BANCA DEL SEMPIONE
SIMPLON BANK
BANQUE DU SIMPLON

Investment Policy

January 2018 - 1. Quarter

CONTENTS

Press date: February 2018

The year 2017 ended with upbeat stock markets. New record highs were recorded in the USA several times during the course of the year, and things went particularly well on this side of the Atlantic as well. In fact, we finally saw a joint acceleration of the various Eurozone economies, in addition to the emerging ones. For the first time since 2008, we can finally say that we are undergoing a period of synchronised global growth.

Corporate earnings, stronger than those envisaged by traders, made a significant contribution to equity prices. After several years of downward revision, analysts found themselves making upward adjustments to their estimates during the year, and this inversion in trend is something never seen before.

This economic and market context should also continue during the first part of 2018 leading to some thought on the available investment opportunities. The opportunities on bonds are very limited. Yields net of inflation are at zero or even negative and, in a scenario in which central banks are slowly normalising their monetary policy, the expected return from traditional investment in bonds is low, particularly in relation to the duration and credit risks implicit in this asset class. From this standpoint, the equity market still offers an attractive yield, at least in relative terms. Although it is at high P/E values, the earnings yield (i.e. the reciprocal of P/E) remains higher than the bond yield, and corporate earnings are expected to grow further.

Without analysing financial market history books, the two years just ended have once again reminded us that making predictions about the future, and consequently positioning our portfolios, is a task that conceals many pitfalls. There are at least two reasons for this: it is extremely difficult to predict binary events, such as the outcomes of political confrontations, and if we do guess the outcomes, the consequences are far from obvious.

The surprise cases in point during 2016 were the Brexit referendum, the US presidential elections and the Italian referendum. In all three cases, the electoral results caught the market by surprise, and the reaction of traders to these outcomes was even more surprising. Catastrophic election results were envisaged for 2017 as well, with strong fears of an anti-European shift in the Dutch and French elections. Fears which proved once again to be unfounded.

The difficulty and risks of making investment choices based on future forecasts, the expected low return on the bond market and the need to move towards asset classes that are considered riskier and less liquid in order to achieve positive returns, require an innovative approach that seeks new sources of diversification and risk balancing in the portfolio.

The global context

The leading global economies appeared to record a synchronised growth trend in 2017, a phenomenon that had not occurred for some time. Consensus estimates on economic growth in developed countries underwent a further upward revision in the last quarter and are now at around 3%.
The tax reform approved in the USA at the end of the year should enable an extension of the economic growth period underway to at least 2018. The emerging economies have come out of 3 difficult years, also due to the recovery in prices of raw materials and the ongoing Asian expansion, increasingly driven by consumption growth.
With the beginning of the new year, it should be noted that the major geographical areas are in very different phases of their economic cycles: in the USA, many symptoms typical of a mature cycle are starting to emerge; the Eurozone and Japan, on the other hand, are further behind in the economic cycle; the emerging markets (such as Brazil and Russia) are still in an initial or intermediate phase of the cycle, rebounding from the recent recessions, but excessive debt makes many of the emerging economies vulnerable to the inversion of monetary policy in the USA. We believe that we may start to see an increasing divergence in terms of policies during the course of the year.

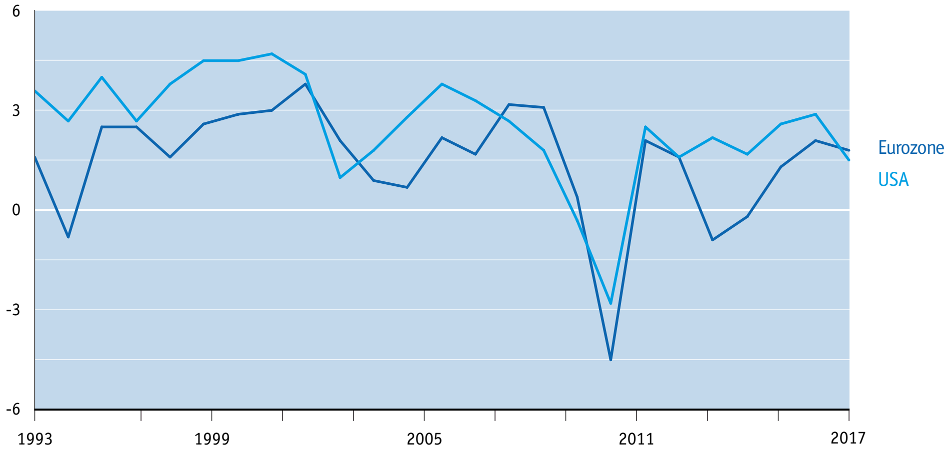
Comparing US and European economic policy

The US economy continues to drive the expansion and is now almost in its ninth year of consecutive growth, with continued stable growth at relatively strong levels in China.
Over the next few quarters, we await an assessment of the impact of the tax reform approved at year-end by Congress. The Federal Reserve is preparing to raise interest rates even further in 2018, with new Governor Powell following along the lines of his predecessor.
On the macro front, Europe continues to show a solid economy as well, albeit without excessive inflationary pressures. This scenario is giving the European Central Bank time to accompany the recovery with a gradual normalisation of monetary policy, triggering a virtuous circle thanks to growth and low rates. In the upcoming months, the ECB will continue to purchase government securities as part of its quantitative easing programme, although some members of the Governing Council are calling for an announcement of the date of the final purchases.

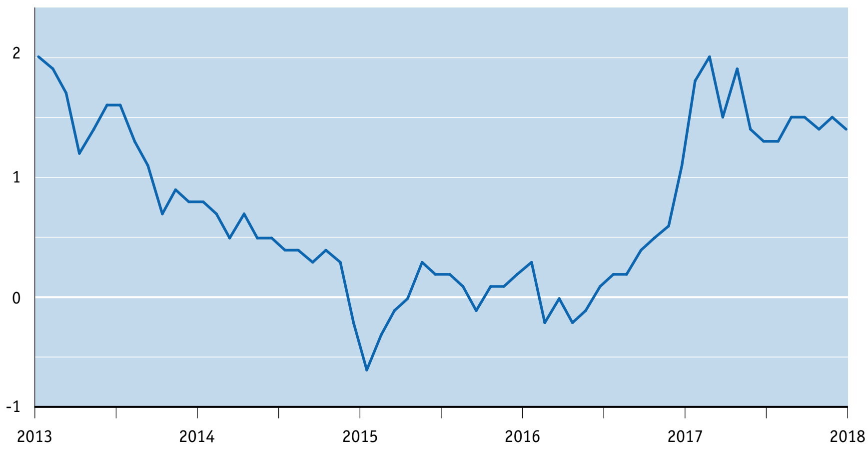
Macro indicators continue to remain in positive territory

Growth in the Eurozone is at 2.6% and at the highest levels since 2011, while the GDP growth rate in the US has returned to above 3%.
The PMI indices continue to remain in positive territory and show a stronger trend in the Eurozone compared to the US. The indices that measure macroeconomic surprises are back to very high levels, although with a slight decline in the European index. The indices measuring financial conditions remain at accommodating levels. The leading indicators continue to show signs of recovery, after a stagnant phase. GDP has re-accelerated.
Overall, the revisions reflect the positive surprises that the flow of economic data has continued to offer in recent months, both in mature and emerging economies, in addition to signs of stronger manufacturing activity, as indicated by business surveys. Forecasts on inflation show moderate recovery: about 2.1% for the United States and 1.5% for the Eurozone.
In summary, we can say that the trend incorporated in these estimates suggests a slight slowdown in growth compared to 2017 and essential stability in inflation.

Eurozone vs. US real GDP growth rate (yoy %)



Eurozone inflation monthly growth rate (yoy %)



Central bankers: the debate between hawks and doves continues

Major growth levels across all of the main economic areas are leading central bankers to debate the current suitability of the aggressive monetary policies introduced after the economic crisis of 2008. Board members are evaluating the instruments to be adopted during the economic recovery underway. In this respect, the different viewpoints of the so-called “hawks”, which fear a rapid return of inflationary trends, and the so-called “doves”, which still consider the long-term achievement of the consumer price index target of 2% a distant event, are being highlighted. As part of an increasingly lively debate, there is a prevailing belief that until salary trends bring inflation rates closer to target levels, monetary policies will be characterised by a slow normalisation phase.

The bullish phase of the EUR-USD rate continues

The foreign exchange market continues to be impacted by the strength of the Euro. Levels that have not been seen since 2014 are being recorded in particular against the USD: over USD 1.22 per EUR. Chancellor Merkel’s attempt to form a coalition government, with a decidedly pro-European attitude alongside France, and an Italian election scenario in which there is no longer talk of abandoning the single currency, have created strong political support for the EUR. In general, all trends appear to be in favour of the Euro, even because positioning on the European currency is still low. In this respect, we are negative on the US dollar, as we believe the EUR-USD exchange rate could reach the 1.25 level going forward. However, considering the negative carry of the position (over 2.5% on an annual basis), it will be fundamental to use the position to take advantage of market fluctuations.

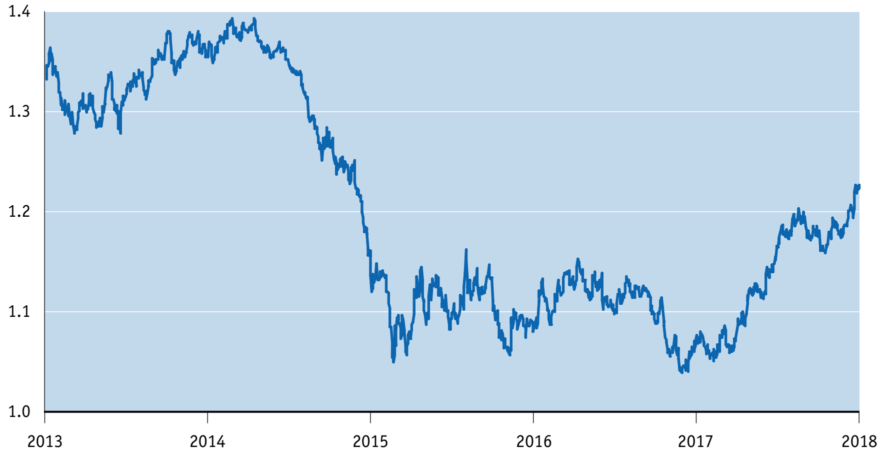
Positive on Scandinavian currencies as well

Both currencies have similar trends and appreciation drivers. Inflation appears to be recovering after the lows recorded in November, and while in Norway consumer prices are approaching the target set by the central bank (2%), in Sweden they have been much higher for months. In their December meeting, the two central banks adopted, after months, a more hawkish approach, highlighting the recovery of inflation and ignoring the possible risk of current appreciation. Sweden in particular surprisingly ended its quantitative easing, whilst still keeping rates in negative territory.
Focusing solely on Norway, another reason to be positive is the price of oil, which has reached USD 70 per barrel.
Offsetting the positive aspects just listed, there is a risk of a real estate bubble for both countries, which is the true reason that led the two currencies to trade at record lows (for the NOK) and lows for the last decade (for the SEK) against the Euro.

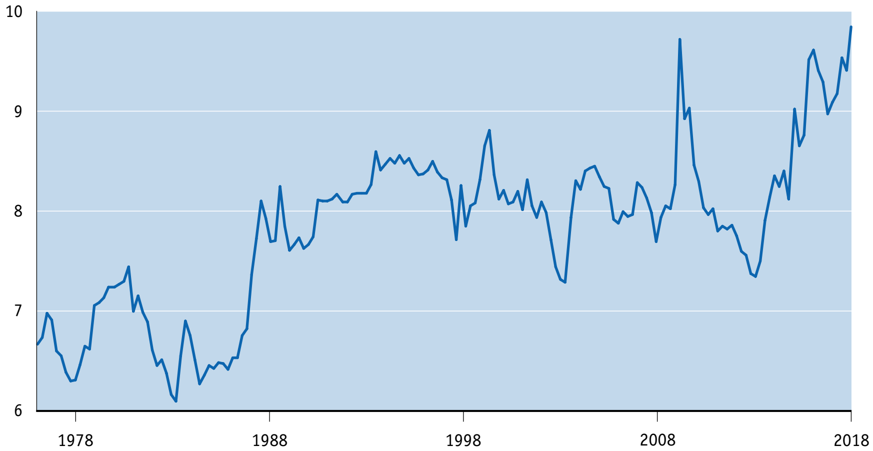
Bearish on the Swiss franc

Swiss inflation continues to under-perform the rest of Europe, forcing the National Bank to remain accommodating and intervene in the forex market in the event of sudden spikes. We believe the continued weak franc may reduce the need for hedging on foreign assets for Swiss investors, and that the general positive climate on the markets could avoid an appreciation of the franc.

EUR-USD exchange rate



EUR-NOK exchange rate



Bond yields remain low, despite the positive economic outlook

The start of 2017 was dominated by the reflation theme, with expectations of rising inflation rates and a correction in the bond markets, although said expectations did not materialise during the year. Trump's policies proved to be much less protectionist than expected, the prices of commodities moved upwards but not excessively, and the excellent health of the labour market did not generate significant growth in salaries. The above, together with other disinflationary pressures in the economy, have kept the US CPI at levels below the Fed target, on average. Such weak inflationary trends have helped bonds remain at low yield levels, despite the upward revision of global growth rates and the high risk appetite. Long-term bonds benefited in particular, thereby triggering a sharp flattening of the US curve.

Central banks remain accommodating but are slowly moving towards normalisation

The expansive policies implemented by the leading central banks are providing further support to bonds. Major bond purchases by the ECB and BoJ have resulted in 2017 being another year of expansion in global liquidity, while the Fed continues to be very cautious in the rate increase cycle. However, 2018 could be the year in which the global liquidity expansion cycle comes to an end. The ECB will continue to purchase until at least September, but at a slower pace; BoJ will keep the ten-year yield at around zero, but to do so, it will probably be necessary to purchase a smaller amount of bonds; the Fed, on the other hand, will begin reducing its balance sheet by not reinvesting the bonds that expire; the BoE has begun a slow and limited rate increase cycle.

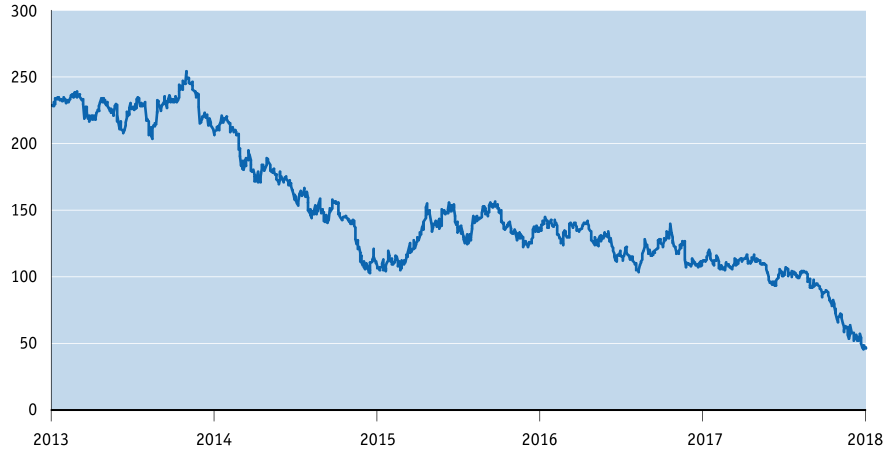
The bond market continues to lack opportunities overall

We believe valuations of both the government and corporate bond markets to be particularly high. If economic growth continues to remain steady, we cannot rule out surprises on the inflationary front which, accompanied by less accommodating central banks, could trigger the hike in yields that did not occur last year. However, we expect that a possible bearish trend in the bond market may be not too violent, as central banks are interested in keeping real rates negative, due to the high rate of public and private indebtedness. The fundamentals should continue to be excellent for corporate bonds, but the spread level might expose them to market corrections.

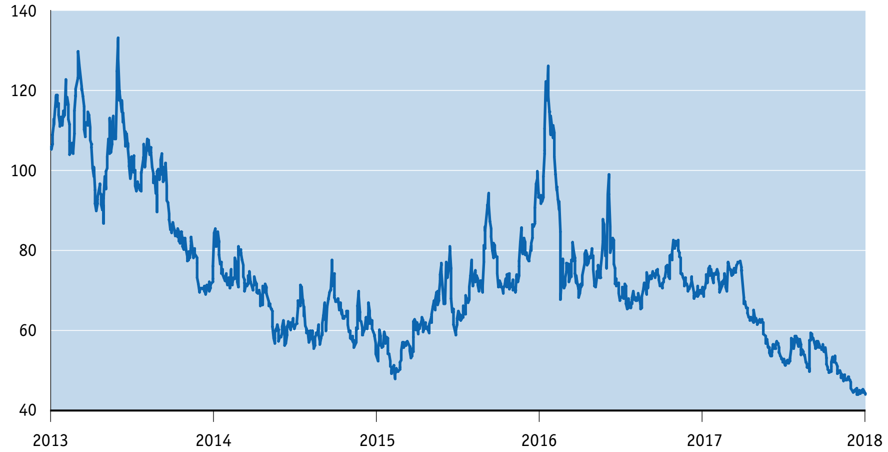
We recommend a prudent approach aimed at tactical themes

We consider it preferable to maintain very low portfolio duration, particularly in EUR and GBP. Greater value can be found in the long US portion, where real yields are slightly positive. Attractive yields can be found in the local currency markets of some emerging markets, such as Mexico, Russia and India. We believe that the global disinflationary trends may progressively impact these countries as well, making current yields attractive, and we recommend paying attention to currency risk management. In Europe, we prefer a flattening position on Spain and Italy, where the curve is particularly steep. On corporate bonds, we still see some residual value on European financial securities and some emerging market hard currency bonds, while we prefer to avoid the high yield segment.

USA 30yr - 5yr yield spread



Europe investment grade credit spread index



A look at the year just ended

2017 was certainly a positive year for equity markets albeit with different facets between the two sides of the Atlantic. The appreciation trend was significant in the USA, with indices up 20% and linear growth, leading the S&P 500 to close the year at near historic highs. In Europe, the strength of the EUR and the initial uncertainties on the French election results generated a more uncertain trend, although positive. Dominance of the technological sector in the USA and its near total absence in Europe weighed on the gap between the two markets. The Swiss market recorded a very positive year, driven by small and medium-cap stocks and cyclical sectors, to the detriment of blue chips, which underperformed the indices despite showing a positive trend.
The year was very positive for the emerging markets as well, which recorded the best performance in 2017, with an increase of over 30%, after 3 years of adjustments and negative performance.
Precious metals appreciated, but devaluation of the USD more than offset the increase.

Prospects for the new year: positive on Europe and Japan

2018 appears to have begun with great momentum. Despite the various European elections this year, which are not expected to have particularly negative impacts, Europe appears to be on the road to closing some of the accumulated gap with respect to the USA.
Support to Europe by macro data is very important: in particular, the overheating German economy should be carefully monitored by investors, and record PMI indices suggest a positive 2018 at least in the first half of the year. In this respect, we believe that all tactical positions in favour of the Eurozone must be maintained, as we expect a sudden recovery shift.
Another area providing satisfying results is Japan. In terms of growth in profits, corporate earnings and multiples, it is one of the most interesting markets, also thanks to the support provided by politics and the central bank. Exposure to the Yen is not seen as an active risk and actually contributes to balancing the portfolio.

Growth in profits and valuations

The recent continued increase in the US market coincided with a moderate expansion of valuation multiples, with a P/E of around 23 and an expected P/E for the year of 18.4.
Despite the recent good performance by the European index, the current P/E declined (due to an increase in profits) and is currently at 18.8, dropping further to 14.4 with regard to the estimate for year-end 2018.
Generally speaking, both the USA and Europe have recorded major signs of recovery in earnings growth, but the second half of 2018 appears to be more at risk for the United States due to valuations rising further.

Importance of alpha-based strategies in the new year

The combination of favourable financial conditions and sharp growth over the last few years has created an exceptionally positive context for beta-levered strategies, especially with regard to risk parity and short volatility strategies. We envisage a possible increase in volatility, therefore we recommend providing portfolios with convex strategies, which could ease rather than exacerbate the decline in performance in bearish markets.

S&P US Technology Sector index (norm.100)

MSCI Emerging Countries index (norm.100)

Goals

In a world characterised by increasingly squeezed yields expected for traditional risk categories (shares and bonds) and by more and more frequent market shocks, the objective set by Banca del Sempione's asset management is to achieve a real growth in capital in the medium-long term. To achieve this result we use the most advanced and innovative techniques accompanied by the healthy values of a Swiss tradition and culture which within the area of asset management can rely on people with an excellent level of professionalism.

Investment Philosophy

Our investment philosophy is based on five main principles:

- Composition of profits
- Drawdown reduction
- Discipline of the method, rather than "passivity" of the method
- Reduction of cognitive and emotional biases
- Limited presumption of market timing

Specifically, a reduction in drawdowns (i.e. negative fluctuations in asset values) combined with capitalisation of profits (defined by Einstein as the eighth wonder of the world), allows for triggering a snowball effect, through which profits are generated on profits, resulting in growth of invested capital over the medium-long term.

Portfolio Structure

		Maximum investment limits (%)					
Investment Profile	Risk category	Cash	Investment Grade Bonds (>=BBB-)	Non Investment Grade Bonds (<BBB>)	Equities	Other Funds*	Currency Diversification
Income	Low	100	100	0	0	5	15
Income Plus	Medium-low	50	100	15	15	15	15
Dynamic	Medium	30	100	20	30	25	25
Balanced	Medium-high	30	80	20	50	25	25
Growth	High	30	50	20	75	30	25
Equity	Very high	30	50	20	100	30	25

* Non-directional funds, total return funds, funds of funds

The limitation of drawdowns via compounding of profits - defined by Einstein as the eighth wonder of the world - permits the accrual of profits on profits, triggering a snowball effect that results in growth of capital invested in the long term. The main innovation of this approach is in the way of limiting losses: in the past, portfolio volatility was offset by investments in instruments considered to be free of risk, namely bonds. Today, the protection offered by such instruments is mostly limited, while in the medium/long-term, traditional investment in bonds could even increase portfolio risk, especially if we consider that over the recent period, stocks and bonds have increased in perfect harmony.

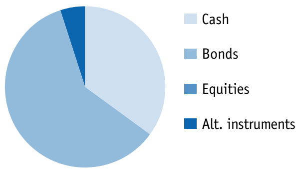
In our opinion, the implementation of systematic strategies allows for portfolio risk reduction and profit achievement whilst protecting invested capital, even in difficult markets. Due to their cold and mechanical approach, these strategies sharply mitigate the emotional component that drives and influences investment decisions and are based on the concept that it is preferable to participate in market trends rather than anticipate a shift or change in trend. On this basis, market prices are the best indicators of the current trend. As opposed to traditional ones, systematic strategies may also participate in market price downturns and, combined with a more traditional fundamental analysis approach, are able to offset sharp downward shifts such as those of 2008 or 2011.

In essence, common sense, systematic behaviour and discipline in making investments are the bases on which we build the portfolios of our clients.

Allocation by asset class

Income

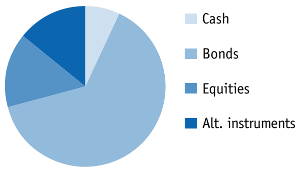
Cash	35
Bonds	60
Equities*	–
Alternative instruments	5
	100



Asset classes

Income Plus

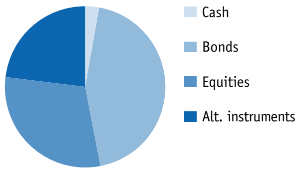
Cash	7
Bonds	64
Equities*	15
Alternative instruments	14
	100



Asset classes

Dynamic

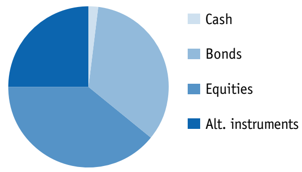
Cash	3
Bonds	44
Equities*	30
Alternative instruments	23
	100



Asset classes

Balanced

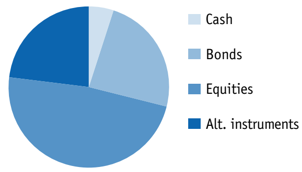
Cash	2
Bonds	34
Equities*	39
Alternative instruments	25
	100



Asset classes

Growth

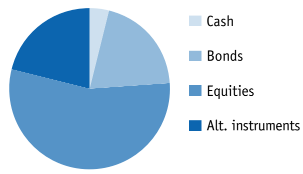
Cash	5
Bonds	24
Equities*	48
Alternative instruments	23
	100



Asset classes

Equity

Cash	4
Bonds	20
Equities*	55
Alternative instruments	21
	100



Asset classes

* Part of equity allocation is hedged with index options or futures

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