

# Strategy update

Get ready for re-entry



BK & Associates  
Private Wealth Management  
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## Asset Allocation Model (AAM)

Momentum: big divergences, Europe still buy, US sell

Valuation: Europe neutral, US expensive

Minor change: volatility is now high in Europe

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

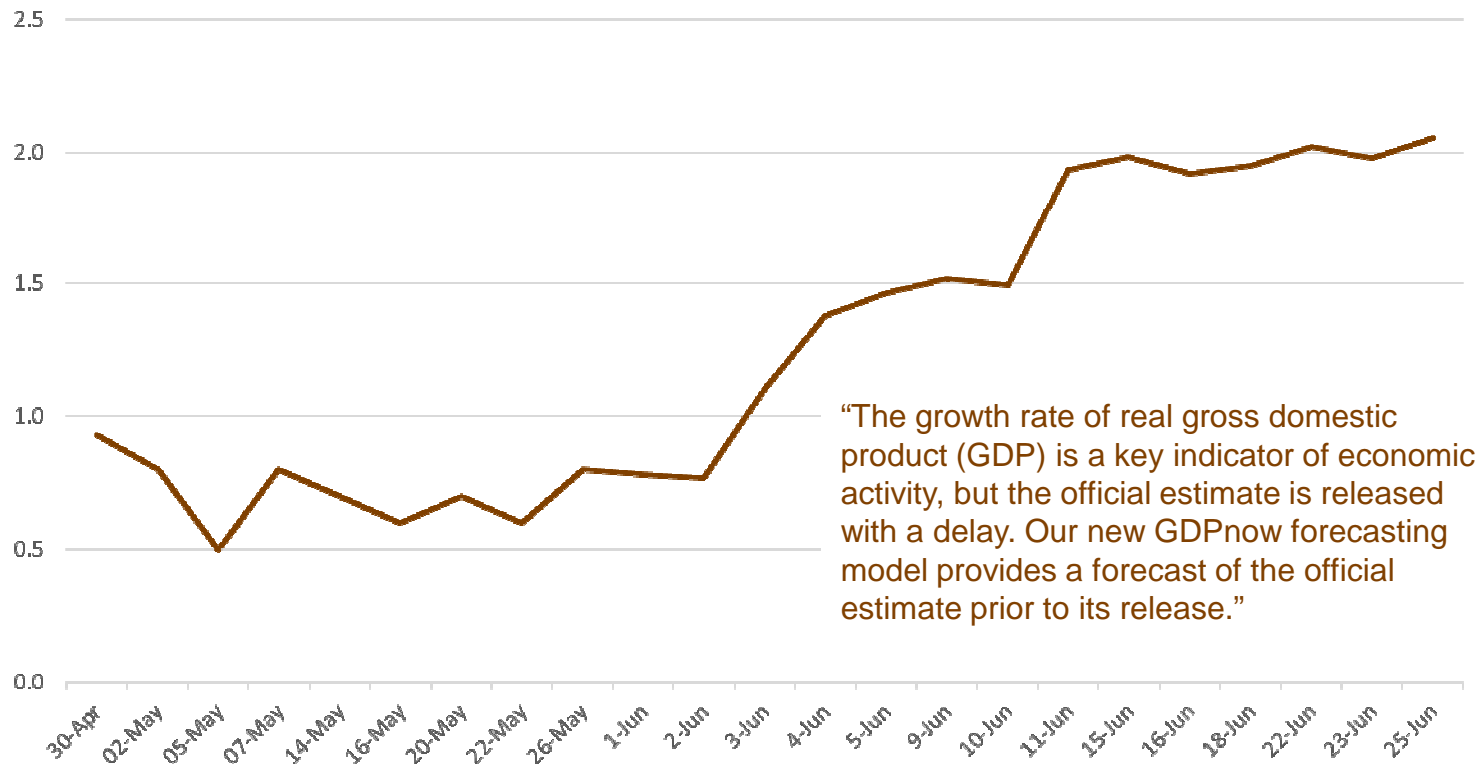


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## US Economics

GDPnow forecast for Q2 2015

Strong improvement in economic activity since June



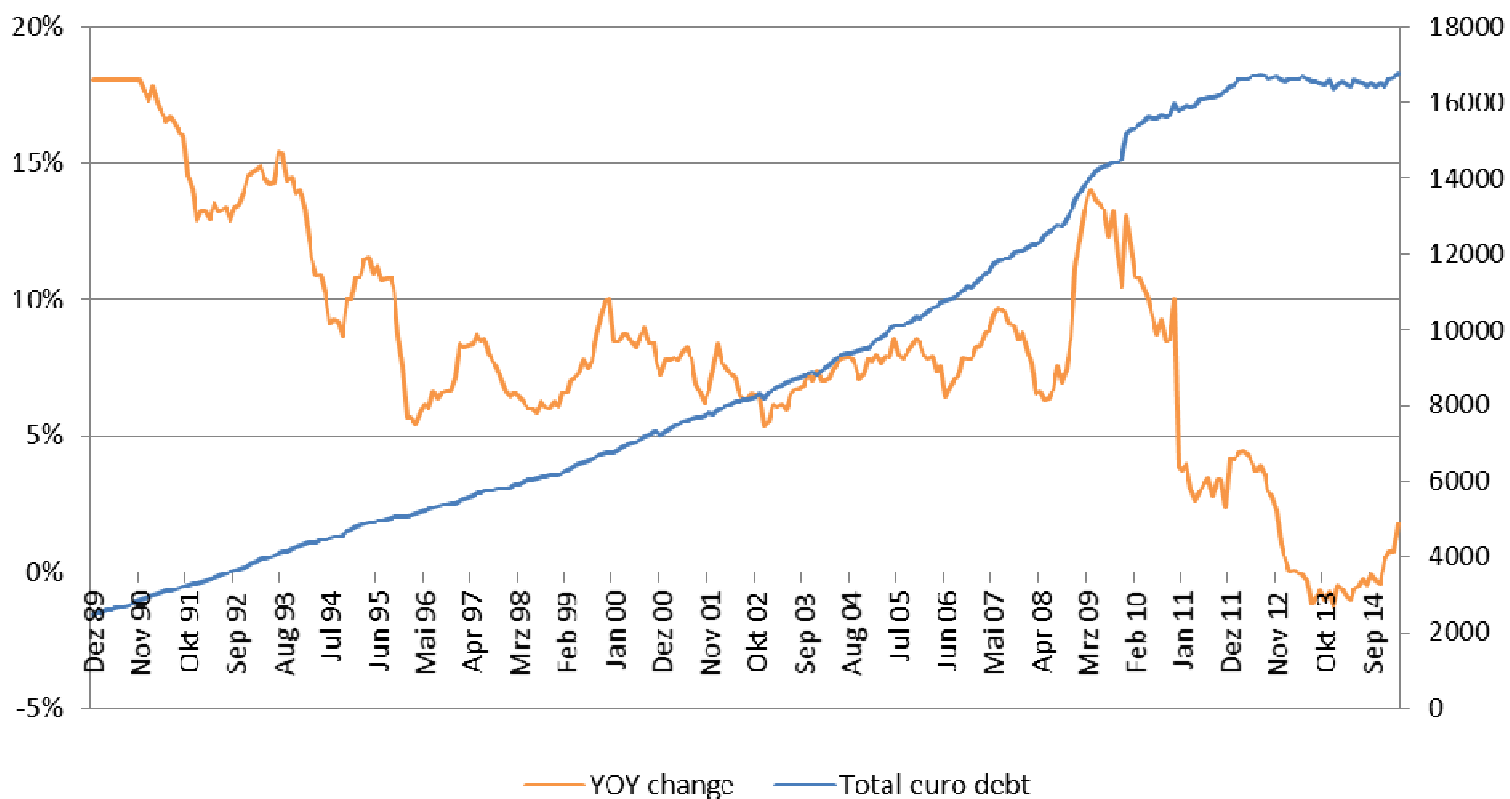
Source: Federal Reserve of Atlanta



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## European Economics

Due to Quantitative Easing (money printing) debt creation “improves” further  
Positive debt creation = less growth concerns



\*see Appendix for our model

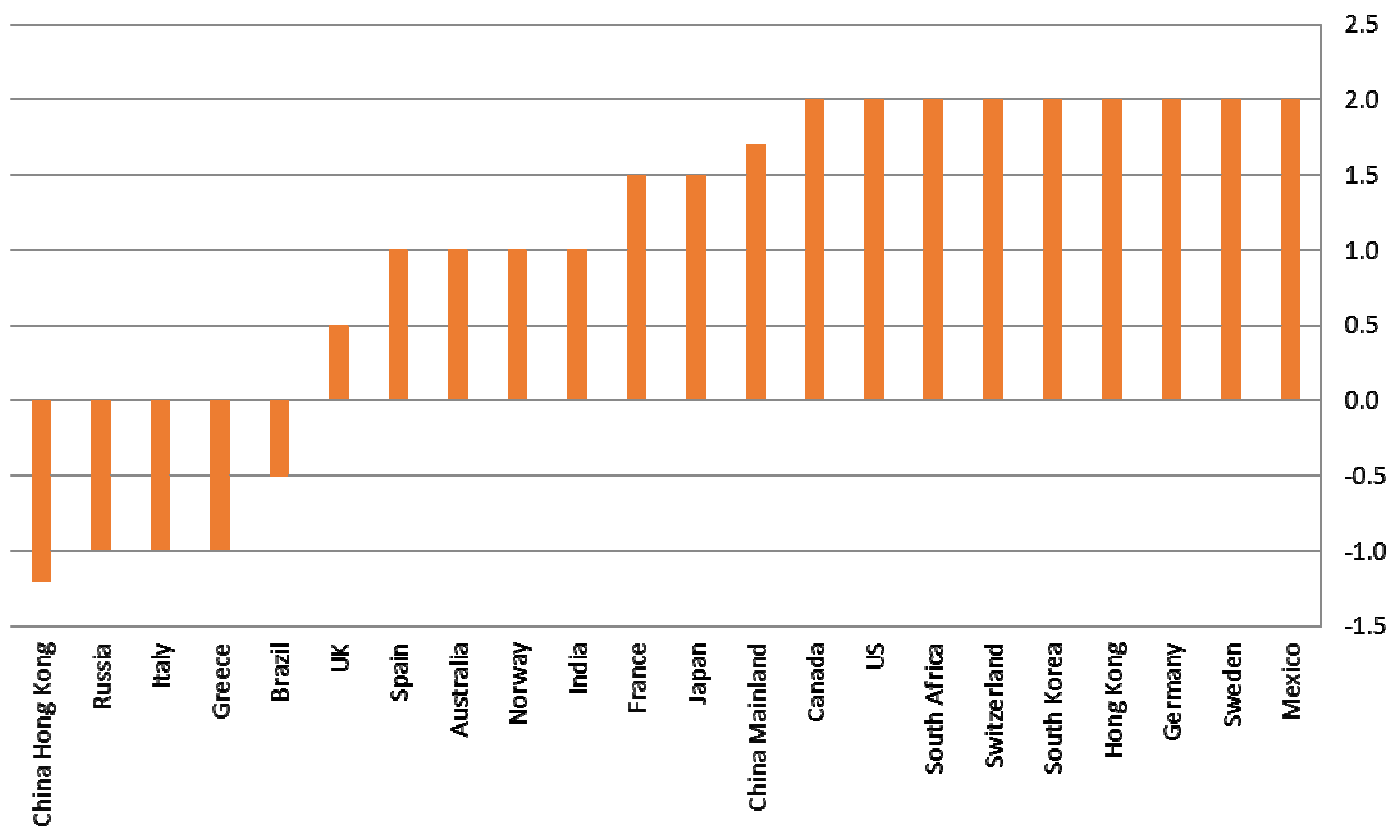
Source: Federal Reserve, BK&Associates



## Valuation Monitor in local currencies

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

China (H-shares) and Southern Europe cheap; USA, Switzerland and Germany expensive

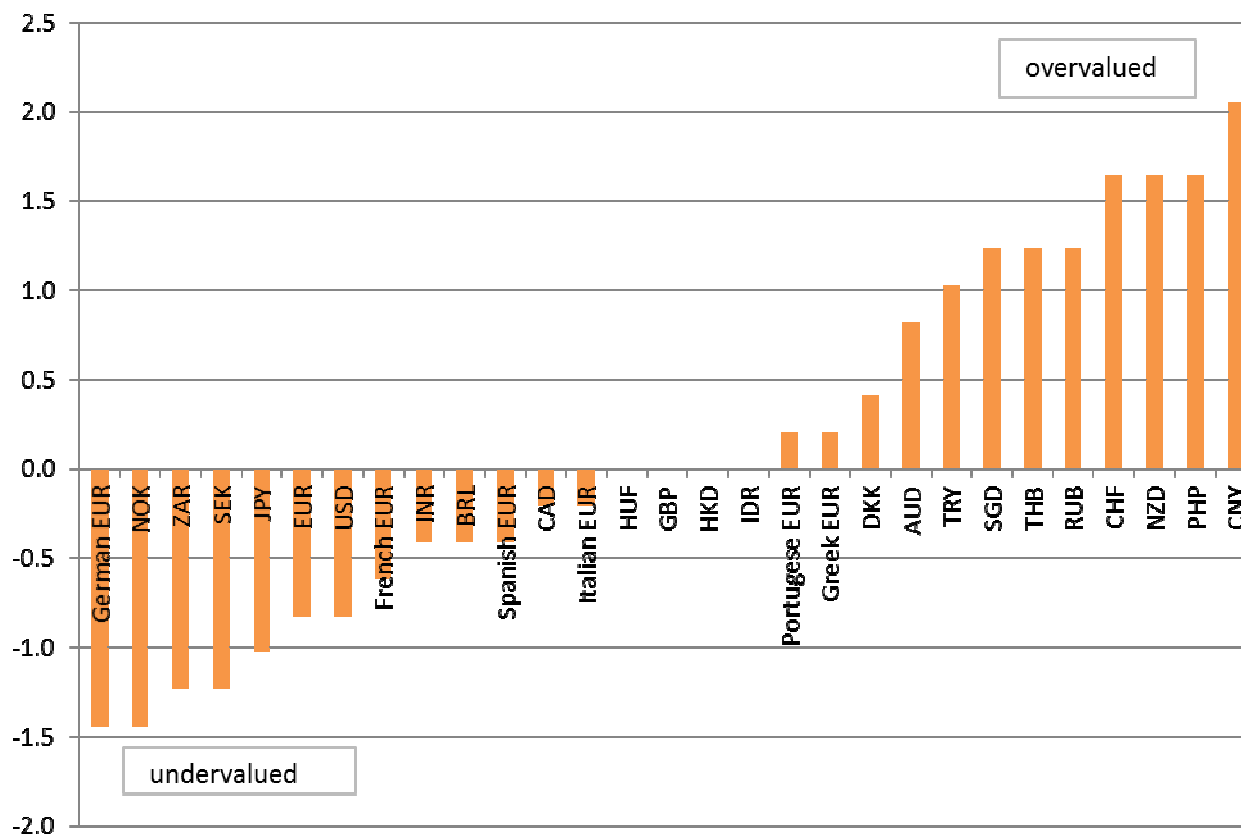




## Currency Monitor

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

Japanese, Nordic and South African currency cheap; Asian, Russian and Swiss currencies expensive



\*see Appendix for an explanation



## Equities: European markets

Stoxx600: strong resistance at all-time-high

Starting carefully adding new positions, but still waiting for a break-out above 400 to buy more aggressively







## Equities: European markets

Eurostoxx50 (European large caps) has still a lot to catch up against S&P (US large caps, in black)  
 It has been a bumpy road and our trade is flat; gap should soon start narrowing again



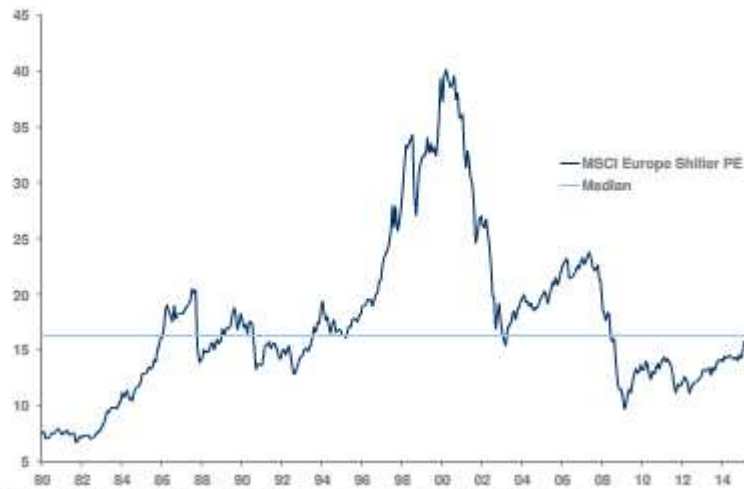


## Equities: European markets

Valuation:

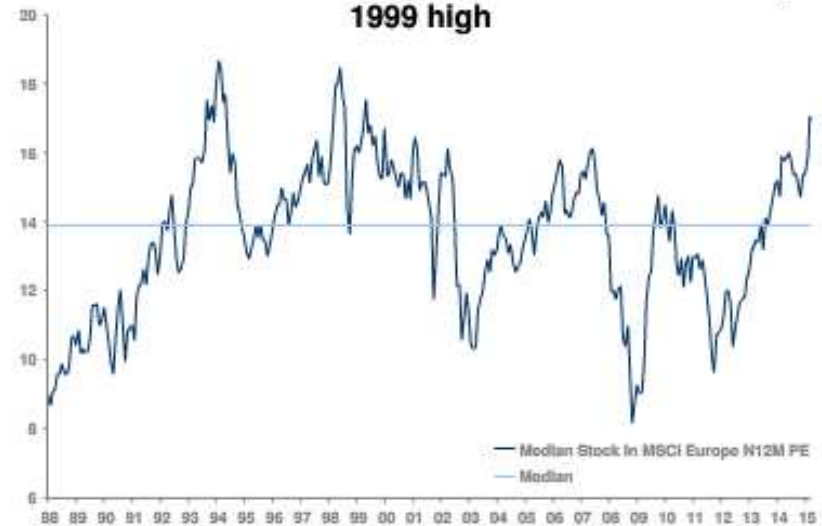
Large caps are fairly valued (left chart), small and mid caps expensive (right chart)

**MSCI Europe Shiller PE is below average**



Source: MSCI, IBES, Various National Sources, Morgan Stanley Research

**Median Stock In MSCI Europe 12M Forward PE is at a post 1999 high**





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

Following the crash in Chinese mainland shares, A-shares are not particularly expensive anymore  
 H-shares have declined as well, offering a buying opportunity with a price to earnings ratio of 8.5



\*See our valuation monitor on page 6



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

The spread between dual listed Chinese stocks has become extreme at almost 50%

People use H-shares to sell, because in Shanghai many A-shares are suspended from trading currently



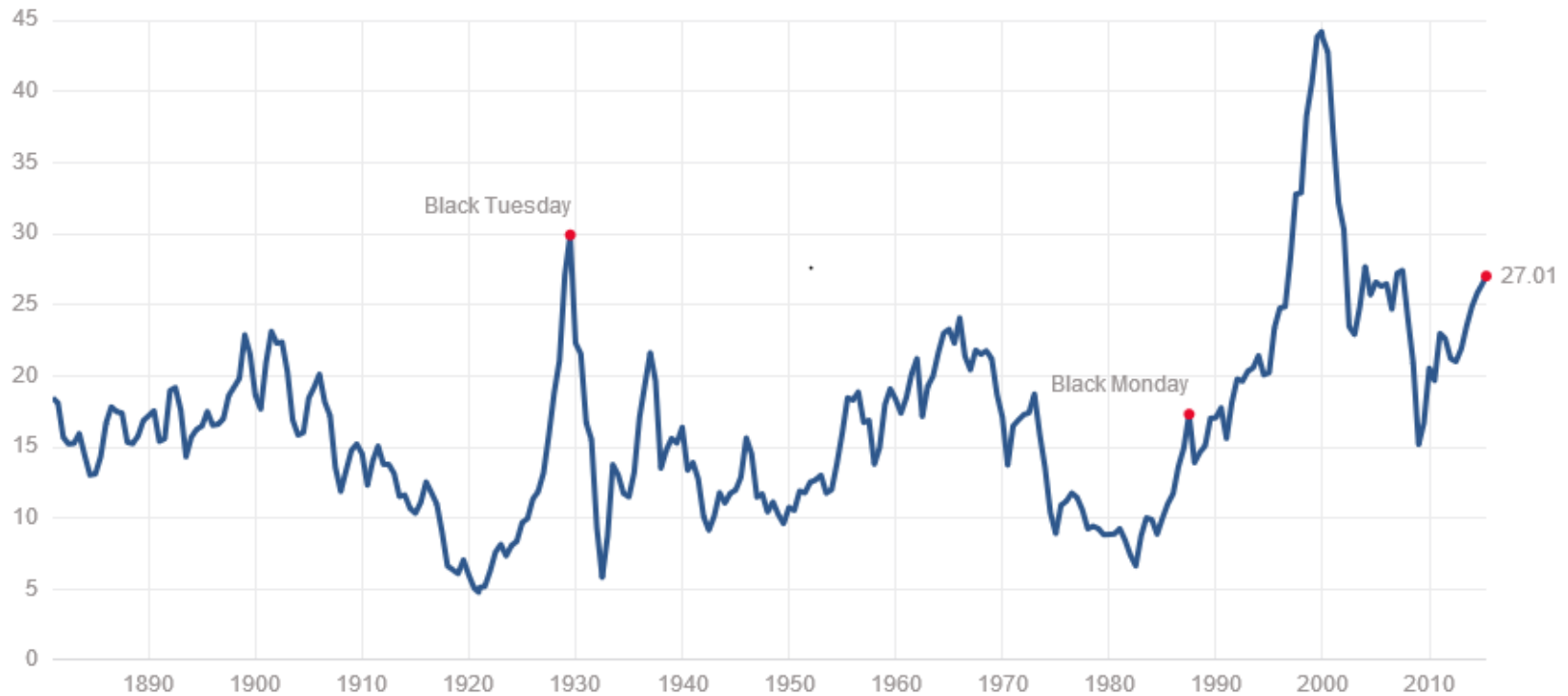


## Equities: US market

### Valuation

Finally, we have also reached the valuation high of 2007/2008!

The market only reached more extreme levels in 1929 and 1999/2000.

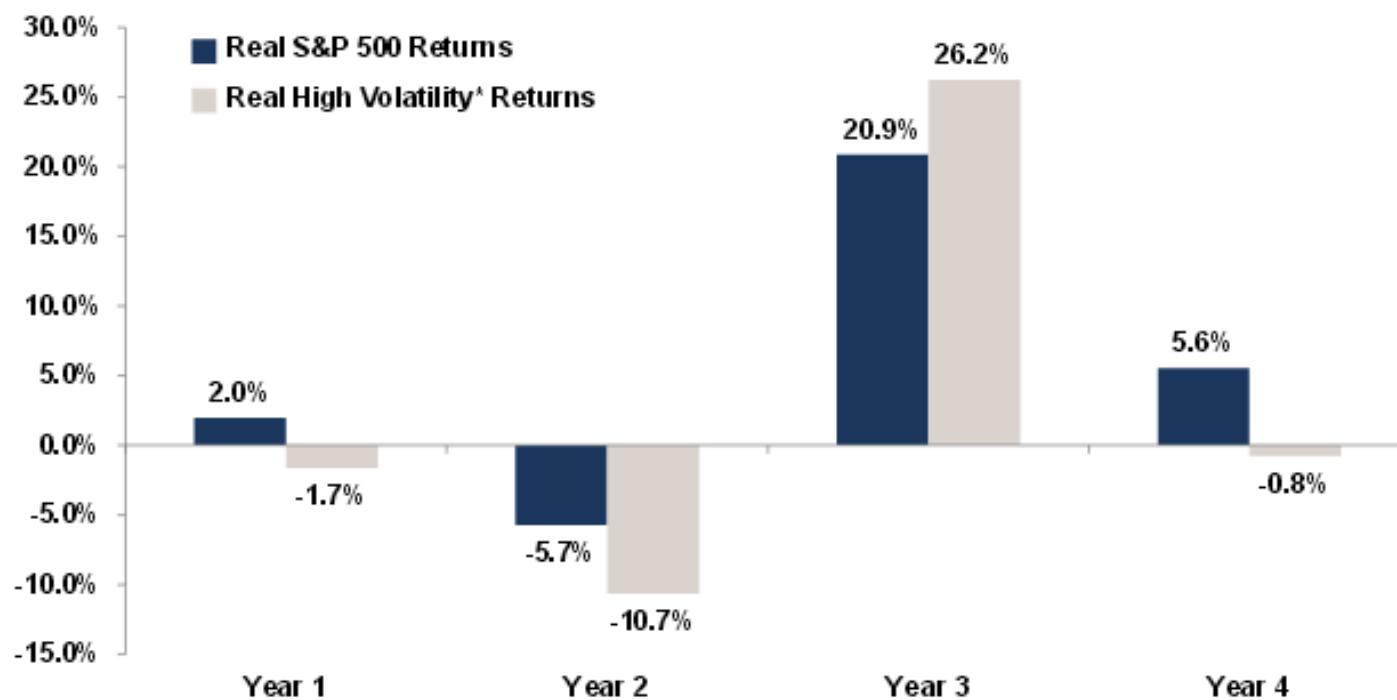




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## Equities US: Presidential cycle since 1964

We are in Year 3, but in the difficult months of the year

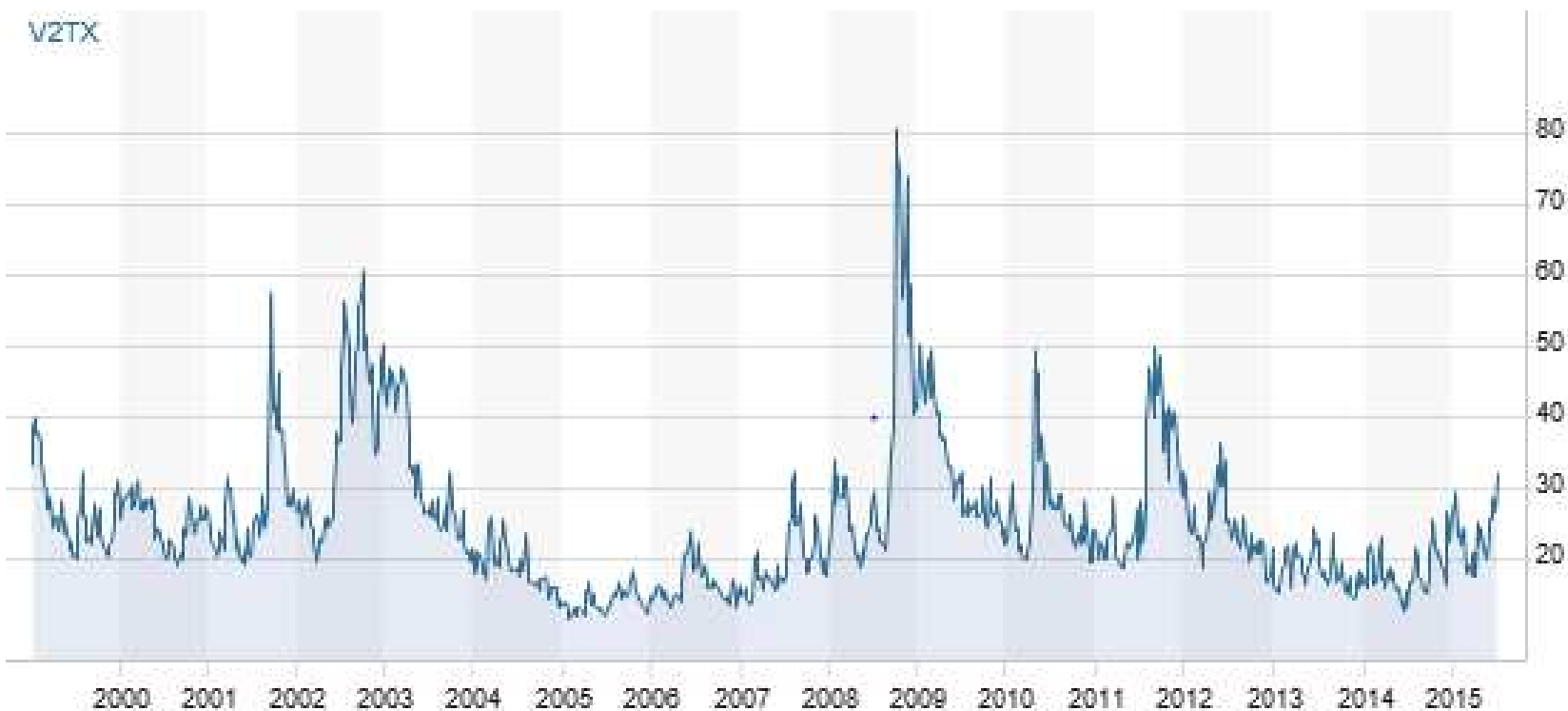


Source: GMO



## Volatility

Highest figure since 2012, barrier reverse convertible products getting finally attractive



Low < 20, high > 30

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 a bit, but still far away from cheap

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







## Summary

### Economics:

- European debt creation first time positive since 2012; means less growth concerns
- Should the Greek crisis escalate further, money printing by the ECB could even increase
- Latest GDPnow data for the US point to fairly strong Q2 growth of around 2.2%

### Asset Allocation:

- 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

### European equities

- Long-term momentum is still bullish and markets enter over-sold territory

### US equities

- Expensive and momentum still negative

### Emerging market equities

- China Hong Kong shares (H-shares) are among the cheapest worldwide and over-sold
- Brazil: latest inflation figures give hope for stabilization, lowering interest rates would be start of a rally
- Russia: the market is cheap, but the Rouble slightly overvalued according to our Currency Monitor



## Strategy implementation

- We keep a maximum allocation to **Alternative Investments**.
- **Emerging Markets equities:**  
Our **Brazil/China** product was paid back early in June; the return was 12% for the nine months. Therefore, our Emerging Markets exposure is currently limited.  
Since then both markets have gone down and we prepare to re-enter these cheap markets step by step.  
**Russia:** we keep the positions, but would not add to it due to the slightly over-valued Rouble.
- **European equities:**  
Higher implied volatility makes Barrier Reverse Convertibles more attractive.  
We made a new product on **Swatch/Allianz/Bouygues** with partial protection of 40% and a coupon of 9% p.a.  
We keep our positions in **Royal Dutch/ENI/Total**.  
We keep playing the spread between **European and US equities**, which is market neutral.  
Should European markets decline further, we would add to European equities.
- We prefer **High Yield Bonds with short duration and maturity**. The yield of longer term government bonds just doesn't compensate for the risks.



## 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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