Editorial

It is remarkable to see how dramatically the geopolitical situation has changed over the past few years. The new multipolar world has almost certainly become more unstable, making the positive economic forecasts all that more welcome. In this Check-Up, we will highlight what the robust economy means for you as an investor.

Technological development is revolutionising one sector after another. Interestingly, as of autumn 2018, the MSCI index provider will be assigning current technology companies to the sectors corresponding to their core business. In the future, digitalisation will also transform existing business models. We are following the process very closely. At the same time, we remain convinced that stability and continuity are decisive elements for you as a client. And that is precisely what we stand for as a family run business.

Jürg Staub,
General Partner

ALL GOOD THINGS COME IN THREES

Turnaround for interest rates, inflation and risk premiums

After a decade, the financial crisis is finally behind us and the global economy is booming. Strong economic figures are welcome news, unemployment is falling, and more employees are enjoying better pay package.

In other words, a normalisation of the economic situation is taking place. The outlook for the real economy remains positive, but what does this mean for investors? Is the strong economy advantageous for them as well?

Gradual normalisation of monetary policy

In the final quarter of 2018, the European Central Bank ECB will most likely put an end to its bond purchasing programme. It is more or less following the script of the US Federal Reserve, which stopped its own quantitative easing, i.e. buying bonds with new money, way back in October 2014 and has only reinvested the proceeds of maturing bonds since. After the US Fed and the Bank of England, the ECB will be the third major central bank to stop printing new money based on the purchase of (government) bonds. The Bank of Japan has not quite reached that point yet and continues to print money. Nevertheless, monetary policy will not be normalised overnight; not a single central bank is showing signs of scaling back their oversized balance sheets to pre-crisis levels by selling off bonds.

Turnaround for key rates

Act 2 in the script features raising key rates, i.e. short-term interest rates. The first rate hike was seen in the US around one year after stopping QE. In the meantime, five more increases have been made, and key rates now hover between 1.5% and 1.75%. The first rate hike in Europe are likely to take place next year. There is no question about which direction they will take – they are on their way up. Only an external shock or a stock market crash could change this.

Turnaround for inflation expectations

The threat of deflation has also ceased to be an issue. Shrinking unemployment, the solid economic outlook, and the once

Continued on the next page

again in vogue protective tariffs are good indicators that the long phase of sinking and low inflation is now over.

Turnaround for long-term interest rates

The combination of higher key rates, higher inflation expectations and the withdrawal of central banks from their bond buying programs means that long-term interest rates will once again appear on the economic agenda. It should be intuitively clear that these rates will not be set at zero or anywhere in the negative territory. In a normal setting, interest rates for 10-year government bonds should correspond approximately to nominal growth. We are still far removed from this. Nominal growth in the US is currently 4.5%, while interest rates are 2.8%. Nominal growth in Europe is also over 4%, and 10-year interest rates in Germany are 0.8%, for example. Switzerland is growing nominally at around 2%, and government bonds are returning 0%. As a result, the trend should remain clear for many years: long-term rates will be rising as well.

A turnaround for risk premiums as well?

The extra return from money markets or government bonds is known as a risk premium. Due to the investment crisis, nearly all premiums for various risks decreased to historically low levels. Thanks to normalisation, the investment crisis should soon be over. This fact, together with the uncertainties fomented by US President Trump, means that we should expect higher risk premiums once again.

Increasing discount rates – lower valuations

All good things come in threes. As interest rates, inflation expectations and risk premiums make a comeback, discount rates are rising – with the corresponding effects being seen on valuations. To put it simply, if for example 10-year interest rates in the US increase from 2% to 3% and we still assume a stable risk premium of 3% for stocks, then the required return for investors rises from 5% to 6%. With constant revenues, i.e. valuations would be around 17% lower. The fact that this has not happened yet this year is due to Donald Trump's tax reforms. They raised profit expectations by 25% and were able to compensate for the interest rate hike. However, this is a non-recurring tax effect on an earnings level, and the strength of interest rates, inflation and risk premiums should still maintain itself for several years.

Investments for an inflationary environment

We are still not seeing any indications that we are entering a high-inflation period such as that of the 1970s. In a more inflationary environment, value-oriented stocks, mainly those from cyclical businesses with high fixed costs, are likely to deliver a good performance. The existing technology leaders, which have created quasi-monopolies, are facing more resistance – and not only from a political perspective. The regulatory framework for these firms are likely to become more difficult.

And how will the issue of government debt be resolved?

High government debt is a known problem and thus less relevant in the short term. In our view, there are three possible solutions:

1. Under President Trump, the US should reduce its excessive debt using normal methods: by inflation and a weaker USD.
2. In Europe, such a strategy is more difficult since there are different states sharing a single currency. As long as the EUR does not disintegrate – and there are no current signs indicating that it will – it should take the route of increased redistribution, coupled with the "Japanese approach".
3. We call the reduction of government debt on the central bank balance sheet the Japanese approach. It remains to be seen if it requires something as drastic as a "reset", in other words writing off government debt from the central bank balance sheet. Perhaps they will be converted into continuous securities, i.e. with no maturity. Whether the interest rate would be 0% or set at something higher is less relevant because the returns would go to the central bank owners in any case, or rather right back to the government.

Cash becomes an asset class once again

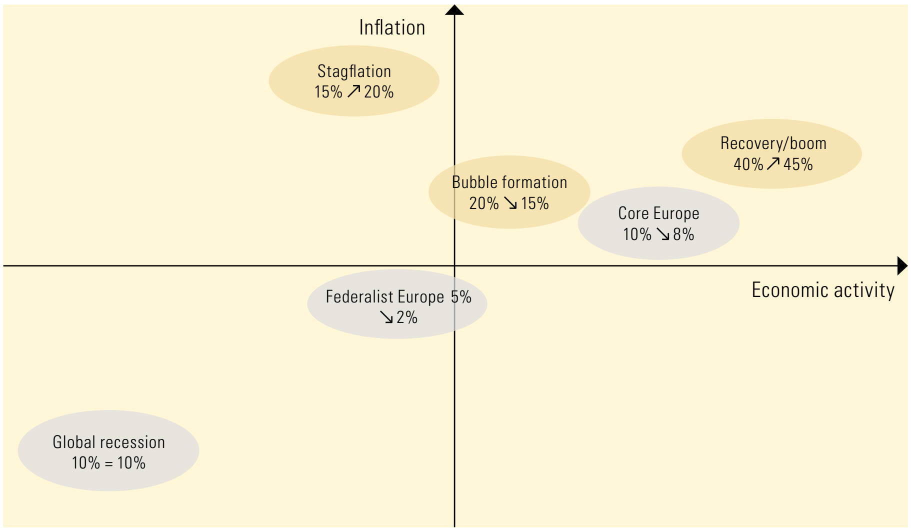
We avoid government securities with write-off risks, such as those in Japan or Southern Europe. In fixed-income, we hold primarily corporate bonds with a short duration and therefore low interest risks. With an end in sight to the disastrous negative interest rates, we are likely to begin reducing the allocation to equities, which remains high, and start to increase some cash reserves. We will resume buying bonds once interest rates become more attractive. As well, we naturally wish to capitalise on the opportunities offered by market situation with increased volatility.

Until then, our advice remains the same. Diversify your portfolio broadly and in such a way that it matches your individual goals and expectations. Our investment team makes weekly tactical adjustments that we use to try and generate additional yields in the face of today's relatively low return expectations. We look forward to the dialog with you in the coming weeks and months.

Christof Reichmuth, General Partner

NEW INVESTMENTS THANKS TO SOLID GROWTH

Political manoeuvring with protective tariffs threatens growth momentum



Yellow = the scenarios described below

Summary
- Infrastructure projects and protective tariffs could fuel inflation against the backdrop of a contracted labour market.
- Still no sign of weakness in global growth momentum.
- Europe stabilised for the time being following elections, but also inhibited due to the weak government in Germany and the protracted government formation process in Italy.

Recovery/boom – new confidence boosts investment projects

Many companies are doing surprisingly well and registering improved order intakes and growth forecasts. Company confidence and better visibility are resulting in new investment projects. Thanks to positive consumer sentiment, the Fed can continue the process of normalising interest rates. Wages are increasing, but only slowly thanks to efficiency gains through automation and digitalisation, and inflation remains under control. In China, Xi Jinping's power is further strengthened, and reforms in state-owned companies, privatisation and a focus on high-quality growth are being driven forward consistently. The economic recovery in Europe is also gaining momentum in the shadow of the strong performance in the US and Asia.

45% Probability 3–6 months

Investment ideas
- Overweight shares (more and more cyclicals)
- Avoid fixed-income investments
- Foreign currencies are attractive
- Alternative, low correlated return sources such as infrastructure or ILS

Stagflation – fiscal stimulus and protective tariffs at the wrong time

The Fed is implementing rate hikes only hesitantly despite an acceleration in growth. Expansive fiscal policy at a time of full employment in the US is leading to wage pressure and an overheating of the labour market. Protective tariffs on imported goods are fuelling inflationary pressure. Real interest rates fall into negative territory. The weaker USD and rising commodity prices are having a positive effect on individual emerging markets. Europe is continuing to struggle with competition problems, and the strengthening of the EUR against the USD is putting new pressure on Southern European countries with poor cost structures.

20% Probability 3–6 months

Investment ideas
- Underweight shares from industrial countries
- Overweight hedge funds
- USD underweight
- Gold overweight

Bubble formation – the Fed stops planned balance sheet reduction

Growth acceleration is weaker than expected. Inflationary pressure in the US is turning out to be a flash in the pan, and disinflationary forces are gaining the upper hand. Weak wage growth and rising interest costs are weighing on US consumption and thus also on growth. The Fed is stopping its balance sheet reduction and lowering expectations for further rate hikes, while the Bank of Japan and European Central Bank are continuing with their expansive approach. Interest rates remain low or even negative worldwide. The bubble formation is shifting from the bond market to the stock market. Fears of debt monetisation and doubts about the value of nominal assets are rising.

15% Probability 3–6 months

Investment ideas
- Overweight shares, focus on equities
- Overweight real estate
- Underweight cash

ADVANCED ECONOMIC CYCLE

Slow withdrawal of expansive monetary policy

Patrick Erne,
Head of Research

Despite the current trade dispute between the US and China, global economic forecasts remain intact. Inflation figures are climbing moderately for now, and the central banks can continue to take their time to withdraw from their expansive monetary policy. After the euphoric mood in the markets at the beginning of the year corrected itself, we continue to be positive on the stock market over the next few months, even if market fluctuations are likely to stay high due to the late stage of the economic cycle and the political environment.

Good US economic outlook

Our global economic outlook for the next few months remains positive. Economic growth appears to be broadly supported, in particular in the US. For the foreseeable future, the United States will be on the most expansive fiscal policy course of all of the largest economic blocks. Tax cuts and infrastructure spending will provide additional impetus to the real economy. The trade dispute between the US and China appears to be intensifying on superficial level. However, Trump is under great political pressure to succeed in order to maintain the Republican majority in Congress, and the Chinese leadership wants to avoid any social tensions. An escalating trade war would hardly be expedient for either party. As a result, we consider the current developments to be a jostling for position in future negotiations. A devaluation of the Chinese currency is conceivable to compensate for punitive US tariffs on Chinese export goods.

Europe needs open export markets.

Overall growth in Europe remains good, even though the mood has recently cooled somewhat. The reasons for this include the stronger EUR coupled with uncertainties regarding US trade policy, which is having a negative influence on export-dominated European economic growth. Even though political risks from populists and extreme parties in Europe's core countries have abated somewhat, there is still a lack of clear political majorities capable of pushing through key reforms. The Swiss economy remains on its recovery course and is benefiting from a growing European domestic economy as well as a weaker currency.

GDP growth expectations	GDP current growth	Growth expectation 2018
United States	2.6%	2.5 – 3.0%
Europe	2.7%	2.0 – 2.5%
Switzerland	1.9%	1.5 – 2.0%
Japan	2.0%	1.5 – 2.0%
China	6.8%	6.0 – 6.5%

Higher US interest rate expectations

At least two further key rate increases are expected for 2018. This does not appear particularly restrictive based on current growth of almost 3% and the additional fiscal stimulus. A risk scenario for the financial markets would be a significantly faster rise in terms of inflation, which would push interest rate expectations upwards. In spite of full employment, the signals indicating an increase in wages remain mixed. If wages do rise sharply over the coming months, it would be a confirmation of a late-cycle boom in the United States and would force the US Federal Reserve to adopt a more restrictive monetary policy. Trade restrictions such as protective tariffs make products more expensive and also drive up prices. Despite increased inflation risks, in our base scenario for the next three to six months we are predicting a moderate rise in US inflation and prime rates.

On the long end of the US yield curve, we expect a further increase to over 3%. The Fed will reinvest fewer expiring government bonds, and the issuance of US government bonds will increase due to the higher new debt load. Current yields (2.8% for 10 years) are, in our opinion, inadequate for an environment with good growth and rising inflation and are therefore unattractive. Should the 10-year US interest rates not rise as expected or even sink and the yield curve become inverted, this would be a warning sign that the economic upswing could end sooner than expected.

Increasing interest rate difference between US and Europe

Inflation pressure in Europe is lower overall, but with the solid economic outlook and increasing capacity utilisation, there are also growing indications of wage pressure and possible inflation effects, particularly in Germany. The ECB continues to remain reserved, possibly to also avoid any unnecessary appreciation of the EUR. Interest rate increases in the next three to six months are improbable, and the interest-rate differential in favour of the US will keep rising. The ECB bond purchasing programme should come to an end in the second half of the year, however, and interest rates will increase at the long end.

The SNB's room for manoeuvre remains limited, and thus key rates remain unchanged. The same applies for monetary policy in Japan. The Bank of Japan is keeping interest rates fixed at the long end (yield anchoring). With the positive economic trend and some inflation, tolerance is growing for raising the fixed interest rate somewhat and further reducing bond buying. Fixed-rate investments in Europe, Japan and Switzerland remain unattractive.

Interest rate expectations	3-m rate (Libor)	Expectation in 3–6 m	10-year swap	Expectation in 3–6 m
United States	2.3%	rising	2.8%	rising
Europe (D)	–0.4%	stable	1.0%	rising slightly
Switzerland	–0.7%	stable	0.4%	rising slightly
Japan	–0.0%	stable	0.3%	rising slightly

Jump in earnings for US companies

Corporate earnings should see double-digit increases in all regions. Thanks to tax reforms, in the US a rise in earnings of almost 30% is forecast for 2018 as measured by the S&P 500. Many of the effects are non-recurring, however, and almost impossible to repeat in the future. Profit margins are also an issue, with those in the US already above average in many sectors. In an environment with rising interest rates and growing inflation, it will be more challenging to maintain margins with a market more susceptible in general to disappointments. Nevertheless, we continue to detect potential in margins in Europe, Japan and emerging markets, most particularly in Asia.

At the moment, the solid economic situation means we do not see any indications of a weakening in economic growth. Furthermore, expansive stock buyback programmes have been announced in the US since the beginning of the year in conjunction with the tax reforms, which should shore up the market in the short term. Cyclical sectors that are primary participants in economic growth are in demand, such as finance, commodities, energy and industry. Technology stocks – the biggest winners in low-interest periods – seem to be facing a much stronger political headwind, however.

International share valuations and expectations

Market	Index level (06.04.2018)	Price / earnings	Price / sales	Price / book value	Div. / yield	Expectation 3 – 6 months
S&P 500	2 604	16.7	2.1	3.2	1.9	sideways
DAX	12 241	12.7	0.9	1.7	2.7	rising
SPI	10 166	16.5	1.8	2.0	3.2	rising
TOPIX	1 729	13.7	0.8	1.3	1.9	rising
China H-Shares	12 135	8.0	1.0	1.1	3.4	rising

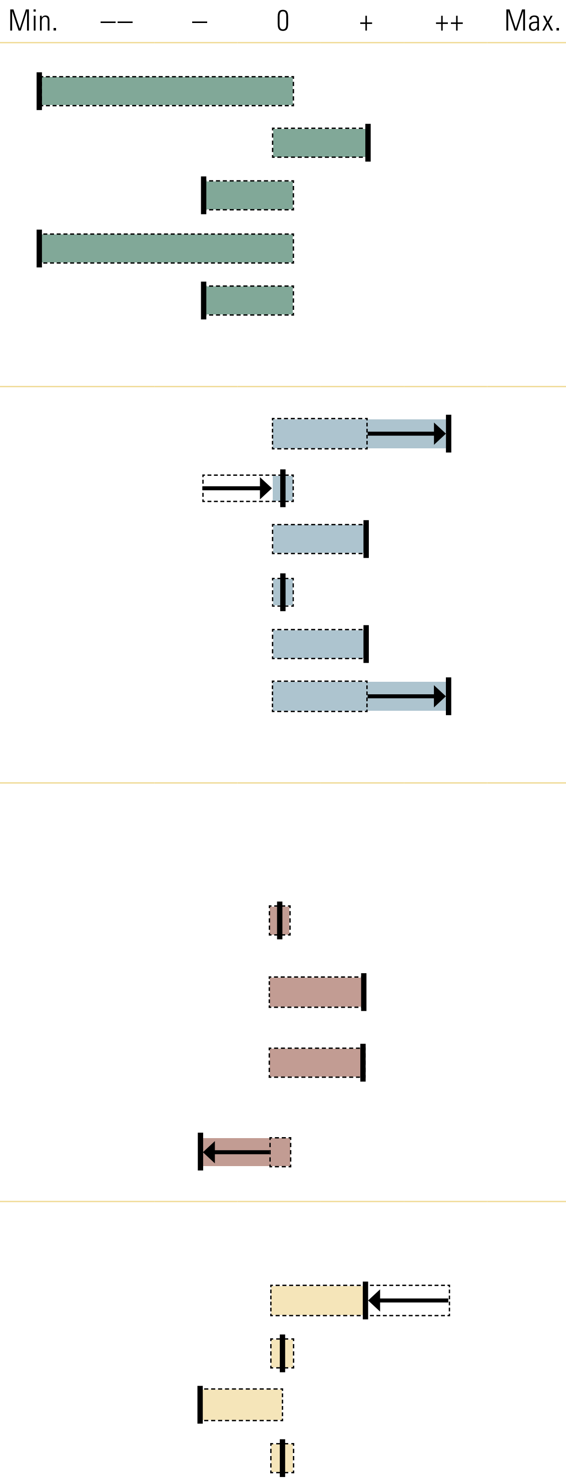
SHORT & SIMPLE

How to react to increasing volatility

Volatility measures how sharply the daily or monthly yields deviate from the historical average. This figure is widely used in the financial sector as a risk indicator. Nevertheless, it only makes a statement about historical developments and does not provide a basis for evaluating future risks. Price fluctuations can be weathered with a sufficiently long time horizon and a quality-focused strategy. Avoiding permanent loss risk is even more important, however. These include insolvency, restructuring or forced sell-offs. This is why we avoid investing in over-indebted countries and companies, treat exaggerated valuations with caution, and diversify our investments. In an environment with rising interest rates, it is particularly vital to evaluate these risks with an eye to the future, instead of bemoaning the lack of foresight at a later point.

INVESTMENT POLICY OVERVIEW

Tactical overweight for equities



Asset class	Change since last investment decision
Bonds	Further rate hikes are expected in the US. Focus on good-quality US corporate bonds with a short maturity. Avoid European and Swiss bonds if possible.
United States	
Europe	
Switzerland	
Emerging markets	
Equities	Liquidation of hedges.
United States	Liquidation of hedges & increase in US banks.
Europe	Slightly more cyclical focus again in Europe.
Switzerland	Around ⅓ in Swiss small caps.
Japan	
Asia/emerging markets	Focus remains on growth markets in Asia (China, India, Vietnam). Eastern Europe in addition to Russia.
Alternative investments	
Hedge funds	Event-driven and Asian long/short equity strategies remain attractive. Setting for macro strategies becomes attractive.
Insurance-linked securities	Ongoing repricing in the (re)insurance sector.
Raw materials incl. gold/silver	Precious metals profit from decreasing real interest rates.
Real estate	Reduction of weightings due to interest-rate sensitivity and high valuations.
Currencies	No clear currency favourites.
USD	USD with high interest rate differential to the CHF and EUR; correspondingly high hedging costs.
EUR	EUR momentum has declined.
CHF	We are increasing our CHF allocation slightly at the expense of the USD and thus further reducing the level of currency risk.
Other	

Previous   Current   Change

If any of our clients would like to receive a copy of our Investment Policy publication with detailed market assessments, please contact your relationship manager or register with Nadine Vonwyl at nadine.vonwyl@reichmuthco.ch.

THE RIGHT MIX FOR YOU?

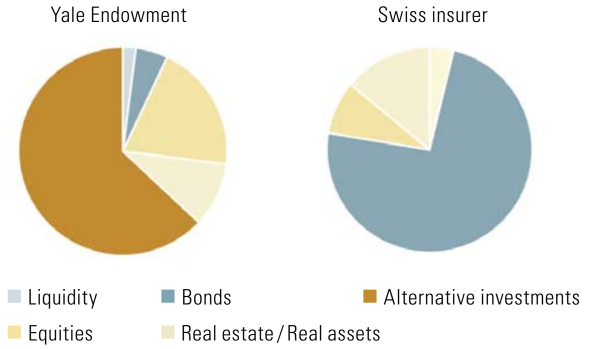
Different positioning and its causes

As Paracelsus once said: "The dose makes the poison" it is all about finding the right mix. When investing, this is just as decisive for returns as it is for stability. Two examples from renowned institutions further illuminate this subject, one using the investment strategy of Yale University, and the other that of a large Swiss insurer. How are their portfolios structured?

The chart on the right displays it clearly:

- The insurer holds only around ⅓ in real assets such as stocks, real estate, etc.; Yale, on the other hand, has weighted its real assets at over 93%.
- The traditional asset classes – bonds and listed shares – only make up about 25% of Yale's allocation.
- Although it is not visible in the graph, it is worth mentioning that in 2012 Yale held around 22% in "Real Estate & Real Assets" and has since halved that to 10%. In contrast, it increased its "Foreign Equity", for example, from 8% to 16% and hedge funds from 14.5% to 25%.

The difference is very telling and has its reasons.



Source: Yale Endowment Report 2017, Business Report 2017 (own chart)

The insurer's viewpoint

The insurer's investment portfolio is focused mainly on existing nominal obligations towards its insured parties (life insurance etc.). This is sometimes based on regulatory requirements such as the solvency test, which evaluates the risk tolerance of an insurance company corresponding to the coverage of its obligations. As a result, due to the nominal obligations on its liabilities, it places nominal investments on its asset side. The bond-heavy portfolio is vulnerable to rising interest rates and inflation. However, since higher interest rates would also reduce the discounted value of obligations, the insurer can and must take this into consideration.

The Yale Endowment's viewpoint

Yale has what amounts to a "limitless" investment horizon. The goal is for the university to receive an annual real contribution from the returns and possible withdrawals, and for the capital to increase. From this perspective, it is less crucial that an investment can be liquidated at any time or whether book losses will occur in the short term. Yale is interested above all in the value of an investment and less in its short-term price driven by market sentiment. It bases its strategy on the long-term risk/return profile and evaluates it with an eye to the future.

Different return expectations...

...are the result. Nominal investments with a high interest risk offer almost no returns. In contrast, real assets promise higher yields in the long term, yet are sometimes comparatively illiquid as a result and their price can fluctuate around the value.

What does this mean for you?

Determining the right strategy for you is influenced by an array of factors: investment goals, investment horizon, risk tolerance and willingness, etc. Is the focus on ongoing expenditures or is the investment goal already in place more focused on the next generation? The latter is similar to Yale's mindset, while the former describes the strongly regulated investment guidelines of an insurer.

Furthermore, returns are the recompense for assumed risks. This makes it vital to gauge which premiums you will receive for assumed risks on the stock markets, or related to interest rates, inflation, liquidity, defaults, unforeseen events, etc. Which risks are you prepared to assume? How will you combine them so that you achieve customised diversification and a robust portfolio tailored to your goals? A positioning really becomes coherent when it incorporates an integrated vision – and fits in perfectly with your overall investments.

Are you more of an "insurer" or "Yale" type? We look forward to discussing this with you and helping find out.

Remy Reichmuth, General Partner

STRONG GROWTH MOMENTUM IN ASIA

Interview with Remo Hegglin, currently based in Singapore

You have been with Reichmuth & Co for almost nine years, but are currently living and working in Singapore – how did that happen?
It was always my desire to gain work experience abroad. A global outlook is key for a future-oriented investment policy, as well as for recognising trends early on.

How did you end up choosing Singapore?
I had never been to Asia before. We have also had a heavy weighting in this region for years in our investment strategy. My goal is to experience the growth dynamic here first-hand and learn from it. I quickly decided on this city-state, which alongside Hong Kong is one of the most important financial centres in Asia.

What are your responsibilities in Singapore?
We offer our clients access to top-class specialists via our Manager Selection approach, which means we cultivate a large international network. I am completing a two-month internship with one of these managers. He specialises in investments in REITs. I am learning a lot during our meetings with companies. We are also involved here with trends in the international real estate industry and the appraisal of commercial properties.

What are REITs?
Real Estate Investment Trusts (REITs) are publicly listed real estate companies with specific legislation. They are found mainly in Asia and the United States. REITs invest in real estate in the office, industrial, logistics, retail, residential, and data-centre sectors. Their legal form obligates REITs to pass on the majority of their earnings (usually 90%) to their investors, but in turn they benefit from tax exemptions at a corporate level. So, dividend payments are only taxed once – namely from the investor's side – which means there is no double taxation. By purchasing a unit in a REIT, you acquire a percentage of the real estate held by the trust and receive the corresponding portion of the rental income as an ongoing return. REITs are more liquid on the markets than direct investments because of their tradeability. Compared to stocks, REITs deliver higher dividend returns and historically lower fluctuations. Among other things, we invest in Asian REITs with our "Reichmuth Himalaja" instrument.

Will this experience influence your work in Lucerne?
As a Client Relationship Manager, I identify with the individual investment goals of our clients. It is both my duty and goal to make the most of this responsibility. My current foray into the analysis of a promising asset class is part of this. In spite of this exciting time spent exploring another side of the industry, my "normal" tasks are still very interesting for me, and I'm looking forward to seeing my clients again very soon.

What has impressed you particularly in Asia up until now?
Besides the many interesting people I have been able to meet, after two months I am still fascinated by the "boomtown" of Singapore. The modern architecture, infrastructure and advanced technology here impress me again and again. I'm also eager to experience the contrast to the other regions in Asia, such as Vietnam.

What is the main message you would like to pass on to our clients?
Asia is considered the growth engine of the global economy. I agree. The conversations I have had in person while here have especially brought home to me how much local companies are investing in the future and developing new projects. In my opinion, a well-considered Asia allocation is a definite must for a diversified investment portfolio, particularly because the Asian markets are still trading with discounted valuations compared to Western markets. However, you need to follow the adage of quality instead of quantity here as well!

How long will you be in Asia?
I will be in Asia until the beginning of June. In May, I will take the chance to visit an equity firm in Ho Chi Minh City and try to learn as much as possible about the rapidly growing economy and the stock market in Vietnam. Afterwards, I will move to Hong Kong, where I will accompany our two analysts, Patrick Erne and Rolf Rathmayr, on their manager visit for Reichmuth Himalaja.

Remo Hegglin, 34, from Zug, Client Relationship Manager and has been with Reichmuth & Co in Lucerne for nine years. In addition to our Swiss private clients, he is in charge for our clients in the UK.

Remo Hegglin,
Client Relationship Manager