Edwards Wealth
Management AG
Switzerland

Investment Policy

April 2022

Our market view in a nutshell – April 2022

- With the war in Ukraine dragging on for nearly two months now and inflation readings worsening as a result of rising energy prices, **pressure is mounting for the Fed to tackle the problem in a decisive manner**. The modest rise in interest rates in March seemed justified given the uncertainty created by the conflict, but as long as the latter continues to be contained geographically, **the gargantuan gap that exists between interest rates at 0.25% and inflation above 8%, gives an idea of the challenge that the Fed has ahead**

- The Fed is now pointing **towards interest rates reaching 3% by the end of the year, as well as a faster-than-expected balance sheet reduction**; whose assets increased during the pandemic by more than $4 trillion. With the largest buyer of US Treasuries leaving the market, bond traders have been forced to **drastically recalibrate their expectations**; thereby causing the **10-year Treasury bond yield to rise by more than 1%** in the last month alone

- The sell-off in Treasury bonds has put an end to the nascent recovery in equity markets, as **the market focus has once again shifted to valuations**. Still, in the current macroeconomic environment, **equities offer investors reasonable protection against inflation, as well as significant appreciation potential** if inflation were to eventually decline faster than expected; which helps explain its resilience despite the current high uncertainty

- **The Fed's balancing act is becoming increasingly difficult**, as the more decisive the charge against inflation is, the higher the **chances of triggering a recession**. At the moment, the economy seems to be still very far from that scenario. **Employment is near record highs and consumer demand remains strong**; largely due to the savings accumulated during the pandemic, as well as large appreciations in the real estate and stock markets

- But as **household savings decline and higher interest rate dent in asset prices**, consumers may begin to cut back on spending; especially if inflation remains a concern. Likewise, **business activity may also begin to suffer from an inventory overhang, particularly if supply chain bottlenecks continue improving** (something that the new wave of Covid in China may delay). But despite the risk of an economic slowdown, investors should not worry too much as long as it happens in a relatively controlled way

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

Jobs are plentiful

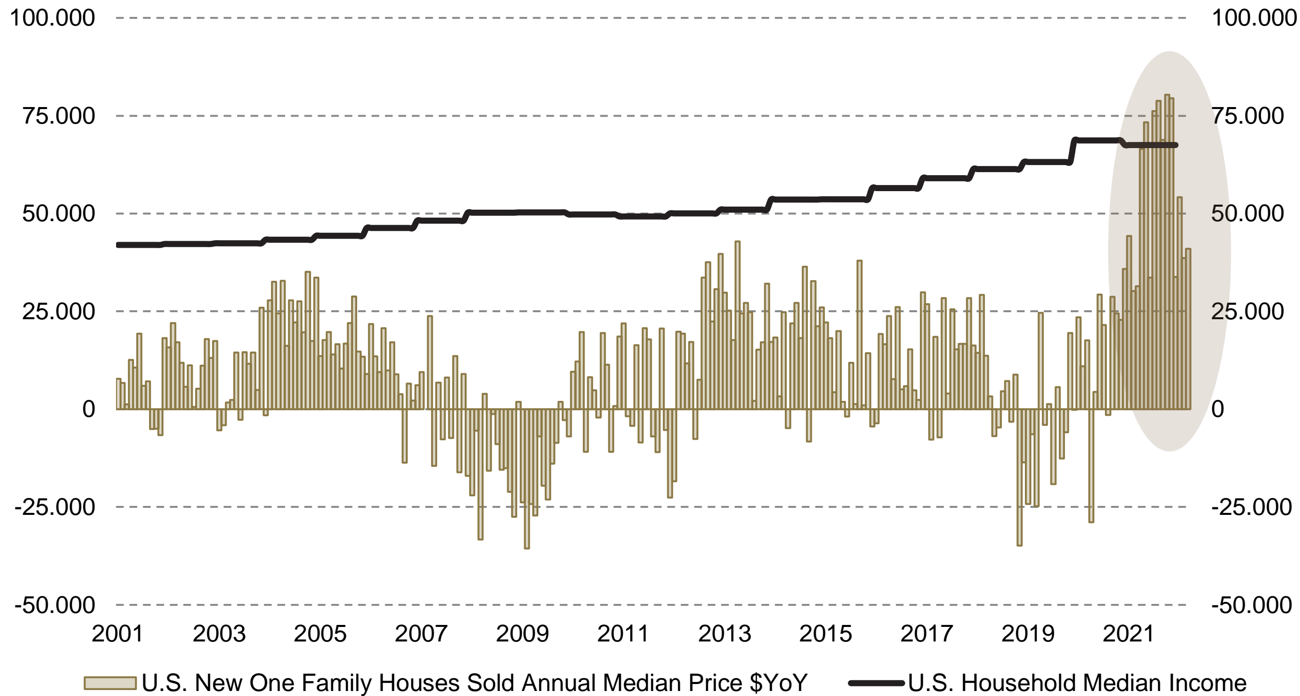
80% 8%
60% 6%
40% 4%
20% 2%
0% 0%
1998 2000 2002 2004 2006 2008 2010 2012 2014 2016 2018 2020 2022

Fed Funds Target Rate - Upper Bound (RHS) % Consumers Confidence Jobs Plentiful (LHS)

- It is **hard to see a recession looming anytime soon**, with full employment and a tight labor market. And this is not just limited to the US, but we are witnessing strong job creation across most developed economies
- But unlike other cycles, **the Fed has been very slow to react**, and there is a risk that in trying to catch up it tightens monetary conditions too much

Source: Bloomberg

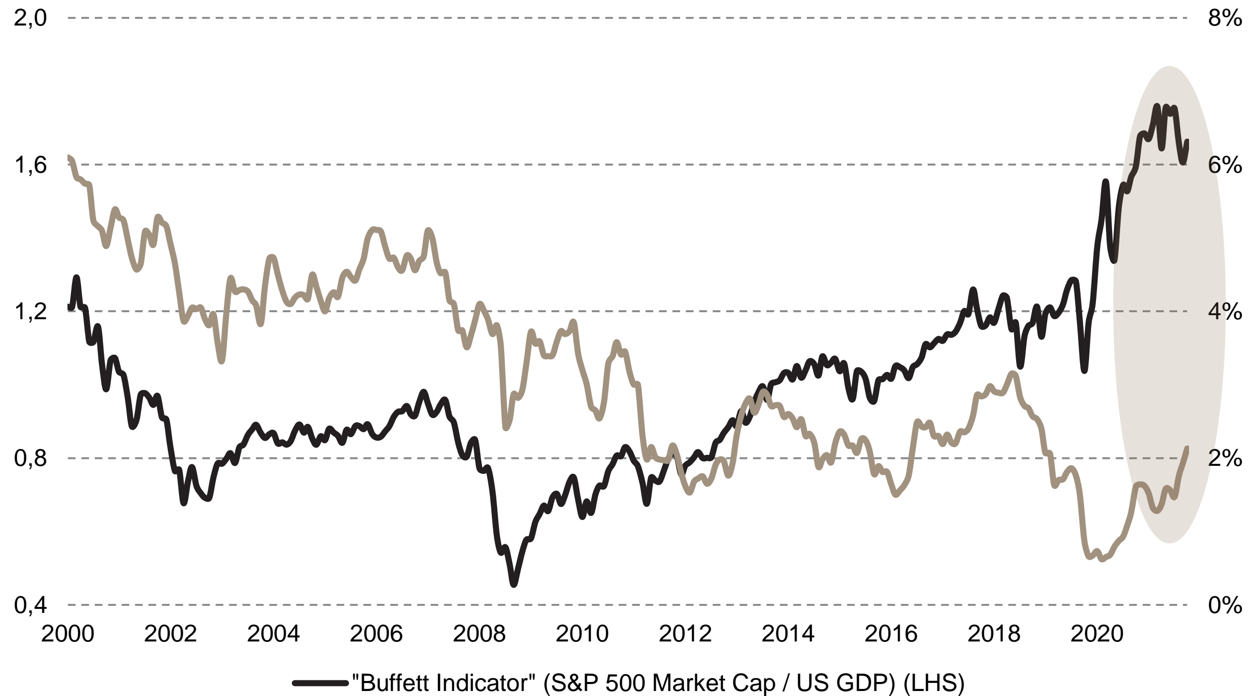
Households feel richer



- Consumers not only have jobs, but they feel richer than before the pandemic due to the **gains accumulated in recent years in the real estate and stock markets**
- Households have seen how the appreciation of their homes was greater than their income; something never seen before, not even in the run-up to the real estate crisis of 2008

Source: Bloomberg

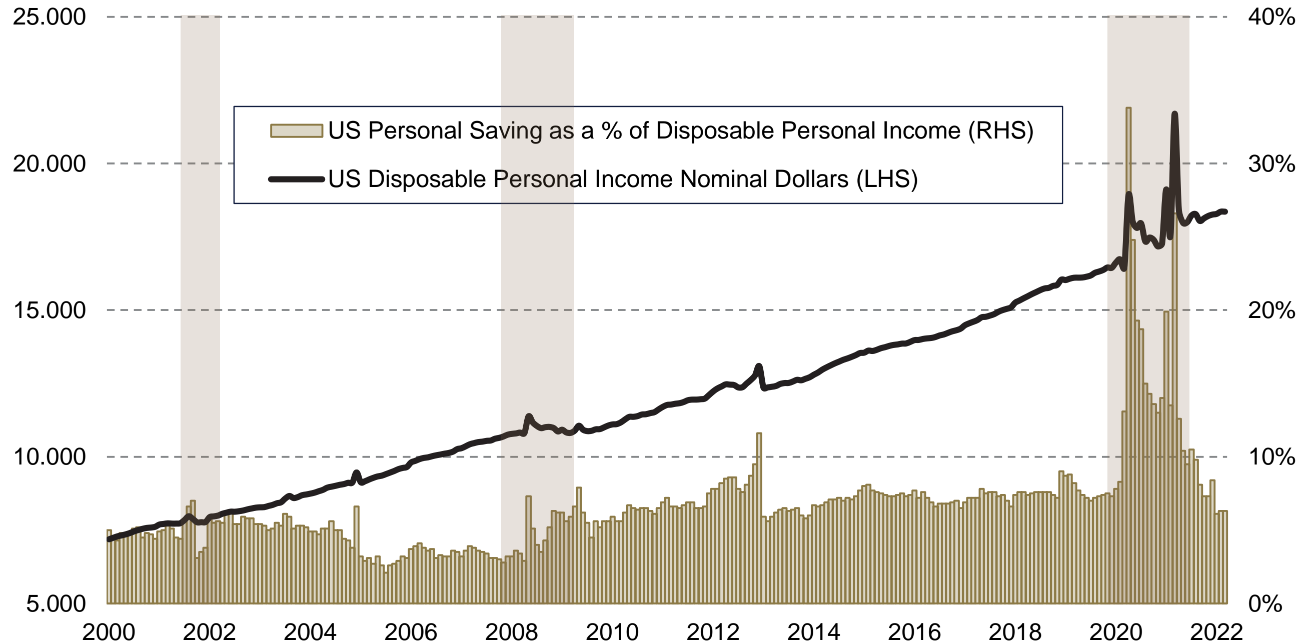
A double-edged sword



- During the years following the financial crisis, **central banks tried to support asset prices to help the economy recover**; given that the lower interest rates bound prevented a more orthodox monetary policy
- Having relied on this new monetary policy transmission mechanism **carries the risk of rendering the economy overly dependent on asset prices**, which now complicates their room for maneuver to fight inflation without triggering a recession

Source: Bloomberg

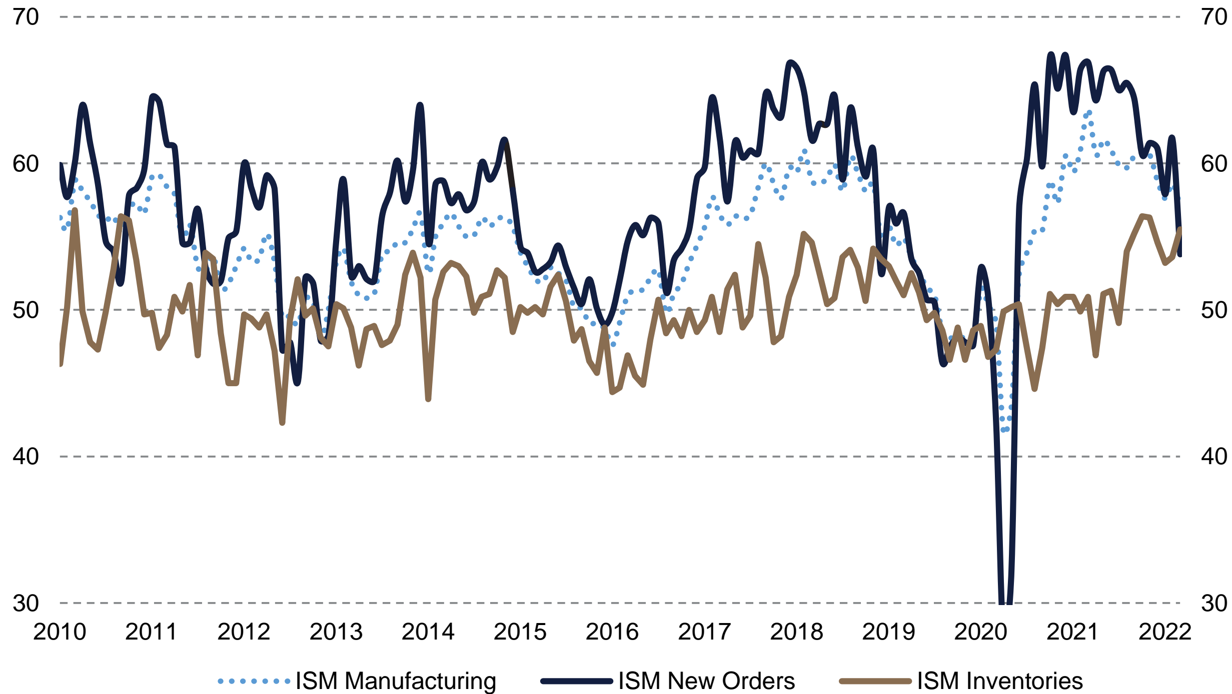
And pandemic savings have largely been depleted



- Undoubtedly, government support helped to avoid a much deeper recession. But **excessive largesse, coupled with tight supply, has fueled inflationary pressures**
- Now that the economy is facing monetary policy headwinds, **the savings surplus has been largely depleted**, and the consumer may start reigning in spending soon

Source: Bloomberg

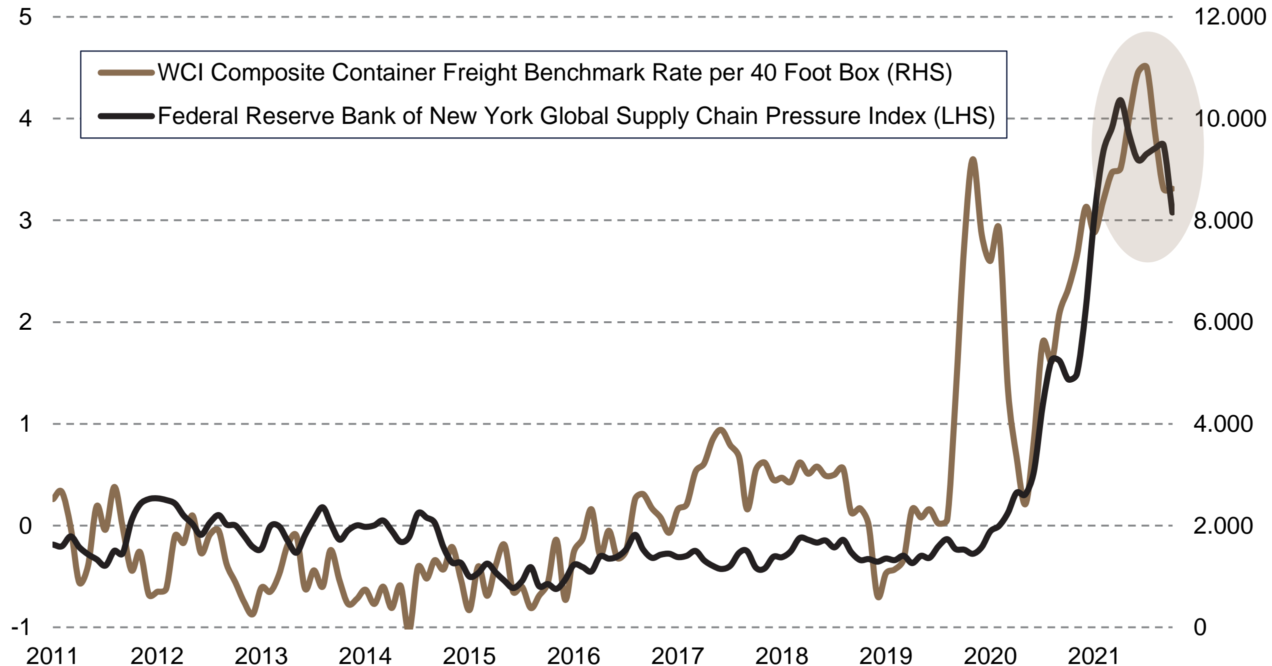
Peak growth?



- Leading **economic indicators are slowing down**, albeit from a very high level
- At the same time, **inventories are rising**, reflecting that pent-up demand caused by the pandemic may be starting to dwindle

Source: Bloomberg

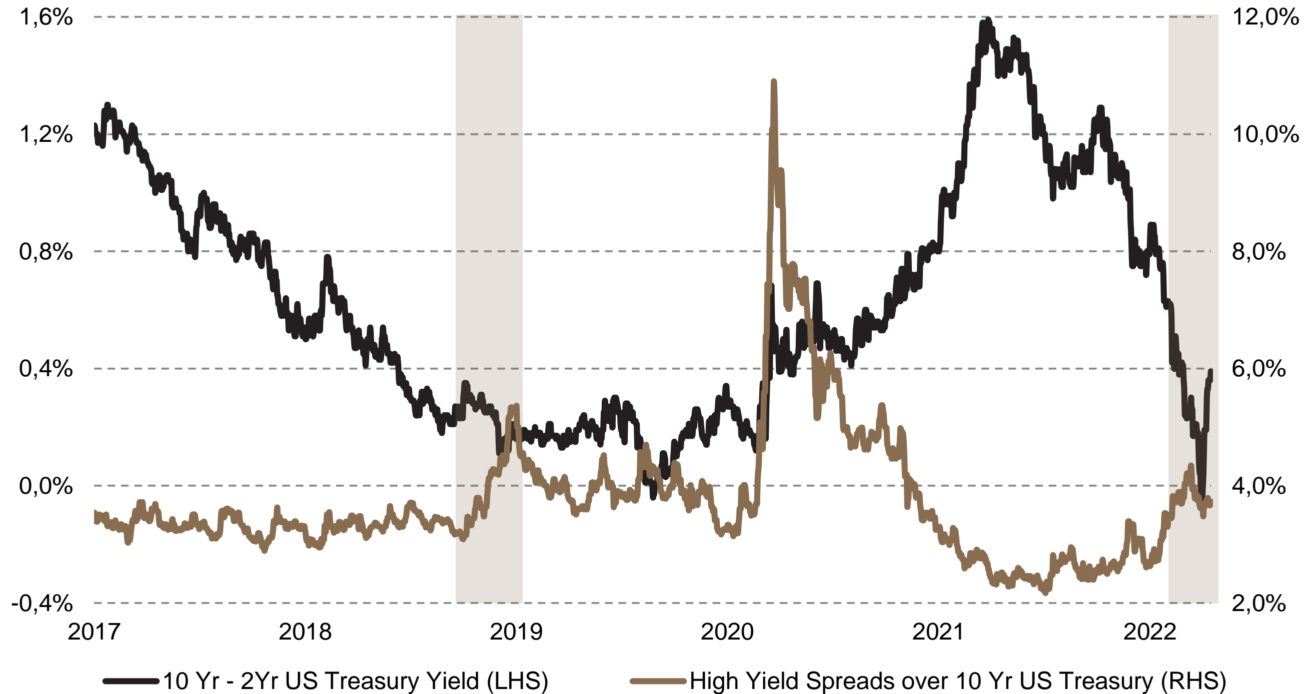
Supply chain woes begin to ease



- We also see some **improvement in the logistical bottlenecks induced by the pandemic**, although the situation may worsen again due to the Covid outbreak in China
- A normalization of the situation would be **critical for inflation to begin to decline**, thereby giving monetary policy time to engineer a soft landing of the economy

Source: Bloomberg

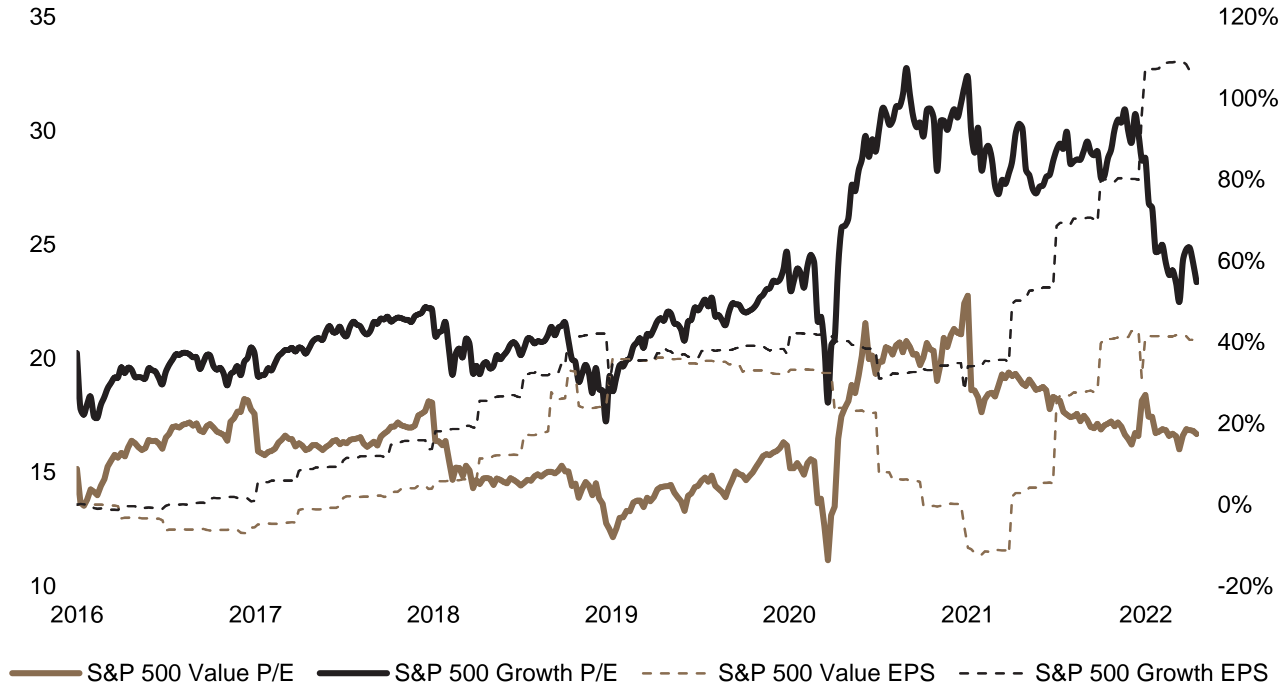
Financial conditions are worsening



- **Financial conditions typically react much faster** to a change in monetary policy than consumer or business sentiment
- Corporate spreads have widened and the yield curve has inverted, in a **clear sign that bond markets are pricing in an increasing likelihood of a recession**

Source: Bloomberg

Valuations reflect higher rates, not a recession



- Equity valuations have adjusted markedly, almost entirely **erasing the expansion in multiples experienced during the pandemic**
- Although **neither value nor growth stocks are pricing in a recession**, if the past is any guide, the latter seem to be better prepared to cope with a potential slowdown in the economy

Source: Bloomberg

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%

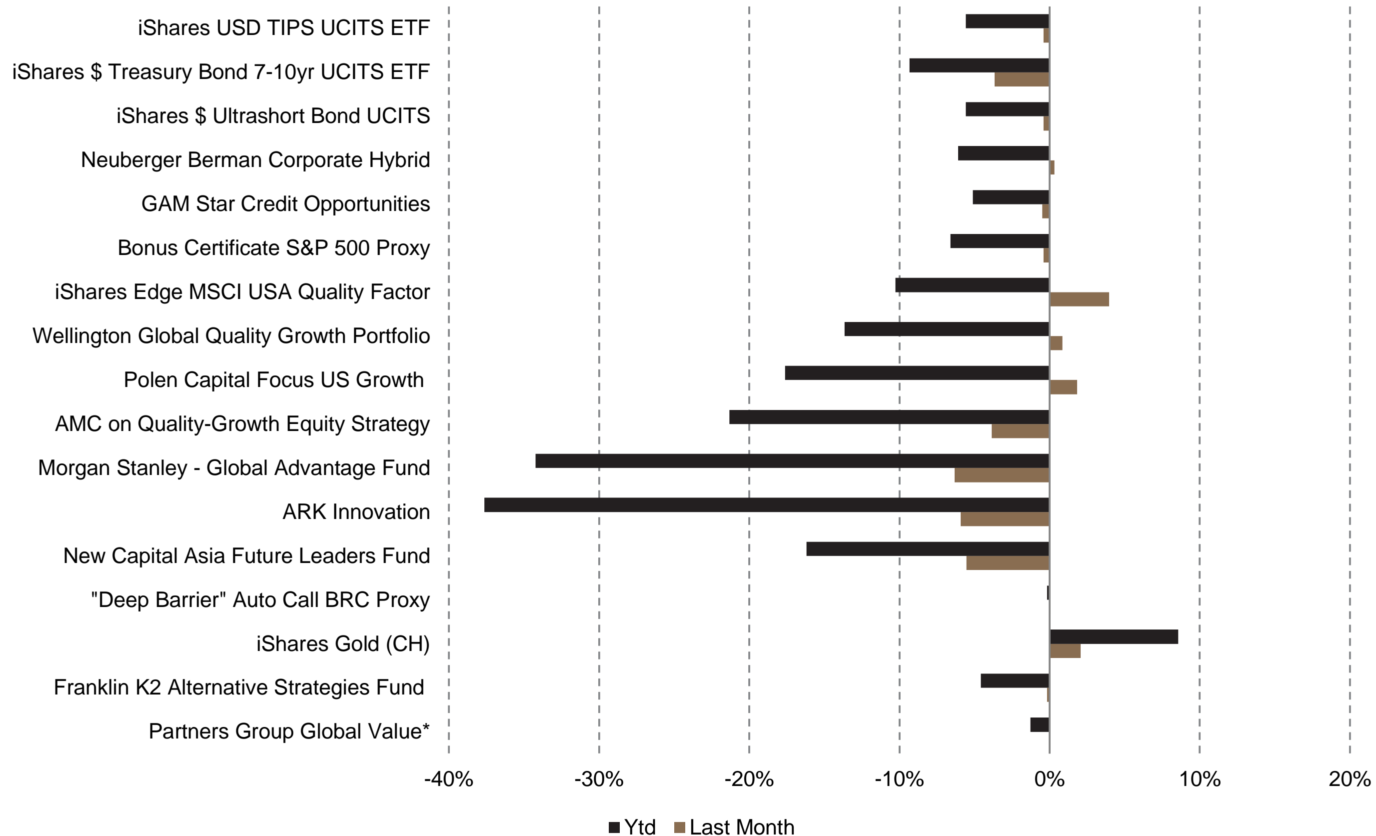
Short-term catalyzers

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

Other risks

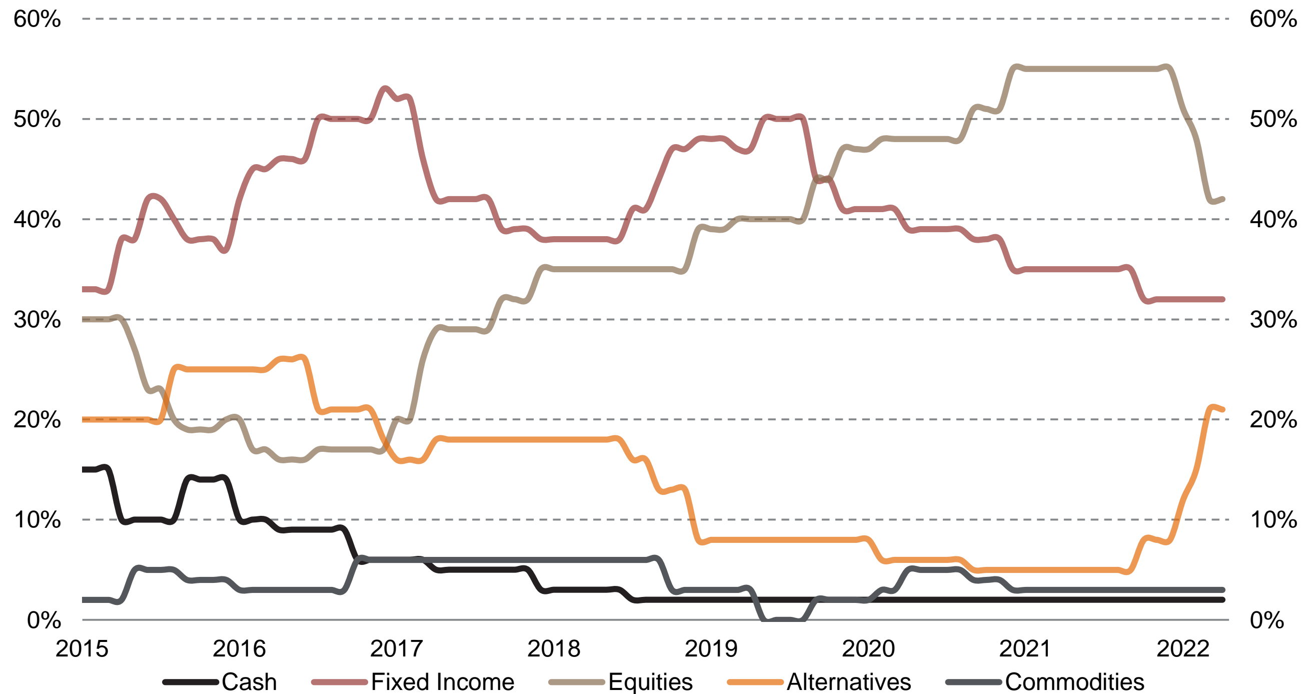
Escalation of the war in Ukraine, China slowdown, Crypto bubble crash

Model portfolio evolution

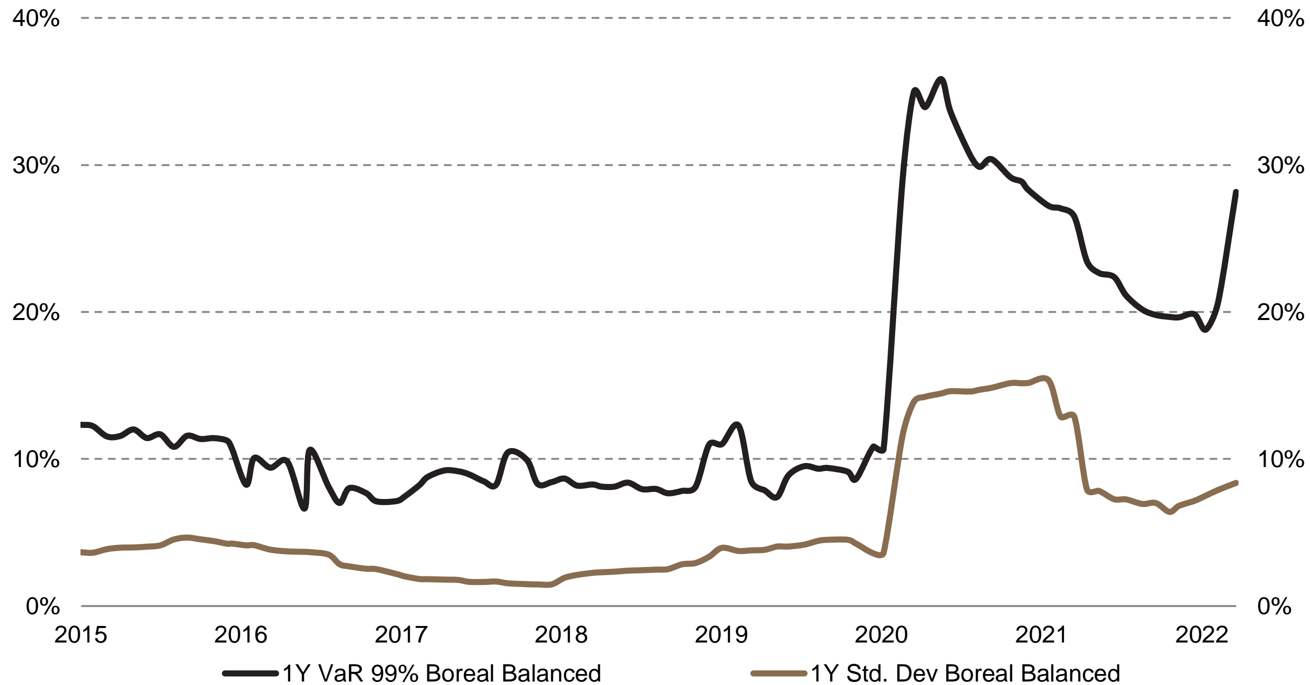


Source: Bloomberg, as of April 13, 2022
* Fund publishes monthly NAV with a 1 month of delay

EWM Model Portfolio – Asset Allocation evolution

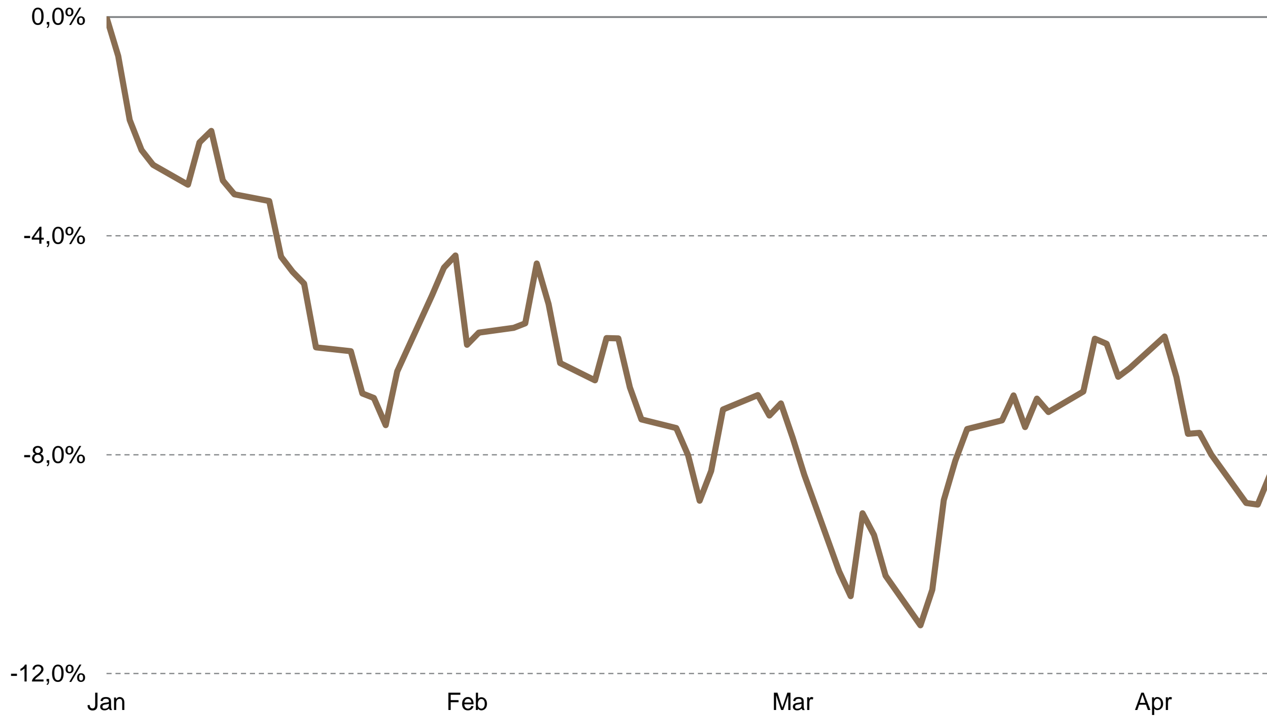


EWM Model Portfolio – VaR evolution



[1] As of April 13, 2022
Source: Bloomberg

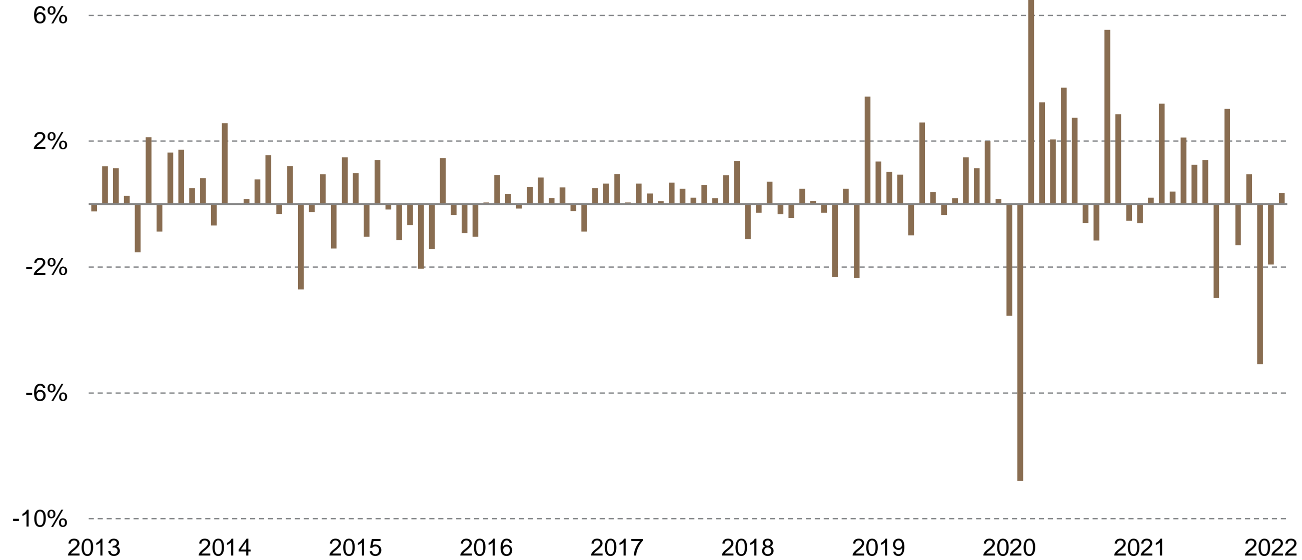
EWM Model Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **-9.14%**
- **Standard Deviation** (Ytd[1]): **12.32%**
- **Downside Risk** (Ytd[1]): **8.26%**
- **Sharpe Ratio** (Ytd[1]): **n/a**

[1] As of April 13, 2022

EWM Model Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **-4.51%**
- **Total Return** (3 year[1]): **17.26%**
- **Total Return** (Since Jan 13[1]): **40.78%**

[1] As of April 13, 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%	-9.14%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	6.96%	12.32%
Sharpe Ratio	2.54	0.58	n/a	0.62	3.57	n/a	3.49	0.87	1.04	n/a

Annualized Return: 3.82%
Annualized Std. Dev: 6.52%

[1] As of April 13, 2022

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