

Investment Views



Contents

Current market assessment	Inside flap
Foreword	1
1. Focus	2
In Focus	3
Economic outlook	5
2. Asset classes	6
Money market and currencies	6
Bonds	10
Equities	14
Alternative investments	18
3. Investment management	22
4. Appendix	26
Contributors	27
VP Bank Group	28
Important legal information	29

Current market assessment

The tables below summarise VP Bank's trend assessments for all asset classes in our investment universe. The arrows reflect the forecasts of our investment strategists for the coming three to six months.

	Q2 Current forecast		
Money market and currencies (pages	6-9)		
Currencies			
EUR vs. USD	Я	→	New
EUR vs. CHF	И	→	New
USD vs. CHF	7	→	New
GBP vs. USD	71	71	
USD vs. JPY	71	71	
AUD vs. USD	71	71	
USD vs. SGD	71	7	
USD vs. RUB	→	→	
Key interest rates			
Switzerland	→	→	
Europe (EMU)	→	→	
USA	71	71	
Bond yields (pages 10-13)			
Investment grade government bonds			
Switzerland	→	→	
Europe	→	→	
USA	7	7	
Investment grade corporate bonds			
Switzerland	→	→	
Europe	→	→	
USA	71	71	
Bonds: total return (pages 10-13)			
High yield bonds			
High yield	צ	И	
Emerging market bonds			
Hard currency bonds	→	→	
Local currency bonds	→	→	
F /			
Equities (pages 14-17)	_	7	Nierr
Switzerland	→ →	7	New
Europe	→ →	7	New
North America Pacific	→	7	New
Emerging markets	→	7	New New
Lineignig markets		• • • • • • • • • • • • • • • • • • • •	14000
Alternative investments (pages 18-21)			
Commodities	→	→	
Crude oil	→	→	
Gold	71	71	
Real estate shares	→	→	
Private equity	→	→	
Convertible bonds	→	→	
Hedge funds	71	7	



Dear Reader

The message from the markets is clear: uncertainties have multiplied since the start of 2018. But the markets can be surprisingly slow to take negative developments on board. After initially downplaying or ignoring events that pose a threat, they suddenly react with belated surprise.

Example 1: US bond yields rose by 40 basis points in January. The equity market ignored this and climbed by over 7% before eventually succumbing to interest rate jitters and beating a retreat.

Example 2: Italian shares continued to climb even when it was clear that a new Eurosceptic government was going to be formed. No other equity market rose as steeply as Italy's in late April. But in May the gains were completely wiped out.

Example 3: The latest example of a delayed reaction is the escalating trade conflict, which rumbled on for a long time before the markets finally woke up to its implications.

What lies behind this pattern of behaviour? Perhaps we should see it as evidence of the markets' composure. Underlying sentiment is solid, and market expectations are upbeat. This leaves a lot of room for negative surprises if the markets' optimistic assumptions are not confirmed. Thanks to their intrinsic strength, however, the markets are quickly able to recover from minor setbacks.



The Trump conundrum

NO OTHER US PRESIDENT HAS
DIVIDED OPINION AS MUCH
AS DONALD TRUMP. HIS
OPPONENTS REGARD HIM AS
AN UNPREDICTABLE MUDDLER
WITH NO COHERENT STRATEGY.
HIS SUPPORTERS PRAISE HIS
UNCONVENTIONAL STYLE AND
POINT TO HIS SUCCESSES AS
A DEAL MAKER. LET'S TRY TO
UNTANGLE THE PUZZIE

Contradictions in economic policy

Trump can be criticised for many things, but certainly not for inactivity. True, no other president has spent so much time playing golf as Trump (as his enemies delight in pointing out), but in the one and a half years of his administration he has already fulfilled a long list of election promises. His economic policy is not easy to characterise. Some measures have been economically counterproductive, others beneficial. The latter include the rollback of financial market regulation. The core deregulation measure has been an easing of the Dodd-Frank Act, which was enacted eight years ago as a regulatory response to the financial crisis. The sheer size of this statute - 541 articles spread over 849 pages - indicates how complex it is. In fact, however, Trump's changes have been limited. Key rules have not been fundamentally eased, let alone abolished. What has been done is to raise the asset threshold for qualification as a systemically important financial institution from USD 50 billion to USD 250 billion. This benefits small and medium-sized banks by freeing them from high compliance costs, but for big players there is scarcely any change at all. Major banks are also still subject to the Volcker Rule, which prohibits proprietary trading. Thus the Trump administration has shown a sense of proportion. The adjustments are sensibly targeted and do not jeopardise the stability of the financial markets or erode investor protection.

Procyclical fiscal policy

Other business-friendly measures have been less well conceived. Tax reform is a case in point. Given that US corporate taxes are high by international standards, reform is basically welcome. But the measures have not been implemented in a way that is fiscally neutral. The reduction in revenues through tax cuts has only been partly balanced by spending cuts or higher income from other sources. This means that the reform has a stimulatory effect on the economy. But the US economy is already outperforming its growth potential, so the stimulus is ill-timed.

Fiscal policy is usually countercyclical, aiming to smooth out ups and downs in the nation's economic activity. But US unemployment is currently in a long-term downtrend – a sure sign that the economy is prospering. It is against this background that the government has chosen to provide extra stimulus and thereby enlarge the budget deficit. The short-term growth effect is positive, but the medium- and long-term risks are substantial. As the American economy is already booming, additional pump priming generates inflation risks. At the same time we are treated to the paradoxical spectacle of public sector debt increasing at a time when the economy is buoyant. If the economy cools or sinks into recession, the federal deficit could get out of control.

US: atypical divergence



■ Unemployment % ■ Fiscal deficit/surplus as % of GDP (r-h scale, inverted)

Strategist or loose cannon?

3

Trump is widely regarded as incurably impulsive and emotional. His enemies claim this makes him unpredictable and incapable of strategic thinking. The fact is that Trump is not dogmatic. His numerous flip-flops make

that clear. He sees himself essentially as a deal maker. For him the important thing is whether or not a deal is right. He loves the hurly-burly of negotiation.

To make a successful deal, it is necessary to take an appropriate initial position. Trump lays great stress on maximising his negotiating advantage. The greater the power imbalance in favour of the US, the better he likes it. This explains why he is uncomfortable with big multilateral organisations and prefers to negotiate on a one-to-one basis with individual countries. His reputation for impulsive irrationality makes his threats all the more effective. This, in itself, can be regarded as a strategy.

Trump's negotiating technique tends to follow a set course. First he flexes his muscles and demonstrates his power to damage the other party. From this position of strength he then surprises his opponent by offering a deal. This unconventional and undiplomatic approach is designed to unsettle the other party and extract as much benefit as possible. Trump believes that the more the other party loses, the more he will gain. This can be seen clearly in his attitude to trade.

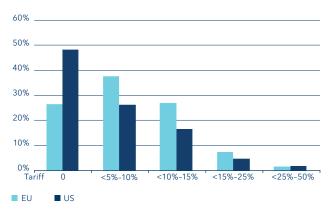
Can a nation be managed like a company?

Trump the politician behaves like Trump the businessman. For him a nation is like a very big company. He regards trade as a zero-sum game in which it is impossible for both sides to be winners. If one side gets a bigger share of the cake, the other will have to be content with less. This might be true in the real estate market, in which Trump made his name. But it is not true in international trade. Trump's approach flies in the face of the theory of comparative advantage that was established by the British economist David Ricardo two centuries ago. Ricardo showed that even a country that has a cost advantage in the production of every single good will benefit from trading with other nations and that all countries can mutually benefit from international trade whatever their cost advantage. Trump is also mistaken in his belief that a trade deficit is the same as a business loss and that global trade is therefore negative for the US.

Even so, the US certainly has some justifiable complaints against its trading partners. While the US imposes no tariffs on 48% of its non-agricultural imports, the corresponding figure for the EU is only 28%. In other words, the EU is more protectionist. Added to that are various

non-tariff barriers which Europe imposes under the guise of consumer protection. America is fond of citing national security for the same purpose. Ultimately, both devices amount to protectionism. Emerging nations often use more obvious expedients like one-sided limits on market access or inadequate respect for intellectual property rights. This also creates an uneven playing field in international trade.

EU and US tariffs compared (proportion of non-agricultural imports subject to tariffs at given % rates)



Looking for the right response

Many long-standing partners find it difficult to negotiate with the 45th President of the United States and bristle at his unconventional style. The trade conflict shows how dangerous it is to get into a spiral of action and reaction in which ultimately everyone loses. Maybe what is needed is a response that matches Trump's unconventional behaviour: instead of resorting to reprisals, why not offer to cooperate in dismantling existing trade barriers? At a time when protectionism and populism are on the march, this might seem counter-intuitive. But perhaps other nations can learn from the US President and have the courage to be unconventional.

World economy flagging?

RECENT ECONOMIC NEWS HAS BEEN MIXED, BUT FEARS THAT THE SYNCHRONISED UPSWING IS COMING TO AN END ARE UNJUSTIFIED.

The soothsayers were euphoric. Growth forecasts had been ratcheted up quarter after quarter. But it turns out that predictions were far too optimistic in many cases. Rose-tinted forecasts are now facing a reality check. In the eurozone, especially, important leading indicators have been disappointing. Eurozone GDP growth in the first three months of this year was 0.4% quarter on quarter, marking a significant slowdown compared with the 0.7% outturn for 2017 Q4. Some of the lost momentum was due to exceptionally bad weather, but even without that factor the upswing has become less energetic.

No cause for alarm - despite political worries

The situation is not yet cause for alarm. What we are witnessing is merely a shift to slower expansion. The eurozone will have to come to terms with weaker growth, but a recession is not on the cards, despite political turbulence in Italy and the tariff spat with America. Encouragingly, the US economy chalked up a respectable growth rate of 0.6% in the first quarter and appears to be gaining further momentum. Donald Trump's tax reform is having an impact; investment growth is gathering steam. Personal consumption, on the other hand, was rather weak in the first three months. Even so, the buoyant employment situation and Trump's tax cuts should encourage consumers to spend more freely in the coming quarters. If consumer spending strengthens while capital expenditure stays solid, the US economy has a good chance of going up a gear in the remainder of this year. In the emerging markets, too, we hear no serious alarm bells as yet. The Chinese economy is admittedly slowing, but its year-on-year growth rate of 6.8% in the first three months of 2018 was still respectable. With a few exceptions, the other up-and-coming economies are likewise showing no notable signs of tiring.

Highlights

- Recent economic data for the eurozone have been disappointing.
- But this is no cause for alarm. The eurozone is merely facing a period of somewhat slower growth.
- The synchronised global economic upswing is intact.

Monetary policy far from synchronised

Thus the synchronised economic upswing is still intact, though with varying rates of expansion. The inflation situation, by contrast, varies greatly from region to region. The US is showing unmistakeable signs of price acceleration. The Fed will therefore continue to push up interest rates. Conditions in the eurozone are very different. Despite a significant improvement in employment, the jobless rate remains high at 8.6%. This puts employees in a weak bargaining position, which obviously impedes wage growth. Without higher wages, significant inflation pressure is lacking. Core inflation in the eurozone (excluding volatile energy and food prices) is therefore very subdued. This means that the European Central Bank will have to stick to an expansionary monetary policy, even though its monthly asset purchases are set to be halted at the end of this year. Mario Draghi has indicated that the ECB intends to leave interest rates frozen at least until the end of summer 2019. The Swiss National Bank will follow the ECB's lead in order to prevent an appreciation of the Swiss franc. In short, while the synchronised economic upswing continues, inflation and interest rates present a very mixed picture.



Market overview

EUR/CHF and EUR/USD: exchange rates since June 2016



USD/CHF: exchange rate since June 2016



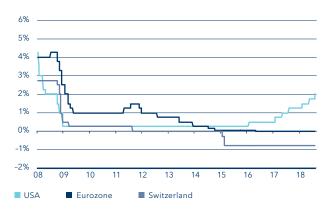
GBP/CHF and GBP/USD: exchange rates since June 2016



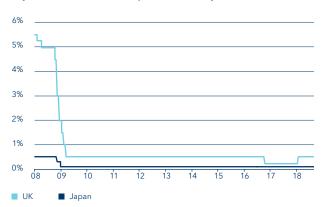
USD/JPY and USD/AUD: exchange rates since June 2016



Key interest rates in Switzerland, eurozone, USA: since January 2008



Key interest rates in UK and Japan: since January 2008



Legal note on page 29

High noon for Brexit

THE ROAD MAP FOR THE UK'S
DEPARTURE FROM THE EUROPEAN UNION HAS BEEN AGREED.
BUT THE SHAPE OF THE FUTURE
POLITICAL AND ECONOMIC
RELATIONSHIP BETWEEN BRITAIN
AND CONTINENTAL EUROPE IS
STILL UNCLEAR. UK PUBLIC
OPINION HAS CHANGED SIGNIFICANTLY, AND THIS WILL HAVE
AN IMPORTANT BEARING ON
THE NEGOTIATIONS.

Brexit negotiations have gathered momentum in recent months, and the modalities of the UK's formal exit from the European Union are taking shape. The UK and the EU have agreed on a 21-month "implementation period" after the UK's scheduled departure in 2019. The transitional arrangements are intended to cushion the British economy against possible negative effects. If previously tariff-free supply chains were to be suddenly cut (the famous "cliff edge" scenario), the UK economy could find itself in dire straits. Many European businesses would also face substantial risks.

While the contours of the formal departure process are becoming clearer, the future political and economic relationship between the UK and continental Europe is still mired in uncertainty. But the clock is ticking; British membership of the EU officially ends in March 2019. It now looks as if negotiations will probably have to be extended in order to bridge the huge gulf that still exists between the two sides. Theresa May continues to press for unimpeded access to the single market but is not prepared to make the concessions that Brussels demands. EU member countries are unanimous: "No cherry picking!" They are offering a free trade agreement that would guarantee tariff-free trade in goods but not cover services. In the services sector the UK would be treated as a "third country", which means

that the financial services industry (the crown jewel of the British economy) would be cut off from the EU.

May's approach is attracting increasingly vocal criticism even within her own party. Former Conservative prime minister John Major has condemned the government's Brexit strategy as unrealistic and is calling for a free vote in the House of Commons on holding a second referendum. Many people in the UK are either still uncomfortable with the result of the first referendum or are dissatisfied with the government's conduct of the negotiations. A survey carried out at the end of January 2018 by the ICM opinion research company on behalf of the Guardian newspaper found a majority in favour of a second referendum once the departure terms are known. People are worried about the prospect of a messy divorce.

Against this background it is increasingly clear that Theresa May would find it very hard to present the British public with a negotiation outcome that amounts to a hard Brexit. If she did, she would face major protests - not least in Parliament. Given the current state of public opinion in the UK, a soft Brexit involving a large degree of access to the single market therefore looks like a viable solution. For this to be achieved, however, the UK will have to make major concessions. Whether this can be done under Theresa May remains questionable. The UK could therefore be heading for a showdown involving changes in its negotiating stance and perhaps even in its political leadership. To sum up: given the shift in UK public opinion since the referendum, we regard a soft Brexit as very possible. That would give a boost to the pound in the forex markets.

Pound under pressure

In recent weeks, however, the pound has come under pressure, especially against the US dollar. This partly reflects the general strength of the greenback, but disappointed expectations of an interest rate hike by the Bank of England have also played a part. In November 2017 the Bank of England raised its key rate by 25 basis points, encouraging hopes of further hikes to come. But weaker leading indicators and feeble GDP growth in the first quarter of this year (0.1% compared with 2017 Q4) have caused the Bank to soften its line.

It should also be noted that inflation, which had been driven upwards by the weak pound, has since decelerated more sharply than expected. Further monetary tightening is therefore probably out of the question at the moment. Frustrated hopes of higher interest rates have helped push the pound down against the dollar.

UK pound versus US dollar



Pound still a political currency

The pound will be driven by political developments during the coming quarters. We believe that economic fundamentals will take a back seat. The pound's performance will depend crucially on the Brexit scenario. Will it be a hard Brexit or an arrangement that permits largely barrier-free access to the single market? We expect the latter, and that should enable the pound to appreciate significantly. But a rapid conclusion of the Brexit negotiations is unlikely, so patience is required before the pound can start to flex its muscles against the dollar. The situation is rather different in relation to the euro and the Swiss franc, against which the pound has performed solidly. The eurozone and Switzerland have been struggling against economic headwinds. Business activity is less dynamic than expected, and inflation is subdued. In this environment the European Central Bank and the Swiss National Bank will stay on an expansionary track for the foreseeable future.

Highlights

- Negotiations between the EU and the UK are approaching the crunch. Access to the single market is the key issue.
- We expect the UK government to make major concessions in order to preserve tariff-free access to EU markets.
- The medium-term outlook for the pound is therefore positive.

Conclusion

Brexit negotiations between London and Brussels have gained momentum recently. The formal Brexit process has largely been agreed, but the future economic relationship between the UK and continental Europe is still up in the air. Given that UK public opinion has become more sceptical about Brexit, the British government will find it hard to dish up a hard Brexit solution. A softer alternative is therefore becoming more probable. If that happens, the pound will benefit.

Key interest rates	Current forecast
Switzerland	→
Europe (EMU)	→
USA	71

→ No change

7 +25 basis points

√ < -50 basis points
</p>

↑ > +50 basis points

→ -25 basis points



Bond yields - overview



11

Legal note on page 29

ECB meeting sparks violent market reactions

THE EUROPEAN CENTRAL BANK
HAS QUASHED RUMOURS OF
A QUICK INTEREST RATE HIKE
AFTER THE TERMINATION OF ITS
ASSET PURCHASE PROGRAMME.
KEY INTEREST RATES WILL STAY
FROZEN FOR A LONG WHILE YET.
THE ANNOUNCEMENT BOOSTED
LONG-TERM GOVERNMENT
BONDS.

Mario Draghi has made things crystal clear. Central bank press announcements tend to be fuzzy, permitting a wide range of interpretations. Not this time. The statement after the ECB meeting in June was almost brutally straightforward.

Here are the key points. Monthly asset purchases will continue at their present volume of EUR 30 billion until September and then carry on for a further three months at a reduced volume of EUR 15 billion. The reduction will depend on incoming data. If the inflation outlook deteriorates, purchases will probably stay at EUR 30 billion. Reinvestment of maturing securities will continue for an extended period of time. At the end of 2018 the purchase programme will be terminated. But interest rates (here, too, the ECB did not mince its words) will remain frozen until the end of summer 2019 at least.

Approaching the end of quantitative easing

The ECB has made a decisive move towards exiting from its quantitative easing programme just when Italy is enmeshed in political turmoil and the eurozone economy is faltering. This highlights the fact that the decision is based on regulatory constraints rather than economics. The biggest legal stumbling block is the rule that the ECB and its associated national central banks must not hold more than 33% of any country's outstanding debt. This rule is designed to shield the ECB from accusations of debt financing by not allowing it to intervene too heavily in the market for government bonds.

Markets caught on the hop

Many market participants were wrong-footed by the ECB's statement, especially by the prospect of a long period of unchanged key interest rates. This explains the markets' sensitive reaction. The euro slumped by 2% against the US dollar in the days following the announcement, while German Bunds chalked up big gains. If key interest rates are going to stay around zero, there is no immediate prospect of rising government bond yields. It should be noted, moreover, that Mario Draghi's timetable is dependent on the eurozone economy staying on its present growth track. If the recent weakening were to deteriorate into a more severe downturn, interest rates would have to be left unchanged for a very long time - probably for several years. It is this consideration that will support Bunds. The same goes for Swiss federal bonds. Switzerland's economy and monetary policy are taking their cue from the eurozone. Added to this are the worries about escalating trade disputes. Talk of further US tariffs on Chinese goods and possible tit-for-tat measures by China are fuelling fears that the global economy could be damaged. If that happened, the US Fed would have to abandon its interest rate hiking course.

Difficult road to higher yields

Recent market movements again show how difficult it is for the financial markets to move towards a higher level of bond yields. Basically, interest rate increases in the US argue for higher rates at the long end of the yield curve – not only in the US but also in Europe. That is conditional, however, on continuing robust growth in the US and the world at large. Disruptions (e.g. escalating trade conflicts) are not yet being factored into the central banks' interest rate planning. Investors are therefore well-advised to act on the expectation that the upward movement of bond yields will be slow.

Eurozone monetary policy on a tightrope

FOLLOWING THE FED'S
SEVENTH INTEREST RATE HIKE,
THE EUROPEAN CENTRAL BANK
ANNOUNCED THAT IT WILL
HALT ITS ASSET PURCHASE
PROGRAMME AT THE END OF
THIS YEAR. THIS FURTHER
HEIGHTENS THE RISK ON HIGH
YIELD BONDS.

Solid US macro data

The economic data are increasingly "America first". Tax reform and the threat of a trade war are having their effect. The Fed started putting up interest rates in 2015. As yields at the long end have risen less than at the short end, the yield curve has flattened significantly. In the years after the financial market crisis the gap between long-dated and short-dated Treasuries was in the region of 2.5% to 3%. It has now shrunk to 0.4%. Historically, an inversion of the yield curve has almost always heralded a recession. But the curve is not inverted yet. It is theoretically possible that the Fed will decide that it has overshot the mark and reinstate lower rates at the short end. In practice, however, such action is very rare. It might also be the case that the shape of the yield curve has become a less important signal in the current market environment.

Mixed tempo in Europe

The situation in Europe is more complex. In Germany, for example, unit labour costs are 16% lower than in Italy. The robust health of Europe's largest economy is comparable with America's, whereas Italy is still facing a mountain of bad loans left over from the financial crisis. The huge burden of debt has necessitated fiscal austerity, and that in turn has fomented political upheaval. All this is putting an additional brake on the Italian economy. The turmoil in the Italian government bond market after the formation of the new government shows how vulnerable the financial system has become.

Highlights

- The ECB has expressed itself with unusual clarity.
- Asset purchases will be terminated at the end of this year, but key interest rates will stay very low for a long time to come.
- This outlook further aggravates the risk on low quality corporate bonds.

ECB dispels the fog

Designing a monetary policy to fit the entire eurozone is very difficult in this situation. The ECB's determination to halt its asset purchases at the end of this year is therefore all the more surprising. Alongside 464 government bond issues, 1,905 corporate issues are also affected. The credit markets had already anticipated this. Spreads on European corporate bonds have widened from 85 to 135 basis points since February, with high yield bonds going from 266 to 350 basis points.

Conclusion: treat high yield bonds with caution

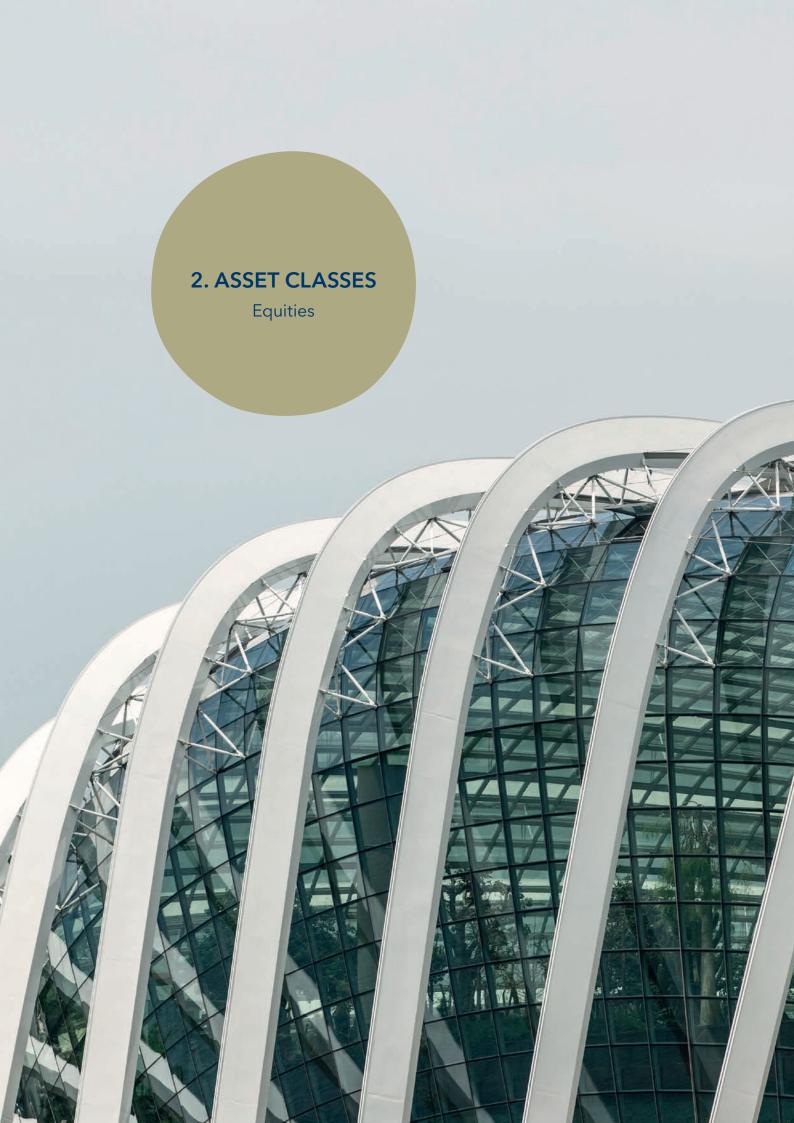
Capital losses on low-quality corporate bonds are therefore on the cards. Investors have reacted to falling yields in the past by switching into lower quality bonds in an attempt to avoid some of the negative impact on returns. If yields on risk-free government bonds rise, this process will go into reverse. Thus ECB policy is still on a tightrope.

Benchmark	Current forecast	% YTD ¹
Gov. bonds Switzerland ²	→	-1.24%
Gov. bonds Europe (EUR) ²	→	0.27%
Gov. bonds USA ²	71	-1.56%
Inv. grade corp. bonds Switzerland ²	→	-0.51%
Inv. grade corp. bonds Europe (EUR) ²	→	-0.34%
Inv. grade corp. bonds USA ²	71	-3.27%
High yield bonds ³	Я	0.98%
Emerging market bonds (hard currency) ³	→	-5.79%
Emerging market bonds (local currency) ³	→	-7.24%

¹ As of 19.06.2018

² Yield

³ Total return



Equity indices - overview

Switzerland: market movement since June 2016 (indexed) 130 120 100 90 Jun Sep Dec Mar Jun Sep Dec Mar Jun

■ MSCI Switzerland TR Index (net) indexed











Legal note on page 29

Investing in more difficult markets

EARNINGS EXPECTATIONS IN ALMOST ALL REGIONS SHOWED A RENEWED IMPROVEMENT IN THE SECOND QUARTER, CREATING A GOOD OUTLOOK FOR THE EQUITY MARKETS.
BUT RISKS ARE ON THE RISE.

The baseline scenario for our current investment stance foresees continuing global growth, expanding production capacity and resultant further job creation. Fundamental valuation levels are not excessive and essentially reflect the current mature stage of the business cycle. The US boasts the strongest growth and has advantages compared with other regions. Europe and the emerging markets continue to display positive earnings momentum and fundamental valuations here look attractive. However, structural challenges in these regions necessitate a discount to respect heightened risks.

Tactically, we prefer a neutral equity weighting at present. We see regional advantages in the US and China, while Europe in particular should offer interesting potential once markets enter calmer waters. In the current environment we recommend a defensive positioning with the accent on fundamental quality.

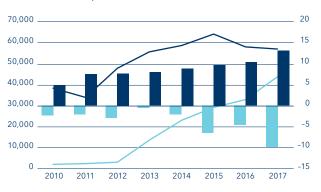
Our defensive approach is a response to gradually rising risks for both equities and bonds. Credit risks increased in May, and the mood among investors became more unsettled. Anxiety now centres on the likely course of US interest rates (and hence corporate borrowing costs) and the short- and medium-term outlook for international trade. The tariff conflict is poison for global trade flows. A further worry is the growing mountain of debt in many countries and companies in the wake of the financial market crisis. Dependence on exports and cheap credit has increased sharply.

Investing in quality

Periods of heightened uncertainty offer a good opportunity to review portfolio allocations. Preference should

be given to positions that offer fundamentally high quality. There is no simple rule for identifying which shares are qualitatively strong enough to weather a period of economic weakness. The common distinction between cyclical and defensive sectors offers some indication of cyclical sensitivity but does not provide an adequate yardstick for appraising individual shares. A deeper analysis has to focus not only on the size and stability of a company's earnings but also on the financial flows generated by its business operations.

Tesla and BMW compared



- Tesla market capitalisation (EUR millions)
- Tesla earnings per share (EUR, r-h scale)BMW market capitalisation (EUR millions)
- BMW earnings per share (EUR, r-h scale)

Equity investments always involve assumptions about the future, and the robustness of these assumptions will depend on the information available. If the outlook seems promising, a company's value can rise irrespective of weak results. Tesla, for example, has posted no profits at all since 2010. Indeed, losses per share have climbed by over 53% since 2015. But over the same period the company's market value has risen by 50%. BMW, by contrast, has increased its net earnings by more than 35% since 2015, but its market value has dropped by almost 11%. Such contradictory developments are commonplace. Ultimately, however, only those business models and trends that are underpinned by strong intrinsic quality will prove to be sustainable.

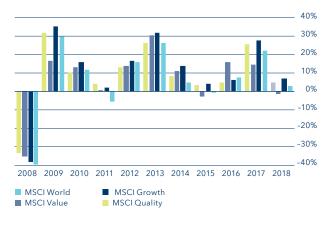
Investors should therefore periodically ask some crucial questions:

- Do the business models still offer good prospects?
- Are the risks adequately compensated?
- Is the equity portfolio well diversified?

Quality criteria

A healthy company must be able to earn enough to service its debt even in an environment of rising interest rates. VP Bank has devised a multi-level quantitative filter that enables us to appraise companies on the basis of earnings stability, cash flow, leverage and share price behaviour during market setbacks. All shares in our investment universe are subjected to this filtering process.

Quality investing: comparison of annual returns



To assess earnings stability we look at diluted earnings per share generated by current business activity. Filtering is done on the basis of the absolute level of profit or loss and continuity over the last ten years.

The cash conversion rate is a metric that shows the relationship between operating cash flow and net earnings. A high cash conversion rate means that earnings are generated by the company's business activity and not puffed up by sleights of hand in the accountancy department.

Various metrics are used in the financial services industry to assess a company's leverage, i.e. its exposure to debt. One of the most commonly used is the ratio of net debt to EBITDA (earnings before interest, taxes, depreciation and amortisation). This ratio indicates how many years it would take for a company to pay off its entire borrowings. A figure of three is regarded as critical, whereas figures below two are unproblematic.

Historical share price performance can be deceptive. Even so, it is useful to know how a share has fared during difficult times. For this purpose we have selected two phases in 2011 and 2015 when the market as a

Highlights

- In the current riskier environment, investors need to subject their portfolios to a fitness test. Are individual equity positions qualitatively sound and underpinned by forward-looking business models?
- We offer the following interesting allocation ideas:
 - "High quality investing"
 - "Telecoms: attractive dividends"
 - "Energy efficiency"
 - "Top 10 baskets"

whole fell by more than 16%. Our criterion is that losses during these stress phases must not exceed the loss on the respective country index.

Conclusion

Based on our positive assessment of the equity markets, we are responding to current challenges by focussing on balanced diversification and a rigorous selection of high-quality companies with forward-looking business models. This enables us to keep calm and well-prepared in stormy times.

MSCI benchmark	Current forecast	% YTD ¹
Switzerland	7	-6.19%
Europe	7	-2.34%
North America	7	4.31%
Pacific (incl. Japan)	7	-0.35%
Emerging markets	7	-3.74%

Upside/downside ranges indicated by our 3-6 month absolute performance assessments:

¹ As of 19.06.2018; net return in local currency incl. dividends



Alternative investments - overview

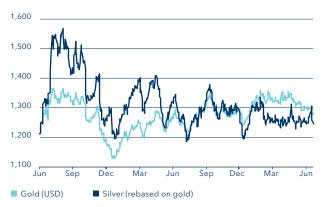
■ WTI crude oil (USD)

Commodities: performance since June 2016 80 70 60 40 30



Precious metals: performance since June 2016

■ Bloomberg Commodity Index (rebased on oil)



Convertible bonds: performance since June 2016 (indexed)



Real estate: performance since June 2016 (indexed)



Hedge funds: performance since June 2016 (indexed)



Legal note on page 29

Precious metals - all roads lead to gold

GOLD HAD A GOOD RUN AT THE START OF THE YEAR BUT FLAGGED IN THE SECOND QUARTER. THE GEOPOLITICAL RISKS THAT FAVOUR GOLD HAVE NOT GONE AWAY -QUITE THE OPPOSITE.

Views about gold are very mixed, but on one point analysts are unanimous: gold is difficult to value. The absence of a dividend or coupon means that the usual valuation models cannot be applied. Nevertheless, it is possible to identify various factors that drive gold's performance. Gold becomes more attractive in periods of crisis, which are usually reflected in heightened volatility on the financial markets. The price of gold is also sensitive to inflation, interest rates, credit risks and changes in the external value of the US dollar. Less widely reported factors like movements in central bank gold reserves and ETF gold holdings likewise have an impact. The combination of these various individual factors is what drives the price of gold.

Can the gold price withstand current pressures?

After the Fed's initial tentative tightening, we are now in a cycle of rising interest rates. The fed funds rate has recently been upped again by 25 basis points to 2%. US inflation accelerated from 2.5% to 2.8% in May. Rising US interest rates push up the opportunity costs for gold investors, while inflation is still too low to offer support. Policy-making in Europe has been unhelpful for the gold market. ECB President Mario Draghi has announced that he intends to freeze interest rates at least until the end of summer 2019. This caused the dollar to rise against the euro. That was not good news for gold, which is traded in dollars.

But how important are macroeconomic factors for the gold price over the long term? Empirically it can be shown that a strengthening US dollar usually means a falling gold price. In recent years, however, this negative correlation has become somewhat weaker. Monetary tightening by the Fed, involving a gradual rise in interest rates, should also be bad for gold, but this correlation too has been significantly

diminished in recent months. Thus the level of interest rates has lost some of its relevance as a downside factor.

Correlation between gold and the US dollar



Nevertheless, as movements in the dollar's external value incorporate inflation expectations, interest rate differences and trade imbalances, the dollar's performance will continue to be the major indicator for the gold price. It should be noted that the correlation is not symmetrical. A weaker dollar tends to push up the gold price more sharply than a stronger dollar causes it to fall.

Stability underpinned by political uncertainty

Gold's positive performance in January was due mainly to the retreat of the dollar prior to the upsurge of volatility in February. Against all expectations, the gold price failed to react to the February turbulence. Macroeconomic factors kept the price on a leash.

Investors were recently spooked by the election result in Italy, but jitters soon subsided. Even so, political events in Italy have undoubtedly exacerbated tensions within the European Union and created renewed potential for conflict. It is now two years since the UK voted to leave the EU, triggering the start of the drawn-out Brexit process. The ongoing negotiations constitute a major imponderable for the EU's future. Across the Atlantic President Donald Trump continues to make waves. He recently again put the cat among the pigeons by suggesting that the multilateral NAFTA agreement could be replaced by separate bilateral agreements with Mexico and Canada. These and other potential frictions support the gold price and could give it a further boost in the medium term.

Gold is also underpinned by rising demand for physical metal. Gold is bought by jewellery makers, physically backed exchange-traded funds and central banks. Growing interest in gold ETFs is due mainly to increased risk aversion among investors, who are worried about the threat of a trade war and the general rise in geopolitical uncertainty. At the same time high valuation levels on the equity markets are fuelling fears of market excesses and making gold more attractive again as a portfolio diversifier.

Around 50% of all central bank reserves are in the form of US dollars. Many central banks turned away from gold in the years leading up to the 2008 financial market crisis. Since the crisis, however, physical gold has become more popular again, having proved itself as a safe haven in troubled times. Russia has increased its gold holdings this year for the eleventh year in succession and remains the biggest buyer, followed by Turkey and Kazakhstan. China is staying on the side lines at present and has left its gold reserves unchanged since the end of 2016, but further Chinese purchases can be expected in the near future. Gold accounts for only 2% of China's entire reserves, and the dollar is losing appeal as the major central bank reserve asset.

Conclusion: opportunity for new investors

The situation at the start of the year seemed very promising despite buoyant equity markets. Gold was able to shrug off interest rate hikes and a strong dollar. Yet again the yellow metal proved its toughness as a store of value in difficult times.

For new investors especially, the weakening of the gold price since mid-April provides a good opportunity to take a position in gold as a medium- to long-term investment. Continuing geopolitical uncertainties should enable gold to hold its own in the face of higher interest rates. Gold currently offers a relatively cheap way of insuring against the risk of resurgent or new problems. Long-term experience shows that the metal provides an effective hedge against portfolio risk. Even a small allocation can reduce risk significantly. We treat gold as an integral portfolio component, not as a speculative play.

Highlights

- The gold price has been hit by interest rate hikes and a resurgent dollar.
- Minor crises, such as the recent troubles in Italy, are helpful for gold.
- Jewellery demand continues to grow, and purchases by ETFs and central banks are firm.
- For new investors in particular, the present price provides an opportunity to invest in gold as an effective medium-term hedge.

Benchmark	Current forecast	% YTD ¹
Commodities	→	-0.87%
Crude oil	→	9.22%
Gold	7	-1.70%
Commercial real estate	→	-0.65%
Private equity	→	4.93%
Convertible bonds	→	1.86%
Hedge funds	7	-0.36%

Upside/downside ranges indicated by our 3-6 month absolute performance

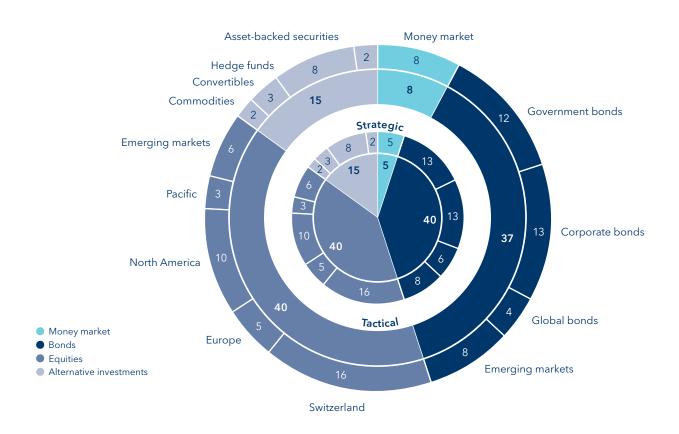
↑ > +5% 7 +2% to +5% → -2% to +2% \(\mathre{\psi} \) -5% to -2% \(\mathre{\psi} \) < -5%

¹ As of 19.06.2018



Investment management portfolios

Strategic and tactical allocation - balanced portfolio based in CHF (% weightings)



VP Bank Strategy Funds

3,							
Product name	Curr.	ISIN	NAV date	NAV	Payout	Currency hedged	YTD perf. %
VP Bank Strategy Fund Conservative (CHF)	CHF	LI0017957502	15.06.2018	1,061.43	no	yes	-2.17%
VP Bank Strategy Fund Conservative (EUR)	EUR	LI0017957528	15.06.2018	1,418.87	no	yes	-1.30%
VP Bank Strategy Fund Conservative (USD)	USD	LI0100145379	15.06.2018	1,368.41	no	yes	-1.77%
VP Bank Strategy Fund Balanced (CHF)	CHF	LI0014803709	15.06.2018	1,585.08	no	yes	-2.61%
VP Bank Strategy Fund Balanced (EUR)	EUR	LI0014803972	15.06.2018	1,002.88	no	yes	-1.14%
VP Bank Strategy Fund Balanced (USD)	USD	LI0014804020	15.06.2018	1,570.84	no	yes	-1.22%

For detailed information on our investment management mandates, please contact your personal advisor.

Legal note on page 29 23

Current investment tactics

Current investment tactics

The trade conflict between the US and the rest of the world has heated up. The EU has implemented retaliatory measures in response to the new US tariffs on steel and aluminium products. The direct consequences of these moves are limited, but there are growing worries that an escalating conflict could pose a serious threat to world trade, putting a further brake on global growth. The eurozone is beset by political risks and deteriorating economic data, notably a sharp decline in foreign demand. A mounting trade conflict could exacerbate this trend.

Against this background we have adjusted our equity allocation. We are particularly concerned about the retreat of the leading indicators and the widening of credit spreads. After the substantial gains posted in recent weeks we are now adopting a more defensive position. In our view, weaker economic data and heightened political risks are hardly a basis for rising share prices. Meanwhile, the interest rate gap should support the US dollar against the euro. We remain underweight in bonds.

Bonds

The acceleration of US inflation is due in large part to higher energy prices. If volatile energy and food prices are bracketed out, US inflation merely inched up from 2.1% to 2.2% in June. The Fed's latest interest rate hike had been expected, and the markets are now pricing in further rises in 2019 and 2020. After its latest meeting the ECB announced that it will halt its asset purchase programme at the end of this year. The markets were more impressed, however, by the ECB's declaration that its key interest rates will be kept on hold at least through the summer of next year. While the interest rate

outlook in the US is upwards, the scope for movement in the eurozone and Switzerland is limited by subdued inflation. We are keeping duration below benchmark in all reference currencies. Overall we remain underweight in investment grade bonds and neutrally weighted in emerging market bonds. We are maintaining our position in inflation-linked securities.

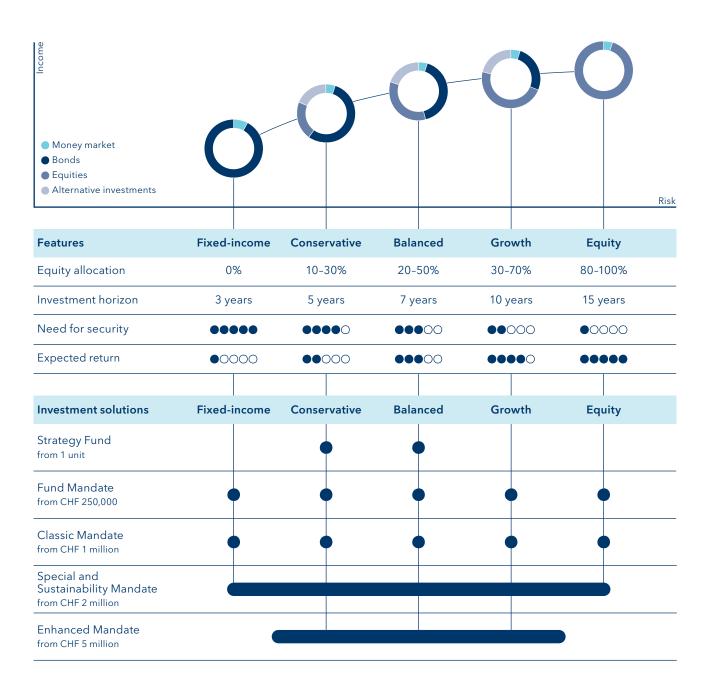
Equities

US technology shares hit a new all-time high in June, but the broad US market and European equities stayed well below their January highs. European shares have profited in relative terms from their lower valuation level compared with the US market. The eurozone still has catch-up potential vis-à-vis the US, but there needs to be an easing of trade tensions and an improvement in the macro data before the catch-up can materialise. European equities are further supported by their relatively high dividend yield compared with bond yields. Emerging market equities have lost ground after a strong January, with the MSCI Emerging Markets index hitting a new low for the year in June. In this sector we continue to favour Asia on the basis of its strong economic growth and fundamentally attractive valuation level.

Alternative investments and currencies

We hold positions in alternative investments, notably commodities, convertible bonds and hedge funds, as a useful portfolio component providing risk diversification. These categories are weighted at neutral. We have an open USD position in our EUR- and CHF-based portfolios. Otherwise currencies of the major developed countries remain hedged.

Our solutions



Legal note on page 29 25



Contributors



Bernhard Allgäuer Senior Investment Strategist



Christoph Boner Head of Investment Management



Harald BrandlSenior Equity Strategist



Thomas GitzelSenior Economist



Bernd HartmannHead of Group Investment Research



Aurelia Schmitt-Marxer Head of Investment Management Liechtenstein



Jérôme Mäser Junior Investment Strategist

Legal note on page 29 27

Your contact - wherever you may be

VP Bank Ltd is a bank domiciled in Liechtenstein and is subject to supervision by the Liechtenstein Financial Market Authority (FMA), Landstrasse 109, 9490 Vaduz, Liechtenstein, www.fma-li.li

VP Bank Ltd	Aeulestrasse 6 · 9490 Vaduz · Liechtenstein T +423 235 66 55 · F +423 235 65 00 info@vpbank.com · www.vpbank.com VAT No. 51.263 · Reg. No. FL-0001.007.080-0
VP Bank (Switzerland) Ltd	Talstrasse 59 · 8001 Zurich · Switzerland T +41 44 226 24 24 · F +41 44 226 25 24 · info.ch@vpbank.com
VP Bank (Luxembourg) SA	26, Avenue de la Liberté · L-1930 Luxembourg · Luxembourg T +352 404 770-1 · F +352 481 117 · info.lu@vpbank.com
VP Bank (BVI) Ltd	VP Bank House · 156 Main Street · PO Box 2341 Road Town · Tortola VG1110 · British Virgin Islands T +1 284 494 11 00 · F +1 284 494 11 44 · info.bvi@vpbank.com
VP Bank (Singapore) Ltd	8 Marina View · #27-03 Asia Square Tower 1 Singapore 018960 · Singapore T +65 6305 0050 · F +65 6305 0051 · info.sg@vpbank.com
VP Wealth Management (Hong Kong) Ltd	33/F · Suite 3305 · Two Exchange Square 8 Connaught Place · Central · Hong Kong T +852 3628 99 00 · F +852 3628 99 11 · info.hkwm@vpbank.com
VP Bank Ltd Hong Kong Representative Office	33/F · Suite 3305 · Two Exchange Square 8 Connaught Place · Central · Hong Kong T +852 3628 99 99 · F +852 3628 99 11 · info.hk@vpbank.com
VP Bank (Switzerland) Ltd Moscow Representative Office	World Trade Center · Office building 2 · Entrance 7 · 5 th Floor · Office 511 12 Krasnopresnenskaya Embankment · 123610 Moscow · Russian Federation T +7 495 967 00 95 · F +7 495 967 00 98 · info.ru@vpbank.com
VP Fund Solutions (Luxembourg) SA	26, Avenue de la Liberté · L-1930 Luxembourg · Luxembourg T +352 404 770-297 · F +352 404 770-283 fundclients-lux@vpbank.com · www.vpfundsolutions.com
VP Fund Solutions (Liechtenstein) AG	Aeulestrasse 6 · 9490 Vaduz · Liechtenstein T +423 235 67 67 · F +423 235 67 77 vpfundsolutions@vpbank.com · www.vpfundsolutions.com



Group Investment Research VP Bank Ltd Aeulestrasse 6 9490 Vaduz T +423 235 61 73 F +423 235 76 21 investmentviews@vpbank.com

Editors and contributors

Stefan Schwitter, Head of Group Investment, Product & Market Management Bernd Hartmann, Head of Group Investment Research Dr Thomas Gitzel, Senior Economist Rolf Kuster, Senior Investment Strategist Marcello Musio, Senior Equity Analyst Harald Brandl, Senior Equity Strategist Bernhard Allgäuer, Senior Investment Strategist Christoph Boner, Head of Investment Management Jérôme Mäser, Junior Investment Strategist Aurelia Schmitt-Marxer, Head of Investment Management Liechtenstein Christina Strutz, Office & Publication Manager

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