DYNAMIC TREE ASSET MANAGEMENT

MARKET REVIEW & OUTLOOK Q3 2019

AGENDA

A GOOD THIRD QUARTER FOR OUR DT 15

The DT Top 15 had a good performance in the third quarter, advancing by +2.36% in USD terms bringing its YTD performance to 25.15%.

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

After a turbulent summer for equities and other risky assets, investors came back from the holiday break in a bullish mood, propelling equity markets higher in September. On balance, global equity markets were little changed for the quarter. During Q3, global economic data continued to deteriorate, which both the US and Europe hoped to mitigate by introducing further monetary easing.

In the case of the US, the Federal Reserve cut interest rates twice, in July and in September, trying to sustain a record US economic expansion at a time when uncertainty over Trump's trade policy is slowing global growth. The quarter-point cut in July was controversial within the committee, with Fed presidents Eric Rosengren of Boston and Esther George of Kansas City dissenting in favour of no change, the first double dissent Powell has faced since he took the Fed's helm in February 2018. Committee members who voted for the policy action sought to better position the overall stance of policy, in order to help counter the effects on the outlook of weak global growth and trade policy uncertainty, to insure against any further downside risks from those sources, and to promote a faster return of inflation to the 2% target, according to minutes of the July 30-31 Federal Open Market Committee meeting. The July cut was the first rate reduction since 2008, a move Chairman Powell called a 'mid-cycle' adjustment. In mid-September, the Federal Reserve once again cut its policy rate target. In the six weeks since the last meeting, global trade risks have risen as the US and China have placed new increased tariffs on each other's goods. While US economic data remains generally solid, the Fed remains wary of weak global growth and trade-related uncertainty, and may reduce rates even further. The Fed's summary of economic projections was little changed. It sees GDP growth decelerating from 2.2% in 2019 to 2% in 2020, and to below 2% in 2021 and 2022. It also forecasted little change in unemployment or core inflation in the near term.

In mid-September, the European Central Bank (ECB) announced its biggest stimulus package in three years and passed the ball to fiscal policy. The ECB stimulus package that was announced initially surprised equity markets by including a rate cut and quasi open-ended quantitative easing through asset purchases. While such asset purchases may have a limited effect on their own, if combined with fiscal stimulus from the economies that can afford it, they could help to support growth. Nevertheless, the timing of any fiscal stimulus from Europe remains uncertain. While equity markets initially reacted strongly to the news, sentiment normalized again during the ECB's press conference as investors started to question the effectiveness of the package. Relative to expectations, eurozone banks are probably the winners of the package. We are of the opinion that monetary easing around the globe will most likely extend the current equity bull beyond 2020.

As was to be expected, the trade war between the US and China also continued to be a major topic in global financial headlines throughout the quarter. We believe it is likely that a final, mutually beneficial agreement is still some ways away. Meanwhile, China's economy continued to slow, with industrial production growing by 4.4%, down from around 7% at the start of 2018. Retail sales in China also slowed to 7.5%, down from close to 10% in early 2018. However, with growth still significantly higher than in the US, and given that the US economy is also slowing as a result of the trade dispute and the presidential election due to be held next year, it is still very uncertain whether China will give in to US demands on trade or not. The current state of affairs is that further tariffs are due to come into effect by the end of the year unless renewed talks between the US and China make sufficient progress. Needless to say, failure to prevent further tariffs could hurt the global economy. On another front, the US announced in early October that it will impose tariffs on USD 7.5 billion of goods coming from the European Union, such as Airbus planes, French wine, Scotch and Irish whiskey, and cheese from across the continent, as punishment for illegal EU aircraft subsidies. If the EU retaliates in kind, there could be worries of prolonged damage to global growth. We will continue to carefully monitor developments on global trade and will act if and as necessary.

In the UK, the seemingly never-ending Brexit saga continues to drag on, with British Prime Minister Boris Johnson having made a final offer to the European Union on October 2, pitching a possible compromise for a last-minute exit deal that was cautiously welcomed by the EU. There is hope, at least, as Boris Johnson went further than was widely expected on the most controversial issue – the border between Northern Ireland, which remains part of the UK, and its neighbour to the south, EU member Ireland. He proposed an all-island regulatory zone to cover all goods, replacing the so-called backstop arrangement, which the British refuse to accept. It remains to be seen whether Johnson's new proposal will result in a breakthrough or not. Should it fail, there is a good chance that the UK will leave the EU without a deal, which could spook financial markets.

Stock Markets

After the surprise introduction of new tariffs on Chinese imports by US President Donald Trump on August 1, equity markets fell sharply. On the other side of the spectrum, however, safe-haven assets surged. Later, with the return of trading volumes following US Labor Day, news broke about the potential reopening of talks between the US and China in an attempt to prevent the trade war from escalating further. That news all but reversed the losses from August. The Swiss Market, meanwhile, hit another all-time high during the course of Q3 2019, once more driven by defensive companies such as Nestlé and Roche, which attracted investors looking for a safe haven. Conversely, Germany's DAX Index was one of the few major equity markets that was negative in Q3, falling by 0.75%. The reasons for its weak performance were primarily recession fears in Germany and the fear of potential tariffs being imposed by the US.

"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.

Stock market performance around the globe was mixed in Q3 2019. The following table shows the performance of selected markets:

World Indices	Price Change Q3 2019 (%)	Price Change YTD (%)
S&P 500	+0.42	+18.74
NASDAQ 100	-0.24	+22.42
TSX Composite	+1.14	+16.31
Euro STOXX 50	+2.06	+18.93
Swiss Market Index	+1.09	+19.05
German DAX	-0.75	+17.47
Japanese Nikkei 225	+2.83	+9.31
MSCI World Index	+0.02	+18.15

Source: Reuters (in local currency terms)

DT Top 15

In Q3 2019, our DT Top 15 strategy was up by 2.36%, beating its benchmark, the MSCI Total Return Index, by the same amount, as the latter remained flat over the quarter.

For the first nine months of 2019, our DT Top 15 Strategy gained 25%, outperforming its benchmark as well as all major equity indexes. Established at the end of April 2013, our DT Top 15 now has a six-year plus track record with a total gross return of 98.57%, and over 11% on an annualized basis.

The top performing stocks within our DT Top 15 strategy in Q3 were: Sony (already a top performer in Q2), advancing by 10%; Merck, also advancing by 10%; and Vinci, a stock we have held in the DT Top 15 since inception and which we still like, advancing by 9%. The worst performing stocks during the quarter were: Royal Dutch Shell, dropping 7%; Salesforce, dropping 4%; and Citigroup, which fell by 2%.

Below is an overview of some of our current holdings:

Merck - Merck KGaA (a German company, not to be confused with the famous US pharma company) is a global

pharmaceutical and chemicals company. The company researches drugs in the areas of oncology, as well as neurodegenerative, autoimmune, and inflammatory diseases. It also markets cardiovascular, fertility, endocrinology, and over-the-counter products, as well as products for flat screens and the pharmaceutical, food, cosmetics, packaging and coatings industries.

We added the stock to our DT Top 15 portfolio in March 2018 at a price of around EUR 77.50. As of September 30, Merck was trading at EUR 103.35, a gain of 33% since inception. In addition, just in the last 20 days of the quarter, Merck advanced by approximately 10%. One of the main reasons for the stock's strong performance in the latter part of September was the fact that the FDA has granted Breakthrough Therapy Designation to Merck's prospective lung cancer treatment tepotinib, which fights against a rare and aggressive subtype of the disease. Breakthrough Therapy status provides for more intensive guidance from the FDA on development, the involvement of more senior agency personnel, and a rolling review of the marketing applications. Also, Merck announced that it expects to achieve sustainable profitable growth in all three of its business divisions in the coming years, and that it will focus on rapid deleveraging and stringent cost discipline. Its three business divisions are: Life Science Tools, which represent about 58% of its operating income; Pharma, about 24% of its operating income, and Performance Materials, about 18% of its operating profit. We like Merck KGaA as it is the largest supplier of liquid crystals, with flagship technologies that are used in the manufacturing of LCD displays. Growing demand for LCD and OLED displays should benefit Merck. Also, Merck has a strong pipeline of pharmaceuticals, with a number of drugs in the second phase of development.

AXA – Based in France, AXA is the largest insurer in commercial lines globally, and one of the largest global insurers in health and protection, with total assets of EUR 763.5 billion as of Q2 2019. It mainly operates through three segments: Property and Casualty, Life and Savings, and Health, along with minor operations in Asset Management and Banking Services. AXA has strong presence in Europe, the US and Asia. After completing the acquisition of XL Group in September 2018, its profile changed fundamentally, moving from a capital market dependent, life-centric Europe/emerging markets/US player to a globally leading property and casualty commercial insurer with a moderate exposure to life business.

We added AXA to our portfolio in March 2015 at around EUR 23.50. As of the end of September, AXA was trading at EUR 23.43, close to where we initially purchased the stock. AXA is a dividend play, currently yielding about 6%. AXA's risk profile has improved significantly since the deconsolidation of its US business, AXA Equitable, and the benefits of the XL Group acquisition still remain to be seen. AXA's disciplined pricing and focus on higher-margin markets in life insurance, as well as it re-pricing efforts in non-life insurance, should continue to support earnings growth, which should create room for an increased dividend going forward.

Salesforce – Salesforce.com is a pure-play provider of cloud services and offers software on demand. The company supplies customer relationship management services to businesses worldwide and technology platforms for customers and developers to build and run business applications. Clients use salesforce.com to manage their customer, sales and operational data.

Salesforce.com enjoys high recurring revenues and already serves more than 60% of the Fortune 500 companies. This allows for strong cross-selling opportunities for its growing product portfolio in new verticals. Furthermore, salesforce.com has defensive and stable cash flows supported by a largely installed customer base. We believe that CRM is well positioned in all its intended markets, and its target to double revenue by 2023 seems realistic. We added Salesforce to our portfolio back in August 2016 at around USD 80. The stock currently trades at USD 148, a gain of 85%. We continue to believe in Salesforce's ability to grow and will stick with the stock for the time being.

Nestlé – Nestlé is the world's largest food company. The group's product categories include powdered and liquid beverages, milk products and ice cream, nutrition and health science products, prepared dishes and cooking aids, confectionery, water, and pet care products. Its most important brands include Nescafé, Nespresso, Maggi, KitKat, Friskies, and San Pellegrino.

Nestlé has had an unbelievable run in 2019, rising from CHF 80 to CHF 106 (+32.5%). For a defensive company such as Nestlé, this is a significant achievement. The reasons for the stock's very positive performance are manifold: Firstly, under its new Chief Executive Officer, who joined the company in 2017, Nestlé has become more agile and innovative, and is focusing more on rebalancing its portfolio to target above-average growth categories such as coffee, while at the same time disposing of businesses that are considered non-core. Secondly, Nestlé reported strong Q2 numbers, with organic sales growth at 3.6%. That growth was driven by the US, strong demand in emerging markets, and economic recovery in Brazil. Lastly, Nestlé benefitted strongly from a shift from growth to defensive stocks in 2019, while the US/China trade war was gaining in intensity. Nestlé has been in our DT Top 15 portfolio since the strategy's inception back in 2013. We originally bought the stock at around CHF 66. Nestlé currently trades at CHF 106, a price gain of 60%. Including a dividend of around CHF 2.30 per year over six years for an additional CHF 14, that equates to a total return of around 80%. Although Nestlé trades at a premium to its peers, we believe its premium valuation is justified and we see the potential for further upside growth.

Market Outlook

The risk of an economic slowdown has increased since the summer, causing the Fed and the ECB to take action. Economic data released recently may point to an overall slowdown in global growth, largely driven by a downturn in the manufacturing sector, continued uncertainty around global protectionist policies and, last but not least, the potential threat of a no-deal Brexit at the end of October. As a result, US equities put in their worst October start since 2008, as investors continue to worry that a global economic slowdown will turn into a recession. The benchmark S&P 500 lost about 2% in the first two days of the month alone.

Nevertheless, we believe that monetary easing around the globe will most likely extend the current equity bull market beyond 2020, and that we should see new all-time highs going forward. At the time of writing, we are only about 4% off the all-time high in the S&P500. In addition, credit markets are reasonably strong, service sector activity is still robust in most economies, unemployment is low, and consumer confidence is relatively high in the US and in Europe. Furthermore, Donald Trump has a clear motivation to avoid a recession before the November 2020 election, which should further support equity markets.

That being said, we acknowledge that risks to global growth have risen considerably and that volatility in the market will increase as a result, and that we could see sizeable corrections in the market over the next few months.

Contact Us

Dynamic Tree Asset Management
Churerstrasse 47
8808 Pfaeffikon
Switzerland
+41 44 787 59 00
info@dynamictree.com
www.dynamictree.com

"Someone is sitting in the shade today because someone planted a tree a long time ago."

— Warren Buffett —

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