MORA WEALTH MANAGEMENT

Investment Policy

January 2019

Our market view in a nutshell – January 2019

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- The **correction experienced during the last quarter accelerated drastically** during the last trading sessions of the year. The carnage reached all risk assets, with only US Treasury bonds benefiting from the "flight to quality“ by investors. Contrary to other similar risk reduction events experienced since the financial crisis, this time there was **no obvious trigger** for mass selling, beyond some obvious **communication errors by the Fed**

- **Macroeconomic data have been losing momentum**, but both confidence indicators and “hard data” are still far from approaching levels that point to a contraction of economic activity. This makes it very difficult to judge if we are experiencing a **transient soft patch** – like the other two already experienced during the current cycle – or if we are at the **beginning of a recession**

- In fact, the **unusual duration of the current expansion** – about to become the longest on record – is causing much **anxiety among investors**, who fear that it is about to reach its end. This fear is compounded by the **memories of the previous two recessions**, which were accompanied by two stock market crashes

- However, it is important to keep in mind that the **last two crises were highly unusual**, as they were caused by a fall in the stock market and a financial crisis respectively. The magnitude of the fall experienced by the S&P 500 was in the range of -50%. However, in **"normal" recessions, stock markets have fallen by -20%/-30%**, an amount similar to that experienced since the peak reached in September of last year. Taking into account the severity of the correction experienced, both equity valuations and corporate spreads have already incorporated a significant amount of bad news. Therefore, we recommend not to realize losses at these levels and wait for more data

- In this respect, **inflation** will probably be the **key variable to observe**. If prices remain contained, it is likely that the Fed will pause to assess whether monetary policy has normalized; helping in this way to extend the cycle. On the other hand, if inflation accelerates, both stock and bond markets may suffer another unpleasant correction, taking into account the current gap in expectations regarding the evolution of interest rates

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Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasuries offer protection from a slowdown in growth – although this less likely with the fiscal stimulus in the US – whilst TIPS offer protection against rising inflation as a consequence of reflationary policies
	US Credit	+	Corporate debt and High Yield currently offer the best combination of risk and return. We prefer medium maturities as the yield curve has flattened considerably and there is little term premium to compensate for taking interest rate risk
	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	=	Emerging Markets currencies and spreads have adjusted significantly to a stronger dollar and the uncertainties around global growth. With the Fed signaling being closer to the neutral rate, we deem current levels to offer fair value
Equities	US	+	After the recent market corrections, valuations have improved substantially. We have therefore increased our exposure to US equities, mostly through quality and growth oriented companies
	Europe	=	From a relative valuation perspective, we like European stocks as they trade at lower multiples, and we expect profits to pick up as economic activity accelerates
	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 have corrected sharply since the beginning of the year affected by a strong dollar and trade concerns. We deem the correction suffered has been excessive, and continue favoring India and Frontier Markets within EM
	Sectors & Themes	+	Amongst others, we favor Biotechnology and listed Real Estate
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	=	A diversified commodities allocations, further help us to increase diversification and to protect the portfolios against a scenario of rising inflation
	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

From synchronized growth to synchronized slowdown

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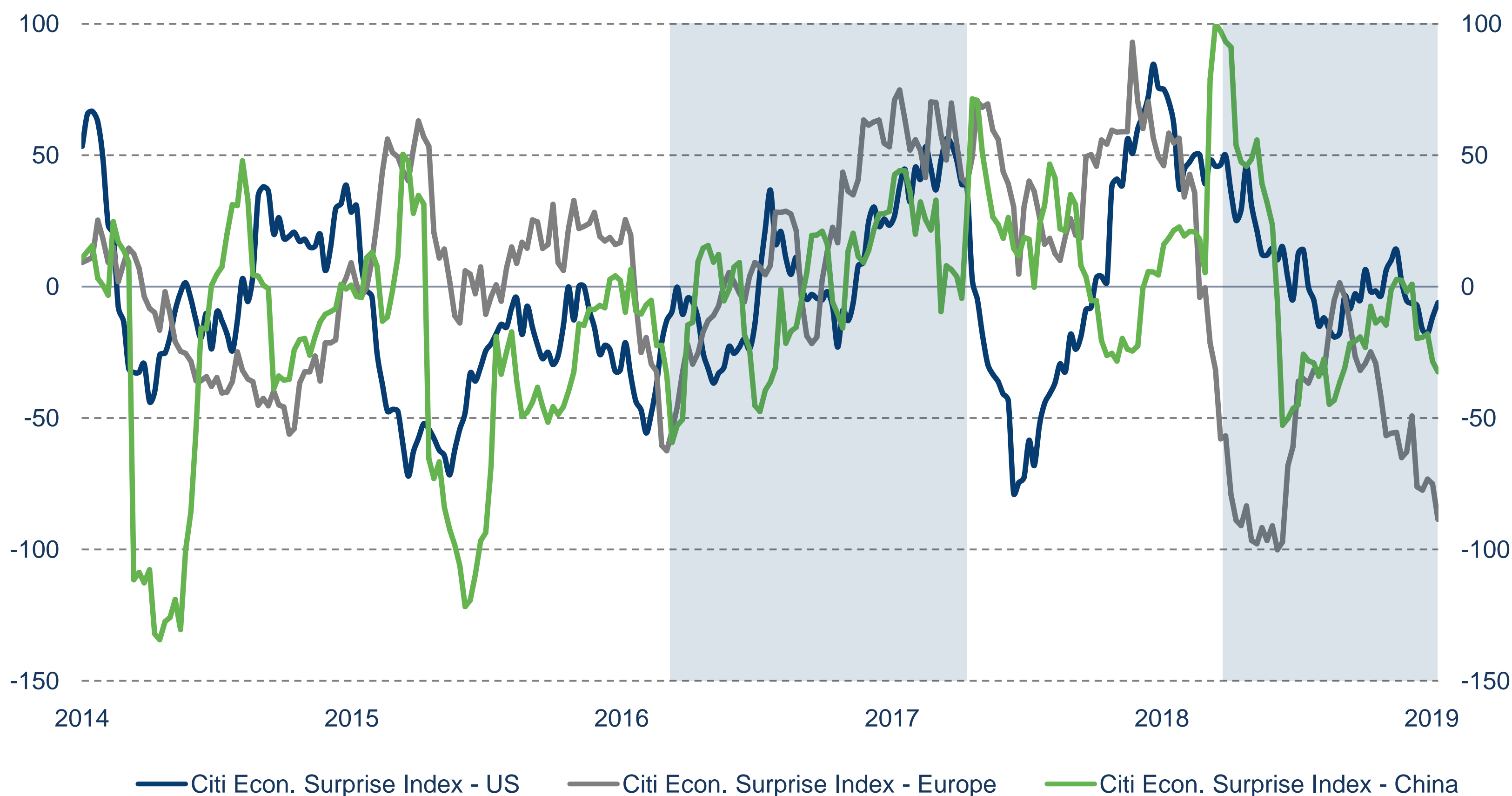

- Concerns about economic growth have been mainly motivated by a **slowdown in economic momentum** in the major economies. While during 2016/17 we experienced **synchronized growth**, in 2018 there was a **synchronized deceleration**
- The main concern is that after the **“sugar rush”** induced by the **tax reform** in the US, its economy will continue loosing momentum

Source: Bloomberg

End-cycle or mini-cycle?

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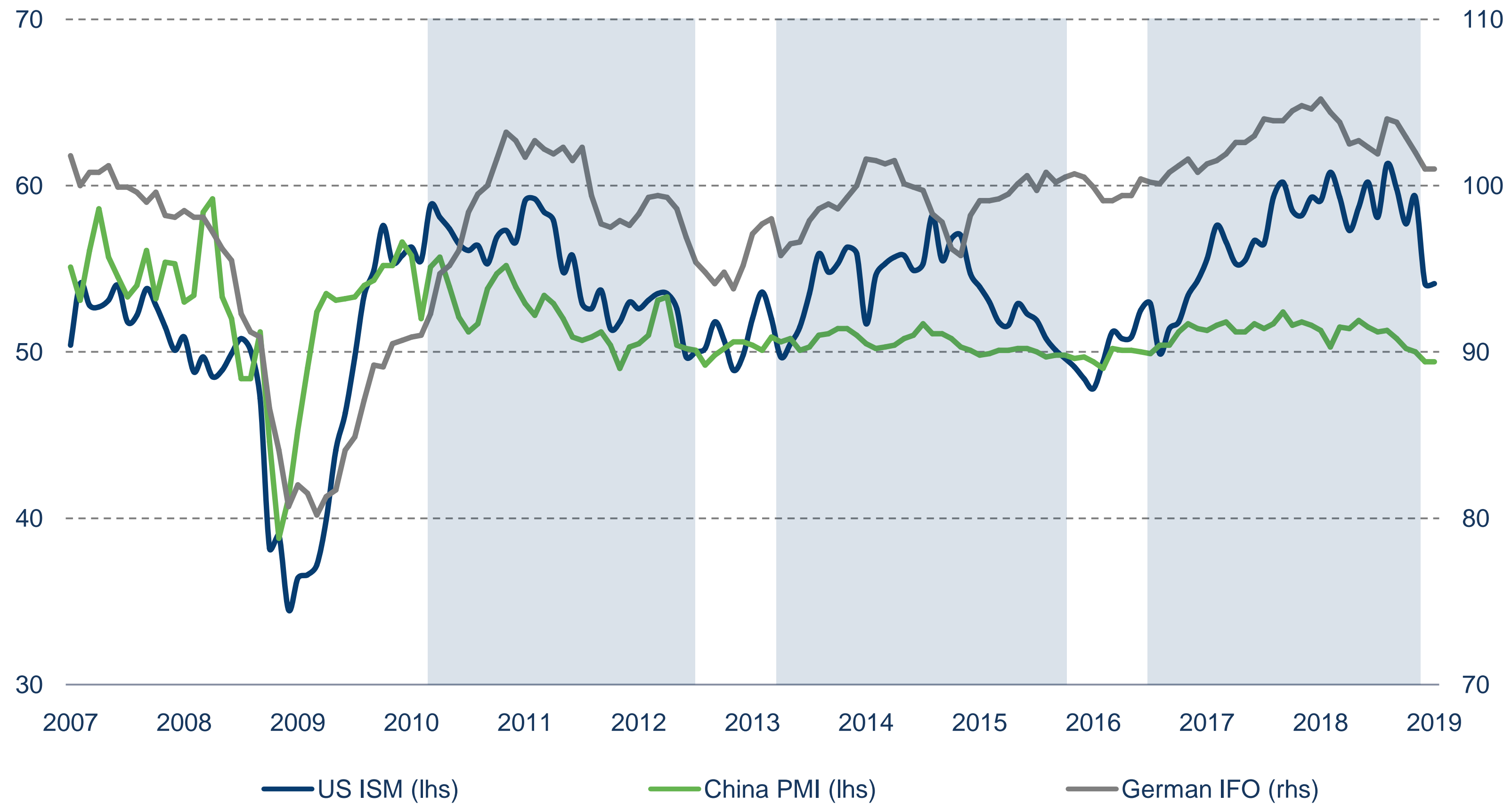

- Market fears about a pronounced economic slowdown worsened at the end of the year, as several **leading indicators showed a marked change in the trend.** However, this development was to be expected given that market corrections are included in future expectations (**Main Street believes that Wall Street knows something they do not know**)
- We have experienced **two "mini-cycles"** during the current expansion, caused respectively by the sovereign debt crisis and concerns about a hard landing in China

Source: Bloomberg and UBS

Hard data vs. soft data

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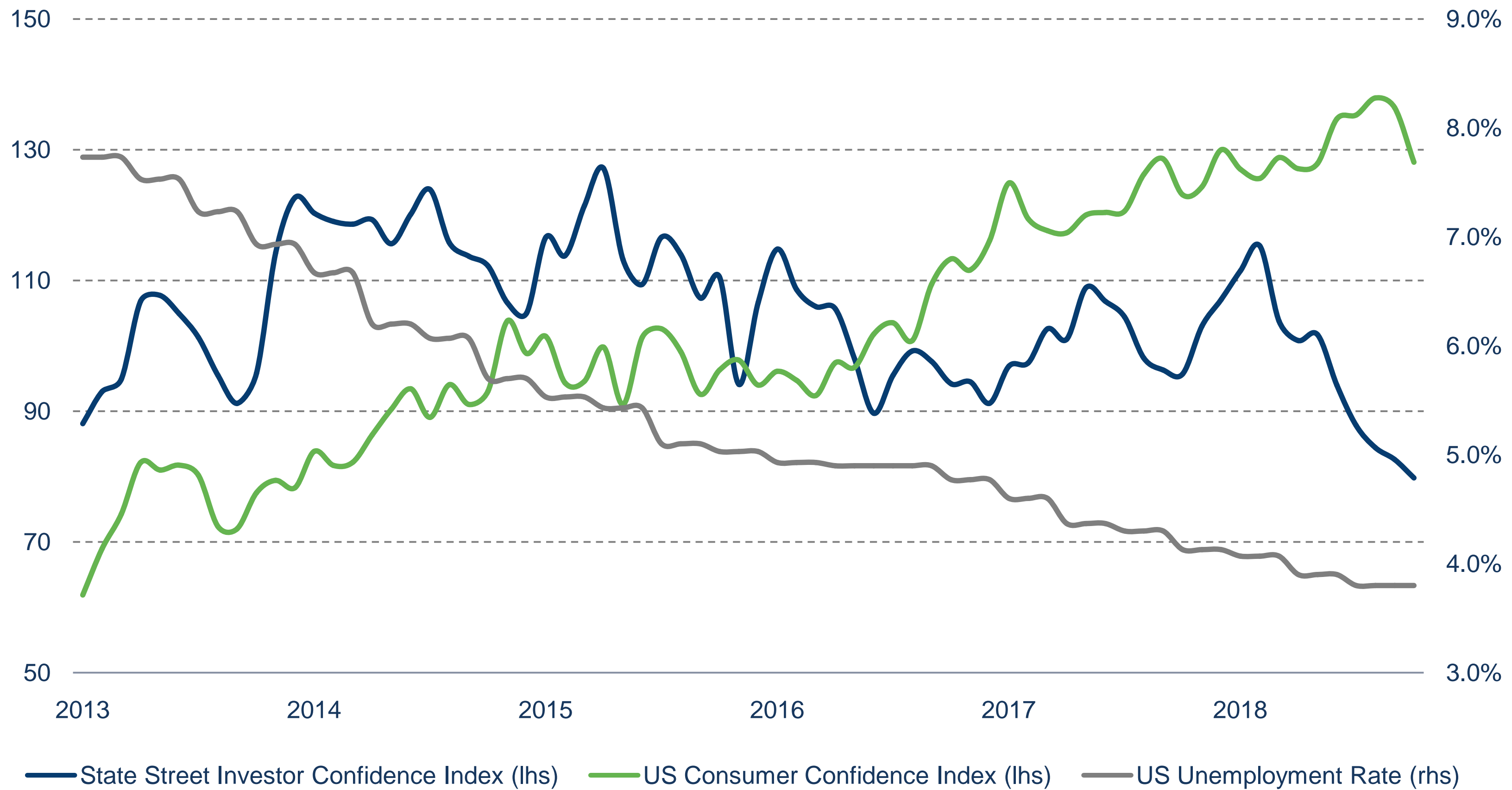

- There is currently a **disconnect** between the **“hard data"** (the last labor report was very solid) and the **“soft data"**, as well as **within the confidence indicators** themselves
- Therefore, we believe it is important to **remain calm and monitor future economic activity**, particularly because market sentiment is very volatile and can quickly turn around

Source: Bloomberg

Recession probability still low

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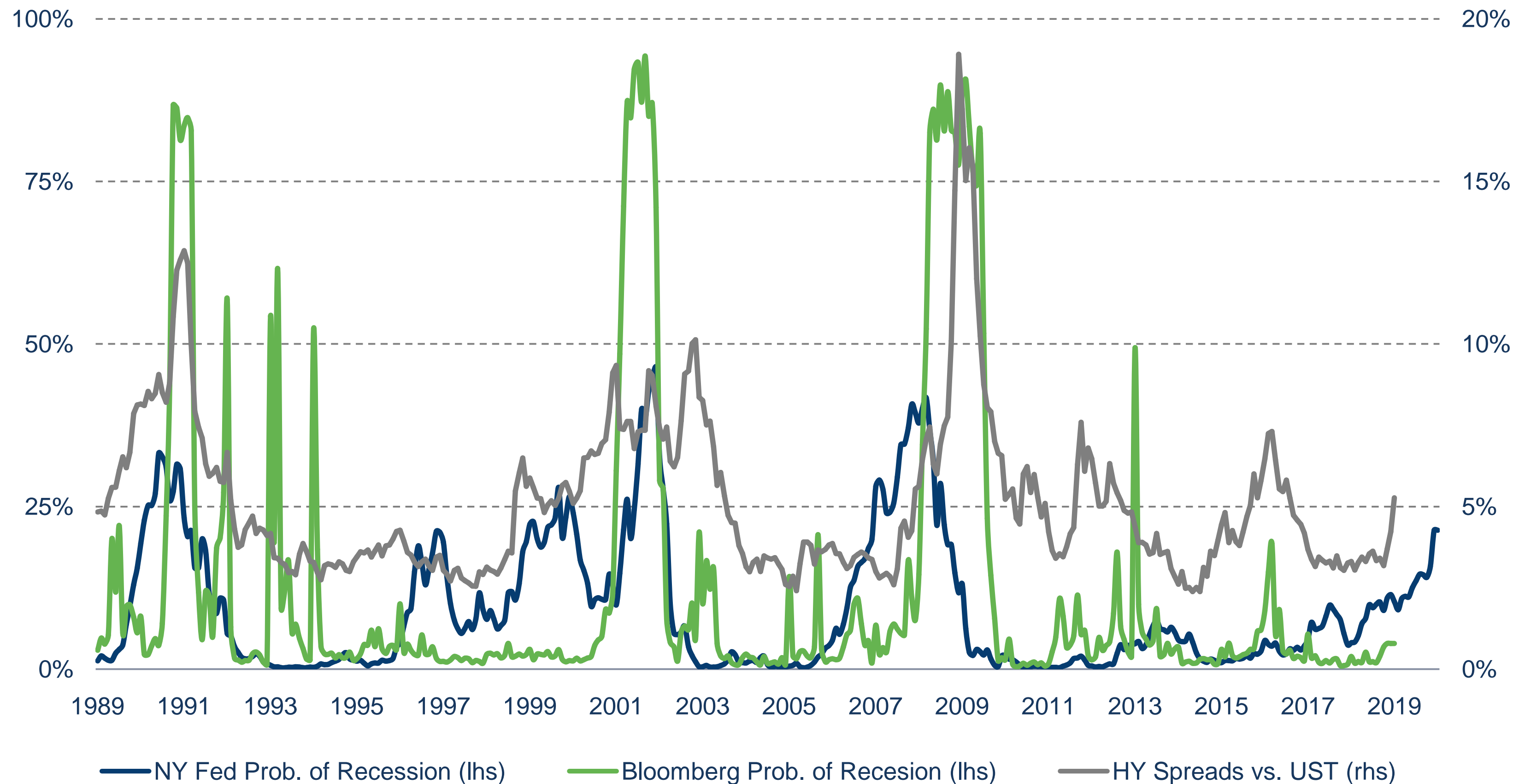

- In fact, the **probability of recession is still relatively low** according to different indicators. The market is becoming obsessed with the **New York Fed model**, which is based on the **steepness of the yield curve**. However, other more **comprehensive models** (eg, Bloomberg, St. Louis Fed) still show low probability of suffering an impending recession
- It is important to bear in mind that all these models tend to present very **sharp turns**, since recessions tend to develop rapidly. In our opinion, a better indicator are **high yield spreads**, which tends to react in a more progressive manner. However, there is **no "magic" level** that can be considered as a yardstick for measuring a recession

Source: Bloomberg

Fed communication mistakes

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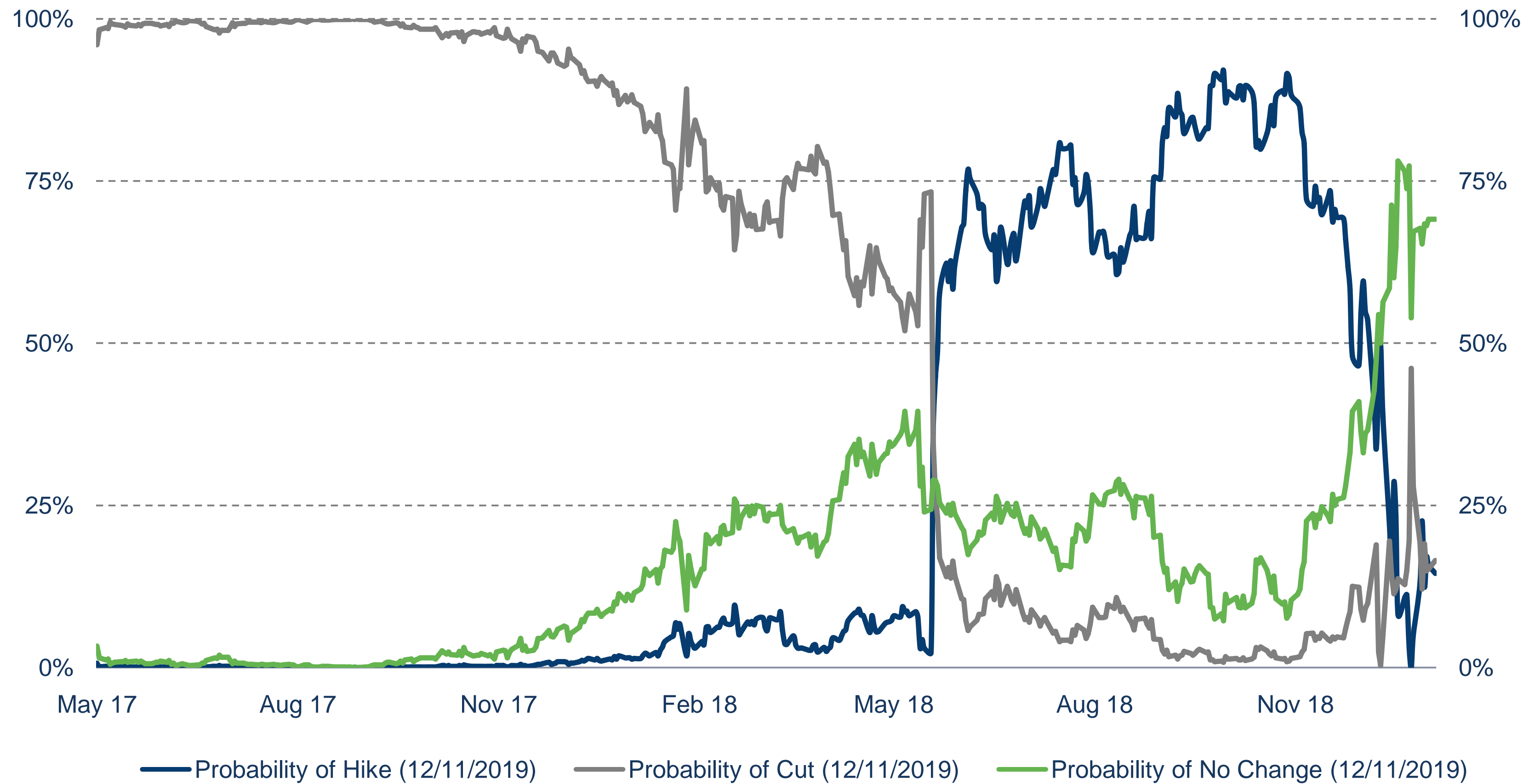
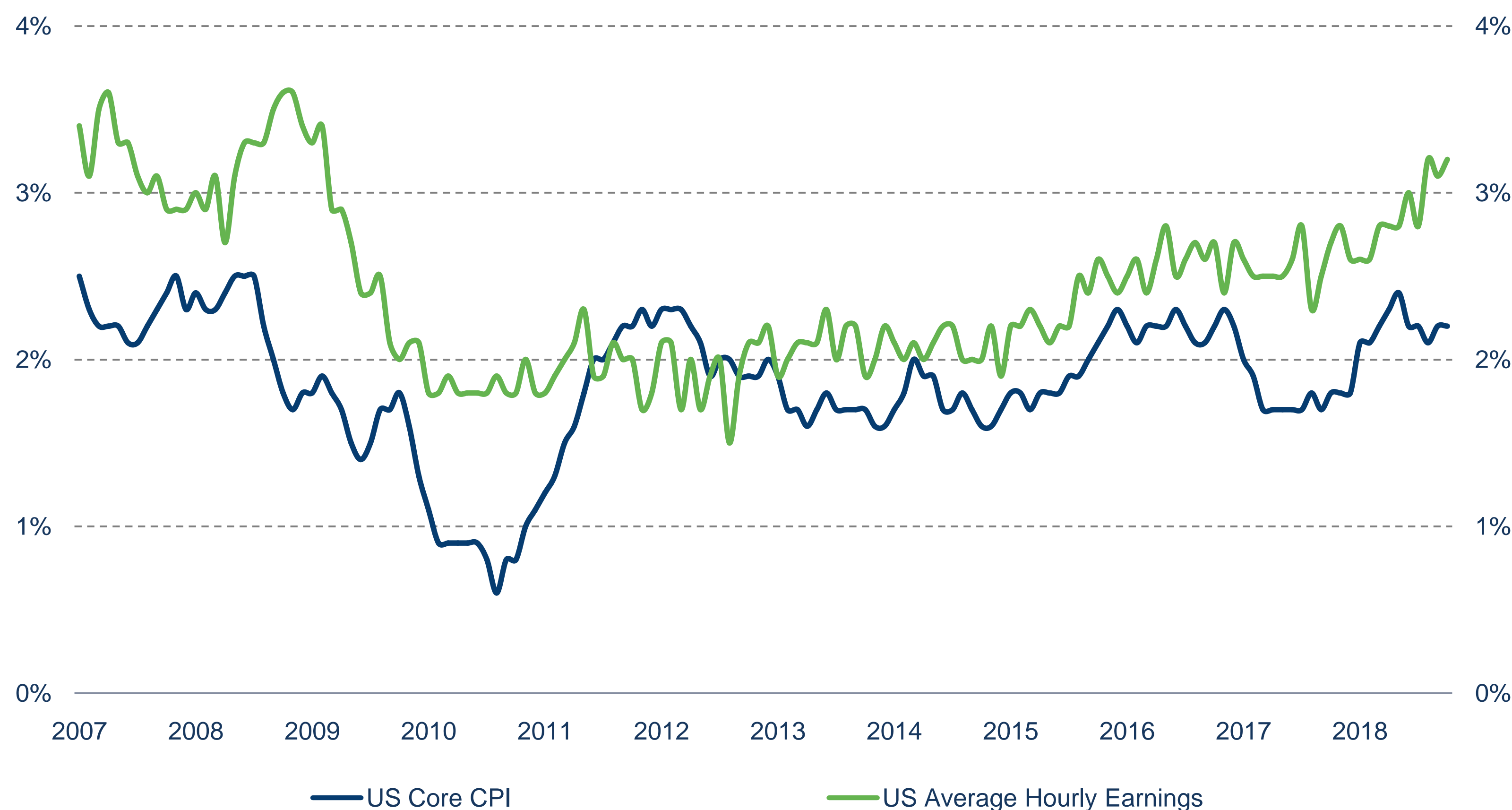


- It could be said that Jerome Powell has made a couple of **rookie mistakes** in recent months. First, ignoring the market's fears about a possible slowdown, showing a **Fed on autopilot** and with ample room to normalize rates, to later retrace, and declare that the **Fed does not have a predetermined path**
- This has once again caused a **large discrepancy between market expectations and the so-called "Fed Dots"**. Currently, the implicit probability of a rise in interest rates during this year is only 14%

Source: Bloomberg

Moderate inflation keeps the goldilocks scenario alive



- However, the key variable will be **inflation**. If despite the fact that the economy is running at full capacity and unemployment is almost at historic lows, inflation continues to perform well, the Fed will have stronger evidence that **interest rates are close to their neutral level**
- On the other hand, **if inflation accelerates**, both the equity and bond markets may **suffer another unpleasant correction**; taking into account the **current gap in expectations** about the evolution of interest rates

Source: Bloomberg

Market overreaction?

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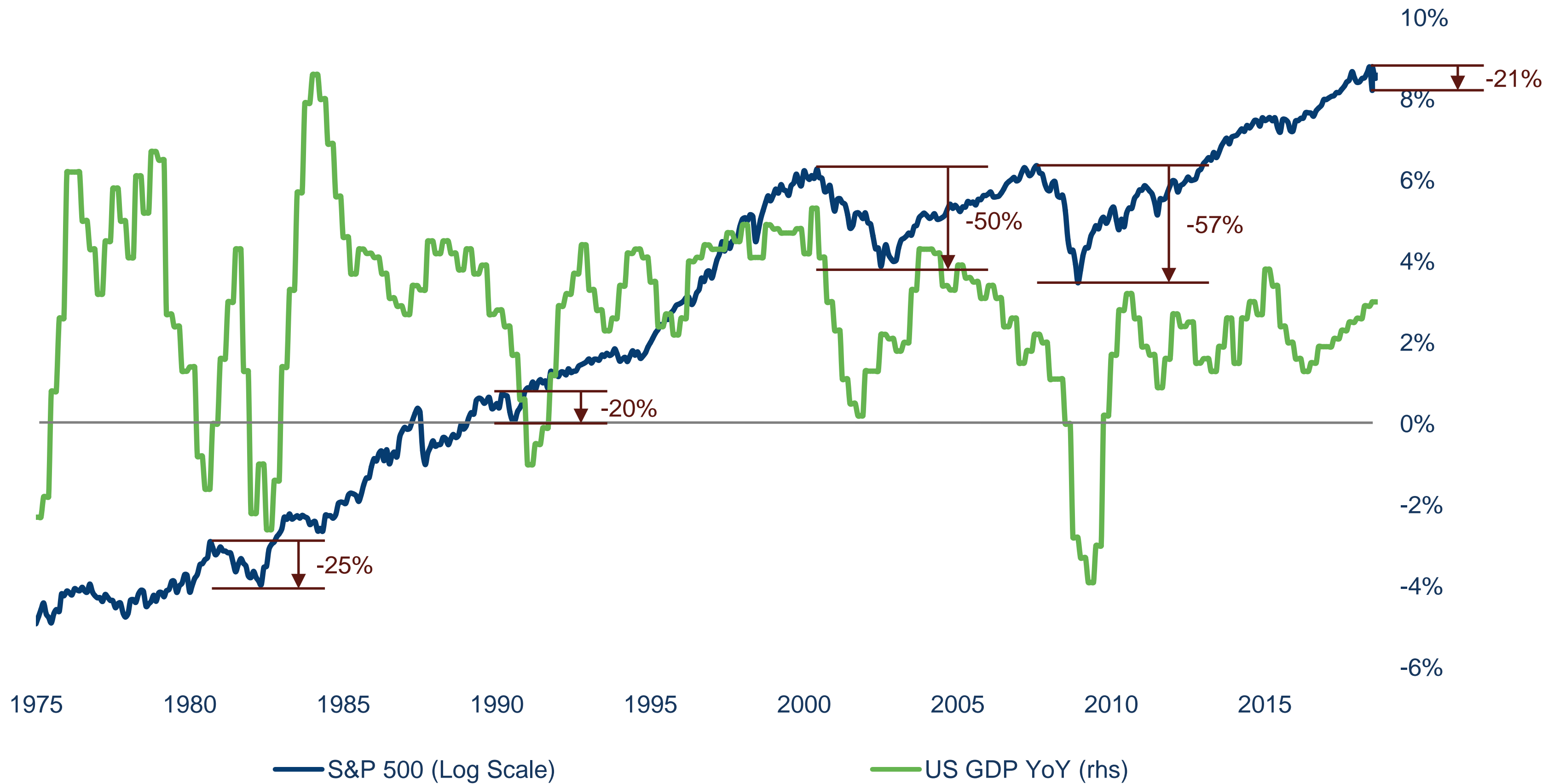

- The **last two recessions have framed investors' minds.** However, the last two crises were highly unusual, since they were caused by a fall in the stock market and a financial crisis respectively
- The magnitude of the fall in the S&P 500 was in the area of -50%. However, in **"normal" recessions**, equity markets have fallen by **-20%/-30%**, an amount **similar to that experienced since the peak reached in September** of last year

Source: Bloomberg

Do not wait to buy insurance before it is too late

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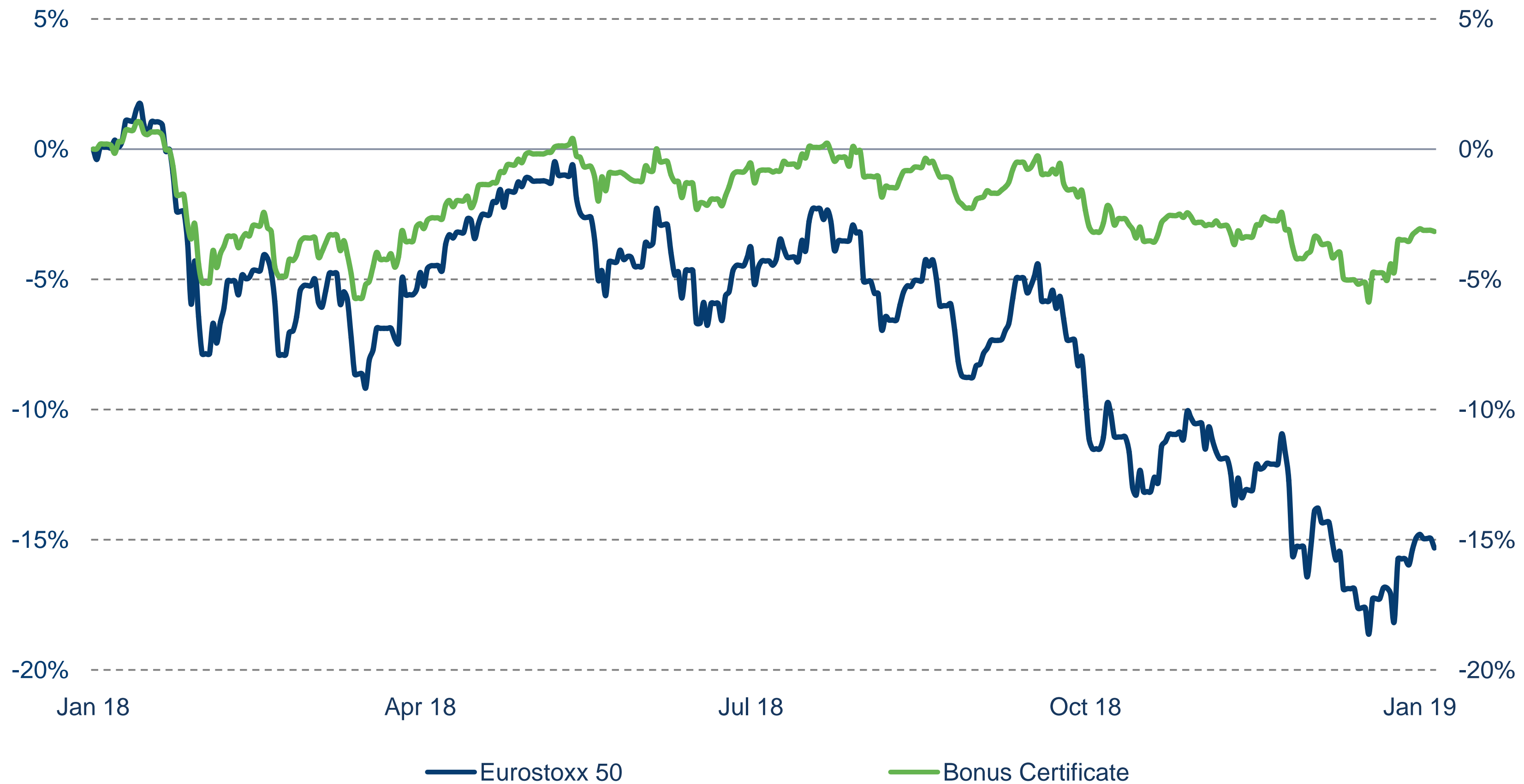

- Although we continue to recommend **maintaining exposure to equities**, the end-of-cycle environment in which we find ourselves speaks for a **conservative positioning** in portfolios
- Therefore, we recommend using **hedging instruments** that help us mitigate potential market downturns

Source: Bloomberg

USD to remain strong despite weaker economic outlook

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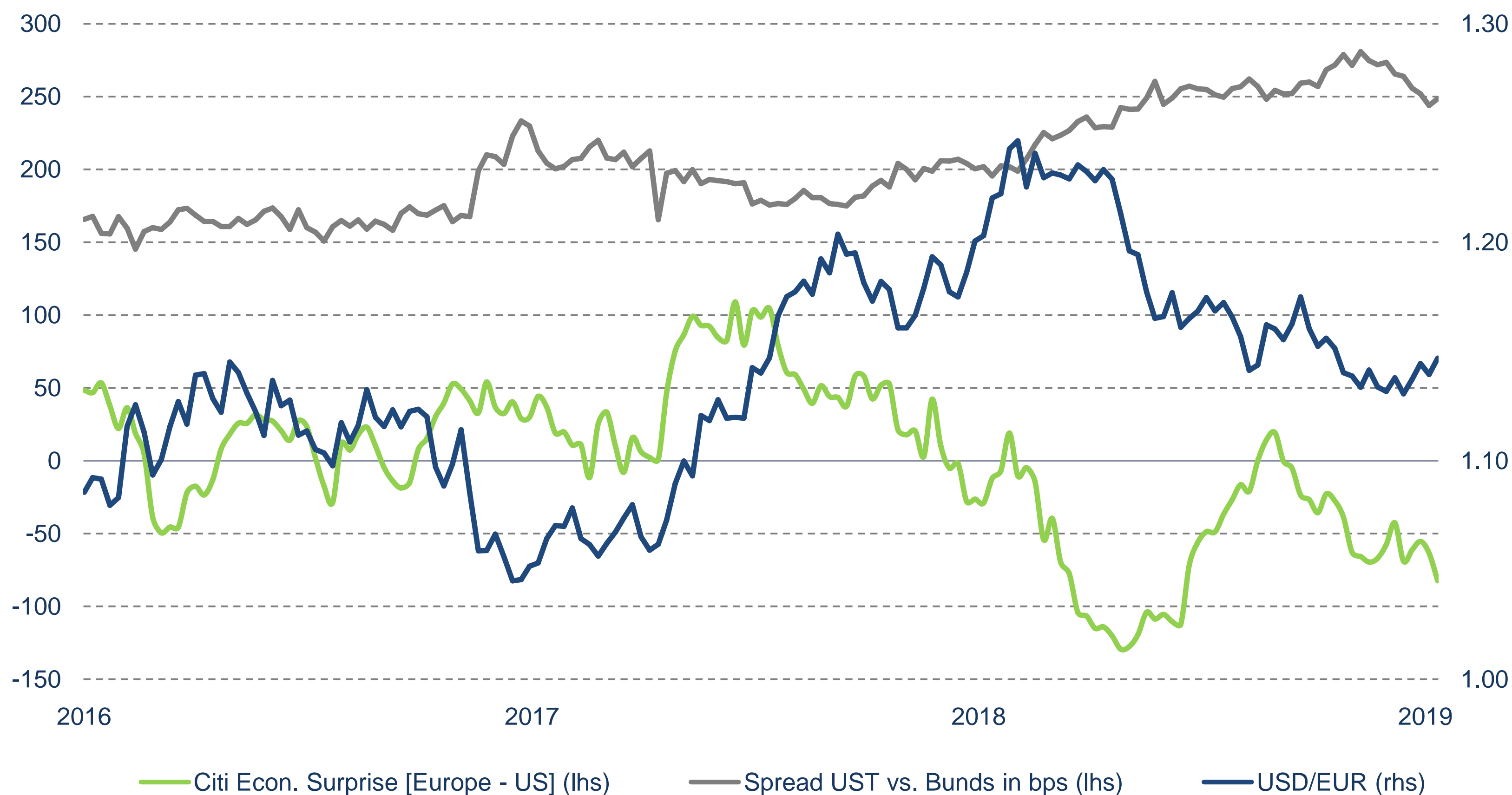

- Currencies are a relative value game. Given that the **economic slowdown** has been **more pronounced in Europe** than in the US, support for the dollar remains intact
- **Interest rate differentials have narrowed** as Treasury yields fell recently, but we **do not see the ECB raising interest rates** in 2019, and we expect interest rates in Europe to remain very low

Source: Bloomberg

Model portfolio evolution

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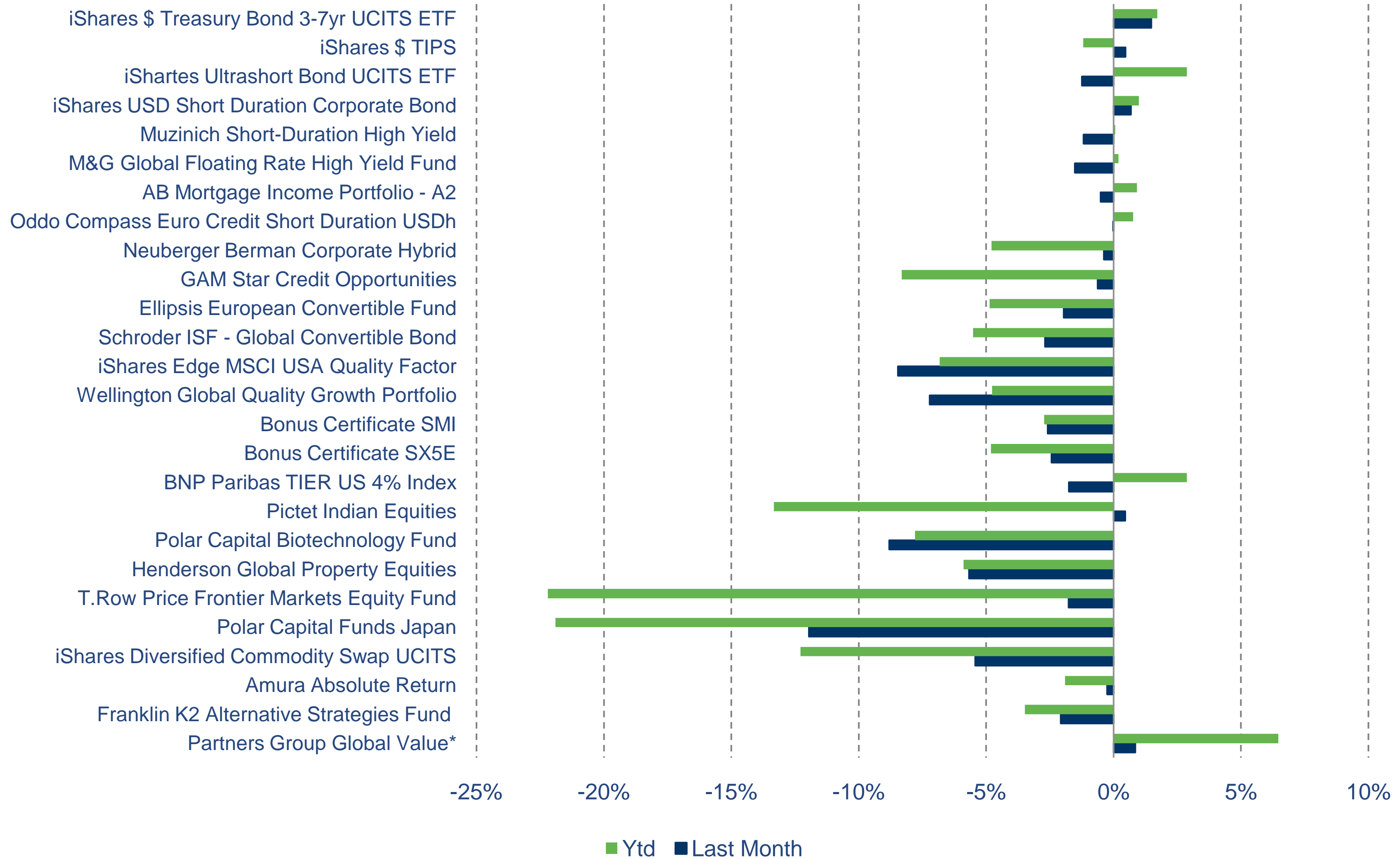

Source: Bloomberg as of December 1, 2018
* Fund publishes monthly NAV with a 1 month of delay

Investment scenarios

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	Scenario 1 Recession by political/policy accident	Scenario 2 Goldilocks	Scenario 3 New regime
Drivers	• Global economic slowdown caused by political accidents or policy errors (Trade war with China, EU breakup, a too aggressive Fed, etc.) • Deflationary scenario due to a combination of low growth and structural factors, although the rise of protectionism would be inflationary • The Fed will have to reverse course, which would be complicated if inflation is rising	• The fiscal stimulus in the US provides a short-term impulse to the global economy, but not enough to attain a higher growth trajectory • Inflation, particularly in the US will pick-up, but remains subdued globally due to structural factors (demographics, low aggregated demand, deleveraging) • The Fed will continue its normalization path	• Growth concerns dissipate, with economic activity accelerating in US, Europe and Japan • Inflation in the US increases, as a consequence of president Trump's fiscal stimulus, and pulls other developed economies off deflation • The Fed will have to step up the pace of rate increases and/or reduce balance sheet
Market impact	• Correction in credit due to a rise in defaults and a widening of corporate spreads • Correction in equities due to lower projected earnings, though declining rates will offer support • Sovereign and IG credit to profit due to flight to quality and the continuation of an ultra-loose monetary policy globally • USD neutral to weak as flight to quality is counterbalanced by low interest rates • Commodities will fall	• Equities appreciate moderately, with Europe and Japan catching up with the US • Credit spreads remain stable as the credit cycle is further elongated • Sovereigns suffer as monetary policy is progressively normalized • USD appreciate moderately due to higher interest rate differentials • Commodity prices will rise in the short-term, normalizing once the impulse vanishes	• Impact on equities will depend on how much real economic growth is sustained, and how accommodative the Fed remains • Sovereign and IG bonds will face steep losses due to higher rates, particularly if long-term inflation expectations rise • Corporate credit will correct moderately if inflation comes together with higher growth • The USD will appreciate, particularly against those currencies facing deflation • Commodities will gain from higher inflation
Probability	45% (+5%)	30%	25% (-5%)

Short-term catalyzers

End of trade dispute, improvement in macro-data globally, lower geopolitical tensions

Other risks

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

MWM Model Portfolio Balanced USD

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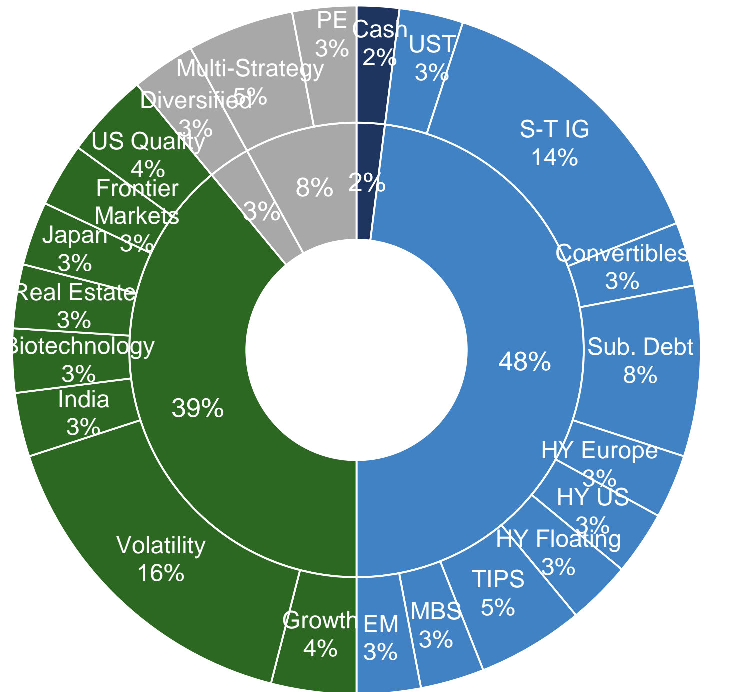
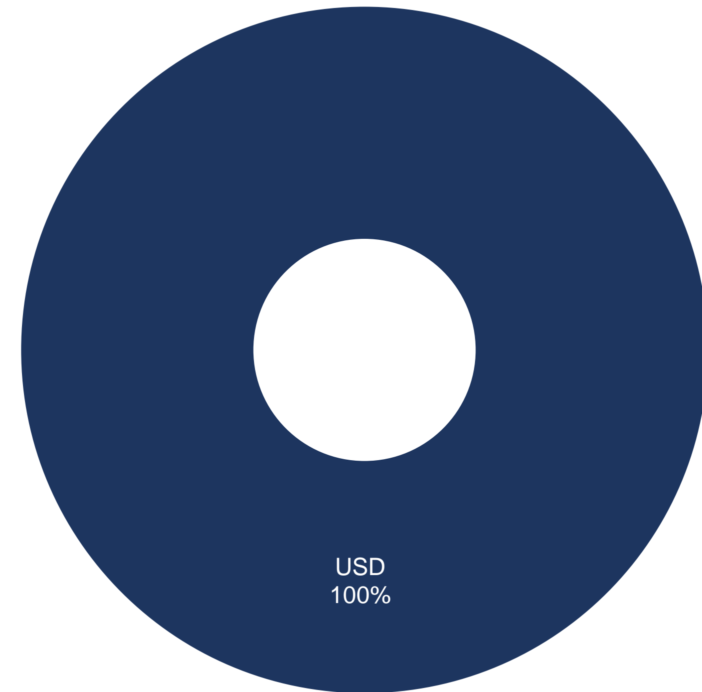
Asset Allocation



Currency Allocation



Cash | Fixed Income | Equity | Commodities | Alternative Inv.

USD

MWM Investment Profiles

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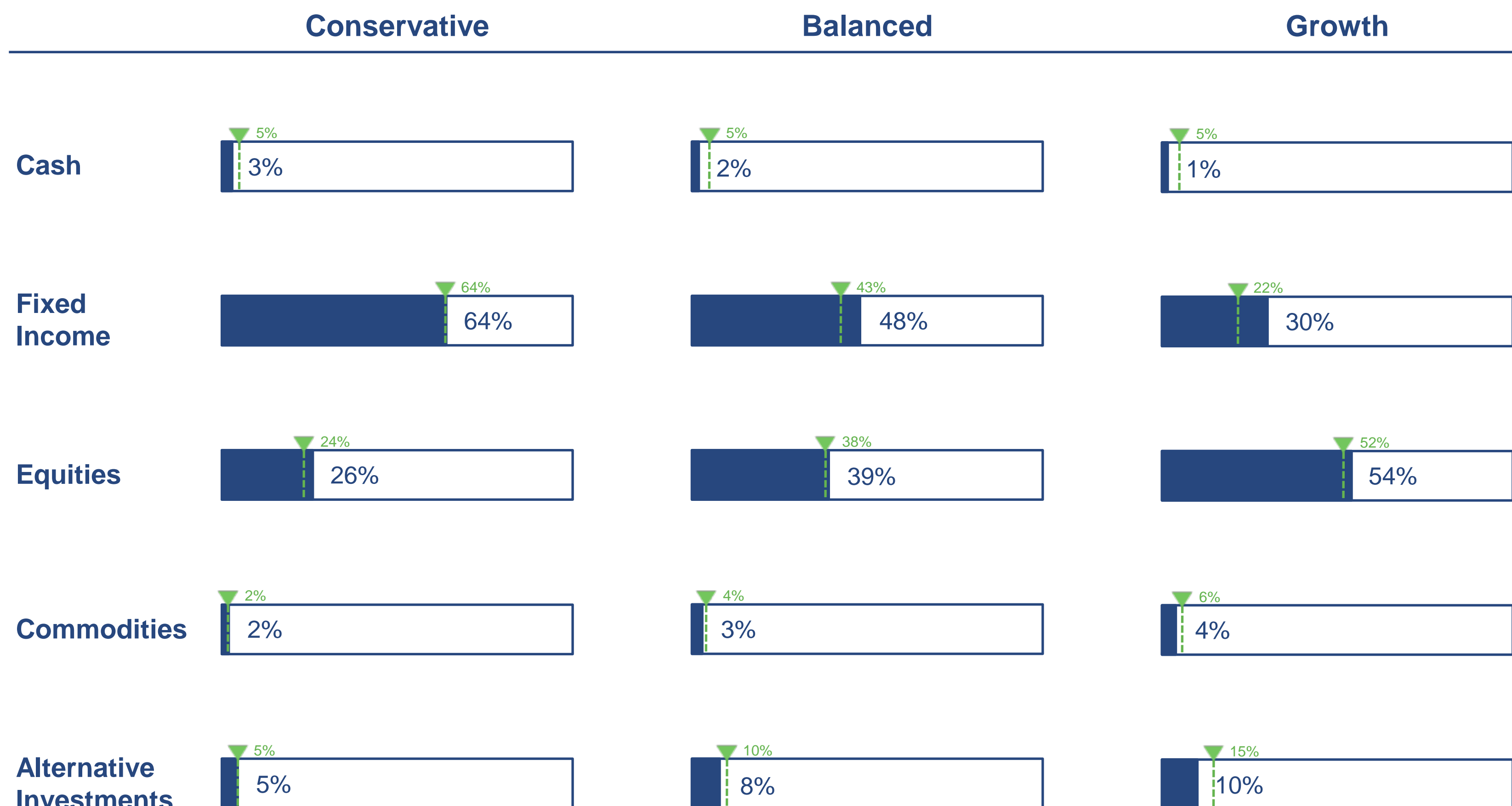

MWM Model Portfolio – Asset Allocation evolution

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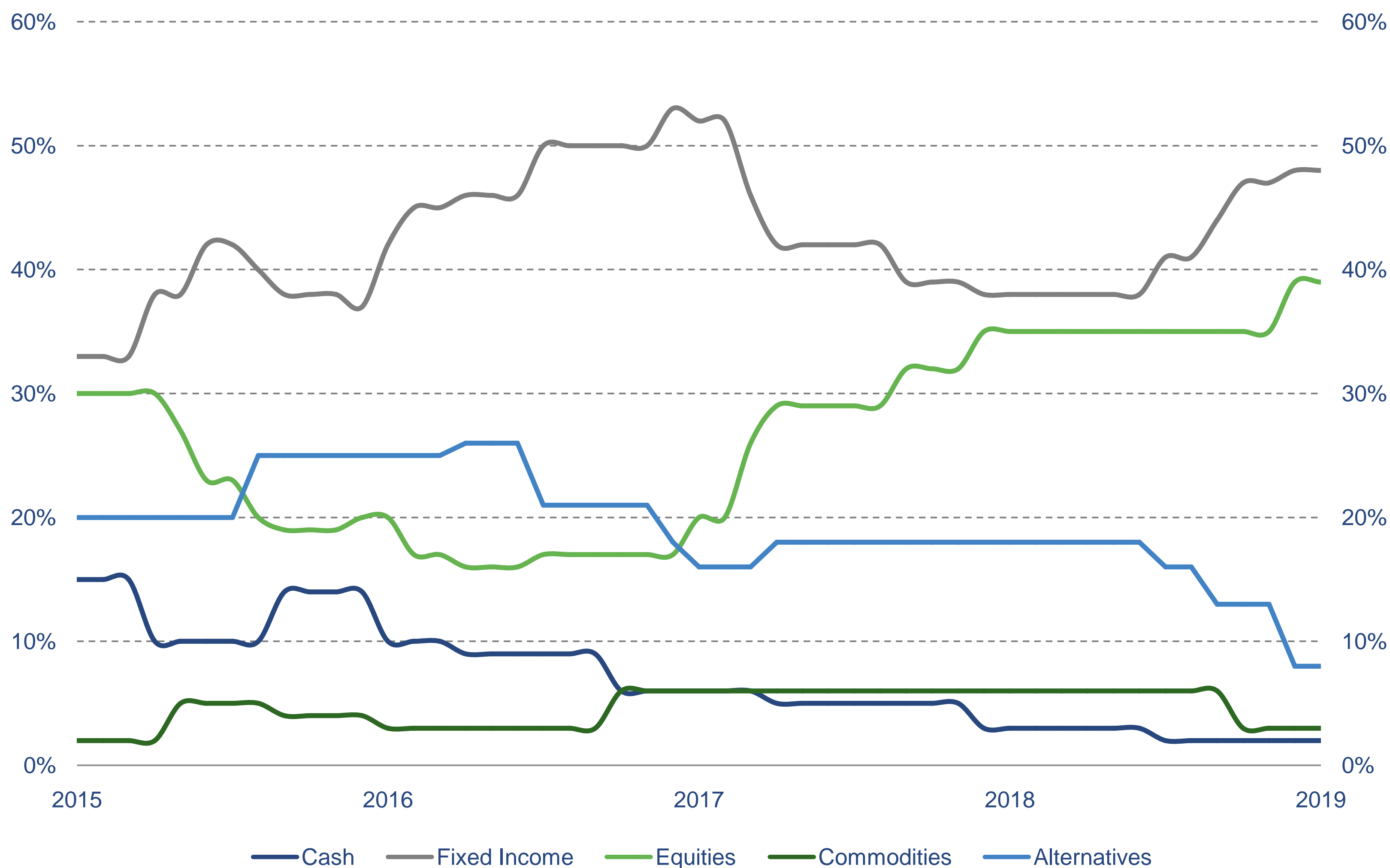
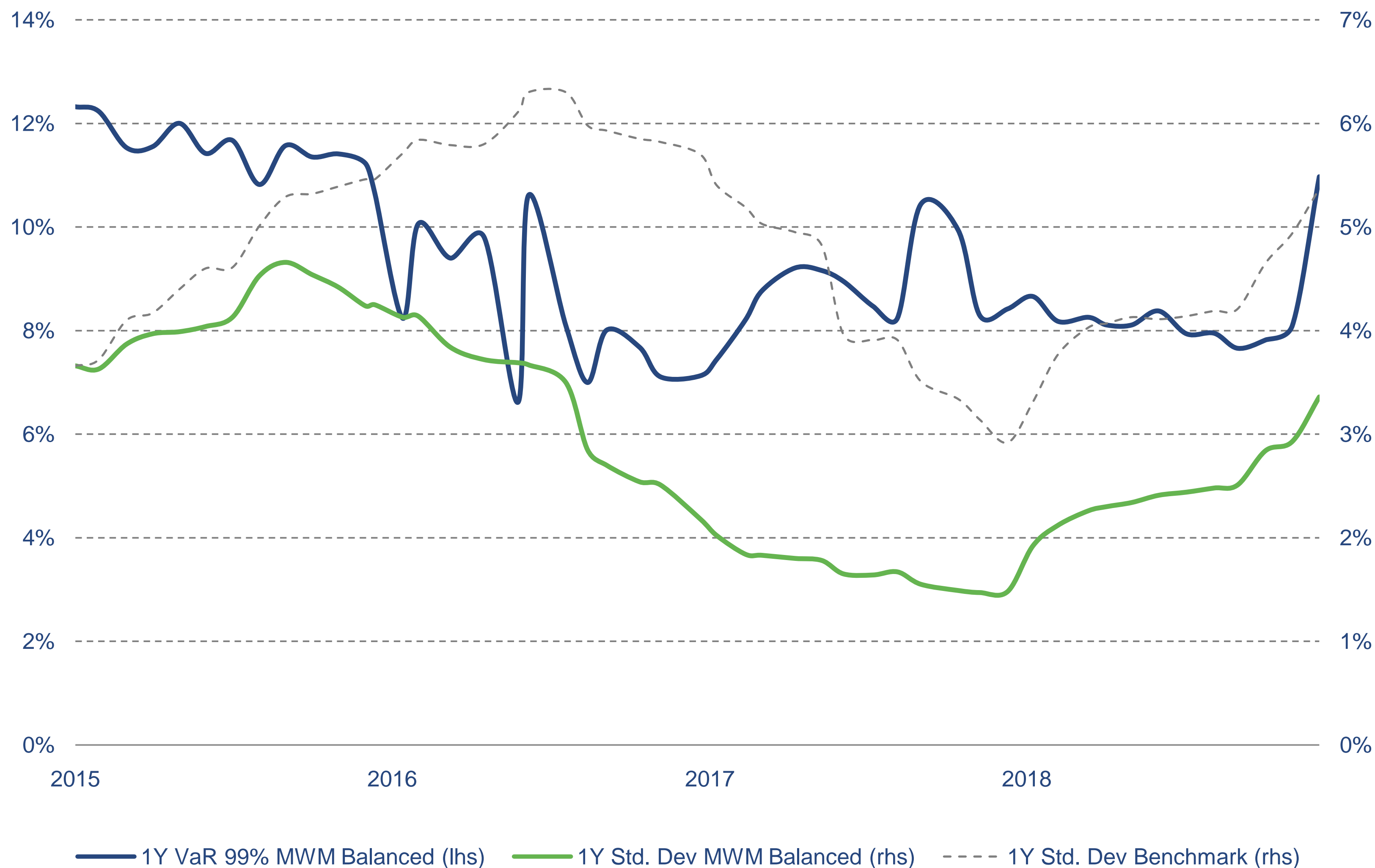


MWM Model Portfolio – VaR evolution



[1] As of December 31, 2018
Source: Bloomberg

MWM Model Portfolio – Peer comparison

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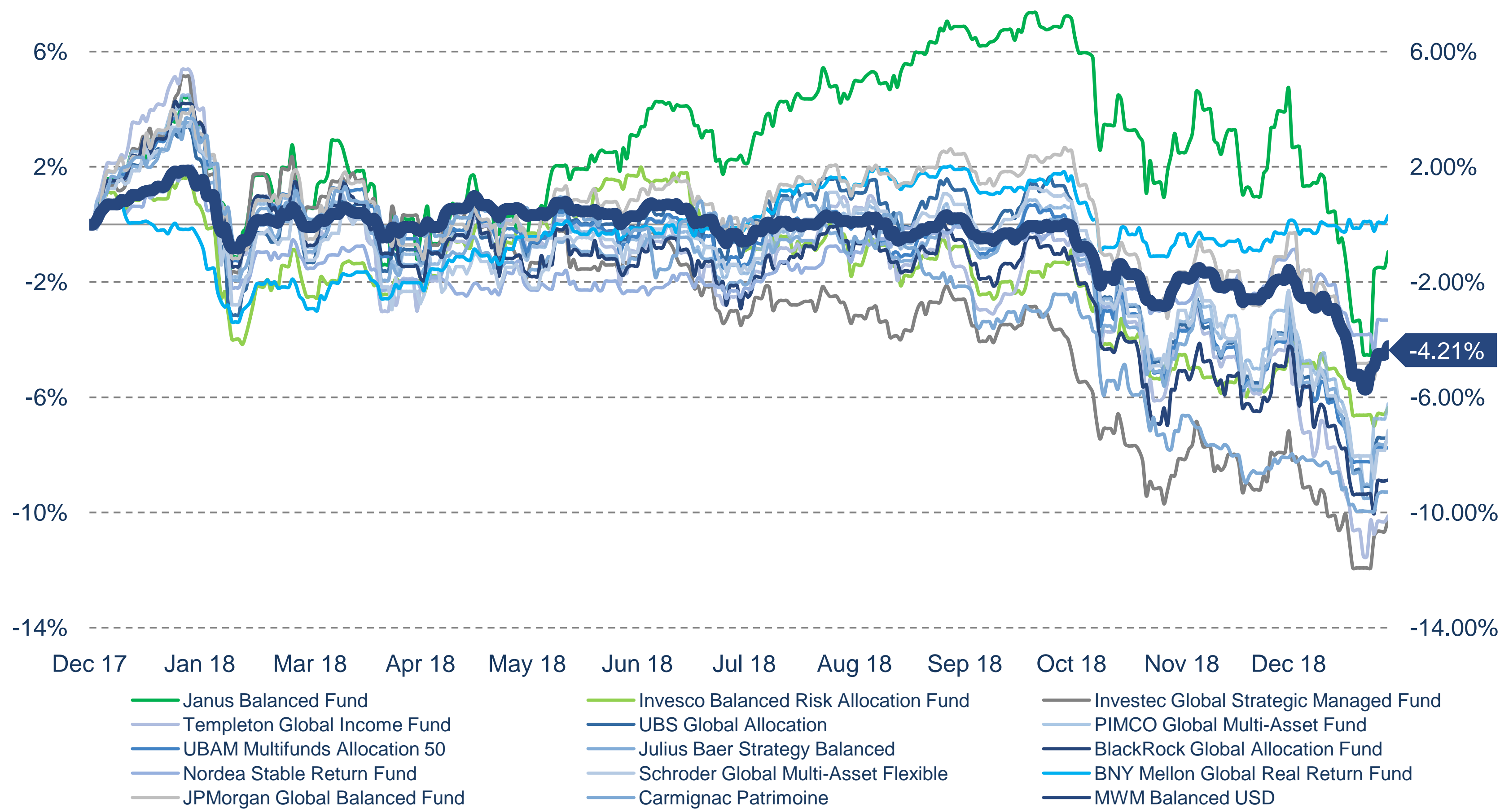

- **Total Return** (Ytd[1]): **4th out of 15**
- **Standard Deviation** (1 year[1]): **1st out of 15**
- **Downside Risk** (1 year[1]): **1st out of 15**
- **Sharp Ratio** (1 year[1]): **n/a**

[1] As of December 31, 2018

Source: Bloomberg

MWM Model Portfolio – Ytd performance

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- **Total Return** (Ytd[1]): **-4.21%** vs. **-4.19%** Benchmark[2]
- **Standard Deviation** (Ytd[1]): **3.37%** vs. **5.37%** Benchmark[2]
- **Downside Risk** (Ytd[1]): **2.59%** vs. **4.02%** Benchmark[2]
- **Sharpe Ratio** (Ytd[1]): **-1.82**vs. **-1.12** Benchmark[2]

[1] As of December 31, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

MWM Model Portfolio – Historical performance (1)

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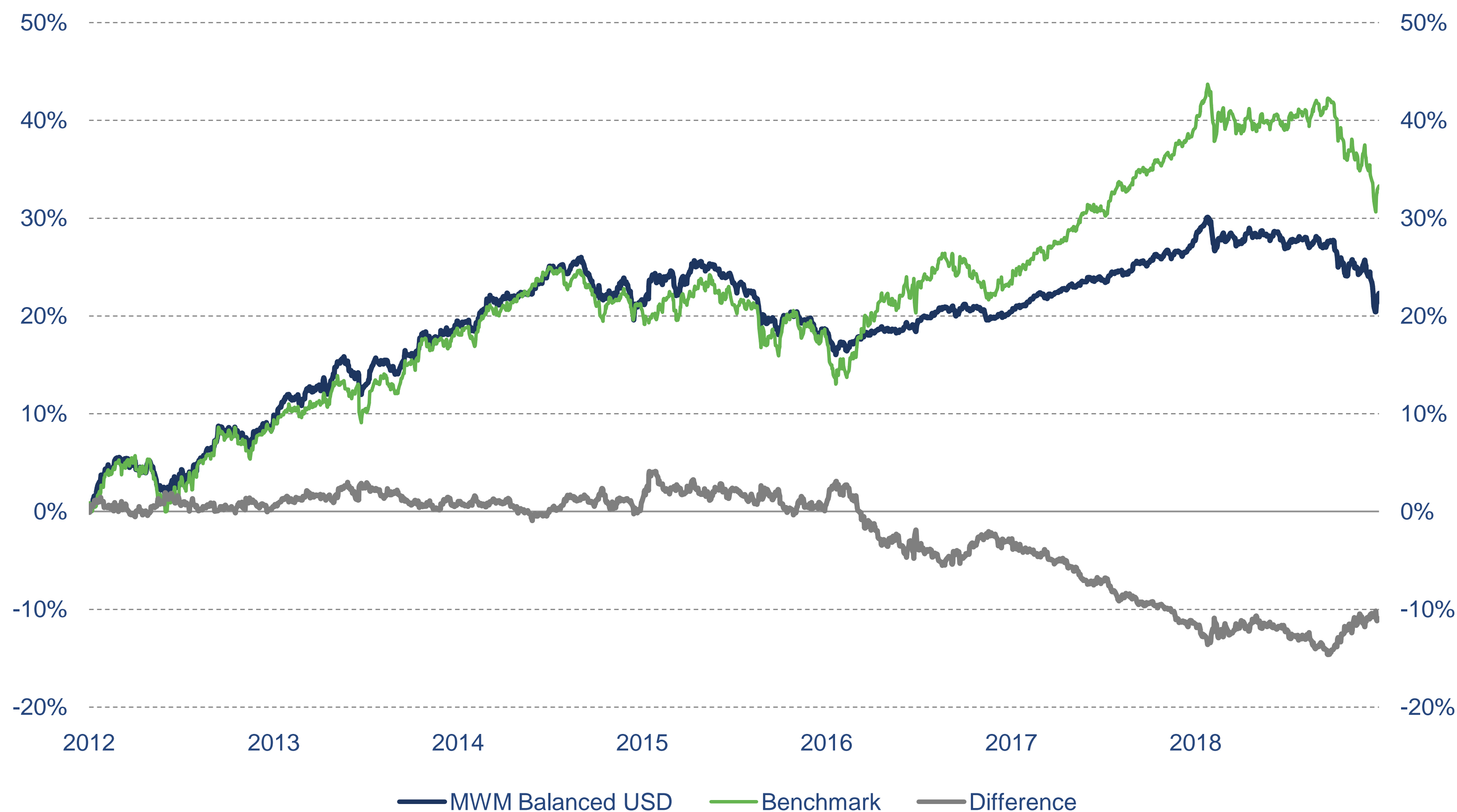

- **Total Return** (1 year[1]): **-4.21%** vs. **4.19%** Benchmark[2]
- **Total Return** (3 year[1]): **3.19%** vs. **13.03%** Benchmark[2]
- **Total Return** (Since Jan 12[1]): **22.31%** vs. **33.24%** Benchmark[2]

[1] As of December 31, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

MWM Model Portfolio – Historical performance (2)

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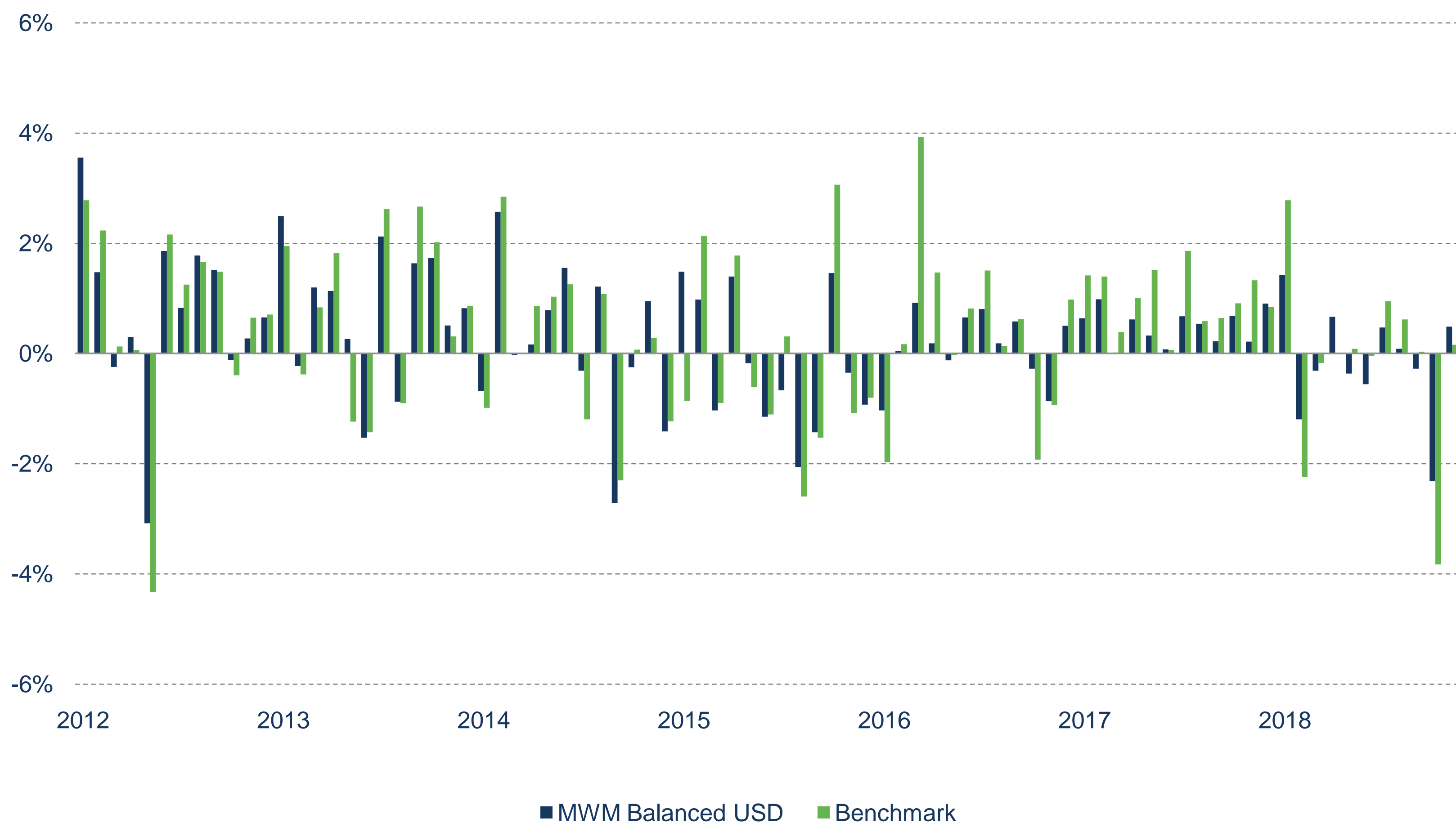

- **Standard Deviation** (1 year[1]): **3.37%** vs. **5.37%** Benchmark[2]
- **Downside Risk** (1 year[1]): **2.59%** vs. **4.02%** Benchmark[2]
- **Sharpe Ratio** (1 year[1]): **-1.82** vs. **-1.12** Benchmark[2]
- **Var 95% - 1day** (1 year[1]): **-0.41%** vs. **-0.60%** Benchmark[2]

[1] As of December 31, 2018

[2] Benchmark = 5% Fed Funds + 43% JPM Global Aggregate Bond Index + 38% MSCI World + 4% S&P GSCI + 10% HFRI FoHF

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