Our Point of View
June 30th 2016

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Performance of the world's major stock markets

A) January 1, 2016 - June 30, 2016		in USD	in local terms
Switzerland	SMI	- 7.87%	- 9.05%
Germany	DAX Xetra	- 8.56%	- 9.89%
France	CAC 40	- 6.88%	- 8.62%
United Kingdom	FTSE 100	- 6.17%	+ 4.20%
Sweden	OMX Stockholm 30	- 9.12%	- 8.52%
Europe	STOXX 50	- 10.66%	- 12.33%
USA	S&P 500	+ 2.69%	+ 2.69%
	Nasdaq	- 3.29%	- 3.29%
Japan	Nikkei	- 4.35%	- 18.17%
India	Sensex	+ 1.40%	+ 3.38%
China	Enterprise Index	- 9.92%	- 9.81%
Morgan Stanley	World Equity Index	- 0.57%	- 0.57%
Bloomberg Effas US$ Bond Index (5-7 years maturity)		+ 5.68%	+ 5.68%
Balanced Mandate Index *		+ 2.55%	+ 2.55%

B) Over five years		in USD	in local terms
Switzerland	SMI	+ 11.68%	+ 29.63%
Germany	DAX Xetra	+ 0.15%	+ 31.23%
France	CAC 40	- 18.80%	+ 6.41%
United Kingdom	FTSE 100	- 9.66%	+ 9.40%
Sweden	OMX Stockholm 30	- 11.53%	+ 18.68%
Europe	STOXX 50	- 23.25%	+ 0.57%
USA	S&P 500	+ 58.93%	+ 58.93%
	Nasdaq	+ 74.60%	+ 74.60%
Japan	Nikkei	+ 23.88%	+ 58.68%
India	Sensex	- 5.46%	+ 43.27%
China	Enterprise Index	- 30.53%	- 30.72%
Morgan Stanley World Equity Index		+ 24.19%	+ 24.19%
Bloomberg Effas USD Bond Index (5-7 years maturity)		+ 20.44%	+ 20.44%
Balanced Mandate Index *		+ 22.31%	+ 22.31%

*50% Morgan Stanley World Equity Index and
50% Bloomberg Effas USD Bond Index (5-7 years maturity)

IN OR OUT?

Discontent in the EU

Unfortunately we went to press before the Brexit referendum took place, so we are unable to comment on the result of the vote here. That doesn't actually matter, however. What counts is that the exit scenario is becoming increasingly topical in many core EU countries, while in Eastern Europe and the Balkans new candidates are scrambling to join and the Schengen accords designed to create free and open borders are in disarray. Barbed wire rather than border freedom is now in fashion.
Regardless of how the Brexit vote went, in this case the mountain has given birth to a molecule of a mouse. In our view it will make no real difference to the UK whether it remains in the EU club or not. This member is too important for Europe. US president Barack Obama made a bad joke when he warned British voters that in the event of Brexit Britain would be at the back of the queue when it came to renegotiating bilateral deals. Europe barely remembers Switzerland's EEA referendum a quarter of a century ago. At the time, politicians and all the many experts (there will soon be more of them than there are citizens) warned the Swiss that a no vote would mean economic isolation and inevitably lead to an unparalleled apocalypse. They nevertheless voted no, and today there are only very few who still talk about Switzerland joining the EU. For the many experts and self-centred politicians were completely wrong in their predictions that rejecting the EEA would bring about the collapse of Helvetia. Quite the opposite happened! Thanks to the admittedly opportunistic approach taken when negotiating bilateral agreements, Switzerland stayed in the premier league for growth, full employment, productivity and innovation, and the Swiss franc remained the poster child of the currency area. With this in mind, we believe that portraying an impending Brexit as a historic catastrophe of the highest order was pure scaremongering on the part of the city and Cameron's Eton boys. It is of course entirely possible that as a non-EU member Switzerland may slowly waste away in the future as a result of global developments, and that the same fate may befall the UK if it casts off its strong(?) EU corset. But is this likely given that little Switzerland has got by perfectly happily for decades without EU membership and with an independent currency? The UK is one of the EU's big players. It goes without saying that if it left then bilateral relationships would be established straight away. The eventual verdict of the electorate on 23 June doesn't really matter, except that Brexit could signal the beginning of the end for the EU. We shudder at the prospect of further

EU expansion, with Montenegro, Serbia, Albania, Macedonia, Bosnia, Ukraine and – no, we haven't forgotten about it – Turkey all potential accession candidates. When we think about these names, we hear Oliver Twist's "Please Sir, I want some more" coming through loud and clear. Only we're not talking about a bowl of porridge here, but about money from Brussels. Lots of it. While it is laudable to think charitably, and even more admirable to act generously, sooner or later parasites kill every host. That sounds hard. Such statements are not politically correct. True, but some politically incorrect statements are nevertheless right.

So, my dear British friends, whichever way your country voted on 23 June, have no fear. In the context of economic history, the referendum was a storm in a teacup. And if you decided to leave, it was a long-term and forward-looking signal to Brussels that the EU has to change tack. Oliver Twist's escalating demands for more will become quite simply unsustainable.

THE SOLUTION IS: FORGET IT!

Big bank shares: the eternal misery game

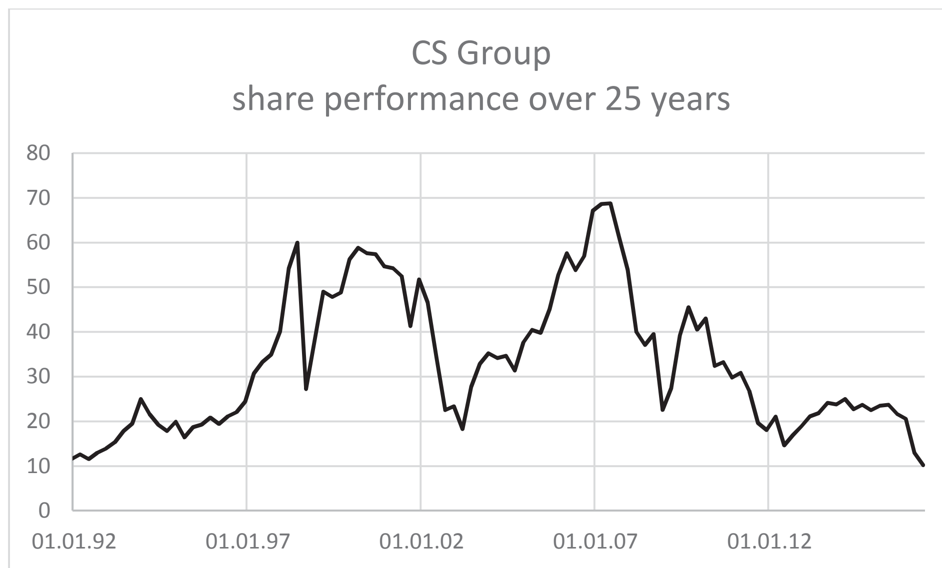
The financial press is constantly suggesting that we will be passing up the opportunity of the century if we don't immediately invest in shares of the world's big banks. Now, these corporate behemoths have a powerful and financially strong lobbying position, which even some journalists are obviously not immune to.

The turnaround is coming, the reorganisation will soon be completed, profits can only go up, costs are under control and other such words of praise are bandied about like a mantra in the hope that soon everyone will believe this sector really does offer the best bargains of all. Don't believe a word of it. When even the CEO of Credit Suisse has no idea what sort of risks his investment banking unit is or has been taking, when this much-vaunted new broom apparently has to suddenly acknowledge, after a year at the helm, that its balance sheet includes countless billions of goodwill that are in fact no longer worth a single penny, then how are investors like you or I supposed to assess such major companies? It's no wonder that the price-to-book ratios of these shares are unusually low when a company's reported value has to be "adjusted" by billions overnight. One should also take care not to succumb to the temptation of attractive dividend yields, whose

sustainability is about as stable as a bottle of beer on a rocking horse. Look at the big (and still proud) Deutsche Bank, which suddenly announced a dividend holiday. Things are on the up at CS, says the management, and that includes dividends. We shall see. Shareholders will probably be fobbed off at least in part with new shares as soon as cash supplies dwindle again. And UBS, no stranger to sinning, is back in court again in New York. This time it "only" concerns USD 2.1 billion in connection with mortgage bundles of dubious quality that were touted as bijou. Bank profits in the US are also stuttering. Goldman Sachs has seen its profits fall for the fourth quarter in succession, and a collapse of way over 50% was reported for the first three months of this year. So much for the reliability of wonderful investment banking.
Bank shares have been an appalling asset class again this year. The worst. The European bank index fell by 33%. People have had just about enough of the constant fines, restructuring costs, opaque business models and casino-style gambling antics of investment banking departments. Bank shares only seem cheap. With a price-to-book ratio of around 0.7, one cannot talk about overvaluation, but balance sheets are unfortunately less reliable than a confidence trickster's certificate of good character. When assets amounting to countless billions of goodwill are carried innocently on balance sheets without being questioned by the Chair or CEO, such book valuations are pure rubbish.

Still fancy some "cheap" bank shares? Well what about this then?
Credit Suisse has just pulled a new vehicle out of its box of tricks, placing – with difficulty – a catastrophe bond offering a fantastic coupon. This bond is designed to protect the bank against financial misfortune such as unauthorised actions by staff, breaches of banking law, failures of IT systems and all kinds of internal disasters. In other words, Credit Suisse is looking for (stupid) investors to foot the bill for its dishonest conduct, errors, and legal fees for lawsuits (which keep on coming). The management is no longer prepared to bear the risks, which it quite clearly lost control of a long time ago, itself and instead wants to pass them on to these gullible investors. We find that the height of brazen effrontery.
Big bank shares are neither sustainable nor reliable investments. Even these shares do rise from time to time of course (artificial increases after recurring falls), but reasonable investors should quite simply eliminate this sector from their considerations. Delete. Enter. Done. For around a quarter of a century, people have earned nothing in this permanently infected sector. No-one wants to spend their holidays in an intensive care unit. So better not to soil your portfolio with shares in big banks, whose managers continue to view their own companies as self-service shops.

If you invest in index products on the stock market, simply choose an ETF that excludes the banking sector. Credit Suisse's catastrophe bond should now open the eyes of even the most credulous investor. The brazenness of this placement, especially given the raft of evidence that disasters of all kinds are part and parcel of everyday life, is the epitome of arrogance. Nothing less.



"A VERY INTERESTING CONCEPT" (Mario Draghi, President of the European Central Bank)

Helicopter money and other such madness

While the US is slowly but surely trying to end its ultra-expansive monetary policy in order to carefully bring the yield curve back to normal levels, the European Central Bank is seeking to increase the money supply through brute force. Interest rates are negative, billions' worth of bonds are yielding less than zero, and Mr Draghi continues to increase central bank securities purchases in order – he says – to haul European inflation up to around 2% p.a. So far without success. Only Japan has an even more frenzied buying programme than Europe, with the aim of cutting interest rates to even more abstruse levels and weakening the currency. But which currency turned out to be this year's poster child? That's right, the yen.
No-one understands it, not least the central bankers. And so the academic idea proposed by Milton Friedman in the sixties, namely that money dropped from a helicopter would theoretically be spent by the population, is now suddenly rumoured to be a serious future measure being considered by the central banks. Of course, this metaphor cannot be taken literally. Money would not physically fall from the sky. Such funds would instead be given to governments, who could use it to increase spending or cut taxes with the aim of boosting consumer spending. Whether citizens would play along with such a game in the manner intended is another matter entirely. It is quite conceivable that they would put the unexpected windfall away for a rainy day or use it to reduce their debts, negating the stimulus effect. But have we not in fact long been in an era of helicopter or monopoly money anyway? The Swiss National Bank has inflated its balance sheet by several hundred percent over the last two years, printing money non-stop and using it to buy up countless billions' worth of securities. This is helicopter money, nothing less. But perhaps we will soon receive something from this blessing in the form of tax reliefs, consumer credits or similar gifts.
However one views the situation, monetary policy is approaching an end point beyond which stimulus will have less and less of an effect. We say this with great reluctance, but the system is quite simply out of control. The existing debt mountains are grotesque, and the actions of the central banks are an academic high-wire act. The end game, which seems to be in full

swing, suggests that government debt and how it is financed in the future will be assumed in a targeted way by the central banks. Permanently, mark you. This megalomaniacal undertaking has now effectively been set in motion and is the reason why the stock markets are still in a frivolous mood. Whether the financial and monetary system can cope with these dangerous goings-on over the long term is debatable. It is worth noting the volatile, albeit not bad, performance of the financial sector on the stock markets. We view this as a bad omen. In a next phase it is entirely possible that investors might lose confidence in paper money, as the central banks' ultra-expansive monetary policy will probably be extremely difficult to roll back. It is for this very reason that helicopter money is now being debated at the highest level. A dip into the central banks' box of tricks that appears well-nigh outrageous. This is precisely why we hold a strategic position in physical gold, as a loss of confidence would result in a flight into real assets. Periods of frenzy always last longer than common sense would suggest is possible. The central banks will continue to work their magic for a while yet, but the day of reckoning will come eventually.

THE EXAMPLE OF JAPAN

The record monetary run

The European Central Bank is slogging away with intensive stimulus measures, but its twin in Tokyo knocks the wild goings-on in Frankfurt into a cocked hat. Securities purchases were increased on an ongoing basis, and when this still didn't lead to long-term success, negative interest rates were introduced. All with the aim of further reducing interest rates and essentially forcing banks to grant loans almost for nothing, weakening the yen and above all fuelling inflation. Unfortunately the self-administered drug does not appear to be working. Inflation refuses to go up, and to make matters worse the external value of the yen has not fallen as intended but has actually risen. A real nightmare for the central bank. We spoke in the previous article about helicopter money. Well, there is a very real possibility that it will become a reality in Japan. The land of the rising sun has in fact begun to finance government spending directly by printing money, which boils down to the same thing as giving every citizen a bundle of notes.

Sooner or later the financial market will recognise this, and we believe the result will be further yen weakening and a rise in share prices. It goes without saying that the yen should be hedged for such exposures.
Events in Japan should serve as a sign that we have already entered the age of helicopter money, and that this abstruse term has already become part of reality. Playing with confidence, nothing less.

BALANCING ACT

The complex stock market environment

At the end of the year we predicted that there could be a stock market correction from March onwards. Now, we were wrong and yet still right. The correction actually took place in January and proved to be pretty brutal in scope – primarily for Swiss blue chips. As a result, the first half of 2016 demonstrated once again just how difficult our job is. Sometimes you correctly predict a forthcoming setback, but are wide of the mark as regards the exact timing.
In our last report we highlighted a number of adverse technical aspects that made a correction a plausible short-term scenario. Some of these negative factors have since ceased to apply, but unfortunately there are now also new warning signs to take into account. These include the background to the Dow theory, which states that the market is in an intact upward trend if the industrials average corresponds with the transportation average. This is not the case at the moment. The transportation average, a leading indicator, is weakening, not a positive omen for the US market. The breadth of the market also leaves a lot to be desired, and trend-following indicators also tend to point to falling rather than rising prices. All these aspects relate to the US market, which remains the bellwether for global sentiment.
Certain warning signs are still evident, therefore, and as such we must state loud and clear that the fortunes of the stock markets now depend almost exclusively on two purely monetary aspects: the central banks' obsession with stimulus measures and the pace of interest rate hikes by the US Federal Reserve Board.

Fortunately the US published poor job creation figures in June – a very cynical sounding statement. While the data for a single month may not be especially meaningful, the apparent weakening of the labour market in May led overnight to an expectation that the interest rate hike in the US, previously considered a near-certainty, would in fact be postponed. Both the dollar and stock market prices reacted promptly to the weak labour market figures and the prospect of the second US rate hike being pushed back even further. The dollar fell and share prices rose. The past month has shown quite clearly once again just how unilaterally today's market environment is influenced. The interest rate trend is king, with little attention paid to the fundamental economic situation. Will the world remain constrained by its zero interest rate corset, or are we about to return to normality? The stock markets are like a junkie hooked on the drug of ultra-low interest rates. If this stimulus measure, which has now taken on absurd proportions, is taken away from them, then price corrections are almost certain to ensue. It is a game of musical chairs, an analogy we have used in the past. When the music stops (the zero interest rate environment is taken away from us), the game is over. Federal Reserve Chairwoman Janet Yellen has the unenviable task of deciding everyone's fate, and it goes without saying that countless interest groups are trying to actively influence the Fed's decisions. So let's remain on our guard by monitoring all the indicators that have historically proved to give reliable counsel. If we do this, then certain warning signs cannot be overlooked. The crucial factor is the interest rate trend, however. The life or death of the zero interest rate policy is the ultimate joker in the pack. At some point the central banks' perverted game, which penalises savers and rewards borrowers, will come to an end. The current situation, which has prevailed for far too long, is economically grotesque, sociopolitical theft and nothing less than brute force politics. At the risk of repeating ourselves, something that makes no sense is quite simply nonsense. But how does knowing this help us when cash balances in an account are hit with negative interest rates and investments in time deposits and bonds trigger a guaranteed loss? The truth is that the world's investors have no other choice but to maintain their equity exposures. Common sense tells us that something is rotten in the state of Denmark, but the central banks are forcing us to maintain the status quo of relatively large equity holdings. Any change in investment policy results in a guaranteed capital loss on day one of a shift into defensive investment vehicles. That is the truth, the whole truth and nothing but the truth.

YOU HAVE TO BE THERE

Virtual reality

From time to time and with increasing frequency, the author, who is no longer in the first flush of youth, is struck with a slightly queasy feeling when he sees how the younger generation are ruled by the internet and their clever electronic devices. Holidaying families sitting round the hotel breakfast table with mum reading a book on her Kindle, dad studying the stock market prices on his iPad, daughter posting a picture of her fruit salad on Facebook and son engrossed in his Gameboy are by no means a new occurrence. But the extent to which millions of people’s everyday lives are now determined by computers and the internet is astonishing if not alarming. Satellite navigation is now taken as read. The internet knows us better than we would like, and the cloud knows more about our lives than we do ourselves. As we travel into the city we are bombarded with recommendations for restaurants and places to park, and the journey time to our destination is also calculated for us. Our computer knows what the traffic is like. We simply have to say yes, and the tentacles of the cloud automatically direct us into an eatery that matches our usual diet. Recently, while manning the barbecue in the garden, my son whispered “Remind me in three minutes” into his iPhone so that his smartphone could keep track of how his sausage was doing. The computer world has a ubiquitous presence, and one sometimes gets the sense that all those city dwellers who are constantly glued to their smartphones should be supplied with a guide dog by official decree. Nothing is left to chance any more. Our computers tell us when our car service is due and put an appointment in our calendar, the umbrella goes blue when rain is forecast for later in the day, and even our cutlery is equipped with sensors that record what we are eating so that we receive a warning as soon as our diet becomes unbalanced. Even dating is no longer left to chance. The internet has long since developed the algorithms for our perfect life partner and leads us directly to them. All rather incredible, but just as we consider a satnav to be a standard piece of equipment, we now fall in love on screen and not during après-ski. Before long we won’t need to move from our computers at all. The world will be brought virtually to our homes. The ultimate yardstick, however, is virtual reality, whereby you place a (still) oversized mask over your eyes and experience an absolutely realistic virtual world. You can saunter through 19th century Paris, dive with sharks or fight a war as a soldier on the front line (especially popular). Or, if you’re feeling lonely and have no desire to go out, you can just dial into a flirt encounter. Your

computer knows precisely what type of woman or man fits your fantasies. Hello virtual world.
Slowly but surely we are all being quietly and discreetly manipulated and led virtually through life. The cloud knows, for example, that we are partial to liver sausage, which we may not really be bothered about. But are we also happy for this information to be sold to our health insurance company? And should our life insurer be aware that we are a keen bungee jumper? Computers are now our life, so it is logical that the technological breakthrough to help us participate in a virtual reality is big business. The technology is not yet fully developed, but the software already available today is nothing less than breathtaking. The first personal computer (PC) went on sale on 12 August 1981. At the time, Mr and Mrs Average asked themselves what it was meant to be. Why on earth would one need to have a personal computer at home? This question now strikes us as a dumb joke, just as the birth of *Facebook* in 2008 seemed to be bordering on lunacy. Once again, we were wrong. Just eight years after its launch, Facebook is one of the world's most valuable companies and knows more about the lifestyles of the world's citizens than anyone else (with perhaps the exception of Google). We believe that virtual reality will be an enormous technological breakthrough. The above two companies are at the forefront of the technology, with Facebook currently enjoying a slight lead. As a seasoned investor it is a good idea to take the lifestyles of our children seriously. Virtual reality is the new normal. Put it to the test with your younger family members and you will see the eyes of the next generation open wide in joy and expectation.
Investing successfully is actually very straightforward. Put your money in a company whose product or service we all consume or use every day. Toothpaste (Colgate), coffee (Nestlé), beer (breweries) or washing powder/razor blades (Procter & Gamble), for example. And we bet you've already searched for something on Google today... but there is more: your children and grandchildren will want to experience the world on a virtual level. Now, immediately, perhaps just for a few minutes. A quick dive off the Maldives during break time at school, a visit to the Louvre before breakfast. Virtual is here to stay. Hello new world. Hello *Facebook*! The *lunacy* that is changing the world.

AND ON A FINAL NOTE

Donald Trump for president

It is of course quite right to wonder just why someone like Donald Trump could actually become the Republican presidential candidate. He may be a billionaire, but he has no real link to Washington and no support within the party. So why did the majority of voters in the Republican primaries choose this peculiar individual as its preferred candidate for the most powerful job in the world? The answer is quite simple: America has had just about enough of the incestuous Washington establishment. Obama was also elected to make things happen in the capital, but unfortunately the young star turned out to be a rather boring leader whose political manoeuvring was a huge disappointment to the American people. Now another outsider is set to fight for the presidency, and we wouldn't be surprised in the least if Donald Trump were to win the race. "For heaven's sake," you may say. Well, just as Obama was unable to bring about any real change either in America or the world, Donald Trump won't be able to either. Congress rules the US, not the president! It is for this very reason that we won't see a ban on Muslims entering the US, or a ten-metre-high wall along the Mexican border. Populism is very effective during an election campaign, but almost always toothless as soon as someone actually comes to power. No, nothing of the sort will happen, and nor will the United States withdraw from NATO should the "casino billionaire" move into the White House. In fact, the forthcoming US presidential election is shaping up in exactly the same way as Brexit, which has been portrayed as a real apocalypse. The Republican Party would come to an arrangement with the glib blondie, and Congress would guarantee that none of Trump's boorishly proclaimed improprieties could actually become a reality.

We have to remember that millions of Americans do not trust Hillary Clinton and have had enough of the arrogant actions of the establishment. You may perhaps believe that Trump is unelectable and a Clinton victory is therefore inevitable. But you could well be wrong. It is often protest votes that tip the scales, and Donald Trump could very well be declared the winner. We can offer you this consolation, however, in the form of the political bon mot par excellence: "Plus ça change, plus c'est la même chose." Even when it comes to the most powerful job in the world.