Investment Policy

January 2021

BOREAL
CAPITAL MANAGEMENT

Our market view in a nutshell – January 2021

- As the **pandemic continues to wreak havoc** and threatens an exhausted population with a new round of lockdowns, **financial markets are closer to euphoria than gloom**; clinging to a widely accepted narrative that economies will rebound strongly when herd immunity is achieved thanks to the vaccines. All this, while interest rates will remain extremely low for a long time
- Looking ahead, **much will depend on how quickly and how strongly the economy recovers** in the second half of the year**. Business and consumer confidence remains high**, underpinned by government relief measures. However, there are **uncertainties about consumers' appetite to spend** once restrictions are lifted, as well as the **extent of the job market recovery**
- At the same time, **growth must accelerate without causing an increase in long-term inflation expectations** (some short-term price increases will be practically unavoidable), as current valuations can only make sense if interest rates do not pick up significantly
- As asset prices are key for financial stability, **the Fed has reassured markets that it will be patient; allowing inflation to overshoot its target before raising rates**. But in the long run, interest rates are determined by supply and demand, and if the Fed fails to convince investors, **there is a risk of a disorderly rise**
- Investors need to accept that **portfolio returns will be lower in the years to come**. The main source of returns needs to come from equity markets, since bonds yields are currently very low as a result of historically low interest rates, and tight credit spreads. Stocks, on the contrary, are fairly valued, and offer a way to participate in the wave of innovation and technological change that we are immersed. However, they entail **accepting a higher degree of risk in the portfolios**, and require thinking like long-term investors in order to weather market volatility

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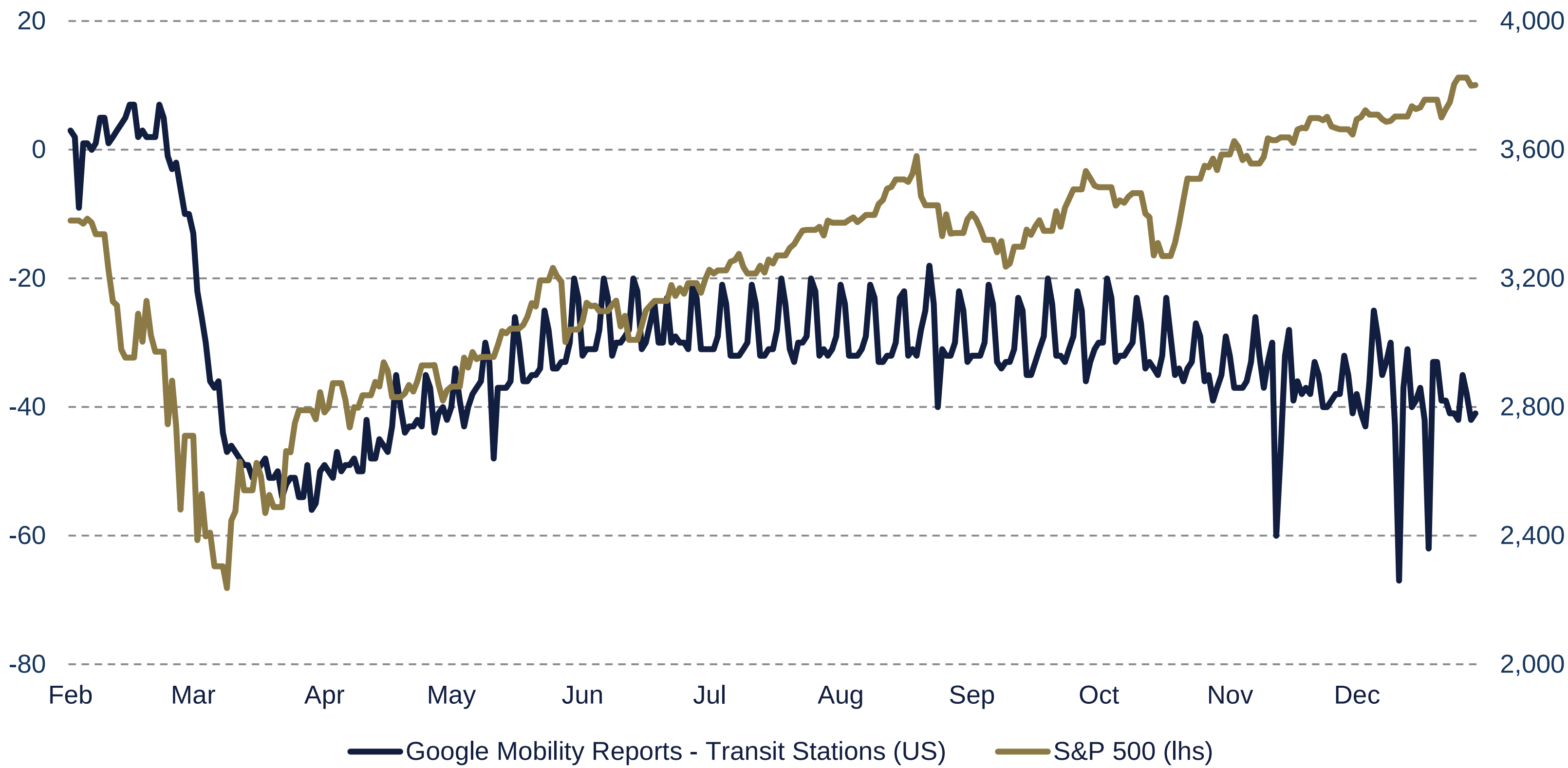
Asset Class		View	Rationale
Fixed Income	US Treasuries	=	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. With interest rates anchored at current levels, and credit spreads that have narrowed massively, we favor long-term US Treasuries
	US Credit	=	The incoming 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
	Asia	=	We recommend investing selectively in the region; favoring high growth stocks
	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, Fintech 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

Fatigue vs. euphoria



- After a year grappling with the virus, it is still surprising how insidious the transmission is. Despite widespread protective measures, **new virus strains threaten us with another round of harsh lockdowns**
- This may cause us to depart from the most optimistic scenarios, and **sooner or later end up affecting asset valuations**. Particularly if the rollout of the vaccines suffer from delays

Source: Google and Bloomberg

Business confidence remains elevated, but…

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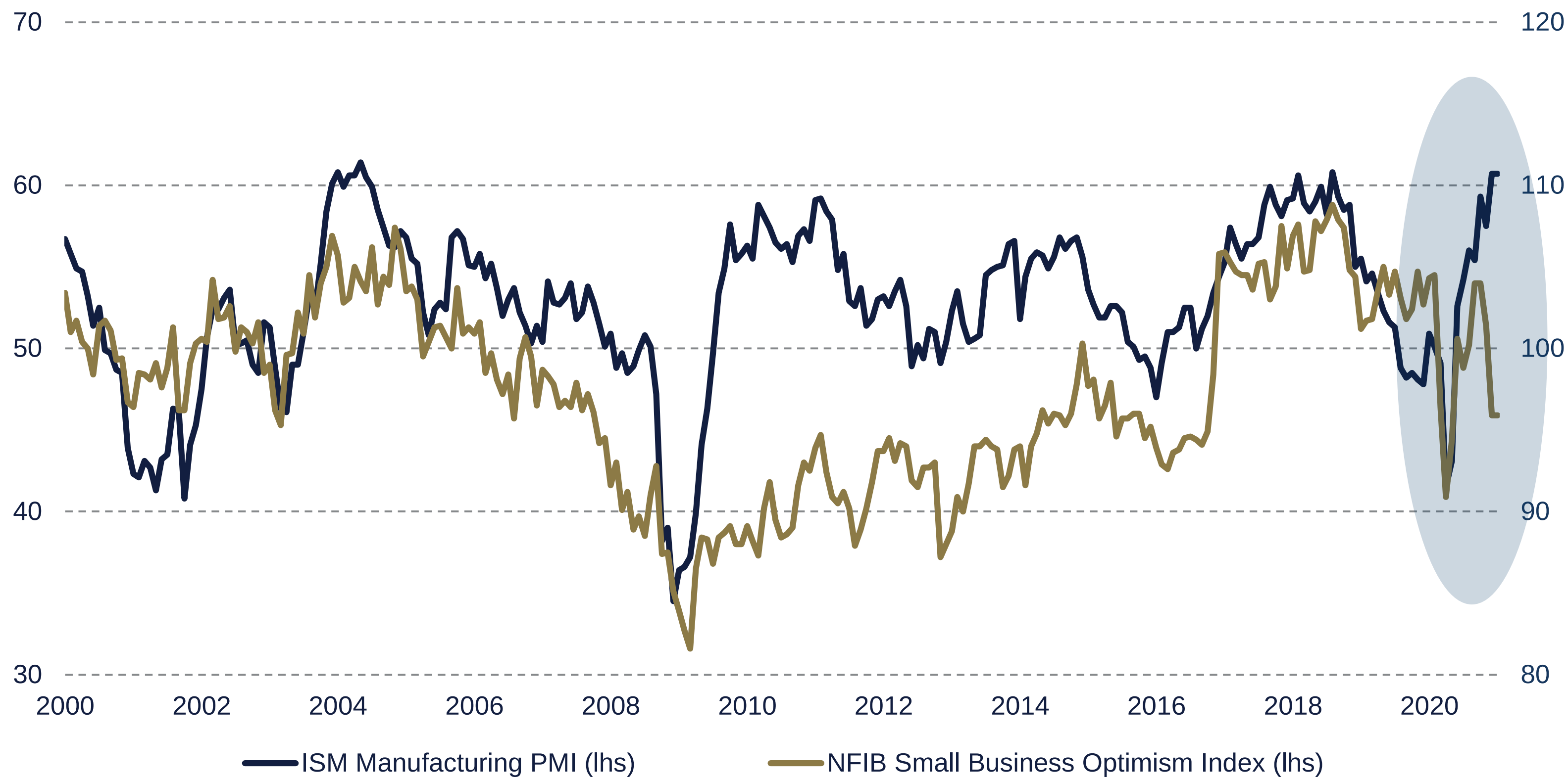
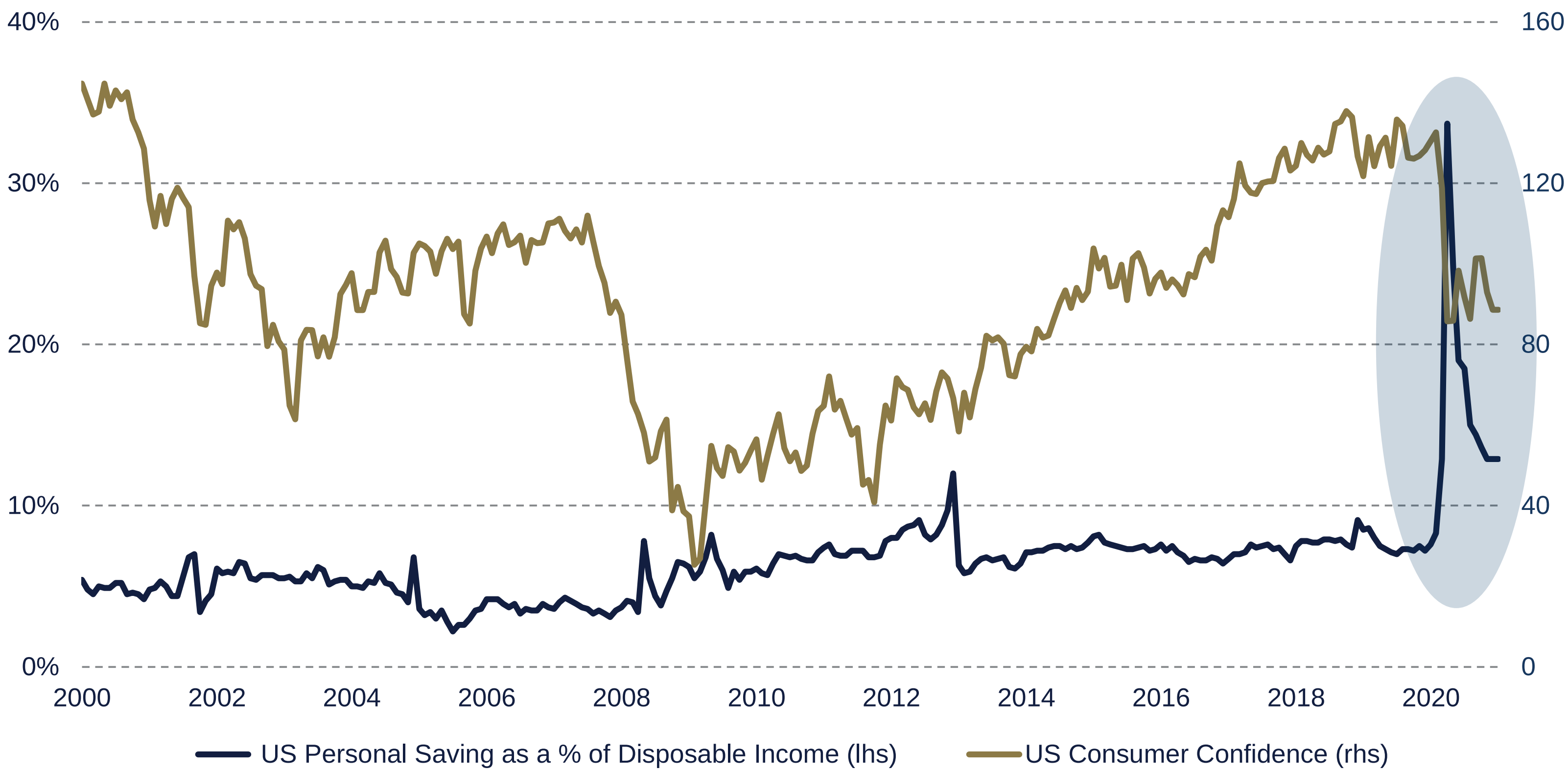


- Like financial markets, **companies remain reasonably optimistic about the economy's medium-term prospects**
- The **fortunes are however diverging on the corporate front**. Manufacturing is performing better than services; and large companies with a strong digital footprint are gaining market share from smaller retail competitors

Source: Bloomberg

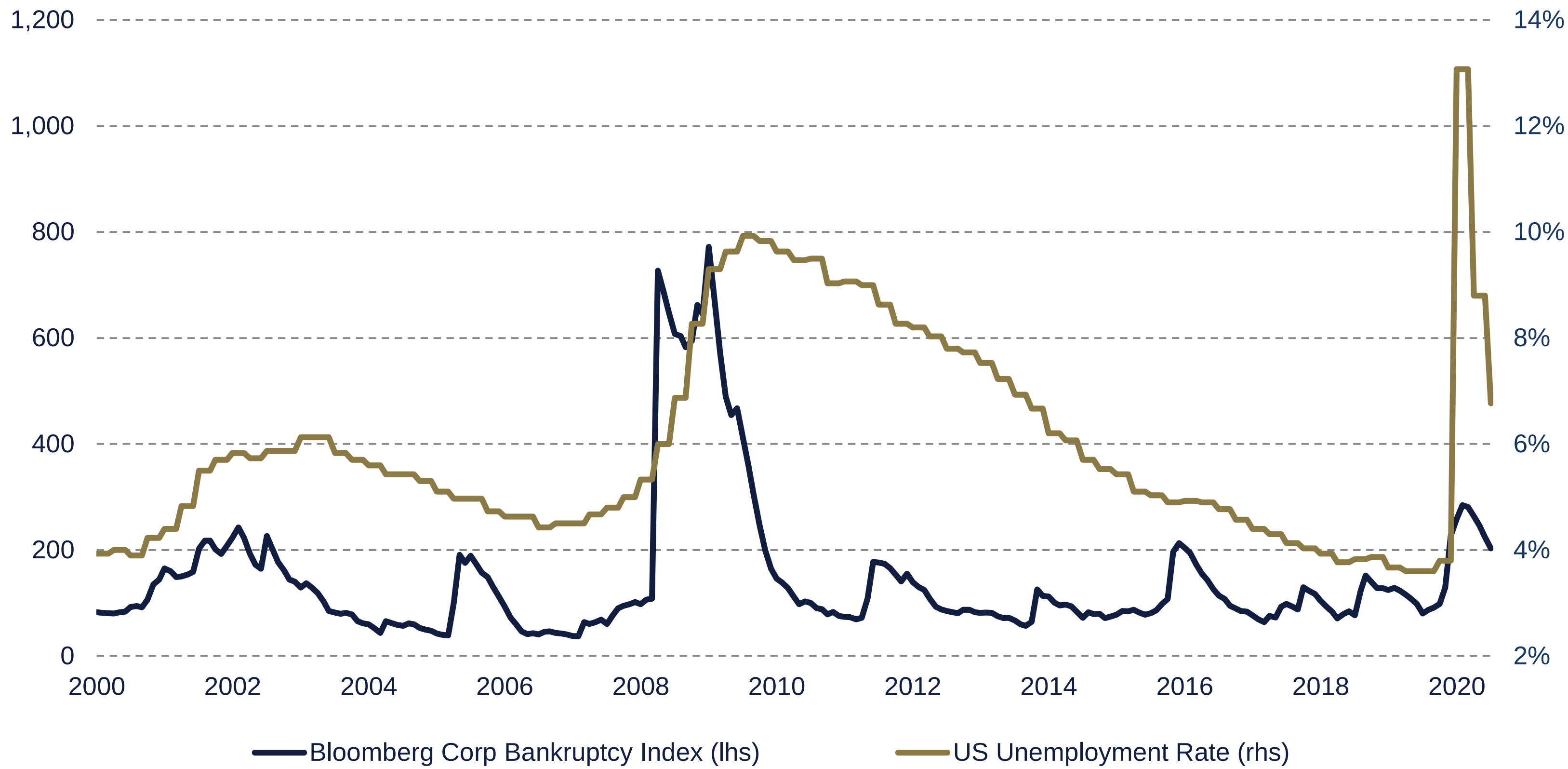
Consumers are the key to the recovery



- **The strength of the economic recovery will fundamentally depend on consumer behavior** once restrictions are lifted
- Consumers, in aggregate terms, have saved during the pandemic. It **remains to be seen if, when restrictions are lifted, households will spend happily** or decide to keep saving for what may come next

Source: Bloomberg

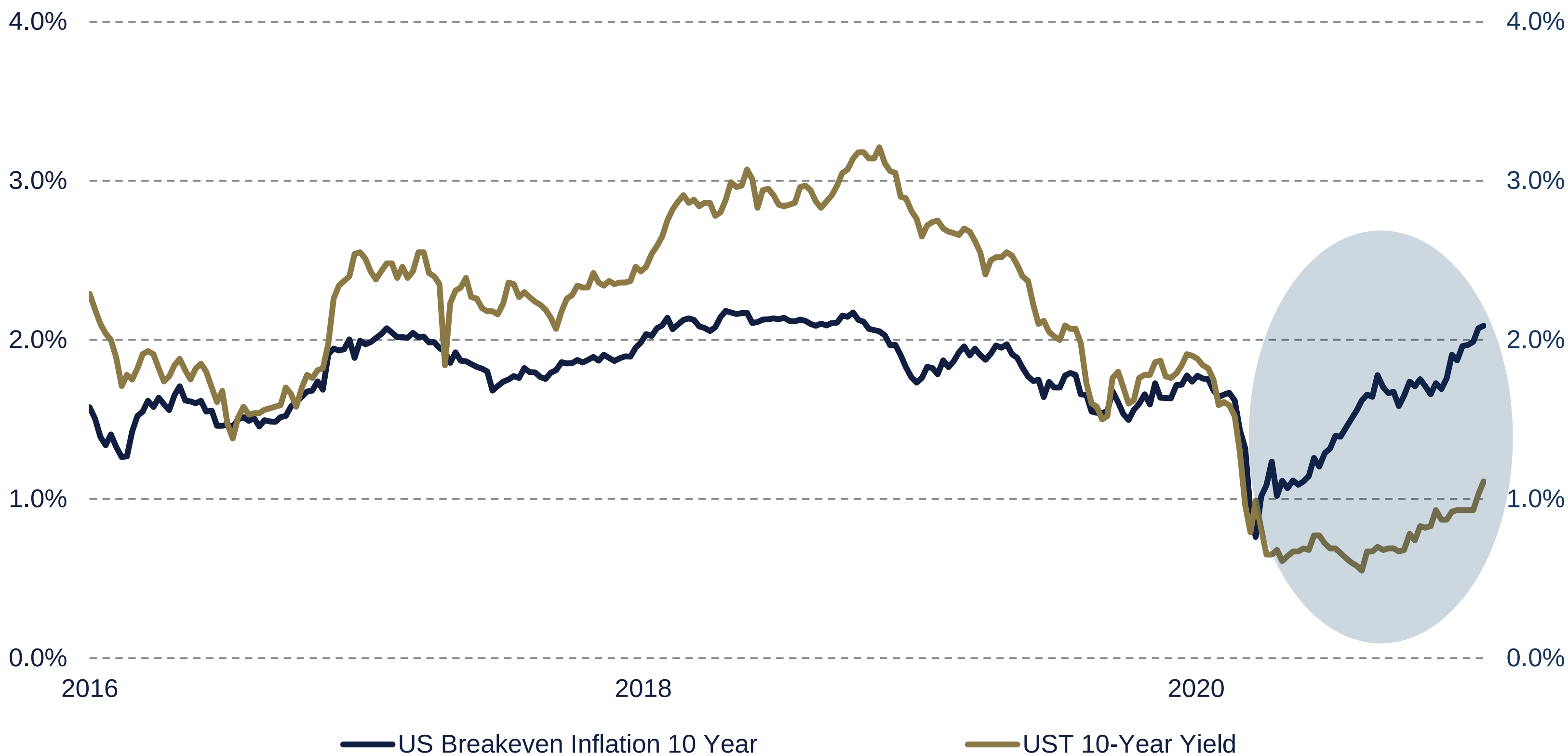
How much permanent damage?



- With a crisis of monstrous proportions, it is still **unclear how much "economic scar tissue" will accumulate**
- Once fiscal support measures necessarily begin to fade, the **momentum in the economy will depend on the evolution of the labor market**

Source: Bloomberg

Allegro, ma non troppo…



- If a weak economy is the main concern, an overly strong one is not without risks. **If inflation accelerates, interest rates may rise, despite the Fed's assurances** that they will keep policy rates on hold
- This is the most important risk for financial markets and, ultimately, for the economy. However, **there is a self-stabilizing mechanism, since if rates rise too much, the risk of recession increases**

Source: Bloomberg

Bubble worries are overblown

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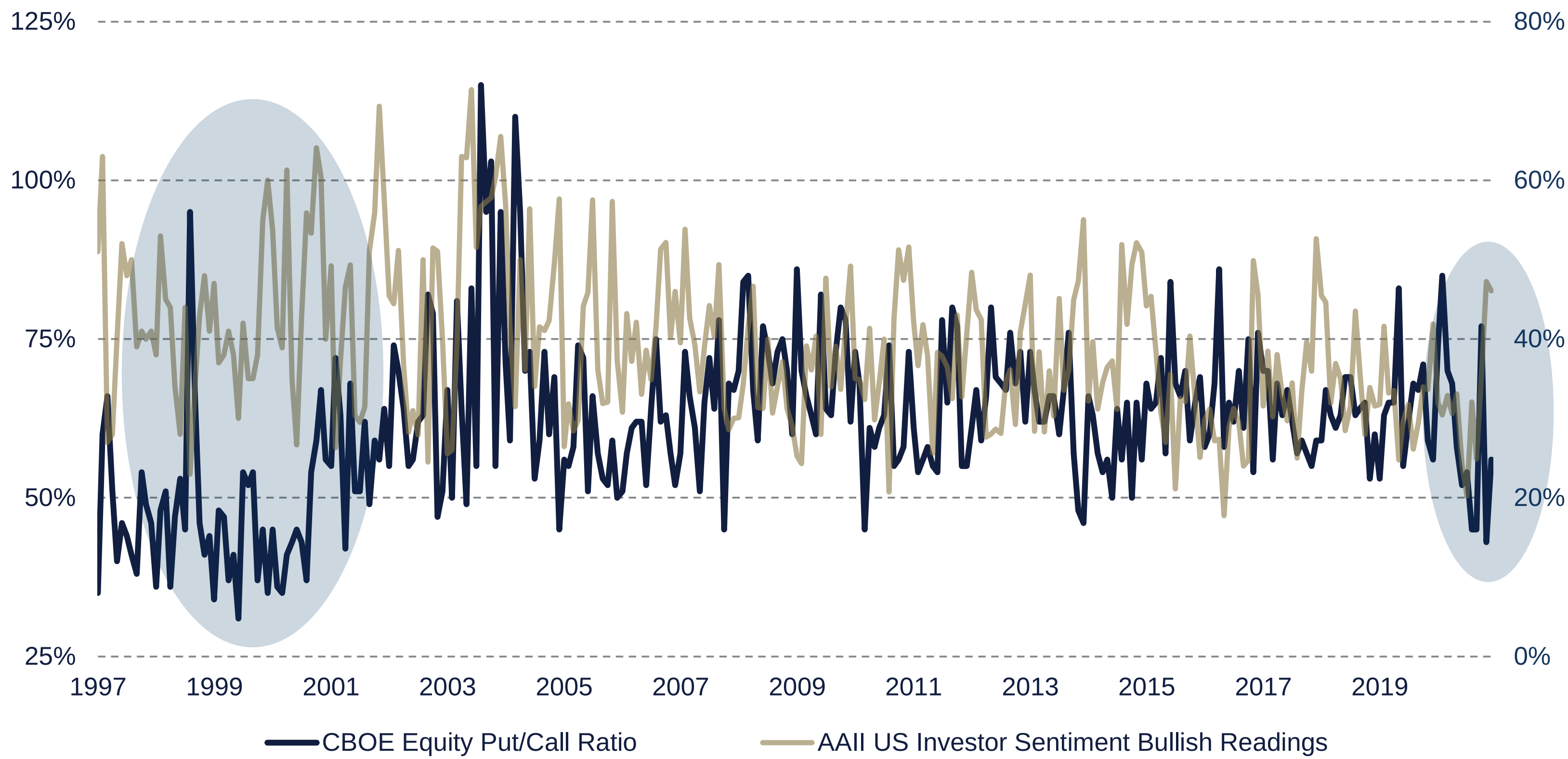
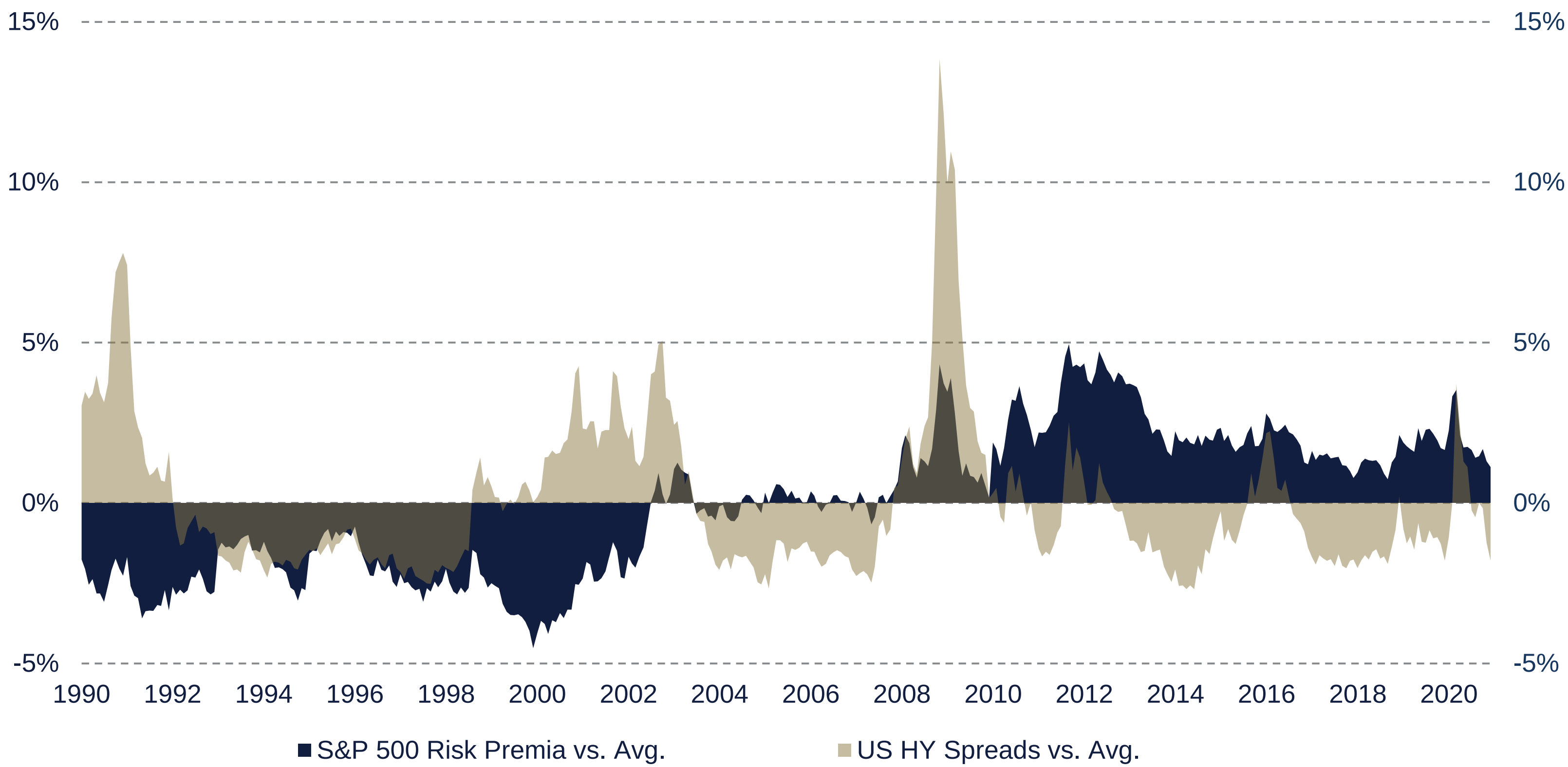


- With some **corners of the stock market in bubble mode**, concern is growing that there is too much optimism
- These fears are probably overblown, but they tell us that the **market is vulnerable to disappointing news**

Source: Bloomberg

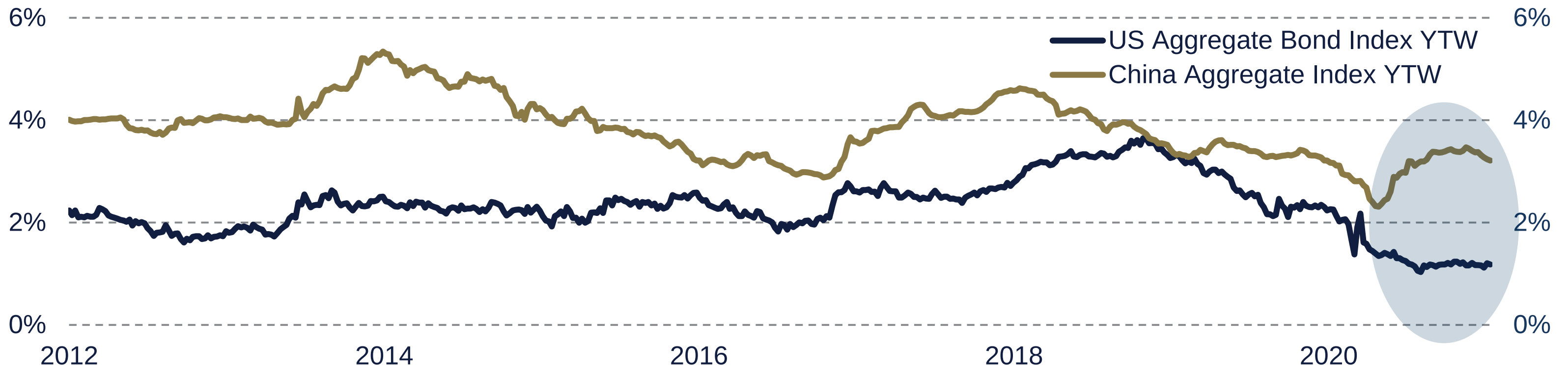
It will have to be equities

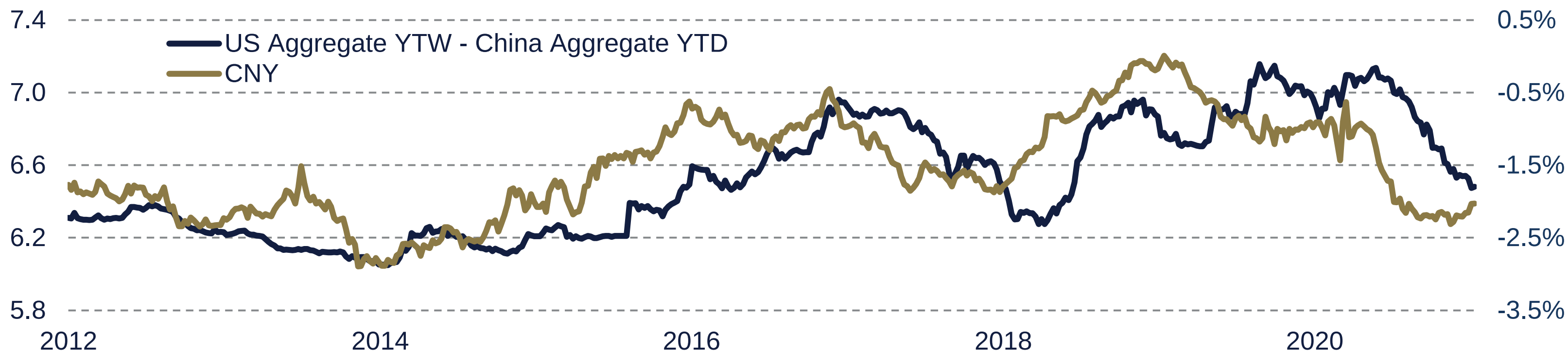


- **Compared to their historical average, equities are still attractive**; but there is an unprecedented dependence on interest rates
- Credit markets, however, present a very different picture, **with high yield and emerging market spreads at the lower end of their spectrum**

Source: Bloomberg

China will be back in the spotlight





- As the Covid crisis draws to a close, **China is emerging in a stronger position**; with the United States immersed in a political crisis
- Incidents like Ant's aborted IPO highlight how, from an investor protection point of view, **Chinese financial markets are still a far cry from those of the US**; although there is no doubt that **they will continue to gain in relative importance**

Source: Bloomberg

Investment scenarios

	Scenario 1 "U" recovery	Scenario 2 "V" Recovery	Scenario 3 "W" Recovery
Drivers	• Global depression caused by the unprecedented sudden stop of economic activity • Lockdowns extend longer than initially anticipated and restrictions on movement and commerce prevent a normal return of activity • 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 • Se consiguen evitar nuevos confinamientos estrictos y la actividad económica continúa, con medidas de control de intensidad variable • 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 • There is some return to normality by the summer, but return of the virus in Autumn causes intermittent lockdowns until the population is vaccinated • 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 • Corporate earnings struggle to reach pre-crisis levels, and equity returns remain lackluster • Sovereign and high-quality benefit from the flight to quality, as well as the continuation of an ultra-loose monetary policy worldwide • USD neutral as flight to quality is offset by low interest rates • 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 • Credit spreads remain tight but do not recover to pre-crisis levels, as investors will favor companies with strong balance-sheets • Wide dispersion between both sovereign bonds and currencies, as yield curves will likely steepen as governments flood the market with new debt • Commodity prices will stabilize	• Wide dispersion in both equity and credit markets, with stronger companies recovering and weak companies lagging behind • Credit spreads remain elevated as the market remains highly volatile and defaults increase • Wide dispersion between both sovereign bonds and currencies, as yield curves will likely steepen as governments flood the market with new debt • Relatively strong USD as the US economy turns the corner faster. The Euro may suffer a remake of the sovereign debt crisis
Probability	10%	60%	30%

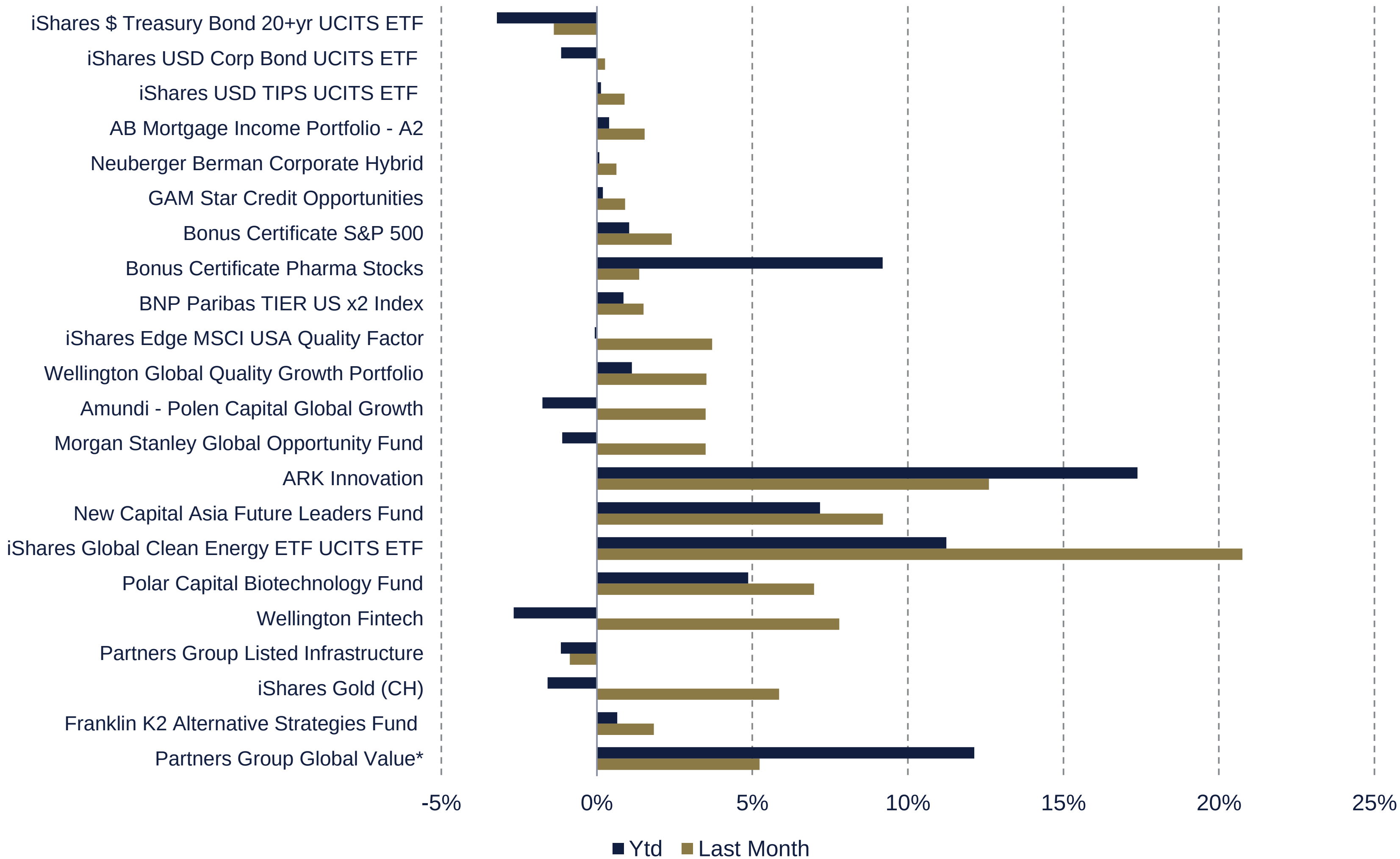
Short-term catalyzers

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

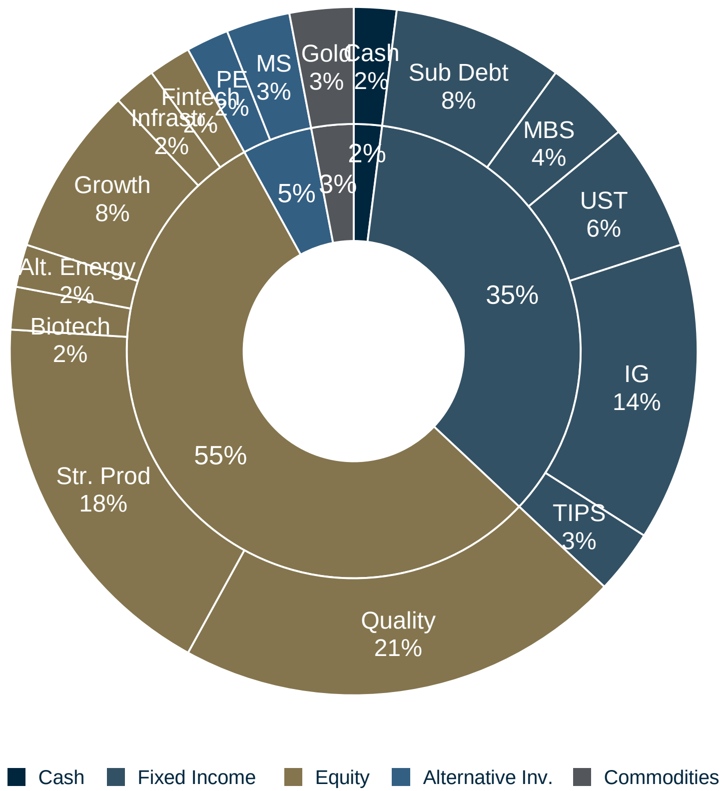
Model portfolio evolution



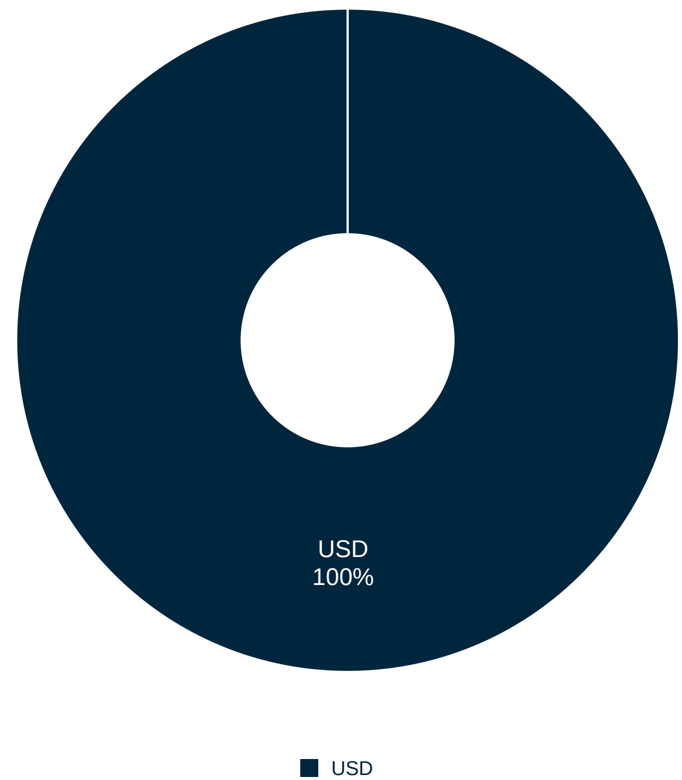
Source: Bloomberg, as of January 20, 2020
* Fund publishes monthly NAV with a 1 month of delay

Boreal Balanced Portfolio USD

Asset Allocation



Currency Allocation



Boreal Investment Profiles

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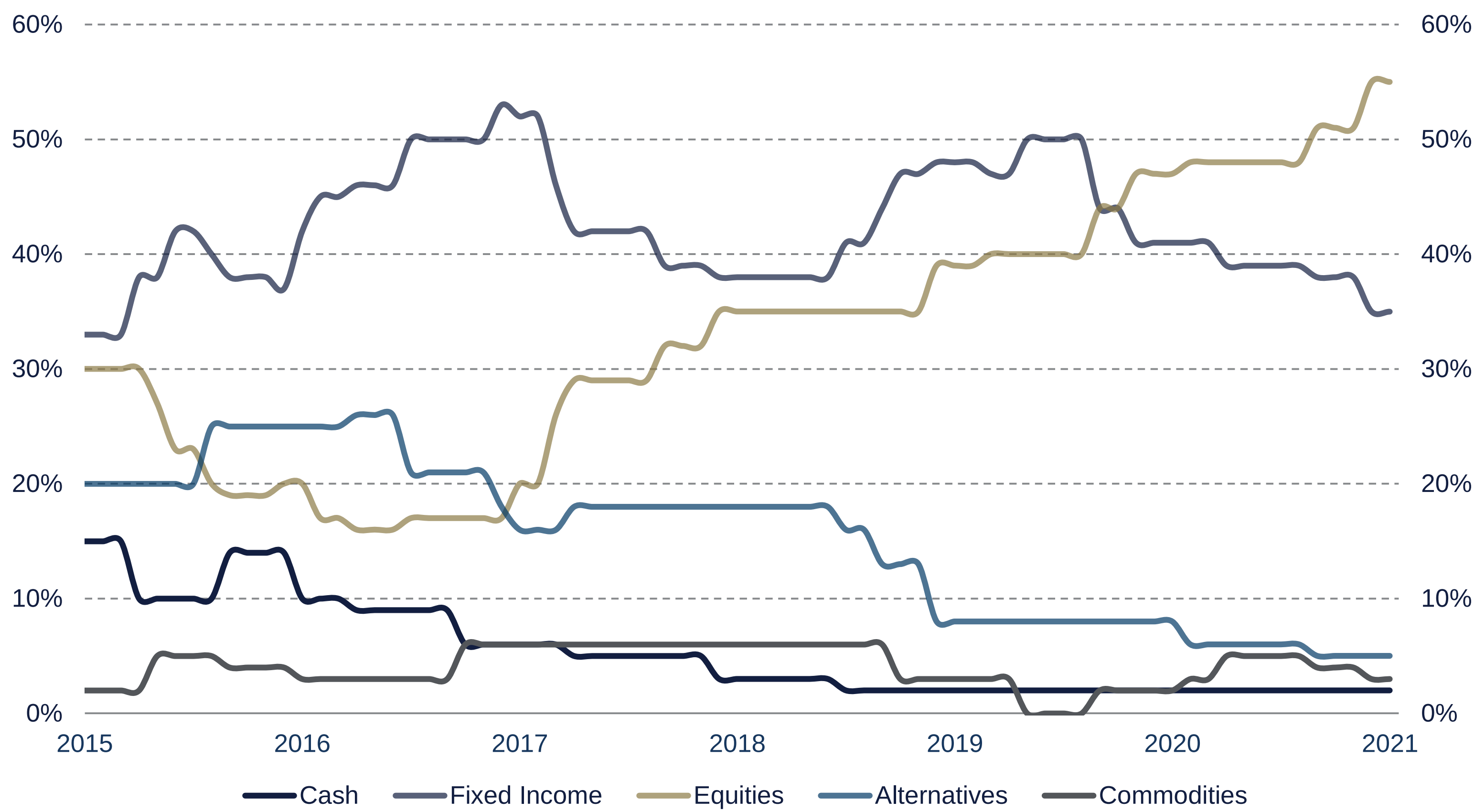
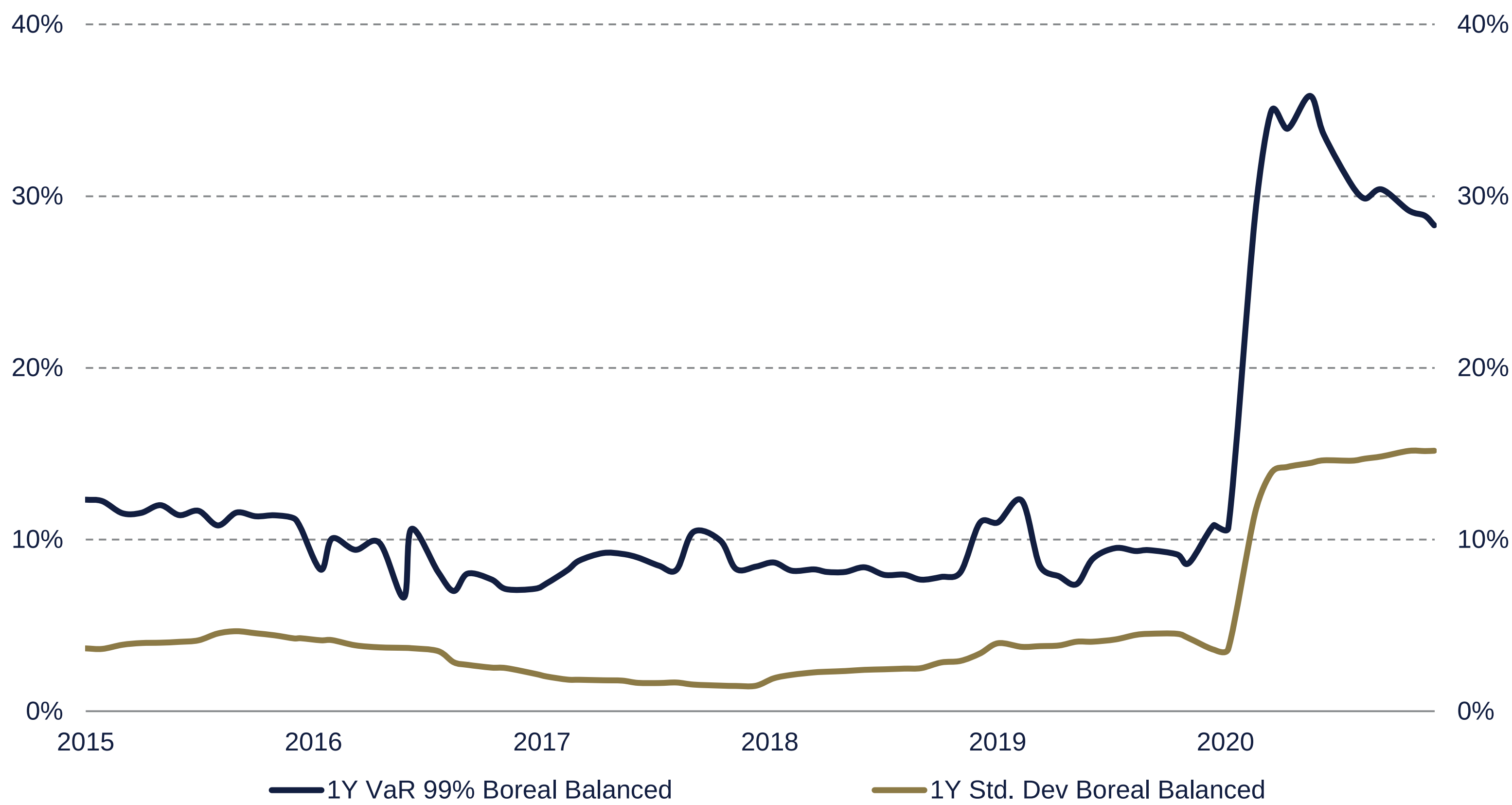
	Conservative	Balanced	Growth
Cash	3% (5%)	2% (5%)	1% (5%)
Fixed Income	57% (64%)	35% (43%)	14% (22%)
Equities	35% (24%)	55% (38%)	72% (52%)
Commodities	2% (2%)	3% (4%)	6% (6%)
Alternative Investments	3% (5%)	5% (10%)	7% (15%)

▼ Strategic Asset Allocation

Boreal Balanced Portfolio – Asset Allocation evolution

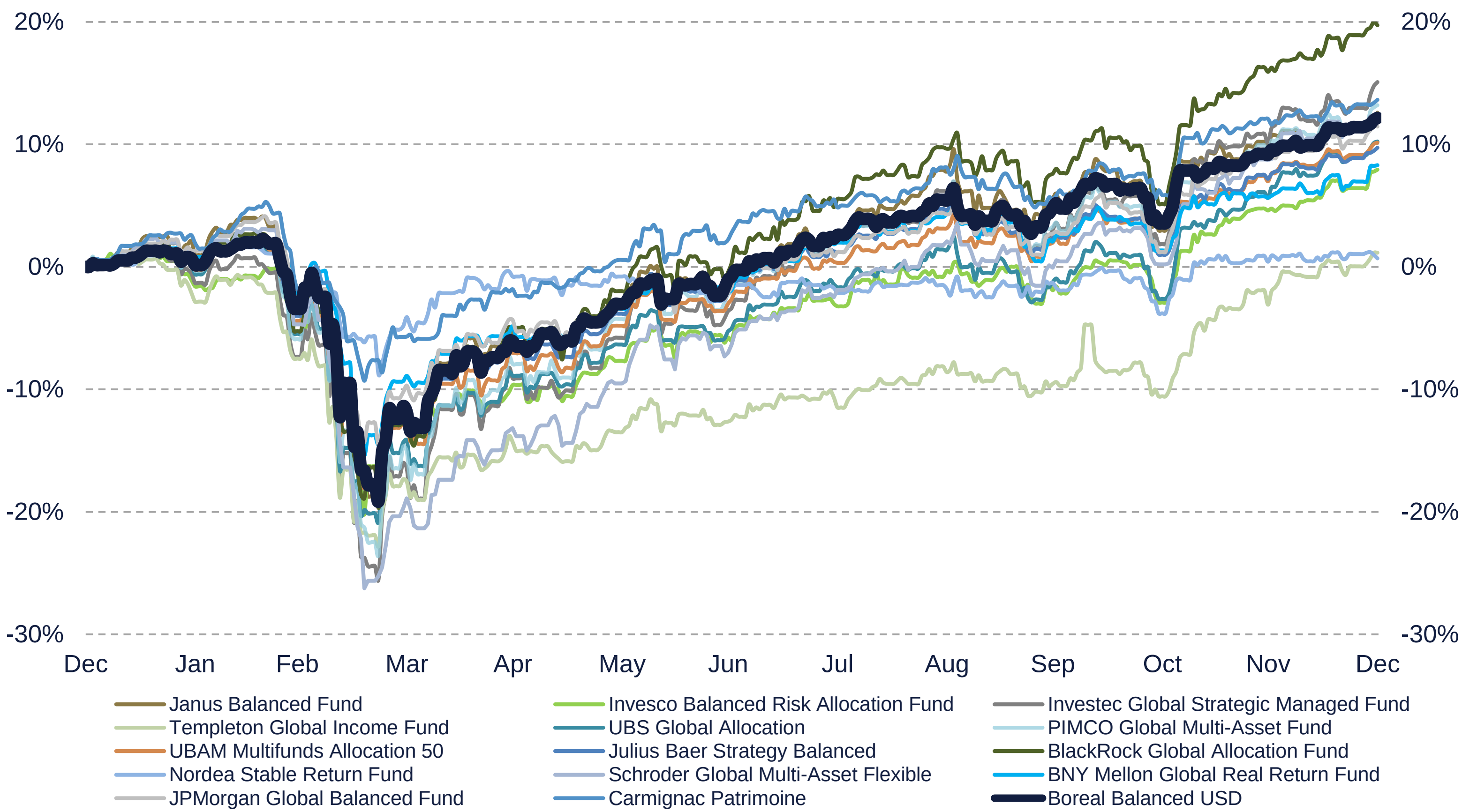


Boreal Balanced Portfolio – VaR evolution



[1] As of December 31, 2020
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **7th out of 15**
- **Standard Deviation** (1 year[1]): **8th out of 15**
- **Downside Risk** (1 year[1]): **3th out of 15**
- **Sharpe Ratio** (1 year[1]): **3th out of 15**

[1] As of December 31, 2020

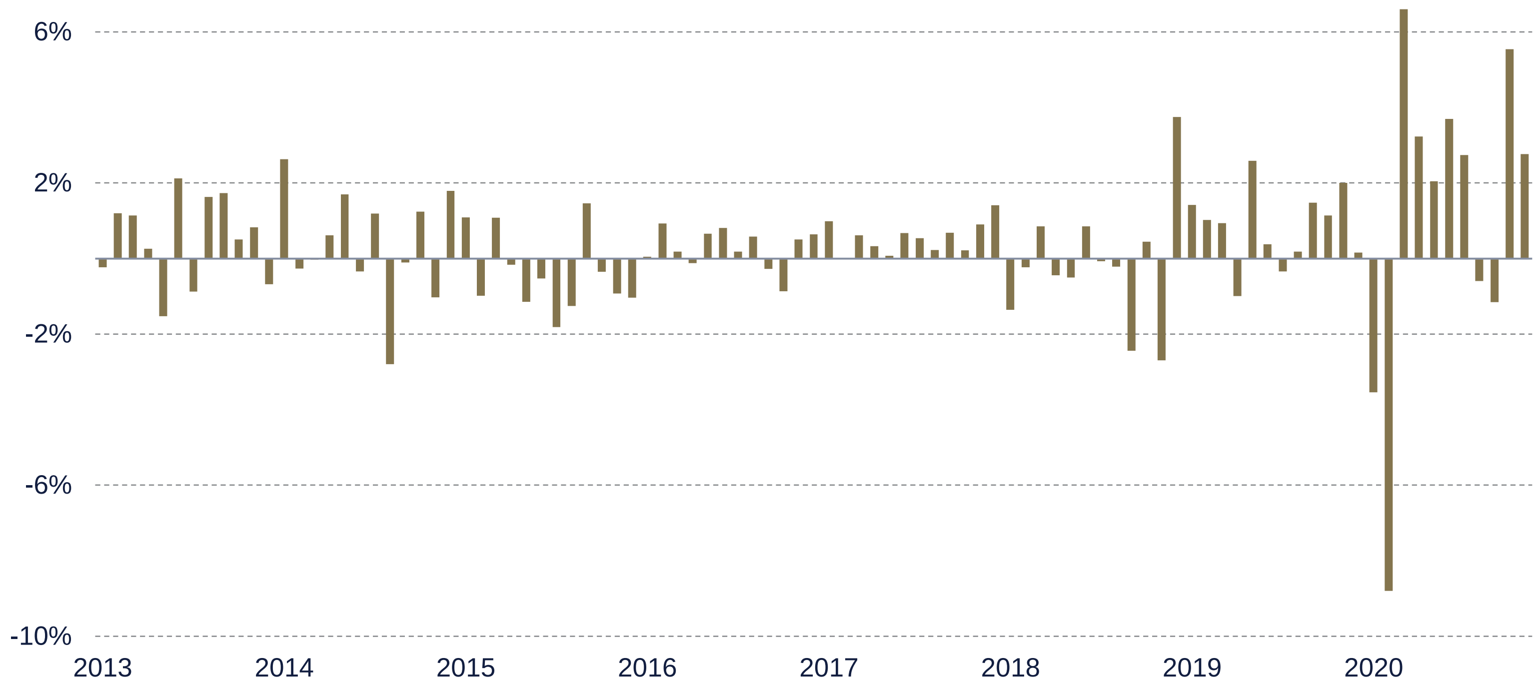
Source: Bloomberg

Boreal Balanced Portfolio – Ytd performance

- **Total Return** (Ytd[1]): **12.35%**
- **Standard Deviation** (Ytd[1]): **15.18%**
- **Downside Risk** (Ytd[1]): **11.95%**
- **Sharpe Ratio** (Ytd[1]): **0.87**

[1] As of December 31, 2020

Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **11.42%**
- **Total Return** (3 year[1]): **21.82%**
- **Total Return** (Since Jan 13[1]): **46.02%**

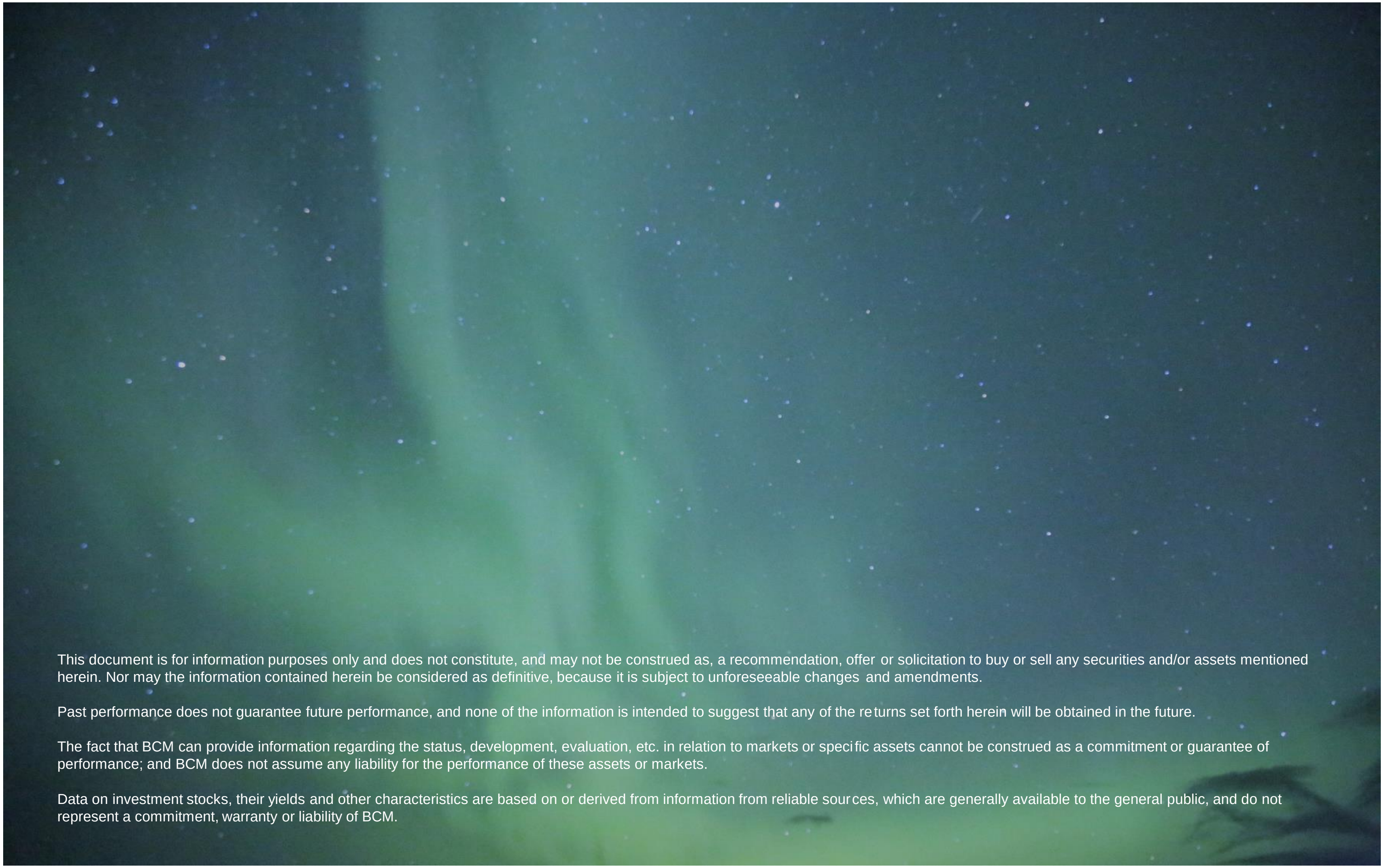
[1] As of January 19, 2020

Boreal Balanced Portfolio – Historical performance (2)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	12.35%	0.47%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	4.71%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.87	1.99

Annualized Return: 4.81%
Annualized Std. Dev: 6.20%

[1] As of January 19, 2020



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