IRISOS

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Q 01 / 2018

Quarterly Investment Review and Outlook

Quarterly Report – Q01/2018

At a glance

Review – 1st quarter of 2018

1. **Volatility on the rise**
   - Lower visibility on both the political and the economic fronts resulted in higher volatility and in an increase of the risk premium for equity markets. Volatility has recently declined but it should stabilize near current levels or slightly higher in the course of this year
   - Global equity markets have bounced back well from the February consolidation. On sector levels, we note that technology and industrials have recovered the quickest.

2. **US Growth**
   - The quality of US growth is deteriorating with among others, higher inflation and the widening of twin deficits. Combined with a less supportive liquidity background, this should maintain the level of volatility above average. Therefore, institutional investors are reviewing more often than in the past the risk/return profile of their assets.
   - Given this, we expect a higher pace of sector rotations and a more frequent risk-premia arbitrage.

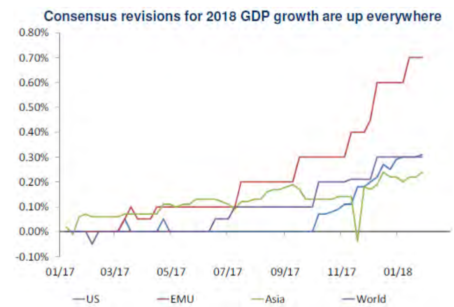
3. **Europe**
   - European stock markets did not recover, compared to others, from the February consolidation.
   - In our previous report we addressed our concern on the European market performance. We argued that while EPS growth of European companies was impressive ever since 2016, the tailwind was not sufficient to rerate the European equity market. As a result of this lackluster situation, investors prefer to pay higher prices for equities that take advantage in multiple manners form the present economic situation.

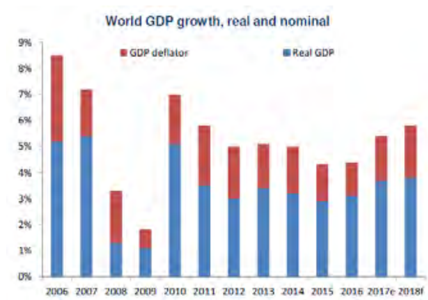
4. **Global economic outlook**
   - World economies are experiencing a full synchronization.
   - Capex is recovering too. Yet, the majority of the project flows are designated to maintain existing infrastructure.
   - We argue that only large scale innovation and disruptive models will fuel the next real growth cycle.

5. **Asset Rotation**
   - The favored sectors are US technology and industrial sectors. Investors tend to shy away from late cyclicals, especially in Europe.
   - As the result of the tax deal for US corporations, an asset rotation (out of technology in favor of the old economy) started in the first weeks December 2017. That process continued in January 2018.

6. **Interest Rate**
   - The Fed started the interest cycle in autumn 2017. Wage inflation was relatively high for the 3rd consecutive time. Inflation related to energy is absent now, but it can be expected that the new FED Chairman will increase interest rates 3 times in 2018.

7. **Credit risk**
   - In late 2017, the credit cycle has reached maturity; given this, credit spread began to increase. Yet, further deterioration would be required to signal the start of a possible recession.





Key concerns

We have identified at least 12 known potential sources of risk that could impact the market in 2018 and beyond. In addition, issues that are not yet considered as potential sources of risk will be added to the list.

Breakdown in US industrial activity

Possible consequences:

- Renewed US stocks market consolidation
- EUR appreciates strongly
- Yield curve steepening

Sharp rise in commodity prices, and in particular, energy

Possible consequences:

- EUR GDP underperformance
- General risk-off by investors
- Yield curve flattening

Revival of the Philips curve (core inflation up)

Possible consequences:

- Term premiums up
- Yield curve steepening
- Debt (Gov't, Corp., and Private) sustainability issues

Re-Introduction of custom tariff/trade war:

Possible consequences:

- Disruption of industrial activities across the globe
- Higher prices for consumer staples
- Stock market corrections (based on lower EPS expectations)

Increase in HY credit spread and subsequent increase of default rates

Possible consequences:

- US stocks down
- Wider credit spreads for HG issues
- Volatility up

Downturn in Chinese economic activity

Possible consequences:

- Emerging market downturn
- Commodity prices down
- Forced liquidation of US Treasury, accompanied by a weak USD

Unexpected increase in US public deficit and sudden increase in twin deficit

Possible consequences:

- Term premiums up
- US downgrade
- Weak USD

Outlook 2018

1. Economy 4.0

The word 'Robot' was coined by the Czech science-fiction writer Karel Capek in the 1920's: since then, they have captured the imagination of mankind for almost 100 years. Today, we are on the verge of intersecting science fiction and reality, as advances in robotics, artificial intelligence, cloud, automation and machine learning look to significantly alter the current economic landscape.

The developments in robotics and automation are facilitating rapid change to traditional business models, capital flows and the role of labor in the new '4.0' economy. Historically, robots and automation were relegated to repetitive and menial tasks with limited flexibility and high cost implications. Indeed, in the 20th century machines have mainly alleviated dull simplistic activities, relieving humans of routine and mundane chores. In the 21st century however, we expect them to significantly substitute low skilled job functions and replace cognitive processes, making tacit judgments that could soon outperform human performance.

McKinsey sees robotic automation raising global productivity growth by 0.8 to 1.4 percent annually. Approximate 70% of all our occupations have at least 30% of constituent activities which can be fully automated. Accordingly, more than half of the work activities performed by today's labor force could be automated by 2055. The way in which this manifests is of course an important consideration for global economic growth and consumption patterns but it is our base case that the implementation of robotics will be net positive in terms of macro-economic development.

Investment solution:

Investing in robotics and automation is participating in a long-term secular growth trend. Yet, product life cycles are short and as we go onwards, they become even shorter. We believe that these investment opportunities are for real, so no hype, and provide real upside potential for investors. IIOT translates into real and very immediate applications that improve industrial processes of any kind into higher productivity, better product quality, and it empowers end consumers.

Most sizeable opportunities can be found in the subsector of "connectivity" as about 60 % all innovation related to Economy 4.0 takes place there. We cover this investment opportunity with our certificate [quoted under CH33226567].

2. Americas

The economic activity in the US is still robust and there is no recession in sight. The length of the present business cycle is longer than on average; there are multiple reasons for this: a) supportive monetary policies, b) business cycle is in synch with the rest of the world, and c) tax deal is supportive for ongoing spending and capex. The prospect of rising interest rates is generating an increasingly negative sentiment toward the consumer staples and discretionary sector, utilities, and ultimately REITs (as sub-sector).

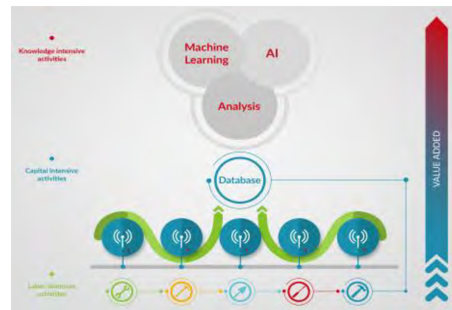
While monetary tightening cycle has started, overall financial conditions are still highly supportive for further share buybacks and M&A. In the recent months, credit growth has experienced a stop. The weak numbers are mainly due to post-hurricane bounce, reconciliated figures though point downwards. Higher commodity and energy prices are broadly positive for industrials and capital spending; one of the largest industrial areas for capex is the oil and gas industry. The raise in core inflation is not a concern. Finally, we note that the revised EPS growth for 2018 is now set for a whopping 17 %.

Investment solution:

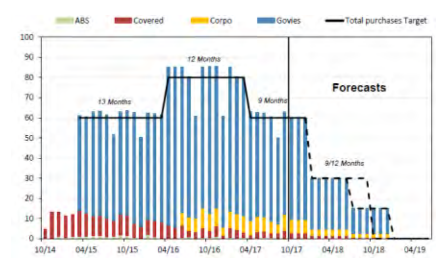
- Higher commodity prices: Deere (agri equip.), Cummins (duty trucks and engines)
- Aerospace: Boeing and Honeywell (specific industrial engineering and construction)
- Energy: Baker Hughes, Apache, and Schlumberger (higher energy prices result to higher capex, which should lead to higher future revenues).

Robotics: Number of robots to increase by up to 20 % p.a.

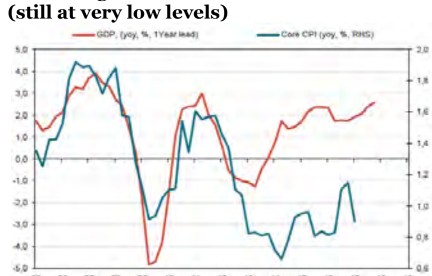
IIOT – Value creation segments



ECB: Step-by-step QE ending



EU: GDP growth and core inflation rate (still at very low levels)



3. Europe

Industrial production growth strengthened during entire 2017. Yet, a weaker consumer sentiment and a stronger Euro prevented the markets taking advantage form the solid foundations. At present, consumer sentiment is again decreasing which ultimately will impact consumption growth.

Eurozone's political arena is still vulnerable and regional issues will keep generating the kind of uncertainties markets do not like. Consequently, the peripheral discrepancies are set to increase. We think that the expected monetary plan was well communicated and that there is no evidences for any kind of surprises.

With global organic top line growth depressed, balance sheets strong and financing costs at historic lows, companies are looking for external growth. Investors can benefit in two ways. A) M&A: potential targets offer an attractive premium in the event of an actual takeover. B) Follow-through impact: some companies have already announced acquisitions; they should be able to provide an above-market earnings growth based on exploiting cost synergies as well as revenue/distribution synergies.

Eurozone core inflation should accelerate as of March 2018. This because of higher base effects, i.e. energy and commodity prices. Give the rather mixed input the revised EPS growth for 2018 is now set for around 10 %.

Investment solution:
- IIoT: ASML (Economy 4.0),
- Empowering Consumers: Adidas, Kering, Volkswagen
- Materials: Covestro AG, and DSM
- M&A: E.On, AMSL, AB Inbev

4. Asia

Emerging markets have shown surprisingly solid economic growth figures, in particular China. In other areas of EMA, industrial activity is less progressing. The BoJ is expected to continue a "yield curve control" with the aim to weaken to JPY while at the same interest rates should rise.

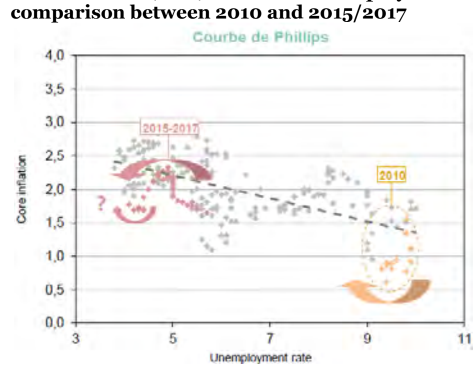
In terms of stock market valuations, the EM rerating has just about started. Further appreciation can be expected as valuations are just in line with the historic average. This is supported by the fact that USD is depreciating, and USD EPS have benefited from better economic prospect (raising commodity and energy prices). Emerging markets are attractive because they remain undervalued by about 30 % versus developed markets; this present situation is particularly attractive as EM economic growth is well above average.

The main risk for EMA is China; while the market appreciates the political changes (more of the same under prolonged mandate of Xi Jinping), the fact that most SME are lacking profitability is questionable and this isn't a save strategy to pursue over term. Yet, CPOC is addressing the issue through disguised wealth taxes, but is this wealth transfer sufficient over time?

Investment solution:
- While investing in EMA is still unpredictable, there are a few opportunities which benefit from a dual investment structure: DM and EM. While developed market companies offer a better investor protection, emerging markets have a higher upside potential than DM. Product XS1677440361 is reflecting this in full.

- **Investment Idea** The credit linked note reflects the performance of the reference debt (senior) of Bombardier Inc, due January 2023. The equity part is linked to the performance of the South Korean, Taiwanese, and Australian stock markets (equal allocation). The performance participation is at 121 %. During the life-time of the product, there is not market reallocation.

US: CPI (core) and unemployment: comparison between 2010 and 2015/2017



The dawn of a new era

Global trade volumes on the rise and according to WTO; available statistics and estimates stipulate that they are expected to progress solidly well into 2020/2023. For 2018, the IMF expects a global GDP growth of 3.7 %.

In fact, ever since 2006, the world merchandise exports have increase in value by more than 32 percent. At the same time, the value of manufactured goods has increased by 37 % and the value of agricultural products has gone up by 67 %. The exception to these increases were energy and mining products; while volumes produced remained about the same, the decrease is due to lower unit prices.

This flow of goods and services is due to numerous free trade agreements; ultimately benefiting all of us! The triggering of new a trade war and protectionism by the US administration makes great headlines but ultimately are hardly any news as these taxes are on two merchandise the US imports very little: i.e. steel and aluminum. Yet, there is room for concern because trade barriers weren't solely implemented by the US.

First of all, let's mention that comparable past US initiated trade distortions were lifted relatively quickly, because they were based on unemployment concerns: Today, the implementation of tariff barriers is based on section 232 of the trade law. In this context, the application is making valid national security. The purchase of Qualcomm by Broadcom (based in Singapore, but initially it was a US based company) was stifled off with the same mind-set, i.e. "America first".

Should we be surprised by this call? No not really, because China maintains a protectionist measure too. For instance no foreign company can set-up freely a branch in China. When doing, western companies are required to associate a local company to the project and to transfer key technology to that dummy unit. So, when Xi Jinping promotes a "China First" policy, the rest of the world deals with it, whether we like it nor not, but it is being done. We can take this same development to another region. Let's look at Russia: President Putin got reelected mid March and whatever he did undertake during the last mandate was characterized by "Russia First", possible sanctions of any kind or not! By the way, western companies did continue to do deal with Russia, because end-users depend on their energy resources.

Finally, we can study Brexit. The decision to exit the trade agreement with the Members of the European Union is being interpreted as a protectionist stance vis-à-vis of Europe, the free trade union, and the free movement of people and goods. Apparently many British people think that "Britain forever" is superior to the well being of all nations.

So, are we moving towards a new societal and economic era?

In industrialized markets [also known as developed markets (DM)], the progress of increased productivity has declined ever since 1990. Increased trade restrictions coupled with other kinds of barriers might just become opportune to unlock a stagnating industrial development in DM. Innovation in many sectors could result in streamlining process flows, improve workflows and ultimately increase economic resilience towards external factors.

More importantly, the newly developed technologies empower end consumers in many ways thereby circumventing trade barriers and idealistic thinking of a minority. Therefore, focusing on companies with algorithmic models in the B2B and B2C customer facing roles is probably the new business model to pursue and to invest in.

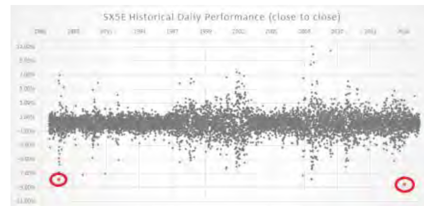
Investment ramification

Our asset allocation is exposed to new technologies and in particular to IIOT (industrial Internet of Things) ever since May 2017. The certificate "Digital Age Transformation" [quoted under CH33226567] is investing in leading companies in the technology space. Ever since the certificate was launched, it has outperformed the main US index. As of March 20, 2018, the outperformance is 6.24 %.

US: The impact of the tax deal, ISM is up!
Estimates suggest that, as a result of the full implementation of the tax deal, GDP will grow by 1 % annually while public debt will increase by 5 %.

The brilliant plan of the US administration[1]

The US administration's brilliant plan is as follows: the United States implements an expansionary fiscal policy (corporate tax cuts, increase in public spending on the military and on infrastructure). The United States' "twin deficits" (fiscal and external) that will result from these measures will be financed at low interest rates by the savings surplus from the Euro zone, Japan, China and other emerging countries. It is therefore savings from the rest of the world that will finance the increase in US corporate earnings and public investment, thanks to the ability of the United States (and the Treasury market) to attract global savings. Instead of these savings financing growth in countries where they appear, they will therefore finance growth in the United States.



The catch 22 for the rest of the world ...

For this brilliant plan to fail, investors (public, such as central banks, or private) would have to refuse to invest more in dollars, and the dollar would therefore have to lose its reserve currency status. If this happened - and we cannot see this happening at present - the policy conducted in the United States would lead to a drastic depreciation of the dollar. Obviously and in the absence of any valid alternative, no-one wants this to occur.

.. but is it any good for America?

Given the above, the US has the supremacy of upgrading its infrastructure and this was acknowledged and largely made public by the present administration. No other President before that has made such strong statement in favor of a much aging infrastructure. In fact, the average age of the US infrastructure is around 25 years, for highways and roads it is well above 30 years.

Yet, a recent decision by the Congress is a game changer. Because of the tax cut and the sizable higher deficit associated with this, there are now fewer funds left for financing infrastructure projects. In other words, if the US infrastructure plan is being executed, it will relay even on a higher degree of foreign financing. It is estimated that Federal funding dedicated to infrastructure may reach just about USD 200bn, plus about USD 50bn for Rural America. Provided the plan is executed as designed, this should trigger total investments in the region of about USD 1.25 trillion.

The Trump administration stipulated that it will lift traditional barriers in this kind of business, i.e. operators should seek efficient developments and appropriate management. While more flexibility, for instance for transportation project that have minimal Federal funding, is a good thing, is the remaining all good? We duly note that when public activities are transferred to the private operators, profit primes over quality and service and we wouldn't expect that to change in the liberal thinking Americas.

Investment ramifications

Infrastructures projects are, by definition, work and capital intensive. But we tend to shy away as they generate little to no value add into investment system we project. Incidentally, infrastructure companies are highly-indebted utilities and as interest rates are rising, the weighted average cost of capital becomes more expensive. Additionally, the credit quality of these companies, because of a higher leverage, will be reviewed negatively too. So, there is little value for bond and equity investors.

[1] Content taken over from Patrick Artus, Chief Economist, Reseach Natixs

Strategy matters

The U.S. oil industry is pumping, by means of On- and Offshore platforms, traditional oil rigs as well as fracturing. In short and according to recent report issued by IEA[2], the oil industry is putting the country on track to surpass Russia as the world's top oil producer as soon as this year ends.

The basis for these developments started in the early years 2000s, when advances in hydraulic fracturing, or fracking, and horizontal drilling techniques in the U.S. made accessible huge reserves of oil – and natural gas – deposited in shale rock formations. In contrast to the traditional exploration techniques, the fracturing can process any oil density (from low to high). Based on this, U.S. energy producers were suddenly able to access giant oil field of low density that they hadn't been able to exploit before. In simple terms, it was technically possible but the cost/return ratio was prohibitive.

With the economic downturn in 2008, oil prices crashed along with global markets. The subsequent years spelled fortune for US oil companies. There were: a) sanctions against Iran in 2012 in response to that country's nuclear program, which hampered Iran's oil production and exports; and b) sanctions against Russian oil executives, banks and energy firms in 2014 in response to the Kremlin's invasion of Ukraine. This was restricting Russians' ability to get capital and equipment for exploration and production. In this run-up, benchmark prices for crude went from around USD 25/30 to USD 110 and back to USD 40 two years later.

The drop in prices forced hundreds of U.S. shale oil producers to take their rigs offline – shale oil is more expensive to produce than traditional oil drilling. Eventually, those lower levels of production allowed prices to begin creeping back up, from less than $40 in 2016 to more than $60 this year. OPEC also reached an agreement in 2016 to set production limits, helping further stabilize prices, even as sanctions against Iran were lifted, allowing that country to begin putting more oil back onto markets.

According to the IEA, the U.S. production alone made up for 60 percent of the production cuts under OPEC. The projection issued last week by the IEA about the future of U.S. output – which included record levels for April – makes official what a range of market analysts and industry experts had increasingly predicted in recent years.

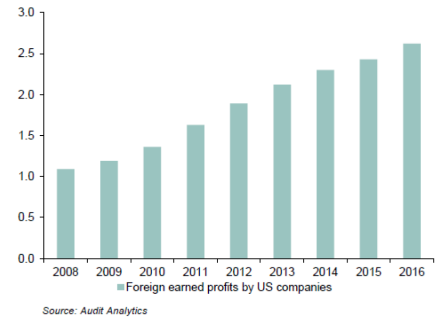
Yet, one thing has become obvious: Investment in the energy sectors will remain highly attractive, but it is a little more volatile. Advised investors can obviously take advantage of this new paradigm.

Investment opportunity:
The part of oil produced by non-OPEC countries (lead by the United States, Russia, Brazil, Canada, Norway, Nigeria, Angola, etc) could change the parameters for the oil market in the coming years. Given there are new players in the market, one can expect that investment opportunities in the energy sector will become more volatile than in the past. On the other hand, the energy sector offers historically one of the better risk/return opportunities and we believe that this will remain so because of the above average long term ROI figures. The question then is how to invest into a more volatile market while maintain investment abreast from higher volatility.

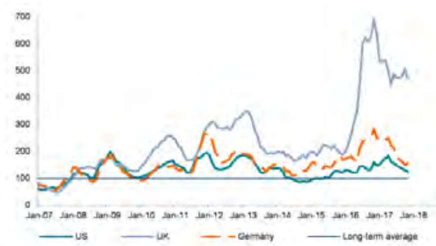
There are two options to address these uncertain market conditions:

a) You conduct a passive investment strategy and expect the market to perform side-ways: > **a bonus certificate appears to be opportune** (based on a larger market segment like an index, or similar). At maturity, you will get the market performance plus a conditional bonus payment.
b) You expect the market to remain highly volatile, but with a tilt to the upside > **a monthly callable express certificate**, yielding in the region of 10 % to 15 %, could be opportune. Repayment structure: a) early redemption: Nominal value plus coupons, b) at due date: Nominal value plus coupon provide barrier has not been observed, or c) repayment of nominal value exercised at barrier level.

US: The impact of the tax deal, the ongoing of the share buy-back program
During the past years, foreign earned profits have constantly increased. The tax deal favors the repatriation of foreign held profits. Consequently and the absence of valid investment opportunities for corporations, shareholders should benefit by means of higher dividend payments and ongoing share buybacks programs.



Economic uncertainty has eased in the US, Germany, and in the UK.
Because of Brexit concerns, economic uncertainty remains particular high in the UK.



Financial conditions have improved too

What are our preferences?

2 International Energy Agency

Key takeaways for 2018

General:

1. Interest rates on the rise in developed markets
2. US-driven economic cycle to continue (based on tax deal and share buybacks fully supportive)
3. QE to be reduced to the lowest possible level in G-7 nations
4. Inflation likely to stay below expected levels
5. Possible trade war initiated by the US administration; destroying confidence in the established system

Americas:

6. Three interest rate increases in 2018 and at least two in 2019
7. Tightening financial conditions and drag on the economy could lead the FED to reverse the intended course of action
8. US Equities appear to be expensive; share buyback generate some kind of self-entertained value appreciation of around 10-12% per annum
9. Consensus view is that GDP growth is over-estimated (tax reform special effects are most likely trigger-based)
10. USD is expected to lose some of its present attractiveness, in favor of EM currencies
11. US companies will expand EPS by about 17 % in 2018

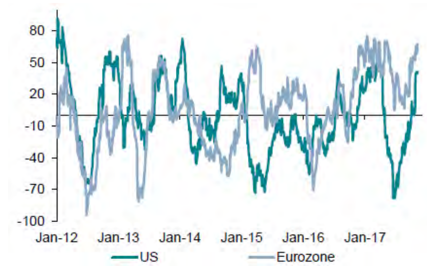
Asia:

12. China's industrial production to slow down after surprisingly solid economic expansion, particularly in China
13. Global investors have consistently underestimated the Chinese government's ability to control events through regulation. In this respect, we believe that financial leverage is well managed and that bad debtors will be cleaned out in a smooth manner.

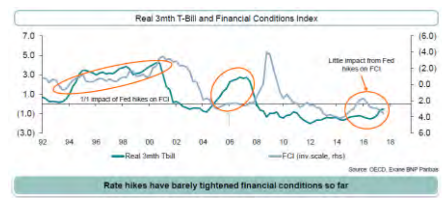
Europe:

14. European recover fully underway now,
15. Industrial production growth is excellent (PMI is at peak levels),
16. Unemployment rates are decreasing across the continent,
17. Wage growth is on a positive track and consumer sentiment is stable,
18. Strength of EUR is preventing the industries to overheat,
19. Macro indicators point to an even stronger €/$ (targeting 1.35 in 12 to 18 months)

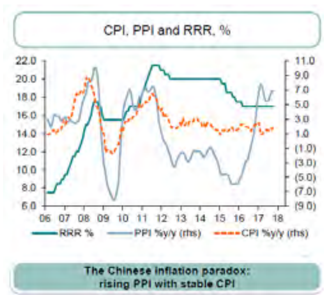
Leading indicators continue to make progress:



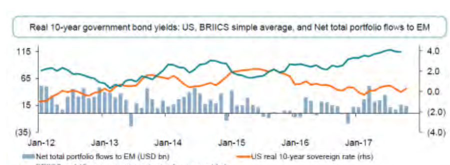
Little impact seen by tightening financial conditions



China: CPI and PPI, a surprising development



EM: The asset flow to EM will continue as the yield differential is at historic high levels.



Sector Analysis

Basic Materials

A bullish scenario is in the making for the material sector. According to research data obtained it can be concluded that material prices are at a sustainable level and that sector can generate higher EPS, ROI, and Free-Cash flows on increased efficiencies. We do see substantial investment plans across many subsectors. They are well perceived by market participants as net financial gearing are at historic low levels (for instance net debt/EBITDA is now below 0.5x). Despite this a good number of companies do trade presently at a discount to their mid-cycle valuation. In some cases, the discount is as big as 50 % which clearly reflects investors' concerns about a possible no re-rating. One major obstacle for the re-rating is that the sector is altogether capital- and work intensive which is a handicap in the eyes of many market participant

The sectors key drivers are:

- Demand is good - slightly weaker from China, but offset by Europe and the USA
- Peak capex was in 2012/2013 and this input starts now materializing, as the sector is not shifting back to a growth model
- The next capex cycle is still far away, and if so, it will take another 3 to 5 years to convert a Greenfield project into sustainable output facility.
- The rate of inflation is raising and this is translating into base prices. So ultimately, sales volume will increase while op-costs are expected to remain stable.

Investment opportunities:

Chemicals:	Air Products, DSM
Metals and Mining:	Glencore, Anglo American
Construction Materials:	Sika

Consumer Staples

The sector is reorganizing itself. Companies have strong balance sheets, low financing costs, and focus on portfolio optimization. Because of this, we think that this sector is due for full and complete M&A cycle. Other self-help strategies to improve ROE and ROI for companies are available and they consist mainly in return cash to investors via share buybacks.

The sectors key drivers are:

- Operational profit to increase by around 10 % in 2018
- EPS growth is expected to be in the region of 12 % to 14 % in 2018
- Op-profit and EPS growth to be driven by EM, as DM are mature markets
- Marketing spend does not always translate into better sales
- Private label products to become the real alternative for consumers
- European companies are the main beneficiaries from better EM conditions
- Companies which have engaged in efficiency improvement strategy are expected to deliver higher EPS growth
- Investors seeking attractive dividend strategy are advised to consider the Tobacco sub-sector.

Investment opportunities:

Tobacco:	Philipp Morris, Imperial Tobacco, BAT
Beverages:	AB Inbev, Heineken
Personal & Household Products & Services:	L'Oreal, Unilever

Key figures for Europe:

Target values:

Present fair value (DJStoxx600): 390
E12 months value (DJStoxx600): 445
Upside potential: +14%

Key economic ratios:

P/E 2017 (E):	15.7
P/E 20178(E):	14.3
Div. Yield 2017:	3.1
Div. Yield 2018:	3.3

Most likely next short-term move:

DJStoxx600	flat/down
DJStoxx50	flat/down
SMI	flat/down
DAX	flat/down

Key names to look at:

Strong intellectual property:
- Roche
- Novartis
- Amadeus

High competitiveness:
- Siemens
- Daimler
- Gemalto
- Richemont
- Swatch

Sustainable dividends:
- ABN-Amro
- Imperial Tobacco
- Altria
- Philip Morris

The self-executing re-convergence supporting a positive stance for material sector.

Technology

For the last five years, the technology sector has been the market darling. Tech shares have outperformed the larger market. This development was possible because previous earnings growth was de-rated; expressed in different words, the growth potential of the secular growth trend covering IIOT was underestimated my the market. In addition, the IT sector company's benefit from healthy balance sheets, excellent refinancing conditions while doing M&A. Finally, IT stocks started paying out dividends, which in turn attracted even more investors.

As time has advanced, the risk-reward tradeoffs normalized and at present the IT company's valuations it at its highest level in nearly a decade. A moderate valuation premium is still warranted given the good number of secular growth drivers which will enable these companies to continue to show solid fundamental key figures and above above-average earnings growth.

For the short-term, we do see some negative drivers; for instance the smartphone market is experiencing a solid oversupply and more importantly, as outlined by the tech research group Gartner, sales of smartphones have declined in the first time during the 4th quarter 2017. There are two possible reasons for this: Firstly, during the last decade, the average product cycle time has been reduced to a few months, if not in some cases, weeks. Now, the speed of valuable innovation appears to have reached its peak level. Secondly, to leverage up on new consumption, end consumers need to be able get the "experience" of the new technology embarked on an application – yet, there are no really new fascination elements which were on boarded. Hence, end consumers show more and more a stiff reluctance to change or upgrade applications.

Investment recommendation:
US software companies have a dominant share of the global technology marketplace. Short-term opportunity can be identified in the cloud computing and an in particular on cybersecurity. Longer-term investors should focus on e-commerce, and the nascent companies covering artificial intelligence and virtual reality.

Investments focused on short-term trends: ETF PureFunds ISE Cyber Security ETF, First Trust NASDAQ Cybersecurity ETF, Cyber-Ark Software Ltd
Investments focused on medium to long-term trends: IRISOS Digital Age Transformation [CH33226567], Nvidia, Hyundai Robotics Co Ltd, Keyence Corp. Asia Optical Inc, Zebra Technologies Corp.

Energy

The recent strength in Brent brought prices back into a « normal » range which many see as «sustainable» for medium term forward. Investors remain cautious and inevitably there will be some volatility. But if companies remain disciplined and drive efficiency on both costs and capex, the sector should see a period of significant cash flow growth.

The sectors key drivers are:

- Op. leverage kicks in for the first time since 2011 : net margins +70bps/12mths
- Companies re-gear balance sheets
  - back in 2010, EU and US had the same leverage at 50% net debt/equity. Since then the US has risen 18ppts, Europe has stayed flat.
  - IG Corporate bond yields iare around 1% vs. European div yield is around 3.5%.
  - Buyback yield stayed at 0% in 2009-2016 while 2018 is expected 0.5%.
  - IG issuance is expected +8%
- Capex set to come back
  - Pick-up in 2018 after capex to sales at a 30 year low.
  - Rising percentage of firms planning to increase capex +31% of European industrials
- M&A (Europe is running 30% below the US), US investors come back (net sellers in the last 3 months), EU fiscal boost

Investment call: Total, Eni, Royal Dutch

Key figures for USA:

Target values:
Present fair value S&P 500: 2675
E12 months value S&P 500: 2850
Upside potential: +6.5%

Key economic ratios:

P/E 2017 (E):	20.1
P/E 2018 (E):	18.2
Div. Yield 2017:	1.9
Div. Yield 2018:	2.0

Most likely next short term move:
S&P 500 down
Nasdaq down

Key names to look at:

Strong intellectual property
- VISA
- Mastercard

Technology:
- Microsoft
- Micron Technology
- Nvidia
- Apple
- IBM

Financials:
- VISA

Financial Services

The landscape for banks is changing. The backdrop for financials remains highly positive. The combination of global economic growth, higher wage rates, higher interest rates, and stable to easing regulatory requirements help improve overall profitability. We consider the US tax deal as neutral for the sector as most major companies still benefit in some manner or another from tax arrangements and that as a consequence of the 2007/2008 FC. Over term, the banking landscape is subject to some considerable changes; the expectation for higher growth and a better ROE will be impacted by a) below average economic growth, b) economies of scale through digitization for which banks are lacking preparation, and c) the threat of disintegration (some banks considered "too big to fail" could be requested to split).

- **Lower economic growth** continues to put pressure on institutions. While general industries take advantage of fiscal stimuli to boost economic activity, the effectiveness of these efforts does not translate into the financial sector. If low economic growth continues, banks will find it hard to increase revenues organically, especially through deposits and lending.
- **Economies of scale**: Banking was once a local scale game: more branches led to higher share of deposits. Digitization is annulling this equation. If banking follows the glide path of general industries, banks that excel at digital brand building, advanced analytics, and machine learning will see outsized gains in customer experience, revenue, and efficiency. But for the time being, this infrastructure is absent at most institutions we looked at. Before taking advantage, the sector must invest heavily in infrastructure, which they have unable to perform up to now because of solvency requirements.
- **Advances in technology** and changing customer expectations are leading to the collapse of the traditional banking value chain and the emergence of an integrated-network economy comprised of "ecosystems". Because of these fast arriving changes, the regulators may impose splitting bigger banks into smaller units (no "too big to fail" units) which are fitter to adapt to changing conditions.

Investment opportunities:
Diversified Institutions: Visa, MasterCard
Banks: Bank of America, BNP Paribas

Consumer Discretionaries

The 2017 holiday season was the best since 2012 – these good results occurred on the back of positive consumer sentiment, low unemployment figures, and raising wages. This overall trend should remain in place, in particular in the US where the employment market shows one of the best readings ever since 1960. More importantly, while the average household in Europe was a net creditor (even during the financial crisis), the average US household wealth is now reaching the break-even point, the first time since this beginning 2000. Based on these good fundamentals, further sales volume growth can be expected for companies in the sector.

While much of the positive news-flow for sector occurs in connection with Amazon, we look at an above average earnings pick-up across the entire sector, which is mostly unrecognized. More specific comments re the sector include:

1. A lower tax rate will increase purchase power
2. Low to middle class income consumer have had the best wage-pickup
3. Valuations are attractive
4. Short interest is elevated compared to other sectors.
5. Above average wage inflation could lead to acceleration in inflation. If so, the Fed would be forced to raise rates more often than expected and therefore household costs for credit and loans would hit discretionary spending.

Investment call: Nike, McDonalds, Walt Disney Co., Adidas, Kering, Swatch.

Key figures for Asia:

Target values:
Present fair value MXAPJ: 694
E12 months value MXAPJ: 750
Upside potential: +8 %

Key economic ratios:

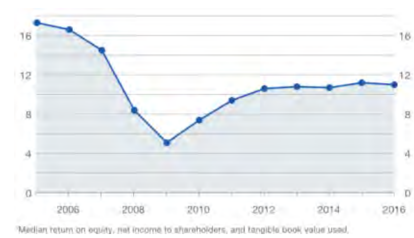
P/E 2017 (E):	14.4
P/E 2018 (E):	12.8
Div. Yield 2017:	2.4
Div. Yield 2018:	2.5

Most likely next short term move:
MXAPJ down

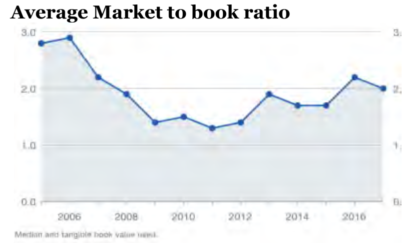
Key names to look at:

- Tencent
- Alibaba

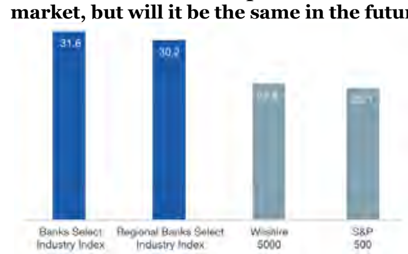
Average ROI of Banks recovered but remains stable!



Average Market to book ratio



The financial sectors outperformed the larger market, but will it be the same in the future



Industrials

Artificial intelligence will soon change how we conduct our daily lives. Are companies prepared to capture value from the oncoming wave of innovation and how companies in the industrial sector respond to the new requirements?

Within AI, deep learning (DL) represents the area of greatest untapped potential. This technology relies on complex neural networks that process information using various architectures, comprised of layers and nodes that approximate or replicate the functions of neurons of a brain. Each set of nodes in the network performs a different pattern analysis, allowing DL to deliver far more sophisticated insights than earlier AI tools. With this increased sophistication come greater needs for leading-edge hardware and software. As AI is still nascent, a clear recipe for success with AI has not emerged.

Findings suggest that industrials facing end-consumer space are most advanced. Despite much hype about AI, no real industry standard has emerged; this is a major handicap for clear-cut investment decisions. In turn, investors are advised to consider multiple technologies and on multiple companies.

Our core beliefs about the future of AI with industrial applications are:
- Initially, most value will be capture by end-consumer facing companies,
- Industrials which can implement numerous microverticals will be part of major enablers and winners,
- Industrials must develop and manage their company specific end-to-end solutions (throughout all nine levels – for full details see graphic: AI has 9 discrete layers),
- Industrials need to embrace SAAS business models as most value will come services and software solutions implemented on hardware.

Investment call:

Based on the above analyses, we observe that a good number of industrials have engaged in the AI process. From the enclosed table Future AI utilization ratios and benefits, we note that Industrials are not only part of the industry group that have the highest requirements, but also, they are in the group that generates and derives the highest benefits from it. Yet, only a limited number of companies out of this category are ready to embrace AI related solutions; at present one of the key enabler is the automotive industry. For producers of AI products and services, this means that value capture will be staggered, with some industries initially producing higher returns than others.

Investment opportunities:
- Individual holdings: a) Deutsche Lufthansa AG, b) Hollysys Automation Technologies Ltd, c) Caterpillar Inc, d) Mitsubishi Corp
- Global investment opportunity: a) Digital Age Transformation [CH33226567]

Healthcare

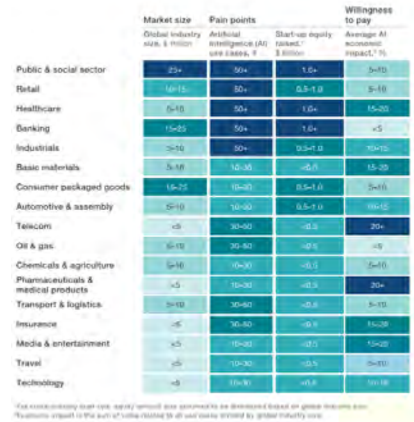
Healthcare is a dynamic industry with significant opportunities; however, uncertainties in the field of R&D, and the complexity to get new molecules approved can also make it a highly vibrant and hazardous investment opportunity. A successful product launch can unlock substantial upside value, while a failure can destroy much of a company's value.

Yet, across the globe the intrinsic demand for healthcare (services and products all inclusive) continues to rise. This is supported by two major secular trends: a) the population in developed markets is aging and therefore is requiring better and more specialized end-live therapies, b) in developing markets, there is an increasing demand for entry-level treatments and basic prevention. Given this, most healthcare companies are initiating business opportunities along these long-term dynamics the healthcare sector. This is opening up in turn significant investment opportunities.

Yet, more importantly, consumers, employers, and the government continue to see the financial burden of healthcare grow faster than their incomes or revenues – that handicap will not disappear any time soon. The industry is therefore in a state of flux; because of this, existing market entry barrier are getting lower, which in turn opens up opportunities

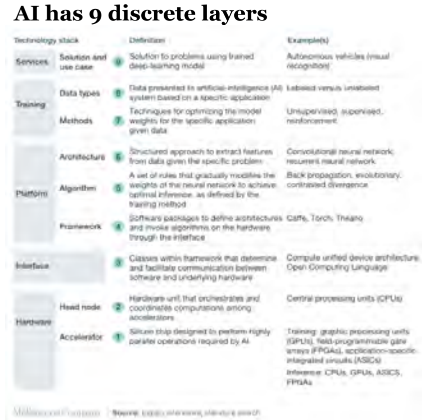
Early adopters versus followers: Industrials are leading the way

Future AI utilization ratios & benefits: Industrials have high requirements



	Market size	Pain points		Willingness to pay
	Global industry size, $ trillion	Artificial intelligence (AI) use cases, #	Start-up equity raised, $ billion	Average AI economic impact, %
Public & social sector	25+	50+	1.0+	5–10
Retail	10–15	50+	0.5–1.0	5–10
Healthcare	5–10	50+	1.0+	15–20
Banking	15–25	50+	1.0+	<5
Industrials	5–10	50+	0.5–1.0	10–15
Basic materials	5–10	10–30	<0.5	15–20
Consumer packaged goods	15–25	10–30	0.5–1.0	5–10
Automotive & assembly	5–10	10–30	0.5–1.0	10–15
Telecom	<5	30–50	<0.5	20+
Oil & gas	5–10	30–50	<0.5	<5
Chemicals & agriculture	5–10	10–30	<0.5	5–10
Pharmaceuticals & medical products	<5	10–30	<0.5	20+
Transport & logistics	5–10	30–50	<0.5	5–10
Insurance	<5	30–50	<0.5	15–20
Media & entertainment	<5	10–30	<0.5	15–20
Travel	<5	10–30	<0.5	5–10
Technology	<5	10–30	<0.5	10–15

AI has 9 discrete layers



Technology stack			Definition	Example(s)
Services	Solution and use case	9	Solution to problems using trained deep-learning model	Autonomous vehicles (visual recognition)
Training	Data types	8	Data presented to artificial-intelligence (AI) system based on a specific application	Labeled versus unlabeled
	Methods	7	Techniques for optimizing the model weights for the specific application given data	Unsupervised, supervised, reinforcement
Platform	Architecture	6	Structured approach to extract features from data given the specific problem	Convolutional neural network, recurrent neural network
	Algorithm	5	A set of rules that gradually modifies the weights of the neural network to achieve optimal inference, as defined by the training method	Back propagation, evolutionary, contrasted divergence
	Framework	4	Software packages to define architectures and invoke algorithms on the hardware through the interface	Caffe, Torch, Theano
Interface		3	Classes within framework that determine and facilitate communication between software and underlying hardware	Compute unified device architecture, Open Computing Language
Hardware	Head node	2	Hardware unit that orchestrates and coordinates computations among accelerators	Central processing units (CPUs)
	Accelerator	1	Silicon chip designed to perform highly parallel operations required by AI	Training: graphic processing units (GPUs), field-programmable gate arrays (FPGAs), application-specific integrated circuits (ASICs); Inference: CPUs, GPUs, ASICS, FPGAs

for disruptors to dislocate existing providers. Here are the areas they can occur:

a) Major tectonic shifts can occur, not only in regulations but also in three other areas: a) technology (both medical science and technology and the onward march of big data, advanced analytics, machine learning, and digital), b) industry orientation (the move toward B2C and rapidly rising consumer expectations), and c) reallocation of risk across the value chain. These forces are fundamentally altering the structure of the industry and basis of competition.
b) The available headroom for improvement in healthcare is huge. Solely for the US market, the most modest estimates make valid saving in excess of USD 500 billion out of a global cost of USD 3 trillion (cost savings rates; low: 16 %, medium: 21 %, high: 36 %)

In recent years, venture capital activity in the healthcare industry largely focused on solutions that create shareholder value in one of three ways: by delivering productivity improvements, enabling improved care quality and outcomes, or supporting member-centric care. Almost all targeted companies were providing in subsequent quarter's stronger EBITDA growth; provided these efforts can be kept up over a prolonged period of time, investors will be able to participate in a more general manner because what was beneficial for a few will become an industry standard.

Investment call:
Investing in dislocators can be opportune but it is riskier than the average healthcare investment. Out of 41 companies that required venture capital funding between 2010 and 2012, 13 companies went into IPO and got acquired at a later stage by a major player. Based on the issue price, the premium paid by the acquirer exceeded on average the 200 % mark. Similar ratios are available for the period of 2007 to 2009. Given the high level of investment activity in the field of healthcare technology during 2015 and 2016, one can consider that a repetition of the past results could occur. Investing in dislocators is replicated through our Digital Age Transformation strategy. The investment opportunity is available through CH33226567.

Utilities

Utilities had a difficult start to the year, down in absolute terms and underperforming the average market. The main reasons were, firstly, lower wholesale power prices due to declining commodity prices, and, secondly, rising bond yields. Historically, regulated utilities do underperform the market when interest rates are rising. As this trend will continue for the quarters, potentially even for the next couple of years, utilities are expected to continue to underperform the larger market.

Longer term considerations: Stakeholders in the electricity-utility industry face challenges that have been building for years. As electricity supply and demand evolves, they must rethink the fundamentals of cost allocation, customer value, and rate design. The decisions they make will have major implications for investments in the grid and utility operations for years to come. They will also have a huge impact on relationships between providers and millions of customers who want more choice, convenience, and control.

The present sectors key drivers are:

- Utilities are capital intensive and therefore the average weighted cost of capital will increase as interest rates rise – we doubt that the economic model in place will enable utilities to close the gap. Therefore, these sector remains exposed to prolonged period with headwinds
- Output prices get more and more commoditized and therefore adding more volatility to the operators cash-flows
- Utilities still offer an attractive dividend yield of around 5 %.

Investment opportunity:
Over the past years, a strong focus on clean energy technologies such as renewables, smarter networks and smart customer solutions made available a number of opportunities. These opportunities are of particular long-term nature and investors who have the financial flexibility to invest in these trends should be rewarded with superior growth in the coming years. Yet, we can only stress that this market segment is still un-mature and requires substantial base knowledge of potential future technologies.

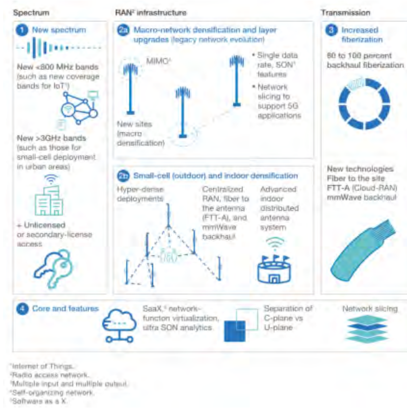
Telecommunication

The road to 5G - the inevitable growth of infrastructure cost! Only nine years after the launch of 4G, the sector is preparing for 5G. While each technology cycle brings new opportunities, it also requires greater infrastructure investment. To maximize their returns on 5G, the sector needs to understand how network infrastructure utilization ratios will look like and the associated cost base that will evolve over the next few years. When 4G was deployed, most telecom operators misunderstood this challenge and as consequence revenues dropped after the introduction. Will it be the same for 5G?

At present, there are still numerous operators that are struggling upgrading their network to 4G and more importantly, upgrading to 5G is being viewed at with resignation and considered as a mandatory move in order to avoid an immediate business exit. According to data available for European operators, we note that network-related capital expenditure will increase to 60 % between now and 2025 so that 5G can be enabled. This is about doubling up the total cost of ownership. More importantly, while the deployment of 4G was about uniform, the deploying of 5G will require much more fine-tuning and operators will be required to shift toward small-cell solution to satisfy urban capacities. That in turn will require a fully fledged and systematic fiberization of all areas where 5G should be available.

Investment opportunity:
Because of the inevitable increase in infrastructure deployment costs and uncertainties about the infrastructure utilization ratios, we are unwilling to make any active allocation into this sector.

5G will require massive investment across many network sections



Foreign exchange

Currencies

Higher US interest rate expectations and the possibility of a slight rise in political uncertainty in Europe are short-term headwinds for the EUR/USD to surpass the 1.20 barrier. All things being equal, the lower limit of the current and future trading range is around 1.15. At this level, we do see buying orders, as the monetary divergence between the US and the EU is already priced-in.

The Pound Sterling will remain driven by political developments and Brexit talks. In the event of a "soft Brexit" scenario, the GBP is expected to appreciate by around 10-15%.

Later in the year, the EUR/USD is likely to stabilize around 1.20 in reaction to several factors, notably:

- Still very weak core inflation (i.e., excluding energy and food)
- An accommodating ECB, that will result in interest rates to stay and below the US rates, this in turn stoking capital outflows by investors reaching out for higher yields
- Political uncertainties subsiding in the run-up to general elections (between March and May) for Italy, and in the creation of a strong coalition in Germany
- A likely build-up of long euro positions

In 2019, the EUR/USD can be expected to recover towards 1.25/1.30, once the market's attention shifts to the prospects of a tightening of the ECB's key policy rates, bearing in mind the Federal Reserve's monetary cycle will be nearly over by then.

The US trade barriers and the implementation of the prohibitive import taxes could shift economic attention to Europe and Asia which could accelerate the appreciation of the Euro.

Energy/Commodities

The annual increase in energy resources is around 2%; at the same time, new and better exploitation methods enable energy companies to meet this demand. Additionally, the present state of the shale production allows the industry to respond to new conditions relative quickly and this without the negative effects of mothballing a rig.

Therefore, for the time being, the barrel price should stay within a range of USD 55.- to USD 60.-.

Target values in 3 months:

EUR/USD:	1.1500 - 1.2000
GBP/USD:	1.3000 - 1.3500
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.25 - 1.30
GBP/USD:	1.20 - 1.30
USD/CHF:	1.00 - 1.05

Purchase power parities:

EUR/USD:	1.25
GBP/USD:	1.58
USD/CHF:	1.00
EUR/CHF:	1.25

Most likely next move:

EUR/USD	down
GBP/USD	down
USD/CHF	down

Target values in 3 months:

Oil:	$55 - $60
Gold:	$1,250

Target values in 12 months:

Oil:	$60 - $70
Gold:	$1,350

Upside potentials:

S&P GSCI	down
Oil	down
Gold	down

Next most likely move:

S&P GSCI	flat
Oil	flat
Gold	flat

Commodity related stocks:

IRISOS

Asset Allocation Preferences – April 2018

Sectors	Region	Fundamenta attractiv.	Risk/Reward	Investment case
Basic Materials	Americas Europe EM			The US administration initiated trade war isn't just a burlesqued action, ramifications go beyond what can imagine. If maintained, material sector is expected to suffer most, yet while we are in the early stage we keep monitoring progress. Longer-term stance remains positive given the ever higher number of people having access to consumption.
Consumer Staples	Americas Europe EM			Improved ROI and ROE occur due to self-helped strategies; this is leading to a new cycle of M&A or to cash-return (share buy backs) strategies for investors.
Consumer Discretionaries	Americas Europe EM			Based on a bottom-up scenario, Consumer Discretionaries are the main beneficiaries from the US tax deal as on the one hand a lower tax rate will increase purchase power and on the other side, the low to middle class has had the best was wage-pickup in the last decade.
Energy	Americas Europe EM			Up and down stream operators remain disciplined in terms of developing new projects; we note that there is also an absolute drive for higher efficiency. Therefore, the sector is expected to deliver significant cash-flow growth.
Financial Services	Americas Europe EM			Improving economic growth, across the globe, driven largely by still healthy US consumers, is set to provide a good backdrop for financial services stocks overall. Main beneficiaries to be found the segment of diversified financials as they benefit from the secular shift (online payments – framework which enables a capital optimization potential).
Healthcare	Americas Europe EM			Healthcare fundamentals are stable but relatively unexciting compared with more cyclical sectors, given our base case of synchronized global growth. We expect healthcare companies to generate mid-single-digit EPS growth in 2018, below the broader market. Better value can be found in start-ups and in companies with "market dislocating" strategies
Industrials	Americas Europe EM			Fundamentals are optimal for sector based capex. The last reporting cycle has confirmed the sectors engagement in this sense. Yet, this does not come as a surprise as the global recovery is well advanced and has, historically speaking, one the highest synchronization level. We see still subsectors where more potential exists, such natural gas transformation and the general transportation sector.
Information Technology (IT)	Americas Europe EM			The sector's companies experienced recent some significant volatility; while the sectors key call such as IIOT remain fully intact, we though expect volatility to remain high. The sector is trading presently with a Fwd PE of close to 18 which is in line with average premium over the past 2 decades. Software and service companies are our preferred play as they take advantage from recurring revenues.
Tele-communication	Americas Europe EM			Telecommunication is a capital intensive business and therefore the most recent underperformance can be attributed to rising interests and still stiff competition for new customers. Given that a new infrastructure advance is in preparation (upgrading to 5G), we would not expect the sector to suddenly start outperforming in a market neutral environment.
Utilities	Americas Europe EM			Near-term attractiveness of the sector is not given the favorable interest outlook. Longer-term investors can focus on companies that are challenging the present set-up of "providing an utility" to an end-consumers.

For the full sector comments, please refer to the quarter investment report available here.

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Sources:
Analysis and comments: Bloomberg, Reuters, Natixis, UBS, BNP-Parisbas.
Data and graphical items: Bloomberg, Reuters.

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