SALMANN
INVESTMENT MANAGEMENT

Climbing the Wall of Worries

Investment Report – 30th September 2019

Climbing the Wall of Worries

Irrespective of the many flashpoints, equity and bond prices continued to rise throughout the third quarter. Gold in particular benefitted from this constellation. At the same time, the economy is slowing down, first and foremost because of the numerous ongoing disputes in politics.

“Bull markets like to climb the wall of worries“ is the proverb on the exchanges. This climbing tour can be observed on many a market, and it appears as if this witticism could be supplemented with “the longer the list of worries, the easier the climb”.

Indeed, performance figures for the third quarter are predominantly lit up in green and with that, pushing total returns for the current year further into positive territory. Gold, as well as Japanese equities, registered a particularly good quarter. At the other end of the table, not only has Asia as region (excluding Japan) had to take up the red light in relative comparison, but it also had to struggle with an absolute negative quarterly return.

Overall the nine month figures give a good showing. Swiss stocks are ahead by a nose (see table “Change in Equity Markets since the beginning of 2019”). American and European equities also featured on the winners’ rostrum. Gold ended up at the thankless fourth place, despite having scored double digits too.

Change in **Equity Markets since the beginning of 2019:**

		Dec. 2018	Sept. 2019	Change
Asia ex Japan	MSCI AC Asia ex Japan	431.1	455.7	5.7%
Europe	DJ STOXX 600	707.7	845.7	19.5%
Japan	MSCI Japan	1’736.20	1’900.5	9.5%
Switzerland	SPI	9’830.10	12’233.1	24.4%
USA	MSCI USA	6’658.80	7’997.3	20.1%
World	MSCI AC World	5412.1	6’364.9	17.6%
Hedge Funds	HFRX Global HF	1’189.90	1’259.9	5.9%

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

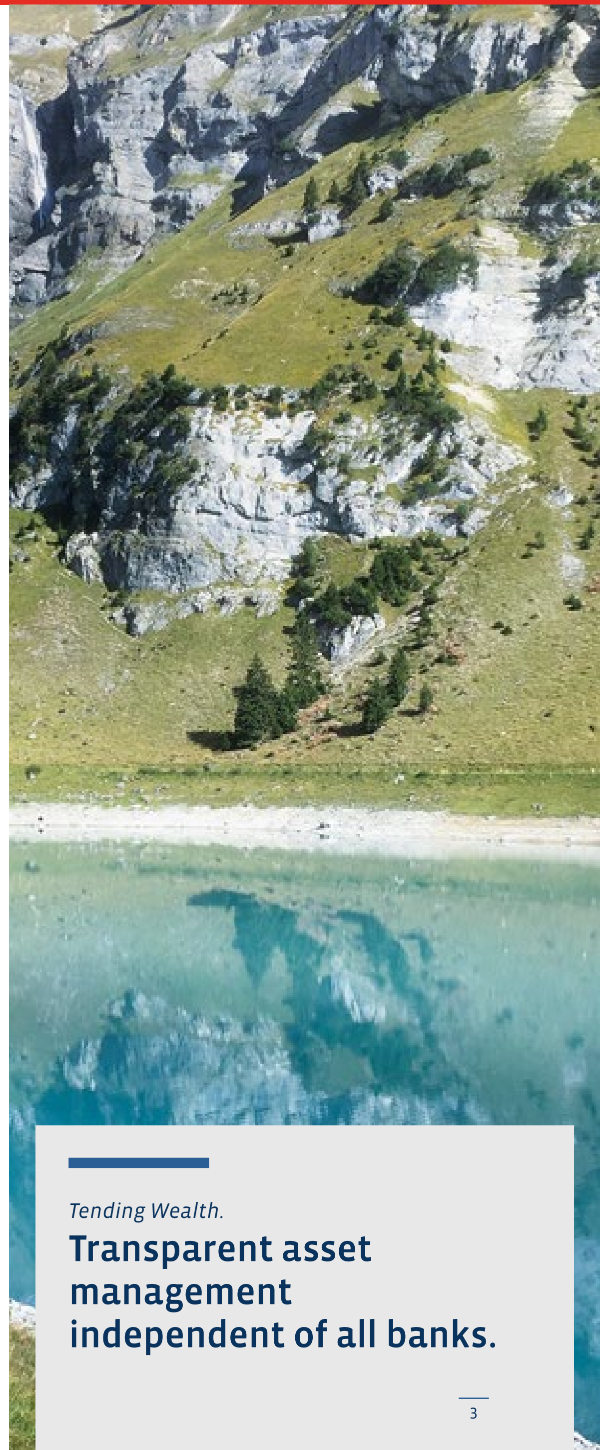
Resilient Financial Markets

In the face of the daily news menu dished up by the media, this apparent nonchalance may surprise. An outage of 5% of global crude production? No problem! Potential escalation on the Persian Gulf, in Hong Kong? Nothing is going to happen! Hard Brexit? So what! Trade war? They’ll meet up eventually! Impeachment proceedings? Never worked before! Negative interest rates? What can we do? North Korean rocket testing? It was nothing much!

Neither the political uncertainty, nor the economic slowdown, succeeded in worrying financial markets for any length of time. In part, this is because nowadays nearly all Central Banks immediately increase the prescribed opiate doses at the merest sight of dark clouds on the horizon. Thus the US Central Bank, the Fed, just recently lowered the much observed Fed Funds Rate by a ¼-percentage point to a target range of 1.75 to 2%. Market participants currently attach a 60% probability to a further cut by a ¼-percentage point to follow by the end of October.

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

	Real GDP Growth		Inflation	
	2019	2020	2019	2020
China	6.2%	6.0%	2.4%	2.3%
Germany	0.6%	0.9%	1.4%	1.4%
EU	1.4%	1.3%	1.5%	1.6%
United Kingdom	1.2%	1.1%	1.9%	2.0%
Japan	0.9%	0.3%	0.7%	1.0%
Switzerland	1.2%	1.3%	0.6%	0.7%
USA	2.3%	1.7%	1.8%	2.0%



Tending Wealth.

Transparent asset management independent of all banks.

The European Central Bank (ECB) also lowered its deposit rate for commercial banks from -0.4 % to -0.5 %, and at the same time extended its bond purchasing programme indefinitely. To mitigate the effect on banks, the Central Bank introduced an exempt amount on which banks do not have to pay interest on deposits placed with it.

One cannot fail to notice the cooling trend of the global economy. Industry in particular is struggling, or even in recession in many countries. In contrast, the services sector is doing rather well in general. The industrial Purchasing Managers Index (PMI) dropped to its lowest reading since 2009 in the USA, Switzerland and Germany, with the purchasing agents' being quite sceptical about the immediate future, particularly so in Germany. There, the current PMI reading dropped to just 41.7 points, which is not only a low reading in a global context, but it is also far below the growth threshold of 50 points.

Admittedly, Switzerland, at 44.6 points, is looking slightly better, however, it is still far from an imminent high pressure area. France and the Netherlands, however, provide bright spots, as do Canada, Australia, China and India, with readings of above 50 and thus in the growth zone.

Consumers are in a generous mood, benefitting from the pleasing employment market. The unemployment rate has reached multi-year lows in many countries, for instance, in the Eurozone, where the last reported reading of 7.4 % is merely a touch above the 2007 all-time low. Even in economically flatlining Italy, the recent unemployment rate of 9.5 % is at a low not seen in eight years. In countries like Switzerland (2.3 %), Germany (3.1 %), the Netherlands (3.5 %) and the USA (3.7 %), it can be factually called full employment.

In this context, let us take a closer look at the economic powerhouse, the USA: Currently there are 7.2 million jobs available there, which is more than the reported number unemployed. For each vacancy there are 0.84 unemployed. This leads to wages trending upwards, stimulating private household consumption, which in turn accounts for a good two-thirds of the American Gross Domestic Product (GDP).

Consumers are also in a spending mood, as they are much less indebted than before (the ratio of household debt to assets is the lowest since 1985), and they benefit from low interest rates (at 10 %, interest payments as a percentage of disposable income are at a 45-year low).

The **equity funds employed by us** achieved the following returns since the beginning of the year:

Aberdeen Asia Pacific (USD)	8.6 %
Swiss Rock Emerging Markets Equities (USD)	5.3 %
GAM Japan Stock Fund (CHF hedged)	7.7 %
GAM Japan Stock Fund (€ hedged)	7.8 %
Strategy Certificate SIM–Swiss Stock Portfolio Basket	16.3 %
iShares Stoxx Europe 600 ETF (€)	16.2 %
Performa European Equities (€)	13.3 %
Performa US Equities (USD)	20.4 %
BB Adamant Medtech & Services Fund (CHF)	16.6 %
BB Adamant Medtech & Services Fund (€)	20.8 %
BB Adamant Medtech & Services Fund (USD)	15.2 %

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

Other funds employed by us developed as follows:

Acatis IfK Value Renten Fond (CHF hedged)	8.0 %
Acatis IfK Value Renten Fond (€)	8.4 %
BCV Liquid Alternative Beta (CHF hedged)	3.6 %
BCV Liquid Alternative Beta (€ hedged)	3.7 %
BCV Liquid Alternative Beta (USD)	6.2 %
Franklin Templeton K2 Alternative Strategies Fund (CHF hedged)	3.4 %
Franklin Templeton K2 Alternative Strategies Fund (€ hedged)	3.7 %
Franklin Templeton K2 Alternative Strategies Fund (USD)	6.1 %
Lyxor ETF Euro Corp. Bond Fund (€)	6.5 %
Pictet CH-CHF Bond Fund	4.7 %
Swiss Rock Absolut Ret. Bond Fund (CHF hedged)	1.9 %
Swiss Rock Absolut Ret. Bond Fund (€ hedged)	2.1 %
ZKB ETF Gold (USD)	14.5 %

Performance incl. re-invested dividends where applicable.

Dent-in-growth or recession?

As long as the centres of power operate under the mantra “everyone does as they please, nobody does what ought to be done, but everyone is joining in” the uncertainty remains, with its negative potential for the economy, and perhaps financial markets as well. In respect of the latter, at least in terms of raised volatility. On the other hand, it is quite conceivable that the observed weakness is just a blip in the economic cycle and 2020 will see a renewed pick-up in global economic growth.

The augurs of the independent research house “Bank Credit Analyst” spotted a silver lining on the horizon, amongst others, in China. According to their analysis, the measures taken by the Middle Kingdom, such as easing lending facilities, lowering social security contributions and increased government spending, contributed to a recovery in building and investments in plant and equipment, as well as a rise in cement and steel imports. The decidedly easy monetary policy of Central Banks globally which, due to the absence of inflation, is likely to stay with us for some time, also argues against a global recession. As experience has taught us, the risk of an extended equity slump is not (yet) with us. The hope remains that no one in the political centres of power loses their nerve.

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).

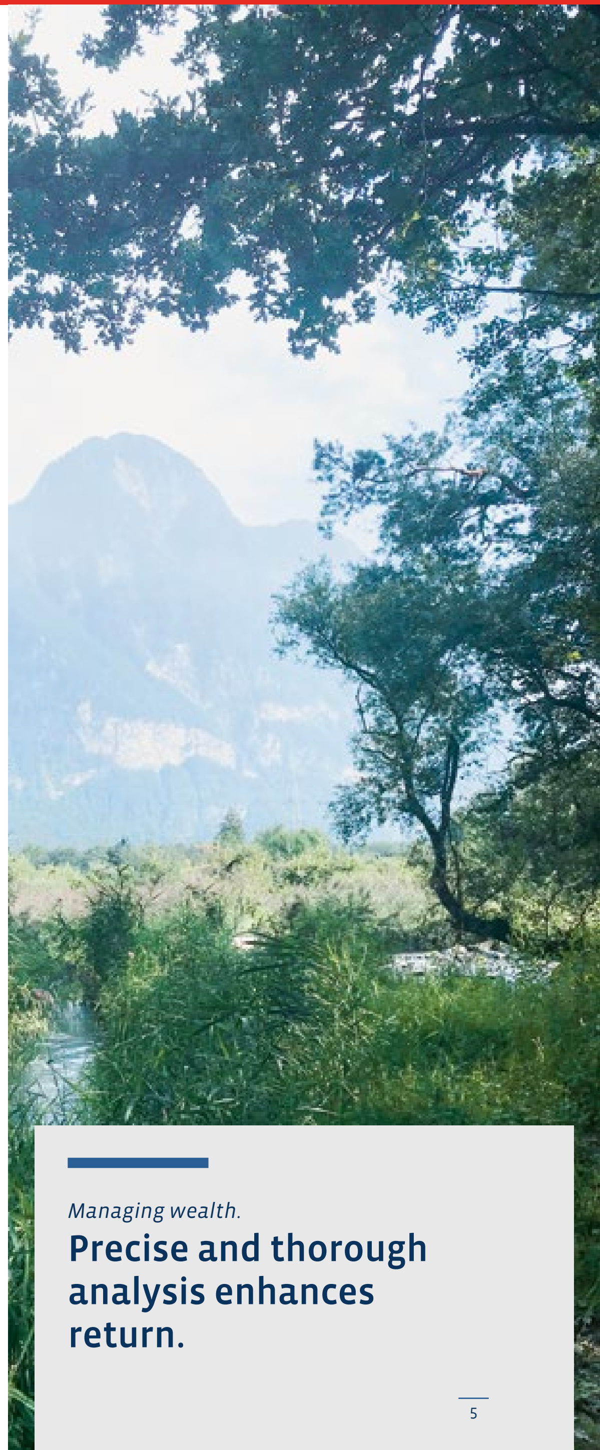
Money Market
The money market allocation remained unchanged throughout the quarter. Liquidity serves as an equalising reservoir and a risk buffer for other asset classes, but remains devoid of return.

Bonds
The global decline in yields again continued during the third quarter, bestowing capital gains on existing positions, however, at the same time making the task of employing newly available money in a reasonably sensible manner even more difficult. We have not initiated any active changes to the inventory and remain underweight in this field.

Since the beginning of the year, yields on **10-year government bonds** declined across the board:

	Dec. 2018	Sept. 2019	Change
Europe	0.24 %	-0.70 %	-392 %
United Kingdom	1.28 %	0.48 %	-63 %
Japan	0.05 %	-0.21 %	-520 %
Switzerland	-0.25 %	-0.76 %	-204 %
USA	2.68 %	1.50 %	-44 %

Equities Switzerland
We remain unchanged neutral weight in Swiss stocks. The directly invested “Swiss Stock Portfolio” (SSP) achieved a performance including dividends of 18.3 % during the first nine months of the year. The Swiss Performance Index (SPI) is ahead with 24.4 %, whereas it has to be said that on its own, the index heavyweight Nestlé contributed about one third to the SPI’s performance. Apart from this, our concentration on the in the long-term, very successful value style investing (more on this in the “Equities Europe” section) accounts for the difference. Since 2012, the average annual performance of the SSP, typically comprised of



Managing wealth.

Precise and thorough analysis enhances return.

about 20 stocks, amounts to 15.5 %, a result that clearly beats the average benchmark's performance of 11.3 %.

Since 2012, the total cumulative return of this strategy amounts to about 206 %, while that of the index to "only" 129 %. 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) has achieved a performance of 16.3 % since the beginning of the year.

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

	Price / Book	Div. Yield
SPI Index	2.2	2.9 %
DJ STOXX 600 Index	1.9	3.7 %
MSCI AC Asia ex Japan	1.4	2.7 %
MSCI Japan	1.2	2.5 %
MSCI USA	3.4	1.9 %
MSCI AC World Index	2.4	2.5 %

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

Equities Europe
The directly invested "European Stock Portfolio" (ESP) achieved a performance of 9.8 % during the first nine months of the year. The Dow Jones Stoxx 600 Index achieved a total return (price change plus dividends) of 19.5 % during the same period. Long term, the ESP selection's outperformance remains intact. Since 1993, the ESP has returned on average 8.2 % compared to the 6.9 % achieved by the Dow Jones Stoxx 600 Index. 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 above 793 %, while that of the benchmark to about 543 %.

Value style investing, the style we follow with the ESP and SSP (see "Equities Switzerland"), also lagged slightly behind growth style investing during the third quarter. It is not unusual for the performance of these two investment approaches to diverge. In the past this could be observed time and again, during certain cycles growth stocks took the lead, whereas during others, value stocks were one step ahead.

We are convinced that it makes sense to remain faithful to value style investing, particularly so since value stocks are valued markedly more attractive than their brethren in the growth segment, and therefore possess catch-up potential.

Additionally, we are now putting even more emphasis on companies with distinctly high dividend pay-outs coupled with a solid financial footing.

At present, there is a marked valuation gap between growth and value stocks. The price/earnings ratio (P/E), for example, currently amounts to a lofty 23.8 on the MSCI Europe Growth Index. The MSCI Europe Value Index, however, is a mere 12.7. Whereas the price/book ratio of growth stocks stands at an airy 3.7, the reading on value stocks is on average a moderate 1.2. Likewise, a look at the dividend yields reveals a large gap; 2.3 % annual yield on growth equities as opposed to 5.5 % in the case of value stocks.

Even when compared to the general index without any style-specific metrics, it crystallises that, based on various key figures, the value segment is more attractively valued than the general market. You will find more on the value topic on our web site www.salmann.com in the "Medien" section of the Investment Blog titled "Value Investing funktioniert nicht immer, aber immer wieder" (unfortunately this article is only available in German). Should you wish, we are happy to send you a hardcopy of the article by mail.

Equities USA
American equities finished second place in the nine-month performance ranking. In spite of high waves and treacherous currents (threat of impeachment proceedings against the president, a trade war with China, a dicey situation in the Near and Middle East), the American super tanker stays its course undeterred in stormy seas. We did not make any changes to the US stock weighting and with it, maintained its slight overweight position.

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

	Dec. 2018	Sept. 2019	Change
SPI Index	17.5	19.2	9.7 %
DJ STOXX 600 Index	15.5	18.8	21.3 %
MSCI AC Asia ex Japan	12.1	14.1	16.5 %
MSCI Japan	11.5	13.9	20.9 %
MSCI USA	16.8	20	19.0 %
MSCI AC World Index	15.6	18.6	19.2 %

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

Equities Asia (excluding Japan)

Asian equities came under pressure during the third quarter. The global economic slowdown and the firm US Dollar (which impedes often US Dollar indebted Asian corporates' ability to service their debt), as well as the risky situation in Hong Kong, dampened investors' appetites. The index performance for the three quarters of the year amount to 5.7 %, the Aberdeen Asia Pacific (ex Japan) Fund employed by us in this area managed to outperform this markedly. The weighting of Asian stocks remained unchanged throughout the reporting period.

Equities Japan

In contrast to the rest of Asia, Japan cut quite a good figure and did credit to its nickname of the "Land Of The Rising Sun". The MSCI Japan advanced by 3.5 % in the third quarter and achieved a performance of 9.5 % in the current year. We remain neutral weight in Japanese equities, which fundamentally are amongst the most attractively valued ones of all industrial nations.

Alternative Investments

Hedge Funds developed slowly but steadily this year. Their global index advanced by 1.6 % during the quarter and achieved 5.9 % (in US Dollar) in 2019 to date. The instruments employed by us in this area exhibited a slightly better performance across the board measured in US Dollars. We have not made any changes to the positions.

Precious Metals

Gold built seamlessly on the good performance of the second quarter and continued to climb. The continued decline in interest rates, respectively, the expansion of negative yields made the precious metal an increasingly presentable alternative. According to all accounts, Central Banks are raising their bullion stockpiles to diversify their currency reserves. Last but not least, gold appears to be an increasingly suited security element with a view to the numerous flashpoints and potential for conflict. Our positions remained unchanged throughout the quarter.

Summary of our current Asset Allocation:

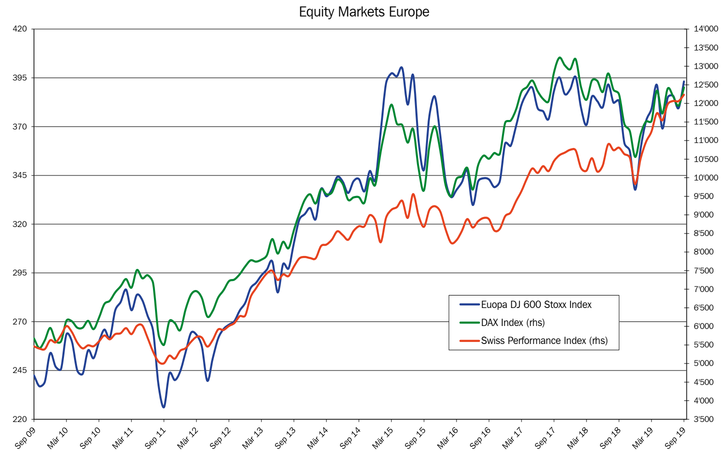
Asset class	
Money Market	overweight
Bonds	underweight/ short duration
Equities Switzerland	neutral
Equities Europe	neutral
Equities USA	overweight
Equities Asia	neutral
Equities Japan	neutral
Precious Metals	overweight
Alternative Investments	overweight

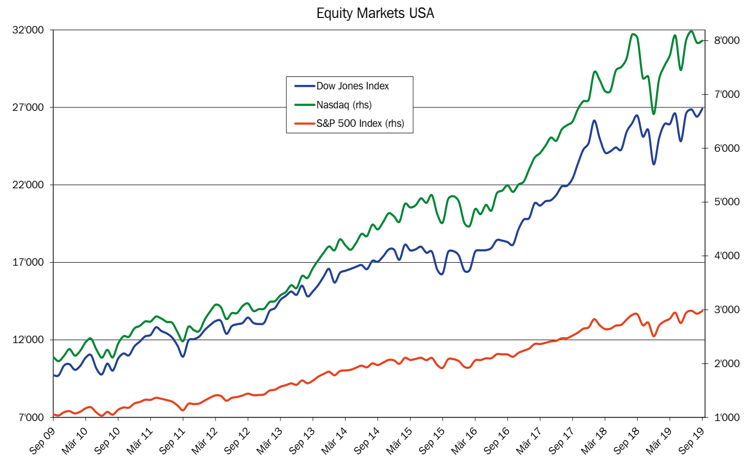
For a Swiss Franc referenced portfolio

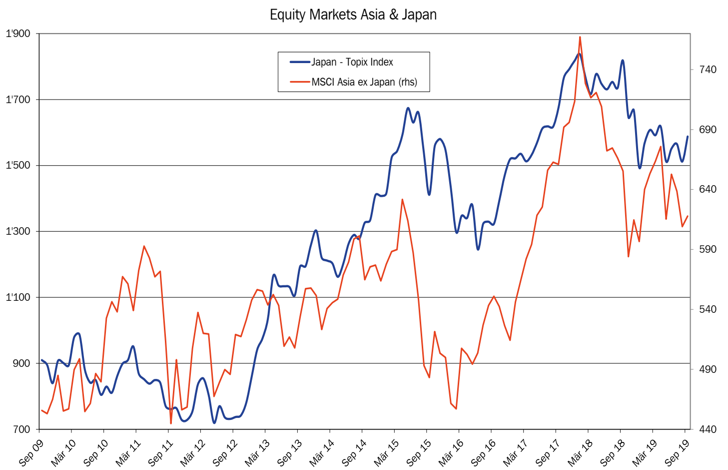
Living wealth.

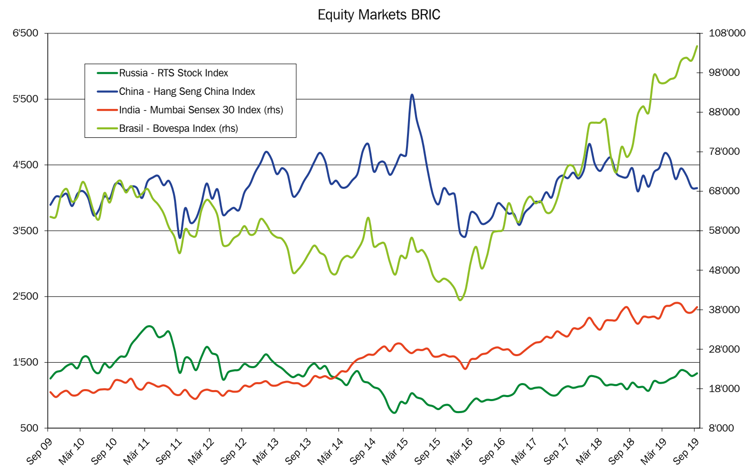
Trust is paramount in asset management.

Equity markets at a glance

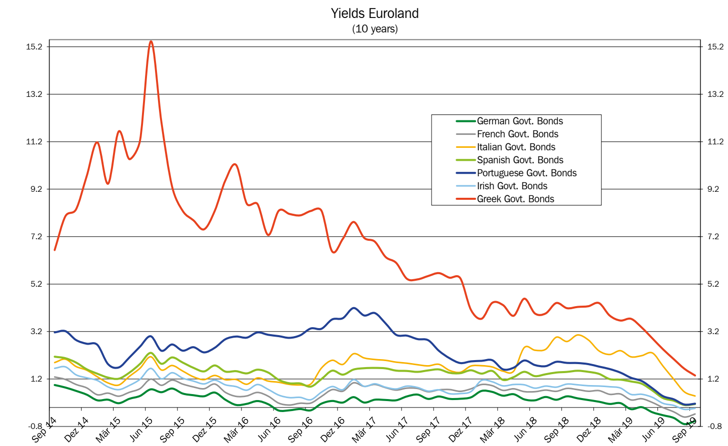


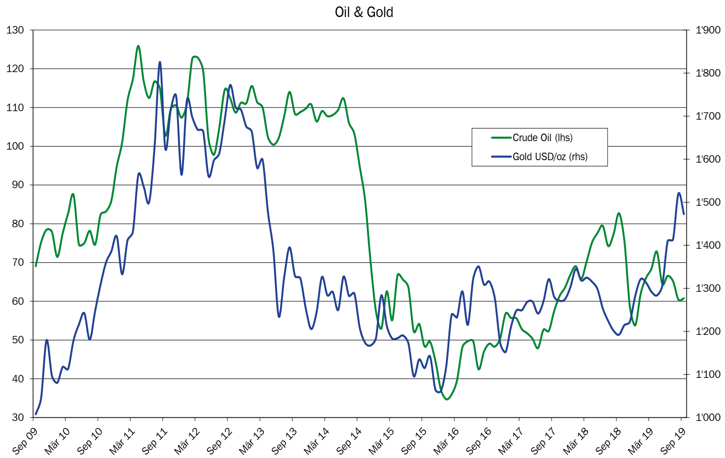


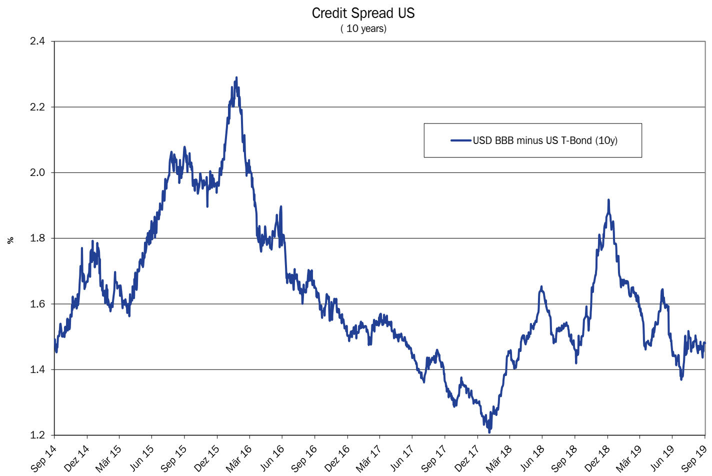


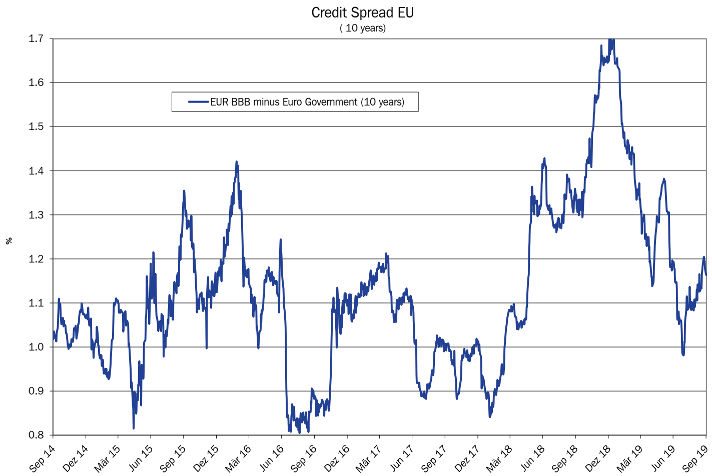


Bond yields and other indicators









Notes

Closing words

We wish you many golden autumn days 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