Edwards Wealth Management AG
Switzerland

Investment Policy

May 2018

Tactical positioning

- We remain cautious in **fixed income** favoring **short to medium** maturities due to a very unattractive combination of risk and return in longer maturities. We have maintained **High Yield** and **subordinated debt** exposure as we think that the current economic cycle will be further elongated. **High quality bonds in the US** – particularly **corporate investment grade** – remain attractive in relative terms, and **Treasury bonds** could protect the portfolios from a slowdown in growth, although the latter is now less likely. We also have a significant position in inflation-linked US Treasury bonds (**TIPS**) to get protection against an increase in inflation as a consequence of reflationary policies. Finally, we have also maintained our allocation to **convertible bonds**, as way to further diversify our portfolios

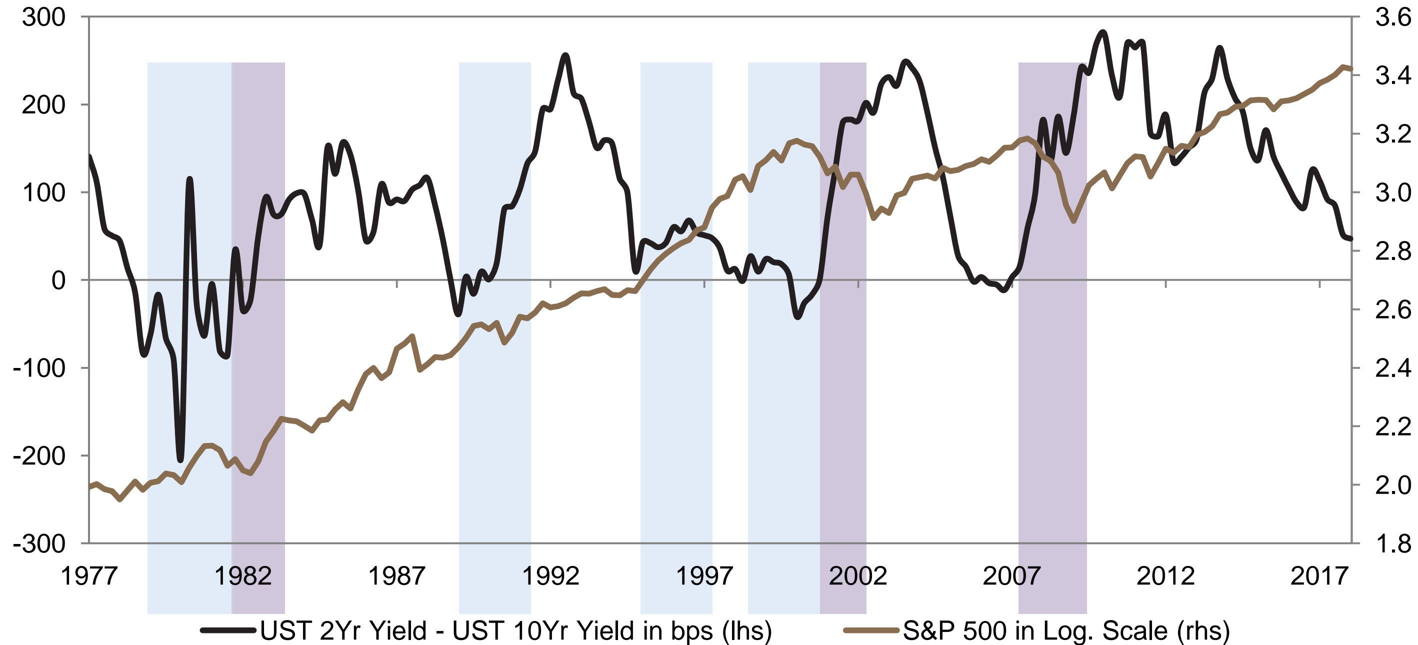
- **Equity valuations in the US** remain very high, mostly **supported by low interest** rates, **tax reform** and **deregulation**. Combined with positive macro data from other main developed markets, we see a **greater chance of a reacceleration in global economic growth.** However, with the **Fed potentially normalizing interest rates at a faster pace**, there is a risk of returning to lower valuation multiples. Therefore, we recommend to take equity exposure in a **non-directional way**. From a relative **valuation** perspective, we favor **European, Japanese and emerging markets equities**, **quality growth stocks**, **biotechnology** and **listed real estate**

- Our **diversified commodities** and **gold** allocations, further help us to **increase diversification** and to position the portfolios for a scenario of **rising inflation**

- **Alternative investments** offer a much needed source of **diversification**. Besides **cat bonds** and **private equity**, we have recently increased the allocation to **hedge-funds**, by investing into liquid and low cost **multi-manager/multi-strategy** fund of funds

- We have **reduced our cash allocation** as **negative interest rates** have been introduced in some of our reference currencies. We have also **reduced** the allocation to **short-term high quality bonds** that we held as an alternative to cash and increased credit exposure instead, with the aim of increasing the yield of the portfolio

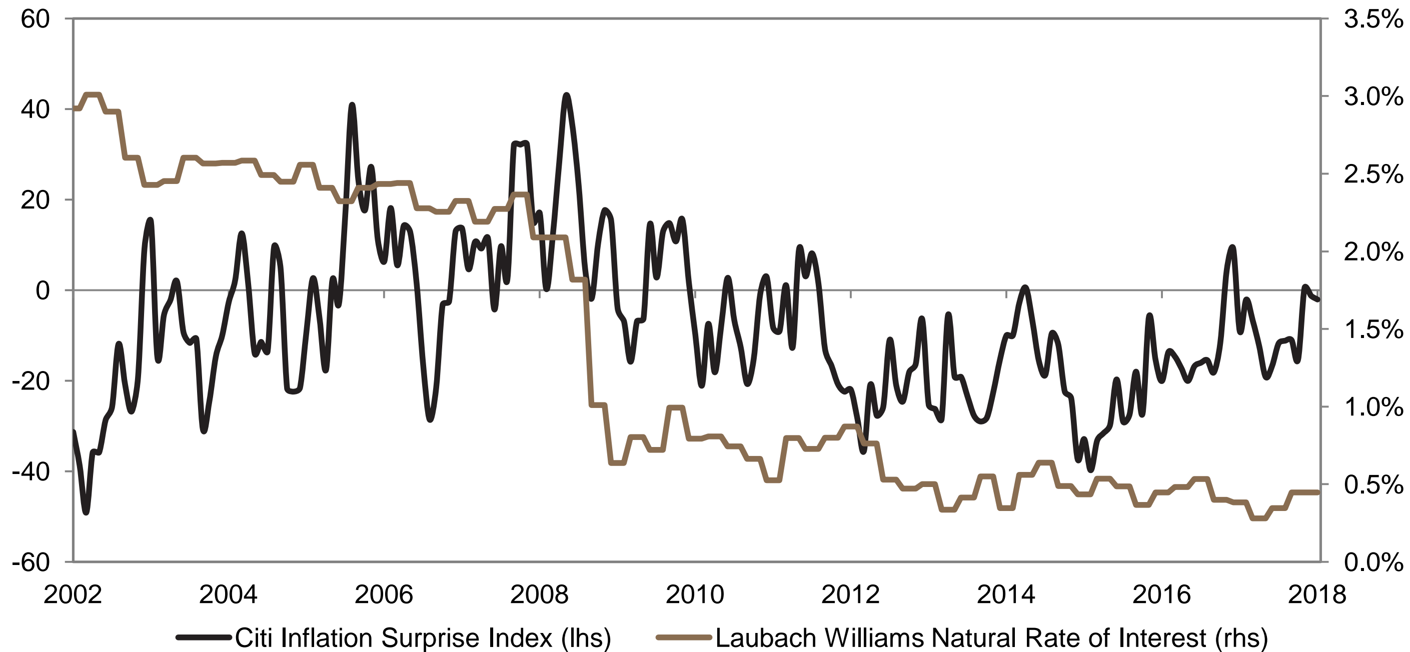
Rates fears back to center stage



- **Rising interest rates** are usually not a good prelude for risk assets, as this happens when the **economic cycle is well advanced**, and cycles tend to end when central banks have to tighten in excess in order to fight inflation. However, **timing the end of the economic cycle** has proven to be **extremely difficult**
- As markets start to price a **higher likelihood of a recession**, long-term interest rates begin to fall, and the **yield curve flattens** as a result. However, a flattening of the curve per se is **not a good predictor of a recession**, whilst an inverted curve turns to be just a lagging indicator

Source: Bloomberg

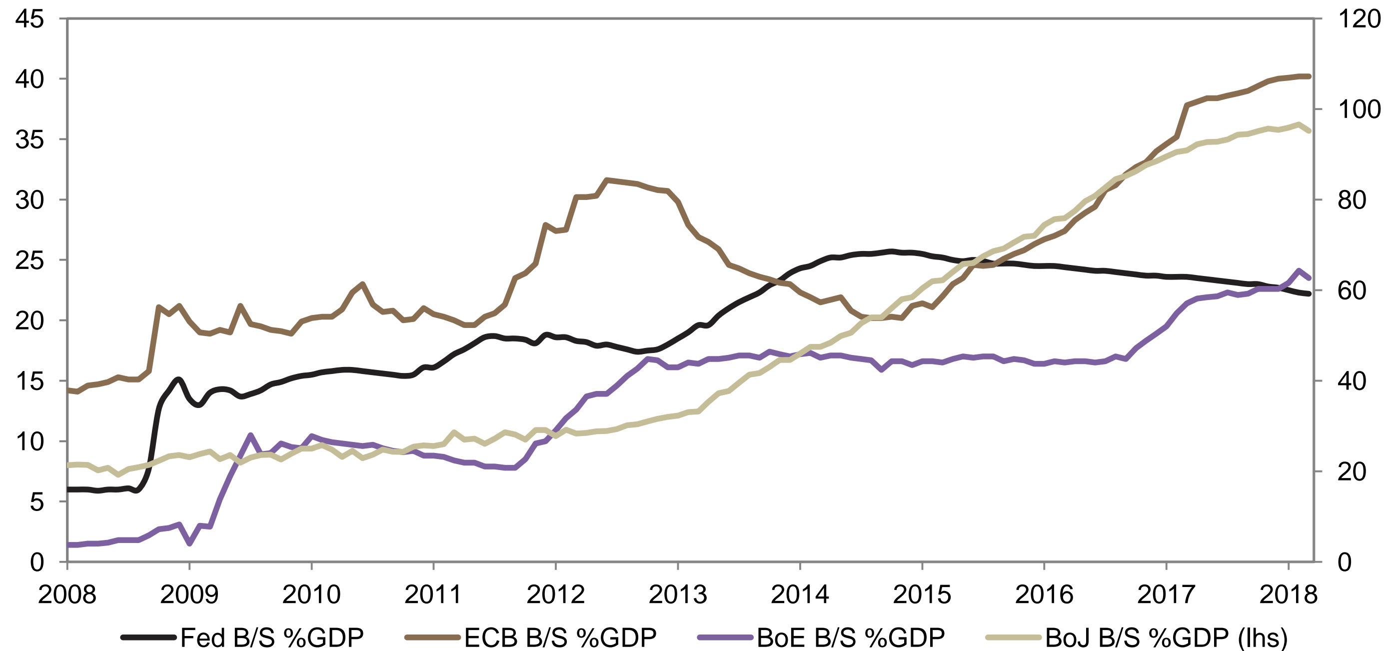
Not a typical economic cycle



- The **current economic cycle does not resemble any previous one**, and has been characterized by tepid but uninterrupted growth, combined with very low inflation
- The process of **monetary policy normalization** has not been driven by an overheating economy, but rather to **put an end to the exceptional measures** introduced in the aftermath of the financial crisis. However, **structural factors** (demographics, over indebtedness, digitalization) are weighting on long-term interest rates, and **constrain the room of maneuver for the Fed**

Source: Bloomberg

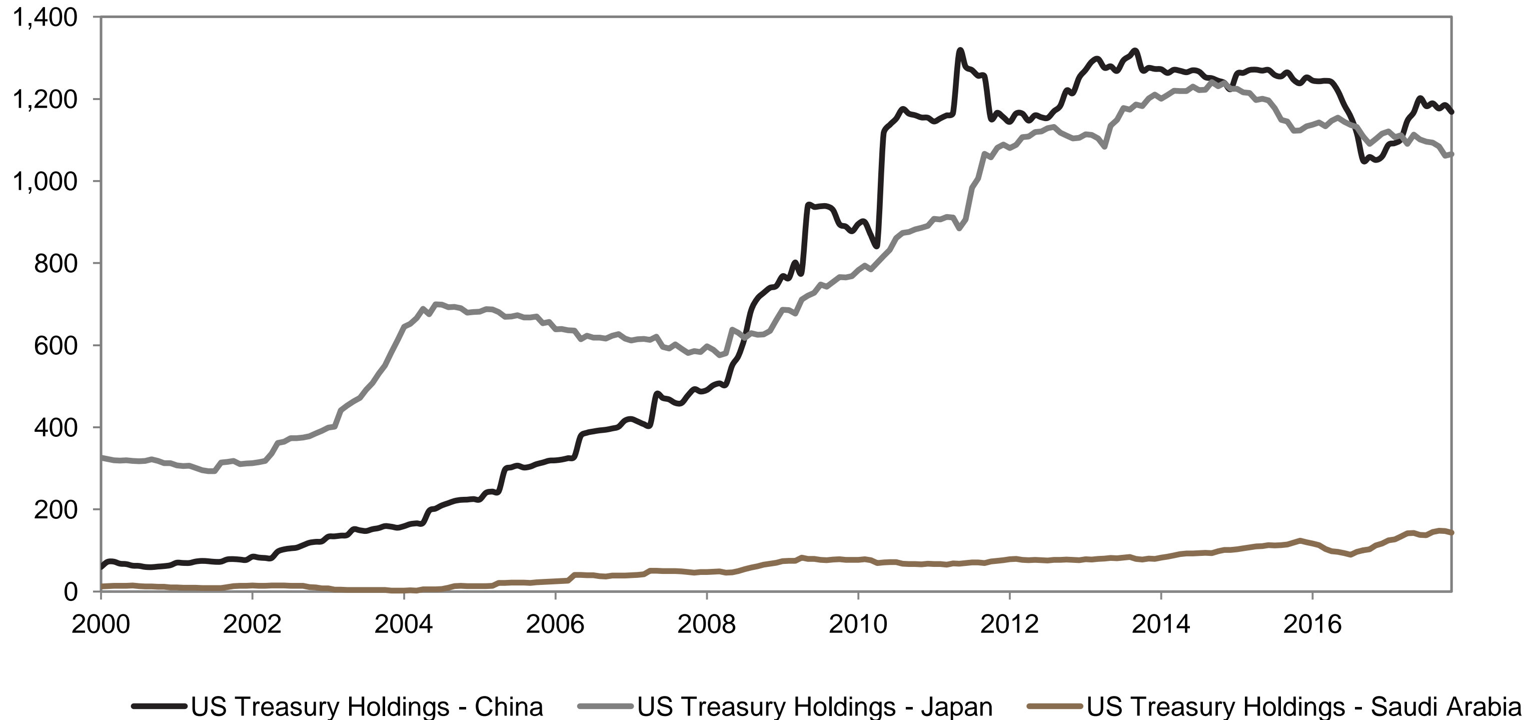
Normalization on both ends of the curve



- **Monetary policy normalization** has started on both ends of the curve, as the Fed has started to reduce the size of its balance sheet. This coincides with a **higher issuance of Treasury bonds** to finance the fiscal deficit
- So far the only central bank that has started to unwind quantitative easing has been the Fed, whilst the **other major central banks continue their programs** contributing to keep yields down. This dynamics will change if, as announced, the **ECB exits QE**, putting upward pressure on long-term yields

Source: Bloomberg

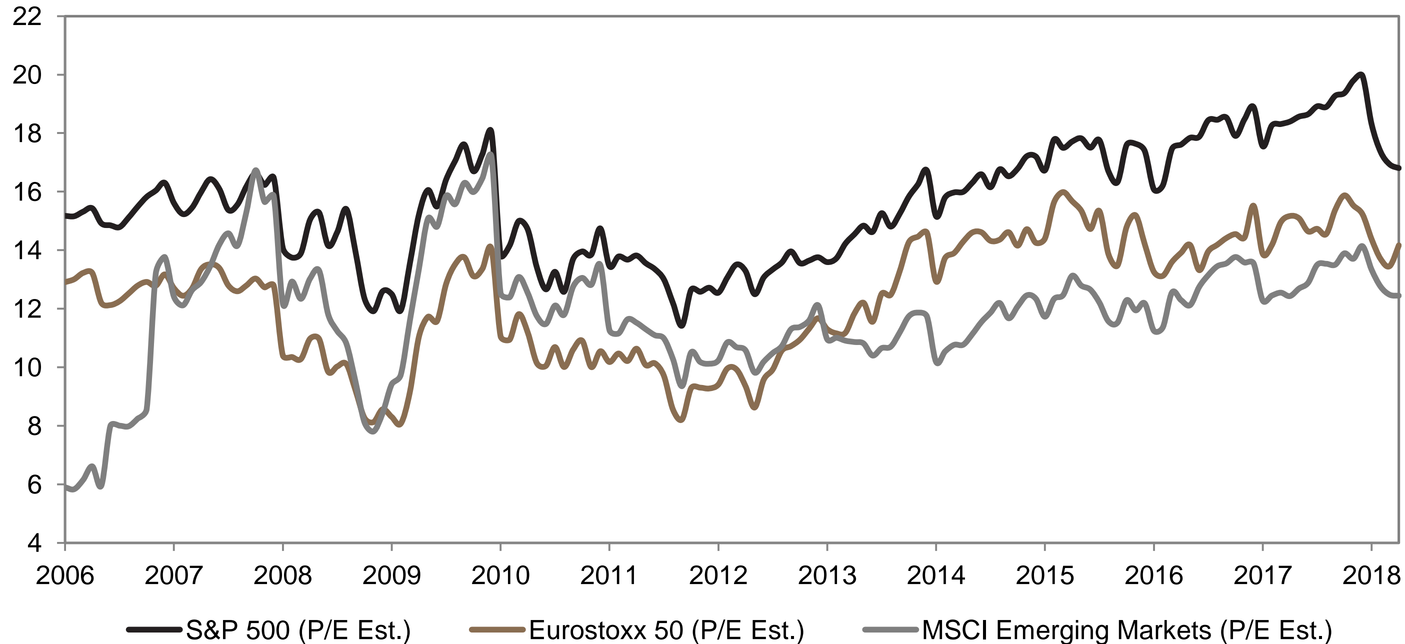
Risk of financial transmission channels



- Should trade tensions escalate, there is a **risk that trading partners will shun away from US Treasuries**, which they usually hold to recycle their trade surpluses
- Lower demand for US Treasuries would cause their yield to increase, inducing a **tightening of financial conditions** that would feed into asset valuations and economic activity – as a reference, the Fed holds about $12.5 trillion in US Treasuries after the successive QE programs

Source: Bloomberg

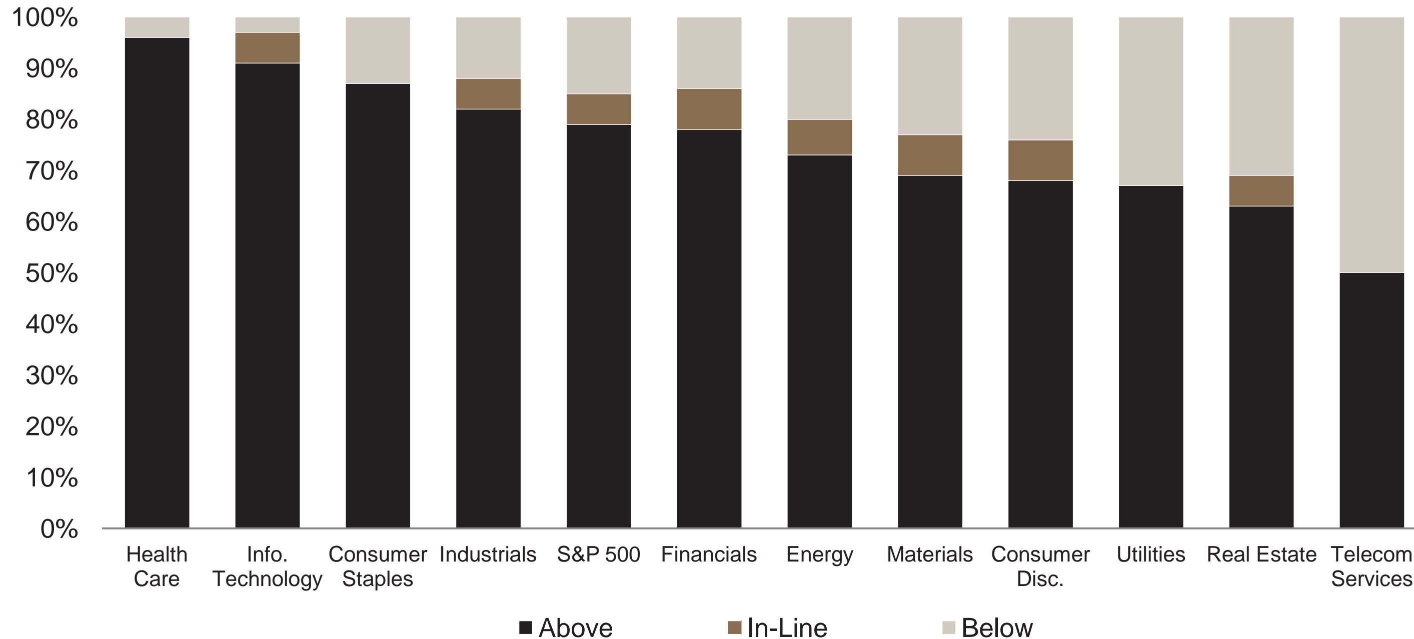
Multiple contraction has started



- **Equity markets** have also reacted to the prospects of higher interest rates, and **multiples have significantly contracted** since the beginning of the year
- The adjustment has been **mainly driven by an acceleration of earnings, and less by a decline in stock prices**

Source: Bloomberg

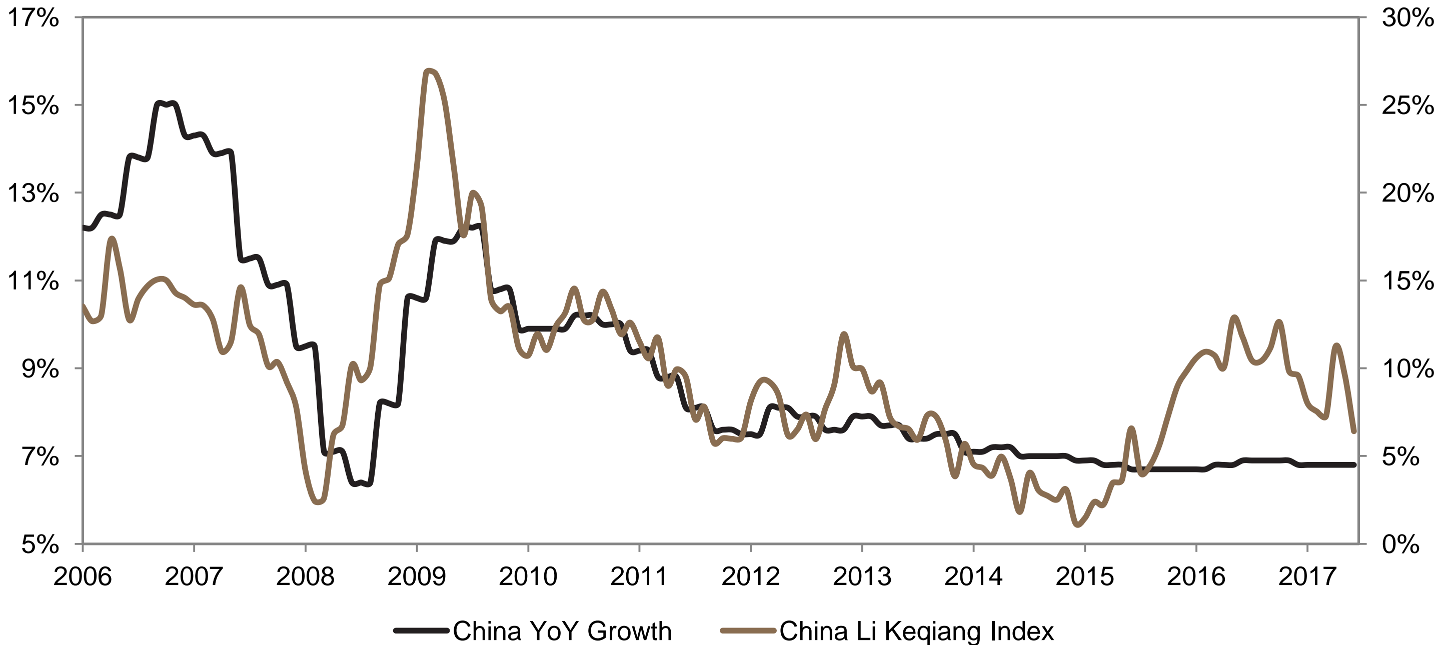
Despite solid earnings growth



- With approximately **50% of the companies of the S&P 500** reporting Q1 earnings, **79%** have reported **earnings above estimates**, and 74% reported a surprise in revenues
- The blended **earnings growth** rate for the period has been **23%**, which if maintained, will be the highest earnings growth since Q3 2010

Source: FactSet

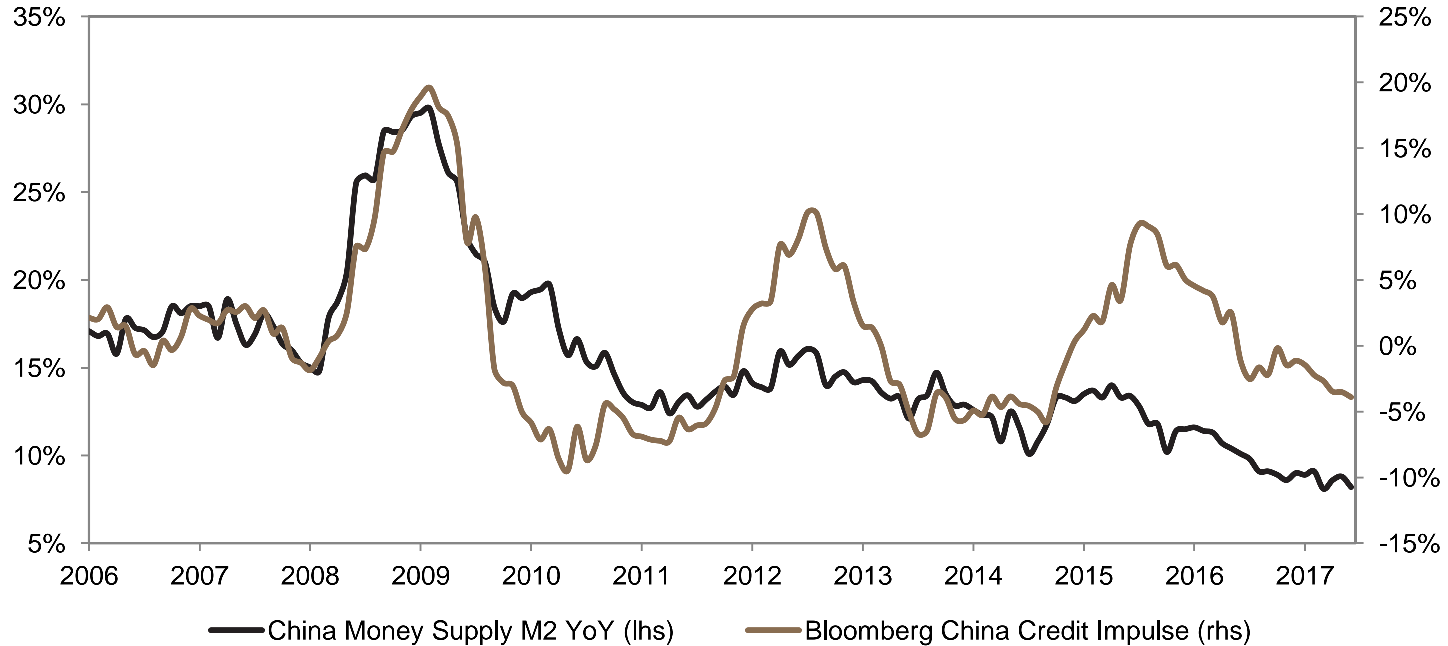
China's impulse fading



- **China's GDP** for the first quarter matched expectations growing at 6.8%. However, widely observed **unofficial estimates** draw a different picture, where **the economy is decelerating** after the government stimulus in 2015
- We believe that the rebound in 2016 has been one of the **main drivers behind the period of synchronized global growth** experienced over the past year. In fact, we are starting to see the first signs of **slowdown in Europe**

Source: Bloomberg

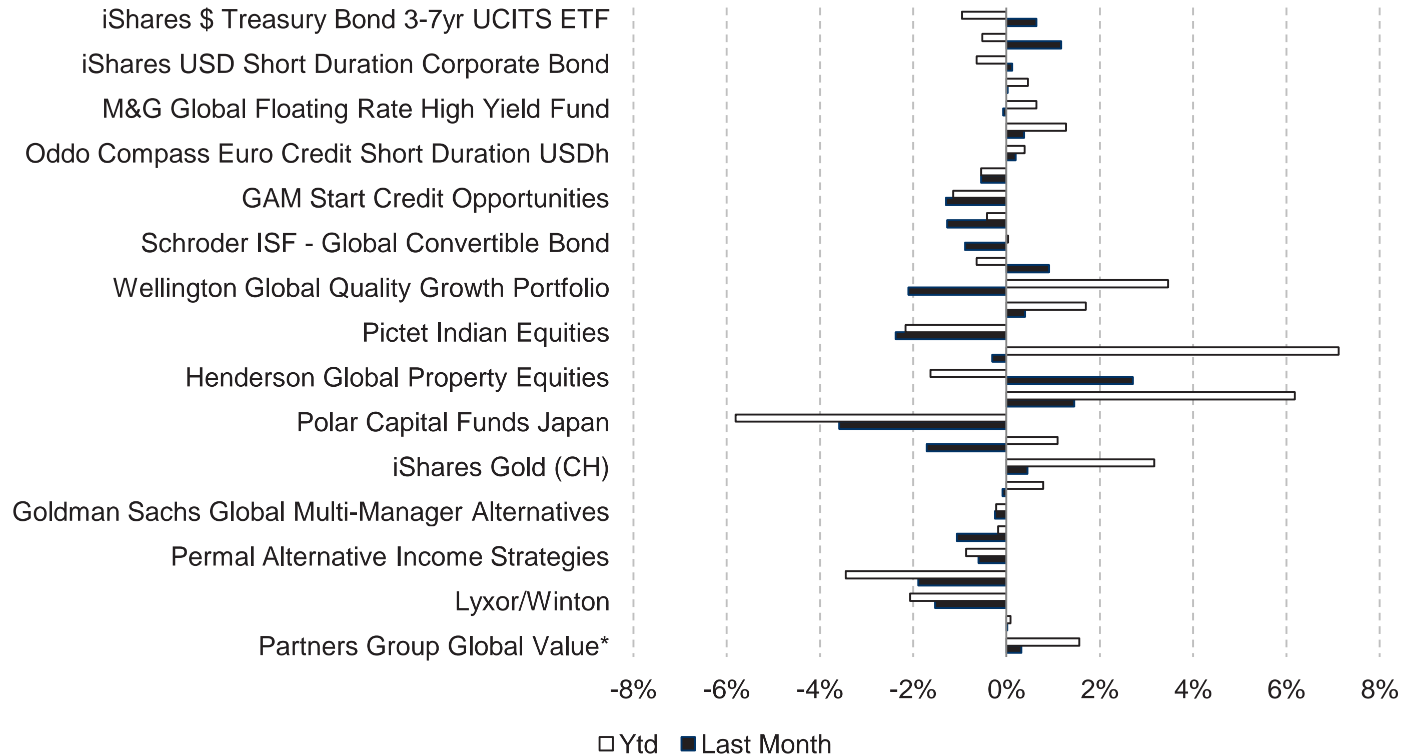
Consequence on deleveraging efforts



- The Chinese authorities look determined to address the **debt problem**, by reigning in public debt issued by local governments, and tightening credit conditions
- However, it remains to be seen whether a **rebalancing** of the Chinese economy can take place **without experiencing a hard landing**

Source: Bloomberg

Model portfolio evolution



- A highly unusual month marked by wide **dispersion within and across asset classes**

Source: Bloomberg as of April 11, 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	30%	40%	30%

Short-term catalyzers

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

Other risks

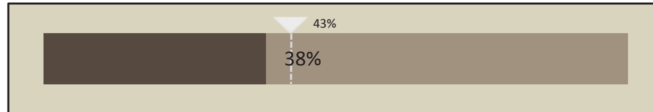
Trade wars, Spread of populist political parties, China slowdown, Terrorism

EWM Investment Policy

Cash

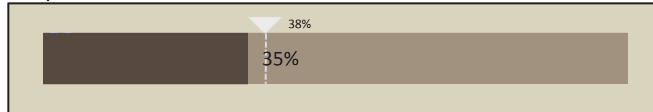
- In the current environment, waiting for good investment opportunities is a sensible investment strategy. However, holding cash is becoming costly due to low interest rates.

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

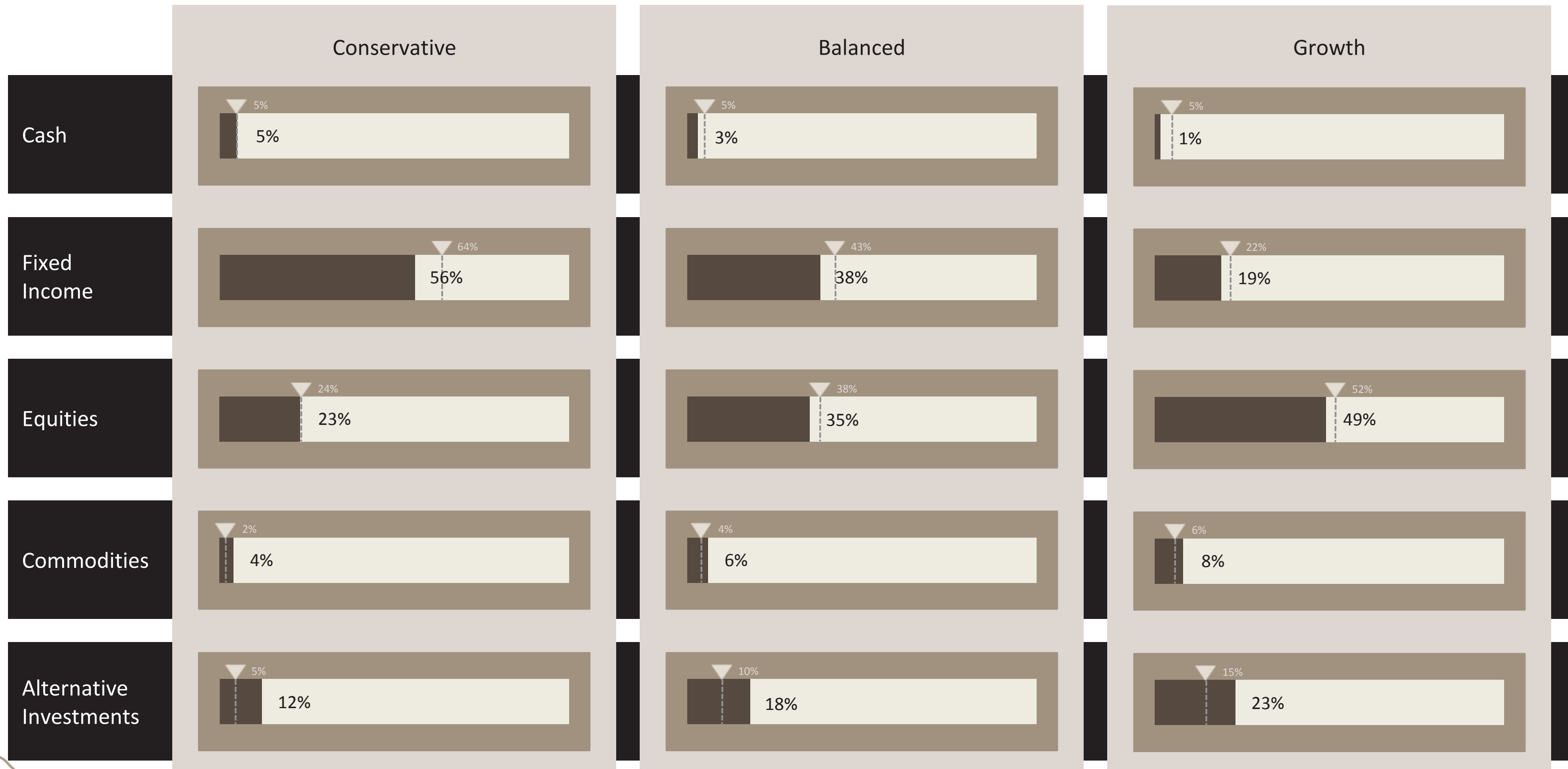
- Alternative investments, as a source of low volatility and uncorrelated returns, are more attractive than ever in the wake of the current latent risks in the market
- However, there is always a certain degree of correlation with traditional asset classes and double digit positive returns cannot be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

Strategic Asset Allocation

EWM Model Portfolio Balanced

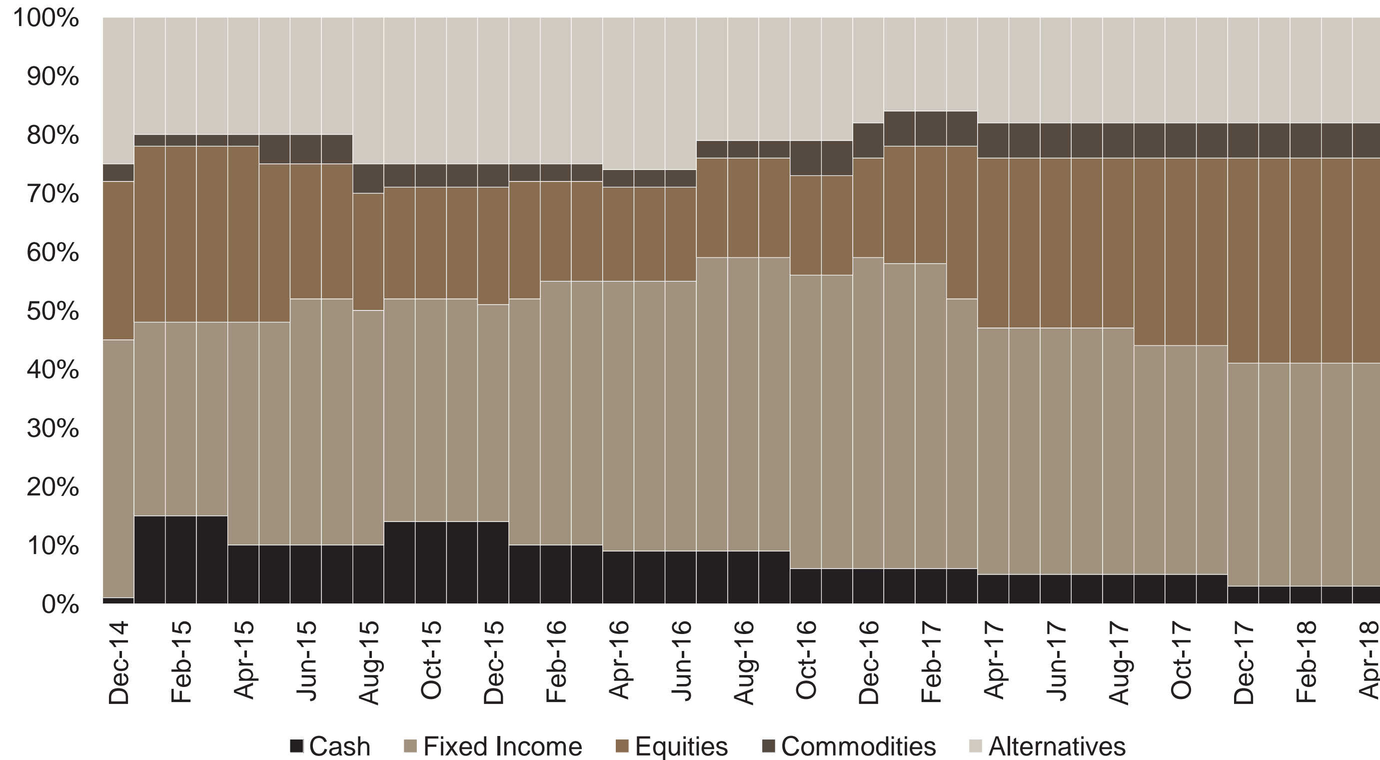
Asset Class	Category	Instrument	Weight	Total
Cash	Cash	• Cash	3%	3%
Fixed Income	US Treasuries	• iShares Treasury Bond 3-7yr	3%	38%
	Short-Term Corporate Bonds	• iShares USD Short Duration Corporate Bond	4%	
	US TIPS	• iShares $ TIPS	5%	
	High Yield US	• Muzinich Short Duration High Yield	3%	
	High Yield Europe	• Oddo Compass Euro Credit Short Duration	3%	
	High Yield Floating	• M&G Global Floating Rate High Yield Fund	3%	
	Leveraged Loans	• Franklin Floating rate II	3%	
	Subordinated Debt	• GAM Star Credit Opportunities	4%	
		• Neuberger Berman Corporate Hybrid	4%	
	Convertible Bonds	• Ellipsis European Convertible Fund	3%	
		• Schroder Global Convertible Bond	3%	
Equities	Volatility	• Reverse Convertibles on Blue Chips	8%	35%
		• Bonus Certificate on Indices	8%	
	Growth	• Wellington Global Quality Growth Portfolio	4%	
	Japan	• Polar Capital Funds Japan	3%	
	India	• Pictet Indian Equities	3%	
	Frontier Markets	• T.Row Price Frontier Markets Equity Fund	3%	
	Biotechnology	• Polar Capital Biotechnology Fund	3%	
	Real Estate	• Henderson Global Property Equities	3%	
Commodities	Diversified	• iShares Diversified Commodity Swap	3%	6%
	Gold	• iShares Gold	3%	
Alternative Investments	Multi-Strategy	• Permal Alternative Income Strategies	2%	18%
	Multi-Strategy	• Amura Absolute Return	2%	
	Multi-Strategy	• Franklin K2 Alternative Strategies Fund	2%	
	Multi-Strategy	• Goldman Sachs Global Multi-Manager Alternatives Portfolio	2%	
	CTA, Diversified	• Lyxor AQR Systematic Total Return	2%	
	CTA, Diversified	• Lyxor Winton Fund	2%	
	Cat Bonds	• Plenum CAT Bond Fund	3%	
	Private Equity	• Partners Group Global Value	3%	

EWM Investment Profiles

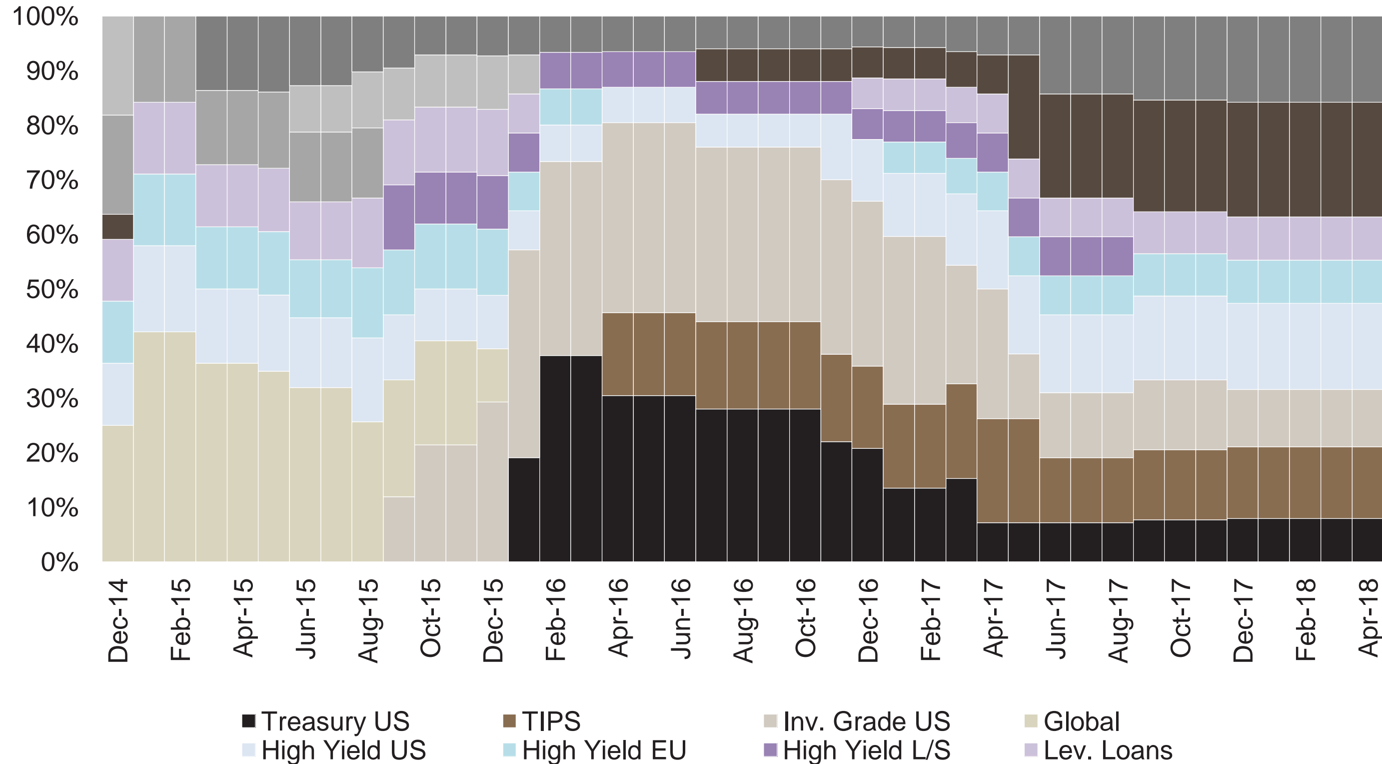


Strategic Asset Allocation

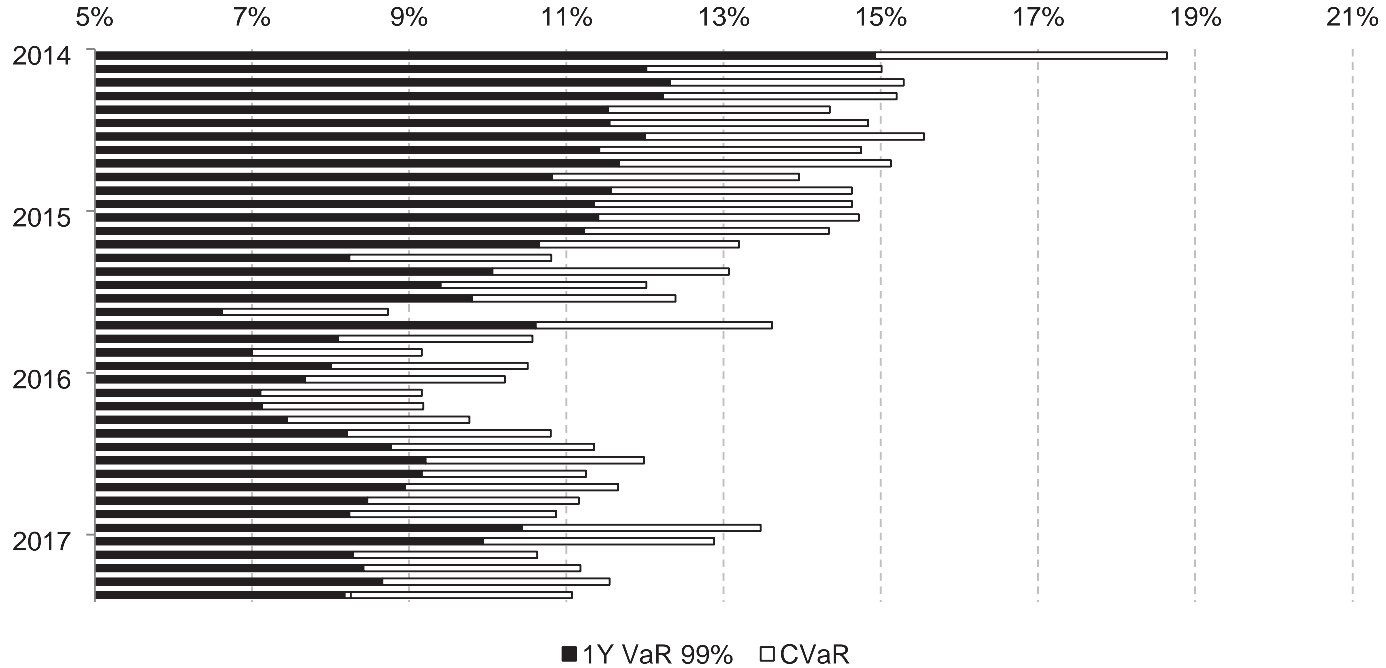
EWM Model Portfolio – Asset Allocation evolution



EWM Model Portfolio – Fixed Income evolution

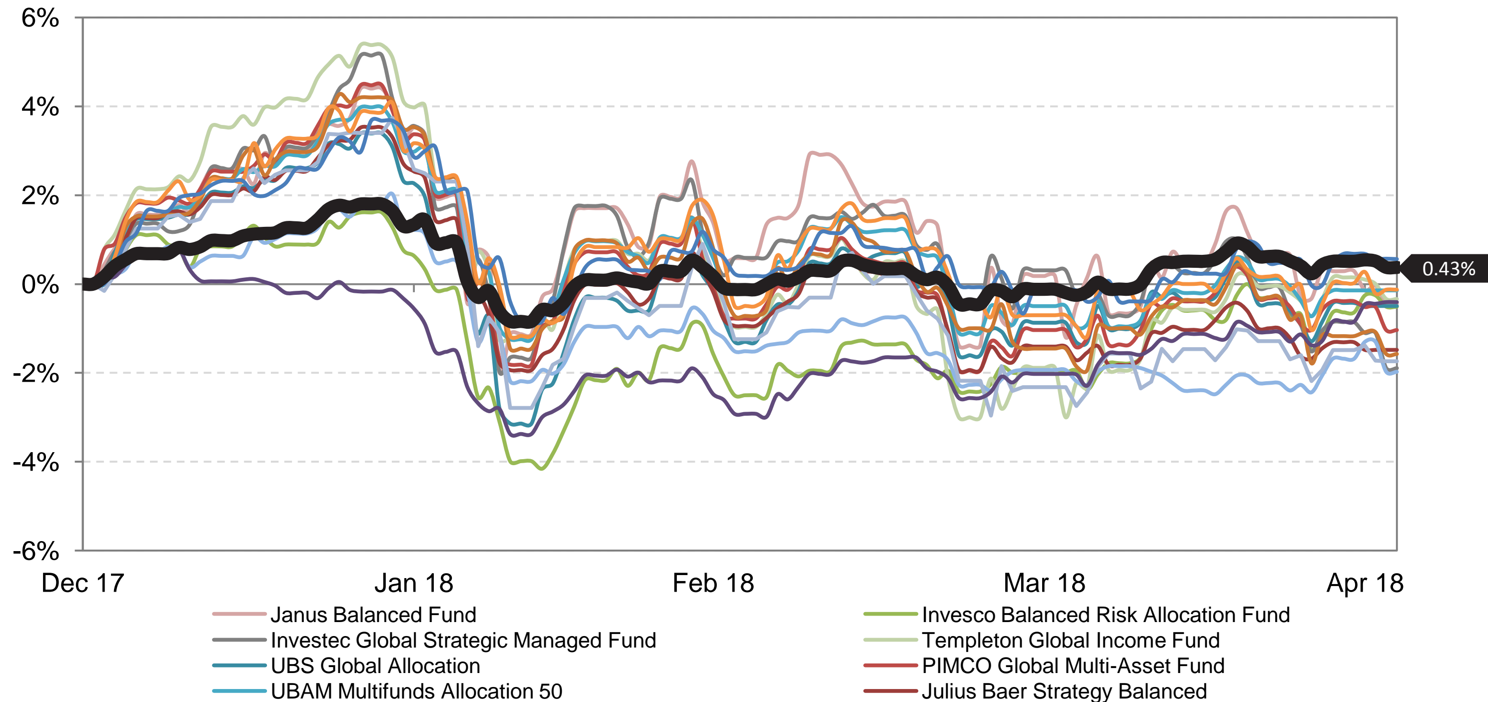


EWM Model Portfolio – VaR evolution



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

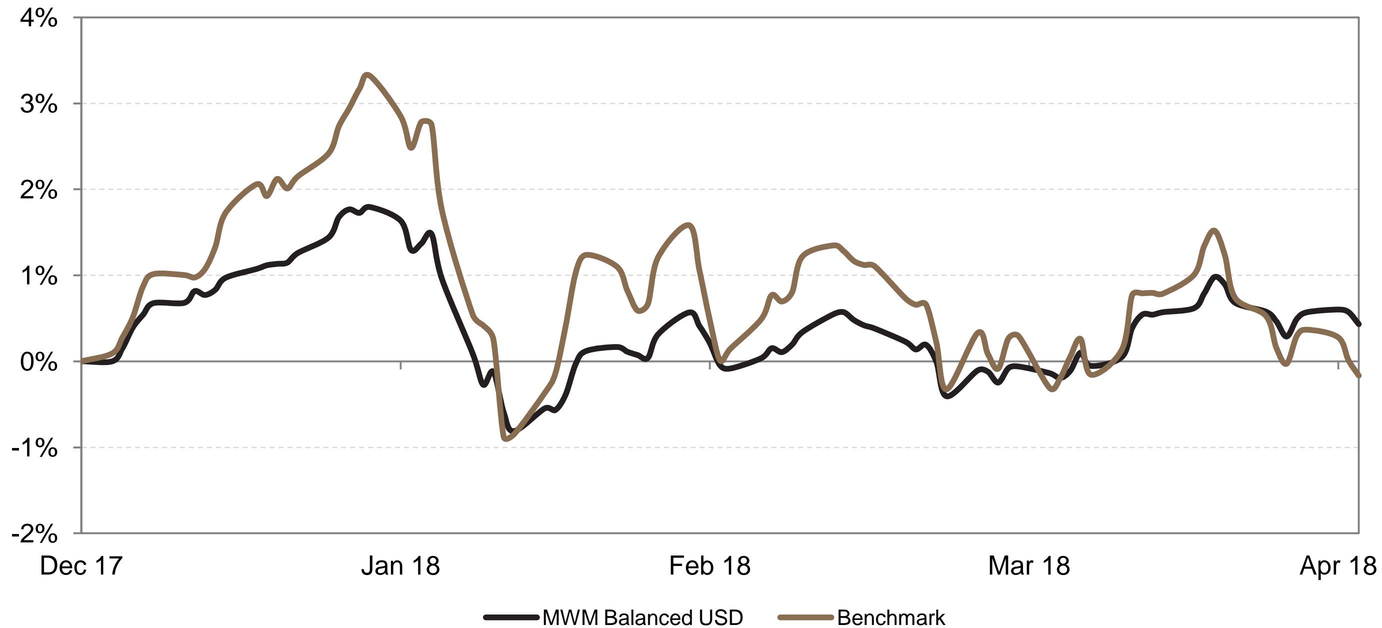
EWM Model Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **2nd 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]): **6th out of 15**

[1] As of May 3, 2018
Source: Bloomberg

EWM Model Portfolio – Ytd performance

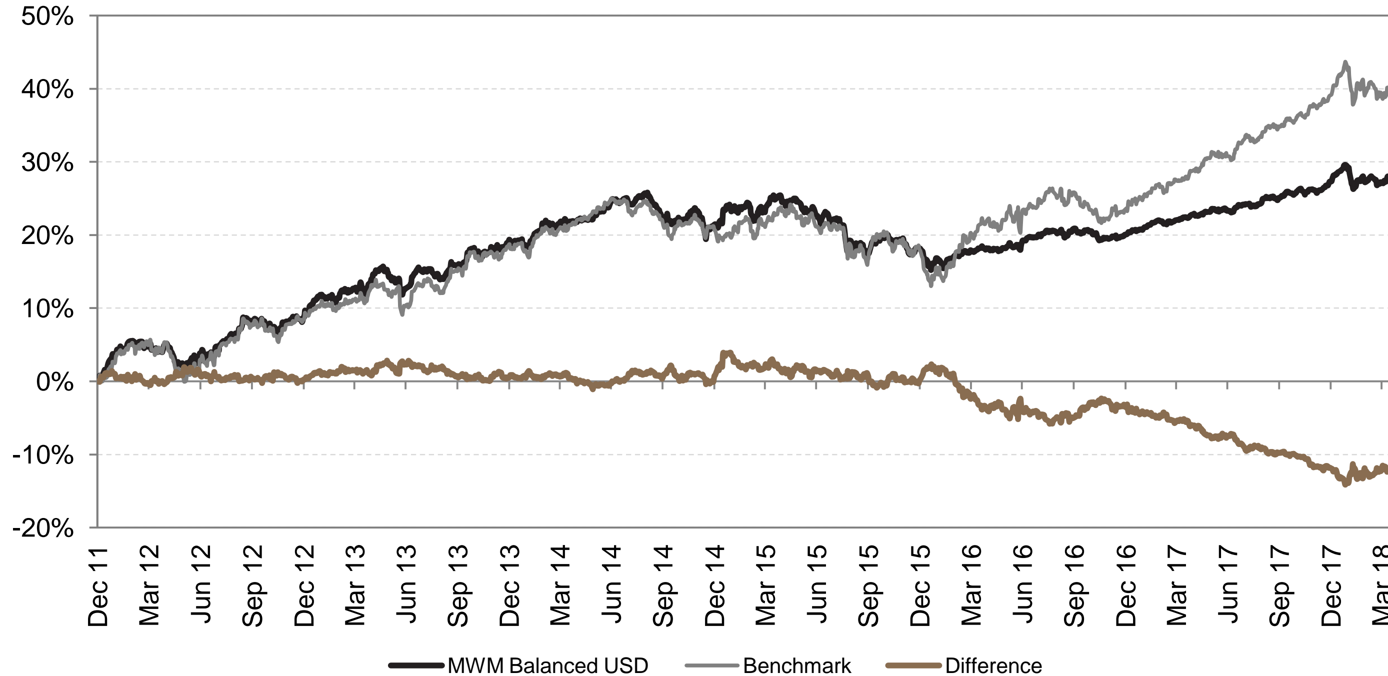


- **Total Return** (Ytd[1]): **0.43%** vs. **-0.17%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.18%** vs. **5.81%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.56%** vs. **4.55%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **-0.09** vs. **-0.34** Benchmark[2]

[1] As of May 3, 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)

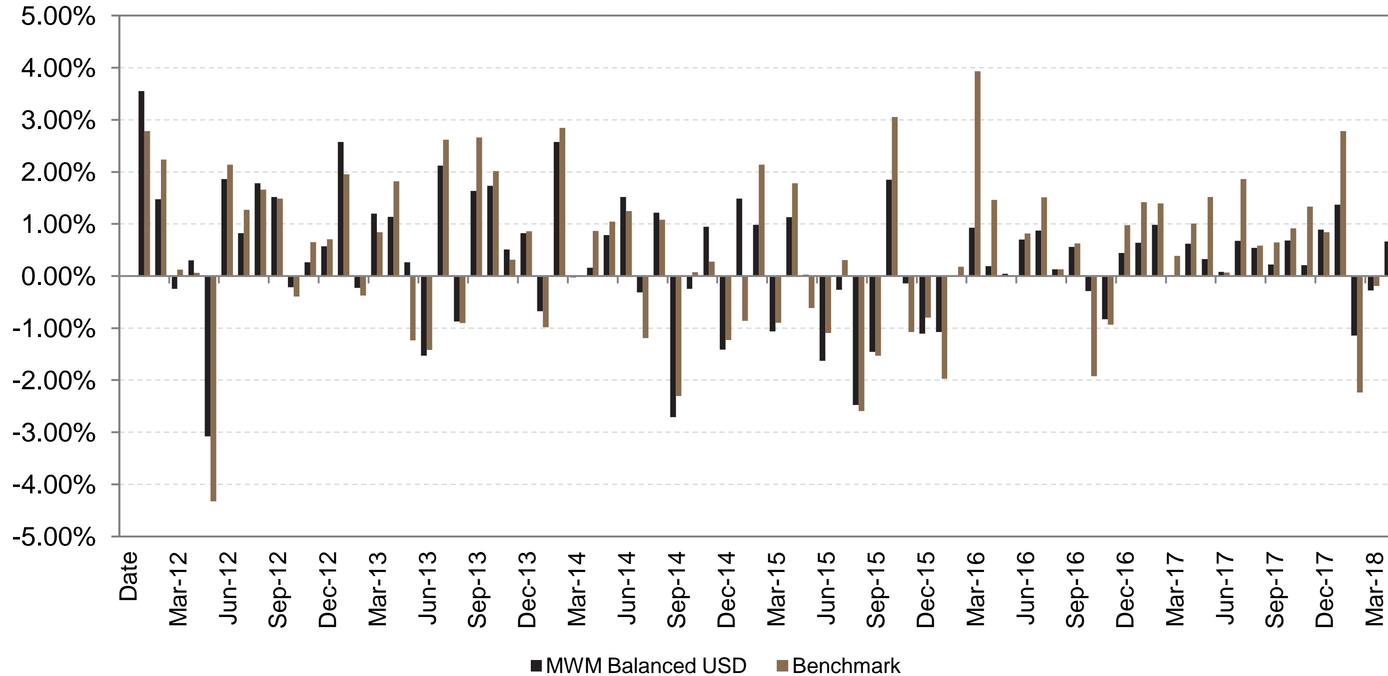


- **Total Return** (1 year[1]): **4.01%** vs. **7.69%** Benchmark[2]
- **Total Return** (3 year[1]): **2.67%** vs. **12.59%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **27.84%** vs. **38.84%** Benchmark[2]

[1] As of May 3, 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]): **2.25%** vs. **4.06%** Benchmark[2]
- **Downside Risk** (1 year[1]): **1.76%** vs. **3.16%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **1.24** vs. **1.61** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.20%** vs. **-0.38%** Benchmark[2]

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