SALMANN
INVESTMENT MANAGEMENT

Investment Report – 31st December 2016

Trump opens the floodgates

The fourth quarter also kept the world in suspense and with that, the year closed true to course. In contrast to the Brexit decision, Donald Trump's election as the next US president only briefly provoked discontent on financial markets. Within a day after the surprising result, equity markets had recovered from the setback again, and in the meantime, American stocks have even reached new highs. The US Dollar continued to strengthen, the Euro weakened marginally against the Swiss Franc and the Greenback. The European common currency only suffered minor injuries from Italy's constitutional vote. As expected, the US Federal Reserve (Fed) increased the benchmark Fed Funds Rate (rate for overnight lending to banks) by ¼ of a percentage point to 0.5%.

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

	Real GDP Growth		Inflation	
	2016	2017	2016	2017
China	6.7%	6.4%	2.0%	2.1%
Germany	1.8%	1.4%	0.4%	1.5%
Euroland	1.6%	1.3%	0.2%	1.3%
United Kingdom	2.0%	1.1%	0.6%	2.5%
Japan	0.7%	1.0%	-0.2%	0.6%
Switzerland	1.4%	1.5%	-0.4%	0.4%
USA	1.6%	2.2%	1.3%	2.3%

In contrast, the European Central Bank (ECB) is sticking to its easy money policy, or is even expanding it. True, the monthly bond purchases by the ECB will decline from April 2017, although the overall programme will run for longer. The bottom line is that Draghi promised the market an additional 540 billion Euros of central bank money as a generous Christmas present.

Marked rise in long-term rates

Long-term interest rates rose across the board and in places, markedly so. Whereas the 10-year US Treasury bond yield was 1.4% midyear, it now stands at 2.4%. In Switzerland, the yield for 10-year Eidgenossen climbed from -0.6% in summer to -0.2% now. In Italy, the yields of Buoni del Tesoro Poliannuali doubled from 1% in September to about 2%, and in Germany, Bunds jumped from -0.2% to +0.2%. The spreads (the difference in yields for varying credit qualities) remained broadly unchanged. Since midyear, yield curves in most countries steepened slightly, meaning, long-term rates rose more than short-term ones.

There has been movement in commodities too. After the Opec and non-Opec countries demonstrated unity for the first time in a long while, oil prices rose markedly. From a low of about 28 US Dollars a year ago, the price for a barrel of Black Gold has almost doubled. Should the agreed production limits be adhered to, global supply will decline by about 2%, according to the "Wall Street Journal". Copper reacted positively too, and rose from below 5,000 to at times above 5,800 US Dollars per ton during the fourth quarter. Only precious metals did not benefit from the euphoria.

Change in **Equity Markets during the year 2016:**

		Dec. 2015	Dec. 2016	Change[1]
Asia ex Japan	DJ STOXX A/P	429.1	445.3	**3.8%**
Germany	DAX	10,743.0	11,481.1	**6.9%**
Europe	DJ STOXX 600	365.8	361.4	**-1.2%**
Japan	TOPIX	1,547.3	1,518.6	**-1.9%**
Switzerland	SPI	9,094.0	8,965.7	**-1.4%**
USA	S&P 500	2,043.9	2,238.8	**9.5%**
World	MSCI World Index	399.3	421.8	**5.6%**
Hedge Funds	HFRX Global HF	1,174.1	1,203.2	**2.5%**

In spite of the continuing flood of liquidity, the growth expectations for the economy held early in the year were not met in 2016, though the prognoses were recently corrected slightly upwards. And it looks even better for 2017. In November, the Purchasing Manager Indices (PMI) rose globally. The global industrial PMI, as provided by J. P. Morgan achieved a two and a half year high with 52.1 points. Readings above 50 point towards an expansion.

Of the 20 major industrial countries, just Brazil, South Africa and South Korea show readings below 50 points. The apparent political change of heart, away from the ultra-easy monetary policy towards a more active fiscal policy, combined with higher government spending, is lending wings to corporate shipmasters. The values shown in the

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

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above table from the "Economist" augurs are likely to be revised upwards soon. The Trump effect has not yet fully worked its way into the figures.

Done with austerity – long live deficit-spending!

In many places, the people have had enough of austerity, and this can be seen from the ballot boxes. Programmes like Trump's, which foresee cuts in taxes, infrastructure programmes and other measures to stimulate the economy, are winning greater approval. The fact that these measures will lead to increased deficits is quite another matter, but for the moment, the pragmatic viewpoint of "let's worry about this later" appears to dominate.

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

Aberdeen Asia Pacific (USD)	**3.8%**
JB Japan Stock Fund (CHF hedged)	**-1.7%**
JB Japan Stock Fund (EUR hedged)	**-1.4%**
Performa Asian Equities (USD)	**0.7%**
Black Rock Swiss Small & Midcap Opp. (CHF)	**12.1%**
Raiffeisen Futura Swiss Stocks (CHF)	**2.9%**
Schroders Swiss Small & Midcap (CHF	**14.5%**
Performa European Equities (EUR)	**0.7%**
Performa US Equities (USD)	**6.4%**

Indeed, this policy is currently providing markets with a fresh boost. Yet, at the same time, it encapsulates major fragility. Trump remains unpredictable, his cabinet looking uncomfortably military biased. The Wall Street gladiators, so disparaged during the election campaign, will soon have their own entry badges to the White House. Russia is sensing a tailwind; Latin America is feeling rather shaky. China is monitoring events suspiciously, as Trump rattles the sabre, and wonders how he is going to work out the punitive tariffs, once consumer goods from the Middle Empire suddenly become much more expensive in America for Trump's chief supporters who shop at Walmart and the like. Furthermore, the Chinese, who remain an important creditor of the USA (after Japan, they own the largest position of American government bonds), hold a hefty pawn in their hands against an over-zealous US president.

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

The fact that Saudi Arabia is now defending higher oil prices, and in doing so, is playing into the hands of its Dakotan shale oil competition, could be interpreted – honi soit qui mal y pense – as Riyadh's protection money for Washington. Ostensibly, the Saudis just want to finance their budget deficit, as well as preparing the ground for the partial privatisation of the government owned oil company, Saudi Aramco.

In the coming year, Europe faces elections in France, the Netherlands and Germany. Everywhere populists are seeing their chance, giving the established parties the shivers. For its part, the EU has to deal with unpleasantries like Brexit, and the bush fires kindling in its wake. Something good might indeed come out of this, in that increasingly, Brussels will have to concern itself once more with fundamental questions instead of the standardisation of the curvature of bananas and cucumbers.

Other funds employed by us developed as follows[3]:

Acatis IfK Value Renten (EUR)	**9.6%**
Acatis IfK Value Renten (CHF)	**9.2%**
BCV Liquid Alternative Beta (EUR)	**2.6%**
BCV Liquid Alternative Beta (CHF)	**2.1%**
Lyxor ETF Euro Corp. Bond Fund (EUR)	**3.5%**
New Capital Wealthy Nations Bond Fund (EUR)	**5.8%**
New Capital Wealthy Nations Bond Fund (CHF)	**5.1%**
New Capital Wealthy Nations Bond Fund (USD)	**7.4%**
Pictet CH-CHF Bond Fund	**1.3%**
Swiss Rock Absolute Ret. Bond Fund (EUR hedged)	**1.0%**
Swiss Rock Absolute Ret. Bond Fund (CHF hedged)	**0.4%**
UBAM Corporate USD-Bonds (EUR hedged)	**2.1%**
UBAM Corporate USD-Bonds (CHF hedged)	**1.5%**
ZKB ETF Gold (USD)	**8.7%**

Conclusion: Green lights ahead

The entire world is expecting a stronger Dollar and a weaker Euro, however, precisely this universal consensus within the pundits prompts us to be sceptical. Though we can subscribe to this view, however we do not see the Dollar going through the roof vis-à-vis the Franc. This is where the behaviour of the US Central Bank comes into sharp

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

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focus. The FOMC voting members anticipate three rate hikes of 25 basis points each. In Europe and Switzerland, however, short-term prime rates are likely to remain low. In respect of bonds, the deflationary scenario will gradually be replaced by an increasing fear of inflation, which could rise quicker than anticipated, particularly so in the USA. Driving factors, amongst others, are the oil price, a rise in the price of raw materials, as well as in interest rates.

During the current year, in spite of at times fierce backlashes, **yields on 10-year government bonds** have in part declined massively:

	Dec. 2015	Dec. 2016	Change
Europe	0.63%	0.21%	-67%
United Kingdom	1.96%	1.24%	-37%
Japan	0.27%	0.05%	-81%
Switzerland	-0.06%	-0.19%	-217%
USA	2.27%	2.44%	7%

The valuation of equities remains ambitious, but can be justified by viewing it in relation to yields on fixed interest securities. We think stocks are more attractive than bonds, particularly so since the corporate earnings recession has run its course and profits are edging upwards. Above all, the major markets are technically in a good condition long term, i.e. the indices are trading above their 50 and 200-day moving averages. A balanced portfolio in Francs currently includes an equity allocation of about 48%, bonds take up about 28%, cash accounts for 13%, gold for 6% and alternative assets for 5%.

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: Cash remains relatively generously available and lies above its long-term strategic target. This serves as a reserve in preparation for opportunities opening up, and as a buffer against value fluctuations in other asset classes.

Bonds: In spite of the rise in yields, the market is quite dried out and offers only limited investment opportunities. Short maturities are to be preferred.

Equities Switzerland: No change in the weighting that, at about 24%, accounts for a major part of the equity allocation. Our selection of direct investments, the Swiss Stock Portfolio (SSP) shows a very pleasant performance of 16.7% (including dividends). Its benchmark index SPI (total return) is quoted 1.4% negative, giving the SSP an outperformance of 18.1%. Since 2010, the annual performance of the SSP amounts to 11.5% p.a. and with that is clearly above the performance of the benchmark of 6.9%. The SSP figures bear transaction costs and withholding taxes. The reference index, however, bears no such costs. The funds employed by us also did well and when compared to their benchmark, even very well indeed (see table).

Equities Europe: No changes here too, the position amounts to 5%. The directly invested European Stock Portfolio (ESP) delivered a performance of 0.5% for 2016. The DJ STOXX 600 index achieved a return of 1.7% during the same period (both values are total return, i.e. including dividends). Since 2004, the average annual performance of our equity selection amounts to 8.9 %, compared to the benchmark's 7.0%. The numbers for the ESP bear transaction costs and withholding taxes, whereas the reference index is naturally calculated without costs. You will always find the performance and index comparison of the ESP and SSP on our website www.salmann.com (under the tab "Produkte").

Equities USA: One of the best performing established markets in the past year, which also provided local investors with a currency gain. Our position remained unchanged in the fourth quarter, and this is reflected in our books with a share of 7.7%.

Equities Asia (excluding Japan): A stronger Dollar and the fear of possible protectionist measures from the new US President kept a lid on Asian markets during the fourth quarter. Our weighting remained unchanged at about 7.4%.

Equities Japan: Unchanged is also our positioning in Japan (2.7%), whose stocks managed an impressive spurt during the final quarter, and in doing so, achieved a conciliatory year-end closing after all.

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Measured on the price/earnings ratio[4] 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	Dec. 2016	Change
DAX Index/DE	22.8	18.0	**-21.1%**
DJ STOXX 600 Index/EU	23.4	27.4	**17.1%**
MSCI World Index	20.7	21.1	**1.9%**
S & P 500 Index/USA	18.2	21.0	**15.4%**
SPI Index/CH	25.4	16.1	**-36.6%**
TOPIX Index/JPN	16.5	19.8	**20.0%**

Alternative Investments: No changes here. The fund employed by us represents a neutral weighting and achieved its purpose, thanks to low volatility growth.

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

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

Precious Metals: Equally unchanged is the gold position. Due to a rising Dollar, as well as interest rates, precious metals had to cede some of their earlier gains.

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

	Price / Book	Div. Yield
DAX Index/DE	1.8	2.7%
DJ STOXX 600 Index/EU	1.9	3.4%
MSCI World Index	2.1	2.5%
S & P 500 Index/USA	2.9	2.1%
SPI Index/CH	2.1	3.3%
TOPIX Index/JPN	1.3	1.9%

With all our best wishes for the New Year, we thank you for the trust placed in us.

Alfred Ernst
Vaduz/Zurich, 31st December 2016

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[4] Source: Bloomberg

[5] For a Swiss Franc referenced portfolio

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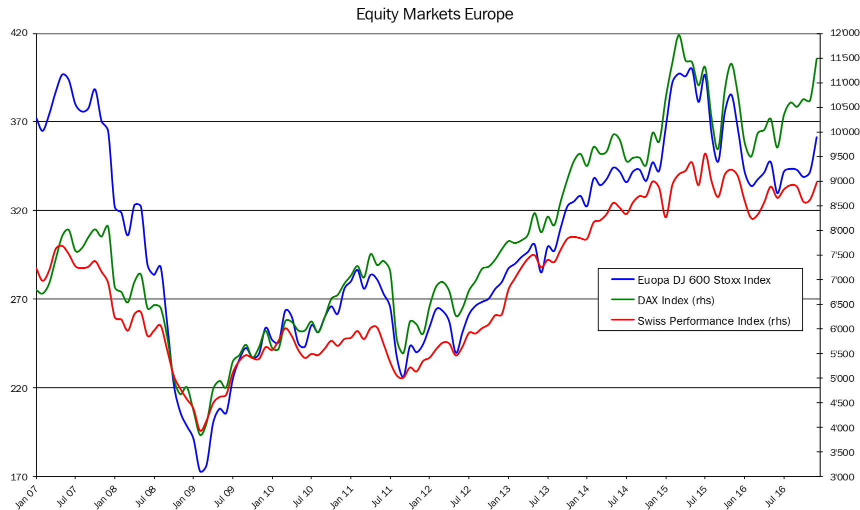

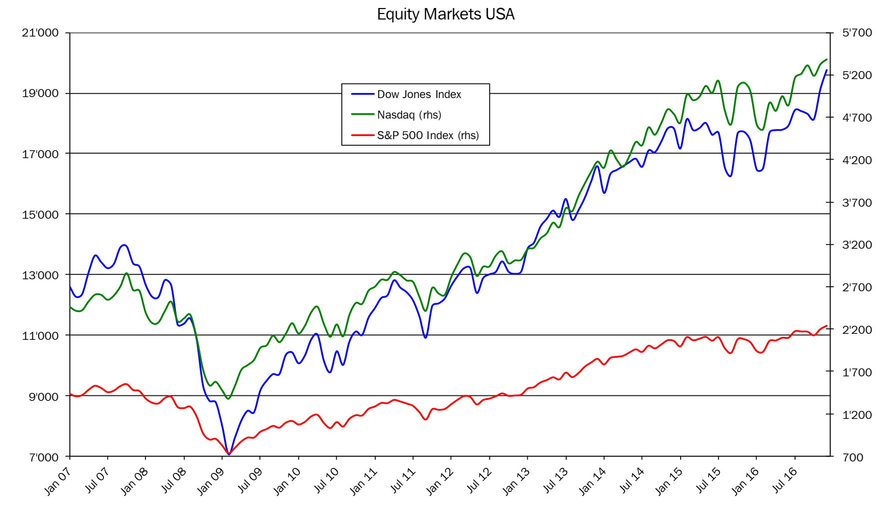

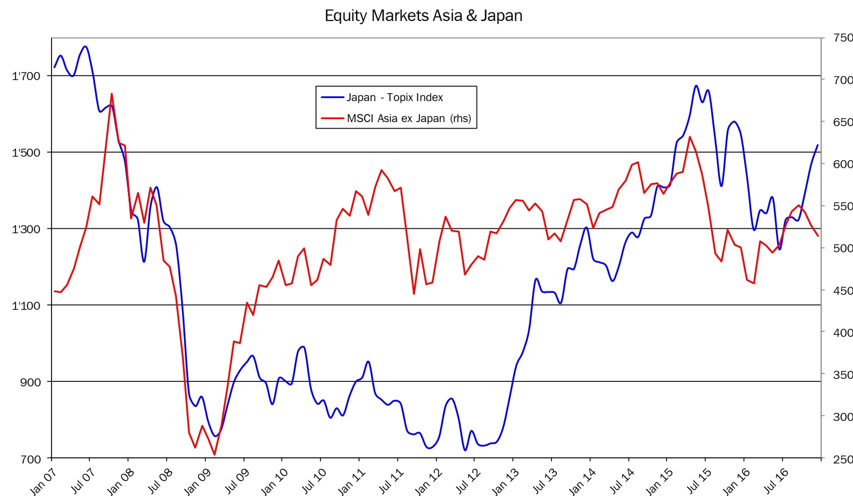

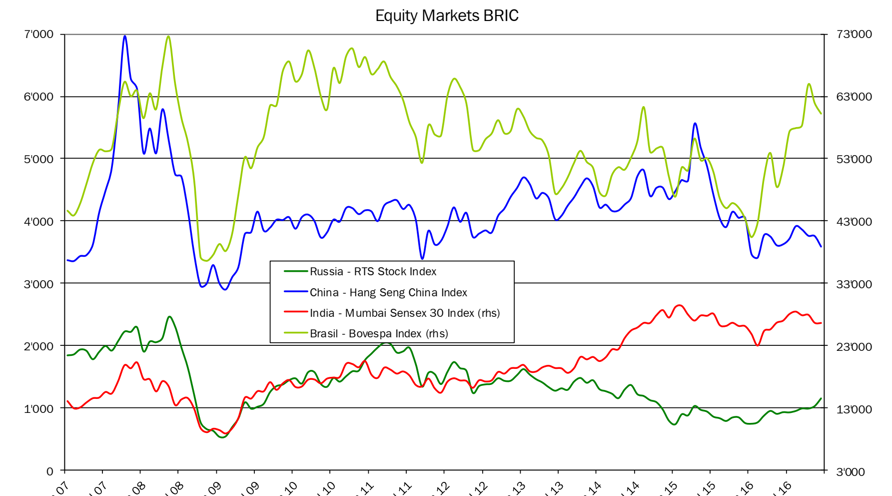

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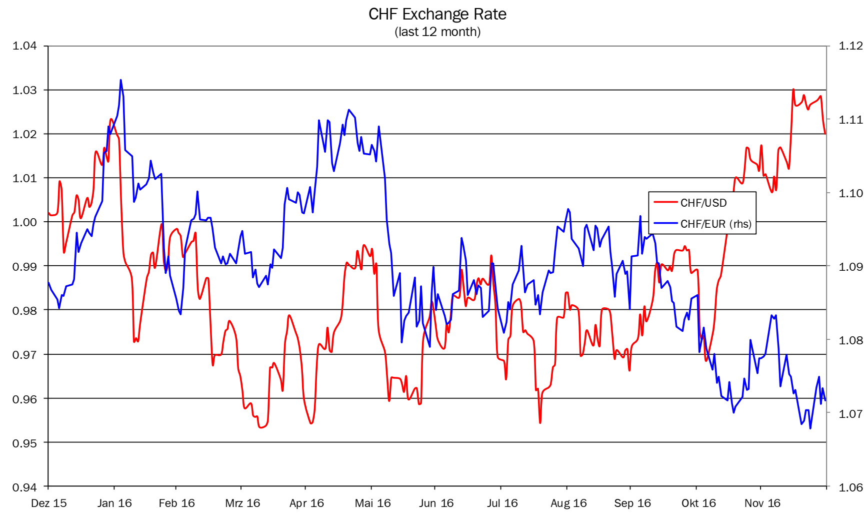

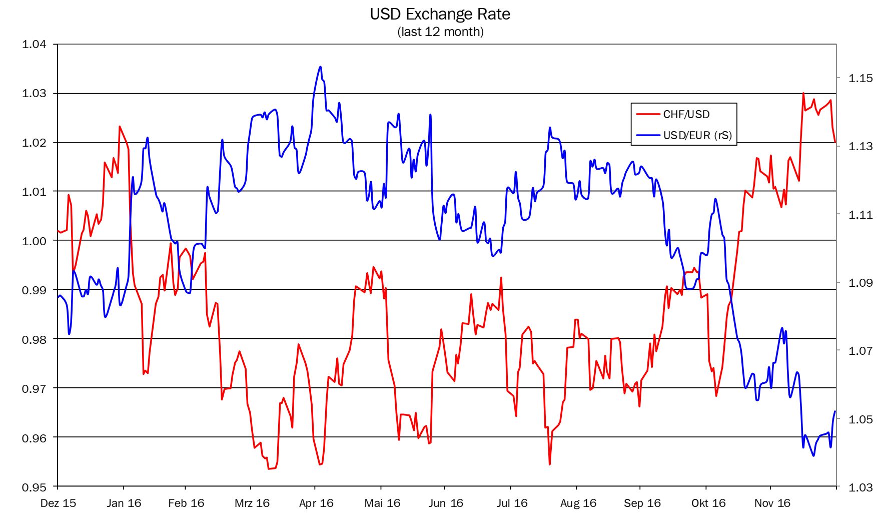

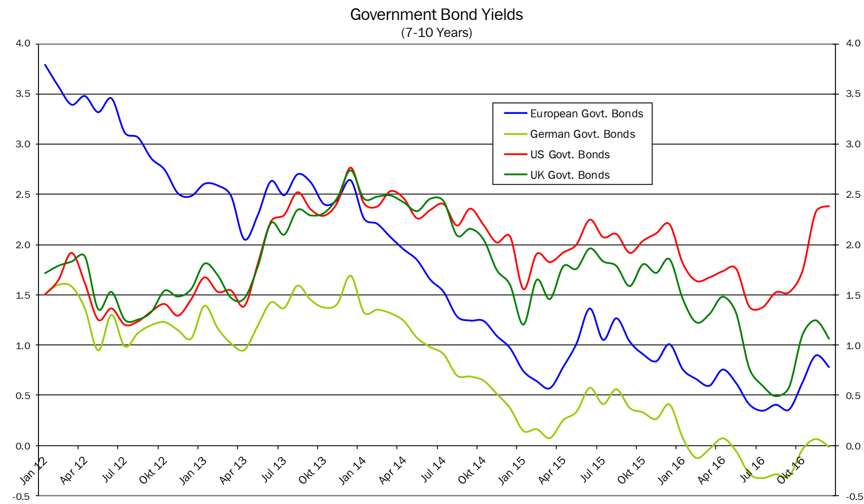

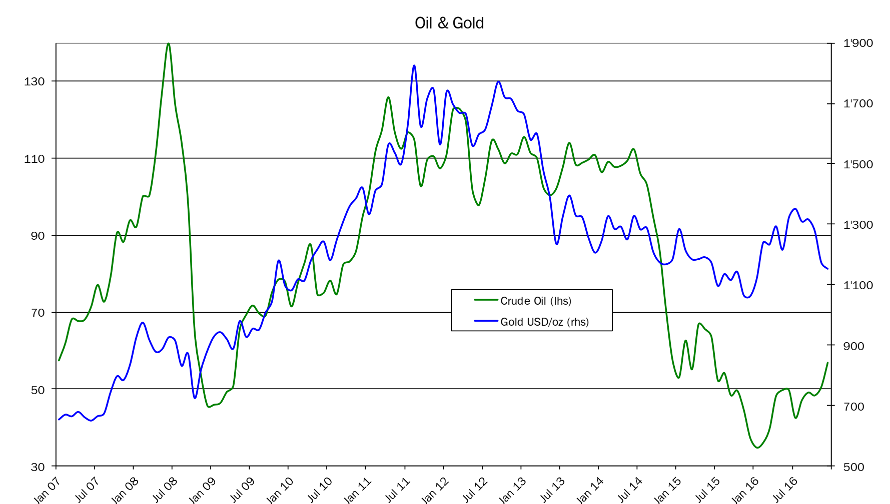

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