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ASSET MANAGEMENT

U.S. Financial Markets
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The S&P 500 Index has been stuck in a rut. It was neither down more than 3.2% nor up more than 3.5% in one day. From 2012 through 2014, the S&P 500 gained 18% a year, while earnings grew by just 5%. The market seems to be in a resting period where earnings need to catch up to valuations. This sideways drifting market could be a correction in time more than price. Economic growth will matter most in the months ahead as growth drives earnings. We expect the economy to perform considerably better in the next quarters with 2.5% in Q3, 3% in Q4 and an increase in earnings to 8% in the S&P 500 index. Furthermore, we do not expect a possible "Grexit" to make a sizeable impact on the U.S. economy and the monetary policy decisions of the Federal Reserve Bank.

Fixed Income Markets

Most fixed-income asset classes corrected as underlying interest rates have risen. 10-year Treasury yields increased to 2.4% in early June from 1.8% in April. The average yield on investment-grade bonds increased from a record low of 0.85% in March to 1.41% in June and non-investment grade bond yields increased to 4.4% from a low of 3.5% in February. The high-yield sector has performed the best (3.8%) driven significantly by the recovery of the energy sector. The funding of strategic acquisitions as well as opportunistic transactions to lock in low-cost, long term debt to fund share repurchases before interest rates would rise further continued to drive the capital market. We continue to expect that high-yield bonds will provide better returns than investment-grade bonds, as it has a much lower correlation to interest rates and is more dependent on economic conditions. Furthermore, an improving economy should be sufficient to hold down default rates. We also expect corporate bonds to continue to outperform Treasury bonds as proceeds from the ECB's accelerated asset-purchase program are likely to be reinvested in the U.S. corporate bond market, creating a technical demand. Liquidity in the bond market, however, has decreased about 20% since 2007 in the U.S. We, therefore, recommend not to trade illiquidity for more yield and rather stay with "less attractive" bonds for maximum liquidity.

Economics – Fiscal Policies Holding Back Growth

Although Q1 GDP growth, which was an aberration due to temporary factors, was revised from -0.7% to -0.2%. Leading indicators, in particular, core capital spending, the real estate market (3%) and lastly manufacturing (15%) are trending upwards, as we expect GDP to grow in the high 2% range in Q2 and 2,5% - 3% in Q3 and Q4. Despite zero percent interest rates and an extended Q2 program until October 2014, fiscal policy remained very tight since 2007. The government reduced the deficit from 10% to 2.5% of GDP. It is notable that despite the sequester induced fiscal shock in 2013, the private sector has kept the economy from falling into a recession. We expect less stringent government spending over time, which should add favorably to GDP growth. The unemployment rate fell from 5.5% to 5.3% in June. Wages are growing at 2% and have reached a high in May although a sustained trend needs yet be established. The Fed's target is 3%. Continued strength in sectors like auto and IT, raising the minimum wage, infrastructure projects, better training of the workforce, passing trade bills to improve exports are all positive trends for the labor market.

Federal Reserve Bank –Cleared for Lift-Off

Low oil prices have kept overall inflation levels low since last fall, but with oil prices 30% above their recent lows, the downward pressure on inflation will start to abate in the second half of the year. The core CPI index remains close to 2%, the Fed's target, and could rise to 2.2% if core inflation stays at 1.8% and gasoline prices stay the same. The strong labor market data in May and June confirm the Fed's expectation of a quick economic recovery in the next quarters. We, therefore, also expect the Fed to start normalizing interest rates in September by a token increase of 0.25% to avoid excessive risk-taking and a miss-reallocation of financial resources which could eventually hurt the economy. However, slow growth, the overhang of leverage, reregulation of the global financial system are likely to keep policy rates of central banks below historic averages for a long time to support the economies which are still in the headwinds of the financial crisis. The Fed is likely to keep the nominal rates between 2.5% and 3%, which is below the historic average.

Outlook

Since late January the expectation of a change in interest rate policy led to rising interest rates and thus put pressure on stocks including almost all dividend paying stocks, even those which are robustly growing dividend distributions. We recommend focusing on more cyclical sectors, such as consumer discretionary, to continue to maintain ample exposure in interest rate neutral sectors like healthcare and build positions in undervalued sectors like financials which will

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particularly benefit from rising interest rates. We expect the market to stabilize and trend upwards in the next quarters.

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