Investment Policy

March 2020

BOREAL
CAPITAL MANAGEMENT

Our market view in a nutshell – March 2020

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- The strong correction in the markets has caught us being well positioned, invested in both quality stocks and hedged instruments. For all these reasons, our portfolios have performed well relative to the market. However, **volatility is extreme**, and forces us to constantly re-evaluate the risk we are taking
- Our **base scenario** continues to be that in **the current crisis, caused by a pathogen, it is known that it will have a limited duration**. What is important and urgent is that governments come up with **a convincing plan to prevent a health collapse**, as well as to **alleviate the financial and labor burden on companies experiencing temporary difficulties**, and thereby avoid a "cash crunch". The second seems easier than the first but, for the moment, the answer is quite disappointing and that is why the markets do not find ground
- To this already complicated situation, the **announcement by Saudi Arabia** has caught the market completely by surprise. Although **a fall in oil prices is generally good for the economy** (similar to a tax cut on consumption), **the fear is that it may generate a credit crisis in the energy sector in the US**, as it happened in 2015. In our opinion, the situation is not comparable. At that time, oil was trading above $ 100, while in recent years it was hovering around $ 50. Therefore, **companies in the sector are better prepared today** to operate at these prices
- The **risk is that the combination of these two shocks will tip the economy into a recession**. However, if this were the case, a rebound would be expected once the epidemic took a back seat. And even if this did not happen immediately, **valuations already discount a recessionary scenario**, so we **do not recommend reducing exposure to equities to these levels**. In addition, the drop in interest rates to record lows, with the 30-year US Treasury bond around 1%, makes equities even more attractive today
- In summary, we believe that **market volatility reflects the growing number of investors who are trying to anticipate the next recession, regardless of fundamentals**. Therefore, we think we are well positioned, although we have made some changes to the portfolio, **reducing exposure to emerging markets and increasing gold**. It should be noted that **there are also "positive risks"**, such as the announcement of a vaccine or an effective treatment, that can cause the market to rebound strongly

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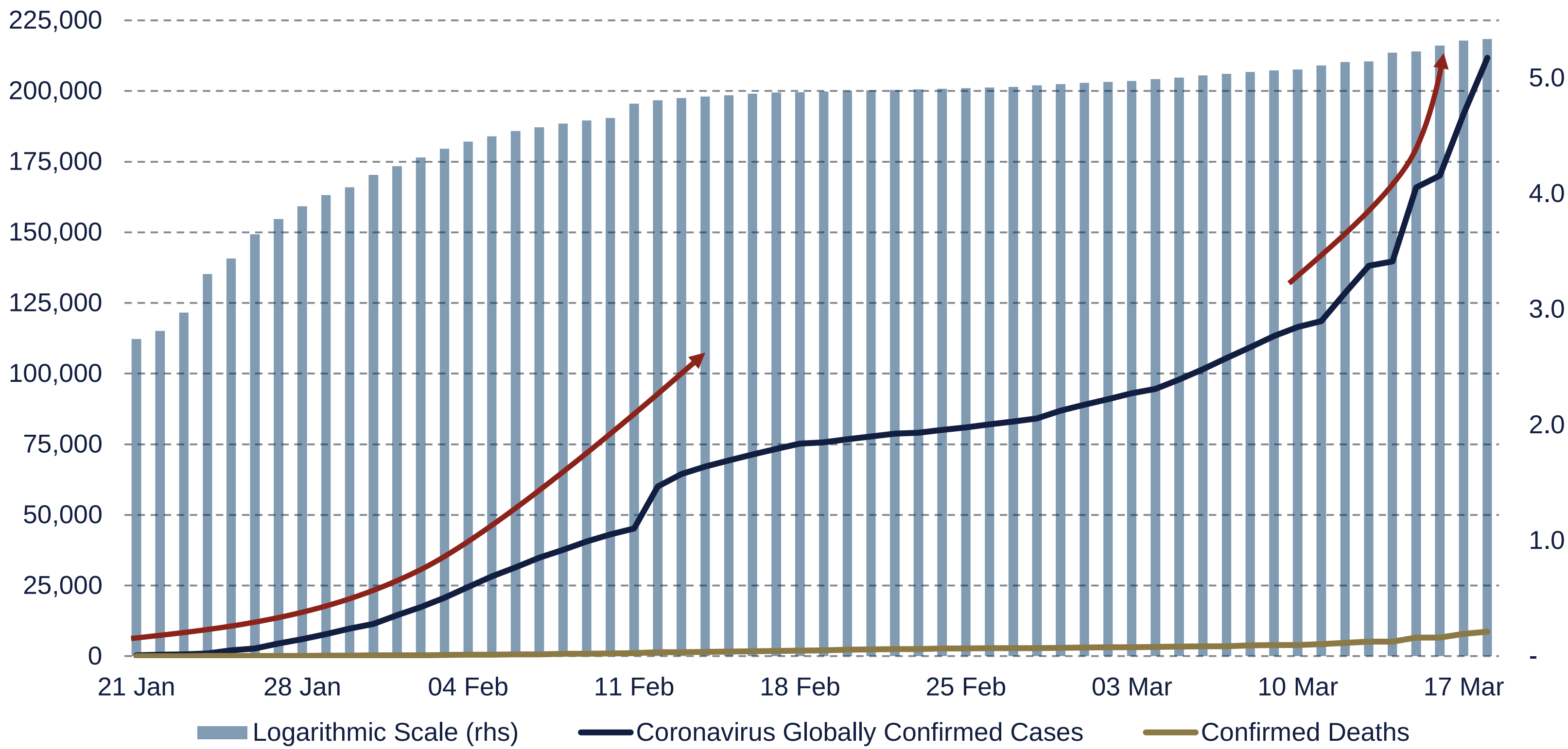
Asset Class		View	Rationale
Fixed Income	US Treasuries	=	Treasuries offer protection from a slowdown in growth, but we believe that current long-term yields are unattractive, preferring shorter maturities
	US Credit	=	Corporate debt and High Yield currently offer a fair combination of risk and return. 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	=	A weaker dollar should help emerging markets, but both currencies and credit spreads have reacted only partially to the risk that the Covid outbreak represents for these countries. In addition, the oil price war will harm exporting countries
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

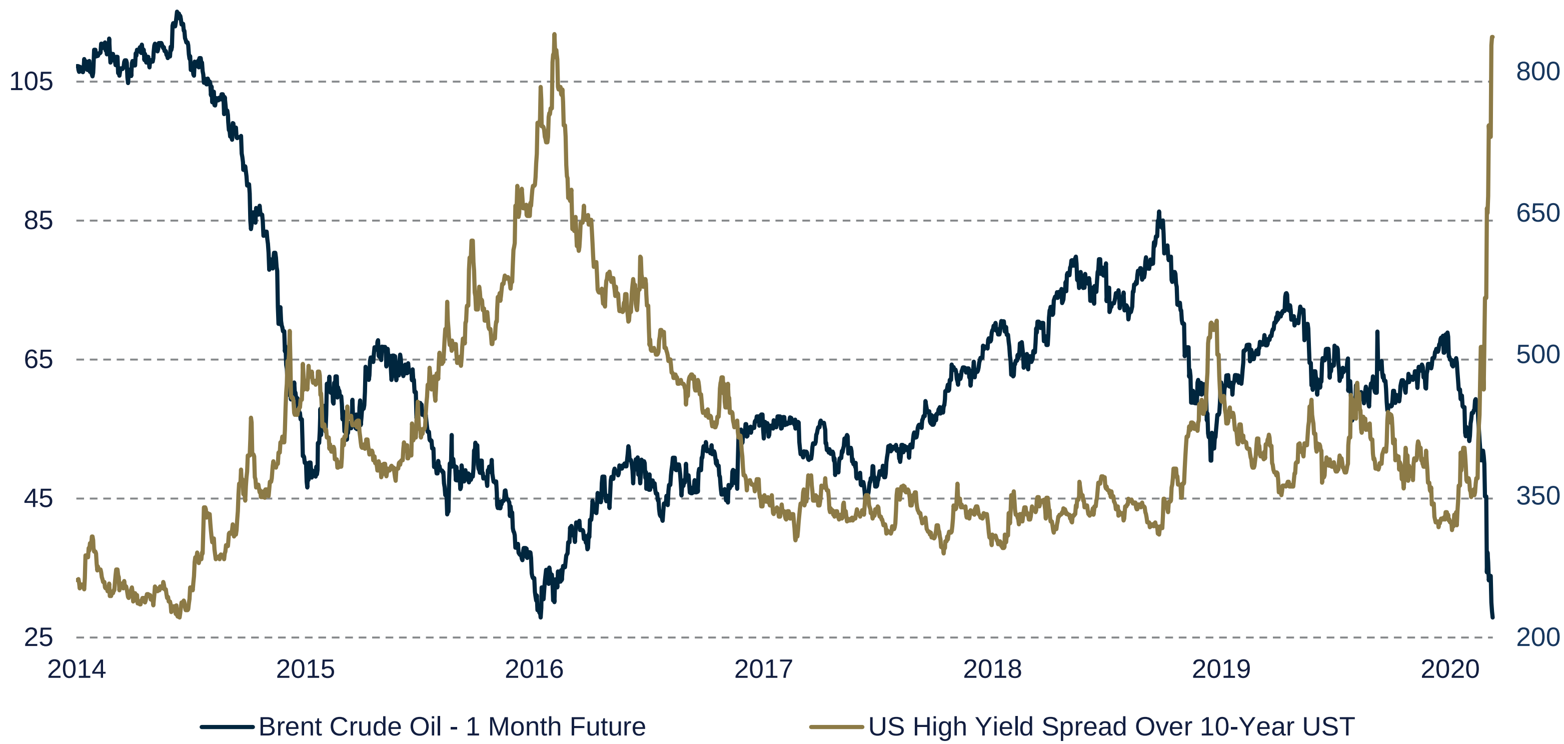
Peaking or accelerating?



- Despite growing social alarm, we continue to see a **linear trend in the spread of the virus**, which gives hope that the epidemic can be largely mitigated until vaccines or effective treatments are discovered.
- But **sudden outbreaks** are possible as the **virus spreads globally**, and with that come restrictions on mobility and social contact that have negative economic consequences

Source: Bloomberg

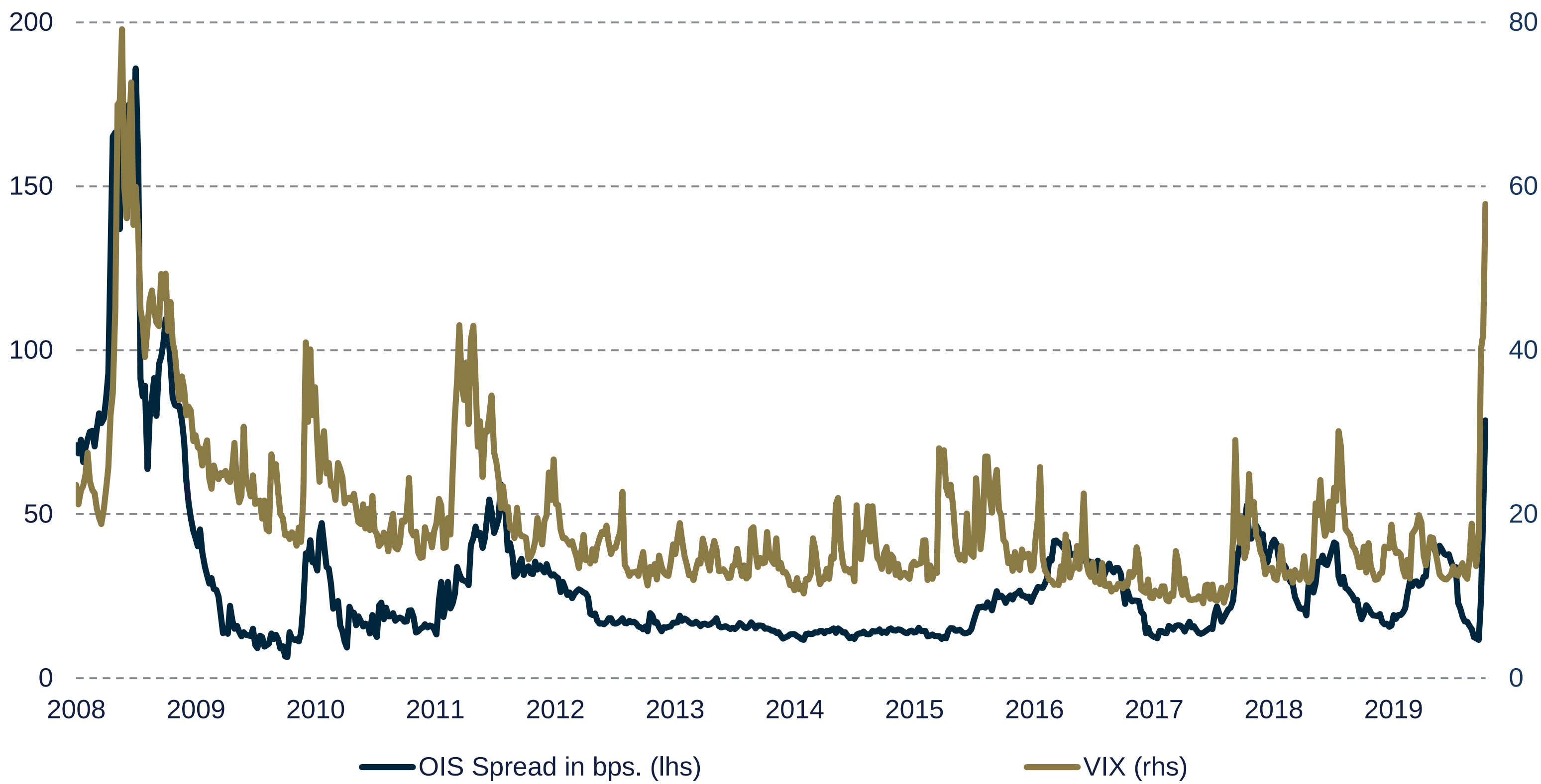
2020 = 2015 + 2018?



- The dispute between Russia and OPEC, and Saudi Arabia's unilateral decision to increase production and lower the oil price target, opens a **new chapter in the "Oil Wars“**
- This has **coincided with fears of a possible recession** due to the impact of the coronavirus; and it has **taken us back to 2015, when the oil sector roiled the US high yield market**. However, at that time oil was trading above $100, while in recent years it was around $50. Therefore, companies in the sector are better prepared today to operate at these prices

Source: Bloomberg

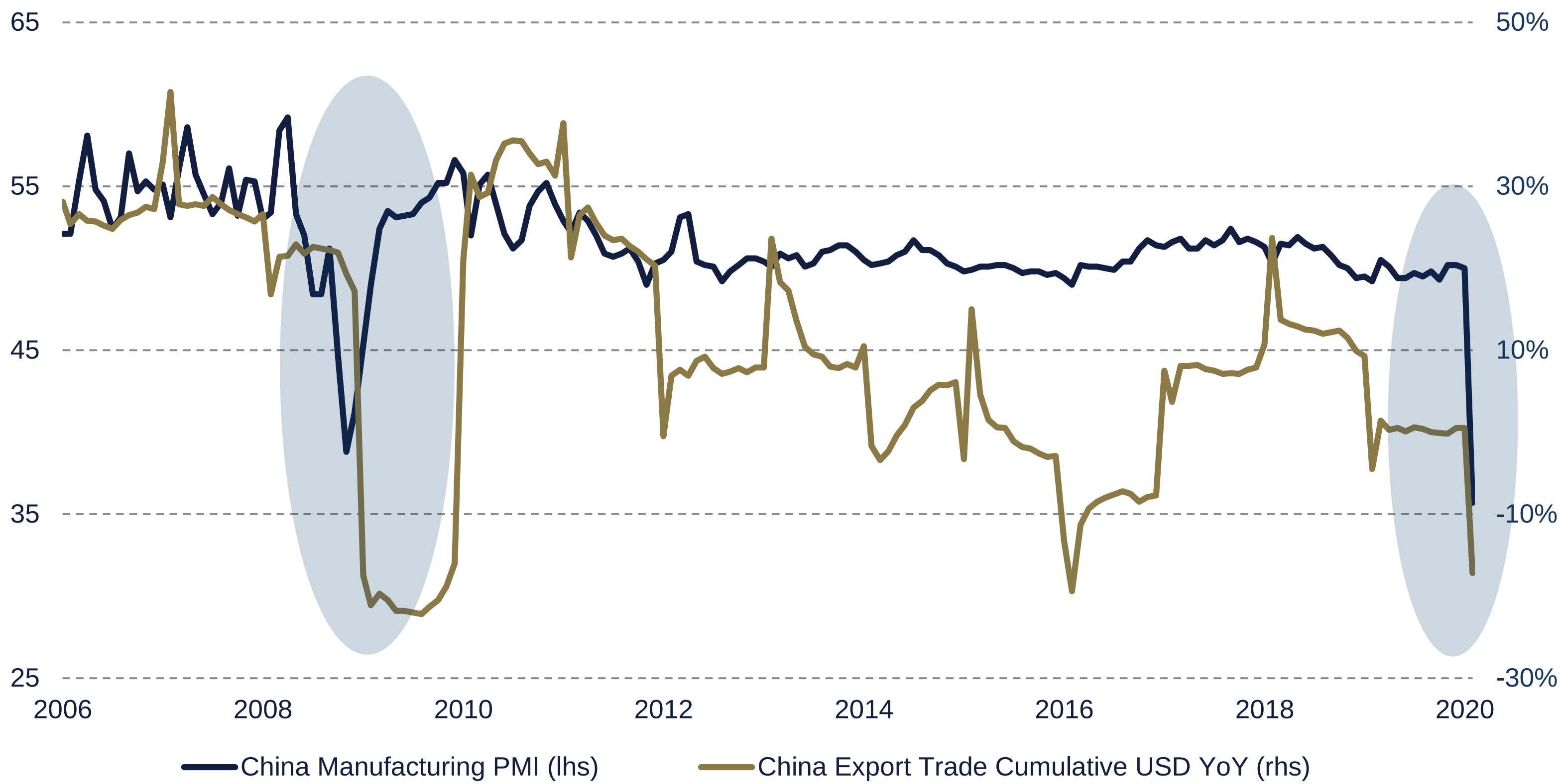
Market distress is very significant



- **Volatility, is trading very close to the levels seen back in 2008**, reflecting the great degree of market uncertainty
- **Funding markets** on the contrary, have not deteriorated to the same extent, although they **are worsening rapidly**. The magnitude of the movement is comparable to more recent episodes, but still far from those reached during the financial crisis

Source: Bloomberg

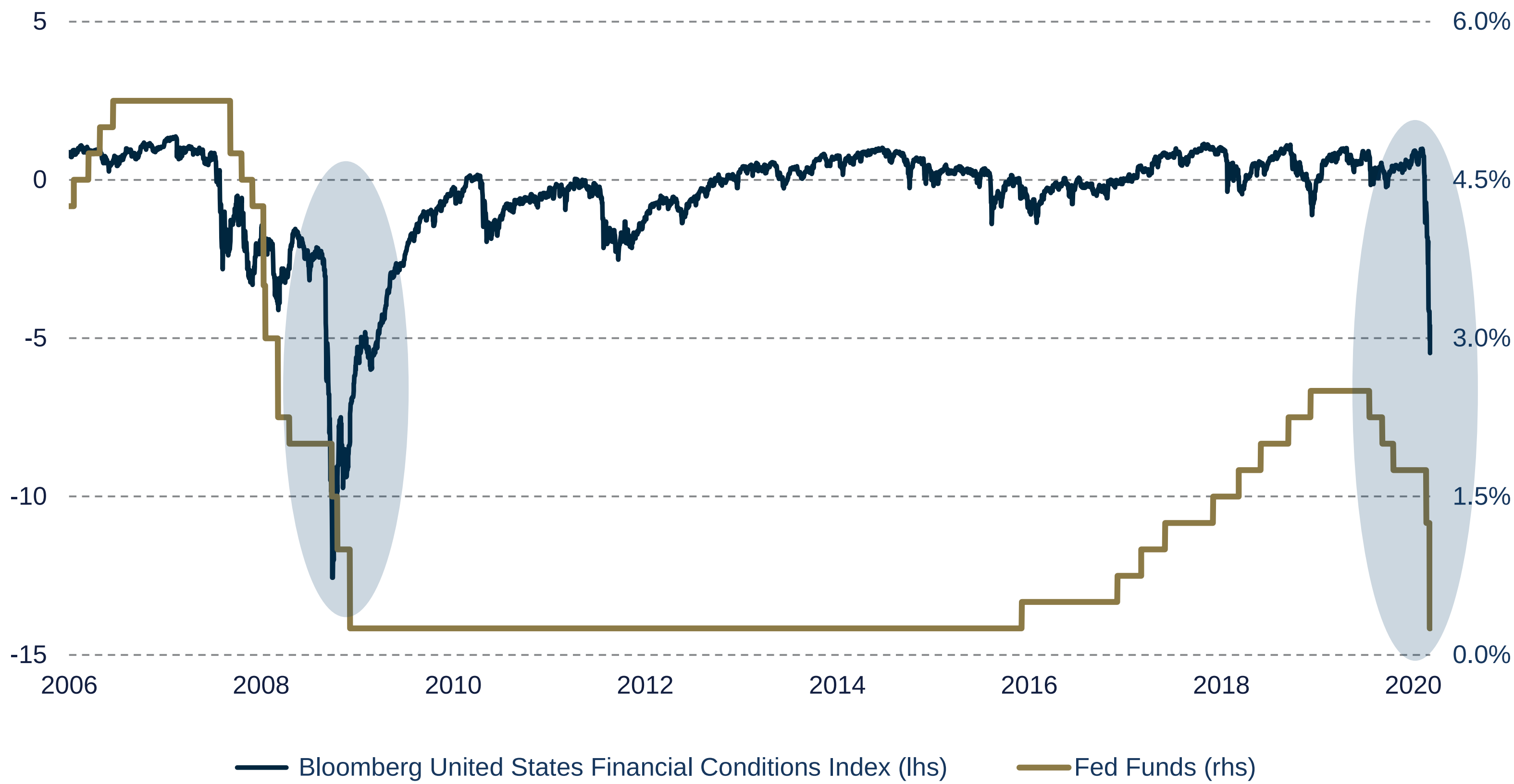
Unprecedented (but temporary) economic stop



- **China** has reported its first macroeconomic figures **showing the extent of the damage to the economy**. The precipitious fall is **worse than in 2008**, although as the country comes back to normality, **we expect activity will recover**
- However, this pattern is likely to repeat itself in other countries, and **the risk is that it will affect the US in the same way**

Source: Bloomberg

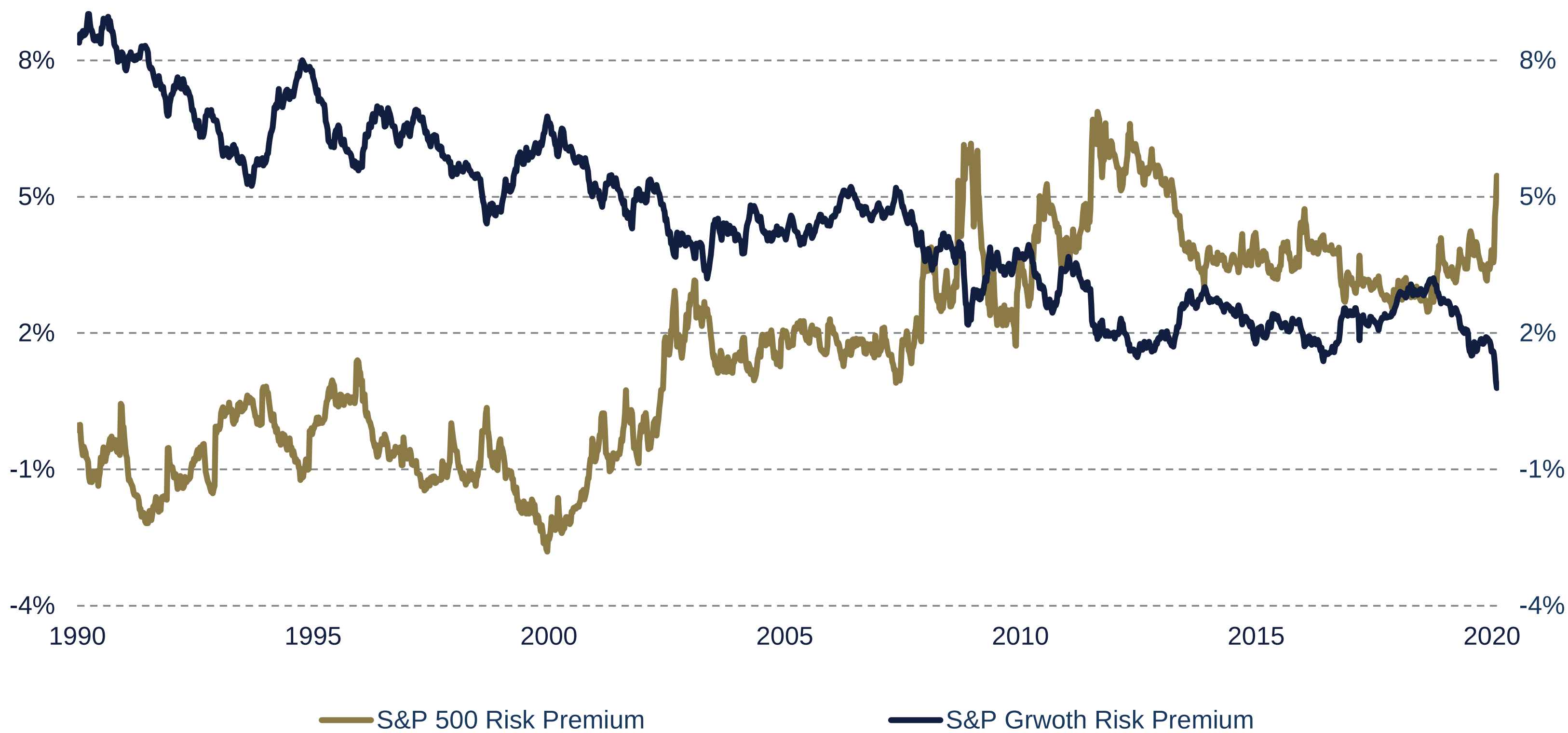
Financial conditions in the "red zone"



- The **worsening in financial conditions** has caused the Fed to act quickly, **lowering rates in an emergency meeting**. The market still expects more cuts at its regular meeting on March 18
- **Other central banks** have followed in the Fed's footsteps, but have much **less monetary ammunition** left

Source: Bloomberg

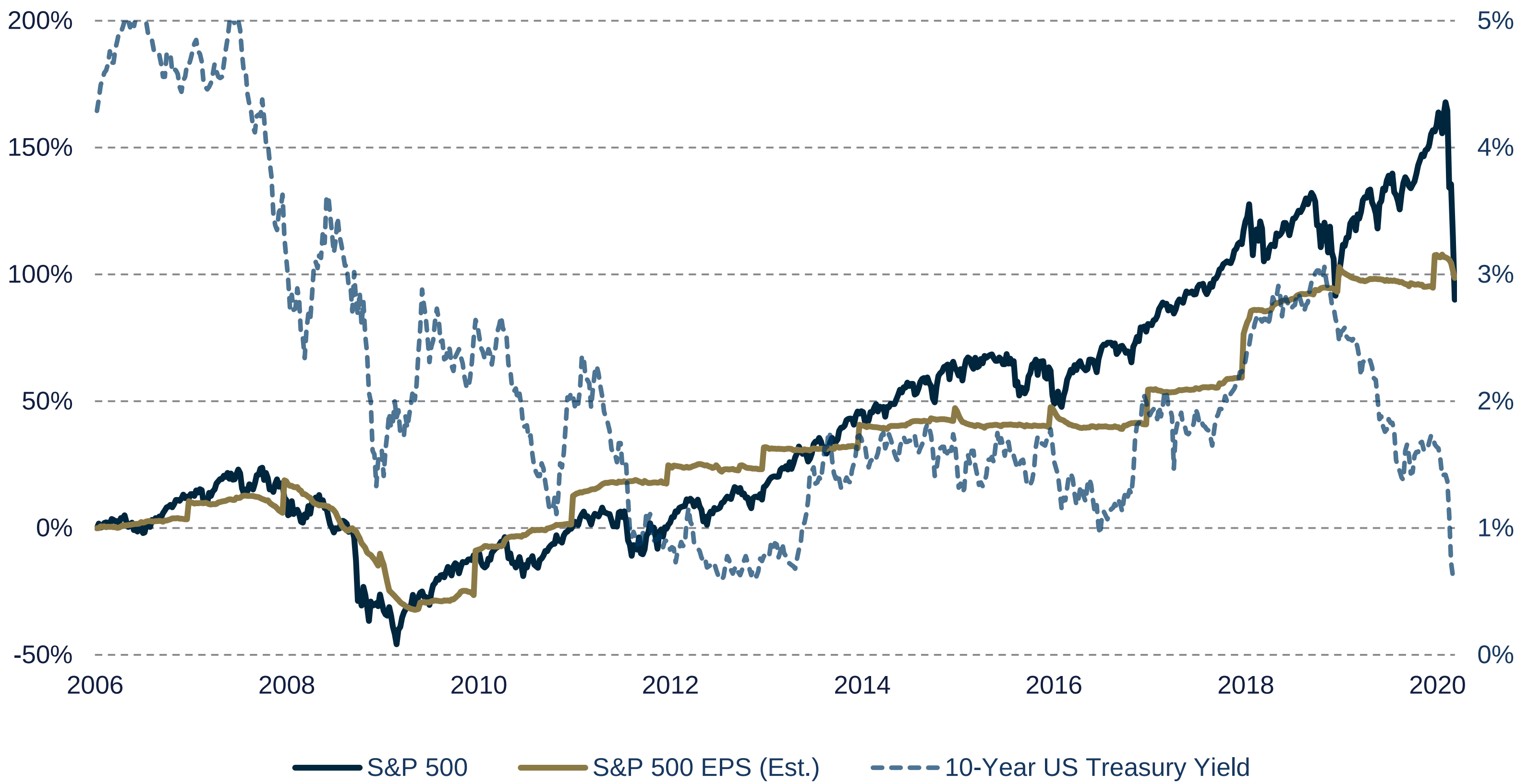
Bond markets pricing an “endless” recession



- **Bonds** are **not being bought as an investment, but as a tool to hedge portfolios**
- **Equity** valuations, by contrast, **have hardly been as attractive before**, with a risk premium of over 5%, compared to their long-term historical average of 1.60%

Source: Bloomberg

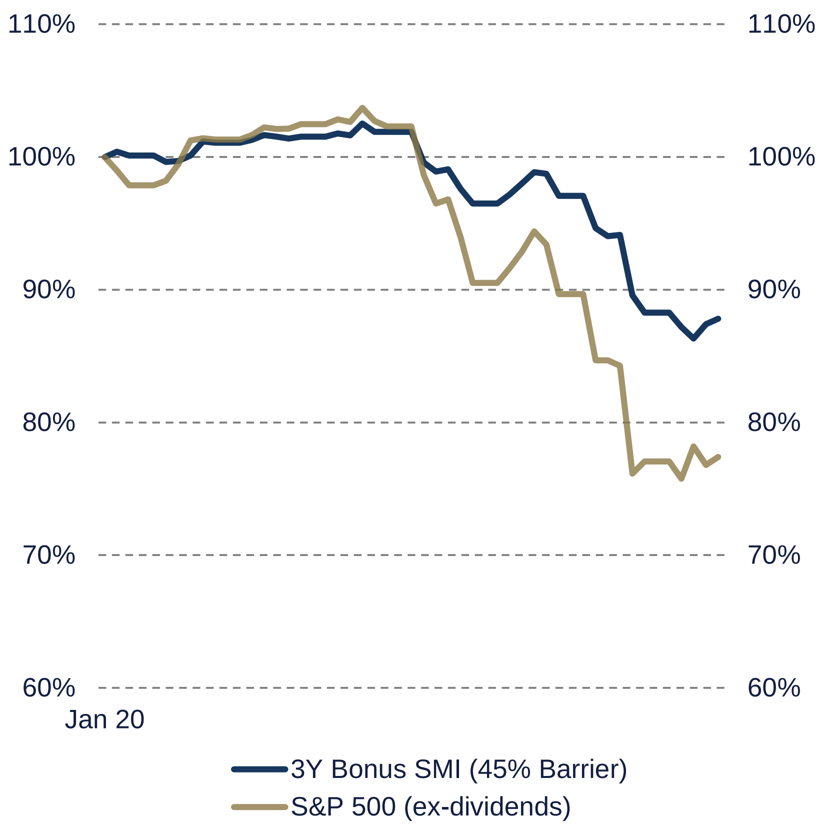
Would you sell your house because of the Covid 19?

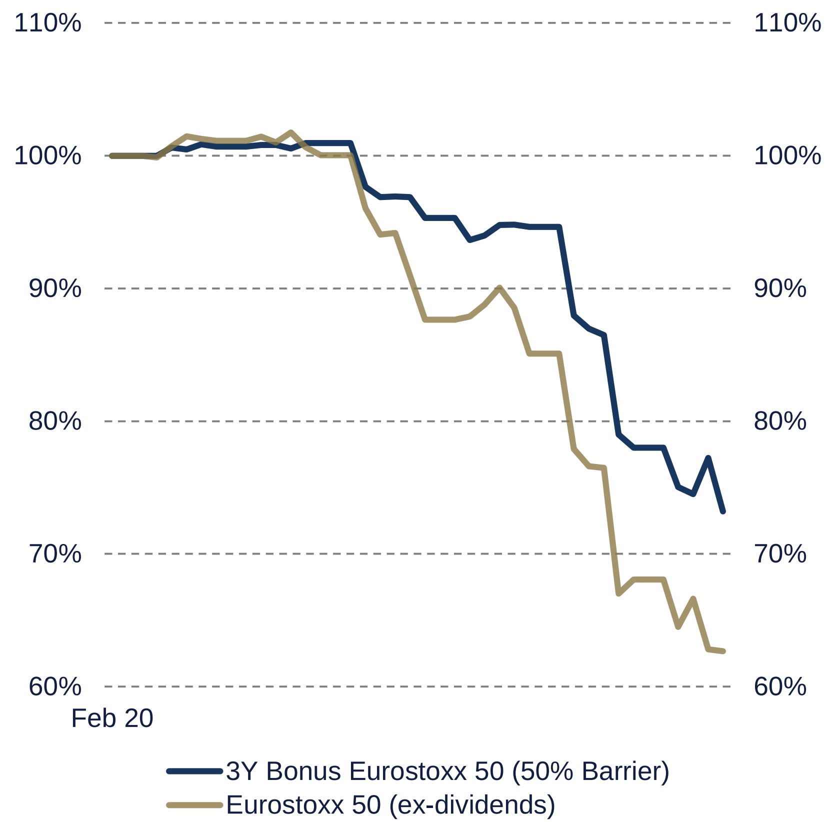


- The Covid 19 crisis will undoubtedly impact earnings in the coming quarters, but long-term earnings should not be compromissed, particularly for quality stocks

Source: Bloomberg

Our defensive positioning is mitigating the downturn

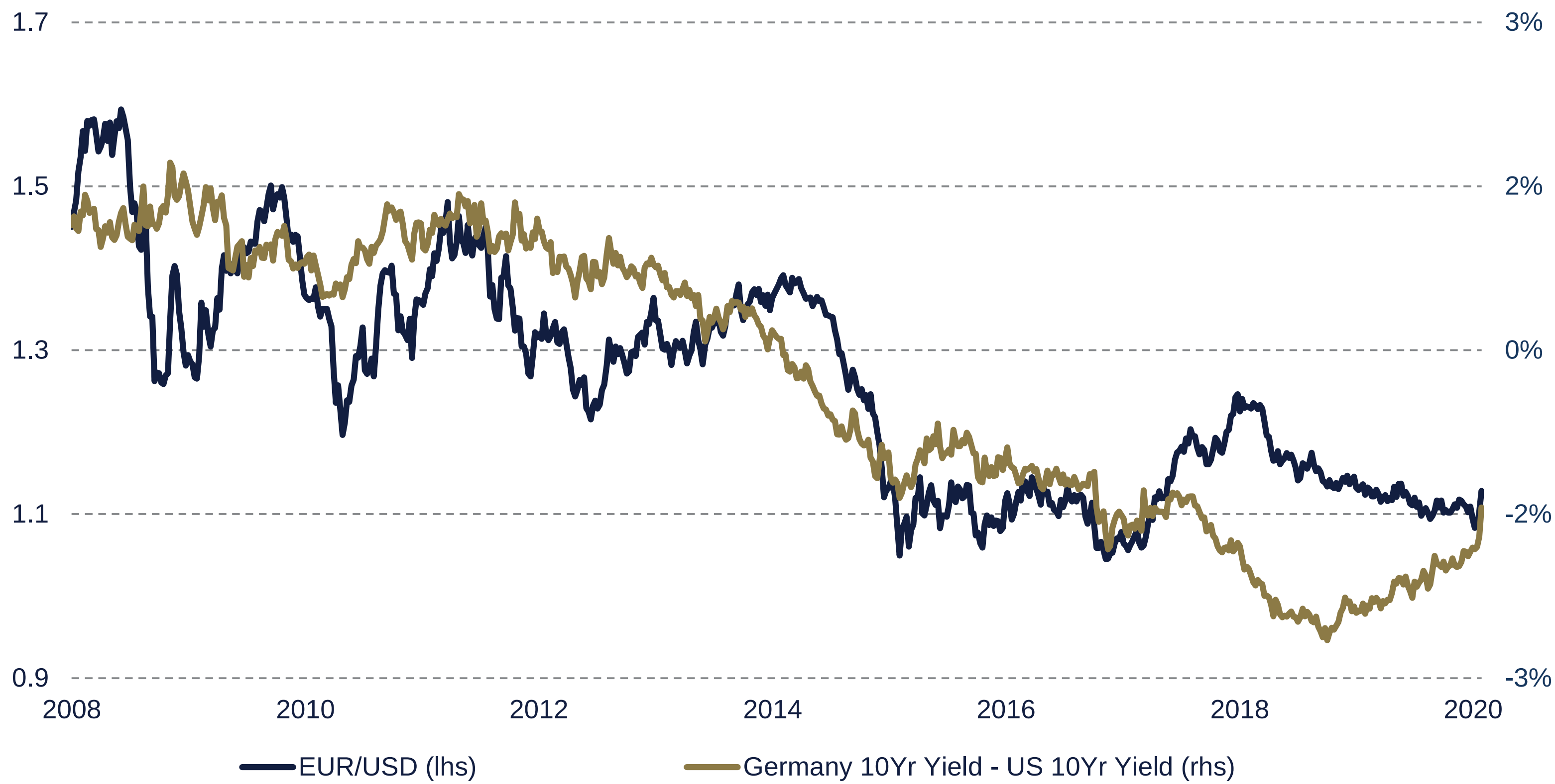




- **Portfolio hedges** have helped mitigate the downturn, particularly **bonus certificates with low barriers**
- Our portfolios have also benefited from our **focus on quality** stocks, as well as in real assets (**Infrastructure**, **Real Estate**) and **Biotech**

Source: Bloomberg

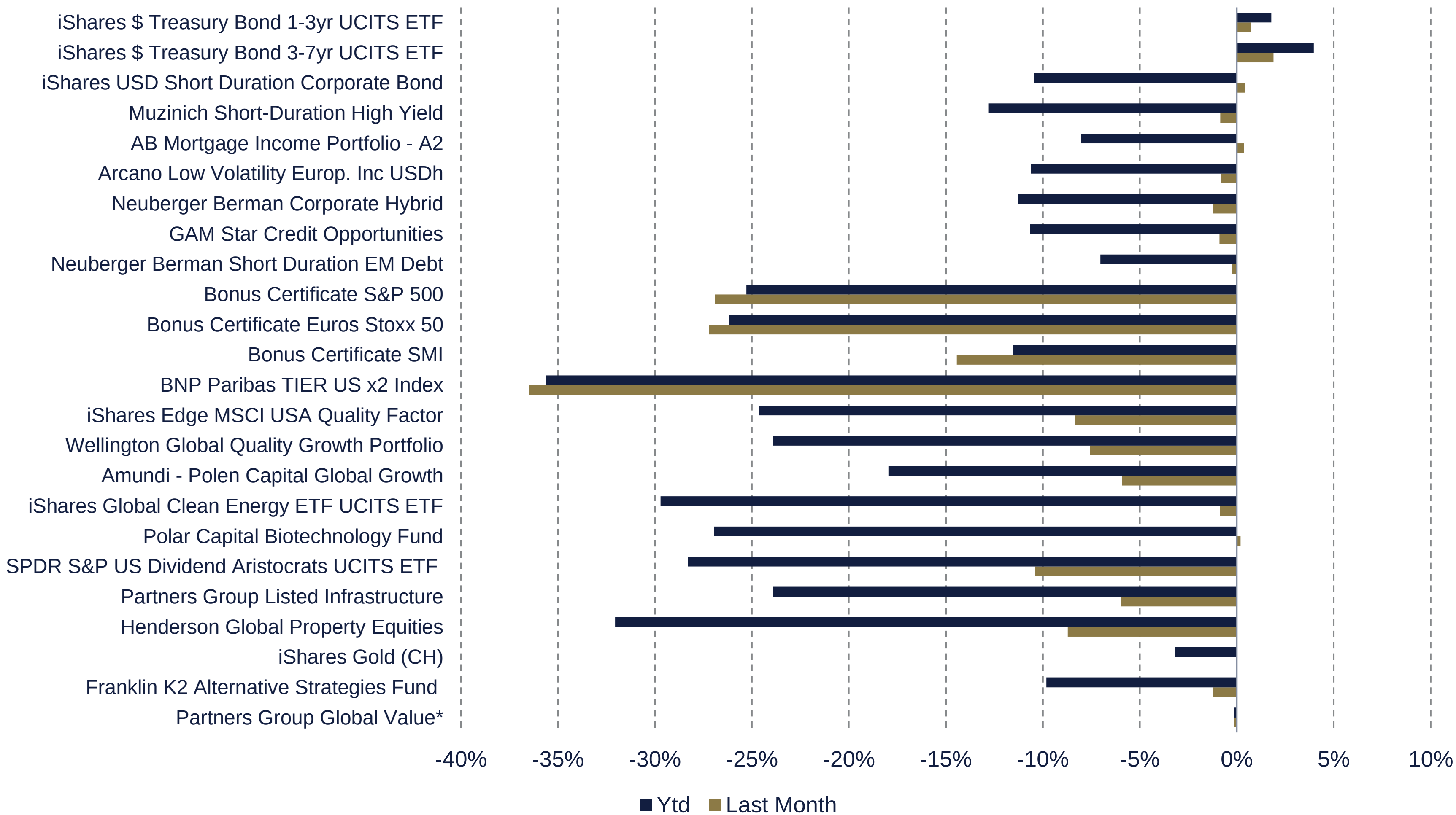
Dollar highs are behind us



- With the Fed emergency cut, and the sharp fall in long-term US Treasury yields, the **interest rate differential against the Euro has narrowed significantly**
- We still believe that both interest rate spreads and growth spreads put the EUR / USD in a **relatively narrow band around 1.15**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg, as of March 19, 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	45% (+10%)	40% (-5%)	15% (-5%)

Short-term catalyzers

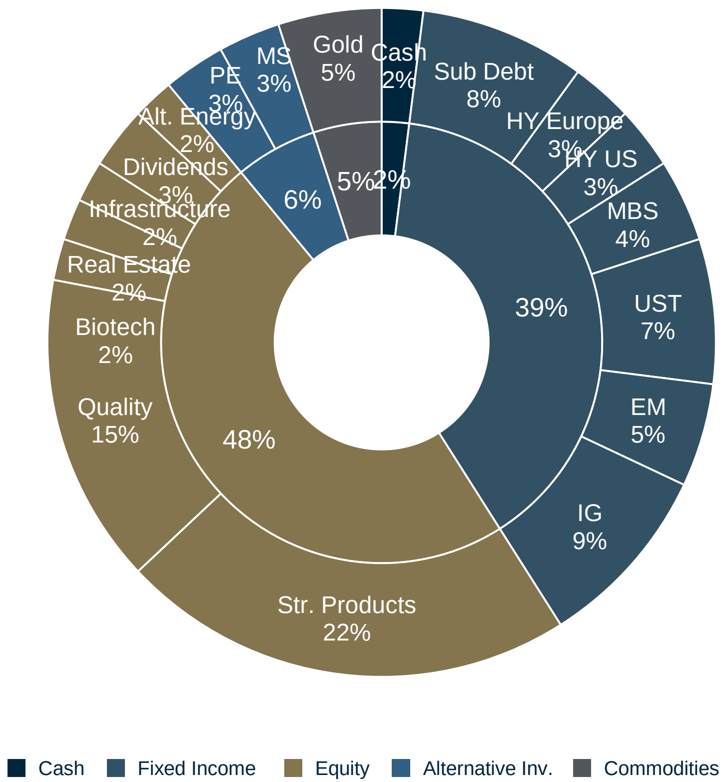
Vaccine or treatment for the coronavirus, coordinated fiscal stimulus, lower geopolitical tensions

Other risks

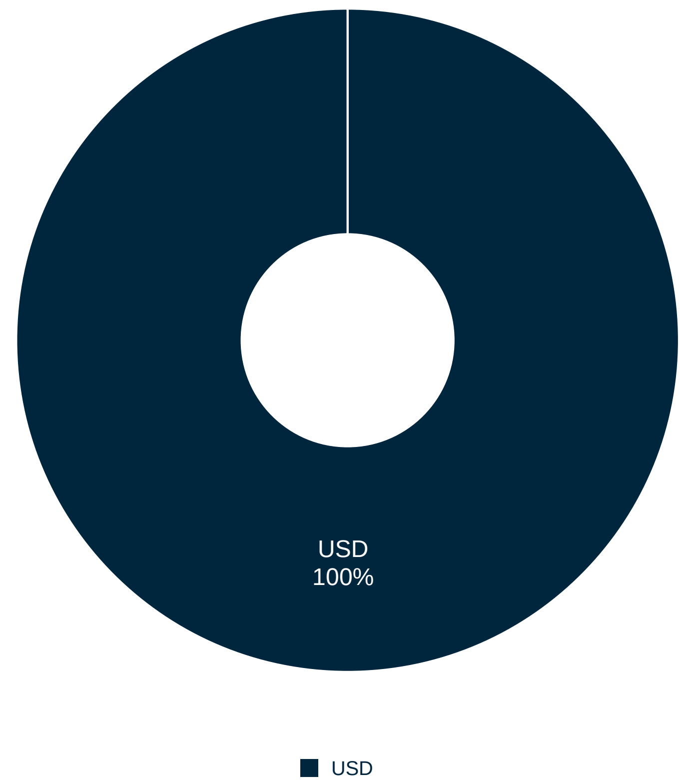
Iran, North Korea, Trade war (II), Brexit implementation, Spread of populist political parties, China slowdown, Terrorism, Hong Kong unrest

Boreal Balanced Portfolio USD

Asset Allocation



Currency Allocation



Boreal Investment Profiles

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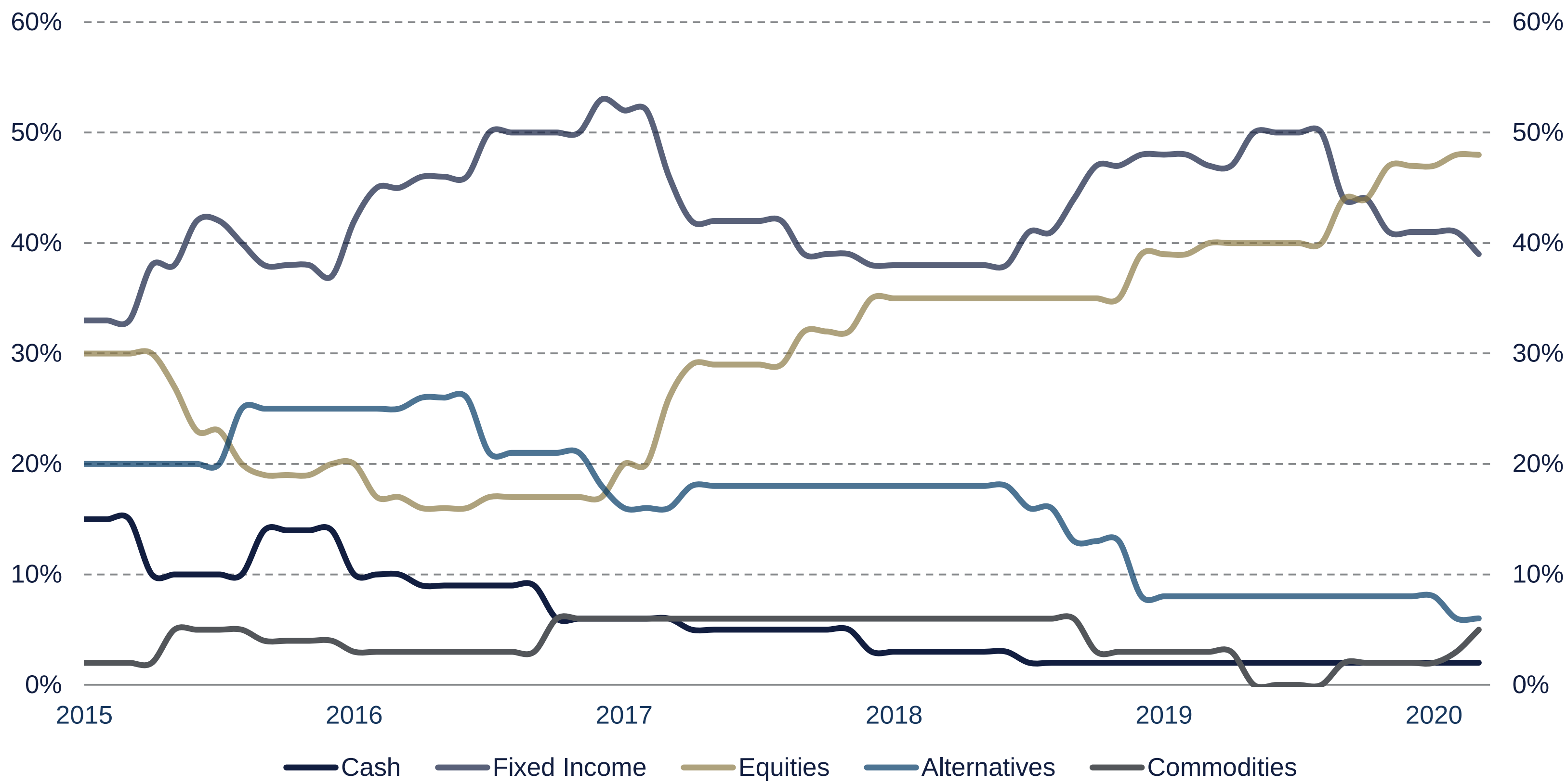
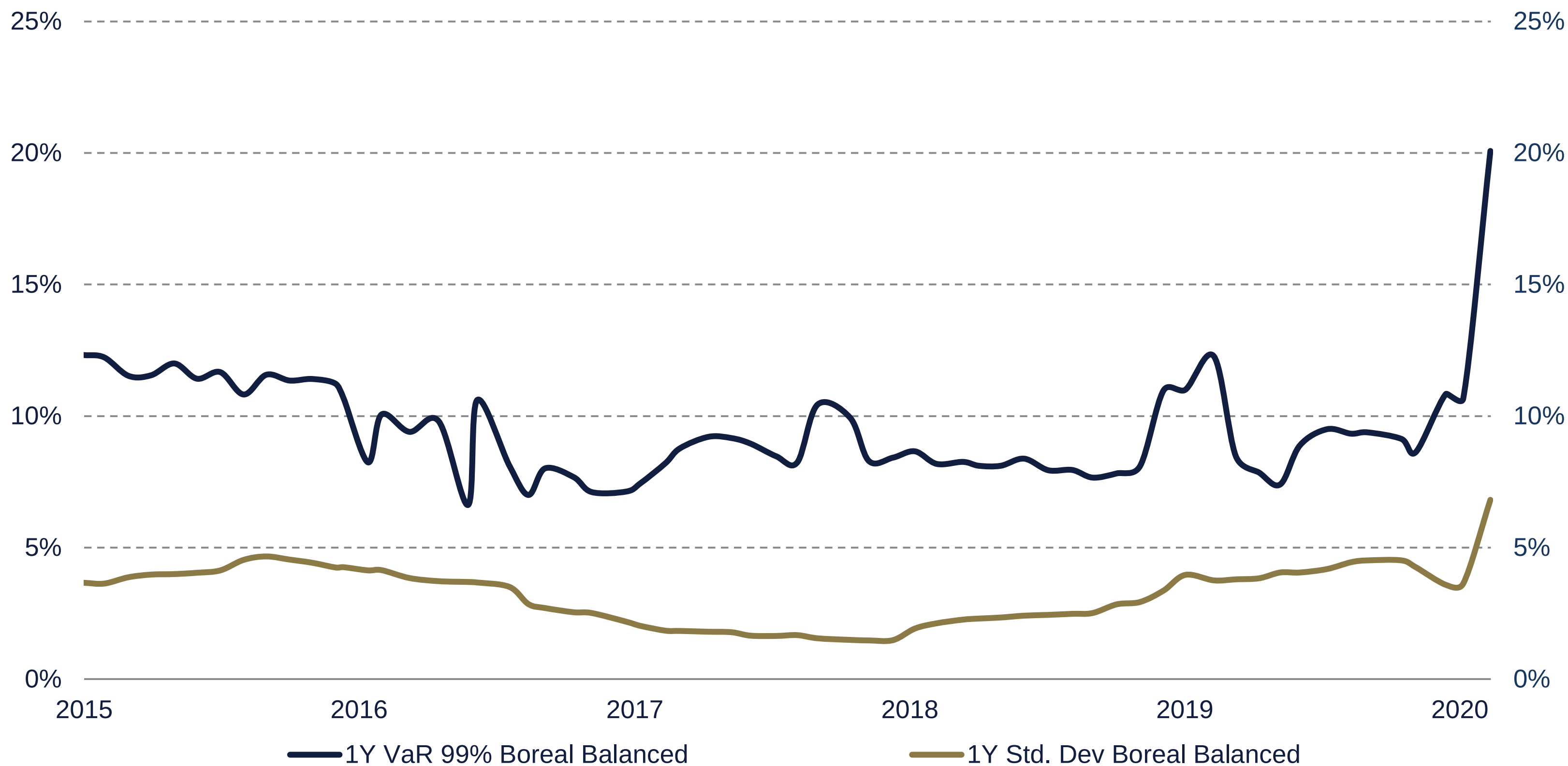
	Conservative		Balanced		Growth	
	Allocation	Strategic Asset Allocation	Allocation	Strategic Asset Allocation	Allocation	Strategic Asset Allocation
Cash	3%	5%	2%	5%	1%	5%
Fixed Income	57%	64%	39%	43%	25%	22%
Equities	34%	24%	48%	38%	60%	52%
Commodities	3%	2%	5%	4%	6%	6%
Alternative Investments	3%	5%	6%	10%	8%	15%

▼ Strategic Asset Allocation

Boreal Balanced Portfolio – Asset Allocation evolution

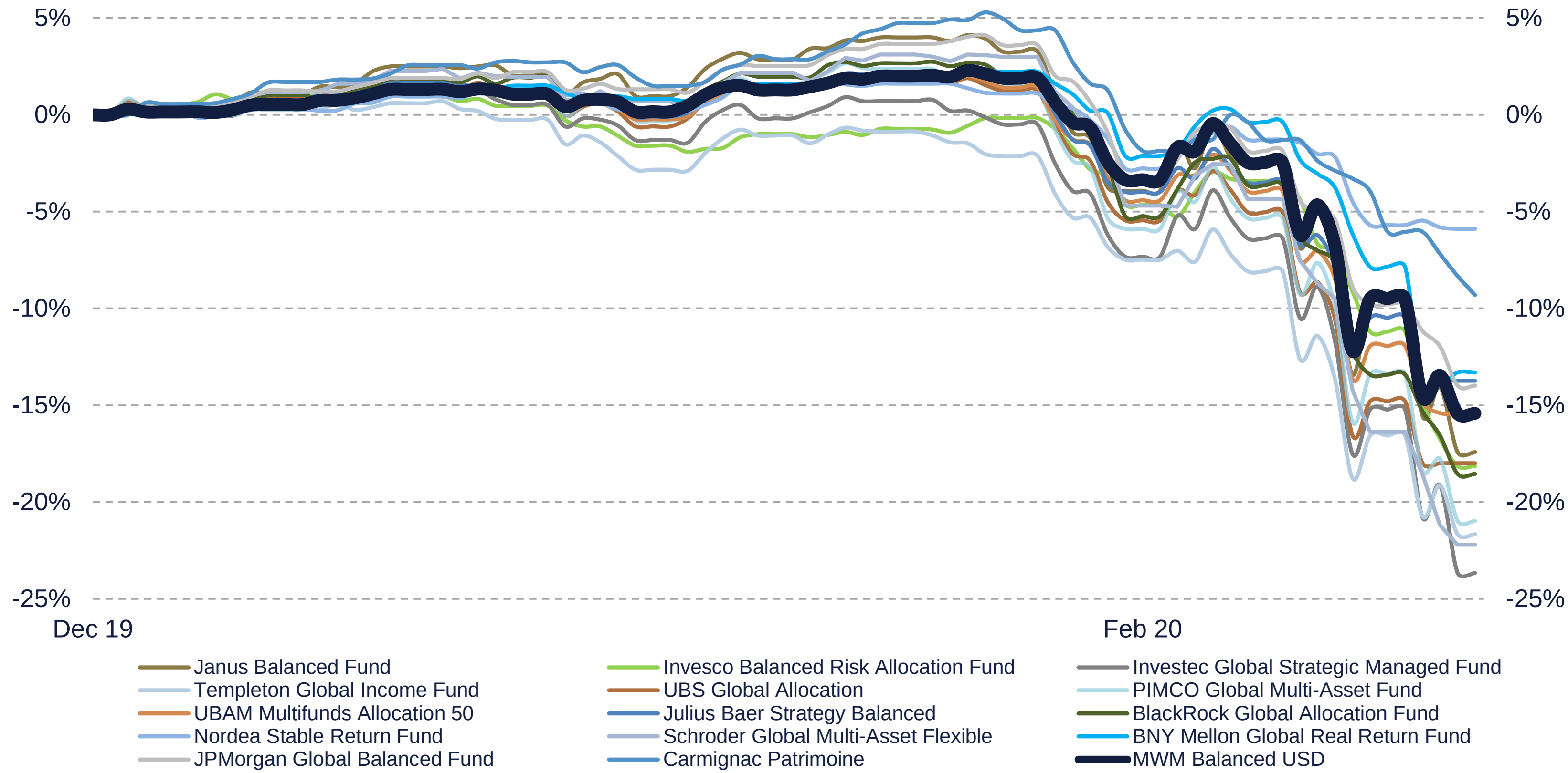


Boreal Balanced Portfolio – VaR evolution



[1] As of March 12, 2020
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **5th out of 15**
- **Standard Deviation** (1 year[1]): **3rd out of 15**
- **Downside Risk** (1 year[1]): **1sd out of 15**
- **Sharp Ratio** (1 year[1]): **1st out of 15**

[1] As of March 9, 2020

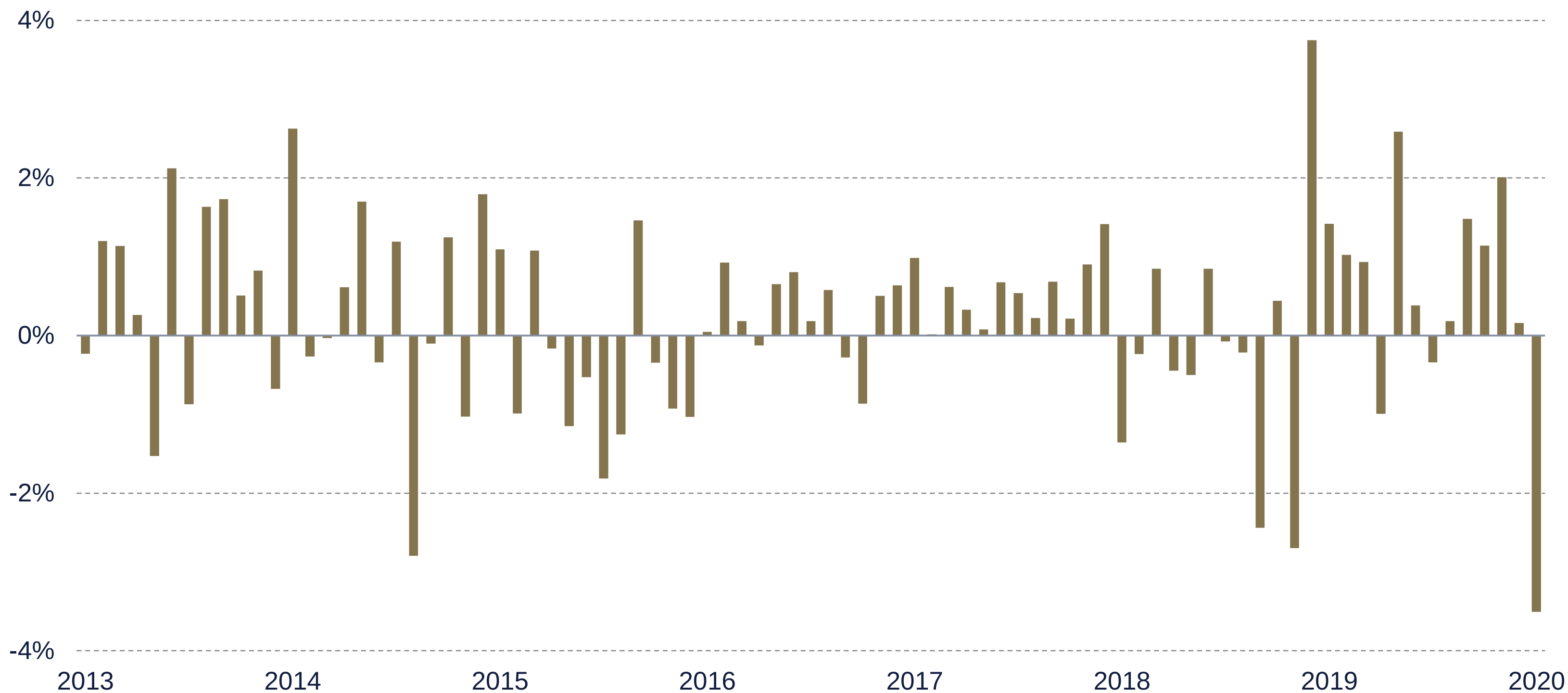
Source: Bloomberg

Boreal Balanced Portfolio – Ytd performance

- **Total Return** (Ytd[1]): **-6.41%**
- **Standard Deviation** (Ytd[1]): **13.74%**
- **Downside Risk** (Ytd[1]): **5.79%**
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of March 12, 2020

Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **1.66%**
- **Total Return** (3 year[1]): **7.20%**
- **Total Return** (Since Jan 13[1]): **21.01%**

[1] As of March 12, 2020

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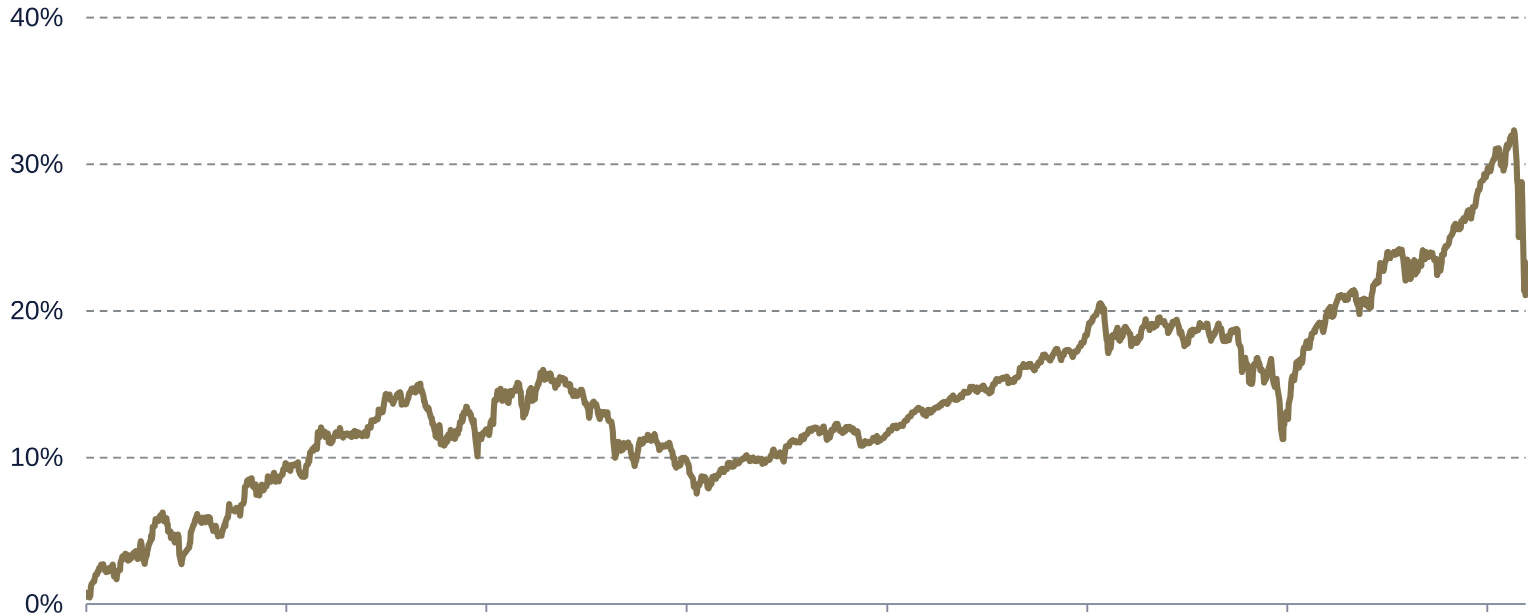
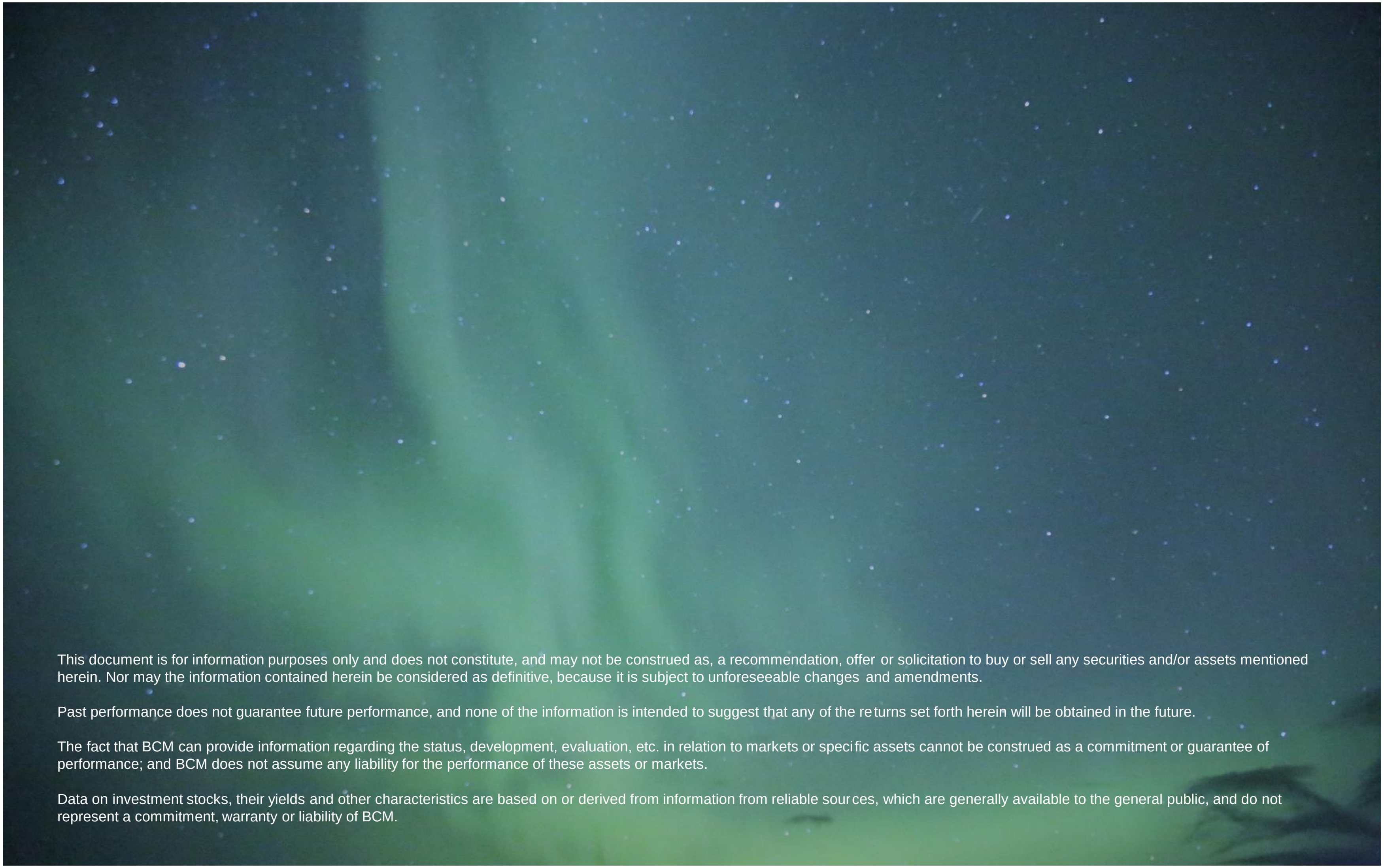
Boreal Balanced Portfolio – Historical performance (2)



	2013	2014	2015	2016	2017	2018	2019	2020
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	-6.41%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	13.74%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	3.03

Annual Return: 2.56%
Annual Std. Dev: 3.98%

[1] As of March 12, 2020



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