BANCA DEL SEMPIONE
SIMPLON BANK
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Investment Policy

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In recent sessions, the relative calm and low volatility permeating the financial markets throughout 2014 appear to have given way to a more negative scenario, with the risk-off sentiment rather widespread in all of the main asset classes. Elements undermining the stability of the economy are also present throughout the world, and it is actually surprising to note that the geopolitical tension, risk of epidemics and structural issues plaguing some of the key economies have had no impact on the financial markets until just recently. However, we are, and will be, forced to live with situations in which economic and geopolitical analysis must be accompanied by an observation of the behaviour of the central banks. Their role in supporting assets and maintaining an extremely low nominal interest rate scenario is instrumental in understanding the performance of financial markets.

Economic growth and the confidence level of investors are showing substantial improvement in the USA, while old Europe is struggling to find a common strategy to face this difficult moment. The markets approve the attitude of the ECB governor, and they see Mr. Draghi as a flexible and forward-thinking point of reference. Above all, his measures are recognised as having permitted a significant improvement in the peripheral debt crisis since 2011. He is also credited with the recent measures aimed at stimulating bank lending, with subsequent expansion of the ECB's budget, which appear to have been the catalyst for weakening of the single currency. In Asia, China is still in the process of implementing a major change in its economic structure, which will inevitably go through stages of optimism, alternating with periods of pessimism by investors and analysts, with inevitable repercussions on the markets. However, we believe the process will move forward and lead the country to less vigorous but more sustainable growth.

We believe that the announced increase in rates by the USA will not be significant in numerical terms. The volume of debt to be cleared and the absence of inflationary pressures are at the basis of our conviction. In Europe, rates will remain near zero for a significant amount of time. In such a scenario, a reversal of the equity markets is not expected to trigger a bear market, but may instead be limited in terms of time and extent, offering purchase opportunities at prices that will become more convenient. In the currency sector, the dollar, which has already edged up significantly not only against the Euro and CHF, but against all other currencies as well, should strengthen further over the course of the next year.

The complexity of the surrounding world, however, calls for a review of the strategy, and a rather quick one. Management of money in such a complicated scenario and with rates still pegged to zero compels investors to become involved further, through more direct contact with professionals with whom to establish relationships of trust and promptly share their medium and long-term objectives, accepting the new rules of the game, which require, for any portfolio, acceptance of at least some volatility.

Context

The global economy appears to be in a positive position overall, but the trends are better in America and Asia rather than in Europe. Central banks generally seem to be in agreement with regard to keeping interest rates at extremely low levels, at least until the initial signs of inflation emerge. In terms of numbers, we can expect gradual global growth of around 3% year-on-year at the end of 2014, increasing to around 3.5% in 2015.
One major highlight in the USA is the strength of the job market: since 2009, the economy has created a quantity of jobs equal to those lost in the first part of the crisis and, considering the participation rate is lower than in 2007, growth in the US market is relatively solid. Thanks to the strong macroeconomic figures during the second half of the year, we foresee year-on-year growth of over 2% in the United States for 2014, while growth will exceed 3% in 2015. However, despite the improvements described above, the economy still needs support from the Fed. For emerging markets, we expect average growth to slow down yet remain steady compared to developed countries. In particular, a favourable climate is being created with regard to China, supported by the efforts from institutions aimed at increasing the country's credibility.

USA: ISM Index and Consumer confidence

At the end of third quarter, the ISM manufacturing index (the US purchasing managers survey on the economic outlook) reached peak levels since the 2008 crisis (mainly due to the increase in new orders and production to a level of over 60) confirming the excellent health of the US economy, also indicated by numerous other data published recently. The new orders component has in fact reached 66.7, exceeding the record of the prior year. This is an excellent indicator of a positive trend for the near future. Additional support was provided by the decrease in costs: raw materials prices are down and there is no upward pressure on the most important component for inflation, namely wages. Consumer confidence in the United States spiked during the quarter, approaching peak levels of the last seven years. The latest encouraging data on the economy and the steady creation of jobs over the last year are at the origin of this significant increase in the confidence index. Consequently, we believe that private consumption may contribute significantly to growth of the US economy over the next few quarters.

Economic growth prospects in the Eurozone: ECB measures

The most anticipated event last quarter was the ECB meeting at the beginning of September. Expectations were high, and the financial markets applauded Draghi once again, thanks to the measures announced: increase in the ECB's budget from the current €2 trillion to €3 trillion, and the purchase of ABSs and covered bonds, in addition to the TLTRO to facilitate the granting of loans for a total of €1 trillion and the cut of 10 basis points in the refinancing rate to 0.05%. Doubt remains as to whether the measures undertaken will be sufficient to resolve the problems of the European economy, but they will certainly facilitate it to a significant degree. Draghi could not go further, as interest rates differ within the various countries of the Eurozone. In order to purchase sovereign securities, the situation would have to worsen. The inflation trend in Europe (+0.3%, down this month as well) is cause for concern by investors: the measures adopted by the ECB during its last meeting only partly reassured the market, which still fears a deflationist spiral. Lastly, the Purchasing Managers' Index (PMI) in the Eurozone (which corresponds to the ISM index in the US) shows no improvement. After a positive phase last year, the index has fallen steadily throughout 2014, anticipating the weak economic figures published recently.

USA : Consumer confidence

Eurozone PMI manufacturing index

Continued weak Euro against the USD

The predominant issue on the forex market is once again the monetary policy decisions by the key central banks and, in this respect, the expansive measures adopted by the European Central Bank (budget increase, purchase of ABSs and covered bonds) have provided new stimuli to weakening of the Euro. Against the US dollar in particular, the exchange rate reached one-year lows. Even if the technical analysis highlights an oversold market, we believe the change will continue over the medium term, as the fundamental reasons and high demand for dollars in the market seem to prevail.

Diversify by betting on emerging currencies

The ECB's decisions actually position the Euro as the main funding currency and, in this respect, the Euro-emerging currencies short trade may become interesting in the upcoming months. Among the emerging issues, we look at currencies with sufficiently high interest rates and short positions on the market. Among the various currencies, we highlight the Mexican Peso, the Turkish Lira and the South African Rand. More specifically, the Mexican Peso is, among the aforementioned currencies, the one with the best macroeconomic fundamentals, and its close links to the US economy make it one of the most interesting emerging currencies. In terms of technical analysis, breaking resistance in the 16.85 area (lowest point since the beginning of September) would open the way for further appreciation of the Peso. The situation with regard to the Turkish Lira is improving from a fundamental standpoint. The current account is recovering, supported by the drop in oil prices (Turkey is a big oil importer), and growth is moderate, as is the unemployment level (8.8%). The main threat to appreciation of the Turkish currency is the geopolitical tension in progress, particularly with regard to the crisis in Iraq and Syria. In fact, exacerbation of this tension would have negative effects on the Turkish Lira for a number of reasons: both countries are key trade partners for Turkey; the geopolitical tensions create negative sentiment on the market for assets considered to be at risk; the price of oil may rise, significantly worsening the current account; and for geographical reasons, as both countries border with Turkey and any trespassing would generate tension, with subsequent pressure on Turkish assets. Lastly, the South African Rand has a significantly short market position and, in this respect, a return of interest in the currencies of emerging countries would likely benefit the South African currency first.

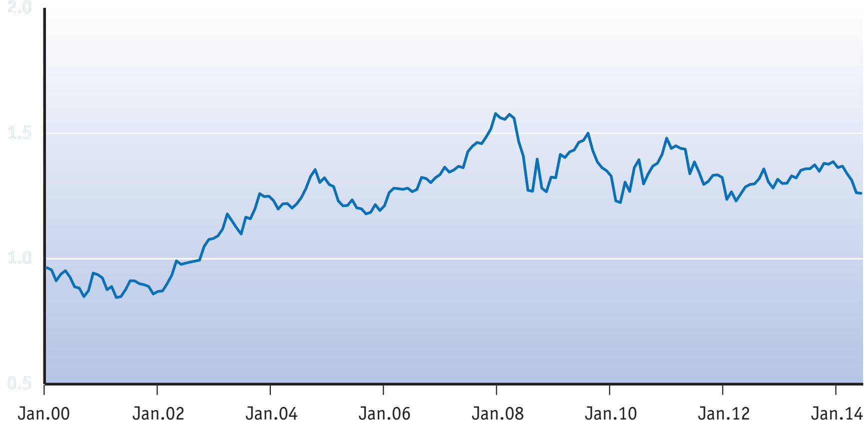
Long AUD against NZD positions offer interesting opportunities as well

Although outside of the trends linked to the US dollar, it is interesting to reflect on the movement of the Aud/Nzd cross rate, which after having interrupted its 2013 bearish trend, appears to be returning to long-term equilibrium levels, supported by sharply deteriorating New Zealand fundamentals and a more constructive price action. We envisage around 1.1700 as the final target of the current movement.

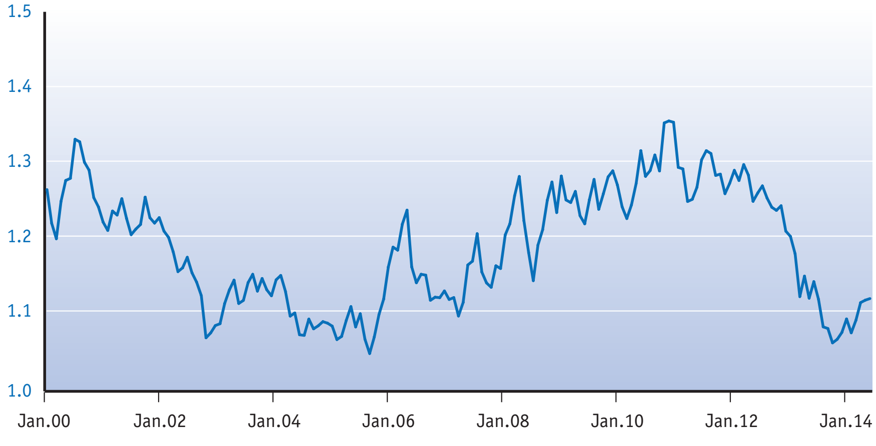
Appreciation potential for the NOK/SEK exchange rate

The last cross rate that deserves further analysis is the Norwegian-Swedish Krona. Both the fundamental and technical analyses indicate the exchange rate's equilibrium level to be at prices that are higher than the current ones (medium-term target 1.1800). With regard to the fundamental analysis, the main driver supporting an appreciation of the NOK/SEK is the net divergence in monetary policies: on the Norwegian side, the good internal situation puts the central bank in a condition to keep its interest rates unchanged and evaluate a possible increase for the beginning of 2016, whereas on the Swedish side, the absence of inflation puts the Risk Bank under pressure, and a further cut in benchmark rates (which would reach record lows) is not excluded. From the technical standpoint, the bullish trend of the cross rate since February 2014 is evident, and only a return to below 1.08 would lead us to question this view.

EURUSD exchange rate



AUDNZD exchange rate



Contex

On the bond front, we do not envisage a clear trend reversal in medium/long-term interest rates in the last quarter of the year. However, within this trend, we do foresee technical increases that shall be appropriately managed within a bond portfolio consisting of individual securities and mutual funds with adequate diversification. In particular, given the substantial liquidity present on the market and guaranteed by the central banks, we witnessed excellent stability of lower-quality bonds during third quarter and, more specifically, generally good performance of peripheral bonds, whose spreads against core bonds have widened only marginally. In this context, therefore, it is not surprising to see the Bund fall below the 1% threshold. We need to determine whether these yields are sustainable over time, but only the future will tell.

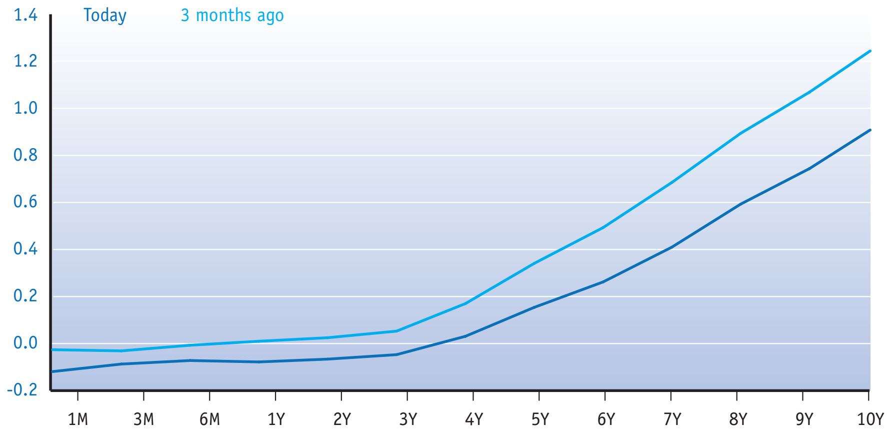
USA: investors' concerns over continued negative real rates policies

On the American front, the ten-year yield is at around 2.50%. It is safe to say that in a scenario of rising rates, this yield is certainly not an attractive one. However, the Japanese syndrome, with ten-year rates at 0.5% and inflation at 2%, now permeates the minds of investors. They have started to believe that central banks may be able to guarantee highly negative real rates to indebted governments by simply prolonging the zero-rate policy indefinitely. This scenario makes it extremely difficult to guarantee solid performance in the months to come, and we believe the market must be approached with extreme caution. When trends are expanded so, they sometimes change direction without an apparent reason and adjustments can be important.

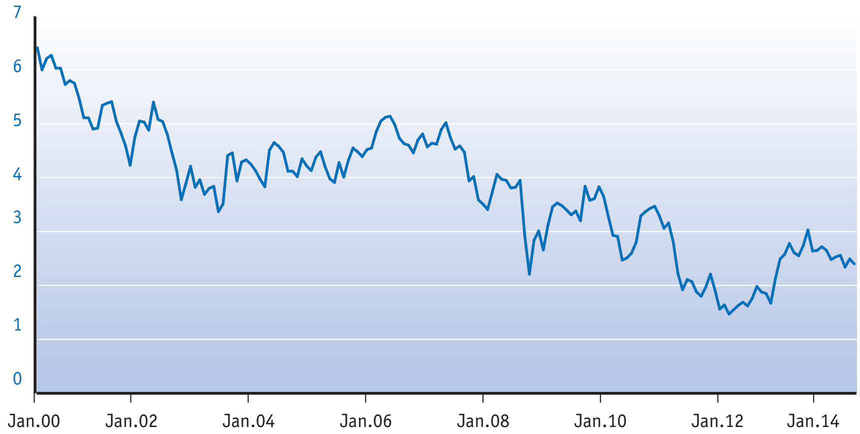
Eurozone: risk propensity down, but the market still offers opportunities

Until now, we have observed a relentless upward trend in the European bond markets, underway since the beginning of the year. From the core markets to the peripheral ones, from the emerging markets to the high yield ones, we have not yet seen any considerable profit-taking, despite the fact that valuations and yields are not very attractive. Nevertheless, the third quarter European macroeconomic data (which highlight a worrisome stagnation phase of the economy, accompanied by a continuous decline in inflation, which is even negative in several countries) and the geopolitical tensions, especially in Ukraine, have encouraged a sort of erosion of the risk propensity of international investors. The part of the market most impacted by investors' lower risk propensity is the subordinated bank and insurance bonds segment, which dropped by a number of digits. The prices of Russian bonds also show some volatility. However, we believe that these more penalised issuers can still provide attractive yields, as the situation improves over the short/medium-term.

German yield curve maturity 1 month - 10 years



USA : 10Y yield



Return of volatility on equity markets

Third-quarter volatility was back to the record lows of the last few years, not having been impacted by any negative event, such as the anticipated hike in reference rates by the Fed. We believe that investors may not have fully comprehended the Fed's guidelines on the timing of an interest rate upward trend, having discounted a more accommodating monetary policy than that envisaged by FOMC members. Another risk factor is underestimation of the recession risk being faced by the Western economies.
For these reasons, we expect a return to higher volatility levels in the short term, preferring Europe, the emerging markets and Asia rather than the North American stock exchanges.

Valuation of the equity markets and the earnings trend in Europe and the US

The valuation multiples of the equity markets (price/earnings) are near record highs since 2007, but we cannot judge them to be excessively expensive if compared to the low interest rates. An increase in multiples from these levels should simply be viewed as excessive optimism, without any upward adjustment in corporate earnings. This is already the case in the United States, while earnings in Europe have continued to decline over the course of the year. These latest downward revisions clearly seem excessive to us, especially in view of the recovering US dollar and the exposure of European companies outside of the stagnant domestic economies.

We shouldn't leave European equity!

Recent trends indicate that we may be approaching a turning point for equities in continental Europe. Indeed, the limited yield of European equities from May onwards is mainly a result of the conflict in Ukraine and renewed weakness of the continental economy. Nevertheless, the discrepancy between forecast macroeconomic figures in Europe and the United States appears to have reached excessive levels and, similarly, even the Eurozone's underperformance now appears to be excessive as well. Episodes like this have often represented interesting turning points in history. Moreover, weakening of the Euro should boost revenues and therefore growth in earnings: there is already evidence that earnings forecasts are reacting to a rather positive 2Q14 reporting season and we believe that earnings growth forecasts in continental Europe may accelerate in 2015, sustained by a weaker Euro. There is also a growing probability that the ECB will further ease its monetary policy in the upcoming future, with an increasingly likely full-fledged QE. In any case, equities remain an interesting asset over the medium term, particularly in light of the low interest rate levels. The single main risk factor continues to be the attitude of the US Federal Reserve.

VIX index

MSCI World Index P/E ratio

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.

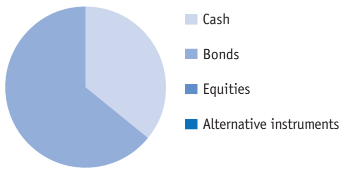
Our sharp focus on risk is also expressed through the use of index options to hedge the equity allocation if our analysis signals probable corrections.

TACTICAL ASSET ALLOCATION

Allocation by asset class

Income

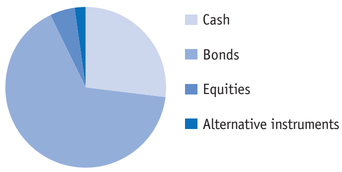
Cash*	36
Bonds	64
Equities*	–
Alternative instruments	–
	100



Asset classes

Income Plus

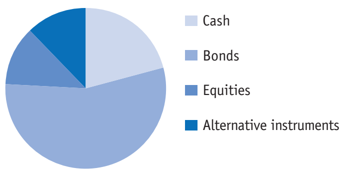
Cash*	27
Bonds	66
Equities*	5
Alternative instruments	2
	100



Asset classes

Dynamic

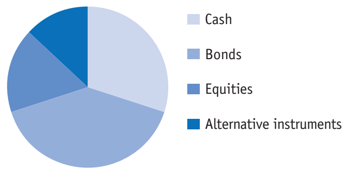
Cash*	21
Bonds	55
Equities*	12
Alternative instruments	12
	100



Asset classes

Balanced

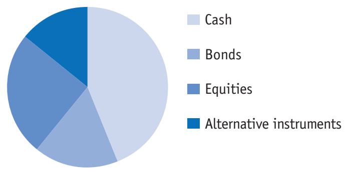
Cash*	30
Bonds	40
Equities*	17
Alternative instruments	13
	100



Asset classes

Growth

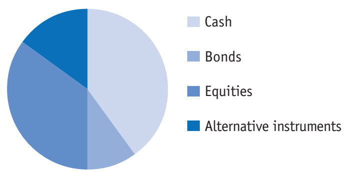
Cash*	44
Bonds	17
Equities*	25
Alternative instruments	14
	100



Asset classes

Equity

Cash*	40
Bonds	10
Equities*	35
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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