swisspartners
The art of finance.

PARTNERS ' VIEW
JULY 2019

WEALTH MANAGEMENT
Bored of BREXIT? Tired of tariffs? Terrified of Tweets? Petrified of politics

Please read on for hopefully a different easily understandable and refreshing viewpoint

For the first time in almost a decade we have temporarily reduced our equity weighting in discretionary portfolios towards the neutral zone from an overweight stance.

Whilst we still don't subscribe to the consensus view that we are in the latter stages of a cyclical bull market (we still believe there there is significant room both in terms of duration and percentage gains for much longer than most anticipate) there are some current issues which give us pause.

The recent threat of tariffs (now removed) on Mexico by the USA for purely political (immigration) purposes not related to economics has we believe led to an increased weaponisation of the tariff tool. The fact that this move led to no censure of the President by either Congress or the Republican party really gives us cause for concern that Presidential powers remain unchecked (rather dangerous in a democracy).

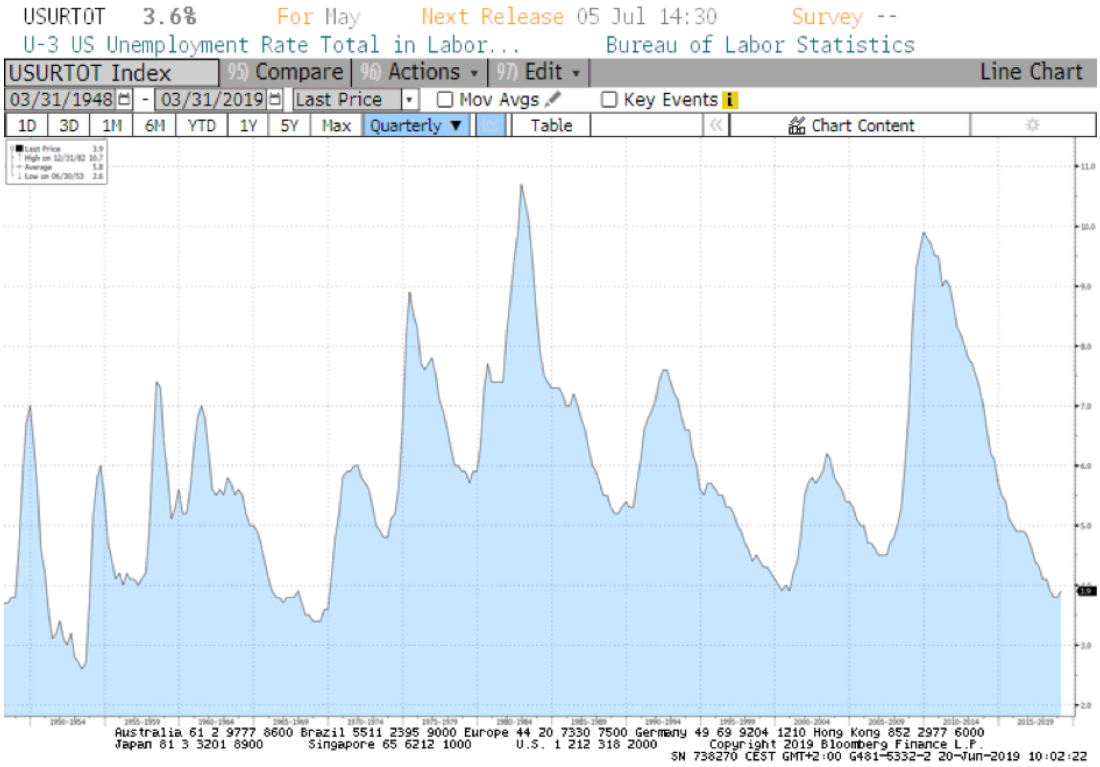
The recent loud calls for interest rate cuts by the Federal Reserve (by TWEET) and the talk of a demotion of the head of the Federal Reserve to be replaced by someone who presumably who will do what is told again sets up a very dangerous precedent of undermining the indepedence of the largest central bank in the world.

We are also concerned about the use of tariffs on named currency manipulators (currently going through the consultative process) as this lead to another area of uncertainty.

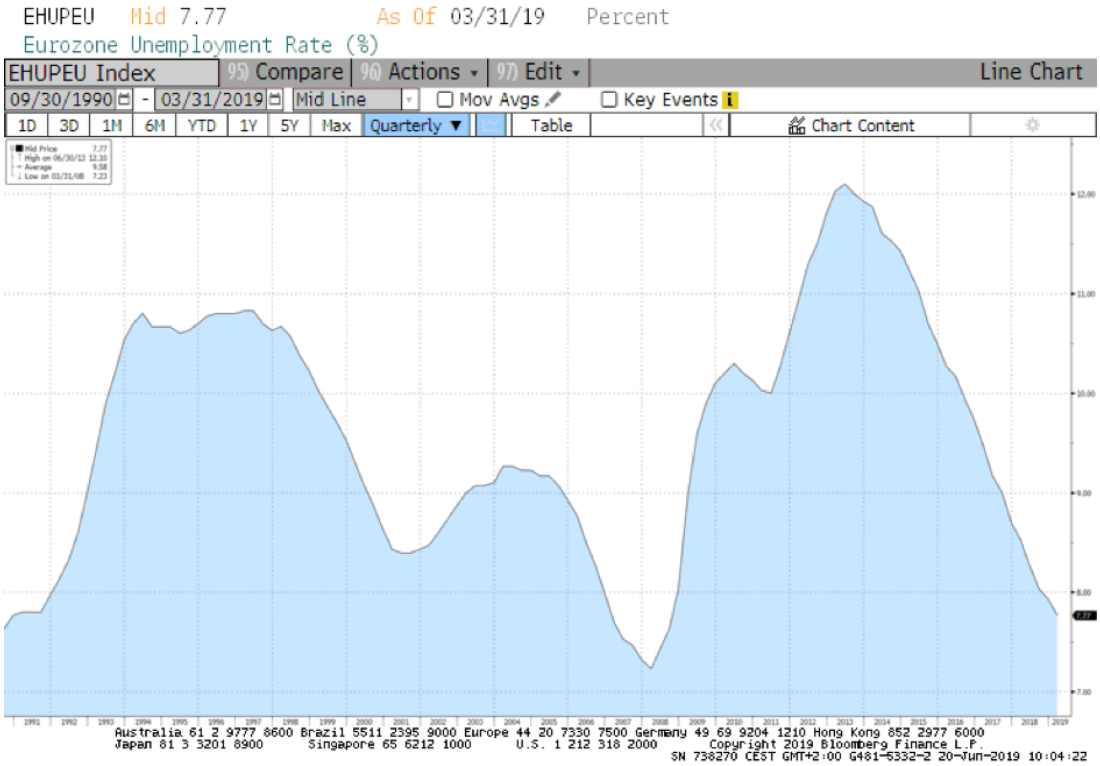
To put it in simple terms think of the walking paterns of a toddler which are highly unpredictable and erratic. This pattern in equity markets makes us nervous – we have no problem in taking risks if the odds are in our favour however with so much depending upon binary outcomes at the moment the odds of 50/50 on many major issues make us cautious and leads us in the short term to have less conviction.

The good news

Consumers remain strong and are still spending probably due to low unemployment rates both in current and historic terms.



In fact even though it has gone unnoticed by most even in Europe the trend is looking encouraging.



Whilst there willundoubtably be a slowdown both in the global economy and the US economy (mainly due to companies reigning in capital expenditure plans due to uncertainty) we still see no recession. The recent moves by central banks- Federal Reserve possibly opening the door to a rate cut in July and the premptive moves by the Chinese central bank and government of tax cuts, infrastructure spending and stimulus for the auto industry should help soothe the negative effects of the tariff uncertainty. The European Central bank has also been active verbally in pushing the notion of further negative rates and despite Mario Draghi`s tenure coming to end in the not too distant future don`t be surprised by a last salvo (perhaps the reintroduction of quantative easing).

Whilst we are still frustrated that global economies are growing below their potential there is still scope for this situation to be rectified.

Trade wars are NOT easy and quick to win –

Especially if you have underestimated the size and resolve of your adversary. Whilst we do not expect a full trade deal at the G20 meeting we think there is a distinct possibility of the next round of tariffs being put on hold whilst discussions between the US and China take place.

We strongly disagree with the notion that this is a long drawn out trade/tech war which will not be resolved for decades (although this makes great headlines and is now a consensus view). The reality is in fact probably much more simple and could lead to an agreement by year end.

Looking at the recent nuances and putting them into simple terms it is rather like a first date when phone numbers are exchanged. You wait for the phone to ring but if it doesn't do you call?

It is telling that the US picked up the phone to China to arrange the meeting between the two leaders at the G20 summit. What is also telling is that the previous rhetoric of there would be no trade deal without adhering to the US previous demands has changed. At Trumps`s formal re election rally in Florida this rhetoric has been dialled back to a fair trade deal with China.

Of course there is still the issue of Huawei but once again we beg to differ from the consensus. We do not really believe that the US President is actually a China hawk but he may however give off that vibe to acheive his objectives. He is first and foremost a businessman and everything is negotiable and he has shown time and time again that he is willing to ignore almost everyone if it acheives his objectives.

The clock is ticking and with the US elections just under one year away an economic recession would not be a great vote winning strategy. Time is also running out on delivering on election promises with only a South Korea trade deal signed so far. The next round of tariffs on China would be felt more acutely by the US consumer who could then possibly reign in spending.

Surely Europe is the next victim with auto tariffs?

Maybe however we should look to the precedent of what happened regarding the steel and aluminium tariffs. Europe reacted in a fast and coordinated way (trade is about the only thing that Europe has a consensual opinion on) specifically and ruthlessly targeting areas of Trump's core base of supporters (Harley Davidson, agriculture, peanut butter, bourbon etc). The European trade comission has already stated that the retaliatory tariffs are ready to go should the US proceed with their auto tariff threat.

In fact according to the office of the United States Trade Representaive Europe if taken as a whole ranked as the most important export market for the USA in 2018 with goods and services trade totalling nearly USD1.2 trillion in 2018 accounting for nearly 20% of the US total exports and supporting over 2.6mn jobs.

Of course everything could change with one late Sunday evening tweet.

Taking some steps back and gaining perspective we should be greatful for the environment we live in. We are unlikely to see its like again!

Peter Ahluwalia,
Chief Investment Office, Partner

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FINANCIAL PLANNING
Early planning is the key to a good retirement

It is astonishing to discover just how little young adults know about the importance and benefits of pension planning. In the majority of cases, the explanation is simple: many people lack the knowledge, interest or financial means to save for their retirement. There is a growing tendency amongst the younger generations to live «in the moment». The money that they earn themselves or obtain by taking out loans is spent on holidays, expensive cars (leasing), luxury goods or other amenities.

The main question is how these generations will finance their lifestyles when they reach retirement age. How can they maintain the same standard of living given the problems that have already been identified in relation to the old-age and survivor's pensions system (AHV) in future?

Many people assume that they are adequately covered by the obligatory pillars 1 and 2 (AHV and pension fund) and will be able to maintain their usual standard of living, which is often beyond their means. Unfortunately, this is an illusion as more free time automatically means more time to spend money, which inevitably leads to a dead end.

To avoid falling into this trap, it is important to look carefully at the subject of retirement provision and its advantages well in advance to maximise profit during the years leading up to pensionable age. In order to reach this «maximum», it is advisable to seek assistance from an independent financial service provider and discuss the various options.

Banks, insurance companies and brokers recognised the potential and earnings opportunities some time ago and have developed various products specifically for this purpose.

The most common way of saving for retirement is the restricted pension scheme, known as pillar 3a, whereby deposits are saved in a bank savings account or via a life insurance policy. In the latter case, it is important to obtain as much information as possible given the huge discrepancies in the returns offered by various providers for the same product, as making the wrong choice could diminish your income. This is because commissions for the seller or advisor can be high.

The savings that are paid in during the term are tax deductible, which is the first advantage. The second advantage is that the pension capital grows over time due to interest and the compound interest effect. However, the disadvantage worth considering is that the funds are tied up until you reach retirement age and cannot be accessed beforehand in an emergency.

Another option for retirement savings is to purchase additional benefits for your pension fund. The annual savings amount can be deducted from your taxable income, while the income from interest and compound interest is tax-free. Another huge advantage is that some or all of the pension pot can be drawn on or pledged to buy a home.

If we have piqued your interest in a personal pension plan that is tailored to your specific needs, we would be happy to assist you as a neutral and independent partner.

Mauro De Luigi

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FIDUCIARY SERVICES
«After-tax returns» – taxation of bonds, derivatives and combined products

1. Introduction

Alongside many traditional, «conventional» types of investment such as accounts, equities, bonds, fixed-term deposits and precious metals, recent years have seen various financial instruments being launched on the market for investment purposes, examples of which include products that combine bonds with option contracts and futures.

In place of conventional bonds the financial industry initially started to deploy specific products entailing – either exclusively or predominantly – one-time interest payments. These included zero-coupon or discount bonds and bond issues with a single repayment of the principal on the maturity date (bullet bonds). Over time, these bonds started to experience competition from derivative financial products combining bonds with option contracts or futures and generating varying returns for investors.

Owing to these developments, the tax authorities were forced to amend their legislative frameworks and practices in line with the new market situation. One especially interesting aspect of the taxation of combined products for private investors is the issue of which income streams from the product represent taxable returns and the point at which these are deemed to have been realised for tax purposes, therefore becoming taxable.

For private investors with unlimited tax liability in Switzerland, the focus of (managing) their investments is always on the returns after taxes and fees generated by the products. We will therefore go on to summarise the principles of tax on financial instruments for the purposes of individuals' income tax. Some readers may be interested in Circular No. 15 of the Swiss Federal Tax Administration dated 3 October 2017 for a more in-depth discussion of all the tax consequences.

2. Bonds

Coupons on conventional bonds are exclusively paid periodically. As a result, these periodic interest payments are treated as taxable income subject to income tax in accordance with the general maturity principle as per the coupon's maturity date. If the bond is sold, the accrued interest is generally treated as a tax-free capital gain.

Things become trickier from a tax perspective if a periodic interest payment is not made or is made only in part, i.e. not providing the usual level of income, as in the case of predominantly one-time interest-bearing products.

Discount bonds are issued at below par value, while repayment is made at their face value (issuance discount). In contrast, bullet bonds are issued at par, while repayment is made above par value (redemption premium). Investors receive no periodic coupon payments at all on pure-play discount and bullet bonds (zero-coupon bonds). Instead, investors' entire proceeds from holding these bonds are exclusively paid on a one-off basis when the bonds are redeemed. In the case of combined discount and bullet bonds, as well as a one-time payment on redeeming the bonds investors also receive periodic coupon payments, which in such cases come in below the interest rate for investments on which interest is exclusively paid periodically. As far as the income tax implications are concerned, a mathematical finance formula is always required to check whether the bond concerned is chiefly characterised by one-time or periodic interest payments.

A bond is deemed to be a predominantly one-time interest-bearing product (referred to as intérêt unique prédominant/IUP) if more than half of the total returns on maturity stem from the issuance discount or redemption premium. In taxation terms, any periodic interest payment to investors always constitutes taxable investment income. In the case of predominantly one-time interest-bearing products, all actual income generated by investors on the sale or redemption of the bonds is taxed in line with the margin taxation method (growth in value principle: taxation of the positive differential between the sale or redemption amount and the purchase amount for the seller and for each transaction).

In the case of non-IUP products, i.e. those not predominantly characterised by one-time interest, the periodic

coupon payments are taxed in line with the general maturity principle, while one-time payments are taxed at the time of redemption («Devil take the hindmost»). Any increase in value realised if the product is sold is treated as a tax-free capital gain. Investors can therefore sell these products prior to redemption (at least three months before the maturity date), realising a tax-free capital gain without any income tax implications. In contrast, this is certainly not possible in the case of predominantly one-time interest-bearing products.

3. Derivative financial products

Derivative financial instruments are used for purposes including hedging and transferring risks as well as matching maturities or currencies for debt claims or liabilities. The value of derivatives depends on that of an underlying instrument, which may include equities, bonds, precious metals or equity indices, for example. Alongside conventional derivatives such as options, futures and swaps, there are now new forms of financial instruments known as structured or combined products.

According to judicial decisions of the Federal Supreme Court of Switzerland, gains generated from forward transactions (options and futures) are capital gains and remain – unless capital gains are expressly specified in the legislation – free from income tax as they fall within the scope of an investor's personal assets. However, losses arising from such transactions are not tax-deductible.

4. Combined products

Financial products such as these combine bonds with option contracts (e.g. option and convertible bonds or other capital-guaranteed derivatives), giving investors various remuneration components. In simple terms, the key issue when it comes to how these products are taxed is whether the product's components can be analytically separated or not (transparent or non-transparent products). In the case of all transparent products, for tax purposes a distinction is made between the investment transaction (the bond whose returns are taxable and for which it is important to know whether or not it is a predominantly one-time interest-bearing product) and the hedging transaction (the option from which the gains generally constitute tax-free capital gains).

Unlike a transparent product, in the case of a non-transparent financial instrument – the option or the convertible right, for example – constitute the variable component of a return from the investment transaction. The tax consequence of this is that anything received by an investor in a non-transparent financial instrument above and beyond the capital he or she originally invested is subject to income tax. As a result, owing to the lack of tax transparency the option component of a product such as this does not – in contrast to a transparent product – remain tax-free. Instead, together with the product's other return components the option component is taxed in full.

5. Conclusion

In my opinion, the key issue for investors or bank clients with unlimited tax liability in Switzerland is the return after income taxes and fees from the financial products they purchase. If investors and bank clients take note of financial products' income tax implications when making their investment choices, they can optimise the net performance after tax, for example by opting for transparent financial products that are not predominantly one-time interest-bearing instruments.

Felix Reinhardt,
Partner

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TRUST & CORPORATE SERVICES
Networking Ladies

On Thursday 9th May 2019, swisspartners Marcuard Heritage AG (SPMH) sponsored an event of the Private Client Dining Club (PCD). The PCD events provide a high-quality networking platform for advisers to global international private clients. What started with London and Swiss based events has even spread globally as far as Asia and Africa.

The company also organises female-only events under the banner «PCD Ladies». SPMH co-sponsored and brought the PCD Ladies concept to Zurich for the first time. The event was very well received, with 60 attendees, drawn from the finance, legal and trust sectors.

Personally, I am a fan of networking events in general, but sometimes there can be an under-representation of women in our industry, so I believe that female-only events help to address the imbalance, as well as providing a support network and mentoring for the younger generation.

The choice of venue was also important and thanks to a personal connection of one of the partners at swisspartners, we were able to secure the venue of the Häusler Contemporary Gallery which provided a perfect backdrop for the event.

The exhibition «Beyond Beauty» was by the American artist, Judy Ledgerwood and attendees had the opportunity to view her paintings and ceramics and to listen to a talk on the exhibition during the evening.

The theme of art and art services resonates strongly with the swisspartners group, where we can assist clients wishing to hold art in suitable vehicles.

The swisspartners group was represented in force at the PCD Ladies event by some of the female partners of the group and new board member, Caroline Fiala (see photo).

The theme of «Women in Wealth» is of interest to the swisspartners group. As we are made aware from many sources, women generally outlive their spouses and are already or will be in sole charge of their finances during their lifetime. According to research from the Boston Consulting Group (Navigating the New Client Landscape: Global Wealth 2016, published by BCG June 2016), it is predicted that by 2020, women are expected to hold USD 72 trillion of the global wealth, with most of the transfer of wealth from one generation to the next likely to go to women.

This could potentially lead to a situation where nearly two thirds of the global wealth is held by women, so it will be important for female clients to be able to choose between male or female advisers for their wealth planning and management needs. Given that we have many female partners within our group, we can already give female clients this option.

It goes without saying that each client is different and female clients should not be treated as an homogeneous group and time should be taken to develop a long-term relationship which is based on trust and each client's needs and situation should be reviewed on an ongoing basis.

We will be organizing more bespoke events related to women in wealth on a regular basis, so watch this space!

Caroline Bennett-Akkaya, Partner