Investment Policy

November 2018

Our market view in a nutshell – November 2018

- The **sharp reversal in equity markets** over the month of October has left investors wondering about the **possible causes**. As it happened in January, the speed of the correction points to **technical factors** (algorithmic trading, high frequency trading, risk parity strategies, etc.). However, we believe that the main driver has been the **increase in long-term interest rates** in the US (as a result of increasing wage pressures), which has resulted into lower P/E multiples

- Despite the **disappointing growth figures in Europe and China**, **US growth remains robust**; underpinned by strong consumer and business sentiment. Moreover, **bond markets show no sign of a downturn in economic activity**, as corporate spreads remain tight and long-term treasury yields did not retreat, despite the equity market correction. Other leading indicators like PMIs or financial conditions, do not point to a recession in the next 12 months either

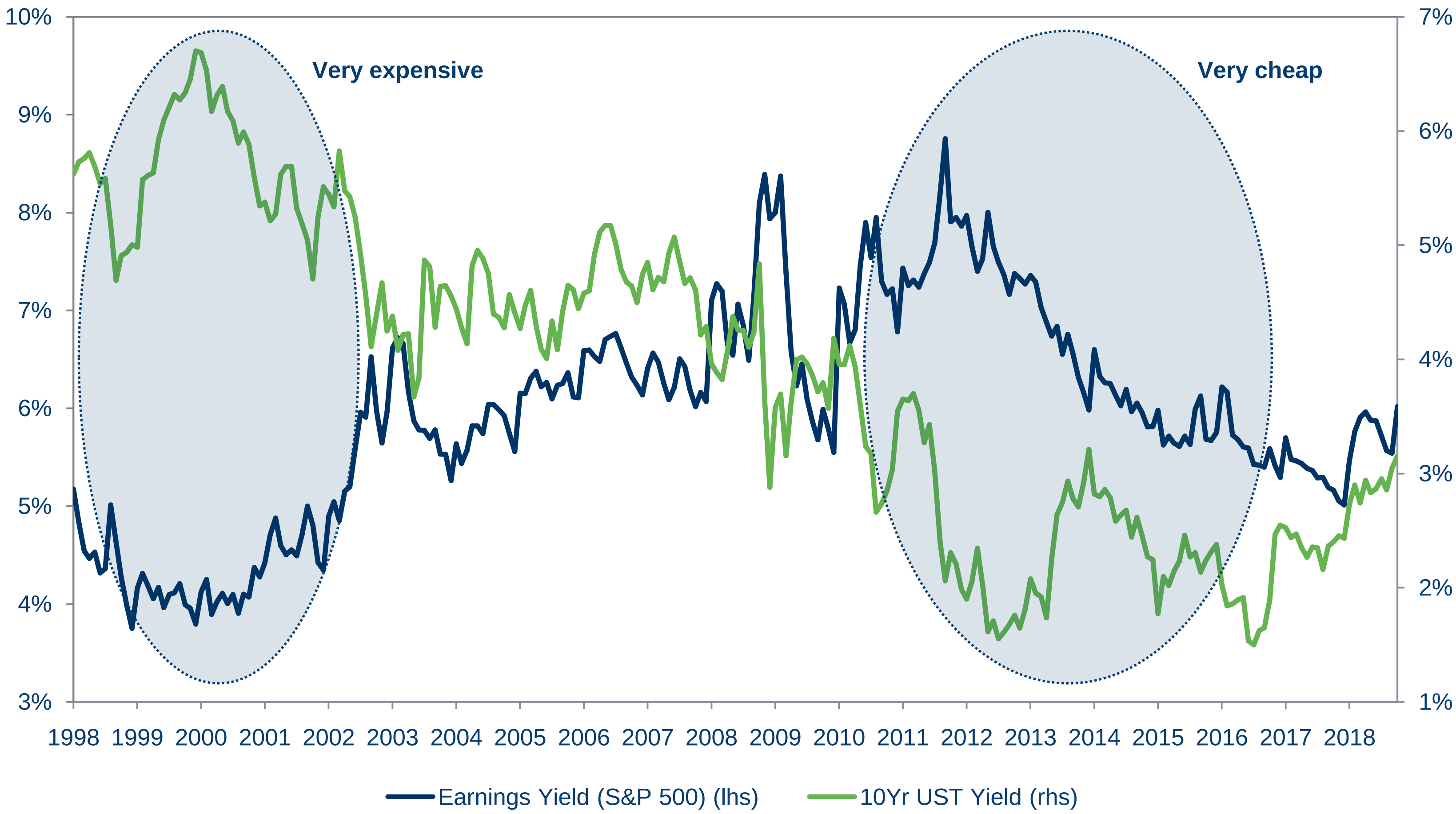
- In summary, we think we have seen a **valuation-driven correction, instead of a macro-driven correction** (like was the case in 2015). Therefore, **we have not reduced our allocation to risk assets**, taking into consideration our **already defensive stance**. Although we continue to believe that we are at the late stages of the cycle, and a prudent approach to risk is warranted, this **correction offers a good opportunity to "buy the dips"** for those clients who are underinvested in equities. In this respect, the fall in some **quality US stocks** has exceeded that of European peers, and offer a chance to increase its allocation in portfolios

MWM Investment Policy

Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasuries offer protection from a slowdown in growth – although this less likely with the fiscal stimulus in the US – whilst TIPS offer protection against rising inflation as a consequence of reflationary policies
	US Credit	+	Corporate debt and High Yield currently offer the best combination of risk and return. We prefer medium maturities as the yield curve has flattened considerably and there is little term premium to compensate for taking interest rate risk
	European Sovereign	–	High quality debt in Euros presents a very unattractive combination of risk and return as current yields offer very little cushion to weather potential interest rates increases
	European Credit	=	In European credit we only see value in subordinated debt, asset-backed securities and short-duration high yield
	Emerging Markets	–	We avoid Emerging Markets until there is more clarity on the new US administration trade policy, and the effects of a stronger dollar and higher financing costs for Emerging Markets are calibrated by the market
Equities	US	=	Equity valuations in the US remain very high, mostly supported by low long-term interest rates, but also due to a reacceleration in profit growth consequence of the tax reform and the deregulation agenda. We retain an exposure to the US market via quality growth companies
	Europe	=	From a relative valuation perspective, we like European stocks as they trade at lower multiples, and we expect profits to pick up as economic activity accelerates
	Japan	+	Japanese stocks are the cheapest in developed markets, but have suffered recently due to sluggish growth, and concerns about global trade
	Emerging Markets	+	Emerging markets have corrected sharply since the beginning of the year affected by a strong dollar and trade concerns. We deem the correction suffered has been excessive, and continue favoring India and Frontier Markets within EM
	Sectors & Themes	+	Amongst others, we favor Biotechnology and listed Real Estate
Alternative Investments	Multi-Strategy Hedge Funds	+	Multi-manager/ multi-strategy hedge funds that offer daily liquidity offer a much needed source of diversification
	Commodities	=	A diversified commodities allocations, further help us to increase diversification and to protect the portfolios against a scenario of rising inflation
	Private Equity	=	Investing in late-stage private equity provides access to the asset class with liquidity provision up to a certain degree

+ Overweight – Underweight = Neutral

Rising rates are the main reason behind the correction



- The **fall in equity markets has been proportional to the increase in long-term interest rates**, since earnings have not been significantly revised. As a result, the **risk premium has hardly been affected**
- Unlike other occasions, there has not been **a "self-correcting" mechanism**, and US Treasury yields have remained elevated despite the correction in stocks markets

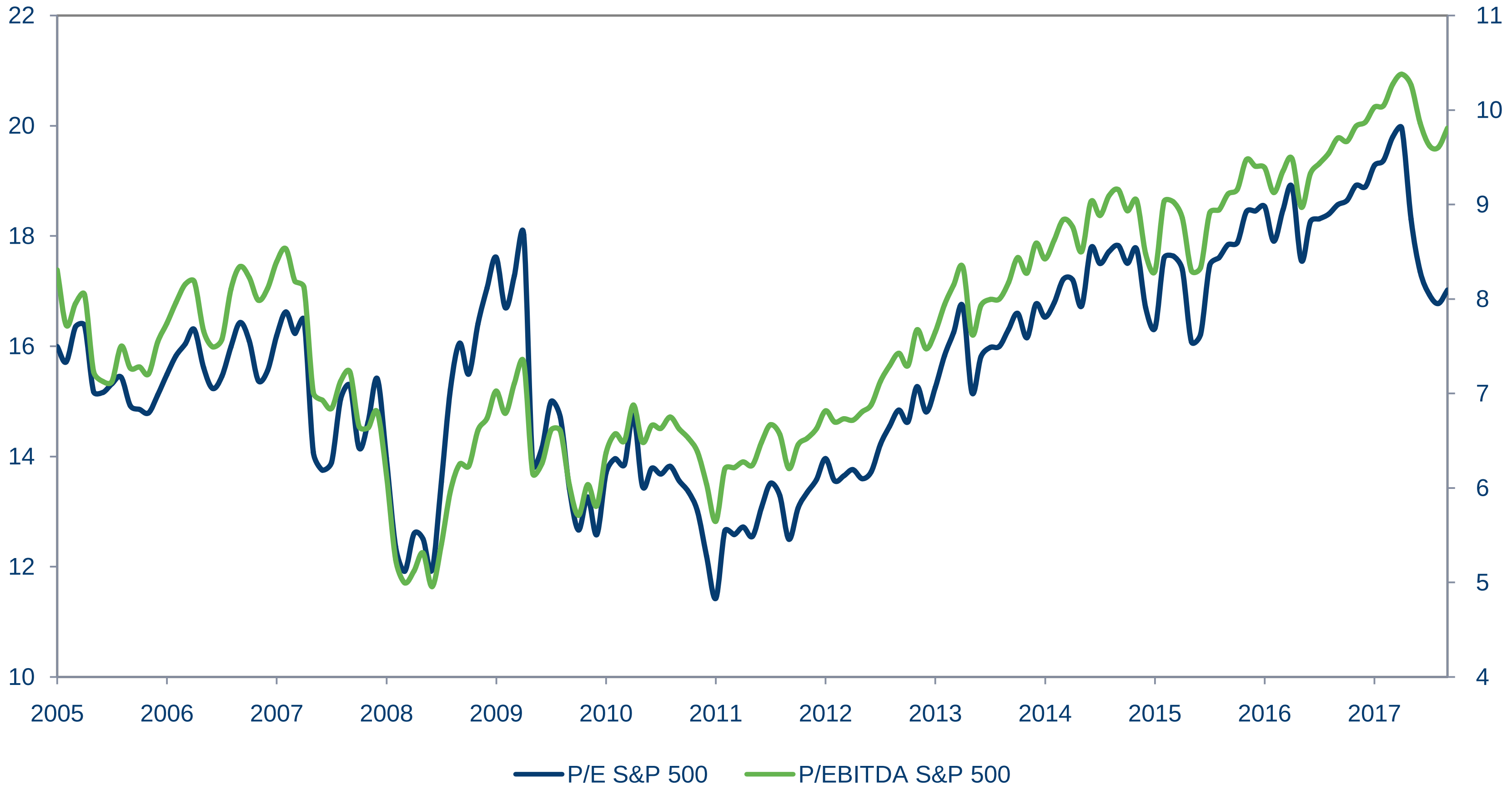
Source: Bloomberg

Equities look no longer expensive

- Both the current **risk premium** and the **multiple P/E** are fairly valued compared to their historical levels, which makes US stocks less vulnerable to earnings expectations.
- In relative terms, US stocks have a **similar valuation to the period 2003-2006**, which in retrospect and excluding the financial sector, was a period in which the stock market was cheap.

Source: Bloomberg

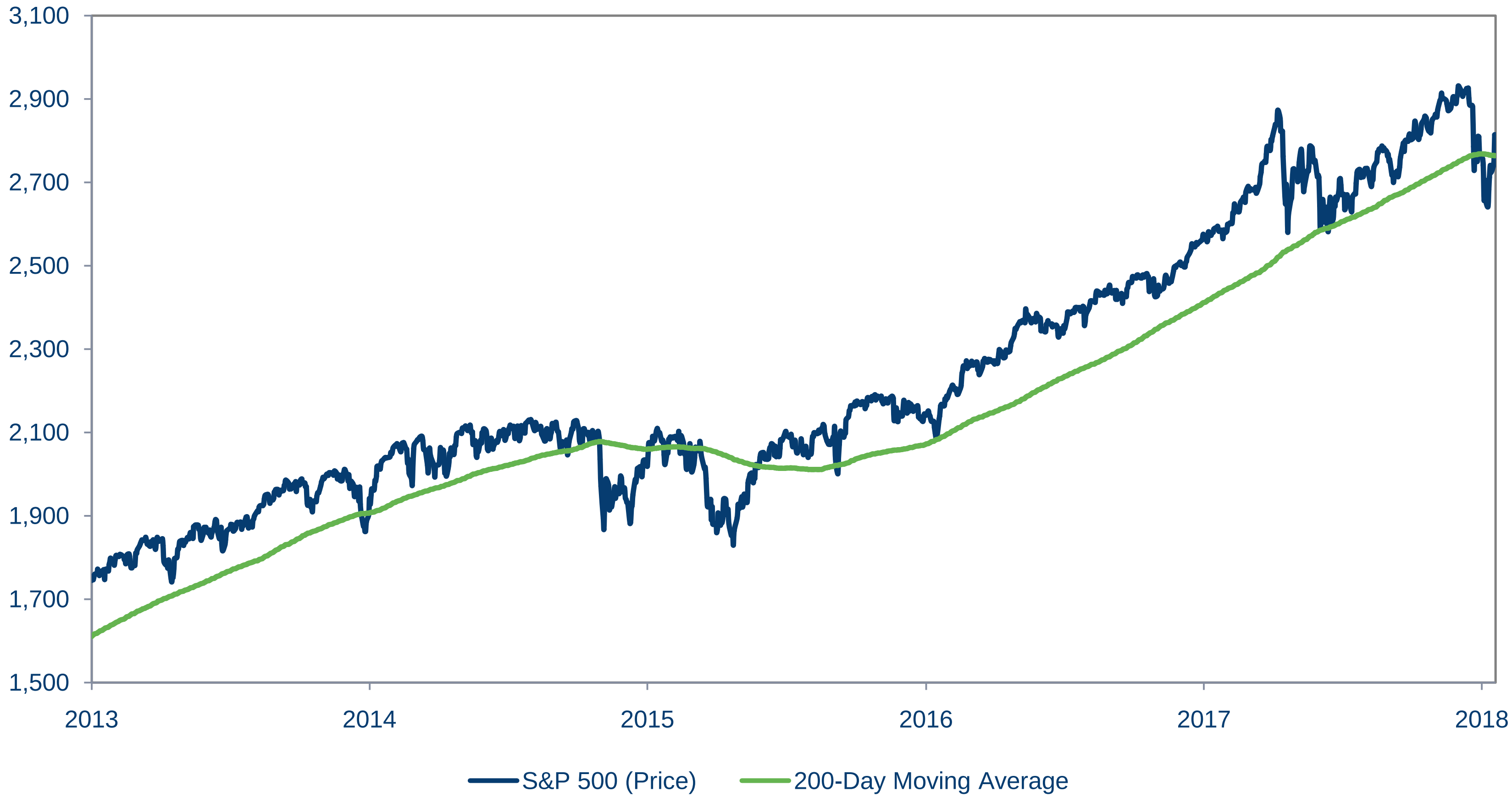
Low interest rates distort valuations



- However, it is important to take into account the **"base effect"**, since the **P/E ratio is not linear**, and the lower than normal level of interest rates means that a change in them has a greater impact on the valuations.
- In addition, **earnings are negatively affected by higher interest rates**. By adjusting to this impact, stocks still seem relatively expensive

Source: Bloomberg

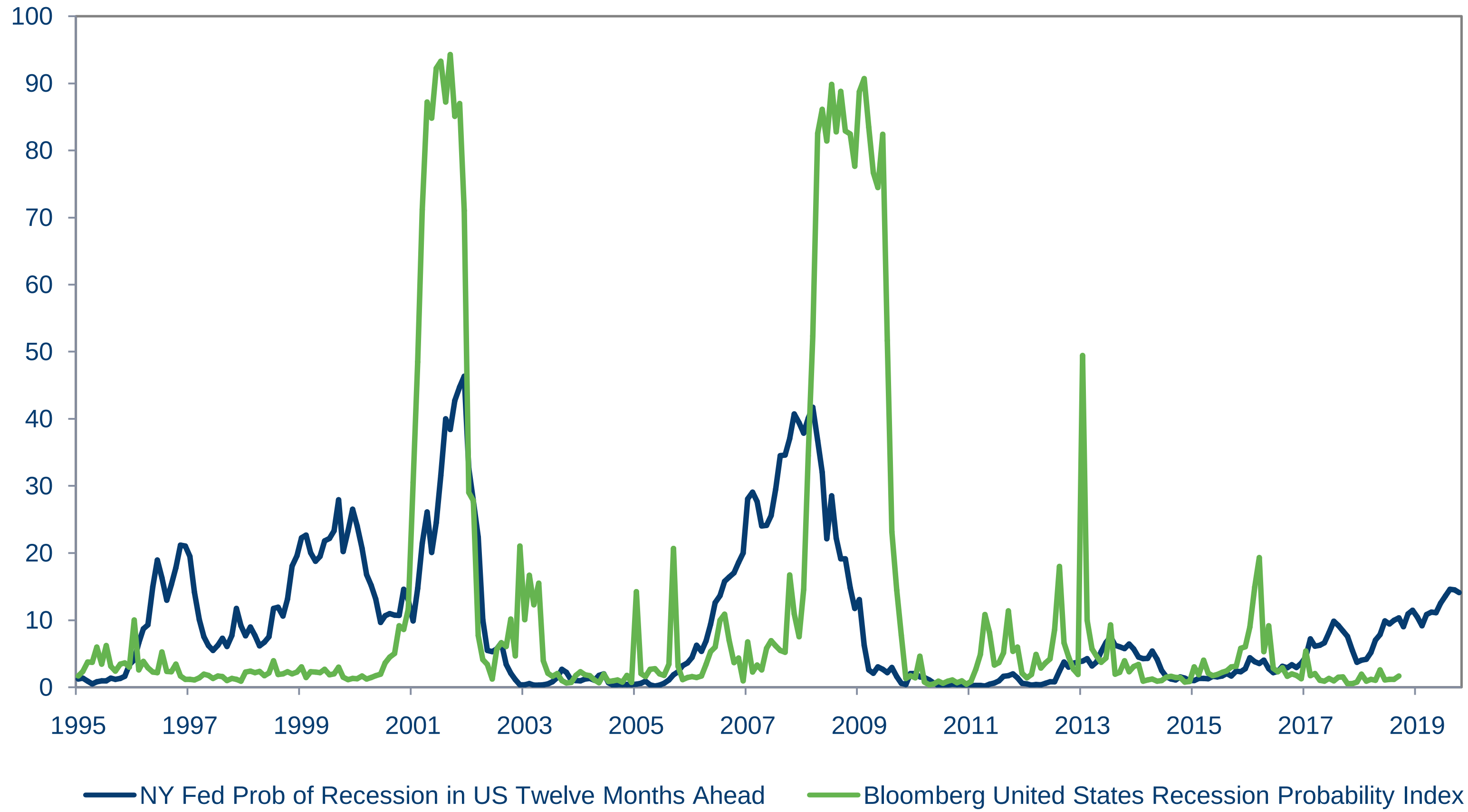
In correction territory from a technical point of view



- After the sell-off in October, the main indices in the United States entered into **correction territory**. However, they have managed to recover since then
- The main difference this time, compared to the correction in 2015, is that **central banks are not showing any intention to provide support** to financial markets

Source: Bloomberg

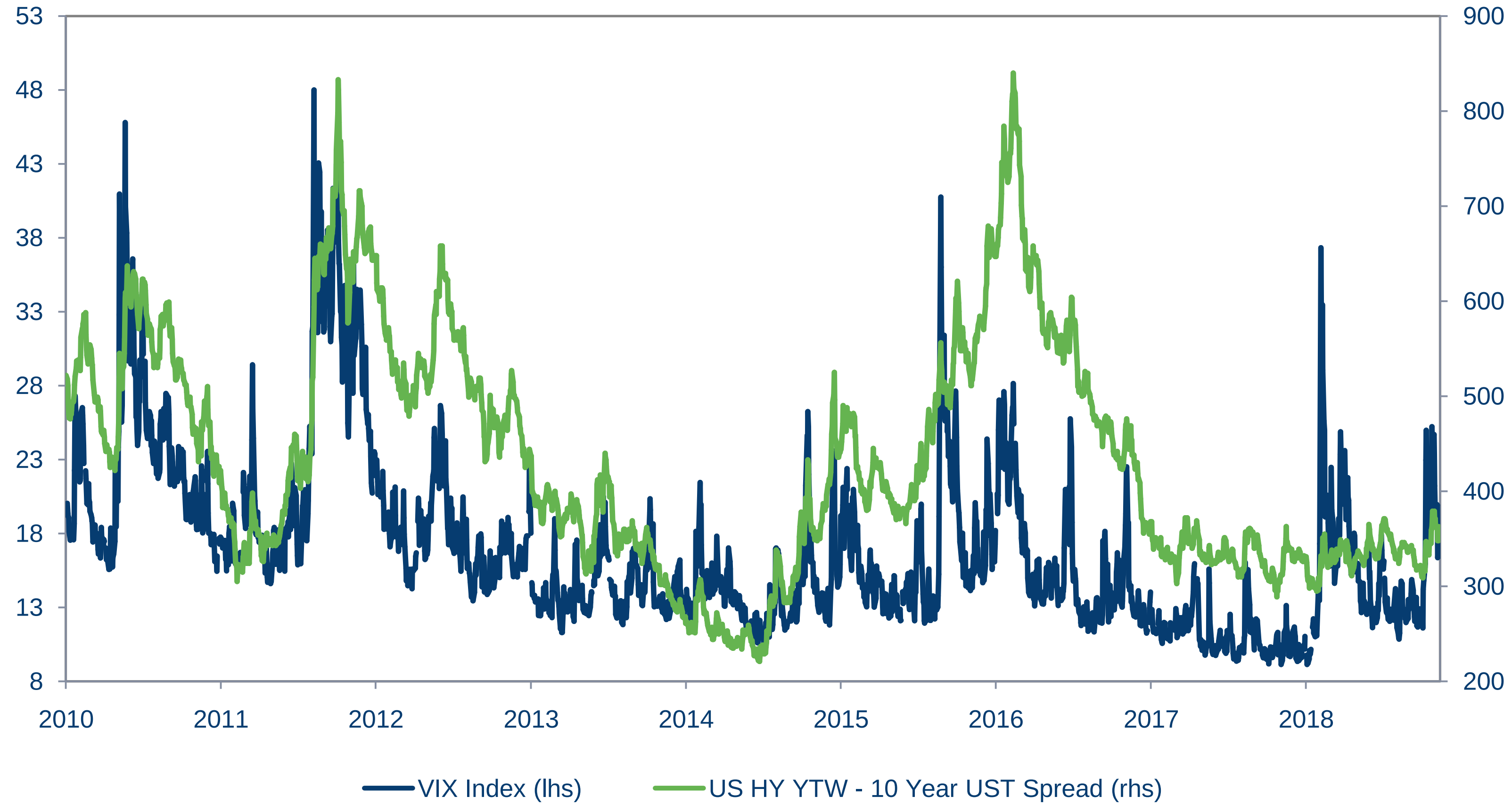
Probability of recession remains low in the US



- The behavior of central banks is a reflection of the **low probability of a recession**, which is manifested by the strength of a large number of macroeconomic indicators (consumer and business confidence, PMI, employment, etc.)
- Only the **shape of the yield curve** is a reason for concern, although we believe that this is the result of the pressure that structural factors exert on long-term rates

Source: Bloomberg

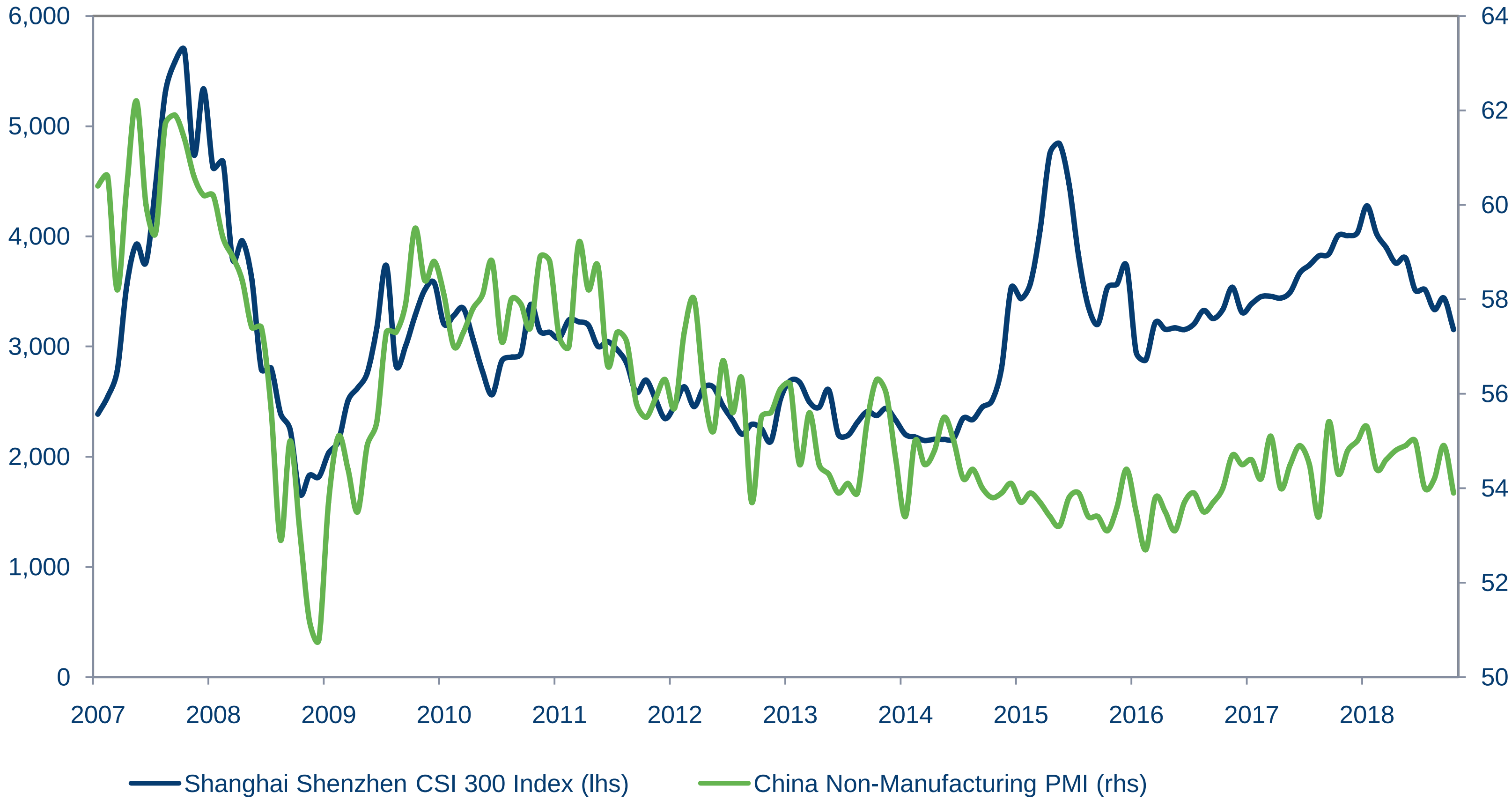
Credit markets do not price a recession either



- **Bond markets**, which are often more successful in anticipating recessions than stock markets, **have barely moved** during the January and October corrections
- This is a very **unusual pattern**, which also **supports the thesis that the correction is due to an increase in interest rates**, as a consequence of the robustness of the US economy

Source: Bloomberg

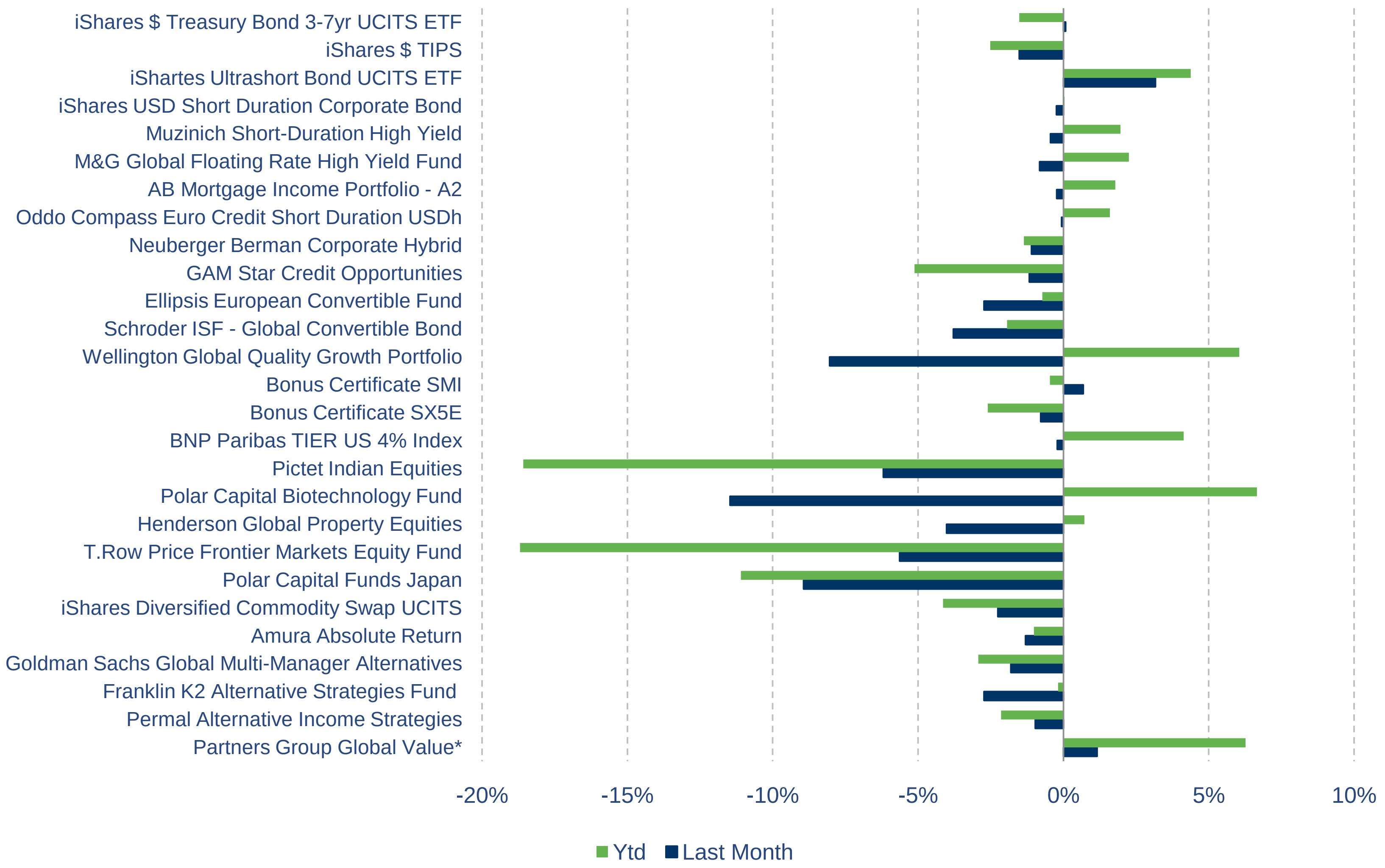
China continues decelerating



- Our main area of **concern at macro level** continues to be the **slowdown in growth in China**, together with the high level of debt in the country
- Growth problems not only affect the **manufacturing sector**, but also the **service economy**, and are the main cause behind the **poor performance of Chinese stocks**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg as of November 2, 2018
* Fund publishes monthly NAV with a 1 month of delay

Investment scenarios

<table>
<tr><th></th><th>Scenario 1
Recession by political/policy accident</th><th>Scenario 2
Goldilocks</th><th>Scenario 3
New regime</th></tr>
<tr><td>Drivers</td><td>• Global economic slowdown caused by political accidents or policy errors (Trade war with China, EU breakup, a too aggressive Fed, etc.)
• Deflationary scenario due to a combination of low growth and structural factors, although the rise of protectionism would be inflationary
• The Fed will have to reverse course, which would be complicated if inflation is rising</td><td>• The fiscal stimulus in the US provides a short-term impulse to the global economy, but not enough to attain a higher growth trajectory
• Inflation, particularly in the US will pick-up, but remains subdued globally due to structural factors (demographics, low aggregated demand, deleveraging)
• The Fed will continue its normalization path</td><td>• Growth concerns dissipate, with economic activity accelerating in US, Europe and Japan
• Inflation in the US increases, as a consequence of president Trump's fiscal stimulus, and pulls other developed economies off deflation
• The Fed will have to step up the pace of rate increases and/or reduce balance sheet</td></tr>
<tr><td>Market impact</td><td>• 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 will fall</td><td>• Equities appreciate moderately, with Europe and Japan catching up with the US
• 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
• Commodity prices will rise in the short-term, normalizing once the impulse vanishes</td><td>• Impact on equities will depend on how much real economic growth is sustained, and how accommodative the Fed remains
• 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</td></tr>
<tr><td>Probability</td><td>40%</td><td>30%</td><td>30%</td></tr>
</table>

Short-term catalyzers

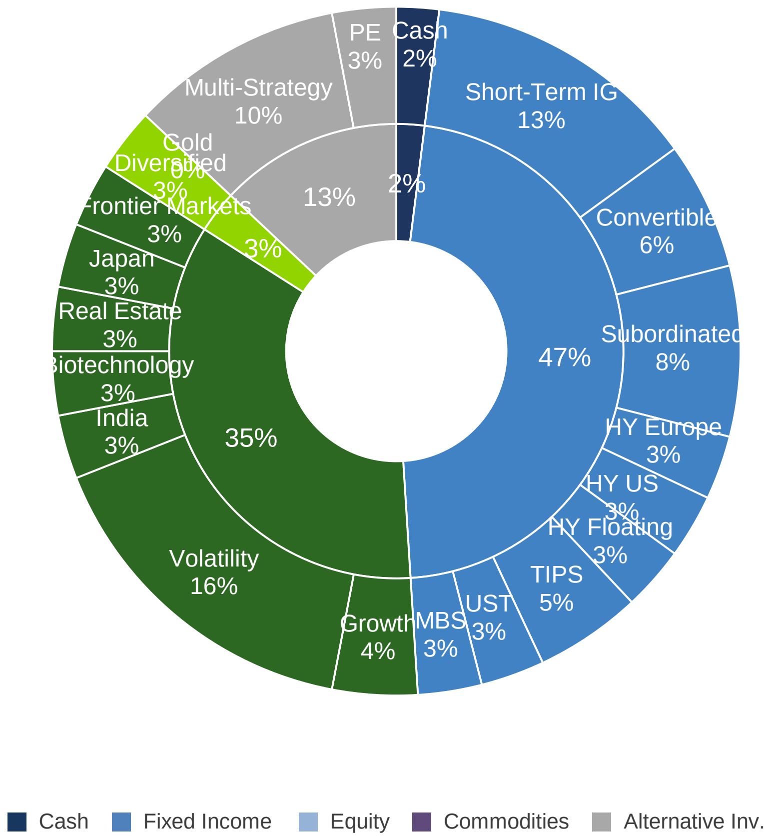
Fiscal stimulus in the US, improvement in macro-data globally, lower geopolitical tensions

Other risks

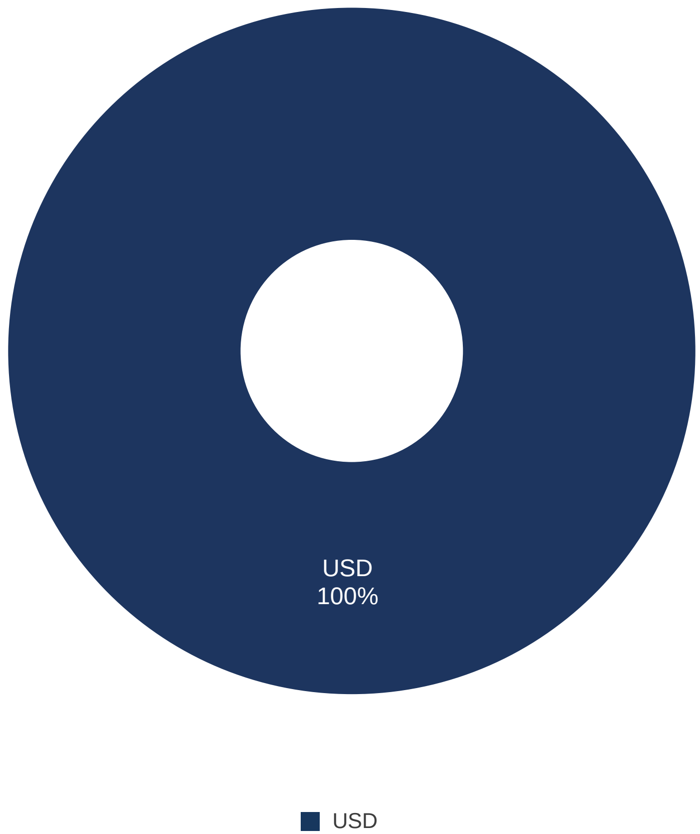
Trade wars, EM crisis, Spread of populist political parties, China slowdown, Terrorism

MWM Model Portfolio Balanced USD

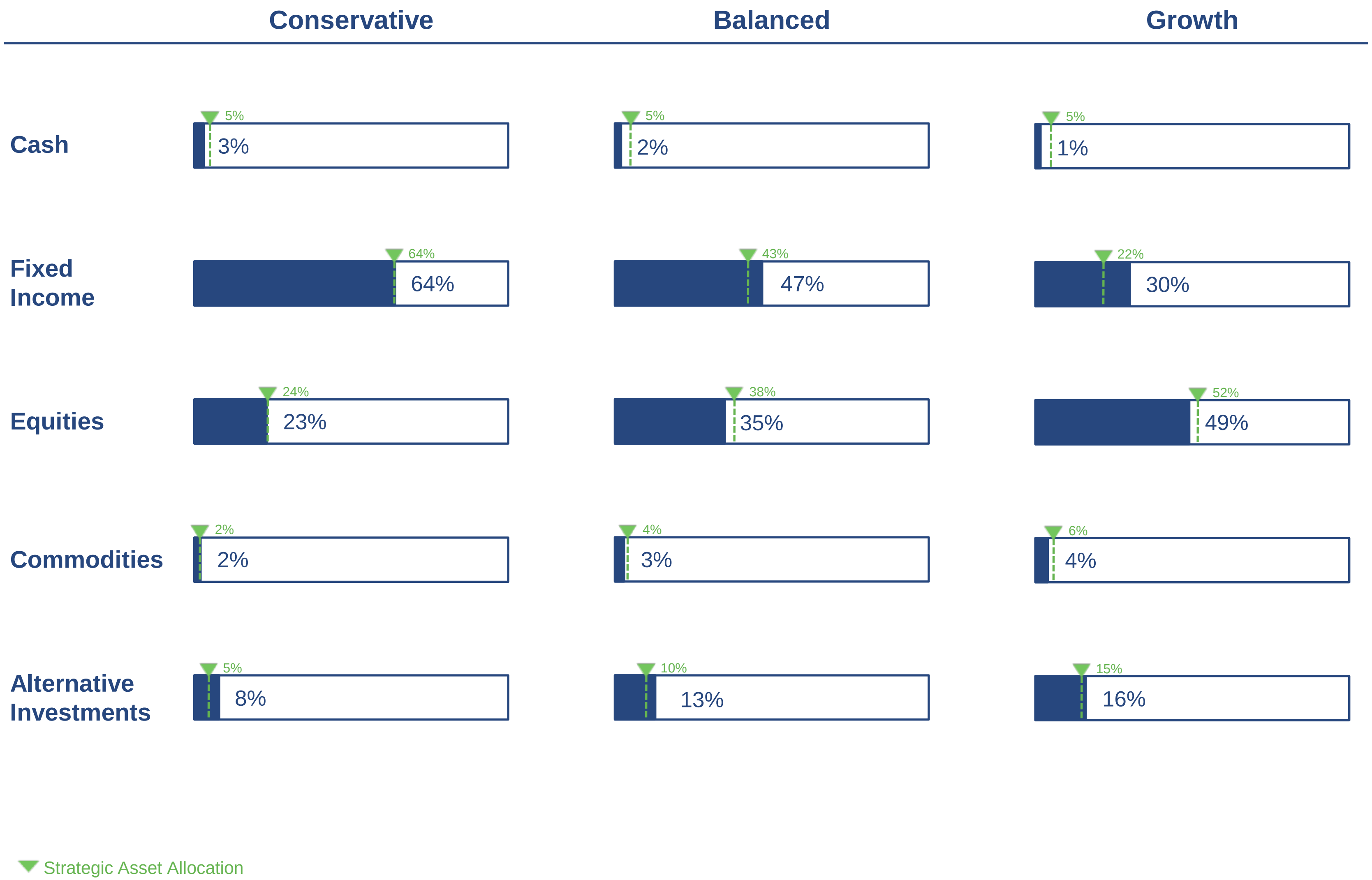
Asset Allocation



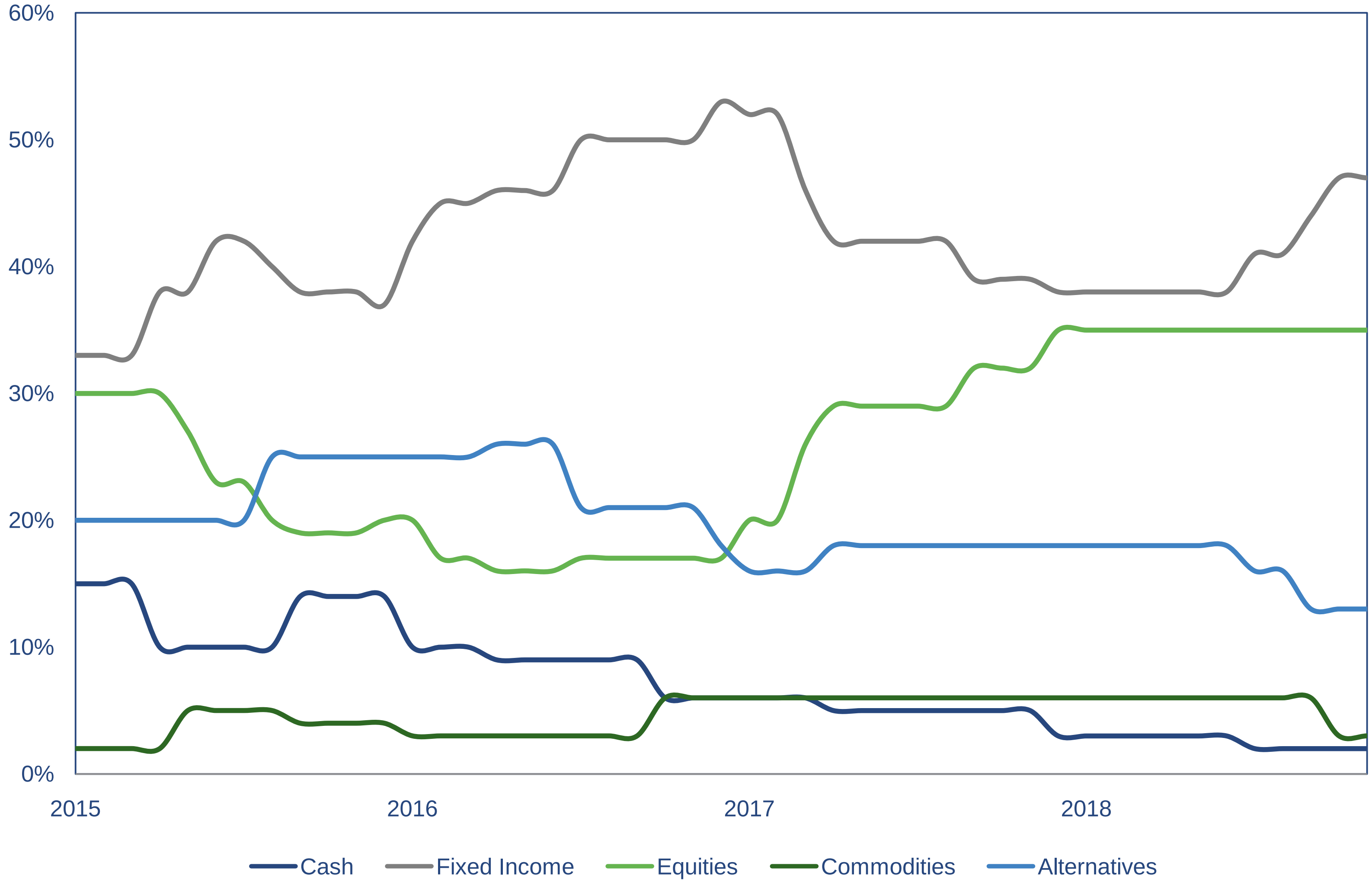
Currency Allocation



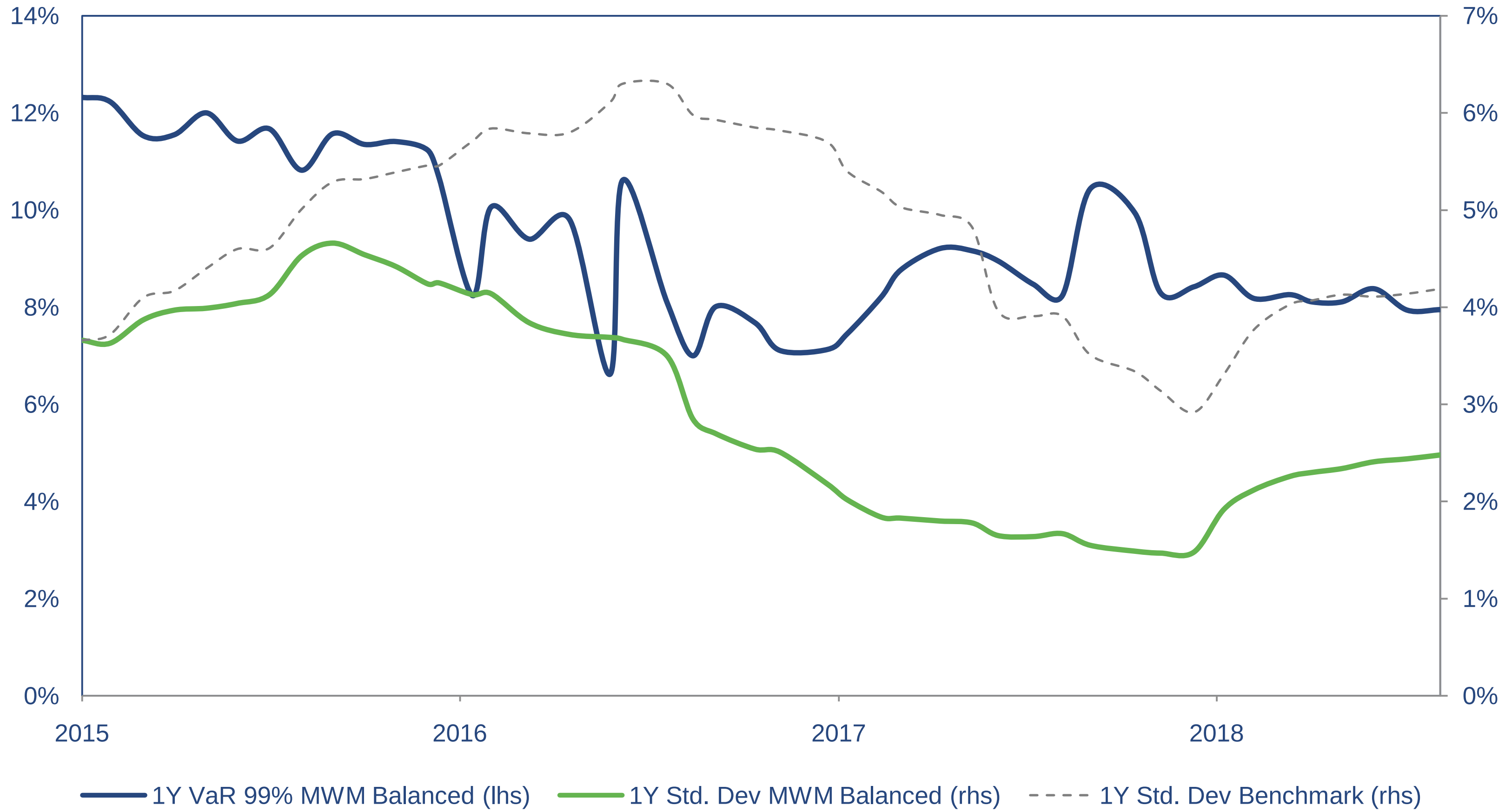
MWM Investment Profiles



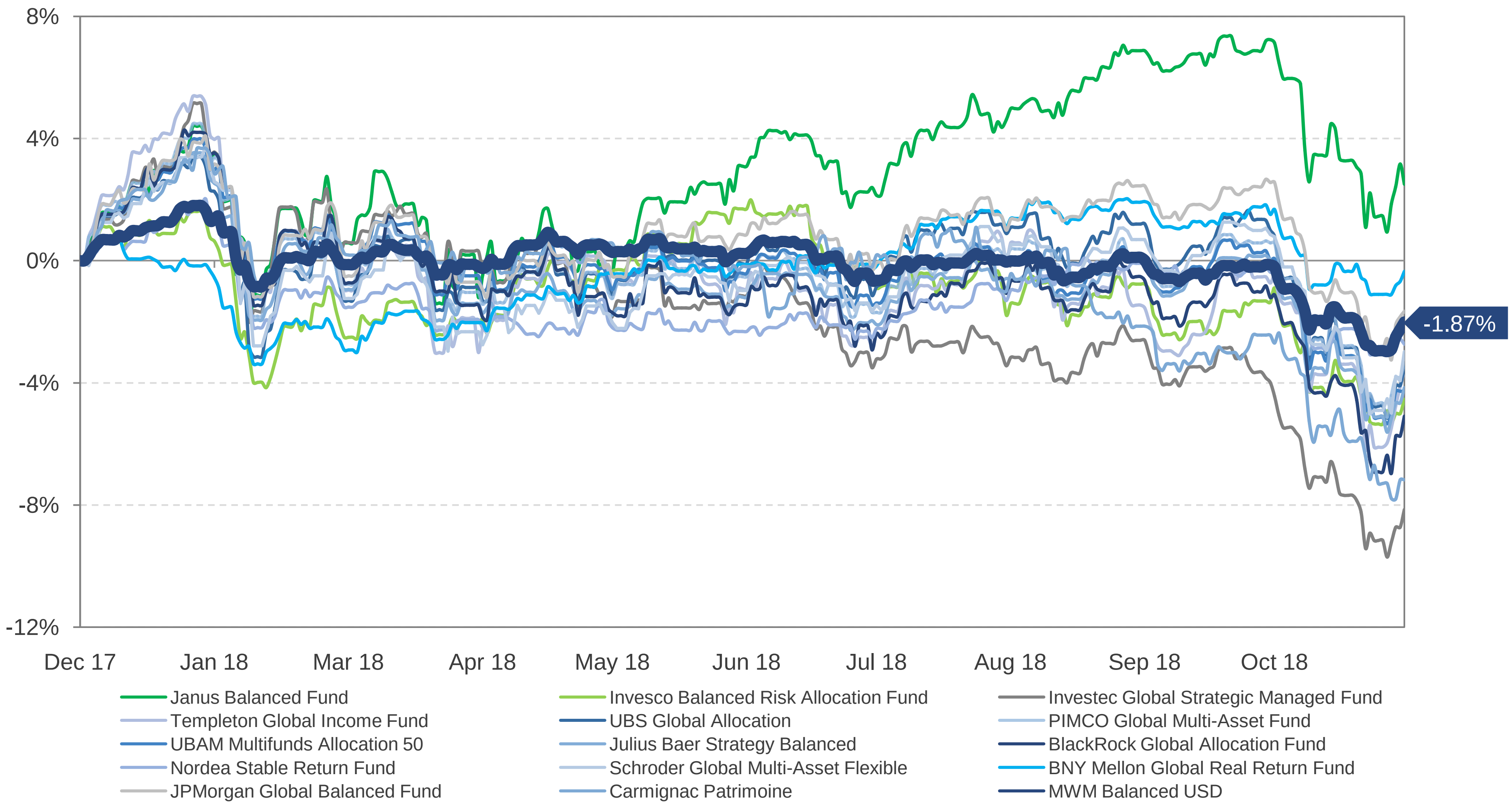
MWM Model Portfolio – Asset Allocation evolution



MWM Model Portfolio – VaR evolution



MWM Model Portfolio – Peer comparison

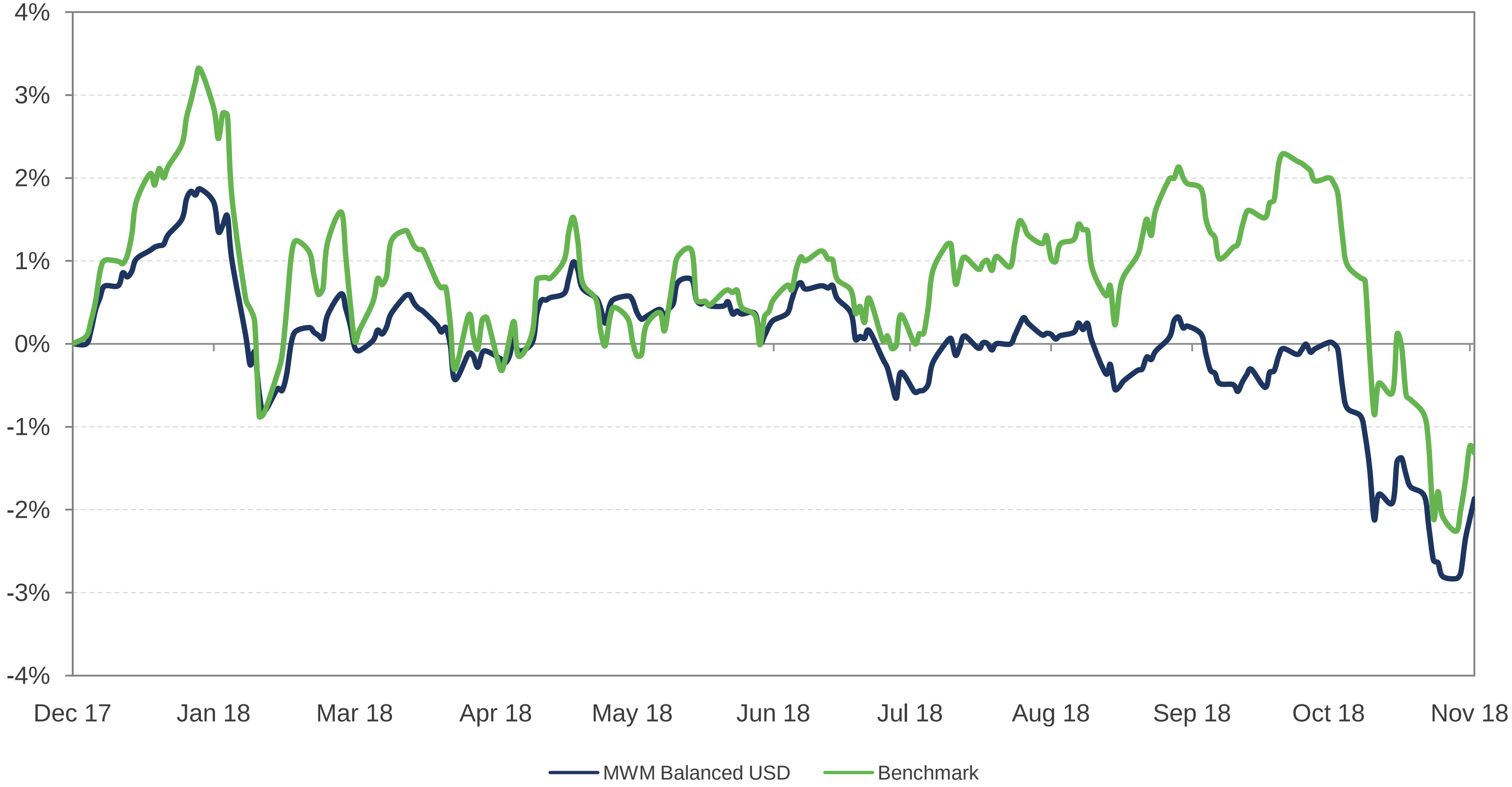


- **Total Return** (Ytd[1]): **4th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **1st out of 15**
- **Sharp Ratio** (1 year[1]): **n/a**

[1] As of November 2, 2018

Source: Bloomberg

MWM Model Portfolio – Ytd performance

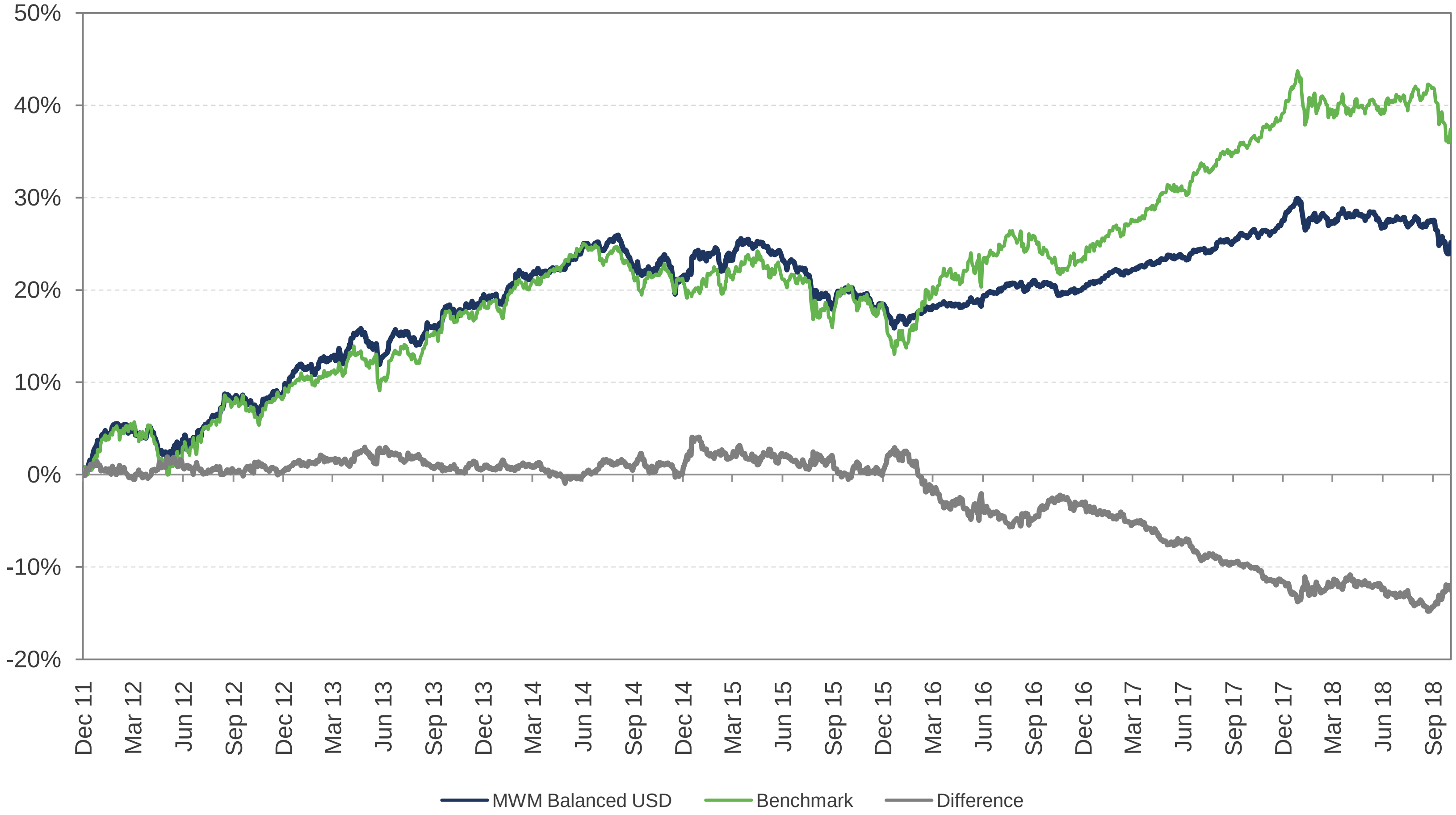


- **Total Return** (Ytd[1]): **-1.87%** vs. **-1.31%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.00%** vs. **4.95%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.33%** vs. **3.81%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **-1.35** vs. **-0.67** Benchmark[2]

[1] As of November 2, 2018

[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)

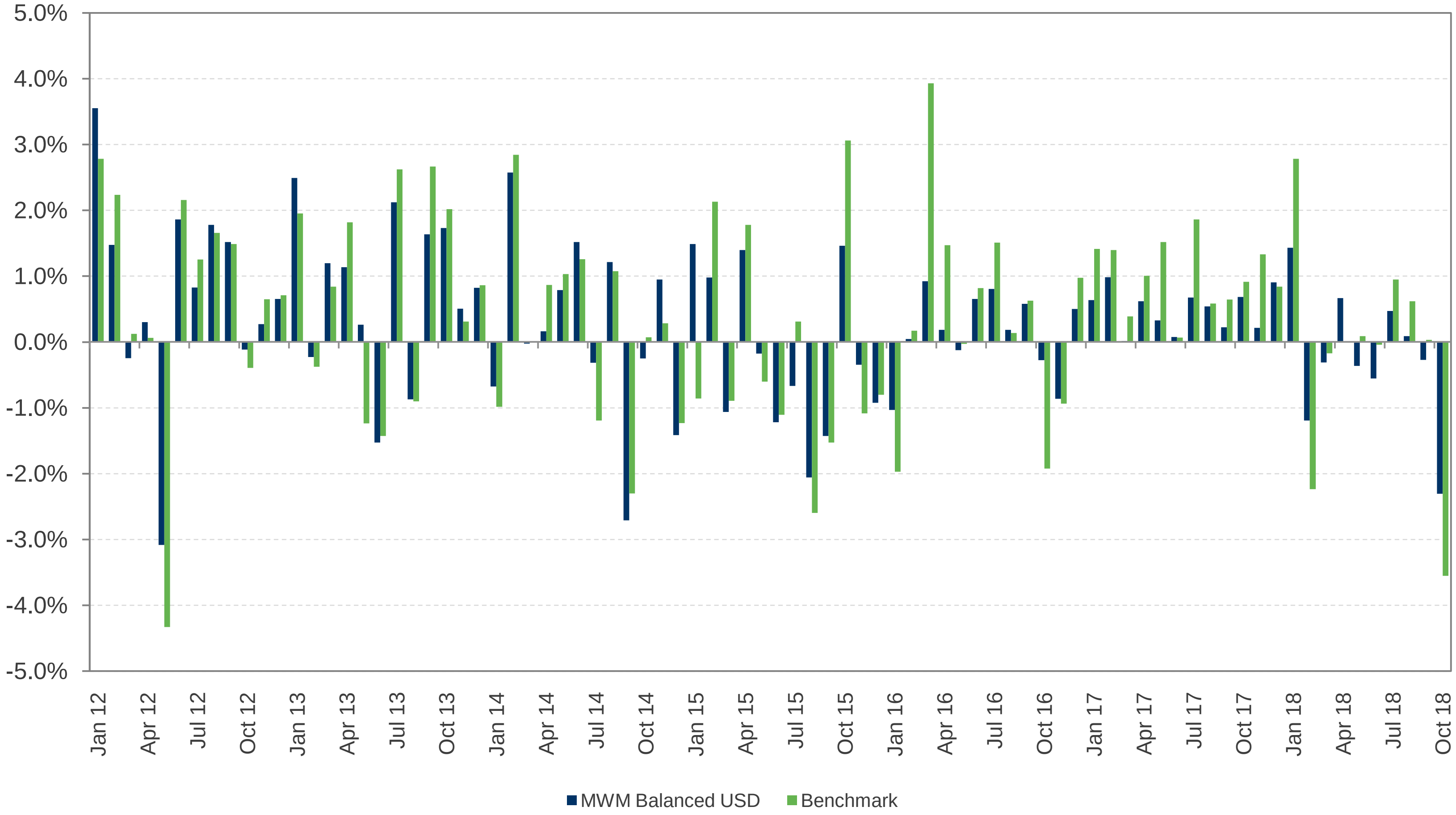


- **Total Return** (1 year[1]): **-0.86%** vs. **0.66%** Benchmark[2]
- **Total Return** (3 year[1]): **4.25%** vs. **14.03%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **24.52%** vs. **36.77%** Benchmark[2]

[1] As of November 2, 2018

[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]): **2.84%** vs. **4.65%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.20%** vs. **3.60%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-0.92** vs. **0.22** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.34%** vs. **-0.50%** Benchmark[2]

[1] As of November 2, 2018

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