

Editorial



Dirk Steinhoff
Chief Investment Officer

After a strong and profitable 2017, with record low volatility, high investor confidence and arguably increased complacency too, this year began with a sharp reminder that the stock market still has the potential for turbulence and unpleasant surprises.

February's selloff rattled investors and brought back volatility, disrupting the calmness and low fear levels that prevailed over the previous year. The stock market might have snapped back relatively quickly and recovered half of the losses incurred during February, but concerns still remain present about the future of the ageing bull market. Fears over the possible eruption of a trade war have also been added to the list of potential risks, following the Trump administration's announcement of new tariffs. Overall, we expect 2018 to be somewhat more challenging than the previous year. With higher volatility levels expected, a more careful and cautious analytical approach will be required for successful portfolio management.

However, good opportunities still exist. The recent tax cuts and the upcoming stimulus packages could help prolong the US economic expansion, while economies in the Eurozone, still in an early growth stage, provide even stronger reasons for optimism. The outlook for the global economy remains positive with continued growth into 2018, while important trends and shifts are also developing in sectors that can have an extensive

economic impact. A prime example of such a significant shift to watch is automation, which we look into in this issue of the BFI Infinity InSights.

This year the BFI Capital Group is celebrating 25 years in the wealth protection and wealth management business.

Throughout this time, we have always welcomed the opportunity to share our insights, thoughts and strategic approach with our clients. Having the chance to do so in person is even more important, which is why we are pleased to share with you the details of our next US visits.

Daniel Zurbrugg, CEO: **April 9th - 15th**, in New York, Alabama and New Orleans, with a global investment outlook presentation on **April 10th** in Birmingham, AL.

Dirk Steinhoff, CIO: **April 8th - 21st**, in Washington D.C., South Carolina, Georgia, Florida, Ohio and Illinois.

We are also very happy to announce our participation in this year's FreedomFest in Las Vegas, from the **11-14th of July**, where our sister company Global Gold AG will be a Gold Sponsor. Together we will hold a private afternoon briefing on the 11th, focused on jurisdictionally diversified wealth strategies.

We look forward to seeing you, updating you on our outlook and answering your questions.

In the Limelight: Investing in innovation

An in-depth look at the investment opportunities in innovation, focusing on the automation sector and its far-reaching, transformative potential, through the lens of history and with a view to what lies ahead.

Are investors' inflation fears justified?

Following February's selloff that was kickstarted by heightened concerns of a potential return of consumer price inflation, we examine the issue in its full context and outline its implications for investors.

CEO Corner



Daniel Zurbrugg
CEO BFI Infinity

The end of low volatility?

While 2017 was a very profitable year for investors, the new year has already brought on some challenges. The sharp sell-off in global markets in early February has painfully reminded

investors that markets are not always going up and volatility won't remain forever at the extremely low levels experienced in the recent past.

The sell-off saw global equity markets fall by almost 10%, but eventually they stabilized and have by now recovered almost half the losses seen a month ago. While the correction as such was not surprising, the question is "why now", as the global economy has gathered good momentum and we are witnessing a situation of globally synchronized growth, for the first time in almost ten years.

Growth is good and will clearly support higher corporate earnings in coming quarters. However, the problem is that the market valuations are rather high by historical standards and therefore might come under pressure as interest rates are starting to move to higher levels.

Thus, while the "E" part of the P/E valuation looks positive, it is the "P" part that looks problematic, given the expectation for higher interest rates. This will create a more difficult environment for stocks going forward, however, it doesn't mean that it would necessarily lead to a further market correction, although it could translate into higher levels of volatility.

Another factor that might limit gains in the coming weeks and months are the concerns about rising trade tensions and the possibility of an outright

trade war. The recent announcement by the U.S. government to put new tariffs in place is certainly not a positive signal for the world economy.

2018 will probably not be as good as 2017 in terms of stock market performance but in our view, it still has the potential to be very solid. With good momentum in corporate earnings, the higher interest rates are not yet problematic and are still very low compared to historical standards, as you'll see in greater detail in our article focusing on inflation fears in this InSights issue. The exact moment when higher rates are going to become painful might be hard to pinpoint, but it is clear that we are not at these levels yet.

The recent correction in equity markets was caused by a painful adjustment to higher levels of volatility that hurt some highly leveraged volatility funds very badly. It was also very interesting to see that the market correction in stocks did not bring about a lot of turbulence to other markets, such as currencies. Thus, this recent sell-off in stocks looks like it was a somewhat isolated event.

February correction: Buy the dip?

We believe the recent sell-off is not the start of a longer correction, however, the question is where one can currently find the opportunities in the stock market. Our view is that Europe and the Emerging Markets continue to look attractive, while we are slightly negative on U.S. markets given their stretched valuations. Also, from a macroeconomic point of view, we see that Europe and many other economies are in a relatively early stage of growth, whereas the situation in the U.S. is at a much more advanced stage.

With the recent tax cuts in the U.S. and additional fiscal stimulus coming, the recent economic expansion might get prolonged for another year or two, but eventually we see a slowdown coming. Given the extraordinary amounts of monetary and fiscal stimulus in the past few years, the underlying business cycle might be longer than in previous

times. What has not changed, however, are the basic principles and factors that drive business cycles. The next slow-down or even recession is a question of when and not if.

Are growth stocks now defensive?

In 2018 investors need to be more active and proactive than last year. Given the higher expected levels of volatility, investors need to look for opportunities while at the same time managing the risks very carefully. This starts with an overall adjustment of the underlying equity exposures in portfolios which should be more conservative than last year. Also, investors need to build up better protection by selecting stocks or sectors that have good momentum, but also have profound defensive qualities. In this context, it was very interesting to see that stocks/sectors that are typically considered defensive did not do well and were falling as much as or more than the overall market. At the same time, some of the high beta stocks, especially technology shares, have been doing really well.

Sector allocation is going to be increasingly important for the successful management of a portfolio. While the outlook for stocks remains slightly positive, we also see the possibility of a rise in the gold price. Despite rising interest rates, gold is holding up well and given the increasing global tensions, we see further upside. The critical question is whether the gold price is able to breakout from the relatively narrow trading ranges we had in the recent past. If this happens, we see a significant positive momentum developing that could move gold prices higher, even as interest rates are rising. In terms of currency markets, we haven't seen much volatility in the past few weeks, even during the selloff in early February. An interesting point was that the U.S. Dollar did not benefit from the increasing uncertainty. Typically, safe haven flows tend to push up the greenback in times of correction, but not this time. The Japanese Yen has been much stronger lately and seems to be the safe haven currency of choice at the moment for a lot of global investors, particularly from Asia.

Given the fact that the peak in this latest Dollar cycle was reached in December 2016, the obvious question now is: what will the U.S. Dollar do once we finally start to see a slowdown in the U.S. economy, which we project for 2019? Such signals will eventually stop the trend of rising yields and therefore take away a lot of support for the U.S. Dollar. We believe that this will eventually lead to a significant correction in the U.S. Dollar during 2019/2020, potentially testing the lows seen in 2011. This would imply a roughly 20% downside risk for the U.S. Dollar in the next 24 months.

In a nutshell, 2018 will not be as easy as 2017 and financial markets are not a one-way street. With rising interest rates, increasing concerns about trade wars and relatively high stock market valuations in certain markets, the upside potential for 2018 is lower than last year. There are still good opportunities, but it will require a more active, tactical investment strategy to benefit from them. Also, having a well-diversified portfolio is key again, which requires investors to reconsider their stock and sector allocation, as well as an investment in gold and other assets that will provide protection in times of market corrections.

Investing in innovation

by Sune Hojgaard Sorensen

Mr. Sorensen is the founder of Librarium Associates, an independent research company focusing on global macro and geopolitical monitoring and analysis.

Introduction

Aligning your money with the forces of human ingenuity has long been a winning investment. However, finding the right idea and people to execute it at the right period in time has historically been a formidable challenge.

Innovation and implementation of new concepts is more art than science, while change can be tantalizing and it can fuel massive opportunities. However, change by itself is difficult. As an investor, you have to identify it before it occurs. Consumers have to change their behaviors to create a viable market to underpin it. These two events are often contradictory and illusive.

As value investors, we seek enduring dynamics, things you can allocate time and capital to today with the odds stacked in your favor, so that you have a reasonable chance of it being a solid long term play, ideally with some catalysts for significant upside driven by innovation.

In his excellent book "Engines that move markets – Technology investing from railroads to the internet and beyond," Mr. Nairn comes to the following conclusions, after a comprehensive review of the history of market-shaping industries and their impact on how we invest: "The best technology does not always win. Winning the technology battle is no guarantee of financial success. Insiders usually make the best returns from new technologies. The only surefire way to make money from new technologies over any extended period of time is through monopoly protection."

With the benefit of an even longer look back in time through Fernand Braudel's seminal work "Civilization & Capitalism 15th-18th Century: The structures of everyday life", we get the following brilliant set of insights:

"In the realm of technology, co-extensive with the whole of history, there is no single onward movement, but many actions and reactions, many changes of gear. It is not a linear process. (...) The history of inventions, taken by itself, is therefore a misleading hall of mirrors. (...) In other words, there are times when technology represents the possible, which for various reasons – economic, social or psychological – men are not yet capable of achieving or fully utilizing; and other times when it is the ceiling which materially and technically blocks their efforts. In the latter case, when one day the ceiling can resist the pressure no longer, the technical breakthrough becomes the point of departure for a rapid acceleration."

Where is the value at?

Our current crop of high profile innovators seem to be adherent to Mr. Zuckerberg's, perhaps ill-advised, motto "Move fast and break things" in the pursuit of the next disruptive idea at breakneck speed. However, away from the headlines, innovation as an expression of inherent human ingenuity, continues its long slog of evolution while innovative concepts just as disruptive and perhaps more lasting in nature materialize every day. Actors in less flamboyant and more industrial sectors such as energy, transportation, chemicals & agriculture are instead channeling the "Bell Labs way" of "move deliberately and build things."

Revolutions happen fast but dawn slowly. Bell Labs and subsequent imitators have achieved real disruptive improvements but at a more incremental pace – achievements that we are still harvesting today. Bell Labs invented the transistor in 1947, which is now the building block of all digital products. Billions of transistors now reside in the chips that power our phones and computers. They created and developed the first communications satellites, the theory and development of digital communications

and the first cellular phone systems. They built the first fiber optic cable system and subsequently created inventions to enable gigabytes of data to zip around the globe. These are just a few of the practical technologies Bell Labs was responsible for. It literally gave Silicon Valley its name.

Taking all this into consideration, how does one go about allocating funds to innovation focused strategies?

A starting point should be to identify sectors of the economy supported by long term trends but where a “bottleneck” or, even better, a “finite supply meets infinite demand” type of situation is forming.

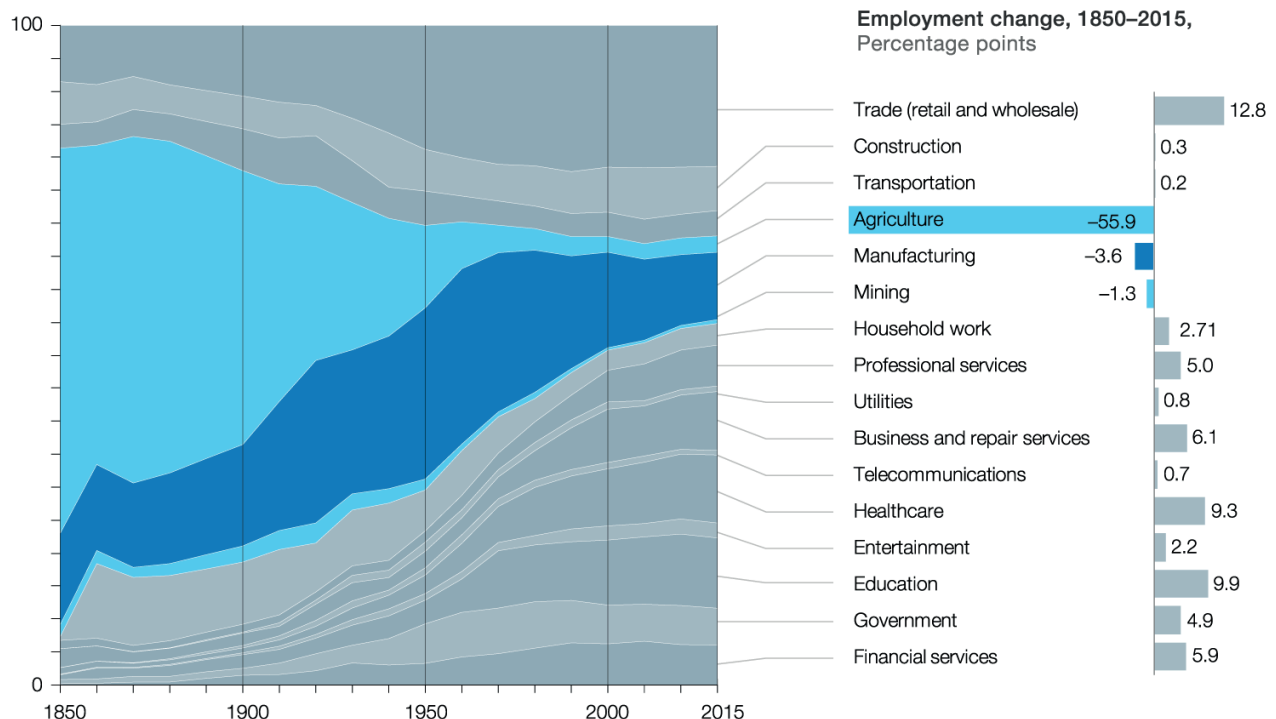
Challenges faced by crucial economic sectors present opportunities where human ingenuity can best be expressed and long-term value created. Historically, agriculture and fresh water, energy and

transportation, healthcare and pharmaceuticals, and unfortunately military hardware, are examples of such economic sectors. Throw in automation, supported by our constant pursuit of increased productivity, which has a strong wind in its sails as we seek to overcome the demographic challenges faced by most of the world’s major economies, and you have a comprehensive investment universe to consider.

Let’s take a look at automation, enhanced by Artificial Intelligence (AI), which is applicable across all these attractive sectors and is set to create the next great leaps in productivity and profitability. Automation is not a new phenomenon, questions about its promise and impact have long accompanied its advances. More than 50 years ago, US President L.B. Johnson declared: “Automation can be the ally of our prosperity.”

History shows that technology has created large employment and sector shifts, but also creates new jobs.

Share of total employment by sector in the United States, 1850–2015, % of jobs



McKinsey&Company | Source: IPUMS USA 2017; US Bureau of Labor Statistics; McKinsey Global Institute analysis

Humans have always shifted away from work suitable for machines and moved on to other jobs. This was true in the 1930s, when the shift was away from agriculture, through the 1990s and early 2000s, when the shift was largely out of manufacturing.

In short, history is reassuring about the impact of technology on employment. For some workers new technology can be disruptive, but if the past is any indication, creation eventually triumphs over destruction and the key is to ensure labor force adaption through ongoing education.

Smart automation - A friend or a foe?

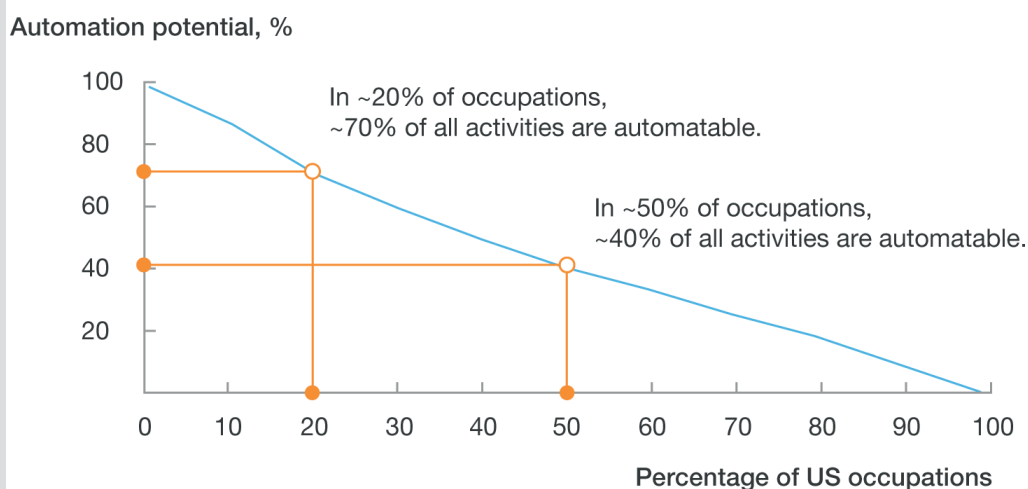
A recent study by McKinsey Global Institute calculated that automation could increase global growth by 0.8% to 1.4% annually, assuming that people replaced by automation largely rejoin the workforce in other capacities. A study by Bain Macro Trends Group estimates that as much as \$8 trillion could be invested in automation technologies by 2030. Falling capital costs in robotics and rising labor costs in places like China reduce the payback period for automation and in turn prompt higher investment in these technologies. China has seen a 10-fold increase in purchases of industrial robots between 2009 and 2015.

The next stage is already well under way. In the past, automation mainly referred to industrial robots and computer hardware and software designed to carry out predictable and routine tasks requiring physical strength, exertion and precision, as well as the repetition of logical tasks such as calculation. With robotics, AI and machine learning, we now see "smart automation" emerge, poised to take on a greater share of high-productivity jobs and an array of tasks that were previously the domain of humans.

Smart automation of this sort includes a wide array of functions from self-driving vehicles to the diagnosing of diseases. In fact, automation is set to play a wider role across all the economic sectors we identified earlier.

In energy and transportation, as we increasingly stop burning things and harnessing technology for our energy needs, Smart Grids and maintenance and operations of installations will be powered by innovations in AI and automation. In agriculture and fresh water, we will increasingly see AI and automation-based solutions take root. In healthcare and pharmaceuticals, some AI-based technology is already saving lives with better and more consistent diagnosing capabilities than humans, while our military equipment is increasingly enabling the men

If companies adapted currently available technologies, approx. 70% of the activities of about 20% of all occupations could be automated:



McKinsey&Company | Source: McKinsey Global Institute analysis

and women in uniform to carry out their work with better risk management tools and greater efficiency. Areas such as mining and retail are also being transformed for the better. Another sector that could be positively affected is education, as displaced workers must be given the opportunity to upgrade their skills effectively and young people entering the workforce will need to have advanced, relevant knowledge under their belt. Lifelong learning will be key to harness the positive impact of these strong trends, for individuals, companies and governments.

Disruption is everywhere and as the technological evolution continues its march towards increased productivity, companies and investors need to be at the forefront of this and embrace the inevitable changes or risk being left behind.

Strategic considerations for investors

It's often said that the key to success is to invest ahead of the path of progress. In order to do this, an investment strategy that focuses on monitoring broad trends is essential. However, when implementing an active strategy that captures such broad changes, one needs to make sure that they don't become blinded by the bright mirrors in the temple of technology.

Generally, as with most investing-related matters, timing is key. It can thus be useful to monitor sustainable long-term trends in society, technology and the global economy to gauge when specific sectors are prone to disruption and to watch out for Mr. Braudel's "ceiling that can resist the pressure no longer", indicating that we are set for the rapid acceleration of a technical breakthrough in the selected sectors.

Taking the macro & going micro – Developing an investment universe

It has long been the case that the nature of industrial innovation in our chosen sectors tends to be housed within larger companies. Such companies have significant R&D budgets and the capability to buy up smaller operators with strong ideas, patents and human capital that can be leveraged within a larger organization with global networks and decades of experience in implementation and bringing solutions to market.

Specific sector ETFs can be useful tools for capturing a broad developing trend. In the Q4 2017 edition of the BFI Infinity InSights, Dirk Steinhoff, the BFI Infinity's C.I.O., eloquently presented a compelling case for Robotics and the use of ETFs in capturing "booming ceaseless innovation in a highly competitive field." ROBO:US is one such tool for harnessing the opportunities presented by the global 'smart automation' drive, as it covers both robotics and AI.

If you are investing for the future, allocating to a 'smart automation'-focused strategy is crucial – **Don't fear the robots, own the robots.**

Are investors' inflation fears justified?

by Dirk Steinhoff

For the better part of the last decade, a common concern on investors' minds was that inflation remained too low. Now, however, they worry about signs that the opposite might soon be the case. Since February, inflation returned to the headlines, as reports from the US on wage gains and consumer prices showed higher than expected increases. Wages rose by 2.9%, beating analysts' expectations of 2.6%, while consumer prices increased by 2.1% year-on-year in January of 2018, above market expectations of 1.9%. Following these reports, US equity markets reacted with a fierce selloff, as fears mounted about the possibility of rising inflation that might put an end to the favorable low interest rate environment that market participants have been accustomed to.

A closer look

In order to properly analyze and weigh the risk that the recent developments could bring to the markets, one needs to examine inflation in its appropriate context. To begin with, it is important to understand and to differentiate between the various ways to measure inflation.

The most commonly mentioned and the one we will mostly examine in this article is consumer price inflation. It is measured by the Consumer Price Index (CPI) and it refers to price changes of goods and services from the consumer's point of view. Various CPI sub-indices calculate these changes in different categories of goods and services, while a commonly used variant, "core CPI", excludes components that can exhibit high volatility from month to month, like food and energy.

Another similar and widely followed measure is the Personal Consumption Expenditures price index (PCE) and its own sub-indices, which the Federal Reserve refers to when setting its inflation targets (Core PCE). Both measures are closely correlated and follow broadly similar trends, but they are not identical, as the CPI generally tends to report somewhat higher inflation numbers.

A second way to measure inflation is the Producer Price Index (PPI), which tracks the changes in selling prices by domestic producers of goods and services. A third way is asset-price inflation and it refers to a nominal rise or fall in the prices of stocks, bonds, derivatives, real estate and other asset classes. Whereas higher numbers in the CPI and PPI are seen as "bad" inflation, higher numbers in the asset price inflation are seen as "good" inflation.

Traditionally, higher inflation is generally connected to either demand growing faster than supply, or business' costs going up. But there are many other factors that can have a significant effect. Demographics, central bank policies, increasing productivity through technological innovations or industrial automation, the growth of the online retail sector, all have an impact on price changes. However, one of the most decisive factors has historically been globalization.

The trend towards more extensive and comprehensive international integration of labor and financial markets, especially after its dramatic acceleration since the early 90s, has drastically pushed prices downwards. Following the collapse of the Soviet Union, China, as well as India, and ex-Soviet bloc countries all entered the global economy, almost doubling the size of the global labor pool from approximately 1.46 billion workers to 2.93 billion, according to data from the International Labor Organization (ILO). With the weakened bargaining power of labor, increased competition, economies of scale and the removal of tariffs and barriers, the effect of the globalized economy has played a key deflationary role.

Why investors fear inflation

While anemic consumer price inflation can be a sign of a weak economy, which was one of the reasons that made investors worry over the low levels of the previous years, a return to what is perceived as a "healthy" pace has now given rise to a different set of concerns. Higher inflation numbers can erode investors' returns, but they also signal a return to a

solid economy and can force the central banks' hand to tighten the money supply. One way of doing so would be to increase interest rates.

In recent years, investors have been increasingly encouraged by positive economic fundamentals both in the US and the Eurozone, like falling unemployment and stronger company earnings, while at the same time they have still been enjoying the benefits of the policies set to fight the previous recession. By pushing and holding rates down to zero and negative levels to control the damage and aftermath of the 2008 crisis, central banks have made a generous contribution to the spike in the asset price inflation we have witnessed over the last years, with the US stock market being one of the best examples.

However, the Fed and the ECB have made it clear that they intend to move towards normalization. While the ECB has been postponing this move, the US central bank has taken more decisive action with a gradual increase in interest rates and the commencement of its quantitative tightening program.

So far, the early stages of the reversal of this long-term policy trend did not have the negative impact on the markets that many had feared.

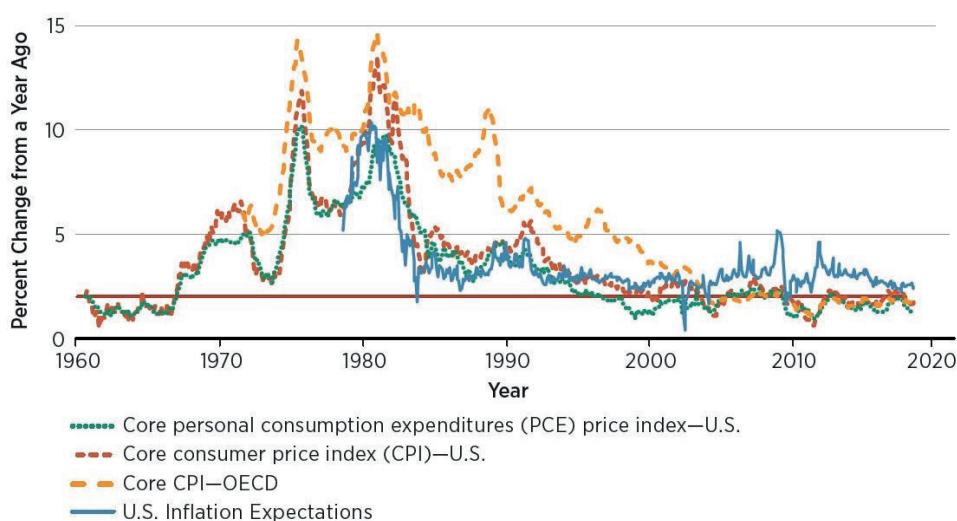
However, its implementation in the US has hitherto been cautious and restrained. The concern now is whether expectations of rising consumer price inflation might expedite rate hikes, causing the economy to slow down and perhaps even triggering a major stock market correction.

The bigger picture

Despite the nervousness over the recent consumer price inflation numbers from the US, it is important to remember that the inflation rate has actually been, and remains, on a long-term downtrend for the last 40 years. Its last peak was during the "Great Inflation" of the late 70s, reaching almost 15% in 1980, and presenting a very real threat to the economy at the time. Gold, traditionally seen as an inflation hedge, skyrocketed from \$380/oz. in November 1979 to a then-record \$850 in January 1980.

Since then, investors, businesses and consumers alike have remained fearful of consumer price inflation, which might go some way into explaining the wide coverage that the recent US wage and CPI reports received. However, when one considers past patterns and ranges, a relatively small CPI uptick hardly suffices as evidence of an upcoming inflation wave.

Recent Evolution of Various Inflation Rates



SOURCES: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Organization for Economic Cooperation and Development (OECD), and University of Michigan's Surveys of Consumers.

NOTES: Core indexes exclude energy and food prices. The red line represents a 2 percent inflation rate, a target that the Federal Reserve formally set in 2012.

As for the rest of the world's large economies, many face the opposite problem, of stubbornly low consumer price inflation. According to the most recent data from the corresponding national economic statistics authorities, the Eurozone's inflation rate slowed down to a 14-month low at 1.2%, China's and Switzerland's to a 6-month low at 1.5% and 0.6% respectively, while Russia's inflation rate remained stuck at 2.2%, its lowest point since 1991. Sweden's central bank is also struggling with a below-target inflation rate of 1.6%, a major hurdle in normalizing the aggressive policies of the past years and raising its negative interest rates. In fact, the latest figures from the OECD showed that the annual rate of inflation dropped to 2.2% in January from 2.3% in December across its 35 members.

What lies ahead

Even though further moderate increases in consumer price inflation would not be surprising in the short run, the fear of it spiraling out of control appears to be rather overblown. A reasonable increase in inflation is a normal observation in growing economies and if anything, it was its absence that was until recently surprising. Also, the magnitude of the recent CPI figures in the US remains in line with historical recovery patterns and expectations for this stage of the business cycle. In other words, this is what normalization looks like.

As the global economy continues on its growth path, as recent forecasts by the OECD and the World Bank show, and as Central Banks are cautiously beginning to rein in the accommodating policies of the last decade, we can expect to see higher inflation numbers and higher rates, as the "new normal" in the next phase of the economy. However, both will likely still remain low in a historical context.

The deflationary forces that have kept prices in check in the past years are still in place. This includes globalization, despite the current political sentiment and resulting pullback attempts. We see the current negative backlash as temporary and insufficient to impact the trend towards an increasingly interconnected world and globalized

economy. That being said, national policies can still have an impact. It is therefore essential to monitor relevant developments on this front, such as the trend to nationalism and populism that can be seen globally or to protectionism like the new tariffs on aluminum and steel recently announced by the Trump administration.

Overall, in the short-run, higher inflation and the subsequent interest rate hikes might hold back and could even trigger a larger correction in the stock market. Nevertheless, the current positive global economic momentum will help to drive corporate profit growth and provide support for the stock markets.



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