CIO Office · Morning Coffee Meeting · 27.05.202

Ideas for Investors **Telescope 1/20**

The Wimpy Dollar

VP BANK

Concept of «Telescope»

"Telescope" - VP Bank's new client publication

- Each issue is focused on a long-term, investor-related and future-oriented issue
- First issue: "The Wimpy Dollar"
- At the core of the magazine are research articles
- Analyses are complemented with investment ideas, expert interviews, background reports and recurring features
- Published twice a year (June/November)
- Replacement for Investment Views (clients who received Investment Views will get Telescope)
- Printed publication to be sent on June 3
- PDF version available on vpbank.com

Key messages in telescope 06/2020 "The Wimpy Dollar"


FIVE REASONS WHY THE DOLLAR WILL WEAKEN

The US dollar is the most important currency. However, this doesn't mean that it is strong. There are good reasons why it will lose value over the coming years.

#2 The United States have a higher rate of inflation than Europe and Japan. Structurally, the dollar is therefore weakening against these currencies over time.

Five reasons why the dollar is weakening:

#1 The US dollar is too expensive relative to other currencies. This is according to the theory of **purchasing power parity**.

#2 The United States have a **higher rate of inflation** than Europe and Japan. Structurally, the dollar is therefore weakening against these currencies over time.

#3 **"Big spending"** has not been a blessing for the greenback to date. But this is exactly the order of the day in the United States.

#4 The coronavirus crisis has given the US dollar a **massive boost.** With the end of the crisis, it is in danger of running out of steam.

#5 There is no longer talk of **divergent monetary policy**. US dollar fans are therefore lacking a popular narrative of recent years.


IDEAS FOR INVESTORS

WHAT SHOULD INVESTORS DO IF THE DOLLAR WEAKENS?

Bernd Hartmann, André Rheinberger

01

Currency hedges for non-US dollar investors

For investors whose reference currency is not the greenback, a weaker US dollar leads to currency losses for investments that are denominated in US dollars. Not holding any US investments would represent a short-sighted perspective, as the IT sector, for example, is dominated by US companies.

Export-oriented US companies become more competitive at an international level when the US dollar is weaker. The foreign profits of these companies are worth more upon being repatriated. With forward currency transactions or currency-hedged fund tranches, investors can exclude or reduce currency fluctuations.

02

Regional diversification for US dollar investors

Investors with the US dollar as their reference currency should be careful not to limit their portfolio allocation too much to the US dollar market. During stock selection, companies with pricing power are to be given preference, as these are able to offset cost fluctuations.

Investments in other countries also help to increase diversification. This is primarily advisable for equity investments, as because with high-quality bonds, currency developments quickly overshadow coupon payments.

03

Emerging market bonds

An important portion of emerging market financing takes place in US dollars. If the US dollar falls in value, this reduces the debt burden of the creditor. The improved affordability has a positive effect on debt or quality ceteris paribus. This increases the attractiveness of emerging market bonds.

04

Emerging market equities

In terms of their real economic importance for the global economy, emerging markets are under-represented in many equity portfolios. In the case of a weaker US dollar, a situation that favours the emerging markets from a structural perspective, the incentive increases to adjust regional diversification.

05

Gold

Most of the production costs of gold are not incurred in dollars. If the greenback weakens, the costs converted into USD rise, which increases the price of gold. As a result, the precious metal, like other commodities, is negatively correlated to the USD. However, it is primarily the diversification characteristics as an investment independent of economic cycles that speaks in favour of gold.

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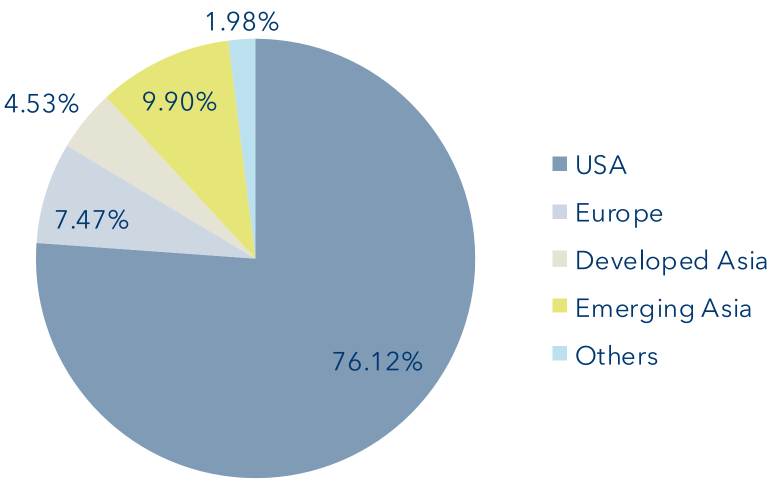
N°1 06/2020 · telescope

Ideas for investors

Investment Idea 1: Currency Hedge for Non-USD investors

Global IT sector by country of origin



- A weaker US dollar results in currency losses on USD-denominated assets for investors whose reference currency is not the greenback
- Keeping no US assets is too short, because some sectors, such as the IT industry, are dominated by US companies
- Export-oriented US corporations are becoming more competitive internationally through a cheaper USD
- Foreign profits of American companies are worth more if they are repatriated

Investment Idea 1: Currency Hedge for Non-USD investors

Foreign exchange forward transactions

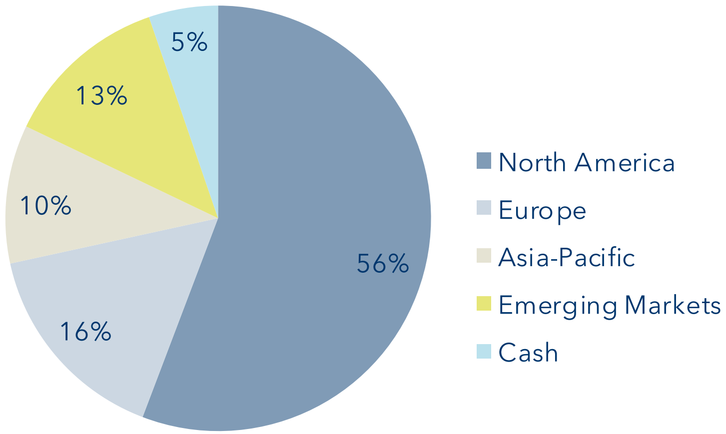
- Currency hedges with foreign exchange futures cost de-facto nothing
- The investor pays (or gets) the interest rate difference between the two currencies
- Currency hedging helps eliminate price-swings and therefore allows the risk budget to be used elsewhere
- Rolling over required

Currency hedged investment fund tranches

- Currency hedged investment fund tranches hedge foreign currency risks based on the investor currency
- This is especially recommended for bond investments
- There are few currency-hedged investment fund tranches for equity investments and portfolios with a variety of currencies
  - ➢ Many companies have a "natural" hedge, the currency influence is reduced to the translation effect.
- However, not every currency tranche different from the investors' own is hedged

Investment idea 2: Regional diversification for USD investors

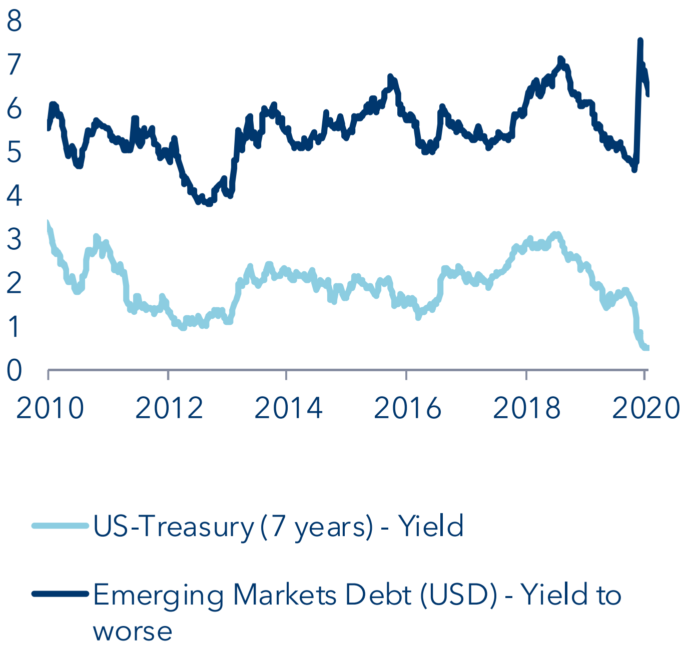
Geography of equity position (USD equity mandate)



- A weaker greenback makes foreign investments more interesting for US investors
- The allocation of USD investors should not be too highly concentrated to the dollar market
- When selecting foreign shares, companies with pricing power should be preferred
- International diversification for USD investors is recommended primarily in the equity portion of the portfolio
- Our USD investment strategies allocate nearly half of the portfolio outside the US
- With high-quality bonds, currency swings cancel out coupon payments all to easy. Our strategies are therefore limited to USD bonds

Investment idea 3: Emerging market bonds

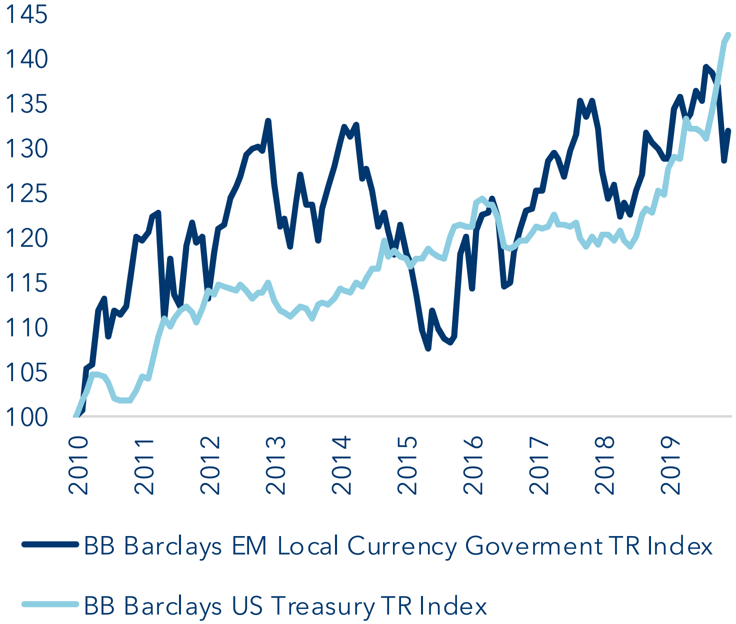
Yields compared



- An important part of the financing of emerging economies is in USD. If the USD depreciates, the creditor's debt burden will be reduced
- This has a positive effects on the credit-worthiness
- Resource-rich countries also benefit from rising commodity prices. However, the competitive-ness of countries with a high export surplus (outside the commodity sector) is declining
- This makes emerging-market bonds more attractive

Investment idea 3: Special case Local Currency Bonds

Total return comparison



- We primarily recommend hard currency bonds, which are mostly denominated in USD
- Local currency bonds should also be in favour. However, they have a much higher risk profile
- Despite higher interest rates, the overall return on investment is dominated by currency movements
- The expected weakness of the USD should be positive, but is only one of many influential factors for emerging markets currencies
- Historically, local currency bonds were only out-shining other assets temporarily
- We therefore recommend using local currency bonds only tactically and are currently cautious

Investment idea 3: Emerging market bonds

Active funds

Asset Class	Segment	Region	Manage-ment	Name	l tranches
Hard Curr.	Governments	EM - Asia	active	BGF Asian Tiger Bond HC	EUR, USD
Hard Curr.	Corporates	EM - Asia	active	Credit Suisse Asia Corporate Bond HC	USD
Local Curr.	Governments	EM - Asia	active	Pictet Asian Local Currency Debt	USD
Local Curr.	Governments	EM - Asia	active	Franklin Templeton Asia Bond	EUR, USD
Hard Curr.	Corporates	EM - Asia	active	Credit Suisse Asia Corporate Bond HC CHF hedged	CHF, EUR
Local Curr.	Governments	Emerging Markets (EM)	active	GAM Local Emerging Market Bond	CHF, EUR, USD
Hard Curr.	Governments	Emerging Markets (EM)	active	HSBC GIF Global Emerging Markets Bond HC	CHF, EUR, USD
Hard Curr.	Governments	Emerging Markets (EM)	active	JPMorgan Emerging Markets Debt HC	CHF, EUR, USD
Hard Curr.	Governments	Emerging Markets (EM)	active	Pictet Global Emerging Debt HC	CHF, EUR, USD
Hard Curr.	Governments	Emerging Markets (EM)	active	Candriam SRI Bond Emerging Markets HC	CHF, EUR, USD
Local Curr.	Corporates	Emerging Markets (EM)	active	Vontobel Emerging Markets Corporate Bond	CHF, EUR, USD

ETF

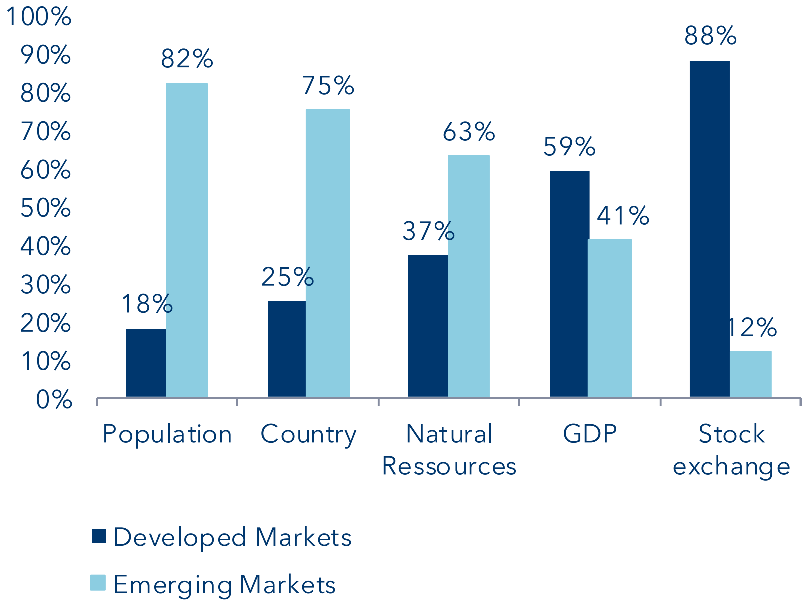
Asset Class	Management	Name	tranches
Hard Currency	passive	iShares USD Hard Currency Schwellenländeranleihen (sov & quasi-sov.)	EUR, CHF, USD
Local Currencies	passive	iShares JP Morgan ESG Emerging Market Bond	USD
Local Currencies	passive	Emerging Markets Corporate Bond (USD)	USD
Local Currencies	passive	Schwellenländer Staatsanleihen (Lokalwährung)	USD

Active funds and ETF

- We recommend to use investment funds especially for lower quality bonds
- For EUR and CHF investors, this also has the advantage that currency-backed tranches are available
- Our selection includes hard currency government bonds as well as corporate and local currency bonds

Investment idea 4: Emerging market equities

Importance of emerging economies

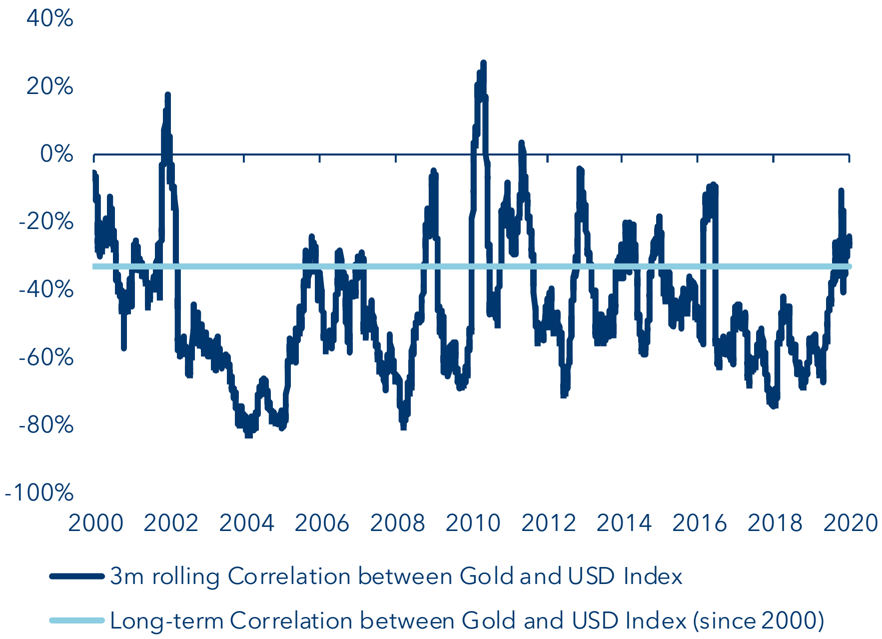


Source: International Monetary Fund (IMF)

- A weaker dollar is causing conflicting developments in emerging market equities
- For emerging market equities, the USD is considered the trading currency. If it devalues, the performance in USD (optically) is interesting
- In many portfolios, emerging markets are underrepresented with regard to their economic contribution to the global economy
- With a weaker dollar, a situation that structurally favours emerging economies, the incentive to adjust regional diversification is increasing

Investment idea 5: Gold

Negative correlation with USD



- Most of the gold production costs are not incurred in USD. However, gold is traded in dollars. If the USD weakens, the cost converted into USD will rise, and so will the price of gold. Therefore, like other commodities, the precious metal has a negative correlation with the USD
- This tailwind provides a positive momentum, which in turn attracts other investors
- But it is the diversification properties as a less cycial asset that speak for the gold

Investment idea 5: Gold

Passive Investments (ETC) Partner ETFs (ZKB, WisdomTree)	☑
XAU account at VP Bank - Counterparty risk No VAT on white metals, cost-effective	☑
Physical gold - higher costs Collective deposit at UBS or VP Bank safe	☑
Physical delivery - higher costs Risk of theft and damage	☑
Equities Currently recommended (B2Gold, Kirkland Lake Gold)	☑
Futures	☑
Funds	☑
Options and derivatives	☑

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Thank you!

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