Investment Policy

1. Quarter 2015

Lugano, January 2015
(Press date: 22 January 2015)

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We cannot maintain the beginning of 2015 will be easily forgotten. The Swiss National Bank's decision to end its peg of 1.20 against the Euro and the European Central Bank's decision to roll out the widely announced quantitative easing strategy are two extraordinary events that have marked and will significantly impact trends in the financial markets.
That the move by the SNB would come as a major surprise for financial operators was inevitable. When the strategy was conceived in 2011, its goal was to ease tension on what was considered an excessively strong franc, bringing the EUR/CHF level sufficiently far from 1.20 to eliminate the need to defend it once the market determined that support by the central institute would no longer be necessary. The fact that after 3 years the exchange rate had come dangerously close to the threshold to be defended, and the various speculative pressures that risked exacerbating the already perilous situation of the SNB, clearly did not leave much leeway for other decisions.
Market consensus indicates an exchange rate that will head towards and stabilise at around 1.10. We are inclined to believe that this will be the most likely scenario in upcoming months as well, while not excluding a certain volatility caused by many positions still present on the market and which could cause sudden moves.
As for the ECB, we see the announced intervention under a very positive light, not so much for its possible effects on economic growth as for the meaning of such an operation with regard to the creation of an economic, monetary, political and fiscal zone that still has a lot of ground to cover but which is taking a further and important step forward.
Behaviour on the markets is once again highly influenced by the actions of the central banks. In this respect, the effect of the compression of interest rates, which are in fact negative on the franc, can only fuel the purchase of assets that offer some hope of higher yields. The collapse of the Swiss stock market will probably recover to a great extent, and the effect of QE on European equity will certainly be felt. Moreover, if the ECB's highly expansive measures, accompanied by a weak euro and sharply revised oil prices, have positive effects on economic growth, the highly desired virtuous circle will have been achieved.
While the danger of an asset bubble must also be considered, we believe that in the foreseeable future, the European and Swiss equity markets will generate positive returns, assuming there are no shocks at the global level. Speaking of shocks, we must continue to carefully observe the Ukrainian situation, as well as development of the scenario in the Middle East.
The US economy continues to show positive signs. However, the US central bank ensures all markets: the next hike in interest rates will not occur before halfway through the current year and the restrictive monetary policy measures implemented will aim not to derail economic growth. The strength of the dollar could create some problems with regard to the profits of many US companies and we believe that, in terms of relative performance, European prices could reduce part of the gap generated in the post-crisis years.
On the currency front, there is a strong consensus that the dollar will continue its revaluation against the EUR and other main currencies. The journey undertaken is already long, but we expect it to continue in this direction in the upcoming months as well.

Context

The year 2014 saw diverging economic trends in the various regions around the world. The United States showed a clear recovery, consolidated in the final part of the year and representing the true driving force behind global growth. The latest unemployment figure also confirms that the US economy is growing, at a likely average rate of around 3%. In other parts of the world, however, the various policies implemented have not always achieved the desired results. In particular, weak performance in Europe and the slowdown in the emerging countries are a concern for the FED, which will consequently be more cautious in its cycle of raising reference interest rates, although this possibility has already been expressed.
In fact, Europe has entered a new phase of economic slowdown: growth has been essentially close to zero, mainly due to countries like Italy and France, weakened by their political incapacity to undertake effective structural measures to revive the economy. Even Germany suffered a slowdown in the second half of 2014, due to the decline in economic growth in the emerging countries, as well as to repercussions of the conflict in Ukraine.

The ISM index and consumer confidence indicate optimism for economic growth in the USA...

In the last quarter of 2014, the ISM index (the US purchasing managers survey on the economic outlook) was stable at its recent highs, driven by an exceptional level of new orders and production, reflecting the strength of the US economy immediately prior to the new year. The new orders component rose to a level permitting an optimistic outlook on growth in the US economy in the upcoming months as well. The price component dropped sharply, due to the fall in prices of raw materials.
Consumer confidence remains at the record highs of the last few years. Recovery in the employment market and remuneration, the collapse in oil prices and the decrease in prices of oil-based products should free up new resources and lead to an increase in private consumption in the upcoming months.

...while the Purchasing Managers Index (PMI) and Inflation are not as positive for the European economy

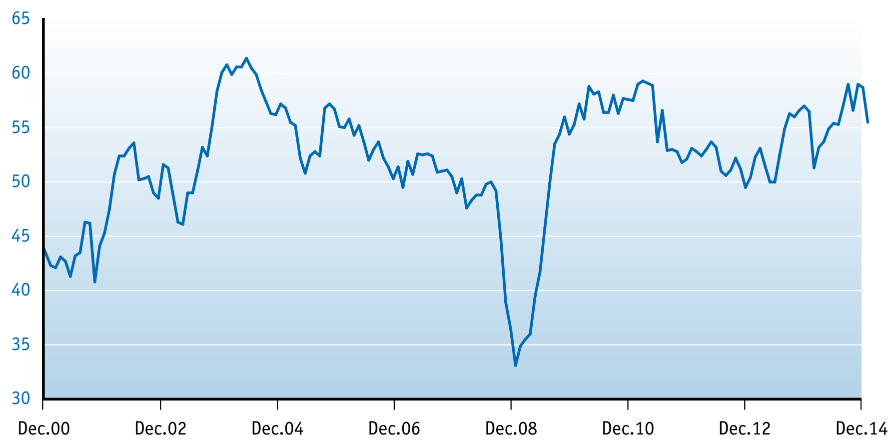
Weakness of the European PMI pervaded the last quarter and clearly highlights the negative economic phase in the old continent, which in recent months has also affected Germany. The monetary stimulus measures promised by the ECB, which may include unconventional measures in the upcoming months, will hopefully be accompanied by more decisive measures by the respective governments: we believe one solution could be a joint agreement on fiscal reforms and stimuli between Germany, France and Italy, but this agreement is proving to be very difficult to achieve, despite extensive diplomatic efforts. European growth is expected to amount to between 0% and 1% in the upcoming year.
The inflation trend in Europe remains a concern. Investors are relying on the ECB, which cannot disappoint them by further procrastinating the quantitative easing measures.

Significant weakness also plagues the emerging countries

Growth in the emerging countries has been far from the usual vigorous performance of recent years. The slowdown in China's economy, which is still up by over 7%, has driven the political authorities and central bank to support the economy. After 2 years of hesitation, investors appear to have renewed confidence in the renewal process undertaken by the Chinese government.
A reasonable degree of concern over the Russian scenario is also justified, with Putin unlikely to back down before the severe stance taken by the USA and Germany, while the economy continues to weaken due to sanctions and oil prices. Specifically, these factors have triggered a heavily critical situation in Russia, most clearly manifested in the collapse of the rouble, down by over 100% against the US dollar during the worst moment of the crisis.

Oil spot price

ISM Manufacturing Index



The collapse in oil prices is driving down the currencies of oil-producing countries

The oil trend is surely the most significant event of the second half of last year, as the price of oil dropped by more than 55% compared to the highs in June. We believe that a recovery in prices is not imminent, as there exists a structural imbalance between demand and supply. In past years, growth in demand by emerging countries was overestimated and supply increased, thanks to new technologies (oil shale). Without an agreement to reduce production quotas, the price of oil is destined to remain low for some time.

This unexpected drop in oil prices has direct implications on the Forex market, manifested through weakness of the currencies of the producer countries, particularly Norway, Russia and Mexico, although countries like Canada or Brazil could also suffer from negative repercussions. We do not recommend long positions on currencies of the aforementioned areas, despite the fact that some of them benefit from good macro-economic fundamentals (Norway and Mexico). We suggest preferring net oil-importing companies (Turkey and India), whose current account balances should improve significantly thanks to the lower prices.

Appreciation of the Dollar continues strong

On the EUR-USD front, the cross-rate at the beginning of first quarter 2015 appears to be continuing in the direction underway since April of last year, dropping to around 1.18. We believe the USD appreciation trend is still intact, sustained by the divergence between the monetary policies of the two central banks, namely the ECB and the FED. In particular, there is a solid belief that the US economy, which closed 2014 on a strong note, will continue to expand at a growing rate. This should gradually cause real rates to rise, to the point where the greenback will still be a currency with good appreciation potential over the long term.

In any case, we believe economic activity in the Eurozone will also begin to see the benefits of an increasingly expansive monetary policy, thanks to the adoption of unconventional instruments by the European Central Bank (such as quantitative easing) to stimulate recovery of inflation, which at the moment seems a distant possibility. In this regard, even the drop in oil prices does not support a rise in consumer prices.

Going long on the currencies of emerging countries that import crude oil could be a winning strategy

As the drop in oil prices has the potential to stimulate growth of emerging countries that import oil, we recommend purchasing currencies such as the Indian Rupee and Turkish Lira.

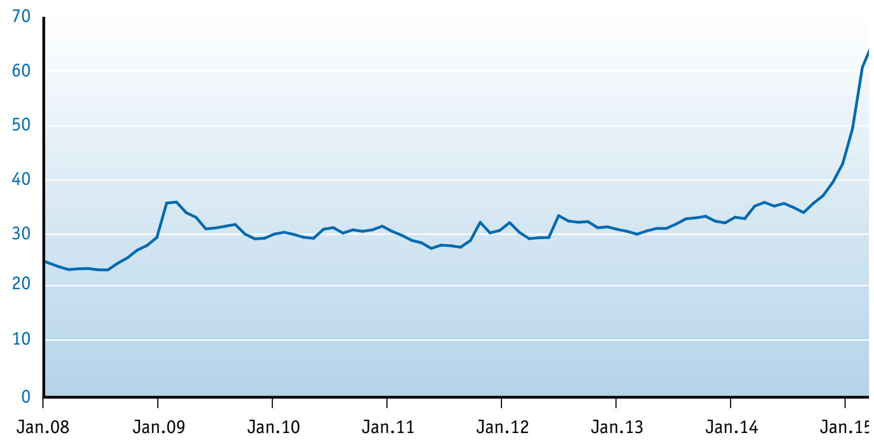
The Indian economy already recorded signs of recovery in 2014, in the wake of strong reforms, but the downward pressure on oil prices could prove to be a significant driver for the national currency. Lastly, we believe that the downward shift of oil prices also has the potential to shift Turkish monetary policy towards a more accommodating attitude, providing a further boost to the Turkish Lira.

Overall, the combined wager on these two currencies could provide significant and profitable currency diversification within the forex portfolio.

SNB suddenly scraps EURO peg

On 15 January, the Swiss National Bank scrapped its peg of 1.20 against the Euro, cutting interest rates on deposits to -0.75% and stating that maintenance of this exchange rate is no longer justified in light of the Euro’s depreciation against the dollar. Governor Jordan has confirmed that, in light of the divergence of monetary policies at the global level, maintaining a minimum exchange rate against the Euro is no longer justified. However, the Central Bank reserves the faculty to intervene on the market, but in a free-floating exchange rate regime. Following the surge of the Swiss Franc, the EUR/CHF cross-rate should stabilise within a range of 0.95 and 1.05.

USD/RUB



EUR/CHF

Contex

A majority of analysts had forecast 2014 to be a year of rising bond yields worldwide, on the heels of renewed economic growth and normalisation of monetary policies. But they were wrong, with bond yields on the core markets declining significantly, particularly for longer maturities. Bond prices were sustained by expectations of declining inflation, the accommodating policies of the ECB and BoJ as well as, following the sharp drop in oil prices in the second half of the year, the downward adjustments to global growth rates.
The 2-year yield in Europe is now under 0%, with very low volatility, while the short-term end of the curve in USD is at around 0.50%. On the long end of the curve, the Bund is at new lows of around 0.60%, while the ten-year USD is back down to around 2%.

Investing in the bonds of net oil-importing countries seems to be an interesting challenge

Added to this context is the more difficult sustainability of debt in many countries and companies linked to oil. The emerging markets, led by Russia and Brazil, have suffered a substantial adjustment on the bond front. The risk-off is evident, but at the beginning of the year, countries benefitting from the lower oil price as net importers (Turkey and India) recorded a net recovery in issues and in their currencies, previously under pressure.
With regard to the future, the ECB is always arousing significant attention, with Draghi having clearly and frequently stressed the ECB's intention to do everything it can to avoid the Eurozone from entering a deflationary phase. Of course, the ECB's presence on the markets provides investors with some peace of mind, and although the uncertainty still favours the core markets, we believe the recovery in prices on issues by companies importing oil, such as India and Turkey, will represent an important challenge for the quarter.

We expect increased volatility on emerging market corporate bond prices and sovereign debt of peripheral Europe

As to emerging market corporate bonds, the widening of credit spreads has been significant and a lack of liquidity has again appeared during moments of tension, exacerbating the downward movements of prices on these issues. At this point, it is too late to sell any outstanding positions but, apart from Russia, a return to more normal market scenarios should permit at least a partial recovery of losses.
Lastly, in light of recent events in Greece, the risk of a new sovereign debt crisis in peripheral Europe should also be taken into consideration, as it is not entirely priced by the markets, as demonstrated by the all-time low yields in Spain and Italy.

Fixed Swiss yield has never been less attractive

Having dropped its peg of 1.20 against the Euro, the Swiss Central Bank has brought interest rates on deposits to -0.75%. This monetary policy move has brought the ten-year Swiss rate from a positive yield to a negative one, slightly under zero, for the first time in history. Therefore, we clearly do not recommend investing in the Swiss fixed income segment.

Germany 2yr government bond yield

Switzerland 10yr government bond yield

Context

The financial markets suffered substantial volatility in the last quarter of 2014. The sharp decline in oil prices surprised the markets for its speed as well as its extent, forcing many operators to revise the base scenario for their investment decisions. In this context, the emerging markets, led by Russia and Brazil, underwent sharp adjustments on both the bond as well as equity fronts.
Share prices are not excessive and the bond alternative is increasingly expensive. In light of this, equities will still be the preferred asset in 2015, provided that current tensions do not degenerate into a financial crisis. At this moment, many stock markets have recovered part of the losses.
However, performance of the US economy also opens up the possibility of an increase in reference rates, already expressed by the Federal Reserve. Historically, the first increase in Fed Funds has not resulted in heavy adjustments, with investors focusing more on positive performance of the economy and on corporate earnings and less on the future negative effects of a monetary squeeze. However, in this cycle characterised by an extraordinarily expansive monetary policy, we do not want to base our decisions too heavily on the past as an indication of future performance. Conversely, even if volatility increased for various asset classes during the course of the past year (such as raw materials, emerging equities and currencies), we expect the equity markets to be even more volatile in 2015 than in 2014.
We therefore recommend caution, not playing the markets and solely profiting from increases. Moreover, it is likely that higher volatility will provide attractive purchasing opportunities as early as in the short term.

Valuations and earnings forecasts

Valuation multiples in the US equity markets are not excessive, but they are already pricing an improvement in the economy and upward earnings forecasts for 2015. Should one of the two variables be disappointing, the price/earnings ratio would decrease. On the other hand, the 12-month forward P/E ratio in Europe appears to be likely to grow in the first part of 2015 and could reach a level of around 15 if the ECB undertakes the expected QE.
However, the situation is not as positive in Europe, although we maintain an EPS growth forecast of around 10% for 2015. We believe that top-line growth will remain moderate, but margins will benefit from the reduction in input costs as well as from the decline in interest costs and the more favourable exchange rates. In this regard, the valuation differential in favour of Europe with respect to the United States leads us to prefer the former.

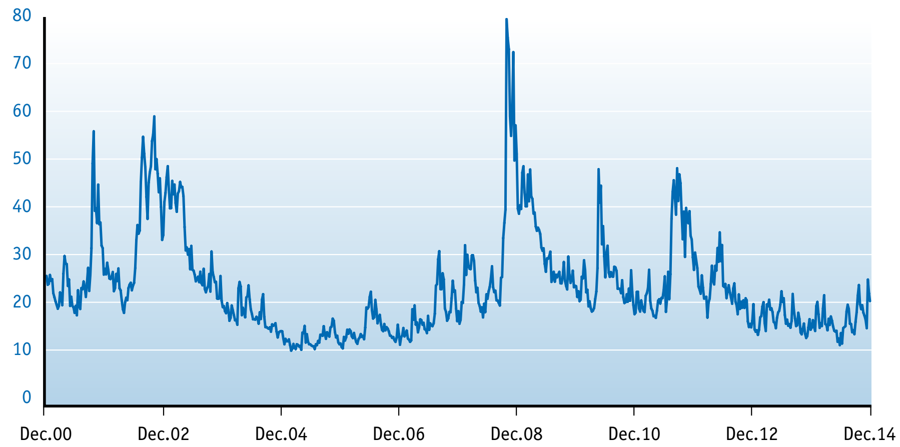
Sector allocation in Europe

At the sector level, we recommend an overweight position in cyclicals which should benefit from ongoing improvement in the flow of economic news and weakness of the Euro, as well as from a rather attractive relative P/E ratio. We believe it would be appropriate to focus on industrial stocks and cyclical consumer goods. Financials should also benefit from the internal recovery in positive macro information flow and the ECB's monetary policy initiatives underway. The valuations of banks and insurance companies appear to be attractive as well.
Conversely, we would recommend an underweight position in the defensive sectors like pharmaceuticals, food and utilities, which are excessively traded at a premium on the market.

Among the emerging markets, Russia and Brazil are a source of strong concern

The slowdown in emerging markets has hit Russia in particular (due to the sanctions) and Latin America: the Brazilian economy is suffering and problems in the financial sector cannot be ruled out in upcoming months. Russia and Brazil will undoubtedly suffer in future months as well, also as a result of the drop in raw materials prices and lack of economic growth, and investments in these areas should therefore be avoided.
In contrast, India is growing, thanks to the measures and enthusiasm surrounding the Modi government, and it should benefit from low oil prices, although much of it appears to be already discounted in market prices.
Even the recent bullish shift of the Chinese market, within a scenario of downward growth revisions, indicates how international investors are placing their trust in the new government policies for the first time after 2-3 years. However, the danger of speculative bubbles on Shanghai's domestic market should be monitored closely, as it recorded significantly higher than normal volumes and volatility during the last quarter.

European stock market volatility index



Russian stock market (USD)

Objectives

Our main asset management objective is total return. Over a 12-month span, we want to achieve capital growth, while containing as much as possible downward price swings due to bearish financial market conditions.

Investment Philosophy

To achieve this result, we apply a management philosophy based on the following points:

- simple benchmarks with broad fluctuation bands to ensure wide flexibility in investment choices;
- high dynamism in, and sharp focus on, managing individual positions, featuring a near-term time horizon for making buy/sell decisions;
- constant search for investment opportunities over all asset classes;
- currency diversification;
- wide portfolio diversification;
- sharp focus on risk, managed in part through use of hedging instruments;
- portfolio liquidity: in no more than five days we can liquidate almost all open positions.

Portfolio Structure and Benchmarks

		Maximum investment limits (%)					
Investment Profile	Risk category	Cash	Investment Grade Bonds (>=BBB-)	Non Investment Grade Bonds (<BBB>)	Equities	Other Funds*	Currency Diversifi-cation
Income	Low	100	100	0	0	5	15
Income Plus	Medium-low	50	100	15	15	15	15
Dynamic	Medium	30	100	20	30	25	25
Balanced	Medium-high	30	80	20	50	25	25
Growth	High	30	50	20	75	30	25
Equity	Very high	30	50	20	100	30	25

* Non-directional funds, total return funds, funds of funds

It is worth emphasising that the portfolio structure is a starting point, determined by the individual client's propensity to risk. Once this is decided, we do not want to statically replicate the benchmark, but offer meaningful portfolio management flexibility (see chart). For example, regarding equities, which are the most volatile component of the portfolio, we want to maintain the flexibility to drastically reduce them in case of an unfavourable stock market view and to increase them when we think it is advisable. This rule also applies to the other assets classes when, based on our analysis, they offer opportunities for gain or there are dangers that signal a sale. Flexibility, then, combined with a sharp focus on risk in the attempt to regulate asset growth.

Asset Classes and Instruments

Along with cash, bonds and stocks, we also invest in alternatives, such as funds of hedge funds, convertible bonds, commodities and precious metals. Currencies are also an alternative investment. Currency diversification allows us to add yield and so, through selected transactions, contribute to achieving our objective. More in detail, we rebalance the currency position arising from investments according to desired exposure, to which we add currency trading transactions which are constantly monitored and actively updated.

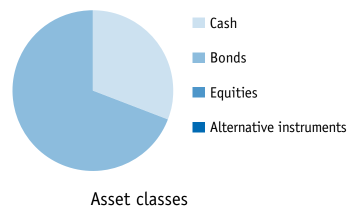
We choose investment instruments based on the objectives. We can distinguish between investment vehicles that give structure to the portfolio and others that take maximum advantage of investment opportunities and enhance risk control. Our bond and stock SICAV funds give structure to the portfolio, while funds of hedge funds are its "core". Part of the equity allocation is invested in stocks with a shorter time horizon, always on the search for new investment opportunities. If deemed more attractive, equity exposure is implemented through options or options structures on individual shares. On the bond side, we focus sharply on maturity and prefer certain segments of the yield curve. Our SICAV bond and equity funds and third party funds of proven reliability representing the core portion of the portfolio are part of the first category. We constantly evaluate the proportion between government and corporate bonds, with a focus on the risk/reward ratio for individual investments.

Our sharp focus on risk is also expressed through the use of index options to hedge the equity allocation if our analysis signals probable corrections.

Allocation by asset class

Income

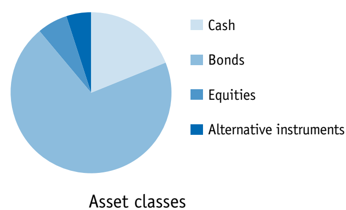
Cash*	31
Bonds	69
Equities*	–
Alternative instruments	–
	100



Asset classes

Income Plus

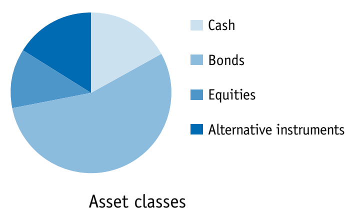
Cash*	19
Bonds	70
Equities*	6
Alternative instruments	5
	100



Asset classes

Dynamic

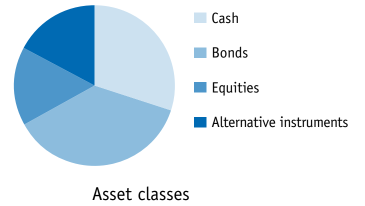
Cash*	17
Bonds	55
Equities*	12
Alternative instruments	16
	100



Asset classes

Balanced

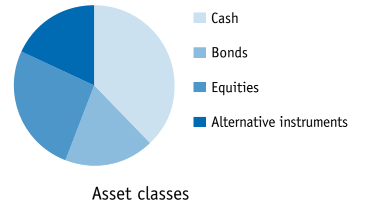
Cash*	30
Bonds	37
Equities*	16
Alternative instruments	17
	100



Asset classes

Growth

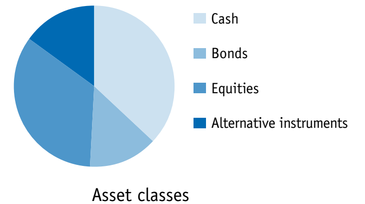
Cash*	38
Bonds	18
Equities*	26
Alternative instruments	18
	100



Asset classes

Equity

Cash*	37
Bonds	14
Equities*	34
Alternative instruments	15
	100



Asset classes

* Part of equity allocation is hedged with index options or futures

* Invest some cash in tactical trading in more risky assets, mainly stocks

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