SALMANN
INVESTMENT MANAGEMENT

A Good Vintage

Investment Report – 31st December 2019

A Good Vintage

If we were vintners, we would be reporting a good vintage. This is what financial markets achieved across the board in 2019. All asset classes contributed positively to the pleasing overall outcome.

"What a difference a year makes!" could be said, or even better, sung, echoing the old evergreen, "What a difference a day makes!". Or, to reflect more closely the (famously violent) mood swings of exchanges; up one minute – down the next. Twelve months lie between these two frames of mind. In figures, this adds up to +30.9% in the USA, +30.6% in Switzerland, and 27.7% for the World equity index, to name but a few.

And these are not even the extremes. Prices shot up even more in Russia (RTS-Index +45% in US Dollars) as well as China, (Shenzen Index +36% in Renminbi). On the other hand, you have to look hard for a market with a negative return before finding it in Malaysia (-6% in local Ringgit).

Nevertheless, it was not only equities that shone. Other asset classes managed to satisfy as well. Gold, for example, rose by about 18% in US Dollar terms, silver became about 15% dearer. Contrary to general expectations, there was money to be made in bonds as well. Not by means of generous coupons though, much rather it was the extremely accommodative policy of the central banks that bestowed further gains on bond inventories.

Hedge Funds were somewhat out of the limelight. Their global index "only" returned 8.7%, which is not altogether such a bad result, when faced with a financial universe moving unanimously in one and the same direction and hardly ever losing its stride for any length of time.

Change in **Equity Markets in 2019:**

		Dec. 2018	Dec. 2019	Change
Asia ex Japan	MSCI AC Asia ex Japan	431.1	509.4	18.2%
Europe	DJ STOXX 600	707.7	897.5	26.8%
Japan	MSCI Japan	1'736.20	2'057.1	18.5%
Switzerland	SPI	9'830.10	12'837.5	30.6%
USA	MSCI USA	6'658.80	8'714.7	30.9%
World	MSCI AC World	5412.1	6'909.7	27.7%
Hedge Funds	HFRX Global HF	1'189.90	1'293.1	8.7%

Development of index in local currency. Exceptions Asia ex Japan and World in USD. MSCI-Indices are net total return.

So what are the reasons for such an extraordinary performance? The main driver was the extremely lax policy of the central banks. Worried about economic growth, 95% of all central banks are operating in "easing mode", i.e. providing financial markets with a great deal of very cheap money.

Even the American monetary watchdog, the Federal Reserve (Fed), did an about-face and ditched its initial plan of higher interest rates and a shrinking balance sheet overboard. Since then, not only have we seen three Federal Funds Rate cuts totalling 0.75 percentage points, but also a restart of the Fed's government bond purchasing programme.

Currently, the Fed Funds Rate's (overnight interbank lending rate) target range is 1.50–1.75%. However, looking at the Taylor Rule, an economists' gauge as to where the (academically) "correct" Fed Funds Rate should be, the American benchmark rate should lie at 5.6%, and with that, about 3.9 percentage points above its current rate. It is not difficult to imagine the dressing-down the Fed governors would be subjected to from the White House, were they to make even the slightest attempt to steer their policy towards this "correct" benchmark rate.

Living wealth.

Trust is paramount in asset management.

Central Bank criticism

Talking of dressing-downs, the Central Bank is being scolded in the Eurozone too, albeit more measuredly. Although in this case, scolding might not be the most appropriate term and the bone of contention is a different one. In the Old World, criticism of too lax a monetary policy is on the rise. Doubts about whether the end still justifies the means are increasing. While it is true that ECB chief Mario Draghi kept the European economy from harm following the financial crisis, and held the Eurozone with its common currency together, the negative aspects of the ultra-lax monetary policy have meanwhile become ever more apparent.

Notably, these are the highly inflationary development of the price of every type of asset (with the 2019 investment year's best compliments, not to mention real estate, artworks etc.) as well as problems in pension systems (with no interest and compound interest, the third contributor is absent). In addition, the virtually free money leading to structural reforms being put off, zombie companies being kept alive, and an ever-increasing debt mountain, are major drawbacks. All in all, in the long term this is damaging to savers, weakens banks and distorts competition.

What's next? While in the third quarter of 2019 we were still expecting a marked economic slowdown, the prospect has now brightened up again. True, the Purchasing Managers Indices (PMIs), which are regarded as important indicators of economic growth in the immediate future, declined marginally in December compared to November. However, the global PMI remained slightly positive and the number of countries reporting above 50 points (growth threshold) was higher than in the preceding months.

Growth and a glut of money are keeping markets happy

The risk of a broad-based recession remains low. Although growth expectations remain low for the Gross Domestic Product (GDP), they remain positive. For the EU, the augurs expect 1.2 % (slightly below 2019), for Switzerland 1.2 % (slightly higher). China (5.9 %) and India (6 %) have seen more dynamic times, so has the USA with an estimated 1.8 % (2.3 for 2019). The International Monetary Fund is expecting global GDP growth of 3.4 %, higher than the 3 % last estimated for 2019.

Average **growth and inflation forecasts** from the "Bloomberg Composite Contributor Forecast" poll of economists:

	Real GDP Growth		Inflation	
	2019	2020	2019	2020
China	6.1 %	5.9 %	2.8 %	3.1 %
Germany	0.5 %	0.6 %	1.4 %	1.4 %
EU	1.4 %	1.2 %	1.5 %	1.5 %
United Kingdom	1.3 %	1.0 %	1.8 %	1.8 %
Japan	0.9 %	0.3 %	0.6 %	0.8 %
Switzerland	0.8 %	1.2 %	0.4 %	0.5 %
USA	2.3 %	1.8 %	1.8 %	2.1 %

With a few exceptions, inflation is likely to remain modest. Predictions for the coming year range between 0.5 % for Switzerland, 1.5 % for the EU, 2.1 % for America, and 3 % for China. The possibility of a totally different outcome has been demonstrated by Argentina, where the value of money about halves in 2019 and 2020 (annual inflation of around 50 %). Apart from such isolated cases, Central Banks can and will keep the monetary floodgates wide open, which is considered positive for investors.

From escalation to de-escalation

The escalation of the trade war between China and the USA has been rolled back for the moment with the closing of the "Phase One Trade Deal". The agreement is to be signed by mid-January. The slight de-escalation of the trade war is a positive

The **equity funds employed by us** achieved the following returns in 2019:

Aberdeen Asia Pacific (USD)	18.7 %
Swiss Rock Emerging Markets Equities (USD)	17.5 %
GAM Japan Stock Fund (CHF hedged)	16.4 %
GAM Japan Stock Fund (€ hedged)	16.7 %
Strategy Certificate SIM–Swiss Stock Portfolio Basket	22.4 %
iShares Stoxx Europe 600 ETF (€)	28.7 %
Performa European Equities (€)	16.8 %
Performa US Equities (USD)	33.7 %
BB Adamant Medtech & Services Fund (CHF)	24.8 %
BB Adamant Medtech & Services Fund (€)	29.4 %
BB Adamant Medtech & Services Fund (USD)	27.0 %

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

factor for economic development. Trump has good reason not to let this particular kettle boil over. He cannot afford a further economic slowdown in the USA if he wants to maintain his chances of re-election. Trouble is lurking for him particularly in the politically equally balanced states (the "swing states", mostly in the mid-West), whose workers in the manufacturing sector are already feeling the slow-down in the form of lower incomes.

Other funds employed by us
developed as follows:

Acatis IfK Value Renten Fond (CHF hedged)	11.4 %
Acatis IfK Value Renten Fond (€)	11.8 %
BCV Liquid Alternative Beta (CHF hedged)	5.8 %
BCV Liquid Alternative Beta (€ hedged)	6.1 %
BCV Liquid Alternative Beta (USD)	9.3 %
Franklin Templeton K2 Alternative Strategies Fund (CHF hedged)	3.6 %
Franklin Templeton K2 Alternative Strategies Fund (€ hedged)	4.1 %
Franklin Templeton K2 Alternative Strategies Fund (USD)	7.2 %
Lyxor ETF Euro Corp. Bond Fund (€)	6.0 %
Pictet CH-CHF Bond Fund	2.8 %
Swiss Rock Absolut Ret. Bond Fund (CHF hedged)	2.6 %
Swiss Rock Absolut Ret. Bond Fund (€ hedged)	3.1 %
ZKB ETF Gold (USD)	18.0 %

Performance incl. re-invested dividends where applicable.

The situation has calmed a little in Great Britain too, in that since the last election, the distribution of power and the main thrust in respect of Brexit are now clearer. So a further positive point.

However, clearly negative were the developments in the Middle East situation around the turn of the year. With the killing of General Qasem Soleimani in Iraq, Trump set light to another fuse. After a brief moment of shock, financial markets (once again) reacted surprisingly composed, apart from a rise in gold and crude oil prices. How long the calm will last is written in the stars.

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
The money market allocation remained more or less unchanged vis-à-vis the third quarter. This position is slightly overweight.

Bonds
We have not initiated any active changes to the inventory and continue to be underweight in this area. The fact that the amount of negative yielding bonds globally has declined by about a third since the end of August is only scant comfort.

During the course of the year,
yields on **10-year government bonds** declined across the board:

	Dec. 2018	Dec. 2019	Change
Europe	0.24 %	-0.19 %	-179 %
United Kingdom	1.28 %	0.82 %	-36 %
Japan	0.05 %	-0.01 %	-120 %
Switzerland	-0.25 %	-0.47 %	-88 %
USA	2.68 %	1.92 %	-28 %

Experiencing wealth.
Every client has top priority.

Equities Switzerland
We have not made any changes to the Swiss equities position and remain neutral weight. The directly invested "Swiss Stock Portfolio" (SSP) achieved a performance including dividends of 24.1% during the calendar year. With 30.6%, the Swiss Performance Index (SPI) is ahead.

The benchmark, however, benefitted more than average from the extraordinary rise of the Nestlé stock (20.8% weighting in the SPI) delivering a fantastic 35% return. The other index heavyweights, Roche (+33%) and Novartis (+27%), also motored along nicely. Such a constellation of the three most important index constituents achieving on average above 30% returns is something of rarity. It has only happened twice in the past 20 years.

With our broadly diversified selection where the stock in the foodstuff company accounts for just 8.4%, it was impossible to keep up with the index. Apart from the above-mentioned names, the shares of Also, Sonova, as well as Vetropack, attracted positive attention in the SSP, with returns of about 50%.

In the long term, the performance of our value-criteria driven selection is quite respectable. Since 2012, the average annual performance of the SSP amounts to 15.7%, a result that beats the average benchmark's performance of 11.6% markedly.

Since 2012, the total cumulative return of this strategy amounts to about 221%, while that of the index to 140%. The SSP figures bear transaction costs, whereas the benchmark index does not bear any costs. The "Strategy Certificate linked to the SIM Swiss Stock Portfolio Basket" (Valor: 36524524, ISIN: CH0365245247) achieved a performance of 22.4% in 2019.

Measured on the **price / earnings** ratio using the latest 12 months profit figures, most equity markets have become more expensive during the course of the year:

	Dec. 2018	Dec. 2019	Change
SPI Index	17.5	15.9	-9.1%
DJ STOXX 600 Index	15.5	20.7	33.5%
MSCI AC Asia ex Japan	12.1	16.3	34.7%
MSCI Japan	11.5	15.7	36.5%
MSCI USA	16.8	22.2	32.1%
MSCI AC World Index	15.6	20.6	32.1%

Source: Bloomberg. MSCI-Indices are net total return.

Equities Europe
Our value focussed, directly invested "European Stock Portfolio" (ESP) achieved a performance of 22.2% during 2019, measured in Euro. The broad Dow Jones Stoxx 600 Index achieved a total return (price change plus dividends) of 26.8%, whereas the value style driven Dow Jones Stoxx 600 Value Index achieved an annual performance of 21.6%.

The value style gap alluded to in last quarter's Investment Report has mitigated slightly during the last months. As the ESP rose by 18.7% during the September-December period, the broad market (DJ Stoxx 600) "only" managed a generous 10%. The marked rise of some British stocks like Persimmon (+51% in Euro), Legal & General (+47%) and Babcock International (+35%) is striking.

The clarification of the power structure following the last parliamentary election provided these attractively valued stocks with a massive uplift, further emphasised by the strength of the Pound against the Euro. Other European value stocks such as Siltronic, Aurubis, Randstad and Nordea, for example, were also re-discovered by investors during the last four months of the year, consequently rising markedly.

In the long term, the ESP displays a marked outperformance against the broad index. Since 1993, the ESP has returned on average 8.6% compared to the 7.1% achieved by the 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 about 894%, while that of the benchmark to about 583%.

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

	Price / Book	Div. Yield
SPI Index	2.3	2.8%
DJ STOXX 600 Index	1.9	3.5%
MSCI AC Asia ex Japan	1.6	2.4%
MSCI Japan	1.3	2.3%
MSCI USA	3.6	1.8%
MSCI AC World Index	2.6	2.4%

Source: Bloomberg. MSCI-Indices are net total return.

Equities USA

American equities hold a top position in last year's ranking of best performing stock exchanges. Amongst the developed markets, it even ranks top. The Performa US Equities Fund employed by us beat its reference index MSCI USA Total Return by nearly 3 percentage points. The BB Adamant Medtech & Services Fund, covering the medical technology sector, developed pleasantly as well. We did not make any changes to the US stock weighting and with it, maintained its slight overweight position.

Equities Asia (excluding Japan)

The trade war between the USA and China, as well as the interim slow-down of the global economy, weighed heavily on emerging markets' stocks. Notwithstanding, the benchmark, as well as the investment funds employed by us, achieved pleasing results of around 18 %. We did not make any changes to the positions and with that, remained neutral weight.

Equities Japan

After a bumpy first half of the year, equities of the Land Of The Rising Sun picked up pace during the second semester. The reference index closed the year with a generous 18 %. The positions remained unchanged during the fourth quarter and are neutral weight.

Alternative Investments

Hedge funds, representing Alternative Investments in our allocation, were in the shadow of other asset classes during 2019. The trends on exchanges were too coherent, the volatility in general too low for hedge funds to be able to play on their strengths. With a plus of 8.7 %, the global benchmark still brought in a decent harvest. Our positions also remained unchanged throughout the last three-month period of the year.

Precious Metals

The gold market was characterised by the German prince of poets, Johann Wolfgang von Goethe: "To gold tends, on gold depends, simply everything! Oh, we poor people!" was the motto. Although the second sentence of the famous verse from "Faust" would have robbed hardly anyone within the investing community of sleep. The search for alternative investment opportunities with a low correlation to other asset classes, and for security, saw the price of the precious metal rise by about 18 % during the year.

Quotes above 1500 US Dollars per ounce were last seen in 2013. Apart from private and institutional investors, several central banks figured as buyers in 2019. By all accounts, the central banks of China, Poland, Russia and Turkey were particularly active buyers. Our position remained unchanged and overweight in the fourth quarter.

Summary of our current Asset Allocation:

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

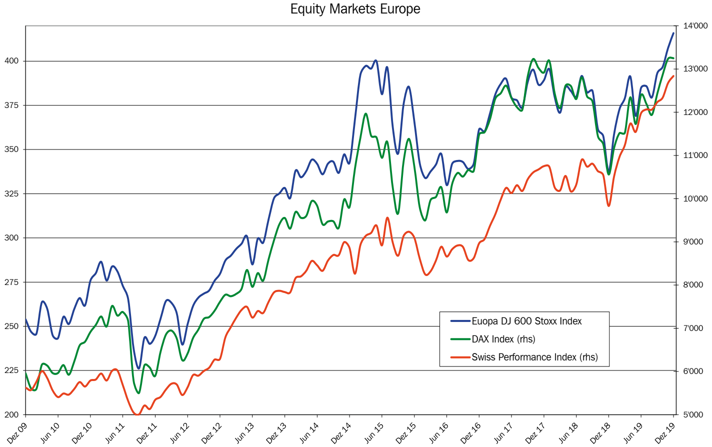
For a Swiss Franc referenced portfolio.

Discovering wealth.

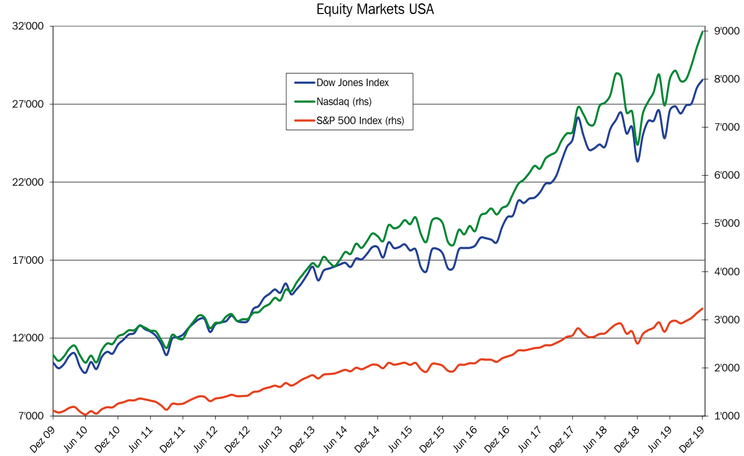
Performance is the tangible result of our expertise.

Equity markets at a glance

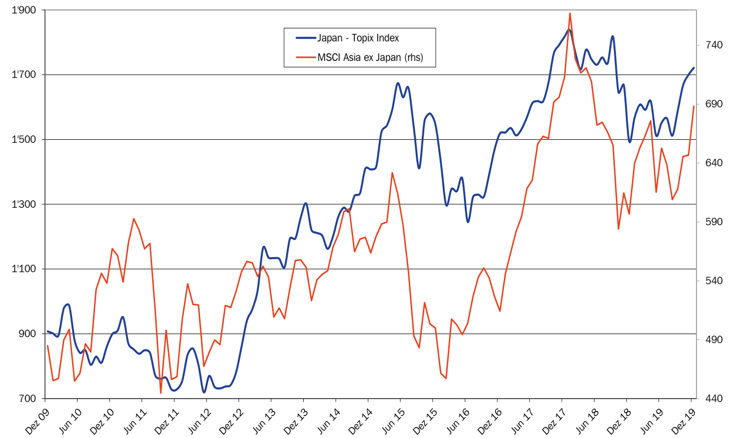
Equity Markets Europe



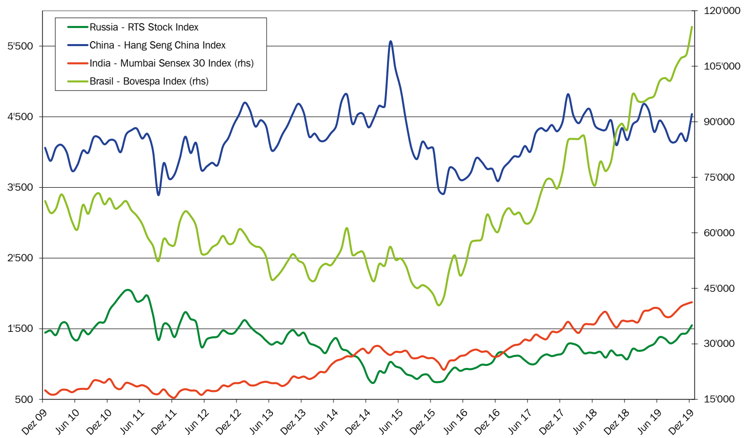
Equity Markets USA



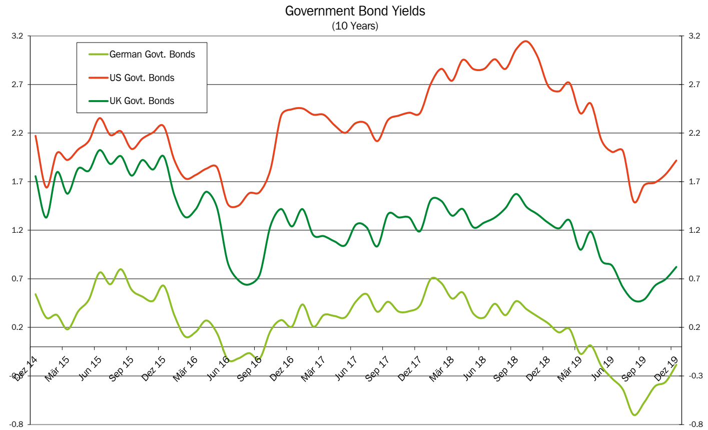
Equity Markets Asia & Japan

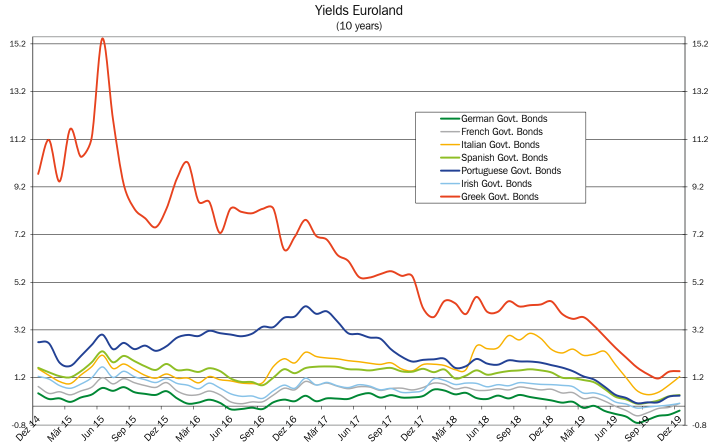


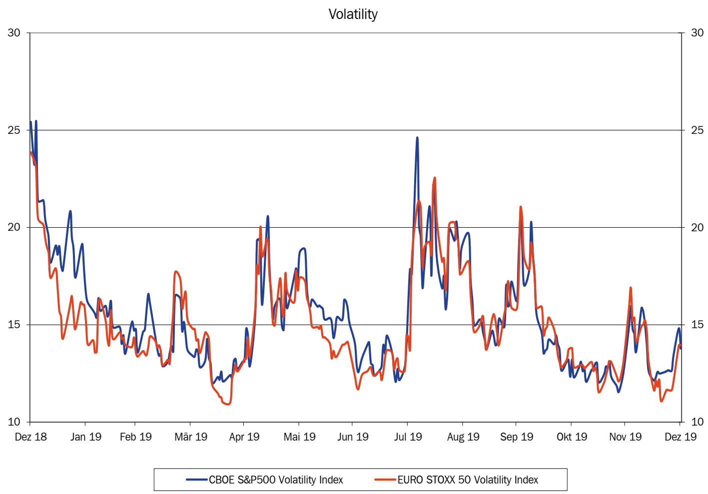
Equity Markets BRIC

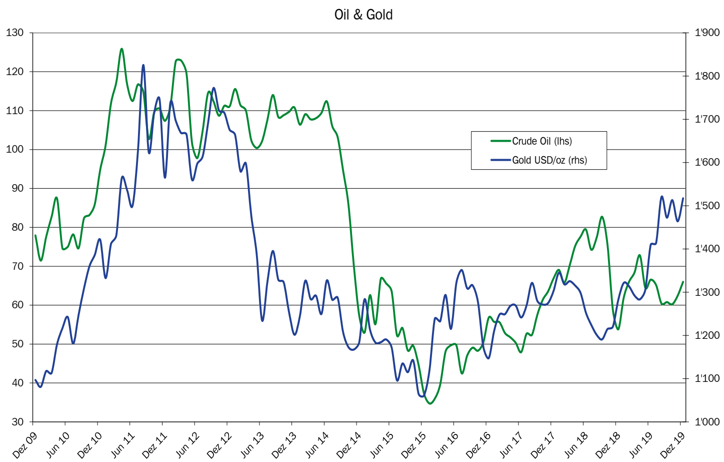


Bond yields and other indicators









Notes

Closing words

We wish you prosperous and successful New Year and thank you for the trust placed in us.

Alfred Ernst
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