Investment Policy

October 2019

BOREAL
CAPITAL MANAGEMENT

Our market view in a nutshell – October 2019

- The economy continues to provide **mixed signals**. The manufacturing sector points to a clear contraction in activity, this time dragging the services sector along. The **slowdown is clearly beginning to affect business sentiment**, as a **rapid resolution of the trade war seems less and less likely**

- Fortunately, the **timely reaction of the Federal Reserve** and other major central banks is providing vital support to the economy, allowing **favorable financial conditions** to continue. These support the financial and housing markets and, ultimately, the US consumer

- However, **this situation cannot last indefinitely** since sooner or later the economic weakness will result in lower corporate profits, which generally lead to corporate restructuring. In this regard, **any deterioration in the labor market has the potential to trigger a massive market sell-off**. Therefore, **we are at a critical juncture**, since time is running out to reach a trade agreement that dissipates business concerns before it is too late

- When it comes to positioning out portfolios, both scenarios speak in favor of long-term assets, since interest rates are likely to remain depressed for a long time, but **a hardly existent term-premium in bonds limits the gains that can be obtained at this point if the economy plunges into a recession**. A **healthy equity risk premium on the contrary, provides some cushion** against a deceleration of earnings, or an increase in interest rates, while it allows to participate from a price appreciation via multiple expansion if the economic cycle continues

- Weighing the economic evidence against the current distortions in asset prices caused by low interest rates, we believe that, today, a prudent allocation should **overweight equities**, **as well as real assets** (such as real estate, infrastructure), and **underweight long-term sovereign bonds**

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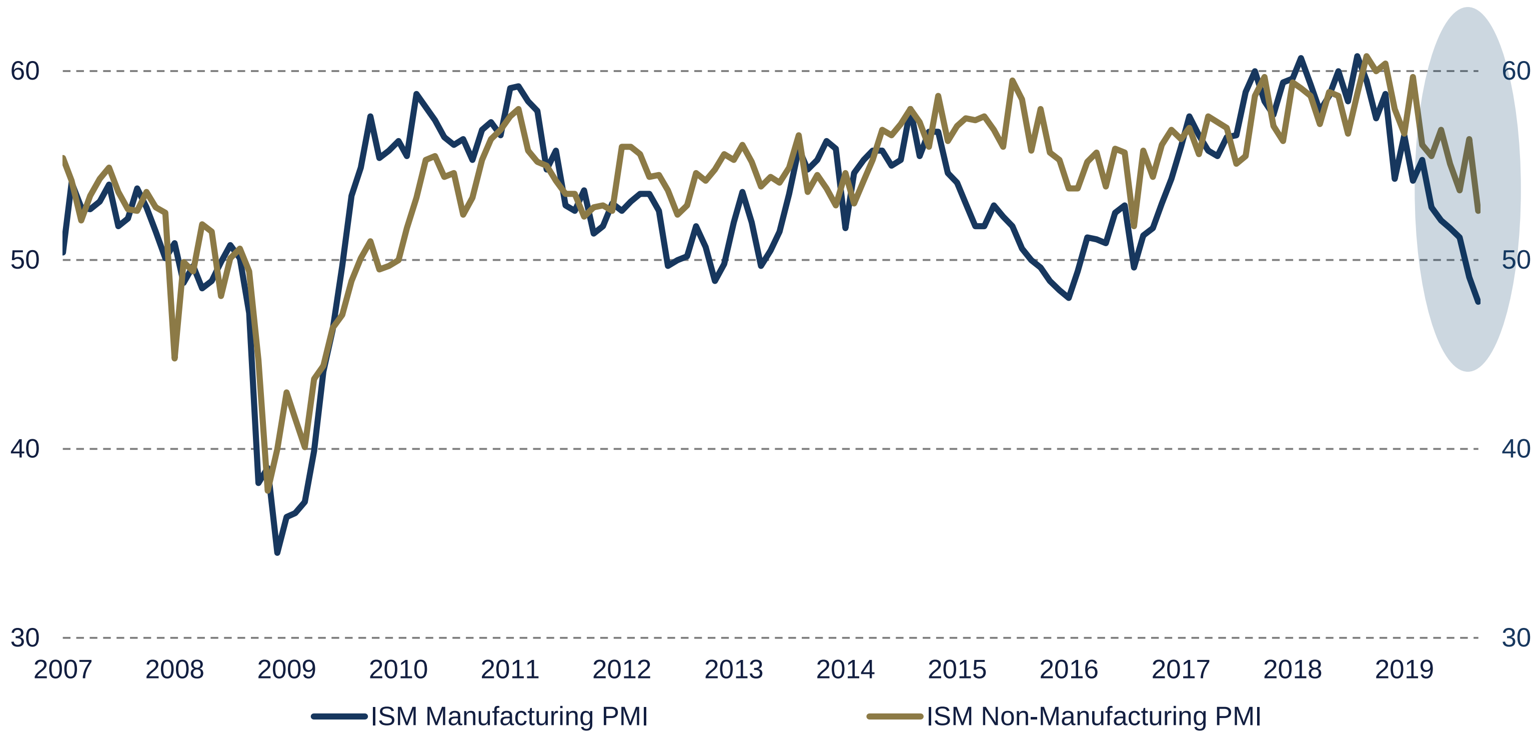
Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasuries offer protection from a slowdown in growth, but we believe that current long-term yields are unattractive, preferring shorter maturities
	US Credit	+	Corporate debt and High Yield currently offer the best combination of risk and return. 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	+	Emerging Markets currencies and spreads have adjusted significantly to a stronger dollar and the uncertainties around global growth. With the Fed signaling being closer to the neutral rate, we deem current levels to offer fair value
Equities	US	+	After the recent market corrections and the increase in corporate earnings, valuations have improved. We have therefore increased our exposure to US equities, mostly through quality and growth oriented 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 recovered significantly as the outlook for a stronger dollar and an economic slowdown subside. Consequently, we have seized the opportunity to reduce our exposure
	Sectors & Themes	+	Beyond our core call for quality-growth companies, we favor Real Estate, Infrastructure, Biotechnology and Healthcare
Alternative Investments	Multi-Strategy Hedge Funds	−	Multi-strategy / multi-manager hedge funds with daily liquidity are having a disappointing performance, particularly when compared with other less risky alternatives, like short-term corporate bonds
	Commodities	−	In the present late-cycle environment, with inflation pressures remaining subdued, we see limited upside for commodities. However, we favor gold in the current negative real interest rates environment
	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

Manufacturing slowdown continues



- The **manufacturing sector continued to slow down** during the month of September, reaching levels that indicate a **contraction in economic activity**
- The **services sector**, which had remained relatively unaffected by the slowdown in the industrial sector, **also begins to show signs of contagion**

Source: Bloomberg

Impacting investment decisions

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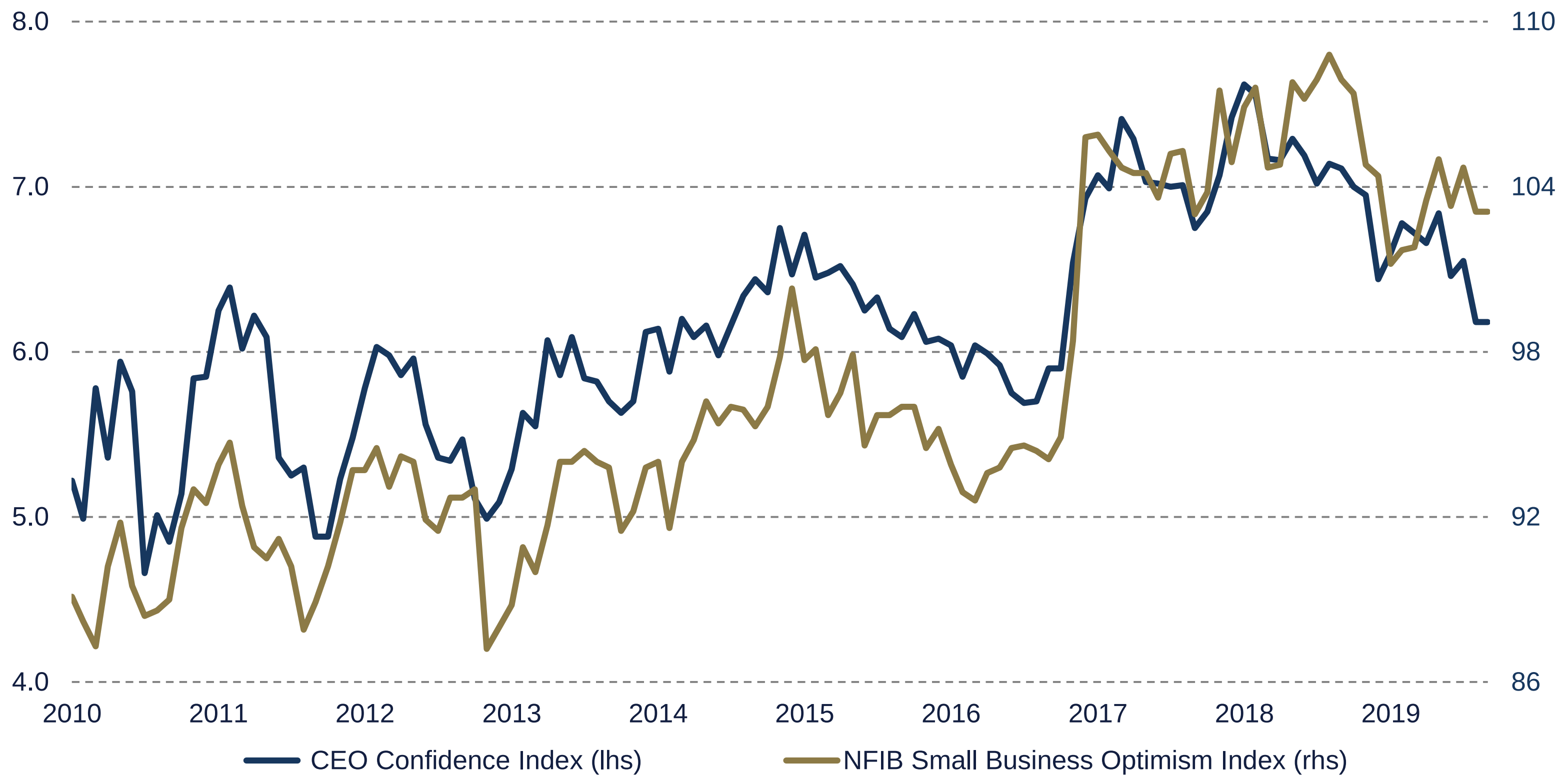
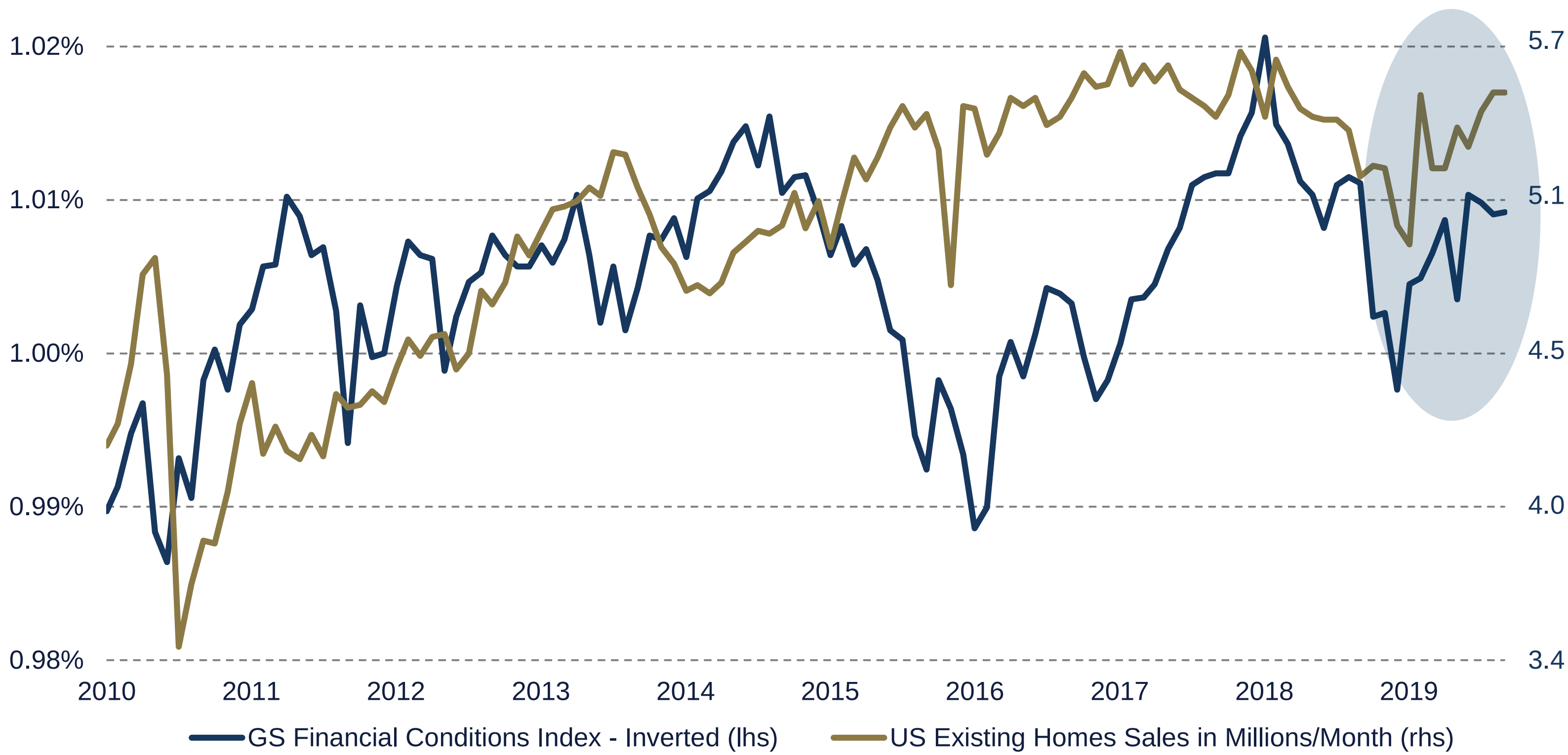


- As the deceleration is proving to be more than just a soft patch in economic activity, and threatens to turn into an economic recession, **businesses are starting to adapt their investment plans**
- Lower corporate earnings can translate into **corporate restructuring** impacting employment, triggering a **negative economic feedback loop**

Source: Bloomberg

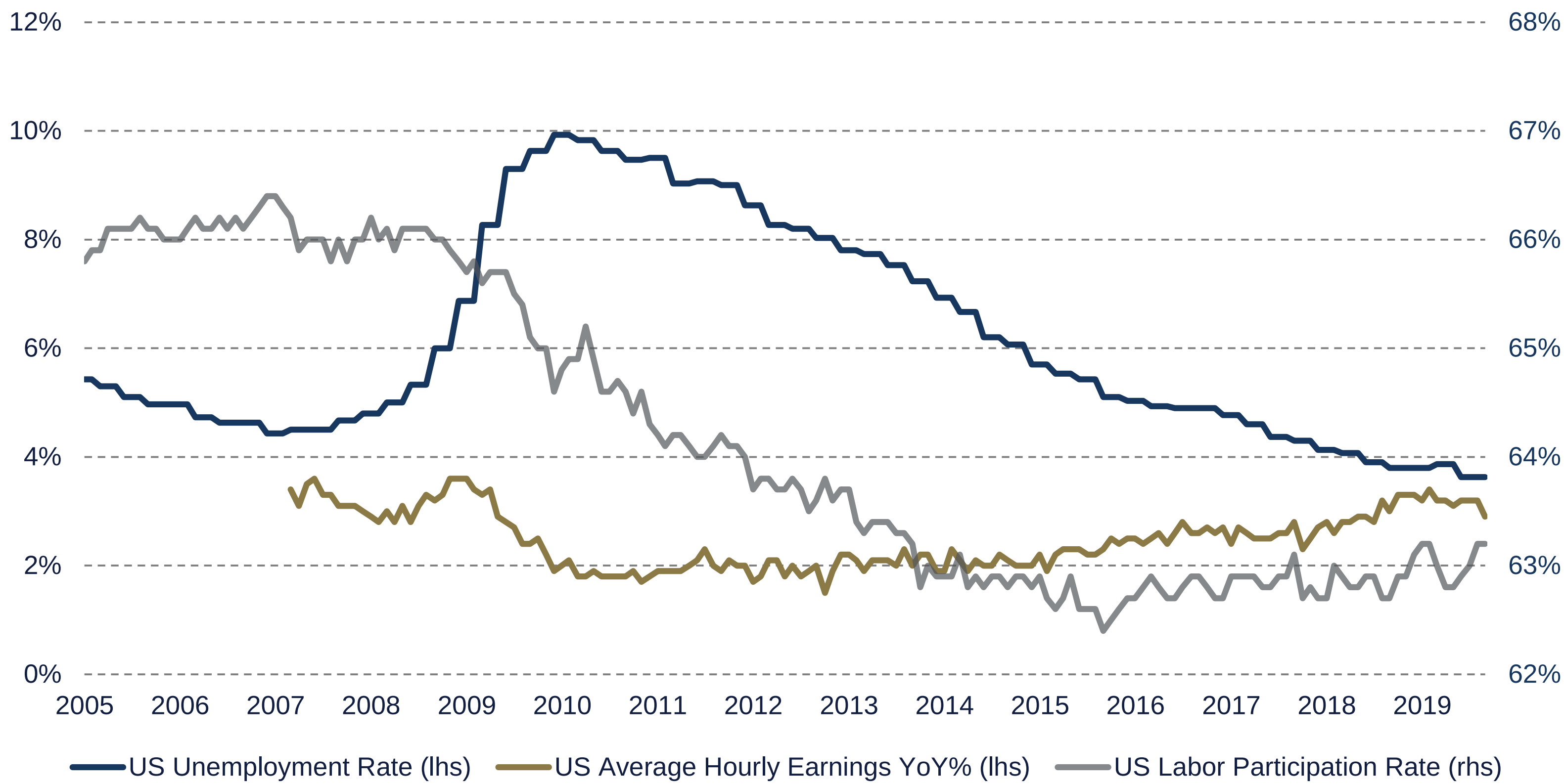
Monetary policy counteracting



- To counter the slowdown, central banks and especially the Fed have embarked on a round of **monetary easing measures**
- This has had a **positive impact on financial conditions**, easing the financial burden for corporations and individuals alike.

Source: Bloomberg

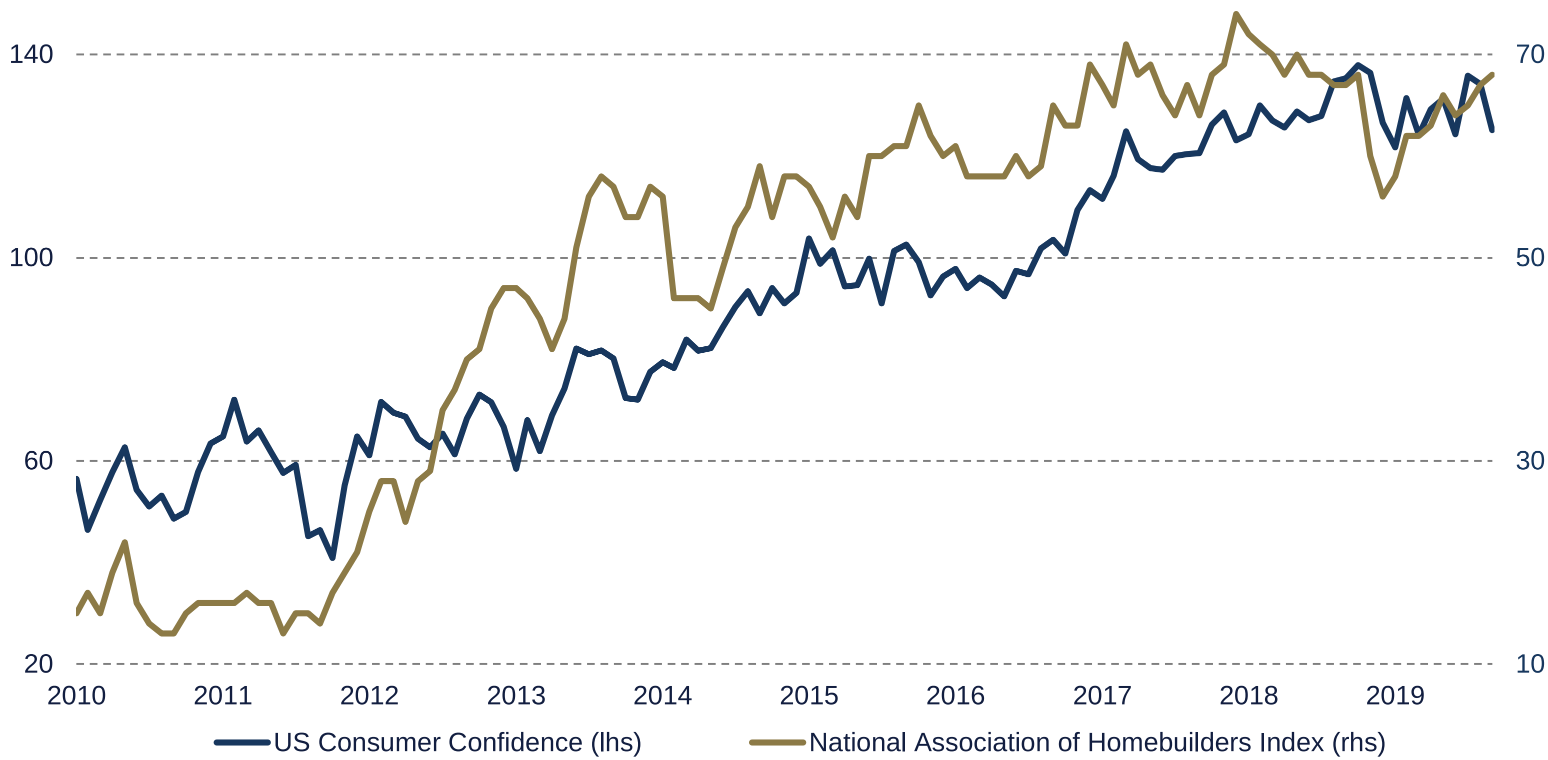
Labor market unaffected so far



- So far there are no signs that corporations are starting rounds of layoffs. On the contrary, we have an **almost perfect labor market**, with **minimum levels of unemployment**, a labor **participation rate** that continues to recover slowly and **limited wage inflation**

Source: Bloomberg

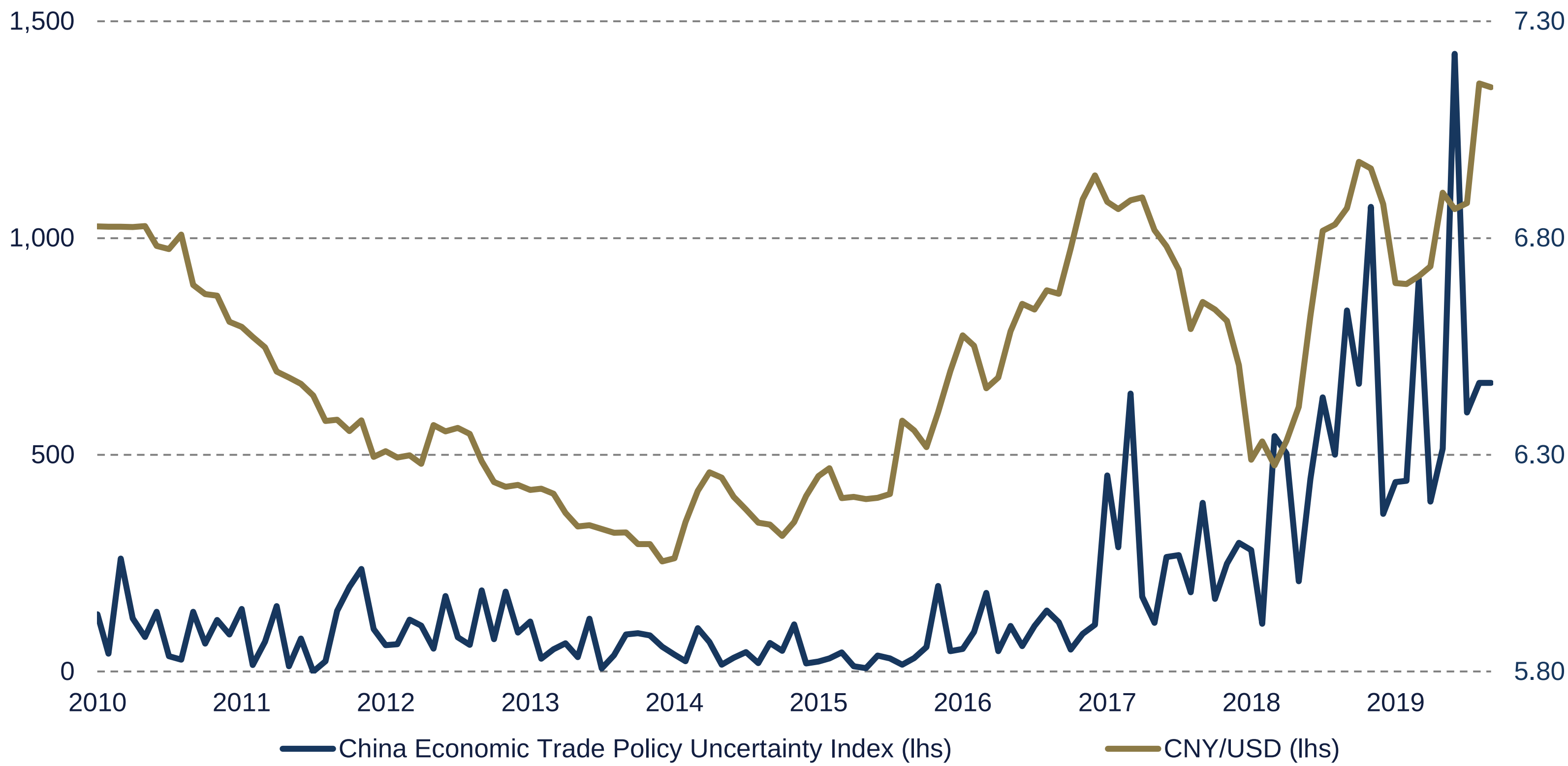
Consumption remains the main pillar



- Full employment, low financing costs and a positive "wealth effect" as a result of the strength of the equity and housing markets, keep the American **consumer isolated from the slowdown for the moment**
- This is **giving the economy time to recover the lost mom**entum, which has been caused by uncertainties about world trade.

Source: Bloomberg

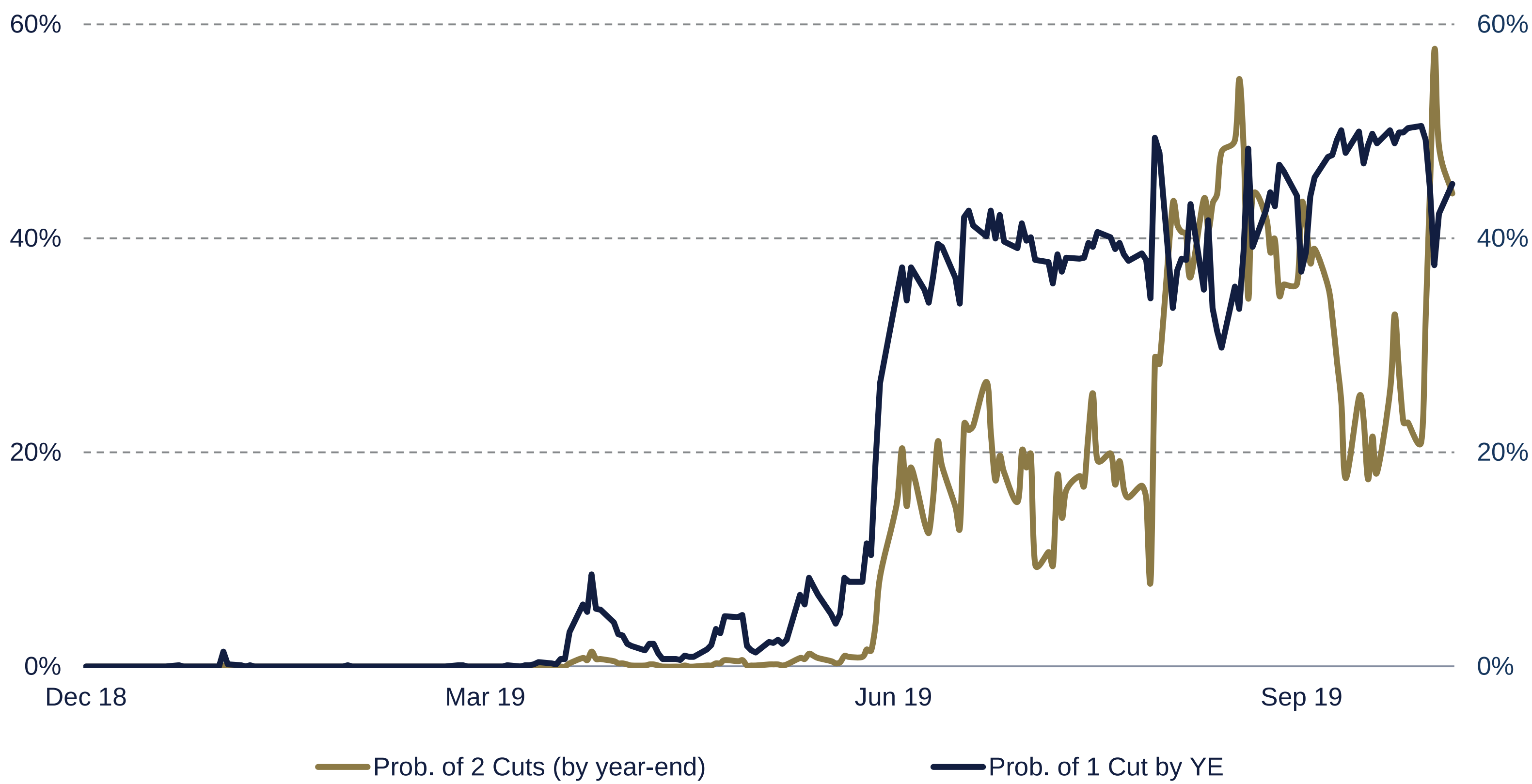
A resolution of the trade war is critical



- **Tensions around the world trade regime**, and particularly the dispute between China and the US, have been the **main cause of the slowdown** in economic activity
- **China** has been able to mitigate the impact of tariffs by **allowing the Renminbi to depreciate and applying fiscal measures**. However, in **Europe monetary policy remains the only tool**, and export-oriented economies such as Germany are on the verge of recession

Source: Bloomberg

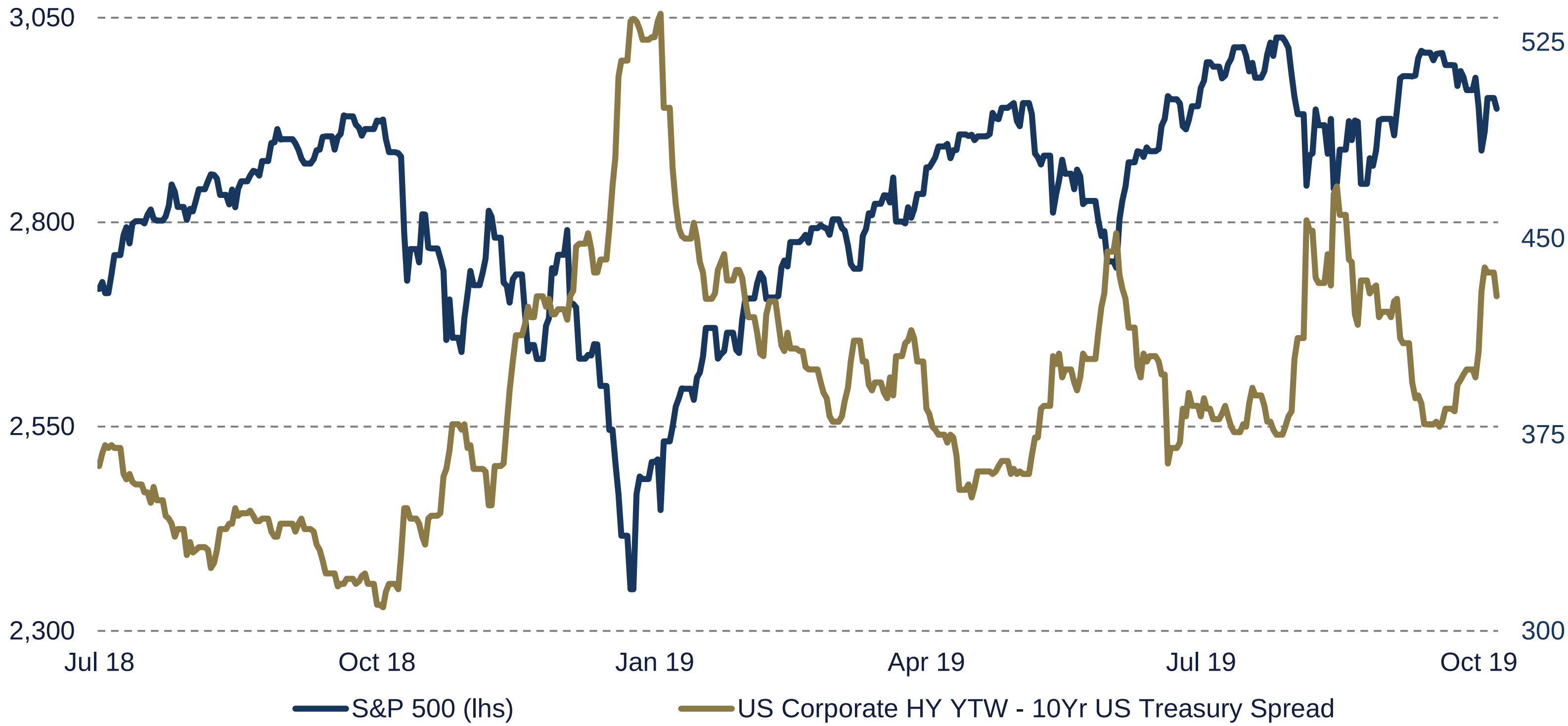
The Fed has to avoid surprises



- The **Fed** has surprised most observers by how quickly it has reacted to weak global demand; a sign that **they want to avoid the economy going into recession at all costs**
- However, **some cracks have begun to emerge within the Fed itself**, with some of its members opposing “insurance cuts" with unemployment approaching historic lows and consumer confidence near historic highs

Source: Bloomberg

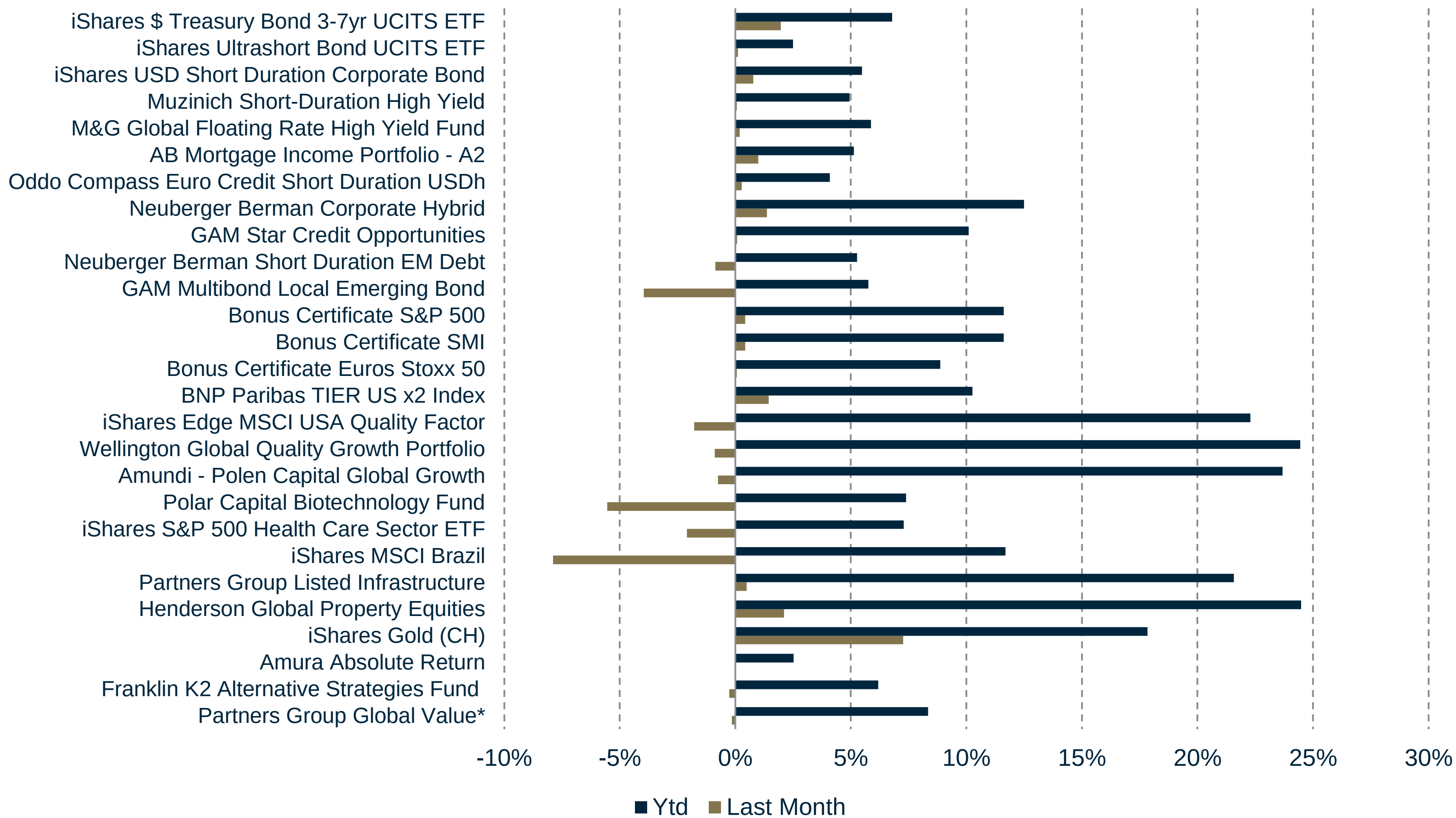
Risk-on, risk-off in the meantime



- With financial markets debating between the effects of the trade war and monetary accommodation, we are **caught in a "risk-on"/ "risk-off" environment**
- Since we assign a similar probability to the recession and "Goldilocks" scenarios, we recommend **maintaining a risk exposure to risk assets, but establishing hedges to protect against a possible correction**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of October 2, 2019
* Fund publishes monthly NAV with a 1 month of delay

Investment scenarios

	Scenario 1 End of the cycle	Scenario 2 Goldilocks	Scenario 3 New regime
Drivers	• 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 sharply reverse course, which would be complicated if inflation is rising	• 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 remains subdued globally due to structural factors (demographics, low aggregated demand, deleveraging, globalization) • The Fed hold rates, or lowers them preemptively to avoid a slowdown	• 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 has to step up the pace of rate increases and/or reduce balance sheet
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 declining 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	• Equities appreciate moderately, with growth outperforming value • Credit spreads remain stable as the credit cycle is further elongated • Short-term sovereign and IG offer interesting yields with little interest rate and credit risk • If the Fed continues to loosen, the USD will weaken, as interest rate differentials narrow • Commodity prices will rise moderately, as prices remain still relatively depressed	• 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
Probability	40%	40%	20%

Short-term catalyzers

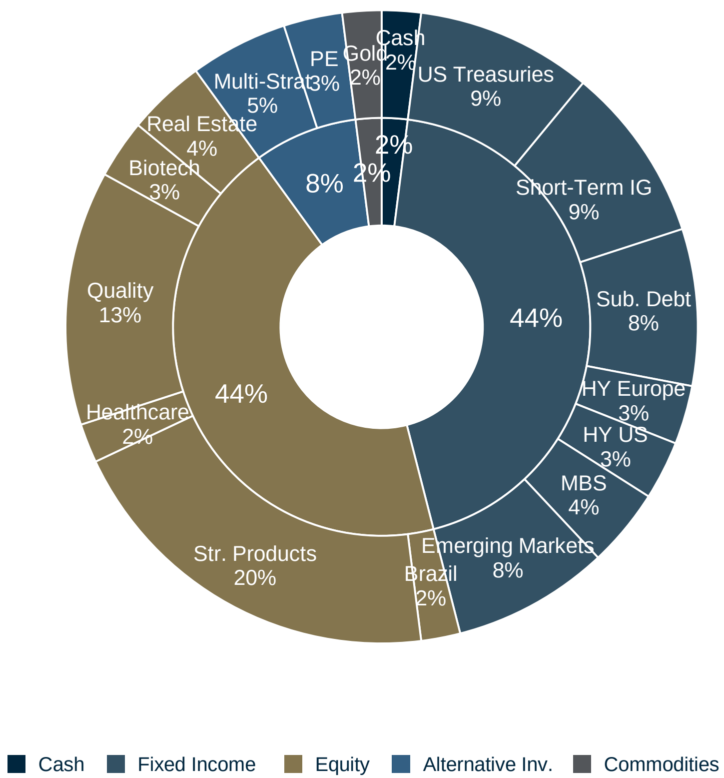
End of trade dispute, improvement in macro-data globally, lower geopolitical tensions

Other risks

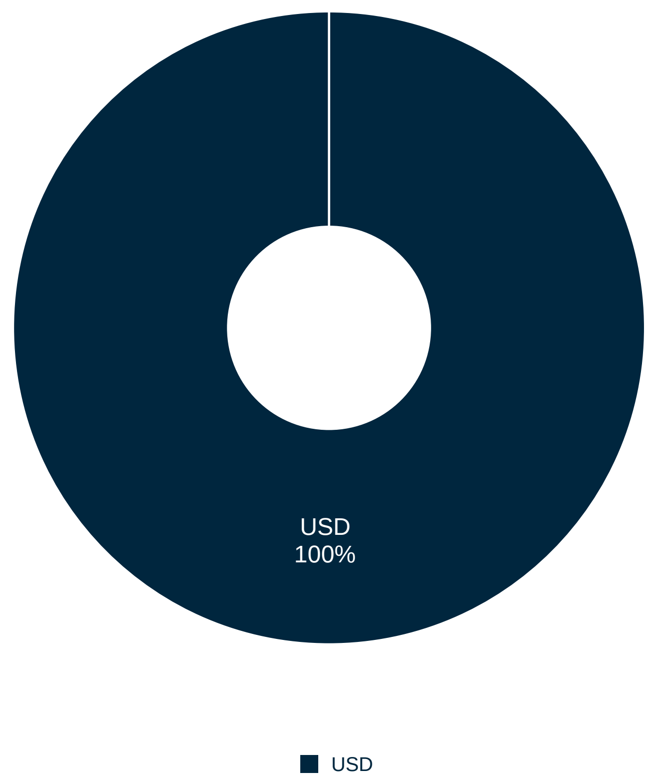
Trade wars, Hard Brexit, Spread of populist political parties, China slowdown, Terrorism

Boreal Model Portfolio Balanced USD

Asset Allocation



Currency Allocation

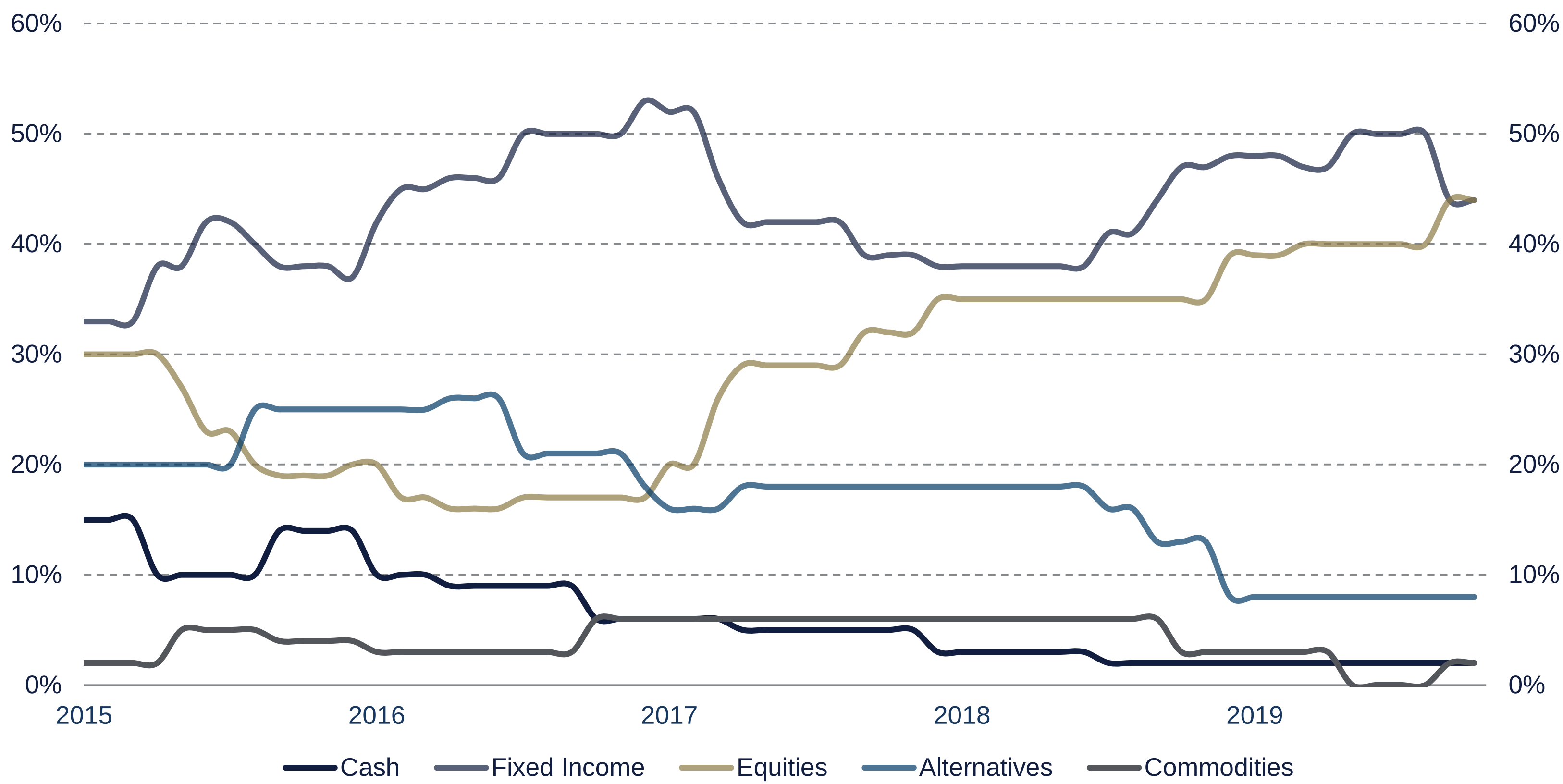


Boreal Investment Profiles

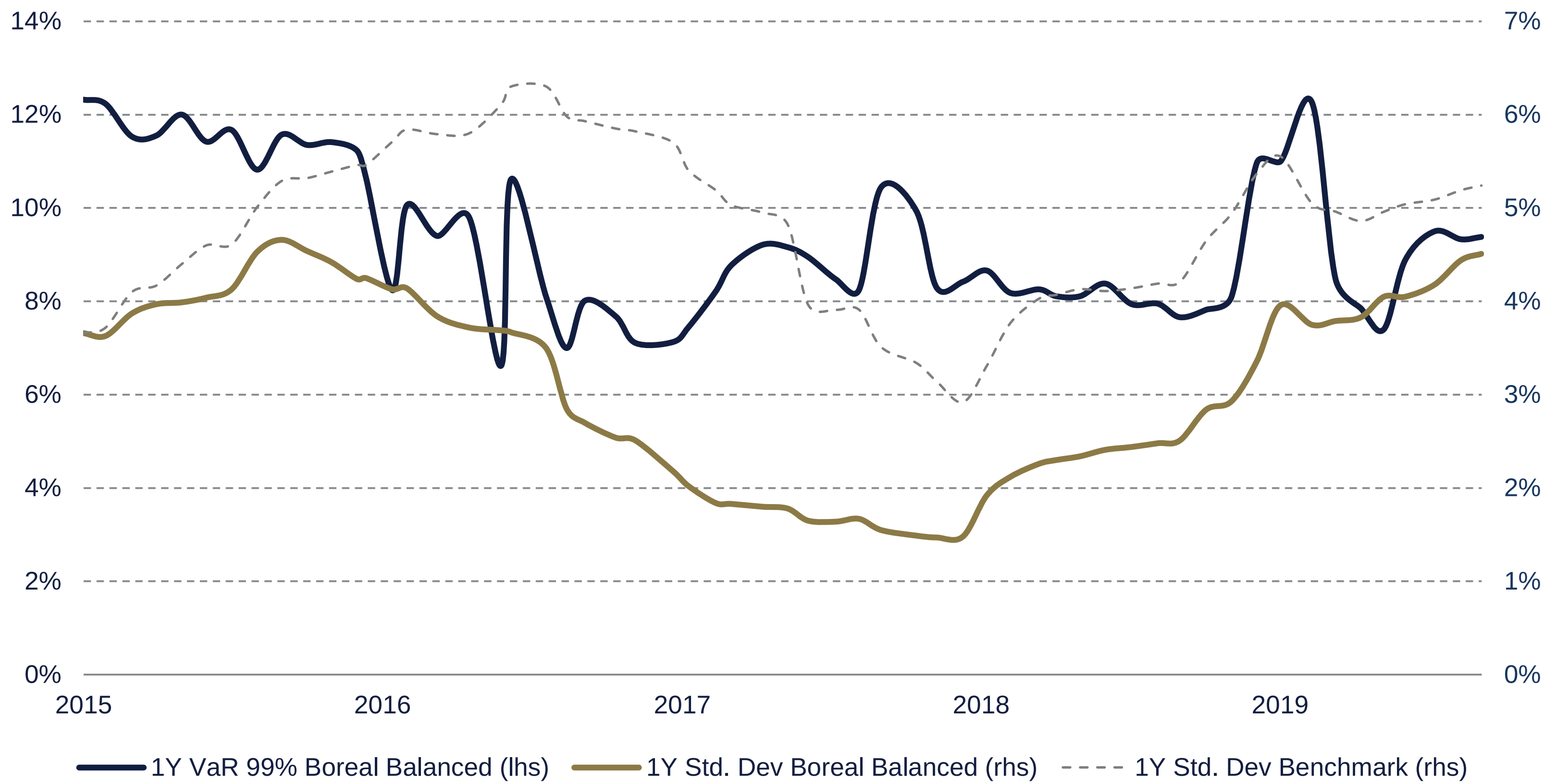
	Conservative	Balanced	Growth
Cash	5% / 3%	5% / 2%	5% / 1%
Fixed Income	64% / 60%	43% / 44%	22% / 31%
Equities	24% / 31%	38% / 44%	52% / 56%
Commodities	2% / 2%	4% / 2%	6% / 2%
Alternative Investments	5% / 4%	10% / 8%	15% / 10%

▼ Strategic Asset Allocation

Boreal Model Portfolio – Asset Allocation evolution



Boreal Model Portfolio – VaR evolution



[1] As of October 1, 2019
Source: Bloomberg

Boreal Model Portfolio – Peer comparison

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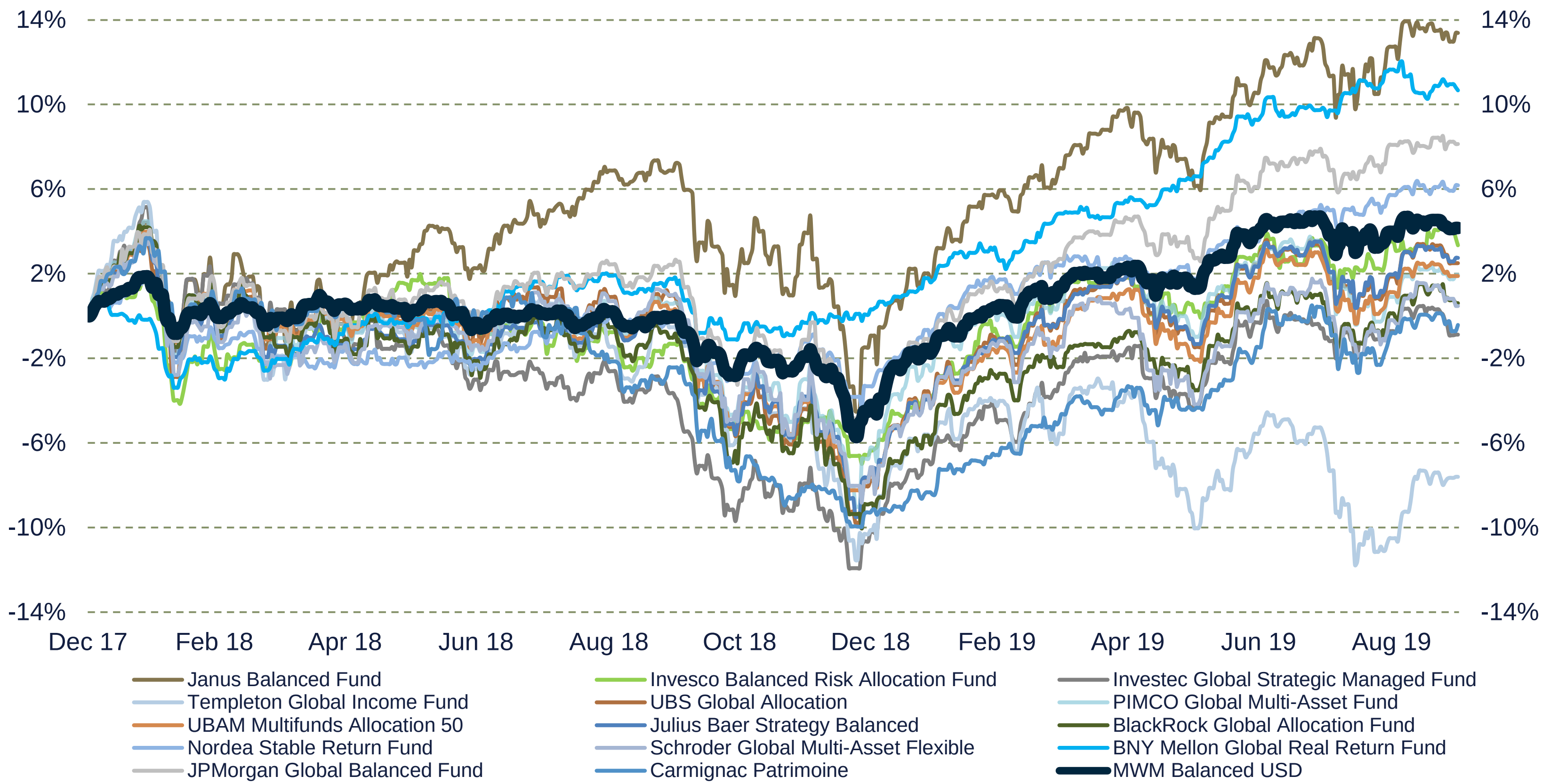
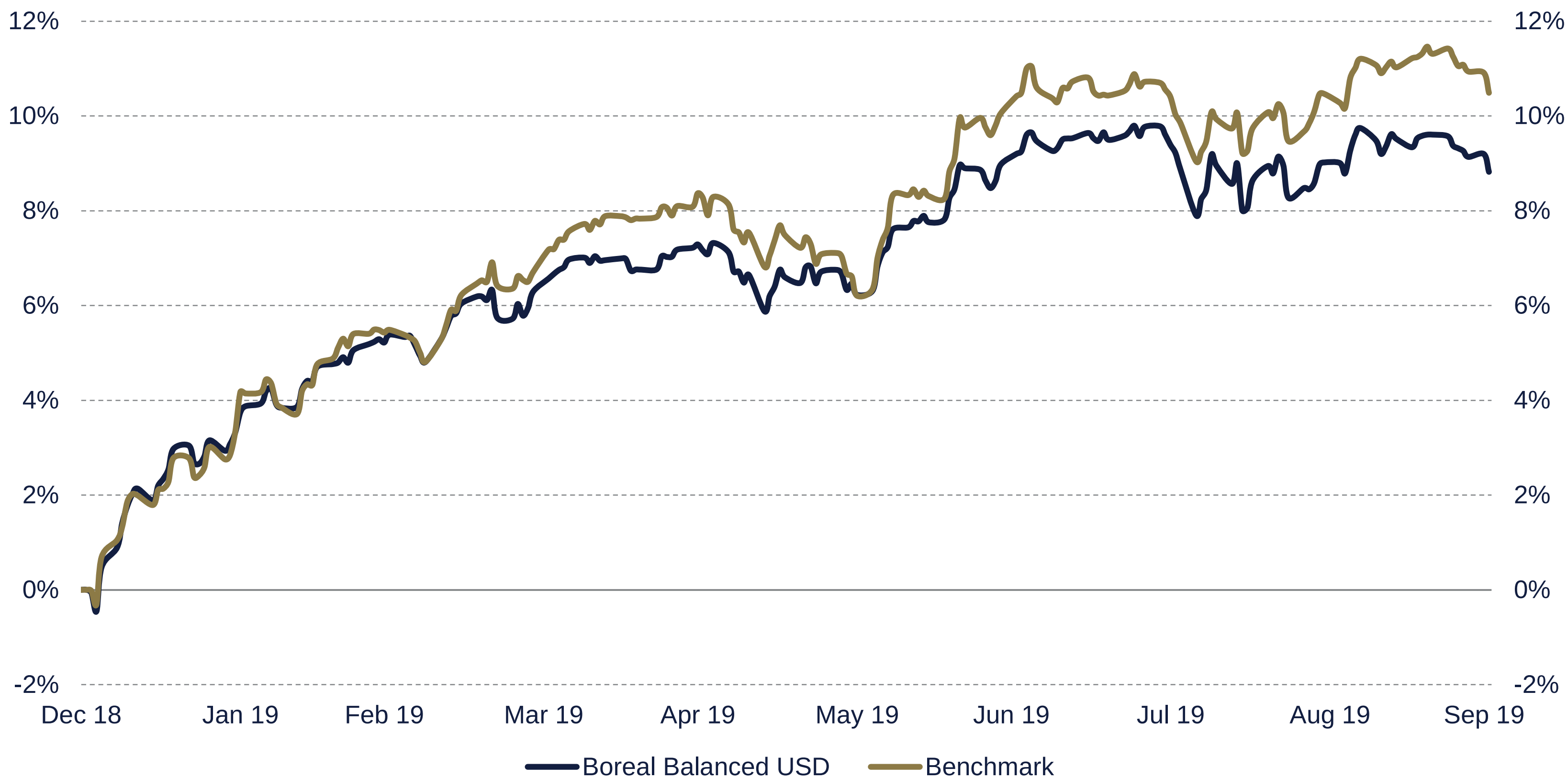


- **Total Return** (Ytd[1]): **12th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **2nd out of 15**
- **Sharp Ratio** (1 year[1]): **3rd out of 15**

[1] As of October 1, 2019

Source: Bloomberg

Boreal Model Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **9.03%** vs. **10.60%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **4.05%** vs. **4.37%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **3.00%** vs. **3.04%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **2.42** vs. **2.73** Benchmark[2]

[1] As of October 1, 2019

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

Boreal Model Portfolio – Historical performance (1)

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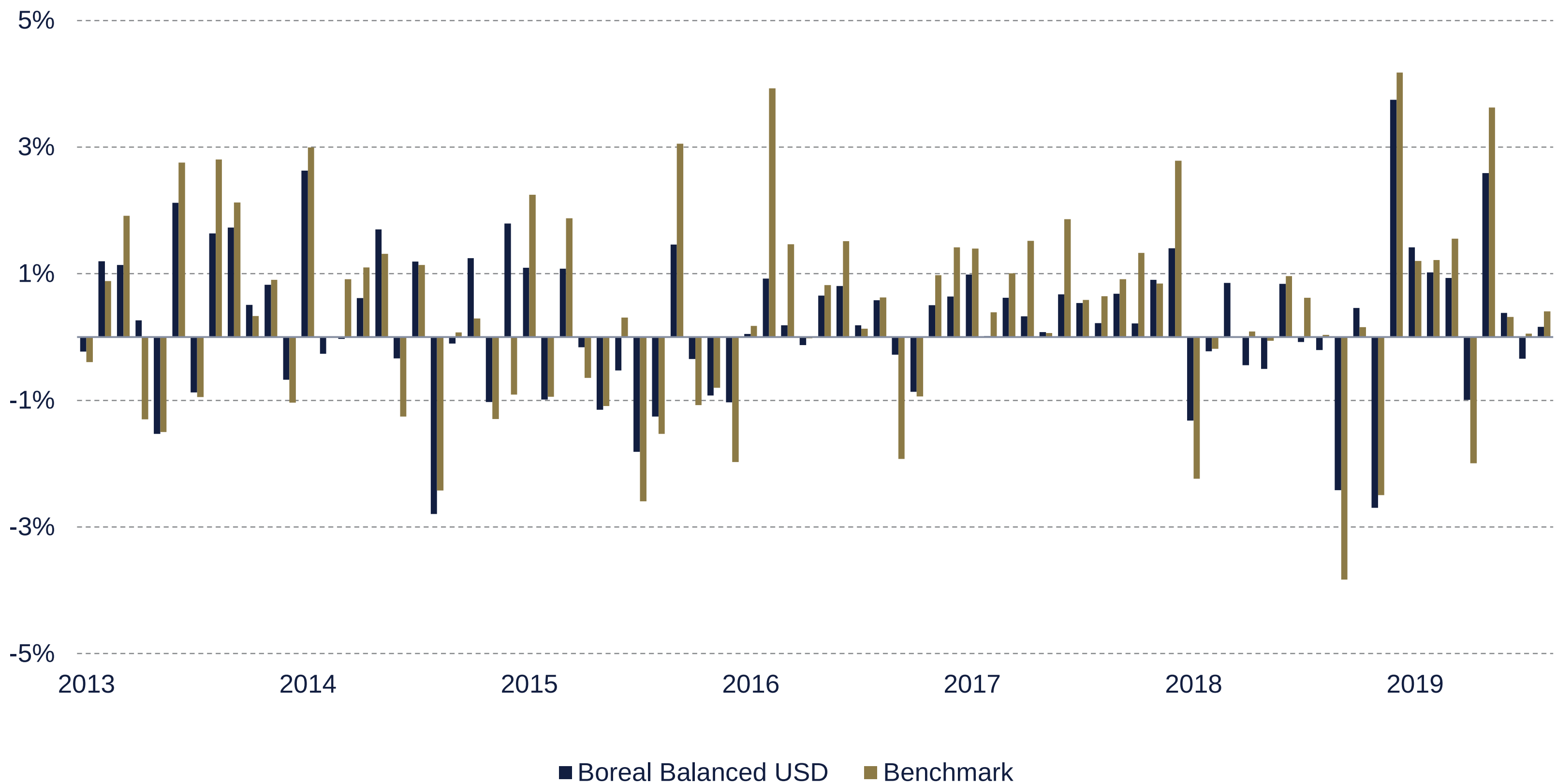
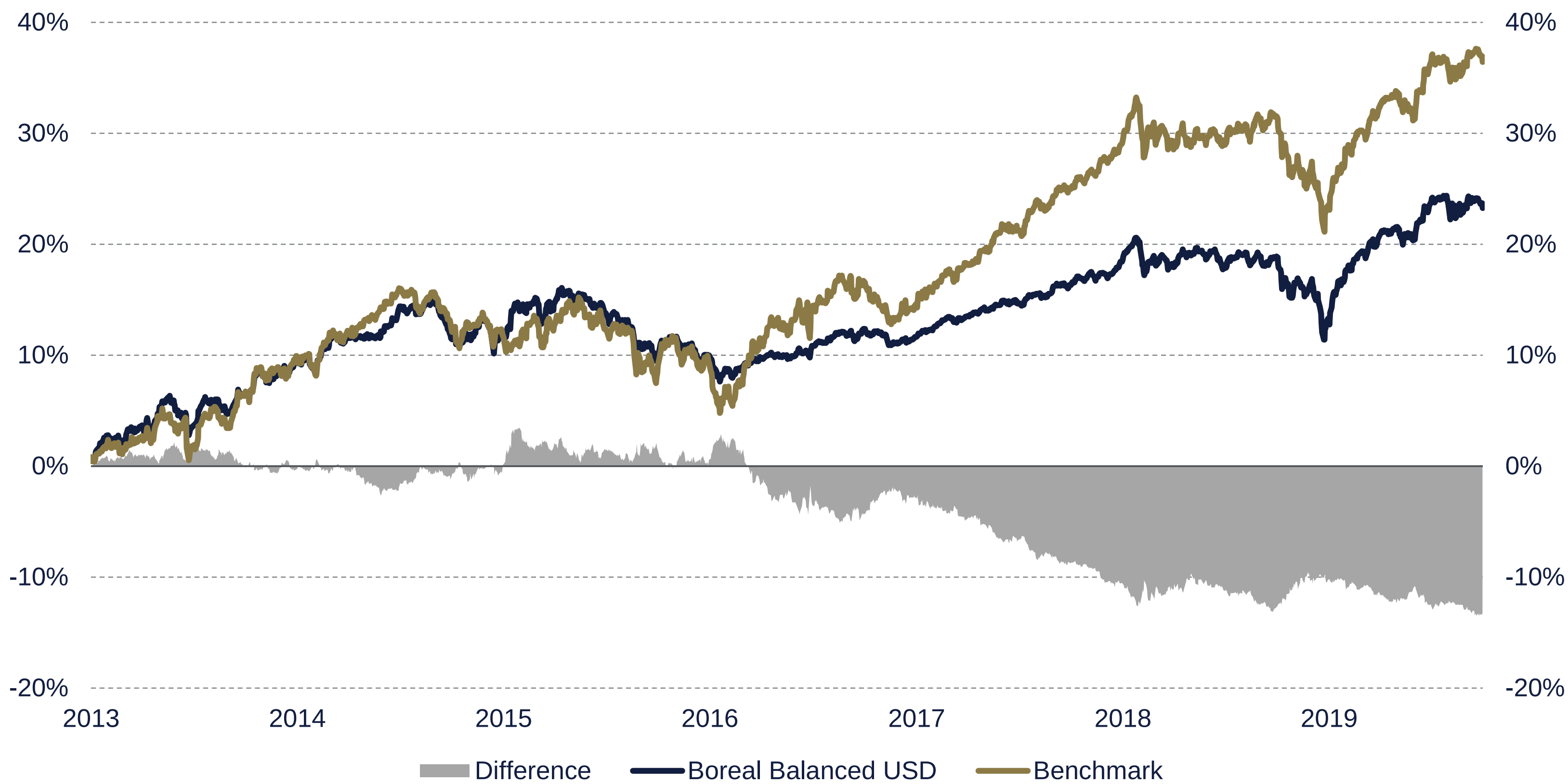


- **Total Return** (1 year[1]): **4.79%** vs. **4.90%** Benchmark[2]
- **Total Return** (3 year[1]): **10.39%** vs. **17.90%** Benchmark[2]
- **Total Return** (Since Jan 13[1]): **23.28%** vs. **36.34%** Benchmark[2]

[1] As of October 1, 2019

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

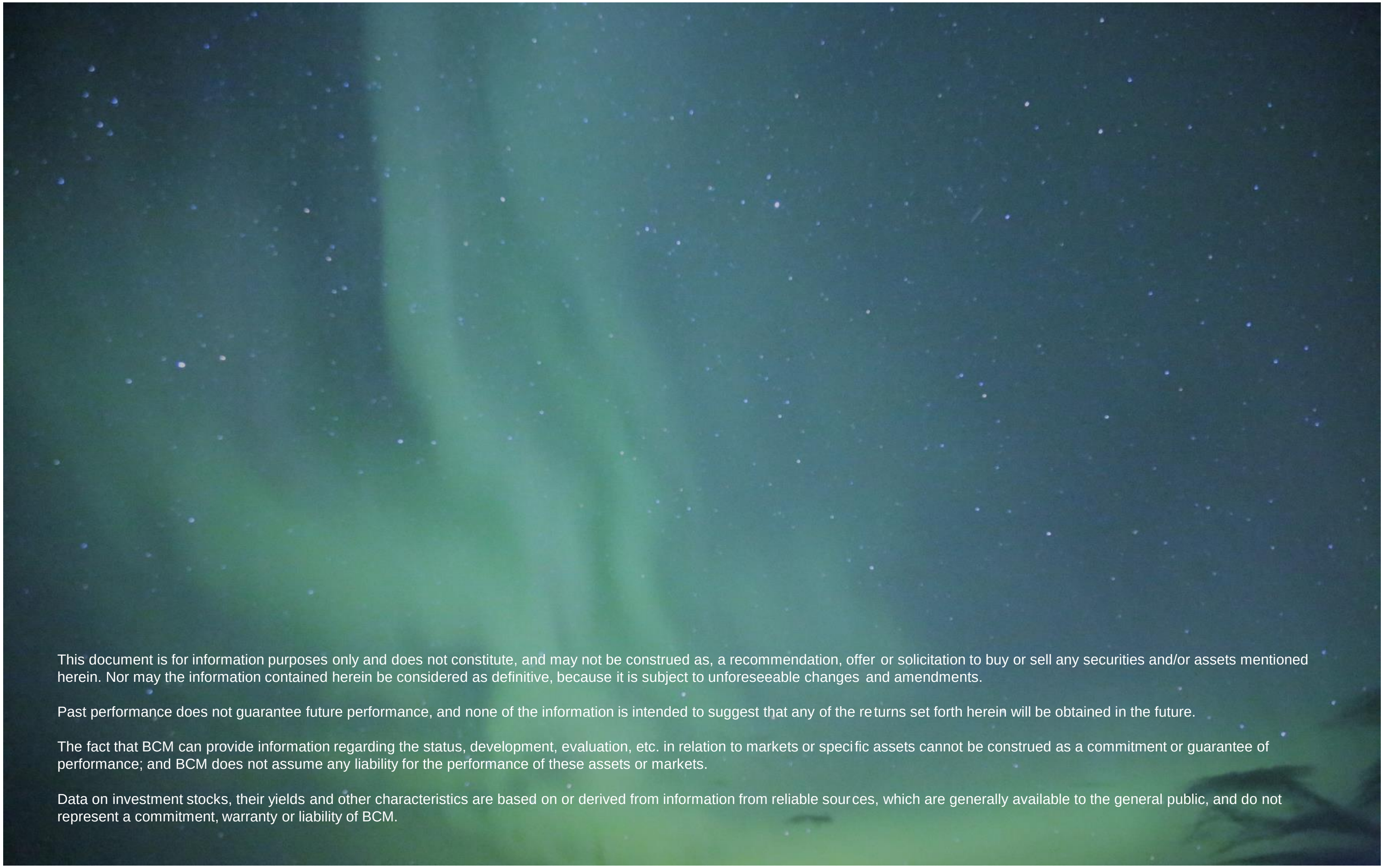
Boreal Model Portfolio – Historical performance (2)



- **Standard Deviation** (1 year[1]): **4.50%** vs. **5.32%** Benchmark[2]
- **Downside Risk** (1 year[1]): **3.33%** vs. **3.73%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **0.58** vs. **0.53** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.52%** vs. **-0.61%** Benchmark[2]

[1] As of October 1, 2019

[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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