Edwards Wealth Management AG
Switzerland

BOREAL
CAPITAL MANAGEMENT

Investment Policy

July 2021

Our market view in a nutshell – July 2021

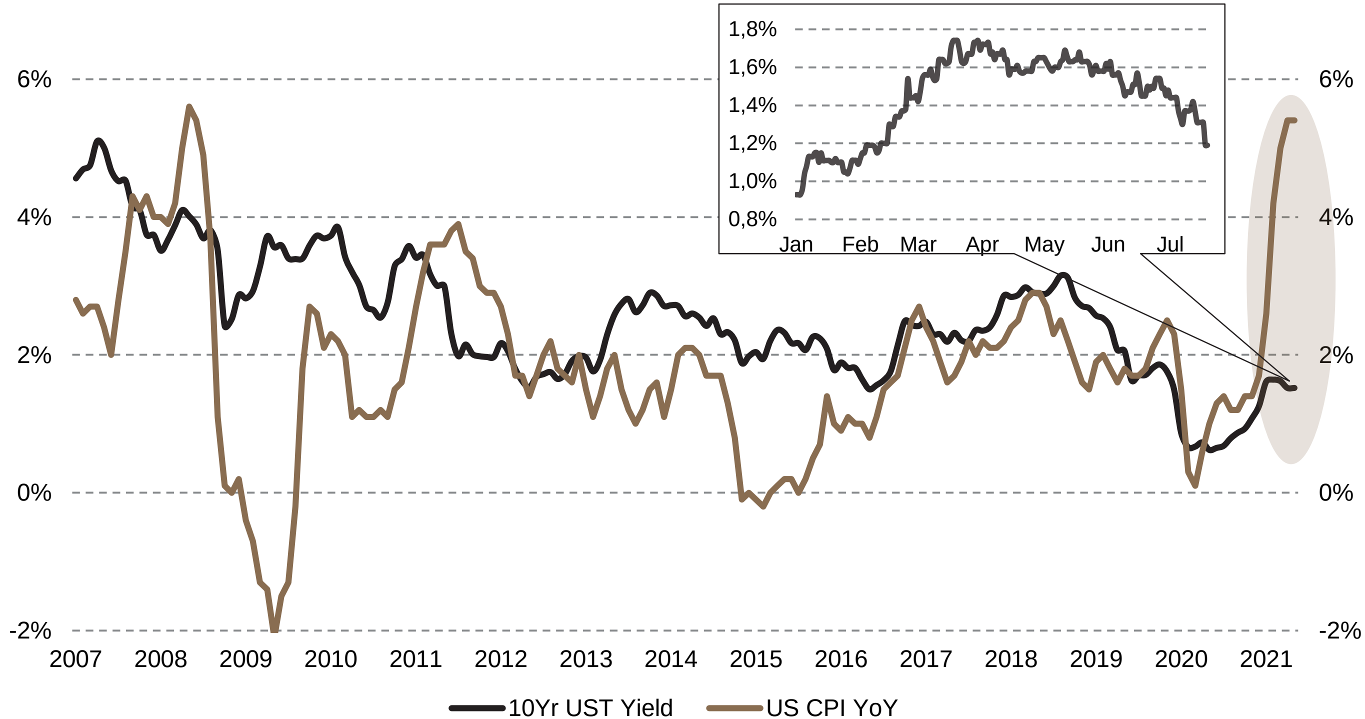
- **The reflation narrative that has dominated the first half of the year has drastically lost steam** in the last month. The **paradox** of this is that initially the market anticipated a sustained increase in inflation, with no data to support it; and that when we began to have evidence that inflation was indeed accelerating, the market has switched narratives
- The **focus now seems to be on growth again**. The market does not appear to be concerned about the economy slipping back into recession anytime soon, but rather about two factors influencing the shape of the recovery. On the one hand, there is the timing of the exit, since the **reopening could be compromised by the emergence of new variants of the virus**. And on the other hand, the intensity of the growth achieved, as we begin to see signs that **the economy may return to its pre-pandemic level faster than expected**; with China offering the best example of this
- The consequence has been a **strong reversal of fortunes** for the proponents of the inflationary narrative. We have seen **growth outperforming value, and interest rates falling almost as sharply as they increased** back in February. This has served as a reminder of how important it is not to fall prey to narratives; especially since we are traversing uncharted territory. In this sense, **we continue to advocate a prudent strategy, focused on quality assets**; although this may mean missing some tactical opportunities
- There is a high degree of uncertainty, given that the uniqueness of this crisis necessarily causes **macroeconomic data to be very volatile. However, market volatility remains relatively low** as the economy continues to be supported by extraordinary levels of fiscal and monetary stimulus. In this context, **we do not expect any major correction in risk assets for the rest of the year, but neither do we expect any further gains from policy tailwinds**. Therefore, future returns should come from positive surprises in corporate earnings; a scenario in which equities have more potential than fixed income

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. We recommend to allocate to Chinese government bonds in Renminbis
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 stocks tend to be more cyclical, and there are fewer quality stocks
	Sectors & Themes	+	We favor Biotechnology and Fintech
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

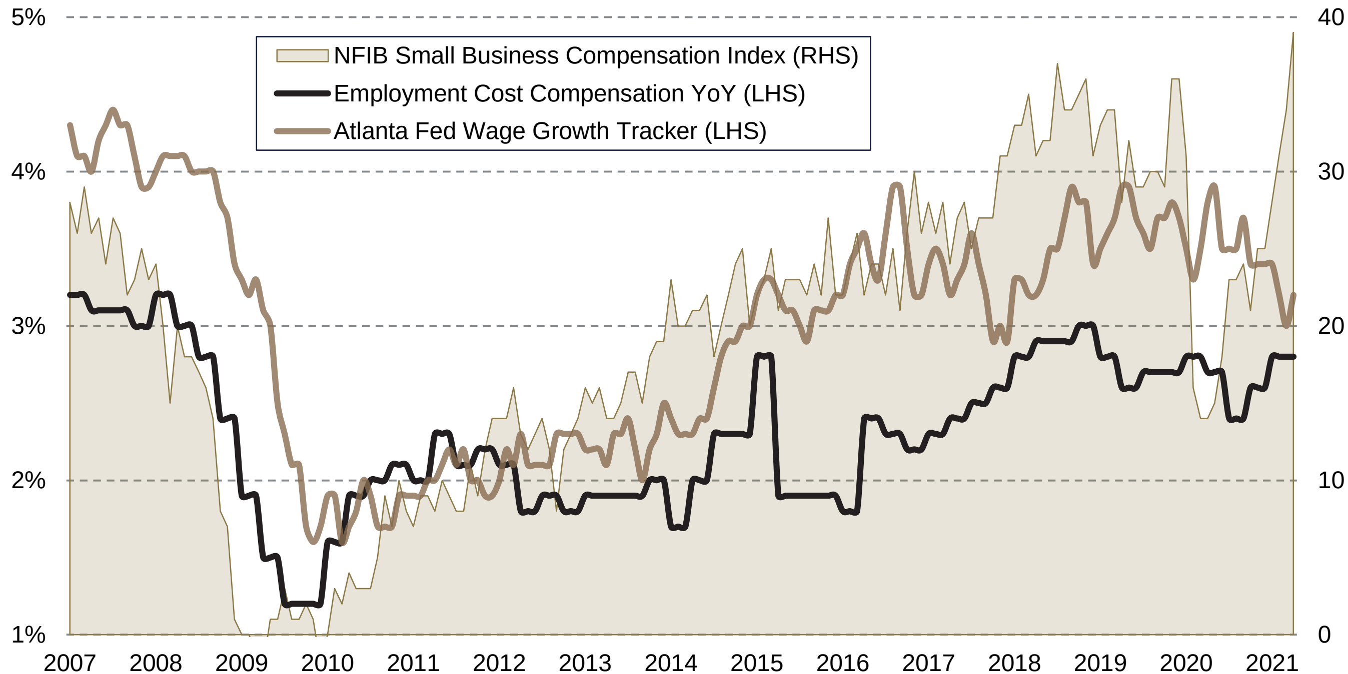
The end of the reflation trade?



- In the last two months, we have seen a **reversal of the "reflation trade"** (defined by rising Treasury yields, and outperformance of value and cyclical stocks versus growth stocks) that was underpinned by the inflation narrative
- **There is no single reason** that explains it, especially since the inflation **data of recent months** have continued to surprise to the upside

Source: Bloomberg

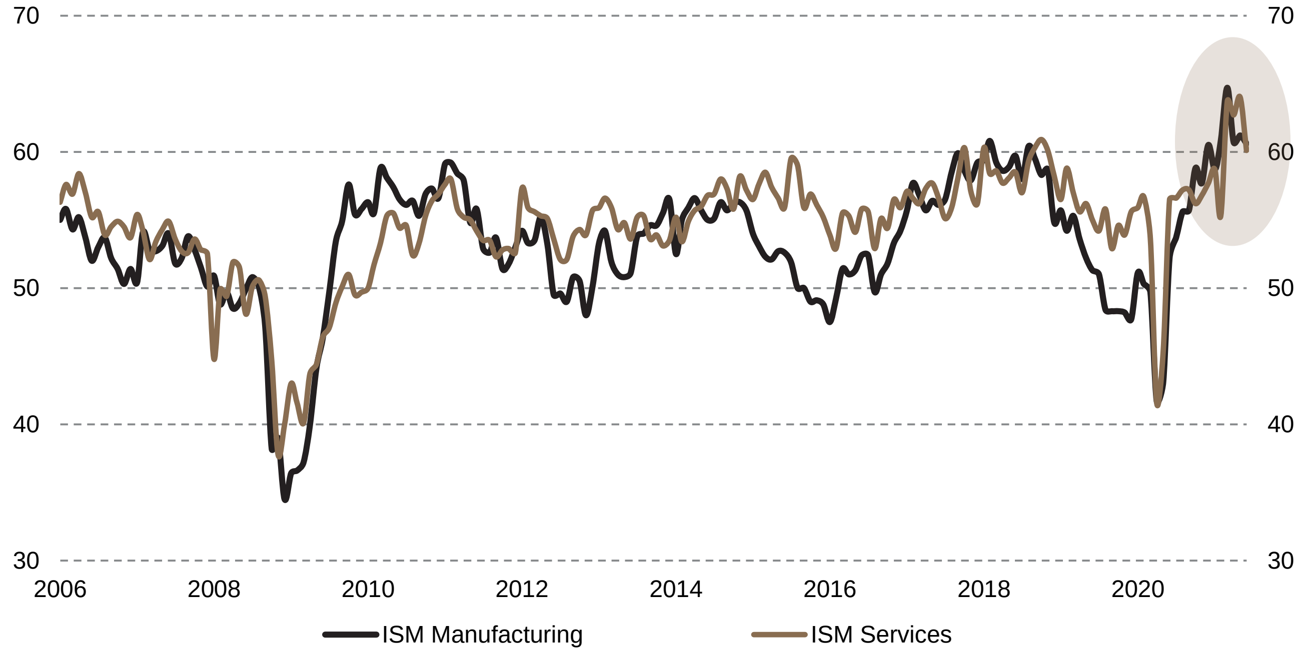
Little transmission to wages so far



- Despite higher-than-expected inflation, **price increases are still limited to a handful of products and services affected by the pandemic**, like car rentals, hotel and airline fares and restaurants
- More importantly, there **does not appear to be a significant pass-through to wages**; beyond low-paying jobs and those in areas directly related to the reopening

Source: Bloomberg

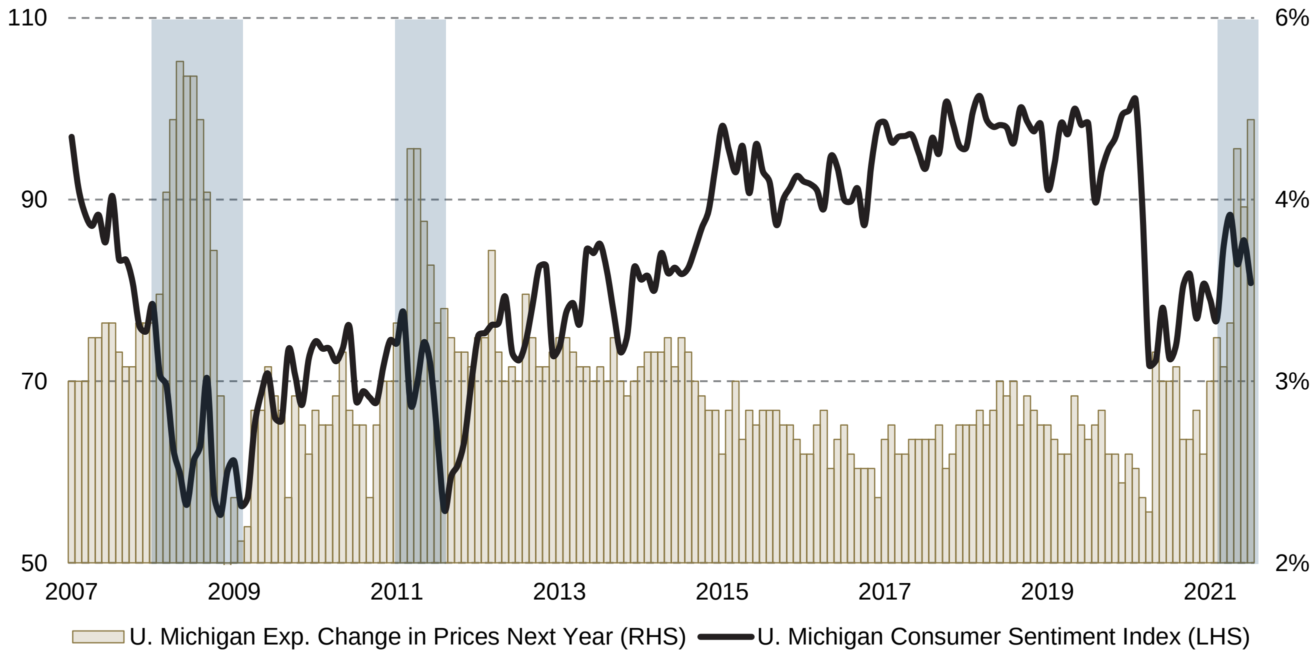
Have we seen peak growth?



- After a stronger (and faster) recovery than expected, we are **beginning to see some moderation in growth**, albeit from still very high levels
- **Leading indicators are showing the first signs of cooling** in both manufacturing and services, as well as job growth

Source: Bloomberg

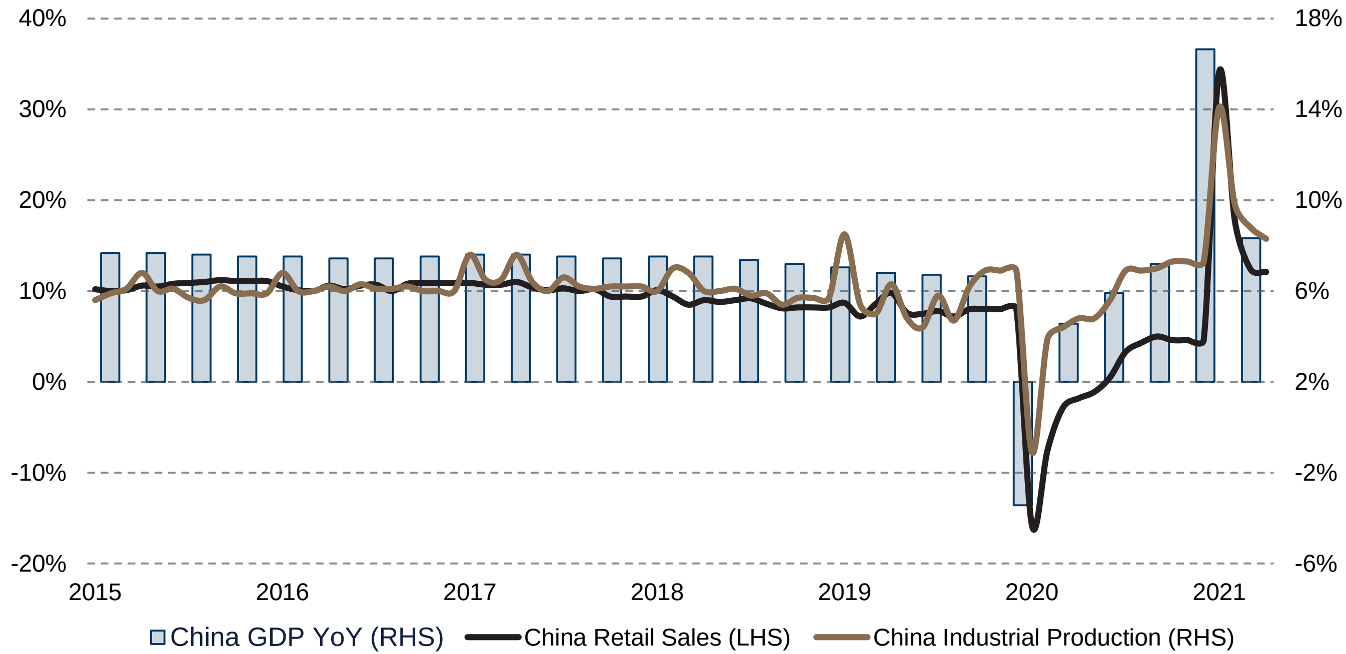
Consumers remain cautious, despite record savings



- **Consumer sentiment has continued to decline, despite the record amount of accumulated savings**; supporting the thesis that government transfers would have resulted primarily in wealth, rather than deferred consumption
- **Rising prices often take a toll on consumption, especially in the absence of wage growth**. This serves as a reminder of how critical this link is for the economy to experience sustained inflation

Source: Bloomberg

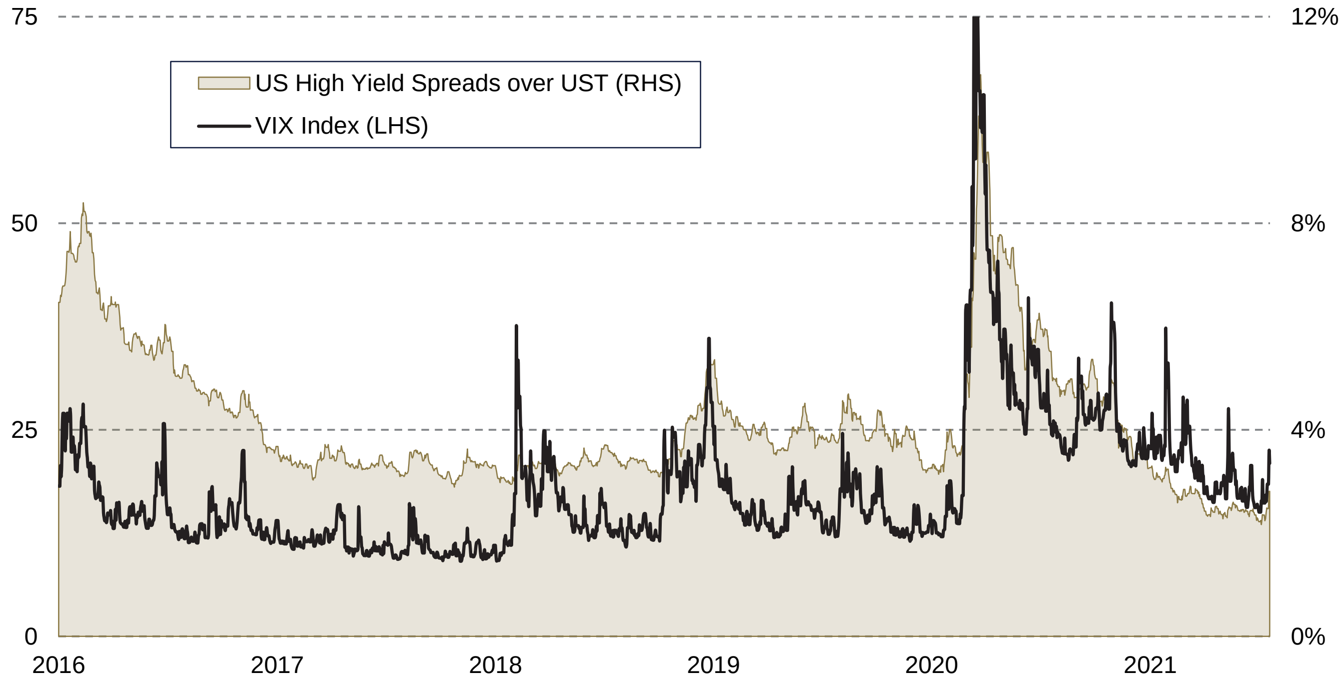
Global growth is slowing down



- Globally, **growth in China continues to return to its pre-pandemic trend**, **while Europe and the rest of Asia face a delay in reopening** caused by the delta variant and delays in the vaccination efforts
- The case of China is particularly telling, since the slowdown has even forced its authorities to loosen their monetary policy; showing how quickly the economic momentum can fade

Source: Bloomberg

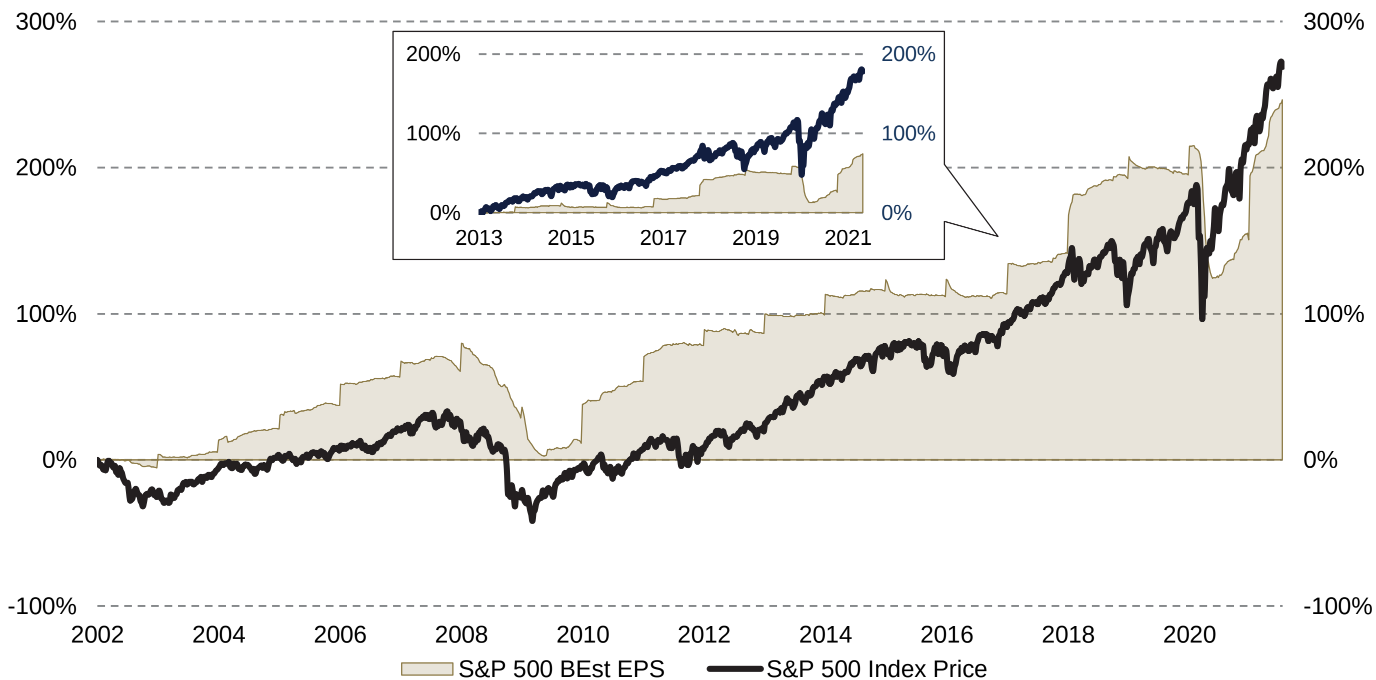
But we are still far away from the next recession



- However, despite the recent jitters, **the probability that the economy will fall into a recession in the short term is very low**, given that we are just beginning a new economic cycle, supported by huge amounts of fiscal and monetary stimulus
- In fact, despite the recent correction, **credit markets continue to price an extremely low default rate**; consistent only with a robust economic expansion

Source: Bloomberg

No more tailwinds for equity markets



- **The earnings season for the second quarter has started very positively**, with a majority of companies beating estimates
- **Earnings growth is by far the most important factor in stock market performance**. However, the massive monetary stimulus after the financial crisis, and now the pandemic, has caused a growing wedge between the two. This poses a **risk from a valuation standpoint**

Source: Bloomberg

Investment scenarios

	Scenario 1 Interest rate shock	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% (-5%)	55%	15% (+5%)

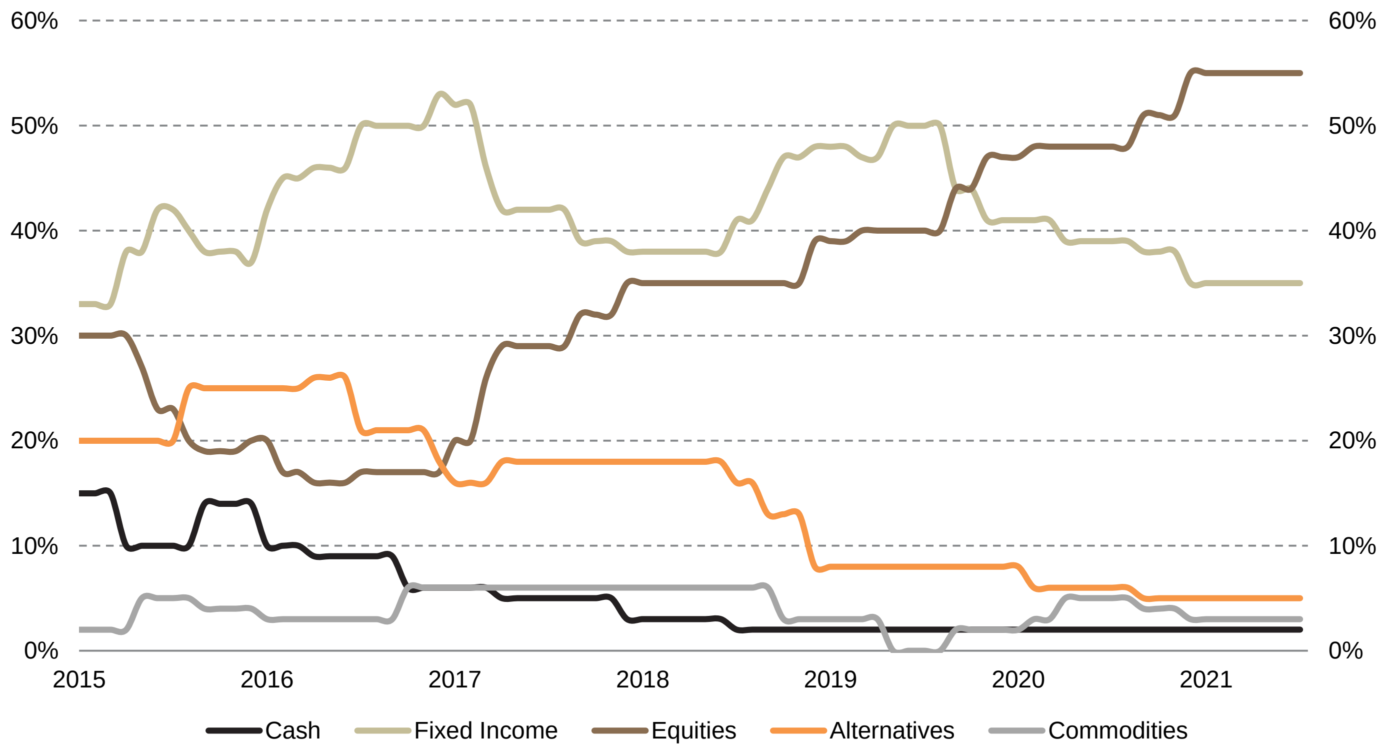
Short-term catalyzers

Acceleration in vaccinations or treatment for the coronavirus, normalization of activity

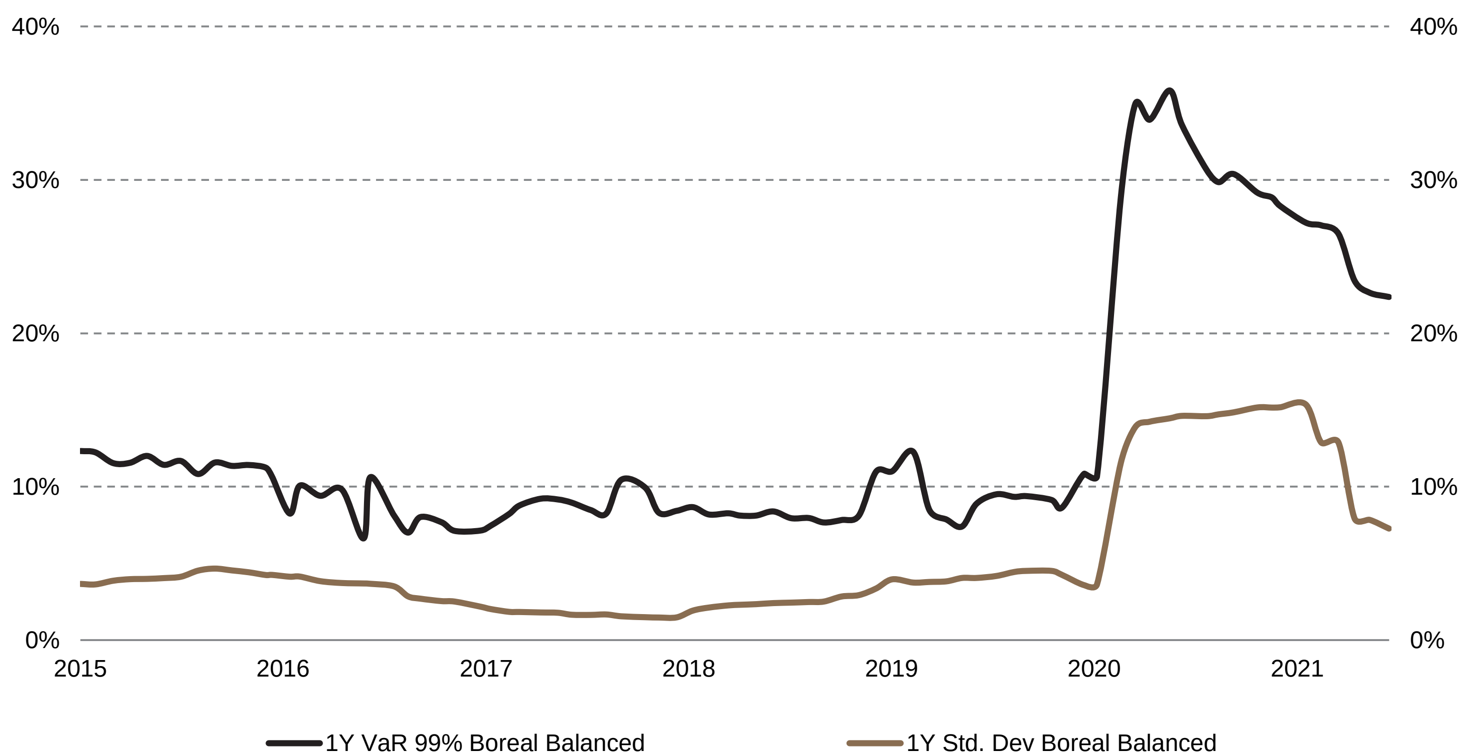
Other risks

Revamp of global taxation, Trade war (II), Spread of populist political parties, Geopolitical (Middle East, Russia, Iran, North Korea)

EWM Model Portfolio – Asset Allocation evolution

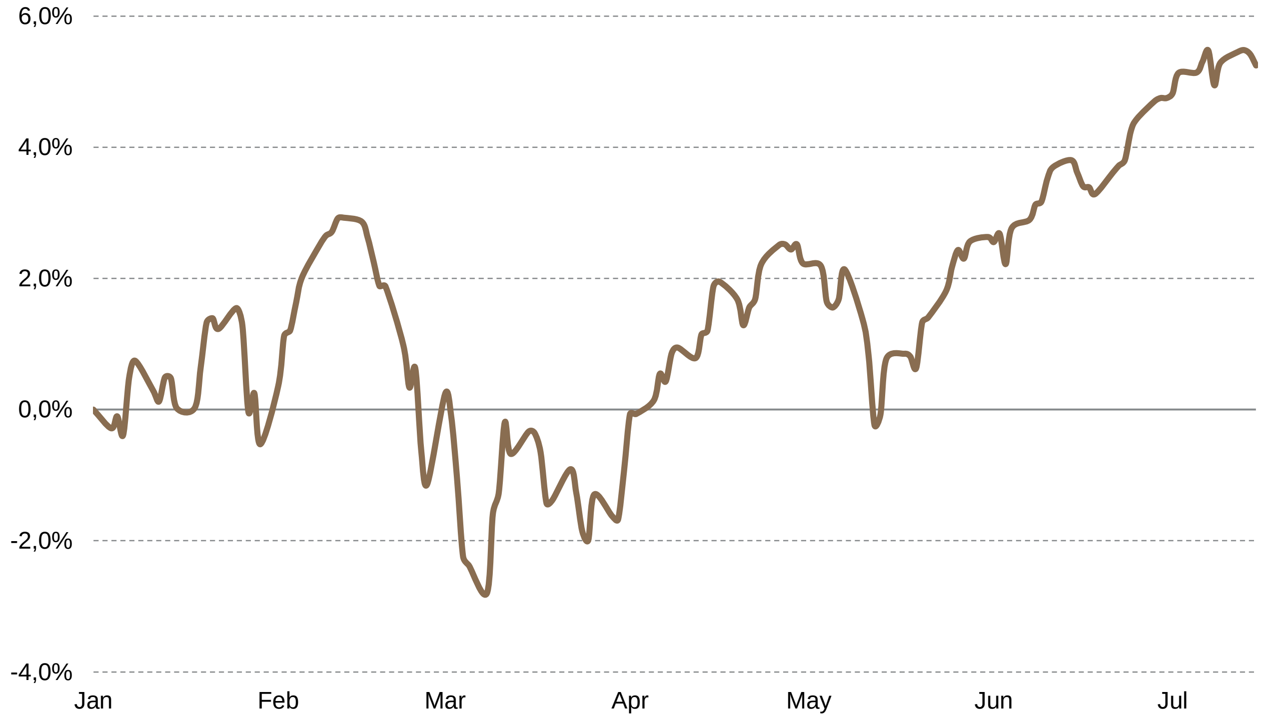


EWM Model Portfolio – VaR evolution



[1] As of July 15, 2021
Source: Bloomberg

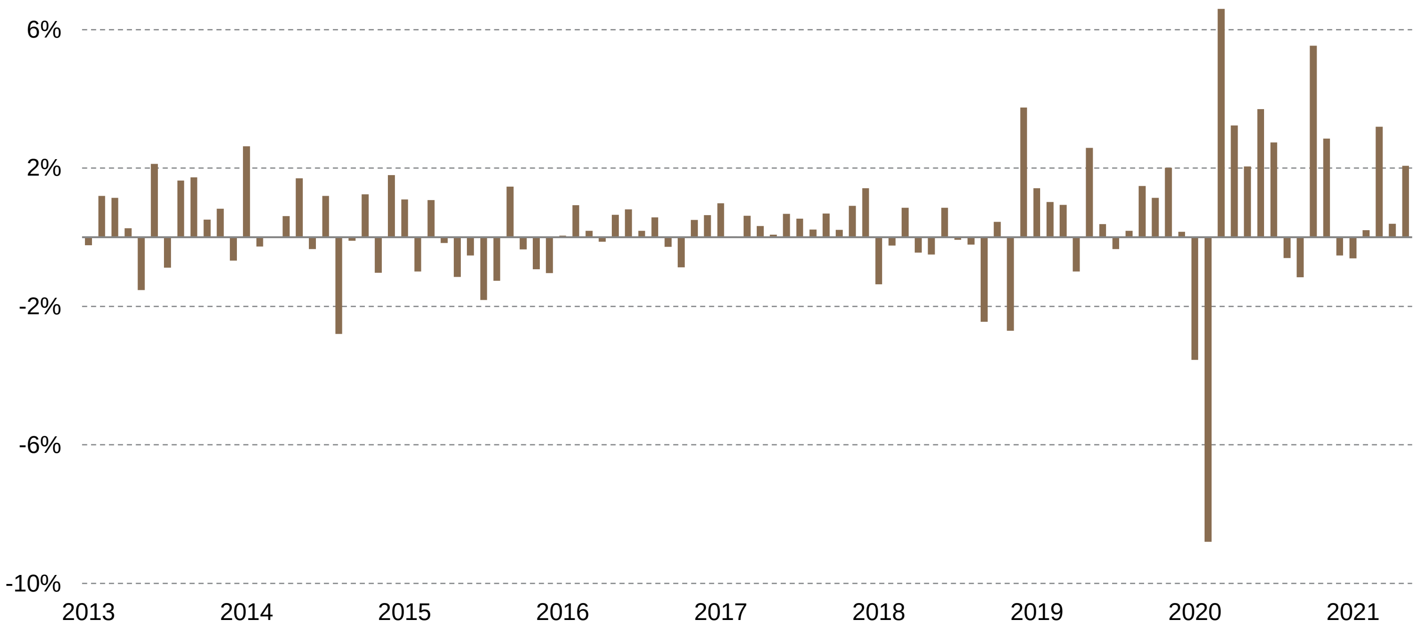
EWM Model Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **5.25%**
- **Standard Deviation** (Ytd[1]): **7.40%**
- **Downside Risk** (Ytd[1]): **5.38%**
- **Sharpe Ratio** (Ytd[1]): **1.39**

[1] As of July 15, 2021

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **16.92%**
- **Total Return** (3 year[1]): **28.95%**
- **Total Return** (Since Jan 13[1]): **53.10%**

[1] As of July 15, 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%	5.25%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	7.40%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.87	1.39

Annualized Return: 5.11%
Annualized Std. Dev: 6.28%

[1] As of July 15, 2021

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