Check-Up

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

Editorial

The year began against a miserable backdrop, but spring dispelled the clouds hanging over the markets. Volatility is unfortunately also on the cards going forward. As the saying goes: "As you make your bed, so you must lie in it". We therefore keep our focus on the future. Given that none of us knows what lies ahead, we are keen to explain the reasons behind our recommendations. What is paramount is that we do this specifically for your individual situation.

In January, we were able to celebrate the 20th anniversary of our company together with our guests at the KKL Lucerne. It was our pleasure to enjoy this day together with you, and also a source of motivation. We look forward to continuing to be there for you in the future for all matters relating to your wealth. For all those interested, we have posted a documentary film on our activities made by Claudia Steiner on our website: www.reichmuthco.ch.

Jürg Staub, General Partner

STORING VALUE WITH MONEY?

Be your own central bank

As usual, so-called scandals such as the Panama Papers dominate the headlines. Are they important, or merely interesting snippets of no real meaning for investors? We would like to categorize them as the latter, were it not for the fact that they have refueled the appetite for regulation.

A level playing field…

This is the lofty goal behind the efforts of the G7, G20, and the OECD. Not so long ago, competition between different systems was welcomed. Now leveling out the playing field is the order of the day, and no stone is being left unturned in the efforts to regulate and equalize, often by institutions that are not democratically elected. Governments are then left to implement it all. It is no wonder that more and more voters are rebelling against this trend. For evidence of this, we need look no further than the successes of the Alternative for Germany (AfD) party, the upcoming referendum on the UK leaving the EU (Brexit), and Donald Trump's surprising victories in the US presidential primaries.

Innovation requires freedom

Progress and innovation flourish more in liberal environments than they do in centralist systems. We would do well to remember this, and to resist the construction of bureaucratic barriers. It is therefore interesting to note, that new and innovative ideas are coming to the fore in the field of money, which is actually the domain of governments. This is being made possible by the combination of the Internet and mobile devices.

45 years of pure paper money

President Nixon abandoned the gold standard on August 15, 1971, and since then money has been based purely on trust. Virtually all currencies function well as a medium of exchange. Nevertheless, this is exactly where many digital innovations are managing to make their mark with so-called cryptocurrencies and payment functions. They make monetary transactions quick and inexpensive. It is entirely conceivable that they may one day prize the exchange function of money away from central banks.

continued on next page

Trust in money intact

For the time being, there is nobody else that can act as a lender of last resort other than central banks. In times of crisis, it is they who have to act. Although we do not have an acute crisis at present, we are beset with chronic problems. And across the globe, the central banks still seem to be the only entities capable of acting. Almost all of them want to achieve higher inflation, using unconventional measures to do so. The experiment with negative interest rates has now been running for nearly two years. We are highly skeptical of this extremely dangerous instrument, which entails disastrous consequences for trust, pension systems, incentives, misallocations, and much more besides.

Competing measures of value?

No country wants a strong currency, and there is even talk of a currency war. Flexible exchange rates are in fact important safety valves in the competition between nations or regions. And the major freely tradable currencies are also likely to remain measures of value for the foreseeable future.

Store-of-value function threatened

"Almost every generation is eventually shocked by the behavior of interest rates because, in fact, market rates of interest in modern times rarely have been stable for long. Usually they are rising or falling to unexpected extremes" (Homer / Sylla, A History of Interest Rates, 2005). We are indeed surprised and shocked at how low interest rates have fallen. Negative interest rates most certainly pose an acute threat for investors. The risk-free rate has become negative. This is a state of affairs that should only be accepted by those who believe in a persistently deflationary trend, and we see little likelihood of this. Given that the central banks are beholden to the (political) environment, investors must themselves deal with money's function as a store of value.

Calm before the storm…?

Nobody knows how interest rates will develop in the future, but scarcely anyone expects a sharp rise. And so an uneasy sense of calm has descended on the financial markets. In our heart of hearts, surely we all realize that the central banks' current measures are not sustainable. Real solutions always hurt someone. And that is why we find ourselves instead muddling along in the existing system with all the stops pulled out. How else would you explain the European Central Bank's latest measures?

A hot summer in Europe

After the domino effect triggered by Austria closing its borders, the refugee issue has moved into the background to some degree, but the problems remain unresolved. This summer sees France host the European Football Championship, and June 23, 2016 will be the first day in the competition without any games. There will be no shortage of excitement, however, because on that day the citizens of the United Kingdom will vote in a referendum on whether to remain in the European Union. We will know if the UK remains both in the EURO 2016 and the EU… The mood in the EU and the UK at present points to an unsettling start to the summer. Uncertainty is anathema for the financial markets, and is normally reflected in lower prices. It is entirely possible that this could open up attractive entry opportunities, above all in the GBP.

An entertaining autumn awaits in the US

The US presidential elections promise to be entertaining. That said, we do not expect any major impact on the financial markets, since the forces in the US political system are too finely balanced. And the US Federal Reserve will under no circumstances want to influence the elections in the run-up, so interest rate increases are likely to be very tentative.

Each to their own – depending on the environment and goals

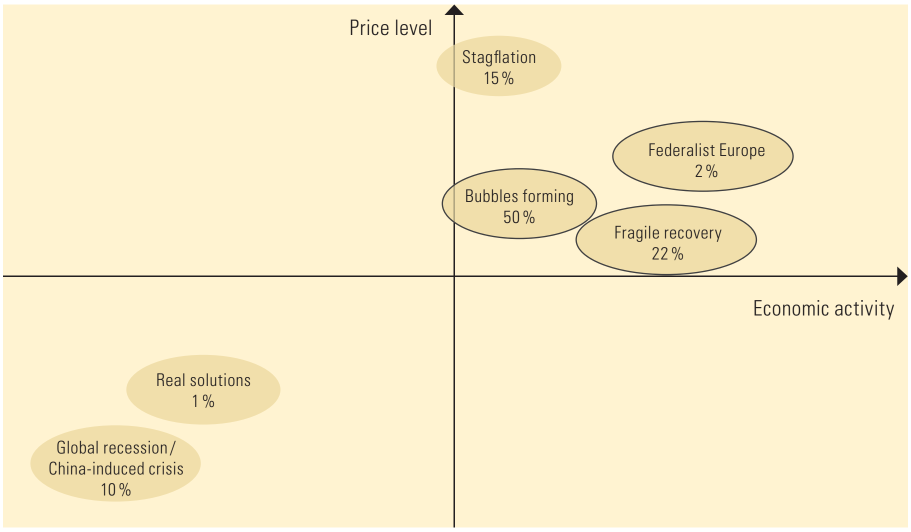
What are investors to do in this environment of relative calm? That depends on their specific situation and objectives. For some time now, when it comes to setting aside some money for my children's college fund every year, I have essentially boiled it down to one criterion: a cheap investment in a cheap currency. Two years ago it was gold mines, last year Russian stocks, and this year it is likely to be Brazil or South America that will come to the fore. These are speculative investments, however they offer high long-term potential. Meanwhile, my wife has a portfolio of Swiss dividend stocks, which we further add to on market weakness. We use the dividends to finance the rent of our holiday home. That, too, is only possible for people able to take on risk. My pension fund is invested in our broadly diversified multi asset class fund Reichmuth Alpin. And we plan to diversify our strategy even more broadly in the future with different sources of returns, offering comparatively attractive performance but also entailing different sources of risk as well. We have implemented a range of initiatives in this regard in recent years and will be able to offer these in the near future, one example being infrastructure investments in Switzerland (see page 8).

As you can see, the answer to the question as to what can be done varies depending on the situation. This is what integral investment management is all about, and the only way we can put this into practice properly is by talking things through with you. We very much look forward to doing so. ■

Christof Reichmuth, General Partner

OUR SCENARIO ANALYSIS IN A NUTSHELL

Our take on the future



Framed = Scenarios described below

Summary

- In light of the expansionary central bank policies, bubble formation is the most likely scenario.
- We are giving global recession risks less weight after the interventions in China.
- We see a fragile recovery without structural reforms, above all in Europe.

Primary scenario: bubble formation – financial repression and stagnation

Against a backdrop of global imponderables, companies invest less in growth, focusing instead on managing their share price. The US Federal Reserve raises interest rates only tentatively. Elsewhere, the central banks continue their expansionary courses, keeping interest rates low or even negative. Negative economic news is immediately countered with further monetary policy measures. Helicopter money is no longer taboo. Amid the dearth of alternatives, investors flood into anything offering returns. Key structural reforms fail to materialize. Trust in central banks and state authorities nears its tipping point.

Investment ideas

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

50% probability 3 – 6 months

Fragile recovery

The ECB's policy starts to take hold, and the credit costs for smaller companies fall. Under the pretext of combating terrorism, politicians in Europe turn their back on austerity. Growth in China stabilizes. The US economy remains robust, and the newly elected President Clinton launches infrastructure projects. Certain emerging markets that were previously hit hard benefit disproportionately as commodity prices establish a foothold. Global growth remains below potential, and debt ratios are still high. Structural reforms are unfortunately addressed only hesitantly, and it remains simply a matter of time before certain problems resurface.

Investment ideas

- Overweight equities
- Underweight fixed income
- Emerging market debt and HY bonds attractive
- Foreign currencies attractive

22% probability 3 – 6 months

Federalist Europe

The terrorist threat, the refugee crisis, financing issues and ever greater political conflicts of interest – the tensions in the EU continue to mount. With the UK voting in favor of a Brexit, the EU embarks on a new course. The plan for a "federalist Europe" is tabled. The focus returns to inherent strengths, with independent monetary policies, flexible exchange rates, and a strong internal market. Europe once again becomes a driving force of global economic growth. Key areas are from now on governed by supranational institutions / bodies and financed by a separate tax. Apart from this, the individual states retain sovereignty over their tax affairs. The European internal market is bolstered by the lifting of customs duty.

Investment ideas

- Southern European exporters appear attractive, avoid northern counterpart
- No bonds of overindebted states or companies in Europe
- Gold & CHF attractive

2% probability 3 – 6 months

MARKET OUTLOOK

2nd Trimester 2016

Patrick Erne

Expansionary monetary policy is supporting the markets, but low and fragile economic growth, coupled with political imponderables, are continuing to lead to strong fluctuations on the financial markets. We are focusing on diversification and alternative sources of returns.

Fragile growth – focus on political risks

In spite of all the turbulence in the first quarter of 2016, there has been no significant change in the outlooks for growth worldwide: fairly robust in the US, still fragile in Europe despite a slight upswing, and more stable in most emerging markets but at lower levels. The US labor market has fared better than its European counterpart, and is nearing full employment. Despite expansionary monetary policies, most countries are lacking structural reforms and the impetus from forward-looking fiscal policies. Hence, capital spending and credit demand remain weak in many countries, and the economic uncertainties persist. We see the risks of a sharp economic downturn in China and the US in the next few months as being low, and anticipate more problems arising from new political imponderables surrounding the Brexit referendum, the refugee crisis in Europe, and the elections in the US.

GDP growth Region	2015	2016 (expected)
United States	2.0 %	2.0 – 2.5 %
Europe	1.6 %	1.5 – 2.0 %
Switzerland	0.4 %	0.5 – 1.0 %
Japan	0.7 %	0.5 – 1.0 %
China	6.8 %	6.0 – 6.5 %

No end to expansionary monetary policy in sight

The key interest rates set by central banks are low across the globe, and even negative in many parts of Europe and in Japan.

This is unlikely to change all that quickly. At its most recent meeting, the ECB expanded its bond buying program to include corporate bonds, took negative interest rates slightly lower once again, and announced TLTRO II, which is aimed at reducing banks' financing costs to support lending. The situation in the US is somewhat different. Higher inflation figures and virtually full employment would actually permit further interest rate hikes. We expect the Federal Reserve to lift its key rate by a further 0.25 % – 0.50 % after the presidential elections, at the latest. There is even the risk of inflation picking up more strongly over the short term, thus increasing the pressure on the Fed to raise interest rates more quickly. In China, we expect interest rates to fall further, in combination with the easing in lending rules.

Long-term interest rates in Europe and Japan are kept low by the central banks' QE programs. Although bond investments offer scant or only negative yields, the purchase volume of the central banks is too large for stronger movements to be on the cards without there being an escalating political crisis.

Interest rate Region	3m Libor	Exp. in 12m	10y govt. bond	Exp. in 12m
United States	0.6 %	rising	1.8 %	rising slightly
Europe (Germany)	–0.3 %	stable	0.2 %	rising slightly
Switzerland	–0.7 %	stable	–0.4 %	rising slightly
Japan	–0.0 %	stable	–0.1 %	rising slightly

Expensive equity markets –
focus on a more robust portfolio structure

We have to assume for the time being that the central banks will remain expansionary, that the US is more likely to hold off somewhat longer than necessary on raising interest rates further, and that Japan may consider experimenting with helicopter money.

Despite below-average economic performance, this will lend a certain amount of support to the equity markets, but also entails heightened market fluctuations.

We therefore remain overweight in equities, albeit with a slightly more cautious stance. The focus remains on dividend stocks of quality companies. Market valuations are no longer favorable, however, and we are therefore diversifying into alternative sources of returns with the lowest possible correlations to the traditional financial markets. Provided the client's liquidity requirements permit this, stable sources of earnings in the form of direct infrastructure and real estate investments can offer the best risk / reward opportunities. In addition to hedge funds, we are now also investing in insurance-linked securities, and are taking advantage of attractive entry prices in emerging market bonds. Overall, we are adhering to our requirements in terms of quality. In times of uncertainty in particular, it is essential to evaluate every single investment decision on its own merits, regardless of any benchmarks, and to only invest if you are convinced of the business model and its sustainable profitability. ■

Country	Index	Index level	Expectation	Dividend in %	Price / Book	Price / Sales	Price / Earnings
		18.04.2016	3 – 6 months				
Switzerland	SMI	8 045	→	3.6	2.3	2.0	16.8
United States	S&P 500	2 094	→	2.2	2.8	1.9	17.8
Germany	DAX	10 120	↗	3.1	1.6	0.8	12.8
Italy	MIB	18 358	↗	3.4	1.0	0.5	14.6
UK	FTSE	6 354	→	4.4	1.8	1.2	17.1
China	HSCEI	3 033	↗	2.0	1.7	1.3	13.3
Japan	TOPIX	1 320	→	2.1	1.1	0.7	12.6

OVERVIEW – ASSET ALLOCATION

Solid dividend stocks complimented with alternative investments

Bonds

- In absolute terms, investments in the fixed-income asset class remain unattractive.
- Assuming that interest rates are raised in moderate steps, we expect the US yield curve to flatten.
- We are giving preference to investment grade corporate bonds over their high-yield counterparts.
- Emerging market bonds and US corporates have the greatest appeal in this asset class.

Equities

- Solid dividend stocks remain attractive given the dearth of investments in the negative interest rate environment.
- Expansionary central banks are providing support to equities, despite demanding valuations in some cases.
- In Switzerland, stocks outside the SMI are favorably valued.
- Regionally, we prefer Europe due to monetary policy considerations. Valuations in Asia remain attractive.

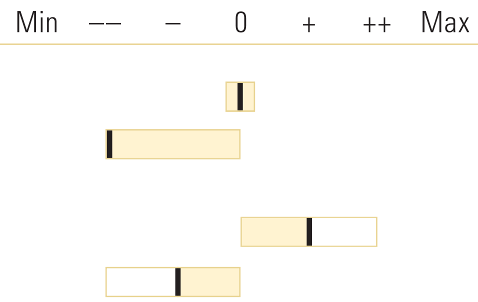
Alternative investments

- In the current environment of negative interest rates and high market volatility, alternative investments play a key role in portfolio diversification.
- Market fluctuations open up interesting new opportunities for active and flexible strategies.
- We are giving preference to investments in hedge funds, infrastructure, and insurance-linked securities.

Currencies

- Despite muted expectations regarding further interest rate rises, the USD remains the most attractive currency.
- We rate the other major currencies as being weaker.
- We will hold gold as a currency and as a portfolio diversifier, for as long as the central banks continue their expansionary monetary policy.

Positioning



Liquidity	Keep liquidity low
Bonds	Increase emerging market bonds at the expense of CHF bonds
Equities	Reduce Swiss & Japanese equities
Alternative investments	Investments in infrastructure & insurance-linked securities (ILSs)

previous   current

Note:
If you are interested in our detailed Investment Policy brochure, please contact your relationship manager or Nadine Vonwyl (nadine.vonwyl@reichmuthco.ch) who will be happy to register you for the publication.

REICHMUTH DIVIDEND SELECTION SWITZERLAND

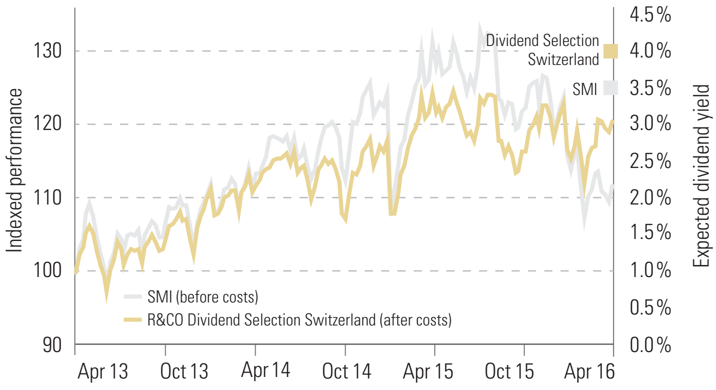
Attractive – particularly amid negative interest rates

Swiss stocks might not be bargain buys, but many companies are continuing to generate solid cash flows and earnings. Our fund Reichmuth Dividend Selection Switzerland invests in a diversified portfolio of well-run firms. We avoid risk clusters arising from industry heavyweights such as Nestlé, Roche, and Novartis (which account for 60 % of the SMI), and instead hold interesting small and mid caps, which can often act more flexibly. Dividend security is an important factor in the selection process. Dividends have to be generated from operations, and there must be the potential for further increases.

The weighted expected dividend yield of our selection is 4 %. The fund has outperformed the SMI by around 8 % over the past three years, and with lower volatility, thanks to its well-balanced diversification.

Philipp Murer

Dividend Selection Switzerland vs SMI



«Integral Circle» **events** Fall 2016

INTEGRAL CIRCLE: PENSION PLANNING

Annuity or lump sum?

Even before you reach retirement age, there are various pension issues that have to be addressed well in advance and that can be of crucial importance.

- Should I take my pension fund benefits as an annuity or as a lump sum?
- Does it make sense to use my pension savings to amortize my mortgage, either in full or in part?
- What do I have to pay attention to with regard to tax?
- What about the liquidation and sale of companies and shareholdings, or the purchase and sale of real estate?

With our pension planning service, we establish a basis with you on which you can make plans in line with your wishes and expectations and which ultimately allow you to simply enjoy your retirement.

Personal plan

One of the most important issues is structuring your occupational pension setup correctly. To do this, we work with you to find the answers to the relevant questions. You receive specific recommendations tailored to your individual circumstances on how to optimize your retirement savings, taxes, finances, and investments.

We would like to invite you to join us at one of our four events in the fall to discuss these issues further.

- **Wednesday, September 7, 2016, 11.30am in Lucerne**
- **Thursday, September 8, 2016, 5.30pm in Lucerne**
- **Tuesday, September 13, 2016, 11.30am in Zurich**
- **Thursday, September 15, 2016, 5.30pm in Zurich**

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

Marco Danelli

STABLE RETURNS WITH REAL VALUE ASSETS

Stefan Hasenböhler talks about infrastructure investments

Mr Hasenböhler, you are a big fan of infrastructure investments. Why?
With limited opportunities against the backdrop of negative interest rates, long-term investments in bonds have been unattractive for some time now. In contrast to this, infrastructure investments offer appealing features for investors such as the prospect of stable, long-term returns, ownership of real value assets, protection against inflation, and a diversification effect on their entire portfolio.

What do you invest in specifically?
Let's take the example of an investment in a district heating plant, to look at these features more closely. The investors finance a district heating system, which becomes their property and is protected in the event of bankruptcy. The heat produced by this facility is bought by the connected households on the basis of long-term purchasing agreements (25 years) – and the revenues flow back to the investors. The length of the contract ensures the stability and durability of the returns and cash flow.

Where do you find these infrastructure investments?
We concentrate on infrastructure investments in Switzerland because we have a broad network here. It also means we can check up on our investments on site. This network and the experience we have amassed in recent years enables us to find appropriate investment opportunities. The market for infrastructure investments has undergone dynamic development of late, and is offering increasingly attractive possibilities.

Reichmuth Infrastructure Switzerland CIP information events

- June 15, 2016, 11.30am Reichmuth & Co, Lucerne
- June 17, 2016, 11.30am Reichmuth & Co, Zurich

If you are interested, please contact Nadine Vonwyl (nadine.vonwyl@reichmuthco.ch) who will be happy to take your registration.

How can an investor put money in these categories with you?
We have launched a fund that invests in Swiss infrastructure in the three areas of transport, utilities / waste disposal, and social infrastructure. Like the example of the district heating plant above, we have thus far made five investments, including a freight car portfolio and a small hydropower plant. The fund's portfolio will be expanded to 10 – 15 positions.

What returns can investors expect from this fund?
The fund has a defensive risk/reward profile, and we seek to achieve an average annual return of 5 % and distributions of 8 %. We minimize the risk by focusing on infrastructure investments in Switzerland, thereby ensuring the corresponding security and stability in terms of the legal system and property rights. We also refrain from investments with project-related risks, and do not use debt capital at the level of the fund.

Such investments are very illiquid, so who are they suitable for?
Investments in infrastructure can make sense for investors with a long-term horizon on two counts. Firstly, they have an investment in real value assets with stable expected returns, and that also delivers a diversification effect for their portfolio as a whole. Added to this, with their investment they can contribute to the construction and development of infrastructure in Switzerland.

Can private investors also invest in such areas, and if so how can they go about this?
Our fund is open to subscriptions from qualified investors from CHF 1 million, with the second and final subscription period closing in summer 2016.

Dr. Stefan Hasenböhler

Reichmuth & Co Private Bankers
Integral Investment Management

Rütligasse 1, CH-6000 Lucerne 7
Phone +41 41 249 49 49

Tödistrasse 63, CH-8002 Zurich
Phone +41 44 299 49 49

www.reichmuthco.ch