Investment Policy

February 2021

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CAPITAL MANAGEMENT

Our market view in a nutshell – February 2021

- There is an eerie atmosphere in financial markets, which has something of **greed and irrationality, bringing back memories of stock market bubbles and crashes**. Episodes like the GameStop saga, Bitcoin's meteoric rise and reverence for tech stocks are sending signals that are hard to ignore for those who have been involved long enough in financial markets.
- **Under normal circumstances, it would be time to start reducing risks**, closing the bets, and piling into US Treasuries. **But these are not normal times. Despite the pervasive feeling of being in a bubble, equity fundamentals remain strong**; and the outlook for those companies that have successfully made the digital transition, and that are leaders in their sectors, are now even better than before the pandemic
- But with the valuations of all financial assets critically dependent on interest rates remaining low, **markets are increasingly nervous of any signs of a possible rise in inflation**. This is based on a theoretical idea that higher fiscal spending can lead to higher inflation, which is not supported by data. So far, inflation remains very low, and if we look at the past decades, it is difficult to see prices rising steadily
- **Credit markets, on the contrary, continue to become increasingly expensive**. The desperate search for yield is driving valuations to levels that are difficult to justify from an economic point of view, and that can only be considered attractive in the most benign scenarios
- Summing up all of the above, **there are no longer any easy decisions to be made in portfolios**, and conviction begins to weaken. Low interest rates have inflated valuations at the cost of lowering future returns. In a way, we cannot escape from being in a bubble, so we must choose the lesser one. In this sense, **a combination of stocks (to capture growth), and US Treasury bonds (to get some protection)** seems to us the most appropriate positioning at this time

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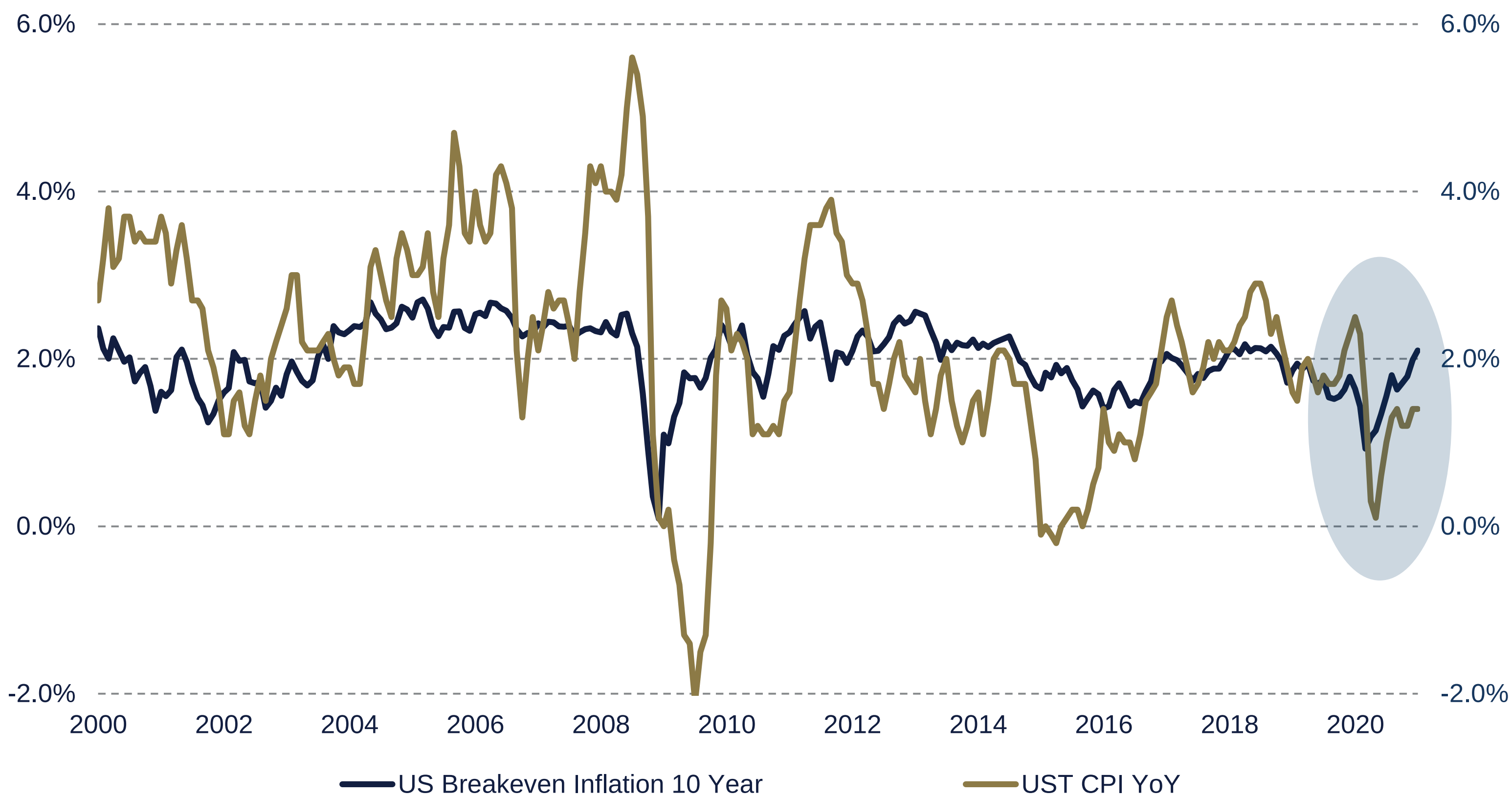
Asset Class		View	Rationale
Fixed Income	US Treasuries	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. With interest rates anchored at current levels, and credit spreads that have narrowed massively, we favor long-term US Treasuries
	US Credit	–	The crisis 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 reacted only partially to the risk that the Covid outbreak represents for these countries. In addition, the oil price war will harm exporting countries
Equities	US	+	After the sharp sell-off, valuations have improved. We have therefore increased our exposure 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
	Asia	+	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 Cybersecurity, Infrastructure, Biotechnology, Fintech and Clean Energy
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	–	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 is back, but only as a trending topic…



- **Whether or not inflation will return is the issue that is most dividing markets today.** One of the two camps expects that increased public spending in the US, combined with an economy that will recover strongly, will generate a sustained increase in inflation
- On the other side are those who, as is our case, **expect inflation to remain largely subdued, anchored by structural forces**, probably experiencing only a temporary rebound

Source: Bloomberg

Still far from full employment

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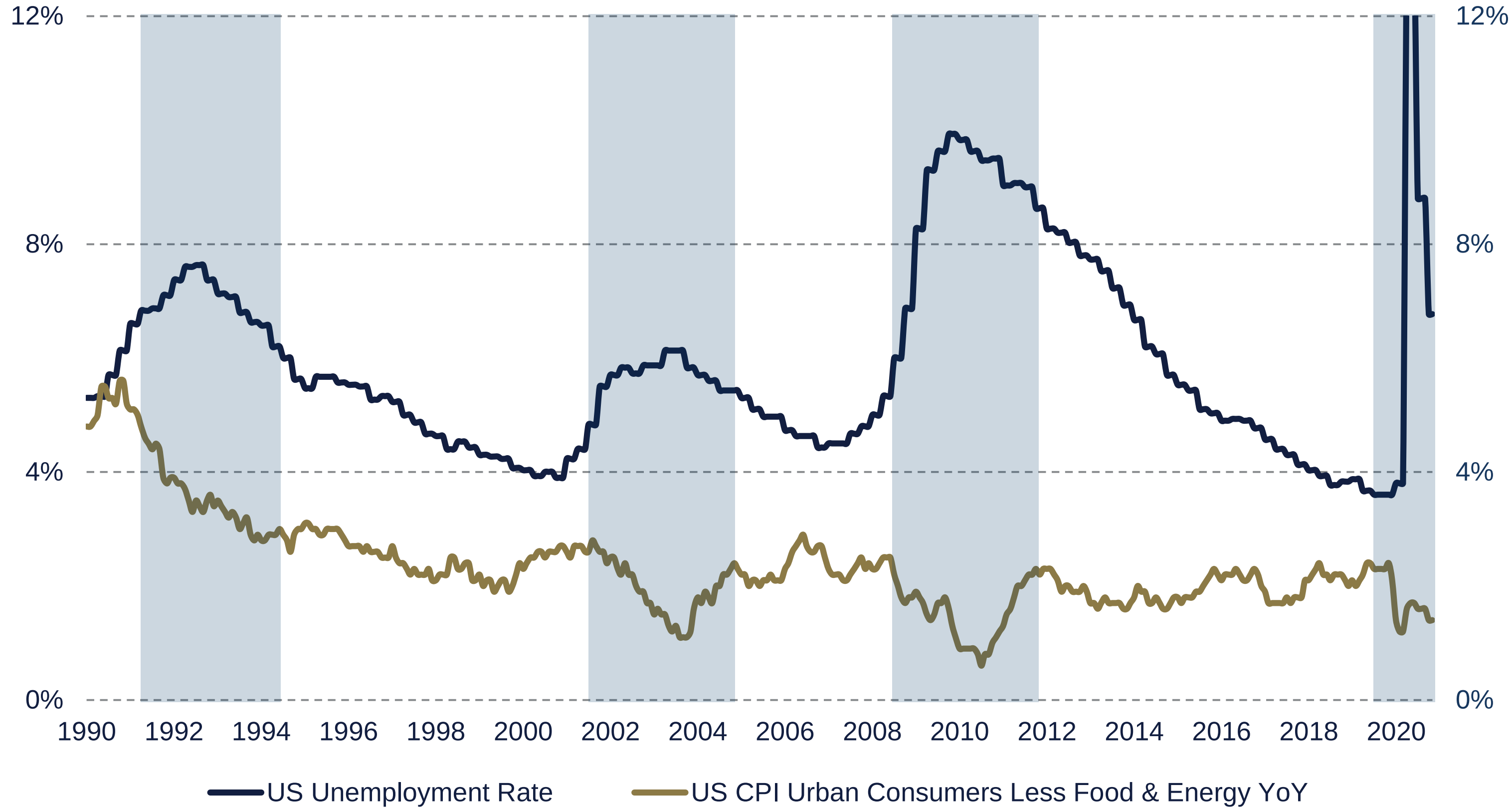


- Putting aside the **secular factors that have been weighing down inflation for decades** (globalization, demographics and technology), the traditional **link between inflation and unemployment** is still far from being tested.
- As long as **we are not close to full employment**, it is not conceivable that we will experience a significant rebound in core inflation

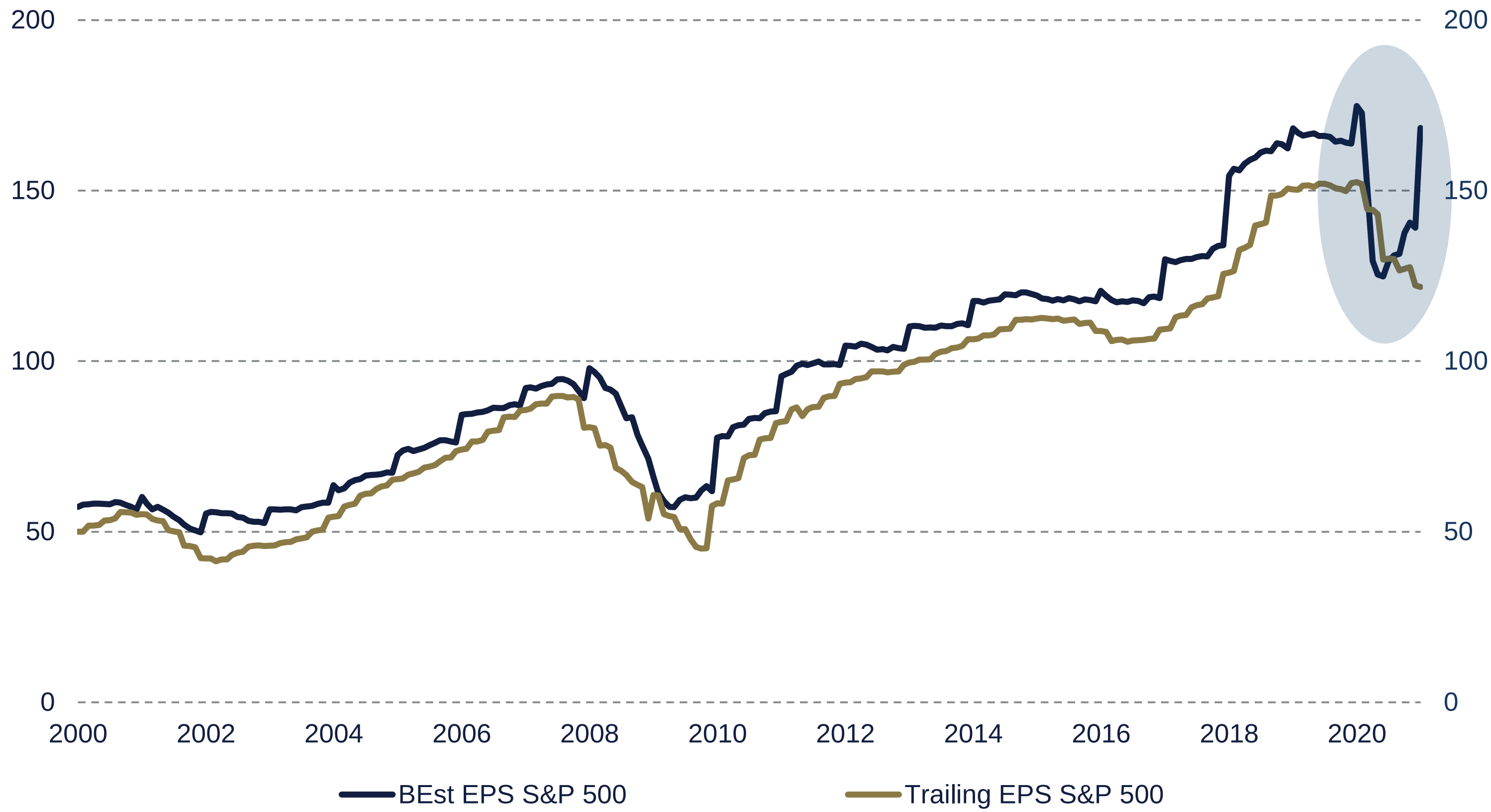
Source: Bloomberg

Peak rates or pause along the way?

- The recent **rise in interest rates can be seen as a first step in a normalization process** (which would imply a correction in equities) **or, conversely, as an opportunity to increase duration in portfolios**
- In our opinion, with current yields, **US Treasuries are a very attractive addition to portfolios** from a risk diversification point of view

Source: Bloomberg

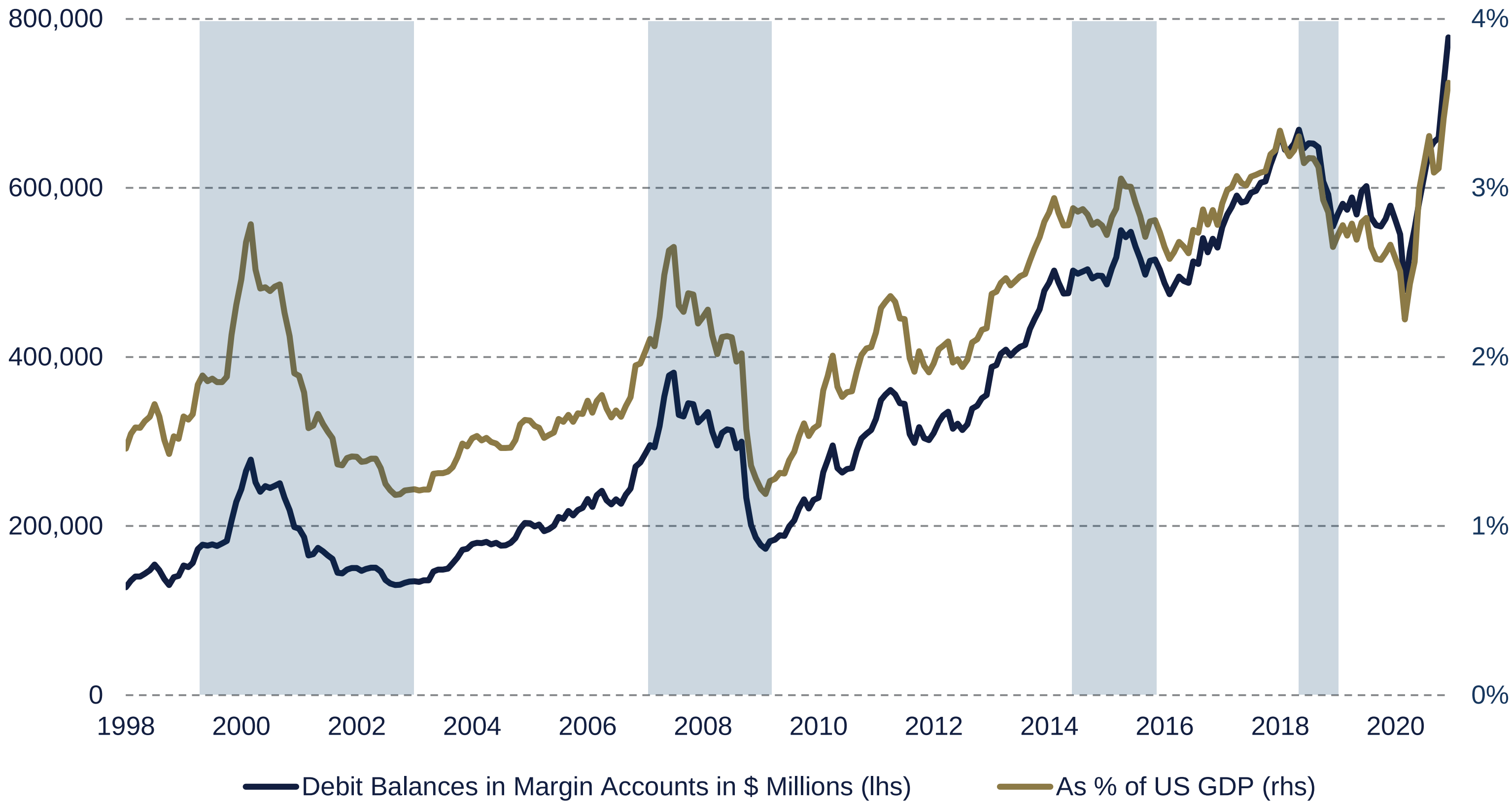
No room for disappointment in equity valuations



- **The relative attractiveness of equities versus bonds is only sustainable if, over the next few quarters, corporate earnings meet analysts' expectations**
- If this were the case, and despite the increase in interest rates, the risk premium would still be very attractive; standing above 3%. But **if we consider trailing EPS instead of expected ones, the premium would be below 2%**

Source: Bloomberg

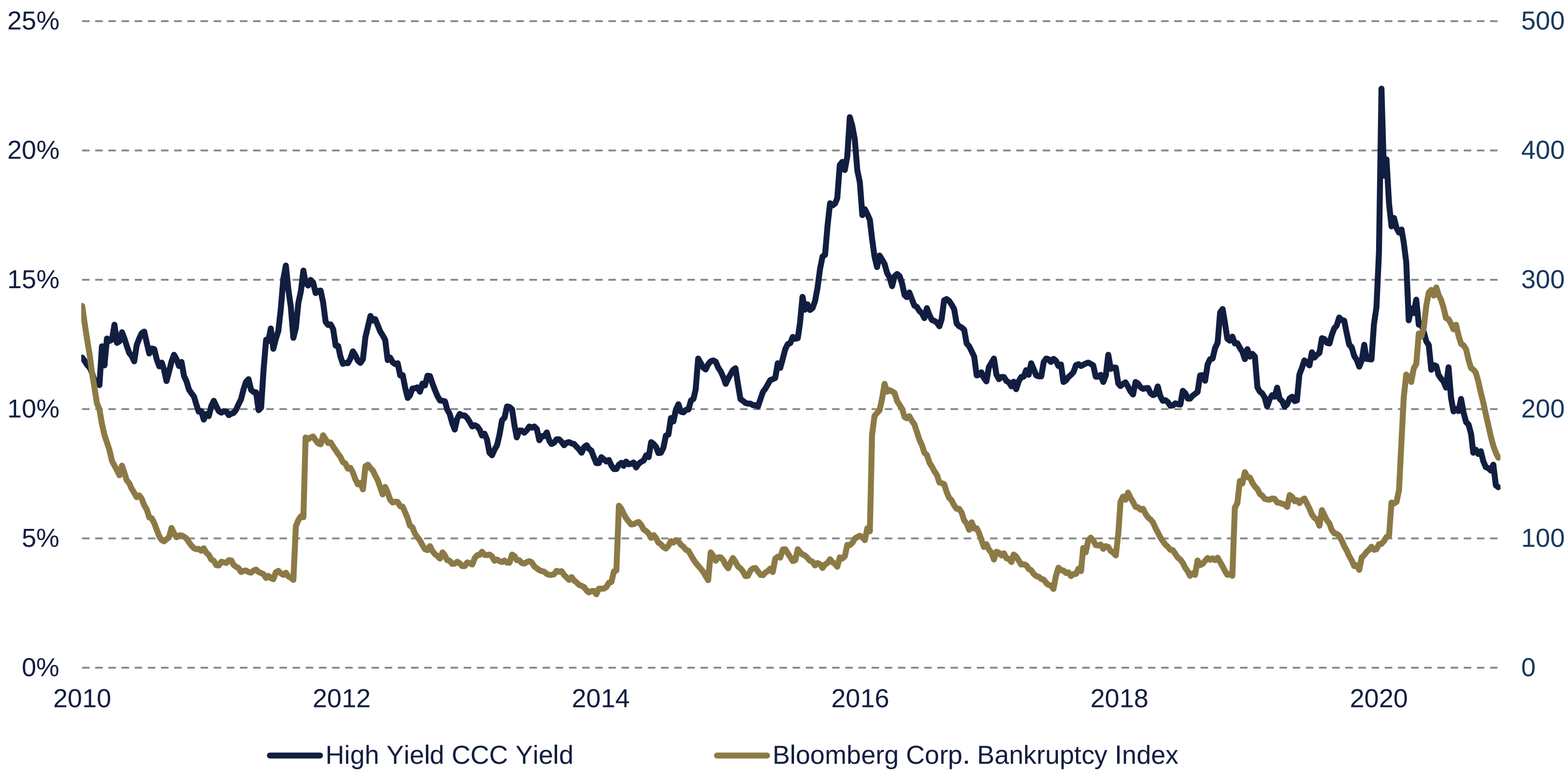
Bubble behavior despite good fundamentals



- Equity markets are attracting significant flows, as investors progressively assume there is no other option
- There is also considerable **flows coming from retail investors using leverage**, as the recent GameStop saga has exposed. This makes **markets more fragile to changes in investor sentiment**, and therefore more prone to panics and mania

Source: Bloomberg and FINRA

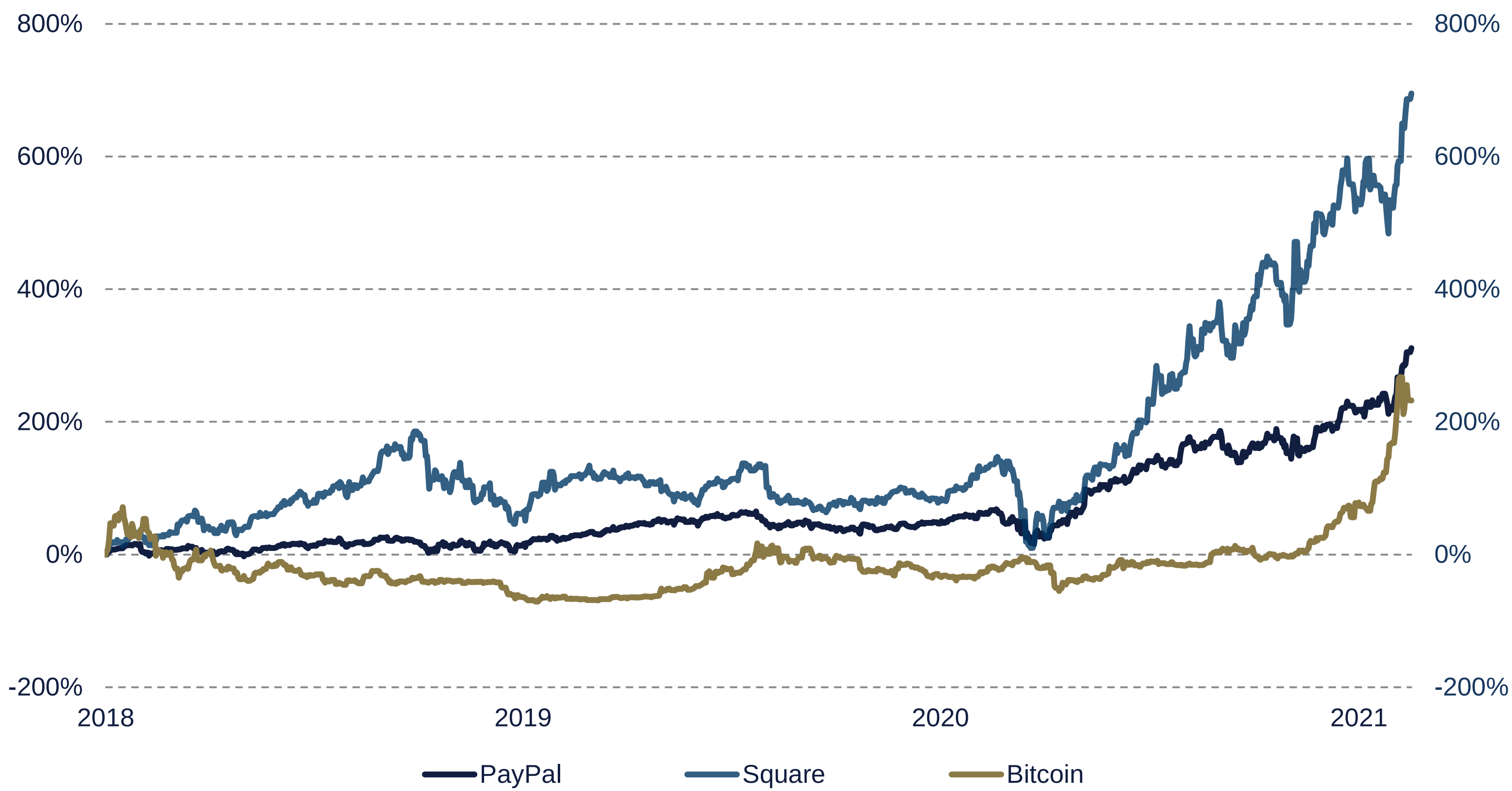
Too much risk for little return



- The **average one-year default rate for bonds with CCC credit rating is above 20%**. Even if bonds in this segment trade at deep discounts and there is certain recovery value, **a return of less than 7% seems simply too small** for the risk incurred
- **High Yield bonds in general currently offer a yield of less than 4%,** with a historical default rate of approximately 4.5%

Source: Bloomberg

And then there is Bitcoin…



- **Bitcoin is in a juxtaposition of several trends: fear of rising inflation, enthusiasm for the digital economy, and increased speculation.** However, the main reason to buy Bitcoins today is that its price will continue to rise as more and more people buy it (that is, the very definition of a bubble)
- Investors should be aware that **technological and regulatory risks are now much higher**, once the market value of the cryptocurrency has reached $ 1 trillion, and that **there are other ways to participate in the FinTech ecosystem**

Source: Bloomberg

Investment scenarios

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	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-haven 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	10%	60%	30%

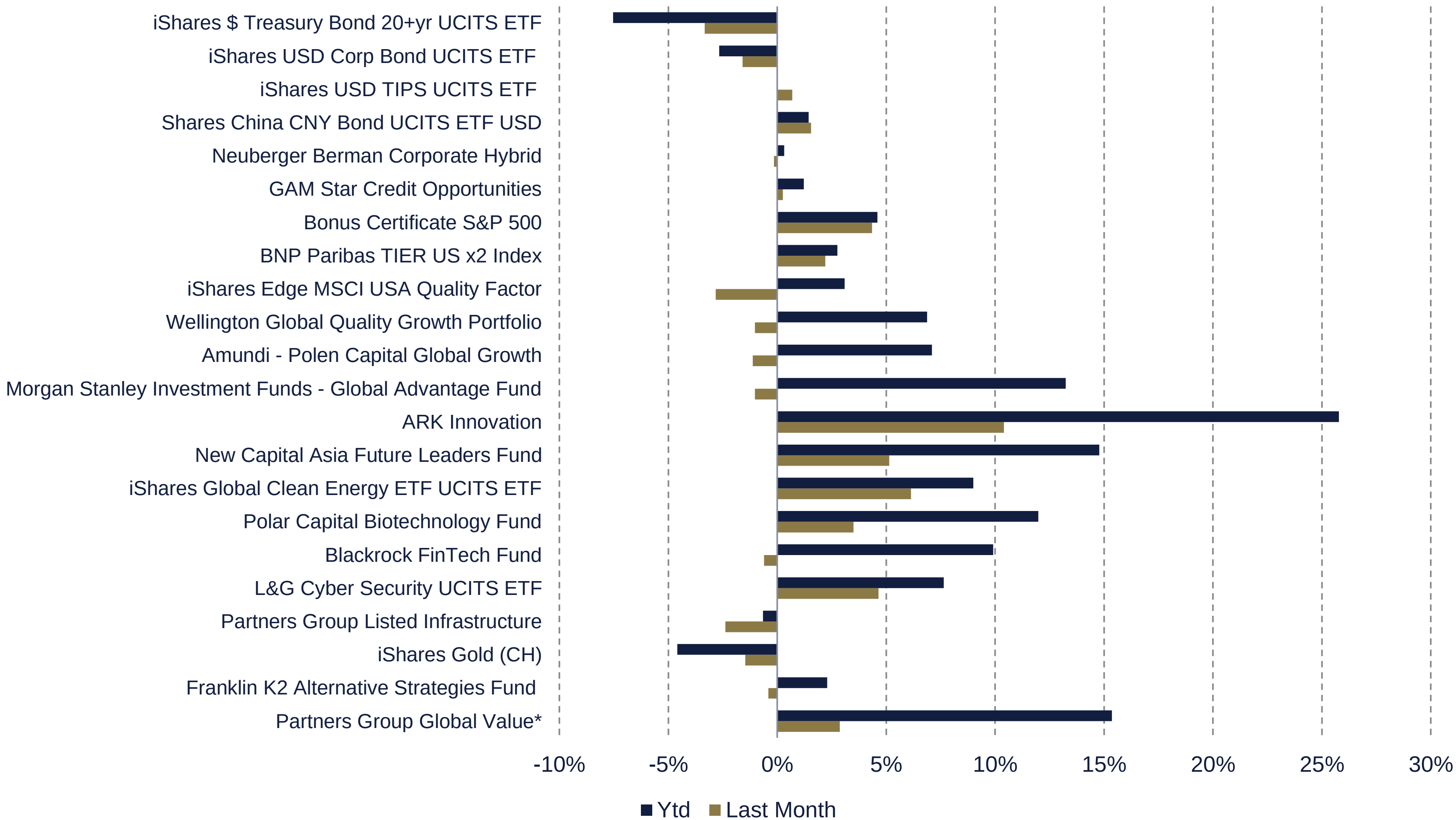
Short-term catalyzers

Slowdown in infections, Vaccine or treatment for the coronavirus, ramp-up in hospital infrastructure

Other risks

Trade war (II), Spread of populist/nationalistic parties, Brexit implementation, Iran, North Korea

Model portfolio evolution



Source: Bloomberg, as of February 15, 2021
* Fund publishes monthly NAV with a 1 month of delay

Boreal Balanced Portfolio USD

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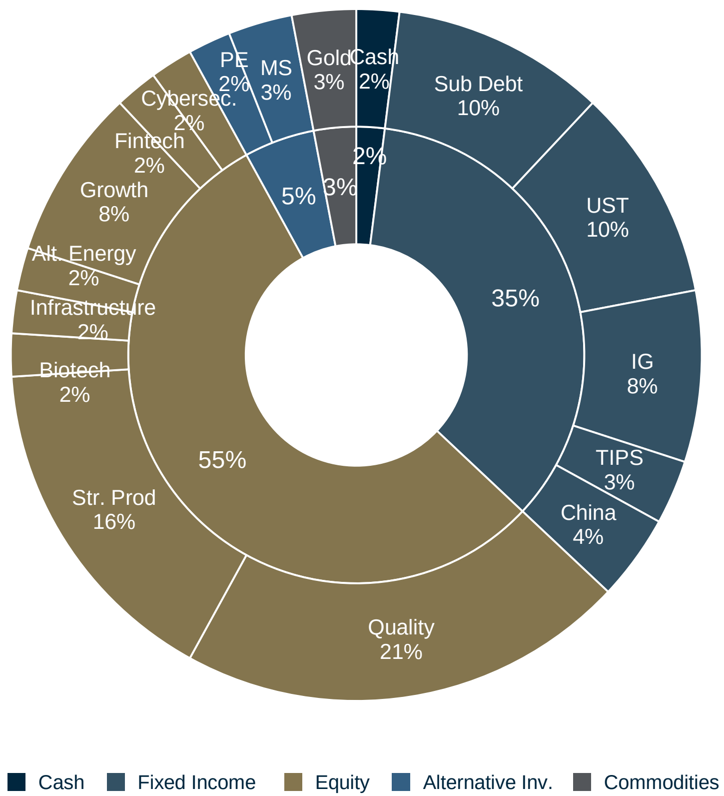
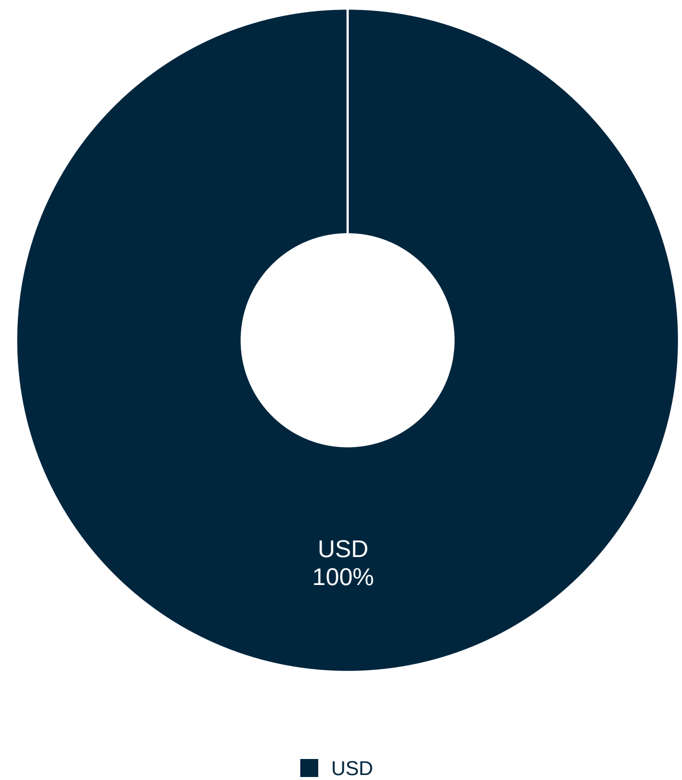
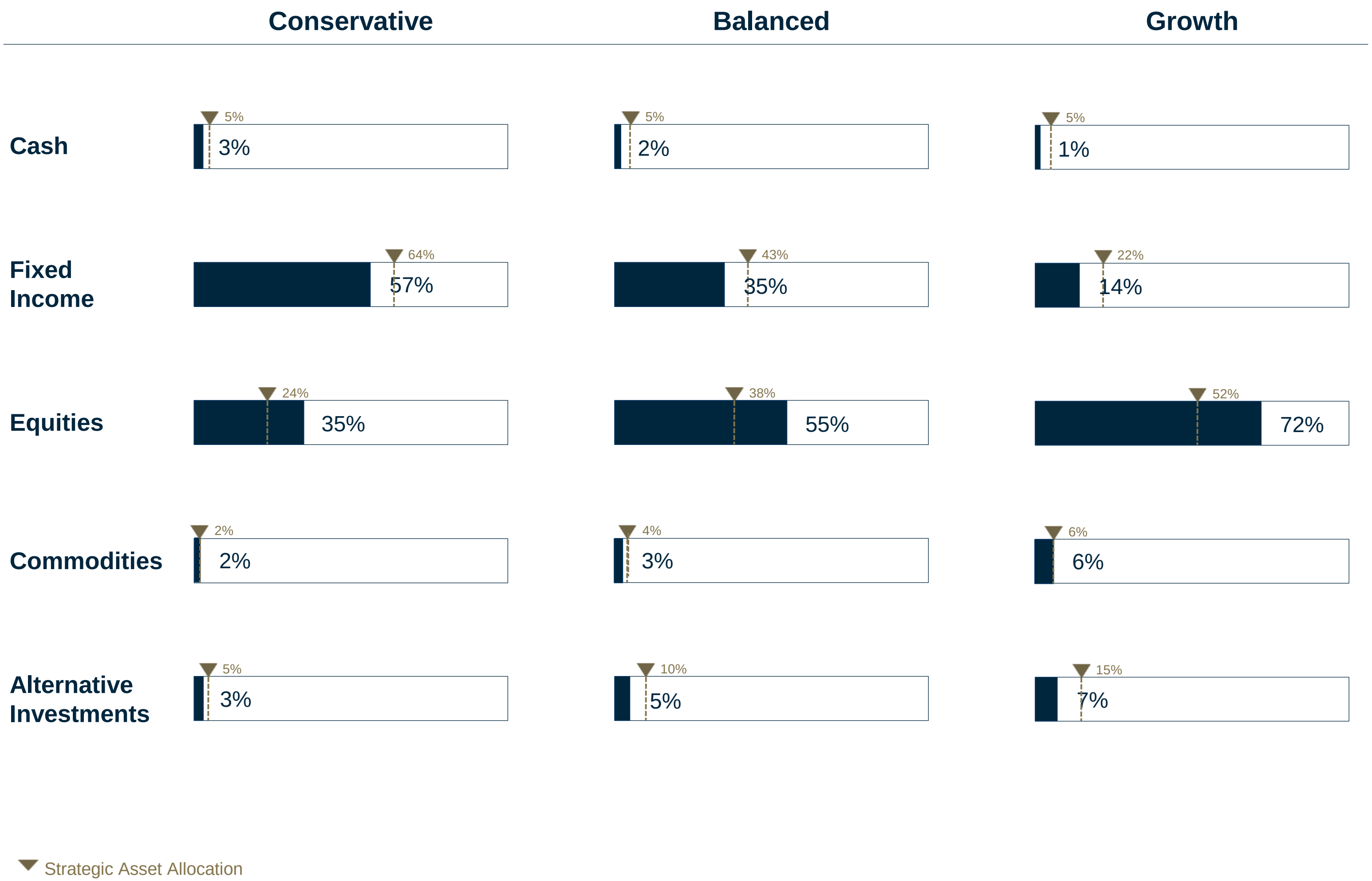
Asset Allocation



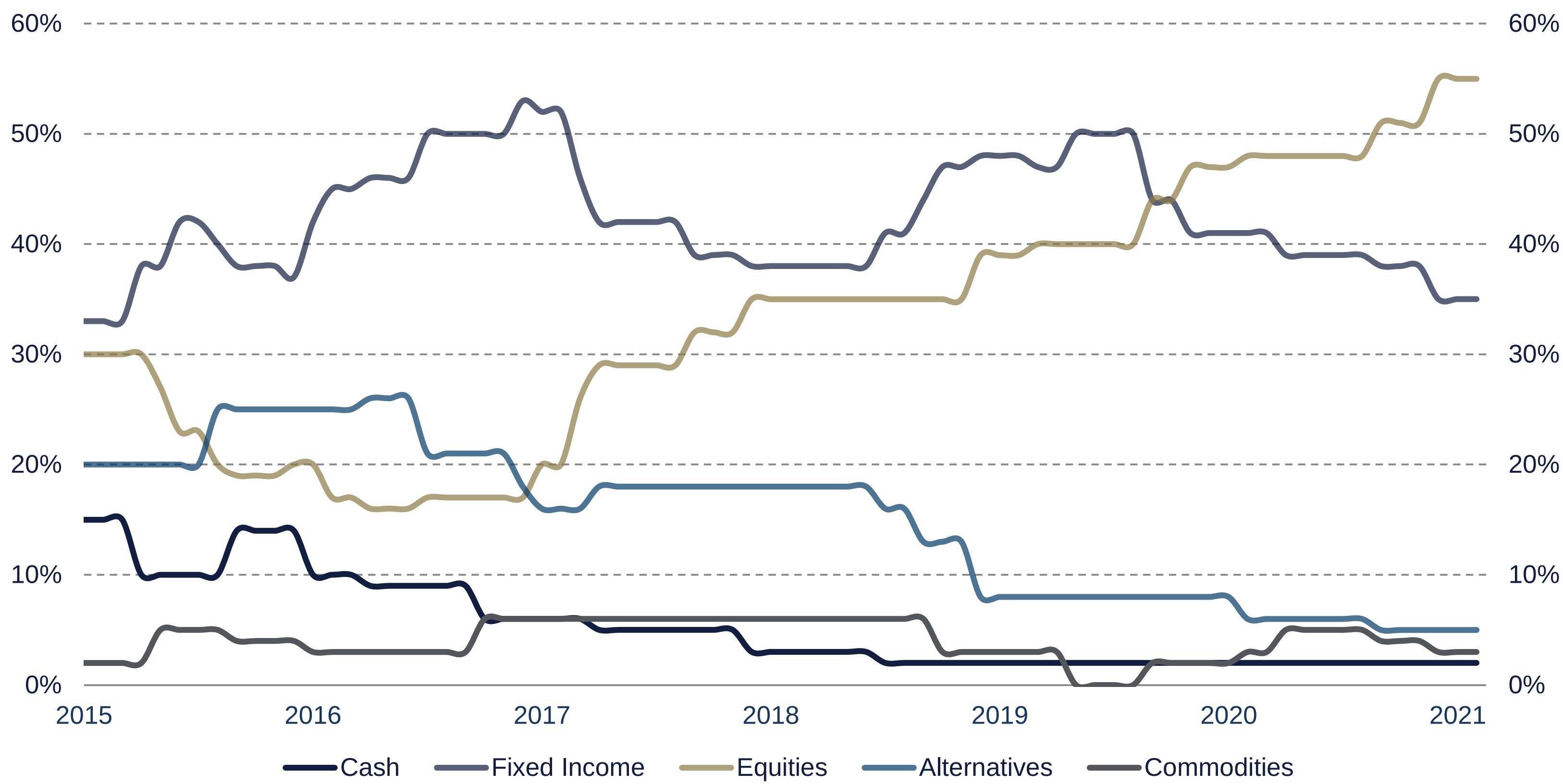
Currency Allocation



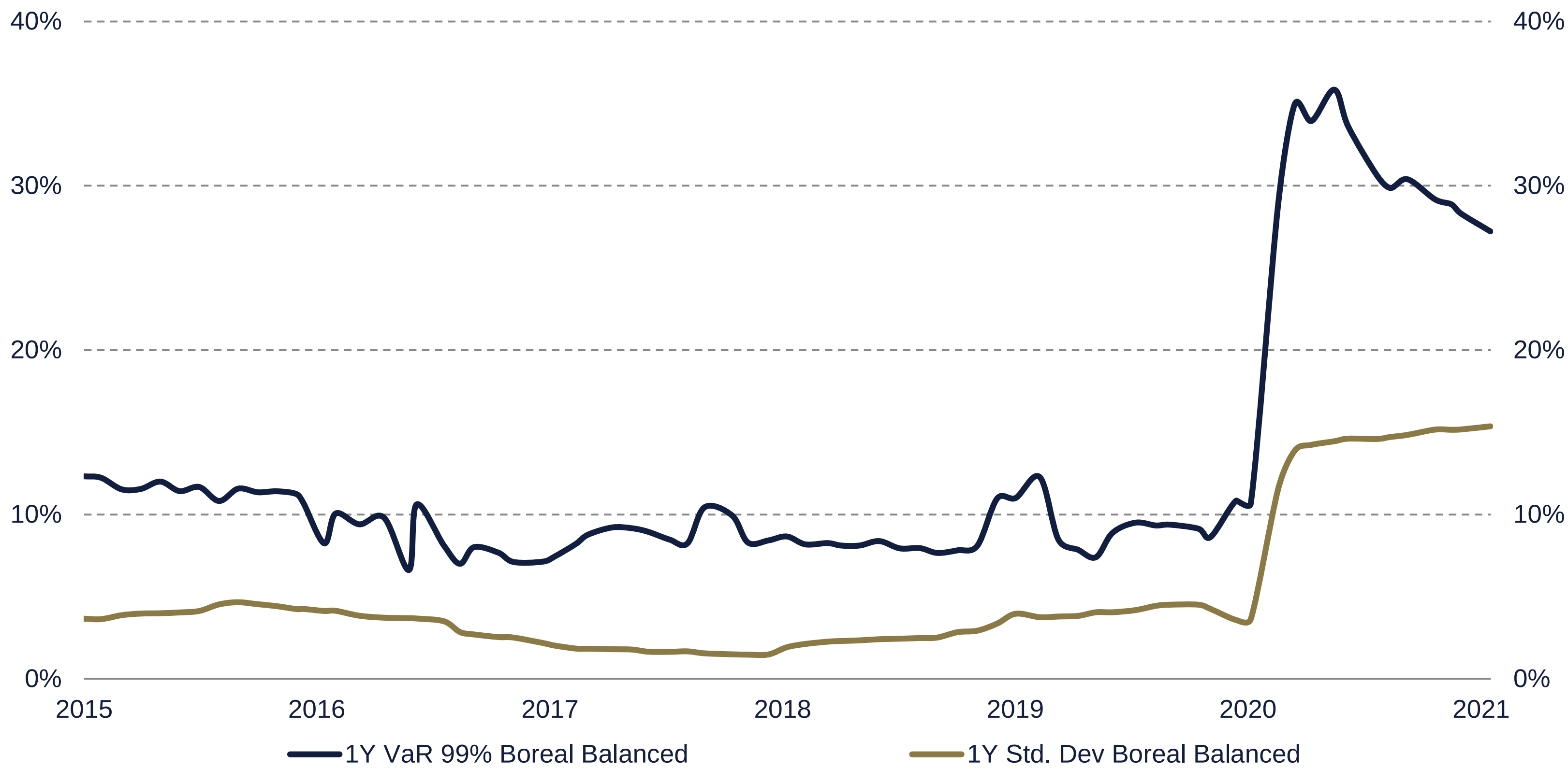
Boreal Investment Profiles



Boreal Balanced Portfolio – Asset Allocation evolution

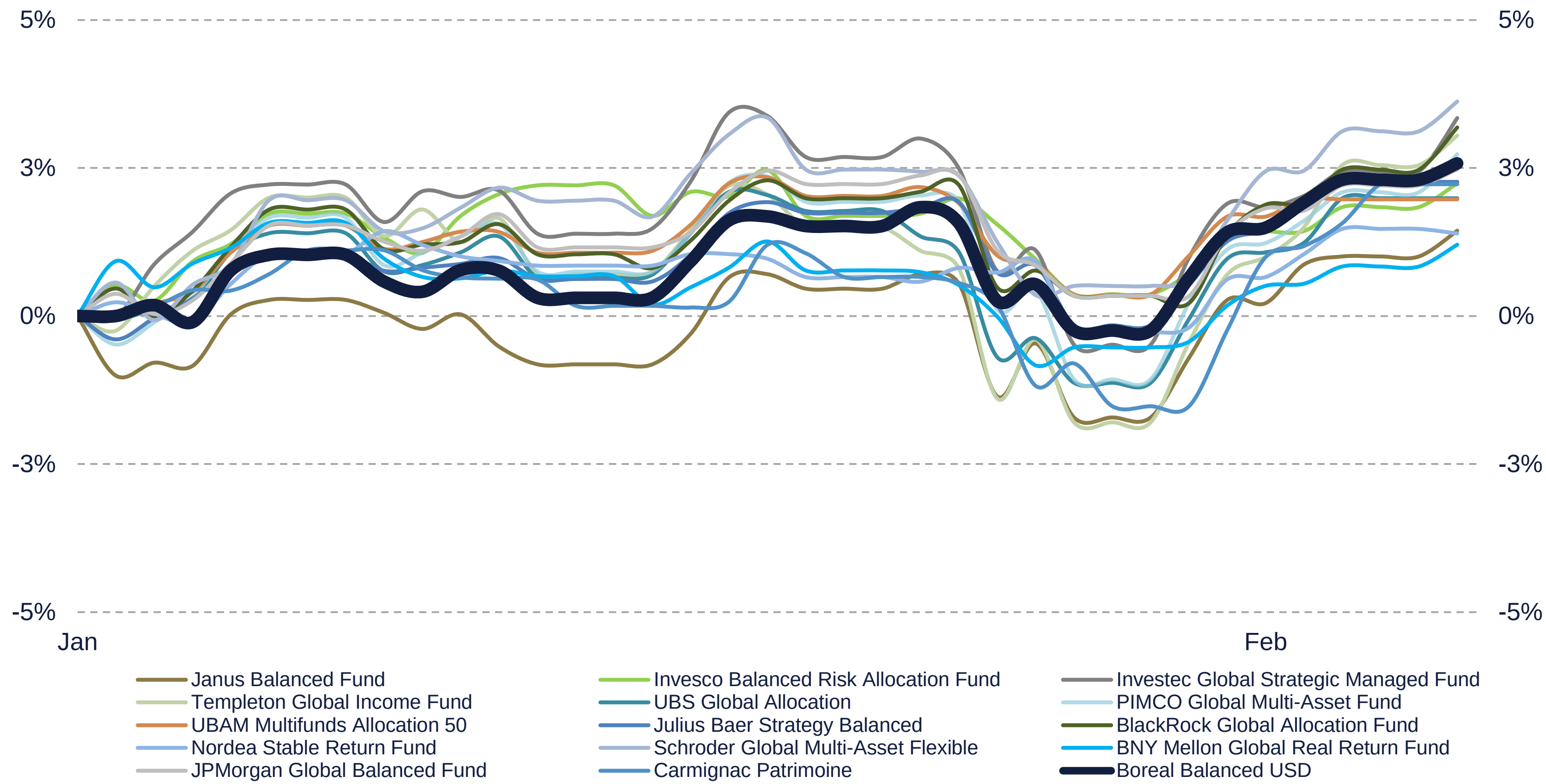


Boreal Balanced Portfolio – VaR evolution



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

Boreal Balanced Portfolio – Peer comparison

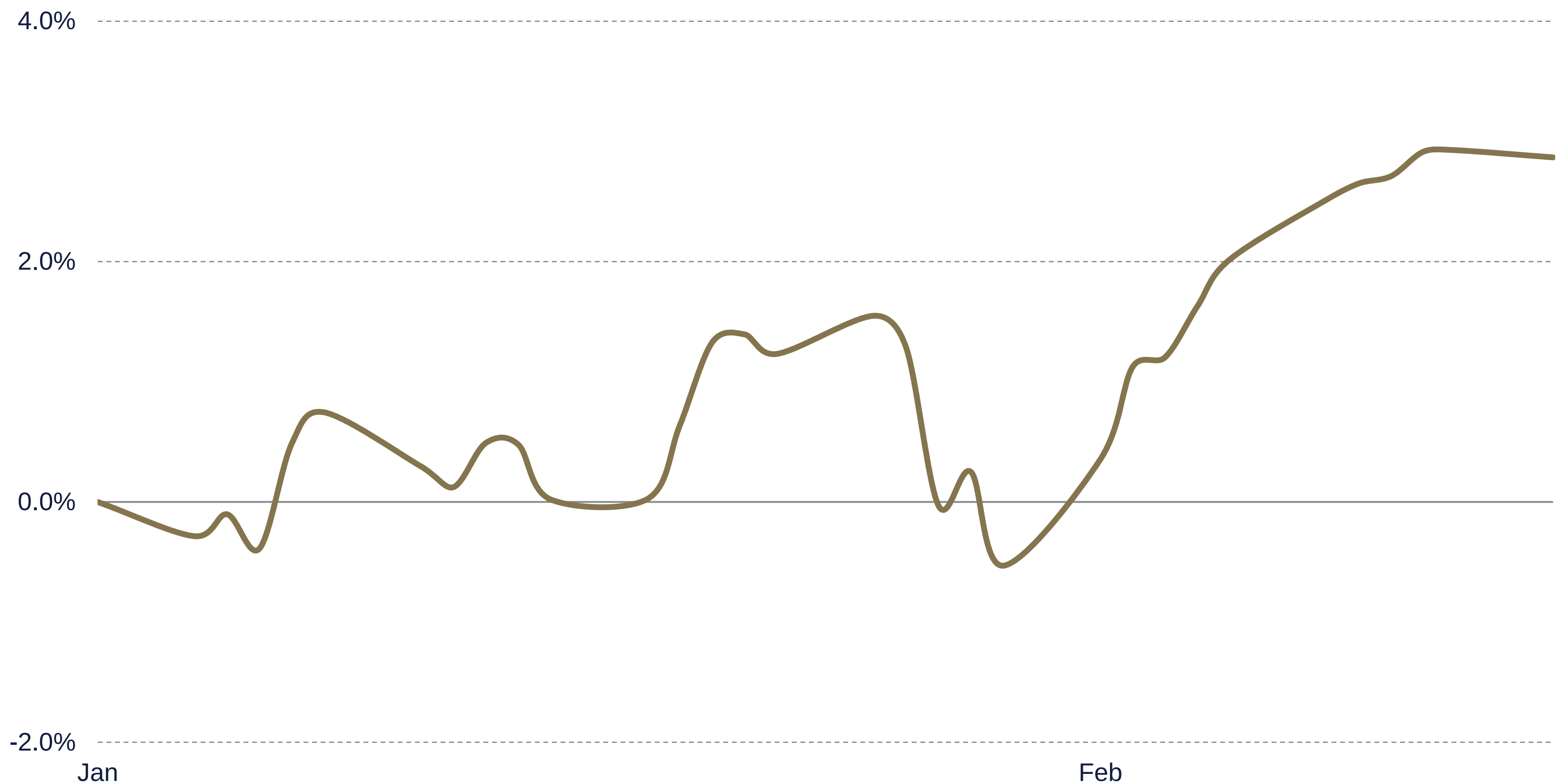


- **Total Return** (Ytd[1]): **6th out of 15**
- **Standard Deviation** (1 year[1]): **8th out of 15**
- **Downside Risk** (1 year[1]): **3th out of 15**
- **Sharpe Ratio** (1 year[1]): **3th out of 15**

[1] As of February 8, 2021

Source: Bloomberg

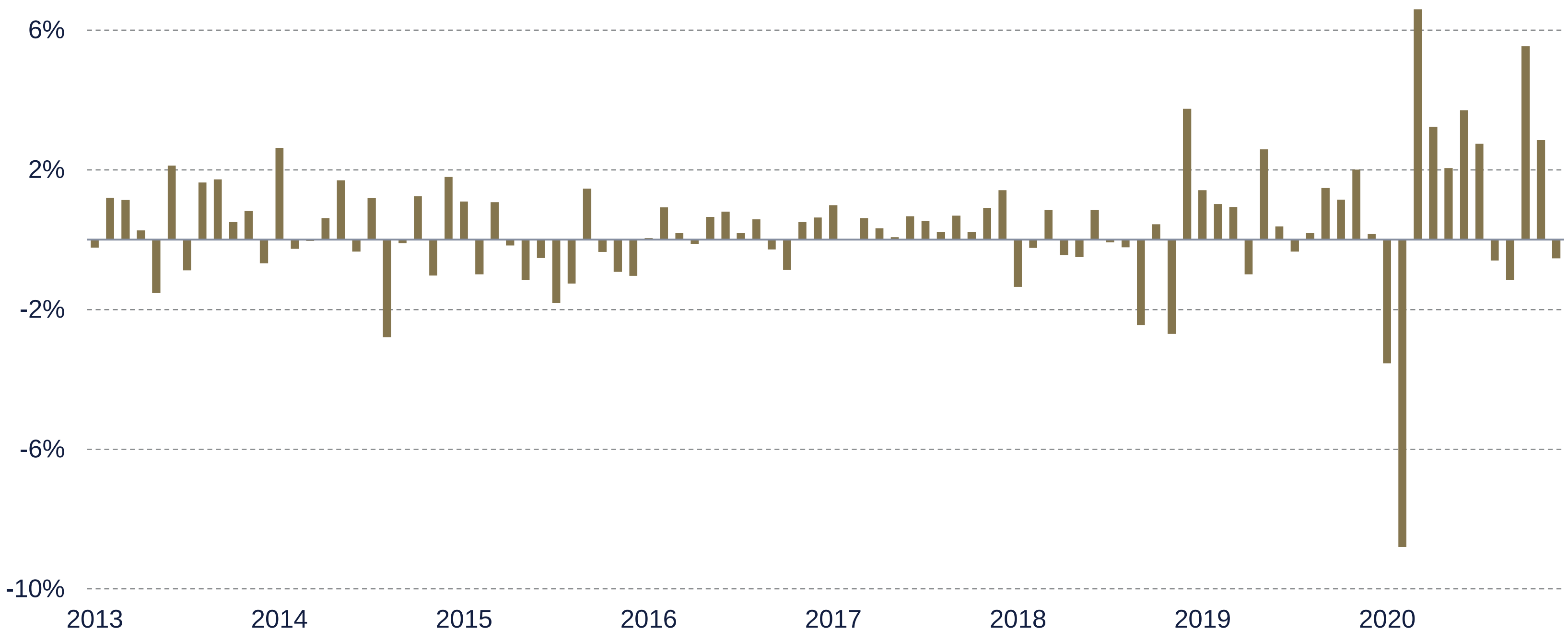
Boreal Balanced Portfolio – Ytd performance



- **Total Return** (Ytd[1]): **2.87%**
- **Standard Deviation** (Ytd[1]): **7.55%**
- **Downside Risk** (Ytd[1]): **5.69%**
- **Sharpe Ratio** (Ytd[1]): **3.47**

[1] As of February 15, 2021

Boreal Balanced Portfolio – Historical performance (1)



- **Total Return** (1 year[1]): **13.40%**
- **Total Return** (3 year[1]): **26.69%**
- **Total Return** (Since Jan 13[1]): **49.63%**

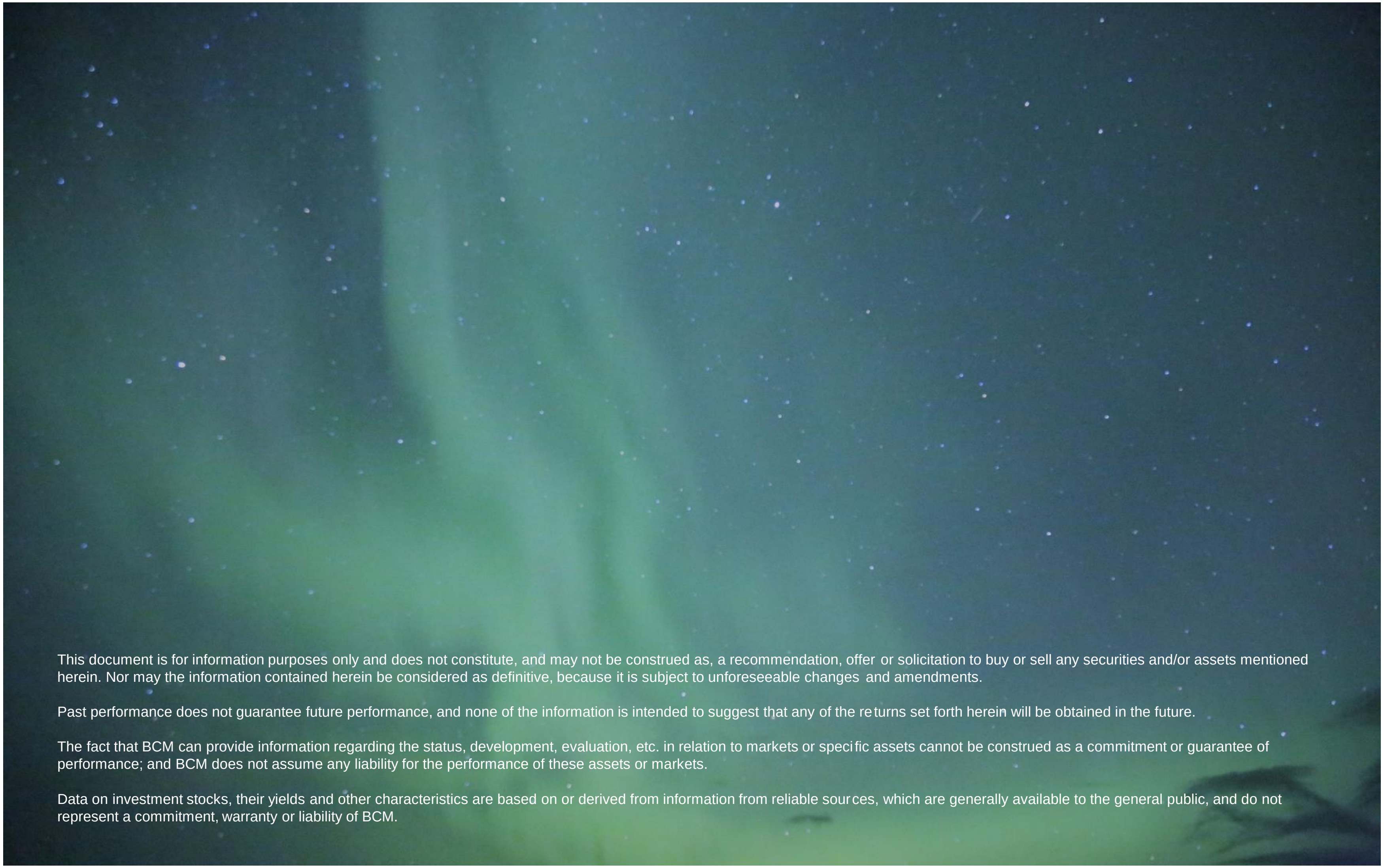
[1] As of February 15, 2021

Boreal Balanced 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%	2.87%
Std. Deviation	3.82%	3.59%	3.67%	2.08%	1.45%	3.77%	3.78%	15.18%	7.55%
Sharpe Ratio	2.54	0.58	-0.48	0.62	3.57	-1.70	3.49	0.87	3.47

Annualized Return: 5.08%
Annualized Std. Dev: 6.22%

[1] As of February 15, 2020



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