Investment Policy

MORA WEALTH MANAGEMENT

March 2016

Dramatic swings in market sentiment

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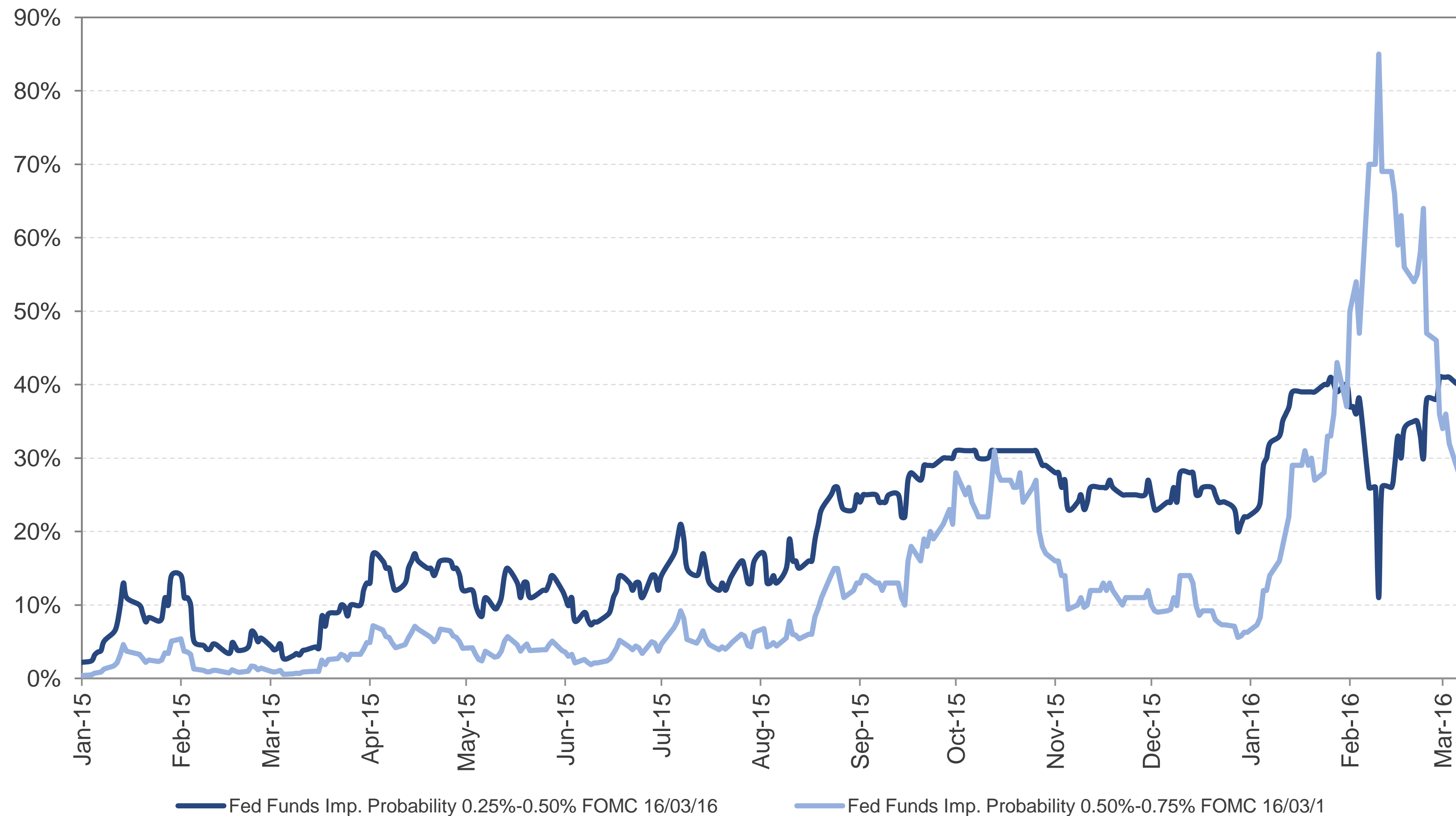

- In the midst of February's correction, the market was implying a very **small probability of interest rates increases** by the Fed for the whole year. The situation has **completely reversed** in the last weeks
- The **drivers of the reversal** in market sentiment have been the strong **US labor figures**, combined with the decisive action by the **ECB**, exceeding market expectations, and further monetary easing by the **PBOC**
- However, **volatility** is here to stay as disappointing macro data can anytime reignite **growth fears**

Source: Bloomberg

Why recession fears in the US?

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- **Recession fears** in the US are a consequence of **deteriorating economic activity data**, a **strong dollar**, a **tightening in financial conditions**, and a **negative wealth effect** due to the stock market correction
- Furthermore, the **length of the current expansionary cycle** is already **beyond the historical average,** increasing the likelihood of an economic downturn to happen

Source: Bloomberg

Other US data complete a fuzzy picture

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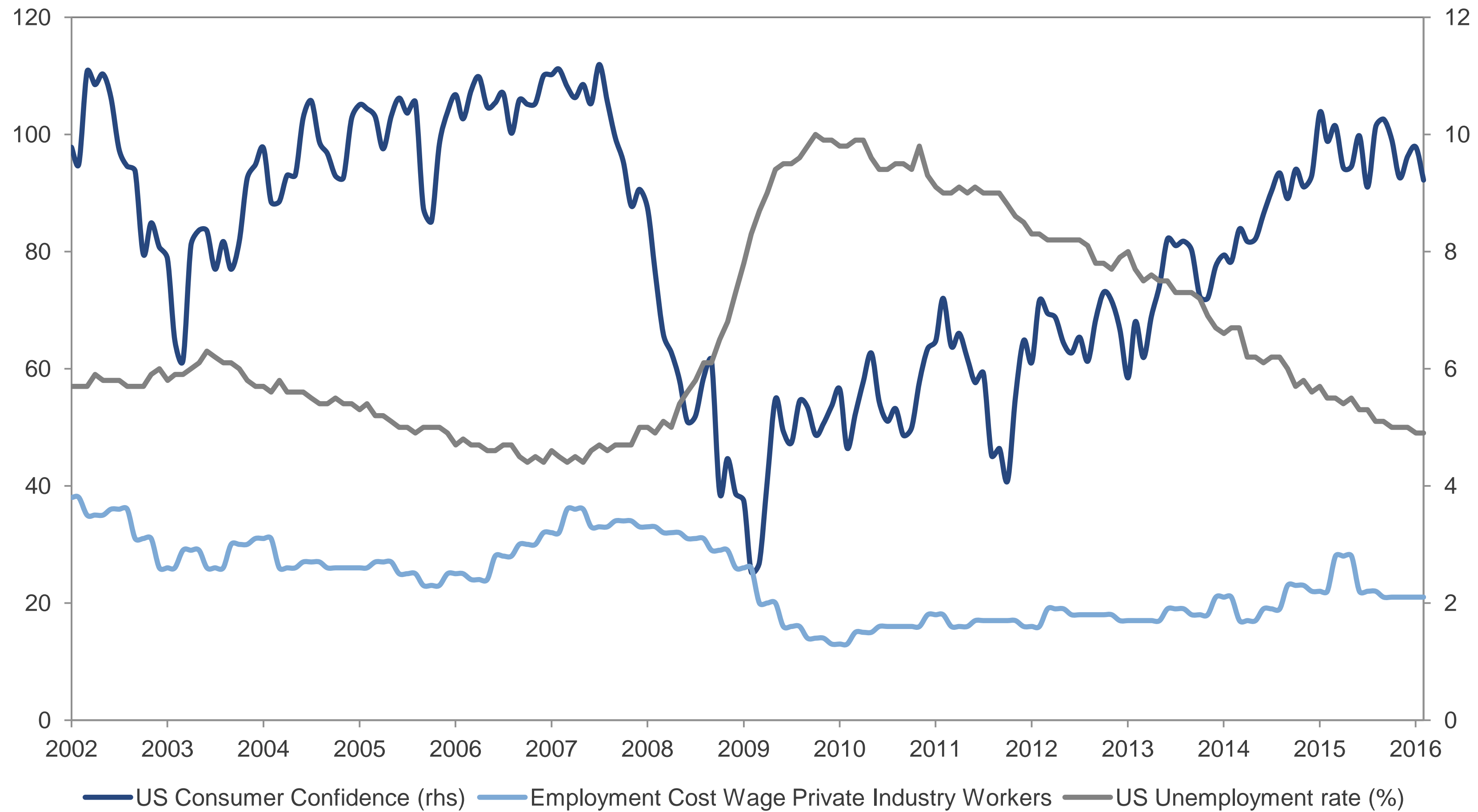

- Despite **unemployment** and **job creation** figures continue with their positive trend, **wage growth** still remains subdued
- More worryingly, the uptrend in **consumer confidence** has halted since the beginning of 2015 and **labor productivity** continues disappointing

Source: Bloomberg

"Old" and "New" China continue disappointing

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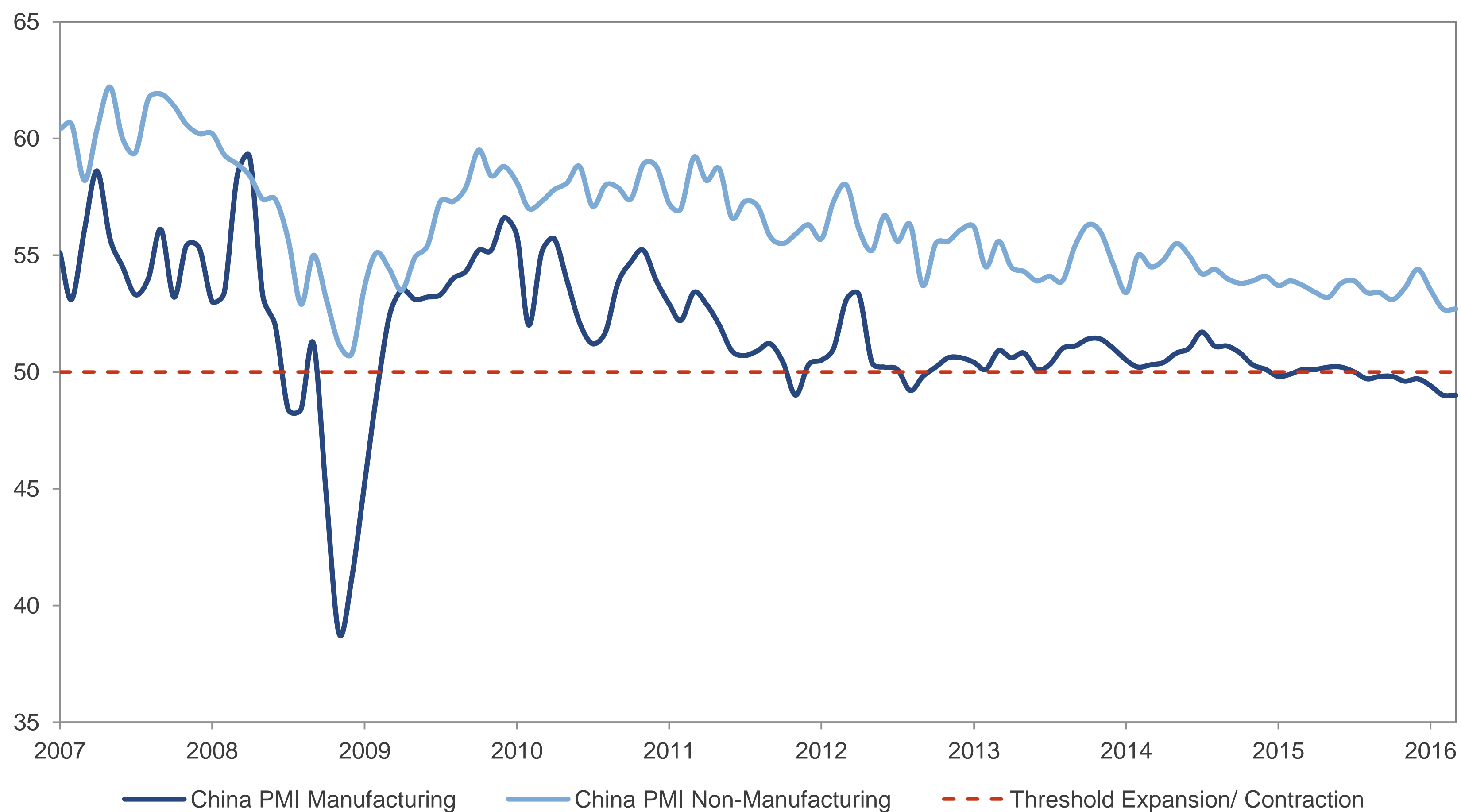

- Current **activity levels are as low as in late 2008**, and exhibit a clear **decelerating trend**
- The rise in non-manufacturing activity in late 2015 has faltered, **reducing hopes of a swift economic rebalancing** of the Chinese economic model from manufacturing/ exports into service/consumption

Source: Bloomberg

Low nominal growth adds to the problem

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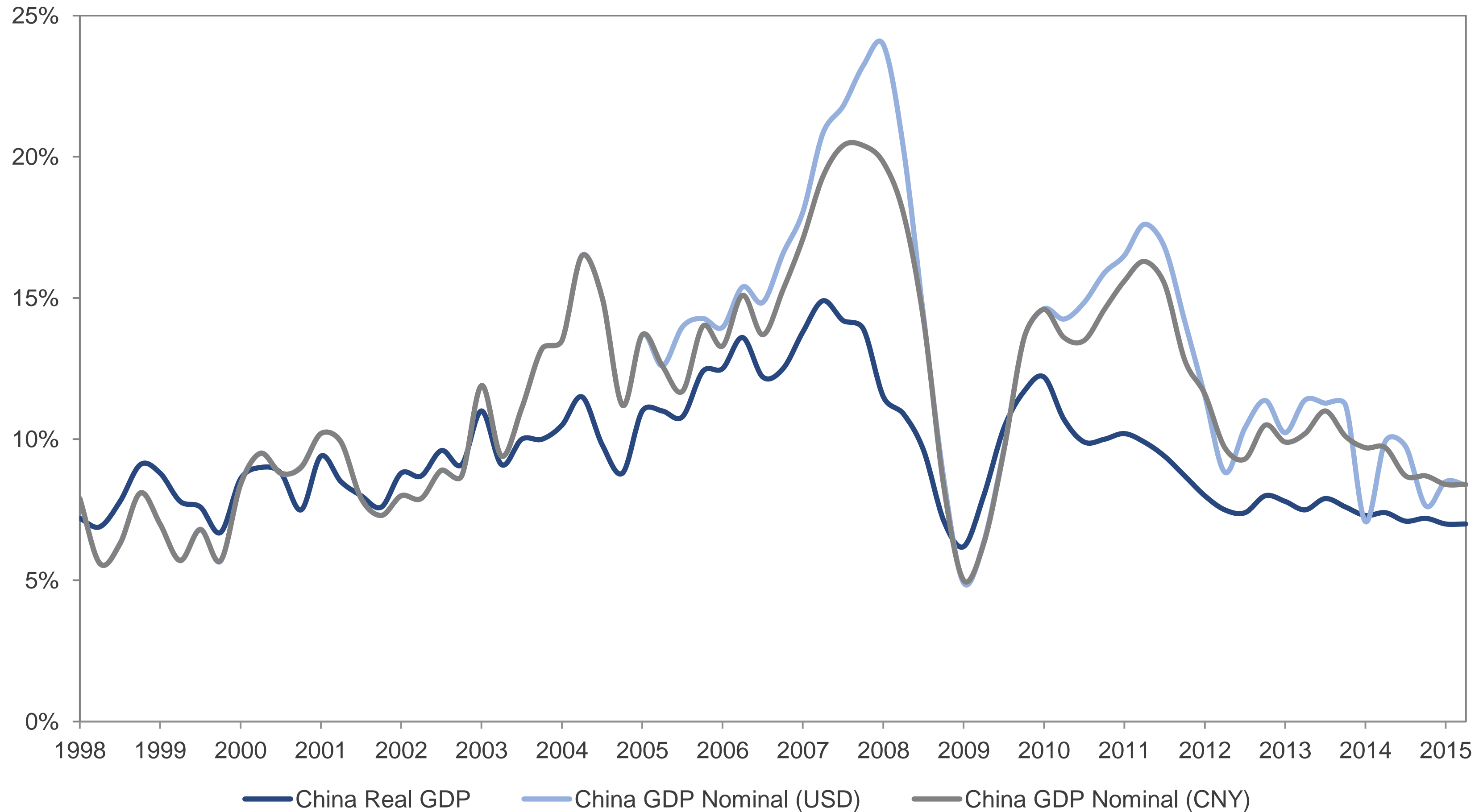
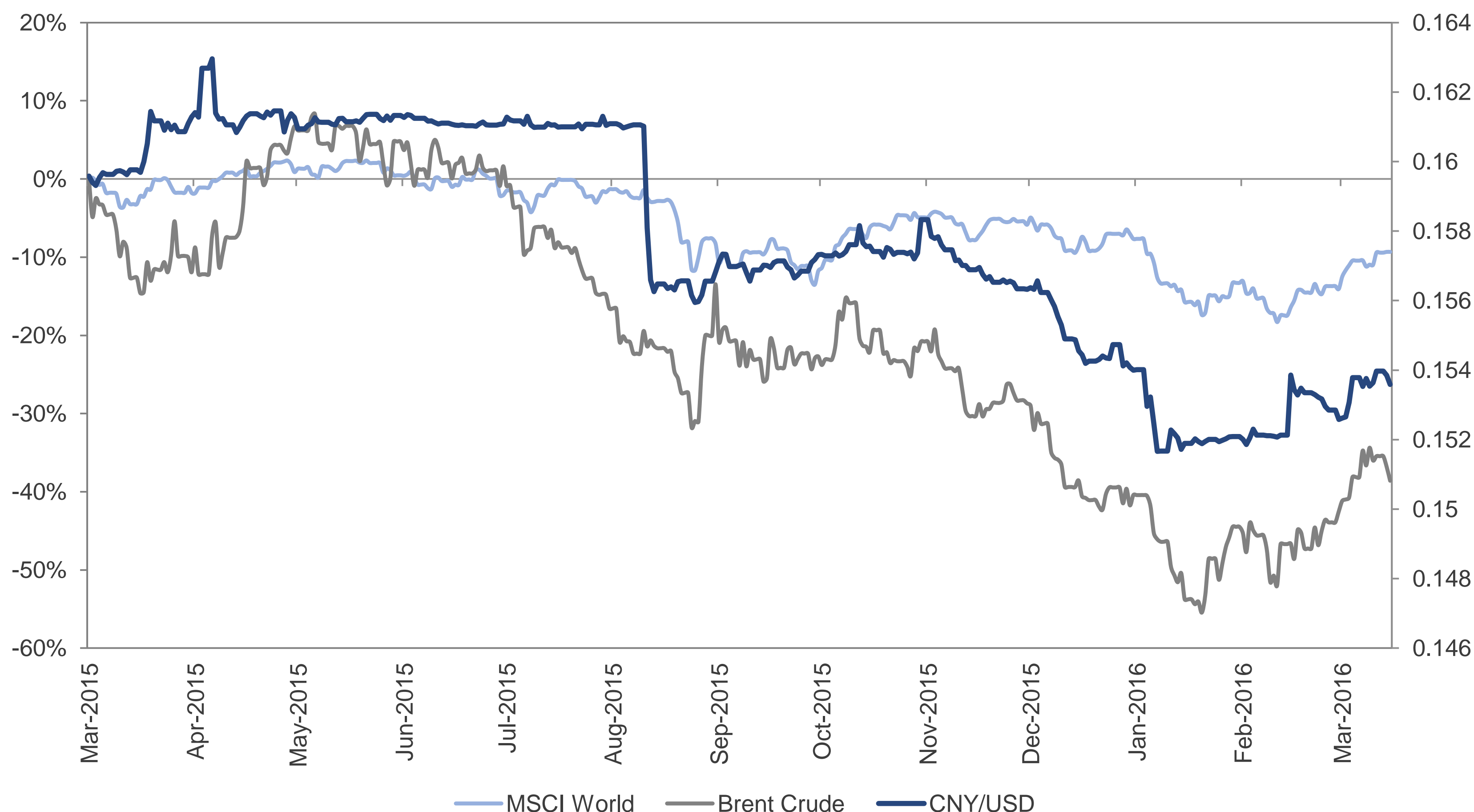


- The picture is more worrisome when looking at **nominal growth**, as **debt servicing** becomes **increasingly difficult**
- At **global level**, it exacerbates **recessionary** and **deflationary** concerns, particularly if the **CNY continues depreciating** against the USD
- This has already been reflected in the decrease in the **US dollar value** of **global trade**, which last year **fell -13.8%**, the first contraction since 2009

Source: Bloomberg and CPB World Trade Monitor

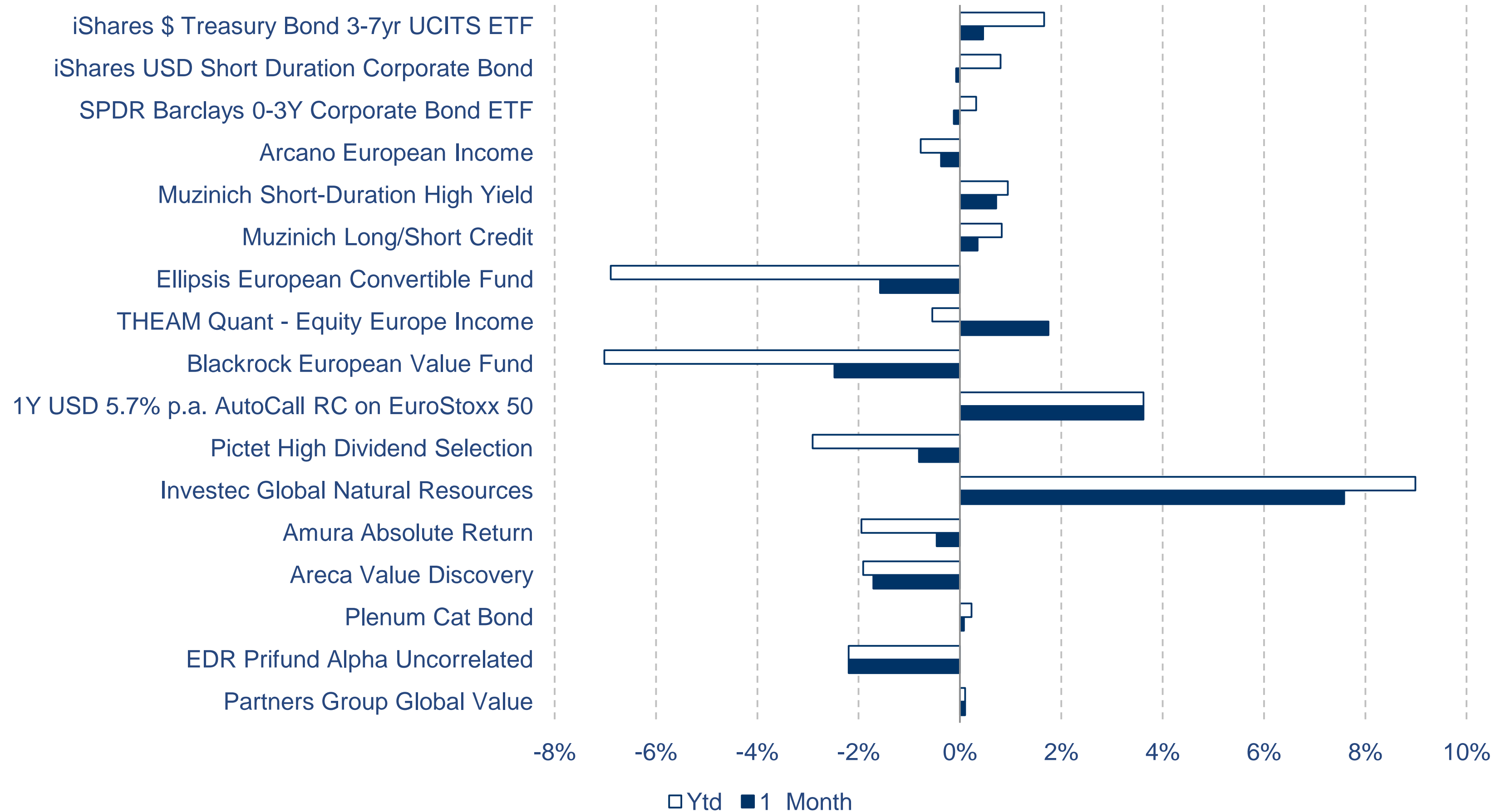
China remains the largest market concern



- The **change of currency regime in the Chinese Yuan** marked the start of the stock **market correction**
- Since then, **commodity** and **equity** prices remain **strongly correlated** with the movements in the **Yuan.** Conversely, with the introduction of the new trading regime, the currency is now more affected by market sentiment and the performance of the Chinese economy

Source: Bloomberg

Performance only partially tied to inherent risk



- **Credit recovered** during the month, whilst **investment grade** corporate bonds **retraced** and **Treasuries gained**
- **Defensive equity positioning** continued paying off, with the exception of convertibles
- **Alternative investments** had a **mixed** result, with multi-strategy funds showing correlation with equity markets

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	40% ↓(-10%)	35% ↑(+5%)	25% ↑(+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 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

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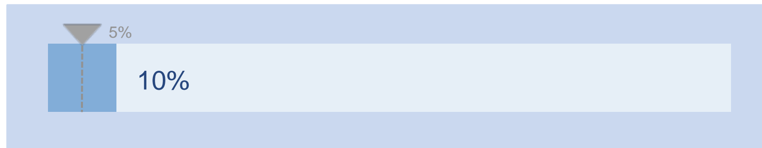
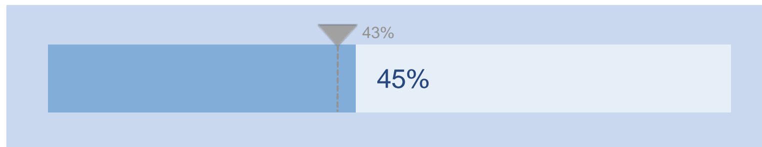
Cash



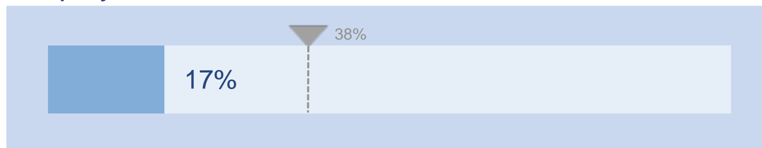
- In the current interest rate environment the opportunity cost of holding cash has significantly decreased, hence, waiting for good investment opportunities is a sensible investment strategy
- Nonetheless, we have reduced the allocation to enhanced cash strategies as we have taken a more conservative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

Fixed Income



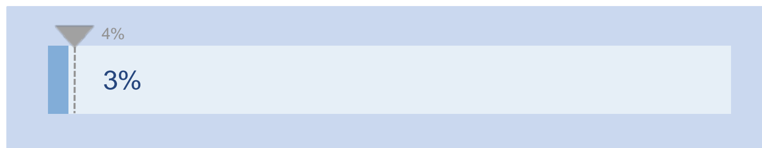
- High-quality fixed income in USD currently offers a better combination of risk and return since credit spreads have widened, and Treasuries offer protection against a market sell-off
- On the other hand, high-yield and emerging markets start to look less attractive in the light of the bleak global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

Equity



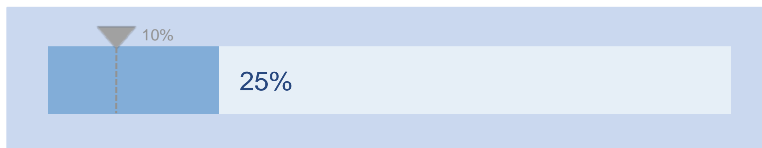
- Despite the correction experienced over the past months, equity valuations remain greatly supported by low interest rates. A potential normalization of interest rates poses a risk of returning to lower valuation multiples
- In relative terms, Europe looks still more attractive than US and Asia

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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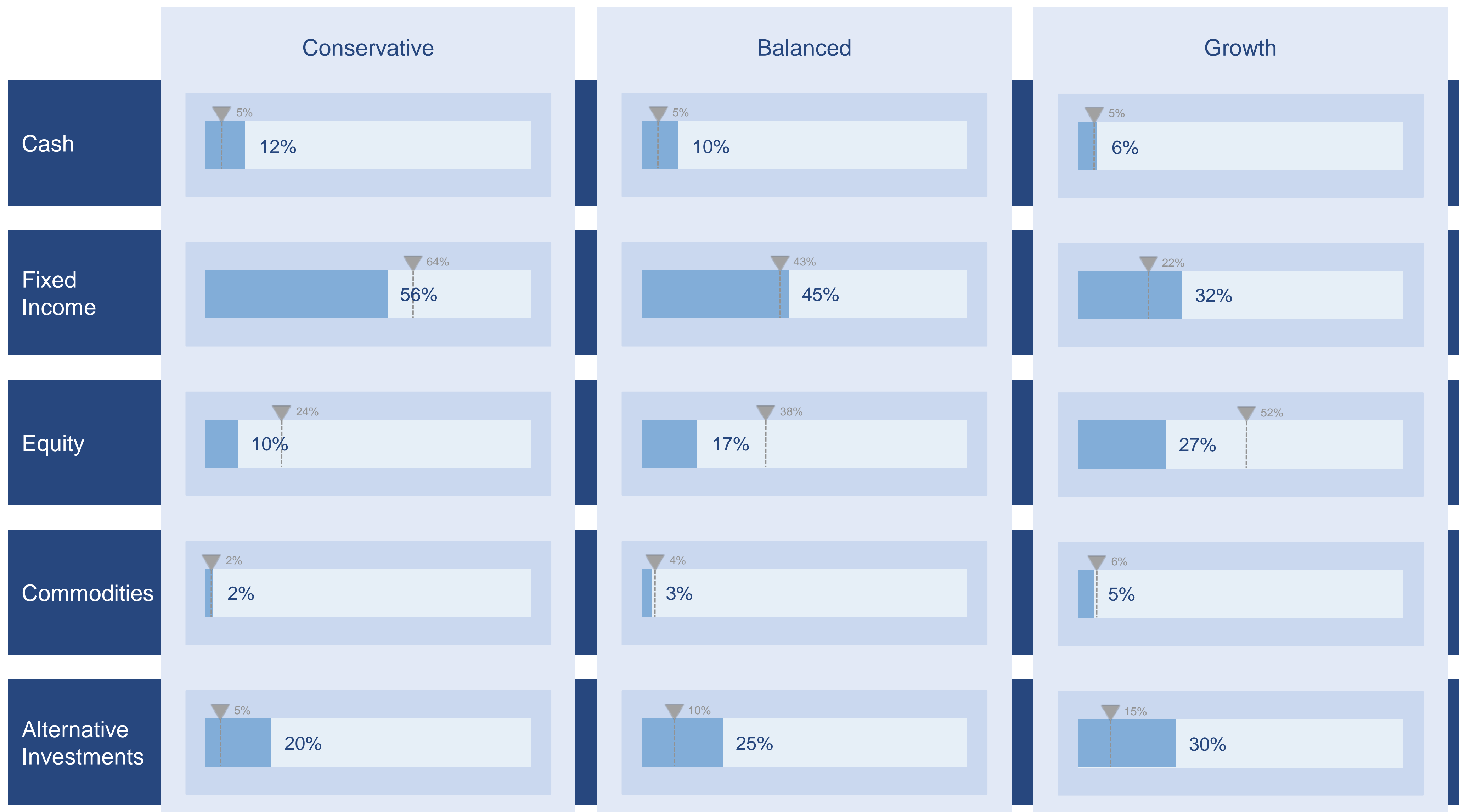

Strategic Asset Allocation

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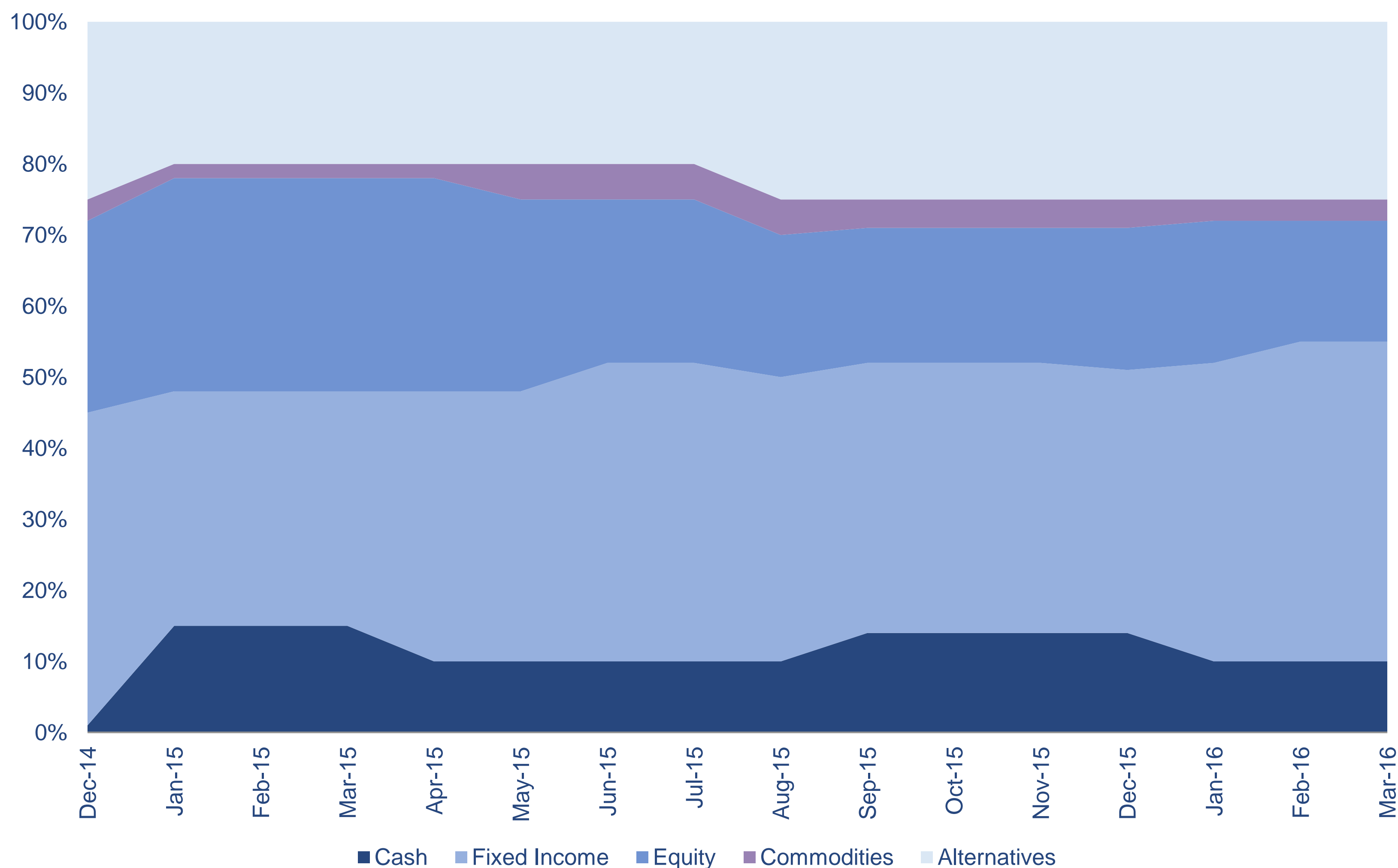
MWM Model Portfolio – Asset Allocation Evolution



MWM Model Portfolio – Fixed Income Evolution

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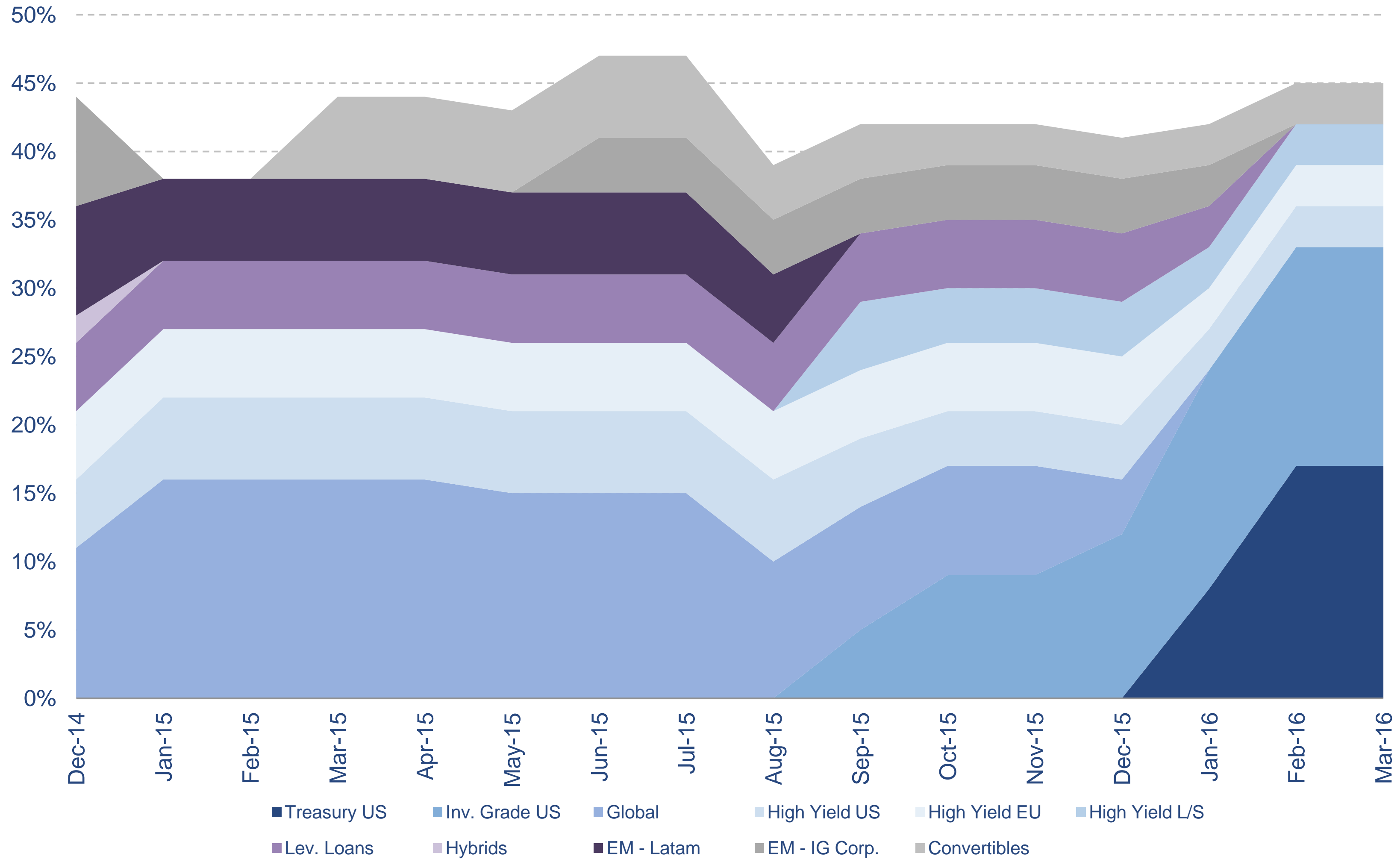
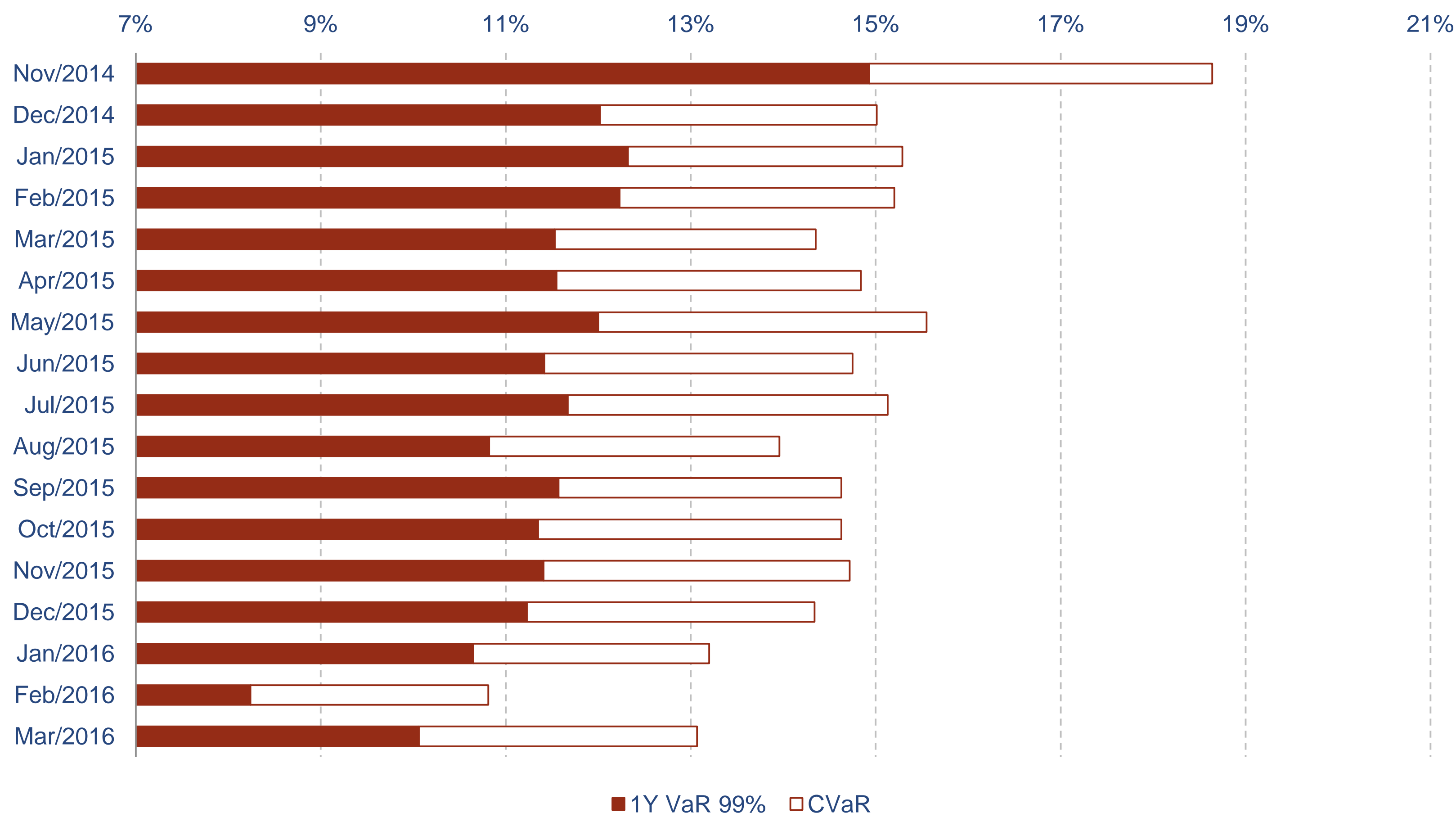


MWM Model Portfolio – VaR Evolution



- 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)

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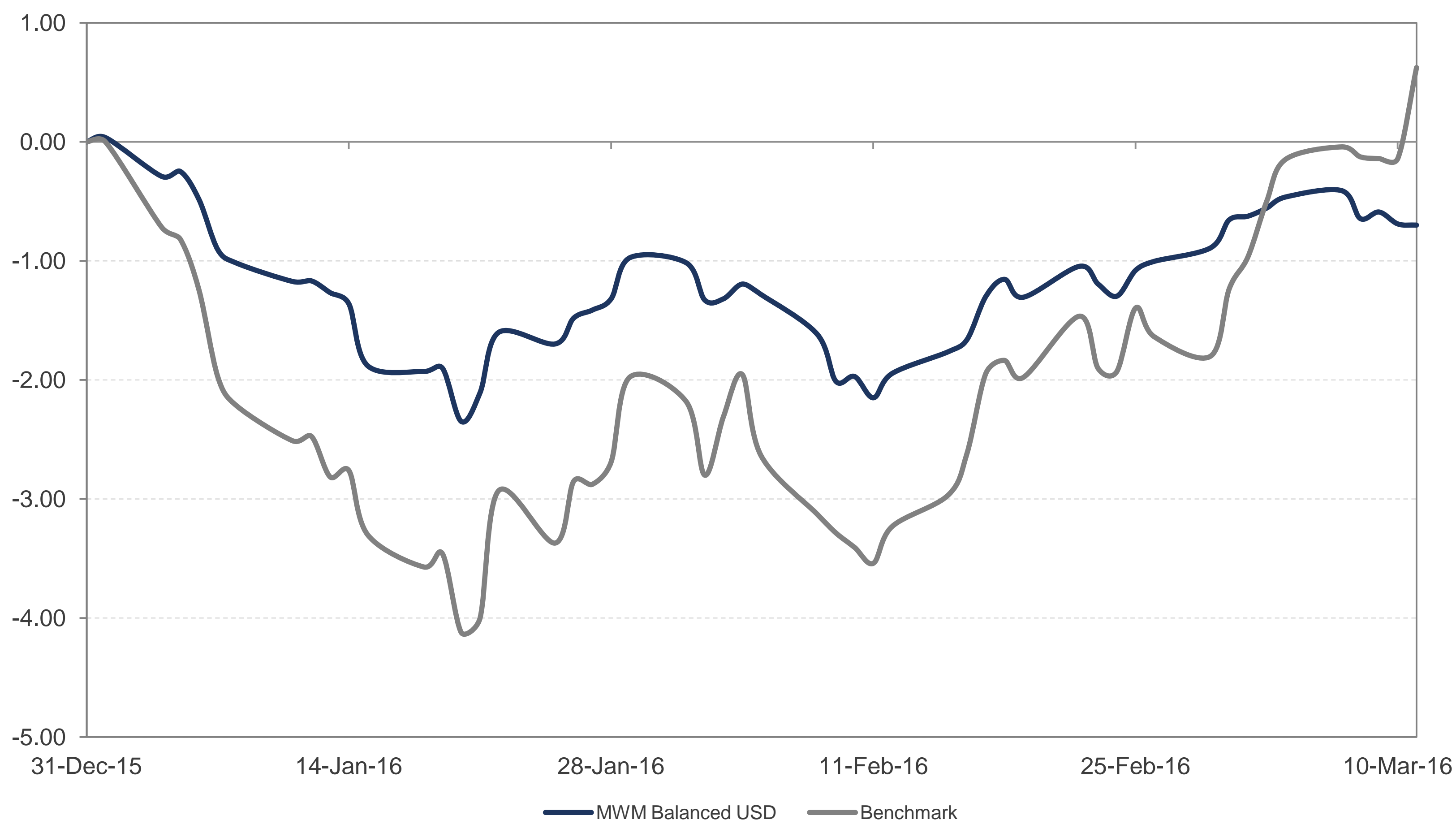

- **Total Return** (Ytd[1]): **-0.70%** vs. **+0.62%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.55%** vs. **7.00%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.62%** vs. **4.78%** Benchmark[2]
- **Var 95%** (Ytd[1]): **-0.41%** vs. **-0.69%** Benchmark[2]

[1] As of March 14, 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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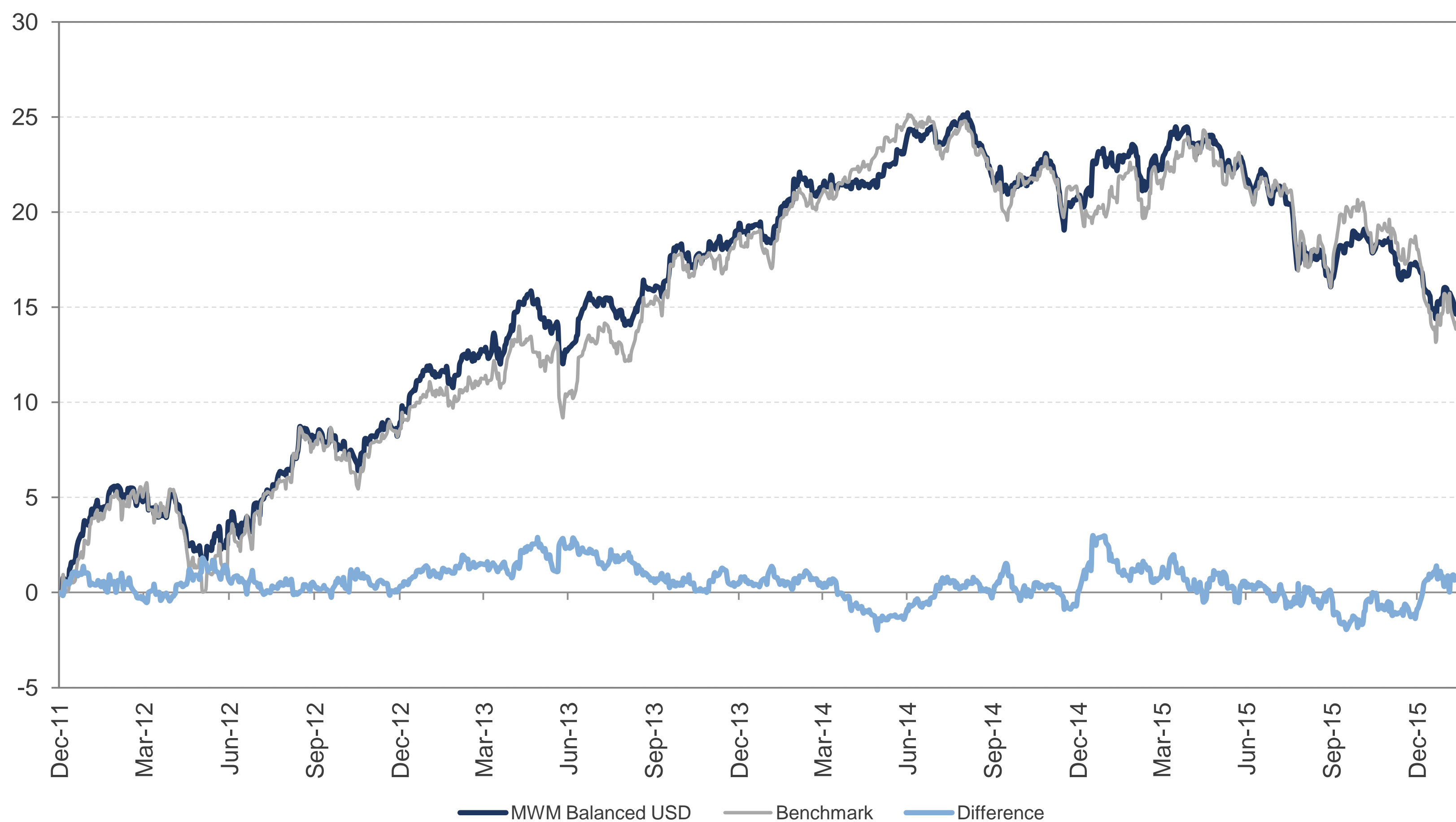

- **Total Return** (1 year[1]): **-4.10%** vs. **-0.76%** Benchmark[2]
- **Total Return** (3 year[1]): **3.38%** vs. **7.27%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **16.11%** vs. **15.90%** Benchmark[2]

[1] As of February 29, 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)

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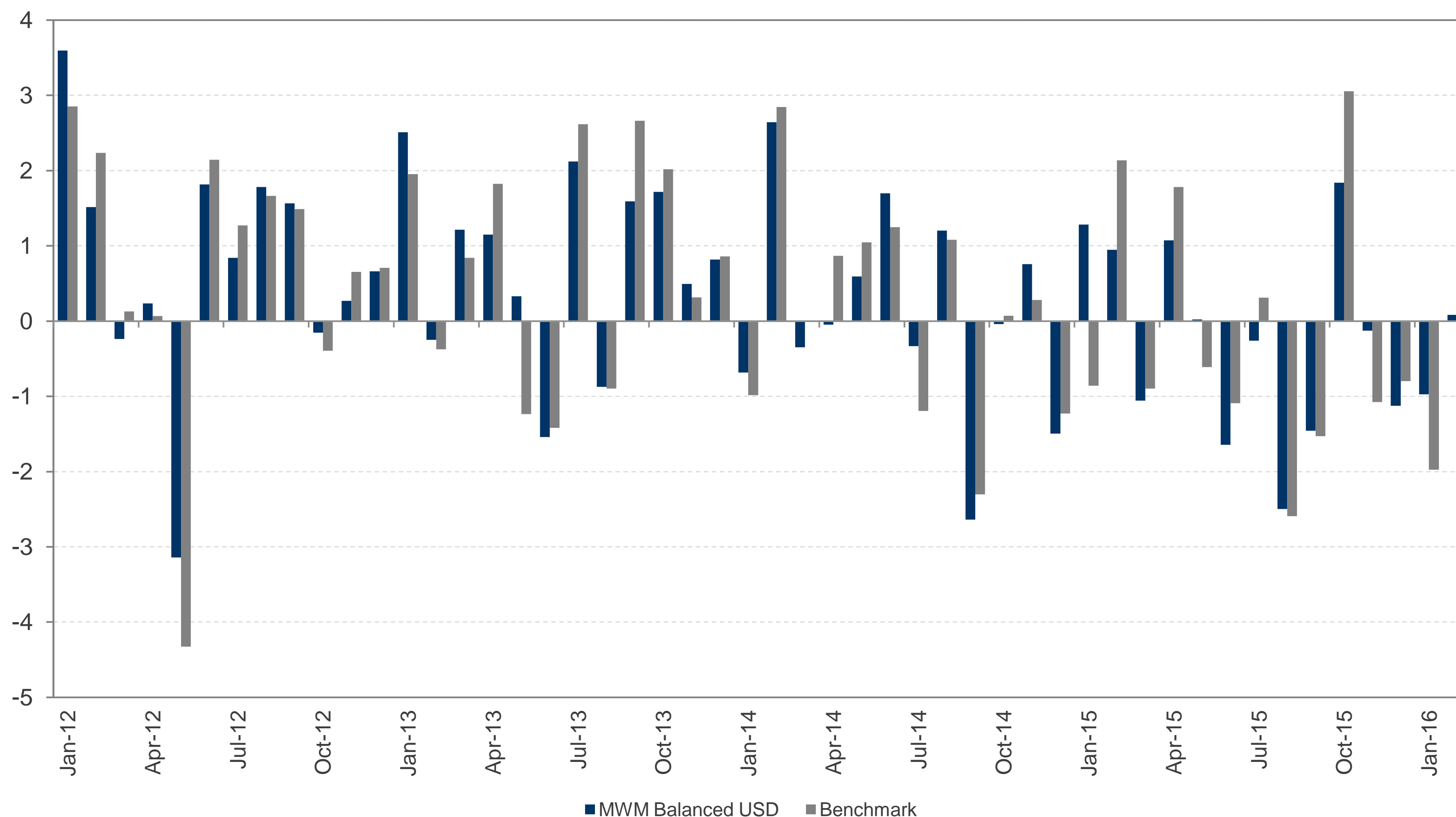

- **Standard Deviation** (1 year[1]): **3.94%** vs. **5.80%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.95%** vs. **4.07%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-1.04%** vs. **-0.12%** Benchmark[2]
- **Var 95%** (1 day[1]): **-0.42%** vs. **-0.57%** Benchmark[2]

[1] As of February 29, 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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