Edwards Wealth
Management AG
Switzerland

Investment Policy

August 2020

Our market view in a nutshell – August 2020

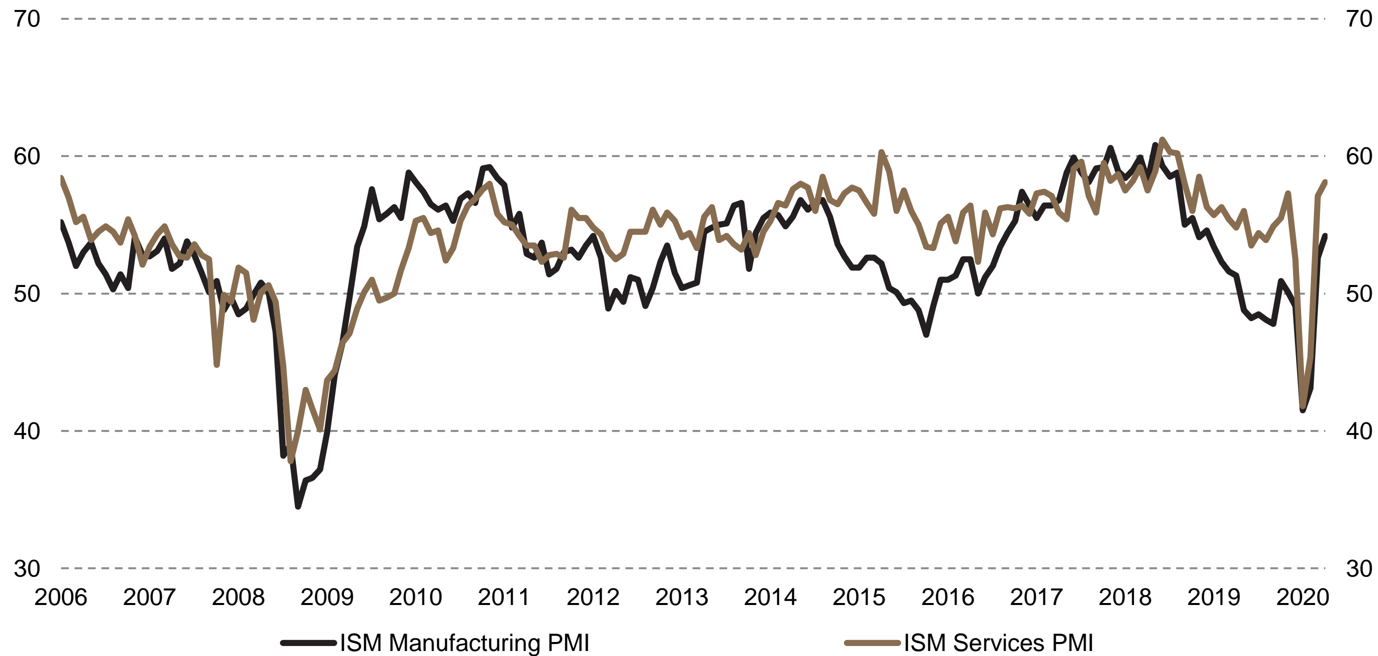
- **Macroeconomic data remains supportive, although the pace of the recovery is slowing**. This is consistent with an economy that experienced a boost once lock-downs were lifted, but has to continue to grapple with restrictions on mobility and social distancing measures due to the recent surge in virus infections
- The massive **fiscal and monetary support is acting as a sort of insurance for economic agents**, who until now are **refraining from reducing consumption and investment**. However, economies continue to operate significantly below potential, and governments must remain vigilant and provide a new round of stimulus if necessary
- The road back to normality will not be easy as **unemployment has risen dramatically and at the same time the economy is rapidly transforming as a result of the pandemic**. The new economy that emerges from it will be more productive, but also more unequal, and will face high restructuring costs in the short term. This will continue to put **downward pressure on interest rates for years to come**
- Only in this context of extremely low interest rates can it be explained why equity markets have recovered in record time. With the **yield on US Treasuries below 1%, the equity risk premium continues to be above 3%**; which is well above its historical average. Furthermore, this figure already assumes a drop in corporate earnings of around 25%, leaving ample **room for a price appreciation** when the economy finally recovers
- There is some **concern that the market rally has been driven by a handful of tech stocks**, rendering the market more vulnerable. But the situation is not at all unusual since each era has its leading companies; which only emphasizes the **importance of diversification and keeping an open mind to change**
- Another consequence of the drop in interest rates is being felt in the **currency markets**. Given that the Fed's normalization target is long gone, the interest rate differential between the dollar and most currencies has narrowed dramatically. And after a brief appreciation caused by the search for liquidity during the worst moments of the crisis, **fundamentals are finally causing the dollar to weaken**

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

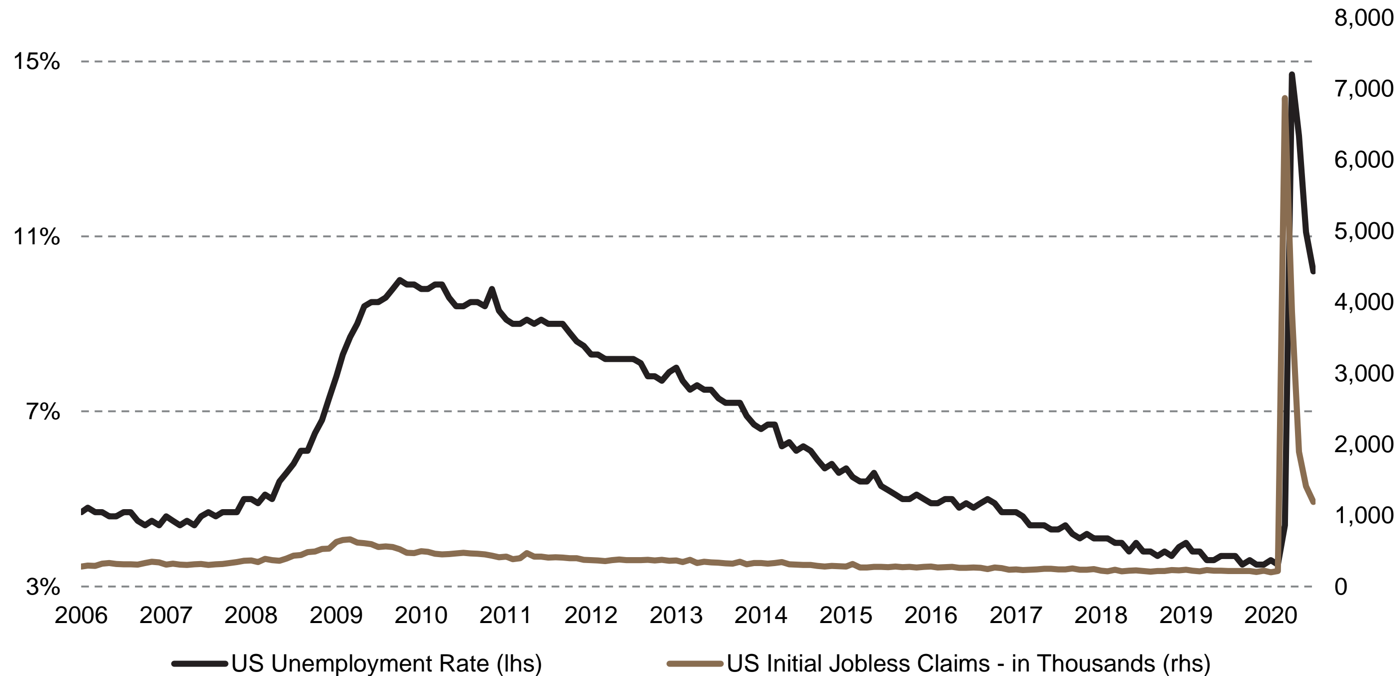
Macro data supports V-shaped recovery



- Leading indicators continue to point towards an **expansion in economic activity, but the pace of recovery is slowing**, as the pandemic continues to strongly affect both mobility and consumption patterns
- It is critical that both **consumption and the housing market have returned to their normal levels**, making it easier to **avoid the typical negative feedback loop** that often deepens recessions

Source: Bloomberg

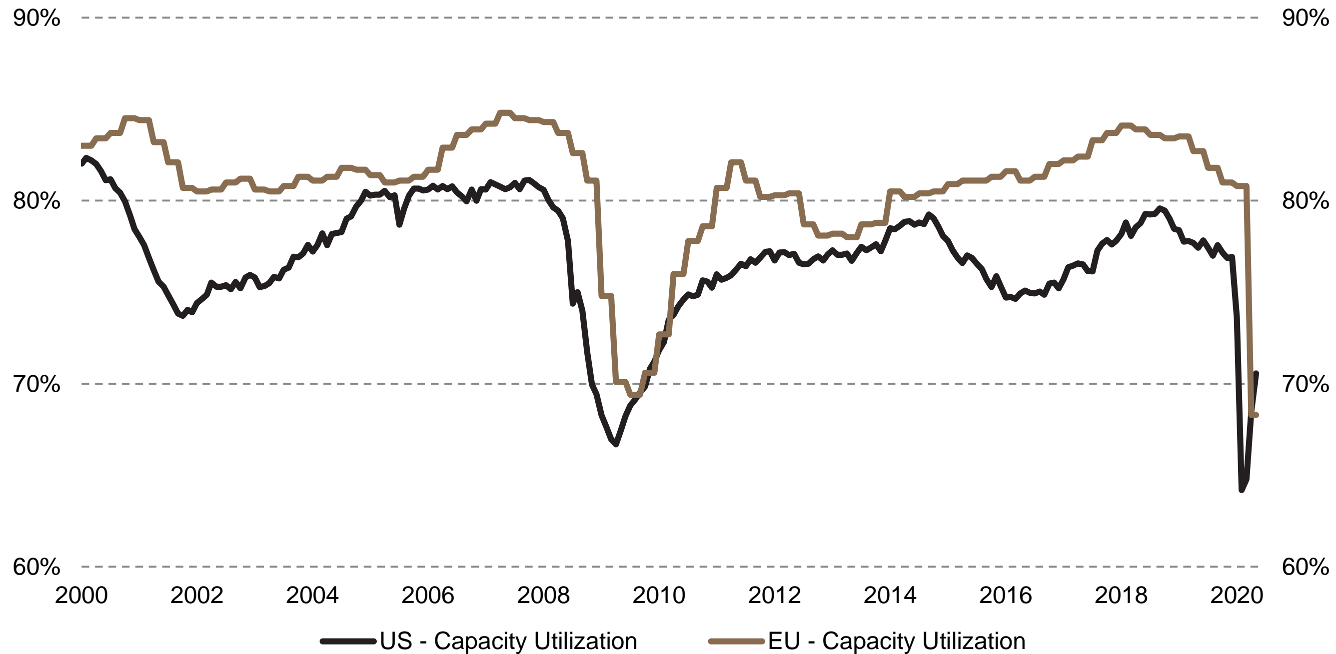
But the road ahead is very hard



- **The good behavior of economic agents cannot be explained without the level of fiscal and monetary support** received, which has been critical for this crisis to be considered as something temporary in nature
- However, the road ahead is still very uncertain and the **permanent economic damages are yet to be revealed**. In addition, the pandemic is accelerating the digitization of the economy, which will result in increased productivity, but will entail certain restructuring costs in the short term

Source: Bloomberg

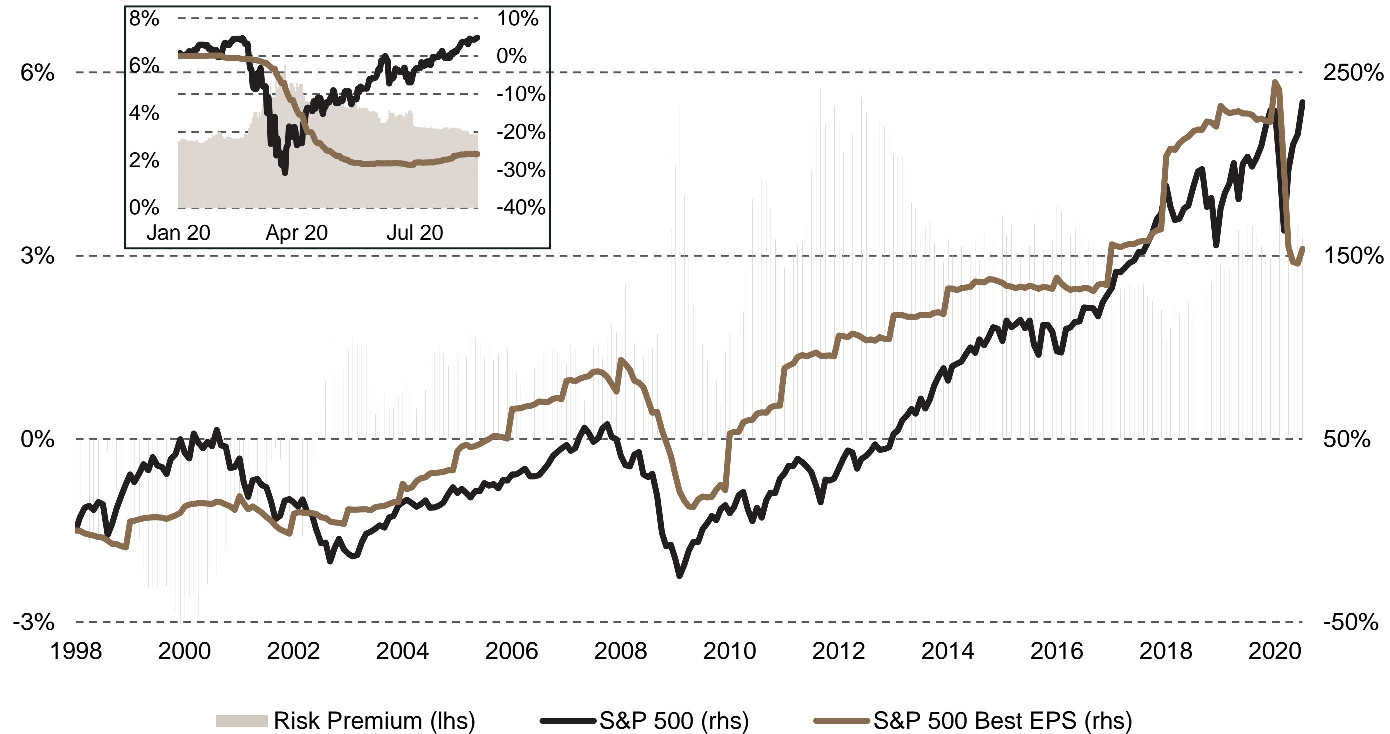
And economies continue on artificial life support



- **Economies continue to operate substantially below potential**, and the longer it takes for activity to return to normal levels, the greater the risk of long-term consequences
- Low interest rates allow governments to provide a "liquidity bridge" to the economy. But if the spread of the virus continues to restrict activity, **a new round of stimuli may be needed**

Source: Bloomberg

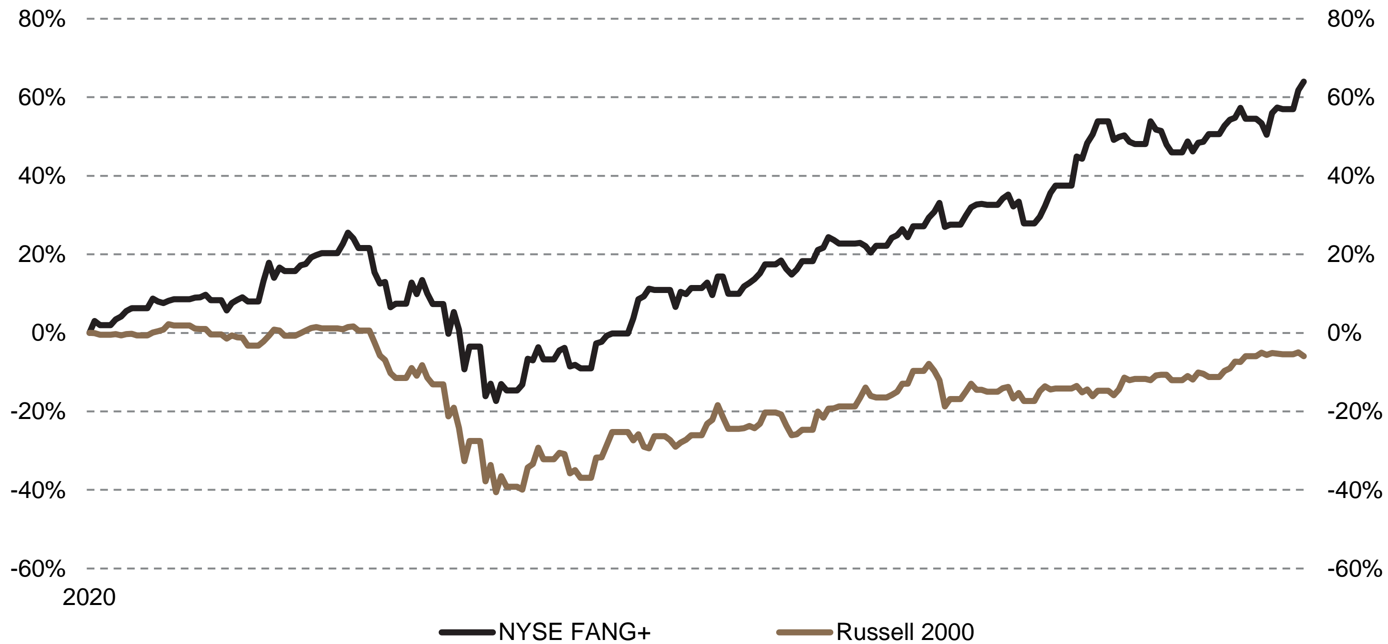
Valuations are all about low interest rates by now



- The **apparent disconnect between a depressed economy and an exuberant stock market** can be explained for two reasons. The first is that **markets always discount the future** and, thanks to the support of both governments and central banks, they are considering this crisis to be temporary
- The second reason is the **collapse of interest rates**, which causes that despite the fall in corporate earnings, the equity risk premium remains well above its historical average. Or in other words, it **renders stocks more attractive than bonds**

Source: Bloomberg

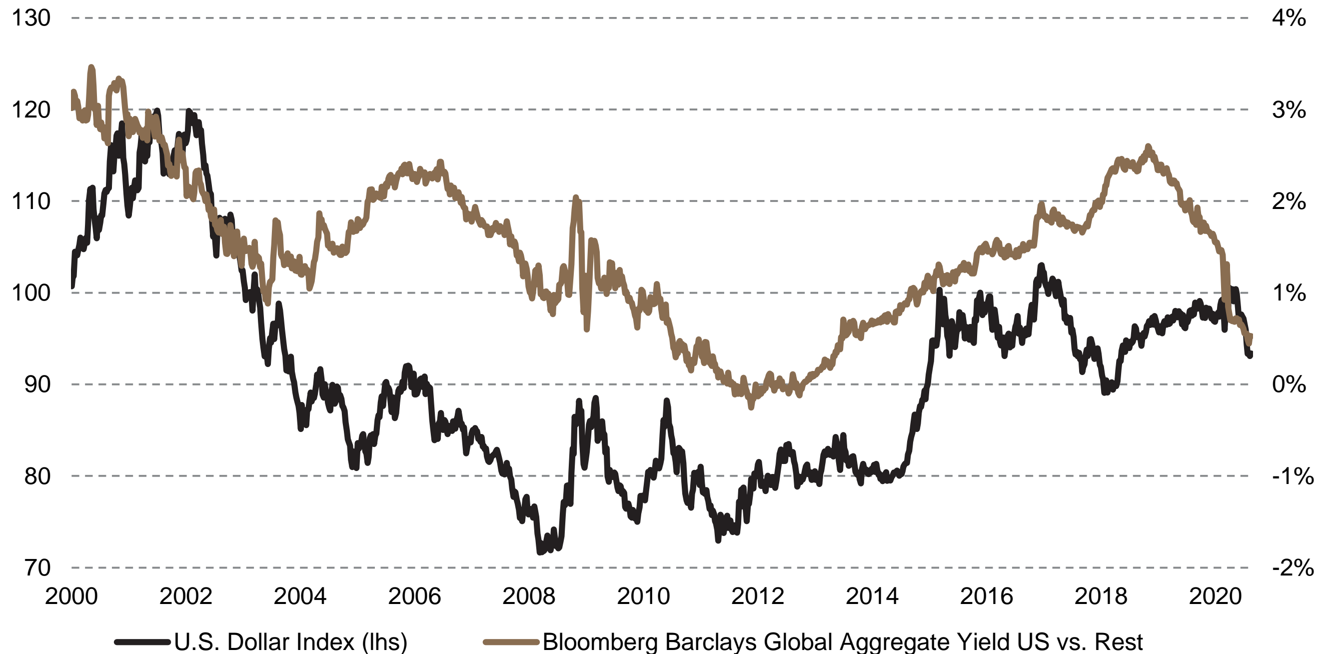
A tale of two markets



- The rally in equity markets masks a **large divergence across sectors and companies**, with a handful of tech heavyweights pulling the index, while the median stock remains well below February levels
- This makes the market more vulnerable, since it depends on the performance of a handful of stocks; but this situation is not unusual. **Each era is usually dominated by a few companies**. Which only emphasizes the **importance of diversification, and keeping an open mind**; trusting that human ingenuity will continue driving progress

Source: Bloomberg

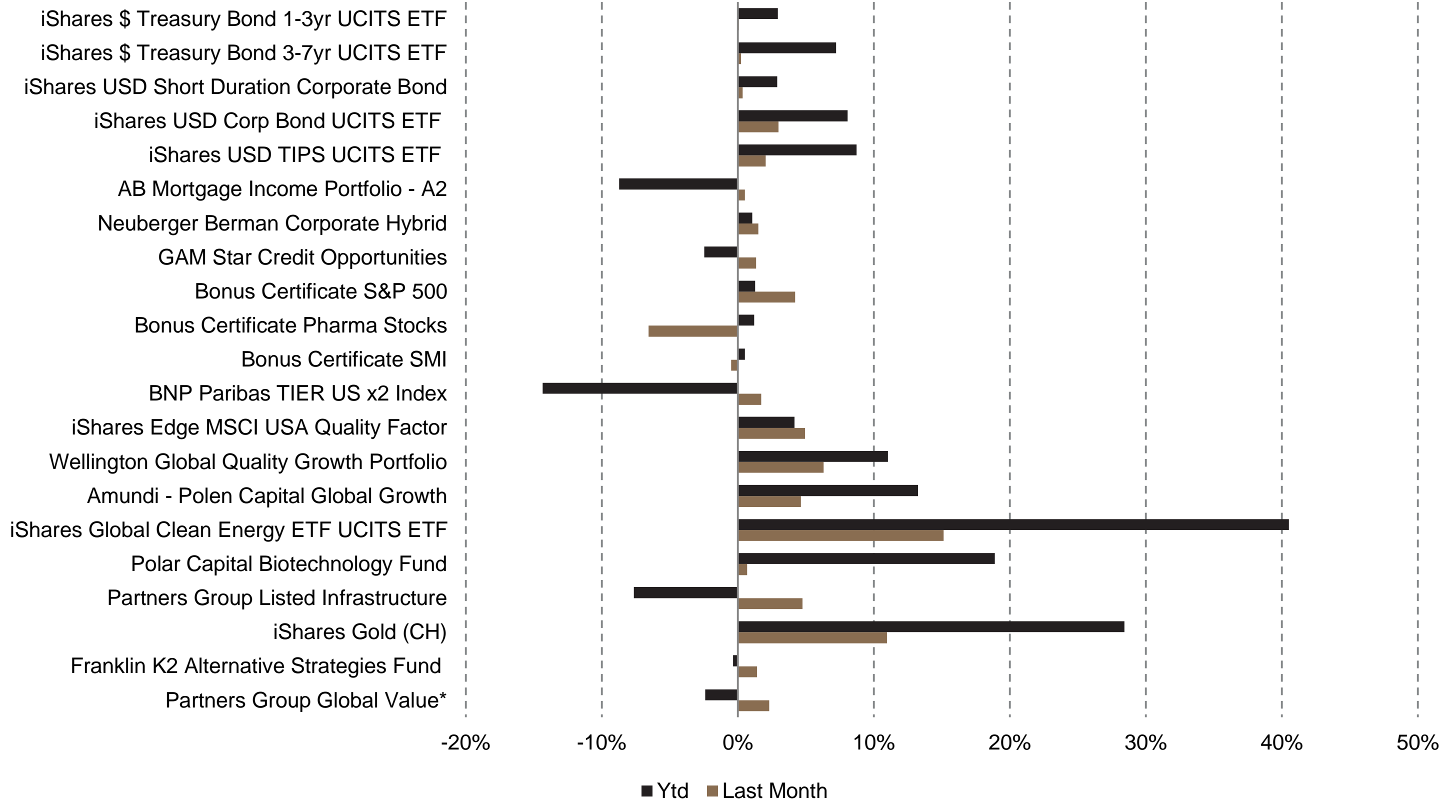
A weak dollar is the flip side of lower rates



- The **fall in interest rates in the US has had consequences not only for the stock market, but also for the FX market**
- The Fed was the only major central bank to try to normalize rates, but after the sharp turn in early 2019 and the emergency cuts this year, **interest rate differentials against the dollar have narrowed sharply**. And after an initial appreciation driven by the search for liquidity during the worst moments of the crisis, **fundamentals are finally causing the dollar to weaken**

Source: Bloomberg

Model portfolio evolution



Source: Bloomberg ,as of August 20, 2020
* Fund publishes monthly NAV with a 1 month of delay

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%

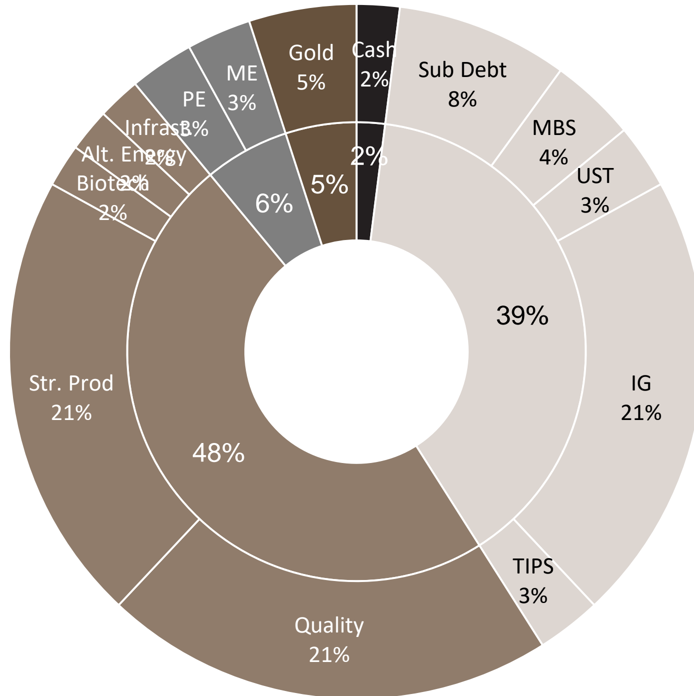
Short-term catalyzers

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

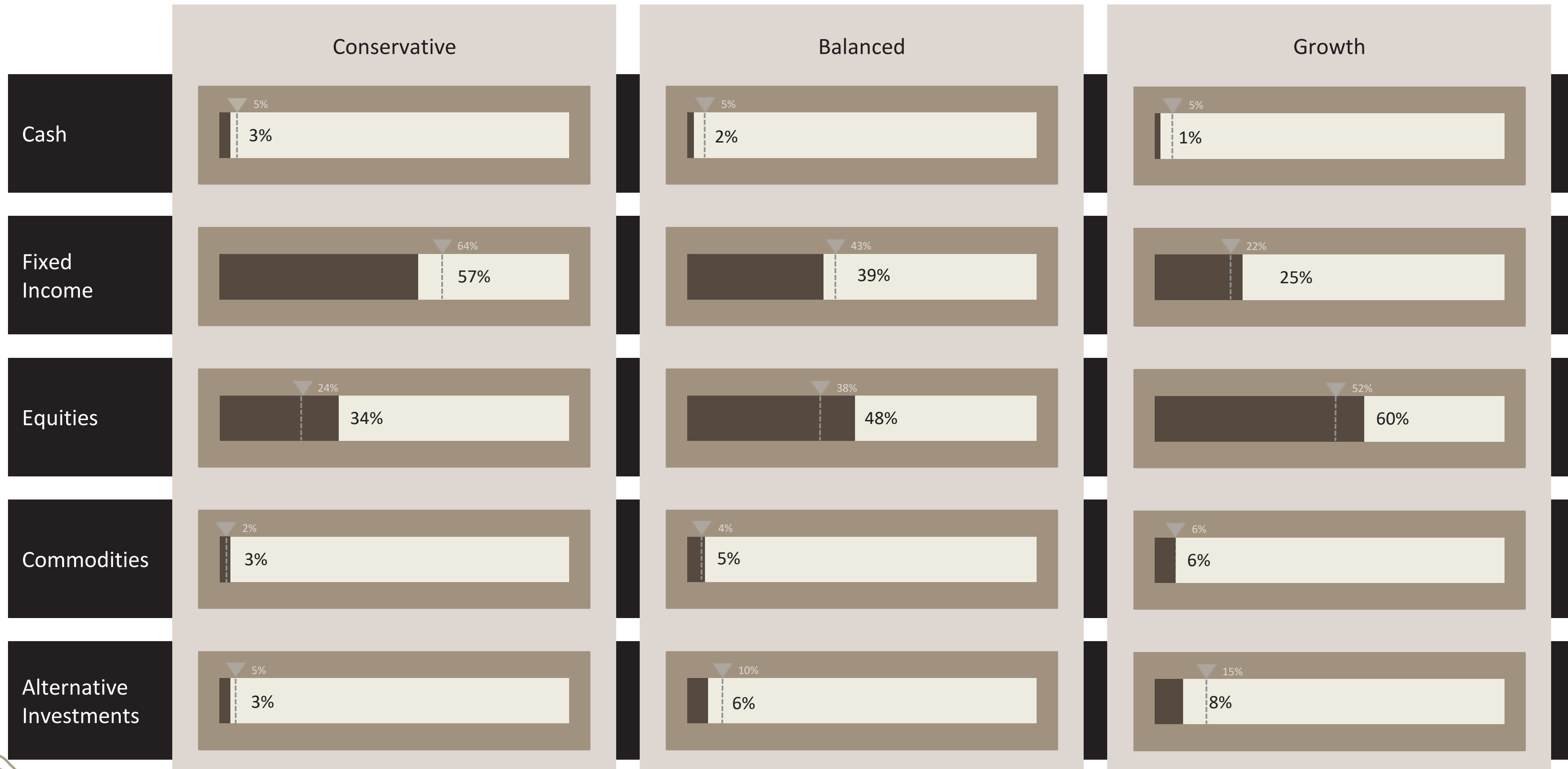
Other risks

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

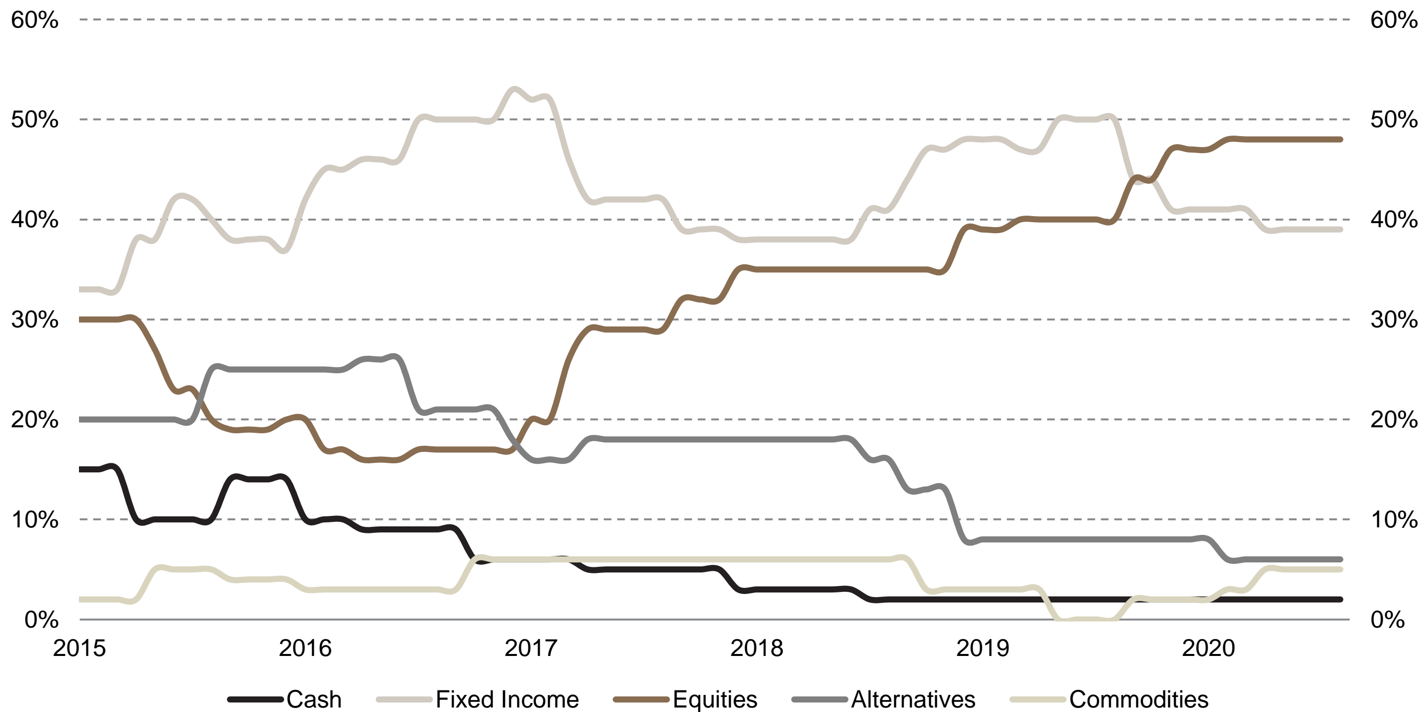
EWM Model Portfolio Balanced USD



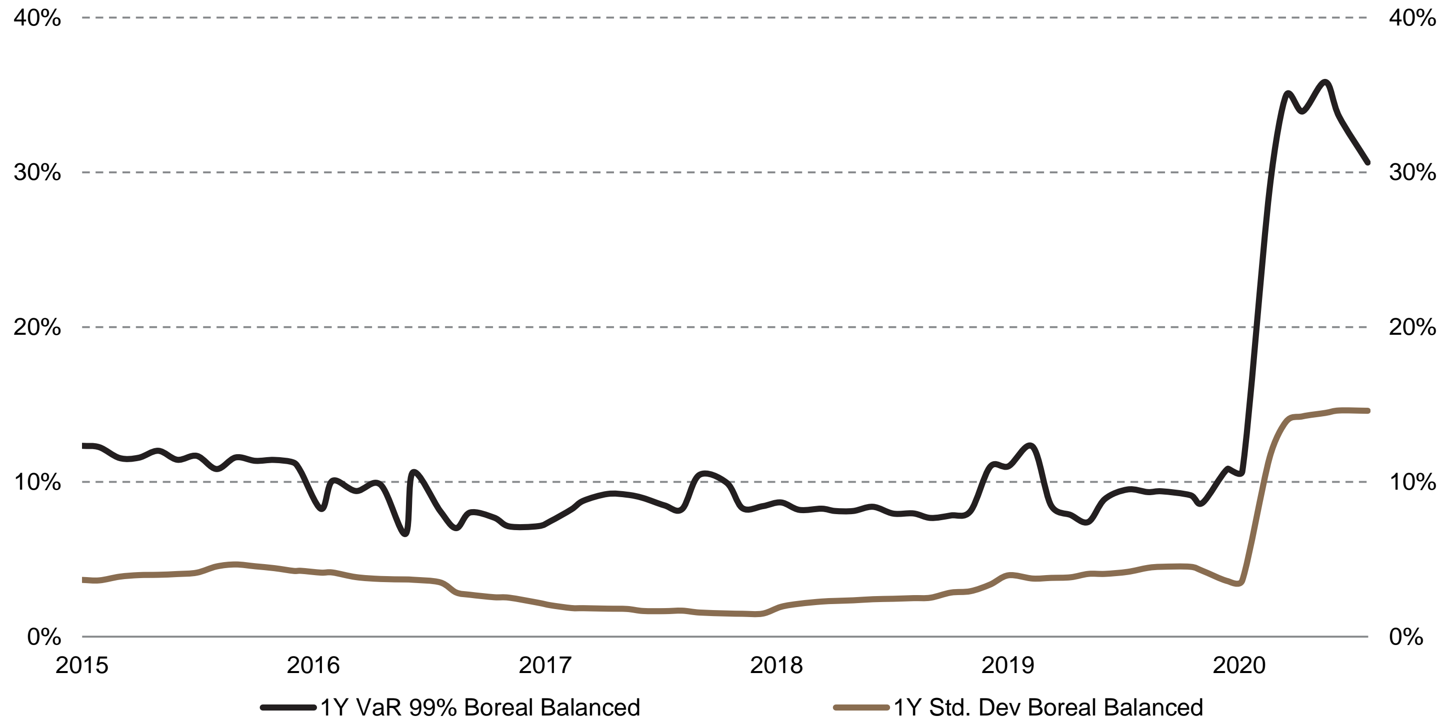
EWM Investment Profiles



EWM Model Portfolio – Asset Allocation evolution

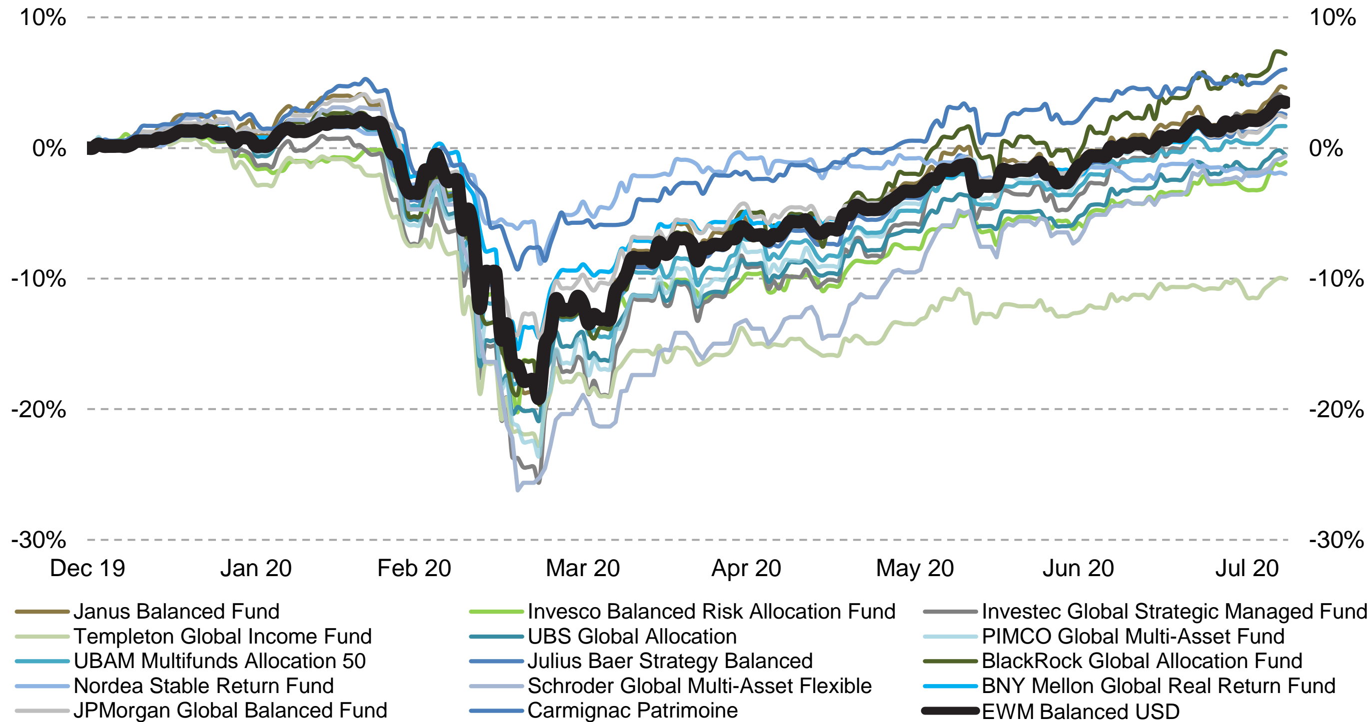


EWM Model Portfolio – VaR evolution



[1] As of August 20, 2020
Source: Bloomberg

EWM Balanced Portfolio – Peer comparison



- **Total Return** (Ytd[1]): **4th out of 15**
- **Standard Deviation** (1 year[1]): **10th out of 15**
- **Downside Risk** (1 year[1]): **4th out of 15**
- **Sharp Ratio** (1 year[1]): **4th out of 15**

[1] As of August 7, 2020

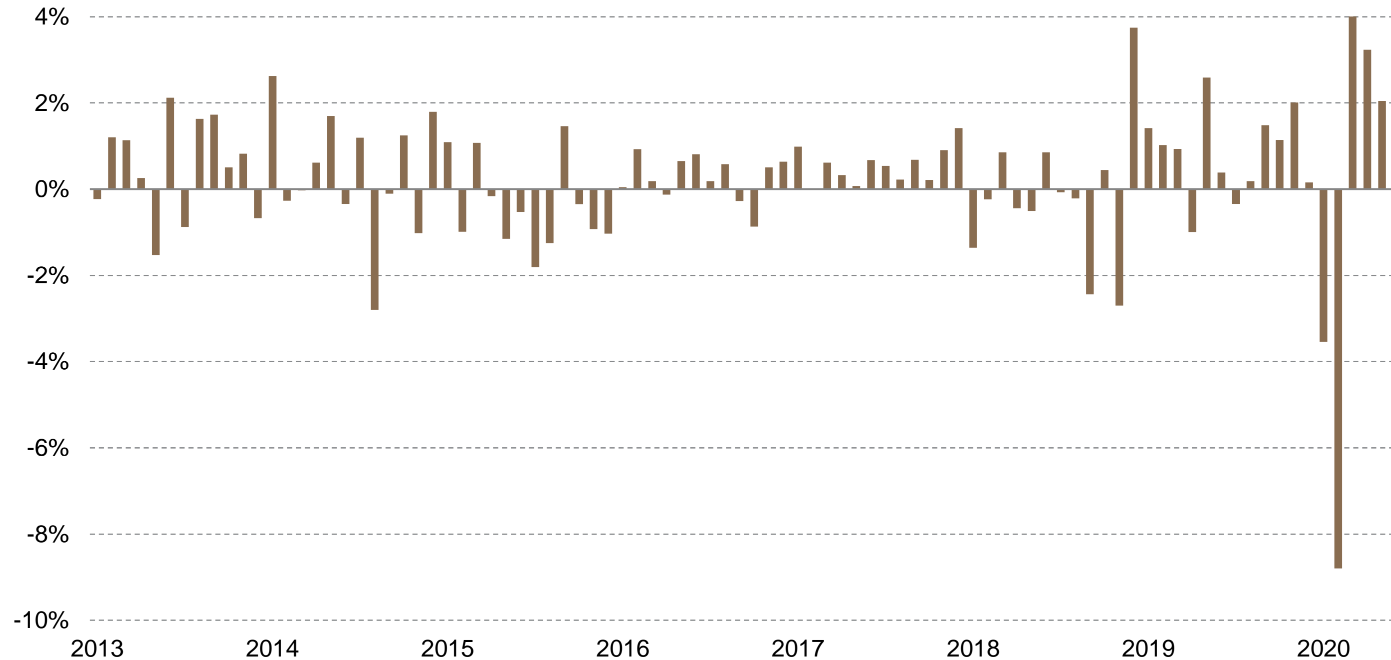
Source: Bloomberg

EWM Model Portfolio – Ytd performance

- **Total Return** (Ytd[1]): **3.96%**
- **Standard Deviation** (Ytd[1]): **18.14%**
- **Downside Risk** (Ytd[1]): **14.29%**
- **Sharpe Ratio** (Ytd[1]): **0.42**

[1] As of August 20, 2020

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **9.29%**
- **Total Return** (3 year[1]): **16.81%**
- **Total Return** (Since Jan 13[1]): **34.49%**

[1] As of August 20, 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%	3.96%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	18.14%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.42

Annual Return: 3.96%
Annual Std. Dev: 6.12%

[1] As of August 20, 2020

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