Investment Report – 30th September 2016

Facelift of long-term strategy

During the third quarter, beautiful fruit ripened on the financial markets, in spite of imponderables such as Brexit, bank problems, the war in Syria, an OPEC production cut, and the presidential election campaign in the USA. Even the US Fed's decision in September to leave key interest rates unchanged triggered nothing but a shrug of the shoulders on the markets. In the US (and with it the rest of the financial world), all eyes are now focused on the December Fed meeting. For this round of talks, financial futures currently imply a probability of a mere 52% in favour of a quarter-percentage point rise in rates.

Markets moving forward

Whilst in June, sour grapes were still being found in places (e.g. Japan's performance for the first half of the year amounted to -19.5%, Germany came in with -9.9%), three months later, the crop was markedly sweeter. Japan hit the headlines again, this time on the positive side with the quarterly rise of 6.2%. In general, Asia presented itself from its most attractive side, as the region with the best market performance in the world. Germany also did things in style and managed to brighten up the previously dismal picture quite markedly, with an increase of +8.6%. For the most part, fixed interest markets and hedge funds also decked themselves out in summery green in the past three-month period. Gold, on the other hand that had run ahead of other asset classes during the first half-year, more or less marked time during the third quarter. However, over the year to date, it has maintained its top position.

More Asia, less America

Apart from the ups and downs on the markets, often prompted by short-term objectives, our attention was given to a decidedly long-term topic. That is to say, we reviewed our strategic asset allocation (SAA) according to schedule and gave it a facelift. Particular focus was placed on the equity content structure. The SAA is the long-term composition of different asset classes we view as ideal over a period of several years. In addition, the SAA defines the proportion of individual countries or regions within the equity allocation. It is the framework for a balanced portfolio in its tactical neutral position. On the one hand, we take this as a starting point to drive portfolio risk content according to client's preferences. On the other hand, the SAA is the basis from which we define the respective tactical asset allocation (TAA) which is the product of our medium term expectations. You will find the information and investment decisions within the TAA in the chapter "Asset allocation" further on.

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

	Real GDP Growth		Inflation	
	2016	2017	2016	2017
China	6.6%	6.3%	2.0%	1.9%
Germany	1.6%	1.2%	0.4%	1.5%
Euroland	1.5%	1.2%	0.3%	1.3%
United Kingdom	1.6%	0.5%	0.7%	2.4%
Japan	0.5%	0.8%	-0.1%	0.7%
Switzerland	1.1%	1.4%	-0.5%	0.4%
USA	1.5%	2.0%	1.3%	2.1%

In order to define of the strategic orientation, we mainly look at the relative weight of gross domestic product (GDP) of global regions, whereas factors such as market capitalisation, population, demographics and international trade have an influence, too. To avoid being overwhelmed with too much detail, we have to accept certain simplifications. For example, we limit ourselves to the USA as a proxy for North America. Further, we forgo South America and Africa and concentrate on Asian developed, as well as emerging, countries within the SAA instead.

Home bias pays

A further important aspect is a markedly overweight position in the respective home markets (home bias), that is to say, a high weighting of engagement in the investors' home - or reference - currencies. For a Swiss client, this is the Franc, for a German client, the Euro. Already in 2010, the analysis of long-term return and risk statistics revealed the fact that it pays for Franc, Euro and USD referenced portfolios to weight the respective home market markedly higher rather than seeking international diversification based on economic and population figures.

What is the result of the SAA review? In the final analysis, the trends already observed earlier have been confirmed. Looking at GDP, market capitalisation, and trade activity, Asia's emerging economies win out both in comparison with developed Asian economies, as well as Europe and North America. It is only when looking at population growth and demographics that Africa outstrips Asia. This is likely to be due primarily to China's one-child policy and with that, China's much faster ageing population as compared to India, for example.

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

		Dec. 2015	Sept. 2016	Change[1]
Asia ex Japan	DJ STOXX A/P	429.1	462.9	7.9%
Germany	DAX	10,743.0	10,511.1	-2.2%
Europe	DJ STOXX 600	365.8	342.9	-6.3%
Japan	TOPIX	1,547.3	1,322.8	-14.5%
Switzerland	SPI	9,094.0	8,883.3	-2.3%
USA	S&P 500	2,043.9	2,168.3	6.1%
World	MSCI World Index	399.3	418.4	4.8%

The review of the "Home Bias Approach" did not throw up any surprises either. Again, it did show that from the return and risk standpoint, it is correct to invest about half of the equity allocation in the respective home market. This is intuitively clear, particularly for the Swiss Equity Market, as many of the local companies are firmly anchored in international markets. It is often so with these stocks that you are buying more global than domestic turnover and profits. This fact is less pronounced with other European companies, and markedly less so with US-American companies.

Conclusion: The overall allocation to Asia for Franc and Euro referenced portfolios will be increased at the expense of US Stocks. For US Dollar mandates, the USA weighting remains unchanged. In addition, across all three reference currencies, an increase in the emerging Asian economies at the expense of developed Asian economies (in particular Japan) is implemented.

We were able to explain how this labour intensive research pays off in our last investment report by means of a performance comparison with other investment managers (see report dated 30th June 2016, "And finally this"). Should you have missed this report, it is not too late to place your order now.

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

The **equity funds employed by us** achieved since the beginning of the year the following returns[2], all beating their benchmarks:

Aberdeen Asia Pacific (USD)	10.1%
JB Japan Stock Fund (CHF hedged)	-13.1%
JB Japan Stock Fund (EUR hedged)	-13.0%
Performa Asian Equities (USD)	8.2%
Black Rock Swiss Small & Midcap Opp. (CHF)	10.7%
Raiffeisen Futura Swiss Stocks (CHF)	2.1%
Schroders Swiss Small & Midcap (CHF	11.7%
Performa European Equities (EUR)	-5.0%
Performa US Equities (USD)	7.2%

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: Due to the regrouping in equities, liquidity bottom-line increased slightly. It is envisaged (though not yet decided) to allocate one to two percentage points of this to European Stocks.

Bonds: In bonds, the fringe markets and the lower credit ratings sector performed particularly brilliantly. Moreover, the Wealthy Nations Bond Fund benefited from a reviving investor interest in emerging country bonds. We have not implemented any active changes to the position, and maintain the tactical underweight in bonds.

Equities Switzerland: We have left the Swiss equity allocation unchanged during the third quarter. Due to the relative market movements, the weighting with just above 24% is below the strategic, and at the same time, tactical target allocation of 25.75%. Our stock selection in the direct invested Swiss Stock Portfolio (SSP) shows a pleasing performance of 10% (including dividends) for the nine-month period. The benchmark index SPI (total return) is quoted down 2.3%. With that, the SSP, consisting currently of a third each in large-, medium- and small-capitalised stocks, registered an outperformance of 12.3%. Since 2010, the annual performance of the SSP amounts to 10.9

[2] Performance in fund currency. Source: Bloomberg or respective fund company

% p.a., clearly ahead of the benchmark's performance of 7%. The SSP figures include transaction cost and taxes at source, whereas the benchmark does not bear any such costs. The funds employed by us, Raiffeisen Futura Swiss Stocks (in the main large cap stocks) as well as the Black Rock Swiss Small & Midcap Opportunities Fund did well too (see table). As the Black Rock Fund is closed for new investments, we have chosen the Schroders Swiss Small & Midcap Fund as an alternative. This fund also shows a solid performance for the current year.

Measured on the price/earnings ratio[3] using the latest 12 months profit figures, some of the equity markets have become dearer since beginning of the year (red), while others have become more attractive (green):

	Dec. 2015	Sept. 2016	Change
DAX Index/DE	22.8	23.8	**4.4%**
DJ STOXX 600 Index/EU	23.4	27.5	**17.5%**
MSCI World Index	20.7	21.3	**3.0%**
S & P 500 Index/USA	18.2	20.4	**12.1%**
SPI Index/CH	25.4	14.5	**-42.9%**
TOPIX Index/JPN	16.5	16.7	**1.2%**

Equities Europe: European stocks weighting remains unchanged. After nine months, the directly-invested European Stock Portfolio (ESP) is in line with the generally weaker market at -3.6%. The benchmark the DJ STOXX 600 Index shows a negative performance of -3.8% (both values are total returns i.e. dividends are accounted for). Since 2004, the annual performance of the stock selection amount to +8.8% compared to 6.9% for the benchmark. The figures for the ESP are net of transaction costs and taxes at source, the benchmark, however, operates free of charges. You will find the performance and benchmark comparisons between ESP and SSP on our website www.salmann.com (under the tab, "Produkte").

Other funds employed by us developed as follows[4]:

Acatis IfK Value Renten (EUR)	**7.7%**
Acatis IfK Value Renten (CHF)	**7.4%**
Lyxor ETF Euro Corp. Bond Fund (EUR)	**4.8%**
New Capital Wealthy Nations Bond Fund (EUR)	**10.5%**
New Capital Wealthy Nations Bond Fund (CHF)	**9.9%**
New Capital Wealthy Nations Bond Fund (USD)	**11.6%**
Pictet CH-CHF Bond Fund	**3.8%**
Swiss Rock Absolute Ret. Bond Fund (EUR hedged)	**1.5%**
Swiss Rock Absolute Ret. Bond Fund (CHF hedged)	**1.0%**
UBAM Corporate USD-Bonds (EUR hedged)	**4.9%**
UBAM Corporate USD-Bonds (CHF hedged)	**4.4%**
ZKB ETF Gold (USD)	**24.0%**

Equities USA: With the realignment of the strategic allocation, we at the same time eliminated the slight tactical overweight position in US Stocks and took some of the profits in the market that did well. The result is a reduction of US Equities to 7.5% in Swiss Franc reference portfolios and with that mandates are showing a neutral weighting. Contrary to accepted view, stocks often do better during democratic presidencies than during republican control of the White House. If this rule holds true in the future, Wall Street is currently hinting at a Clinton victory.

Equities Asia (excluding Japan): The expansion to 7.5% in CHF referenced portfolios is a consequence of the new SAA. The Asian exchanges staged themselves well during the third quarter, as better economic indicators where received from China. The weighting is now neutral.

Equities Japan: Also neutral is the weighting in Japan and this with a new quota of 2.5%. Again, this is due to the SAA's adjustment.

[3] Source: Bloomberg

[4] Performance incl. re-invested dividends where applicable

During the current year, **yields on 10-year government bonds** declined:

	Dec. 2015	Sept. 2016	Change
Europe	0.63%	-0.12%	-119%
United Kingdom	1.96%	0.75%	-62%
Japan	0.27%	-0.09%	-133%
Switzerland	-0.06%	-0.55%	-817%
USA	2.27%	1.59%	-35%

Alternative Investments: No changes have been made here. The Fund employed by us represents a neutral weighting and fulfils its intended purpose by means of capital appreciation associated with very low volatility.

Precious Metals: Gold has been treading water recently but with a plus of about 20% in Swiss Francs as well as Euro, it continues to sparkle unchanged during the first nine months of the year. No changes have been made to this position during the third quarter.

Summary of our current **Asset Allocation**[5]**:**

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

Conclusion

Economic activity, though not heady, is better than often perceived. Interest rates remain at very low levels and there are hardly any alternatives to equities. Gold is in a moderate upward trend.

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

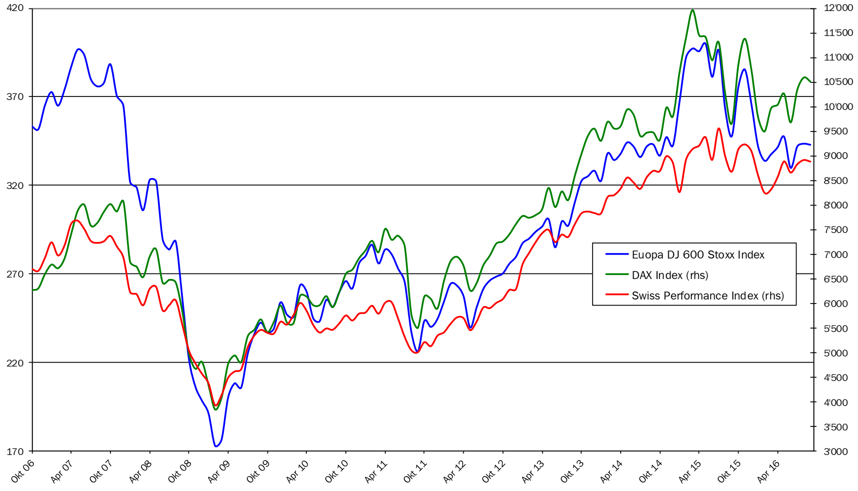
	Price / Book	Div. Yield
DAX Index/DE	1.7	2.9%
DJ STOXX 600 Index/EU	1.8	3.6%
MSCI World Index	2.1	2.6%
S & P 500 Index/USA	2.9	2.2%
SPI Index/CH	2.1	3.4%
TOPIX Index/JPN	1.2	2.1%

We thank you for the trust placed in us as well as the pleasant collaboration and wish you many golden autumn days.

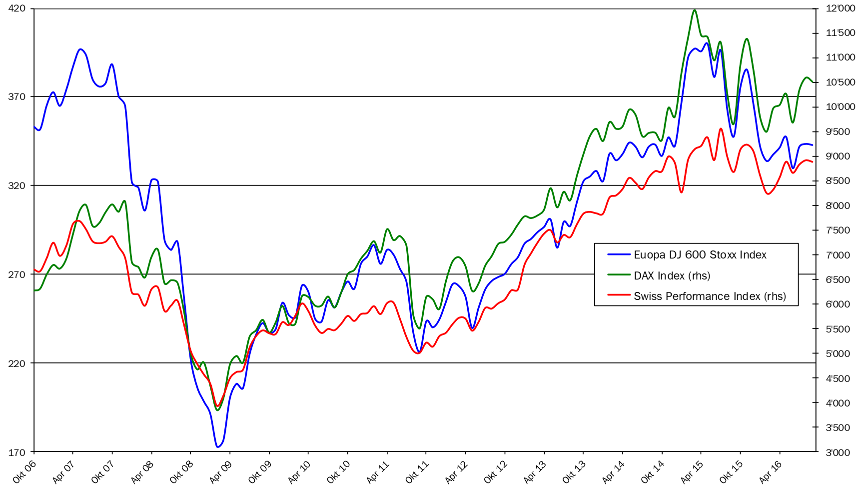
Alfred Ernst
Vaduz/Zurich, 30th September 2016

[5] For a Swiss Franc referenced portfolio

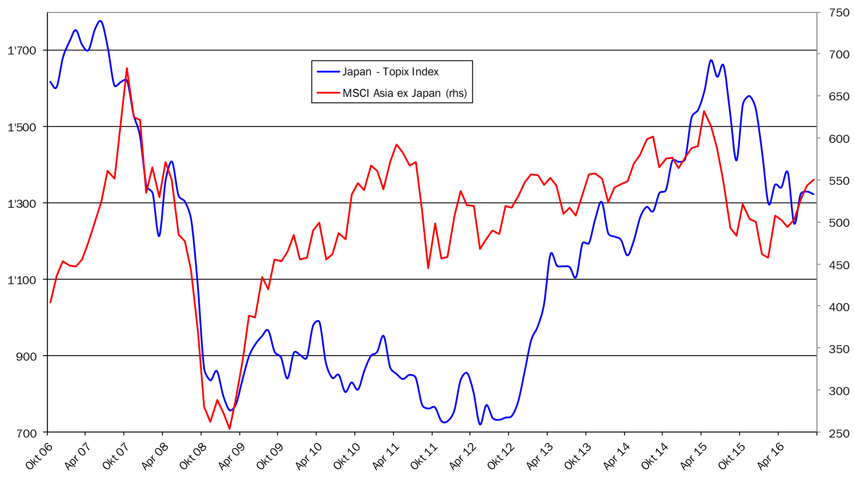
Equity Markets Europe



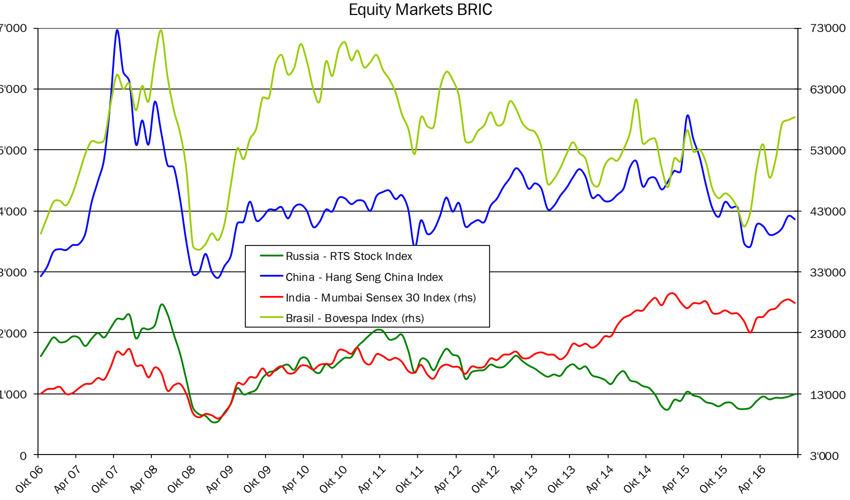
Equity Markets Europe



Equity Markets Asia & Japan



Equity Markets BRIC



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