SALMANN
INVESTMENT MANAGEMENT

Investment Report – 30th September 2014

Markets climb the Wall of Worry

“Bull markets like to climb the Wall of Worry”, this well-known saying accurately describes the mood of the moment. Headlines abound in droves that are capable of spoiling the day for investors and consequently, are good reasons for every logically-thinking non-market operators’ sweeping sadness about financial markets. In spite of all this, equities have done rather well during the course of the year so far (which in its own right is again rather disconcerting to our sceptical peers). Quotes for bonds continue to rise briskly despite the thin air of the high altitudes. Only gold, silver and oil, usually sought-after assets in times of crises, were left out in the cold and are experiencing falling prices.

“America, you’ve got it better…”

Apart from the geopolitical tensions in the Ukraine, Syria, Iraq and others, the economy is also sending out disappointing signals. It appears that growth in the USA and Europe is also unlikely to meet expectations to the full. “America you’ve got it better than our old continent”, Goethe already romanticised. Looking at today’s economic data, he would arguably make a similar remark today. The earlier growth projections for the American Gross Domestic Product (GDP) of up to 3% are unlikely to be met this year. Currently, average expectations are at 2%, with economist’s consoling us with predictions of stronger growth next year.

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

	Real GDP Growth		Inflation	
	2014	2015	2014	2015
Germany	1.7%	1.8%	1.0%	1.7%
Euroland	0.9%	1.3%	0.6%	1.0%
United Kingdom	3.2%	2.8%	1.7%	1.9%
Japan	1.3%	1.2%	2.8%	1.8%
Switzerland	1.9%	2.2%	0.1%	0.7%
USA	2.0%	3.0%	1.9%	2.2%

In Germany and Switzerland, a dent is also beginning to appear. With 1.7 and 1.9% respectively for this year, and 1.8 and 2.2% respectively in the coming year, both countries are impressive. However, the Eurozone is not getting into gear at all. There, the search for a culprit has shifted slightly northwards. Whereas, for example, Spain was until recently amongst the usual suspects in the search for the culprit responsible for the lull, the Iberian Kingdom can in the meantime point to its above European average growth. For 2014, the ”Economist’s” pundits believe Spain is capable of producing 1.1% growth, while Madrid is expecting 1.3%. The drastic treatment undergone in recent years appears to be taking effect.

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

		Dec. 2013	Sept. 2014	Change[1]
Asia ex Japan	DJ STOXX A/P	506.4	497.3	-1.8%
Germany	DAX	9,552.2	9,474.3	-0.8%
Europe	DJ STOXX 600	328.3	343.1	4.5%
Japan	TOPIX	1,302.3	1,326.3	1.8%
Switzerland	SPI	7,838.0	8,695.6	10.9%
USA	S&P 500	1,848.4	1,972.3	6.7%
World	MSCI World Index	408.6	416.9	2.0%

In contrast, France is increasingly becoming a cause for concern. “Much ado about nothing”, one is tempted to say. Economic entities are comporting themselves with corresponding disillusionment. Faced with unemployment persisting at high levels, this does not come as a surprise. Whereas it rose in the “Grande Nation” to 10.5% against the wider EU trend (EU average 10.1%), on the Iberian Peninsula unemployment has been declining during the course of the past twelve months.

The fact that stock exchanges are doing so well in such an environment may come as a surprise. On closer inspection, however, it becomes clear what is pushing prices up; the monetary glut initiated by central banks. Just a quick reminder, since 2008 and the onset of the global financial crisis, the five most important central banks in the

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

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developed world, the European Central Bank (ECB), the US Federal Reserve (Fed), the Bank of England, the Bank of Japan and the Swiss National Bank have increased their cumulative balance sheet totals by a factor of three. True, in the current year the Fed has taken its foot off the accelerator slightly by continuously cutting back bond purchases with a view to stopping entirely in October. The ECB will now step into the breach in its place. It is now to introduce a bond and collateralised debt buying programme of this sort in order to support the ailing economy of the Old World.

Since the beginning of the year, **yields on 10-year government bonds** fell in all countries:

	Dec. 2013	Sept. 2014	Change
Europe	1.9%	0.95%	-50%
United Kingdom	3.0%	2.43%	-19%
Japan	0.7%	0.53%	-24%
Switzerland	1.1%	0.49%	-55%
USA	3.0%	2.49%	-17%

Flaunting all prophecies of doom, the economy is growing

Since in the wake of these measures loans come nearly for free and the yields on fixed interest securities are very low, investors have little choice but to invest in equities. Indeed, these are not quite as attractively valued as has been the case in the past. On the other hand, it would not be right to talk of a crass overvaluation. Above all, despite the to-ing and fro-ing which gets the “normal” fluctuations of growth rates into the headlines, one should not forget that ultimately the world economy is growing, albeit hesitantly. In all probability it will continue to do so in 2015, and possibly even a bit faster than in the current year.

So much for the good news. The not-so-good news lies hidden in the question as to how markets will react once the central banks (have to) close the flood gates. The past does not offer a guide on this, as the stabilisation programs currently underway are of a dimension never before seen. Only Japan has massively skimmed off liquidity during the years 2005 and 2006. At the time, industrial production and stock prices hardly reacted negatively at all to this measure and it was only about two years later that the collapse came during the course of the global crisis. Will this process be similarly painless for the USA and Europe? One will have to wait and see.

Commentary on 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: Early in the third quarter, we invested part of the liquidity in a bond fund (see “Bond” paragraph). This apart, we continue to hold liquidity over and above the long-term strategic target.

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

Aberdeen Asia Pacific (USD)	**5.6%**
JB Japan Stock Fund (CHF hedged)	**6.0%**
JB Japan Stock Fund (€ hedged)	**6.2%**
Performa Asian Equities (USD)	**2.0%**
Black Rock Swiss Small & Midcap Opp. (CHF)	**9.7%**
Raiffeisen Futura Swiss Stocks (CHF)	**9.9%**
CIIM European Stock Portfolio (EUR)	**-1.0%**
Performa European Equities (EUR)	**4.9%**
Performa US Equities (USD)	**-3.2%**
Perkins US Strategic Value (USD)	**4.5%**

Bonds: Early July we built positions in the Swiss Rock Absolute Return Bond Fund (CHF and EURO hedged). This fund invests in international fixed-interest securities of sound companies whereby the currency risk is hedged and the duration kept very short. The fund is highly diversified. Banking debt and bonds from southern European countries are avoided. Apart from this, there was no change in this asset class. The market has settled down at extremely low yield levels. Issuers are looking to take advantage of the

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

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low interest rate levels by issuing longer term paper, making it even more difficult for investors to find suitable investments.

Equities Switzerland: The Swiss equity market is among the best performing markets in the world in 2014. We have not made any changes to the allocation and continue to be neutrally weighted. In direct investments, our selection of equities in the "Swiss Stock Portfolio" (SSP), achieved a performance of 7.5% during the first nine months, while the Swiss Performance Index rose by about 10.9% (both including dividends). The total annual performance of the SSP since 2010 amounts to 9.6% per annum and with that corresponds exactly to its benchmark.

Equities Europe: We are neutral weight in European stocks too. The directly-invested "European Stock Portfolio" (ESP) achieved a total return (price plus dividends) of 5.8% by the end of September. The Dow Jones Stoxx 600 Index added 7.0% during the same period. Since 2004, the average annual performance of the directly invested portfolio amounts to 9.7%, compared to 6.9% for the benchmark.

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

Fund	Performance
Acatis IfK Value Renten Fond (EUR)	**5.3%**
Acatis IfK Value Renten Fond (CHF)	**5.0%**
BlueBay High Yield Bond Fund (EUR)	**2.5%**
Lyxor ETF Euro Corp. Bond Fund (EUR)	**5.4%**
New Capital Wealthy Nations Bond Fund (EUR)	**6.2%**
New Capital Wealthy Nations Bond Fund (CHF)	**6.0%**
New Capital Wealthy Nations Bond Fund (USD)	**6.3%**
Pictet CH-CHF Bond Fund	**4.7%**
Swiss Rock Absolute Ret. Bond Fund (€ hedged) [4]	**0.4%**
Swiss Rock Absolute Ret. Bond Fund (CHF hedged) [5]	**0.2%**

Equities USA: True, American equities are fundamentally more expensively valued than the European but continue unchanged to benefit from higher growth dynamics displayed in the US vis-à-vis Europe. Currently, the allocation of US Stocks in a balanced portfolio amounts to about 9%. With that, they are neutral weight, just as in the previous quarter.

Equities Asia (excluding Japan): Asian exchanges gave some ground during the third quarter. We have not made any changes to the allocation, and with a 5% share we are slightly overweight when compared to the strategic target.

Equities Japan: Nippon's equities partially recovered from the losses suffered during the first quarter. The position remained unchanged in the portfolios and with an allocation of about 4% we are neutral weight in the Land of the Rising Sun.

Summary of our current **Asset Allocation**[6]**:**

Investment Category	
Money Market	overweight
Bonds	underweight/short duration
Equities Switzerland	neutral
Equities Europe	neutral
Equities USA	neutral
Equities Asia	overweight
Equities Japan	neutral
Non-traditional assets	no position

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

	Price / Book	Div. Yield
DAX Index/DE	1.7	2.8%
DJ STOXX 600 Index/EU	1.9	3.6%
MSCI World Index	2.0	2.6%
S & P 500 Index/USA	2.7	2.0%
SPI Index/CH	2.5	3.0%
TOPIX Index/JPN	1.3	1.7%

[3] Performance incl. re-invested dividends where applicable
[4] Performance since purchase July 2014
[5] Performance since purchase July 2014
[6] For a Swiss Franc referenced portfolio

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Measured on the **price/earnings ratio**[7] using the latest 12 months profit figures, some equity markets have become dearer (red) since the beginning of the year while others turned more attractive (green):

	Dec. 2013	Sept. 2014	Change
DAX Index/DE	16.3	17.7	**+9%**
DJ STOXX 600 Index/EU	21.6	20.8	**-4%**
MSCI World Index	17.9	17.0	**-5%**
S & P 500 Index/USA	17.4	17.9	**+3%**
SPI Index/CH	19.2	19.6	**+2%**
TOPIX Index/JPN	17.3	16.0	**-8%**

And finally this

Football fans are delighted; it is Champions League time again, the time when modern day gladiators in fully booked arenas provide for emotions, thrills and ringing cash tills in front of live TV cameras.

What market capitalisation (number of outstanding shares multiplied by price) is for listed companies, is the transfer value (the sum of the estimated transfer values of their players) for the soccer clubs participating in Europe's top league. According to the internet site "transfermarkt.de", chart-topper Real Madrid weighs in with a value of 673 million Euros, with Christiano Ronaldo alone contributing about 100 million, closely followed by archrival FC Barcelona with 611 million Euros. Its Lionel Messi contributes 120 million Euros. Third place goes to FC Bayern Munich, to whom the observers attribute a transfer value of about 564 million Euros. The top player here is Robert Lewandowski with a price tag of 50 million Euros.

"Typical soccer", you may snort derisively, "totally excessive personality cult!" This may well be. But compared to the world of finance, this is all rather trivial. There, celebrated personalities have quite different "transfer values", as the example of Bill Gross recently demonstrated. Gross, founder and until recently bond guru at the American investment fund provider Pimco recently announced his move to Janus Capital. This surprising transfer saw the market value of Pimco owner Allianz AG fall by about 4.9 billion Euros, or nearly 8%, in a single day. The market capitalisation of Janus Capital on the other hand shot up on that same day by about 736 million Euros, a sporty plus of 45%! So what was that remark about excessive personality cult in the sport and entertainment business?

We thank you for the trust placed in us and wish you many golden autumn days.

Alfred Ernst
Vaduz/Zurich, 30th September 2014

[7] Source: Bloomberg

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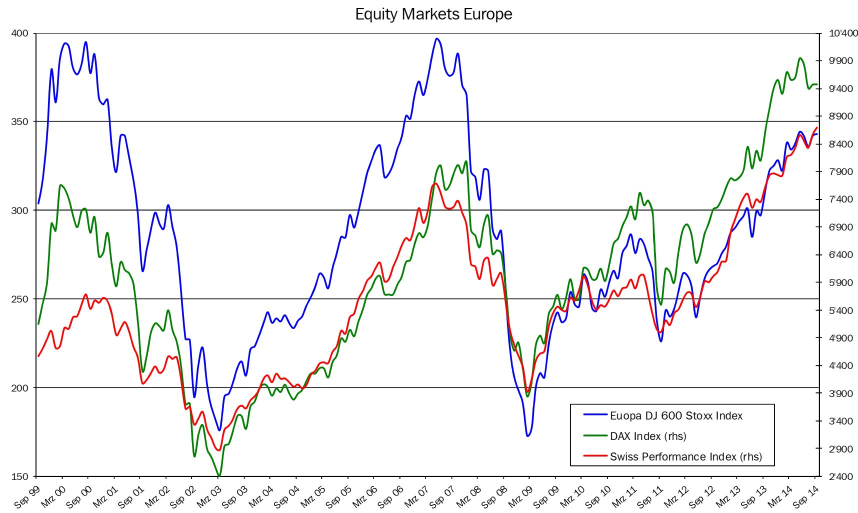
Equity Markets Europe
Euopa DJ 600 Stoxx Index
DAX Index (rhs)
Swiss Performance Index (rhs)
400
350
300
250
200
150
10'400
9'900
9'400
8'900
8'400
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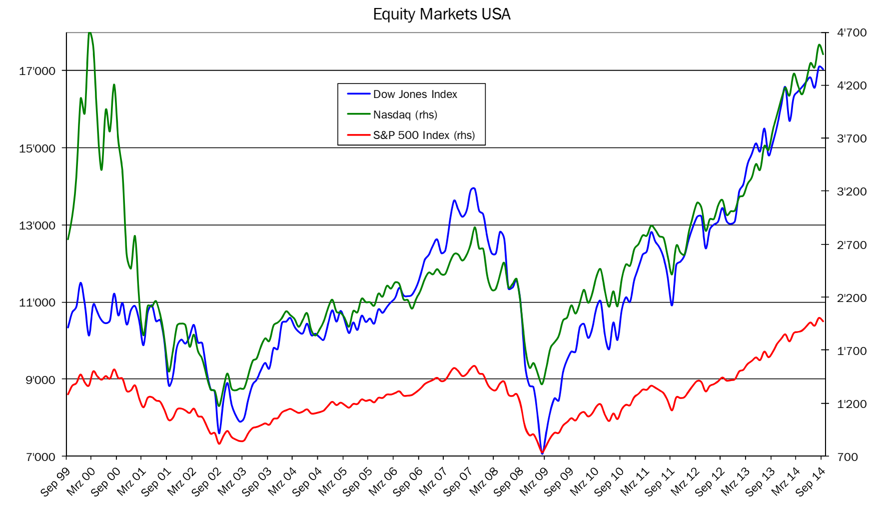
Equity Markets USA
Dow Jones Index
Nasdaq (rhs)
S&P 500 Index (rhs)
17'000
15'000
13'000
11'000
9'000
7'000
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4'200
3'700
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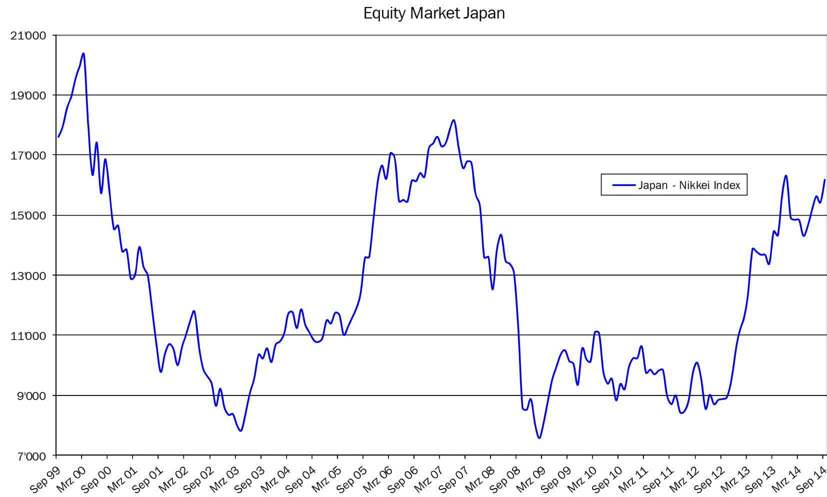
Equity Market Japan
Japan - Nikkei Index
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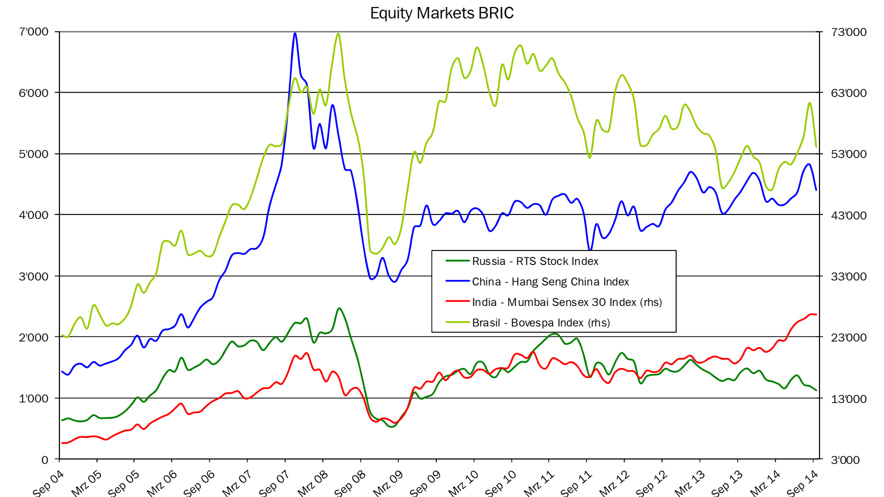
19000
17000
15000
13000
11000
9'000
7'000


Equity Markets BRIC
Russia - RTS Stock Index
China - Hang Seng China Index
India - Mumbai Sensex 30 Index (rhs)
Brasil - Bovespa Index (rhs)
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6'000
5'000
4'000
3'000
2'000
1'000
0
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63'000
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43'000
33'000
23'000
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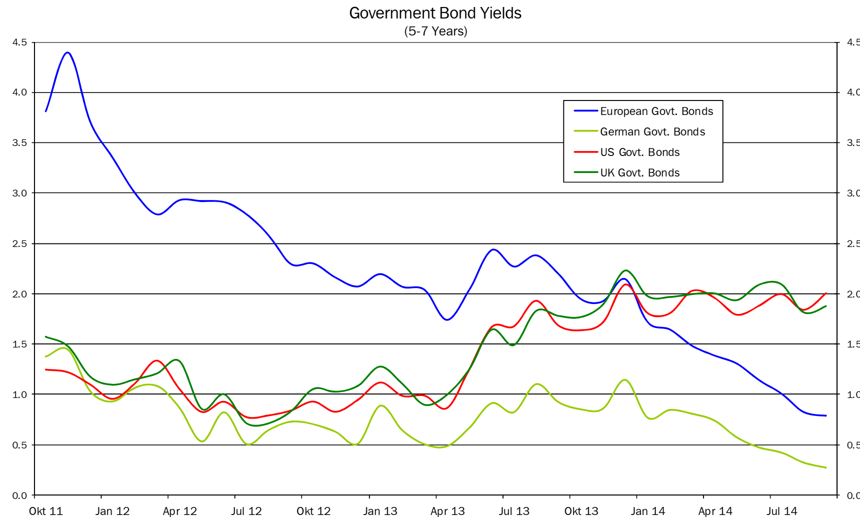
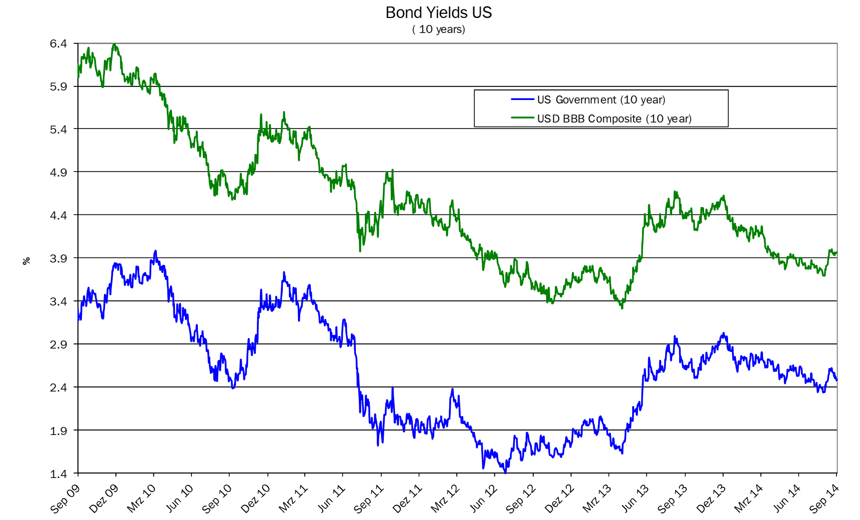
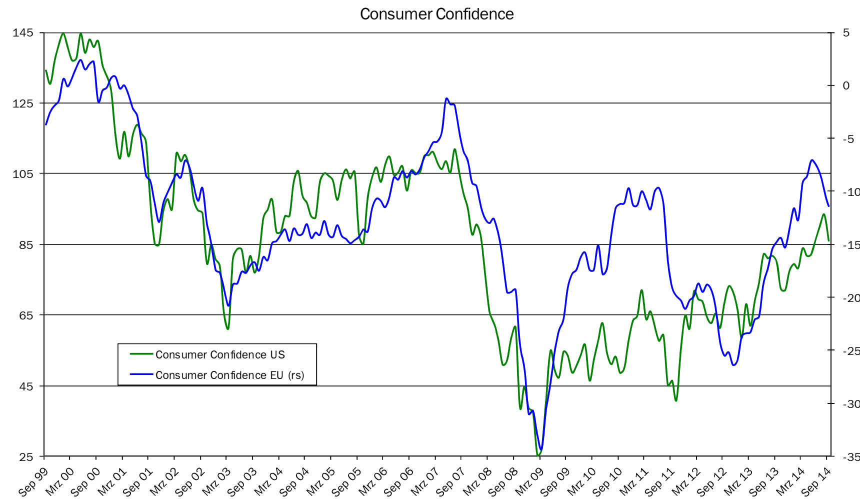
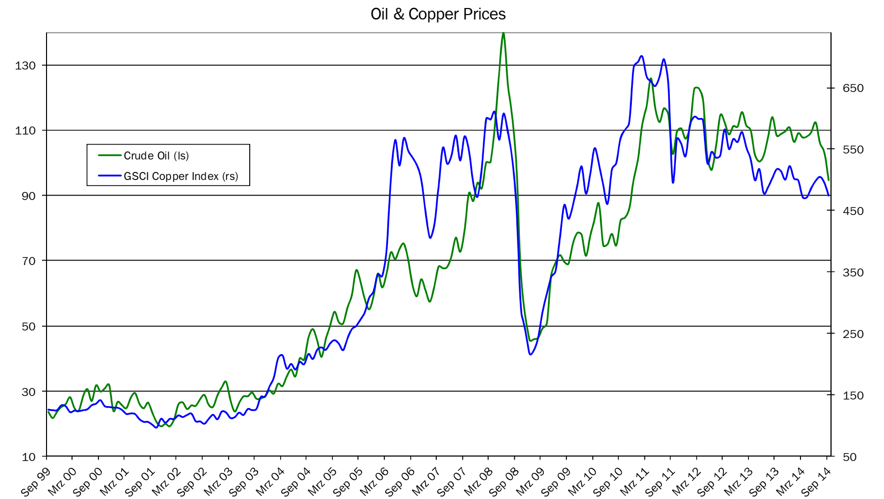
3'000


Government Bond Yields
(5-7 Years)
European Govt. Bonds
German Govt. Bonds
US Govt. Bonds
UK Govt. Bonds
Okt 11
Jan 12
Apr 12
Jul 12
Okt 12
Jan 13
Apr 13
Jul 13
Okt 13
Jan 14
Apr 14
Jul 14


Bond Yields US
(10 years)
US Government (10 year)
USD BBB Composite (10 year)
%


Consumer Confidence
Consumer Confidence US
Consumer Confidence EU (rs)


Oil & Copper Prices
Crude Oil (ls)
GSCI Copper Index (rs)