Investment Policy

December 2023

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Our market view in a nutshell – December 2023

- **Financial markets continue to defy expectations**. After a brutal correction in 2022, fueled by a devastating rise in interest rates – particularly for high-growth stocks – 2023 has witnessed a **remarkable rebound to new highs** despite long-term rates reaching 15-year highs. This rally is even more surprising given the stagnation of corporate earnings during this same period.

- The **volatility in long-term rates is equally unprecedented**. Swings exceeding 100 basis points in the absence of significant economic data are highly unusual, especially when coupled with falling short-term rate expectations. This has resulted in **another turbulent year for bonds**, with the US Treasury Index swinging from a 4% gain in April (amidst pivot hopes) to a -3% loss in October, before recovering by year end towards its April peak.

- At macro level, the year has been defined by the **resilience of the global economy**. Consumers have shrugged off higher rates and gloomy forecasts, continuing to spend. Businesses, facing post-pandemic labor shortages, have opted to forego restructuring despite declining profitability. This has **prolonged the window for a soft landing, allowing inflation to gradually recede**. With supply-side bottlenecks easing, no major price shocks, and central bank resolve preventing second-round inflation effects, prices have steadily declined from a 9% peak to 3% within a year, broadly in line with analyst expectations.

- After misjudging the Fed's intentions twice, **markets finally received their long-awaited pivot in December**. The rate hike cycle was officially declared over, despite record-low unemployment, wage inflation, and core inflation hovering near 4%, as well as a resilient housing market. The Fed's motivation remains opaque, but **this shift marks a clear move from taming inflation to supporting economic growth**, significantly boosting the odds of a soft landing. While a new economic cycle may be on the horizon, asset prices remain elevated, potentially facing a correction.

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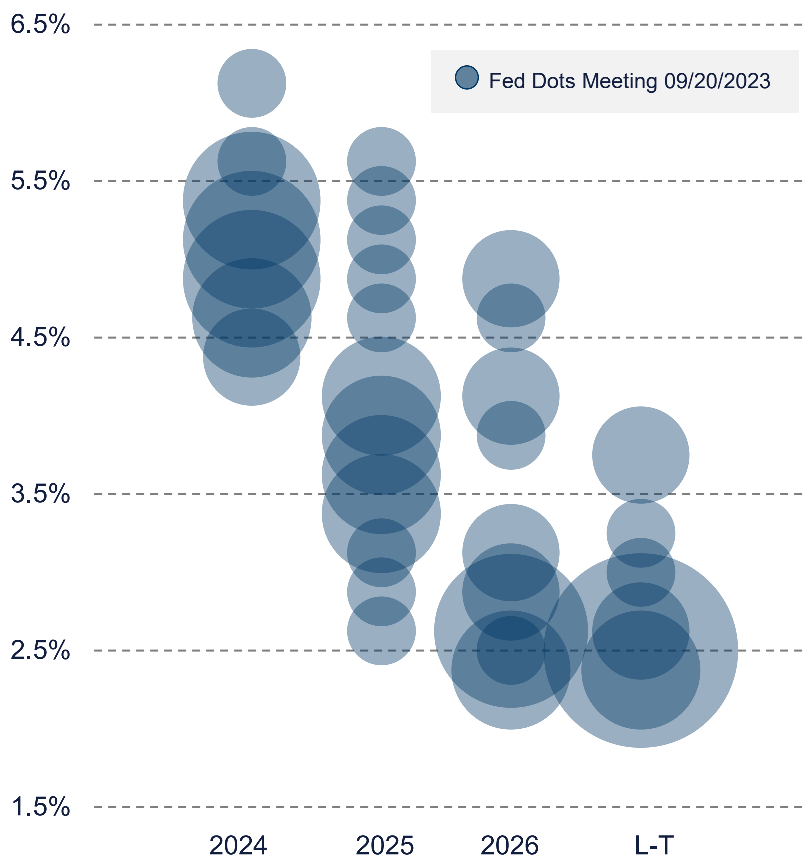
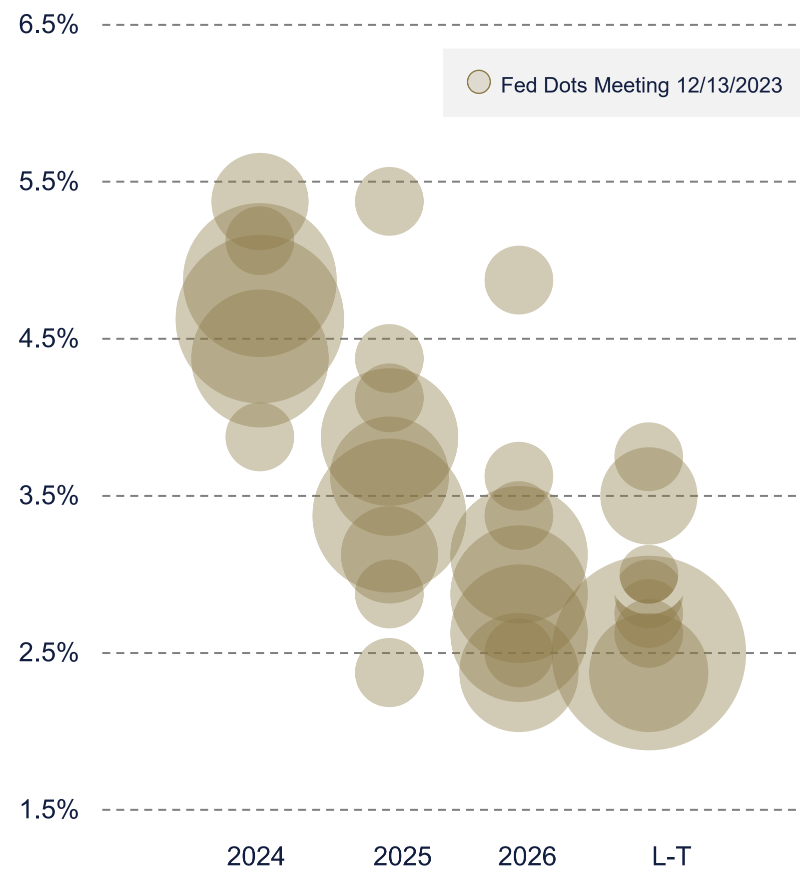
Asset Class		View	Rationale
Fixed Income	US Investment Grade	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. Given the binary macroeconomic risks we are facing (stagflation vs. recession), we favor TIPS and short-duration bonds
	US Credit	=	Higher probability of an economic slowdown caused by rising interest rates and inflation have pushed up credit spreads, so returns are beginning to compensate for the risks taken
	EU Investment Grade	+	The decisive action of the ECB and the widening of corporate spreads has caused high-quality euro-denominated debt to begin to offer an acceptable risk-adjusted return
	European Credit	=	As with US credit, but from a lower base, higher credit spreads make European credit investable again
	Emerging Markets	–	Emerging market debt attractiveness has improved, but tends to underperform in a strong dollar environment
Equities	US	+	After the sharp sell-off, valuations have improved. We maintain our exposure to US equities, mostly through quality and growth-oriented companies
	Europe	=	The European economy has emerged from the pandemic faster and stronger than many expected. However, the continent is more exposed to the falling out with Russia
	Asia	=	We recommend investing selectively in the region
	Emerging Markets	–	Emerging market stocks tend to be more cyclical, and there are fewer quality stocks. Russian sanctions and regulatory pressure on China have increased the risk premium
	Sectors & Themes	+	To complement our core allocation, we favor Healthcare and companies that pay sustainable dividends
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	=	Commodity prices have been driven up by (and not caused by) inflation, as well as the war in Ukraine. We do not expect these levels to be sustainable in the long term
	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

“Hawks” and “Doves” align





- The long-awaited pivot from the Fed has finally materialized. A **developing consensus among FOMC members** paves the way for **potential rate cuts in the coming year**.
- While the timing and reasoning behind this shift remain shrouded in some ambiguity, particularly with inflation still distant from their 2% target, the **net effect is a pro-growth stance that enhances the prospects for a soft landing**.

Source: Bloomberg

Interest rates volatility remains elevated

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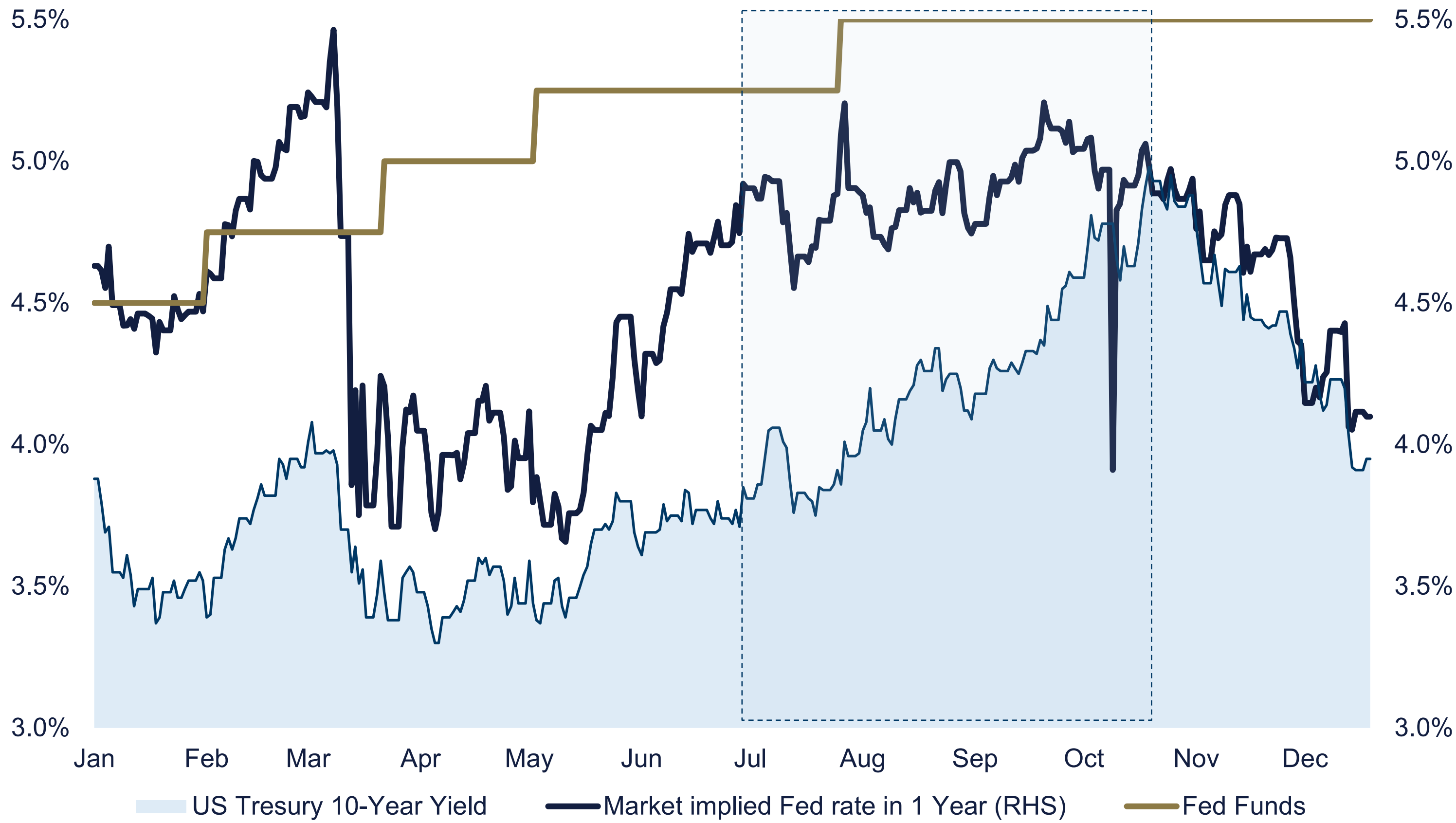
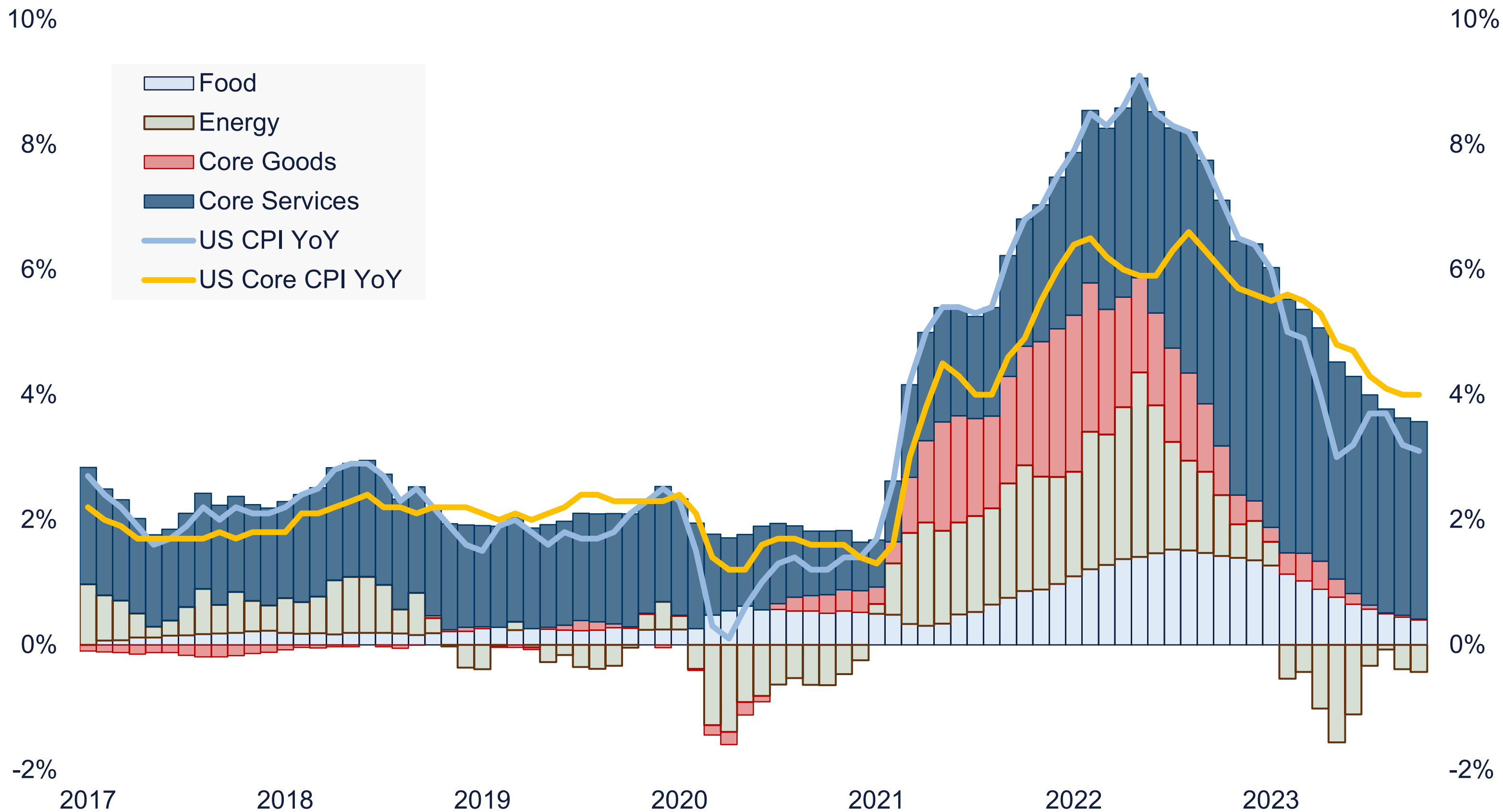


- Discerning the movements of the long-end of the yield curve remains a challenge. Beyond technical explanations, these fluctuations highlight the **market's struggle to calibrate the "new normal" for interest rates**.
- **The yield curve**, which inverted mid-2023 amid heightened recessionary fears, **has recently steepened**.

Source: Bloomberg

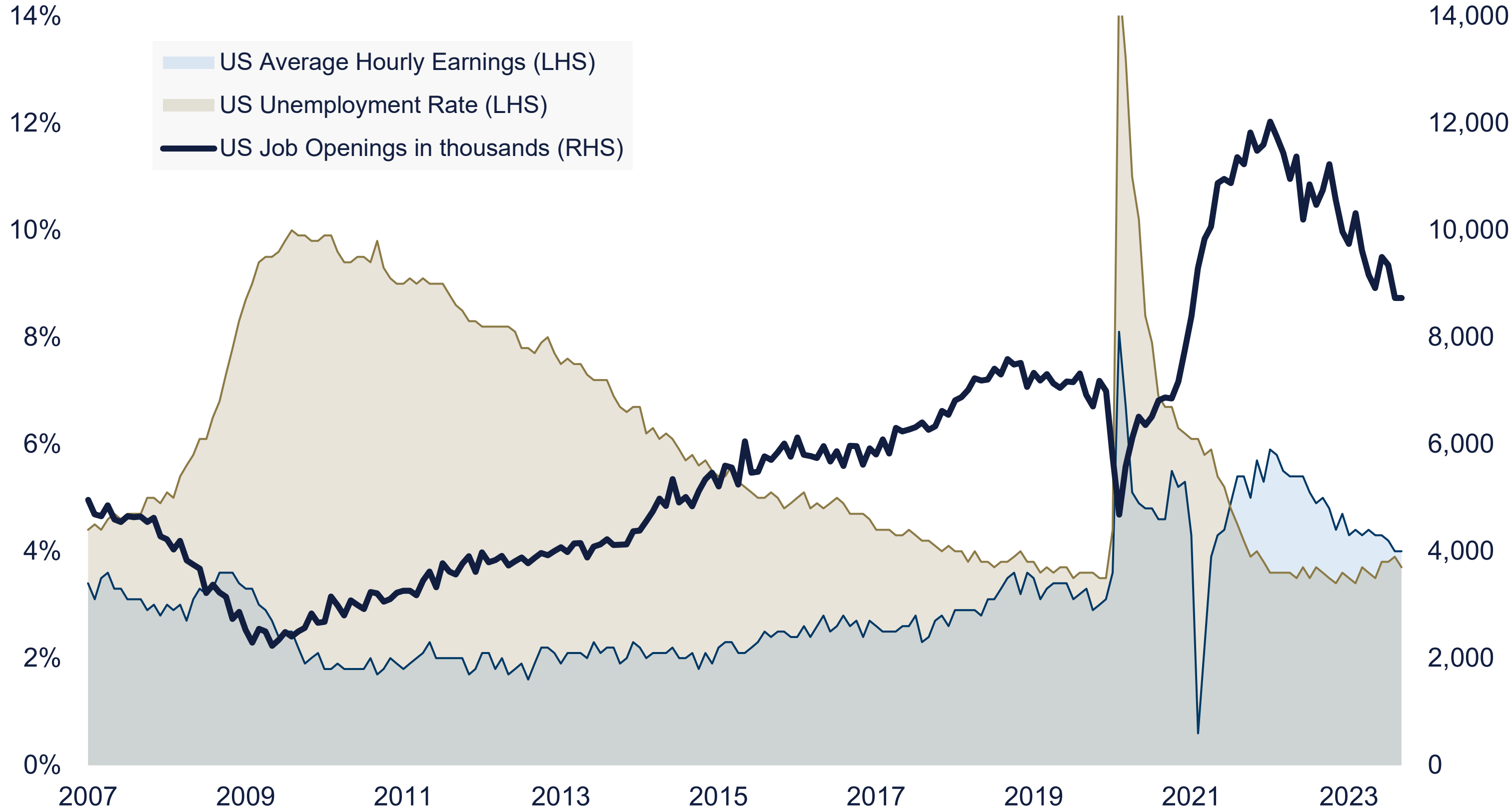
Risk of a policy mistake



- The Fed has anchored its decision to pause rate hikes on the positive trend in inflation. **Lower inflation passively tightens monetary policy**, as real rates rise even with nominal rates unchanged.
- However, **core inflation remains still near 4%**, heavily influenced by the lagging shelter component. Despite rising mortgage rates, **house prices have barely corrected**, causing a slow adjustment in shelter costs.

Source: Bloomberg

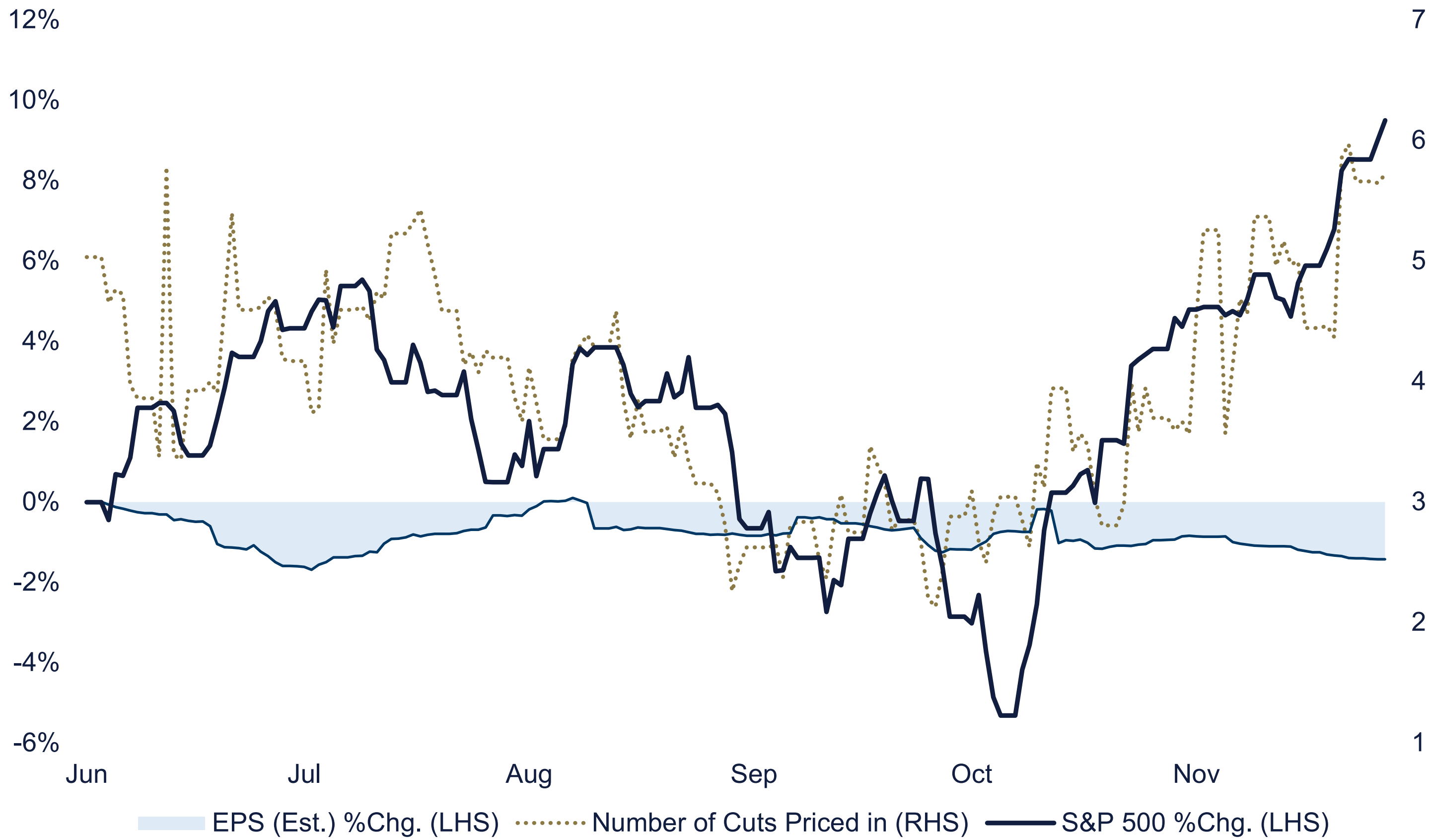
Job market cooling but still too tight



- Perhaps the **greatest risk of renewed inflationary pressures resides in the labor market**. Workers have only partially recouped the losses in real disposable income caused by inflation, and they may push for further wage increases if they perceive the job market to remain unbalanced in their favor.

Source: Bloomberg

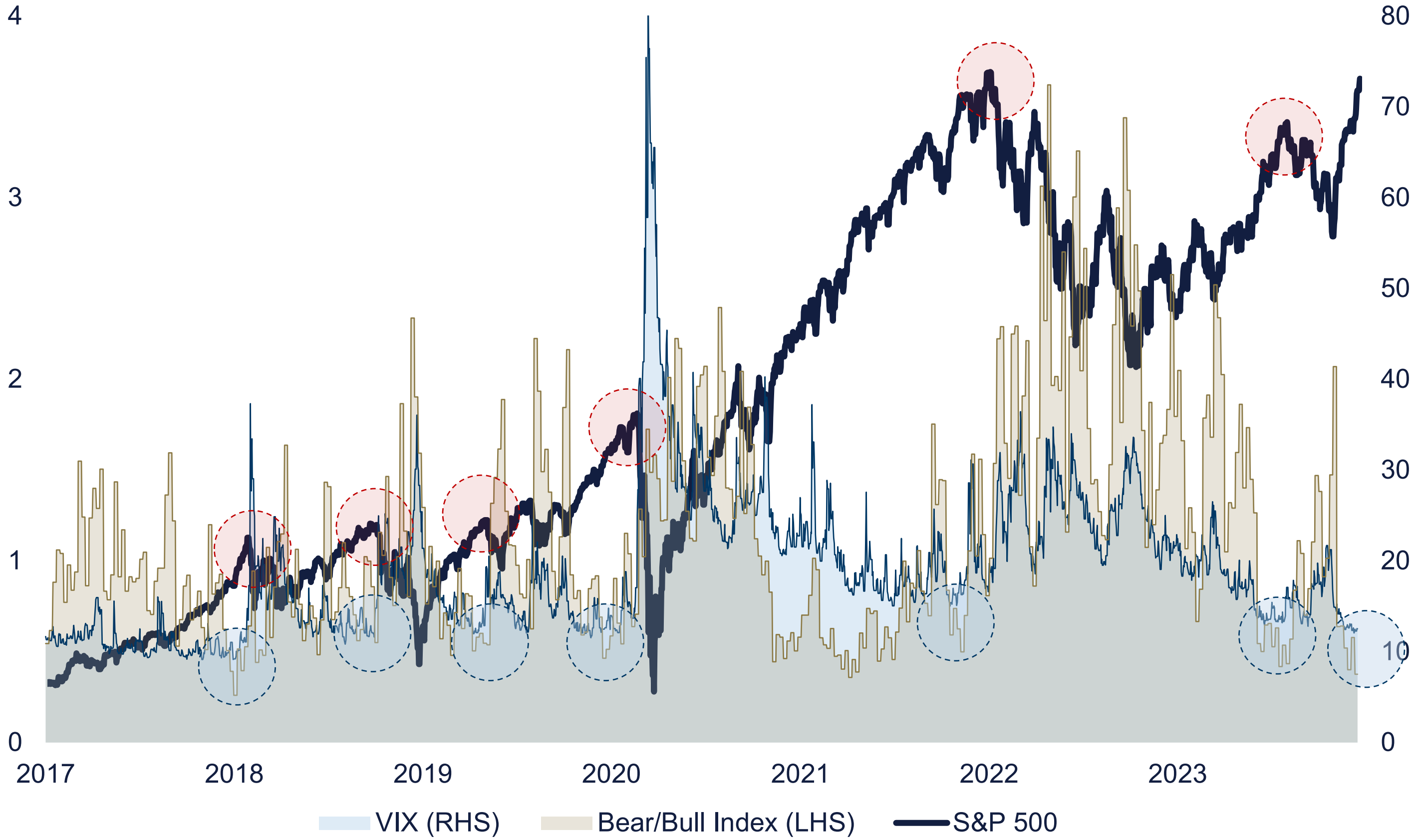
A macro-driven equity market



- Equity **markets have, to some extent, decoupled from fundamentals**, remaining heavily influenced by interest rate expectations. Despite new highs in interest rates and stagnant corporate profits throughout the year, stocks have recovered their losses from last year.
- The **investment thesis for equities** at current valuations hinges on the **start of a new economic cycle**, which could push earnings to double-digit growth.

Source: Bloomberg

Technical indicators at play



- Beyond valuations, **excessively optimistic investor sentiment and historically low market volatility** suggest the recent rally may be losing momentum.
- However, the **proximity to key technical levels** and the possibility that sidelined investors will deploy the liquidity that is waiting in the system create a **risk of a "melt-up"**.

Source: Bloomberg

“Risk-on”

- **Credit markets** have consistently **priced in an increased probability of a soft landing since last year**, with spreads tightening from recessionary levels to their long-term averages.
- The **Fed's pivot** has further reduced the likelihood of a recession, **prompting spreads to tighten even further**.

Source: Bloomberg

Temporary weakness

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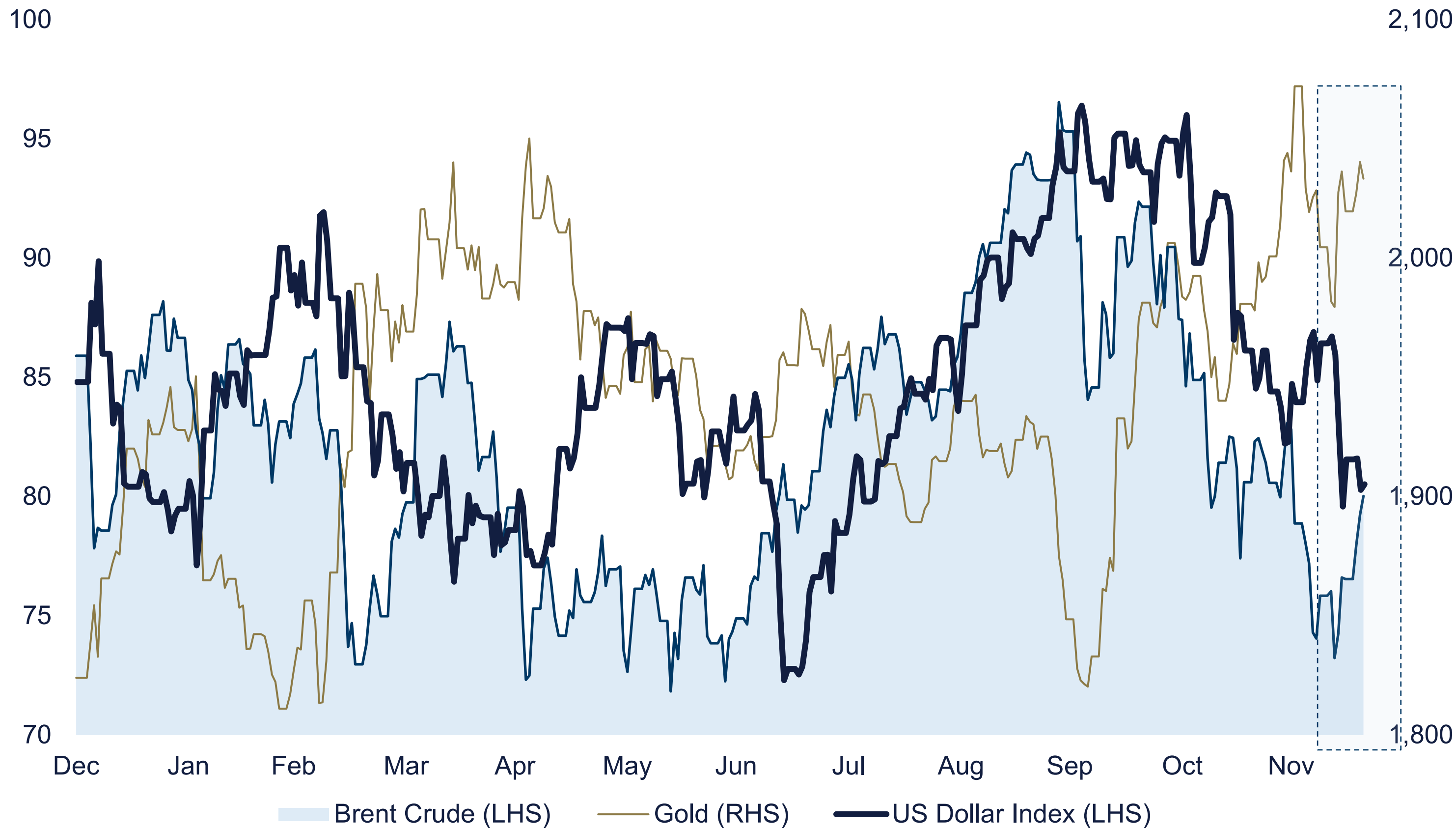

- **Lower interest rate differentials have exerted downward pressure on the US dollar**. However, this is unlikely to constitute a permanent trend. **Most central banks are expected to eventually follow the lead of the Fed**, as inflation has moderated globally, with Europe experiencing particularly rapid deceleration.
- The Fed's early pivot could also **bolster the dollar by fostering a more positive growth differential** between the US and other developed economies.

Source: Bloomberg

Investment scenarios

	Scenario 1 Policy Mistake	Scenario 2 “Boiling Frog”	Scenario 3 “Soft landing”
Drivers	• Sticky inflation persists amid a hot labor market and resilient housing prices, with core services inflation defying the Fed´s 2% target • The Fed must reverse course and implement further tightening, keeping interest rates elevated for longer • Macroeconomic uncertainty and market volatility increase. Long-term interest rates pick up again along with inflation expectations	• Consumption, which has barely budged despite the sharp increase in borrowing costs, finally adjusts • Firms, which in the face of a tight labor market have been reluctant to lay off workers despite higher costs and sluggish profitability, begin to restructure • In order to help the economy, the Fed is forced to loosen monetary policy aggressively, but it is too late to prevent the economy falling into recession	• Fiscal policy remains accommodative, and the economy continues to grow, avoiding a recession • The Fed pauses rate hikes and eases policy. Inflation continues normalizing without the economy slowing down significantly • The yield curve steepens, credit spreads narrow further, and corporate earnings resume growth. It is the beginning of a new economic cycle
Market impact	• Corporate profits rise if inflation is caused by strong economic growth, but higher interest rates have a negative impact on equity valuations • High-quality and sovereign bonds fall due to rising interest rates • Credit performs relatively better despite higher rates, as the risk of corporate defaults remains low • The US dollar appreciates against safe-haven currencies as long as the economy remains strong. Gold gains as inflation expectations get de-anchored	• Equity markets fall, and cyclicals underperform quality and defensive stocks • Credit spreads widen sharply as the prospect of corporate defaults looms • Sovereign debt appreciates due to "flight to quality“ and lower interest rates. Commodity prices will fall. • The US dollar will depreciate if the Fed leads the way cutting interest rates and / or if the economic slowdown is not a global phenomenon. Otherwise, "flight to quality“ will support the US dollar	• Equity markets rally, as the economy returns to the “Goldilocks”, and valuation multiples widen • Credit spreads tighten further as investors chase yield again • High-quality and sovereign debt trade range-bound • Commodity prices stabilize. The fate of the US dollar is determined by growth differentials and real interest rate differentials
Probability	20%	30%	50%

Short-term catalyzers

Peace agreement in Ukraine, Slowdown in inflation, Supply chain problems continue to ease

Other risks

US Presidential Election, Debt ceiling, Banking crisis, Escalation of geopolitical tensions, China slowdown, Housing market correction

Boreal Balanced Portfolio USD

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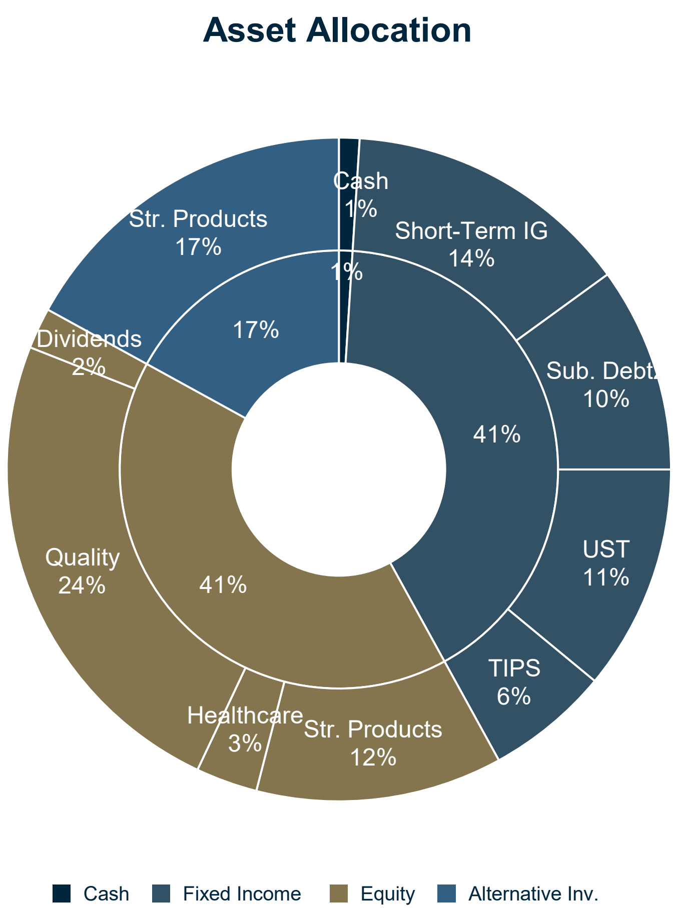

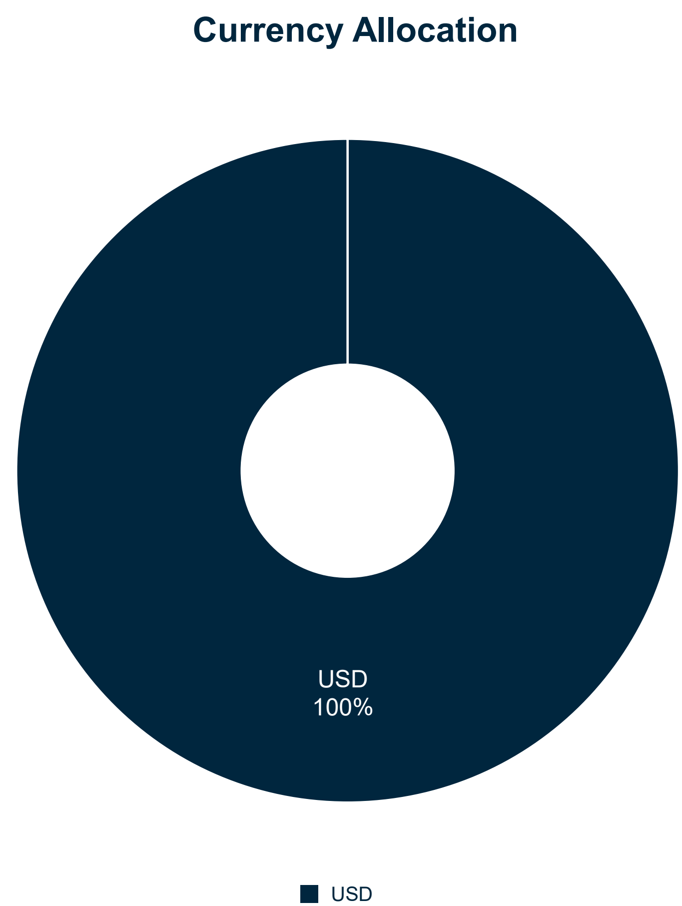

Boreal Investment Profiles

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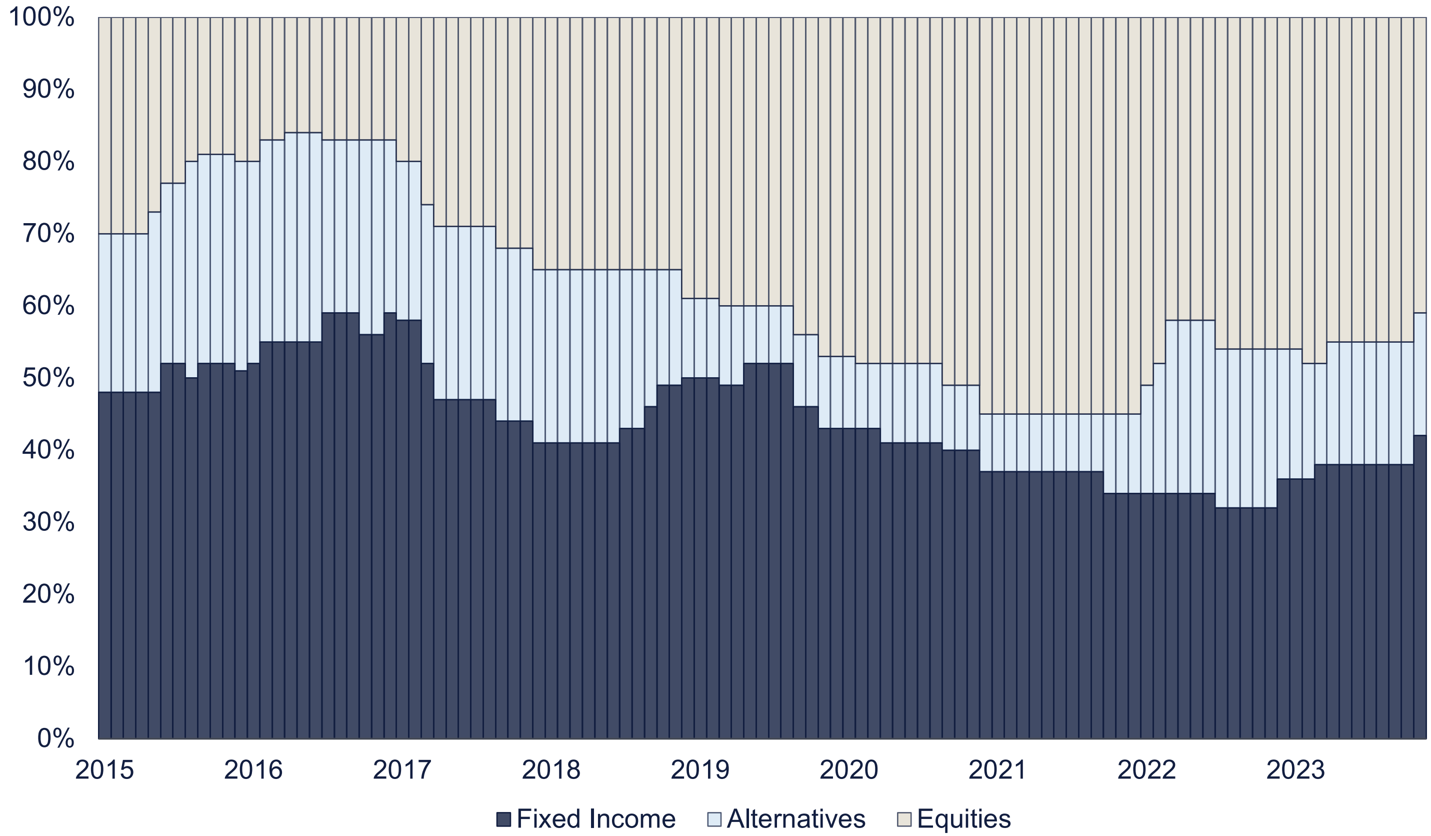
	Extra-Conservative	Conservative	Balanced	Growth
Cash & Fixed Income	85% ▼86%	65% ▼66%	42% ▼44%	21% ▼22%
Equities	7% ▼10%	24% ▼30%	41% ▼50%	56% ▼70%
Alternative Investments	8% ▼4%	11% ▼4%	17% ▼6%	23% ▼8%

▼ Strategic Asset Allocation

Boreal Balanced Portfolio – Asset Allocation evolution



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