Edwards Wealth Management AG
Switzerland

BOREAL
CAPITAL MANAGEMENT

Investment Policy

March 2022

Our market view in a nutshell – March 2022

- The war in Ukraine represents a **geopolitical crisis of enormous dimensions**, probably only comparable to the Cuban missile crisis. As back then, we have to **trust the rationality of the parties involved**. And although it may seem that Putin is not moving by rational calculation, the most likely explanation is that he has not timed his steps well. Just as the West has failed to interpret how important the Ukraine issue was to Russia

- The invasion of Ukraine **was judged as a low-probability event by financial markets**, and therefore it has caused a negative shock. This has come to end the incipient upturn in equity markets, which had been falling since the beginning of the year. However, despite the gravity of the events, **the correction has been relatively contained**. From this it can be inferred that: (1) Equity markets were probably oversold before the invasion and (2) The market is assigning a very low probability to a potential escalation of the conflict

- The **immediate impact of the war on financial markets has been felt in commodity markets**. The spike in energy prices comes at a time when the Fed has been forced to tighten monetary policy to try to control inflation. Before the conflict, there was already a risk that the economy would slow down as a result of rate hikes; which have a negative impact on both consumption and corporate investment. The rise in energy prices, that acts as a sort of consumption tax, **increases the likelihood that the economy will fall into recession**

- Faced with a less positive macroeconomic scenario, it is **prudent to reduce the risk in the portfolios**. This translates into **lowering equity exposure** (both by reducing the allocation and by making use of hedging instruments). Likewise, given that the macroeconomic scenarios we are facing are quite binary (stagflation vs. recession), **inflation-linked US Treasury bonds (TIPS**) are a good addition to the fixed income allocation

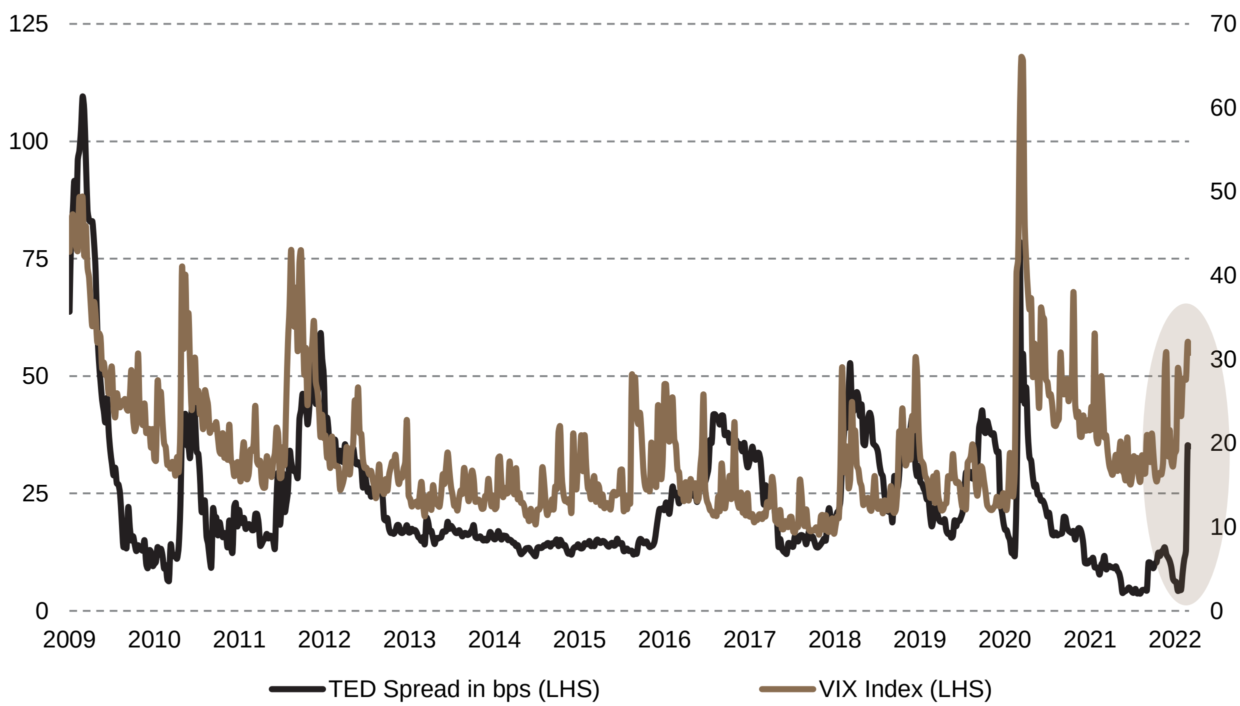
- In short, we recommend keeping a cool head, **following a gradual approach**, and not getting carried away by catastrophic scenarios; despite the fact that unfortunately the latter cannot be completely ruled out. The market correction has already been very pronounced, and **realizing losses at these levels can entail a high opportunity cost** if a negotiated solution to the conflict is reached

EWM Investment Policy

	Asset Class	View	Rationale
Fixed Income	US Treasuries	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. Given the binary macroeconomic risks we are facing (stagflation vs. recession), we favour TIPS
	US Credit	=	Higher probability of an economic slowdown caused by rising interest rates and inflation have pushed up credit spreads, so returns are beginning to compensate for the risks taken
	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	=	As with US credit, but from a lower base, higher credit spreads make European credit investable again
	Emerging Markets	–	Emerging market debt attractiveness has improved, but tends to underperform in a strong dollar environment
Equities	US	+	After a sharp sell-off, valuations have improved. We maintain our exposure to US equities, mostly through quality and growth oriented companies
	Europe	=	The European economy has emerged from the pandemic faster and stronger than many expected. However, the continent is more exposed to the falling out with Russia
	Japan	=	We recommend investing selectively in the region; favouring high growth stocks
	Emerging Markets	–	Emerging markets stocks tend to be more cyclical, and there are fewer quality stocks. Russian sanctions and regulatory pressure on China have increased the risk premium
	Sectors & Themes	+	Although we continue to like secular growth sectors such as Biotech and Fintech, we are currently reducing direct exposure to them
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	=	Commodity prices have been driven up by (and not caused by) inflation, as well as the war in Ukraine. We do not expect these levels to be sustainable in the long term
	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

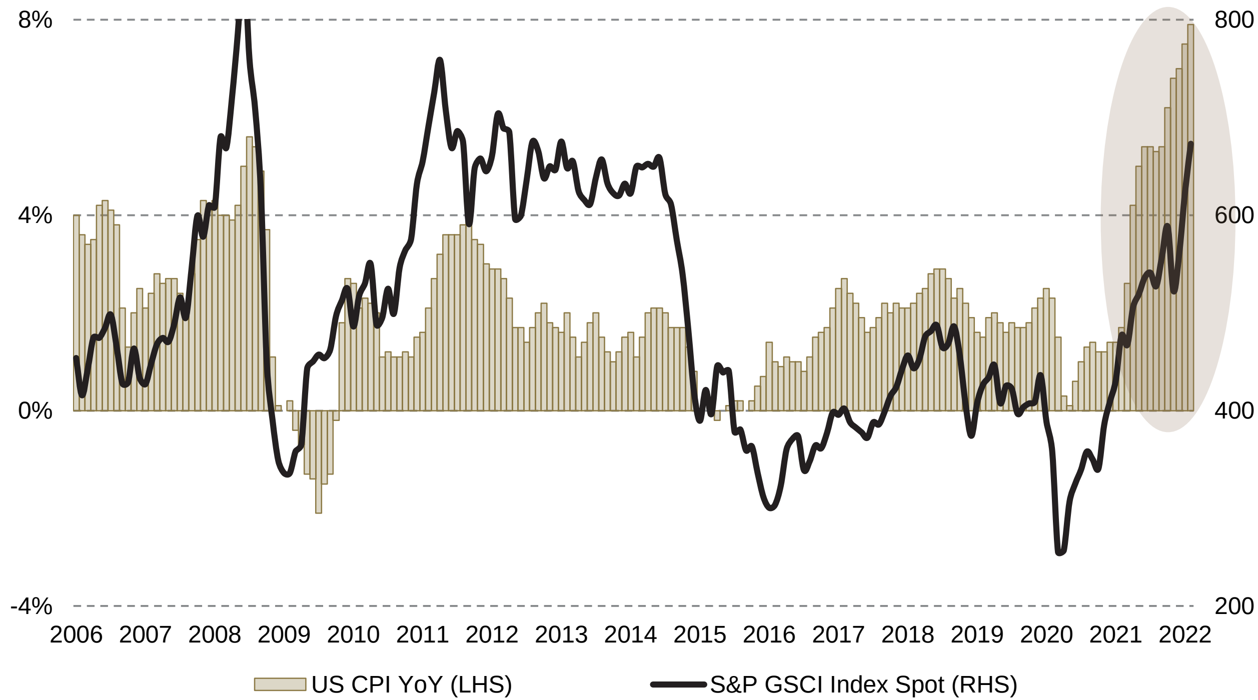
Big surprise, small shock



- The decision to invade Ukraine was **not expected and therefore not discounted by financial markets**. Despite the surprise, and the seriousness of the geopolitical crisis, the **market reaction has been relatively contained**
- This means that an **escalation of the conflict is regarded as a low probability event**, and that the evolution of the war will probably dominate market movements in the near term

Source: Bloomberg

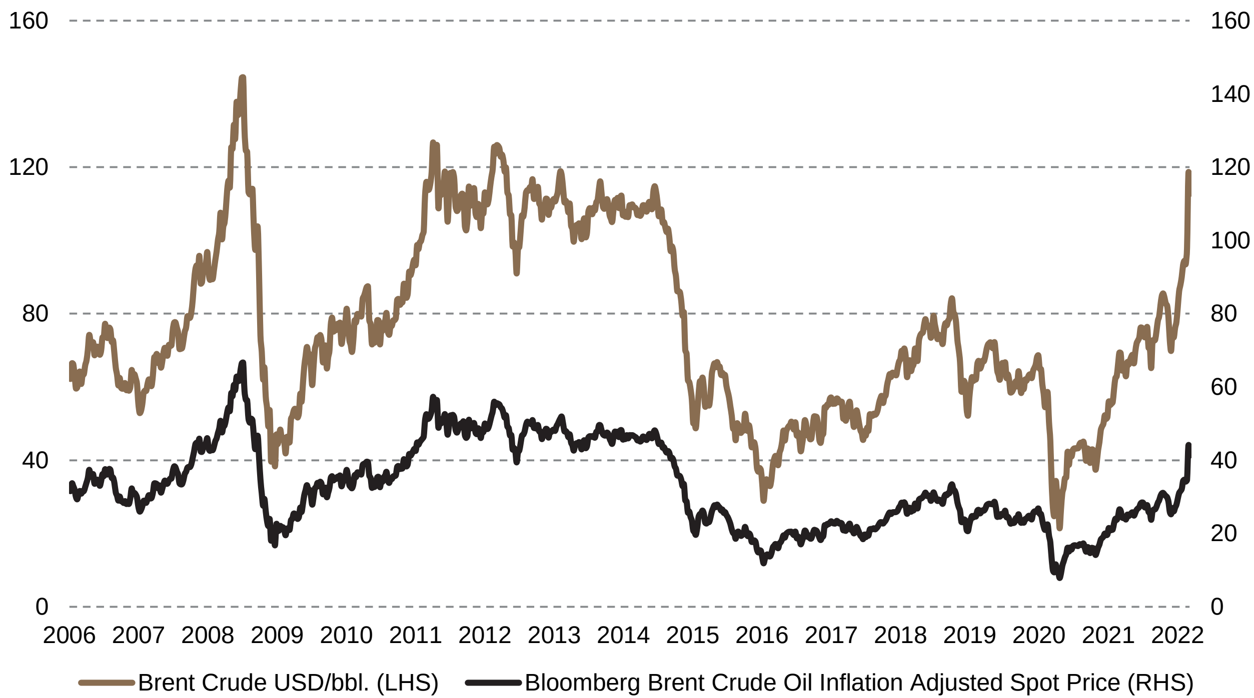
Commodities as a transmission channel



- Unlike previous inflationary cycles, this time commodity prices have been **lagging behind, rather than leading** the surge in consumer prices
- However, sanctions on Russia are turning **commodities (and energy in particular) into a new powerful source of inflation**

Source: Bloomberg

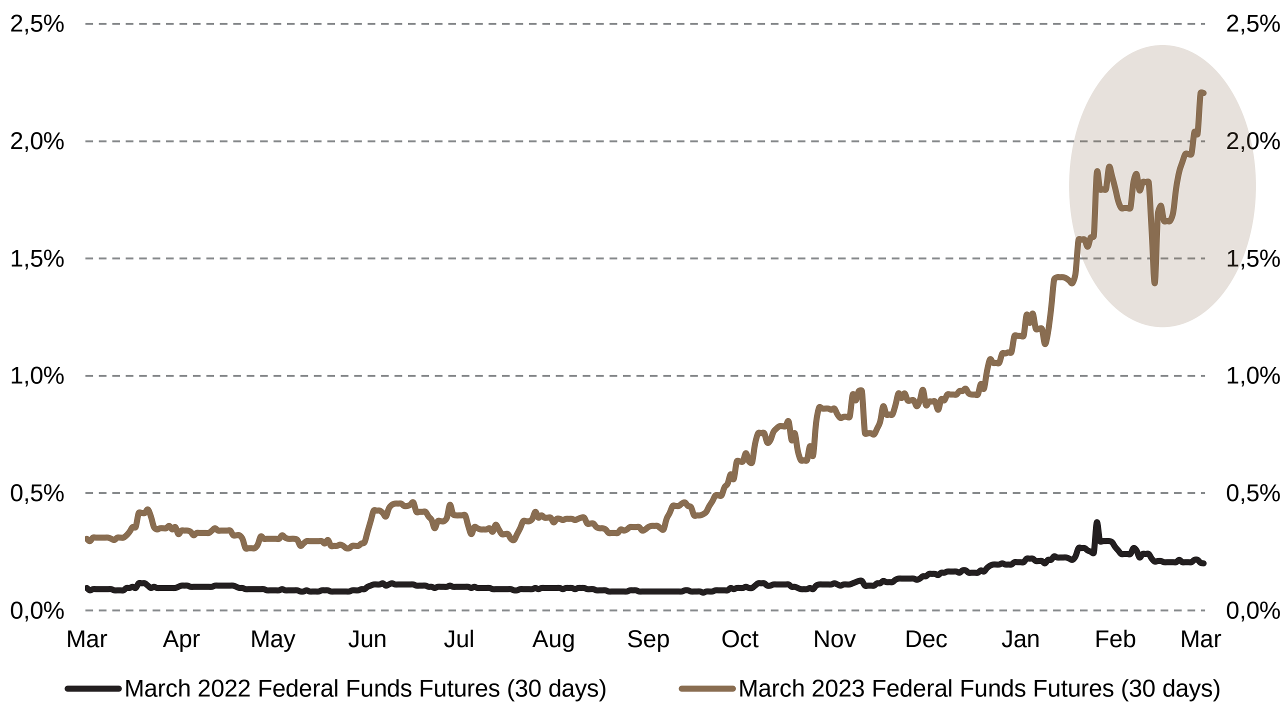
A very different oil market



- Russia accounts for about 11% of world oil exports. If the current crisis had occurred **a decade ago, the spike in prices would have been much more acute**
- The **"Shale Revolution"** and the energy transition to a **decarbonized economy** have significantly attenuated the shock. The longer the crisis lasts, the greater and faster the substitution of energy sources will be

Source: Bloomberg

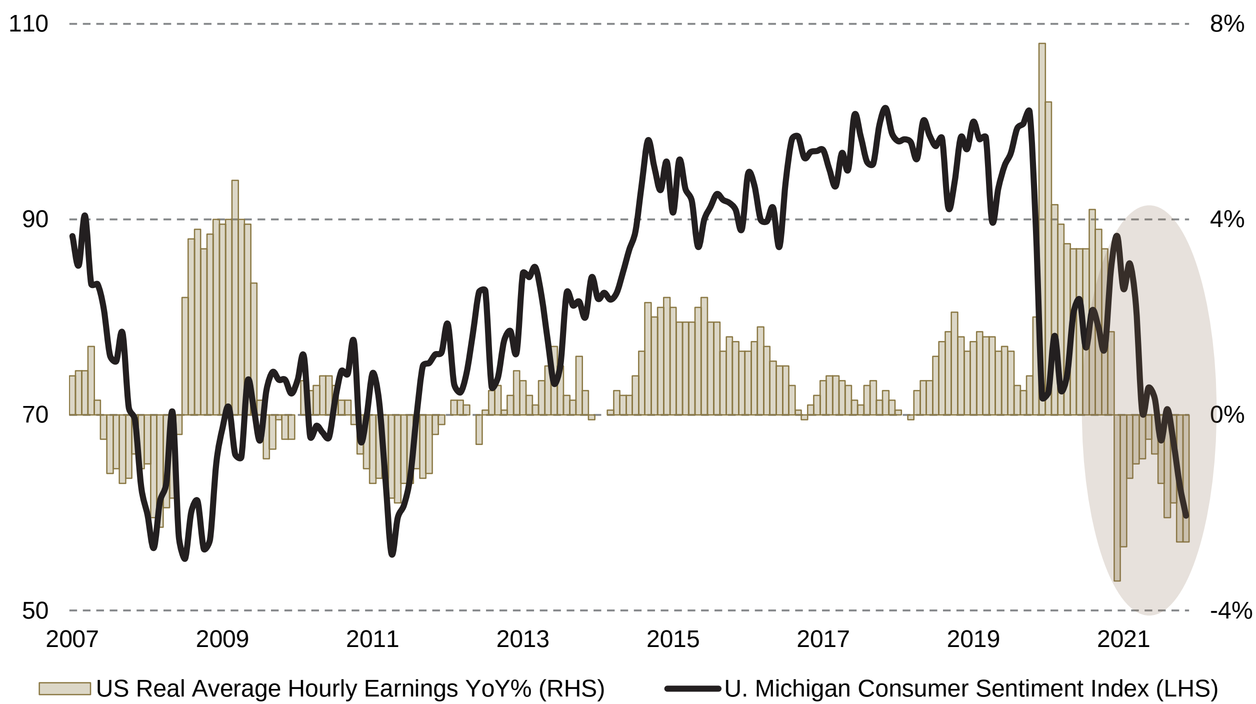
Do not count on central banks this time



- Given the limited impact so far on liquidity conditions, **central banks have not rushed this time to calm financial markets**
- The war in Ukraine is **significantly complicating the Fed's room for maneuver** to control inflation, and therefore the risks of a **"hard landing"** of the economy have increased markedly

Source: Bloomberg

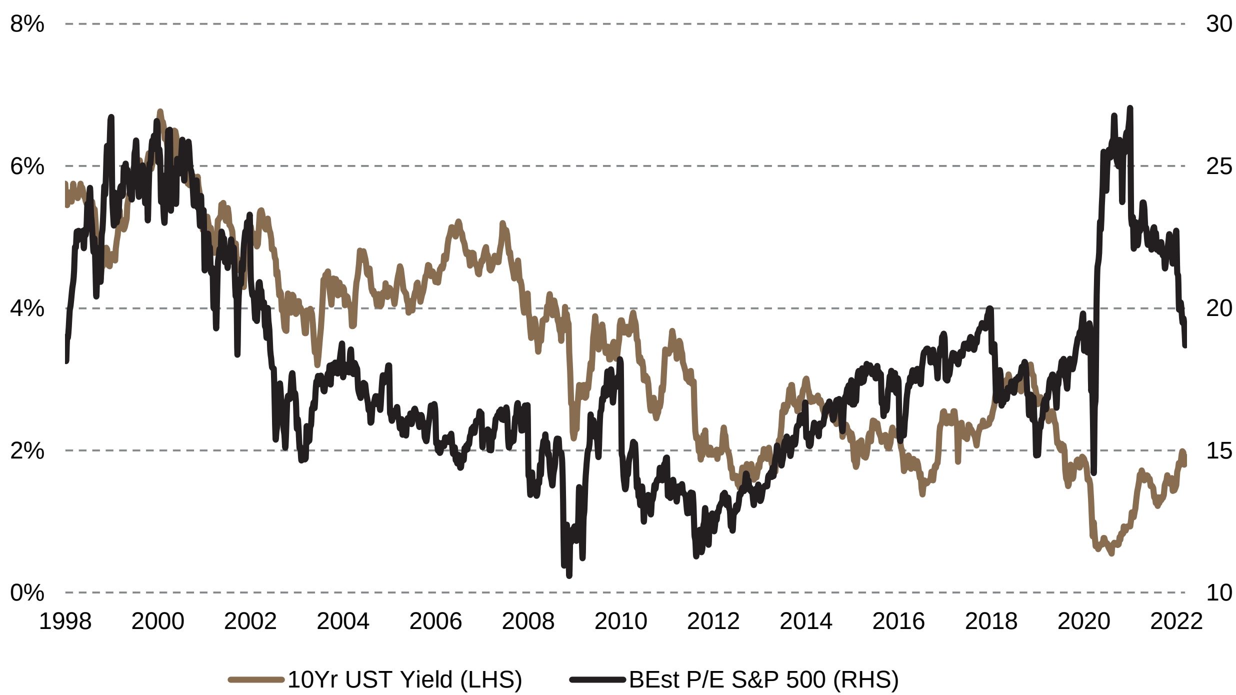
Stimulus keeps supporting consumption, but for how long?



- **Consumer prices have been rising faster than wages**, causing the latter to contract in real terms, which is clearly affecting consumer sentiment
- The **surge in disposable income during the pandemic**, thanks to direct transfers from the government**, is what keeps consumers spending**, but this situation may soon become unsustainable

Source: Bloomberg

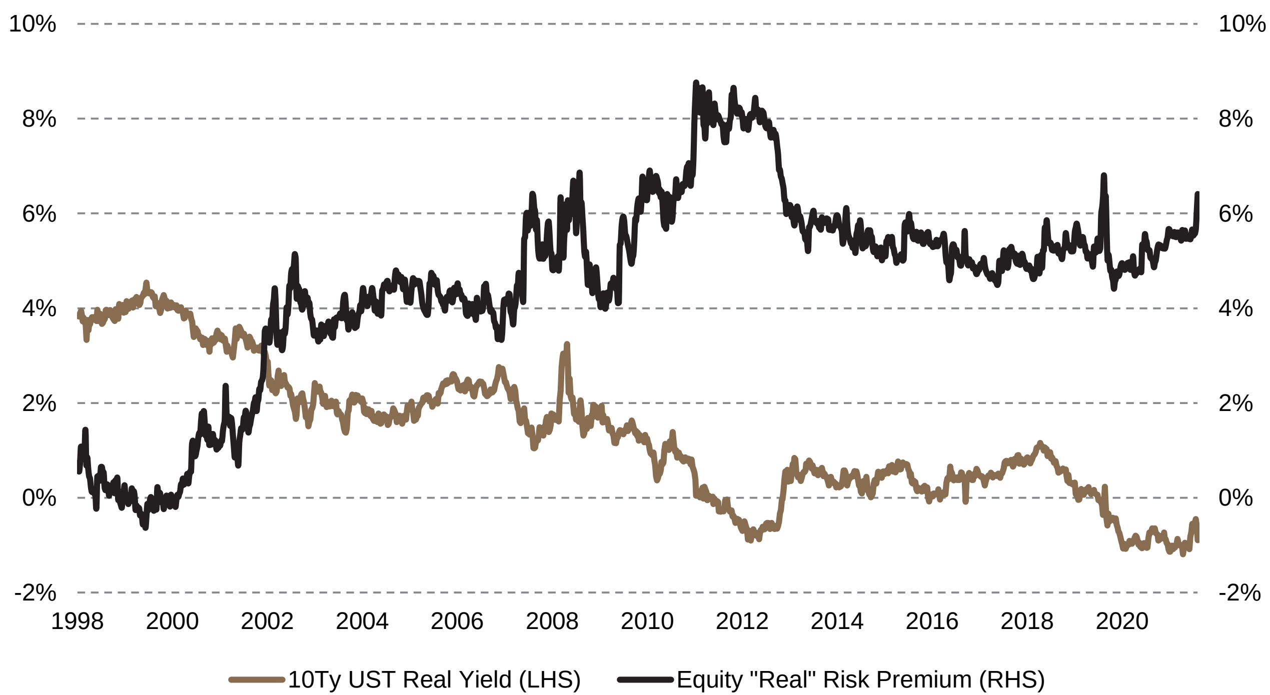
A more than healthy correction



- The **contraction in valuation multiples has been very pronounced**, bringing valuations to levels that largely discount the potential rise in long-term interest rates

Source: Bloomberg

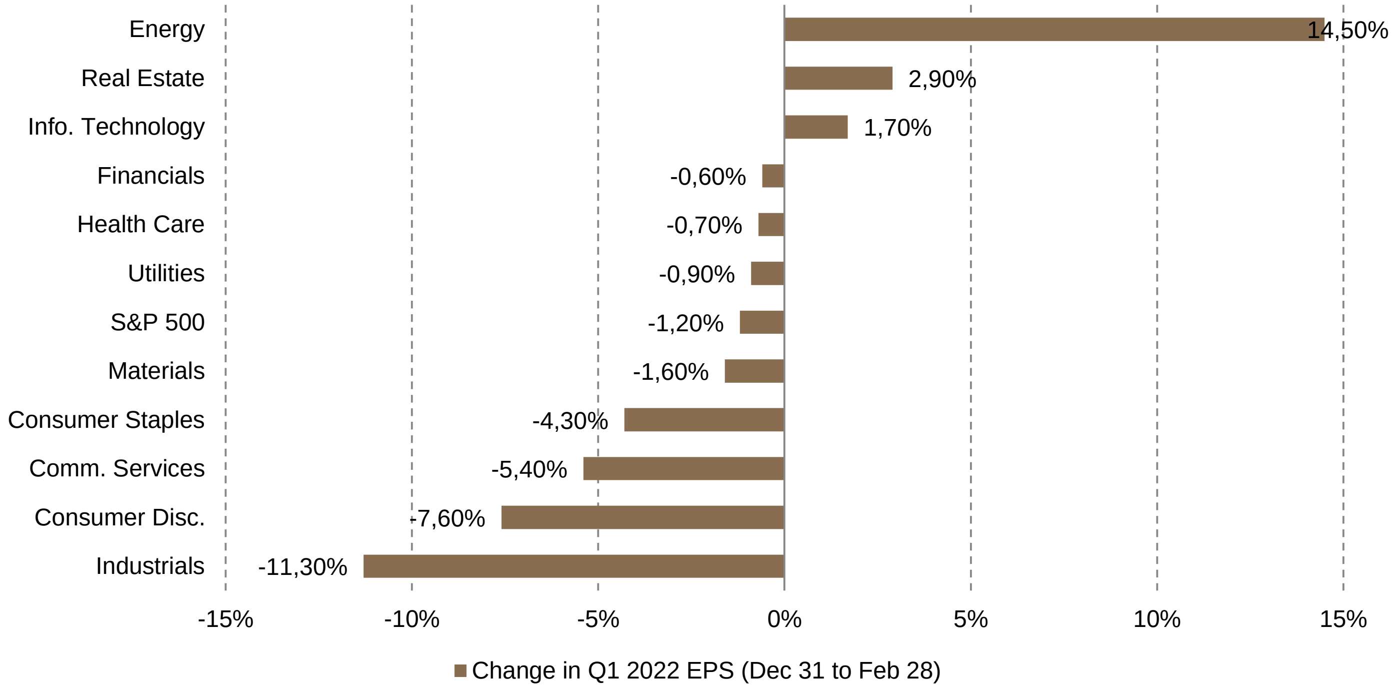
“ Real” attractiveness



- Despite the rise in interest rates, **when adjusting for inflation equities still look much more attractive than bonds**
- In addition, those companies that can pass price increases on to their customers offer a **much better hedge against inflation**

Source: Bloomberg

Better never than late *(sic)*



- Sector **rotation has been very pronounced since last year**, driven by higher-than-expected inflation and the rebound in energy prices
- With the probability of an economic slowdown increasing, **chasing the winners of recent months now can be risky**; as we are starting to see from earnings revisions

Source: FactSet

Investment scenarios

	Scenario 1 Stagflation	Scenario 2 “Soft landing”	Scenario 3 “Hard landing”
Drivers	• Inflation remains high due to labor shortages, supply chain bottlenecks, and rising commodity prices due to war sanctions on Russia • The Fed tightens its monetary policy at an accommodating pace, which fails to control inflation, but does not slow down the economy either • As a result, long-term inflation expectations rise, as do long-term interest rates	• Fiscal policy remains highly accommodative and the economy continues to grow with strong momentum • The Fed raises interest rates progressively. Inflation begins to normalize without the economy slowing down significantly • The yield curve flattens, and long-term interest rates rise only moderately	• Consumption slows down given that, despite the rise in wages, high inflation translates into lower real disposable income • In order to bring inflation down, the Fed is forced to raise interest rates aggressively, causing a drop in consumption as well as corporate investment • The economy falls into recession, slowing down inflation and lowering interest rates
Market impact	• Corporate profits rise with inflation, but higher interest rates have a negative impact on equity valuations • High-quality and sovereign bonds fall due to rising interest rates • Credit performs relatively better despite higher rates, as the risk of corporate defaults remains low • The US dollar depreciates against safe-haven currencies as well as against gold	• Equities appreciate, as the economy returns to the “Goldilocks”, and valuation multiples widen • Credit spreads tighten moderately as investors chase yield again • High-quality and sovereign debt trade range-bound • Commodity prices stabilize and the US dollar appreciates due to higher real interest rate differentials	• Equity markets fall, and cyclicals underperform quality and defensive stocks • Credit spreads widen sharply as the prospect of corporate defaults increases • Sovereign debt and the US dollar appreciates due to "flight to quality“ • The economic recovery will be greatly influenced by the fiscal policy response (a repeat of the emergency measures tried during the pandemic, or a more orthodox approach)
Probability	35%	30%	35%

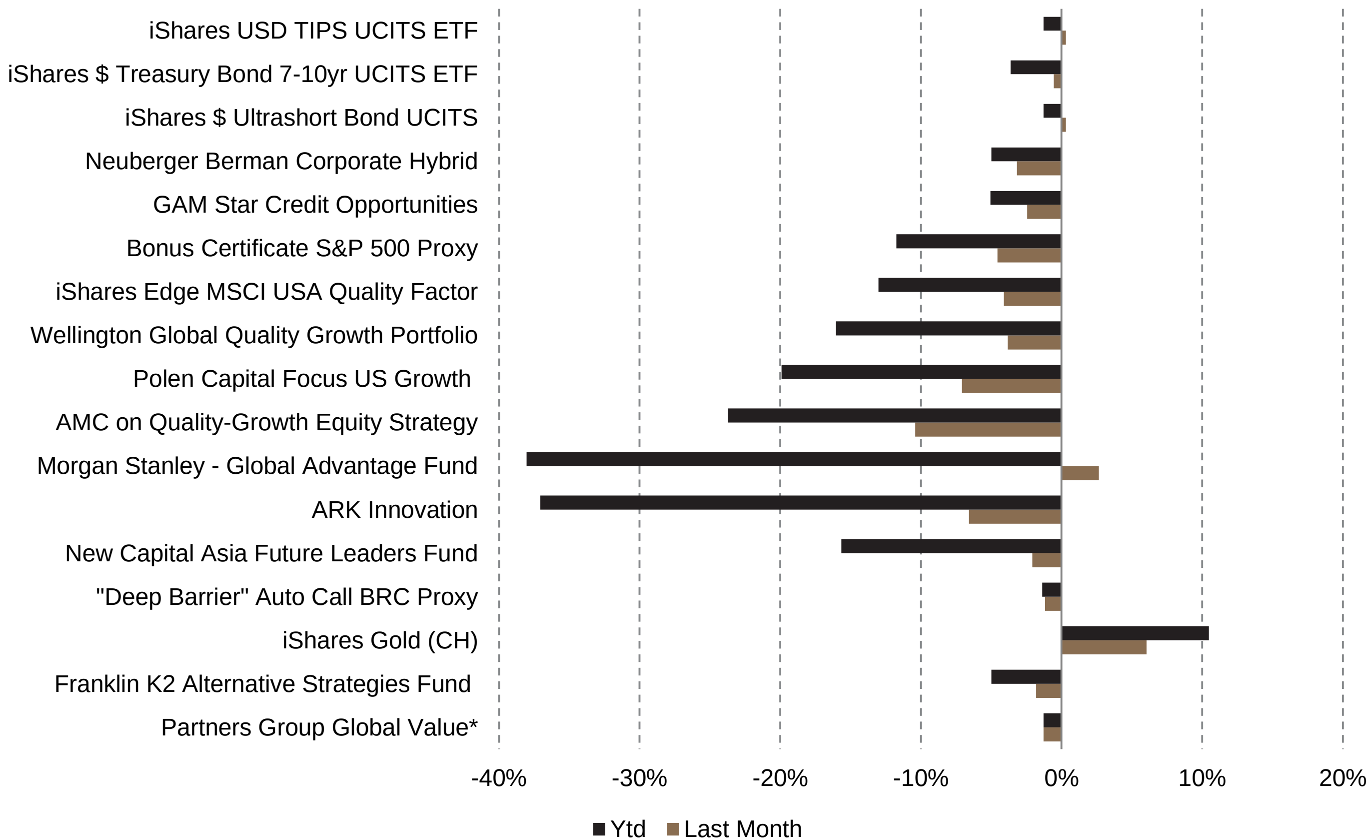
Short-term catalyzers

Peace agreement in Ukraine, Slowdown in inflation, Pandemic becomes endemic

Other risks

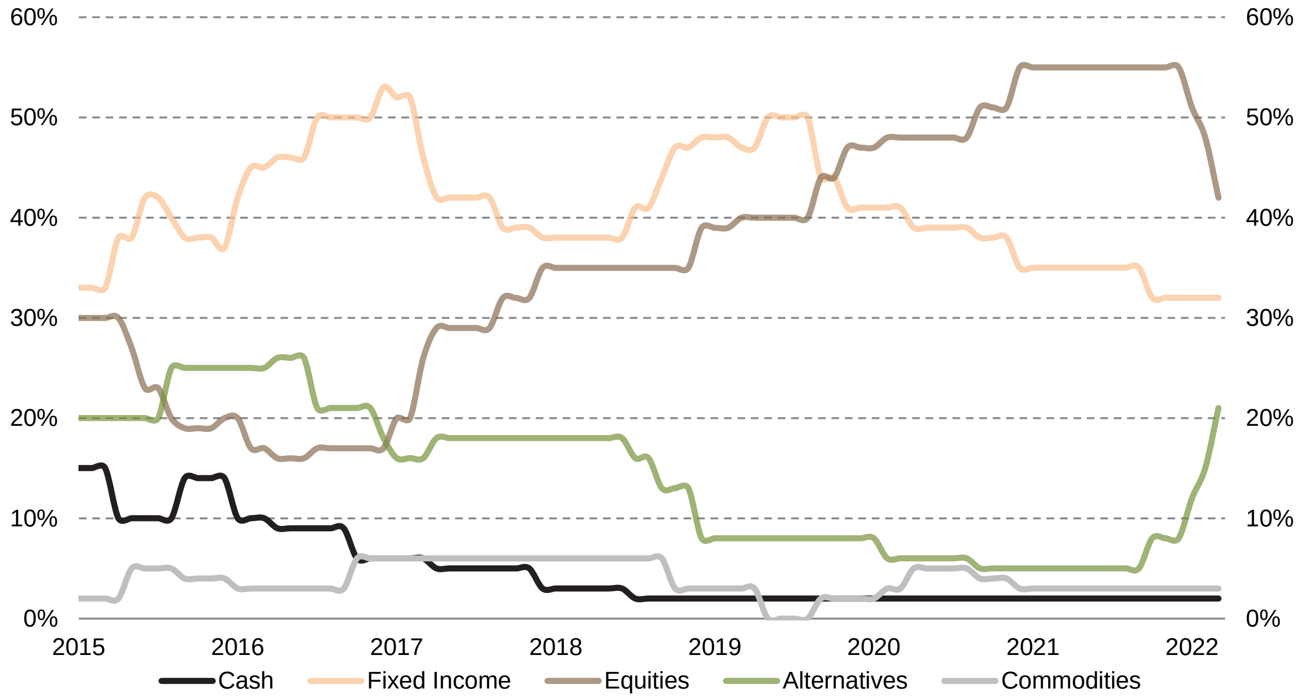
Escalation of the war in Ukraine, China slowdown, Crypto bubble crash

Model portfolio evolution

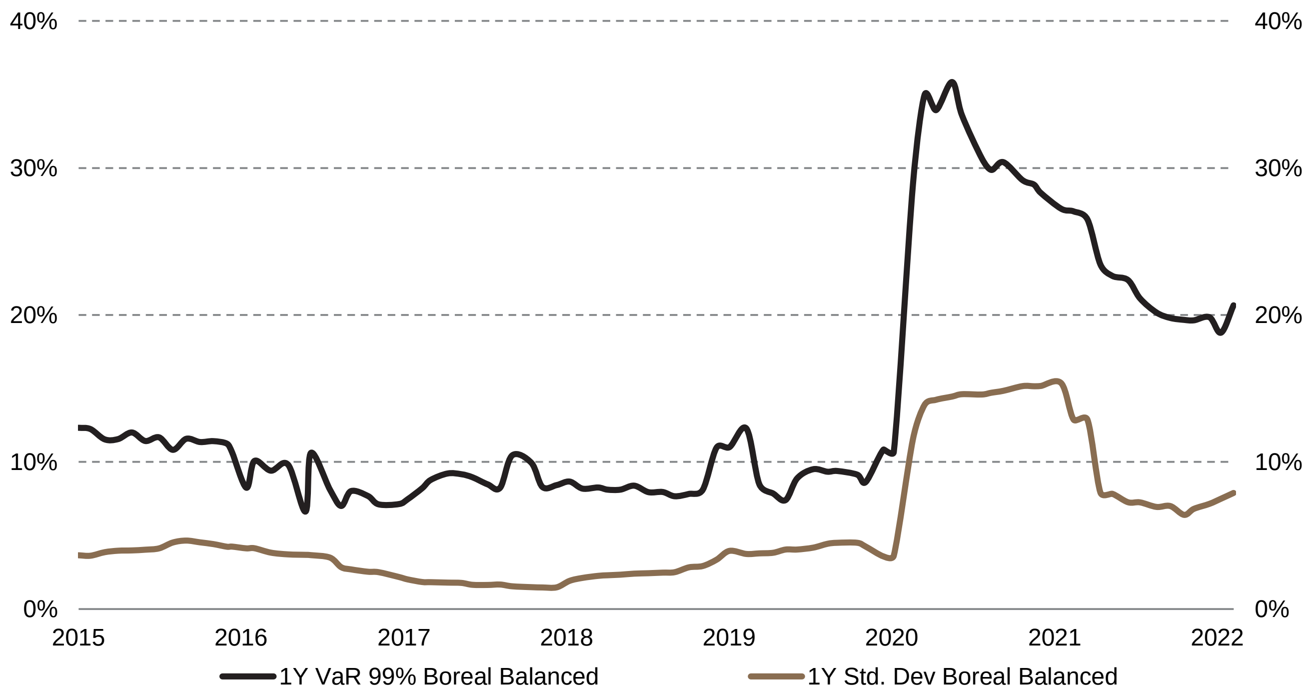


Source: Bloomberg, as of March 11, 2022
* Fund publishes monthly NAV with a 1 month of delay

EWM Model Portfolio – Asset Allocation evolution

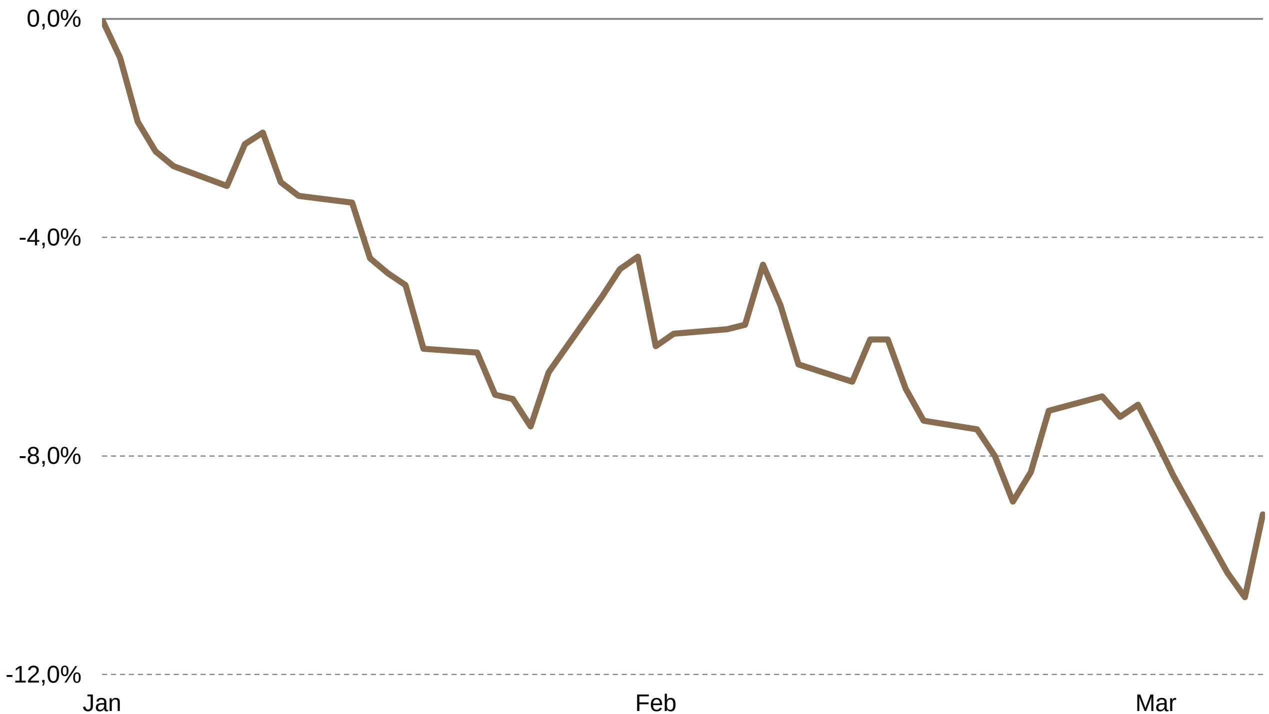


EWM Model Portfolio – VaR evolution



[1] As of March 9, 2022
Source: Bloomberg

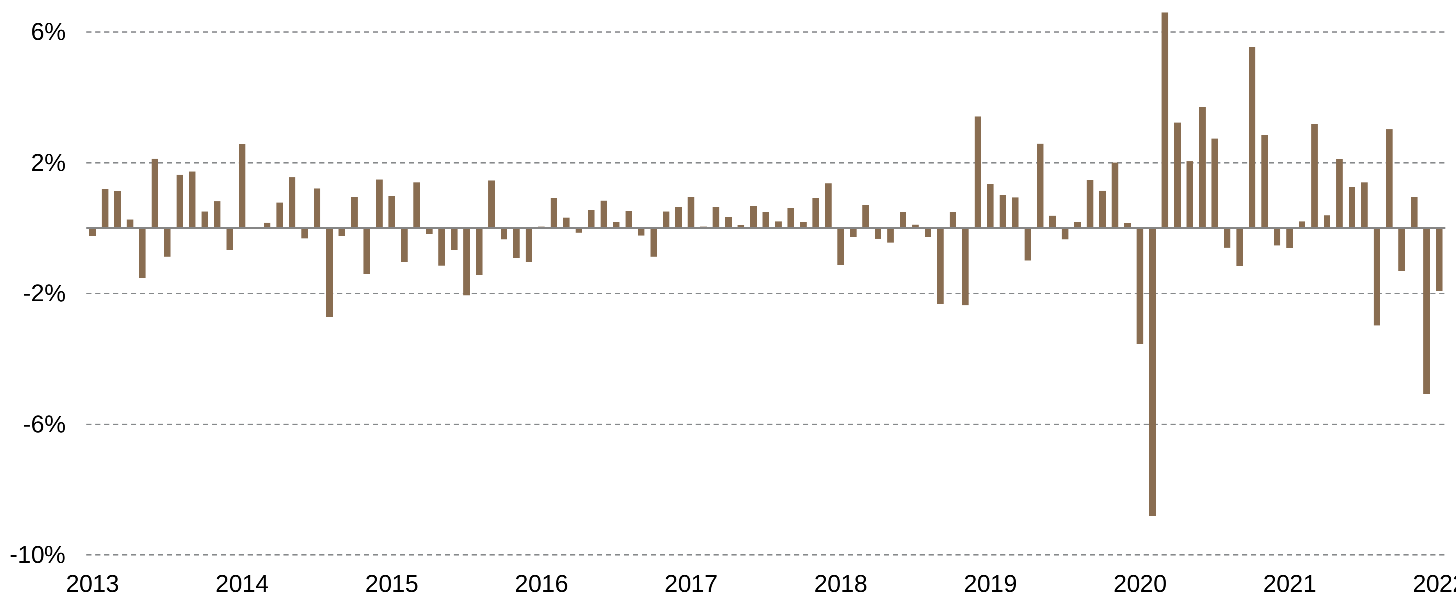
EWM Model Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **-9.07%**
- **Standard Deviation** (Ytd[1]): **12.72%**
- **Downside Risk** (Ytd[1]): **8.45%**
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of March 9, 2022

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **-0.99%**
- **Total Return** (3 year[1]): **19.54%**
- **Total Return** (Since Jan 13[1]): **40.53%**

[1] As of March 9, 2022

EWM Model Portfolio – Historical performance (2)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return	9.58%	2.05%	-1.80%	1.57%	6.06%	-4.62%	14.67%	12.35%	7.01%	-9.07%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	6.96%	12.72%
Sharpe Ratio	2.54	0.58	n/a	0.62	3.57	n/a	3.49	0.87	1.04	n/a

Annualized Return: 3.77%
Annualized Std. Dev: 6.45%

[1] As of March 9, 2022

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