Edwards Wealth Management AG
Switzerland

MORA wealth management

Investment Policy

June 2019

Our market view in a nutshell – June 2019

- In recent months we have witnessed a **deterioration in the main leading economic indicators**. This can be attributed in part to the deterioration in business and investor confidence as a result of the **stall in trade talks**, but it also reflects the gradual **withdrawal of fiscal and monetary stimuli** in the main developed economies, as well as what seems a failed effort by the Chinese authorities to revive their economy

- Currently, several indicators show an **increasing probability that the economy will enter into recession in the next 12 months**. However, we have already had "false signals" in the past, and it is too early to conclude that a recession is inevitable

- As a result, there has been a **significant drop in bond yields as well as a marked change in market expectations about future interest rates**, the latter partly motivated by the apparent readiness of the Federal Reserve to begin to cut interest rates if the economy continues to decelerate

- But as we have seen in two other occasions within the current cycle, trends do not necessarily have to continue, and **it is still too early to call a recession, particularly when looking at the hard data**. In this respect, the likely **monetary easing will provide a further impulse** that can help revert the trend

- In addition, **risk assets (equity and credit) are not pricing a recession anytime soon**, but rather a **return to the "Goldilocks"**, with low growth, low inflation and low interest rates. Should this scenario materialize, equities look more attractive than bonds from a relative value perspective

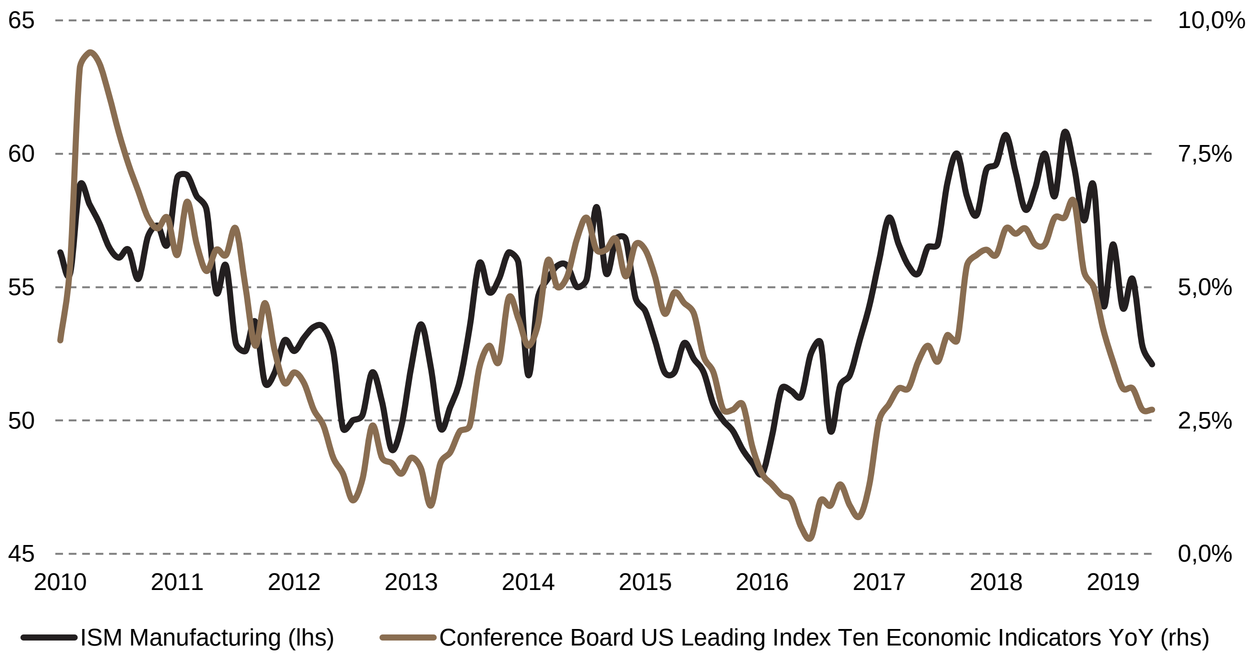
- In the current environment, **risk management in portfolios gets complicated**, since long-dated high quality bonds – the traditional portfolio hedge against a recessions – provide little upside. For this reason, we recommend to seek **protection through derivatives**, a tilt towards **quality stocks** and **high-quality bonds with short maturities**

EWM Investment Policy

Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasuries offer protection from a slowdown in growth, but we believe that current long-term yields are unattractive, preferring shorter maturities
	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 and the increase in corporate earnings, valuations have improved. 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, Frontier Markets and Brazil within EM
	Sectors & Themes	+	Amongst others, we favor Biotechnology and Healthcare
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
	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

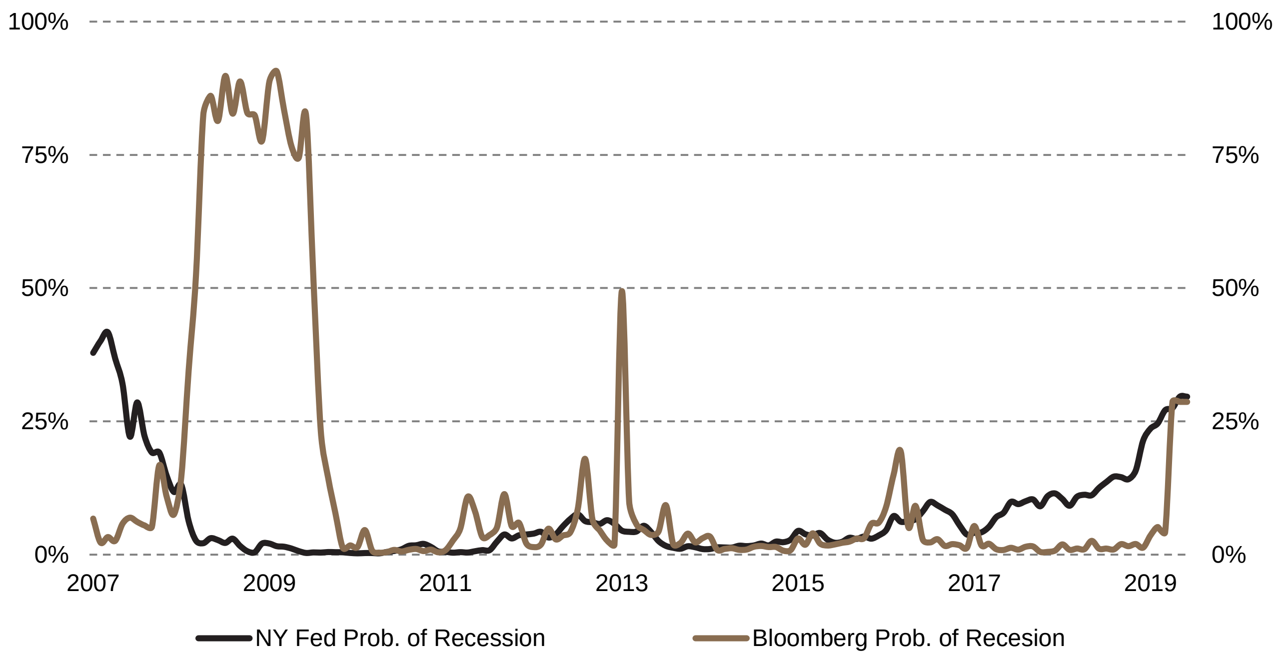
Recession fears are back



- After what seemed to be the first signs of stabilization in macro data at the beginning of the year, the **main leading indicators have resumed their downward trend**, which has generated new fears about an incoming recession
- While **the economy has recovered from similar levels in the past**, the trend is making investors nervous

Source: Bloomberg

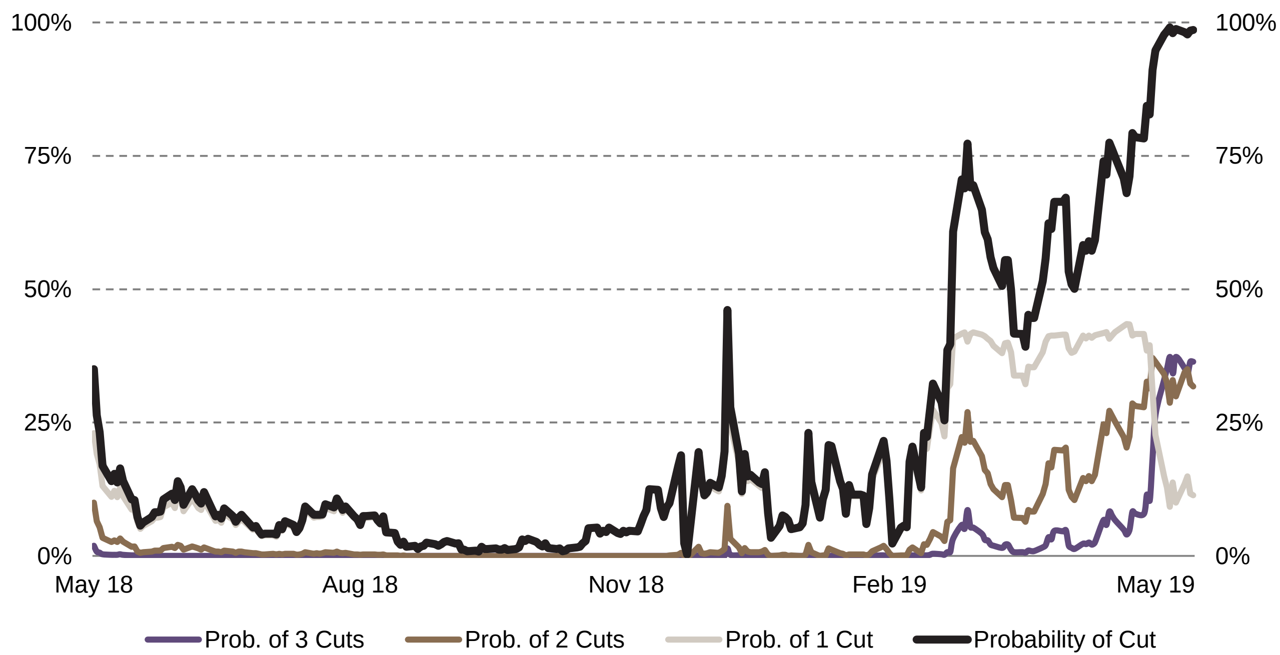
And this time is not only the shape of the yield curve



- Contrary to previous signs of recession, coming from indicators linked to the shape of the yield curve, this time we see that **broader recession indicators are also flashing red**
- Despite the above, we have had "false signals" in the past, and it is **too early to conclude that a recession is inevitable**

Source: Bloomberg

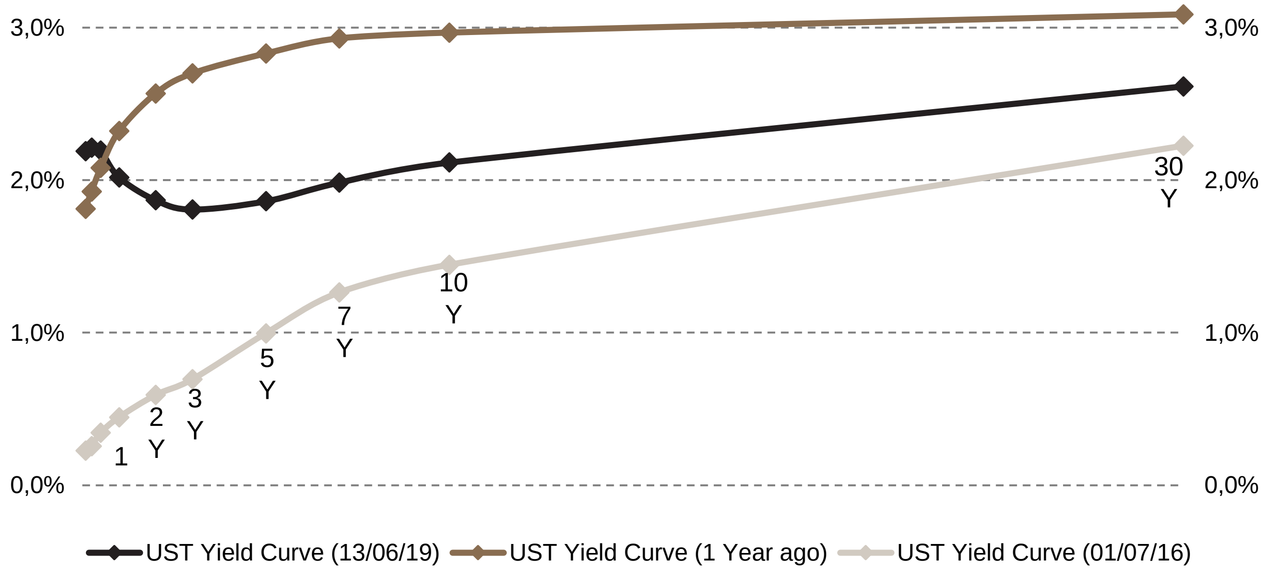
Normalization is over, monetary easing is back



- As it happened in previous episodes of uncertainty, **the Federal Reserve has come to the rescue**, indicating its willingness to cut interest rates
- This has caused a **drastic change in expectations**, with the market currently discounting 2-3 interest rates cuts by year-end

Source: Bloomberg

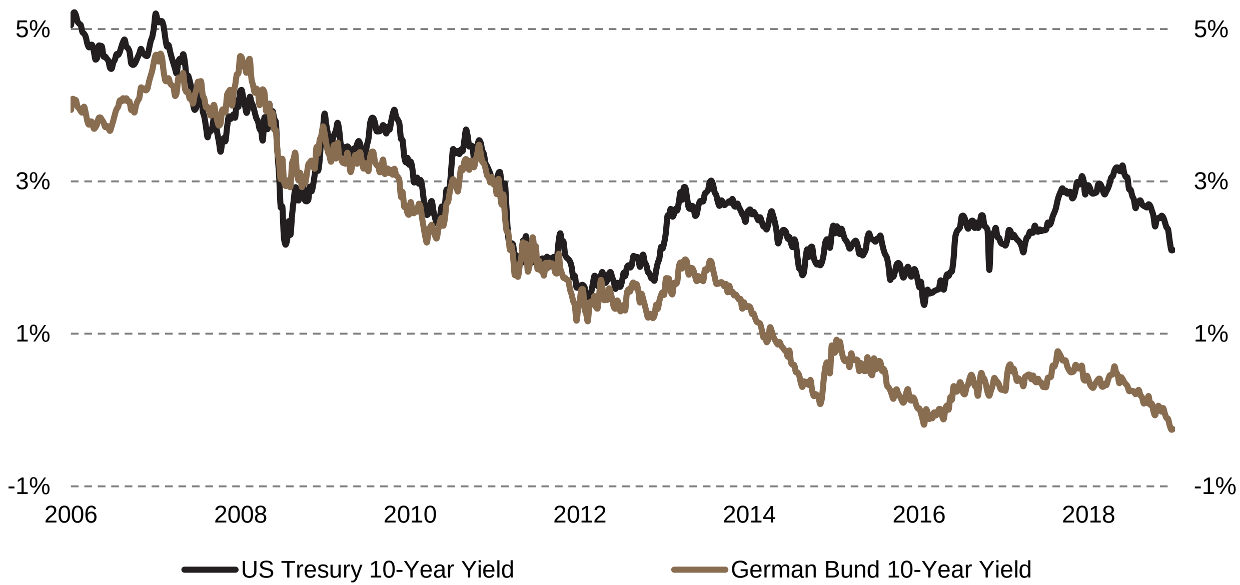
What are bond markets pricing?



- The Fed's policy **u-turn can be observed in the dramatic change in the shape of the yield curve** over the last year, from discounting further increases to a marked inversion in the short-term
- The curve has inverted over some periods, and shifted downwards in the long end, but it is **at levels consistent with a "Goldilocks" scenario**

Source: Bloomberg

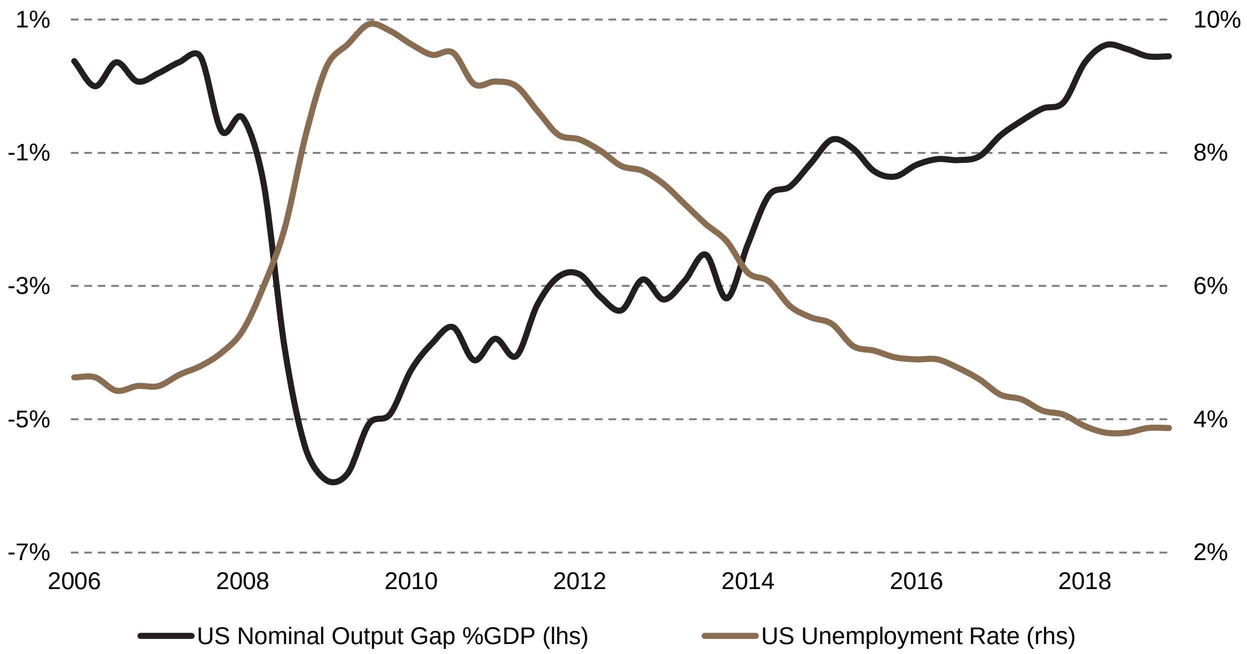
Yields are falling not just in the US



- The sharp decrease in long-term interest rates is **not just a US phenomenon**, but it has been mirrored in all major currencies
- Particularly pronounced has been the case of **Europe, where we are testing all-time lows**. The German 10-year Bund yield hit a low at -0.25%; a move that has been also felt in the periphery, with the Spanish 10-year Government Bond yielding a record low of +0.57%

Source: Bloomberg

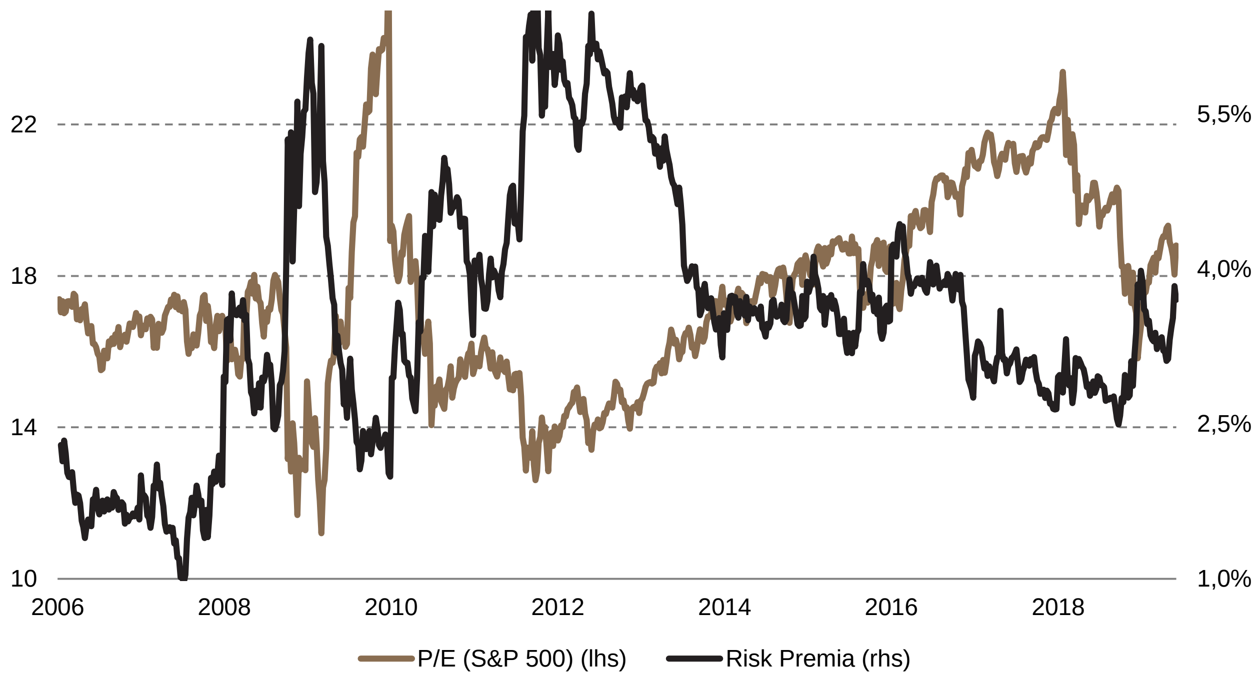
What does the «hard data» says?



- The **economy is running at full capacity** and with its own impulse. This does not necessary imply that it should decelerate, but it is more **vulnerable to the natural fluctuations in supply and demand**
- **Large fiscal and monetary impulses are behind us** (until the next recession), but **monetary easing** – or at least the end of the tightening cycle – will provide confidence to consumers and investors

Source: Bloomberg

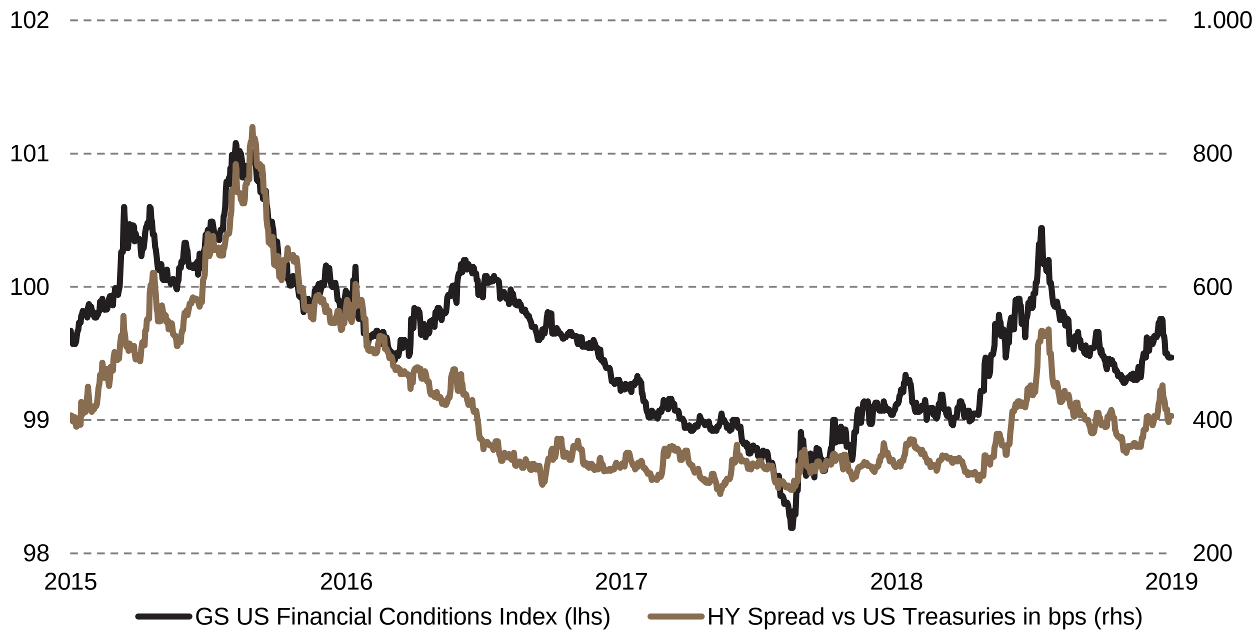
What does it mean for risk assets?



- The decrease in interest rates, and the relatively good evolution of corporate earnings have caused the **equity risk premium to increase to close to 4%, way beyond its historical average** over the last 20 years (~2%)
- This provides a good **cushion against a deceleration of earnings**, and encourages us to maintain our allocation to equities, since they are cheap from a relative value perspective

Source: Bloomberg

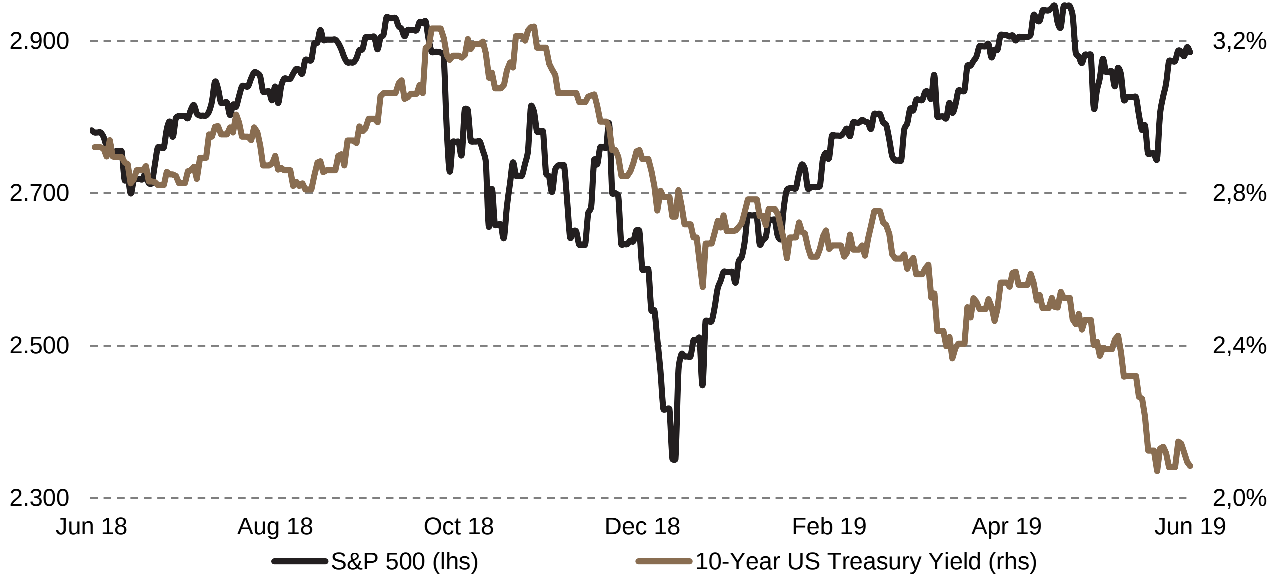
Credit markets not distressed



- **High Yield spreads** – our preferred recession indicator – continue **flashing green** despite the worsening leading indicators
- In fact, **financial conditions remain relatively accommodative** (helped by the Fed), which is **consistent with a "Goldilocks" scenario**

Source: Bloomberg

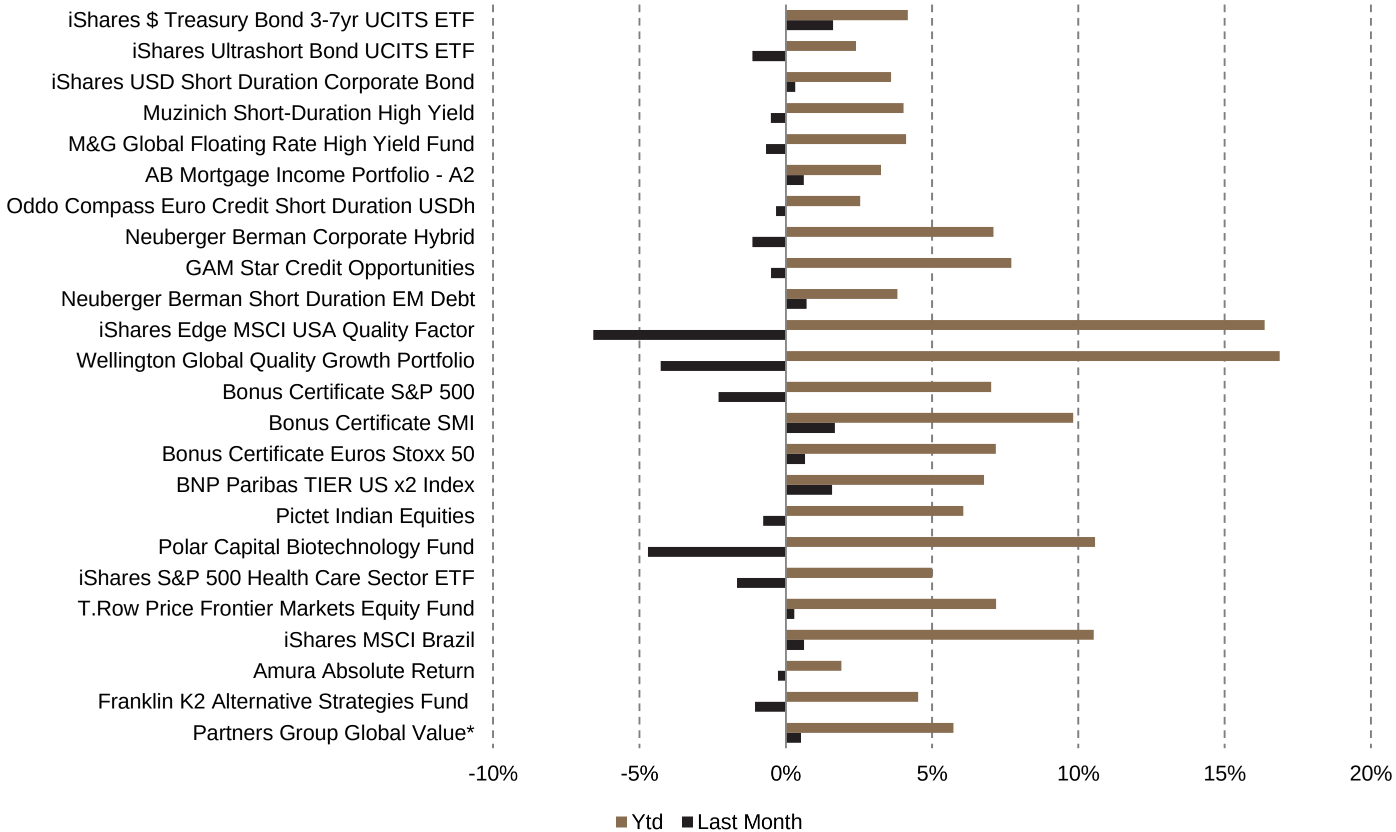
What is more risky?



- From a portfolio perspective, **the decrease in bond yields**, although it provides profitability in the short term, is not good news. Low yields **reduce portfolio carry going forward, and limit the benefits of diversification**
- Conversely, with lower bond yields **the opportunity cost of equities decreases**, incentivizing us to continue taking risks. At this juncture, **we continue to recommend quality stocks**, which in a recession scenario are less likely to suffer a sudden deterioration in corporate earnings

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg ,as of June 6, 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%	40%	25%

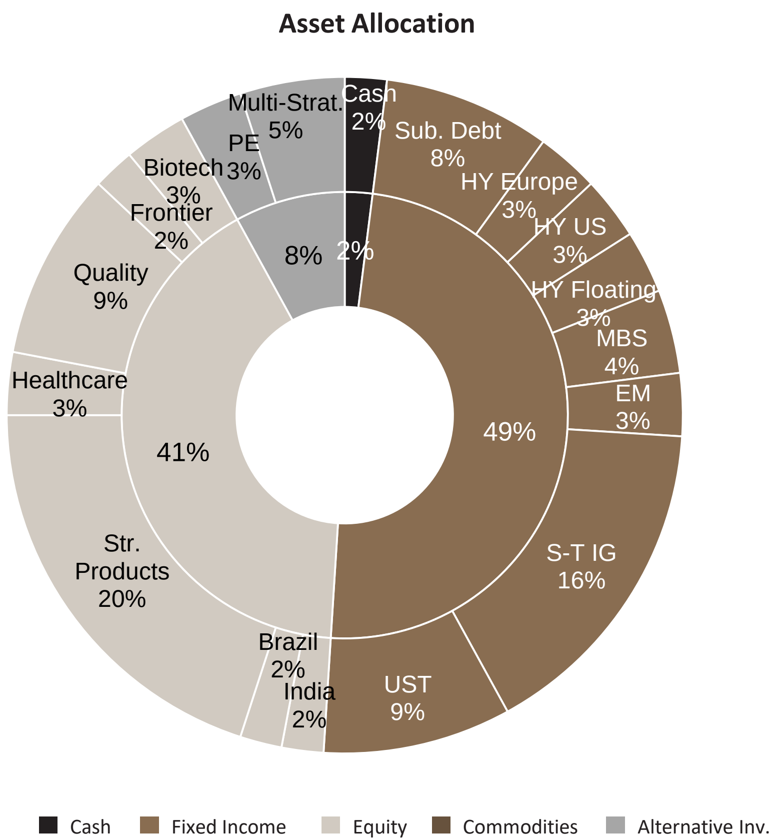
Short-term catalyzers

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

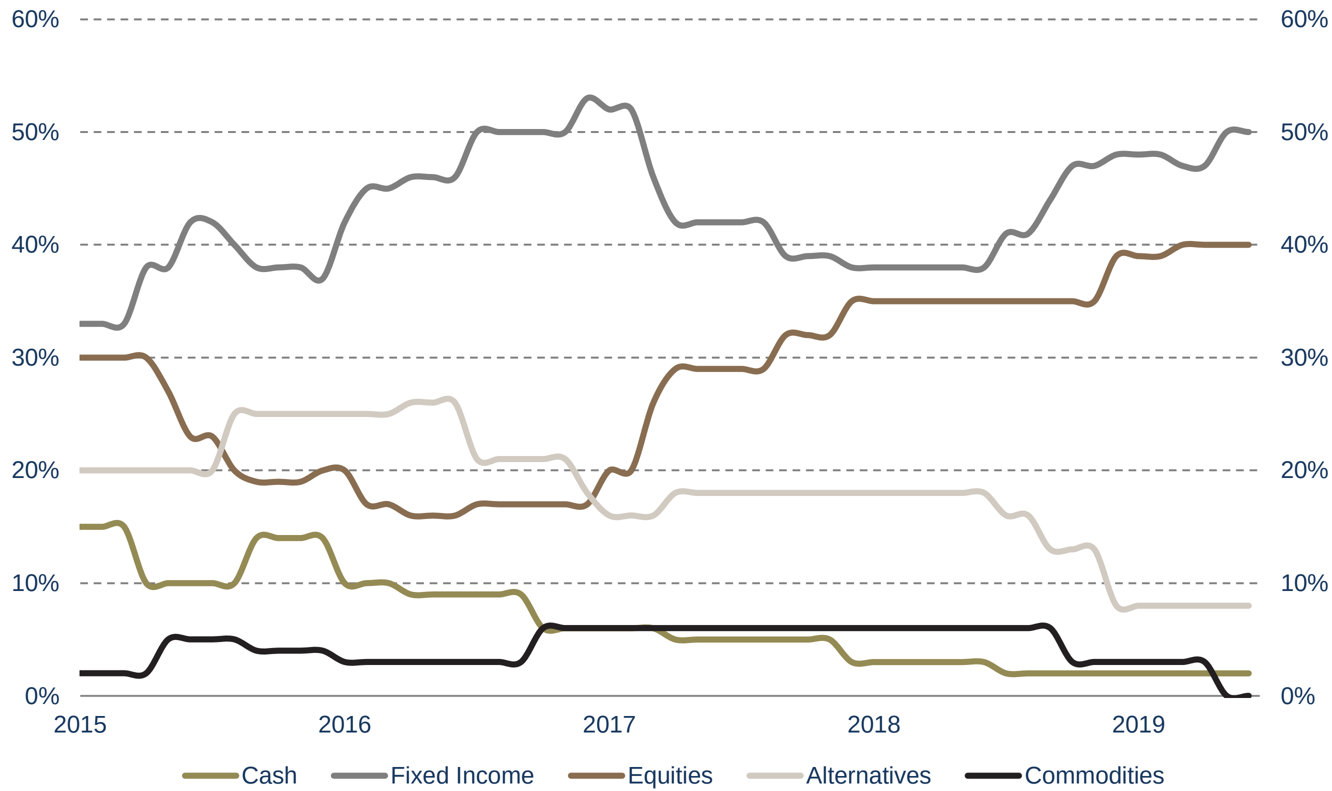


EWM Investment Profiles

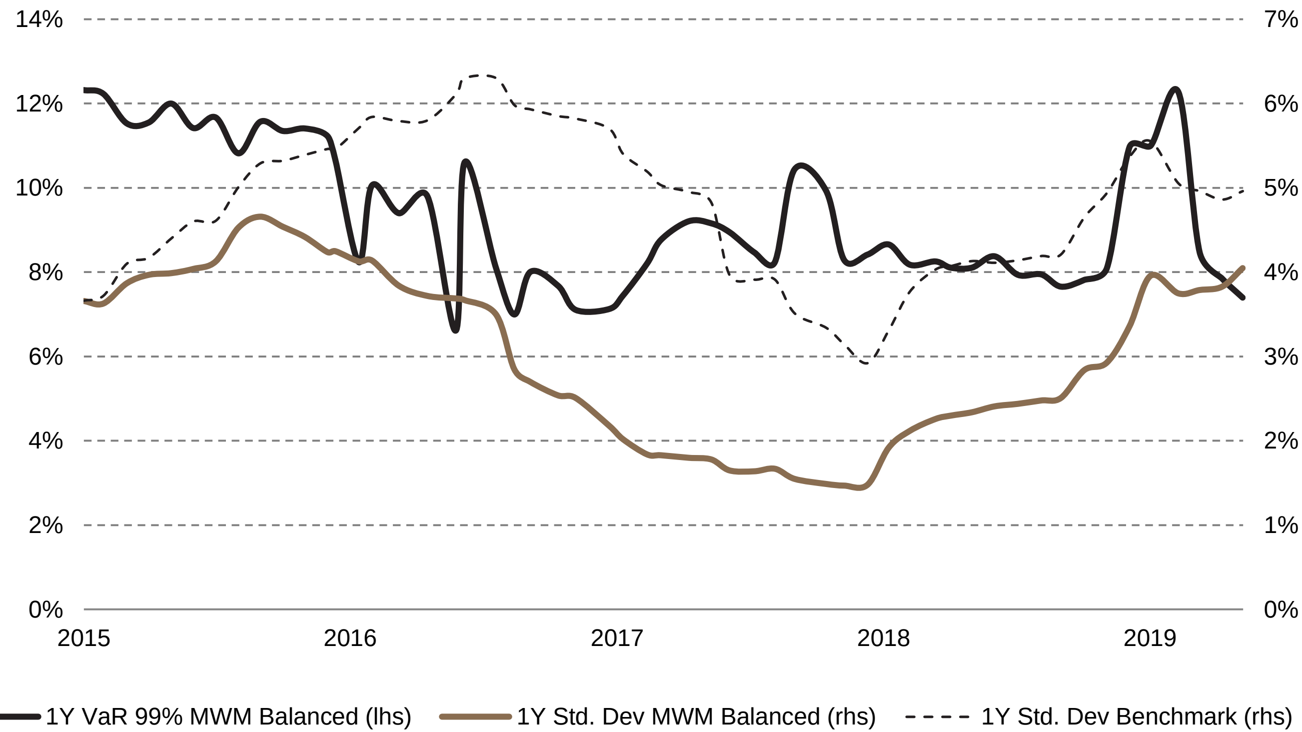
	Conservative		Balanced		Growth	
Cash	5%	3%	5%	2%	5%	1%
Fixed Income	64%	64%	43%	49%	22%	33%
Equities	24%	29%	38%	41%	52%	56%
Commodities	2%	0%	4%	0%	6%	0%
Alternative Investments	5%	4%	10%	8%	15%	10%

▼ Strategic Asset Allocation

EWM Model Portfolio – Asset Allocation evolution

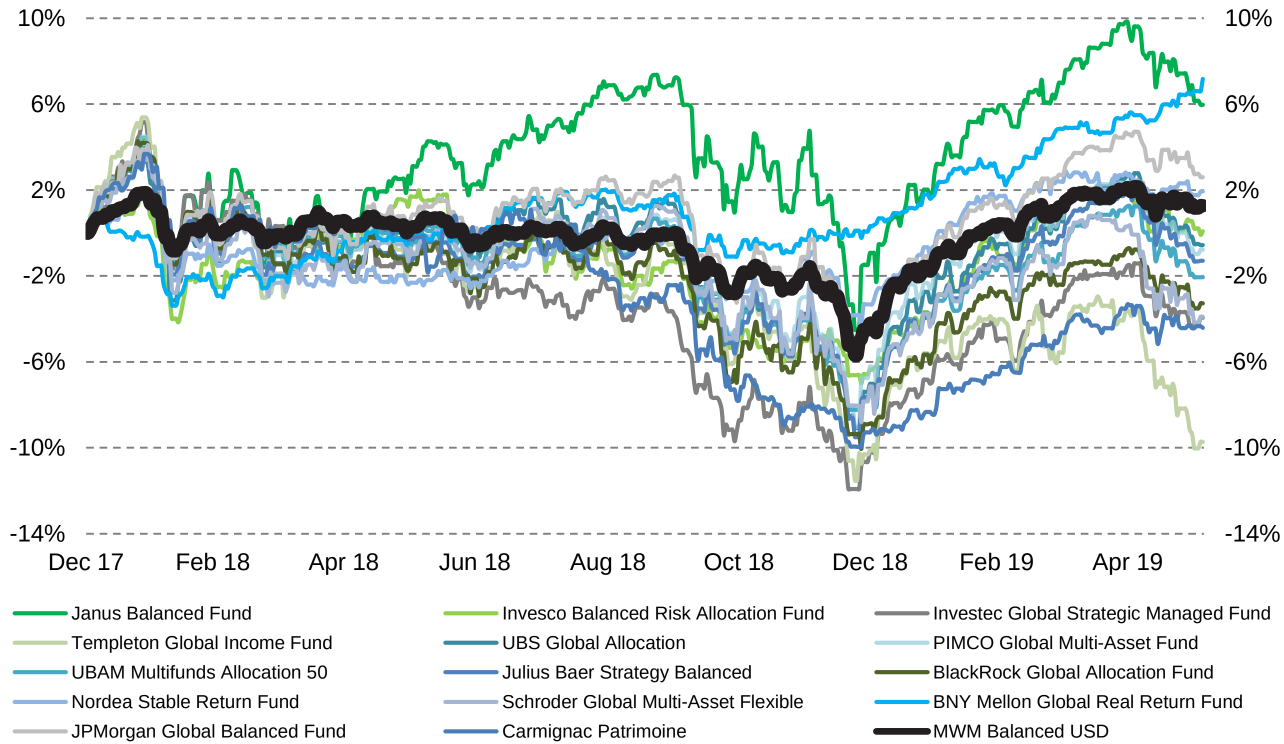


EWM Model Portfolio – VaR evolution



[1] As of June 6, 2019
Source: Bloomberg

EWM Model Portfolio – Peer comparison

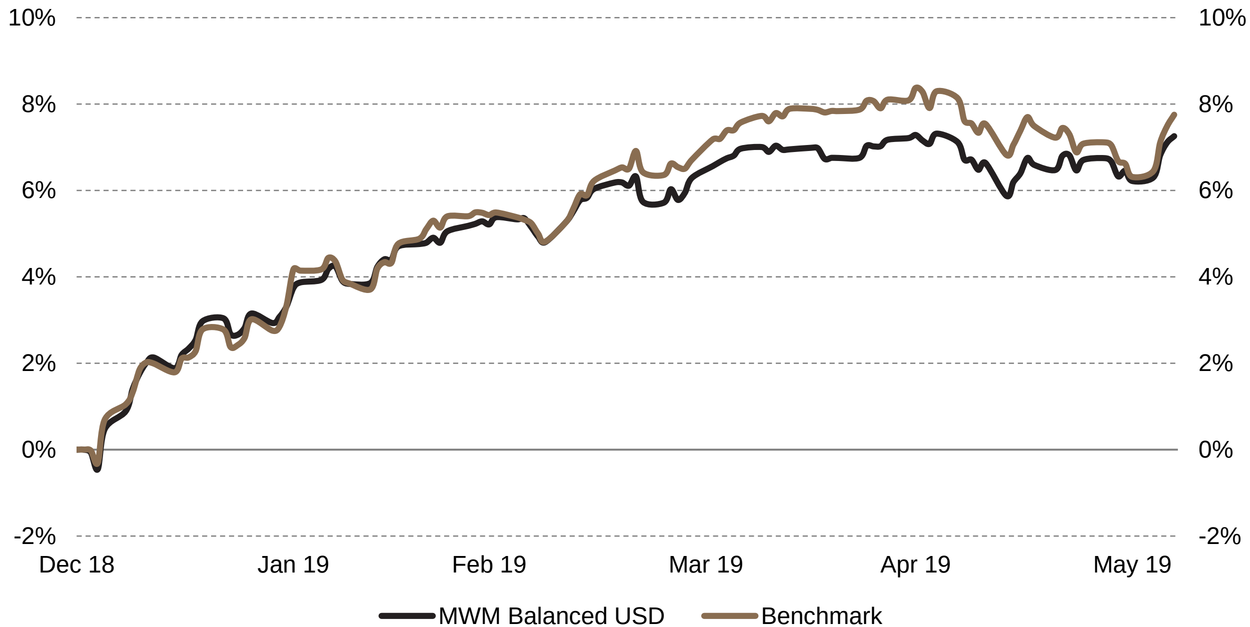


- **Total Return** (Ytd[1]): **8th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **2nd out of 15**
- **Sharp Ratio** (1 year[1]): **n/a**

[1] As of June 4, 2019

Source: Bloomberg

EWM Model Portfolio – Ytd performance

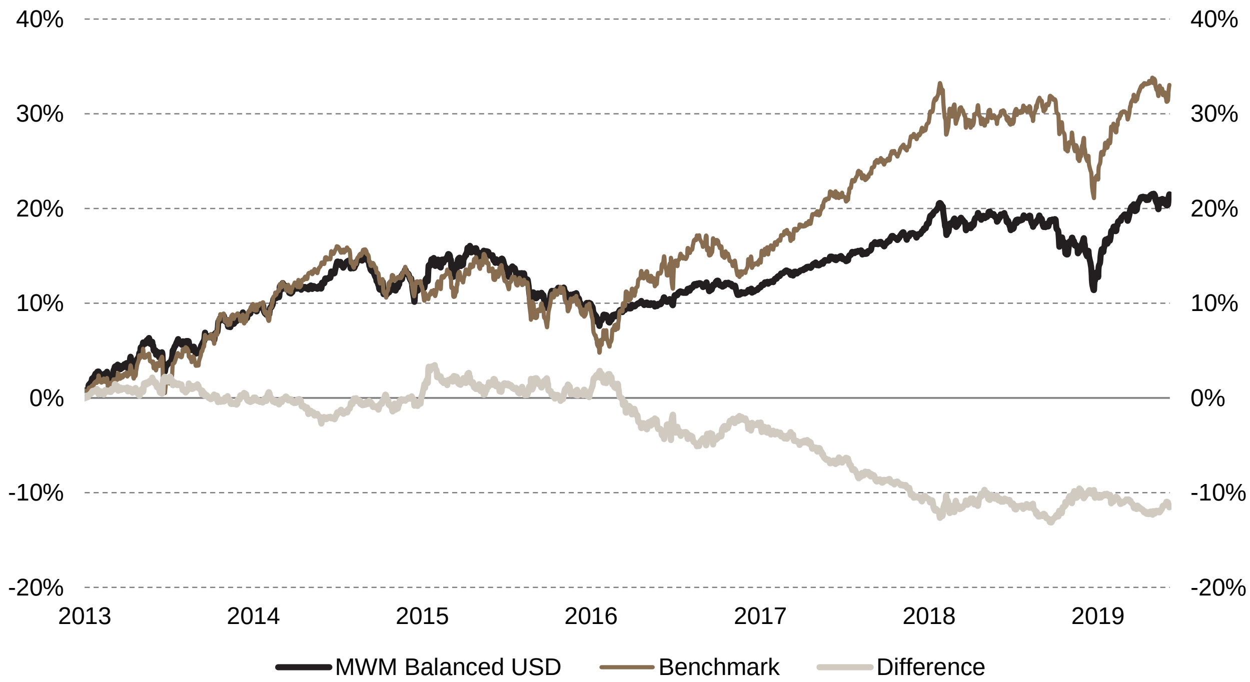


- **Total Return** (Ytd[1]): **7.26%** vs. **7.75%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.74%** vs. **4.24%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.70%** vs. **2.87%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **4.08** vs. **3.90** Benchmark[2]

[1] As of June 6, 2019

[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)

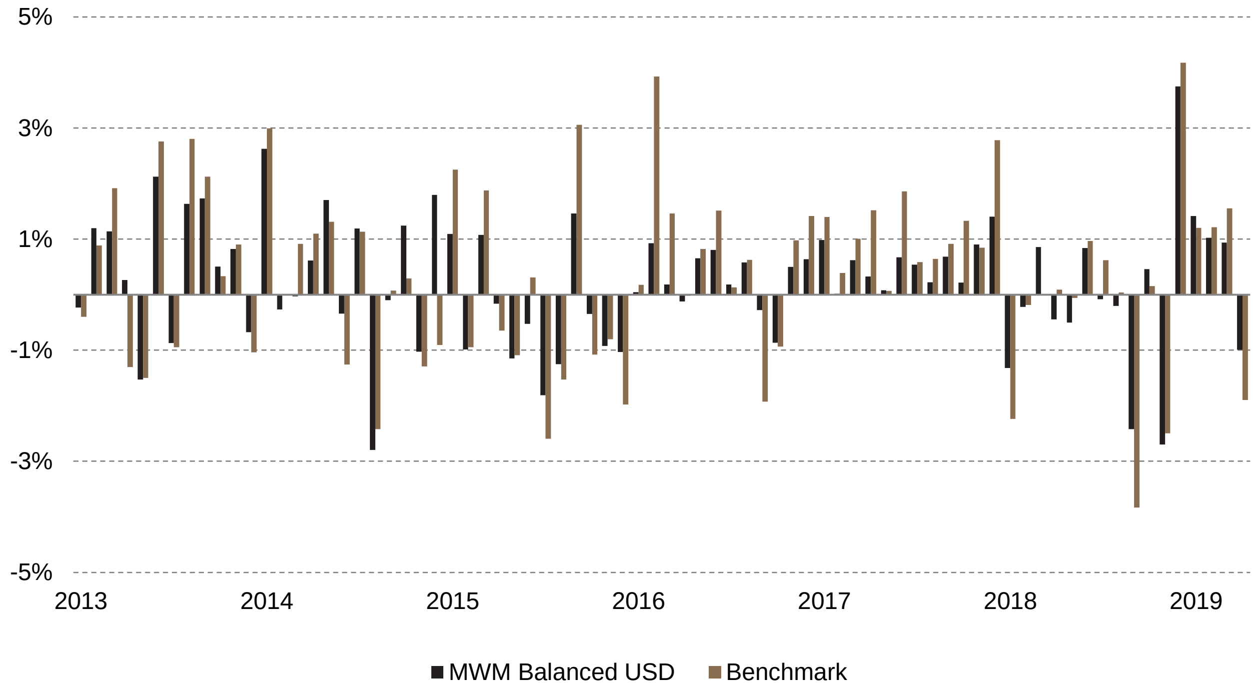


- **Total Return** (1 year[1]): **1.78%** vs. **2.28%** Benchmark[2]
- **Total Return** (3 year[1]): **10.20%** vs. **16.40%** Benchmark[2]
- **Total Return** (Since Jan 13[1]): **21.51%** vs. **33.05%** Benchmark[2]

[1] As of June 6, 2019

[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]): **4.05%** vs. **4.96%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.98%** vs. **3.54%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-0.10** vs. **0.03** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.44%** vs. -**0.50%** Benchmark[2]

[1] As of June 6, 2019

[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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