Strategy update

Safety on

BK & Associates

Private Wealth Management

Zurich, 7th September 2015

Contents

Asset Allocation Model (AAM)

Momentum: Europe neutral, US negative, Emerging Markets negative
Valuation: Europe neutral, US expensive, Emerging Markets cheap
Still prefer the relative play, buy European against US equities

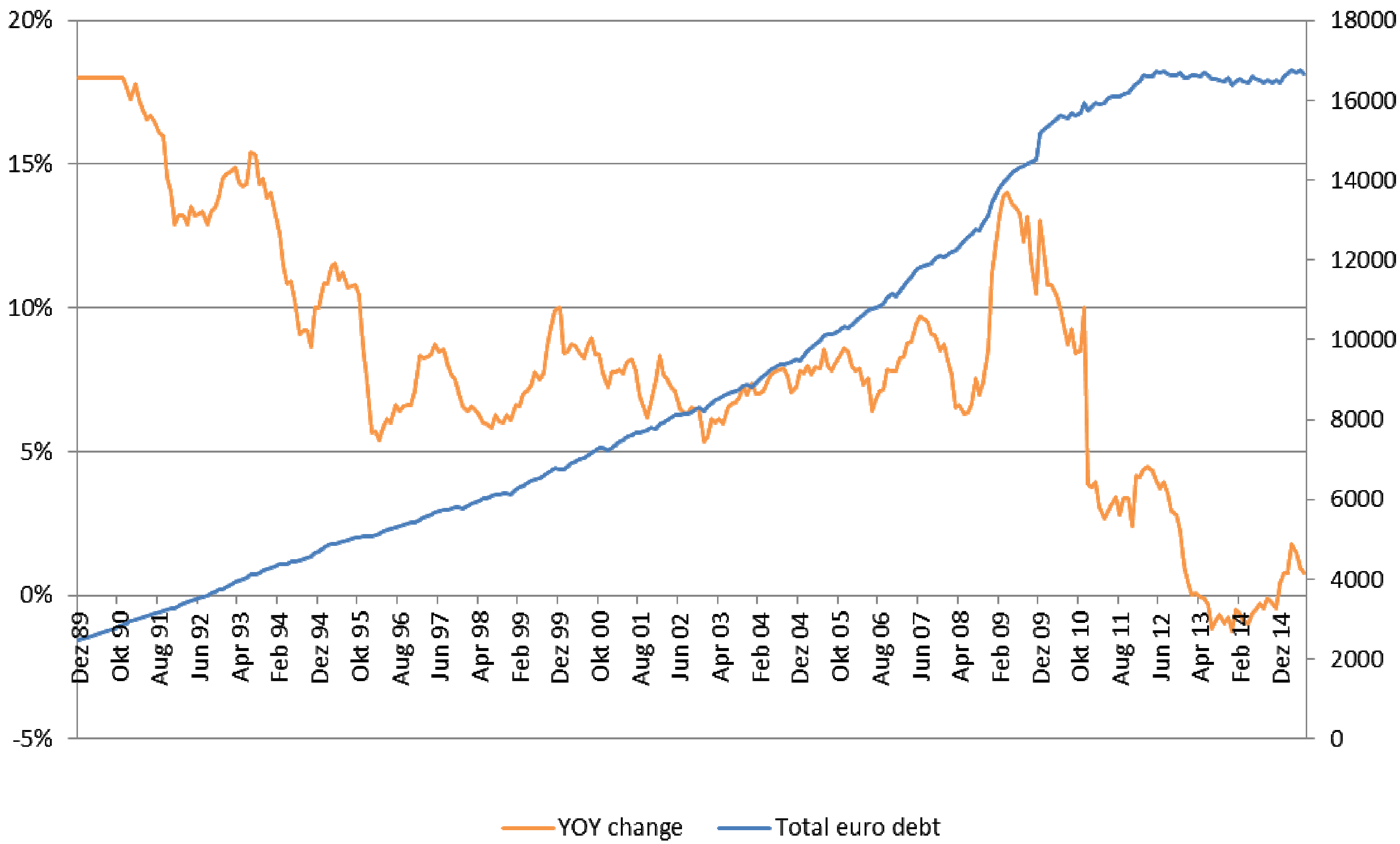
Valuation	Momentum Model: Buy					Momentum Model: Sell					Momentum Model: Neutral				
very high	P	C	C	B	B	C	C	C	C	C/B	C	C	C	C/B	C/B
high	P	P	C/E	B	B	C	C	C	C/B	B	P	C	C/B	C/B	C/B
neutral	E/P	E/P	E/B	E/B	E/B	C	C	C	C/B	B	E/P	C/E	C/B	B	B
low	E	E	E/B	E/B	E/B	P/E	C/E	C/E	C/B	C/B	E/P	C/E	E/B	E/B	E/B
very low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

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 growing growth concerns if confirmed in the next months



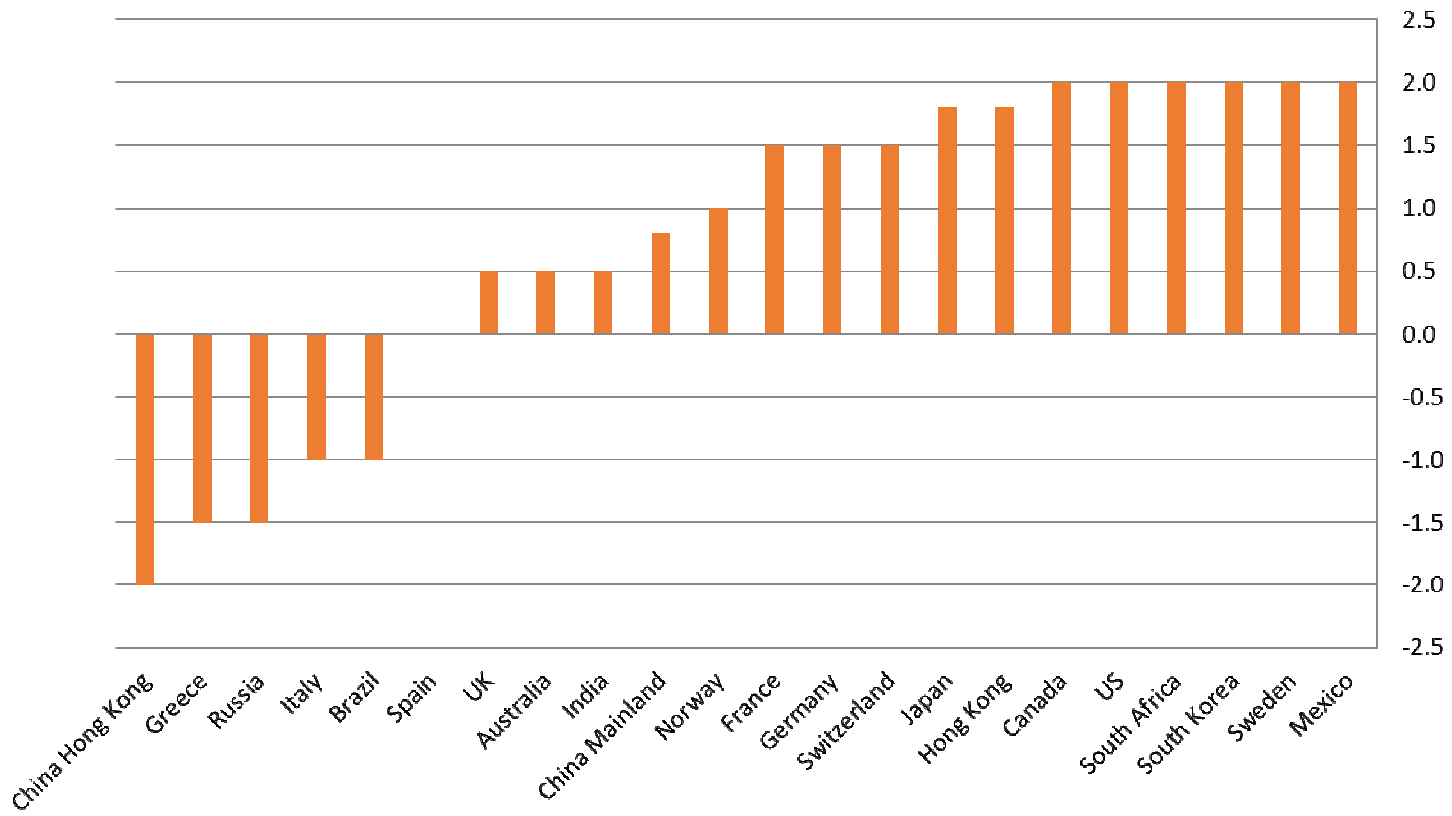
Source: ECB, BK&Associates

ONE STEP AHEAD THE MARKET

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

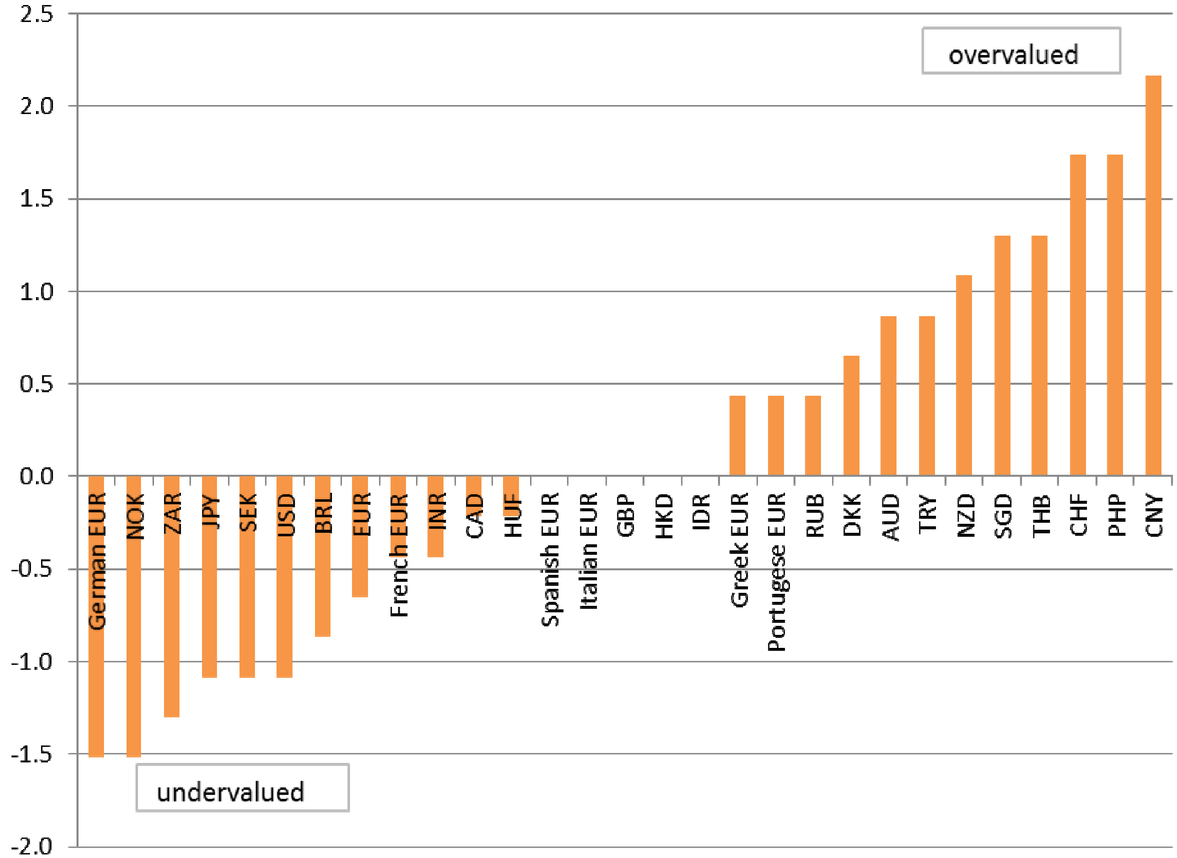


Source: National Inflation Association, Gurufocus, BK&Associates

Currency Monitor

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

The Chinese currency is still the most expensive and we expect further devaluation of the Renmimbi

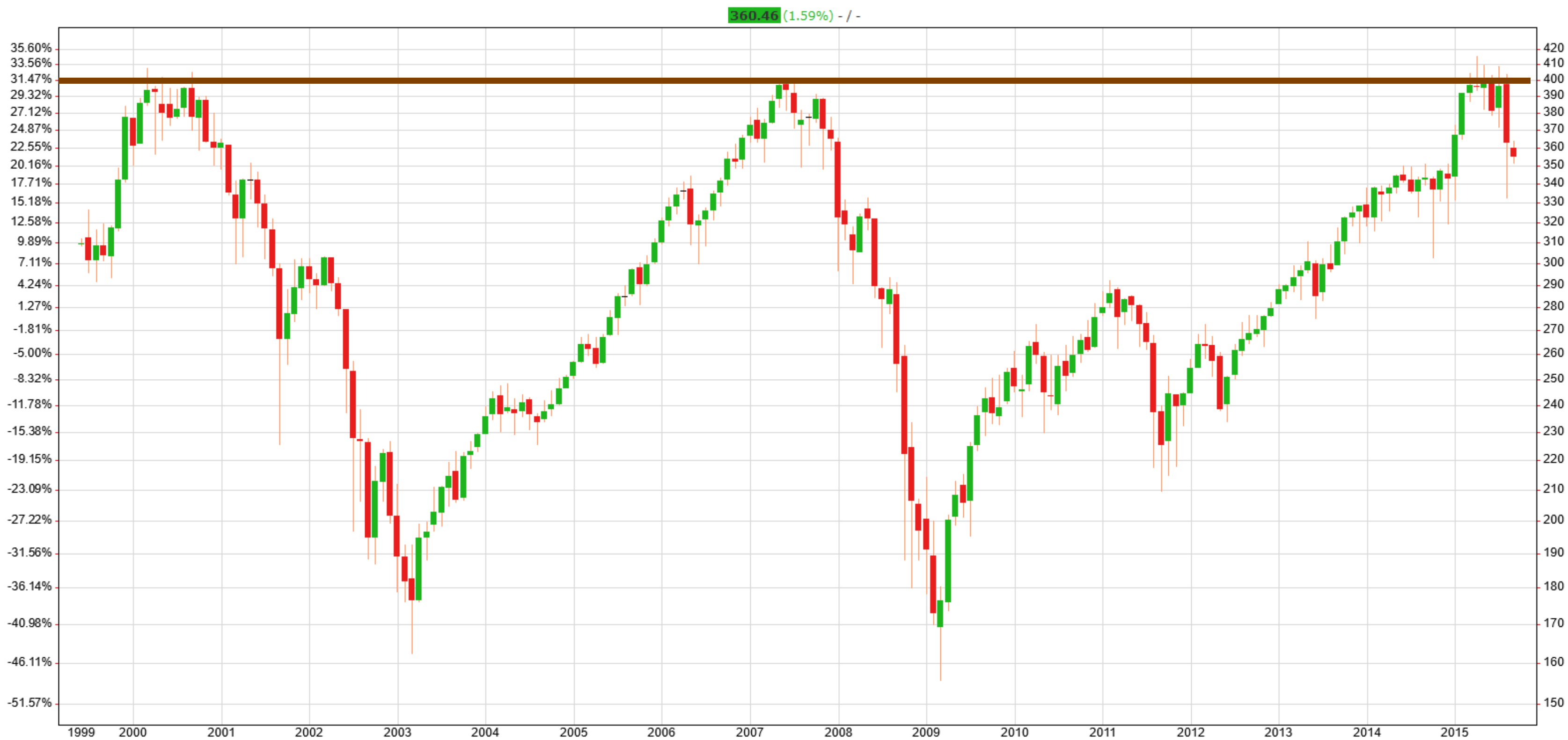


*see Appendix for an explanation

Source: BIS, OECD, BK&Associates

Equities: European markets

Stoxx600: for safety reasons we would only add European stocks if the key level of 400 is broken to the upside or if we see another sell-off



Source: Swissquote

Equities: European markets

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

We still believe that the relative trade will pay of nicely

Source: Swissquote

Equities: European markets

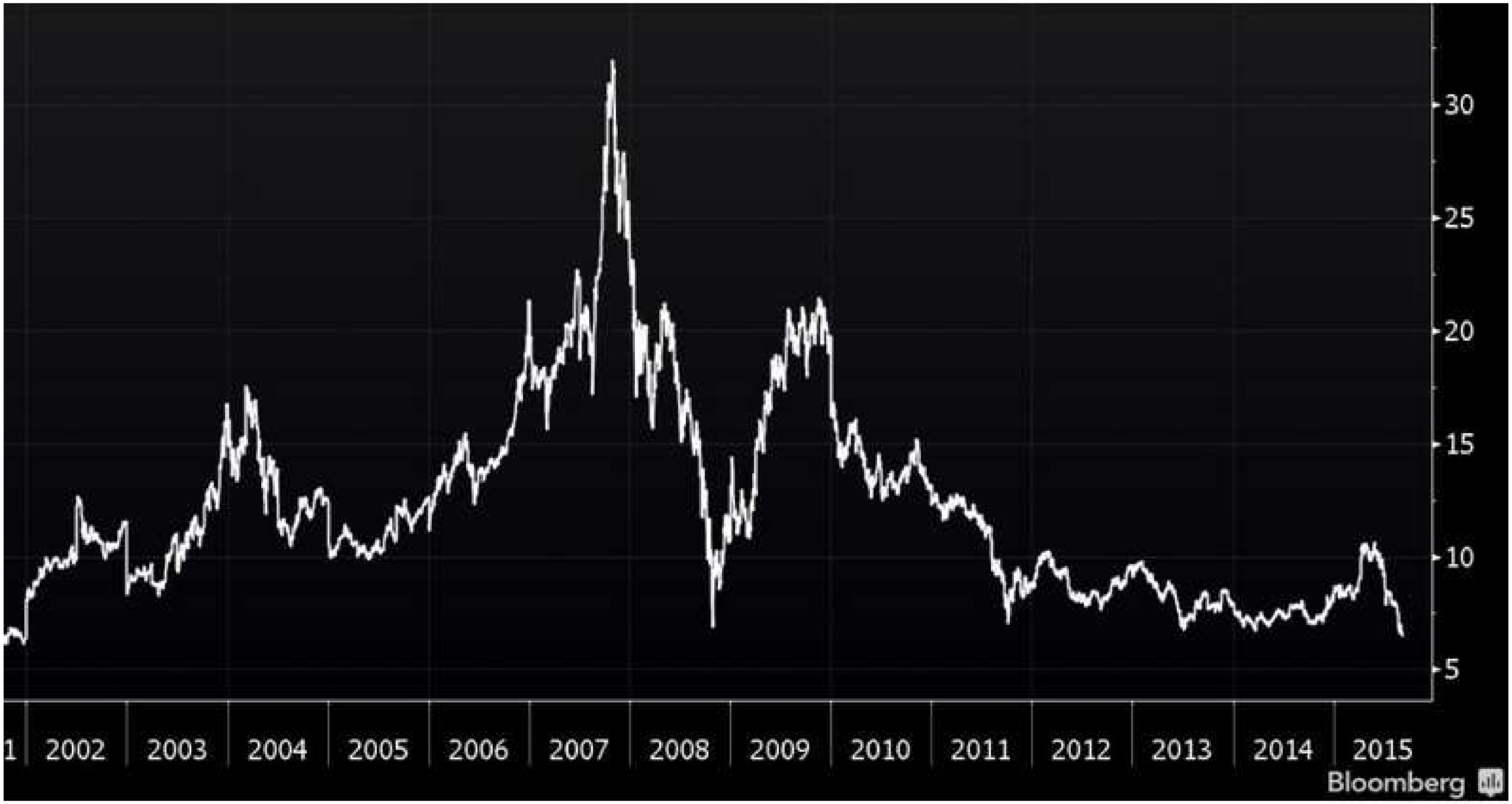
Valuation:

European equities are fairly valued at these levels

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

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

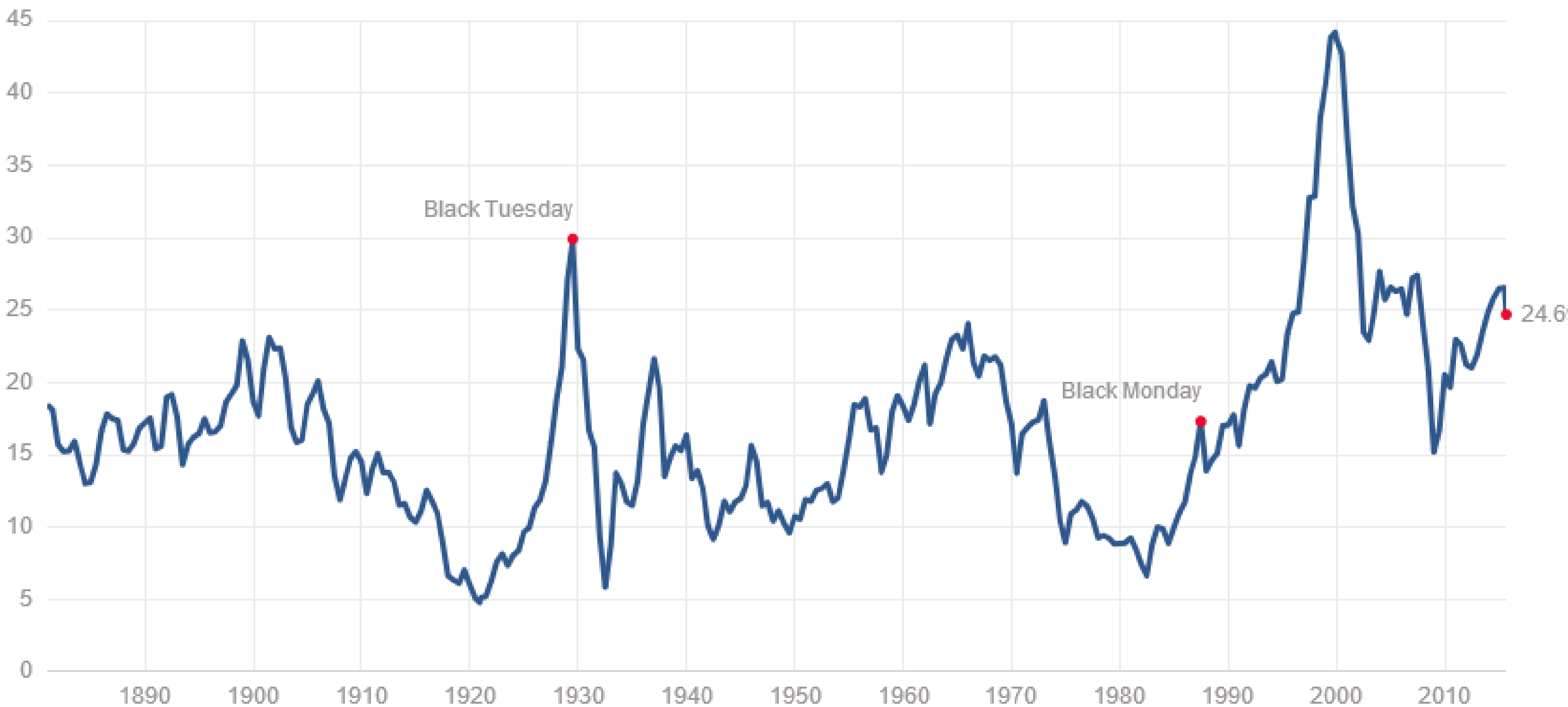
Chinese stocks listed in Hong Kong trade at the lowest level since 2001 and even lower than at the bottom of 2008!



*See our valuation monitor on page 6

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



Source: www.multpl.com

ONE STEP AHEAD THE MARKET

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

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

Commodities: Gold mining stocks

- Gold mining stocks are at a more extreme than the Gold price itself

- Surviving Gold companies will have profits in the future and potentially pay dividends (compounding effect)

- Therefore, we prefer to buy the stocks at this stage

- The volatility in this sector is so high that we recommend to buy a diversified ETF

- If these companies lost 80% from the top, they can also lose 90% briefly, which would be a drop of another 50% from current levels; but it would be a life-time opportunity

- Hence, the strategy is to open the trade step-by-step

- We target an allocation of maximum 5% to the sector, depending on the level

- Timing:

  - We´ve bought 1%
  - If stocks lose 20% from current levels, we add 1%
  - If stocks lose 40-50% from current levels, we add 2-3%

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)

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

Source: BofA, FED St. Louis

Summary

<u>Asset Allocation:</u>

- September and October are the weakest months for stock markets, on average
- European Quantitative Easing supports European equity and bond markets
- Negligible yield on government and investment grade bonds
- Although expensive, there is little alternative to European high yield bonds and equities

<u>European equities</u>

- Long-term momentum neutral
- Stoxx600 key resistance is at 400

<u>US equities</u>

- Expensive and momentum negative

<u>Emerging market equities</u>

- 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 and over-sold

- <u>Gold mining stocks</u>
- Lost 80% from the top and are at levels of 1974

Strategy implementation

- We keep a maximum allocation to Alternative Investments.
  Some products will be paid back in the next month and provide us with liquidity

- 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 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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