Investment Policy

MORA WEALTH MANAGEMENT

April 2016

Market recovery continues

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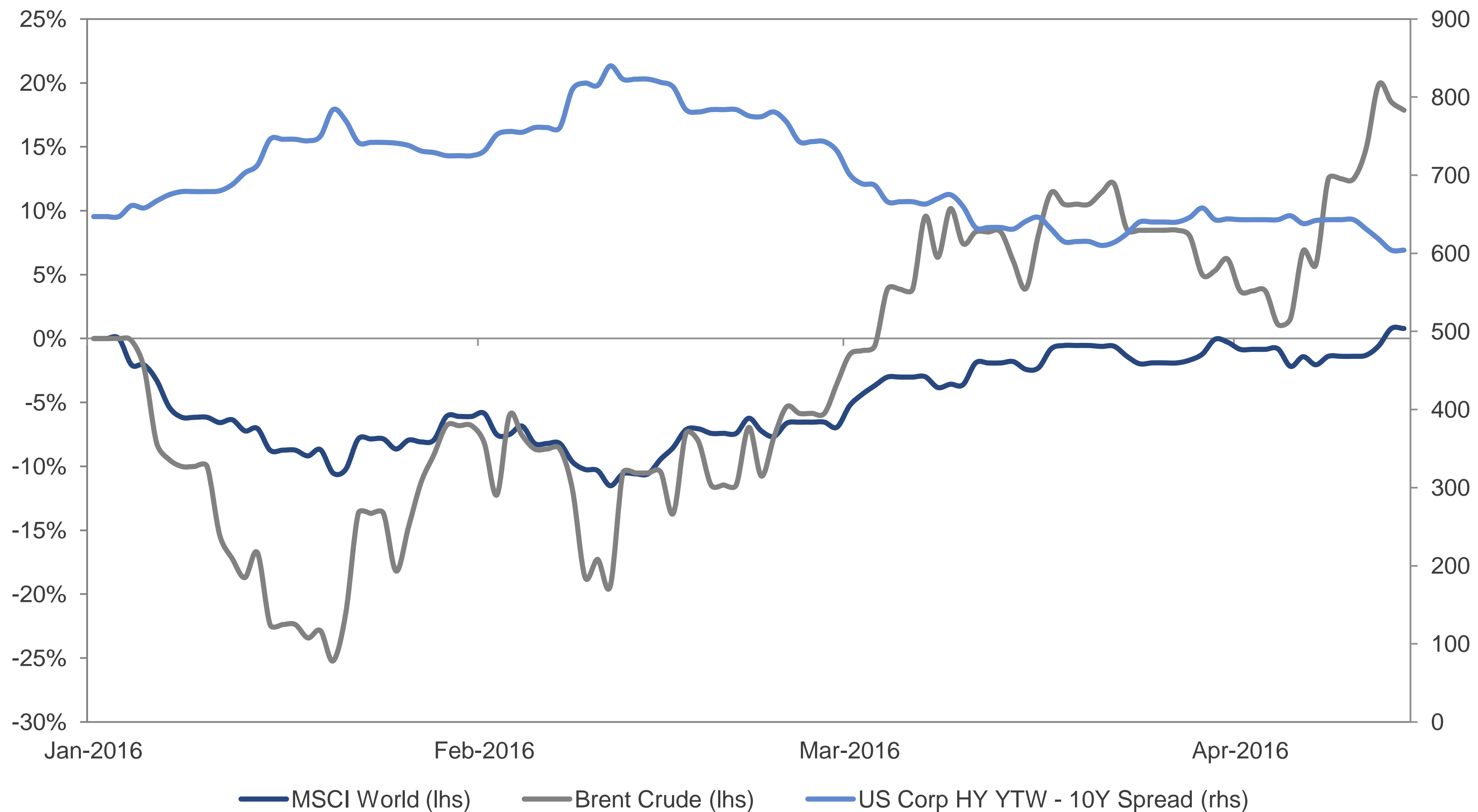

- During the last month **markets continued recovering** from the lows in January/ February, with **risky asset classes** – equity, commodities, credit and EM currencies (including the Yuan) – showing positive year to date performance
- What is **surprising** is that at the same time, **safe-haven assets** like US Treasuries or Gold have also appreciated, which reveals the extent to which market **valuations are influenced by central bank actions**

Source: Bloomberg

We live in an asymetric environment

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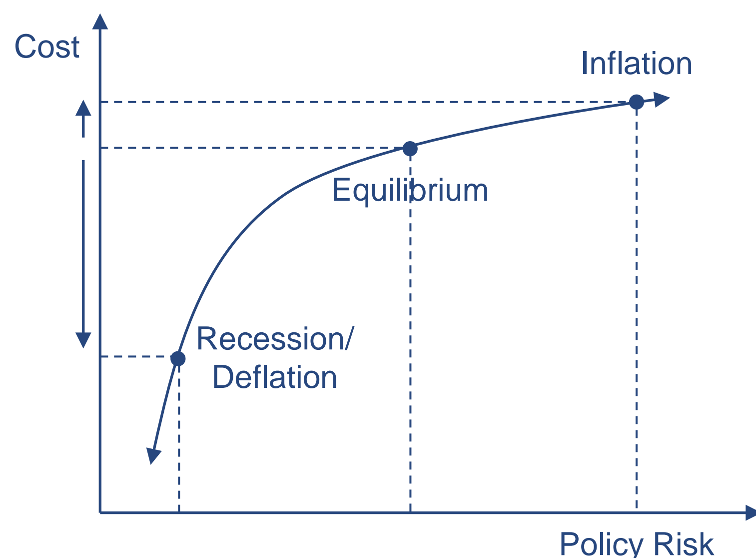
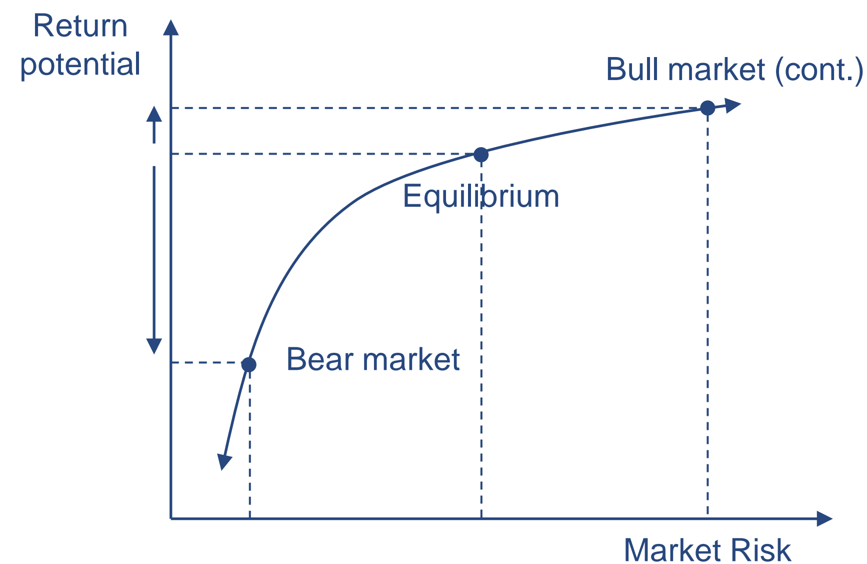
*"**Given the risks to the outlook, I consider it appropriate for the Committee to proceed cautiously in adjusting policy**. This caution is especially warranted because, with the federal funds rate so low, **the FOMC's ability to use conventional monetary policy to respond to economic disturbances is asymmetric**. If economic conditions were to strengthen considerably more than currently expected, the FOMC could readily raise its target range for the federal funds rate to stabilize the economy. By contrast, if the expansion was to falter or if inflation was to remain stubbornly low, the FOMC would be able to provide only a modest degree of additional stimulus by cutting the federal funds rate back to near zero"*

Janet Yellen at the Economic Club of New York. March 29, 2016



For central bankers



For investors

Source: Bloomberg

Risk of inflation as an unintended side-effect

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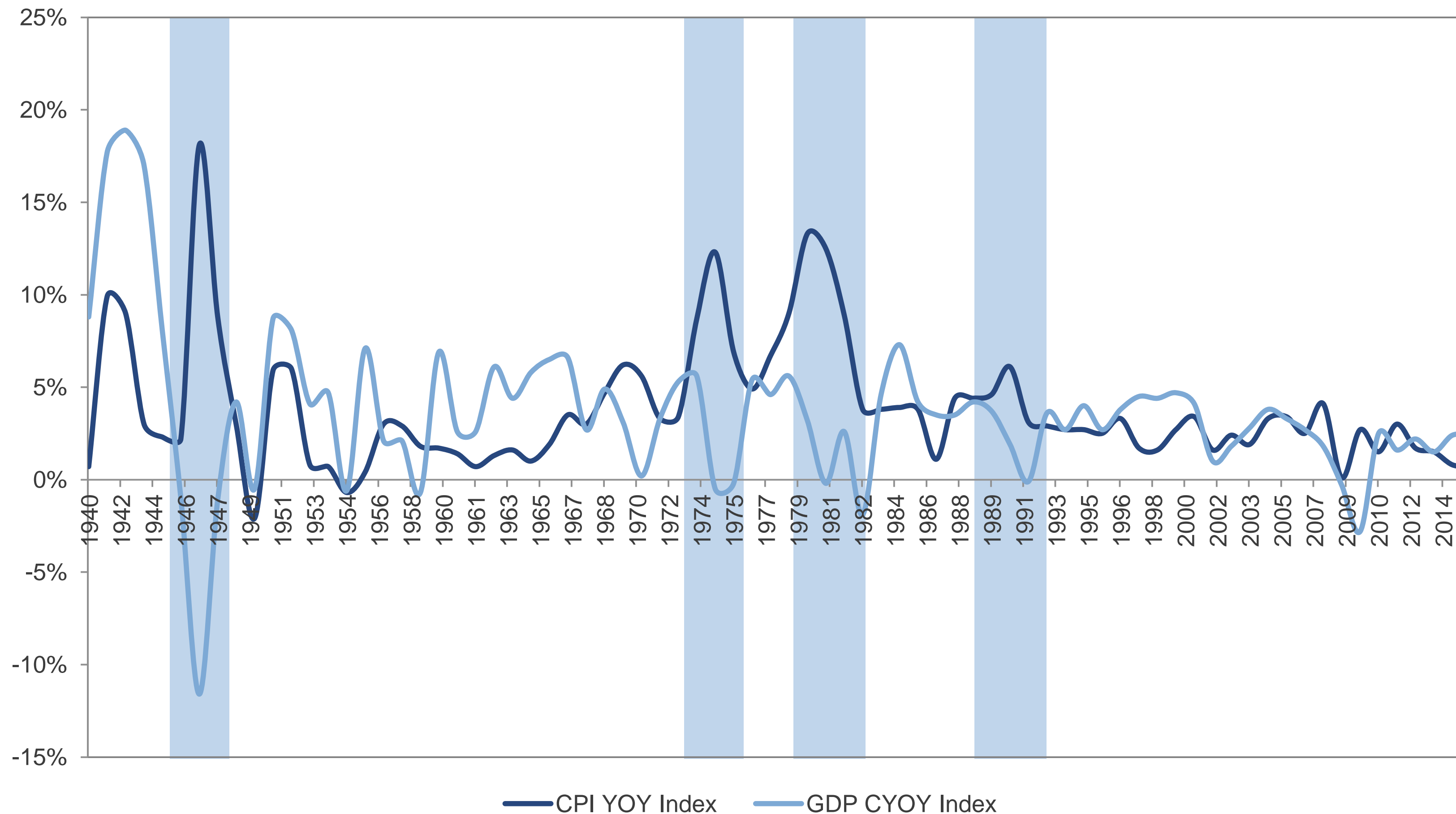
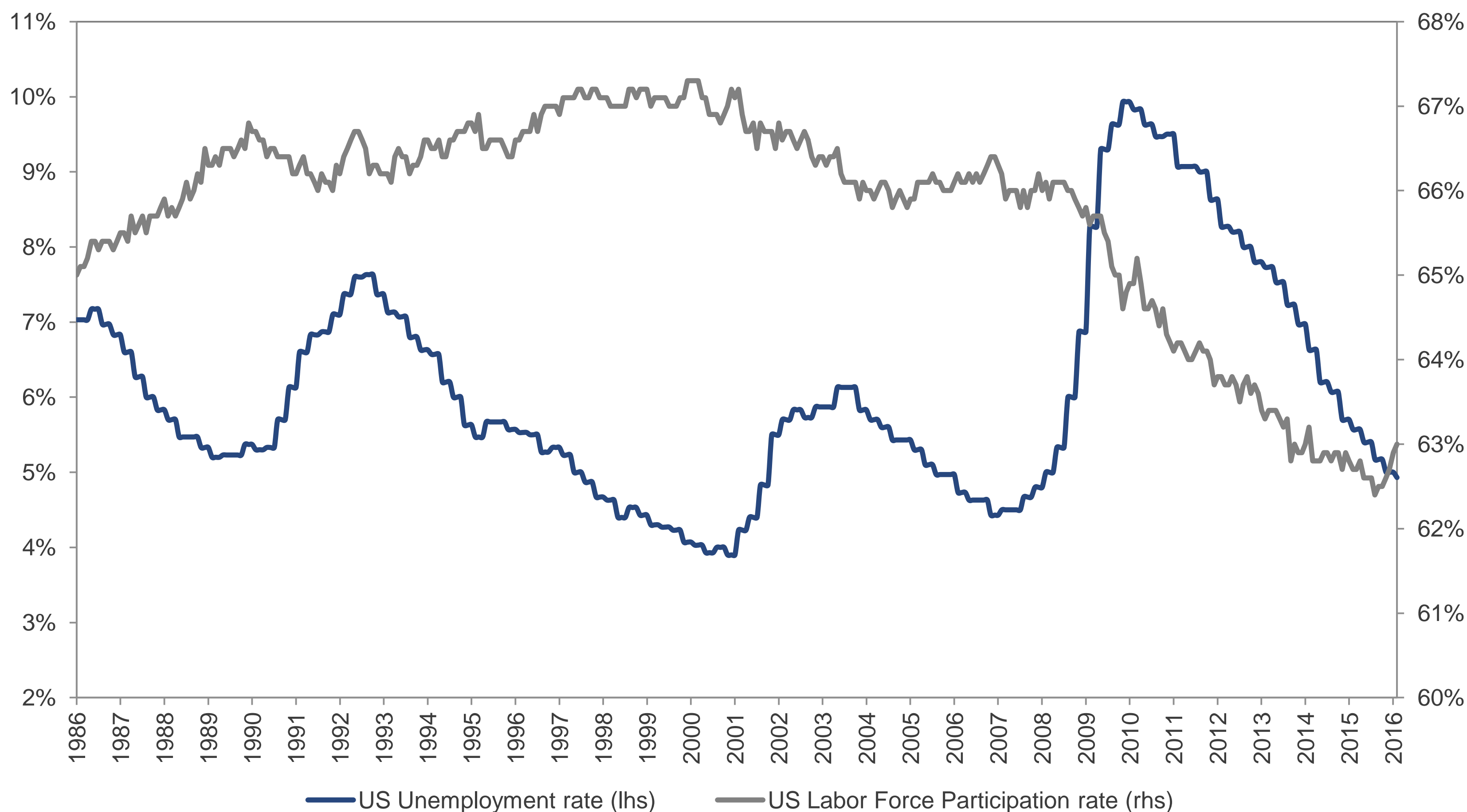


- The **Fed** stance towards inflation risks is **unusually accommodative.** However, contrary to central banks in Europe or Japan, **deflation is not the Fed's main worry.** As a result, they are reassessing the **impact that further rates can have on growth**, particularly in the light of the weak global demand
- However, low rates can stir inflation without stimulating growth, what is known as **"stagflation".** The likelihood of this scenario is increasing once **commodity prices are stabilizing**

Source: Bloomberg

Why can inflation pick up?



- The main risk of accelerating inflation in the US comes from the **labor market**, where **unemployment rates** are close to historical lows. However, the labor market looks less tight when accounting for **low labor fore participation**
- Another risk comes from the **low base reached in commodity prices** after the sharp correction experienced, which would translate into inflation pressure should the levels normalize faster than expected

Source: Bloomberg

TIPS offer cheap protection with limited downside risk

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- **Inflation-linked bonds offer currently cheap protection** against an environment of **decreasing real yields** (inflation rising faster than nominal rates)
- In a **deflationary environment** they will tend to underperform nominal bonds. However, the **downside is limited** due to the embedded **"deflation floor"** at maturity, which guarantees a nominal positive total return at maturity

Source: Bloomberg

Broad recovery across all asset classes

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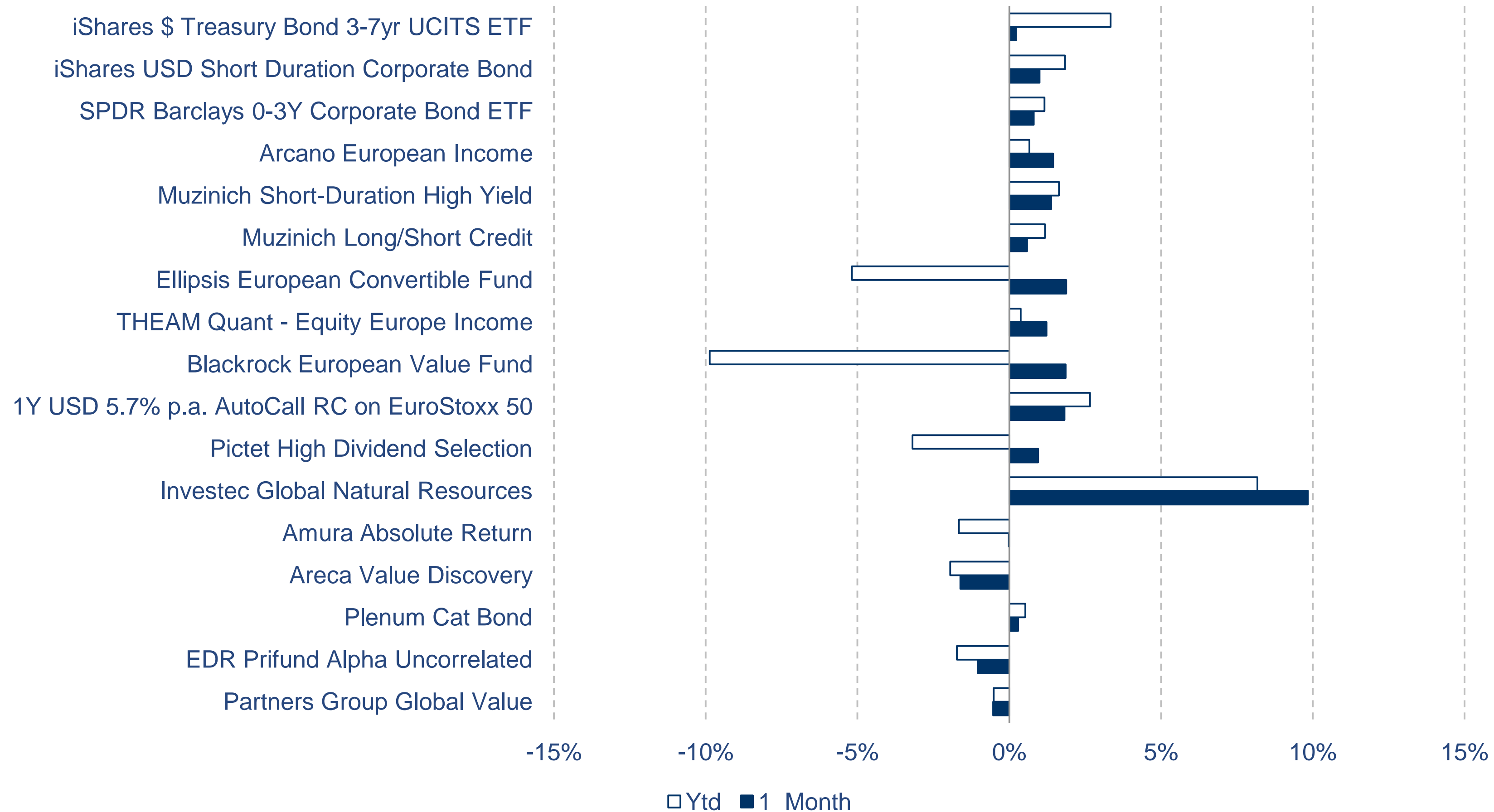

- Most **hardly hit asset classes have continued recovering** (commodities, high-yield and Emerging Markets)
- **Alternative investments'** bad performance is partly explained because of the **delay in valuations** in those underlying funds that are less liquid, and is expected to pick up in the following month

Source: Bloomberg as of February 29, 2016

Investment scenarios

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	Scenario 1 Global economic slowdown	Scenario 2 Muddling through	Scenario 3 Inflation surprise
Drivers	• Global economic slowdown led by a hard-landing in China and/ or recession in the US • Fed delays rate rises • Strong deflationary scenario due to a combination of low growth and structural factors (demographics, low aggregated demand, deleveraging)	• Chinese authorities stabilize the market and halt economic rebalancing (weaker yuan, higher IP). US, Japan and Europe continue exhibiting low but stable growth • Fed rise rates at an accommodative pace • Low inflation due to structural factors (demographics, low aggregated demand, deleveraging)	• Growth concerns dissipate, with economic activity accelerating in Europe and Japan • Inflation in US unexpectedly increases • The Fed is behind the curve and is forced to rise rates aggressively
Market impact	• Correction in credit due to a rise in defaults and a widening of corporate spreads • Correction in equities due to lower projected earnings, though low rates will offer support • Sovereign and IG credit to profit due to flight to quality and the continuation of an ultra-loose monetary policy globally • USD neutral to weak as flight to quality is counterbalanced by low interest rates • Commodities to remain depressed	• Equities recover moderately, particularly in Europe • Credit spreads remain stable as the credit cycle is further elongated • Sovereigns suffer as monetary policy is progressively normalized • USD appreciate moderately due to higher interest rate differentials • Commodities remain weak in short term, but rebound in long-term as supply and demand balance out	• Correction in equities due to higher rates. Impact will be mitigated if higher inflation is the consequence of an acceleration in growth • Sovereign and IG bonds will face steep losses due to higher rates, particularly if long-term inflation expectations rise • Corporate credit will correct moderately if inflation comes together with higher growth • The USD will appreciate, particularly against those currencies facing deflation • Commodities will gain from higher inflation
Probability	35% ↓(-5%)	35%	30% ↑(+5%)

Short-term catalyzers

QE Ramp up (EU, Japan, China?), Fed pauses, macro-data (particularly in China) showing resilience

Other risks

Commodity prices lead to political destabilization (Russia, Saudi Arabia, Iran, Venezuela, etc.), US elections, Greece, Terrorism, Brexit…

Tactical positioning

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- We remain cautious in **fixed income** favoring **short-medium** maturities due to a very unattractive combination of risk and return. We **no longer favor credit exposure** as we think the macroeconomic picture has deteriorated significantly. On the other hand, **high quality bonds** – particularly **corporate investment grade** – have turned attractive following the widening in spreads, and **Treasury bonds** can benefit from a slowdown in growth. We have also added a position in inflation-linked US Treasury bonds (**TIPS**) to get partial protection against an unexpected bout of inflation as a consequence of the extremely accommodative monetary conditions

- Central banks have created an environment where **valuations** are largely **dependent on interest rates to remain low for long**. Broadly speaking, we think that prospects for **corporate earnings** cannot be positive in an environment of **lackluster economic growth**. From a relative **valuation** perspective, we favor **European equities** and **high-dividend stocks**

- **Alternative investments** offer a much needed source of **diversification** and (partially) **uncorrelated returns**. We recommend allocating a significant part of the portfolio to Multi-Strategy Hedge-Funds, Private Equity, Cat Bonds, Commodities and derivative strategies (covered-calls)

- A **larger than usual cash allocation** is advisable as the **opportunity cost** of holding cash has decreased dramatically, and it offers **flexibility** to enter the market in an opportunistic manner

MWM Investment Policy

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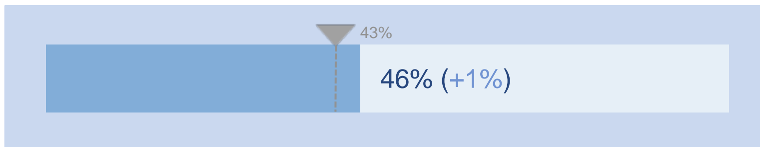
Cash

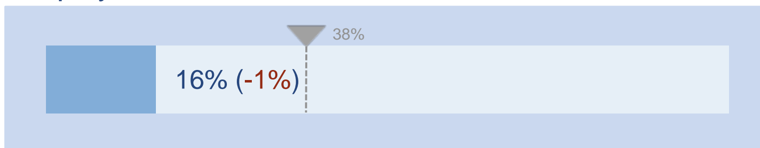
- In the current interest rate environment the opportunity cost of holding cash has significantly decreased, hence, waiting for good investment opportunities is a sensible investment strategy
- Nonetheless, we have reduced the allocation to enhanced cash strategies as we have taken a more conservative stance on credit and allocated to short-term Treasuries

Fixed Income



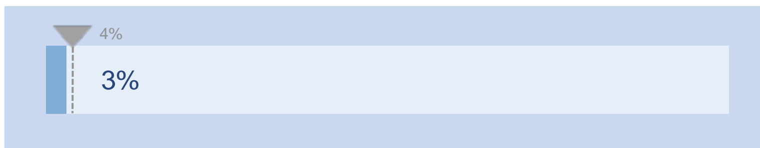
- High-quality fixed income in USD currently offers a better combination of risk and return since credit spreads have widened. Treasuries can benefit from a slowdown in growth, whilst TIPS offer protection against an unexpected bout of inflation
- We avoid high-yield and emerging markets in the light of the bleak global economic outlook

Equity



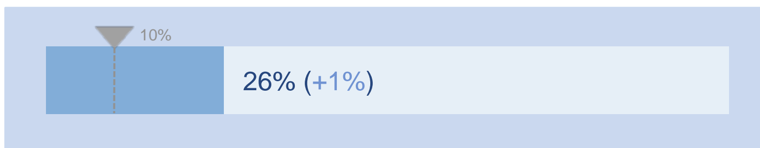
- Despite the correction experienced over the past months, equity valuations remain greatly supported by low interest rates. A potential normalization of interest rates poses a risk of returning to lower valuation multiples
- In relative terms, Europe looks still more attractive than US and Asia

Commodities



- The sell-of in commodities can no longer be solely explained due to an oversupply in the market, and needs to be reflecting certain expectations of a deceleration in global economic activity
- Despite we think that the price decline has been too pronounced and current levels may be a good entry point, we prefer to cut exposure to mitigate downside risks in case we are proved to be wrong

Alternative investments



- Alternative investments as a source of low volatility and uncorrelated returns are more attractive than ever in the wake of the current latent risks in the market
- However, there is always a certain degree of correlation with traditional asset classes and double digit positive returns cannot be expected in the current environment

▼ Strategic Asset Allocation

MWM Model Portfolio

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Asset Class	Category	Fund	Weight	Total
Cash	Cash	• Cash	6%	9%
	Money market	• Mora Money Market	3%	
Fixed Income	US Treasuries	• iShares Treasury Bond 1-3yr	8%	46%
		• iShares Treasury Bond 3-7yr	6%	
	Short-Term Corporate Bonds	• SPDR Barclays 0-3Y Corporate Bond	8%	
		• iShares USD Short Duration Corporate Bond	8%	
	US TIPS	• iShares $ TIPS	7%	
	High Yield US	• Muzinich Short Duration High Yield	3%	
	High Yield Absolute Return	• Muzinich Long/Short Credit Yield	3%	
	Convertible Bonds	• Ellipsis European Convertible Fund	3%	
Equity	Growth	• Wellington Global Quality Growth Portfolio	3%	16%
	Europe	• THEAM Quant Equity Europe Income	3%	
	Volatility	• Reverse Convertibles on Blue Chips	6%	
	High Dividend Yield	• Pictet High-Dividend Selection	4%	
Commodities	Diversified	• Investec Global Natural Resources	3%	3%
Alternative Investments	Multi-Strategy	• EDR Prifund Alpha Uncorrelated	4%	26%
	Multi-Strategy	• Amura Absolute Return	4%	
	Relative Value	• Areca Value Discovery	4%	
	Multi-Strategy	• Lyxor AQR Systematic Total Return	3%	
	CTA, Diversified	• Lyxor Winton Fund	3%	
	Cat Bonds	• Plenum CAT Bond Fund	4%	
	Private Equity	• Partners Group Global Value	4%	

MWM Investment Profiles

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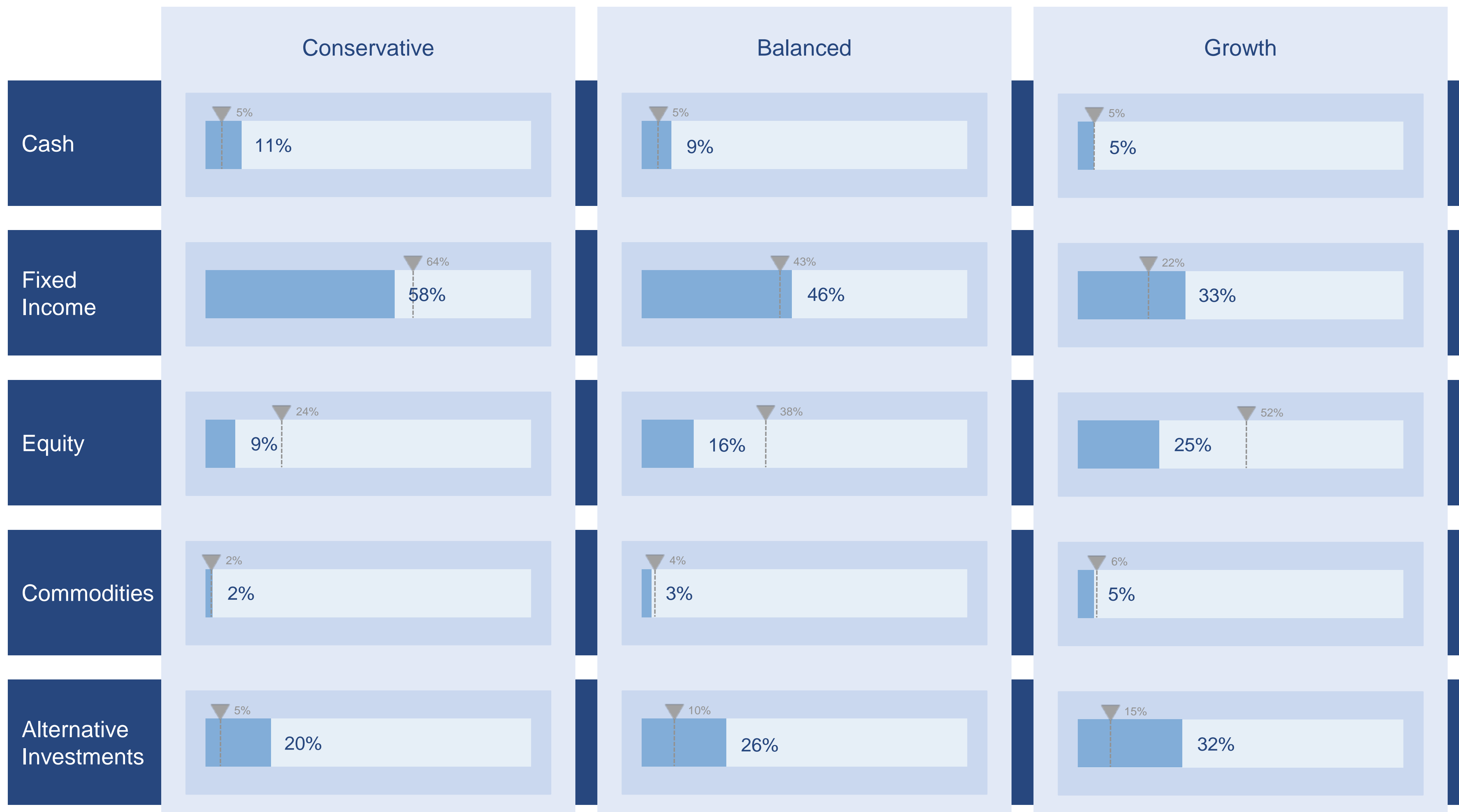

Strategic Asset Allocation

MWM Model Portfolio – Fixed Income Evolution

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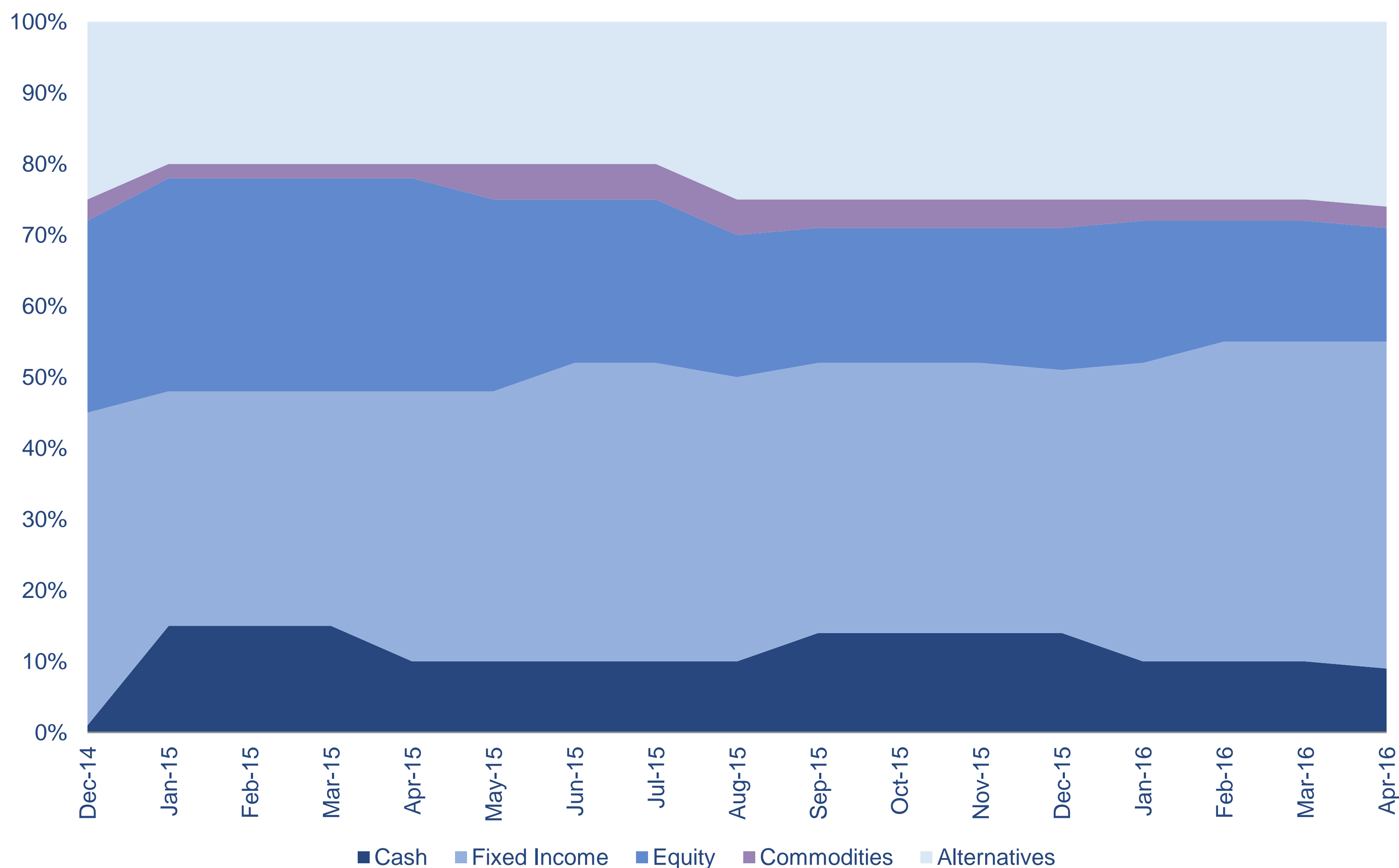

MWM Model Portfolio – Fixed Income Evolution

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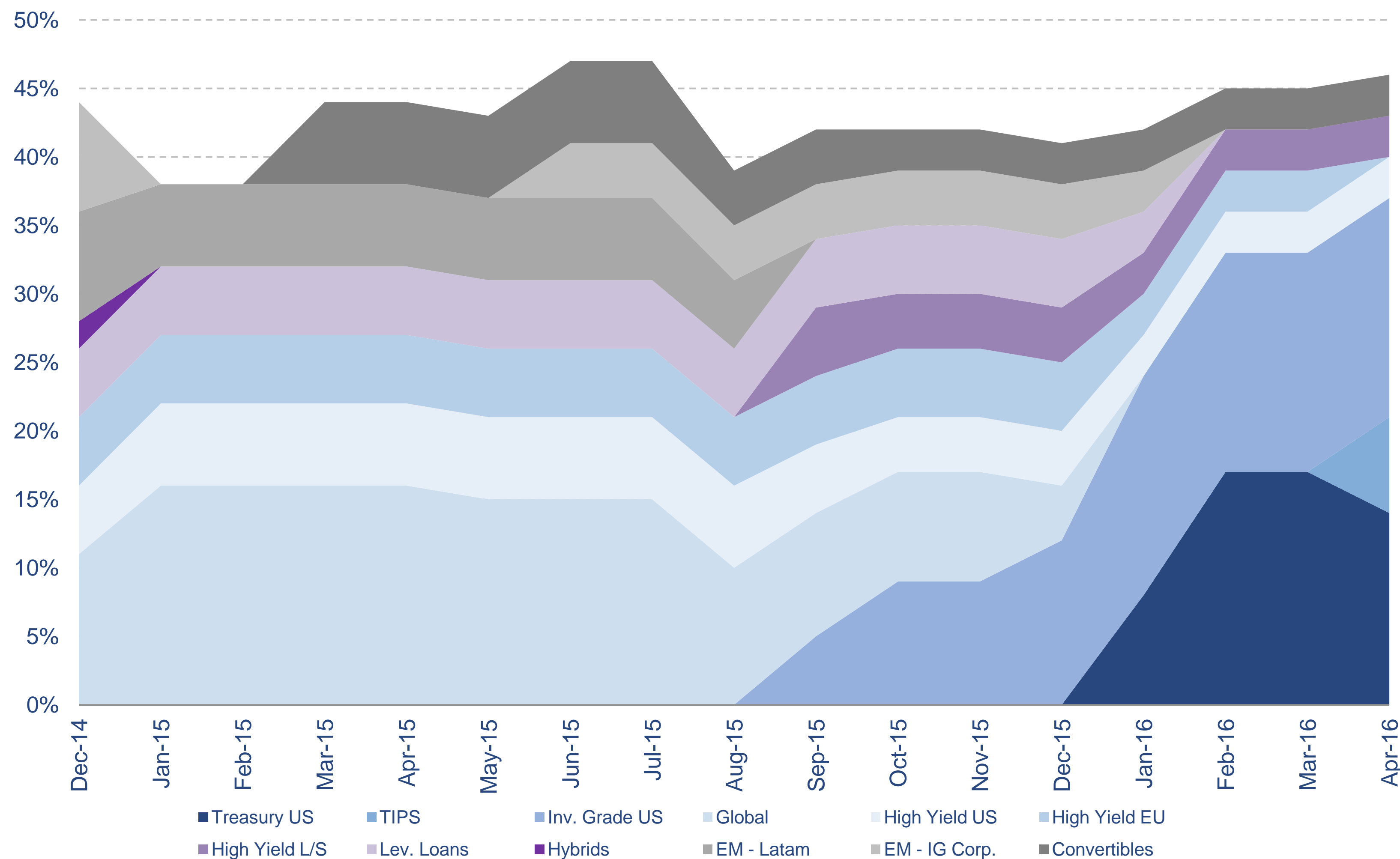

MWM Model Portfolio – VaR Evolution

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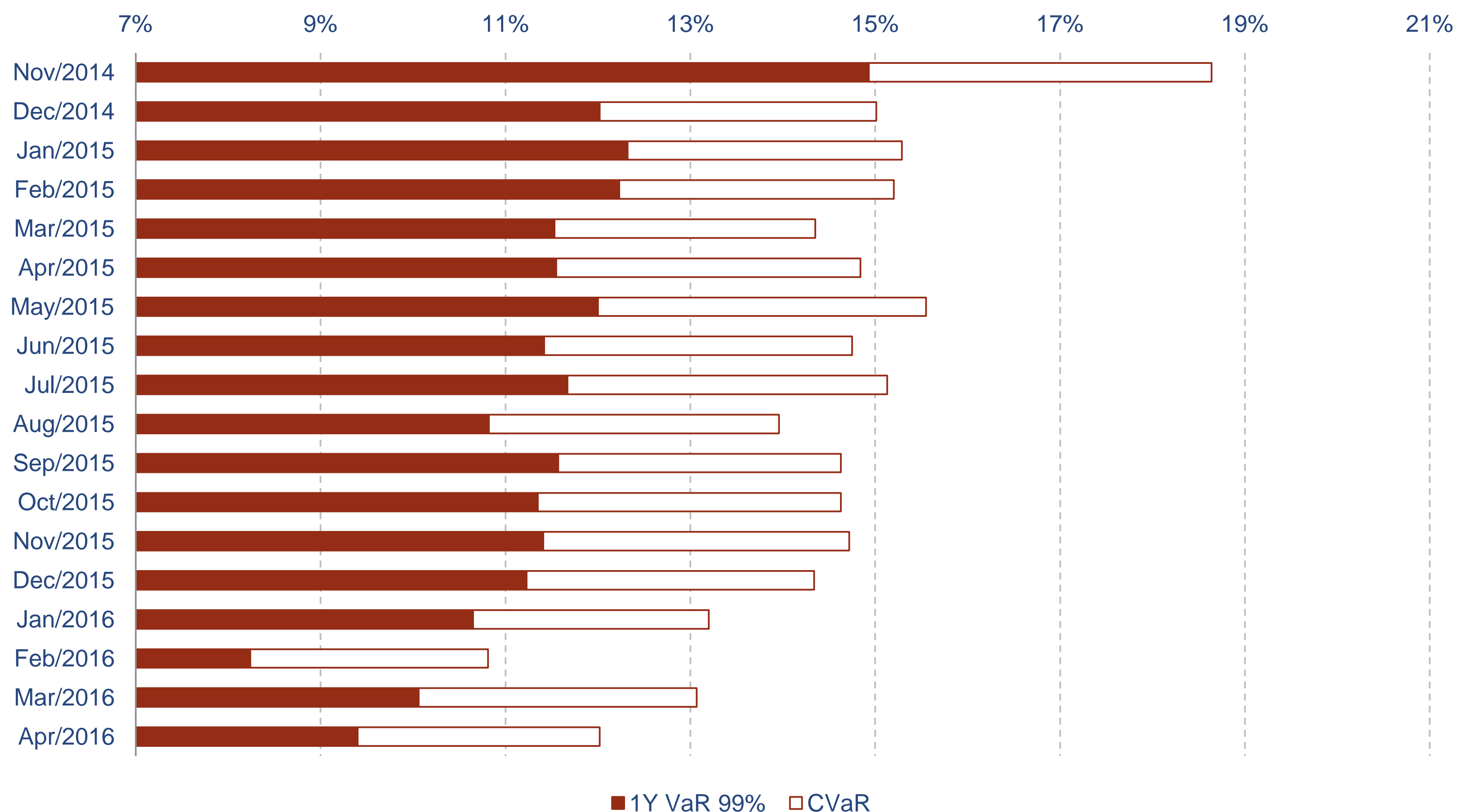

- Since **August's** correction, we have **further taken out risk** from the portfolio; a process continued this year by further **reducing exposure to credit** (High Yield and Emerging Markets) and increasing the allocation to **US Treasuries**
- The **reduction in risk** has been greater than that indicated by the VaR, as **volatility has markedly increased** throughout the year, which causes the VaR to increase automatically

MWM Model Portfolio – VaR Contributions

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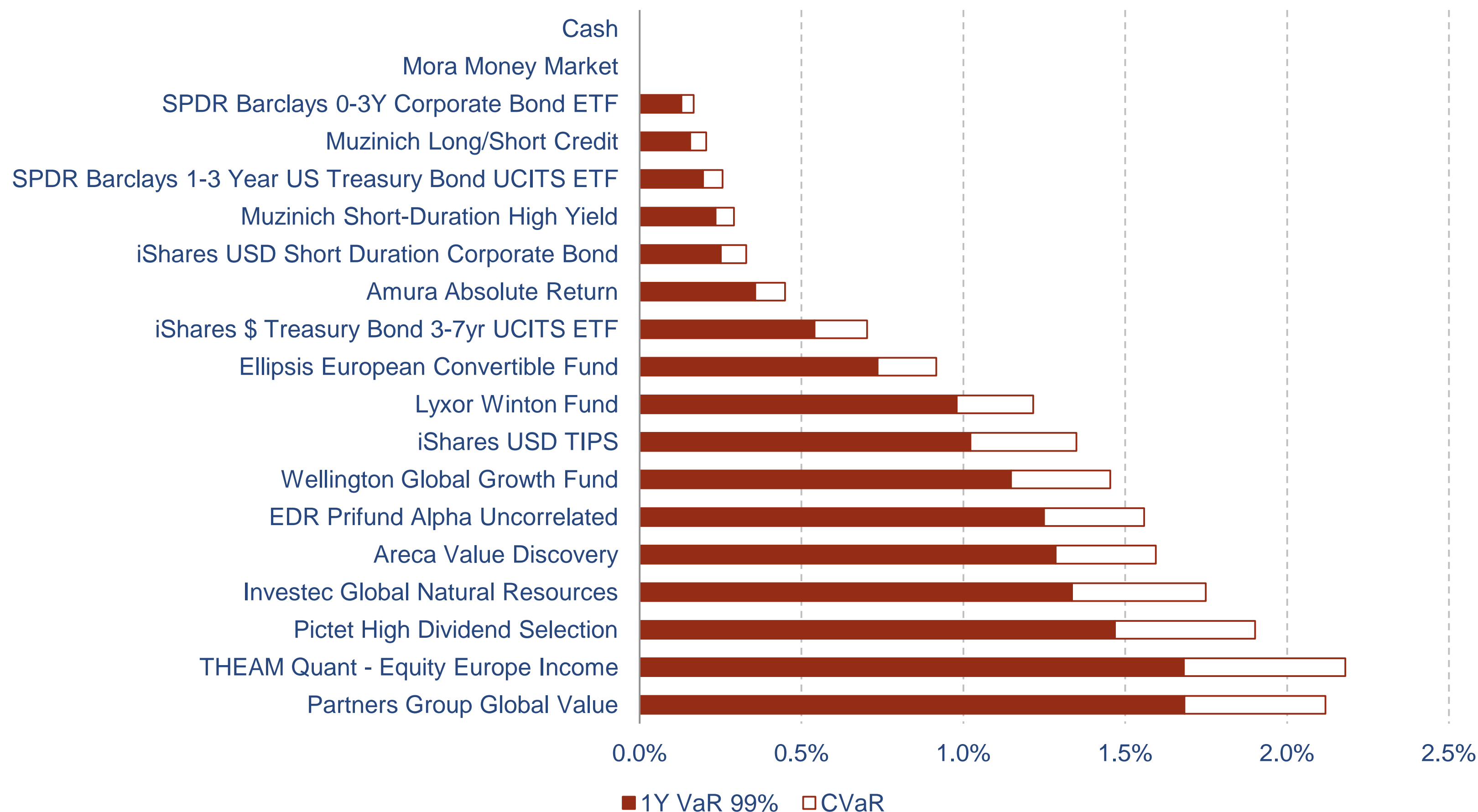
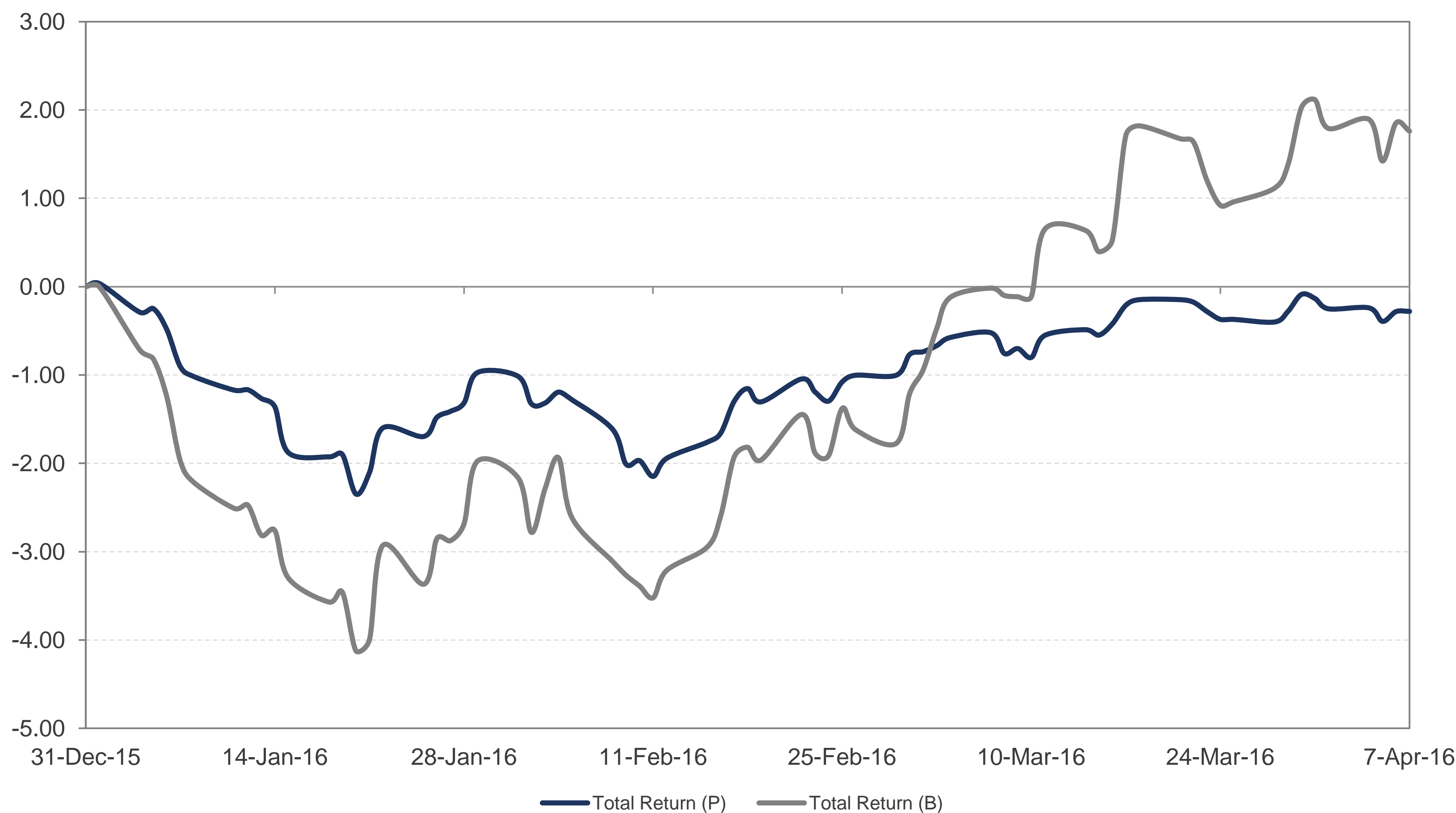


- Risk is controlled by making larger allocations in the portfolio to positions exhibiting a low VaR, and vice versa
- Recent changes in the portfolio – TIPS for Arcano and Wellington Global Growth replacing Blackrock European Value – have resulted in a reduction of the overall risk in the portfolio

MWM Model Portfolio – Ytd performance (Net)



- **Total Return** (Ytd[1]): **-0.70%** vs. **+0.62%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.55%** vs. **7.00%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.62%** vs. **4.78%** Benchmark[2]
- **Var 95%** (Ytd[1]): **-0.41%** vs. **-0.69%** Benchmark[2]

[1] As of April 8, 2016

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

MWM Model Portfolio - Historical performance (1)

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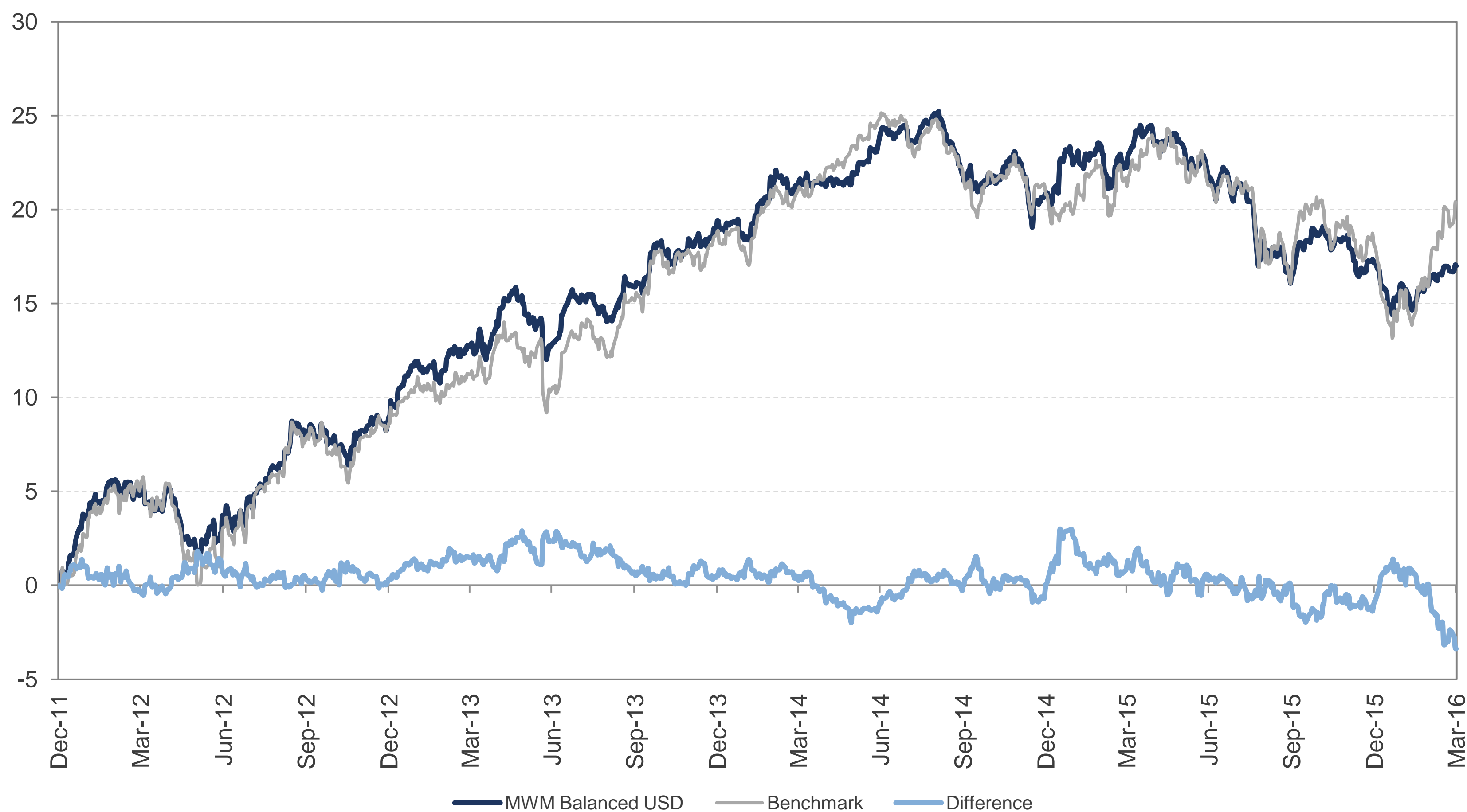
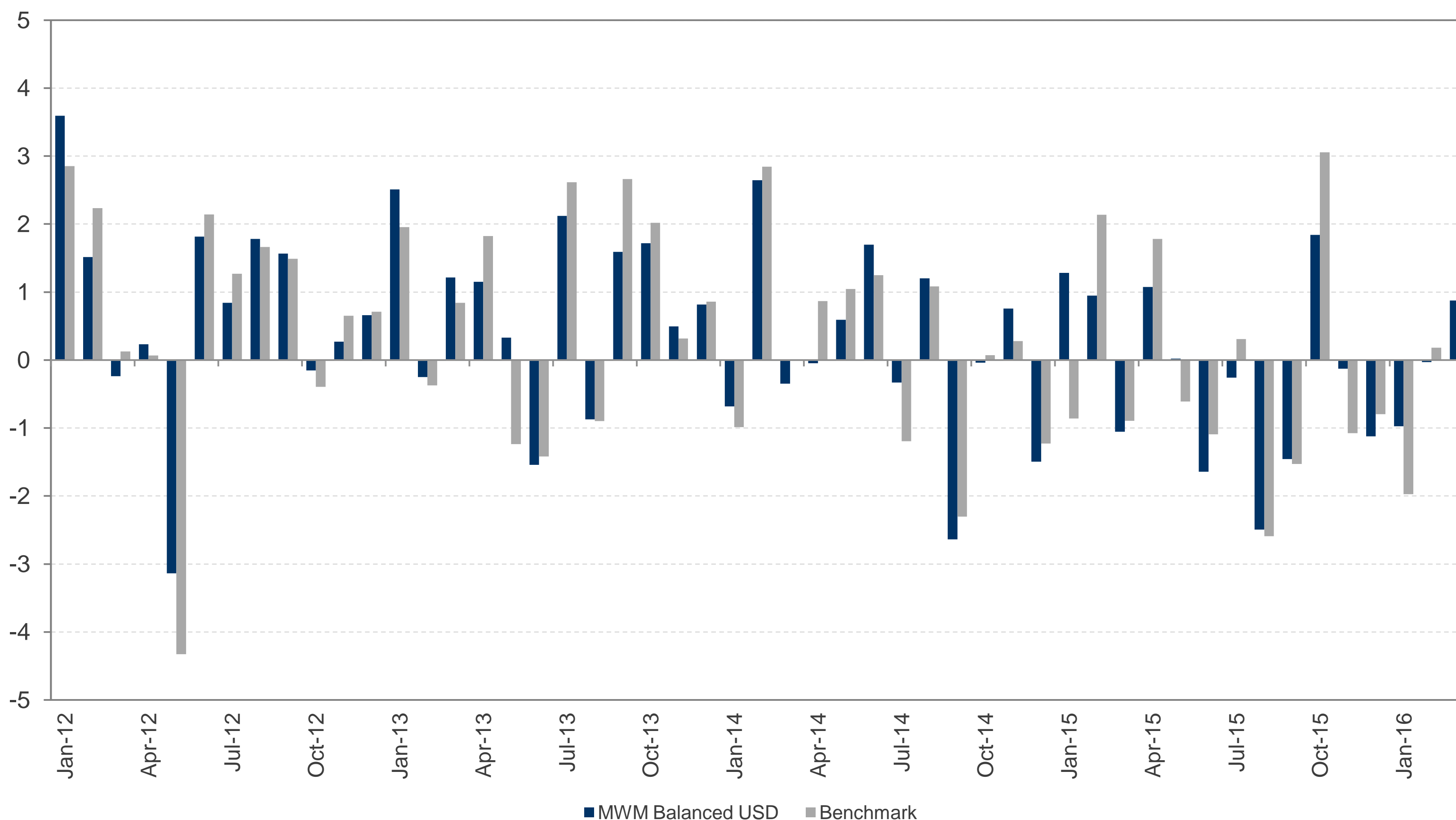


- **Total Return** (1 year[1]): **-4.30%** vs. **-0.58%** Benchmark[2]
- **Total Return** (3 year[1]): **3.76%** vs. **8.34%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **17.00%** vs. **20.52%** Benchmark[2]

[1] As of March 31, 2016

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

MWM Model Portfolio - Historical performance (2)



- **Standard Deviation** (1 year[1]): **3.79%** vs. **5.79%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.88%** vs. **4.05%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-1.14%** vs. **-0.09%** Benchmark[2]
- **Var 95%** (1 day[1]): **-0.42%** vs. **-0.57%** Benchmark[2]

[1] As of March 31, 2016

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

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