PRIVATBANKIERS
REICHMUTH & CO
INTEGRAL INVESTMENT MANAGEMENT

CHECK-UP

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

What a traumatic start of the year. After just 10 days, the global stock markets were down about 20%, and the pace of emergency measures being taken by central banks was steadily picking up. Has the storm passed, or have we merely entered the calm at its eye?

Looking forward, we are more optimistic now than at the beginning of the year. Most of the exaggerations of the past years have been corrected with much noise. It seems that financial markets are entering a healthier state. Short-term, the crisis management of the central banks – meant to correct the errors of the past - seems to be successful. At hindsight, we are happy to have reduced our exposure to equities to the minimum allocation at an early – for many at a very early – stage. Consequently, we were able to reduce losses by 2/3 that occurred during the weak markets since the beginning of the year.

This edition of the Check-Up outlines how we plan to structure portfolios for the coming difficult and challenging stagflation years ahead.

Karl Reichmuth
General Partner

THE PERFECT STORM

CREDIT CRISIS – BANKING CRISIS – USD CRISIS

Last year's credit crunch on the US mortgage market did not take us by surprise. House price rises, financing practices, and the flood of securitization were simply too extreme. Luckily, we were able to hedge the assets under management before the crisis hit. Consequently, we posted good results – indeed, very good ones from a comparative viewpoint – for 2007. We also spotted the risk of crises hitting the banking sector and the USD in good time, although we underestimated their probability. This meant that we could only derive minimal benefits from them – yet, at least, we were able to limit our losses. The key idea behind our investment philosophy is to maintain a stable basis in hard times so as to be able to take advantage of opportunities again when they arise. It is a well known fact that, over time, a higher basis and compound interest can work wonders.

Risk of system collapse averted

A lot has been written about the reasons for the current misery in the banking sector. We, too, have been discussing the topic for the past year (see our website).

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Visit our website www.reichmuthco.ch. There you will find our previous editions of the Check-Up as well as other publications and articles related to your private bank.

Today, we are looking to the future with a little more optimism. We believe the risk of a system collapse has now largely been averted. It is time to clear up the debris, and there is a lot of work to do here. The message of the rescue measures of the central banks is clear: banks that are important to the system will be rescued, their shareholders will not. This is quite right. Shareholders provide risk capital. If the bank they invest in makes mistakes that is their problem. Losses are a fact of life in the investment business – and risk always has its price. However, one thing that must be avoided at all costs is the domino effect. If a system-critical bank goes under, it could potentially drag several others down with it. This would destabilize the entire financial system – something that should never be allowed to happen, even if it ultimately means resorting to temporary nationalization.

Bad loans are socialized

In some countries we expect to see pu-

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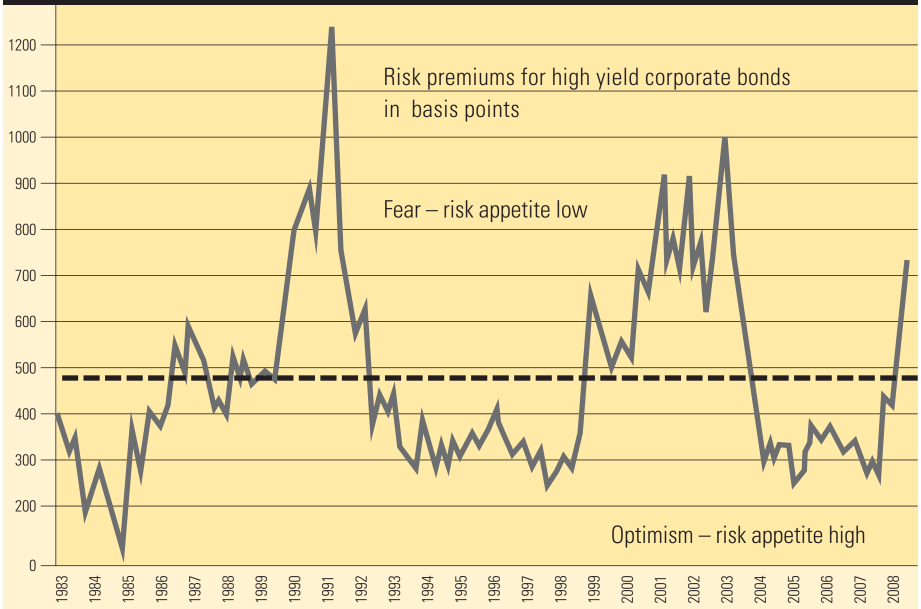
CONTENT

RISK HAS A PRICE AGAIN



Source: NDR

blic-sector entities taking distressed paper off banks' balance sheets. This has already happened in Germany and England with some banks. Ultimately, it is the taxpayer who bears the brunt of the losses rather than the banks. This socialization of losses is in itself reprehensible, yet the benefits are clear to see. It allows banks to get back to business, which is essential for growth. It also eliminates a huge supply overhang in barely tradable securities – a supply that is pushing prices ever lower. This is what happened in Switzerland following the real estate crisis in 1991. Some of the cantonal banks had to temporarily outsource part of their credit portfolios, and were allowed to do so, until the real estate markets recovered after 1995.

What is «de-leveraging»?

A rescue is never for free. Regulators will issue new guidelines. This will extend the process of «de-leveraging», i.e. debt reduction. Assets, such as financial instruments, will and have to be sold in order to pay off debts. This, together with the banks' major capital increases, means that there will continue to be plenty of supply of financial assets, set against a less than euphoric demand situation. As long as this continues, the chance of rising prices is slim.

Profit margins under pressure

Plummeting prices led to a drop in price/earnings ratios. Now, however, earnings are under pressure as well due to the slowdown in the world economy and rising wage, financing, and materials costs. If sales volumes fall as well, margins will come under further pressure. We have anticipated this scenario for some time. Profit margins have been too high for years. With both earnings and price/earnings ratios set to remain flat or fall, the best-case scenario for the stock markets is a sideways trend.

What can we expect?

The global economic outlook is not rosy, but it is not disastrous either. The real economy is in good shape, albeit with the weakening now spreading from the US to Europe and Asia as well. However, this has already been priced in amid the storm on the financial markets. The risk of a system collapse has fallen since the start of the year. Since all traded securities fall in unison during such a strong correction, there are no opportunities here either. We expect neither positive earnings surprises nor improvements in price/earnings ratios. A rally is thus not on the cards, but isolated buying opportunities will arise in stocks that have fallen too sharply while maintaining good dividends and reasonable valuations.

An interesting glance at the US

The dramatic weakening of the USD is also prompting us to look increasingly to the US for good value investments for the first time in years. For example, US export stocks will start to look attractive soon, as will distressed bond strategies. Investors are always fearful when risk premiums are high, but this is exactly the right time to buy risks (see graph). While it goes against most people's gut feeling, it is best to resist the urge to buy at high prices when everything is expensive and the reward offered for the risk taken on is low.

Commodity stocks in vogue and overpriced

We advise against buying commodity stocks. They are already overpriced, although their overvaluation may yet become even more pronounced in view of low interest rates and the worldwide rush to print money. However, the opportunities are not looking good relative to the high risks.

Inflation set to be the topic of the future

The countries of the Middle East and China are already at a loss as to how they can keep inflation under control. They face a choice between adopting a restrictive monetary policy with higher interest rates, increasing reserve requirements for banks or revaluing their currencies. In the West, meanwhile, the central banks are clearly focused on saving the financial system. The threat of higher consumer price inflation combined with asset deflation will therefore be a hot topic in the next few years as we seek to preserve our clients' assets and make the most of the opportunities available, even when times are hard.

Christof Reichmuth
General Partner

THE BIG PICTURE

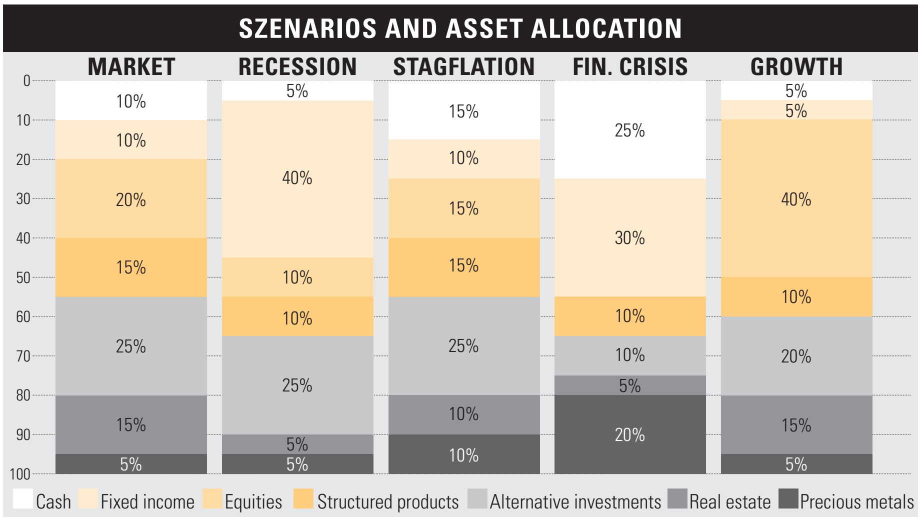
OUR SCENARIO ANALYSIS IN A NUTSHELL

MARKET	RECESSION	STAGFLATION	FINANCIAL CRISIS	GROWTH
The US financial crisis impacts all financial markets. Uncertainty and volatility remain high. The United States enter into a recession. Nevertheless, average worldwide economic growth remains positive. The central banks, the US Fed in particular, continue to pump liquidity into the financial system. Over time confidence returns.	US real estate prices continue to fall and thus amplify the financial crisis. Further reductions of the Federal Funds rate by the Fed do not help enough, many banks default and must be bailed out by the government. The real economy goes into a deep recession. Many other countries all over the world also slip into a recession, although much less pronounced than the United States.	The central banks are successful in their fight against the financial crisis by applying extremely expansive money market policies. The politicians want to defend their domestic economies with more protectionist measures. This leads to more inflation and also to a stabilisation of real estate prices. The economy recovers only moderately and slips into stagflation.	Banking crisis Counterparty risks / collapse of the system Foreign exchange market crisis The US Fed follows an extreme low interest rate policy in order to overcome the financial crisis. The other central banks do not follow this policy because they want to fight against increasing inflation. This leads to a total collapse of the USD and, therefore, to an extremely difficult situation for the European and Asian export industry.	The financial crisis in the United States slowly abates, without massive interventions by the central banks. Confidence on financial markets returns. Economic growth returns and enters into an increasing trend, particularly in the United States.
Cash: Neutral Bonds: Neutral Equities: Neutral Japan: Long Energy: Long Emma: Long Commodities: Neutral USD: Neutral Asia FX: Long Gold: Neutral	Cash: Long Bonds: Long (AAA) Equities: Short Japan: Short Energy: Short Emma: Short Commodities: Short USD: Short Asia FX: Neutral Gold: Long	Cash: Long Bonds: Short Equities: Short Japan: Short Energy: Long Emma: Short Commodities: Long USD: Short Asia FX: Long Gold: Long	Cash: Long (ex USD) Bonds: Long (ex USD) Equities: Short Japan: Short Energy: Short Emma: Short Commodities: Short USD: Short Asia FX: Long Gold: Long	Cash: Short Bonds: Short Equities: Long Japan: Long Energy: Very Long Emma: Very Long Commodities: Very Long USD: Neutral Asia FX: Long Gold: Neutral
Probability: 25%	Probability: 20%	Probability: 40%	Probability: 10%	Probability: 5%

SCENARIO ANALYSIS LEADS TO ASSET ALLOCATION

FUTURE-ORIENTED PORTFOLIO MANAGEMENT

The discussion about the scenarios mentioned above form the basis for our investment strategy. Hence, the asset allocation is derived depending upon the various scenarios. The following graph shows the differing weightings of our building blocks for a portfolio in a simplified manner.



Future-oriented Implementation

One of the main tasks in the portfolio construction is to choose the investments with the most attractive return/risk characteristics within the individual building blocks. For example, taking the very likely scenario of a forthcoming stagflation, we would allocate the major part within the building block for fixed income to money market investments and short-duration bonds. Within the building blocks for equities and alternative investments we currently opt to choose defensive stocks and strategies. For structured products, we would focus on opportunities in foreign currencies. Yet, as always, the definition of the scenario and, consequently, the appropriate, tailor-made allocation can only be decided as a result of a personal conversation with you.

Jürg Staub
General Partner

INVESTMENT POLICY

2nd TRIMESTER 2008

BASIS	CH	EU	USA	J	CHINA
Purchasing Power Parities					
Ned Davis Research		1.52	1.18	1.13	
GDP Growth					
actual	3.6%	2.2%	2.5%	2.0%	10.6%
6 months	↘	↘	↘	↘	↘
3 years	↘	↘	→	→	↘
Inflation					
actual	2.6%	3.6%	4.0%	1.2%	8.3%
6 months	→	→	→	↗	↗
3 years	2.5%	3.5%	5.0%	1.5%	5.0%
Stock Markets	**SPI**	**DAX**	**S&P 500**	**TOPIX**	**HSCEI**
Price/Sales	1.6	0.8	1.4	0.5	2.3
Dividend yield	2.8	3.1	2.2	1.6	1.7
Price/Book	2.3	1.7	2.6	1.4	3.0
Price/Earnings actual	17	11	22	16	17
Price/Earnings estimate	16	11	15	15	14

FORECAST	CH	EU	USA	J	CHINA
Money Markets (3 months)					
actual	2.8%	4.8%	2.9%	0.9%	4.5%
6 months	→	↘	↘	→	↗
Swap Rates (10 years)					
actual	3.6%	4.7%	4.5%	1.8%	n.a.
6 months	→	→	↗	→	n.a.
3 years	↗	↗	↗	↗	n.a.
Currencies					
actual		1.62	1.03	0.99	6.97
6 months		↘	→	↗	↘
3 years		↘	↘	↗	↘
Stock Markets	**SPI**	**DAX**	**S&P 500**	**TOPIX**	**HSCEI**
actual	6’200	6’800	1’390	1’330	12’670
6 months	→	→	→	→	→
3 years	↗	↗	↗	↗	↗
Real Estate Market	→	→	↘	↗	↗

Legend: ↗ = increasing → = neutral ↘ = decreasing as of: April 25, 2008

MARKET OUTLOOK

2nd TRIMESTER 2008

CURRENCIES

USD weakness dominates exchange rate movements. Following the EUR and CHF strength, the JPY and SGD are now rising as well, and the appreciation pressure on the currencies still pegged to the dollar in Asia (CNY) and the oil-producing countries (AED) is mounting.

Exchange rate movements continue to be dominated by the weakness of the USD. To begin with, it was primarily the EUR that appreciated sharply. The JPY and CHF have made the strongest gains of late on the back of a decline in carry trade volumes. Meanwhile, most other Asian currencies, including the CNY, SGD, and HKD, as well as the currencies of the Arabian oil-producing countries, are still closely pegged to the USD. They will therefore be subject to increasing appreciation pressure over the next few months. The alternative would be rising inflation and overheating economies in these countries. Measured in terms of purchasing power parity, the USD is now undervalued. However, the current account deficit is still very high, and the macroeconomic trend in the US is not positive for the USD either. The dollar could thus recover slightly from the oversold market situation in the near future, yet it is set to remain a fundamentally weak currency over the longer term. In Europe, the renewed strength of the CHF and the weak GBP are the standout exchange rate trends. Both are likely to become more pronounced going forward.

INTEREST RATES

The financial market crisis is forcing central banks to inject a great deal of liquidity into the money markets. Short-term interest rates in the US will fall further, while those in Europe and Japan will remain unchanged. Low government bond yields will rise.

The crisis on the financial markets, which originated on the US real estate market about a year ago, is forcing central banks to supply the money markets with an extraordinarily large amount of liquidity in order to avert the risk of a collapse of large banks. The US Federal Reserve Bank has already lowered its headline federal funds rate sharply and will cut it further. Since the inflation rate has risen at the same time, real interest rates are now negative and thus anything but conducive to stability. In the current situation, however, the prevention of an all-out crisis on the US financial market takes precedence over fighting inflation. In Europe, on the other hand, the central banks are sticking to their primary goal of ensuring monetary stability. Therefore, they are keeping their base rates on hold and only providing additional liquidity on a short-term basis to cover the exceptionally high demand for liquidity from the banks as a result of the financial crisis. As long as the financial crisis does not get any worse, they will stick to this policy. Money market rates in Europe, as in Japan, are thus set to remain at their current levels.

Yields on long-term government bonds have fallen to unusually low levels, in some cases below inflation, due to the financial crisis and the resulting flight into safe investments. At the same time, credit spreads for bonds from banks and industrial firms have increased massively. As the financial crisis is gradually overcome, normalization will set in here, with government bond yields rising and credit spreads on corporate paper falling again.

STOCK MARKETS

Stock markets have endured several bad months with extreme volatility, especially as regards the financial sector. Current valuations are moderate, which is why we expect a sideways trend with considerable volatility.

Stock markets have lost 10-20% year to date, with some financial stocks losing much more. Valuations are currently moderate, even cheap in some cases, assuming that profit margins stay high. Rising interest rates at the long end of the curve are a negative factor. Overall, a sideways trend can be expected for most markets, but the high volatility will not diminish until the financial crisis is overcome. Japan has yet to achieve the long-awaited outperformance based on profit margins improving from low levels, but its chances are intact. Selected emerging markets, especially ones with currencies that have additional upside potential, also appear attractive.

As far as sectors are concerned, some financials – especially insurers – look very cheap following massive price falls.

Dr. Max Rössler

PORTFOLIO OF THE FUTURE

DIVERSIFIED AND FUTURE-ORIENTED – ADAPTED TO THE PREVAILING MARKET CONDITIONS

%	WHAT	HOW	RETURN*	VOLATILITY*
25%	Fixed Income	Large allocation to money market investments Short-term bonds	2-4%	4%
20%	Equities	Scale in – scale out concept. Value stocks with stable cash flows and balance sheets Active management using country and sector ETFs Infrastructure, Pharma, Food	4-6%	15%
15%	Structured products	Asian currencies and AED vs. USD/EUR	10-15%	8%
25%	Alternative Investments	Reichmuth Matterhorn or third party instruments Reichmuth Himalaja	8-10% 10-15%	< 5% < 10%
10%	Real Estate	1/2 Switzerland, 1/2 Asia	5-8%	8%
5%	Commodities	Precious metals	8-10%	10%
		Total	**5-9%**	**approx. 5%**

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

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- we, the General Partners of the Bank, have an unlimited liability that is guaranteed with our own private wealth?
- we, therefore, manage our balance sheet very conservatively?
- the capital of our Bank meanwhile amounts to over CHF 150 millions?
- all securities held in custody for our clients are fully segregated and, hence, are not exposed to an eventual bankruptcy risk of the bank?
- the biggest risk for the client always arises from a bad advisor and not from the bank?

THE USD KEEPS ON FALLING

«IN GOD WE TRUST»...

...is what is says on USD banknotes. At present, however, many would prefer to say «In gold we trust». The gold price has tripled since the Swiss National Bank's sales and already stands at USD 920 per ounce. And it is not only gold that has gained versus the USD. The greenback has lost a lot of value against practically all other currencies. It may slide further - indeed it may have to – in order to clear up the imbalances. Adjusted for purchasing power parity, the USD is now undervalued against the CHF and EUR. Nevertheless, we advise against buying dollars for the time being and continue to hedge against the USD. Asian currencies, meanwhile, are under considerable appreciation pressure, as are those currencies of the Middle East.

Asian currencies and the Dirham

For some time now, we have held, via structured products, options that will benefit from an appreciation in Asian currencies. We are currently structuring an idea that will profit from the potential removal or adjustment of the peg linking the AED (United Arab Emirates Dirham) to the USD. Thanks to the high oil price, the Middle East is enjoying enormous inflows of capital from the West. These, combined with low interest rates – rates are in fact negative in real terms – have triggered an investment boom in that region. A partial de-pegging from the USD would seem to be the only way to bring inflation under control.

Attractive risk/return profile

Despite assertion that the USD peg will hold, we expect the AED to be revalued. If this proves to be the case, this investment idea will produce a return some three to four times higher than the loss that would be incurred if the peg stays in place after all. This seems an attractive risk/return profile. However, the question of how much can sensibly be invested in such a currency idea can only ever be answered for each portfolio individually.

Philipp Murer

ASIA TAKES A BREATHER

HEADWIND AND INFLATION – BUT NO REPEAT OF THE 1997/98 CRISIS

Asia has enjoyed strong economic growth for a long time. China and India are expected to replace the US as the driving force behind the global economy. However, the Chinese and Indian stock markets are currently down 20-40%. Is this an opportunity or a foretaste of rough times ahead? A recent trip to Asia made it clear to us that the region is booming. For example, Hotels in Singapore are 95% booked out. But growth is starting to tail off.

From tailwind to headwind

The tailwind phase in Asia is over for now. Most of the factors contributing to the tailwind appear to be turning around. China, for instance, benefited for years from huge investments, low wage costs, an undervalued currency, and strong demand for Chinese goods from the West. Now, almost all these factors seem to be taking a turn for the worse simultaneously:

Headwind from all directions:

- WAGE COSTS: Guaranteed minimum wages and employee protection have been in place since the start of this year.
- INVESTMENT: The «de-leveraging» due to the credit crunch has spread to China. There is a lack of buyers on the stock markets for the time being, and more expensive or virtually impossible refinancing of existing loans will soon become a factor as well.
- CURRENCY: The currency's artificially maintained weakness has reached its limit. A further increase is needed to combat inflation.
- DEMAND: Demand is leveling out as economies in the West weaken.

This headwind is leading to margin pressure, and around 60,000 firms are expected to shut down this year in southern China alone.

2008 cannot be compared to 1998

Despite this less than rosy outlook, it would be wrong to compare 2008 to 1998. At that time, the Asian countries had debts in foreign currency, whereas this time China is a net creditor. Many fundamental factors remain in Asia's favor. Nevertheless, growth rates will fall, but they will still be higher than in the West. We might, therefore, say that Asia is taking a breather.

From growth to inflation

As the year progresses, Asia, too, will be hit by the credit crisis. So far, only portfolio assets have been withdrawn from Asia. In the coming months, however, there will be a lot less (possibly too little) money available for debt refinancing. A lot of loans were granted at interest rates that were much too low in return for options to buy shares at a specific price. These options are now worthless. Refinancing will no longer be possible at such cheap terms. The massive growth of the middle class has also led to changes in consumer habits. People are eating more meat than they used to, but meat takes more energy and much more land to produce than, say, rice. In addition, the trend toward renewable energies is competing with food production, the result being rising basic food prices. This is a time bomb waiting to go off. People in emerging markets already have to pay relatively high prices for their food. If these prices rise, and if wages are increased, inflation will spiral out of control. If wages are not increased, on the other hand, there will be social unrest. Food prices cannot be fought with higher interest rates, only with increased supply or reduced demand. This takes time and requires a less rapid pace of economic growth. China is thus likely to export inflation rather than deflation in the future. Add the extreme US monetary policy to the equation, and consumer price inflation looks set to be a hot topic for the years ahead. (Our scenario: asset deflation – consumer price inflation).

Investment ideas

In 2008, it is scarcely likely that Asia will continue to produce the excellent returns of recent years. However, we are bullish with regard to Taiwan (policy of openness toward China) and Thailand (new government and attractively valued market). We also continue to view the United Arab Emirates positively owning to its strong fundamentals. In addition, we take a positive view of the Asian currencies. Real estate is no longer cheap, but lower property prices are already priced into real estate stocks in Singapore.

Reichmuth Himalaja well positioned

We cover most of our Asian allocation through our fund of hedge funds, Reichmuth Himalaja. After four above-average years, we are not expecting a great leap forward in 2008. We like to say that Reichmuth Himalaja needs a Sherpa to guide the way, and plenty of oxygen. Hence, it is currently pausing to catch its breath. For investors with a long-term focus, the air is not getting thin, and we are well positioned. If weaker growth is the consensus expectation, and if a solution to the inflation problem takes shape, we will set down the oxygen tank and advise investors to start buying ready for the next ascent.

Patrick Erne

MONEY IS WHAT MONEY DOES

COMBINING «HAVING» WITH «BEING»

One thing that gives many wealthy people pleasure is their ability to finance charitable projects. This is something I experienced to an unexpectedly great extent in connection with the construction of Lucerne's Culture and Convention Center (KKL). As part of our integrated service philosophy, we developed a concept through our Rütli Endowment aimed at bridging the gap between clients' philanthropic intentions and projects that deserve support.

A charity for music lovers

The KKL remains a shining example of a public/private partnership. At that time, an agreement was reached with the City and the Canton whereby half the cost of this highbrow concert venue would be covered by private funding. The City provided the land. Half the cost of the building was budgeted at CHF 45 million. Few believed that it would be possible to gather so much money from private individuals and companies. The Concert Hall Foundation that was formed for that purpose divided up its tasks. Robert Studer, the former Chairman of the old Union Bank of Switzerland, took care of canvassing big industrials throughout Switzerland. I targeted private individuals, particularly in central Switzerland, with the aid of a large committee. We saw how generous many wealth people can be when it comes to causes they believe in. A community project for music lovers and also for the long-term good of tourism in central Switzerland as well as the economy as a whole was clearly just such a cause.

Money is what money does

The Lucerne Festival, which had been growing since 1929, was a firm fixture in Lucerne's cultural calendar. The old concert hall could no longer meet the demands of audiences and orchestras as regards its acoustics. The late Herbert von Karajan, star conductor, and maestro Claudio Abbado threatened never to perform in Lucerne again unless it was renovated. Fears over this potential loss, together with the impressive design by star architect Jean Nouvel, gave rise to what became known as the «Wonder of Lucerne». It is a wonder because the referendum in Lucerne had a positive outcome on the very same Sunday that a new cultural legislation was rejected in a nationwide vote. Public approval was possible thanks to the unexpected generosity of private donors.

Individuality is key

Charitable projects are especially gratifying when they allow you to combine «having» (i.e. private wealth) with «being» (i.e. your individual personality). Leaders of industry and entrepreneurs are used to putting their time and money to use in a carefully thought-out manner. With this in mind, the Rütli Endowment's task is to understand donors' priorities on the one hand and maintain an overview of worthwhile projects on the other.

Bridging the gap

Back in 2001, the Rütli Endowment was something of a novelty. It was the first time the federal body responsible for regulating foundations had ever approved the establishment of an umbrella endowment. As a result, individual donors can have the tax-deductible 20% of their income and/or their personal asset donations managed professionally at minimal cost to themselves and in line with their personal goals via an individually managed charity account. The things these wealthy clients do for society as a whole without any publicity whatsoever are remarkable.

Acknowledgement

The increasing level of government support for public/private partnerships is to be welcomed. They have been the done thing among the well-to-do in the US for decades. Lucerne, however, had restricted the tax-deductible allowance for such charitable endeavors to a maximum of CHF 5,400 until just a few years ago. In the case of the KKL, the Lucerne government decided to make an exception. Today, the tax-deductible limit is 20% for the whole of Switzerland. This freedom to decide which projects deserve support privately rather than through government bureaucracy has already made many new projects possible that benefit the greater good.

To conclude our series of articles on the theme «Combining 'having' with 'being'», I would like to take this opportunity to thank the many wealthy donors for their mostly discreet support – both personally and on behalf of the Rütli Endowment, which is itself merely a federally regulated service foundation rather than a donating one.

Karl Reichmuth
General Partner