Investment Policy

June 2021

Our market view in a nutshell – June 2021

- During the last month, **financial markets have been largely moved by macroeconomic data**, and particularly those referring to inflation. Consumer **prices have jumped in the past two months to levels not seen in decades**. But this has been anything but a surprise, since the **comparisons are distorted by base effects and transitory factors**; caused by a faster-than-expected reopening of the economy, after a forced shutdown last year
- As there is great **uncertainty when interpreting the data**, investors are practically forced to make macro bets. There are basically two camps here, one championed by central banks, which considers that **most of these effects are transitory** and, therefore, ignores the risk of a sustained acceleration in inflation; and the other, who perceives the **shortages in labor and raw materials as the beginning of an inflationary spiral**, fueled by an extraordinary monetary and fiscal largesse
- In our opinion, the first of the two hypotheses carries more weight, given that shortages in some parts of the economy are due more to **bottlenecks in the production and transportation chain than to structural changes**. In addition, there are **still many lost jobs to be recovered.** In fact, the **low growth and low inflation problems of recent decades are likely to be aggravated** as a consequence of the pandemic; given the increase in debt and the push towards further digitization of the economy
- **The Federal Reserve's reaction to higher inflation and a stronger economy remains critical for markets**. If Fed members continue to be patient and the above effects turn out to be short-lived, asset prices will remain on a strong footing. However, **if they tighten prematurely, or react late, when inflation is already out of control, there is a risk of experiencing a sharp correction**, which could affect both equity and fixed income markets
- **Managing the current macroeconomic uncertainty is notoriously difficult, so we recommend positioning the portfolios for the long term**. On the one hand, avoiding timing interest rate movements in excess, given that the latter are still strongly anchored by secular factors and the strong demand for yield. And on the other hand, investing in innovative and high-quality companies that will be able to increase their income regardless of economic cycles

Boreal Investment Policy

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 crisis caused by the pandemic will lead to an increase in the number of corporate defaults. Credit spreads hardly reflect this risk currently
	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 are expensive, in general. We only recommend to allocate to Chinese government bonds in Renminbis
	Sectors & Themes	+	We favor Biotechnology and Fintech
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

Transitory or sticky?

- **Inflation increased 5% year-on-year** in May, while core inflation (excluding food and energy) increased by 3.8%. Both are **levels that have not been seen in the last decades**; although we have not had a pandemic during that time either
- **Discerning between temporary and permanent price increases** is not easy, since the former can lead to the latter, but so far the key components (housing, education, health) seem well anchored

Source: Bloomberg

Not so different from other cycles

15% 10% 5% 0% -5% -10%

100 90 80 70 60 50 40 30 20 10 0

2006 2008 2010 2012 2014 2016 2018 2020

US Core CPI (LHS) China PPI YoY (LHS) ISM Manufacturing Report on Business Prices (RHS)

- Prices are rising as a result of the **adjustments needed to quickly reopen the economy after a forced halt**. Product shortages are observed, from raw materials to microchips, due to bottlenecks in production and transportation
- Although **it will take time for the economy to fully normalize**, there is no indication that we will see a repeat of the China-led commodity boom of previous decades

Source: Bloomberg

Labor market recovery far from complete

6.1 Million

1,000 | 750 | 500 | 250 | 0

16% | 12% | 8% | 4% | 0%

2000 2002 2004 2006 2008 2010 2012 2014 2016 2018 2020

US Initial Jobless Claims in Thousands (LHS)

US Unemployment Rate (RHS)

- The **labor market continues to make great strides**, but job creation is slowing, and jobless claims are still at crisis levels

Source: Bloomberg

Peak recovery?

300
100
-100
-300
2017
2019
2021
US Econ. Surprise
EU Econ. Surprise
China Econ. Surprise

- As expected, the **pace of economic recovery is moderating**, reducing the risk of the economy overheating
- After the initial impulse caused by the reopening, the reality will be an **economy still subject to restrictions for a long time**, and with great divergence in performance at sector and country level

Source: Bloomberg

Inflation is only one part of the puzzle

R-Star (Natural Rate of Interest)
10-Yr UST Yield
5-Yr Forward Inflation in 5-Yr

6% 4% 2% 0%

2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021

- Interest rates are influenced by inflation expectations, but there are **other variables that also play an important role**
- The “**Natural Rate of Interest" has been declining over the past decades**, and in particular after the Financial Crisis. The impact of the pandemic points towards a new slump. This would mean that interest rates can remain low despite higher inflation

Source: Bloomberg

Interest rates are global

6%
4%
2%
0%
-2%
2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021
US Japan Germany UK Switzerland China

- Globalization, digitization and demographics have been weighing down global interest rates for a long time. And with capital moving freely, **rates are no longer solely determined by local conditions**
- The US has so far managed to escape the "zero interest rate trap", but **global demand limits the rise in US Treasury yields**

Source: Bloomberg

The Fed's balancing act

4%
3%
2%
1%
0%

#FOMC Members' Dot Projections for meeting date 03/17/2021
Fed Funds Futures

2021: 18
2022: 1, 3, 14
2023: 2, 3, 1, 1, 11
Longer Term: 2, 1, 8, 1, 4, 1

2021 2022 2023 Longer Term

- The Fed must **balance rising inflation and a labor market** that still has room for recovery; while avoiding any communication mistakes that could cause a repetition of the **"Tapper Tantrum"**
- So far, **the Fed has managed to convince the market that they are going to remain patient**, and that they will not raise rates or reduce asset purchases until the economy is completely out of the tunnel, but the number of dissenting voices is increasing

Source: Bloomberg

Micro or macro risks?

2.2 | 1.9 | 1.6 | 1.3 | 1.0

4% | 3% | 2% | 1% | 0%

2010 | 2012 | 2014 | 2016 | 2018 | 2020

S&P 500 Growth / S&P 500 Value (LHS) | 10Yr UST Yield (RHS)

- **Macroeconomic uncertainty is weighing on growth stocks**, whose valuations are seen as more affected by rising interest rates
- However, in the long run, the ability to increase earnings has a much greater impact on the performance of stocks than movements in interest rates

Source: Bloomberg

The rise of a new reserve currency

1.00 | 0.96 | 0.92 | 0.88 | 0.84 | 0.80

7.2 | 7.0 | 6.8 | 6.6 | 6.4 | 6.2

2016 | 2017 | 2018 | 2019 | 2020 | 2021

EUR/USD (LHS) | CNY/USD (RHS)

- The FX market also remains subject to macroeconomic uncertainty, since **the value of the dollar is highly dependent on the interest rate differential against other currencies**
- In this regard, we see the **Chinese Renminbi as one of the most attractive currencies**, as government bonds still yield above 3%. The Chinese authorities have also demonstrated their clear commitment to responsibly managing their currency, with the aim of enhancing its **status as a global reserve currency**

Source: Bloomberg

Investment scenarios

	Scenario 1 Interest rate shock	Scenario 2 "V" Recovery	Scenario 3 "W" Recovery
Drivers	• Inflation accelerates due to large fiscal stimulus combined with Infrastructure spending in the US • Commodity prices rise as the global economy bounces back strongly • Central banks try to assure markets that they will not increase interest rates, but long-term rates do increase anyway	• Global recession caused by the unprecedented sudden stop of economic activity • Strict quarantines are avoided and economic activity continues to a greater or lesser extent, depending on control measures of variable intensity • 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 recovery, but momentum fails to be sustained • The pandemic starts to be under control by summer thanks to massive vaccination campaigns, but economic activity does not fully return to normal • Countries with a stronger fiscal position may be able to provide further stimulus and avert a "W" shaped recovery
Market impact	• Corporate earnings rise sharply, but higher interest rates negatively impact equity valuations • High-quality and sovereign bonds fall due to rising interest rates, failing to play their traditional cushioning role in portfolios • Credit performs relatively better despite higher rates, as the risk of corporate defaults remains low • The US dollar depreciates against safe-haven currencies, as well as against gold	• Equities appreciate moderately, as TINA ("There Is No Alternative") lure investors back to stock markets, but there is wide dispersion across sectors • Credit spreads recover to pre-crisis levels as the chase for yield intensifies • 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 equity and credit markets, with the strongest companies recovering and the weakest lagging behind • Credit spreads widen as the market remains highly volatile and corporate defaults rise • Wide dispersion between sovereign bonds and currencies due to "flight-to-quality" • A relatively strong USD as the US economy turns the corner faster than other developed economies. Wide dispersion within Emerging Markets, as countries exit the pandemic at different speeds
Probability	35% (+5%)	55% (-5%)	10%

Short-term catalyzers

Acceleration in vaccinations or treatment for the coronavirus, normalization of activity

Other risks

Revamp of global taxation, Trade War (II), Spread of populist/nationalistic parties, Geopolitical (Middle East, Russia, Iran, North Korea)

iShares $ Treasury Bond 20+yr UCITS ETF
iShares $ Treasury Bond 7-10yr UCITS ETF
iShares USD Corp Bond UCITS ETF
iShares USD TIPS UCITS ETF
Shares China CNY Bond UCITS ETF USD
Neuberger Berman Corporate Hybrid
GAM Star Credit Opportunities
Bonus Certificate S&P 500
BNP Paribas TIER US x2 Index
iShares Edge MSCI USA Quality Factor
Wellington Global Quality Growth Portfolio
Amundi - Polen Capital Global Growth
AMC on Quality-Growth Equity Strategy
Morgan Stanley Investment Funds - Global Advantage Fund
ARK Innovation
New Capital Asia Future Leaders Fund
Polar Capital Biotechnology Fund
Blackrock FinTech Fund
iShares Gold (CH)
Franklin K2 Alternative Strategies Fund
Partners Group Global Value*

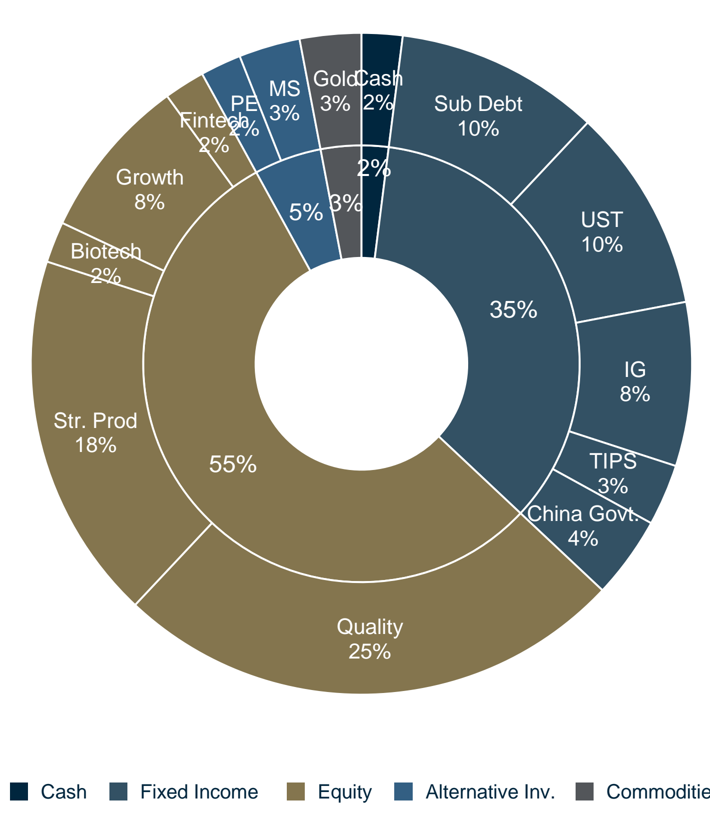
-20% -15% -10% -5% 0% 5% 10% 15% 20%

■ Ytd ■ Last Month

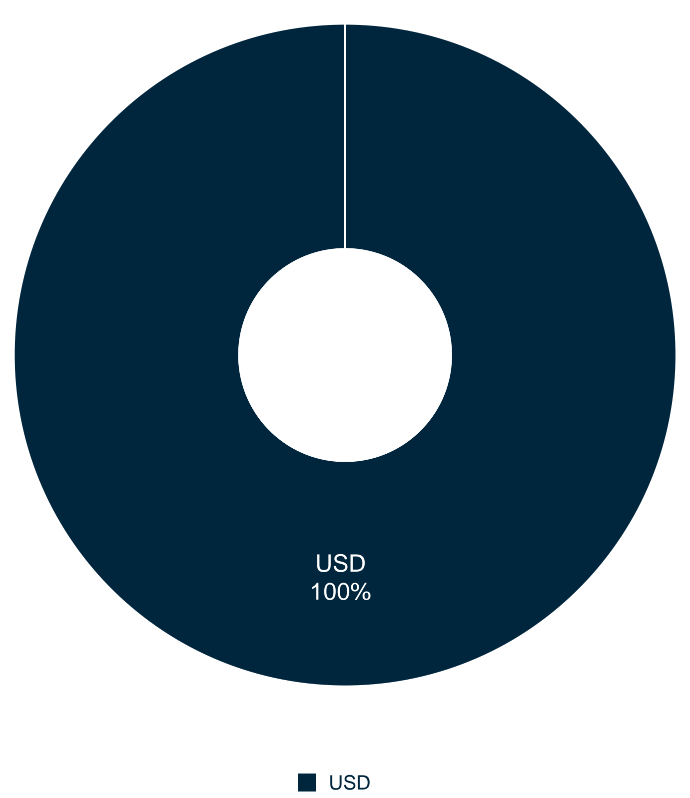
Source: Bloomberg, as of June 10, 2021
* Fund publishes monthly NAV with a 1 month of delay

Boreal Balanced Portfolio USD

Asset Allocation



Currency Allocation



Boreal Investment Profiles

	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 (shown in parentheses)

60%
50%
40%
30%
20%
10%
0%

2015 2016 2017 2018 2019 2020 2021

Cash Fixed Income Equities Alternatives Commodities

40%
30%
20%
10%
0%
2015 2016 2017 2018 2019 2020 2021

1Y VaR 99% Boreal Balanced
1Y Std. Dev Boreal Balanced

[1] As of June 10, 2021
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison

10% 8% 6% 4% 2% 0% -2% -4%

Jan Feb Mar Apr May Jun

- Janus Balanced Fund
- Invesco Balanced Risk Allocation Fund
- Investec Global Strategic Managed Fund
- Credit Suisse Lux Portfolio Fund Balanced
- UBS Global Allocation
- PIMCO Global Multi-Asset Fund
- UBAM Multifunds Allocation 50
- Julius Baer Strategy Balanced
- BlackRock Global Allocation Fund
- Nordea Stable Return Fund
- Schroder Global Multi-Asset Flexible
- BNY Mellon Global Real Return Fund
- JPMorgan Global Balanced Fund
- Carmignac Patrimoine
- Boreal Balanced USD

- **Total Return** (Ytd[1]): **14th out of 15**
- **Standard Deviation** (1 year[1]): **6th out of 15**
- **Downside Risk** (1 year[1]): **4th out of 15**
- **Sharpe Ratio** (1 year[1]): **8th out of 15**

[1] As of June 10, 2021

Source: Bloomberg

Boreal Balanced Portfolio – Ytd performance

4.0%
2.0%
0.0%
-2.0%
-4.0%

Jan Feb Mar Apr May Jun

- **Total Return** (Ytd[1]): **3.41%**
- **Standard Deviation** (Ytd[1]): **8.02%**
- **Downside Risk** (Ytd[1]): **5.79%**
- **Sharpe Ratio** (Ytd[1]): **1.03**

[1] As of June 10, 2021

Boreal Balanced Portfolio – Historical performance (1)

6%
2%
-2%
-6%
-10%
2013 2014 2015 2016 2017 2018 2019 2020 2021

- **Total Return** (1 year[1]): **17.50%**
- **Total Return** (3 year[1]): **26.22%**
- **Total Return** (Since Jan 13[1]): **50.42%**

[1] As of June 10, 2021

Boreal Balanced Portfolio – Historical performance (2)

50%
40%
30%
20%
10%
0%

	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%	3.41%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	8.02%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.87	1.03

Annualized Return: 4.95%
Annualized Std. Dev: 6.31%

[1] As of June 10, 2021

This document is for information purposes only and does not constitute, and may not be construed as, a recommendation, offer or solicitation to buy or sell any securities and/or assets mentioned herein. Nor may the information contained herein be considered as definitive, because it is subject to unforeseeable changes and amendments.

Past performance does not guarantee future performance, and none of the information is intended to suggest that any of the returns set forth herein will be obtained in the future.

The fact that BCM can provide information regarding the status, development, evaluation, etc. in relation to markets or specific assets cannot be construed as a commitment or guarantee of performance; and BCM does not assume any liability for the performance of these assets or markets.

Data on investment stocks, their yields and other characteristics are based on or derived from information from reliable sources, which are generally available to the general public, and do not represent a commitment, warranty or liability of BCM.