BANCA DEL SEMPIONE
SIMPLON BANK
BANQUE DU SIMPLON

Investment Policy

3. Quarter 2015

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Contents

Asset management

The Greek crisis and the sharp adjustments on the Chinese stock market were the key issues of the last few months.
The former, despite the exhausting but unanimous agreement reached, is far from having been resolved definitively. We believe that the key participant in these intensive years of building a single monetary and political zone is ECB President Mario Draghi, who rather directly explains the extreme importance of not disputing the irreversibility of the Euro, as the existence of the common currency is essential in order for the European Union to continue.
It is quite a bold challenge to assume that countries that are highly diverse both economically and culturally can quickly change to resemble one another to a point where they can share their common monetary, fiscal and regulatory policies to an increasingly significant extent. All starting from a scenario in which many public budgets are heavily indebted. It is clear that the intensification of the crisis accelerated this process of reforms that would have otherwise triggered greater opposition by some member countries, fuelled by their respective power within the Eurozone. Nevertheless, although we cannot ignore the strategic medium/long-term considerations which clearly take on greater importance in moments such as these, operations cannot disregard market trends, even if the behaviours could later turn out to be too “short-sighted”. There currently appears to be abundant liquidity, and the support guaranteed by the central banks continues to be viewed in a positive light by investors. The US economy is supporting the strong dollar, which in turn facilitates the European economies. Oil prices remain at record lows, after being halved; the recent agreement with Iran and elimination of the embargo represent, to the extent probably already discounted, an additional factor preventing any significant increases in oil rates.
Performance of the Chinese stock market requires separate consideration. The change in direction imposed on the economy by the current managerial class certainly leads to greater volatility in the performance of stock prices. A relatively less mature financial market may in turn see less rational behaviours by private investors. However, we do not feel that an additional significant reduction in prices is very likely: we therefore prefer to focus our attention on a process of medium/long-term growth of the real economy and a significant presence of the political and monetary authorities. This leads us to look at the reversal more as an opportunity rather than a harbinger of additional declines.
As far as interest rates are concerned, despite some positive US data, we believe the move to raise rates will be limited and will probably not trigger the beginning of a long bullish cycle. We are reassured by limited signs of inflation and a gradual reduction in raw material prices.
In Europe, despite the sharp hike in yields in the long end of the curve (which, from zero, brought the ten-year German yield to nearly 1 percent), we believe the stock of debt and the quantitative easing process will not allow for a significant increase in yields.

Scenario: heading towards higher economic growth and a bit of inflation

Overall average growth for 2015 was adjusted downwards compared to the previous year and is at around 3% (particularly due to the revised growth rates in the United States and in the emerging countries, headed by China). However, global growth looks set to improve gradually during the second half of 2015, after a very weak beginning of the year. In fact, inflation in the major economies reached turning points in the 1st half of the year and this should allow the FED to start getting off the ground by year-end, with an increase in the reference interest rates.

The two trends that triggered major economic changes starting in mid-2014 were the lower oil prices and a stronger US dollar, the effects of which - despite currently being in a stalemate - will continue to impact the global economy, in our opinion.

In particular, however, we believe they currently provide positive inputs to the US economy, mainly in the creation of new jobs, which is up, and an increase in wages, which are starting to grow at interesting rates. Consequently, we also expect private consumption to accelerate and drive the economy in the upcoming months. Lastly, even the real estate sector is taking advantage of this excellent phase in the employment segment, with building construction at record highs since the 2008 crisis.

With the United States in a fairly healthy position, the rest of the world will achieve benefits as well. In fact, the ECB's quantitative easing is generating an acceleration in the disbursement of loans, the link that was until now missing in the European financial transmission mechanism. Therefore, the prerequisites are in place for an economic recovery in the "Old Continent".

We do not believe the recent adjustment on European long-term rates will continue along the drastic lines recently observed, with a gradual and systematic increase in yields more likely over the upcoming months.

Finally an agreement on Greece, but there is still a long road ahead

In order to ensure that it obtains the third bailout and a continued presence in the Eurozone, Greece must first accept a series of measures through its parliament, including an increase in VAT, pension reform and close oversight by international institutions. It must also establish a fund with assets of €50 billion to be privatised, as collateral for the aid. Support by the ESM (the so-called "state-saving fund") will amount to over €80 billion, with 25 allocated to the banking sector in the event of lack of liquidity.

A cut to the nominal rate on Greek debt is excluded, while extension of the maturities on debt is likely, but only in a few months.

This process clearly masks many pitfalls, and tensions could reignite in a second. Therefore, we do not feel ready to archive the "Greece" file just yet.

Not only must Greek parliament accept the conditions of the agreement, but many other countries in the Eurozone shall also express their concerns on the issue. Even over the medium term, the solution hides many uncertainties with regard to its implementation.

ISM leading indicator and PMI improving

The ISM manufacturing index (which surveys the economic outlook among US purchasing managers) has resumed growth, confirming a timid recovery, following the first two quarters of the year which were decidedly weak. Other economic data are performing better than forecasted as well, in line with growth near potential for the current quarter. A significant contribution was made by the new orders component, growing further to 56 at the end of the first half of the year, thereby indicating good prospects for economic growth over the next few months (a figure of over 50 indicates expansion).

The European Purchasing Managers' Index (PMI) remains above 52 points, a record for the last 10 months. This figure is interesting as it indicates economic development, confirming recovery: the peripheral countries (Spain and Italy) are particularly strong, while France and Germany are on the rise. The latter in particular buckled under the weight of exports, due to a momentary drop in foreign demand, but private consumption remained fairly strong.

USA: new job creation on a monthly basis (in thousands)

Eurozone: PMI Index

The US dollar still offers investment opportunities, although less evident than in the past

The forex market continues to be highly uncertain and driven by external factors (such as the Greek crisis) rather than by the macroeconomic fundamentals of the individual countries. In terms of currency diversification, we remain positive on the US dollar, although we are less convinced than in the past. This lower confidence is mainly due to the Euro side and to the decline in government bond prices. One of the main reasons driving us to sell the Euro against the Dollar was in fact the rate spread between Europe and the United States: now that the spread has narrowed, some confidence has been shaken.

The situation on the US front is encouraging: after a sluggish start of the year, the economy appears to be recovering, once again driven by employment (with 220,000 new workers added in June) and retail sales (which after a few difficult months resumed growth), reigniting expectations of an increase in rates by the end of the year.

Given the above, we recommend keeping a portion of the portfolio in dollars, albeit to a lesser extent than in previous months. It will also be important to know how to strategically manage this portion, increasing exposure in area 1.15 and decreasing it in area 1.05.

We are also positive on the Norwegian Krone

A less inflated currency but which at current levels we consider to be valuable is the Norwegian Krone: the country's macroeconomic fundamentals appear to be qualitatively good and inflation is in line with the central bank's target (2.0%), which should exclude the risk of an increasingly expansive monetary policy (although this hypothesis had been brought forward by the Norwegian monetary authorities in their last meeting). Lastly, an equally important risk factor that could invalidate our outlook on the currency is the price of oil: oil rates underwent a sharp adjustment at the beginning of the current quarter, with a potential risk to the currencies of oil-producing countries.

With the Greek crisis underway, the Swiss Franc did not hold its usual role of safe haven currency

The ongoing succession of first positive and then negative news on the Greek front has so far had surprisingly moderate implications on the markets, especially the forex. Specifically, currencies that generally hold a safe haven role, such as the Swiss Franc and the Yen, showed much more limited performance than one would expect. Last week's move by the Swiss Central Bank to directly intervene on the market by selling the currency appears to have discouraged speculation, essentially making the Franc immune to market turbulence.

We recommend maintaining a prudent approach on the currency, trying to contain exposure rather than increasing it in the attempt to secure hedging which - given the uncertainty of the market - could actually be counterproductive.

Caution on the emerging currencies

With regard to the currencies of emerging countries, our recommendation is to adopt a prudent approach with regard to the extent of positions held, increasing positions only on particularly undervalued currencies with good macroeconomic fundamentals (like the Mexican Peso and Indian Rupee).

EUR/NOK exchange rate

EUR/CHF exchange rate

Context

The financial markets saw extremely high volatility in the last quarter. Various factors, both economic and non-economic, generated unpredictable changes, often undermining traders' beliefs. After the euphoria at the beginning of the year, following the European Central Bank's QE, in which markets hypothesised long-term scenarios of zero inflation and rising growth, we observed the profit-taking typical of excessively sharp movements. The result was a rebound in yields in the core bond markets, which led many to hypothesise the end of the now twenty-year downward trend in yields and to fear additional major declines in prices.
But just as the conviction of this inversion of trend was establishing itself, new disturbances appeared, starting with Greece, undermining the prospects for European growth. The excessively long amount of time that was required to find a compromise solution led many traders to once again seek refuge in German government bonds, at yields that just days earlier had been considered widely unappealing.

The Euro yields curve over 4 years is back to a positive yield

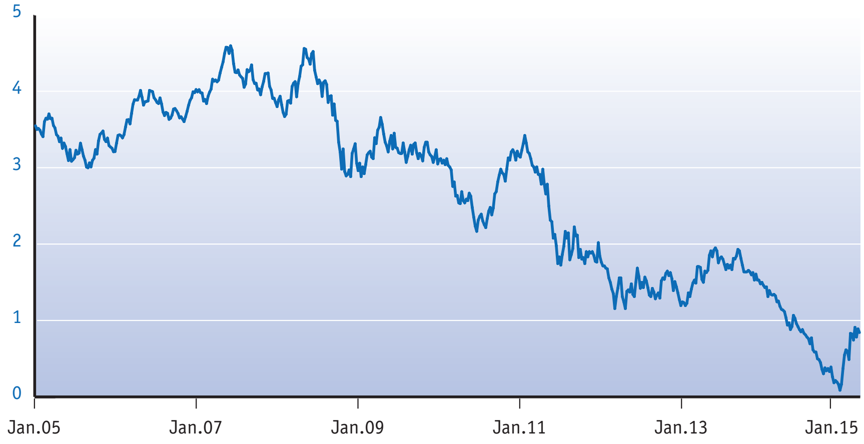
The macro scenario and the ECB's desire to continue in its stimulus policy keeps the very short portion of the rates curve at around 0%. The yield in the 2-year section of the German curve remains negative at around -0.20%, while the Euro curve recovers positive yields in the section over 4 years.
However, what is more striking is the upward adjustment on the German 10-year curve. The start of QE by the ECB coincided with the new absolute lows on the ten-year yield at 0.08%. Nevertheless, a significant generalised profit-taking on the market during the last quarter brought yields to around 1.0%, to then settle at the current 0.7%.
After having shifted downwards over the last 2 years thanks to the ten-year trend, the US government bond 10Y-2Y spread has now recorded a significant adjustment. We expect further flattening when the Bund yields go back to around 1%.

The 10-year USD yield curve

In general, the dollar yield curve shifted downward over the last quarter.
Yields have been at a standstill on the US monetary market for years now. Rate hikes are delaying, with nothing moving on this section of the curve. The 2-year section of the curve is at around 0.60%, slightly up. The long section of the US curve, on the other hand, is showing volatility due to substantial uncertainties on whether and when the FED will begin to raise rates: after reaching lows at 1.60% at the end of January, ten-year US yields bounced back to the current 2.30% in the last quarter. The market was stuck between forecasts of rate hikes that were constantly not achieved and the conviction that any hikes would not be too sharp.
The spread on the 2-10 year yield, after dropping to nearly 100 basis points during the last quarter, is now around 150. We expect the curve to return to flattening from these levels again for the USA, as well.

In conclusion, recalling that for the third quarter of the year we continue to prefer US government bonds over European ones, we maintain a tactical attitude in Europe with regard to the corporate bonds that expanded, under pressure due to the Greek crisis. On this front, illiquidity of the market may create purchase opportunities.

10Y German government bond yield



2Y US government bond yield

Context

We believe that the adjustment in European stocks that characterised the entire prior quarter has entered its final phase. Deterioration of investor sentiment across all major stock markets is so pronounced that a recovery in the second half of the year now appears to be likely.
In our opinion, the downward risk that European stocks will face during this quarter is determined by the US market, which remained stable throughout the entire previous quarter. We believe that in this final downward phase of the last few months, the main European indexes will not have to excessively adjust their current levels, unless the S&P 500 ceases its support in the 2040-2050 area. However, at the present time, we have no reason to believe that this will occur: although the flow of economic news from the USA has begun to improve, it is too early for the FED to adopt a significantly restrictive monetary policy by increasing rates.
As the indexes are moving within a limited range, current volatility on the US stock market (VIX index) remains low. The risk at these levels is to see a rebound in volatility, already higher on the European indexes.

It is still too early to consider the agreement on Greek debt as an investment opportunity

Implementation of the agreement on Greek debt is far from simple. The risk is that something in the various steps could create tension. The equity market is feeling the effects of a rather smooth resolution albeit not a definitive one. The stock markets reacted positively to the referendum on the debt agreements that could have triggered Greece's exit from the Eurozone, and at the first signs of a possible solution to the problem, they rose swiftly. As for trading, we still recommend caution.

Valuations of the equity markets and the earnings trend

At this moment, the problem is not so much the perception of risk as the awareness that appreciation of the more traditional defensive assets has made them relatively less attractive. In fact, despite the recent consolidation that led to a healthy reduction of valuations in Europe, multiples on the equity markets (12-month forward P/E) remain high on a historical comparison.
Nevertheless, the trend in earnings forecasts (EPS Momentum) appears to be improving both in the United States and Europe, and we believe this trend may continue in the upcoming months as well, thanks to higher economic growth. In this respect, if earnings are adjusted upwards during the second half of the year, as we expect them to be, the historically high multiples should not be cause for excessive concern.

The adjustment on Chinese equities may not be over yet

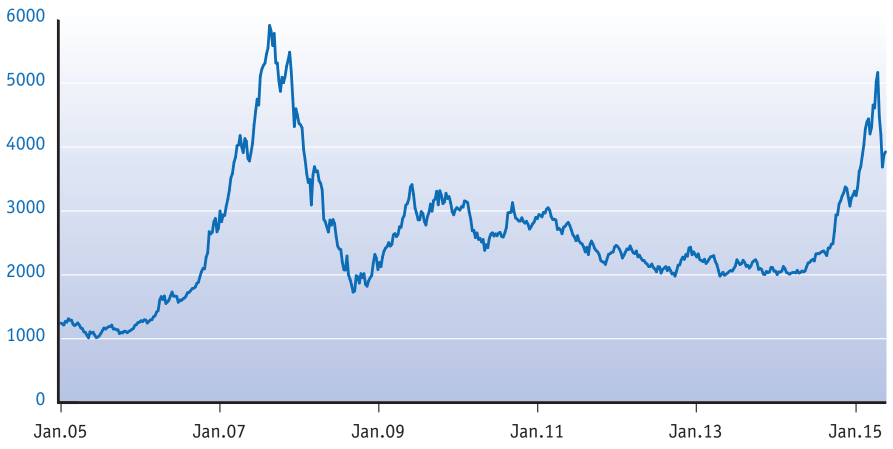
Credibility of the Chinese government in its supportive role to markets appears to have been structurally eroded. This is because the prices of local type A shares in the Chinese market suffered severe volatility starting from halfway through the prior year, compromising investor confidence in the government's ability to stabilise their fluctuations. Consequently, we expect many assets to be repriced at lower levels over time.
We also believe that the avalanche effect of the sharp market adjustment has not yet manifested its full effects: in fact, we expect slower growth in the real economy, lower corporate earnings and undoubtedly greater risk of a financial crisis in the country.

Facing the third quarter constructively but with caution

Although we believe the commitments made by Greece with the European authorities may put an end to the stock markets stalemate, the Greek problem has in fact been accompanied by a significant decline in investor confidence from the beginning of the year until now. This is, in our opinion, also connected to the gradual disappearance of deflationary risk and, therefore, the end of expansive policies by central banks.
Therefore, our outlook for the third quarter remains moderately optimistic on equities, with a preference for the Swiss and European markets. Simultaneously, with the risks connected to implementation of the Greek agreement and rising volatility across all asset classes, we cannot rule out stock market adjustments. We therefore recommend limiting exposure to equities, while taking advantage of dips to make new purchases.

Eurostoxx 50 Index volatility on a historical basis

Shanghai Stock Index performance



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.

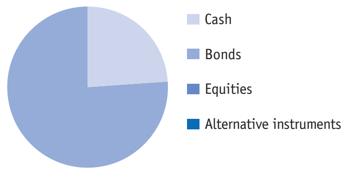
Our sharp focus on risk is also expressed through the use of index options to hedge the equity allocation if our analysis signals probable corrections.

TACTICAL ASSET ALLOCATION

Allocation by asset class

Income

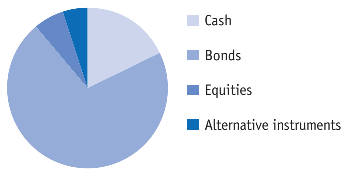
Cash*	24
Bonds	76
Equities*	–
Alternative instruments	–
	100



Asset classes

Income Plus

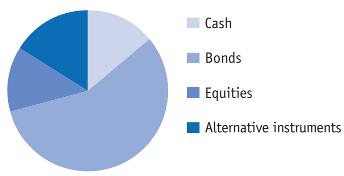
Cash*	18
Bonds	71
Equities*	6
Alternative instruments	5
	100



Asset classes

Dynamic

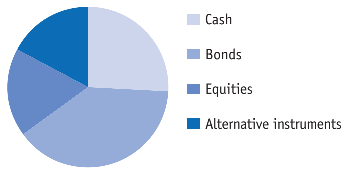
Cash*	14
Bonds	57
Equities*	13
Alternative instruments	16
	100



Asset classes

Balanced

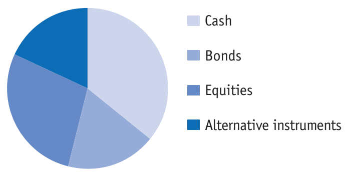
Cash*	26
Bonds	39
Equities*	18
Alternative instruments	17
	100



Asset classes

Growth

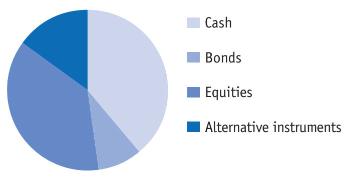
Cash*	36
Bonds	18
Equities*	28
Alternative instruments	18
	100



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

Head of Financial Department

P. Scibona	Tel. +41 (0)91 910 73 79

Research and Analysis - Portfolio Management

G. Flematti	Tel. +41 (0)91 910 72 38
M. Valsangiacomo	Tel. +41 (0)91 910 73 12
M. Bergamaschi	Tel. +41 (0)91 910 73 76
G. Bertoli	Tel. +41 (0)91 910 72 08
R. Bracchi	Tel. +41 (0)91 910 72 30

Customer Consulting

A. Walter	Tel. +41 (0)91 910 73 01
C. Buono	Tel. +41 (0)91 910 72 68
C. Saporito	Tel. +41 (0)91 910 72 34
D. Piffaretti	Tel. +41 (0)91 910 72 10
G. Rossi	Tel. +41 (0)91 910 72 40
M. Donelli	Tel. +41 (0)91 910 73 03
G. Bloch	Tel. +41 (0)91 910 72 31
C. Croci	Tel. +41 (0)91 910 72 32
S. Santovito	Tel. +41 (0)91 910 72 35

Divise-Cash Management

F. Casari	Tel. +41 (0)91 910 73 19
C. Dietschi	Tel. +41 (0)91 910 73 72
M. Maetzler	Tel. +41 (0)91 910 73 17
J. Brignoni	Tel. +41 (0)91 910 73 96

Branches Chiasso

R. Piccioli	Tel. +41 (0)91 910 71 76
M. Frigerio	Tel. +41 (0)91 910 71 74
A. Novati	Tel. +41 (0)91 910 71 78

Branches Bellinzona

E. Bizzozero	Tel. +41 (0)91 910 73 31
B. Tommasina	Tel. +41 (0)91 910 73 35

Branches Locarno

L. Soldati	Tel. +41 (0)91 910 72 56
C. Lanini	Tel. +41 (0)91 910 72 52

Banca del Sempione (Overseas) Ltd., Nassau

B. Meier	Tel. +1 242 322 80 15