Investment Policy

January 2020

BOREAL
CAPITAL MANAGEMENT

Our market view in a nutshell – January 2020

- At the beginning of the new year, there are **two factors that support financial markets**, and that give us the confidence to remain fully invested:

  - **Monetary policy worldwide will remain highly accommodative**. The Fed has proved that will react timely to any slowdown in order to prevent a recession, and has conveyed the message that it will be patient in the event that inflation picks up (which we do not expect). In addition, the results of the review of the Fed's monetary policy tools will be announced this year and will likely include a "flexible inflation target"

  - The **de-escalation of the Trade War between the US and China** should reduce the uncertainty generated during the last two years, and thereby help the manufacturing industry out of the recession. The war will not end completely, as discussions on Phase 2 of the agreement will soon begin; the dispute may also extend to other regions (e.g. Europe)

- The latter does not prevent this year from being difficult for investors. Valuations remain high, particularly in fixed income, and there are a **number of obstacles that must be overcome** to, at best, achieve **a year of average returns**:

  - The proximity of the US **presidential elections** will lead to an increase in volatility, given that the country remains highly polarized and the end result is far from certain. Volatility can be exacerbated if a candidate who is not well perceived by the market secures the democratic nomination

  - As for the fundamentals, **companies will have to demonstrate that they can again grow their profits**, since although the high multiples are justified by low interest rates, they also make stocks more vulnerable to earnings disappointments

- Taking into account that although **we expect the world economy to recover**, valuations are rich and the catalysts of the bull market (margin growth, financial engineering and multiples expansion) are running out, we recommend continuing **to add low-cost hedges to the portfolios**

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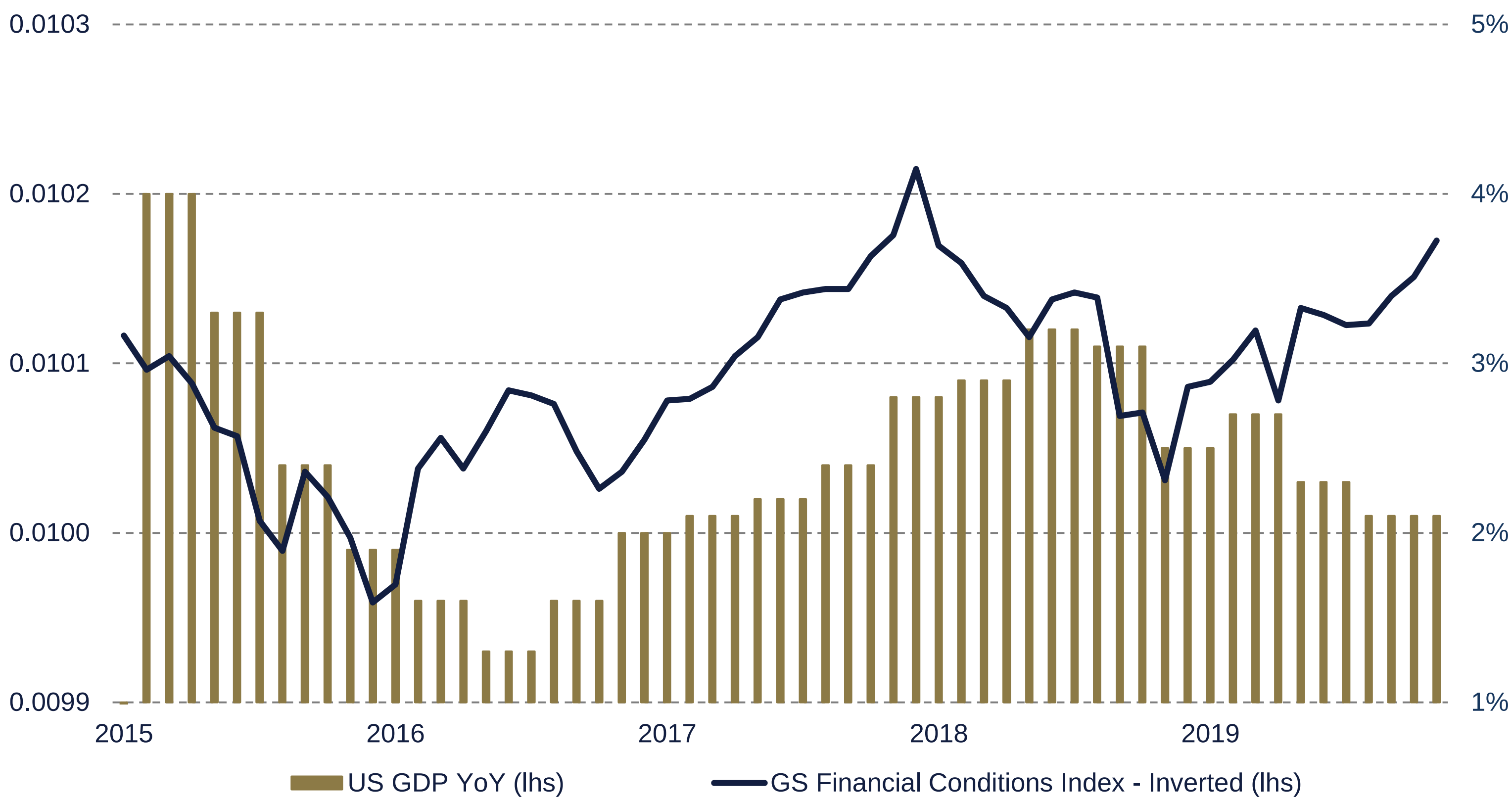
Asset Class		View	Rationale
Fixed Income	US Treasuries	=	Treasuries offer protection from a slowdown in growth, but we believe that current long-term yields are unattractive, preferring shorter maturities
	US Credit	+	Corporate debt and High Yield currently offer the best combination of risk and return. 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

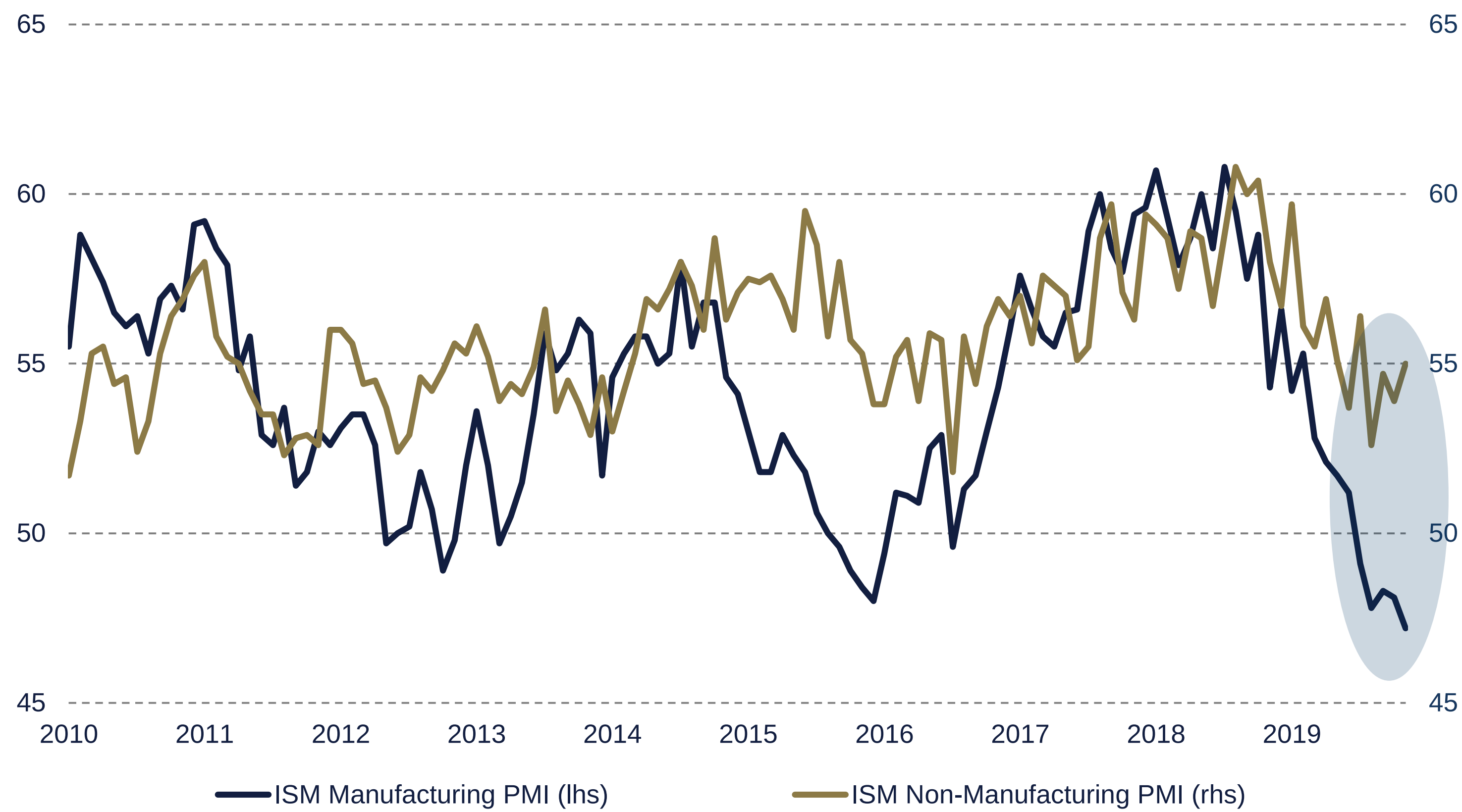
A repeat of 2017?



- **Financial conditions remain very favourable**. The Fed has not only reversed the course, but has also indicated that it will remain very patient before raising rates again
- Until now, the improvement in financial conditions has been felt mainly in the performance of financial assets. However, **we expect real economic activity to recover soon, as happened in 2017**

Source: Bloomberg

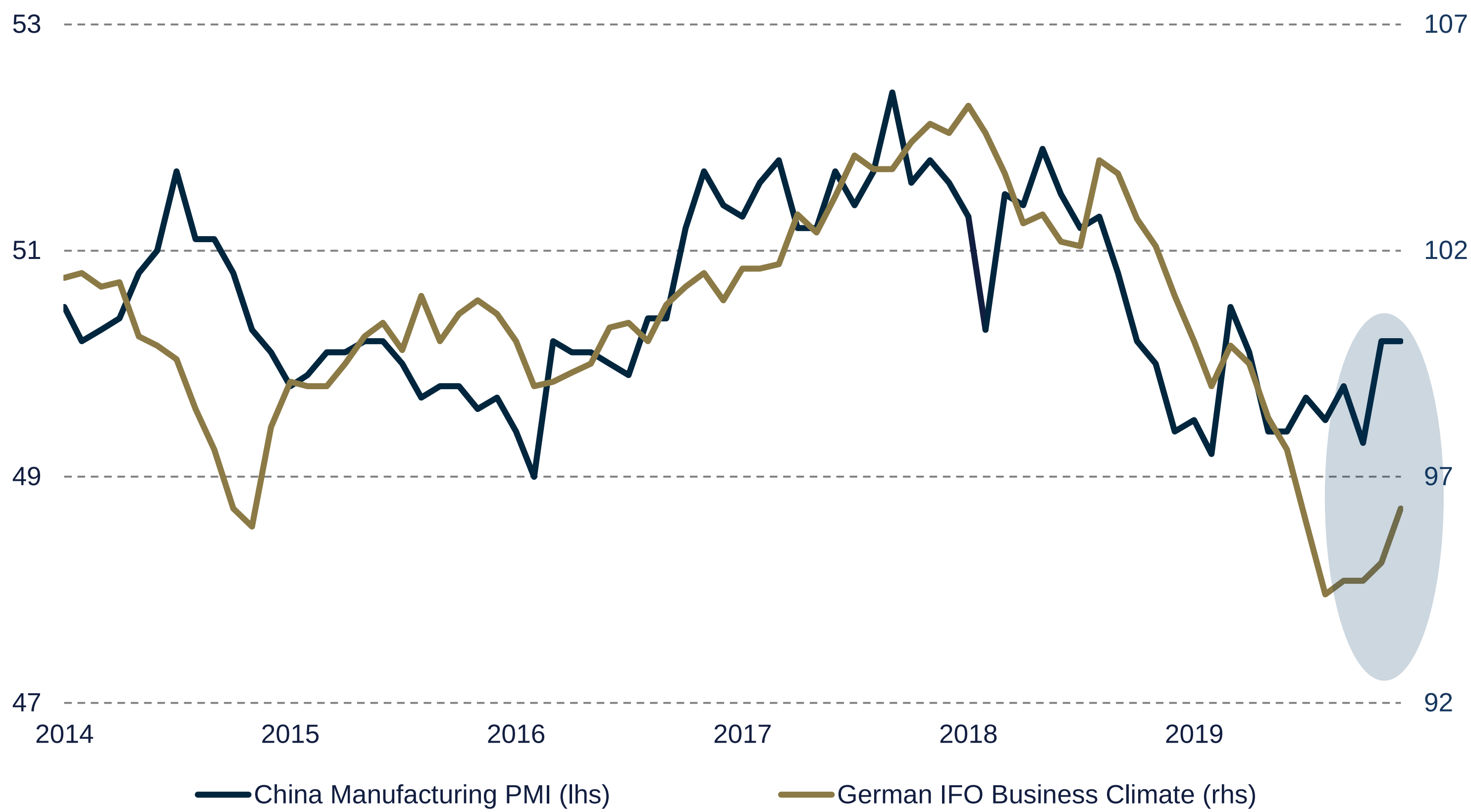
Trade truce as the new impulse?



- If in **2017 it was the investment boost by China**, in **2020 we expect the de-escalation of the trade war** to end the recession in the manufacturing industry
- However, the **manufacturing sector in the US still does not show any signs of recovery**, although the **service sector seems to have already hit bottom**

Source: Bloomberg

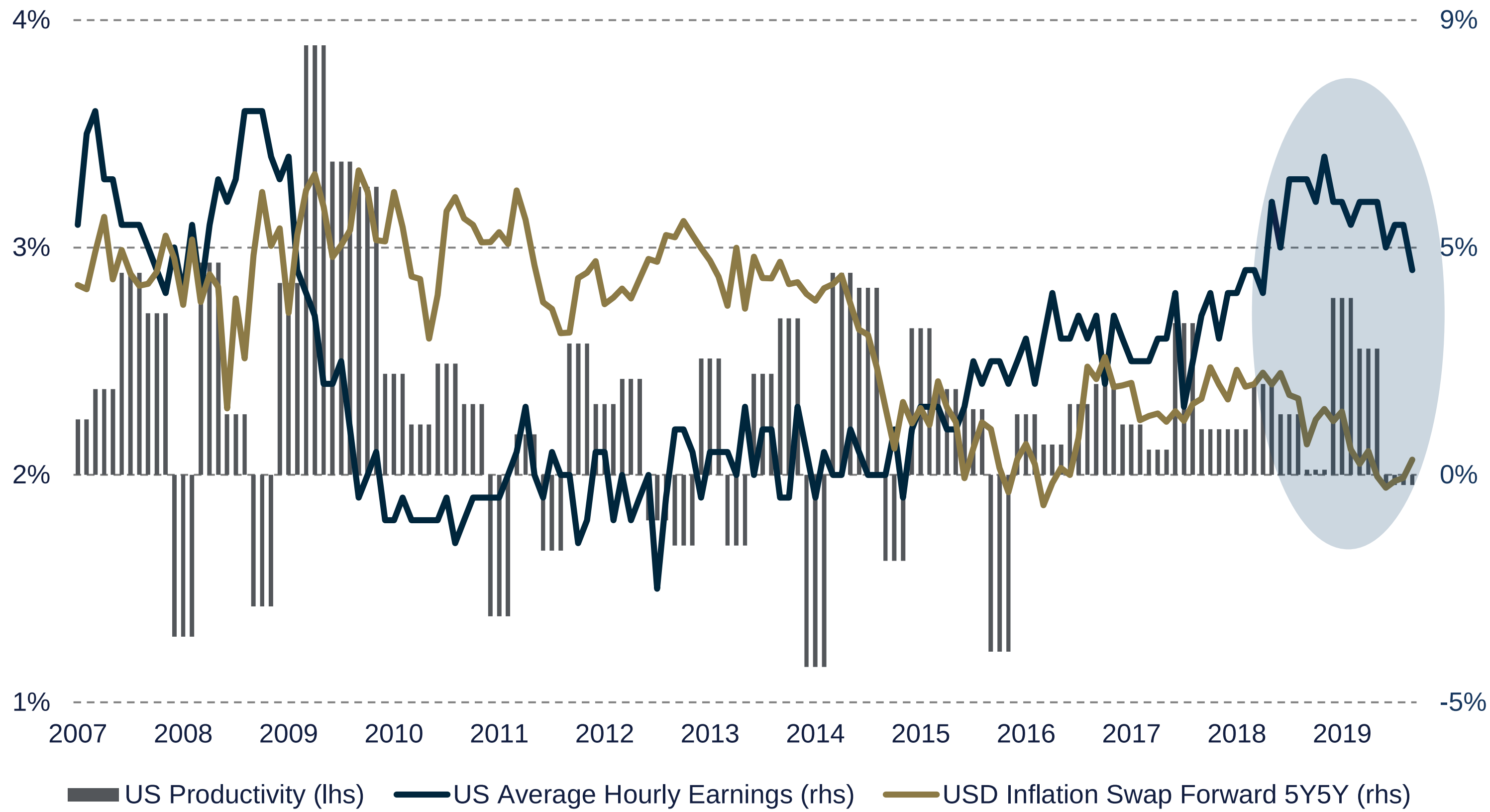
Early signs of a manufacturing turnaround abroad



- Contrary to what happens in the US, we do see some **early signs of an improvement in manufacturing, both in Europe and emerging markets**

Source: Bloomberg

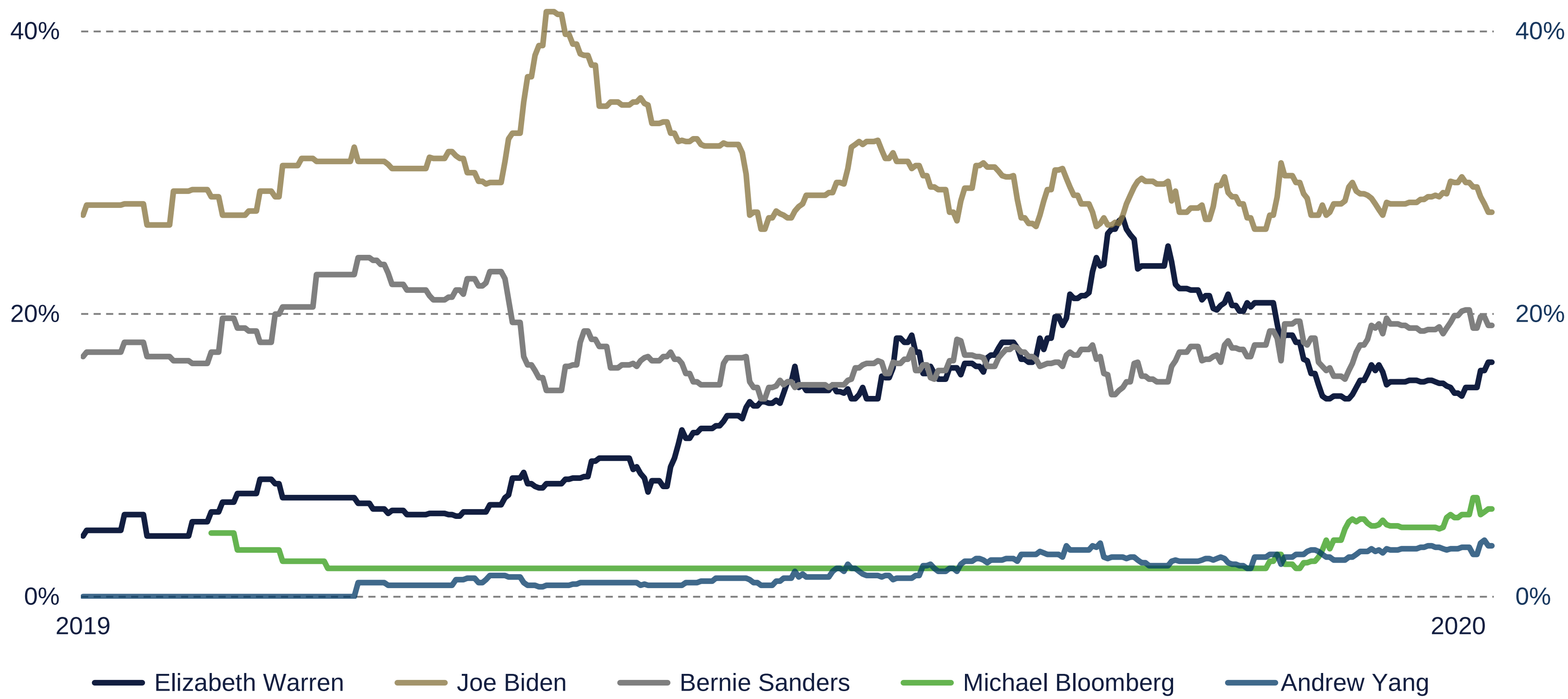
Inflation remains contained



- Although the Fed has indicated that it will allow inflation to increase before rising rates, **a sustained recovery in inflation is one of the biggest risks for financial markets**, especially for fixed income valuations
- However, we **expect inflation to remain low, weighed down by secular trends**. In fact, we believe that official inflation data systematically overestimates real inflation, and underestimates productivity

Source: Bloomberg

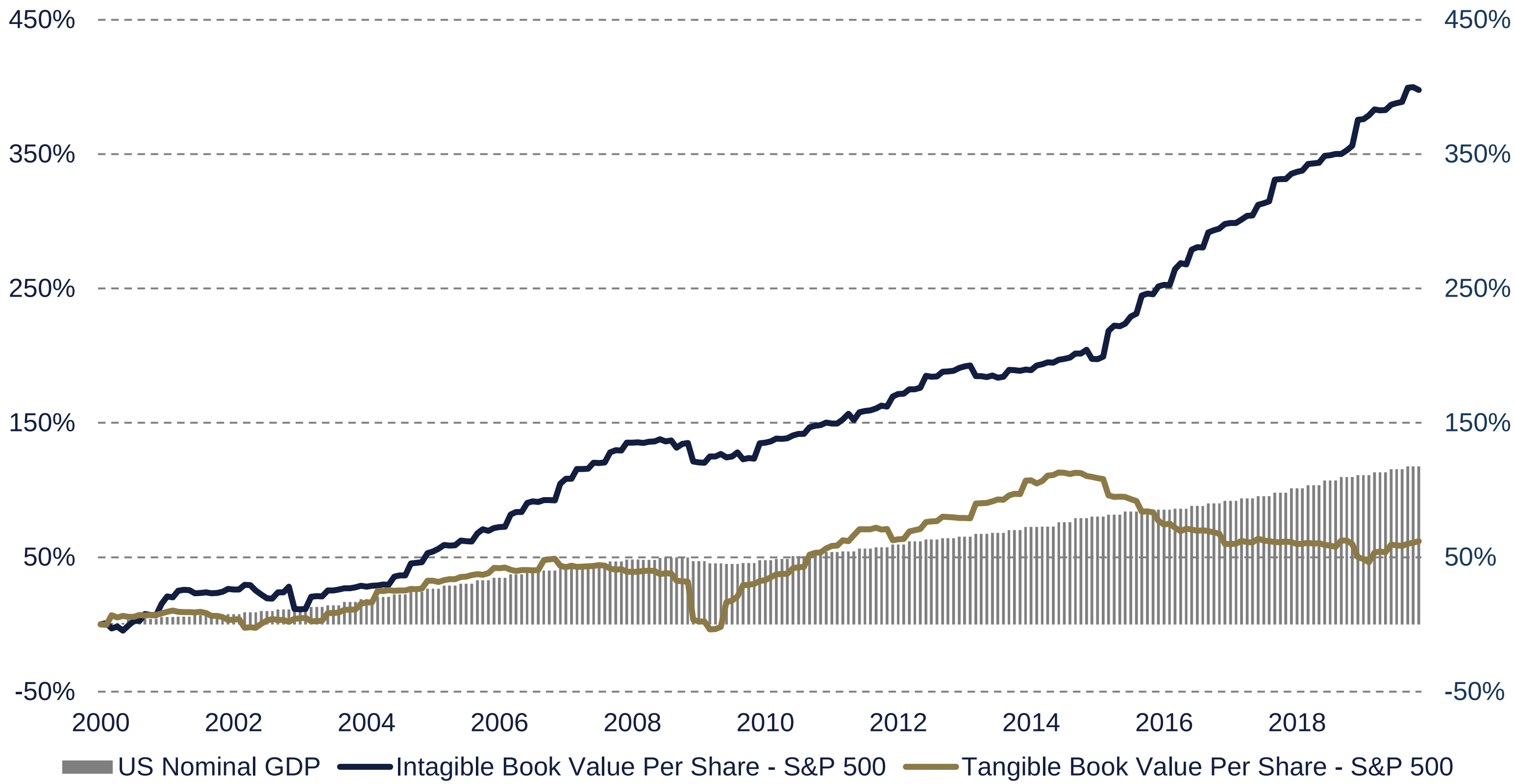
To hedge, or not to hedge?



- The proximity of the **US presidential elections will lead to an increase in volatility**, given that the country remains highly polarized and the end result is far from certain
- Volatility can be exacerbated if a candidate who is not well perceived by the market secures the democratic nomination

Source: Real Clear Politics Poll Average 2020 Democratic Nomination

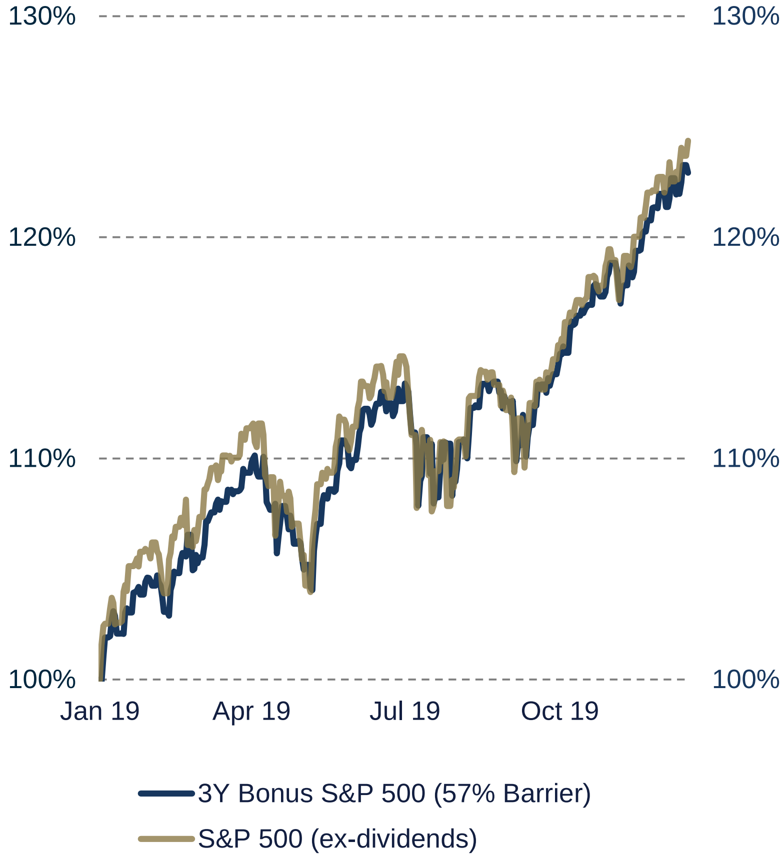
Quality/Growth will continue outperforming

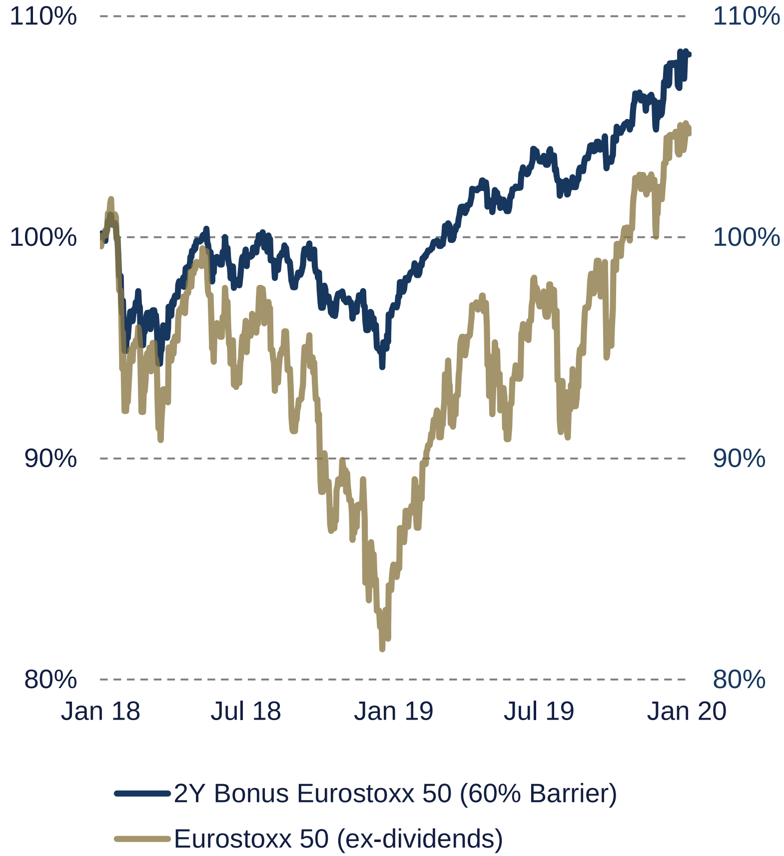


- In recent decades we have experienced a **profound economic transformation**. In the 80s it was driven by **deregulation** and **globalization of capital**, in the 90s by **technologically driven improvements in productivity**, and in the first decade of this century, by the **globalization of value chains**
- During the last decade, we have witnessed a **different transformation, led by digitalization**, which is causing a **"winner takes it all“** effect. Although there is a possibility that antitrust policies limit the extent to which some companies can grow, we believe that the trend will continue during the new decade

Source: Bloomberg

Overweight in equities, but with a parachute

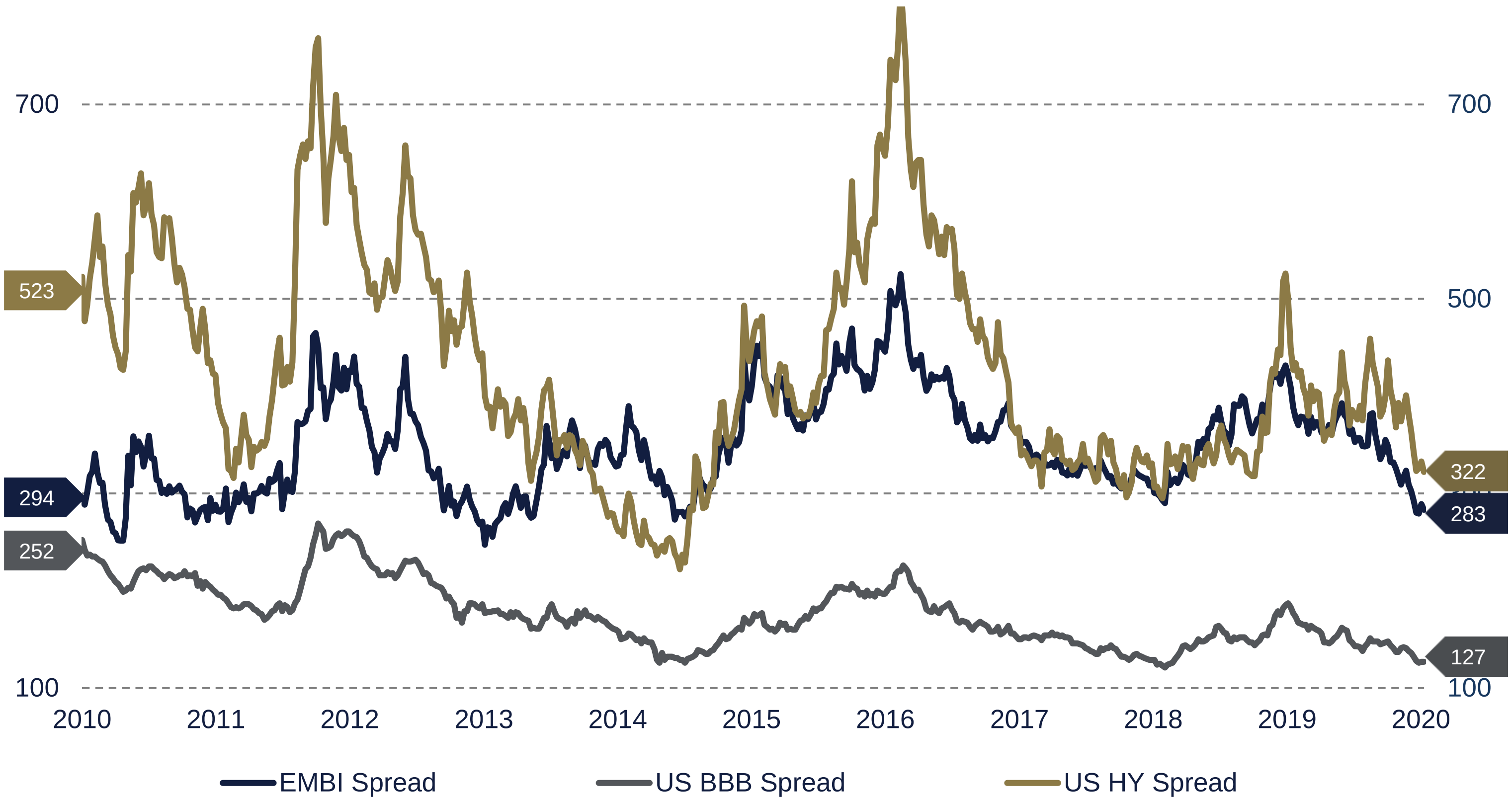




- Despite our conviction that **equities is the asset class that offers the best prospects**, we acknowledge that this economic cycle is in its final stages once monetary and fiscal stimuli have been largely exhausted. Therefore, we **recommend buying some protection in the form of very cheap long-term barrier put options**
- **Bonus certificates** lag their underlying indices in a bull scenario, but can drastically mitigate downside risk in the case of a market correction

Source: Bloomberg

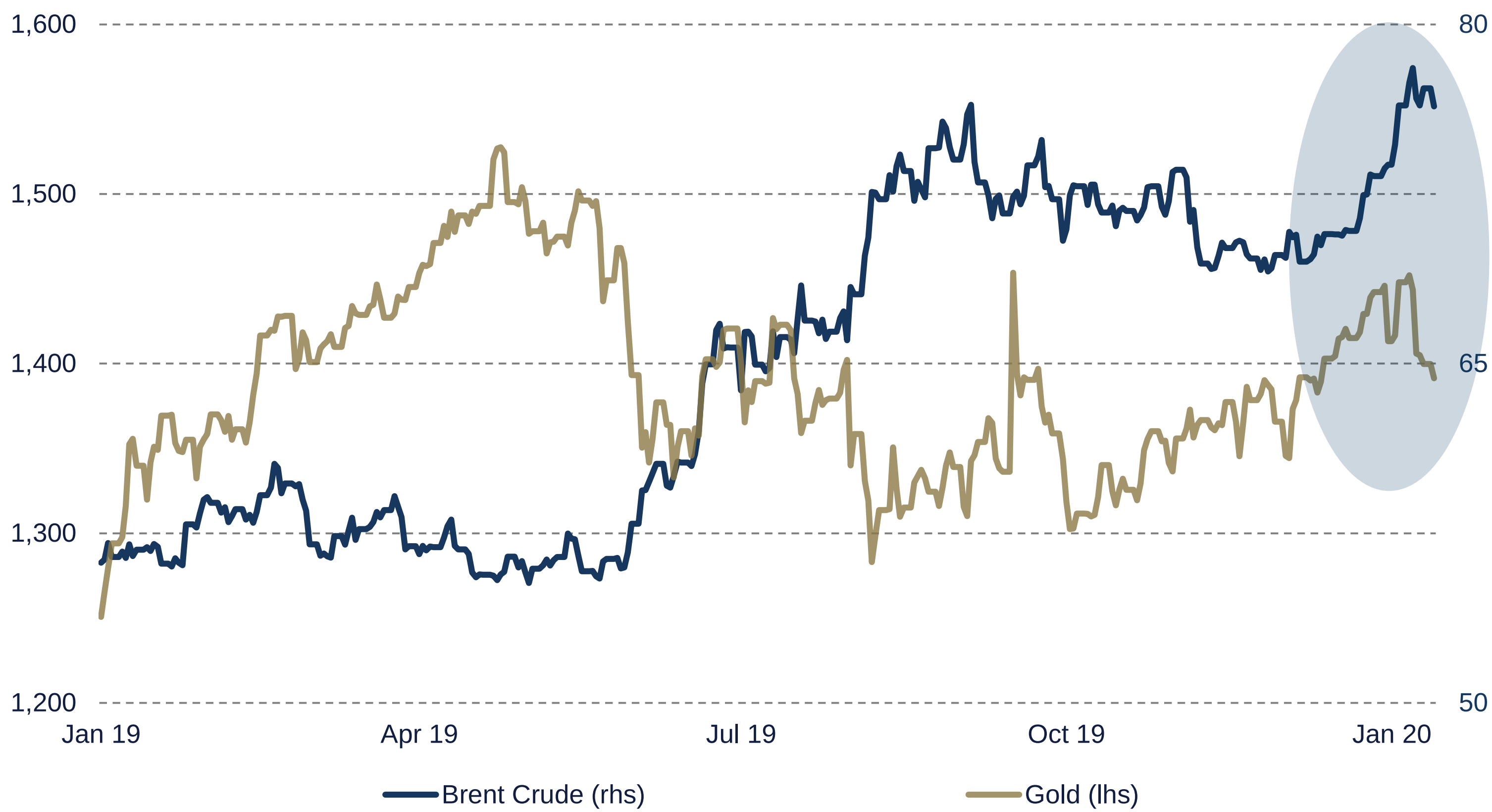
Fixed income increasingly unattractive



- During the last month **spreads compressed further**, and they are trading at levels **close to their respective historical lows**
- Despite these levels are consistent with a continuation of the economic cycle, they leave **investors exposed to any widening of spreads caused by a risk-off event** in the market. Particularly unattractive are Investment Grade bonds, whose spreads have halved in the last decade, despite the increase in leverage in the corporate sector

Source: Bloomberg

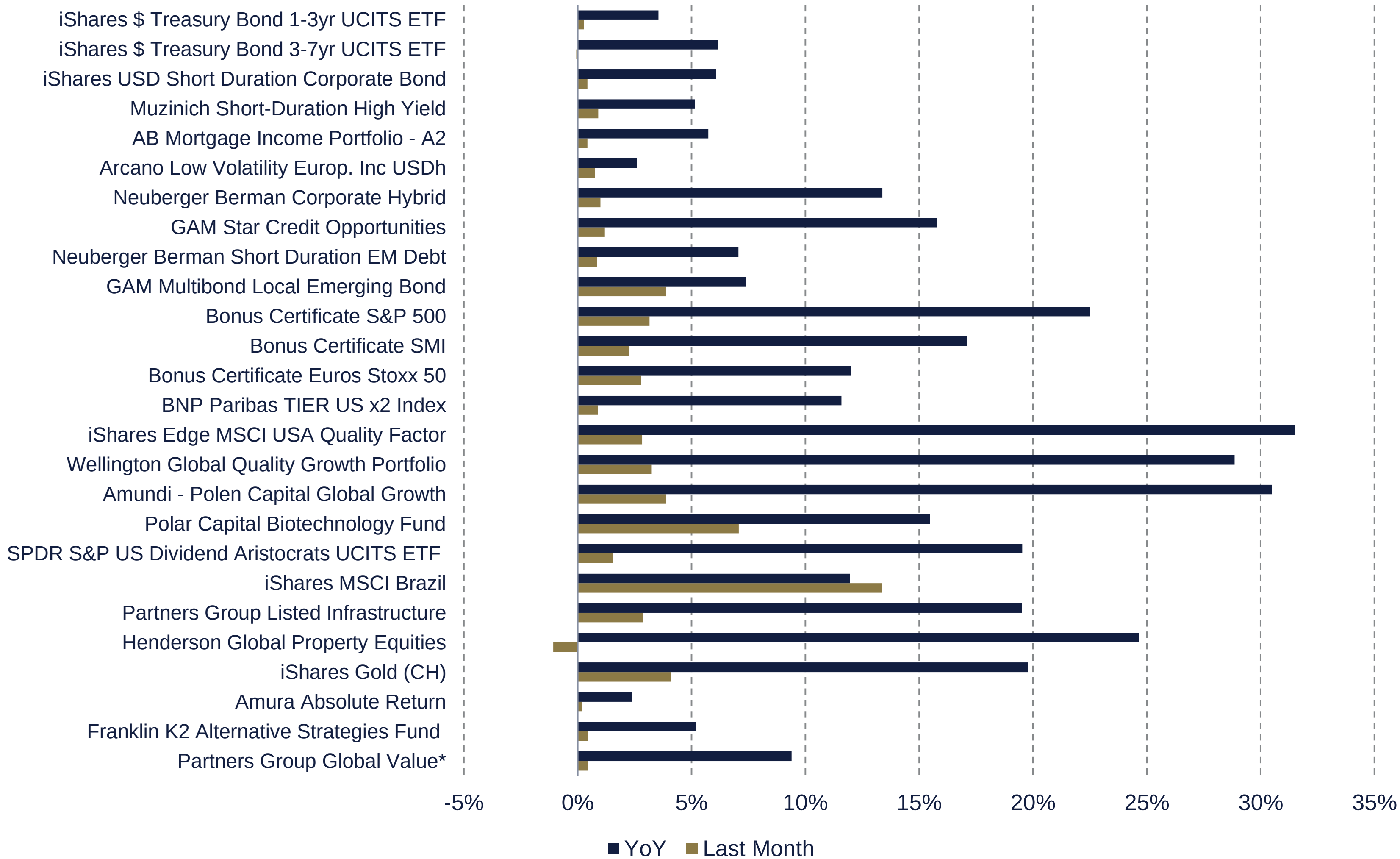
Geopolitical risk is business as usual



- Tensions in the Middle East have recently pushed up the price of oil and gold. However, we **do not recommend to invest based on catastrophist scenarios**
- After all, despite the US current spats with North Korea and Iran, **the world is now much safer place** than, for example, during the Cold War, which did not prevent the S&P 500 from returning 8.6% p.a. during the 1947-1989 period

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of January 6, 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

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

Boreal Model Portfolio Balanced USD

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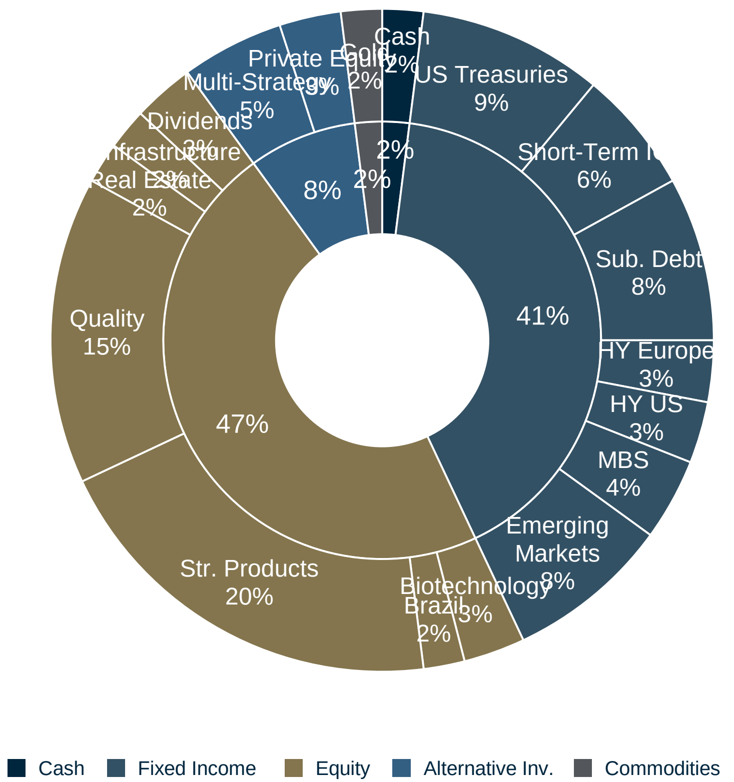
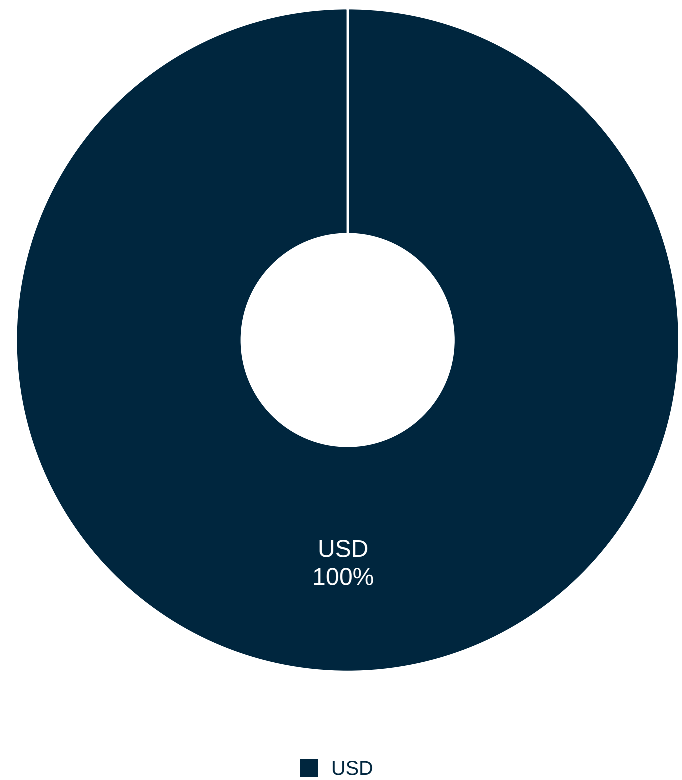
Asset Allocation



Currency Allocation

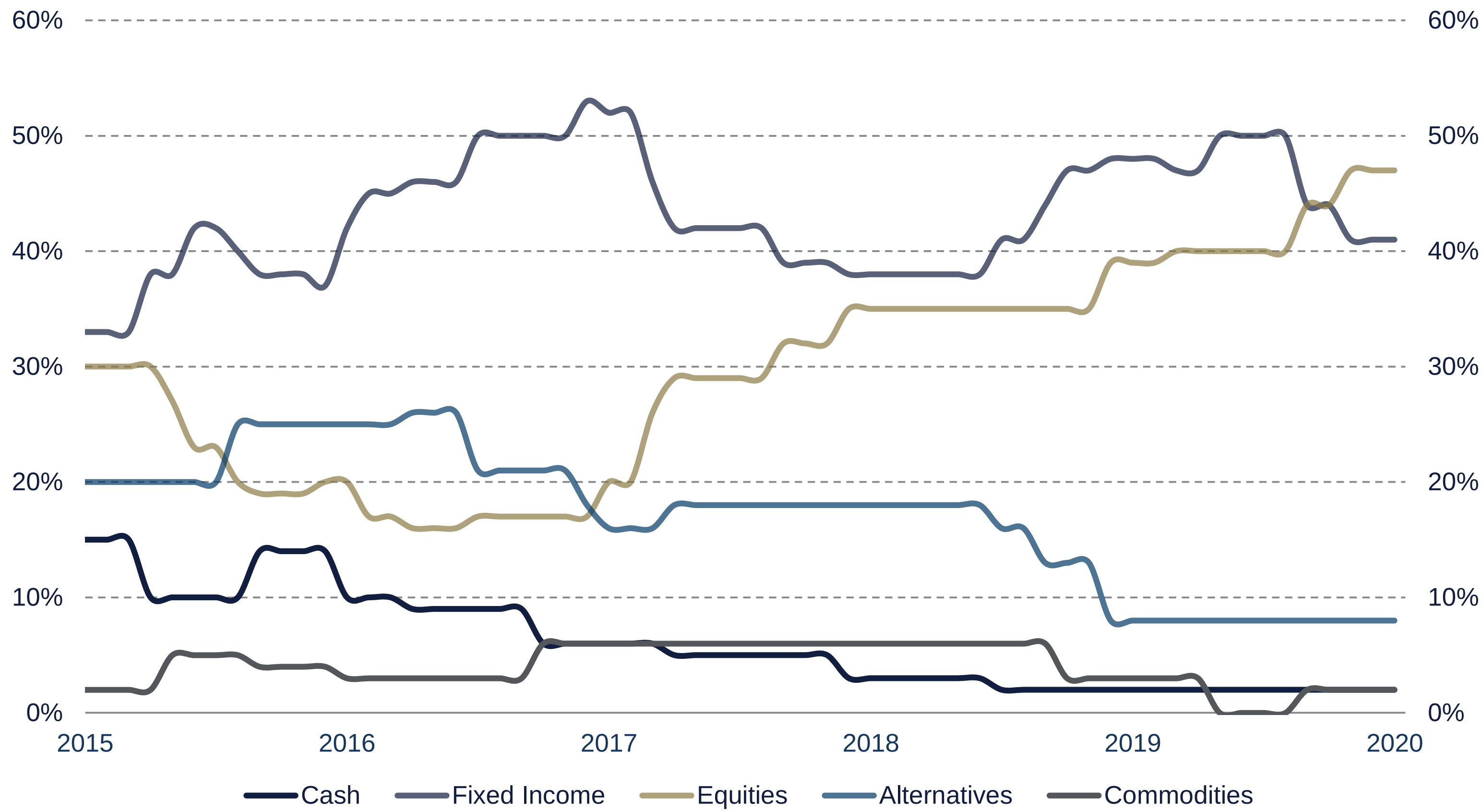


Boreal Investment Profiles

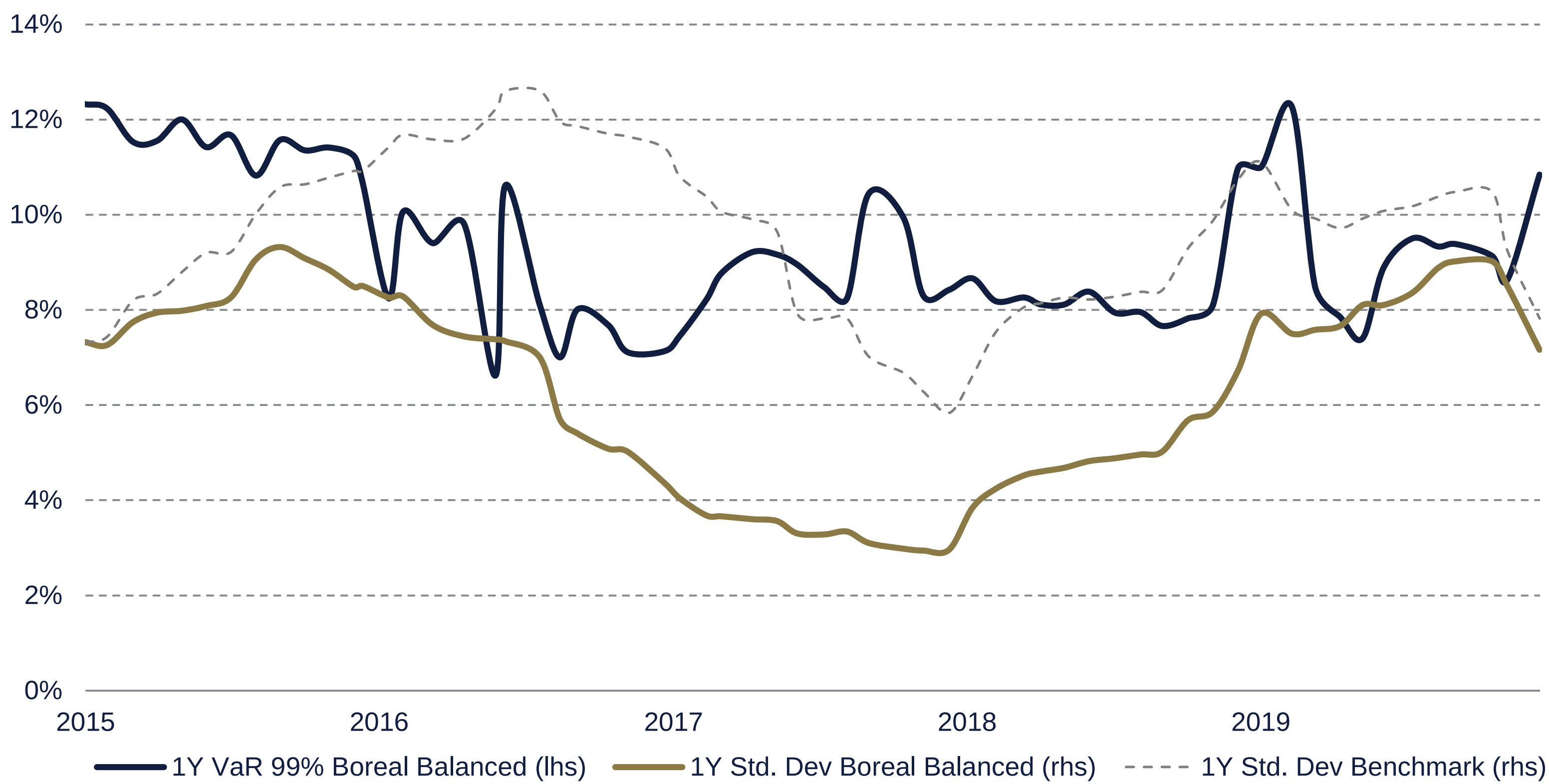
	Conservative	Balanced	Growth
Cash	3% (5%)	2% (5%)	1% (5%)
Fixed Income	58% (64%)	41% (43%)	27% (22%)
Equities	33% (24%)	47% (38%)	60% (52%)
Commodities	2% (2%)	2% (4%)	2% (6%)
Alternative Investments	4% (5%)	8% (10%)	10% (15%)

▼ Strategic Asset Allocation

Boreal Model Portfolio – Asset Allocation evolution



Boreal Model Portfolio – VaR evolution



[1] As of January 13, 2020
Source: Bloomberg

Boreal Model Portfolio – Peer comparison

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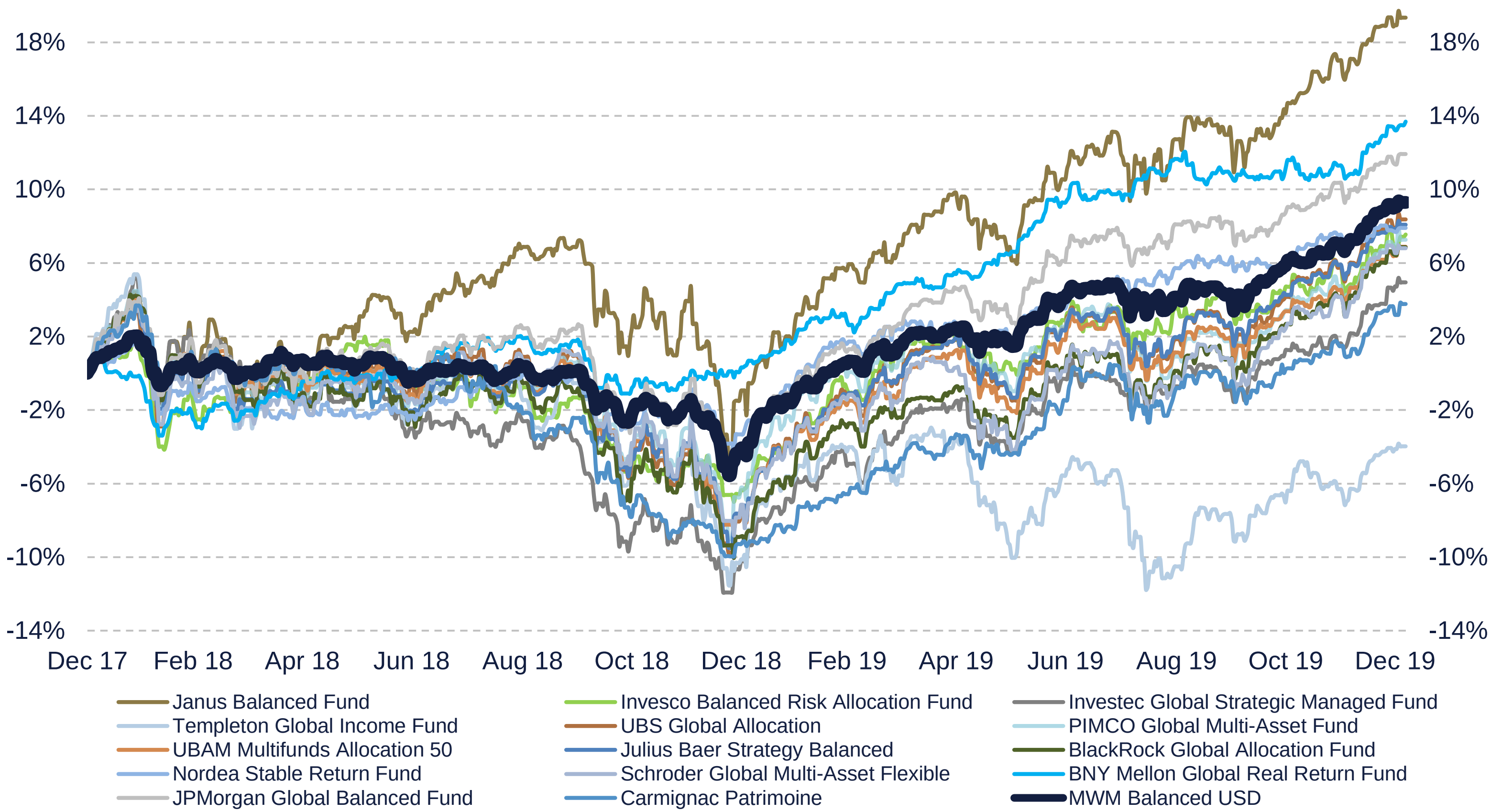
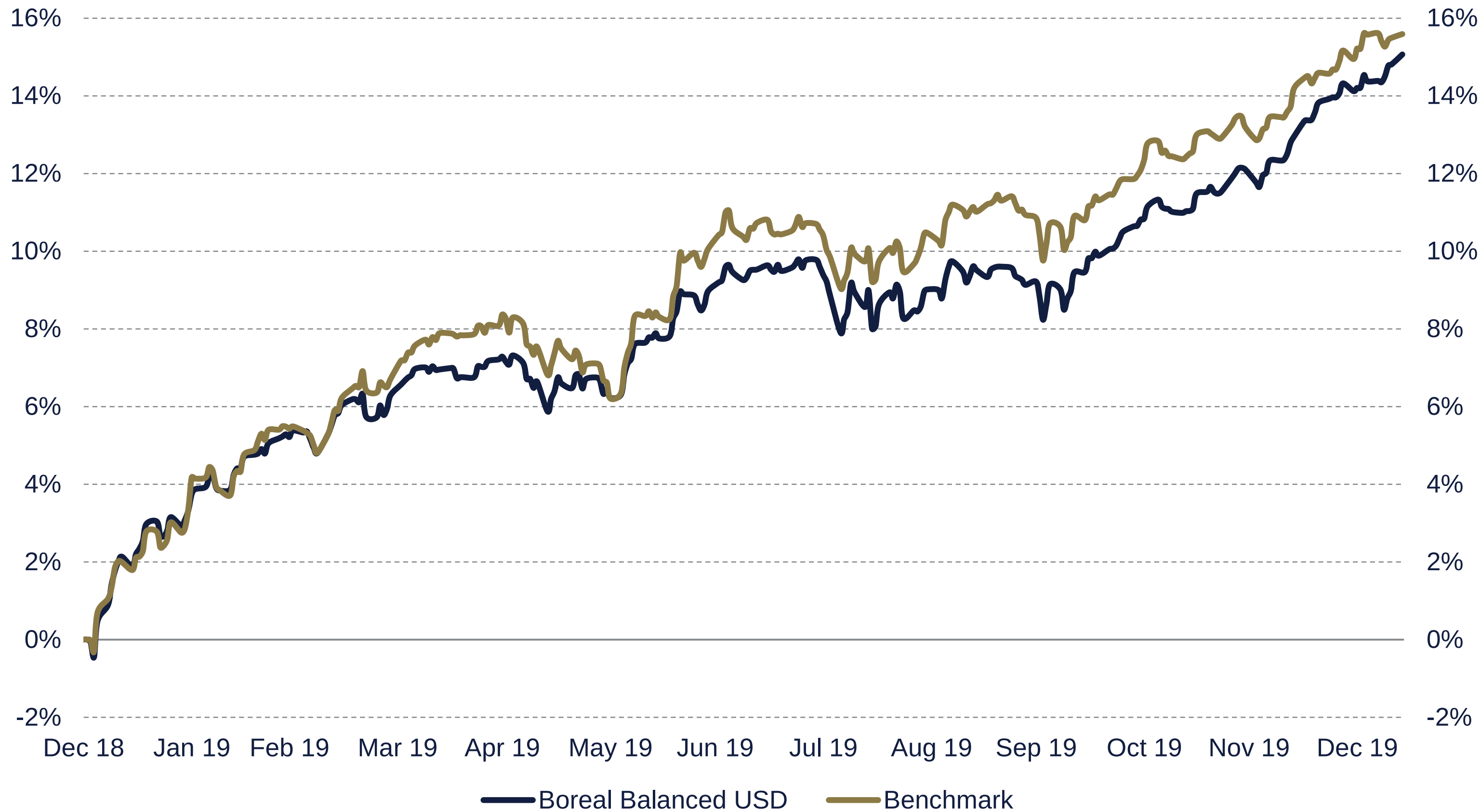


- **Total Return** (Ytd[1]): **12th out of 15**
- **Standard Deviation** (1 year[1]): **3rd out of 15**
- **Downside Risk** (1 year[1]): **3rd out of 15**
- **Sharp Ratio** (1 year[1]): **1st out of 15**

[1] As of January 6, 2020

Source: Bloomberg

Boreal Model Portfolio – Performance since 2018

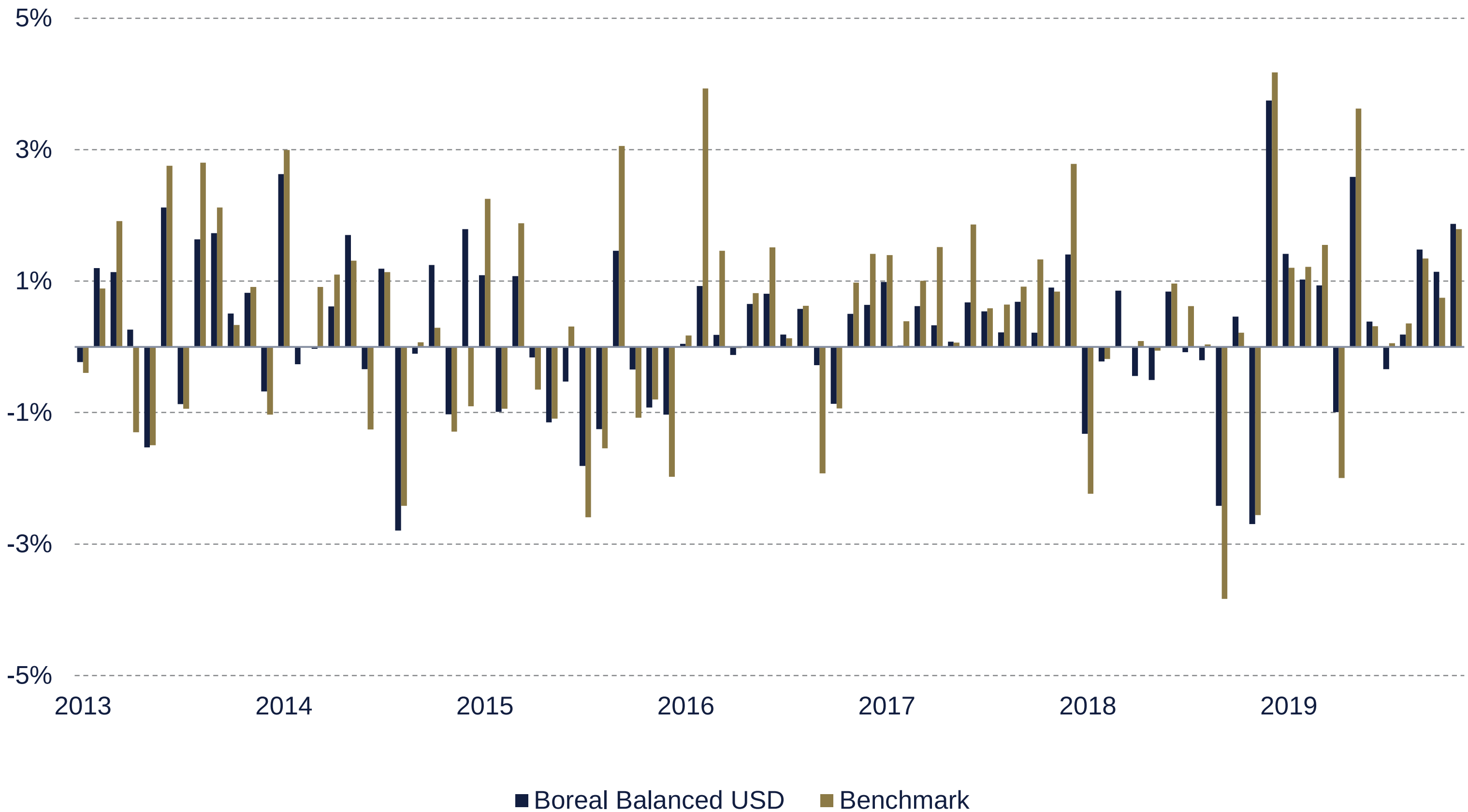


- **Total Return** (Ytd[1]): **0.75%** vs. **0.33%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **2.31%** vs. **2.46%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **1.59%** vs. **1.58%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of January 13, 2020

[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)

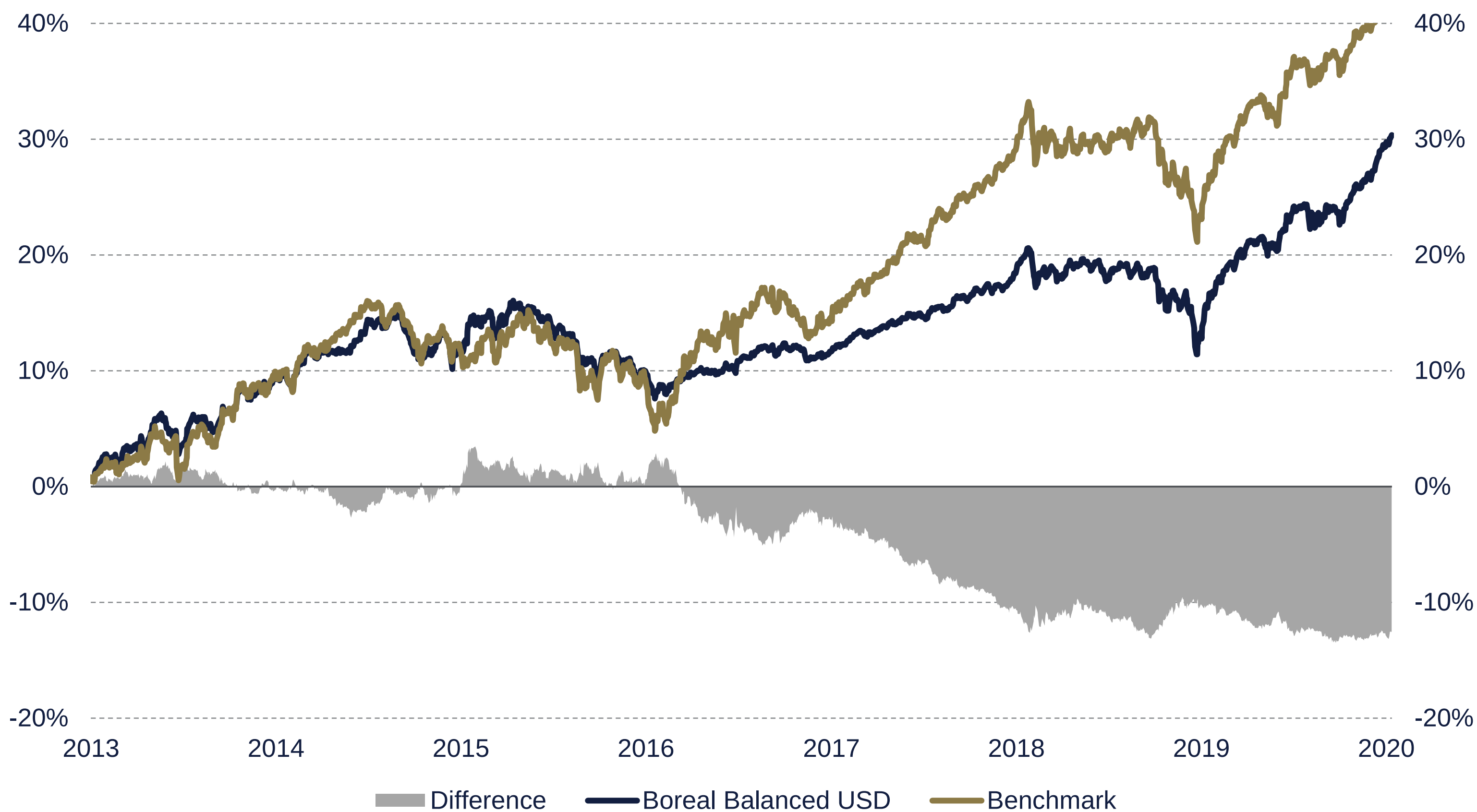


- **Total Return** (1 year[1]): **12.66%** vs. **13.33%** Benchmark[2]
- **Total Return** (3 year[1]): **16.23%** vs. **23.37%** Benchmark[2]
- **Total Return** (Since Jan 13[1]): **30.35%** vs. **42.72%** Benchmark[2]

[1] As of January 13, 2020

[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]): **3.58%** vs. **3.91%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.72%** vs. **2.79%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **2.98** vs. **2.91** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.32%** vs. **-0.38%** Benchmark[2]

[1] As of January 13, 2020

[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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