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INVESTMENT MANAGEMENT

Trump against the Rest of the World

Investment Report – 31st March 2018

Trump against the Rest of the World

The calm is over. While investors, particularly those in equities, once again relished a fair tailwind in January, February saw them being overswept by a cold front and rudely brought back to reality with a thump. International trade disputes as well as rising interest rates have put an end to the stock exchange party for the present. However, the economic environment continues to remain positive, which should help markets.

To visualise this recent change in the economic barometer, a glance at volatility indices (the seismographs of financial markets) is more telling than a thousand words. The VIX Index of American equities, as well as its European counterpart the V2X-Index, literally exploded early February after an exceptionally quiet 2017. In doing so, they rocketed from a mere 10 points at the beginning of the year to over 35 counters in February. In the meantime, they have settled back into a range of between 18 and 22 points (see chart page 9). These are readings as were quite commonplace in the past.

Change in **Equity Markets since the beginning of 2018:**

		Dec. 2017	Mar. 2018	Change
Asia ex Japan	DJ STOXX A/P	538.7	517.4	-4.0%
Germany	DAX	12917.6	12'096.7	-6.4%
Europe	DJ STOXX 600	389.2	370.9	-4.7%
Japan	TOPIX	1'817.6	1'716.3	-5.6%
Switzerland	SPI	10751.5	10'189.9	-5.2%
USA	S & P 500	2'673.6	2'640.9	-1.2%
World	MSCI World	513	505.8	-1.4%
Hedge Funds	HFRX Global HF	1'275.5	1'262.6	-1.0%

Development of index in local currency.
Exceptions Asia ex Japan and World in USD.

Our view previously stated here, namely that the threats to the financial markets are to be found less in economics, rather in politics, has been vindicated. The trigger for the setback on financial markets is generally seen to have originated in Washington, although at present, as is often the case, it is not possible to determine what it was exactly that tipped the exchange's mood from one day to the next. Be that as it may, the American President's announcement of customs duties on, in terms of value not unduly large aluminium and steel imports, has led to turmoil.

Higgledy-piggledy trade dispute

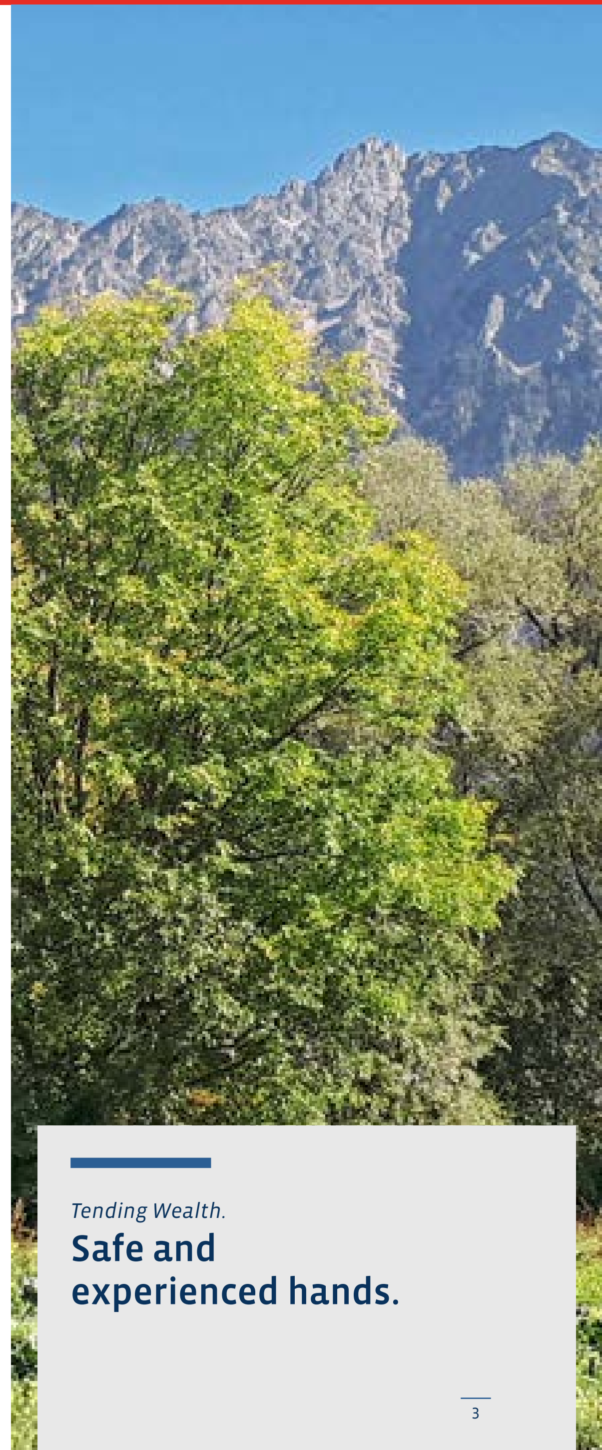
"Trump against the Rest of the World", one is inclined to conclude in reference to the German language film, "Theo against the Rest of the World" (1980, starring Marius Müller-Westernhagen). Not wanting to be seen as meek, the targeted trading partners immediately announced a sheaf of counter measures. This in turn motivated Trump to levy customs duties on additional goods. Meanwhile, the situation has become rather confusing, not least due to the many exemptions in favour of the USA's preferenced trading partners.

This global "tit for tat" has left a nasty taste in the investment public's mouth. A trade war, which in any case can only result in everyone losing, is not in the interest of investors. Consequently, a proper damper has been put on risk appetite.

The **equity funds employed by us** achieved the following returns since the beginning of the year, with nearly all beating their benchmarks:

Aberdeen Asia Pacific (USD)	1.0 %
Swiss Rock Emerging Markets Equities (USD)	2.6 %
JB Japan Stock Fund (CHF hedged)	-5.7 %
JB Japan Stock Fund (€ hedged)	-5.7 %
Strategy Certificates SIM–Swiss Stock Portfolio Basket	-5.4 %
iShares Stoxx Europe 600 ETF (€)	-3.5 %
Performa European Equities (€)	-2.7 %
Performa US Equities (USD)	4.9 %

Performance in fund currency. Source: Bloomberg or respective fund company.



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However, Trump's primary objective is to serve his clientele and force the opposite sides to the negotiating table, particularly so as far as regards the Chinese-enforced transfer of technology from the USA to the Middle Empire. Just a little remark on the irony; in the film mentioned above, Theo managed a small haulage business and, as such, was also involved in the movement of merchandise across borders. In this story too, things very soon became extremely chaotic …

Since the beginning of the year, yields on **10-year government bonds** have increased nearly everywhere:

	Dec. 2017	Mar. 2018	Change
Europe	0.43 %	0.50 %	16 %
United Kingdom	1.19 %	1.35 %	13 %
Japan	0.05 %	0.05 %	0 %
Switzerland	-0.15 %	0.03 %	120 %
USA	2.41 %	2.74 %	14 %

Other funds employed by us developed as follows:

Acatis IfK Value Renten Fond (€)	-1.1 %
Acatis IfK Value Renten Fond (CHF hedged)	-1.2 %
BCV Liquid Alternative Beta (€ hedged)	-0.4 %
BCV Liquid Alternative Beta (CHF hedged)	-0.5 %
BCV Liquid Alternative Beta (USD)	0.3 %
Franklin Templeton K2 Alternative Strategies Fund (€ hedged)	-0.7 %
Franklin Templeton K2 Alternative Strategies Fund (CHF hedged)	-0.9 %
Franklin Templeton K2 Alternative Strategies Fund (USD)	0.0 %
Lyxor ETF Euro Corp. Bond Fund (€)	-0.5 %
New Capital Wealthy Nations Bond Fund (€ hedged)	-3.0 %
New Capital Wealthy Nations Bond Fund (CHF hedged)	-3.0 %
New Capital Wealthy Nations Bond Fund (USD)	-2.3 %
Pictet CH-CHF Bond Fund	-0.7 %
Swiss Rock Absolut Ret. Bond Fund (€ hedged)	-0.8 %
Swiss Rock Absolut Ret. Bond Fund (CHF hedged)	-0.9 %
UBAM Corporate USD-Bonds (€ hedged)	-2.2 %
UBAM Corporate USD-Bonds (CHF hedged)	-2.3 %
ZKB ETF Gold (USD)	1.4 %

Performance incl. reinvested dividends where applicable.

Global rate rise

The hike in the interest rate for the Fed Funds (interbank overnight lending) by ¼ percentage point to a target range of 1.5 to 1.75 % was expected and became a matter of minor importance in the heat of the battle. However, it does not go unnoticed that interest rates in the USA are on the rise. There are at least two more such hikes expected in the USA for the current year. At the long end of the bond-curve, the increase in the cost of borrowing manifested itself in an increase in yield of 10-year government debt from 2.41 to 2.74 %. In other countries as well, bond yields have increased since the beginning of the year.

Meanwhile, the economy is powered up globally. The global Purchasing Managers Index (PMI, February readings) at 54.2 points would indicate a continuation of the favourable economic environment can be expected, even though signs of a slight deceleration have become visible in places. No major country has recently registered a negative reading. Switzerland is leading the pack with a 65.5 reading and with values above 60, Germany, Holland and the USA are equally showing very good results. Nevertheless, some preliminary March readings indicate that setbacks rather than further rises from current levels are to be expected.

Average **growth and inflation forecasts** from "The Economist's" March poll of economists:

	Real GDP Growth		Inflation	
	2018	2019	2018	2019
China	6.6 %	6.4 %	2.3 %	2.4 %
Germany	2.5 %	2.1 %	1.7 %	1.8 %
Euroland	2.5 %	2.0 %	1.5 %	1.5 %
United Kingdom	1.5 %	1.5 %	2.6 %	2.2 %
Japan	1.4 %	1.1 %	1.0 %	1.3 %
Switzerland	2.0 %	1.9 %	0.6 %	0.9 %
USA	2.8 %	2.4 %	2.3 %	2.2 %

Economy ticking over nicely

Expectations for economic growth in 2018 paint a rosy picture. On average, the augurs polled by “The Economist” expect 2 % growth in Gross Domestic Product (GDP) in Switzerland for the current year. The experts at the economic research institute, KOF, at the ETH Zurich are even more optimistic, considering even 2.5 % possible in their latest revision of expectations. Again, according to “The Economist’s” poll of forecasters, the USA can reckon on 2.8 %, on a par with the Netherlands and Spain. For Germany and the Eurozone, 2.5 % is anticipated. As usual, with 6.6 and 7.2 % respectively, China and India play in a different league.

So far, so good. Particularly in the USA, the economic cycle is already far advanced. The labour market is tight, consumers are enjoying the upswing, but it is becoming gradually more difficult to see further room for improvement from the levels currently achieved. In addition to this are the USA’s rising deficits in trade and budget. As another sword of Damocles, there is the global debt mountain, not only gigantic in America, but also in China and some European countries. Faced with extremely low interest rates and the ongoing, but not never-ending, willingness of central banks to flood markets with near limitless amounts of money, structural corrections or debt reductions have been shelved in many places. So overall, it does not come as a surprise that expectations for 2019 come in slightly below those for the current year.

Conclusion: A tall order

Faced with upward trending interest rates on the one hand, and relatively expensively valued equities on the other, investors are faced with quite a challenge. We will maintain our slight overweight in equities and remain underweight bonds for the time being. Equally unchanged remain our portfolio weightings in gold and alternatives. After extraordinarily low readings during 2017, market volatility is likely to settle down to a markedly higher but more normal long-term level.

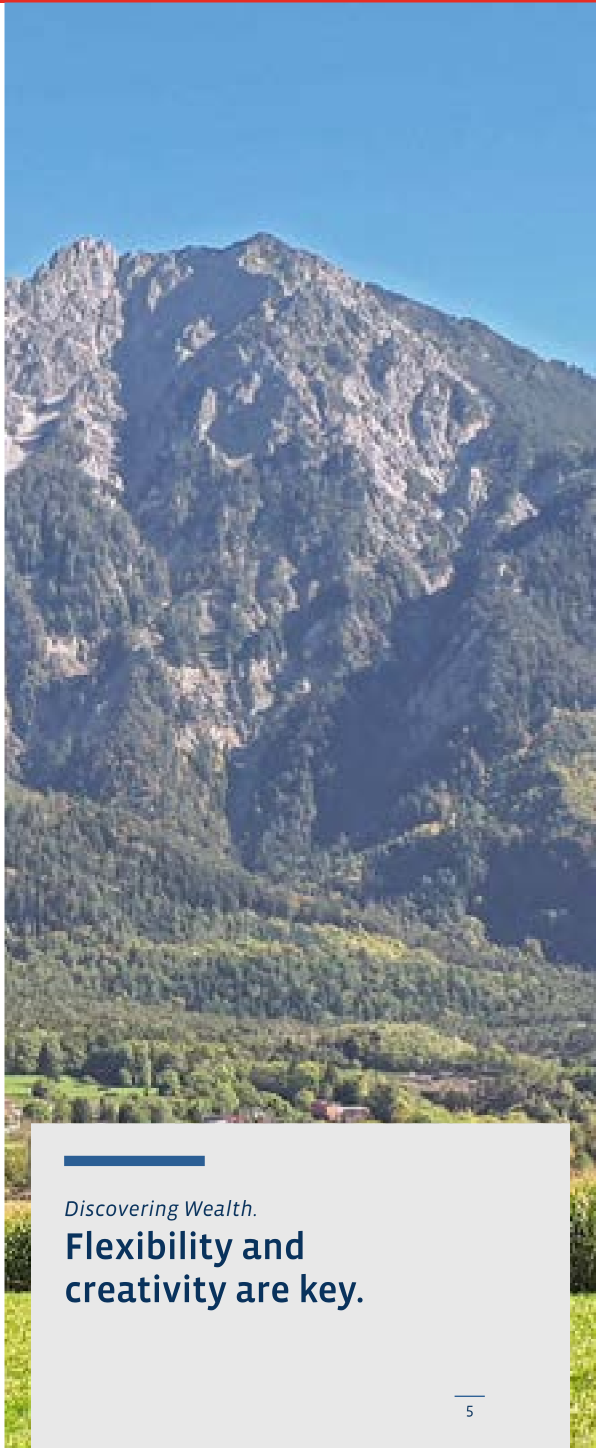
We are currently intensively occupied with a thorough analysis of European and Swiss stocks. For the coming weeks, the rebalancing of the direct equity investments and the certificate on Swiss equities is scheduled. The fundamentally most attractive stocks will be identified and added to the portfolios at equal weights.

Asset Allocation

At its meetings, the Investment Committee decided on the following changes to the asset allocation for medium-risk balanced Swiss Franc portfolios, not subject to client’s restrictions (mandates in different reference currencies at times display different nominal weightings and weighting changes).

Money Market
Since the beginning of the year, the money market allocation has remained broadly unchanged. With that, it lies just below its strategic target, or in other words, we are slightly underweight.

Bonds
Markedly underweight is our bond position. The rise in interest rates during the first quarter startled many investors and had a negative impact on performance. We are, however, still far from attractive levels for bond buyers. We have not made any active changes to our bond position during the past three-month period.



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Equities Switzerland
No changes have been made to the position in Swiss stocks. The local market has experienced quite a lot of turbulence in the past two months. Our selection of Swiss equities composed according to value criteria (see also last paragraph “And finally this”), the ‘Swiss Stock Portfolio’ (SSP), experienced a negative return (including dividends) of 5.2% in the year to date. Its benchmark index SPI (Total Return) corrected by the same percentage during this period.

Since 2010, the SSP’s mean annual performance amounts to 11.6% p.a., clearly beating the 7.5% achieved by its benchmark. Since 2010, the cumulative total return of this strategy amounts to 148%. The SSP figures are net of transaction costs and withholding taxes. The benchmark, however, does not bear any such costs. The certificate we launched in July 2017, the “Strategy Certificates linked to the SIM–Swiss Stock Portfolio Basket” (Valor: 36524524, ISIN: CH0365245247), which mirrors this equity portfolio 1:1, lost 5.4% in step with the negative development on the market.

Equities Europe
Amongst the European equities, the UK (FTSE 100 Index -8.2%) and German equities (DAX -6.4%) experienced particular stress during the first quarter, losing more than the pan-European indices. The pan-European composed price barometer, the DJ STOXX 600 Index, lost 4.2%. Compared to this, our selection composed according to value-criteria (see also last paragraph “And finally this”) once again put up a good show. The directly-invested “European Stock Portfolio” (ESP) achieved a -2.5% return since the beginning of the year (both values are total return, i.e. including dividends), yielding an outperformance of 1.7 percentage points. Compared to a pure value index, which reflects our investment approach more closely, the performance is identical.

Since 1993, the mean annual performance of our equities selection amounts to about 9%, compared to the 6.9% of the above general benchmark. The transaction costs, as well as taxes withheld, are deducted in ESP figures, whereas the index is calculated without bearing any costs. The cumulative performance of the ESP since 1993 amounts to 861%. We have not made any changes to the positions during the first quarter and carry an unchanged neutral weighting.

Equities USA
At the end of the day, due to their high fundamental valuation, the spring storms did not inflict lasting damage on the performance of the much-berated American stocks. Admittedly, Wall Street also suffered from at times tempestuous distortions and on occasion downright shocking single-day losses. Ultimately, however, after three months, the trendsetting S&P 500 Index was only 1.2% lower than at the end of 2017. The technology-based Nasdaq Index even stands 1.8% higher than its New Years Eve reading. The Performa US Equity Fund proved itself a tower of strength with a sparkling performance of up 4.9%. The position remained unchanged throughout the quarter. We are currently overweight in US stocks.

Measured on the **price/earnings ratio** using the latest 12 months profit figures, most equity markets have become more attractive:

	Dec. 2017	Mar. 2018	Change
DAX Index/DE	19	13.8	-27.4%
DJ STOXX 600 Index/EU	20.8	15.6	-25.0%
MSCI World Index	20.7	18.5	-10.6%
S & P 500 Index/USA	22.5	21.3	-5.3%
SPI Index/CH	13.2	14	6.1%
TOPIX Index/JPN	16.3	14.2	-12.9%

Source: Bloomberg

Equities Asia (excluding Japan)
The Far East and emerging economies were also unable to escape the price caprices. However, the fund managers employed by us managed to avoid any substantial damage and distanced themselves from the downdraft on the broader market, closing the quarter slightly positive. We did not make any changes to the positions. We remain unchanged, neutral weight.

Equities Japan
In Japan, where we are slightly overweight against out strategic target, the threatening gestures from Washington were not perceived well. Japan, which sees itself as a staunch ally of the USA, has to date not been exempted from the steel and aluminium customs duties. The leading index’s quotations on the Kabutocho dropped by 5.6% during the first quarter, the fund employed by us in similar magnitude. No changes have been made to our position in the Land of the Rising Sun.

Alternative Investments
We have not made any changes to the alternative investments either. Overall, about 7.6 % of a portfolio is engaged in this segment, making it an overweight position. Both positions show a slight negative performance of around 0.5 to 0.9 % and with that did better than most equity and bond markets.

Summary of our current
Asset Allocation:

Asset class	
Money Market	underweight
Bonds	underweight/ short duration
Equities Switzerland	neutral
Equities Europe	neutral
Equities USA	overweight
Equities Asia	neutral
Equities Japan	overweight
Precious Metals	overweight
Alternative Investments	overweight

For a Swiss Franc referenced portfolio.

Precious Metals
No changes have been made to the gold position. Measured in US Dollars, the Gold ETF delivered a positive performance of 1.4 %, re-confirming the adage that precious metals are a safe haven for investment in a storm.

And finally this

On equity investments for our clients, we have always upheld a value-driven investment approach, the Value Style. The principle of this style is to identify stocks whose valuation criteria, such as the ratios of price to earnings, cash flow, turnover or book value, are as low as possible and whose dividend yield is as high as possible. In the long term, this approach is superior to growth or momentum-oriented strategies. Famous investors such as Benjamin Graham and Warren Buffett achieved wealth by investing this way.

These past years, however, value has not had an easy time of it. During the course of the digital boom and the central banks' monetary glut, investors preferred growth stocks, until a short while ago when they rediscovered value. In a recently published article "Value does not continuously work, but consistently" in the newspaper "WirtschaftRegional" we put some of our thoughts on value investing to paper (unfortunately only available in German). You will find this article as a pdf-file on our website www.salmann.com under the heading Investment-Blog or directly via the link https://www.salmann.com/de/investment-blog/post/value-investing-funktioniert-nicht-immer-aber-immer-wieder. Should you prefer, we would be happy to send you a hard copy.

Price / Book and **Dividend Yield**
of major equity markets:

	Price/ Book	Div. Yield
DAX Index / DE	1.7	2.7 %
DJ STOXX 600 Index / EU	1.8	3.4 %
MSCI World Index	2.3	2.4 %
S & P 500 Index / USA	3.2	2.0 %
SPI Index / CH	3.3	3.1 %
TOPIX Index / JPN	2	1.9 %

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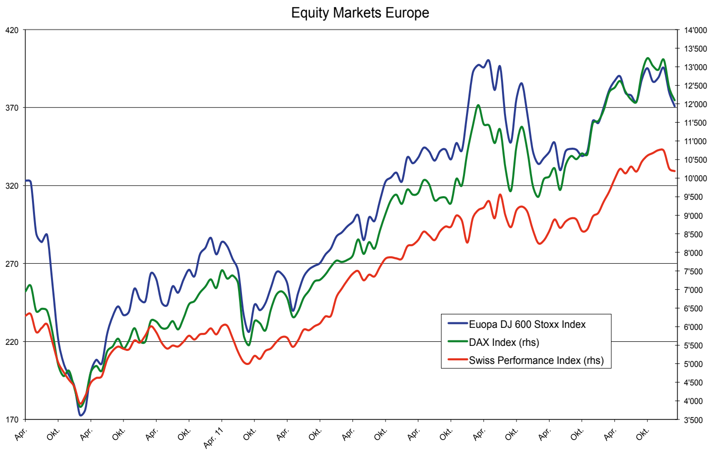
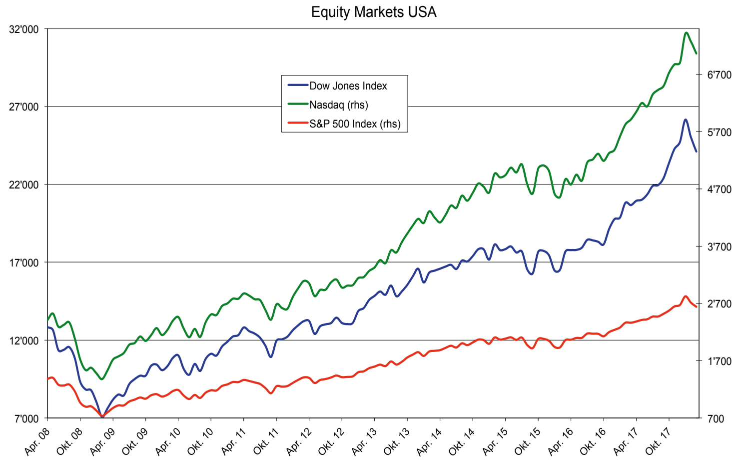
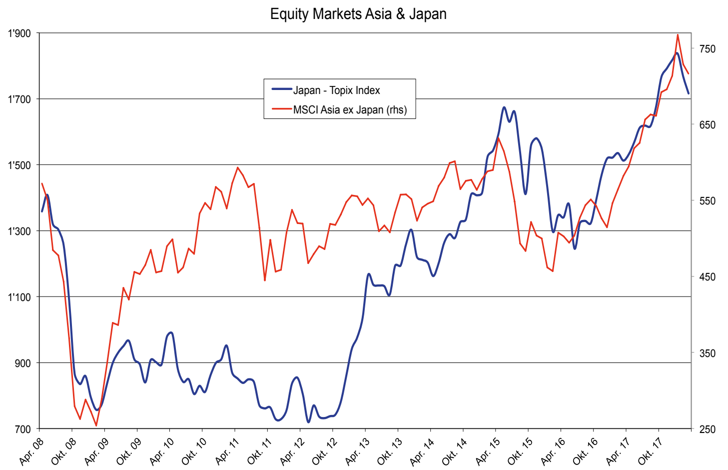
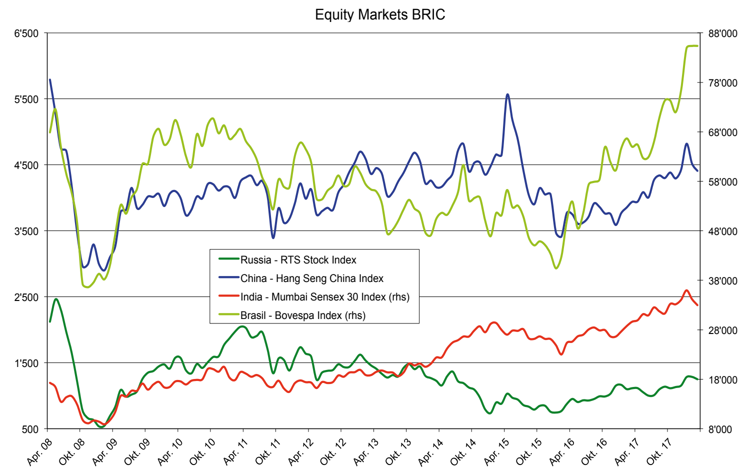
Equity markets at a glance









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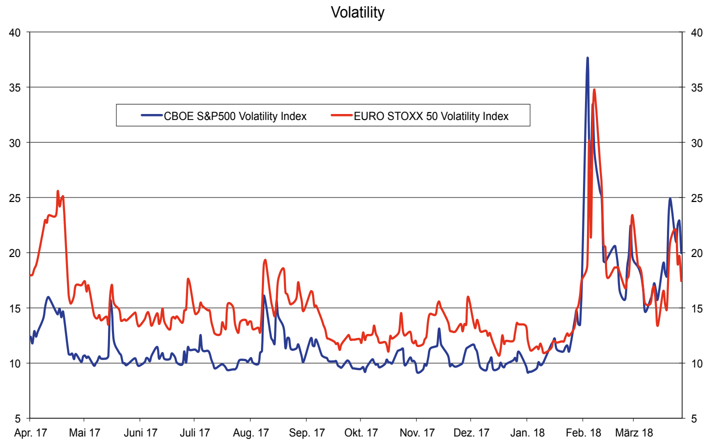
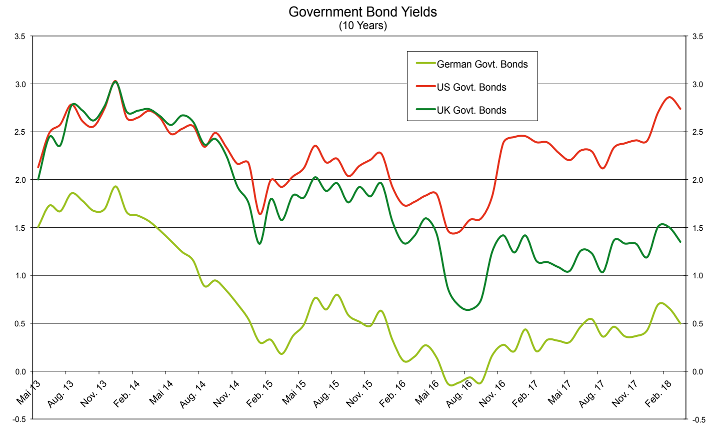
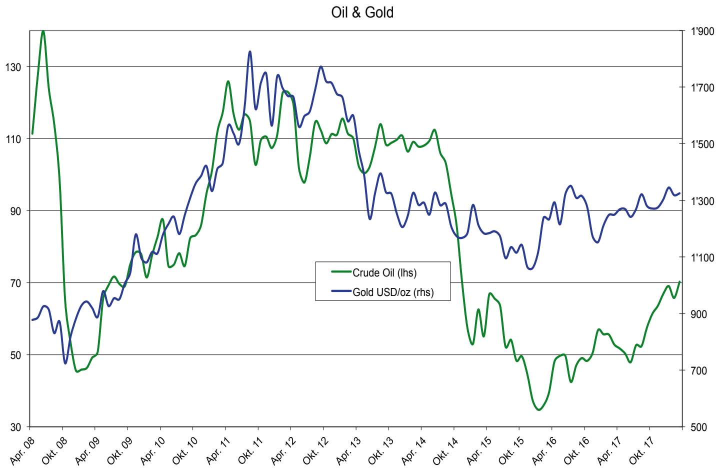
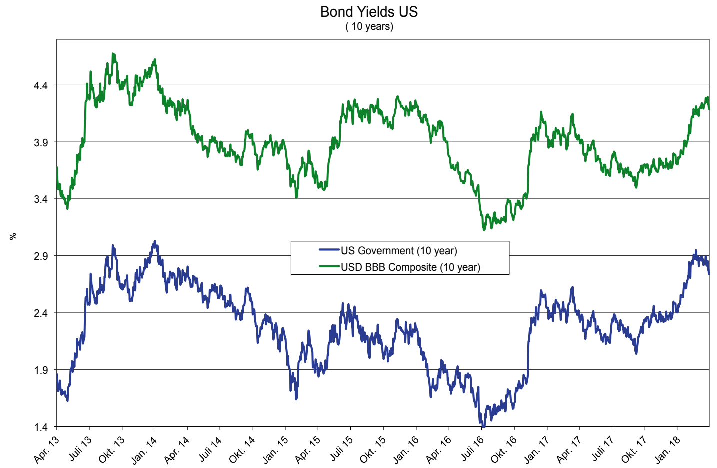
Bond yields and other indicators









Notes

Source of the following graphics: Bloomberg

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Closing words

We wish you bountiful spring days and thank you for the trust placed in us.

Alfred Ernst
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