Edwards Wealth Management AG
Switzerland

BOREAL
CAPITAL MANAGEMENT

Investment Policy

May 2021

Our market view in a nutshell – May 2021

- After months of speculation, **this month we had the first data that lends some evidence to the inflation narrative**. However, the CPI rebound was almost inevitable due to the **strong base effects that are affecting all macroeconomic statistics**; we are comparing with April of last year, when the economic impact of the pandemic was more pronounced. Furthermore, current readings are statistically less reliable and subject to frequent revisions; making it **necessary to have more data before jumping on the inflation bandwagon**

- **Employment data, by contrast, showed a completely different picture**. Nonfarm payrolls fell far short of estimates, increasing by only 266,000 compared to the million expected by analysts; causing an increase in the unemployment rate. In turn, the report showed that companies are finding it increasingly difficult to find workers; something the markets interpreted as a harbinger of future inflation

- The **Fed remains committed to achieving full employment**, and is willing to allow inflation to temporarily remain above its target. However, this is a **new monetary framework, and no one knows (not even the Fed) how much and for how long excess inflation will be tolerated**. Our best guess is that as long as long-term inflation expectations remain firmly anchored and labor costs do not rise, the Fed will not blink

- **Unreliable macroeconomic data coupled with monetary policy uncertainty is a recipe for market volatility**. This is further compounded as **risk asset valuations are increasingly dependent on low interest rates**. Therefore, we expect volatility to continue over the months to come, until there is more clarity about the path inflation is taking

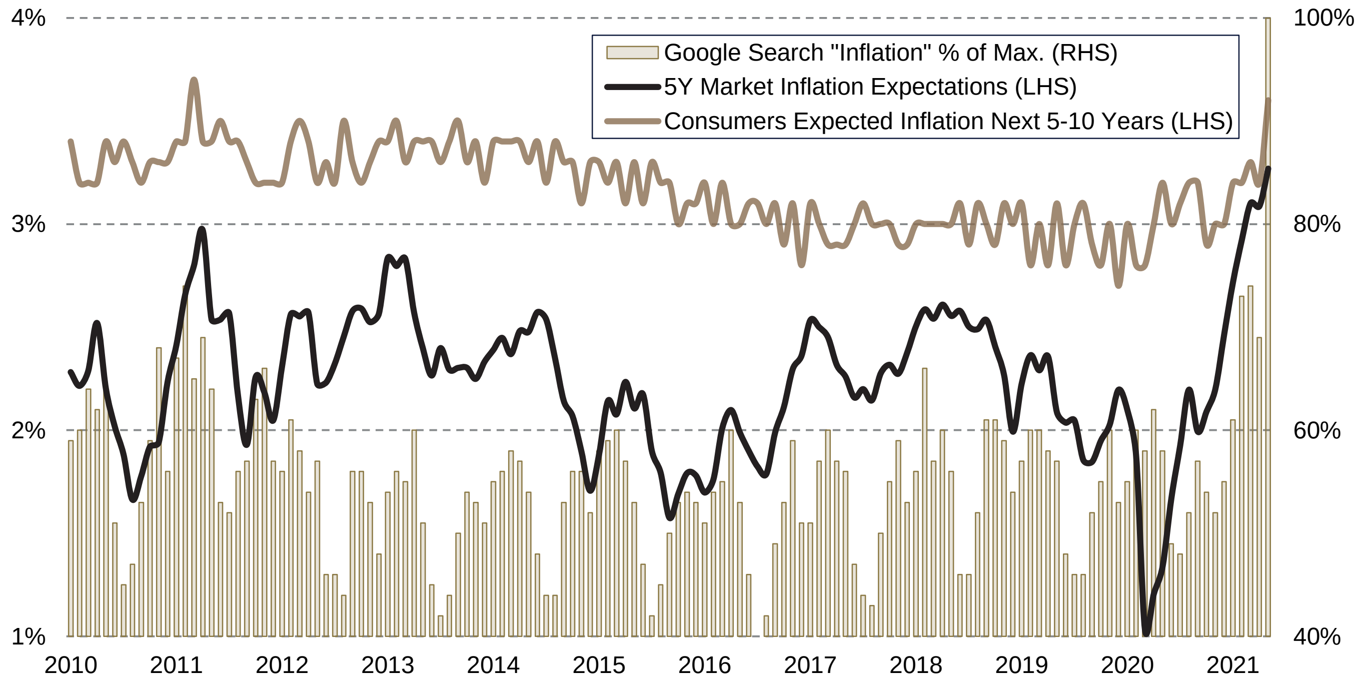
- In an environment of uncertainty caused by mixed signals, **jumping prematurely to an alternative investment thesis can be very costly**. Even though we are all celebrating a stronger than expected bounce-back, it is important not to get carried away by stories of a “red hot” economy. The **fiscal stimulus**, not only cannot last forever, but has focused on covering the loss of household income due to a collapse in demand; and this **is nothing that structurally affects the growth potential of the economy in the long term**

EWM Investment Policy

	Asset Class	View	Rationale
Fixed Income	US Treasuries	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. With interest rates anchored at current levels, and credit spreads that have narrowed massively, we favor long-term US Treasuries
	US Credit	–	The crisis caused by the pandemic will lead to an increase in the number of corporate defaults. Credit spreads hardly reflect this risk currently
	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 and Investment Grade
	Emerging Markets	–	A weaker dollar should help emerging markets, but both currencies and credit spreads have only partially reacted 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	+	We recommend investing selectively in the region; favoring high growth stocks
	Emerging Markets	–	Emerging markets are expensive, in general. We only recommend to allocate to Chinese government bonds in Renminbis
	Sectors & Themes	+	We favor Infrastructure, Biotechnology, Fintech and Clean Energy
Alternative Investments	Multi-Strategy Hedge Funds	–	Multi-strategy / multi-manager hedge funds with daily liquidity are having 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

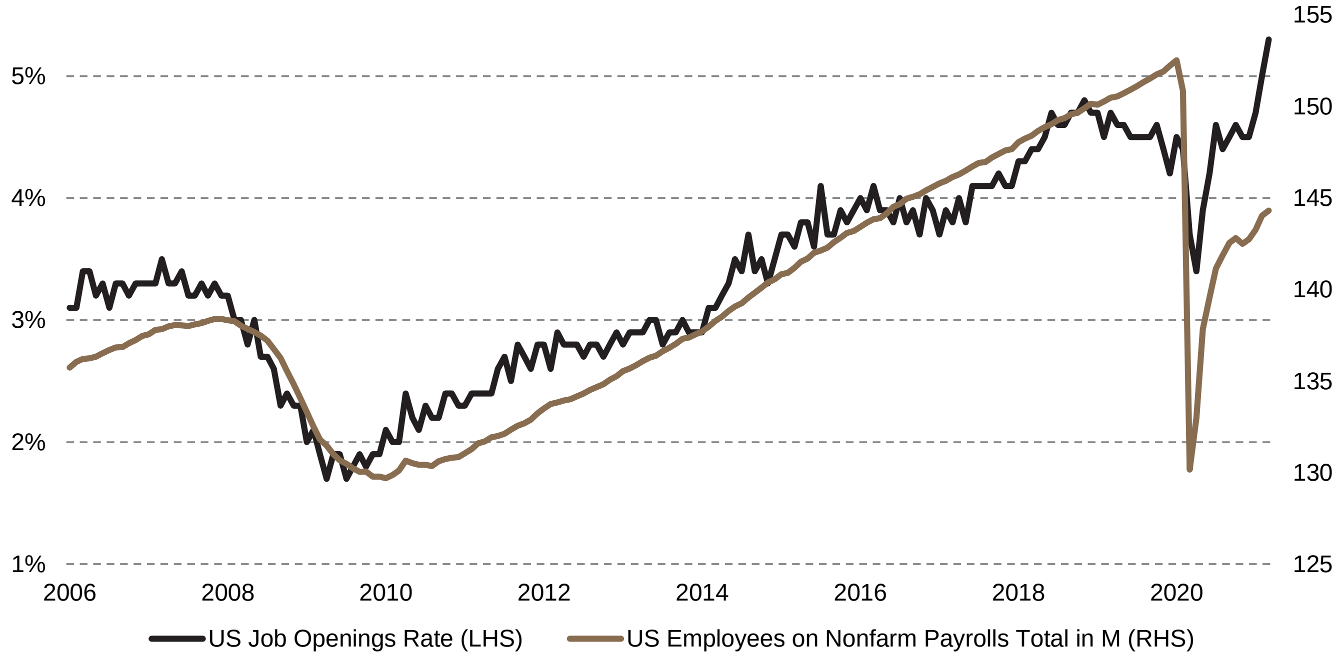
Inflation can be self-fulfilling



- The **inflation reading for the month of April** was 4.2%, **well above** the 3.6% expected by economists. Core inflation, excluding food and energy, increased by 3% compared to the 2.3% expected
- This is the first evidence of an increase in inflation. However, **this is a single piece of data and is subject to strong base effects**. At the component level, there is a large influence from used and rental cars, and hotel and airline rates, while the most important components of the CPI such as health care and housing remained stable

Source: Bloomberg

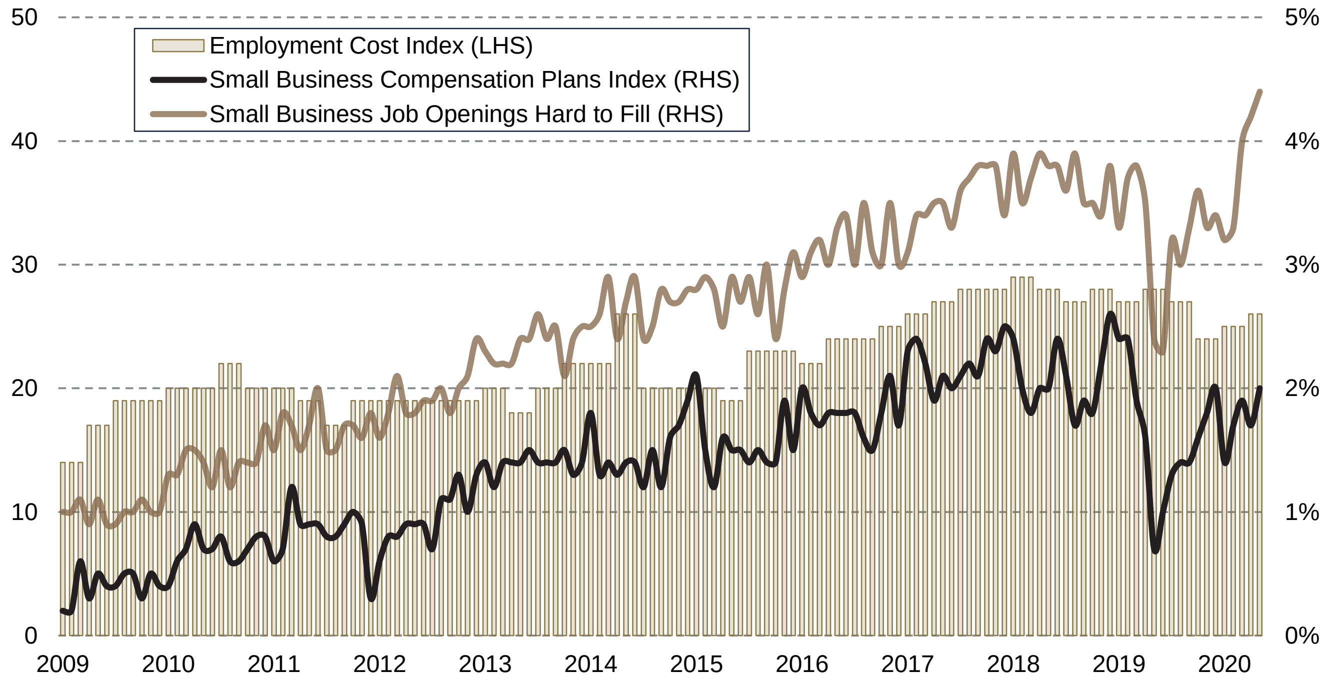
Job market far from normalizing



- The **Fed has stated that it will tolerate inflation to be temporarily above its target** (2% core inflation) before preventively raising rates, **provided there is slack in the job market**. April's change in nonfarm payrolls missed all estimates, increasing by 266k compared to 1 million expected by analysts
- **Difficulty finding workers was already a problem before the pandemic**, which has been exacerbated by a combination of factors: schools closed, improved unemployment benefits, and pandemic-induced business adjustments

Source: Bloomberg

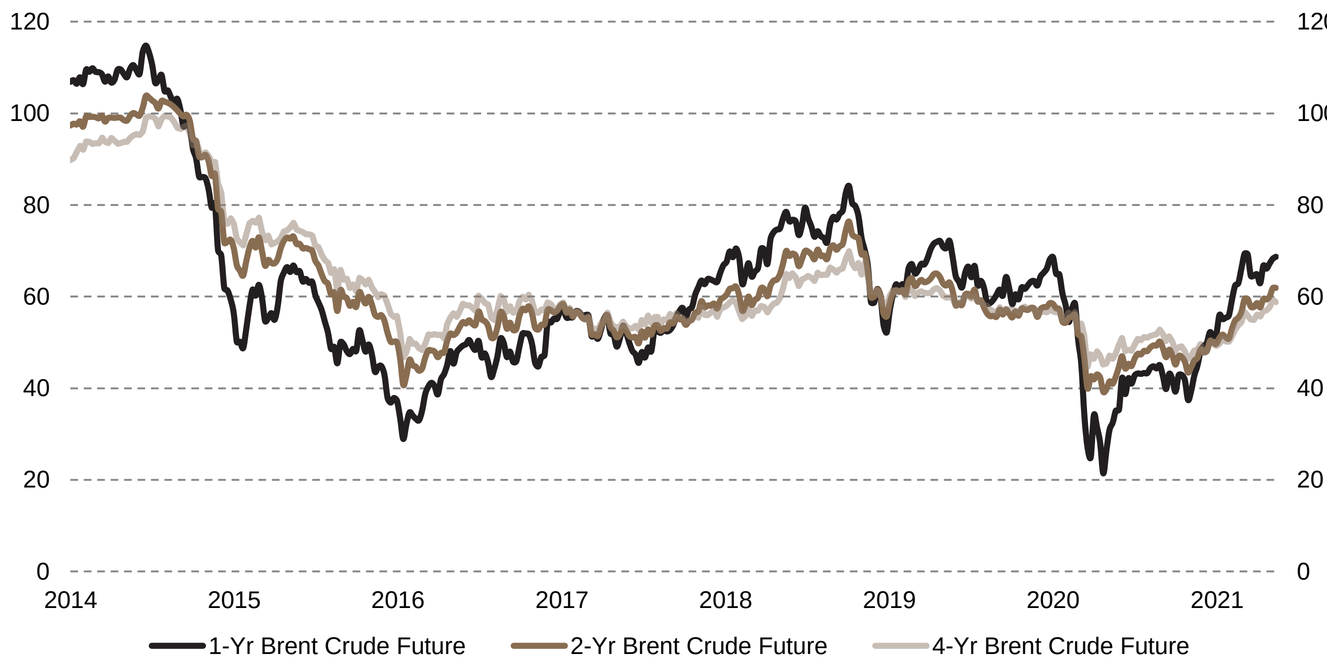
No transmission to wages so far



- The disappointing jobs data initially caused interest rates to fall, but the inflation narrative eventually prevailed; seeing in the **difficulty of finding workers a harbinger of inflation**
- However, **wages remain contained, as labor bargaining power, if anything, has decreased** as a result of the pandemic. In fact, this may mark the beginning of the relocation of qualified workers, thanks to the successful experiment that teleworking has entailed

Source: Bloomberg

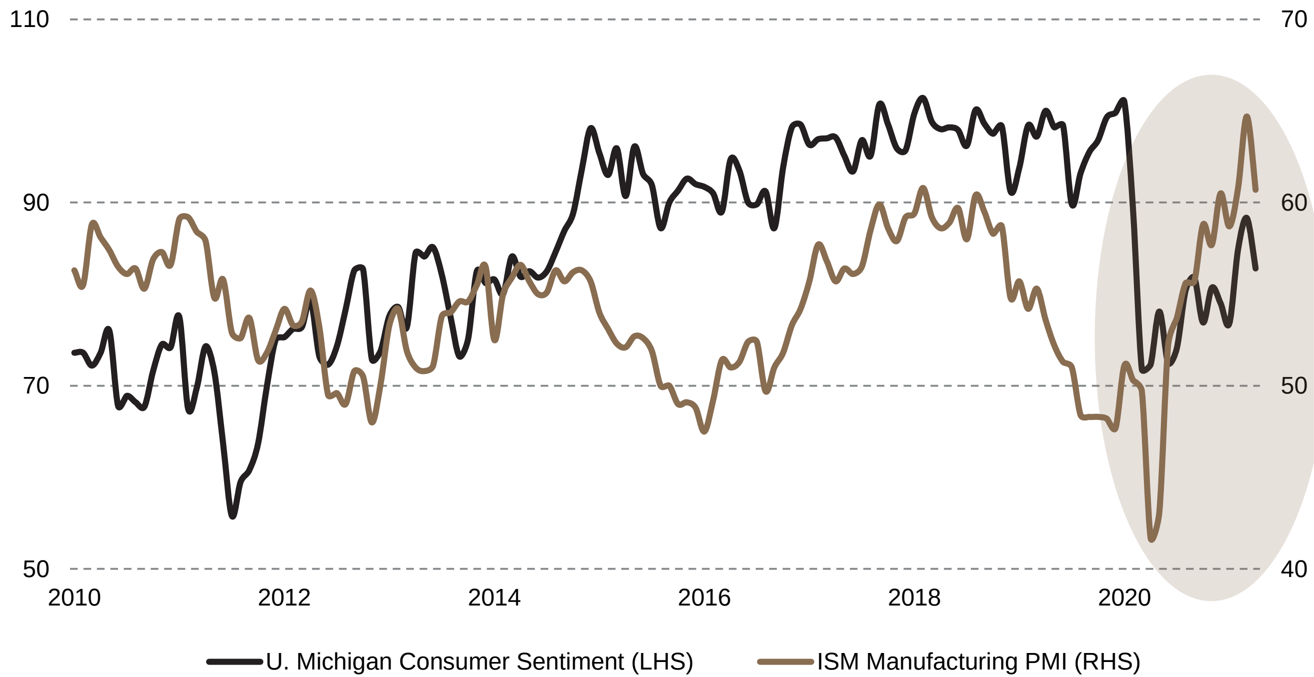
Too early to call a new commodities "supercycle"



- Another **important element of the inflation narrative is the sharp rise in some commodities**, driven by the reopening of the economy and some recent logistical and transportation disruptions
- However, in most cases, the increase in prices (particularly in the short term) is nothing more than **a reversal of the process of collapse of demand and adjustment of supply of last year**. In general, commodity indices are a long way from their all-time highs

Source: Bloomberg

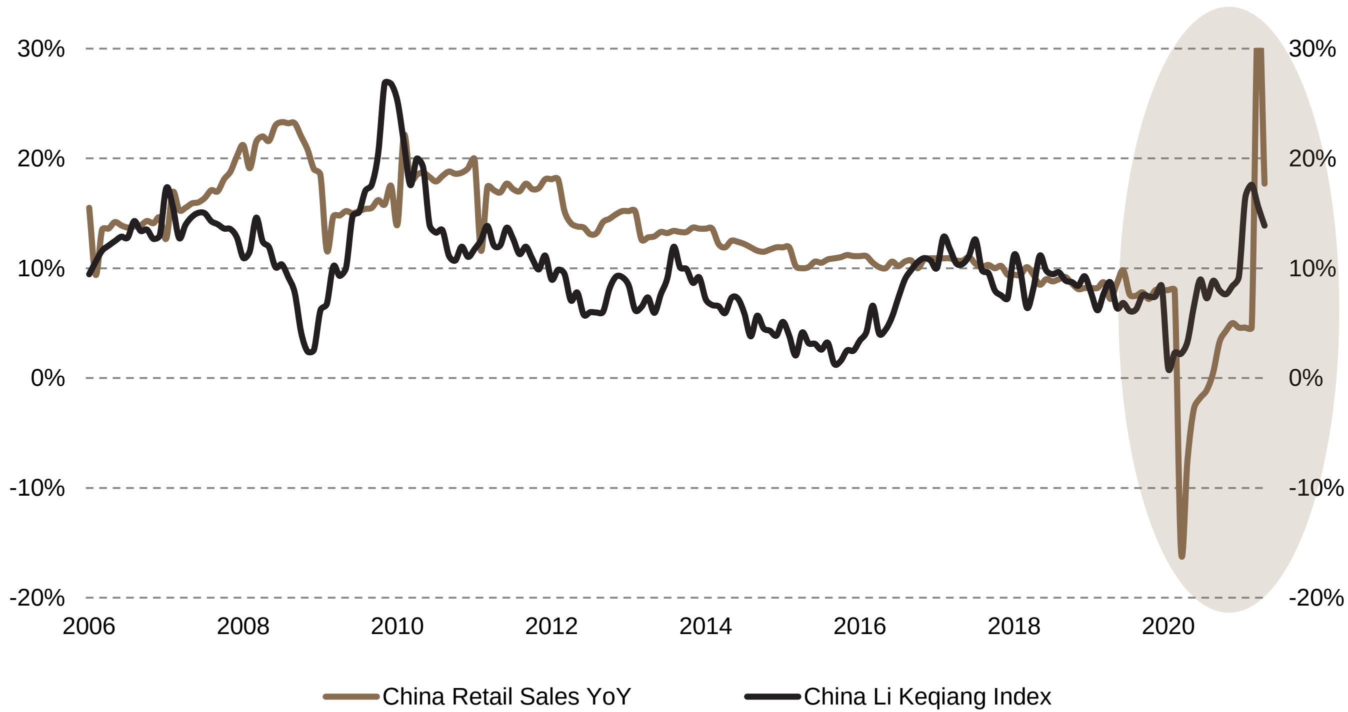
Boom in consumer spending, but not in sentiment



- One way to **look beyond the base effects** caused by the sudden collapse (and faster-than-expected reopening) of the economy is to gauge **consumer confidence**
- Despite receiving direct transfers from the government, **consumers are lukewarm in their spending intentions**

Source: Bloomberg

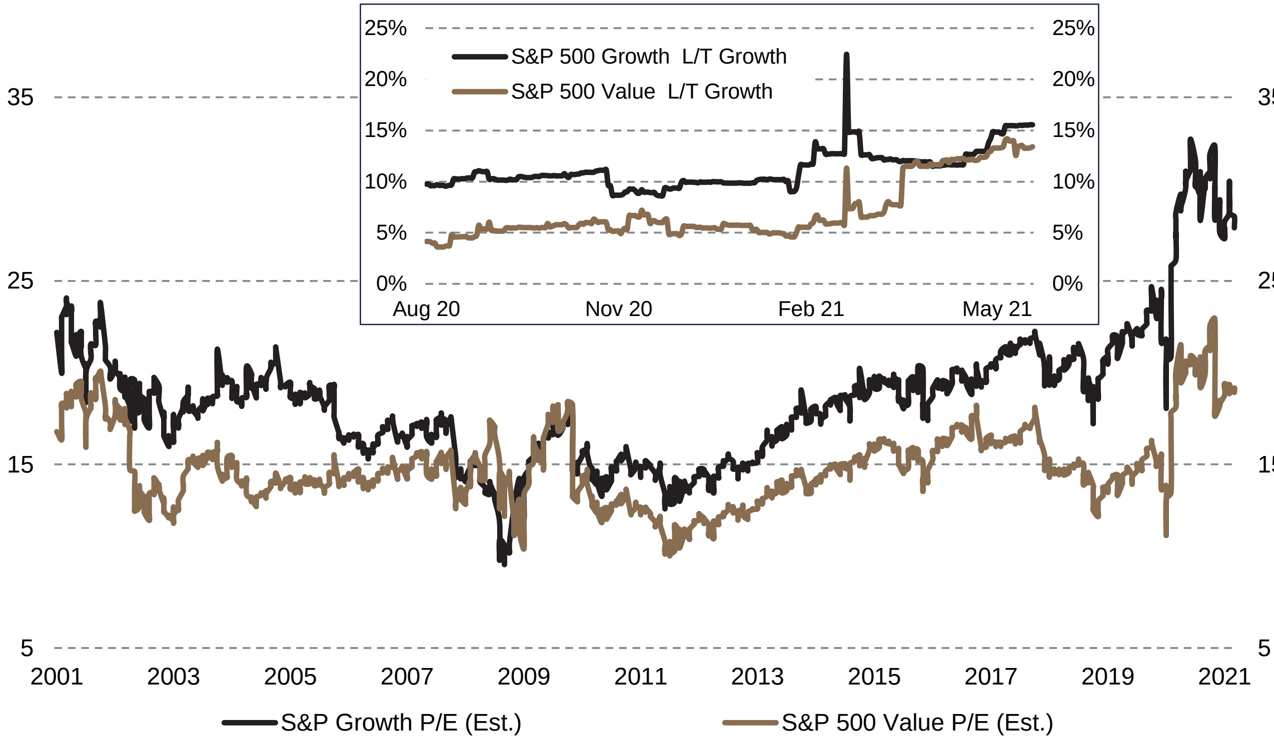
China continues to show the way



- **China** is further along in the recovery, and it continues to **give us clues as to what the post-pandemic economy may look like**
- There, we see how the economy is driven by **exports and fixed-asset investments**, whilst **consumer spending is lagging**

Source: Bloomberg

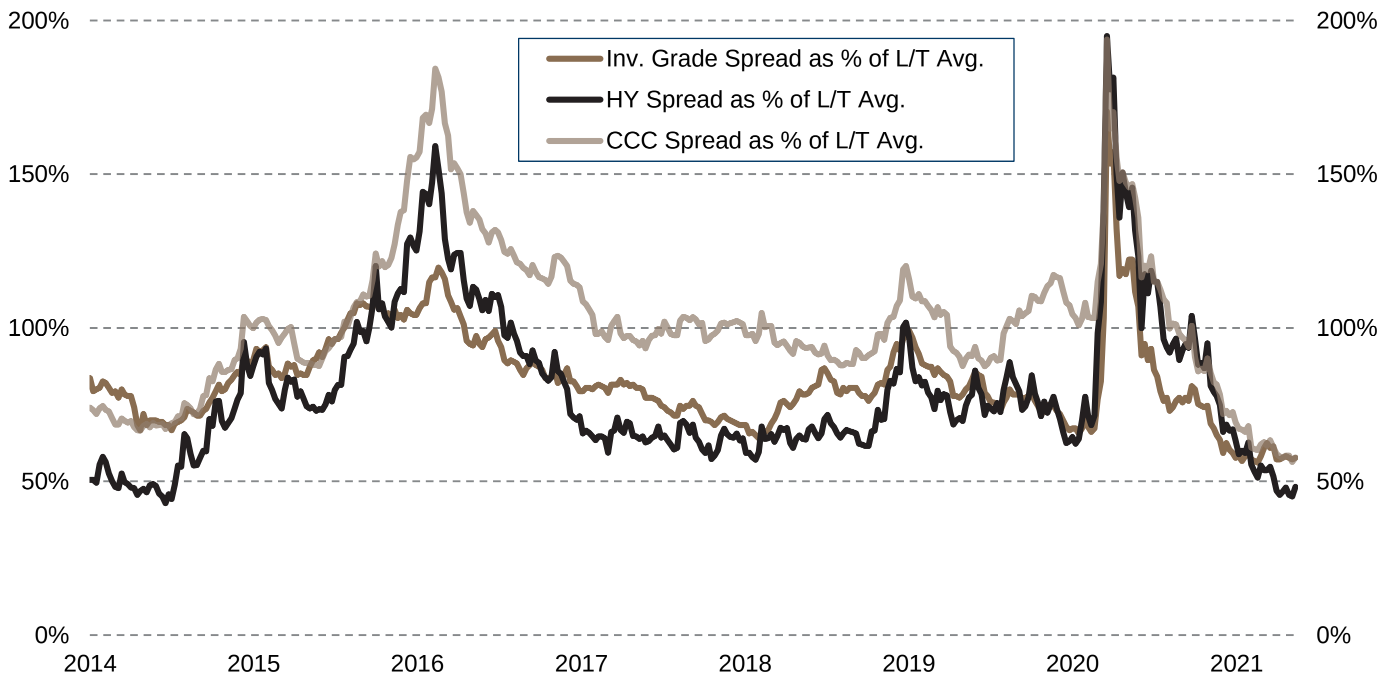
Is there still value in value?



- **Value stocks** are performing better this year, driven by a **stronger (and faster) than expected economic recovery**, and a **lower starting point**
- However, current **valuations reflect a jump in structural growth that is not justified**. We consider that these stocks are currently more vulnerable to a deterioration in investor sentiment

Source: Bloomberg

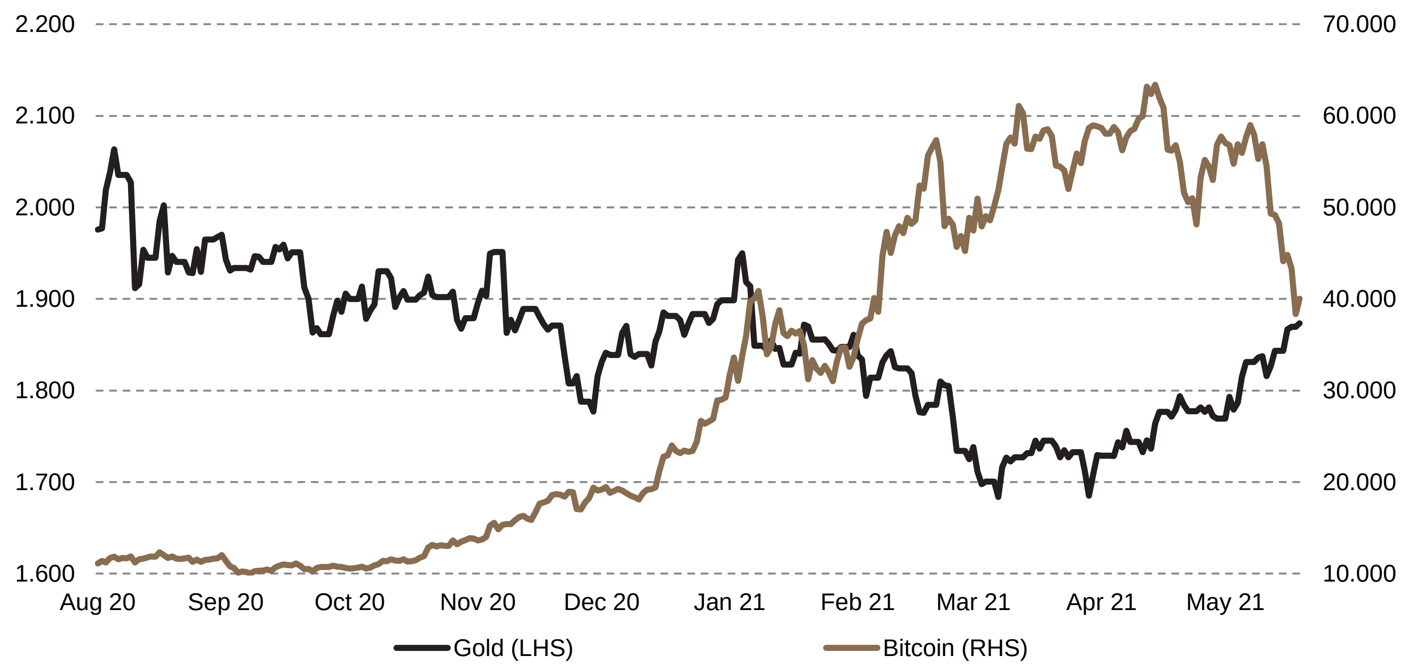
Credit spreads are vulnerable



- **Credit markets remain largely "insulated" from market volatility** as the chase for yield continues to narrow credit spreads
- The latter are not only **close to the lowest levels on record, but are also far from their historical average**. This means that the potential widening in spreads is considerable, especially for riskier loans

Source: Bloomberg

Gold is regaining lost allure



- In recent months, **gold has moved away from its fundamentals**. Negative real interest rates and rising inflation expectations should be a favorable environment for gold
- Part of this abnormal behavior can be attributed to the **competition that it has faced from cryptocurrencies**; which is starting to decline, at least temporarily

Source: Bloomberg

Investment scenarios

	Scenario 1 "U" Recovery	Scenario 2 "V" Recovery	Scenario 3 "W" Recovery
Drivers	• Inflation accelerates due to large fiscal stimulus combined with Infrastructure spending in the US • Commodity prices rise as the global economy bounces back strongly • Central banks try to assure markets that they will not increase interest rates, but long-term rates do increase anyway	• Global recession caused by the unprecedented sudden stop of economic activity • Strict quarantines are avoided and economic activity continues to a greater or lesser extent, depending on control measures of variable intensity • 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 recovery, but momentum fails to be sustained • The pandemic starts to be under control by summer thanks to massive vaccination campaigns, but economic activity does not fully return to normal • Countries with a stronger fiscal position may be able to provide further stimulus and avert a "W" shaped recovery
Market impact	• Corporate earnings rise sharply, but higher interest rates negatively impact equity valuations • High-quality and sovereign bonds fall due to rising interest rates, failing to play their traditional cushioning role in portfolios • Credit performs relatively better despite higher rates, as the risk of corporate defaults remains low • The US dollar depreciates against safe-heaven currencies, as well as against gold	• Equities appreciate moderately, as TINA ("There Is No Alternative") lure investors back to stock markets, but there is wide dispersion across sectors • Credit spreads recover to pre-crisis levels as the chase for yield intensifies • 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 equity and credit markets, with the strongest companies recovering and the weakest lagging behind • Credit spreads widen as the market remains highly volatile and corporate defaults rise • Wide dispersion between sovereign bonds and currencies due to "flight-to-quality" • A relatively strong USD as the US economy turns the corner faster than other developed economies. Wide dispersion within Emerging Markets, as countries exit the pandemic at different speeds
Probability	30% (+10%)	60%	10% (-10%)

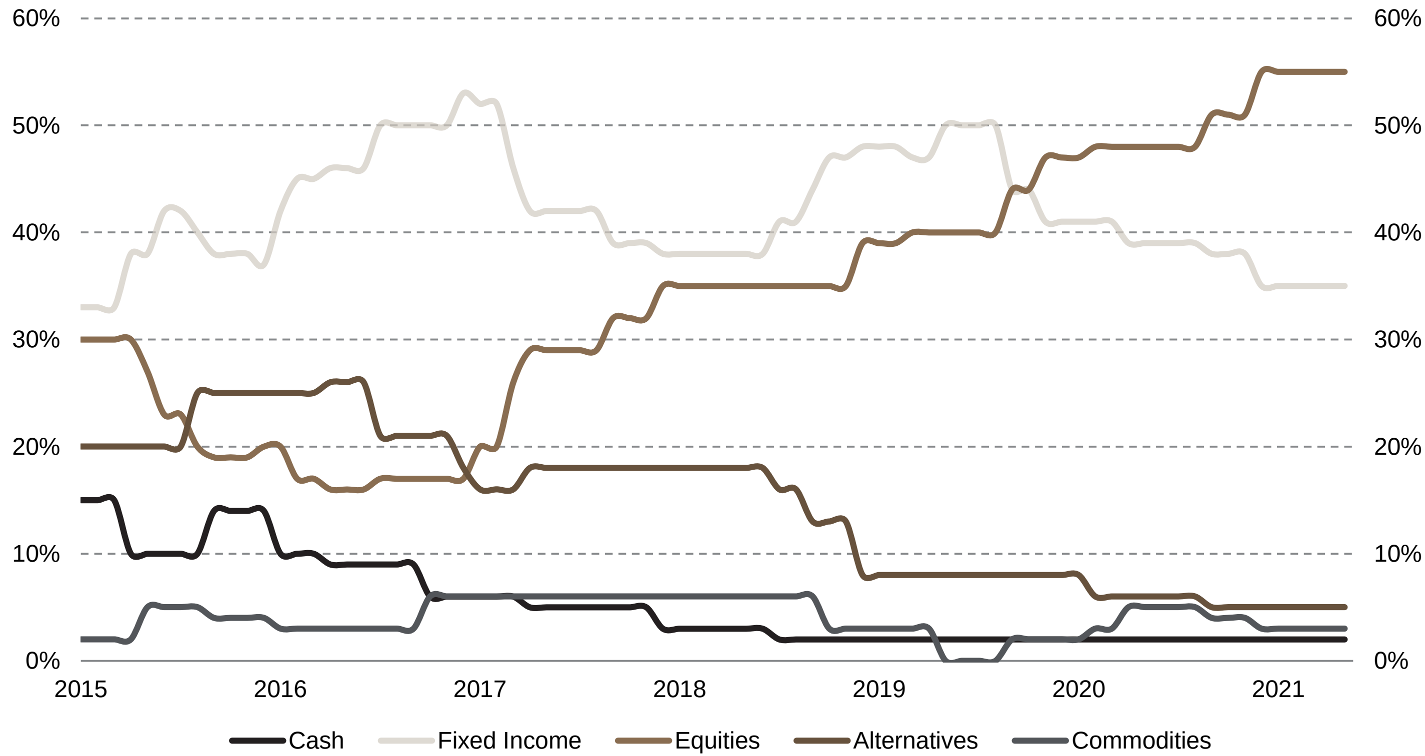
Short-term catalyzers

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

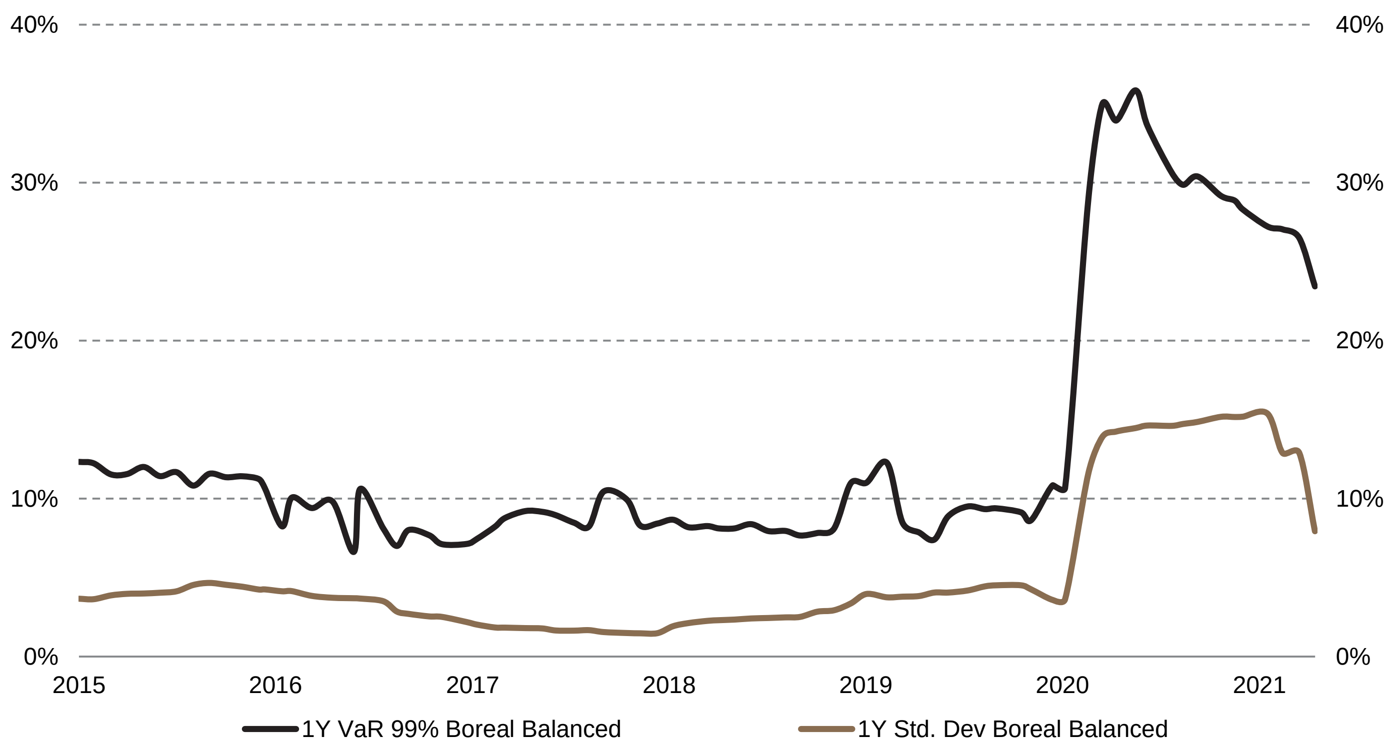
Other risks

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

EWM Model Portfolio – Asset Allocation evolution

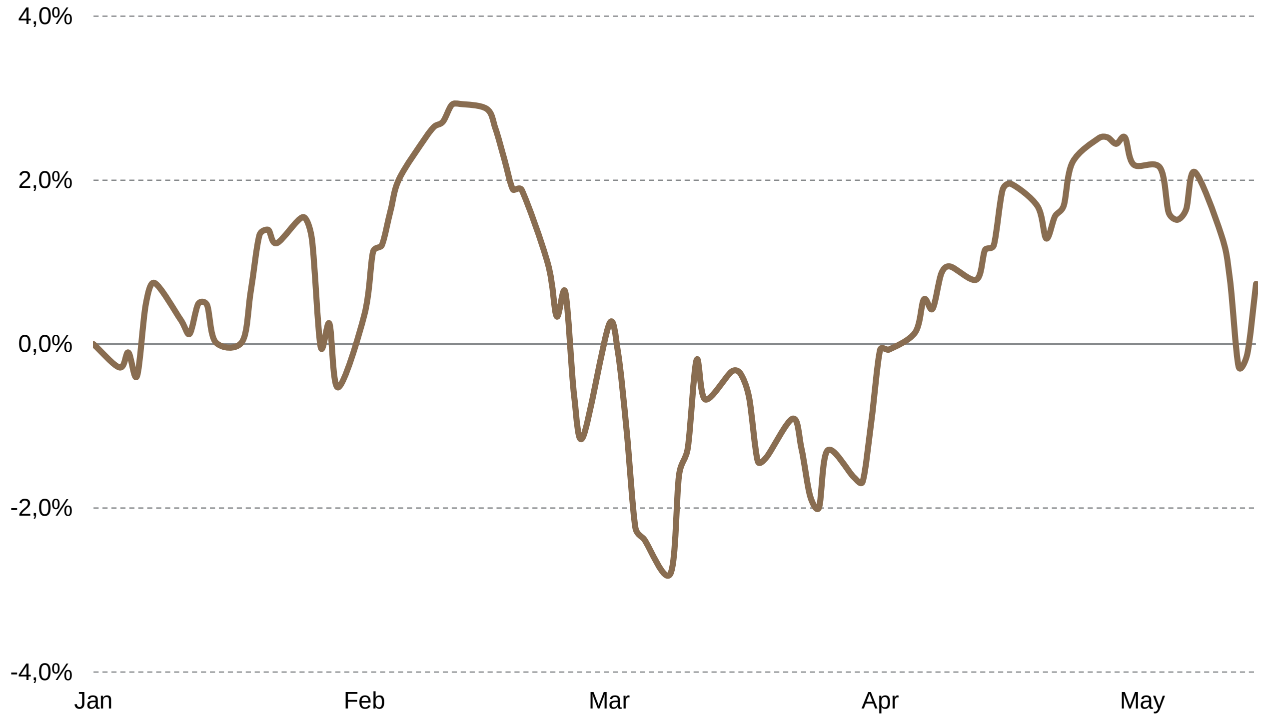


EWM Model Portfolio – VaR evolution



[1] As of May 14, 2021
Source: Bloomberg

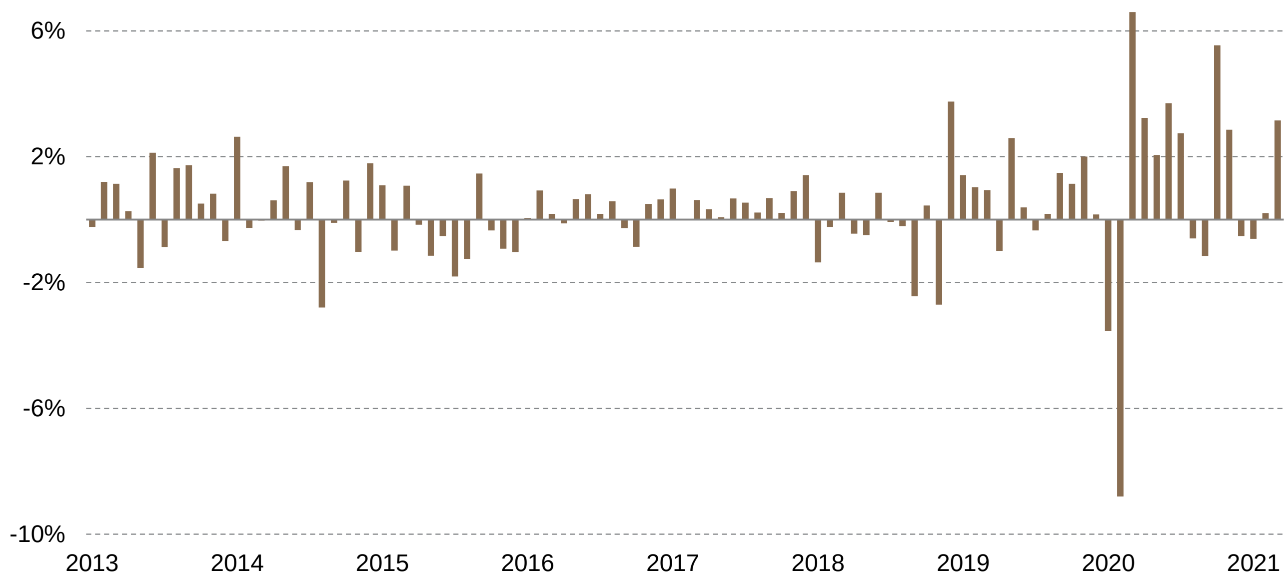
EWM Model Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **0.73%**
- **Standard Deviation** (Ytd[1]): **8.55%**
- **Downside Risk** (Ytd[1]): **6.09%**
- **Sharpe Ratio** (Ytd[1]): **0.27**

[1] As of May 14, 2021

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **20.91%**
- **Total Return** (3 year[1]): **22.57%**
- **Total Return** (Since Jan 13[1]): **45.01%**

[1] As of May 14, 2021

EWM Model Portfolio – Historical performance (2)

	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	12.35%	0.73%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	8.55%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.87	0.27

Annualized Return: 4.67%
Annualized Std. Dev: 6.35%

[1] As of May 14, 2021

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