Investment Policy

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The start of the year has been both highly negative as well as unexpected, at least with regard to its extent, demonstrating a worrisome fragility of the financial markets.
The slowdown in the Chinese economy has been the core of the crisis, generating sharp declines in domestic stock market prices and in the Hong Kong stock exchange. The drop in oil prices, apparently justified by a slowing global economy and excess supply as a result of the end of sanctions against Iran, is not a small concern for investors. However, there are suspicions that behind these low prices is Saudi Arabia's willingness at least not to counter this trend, aiming to remove from the market countries whose production costs are significantly higher than the price levels achieved. In any case, the market seems to have targeted the decline in oil prices as the source of every possible downturn in the economy and stock markets.
We believe this scenario is impacted by at least some level of emotional reaction by investors, and we will observe performance in the upcoming weeks before declaring a sharp slowdown or recession that could justify further significant decreases in prices.
During recent sessions, the Chinese issue and concerns of a slowdown were accompanied by renewed fears with regard to Italy and, in particular, the country's banks. Heavy sales have steered clear of public debt securities, as these enjoy greater protection guaranteed by the ECB. The fear that non-performing loans in bank portfolios are higher than those declared, and the added concern about disposing these assets to a bad bank at prices that would impose new recapitalisation requirements on the Italian banking system, have generated heavy sales trends. The ECB governor has once again achieved confidence by the markets which, following his intervention, showed a more regular trend.
Interest rates, up for the first time since the major crisis in the USA last December, remain and shall presumably remain at exceptionally low levels in the old continent. Consequently, without significant slowdowns in the global economy, we expect reversal of stock market prices (indicatively 25% of the highs recorded last spring) to offer some purchase opportunities for long-term investors. However, we cannot ignore the price action and mood of investors, who are not currently in favour of a rise in prices: in our opinion, any rounding of positions must take place gradually and in line with the trend underway.
On the currency front, the EUR/USD exchange rate has been within an ample range (1.05-1.15) for a year now, and is expected to remain there over the upcoming months. There is continued weakness in the emerging currencies which have, however, reached exchange rates that may begin to attract long-term investors. The Swiss franc appears not to be responding to the current shocks, and this may lead investors to marginally drive down the value of the currency, as desired by the Swiss National Bank.

A turbulent start up to the new year

The fact that the economy and the financial markets had issues was no secret. However, seeing them explode to this extent at the very beginning of 2016 was quite a surprise. The epicentre of the concerns is the health of the Chinese economy. Over 2 years ago, the government decided to rebalance the growth components, giving priority to consumption rather than investments, which had created significant imbalances, starting with excess supply in many sectors. This has clearly resulted in a lower rate of growth, but the most worrisome part is that at the moment the market seems no longer to believe the data published by official Chinese agencies. In fact, we believe that the current prevailing opinion is an essential non-transparency of the Chinese statistics, although we do not consider China to have a high probability of systemic risk. In our opinion, the Chinese currency will continue to slowly devalue against the dollar, but without destabilising effects on the markets.

The American economy is showing slight worsening, despite the fairly healthy scenario of the labour market. It is the very figure on employment that convinced the FED to carry out the first increase in interest rates for many years now, indicating the Federal Reserve's conviction that the US economy has reached a decent level of self-sufficiency. As forecast, the FED has highlighted the fact that additional increases will depend on the performance of domestic and global economies. A guarantee that the pace of increases will be moderate.

In Europe, the timid path to recovery undertaken is expected to be confirmed in 2016. The leading indicators, such as the PMI, are rising slightly.

We forecast global GDP growth at around 3%

Despite the difficulties at the beginning of the year, we still believe that the timid path to recovery may continue into 2016, with global growth recording a "lateral" growth phase, and that a period of steady growth may finally set out the conditions for better macroeconomic data during the course of the new year, supporting the appetite for global risk. Corporate investments are still impacted by the effects of weakness in earnings growth (particularly in emerging markets) and the credit squeeze (which continues to be a real constraint outside of the United States). Therefore, we believe it will take some time before the bases laid out during 2015 in support of global expansion are robust enough for it to take another step forward. In any case, our current forecasts indicate that global GDP will expand during the first part of the year to a rate of just under 3% annually. In general, we expect 2.5% in the USA and 1.5% in Europe as positive signs for the beginning of a more solid growth phase.

The ISM index and the Consumer confidence

At the end of 2015, the ISM manufacturing index (which surveys the economic outlook among US purchasing managers) dropped below 50, indicating a decline in the manufacturing activity. Nevertheless, we consider the weak international demand and the liquidation of inventories which support of this trend as temporary, as other economic indicators seem to confirm the opposite. Indeed, despite the fact that consumer confidence has continued to slide from its maximum levels, its weakness is not a significant concern, as the index is not far from the record highs of the last 8 years. We believe private consumption may continue to be fairly strong in the upcoming months, as employment is high and growth in salaries moderate yet steady.

Eurozone: Manufacturing PMI Index

USA: Consumer Confidence Index

The US dollar remains the best diversification-opportunity

The forex market was extremely volatile at the end of 2015. The Federal Reserve finally raised interest rates, while the European Central Bank lowered them, lengthening the duration of Quantitative Easing.
With regard to the EUR/USD exchange rate, we believe that the most likely scenario will be a trading range at a support level of 1.05 and resistance at 1.15, and that most of the USD revaluation is now behind us.
Although the strengthening trend has slowed, diversification on the USD remains a crucial point of focus, essentially because the divergence between European and US economies and monetary policies, together with the higher yields offered by USD bonds, still support the investment on the dollar.

Emerging currencies continue to pose a risk, as well as an unexpressed recovery potential

The trend that has characterized part of 2015 and the beginning of 2016 has been the persistent problems in the emerging currency markets.
The collapse of commodity prices and the fears linked to Chinese growth were undoubtedly the two main factors of weakness. The Chinese authorities' determination to defend the CNY has highlighted a willingness to encourage moderate weakening of the currency. Nevertheless, we believe the yuan may continue to gradually devalue against the dollar and approach a fair value earlier than we had envisaged.
Among the emerging currencies, the most interesting opportunities are provided by the Russian rouble and the Mexican peso. We believe that the improvement of relations between Russia and the western countries could ease the pressure on a currency that is still suffering. The negative year-end performance was mainly due to the correlation between the currency and oil prices. Stabilisation of oil prices, accompanied by greater market sentiment, may lead to a recovery. Apart from the rouble, we believe that Mexican peso also has good fundamentals and, in a US monetary squeeze, is undoubtedly the emerging currency that would suffer the least.
On the other hand, we do not recommend the Turkish lira which, despite the country's improving macroeconomic situation, is subjected to high geopolitical tensions that may heavily influence it. We also maintain a negative stance on the Brazilian real and the Asian currencies.

No signs of appreciation on the Swiss franc

Lastly, we would like to provide a short focus on the Swiss franc: the currency's performance during the beginning of the year has given evidence of how the Swiss franc has lost its role of 'safe-haven currency' for some time now. The stock markets have put in heavily negative performances for weeks, with an overall climate clearly in risk-off mode. Nonetheless, the Swiss franc's exchange-rate against the main currencies has remained essentially unchanged. We believe –instead- that if market sentiment improves, the Swiss currency may weaken against the main currencies.

Chinese Yuan/US Dollar Exchange Rate

Rouble/Euro Exchange Rate

Context

After a very volatile December, financial markets were quite turbulent at the start of the year. The serious geopolitical tensions, fears of a global slowdown headed by China and the emerging markets, as well as the heavy decline in commodity prices, particularly oil, have been triggering a major resurgence of deflationary concerns. The majority of bond asset classes, from corporate investment grade to high yield and, above all, emerging markets, are undergoing a very difficult period, with investors unable to liquidate their positions, due to the lack of market makers capable of absorbing the sales flow.
The ECB's decision in December to lower benchmark rates and lengthen the QE has not had an excessively positive effect on the market. Spreads between core (Germany) and peripheral bonds widened slightly and the climate of confidence that arose in Europe rapidly dissolved at the beginning of the year. We do not believe the FED can be blamed for this situation, as it finally raised benchmark rates in December after a lengthy ordeal. The first step of a recovery process with limited expectations cannot therefore be considered as the cause of the market turbulence.

In this phase the core bond markets suffer less

As part of the substantial decline of bond markets from the beginning of the year, the core markets played only partially the role of safe haven assets: we believe that the current yield levels, while justifiable within the current context, are not justified with regard to a longer-term value, for example, this is the case of the German ten-year and thirty-year yields. We recommend keeping the duration of portfolios very low and, for those who can, short selling on these markets.
We believe the current causes of uncertainty may be with us for a while, but that none of them represents such a high risk as to jeopardise systemic stability. Overall, we do not see any unbursted or dangerous bubbles on the markets. Consequently, any adjustments, even significant ones, will not take on the dramatic tones typical of a bubble burst. We are therefore gearing up for phases of sharp volatility, with the awareness that they could dissolve quickly.

Oil issuers could offer interesting opportunities on the corporate bond market

The bonds of issuers in the oil and commodities sector (which have substantial weight on indexes) and those of emerging countries in general have been particularly under pressure in this phase. Even in the previous quarter, we were of the opinion that some valuations in this area had amply returned to a position above the minimum threshold of interest: the timing proved to be premature, but the recommendation is now more valid than ever.

Bloomberg USD Emerging Market Corporate Bond Index

10Y German Government Bond Yield

The new year begins with panic on the markets

The global stock market indexes kicked off 2016 with the worst weekly drop since September 2011 (the MSCI World index was adjusted by over 6% during the first week of the year). Renewed concerns on China were the main driver of weakness: during the first week of the year, A-shares of the Shanghai Stock Exchange recorded a daily drop of 7% twice in one week, and the currency depreciated against the USD.
Geopolitical risks also weighed on the stock market collapse, with further hostility between Saudi Arabia and Iran and exacerbation of the climate in North Korea, which claimed to have tested a hydrogen bomb. Oil prices slid further, below USD 30 per barrel for WTI, and stock volatility increased on a global level. Oil futures approached the lowest values since 2003, while energy and mining stocks were under particular pressure, bringing the MSCI All-Country World global stock index to losses of nearly 10% in the first half of January.

...but we are moderately optimistic

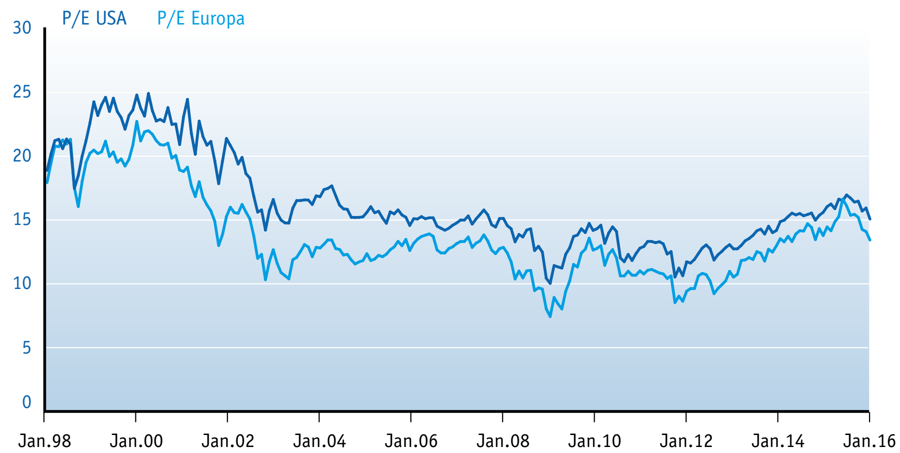
The risk of a full-blown bear market remains low, given the absence of an actual recession, a scenario that we continue to consider unlikely. Most structurally bearish market trends of the S&P 500 index have generally coincided with recession phases in the US economy. Exceptions were observed in 1961, 1966 and 1987 and, just because they did not occur during recessions, they did not last long and were followed by rapid recovery periods.
We believe caution over the short-term to be justified, although we do not recommend selling in the wave of the panic phase.

Some factors still support the stock markets

Company profits are still under pressure, but valuation multiples are low in terms of price/earnings and give a moderate value to the market.
On a fundamental level, we do not envisage a bubble situation, with excessive valuations and significant reduction in earnings forecasts in the upcoming future. Consequently, we consider a vertical drop in the equity markets to be unlikely. The main risk factor is the price of oil, which has moved downwards in a haphazard manner. A further sharp decline in oil prices to around USD 20 would cause additional pressure on the stock markets. We would like to point out that this is not our base scenario.
In this context, investor sentiment is highly negative and some indicators have reached excessive values, such as the CBOE put/call ratio, Volatility indexes and Number of bear investors. In such technically oversold scenario, a bounce-back is likely.
In a medium-term outlook, the stock market weaknesses can be used to create new positions, without excessive exposure. In fact, volatility will be a constant in the new year. We continue to prefer the Eurozone, as it is supported by a weakened currency and, above all, by a central bank with a highly expansive monetary policy.

Shanghai Stock Exchange Index Performance

P/E of European and US Stock Markets



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

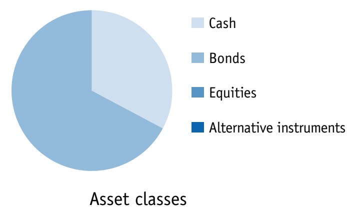
Along with cash, bonds and stocks, we also invest in alternatives, such as funds of hedge funds, convertible bonds, commodities and precious metals. Currencies are also an alternative investment. Currency diversification allows us to add yield and so, through selected transactions, contribute to achieving 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.

TACTICAL ASSET ALLOCATION

Allocation by asset class

Income

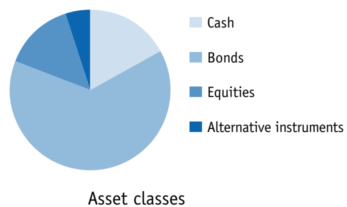
Cash	33
Bonds	67
Equities*	–
Alternative instruments	–
	100



Asset classes

Income Plus

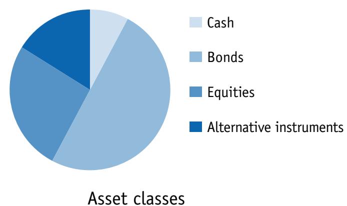
Cash	17
Bonds	64
Equities*	14
Alternative instruments	5
	100



Asset classes

Dynamic

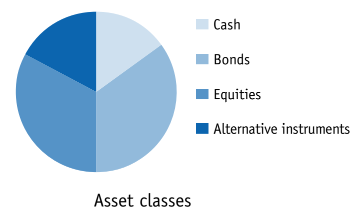
Cash	8
Bonds	50
Equities*	26
Alternative instruments	16
	100



Asset classes

Balanced

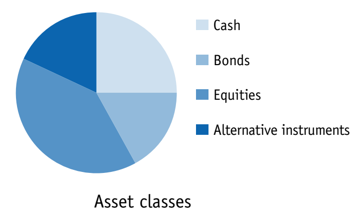
Cash	15
Bonds	35
Equities*	33
Alternative instruments	17
	100



Asset classes

Growth

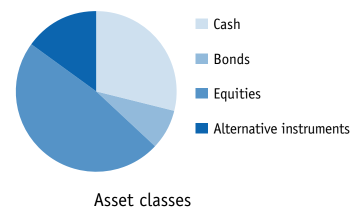
Cash	25
Bonds	17
Equities*	40
Alternative instruments	18
	100



Asset classes

Equity

Cash	29
Bonds	8
Equities*	48
Alternative instruments	15
	100



Asset classes

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

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