Investment Policy

February 2020

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CAPITAL MANAGEMENT

Our market view in a nutshell – February 2020

- The new **coronavirus outbreak has dominated the headlines and shocked financial markets**. Although compared to the SARS epidemic, the new virus is proving to be less lethal, it is also becoming much more contagious, increasing the **risk of a global pandemic**. Fortunately, this time the Chinese authorities have reacted quickly and have taken decisive measures to stop the spread of the disease

- Currently, it is **still too early to judge whether the virus can be controlled**. The number of new cases will undoubtedly increase in the coming months, but in order to consider it as an isolated incident we need to observe a slowdown in the rate of disease spread

- Beyond the regrettable cost in human lives, **from an economic perspective**, we must try to **discern whether the effects caused by the disease will be irreversible** (destruction of capital or foregone consumption) **or transitory** (postponed investments or deferred consumption).

- More **harmful long-term effects can be ruled out**, since a vaccine should be ready in the coming months. However, the **Chinese economy will be negatively affected** and, depending on how seriously, there is a risk that the world economy may fall into a recession

- The epidemic has triggered a typical **“risk-off”** event in financial markets, with interest rates declining, volatility increasing, and credit spreads widening. However, **the correction seems excessive**, taking into account that **the probability that the new disease may cause an economic recession is low**

- The emergence of the coronavirus has **taken the focus away from the latest batch of macroeconomic data**, which points to a **worldwide synchronized recovery in manufacturing**. A lower probability of recession combined with extremely low interest rates continue to underpin risk assets. **Equities in particular continue offering a very attractive risk premium**, both in absolute terms (compared to its historical average) and in relative terms (compared to credit)

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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; 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

Epidemic or pandemic?

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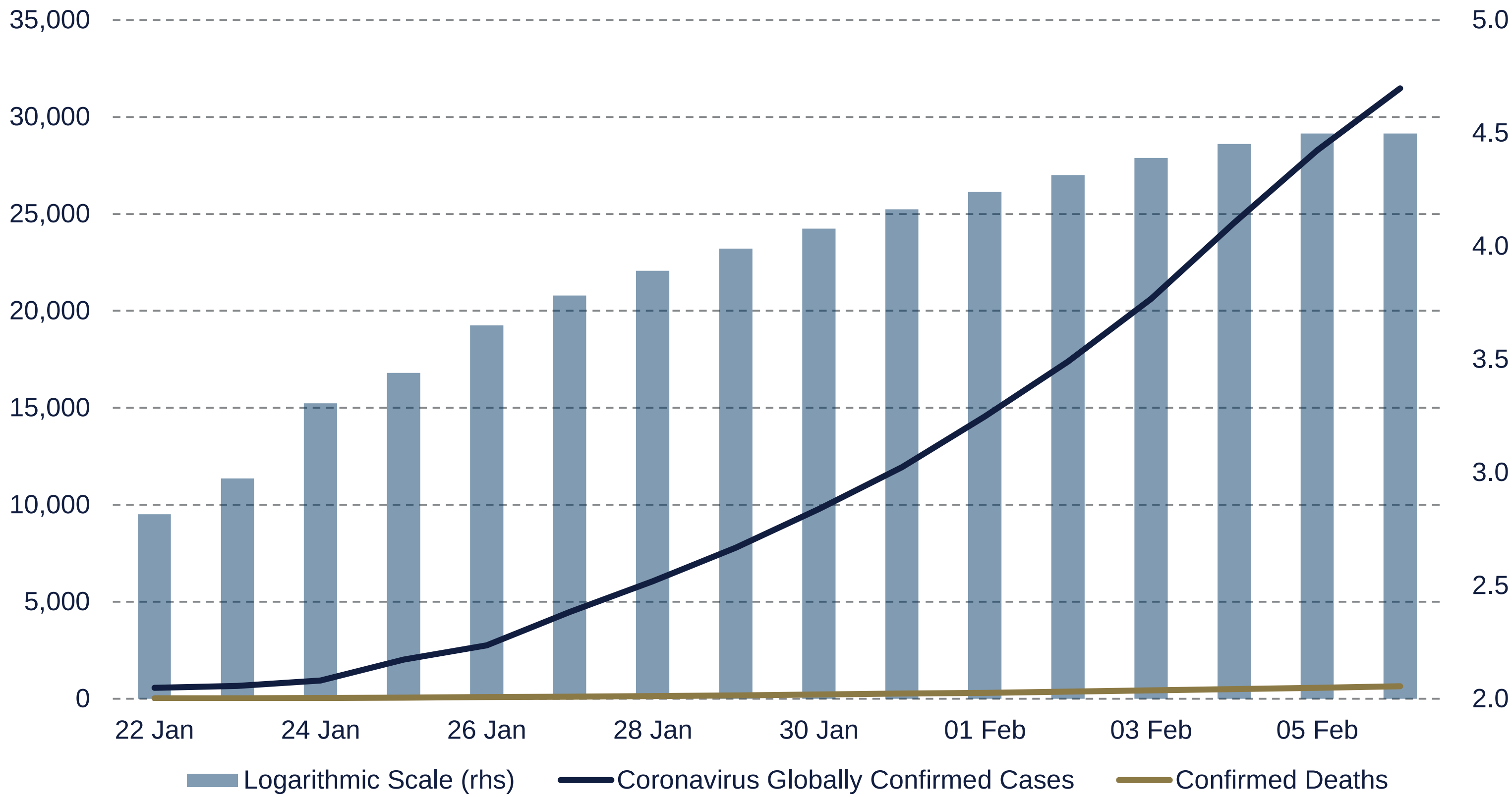
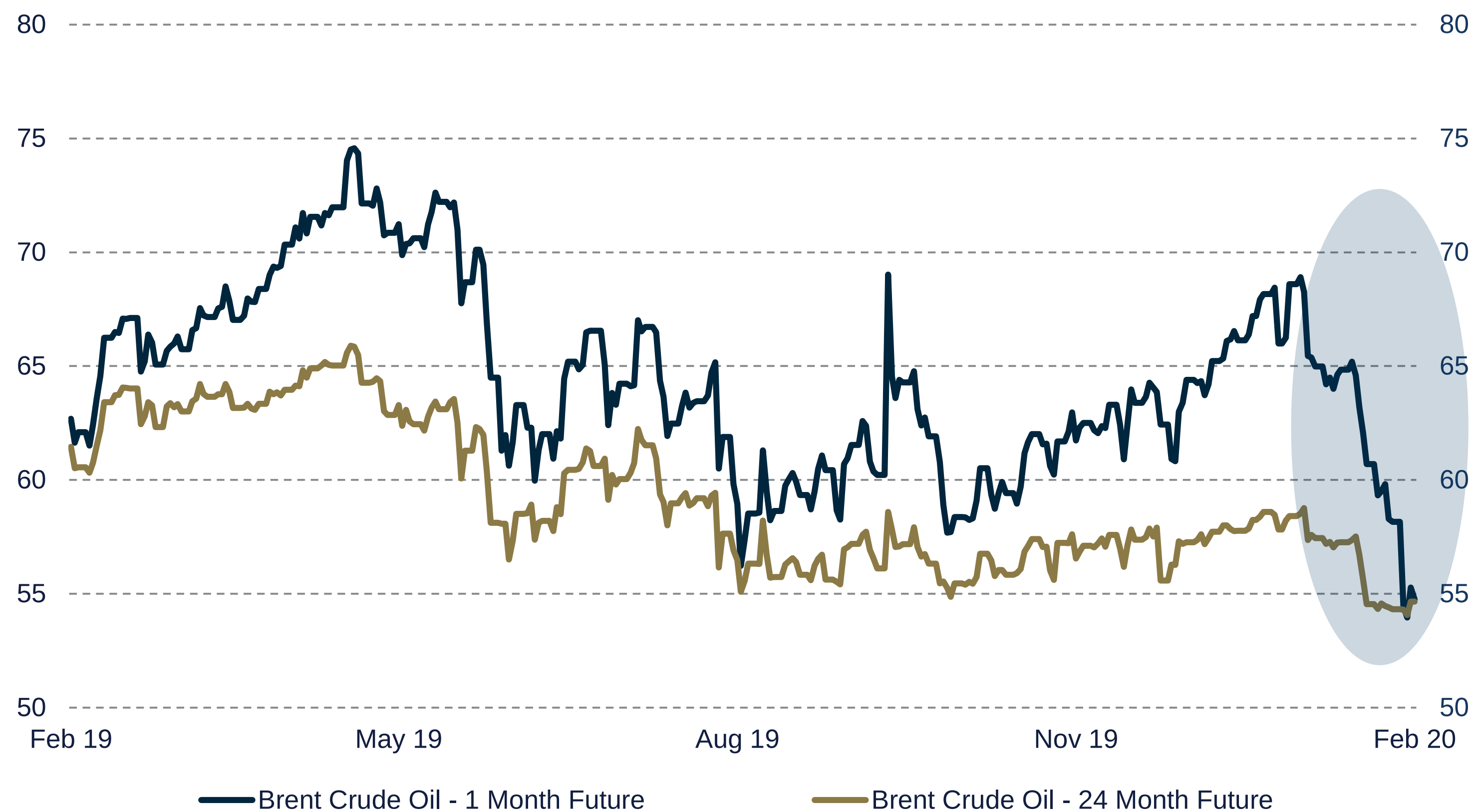


- The outbreak of the new coronavirus is a good example of what economists call **"external shocks"** events that can have a profound economic impact, but are impossible to predict
- Compared to the **SARS epidemic**, the new virus is proving to be more contagious, but less lethal. Another difference is that this time the Chinese authorities have reacted more quickly. At this time, it is **critical that the spread of the disease begin to show signs of being under control**

Source: Bloomberg

Long run vs. short run effects



- We are always exposed to this type of unfortunate events, from an economic point of view, the relevant thing is to **assess whether they can cause effects that are irreversible** (destruction of capital or foregone consumption) or transitory (postponed investments or deferred consumption)
- At the moment, it seems that the **Chinese economy is going to take the worst part** due to transport restrictions and lower commercial activity**. Second-order effects** will also be felt in the global economy, particularly in the raw materials, luxury and transportation sectors

Source: Bloomberg

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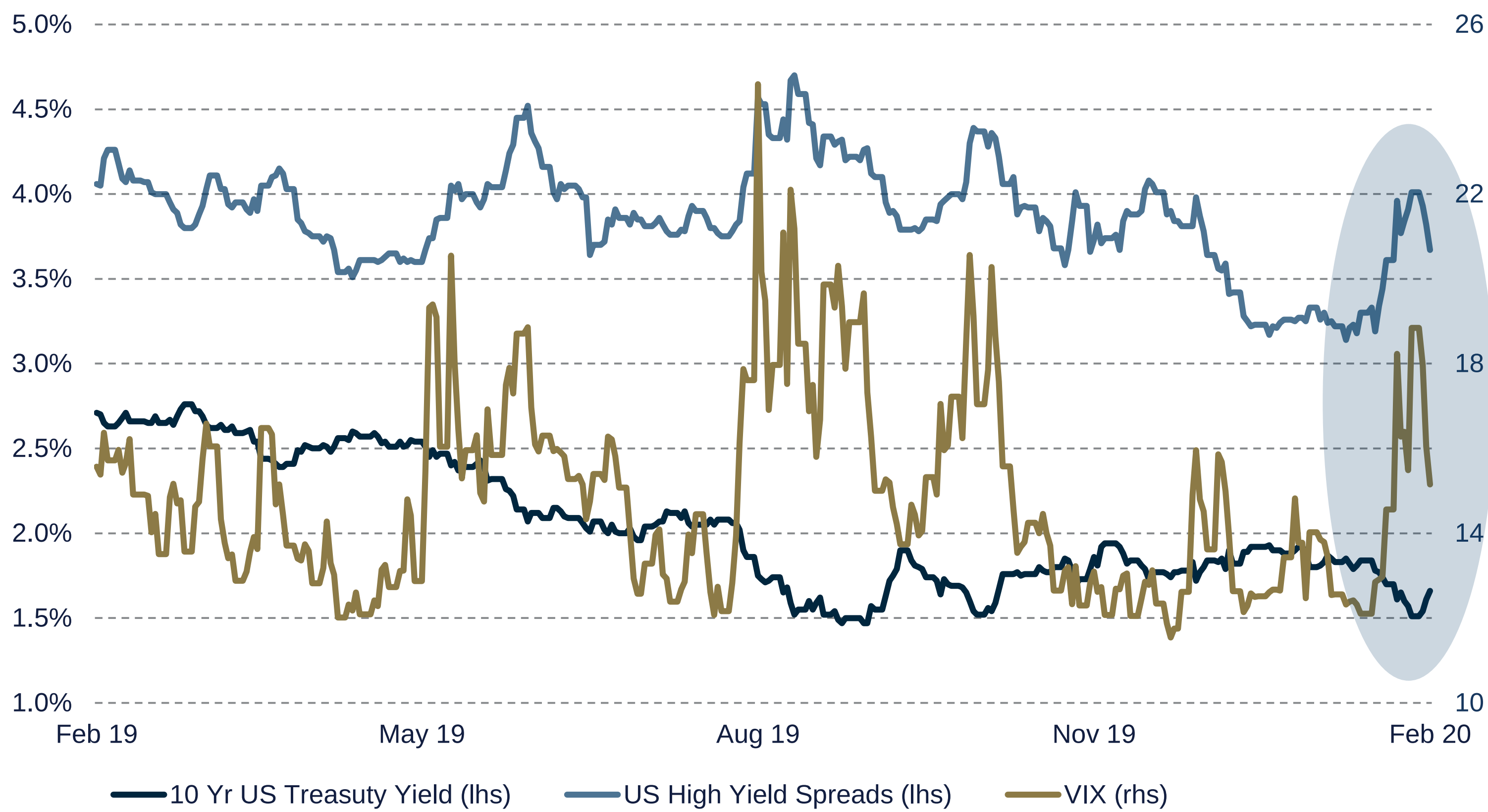
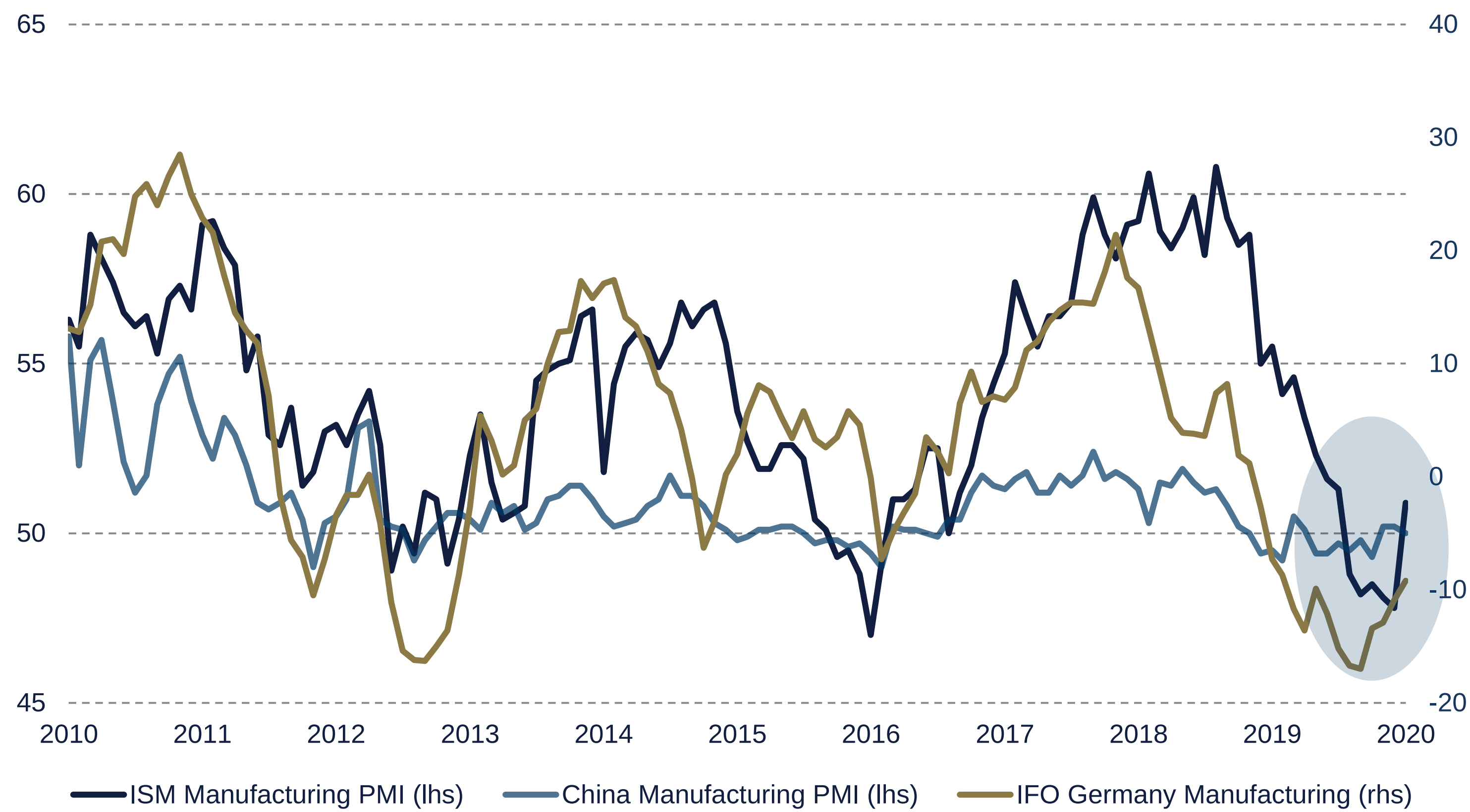


- Financial markets have reacted in the well-rehearsed **"risk-off"** fashion, with interest rates declining, volatility increasing, and credit spreads widening
- However, **the correction seems excessive**, taking into account that the probability that the new disease may cause an economic recession is low and, as a consequence, has already been partially reversed

Source: Bloomberg

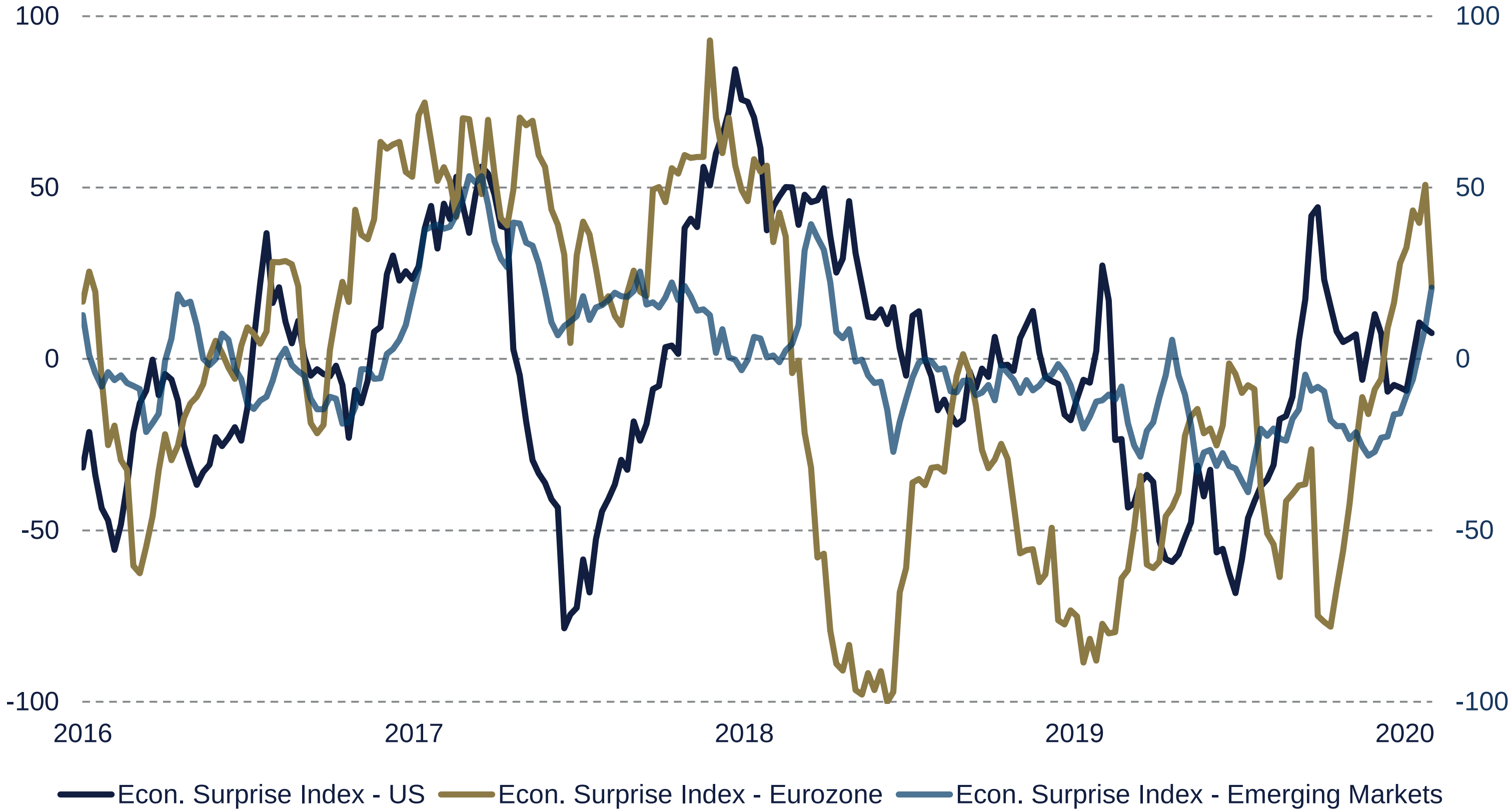
The global economy was turning the corner



- **The virus outbreak has masked the improvement in macroeconomic data**, particularly in the manufacturing sector, which continued pulling out of the bottom through January
- This provides **confirmatory evidence that the slowdown was mainly due to trade tensions** and, once the latter have been resolved, points to a continuation of the recovery

Source: Bloomberg

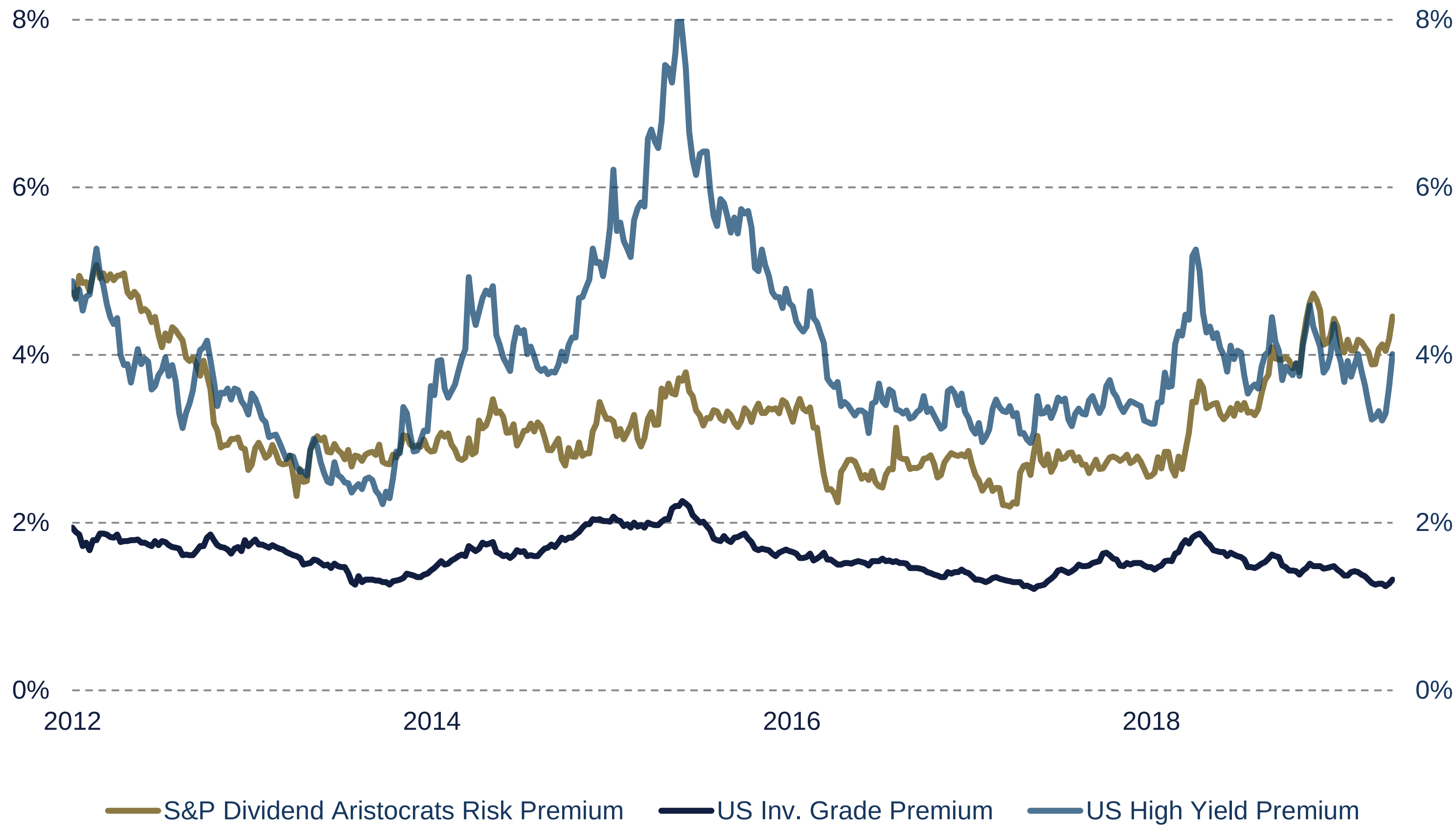
Broad synchronized improvement



- The **rebound in activity** has been felt not only in the manufacturing sector, but **also across a wide range of economic indicators**
- In addition, economic conditions have **improved simultaneously in the main economic blocs**, which had not happened since 2017

Source: Bloomberg

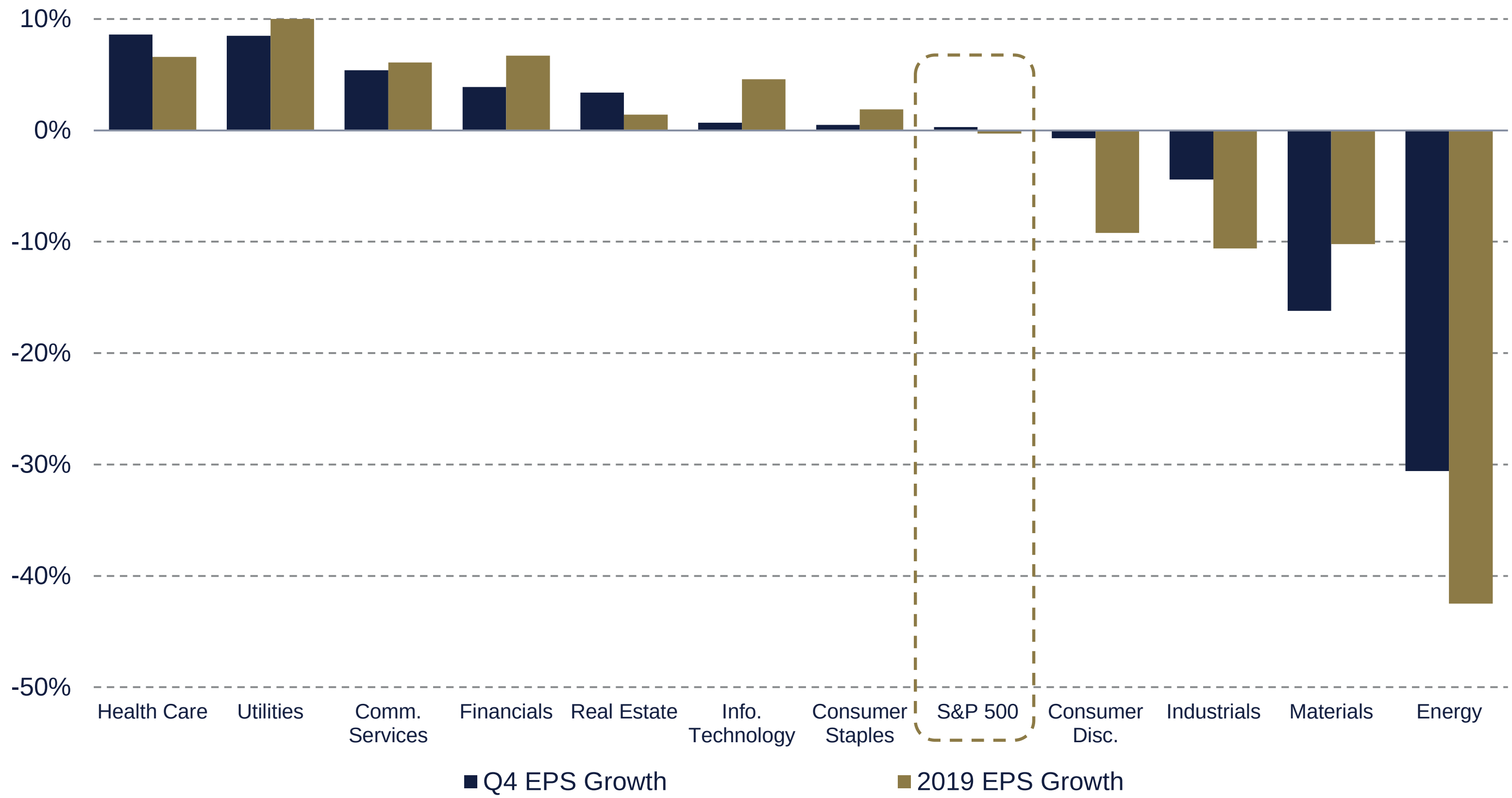
Equities still offering most value



- The sharp **decline in long-term interest rates continues to underpin risk assets**
- **Equities continue to offer a very attractive risk premium**, both in absolute terms (compared to their historical average), and in relative terms (compared to credit)

Source: Bloomberg

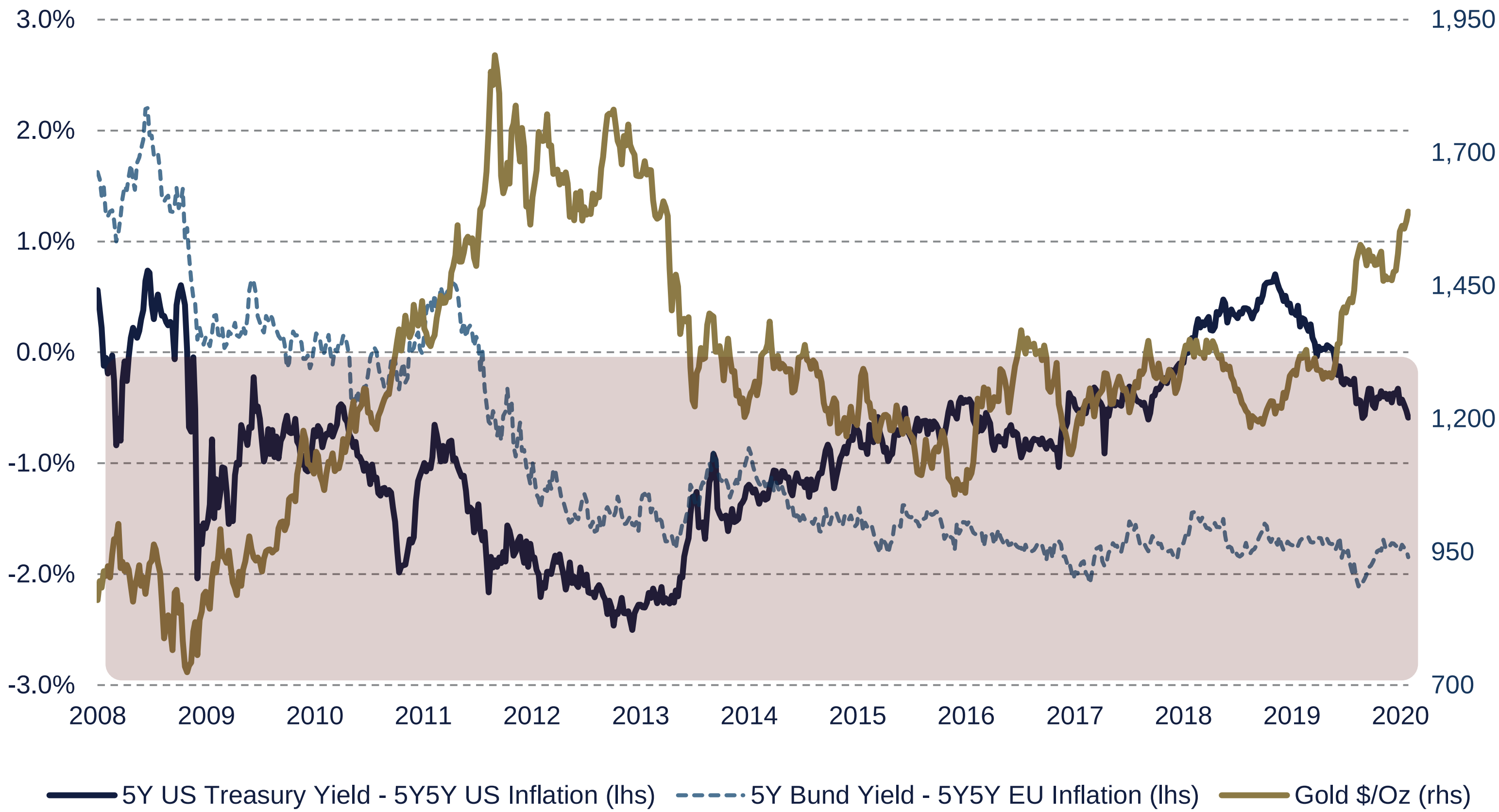
Sector dispersion continues



- On average, **corporate earnings in the last quarter have exceeded expectations**, although by a smaller margin compared to previous quarters. In general, **the year will close with a slight decrease in profits**, after four consecutive quarters of contraction
- A **growing dispersion across sectors** can be observed, with the "new economy" having much better performance than the "old economy". We expect this trend to continue and, therefore, **we favour “quality-growth" over "value" stocks**

Source: FactSet

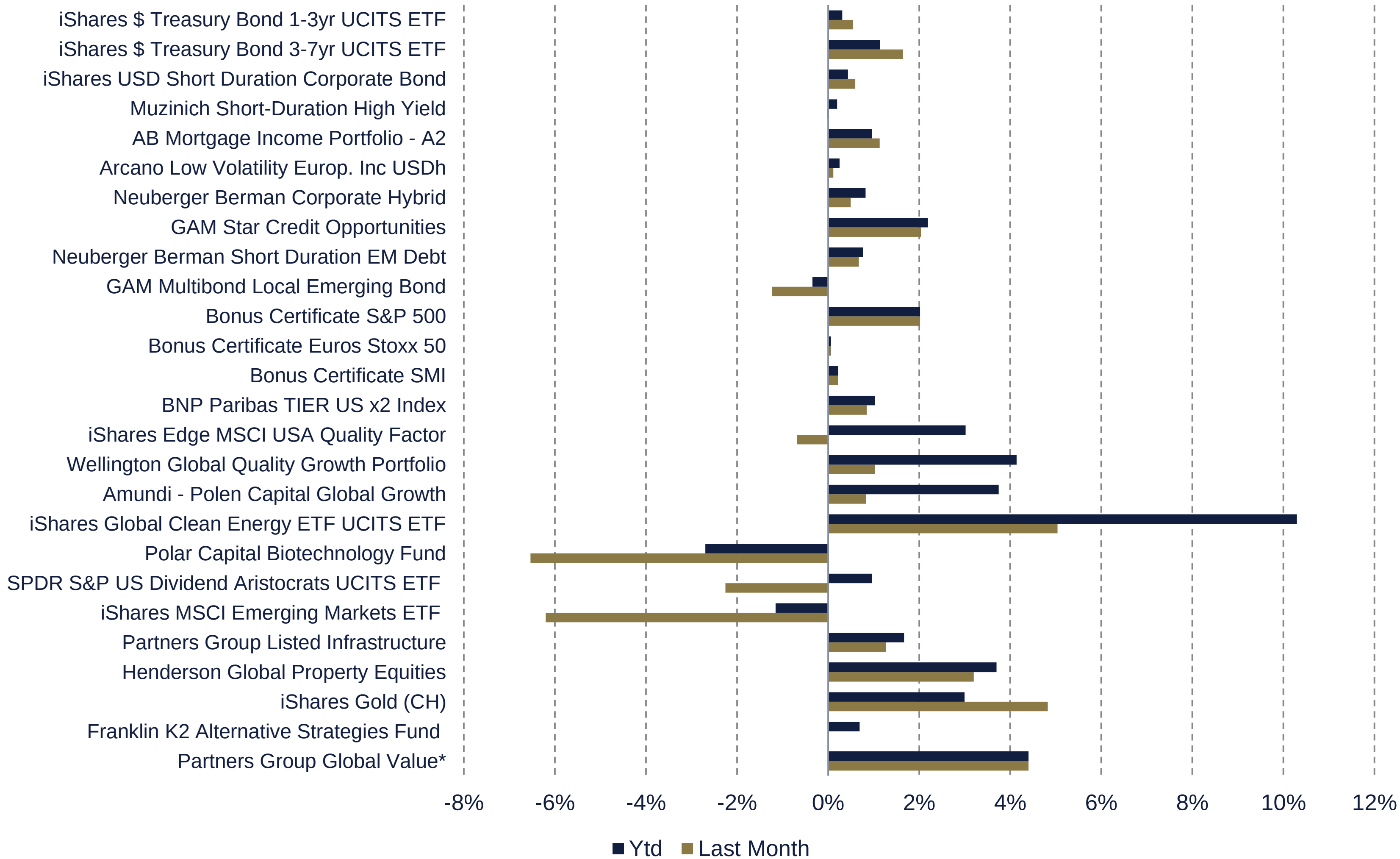
Back to negative real interest rates



- **Adjusting for inflation, interest rates have turn again negative**. This reinforces the **attractiveness of real assets** such as gold, real estate and infrastructure
- **In relation to the euro**, the fundamentals of the dollar have weakened slightly, but it is **still strongly supported by its higher real returns**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of February 6, 2020
* 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	35% (-5%)	45% (+5%)	20%

Short-term catalyzers

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

Other risks

Iran, Trade war, Brexit implementation, Spread of populist political parties, China slowdown, Terrorism, Hong Kong unrest

Boreal Balanced Portfolio USD

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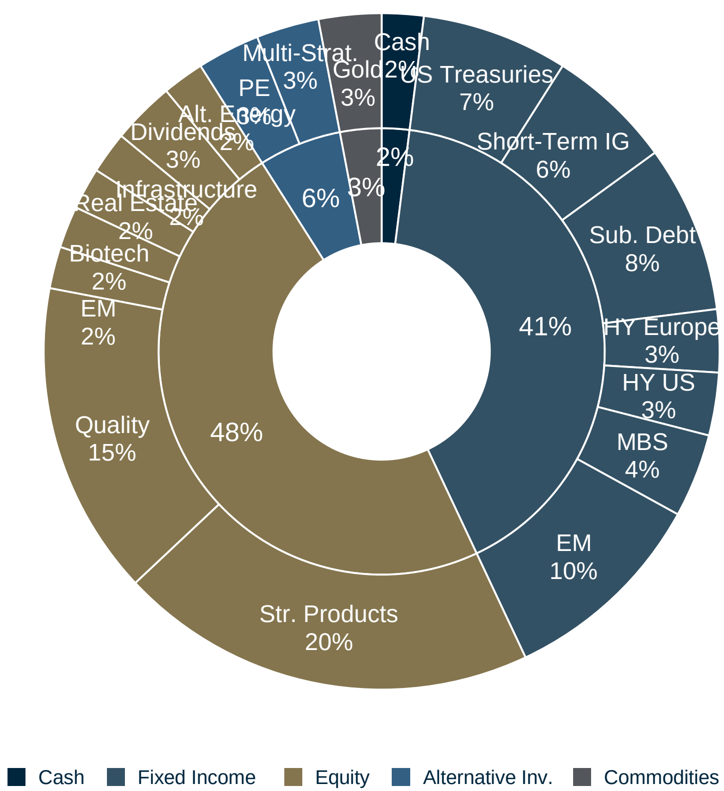
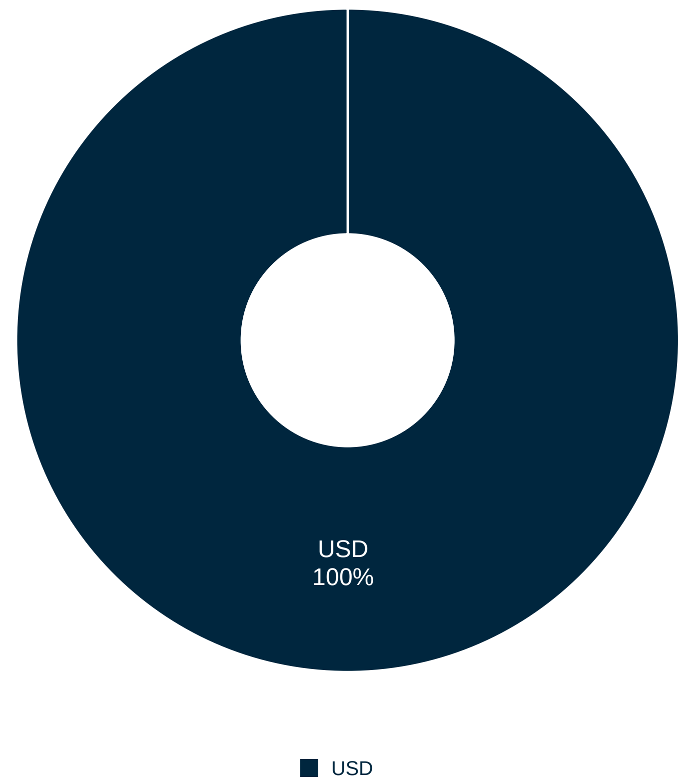
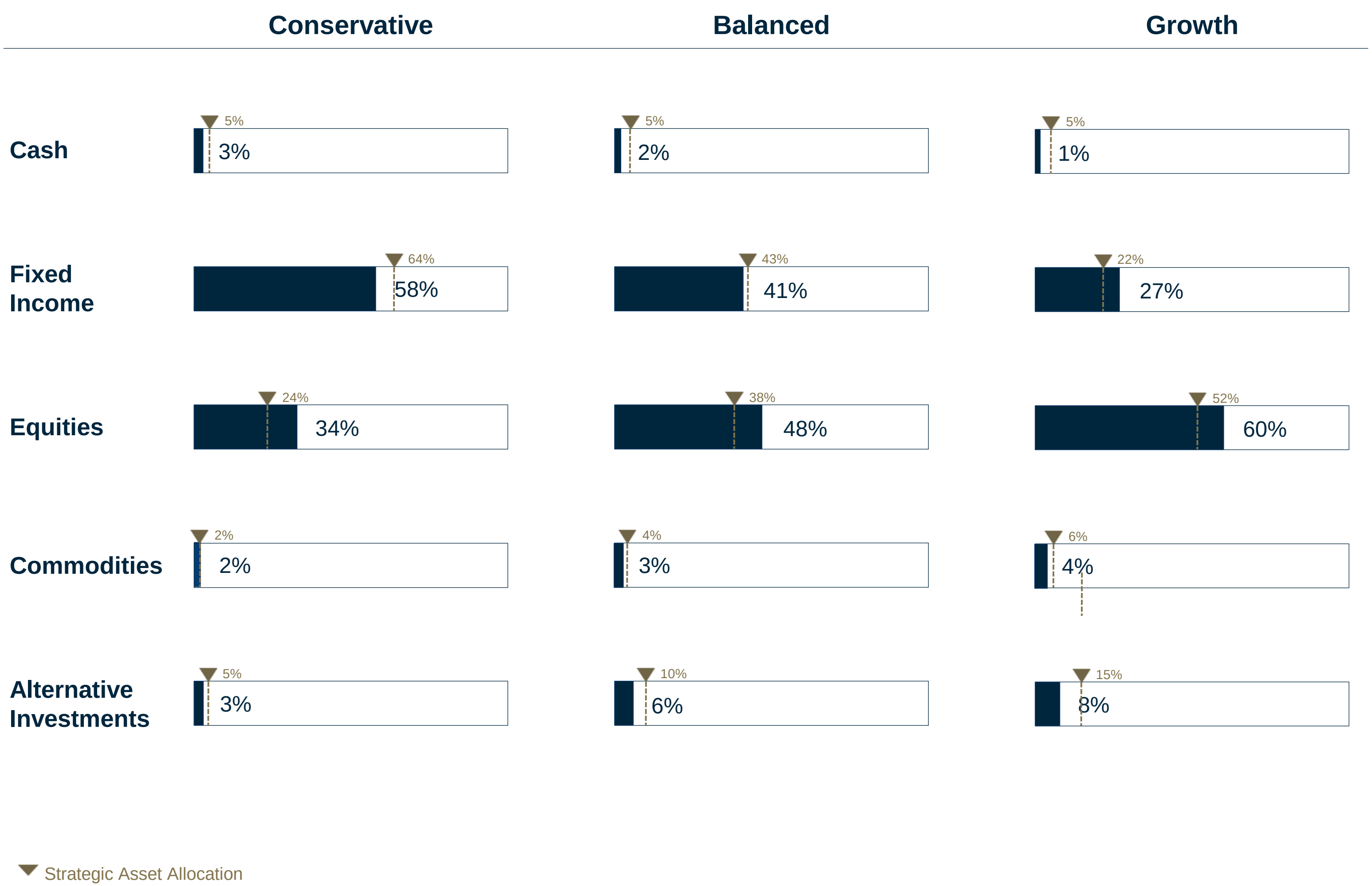
Asset Allocation



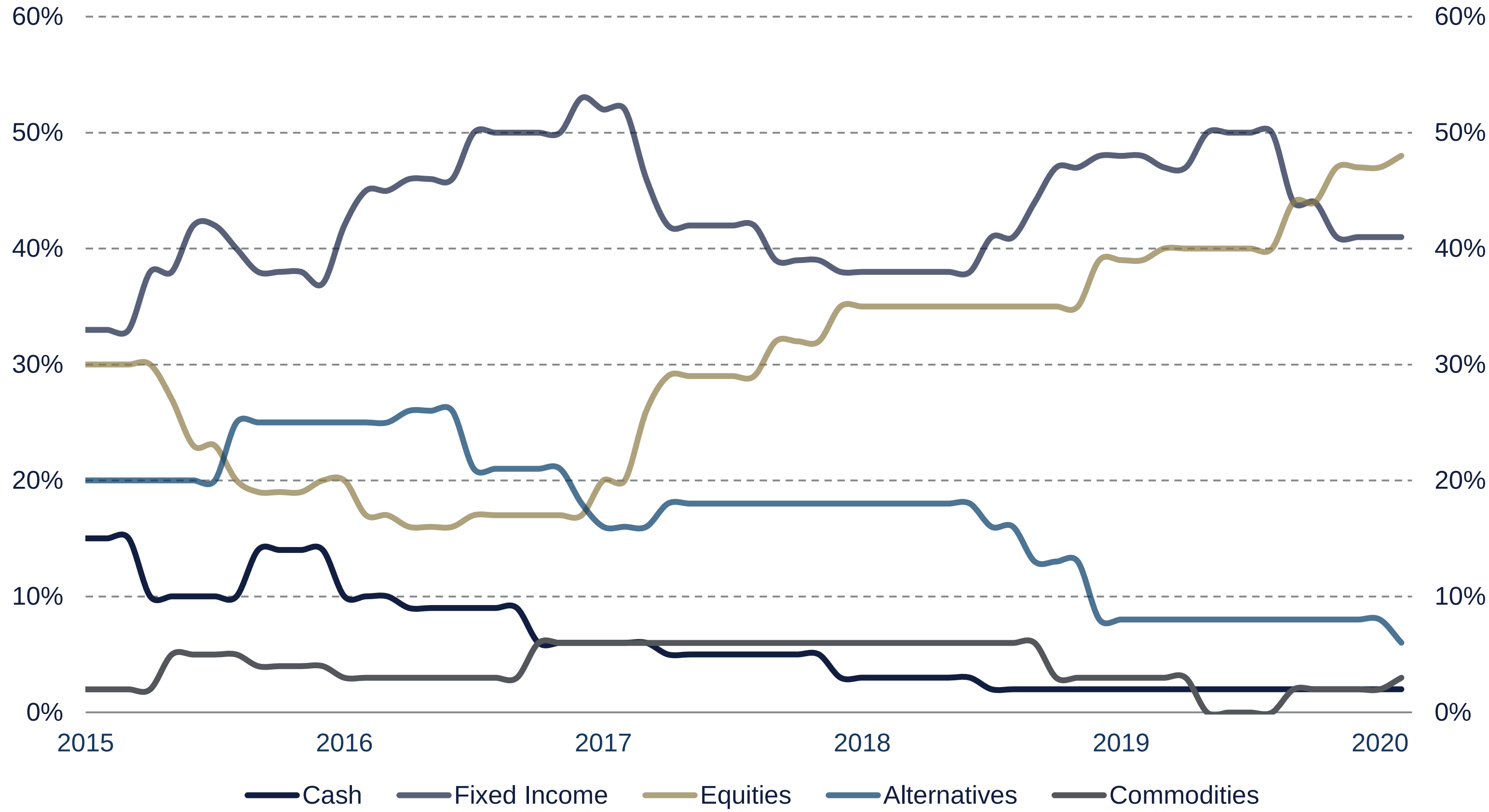
Currency Allocation



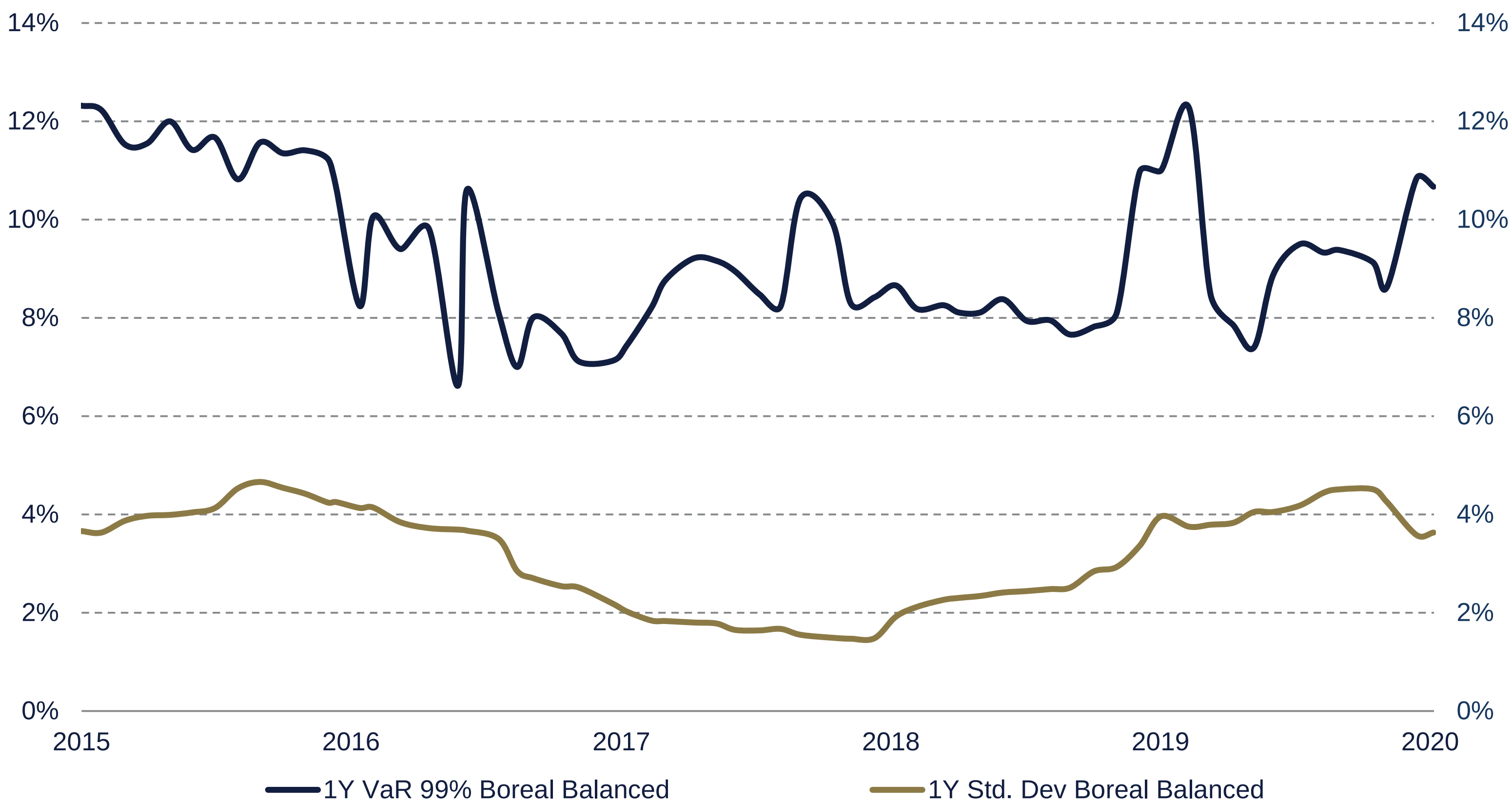
Boreal Investment Profiles



Boreal Balanced Portfolio – Asset Allocation evolution

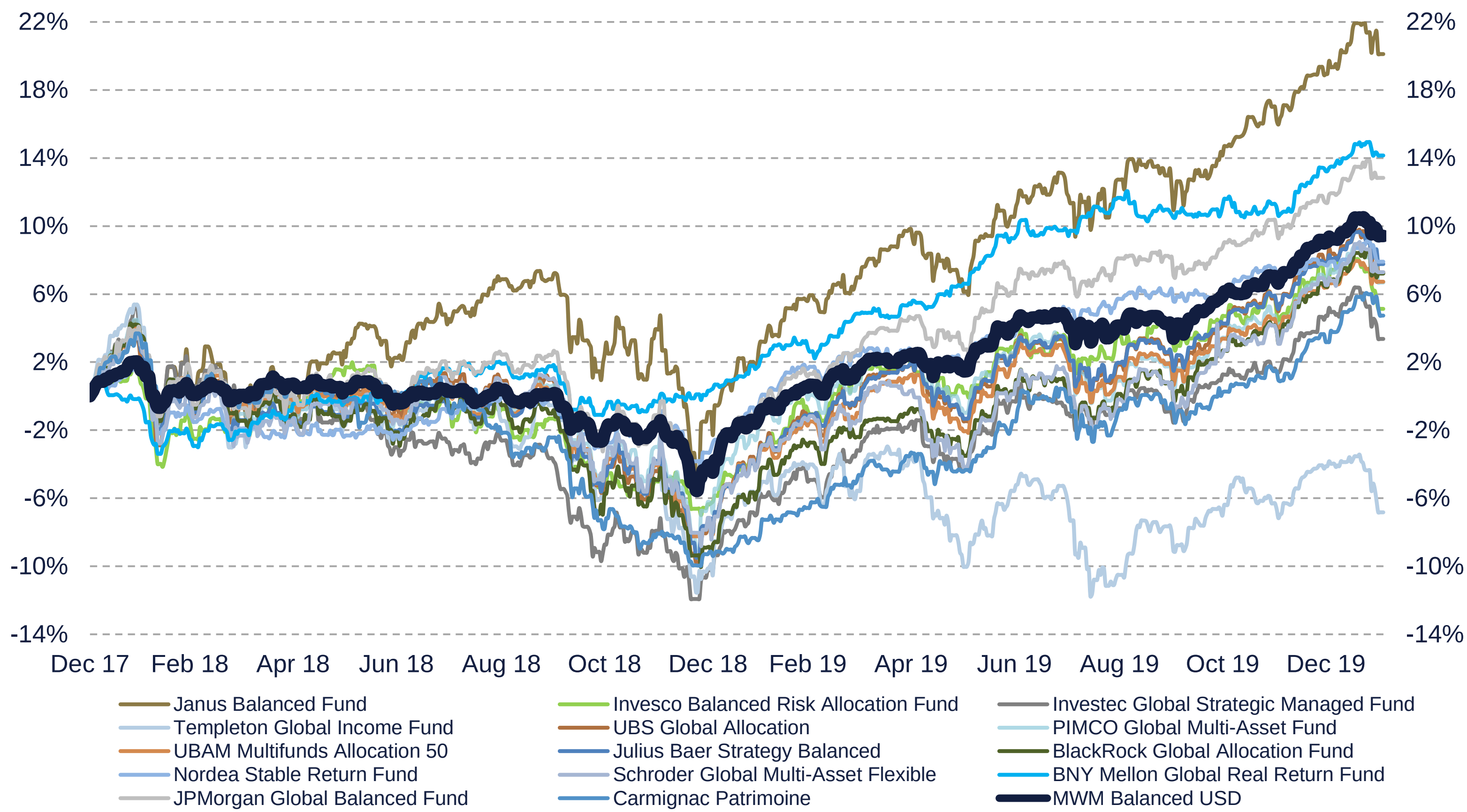


Boreal Balanced Portfolio – VaR evolution



[1] As of February 6, 2020
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison

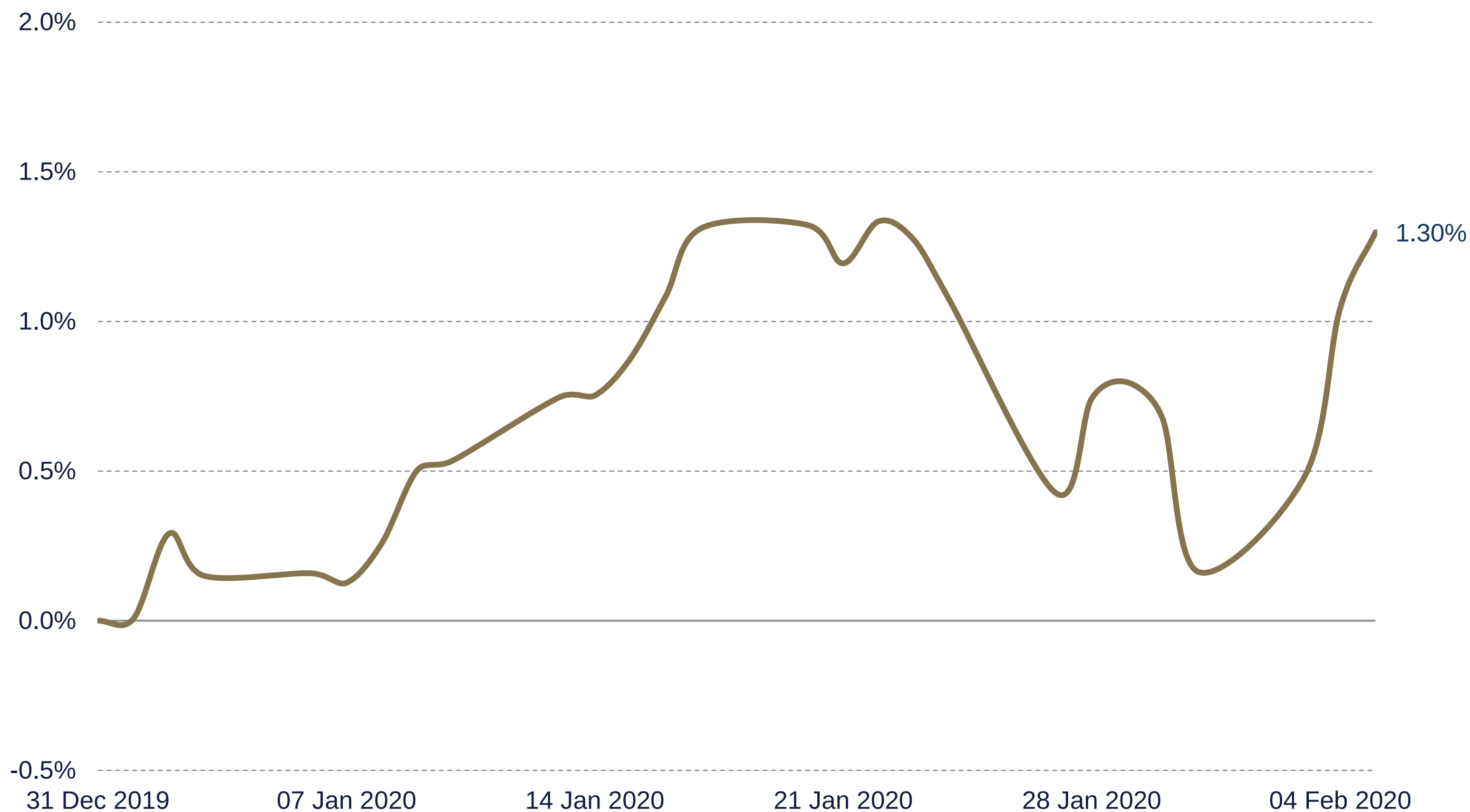


- **Total Return** (Ytd[1]): **8th out of 15**
- **Standard Deviation** (1 year[1]): **3rd out of 15**
- **Downside Risk** (1 year[1]): **3rd out of 15**
- **Sharp Ratio** (1 year[1]): **4th out of 15**

[1] As of February 1, 2020

Source: Bloomberg

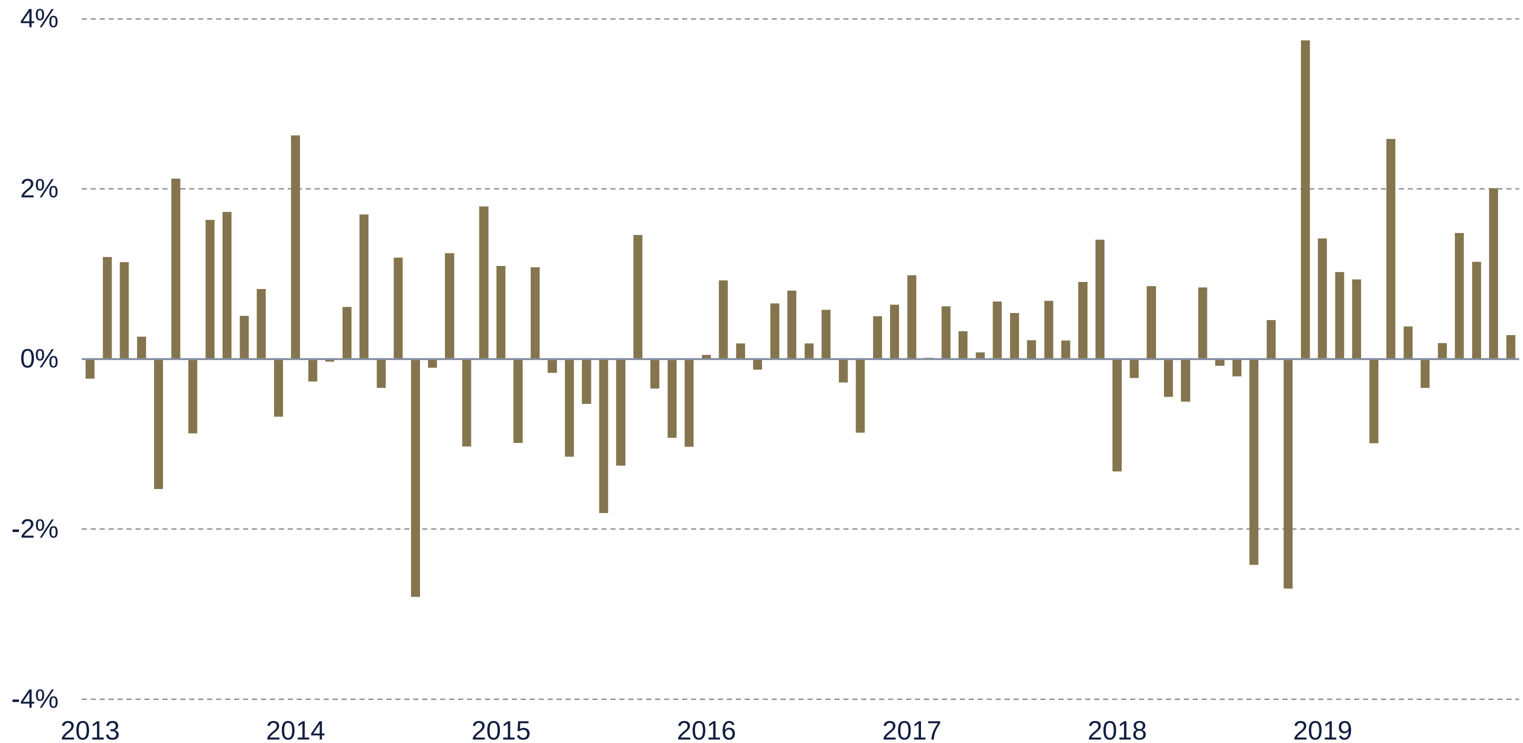
Boreal Balanced Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **1.30%**
- **Standard Deviation** (Ytd[1]): **4.09%**
- **Downside Risk** (Ytd[1]): **3.18%**
- **Sharpe Ratio** (Ytd[1]): **3.03**

[1] As of February 6, 2020

Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **11.18%**
- **Total Return** (3 year[1]): **16.55%**
- **Total Return** (Since Jan 13[1]): **31.23%**

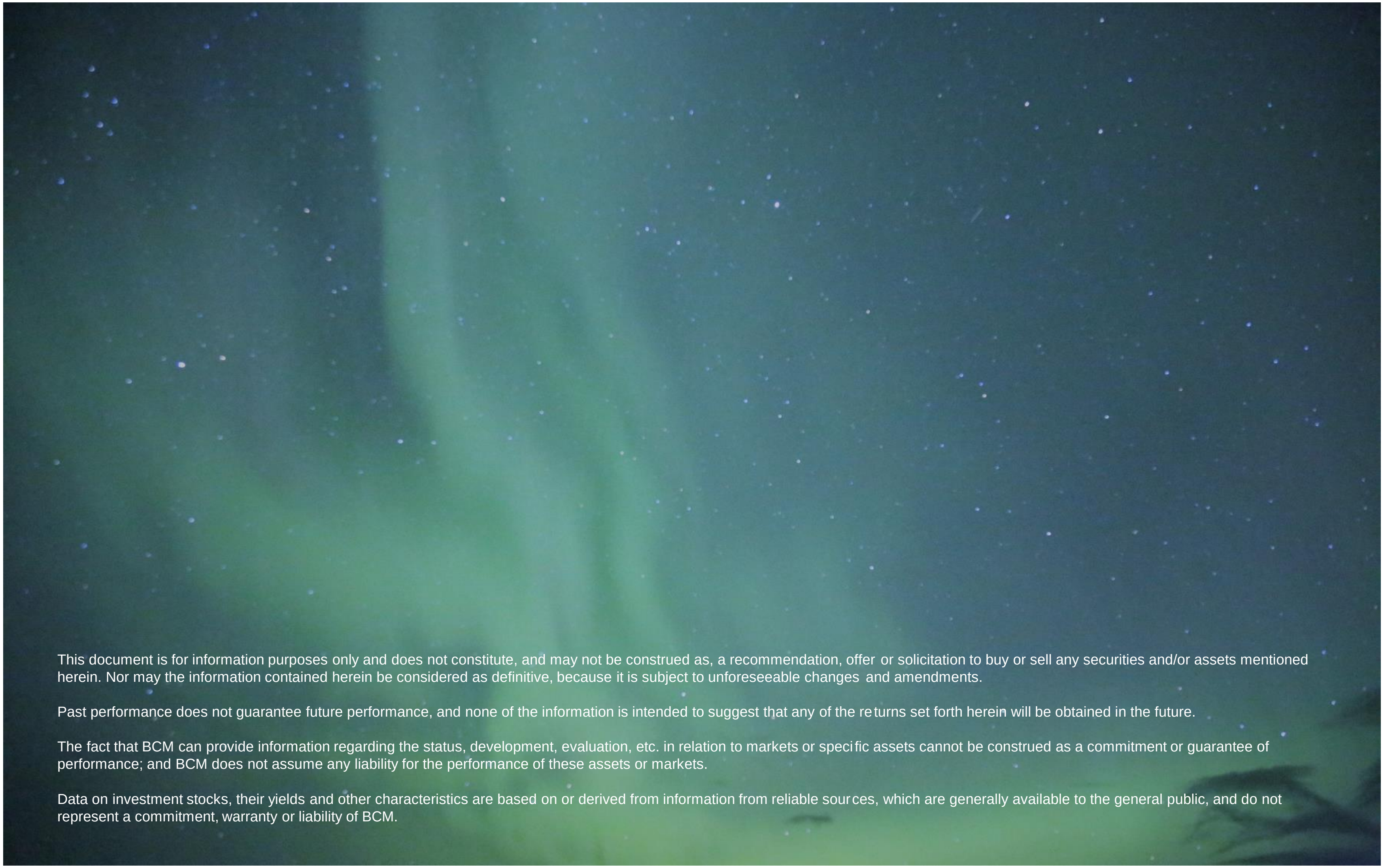
[1] As of February 6, 2020

Boreal Balanced Portfolio – Historical performance

	2013	2014	2015	2016	2017	2018	2019	2020
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	1.30%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	4.09%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	3.03

Annual Return: 3.60%
Annual Std. Dev: 3.33%

[1] As of February 6, 2020



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