Investment Policy

December 2019

BOREAL CAPITAL MANAGEMENT

Our market view in a nutshell – December 2019

- As we approach the end of a year that has witnessed a **historic rebound in financial markets**, with all major asset classes showing double-digit gains, optimism is increasing among investors. However, it is important to keep in mind that **the economy remains at a critical juncture** and that weakness in the manufacturing sector can begin to translate into job losses and a decrease in consumer confidence

- Hopes for an improvement in economic activity are being driven by the **growing likelihood of a trade agreement between the US and China**, which would remove the uncertainty faced by corporations when making investment decisions. However, there is a **risk that the causes of the slowdown may be deeper**, and that industrial activity will continue to slow down despite an agreement

- Meanwhile, **central banks are making sure the market is flushed with liquidity**, so that financial conditions remain very favourable. It is very unlikely that this situation will be reversed until it is clear that the global economy is growing strongly and inflation is picking in a clear and sustained manner

- As a result, **long-term interest rates will remain low for a long period of time**, but this does not mean that they cannot increase from current levels. If the economic cycle is finally prolonged, we see room for the 10-year Treasury bond yield to reach levels close to 3%

- Given this scenario we **continue regarding equities as the most attractive asset class**. Although at this point in the current bull market we can no longer count on margin growth and financial engineering to continue boosting profits, organic growth and free-cash flow yields are sufficient to provide further support to the stock market

- In fact, if there is only one certainty for next year, it is that **returns will be lower for most asset classes**. Therefore, the importance of **selecting instruments that generate yield, pay stable dividends and exhibit growth** in an environment of low growth and low interest rates

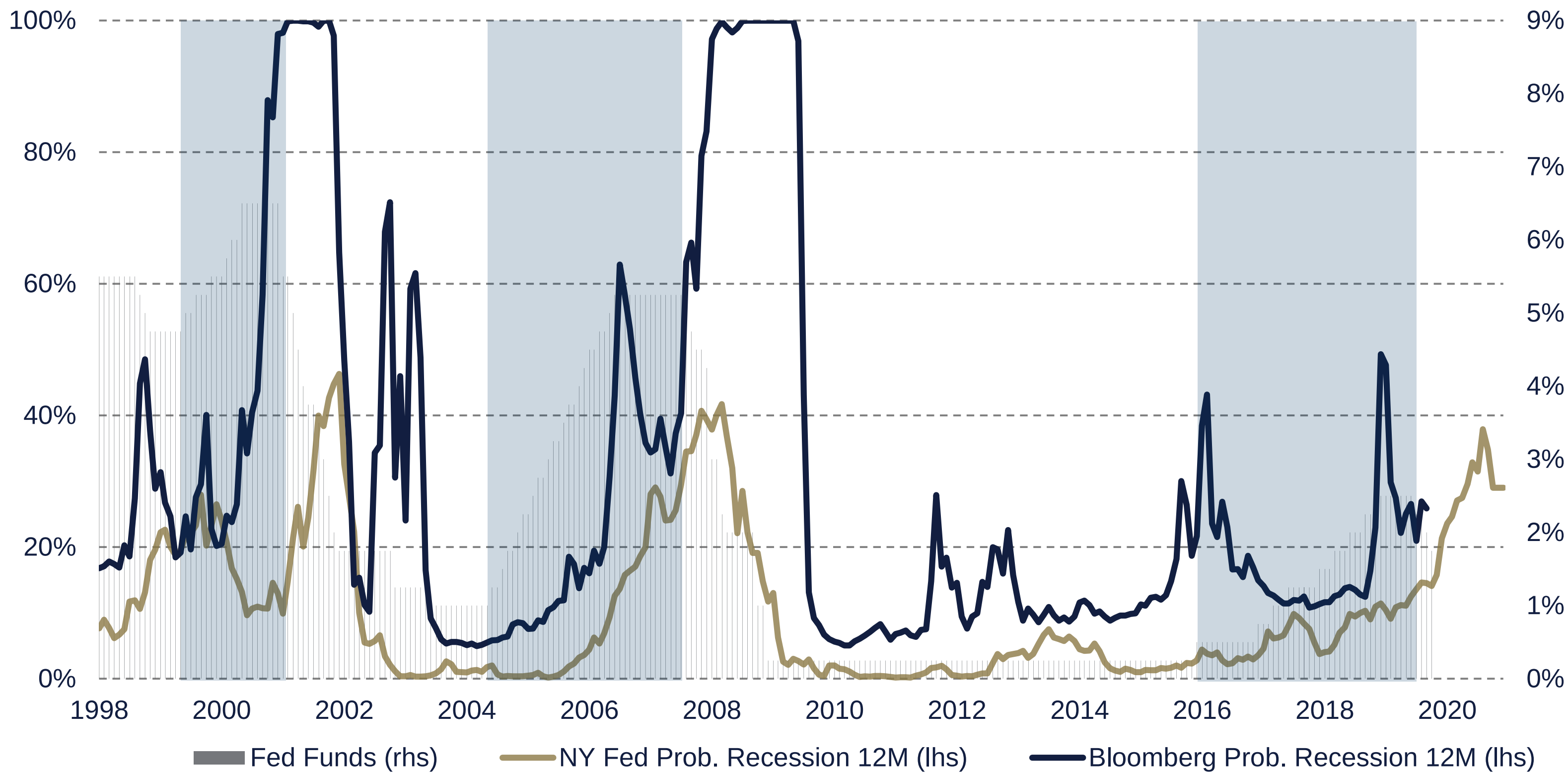
Boreal Investment Policy

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

Recession risk is not over

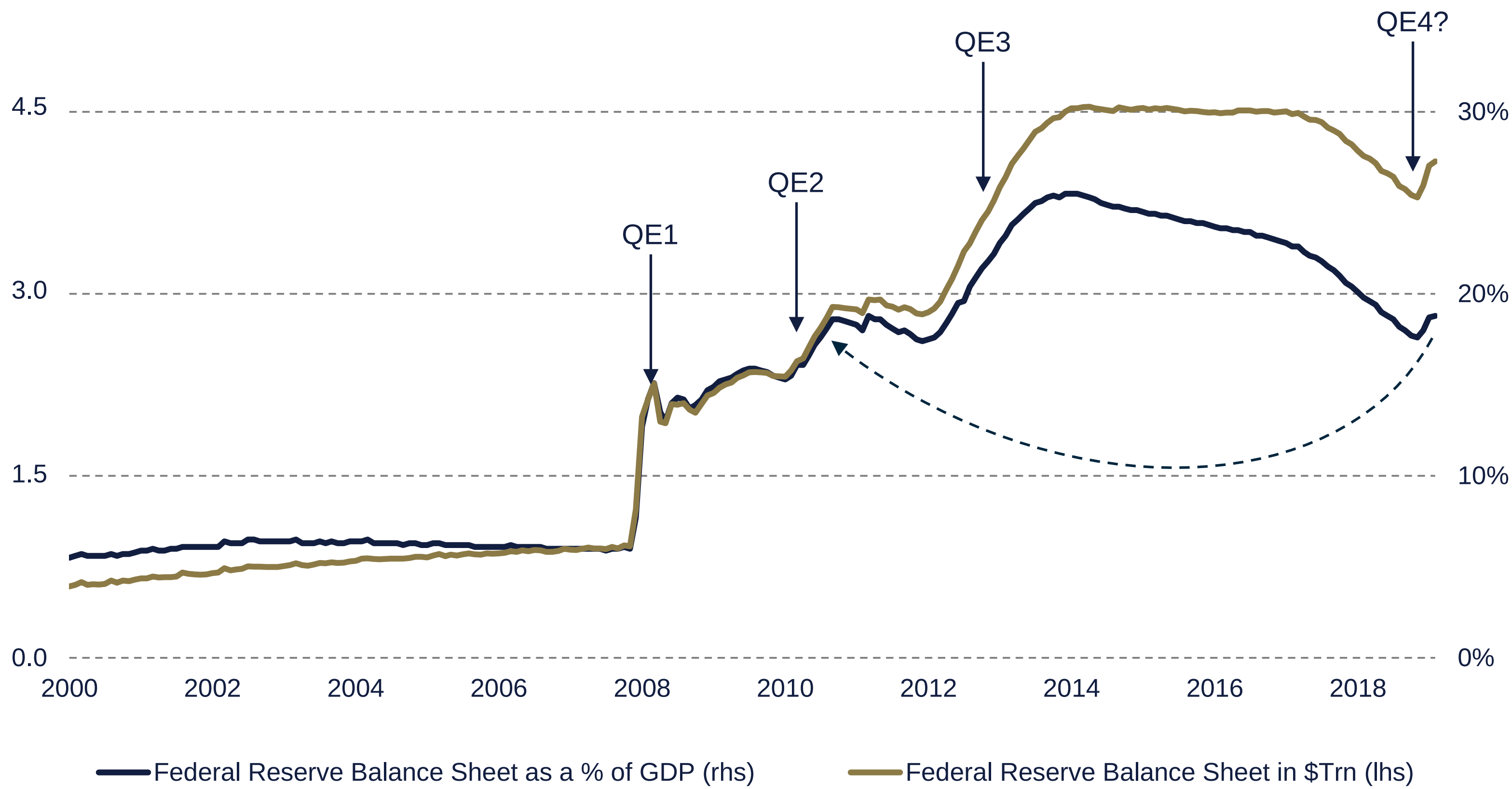
BOREAL CAPITAL MANAGEMENT



- In one year, the **investment consensus** has gone fro**m assigning a high probability of recession to discounting a trade agreement** that allows the economy to take a positive turn
- However, the economic slowdown is real and the **probability of recession remains high** under several metrics. Ultimately, **most recessions have been triggered by the Fed**, and it remains to be seen whether this time the monetary policy turn will be fast enough

Source: Bloomberg

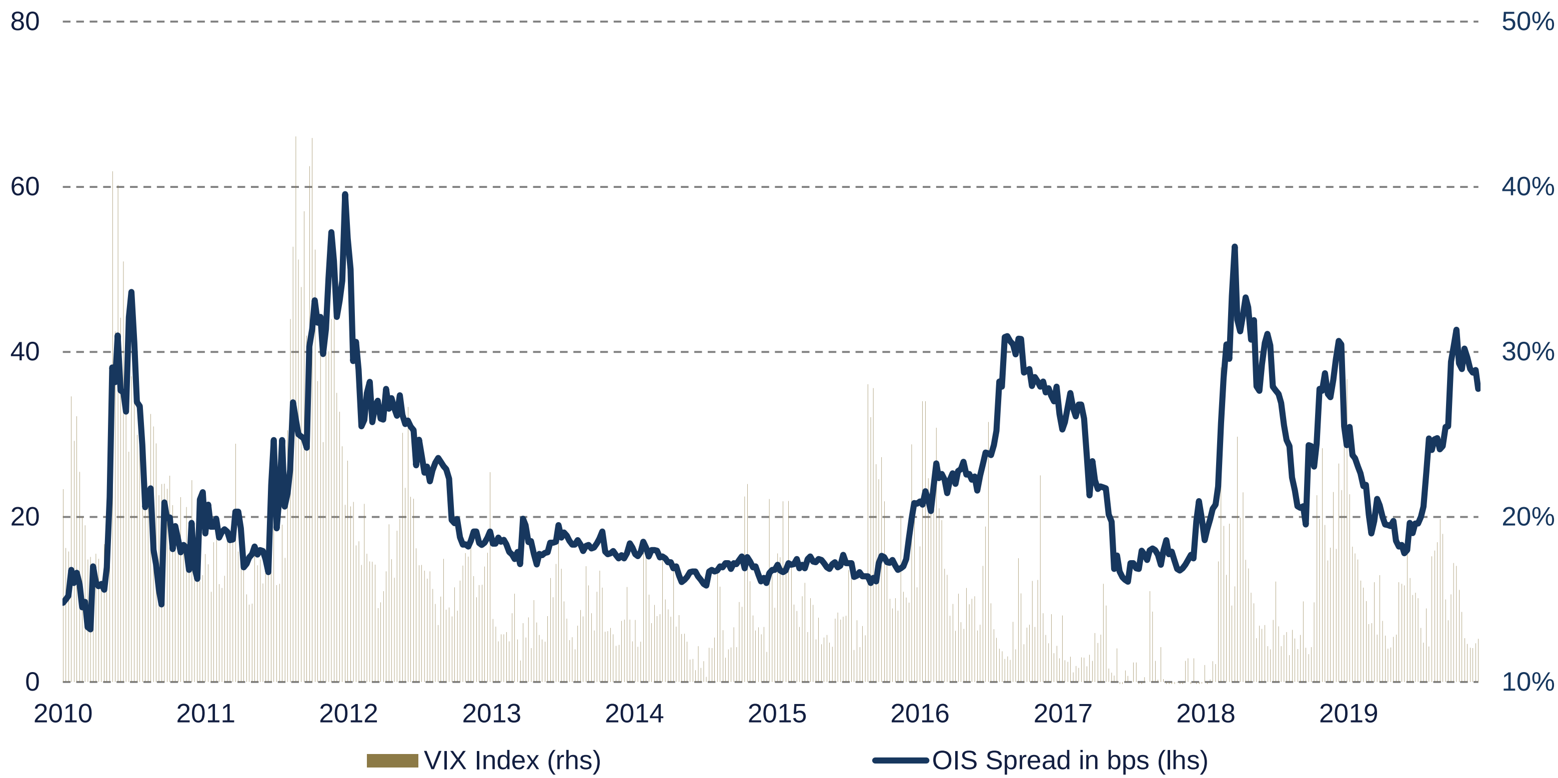
Central bank support is still needed



- The apparent **disconnection between stock markets reaching record highs and a decelerating economy** can mainly be attributed to the fact that **central banks have continued to provide abundant liquidity to the markets**
- This support is expected to continue, as it is clear that **central banks want to avoid a recession at all costs**

Source: Bloomberg

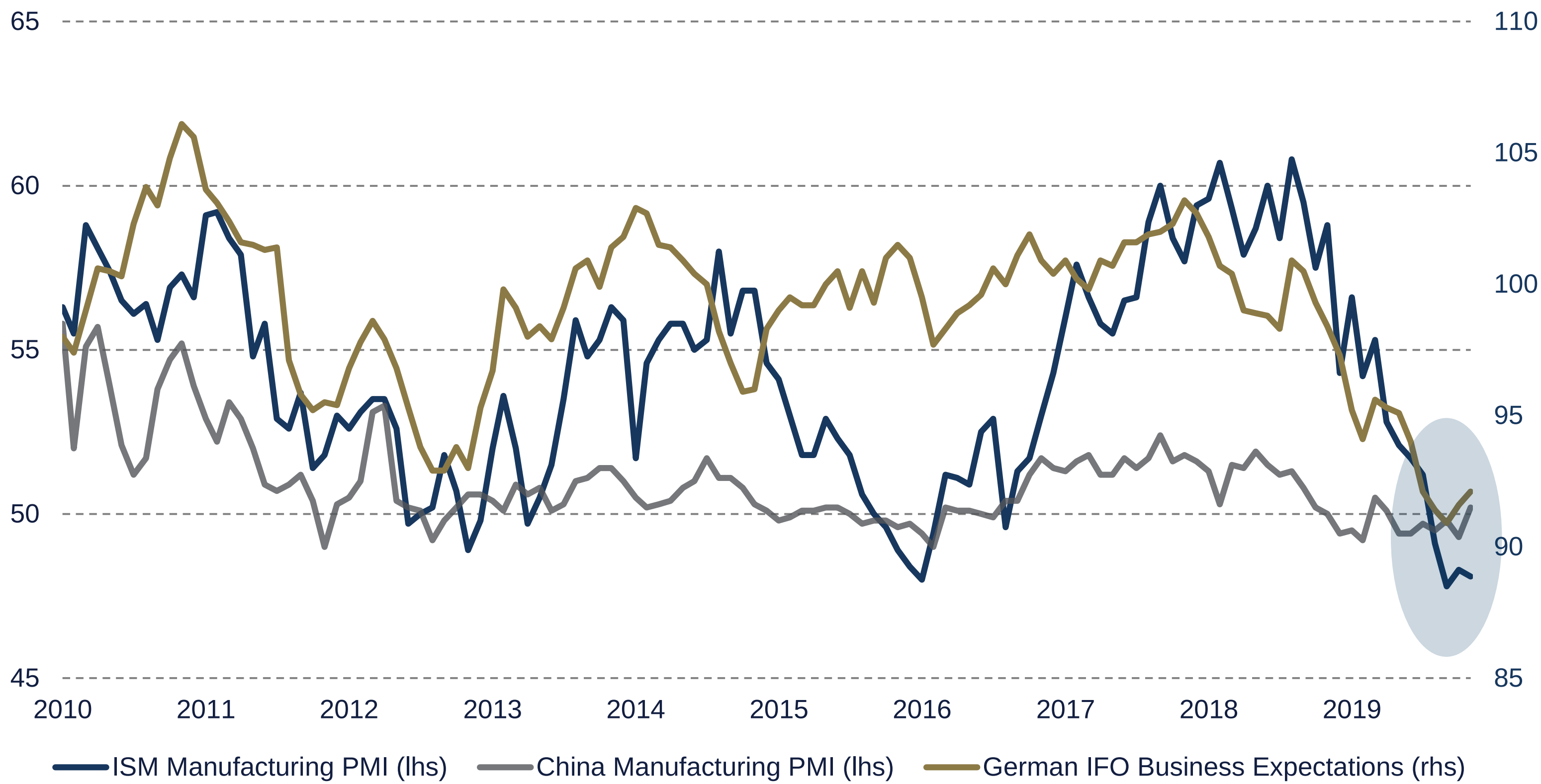
Liquidity must remain abundant



- Recent tensions in the money market have shown that **the process of reversing QE**, by letting current holdings expire without reinvesting them, **is not without risk**
- **The Fed has no need to reduce its balance** and, therefore, we believe that it will continue buying Treasury notes if it considers it appropriate

Source: Bloomberg

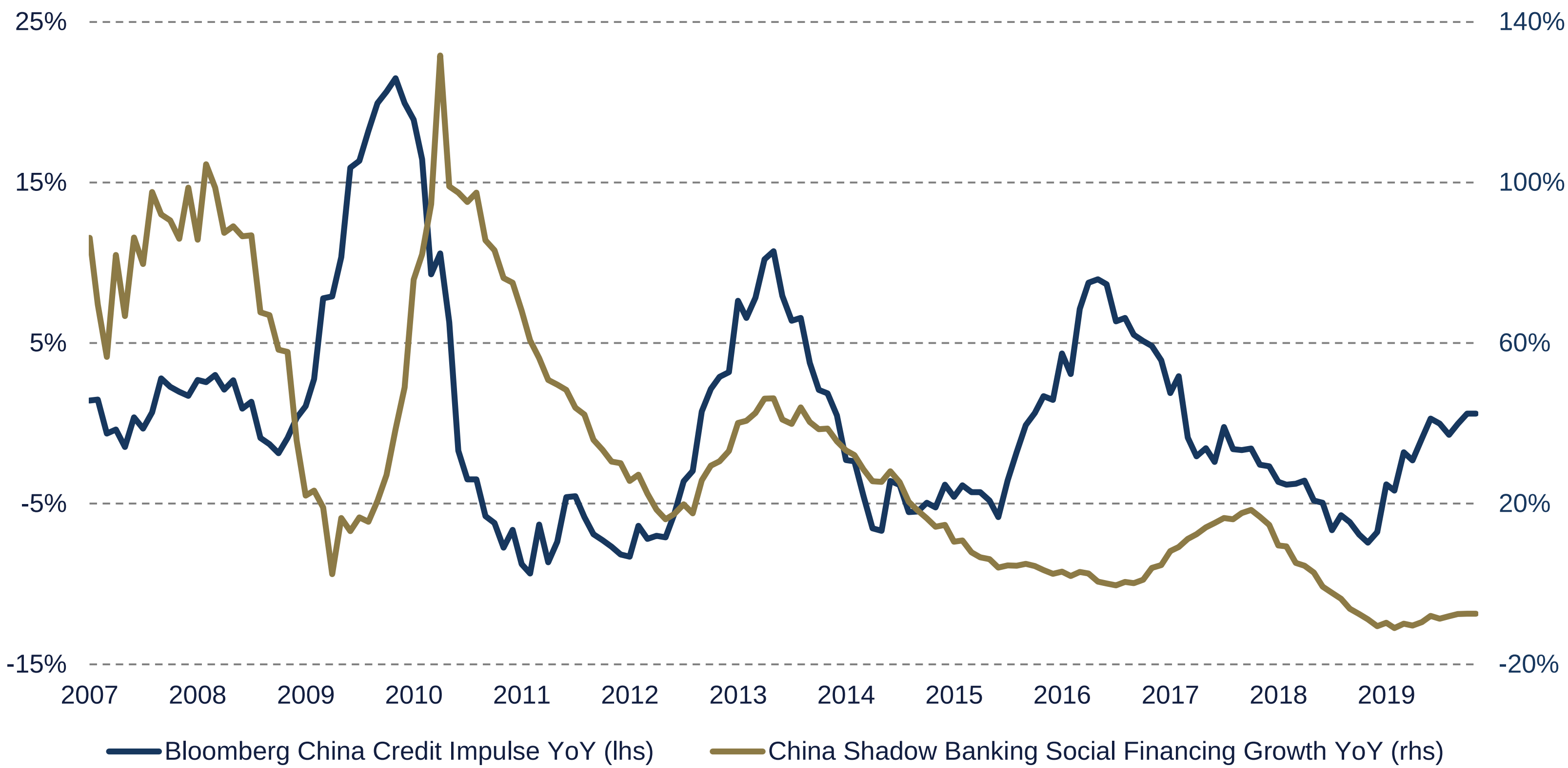
Too early to call



- In the last two months, **global manufacturing activity has shown incipient signs of being able to reverse the trend**, but it is still too early to declare a victory
- The **risk remains that the situation does not improve even though a commercial agreement is reached**

Source: Bloomberg

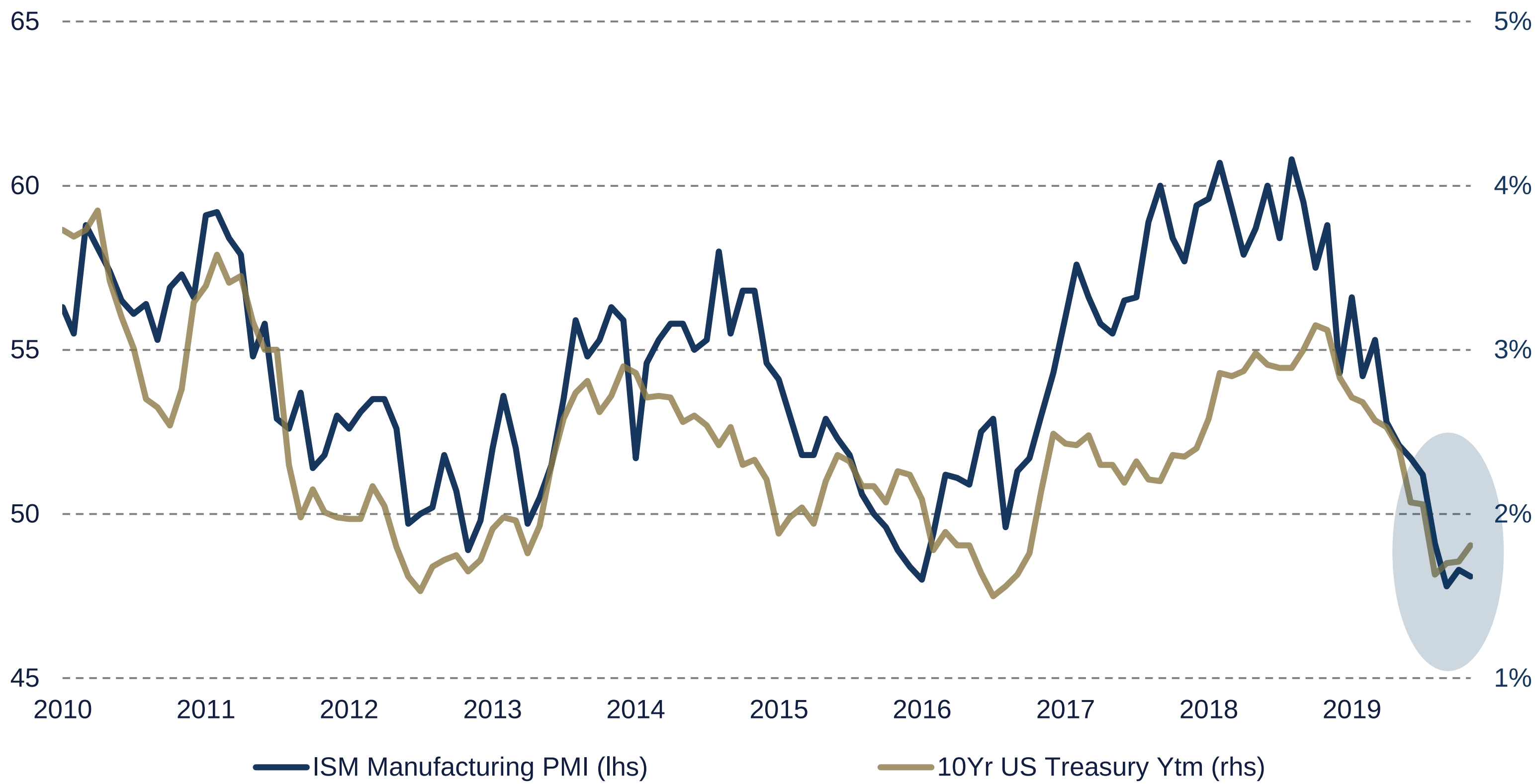
China’s slowdown masked by trade dispute



- One of the **disappointments in economic policy** this year has been the **limited scope of monetary and fiscal measures implemented by the Chinese authorities**
- The latter have **given priority to the financial deleveraging process**, as opposed to trying to reactivate the economy aggressively

Source: Bloomberg

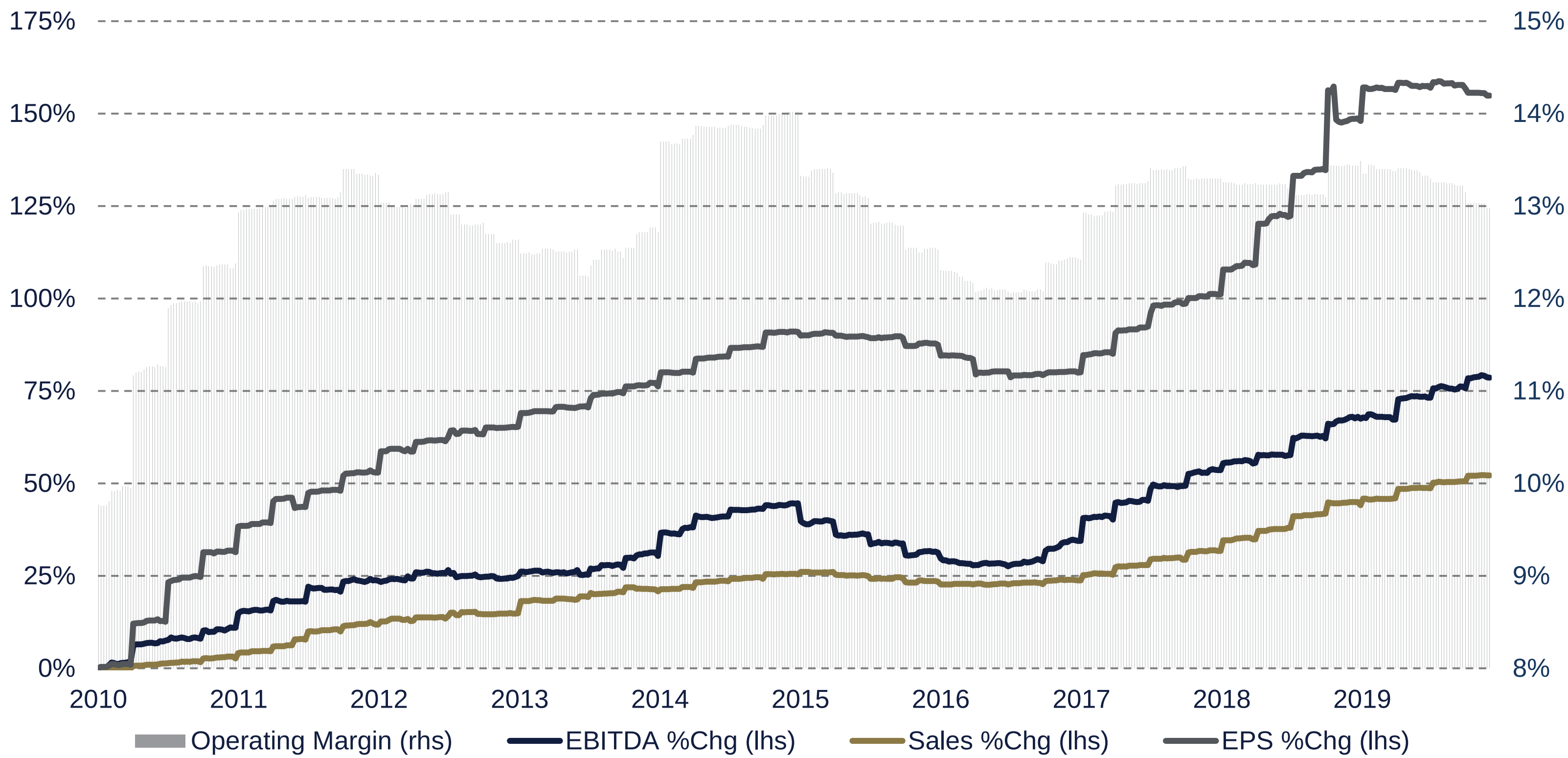
A pick up in activity is not all good news



- Although the expected pick up in activity will lower the risk of recession and be supportive of risk assets, we must not forget that **current equity and bond valuations are dependent on interest rates to remain low**

Source: Bloomberg

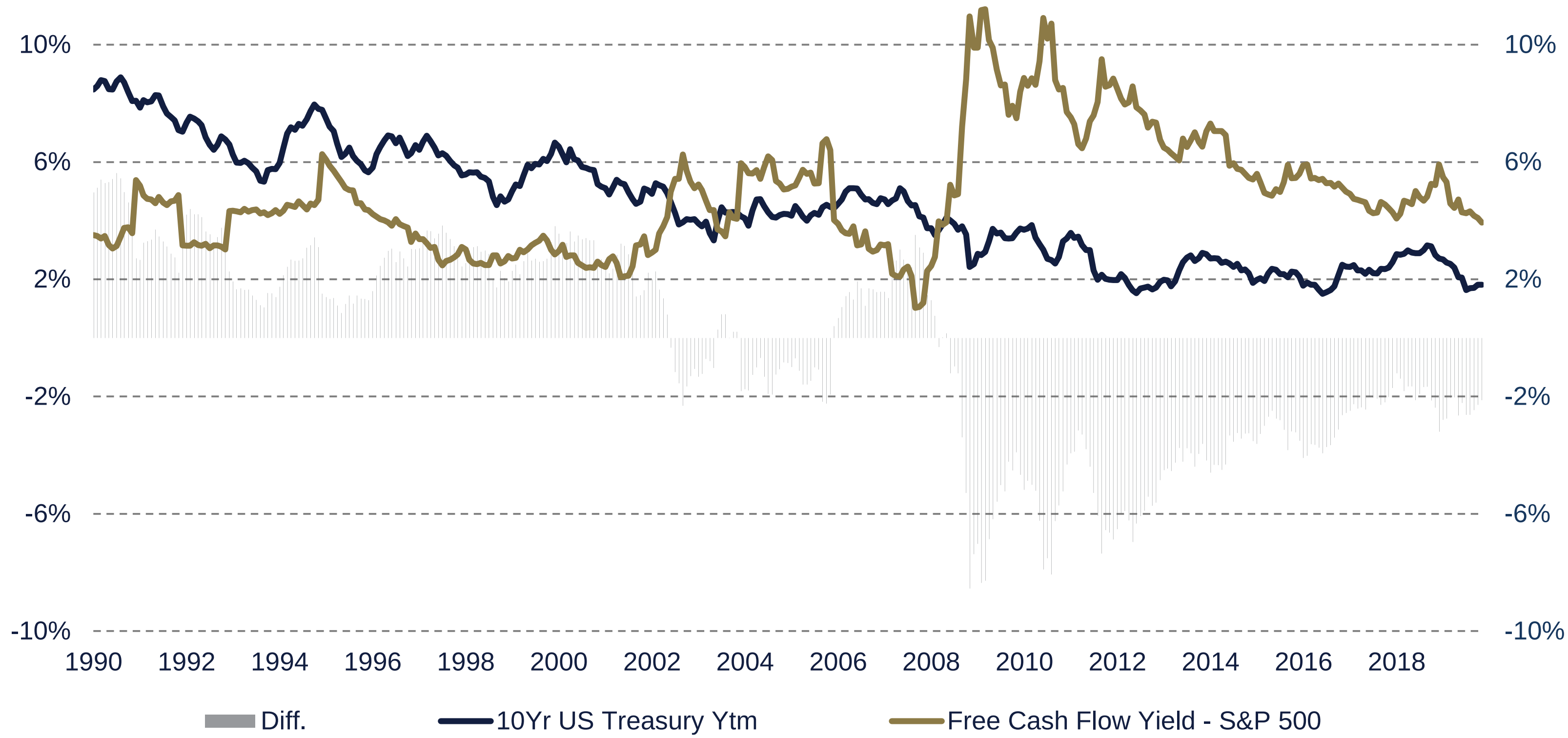
Corporates are in good shape, but margin to improve is low



• On the corporate front, we continue to observe an **unbroken trend in organic growth**. However, at this point in the current bull market, we can **no longer count on margin growth and financial engineering to continue boosting profits**

Source: Bloomberg

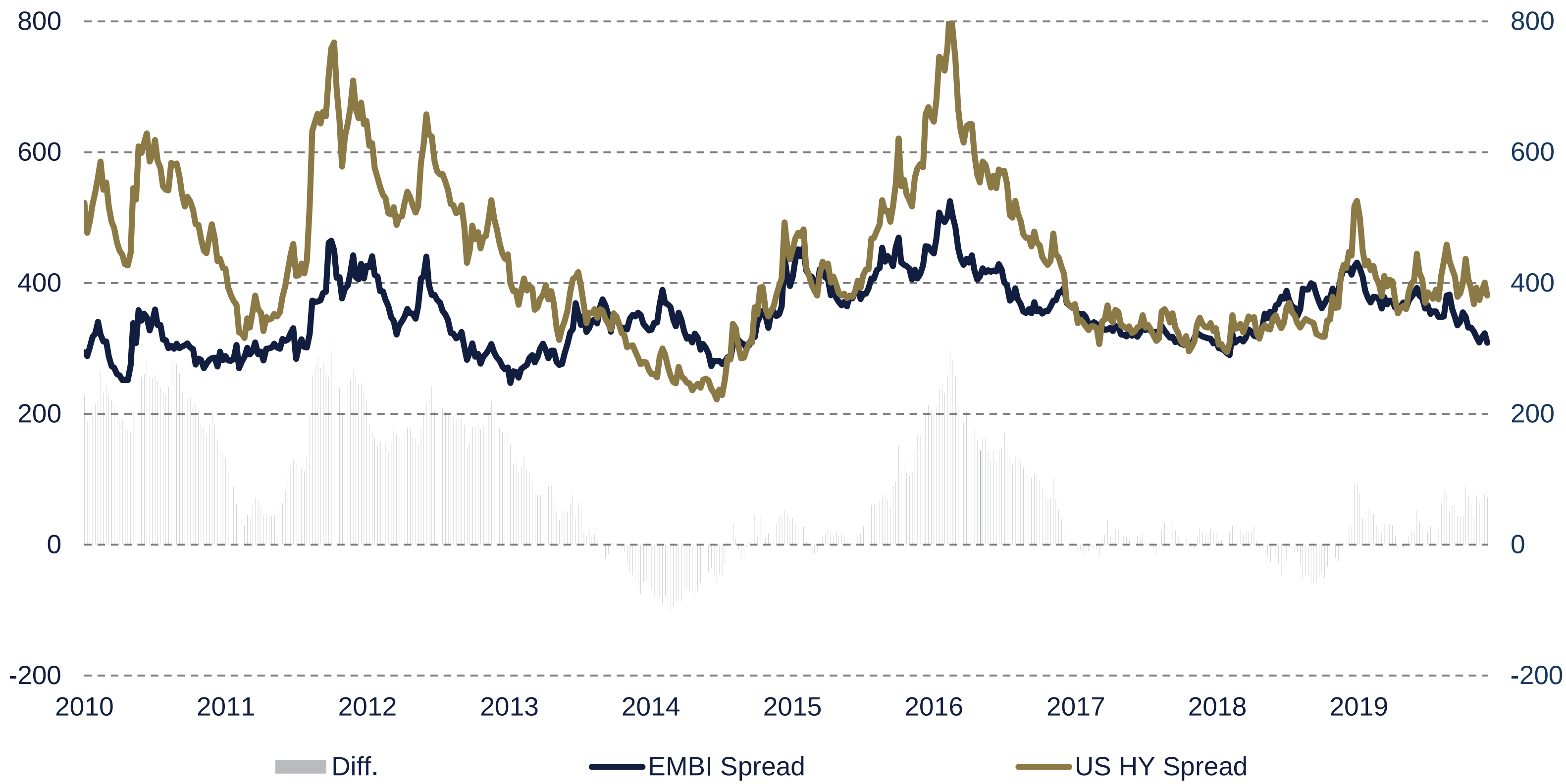
Equities remain the most attractive asset class



- On a relative basis, we continue to consider that **equities are the most attractive asset class**. This implies that if interest rates do not increase significantly, there is **still room for multiple expansion**
- However, **investors should lower their return expectations**, since in the future performance will be more closely linked to the underlying growth in corporate profits

Source: Bloomberg

Credit spreads are tight, but still offer carry



- **Credit spreads remain in their lowest range**. They are probably too **tight considering the uncertainties surrounding the direction of the global economy**, but they still offer enough carry to consider including them in the portfolios
- Comparing **between High Yield and Emerging Markets, the latter seem to have a slightly more attractive valuation**

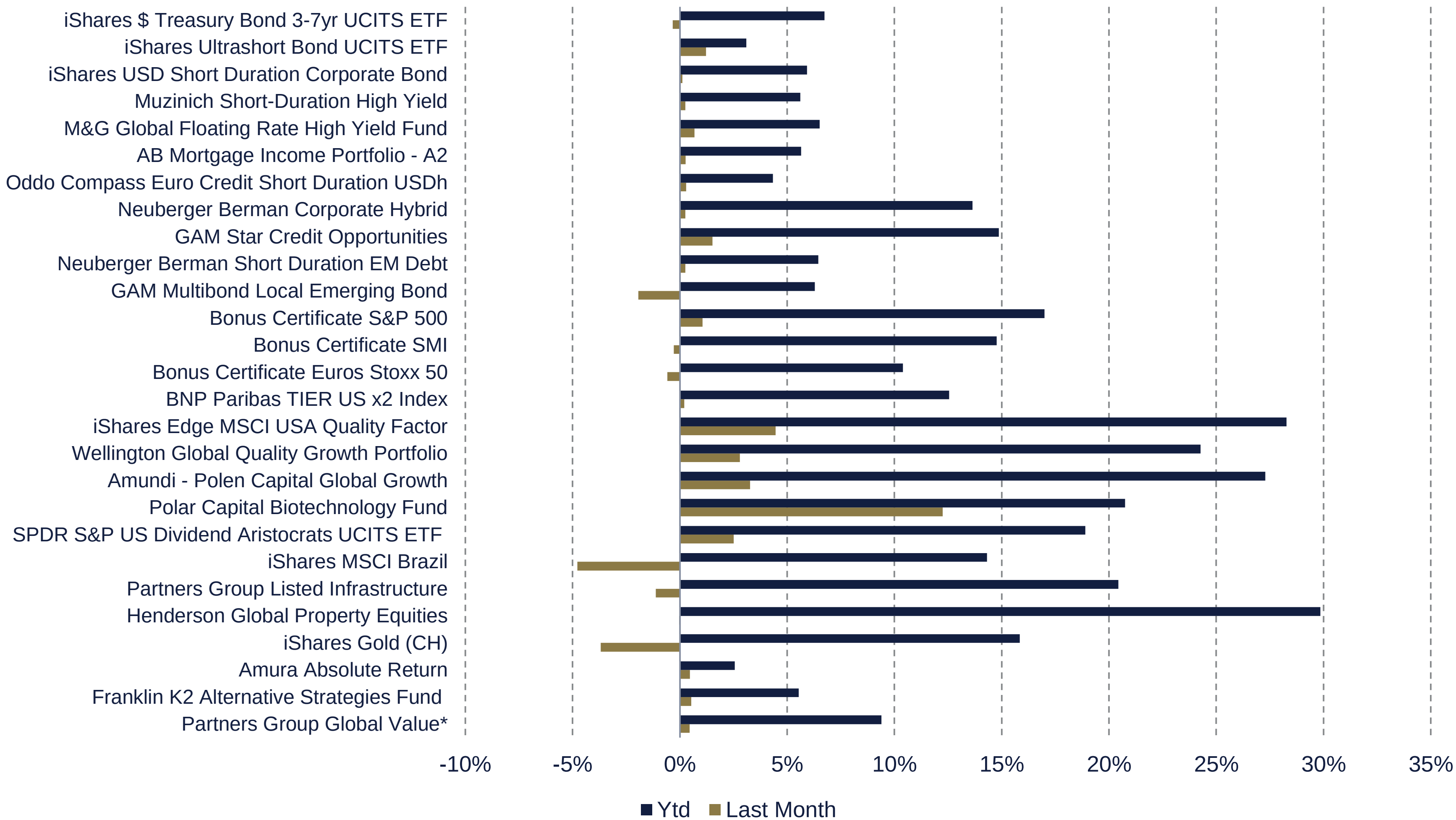
Source: Bloomberg

USD, more downside than upside risk

- The **fundamentals continue to support a strong US dollar**. However, there is a **greater risk that both, interest rates and growth differentials, will be narrowed**, rather than the opposite. This is one of the reasons behind our **tactical allocation to local currency emerging market debt**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of December 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

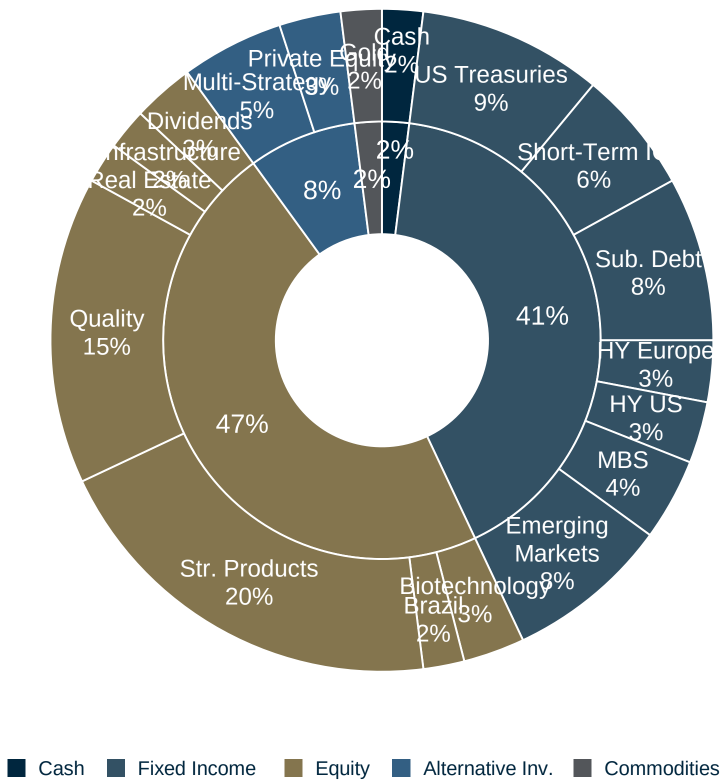
End of trade dispute, improvement in macro-data globally, lower geopolitical tensions

Other risks

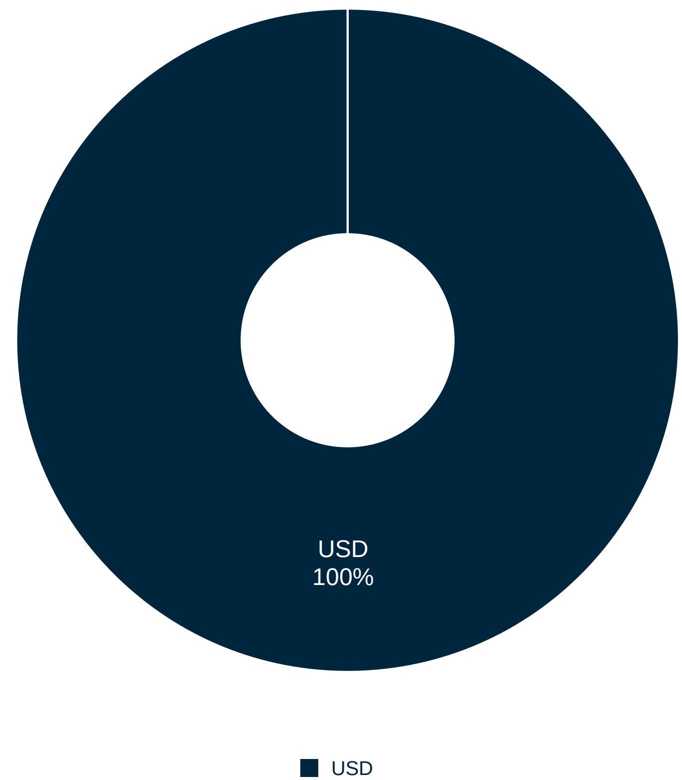
Trade wars, Hard Brexit, Spread of populist political parties, China slowdown, Terrorism, Hong Kong unrest

Boreal Model Portfolio Balanced USD

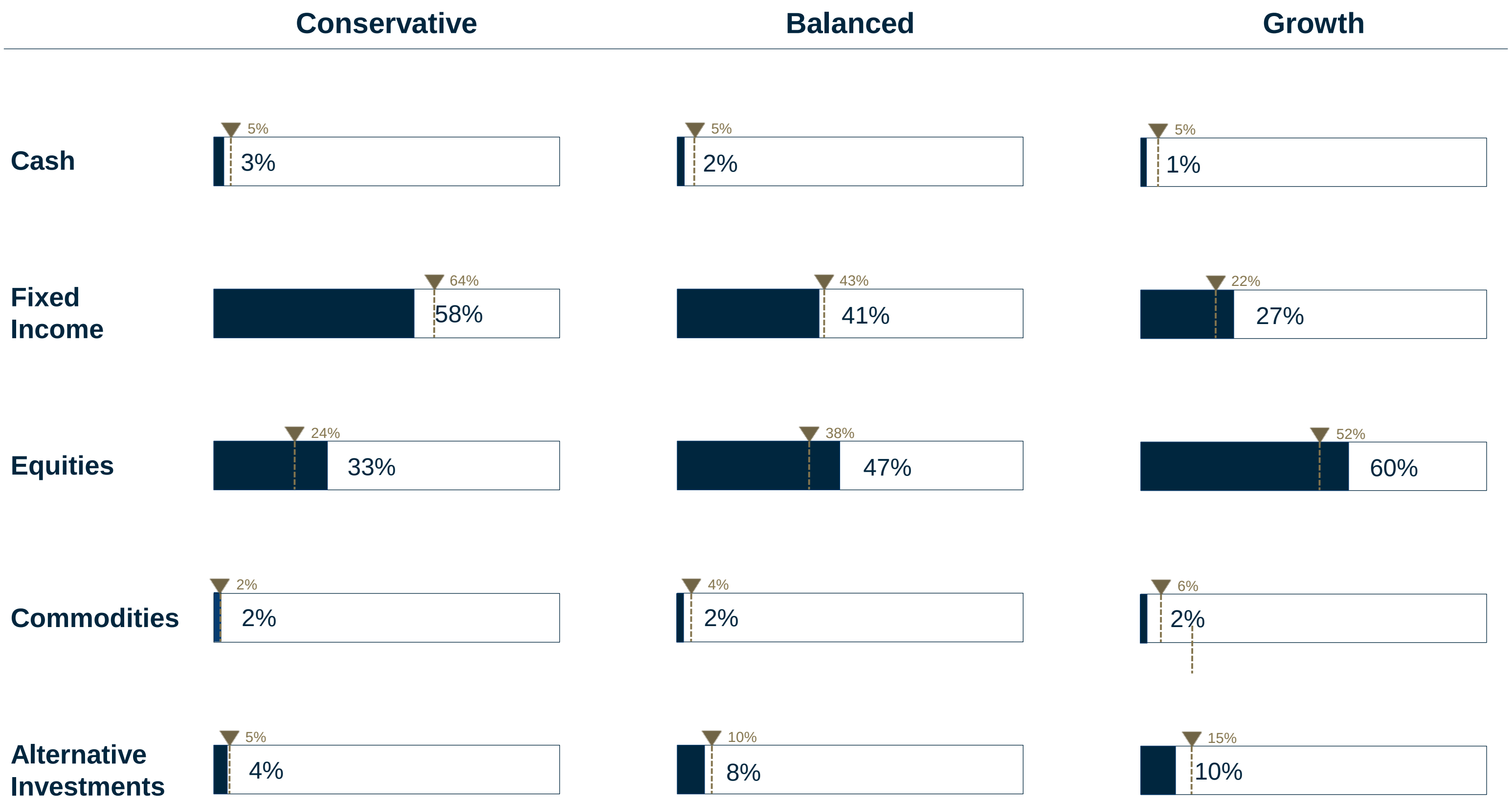
Asset Allocation



Currency Allocation

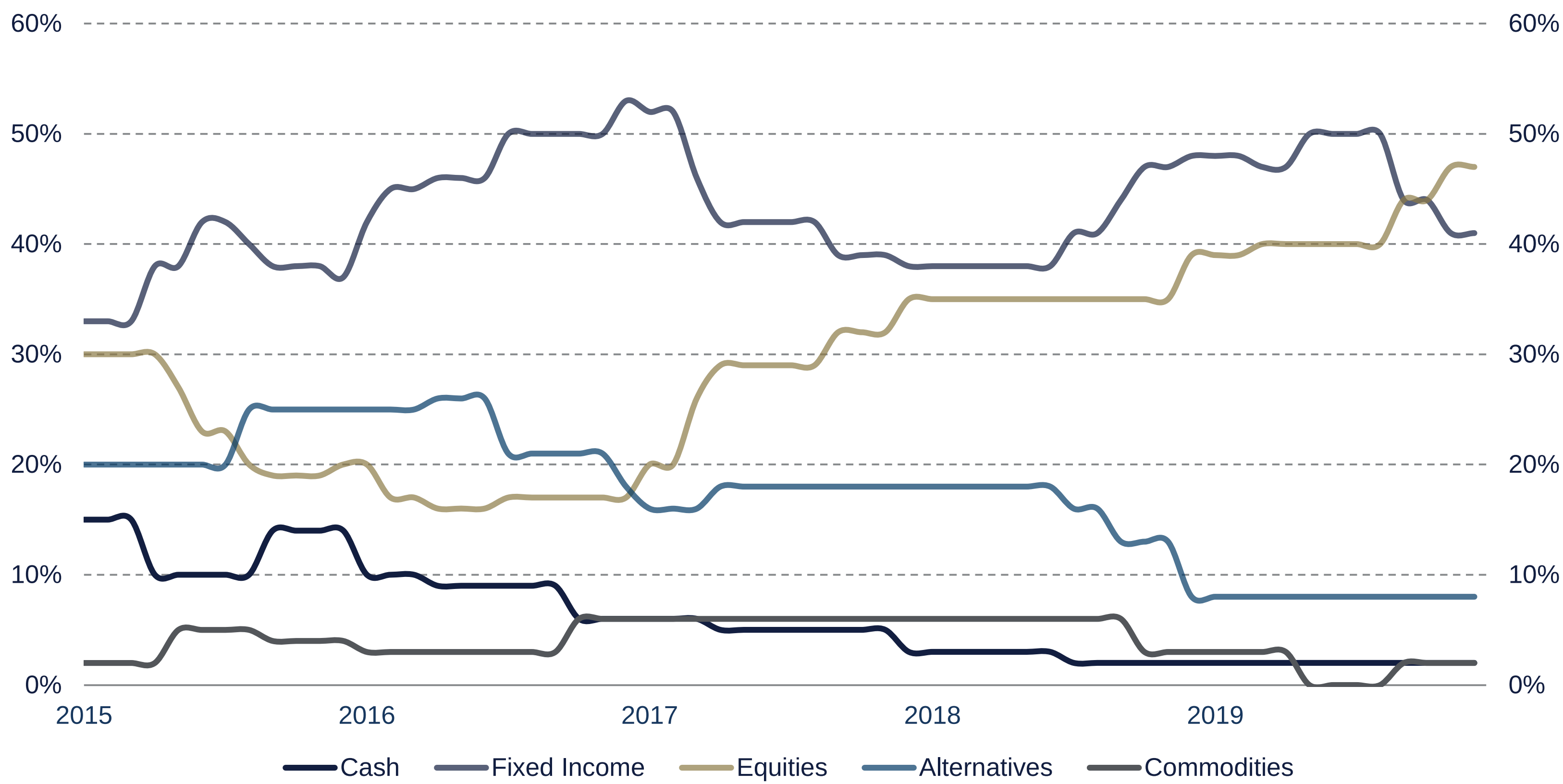


Boreal Investment Profiles

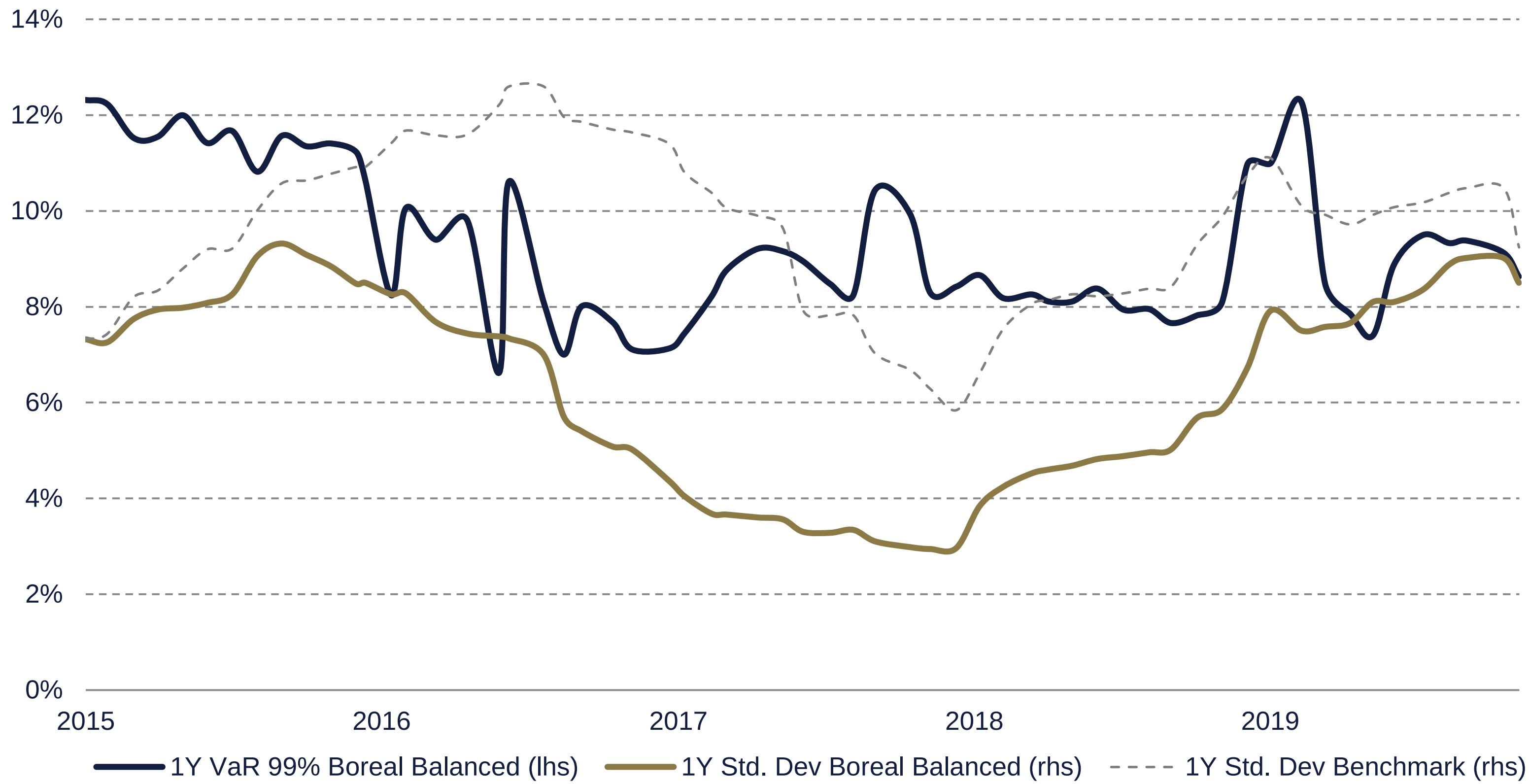


▼ Strategic Asset Allocation

Boreal Model Portfolio – Asset Allocation evolution

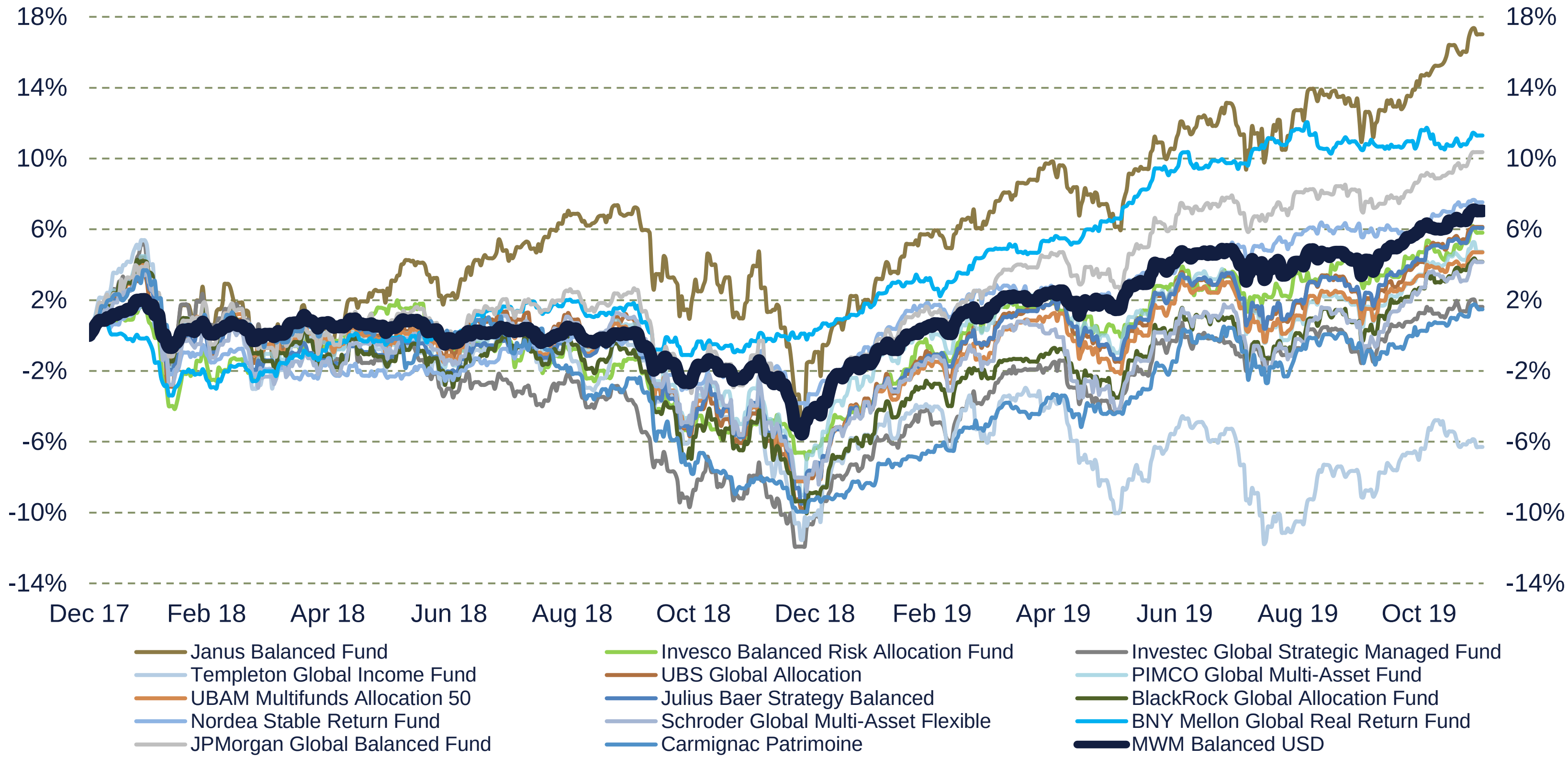


Boreal Model Portfolio – VaR evolution



[1] As of December 2, 2019
Source: Bloomberg

Boreal Model Portfolio – Peer comparison

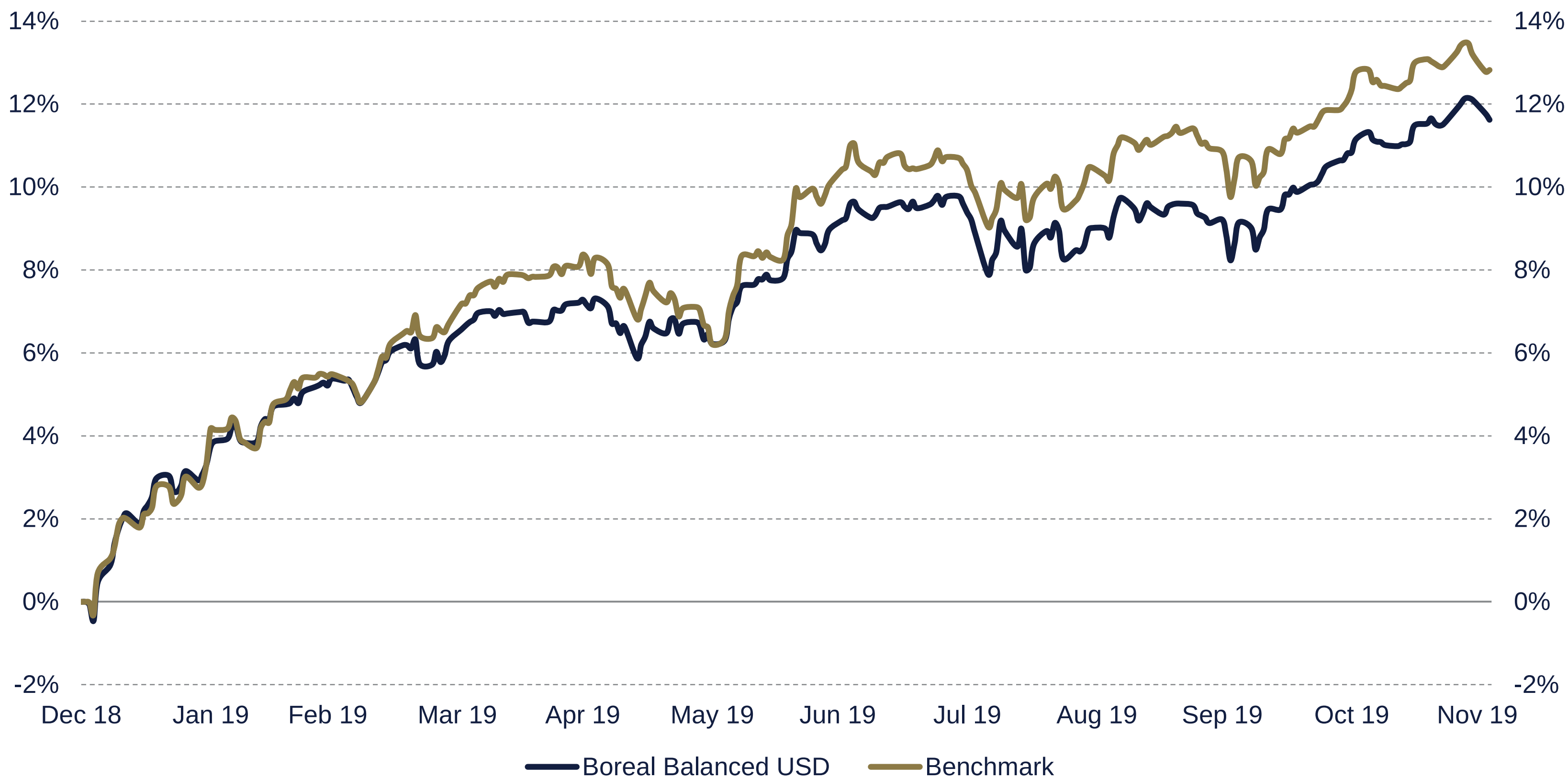


- **Total Return** (Ytd[1]): **10th out of 15**
- **Standard Deviation** (1 year[1]): **2nd out of 15**
- **Downside Risk** (1 year[1]): **3rd out of 15**
- **Sharp Ratio** (1 year[1]): **2nd out of 15**

[1] As of December 2, 2019

Source: Bloomberg

Boreal Model Portfolio – Ytd performance

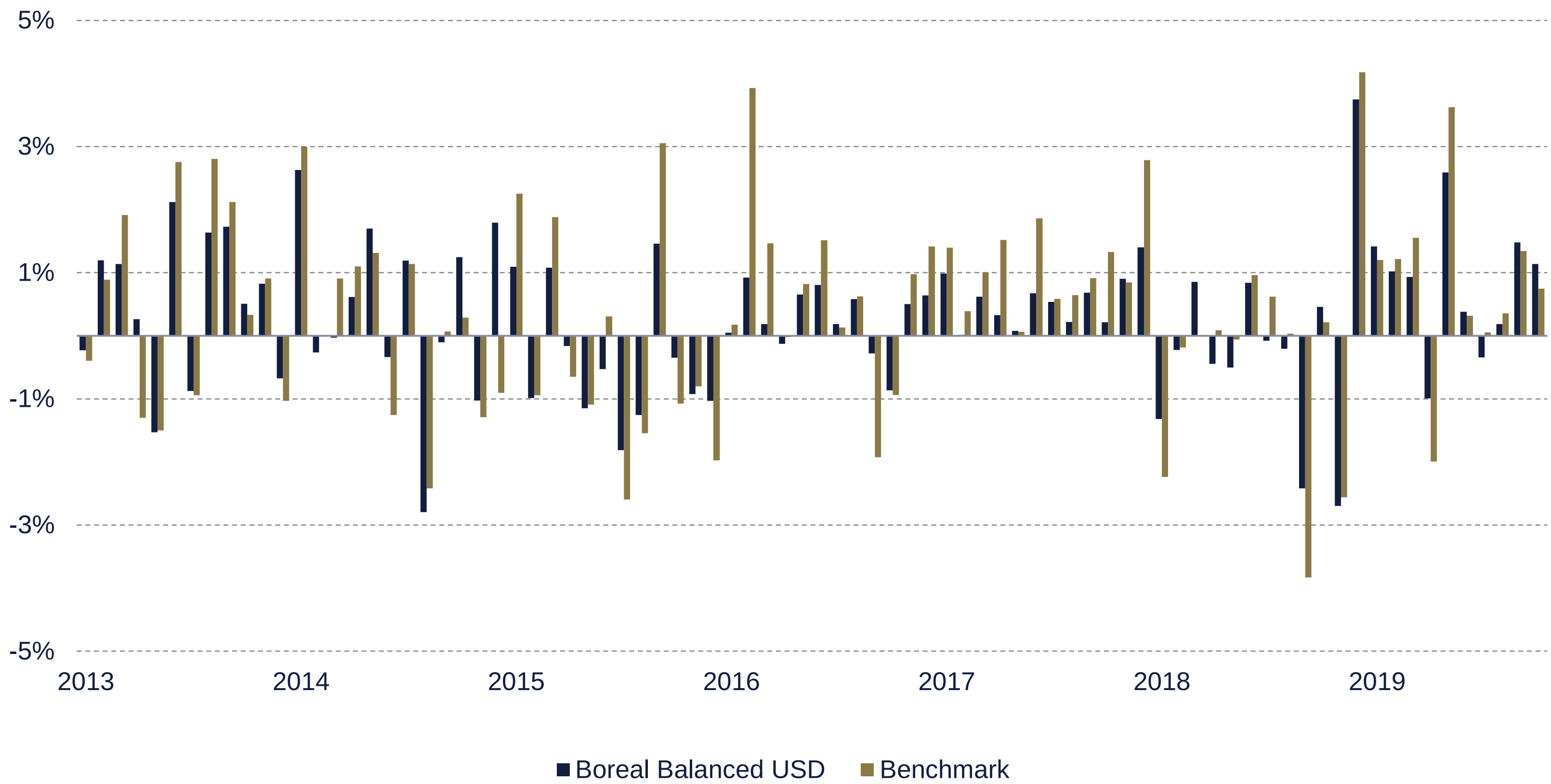


- **Total Return** (Ytd[1]): **11.77%** vs. **12.78%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.86%** vs. **4.18%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.86%** vs. **2.93%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **2.80** vs. **2.86** Benchmark[2]

[1] As of December 2, 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)

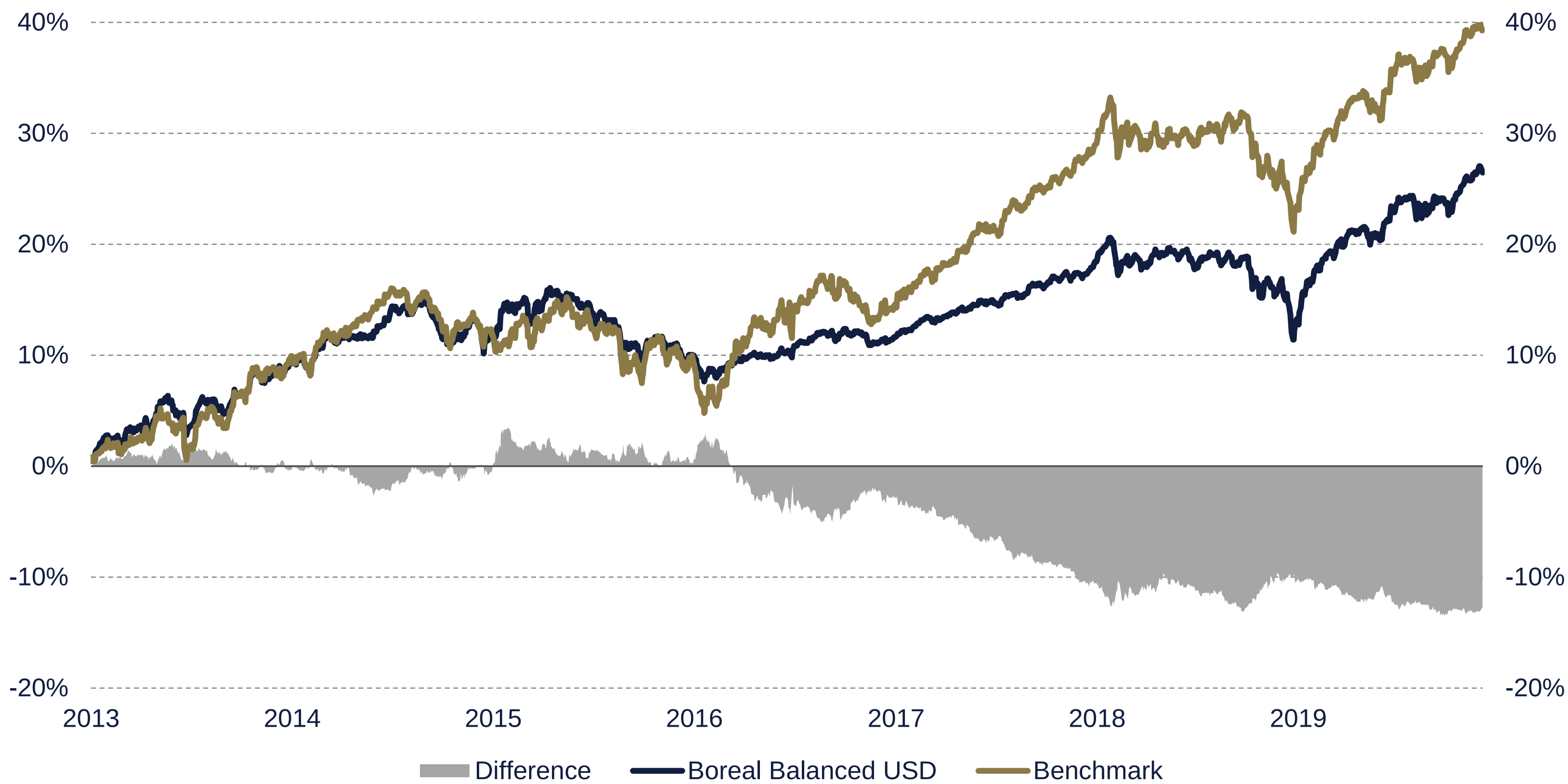


- **Total Return** (1 year[1]): **8.76%** vs. **9.90%** Benchmark[2]
- **Total Return** (3 year[1]): **13.93%** vs. **22.74%** Benchmark[2]
- **Total Return** (Since Jan 13[1]): **26.46%** vs. **39.31%** Benchmark[2]

[1] As of December 2, 2019

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

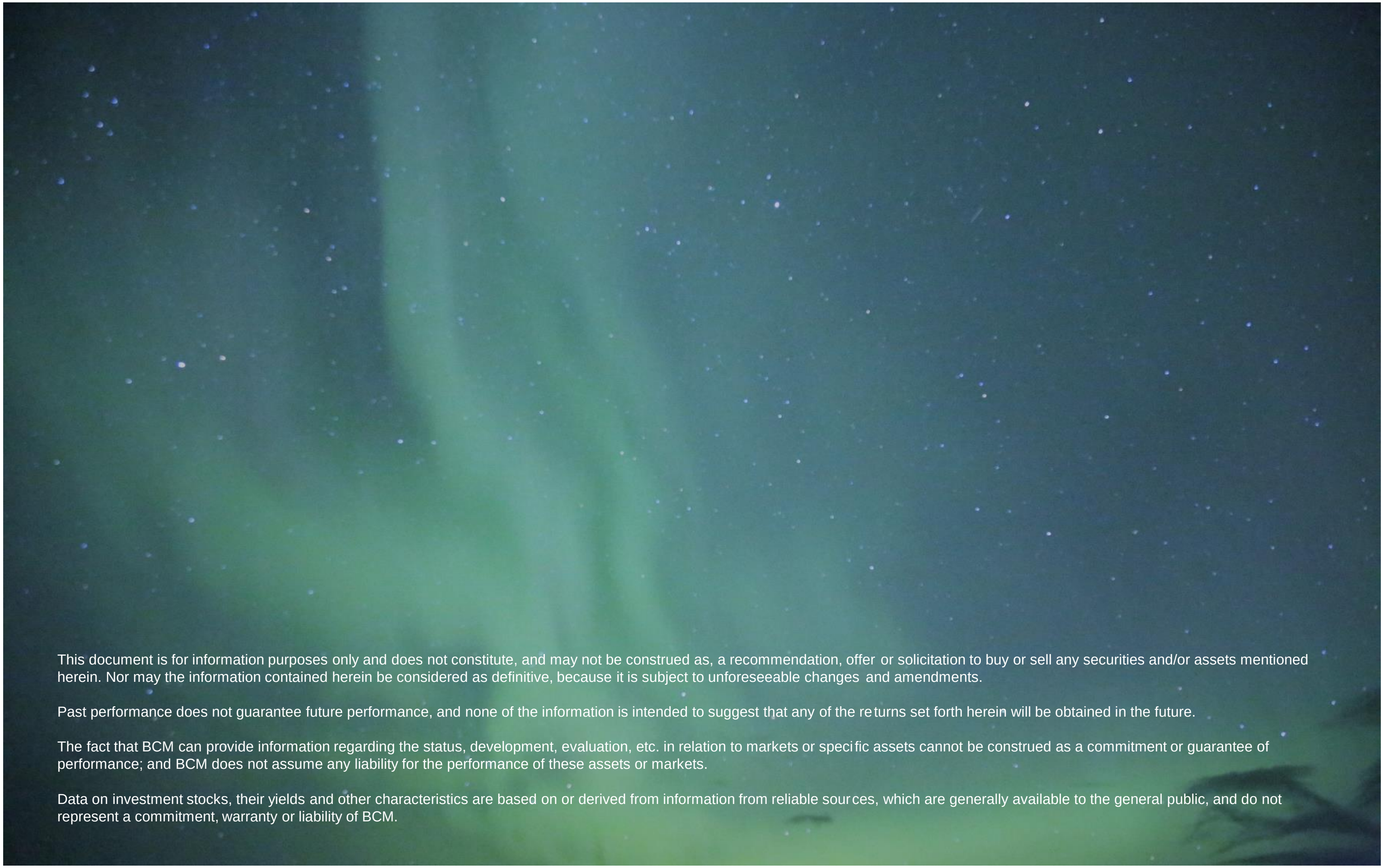
Boreal Model Portfolio – Historical performance (2)



- **Standard Deviation** (1 year[1]): **4.26%** vs. **4.66%** Benchmark[2]
- **Downside Risk** (1 year[1]): **3.17%** vs. **3.27%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **1.57** vs. **1.69** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.44%** vs. **-0.46%** Benchmark[2]

[1] As of December 2, 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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