Investment Policy

MORA WEALTH MANAGEMENT

February 2016

Will the Fed consider market expectations as “data”?

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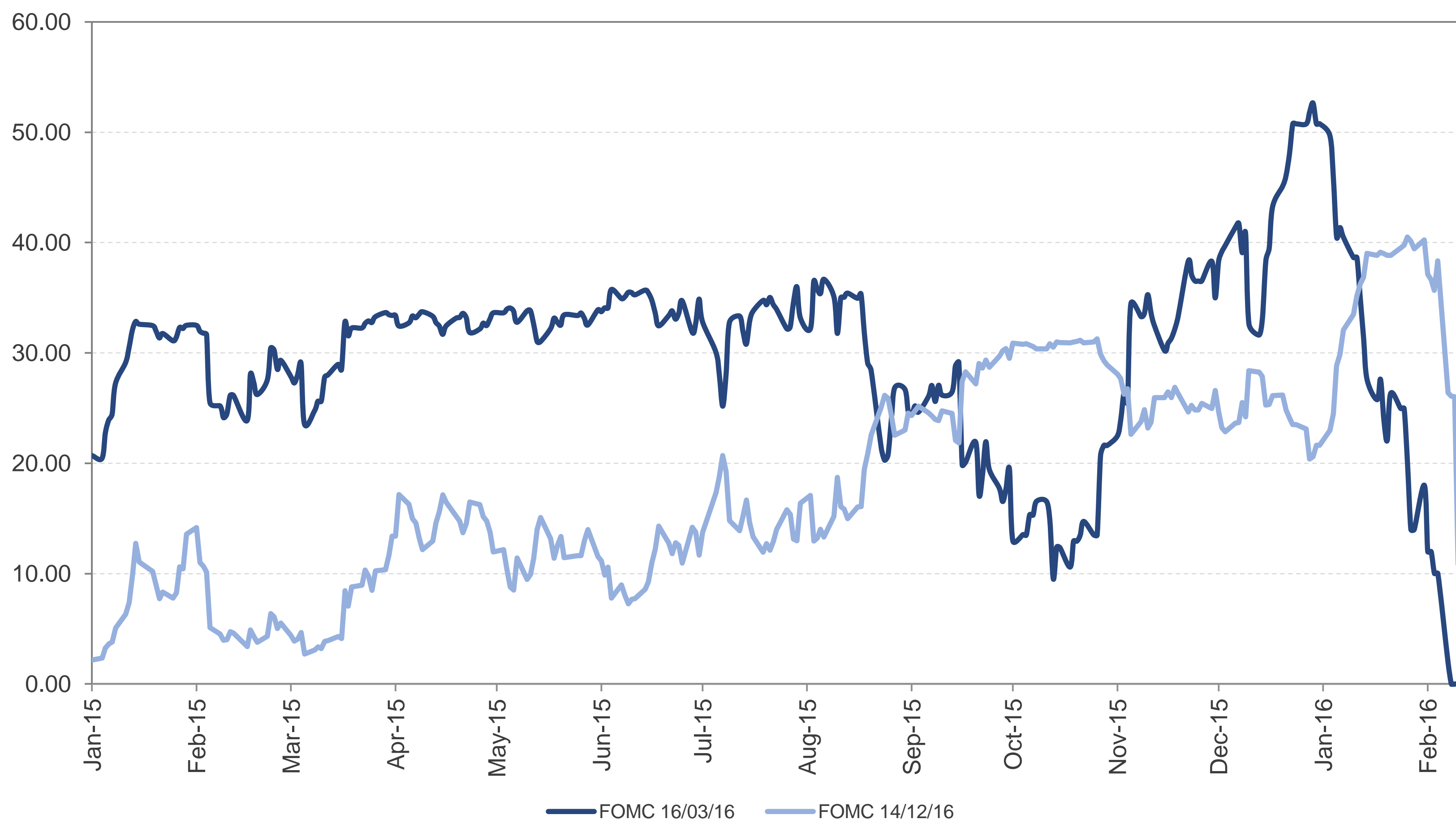

- After the “Taper Tantrum” in 2013, the Fed has turned increasingly cautions in communicating to the market, committing itself to remain **“data dependent”**
- However, despite the benefits of greater transparency, this communication strategy poses the risk of creating **more volatility** due to the **absence of guidance**, and losing independence, ending hijacked by **market expectations**

Source: Bloomberg

Greenspan's bond "conundrum" redux

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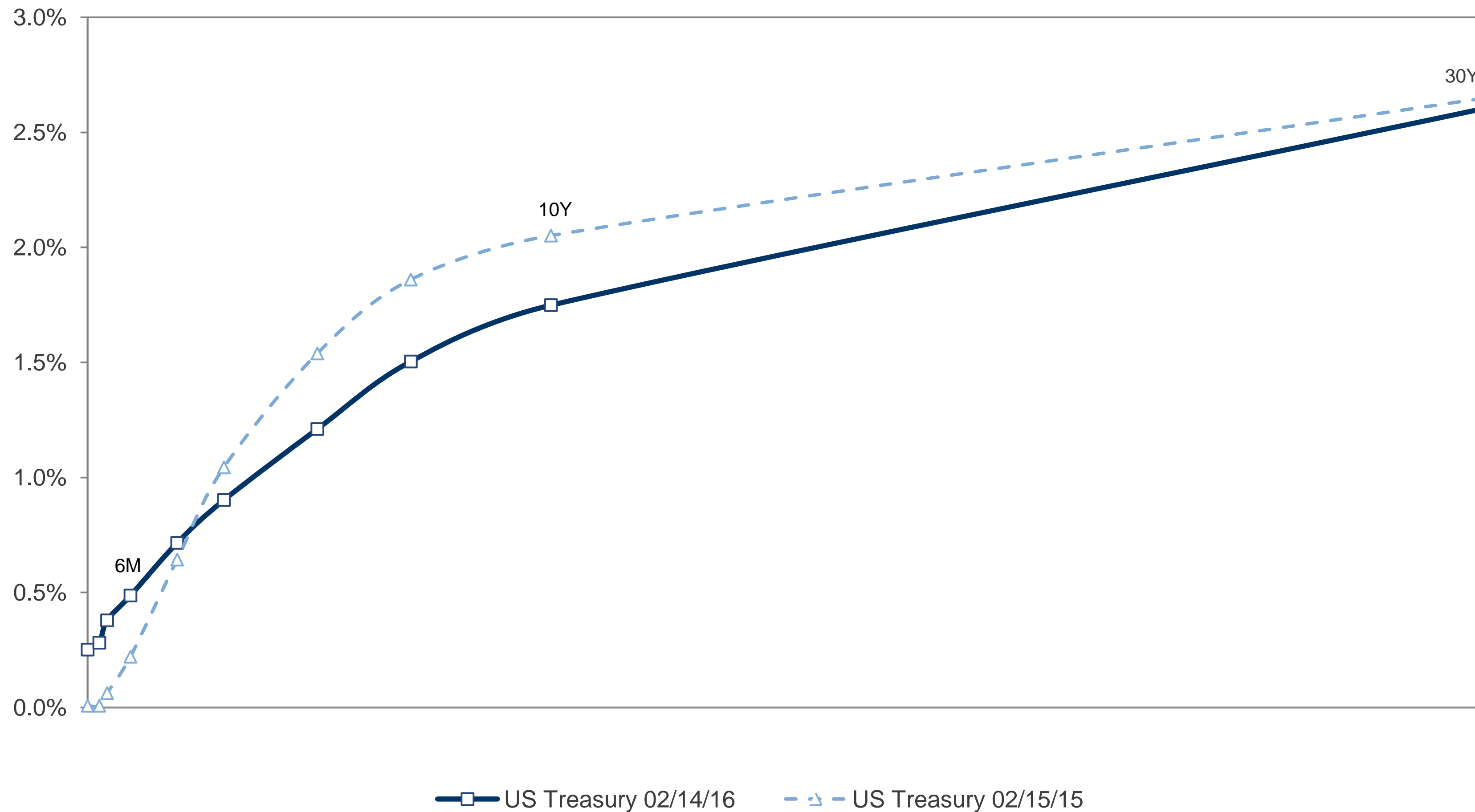

- The **bond market is not believing the Fed** will rise interest rates as far and as fast as predicted by the "Fed dots", with long-term **US Treasury yields below those a year ago**
- In fact, the **flattening of the yield curve** suggests that low **inflation expectations are well anchored**, and probably that the market is **starting to price a recession**

Source: Bloomberg

Credit spreads: risk or opportunity?

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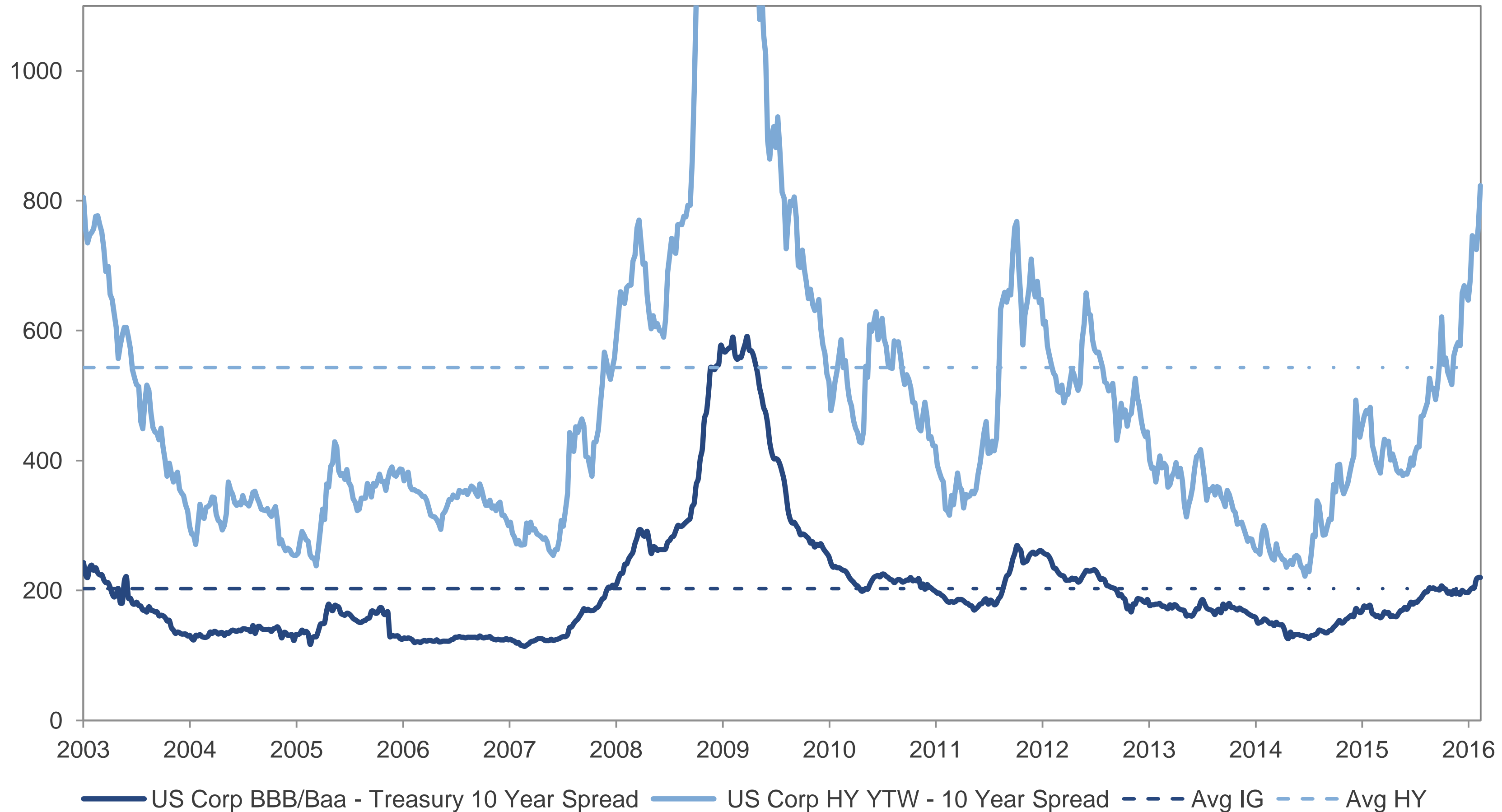

- Credit spreads have **continue widening** during the past month. At this point it is possible to buy **investment grade bonds with a yield close to that of High-Yield bonds back in 2013**
- The worrying part of the **tightening in credit conditions** is that the market is beginning to price in an **economic recession in the US**, which is consistent with the flattening of the yield curve

Source: Bloomberg

EM: decoupling, or converging to the “new normal”?

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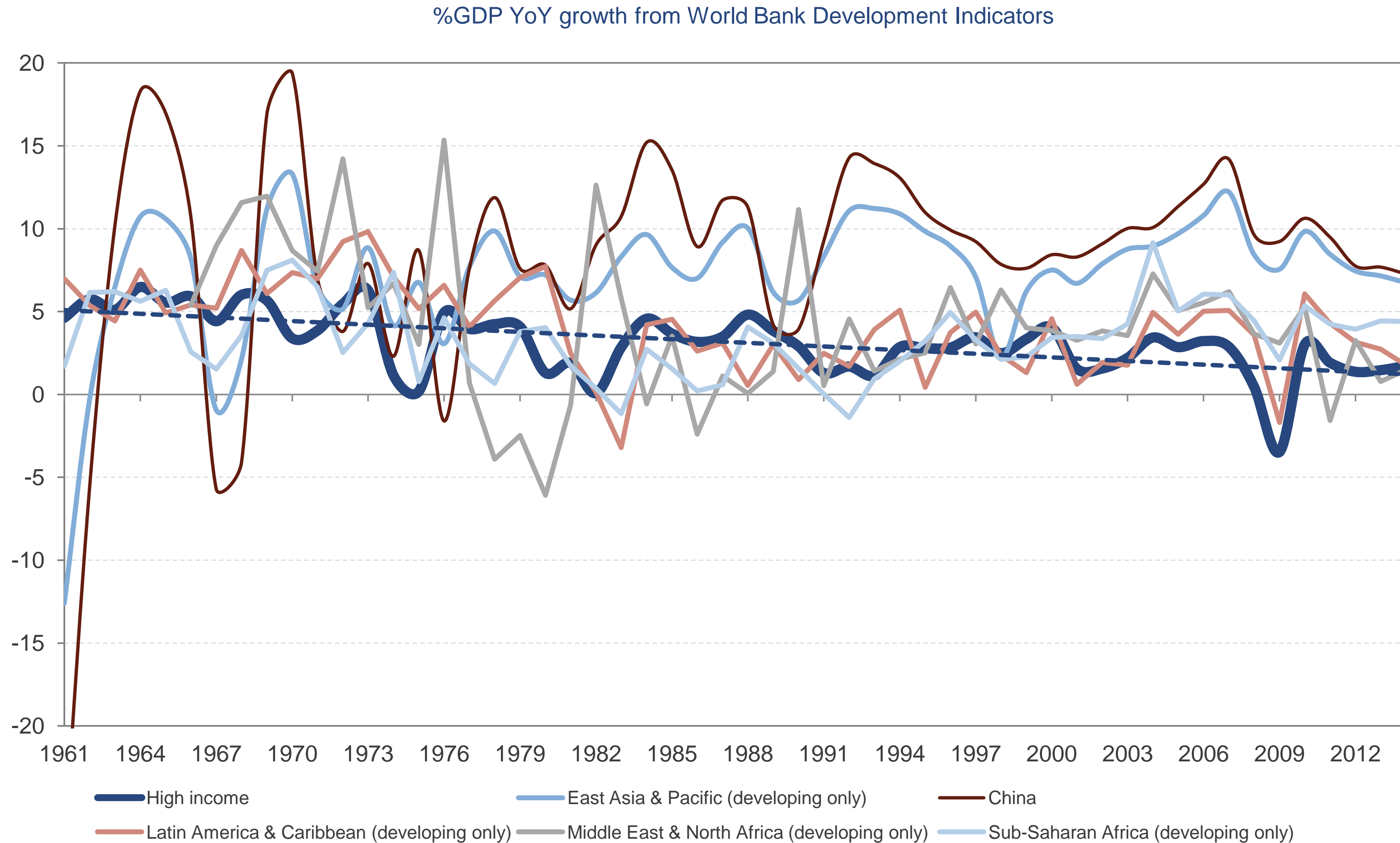
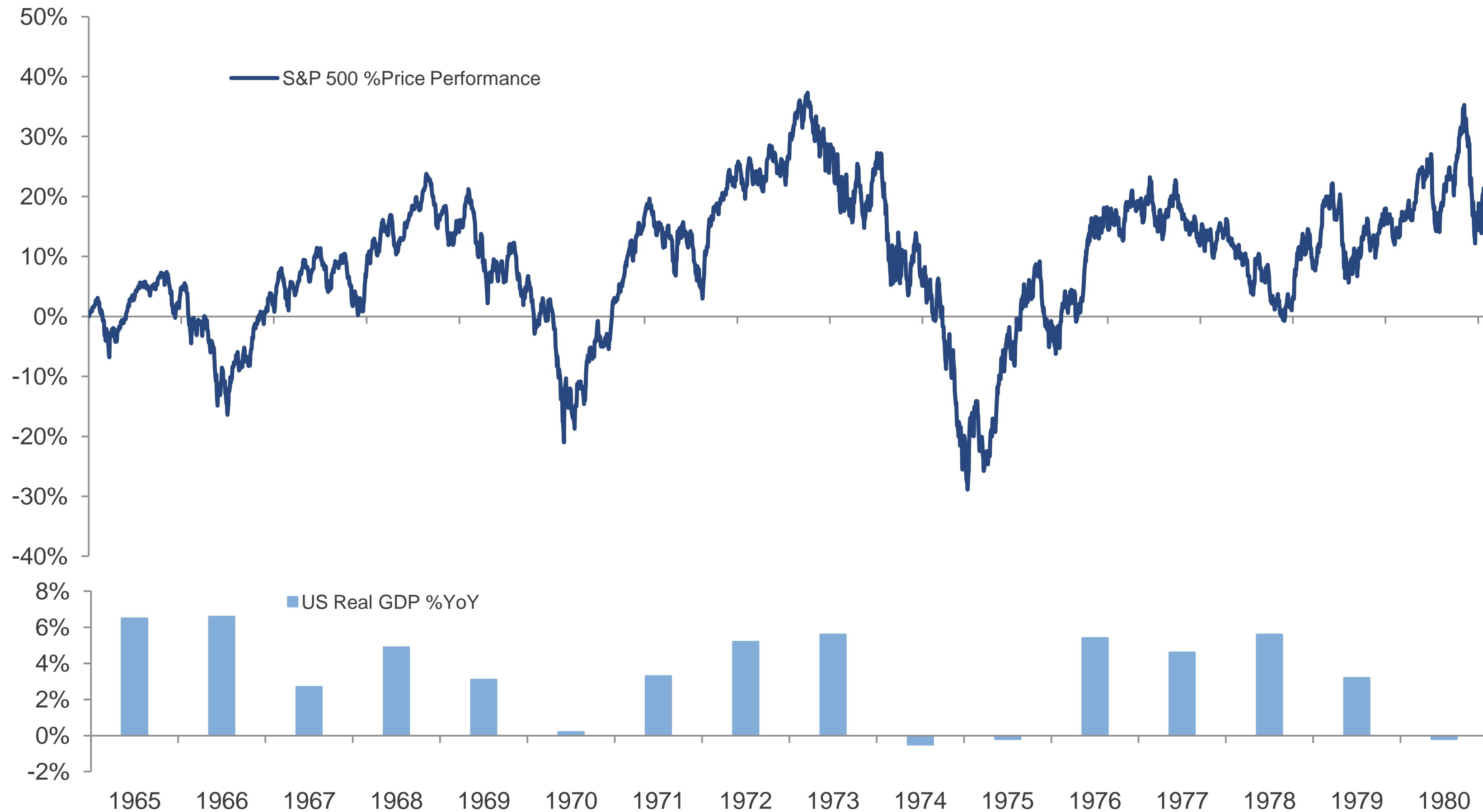


- The **deceleration of Emerging Markets** needs to be put into the wider perspective of the **low growth malaise** afflicting developed economies
- Even if emerging **Asian economies** have managed to decouple from the world economy and maintain a sustained growth path, a **sudden drop** like that occurred in 1998 cannot be ruled out, particularly due to the present **size of the Chinese economy**, and its **high degree of indebtedness**

Source: World Bank Development Indicators

Mind the trends: buy and hold does not always work!



- The commonly accepted idea that **long-term equity investments** produce superior returns depends both on the **length of the period** analyzed, as well as the **market selected** (in Japan, we are still -60% below the peak in 1989)
- Even in the most successful market, the US, there have been **long periods of lackluster performance**. Importantly, these happened despite the **real economy displaying vigorous, though more volatile, growth**

Source: World Bank Development Indicators

The divorce of “Wall Street” and “Main Street” needs to end

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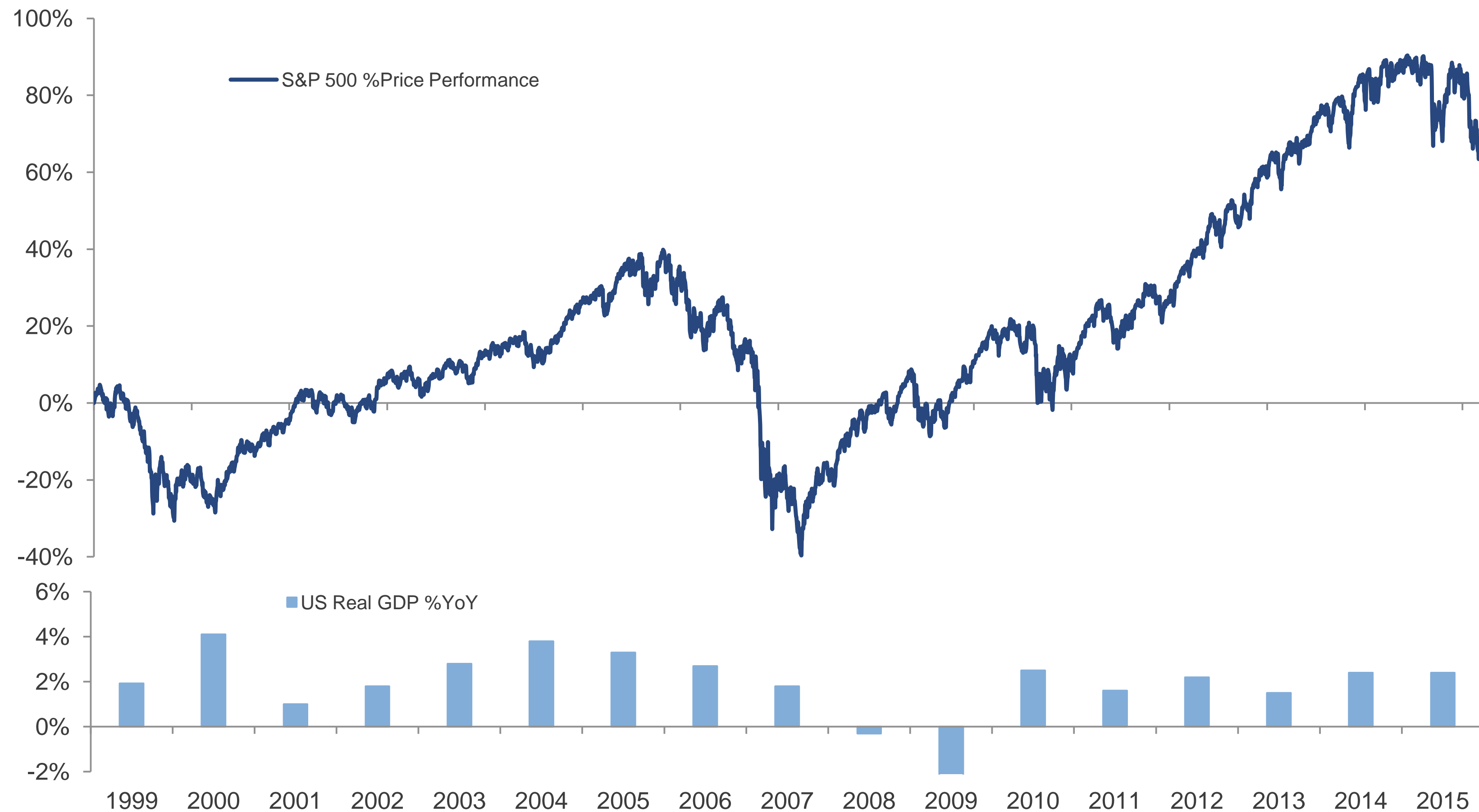

- On the contrary, **since the financial crisis** we have seen a **deceleration in economic growth**, coupled with a **strong equity bull market**
- The worsening in the **current macro environment** make less likely that the **wedge between Wall Street and Main Street** will be closed by a pick up in economic activity, and hence speaks **for lower equity returns**

Source: World Bank Development Indicators

Time to favor “micro” vs. “macro”

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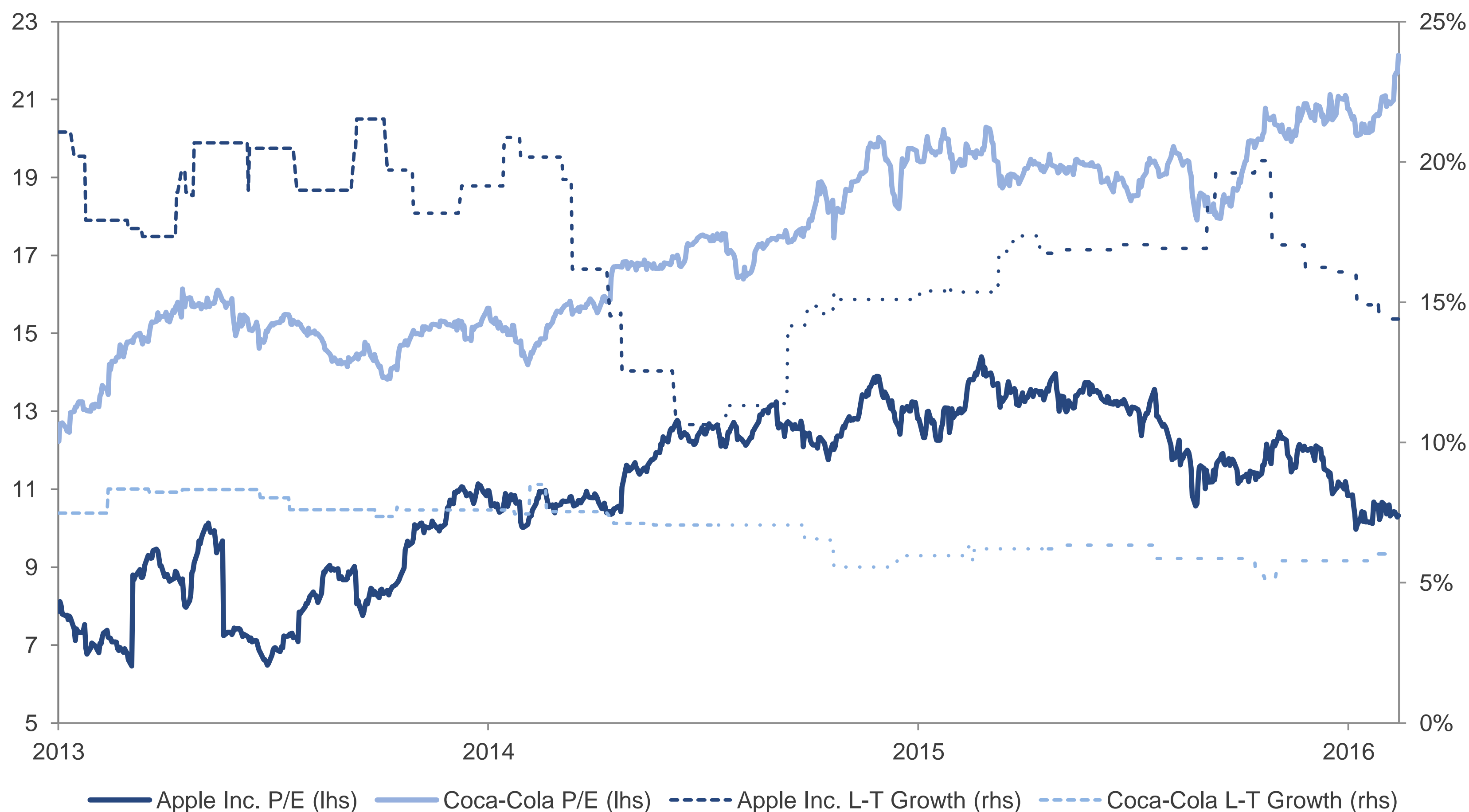

- The market correction is also starting to offer interesting **opportunities for alpha generation**, as dispersion of returns will increase in a non-trending market
- Currently, it is possible **to buy growth stocks at multiples of value stocks** a year ago
- We particularly see value in **quality stocks** that are able show **resilient EPS growth**, preferably in **defensive sectors** like pharmaceuticals, retail, insurance, etc.

Source: World Bank Development Indicators

“Flight to quality” paying off so far

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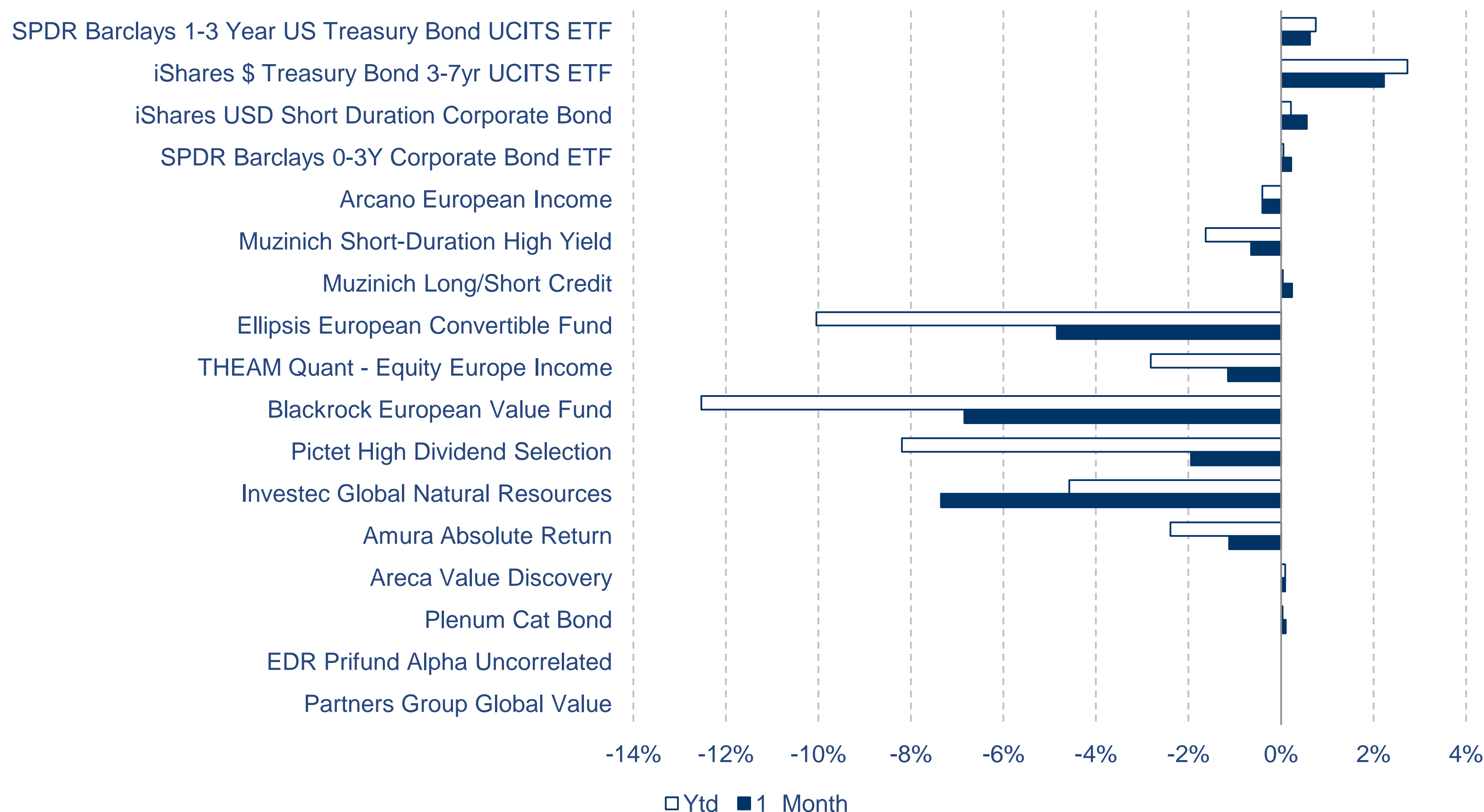

- Taking an **increasingly defensive** stance by **reducing equity** and **increasing the credit quality** of the portfolios has helped in weathering the market meltdown
- The preference for **asymmetric equity strategies** and **high dividend stocks** has contributed to mitigate the losses
- On the contrary, the **overweight in European equities** has not worked out well so far this year

Source: Bloomberg as of February 16, 2016

Three broad 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 indefinitely • 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	50% ↑ (+10%)	30% ↓ (-10%)	20%

Short-term catalyzers

Chinese QE, 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 extremely 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** offer protection against “risk-off” movements in the markets

- Central banks have created an environment where **valuations** are largely **dependent on interest rates to remain low for long**. Hence, the incoming normalization in US monetary policy is causing **investor anxiety**. From a **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)

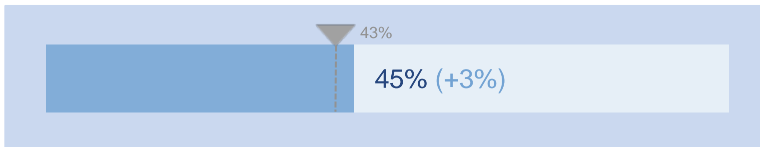
- A **larger than usual cash allocation** is advisable as the **opportunity cost** of holding cash has decreased dramatically, and it offers **flexibility** to enter the market in an opportunistic manner

MWM Investment Policy

Cash

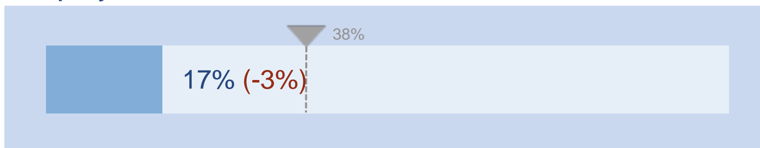
- In the current interest rate environment the opportunity cost of holding cash has significantly decreased, hence, waiting for good investment opportunities is a sensible investment strategy
- Nonetheless, we have reduced the allocation to enhanced cash strategies as we have taken a more conservative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

Fixed Income



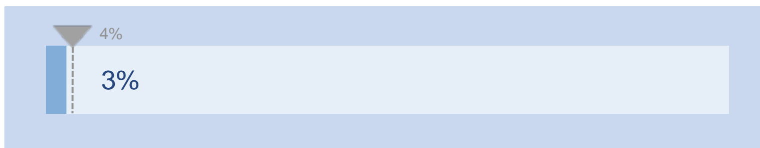
- High-quality fixed income in USD currently offers a better combination of risk and return since credit spreads have widened, and Treasuries offer protection against a market sell-off
- On the other hand, high-yield and emerging markets start to look less attractive in the light of the bleak global economic outlook

Equity



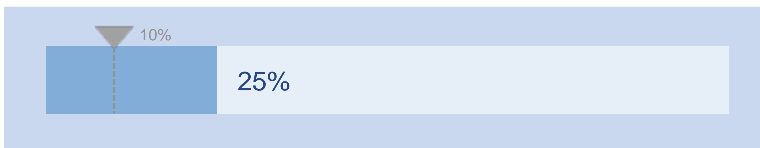
- Despite the correction experienced over the past months, equity valuations remain greatly supported by low interest rates. A potential normalization of interest rates poses a risk of returning to lower valuation multiples
- In relative terms, Europe looks still more attractive than US and Asia

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%	10%
	Money market	• Mora Money Market	4%	
Fixed Income	US Treasuries	• iShares Treasury Bond 1-3yr	9%	45%
		• iShares Treasury Bond 3-7yr	8%	
	Short-Term Corporate Bonds	• SPDR Barclays 0-3Y Corporate Bond ETF	8%	
		• iShares USD Short Duration Corporate Bond	8%	
	High Yield US	• Muzinich Short Duration High Yield	3%	
	High Yield Europe	• Arcano European Income	3%	
	High Yield Absolute Return	• Muzinich Long/Short Credit Yield	3%	
	Convertible Bonds	• Ellipsis European Convertible Fund	3%	
Equity	Europe	• Blackrock European Value Fund	3%	17%
		• THEAM Quant Equity Europe Income	3%	
	Volatility	• Reverse Convertibles on Blue Chips	6%	
	High Dividend Yield	• Pictet High-Dividend Selection	5%	
Commodities	Diversified	• Investec Global Natural Resources	3%	3%
Alternative Investments	Multi-Strategy	• EDR Prifund Alpha Uncorrelated	5%	25%
	Multi-Strategy	• Amura Absolute Return	5%	
	Relative Value	• Areca Value Discovery	5%	
	Cat Bonds	• Plenum CAT Bond Fund	5%	
	Private Equity	• Partners Group Global Value	5%	

MWM Investment Profiles

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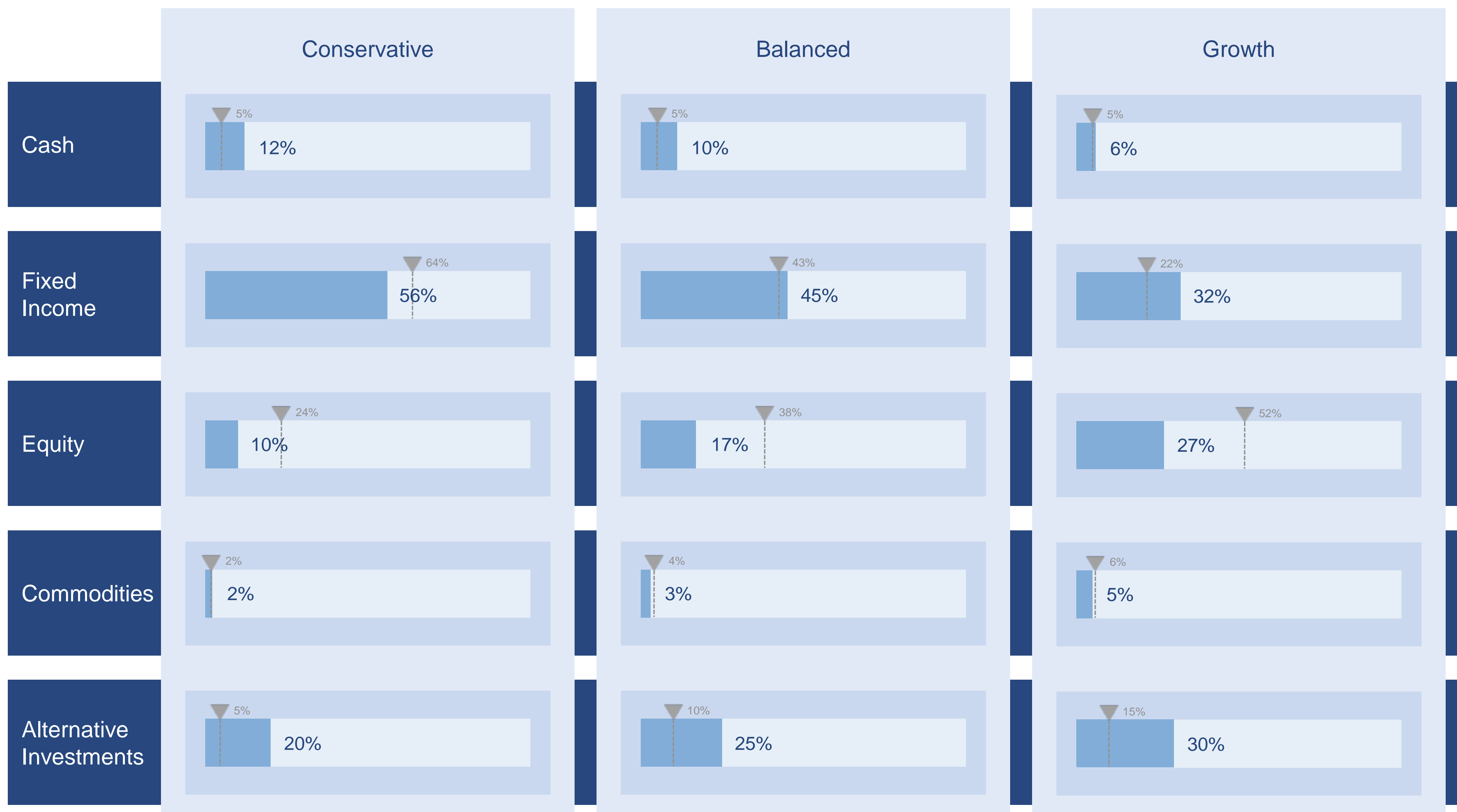

Strategic Asset Allocation

MWM Model Portfolio – Asset Allocation Evolution

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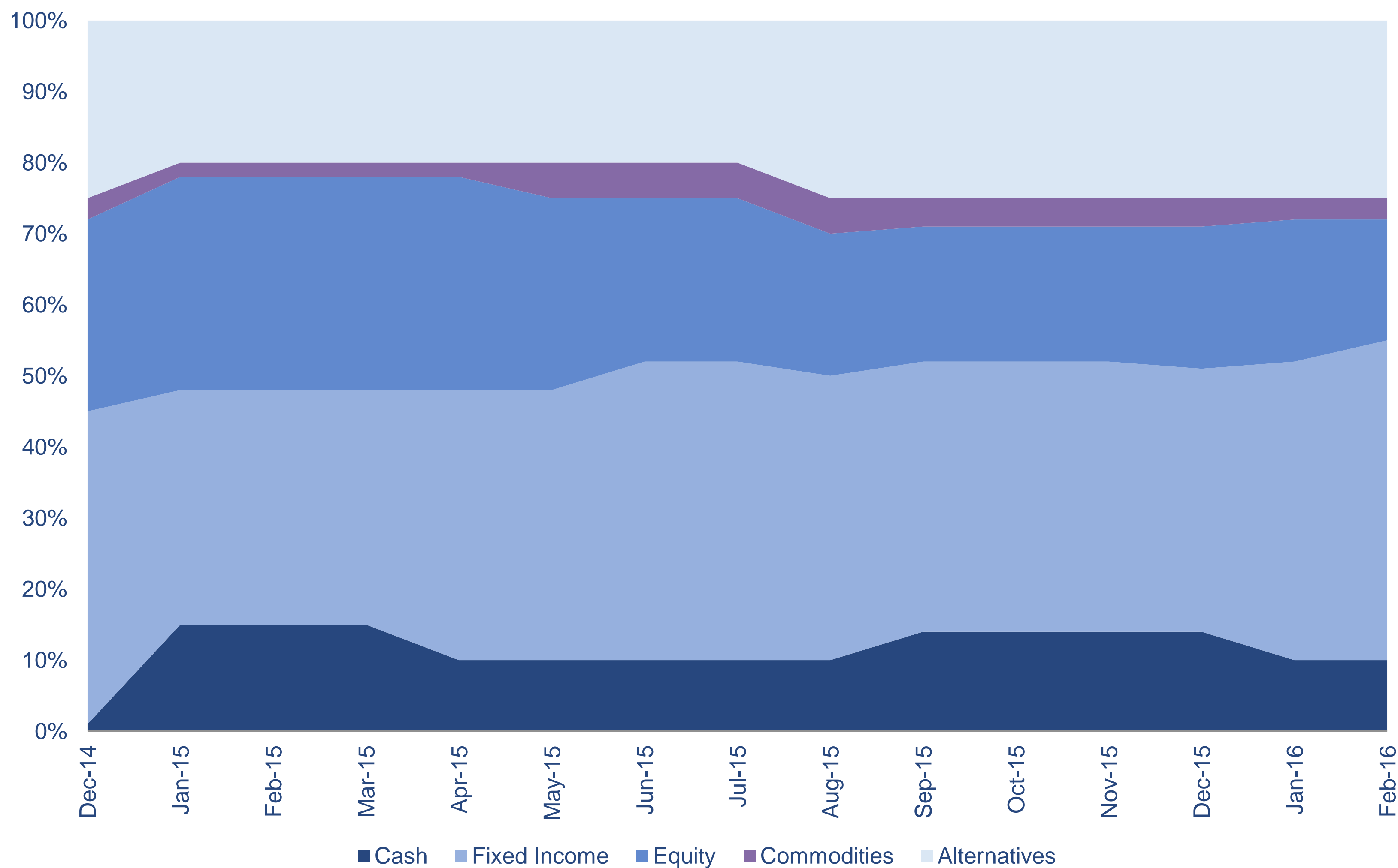

MWM Model Portfolio – Fixed Income Evolution

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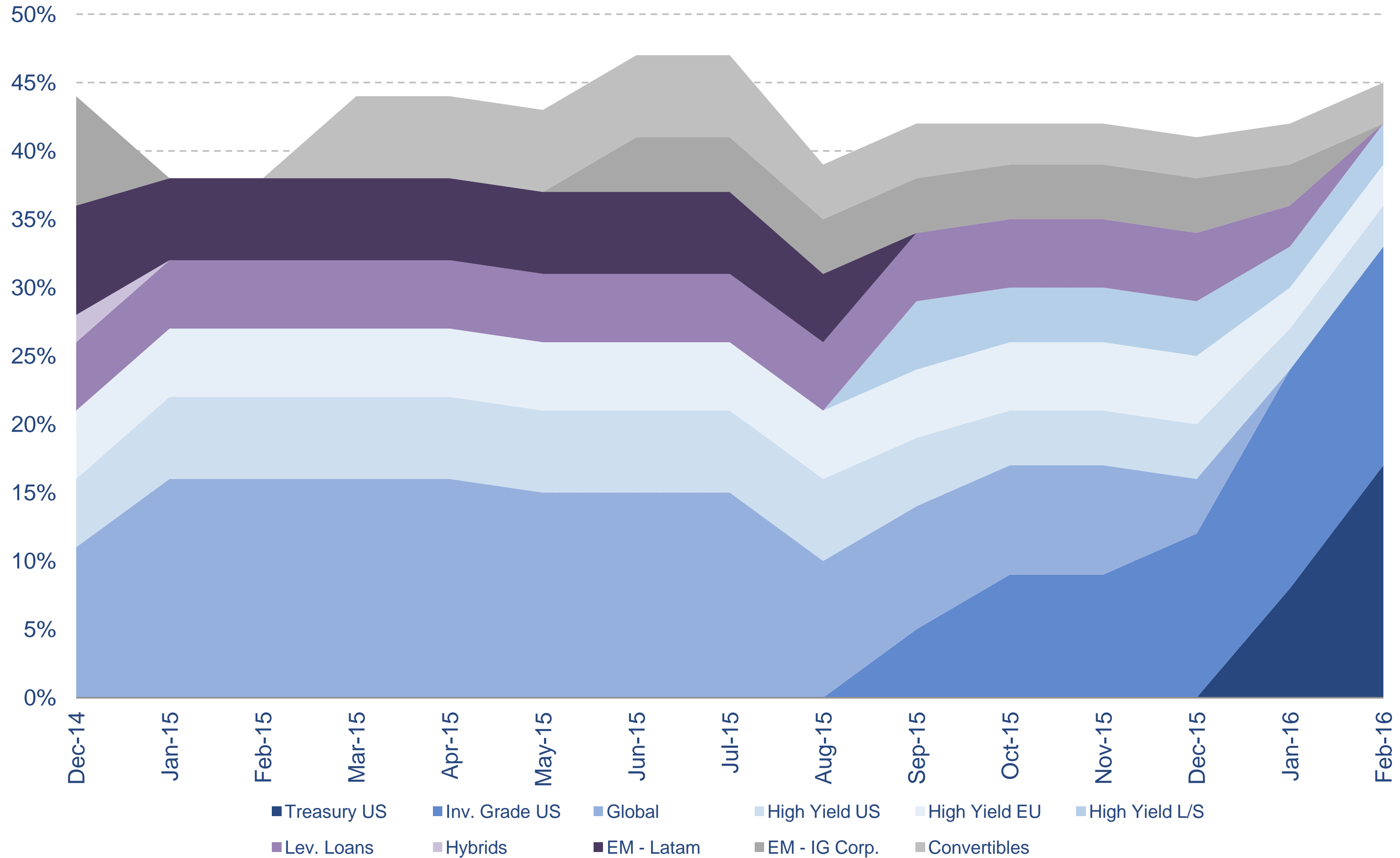

MWM Model Portfolio – VaR Evolution

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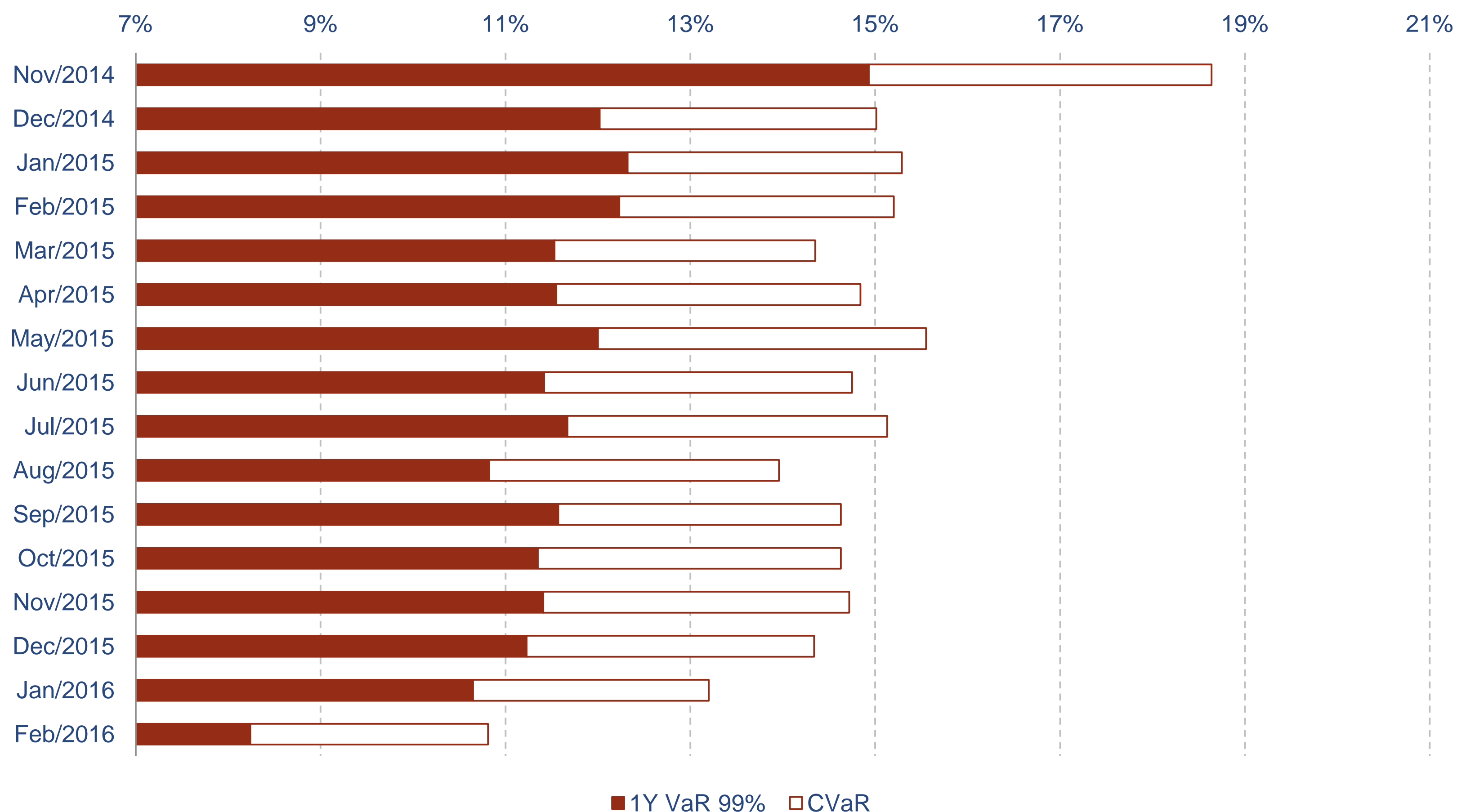
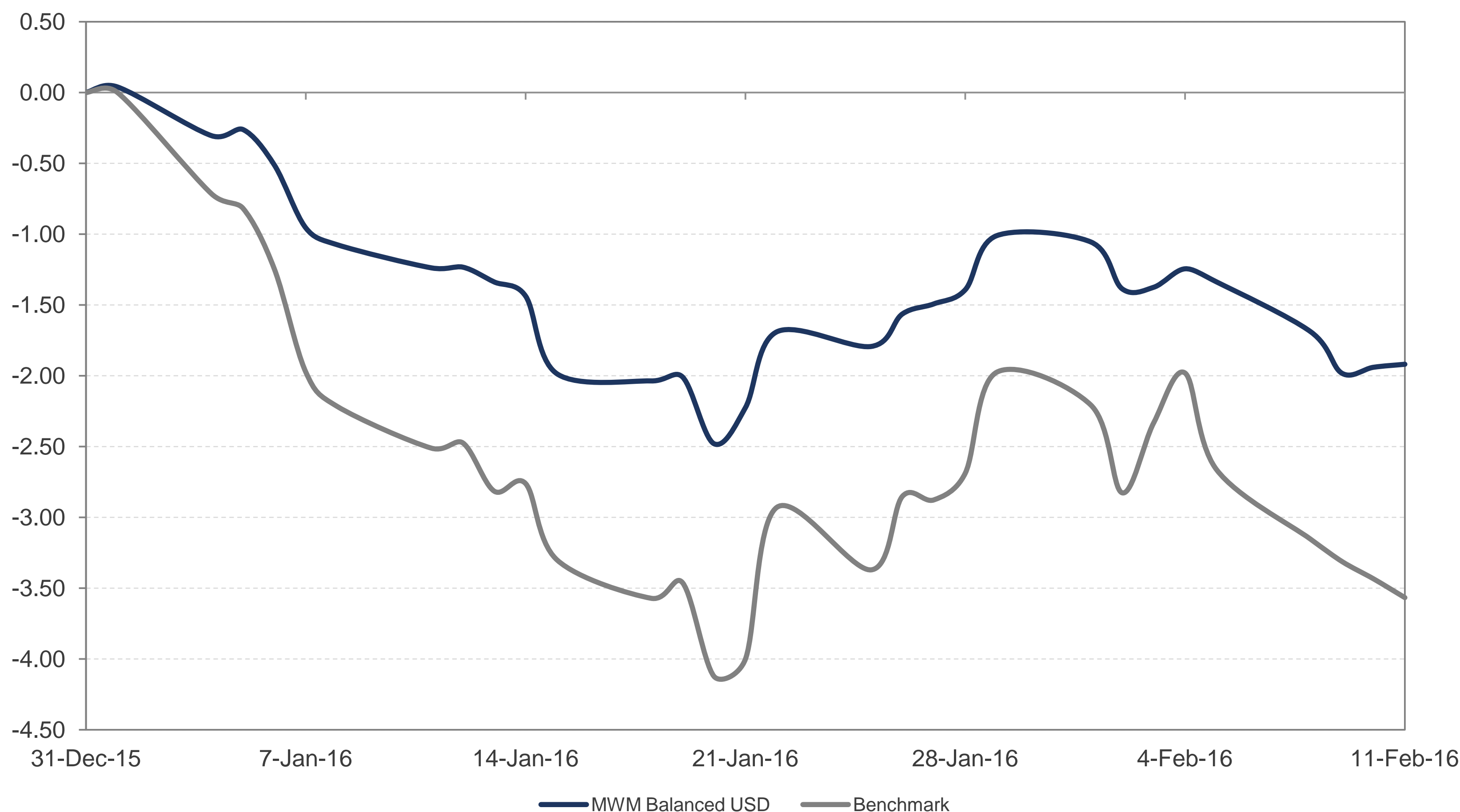


- Since **August's** correction, we have **further taken out risk** from the portfolio; a process continued this year by further **reducing exposure to credit** (High Yield and Emerging Markets) and increasing the allocation to **US Treasuries**
- The **reduction in risk** has been greater than that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

MWM Model Portfolio – Ytd performance (Net)



- **Total Return** (Ytd[1]): **-1.92%** vs. **-3.57%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **4.05%** vs. **7.31%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.86%** vs. **4.59%** Benchmark[2]
- **Var 95%** (Ytd[1]): **-0.46%** vs. **-0.71%** Benchmark[2]

[1] As of February 12, 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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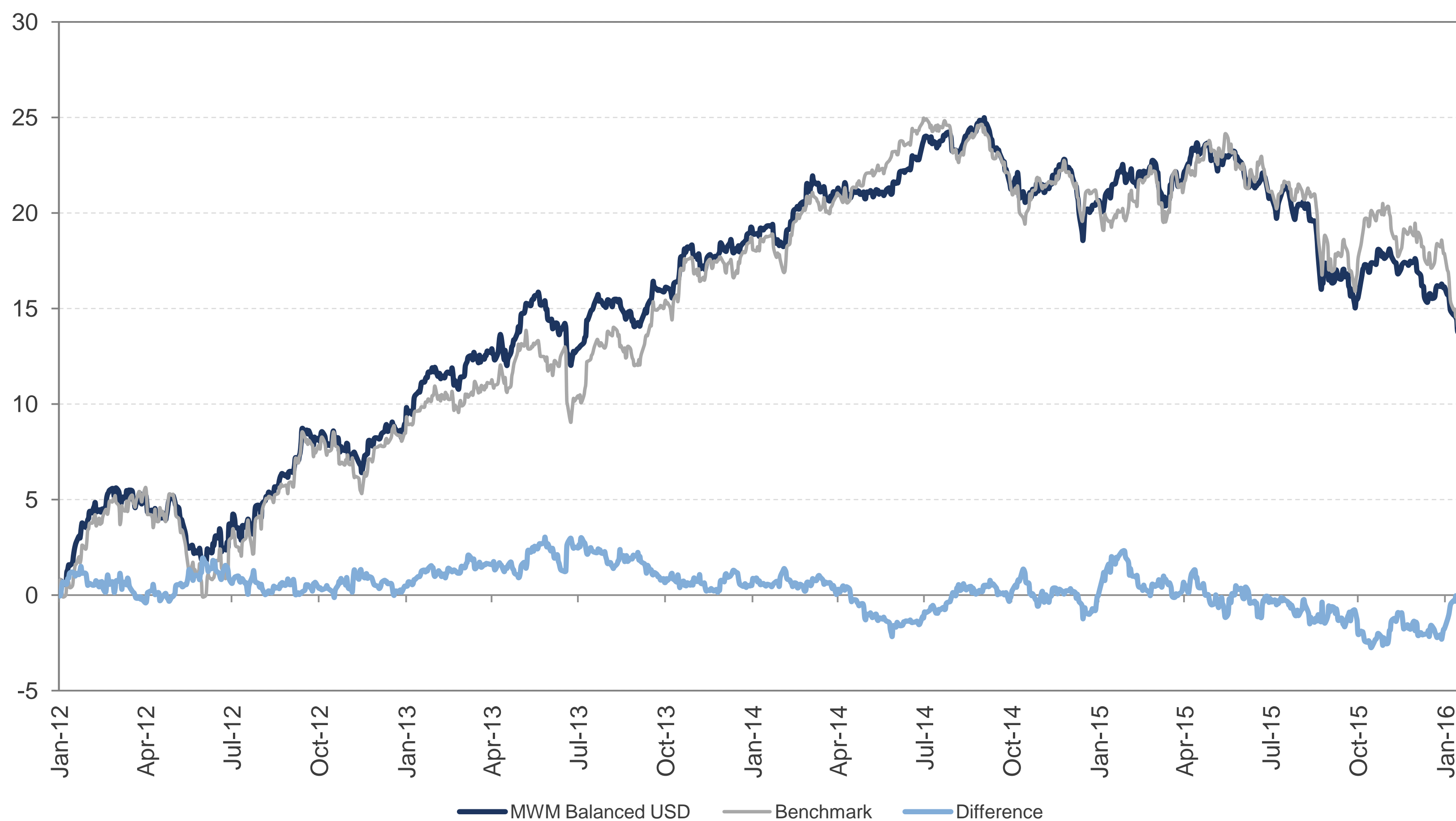

- **Total Return** (1 year[1]): **-5.50%** vs. **-3.40%** Benchmark[2]
- **Total Return** (3 year[1]): **2.89%** vs. **4.48%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **14.91%** vs. **15.55%** Benchmark[2]

[1] As of January 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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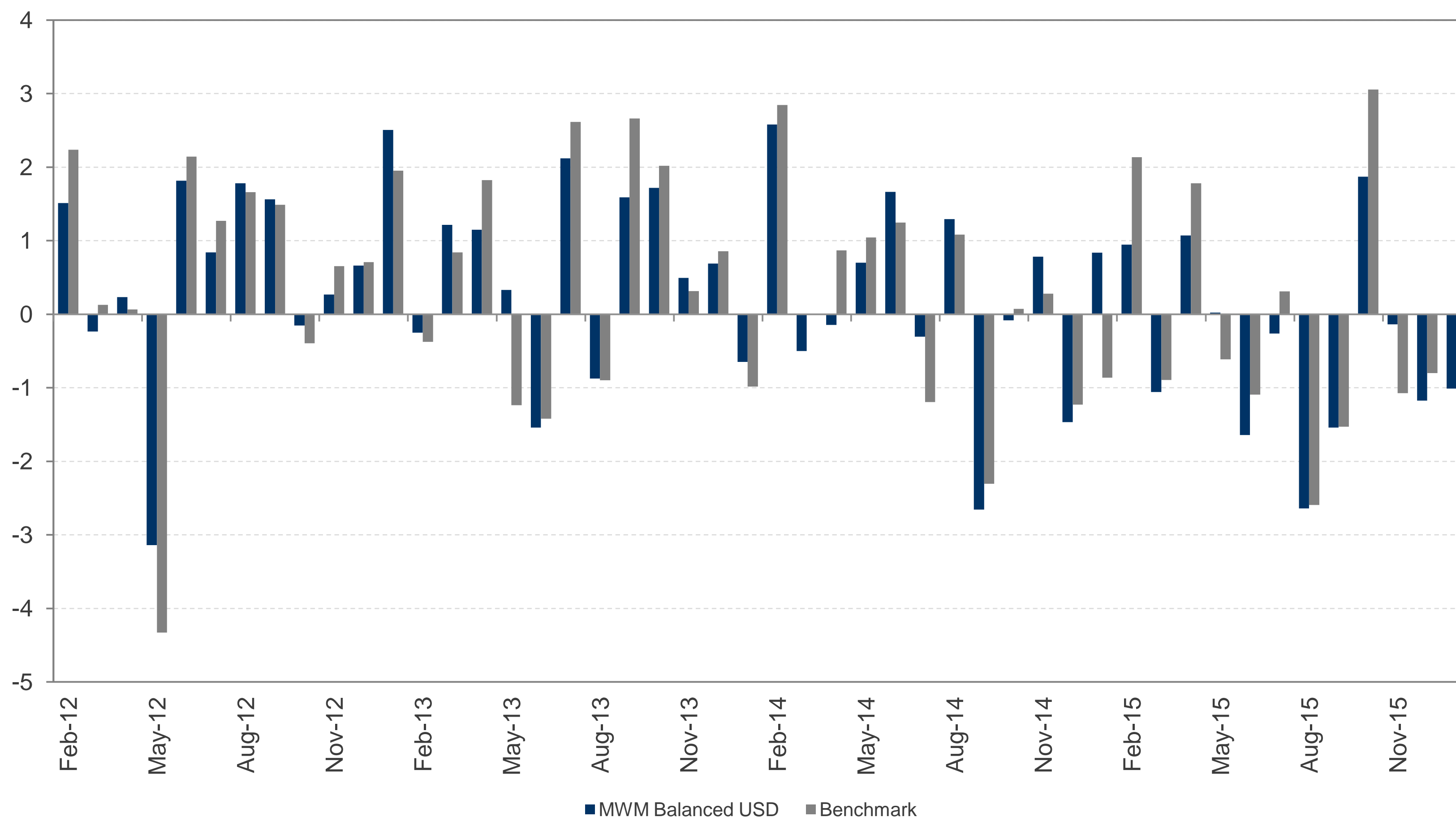
MWM Model Portfolio - Historical performance (2)



- **Standard Deviation** (1 year[1]): **4.49%** vs. **7.70%** Benchmark[2]
- **Downside Risk** (1 year[1]): **3.13%** vs. **4.04%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-1.31%** vs. **-0.58%** Benchmark[2]
- **Var 95%** (1 day[1]): **-0.48%** vs. **-0.57%** Benchmark[2]

[1] As of January 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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