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REPORT 2016 OF INVESTMENT COMMITTEE

A YEAR OF TWISTS AND TURNS

2016 was full of surprises in many respects: Brexit, the victory of Donald Trump, a change in economic policy with the prospect of a less monetary and more budgetary approach, the OPEC agreement, better economic data at year end, and so on. And not forgetting the marked fluctuations in the share, bond, currency and commodity markets which reflect both an evolution of the economic fundamentals and the return of investors' appetite for risk. The economic consequences of these phenomena will be particularly visible in 2017.

Never had a year begun so badly: -3% when the markets opened on 1 January. Pulled down by fears about growth in China, 2016 got off to an extremely nervous start. New economic indicators had been published on 31 December showing that Chinese economic activity was deteriorating. Hopes of a recovery in China went up in smoke. This was enough to cause the Chinese financial market to begin the year with an unprecedented drop of 8%. In panic all the world markets followed the same trajectory for 6 weeks. The reduction in the oil price that had begun in mid-2014 culminated on 11 February 2016 when the barrel dropped to 27$, its lowest level for 13 years. Oil had seen its price divided by 4 in the space of 2 years. The causes – the slowdown of world growth of which China was the catalyst, the development of sources of renewable energy, the explosion of shale gas in the USA and the incapacity of OPEC (Organisation of Petroleum Exporting Countries) to agree on a reduction of the production. Only a rally in the oil price was able to stop this decline. According to the economic press, it was the end of the rise in the financial markets, the beginning of the recession.

At the beginning of February everyone seemed to have capitulated and abandoned their expectations of positive returns. In the end the market lost only16% at the beginning of 2016. While the drop was steep, a fall of such a scope is a financial event that happens from time to time. Once the storm had passed, the markets headed upwards again. Anxiously they kept a constant eye on the next potentially disastrous event. This came first with the Brexit in June, then with the American election in November, with the sword of Damocles constantly hovering in the form of a rise in American interest rates.

On 24 June, like the morning after a pub crawl, Europe awoke with a mighty hangover. Nigel Farage was triumphant, and David Cameron resigned. The stock market relived the financial crises of 2011. However the significant drop of the first day was rapidly followed by a rise. At the end of the week, world shares had regained their losses. And with good reason, as Brexit only had consequences in Europe, and no concrete implications in the short term. It was at most the beginning of a process of 2 to 3 years which would see Europe lose a member state that was sceptical, to say the least, about the European project.

With Brexit finally having had no major consequence, all eyes turned to the show of the moment: the American presidential election. Who other than Donald Trump, the central character of the American TV sensation programme « The Apprentice », could win this 2016 election in tele-reality style? The unexpected winner, Trump, succeeded in benefiting from the media to attract the popular vote. According to most economists, a Trump victory was highly improbable and its consequences would be harmful for the financial markets. Nevertheless once again the reverse happened. The financial markets reacted in a volatile manner on the day after the election. But the opening drop was quickly forgotten, to give way to a wave of optimism driven by the expansionist economic policy promised by Trump. Over the three weeks that followed the American election the markets rose by 7%, while the dollar strengthened to reach a new record level.

After maintaining its rates at rock-bottom since 2009, the US Federal Reserve (Fed) finally took the decision to raise its rates by 0.25% in December, and envisages doing the same 3 times in 2017. This was both the most expected and most feared decision of the year. The most expected, because it had initially been planned for the first quarter, before being postponed several times in the light of the weakness of the markets and of the global economic recovery. The most feared because this increase heralded the end of easy and cheap money, putting something of a brake on growth. Many saw in this rise a threat for the markets. In fact, an increase in rates means a drop in the price of bonds and also a drop in share prices due to a substitution effect. A rise in rates is nevertheless most often the consequence of a strong and dynamic economy.

Despite everything, 2016 was a fairly classic year of rises which experienced some episodes of volatility and a temporary drop of over 10%.

SUSTAINED AND INNOVATIVE ACTIVITY ON THE PART OF THE COMMITTEE

Copré's Investment Committee met formally in corpore over 8 times in the course of 2016. It also held meetings with and made trips to visit the asset managers, as well as seeking investment opportunities. Numerous themes were addressed, targeting in particular the gradual replacement of bond investments, which currently represent more risks than returns. The major focus was the search for new credit asset classes. The lifetime annuity programme continued to develop and a structure was set up to professionalise the analysis of assets taken under contract. A working group was established specifically to discuss the problem of interest rates. It was decided to continue acquiring Swiss properties with a Swiss-German component so as to maximise the diversification of the portfolio. The trade finance programme was also strengthened, and in this context a mandate was entrusted to a consultant in order to analyse a potential new asset manager. The Private Equity programme also continues to develop, even though it is struggling to find good new investment prospects. The Committee also decided to allocate 12 million in a Credit Suisse direct credit investment programme (currently 3 million in the financing of freight cars). For this year the two new major highlights were a decision taken in the context of direct investment abroad in the hotel sector in the Caribbean, and the deployment of credit to American companies under the Senior Secured Loan (SSL) programme.

In view of the constant progression of the Foundation's assets over the past few years, together with the changes mentioned in the structure of the investments and the evolution of the average age, Copré's Board of Trustees decided at the end of 2016 to proceed with a study of ALM, based on the figures in the accounts as at 31.12.2016, by the company Willis Towers Watson. We have just received and examined this study and are delighted to inform you that « all is well ». Our strategic allocation is considered as perfectly adequate and the proposals for alternative allocations correspond to the deliberations already initiated within the Investment Committee. The technical rates are in line with the markets, and the Foundation's balance is good. Only our conversion rate is judged to be too high, which we knew, and the decision to reduce it progressively was already taken last year.

A decision on the capitalisation rate for the buildings was also discussed at length. It was decided to lower the capitalisation rate for COPRE's properties from 6.25% to 5.75%. The reduction of this rate results in an appreciation of the Foundation's property portfolio, which contributed to the year's good performance to the extent of 4.9%.

The Committee continues to follow its investment strategy, namely investments in real assets and the real economy, broad diversification, especially in growth sectors and in seeking illiquidity premiums, as well as a cover aimed at cushioning the extreme shocks on financial markets through a systematic programme of selling options on the market index. The alternative proportion grew from 10% to 16%, real estate remains stable at 40%, while claims, in anticipation of a long period of low interest rates, have been reduced still further from 22% to 17% (as against almost 40% in 2015), while the average for Swiss pension funds amounts to 39%.

The Committee is confronting an increasing number of challenges and is considering, in face of these limits, the hiring of operational staff dedicated in future solely to asset management.

The year 2016 is ending on a high note, but investments represent a perpetual renewal, and the year 2017 should be considered with a good deal of circumspection in the light of new global issues.

The Investment Committee