Edwards Wealth Management AG
Switzerland

Investment Policy

August 2018

Market overview

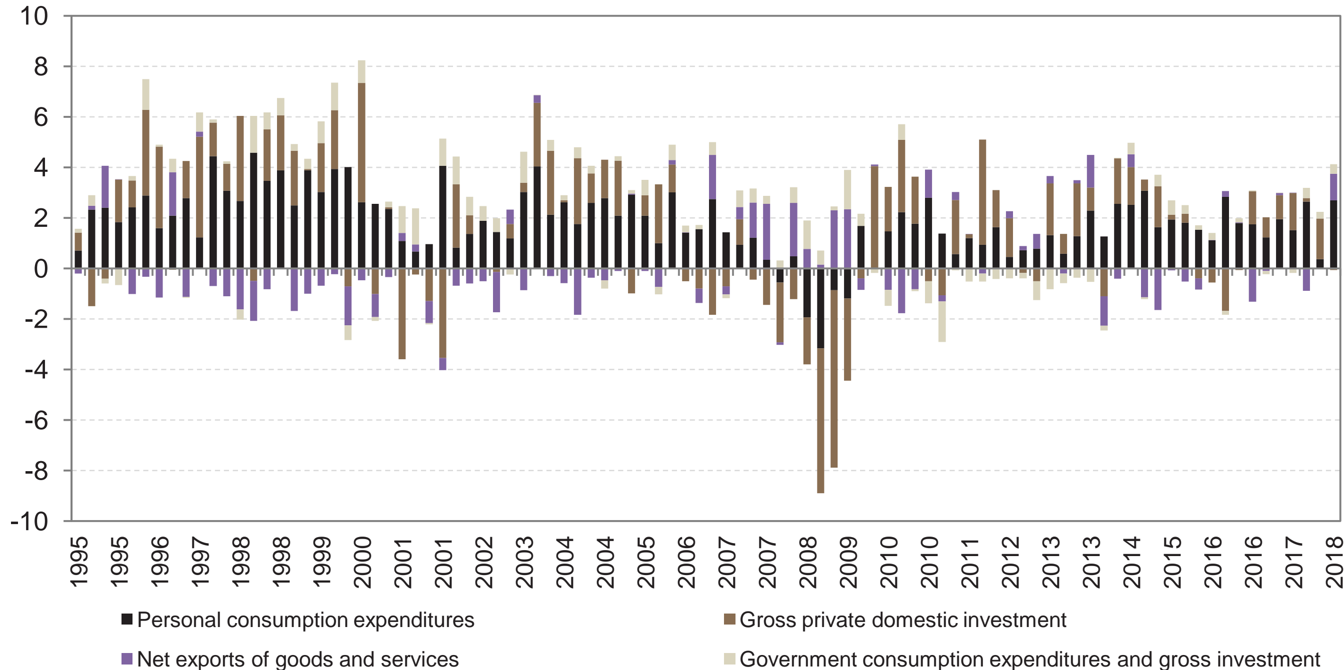
- Second quarter GDP figures show that global **growth remains robust, but not so synchronized** as during 2017. On the one hand we have the **US economy outperforming** on the back of the tax reform, whilst one the other hand we have **Europe** and **Japan** losing steam, and **Emerging markets starting to suffer** from **rising interest rates** and a **higher US dollar** - and the stronger the US economy performs, the more will increase both interest rates and the dollar

- Besides the former, we see as further reasons for this global slowdown the **fading off of the stimulus** that the Chinese authorities put in place in 2016 to avoid a hard-landing, combined with the negative impact that **the trade dispute** is having on corporate investments

- Although it seems that after trying to reign on the leverage problem during the last year, the **Chinese are on loosening** mode **again**, lowering interest rates and letting the Yuan depreciate. However, we are skeptical about the apparent stability of the country's main macroeconomic indicators, and remain highly concerned about the risks that a slowdown of the Chinese economy poses on the global economy

- Our assessment of the **risks** of (1) **US overheating** and (2) **Chinese hard-landing** are still modest; hence, we are **maintaining our current exposure to risk assets**. However, as the yield curve continues to flatten, the sharp ratio of many asset classes − from credit to alternative investments − is worsening, and we will **continue gradually increasing our allocation to short-term investment grade bonds**

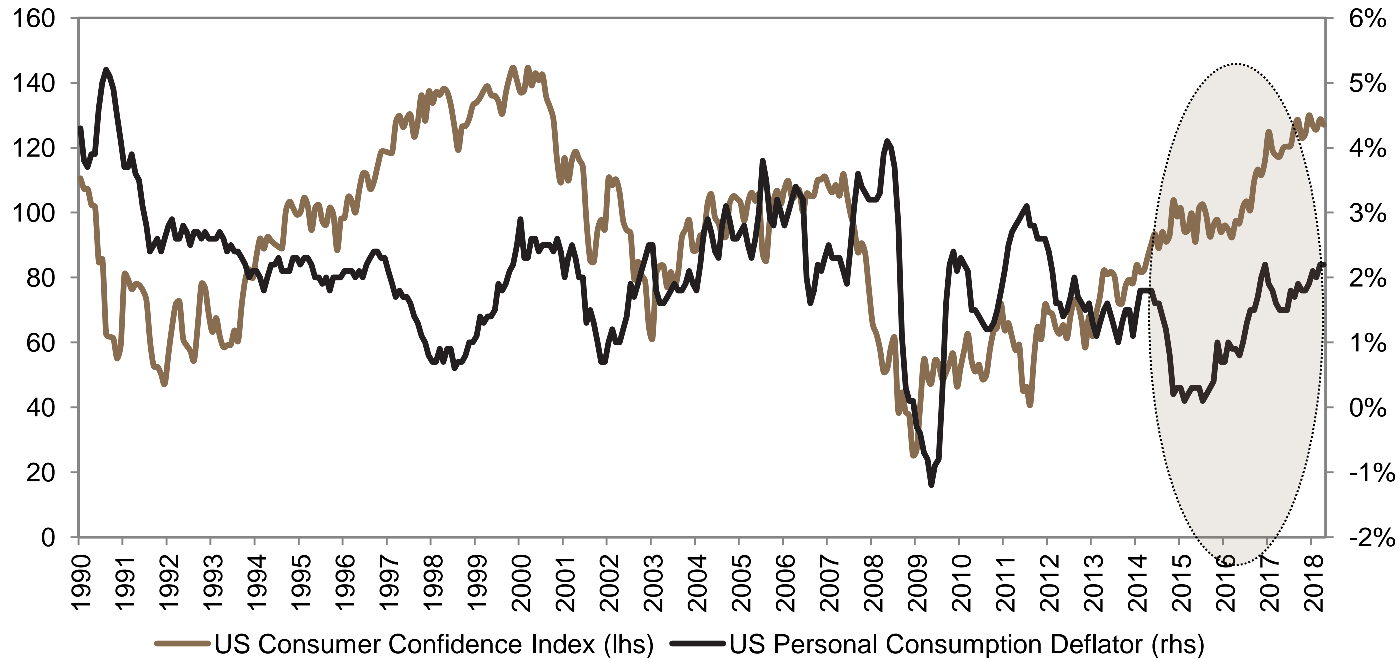
The US remains the main engine for growth



- **US GDP grew at 4.1%** over the second quarter, a figure above expectations that confirms the expected acceleration in economic activity following the **tax reform**
- The **main contributor to growth was personal consumption**. The **investments component decelerated** from previous quarter, although we expect it to be the one most positively affected from the changes in the tax code

Source: Bureau of Economic Analysis

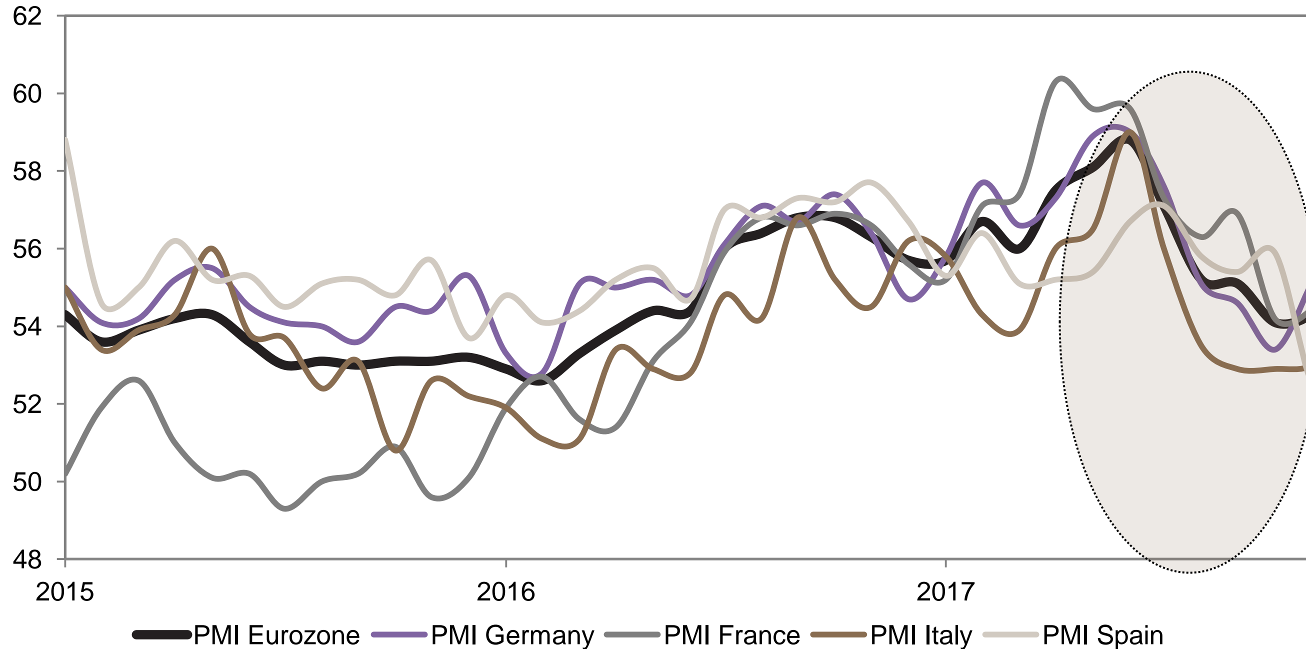
Consumer prices remain contrained, but rising



- With fresh tax cuts and unemployment at historical lows, US **consumers are feeling increasingly confident**. However, as consumer spending rises, **inflation tends to show up**. This has not been the case so far during this business cycle, but sooner or later it is expected to happen if the economy continues heating up
- Higher growth and higher inflation may prompt the Fed to rise rates more aggressively, putting an **end to the "goldilocks "scenario**

Source: Bloomberg

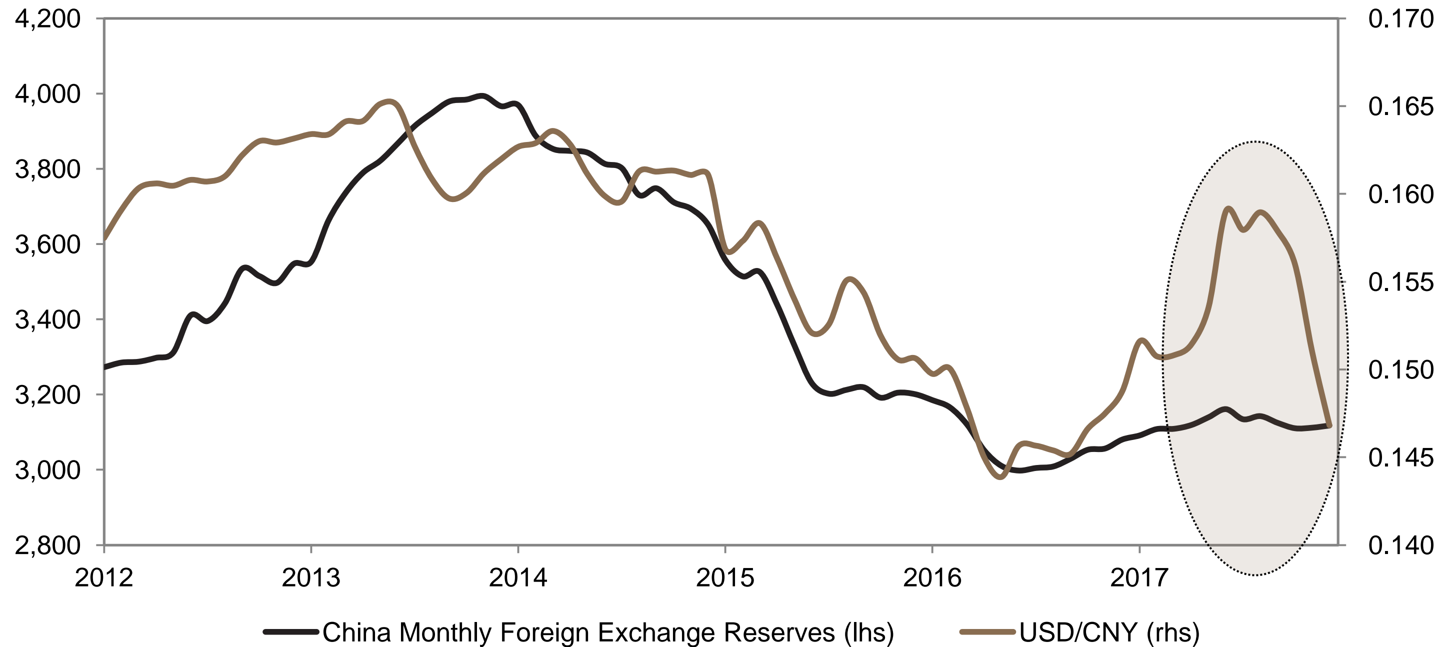
Synchronized growth under question



- The **synchronized acceleration in global growth has not lasted long**, and during the first half of the year we have seen an economic **slowdown**, particularly in the **Eurozone**
- **Leading indicators are still pointing to an economic expansion**, and are no reason for concern. However, investors need to rebase their expectations concerning the strength of the global economy

Source: Bloomberg

Trade wars morph into currency wars



- As the tension around the **trade dispute** between the US and China escalates, the Chinese authorities seem to be **letting the Yuan depreciate** in response (currency **reserves remain flat**)
- If the Yuan depreciates sharply, it could have global repercussions, as it would create a **deflationary wave** that would significantly slow down nominal growth

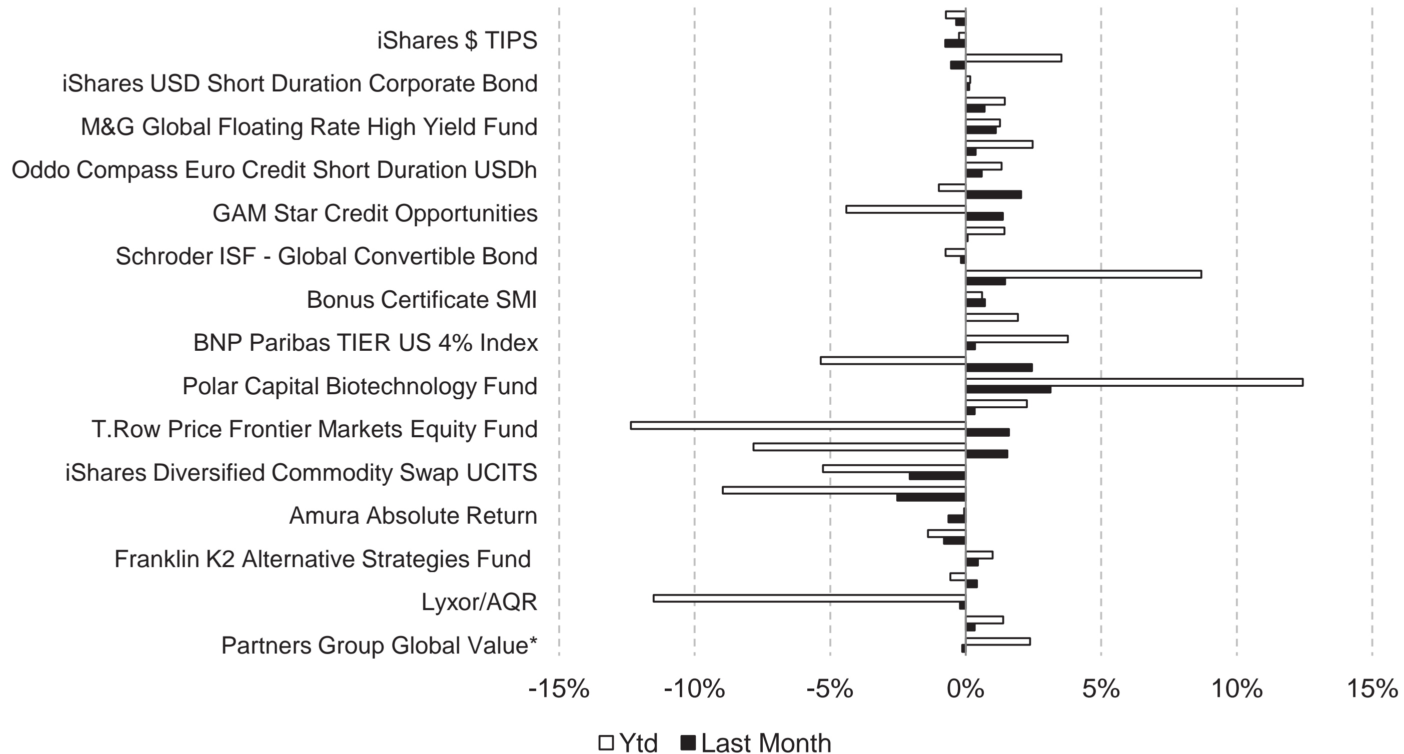
Source: Bloomberg

Emerging markets bearing the brunt

- **Rising interest rates**, slowing global growth and a **stronger dollar** are impacting emerging markets currencies, bonds and equities
- Countries like **Turkey** or **Argentina** that in a weaker position (current account deficits, dollar financing, poor governance, etc.) are suffering the most. However, it is **too early to speak about a generalized emerging markets crisis**

Source: Bloomberg

Model portfolio evolution



• Last month **most asset classes in the portfolios recovered**, with the **exception of Treasuries and commodities**

Source: Bloomberg as of August 1, 2018
* Fund publishes monthly NAV with a 1 month of delay

Investment scenarios

	Scenario 1 Recession by political/policy accident	Scenario 2 Goldilocks	Scenario 3 New regime
Drivers	• Global economic slowdown caused by political accidents or policy errors (Trade war with China, EU breakup, a too aggressive Fed, etc.) • Deflationary scenario due to a combination of low growth and structural factors, although the rise of protectionism would be inflationary • The Fed will have to reverse curse, which would be complicated if inflation is rising	• The fiscal stimulus in the US provides a short-term impulse to the global economy, but not enough to attain a higher growth trajectory • Inflation, particularly in the US will pick-up, but remains subdued globally due to structural factors (demographics, low aggregated demand, deleveraging) • The Fed will continue its normalization path	• Growth concerns dissipate, with economic activity accelerating in US, Europe and Japan • Inflation in the US increases, as a consequence of president Trump's fiscal stimulus, and pulls other developed economies off deflation • The Fed will have to step up the pace of rate increases and/or reduce balance sheet
Market impact	• Correction in credit due to a rise in defaults and a widening of corporate spreads • Correction in equities due to lower projected earnings, though low rates will offer support • Sovereign and IG credit to profit due to flight to quality and the continuation of an ultra-loose monetary policy globally • USD neutral to weak as flight to quality is counterbalanced by low interest rates • Commodities will fall	• Equities appreciate moderately, with Europe and Japan catching up with the US • Credit spreads remain stable as the credit cycle is further elongated • Sovereigns suffer as monetary policy is progressively normalized • USD appreciate moderately due to higher interest rate differentials • Commodity prices will rise in the short-term, normalizing once the impulse vanishes	• Impact on equities will depend on how much real economic growth is sustained, and how accommodative the Fed remains • Sovereign and IG bonds will face steep losses due to higher rates, particularly if long-term inflation expectations rise • Corporate credit will correct moderately if inflation comes together with higher growth • The USD will appreciate, particularly against those currencies facing deflation • Commodities will gain from higher inflation
Probability	35%	35%	30%

Short-term catalyzers

Fiscal stimulus in the US, improvement in macro-data globally, lower geopolitical tensions

Other risks

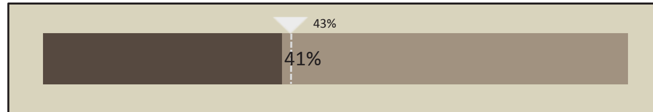
Trade wars, Spread of populist political parties, China slowdown, Terrorism

EWM Investment Policy

Cash

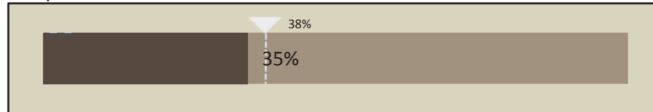
- In the current environment, waiting for good investment opportunities is a sensible investment strategy. However, holding cash is becoming costly due to low interest rates.

Fixed Income



- Corporate and high yield debt currently offer the best combination of risk and return. Treasuries can benefit from a slowdown in growth, although this less likely with the expected fiscal stimulus in the US, whilst TIPS offer protection against rising inflation
- We will avoid emerging markets until there is more clarity on trade policy by the new US administration

Equities



- The expected fiscal stimulus in the US will accelerate growth and postpone the fear of deflation, which will be supportive for equities as the top line will increase. However, it remains to be seen to which extent this comes along with an increase of interest rates, which will be a drag on valuations
- We favor investments in non-directional strategies as well as in preferred companies and sectors

Commodities

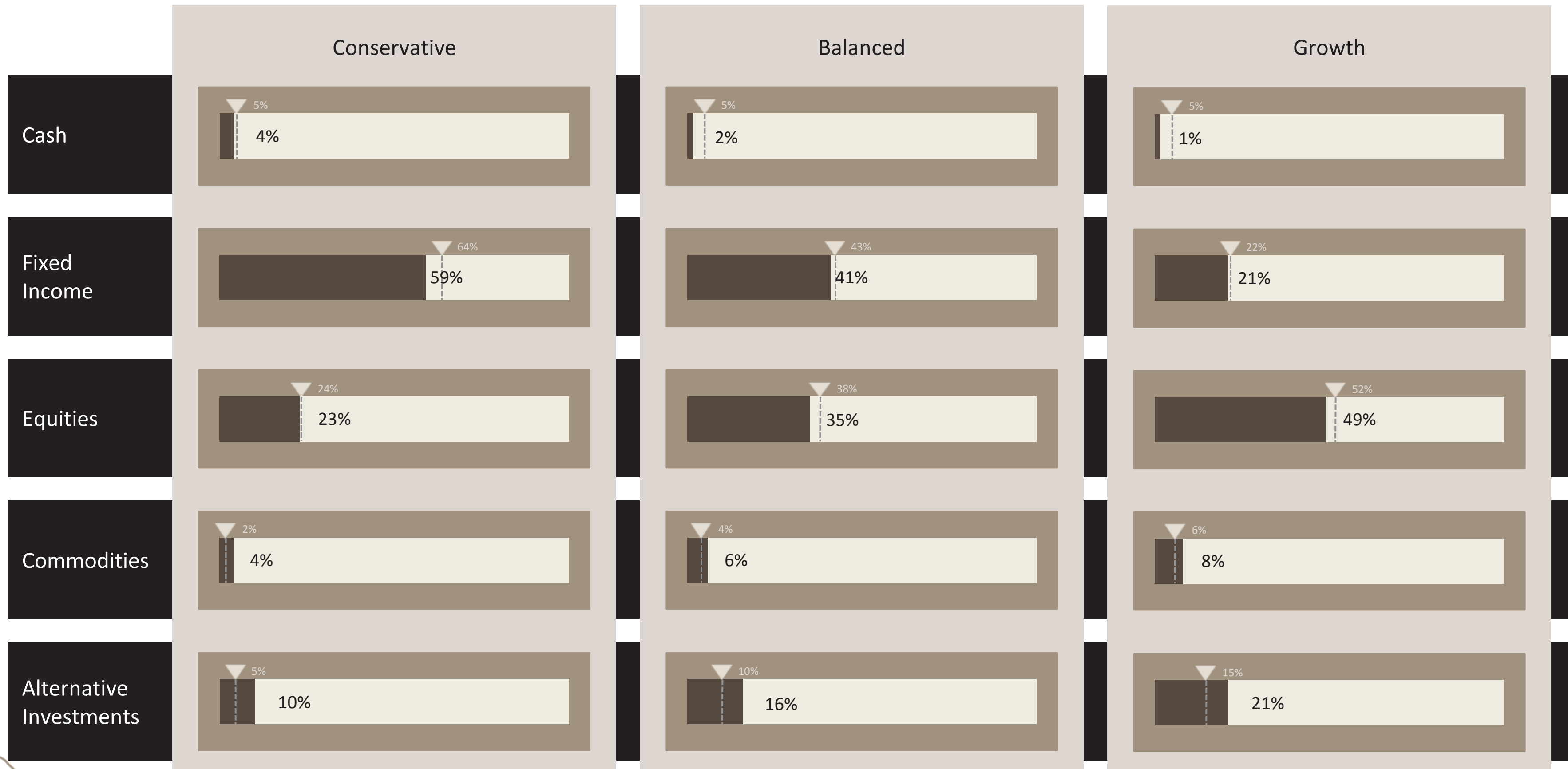
- Commodity prices have recently stabilized. Reflationary policies, and in particular a boost in infrastructure spending, will further support energy and industrial metals
- Gold and precious metals will be dependent on the relative pace of increase in both inflation and interest rates, but offer good diversification for the portfolio

Alternative Investments

- Alternative investments, as a source of low volatility and uncorrelated returns, are more attractive than ever in the wake of the current latent risks in the market
- However, there is always a certain degree of correlation with traditional asset classes and double digit positive returns cannot be expected in the current environment

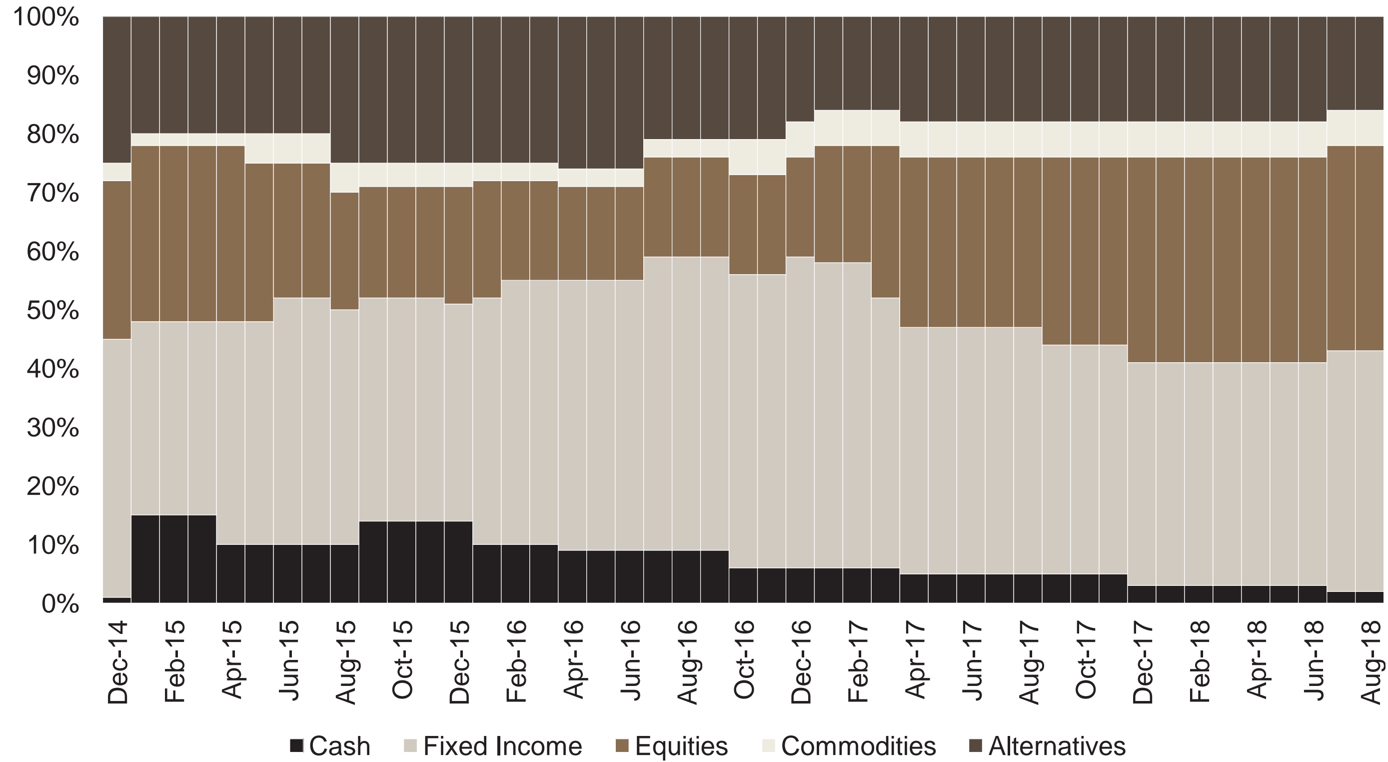
▼ Strategic Asset Allocation

EWM Investment Profiles

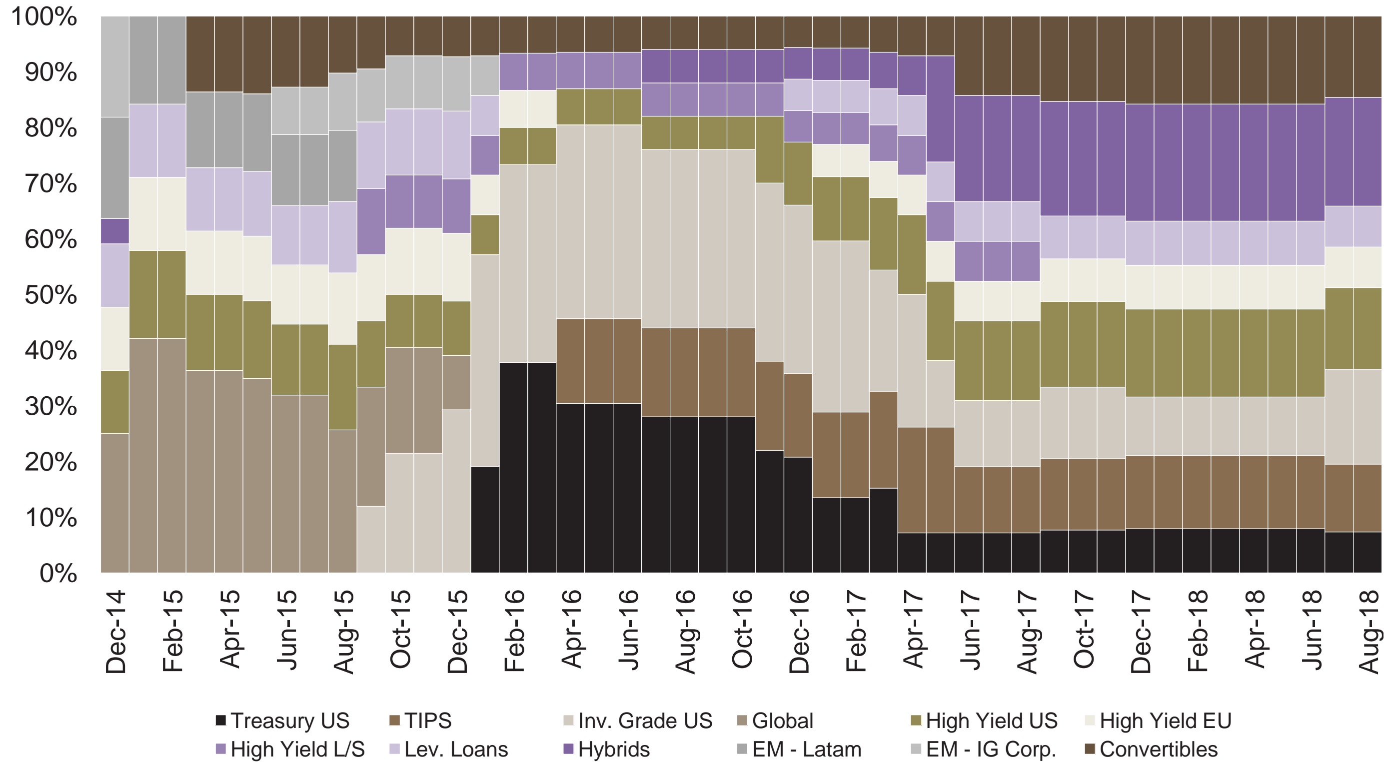


Strategic Asset Allocation

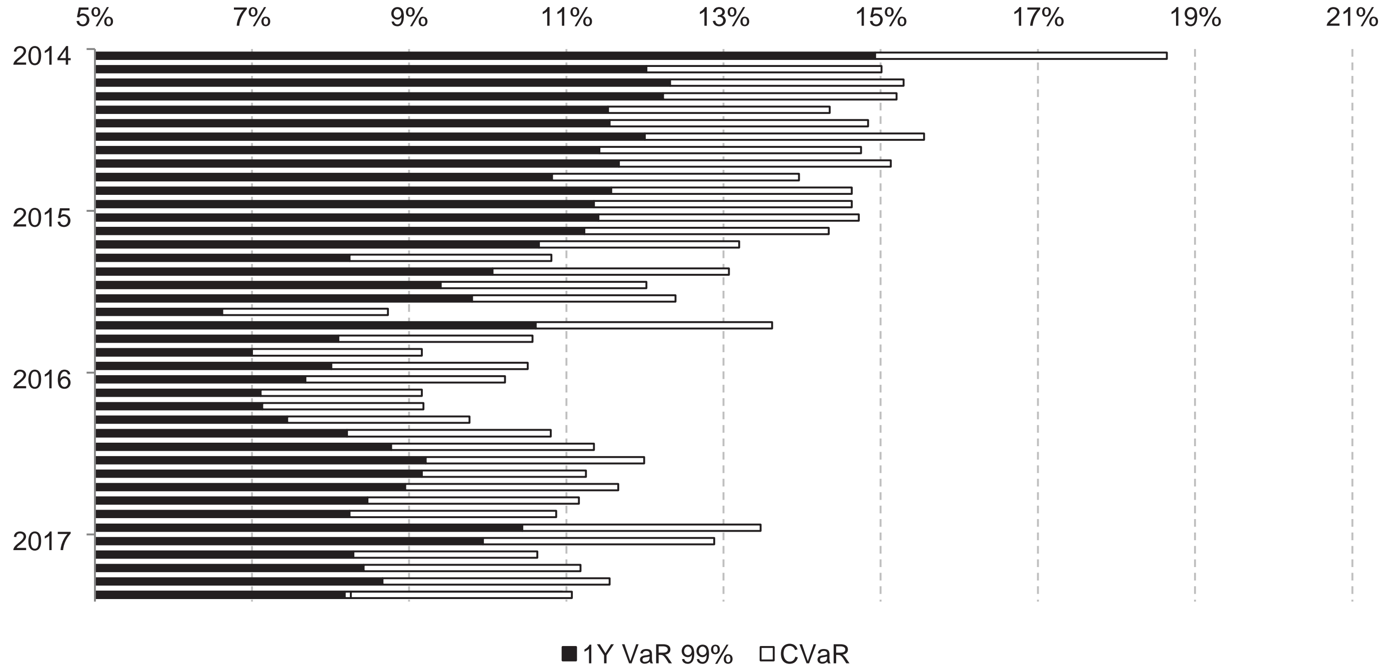
EWM Model Portfolio – Asset Allocation evolution



EWM Model Portfolio – Fixed Income evolution

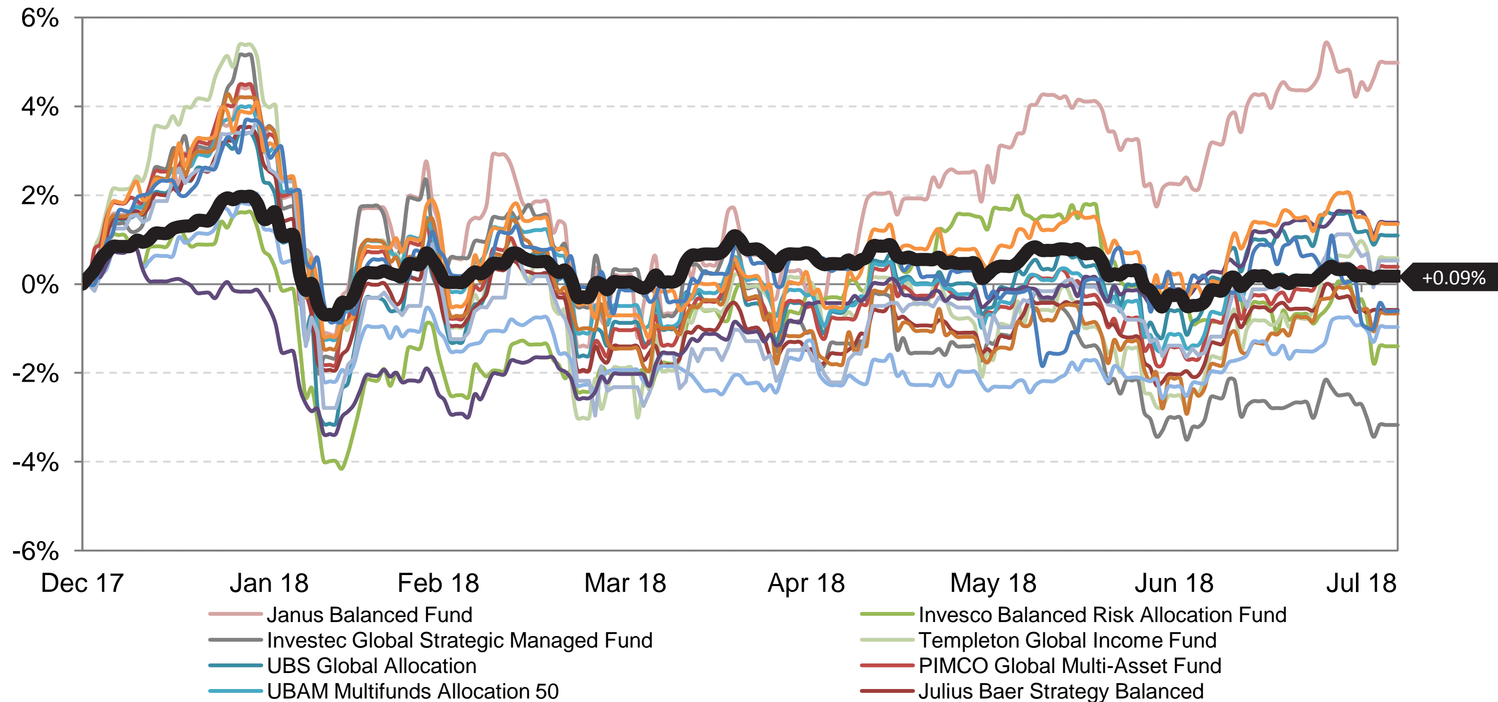


EWM Model Portfolio – VaR evolution



- The **VaR** of the portfolio remains contained, despite the recent rise in volatility, reflecting the conservative positioning of our portfolio

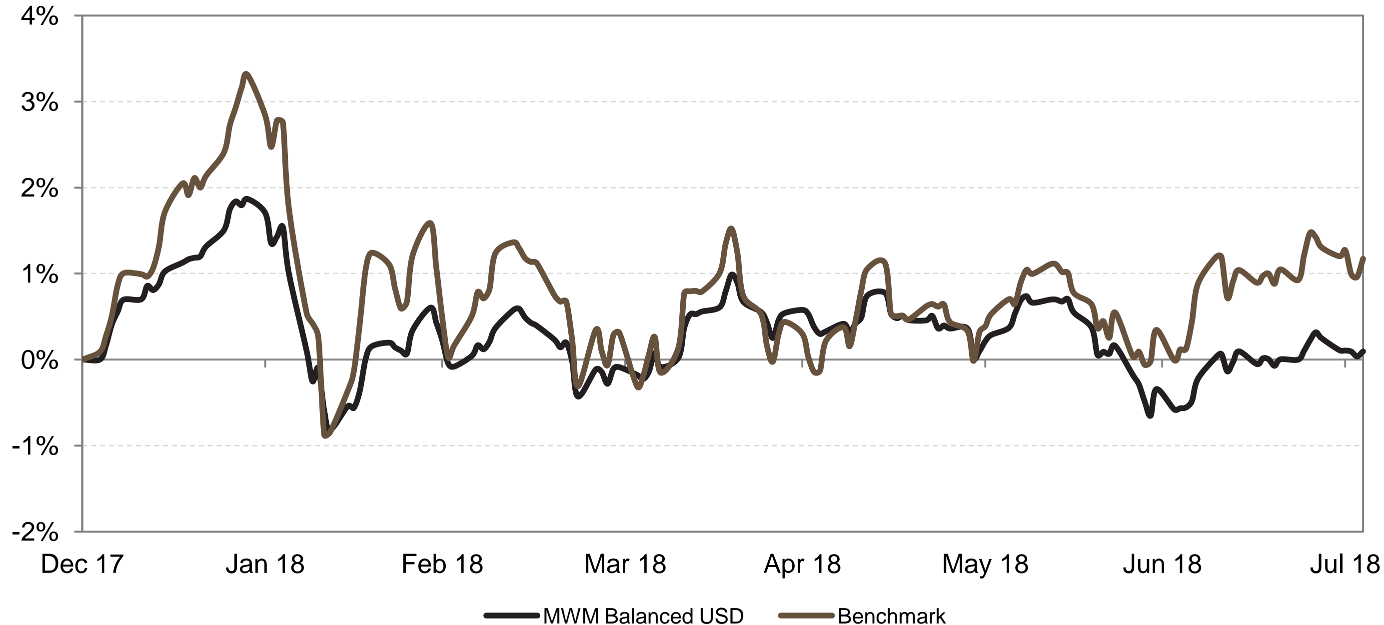
EWM Model Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **8th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **1st out of 15**
- **Sharp Ratio** (1 year[1]): **8th out of 15**

[1] As of August 6, 2018
Source: Bloomberg

EWM Model Portfolio – Ytd performance

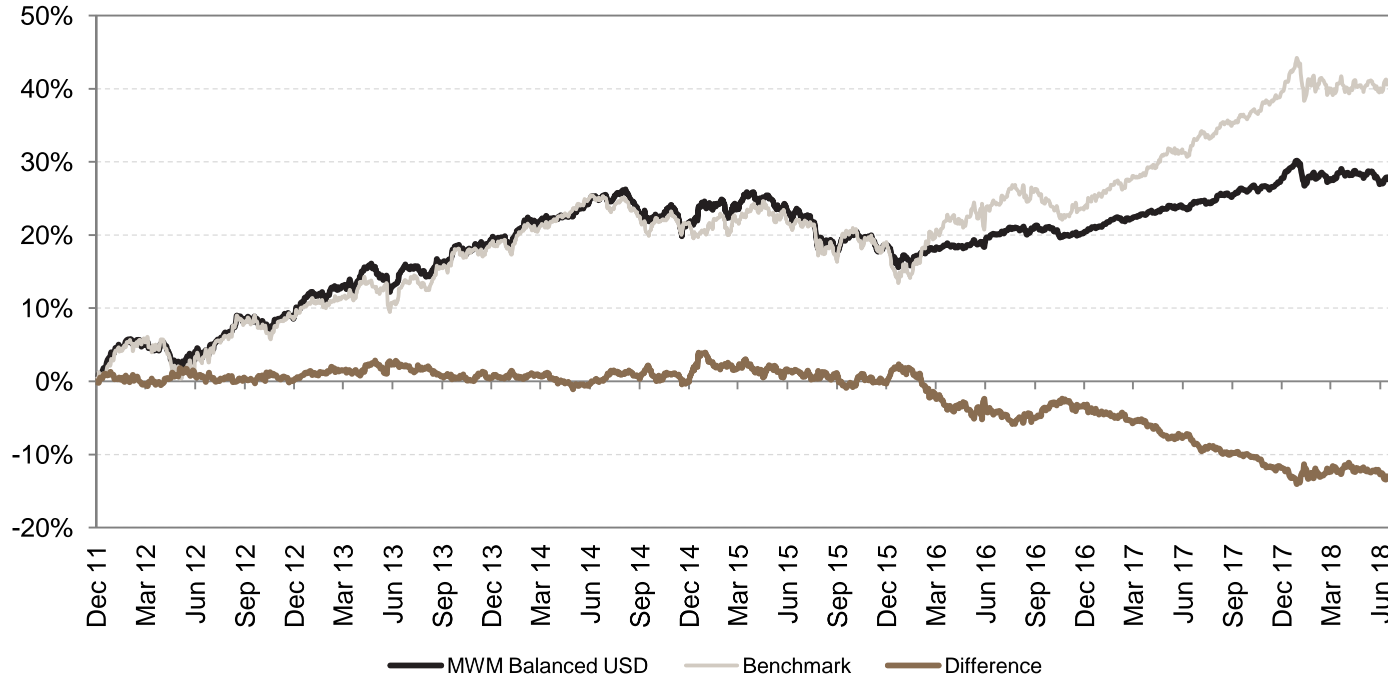


- **Total Return** (Ytd[1]): **0.09%** vs. **1.17%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **2.86%** vs. **4.95%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.26%** vs. **3.85%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **-0.54** vs. **0.07** Benchmark[2]

[1] As of August 6, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

EWM Model Portfolio – Historical performance (1)

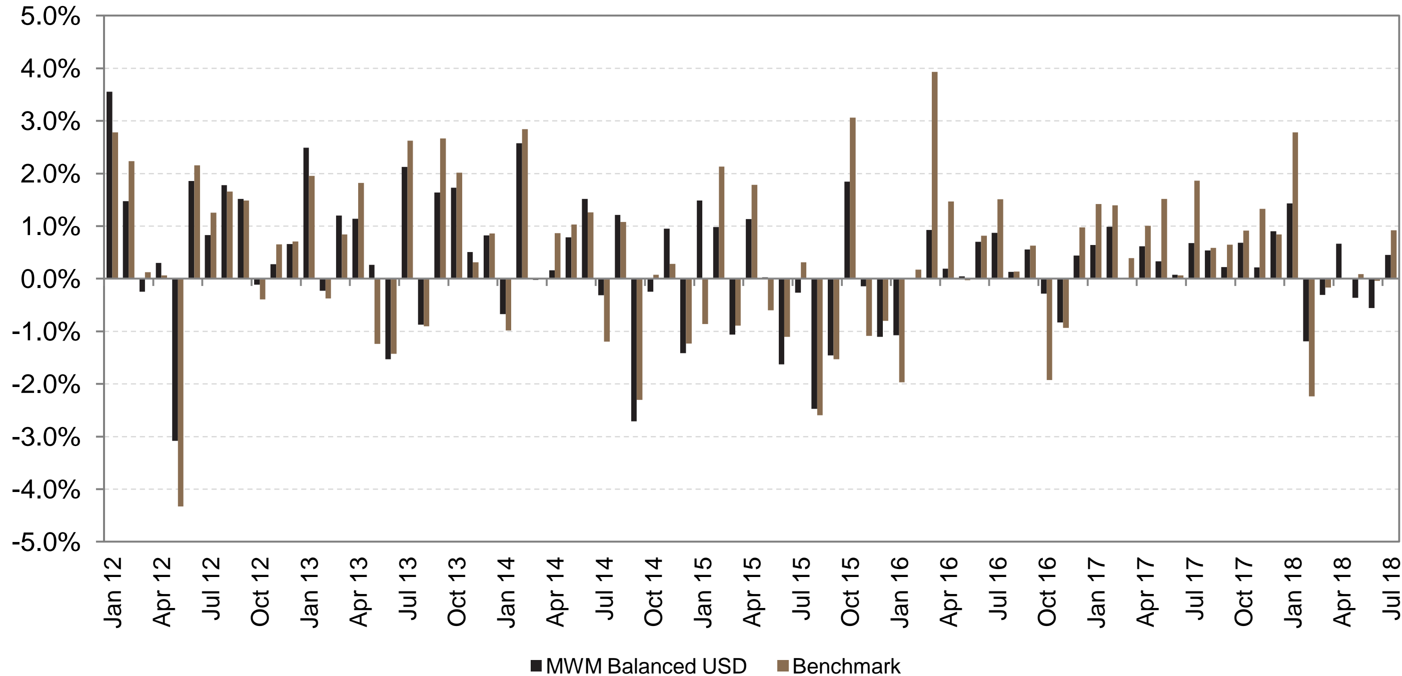


- **Total Return** (1 year[1]): **2.61%** vs. **5.23%** Benchmark[2]
- **Total Return** (3 year[1]): **4.33%** vs. **16.03%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **27.89%** vs. **41.22%** Benchmark[2]

[1] As of August 6, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

EWM Model Portfolio – Historical performance (2)



- **Standard Deviation** (1 year[1]): **2.44%** vs. **4.14%** Benchmark[2]
- **Downside Risk** (1 year[1]): **1.90%** vs. **3.22%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **0.47** vs. **0.92** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.22%** vs. **-0.44%** Benchmark[2]

[1] As of August 6, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

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