Investment Policy

January 2022

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CAPITAL MANAGEMENT

Our market view in a nutshell – January 2022

- Markets have had a **rude awakening** at the beginning of the year, triggered by the publication of two important data. First, **employment data** showing that companies are finding it increasingly difficult to fill jobs, even though many jobs lost during the pandemic still need to be recovered. This tightness in the labor market stokes fears of rising wages. Second, the publication of the **minutes of the last Fed meeting**, through which we learned that the central bank considers that the level of full employment has already been reached, and is now shifting the focus to controlling inflation

- Once the bond market realized that **the central bank might turn much more hawkish than initially thought**, and with inflation showing no signs of abating, **long-term interest rates have gone up**. As a result, **bond and equity markets have fallen in tandem**, in a repeat of the sell-off experienced in February of last year. However, this time the situation is quite different

- Back then, the expectation was that an overheating economy would cause inflation to rise and, with it, interest rates. But today we are experiencing inflation of a very different kind. Currently, there are **three main factors** driving price increases: **(1) Base effects**, when current prices are compared with those at the start of the pandemic **(2) Supply chain constraints** as well as labor shortages in some sectors, and **(3) A subjective element**, as economic agents build their own inflation expectations

- Base effects should reverse this year, as we will be comparing against much higher price levels. The Fed can also influence expectations by raising (or threatening to raise) interest rates. However, supply-side problems are beyond the Fed's reach, and it is **impossible to predict how long-lasting inflationary pressures will be**. With the Fed "behind the curve**," a policy mistake that causes an economic slowdown appears to be the biggest short-term market risk**. And in this respect, Value and Cyclical stocks, which may perform better in the face of a valuation shock like the one we have just experienced, are much more vulnerable to a growth shock than "Growth" and “Quality” stocks

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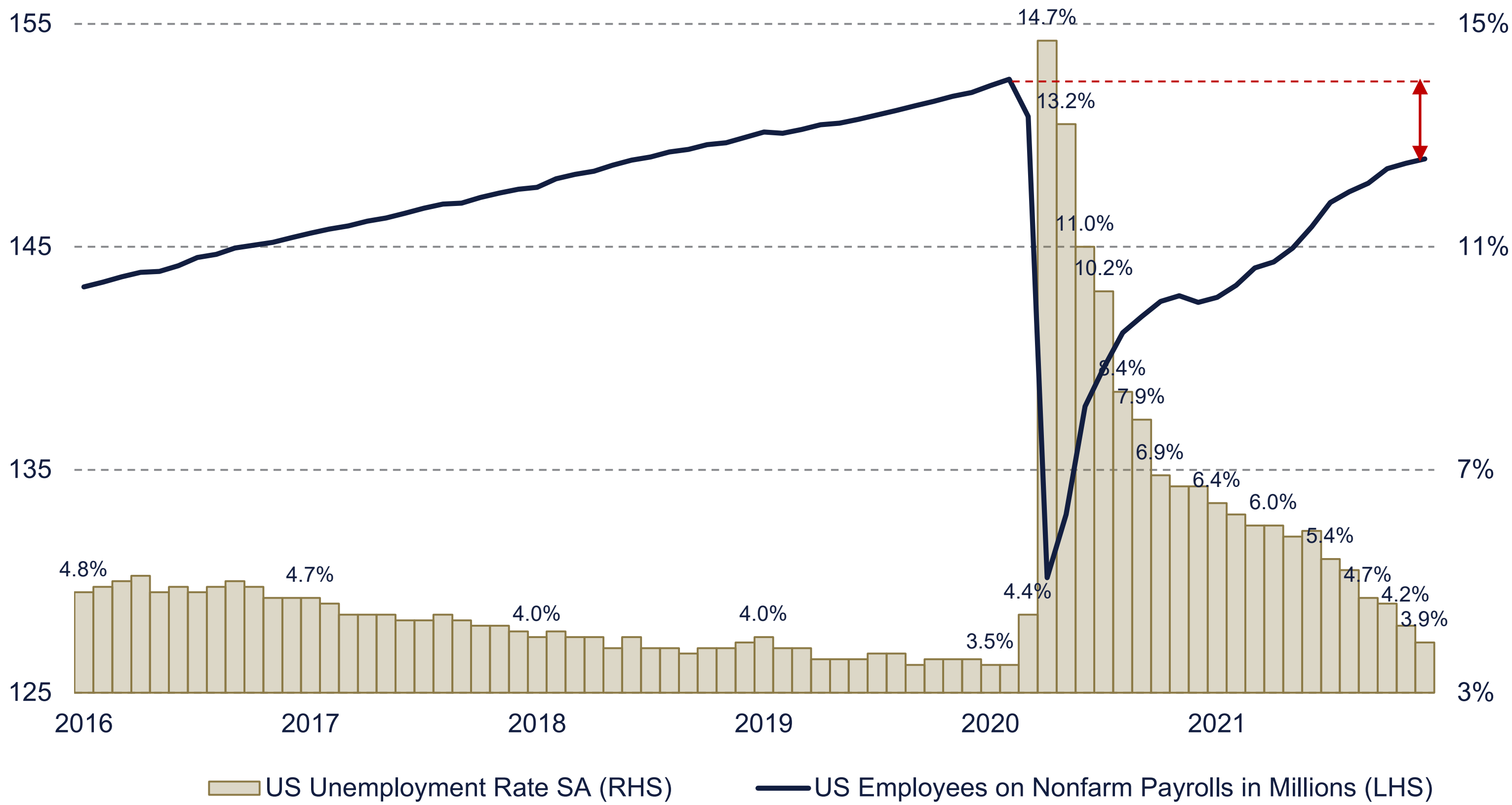
Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. With interest rates anchored at current levels, and credit spreads that have narrowed massively, we favor long-term US Treasuries
	US Credit	–	The crisis 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	+	Although we continue to like secular growth sectors such as Biotech and Fintech, we are currently reducing direct exposure to them
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

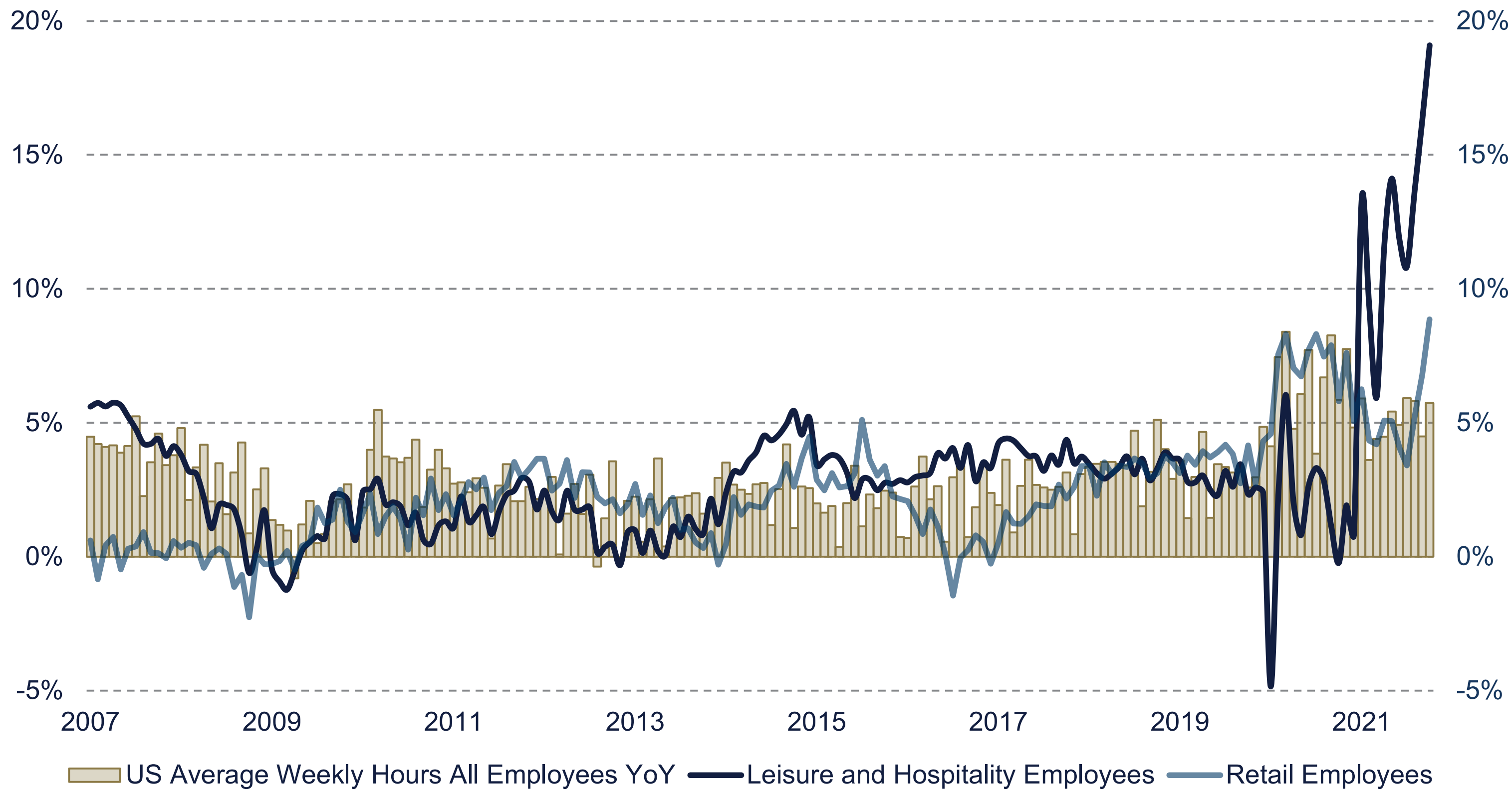
The Fed declares victory over employment



- The **harsh correction** we have experienced has two triggers. In the first place, the latest **employment figures**, which showed a labor market close to full employment, in which companies are finding it increasingly difficult to fill jobs
- The data was published practically at the same time as the **minutes of the last Fed meeting**, which showed that the positioning of its members was much more hawkish than the markets initially expected

Source: Bloomberg

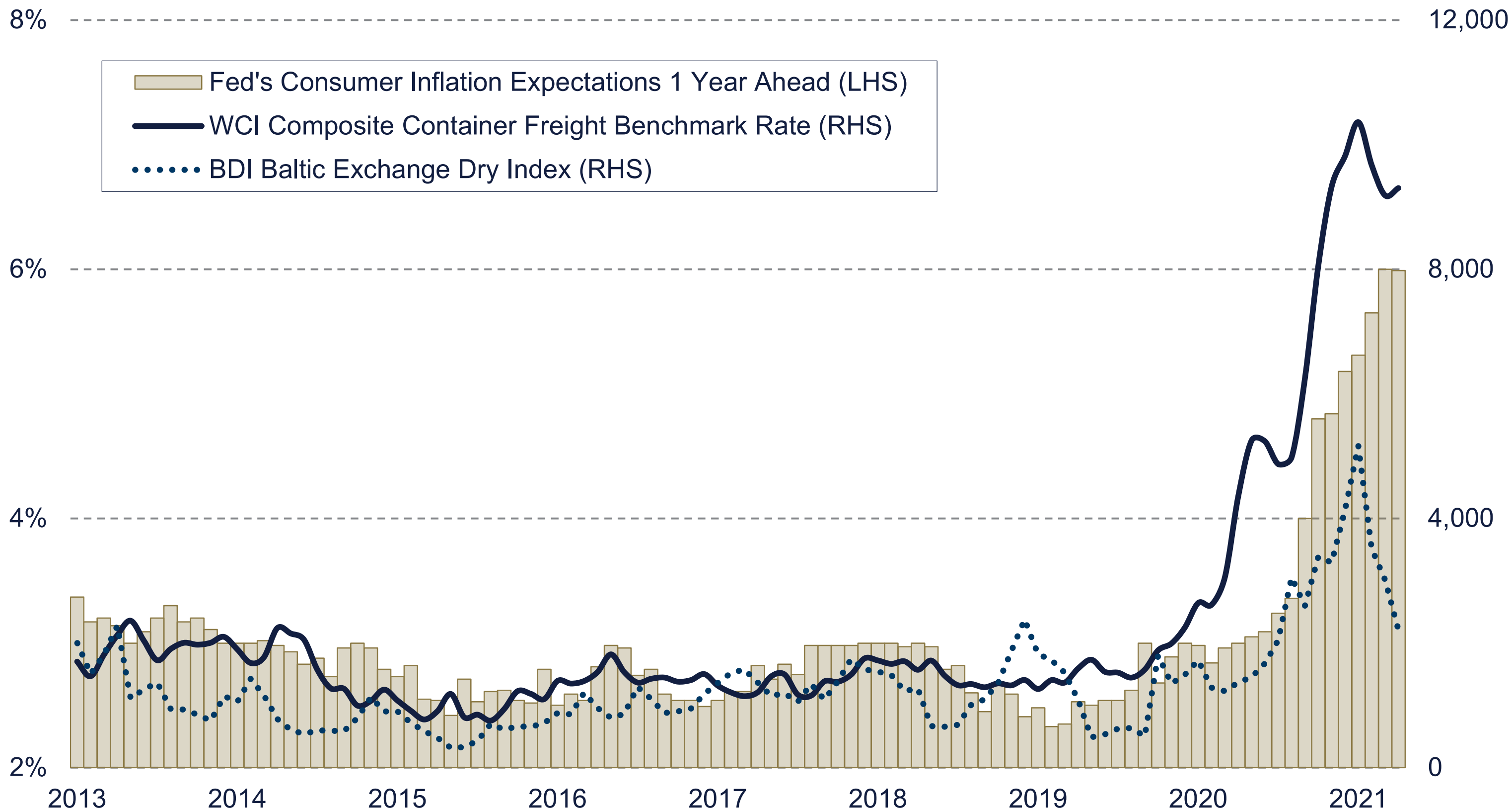
The focus is now exclusively on inflation



- Disappointing job creation figures (non-farm payrolls) are seen as a sign of **tightness in the labor market**, which can translate into **higher wages**
- Although this did not happen in the previous cycle, when unemployment reached 3.5% without exerting any pressure on wages, this time some **salary increases can be seen in sectors directly affected by the pandemic**

Source: Bloomberg

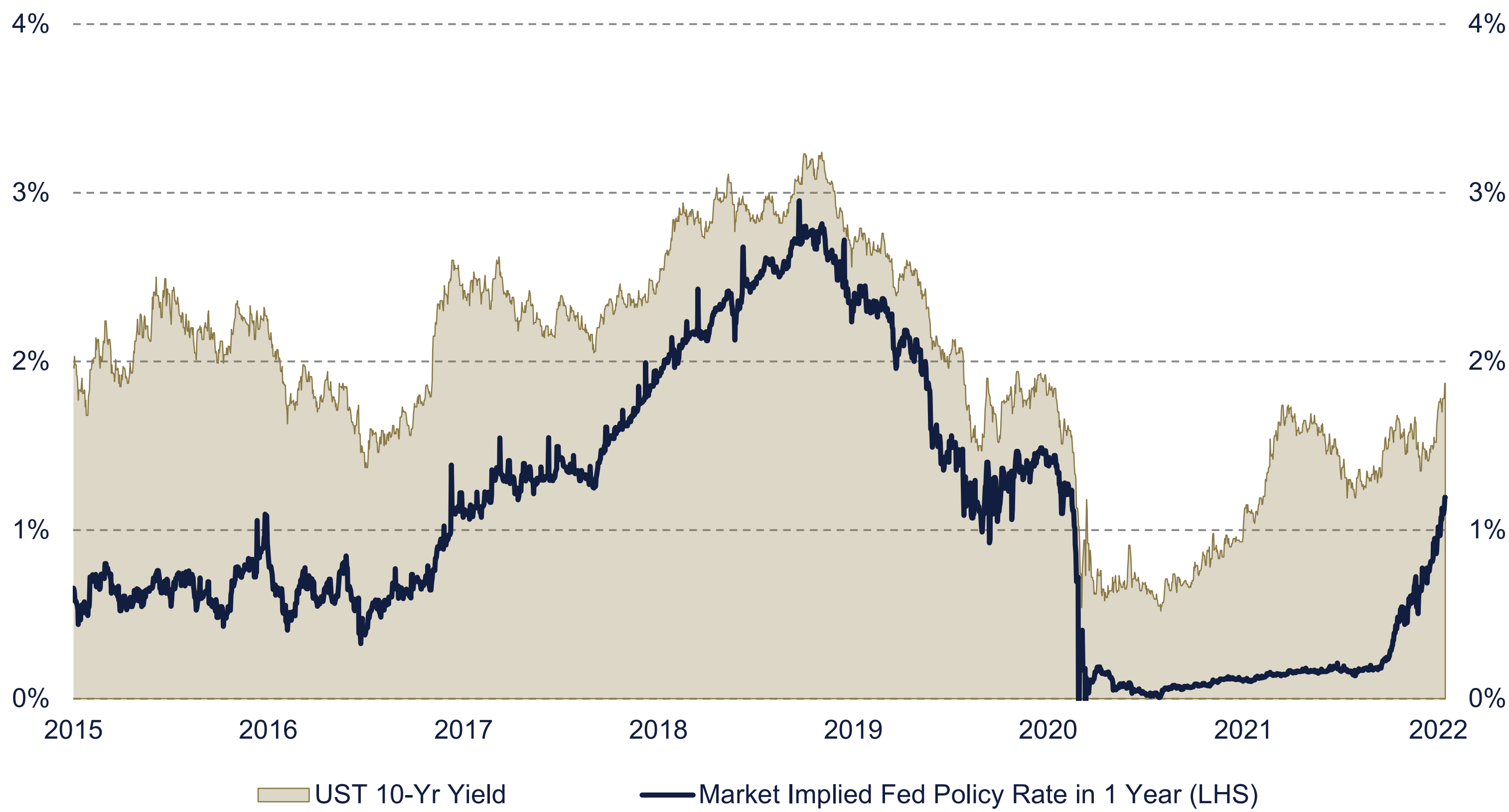
Current inflation dynamics are hard to predict



- The main cause of the rise in inflation has been **base effects and supply chain constraints**. However, once inflation expectations have taken hold, there is also a certain element of **self-fulfillment**
- The Fed can influence expectations, and base effects should now have the opposite effect. However**, logistical problems are a never-before-experienced source of inflation**, making it very difficult to predict the immediate path of inflation

Source: Bloomberg

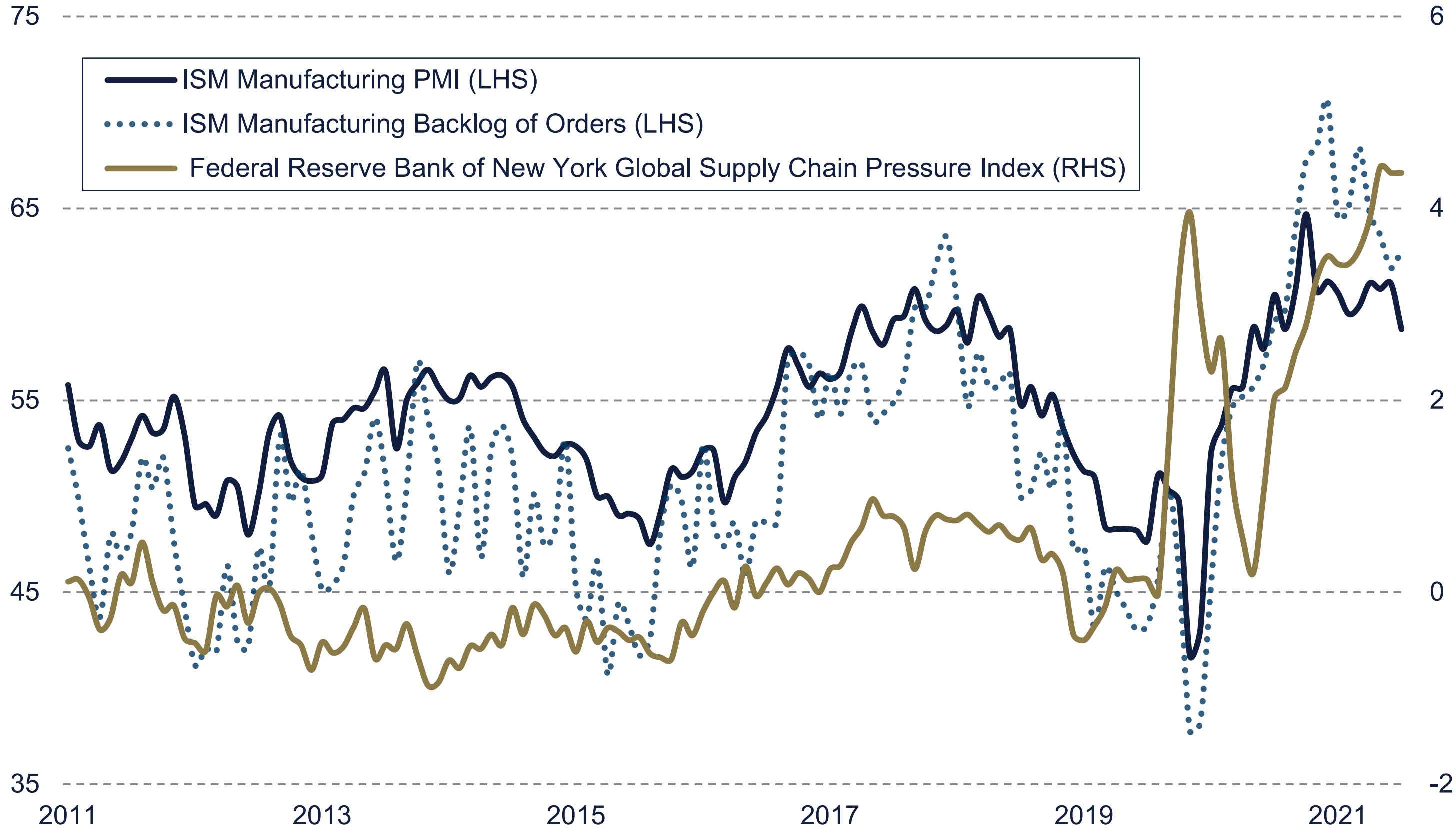
Risk of a monetary policy mistake increases



- The **Fed has undone (verbally) in just two months the monetary policy path** followed after the start of the pandemic
- **Long-term interest rates have also recovered** to levels similar to those prior to the pandemic. The question is whether the state of the economy is now fundamentally different and **to what extent it can absorb a tightening of financial conditions**

Source: Bloomberg

Approaching mid-cycle



- Decisive **government support** provided an unprecedented boost to consumption, **creating even more demand than the economy could absorb** at the time of the reopening
- Although logistical problems persist, we are **beginning to see the first signs of a slowdown in the most follwed leading indicators**, which points to the economy entering mid-cycle

Source: Bloomberg

The Value vs. Growth narrative is back

- As it happened at the beginning of last year, **with the increase in interest rates, the market is favoring Value and Cyclicals against Growth and Quality**
- However, this time we are at a different juncture, with **the Fed in tightening mode (thereby increasing the risk of a recession)** and inflation caused by factors other than an overheating economy

Source: Bloomberg

Bond yields pick up, but credit remains unattractive

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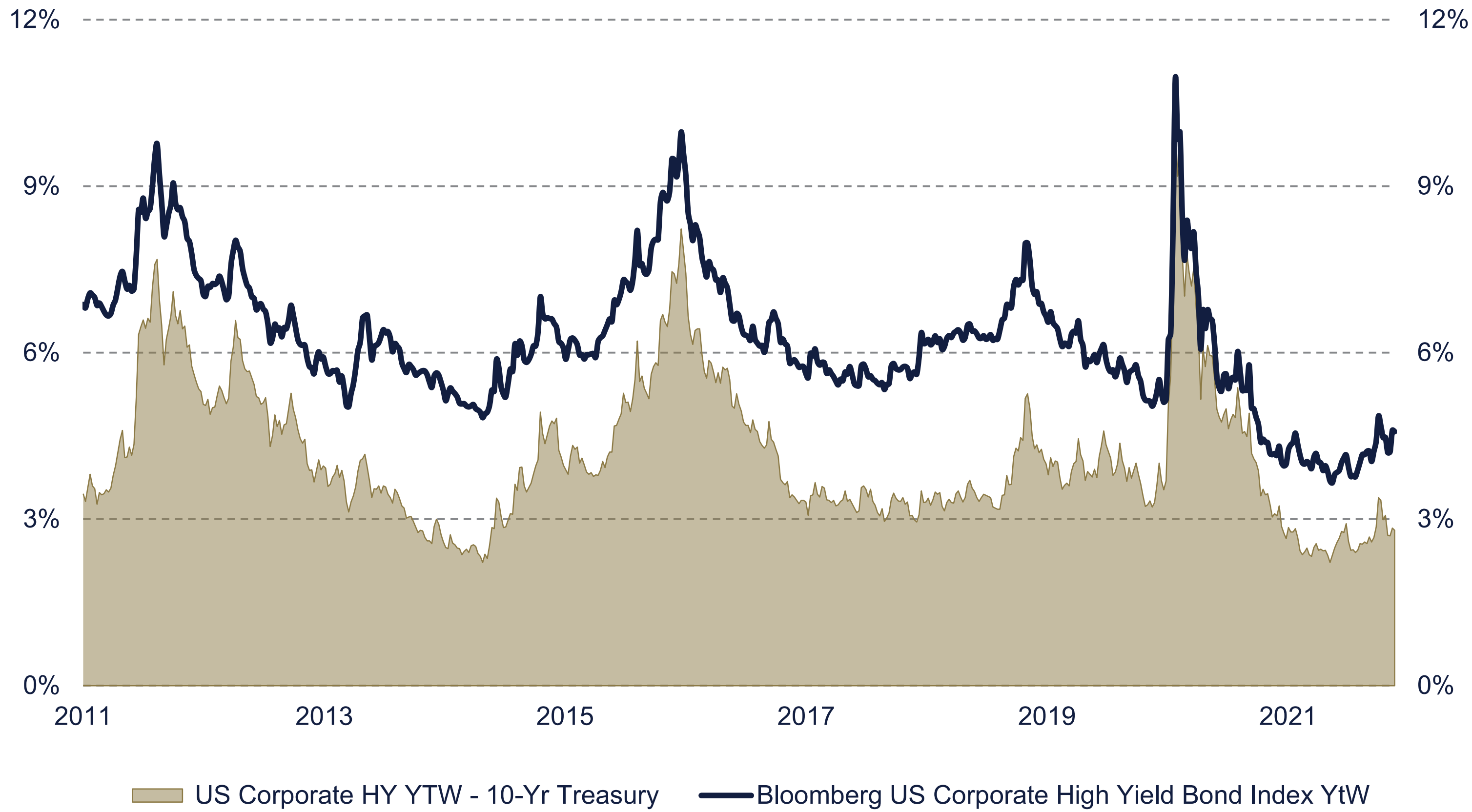


- With higher interest rates and somewhat wider credit spreads, **high yield bonds have improved their carry**
- However, both spreads and yields are **still far from their historical averages**

Source: Bloomberg

Dollar rising in tandem with rates

- **Rising interest rate differentials favor the dollar**, although **inflation differentials reduce the gap in real terms**
- Given that **growth differentials** also support the dollar, we expect the dollar to remain strong through 2022

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 • Economic activity does not completely return to normal, and high inflation forces central banks to withdraw stimulus • 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%	35% (-5%)	30% (+5%)

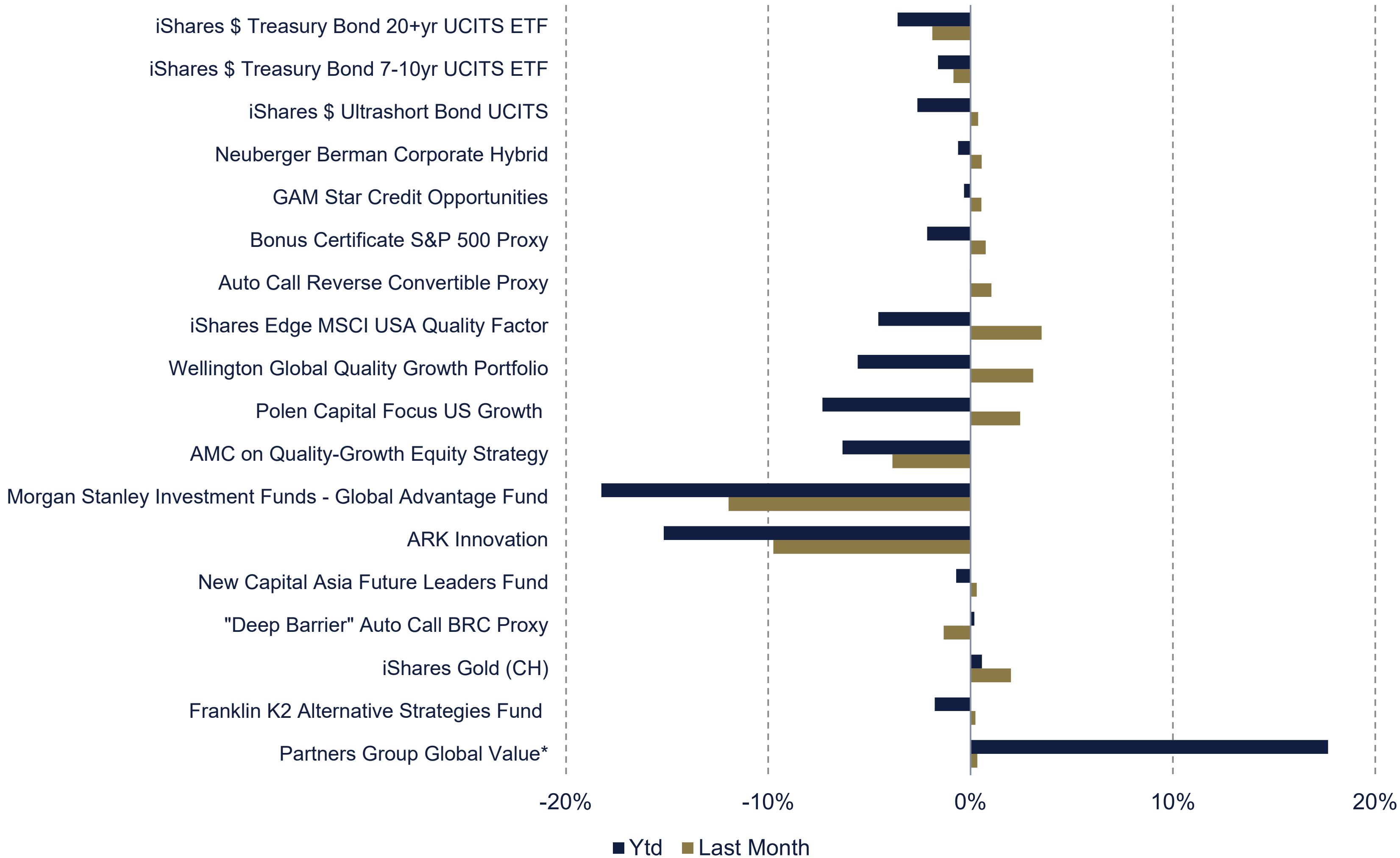
Short-term catalyzers

Slowdown in inflation, acceleration in vaccinations or highly effective treatment for the coronavirus

Other risks

China slowdown, Crypto bubble crash, Geopolitical (Middle East, Russia, Iran, North Korea)

Model portfolio evolution



Source: Bloomberg, as of January14, 2022
* Fund publishes monthly NAV with a 1 month of delay

Boreal Balanced Portfolio USD

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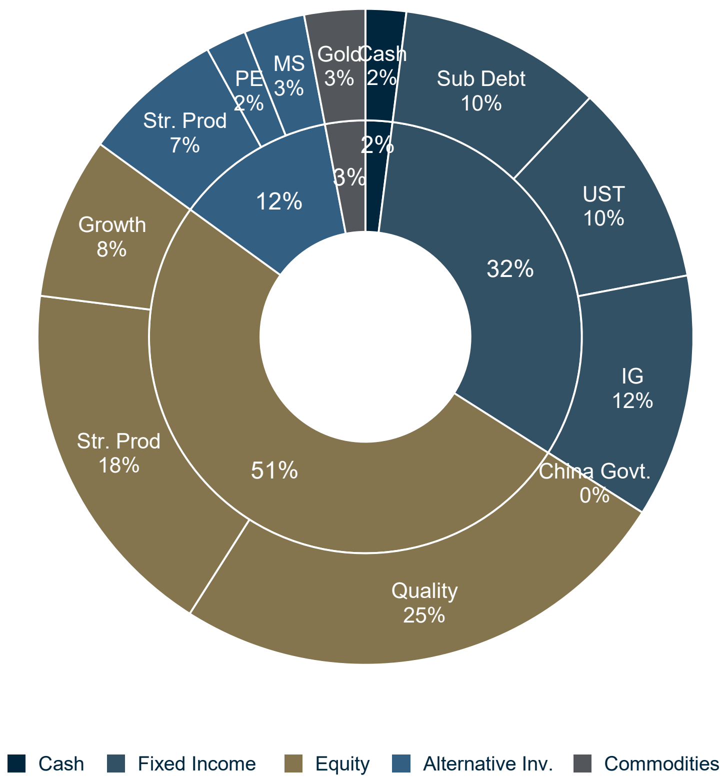
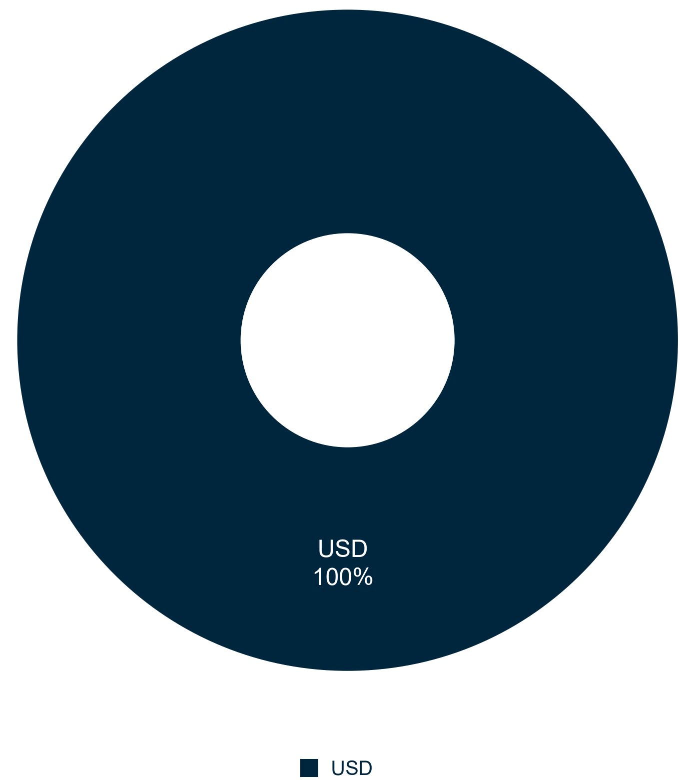
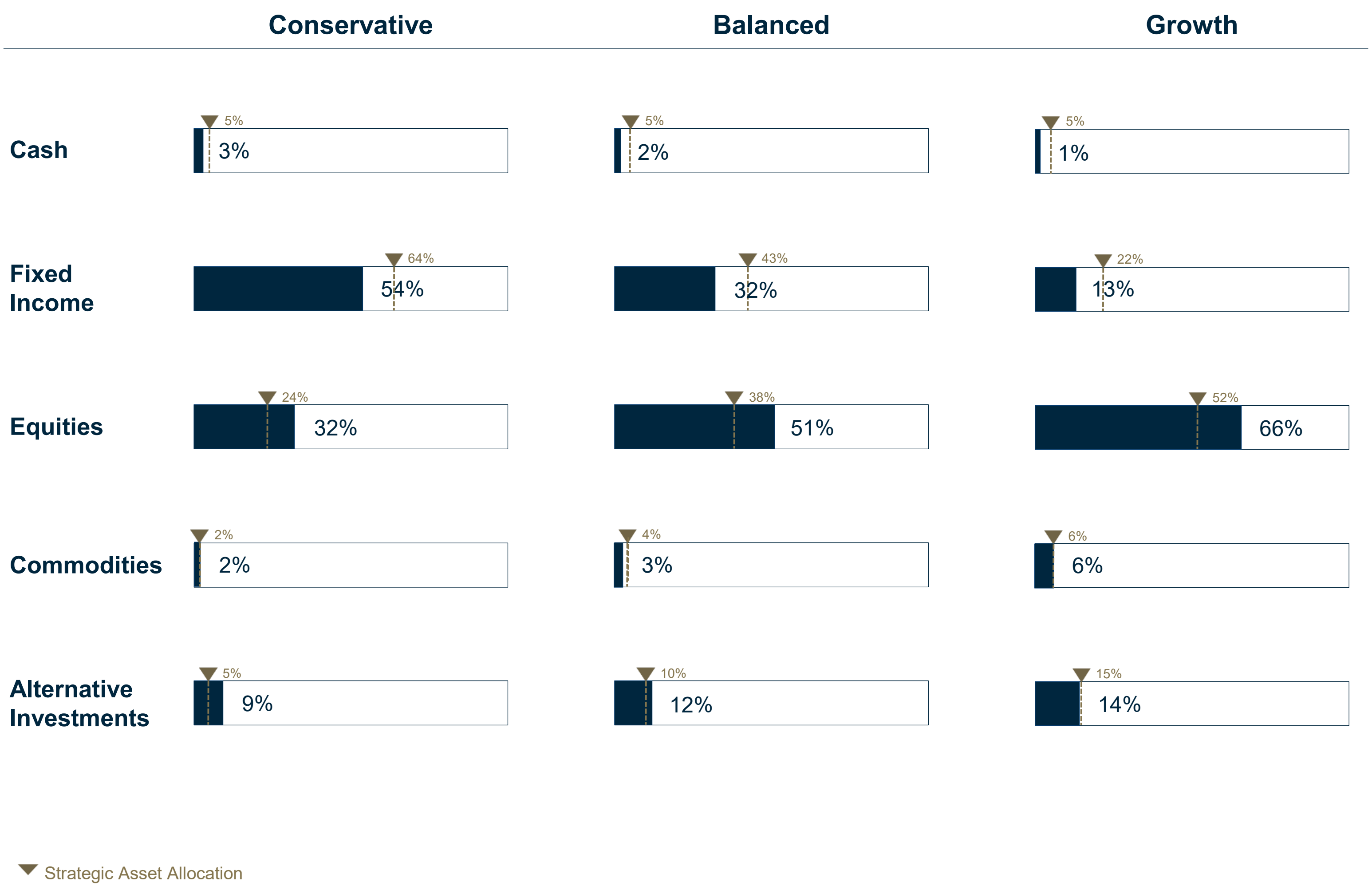
Asset Allocation



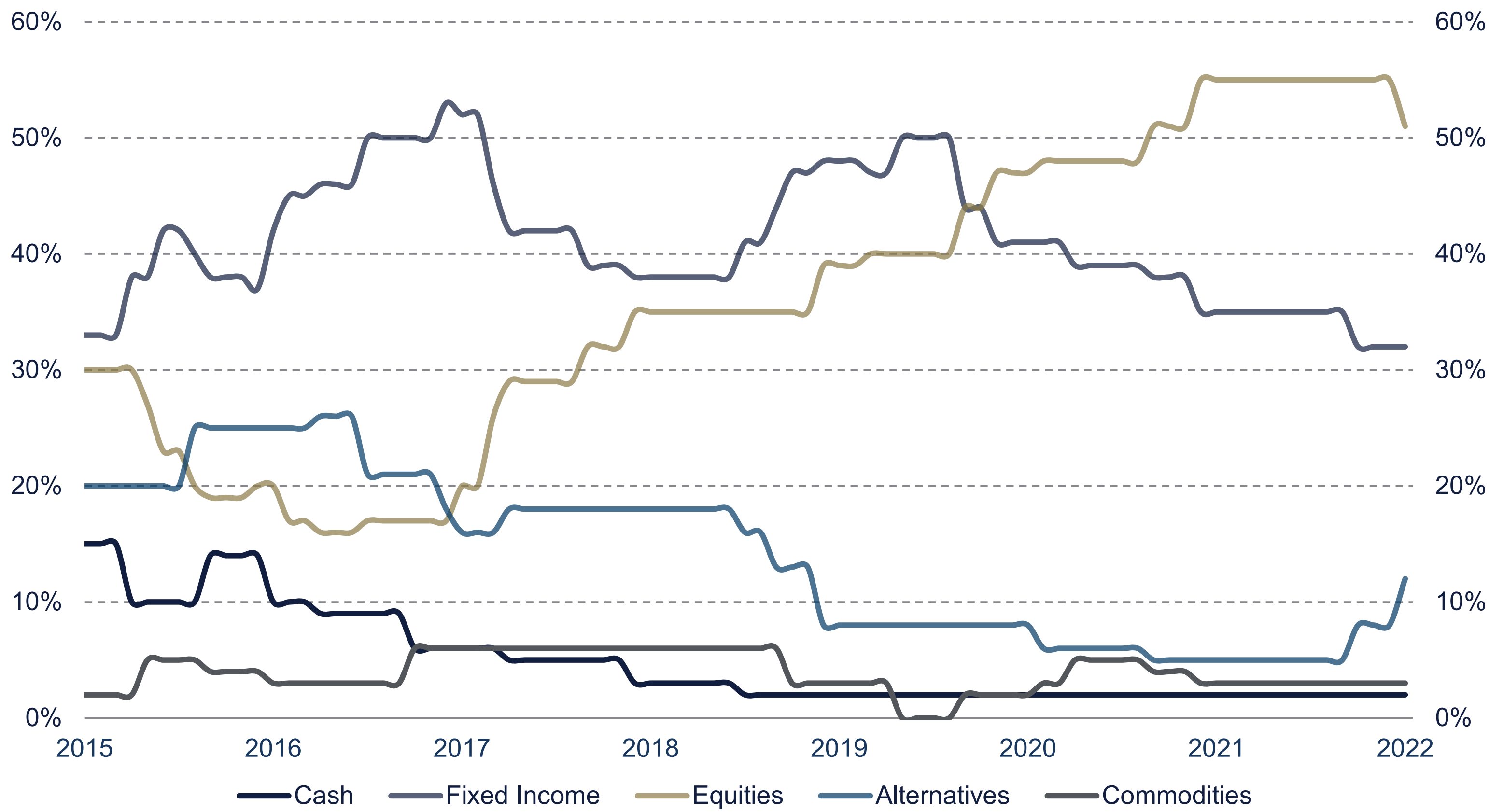
Currency Allocation



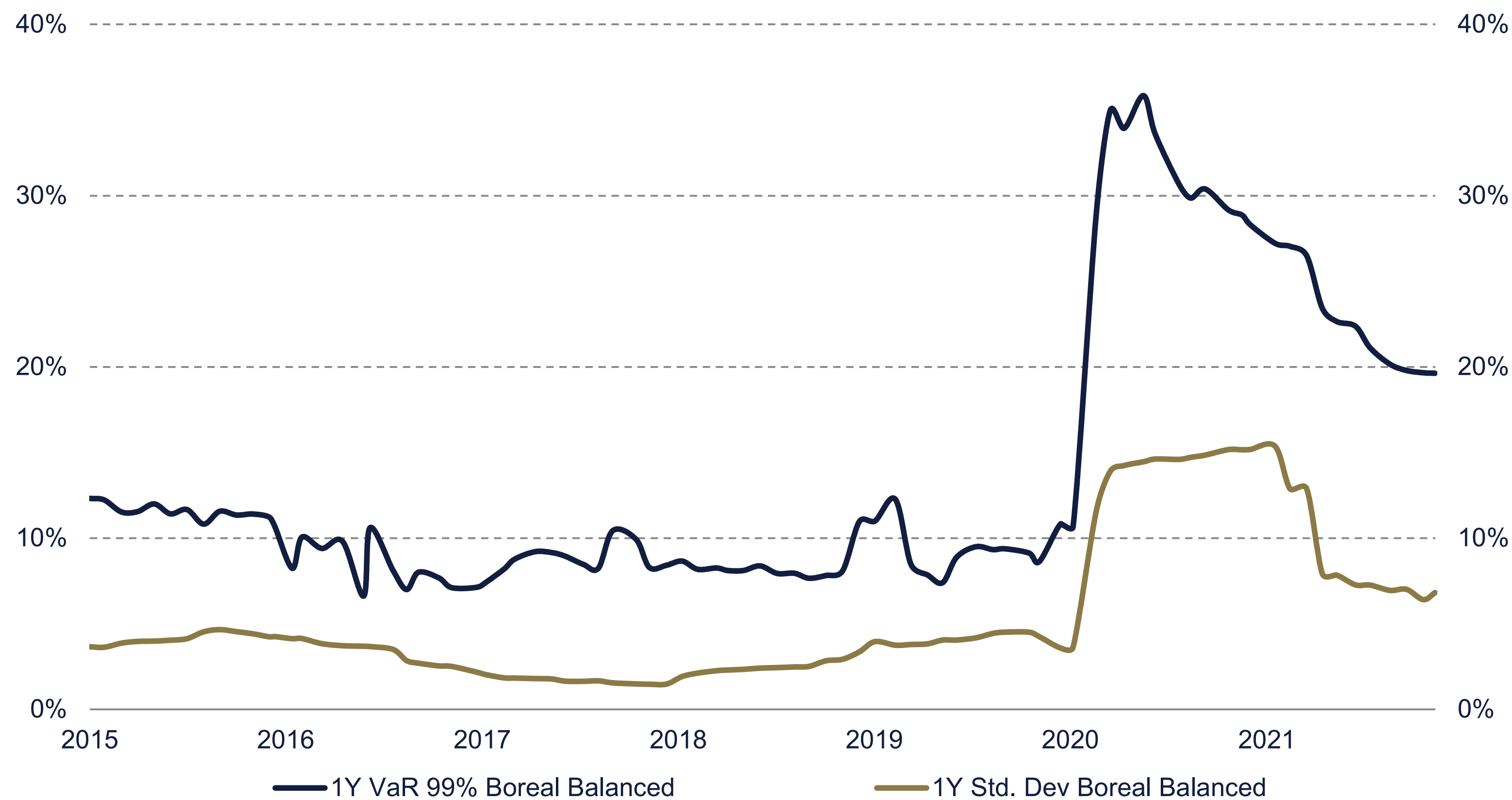
Boreal Investment Profiles



Boreal Balanced Portfolio – Asset Allocation evolution

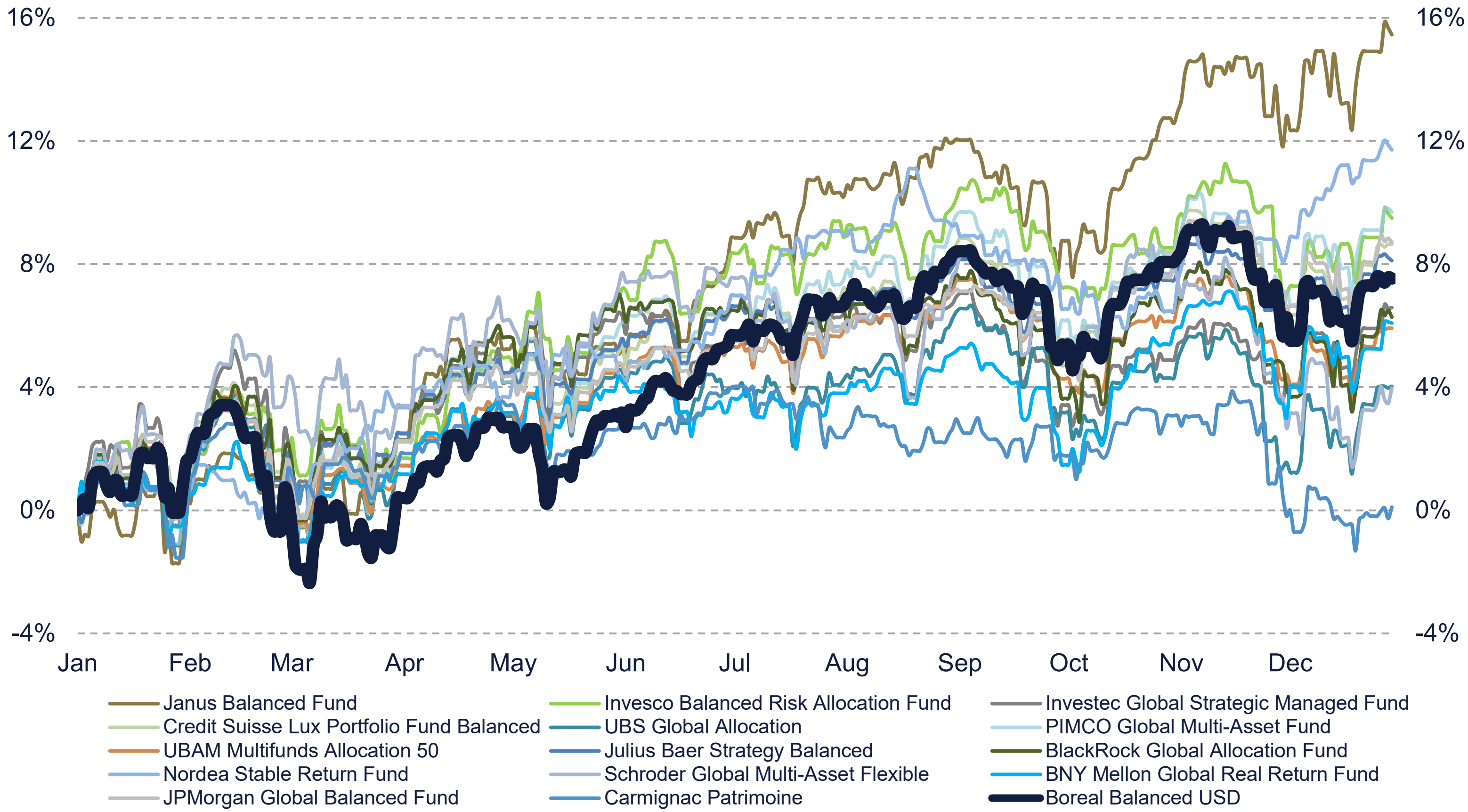


Boreal Balanced Portfolio – VaR evolution



[1] As of January14, 2021
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison (1)



- **Total Return** (Ytd[1]): **15th out of 15**
- **Standard Deviation** (1 year[1]): **14th out of 15**
- **Downside Risk** (1 year[1]): **7th out of 15**
- **Sharpe Ratio** (1 year[1]): **14th out of 15**

[1] As of January 14, 2022

Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison (2)

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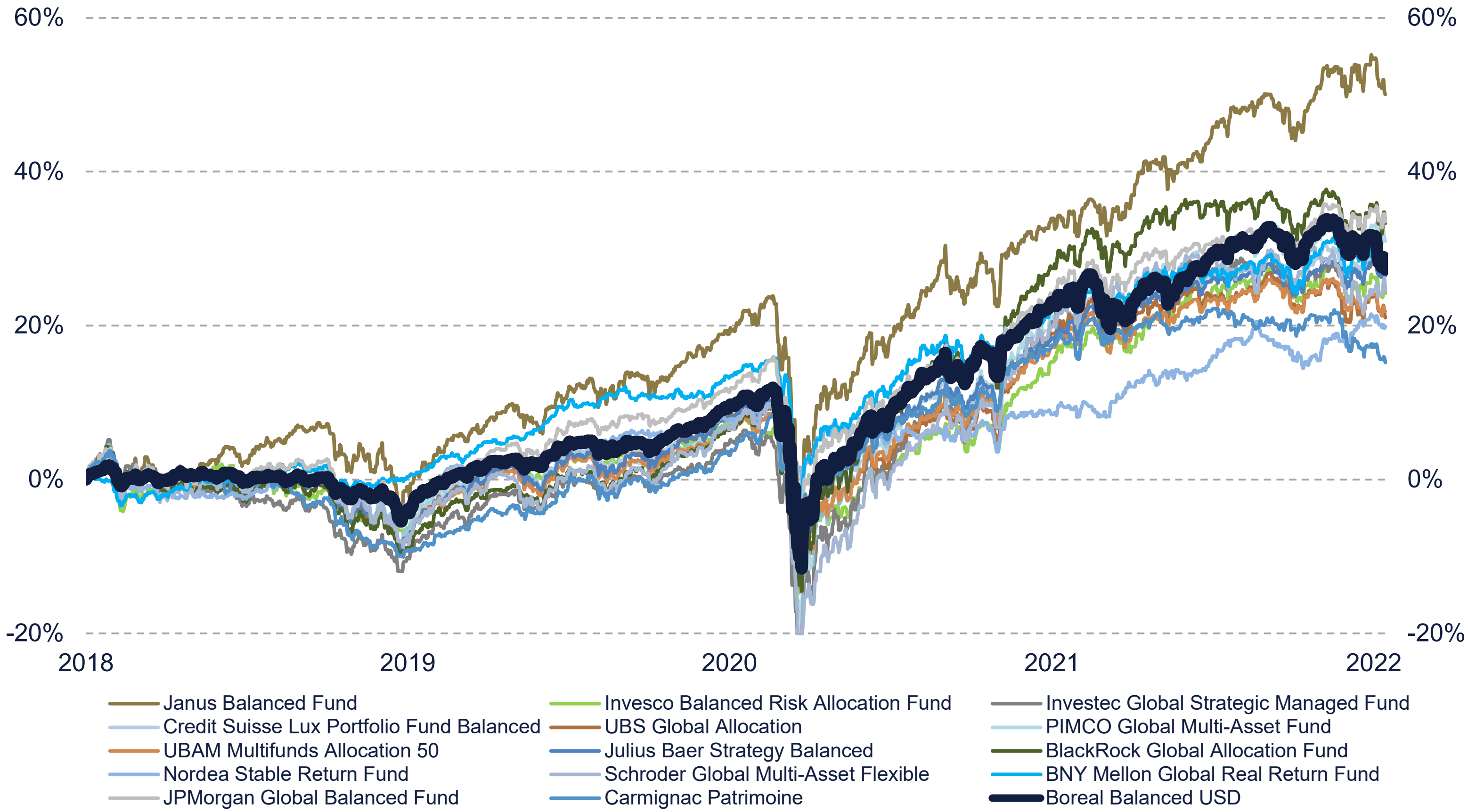
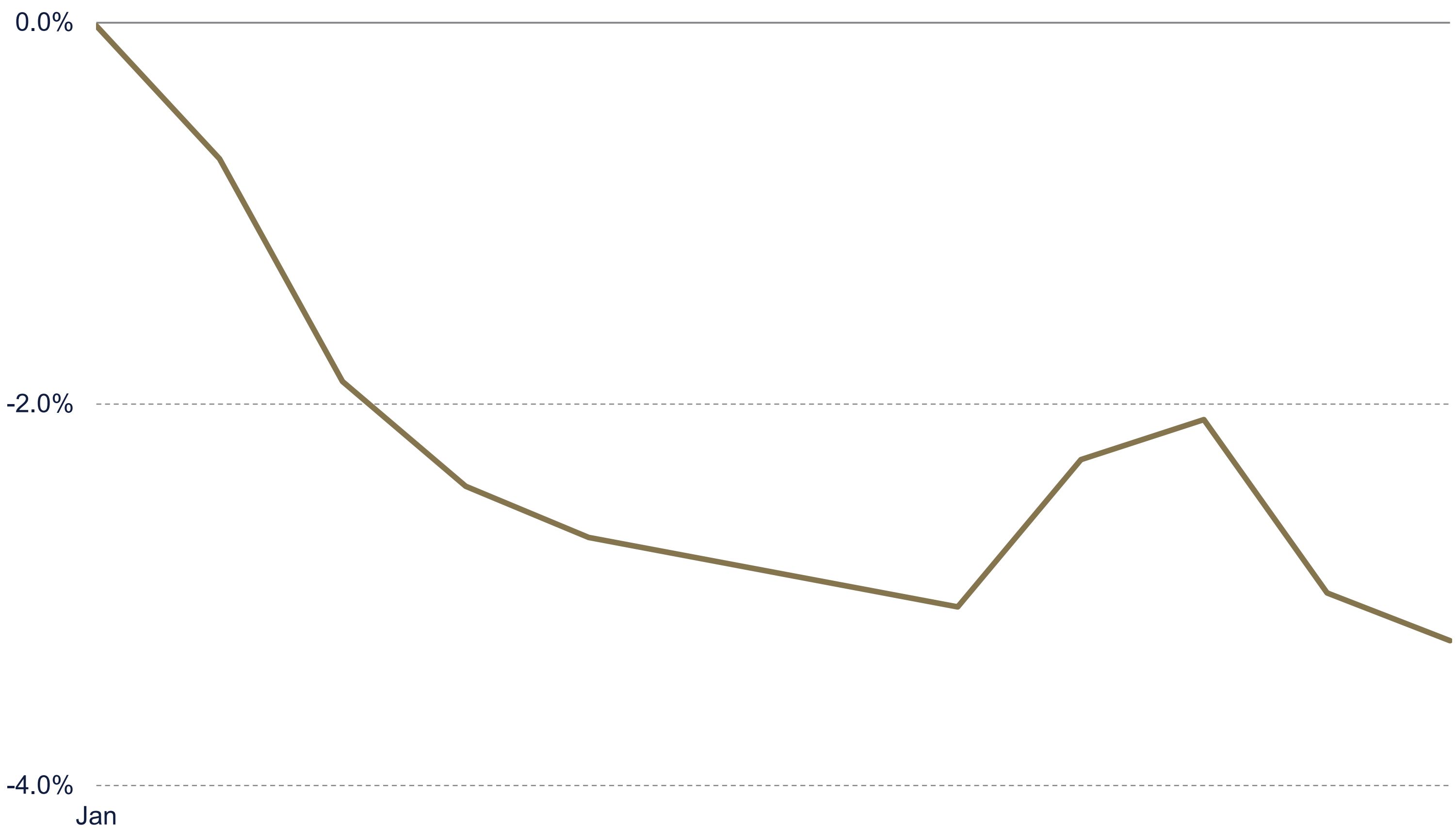


[1] As of January 14, 2022
Source: Bloomberg

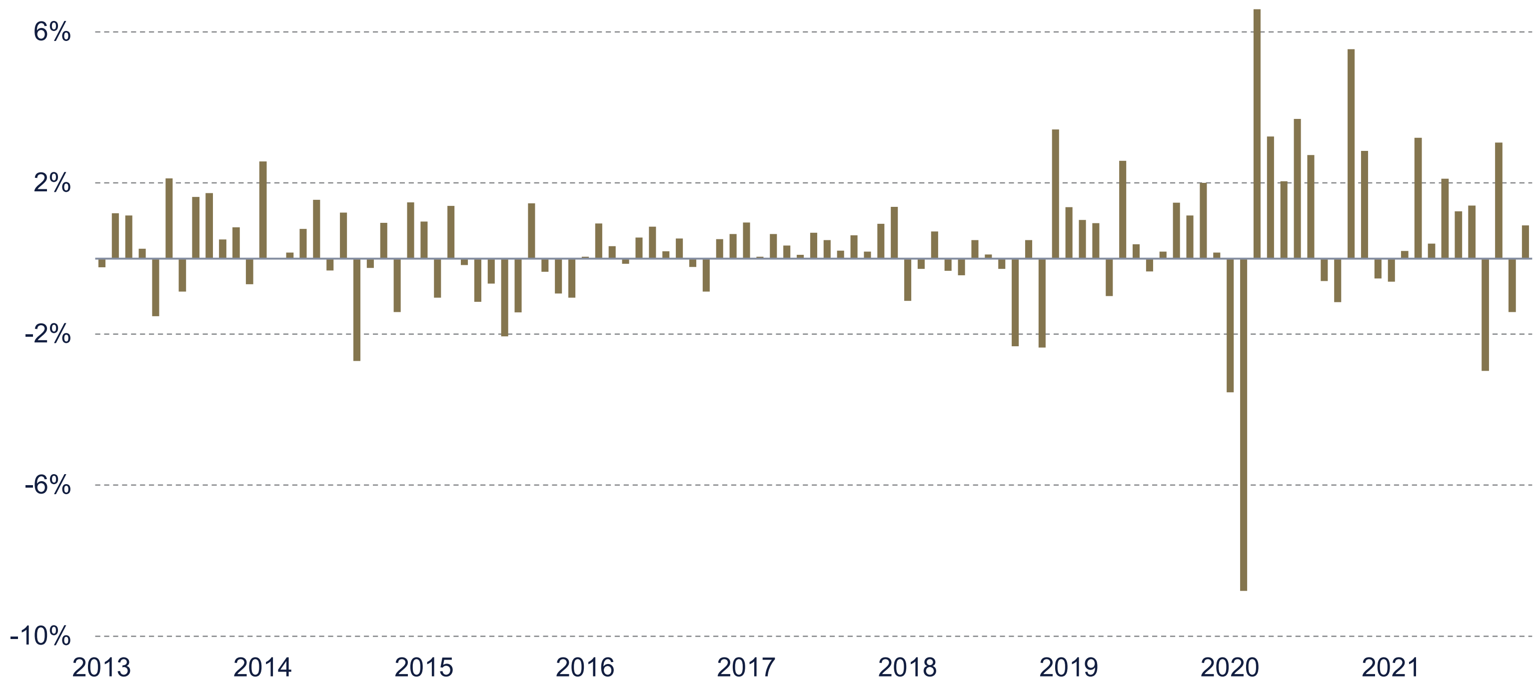
Boreal Balanced Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **-3.36%**
- **Standard Deviation** (Ytd[1]): **8.80%**
- **Downside Risk** (Ytd[1]): **5.94%**
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of January 14, 2022

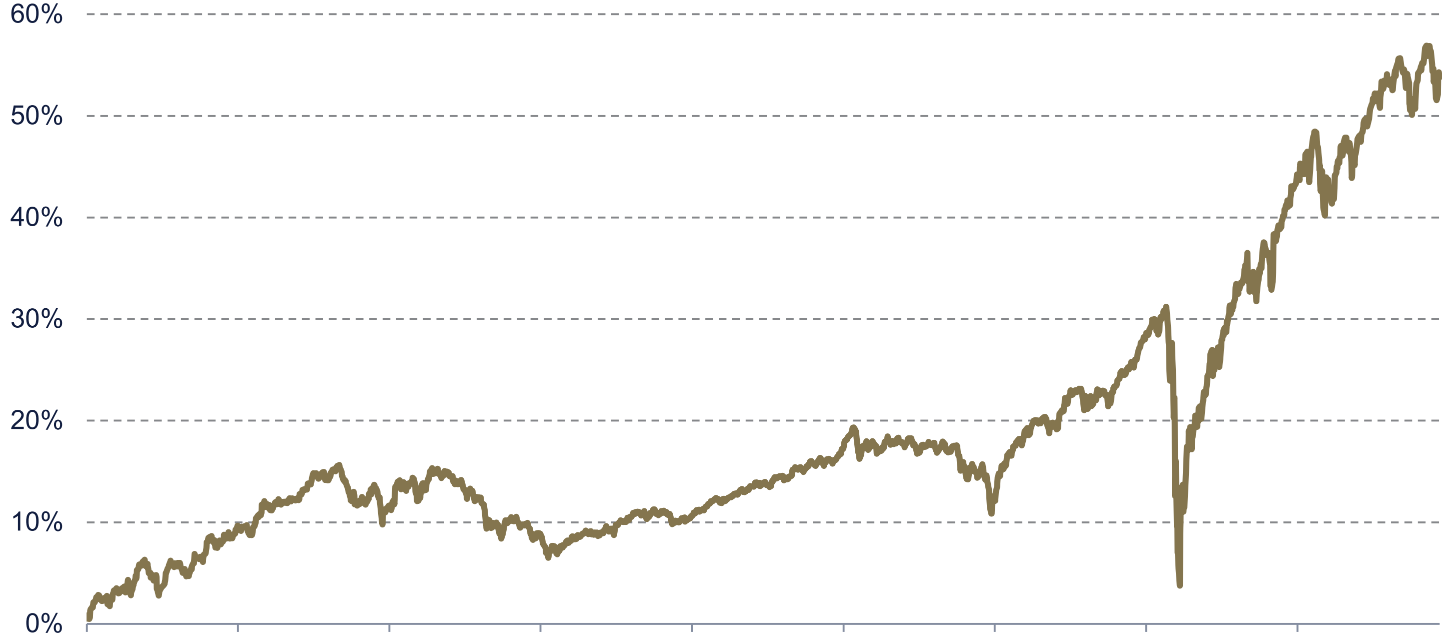
Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **3.50%**
- **Total Return** (3 year[1]): **29.65%**
- **Total Return** (Since Jan 13[1]): **49.31%**

[1] As of January 14, 2022

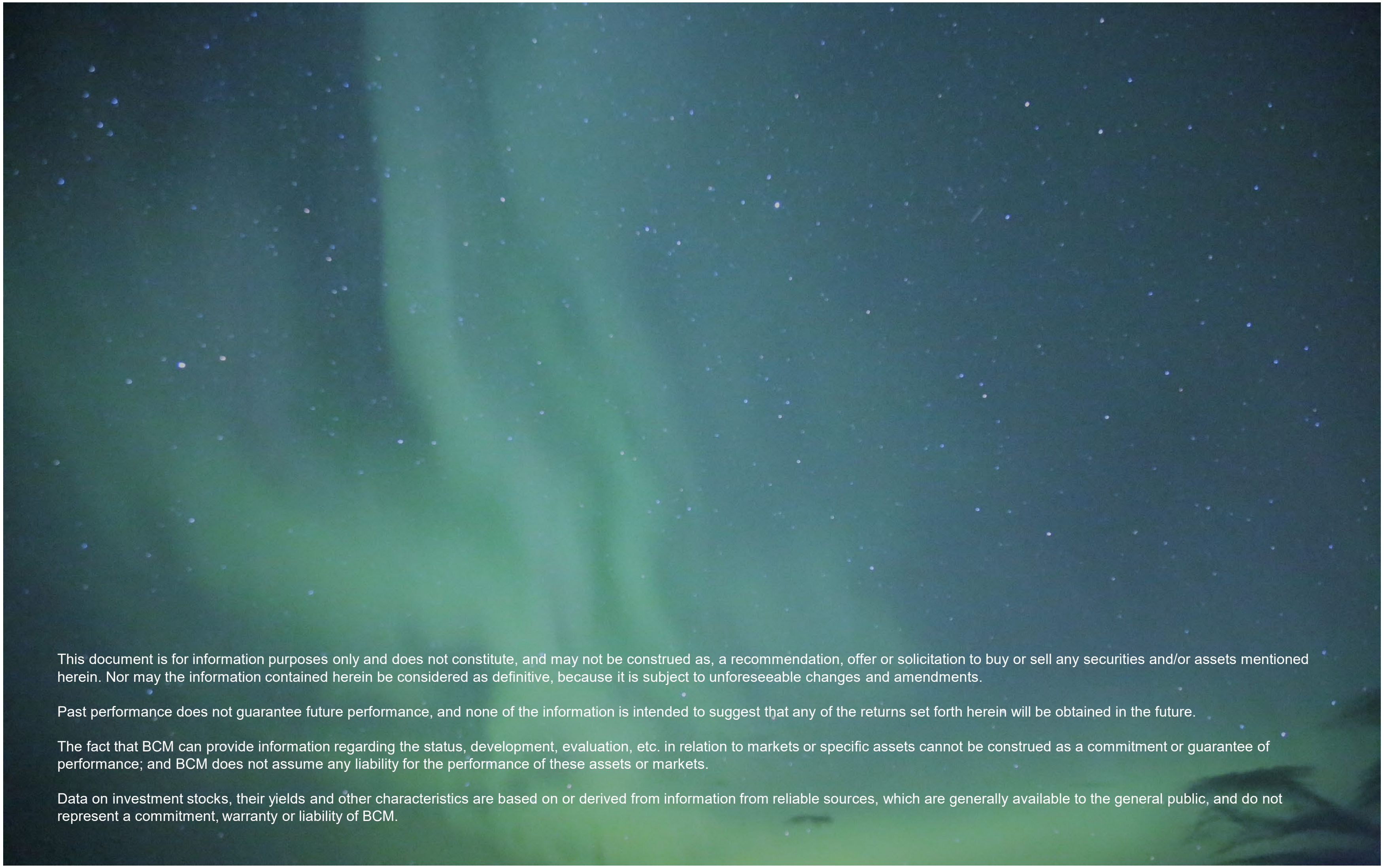
Boreal Balanced Portfolio – Historical performance (2)



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	12.35%	7.01%	-3.36%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	6.96%	6.97%
Sharpe Ratio	2.54	0.58	n/a	0.62	3.57	n/a	3.49	0.87	1.04	n/a

Annualized Return: 4.53%
Annualized Std. Dev: 6.26%

[1] As of January 14, 2022



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