EDMOND DE ROTHSCHILD

PRIVATE BANKING

INVESTMENT STRATEGY

September 2016

KEY POINTS

We are maintaining a diversified and cautious approach in our portfolios, in line with our investment scenario.

We continue to keep a close eye on the US dollar, as we do on the monetary policies of the leading central banks.

We maintain our under-weight position in equities and are diversifying geographic risk by adding an allocation to UK equities.

The impact of Brexit, at least for the time being, is less dramatic than the financial markets expected.

EDITORIAL

by Craig Lewis
Head of Investments
International Private Banking

In searching for a musical reference for this month's editorial I was torn between two tunes, "Let the music play" by the one and only Barry White, and Ella Fitzgerald's "Summertime"... and the livin'(money) is easy. These on account of the big Four Central Banks (FED, ECB, BoJ & BoE) keeping the monetary party alive during the summer and pushing certain asset prices to new highs. However, both songs can lull the listener into a false sense of security and complacency is an enemy of love... and bull markets.

CAPITAL PROTECTION IS MORE THAN EVER A KEY ELEMENT OF OUR ACTIVE MANAGEMENT.

There are plenty of headlines to justify why equity markets are so high and bond yields so low but there are also many reasons why this is one of the most hated bull markets in recent years. In particular, fundamentalists will point to low growth, inactive fiscal policies, high price/earnings multiples, and late-in-the-cycle concerns as to why they are so cautiously positioned in terms of asset allocation.

Furthermore, although world equity and bond markets in aggregate have posted solid returns this year, closer inspection shows huge divergences in performance. For example, whilst the MSCI World index is up 2.5% year to date, the EuroStoxx 600 index is down close to 6%. Sector-wise, Energy and Materials have been two of the global winners, but investments in European Financials and Telecoms would have delivered investors double-digit losses.

Capital protection is more than ever a key element of our active management. Having just attended our Global Investment Committee, I am reassured that our systematic review of the five driving forces we focus on, namely Corporates, Valuations, Economics, Technicals/Sentiment and Risk, will enable us to continue to protect and grow the assets our clients entrust us to manage.

Over the following pages our experts will highlight to you the key risks and opportunities they foresee. We hope these insights will help you navigate today's challenging financial markets and moreover retain your confidence in our Group's ability to advise you on your wealth.

INVESTMENT CONVICTIONS

MACRO OVERVIEW

WAY PAVED FOR A FED HIKE

HIGHLIGHTS

- ☑ Expectations have jumped for one Fed uptick by end-2016. The decision will be based on job creation.
- ☑ Meanwhile fiscal stimulus and ECB support are likely to spur economic activity in the Eurozone.

All eyes were on the US Fed Chair Janet Yellen last Friday as she addressed other central bankers gathered for their annual conference at Jackson Hole. The statement and minutes of the 27 July FOMC meeting had shown that the members of the Fed's monetary policy committee saw fewer short-term risks facing the American economy than in the spring. In particular, they were less concerned about the recent developments. Moreover, the financial stress in the wake of the UK's Brexit referendum decreased. In addition, recent comments, most notably by FOMC Vice-Chairman William Dudley on 16 August, seemingly pointed to a rate hike in the coming months.

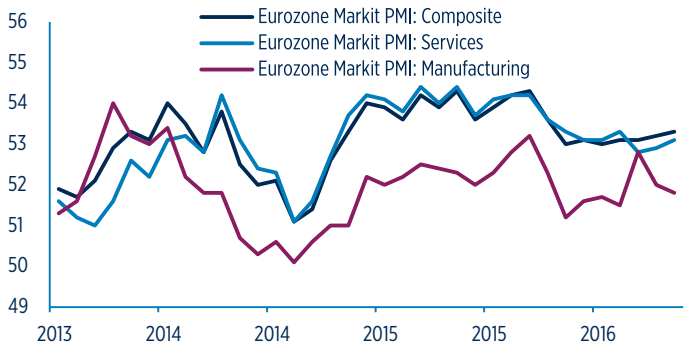
With this in mind, investors were expecting Yellen to reiterate the prospect of further monetary tightening. In fact she did so, but only to a point. She confirmed that an uptick was possible considering the improvement in jobs data and the outlook for growth and inflation observed in recent months. This, she said, had strengthened the case for a rate hike. However, she gave no indication for the timing of such an accommodative move. Investors therefore failed to react immediately to her message. It was the speech by her deputy, Stanley Fischer, a few minutes later that shed real light on the prospects of a forthcoming uptick. For him Yellen's words set the stage for a hike in the federal funds rate in September and perhaps even a second one by the end of the year. In Fischer's view it would all hinge on the August employment report to be published this Friday.

So in the end it was Fischer's address, more than Yellen's, that provided a clear answer for investors. As a consequence, the dollar appreciated against most other currencies. The DXY index, which tracks the greenback's nominal effective exchange rate, was up 1.1% on Friday compared with its week-earlier level.

Meanwhile in the Eurozone, the latest PMI surveys showed an improving economic outlook in August. The composite index edged up to 53.3 points, a seven-month high, from 53.2 in July (see chart above). Although the Brexit vote has not dented the morale of purchasing managers in the 19-member currency zone, they are still worried about the weakness of economic growth worldwide. New orders in the manufacturing sector were down significantly this month and the recent upturn in commodity prices has started pushing up the prices of finished products. However, the rise in public expenditure that we expect to see in the second half of 2016 should spur GDP growth in the Euro Zone. The area's low inflation rate (0.2% yoy in July) moreover gives the European Central Bank (ECB) enough leeway to step up its program of corporate and sovereign bond purchases, providing another fillip for economic activity.

Despite political uncertainties, Euroland's GDP growth could therefore deliver pleasant surprises in the coming quarters.

GDP growth in the Euro Zone continues to be driven by services
Sources: Thomson Reuters Datastream, Edmond de Rothschild (Suisse) S.A.



ECONOMIC FOCUS

WILL THE MONETARY ANAESTHETIC HAVE LASTING EFFECTS?

HIGHLIGHTS

- ☑ Rising expectations of monetary stimulus, dollar drops slightly...
- ☑ ...central banks have managed to provide a calming cocktail for markets this summer.
- ☑ But expectations are now very high, as is the risk of disappointment.

Central banks once again at the front line

With their dovish actions or communications, central banks have once again played an essential role in guiding markets this summer. The most awaited event was certainly the announcement a few weeks ago, 4 August, by the Bank of England (BoE) of its measures for supporting the British economy. It did not disappoint. Not only did it cut its key rate, it also took measures to ensure that this reduction would be passed on to households and businesses and, most importantly, it reactivated its government and corporate bond purchase programmes. Furthermore, it indicated that it would probably cut further its rate by the end the year and that it might, if necessary, extend its quantitative easing measures.

Given the low level of interest rates and the high degree of uncertainty created by the Brexit vote, these measures are unlikely to have a sharp effect on the economy although they should prevent a collapse of confidence in the short term. This is why we have not revised our GDP forecasts for the United Kingdom. But the determination shown by the BoE has reassured investors. Firstly, it has led them to regard this monetary policy as giving the UK government more room for manoeuvre to introduce a stimulus plan in the autumn. Secondly, and most importantly, it has fuelled expectations that other major central banks will maintain, or even expand, their monetary easing policies.

The sluggishness of expectations of interest rate changes has been particularly striking in the United States (between 22 July and 19 August, the Fed funds futures contracts assumed that the Fed would remain on hold throughout 2016). Certainly, some US data were disappointing, such as second-quarter GDP (which rose only 1.2%, QoQ annualized, after a Q1 increase downward revised from 1.1% to 0.8%). But leading indicators such as the ISM remained well oriented and continued to suggest that the activity should strengthened in S2. What's more, the absence of major financial turmoil following the British referendum and the improved job figures for June and July banished the two risks that had convinced the US Federal Reserve to postpone a rate hike during spring. However, investors continued to expect that US monetary policy would remain on hold for an extended period . The dovish tone of the minutes of the meeting of 27 July no doubt contributed to it. But these expectations have certainly also been boosted by the fact that investors have considered a Fed funds rate hike as even more difficult to implement given the new wave of monetary easing introduced by the BoE.

These low interest rate expectations in the United States have also contributed to a slight depreciation of the dollar. Between 22 July and 19 August, the nominal effective exchange rate of the US dollar (DXY Index) lost 3.0% after having gained 4.2% between 24 June (the announcement of the result of the UK vote) and 22 July. This bolstered expectations that authorities in emerging markets would have more room of manoeuvre for additional stimulus measures and has thus reassured investors. Against this background, in China, the slightly disappointing data for July (particularly the deeper-than-expected slowdown in investment) did not cause major concern.

In the eurozone, expectations of an even more accommodating monetary policy were also marginally boosted. Even though surveys suggested that the Brexit result had not, as yet, adversely impacted confidence, the minutes of the ECB July meeting were considered dovish and likely to open the door to further measures in September. Investors have also seemed to be aware of the "technical" constraints facing the ECB. Thus, given the persistent distrust of the banking system, they did not expect a further cut in deposit rates: according to the OIS curve, the probability of a deposit rate cut has fallen from 52.0% on 22 July to 43.0% on 19 August. Similarly, they remained aware that the universe of bonds eligible for the ECB's asset purchase programme

was scarce (for example, on 19 August, all German government bonds with a maturity below 7 years were ineligible for the ECB programme because their yields were lower than -0.40%). Consequently, investors did not seem to expect an increase in monthly bond purchases but rather a QE extension beyond March 2017 and a change in the rules of the ECB's programmes (such as abandoning capital key structure of purchases, as we expected since several months). These expectations have contributed to lower peripheral yield spreads.

Japan, however, has proven to be more complicated as the authorities have not "delivered" as expected. Since the Bank of Japan (BoJ) was to meet on 29 July and the government had advised a few days earlier that it would announce a new stimulus plan, some investors were looking for "helicopter money" whereby the BoJ would have directly funded budgetary measures. But that was not to be. Even though the Japanese government announced a JPY 28 trillion budgetary stimulus plan, the BoJ's own decisions were marginal. Certainly, it attempted to support expectations of new actions by announcing that it would review all its measures at its September meeting. But, in the meantime, it was exposed to a resurgence of investor distrust. The yen continued to appreciate and government yields went up.

We expected central banks to accentuate their monetary expansion in 2016 and the big lesson of this summer will have been that Brexit have reaffirmed their resolve to do so and has even led some of them to go further still. This has had consequences on assets. Between 22 July and 19 August:

- Risk aversion receded and underpinned equity markets.
- On bond markets, British sovereign bond yields fall sharply. Sovereign rates curves in the United States and the core eurozone countries remained stable. Investors, once again looking for returns, have opted for bonds on the periphery of the eurozone. The appetite for High Yield bonds and emerging bonds has stepped up.
- On the foreign exchange markets, BoE announcements accentuated the British pound's decline against all currencies The dollar index also depreciated.
- On commodity markets, the weaker dollar, the slightest hints of uncertainty over the outlook in China, and, above all, expectations of a possible agreement among oil producing countries, all combined to lift the barrel price.

However, as this favourable market outlook has been fuelled not by just by the actions of the central banks but also strong expectations that they will act further, the risk of disappointment is high.

BONDS MARKETS

AFTER A GLORIOUS SUMMER, THE KEY WORD IS CAUTION

HIGHLIGHTS

- ☑ Once again, the markets believe a US interest rate hike by the end of the year is likely.
- ☑ The potential for tightening credit spreads appears increasingly limited.

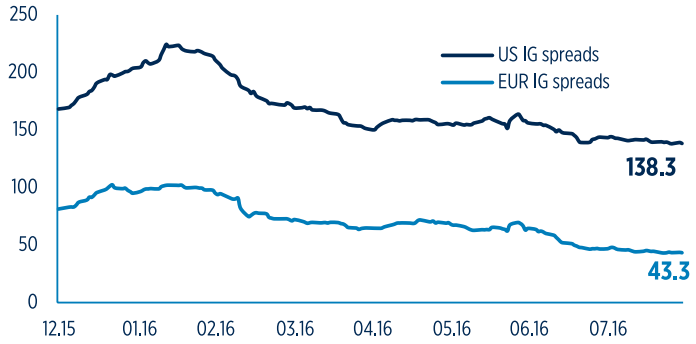
After the turmoil caused in late June by the pro-Brexit vote and poor employment figures from the US, the bond markets turned out to be surprisingly resilient. Thus, in July and August, credit spreads tightened and fell below the levels observed prior to the UK referendum. US and German government bond yields increased over the same period but still remained below the levels of the week before the referendum.

We see two main reasons for this performance. The first is that US employment statistics were reassuring. 255,000 jobs were created in July and the figures for the previous two previous periods were revised upwards. The second reason is the determination of the central banks to take action to minimise the effects of Brexit. The Bank of England in particular cut its rates and announced a bond purchase programme. Investors are also banking on the European Central Bank ramping up its quantitative easing programme in September.

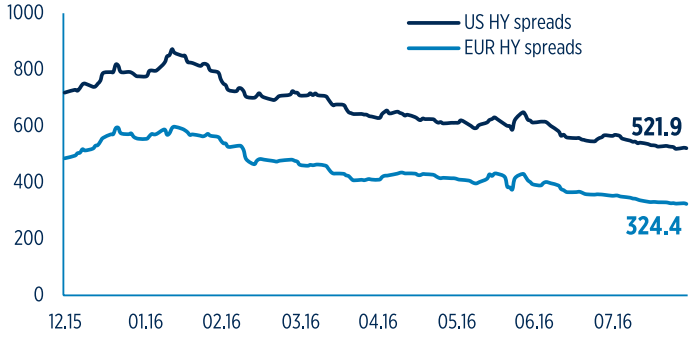
However, this summer's strong performance should not make us forget that all is not that rosy. First of all, political risk is likely to take centre stage with the constitutional referendum in Italy, the Spanish government's difficulty in forming a parliamentary majority and the upcoming US elections in November. Secondly, since the start of the year we have noticed a deterioration in corporate balance sheets in Europe and the United States with, in particular, an increase in average corporate debt.

For emerging debt, the environment is more favourable. Commodity prices have comfortably stabilised above their record lows and the dollar shows little or no sign of firmness. The search for yield remains the primary concern of financial players and boosts the attractiveness of the asset class. Despite the excellent performances recorded in recent months, the current assessment, together with the attractive profits outlook, should attract investors ready to raise their risk tolerance level. This market has a stronger beta and requires closer monitoring.

Investment grade spreads in Europe and US are at their lowest since the beginning of the year
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



High Yield spreads in Europe and US are at their lowest since the beginning of the year
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



EQUITY MARKETS

GUILTY OR COMPLACENCY?

HIGHLIGHTS

- ☑ Beware of complacency.
- ☑ Visibility and the profits momentum are positive signs for the US.
- ☑ Stimulate consumer spending, but based on purchasing criteria and retailing channels.

Whatever happened to the uncertainties from Brexit, the political risks in Europe, the pressures from the US presidential race or the multiple regional conflict zones?

The US market is soaring to historic new highs while European markets have returned to their pre Brexit levels! Clearly, the risk right now is that investors are guilty of complacency!

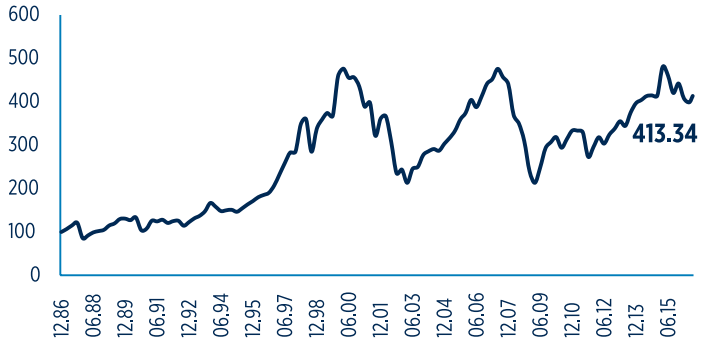
From this viewpoint, the long-term chart of the Stoxx 600 index calls for extreme vigilance, suggesting the formation of a major cyclical top. Obviously, because of the widespread rollout of unconventional monetary policies, comparisons are partly devoid of meaning, but these are market signals which should not be ignored.

We are therefore advocating a selective approach which focuses on companies capable of differentiating themselves in a highly competitive environment, which is active in segments with buoyant structural trends and benefits from internal management initiatives which enable growth, while preserving (or even raising) profit margins.

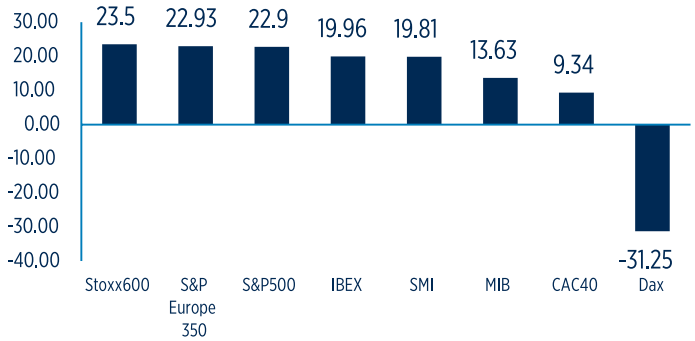
There are, indeed, huge performance gaps between companies with disappointing results and those which exceed expectations. Even the ability to identify buoyant sectors correctly does not guarantee stock market performance. In the earnings announcements period between mid-July and mid-August, results spoke volumes. In the United States, Tech stocks recorded the highest growth (+4.6%) but within that sector, the best performer reported 33% growth whilst the words lost 22%! Similarly, in Europe, where industrials performed well (+4.9%), performances ranged from +28% to -14%! Stock picking is therefore an essential skill!

More generally, the key question today for investors in equity markets no doubt concerns the scale and speed of US interest rate hikes. Here again, visibility is sorely lacking and investors need to be able to react rapidly. The continuing search for yield in a low interest environment is good for real estate and public utilities. But in the event of a sharp interest rate hike, we should then focus on insurance. In both cases, consumer spending will drive growth.

Stoxx600: Creation of a triple top?
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



Market valuations: P/E 2016 compared to 10Y average
Premiums/Discounts in percentage
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



COMMODITIES

STABILISATION OR TURNAROUND

HIGHLIGHTS

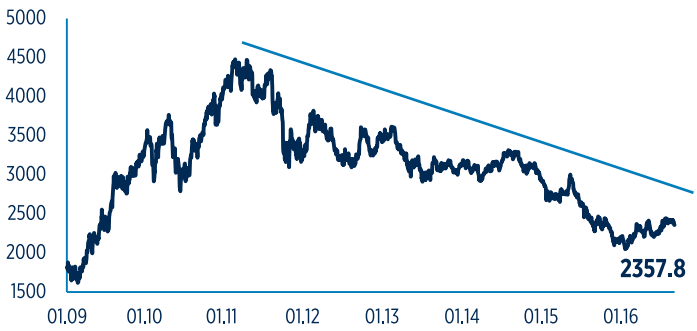
- ☑ Gold retains all its ability to diversify risk.
- ☑ Oil continues to establish a volatile floor between $40 and $50.
- ☑ Industrial metals stabilise but another bullish wave would be premature.

Gold has retained all its ability to diversify risk as part of a balanced management strategy. These are the qualities that have attracted investors in unprecedented numbers: 448 tons of investor demand in the second quarter, i.e. 141% hike year on year, which takes the first half year to record levels. Demand for jewellery should pick up seasonally in the fourth quarter and support the price. The biggest threat may come from a faster and larger than expected hike in US rates (more than two hikes of 25 bps in the next six months).

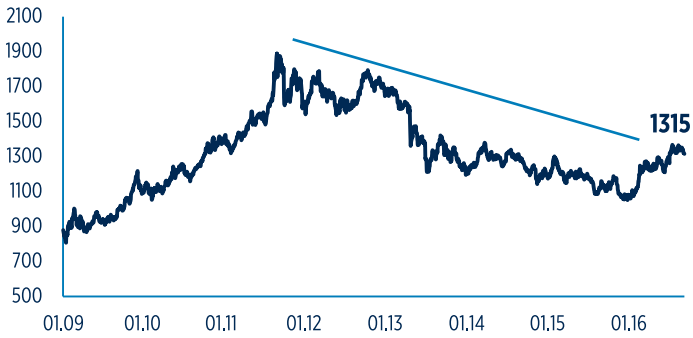
Oil continues to establish a long term floor between $40 et $50, but volatility remains strong in the short term. US production returned to an upward trend with a 29% jump in the number of active wells since the trough in May. Coupled with high levels of stock, this places a cap on recovery potential. Investors are once again fretting about a potential capping agreement on the volumes of producer countries, including Russia, Saudi Arabia and Iran. This is slightly more credible than in the recent past, given the strong surge in Iranian volumes. But this is still highly unlikely considering the major political (and military) differences between the two countries. We think that a continued sideways trend of $40-$50 is more likely.

The six **industrial metals** included in the LMEX index (aluminium, copper, zinc, nickel, tin and lead) continue to establish a solid floor between 2,200 and 2,400 thanks to the streamlining of production based on profitability criteria (as clearly illustrated by the quarterly results of mining groups). However, for a more optimistic outlook, we still lack another boost to demand which would require a recovery in China (the signs of which are sadly lacking) or massive capital expenditure plans, as strongly desired by many in Europe and in the US.

LMEX Index(six precious metals) since January 2009
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



Gold ounce since January 2009: the break of the downtrend confirmed
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



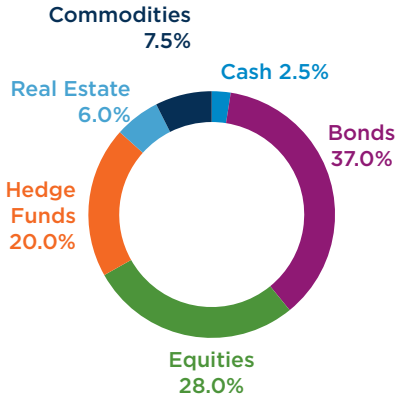
ASSETS ALLOCATION

OUR INVESTMENT SCENARIO

HIGHLIGHTS

- ☑ Moderate risk taking and diversification remains the rule.
- ☑ Geographic diversification in equities with the introduction of UK equities.
- ☑ Pay attention to the Fed's decisions in September and movements in US dollar.

Balanced allocation



Bonds	37.0%
Sovereign bonds	8.0%
Corporate bonds	16.0%
Emerging bonds	4.0%
High yield bonds	4.0%
Convertible bonds	5.0%

Equities	28.0%
Europe	8.0%
North America	11.0%
United Kingdom	2.0%
Switzerland	2.0%
Japan	2.0%
Emerging Markets	3.0%

Source: Edmond de Rothschild (Suisse) S.A.

Recent publication of macroeconomic data together with the latest earnings reporting season confirm our scenario of a mature economic cycle. We maintain our under-weight position in equities and continue to favour diversification and moderate risk taking.

The weak growth in profits and narrow widening of margins are no incentive for us to buy companies with high price/earnings (P/E) ratios, unless they are supported by improved sales figures or economic growth. The outlook for yields is barely encouraging for bonds considering the extremely low levels of nominal or real interest rates and the risk associated with inflationary expectations. Therefore, from a fundamental point of view, it is difficult for us to be strongly convinced in favour of one asset class or the other. Furthermore, the search for alternative performance drivers is made even more difficult by the very strong influence of the communications and decisions of leading central banks on all asset classes. "Fed speak reading" has become a required skill! Finally, we must also include in our tactical positioning the technical and graphic aspects of markets, which are the result of investor preferences and creators of trends and changes. It is indeed important to understand that fundamental aspects alone cannot justify an allocation. Nevertheless, we would like to be able include market trends, completely or partially, even if the fundamentals are hardly encouraging.

As a result, we are making no major changes to our asset allocation this month, but will closely monitor market developments. For instance, we are maintaining our tactical exposure to the US dollar because of the temporary strengthening of the greenback, even if we are not fully convinced of a significantly and persistently stronger dollar. We will also pay attention to the upcoming G-20 meeting, which could indicate greater international co-ordination, which could, in turn, impact our long-term investment scenario. We expect central bankers gradually to hand over to their respective governments the task of supplementing monetary policies with budget stimulus plans. This inflationist policy would have an impact primarily on yield curves and would favour topics such as infrastructure related spending.

Our bond strategy is split into two parts: an exposure to interest rates, by seeking to benefit from the flattening of the yield curve, complemented by an allocation to short-term credit risk. This explains why, in this current environment, we favour active management of interest rate risk and why we have chosen to spread this risk using debt instruments such as the high yield, senior debt or hybrid bonds segments. With respect to equities, we have diversified our geographic exposure by implementing an allocation to UK equities. These companies will continue to profit from weaker sterling and will take advantage of increases in stimulatory measures by the Bank of England. Our exposure to equities is still cautious and designed to be asymmetric, at a time where signs of complacency are once again appearing in the market. Our allocations in convertible bonds, hedge funds, and optional protection strategies with puts and calls, have demonstrated their efficiency and are maintained.

INVESTMENT DECISIONS

DIVERSIFICATION AND CAUTION

Bristish equities ↗

European equities ↘

Bonds:
We are not changing our bond allocation. For the sovereign bonds portion, we prefer medium duration US government bonds and retain an exposure to inflation-linked securities. Exposure to peripheral European countries recently generated a very welcome positive performance and has been maintained. Regarding corporate bonds, we keep a substantial exposure, but are diversifying our interest rate risk by selecting short maturity, floating rate or alternative securities, such as loans or cat bonds. In our view, emerging market bonds continue to offer interesting prospects for yields, as do convertible bonds which offer a moderate exposure to equities.

Equities:
We continue to be underweight in equities in order to keep a moderate risk in our allocation grids, but we are adjusting our geographic exposure. We are introducing an allocation to UK equities, in particular because of the persistently weak pound sterling. Regarding sector exposure, we prefer consumer driven sectors, as well as securities associated with the infrastructure sector. Finally, the signs of complacency and the very low volatility of the leading equity markets encourage us to be cautious and maintain the currently attractive portfolio insurance strategies.

Hedge funds:
Alternative management continues to represent an asset class of choice in our allocation, particularly because of its attractive risk/reward profile, the variety of investment strategies deployed and its capacity to adapt to complex markets. We prefer trading, quantitative management or arbitrage strategies, while strategies based on fundamental research in equities are underweight.

Commodities:
After increasing our exposure to the yellow metal last month, the gold price stabilised, linked to fluctuations in the US dollar's fluctuations. The diversifying properties of a gold allocation in the portfolios remain undimmed and we have decided to maintain our allocation in light of the fundamentals.

Currencies:
The introduction of an exposure to UK equities has resulted in the creation of exposure to the pound sterling, which we want to fully hedge in order to protect ourselves against the risk of a further drop in the value of the British currency. We maintain our exposure to the US dollar for tactical reasons. Recent US economic news and announcements from the Fed about its intentions have created a climate which favours an appreciation of the greenback in the short term. However, in the longer term, our conviction in a significantly stronger dollar is limited.

RISK MANAGEMENT

PROTECT AND PARTICIPATE

HIGHLIGHTS

- ☑ Our stress-tests confirm the beneficial effects of diversification.
- ☑ Equity risk continues to be the primary risk in portfolios.
- ☑ Our indicators of risk are at low levels, close to complacency.

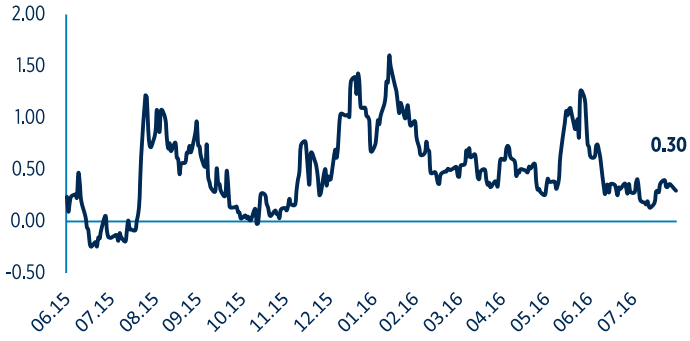
Are equities the primary source of risks for our multi-asset class portfolios? Or, on the contrary, should we fear a possible hike in interest rates?

Intuitively, we know that equities are more volatile and therefore riskier than bonds and should logically represent a greater source of risk in a portfolio. As proof of this, the expected volatility of the US equities index is now around 11.9% (very low), while that of the US government bond index is nearly five times lower (2.5%). Therefore, in terms of contribution to the total risk of a balanced portfolio, the impact of an equity market correction on the portfolio's valuation would be higher since 60% of the risk is from equities. Conclusion: we need to be on our guard against equity risk... That said, with interest rates as low as they are and a de facto weak expectation of profits, the impact of an interest rate shock could wipe out any potential profit in bonds probably much faster than in equities. We should therefore analyse a scenario which takes into account a break in the correlation between interest rates and equities, which would cause simultaneous falls in prices for both asset classes. For example, the simulation of a -10% decline in equities and a 1% increase on the yield curve (with no correlation effect) would result - all things being equal - in a -5.5% decline in our balanced portfolio model. A fairly modest level of loss thanks to our diversified and cautious approach.

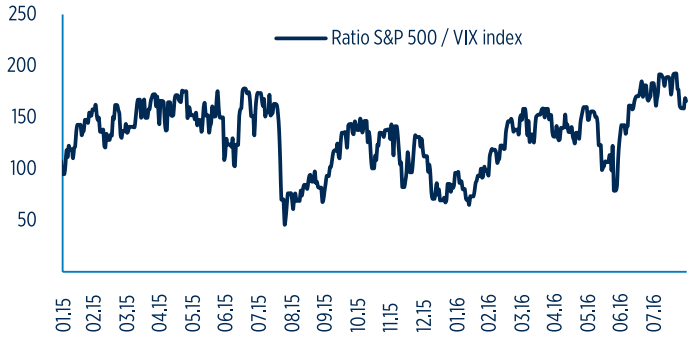
Our risk scenario simulations are not driven by excessive pessimism, but by the need to estimate the impact of shocks, the probability of which exists or is on the increase. In our case, US equities are highly priced, on historic comparisons, the outlook for profitable growth is rather weak, considering economic growth, and their benchmark index is close to the highest ever achieved in a market which has now been bullish for more than seven years. Adding to this, expectations of low volatility despite obvious political uncertainties, plus what we believe to be a significantly strong feeling of complacency, and one can easily understand the attraction of assessing the impact of a possible correction. For interest rates, several factors could trigger a rise in the yield curve, such as higher than expected economic growth, an inflation hike above the Fed's 2% target, or again massive sales of several foreign investments in US Treasury bonds.

Smart portfolio management must take account of alternative developments which are contrary to the central investment scenario. This results in a carefully constructed portfolio which does not seek to minimise risks, but to manage them. Accordingly, we are not trying to cut our exposure to equities, but to calibrate the portfolio to reflect the impact of any possible correction. The low cost of portfolio insurance (options) represents, in our view, an opportunity to protect portfolios before the US elections, and allows us to stay exposed to US equities which have soared to record highs.

The level of risk of the EDR Risk Indicator is low compared to its historical levels , nevertheless remains positive
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.



The ratio of the S & P 500 and the implied volatility index is an indicator of complacency which oscillates at high levels
Sources: Bloomberg, Edmond de Rothschild (Suisse) S.A.




HSBC

HEDGE FUNDS FOR INVESTMENT STRATEGY

INTERVIEW

Roland Eberhard, Head of Alternative Multi-Management

Have hedge funds disappointed?

Good question. Did hedge funds under-perform or did investors overexpect? Systematic alternative strategies continue to perform quite well. Discretionary fundamental managers, however, are cautious. The bad press is not that hedge funds lose money or take too much risk but that in contrary thoughtful investors conclude to be prudent in the current environment. We see this phenomena across different strategies and locations. Valuations are rich for equities by any measure. Sovereign and investment grade bonds trade at yields hitherto unheard of. Thus, managers tend to "hedge" themselves, missing beta in the process as markets keep on reaching new highs.

Could you please elaborate on systematic alternative strategies?

We favour non-directional hedge fund strategies, which we expect will continue to outperform, particularly on a risk adjusted basis. We believe systematic strategies specifically are a source of true alpha. They benefit from equity market volatility as happened post-Brexit and from dispersion among equity sectors or individual stocks. Systematic Managers keep discovering market inefficiencies through big data technology for instance. Some have developed algorithms that analyse thousands of earnings call transcripts each quarter, turning text into statistical forms and ranking stocks based on sentiment and management quality. That's just one example. Other algorithms filter topics mentioned during conference calls and map them for each company. These topics can capture momentum effects and be exploited across baskets of stocks with exposures to each topic.

Any good news this summer?

Plenty! We are particularly excited about developments in Asia. China and India made big announcements.

Do you refer to the Hong Kong – China Stock Connect program?

Indeed. Announced mid-August, this is the second phase of the opening of the Chinese equity markets to foreign investors who have now access to 880 stocks listed in the southern city of Shenzhen. The first tranche acted as a catalyst for a 25% return of the Hang Seng Index between April 2014 and June 2015 and a 130% return for the Shanghai Shenzhen Index over the same periods. This time, the effects will be different but not less significant as the last big barrier to investing in onshore Chinese equities is opened when it goes live in December 2016. In June, MSCI delayed the inclusion of China A-shares in its indices. We believe it is likely this will change at the next revision.

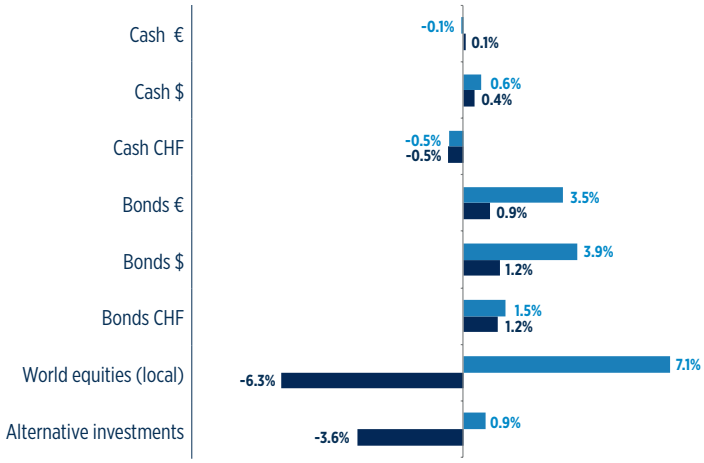
And in India, do you refer to the tax reform?

Precisely. The Goods and Services Tax (GST) is a "big-bang" reform creating a genuinely common market for 1.3 billion people, boosting aggregate domestic demand, cutting the cost of business and hopefully transforming India into a viable manufacturing base. Other countries that introduced unified tax systems, such as Australia, Malaysia and Canada, saw GDP increase by 1.5% to 2% p.a.

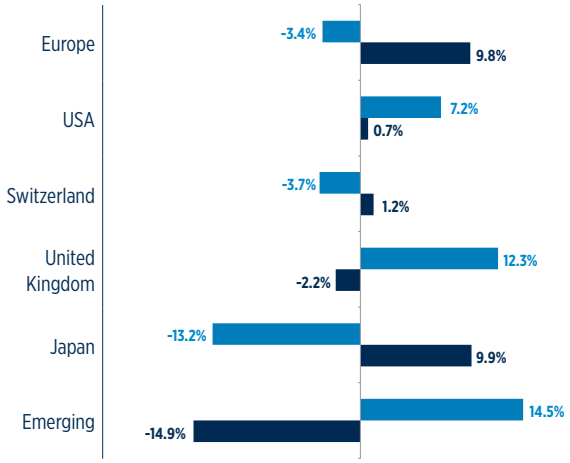
All in all, these major decisions in China and in India will create winners and losers, offering plenty of opportunities to long/short managers. Active strategies might out-perform passive investing due to rising volatility and widening dispersion of securities, and not just in Asia.

MARKET PERFORMANCES

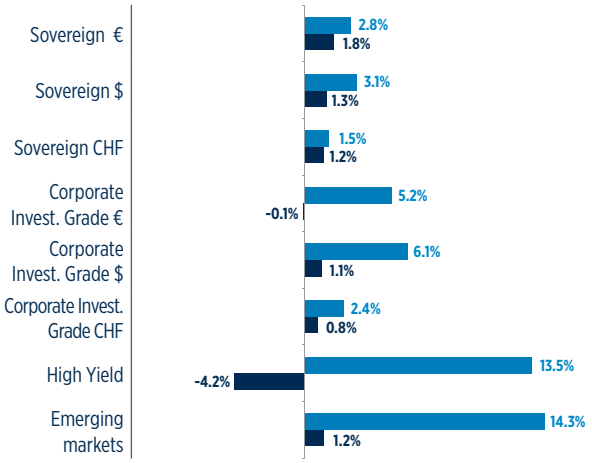
Asset classes



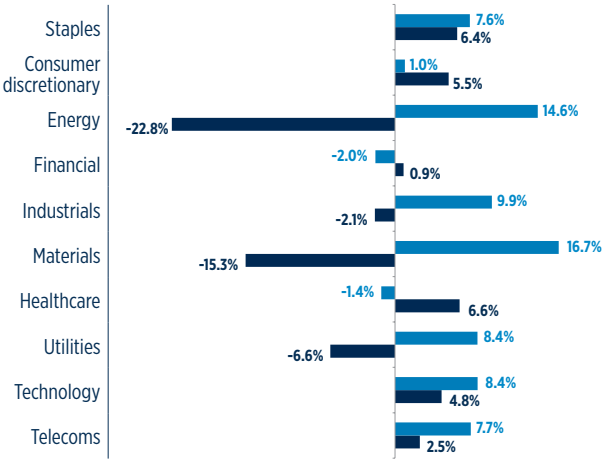
Equities



Bonds



Sectors



YTD (30/06/2016) ■ 2015
Sources: Edmond de Rothschild (Suisse) S.A., Bloomberg

IMPORTANT LEGAL INFORMATION

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