INVESTMENT COMMENT

November 2017

- **Main risk: Complacency**

  Most equity indices worldwide are trading at decade or all-time highs, corporate profits continue to rise, high-grade and low-grade debt alike have rallied, private equity valuations are sky-high, real assets change hands at astronomical prices, expected tax cuts in the U.S. and elsewhere have boosted sentiment, and even populism in Europe appears to have been defeated. The skies are all blue.

  The prevalent mindset is that central banks have saved us again and again, so why waste money on insurance? Eight years into the bull market, this is like racing a Ferrari without breaks. Why are investors not buying protection? Central banks have always saved us, they will surely do so again.

  The central bank has pushed the environment from risk-free interest to interest-free risk. Investment confidence has reached such extreme levels that insurance (volatility and gold) are trading at depressed prices.

- **Other risks**

  While we are not anticipating a U-turn to this positive backdrop, the environment is not without risks either.

  1. Change in liquidity regime by central banks (taper tantrum or quantitative tightening)
  2. Default in Italian sovereign or bank debt (and the lack of structural reform in Italy)
  3. Bitcoin bubble

  We advocate buying some sort of protection. For this we recommend buying gold, tail risk protection or volatility.

- **Three possible anti-bubble strategies**:

  1. Sell everything and sit in cash. This strategy is for very conservative investors (but could cost a lot of upside).
  2. Reduce equity and fixed income exposure and buy physical gold, gold equities and volatility. This strategy is for the worried.
  3. Sell the fixed income holdings, maintain a portfolio that consists of 70% equities and 30% CTA funds. This strategy is for the cautiously optimistic.

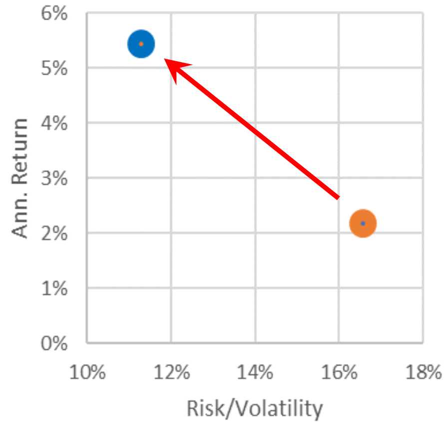
  The second page illustrates how substituting 30% of equities with three equally weighted CTA managers would have allowed an investor to make almost three times as much during the past 10-year cycle.

  We do not anticipate a slowdown in growth, a quick change in the central banks' liquidity regime is not in sight, nor do we expect a crash to derail financial markets near-term. Growth remains strong and broad-based. In fact, we expect growth to continue above trend. Besides, as long as large institutions need to deploy cash, any selling pressure will be met by demand.

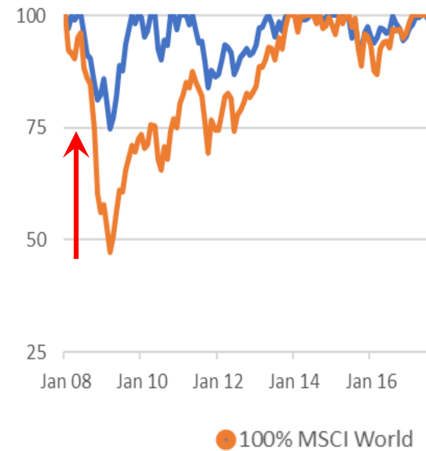
  Nevertheless, it is better to be safe than sorry.

As The Cycle Matures The Case For PROTECTION Is Gaining Momentum

Improved Risk Return



Smaller Draw Downs



Higher Returns

100% MSCI World   70% MSCI World 30% Protection

The Proposed Portfolio Protection

- Liquid, transparent and proven
- Asset class agnostic
- No long bond bias
- Consists of three shorter term CTAs
- Diligent selection by Kehrli & Zehnder
- Based on audited fund returns

	100% Equity	**70% Equity 30% Protection**	**Your Benefit**
Return SI	28.06%	73.82%	+45.76%
Return ann.	2.55%	5.78%	+3.23%
Volatility	16.45%	11.23%	-5.22%
Maximum DD	-52.74%	-25.33%	-27.41%
Sharpe Ratio	0.16	0.51	+0.35

The analysis is based on USD returns for the period of January 2008 to October 2017. The «Portfolio Protection» consist of a portfolio of three equally weighted CTAs, all single fund returns are net of fees and audited (no back tested or hypothetical returns are used), numbers are gross of Kehrli & Zehnder fees, Sharpe ratio is calculated using 0.0% interest rate.