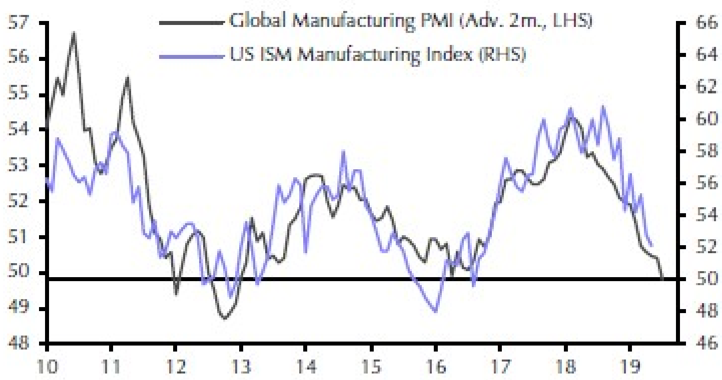
ISGAM AG, Beethovenstrasse 48, CH-8002 Zurich. Switzerland
T: +41 44 286 6060. F: +41 44 286 6065. E: enquiry@isgam.ch.

# Manager's Report
# For the Quarter to 30 June 2019

The second quarter of 2019 was somewhat volatile, but ended on a positive note.
The upbeat mood of the first quarter initially carried on into April before being buffeted by renewed trade tensions and growing evidence of a global economic slowdown. Markets recovered their poise in June as it became clear that all major central banks are once again stepping up to the plate with promises of easy monetary policy and ample liquidity to counter the growing risks to the global economy emanating from these trade tensions.

Chart 1) Manufacturing surveys are weakening in the US and globally




Sources: Refinitiv, Markit, Capital Economics

Leading indicators for the US and the global economy, such as the Manufacturing PMI depicted above, show a dramatic softening of activity from mid-2018 to date. This is probably due to increasing uncertainty around trade policy, the resulting disruption of global supply chains, as well as the impact of higher US lending rates on consumer spending. We had reduced equity exposure in the portfolios in 2 steps last year. The first one was done in early 2018 as we anticipated central bank tightening and a less benign global liquidity environment. The second reduction was made on a temporary rebound later in the year, caused by hopes of a "truce" in trade talks between the US and China, which we feared would prove to be only temporary. As mentioned before, we see the trade spat between the USA and China as a long-term struggle for technological and economic dominance between two global super powers. In the "old days" wars were fought over land and access to physical resources, areas where cash was generated. These days, cash is generated by technological know-how, internet spectrum, access to internet users. Blackrock has put together a fascinating table showing the value of cash flows represented by different types of assets:

Chart 2) Where is the value of the cash flows

| Metric | $ trn | Time Taken to Create |
|---|---|---|
| Value of all gold in the world | 6 | Millennia |
| Value of GPS | 9 | Decades |
| Value of web search | 18 | Decades |
| Value of all oil reserves | 102 | Centuries |
| Value of all global real estate | 217 | Millennia |
| Value of the internet (2.9bn users) | 226 | Decades |
| Estimated Future Value of the internet (7bn users) | 546 | Decades |

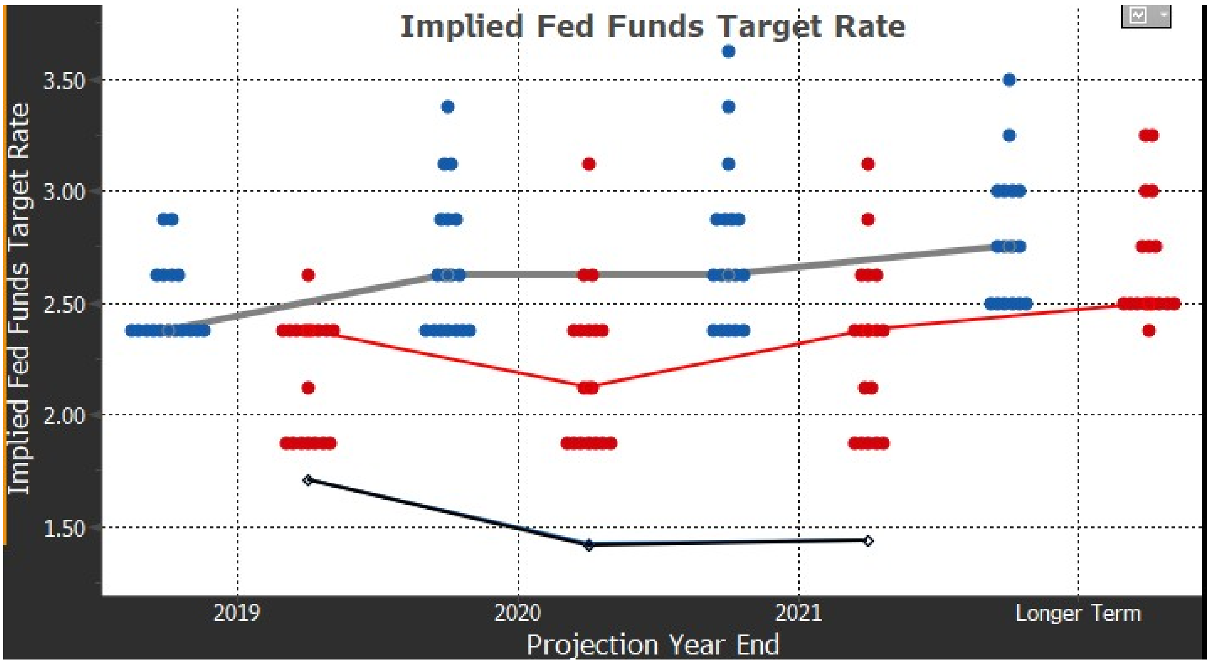
Source: Statista, Bloomberg, Blackrock and The Economist per May 2019

It is not an exhaustive list but certainly shows what is at stake in the current struggle for technological dominance (masquerading as a trade and tariffs war) between the US and China.

By December last year markets had decided that the US Federal Reserve seemed to be on "auto pilot", having delivered its 9th quarter point rate hike and having committed to a reduction of its balance sheet, seemingly oblivious to gathering storm clouds over the global economy. This was compounded by the fact that the European Central Bank had stopped its QE program and seemed ready to start tightening interest rates later this year, in spite of uncertainty emanating from Brexit, tough conditions for the European car industry and a sharp slowdown in power house Germany's export-oriented economy due to global trade tensions. Adding to the uncertainty in Europe was the fact that Mario Draghi's term as governor of the European Central Bank expires in October, igniting fears that a much more "hawkish" person would replace him. By late June however the outlook for global liquidity conditions (which is a major driver of asset markets) had turned around completely, with central banks adopting a decidedly dovish tone.

The Graph below shows the "dot plot" published by the US Federal Reserve after each Open Markets Committee meeting. On it, the 12 voting members each indicate with a "dot" where they see the appropriate level for the Federal Funds Target rate, now and projected into the future. This chart compares the "dot plot" published by the Fed in March 2019 (the blue dots, with the grey line representing the median projected rate) with the "dot plot" resulting from the June meeting (the red dots, with the red line representing the median projected rate). The dark solid line below the dots shows the predicted Federal Funds Rate as projected by the markets, through the forward curve.

Chart 3) The Fed's "Dot Plot" has shifted downwards




Source: Bloomberg

Clearly, the voting members of the Fed have moved their "dots" markedly lower, and the red "median" line projects one or two rate cuts by year end, as opposed to further rate hikes anticipated in March. It is noteworthy that the market's projection is for even more aggressive rate cuts.
In subsequent statements Jeremy Powell, chair of the US Federal Reserve, has all but committed to at least an 0.25% rate cut at the July meeting. Economic research firm Capital Economics expects further rate cuts in September and December to support flagging economic growth. The Fed's

balance sheet reduction, meanwhile, is signalled to cease in September at a remaining level of USD 3.5 trillion.

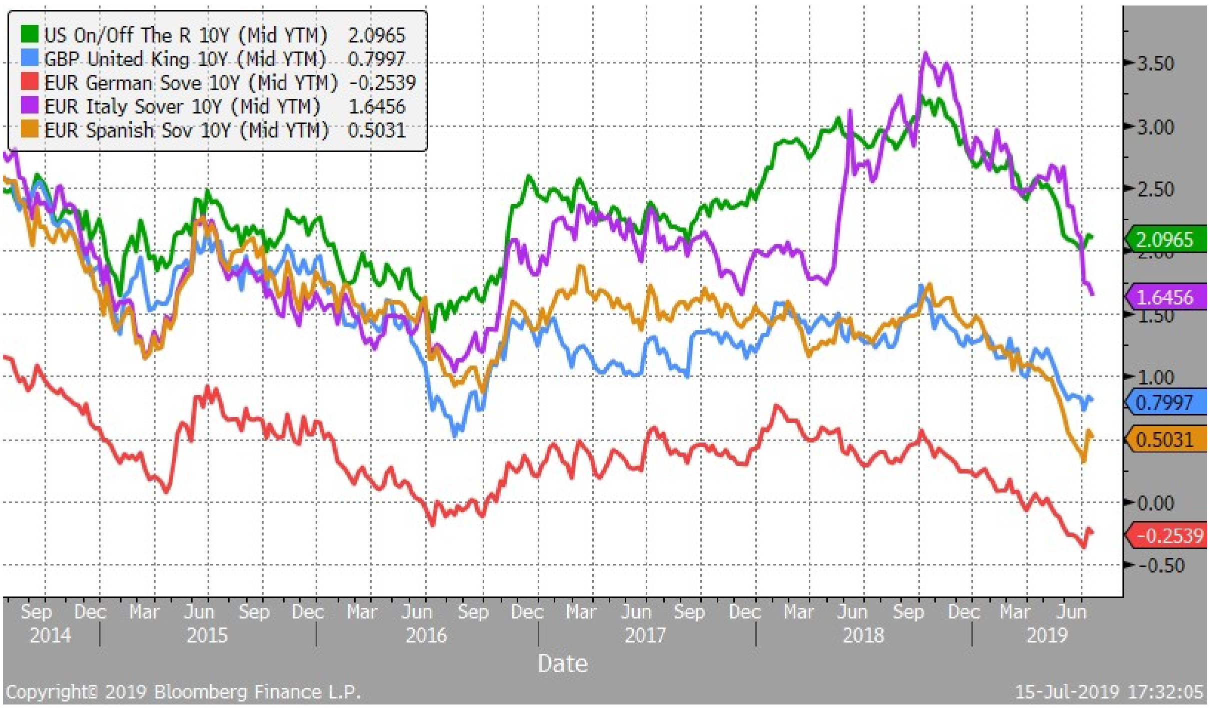
Meanwhile, across the pond, it has become clear that the experienced and highly regarded Christine Lagarde will become the next governor of the ECB. She is expected to continue Mario Draghi's supportive policy and "do what it takes" to support the Eurozone economy and keep the euro bloc together. She has obtained thorough political experience in her current role of Managing director of the IMF, which is a crucial skill given the fact that the ECB is currently the Eurozone's main unifying institution. It is now expected that the ECB, rather than hiking rates, will perhaps cut rates into deeper negative territory and resume its asset purchases later this year.
Central banks in Asia and Latin America are also in easing mode – of the 20 Central Banks tracked by Capital Economics, only one (Norway) is expected to tighten policy this year.

Chart 4) The outlook for global central bank policy

| Policy Direction | Economies |
|---|---|
| Easing | US, Australia, New Zealand, Canada, China, India, Mexico, Turkey, Russia, South Korea, South Africa, Euro-zone, Brazil |
| No Change | UK, Japan, Sweden, Denmark, Switzerland, Poland |
| Tightening | Norway |

Source: Capital Economics

Chart 5) Progression of 10-year government bond yields

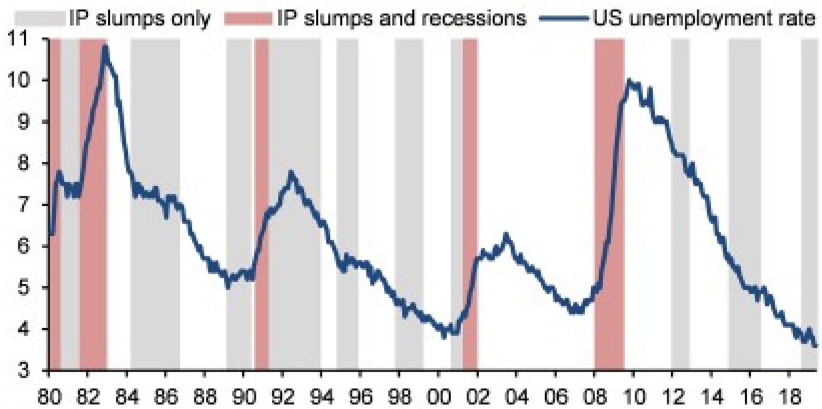


The chart above depicts the progression of 10-year government bond yields for the US, UK and different Eurozone economies. Where these seemed to have bottomed in 2016 and were on a clear uptrend in 2017 and 2018, they have decidedly turned lower this year on the back of disappointing growth and dovish central banks.

In today's fast paced environment there is not enough time to adjust one's asset allocation to the news flow (let alone tweets) so it is more important than ever to remain invested according to the main secular themes. One of these themes is that there is simply not enough income in the world to satisfy demand. Currently between 12 and 13 trillion dollars of bonds globally carry a negative yield. This means quality assets with a positive yield will remain in high demand, and investors will continue to be pushed out onto the risk spectrum in search for positive yield. Blackrock calls it one of the great ironies of our time that in the late 20th century when the young, working ("baby boom") generation did not need income generating assets, the economic growth they created generated ample income through high interest rates. Today, as the population ages and thus needs income generating assets, the lack of growth resulting from this aging means lower interest rates and hence less income!

What does all this mean for our current investment strategy?
We believe the US economy is in the later stages of the economic cycle, but this cycle has probably been extended further, once again, through policy easing by the US Federal Reserve. This has happened before – the chart below shows previous periods where the US economy experienced a sharp downturn in Industrial Production which was NOT followed by an actual recession:

Chart 6) Previous global industrial production slumps and US recessions



%, Global industrial production slumps and US recessions are shaded

Source: Credit Suisse, Thomson Reuters Datastream, Bureau of Labor Statistics

It is clear from the chart above that employment data are a key indicator to watch – Industrial Production slumps that turned into full blown recessions were always preceded by a sharp deterioration in the jobs market.

Given the dovish U-turn made by global central banks, including the Fed, we realize that one of our reasons for last year's reduction in equity exposure (tighter monetary policy and less global liquidity, a key driver of equity markets) has disappeared. We have therefore taken some profits in the Fixed Income part of the portfolios and added it back to equity allocations, in early July. Global bond yields have fallen back far, fast, as illustrated by chart 5) above. We still see value in certain parts of the fixed income market – selected corporate bonds, asset backed and mortgage backed securities, and selected emerging markets bonds. However developed market government bond yields at current levels are unlikely to represent good long-term value should there be a recovery in growth, and inflation.

We remain slightly underweight equities though (corresponding to “step 2” of last year's equity reduction), as the outlook for corporate profits (another main driver of equity markets) remains uncertain. Expectations for corporate earnings growth this year have fallen, but it is unclear whether they have fallen enough. Some companies are reducing earnings guidance only now, citing disruptions to their supply chain or uncertainties emanating from changes in trade policy, Brexit, new regulations…. several of the “global policy uncertainty” and “geopolitical uncertainty” measures we follow remain at stubbornly high levels.

In summary, we continue with our balanced, slightly more cautious approach. We see value in certain parts of the bond market, as described above. We also like certain areas of the alternative investment space, such as global real estate, private equity, and Merger and Acquisition arbitrage, as M&A continues apace.
Our global equity exposure has been increased a bit but remains slightly below neutral allocations, using a neutral global regional allocation and a focus on high quality companies that have the ability to grow revenues organically in an era where many traditional business models face disruption.

As always, please do not hesitate to contact us if you have any questions or comments, about the contents of this report or your portfolio in general.

Portfolio Management Team ISGAM AG