

Strategy update

Still safety on



BK & Associates
Private Wealth Management
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ONE STEP AHEAD THE MARKET

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Asset Allocation Model (AAM)

Momentum: all regions negative

Valuation: Europe neutral, US expensive, Emerging Markets cheap

Still prefer the relative play, buy European against US equities

| Valuation | Momentum Model: Buy | | | | | Momentum Model: Sell | | | | | Momentum Model: Neutral | | | | |
|-----------|---------------------|-----|-----|-----|-----|----------------------|-----|-----|-----|-----|-------------------------|-----|-----|-----|-----|
| very high | P | C | C | B | B | C | C | C | C | C/B | C | C | C | C/B | C/B |
| high | P | P | C/E | B | B | C | C | C | C/B | B | P | C | C/B | C/B | C/B |
| neutral | E/P | E/P | E/B | E/B | E/B | C | C | C | C/B | B | E/P | C/E | C/B | B | B |
| low | E | E | E/B | E/B | E/B | P/E | C/E | C/E | C/B | C/B | E/P | C/E | E/B | E/B | E/B |
| very low | E | E | E | E | E/B | E | E | E/B | E/B | E/B | E | E | E/B | E/B | E/B |

very low low neutral high very high very low low neutral high very high very low low neutral high very high

Volatility

Stoxx S&P MSCI Emerging Markets

E = Equity, High Yield Bonds

B = Barrier

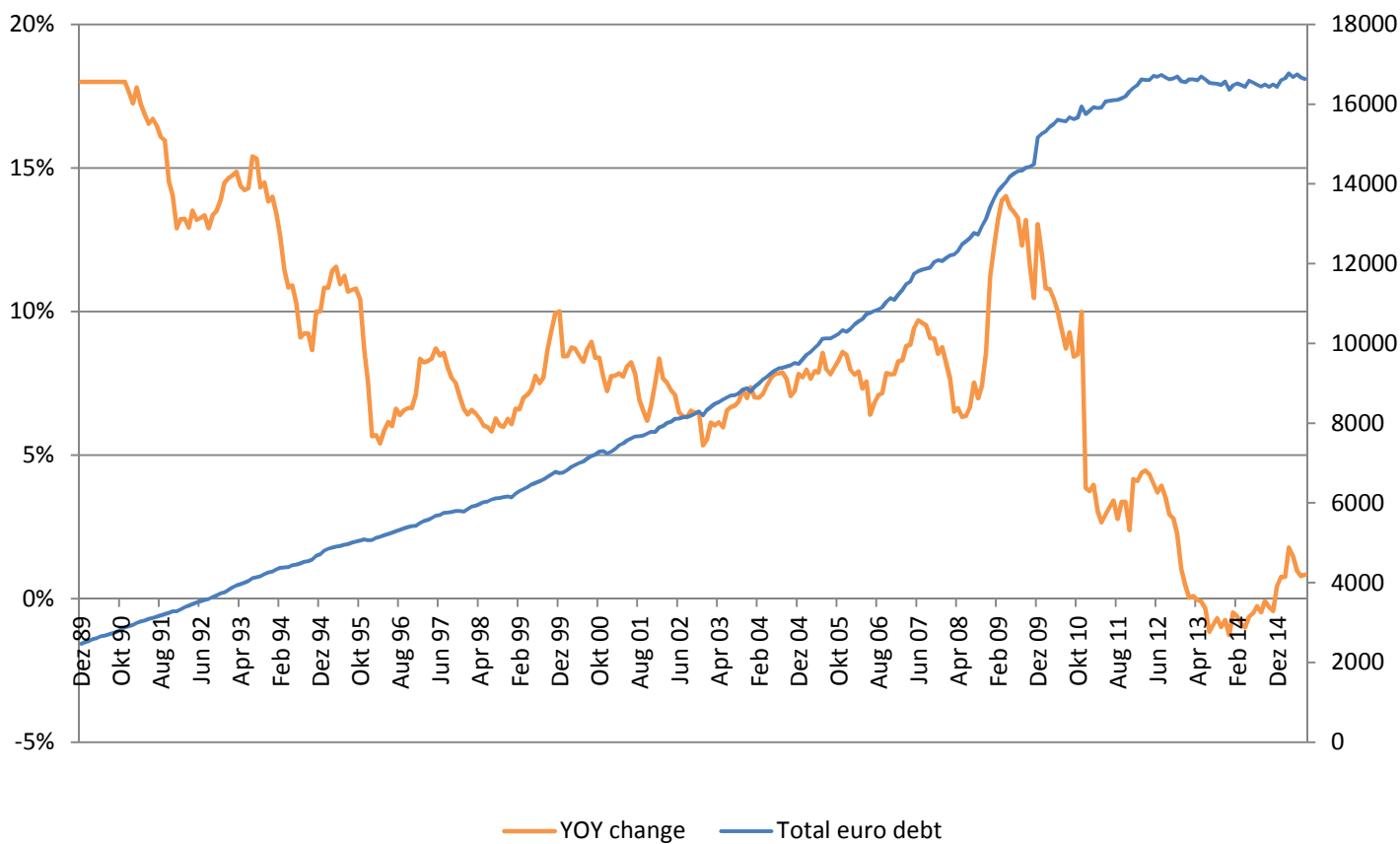
P = Protection / Participation / Hedge funds

C = Cash / Quality bonds



European Economics

Debt creation stagnates and could lead to increasing growth concerns if confirmed in the next months



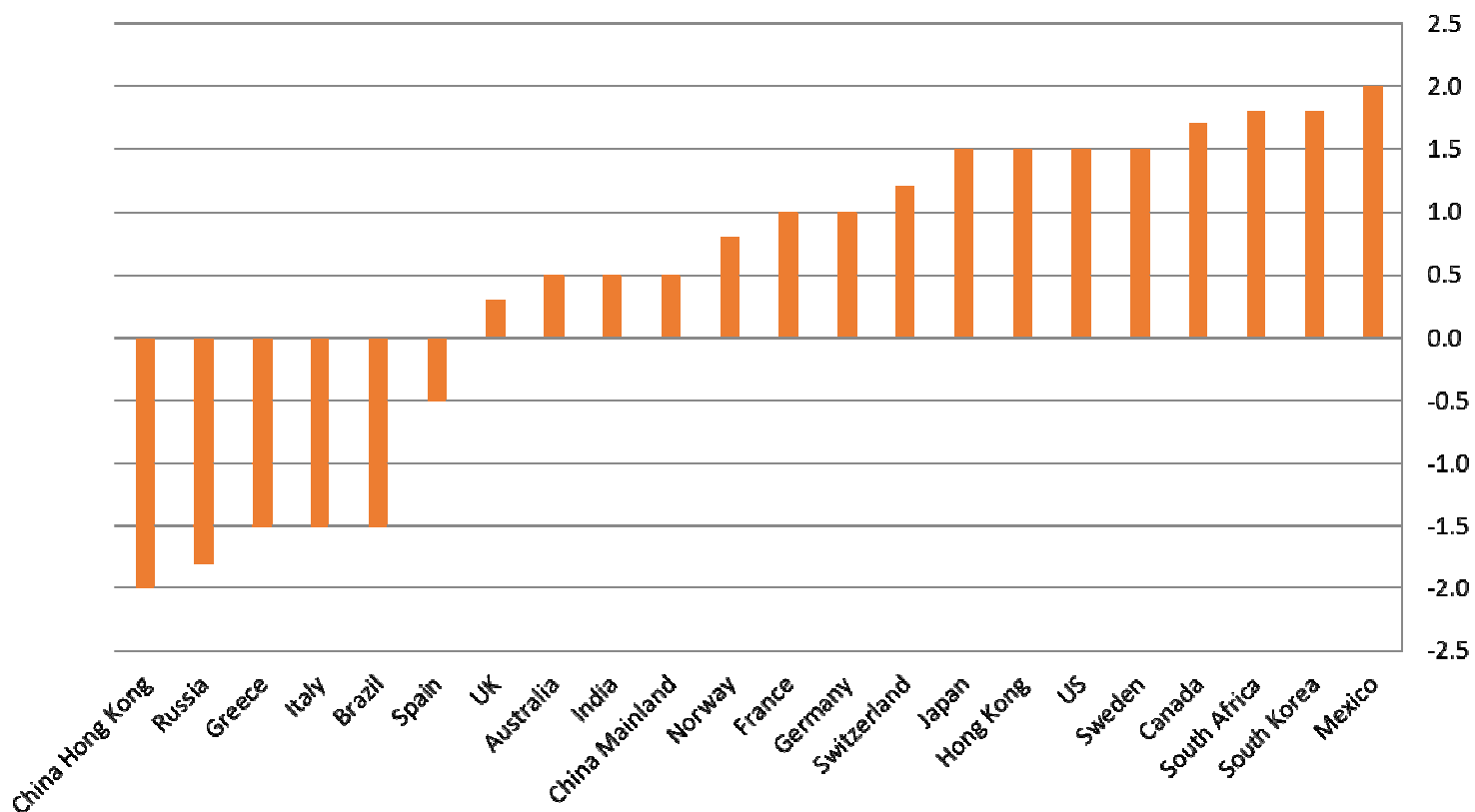
Source: ECB, BK&Associates



Valuation Monitor in local currencies

Market capitalization to GDP (-2 = very cheap, 2 = very expensive)

China (H-shares) has become very cheap, North America still very expensive

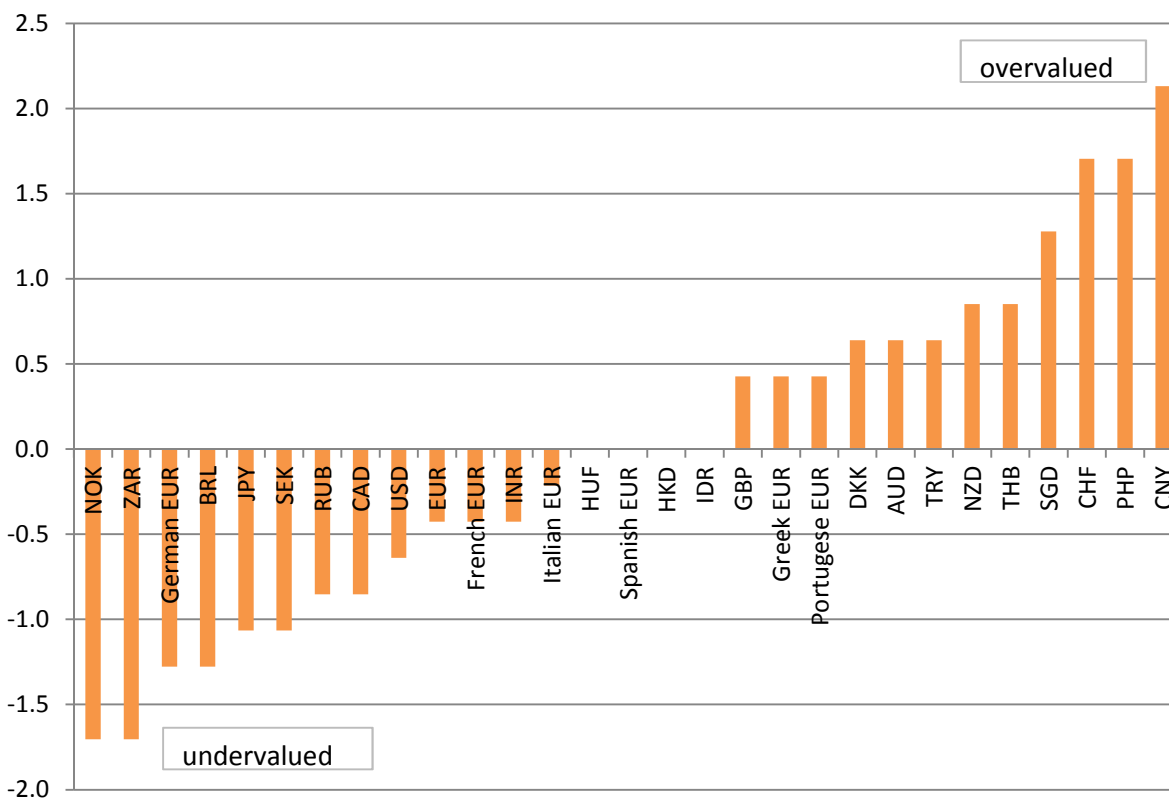




Currency Monitor

Trade weighted real exchange rates (-2 = very cheap, 2 = very expensive*)

Commodity related currencies cheap (Norwegian, Brazilian, Canadian, Russian), Asian currencies still expensive



*see Appendix for an explanation



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Equities: European markets

Eurostoxx50 (European large caps, orange) has still a lot to catch up against S&P (US large caps, black)

We still believe that the relative trade will pay off nicely





Equities: European markets

Valuation:

European equities are fairly valued at these levels



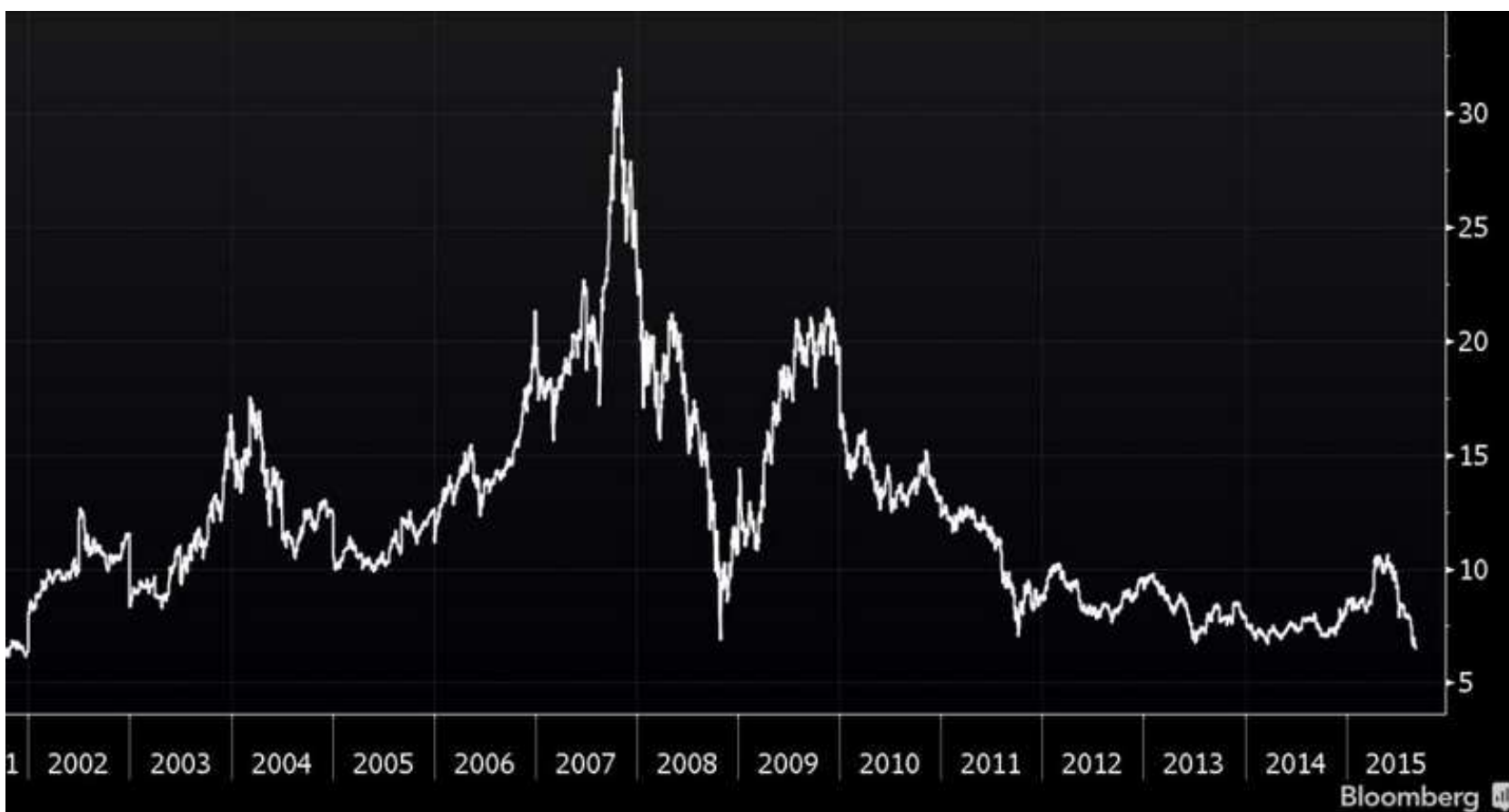


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Equities: Chinese stocks listed in Hong Kong (H-shares)

The chart shows the average price-to-earnings ratio for Chinese H-shares

Chinese stocks listed in Hong Kong trade at the lowest level since 2001 and even lower than at the bottom of 2008!



*See our valuation monitor on page 6



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Equities: US market

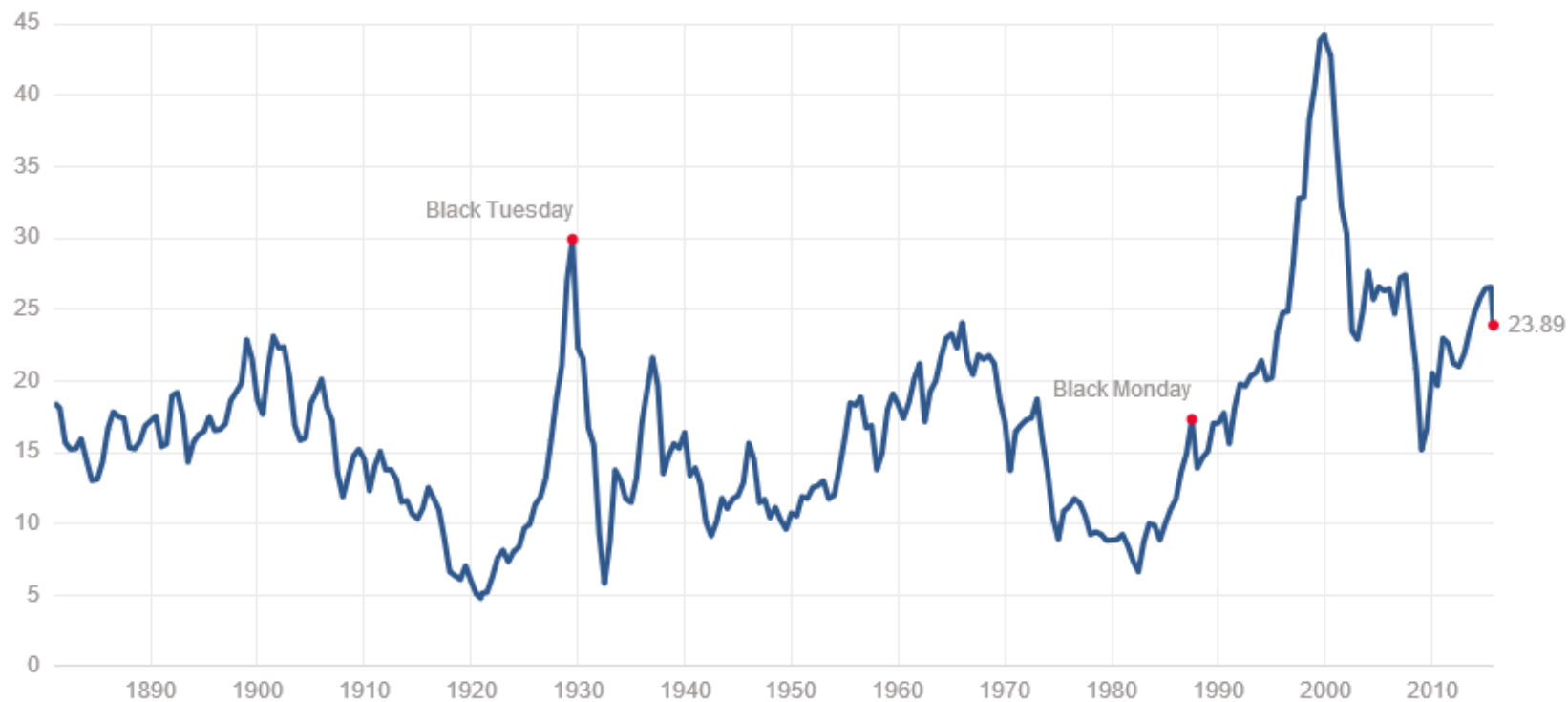
The long-term uptrend in S&P is clearly broken which is a drag for markets worldwide
We would only buy more equities if S&P breaks above 2'000





Equities: US market

Despite the sharp downturn, valuations have only slightly improved.
 US stocks are far away from cheap, which is also a danger for other markets





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Equities US: seasonality

The chart shows the average performance of the S&P over the last 37 years
September and October are the worst months of the year – on average





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Commodities: Gold mining stocks

Gold mining stocks have lost 80% from the top and are at the level of 1974, even without inflation adjustment
This bear market is the biggest and longest in the history of the Barron's gold mining index



Source: Barron's



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Volatility

From now on, we will show the long-term volatility index, which is more important for our structured products
Long-term volatility is at the highest level since 2012



Low < 24, high > 28

Low volatility is good for participation (buy call options) or protection (buy put options)
High volatility is good for barrier reverse convertibles products (sell call and put options)

Source: Marketwatch



High yield corporate bonds: Europe

Yields increased further, but still far away from cheap

Support from Quantitative Easing and negligible yield on government and investment grade bonds





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Summary

Asset Allocation:

- The long-term bull market in US equities is broken which is a drag for stocks worldwide
- September and October are the weakest months for stock markets, on average
- Negligible yield on government and investment grade bonds

European equities

- Long-term momentum slightly negative
- Fair valuation

US equities

- Expensive and momentum negative
- Could already be in a bear market

Emerging market equities

- Brazil/Russia
 - Currencies are cheap after latest devaluations
 - Oil price in local currencies quite stable over last quarters
 - Low valuation
- China Hong Kong shares (H-shares) among the cheapest worldwide

Gold mining stocks

- Lost 80% from the top and are at levels of 1974



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Strategy implementation

- Since August 2014 we've held a maximum allocation to **Alternative Investments**.
We now start to reduce some positions and increase cash to be ready to buy low, should stocks and high yield bonds correct further
- **European equities:**
Due to the strong downturn of the last month, the equity character of our structured products has increased
Hence, we will not increase the exposure at this stage
We keep playing the spread between **European and US equities**, which is market neutral
- **Emerging Market equities:**
Currently we have limited exposure, mainly via **Russian and China H-shares**
We plan to increase positions in **Chinese H-shares and Brazilian stocks** into further falling markets
- **Gold Mining stocks:**
We opened a small position and will increase it step-by-step into falling markets
- **High Yield Bonds**
We prefer short duration
Our European product has a finite maturity 2018 and a yield of 6.5%
To diversify we are buying an Emerging Market product with finite maturity 2020 and yield of 7.5%



Appendix: Currency Monitor explanation

- An investment idea has to be split into 1) an analysis of the local market and 2) the currency
- It could be that the local market is cheap, but the currency expensive, in which case costs for currency hedging have to be taken into account if doing an investment
- That's why we now split our analysis in 1) a Valuation Monitor and 2) a Currency Monitor
- The results of the Currency Monitor are a combination of exchange rates, price differentials and GDP per capita
- GDP per capita has to be considered, because rich people do care less about price arbitrage
For example: most Swiss prices are always higher compared to other countries
Therefore, without GDP per capita adjustment, the Swiss franc would always look overvalued
- Nominal exchange rates have been abandoned within the European Currency Union
Nonetheless, we can calculate real exchange rates, for example a German or Greek EUR
This gives us an indication about the competitiveness of different ECU countries
- The values in the Currency Monitor are standard deviations around the mean



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Thank You for Your Attention!

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