Investment Policy

November 2019

Our market view in a nutshell – November 2019

- Another month has passed without the expected trade agreement materializing, and **the economy continues approaching stall speed**, with the main economic indicators pointing towards an imminent contraction of activity, and a recession lurking on the horizon

- **The market seems to perceive this standstill as a problem that will eventually be resolved**, and stock markets continue to reach new highs. However, **there is a risk that there are other underlying reasons for the slow**down, which is mainly affecting investment and trade, and that the weakness continues despite an agreement

- In this **dissonant environment of lukewarm economic growth and buoyant markets**, it is important to take perspective and realize that **asset prices have been reflated by central banks**, and that this is very unlikely to continue in the future given that policy monetary is being exhausted

- When **comparing the relative merits of the different asset classes**, and contrary to intuition, **equities stand out as the one that offers the best risk-adjusted returns.** This is the result of offering a healthy risk premium along with growth in earnings, which, in our opinion, remains unchanged in the medium term

- Some investors would oppose this optimistic view, adhering to **Stein's law**, which states that **"if something cannot go on forever, it will stop"** However, it is important to keep in mind that, despite the vertigo produced by investing at a time when the stock market is reaching new historical highs, **there is no foreseeable ceiling in the returns of equity markets in the long term; while there is a clear floor in bond yields**, which we are approaching

Boreal Investment Policy

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; favoring those that pay reliable dividends
	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 and Biotechnology
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

The economy continues approaching stall speed

60
50
40
30
10
0
-10
-20
2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019
ISM Manufacturing PMI (lhs)
US Leading Index Ten Economic Indicators YoY (rhs)

- During the month of October, **global PMIs stopped falling**, but levels continue to point towards a contraction in economic activity
- The predominant explanation for the slowdown remains the uncertainty caused by a **trade dispute between China and the United States**. The market is perceiving it as something that can be resolved, so there is no panic among investors. However, **there is a risk that there are other underlying reasons** and that the weakness continues despite an agreement

Source: Bloomberg

Investments remain the weakest link

4% 2% 0% -2% -4%

8% 7% 6% 5% 4% 3%

1998 2000 2002 2004 2006 2008 2010 2012 2014 2016 2018

%GDP - Residential Inv. (lhs) %GDP - Non-Residential Inv. (lhs) US Home Mortgage 30 Year (rhs)

- US **GDP in the 3rd quarter was better than expected** (1.9% vs. 1.6%). The main contributors were personal **consumption** (+2.9%) and **government spending** (2%)
- Private domestic **investment continued to be the weakest component**, with a decrease of -1.5%. The good news was that **residential investments rebounded**, which we see as a first **sign that monetary accommodation begins to be transmitted to the economy**

Source: Bloomberg

Why such buoyant markets?

	Ytd Return	Implicit Yield*
Treasuries	5%	1%
Corporate IG	12%	3%
High Yield	12%	6%
EM ($)	11%	5%
Sub. Debt	12%	1%
MBS	6%	3%
S&P 500	27%	5%
Euro Stoxx 50	28%	5%
MSCI EM	11%	7%
Real Estate	22%	4%
Infrastructure	22%	5%

- At first glance there seems to be a **disconnect between financial markets and the state of the economy**. However, it should be borne in mind that an important part of this year's profitability is nothing more than the **recovery of last year's heavy losses**
- Looking forward to the coming year, **investors must drastically reduce their return expectations**. In addition, it is very unlikely that all asset classes will rise again in a synchronized manner, and **asset allocation decisions will become important again**

Source: Bloomberg

Risk perception is conditioned by repeated trauma

Equity Risk Premium
US Inv. Grade Premium
US High Yield Premium

- The way investors are assessing the risk of the different asset classes seems to **be influenced by the two dramatic stock market crashes of this century.** After each of them, investors appear to have **increased the safety cushion required in order to invest in equities**
- Credit premiums, by contrast, have remained within their historical levels. This fact, together with the current low interest rate environment, makes **bonds much less appealing than equities in relative terms**

Source: Bloomberg

No signs of irrational exuberance

135 3,500
110 2,500
85 1,500
60 500
2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019

State Street Investor Confidence Index (lhs) S&P 500 (rhs)

- The surprising fact is that the **decrease in risk appetite has affected retail and institutional investors alike**
- This gives us at least the peace of mind of knowing that the **market is not reaching new highs led by "irrational exuberance"**, but despite having to climb a "wall of worry"

Source: Bloomberg

Negative EPS growth, but above expectations

100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

Consumer Staples | Health Care | Info. Technology | Financials | S&P 500 | Industrials | Comm. Services | Utilities | Consumer Disc. | Real Estate | Energy | Materials

Below | In-Line | Above

- Third quarter earnings have provided some further support to the stock market. **75% of S&P 500 companies have reported better than expected results**, while 60% have reported better revenues
- However, **overall earnings for the S&P 500 have declined by -2.4%**, which constitutes the third consecutive quarter of year-on-year declines, something that happened for the last time in 2015-16

Source: FactSet

Earnings consolidation or earnings recession?

3,200
3,000
2,800
2,600
2,400
2,200

160
145
130
115
100

2017
2018
2019

3,120
EPS +9% (vs. 6% Index)
EPS +23% (vs. 6% Index)
2,930
2,853

S&P 500 (lhs)
S&P 500 Trailing 12M EPS (rhs)

- Earnings have been stagnating during 2019, although this was expected due to the **base-effect of the tax reform in 2018**
- The **underlying trend in revenues however continues unaltered**, and speaks for a solid momentum for US equities despite lukewarm economic growth, a trend that can still continue for long

Source: Bloomberg

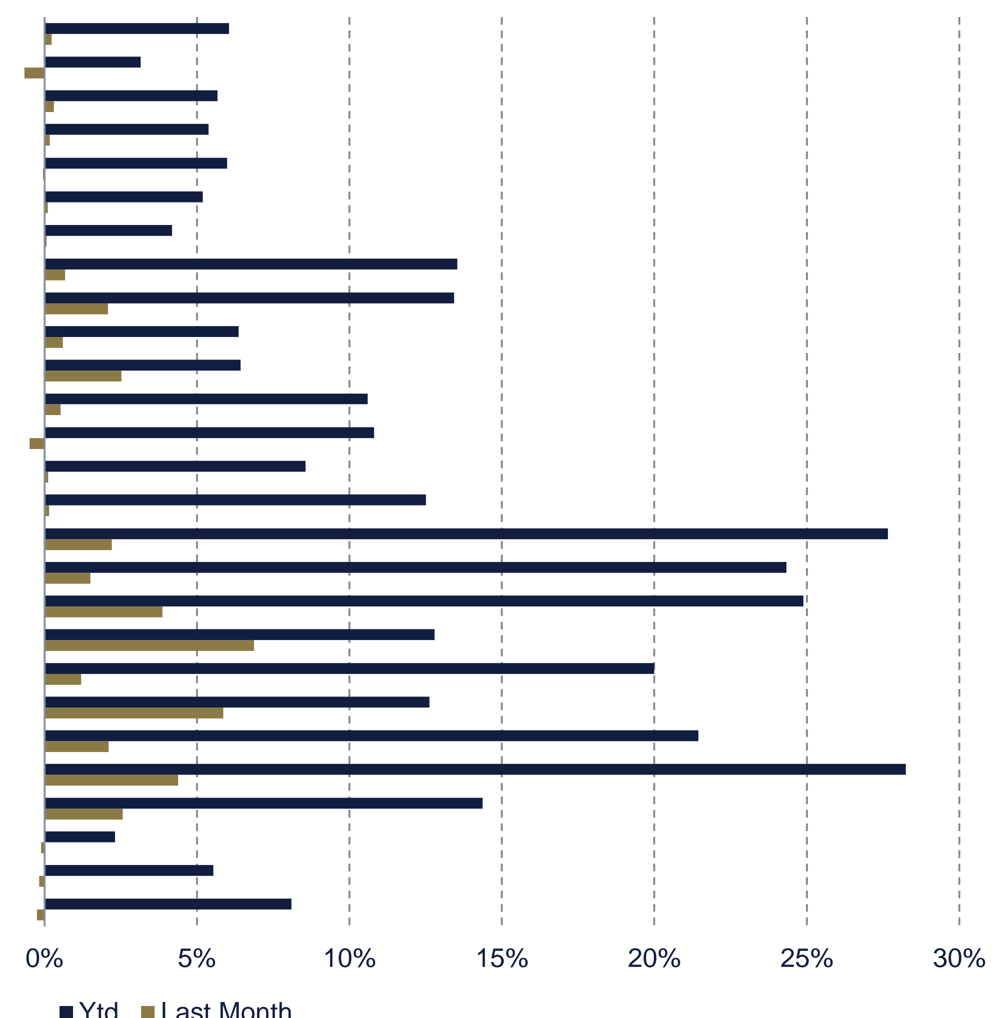
Betting on a recession can be risky

220% 14,000
180% 10,000
140% 6,000
100% 2,000
-30%
Aug 18 Nov 18 Feb 19 May 19 Aug 19 Nov 19
Republic of Austria 2.1% Maturity 2117 (lhs)
Bitcoin (rhs)

- **Investors feel uncomfortable investing with the market reaching new highs**. However, it is important to keep in mind that betting against stock markets can be very expensive in the long term.
- But **even more expensive may be to seek the safety of high-quality sovereign bonds, given current yields**. Therefore, our call to keep a cool head and bet on those asset classes that offer the best relative valuations

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of November 15, 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

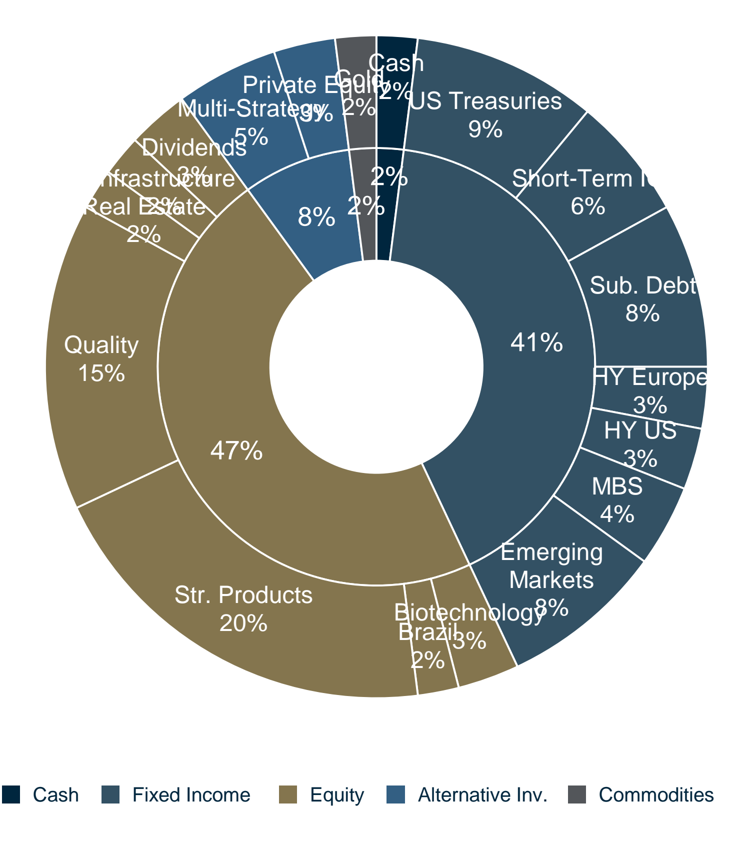
End of trade dispute, improvement in macro-data globally, lower geopolitical tensions

Other risks

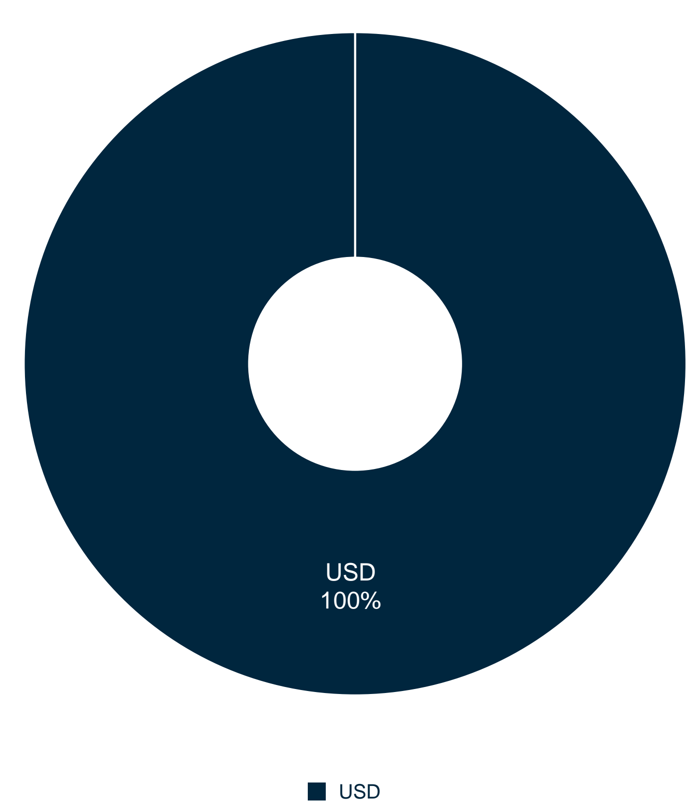
Trade wars, Hard Brexit, Spread of populist political parties, China slowdown, Terrorism

Boreal Model Portfolio Balanced USD

Asset Allocation



Currency Allocation



	Conservative	Conservative (Strategic Asset Allocation)	Balanced	Balanced (Strategic Asset Allocation)	Growth	Growth (Strategic Asset Allocation)
Cash	3%	5%	2%	5%	1%	5%
Fixed Income	58%	64%	41%	43%	27%	22%
Equities	33%	24%	47%	38%	60%	52%
Commodities	2%	2%	2%	4%	2%	6%
Alternative Investments	4%	5%	8%	10%	10%	15%

▼ Strategic Asset Allocation

Boreal Model Portfolio – Asset Allocation evolution

60%
50%
40%
30%
20%
10%
0%

2015 2016 2017 2018 2019

Cash Fixed Income Equities Alternatives Commodities

14% 12% 10% 8% 6% 4% 2% 0%

7% 6% 5% 4% 3% 2% 1% 0%

2015 2016 2017 2018 2019

1Y VaR 99% Boreal Balanced (lhs) — 1Y Std. Dev Boreal Balanced (rhs) - - - 1Y Std. Dev Benchmark (rhs)

[1] As of November 15, 2019
Source: Bloomberg

Boreal Model Portfolio – Peer comparison

14%
10%
6%
2%
-2%
-6%
-10%
-14%

Dec 17 Feb 18 Apr 18 Jun 18 Aug 18 Oct 18 Dec 18 Feb 19 Apr 19 Jun 19 Aug 19 Oct 19

Janus Balanced Fund
Invesco Balanced Risk Allocation Fund
Investec Global Strategic Managed Fund
Templeton Global Income Fund
UBS Global Allocation
PIMCO Global Multi-Asset Fund
UBAM Multifunds Allocation 50
Julius Baer Strategy Balanced
BlackRock Global Allocation Fund
Nordea Stable Return Fund
Schroder Global Multi-Asset Flexible
BNY Mellon Global Real Return Fund
JPMorgan Global Balanced Fund
Carmignac Patrimoine
MWM Balanced USD

- **Total Return** (Ytd[1]): **9th out of 15**
- **Standard Deviation** (1 year[1]): **2nd out of 15**
- **Downside Risk** (1 year[1]): **3rd out of 15**
- **Sharp Ratio** (1 year[1]): **2nd out of 15**

[1] As of November 15, 2019

Source: Bloomberg

Boreal Model Portfolio – Ytd performance

14% 12% 10% 8% 6% 4% 2% 0% -2%

Dec 18 | Jan 19 | Feb 19 | Mar 19 | Apr 19 | May 19 | Jun 19 | Jul 19 | Aug 19 | Sep 19 | Oct 19

Boreal Balanced USD — Benchmark

- **Total Return** (Ytd[1]): **11.11%** vs. **12.58%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **4.29%** vs. **4.79%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **3.20%** vs. **3.40%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **2.75** vs. **2.95** Benchmark[2]

[1] As of November 15, 2019

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

5%
3%
1%
-1%
-3%
-5%

2013 2014 2015 2016 2017 2018 2019

■ Boreal Balanced USD ■ Benchmark

- **Total Return** (1 year[1]): **8.42%** vs. **10.28%** Benchmark[2]
- **Total Return** (3 year[1]): **13.51%** vs. **23.07%** Benchmark[2]
- **Total Return** (Since Jan 13[1]): **25.87%** vs. **39.02%** Benchmark[2]

[1] As of November 15, 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)

40%
30%
20%
10%
0%
-10%
-20%

2013 2014 2015 2016 2017 2018 2019

Difference — Boreal Balanced USD — Benchmark

- **Standard Deviation** (1 year[1]): **4.29%** vs. **4.79%** Benchmark[2]
- **Downside Risk** (1 year[1]): **3.20%** vs. **3.40%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **1.48** vs. **1.72** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.47%** vs. **-0.49%** Benchmark[2]

[1] As of November 15, 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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