Check-Up

Client Newsletter of Privatbankiers Reichmuth & Co
Integral Investment Management | January 2016

Editorial

We started out 20 years ago as the youngest of private bankers, seeking to deliver integral investment management. The core philosophy behind our business idea was and still is to bring "people and money into harmony". This is the very essence of what we do, and will remain so in the future. We always try to put ourselves in the position of our clients.

Coupled with this, we form our own opinions on the financial markets, communicate them, and focus our investment strategy accordingly. You can find a recording of our 2016 market outlook presentation (german only) held on November 4, 2015 at the KKL Lucerne at www.reichmuthco.ch.

I would like to express my heartfelt thanks for the trust you have placed in us over the past 20 years and we look forward to seeing you at our event on January 23, 2016 to celebrate our anniversary.

Christof Reichmuth, General Partner

OVERBURDENED CENTRAL BANKS

Four options for investors

After seven years, the US Federal Reserve is starting to raise interest rates. Since this has been expected, the USD, along with the CHF, ranks among the strongest currencies in 2015. The opposite is true for the EUR and JPY, where central banks still have their feet firmly on the gas pedal.

What central banks are for

A core function of a central bank is to act as the lender of last resort – the savior of the banking system – as in 2008, for instance. During inflationary periods, it is important for a central bank to be independent. It has to take unpopular measures to hold the economy in check to ensure price stability. In periods such as the present, where there is no confidence in the future and therefore scarcely any growth in sight, the best it can do is to maintain the status quo. Overburdening a central bank with additional objectives and tasks relating to unemployment, economic growth, or holding the Eurozone together, is a questionable move.

SNB decision putting pressure on politicians

At the start of the year, Switzerland saw what happens when a central bank is forced to admit that its policy is unsustainable. The sudden appreciation of the CHF sent a shockwave throughout the country and also had an impact on the political front in the October elections. The economy has to be looked after, and in a globalized world, imposing additional requirements – even though well-intentioned – can take a heavy toll. A central bank cannot solve fiscal and economic policy problems through its monetary stance.

Negative interest rates as an emergency measure

According to the SNB, the strategy of negative interest rates combined with forex market interventions is working whereas the two elements are strengthening each other. It has to be said that foreign currencies are, on average, down only around 10 % vs the CHF, and the USD is even at roughly the same level as one year ago. The strategy was well

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thought-out. Currency hedges have become less attractive as have interest rate hedges. This has avoided fueling the already overheated real estate market any further. Thanks to the allowances for banks, private investors are yet to feel the impact of negative interest rates, which has somewhat reduced the political pressure on the SNB. However, the collateral damage of this emergency measure will soon become apparent in insurance companies and the pension system.

The balance sheet is an instrument …

ECB President Mario Draghi recently made it clear that the balance sheet of a central bank is a means of achieving ends. He has also promised to do more if necessary. As a consequence, his plea to politicians to finally do their part to resolve the problem with structural reforms is being pushed further into the background.

… until the central bank itself becomes an instrument

Mario Draghi believes the ECB must do more because its policy is working. We can therefore expect to see very low interest rates in 2016, possibly even moving deeper into negative territory – not least because there are no major elections in 2016. That said, the impact of the wave of migration from the Middle East points to new problems for 2017. Right-wing nationalist forces are likely to become stronger, further increasing the threat to Eurozone cohesion. I wish the ECB would not continually promise to deliver more and more and would instead honestly admit what it can and can't do. This is the only way to put effective pressure on the politicians. The ECB might otherwise soon find that it has itself become an instrument. How could that come about?

QE as the precursor to debt cancellation?

When sovereign debt is replaced by money, which is in turn hoarded rather than being invested in the real economy, there is no gain. I have never been convinced of the idea that national debt on the central bank's balance sheet could simply be written off. The central bank would then be bankrupt. Time and again we find ourselves gazing on in wonder at the innovative ingenuity of today's central bankers. Perhaps there will be no currency reform and no recapitalization either. Perhaps a new vehicle will be invented that no one can fathom. All that matters is avoiding hyperinflation, at any price. Replacing debt with money and canceling the debt is nothing more than helicopter money. Japan is further down the road with this experiment and it is possible to see if developments there are heading in such a direction. This cannot happen overnight in Europe; it would not go unnoticed. There are too many national governments involved.

Digital revolution in the monetary system?

Central banks are also facing increasing competition from the digital world. The block chain technology made popular by bitcoin is regarded as having considerable potential. Essentially, it is an open ledger where a transaction is verified by all the other system participants. This means the confidence issue can be resolved at the transaction level but not when it comes to preserving value – there, investors only have two options.

The omnipotence of the state or individual responsibility

You either trust in the omnipotence of the state, or take matters into your own hands. As the owner of assets, you can put together a portfolio you are responsible for. You are your own central bank, so to speak, investing in real estate, gold and jewelry, and other real value assets rather than government bonds offering no return. Assets held in custody accounts are segregated, and thus beyond the state-regulated banking system.

What can investors do?

The problems are well known: zero or negative interest rates on bank accounts, virtually zero or negative yields on bonds, and rather expensive equity markets (although these do still deliver dividends). While alternative strategies are attractive, they are illiquid in part. For this reason, equities are still the mainstay of our investment strategy. And though we might not be able to change the starting point, we can choose for ourselves the road we want to go down in the future. In our view, there are four to choose from:

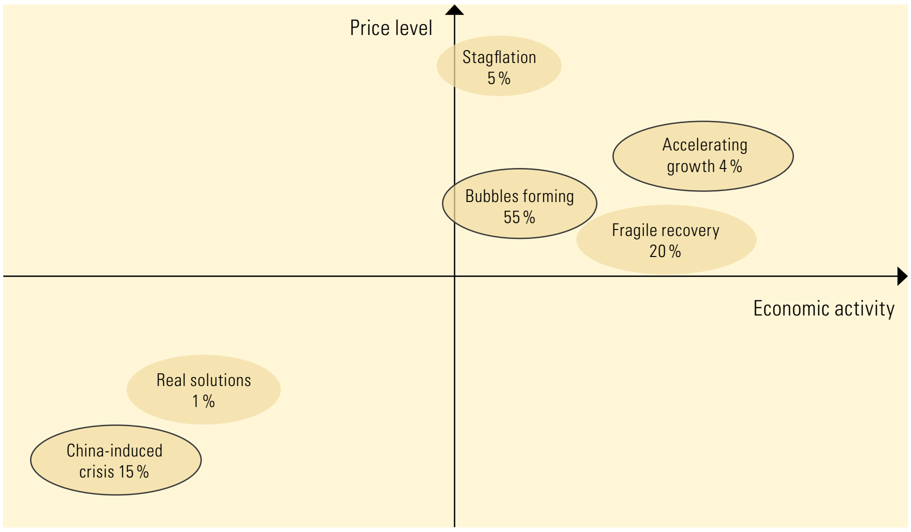
a) ***Do the same as everyone else:*** This option is the most appealing for investors subject to career risk, or who sit on decision-making bodies about other people's money. The primary objective is to ensure that nobody can be shown to have made a mistake.
b) ***Take fluctuations in your stride:*** This is the road traveled by experienced investors, who know that price and value are not the same thing, and that a long-term strategy based on periodic assessment brings the best results.
c) ***Buy (partial) insurance:*** This involves accepting certain costs to reduce fluctuations, or to be able to take a more relaxed view of them. Out-of-the-money put options offer protection against sharp slumps, or possibly bear spreads for weaker corrections.
d) ***Construct more robust portfolios:*** This is the choice of investors who want to diversify their sources of returns. They are prepared to buck the prevailing trend with their investments, and focus on the longer-term results with low portfolio volatility.

With all of these possibilities, it's not a matter of right or wrong – it's always down to the circumstances and goals of the individual in question. Our relationship managers will be happy to help you.

Christof Reichmuth

OUR SCENARIO ANALYSIS IN A NUTSHELL

Our take on the future



Framed = Scenarios described below

Summary

- Owing to the active central banks, Bubbles forming is most likely
- We are giving the risk scenarios less weight than in the last trimester
- The probability of "real solutions" or radical reforms remains low

Primary scenario: Bubbles forming – financial repression and stagnation

Against a backdrop of global uncertainty (Syria/IS, refugee crisis & China) companies are hardly investing in growth, focusing instead on managing their share prices. The US Federal Reserve only tentatively raises interest rates. Elsewhere, central banks continue their expansionary courses, keeping interest rates low or even negative. Negative economic news is immediately countered with further monetary policy measures. Amid the dearth of alternatives, investors are flooding into anything offering returns. Key structural reforms fail to materialize. Trust in central banks and state authorities are reaching a tipping point.

Investment ideas

- Dividend stocks
- Stocks of global leaders
- Real estate
- USD
- Underweight commodities

55 % probability 3 – 6 months

China-induced crisis

Chinese economic growth collapses, with negative consequences for the global economy: export-oriented companies in Europe suffer from slumps in sales and margins crumble. Owing to declining revenues, commodity-producing countries become mired in a debt trap. Credit spreads widen, and there are major defaults. Tension mounts on the international currency front with marked depreciations in some emerging markets, exacerbating the deflationary pressure. Pension schemes and insurance companies come under pressure across the world amid the low interest rate environment. Pensions have to be cut in certain countries.

Investment ideas

- Cash
- Underweight equities
- Overweight fixed-income (high quality)
- CHF attractive

15 % probability 3 – 6 months

Accelerating growth

European politicians turn their backs on austerity. Government spending is increased and growth is stimulated via infrastructure projects. The ECB expands its bond-buying program to finance national deficits. Investors regard public sector debt as unproblematic. Japan, where the central bank holds a large portion of the country's debt, leads the way in this regard and goes so far as to entirely write it off. Consumer confidence returns and companies increase their capital spending. Growth rates and inflation figures in Europe provide a positive surprise. The recovery in the US builds more momentum. Certain emerging markets that were previously hit hard, will benefit disproportionately.

Investment ideas

- Overweight equities (especially emerging markets)
- Emerging market bonds & selectively inflation-linked bonds
- Foreign currencies generally attractive

4 % probability 3 – 6 months

MARKET OUTLOOK

1st Trimester 2016

Dr. Max Rössler

Uncertainty remains high in financial markets and so, too, does volatility. More stability will emerge only when central banks are able to normalize their extremely expansionary monetary policies.

Currencies

Exchange rate movements were driven by the strengthening USD, which gained ground particularly against the EUR and – with EUR/CHF virtually unchanged – also the CHF. Given the different monetary policies and the resultant widening in the interest rate differential between the US and Europe, this trend could persist for the time being. Over the long-term, however, a countermovement is in the cards.

The decisions of the Federal Reserve and the ECB were more or less in line with the scenario expected by the markets. The USD rose slightly as forecasted, even though certain minor deviations to the prognosis prompted a number of sharp short-term reactions on the exchange rate front. We will now see how the economy responds to the interest rate signals. If economic growth continues to improve in the US, the USD's upward trend will remain intact.

The CHF is still heavily overvalued, and the Swiss National Bank is endeavoring to reduce this by using negative interest rates and occasional interventions on the forex market. It has indeed succeeded in holding the EUR/CHF exchange rate stable despite the weakness of the EUR vs the USD. That said, given Switzerland's high current account surplus and the insufficient willingness of major Swiss institutional investors to invest abroad, we must expect to see the CHF tend towards overvaluation.

Currency	**Exchange rate**	**Expectation**
	18.12.2015	3 – 6 months
USD	0.99	↗
EUR	1.08	→
GBP	1.48	↗
NOK	11.3	↗
CNY	0.15	→
JPY	0.82	↗

Interest rates

Inflation is still too low, at levels close to zero or even below it in the case of Switzerland. Despite the extremely expansionary monetary policies of the leading central banks, there is still no sign of inflation starting to rise again. The major central banks will therefore not make any fundamental change to their stance and interest rates are set to remain very low.

There is increasing divergence in the trends of the individual currencies. In the US, the initial rise in the benchmark interest rate has been announced given that economic growth is rising, albeit very gradually. Meanwhile in Europe, the ECB lowered its key rate again, pushing it slightly further into negative territory, and has extended its bond buying program into 2017. Against this backdrop, the SNB had no option other than to keep interest rates negative in order to maintain the interest rate differential vs the EUR at an acceptable level.

We can therefore expect to see short-term interest rates close to zero for some time, while in Switzerland they are set to remain negative. Long-term yields – which are somewhat higher for the USD than for the EUR and JPY – will also remain very low by historic standards. With commodity prices plunging – in particular the price of oil – the risk premiums on corporate bonds in the commodity sector have risen sharply in some cases and the threat of default is looming.

Country	3M Libor	10y swap	Inflation
	18.12.2015	18.12.2015	
Switzerland	–0.8 % →	0.2 % →	–1.4 % ↗
US	0.6 % ↗	2.2 % ↗	0.5 % ↗
Germany	–0.1 % →	0.9 % →	0.4 % ↗
Italy	–0.1 % →	0.9 % →	0.1 % ↗
UK	0.6 % ↗	1.9 % →	0.1 % ↗
China	3.1 % ↘	n.a.	1.5 % ↗
Japan	0.1 % →	0.4 % →	0.3 % ↗

Stock markets

Stock markets initially posted gains from the fall onwards, but corrected in some cases toward the end of the year. The persisting uncertainty is reflected in doggedly high volatility. There are mounting differences in the share price trends across various sectors, with commodity stocks further losing ground. Meanwhile, the gains are mostly concentrated in an increasingly smaller group of consumer goods, pharmaceuticals and IT companies that hold sway in their respective markets. Despite having rather high valuations in some instances now, these global leaders remain the favored asset class in the allocation due to the lack of attractive alternatives.

A good and secure dividend yield remains the most important criterion when selecting stocks. Many equities of first-class companies operating in defensive and relatively less cyclical sectors and offering stable earnings meet this requirement. Even though they offer little prospect of further significant share price gains, they can deliver a reasonable performance thanks to the regular high dividends.

Supplementing the main investment categories with a strategic selection of specific segments opens up additional earnings opportunities. Although the stocks of small- and medium-sized companies are generally less liquid, they often have lower valuations. Looking at sectors, banks are gradually becoming more appealing. In regards to countries, the Japanese market is offering cheap valuations, still well below its highs of 25 years ago, and is profiting from low commodity prices. However, until commodity prices stabilize, oil and other energy and commodity stocks are only to be recommended for very risk-tolerant investors. ■

Country	Index	Index level	Expectation	Dividend in %	Price / Book	Price / Sales	Price / Earnings
		18.12.2015	3–6 months				
Switzerland	SMI	8 609	↗	3.3	2.6	2.3	14.3
US	S&P 500	2 006	→	2.2	2.7	1.8	17.0
Germany	DAX	10 608	↗	2.8	1.7	0.8	13.2
Italy	MIB	21 242	↗	3.0	1.1	0.6	17.8
UK	FTSE	6 052	→	4.4	1.7	1.1	10.9
China	HSCEI	9 634	↗	4.3	1.0	0.9	7.5
Japan	TOPIX	1 537	↗	1.9	1.3	0.8	14.8

MODULAR CONCEPT “PORTFOLIO OF THE FUTURE”

Diversify return sources, remain overweight equities

Recommendations for individual portfolios		Investment instrument		
		Voralpin traditional	**Alpin** diversified	**Hochalpin** dynamic
Min. Neutral Max.	**Liquidity** Unattractive due to negative interest rates - Sufficient cash in home currency to cover obligations for the next two years	5 %	4 %	– 5 %
Min. Neutral Max.	**Fixed-income** Scarcely any yields available – avoid long maturities - Only to smooth out fluctuations - USD bonds during the term of 5 to 9 years - Inflation-linked bonds as diversification	37 %	35 %	1 %
Min. Neutral Max.	**Equities** Give preference to shares in companies with strong cashflows and sustainable dividend policies - European dividend stocks - Global leaders - Selectively emerging markets with low valuations	42 %	42 %	70 %
Min. Neutral Max.	**Real estate** Stable returns and dividends - Focus on Switzerland - Singapore, Spain, and Germany as diversification	13 %	7 %	6 %
Min. Neutral Max.	**Alternative investments** Use the diversification potential of specialized investment strategies	not permitted	16 %	19 %
Min. Neutral Max.	**Precious metals** We regard gold as a currency that no central bank can print	3 %	4 %	9 %
Min. Neutral Max.	**Currencies**			
	CHF	75 %	72 %	53 %
	USD	10 %	13 %	22 %
	EUR	4 %	1 %	1 %
	Asia	2 %	4 %	11 %
	Various (NOK/SEK/CAD)	9 %	10 %	13 %

Allocation as of 15.12.2015
Recommendations are subject to change at any time

CONTINUOUS DISTRIBUTIONS AND STABLE RETURNS

Successful start for Reichmuth Infrastructure Switzerland

With our forward-looking investment policy, we have been active in the structuring of investments in real assets since the 1990s. Working closely together with external specialists – in some cases with exclusive network partners – we have used our expertise to build up a highly promising pipeline for infrastructure investments in Switzerland.

Reichmuth Infrastructure Switzerland CIP, a FINMA-regulated fund for qualified investors set up one year ago, was already showing positive development at the end of 2015. Around CHF 55 million was invested in three portfolio companies in the areas of transport and utilities / waste disposal. Long-term leasing and fee models are generating positive distributions, and the fund already shows a high investment level of around 50 %. In contrast to direct investments, this fund gives qualified investors a platform to invest in a broadly diversified portfolio covering different infrastructure segments in Switzerland.

The second and final subscription period for this attractive investment solution is set to close in summer 2016. If you have any questions or would like more information on this investment theme, please contact Stefan Zumtaugwald or Marc Moser, who will be happy to help you.

Portfolio Characteristics

Target Return	5 % plus inflation p.a.
Cash Flow Return on Investment	> 8 % p.a.
Return of Invested Capital	12 years
Diversification	8 – 12 portfolio companies
Risk profile	defensive risk profile

only for qualified investors

INTEGRAL CIRCLE ON POWERS OF ATTORNEY

“Intergral Circle”
Event
March 2016

Decide yourself rather than leaving it to others

Anyone, regardless of age, can suddenly find themselves incapacitated, be it as a result of accident, dementia, heart failure, etc. So, who takes decisions for you when you are no longer able to do so yourself? Who pays bills as they come in, who handles business matters? If the person in question is married, the spouse has the right of representation. However, this is restricted to the needs of the family and “ordinary” legal acts. Everything else requires the approval of the child and adult protection authority, the so called KESB.

Take individual responsibility

Issuing a power of attorney is in the interests of those affected, but above all also for their relatives. Without it, the KESB is officially required to look after the person's care and their assets. To avoid this scenario, you can determine now, while you are in good health, who should take decisions on your behalf.

Integral Circle on “Powers of Attorney”

Here, you can find out first hand what you need to do, and where our practical emergency folder can come in. The next dates together with Thomas Tschümperlin, Swiss Bar Association attorney, specializing in inheritance law, are:

- **Wednesday, March 9, 2016, 11.30 a.m. in Lucerne**
- **Thursday, March 10, 2016, 5.30 p.m. in Lucerne**
- **Thursday, March 17, 2016, 5.30 p.m. in Zurich**

We would be delighted if you would take part. The presentation will be held in German. If you have any questions or would like to register, please contact our relationship managers, who will be happy to help you.

Cornelia Wyrsch Klötzel
Relationship Manager / Partner

FIRST-CLASS CLIENTS – EXTENDED TEAM

Individual – forward-looking – taking responsibility

The financial world is experiencing massive upheaval, affecting both the market environment and financial institutions. To provide our clients with services that offer additional value and clear guidance, we are sharpening our profile by focusing our organization on different client needs. For 20 years, we have been working with the money entrusted to us just as we would if it was our own. We have a strong team delivering such services for first-class clients, and we owe you our gratitude for allowing us to do this.

PRIVATE BANKERS REICHMUTH & CO INTEGRAL INVESTMENT MANAGEMENT	REICHMUTH & CO INVESTMENT MANAGEMENT	PensExpert Eigenverantwortliche Vorsorge
		
Jürg Staub, CEO Reichmuth & Co Integral Investment Management	Marcel Schnyder, CEO Reichmuth & Co Investment Management	Jörg Odermatt, CEO PensExpert
Why do you do what you do?		
Because as an owner-managed family business with general partners, we think for ourselves, and this allows us to deliver bespoke, innovative wealth management services in line with our clients' needs.	Because our scenario-based investment approach means we can be active and bold, while focusing on the future, and therefore fill a gap in the banking business. We believe this will enable us to firmly add value over the long-term.	Because occupational pension provision offers extremely attractive tax advantages and a high level of investment freedom, and it's possible to take personal responsibility in implementing this individually in the extra-mandatory segment. Our clients thus benefit from greater transparency, ideal coordination with their private assets, and better long-term performance.
What are the three defining characteristics?		
1. Individual and flexible, with an integral mindset 2. We think for ourselves, and form our own market opinion 3. Our innovative solutions offer significant client benefits	1. Investment solutions tailored to the clients' needs (mandates or funds) 2. Active implementation, independent of benchmarks 3. Transparent and fair cost structure	1. Free choice of investment strategy for insured persons, aligned with their private assets 2. No financing of collective fluctuation reserves 3. Absolute transparency on costs and performance
Who benefits the most?		
Families, managers, and companies with a long-term mindset, keen to take individual responsibility.	Private and institutional clients who appreciate professional investment solutions with clear opinions and no conflicts of interest.	Entrepreneurs, senior managers, and self-employed people.

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