Edwards Wealth Management AG
Switzerland

MORA wealth management

# Investment Policy

October 2018

# Our market view in a nutshell – October 2018

- Rising **interest rates** – both in the short-term and in the long-term – are creating some **market jitters**. On the one hand, with the **Fed normalizing rates**, the opportunity cost of holding cash is decreasing sharply, hence reducing the incentive for investing in risk assets. On the other hand, **long-term interest rates**, which have remained relatively unaffected by the Fed hikes (as monetary policy transmission has decreased its effectiveness over the last decades) are now **resuming the upward trend initiated since the US election**

- The **main risk is that inflation surprises on the upside**, forcing the market to revise its long-term inflation expectations, which have remained very much subdued despite the economy running at full steam. In this respect, the **acceleration in wages** and the recovery of **core inflation**, which is already at the Fed's target level, are at the center of attention of both the Fed and the markets

- Against this backdrop, **equity markets in the US have been supported by a rise in corporate profits** that have exceeded the rise in the discount rate, and even caused P/E multiples to compress to more normal levels. However, **maintaining the current high rate of growth in earnings will be very challenging**. For this reason, we prefer **growth over value stocks**, whose rate of profit growth we find more difficult to maintain

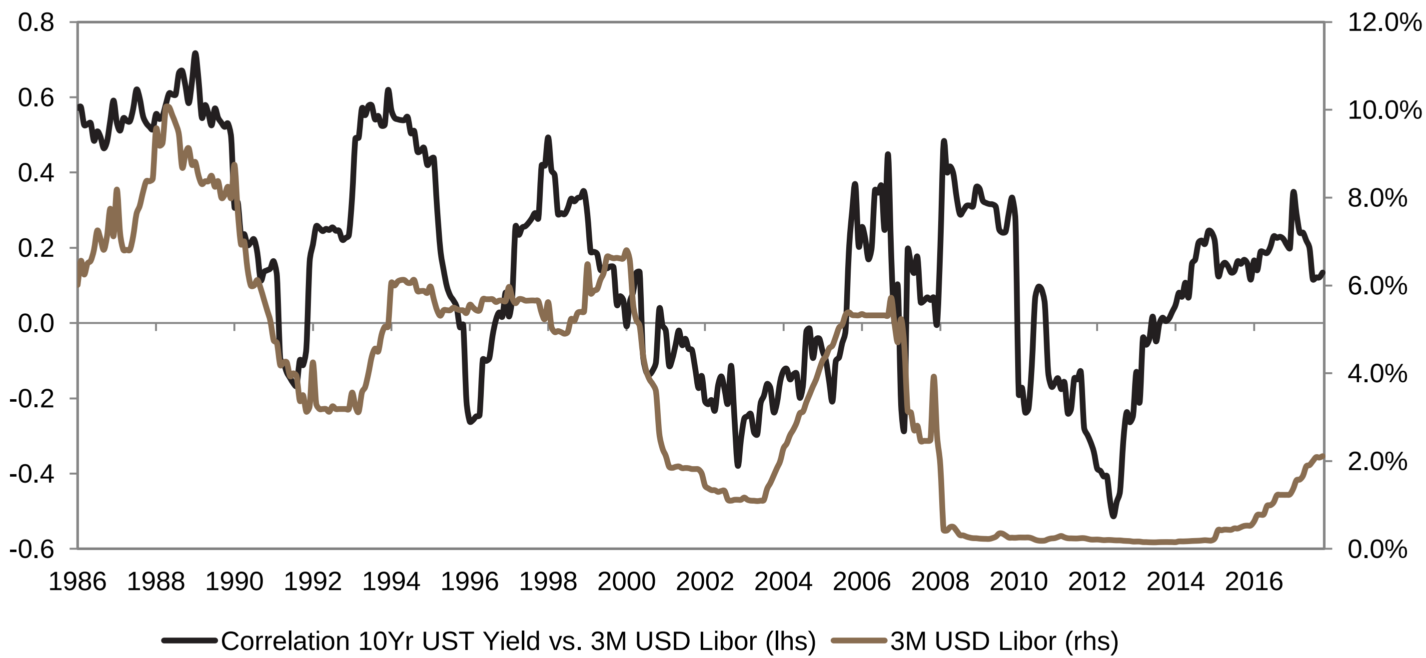
- Besides the risks posed by a rising interest rates environment, we continue carefully looking at the **response of the Chinese authorities to the trade dispute** with the US, as well as to the market turbulences that a **belligerent Italy** may induce in the Eurozone

# 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 | – | We avoid Emerging Markets until there is more clarity on the new US administration trade policy, and the effects of a stronger dollar and higher financing costs for Emerging Markets are calibrated by the market |
| **Equities** | US | – | Equity valuations in the US remain very high, mostly supported by low long-term interest rates, but also due to a reacceleration in profit growth consequence of the tax reform and the deregulation agenda. We retain an exposure to the US market via quality growth 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 | + | Multi-manager/ multi-strategy hedge funds that offer daily liquidity offer a much needed source of diversification |
| | Multi-Strategy Hedge Funds | = | Our diversified commodities and gold allocations, further help us to increase diversification and to protect the portfolios against a scenario of rising inflation |
| | 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

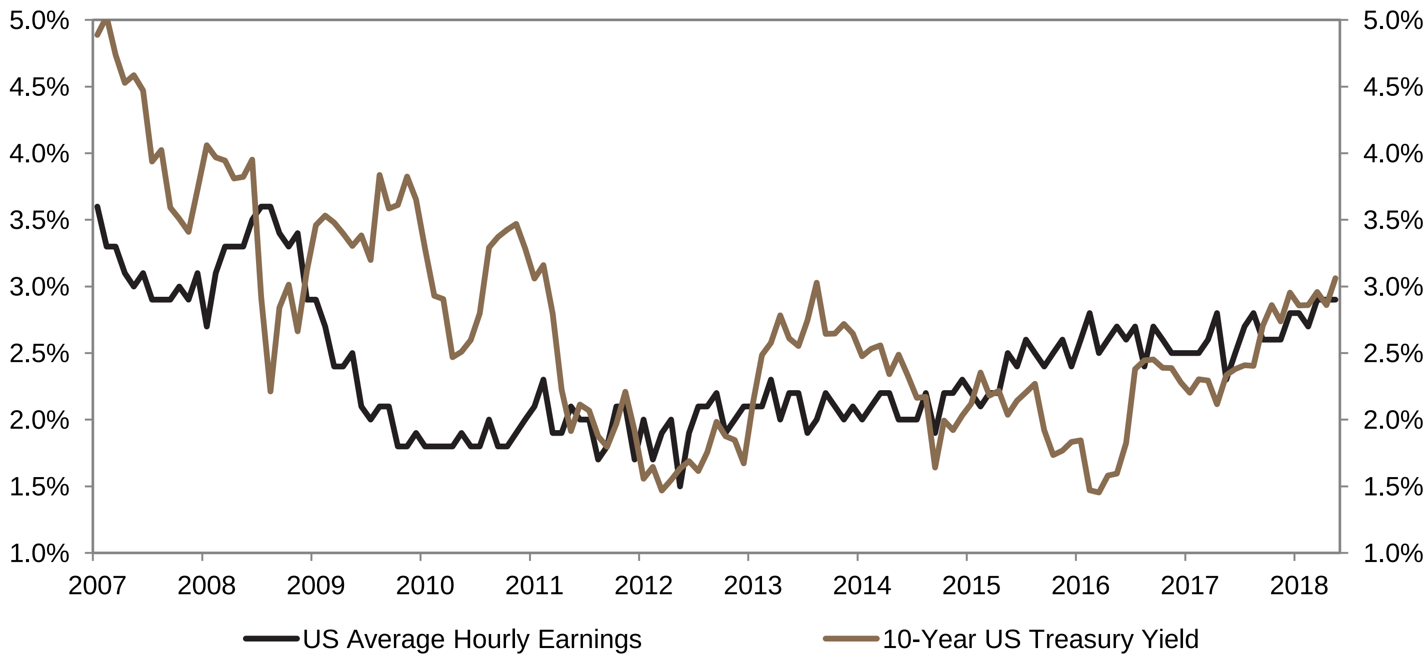
# Monetary policy transmission weakening over time




- **Monetary policy transmission** is proving increasingly ineffective. **Correlation between the short and the long** end of the curve is on a **secular decline**, as inflation remains anchored by structural factors
- This is a major factor behind the **flattening of the yield curve**, that is complicating monetary policy implementation by the Fed

Source: Bloomberg

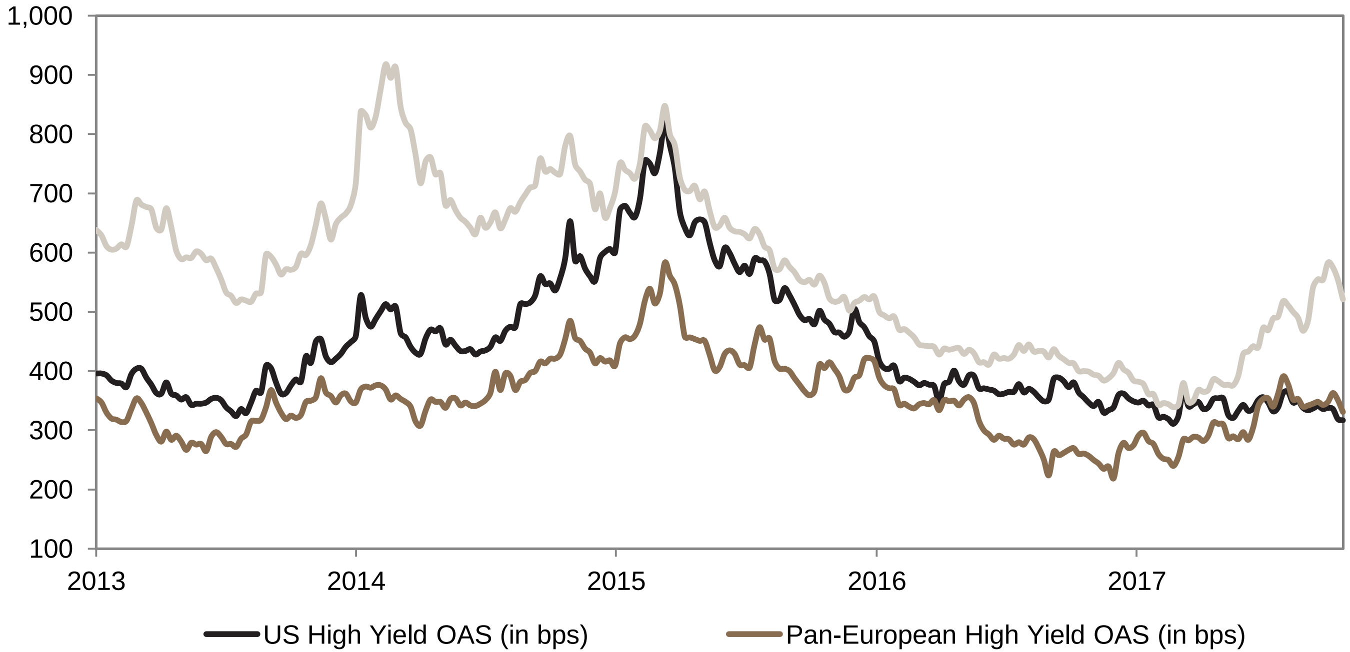
# Inflation is the variable to watch for now




- **Long-term interest rates** correlate with **inflation expectations.** The latter have remained subdued, as the usual **relationship between unemployment and inflation** seems to be broken
- However, we can observe some pick-up in in **wage-inflation** and a **normalization of consumer inflation** towards the Fed's target. Should inflation accelerate from this point, the market may be forced to **drastically review its expectations**

Source: Bloomberg

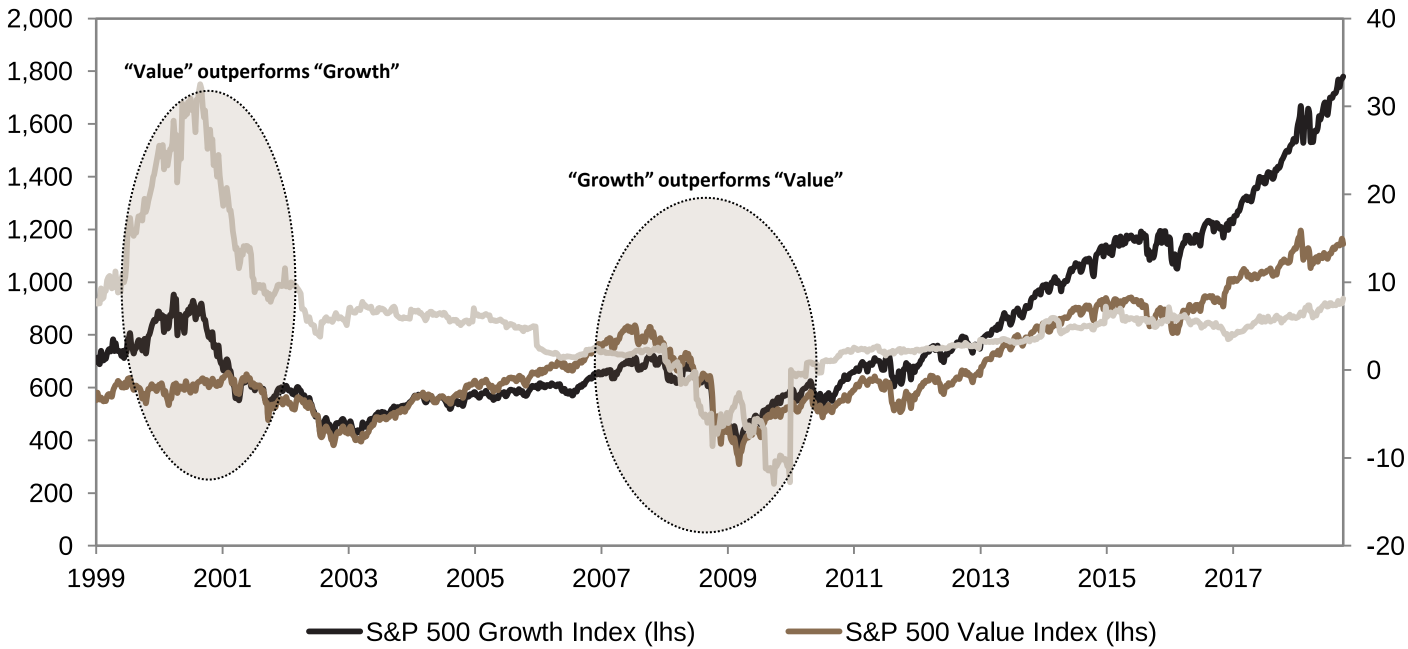
# Financial conditions remain loose despite Fed hikes




- The other main determinant of financial conditions are **credit spreads**. Here we continue to observe a very **favorable environment for risk assets**, despite the widening of spreads in Emerging Markets and European High Yield
- This is a reflection of the **low probability that the market is assigning to an economic recession** in the near term, and supports maintaining our credit exposure (though with short interest rate duration)

Source: Bloomberg

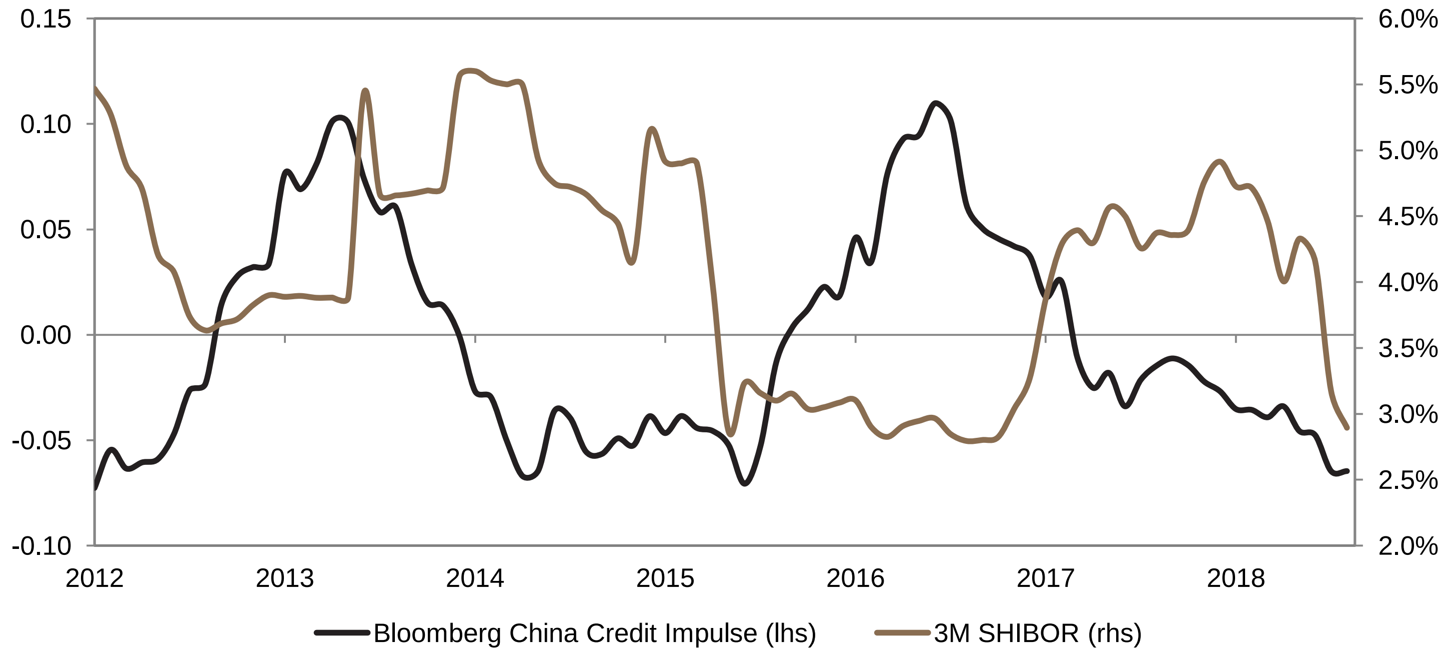
# Growth stocks can be defensive




- **Interest rates are a key determinant of equity valuations**, as low interest rates can accommodate for higher multiples. So far, **growth in corporate earnings have compensated for the increase in interest rates**, bringing the P/E multiple down without a correction in price
- In fact, companies that exhibit **quality growth in earnings** (not just in sales) tend to be **less sensitive to multiple contraction** when a downturn occurs (growth P/E falls more because earnings hold on better)

Source: Bloomberg

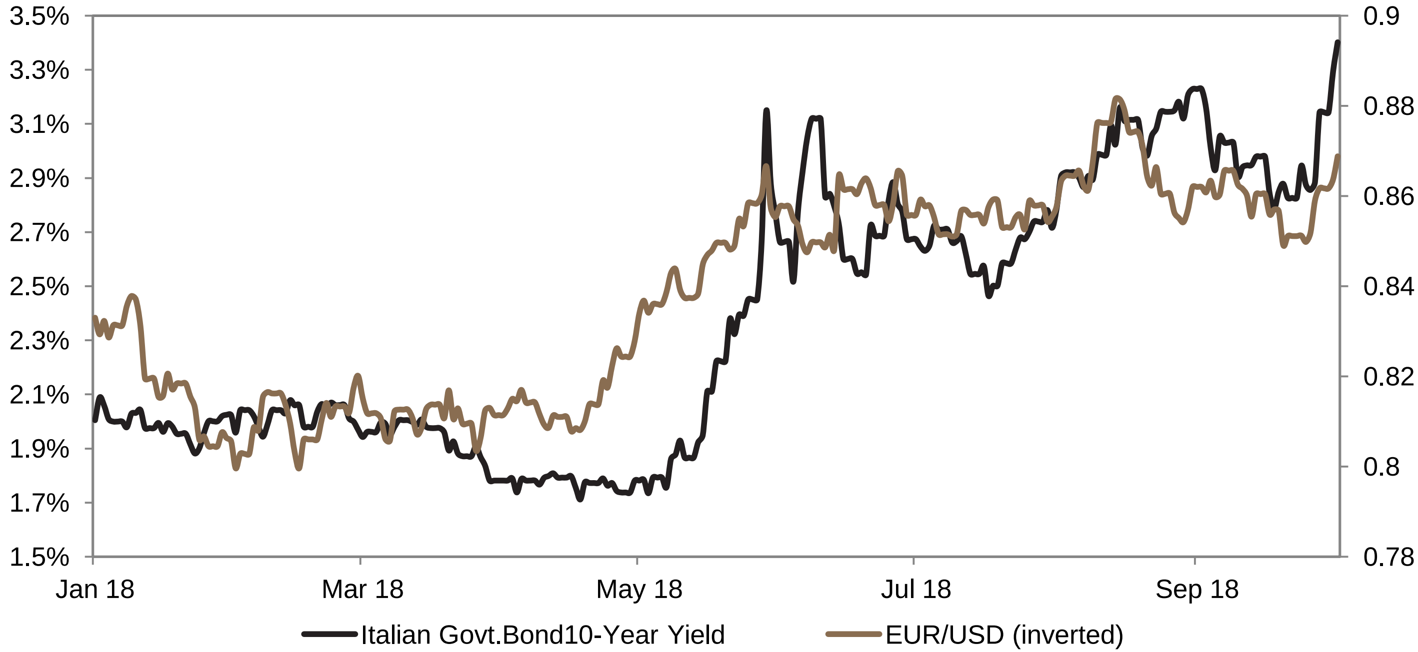
# China: pressing on gas and brake at the same time




- Whilst the fed keeps on normalizing rates, China has **sharply eased monetary policy** to counteract a slowdown of its economy and (although not overtly) to **depreciate the Yuan** to counteract the tariffs imposed by the US
- This means **another step back in their efforts to reign on the debt problem**, and a reflection of the **vulnerabilities** they face in **transitioning to a service/consumption economy**, from an export/savings one

Source: Bloomberg

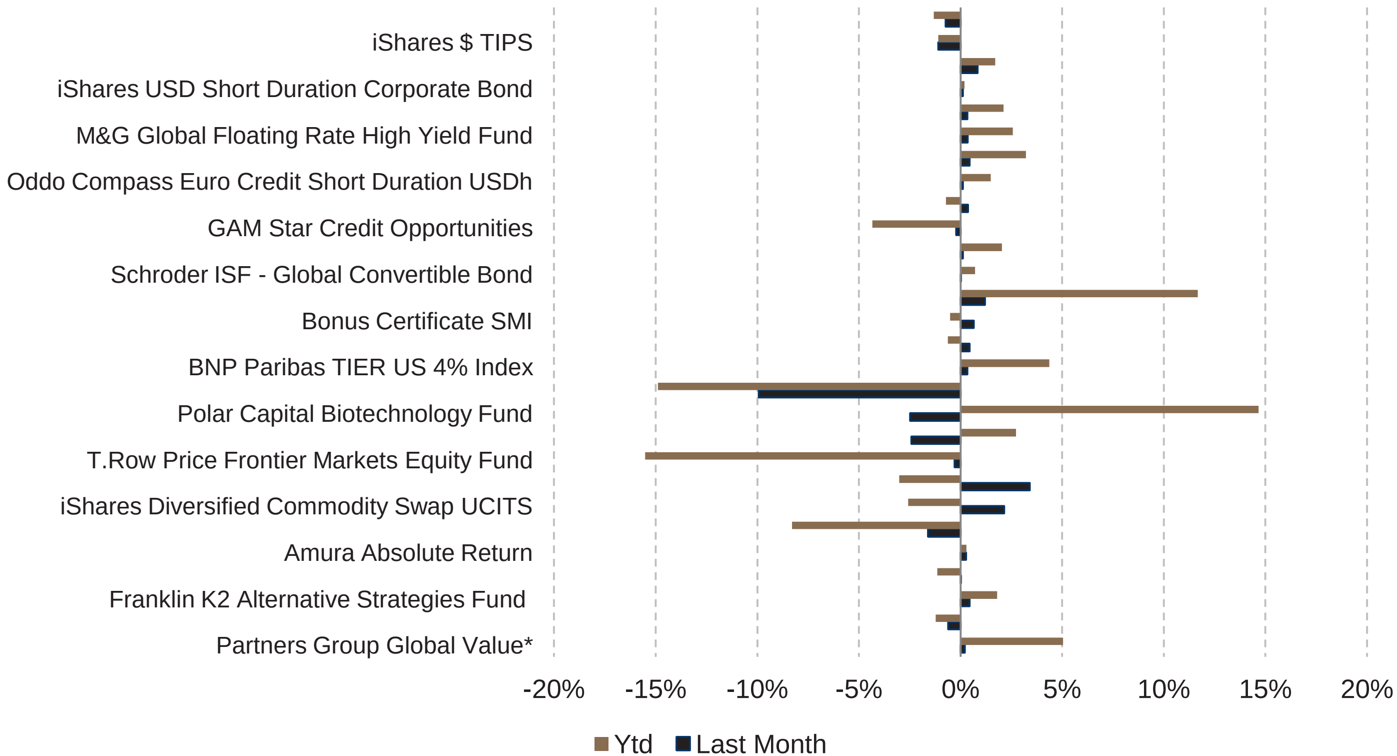
# A new Euro crisis is brewing




- The new **Italian government** is set on **collision course with the EU**, and this time the magnitude of the challenge poses an existential **threat to the common currency**
- We expect Italy to lobby within the EU for a competitiveness funds, for a **lessening of the budgetary discipline** and for a continuation of the current **ultra loose monetary policy**; all them a **negative for the Euro**

Source: Bloomberg

# Model portfolio evolution




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

# Investment scenarios

| | **Scenario 1**<br>Recession by political/policy accident | **Scenario 2**<br>Goldilocks | **Scenario 3**<br>New regime |
|---|---|---|---|
| Drivers | • Global economic slowdown caused by political accidents or policy errors (Trade war with China, EU breakup, a too aggressive Fed, etc.)<br>• Deflationary scenario due to a combination of low growth and structural factors, although the rise of protectionism would be inflationary<br>• 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<br>• Inflation, particularly in the US will pick-up, but remains subdued globally due to structural factors (demographics, low aggregated demand, deleveraging)<br>• The Fed will continue its normalization path | • Growth concerns dissipate, with economic activity accelerating in US, Europe and Japan<br>• Inflation in the US increases, as a consequence of president Trump's fiscal stimulus, and pulls other developed economies off deflation<br>• 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<br>• Correction in equities due to lower projected earnings, though low rates will offer support<br>• Sovereign and IG credit to profit due to flight to quality and the continuation of an ultra-loose monetary policy globally<br>• USD neutral to weak as flight to quality is counterbalanced by low interest rates<br>• Commodities will fall | • Equities appreciate moderately, with Europe and Japan catching up with the US<br>• Credit spreads remain stable as the credit cycle is further elongated<br>• Sovereigns suffer as monetary policy is progressively normalized<br>• USD appreciate moderately due to higher interest rate differentials<br>• 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<br>• Sovereign and IG bonds will face steep losses due to higher rates, particularly if long-term inflation expectations rise<br>• Corporate credit will correct moderately if inflation comes together with higher growth<br>• The USD will appreciate, particularly against those currencies facing deflation<br>• Commodities will gain from higher inflation |
| Probability | 40% | 30% | 30% |

**Short-term catalyzers**

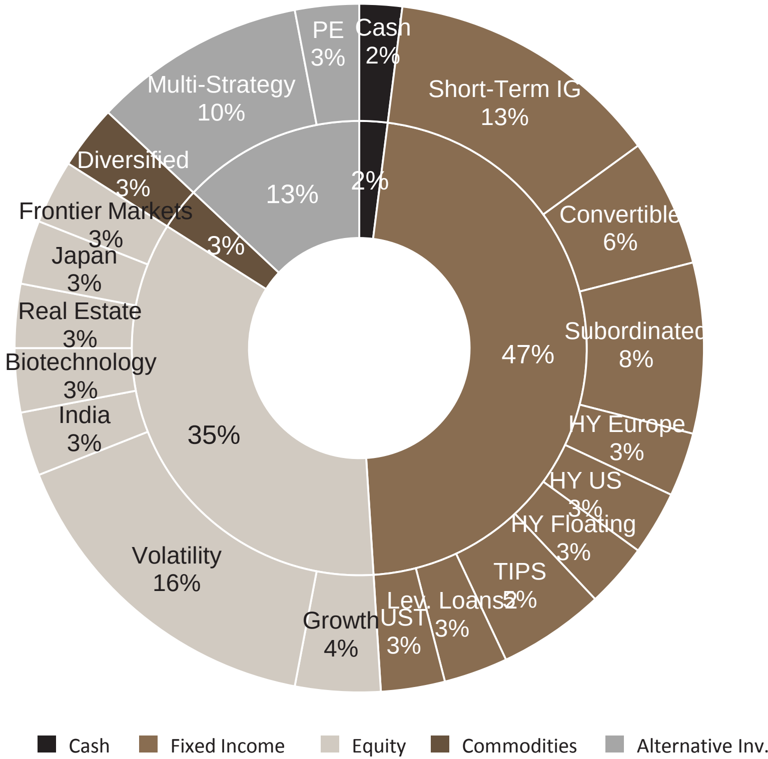
Fiscal stimulus in the US, improvement in macro-data globally, lower geopolitical tensions

**Other risks**

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

# EWM Model Portfolio Balanced USD

**Asset Allocation**



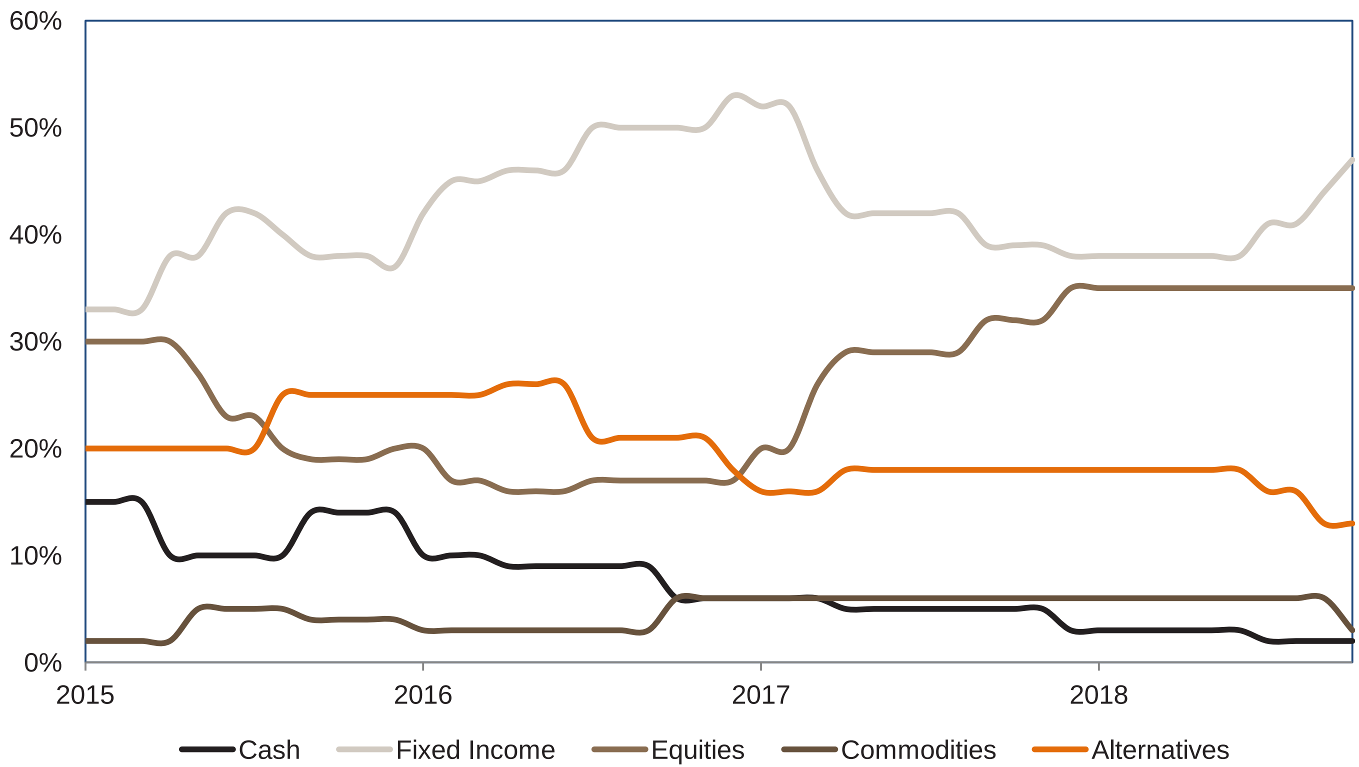

**Currency Allocation**

# EWM Investment Profiles

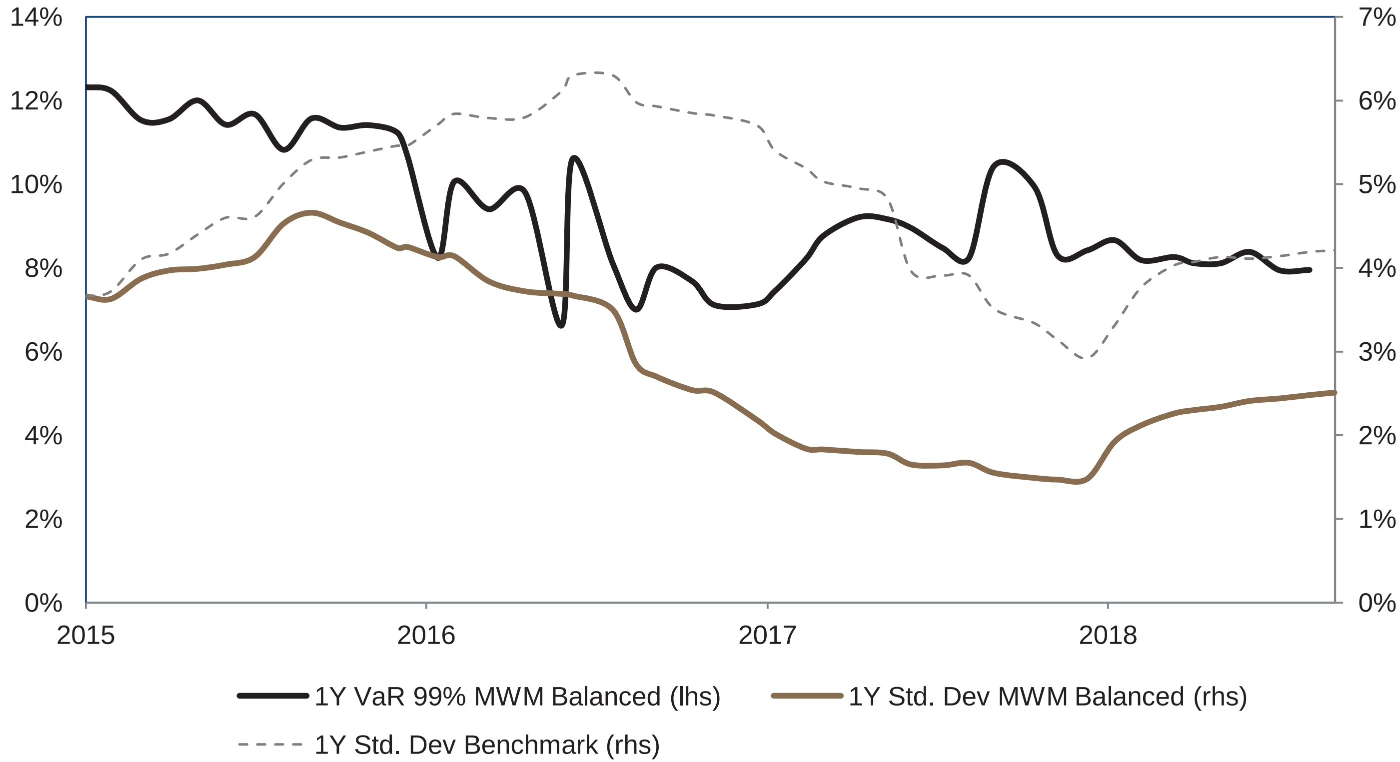
| | Conservative | | Balanced | | Growth | |
|---|---|---|---|---|---|---|
| | Allocation | Strategic Asset Allocation | Allocation | Strategic Asset Allocation | Allocation | Strategic Asset Allocation |
| Cash | 3% | 5% | 2% | 5% | 1% | 5% |
| Fixed Income | 64% | 64% | 47% | 43% | 30% | 22% |
| Equities | 23% | 24% | 35% | 38% | 49% | 52% |
| Commodities | 2% | 2% | 3% | 4% | 4% | 6% |
| Alternative Investments | 8% | 5% | 13% | 10% | 16% | 15% |

▼ Strategic Asset Allocation

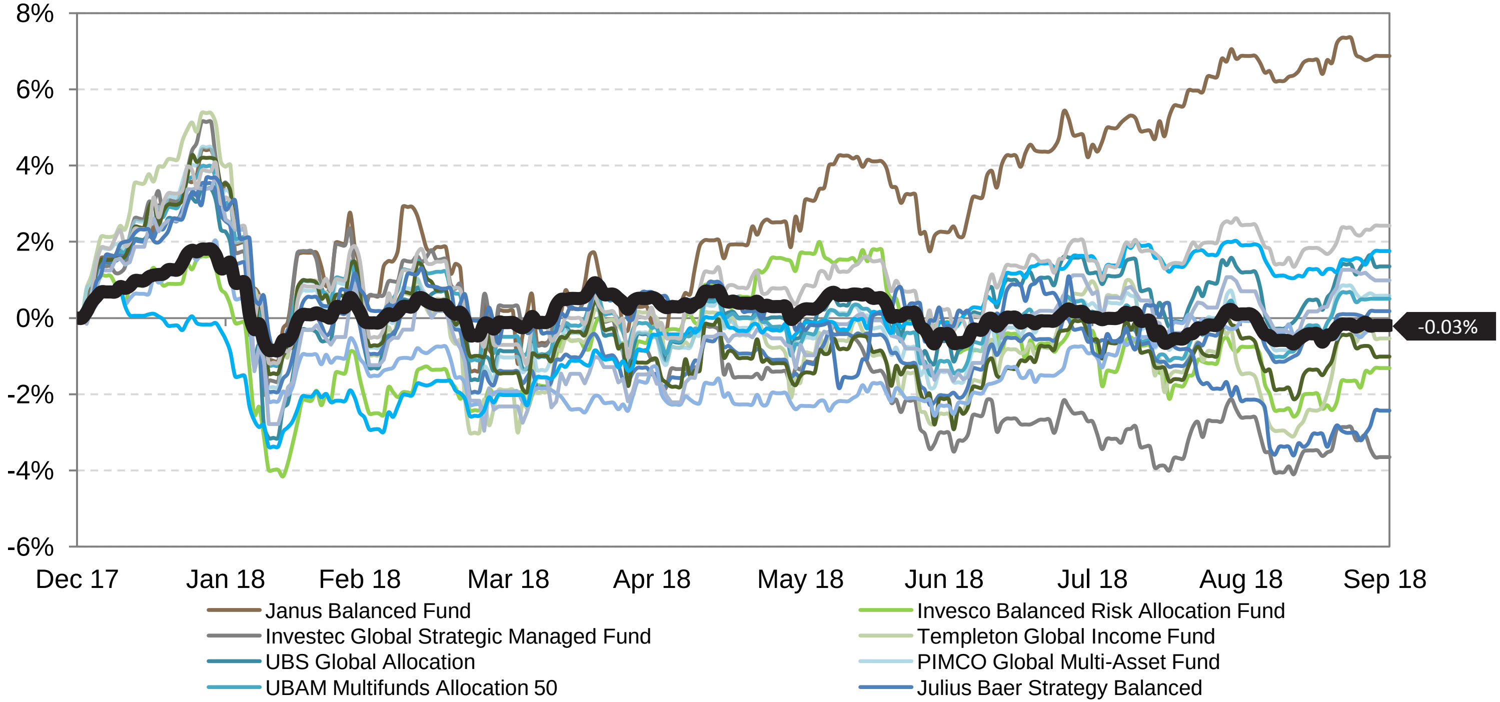
# EWM Model Portfolio – Asset Allocation evolution



# EWM Model Portfolio – VaR evolution



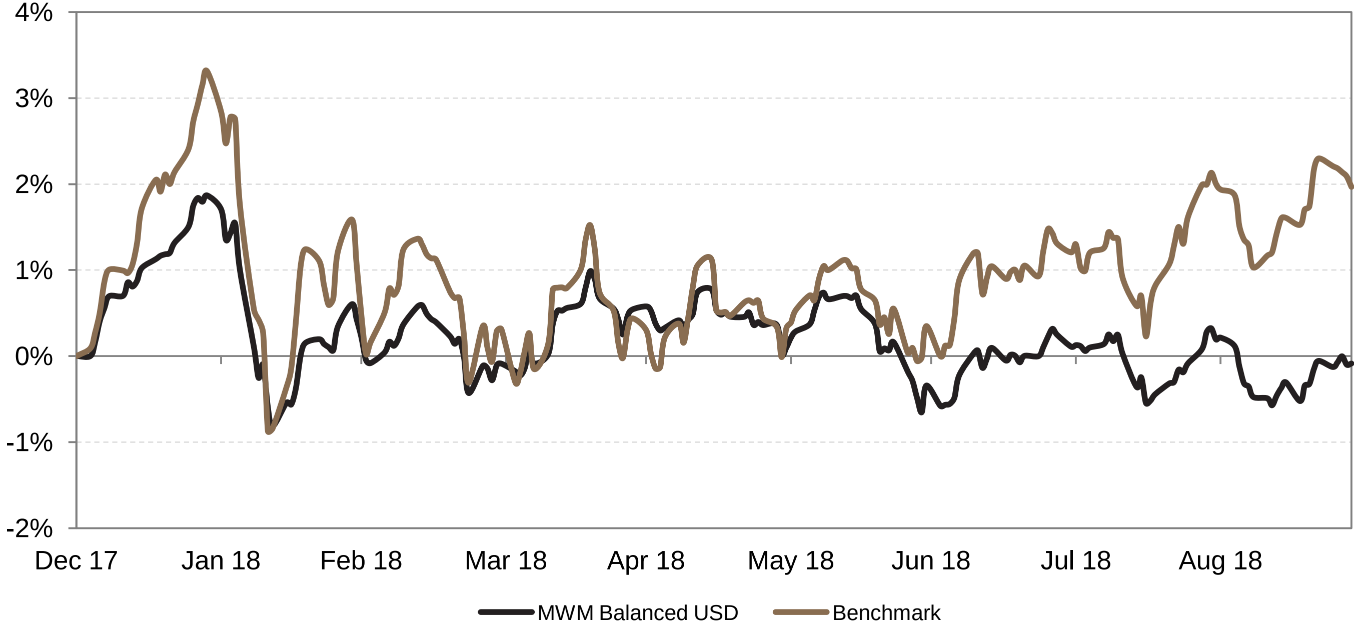
# EWM Model Portfolio – Peer comparison




- **Total Return** (Ytd[1]): **9th 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]): **10th out of 15**

[1] As of October 2, 2018
Source: Bloomberg

# EWM Model Portfolio – Ytd performance

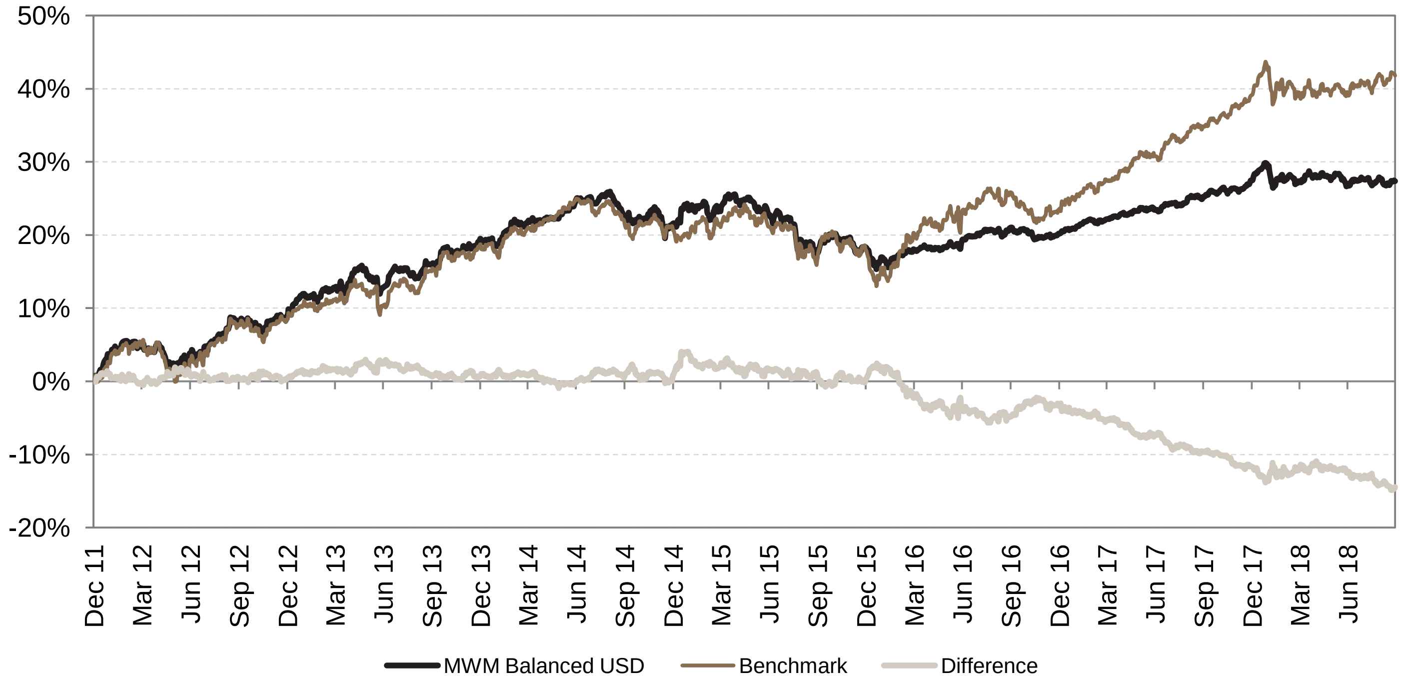



- **Total Return** (Ytd[1]): **-0.03%** vs. **1.97%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **2.73%** vs. **4.65%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.15%** vs. **3.60%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **-0.67** vs. **0.19** Benchmark[2]

[1] As of October 2, 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)

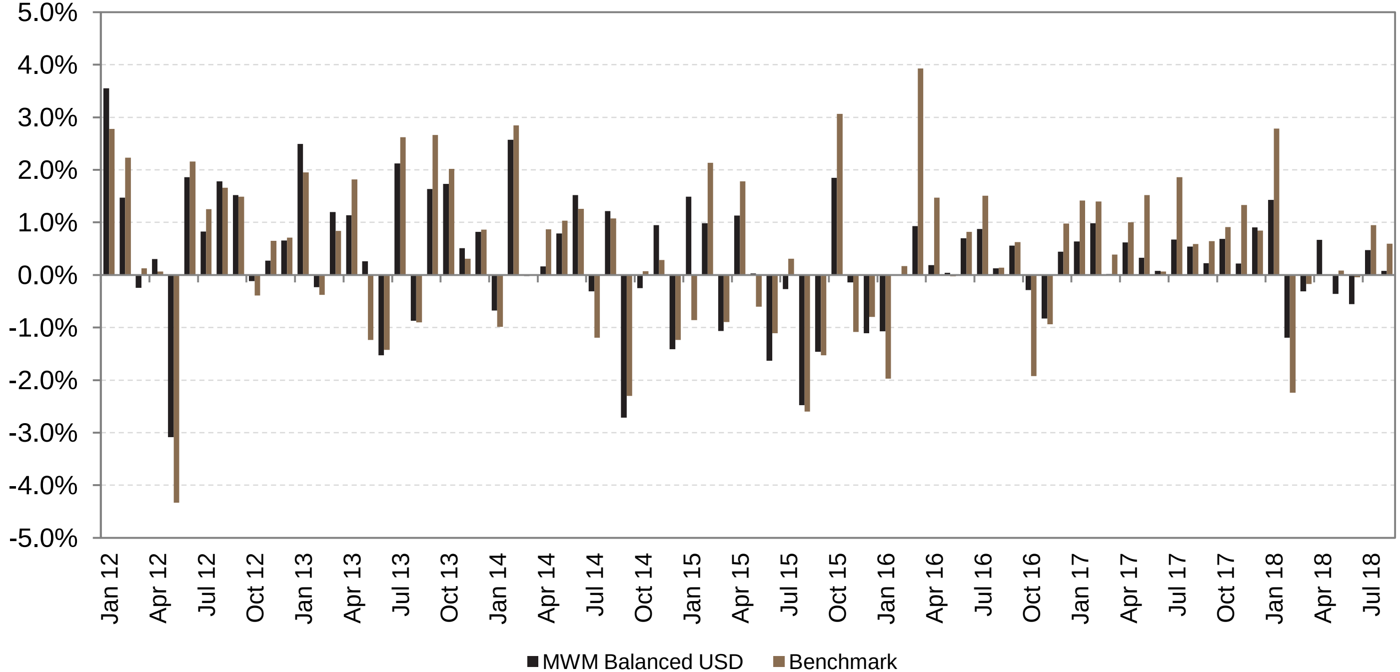



- **Total Return** (1 year[1]): **1.76%** vs. **5.19%** Benchmark[2]
- **Total Return** (3 year[1]): **8.30%** vs. **20.53%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **27.43%** vs. **41.80%** Benchmark[2]

[1] As of October 2, 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]): **2.50%** vs. **4.20%** Benchmark[2]
- **Downside Risk** (1 year[1]): **1.97%** vs. **3.26%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **0.05** vs. **0.86** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.24%** vs. -**0.46%** Benchmark[2]

[1] As of October 2, 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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