Rothschild & Co
Wealth Management

Mosaique Insights

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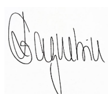
"One must maintain a little bit of summer, even in the middle of the winter." - Henry David Thoreau

Laurent Gagnebin
CEO, Rothschild & Co Bank AG



Dr. Carlos Mejia
CIO, Rothschild & Co Bank AG

So far, 2022 has not been what investors would deem a smooth ride: persistent inflation concerns on one side and a rapidly shrinking liquidity environment on the other – a challenging environment for markets. One would wish to live in more serene times. However, this is the (investment) world we live in.

Remembering the wise words attributed to the philosopher Henry David Thoreau, it is all the more important to remain positive, even in the face of many uncertainties. It is in times like these that our strength as wealth managers is put squarely to the test. With our heritage firmly rooted in the multi-generational preservation of wealth, we wanted to share with you in this edition of Mosaique Insights how we've navigated these past months with articles from our portfolio managers, investment and client advisers.

We also use this opportunity to take a closer look at what type of investments can thrive in challenging times, take you on a trip to the Nordics and introduce to you our new Rothschild & Co Switzerland art collection. No edition would be complete without our latest views from our advisory team which sheds light on the potential of the healthcare sector.

We hope you enjoy this edition of Mosaique Insights, wish you a happy summer, un bon été, einen schönen Sommer and look forward to seeing you in autumn!

Value: all data as of June 2022

Few places to hide

Kevin Gardiner
Global Investment Strategist

Investment worries are of course inconsequential alongside the trauma in Ukraine. But in the narrow, impersonal perspective of finance, this has also been a remarkable few months – and only partly because of the conflict.

Stocks are volatile at the best of times. Bonds, however, are supposed to offer stability. So to reach the half-way stage of 2022 and find global stocks down by a fifth, but bonds not far behind, is extraordinary. Net of inflation – of which more below – losses have been bigger.

There have been few places to hide: most regions, sectors, maturities and grades have fallen (in dollars, but in most other big currencies too). “Alternative” investments may not have done much better. Private markets, for example, are subject to the same macro stresses and strains, and only seem more stable because they are valued less frequently. Oil – and the energy sector – has done well, but many other commodities haven’t. Gold has failed to sparkle, but has at least strongly outperformed “crypto” assets, whose pretensions have been exposed.

The main drivers of this widespread loss of value are distinct but related.

The scale of Russia’s actions, and the ensuing disruption to energy, food prices and trade, was unexpected. It presents a new risk for a world accustomed, since perhaps 1962, mostly to geopolitical progress and détente.

The danger of escalation is very visible. So too however is the possibility of a less grim outcome. For the time being we can only assume that the awful attrition continues, and advise against taking pundits’ “Big Pictures” – a reversal of globalisation, Western decline – to heart just yet.

The second main driver has been the further increase in inflation and interest rate risk. This was more predictable, in direction if not extent, and poses more familiar – though still significant – investment concerns. But it is likely responsible for the bulk of portfolio declines so far. And while inflation risk has been amplified by the conflict, it pre-dated it, and is largely independent of it. If peace were to break out, inflation would still be an issue: its roots lie not in the commodity markets, but in the lack of much spare capacity in Western economies.

Central banks were slow to recognise the inflation threat, and guilty of groupthink in trying to fine tune it. They may not have been technically “behind the curve”, but only because their bond purchases helped define the curve. The global economy has not needed emergency levels of interest rates and liquidity since perhaps late 2020, yet such levels persisted even with unemployment levels close to multi-decade lows. History will not be kind.

They have now belatedly recognised the need to raise rates faster and further to retain hard-won monetary credibility, and both the Federal Reserve and most recently the ECB have raised rates by more than the usual quarter-point moves (with a further significant move from the Fed likely as we write). An honourable mention should go to the Swiss National Bank for earlier stepping out of the ECB’s shadow with its decisive rate hike in June, even though it has one of the better-behaved inflation rates.

When inflation and interest rates are in play, few assets are safe – including inflation-indexed bonds, which are also down. Bonds generally have had such a bad time, by their standards, because rates and yields are rising from such low levels.

We have long been underweight in bonds, and were able quickly to cut our equity positions back to neutral in two stages: in January, and then on the day of the invasion, increasing cash positions as we did so. Holding deposits when bank rates are so low, and inflation is high, might seem strange. But the real value of cash is more stable by far than that of stocks or bonds.

This asset allocation has supported clients’ portfolios through the second quarter, but could not avoid significant drawdowns. As we write, implied policy rates look more credible, and value is beginning to re-emerge in some US bonds at least. The cost of regaining control of inflation may yet however include a recession (and the conflict is keeping wider risk elevated). Stock volatility may persist for a while.

But this is not the stagflationary 1970s. And the global economy was recently remarkably resilient in the face of a much bigger shock than even a big recession might now present – namely, the lockdowns of 2020. Markets are always more volatile than economies. We have been around the inflation, interest rate and recession course many times, albeit not recently, and where these familiar risks at least are concerned, we believe “this too shall pass”.

Note from the CIO

Dr. Carlos Mejia
CIO, Rothschild & Co Bank AG

As our Global Investment Strategist notes, the second quarter of 2022 provided a challenging backdrop for financial markets. It is at times like this we must remember our long-term wealth preservation strategy. This meant enacting tactical changes at an Asset Allocation level as well as reinforcing our security selection process. For the latter our equity analysts continue to work in partnership with leading Equity Research House, Redburn.

Over the quarter, volatility remained elevated across stocks and bonds as global growth concerns mounted, alongside ongoing inflation risks. As set out in our Mosaique Views below, we reduced our exposure to some cyclical positions and became less underweight on defensives. We have also begun to reduce our underweight Fixed Income positions in US portfolios. Each incremental piece that we adjust must ultimately make sense in the whole – this is the essence of the Mosaique Strategy. Looking ahead, we remain aware that these are turbulent times and will review our asset allocation as frequently as is required.

Our Mosaique Views

By asset class, region and sector

→ ← Changes made to our Tactical Asset Allocation in Q2 2022

KEY	–		Neutral		+
Material overweight					◉
Benchmark weight			◉		
Material underweight	◉				

Fixed income	–		Neutral		+
EUR					
High-grade	◉				
IG low-grade				◉	
High-yield				◉	
Duration		◉			
USD					
High-grade		◉			
IG low-grade				◉	
High-yield			◉		
Duration		◉			
CHF					
High-grade	◉				
IG low-grade				◉	
High-yield				◉	
Duration		◉			

Gold	–		Neutral		+
Gold			◉		

Currencies	–		Neutral		+
USD			◉		
EUR			◉		
CHF			◉		
ROW			◉		

Equity regions	–		Neutral		+
North America				◉	
Developed Europe ex-UK		◉			
UK			◉		
Switzerland		◉			
Japan			◉		
Pacific ex-Japan			◉		
EM ex-Asia			◉		
EM Asia				◉	

Equity sectors	Change	–		Neutral		+
US						
Energy			◉			
Materials					◉	
Industrials				◉		
Utilities	→		◉			
Consumer discretionary	←			◉		
Consumer staples				◉		
Communications				◉		
Healthcare					◉	
Technology					◉	
Financials				◉		
Real estate			◉			
Europe						
Energy			◉			
Materials						◉
Industrials				◉		
Utilities			◉			
Consumer discretionary	←			◉		
Consumer staples				◉		
Communications				◉		
Healthcare	→				◉	
Technology					◉	
Financials			◉			
Real estate			◉			

Notes from the Manager

Clément Boisson
Portfolio Manager

2022 continues to be a difficult year for financial markets. The first quarter kept us preoccupied with geopolitical uncertainty and rising inflation from the aftermath of the Covid pandemic, the second quarter unfortunately hasn't brought a resolution of any of these subjects. The focus remains therefore on inflation and its implied economic consequences.

As discussed carefully in other publications we have produced this year, central banks are now moving quickly to tighten monetary policies in almost all developed countries. The main tool of this policy is - of course - a rapid increase in interest rates. This policy change should manage to tackle inflation. The problem is that to do so, it also needs to limit growth and economic activity. It remains to be seen if central banks manage to avoid sending majors economies into a recession, or at least, limit the impact of such an event.

Rates have therefore continued to rise dramatically, as central banks have raised current and projected policy rates. Fixed income markets have their worst year in decades, as explained by our Fixed Income team on pages 6-9.

Equity markets have also continued to suffer. To assess the value of a stock, equity analysts discount future cash flows at a discount rate which is linked to interest rates. The higher the interest rates and the discount rate, the less valuable future cash flows become. Consequently, valuations of stocks then have to be revised lower when rates go up. On top of this, estimated cash flows fall with the anticipation of an economic slowdown. Together, this has lowered expected prices and pulled markets down. Within markets, cheaper value stocks have outperformed more expensive growth or "quality" stocks. The gap in performance this year between growth and value blocs is 16%, a historically big gap.

In this context, we decided to remain careful and keep our neutral stance on equities through the second quarter. Valuations are more attractive, but uncertainty remains. We have also decided to position portfolios more defensively by reducing exposure to consumer discretionary, a sector which could suffer from a decline in consumer spending, to neutral. We have also upgraded healthcare in Europe to overweight and have reduced our underweight in utilities in the US. These two sectors are defensive with interesting long-term trends.

In US portfolios, we felt at the end of the quarter that it was time to reduce our maximum underweight in bonds to a single underweight, since US rates are now at a level that allows for more opportunities.

In terms of performance, balanced portfolios have fallen by 12.5% to 15.1% (depending on currency), broadly in line with competitors as measured by the ARC Private Clients indices.

While uncertainty remains very high, we believe opportunities will emerge. The current situation is challenging, with a renewed focus on inflation for the first time in 40 years. Nevertheless, we believe that selecting the best-run companies, with stable cash flows and pricing power, will help us build a solid portfolio with which to navigate this environment. This strategy remains at the core of what we do daily and will prove the best way to protect your wealth over the long term.

Figure 1: Absolute Performance of Mosaique Portfolios

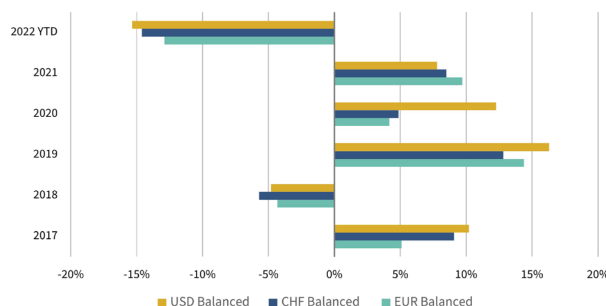
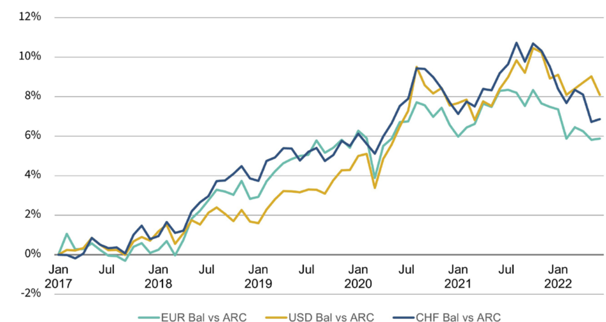


Figure 2: Mosaique Performance Relative to ARC



ARC figures for the last three months (April-June) are estimates.

The inflation game

Inflation readings in many countries have been at highs not seen for decades, and central banks have started to raise interest rates. What does this mean for fixed income markets and investor portfolios?

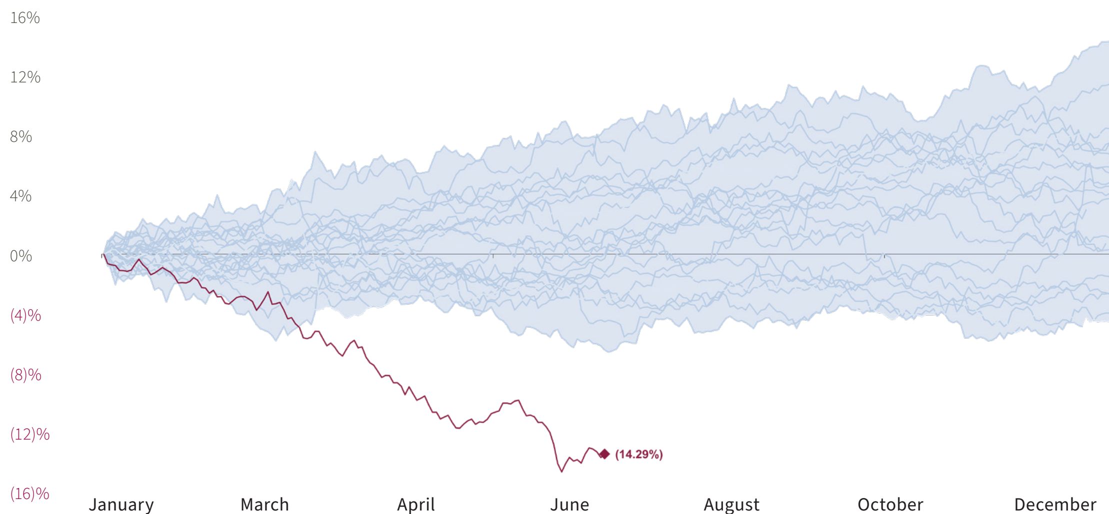
Tristan Dupont
Fixed Income Portfolio Manager

As already described by our Global Investment Strategist, 2022 so far has been one of the most challenging years in decades for financial markets, in particular for the fixed income asset class. For bond investors, headwinds have been twofold: "risk-free" rates (government yields) have risen significantly, and credit spreads have widened. Most of the bond markets' negative returns this year have come from the former.

So, what has changed? Last year, central banks were rather muted in their response ("Inflation is transitory") to the beginnings of the inflation surge. They were beginning to realise their mistake when the invasion of Ukraine amplified that surge by boosting commodity prices further: first energy, then metal, then food. Inflation is now the main focus of the macroeconomic landscape, and central banks are fighting to bring it down and maintain monetary credibility.

As interest rates rise, bond prices fall – and they were very high to begin with. Hence this year's dramatic falls in fixed income markets. The Bloomberg Global Aggregate Total Return Index (unhedged, in USD), one of the top benchmarks for government and corporate debt, has fallen almost 15% since the beginning of the year. This is the largest index decline in data stretching back to 1990.

Exhibit 1: Total Return Performance of the Bloomberg Global-Aggregate Total Return Index Value Unhedged USD Index



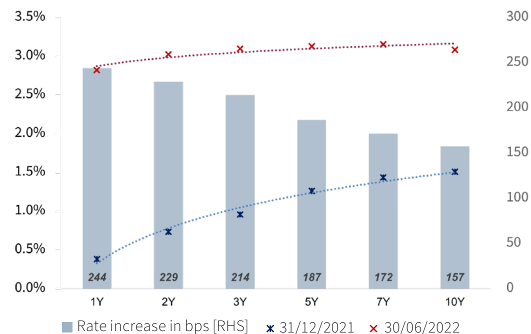
Source: Rothschild & Co, Bloomberg, data as of June 30th 2022

Within this, a spread widening for lower quality bonds, including credit, has been playing a role. The biggest driver however is coming from the general rise in core "risk free" yields. There has been an abrupt upward shift of the yield curve. The important 10-year maturities for US and German government bonds have seen upwards moves in yield of around 155 basis points (1.5 percentage points) and 170 basis points (1.7 percentage points) respectively in less than six months.

These movements reflect the double effects of higher expected inflation, and the need for higher real yields as more hawkish central banks tighten monetary policy.

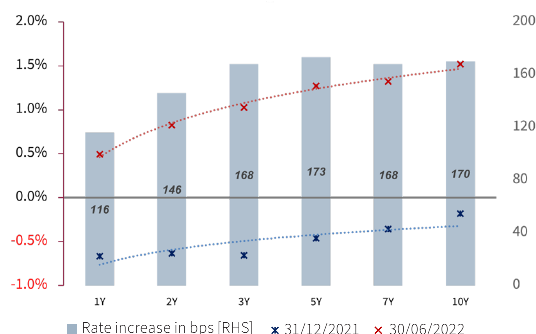
The change in the expected policy rates embedded in markets has been extreme. Looking at the Fed Funds futures, the evolution of expectations has been significant: As of December 2021, the market was expecting the Fed to hike 3 times (+0.75 percentage points) by the end of 2023. As of June 30th, the Fed had already raised the policy rate by 1.5 percentage points, and the market was pricing in another 1.75 percentage points by year-end.

Exhibit 2a: US Treasury Actives Curve



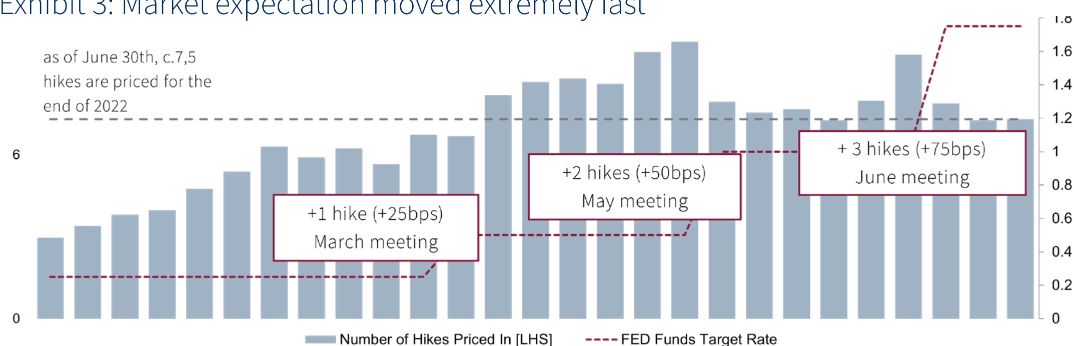
Source: Rothschild & Co, Bloomberg, data as of June 30th

Exhibit 2b: EUR German Sovereign Curve



Source: Rothschild & Co, Bloomberg, data as of June 30th

Exhibit 3: Market expectation moved extremely fast



Source: Rothschild & Co, Bloomberg, data as of June 30th

The move in market expectations reiterates how the Fed's changed stance took most investors by surprise. The repricing of "risk-free" rates, augmented by the widening of credit spreads, created an unusually challenging environment for fixed income investors (and also caused sell offs in equities – further undermining credit).

With financial conditions tightening swiftly and liquidity draining from the system, it is not impossible that central banks may yet have to modify their stances again – this time downwards – if the stress generated on the global economy turns out to be prohibitive. As yet, however, the likely economic slowdown does not look dramatic.

In this context, an emphasis on capital preservation, one of the main pillars of the Rothschild & Co approach, is essential. We started the year short in terms of duration versus benchmark. With realized inflation printing higher month after month and central banks starting to become more vocal, we enhanced our short duration stance. This positioning has so far offered some protection in a rising rate environment. Additionally, we tried to reallocate some credit exposure at the shorter tenor of the curve, focusing on less cyclical sectors whenever possible. For example, we recently reduced some "building materials" exposure and initiated positions in the Healthcare sector.

Given the movement on the rate side, we are actively monitoring the absolute levels of yields and intend to reduce tactically our short duration stance in due course (we have already started in USD). Our intention is to leverage specific tools such as an actively managed certificate to adjust our duration exposition in an efficient way. In addition, we took the opportunity of this rising rates environment to reinvest maturing papers at attractive levels and a moderate duration.

So, where are we heading? Since the great financial crisis, markets have benefited from constant liquidity infusion. In transition phases in which central banks are stepping down and "free" money will be scarce, pain is unavoidable. However, this transition period will eventually also offer great opportunities for fixed income investors as longer-term value re-emerges.

ADVISORY

The Healthcare Industry

Amaya Gutiérrez
Investment and Portfolio Advisor

Margot de Ziegler
Investment and Portfolio Advisor

Everyone needs Healthcare or will at some point. While the pandemic has posed an array of challenges for the Healthcare Industry, it has also served as a reminder of its importance. As the industry turns its attention to a world beyond Covid-19, there is a good opportunity to reflect on why it is so important, how it has evolved and what we can expect from it in the future.

Healthcare Industry - an overview

The Healthcare Industry can be considered as one of the most important and fast-growing sectors globally. The main growth drivers of the 10 trillion USD [1] sector are demographic trends (aging population), economic growth of emerging markets as well as technological progress and innovation enhancing access to specialized care. The sector is expected to grow over the next five years between 5 to 9% annually.[2]

Healthcare Industry - a breakdown

The Healthcare Industry is multi-faceted and can be broken down into various segments. Some of the most important ones are **Pharmaceuticals, Healthcare Equipment, Life Science Tools and Managed Healthcare and Biotechnology.**

The top segment, **Pharmaceutics**, consists of companies operating in research and development. It also includes makers of active ingredients, also known as "classical" drugs. This sector was central to the response to Covid-19 with companies such as Roche, Pfizer and Johnson & Johnson key to both vaccine development and diagnostic campaigns.

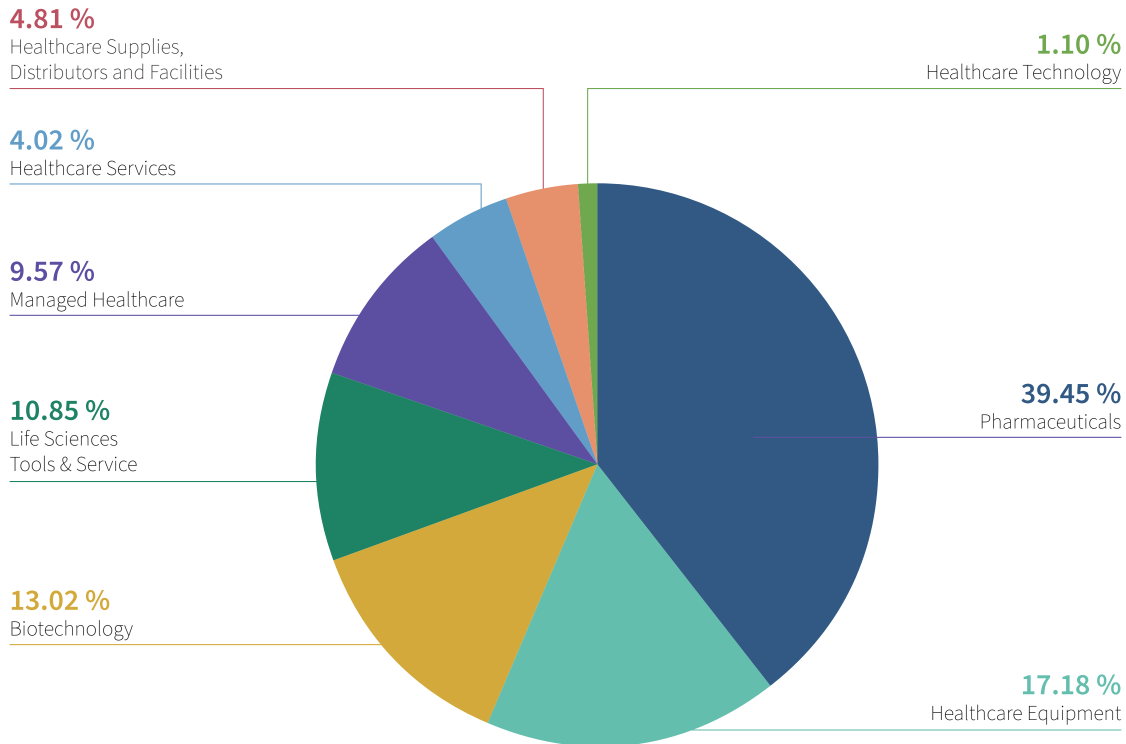
The **Healthcare Equipment** segment supports long-term demographic trends surrounding the Silver Economy (economic activities, products and services designed to meet the needs of people over 50) as well as the shift to specialised medical treatments. With Medtech being a part of this space, the global Healthcare equipment market is valued at roughly $434.2 billion (2021)[3]. Key players include Sonova, Alcon, Straumann or Intuitive Surgical.

Science & Managed Healthcare covers a broad spectrum from analytical tools, instruments, consumables, and clinical trial services. The two sectors combined make up close to 20% of the Healthcare market. Key players in this space include - amongst others - Thermo Fisher, UnitedHealth Group and Danaher.

The **Biotechnology** segment got the public's attention during Covid-19 with two key vaccines developed by biotechnology companies, BioNTech and Moderna. This segment can be regarded as the innovation cornerstone of the large pharma companies that often acquire them.

1. Fitch Solutions, as of June 2022.
2. Global Market Insights, Insights to Innovation
3. GlobeNewswire, Global Medical Device Market to 2027

Sub-industry weights

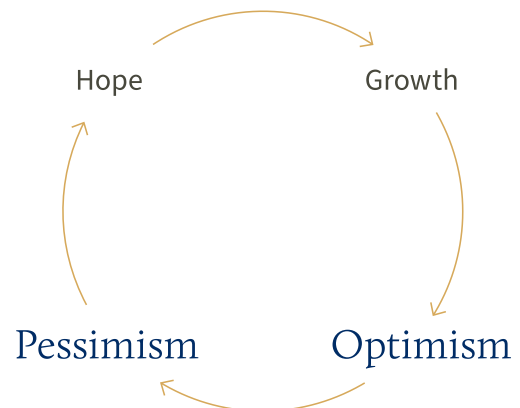


Healthcare after Covid-19

Healthcare companies' critical role in the fight against Covid-19 has contributed positively towards changing the public's perception of the sector. With pharmaceutical businesses developing vaccines and diagnostics that keep people out of hospital, the last two years have shown the innovative power and the importance of proper funding for Research & Development (R&D) in fighting new diseases. Going forward, government price controls and the detrimental impact this could have on R&D capabilities will be a harder political message to sell. The focus on R&D is also reflected in the spend of large cap pharmaceutical companies' R&D as a % of sales. In the past, they pledged circa 15% of sales to R&D on average. Today, this number has increased to nearly 20% of sales – a positive sign that the sector is investing for the long-term. The same development can be seen in the biotechnology segment which is estimated to grow at an compounded annual R&D rate of 9.5% between 2021 and 2027.[4]

Healthcare Industry and the Markets

Historically, the Healthcare Industry has shown itself to be relatively agnostic to shorter-term changes in macro-economic sentiment. Its resilience is illustrated looking at its historical returns vs other sectors during periods where macro-economic surveys, such as purchasing manufacturing indices (PMIs) have been positive or negative. This analysis shows that during historical periods of pessimism (when PMI surveys were below 50 and falling), Healthcare outperformed its sector peers. Conversely in periods of optimism (when PMI surveys were above 50 but falling), the Healthcare sector was still a top three performing sector in terms of sector returns.



Pessimism	Optimism
1. Healthcare	1. IT
2. IT	2. Energy
3. Cons Staples	3. Healthcare
4. Telecoms	4. Global equities
5. Cons Discr.	5. Utilities
6. Global equities	6. Cons Staples
7. Utilities	7. Industrials
8. Energy	8. Cons Discr.
9. Materials	9. Real Estate
10. Industrals	10. Financials

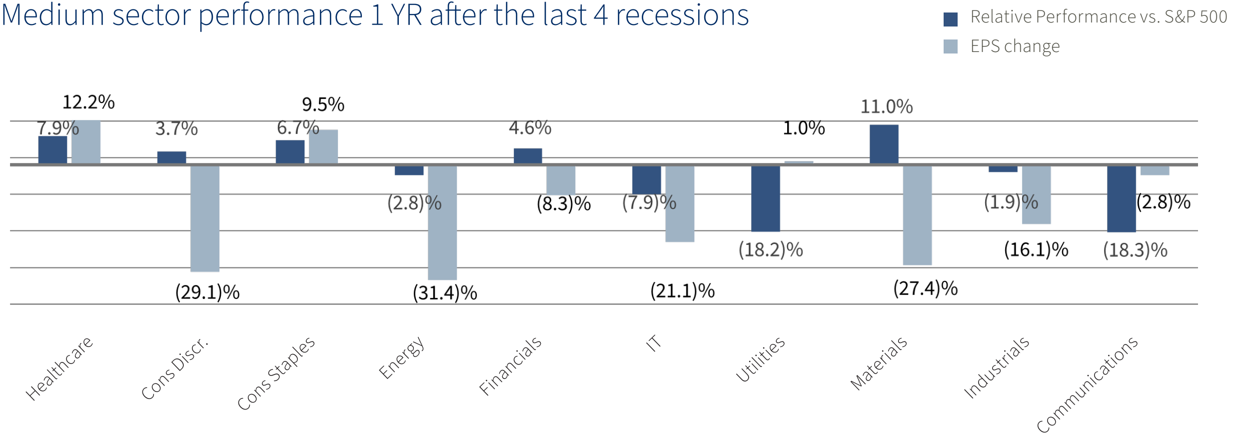
Source: Rothschild & Co. Analysis done with Bloomberg data, since 1995 (initiation of WSCI World sector price indices, monthly data & US PMI Manufacturing).

4. Global Market Insights, Insights to Innovation

Healthcare Industry and recession

Historically, the Healthcare sector has also outperformed in recessionary periods. This is illustrated by the below graph: With a performance of +7.9%, Healthcare is one of the top sector performers relative to the S&P 500 index one year after the start of a recession. This is supported by a 12.2% earnings per share upgrade over the same period of time.

Medium sector performance 1 YR after the last 4 recessions



*Last 4 recessions starting date: 01.08.1990, 01.04.2001, 01.01.2008, 01.03.2020

Healthcare presents the opportunity to invest in companies that are constantly innovating to improve quality of life. This can be done through a varied palette of strategies, depending on the risk and return profile of each investor.

By selecting individual companies, investors can decide to gain exposure to a specific secular theme within Healthcare, be it hearing aids, robotic surgery, specialized drugs or dental implants. For those investors that prefer to play the sector in an efficient diversified manner, broader exchange traded funds **(ETFs)** are available, either globally or regionally (US and Europe). By doing that, the number of sub-investments is enhanced, resulting in reduced volatility. Finally, investors can focus on **thematic strategies** offered by specialist fund managers which, based on their knowledge and experience, select companies that should benefit from the strongest megatrends. One example highlighted above is the silver economy, a long-term demographic trend, that will shape the future of the Healthcare sector.

Watch the silver economy

Find out more about navigating shifting demographics in our short infographic video

What is the outlook?

Looking ahead, there are several key trends in the Healthcare market. Among them are robotics (e.g., surgical robotic systems), Internet of Things[5] as well as specialty medicines. The latter are high-cost prescription medications used to treat complex, chronic conditions which are expected to represent nearly half of global healthcare spending in 2025 and almost 60% of total spending in developed markets. Meanwhile, two leading global therapy areas — oncology and immunology — are forecast to grow by a compound annual growth rate of 9–12% through 2025.[6] Underpinning these trends are long-term demographic shifts in developed markets with an ageing population supporting a silver economy over the coming decades. With one in five people globally projected to be aged 60+ by 2050, this cohort is the fastest-growing consumer market in the world. With most Healthcare spending happening in the last 10 years of life - be it from discretionary spending to interventions - there are clear long-term structural reasons to support the Healthcare sector in the years to come.

5. The interconnection via the internet of computing devices embedded in everyday objects, enabling them to send and receive data.

6 . IQVIA Institute, Outlook 2025.

Inside Rothschild & Co Switzerland's art collection

Artworks by Julian Göthe, courtesy of the artist and suns.works, Zurich.

Jonathan Levy
Independent Art Advisor

Starting in 2021 Rothschild & Co launched The Rothschild & Co Switzerland Art Collection and Exhibition Series. A continuation of the family's tradition of promoting the arts and a new direction for both the bank's collection and art services. The result? Find out below.

1. Rothschild & Co Switzerland has recently taken a new direction in its approach to art – can you tell our readers about our new strategy and what we aim to achieve?

The mission of the Rothschild & Co Switzerland Exhibition Series is to look to the future while linking all our activities to the family's long history of patronage. How do we look to the future? We keep up with the times, engage with our clients and staff, and focus on showcasing contemporary art created by younger artists. In terms of tradition and heritage, our collection focuses on the five countries at the origin of the Rothschild business, represented by the five arrows in the family's coat of arms: Germany, France, Italy, Austria, and the UK. The artists in the Rothschild & Co Switzerland Art Collection must either be from, live, or work in any of these five countries. We will organise one thematic exhibition per year with loans from selected artists or their galleries and will acquire artworks from our curated exhibitions, gradually adding new pieces to our existing collection. Why do we do this? We follow three objectives with the Rothschild & Co Switzerland Exhibition Series: First, we support younger artists and their galleries, creating opportunities in an alternative environment and helping them build their respective networks. Second, we create interesting content for clients, staff and prospects, both around the art we exhibit and, of course, the art market in general. Third, in this process, we discover great new talents and excellent artworks for our growing collection.

Interviewed by:
Laura Kuenlen
Investment Insights
28 June 2022

2. As a Curator, you've gained considerable experience across the art sector – what have you learnt with regard to creating and curating collections and how will you apply this to your work at Rothschild & Co?

Art is like a time capsule, which tells the story of an individual, a community and a certain moment in history. Our curated exhibitions aim to reflect the relevant topics of our times. Take our current "Dwellings" exhibition for example, which looks at different aspects of the places we inhabit, ranging from questions around intimacy, privacy, and representation to questions around the social dynamics of congregation and productivity. The role of the home, the office or the city as "dwelling" places lay at the centre of the concept for this exhibition. Covid-19 meant that most people worked remotely and had to renegotiate their work-life balances. Offices and buildings, which used to have a busy, productive energy, suddenly became quiet, like libraries. I noticed that a lot of artists I liked had been reflecting on these questions long before the pandemic. While dealing with the fragility of the places we inhabit, our exhibition also addresses the challenges of translating a familiar terminology from the physical realm into a digital experience. The art we exhibit and the artworks we acquire for the collection, reflect the pertinent concerns which are characteristic of our time and place.

3. You've worked with clients in providing independent advisory services around collection management over many years, what are the types of issues commonly faced by private wealth clients?

Art collecting always lives through three stages: Buying, Owning and Selling or Passing-on. Why do people buy art? Many collect out of passion or family traditions. Some buy art as an investment or as a hedge against inflation, and some have friends who are either artists or gallerists from which they like to buy the occasional artwork. My job as an independent art advisor is to minimize risk along all stages of collecting and assure that clients get the best artworks for their particular budget and needs. I ensure that there is proper research and due diligence before an acquisition to eliminate the risk of buying something that is either faulty or poorly documented. Once the artwork is acquired, my job is to make sure that it is transported, exhibited and/or stored as well as insured professionally, and that any risk of a loss in value is minimized. Meanwhile, I also help to maximize the potential of the collection through loans to exhibitions and other forms of presentation. Lastly, I assist whenever a client wishes to sell a piece of art.

4. Much has been said about the rise of digital art and particularly NFTs, how should clients approach this topic?

My opinion as an art historian is that we should always consider the artist's work as a whole and the natural progression that has led an artist to select NFTs as their medium. Art needs to be good, first and foremost. This means that the art needs to be an authentic expression of the artist's intention and it should have particular relevance to the artists' circumstances or wider societal questions. If an artist's work is authentic, the medium will be a natural means to the creator's artistic end. What I would be careful about, however, is to consider NFTs a new gold standard of artistic production. In the end it needs to make sense in the artist's oeuvre. Blockchain technology, on the other hand, could be here to stay. It has a lot of potential to improve the art market thanks to the security it offers. One example is the documentation that accompanies any artwork: If the owner needs a safe place to store accompanying documents - such as authenticity reports - this could be done via blockchain technology, thus making art transactions more fluid. Another challenge that comes with digital artwork is how to display it. I once advised a company that was making all its money in the digital sphere. There were large screens everywhere, especially in the company's client zone. For them it made complete sense to start a digital corporate collection and use digital artworks as screensavers or backgrounds for their conference calls. As I said at the beginning - one should always judge the quality of the work and that doesn't get better just because it is an NFT. When you look at art history, there were many people who used to be sceptical of impressionism, cubism, collage, video art etc. but over time these artforms became part of the art historical canon.

5. Finally, what key trends could you detect in the art market during Art Basel 2022, which our readers should know about?

What I noticed not only at Art Basel, but also in the New York spring auctions, was the art market's resilience and how seemingly uncorrelated it is with other traditional asset classes. People who were buying at Art Basel were happy to be back after a long break. There seems to be a strong focus on the younger end of the art market and there were many new buyers from new geographies. Art Basel offers a great opportunity to broaden one's horizon and to see the world through the eyes of young artists, who reflect on their personal experiences and the particular circumstances of their regions. When it comes to questions of racial and gender equality, the art market has also become much more considerate and inclusive, which is a very positive development and one that's here to stay. A trend I am observing with worry, on the other hand, is that some young and previously marginalized artists seem to become the object of market speculation. This can cause a lot of stress for the artists and the galleries they are represented by. Artists end up working to tighter deadlines as their waiting lists grow and they worry that their career may only be a bubble that could burst if their galleries cannot protect them from speculative "flippers". The bank's collection, by contrasts, intends to act as a patron of art, creating opportunities for artists, providing a platform for encounters and acquiring artworks that will inspire us today and in the years to come.

After completing his Master's degree in Art history at the University of Edinburgh, Jonathan Levy worked as a Contemporary Art expert at Christie's and renowned galleries in London. In 2009, he joined AXA Art Insurance. After completing his MBA at the University of St. Gallen (HSG), he built up the art department of a Swiss family office and the DACH-representation of the London-based Fine Art Group. Today, he works as an Art expert and curator in Zurich and looks after various private and corporate collections.

A Nordic Road Trip: Views from the analysts

David Windisch

Equity Analyst

In June, we took a break from the warm Zurich summer and headed off to cooler realms: the Nordics.

The main reason for our trip was the capital markets day of Kone in Helsinki. Kone is one of the 4 largest elevator and escalator companies worldwide, transporting over 1 billion people per day. With a global market share of around 15%, Kone displays many of the characteristics we admire: It has a limited number of rational competitors and develops essential products which we use daily. Recurring revenue levels are high because once a new elevator is sold and installed, customers often commit to multi-year maintenance contracts which - if they are satisfied - lead to potential modernisation projects. Whilst the initial sale is one-off, the aftermarket service is recurring, allowing good overall revenue visibility. With a large base installed across China, Kone is also well positioned to profit from maintenance and modernisation growth in the country for years to come. Over lunch, we had the opportunity to speak to the CEO of Kone, Henrik Ehrnrooth, who shared some valuable insights. Did you know that by leaning into the corner whilst using an elevator you can better sense the vibrations, an indicator of how well the elevator has been serviced? I now do this all the time.

Our next stop was Stockholm where we met with Atlas Copco and Epiroc. Atlas Copco's main focus is on industrial compressors and with a 25% market share, it is about twice as large as its closest competitor. The global market share of Epiroc and its closest competitor is even more impressive: together they provide around 70% of hard rock drilling equipment worldwide.

The Nordics – A "cool" investment case

The Nordics include Norway, Sweden, Finland, Denmark, Iceland and the territories of Greenland, Faroe Islands and Aland. Overall, the population enjoys a high standard of living including good infrastructure, excellent education systems and extensive public welfare. Despite the geographic reach and the high livelihood, the total population is only around 30 million. Therefore, companies from the Nordics have always looked beyond their home markets to expand. To succeed in foreign markets, they strive to become the best in their fields through innovation, high productivity, and perseverance. Today, companies from the Nordics cater to clients globally, for instance the fashion group H&M, which operates more than 4500 stores globally and the streaming service Spotify, which has in excess of 180 million subscribers. There are of course also some lesser known but equally successful companies in the industrial space, some of which we visited.

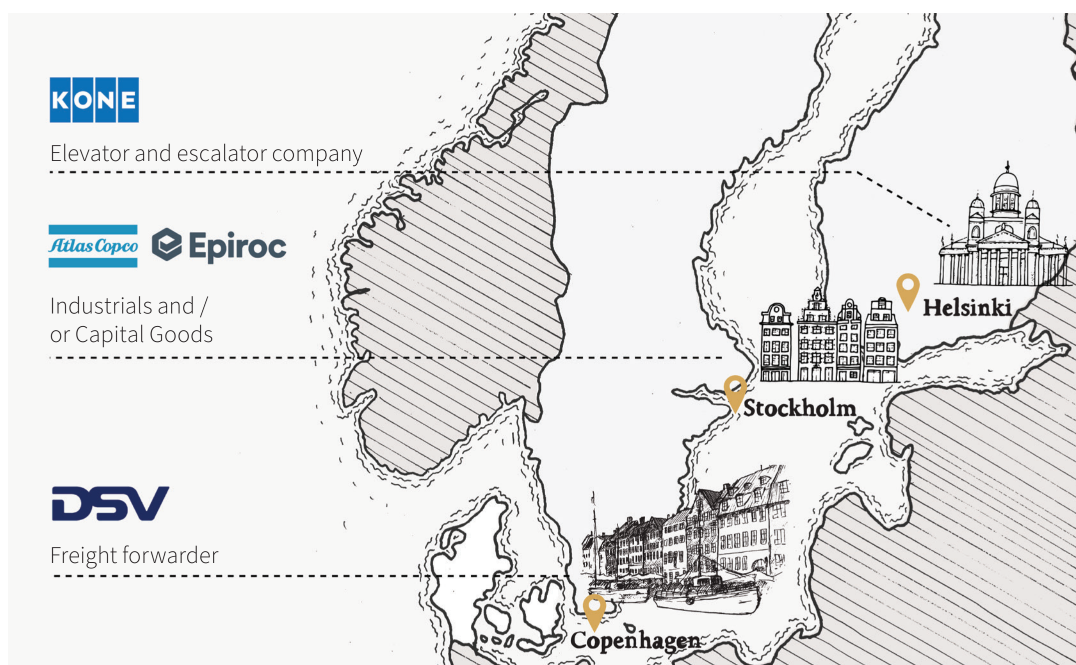
Atlas Copco & Epiroc – A historical overview

Atlas Copco is a 140-year-old Swedish company and a pioneer in air compression technology. It supplies compressors and vacuum pumps to diverse industries including food processing, automobile manufacturing and semiconductor manufacturing. Epiroc was a subsidiary of Atlas Copco until its spin-off in 2018. The split from Atlas Copco created another world-leading company fully focused on hard rock drilling tools for a diverse client base including infrastructure construction and mining companies. To this day, both companies are based in the same building, a very non-descript site on the outskirts of Stockholm.

Our meeting with Atlas Copco allowed us to better understand its strong corporate culture and independent and decentralised management style. This clearly made it easier for Epiroc to transform from a subsidiary of Atlas Copco into a successful stand-alone company. Is it surprising that Epiroc as well as its only direct competitor, both leading companies in niche heavy construction machinery, are based in the Nordics? Not really since the rock bed there is particularly hard, making the development of highly specialized and extremely durable equipment inevitable. We took the time to discuss Epiroc's business model as well as some new tools they have developed. From our visit it was clear that the firm is increasing its share of "equipment under service" which provides recurring income and thereby higher revenue visibility. Another interesting factor is that whilst mining companies themselves are commodity price dependent, "picks and shovels" are always needed and are at least to a certain extent more insulated from commodity price swings. I am already very much looking forward to our next visit when we will have to visit the test mine underneath the building where one can see some of Epiroc's equipment in action.

Our last stop was Copenhagen, where we met with some competitors of companies we already own. One of them was Jens Bjorn Andersen, the CEO of Danish freight forwarder DSV, who has managed to build the firm's market share to a global average of 4% across all markets they compete in. The company is benefitting from the current global logistics issues as many of their customers require better service, more information and smart routing of the goods they are shipping. Commoditised logistics providers cannot do that. Over the past years, DSV has continued to acquire competitors and successfully integrated these. It seems they are not done yet. For instance, on any day, their IT system would be able to handle a 50% increase in orders meaning they can act swiftly when an acquisition opportunity arises. Today, they can handle a full integration of an acquired company within 12-18 months. DSV's offices are located on the outskirts of Copenhagen near several highways, a convenient location for a logistics company. We are currently invested with Kuehne + Nagel, a competitor of DSV but it is insights like the ones gained from talking to Jens Bjorn Andersen which give us a more granular understanding of the industry.

After this tour, we returned to the hot summer in Zurich. Such journeys help build our investment cases and it is through these careful and methodical field trips, that we can build a long-term picture of the businesses we own as part of our long-term wealth preservation strategy.



Private equity turns crisis periods into opportunities

Axel Favre
Investment Director

Private equity funds are generally structured over a lifetime period of 10 years. A fund will invest over the first 5-6 years and then implement value creation initiatives over the following 5 years. This ability to take a long-term investment view provides important advantages, allowing managers to deploy capital in line with market opportunities and to provide financial and operational support to their investments over several years. Hence, it is not surprising that private equity has a proven track record of outperforming public markets during recessions.

In times of economic turbulence, companies need to reassess their strategies. For larger companies, this can result in "carve-outs", i.e. transactions in which a parent company disposes of non-strategic assets to refocus on its core business. Private equity funds are well positioned to take advantage of these transactions, buying assets at below market prices and bringing in capital and expertise to enhance the value of a company that is often under-utilised by the seller. At the same time, the instability of the stock markets is prompting listed companies to turn to private sponsors in order to protect themselves from market volatility and to focus on strategic initiatives which will bring long-term value creation. These

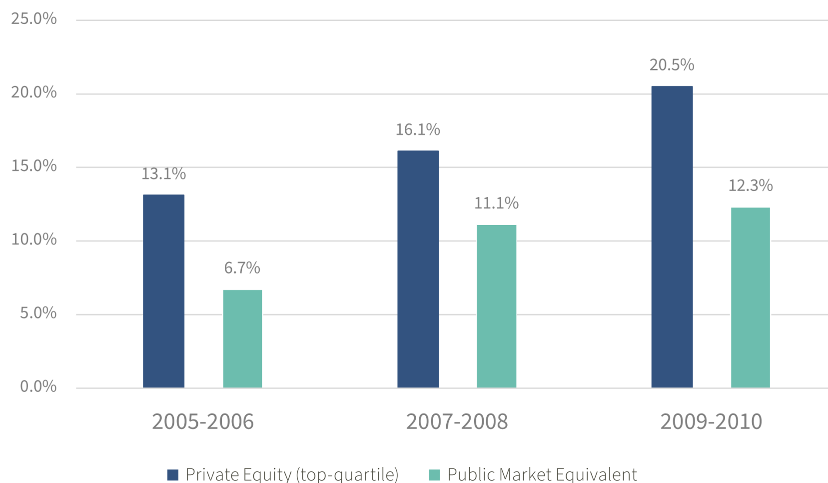
"take private" transactions are particularly attractive during downturns, when public markets offer the opportunity to take undervalued companies private.

Private equity fund managers are experts in providing managerial and technical support to their portfolio companies. They have a wide range of tools at their disposal that allow them to modify their approach during times of crisis to help their investments weather the storm. They can use their funds' reserve capital to pursue both defensive and offensive strategies, for example by mitigating a company's temporary liquidity problems, or by accelerating "buy & build" strategies, which involve making multiple sectoral acquisitions around a portfolio company at low purchase price multiples. The latter approach can be particularly effective in volatile markets such as today, as public companies tend to retreat and avoid making investments during these periods, allowing private companies to take the lead. As a result, companies under management will be more competitive after a crisis, will have gained market share, and will become an attractive target for a new acquirer.

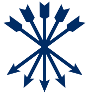
This operational flexibility has enabled private equity to outperform public markets, particularly in difficult times. An interesting study on the subject was carried out a few years ago by Cliffwater, an alternative investment advisor. The report analyses the performance of 21 US pension funds over a 16-year period (2002-2017) that includes two bull markets and two bear markets. It turns out that over this period private equity has outperformed public equities by an average of more than 440 basis points per year. This outperformance is even more pronounced during periods of contraction. When the economy was stronger, private equity outperformed by an average of 290 basis points per annum, whereas during periods of economic downturn this figure rose to 660 basis points. It has to be mentioned however, that Private Equity investments are not suitable for every investor due to illiquidity and minimum investment amounts.

Given the inherent attributes of private equity - a long-term, opportunity-driven investment philosophy and a very active involvement in portfolio companies - private equity funds are not only likely to outperform public indices in times of crisis, but those that start their investment programme during or just after these periods can ultimately deliver higher than average returns. Indeed, funds launched at the peak of the market, when valuations were at their highest just before the Great Financial Crisis, have up to doubled the performance of the MSCI World thanks to the operational and financial support provided to portfolio companies, while those launched between 2007 and 2010 have taken advantage of the market dislocation to generate even higher returns (chart). Based on this historic track record and the characteristics of private equity, the recent downturn in public markets offers investors a great timing opportunity to increase their private equity investments and earn attractive returns in the long run.

Average performance of Private Equity funds launched before, during and after the Global Financial Crises (GCF)



Sources: GCM Grosvenor "creating a private equity program for any market cycle", Burgiss, MSCI World, as of 30th March 2019.



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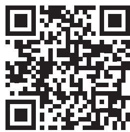

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