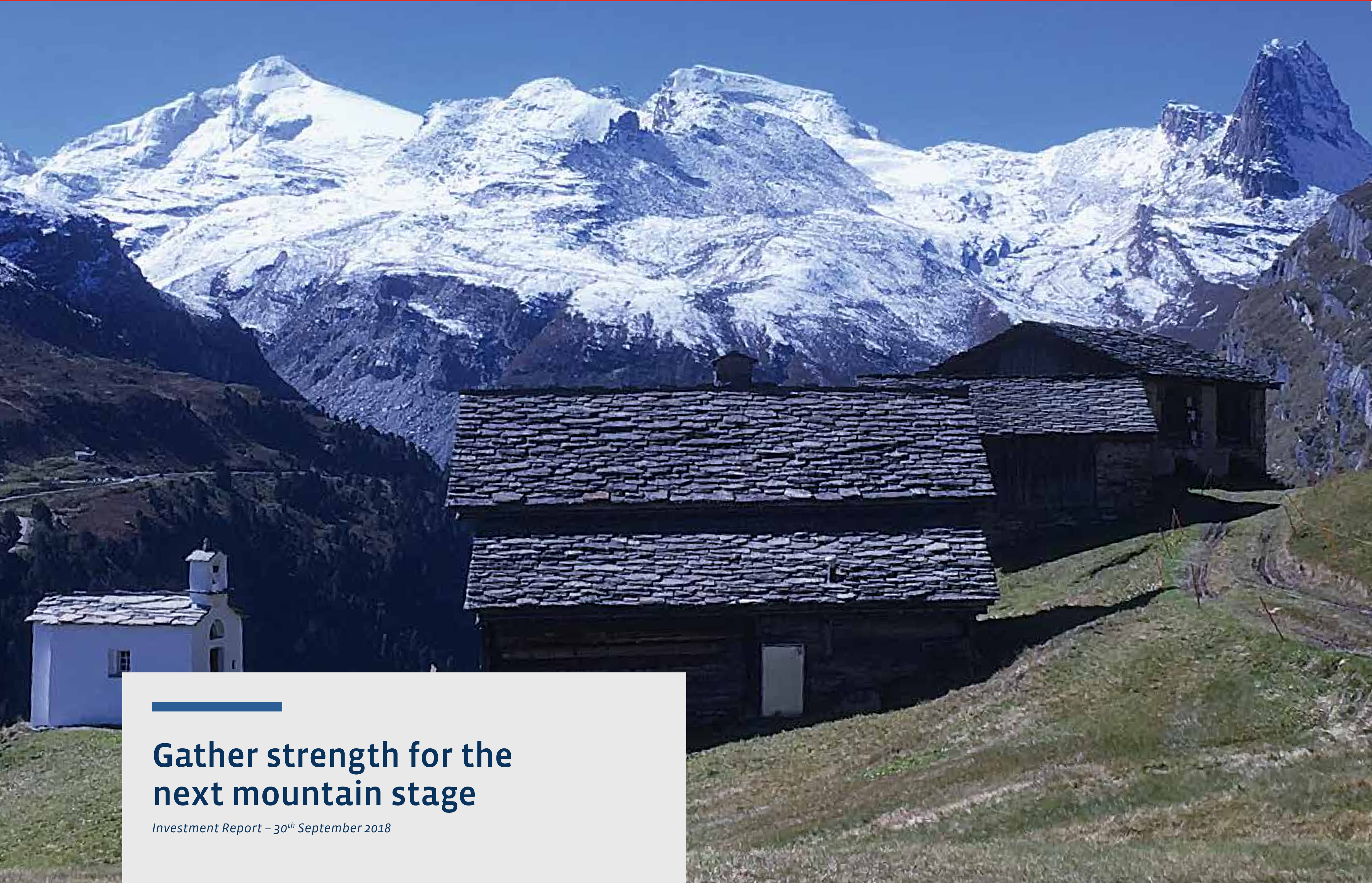
SALMANN
INVESTMENT MANAGEMENT



Gather strength for the next mountain stage

Investment Report – 30th September 2018

Gather strength for the next mountain stage

On the surface of it, the summer months passed rather quietly. The major exchanges were trending sideways, like most of the European ones for example, or more or less upwards, such as Switzerland, Japan and the USA. A rumbling could be heard from emerging countries like Turkey and Argentina, as well as from gold that shone only faintly. Fixed interest securities suffered from the negative impact of rising rates. The economic upswing lost its verve, politics continued to keep markets on their toes.

Economically, the world is thriving. Gross Domestic Product (GDP) is to rise in most countries this year, unemployment is declining and consumers are in good spirits. True, the economic engine is decelerating, but overall the outlook remains positive well into next year.

However, the political landscape is looking less rosy. The USA-China trade war has pushed the temperature of this relationship down into frosty climes. The UK and EU are headed in a similar direction over Brexit. Brussels and Rome are whetting their knives over the Italian household budget. The list of domestic and foreign policy tensions could be added to as you wish.

The fact that not everything is coming up roses is one of the reasons behind the patchy performance on financial markets. Various seismographs have also been recording readings on currencies too; amongst these is the Euro. It declined markedly during the past quarter, whereas the Dollar strengthened.

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

	Real GDP Growth		Inflation	
	2018	2019	2018	2019
China	6.6%	6.3%	2.1%	2.3%
Germany	2.0%	2.0%	1.8%	1.7%
Euroland	2.1%	1.8%	1.7%	1.6%
United Kingdom	1.3%	1.4%	2.4%	2.1%
Japan	1.1%	1.2%	0.9%	1.2%
Switzerland	2.2%	1.9%	0.8%	0.9%
USA	2.9%	2.5%	2.5%	2.3%

Spreads are widening

True, interest rate differentials do play an important role here. While borrowing costs in America are on the rise – the Federal Reserve (in short Fed) hiked rates another ¼ percentage point in September to the current 2.25% – in the Eurozone they remain stuck in the basement. On top of all this, political concerns weigh in, such as most recently, about Turkey and Italy.

In case of Turkey, the concern is on the one hand, a possible spill-over into other countries. French, Italian and Spanish banks, in particular, have outstanding loans to Turkey and, what is more, to Turkish banks and companies. The decline in the Lira will make it ever more challenging for borrowers to serve interest and capital repayments on these loans, denominated largely in foreign currency. On the other hand, investors tend to navigate their assets towards safe havens during times of crises.

Change in **Equity Markets since the beginning of 2018:**

		Dec. 2017	Sept. 2018	Change
Asia ex Japan	DJ STOXX A/P	538.7	509.3	-5.5%
Germany	DAX	12'917.6	12'246.7	-5.2%
Europe	DJ STOXX 600	389.2	383.2	-1.5%
Japan	TOPIX	1'817.6	1'817.3	0.0%
Switzerland	SPI	10'751.5	10'807.8	0.5%
USA	S & P 500	2'673.6	2'914.0	9.0%
World	MSCI World	513	524.3	2.2%
Hedge Funds	HFRX Global HF	1'275.5	1'259.9	-1.2%

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

Discovering wealth.

Flexibility and creativity are key.

The Bel Paese is also doggedly "defending" its top-ranking position on the fear barometer. The plan to increase the government deficit to compensate for tax deficits and to finance increased pension spending, has Brussels as well as investors, worried. How the 2019 Budget (as yet to be detailed), with a shortfall of 2.4% of GDP, will be received by the EU Commission remains to be seen. Already now, the odds are on that there is going to be little, if any, enthusiasm. Italy cannot afford a further increase in indebtedness. Currently, its liabilities amount to over 130% of GDP, which in a European context means second place in the masters-of-debt ranking, behind Greece.
Bond markets have already made up their minds, as the marked increase in yields on 10-year Italian government bonds to 3.14% testifies. Even more telling is their spread (yield difference) to German Bundesanleihen. Currently, the BBB-rated Italy has to pay 2.63 percentage points more than AAA-rated Germany. This is nearly double that of next-placed Portugal, and just one percentage point less than frontrunner Greece.

Since the beginning of the year, yields on **10-year government bonds** have increased:

	Dec. 2017	Sept. 2018	Change
Europe	0.43%	0.47%	9%
United Kingdom	1.19%	1.57%	32%
Japan	0.05%	0.13%	160%
Switzerland	-0.15%	0.04%	127%
USA	2.41%	3.06%	27%

Bond yields rose in the USA too, however, for a better reason. The economic upswing continues. The job market is in top form. Initial jobless claims declined once again, and the number of weekly hours worked went up. Effectively, full-employment has been achieved, which amongst others, is evidenced by faster wage increases. Many companies are reporting difficulty in recruiting suitable staff. Consumers are feeling generous, and inflation is accelerating.

Hence, the latest hike in interest rates does not come as a surprise. In addition, the Fed is sticking with its intention to continue hiking rates this year, as well as next. According to the Taylor Rule, a formula to estimate the correct benchmark rate named after the American economist of the same name, the Fed Funds Rate should now be above 6% already.

Problem-zone emerging market debt

What could put the brakes on the current upswing in interest rates? Currently, only a pronounced crisis, perhaps arising as a consequence of the rising US Dollar in the emerging economies. In this respect, the "Bank Credit Analyst", an independent Canadian research institute, calls the in US Dollars-denominated debt of such nations, a ticking time-bomb.

Relative to their economic output, as well as exports of these countries, US Dollar-denominated debt is back at the high levels of the late nineties. At that time, the crashes in local currencies (led by the Thai Baht) vis-a-vis the Greenback triggered economic turbulence and a bear market, first in Thailand, Indonesia and South Korea and later globally, making its way into history books as the "Asian Crisis".

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

Aberdeen Asia Pacific (USD)	-6.0%
Swiss Rock Emerging Markets Equities (USD)	-6.7%
GAM Japan Stock Fund (CHF hedged)	-0.5%
GAM Japan Stock Fund (€ hedged)	-0.6%
Strategy Certificates SIM–Swiss Stock Portfolio Basket	0.1%
iShares Stoxx Europe 600 ETF (€)	1.4%
Performa European Equities (€)	0.6%
Performa US Equities (USD)	28.0%

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

Conclusion: Equities more attractive than bonds

Following the consolidation of these past months, we view equities as more attractive than bonds and consequently are slightly overweight in the first and underweight in the latter in a balanced portfolio. The upswing in interest rates in the USA is to continue. In contrast, borrowing costs in Europe are to remain low, with few exceptions.

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 will decline marginally due to the planned purchase of a fund (see Equities USA). During the past quarter, it remained stable at a slight overweight level.

Bonds
Again, it was a tiresome three-month period for bond holders. A gradual rise in yields weighed on prices of existing positions without providing for an attractive environment for new engagements. An exception being the Dollar Zone, where a more normal environment is now prevailing, with the interest rates being paid living up to their name. Which is the reason why we sold half of our gold position for US Dollar referenced portfolios and reinvested the proceeds in corporate bonds. Apart from this, no changes have been made.

Other funds employed by us
developed as follows:

Acatis IfK Value Renten Fond (€)	-4.9 %
Acatis IfK Value Renten Fond (CHF hedged)	-5.2 %
BCV Liquid Alternative Beta (€ hedged)	-0.5 %
BCV Liquid Alternative Beta (CHF hedged)	-0.8 %
BCV Liquid Alternative Beta (USD)	1.6 %
Franklin Templeton K2 Alternative Strategies Fund (€ hedged)	0.5 %
Franklin Templeton K2 Alternative Strategies Fund (CHF hedged)	0.0 %
Franklin Templeton K2 Alternative Strategies Fund (USD)	2.4 %
Lyxor ETF Euro Corp. Bond Fund (€)	-0.6 %
New Capital Wealthy Nations Bond Fund (€ hedged)	-4.0 %
New Capital Wealthy Nations Bond Fund (CHF hedged)	-4.2 %
New Capital Wealthy Nations Bond Fund (USD)	-1.9 %
Pictet CH-CHF Bond Fund	-1.5 %
Swiss Rock Absolut Ret. Bond Fund (€ hedged)	-1.8 %
Swiss Rock Absolut Ret. Bond Fund (CHF hedged)	-2.0 %
UBAM Corporate USD-Bonds (€ hedged)	-3.2 %
UBAM Corporate USD-Bonds (CHF hedged)	-3.6 %
ZKB ETF Gold (USD)	-9.5 %

Performance incl. reinvested dividends where applicable.

Experiencing wealth.

Every client has top priority.

Equities Switzerland
As measured by the Swiss Performance Index (SPI), Swiss stocks performed well during the third quarter and are up 4.7%, managing to repair the dent suffered mid-year. The weighting did not experience any changes during the past months.

Year to date, the total return of the directly-invested "Swiss Stock Portfolio" (SSP) amounted to 0.4% (including dividends). With that, it came in a sliver below the benchmark index SPI (Total Return) with a plus of 0.5%. Since 2010, the SSP's annual performance amounts to 11.7%, a result that clearly beats the benchmark performance of 7.8%. Since 2010, this strategy's cumulative total return amounts to about 162%. The SSP figures bear transaction costs and withholding taxes, whereas the benchmark index does not bear any costs.

The "Strategy Certificates linked to the SIM Swiss Stock Portfolio Basket" (Valor: 36524524, ISIN: CH0365245247) rose 4.1% during the third quarter and with that, also lifting its 2018 performance above the zero-line with a positive 0.1% return.

Equities Europe
By and large, European equities trended sideways during the reporting period. The directly-invested "European Stock Portfolio" (ESP) managed to expand its performance slightly since the beginning of the year, closing at the end of September up 0.7%. With this result, it missed its benchmark's performance, the Stoxx 600 Index, by a hair's breadth, i.e. 0.2 percentage points. Both figures are total return, meaning they include price changes as well as dividends.

Since 1993, this equity selection's average annual performance amounts to about 9%, compared to the 7% achieved by the above-mentioned broad 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 892%. We have not made any changes to the positions during the third and carry an unchanged neutral weighting in European equities.

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

	Dec. 2017	Sept. 2018	Change
DAX Index/DE	19	14.4	-24.2%
DJ STOXX 600 Index/EU	20.8	17.3	-16.8%
MSCI World Index	20.7	17.8	-14.0%
S & P 500 Index/USA	22.5	21.1	-6.2%
SPI Index/CH	13.2	12.7	-3.8%
TOPIX Index/JPN	16.3	14.1	-13.5%

Source: Bloomberg

Equities USA
US companies are doing as well as can be. 2018 could turn out to be one of the best years since the financial crisis, and increase earnings per share of S&P-500 companies by about 20% on average. Part of the impetus, however, has to be attributed to the stock repurchases financed by companies repatriating foreign profits. During the second quarter alone, these are said to have amounted to well in excess of 200 billion US Dollars. About double that amount in share buy-backs already announced is still pending.

Just before the end of the quarter, we decided to establish a position in the BB Adamant Medtech & Services Fund. This fund, from the Swiss provider, Bellevue Asset Management, invests in companies in the healthcare sector excluding pharmaceutical producers. Under the headline "digital health", these companies seek to improve efficiency and cost effectiveness in the healthcare sector. Minimally-invasive techniques and optimised processes are to cut treatment periods and cost, as well as to increase the well-being of patients. The fund's assets currently amount to about 427 million Swiss Francs. It carries a 5-Star rating from Morningstar, as well as an AAA-rating from Citywire. As the bulk of the capital is currently invested in American companies, we will attribute this investment to the US equity allocation in our reporting. The purchases will be executed during the course of October.

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

	Price/Book	Div. Yield
DAX Index/DE	1.7	3.1%
DJ STOXX 600 Index/EU	1.9	3.5%
MSCI World Index	2.3	2.4%
S & P 500 Index/USA	3.5	1.8%
SPI Index/CH	2	3.1%
TOPIX Index/JPN	1.4	2.0%

As for the existing engagements, the Performa US Equity Fund again provided reasons to be pleased. During the third quarter alone, it rose by a good 9%, and in so doing, raised its year-to-date performance to 28%. With this result, it beat its benchmark markedly. Smaller companies in particular, provided for much of the impetus within the fund. Together with the BB Adamant engagement, we are now overweight American equities.

Equities Asia (excluding Japan)
Emerging market equities remained under pressure. Rhetoric and measures taken by the White House, in particular targeting China, the evolution of US Dollar and American interest rates, as well as rising oil prices, all add to international investors' reserved sentiment vis-a-vis emerging economies. We are currently neutral weight.

Equities Japan
We left the GAM Equity Fund position unchanged during the quarter, and so maintained our neutral weight. By comparison, both against stocks of other countries, as well as against their own historical data, Japanese equities are valued attractively. In the first nine months of 2018, the fund's performance just about matches that of the broader market. The suspension of the fund manager, Tim Haywood, who managed a different vehicle, and the subsequent liquidation of that vehicle, in no way impacted the Japan equity fund held by us. The asset manager GAM, with its Far-East experts we have known for a long time, continues to manage the Japan fund in the usual reliable manner.

Alternative Investments
The positioning in alternative investments remained unchanged throughout the quarter. Prices moved only marginally, and the alternatives proved their worth in their role as a buffer against volatility from equities, bonds and gold.

Precious Metals
Gold shone only faintly in the third quarter. Amongst others, the price trend is linked to rising US Dollar rates, rendering interest rate-bearing instruments denominated in US Dollars more attractive versus the non-interest-bearing precious metal. This is also the reason why we halved the gold position in US Dollar-referenced portfolios, as the original argument to buy (gold is a reserve currency without opportunity cost) lost significance. We invested the proceeds in US Dollar bonds. Quite possibly, sales by emerging countries, above all Turkey, may have hurt the metal's price. It is quite possible that Turkey attempts to stabilise the country's tumbling currency by switching gold into Lira.

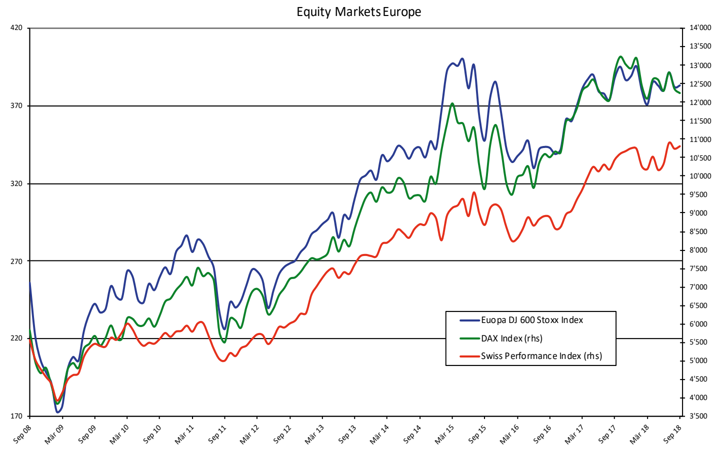
Summary of our current
Asset Allocation:

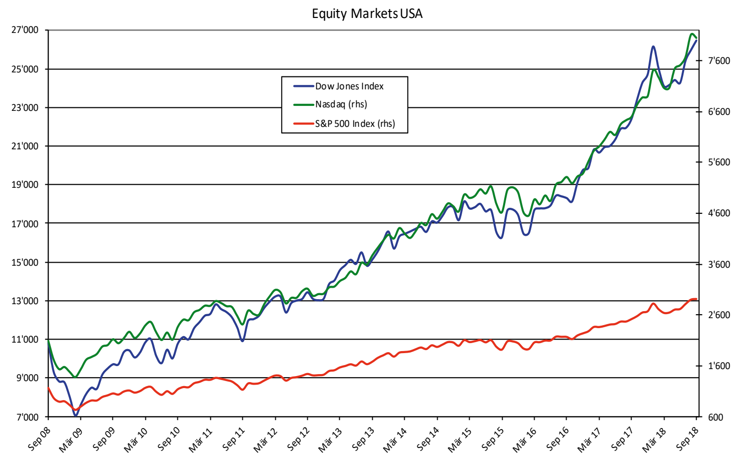
Asset class	
Money Market	neutral
Bonds	underweight/ short duration
Equities Switzerland	neutral
Equities Europe	neutral
Equities USA	overweight
Equities Asia	neutral
Equities Japan	neutral
Precious Metals	overweight
Alternative Investments	overweight

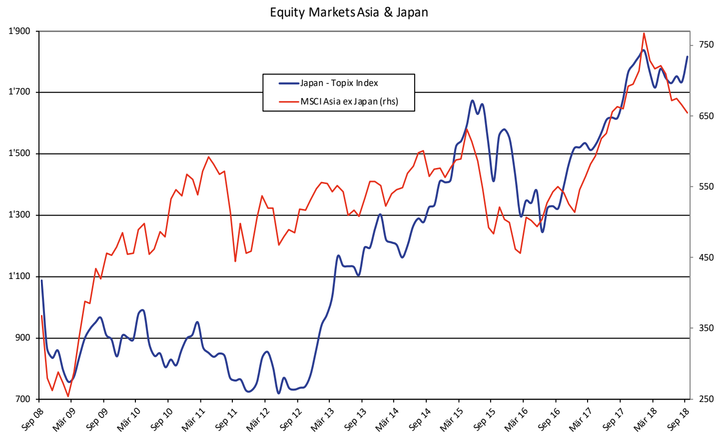
For a Swiss Franc referenced portfolio.

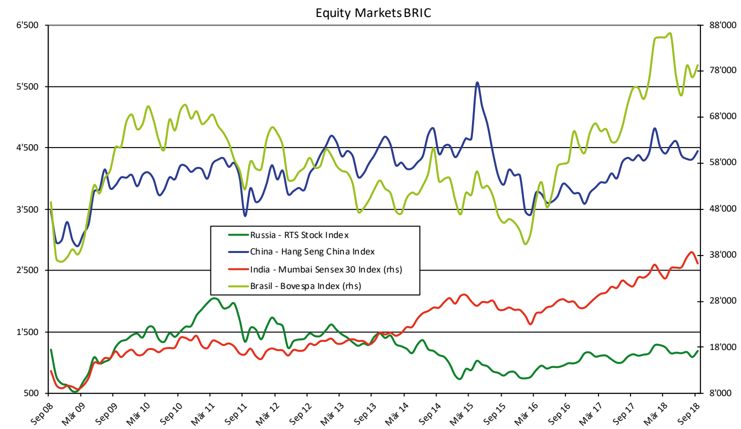
Managing wealth.
Precise and thorough analysis enhances return.

Equity markets at a glance

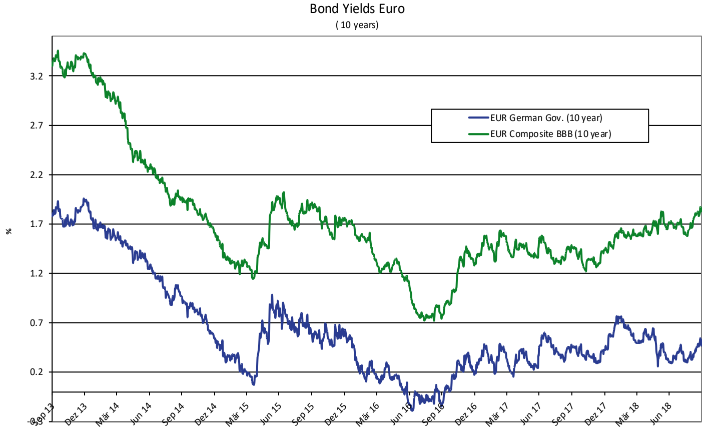


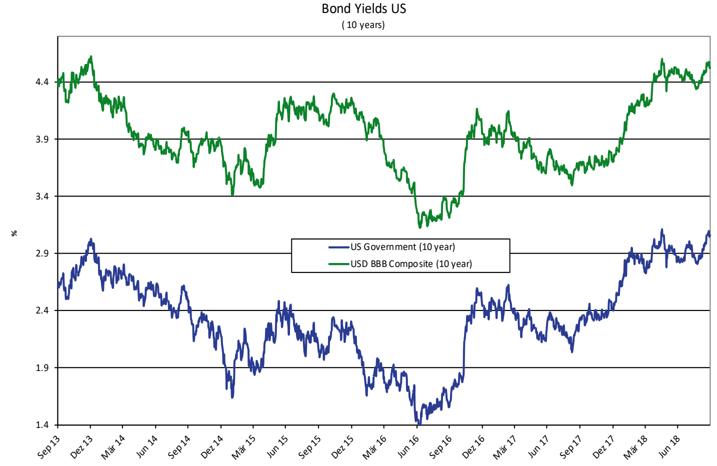


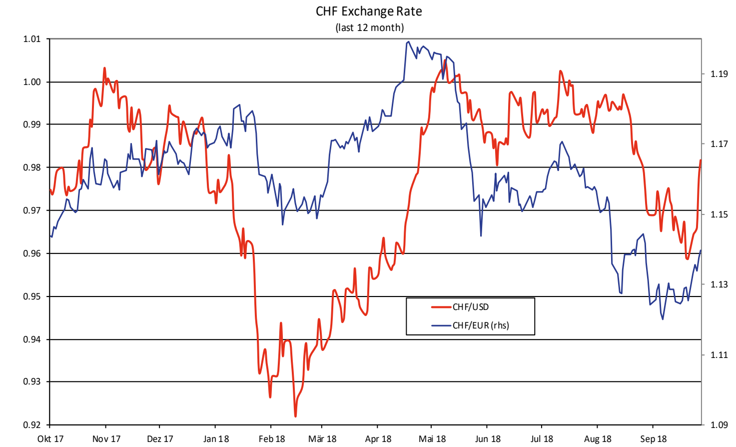


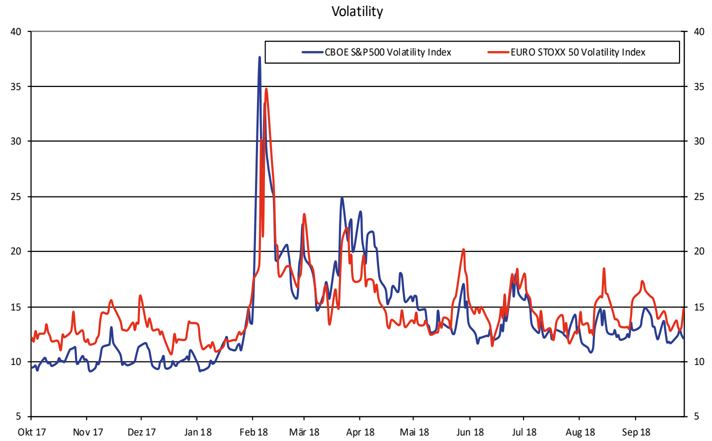


Bond yields and other indicators









Notes

Source of the following graphics: Bloomberg

SALMANN
INVESTMENT MANAGEMENT

Closing words

We wish you many golden autumn days and thank you for your 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