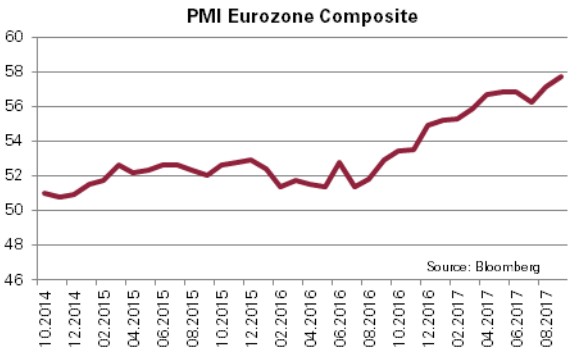
Investment Strategy October 2017

Global economy is in a synchronous upswing. Several factors call for caution and a slight underweight in equities.

Macroeconomic Environment

Synchronous upswing

In September, growth in Europe reached the highest level in 6 ½ years and chances are good to record even the strongest growth in 10 years. Global purchasing manager indices (PMI) remain at high levels, exception being emerging markets which exhibit some catch-up potential. The synchronous global upswing is pleasing and shows a solid gap to a recession scenario. The positive trend in the development of corporate profits (12-month rolling EPS) continued.



Geopolitical risks have somewhat cooled down recently. However, no solutions could be achieved. Trumps unpredictability, North Korea, Near and Middle East, Venezuela and Europe (Spain, formation of government in Germany, elections in Italy) remain in place. The markets seem to ignore these risks at the moment.

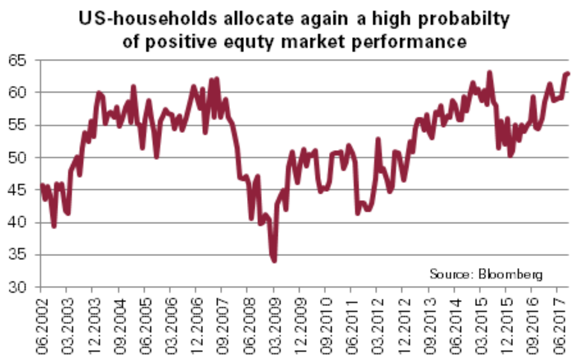
It is becoming apparent that the central banks will not make their monetary policy even more expansive. The US-Fed is expected to make another interest rate hike in December. The tone of the ECB is likely to be somewhat more pronounced at the October meeting (26.10.2017). On the one hand, central banks are not under immediate pressure due to low inflation rates and under-utilization of capacity. On the other hand, they have little "dry powder" because of low interest rates and could therefore raise interest rates more quickly than currently anticipated by market participants. In any case, we witness the bottoming out of interest rates after a 30-year period of interest rate reductions with only short interruptions. Investors will have to face this.

Last month we pointed to a divergent assessment of the economic situation by participants in equity and bond markets. Market development has at least for the time being proven stock markets right and let interest rates slightly increase. The interest rate curves have once again slightly steepend, which can be considered positive.

Equity Markets

Too much complacency?

September was a positive month for equities. Solid economic data provided the signal that enabled many indices to gain back their peak levels reached earlier in the year. The somewhat weaker Euro helped again European equities. However, there is evidence that retail investors are more and more amplifying the positive trend. US households regard equity investements as positive as for example shortly before the financial crisis (according to regular surveys conducted by the University of Michigan).



On the other hand, share buybacks of US-corporates are currently showing a negative development and indicators on market activity of hedge funds and other professional investors are tending sideways. Optimists consider that we are far from an euphoria. However, we deem the complacency of many investors as carrying the same risk potential. Negative news is ignored and the volatility is on record lows. The high valuations are often justified by the low interest rate environment, which may be true at first

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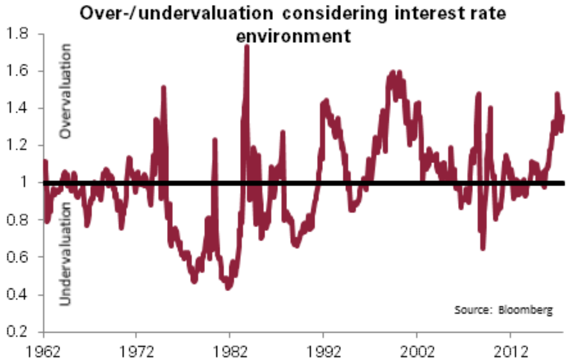
sight. Even when taking this factor into account, we nonetheless consider the valuations to be too expensive - especially of the leading exchanges in the USA. Based on historical data, we calculated a "fair" price-earnings ratio (P/E) for the S&P 500, taking into account the prevailing real interest rates (10-year Treasury minus inflation) and compared it with the current P/E ratio.



This indicates an overvaluation even taking into account the low interest-rate environment. Nevertheless, the current market boom could persist for a while.

We follow the motto **"forward but with foresight"** and therefore **leave the slight underweight in our equity allocation**. The protection of capital is a priority for us, and we place more weight on the risk of a market correction given high equity valuations and an impending policy change of central banks, as well as the diverse, unresolved geopolitical problems. In our view, the positive economic data are already priced in to a large extent. However, it is not advisable to abolish stock markets completely. We will take advantage of possible market advances - assessing the respective market situation - to further reduce the equity allocation.

Bonds

Diversification and flexibility

The indicators we are observing show us a neutral stance towards bonds at the moment, with corporate bonds being preferred to government bonds. We focus on diversification and flexibility in this asset class, which is why we are increasingly investing in solutions with a wide range of investment opportunities. The risk premiums (spreads) have narrowed sharply. We are cautious with high-yield bonds. We are talking to different specialists who are expecting some distortion in the high-yield bond market. We maintain the duration below that of the broad market; a problem that manifests itself in indexed investments the longer the more.

Gold and Currencies

Gold: Diversification and portfolio protection

We are convinced of physical gold holdings supplemented by goldmine stocks with a view to the many uncertainties and the risk of policy errors at central banks. An allocation in the range of 10% seems appropriate to us. The set-back in price towards the end of September can be seen against the beginning of the Chinese "Golden Week" and speculation about interest rate hikes. We see this as a temporary weakness and anticipate a new positive cycle in the yellow metal.

The weakness of the US-Dollar seems to be completed for the moment. Since we currently hold a neutral allocation to the US-Dollar and expect a possible range of fluctuation in the area of 1.15 to 1.23 against the Euro respectively 0.95 to 0.98 against the Swiss Franc, we do not currently see any immediate need for action. The elections in Germany and the squabbling around the independence of Catalonia have somewhat weakened the Euro, while the very positive economic development in the Eurozone supports the common currency.

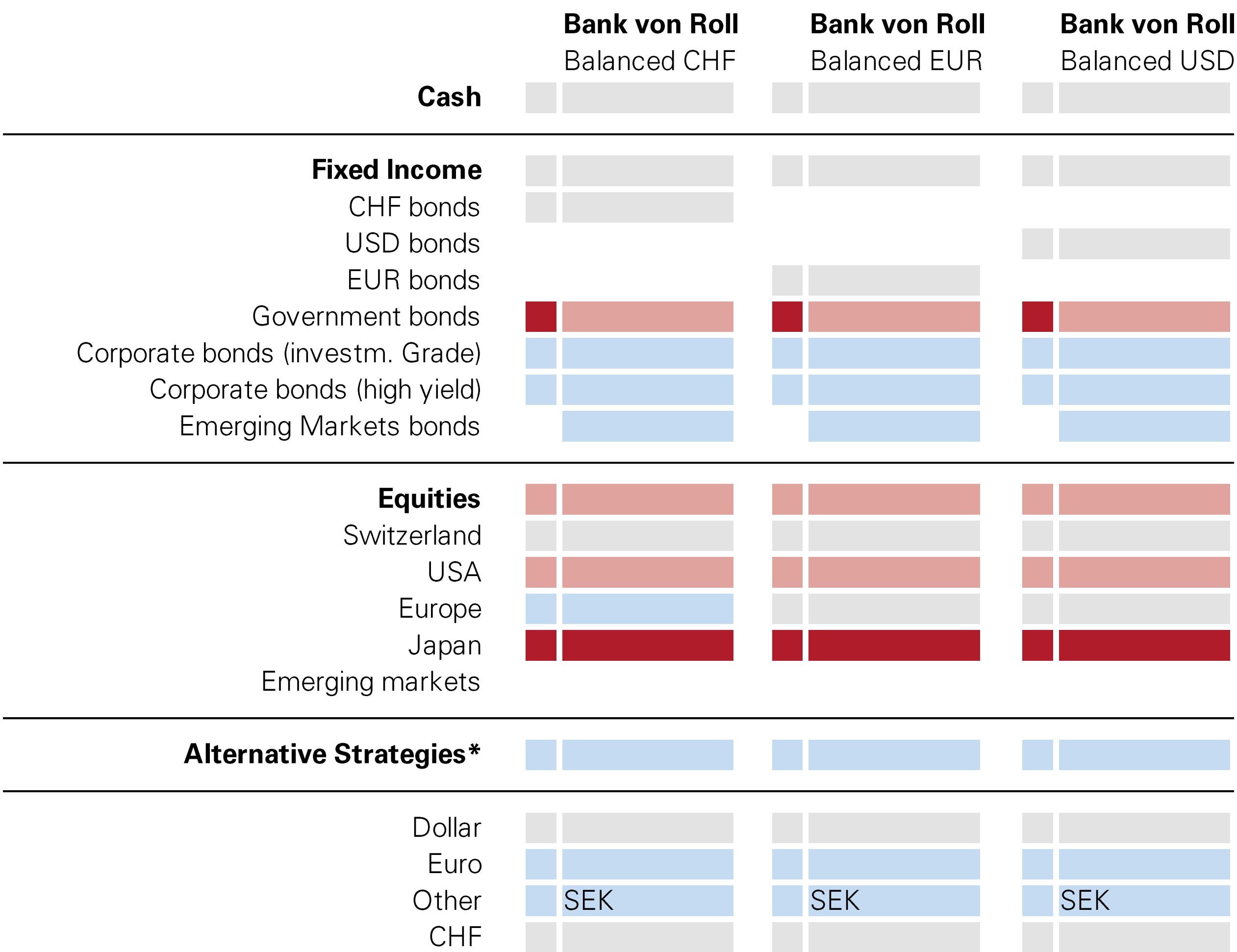
Outlook

Despite the recent price advances in stock markets, we are still assuming markets to remain in a deadlock caused by mutually neutralizing forces: on the one hand positive economic momentum and lack of euphoria and, on the other hand, event risks from geopolitics, high valuations and a rising complacency. The pulling forces will move the markets in one direction or the other over the course of time. Neither are we currently convinced buyers of shares, nor are we fully leaving the markets. When selecting stocks, we pay attention to quality while we look for diversification and flexibility in bonds. In light of the interest-driven boom in various asset classes (stocks, bonds, real estate) - some speak of the "everything-bubble" -, Gold is and will remain for us a central building block in our asset allocation

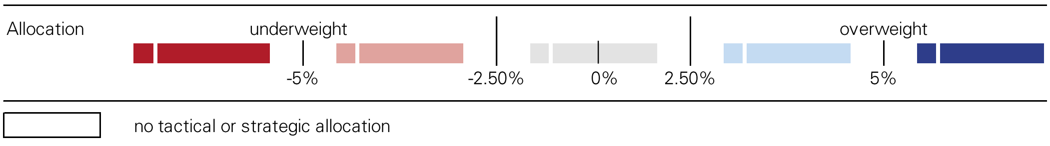
Asset Allocation (with change vis-à-vis previous month)

Equity allocation = slightly underweight

Small square = previous month; large bar = target quota



Basis:Balanced portfolio for a CHF investor



*) contains Gold, commodities, real-estate, hedge funds, private equity etc.

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