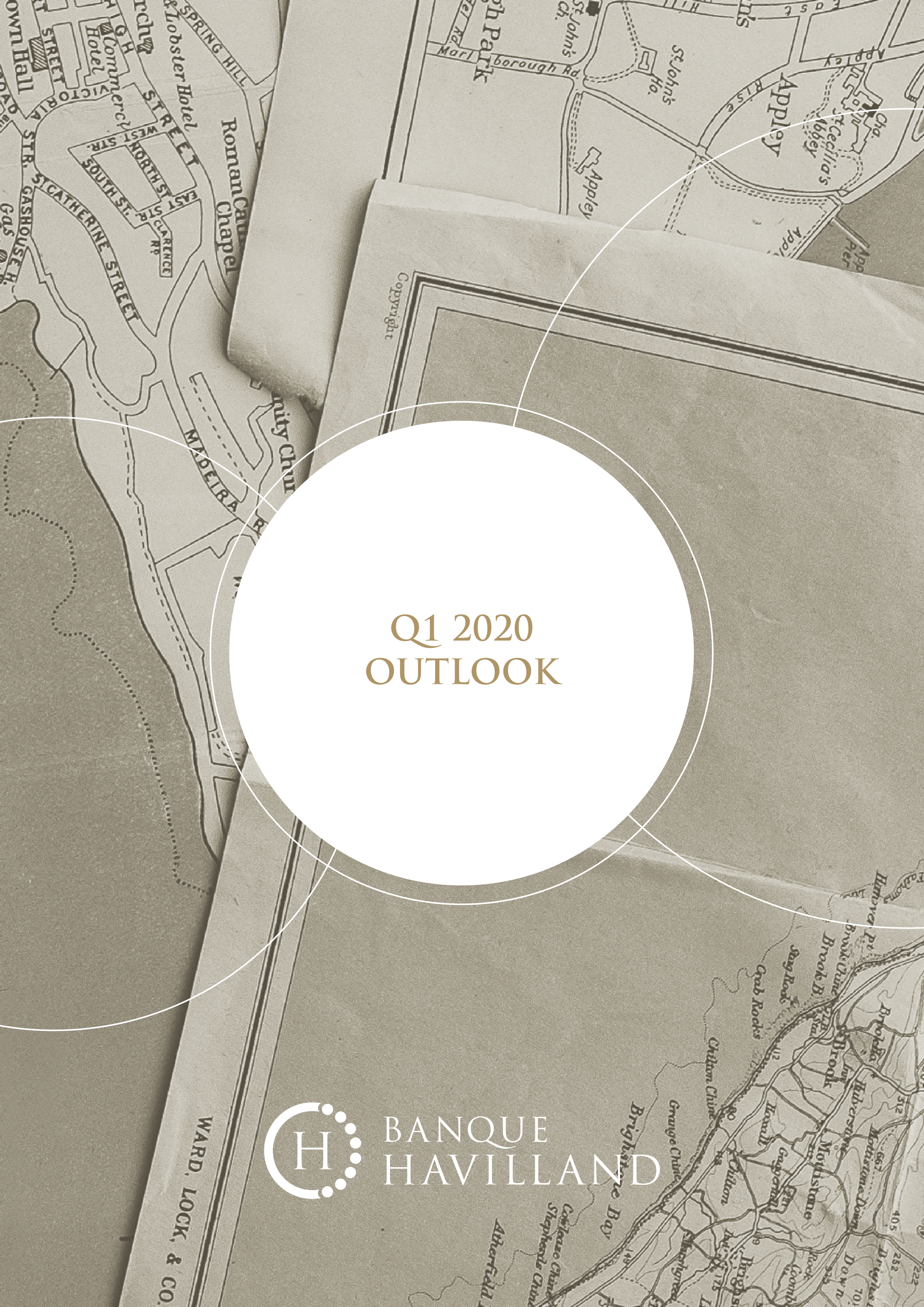

Q1 2020 OUTLOOK

BANQUE HAVILLAND

Banque Havilland is a Private Banking Group established in 2009. The Bank is headquartered in Luxembourg with offices in London, Monaco, Liechtenstein, Dubai and Switzerland. The Group provides private banking, asset and wealth management services and institutional banking services to High Net Worth families and individuals from all over the world.

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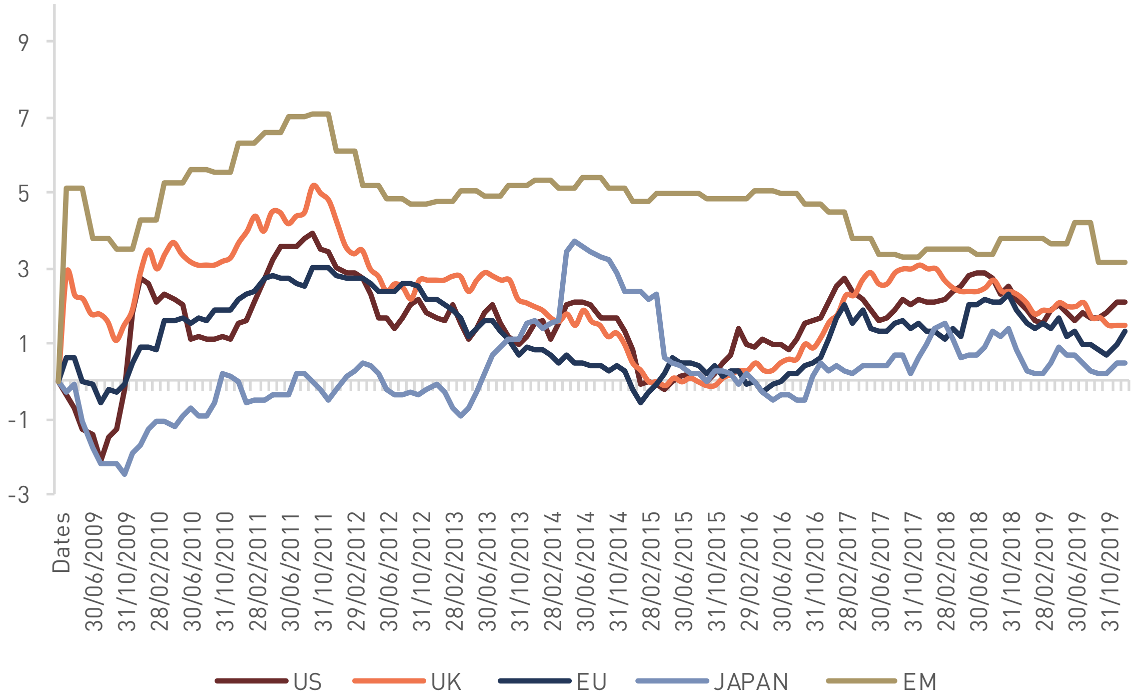
MARKET ENVIRONMENT

Low growth, **high stimulus** and no inflation?

2019 proved to be something of a bumper year for investors in an almost direct reversal of the woeful returns of 2018, with all major asset classes returning positive numbers at the top line. Equities as measured by the MSCI World Index saw a total return of over 28%, while the Global Aggregate Bond Index gained a little under 7% followed by Commodities (BCOM Index) at just over 5%, meaning any multi-asset portfolio should have made money whatever the allocation. Such a year is another reminder to stay broadly invested for the long term, rather than reacting to turns in sentiment, noisy news headlines, political turmoil or even human instinct – a new client who started their equity portfolio at the beginning of 2018, and sat tight following that years' losses rather than selling out would have enjoyed over 17% returns over the two years. We are not in the business of predicting future returns or putting a forward number on any index or asset over any given period, (indeed all evidence shows that big banks' and other various financial institutions' attempts to do so each year are largely useless), rather we look to sensibly diversify across the various asset classes remaining largely invested one way or another while avoiding the most expensive parts of the market and the most politically and economically volatile parts of the world. Another reason for not being drawn into cut and dry predictions is the ability of prevalent current headlines and themes to overly-influence a more rational long term view, and this is no more relevant than at the time of writing as the world holds its breath following the US airstrike on an Iranian leader – the change in market sentiment over the space of a few days has been severe. The temptation, therefore is to look to adjust our investment allocation to protect against a more unstable middle-east, higher oil-price and a continued sell-off in risk assets, however, from an investment point of view our multi-asset clients can afford to be fairly relaxed due to the relative defensive positioning, but also due to the built-in protection that a long-term, unemotional approach offers. Time will tell if the current political crisis escalates into something more sinister, and we hope not, but it has certainly poured cold water over the late year exuberance of the markets in December and will have a number of over-bullish analysts worried following their sanguine predictions for 2020.

As it is, we think it unlikely the oil price will continue to rise a great deal further, with oil production being less concentrated in the Middle East than it has been historically, but nevertheless it does bring back into focus a threat mostly forgotten or ignored - that of higher inflation.

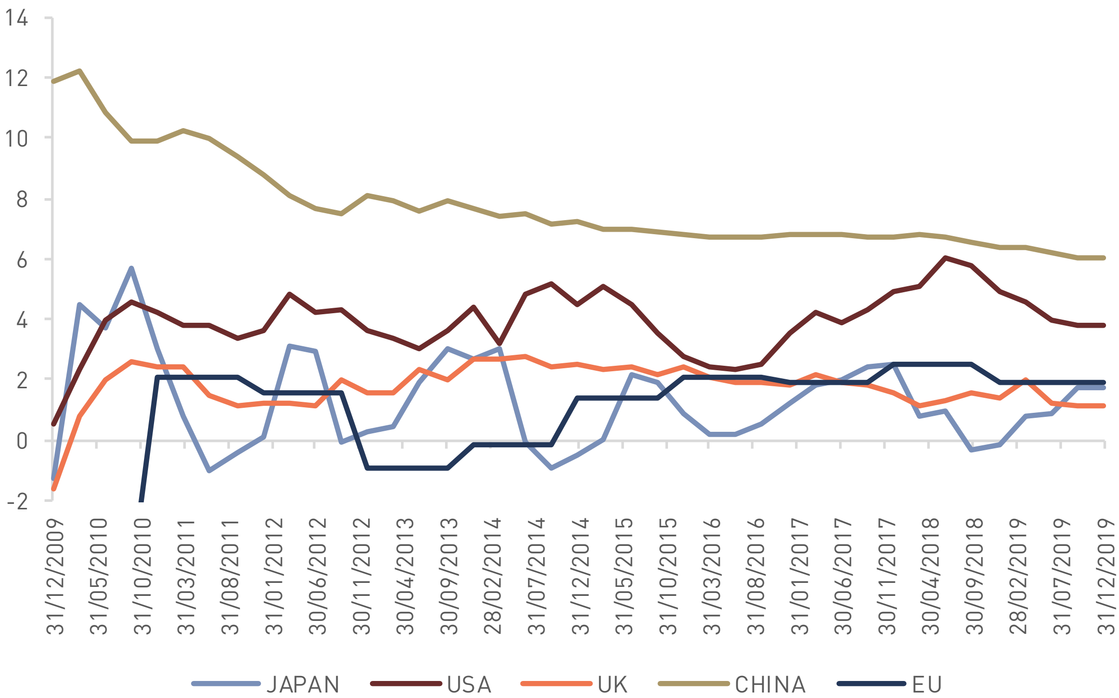
Inflation readings since 2009 (CPI)



Despite the unprecedented level of stimulus and ultra-low interest rates since the financial crisis, headline inflation has yet to move upwards. (source: Bloomberg)

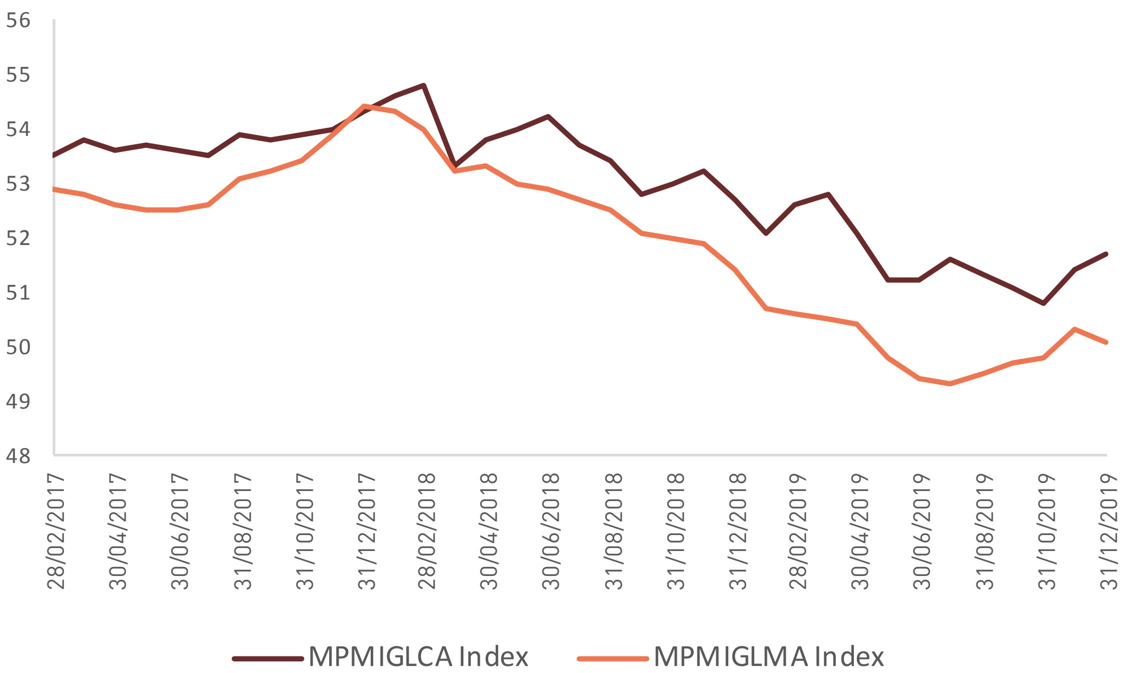
Consensus is that inflation should remain contained in virtually all developed markets, and it is indeed trailing or in line with most of the target levels of 2% the main central banks, the UK and EU are at 1% and 1.5%, while Japan is languishing at 0.5% - and this despite the vast stimulus that has been thrown at these economies since the financial crisis (we discussed 'Japanification' in our last outlook, and the increasing fears that the Eurozone is heading in the same direction). It is expected that the US, Europe, Japan and China will increase liquidity provision by a total of $1 Trillion next year , though even this staggering figure is 20% lower than the average inputs of the last 11 years. Signs of higher prices are not entirely absent, however, with the latest US CPI reading moving up to 2.1% and perhaps more significantly the Federal Reserve openly discussing abandoning their inflation target and rather allowing a 'range' for it to move in. The official reason for this being it would allow the FED more flexibility in the future should they need to react to some sort of economic shock, but cynics might argue that they are worried about losing control of inflation and want more leeway. And this surely is the biggest worry for policy makers and investors alike, i.e. the return of inflation without accompanying economic growth, where inflation takes off but central banks are torn between stimulating growth by keeping rates low, or raising rates to curb rising prices. A prolonged spike in the oil price, caused by an ongoing conflict between the US and Iran or any other reason is something that could cause this and it is unclear what the central banks have left in their armoury to combat this, particularly as it seems that the experiment of negative interest rates is becoming rapidly unfashionable. The controversy of negative interest rates has polarised opinion in the financial world for many reasons, and while the potential damage of such policy may yet to transpire, the real dull truth is that they have neither been particularly damaging or effective. Undoubtedly banks are finding it harder to squeeze out lending profits and pension funds are finding it harder to manage the long-end of their books, but the greater fears such as negative rates causing an environment of excessive risk taking or an army of 'zombie' companies that stay afloat only because of the option to roll over their debt favourably have yet to materialise. Even suspicions that actually negative deposit rates would drive investors to cash have proven unfounded, as the rate of money supply (as a % of GDP) has not really changed in the affected nations, e.g. Japan. However, neither have negative or ultra-low rates really stimulated the level of growth that central banks will have hoped for (until recently 60% of countries were in technical manufacturing recessions) so while the jury is still out, public and political hostility is growing to the extent that it seems central banks will not pursue this policy further (Sweden has already exited). Big questions remain as to how nations and companies that have borrowed heavily at depressed rates will cope when the cost of rolling debt over rises in the future. For now then, monetary policy would not seem to be moving in an inflationary direction, with even the Chinese government making it clear that aggressive policy easing is not on the table. There is a risk that a new wave of fiscal spending at government level in certain developed markets that are at full employment could push prices higher and the effect of a reflation shock remains asymmetric and as such we retain our exposure to both Gold and inflation-linked bonds as a precaution. Much of the surge in equity markets that occurred in the second half of last year was in relief that two of the major concerns of the year did not

Developed Market GDP Growth % YoY



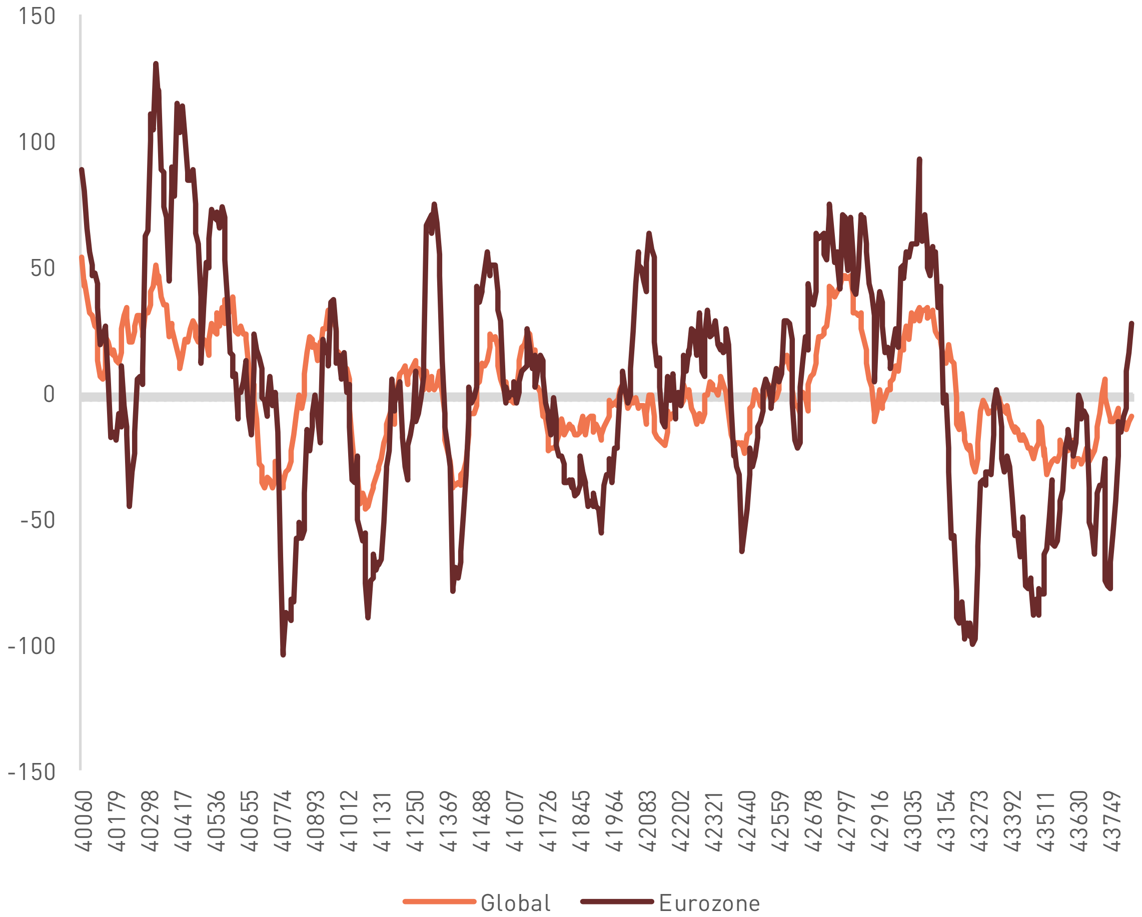
Growth remains positive but has been slowly flattening since the financial crisis - even with stimulus this look set to continue. (source: Bloomberg) play out as badly as they may have done, namely a 'Phase One' trade deal between the US and China became more likely and uncertainty over the UK's departure from the EU became less pronounced following the agreement of a trade deal and the subsequent conclusive UK election. It is ironic then, that neither of these two issues have really been 'resolved' as such, with the meaty details of the UK's future relationship with the EU to be thrashed out in the coming months and the threat of meaningful tariffs between the US and China a real possibility still. In fact many see this initial trade scrap as the first skirmish of a protracted power struggle between the two superpowers that is likely to last long past the coming decade. As such we expect volatility around news-flow with regards to these developments and then there is the prospect of a presidential impeachment to precede the US election that will create further headlines. While, ordinarily (as above) we would not concern ourselves too much over political comings and goings, the prospect of a more radical socialist than ever seen before in the White House in the form of Sanders or Warren would indeed have ramifications for investors. Much like the recent election in the UK, in terms of the opposition manifesto the rump of the headline policies are actually specific to the corporate world as we know it – Elizabeth Warren has shown her intention to break up Google, Facebook and Amazon, while Sanders has his sights set on dismantling 'too big to fail' banks (of which there are 31 in the US!), both wish to substantially hike corporation tax. Then there is their association with Modern Monetary theory (MMT), which despite representing a huge gamble in itself with respect to inflation, is moving into mainstream political and

JP Morgan Global Composite PMI v Manufacturing PMI



Composite and Manufacturing PMI data picked up in late 2019, though resides in the early 50's indicating lukewarm growth. (source: Bloomberg) economic discussion - often under the guise of the 'green' movement. As such it is well worth following the Democratic leadership contest, because with the US stock market being the most expensive in the world it is quite likely that profits made over the past few years will (particularly in the very companies with most to lose) be cashed in prior to a potentially fractious election contest. Moreover, with economic growth outside the US yet to show any meaningful signs of life and with valuations far from cheap on a historical basis (following a year of stellar returns for the equity markets), we advise a cautious allocation and a selective approach to seeking out inexpensive opportunities in the coming months. We may be in an era of indefinite monetary support and thus a favourable one for financial assets, but complacency could be costly.

Citi Economic Surprise Index: Global and Eurozone

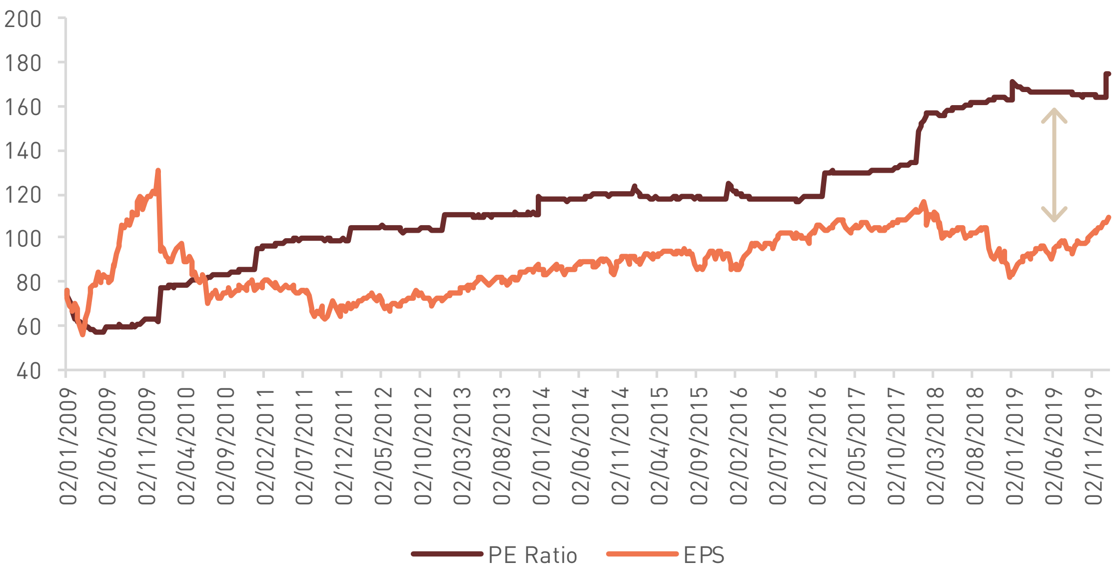


The Citi Economic Surprise Indices measure data surprises relative to market expectations. A positive reading means that data releases have been stronger than expected and a negative reading means that data releases have been worse than expected. Eurozone readings have spiked recently. (source: Bloomberg)

Share prices are detached from the fundamentals, **but does this matter?**

Within our cautious allocation, shares still look preferable to bonds going into the new year, with most of the fixed income market feeling too expensive under the threat of resurgent inflation at some point, though that is not to say we expect returns anything like we enjoyed in 2019. While the US market looks very expensive by virtually any measurement, the rest of the world does not look excessively valued and we are comfortable taking decent bets in attractively-priced regions with the background of low rates and plenty of stimulus. While recession 'indicators' have perhaps been downgraded from flashing 'red' last summer to merely 'amber' now it is prudent to remember that the US stock market (S&P 500) is now at all-time highs, having risen over 370% since 2009 in the longest ever bull-market. At 3.6x book value the S&P is trading at a level not seen prior to the 9/11 terror attacks of 2001, and furthermore it is well known that all of the share price gains have been driven by higher price/earnings ratios as opposed to fundamental corporate growth. Indeed the P/E ratio jumped around 30% in 2019, while the earnings-per-share figure actually moved lower over the same period as shown in the chart below. Even if earnings in the US pick up by 10% (the average analysts prediction), it is not clear that this would justify a further move in the index price as the gains last year have arguably already priced this in. Having said this, investors can find some comfort in the likelihood of president Trump pulling some sort of economically supportive rabbit from the hat in the run up to the election, notwithstanding the aforementioned

S&P 500: Valuation vs Earnings



The Citi Economic Surprise Indices measure data surprises relative to market expectations. A positive reading means that data releases have been stronger than expected and a negative reading means that data releases have been worse than expected. Eurozone readings have spiked recently. (source: Bloomberg) risks of who wins the Democratic party nomination, so it would not be a huge surprise if US shares manage to become more expensive yet.

Undoubtedly it has been a stellar decade for equities, as it has been for bonds – fed by a consistent diet of easy money, but if one strips out the US market and looks at the past two years in particular then the opportunity set for non-US markets looks clear as essentially the UK, Japan, Europe and Emerging markets have returned very little since the start of 2018 in USD terms. Again, without being overly optimistic of high double-digit returns over the coming year, we do believe that interesting opportunities exist in terms of certain regional markets 'catching up' and also of undervalued assets attracting more attention. We have been shifting our equity exposure to a more 'value' orientated approach, as we feel there is a certain logic to this in the current environment. It is no secret that a certain subsection of the equity markets have accounted for a disproportionate degree of the heavy-lifting for equity indices for some time: be it the FANG stocks (Facebook, Amazon, Google etc) in the US or the 'safe' multinationals of the Swiss market such as Nestle and Novartis, or generally stocks that have gained on the promise of future earnings rather than current cash. Therefore as the business cycle deepens and these companies' valuations stretch further still, investors who are still happy with equity risk (easy monetary conditions etc) will increasingly prefer to reallocate or deploy new capital to those companies that are good businesses but have not enjoyed the same price surge. This strategy has started to show real signs of life since the summer, especially during September and we think it will continue with value stocks trading very cheaply versus growth stocks historically. Much the same logic applies to our appetite for UK stocks, a conviction that played out very well in December, as investors return to a diversified and mature market following 3 years of political dithering that we feel held back growth and positive sentiment – markets hate uncertainty, and with that main uncertainty now having dissipated (i.e. the UK will leave the EU), then even with tepid economic growth UK indices should close the gap that has opened with other regions. It is probable that it will take a quarter or two of economic data releases before we get a clear indication of how much confidence has returned to the UK corporate sector, so of course volatility is to be anticipated.

The Brexit cloud lifting is also a relief for mainland European assets, while low unemployment rates and resilient consumer demand keep the various economies going, despite the headwinds presented by the global trade slowdown.

We believe in a highly selective approach to Europe, favouring a value and small-cap bias, with the potential to close the value gap with the US. Despite the weak economic backdrop in 2019 European stocks were very resilient, and should a bottoming out or improvement in global manufacturing materialise, the region could do well – furthermore the Citi Economic Surprise Index turned positive in December and is trending upwards. However, if last year was an example of markets ignoring the underlying economics then conversely we have to be prepared for the same this year if growth does pick up! Our current conviction in value stocks also supports the case for Europe, with such sectors as banks and energy comprising 37% of the Stoxx 600 Index compared with 22% of the S&P, with European banks still painfully cheap against the main index. Nevertheless, we mentioned earlier that China/US trade tensions would not be cured by the coming 'Phase One' deal, so the export-heavy nature of the Europe Index is vulnerable here, and earnings optimism that has been rising steadily could result in disappointment come the earnings season later this month. As is tradition at the start of each year, analysts are again queuing up to espouse the opportunity in emerging markets, and by definition they will always be relatively attractive on a valuation basis – but is it different today with the US so fully priced? Last year the broad index saw solid gains of 17%, but well behind many developed markets, and as ever there were a number of country-specific issues that meant some regions faced serious headwinds. Ironically, Chinese A-shares were especially strong last year, despite supposedly being the most vulnerable to a trade war – even out-performing the S&P 500 in USD terms.Trade tensions aside, there was civil unrest in Hong Kong and Chile, a sharp recession in South Africa and near-default in Argentina (again), furthermore the US dollar strengthened for much of the year causing another headwind for commodity-reliant nations. Nevertheless, monetary and fiscal policy is favourable in many emerging markets and the growing consumption theme remains a compelling investment draw. We are inclined to leave alone markets where a) political and civil unrest can flare up, and b) where there is a heavy correlation to commodities and oil as commodity exposure can be managed more directly elsewhere. In practice this means much of Latin and South America, Africa and the Middle East are off our radar most of the time, leaving Asia as the preferred region. It will be important to monitor the corporate default rate in China as well as any further moves towards protectionism in India, but the size and relative economic growth rate of both these countries means that well-managed companies that can benefit from the swelling middle class consumer will be interesting.

		–		=		+		
EQUITIES								**Stocks are at records high and valuations full. Growth is slowing, but prices are supported by monetary stimulus.**
US								The most expensive market at top line level, with a small number of companies dragging the indices higher. Value and small cap are lagging, though.
UK								Renewed political stability and an attractive relative valuation should see the UK outperform as the year progresses.
Eurozone								Earnings and growth are slowing, with Germany in particular stuggling with the stalling of global trade. France and Spain on the mend though.
Switzerland								Quality, defensive nature of the market ramins in demand, but we reduce our view to neutral following a stellar 2019.
EM								We favour emerging Asia with too much political risk elsewhere, trade tensions prevent us from being too bullish. Avoid South America.
Japan								Attractive valuation for a developed market, and we like the safe-haven qualities of the currency. Data has been anaemic, and BOJ stimulus is substantial so anticipation of growth should benefit stocks

FIXED INCOME

Low yields make Bonds an **unattractive** standalone asset class

With an astonishing $14 trillion of global debt yielding below zero, it is little wonder that the appeal of the fixed income market in general is low and that attractively priced bonds are getting harder and harder to find. Indeed, generally we would go as far to say that on a standalone basis a portfolio of bonds alone make little sense - even US Dollar investors who still get a positive yield (but not in real terms after inflation) may as well keep their cash in the money markets or savings account, when the 10yr yield on a treasury is 1.8% and the LIBOR 3M is the same more or less. With rates where they are, bonds by index have essentially become a directional asset class - that is to say that with high quality bonds' coupons and yields below the rate of inflation and the price trading above par, they neither serve as a store of capital nor a provision of income. Assuming the traditional negative correlation between bonds and stocks still exists – and it certainly seems to in times of stress, despite both asset classes rising since 2009 – then there is still a place for a bond allocation within a multi-asset class portfolio in terms of offsetting equity risk and managing volatility. Monetary stimulus and negative/lower interest rates have of course been the principle driver of lower yields, but as discussed above it looks as though central banks are at least pausing such policy if not yet reversing it, and this is likely to deliver losses for government

2 Year Bond Yields

COUNTRY	MATURITY	YIELD + / -
SWITZERLAND	25/05/2022	-0.80
FINLAND	15/04/2021	-0.63
DENMARK	15/11/2022	-0.62
NETHERLANDS	15/07/2021	-0.62
AUSTRIA	15/09/2021	-0.62
BELGIUM	28/09/2021	-0.61
GERMANY	10/12/2021	-0.61
FRANCE	25/02/2022	-0.60
PORTUGAL	15/04/2021	-0.51
SPAIN	31/10/2021	-0.39
SWEDEN	01/12/2020	-0.32
JAPAN	01/01/2022	-0.15

COUNTRY	MATURITY	YIELD + / -
ITALY	15/10/2021	-0.09
ISRAEL	31/01/2022	0.15
BRITAIN	07/09/2021	0.56
AUSTRALIA	21/12/2021	0.81
NEW ZEALAND	15/05/2021	1.04
NORWAY	25/05/2021	1.33
SINGAPORE	01/10/2021	1.45
HONG KONG	22/11/2021	1.56
UNITED STATES	31/12/2021	1.58
CANADA	01/02/2022	1.63
ICELAND	05/08/2021	3.05

(source: Bloomberg)

bonds in 2020, notwithstanding any severe volatility in the equity markets.

Expectations are that national governments will step into the shoes of central banks and provide a new wave of fiscal stimulus, though realistically with debt levels so high in many nations, this may not be practical (in the case of Japan) or desirable (in the case of Germany), so the effect on bond yields may not be so keenly felt.

Much will depend on how macroeconomic data around the world pans out, with an anaemic level of positive growth currently looking the most probable scenario, so investment grade credit should receive some support as the relative carry to sovereigns will appeal and this is also a mildly favourable environment for the high yield market, albeit with lower return expectations than last year. The 'belly' of the curve offers best value in the 5-10 year area where spreads are a little wider. With corporate default rates slowly ticking up in the US, and corporate debt levels in the US at record highs and cracks opening up in the loans market, we have less conviction in high yield than this time last year, but the extra spread is worthwhile providing the outlook for a US recession remains unlikely. In order to generate some meaningful income, looking further afield to emerging market debt is essential, and with no great expectation that the US Dollar will appreciate vastly in 2020 and as interest rates are on hold, investors can be comfortable with a decent allocation of selective EM bonds. As with EM equities, avoiding the sharper end of the universe is advisable, meaning a bias to shorter duration and to stable, well run economies. The 'hunt for yield' does not bear sufficient reward in many cases, with many professional bond investors getting burnt last year by the high-coupon Argentinian debt which has yet to recover having tanked following the latest political setback there.

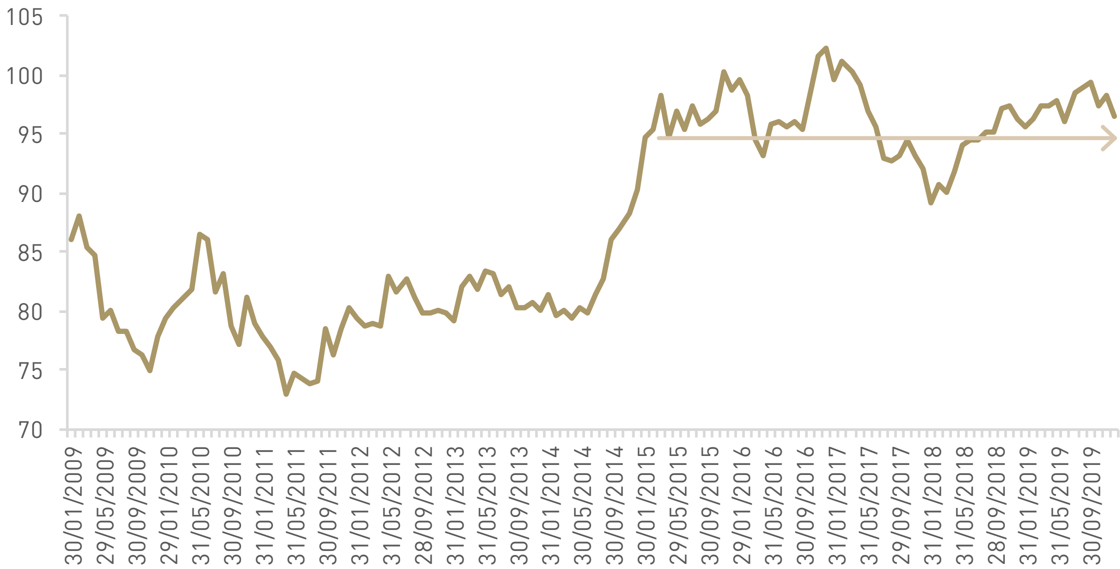
		–		=		+		
FIXED INCOME								**Low yields and low return profile make bonds a relatively unnattractive asset class, though Treasuries remain a short term safe haven.**
Sovereign Bonds								Sovereigns offer safe harbour in time of market stress, but have limited upside remaining and negative real yields long-term.
Corporate I.Grade Bonds								Investors should adjust expectations accordingly in terms of yield with a focus on low-duration senior debt. HQ corporates are not offering compelling yields.
High Yield Bonds								Credit downgrades and defaults are increasing, though from a very low base. A selective, low risk allocation still offers worthwhile yield pick-up.
EM Bonds								Yields are still relatively preferable to developed markets, though we only choose to take low-duration, quality exposure. Trade war risks. Hard currency for now.

COMMODITIES AND CURRENCIES

Gold looks an increasingly feasible **store of wealth**

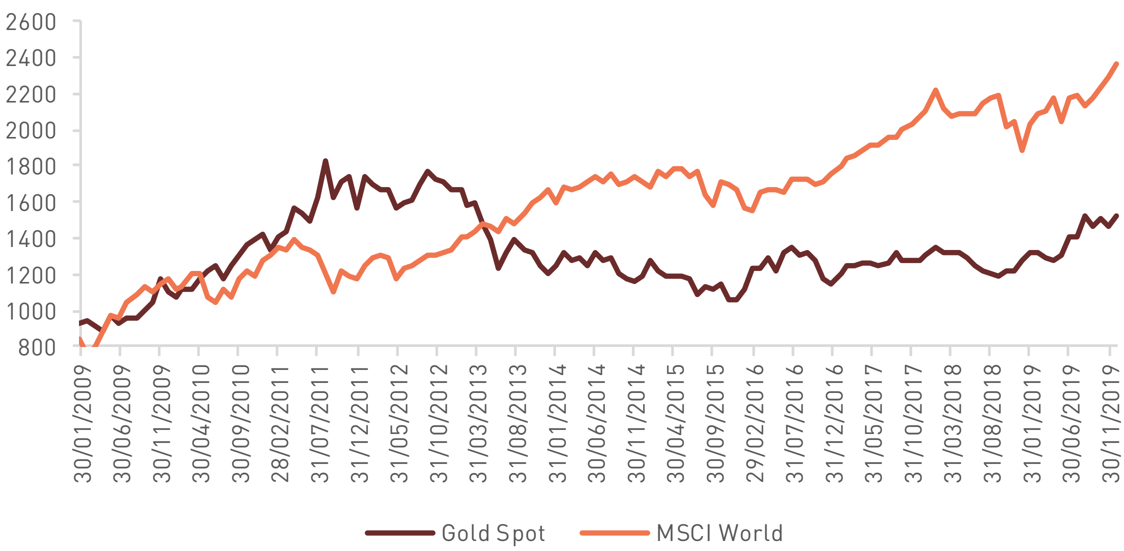
Whether growth picks up in the US or not will affect the US Dollar, which has been strong in recent years as US GDP growth has consistently outstripped the rest of the developed world along with a substantial rate differential, and much will hang on any fiscal stimulus that is introduced in the run up to the election in November. As it stands the futures market is seeing virtually zero chance of a hike in 2020, but over a 50% chance of another cut towards the end of the year suggesting that the relative rate differential compared with other currencies will not continue to be such a boon for the dollar as it has been, though clearly other central banks are also unlikely to be hiking either. However, the calls for further fiscal stimulus are getting louder, and may prove irresistible to both Trump (in order to further jack the economy in seeking re-election, or a democratic President who is more ideologically inclined to further spending. The 'Green New Deal' for example would load trillions of USD on top of the existing twin deficit which would surely put pressure on the dollar over longer term, and may play out sooner depending on who wins the Democrat nomination, though conversely were the democrats to swing further left this may be perceived by the currency markets as making Trump the continuity candidate. The dollar continues to enjoy reserve status, however, and as

US Dollar (DXY Index) since the Financial Crisis



Since Trump's election in 2016 the Dollar has been trading at a similar level, which is likely set to continue with cooling growth. (source: Bloomberg) we fully anticipate bouts of volatility it may benefit from flurries of 'flight to safety' and thus we arrive a neutral view on the greenback, with no great conviction in its major trading partners. In the short term we expect weaker economic data out of the UK reflecting the nervousness of Q4 2019 but thereafter the pound could continue to strengthen, though there will no doubt be big swings in GBPUSD and EURGBP as trade deal negotiations develop. Since the ECB's December meeting, money market rates climbed piquing interest in German bunds so a continuation of this may be positive for the Euro, but otherwise the stifled growth in the Eurozone (especially Germany) combined with a central bank that is a little stuck prevents us being too bullish on the single currency. Our faith in precious metals as an essential part of an investor's portfolio was rewarded handsomely last year, as Gold surged over 20% and silver around 16%, and most pleasingly did so in a manner largely uncorrelated to the equity and fixed income markets. The fact precious metals are uncorrelated to the main asset classes is of course our primary reason for holding gold and silver, but with the prospect of indefinite low rates and the spectre of inflation at some point, there is extra incentive at the moment. Low bond yields make gold look attractive by comparison, and the general environment for gold is favourable with the added plus that it tends to spike in times of unforeseen crisis (see the latest US/Iran event). Should the Middle East flare-up settle down, then gold is likely to retreat in the near term presenting buying opportunities for those without exposure yet, and we also anticipate that Crude oil will move back in to the $60 level as the supply/demand dynamic is dominated by more production and demand is subdued due to the economy. The general commodity index has been largely drifting since 2015 in line with global GDP growth, and while a strong resurgence in growth is doubtful, there is the prospect of major infrastructure policies in the US, China and the UK – and infrastructure requires basic materials, growth or no growth. Again this may be a development further down the line, as opposed to imminent, so we do not see a strong enough case for a specific investment here at the moment.

Price of Gold vs Equities since 2009



The spread between stocks and the value of Gold is wide, suggesting there is scope for further gains for the precious metal in light of the favourable monetary backdrop. (source: Bloomberg)

		–		=		+		
ALTERNATIVES								**Uncorrelated assets will play an increasingly important part of a portfolios' asset allocation.**
Precious Metal								Gold is supported long term by low yields in fixed income and loose monetary policy, while offering a safe-haven from geopolitical risk.
Hedge Funds								Genuine alternative funds that behave in a different manner to traditional assets are a vital source of wealth preservation.
Oil/Commods								$60 a barrel for Crude seems to be a reference point. Shale supply increases are tempered by geopolitical risk. Copper and others will likely reflect global economic health.

		–		=		+		
CURRENCIES								**Asset price sentiment to provide the background for currency gyrations as easy monetary policy persists. Most currency pairs continue to trade within the established three month ranges with GBP the standout in the last quarter. 2020 event risk remains with global trade friction, regional instability and US Elections.**
US Dollar (DXY)								Short term DXY consolidation, within the past years range, appears likely. The 2020 US Elections will provide significant discussion and US Dollar event risk in the later part of the year.
Sterling (GBP)								The clear majority in the recent election, provides the platform to move ahead with Brexit. Sterling rallied into the end of the year, however the outlook for 2020 appears pegged to the progress of the actual leave agreement.
Euro (EUR)								Eurozone growth has slowed and monetary policy is loose. Expect medium term weakness as Brexit/trade risk remains.
Japanese Yen (JPY)								The Yen consolidated in the past month as accommodative monetary policies continue and asset markets remain firm. We favour as a diversifier.
Swiss Franc (CHF)								The Swiss Franc continues to be buffeted by loose monetary policy, safe haven status and pragmatic action by the SNB. Consolidation continues against US Dollar and Euro.

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ASSET MANAGEMENT DEPARTMENT

Jonathan Unwin
t. +44 207 087 7976
e. j.unwin@banquehavilland.com

BANQUE HAVILLAND S.A.

35a, avenue J.F. Kennedy • L-1855 Luxembourg
t. +352 463 131
f. +352 463 132
e. info@banquehavilland.com

BANQUE HAVILLAND S.A. (UK BRANCH)

5 Savile Row • London W1S 3PB • United Kingdom
t. +44 (0) 20 7087 7999
f. +44 (0) 20 7087 7995
e. info.uk@banquehavilland.com

BANQUE HAVILLAND (MONACO) S.A.M.

Le Monte Carlo Palace • 3-7, Boulevard des Moulins • MC-98000 Monaco
t. +377 999 995 00
f. +377 999 995 01
e. info.monaco@banquehavilland.com

BANQUE HAVILLAND (LIECHTENSTEIN) AG

Austrasse 61 • LI - 9490 Vaduz • Liechtenstein
t. +423 239 33 33
f. +423 239 33 00
e. info.lie@banquehavilland.li

BANQUE HAVILLAND S.A. REPRESENTATIVE OFFICE

Aspin Commercial Tower • Office #4001 • Dubai • UAE
t. +971 430 62 888
e. info.dubai@banquehavilland.com

BANQUE HAVILLAND (SUISSE) S.A.

10, rue de Hollande • C.P.5760 • CH - 1211 Geneva 11
t.+41 22 818 82 22
f. +41 22 818 82 35
Zurich branch: Bellariastrasse 23 • CH – 8027 Zurich
t. +41 44 204 80 00
f. +41 44 204 80 80
e. info.switzerland@banquehavilland.ch

w. banquehavilland.com