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BANQUIERS
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Compass

3rd Quarter 2019

An improving macroeconomic environment

Management of the equity exposure in the portfolio

Make early provisions

Your wealth, our responsibility.

Management of the equity exposure in the portfolio

In the summer of 2018, various leading indicators signaled the entry into the late phase of the business cycle. From October to the end of the year, interim stock market profits completely evaporated. At the end of last year, some of these leading economic indicators turned in a positive trend direction and again signaled a promising environment for equities. In particular, leading indicators for the emerging markets are forecasting a rebound in economic growth. Although the global economy is losing momentum, economic growth remains positive. The US Federal Reserve is also aware of this development. At the beginning of the year, the Fed announced its intention to leave its rising interest rate path. Recently, more and more market participants are even assuming that key interest rates will be lowered again. This would result in the already inverted yield curve regaining steepness. Since 1950, the yield curve has been one of the most reliable leading indicators for forecasting a recession. It is an important instrument in managing the equity exposure of a portfolio.
In the third part of this Compass edition "Knowledge & Experience" we highlight the topic of pension provision in Switzerland. We explain the challenges facing the three-pillar system and which pension solutions you can take advantage of.

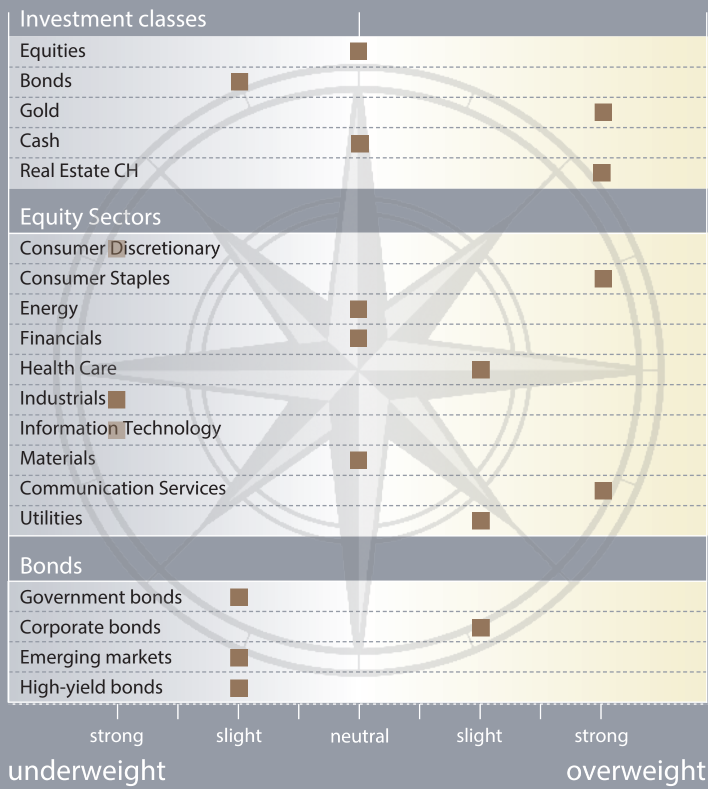
Sector rotation due to momentum

In the middle of last year, growth prospects deteriorated noticeably. Although some leading indicators have recently recovered, there is still an increased risk. For this reason, we are maintaining our neutral allocation at asset class level for the time being.

Within equities, we are reducing the allocation to the healthcare sector to slightly overweighted due to a deterioration in momentum. In return, we increase the weighting of communication services to heavily overweighted due to a positive momentum and attractive opportunities in single stock selection.

Within bonds, we continue to favour corporate bonds over government bonds. For emerging market bonds and high-yield bonds, we leave a slight underweight each.

Asset allocation recommendation as of June 24th, 2019 for investors with CHF as their reference currency.



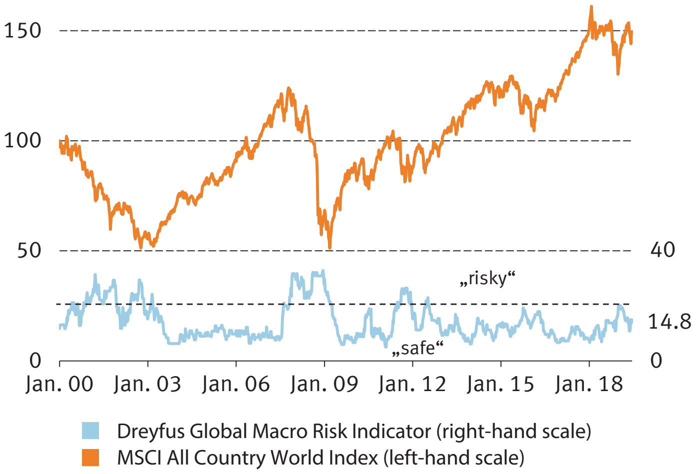
Basic Trend:
An improving macroeconomic environment

Basic Trend 1:

Source: Own calculations

Indexed performance in USD

Indicator value



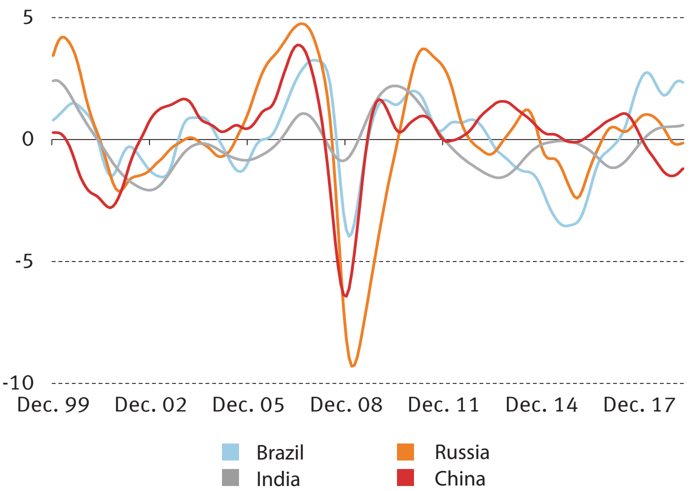
Moving away from the risk zone

Dreyfus Banquiers has developed a risk indicator, the Global Macro Risk Indicator (GMRI), in order to be able to identify long-lasting correction phases in the equity market at an early stage. The GMRI is based on 27 different leading indicators that forecast the development of the global economy, individual continents, regions and countries. The value range of the indicator is defined as the interval 5 to 35, with values above 20 predicting a crisis. In the summer of last year, macroeconomic risks increased and the GMRI approached the threshold of the risk zone. Since the end of last year, individual leading economic indicators have improved, causing the GMRI to fall again. It currently stands at 14.8 and again forecasts a promising environment for equities.

Basic Trend 2:

Source: OECD

Indicator value



Emerging Markets - On the way to old strength

The Dreyfus GMRI includes not only leading indicators for industrialized countries but also those for emerging market countries. Emerging market countries include Brazil, Russia, India and China. For these countries, the Organisation for Economic Co-Operation and Development (OECD) calculates its own leading indicators, which are based on a whole basket of sub-indicators (such as incoming orders and inventories or financial market data). With a lead time of 6 to 9 months, these leading indicators forecast the next phase in the business cycle. At the end of 2018, some of these leading indicators turned in a positive direction, signaling weaker economic growth by historical standards, but one that is gaining strength.

Basic Trend 3:

Probabilities of market participants regarding the Federal Funds Rate

Range	1.25-1.5	1.5-1.75	1.75-2.0	2.0-2.25
07/31/2019	0.0%	0.0%	31.0%	69.0%
09/18/2019	0.0%	25.5%	62.2%	12.4%
10/30/2019	10.2%	40.1%	42.3%	7.4%
12/11/2019	24.5%	41.2%	25.6%	3.9%
01/29/2020	29.7%	36.3%	18.8%	2.7%
03/18/2020	31.3%	32.2%	15.0%	2.0%
04/29/2020	31.4%	29.9%	13.3%	1.8%
06/10/2020	31.1%	26.3%	10.8%	1.4%

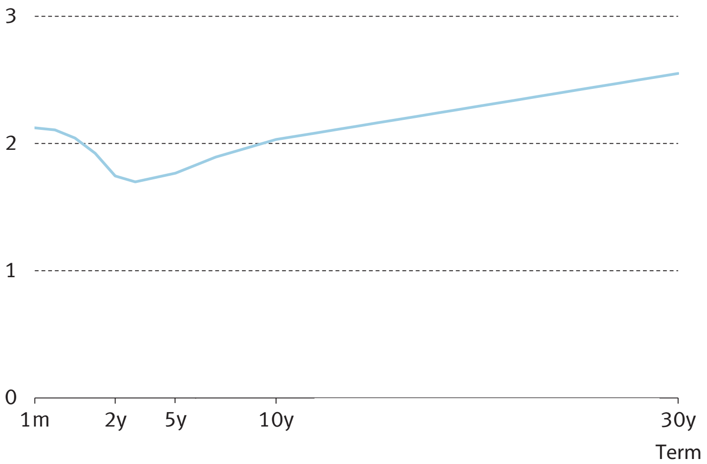
Is the US Federal Reserve even rowing back?

Since the middle of last year, the market environment has become increasingly gloomy. On January 30, 2019, US Federal Reserve Chairman Jerome Powell announced that he would leave the steep interest rate path and be patient about future changes in key interest rates. The financial markets are not expecting any rate hikes this year, in some cases even with a rate cut. Currently, the Federal Funds Rate band is 2.25-2.5%. Looking at the expectations of market participants, the following can be seen, for example: For the future meeting of the Federal Reserve on December 11, 2019, market participants expect the US key interest rate to be between 1.5 and 1.75% with a probability of 41.2%. The market therefore expects interest rate cuts.

Current Topic:
Management of the equity exposure in the portfolio

Current Topic 1:

Yield to maturity of US government bonds in % p. a.

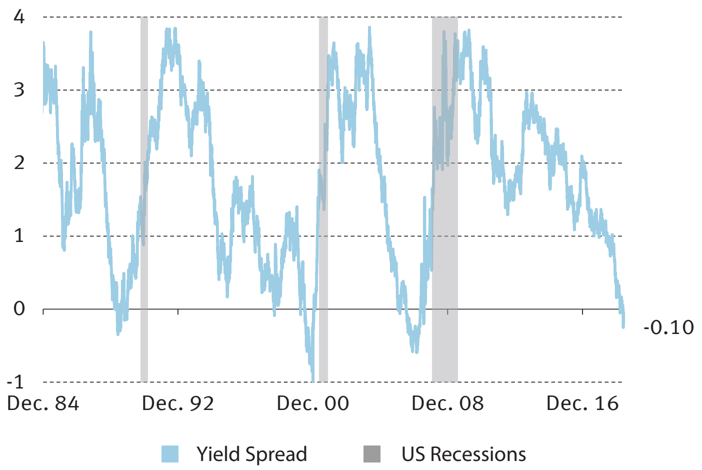


The impact of the interest rate policy on the yield curve

Falling key interest rates mean that yields are falling, especially at the front end of the yield curve. The yield curve tracks bond yields over various maturities. Normally, the yield of a bond with a shorter maturity is lower than that of a long-term bond. This means that the yield curve usually rises. The adjacent chart shows that this is not currently the case for US government bonds at the front end of the yield curve. The yield on 6-month US government bonds is 2.0%, while the yield on 3-year bonds is only 1.7%. This is referred to as an inversion of the yield curve. If the analysts' forecasts are correct and the US Federal Reserve cuts its key interest rate, yields at the front end of the yield curve fall - it becomes steeper.

Current Topic 2:

Yield spread of 10-year government bonds and 3-month T-bills in % p. a.



The yield spread as an indicator of recession

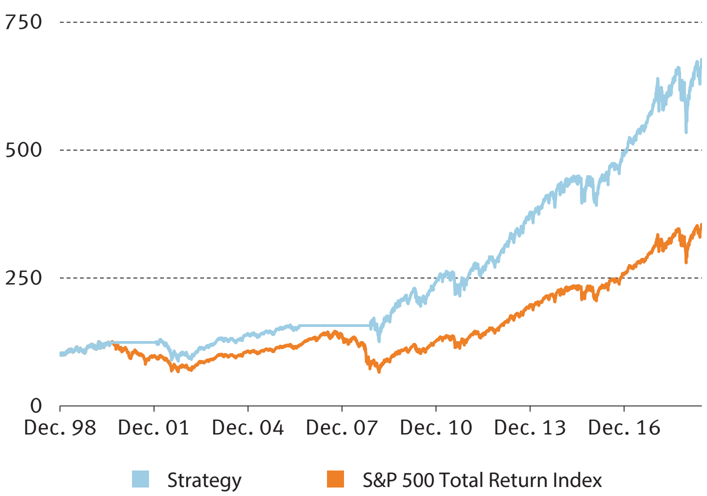
The slope of the yield curve can be measured simply by the difference between long-term and short-term interest rates. This is known as the yield spread.

The yield spread is one of the most reliable leading indicators for forecasting a recession. Since 1950, almost every recession in the USA has been preceded by a negative yield spread and thus an inversion of the yield curve. However, the lead time varied between one and 18 months.

Recently, a negative yield spread was again evident in the USA. The difference between 10-year government bonds and 3-month treasury bills is -0.10%. Fears of a recession are spreading.

Current Topic 3:

Indexed performance in USD

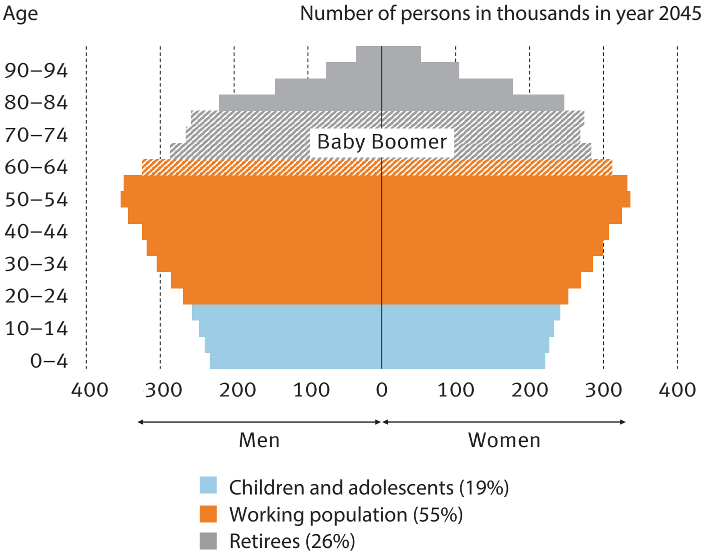


Management of the equity exposure in the portfolio

The yield spread is one of the most important instruments for managing the equity exposure in a portfolio. To examine the forecasting quality of the yield spread, for the sake of simplicity we consider a portfolio that either invests entirely in equities of the S&P 500 index or consists only of cash. We sell all stocks in the portfolio if the yield spread is negative (and hold 100% cash). On the other hand, we buy all stocks when the yield spread rises again to +3%. Since equity market corrections occur with a time lag, we use a simple 3-month average of the yield spread. A very simple investment rule, with surprising success. From December 1998 to the present, this strategy has achieved an annualised return of 10.0%. The S&P 500 index generated only 4.9% p. a. over the same period.

Knowledge & Experience: Make early provisions

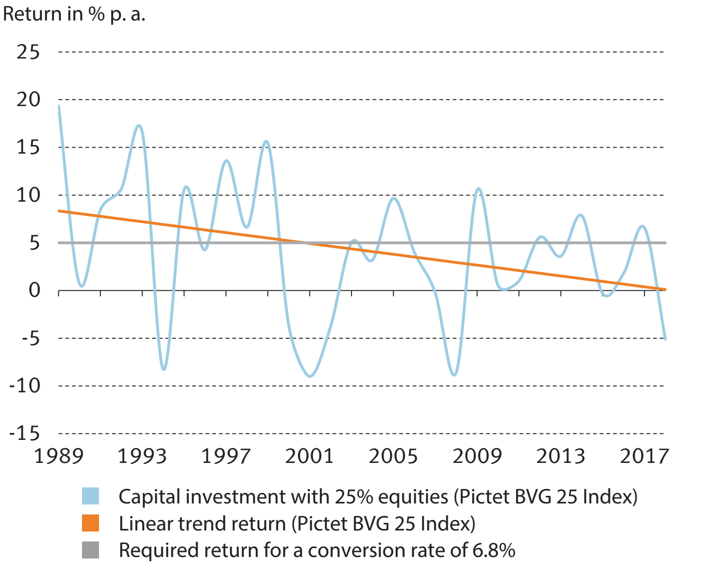
Knowledge & Experience 1: Source: Federal Statistical Office



Pension provisions in Switzerland

With its three-pillar system, Switzerland's retirement provision offers a mix of pay-as-you-go financing (1st pillar), funded schemes (2nd pillar) and individual savings (3rd pillar). Today, this system faces various challenges: Life expectancy is rising steadily, interest rates have been at a very low level for years and baby boomers are gradually reaching retirement age, which further increases the financial burden. The 1st and 2nd pillars in particular need reform proposals so that they do not get into trouble. Given medium to longer term concerns, it is advisable to take individual precautions in the area of pension provision (supplementary provisions under pillar 2 and pillar 3).

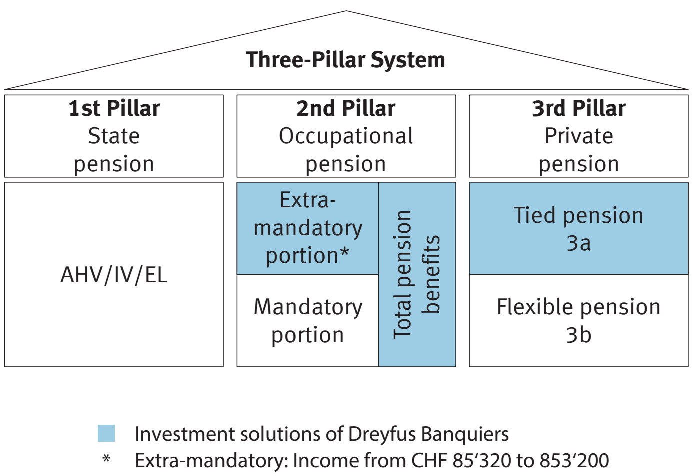
Knowledge & Experience 2: Source: Federal Social Insurance Office



Hidden redistribution in the 2nd pillar

The demographic development as well as lower returns on invested capital lead to a redistribution from younger to older generations within the 2nd pillar. In order to finance the current pensions, an average return of 5% is necessary. Since 2000, however, the average return has been significantly lower. Since pensions are not sufficiently financed, redistribution takes place at the expense of the working population. They have to pay part of current pensions of the retirees instead of saving for their own pensions. According to the latest studies, this redistribution has amounted to CHF 6.7 billion per year since 2014. The independence of the conversion rate from political influences, the raising of the retirement age and the individualisation of pension provision are becoming increasingly urgent.

Knowledge & Experience 3:



Individual pension solutions

Individual investment solutions in the area of pension provision are subject to legal constraints. Nonetheless, pension funds have the option of offering extended investment regulations in their statutes. This allows them, for example, to hold a higher proportion of equities. In addition, assets under management are exempt from income and wealth tax. It is possible to individualize asset management and adapt it to the investor's risk profile as well as to his free wealth. In this area, we offer an innovative and flexible asset management solution that is subject to legal guidelines and follows our proven investment principles. Our specialists will be happy to answer any questions you may have on this complex subject.

The prices used in our analysis are end-of-period prices. The figures used for our valuation model are estimates referring to dates and therefore carry a risk. These are liable to change without notice. The usage of valuation models does not rule out the risk that fair valuations over a specific investment period cannot be attained. A complex multitude of factors influences price developments. Unforeseeable changes could, for instance, arise from technological innovations, general economic activities, exchange-rate fluctuations or changes in social values. This discussion of valuation methods makes no claim to be complete.

Dreyfus Sons & Co Ltd publishes Compass four times a year since June 2008. The publication is aimed at clients of the bank and interested parties. It describes some of the instruments and methods the bank uses to monitor everything to do with the financial markets. A description of the investment process can be obtained from your client advisers or our website. Compass provides guidance but cannot take the circumstances of an individual portfolio into account.

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