Edwards Wealth Management AG
Switzerland

MORA wealth management

Investment Policy

February 2019

Our market view in a nutshell – February 2019

- As the dust settles after the end of the year panic, both **macroeconomic data and corporate profits are bringing calm back to financial markets**. A more **constructive US administration** is also contributing to this normalization, having understood that the patience of the market is limited when it comes to disputes that are detrimental to economic growth, such as the government shutdown or the trade dispute

- If we avoid a policy accident, and with the **Federal Reserve on hold** as long as inflationary pressures remain contained, we are **returning to the "Goldilocks" scenario**. This would be an **environment conducive to risk assets**, particularly for stocks, since valuations now seem relatively attractive

- The same cannot be said for bonds, since the **term premium hardly** exists. This is the result of (yet another) **expectations mismatch between the Fed** – **which sees robust growth** – **and bond markets** – that seem to be pricing a slowdown. If the latter does not happen, the bond market could be ready for a painful correction

- As investors, **we should not be overly concerned about recessions**. After all, when price increases are accounted for, economic growth has been almost uninterrupted over the last century. The end of a cycle is just the beginning of the next, and what matters is to **be invested in companies that can withstand them**

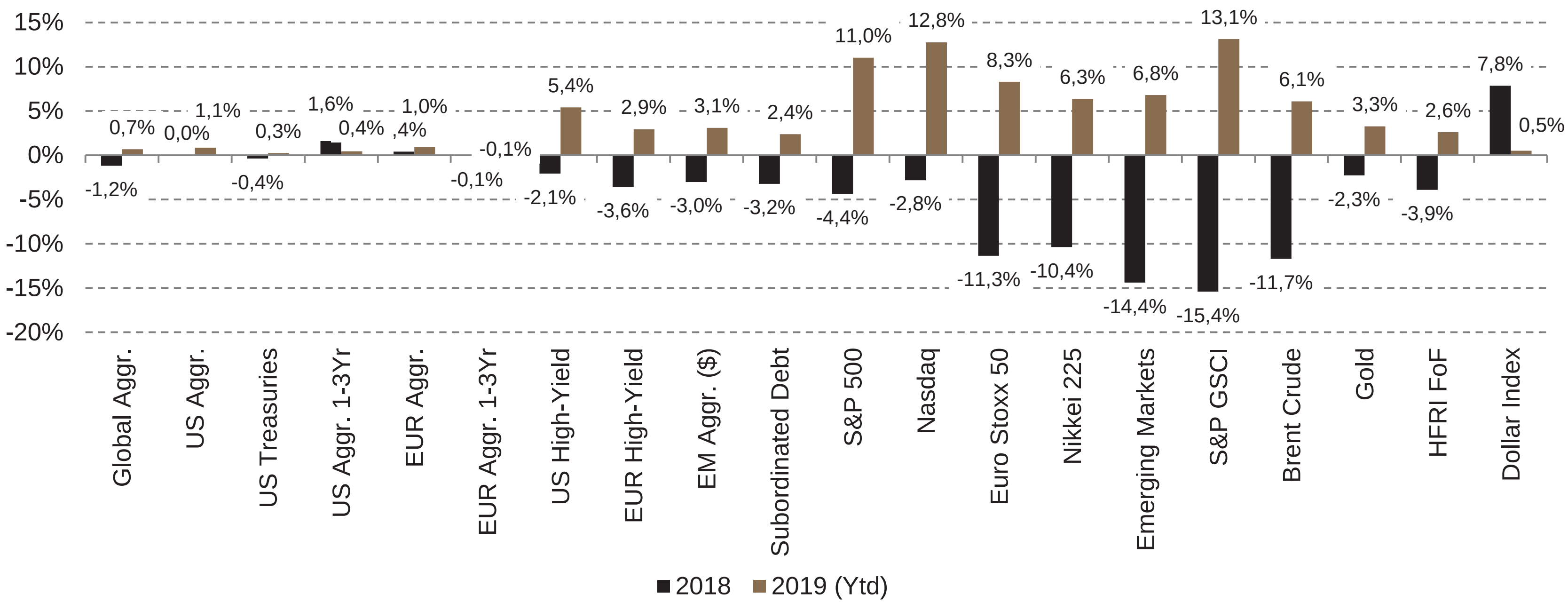
- When it comes to **risks for the global economy**, we continue to perceive an economic **slowdown in China** as the largest of them; and although there is clear evidence that the rebalancing of their economy will be a long and difficult process, the **Chinese authorities still have certain levers** to stabilize their economy. As the impact of infrastructure spending on growth decreases, **fiscal and monetary stimuli** are gaining importance, which is why we expect China's expansionary policies to act once again as a stabilizer of global growth

EWM Investment Policy

Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasuries offer protection from a slowdown in growth – although this less likely with the fiscal stimulus in the US – whilst TIPS offer protection against rising inflation as a consequence of reflationary policies
	US Credit	+	Corporate debt and High Yield currently offer the best combination of risk and return. We prefer medium maturities as the yield curve has flattened considerably and there is little term premium to compensate for taking interest rate risk
	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, asset-backed securities and short-duration high yield
	Emerging Markets	=	Emerging Markets currencies and spreads have adjusted significantly to a stronger dollar and the uncertainties around global growth. With the Fed signaling being closer to the neutral rate, we deem current levels to offer fair value
Equities	US	+	After the recent market corrections, valuations have improved substantially. We have therefore increased our exposure to US equities, mostly through quality and growth oriented companies
	Europe	=	From a relative valuation perspective, we like European stocks as they trade at lower multiples, and we expect profits to pick up as economic activity accelerates
	Japan	=	Japanese stocks are the cheapest in developed markets, but have suffered recently due to sluggish growth, and concerns about global trade
	Emerging Markets	+	Emerging markets have corrected sharply since the beginning of the year affected by a strong dollar and trade concerns. We deem the correction suffered has been excessive, and continue favoring India and Frontier Markets within EM
	Sectors & Themes	+	Amongst others, we favor Biotechnology and listed Real Estate
Alternative Investments	Commodities	=	A diversified commodities allocations, further help us to increase diversification and to protect the portfolios against a scenario of rising inflation
	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
	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

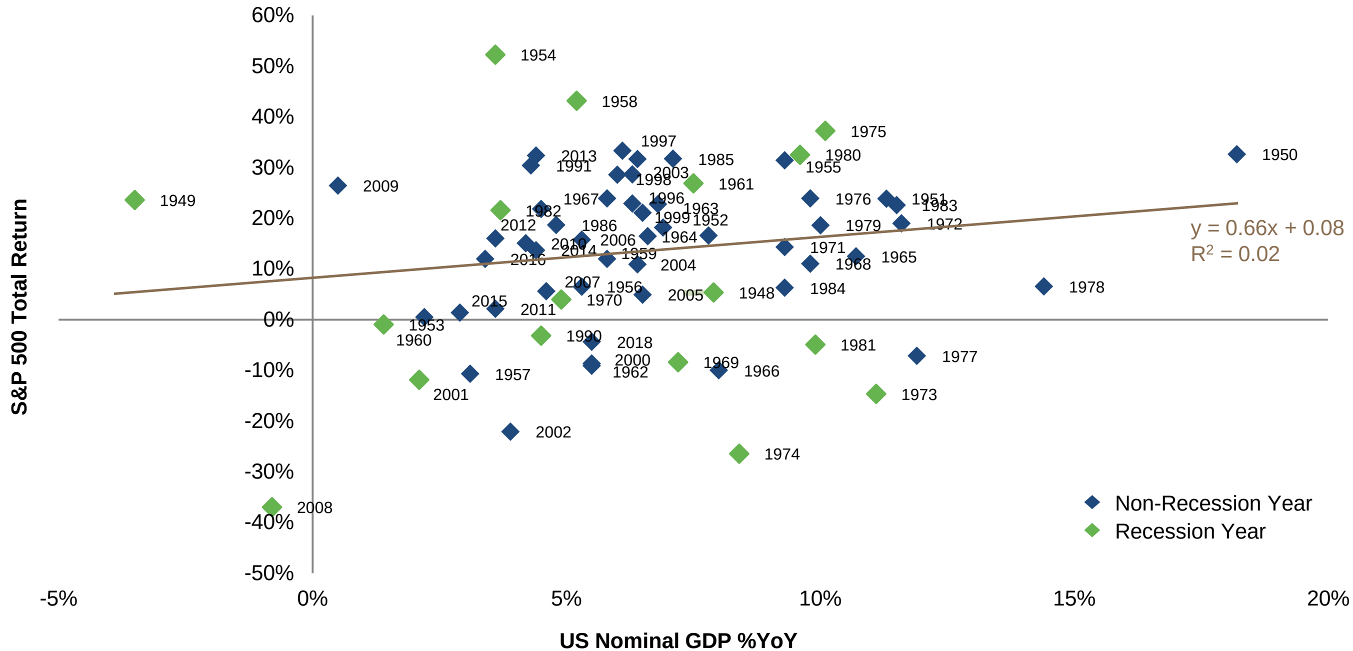
A sharp turn in market expectations



- As we have more data about the real state of the economy, it seems increasingly clear that the sharp correction in equity markets that occurred at the end of the year, was just **another incident of anomalous market behavior**, caused by thin liquidity and the increase in automated trading
- Despite the **strong recovery** experienced by risk assets at the beginning of the year, concerns about the slowdown in global growth, the trade war, and a chaotic US administration have not disappeared, and **we must remain vigilant**

Source: Bloomberg, as of February 18, 2019

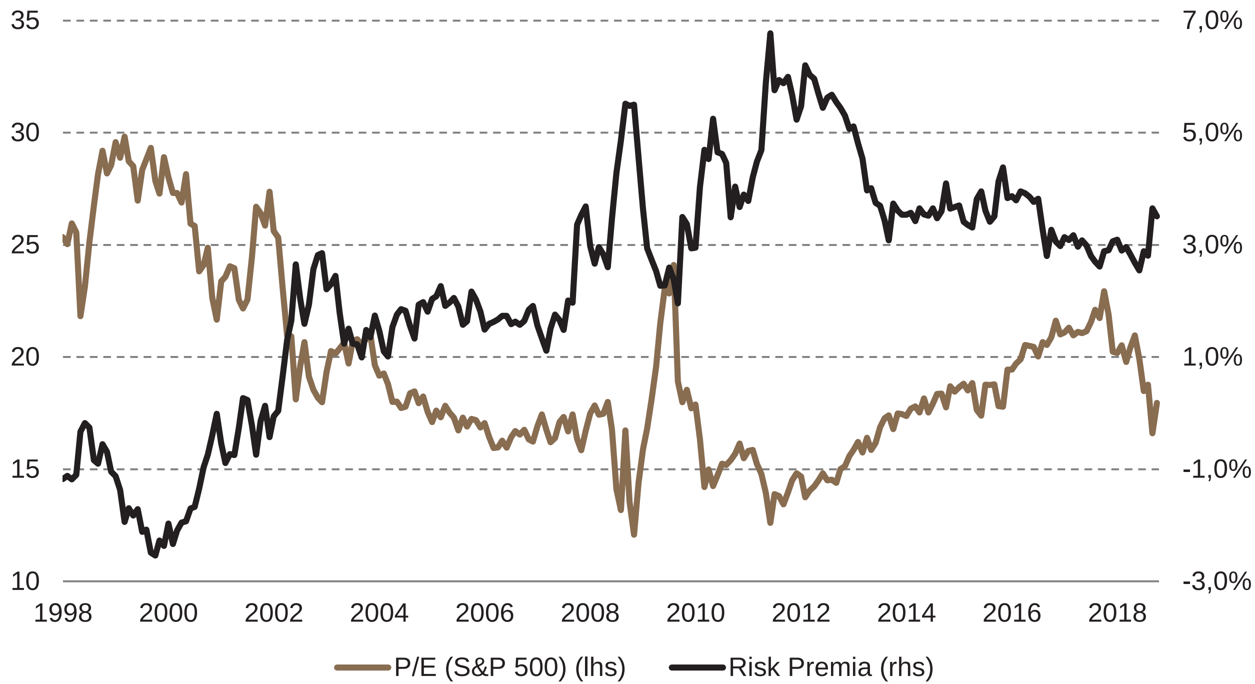
Recession obsession



- As investors, it is important to **look beyond the economic cycles**. The end of a cycle is just the beginning of the next, and during the last century there have been very few years in which the economy did not grow
- Recessions tend to be accompanied by a fall in equity markets, but they are not a sufficient or necessary condition. Therefore, we consider that it is more productive to try to **evaluate the growth that is implicitly discounted in stock prices** (i.e., whether equities are cheap or expensive) instead of trying to anticipate the next recession

Source: Bloomberg

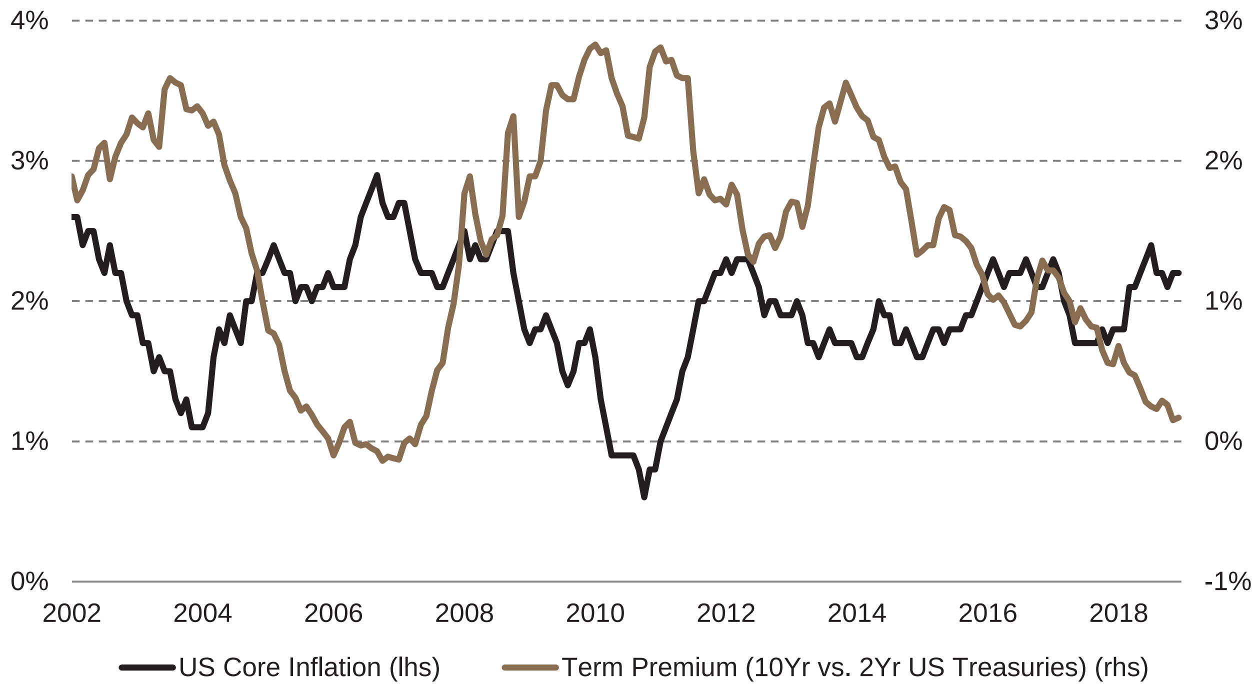
Valuations and risk permium provide a cushion



- In fact, when looking at valuations, **US equities seem to be fairly valued, or even cheap**. This is the result of falling equity prices in a context of widespread increases in corporate earnings
- Moreover, if we normalize P/Es taking into account the level of interest rates, **current valuations provide a decent cushion against a slowdown** in corporate earnings

Source: Bloomberg

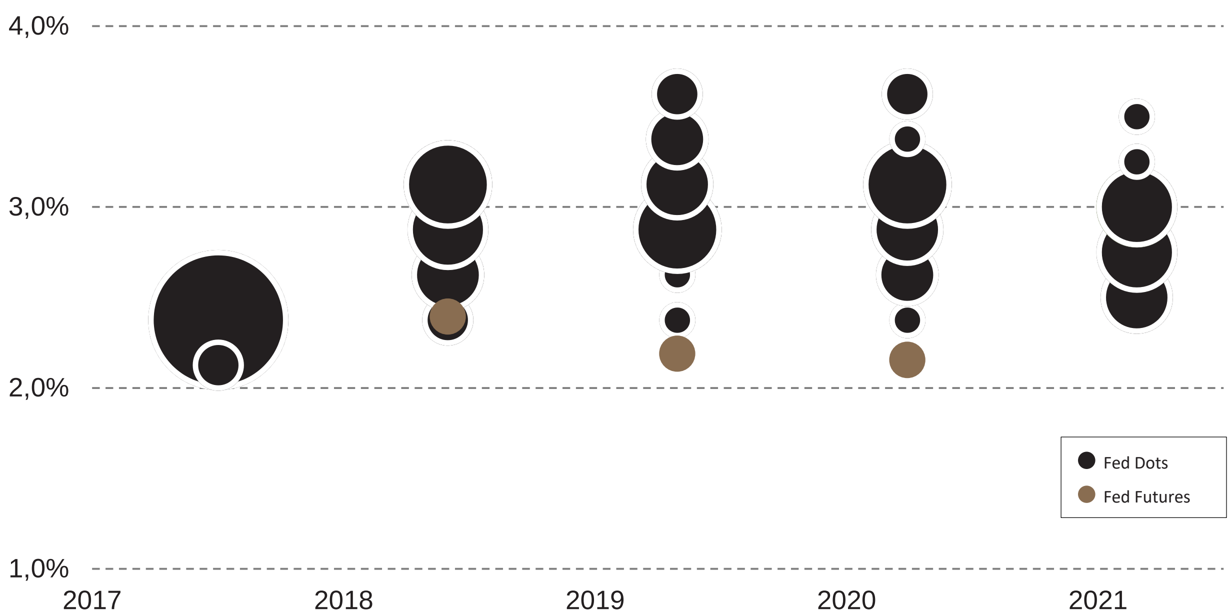
Term premium speaks potential trouble for bonds



- Conversely, **bonds seem less and less attractive**, with an **insufficient term premium** offered for holding longer maturities
- With inflation stable around the 2% Fed's target, **a flat yield curve poses a risk of a sharp re-pricing** in long-term interest rates, should there be no slowdown in economic activity

Source: Bloomberg

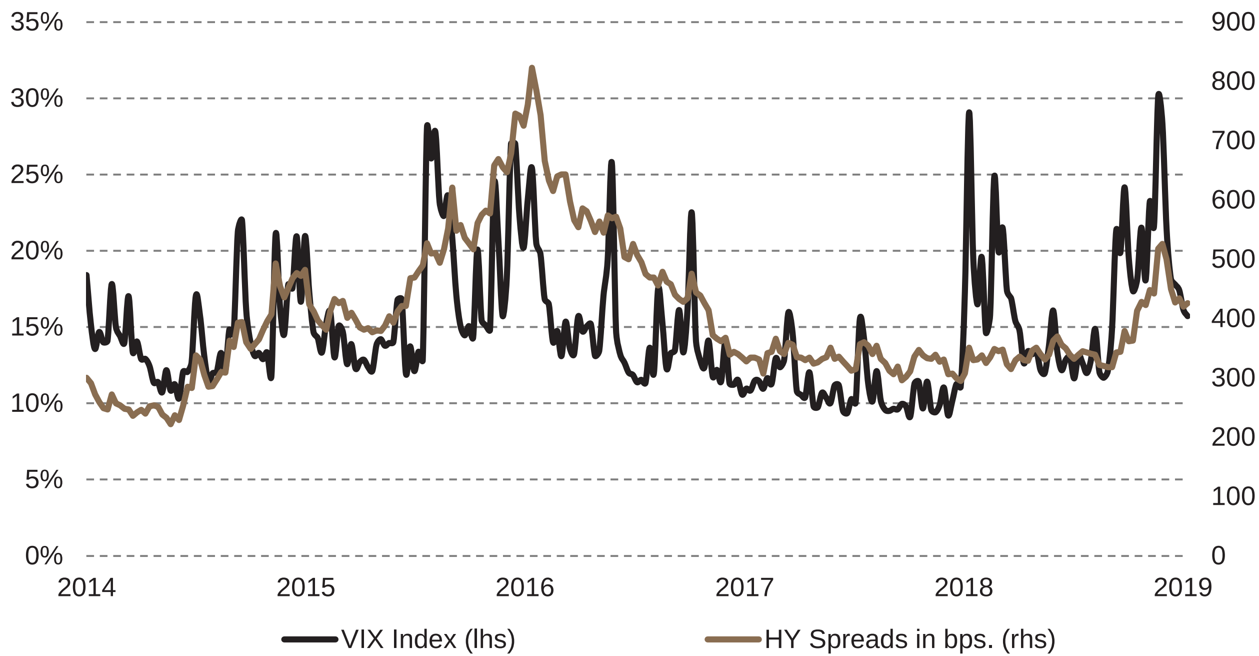
The Fed and the markets see things differently



- The current **gap in interest rate expectations** between the Fed and the markets can have several explanations; the Fed might have **tightened above the neutral rate**, or the **market could have overestimated the likelihood of a recession**
- On previous occasions, the market has been right, or alternatively, the Fed has accommodated itself to market consensus. However, we see a **very asymmetric risk in following the market** and we continue to recommend short durations

Source: Bloomberg

Back to the «goldilocks»?



- The **normalization of spreads and volatility**, together with a **patient Fed and contained inflation**, can bring us back to the **"Goldilocks"** scenario, in which the economy continues to grow at a moderate pace without overheating
- This would be a **favorable environment for risk assets**. Hence our decision not to reduce risk despite the recent correction of the market

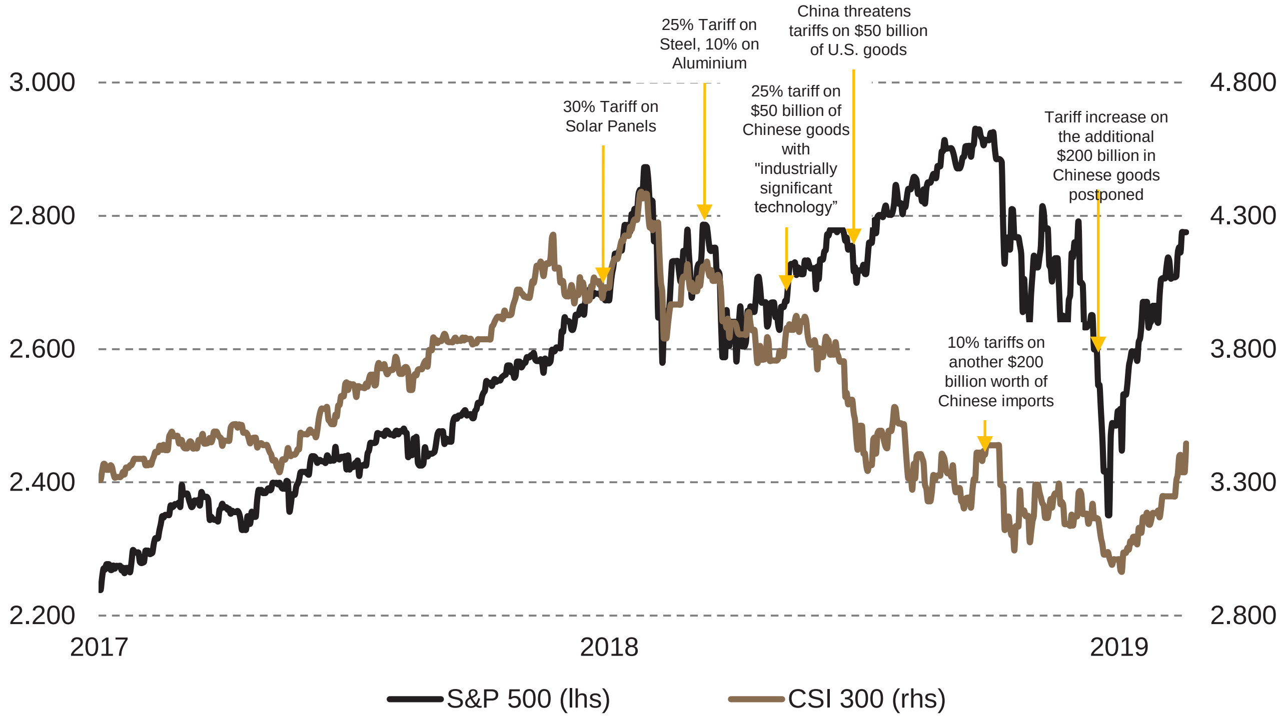
Source: Bloomberg

China’s economic rebalancing will take time

- From a macroeconomic perspective, China continues posing the single largest risk to the global economy. With the **impulse of 2015-16 fading**, it is apparent now that the **rebalancing of its economy will be a multi-decade process**
- As the **room for maneuver to stimulate the economy decreases** through spending on infrastructure, the Chinese authorities are launching **fiscal and monetary stimuli**

Source: Bloomberg

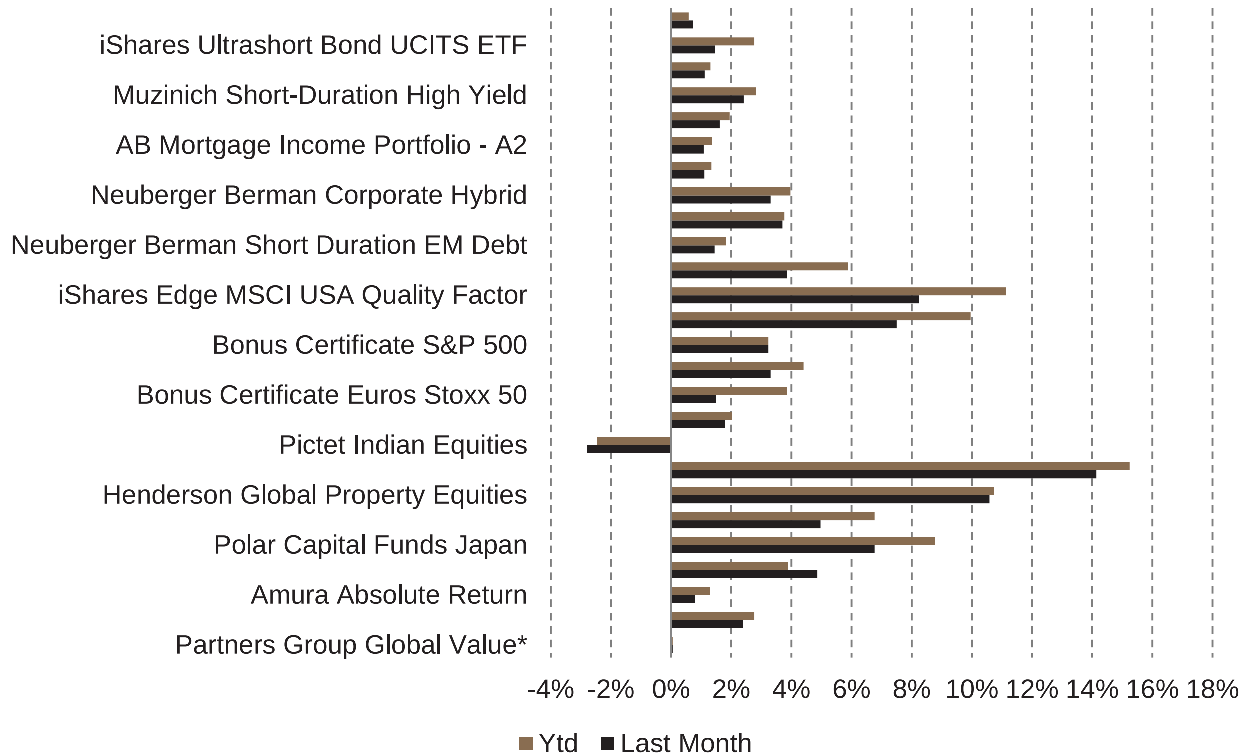
Trade war no longer looks so easy to win



- The US administration was **emboldened by the initial market reaction to the trade sanctions** on China. If the trade war was conceived as a "game of chicken", the new highs in US stock indices and the collapse in Chinese stocks seemed to indicate that there was a clear winner
- However, the strong correction in December, motivated mainly by the impact that trade tensions may have on growth, has served as a **timely reminder that trade is not a zero-sum game**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg ,as of January 1, 2019
* 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% (-10%)	40% (+10%)	25%

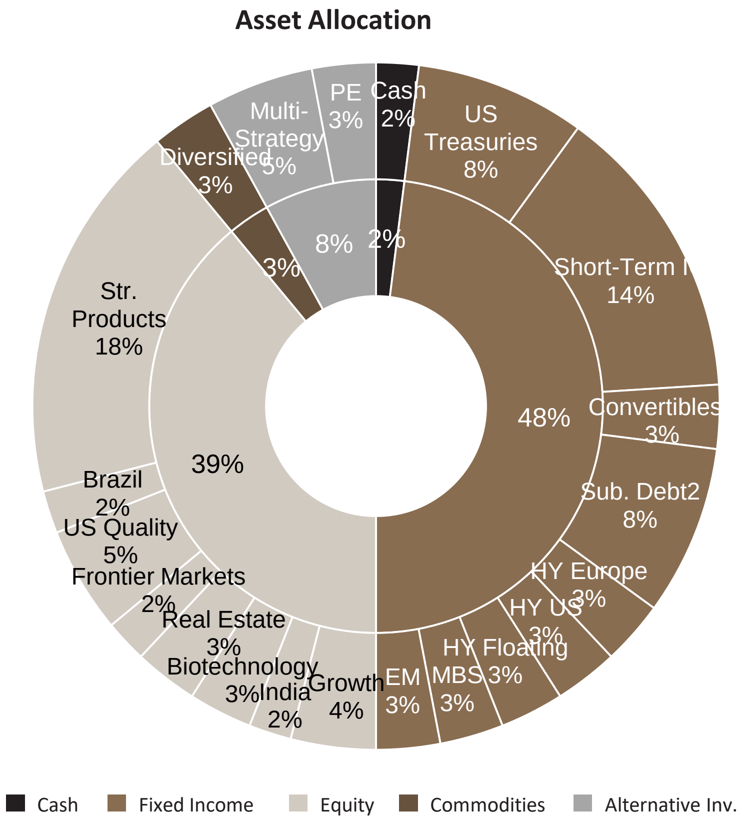
Short-term catalyzers

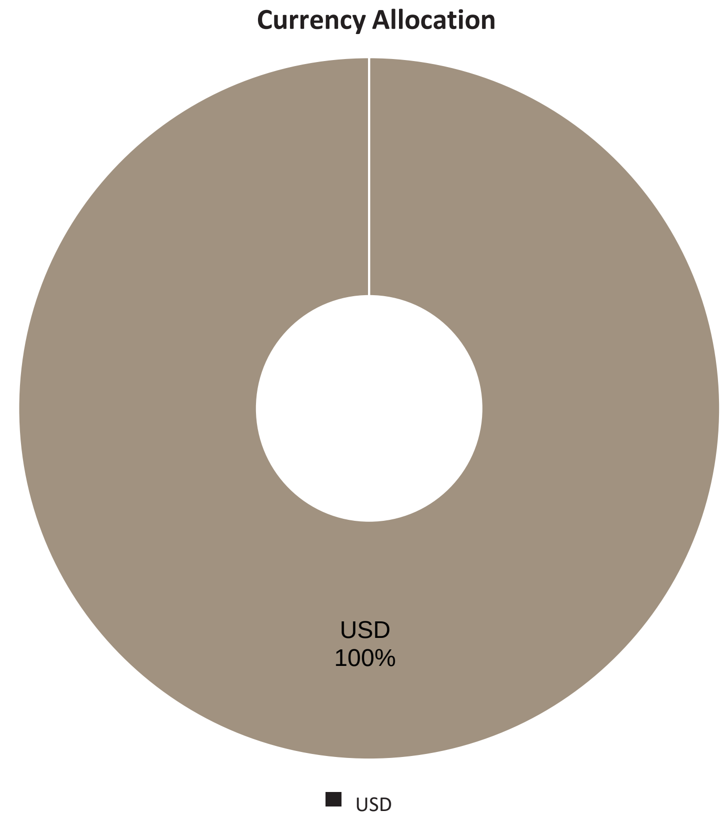
Fiscal stimulus in the US, improvement in macro-data globally, lower geopolitical tensions

Other risks

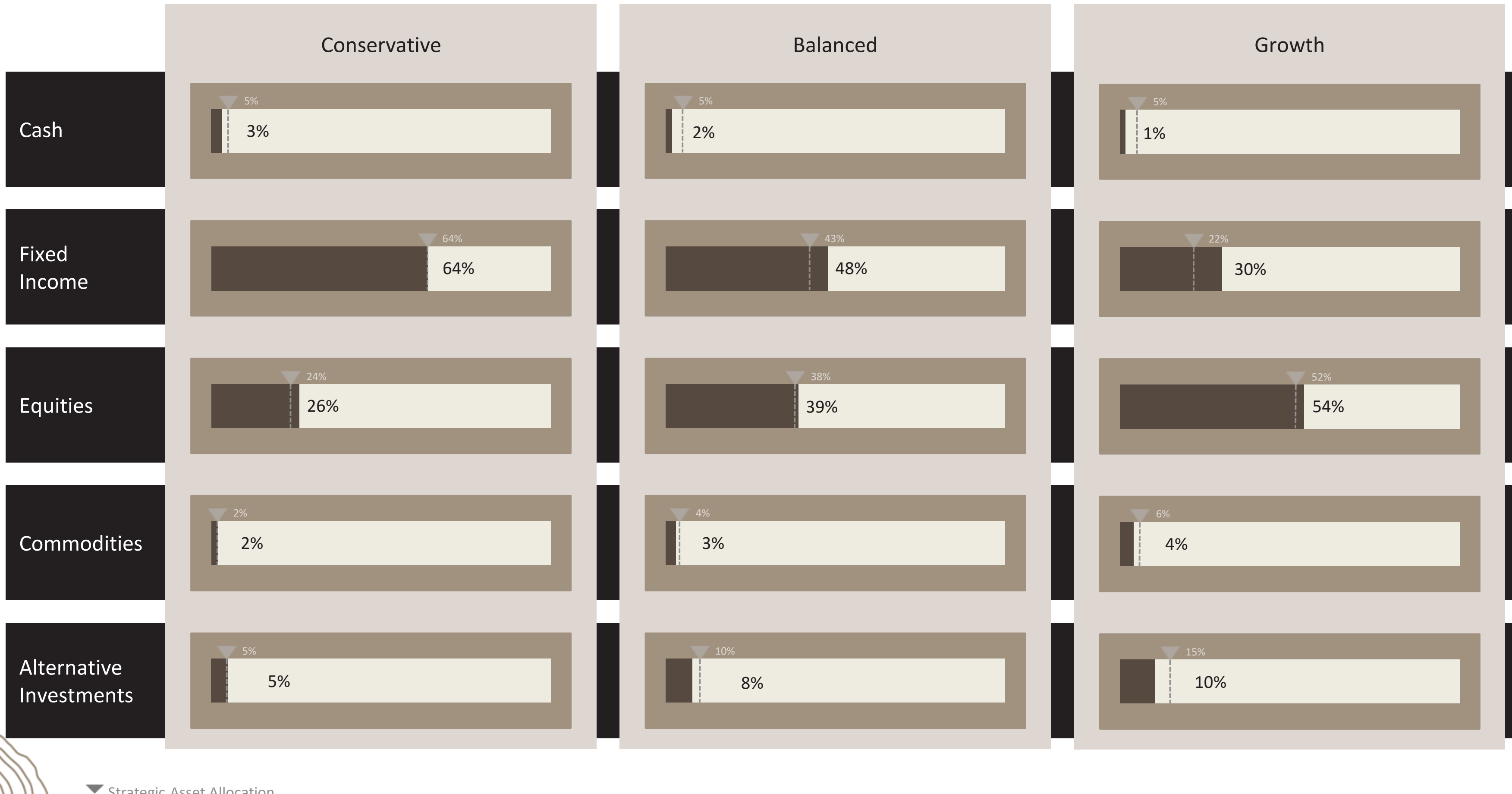
Trade wars, Spread of populist political parties, China slowdown, Terrorism

EWM Model Portfolio Balanced USD

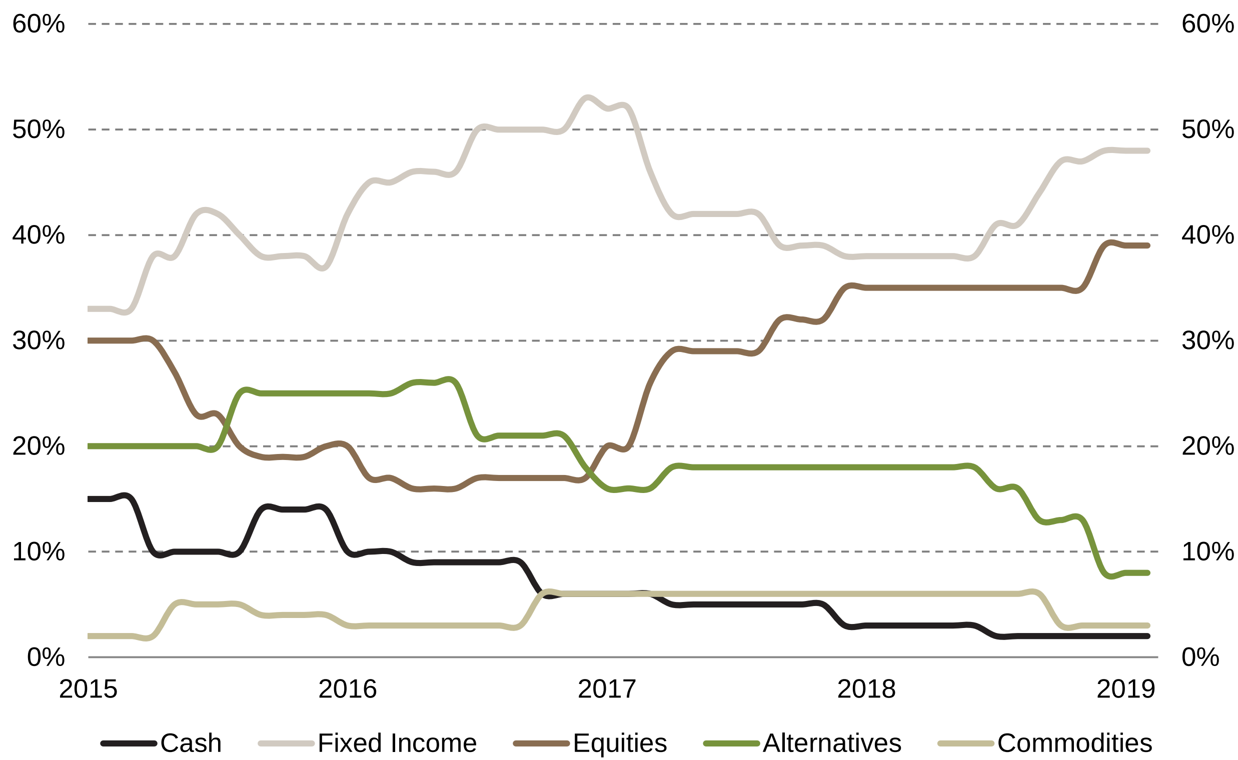




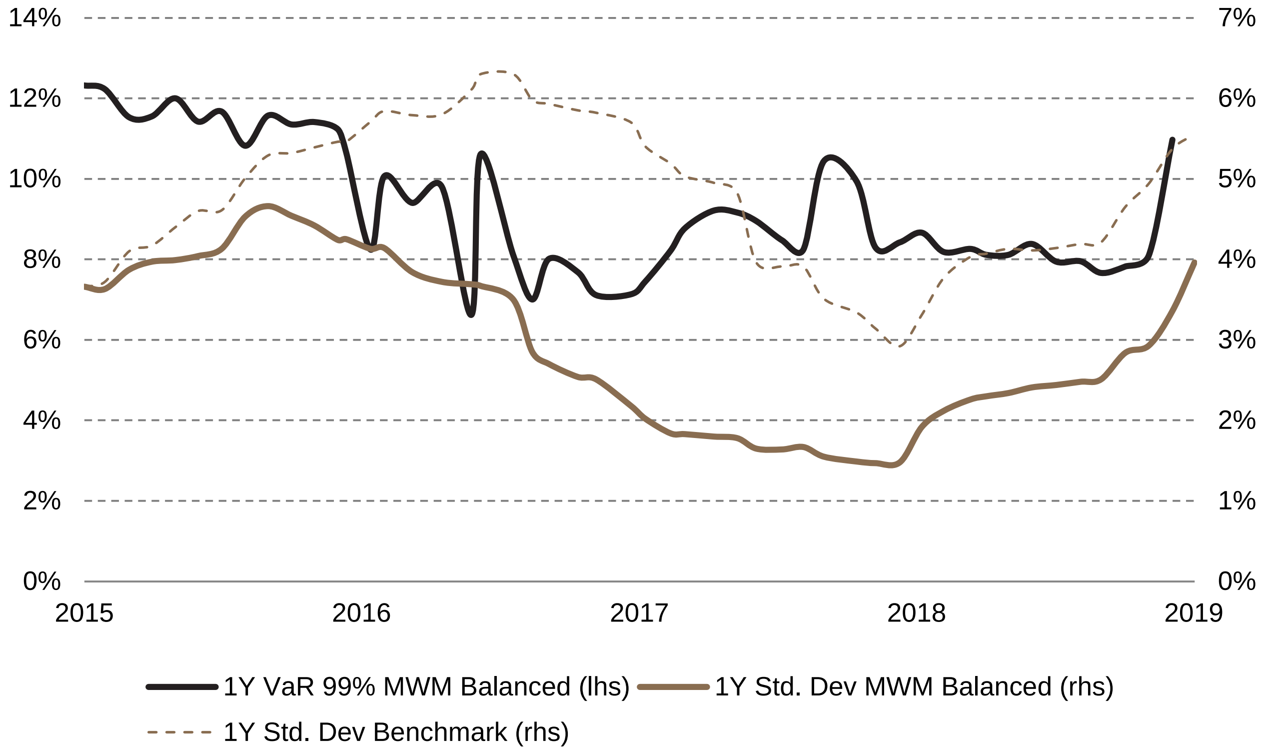
EWM Investment Profiles



EWM Model Portfolio – Asset Allocation evolution

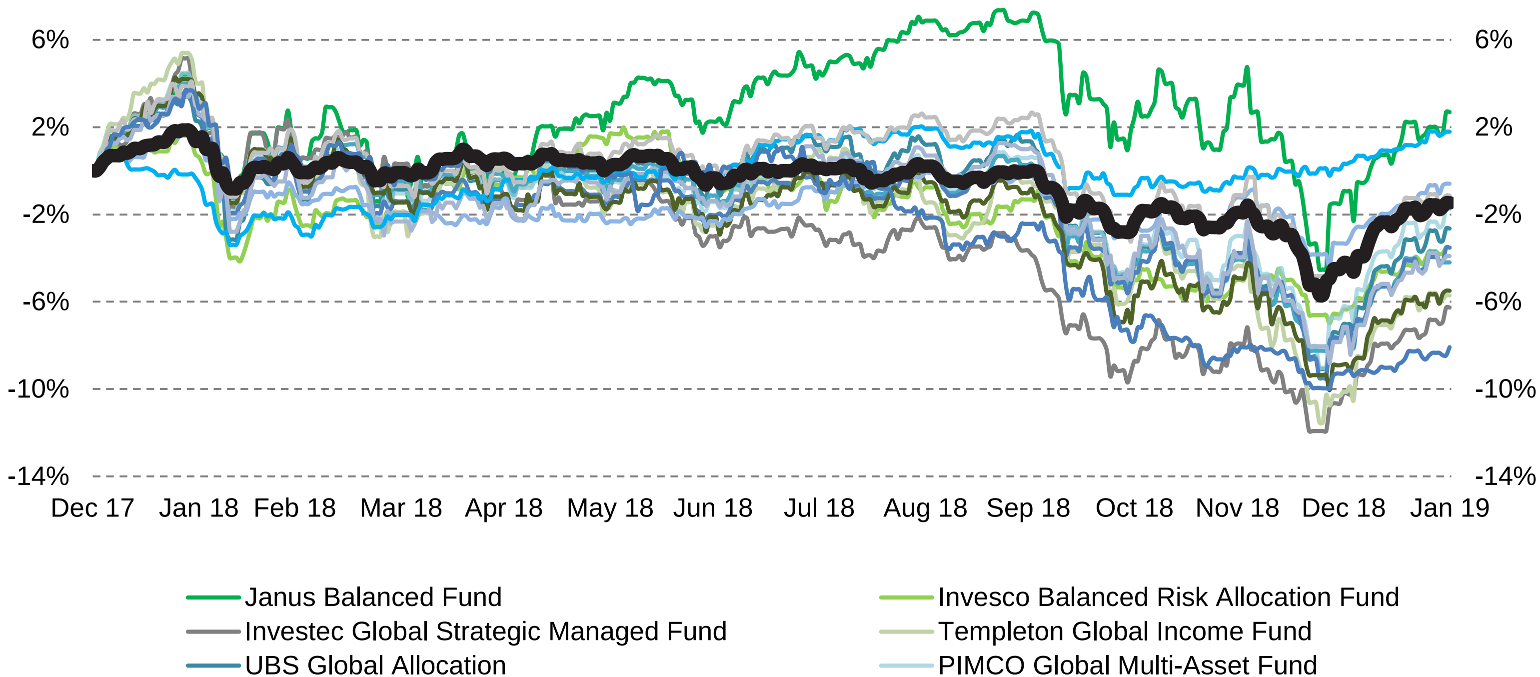


EWM Model Portfolio – VaR evolution



[1] As of January 31, 2018
Source: Bloomberg

EWM Model Portfolio – Peer comparison

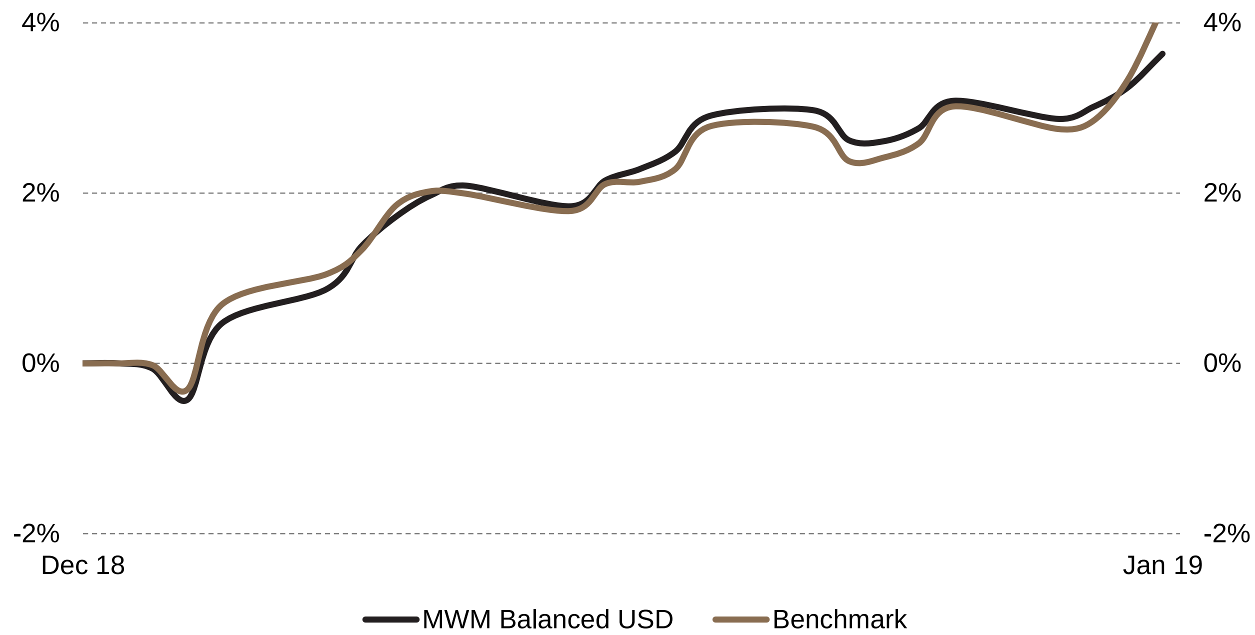


- **Total Return** (Ytd[1]): **11th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **1st out of 15**
- **Sharp Ratio** (1 year[1]): **n/a**

[1] As of January 31, 2018

Source: Bloomberg

EWM Model Portfolio – Ytd performance

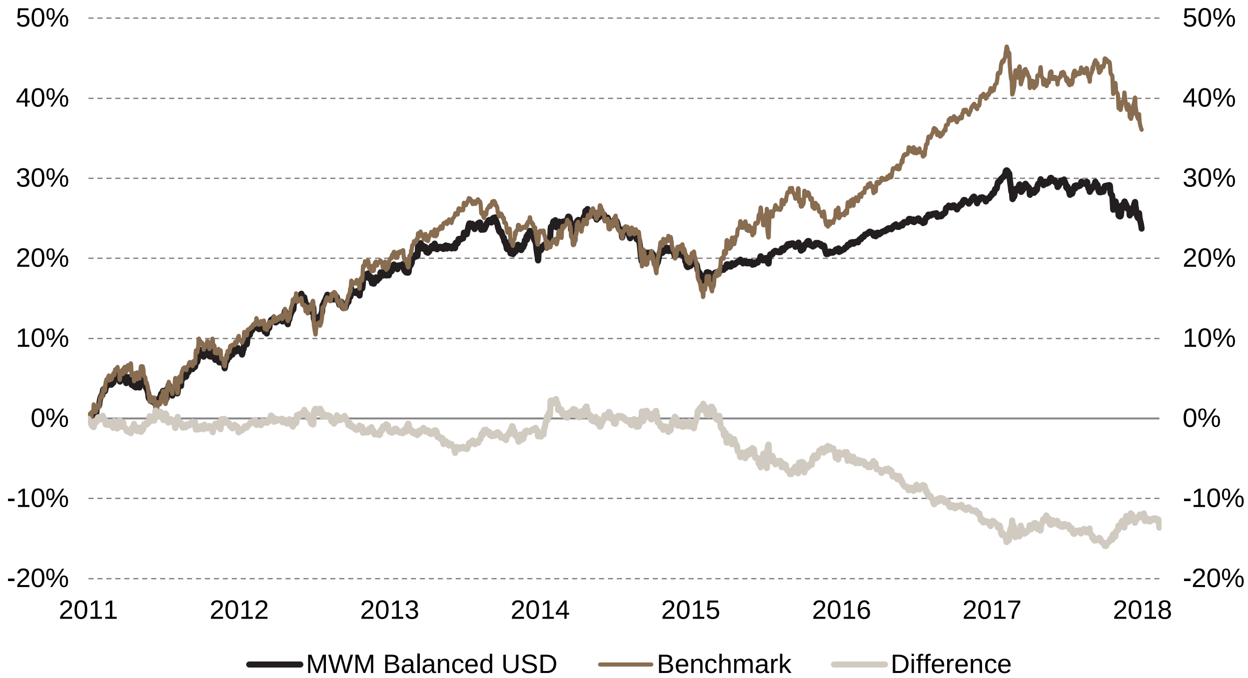


- **Total Return** (Ytd[1]): **3.19%** vs. **3.33%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **4.74%** vs. **5.18%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **3.26%** vs. **3.36%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **9.08**vs. **8.79** Benchmark[2]

[1] As of January 31, 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)

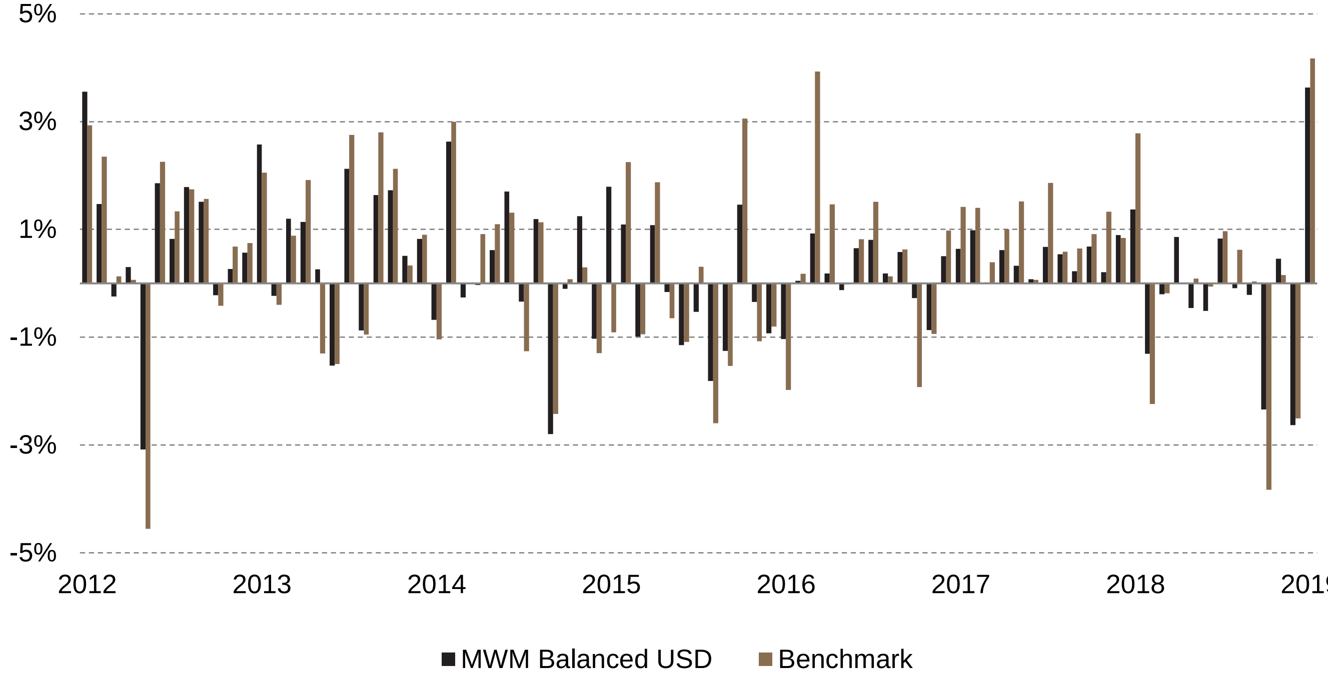


- **Total Return** (1 year[1]): **-2.44%** vs. **-3.44%** Benchmark[2]
- **Total Return** (3 year[1]): **7.58%** vs. **19.09%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **27.33%** vs. **39.07%** Benchmark[2]

[1] As of January 31, 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]): **3.94%** vs. **5.50%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.92%** vs. **4.04%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-1.12** vs. **-0.97** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.48%** vs. -**0.60%** Benchmark[2]

[1] As of January 31, 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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