ALPINE ATLANTIC
GLOBAL ASSET MANAGEMENT AG

ECHO FROM THE ALPS | 3/2014

OCTOBER 2014 INVESTMENT UPDATE & OUTLOOK

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THE (INVESTMENT) WORLD FIVE YEARS FROM NOW

Dear Readers,

A key principle for long-term success in investments is to identify large trends and changes in the economy and look at current developments in economics and politics and see how they fit into the bigger picture. Recent geopolitical events certainly make one feel like we are moving backwards in time; the recent problems between Russia and the western world clearly illustrates that. Also, new conflicts in Iraq and Syria created renewed tension in a region that was thought to have the worst behind it but where it seems like it is impossible to make real progress. A similar trend can be observed in the investment world. After two decades of rapid change and globalization, the last two years were different. Sovereign debt problems, aggressive monetary policies and lower global economic growth caused global capital flows to reverse somewhat and as a direct consequence, the U.S. Dollar could gain ground versus major currencies despite its many fundamental problems. Is the U.S. Dollar about to start a comeback or is it just a short-term bounce in a long-term downward trend? The answer to this question depends on the future development of global capital markets. What are the chances of global capital markets becoming more global again in the coming years? In our view, while we are witnessing a short-term situation that has pushed up the U.S. Dollar, over the next couple of years, the role of the U.S. Dollar in the global financial system will diminish further.

Global growth has remained low and has only slightly improved from last year. For next year we see some further improvement but the pace of economic recovery will remain sluggish. Looking at current GDP expansion in the three major economies (U.S., Europe, Japan) shows that growth levels are well below the long-term average. At first glance, the U.S. looks like it is ahead a bit with GDP expanding at around 2.2%, however, adjusted for the rate of inflation, real economic growth is disappointing in pretty much every developed country. Regular readers of our commentaries know that we have talked about this global situation of low growth a number of times in the past few years, trying to explain the factors that are causing this. We are referring to it as the “New Normal” in global economics and argue that the headwinds for global growth are mainly based on structural changes that are impossible to correct short- and medium term.

The dominant structural driver is the rapidly changing demographics and in particular the aging of the developed world. The influence from this powerful trend has only just started in the last few years and its impact will be felt for the next 20 to 30 years. This will change the structure of every major economy on this planet and governments will have to find new solutions to deal with the problems being caused by these structural factors. This will, for example, lead to a complete change over of pension systems, especially public pension schemes, where a declining number of younger workers is financing an ever larger and larger number of retirees. This will lead to tensions and eventually reforms in public pension systems across the globe.

Governments will find it harder and harder to find good compromises, especially as their own financial situation remains very difficult. Many governments these days deal with enormous amounts of sovereign debt and these governments will find it increasingly difficult to service that debt. In light of this, it seems rather hard to believe that interest rates in major markets are

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going to rise in any meaningful way in the coming 2-3 years. The fact that the yields for sovereign bonds for most major countries have been declining since the beginning of the year is a clear indication what the market expects.

While it is one thing to speculate about a few possible scenarios for the future, making actual investment decisions is a lot harder and it is essential to have a longer term view and see how things develop in the long-run. Making good investments in the long-run is the backbone of every successful investment strategy, so time is an essential component of good performance results. The world and especially the investment world will look quite a bit different five and ten years from now.

After another 1-2 years of low global growth, we believe, we are going to see stronger economic momentum but we do not expect major economies to return to the high growth rates seen historically. Eventually higher inflation will show up as the vast amount of global liquidity will finally find its way into the real economy. Interest rates are starting to go up but probably not as much as they should given the levels of inflation. This would mean that debt would be monetized and the purchasing power of money further destroyed. Stronger growth, still low enough levels of interest rates and a lot of pent up demand for capital investments and consumption would create an almost perfect environment for global equity markets. Also these factors should eventually result in a strong upward move in precious metals and other hard assets and commodities. Of course, the impact on bond markets would be negative, but we can't see an actual crash of the bond market, simply because interest rates will only go up slowly.

Despite today's valuation of equity markets, we believe there is a lot more return potential in the coming years. Partially driven by higher corporate earnings and partially driven by the fact that there are not going to be a lot of investment alternatives. Many companies today find themselves in a very lean and cash rich position, they will be able to generate rapidly growing profits even if there is only a small improvement in economic growth. Productive assets, such as stocks of well managed firms, are going to be something very scarce in a world of lower (by long-term historical standards) growth, they should therefore trade at a premium and that speaks for further expansion of today's multiples.

Successful long-term investing requires a well defined strategy and the discipline to execute on a long-term plan even in times when financial markets make it difficult to generate positive investment performance. In the coming years, there will be plenty of highly lucrative investment opportunities even if the overall economic momentum remains below the historical averages. The outlook for a long period of low interest rates will require investors globally to switch to equities for long-term capital appreciation.

With the very best regards from Switzerland,

Daniel Zurbruegg

Daniel Zurbruegg CFA

MARKET UPDATE

PRICES AS PER SEPTEMBER 30TH, 2014

Global Equity Indices	Last Close	YTD%
Swiss Market Index	8825	5.7
Swiss Performance Index	8685	8.9
Eurostoxx 50	3068	4.6
German DAX Index	9467	-0.7
FTSE 100.28	6646	-1.1
CAC40 Paris	4424	3.7
Standard & Poors 500	1977	7.6
Dow Jones Industrials	17'071	3.7
Nasdaq 100	4060	13.8
Nikkei	16'173	1.8
Topix	1326	2.3
Hang Seng	22'932	0.6
All Ordinaries	5296	-0.6

Government Bond Yields 10Y	Last Close	YTD%
USA	2.50	-16.4
EUROPE	0.20	-49.7
U.K.	0.55	-18.2
SWITZERLAND	0.48	-59.7
JAPAN	0.52	-25.7

Libor 3 Months	Last Close	YTD%
USA	0.03	-41.9
EUROPE	0.21	-23.1
U.K.	0.55	5.8
SWITZERLAND	0.00	-100.0
JAPAN	0.10	-28.6

Exchange Rates	Last Price	YTD%
US Dollar / Swiss Franc	0.9556	5.4
Euro / US Dollar	1.2600	-7.4
US Dollar / Japanese Yen	109.6300	1.5
Euro / Swiss Franc	1.2060	-2.6
Pound Sterling / Swiss Franc	1.5500	3.6

Commodities	Last Price	YTD%
Crude Oil	94.57	1.2
Gold	1218	-0.8

Alternative Investments	Last Price	YTD%
Dow Jones Hedge Index	550.1	4.7
Goldman Sachs Commodities	613.0	0.0
LPX Private Equity	1449.0	0.0

GLOBAL MACROECONOMICS UPDATE / STAYING COMPETITIVE IN A WORLD OF MODERATE GROWTH

Despite record low interest rates in most major economies, global GDP growth has remained subdued and significantly below the historical averages. The GDP forecast for 2014 needed to be adjusted several times this year and it now looks like global growth is just under 3 percent. The outlook for 2015 is slightly more positive but even with growth accelerating towards 3.5%, it is still low compared to historical numbers. So the obvious questions are: when will we return to the historical averages for GDP growth? Is there a chance that we might not see such growth rates anymore?

Looking at the major economies shows one common characteristic. When GDP growth rates are adjusted for the rate of inflation, the results show that very few economies are experiencing real economic growth. While inflation in the U.S. is close to 2% (based on the official statistics), inflation in Europe and Japan are lower, in fact they are close to zero. Despite a lot of economic stimulus and low interest rates, we have not seen a pick up in real economic activity. This fact is confirmed by a number of other economic statistics such as the velocity of the money flow. Central banks around the world have done what they could, in fact they might have done more than they should have, but going forward, economic growth needs to come from structural reforms, increasing productivity and a reawakening of "animal spirits". To give you the answer upfront, it is going to be very hard to achieve this, but it is not impossible. However, it looks like we might need to redefine what we understand as reasonable in terms of long-term economic growth.

Today's situation is such that central banks are concerned about deflationary pressures, which is understandable looking at the lacklustre growth dynamic in most major economies. In the next couple of years, central bank will focus on fighting deflation much more rather than worrying about inflation. In addition to that, countries need to make changes and adopt policies that will promote economic growth. This will be harder in Europe and Japan but the growing pressure will eventually force change; countries will not be left with any other alternatives. This increasing pressure is also being reinforced by structural changes such as an aging population. This means that the most likely scenario for the coming months and years is that global growth will recover but at a rate that is going to be too slow to help solving important issues such as the high unemployment rate in Europe and the U.S. or the increasingly difficult situation for pension systems. Pensions systems in most countries are based on unrealistic assumptions about growth and investment returns. During times of higher, actually significantly higher rates, it was easy to achieve investment returns of 5 percent when the yields on government bonds were already close to the number but today is a whole different game.

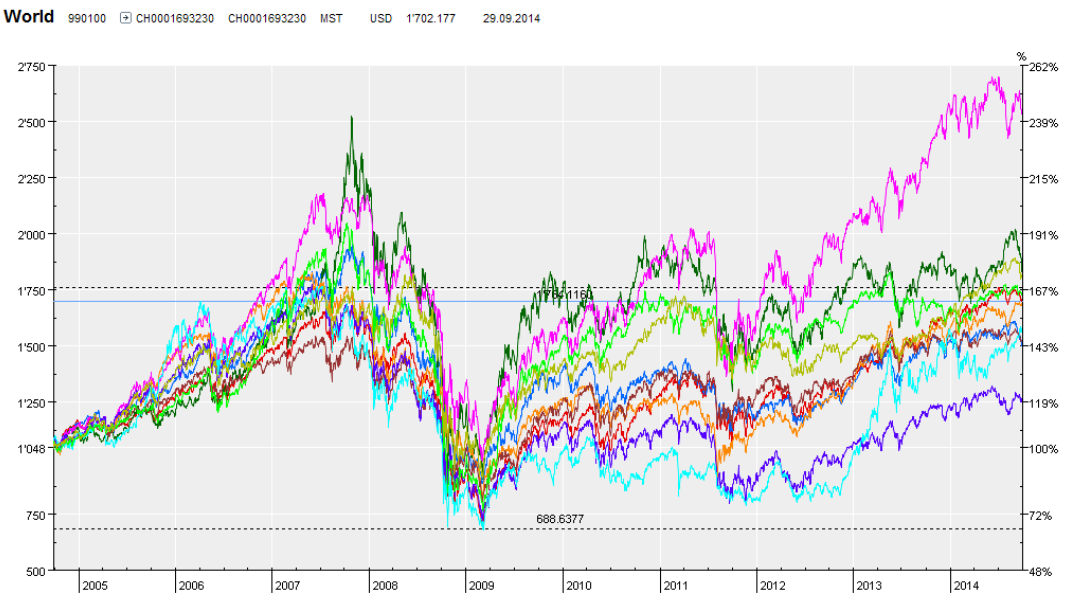
This environment with anaemic growth in the developed world and deflationary pressure will continue to keep interest rates at very low levels, this in turn will make it easier for countries in emerging markets which are still more dependent on financing in U.S. Dollar, Euro or Yen. This will help and support growth in emerging markets and we expect that the contribution to global growth coming from emerging markets will go even higher. Today already, around 70% of GDP growth comes from emerging market countries.
For countries in the developed world, the main goal will be to become more productive and competitive. Some of these countries are already on a very high level but others have a lot of catching up to do. The World Economic Forum (WEF) recently published its 2014 "Global Competitiveness Report" and a look at it reveals some highly interesting details. For the 7th year in a row, Switzerland has ranked no. 1 and is the

world's most competitive economy. There are several reasons for this but clearly Switzerland has always remained a very "open" economy with strong business ties internationally. Also, Switzerland's economy is well diversified among a number of sectors and not just dependent on one or two major sectors. Singapore has remained no. 2 in this global ranking, closely followed by the U.S., Finland and Germany. Even more interesting is a quick look at some large countries that are not found in the top group. Italy, for example, is only ranked no. 49 in the world, Spain a little bit better at no. 35 and finally Greece, ranked no. 91 and way behind their European peers.

The report is highly interesting as the study defines competitiveness as the set of institutions, policies and factors that determine the level of productivity. Clearly, there is a close correlation between the ranking and the level of GDP per capita in each country. But also several other factors were taken into consideration and it might be worth some time to have a detailed look at this report that can be found under the following link: http://reports.weforum.org/global-competitiveness-report-2014-2015/report-highlights/

INVESTMENT PERFORMANCE AND FINANCIAL MARKET UPDATE

In the third quarter of 2014, global financial markets were overshadowed by geopolitical events. The events in the Ukraine in particular created negative volatility but also the renewed clash between Israel and the Palestinians as well as the advance of the IS movement in Iraq/Syria have made investors a little bit nervous. Besides these geopolitical events, the focus was on central banks; namely the Federal Reserve and the European Central bank. Investors are trying to get a better idea of future monetary policies and there has been plenty of news in the third quarter. The European Central Bank made it clear that it will fight any deflationary tendencies and they have announced further steps, including a bond buying program. This means that we now have very similar situation in Europe, the U.S. and in Japan, with all three countries following a very aggressive monetary policy. Of course, it needs to be mentioned that the Federal Reserve has taken steps already to reduce its bond buying program and it looks like the program will be stopped in the coming months.



Equity markets remain strong and have only just reached the levels seen in 2008

This,

however, does not mean that rates have to rise significantly since there are alternate ways to drive liquidity into the monetary system.

Most investors, at least in the short-term, expect the interest differential between the U.S. and Europe to increase and these investors feel that the U.S. is already further ahead in the rate cycle and expect economic sentiment to improve further from here. Only with a time lag of 6-12 do these investors see a pickup for Europe and eventually Japan. These factors, together with a general opinion that rates are going to remain low for a long time to come, have resulted in the following developments in financial markets:

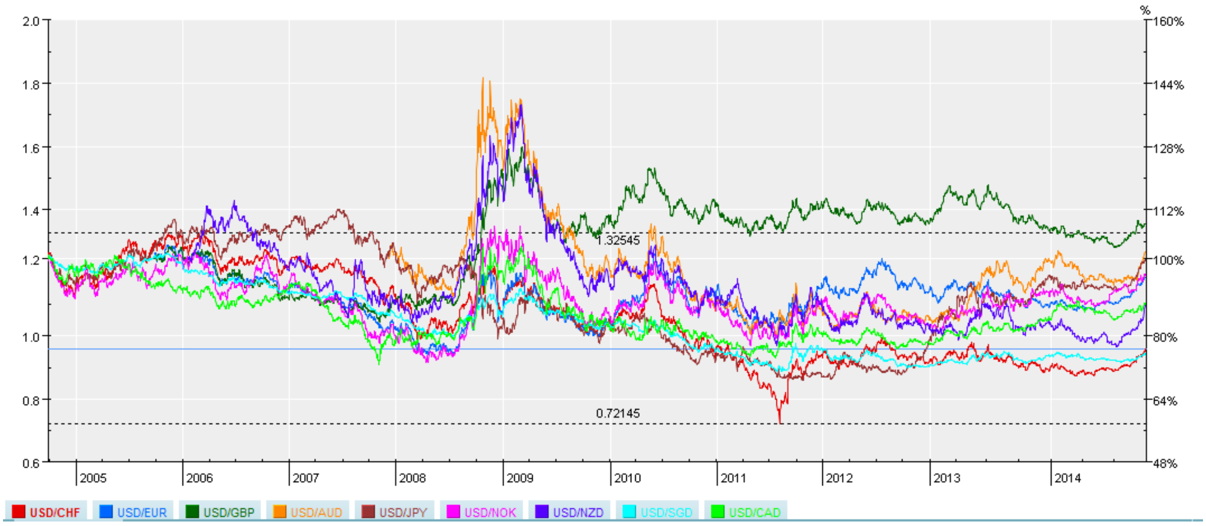
- Equities have remained strong, despite a small consolidation at the end of summer
- The U.S. Dollar has managed to gain ground versus most major currencies
- Precious metals continue to underperform and are retesting their recent lows
- Bond markets, including high-yield, remain unattractive given the historically low levels

While our strategy has performed strongly until the middle of the summer, we have given back ground during Q3, mainly because of the stronger U.S. Dollar and lower precious metals. Our investments in global equities on the other hand, performed very strongly. Despite some headwinds during Q3 we stick with our outlook for the next 12 months. We continue to be very optimistic for global equities and see further upside in the next 12-24 months. We base our opinion on a few factors:

- Equities remain the asset of choice, given their relative attractiveness (versus bonds and cash)
- Equities are the only investment which give investors a share of real value production, real profits in times of low growth and low interest rates should be trading at a premium, in fact even at a significant premium
- Valuations are in line with historical averages, but our view is that they should be higher now based on the low levels of corporate debt, record high profit margins, high productivity and low interest rates almost everywhere, just a small improvement in global GDP would boost bottom line profits significantly.

The ongoing consolidation/bottom building in precious metals may present a highly compelling entry opportunity for investors. With the ongoing fight against deflation (mainly done by liquidity generation), there is going to be more liquidity injected and eventually this will result in higher inflation and/or a further increase in asset prices. With precious metals prices now being close to the cost of production and with a lot of short-term speculative investment money being pushed out of the market, this looks finally like an ideal entry opportunity for the long-term minded investor. We also stick with our 10% target allocation to precious metals and expect a renewed increase in prices of the next 12-24 months, this next move to the upside could push prices above USD 2’000/ ounce in our view.

In currency markets, the U.S. Dollar has been able to gain ground versus most major currencies in the last few week, several factors are driving the development. First of all, recent economic data has been better in the U.S. and therefore the outlook for higher economic growth has improved. At the same time, large quantitative easing programs by the European Central Bank and the Bank of Japan are driving liquidity from EUR and JPY to the U.S. Dollar. With the additional geopolitical tensions in the last few weeks (such as Ukraine, Iraq, HK), additional safe haven flows are taking place. The last time this happened was in 2007/2008 when the global banking crisis was spreading. This short-term bounce in the Dollar was followed by a sharp reversal to the long-term downward trend.



The U.S. Dollar is experiencing a short-term bounce, similar to 2008, yet not as strong

We are expecting the following specific market trends for the coming months:

- Global recovery to continue, but slower than anticipated six month ago
- Positive market environment for global equities to continue, after a small correction during the summer, we are expecting renewed strength towards the end of the year and then going into 2015
- Emerging markets to catch up and reduce performance gap to developed markets, U.S. market to be positive as well but underperform international markets
- Volatility to remain elevated unless any new significant geopolitical event unfolds
- Precious metals to remain flat for now but price trend should get new direction in the coming weeks as the market is coming out of a what is usually a very slow summer season, support level for gold to be watched at USD 1180
- Bond markets remain unattractive with the except of high yielding bonds, those however are already trading at significant premiums
- Energy prices will continue to be low and after not showing any meaningful reaction to the geopolitical events in the past few weeks, we see further downside pressure
- U.S. Dollar with some additional upside short-term (3-6 months) due to the increasing yield differential and higher growth momentum; however, we continue to see the structural downward trend to resume thereafter.

We will continue to hold relatively high exposure to global equities and will further reduce our bond positions as more of our fixed income investments are maturing. We also hold on to our gold position and would increase them as soon as we see some more positive price dynamics. In the near future we might also consider several currency hedges to protect the value of our non-U.S. Dollar positions.

ARE PRECIOUS METALS FINALLY PRESENTING AN ATTRACTIVE BUYING OPPORTUNITY?

The precious metals market has been relatively quiet the past few weeks and prices have been moving lower during the summer, even the month of September was slow and prices further reversed towards the lower end of the support channel. After hitting their highs in 2011, prices for precious metals, except palladium, moved lower and are now in a bottom building process. Prices are now back at levels like we saw in 2010, right before they were pushed up to record highs when the Federal Reserve and other central banks started a set of aggressive monetary policies to revive growth and fight recession. After such a significant correction of prices, the obvious question is: Are precious metals presenting a compelling entry opportunity for long-term investors?

In order to answer this question, we first need to realize what was driving prices during the "hot" phase during 2010/2011 and what caused prices to correct after the highs were reached in 2011.

ated a situation where investors had to be concerned about counterparty risk. In an attempt to reduce this counterparty exposure, more and more investors were exchanging cash for precious metals because it was seen as the safer alternative.

The collapse of Lehman as well as the various problems in the global banking system created strong reaction among politicians and regulators and it started a global debate about the banking

After a big correction from their 2011 highs, precious metals are starting to find good support

Like every strong price trend, also the price development for precious metals can be divided up into two factors, fundamental price drivers and price momentum. In the case of precious metals it is obvious what caused the fundamental investment case. With central banks becoming more and more aggressive with their monetary policies, the enormous liquidity creation created a lot of investors to think that eventually a sharp increase in inflation would follow and with it the investment premium for hard assets, such as gold and silver, would go up. Another factor that played an important role was the stability (or lack thereof) of the global banking system, which has been questioned many times the past few years and was an especially important topic after the collapse of Lehman Brothers. This suddenly cre-

sector and what an adequate capitalization for these institutes should be. In the meantime, action has been taken and there is a global trend in the banking industry that regulators require banks to hold higher levels of capital and therefore increase the stability of banks. This regulatory push is understandable, especially given the fact that in many countries taxpayer money was used to bail out banks that had gotten into trouble. Banks in return responded to the higher capitalization requirements by reducing risky positions and where necessary increased capital by either directly raising capital in the market or by holding back profits instead of paying them out as dividends. While certainly a lot has been done already, it is important to realize that we are still in the midst of this process and it will require

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several more years until all banks have finally restructured and improved their balance sheet.

In principle, it is good to see banks getting better capitalized but the challenge now is that they do it at the expense of new business. Despite record low interest rates in many major economies, growth has not picked up in a strong enough way. While loans are cheap due to the low interest rates, the availability of credit is still very low. Banks are not willing to take on any business that they consider to be risky, or at least too risky for their (new) standards. Unfortunately, this comes at a time when global growth is already on the weak side and the reduced willingness of banks to lend will certainly not help much in this regard. The market has thus come to the conclusion that interest rates are not going up in any meaningful way in the coming 12-24 months. Private households are reluctant to spend and invest and banks are reluctant to lend: this probably means that global growth will continue to be below expectations in the near future. This probably also means that central banks around the world will watch the development very carefully and do everything they can to promote growth and avoid a deflationary spiral of falling prices.

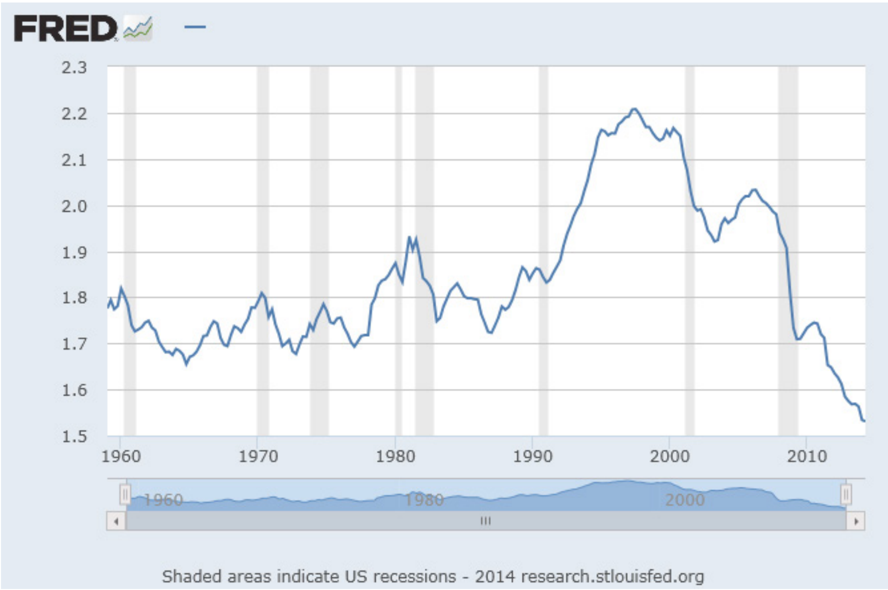
Much of that is already priced-in in the precious metals market and since inflation is low for the foreseeable future, gold and sliver prices are lost in a trendless price pattern for now. After such a steep correction in the past two years, we believe that prices are in the last phase of bottoming out. In our view, the support on the downside should be relatively strong, especially when one is considering the fact that the cost price of production is pretty much around the level where prices are trading now. With the enormous increase of central banks balance sheets and the still rather fragile global growth picture, we feel that the upside potential of owning precious metals clearly outweigh the downside risk. In the recent past, several factors have been driving prices lower, most of those factors are starting to have lesser impact and therefore we feel that the current bottom building process in precious metals are presenting a highly attractive entry opportunity for the long-term minded investor.

SPECIAL FOCUS: LOW YIELDS FOREVER? EXPLAINING THE INTEREST RATES CONUNDRUM

After rising to around 3 percent last year, the yield on 10 year U.S. Treasury bond has reversed course and recently moved as low as 2.30%. It seems like they continue to move lower toward the record low seen in 2012, when the 10 year Treasury bond yielded around 1.85%. Despite a small uptick in yields, it is rather surprising, especially considering the fact that the Federal Reserve is about to wind up its Quantitative Easing program, given the improvement in the economy and the falling unemployment rate, which currently stands at 6.1%. Interest rates are moving lower despite an improving economy? Something does not seem to be right here because normally rates should move higher as a reaction to a stronger economy and in light of a further normalization of the Fed's monetary policy. What is pushing yields down and what do the lower rates means for the outlook of the economy? We try to analyze this and give some answer to the new but old interest rates "conundrum".

In 1996, the former Federal Reserve chairman Alan Greenspan used the term "irrational exuberance" to describe what he believed was a stock market bubble. He simply couldn't explain the rather rapid increase in equity prices seen in the early 90's. Only very few people back at that time would have thought that equity markets were nowhere near their top, they continued to climb for another three years before their sharp correction early in the new millennium. Between 1998 and 2000, the Fed Funds rate rose from around 4 percent to 6.5 percent before the stock market started a large correction and the economy began to slow as all the hype and enthusiasm about the new age of technological revolution began to fade. In order to support the economy, the Federal Reserve began to lower interest rates and within less than 2 years (!!), the Fed Funds rate fell below 2 percent and eventually bottomed out at 1.5% in 2003/2004. The yield on 10 year Treasury bonds had fallen to around 4 percent which even surprised the Federal Reserve. Back in 2005, Alan Greenspan referred to the surprisingly low yields as a "conundrum", meaning that it was simply not possible to explain why yields had fallen so much. Today, almost 10 years after Greenspan first used the term conundrum, the Fed Funds rate is basically at zero and 10 year Treasury bond yields only 2.55%, which means they have fallen by another 40 percent compared with the levels seen in 2005.

There have been many reasons mentioned to explain why yields are so low but the fact is that long-term yields have been in decline for almost 25 years now, so it is obvious that some very powerful changes/factors are driving this. We will try to explain this in detail here.



VELOCITY OF M2 MONEY STOCK 1958 – 2014

We believe we are witnessing a rather unique combination of different factors that keep pushing yields lower. While some of those factors are structural in nature, others are directly related to monetary policies which have become increasingly expansionary in recent years. We should simply say here that global liquidity outright exploded in recent years. So we have a situation where there are inflationary factors and deflationary tendencies at work at the same time. This makes it hard to predict the future level of inflation and with it interest rates. At the very basic, the quantity theory of money is a good equation to look at the basic factors. The Quantity theory of money states that:

MV = PQ where M stands for money supply, V stands for the velocity of money, P stands for prices and Q stands for the quantity of goods and services produced. In theory, if the money creation and the velocity of the money supply grows faster than the economy, we should see higher prices eventually. So how can it be that the money supply has grown by almost 30 percent (annually) the past few years and prices have not gone up, or at least not much in most areas? The answer can be found in the velocity factor of money which measures how fast money is moving in the economy. The chart below (taken from the St. Louis Fed web page) clearly illustrates what is happening. Velocity has tumbled from the record highs reached in the mid 90's to new lows that we have not been seeing in more than 50 years, in fact we have never seen such low levels historically.

While part of this fall can be explained by the unprecedented increase in the money supply, the bottom line still is that money is not flowing as quickly as it should, meaning that the newly created liquidity does not find its way into the economy because business and private households are not investing and spending as much as the did in the past (long-term average). This also confirms that what matters is not so much the price of money (which is historically low) but more the willingness to invest and spend.

Monetary policy alone would be inflationary, even highly inflationary, but there are some very powerful trends at work here that are deflationary, in some cases even strongly deflationary. For example, since the end of the 90's labor force participation rates are falling, after reaching record highs some 15 years ago. This trend will continue as baby boomers are retiring and more and more people are unable to find or unwilling to seek employment. Fewer and fewer workers need to support a growing number of people that depend on the support of income earners. So even as official statistics show a declining jobless rate, labor participation continues to fall, therefore we should take official data with a grain of salt. With more and more people unable to find employment, the number of discouraged workers is at an all time high. Also a growing number of those who can find jobs are on time contracts or even only work part-time, often with lower pay than they had in their previous jobs. Also there seems to be more uncertainty regarding the future and what it might hold for the people. This is reflected in a very strong increase in the willingness to hoard money instead of spending/investing it. In general, there is a clear tendency for the private sector to think and act more short-term and hold more cash.

This combination of factors mentioned above can't be seen as a short-term phenomena but much rather like an indication what is going to be the new normal in coming years. The economies of developed nations are all driven by the same trends and factors and those are not going to be great in the next years, maybe not for the next one or two decades. This on the other hand does not mean that things will necessarily be bad, but economic growth and interest rates are going to stay well below their long-term averages (we do not expect any meaningful increase of interest rates in the next 12-24 months which will be positive for the stock market). Remember, in an economy with low growth and deflationary factors, the premium for productive capital, meaning share prices for highly successful/profitable companies should increase not decrease. We therefore expect a further, maybe significant increase in global equity prices. These higher prices will not be primarily driven by profit growth but an increasing valuation of these profits which would imply a further increase in P/E levels in the years to come.