Investment Policy

February 2022

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Our market view in a nutshell – February 2022

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- Over the past month, **inflation has shown no sign of slowing down**. Most price-related indicators (wages, producer prices, etc.) have **continued to surprise on the upside**. Showing that inflation is not only **gaining momentum, but also gaining breadth**. It is no longer just those items of the consumer basket affected by the pandemic that are increasing in price, but also key components such as shelter and health care

- Having missed the initial diagnosis, **the Fed is now trying to figure out how to react appropriately, and financial markets in turn are second-guessing their moves**. A gradual approach would allow the Fed to be “data-dependent” and thus reduce the risk of a hard landing of the economy due to a policy mistake. However, the longer they let inflation run high, the greater the risk that they will lose control of the situation

- With some of the factors causing inflation out of the Fed’s control, and a long transmission of monetary policy to both consumption and corporate investment decisions, **an increase in interest rates has its most immediate impact on the economy through financial assets**. After the correction in stock markets, **house prices appear to be the most vulnerable at the moment**. Investors therefore face the **typical mid-cycle risks**, when they need to constantly assess the length of the economic cycle

- By asset class, we see **attractive valuations in growth and quality stocks**, where the **correction has not been proportional to the impact that higher interest rates** (driven by inflation) may have on these types of companies. Many of them have a unique competitive advantage that allows them to pass price increases on to their customers, thereby largely offsetting the impact on valuations

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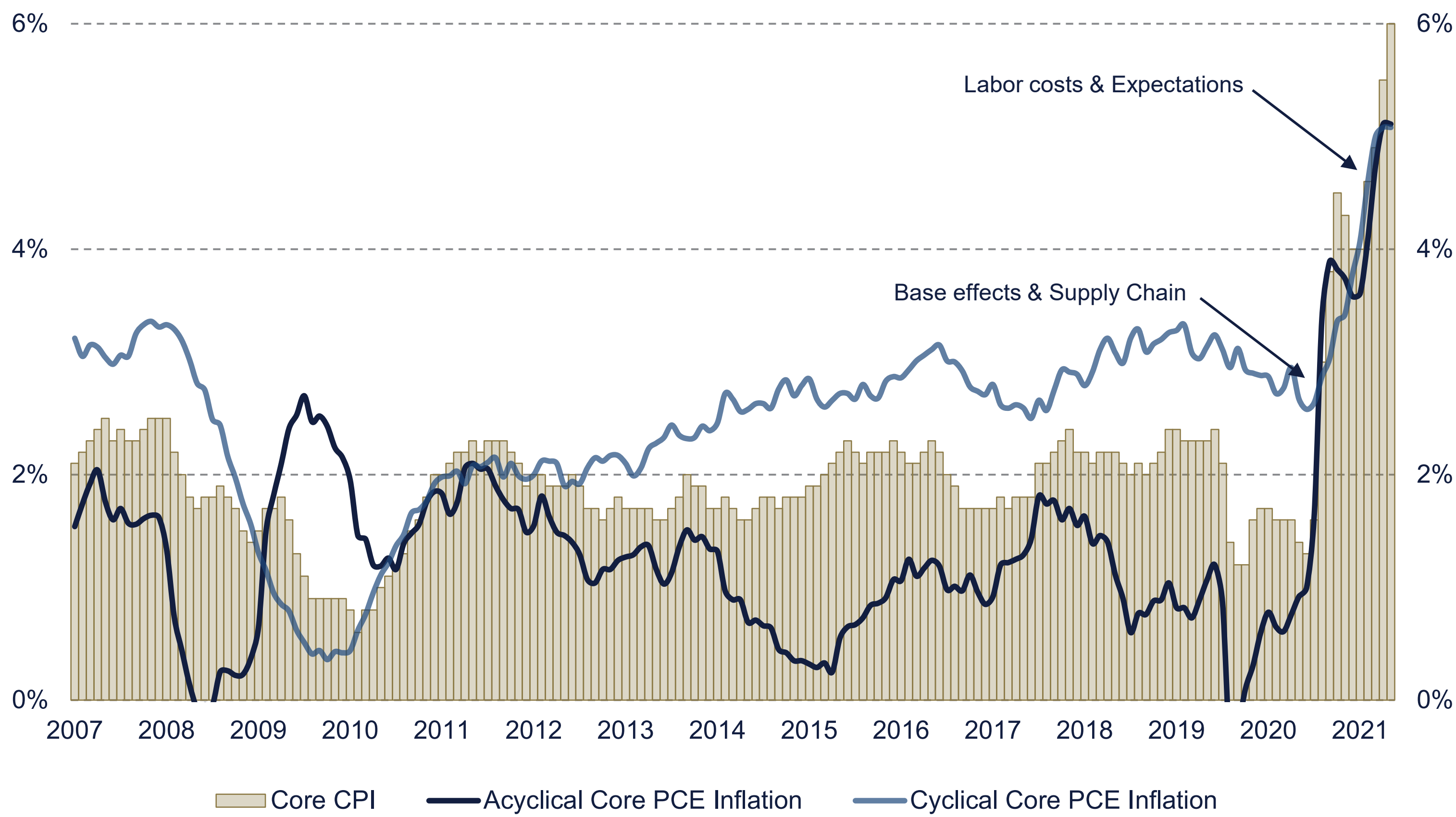
Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. With interest rates anchored at current levels, and credit spreads that have narrowed massively, we favor long-term US Treasuries
	US Credit	–	The crisis 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

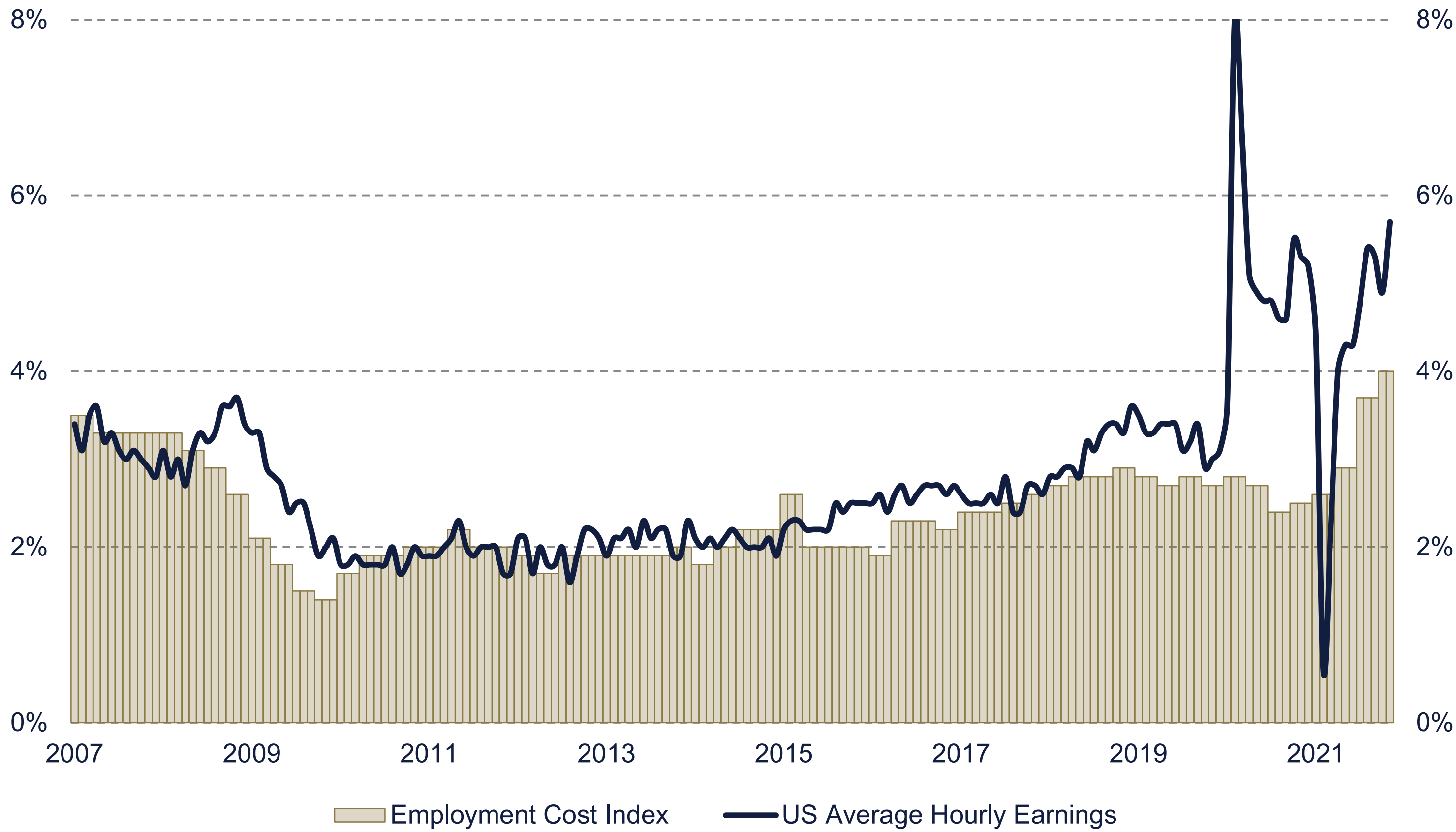
Inflation gathers breadth and momentum



- Contrary to expectations, **inflation continues to accelerate** rather than return its pre-pandemic trend
- Not only every inflation metric keeps surprising to the upside, but **inflation is also gaining breath**; with the rise in prices spilling over into most of the items that make up the consumer basket

Source: Bloomberg

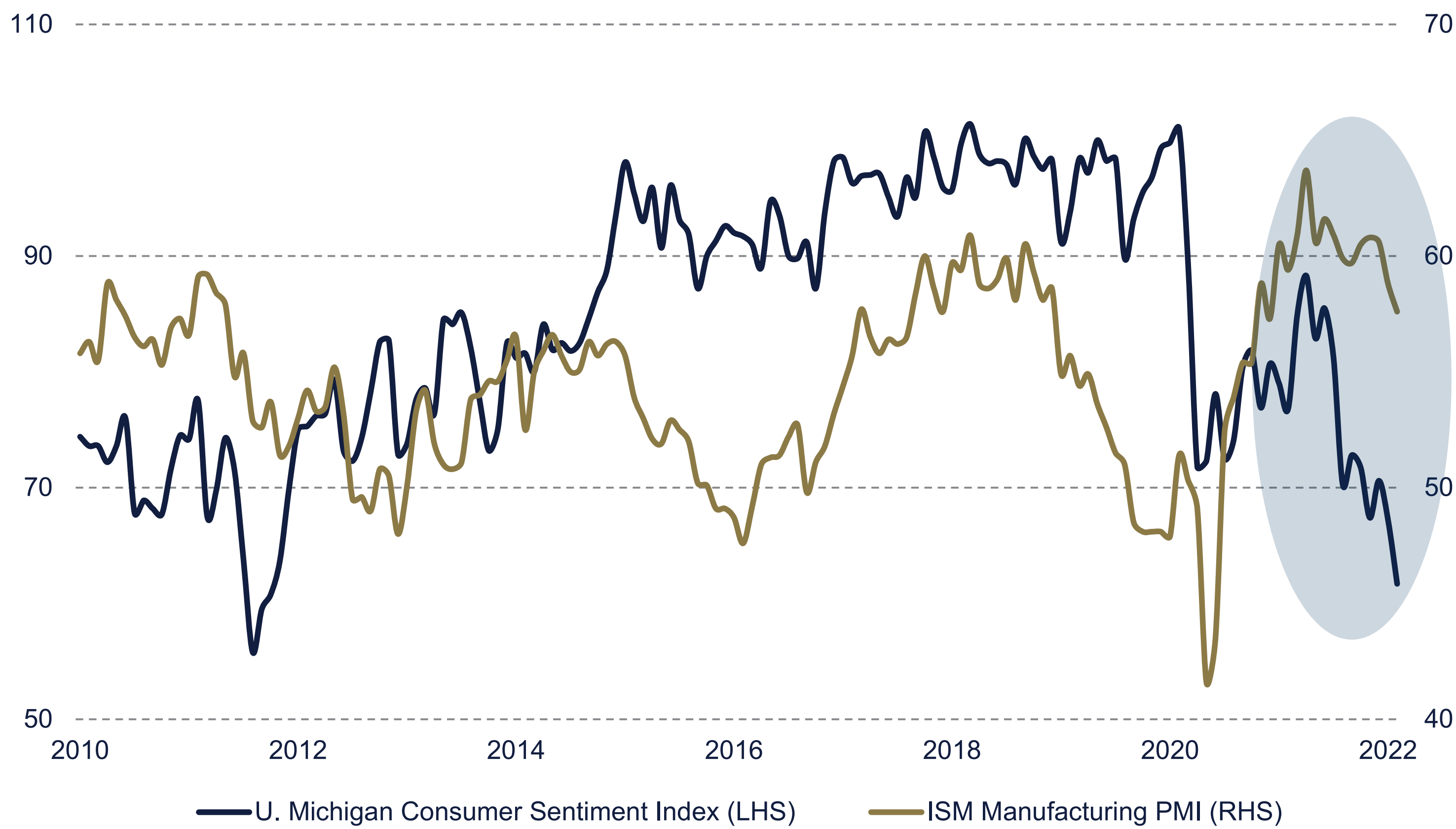
The Phillips curve is alive



- Contrary to what happened during the last economic cycle, when unemployment reached record lows without triggering wage pressures, **we are now witnessing a clear rise in labor costs**

Source: Bloomberg

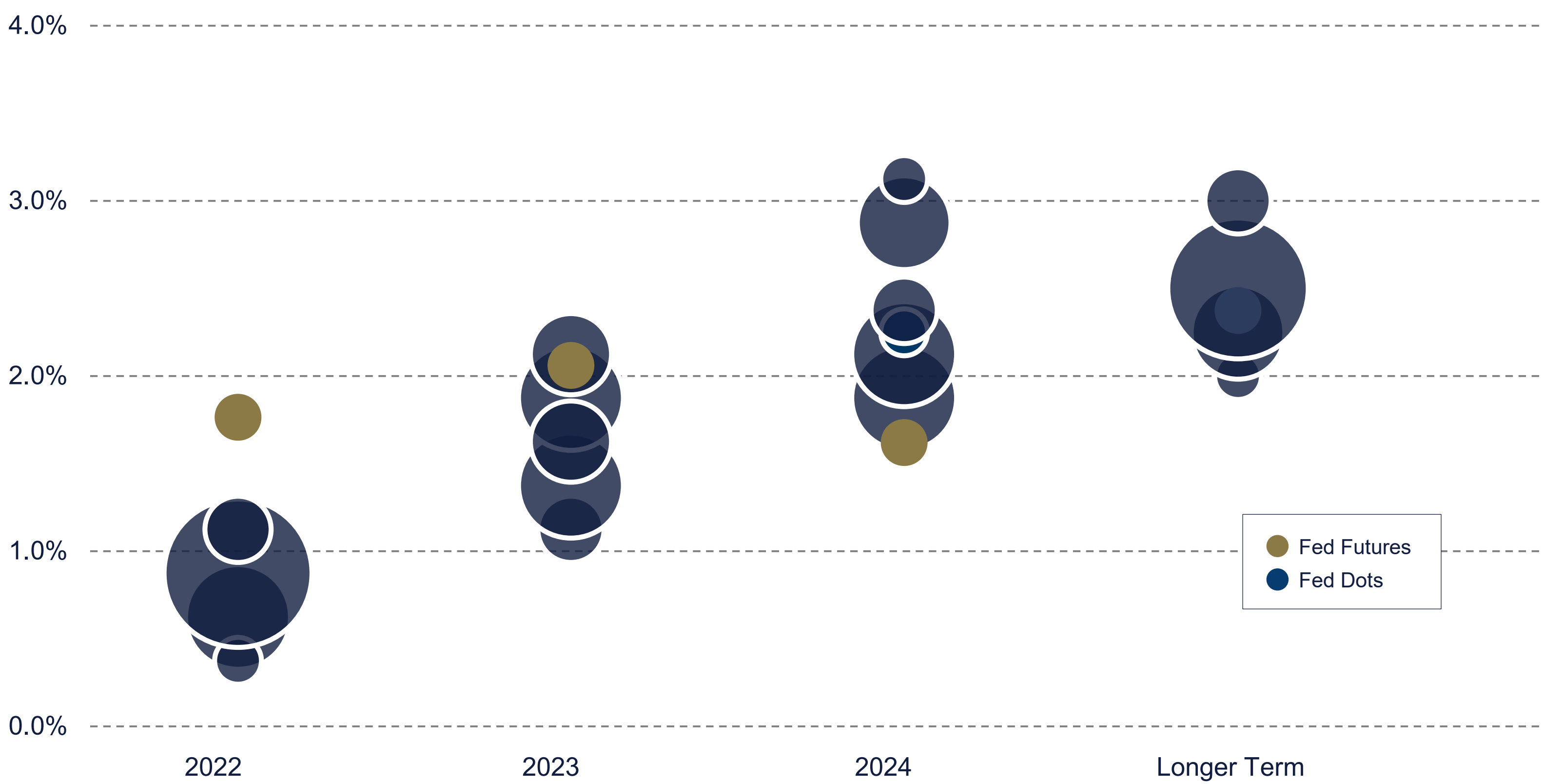
The cure for high prices is… high prices



- The pandemic has caused a **transfer of consumption from services to durable goods**; which, combined with fiscal stimulus and supply chain bottlenecks, have triggered inflation
- **Consumer prices have been rising faster than household disposable income**, and may end up causing a slowdown in consumption. Something that could be followed by an inventory overhang

Source: Bloomberg

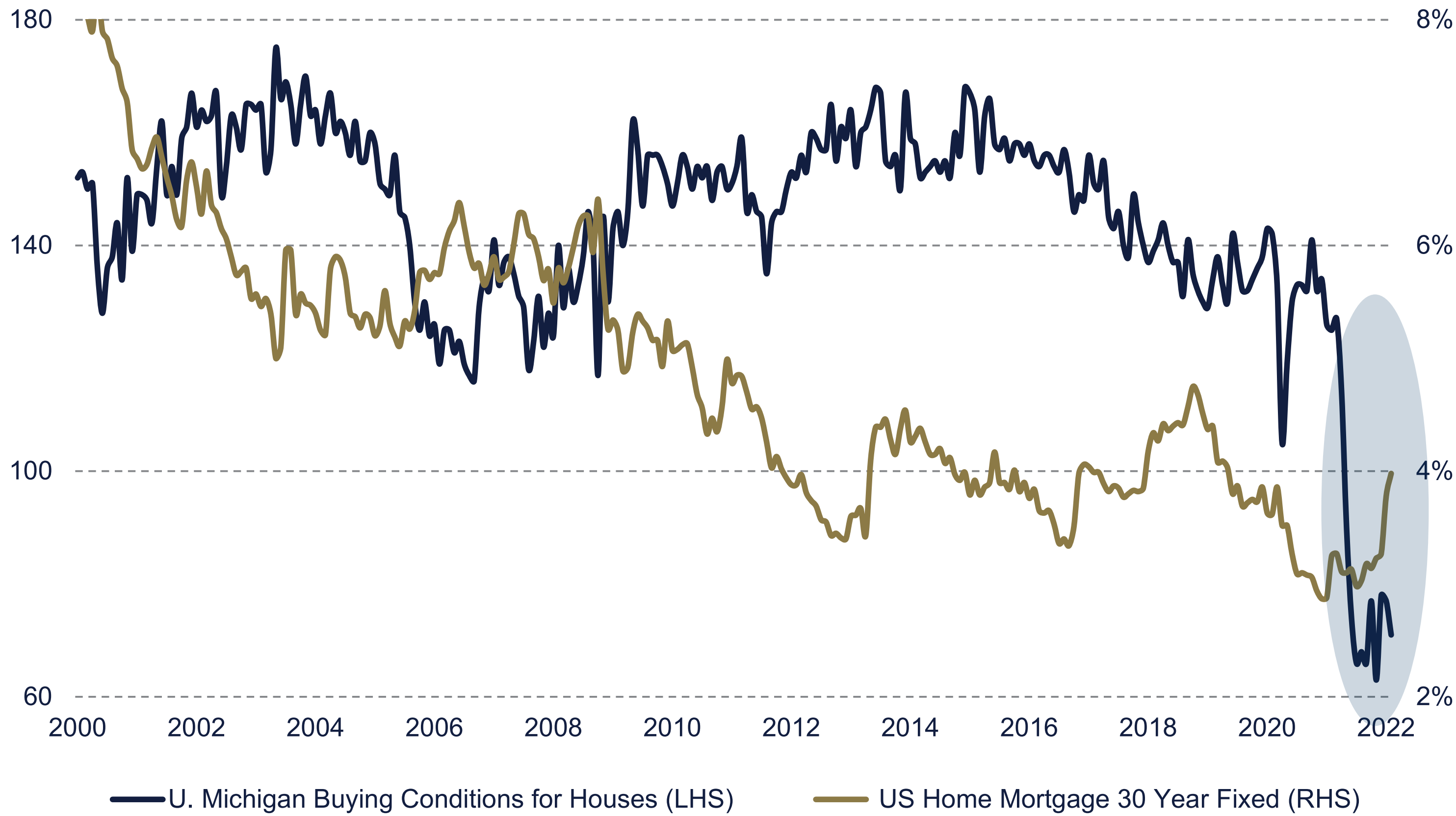
Between a rock and a hard place



- Having been **slow to acknowledge that inflation was a problem, the Fed is now under great pressure** to do something about it; an issue that is also becoming increasingly salient from a political point of view
- However, **the latest tightening cycle is a good reminder** of how many rate hikes the economy can absorb without slowing down

Source: Bloomberg

Monetary tightening has begun



- The fastest and most effective **channel for monetary policy transmission is usually through asset prices**
- We have already seen a **negative wealth effect caused by corrections in financial markets**, and judging by the spike in mortgage rates, combined with declining affordability, the **next adjustment may come from the housing market**

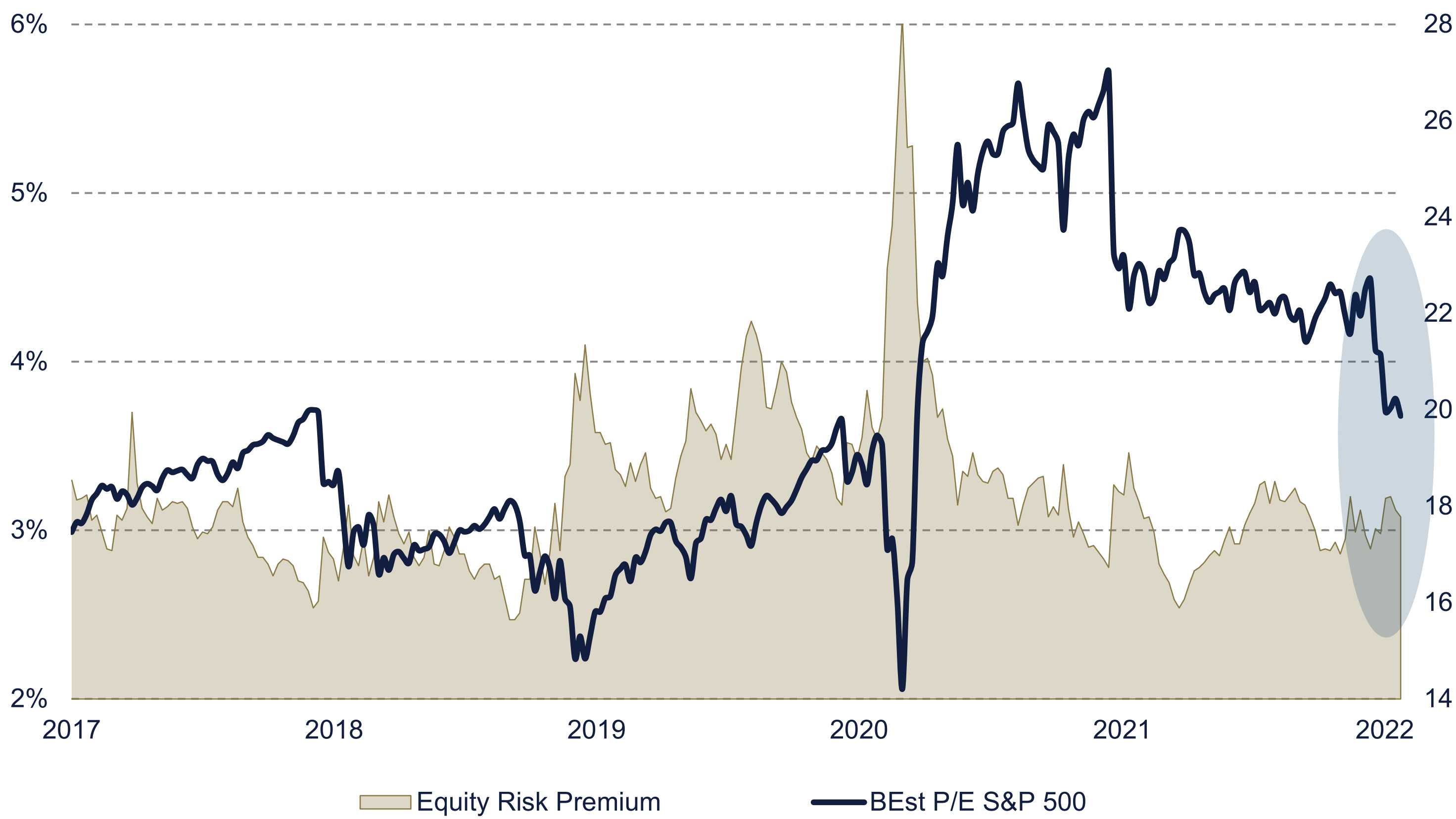
Source: Bloomberg

Recession risks start to be priced

- The market is closely watching the **Fed's moves**, and whether they **may increase the likelihood of an economic slowdown**
- Judging by credit spreads and the shape of the yield curve, **we are clearly entering mid-cycle**. This means that investors must constantly assess the strength of the economy, and that **markets are more vulnerable to corrections**

Source: Bloomberg

Equity valuations offer enough cushion



- A relatively **modest increase in interest rates has triggered a large correction in equity markets**; all this while corporate earnings have continued to increase
- As a result, **stock valuations have become cheaper and remain attractive in relative terms**; despite rising bond yields

Source: Bloomberg

A disproportionate correction

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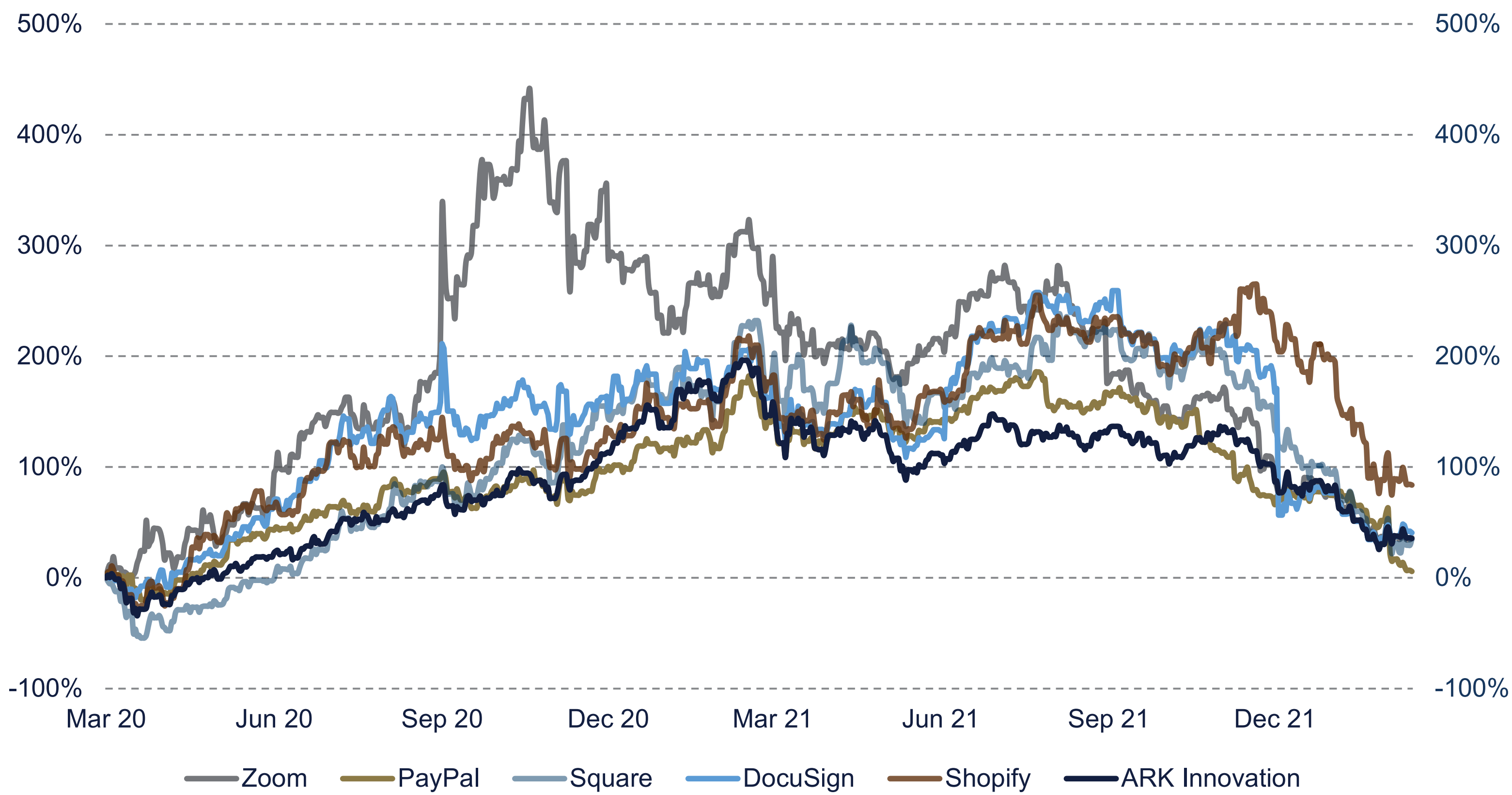


- The **market has been very harsh with companies that exhibit high growth rates**. Despite the fact that many of these companies have a **competitive advantage that allows them to pass on price increases to their customers**; thereby largely offsetting the impact on valuations
- In addition, the correction seems to ignore all the progress made over the last two years. As an example, just look at Zoom, whose revenues have multiplied by a factor of 5, while the stock is trading at pre-pandemic levels

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%	30%

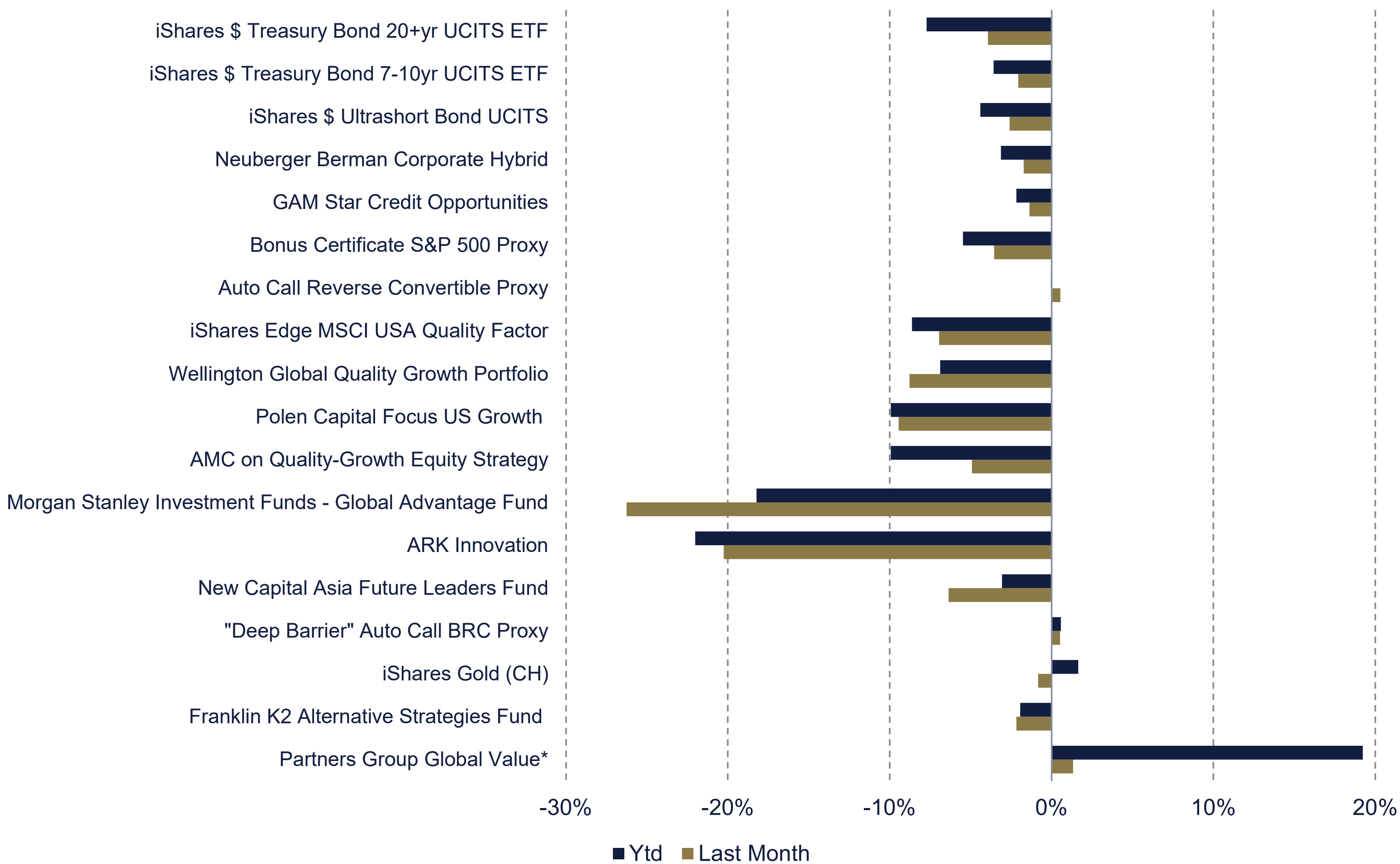
Short-term catalyzers

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)

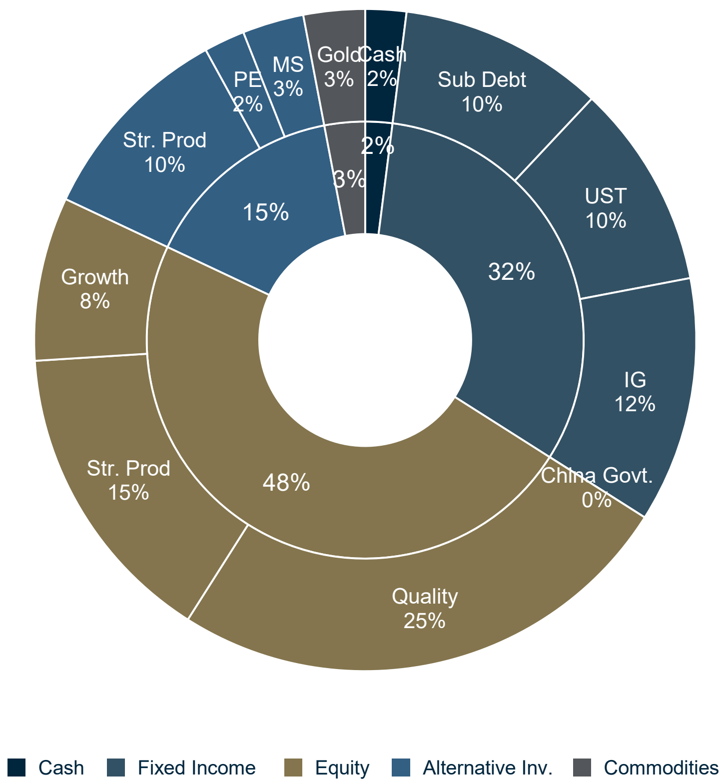
Model portfolio evolution



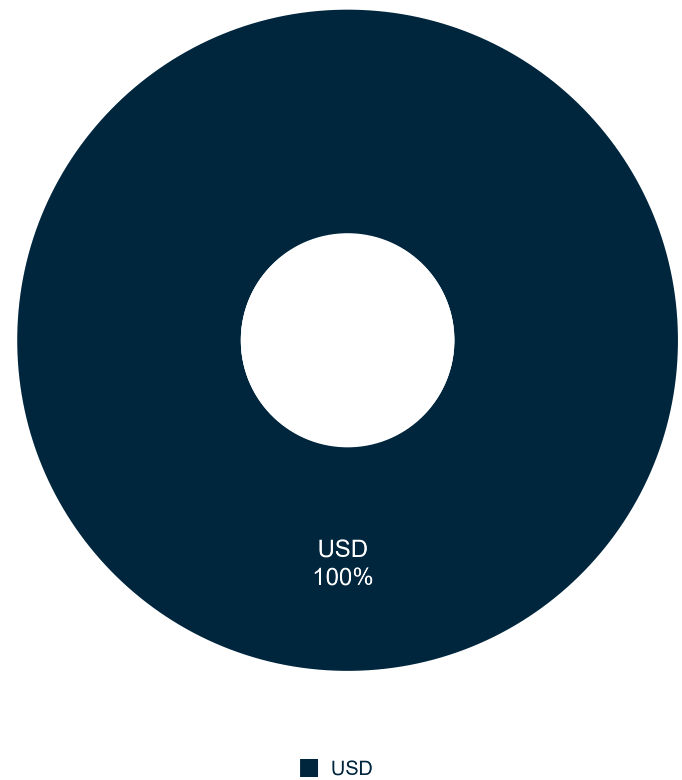
Source: Bloomberg, as of February 9, 2022
* Fund publishes monthly NAV with a 1 month of delay

Boreal Balanced Portfolio USD

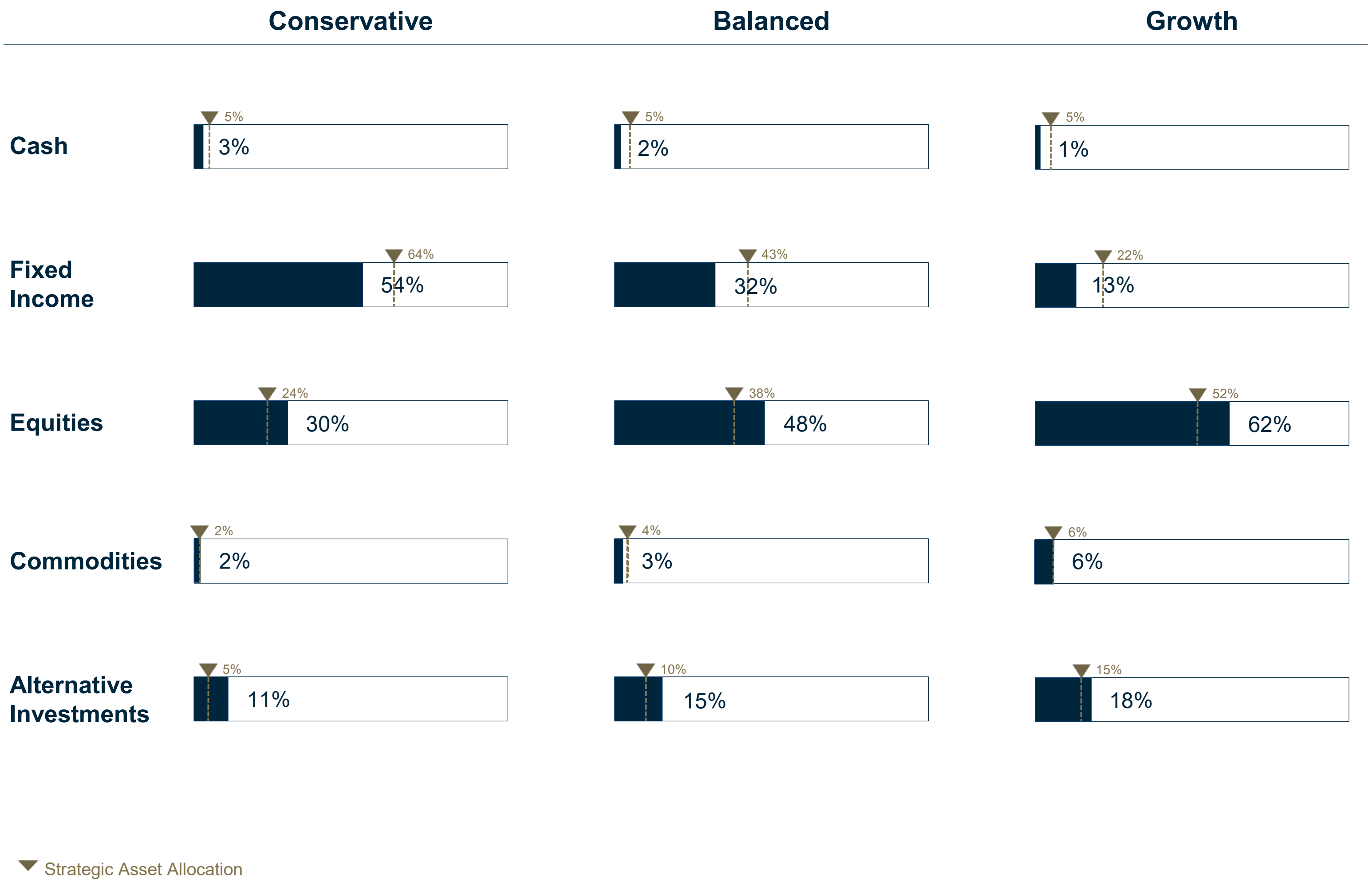
Asset Allocation



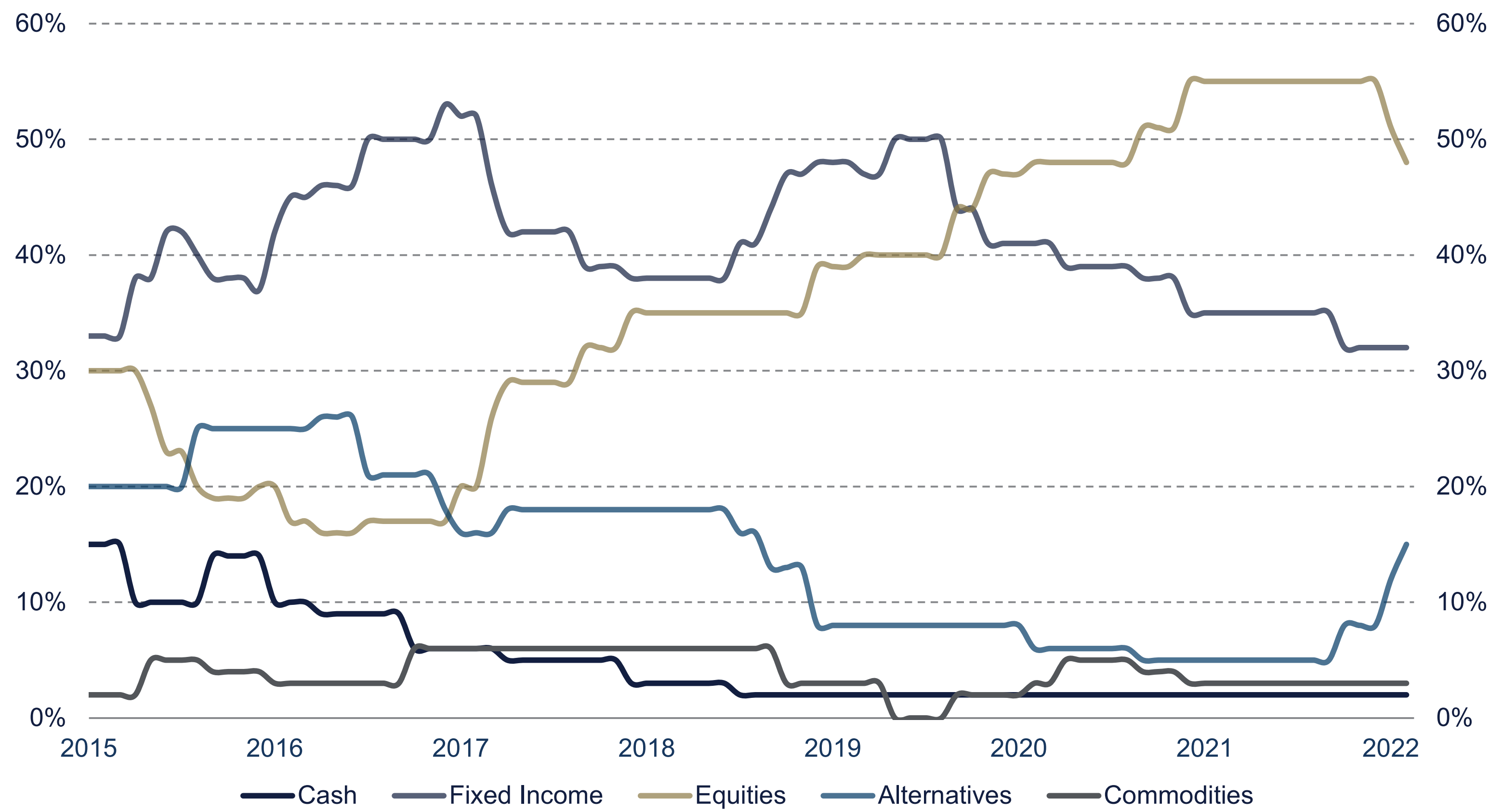
Currency Allocation



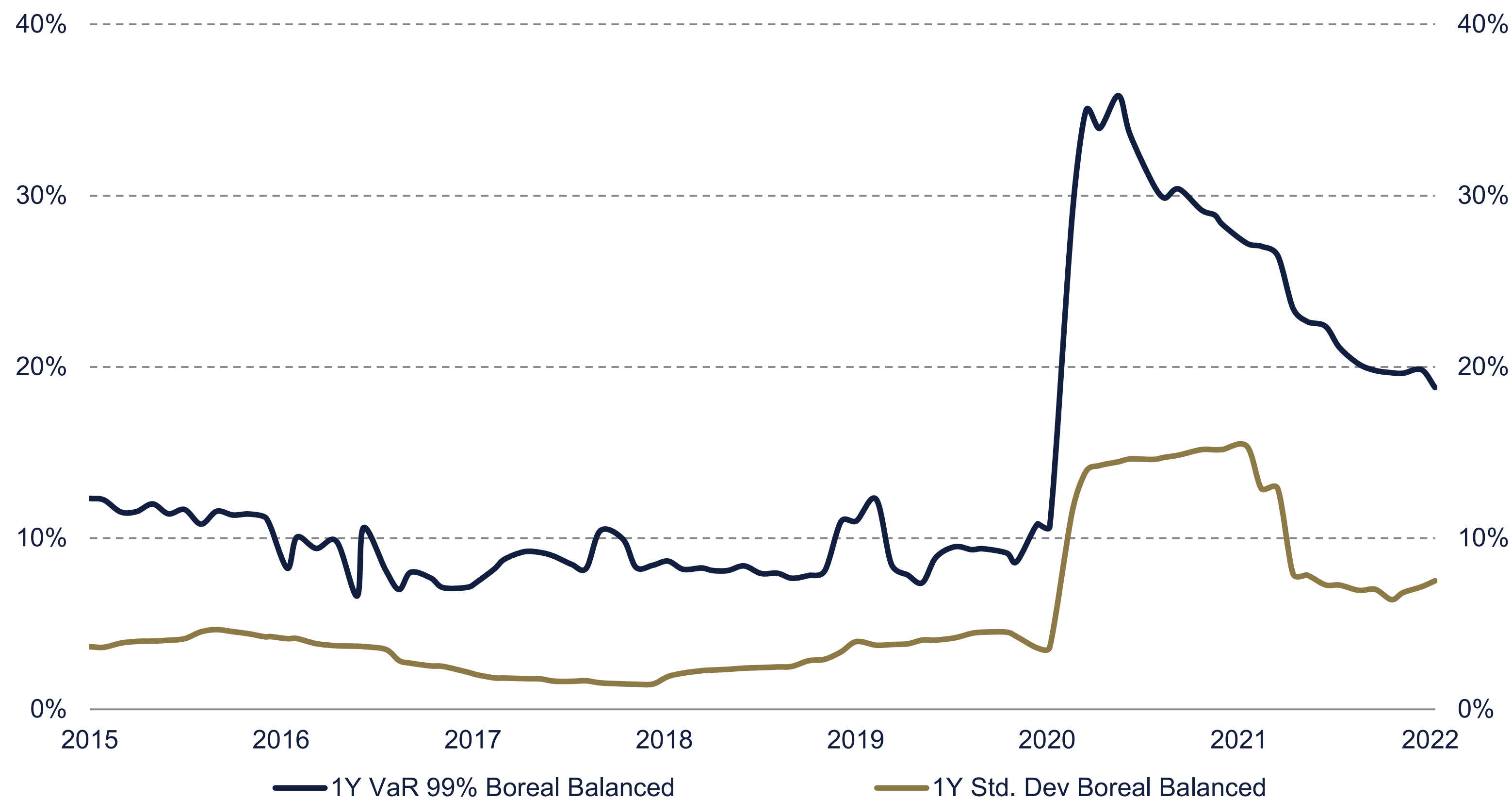
Boreal Investment Profiles



Boreal Balanced Portfolio – Asset Allocation evolution

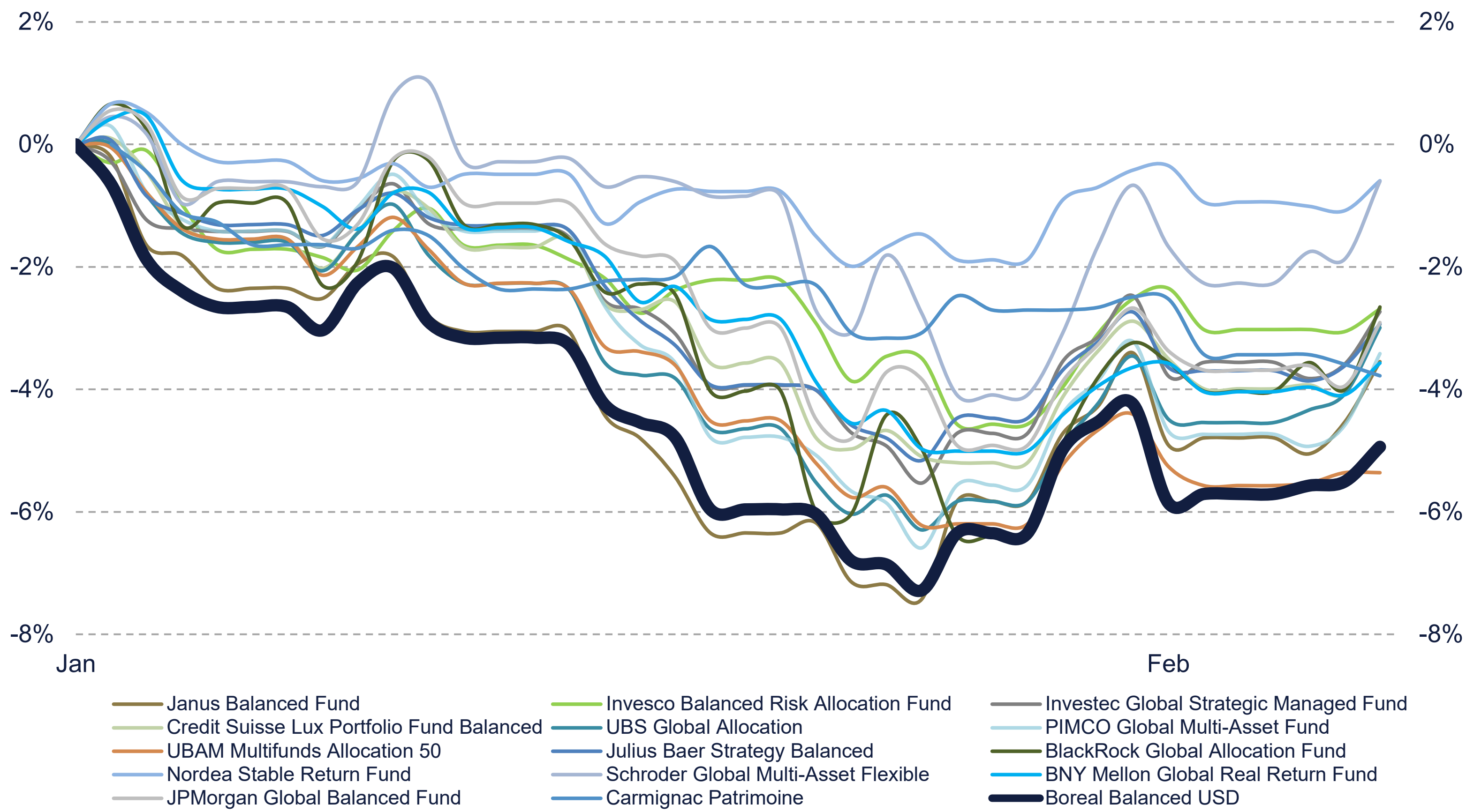


Boreal Balanced Portfolio – VaR evolution



[1] As of February 9, 2021
Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison (YTD)

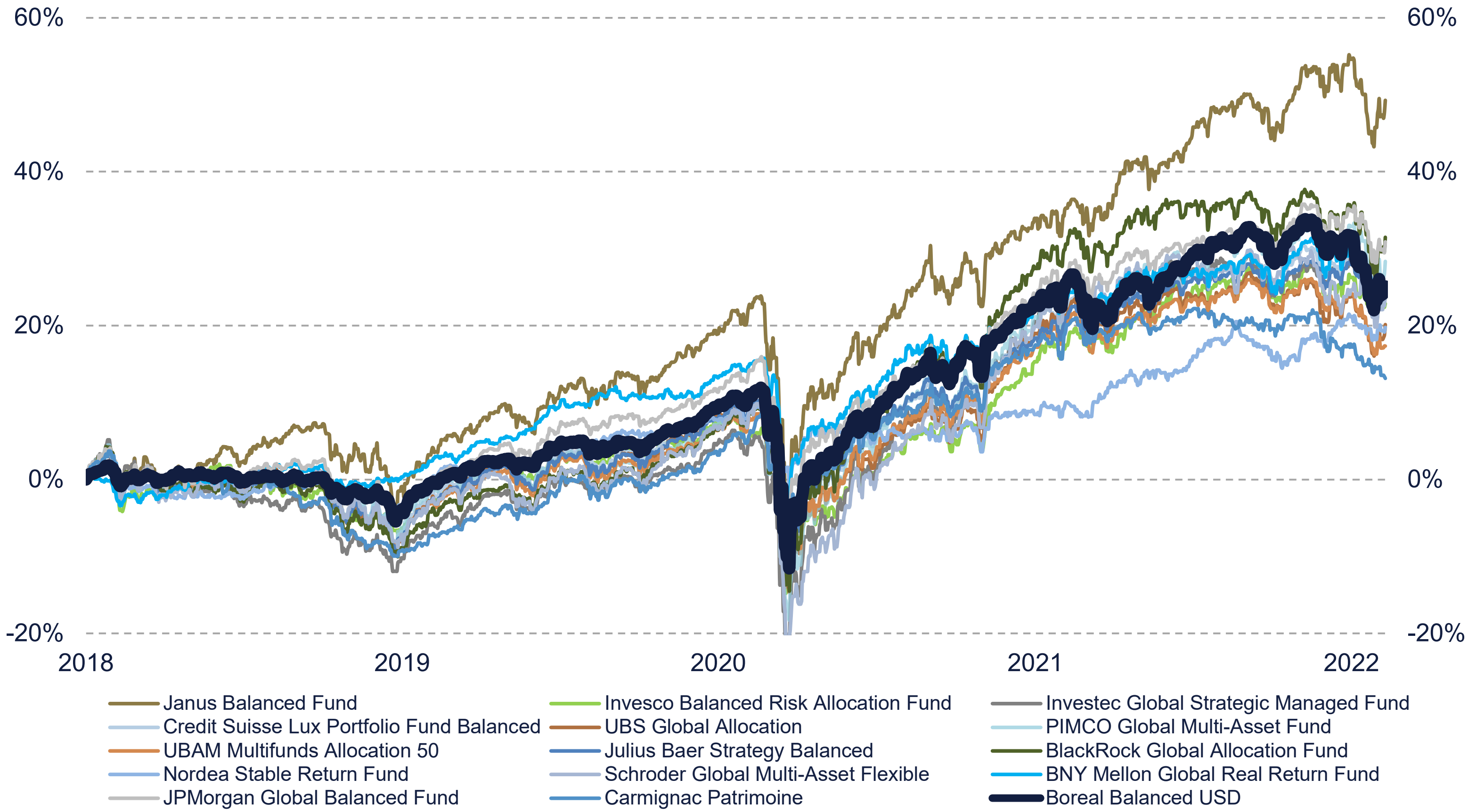


- **Total Return** (Ytd[1]): **14h out of 15**
- **Standard Deviation** (1 year[1]): **8th out of 15**
- **Downside Risk** (1 year[1]): **7th out of 15**
- **Sharpe Ratio** (1 year[1]): **14th out of 15**

[1] As of February 9, 2022

Source: Bloomberg

Boreal Balanced Portfolio – Peer comparison (2)



[1] As of February 9, 2022
Source: Bloomberg

Boreal Balanced Portfolio – Ytd performance

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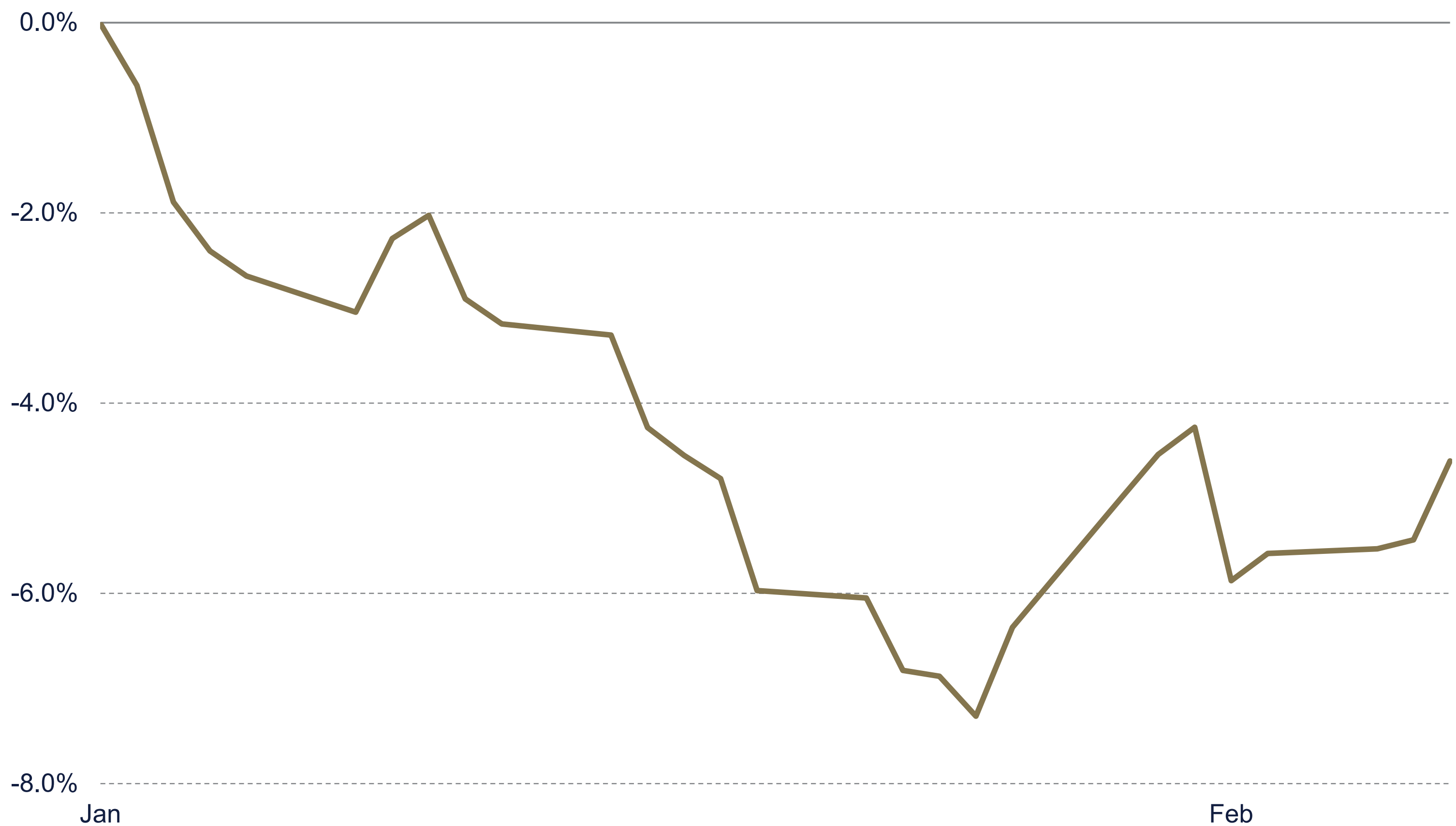
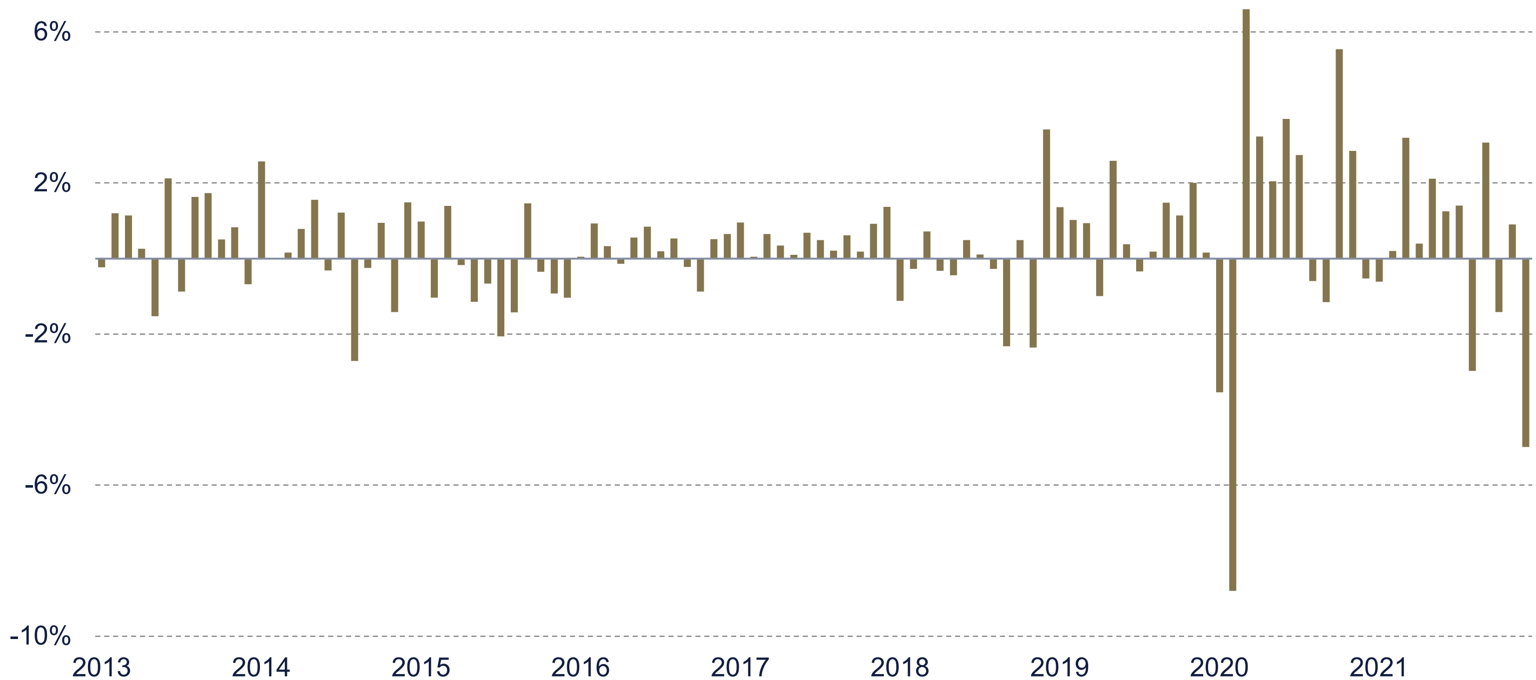


- **Total Return** (Ytd[1]): **-4.61%**
- **Standard Deviation** (Ytd[1]): **11.75%**
- **Downside Risk** (Ytd[1]): **8.02%**
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of February 9, 2022

Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **-1.09%**
- **Total Return** (3 year[1]): **25.71%**
- **Total Return** (Since Jan 13[1]): **47.59%**

[1] As of February 9, 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%	-4.61%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	6.96%	11.75%
Sharpe Ratio	2.54	0.58	n/a	0.62	3.57	n/a	3.49	0.87	1.04	n/a

Annualized Return: 4.34%
Annualized Std. Dev: 6.34%

[1] As of February 9, 2022