INNOVATIS
THE ASSET OF INNOVATION

August 2014

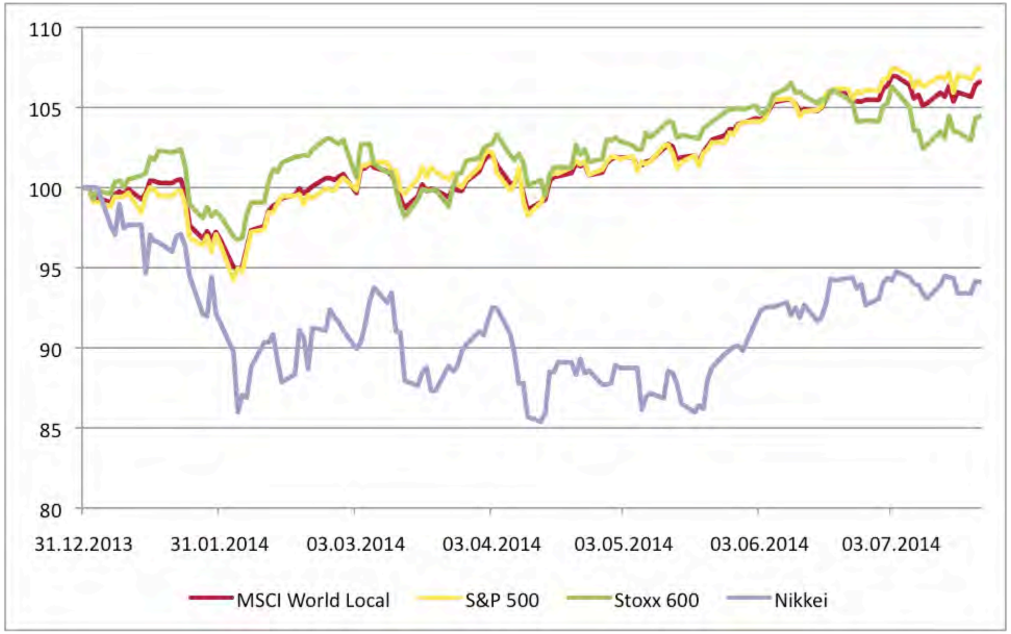
Quarterly Report

CONSULTING • ASSET MANAGEMENT • EQUITY & REAL ESTATE

Equities - The only way is up

After a bumpy start into the new year equity markets continued their way up, even if overall the gains were moderate. But record levels and partly high valuations were definitely not an obstacle for investors to buy into the equity market in the first half of 2014.

Whereas US- and European stocks contributed positively to the performance of most investors, Japan did the opposite. The Japanese equity market was the big winner in 2013, but this year Japanese market is lacking performance. From year‘s start it underperformed European and US markets by about 7-10% and also shows an absolute minus of 6%.



Source: Bloomberg; normalized

Equities – Sentiment extremely bullish

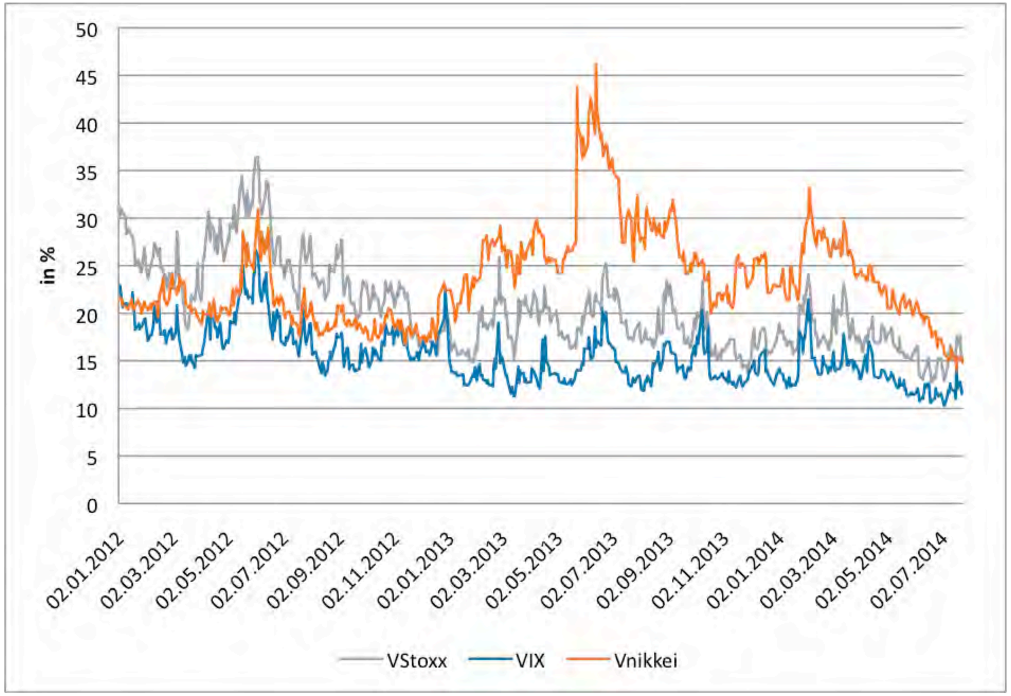
The markets way up and the difficult yield environment led to an investors sentiment, which is extremely optimistic, despite the record levels we are currently seeing.

The Advisors Sentiment of Investors Intelligence for example shows a extremely high percentage of bullish advisors accompanied by an overly low number of bearish advisors. Very often this was a sign for an upcoming correction in the past.

Source: Investors Intelligence

Low implied volatilities in Developed Market equities continue to exist

The markets expectation regarding the volatility of equities is also extremely low. That's just another sign of the exuberant optimism that currently dominates the equity market. Even the implied volatility of the Japanese market is next to a record low.



Source: Bloomberg

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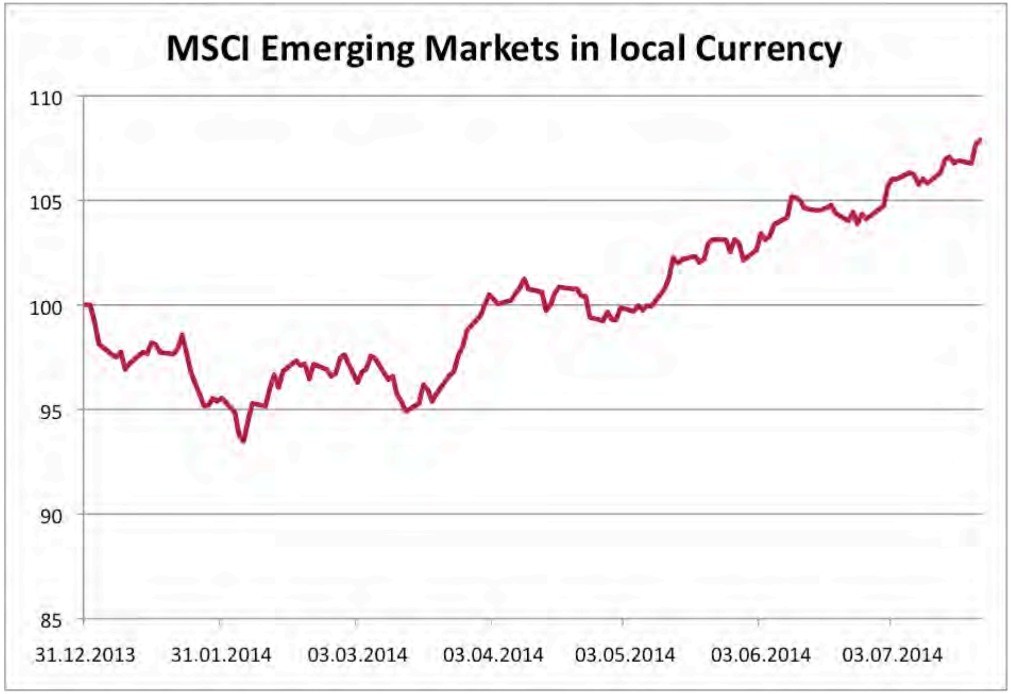
Positive 2014 for Emerging Markets

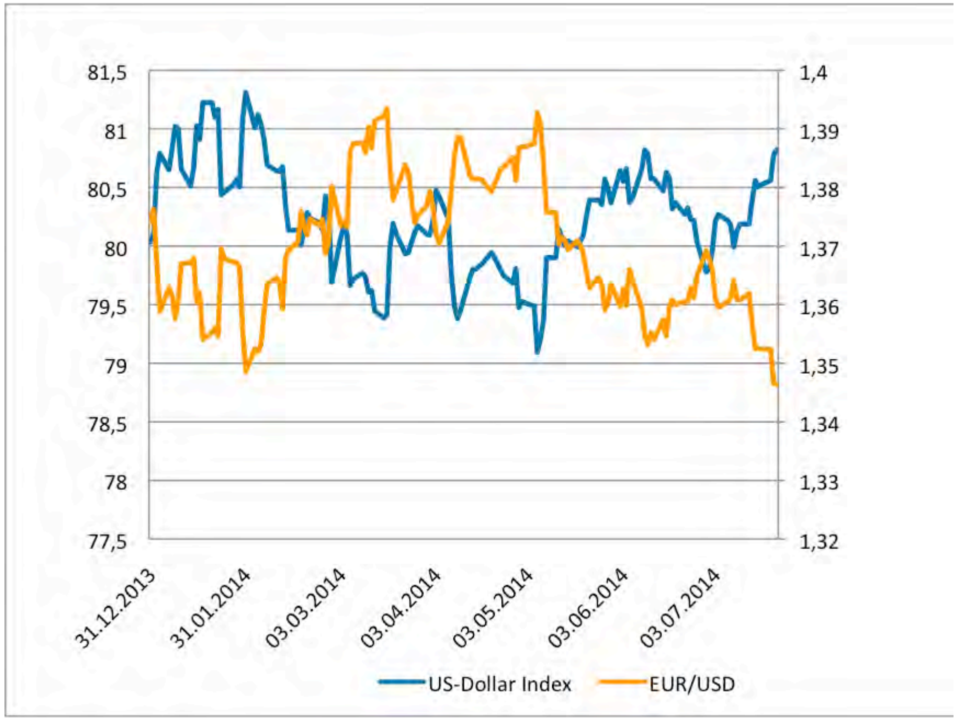
Emerging Markets equities had a difficult year 2013. The start in 2014 wasn‘t easy either. But from March on those markets started a strong recovery and even caught up with the US and Europe in the end.



Source: Bloomberg; normalized

US-Dollar a bit stronger

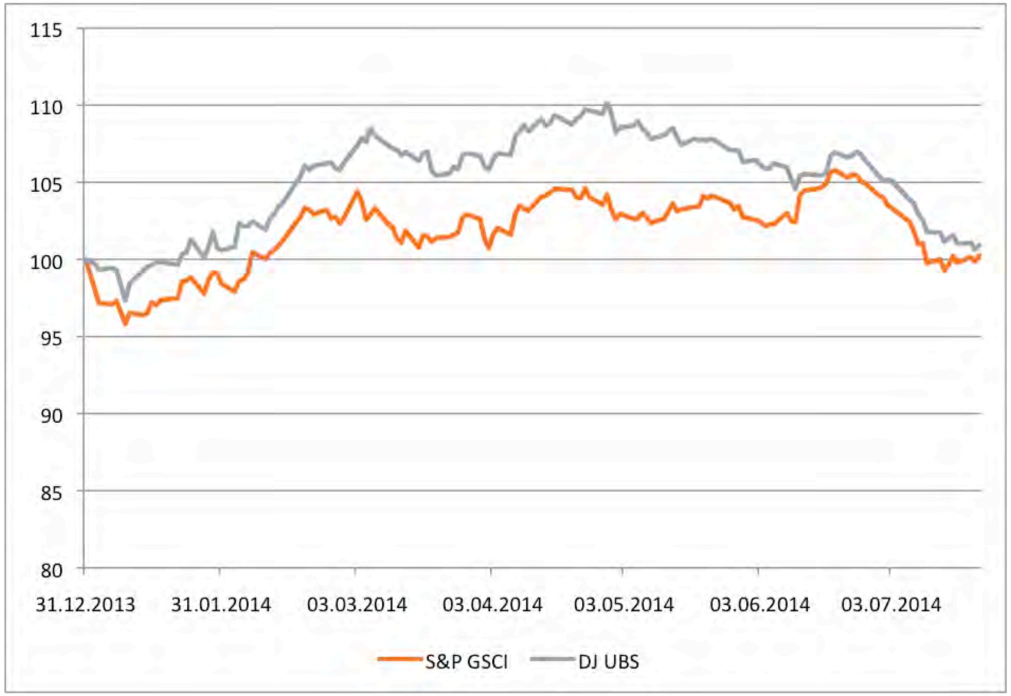
The US-Dollar lost some ground in the first quarter of 2014 just to reverse this trend in the second quarter and to end up a little bit stronger than at the beginning of the year. Whereas the US-Dollar Index, which compares the Greenback to the major world currencies, only rose marginally, the Dollar won 3% against the Euro in the first months of 2014.



Source: Bloomberg

Commodities – up and down in 2014

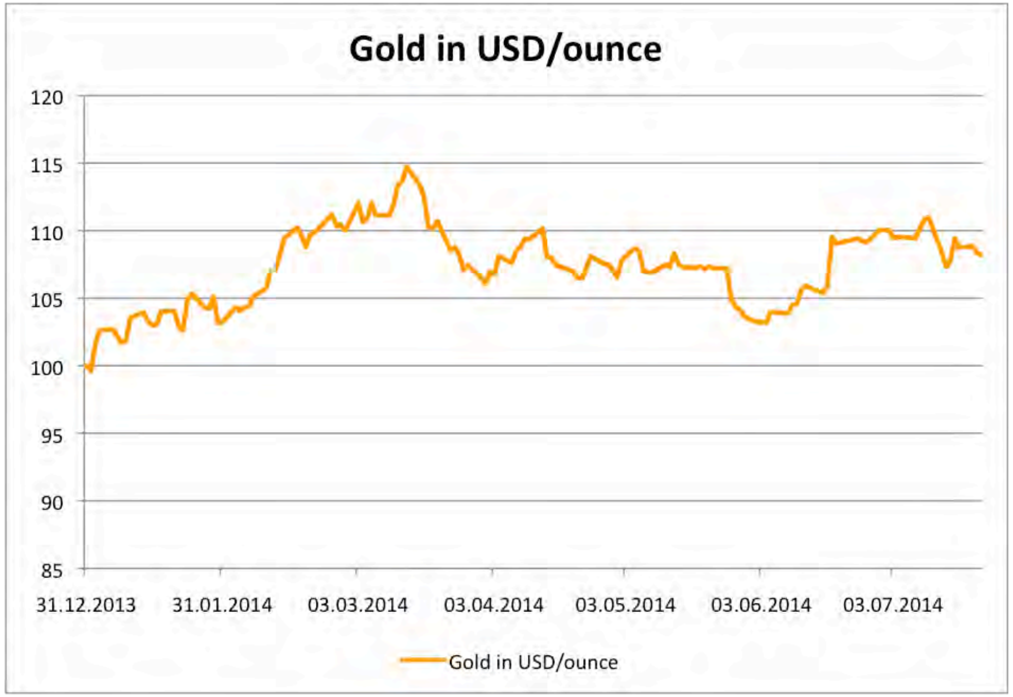
You wouldn‘t call it a rally, but commodities showed a very strong first quarter in 2014. From the end of April however commodities started loosing some ground again. In June and July the downward trend even accelerated and all of the gains were erased finally, so that in total commodities as an asset class are unchanged this year.



Source: Bloomberg; normalized

Gold – at least positive in 2014

Gold was one of the big profiteers from the geopolitical tensions this year. This pushed the price higher with a spike of over USD 1380/Oz in mid march. There is still ample of room in regard of the all time highs in 2011, but from an investors standpoint the first half of 2014 was at least a positive semester.

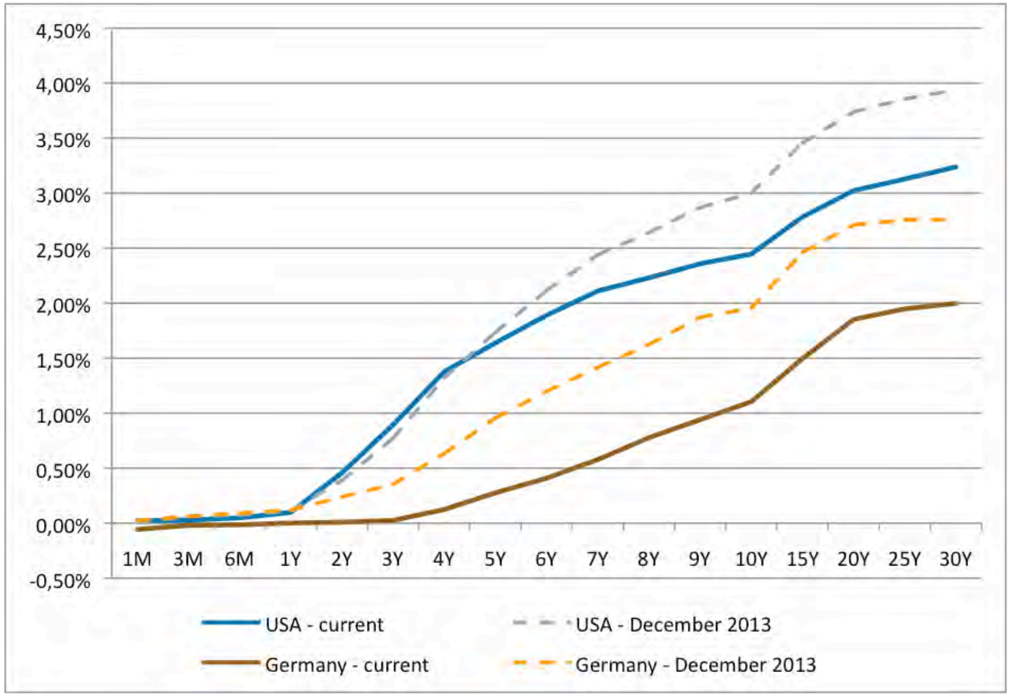


Source: Bloomberg; normalized

Yield curves in US and Europe with a similar development

Regarding the development of the yield curve the divergences between the US and Europe disapeared a bit. Up to a maturity of 5 years (so short and mid term) the US-yields basically stayed the same. But over 5 years the yields clearly fell resulting in a considerable flatter yield curve with 10y – 2y of 2% (December 2013: 2.61%).

Yields seemed to be attractive enough for a lot of investors to invest in US Treasuries again. In Europe the yields basically fell over all maturities and the yield curve flattened with 10y – 2y at 1.1% at the moment (December 2013: 1.72%). On the short end of the yield curve we are seeing negative yields now as an expression of the ECB interest rate politics and the fear of deflation in Europe.

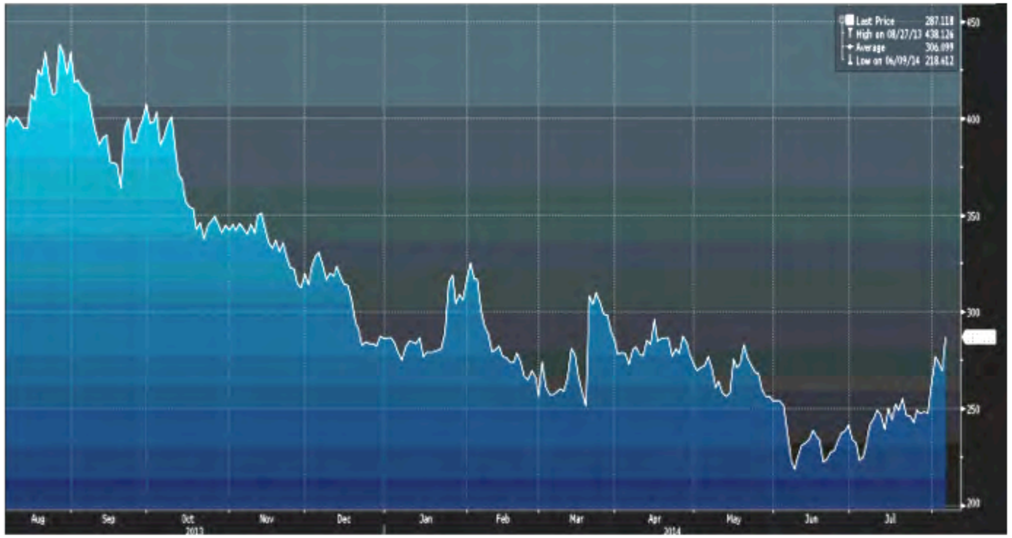


Source: Bloomberg, Yield Curves USA & Germany

Credit spreads continue to fall

No real news from the credits, the spreads are still falling. A pretty tricky situation for investors. If you are long credit you maybe are delighted by the returns, but for sure are afraid of a trend reversal. If you don't have any position in credit, the tightening of the spreads not only shows you an oppurtunity you missed, but also takes you an opportunity to invest.

Because the lower the spreads, the more unfavorable the risk/return profile. So falling credit spreads simply mean less investment opportunities to choose from, especially in times with low interest rates and high equity markets



Source: Bloomberg, ITraxx Crossover Generic 5 Years Index

US-unemployment rate: „The trend is investor‘s friend“

Positive news are still coming from the US economy. The unemployment rate reached a level of 6% in the last month, a value that was last seen in September 2008 and which is already below the average of the last 30 years (6.1%).

Source: Bloomberg, US Unemployment Rate Total in Labor Force Seasonally Adjusted in %

In the US the positive economic development continues

US-GDP also shows a very healthy picture, and GDP-growth was again above 4% so that the strong growth-trend for the US remains. GDP-growth has never been below 3% since mid 2010 now.

Source: Bloomberg; US GDP Nominal Dollars YoY Seasonally Adjusted

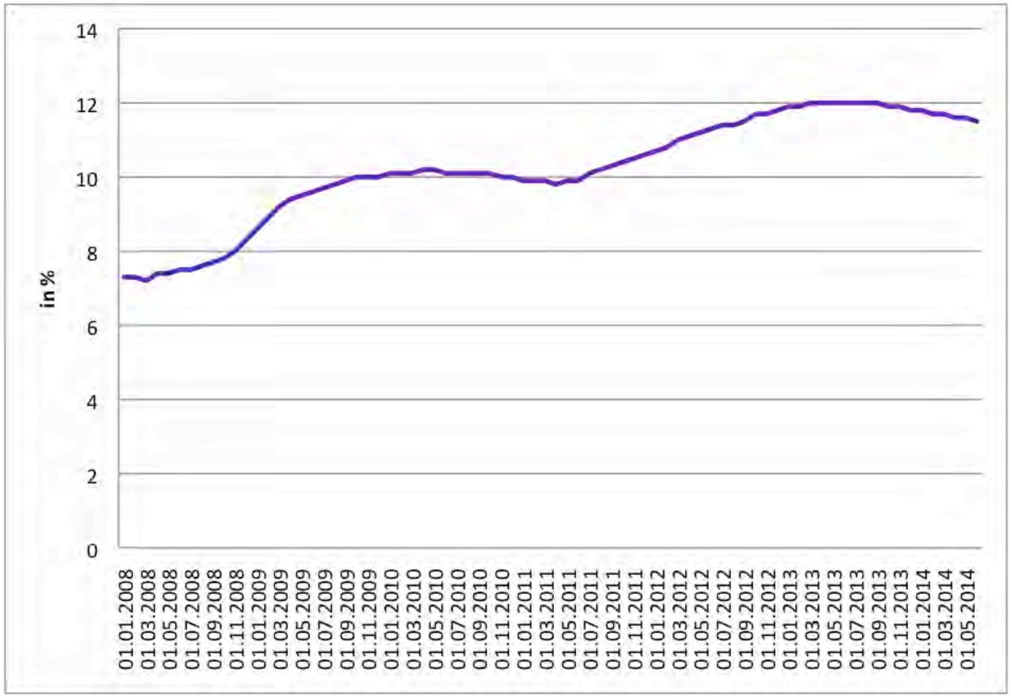
Positive European Trend continues

What's wrong with Europe? Nothing! The economic data are still weak but nobody is expecting a miracle. The trend is a good reason for optimism and it seems that Europe is really gaining momentum. The growth numbers were positive again and the last GDP data showed a nominal growth of nearly 1% for the Eurozone.

Source: Bloomberg; Eurostat GDP constant prices Eurozone YoY in %

Unemployment rate in Europe remains to be extremely high

The unemployment rate in Europe is still high and the divergences between the member countries in regard of economic growth and employment are still huge. Nevertheless, in total the situation improves and unemployment rates are falling…slowly but steadily. If this positive trend for Europe continues investors should already consider investing in Europe – not in 2 or 3 years time, but now!

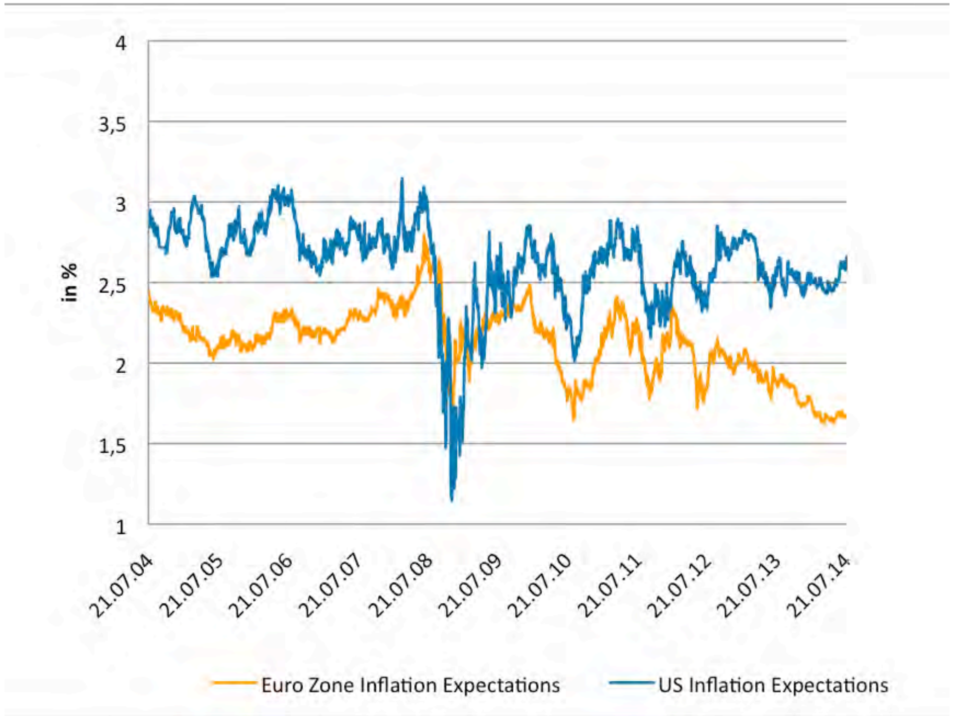


Source: Bloomberg; Eurostat GDP constant prices Eurozone YoY in %

Expectations on inflation

The current situation on the financial markets is clearly an extreme one. Extremely low yields, extremely low credit spreads, equity markets with record levels and record low implied volatilities. Another extreme are the low expectations regarding inflation in Europe. People don‘t fear inflation, they currently fear deflation.

The old rule of thumb, that inflation is „cheap“ at expectation below 2% seems to be not valid anymore. Nevertheless, if Europe continues its way to recovery, investors in inflation protected investments will profit for sure.

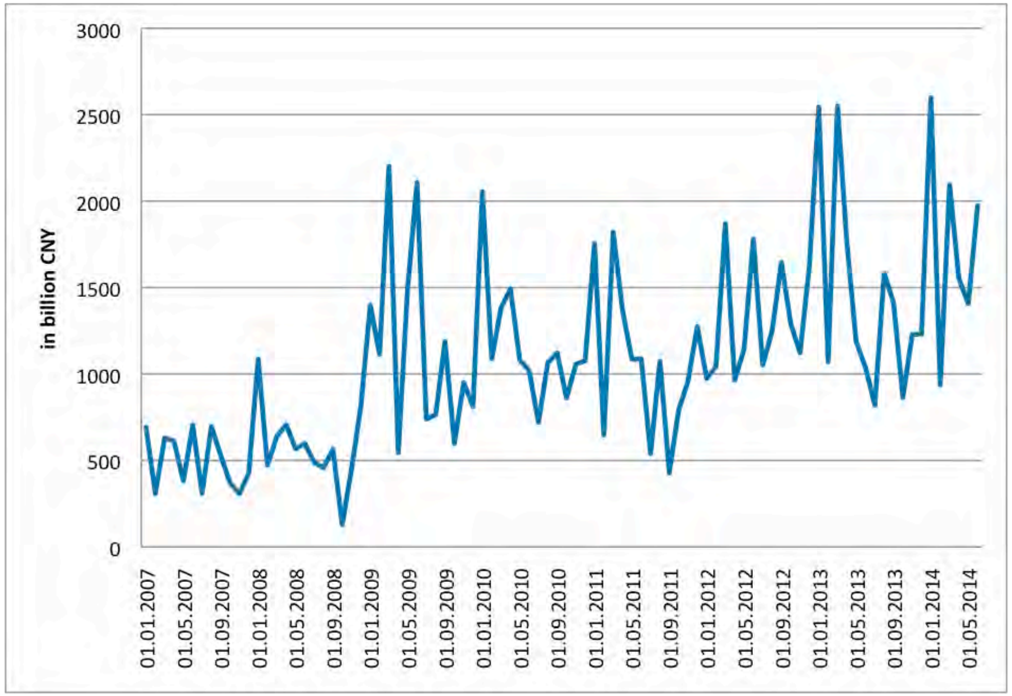


Source: Bloomberg; Inflation Swaps USA & Europe

Financing in China

The situation in China is not an easy one. Despite declining growth tendencies the People's Bank of China tries to hold the growth constant and to reach the self imposed growth targets. A few quarters ago the PBOC declared war to Chinas increasingly worrying shadow banking system.

Nowadays this seems to be no topic anymore and supporting the economic growth by increasing the aggregate financing has absolute priority. PBOC has started monetary easing which should result in a restarted growth of shadow banking



Source: Bloomberg; China All-system Financing Aggregate

Staple Chinese GDP

The Chinese economy shows a kind of stabilization. The pro growth measures start to show first results and also have an positive impact on the Chinese equity markets. But it is clear that the current growth numbers are not only artificially supported but in real danger especially by falling property construction and markably lower growth of home-prices. Even with the current support measures China's full year growth is forecasted to be the lowest since 1990.

Source: Bloomberg; China All-system Financing Aggregate

Outlook Equities

It can't be denied that equities already have a rich valuation. An isolated view on equities maybe wouldn't make them appear really attractive. But it is a fact that the investment environment currently is not an easy one with less than usual opportunities.

Therefore from a relative standpoint equities don't look as unattractive, as an absolute view would make you believe. Nevertheless the things said in our last report are still valid. Proper research regarding the quality of an equity is necessary ... and a long time investment horizon, cause nobody should strive for fast money at current valuation levels.

Source: Shiller

Outlook 2014 –Fixed Income

- ECB has just lowered the rates whereas in the US the short rates are anticipated to rise soon. So basically it seems that the historical interest rate-relationship between the US and Europe persists, where Europe is simply 1-2 years behind the US. The economic development of those two regions underlines this theory. Europe is just in the course to start the recovery, whereas the US is already in the middle of it.

- European Inflation Linker still look like a very interesting addition to the portfolio, as the expectations regarding inflation still are extremely low and people are feared of a sustainable deflation in Europe. The economic recovery would help to overcome those fears, but investing in Inflation linker nevertheless could mean to be confronted with a high level of suffering.

- On Credit generally it does not make sense to be long at moment. If Investors really want to have positions in Credit they should exploit isolated possibilities in stable names with reasonable balance sheets.

- For Euro-investors the additions of foreign currencies still should make sense. Nevertheless, on the longer term Euro investors have to keep in mind, that a change in the expectation of the domestic interest environment will have a large influence on their foreign currency investments.

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Outlook 2014 – Commodities & Gold

- No changes in the evaluation of Gold. It stays as an asset neither paying coupons nor dividends and the yield of the asset solely depends on it‘s price development, which can‘t be reliably predicted or valued. Therefore the current price can‘t be assessed properly, even if Gold will stay a good value for storing value.

- Commodities had a kind of revival in the first quarter this year and the development of the US supports a positive view on this asset class. Nevertheless China and some other Emerging Markets remain a worry in regard of the quotations. However, if Europe continues it‘s way out of the crisis this could have a huge indirect effect on commodities. Geopolitical influences will remain to have an huge influence on certain commodity prices.

INNOVATIS Products – 2. Quarter

- Innovatis issued and traded around 20 different products in the second quarter of 2014
- Especially the issues and trades in our equity-linked Multi Express Return Notes, which are intended for yield enhancement, need to be emphasized, as the performance of these products was once again outstanding.
- Innovatis traded a nominal amount of USD 8 million in Multi Express Return Notes in the second quarter of 2014.
- The performance of the trades in these products was 12,81% for the second quarter.
- 80% of the trades showed a positive performance at the end of the quarter with +28,51% as the highest quarterly gain in a product
- Only 20% showed a negative performance at the end of the quarter with -13,12% as the highest quarterly loss in a product

Impressum

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