Edwards Wealth
Management AG
Switzerland

BOREAL
CAPITAL MANAGEMENT

Investment Policy

September 2020

Our market view in a nutshell – September 2020

- The rise in **virus infections during the summer has hardly slowed the economic recovery in the United States**. Thanks to a decisive fiscal and monetary stimulus, **key components of the economy, such as consumption and housing, have managed to avoid a contraction**, and with it, the economy falling into a protracted recession. However, the health crisis is still far from abating, and there is a risk that it will wreak further havoc in the autumn, as we are already seeing in some parts of Europe

- In addition to avoiding a liquidity crisis, the **main contribution of central banks has been to stabilize financial markets, preventing a negative "wealth effect" from feeding back into the crisis**. However, this comes at a price, as using asset prices as the main transmission channel for monetary policy **renders the economy more vulnerable to financial markets**. Equity markets in particular are the biggest concern as they have benefited disproportionately from the collapse in interest rates

- On the other hand, the only conceivable manner by which interest rates could rise would be if inflation expectations were to pick up at some point. However, **the most common non-monetary factors causing inflation remain depressed** (labor bargaining power, commodities, and aggregated demand). At the same time, central banks have failed to create inflation, despite unprecedented monetary easing. Moreover, the **Fed is providing us reassurances** that should inflation resurface, they will not raise interest rates until catching up for previous undershoots

- The **US presidential elections remain still undecided**, despite the apparent lead of the democratic candidate. However, it is very difficult to judge the potential impact of the final result, since **markets should, to a large extent, have already discounted a possible victory for Joe Biden**. A change in administration could **negatively affect some sectors** (energy, pharmaceutical, financials), but what would affect the markets the most would be a possible **rollback of the 2017 tax reform**

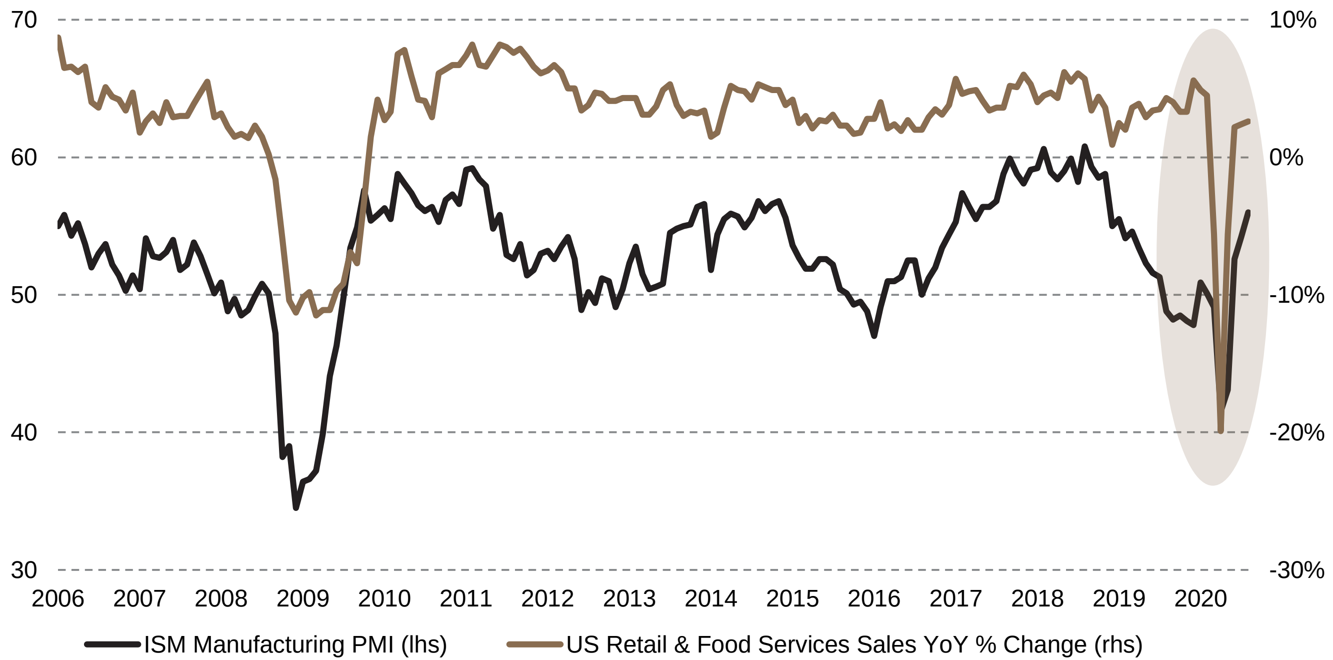
- On the currency front, the **US dollar has depreciated against the Euro as a result of narrowing interest rate differentials**. However, at the same time that this was happening, economic **growth differentials have widened significantly; which supports a stronger dollar**. In the first and second quarters together, the Eurozone economy contracted 9% more than that of the US. Going forward, this gap is expected to widen based on a much stronger policy response in the US, as well as a different economic structure

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	=	The incoming economic downturn will undoubtedly lead to an increase in the number of corporate defaults. Although credit spreads already reflect this risk, we favor Investment Grade over High Yield.
	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	–	A weaker dollar should help emerging markets, but both currencies and credit spreads have reacted only partially to the risk that the Covid outbreak represents for these countries. In addition, the oil price war will harm exporting countries
Equities	US	+	After a sharp sell-off, valuations have improved. We have therefore increased our exposer 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
	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, in general, will lack sufficient fiscal freedom to stimulate the economy after the pandemic
	Sectors & Themes	+	Beyond our core call for quality-growth companies, we favor Real Estate, Infrastructure and Biotechnology
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

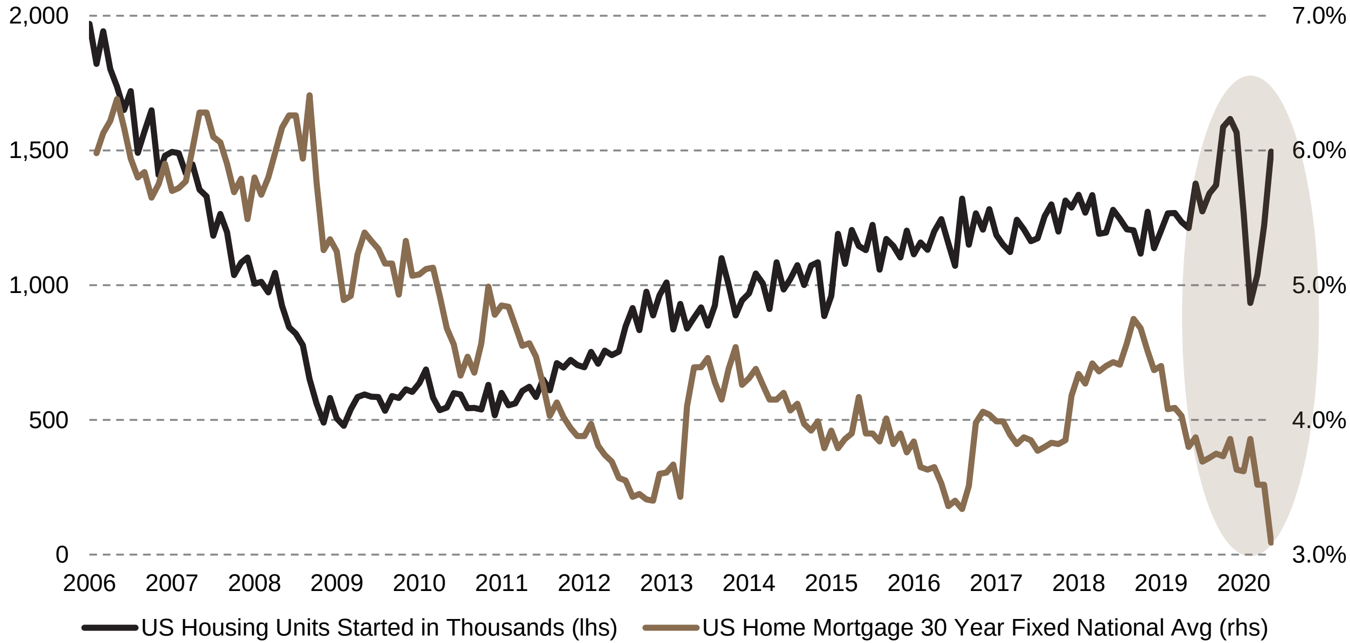
Too much of a good thing?



- Given how quickly the economy has recovered, it is clear that both **fiscal and monetary support measures have been successful**; managing to prevent the economy from falling into a protracted recession
- In fact, the stimulus has been so significant that **leading indicators suggest that the economy will grow with more momentum than pre-Covid (although there is a base effect)**. If a new aid package is approved, this could well be the beginning of a new expansionary cycle

Source: Bloomberg

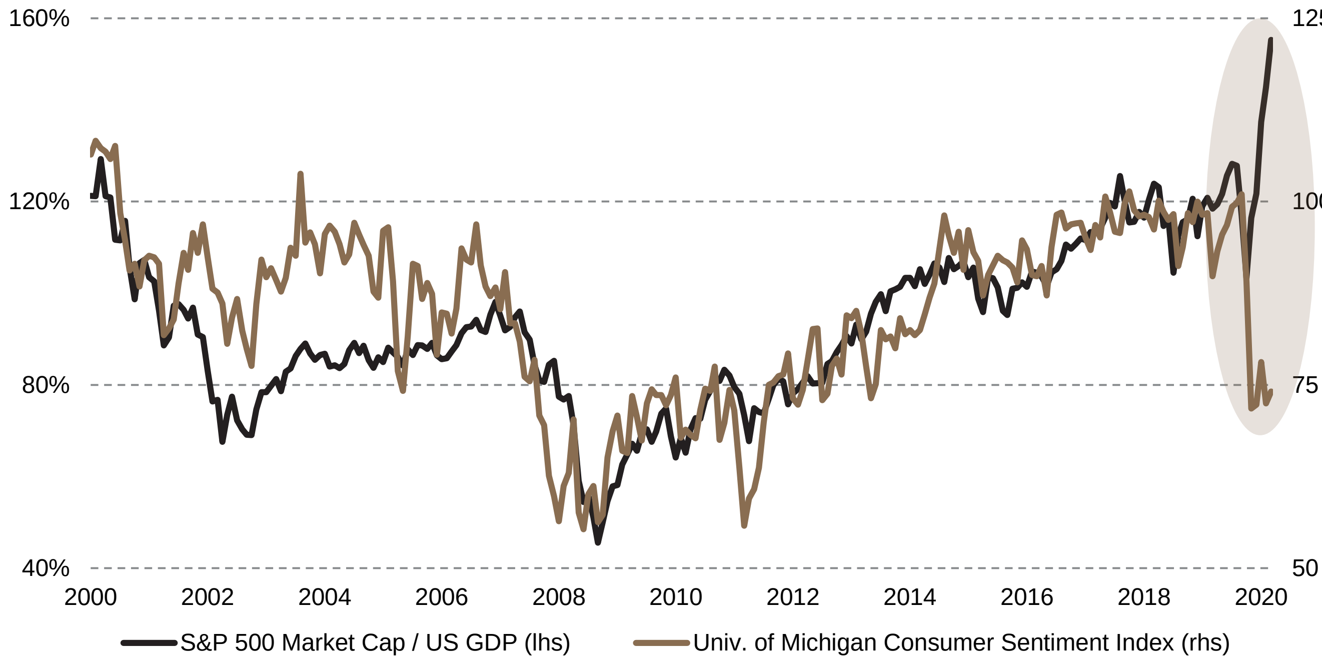
The resilience of the housing market is a good example



- Furlough schemes for workers, combined with rent relief programs for tenants, have **prevented a downward spiral in real estate**. This is particularly visible in the residential market, where the **CASE-Shiller index rises 3% in the year**
- American **households had deleveraged massively** in the decade before the Covid crisis, which, coupled with the sharp **drop in mortgages rates**, is helping to maintain a relatively low mortgage delinquency rate

Source: Bloomberg

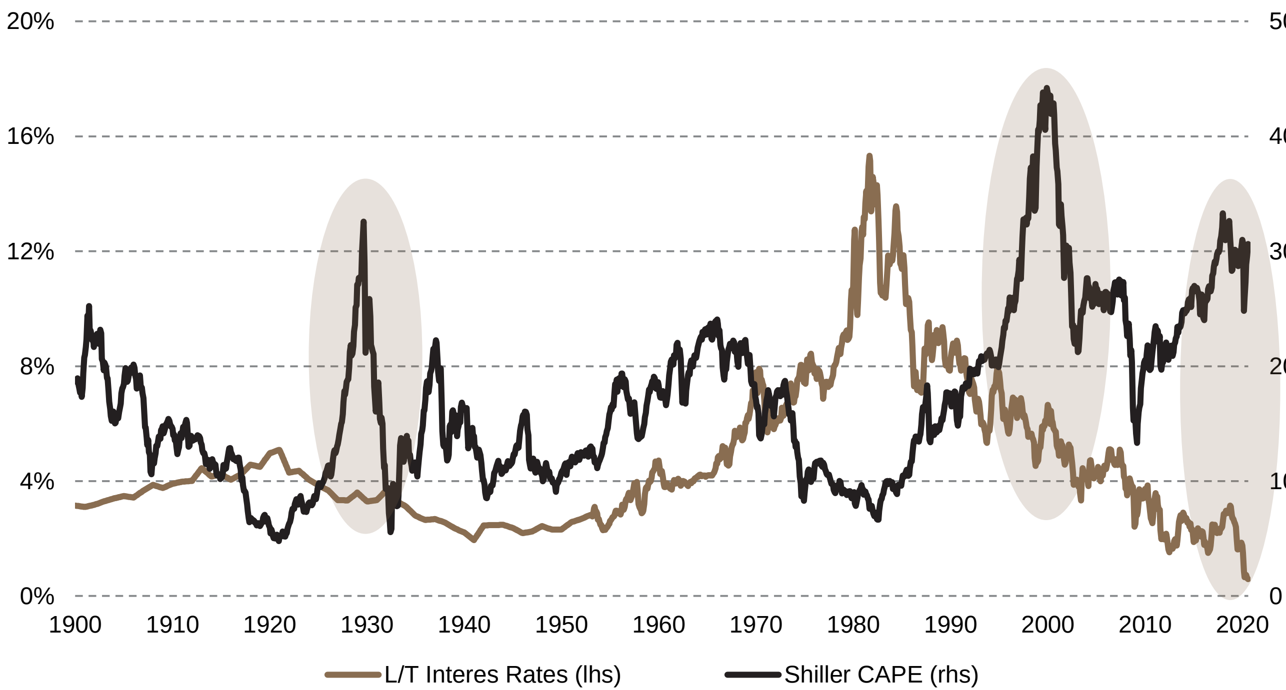
Stock markets also underpin the "wealth effect"



- Stock **markets are also helping to underpin the "wealth effect"** and thus mitigate the economic downturn; since households are less inclined to cut on consumption
- However, the last leg up in equity markets is only explained by the movement in interest rates. This carries the risk that the **economy is more vulnerable to corrections in financial markets, as it happened in 2000**

Source: Bloomberg

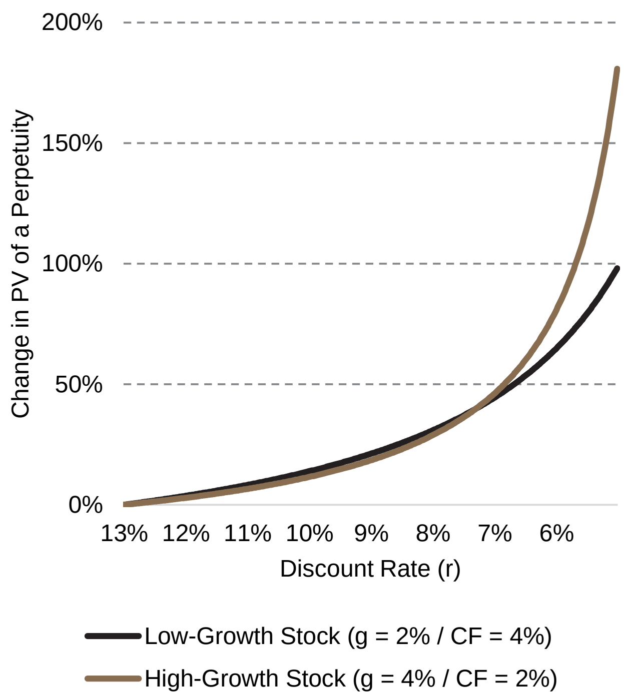
Bubble or bargain?

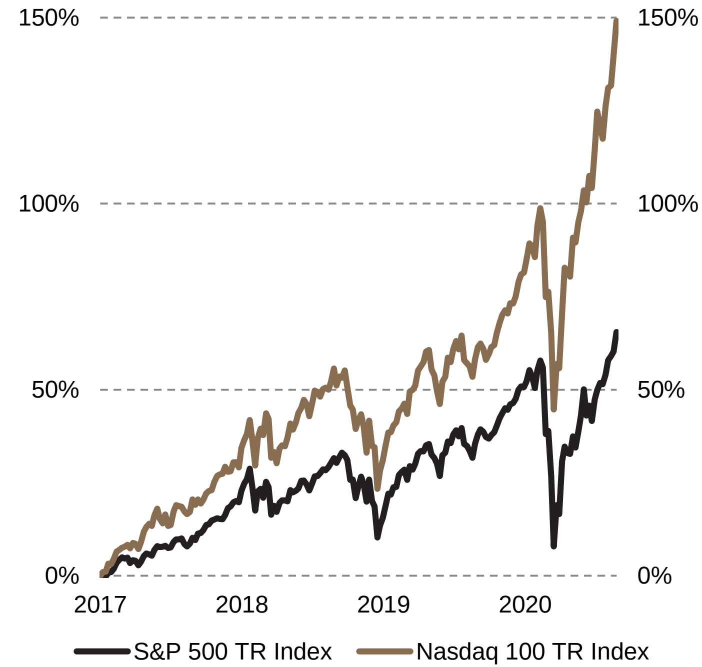


- **Only twice in financial history have we had P/E multiples similar to today**. Both times ended in tears, since investors projected growth rates in earnings that were not realistic
- **This time it is different (at least the causes are)**, given that it is the collapse in interest rates that is driving the rally, while earnings projections are (with the exception of some technology stocks), relatively low due to the pandemic

Source: Bloomberg

Growth, at what price?

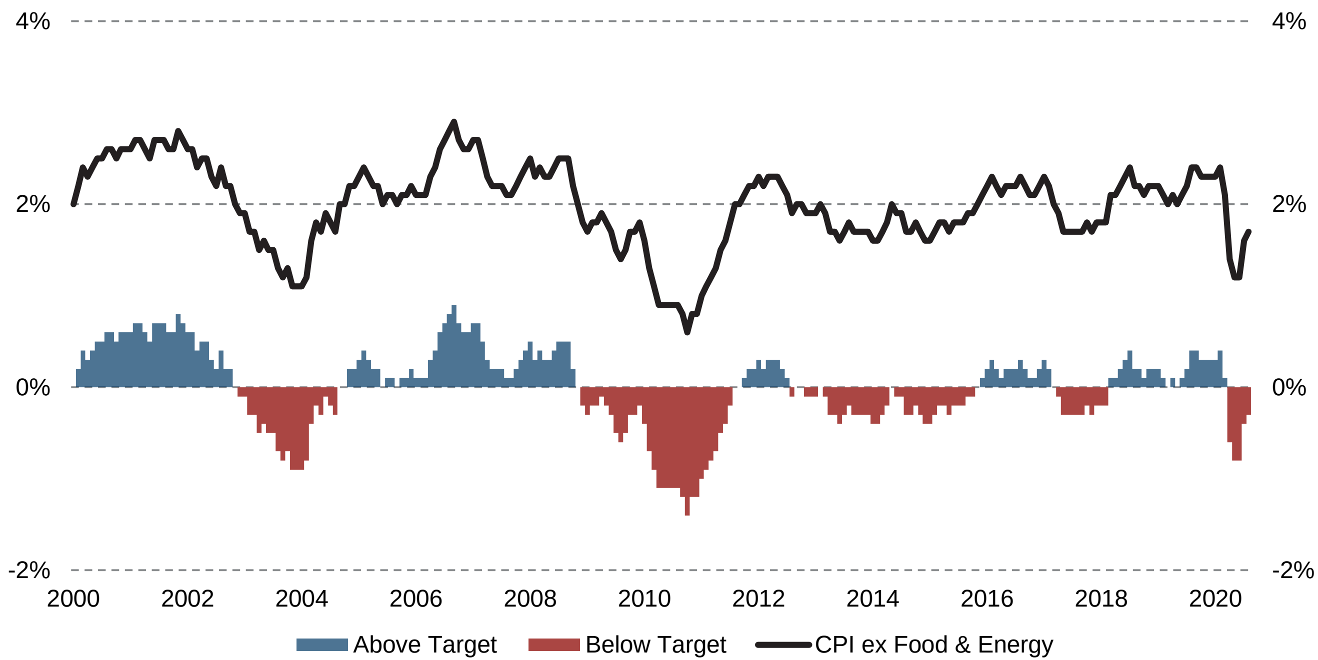




- **As low interest rates are reflected in asset valuations, growth stocks become more and more attractive**. This is because when the discount rate approaches the growth rate in earnings, the present value of future cash flows increases dramatically
- The problem with the expansion in multiples that we are witnessing is that valuations become increasingly dependent on interest rates, and any small change can have a big impact on prices. Therefore, **volatility is expected to remain elevated**

Source: Bloomberg

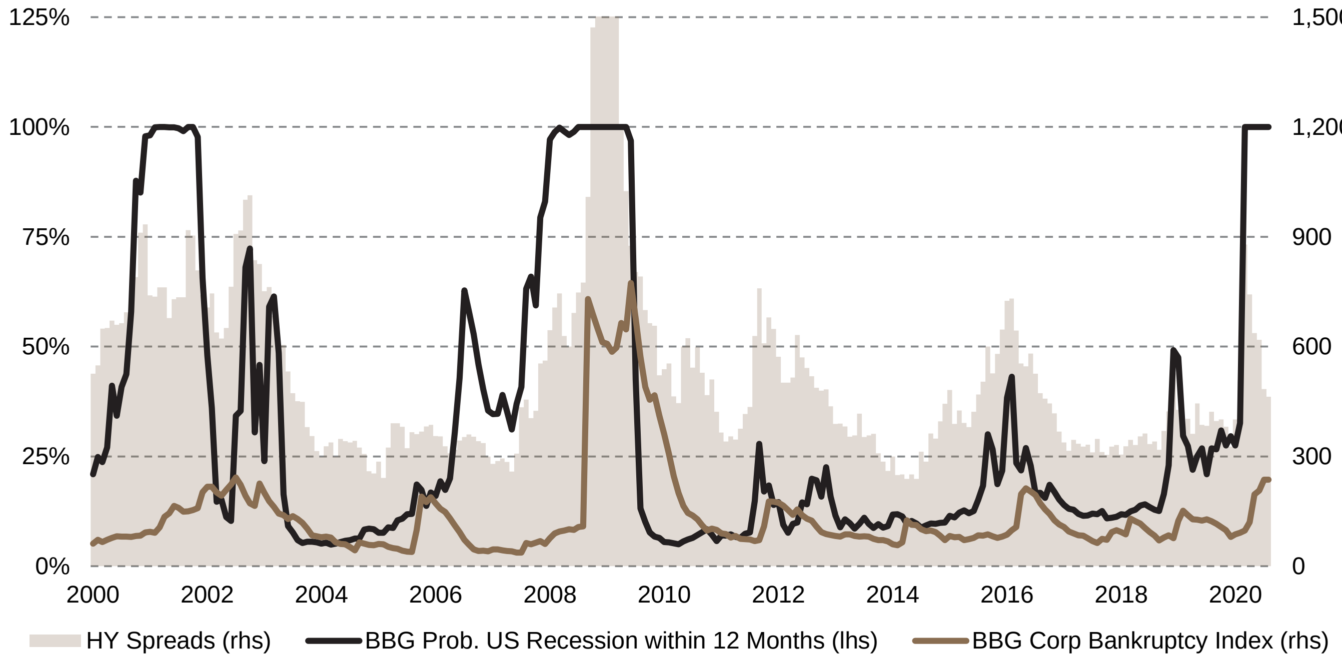
Is inflation the threat?



- The only conceivable manner by which interest rates could rise would be if inflation expectations were to pick up at some point. However, the **most common non-monetary factors causing inflation remain depress**ed (labor bargaining power, commodity prices, and aggregated demand). At the same time, central banks have failed to create inflation, despite unprecedented monetary easing
- Moreover, **the Fed is providing us reassurances** that should inflation resurface, they will not raise interest rates until catching up for previous undershoots

Source: Bloomberg

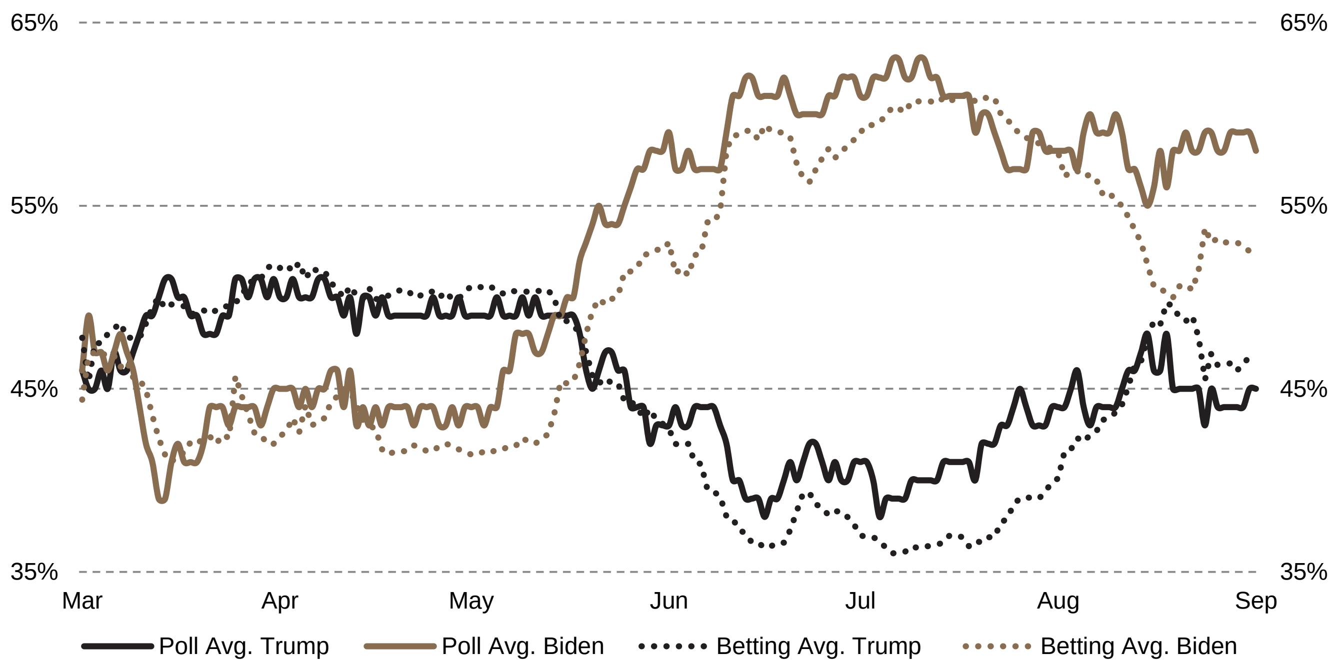
Credit markets remain difficult to assess



- During the crisis, High Yield credit spreads widened to 1,100 bps, before retreating dramatically to current levels. **Spreads hover typically around 600 basis points during recessions, but this is not a normal recession**
- It is plausible that the unprecedented fiscal and monetary support helps keep the number of corporate bankruptcies low. However, there is still a **high degree of uncertainty, which we believe is not adequately reflected in current valuations**

Source: Bloomberg

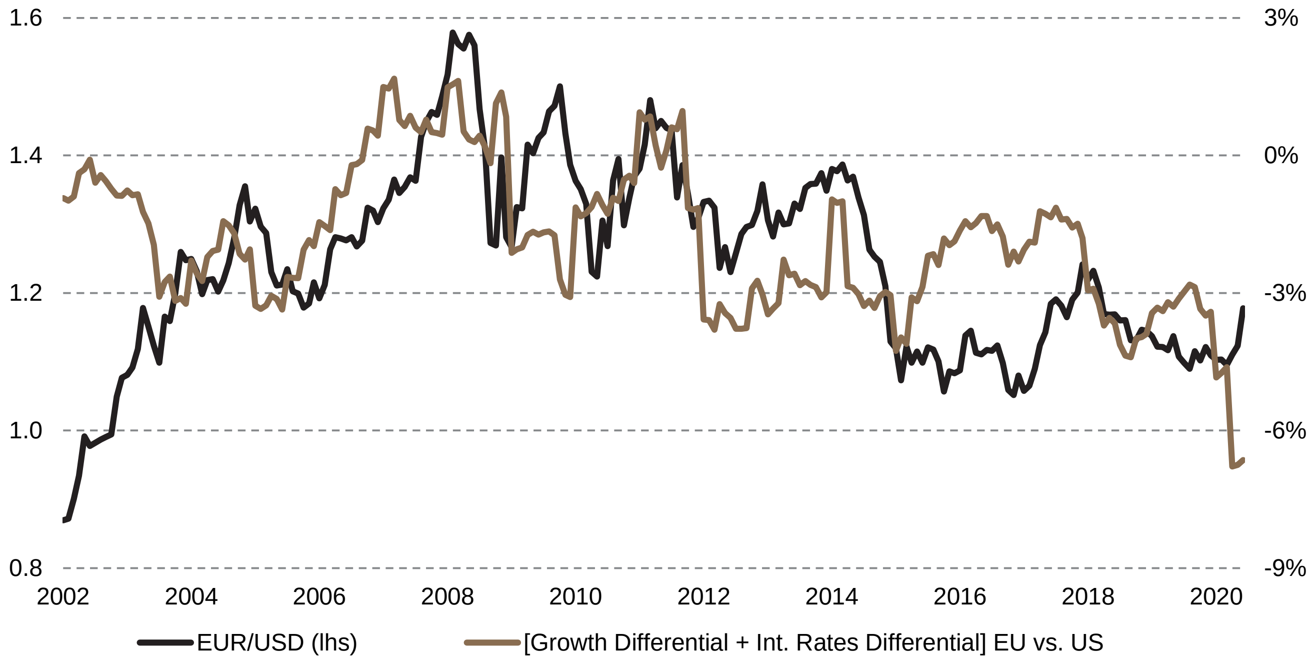
Place your bets



- The **US presidential elections remain still undecided**, despite the apparent lead of the democratic candidate. However, it is very difficult to judge the potential impact of the final result, since, to a large extent, **markets should have already discounted a possible victory for Joe Biden**
- A change in administration could **negatively affect some sectors** (energy, pharmaceutical, financials), but what would affect the markets the most would be a possible **rollback of the 2017 tax reform**

Source: Bloomberg

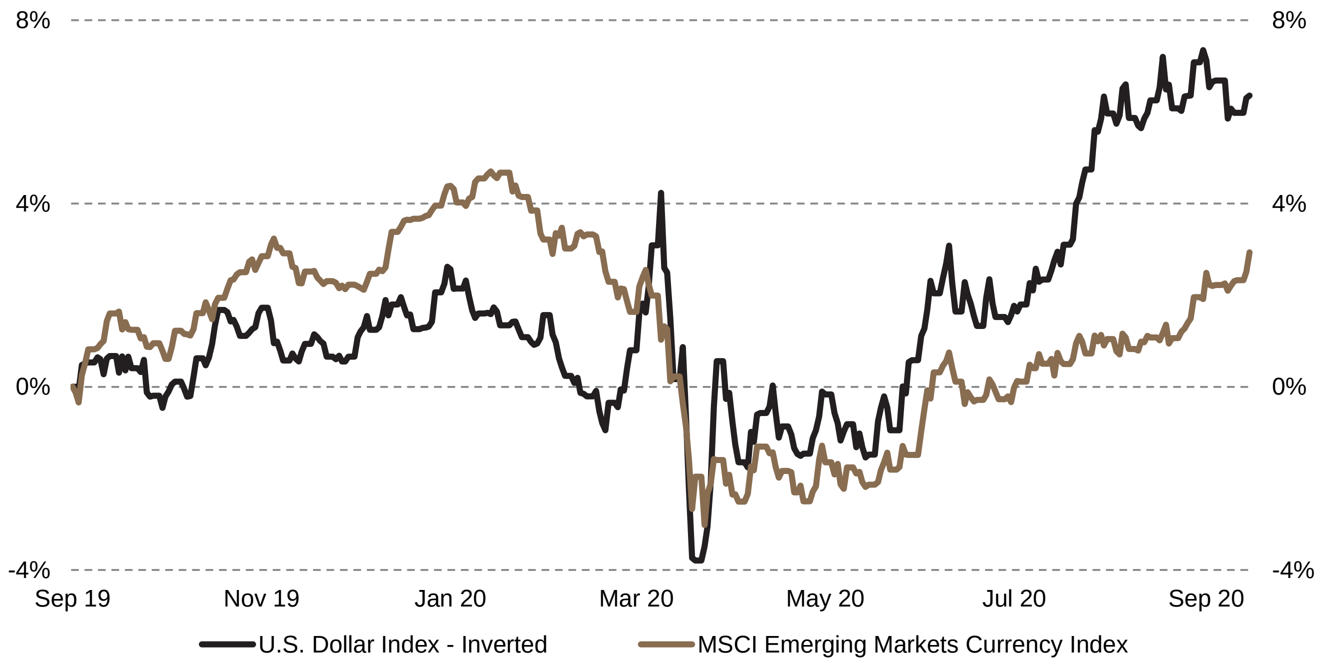
USD: Growth differentials take over



- The **dollar has depreciated as a result of narrowing interest rate differentials**. However, at the same time that this was happening, economic **growth differentials have widened significantly**. In the first and second quarters together, the Eurozone economy contracted 9% more than that of the US.
- This **gap is expected to widen** based on a much stronger policy response in the US, as well as a different economic structure, where tourism plays a much less important role

Source: Bloomberg

Risks remains elevated in Emerging Markets



- **Emerging Markets currencies have appreciated in a lesser extent than those of developed countries**. Hence, this countries may still face strong headwinds if the dollar regains strength
- As with High Yield, **we recommend taking a cautious approach to EM**, bearing in mind that we do not yet know the extent of the economic damage caused by this unique crisis

Source: Bloomberg

Investment scenarios

	Scenario 1 "U" Recovery	Scenario 2 "V" Recovery	Scenario 3 "W" Recovery
Drivers	• Global depression caused by the unprecedented sudden stop of economic activity • Lockdowns extend longer than initially anticipated and restrictions on movement and commerce prevent a normal return of activity • Fiscal support packages prove to be insufficient, and countries with a lesser fiscal latitude suffer prolonged recessions	• Global recession caused by the unprecedented sudden stop of economic activity • Lockdowns can be lifted by summer, and economic activity is largely resumed, with some adaptations to control the spread of the disease • 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 but failed recovery • There is some return to normality by the summer, but return of the virus in Autumn causes intermittent lockdowns until a vaccine is available • Countries with a stronger fiscal position may be able to provide further stimulus and avert a "W" recovery
Market impact	• Credit spreads remain high, fueled by a wave of corporate defaults. Weak sovereign bonds underperform significantly • Corporate earnings struggle to reach pre-crisis levels, and equity returns remain lackluster • Sovereign and high-quality benefit from the flight to quality, as well as the continuation of an ultra-loose monetary policy worldwide • USD neutral as flight to quality is offset by low interest rates • Commodities fall further	• Equities appreciate moderately, as TINA ("There Is No Alternative") lure investors back to stock markets, but there is wide dispersion across sectors • Credit spreads remain tight but do not recover to pre-crisis levels, as investors will favor companies with strong balance-sheets • 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 both equity and credit markets, with stronger companies recovering and weak companies lagging behind • Credit spreads remain elevated as the market remains highly volatile and defaults increase • Wide dispersion between both sovereign bonds and currencies, as yield curves will likely steepen as governments flood the market with new debt • Relatively strong USD as the US economy turns the corner faster. The Euro may suffer a remake of the sovereign debt crisis
Probability	10%	55%	35%

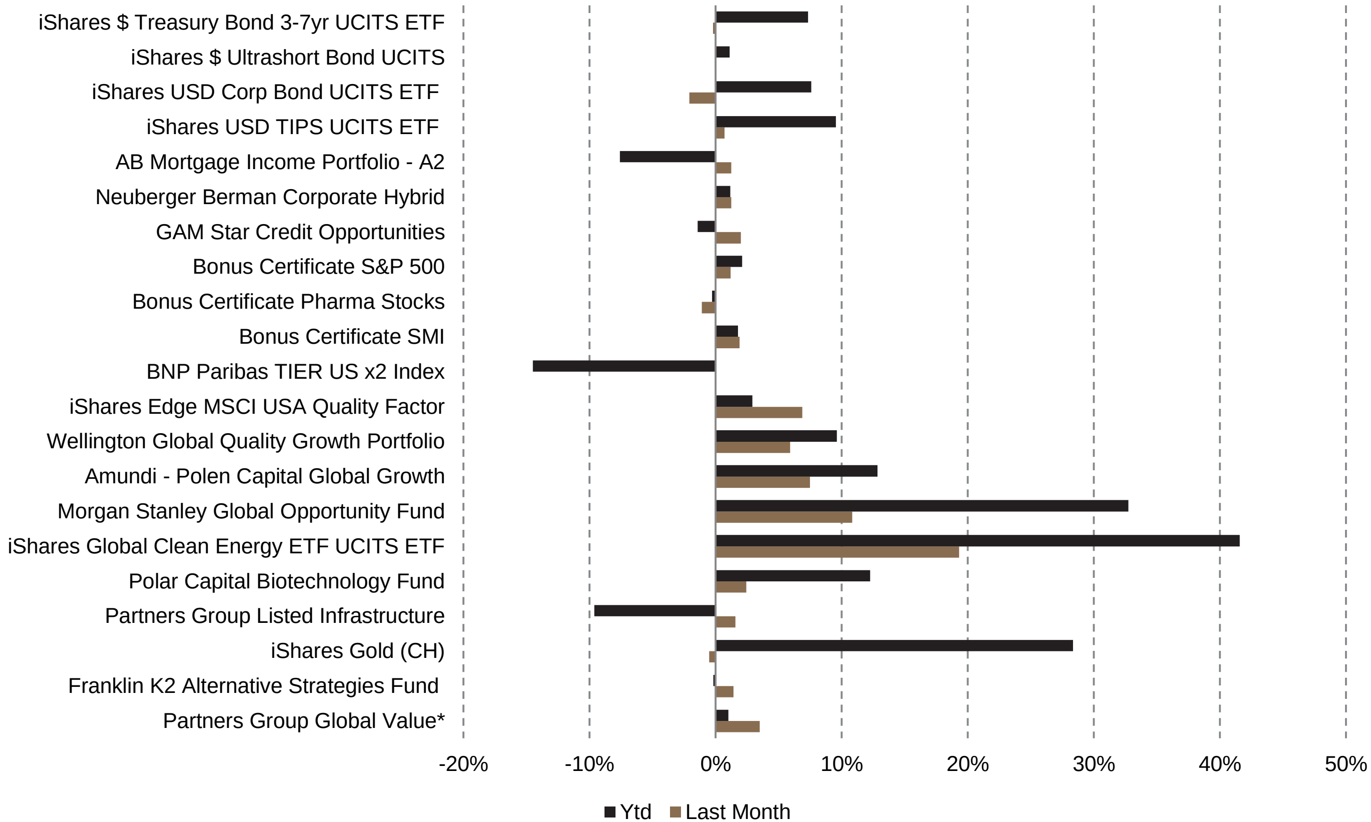
Short-term catalyzers

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

Other risks

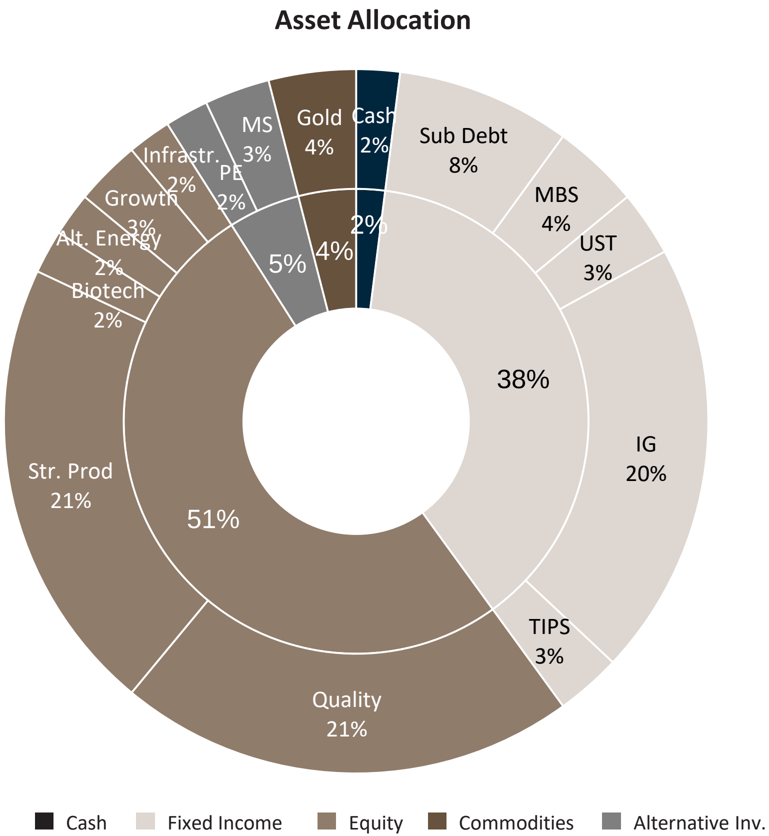
Trade wars, Spread of populist political parties, China slowdown, Terrorism

Model portfolio evolution

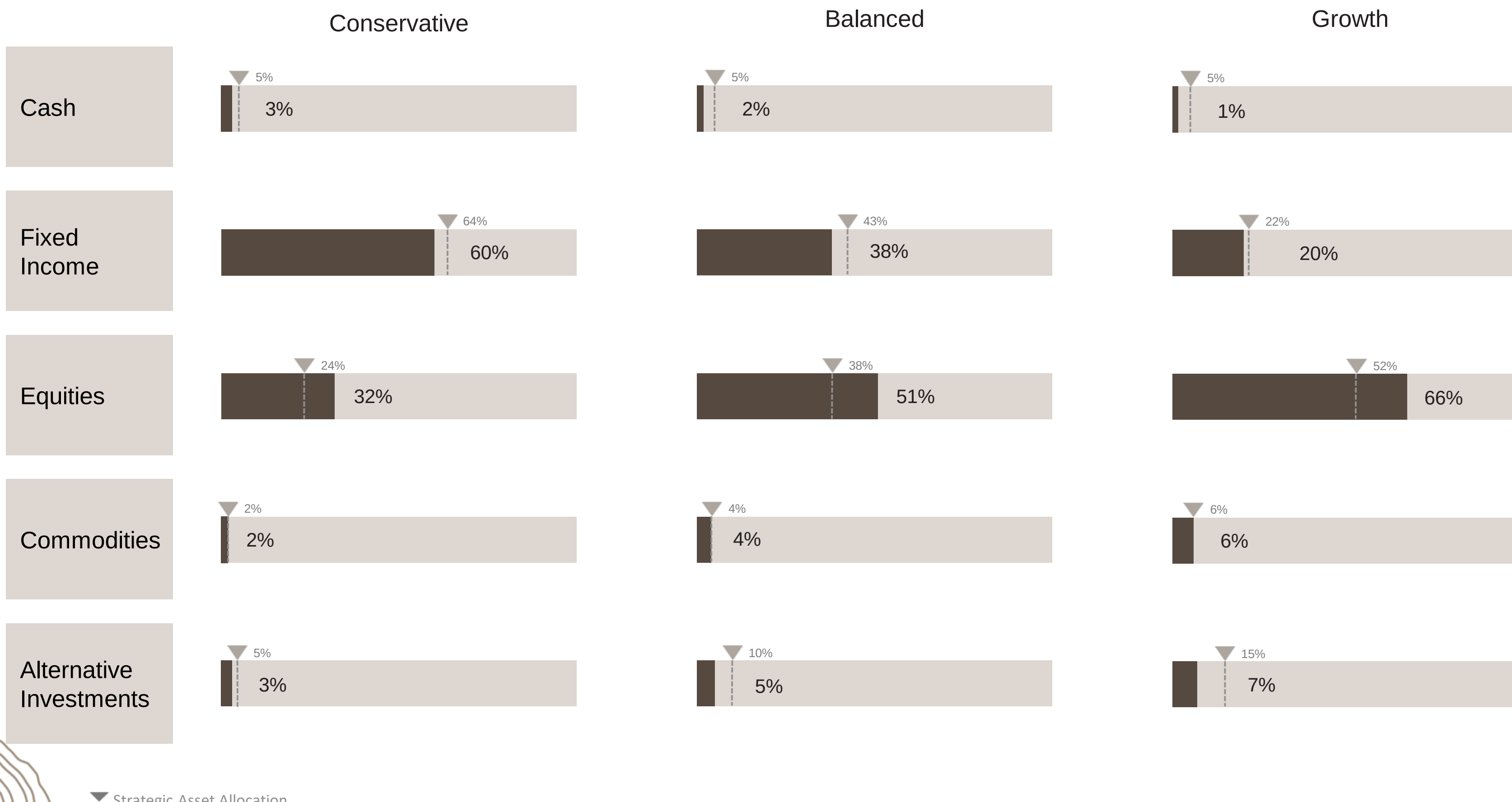


Source: Bloomberg ,as of September 14, 2020
* Fund publishes monthly NAV with a 1 month of delay

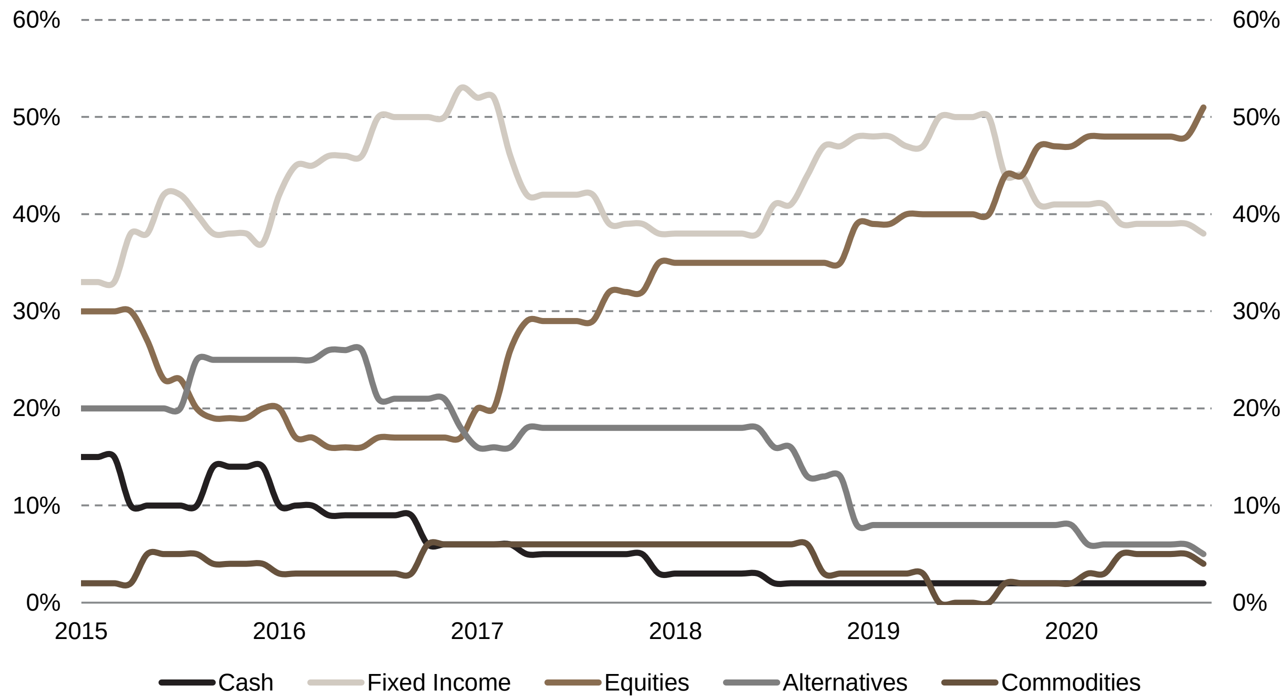
EWM Model Portfolio Balanced USD



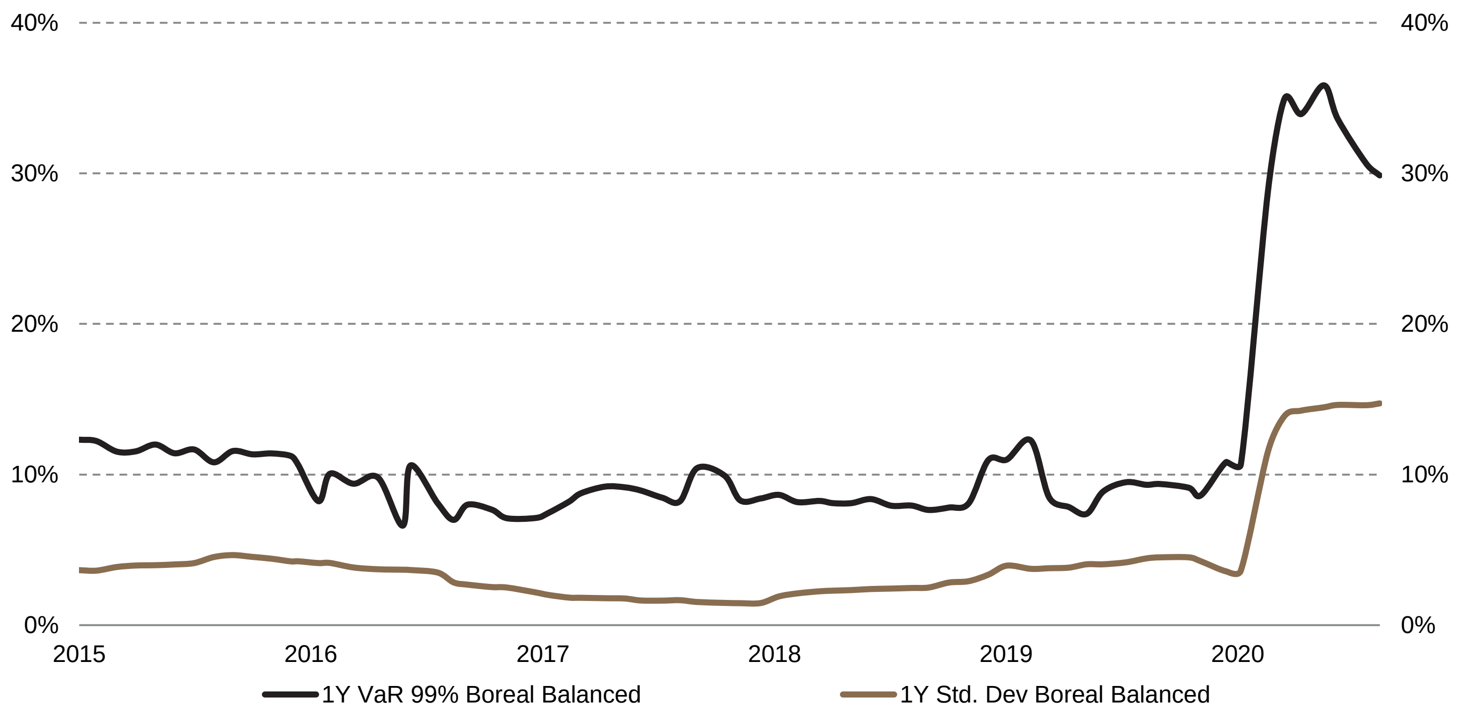
EWM Investment Profiles



EWM Model Portfolio – Asset Allocation evolution

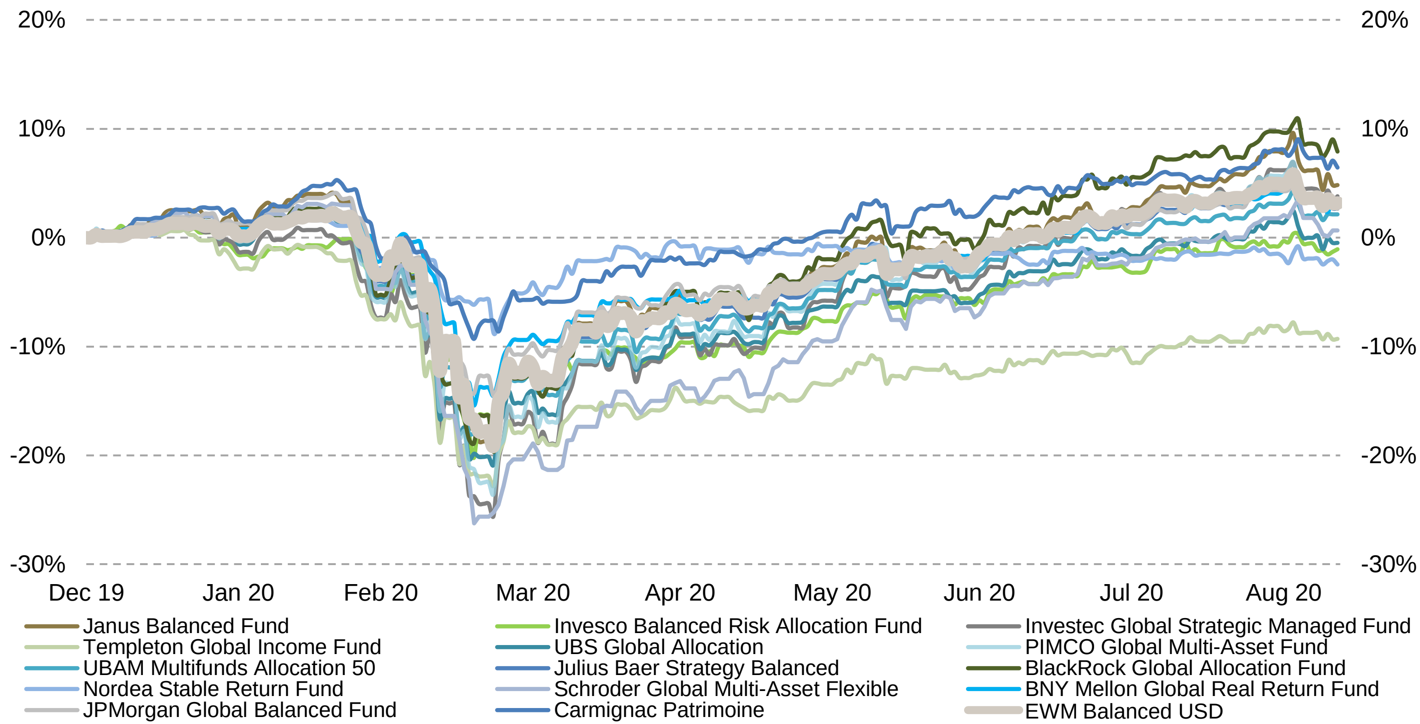


EWM Model Portfolio – VaR evolution



[1] As of September 14, 2020
Source: Bloomberg

EWM Balanced Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **5th out of 15**
- **Standard Deviation** (1 year[1]): **11th out of 15**
- **Downside Risk** (1 year[1]): **6th out of 15**
- **Sharp Ratio** (1 year[1]): **8th out of 15**

[1] As of September 14, 2020

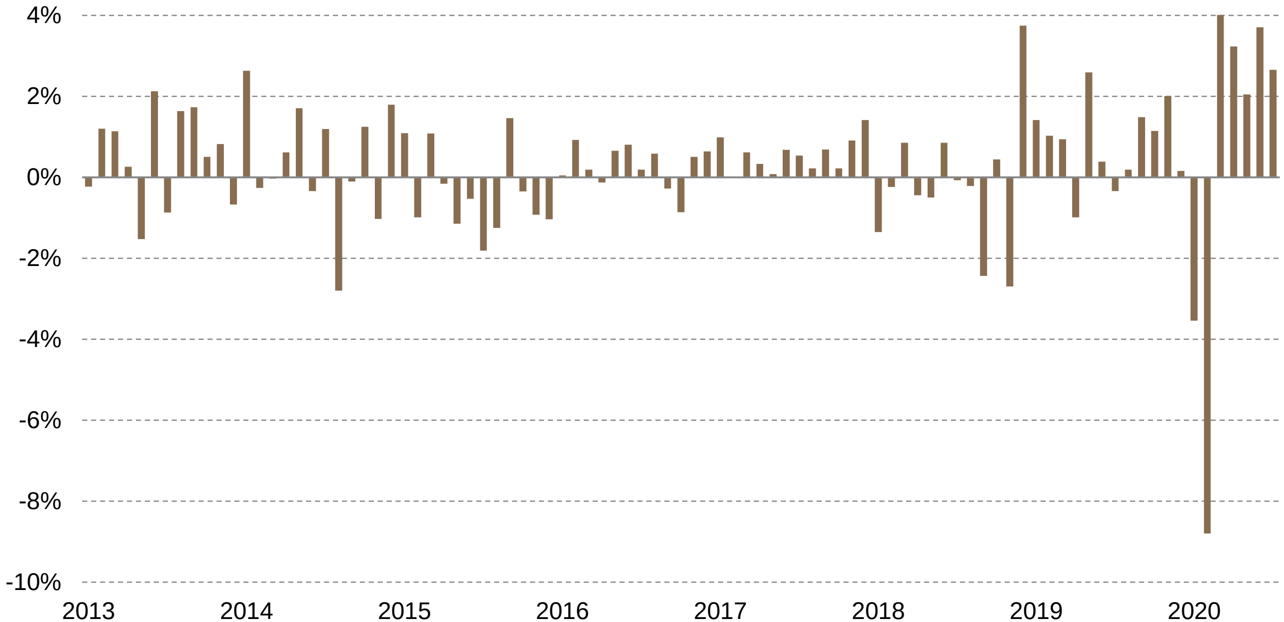
Source: Bloomberg

EWM Model Portfolio – Ytd performance

- **Total Return** (Ytd[1]): **3.70%**
- **Standard Deviation** (Ytd[1]): **17.52%**
- **Downside Risk** (Ytd[1]): **13.81%**
- **Sharpe Ratio** (Ytd[1]): **0.37**

[1] As of September 14, 2020

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **8.43%**
- **Total Return** (3 year[1]): **15.42%**
- **Total Return** (Since Jan 13[1]): **34.14%**

[1] As of September 14, 2020

EWM Model Portfolio – Historical performance (2)

	2013	2014	2015	2016	2017	2018	2019	2020
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	3.70%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	17.52%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.37

Annual Return: 3.94%
Annual Std. Dev: 6.15%

[1] As of September 14, 2020

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