Check-Up

Client Newsletter of Privatbankiers Reichmuth & Co
Integral Investment Management | January 2017

Editorial

The turn of the year is a time for reflection, for me as the former bank head it has been a satisfactory year. I continue to have dialogs with so clients, even if only to offer advice. My successors have taken over the reign and successfully so as the performance comparisons show.

My outlook is positive. The following quote inspires me: "*Don't judge each day by the harvest you reap but by the seeds that you plant.*" Bucking the trend, the next generation has decided to remain general partners with unlimited liability. This will prove to be a smart move, upward delegation of responsibility has led to dissatisfaction. People will increasingly take matters into their own hands. Our objective when we set up our bank 20 years ago was to bring people and money into harmony, and this is set to become even more important. My confidence is underpinned by our expansion, with the opening of a new branch office in St. Gallen. I could not be more content, and I sincerely wish you the same happiness.

Karl Reichmuth,
General Partner

MAJOR POLITICAL CROSSROADS

The Trump Era – Super Election Year in Europe

The unexpected results of the Brexit referendum and the US presidential election indicate that power in future will likely increasingly revert to nations and regions and lie less with supranational and global bodies short on democratic legitimacy.

Asia – China-centric region

The Trans-Pacific Partnership (TPP) was all but doomed even before the US presidential election. For a long time, Asia was the workshop of the West. On the one hand, China's manufacturers needed US consumers, while on the other China financed the resulting US balance of trade deficit. China has moved on since then. Its currency, the CNY, has now been recognized as a reserve currency by the International Monetary Fund (IMF). Trade in Asia is also increasingly being conducted in CNY rather than USD. As a result, Asian countries are becoming less susceptible to the vagaries of the USD. The arrival of Donald Trump on the scene will heighten the pace with which the Asian region establishes its autonomy. Asia remains a growth region, and it is now no longer the US that is holding center stage there, but China.

"America First"

At present, it would appear that patriotism is the only thing predictable about President-elect Donald Trump – save perhaps for his unpredictability. Change always prompts excitation, and there has been an outcry from the media and investors alike. But even in the US, things are never quite as bad as they seem. It is amazing how quickly financial market participants changed their views on the "enfant terrible" after his election.

No helicopter money

"The upswing begins in the mind" was the mantra in Switzerland in the 1990s. The election alone appears to have prompted a turnaround in sentiment in the US. Lower corporate taxes are certainly a powerful argument, and so is the slimming down of the state apparatus. If this positive mood comes together with

continued on next page

the record high volumes of money created by the monetary tsunami unleashed by the central banks, it will likely give rise to a thoroughly potent mixture. Whether this triggers a swifter drying up of liquidity by the US Federal Reserve, higher inflation, higher real growth, or a combination of the above is something we will have to track closely. What we can say at this juncture is that further monetary policy experiments – such as helicopter money, for example – are off the table in the US for the time being.

Creative destruction

It is no secret that we are not fans of central banks engaging in excessively expansionary experiments. These may have been necessary during the financial crisis, but they are harmful if they are maintained for too long and at too high a dose. The result is zombie companies prevailing in the market, trust in the future cannot develop, and the cleansing forces of the economic cycles and creative destruction are disabled. From the media reports, we can see that Donald Trump has, as a businessman, had his own painful experiences with cycles and creative destruction alike. He is therefore aware that restructuring and bankruptcies are part and parcel of our economic system, whereas monetary policy can only buy time and hinders structural reforms and shakeouts.

Printing money in Europe

Mario Draghi recently set out the ECB's plans for printing money in 2017, with volumes likely to be around EUR 780 billion in total. The ECB will now also buy shorter-term bonds with yields lower than – 0.4 %. Draghi will thus seek to use a steeper yield curve to help the ailing European banking system. This comes as little surprise – after all, what else can he do? In 2012 he promised to do whatever it takes to hold the Eurozone together in the face of the pressure from the financial markets. In light of the new state of play in the US and in the run-up to the super election year in Europe, he cannot allow any anxiety to take hold.

Landmark elections

Dutch voters will go to the polls in March, and this will be followed by elections in France in May and Germany in September. These elections will reveal the direction the EU will take going forward. What is already clear is that in the aftermath of Brexit, things cannot continue as before. The EU is blocking itself. It is to be hoped that as part of establishing a new vision for the European Union, a face-saving way is found to adapt the EUR, which was flawed in its very design. Southern Europe cannot be competitive while bound by the current constraints of the EUR. If there is no solution in the offing here, the Italian elections that have to be held by 2018 at the latest should finally bring clarity on the matter. By way of exception, the developments in France offer a source of hope. The former Prime Minister François Fillon with his liberal agenda has a viable chance of becoming President, and this is cause for optimism. He can ward off Marine Le Pen while also bringing an end to the French Socialist logjam. Given the pressure from Donald Trump for Europe to look after its own defense, a type of Core EU could even emerge with a few clearly defined roles, such as defense and foreign policy (migration), and a common budget. However, such things take time and will only be visible in fledgling form in 2017 depending on the outcome of the elections.

Money flowing overseas?

While the waiting goes on for better solutions in Europe, and the ECB persists in printing money apace, we can expect to see money flows continuing to head for USD investments in the first half of the year at least. This despite financial market valuations in the US having been strong for some time already, and the fact that the currency will exert a curbing effect over the longer term via higher inflation. The US seems to be the least fragile region in investors' minds at present. The ECB has nothing new in its arsenal: it will keep interest rates negative and print money. The Swiss National Bank's hands are therefore also tied. It is currently unable to move off the misguided path of negative interest rates. However, it will make its currency market interventions increasingly dependent on the development of the export-weighted currency basket. With the USD firming, this will trim back the EUR exchange rate somewhat.

What this means for your investment strategy

Essentially, this means that the established, broadly diversified strategy focusing primarily on stocks should be maintained. This has already paid off in 2016 and delivered very good results. However, there are likely to be tactical adjustments required from time to time, for example as a result of the upcoming Trump Era (see page 7) and then over the course of 2017 in response to the developments in the elections in Europe. 2017 will be a decisive year for the EU and the EUR, and thus also for us here in Switzerland. After all, we are in the heart of Europe.

Christof Reichmuth, General Partner

"INTERREGNUM"

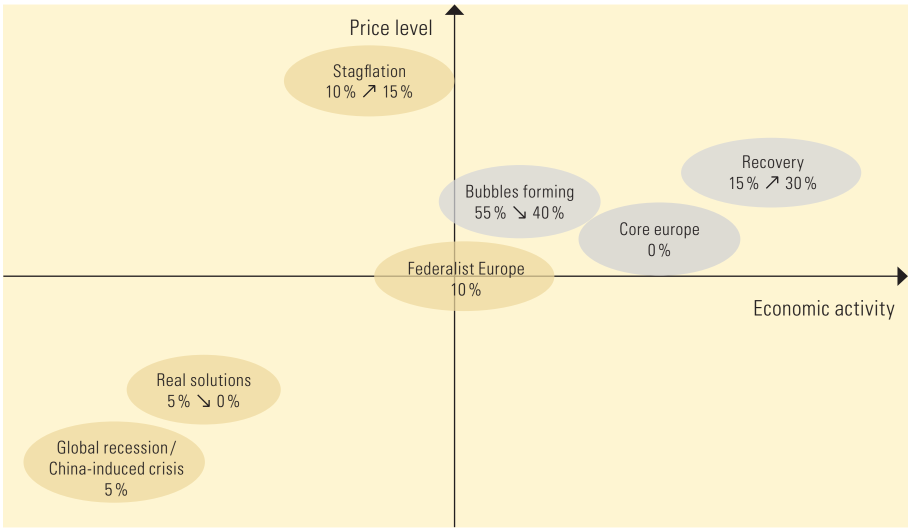
You can see a video recording of our event for private clients held at the KKL Lucerne on November 7, 2016 at

www.reichmuthco.ch

New video

RECOVERY – FICTION OR REALITY?

Our take on the future



Grey = Scenarios described below

Summary

- The Trump presidency is a game changer
- In light of the expansionary fiscal policy in the US, the prospects of a broader recovery for the global economy are improving
- Core Europe as a new European scenario with potential

Primary scenario: bubble formation

Persisting imponderables prevent a global economic upturn. Share buyback programs and higher distribution yields are given preference over investment in growth. Negative economic news is immediately countered with further monetary policy measures. Helicopter money is used, exacerbating the problem of negative interest rates. The formation of bubbles moves into the final and most extreme phase, spreading from bonds into the equity market. Doubts increase over the intrinsic value of nominal assets such as bonds and paper money.

Investment ideas

- Overweight equities
- Underweight fixed income
- Overweight USD & gold

40% probability 3 – 6 months

Recovery – higher growth thanks to expansionary fiscal policy

Under President Trump US fiscal policy becomes very expansionary. Massive tax cuts have a positive impact on capital spending and private consumption. Major infrastructure projects stimulate economic growth. Interest rates start to rise sustainably, and bolster the USD. Inflation rises, but real interest rates remain mostly in positive territory. Expansionary fiscal policy programs are launched in Japan as well, while Europe makes no headway. China's transformation from an export-based to a consumption-based model continues without negative consequences for the rest of the world. Global economic growth gathers pace.

Investment ideas

- Overweight equities (JP & US) (tactically: cyclicals)
- Avoid fixed income
- Foreign currencies are attractive; in particular USD

30% probability 3 – 6 months

Core Europe – new EU scenario takes form

The Brexit decision in June marks the start of a turnaround in Europe. In the wake of the British referendum result, the likelihood of the EU tackling the long-overdue reforms of its institutions increases. After the elections in Germany, there is an open debate on setting up a core eurozone including fiscal union, and with a joint migration and security policy as well. Besides Germany and the Benelux states, this could also include Finland, Austria, and even France. Ideally, the structurally weak countries leave the eurozone of their own accord and Italy takes the lead in restructuring the European Economic Area (EEA).

Investment ideas

- Underweight Northern European equities
- Overweight EUR / underweight CHF
- Avoid Southern European nominal assets in EUR

0% probability 3 – 6 months

US ECONOMIC MOTOR GETS A RETUNE

Trump rouses growth hopes and inflation fears

Patrick Erne, Head of Research

In Donald Trump, a striking personality has taken center stage who represents business interests. Less regulation, lower taxes, and higher spending on defense and infrastructure mean a business-friendly approach is on the cards, at least for the US. With rising interest rates and inflation picking up, the bond supercycle is nearing its end.

Trump stimulating growth

Growth in the US is robust, and most of the leading indicators are pointing toward an acceleration. Trump's newly assembled Administration with representatives from the business community promises growth impetus through deregulation and tax cuts. Governments in the UK, China, and Japan are also looking to increase fiscal spending. The latter remains wishful thinking in the EU at present, as it is still mired in political gridlock and crucial elections are coming up in several member states. The positive leading indicators in Europe are therefore to be viewed with caution. A possible wave of deregulation in the US financial sector could bolster credit growth and thus private investment spending in the coming 1 – 2 years. In the wake of a strong US economy and in the absence of protectionism, other regions would also stand to benefit, thus giving a slight fillip to global growth overall. For Switzerland, with its strong ties to the rest of Europe, the growth prospects remain uncertain, even though some Swiss companies have been able to adapt remarkably quickly and well to the appreciation of the CHF, and Switzerland will likely see overall exports return to near historic highs in 2016.

GDP growth expectations	Current GDP growth	Growth expectation (12 months)
United States	1.6 %	2.0 – 2.5 %
Europe	1.7 %	1.0 – 1.5 %
Switzerland	1.3 %	1.0 – 1.5 %
Japan	1.1 %	1.0 – 1.5 %
China	6.7 %	6.0 – 7.0 %

Fiscal policy driving inflation expectations

The turnaround has begun: fiscal policy is set to become increasingly important, supplementing the expansionary monetary policy. US interest rates are therefore likely to have reached their lows in the long-term cycle. Outside the US, no hikes in key interest rates are on the cards as yet. However, the central banks cannot go on buying up bonds indefinitely. With efforts now being undertaken worldwide to increase fiscal spending, deficits are rising and so too are inflation expectations. This will see interest rates rise at the long end. A correction in the completely distorted long-term rates has been overdue for some time. Our assumption is that this correction will persist for a while yet, and yield curves will steepen.

While nominal interest rates are set to rise further, especially in the US, we expect no major changes in real interest rates. The latter will remain very low for the foreseeable future since the central banks will allow inflation to overshoot in the case of doubt. Bonds remain unattractive. Within this asset class, we prefer inflation-linked bonds, with a selective diversification in emerging market bonds. We are avoiding government bonds, especially from the European periphery.

Interest rate expectations	3m rate (Libor)	Expectation in 12m	10y swap	Expectation in 3 – 6m
United States	1.0 %	rising	2.4 %	rising
Europe (Germany)	– 0.3 %	stable	0.7 %	rising slightly
Switzerland	– 0.7 %	stable	0.1 %	rising slightly
Japan	– 0.0 %	stable	0.2 %	unchanged

Expensive US equity market profiting from money flows

Over the short and medium term, US firms are set to benefit from less regulation, tax cuts, and possible share buyback programs or M&A activity stemming from the repatriation of capital from abroad, provided these are conducted in a timely manner. This would drive share prices and would likely support the US equity market, even though these measures have already been priced in to a considerable extent. Over the medium to long term, the decisive factor will be companies ramping up their capital spending again. A clear increase in CAPEX would be a positive sign that the upswing may continue for longer. After all, the strong USD, higher interest rates, and rising wages pose headwinds for corporate earnings and the equity market, particularly given that valuations are already high.

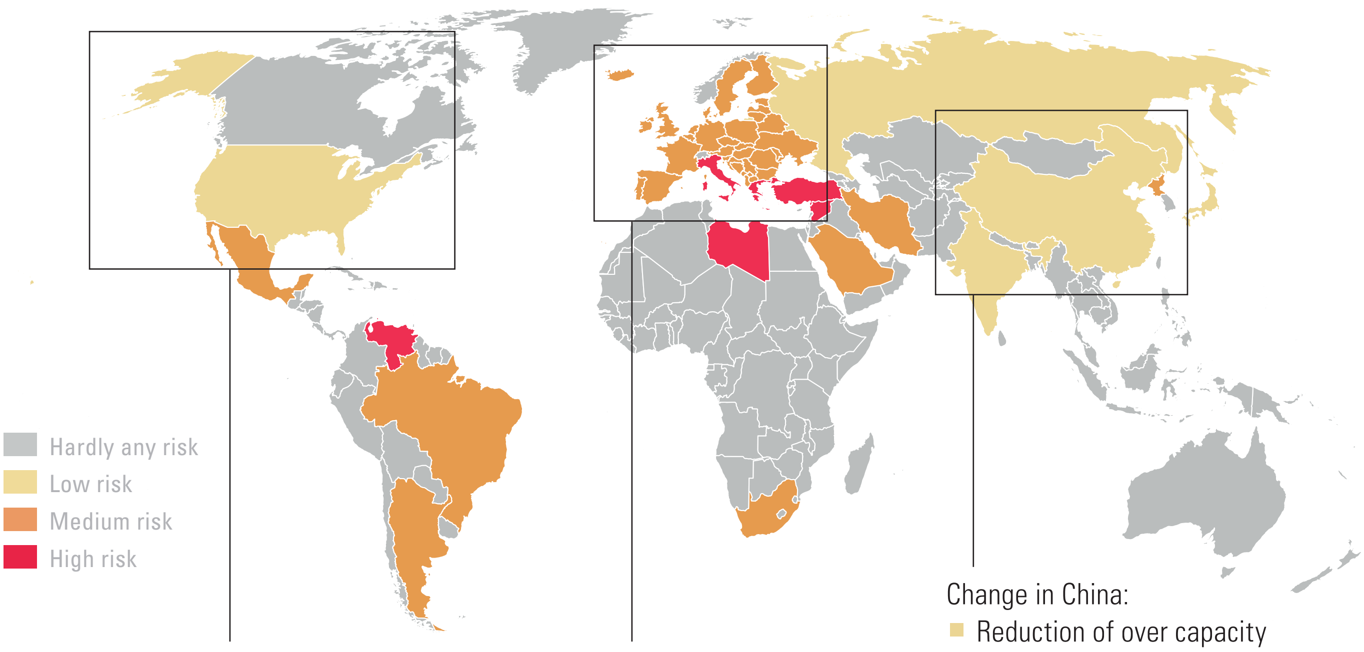
The European stock market valuations look attractive only in relative terms. Although a weak EUR and expansionary central bank are limiting the downside risk, the political imponderables, more restrictive fiscal policy, and an undercapitalized banking system make Europe unattractive for many global investors, and the investment climate remains poor.

We see Japanese stocks offering more upside potential in the coming months. Relatively attractive valuations, a weak currency, and fiscal stimulus coupled with interest rates being kept artificially low should lend broad support to the Japanese equity market. As long as the Trump Administration refrains from excessively tough protectionist measures, we also see upside potential for selected emerging market stocks, e.g. in Russia, China, and Mexico.

Equity valuations and expectations worldwide

Market	Index level 21.12.2016	P/E	P/S	P/B	D/P	Expectation 3–6 months
S&P 500	2 265	19.1	2.0	2.9	2.1	rising
DAX	11 469	14.2	0.9	1.8	2.7	sideways
SMI	8 233	17.5	2.1	2.5	3.5	sideways
TOPIX	1 545	16.2	0.8	1.4	1.9	rising
China H Shares	9 332	8.1	0.9	0.9	4.0	rising

Macroeconomic risks



Trump Era:
- FED facing balancing act
- Overshooting inflation
- Increasing protectionism

Political instability in the EU:
- Elections in core EU countries
- Undercapitalized banks
- Italian government crisis

Change in China:
- Reduction of over capacity
- Bad loans from unprofitable government owned companies
- Opening of the capital markets and devaluation of the RMB

OVERVIEW – ASSET CLASSES

The Great Rotation – "America First"

Bonds

- Interest rates have risen noticeably, particularly at the long end – yield curves are steepening.
- Spread between 10-year US Treasuries and German bunds stand at over 2 %.
- We are sticking to the clear underweighting of bonds, and continue to recommend a short duration. Meanwhile, we are increasing inflation-linked US bonds, emerging markets & now also convertible bonds.

Equities

- Clear rotation within the equity sectors in favor of banks and cyclical stocks following the US elections.
- Japan & US remain the regions on the up. Increase Japan equities – hedge JPY.
- We are replacing the call options on the S&P500 with direct investments in US financial stocks, US small caps, biotech, energy & IT firms. Meanwhile, we are reducing the European equity exposure slightly.

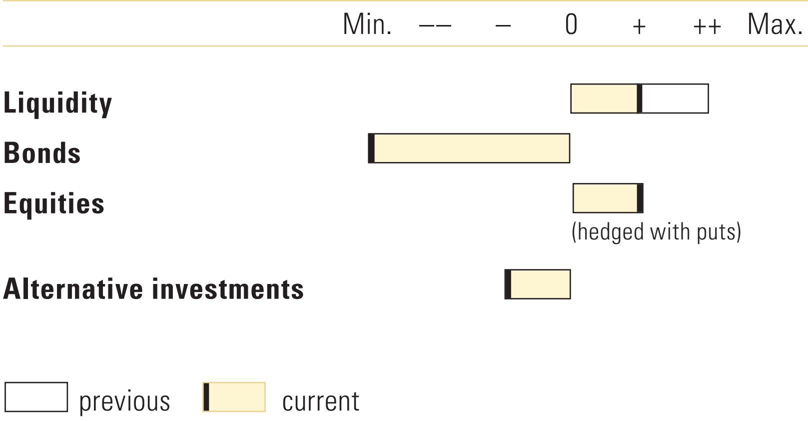
Alternative investments

- At the end of the year we are increasing our allocation to insurance linked securities (ILSs), moving closer to the strategic weighting of around 5 % for traditional strategy portfolios.
- The central banks in Europe and Japan remain ultra-expansionary, and debt conundrums remain unresolved across the world. As a form of insurance we are buying a gold call option with a 5-year term, strike USD 1,750.

Currencies

- The hedging of the JPY & EUR is paying off, and we will be adhering to this.
- We remain overweight in USD & GBP, and are now also stating our gold exposure separately as a currency.
- Emerging market currencies are being increased via EM bonds.

Positioning



- Use liquidity built up in recent weeks and replace S&P call options with direct equity components.
- Hold minimum weightings of bonds
  Replace corporate bonds with extended fixed-income classes (GILB, EM & convertibles)

Please note:
If you would like to receive a copy of our Investment Policy publication with detailed market assessments, please contact your relationship manager or register with Nadine Vonwyl (nadine.vonwyl@reichmuthco.ch).

INVESTMENT IDEAS FOR THE TRUMP ERA

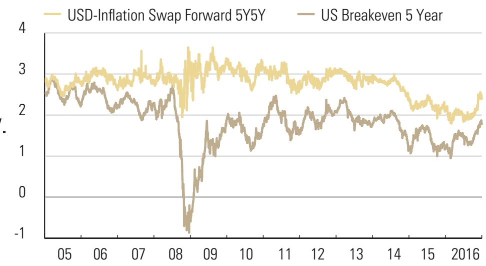
Greater investment appeal thanks to deregulation and tax incentives

Trump has emerged as the new hope for the US economy in recent weeks. His election platform is conducive to growth, and offers the prospect of deregulation, a strong energy sector, and credit growth in the financial sector. Donald Trump represents an opportunity for the financial markets but also poses a risk. Against this backdrop, we firmly believe that the fundamental strategic focus will have to be periodically accompanied by tactical portfolio adjustments. Here we outline some of our investment ideas for the Trump Era. We will be happy to discuss these with you, and how we would put them into practice. Should you be interested, please contact your relationship manager.

Inflation-linked bonds

- Trump's economic program will foster inflation.
- The recovery in energy prices, rising wages, a pick-up in lending and possible customs duties and trade restrictions are heightening inflation expectations.
- If in doubt, the US Federal Reserve will allow inflation to overshoot temporarily. Nominal investments are therefore unattractive in the US in particular. Anyone wanting to hold bonds should switch into inflation-linked bonds.
- Implementation: US TIPS with terms to maturity of 5 – 7 years

US inflation expectations

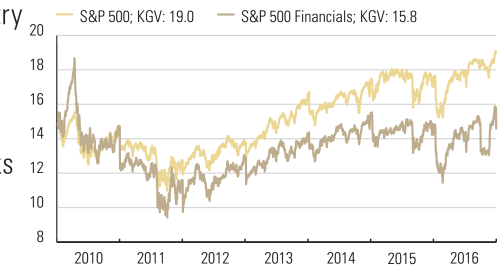


Source: Bloomberg

Deregulation in the financial sector

- Trump wants to dismantle regulation and barriers to investment.
- Trump's Administration features various representatives of the banking industry who are particularly keen to ease the restrictions of the Dodd-Frank Act.
- A steeper yield curve, looser regulation, and a pick-up in credit demand are helping the profitability of US banks.
- The latter are set to gain market share at the expense of other European banks that are less well capitalized and have to reduce their balance-sheet risks.
- Implementation: ETF on US banks.

P/E banks vs S&P 500

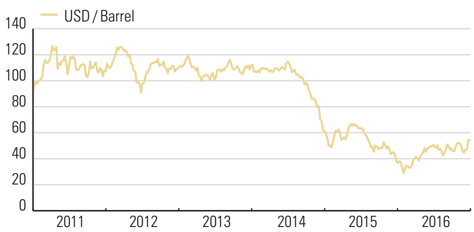


Source: Bloomberg

Energy stocks with a tailwind

- Trump has nominated ExxonMobil CEO Rex Tillerson for Secretary of State Tillerson represents the oil industry, and is a friend of Russia.
- Reductions in production volumes are supporting the recovery in the price of oil.
- As the oil price rises, a recovery in equipment investment becomes probable.
- Implementation: US oil services firms, Russian equities ETF.

Oil price

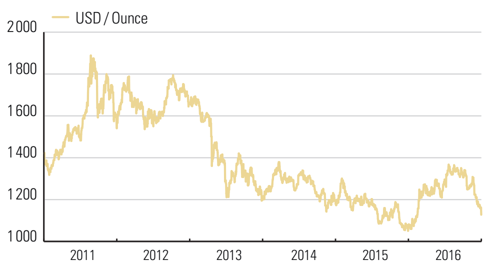


Source: Bloomberg

Gold options for all eventualities

- There are high hopes of Donald Trump, and this also increases the potential for future disappointment.
- The extremely expansionary monetary policy of recent years, coupled with business-friendly government, rising fiscal spending, and higher credit growth could lead to an unwelcome surge in inflation.
- Implementation: We are taking out cheap insurance against pronounced financial market turbulence and overshooting inflation with 5-year gold options with high strikes.

Gold



Source: Bloomberg

EASTERN SWITZERLAND HAS POTENTIAL

Jürg Staub on the opening of the St. Gallen branch

You are opening a branch at a time of large-scale job cuts across the financial industry. Why?
Yes we are, and we are delighted to be making this move. We have long since been operating in a distinct niche. With our concept of integral investment management, we focus on our clients and from the outset we have bought in the activities where economies of scale can be achieved. This outsourcing approach means we have a very flexible cost structure, which is why we can take a relaxed and somewhat detached view of the debate regarding the minimum critical mass for private banks.

Which niche do you operate in?
Integral investment management is a mindset. We are not interested in selling products to our clients – instead we tell them what we would do in their position. This strikes a chord with families, entrepreneurs, and top managers in particular. We take a very long-term view, with a fundamental approach centered on personal responsibility. We are also very liberal and tend to take a critical stance toward the state. At the same time, we also succeed in offering new and innovative ideas.

Could you give us an example?
Our highly individual and flexible pension solution PensFlex is well known, and is exceptionally useful for senior managers in particular. PensExpert will therefore also have an office in St. Gallen. Our niche offering also includes our clear view of the market and the courage to then put this into practice. We are currently celebrating the 20th anniversary of our Reichmuth Pilatus fund, which was able to generate a performance of 8 % p.a. since inception. A newer area for us is Swiss infrastructure investments, where we are seeking to achieve stable cash flows.

Why have you chosen St. Gallen as the location for the new branch?
We believe our values have firm roots in Eastern Switzerland, and the area therefore has considerable potential for us. Added to this, we have staff from the region and graduates from the University of St. Gallen HSG. But the most important thing is that we can put our culture in place in St. Gallen with a team that shares our philosophy. That was what prompted this move.

Could you expand on that?
We have been able to start with Sirius Wealth Management as our basis, which we will now be transferring to a branch. Ernst Eisenhut founded Sirius 20 years ago, and we hit it off immediately the first time we met. We share the same values and corporate culture: these are covered in depth in our anniversary film "The Roots, Values, and Knowledge of a Private Bank" which can be viewed online at www.reichmuthco.ch. As part of the solution for Ernst Eisenhut's succession planning, we are building up a well-networked local team, and it is this that will hold the key to success.

What else do you do differently from other private banks?
We are an owner-managed family business run by general partners with unlimited liability, and take a very-long term view. This enables us to offer our clients continuity and security. Our relationship managers are not just responsible for the relationship, they also handle the implementation of the investment strategy. This approach is greatly appreciated.

What do you hope the St. Gallen branch will achieve going forward?
Our ultimate goal is to have clients who are more than satisfied, in St. Gallen as everywhere else. Best of all is when our clients become our "fans", then we have certainly achieved what we set out to do.

What sort of clients are you looking for and why?
Anyone who shares our client and investment philosophy, i.e. people who go their own way. The best thing to do is get to know us by visiting us at our new St. Gallen branch, or also in Zurich or in the Segesser Haus in Lucerne.

WELCOME TO ST. GALLEN
We opened our new offices for you at Schmiedgasse 28 in St. Gallen on January 1, 2017, where branch manager Ernst Eisenhut and Frank Burri will be pleased to welcome you. We will also be happy to arrange to visit you at home as well.