DYNAMIC TREE ASSET MANAGEMENT

MARKET REVIEW & OUTLOOK Q1 2019

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A VERY STRONG QUARTER FOR OUR DT 15

The DT Top 15 had a great start in the first quarter, advancing by +13.86% in USD terms.

With this result, we have beaten the MSCI World and most global markets.

After a dismal final quarter of 2018, global financial markets came roaring back with a vengeance, delivering a stunning performance few would have believed possible just a few months ago. We stated in our last update in mid-January that the negative market reaction was likely overdone and that we continued to believe in equities. However, even we did not anticipate that global markets would stage such a dramatic comeback!

Optimism prevailed in Q1, with equities rallying strongly across the world. The sell-off in equities in Q4 of last year was caused predominantly by concerns about a potential escalation in the trade war between the US and China, fears that higher interest rates could hurt the US economy, and broader worries about a slowdown in global growth.

The weakness in Q4 laid the groundwork for the recovery seen in equity markets in Q1. The FED acted on market weakness and weakening global growth by putting the brakes on further interest rate hikes. A large portion of the gains this year has been achieved based on market beliefs that the FED will now abstain from raising interest rates again at any point in the next few years. In contrast, the bond market now expects the next move by the FED to be a cut, with 10-year treasury yields dropping to 2.5%. The steep decline in the US market in Q4 last year likely also played a major role in stopping the US government from slapping additional tariffs on Chinese imports. In fact, it now appears there has been significant progress in the negotiations between the US government and China concerning trade. Global markets have already priced in a favourable outcome in the negotiations, and anything other than a mutually beneficial trade agreement could seriously rattle markets. We believe Trump is well aware that unsuccessful trade negotiations would jeopardize market stability, a risk we believe he is not willing to take prior to next year's presidential election. Consequently, we anticipate a positive outcome regarding trade with China in the next few weeks, which will provide further ammunition for equities. What is not so clear, however, is how the US administration will handle trade with Europe. If the US opts for a more confrontational trade policy with Europe, it could lead to serious problems for the German automobile industry. European Union governments are currently struggling to reach a consensus concerning a clear mandate for trade talks with the US, risking a delay that could further provoke Donald Trump's anger after the bloc's refusal to include agriculture in the negotiations. An escalation of trade tensions with the US would come at a very bad time for Europe's economy, which is already

struggling to reach a consensus concerning a clear mandate for trade talks with the US, risking a delay that could further provoke Donald Trump's anger after the bloc's refusal to include agriculture in the negotiations. An escalation of trade tensions with the US would come at a very bad time for Europe's economy, which is already struggling amid a global slowdown. Germany's automotive industry is already facing a challenging situation of stricter emissions regulations and weaker demand. A 25 percent levy on foreign cars would add about 10,000 euros to the price of European vehicles imported into the US, according to the EU Commission, the bloc's executive arm. If that happened, it would be major blow to the German automobile industry.

On the interest rate front, however, there is more room for optimism. Despite the recent market recovery, comments from some key Fed officials suggest that the US central bank is considering changing the way it responds to inflation. In short, their argument is that with inflation having stood below 2% for most of the last decade, perhaps it should be allowed to run above 2% for a while so that inflation averages out to 2% over an as-yet unspecified period of time, rather than having the punch bowl being taken away from the party as soon as inflation exceeds target.

To sum up, there is reason for optimism on both the trade front and regarding monetary policy, although global equity markets have already priced this in to a certain degree. In order for global markets to continue to rise, however, the overall weakness in global economic growth needs to disappear. There are now signs that that could happen, but we need to wait for further evidence.

It appears that Brexit is no longer having much of an impact on global markets at this point in time. Although not a day goes by without a Brexit-related headline, the impact on markets, other than on the UK market and the GBP, is currently muted. It still remains to be seen how the Brexit debate will ultimately unfold. Now that Julian Assange is in British custody, however, the Brits may finally have a welcome diversion from their ridiculous Brexit saga.

Stock Markets

Last quarter, we wrote what an extraordinary end to the year it had been. This quarter, we write the same: what an extraordinary start to the year it has been! Markets are in full rebound mode. Stock markets around the globe rose significantly during Q1. For example, after losing 17.79% in Q4, the US Tech Index Nasdaq made up almost all of its losses, gaining over 16%. The following table clearly illustrates the losses in Q4 2018 compared with the gains in Q1 2019:

World Indices	Price Change Q4 2018 (%)	Price Change Q1 2019 (%)
S&P 500	-15.01	+13.07
NASDAQ 100	-17.79	+16.57
Toronto TSX	-11.69	+12.42
Euro STOXX 50	-13.90	+11.67
SMI Swiss Market Index	-7.64	+12.44
German DAX	-14.25	+8.94
Japanese Nikkei 225	-17.45	+5.95
MSCI World	-14.50	+11.88

Source: Reuters (in local currency terms)

Technology shares raised markets in Q1, after showing the biggest losses in the previous quarter. Other major markets performed similarly, with the German DAX trailing behind somewhat. One major reason for the underperformance of the DAX in Q1 was the current uncertainty surrounding the German automotive industry, owing to the looming threat of massive US import tariffs being placed on German cars.

"Building wealth is a process of managing risk, not ignoring it."
Jon Duncan

International diversification helps to spread and diminish risks globally while exposing the portfolio to additional opportunities.

Oil prices were considerably higher during Q1, gaining 32% by March 31. This was in stark contrast to the 38% plunge seen in Q4 2018, when oversupply and fears of decreasing demand weighed on prices, amidst an overall slowdown in global economic growth. The reasons for the bullish tone in Q1 are manifold: OPEC's ongoing supply cuts, US sanctions against Iran and Venezuela, and most recently, fighting in Libya, which could cause additional oil supply disruptions. Despite the current optimism, however, there are other factors that could bring oil down later this year. Russia is a reluctant participant in its agreement with OPEC to withhold output, and according to comments made by Russian Energy Minister Alexander Novak on April 5, the country may decide to increase production if the current deal is not extended before it expires on July 1. Relentless growth in US shale production is yet another risk factor, which could bring the rally to an end.

While gold has rallied from the lows seen throughout most of 2018, the yellow metal only managed to make slight gains during the first quarter of 2019, climbing by just under one percent. A softer US dollar, geopolitical issues, and slowing economic growth, were the main impediments to the precious metal's ability to stay above US$1,250 per ounce throughout the quarter. Additionally, investors regained interest in the metal as a safe haven, particularly after the US Federal Reserve put the brakes on rate hikes. Despite gold's reaction to these factors, however, prices remain in murky territory. Nevertheless, many industry insiders currently believe that gold is set to rise and remain above US$1,300.

DT Top 15

The DT Top 15 Strategy held up relatively well in 2018, losing 5.35% for the year. In Q1 2019, the DT Top 15 staged an impressive comeback together with global equity markets, finishing Q1 with an increase of 13.85% in USD terms. Established at the end of April 2013, the DT Top 15 now has an almost six-year track record with a total gross return of 80.64%, or 10.50% on an annualized basis. With our solid mix of growth and value stocks, we hope to continue to perform well throughout the remainder of 2019 and beyond.

The top performing stock within the DT Top 15 strategy in Q1 was Zalando, a leading company in the fast-growing European online fashion retail market. Zalando gained an astounding 52% during the quarter. The second-best performing stock was Sonova, one of the dominant players in the hearing healthcare solutions market. Sonova rose by 21% during the quarter and even reached a new all-time high in the first week of April. The worst performers during the quarter were Sony, falling by 12.5%, and ABB, which fell by 1%.

During Q4 2018, we made no changes to the composition of the DT Top 15. Below is an overview of some of our current holdings:

Zalando – With its high brand recognition, Zalando is the leading company in the fast-growing European online fashion retail market. It has a strong balance sheet and enjoys solid top-line growth backed by the overall growth of the online industry, but it is also still likely to gain in

market share. The company, like many of its competitors, is barely profitable as management is prioritising growth over profitability, which in our view is the right strategy. The stock was under heavy selling pressure in Q4 after Zalando had to reduce revenue guidance following a disappointing quarter. After reporting much higher than expected numbers for Q4 2018, however, the stock shot up by over 20% on the date of the announcement. Q4 sales rose by 24.6% year-on-year to EUR 1.7 billion, and key performance indicators also improved, with total orders up 32.2% year-on-year, the site visit count increasing 30.7% year-on-year, and active customers standing at 26.4 million, up 14.3% year-on-year. At the end of March 2019, Zalando traded at EUR 34.75, up from EUR 22.44 at the end of 2018. We believe Zalando can continue to grow its revenues by around 20% per year. The company's management is still prioritizing growth over profitability, which we believe is the right strategy to gain market share. We realize that Zalando's valuation is elevated, so the company is susceptible to disappointing quarterly sales numbers that could cause its shares to drop noticeably. On balance, however, we believe in the stock despite its elevated valuation, and even more so in the potential Zalando has as a takeover target. As we were writing this report, Zalando reported a preliminary profit for Q1 2019, where analysts had projected a loss. As a result, Zalando traded as high as EUR 42 on April 16.

Nestlé – Nestlé is the world's largest food company. Nestlé is well diversified and offers a low risk profile. It has consistently delivered sector-leading and well-balanced organic sales and earnings growth. A strong balance sheet and robust cash flow generation support its innovation and marketing efforts. Nestlé is one of the stocks that we have held for the longest period of time within the DT Top 15. We bought it at the end of April 2013 at around CHF 66. Given that Nestlé is a very defensive stock, it surprised us to see the stock gain 19% during the course of Q1, significantly outperforming both the Swiss Market Index and Unilever, one of Nestlé's main competitors in Europe. Despite recent gains, we continue to like Nestlé because of its rock-solid balance sheet, its defensive profile and its ability to regularly introduce new products on the market, ensuring profitable and consistent growth.

Sony – Sony Corporation (Sony) is a technology and consumer goods conglomerate. Sony was one of the worst performers in the DT 15 in Q1, with the stock falling 12%. The main reason for the dive is easy to identify: Google launched its game streaming service, Stadia, at the Game Developer's Conference on March 19, 2019. Google's service, which is set to be launched in the US, Canada, the UK and Europe later this year, is a significant threat to Sony's PlayStation ecosystem, as it would be available on various devices, including televisions, tablets, smartphones and personal computers. Stadia would also leverage existing Google Cloud infrastructure, which does not require additional hardware (i.e. specific gaming consoles), enabling consumers to play games within seconds on any device. Stadia could end up expanding the game software market, but might also eat up Sony's share in the current market, given its low price, speed and flexibility.

Shortly after the end of Q1, Sony shares increased by more than 9% on April 9, after a Reuters report saying Third Point LLC was again raising its stake in the Japanese conglomerate stoked speculation that fund owner Daniel Loeb was preparing to agitate for more changes at Sony. Third Point, which has about USD 14.5 billion in assets under management, is raising a dedicated investment vehicle targeting USD 500 million to USD 1 billion in capital to buy Sony shares, according to those familiar with the matter. It is believed that Third Point wants Sony to explore different options for some of its divisions, including its movie studio, which Third Point believes has attracted takeover interest. We view this as a positive sign, however. We initially bought the stock at around USD 39, and will continue to follow further developments closely.

Royal Dutch Shell – Netherlands-based Royal Dutch Shell (Shell) is one of the largest integrated oil and gas companies in the world. Shell operates through the integrated gas (11.3% of FY 2018 revenues), upstream (2.5%), and downstream (86.2%) segments. We bought the stock back in 2015 at about EUR 29, in the middle of the price collapse in crude oil, in anticipation of higher oil prices down the road. Royal Dutch provides good exposure to the oil and gas sector and also offers an extremely attractive dividend yield of currently around 6%. The stock has fulfilled our expectations in Q1, advancing by 10%.

Continued unrest in Libya, US sanctions on Iran and Venezuela, and OPEC cuts, should all put a floor under the price of oil, ultimately benefitting Royal Dutch. The company's balance sheet contains an elevated level of debt, however, which is of some concern. Nevertheless, efforts have been made to reduce the debt level since 2017, following the acquisition of BG in February 2016.

Sonova – Sonova provides hearing healthcare solutions. The company is greatly benefitting from the strong volume trends (aging population, emerging market growth) in the hearing aid market. We believe that those trends will continue and that Sonova, being a major player in this market, will benefit immensely in years to come. We bought Sonova back in April 2017 at around CHF 144.90. In Q1 2019, there was barely any news on Sonova. Despite the lack of news, however, the stock managed to gain 22% and hit a new all-time high around the CHF 200 mark. Should the stock price of Sonova be able to break out, further short -term gains are likely. As a result, we believe there are both short-term catalysts and a fully intact long-term story for this stock. The combination of the two makes for a great investment from a risk/reward point of view.

Market Outlook

Equity investors especially benefitted from central bank dovishness in Q1. With interest rates relatively low and FED balance sheet reductions off the table for the time being, current monetary policy is providing a tailwind for equity markets. Equity returns in Q1 were received with low volatility, as the VIX, a measure of volatility, has declined significantly from the elevated level that prevailed over much of Q4 2018. Furthermore, Q4 corporate earnings have been coming in mostly above estimates, which is reflective of the underlying strength of the US economy. Still to come, however, is a trade deal with China that could spring-load gains for the equity market.

Q1 gains left investors in a good position to prudently re-evaluate their portfolios. The US economy remains strong. The risk of a recession is low and central banks are determined to manage the economy without any surprises.

We believe markets have room to run given the recent change in the FED's monetary policy, a potential US-China trade deal, the still robust US economy, and healthy projected corporate earnings for the remainder of 2019. On the cautious side, however, we observed an inversion of the yield curve towards the end of Q1, with long-term yields falling below short-term yields. An inverted yield curve is believed to be an indicator of a looming recession. Typically though, a recession signalled by an inverted yield curve only happens 12 to 18 month later. As a result, if the indicator is correct, we may see a recession around the middle of 2020. Traditionally, the depth of the inversion also indicates the magnitude of the indicator. The inversion that was noticed in Q1 was shallow, however, which could explain why markets barely reacted to the inversion this time around. Unless the indicator deepens, the signal will continue to remain weak.

Commodities should also continue to do well in the current environment. We will keep our gold allocation, and will selectively try to take advantage of opportunities as they arise.

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"Far more money has been lost by investors preparing for corrections than has been lost in corrections themselves"

— Peter Lynch —

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