Investment Policy

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From words to action: the ECB has begun its heralded quantitative easing programme, which should last at least until September 2016. Apart from keeping interest rates low, the significant presence of the European central banks will enable commercial banks, which hoarded public debt securities in past years, to dispose of them without causing any violent price drops. Ideally, this should occur in a context in which the liquidity present, in addition to the other important stimuli such as weak currency and sharp decline in oil prices, will concretely help the European economy to leave this major crisis behind.

Also looming over Europe is the now tedious debate on Greece where, in the end, an agreement will most likely be reached through the application of the required reforms and extension/restructuring of debt.

For now, the market is living on expectations and lack of opportunities: stock indexes are up, but the prices of bonds do not appear to be deflating, awaiting some tangible signs of improvement in the economy.

On the other side of the Atlantic, investors are attentive to each word spoken by the monetary authorities, in the search for a possible clue that clarifies when and if interest rates will increase. The US economy has shown signs of life, but the fear of interrupting a trend that is still too fragile prevents it from exhibiting excessive confidence.

Even the Chinese authorities, committed to a significant change in their economic structure, are ensuring that the necessary monetary stimuli are implemented.

At least a truce appears to have been achieved on the Russian/Ukrainian front, although it is not an actual resolution. Russian securities and the rouble are enjoying excellent performance, both having recovered to a significant extent from the heavy devaluation they suffered.

On the currency front, QE continues to weigh on the single currency, whose external value is likely to change further. The Swiss franc appears to have found a certain equilibrium with respect to the euro: despite the negative rates, the dilutive effect of the European QE and the concerns with regard to Greece prevent the currency from remaining above 1.05 against the euro.

The currencies of emerging countries, partly recovered from the sharp devaluation following announcement of the likely intensification of US monetary policy, are experiencing a less volatile scenario: even a real increase in the US rates should not result in a strong sell off of these currencies.

It is clear that the market is increasingly less reactive to potentially destabilising events and, in the absence of significant global shocks, this may continue for some time.

US economic growth hints at a momentary slowdown

The US economic figures for the first quarter of the year were rather disappointing compared to analysts' forecasts. However, as is often the case, we believe the estimates were adjusted upwards with excessive optimism. Nevertheless, the US economy remains solid, as confirmed by the latest figures on employment, but the substantial creation of jobs is not currently accompanied by any appreciable growth in salaries. Indeed, the contrast between declining unemployment and lack of inflationary pressures is a dilemma for the Fed which, despite this, may decide not to raise interest rates before the end of the summer.
However, we do not believe that this will cast doubt on the American recovery and on the trend of the dollar against the euro. In fact, we believe that, like last year, the harsh winter played a significant role, causing a slowdown in economic activity. Supporting our opinion on the impact of bad weather are the weak data on housing starts for February, in contrast with the number of building permits issued, which were higher than expected during the same month.

The ISM index and consumer confidence in the USA

The ISM index (the US purchasing managers survey on the economic outlook) continues its consolidation phase. However, as highlighted, apart from the ISM and employment data, we believe that a quarterly scenario with lower economic growth will not impact the overall recovery trend for the year. The new orders component is undergoing consolidation, but the trend is still at an absolutely acceptable level.
Furthermore, consumer confidence remains solid: given the collapse in prices of oil-based products, we might have expected a higher figure, but it is in all likelihood impacted by salaries which, although increasing, are growing at more moderate rate than in other employment recovery phases experienced in the past.

Economic situation, PMI and inflation in Europe

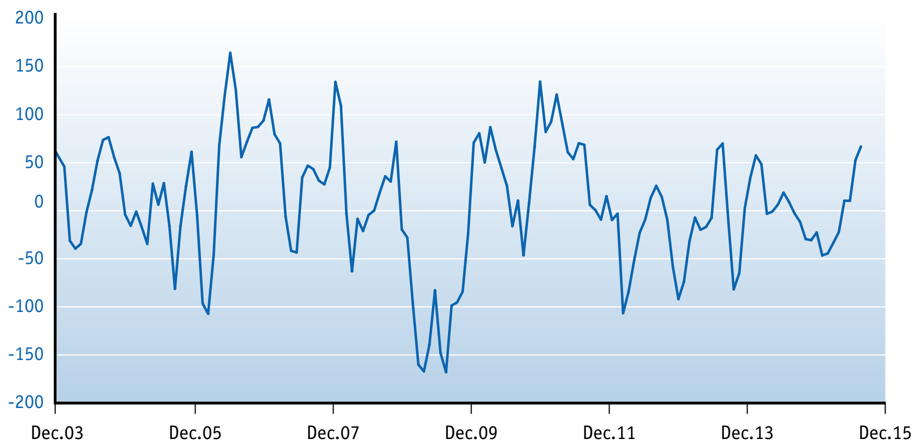
The ECB's announcement at the beginning of the last quarter of 60 billion euro in monthly purchases of bonds until September 2016 is without a doubt a truly extraordinary event. While on the one hand there may be some doubts whether these measures will actually affect growth of the European economies at the structural level, on the other it is undeniable that the impact on the financial markets has been and may continue to be highly significant.
Overall, economists have been too conservative on the possibilities for success of Quantitative Easing by the ECB: indeed, this measure has improved credit conditions and given a minimum but significant momentum to the economy. We do not envisage sharp growth, but it is important to recognise that the economy is moving in the right direction, leading to a significant change with respect to the past: since fourth quarter 2014, published European economic data have predominantly been above expectations. The situation is described clearly in the chart to the right, which measures the quantity of economic data published above or below economists' forecasts (where a positive level indicates that the data are on average above forecasts, a low one the opposite).
Moreover, while weakness of the PMI leading indicator in the first quarter is not in favour a strong economic recovery in Europe, other variables such as the increase in lending and a weak euro provide some optimism on the European economic trend over the next few months.
What continues to be a concern in Europe is the trend in inflation: the beginning of bond purchases by the ECB has facilitated a further decline in yields, but for now it has still not stimulated the expected increase in inflation forecasts.

The Swiss economy is showing excellent ability to handle appreciation of the franc

There were fears over the beginning of a recession in Switzerland starting from the second quarter, following abandonment of the fixed exchange rate against the euro by the national bank. However, since then, there has been a shift in opinion by the country's leading economic forecast institutes, due to stability of the euro-franc exchange rate at around 1.05, as well as strengthening of the dollar. The Swiss economy should see minimum growth in 2015, estimated at around 0.5%.

US Consumer Confidence

Eurozone: Citigroup Economic Surprise Index



We maintain a structural position on the US dollar

During the first quarter of the year, the currency market saw a continuation of the trends underway, with respect to which the main driver remains the monetary policy of the individual central banks: while in past months, the focus centred on the ECB, now that quantitative easing is fully operational, attention has moved to the choices of the Federal Reserve and its timing of the interest rate increase. Towards the end of the quarter, fears linked to excessive appreciation of the greenback (with a consequent slowdown in American exports), together with the strong market positioning, led to a series of profit takings, with a resulting jump in the EUR/USD cross-rate of over 5% compared to the lows achieved in the area of 1.05. However, we believe that the dollar's appreciation trend will remain intact, as this jump is considered normal within a medium-term shift. In fact, we see this adjustment as an opportunity, for those who took profits or for those without exposure, to build a "long USD" position.

The franc appears to have found an equilibrium between parity and 1.10.

After the shock with which the SNB announced its abandonment of the peg against the euro, the franc appears to have found an equilibrium above parity. The negative rates and a level judged to be excessively high, at least in terms of parity of purchasing power, prevent a further appreciation of the franc, a currency still highly valued for its status as safe haven currency. In addition to the above, we believe the presence of the central bank offers some guarantee with regard to greater stability of this exchange rate, namely between 1 and 1.10 against the euro.

We are evaluating investment in emerging countries' currencies carefully, selecting those with the highest value

In terms of emerging countries' currencies, our recommendation is to move cautiously. We believe the hike in American rates could weigh on these currencies, but to a more selective extent than in 2013. Therefore, it will be important to choose currencies with good macroeconomic fundamentals (supported by a central bank that is present and ready to intervene in tension situations) and with a market positioning that is not excessively strong. In this respect, we recommend the Mexican peso and the Turkish lira (even though the latter is impacted by the interference of president Erdogan with regard to independence of the central bank and the fierce conflicts in nearby Syria), while we are less positive with respect to the Brazilian real and the Asian currencies (except for the Indian rupee) for the above-mentioned reasons.
More specifically, the Mexican peso should benefit from its direct link with the US economy, and the monetary authorities have demonstrated to be active on the market, intervening directly with purchases in their national currency on days in which the currency was particularly under pressure.
Turkey is supported by good macroeconomic fundamentals and by a favourable and significant yield spread. Moreover, the low oil prices should benefit net oil-importing countries, and first and foremost Turkey. Nevertheless, a potential factor of concern is the country's risk of Islamisation, although at the moment this appears to be a rather remote scenario.
Lastly, with regard to Russia, we note a partial decline in geopolitical tensions, reflected in good performance of the rouble in the final weeks of the first quarter. However, the situation is still highly uncertain, and only the possible end of sanctions, at least on the European end, could support a further significant recovery in the currency.

A short position on the New Zealand dollar is an interesting challenge for the quarter as well

The New Zealand dollar is the currency that has probably undergone the most appreciation over the last 3 years. The underlying causes of this movement can be found in the restrictive monetary policy implemented by the central bank, in the strong immigration flow that has supported the real estate market in particular, and in the strong development of the milk industry, especially thanks to exports to China.
The exchange rate has in any case reached levels deemed to be unsustainable by the same New Zealand monetary authorities, and the latest economic figures are tangible evidence of the slowdown underway. However, the market does not yet appear to be banking on significant weakening of the currency. To achieve a greater short position in NZD, we await a catalyst that permits the market devaluation to change the attitude which, as of now, is still in favour of the New Zealand dollar (most likely, a rates-cutting cycle by New Zealand's central bank).

EUR-USD exchange rate

EUR-MXN exchange rate

Government bond yields in the Eurozone at record lows

The 60 billion euro in monthly purchases up to September 2016 is seen as a truly extraordinary intervention potential. In particular, a decline in yields was recorded throughout the entire Eurozone. A decline that appears to be unstoppable, with the Bund continuing to see new record lows (around 0.20 at the end of the first quarter of the year) and the yield curve in negative territory up to the 7-year maturities. This situation is driving investors to lengthen the duration of their portfolios and triggers a striking process of curve flattening. Until the market believes ECB can actually recreate inflation, the current situation will presumably continue over time. Of course, if the ECB measures prove to be effective in the upcoming months and are able to bring the inflation rate back towards the 2% objective, the long sections of the curve would be extremely vulnerable to a correction; just think of the 0.60% yield on the 30-year German bond.

US dollar issues more attractive than those in euro

On the other side of the ocean, macroeconomic conditions seem decidedly better than in Europe and the FED is expected to make its first increase in rates in the upcoming months. This situation has resulted in a sharp widening of yields between the two curves (US and European), actually facilitating further strengthening of the dollar, which at the end of the quarter was traded at between 1.05 and 1.10 against the euro. At these spread levels, we clearly prefer to invest in dollars.
After stabilising at a relative low of 1.6% at the end of January, the yield on the ten-year US bond has momentarily risen to above 2%. The market is highly volatile and operators are not sure of the next move by the Fed, which should begin to raise rates, albeit at a moderate pace.

Spread on yields between 10-year and 2-year government bonds in euro and USD

The yield on the 2-year section of the German curve is now negative at around -0.20% and, paradoxically, has benefitted marginally from the QE, as -0.20% is the very level indicated by the central bank as the low below which it will not purchase securities on the market. The beginning of QE by the European Central Bank brought the 10-year German yield to new absolute lows of around 0.20%.
In the USA, the 2-year section of the curve is at around 0.50%, slightly up. The market is in a sort of limbo: there are no significant hikes in the Fed funds, but we should now be close to the next restrictive move by the Fed.
Over the short terms, considering that the spread has continued to move downwards as a result of the change in ten-year rate, we recommend betting on the flattening at any indication of a steepening of the curve. In fact, after dropping to nearly 100 basis points, the 10/2-year US spread has now jumped back to around 150: at these levels, we favour recovery of a flattening yield curve.

We maintain a selective approach on emerging markets

On the emerging markets front, persistent weakness of oil prices is certainly creating tension for many issuers, and countries like Brazil and Russia are undergoing very difficult economic and political scenarios. It is worth monitoring these markets carefully, as high credit spreads could offer attractive investment solutions. However, a selective approach should be maintained, in order to avoid situations where creditworthiness deteriorates sharply. At the moment, we prefer securities in dollars, pegged to the Asian countries and to Turkey.

Bund yield – 10 years maturity

US Bond yield differential (10-2 years)

Context

In a context of increasingly low interest rates, equities are certainly the most interesting asset. This opinion is clearly shared by the large majority of investors and reflected in the valuations of stock indexes which, at the end of the first quarter, are not low-priced. In this respect, any negative surprises may transform into consolidation, which would still constitute a chance to accumulate new positions.

In general, with European Quantitative Easing supporting the markets, we believe that the improvement in economic growth expectations will make a significant reversal on European prices less probable than in past months, unless there are strong external shocks. Despite the Greek situation not yet being resolved, as the relative government does not appear to be willing to implement a concrete reform plan, the country's problems seem to have settled down for the moment (but with the recommendation to maintain sufficient attention on the issue).

The economies of the emerging countries appear more fragile at the moment, especially Russia and Brazil. As proof of this, the exposure of international investors to the emerging markets is lower than in the past, reducing the correlation of such markets to the trend in the US rates.

Valuations and EPS momentum in Europe

Over-performance of European prices shows how interest rates are of primary importance in determining performance of stocks. European companies are in an ideal situation: the central bank's QE resulted in sharp depreciation of the euro against the dollar, a reduction in financing costs and an overall climate of confidence.

The valuation multiples of the equity markets have undoubtedly risen, especially in Europe, due to the rally on the stock markets but, thanks to the announcement of QE, expectations have risen as well: we believe that we will most likely see a gradual increase in profit estimates over the next few months, to justify growth in valuations.

Forecasts on corporate earnings for the first quarter are already seeing better adjustments in Europe compared to the USA: the opposite of what happened last year.

Ultimately, as profits are one of the two most important variables for performance of the stock markets, together with interest rates, we maintain our opinion of a greater upside potential for European equities compared to US ones.

Excellent potential on Swiss stock market as well

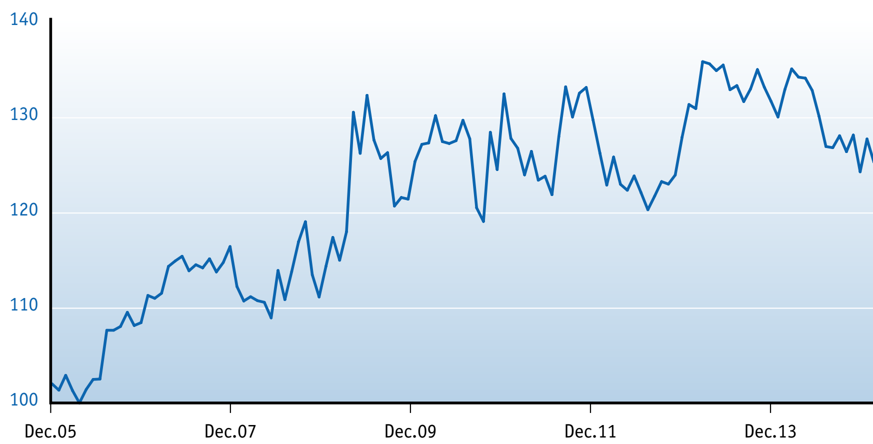
For the Swiss stock market, we envisage over-performance sustainable over the long-term, compared to the other global stock markets, driven by an excellent capacity to generate cash flows. In fact, the Swiss stock market has demonstrated an excellent level of relative strength, during adjustment periods as well as stock market increase phases. One of the strengths of the Swiss stock exchange lies in its high diversification, thanks to a mix of high-quality defensive companies and innovative cyclical ones, operating in market niches.

We believe this trend will continue in 2015: at the end of the first quarter, the Swiss Market Index (SMI) had already recovered what was lost during the January drop, linked to abandonment by the Central Bank of the peg against the euro.

Lastly, we believe that the appreciation of the franc has attracted the attention of international investors to Switzerland, to its quality companies and to its historically strong yields. The equity markets appear to have reacted more rationally to the SNB decision of 16 January than the currency markets: they have been exceptionally fast in absorbing the currency impact on Swiss companies' earnings forecasts.

Eurozone: EPS Momentum

SMI relative performance against MSCI World in 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 Diversification
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.

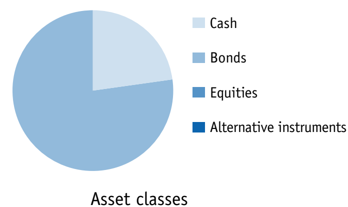
Asset Classes and Instruments

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

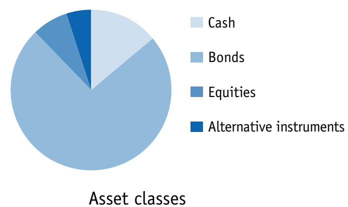
Cash*	23
Bonds	77
Equities*	–
Alternative instruments	–
	100



Asset classes

Income Plus

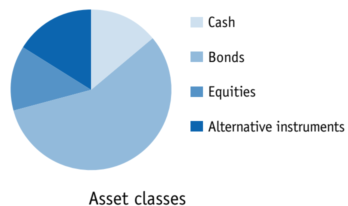
Cash*	14
Bonds	74
Equities*	7
Alternative instruments	5
	100



Asset classes

Dynamic

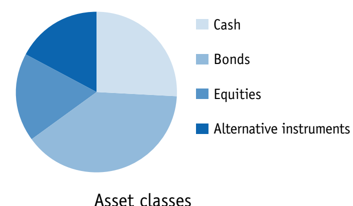
Cash*	14
Bonds	57
Equities*	13
Alternative instruments	16
	100



Asset classes

Balanced

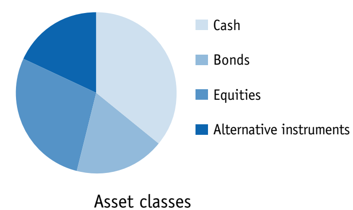
Cash*	26
Bonds	39
Equities*	18
Alternative instruments	17
	100



Asset classes

Growth

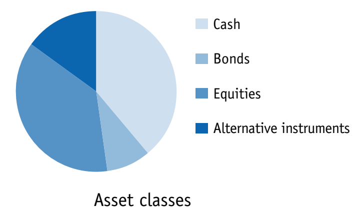
Cash*	36
Bonds	18
Equities*	28
Alternative instruments	18
	100



Asset classes

Equity

Cash*	39
Bonds	9
Equities*	37
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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