# Investment Policy

October 2021

BOREAL
CAPITAL MANAGEMENT

# Our market view in a nutshell – October 2021

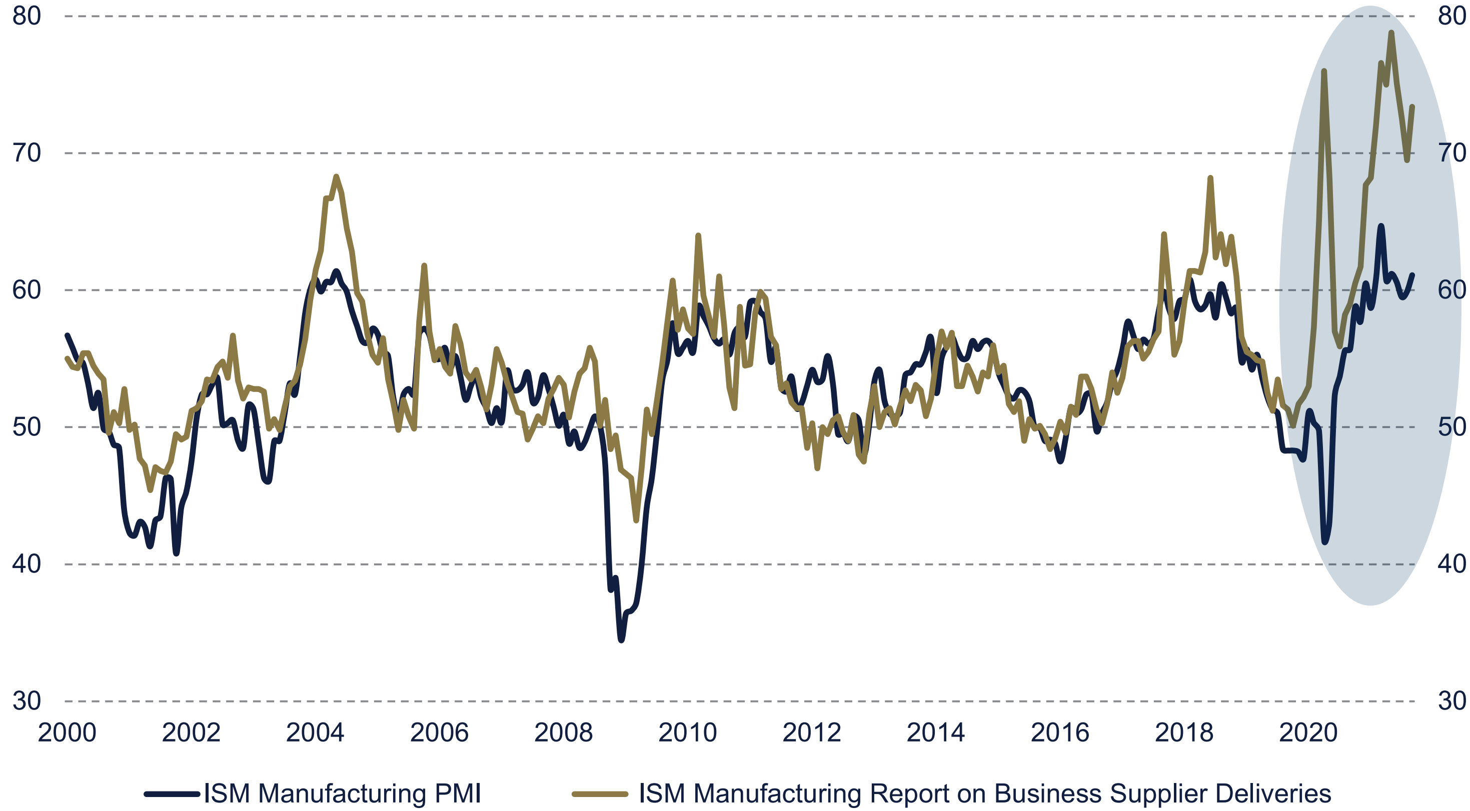
- One more month, another batch of macroeconomic data. As time passes, **evidence grows that inflationary pressures may last longer than initially expected**. Logistical bottlenecks, rising energy prices, labor shortages, and rising house prices are beginning to filter into **consumers' medium-term inflation expectations**; which increases the risk of triggering an inflationary spiral
- Regardless of whether these factors ultimately turn out to be **transitory or not, the Fed can no longer ignore them**; particularly if wage pressures continue. **The Fed is between a rock and a hard place**, as if it does nothing it risks losing control of the situation, while a premature tightening could slow down the economy at a critical juncture
- Both an acceleration in inflation and a Fed policy mistake are plausible scenarios, but their potential impact on financial markets is a matter of degree. A reasonable assumption is that **inflation will rise but will not get out of control,** and that the **Fed will remain patient and will only tighten its monetary policy gradually**. This thesis implies that we will not see a recession in the near-term
- Even if the US economy is on a solid growth path, it is not insulated from external risks; the pandemic being the most obvious reminder of it. In this sense, currently the **biggest risks come from China**; where we have a **combination of slowing growth and problems in the real estate sector that could feed each other**. So far, the market seems to believe that contagion risks are contained, but investors should keep a close eye on developments
- With macro tailwinds waning and interest rates rising, **equity valuations are increasingly dependent on earnings growth**. In this regard, we continue to witness strong earnings momentum, which supports our constructive view on equities. However, we expect **volatility to remain high as valuation multiples are more likely to compress rather than expand**

# 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 | – | Emerging debt is currently unattractive from a risk-return point of view |
| 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 market stocks tend to be more cyclical, and there are fewer quality stocks |
| | 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

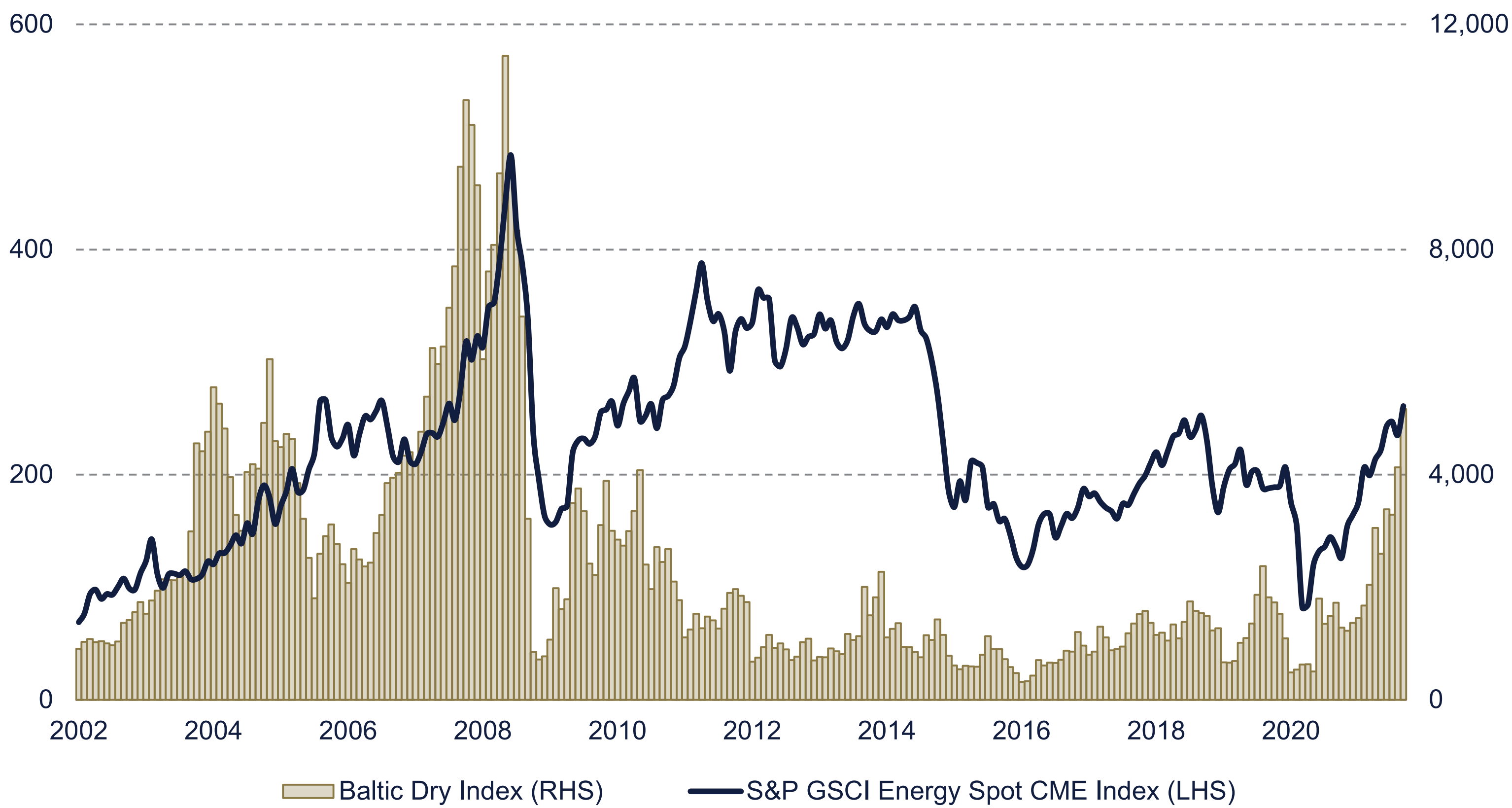
# Supply chain constraints lasting longer than expected




- **Logistics bottlenecks are making headlines** as manufacturers face increasing problems producing and distributing their products; as the economy emerges from the pandemic

Source: Bloomberg

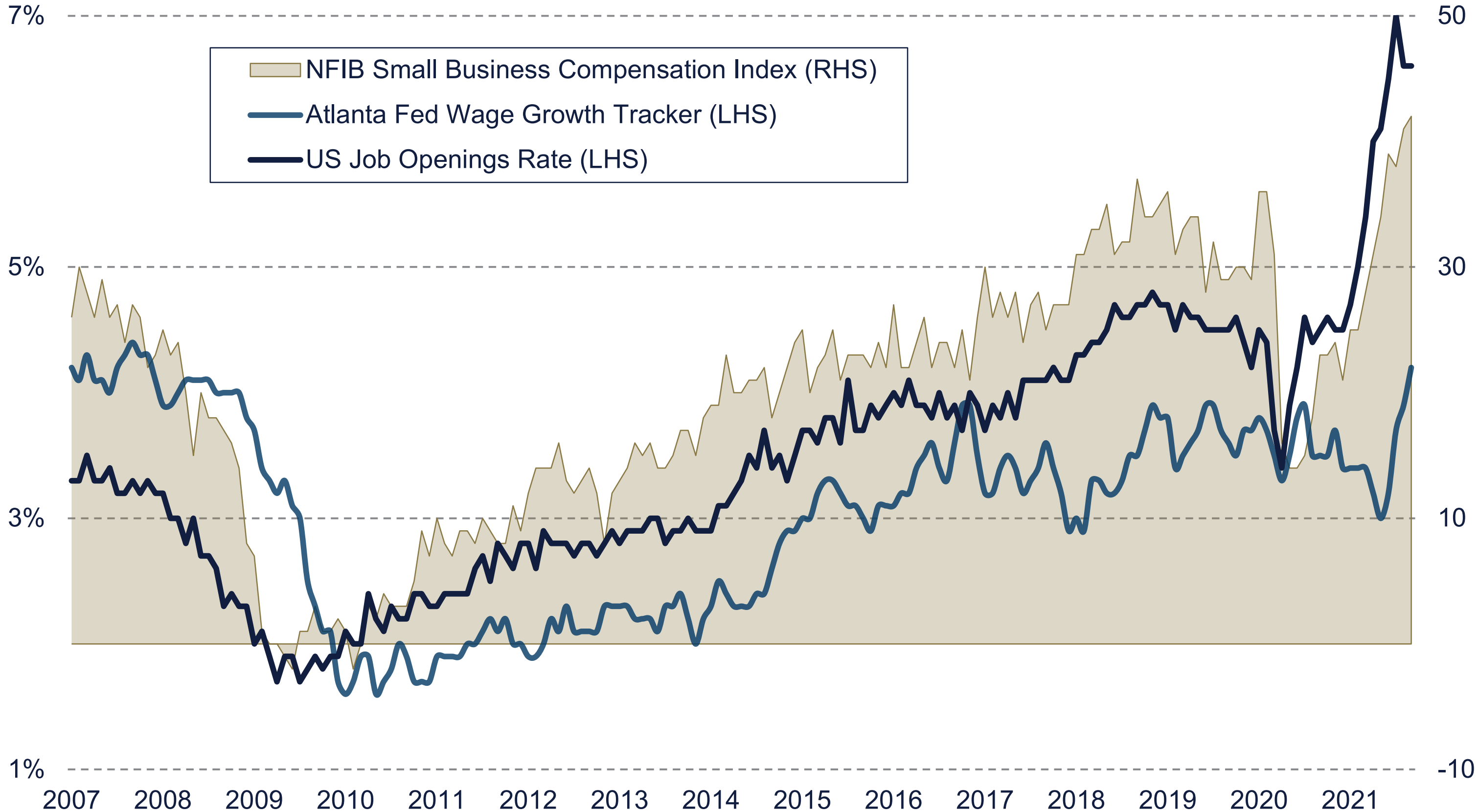
# The economy is cyclical




- Even though supply chain disruptions are proving to last longer than initially expected, we must try to **differentiate between the anecdotal and the structural**
- This time, **energy and transportation costs are not increasing due to an overheating of the economy**, but due to disruptions and lack of investment caused by the pandemic

Source: Bloomberg

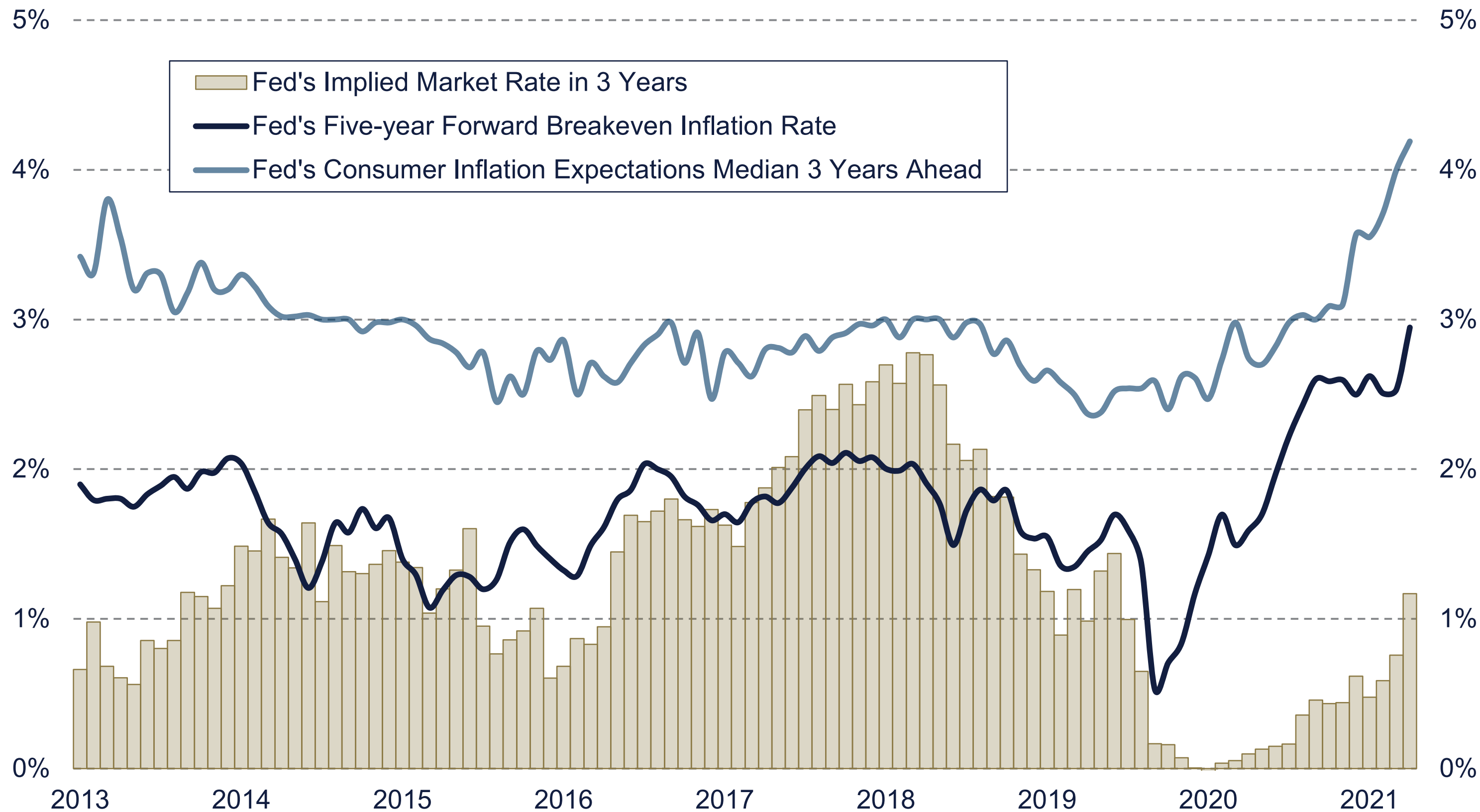
# Where are the workers?




- Evidence is mounting that **labor shortages are beginning to translate into higher wages**
- If this trend continues, we will have all **the ingredients for a sustained increase in inflation**

Source: Bloomberg

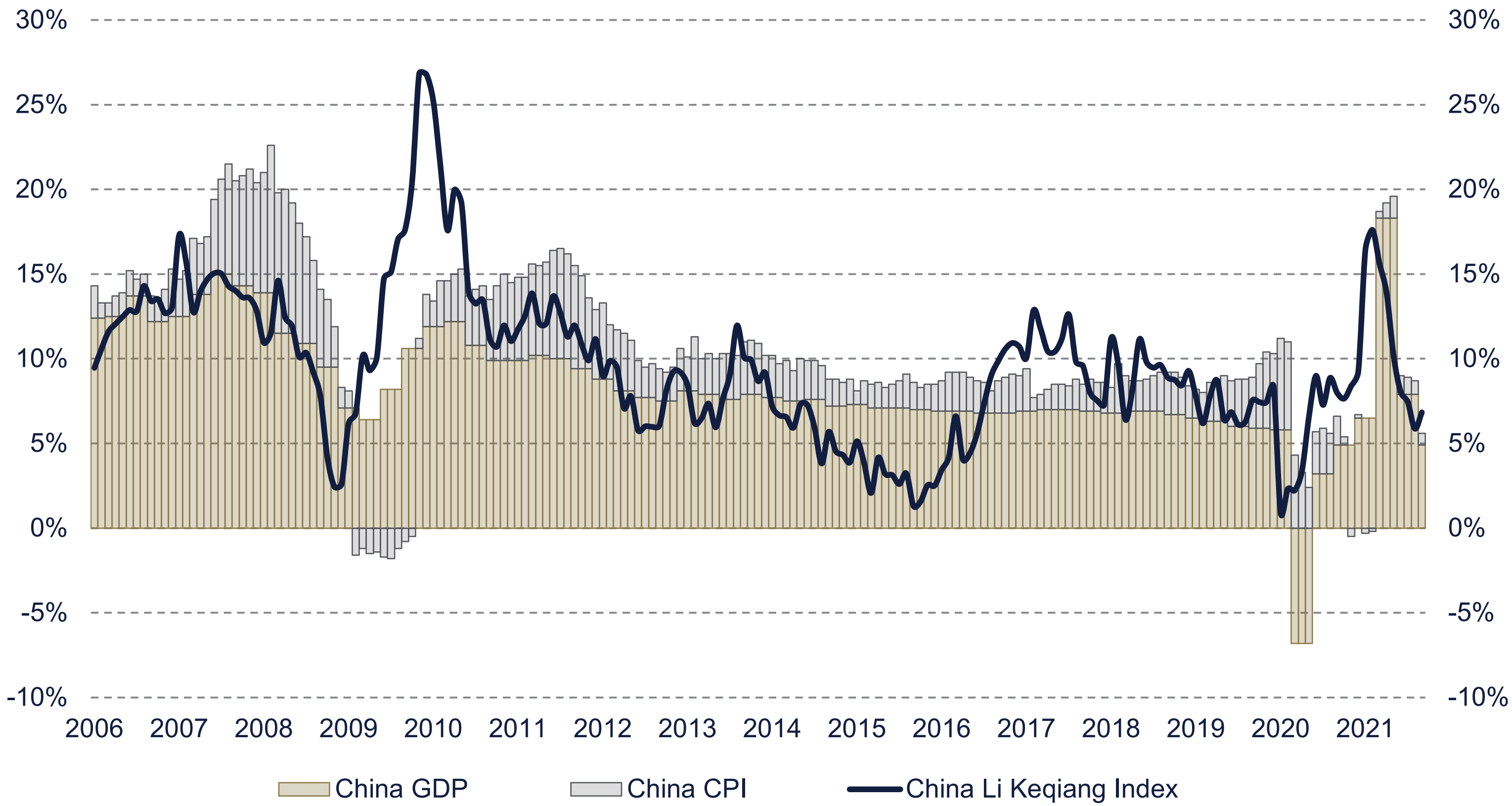
# No longer transitory




- Rising prices caused by shortages in certain goods and services, as well as rising wages and house prices, are **beginning to filter into consumer inflation expectations**
- **The Fed cannot remain patient for much longer**, otherwise there is a risk that it will later have to raise rates more aggressively; putting the economic recovery at risk

Source: Bloomberg

# Inflation is not the biggest risk right now




- **China's troubles are going relatively unnoticed**, with the market little concerned so far about a potential economic slowdown in the country
- Growth continues to slow and, unlike the rest of the world, inflation remains depressed; resulting in **real GDP levels not seen in decades**

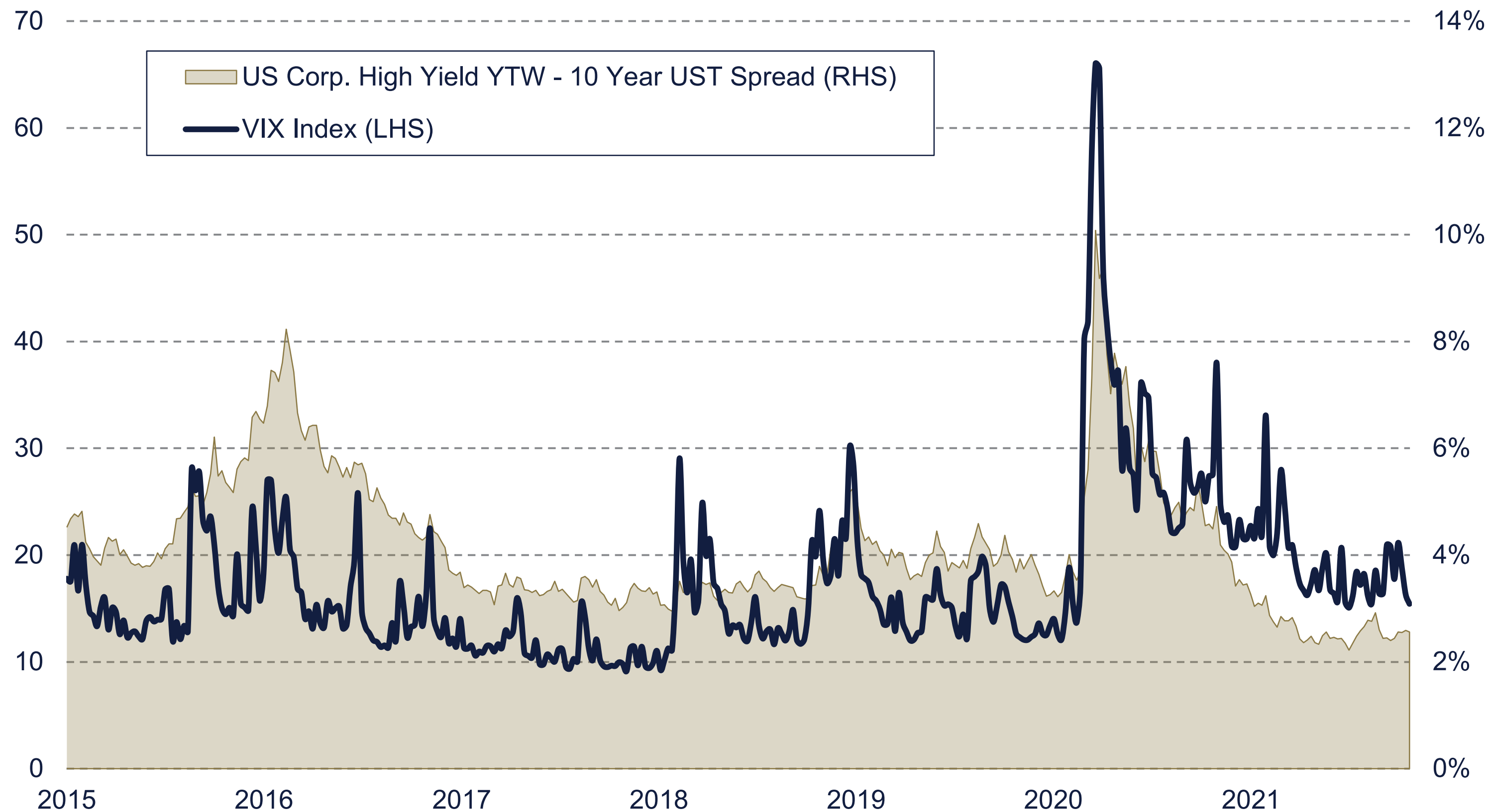
Source: Bloomberg

# Contagion risk contained so far


- The **crisis of the property developer Evergrande** seems to have been **confined to the most indebted corners** of the real estate sector
- However, a there is a **risk of a potential spillovers to consumers** if property prices were at some point affected

Source: Bloomberg

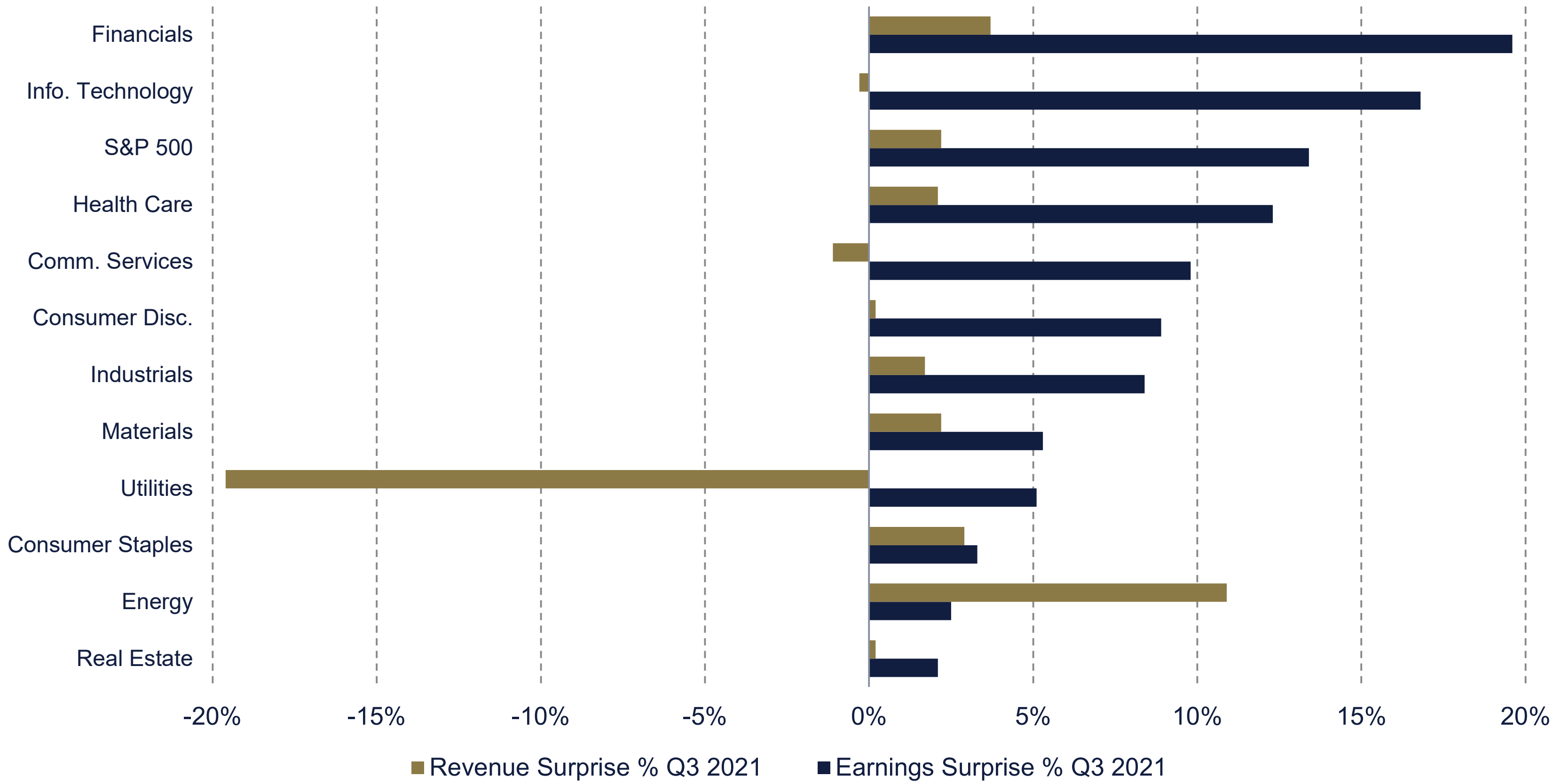
# Corrections driven by valuations, not growth




- Judging by credit spreads, **financial markets are not pricing a recession anytime soon**
- However, as the trajectory of interest rates become less predictable, and valuation multiples begin to compress, **equity markets are increasingly vulnerable to changes in market sentiment**

Source: Bloomberg

# Back to fundamentals




- With **multiple expansion over**, **earnings growth will be the most critical factor determining performance** in the medium term, underscoring the importance of **remaining highly selective**

Source: FactSet

# Investment scenarios

| | Scenario 1<br>Interest rate shock | Scenario 2<br>"V" Recovery | Scenario 3<br>"W" Recovery |
|---|---|---|---|
| **Drivers** | • Inflation accelerates due to large fiscal stimulus combined with Infrastructure spending in the US<br>• Commodity prices rise as the global economy bounces back strongly<br>• 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<br>• Strict quarantines are avoided and economic activity continues to a greater or lesser extent, depending on control measures of variable intensity<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 recovery, but momentum fails to be sustained<br>• The pandemic starts to be under control by summer thanks to massive vaccination campaigns, but economic activity does not fully return to normal<br>• 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<br>• High-quality and sovereign bonds fall due to rising interest rates, failing to play their traditional cushioning role in portfolios<br>• Credit performs relatively better despite higher rates, as the risk of corporate defaults remains low<br>• 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<br>• Credit spreads recover to pre-crisis levels as the chase for yield intensifies<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 equity and credit markets, with the strongest companies recovering and the weakest lagging behind<br>• Credit spreads widen as the market remains highly volatile and corporate defaults rise<br>• Wide dispersion between sovereign bonds and currencies due to "flight-to-quality"<br>• 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%) | 45% (-10%) | 20% (+5%) |

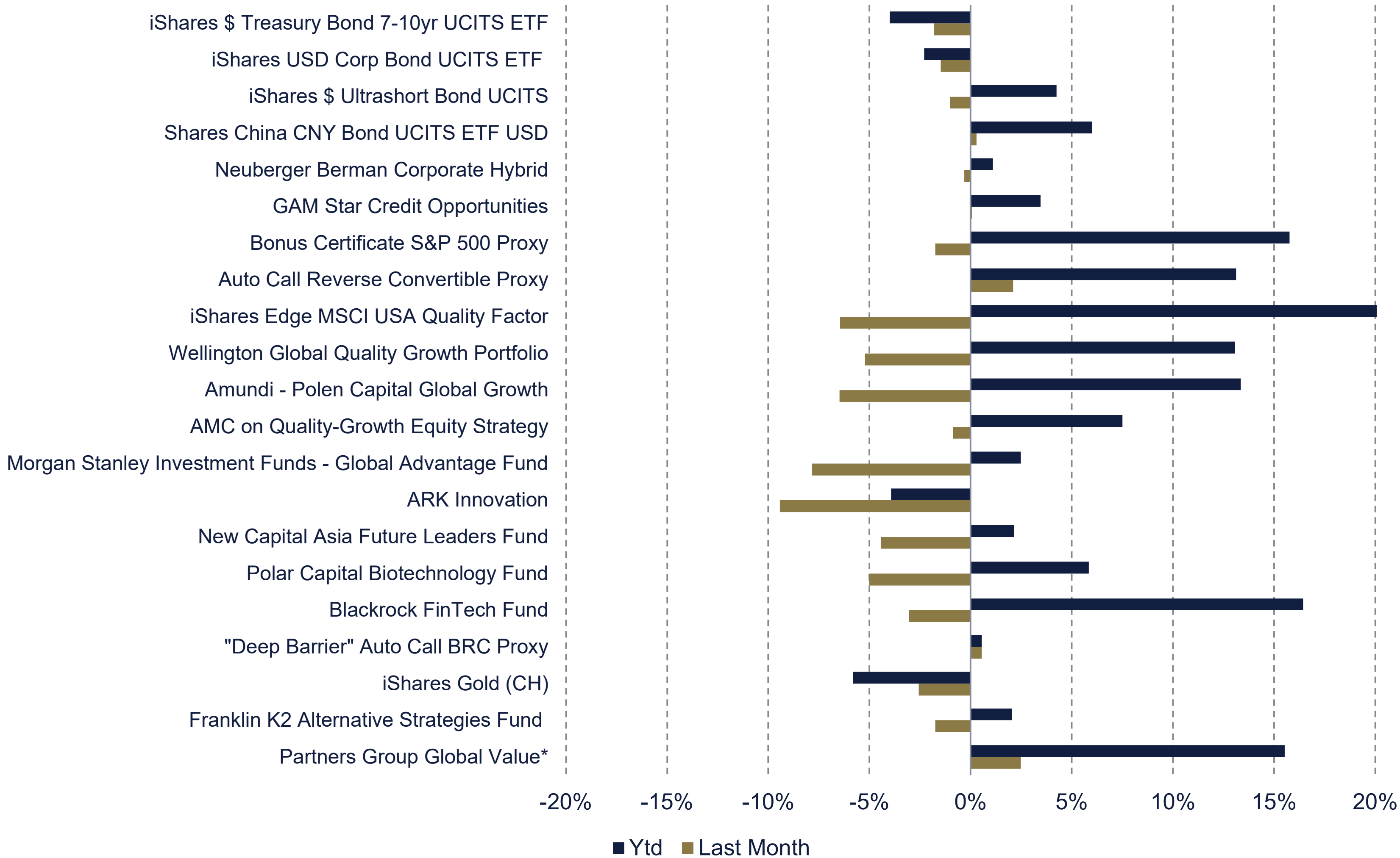
**Short-term catalyzers**

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)

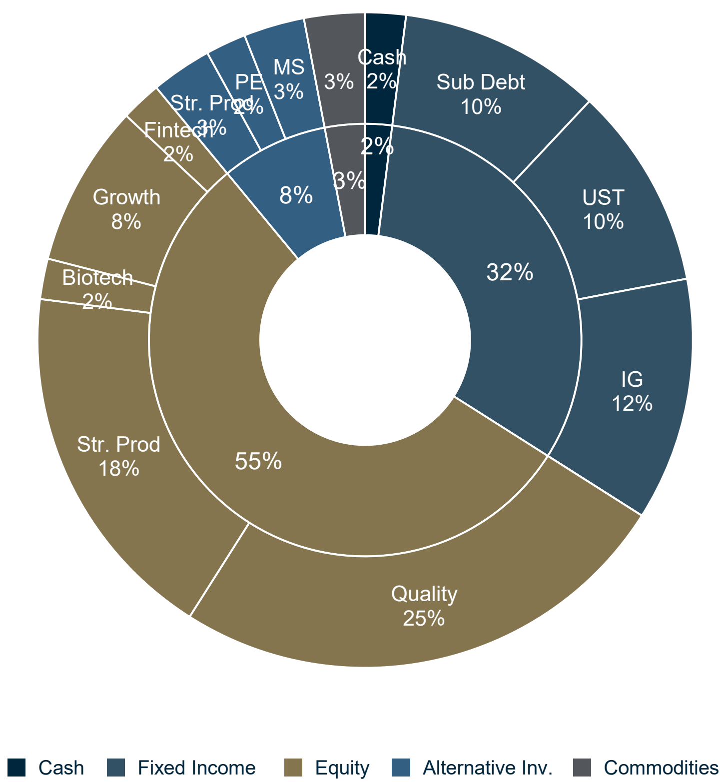
# Model portfolio evolution



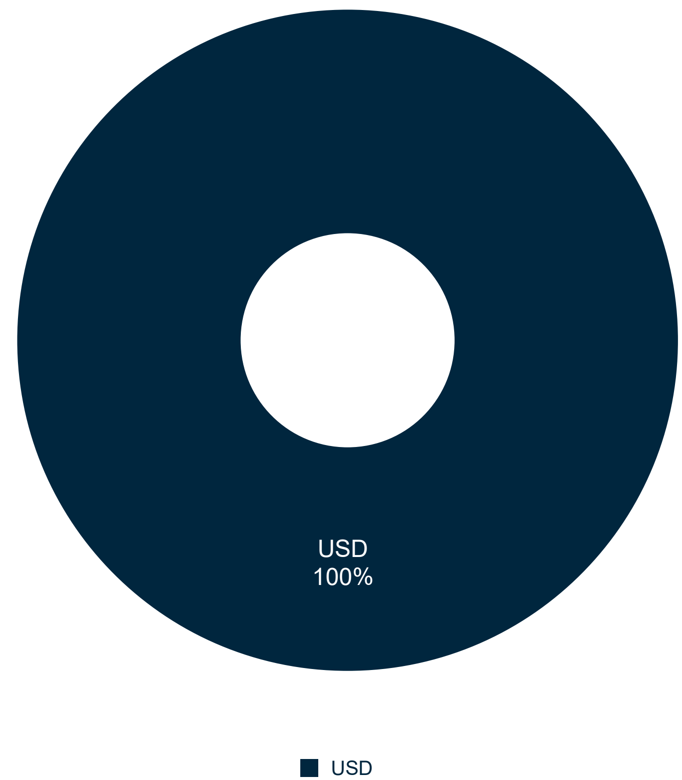

Source: Bloomberg, as of October 18, 2021
* Fund publishes monthly NAV with a 1 month of delay

# Boreal Balanced Portfolio USD

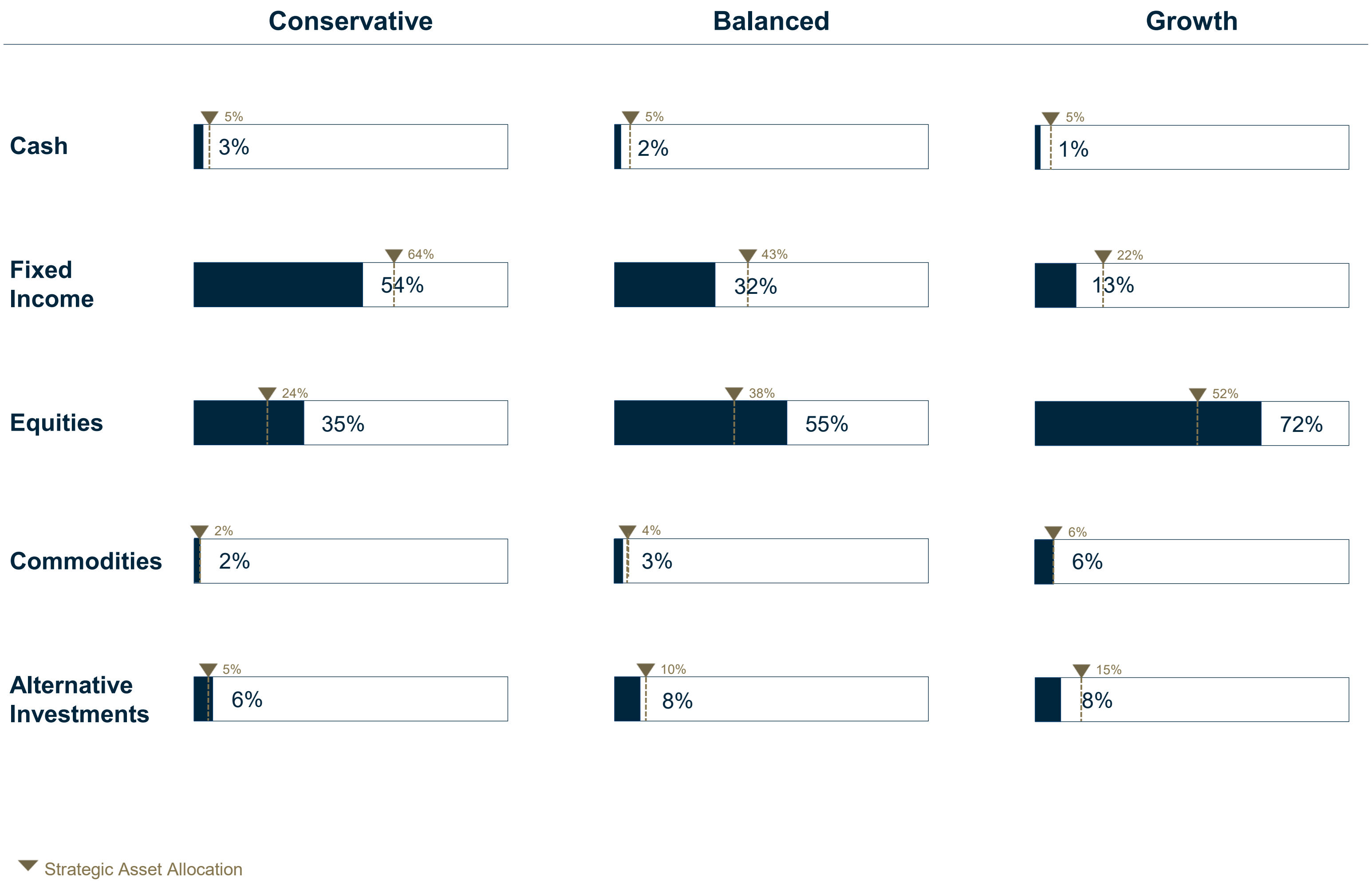
## Asset Allocation



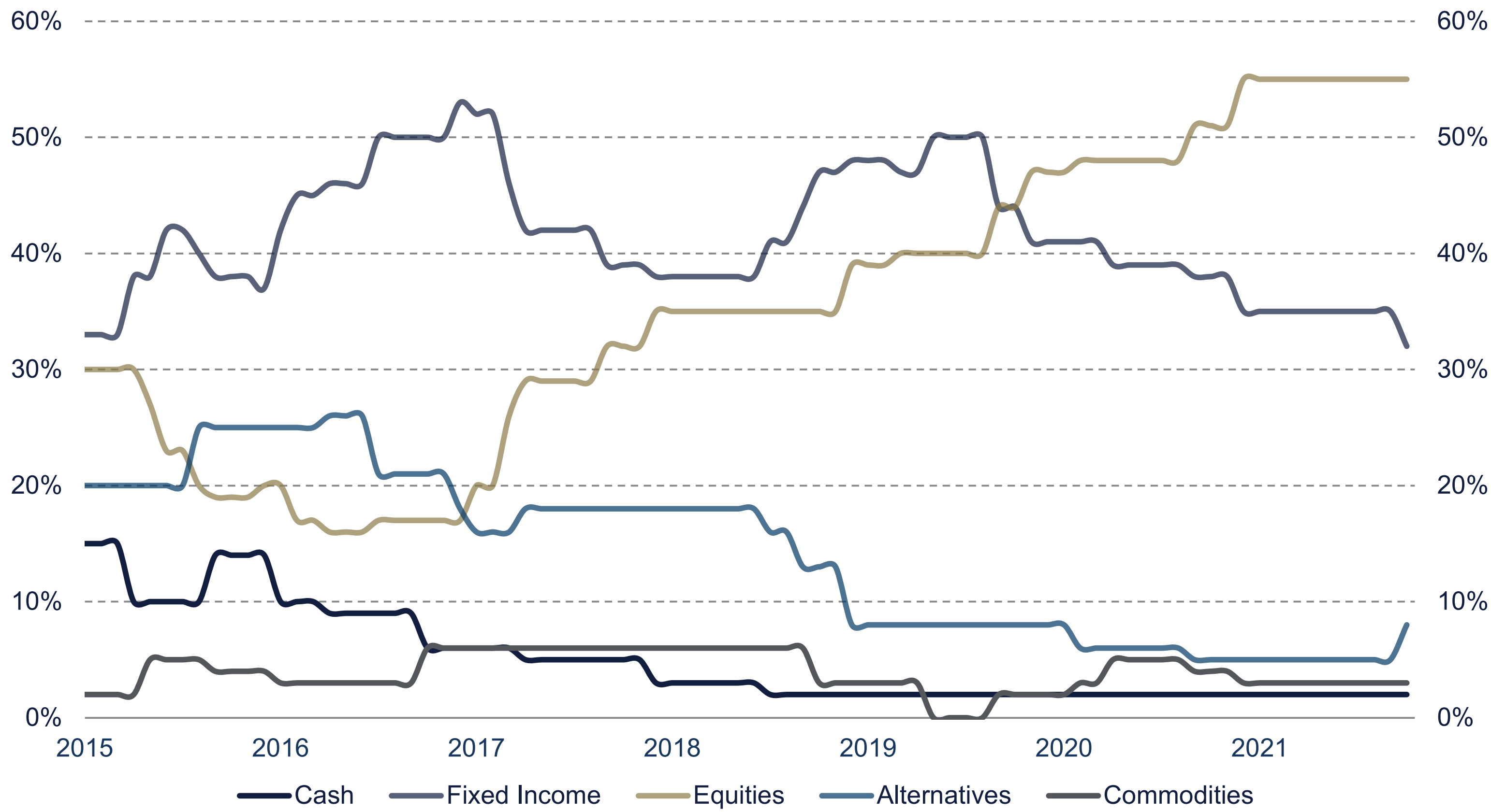

## Currency Allocation



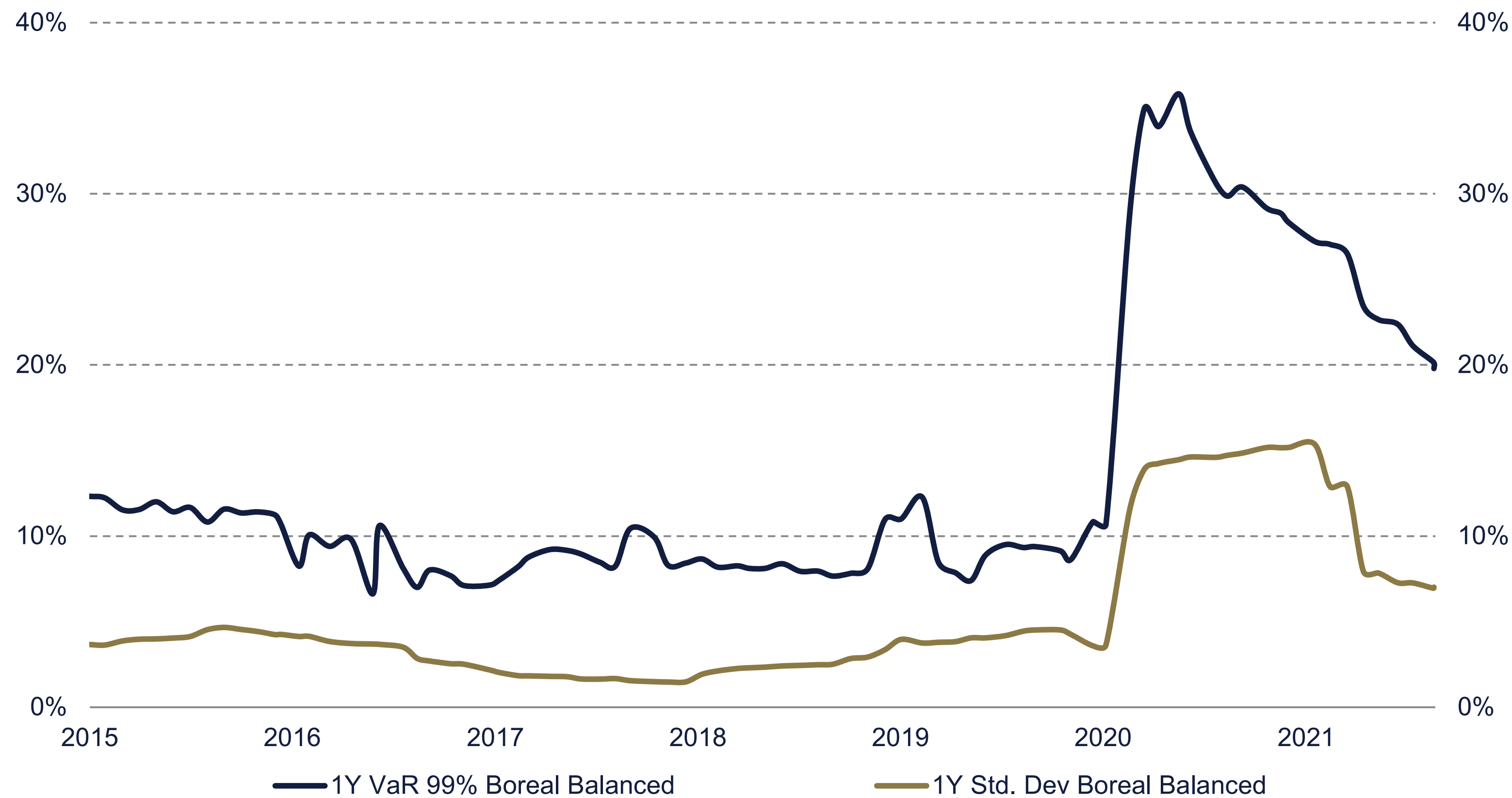
# Boreal Investment Profiles



# Boreal Balanced Portfolio – Asset Allocation evolution

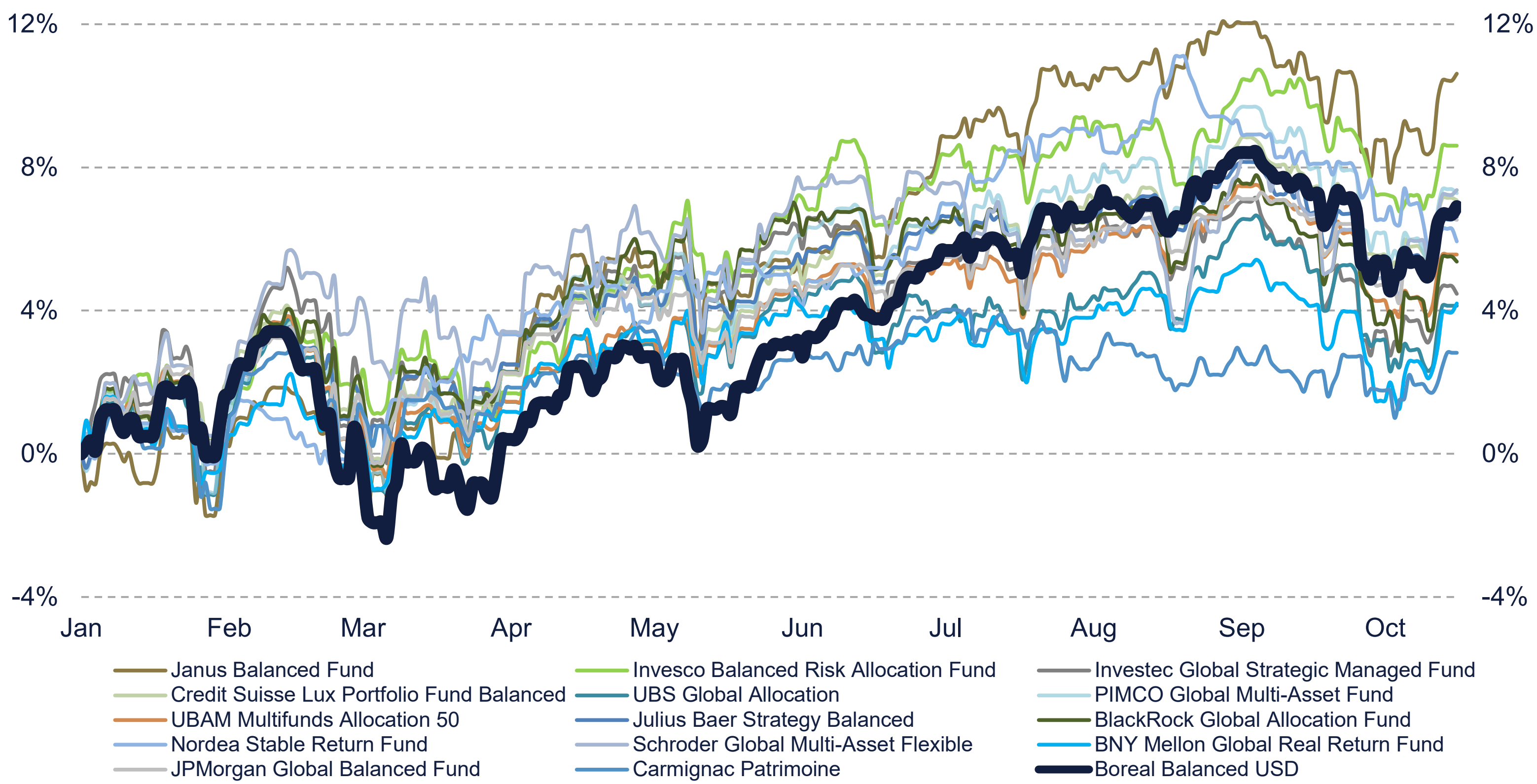


# Boreal Balanced Portfolio – VaR evolution




[1] As of October 18, 2021
Source: Bloomberg

# Boreal Balanced Portfolio – Peer comparison (YTD)

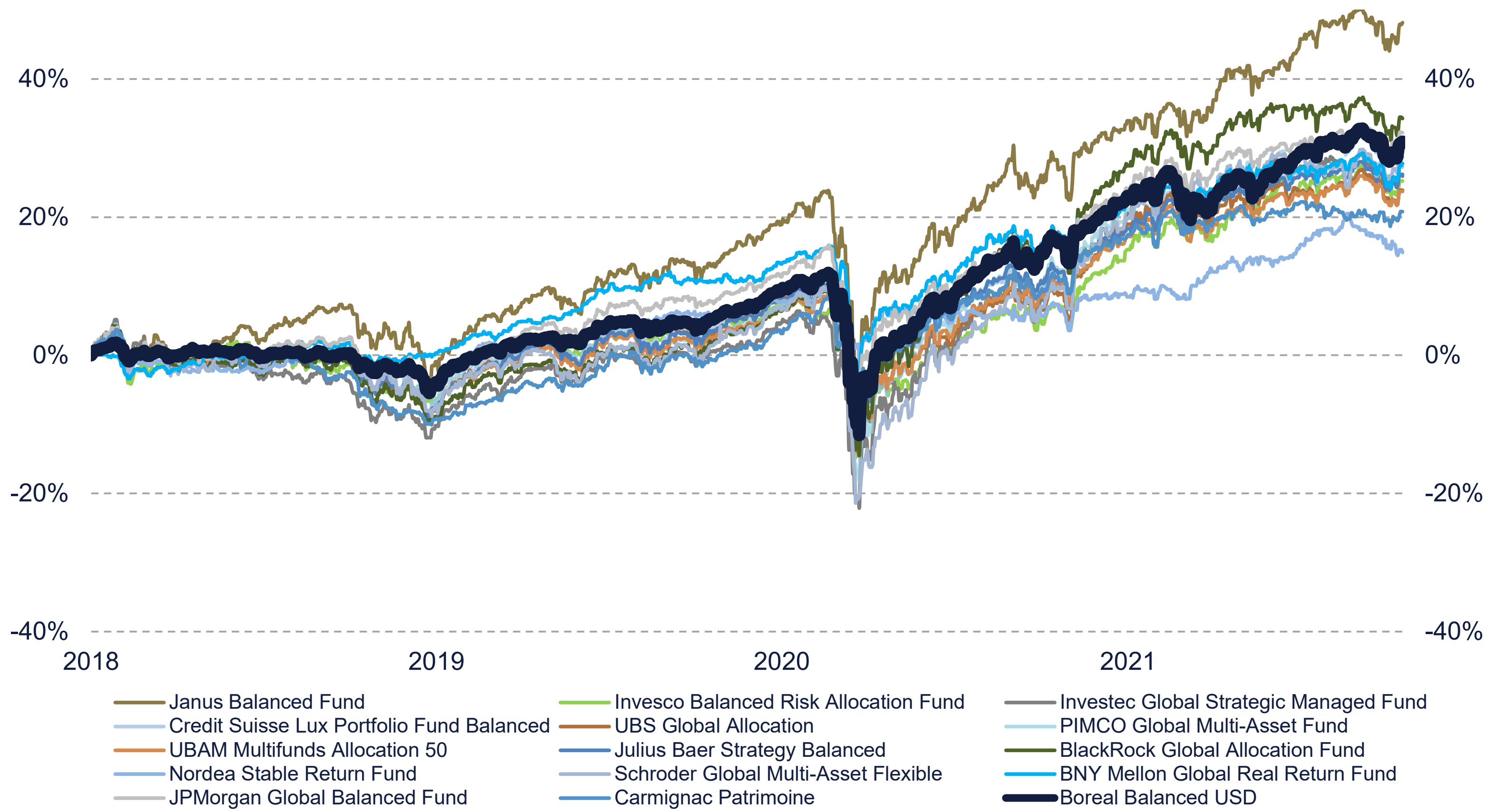



- **Total Return** (Ytd[1]): **8th out of 15**
- **Standard Deviation** (1 year[1]): **4th out of 15**
- **Downside Risk** (1 year[1]): **4th out of 15**
- **Sharpe Ratio** (1 year[1]): **3rd out of 15**

[1] As of October 18, 2021

Source: Bloomberg

# Boreal Balanced Portfolio – Peer comparison (2)



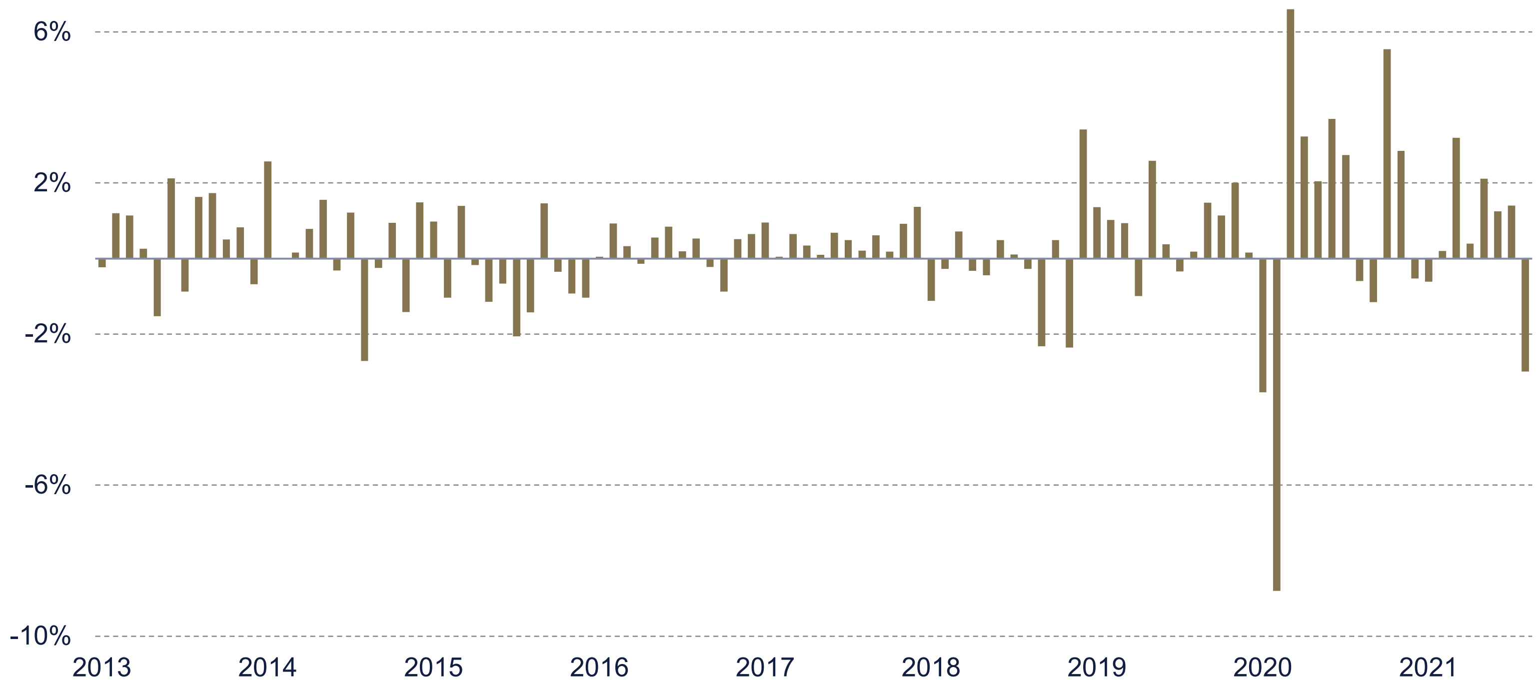

[1] As of October 18, 2021
Source: Bloomberg

# Boreal Balanced Portfolio – Ytd performance


- **Total Return** (Ytd[1]): **6.40%**
- **Standard Deviation** (Ytd[1]): **6.96%**
- **Downside Risk** (Ytd[1]): **5.09%**
- **Sharpe Ratio** (Ytd[1]): **1.20**

[1] As of October 18, 2021

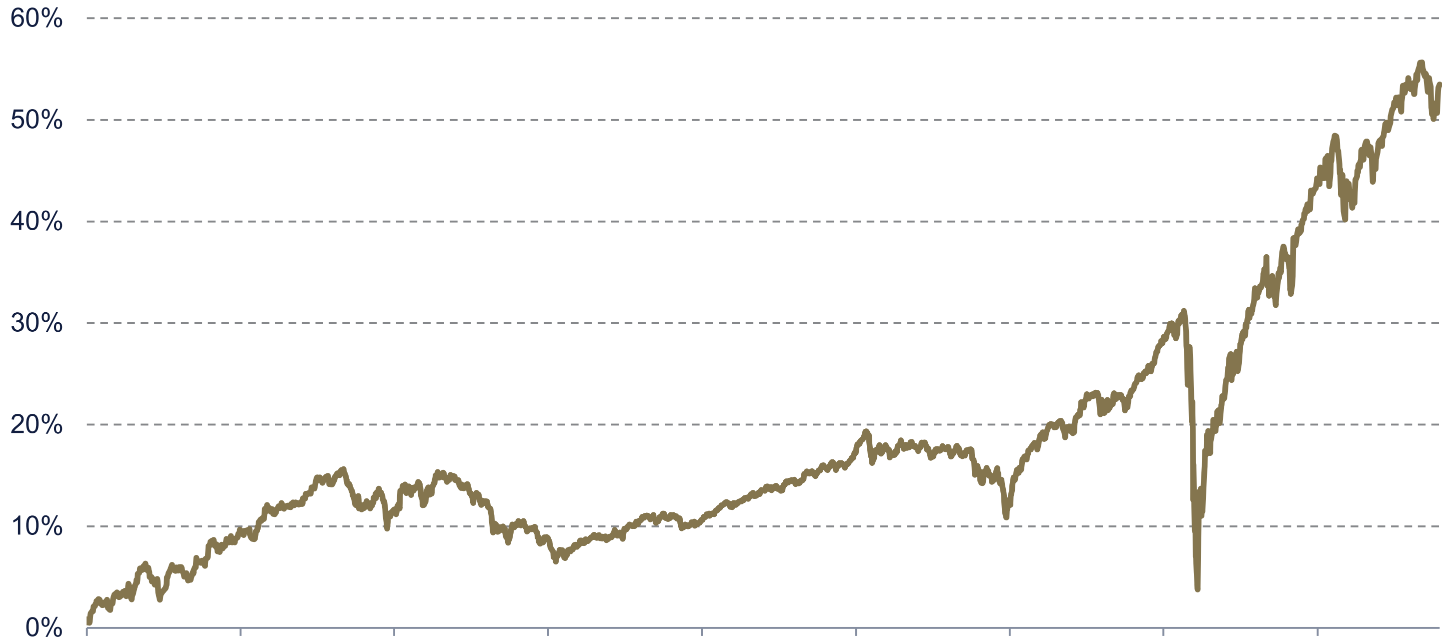
# Boreal Balanced Portfolio – Historical performance (1)




- **Total Return** (1 year[1]): **12.09%**
- **Total Return** (3 year[1]): **32.65%**
- **Total Return** (Since Jan 13[1]): **53.47%**

[1] As of October 18, 2021

# 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% | 6.40% |
| Std. Deviation | 3.82% | 3.59% | 3.67% | 2.08% | 1.45% | 3.77% | 3.78% | 15.18% | 6.96% |
| Sharpe Ratio | 2.54 | 0.58 | -0.48 | 0.62 | 3.57 | -1.70 | 3.49 | 0.87 | 1.20 |

Annualized Return: 4.99%
Annualized Std. Dev: 6.23%

[1] As of October 18, 2021