# Investment Policy

October 2020

BOREAL
CAPITAL MANAGEMENT

# Our market view in a nutshell – October 2020

BOREAL CAPITAL MANAGEMENT

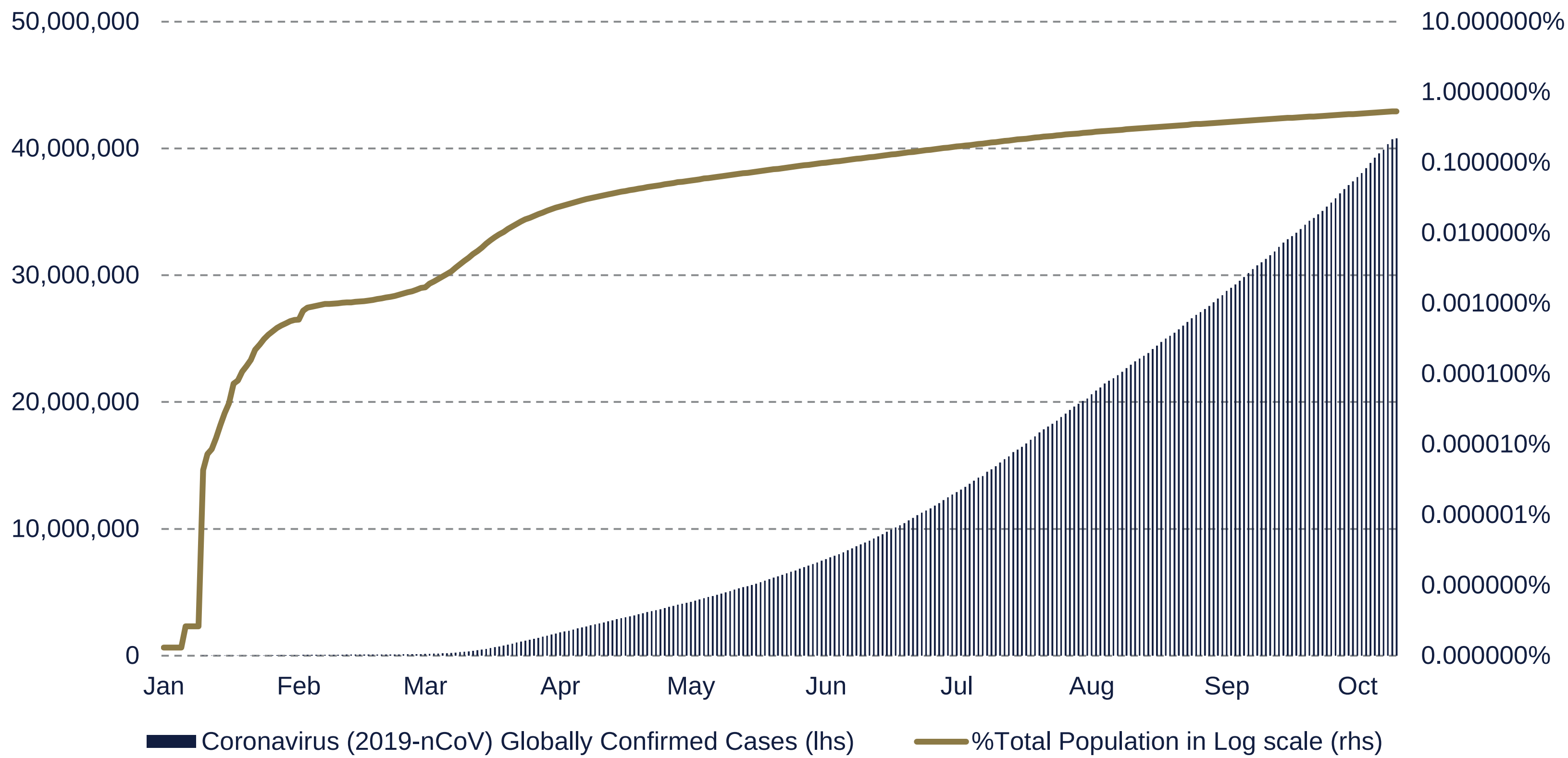
- The **second wave of the pandemic** is crushing hopes of a progressive return to normality. Although the disease continues to spread at a relatively constant rate, as the base of infected people increases, there is a **risk that the virus will spiral out of control and end up infecting a large percentage of the population**. This scenario would require new lockdowns and provide a second fatal blow to the economy. **Our baseline scenario remains however that containment measures will be sufficient to keep the disease under control**, and that the economy will continue to operate at 90% -95% capacity until a vaccine arrives
- The **prolongation of the health crisis will require a continuation of support measures** to allow the economy to continue operating – albeit at a slower pace – in order to avoid further long-term economic losses. Regardless of whether a large part of the economy can be preserved, there will be long-lasting social changes. **The economy that will emerge post-Covid will be different**, and some jobs will disappear forever. **Labor market flexibility will be key** to the reabsorption of unemployed workers, and in this respect, we believe that the adjustment will be faster in the US and emerging markets, compared to Europe
- **Record-low interest rates are giving governments a window of opportunity to borrow**. Despite the ballooning debt, the interest expense is only a fraction of what it used to represent in government budgets in the past. Not surprisingly, there is a **new round of stimulus measures on the table in the US**. Austerity is out of fashion, but public funds will have to be allocated wisely, as otherwise **the sustainability of public finances could be called into question**
- The **US presidential elections seem increasingly tilted towards a victory for the Democrats**, with the stakes being 2/1 in favor of Biden, but still far from being decided. **Voter turnout can be critical** to the outcome. If the Democrats vote en masse, a Biden victory seems certain; otherwise the elections will be very close. **Overall, we see relatively low risk in the current presidential elections, as both candidates are perceived as relatively pro-market**. At sectoral level, there will be winners and losers, but the various underlying sectoral trends are so strong that the victory of one or the other candidate will hardly affect them

# 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 | = | The incoming economic downturn will undoubtedly lead to an increase in the number of corporate defaults. Although credit spreads already reflect this risk, we favor Investment Grade over High Yield. |
| | 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 and Investment Grade |
| | 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 sharp sell-off, valuations have improved. We have therefore increased our exposure to US equities, mostly through quality and growth oriented companies |
| | Europe | – | The European economy has been more affected by Covid than that of the US or Asia. Relaunching it will require a greater fiscal effort, which will have to be financed by new debt. A repeat of the sovereign debt crisis is a real risk |
| | 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, in general, will lack sufficient fiscal freedom to stimulate the economy after the pandemic |
| | Sectors & Themes | + | Beyond our core call for quality-growth companies, we favor Infrastructure, Biotechnology and Clean Energy |
| 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

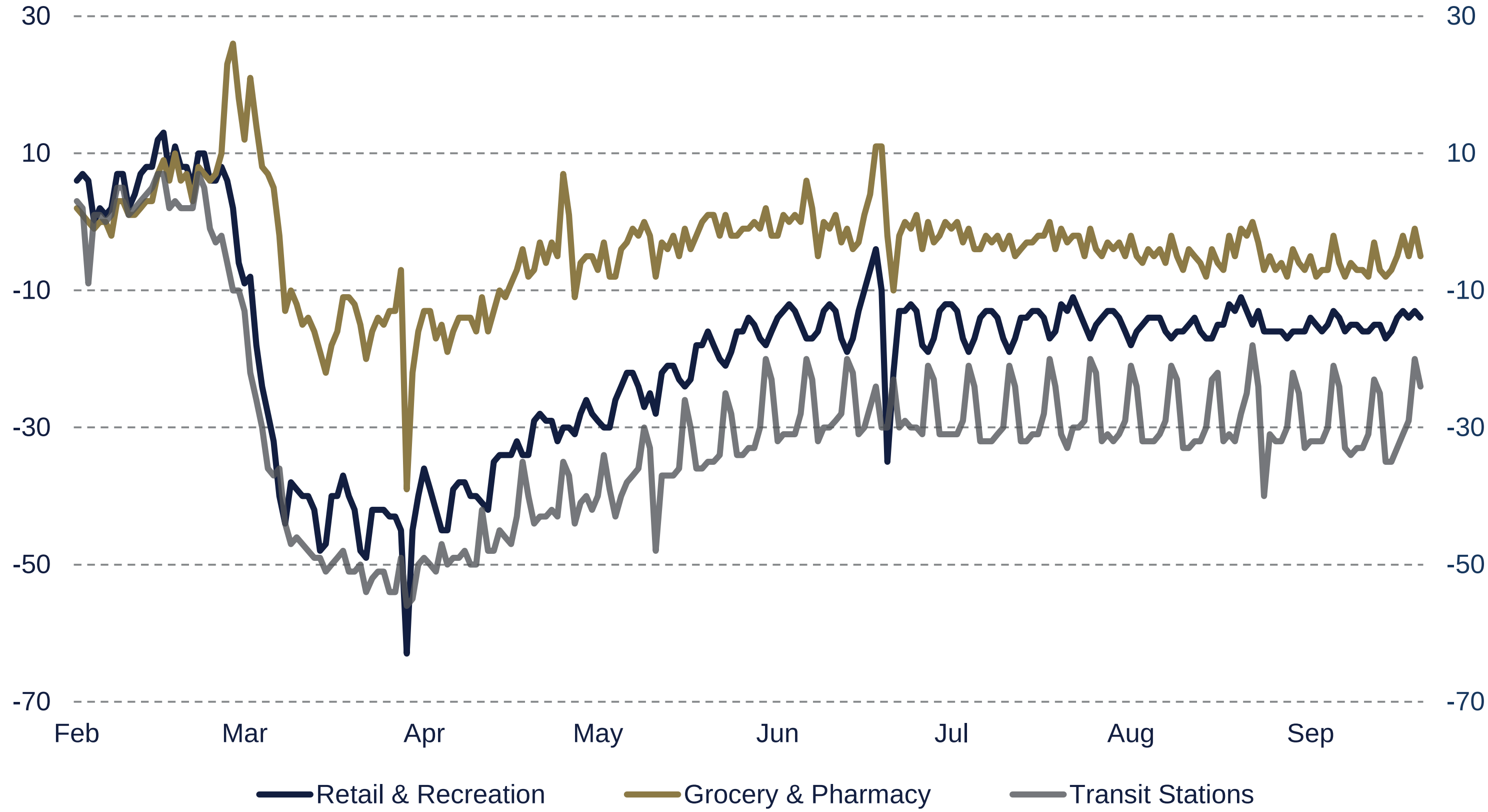
# No end in sight




- Despite the alarming headlines, **the disease continues to spread at a relatively constant rate**. However, as the base of infected people increases, there is a constant **risk that the virus will spiral out of control** and end up infecting a large percentage of the population
- Our **baseline scenario** remains that **containment measures will prevent strict lock-downs** from being necessary, and that **the economy will continue to operate at 90%-95% capacity** until a vaccine arrives.

Source: Bloomberg

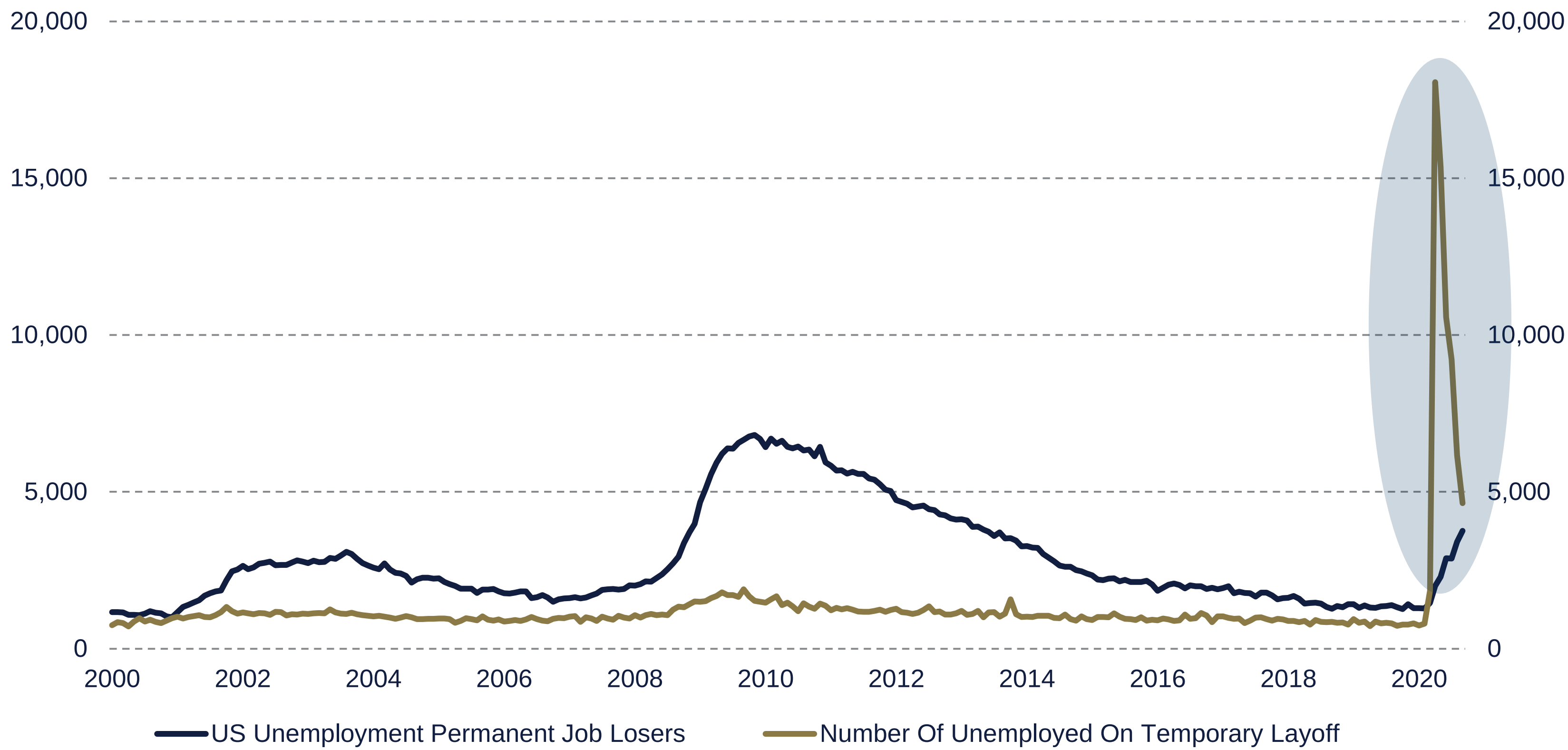
# A “90% economy” until a vaccine arrives




- Some of the **social adaptations** caused by the pandemic will be only **temporary** in nature, but others will **become** permanent
- **The longer the health crisis lasts, the greater the degree of transformation in the economy**, and with it the associated cost in the short and medium term

Source: Bloomberg

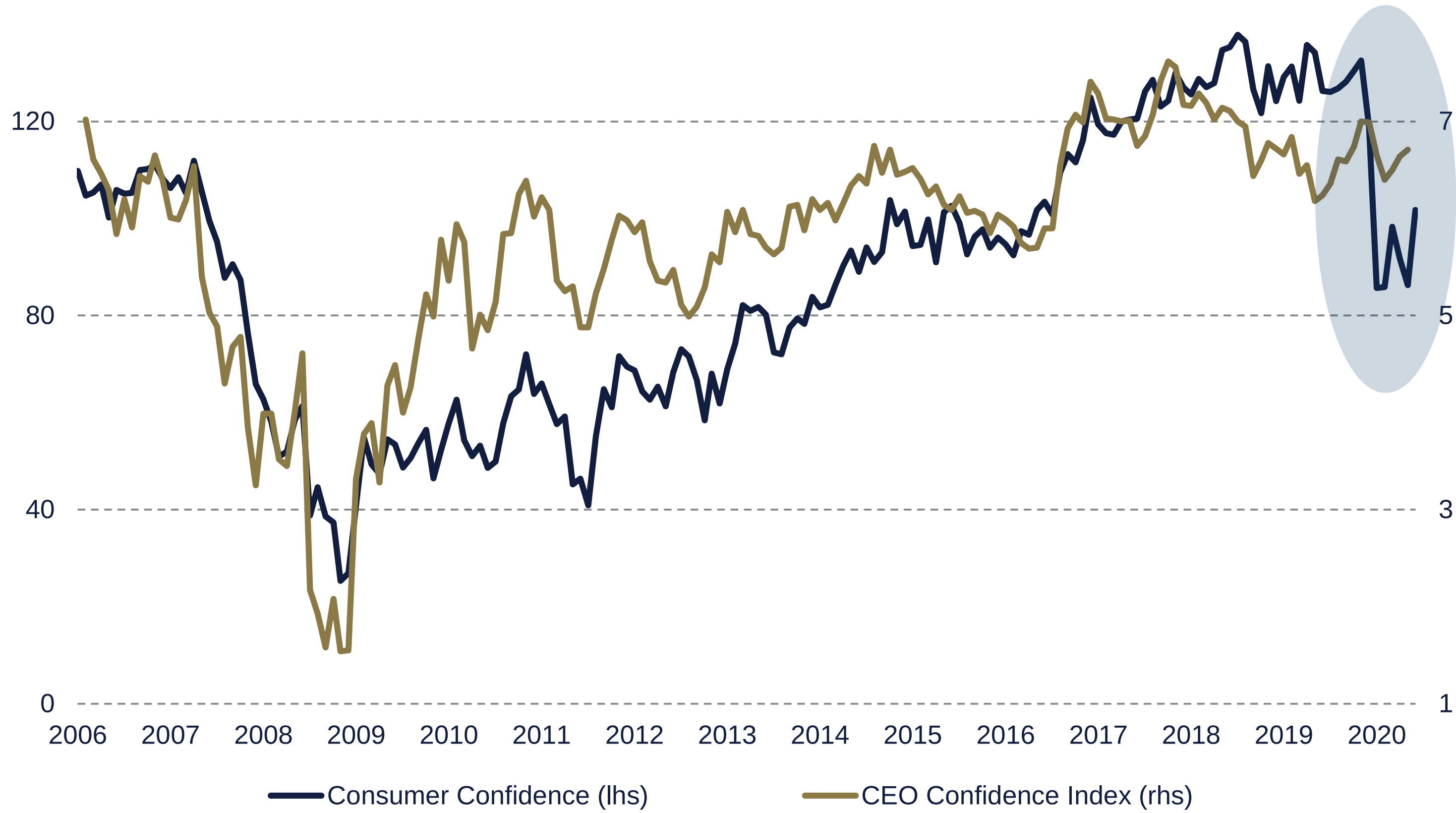
# Temporal unemployment turning permanent




- So far, the decisive **support provided by governments and central banks has saved many jobs**, thus mitigating the long-term impact of the pandemic on the economy
- However, the reality that will emerge post-Covid will be different, and some jobs will disappear forever. **Labor market flexibility will be key** to the reabsorption of unemployed workers, and in this respect, we believe that the adjustment will be faster in the US and emerging markets, compared to Europe

Source: Bloomberg

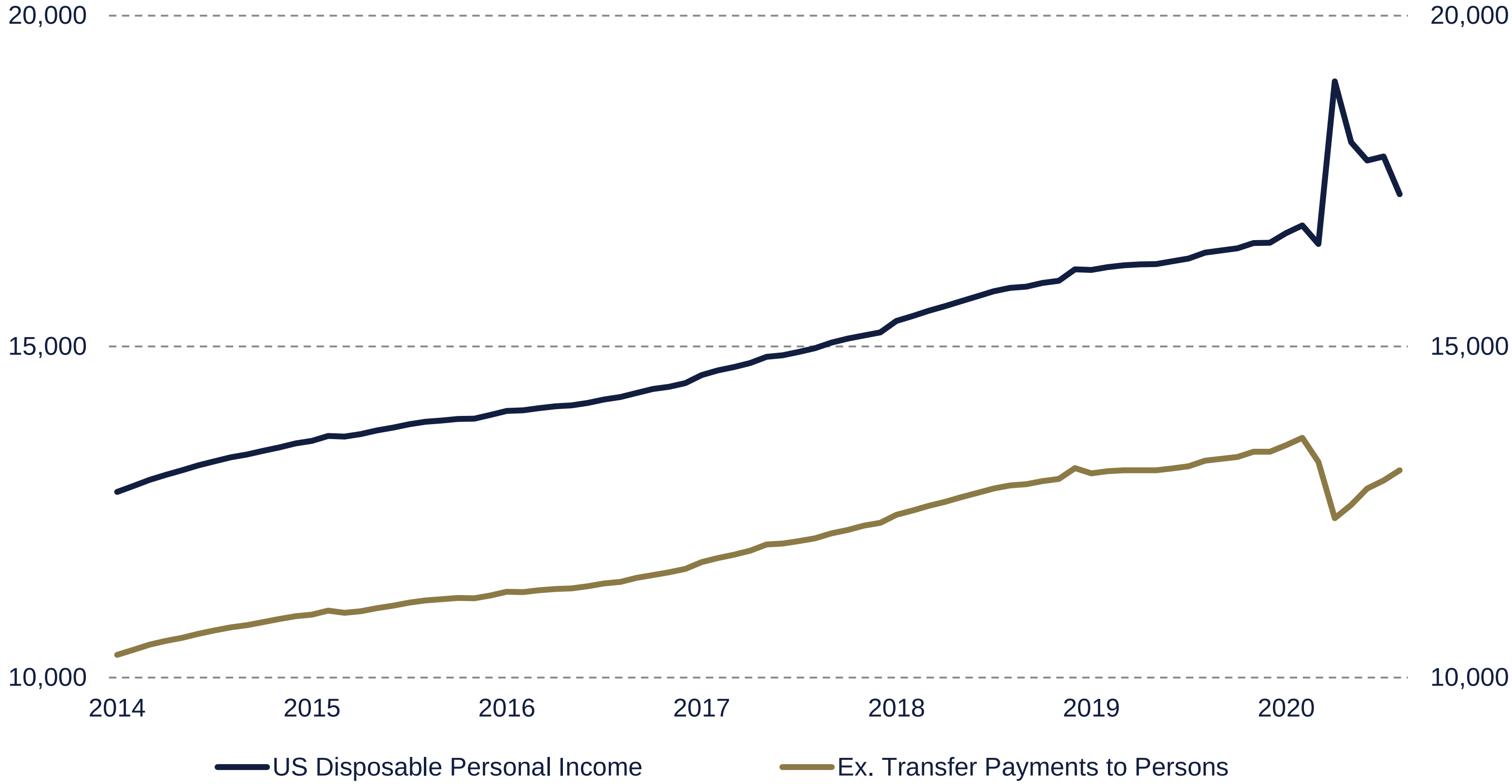
# Confidence is fragile




- So far and despite the unprecedented nature of the crisis, **consumer, investor and business confidence has remained surprisingly high**
- But **confidence is fragile**, and will only last as long as monetary and fiscal policy are perceived to be working together in a forceful manner

Source: Bloomberg

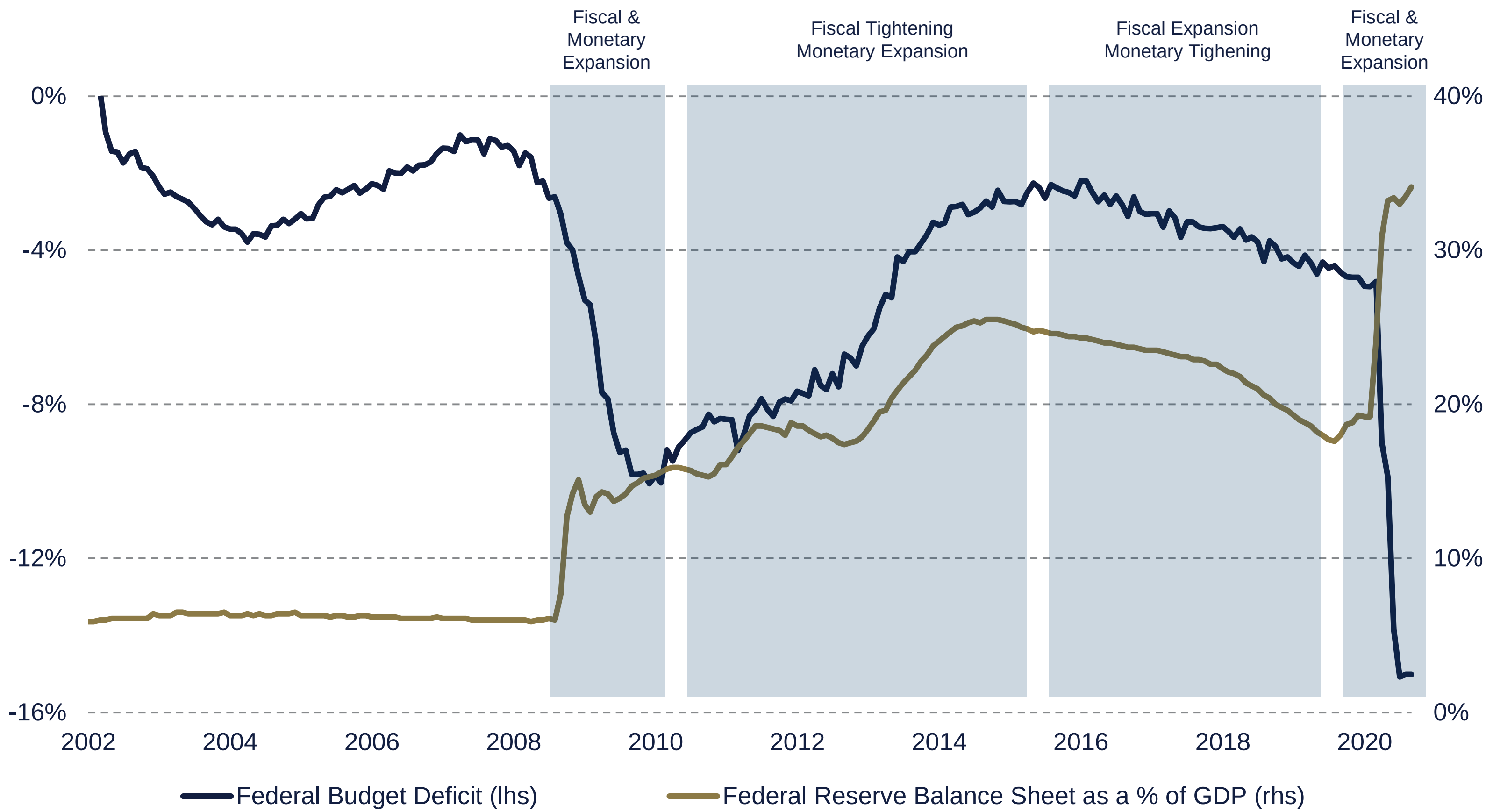
# Fiscal stimulus is running out of steam




- **Fiscal stimulus has rightly erred on the side of caution**, allowing both personal income and savings to have increased during the worst of the crisis
- As the **stimulus has started to fade, while the crisis is lasting longer than initially anticipated**, further support measures will be necessary. The **uncertainty surrounding the new stimulus package in the US** is caused by ideological differences over the use of public funds, but an agreement will necessarily have to be reached

Source: Bloomberg

# Monetary and fiscal policy working in tandem

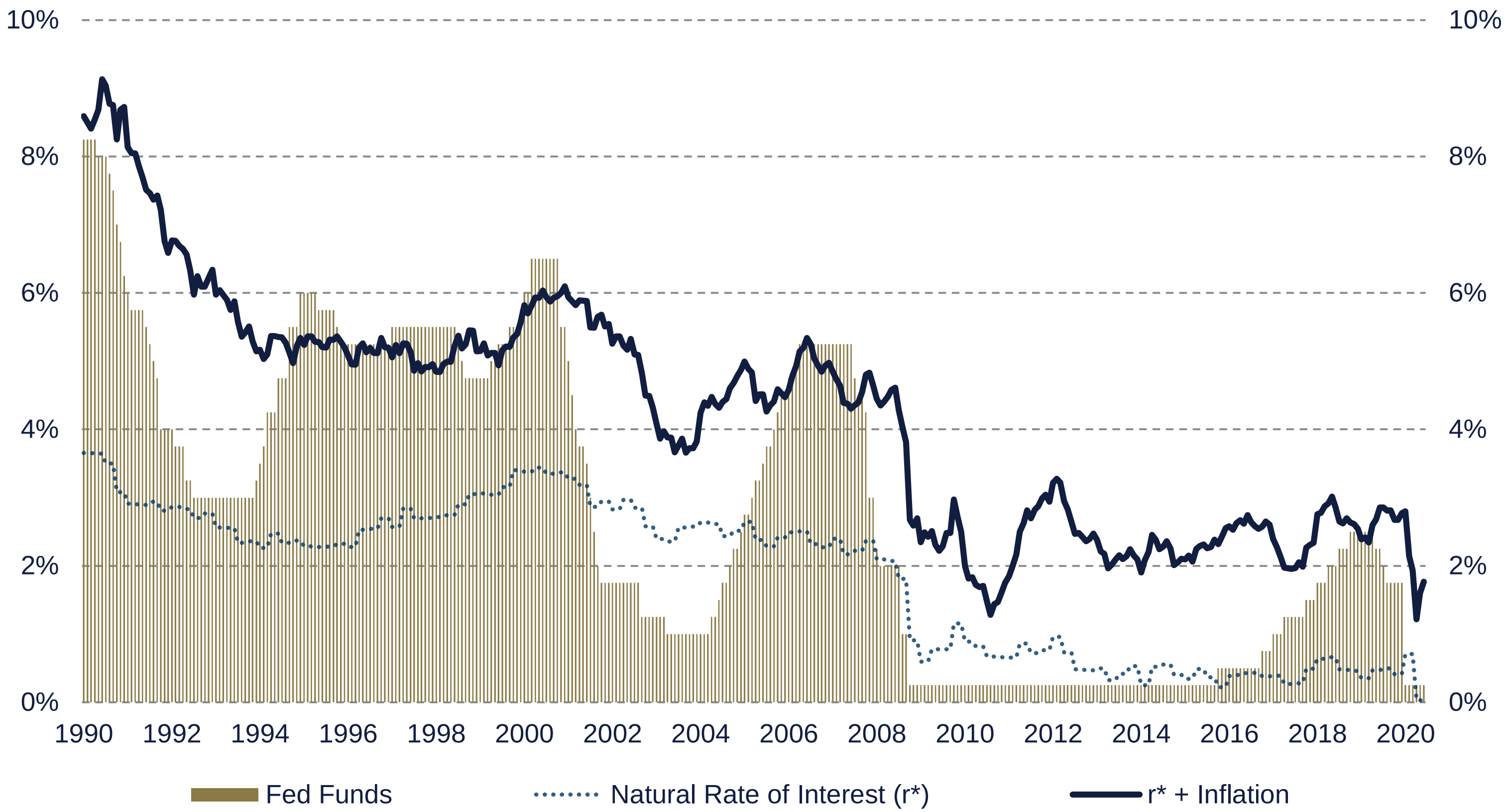



- As important as the support for the economy in the short term, it will be that **said stimulus is not withdrawn too soon, as happened with the "Debt Ceiling" crisis in 2011**; which started a spiral that led to the sovereign debt crisis in 2012
- **The biggest risk remains the reaction of bond markets** to what may be perceived as a **loss of independence for central banks**, if they subordinate their monetary policy to financing profligate governments

Source: Bloomberg

# Low interest rates keep bond vigilantes away

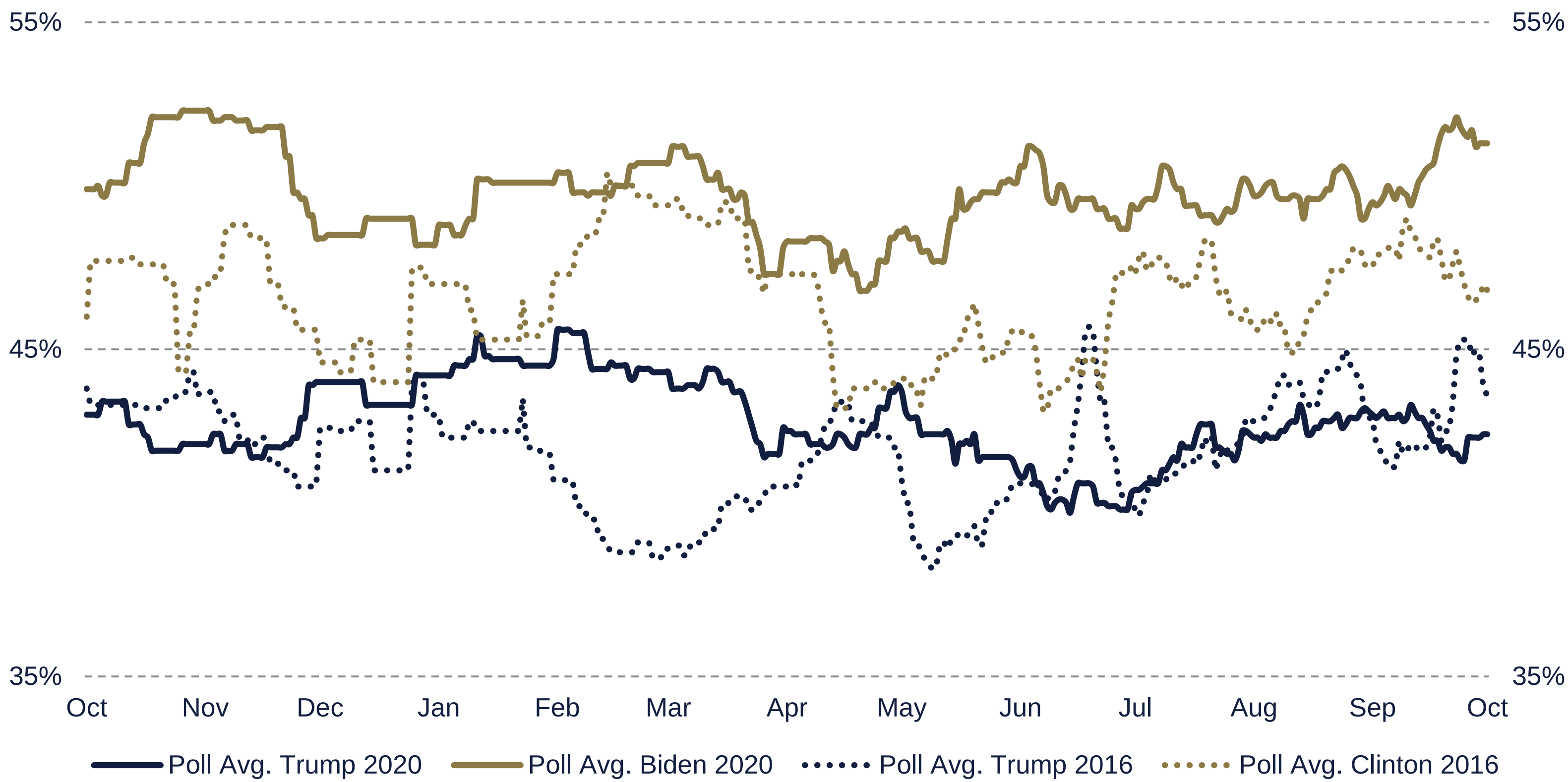
BOREAL CAPITAL MANAGEMENT




- In the decade that has elapsed since the sovereign debt crisis, much has changed regarding long-term interest rates expectations. By now, it **is widely accepted that central banks have adapted their policies to a long-term secular decline in the natural interest rate, and are not the cause of the decline**
- With interest rate expected to remain low for a very long time, **concerns about sustainability of the debt are misplaced, since the interest rate burden is then much more bearable** (with debt to GDP standing at about 50% in 2000, the cost of servicing it was double the current one with debt over 100%)

Source: Bloomberg

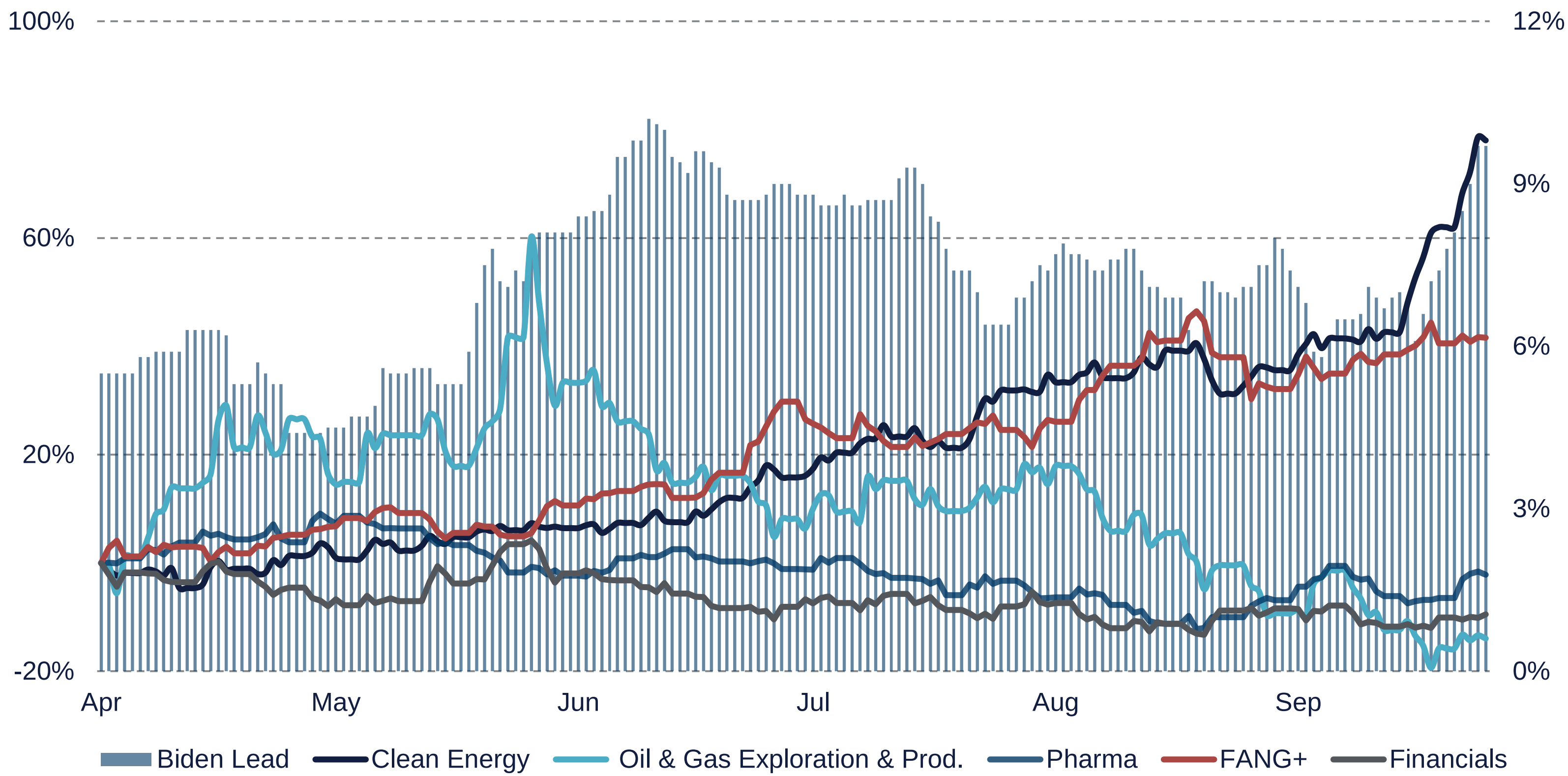
# Stakes are 2/1for Biden




- The US presidential elections seem **increasingly tilted towards a victory for the Democrats**, with the stakes being 2/1 in favor of Biden, but still far from being decided
- Support for Trump has remained very strong, with voter intention levels similar to those of the 2016 presidential election. **Voter turnout can be critical to the outcome**. If the Democrats vote en masse, a Biden victory seems certain; otherwise the elections will be very close

Source: Bloomberg

# A result largely discounted by markets




- Overall, we see **relatively low risk in the current presidential elections, as both candidates are perceived as relatively pro-market.** Trump's appeal as an economy-oriented president is offset by his unpredictability, which has resulted in a chaotic administration
- At sectoral level, there will be winners and losers, but **the various underlying sectoral trends are so strong that the victory of one or the other candidate will hardly affect them**

Source: Bloomberg

# Investment scenarios

BOREAL CAPITAL MANAGEMENT

| | Scenario 1<br>"U" recovery | Scenario 2<br>"V" Recovery | Scenario 3<br>"W" Recovery |
|---|---|---|---|
| **Drivers** | • Global depression caused by the unprecedented sudden stop of economic activity<br>• Lockdowns extend longer than initially anticipated and restrictions on movement and commerce prevent a normal return of activity<br>• Fiscal support packages prove to be insufficient, and countries with a lesser fiscal latitude suffer prolonged recessions | • Global recession caused by the unprecedented sudden stop of economic activity<br>• Lockdowns can be lifted by summer, and economic activity is largely resumed, with some adaptations to control the spread of the disease<br>• Fiscal and monetary support allow the economy to rebound strongly, while low interest rates make the debt burden manageable | • Deep recession followed by a rapid but failed recovery<br>• There is some return to normality by the summer, but return of the virus in Autumn causes intermittent lockdowns until a vaccine is available<br>• Countries with a stronger fiscal position may be able to provide further stimulus and avert a "W" recovery |
| **Market impact** | • Credit spreads remain high, fueled by a wave of corporate defaults. Weak sovereign bonds underperform significantly<br>• Corporate earnings struggle to reach pre-crisis levels, and equity returns remain lackluster<br>• Sovereign and high-quality benefit from the flight to quality, as well as the continuation of an ultra-loose monetary policy worldwide<br>• USD neutral as flight to quality is offset by low interest rates<br>• Commodities fall further | • Equities appreciate moderately, as TINA ("There Is No Alternative") lure investors back to stock markets, but there is wide dispersion across sectors<br>• Credit spreads remain tight but do not recover to pre-crisis levels, as investors will favor companies with strong balance-sheets<br>• Wide dispersion between both sovereign bonds and currencies, as yield curves will likely steepen as governments flood the market with new debt<br>• Commodity prices will stabilize | • Wide dispersion in both equity and credit markets, with stronger companies recovering and weak companies lagging behind<br>• Credit spreads remain elevated as the market remains highly volatile and defaults increase<br>• Wide dispersion between both sovereign bonds and currencies, as yield curves will likely steepen as governments flood the market with new debt<br>• Relatively strong USD as the US economy turns the corner faster. The Euro may suffer a remake of the sovereign debt crisis |
| **Probability** | 10% | 50% (-5%) | 40% (+5%) |

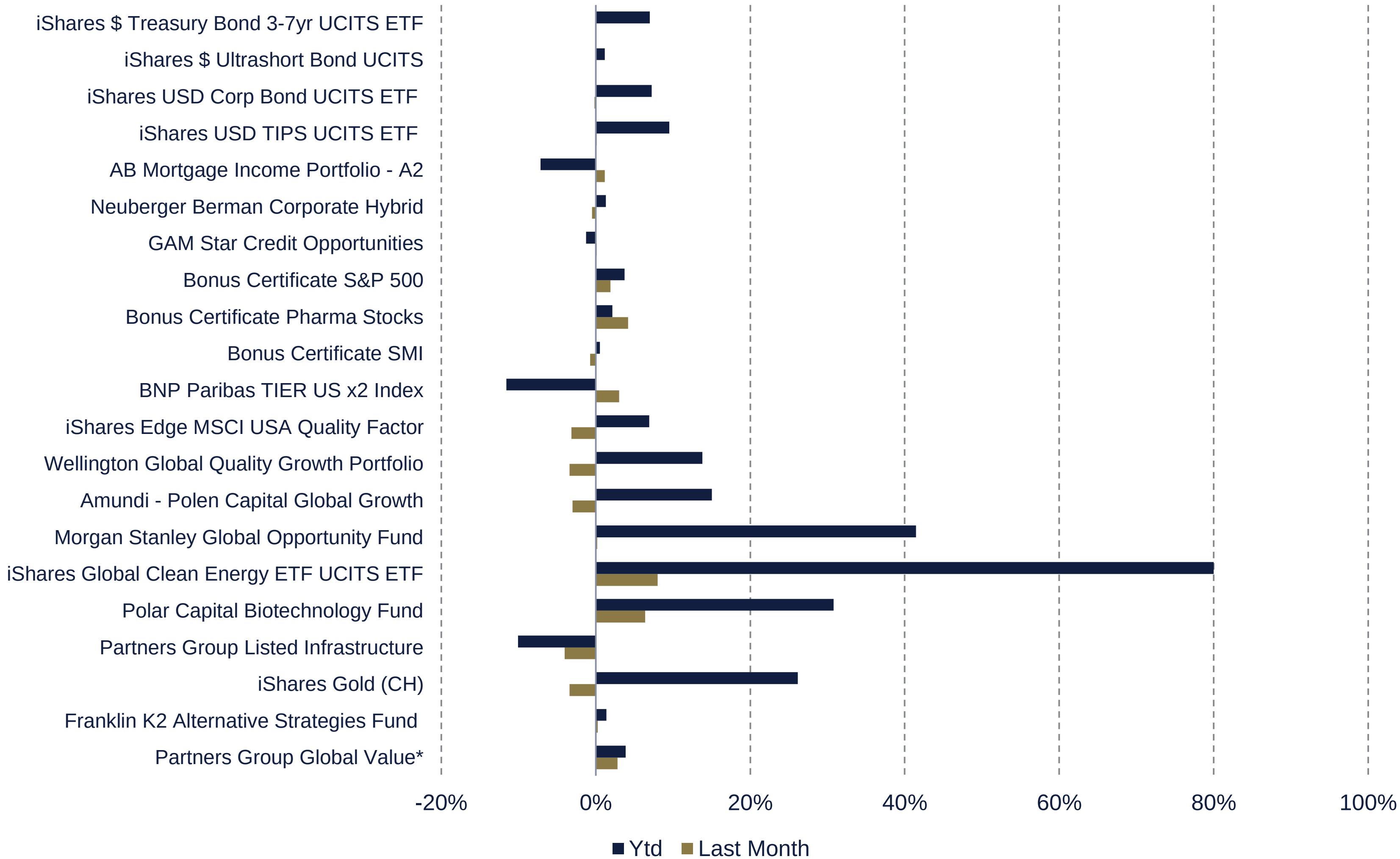
**Short-term catalyzers**

Slowdown in infections, Vaccine or treatment for the coronavirus, ramp-up in hospital infrastructure

**Other risks**

Trade war (II), Spread of populist/nationalistic parties, Brexit implementation, Iran, North Korea

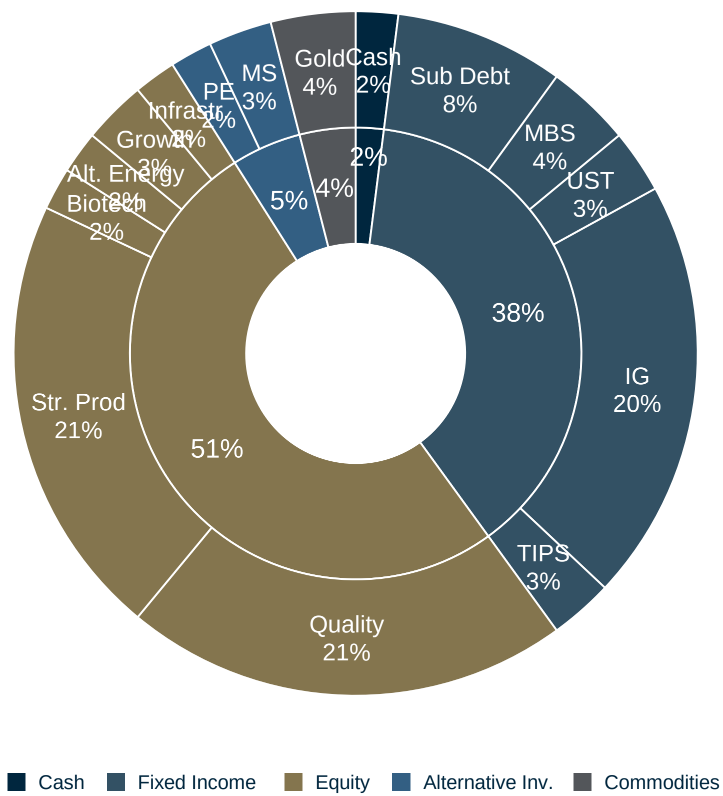
# Model portfolio evolution



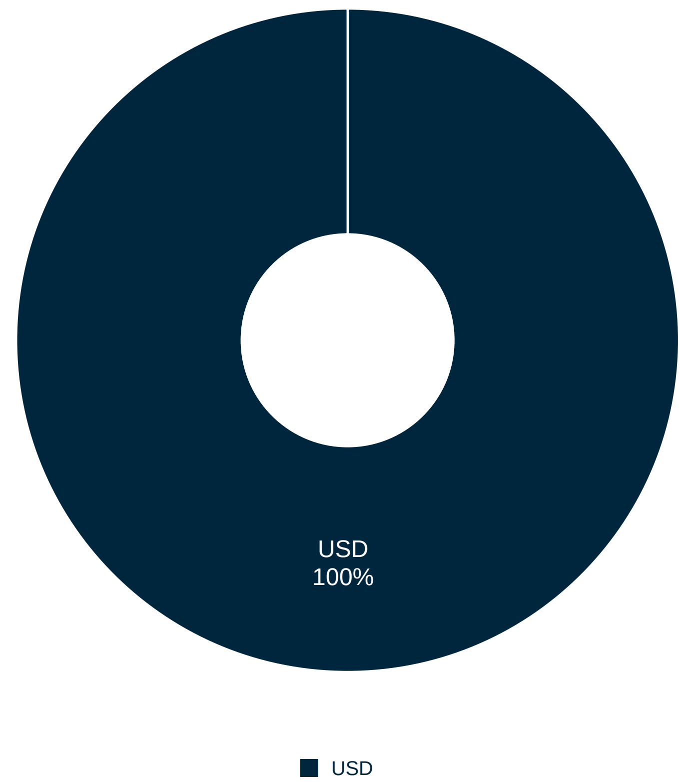

Source: Bloomberg, as of October 7, 2020
* Fund publishes monthly NAV with a 1 month of delay

# Boreal Balanced Portfolio USD

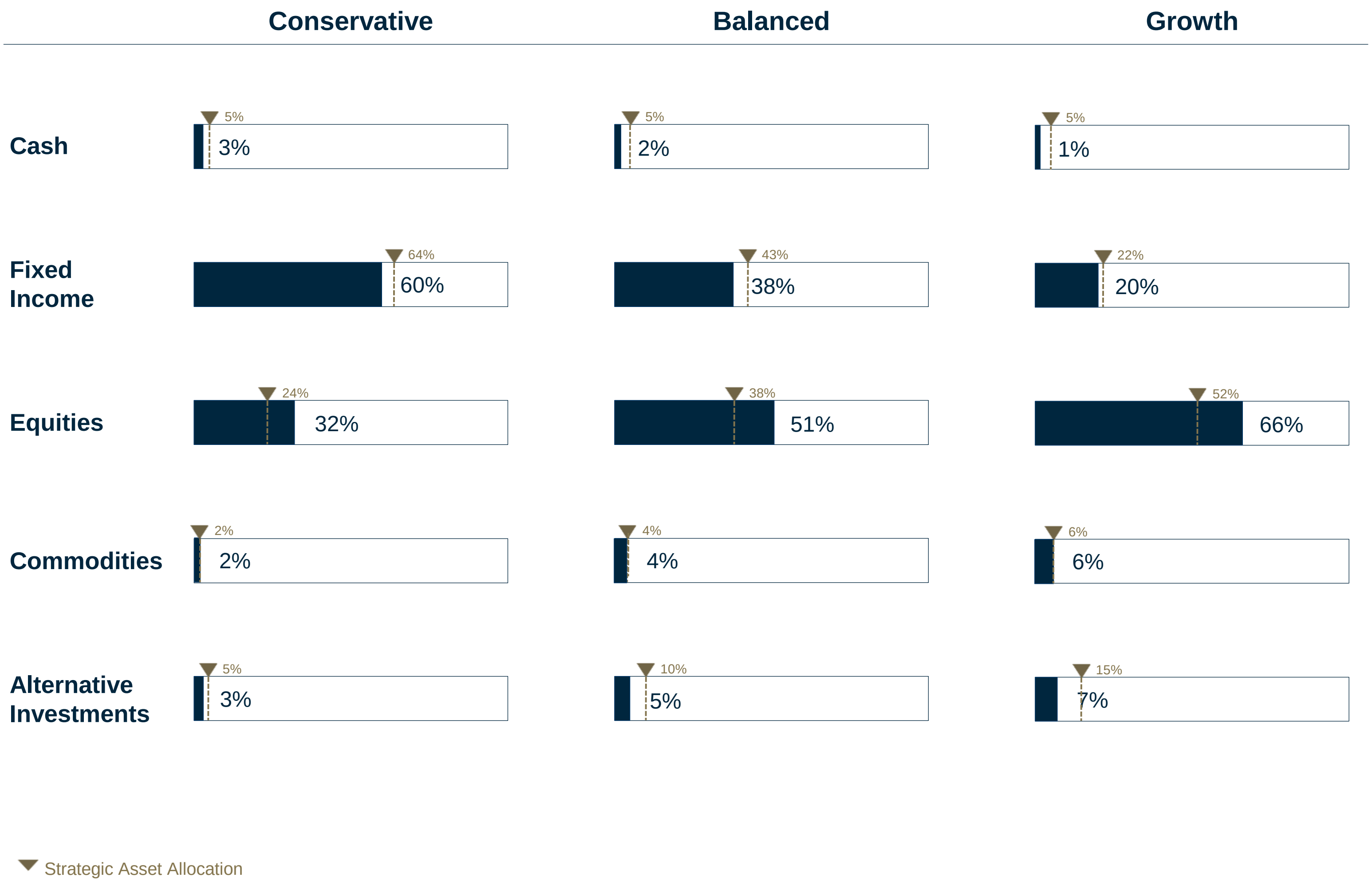
### Asset Allocation



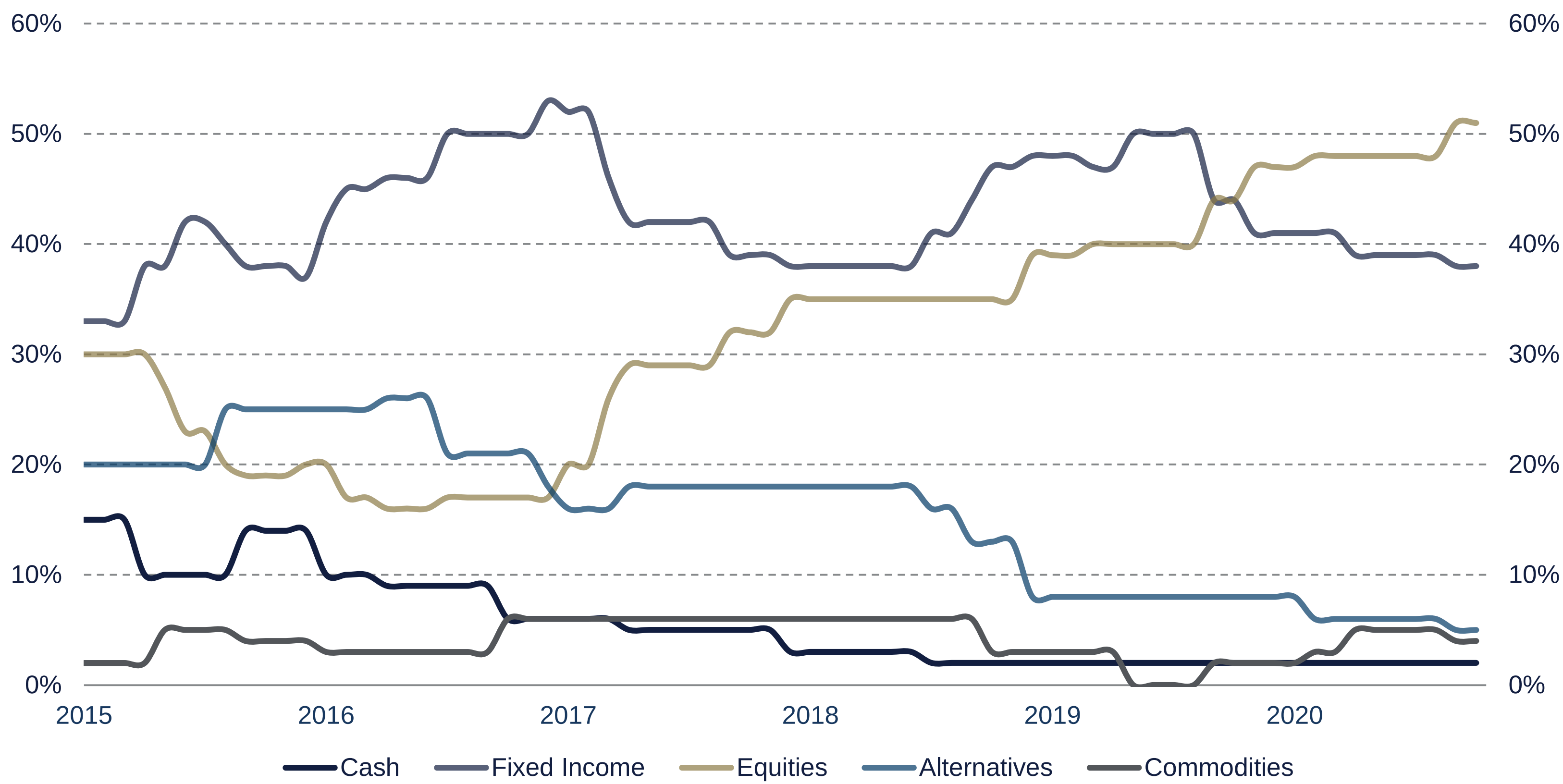

### Currency Allocation



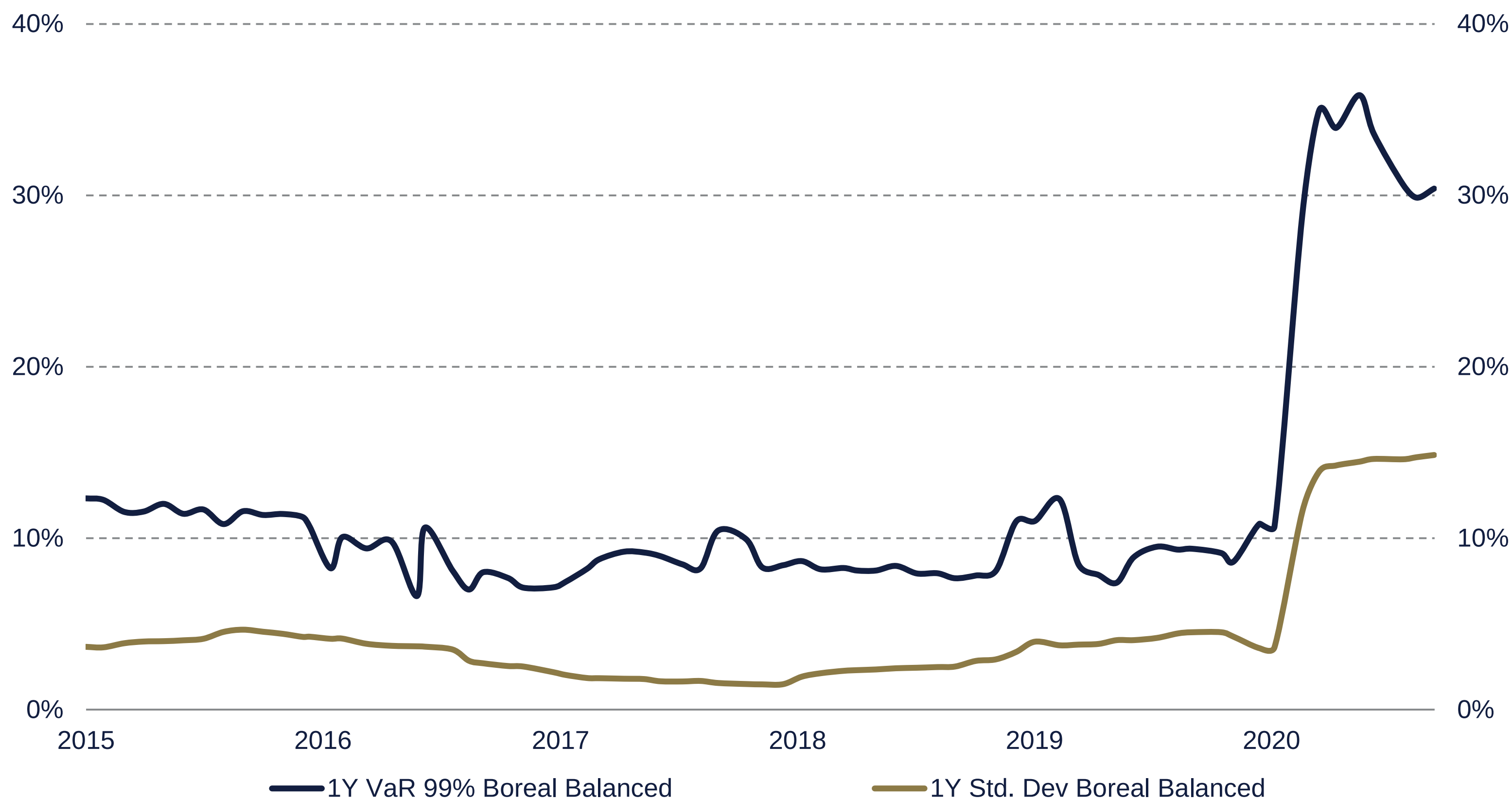
# Boreal Investment Profiles



# Boreal Balanced Portfolio – Asset Allocation evolution

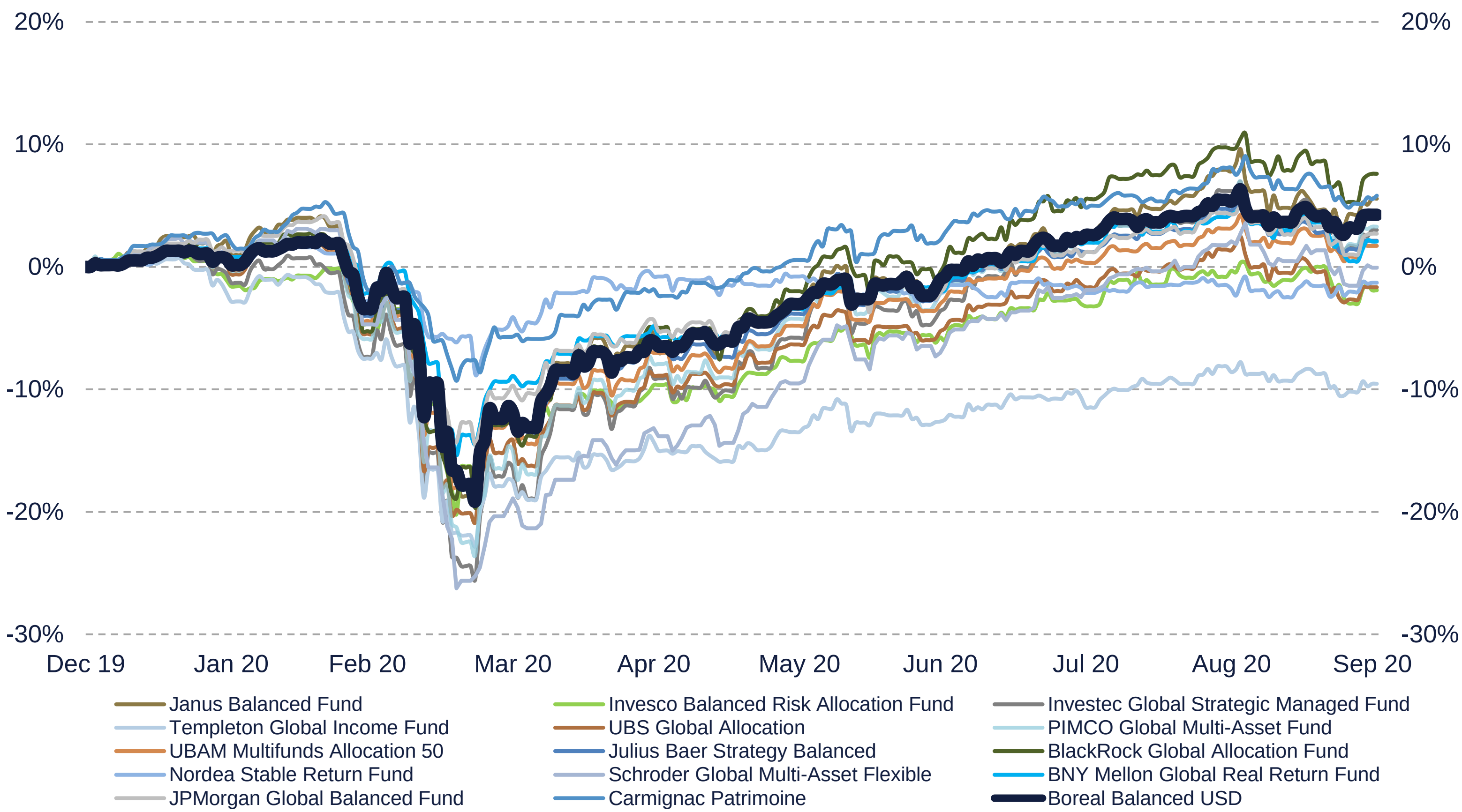


# Boreal Balanced Portfolio – VaR evolution




[1] As of October 7, 2020
Source: Bloomberg

# Boreal Balanced Portfolio – Peer comparison




- **Total Return** (Ytd[1]): **4th out of 15**
- **Standard Deviation** (1 year[1]): **11th out of 15**
- **Downside Risk** (1 year[1]): **4th out of 15**
- **Sharp Ratio** (1 year[1]): **6th out of 15**

[1] As of October 1, 2020

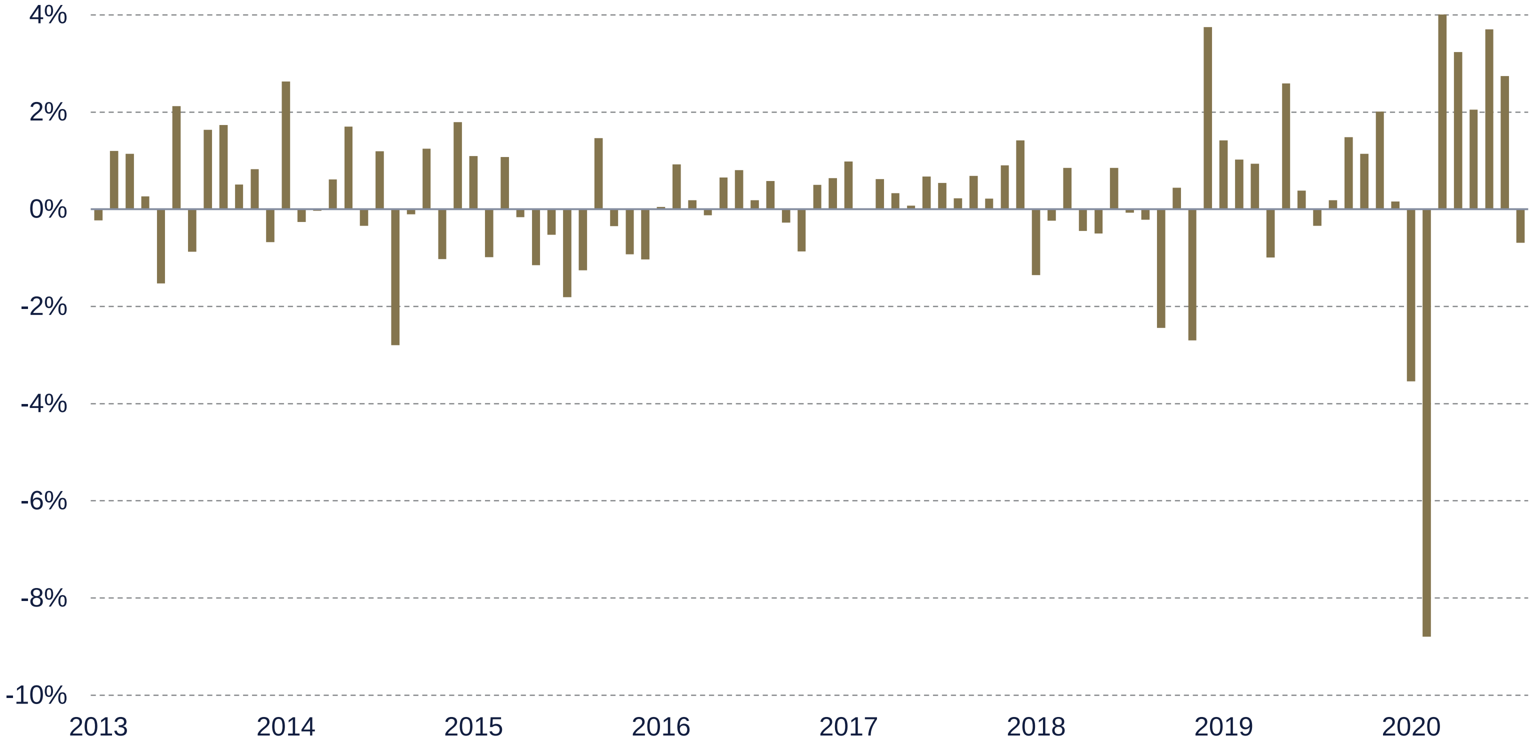
Source: Bloomberg

# Boreal Balanced Portfolio – Ytd performance


- **Total Return** (Ytd[1]): **5.67%**
- **Standard Deviation** (Ytd[1]): **16.90%**
- **Downside Risk** (Ytd[1]): **13.31%**
- **Sharpe Ratio** (Ytd[1]): **0.51**

[1] As of October 7, 2020

# Boreal Balanced Portfolio – Historical performance (1)




- **Total Return** (1 year[1]): **10.85%**
- **Total Return** (3 year[1]): **17.40%**
- **Total Return** (Since Jan 13[1]): **36.70%**

[1] As of October 7, 2020

# 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% | 3.90% |
| Std. Deviation | 3.82% | 3.59% | 3.67% | 2.08% | 1.45% | 3.77% | 3.78% | 16.90% |
| Sharpe Ratio | 2.54 | 0.58 | -0.48 | 0.62 | 3.57 | -1.70 | 3.49 | 0.51 |

Annual Return: 3.94%
Annual Std. Dev: 6.17%

[1] As of October 7, 2020