SALMANN
INVESTMENT MANAGEMENT

A good vintage

Investment Report – 31st December 2017

A good vintage

2017 will enter the history books as a good year for financial investors. Equities played a major part in this, but gold and hedge funds also managed to turn in a pleasing performance. It was by courtesy of bonds that the party was not spoiled. The economic outlook is good, supporting financial markets. Investors, however, are worried about high valuations.

"Equities, Equities, Equities!" was the motto of the past year. And the results are quite respectable. The global equity index MSCI World rose by about 21%, calculated in US Dollars. The Stoxx Asia/Pacific Index increased by a similar amount. With increases of around 20%, Switzerland, the United States of America, as well as Japan, were amongst investors' favourites, beating Germany and Europe as a whole.

Change in **Equity Markets since beginning of 2017:**

		Dec. 2016	Dec. 2017	Change
Asia ex Japan	DJ STOXX A/P	445.3	538.7	21.0 %
Germany	DAX	11'481.1	12'917.6	12.5 %
Europe	DJ STOXX 600	361.4	389.2	7.7 %
Japan	TOPIX	1'518.60	1'817.6	19.7 %
Switzerland	SPI	8'965.70	10'751.5	19.9 %
USA	S & P 500	2'238.80	2'673.6	19.4 %
World	MSCI World	421.8	513.0	21.6 %
Hedge Funds	HFRX Global HF	1'203.20	1'275.5	6.0 %

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

The year was unspectacular for bonds. The sovereign bond yields of the major industrialised nations moved sideways at low levels. While 10-year US Treasuries still yielded 2.4%, investors in Switzerland and Japan handed over their money for safekeeping to the government for free, or even paid for it.

In the periphery, a lack of concern is salient, with yield spreads versus German "Bundesanleihen" melting away markedly in countries like France, Ireland, Portugal and Greece. Those funds employed by us covering market niches again managed to achieve pleasing returns in spite of this difficult environment.

The nomination of Jerome Powell as successor to Janet Yellen to head the American Central Bank (Federal Reserve, in short, Fed) did not cause any ripples. The same applies to the rise in short-term interest rates (Fed Funds). Like the outgoing chairwoman, Powell is considered a moderate, and on certain issues, supporting an even softer approach than Yellen. In addition, Powell follows Trump's course with respect to the liberalisation of regulation.

Hedge funds had a quiet, pleasant year. Their global HFRX Index achieved a positive 6% return. The more modest return does not surprise. In an environment where markets are nearly all headed in the same direction, accompanied by hardly any volatility, agile hedge funds find it difficult to play to their strengths. It is like wanting to impress on a duck-pond with an ocean-going yacht and have the show stolen by the kids playing with their model boats.

In 2017, the **equity funds employed by us** achieved the following returns, with nearly all beating their benchmarks:

Aberdeen Asia Pacific (USD)	32.4 %
Swiss Rock Emerging Markets Equities (USD)*	16.5 %
JB Japan Stock Fund (CHF hedged)	21.1 %
JB Japan Stock Fund (€ hedged)	21.2 %
Strategy Certificates SIM-Swiss Stock Portfolio Basket*	1.3 %
iShares Stoxx Europe 600 ETF (€)	10.0 %
Performa European Equities (€)	20.4 %
Performa US Equities (USD)	25.4 %

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

* Performance since launch July 2017.

Discovering wealth.

Performance is the tangible result of our expertise.

Other funds employed by us
developed as follows:

Acatis IfK Value Renten Fond (€)	7.1 %
Acatis IfK Value Renten Fond (CHF hedged)	6.9 %
BCV Liquid Alternative Beta (€ hedged)	4.6 %
BCV Liquid Alternative Beta (CHF hedged)	4.2 %
BCV Liquid Alternative Beta (USD)	7.3 %
Franklin Templeton K2 Alternative Strategies Fund (€ hedged)	3.8 %
Franklin Templeton K2 Alternative Strategies Fund (CHF hedged)	3.9 %
Franklin Templeton K2 Alternative Strategies Fund (USD)	6.4 %
Lyxor ETF Euro Corp. Bond Fund (€)	1.1 %
New Capital Wealthy Nations Bond Fund (€ hedged)	5.0 %
New Capital Wealthy Nations Bond Fund (CHF hedged)	4.5 %
New Capital Wealthy Nations Bond Fund (USD)	7.4 %
Pictet CH-CHF Bond Fund	-0.1 %
Swiss Rock Absolut Ret. Bond Fund (€ hedged)	-0.1 %
Swiss Rock Absolut Ret. Bond Fund (CHF hedged)	-0.6 %
UBAM Corporate USD-Bonds (€ hedged)	1.6 %
UBAM Corporate USD-Bonds (CHF hedged)	1.2 %
ZKB ETF Gold (USD)	12.2 %

Performance incl. reinvested dividends where applicable.

Those seeking an adrenalin kick (definitely not our business, but time and again, interesting to observe) had to dare to dip into crypto currencies. Their most prominent representative, the Bitcoin, finished the year up by about 1400 % (in US Dollars). At times it stood even markedly higher, but this is how it goes in bungee jumping; you swing violently up and down before the rubber band settles down at its length. Its price fluctuation shows all the characteristics of a speculative bubble. Even level-headed observers are beginning to become concerned. With the start of trading futures contracts in the crypto currency, a link to the rest of the financial system has been created, which in the case of a crash of a crypto currency, may allow shockwaves to reverberate into the system under certain circumstances.

Apart from this, as far as currencies go, the year played into the hands of Swiss Franc based investors. After a dive in summer, the US Dollar approached parity to the Swiss Franc again. Having established an upward trend, the Euro is now adding an extra 10 % to the scales. Gold, which we look at more as currency than a natural resource, is now 12 % dearer than a year back.

Rosy Outlook

Globally, the economic upturn has accelerated and broadened. Growth in the Eurozone is equal to, and in some individual countries, stronger than in the USA. In spite of all the boom-headlines, US growth is currently only at about its 20-year average. In Europe, however, it is above its average of 1.5 %.

The global economy will continue to grow. The Purchasing Managers Indices (PMI), for example, all speak for it, with their readings in green territory (readings above 50 points implying economic expansion) for almost all the major economies, with the exception of South Africa. The global PMI stood at 54 points. There were particularly good readings of between 62 and 65 points in Switzerland (the leader, at a seven-year high!), Sweden, Germany and the Netherlands, with the Eurozone as a whole coming in at 60.2, and the USA at 58.2. Even problem children like the UK, France and Italy managed a pleasing figure. Less momentum can be observed in Asia. China lies only just in light-green territory with a little over 50, a position the Middle Kingdom shares with South Korea and India.

Average **growth and inflation forecasts** from “The Economist’s“ December poll of economists:

	Real GDP Growth		Inflation	
	2017	2018	2017	2018
China	6.8 %	6.5 %	1.6 %	2.3 %
Germany	2.4 %	2.3 %	1.7 %	1.6 %
Euroland	2.2 %	2.1 %	1.5 %	1.4 %
United Kingdom	1.5 %	1.3 %	2.7 %	2.6 %
Japan	1.5 %	1.3 %	0.5 %	0.9 %
Switzerland	0.9 %	1.7 %	0.5 %	0.7 %
USA	2.2 %	2.4 %	2.1 %	2.1 %

Consumer sentiment too has brightened up. In the USA and Eurozone, consumer sentiment is now higher than in the last pre-crisis year 2007. Whereas there was an interim high in 2010 in Germany and Switzerland, their consumers today, however, perceive their position as less attractive than at that time, respectively, prior to the financial crisis.

Overall, the outlook for economic growth in 2018 is rosy. The augurs polled by "The Economist" expect on average growth of 1.7 % for Switzerland in 2018, compared to 0.9 % for 2017. The USA can lay claim to 2.4 %, the Eurozone 2.1 %, whereas countries like Germany, the Netherlands and Spain could experience faster Gross Domestic Product (GDP) expansion. For China and India, these wise men expect stronger growth of 6.5 % and 7.4 %, respectively.

The risks, however, are to be found less in economic development than in politics. Trump continues to be unpredictable, as does Kim Jong-Un. Germany continues to be struggling in forming a government, and in Italy, the election in March is casting its long shadow. And then, of course, there is Brexit, which is quite a lump to swallow for both the UK and the EU.

Upshot: The lights are on green, orange may follow soon

On financial markets, analysts are concerned as the American Central Bank continues to take its foot off the accelerator. Following the last Fed Funds hike to 1.5 %, the Fed anticipates three further steps of a quarter point each in 2018. Markets are still dubious about this pace. According to the "Taylor Rule", however, which estimates the "correct" level of rates based on a number of indicators, interest rates should already now be above 4 %. In addition, the Fed is successively cutting down on its bond purchases.

In Europe, however, an end to the ultra-easy monetary policy is not yet visible, but given the economic trend, any change is just a question of time. Critical voices point out that higher interest rates would be necessary and appropriate in the booming central European countries. Inflation remains unchanged, off the radar. Once it takes off, then it will most likely happen in the USA first, where the labour market is tight.

Fundamental valuations of equities give rise to frowns too. This is particularly so in the USA. Amongst the more attractive markets are Switzerland, China, Japan and the Eurozone. Equities are helped by, in relation to the interest rates, the attractive dividend yields. In the Eurozone, Switzerland, China and Russia, these are on average above 3 %. High valuations and the calm on the markets, however, caution us to be on our guard.

In 2017, **yields on 10-year government bonds** developed in a non-uniform manner:

	Dec. 2016	Dec. 2017	Change
Europe	0.21 %	0.43 %	105 %
United Kingdom	1.24 %	1.19 %	-4 %
Japan	0.05 %	0.05 %	0 %
Switzerland	-0.19 %	-0.15 %	21 %
USA	2.44 %	2.41 %	-1 %

Living wealth.

Trust is paramount in asset management.

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
We have left the money market weighting in the portfolios broadly unchanged during the past quarter. With that, it remains at a near neutral weighting when compared to our long-term strategic allocation.

Bonds
Faced with the low levels of interest rates, it is difficult, respectively, almost impossible to identify suitable opportunities of reasonable quality for investments. The development of yields and spreads between the various country and quality tiers illustrates the sheer desperation of investors. An imminent change in this situation is currently not in sight.

Equities Switzerland
During the final quarter too, we left the Swiss equity allocation unchanged. The large part of the gains occurred during the first six-month period of the year, whereas the second half was somewhat quieter. Our selection of Swiss equities composed according to value criteria, the 'Swiss Stock Portfolio' (SSP), achieved a total return (including dividends) of 22.2% during the year. Its benchmark SPI (total return) achieved a 19.9% total return during the same period. With that, the SSP achieved an outperformance of 2.3%

Since 2010, the SSP's mean annual performance amounts to 12.8% p.a., clearly beating the 8.4% achieved by its benchmark. Since 2010, the cumulative total return of this strategy amounts to 161.5%. 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 this year, the "Strategy Certificates linked to the SIM–Swiss Stock Portfolio Basket" (Valor: 36524524, ISIN: CH0365245247), which mirrors this equity portfolio 1:1, rose 1.3% since its launch in early July.

Equities Europe
In 2017, European equities were torn between the markedly improving economies and the rise of the common currency. Where the first provided a tailwind for corporate profits, the latter produced quite the opposite for export-oriented businesses. Bottom line, the positives prevailed. As we had achieved a markedly overweight position by autumn, we reduced the positions by 3 percentage points in the fourth quarter. We are now neutral weight.

The directly-invested 'European Stock Portfolio' (ESP) achieved a 17.8% return in 2017. The DJ STOXX 600 Index achieved only a return of 10.6% during the same time span (both values are total return, i.e. incl. dividends), yielding an outperformance 7.2 percentage points to the ESP. Compared to a pure value index that more closely reflects our investment approach, the outperformance even amounts to some 8.1 percentage points. Since 1993, the mean annual performance of our equity selection amounts to about 9.2%, compared to the 7.2% of the above-mentioned 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 885%.

Equities USA
American equity markets went from record to record in 2017, and with that, caught the media's attention. We have not made any changes to the position, but are slightly overweight due to past performance.

Equities Asia (excluding Japan)
Asian equities had a particularly good run in 2017. We did not make any changes to their weighting during the fourth quarter period. Far-Eastern stocks remain unchanged at neutral weight.

Equities Japan
In 2017, the sun literally rose on the Japanese exchanges. The fund employed there slightly outperformed the market as a whole. We have not made any active changes to the position, but due to prices rising over 20%, we are now slightly overweight.

Measured on the **price/earnings** ratio using the latest 12 months profit figures, some of the equity markets have become dearer since beginning of the year, while others have become more attractive:

	Dec. 2016	Dec. 2017	Change
DAX Index/DE	18	19	5.6%
DJ STOXX 600 Index/EU	27.4	20.8	-24.1%
MSCI World Index	21.1	20.7	-1.9%
S & P 500 Index/USA	21	22.5	7.1%
SPI Index/CH	16.1	13.2	-18.0%
TOPIX Index/JPN	19.8	16.3	-17.7%

Source: Bloomberg

Alternative Investments
The proceeds from the reduction in European stocks – about 3 percentage points of the portfolio – were added to alternative investments during the final quarter. We decided on a further investment product there, the Franklin K2 Alternative Strategies Fund from Franklin Templeton. It is worth pointing out that this is not just a fund of hedge funds, but the underlying strategies are held at Franklin Templeton in managed accounts run by the specialists and as such, they may be examined in detail at any time. Compared to the world equity index, the fund has a very low correlation, as well as a low volatility, which makes it appear attractive. The fund is available in several currency-hedged classes and offers daily liquidity. With this step, the overall allocation to alternative investments has increased to about 7.5 %.

Precious Metals
No changes have been made to the gold position. It continues to serve unchanged as diversification to other (interest free) currencies, as well as other asset classes, and gave satisfaction with a return in the low double digits.

Summary of our current
Asset Allocation:

Investment Category	
Money Market	neutral
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.

News of our own

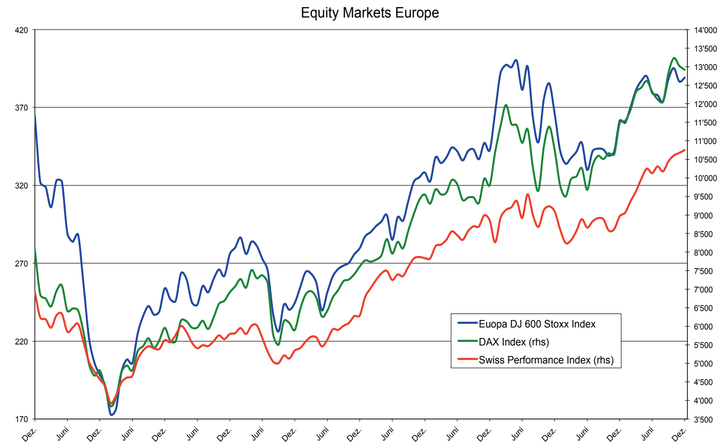
As from 2018, our Head of Portfolio Management, Adrian Müller, CFA, will be joining our management board. He is a member of the Investment Committee where he holds signatory responsibility for Swiss equities. Mr Müller completed a banking apprenticeship in conjunction with the Swiss vocational matriculation at a Swiss bank. Following the successful completion of his apprenticeship and matriculation, he gained two years of experience in their client advisory and securities departments. Subsequently, he read business administration at FHS St. Gallen (B.Sc. in Business Administration) with an emphasis on corporate finance. To round off his analytical education, he successfully achieved his CFA in 2017. Mr Müller began his career with us in 2008.

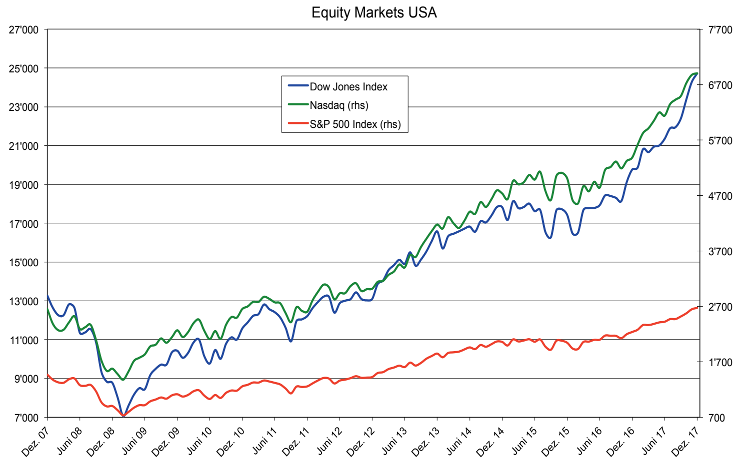
Price / Book and **Dividend Yield**
of major equity markets:

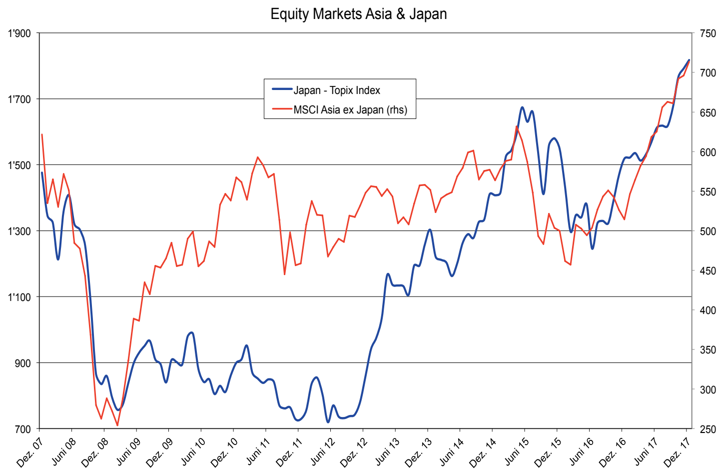
	Price / Book	Div. Yield
DAX Index / DE	1.9	2.5 %
DJ STOXX 600 Index / EU	1.9	3.2 %
MSCI World Index	2.4	2.3 %
S & P 500 Index / USA	3.3	1.9 %
SPI Index / CH	2.2	2.9 %
TOPIX Index / JPN	1.4	1.8 %

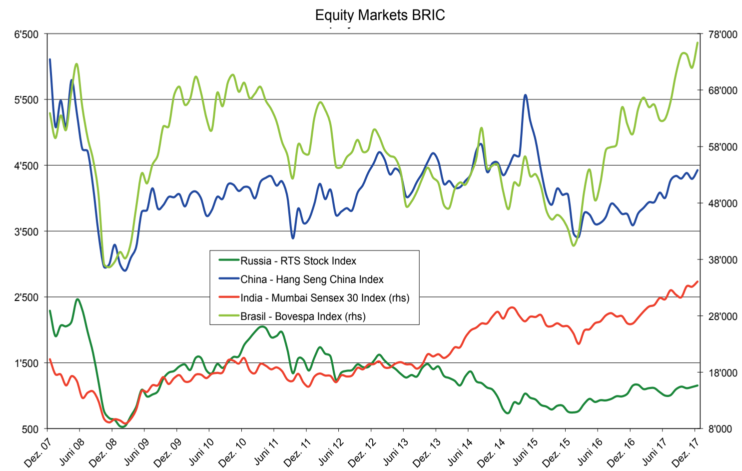
Growing wealth.
The outcome of this close client relationship and our competent counselling is, at all times, a truly individual tailor-made solution.

Equity markets at a glance

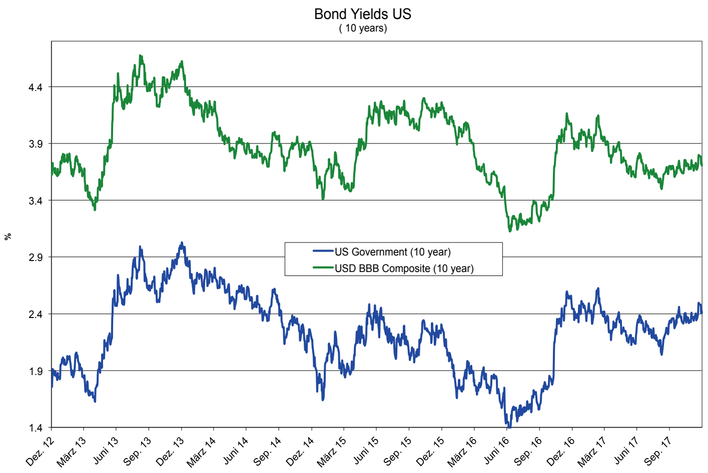


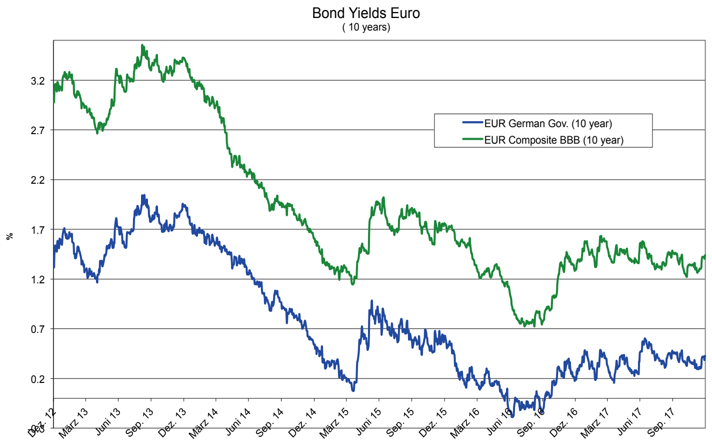


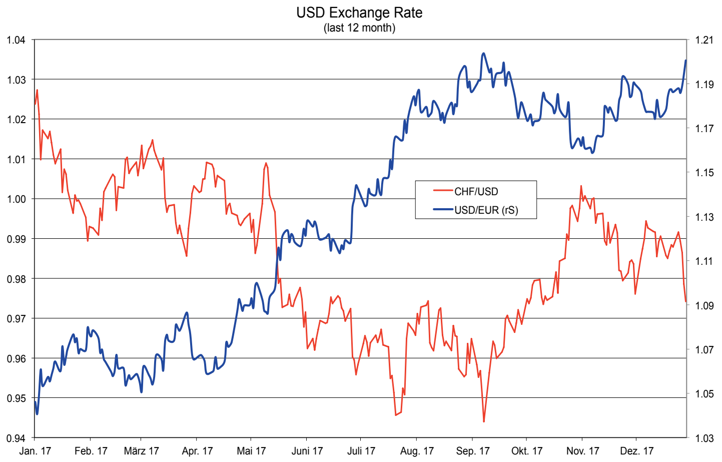


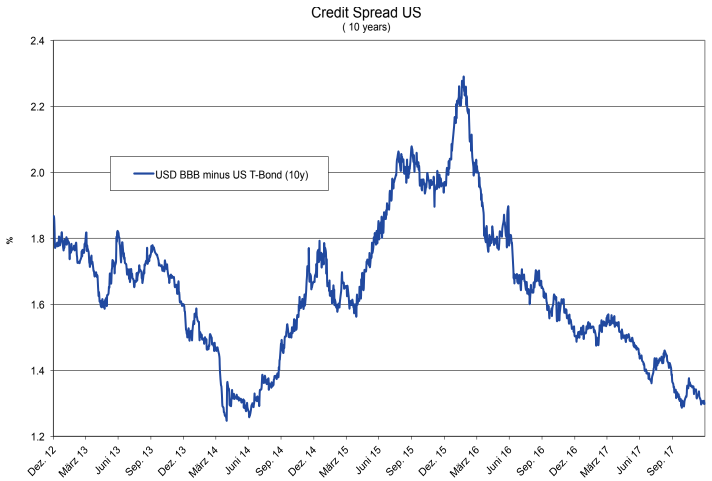


Bond yields and other indicators









Notes

Source of the following graphics: Bloomberg

SALMANN
INVESTMENT MANAGEMENT

Closing words

We wish you all the best for 2018 and thank you for the trust placed in us.

Alfred Ernst
Director, Relationship Manager

Contact us

Salmann
Investment Management AG

Beckagässli 8
FL-9490 Vaduz

T +423 239 90 00
F +423 239 90 01

www.salmann.com