CHECK-UP

September 2021
Client information
Reichmuth & Co Private Bankers

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Editorial

The Bundestag elections are coming up in Germany. However, the election campaign resembles the candidates: less than inspiring. In Europe, stability is paramount. Things will only start to get interesting after the elections, because the question of how Europe will position itself in the increasingly fierce rivalry between the USA and China remains unanswered. Will it still be possible to do business freely with both of these world powers?

The main focus for investors is on developments in the USA, which is where the nature of the western world's response to this rival system will take shape and where it will become apparent whether the low interest rate policy and the longstanding stock market boom will last.

We look forward to discussing the current situation with you and, as always, we also welcome input, objections and suggestions for improvement.

Remy Reichmuth
General Partner

"Big government" is back

Bill Clinton declared "the end of the era of big government" in 1996. Overbearing administrations should no longer interfere in everything and slow down economic growth.

That era is now back. And there are increasing signs that past mistakes are being repeated.

"Spend until inflation stops us" appears to be the new US government mantra. In practice, this corresponds more or less to MMT, the Modern Monetary Theory. The government spends far more than it collects, and everything is financed by new debt. This should cause growth to rise above long-term potential, and employees would also benefit. That's Joe Biden's plan.

REICHMUTH & CO
PRIVATBANKIERS

Is the increase in inflation temporary?
US administrations were also very active in the ’60s and ’70s, and inflationary pressure began to form. Initially, this was negated or attributed to short-lived factors. Later, attempts were made to lower inflation rates with imposed price and wage controls. Nevertheless, the underlying market forces could not be stopped. The outcome was higher unemployment and high inflation with relatively low economic growth.

The course is set for an overheated economy
At the moment, the US government continues to stoke an economy that is already doing well – a strategy meant to push unemployment below normal levels, leading to wage increases. This is by all means intentional due to the fact that the Labor Force Participation Rate has fallen (in the last two decades). One major reason for that has been China’s huge labour potential, which has stymied almost all wage increases since it joined the WTO in 2001. Inflation expectations in the US are being allowed to rise above the medium-term target, which reduces the debt burden in relation to GDP. This is to be implemented with large-scale infrastructure and social programmes, which are predominantly debt-financed. While infrastructure spending still makes sense, the social aspect remains more questionable. Social spending should not be financed with debt.

How long will the US Federal Reserve play along?
For more than a decade now, the Fed has responded to every crisis with even lower interest rates and even more money. Warnings of deflation and the risk of a depression have been sounded, but these arguments no longer apply. There is currently no talk of a crisis or deflation. It remains to be seen how much longer the US government can rely on its own central bank. The money-printing machine is still running continuously to finance the budget deficit and national debt, but when will it finally stop? And when it stops, how long will long-term interest rates actually stay below inflation expectations, which are currently at around 2.6%?

Are price controls on interest rates imminent?
It is conceivable that attempts will be made to keep interest rates low using not only rhetoric but also regulatory or administrative measures, because if the Fed loses control over long-term interest rates, both bond and stock prices will fall. On the other hand, if it can keep long-term interest rates low but ends up losing control over inflation expectations, the USD will weaken. This scenario would likely cause fewer problems domestically in the US.

Robust economy – so where’s the danger?
Historically, big government has always led to lower potential growth. However, the economy should remain strong next year. Probably not quite as good as this year, but strong nonetheless. The only danger for investors is when dynamic economic activity results in satisfying profits but these are then discounted with too low – due to manipulation – long-term interest rates. Such rates would lead to very high share prices, which can come under pressure on two fronts if interest rates rise: from lower profits and higher discount rates.

What does this mean for investors?
Portfolios have performed well, also this year. It makes us think of the guiding principles of US analyst Ned Davis.

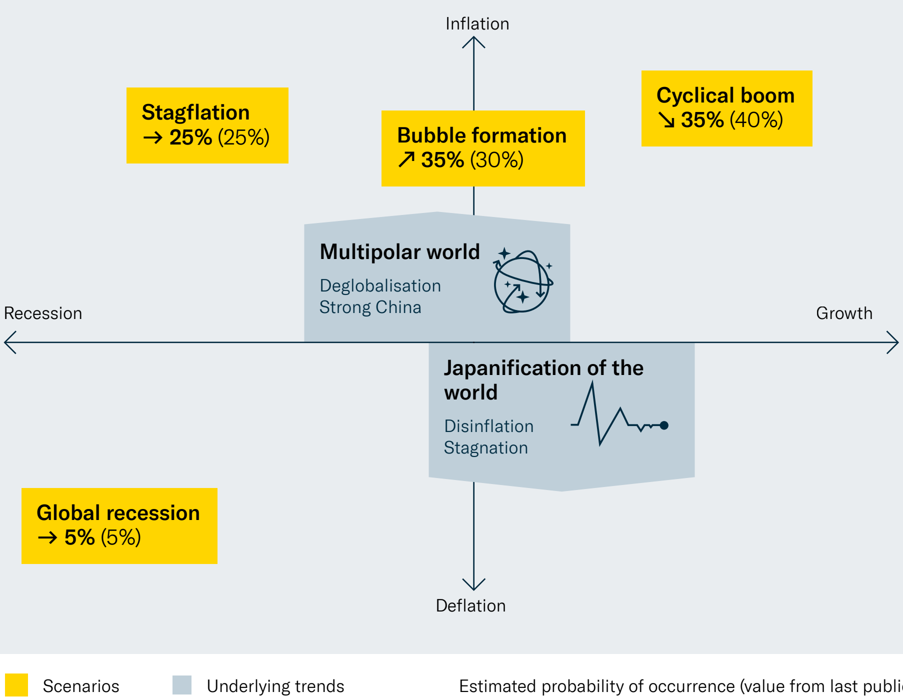
Being right or making money
1. Don’t fight the Fed
2. Don’t fight the trend
3. Study history so you don’t repeat the same mistakes
4. Beware of the crowd at extremes
5. Take your losses quickly and let your profits run
6. Don’t fight the government (new)

Our plan for the next few months is to follow the first two rules and remain invested. The sixth point was only added recently. Whether it suits my liberal, pro-business and state-sceptic feelings or not, big government is back. Point 3, the study of history, reminds us to keep a close eye on inflation and interest rate indicators because any unusual development of these parameters could cause not only a correction, but also a prolonged slump on the stock and bond markets. Diversification and the integral alignment of portfolios can help in such a case, but it would also lead to portfolio adjustments.

Christof Reichmuth
General Partner

Our considered scenarios

Navigating a multipolar world



Current assessment

- Growth rates have peaked but remain above potential for the time being.
- A significant percentage of inflation momentum is temporary – above-average underlying rate of inflation remains.
- Fiscal policy is becoming the dominant factor. The effectiveness of central banks is increasingly being called into question.

In Focus: Stagflation

Big government squeezes potential growth

With the onset of the coronavirus crisis, the global trend towards more regulation and "state" micromanagement intensified further. This is evidenced by the rising government spending ratios in many countries, among other things, and should also slow the tendency towards lower corporate taxes and shift it in the opposite direction. At the same time, minimum wages are being adjusted upwards because the wage gap is widening. In the short term, government-imposed spending – e.g. current infrastructure programmes – may shore up the economy; in the longer term, however, interventionism leads to lower potential growth as well as higher price levels. Therefore, policymakers need to carefully weigh the expected growth spurt over the next 12 months against the increased longer-term inflation risks.

Investment ideas

- Keep home bias high
- Hedge funds move into focus
- Underweight USD and EUR
- Overweight gold

OUT-OF-THE-BOX

Technology delivers productivity boost

The discussion on climate change aims to improve the balance between the resources used and the impact they achieve. In the past, economies have experienced a surge in productivity enabled by crisis management. One of the few positive effects of the pandemic has been the widespread adoption of new technologies, from efficient video meetings to customised e-commerce. Even though such technologies would have been introduced regardless of the pandemic, the accelerated rate of this wide-scale adaptation is helping economies to achieve sustained efficiency gains and ultimately higher potential growth.

Investment ideas

- Equities from high-growth segments, megatrends
- Overweight technology shares
- Underweight nominal assets such as bonds

Cajetan Bilgischer and Silvan Betschart

Has the cycle peaked?

Inflation and slowing economic momentum

The coronavirus crisis caused an extreme demand and supply shock. Whereas the demand side has normalised in many sectors thanks to support measures and a rapid opening of the economy, the supply side remains under stress. Bottlenecks in global supply chains are persisting longer than expected, and price pressures remain high. Simultaneously, the virus variants are once again threatening to create adverse headwinds for economic growth. Will this cause the abrupt end of the cyclical upswing? Even if the real economy has passed its growth peak, we still expect above-average growth and remain positive on equities. But it is also essential to prepare for alternative interest rate scenarios.

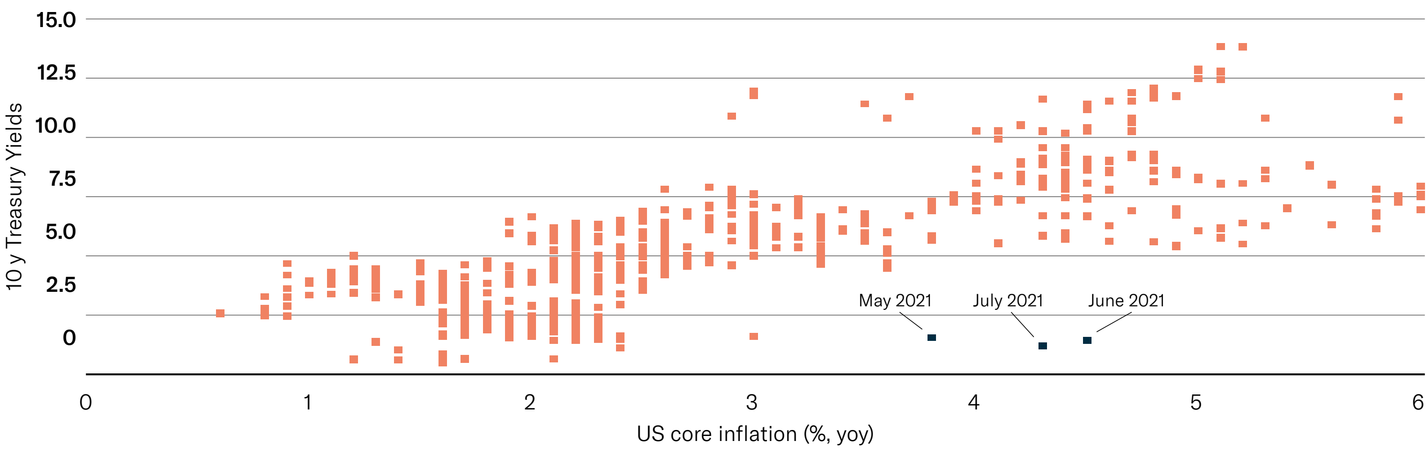
Rise in long-term interest rates

With the current growth outlook and higher inflation figures, it is astonishing to observe how low the interest rate markets are trading (see chart). Even with a delay in economic recovery caused by new virus variants, US interest rates are heavily manipulated at the long end of the curve. Although there are technical reasons for the decline in interest rates, and central banks continue purchasing bonds on a large scale, we expect long-term interest rates to rise in the coming months. As the pandemic support programmes are phased out, more people will return to the labour market in the US, and it will quickly shift towards full employment. For the US Federal Reserve, this development, along with inflation, is the most important condition for reducing monetary policy support and preparing the markets for the curtailment of bond purchases over the course of 2022. This adjustment of long interest rates is a delicate balancing act, set as it is against the background of high government debt, further budget deficits and higher inflation. If the official wording is too hesitant, assets such as equities or real estate risk heating up and the USD would enter a phase of weakness; if the rhetoric is too harsh, interest rate expectations could rise significantly and put pressure on assets and the real economy. The environment for fixed-income investments remains challenging, and we continue to recommend a ratio in line with the strategic minimum as well as a short duration.

Focus on quality stocks

We continue to view the profit trend for companies as positive. In the coming months, we expect a moderate rise in long-term interest rates towards 2%. Valuation pressure thus remains moderate, and the environment for equities continues to be positive. However, pricing power will become more important as the pressure on companies' costs remains high. While the focus in 2021 was mainly on input costs due to temporary logistical bottlenecks, it is likely to shift in 2022 towards rising labour costs and the associated structural inflation risks. As a result, quality stocks with strong cash flow from global market leaders remain our first choice (see article on page 6). Tactically, we do prefer bank and commodity stocks. Banks are still priced low compared to the overall market, benefiting from rising interest rates and credit growth. Infrastructure programmes, especially in the clean energy space, will boost commodity demand for many years to come. Shares from the structural "clean energy" megatrend should continue to enjoy tailwinds.

ARE WE ENTERING A PHASE OF RISING INTEREST RATES?
Actual levels of interest rates are too low in relation to inflation.



Source: Macrobond, Bloomberg (as of 18.08.2021)

Alternative interest rate scenarios

The expected development of interest rates will have a significant influence on the prices of equities and other risky investments. If central banks manage to maintain a financially repressive environment with low interest rates despite high growth, risk assets will remain attractive. It is almost impossible to maintain purchasing power with nominal investments such as cash or fixed income investments with interest rates below inflation. Risky investments like equities are the only alternative. If, however, the central banks become more restrictive and the pricing of interest rates is once again increasingly left to free market forces, then rates risk rising more than expected and could exert temporary pressure on equities despite rising corporate profits.

A shift in strategy towards a smaller share in equities becomes imperative in a stagflation scenario, where inflation is more persistent and stronger than expected and central banks are forced to raise interest rates to prevent a loss of confidence in the currency. This puts a strain on growth, with both valuations and profits coming under pressure. Defensive value stocks from the healthcare and food sectors should prove more robust than highly valued growth stocks. In the face of such a scenario, only alternative investments offer actual diversification potential. Gold, for example, should benefit in an environment of runaway inflation. Nevertheless, active, alternative strategies that are aligned with accentuating trends or higher volatilities in interest rate, currency and commodity markets also offer the opportunity to diversify an equity-heavy portfolio. In the illiquid sector, real value-based investments such as agricultural land or infrastructure assets are a suitable option. While the balancing act is becoming more challenging for central banks, investors will also have to align their portfolios to match different scenarios (see chart). Even though we expect the cyclical upswing to continue in the coming months, it is vital to prepare your portfolio for alternative interest rate scenarios. We would be happy to advise you in a personal meeting.

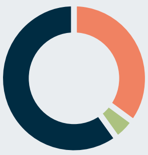
Patrick Erne
Head of Research

THE APPROPRIATE INVESTMENT IDEAS FOR THE RESPECTIVE INTEREST RATE AND ECONOMIC GROWTH ENVIRONMENT

Rising interest rates

Current environment

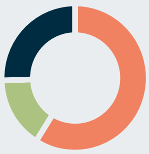
Stagflation
Inflation > 4%, interest rates > 3 %, growth < 2 %



Overweight alternatives, bonds offer no inflation protection, equities at least some.

Best ideas:
- Equities: Quality shares with pricing power
- Bonds: TIPS
- Alternatives: Gold, Protection, macro, farmland

Cyclical Boom
Inflation 2–4%, interest rates 2–3%, growth > 3%

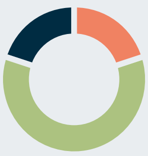


Overweight equities

Best ideas:
- Cyclical stocks (commodities, banks, EM, Pilatus, small caps)
- Bonds: Emerging market bonds, China bonds, TIPS
- Alternatives: ILS, infrastructure, PE, macro, Credit

Less growth — More growth

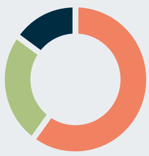
Recession
Inflation < 0%, interest rates < 1%, growth < 0%



Underweight equities
Overweight bonds

Best ideas:
- Equities: Defensive quality shares (food, health)
- Bonds: Cash, long-term quality bonds
- Alternatives: Short Credit, Protection

Bubble formation
Inflation < 2%, interest rates 1–2%, growth < 2%



Overweight equities

Best ideas:
- Equities: Growth stocks (tech, life science, megatrends)
- Bonds: High Yield, Emerging market debt
- Alternatives: Short Credit, Protection

Falling interest rates

Focus on quality

Benefiting from the “time” factor

The world is in a state of upheaval. On the one hand, we have a technological revolution taking place, while on the other hand, we are moving from an environment dominated by monetary policy to one dominated by fiscal policy. These major changes are challenging many existing business models, which are proving unable to adapt sufficiently. At the same time, it is unclear which new business models will prove successful. There is a real demand for companies that have a good visibility in these uncertain times and are less affected by short-lived trends.

Characteristics of quality stocks

What distinguishes quality stocks? They are most often associated with companies that are global leaders in specific niches. They continuously gain market share in a growing end market, both thanks to higher organic growth than the market itself and to their position as consolidation winners. It is not uncommon for them to face relatively few competitors, resulting in less price pressure. Thanks to strong innovative power and robust products, they can generate attractive returns over a long period, enabling them to make new investments in growth. This leads to the creation of above-average shareholder value over time. “Time” is considered an investor’s best friend when it comes to quality stocks. Management, to which we attach great importance especially in the selection of Swiss small-caps, also plays an important role in global quality stocks – not only with regard to capital allocation, but also for long-term issues such as sustainability and climate protection.

“ R&Co Selection Global Leaders” vs. overall market

	Global leaders	MSCI World
Return on investment	19.8%	11.5%
EBITDA margin	30.1%	26.2%
Debt-to-equity ratio*	0.9×	1.43×
FCF growth	20.2%	9%
P/E 2022	24.3	18.3

Calculation: MSCI World weighted average; Global Leaders universe weighted equally
*median calculation

Many of these quality stocks not only have quantitatively comparable characteristics, but can also be grouped qualitatively:

- High share of recurring income, e.g. from servicing or licence fees (Schindler, Microsoft)
- Essential product components with a small cost share in the end product (Givaudan, Novozymes)
- Brand heavyweights (LVMH, Nestlé)
- Innovation leaders with high research expenditures (TSMC, Lonza)
- Steady market-share winners (Sika, Thermo Fisher)
- Gold standard – established service providers (SGS, Moody’s)

Based on the aforementioned characteristics, quality stocks are primarily found in the technology, communication, healthcare and consumer sectors and less commonly in capital-intensive sectors such as finance or energy.

Quality stocks in an inflationary environment

We are expecting higher inflation rates over the next ten years compared to the past decade. What does this mean for quality stocks? Inflation has led to price pressures on companies. It is essential that price increases can be passed on in order to protect margins. This is where quality stocks are much better positioned than companies that cannot differentiate themselves through products and services and must engage in fierce price wars. On the other hand, inflationary pressures have historically meant rising interest rates, which in turn cause valuation pressures. This mainly affects very expensive growth stocks whose cash flow will only materialise in the distant future. Quality stocks are characterised by the fact that they already have a substantial cash flow. While this does not make them immune to a valuation contraction due to rising interest rates, they are likely to be more robust than the overall market due to their resilient business model and growing cash flow. Ignoring quality stocks is not an option for long-term oriented investors.

Silvan Betschart
Research, Head of Investment Policy

Essentials for your pension plan

These parameters are central to prudent pension planning

It is often vitally important to take the right steps at the right time in life. However, we only find out in retrospect whether our actions were appropriate and correct. Missed opportunities rarely return – and the same applies to personal pension planning.

1. Vested benefits
Career changes, a new job, or a shift into self-employment are significant and unique opportunities for your personal pension provision. The flexibility this can offer in the second pillar of occupational pension provision (pension fund) must be used sensibly for your own personal benefit. This also applies to a divorce. Although the division of pension fund assets is largely regulated by the applicable legal framework, the specific implementation and structuring of the payment distribution should be addressed beforehand in the separation agreement. Likewise, possible coverage with supplementary insurance benefits (covering risks such as death, disability, etc.) can be crucial for future single spouses.

While the focus of standardised investment solutions is usually on cost efficiency, in the case of larger pension amounts in particular, an even higher priority is placed on sustainable tax planning, integral coordination with the overall situation, and the choice of a reliable financial partner – a "personal financial coach", so to speak.

2. Additional purchases into the pension plan
Voluntary purchases into the pension plan are a very attractive way, from a tax perspective, to build up assets. However, keep the following points in mind:

- Analyse your pension plan thoroughly. How will my pension assets earn interest? Is there an opportunity for cross-subsidisation? What is the technical interest rate and the coverage ratio of the fund? What happens to my pension assets in the event of death?
- Optimise your management pension provision by redesigning the plan and the rise of retirement credits. In this way, several hundred thousand francs of additional purchasing capacity can be generated with no change in salary.
- It is advisable to choose a staggered payment plan, as in most cases higher tax savings can be realised with this approach compared to a one-off purchase on account of the gradation.
- The higher the taxable income and the quicker you can withdraw the money again, the greater will be the effect of the purchase. The most significant added value is therefore usually achieved with a purchase in the final years before retirement, but you must always take into account the three-year blocking period for withdrawing pension assets after your last purchase.

> **"Choosing a reliable financial partner as your personal financial coach is indispensable."**

3. Start your own pension planning at the age of 50
The magic word for an optimally designed retirement is "early". In concrete terms, people should start handling their own pension planning from the age of 50. This is the best way to take advantage of the greatest opportunities and secure benefits. In-depth pension planning often focuses on the following questions: Can I afford to retire early? Should I choose annuities or lump-sum withdrawals? Does it make sense to amortise my mortgage?

Our pension specialists focus not only on quantitative aspects, but also on qualitative factors such as personal wishes, expectations and your lifestyle in general.

Would you like to meet with one of our specialists and explore your own personal possibilities with absolutely no obligations? We look forward to welcoming you.

Michael Widmer
Pension Planning

“I love people”


Interview with Jürg Staub

At the beginning of the year, you handed over the reins as CEO. What has 2021 been like for you so far?
Certainly positive in various respects. To begin with, I'm very pleased that for some weeks now we have finally been able to have more client meetings in person. Secondly, we are making steady progress on the further offerings for our clients. And thirdly, I have now had the time to attend a course at the University of Lucerne on the hot topics of cryptofinance and cryptocurrencies, where I acquired a great deal of understanding and hope to be able to implement some of the things I learned in our company.

Before we expand further on these three points, how has Reichmuth & Co fared in the current year?
The response from our clients confirms that our solutions are in demand and deliver benefits. Occupational pension provision, e.g., is ideal for asset accumulation. Families, on the other hand, think in terms of generations, and the determination of each individual asset return is based on an integral view of investments, risks and the overall situation. This corresponds to our motto “People and money in harmony”, because money is something very personal. In short, we were able to carry the momentum from the previous year forward and remain on course for growth in 2021.

What is your most effective input when communicating with clients?
My professional career began in 1982 with an apprenticeship in a bank. Since then, I have witnessed the constant change over time and observed and learned a great deal. These experiences help me when talking with clients. I can also use examples from my own family's financial decisions in client discussions and thus identify with clients on a more personal level. My guiding principle is “I help our clients gain financial independence”. We often talk about issues ranging from succession, wills and financing to charitable activities. I love people and I'm interested in what makes them tick. In our conversations I often learn a lot more about them as individuals, which I can then integrate into solutions and pass on to them.

What did you mean by your reference to further offerings?
The low interest rate environment means we must look for alternative earnings sources beyond traditional asset classes such as equities, bonds and real estate. These can be found, for example, in infrastructure or agricultural investments – direct real-value assets with a stable cash flow. And of course start-ups are another option, as they are transforming our world with new technologies and disruptive innovations. In addition, hedge funds and insurance-linked strategies can be used, which have a stabilising effect on portfolios. This combination has resulted in our “generation portfolio”, and it is the same approach I use for my own family. The aim is to utilise a robust structure to preserve and increase the value of one's assets over generations.

Specifically in light of your recent university studies, what is your opinion on cryptocurrencies?
The idea is groundbreaking. The tremendous potential of blockchain technology cannot be realised without cryptocurrencies. I believe this will change finance in the same way that the internet transformed retail business. The world is changing rapidly and we strive to anticipate early on both the risks as well as the opportunities and benefits for our clients.

“2022 Market Outlook”
Last year, the Market Outlook could only be presented in a video format, so we are even more excited than usual to welcome you in person once again in November.

Lucerne:	10. Nov., 5:30 p.m.
	22. Nov., 6:30 p.m.
St Gallen:	18. Nov., 6:30 p.m.
Zug:	8. Nov., 6:30 p.m.
Zurich:	11. Nov., 5:30 p.m.
	16. Nov., 6:30 p.m.
Essen (DE):	23. Nov., 5:30 p.m.
Munich (DE):	29. Nov., 5:30 p.m.

Space will be limited – more detailed information will be included in the invitation letters.