precious metals, and generally assets with intrinsic value are in demand. Nominal liabilities and obligations (i.e. pension protection) are easier to be fulfilled.	Growth in emerging markets functions as the locomotive for the world economic development. In the industrialized countries, including the US, growth remains at a stable level. Imbalances on current accounts slightly decrease. Equity markets and real estate prices continue to increase. Interest rates increase as well. Prices for energy and resources/ commodities go up. Overstatements and speculation accelerate.
Cash:	Neutral	Long	Long	Short	Short
Bonds:	Neutral	Long (AAA)	Long	Short	Short
Stocks:	Neutral	Short	Short	Short	Long
Japan:	Long	Short	Neutral	Short	Long
Energy:	Long	Short	Short	Long	Very Long
Emma:	Long	Short	Short	Short	Very Long
Commodities:	Neutral	Short	Short	Long	Very Long
USD:	Neutral	Short	Short	Short	Neutral
Asia FX:	Long	Neutral	Long	Long	Long
Gold:	Neutral	Long	Neutral	Long	Neutral
	Probability: 40%	Probability: 25%	Probability: 20%	Probability: 10%	Probability: 5%

HIGHER RETURN WITH LOWER VOLATILITY

SUCCESSFUL INVESTING THANKS TO TARGET ORIENTED STRATEGY

Reichmuth Alpin is our target oriented strategy fund which implements the Reichmuth & Co investment policy in a conservative manner. Hereby, the fund abides to the investment guidelines for Swiss pension funds. Hence, the fund is very well suited for target oriented private investors or as an alternative to a balanced portfolio for pension funds.

COMPARSION OF REICHMUTH ALPIN



Reichmuth Alpin is much broader diversified than conventional strategies. Further, the asset allocation is not rigid – much more, we manage the portfolio by applying a market and future oriented investment approach. That way, we try to take advantage of existing opportunities and avoid risks. As a result, we expect higher returns and lower volatility than for conventional portfolios. The chart below shows the return/risk profile of Reichmuth Alpin vis-à-vis relevant pension fund indices containing a 20, 40 or 60% allocation to equities. As can be seen, in a 3-year comparison, we could underpin our thesis with concrete results.

Sergio Hartweger

HOW WAS THE «SUBPRIME CRISIS» POSSIBLE?

SECURITIZED MORTGAGES MOVING THE WORLD'S FINANCIAL MARKETS

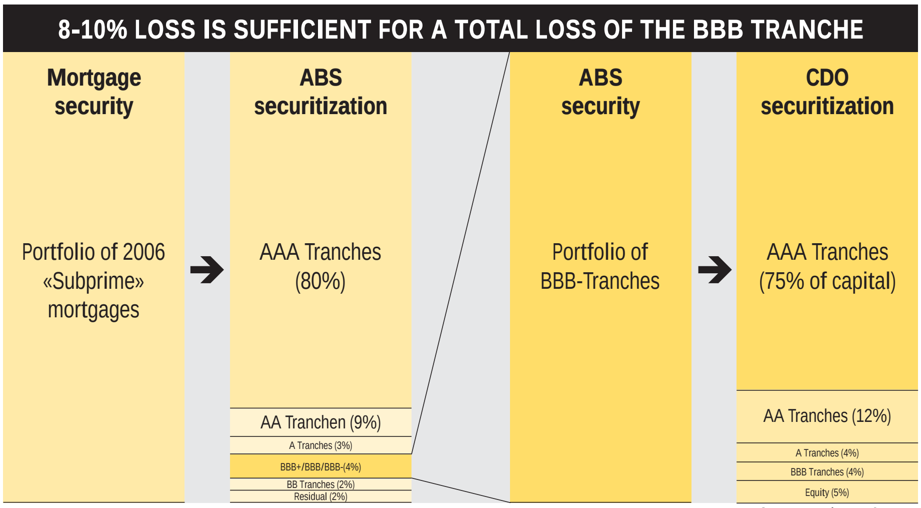
The current problem stems from a number of different factors. In part, the highly generous central banks are responsible. Consumer-friendly homeowners bear another part of the responsibility. Ratings agencies with their faith in models are just as much to blame as the aggressive mortgage sellers. But we should also not forget the investors around the world lusting for returns in this regard. Only a combination of these factors could take a simple thing such as a mortgage and, through several stages of securitization, turn it into an instrument in which no one is interested any longer in the original underlying transaction!

In the beginning, there were mortgages

These were given to homeowners of second-class creditworthiness (so called «subprime»). From the outset, the banks did not want to take these mortgages onto their own balance sheets, opting instead to sell them on the securities markets. By doing so, the risk is passed on from the bank's balance sheet to the securities markets.

The structure of asset-backed securities (ABS)

In essence, in order to structure an ABS, a large number of mortgages are brought together in a pool (see chart). This pool is then assessed by ratings agencies and rated in terms of default probability, as the pool is to be financed with the cheapest possible debt (bonds). The more of these bonds there are in the capital structure, the safer they are and vice versa. We doubt whether the historical models of the ratings agencies take sufficient account of the economic circumstances. Much more, it seems to us that the faith in the models and their results is moving in an almost totalitarian – and thus dangerous – direction.



Source: Paulson & Co. Inc.

An ABS becomes a CDO

Now comes the part, where it gets interesting. For while the AAA bonds from the ABS can still be readily placed with investors, it is somewhat more difficult to sell the lower-quality tranches. These tranches often appear in the form of collateralized debt obligations (CDOs). This is a further form of securitization, yet one that finances debt and no longer «assets». In principle, this is exactly the same scenario as above, but this time with a much higher concentration of poorer quality, as shown in the chart with the BBB tranches. A large number of these BBB tranches are gathered together in a pool, split up into new tranches, and financed in this manner. As a result, from low quality you can create AAA bonds again. Economically, all of the above makes little sense – yet using historical data, almost anything can be modeled statistically.

And on top of this you buy CDSs

CDS stands for credit default swap. These work like an insurance policy. You pay an annual premium, and in return you are paid the nominal amount of the bond if the borrower can no longer pay. And precisely these CDS are helping us now in our short credit strategies, where we buy this insurance. It is interesting to see who sells this insurance on ABS or CDO vehicles, i.e. who the counterparty is. Often it is so-called synthetic CDO vehicles that form a concentrated pool of debt securities synthetically using derivatives.

Where is the risk of the CDO?

If only around 8-10% of all the original mortgages in the chart default, the entire CDO is worthless – including the AAA bonds! Of course not all CDOs will default completely – but due to exaggeration some will. The real test for the markets will only come when the «insured» amounts from the CDSs not only have to be revalued, but also actually have to be paid!

Who buys these securities?

We have often asked ourselves and to this day do not understand how these securities are now popping up all over the world and causing losses. This is likely to result in a massive destruction of wealth totaling several hundred billions of USD. The reactions to this will show whether this will turn into a true crisis or not.

Patrick Erne

COMBINING «HAVING» WITH «BEING»

KARL REICHMUTH ON A CORPORATE SUCCESSION SOLUTION

Wealth is always something very personal. Identifying clients' needs and proposing a strategic structure is the core task of integral investment management. This also includes timely estate planning – especially for entrepreneurs.

Succession planning and fairness

The father of one of our clients provided us with a shining example many decades ago. As the owner of his firm, he passed the responsibility for it to his son at an early stage. The principle of fairness is important for all parents, and he addressed this by setting up separate assets for his only daughter, again at an early stage.

Succession planning for the fourth generation

Since the beginning of the 1970s, the then very young entrepreneur has led the German firm with its strong traditions into a new dimension. He has four children: three sons and one daughter. Two of his sons are interested in taking on the company and are capable of doing so. Following his father's example, he also set up separate assets for his daughter. However, for the entrepreneur, the greatest challenge of all was to ensure the highest level of security, welfare and care for one son who has been disabled from birth.

Individual and target oriented solution

His company would now be ready for an IPO in terms of both sales and earnings. This would be the simplest way of ensuring a fair distribution of wealth among the children. Yet, since he is committed to keeping his business in the family, an IPO is not what the client wanted. In our role as integral investment manager and advisor in such situations, he set us the following objective: «fairness for all, security for the disabled son, and the preservation of the company as a family firm».

Paving the way

While he was still CEO, he introduced the solution he developed together with his tax and family lawyer. In addition to his two sons, who both work in the company, he brought professionals from outside into the management team. This will enable the next generation to stage an IPO, should it wish to and provided that the company grows beyond «family size». Furthermore, by splitting off his large real estate portfolio into a Liechtenstein foundation, he can provide both security and care for his disabled son and growing assets for his daughter.

Tax issues

As with every inheritance solution in Germany, tax issues play an important role. It is essential that the company avoid potentially lethal inheritance taxes. This is why the real estate holdings were transferred to a «transparent» foundation, a construction under Liechtenstein law that is known to the tax authorities. Once the assets have been transferred to it, neither the German nor Swiss tax authorities can demand any inheritance tax. Of course, the distributions of income from the foundation will be subject to income tax, irrespective of where the heirs live.

Elements offering broad scope

Thanks to the early planning of possible inheritance scenarios and creating different elements, it was possible to achieve all of the objectives set:

1. The disabled son is the primary beneficiary, with the rent from the extensive real estate holdings providing for his care and welfare in line with his current standard of living, including protection from inflation.
2. The secondary beneficiary, his daughter, can also expect a secure rental income for herself and her family from the properties thanks to their prime locations. This helps ensure a fair distribution of capital among all the heirs.
3. The other two sons have already participated in value they have added to the company through their executive positions and the granting of large minority shareholdings, again at an early stage.
4. By withdrawing to the legislative level of the Board of Directors as well as creating correspondingly neutral bodies by adding an outside CEO to the management team, the client has ensured that his company's fate is less dependent on the family.

The father can thus look at the well deserved fruits of his long-term planning with a certain distance, and provide the younger generation with his support and advice. Such security is the true goal of combining «having» with «being».

Karl Reichmuth
General Partner