Sallfort Privatbank AG

Quarterly Letter April 2018

„In a closed system, chaos increases over time.“ (Origin unknown, context: second law of thermodynamics)

Dear Clients, Partners and Interested Parties,

In physics, one speaks of chaotic behavior when systems are so sensitive to certain changes that long-term predictions become impossible. The transition to the financial markets is easy here. The world has chaotic traits. Changes, even chaotic ones, are currently mostly politically motivated and have great influence. As an example, only the threatening trade wars are mentioned, which amongst other things are responsible for the increase in volatility.

The very good start to the new year came to an abrupt halt. The initial gains on the stock markets have disappeared and significant shortfalls are predominant. All of a sudden one remembers that valuations are very high, especially in the technology sector. Technical factors come to the fore and the fundamental data seems unimportant. Is everything really so chaotic and so negative? Or isn’t the good economic situation a reason to hope for rising prices again?

Don’t worry, we do not want to present a new investment approach with the help of chaos theory. Rather, in this quarterly report, we are focusing on the fundamental data and trying to provide navigation assistance.

A word in advance: We do not believe that chaos leads to further chaos and are cautiously positive. Already in the last report, we pointed out that active management will be necessary. This has come true and will continue to be the key to good performance.

We wish you an exciting read.

Best regards,

Thomas Pfefferle
Chief Investment Officer

Current topics for the second quarter

World economy

Global environment remains favourable despite stock market turbulence

Despite the recent rise in volatility in the international finance markets, the prospects for the development of the real economy remain good. Although the slight weakening in the purchasing managers' index in February and March indicates that growth has already peaked in the eurozone in particular, the most recent survey findings are still in keeping with stable growth rates. Therefore, a rise of 3.2 per cent in global economic performance is forecast for the year 2018. However, this is subject to the condition that the imposition of punitive tariffs by the USA does not lead to a global trade war.

Growth in the eurozone only slightly subdued

The eurozone economy saw strong growth of 2.5% in 2017. Although the mood among industrial companies deteriorated somewhat in February and March, with employment continuing to rise and order intake figures remaining good, there is every indication that the pace of growth will only ease slightly during the course of 2018. The eurozone economy continues to enjoy support from low interest rates and mildly expansionary fiscal policy. In some countries such as Germany, however, due to the prolonged period of above-potential growth, capacity bottlenecks are increasingly having a slowdown effect. Nevertheless, in 2018 GDP growth in the eurozone can be expected to be well above average again at 2.3%.

US economic growth likely to accelerate in course of 2018

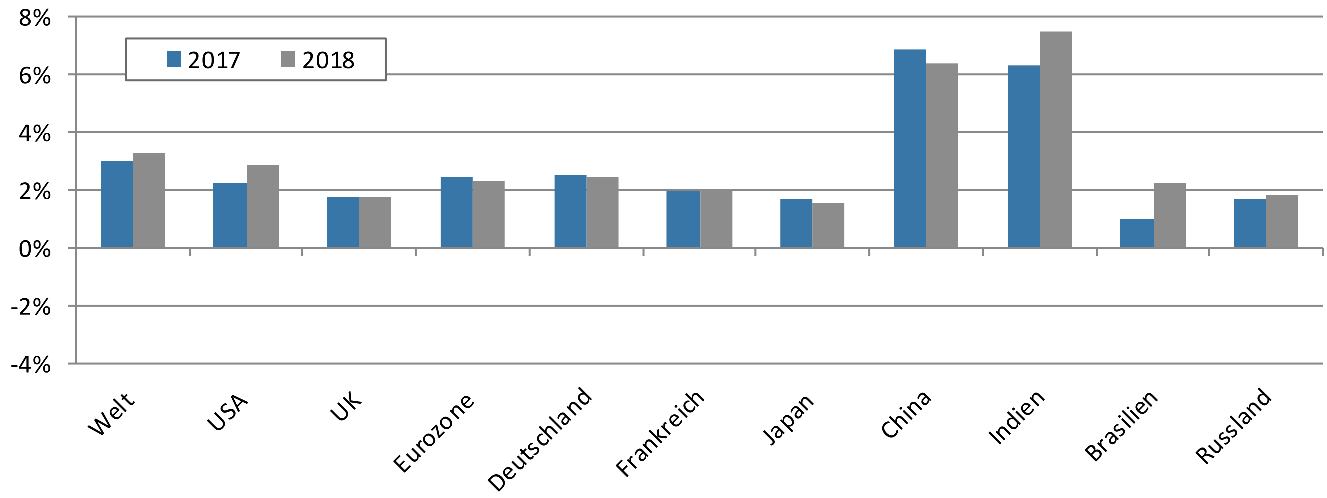
The economic indicators in the USA point to a slight easing of economic growth in the first quarter of 2018. Judging by the weak devlopment of the retail trade sales, private consumption is assumed to have grown only moderately at the beginning of the year. However, growth can be expected to accelerate again in the USA over the remnaining part of the year. In view of the continued positive development of the labour market, private consumer spending ought to expand again more significantly in the near future. The tax reform is likely to stimulate companies' investment activities. Therefore, strong growth of 2.9% is forecast for 2018. Due to expansionary fiscal policy, however, the US deficit will continue to grow, which could have adverse effects on the country's growth potential in the medium term.

Emerging economies have sound prospects

In the BRIC states, economic development is expected to be healthy in 2018. China in particular started the new year well, as the recent sharp rise in its exports shows. The robust economic situation in the industrial countries should provide stimulus for exports from the emerging economies in the months ahead. Moreover, countries such as Russia and

Brazil are profiting from the (so far) higher oil prices. The impact of US punitive tariffs on the emerging economies, on the other hand, is likely to be limited, provided that there is no further escalation of protectionist measures.

Fig. 1-1 Economic growth in selected countries



GDP-Growth in %
Source: BAK Economics, Oxford Economics

Swiss economy

Upward trend continues in Swiss economy

The final quarter of 2017 saw a continuation of the upward trend for the Swiss economy. Gross domestic product expanded at a brisk 0.6 per cent, bringing full-year growth for 2017 to 1.0%. Growth should turn out to be significantly higher in the current year. The momentum here is coming from the still favourable international economic environment which will continue to boost Switzerland's foreign trade in the coming months.

Domestic demand gathers pace in 2018

The global environment is not the only source of positive stimulus for the Swiss economy. Domestic demand is also set to accelerate further in 2018. Consumer spending is profiting from the upswing in the labour market in particular. In view of the rising growth in employment, the decline in the unemployment rate is expected to continue in the coming months. BAK anticipates that the unemployment rate will have fallen to only 2.7 per cent by the year-end. However, unemployment will probably bottom out at that point, as companies will find it increasingly difficult to recruit suitable workers.

On the whole, the outlook for investment is also positive. In view of the increase in companies' capacity utilisation, the need for investment in expansion will grow. The still excellent mood among companies is also indicative of a sustained increase in capital investment activity. Investment in buildings, on the other hand, is expected to develop more cautiously in the next few years, as the stimulus from the recent drivers of demand (immigration, favourable financing conditions in conjunction with the scarcity of investment opportunities, and pent-up demand in some construction segments) gradually subsides. In addition, the rising vacancy rate in the residential property segment shows that the sharp increase in supply has outpaced the growth in demand in recent years.

Swiss GDP to grow by +2.4% in 2018

All in all, thanks to the robust global environment and accelerating domestic growth in the current year, the Swiss economy can be expected to develop dynamically. BAK forecasts expansion of Swiss GDP at a rate of 2.4 per cent.

Tab. 1-1 Historic forecasts for Swiss GDP and individual components

	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18	Ø 08-17
GDP CH	2.8	3.1	4.0	4.1	2.2	-2.2	3.0	1.7	1.0	1.9	2.4	1.2	1.4	1.0	2.4	1.3
GDP per cap.	2.1	2.5	3.3	2.9	0.7	-3.3	1.9	0.6	-0.1	0.6	1.2	0.1	0.3	0.1	1.4	0.2
Priv. Spending	1.7	1.6	1.4	2.4	1.5	1.3	1.7	0.7	2.3	2.6	1.3	1.8	1.5	1.2	1.6	1.6
Pub. Spending	1.0	1.8	0.3	0.7	1.2	3.0	1.1	1.7	1.5	2.3	2.2	1.2	1.6	0.9	1.2	1.7
Inv. Constru.	3.9	3.5	-1.4	-2.3	0.0	3.0	3.5	2.5	2.9	3.1	3.2	1.6	0.9	1.9	0.7	2.3
Inv. Equipm.	5.7	3.1	8.2	8.9	1.1	-12.3	4.9	5.6	3.5	-1.0	2.9	2.6	4.5	3.8	4.7	1.4
Exports	8.6	7.9	9.8	10.0	2.3	-7.2	7.9	3.5	3.0	-0.1	5.2	2.3	6.8	2.7	4.8	2.6
Goods	7.9	6.3	11.2	8.1	2.0	-11.3	9.8	6.5	1.7	-1.0	4.1	0.7	6.6	5.1	5.6	2.3
Trans. Trade	74.1	17.1	31.8	15.7	20.0	18.0	25.6	4.0	-4.3	-11.6	20.1	16.5	2.9	-1.3	-2.8	8.3
Services	6.6	10.3	5.3	12.8	0.2	-4.2	1.2	-2.2	7.5	4.5	4.0	1.7	7.9	-0.5	4.8	2.0
Imports	6.6	5.6	5.8	6.4	-0.2	-4.8	9.5	4.7	4.4	1.4	3.3	3.2	4.7	2.2	4.8	2.8
Goods	6.0	5.1	7.2	6.6	-0.7	-8.3	10.9	3.1	2.3	0.7	1.7	0.0	4.4	3.6	6.7	1.7
Services	8.1	6.8	2.2	5.8	1.2	4.8	6.4	8.6	9.3	3.0	6.8	9.6	5.4	-0.2	1.2	5.4

Component growth on use side (real, % p.a.) lower than corresponding trend 08-17 higher
Source: BFS, SECO, BAK Economics

Developments in the stock and commodities markets

Increasing volatility in global finance markets in first quarter

Volatility increased sharply in the global stock markets in the first quarter of 2018. Having reached new record levels in many countries in January, share prices slipped – in some cases significantly – in February and March. The turbulence in February was triggered by higher-than-expected wage settlements in the USA, which were interpreted as precursors of rising inflation. This increased fears of more rapid interest rate increases by the US central bank, the Fed, which led to rising bond yields and falling share prices. In March, additional pressure was brought to bear on the stock markets by the USA's imposition of punitive tariffs on selected goods such as steel and aluminium. Punitive tariffs were also imposed on other goods from China, while the EU and certain other countries (however, not Switzerland) were provisionally exempted from the tariffs. Although the effects on the real economy of the measures announced thus far will probably be limited, the risk of the situation between the USA and China escalating into a possible global trade war is causing uncertainty and driving share prices down.

Nevertheless, in our opinion the turbulence in the stock markets in the first quarter should not be interpreted as a signal for an imminent downturn in the world economy. The good economic environment and the continued rise expected in corporate profits should therefore ensure that share prices will rise again on stock markets around the world in the course of the year.

Oil price rise unlikely to continue

The development of the oil price was also volatile in the first quarter of 2018. In January, the price of (Brent) oil briefly exceeded the threshold of 70 US dollars, only to fall again significantly towards 60 US dollars in February. In recent weeks, however, the oil price has once again risen in the direction of 70 US dollars a barrel as fears have mounted of stronger action by the USA against the major oil producer Iran. There is also speculation that the production ceiling agreed by the OPEC states and other producers may even remain in effect in 2019. Nevertheless, we expect oil prices to fall slightly in the coming months, as shale oil production in the USA is likely to rise again, with prices at their present level.

Prices, foreign exchange and capital markets

Only very gradual increase in inflationary pressure likely

As a result of the higher wage settlements in the USA in February, fears of rising inflation have increased. Inflationary pressure in the industrial economies remains low, however. In the USA, core inflation, which excludes volatile factors such as energy prices, was 1.8% in March and therefore still below the inflation target of 2%. In the eurozone, core inflation is currently running at only 1.0%, and in Switzerland it is in fact only 0.5%. We still expect only a moderate rise in inflation in the industrial economies. For Switzerland, we anticipate an average inflation rate of 0.7% in 2018 (2017: +0.5%).

US monetary policy tightening continues

Despite having a new chair, the Fed is continuing on its course of monetary policy tightening and raised its benchmark lending rate in March by 25 basis points to a range of 1.5 to 1.75%. We anticipate further interest rate increases this year, as US growth will probably accelerate further in the course of the year. The upward trend in 10-year Treasury bond yield is therefore likely to continue, and we expect it to increase further in the second half of 2018.

In the eurozone and in Switzerland, on the other hand, normalisation of monetary policy will continue to be a very slow process on account of low inflationary pressure. Although the ECB is expected to discontinue its monthly bond-purchasing programme in the second half of 2018, interest rates are not expected to be raised either in the eurozone or in Switzerland until 2019. The yields on long-term government bonds will probably rise in the next few months, however.

Dollar weakness?

The euro-dollar exchange rate levelled off between 1.22 and 1.24 EUR/USD in February and March. The value of the US dollar is still historically high and in addition, the twin deficits, i.e. the US fiscal deficit and the foreign trade deficit, are weighing down on the dollar. At the same time, the higher interest rate level compared with the eurozone has little influence on the dollar's exchange rate. We therefore expect the Dollar to stabilize and the franc to level off at 1.18 EUR/CHF during the course of the year.

Risks & opportunities in 2018

Risk of global trade war increases significantly

Although the economic outlook is consistently optimistic, the negative risks have also increased. Above all, the risk of a global trade war has increased significantly.

The punitive tariffs announced by the USA – particularly those aimed at China – go far beyond previous measures which were very specific in nature (e.g. import restrictions on solar panels and washing machines).

Brexit remains unresolved

But other risk factors have become, if anything, more explosive. The question as to how the United Kingdom and the EU will structure their relations after the UK's exit is still completely unresolved. The increasingly bitter dispute over Northern Ireland's post-Brexit status is further endangering the successful outcome of the Brexit negotiations. At least by agreeing on an extension of the transition period, the parties appear to have gained valuable time to avoid a chaotic exit after all.

New driving force for Europe?

The extent to which Europe can act as a positive counterweight to the uncertain geopolitical situation remains unclear. Potentially, it has a strong pair of leaders in Macron and Merkel, enabling it to provide a spirited response to the many uncertainties. On the other hand, the elections in Italy have given new impetus to the divisive populists and the continuing conflict over Catalonia points to further fault lines. In addition, the newly re-formed German government has yet to prove its stability.

Monetary policy withdrawal with high risk potential

The turbulence on the stock exchanges in recent weeks confirms our view that the impending withdrawal from the extremely expansionary monetary policy of recent years entails significant economic risks. However, danger threatens not only from there. The "nationalisation" of the Chinese insurance giant Anbang, for example, is symptomatic of increasing nervousness about the possibility that the high debts accumulated by Chinese companies might trigger off a new financial crisis.

Opportunities in the economic environment

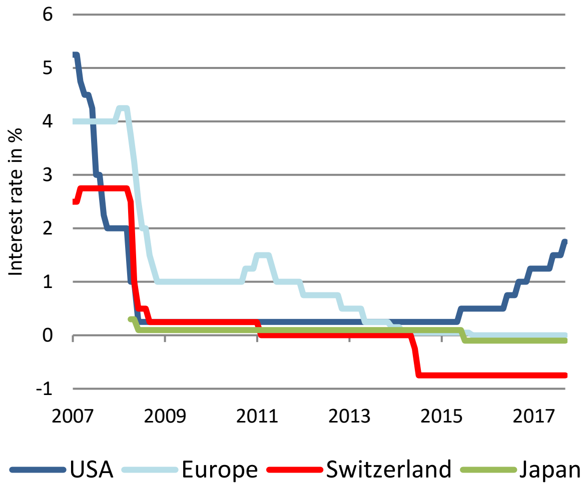
We still see the greatest opportunities for 2018 in the fact that, in spite of what are already very optimistic forecasts, the strength of the current global upswing is still being underestimated. There is further room for improvement – above all in the underperformer of recent years, i.e. global corporate investment. With regard to the Swiss economy, the return to a weaker franc and the noticeable decline in unemployment could make for an even stronger additional stimulus than is currently anticipated.

2017 tax proposal

Thanks to the direct democratic processes in Switzerland, the country's voters are themselves to a great extent in a position to decide whether the present upward trends in Switzerland are further consolidated or come to nothing in a brief straw fire. One key element here in 2018 will be the 2017 tax proposal in particular.

Our assessment for Q2, 2018

Biggest Risks	***Biggest Opportunities***
Escalating trade war with strongly negative repercussions on the world economy	Positive aspects of the Trump Agenda win the upper hand
Unexpected overheating of the world economy leads to excessive reaction of the central banks	Normalization of the interest rate situation
Elimination of the holding privilege leads to negative effects on Switzerland as a business location	Global investment cycle starts even stronger than expected
Resurgence of the euro crisis	Low oil prices and the recovery of labor markets are pushing private consumption to new heights
Bankruptcy of Tesla or other big-tech	Emergence of new products or companies through technological progress
Fight for opinion leadership - eg Fake News	Unconventional political measures lead to the breaking up of old structures
Societal challenges through the use of new technologies	Efficiency gains and easier capital raising through the use of blockchain technology

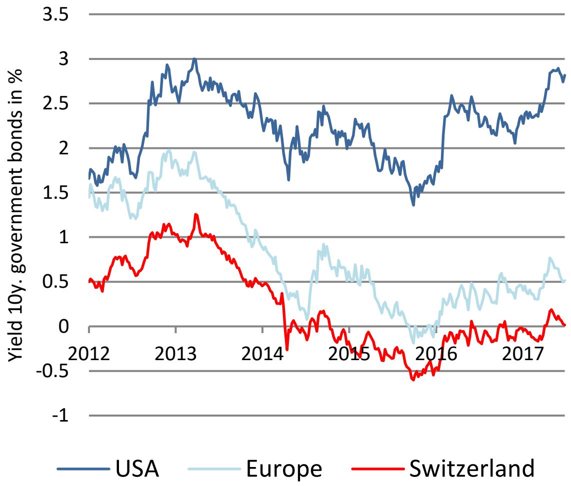


Money market — overweight

(no change)

In the text above, we have already described that even the new leadership of the US Federal Reserve seeks no change in policy. Further interest rate steps will follow. In Europe and Switzerland, interest rate increases are not expected at this time. We expect these early in the late autumn d.J.

We consider the overweighting in the money market to exploit tactical opportunities.

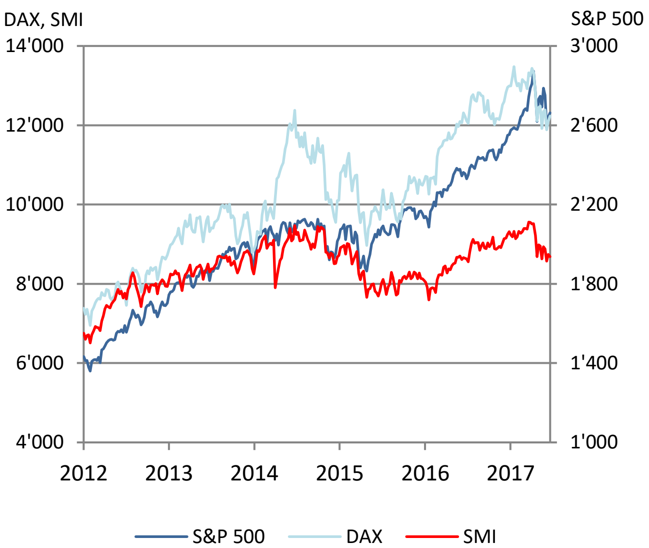


Fixed-interest securities — underweight

(no change)

The already expected rise of 10y US government bonds towards 3% has arrived. We do not expect any major changes for the next quarter. This also applies to the Swiss and European capital markets.

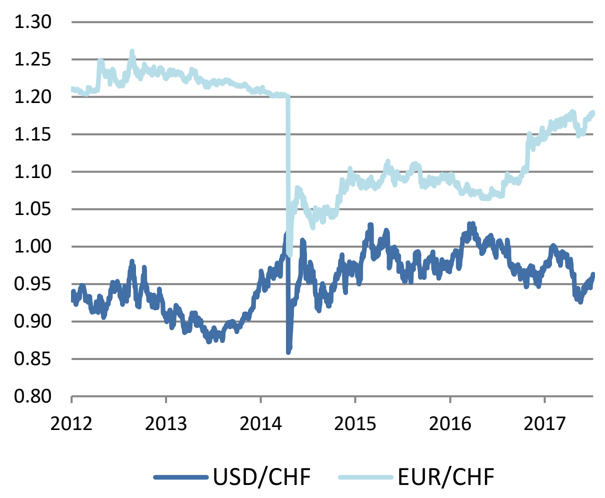
The bond market remains unattractive. Investments are only made in short-term corporate bonds.



Shares — neutral

(no change)

The first quarter was characterized by high volatility. On an annual basis, most stock markets trade at a significant discount. The trade disputes are a significant burdening factor. However, we do not expect a sustainable burden on the global economy. Provided that the fundamental data continues to be positive. The valuation of the stock markets is attractive and we still see a further increase in corporate profits. This is supported by the greater propensity to invest and M & A activities. On the other hand, there is a very fragile technical situation. We assume that the volatility will remain high, but still see a positive tone. In our tactical allocation, we have a neutral weighting in equity positions. We focus primarily on Swiss and European stocks, as they are especially attractive after the correction. Commitments in the US are being used to cover the booming technology industry.



Currencies: neutral

(no change)

The USD has weakened significantly. We expect a small recovery, which will, however, be characterized by strong fluctuations. The Swiss franc will move sideways against the euro, with a slight tendency to further weakening.

We follow a neutral weighting of the currencies according to the reference currencies of the portfolios.

Precious metals: overweight

(no change)

The gold price is in a slight uptrend. We continue to expect rising prices and hold the precious metals position at around 10% of the deposit value.

All charts are courtesy of Bloomberg

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