Investment Policy

October 2024

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Our market view in a nutshell – October 2024

- The prospect of a "soft landing" emerged in late 2021 as the economy began to recover from the pandemic-induced recession. Inflation surged to multi-decade highs, prompting the Federal Reserve to aggressively raise interest rates, significantly increasing the risk of a recession by 2023. However, strong consumer spending has kept the economy afloat, allowing inflation to cool and giving the Fed room to begin easing. With inflation now near target, **the soft-landing scenario seems closer than ever**.

- **Two key risks remain** and are the focus of market attention: the **strength of the labor market and the potential for lower rates to reignite inflation**, particularly through the housing market, where shelter costs remain stubbornly high. In September, headline inflation cooled but less than anticipated, while core inflation edged higher due to rising goods prices. Meanwhile, unemployment bucked the trend, dropping from 4.3% in July to 4.1% in September, with job creation exceeding expectations.

- **Globally**, economic signals are mixed. **China has rolled out new rounds of fiscal and monetary stimulus** to support its faltering economy, though much of the focus has been on boosting equity markets, while measures to address the housing market slump have lacked clarity. Meanwhile, **Europe continues to slow**, with Germany entering into contraction again, adding uncertainty to the global outlook.

- Despite mixed economic data, market reaction has been largely predictable. **Interest rates have risen, delaying expectations for rate cuts**. Equity and credit markets have responded positively to stronger growth prospects, **tightening equity risk premium and credit spreads**. This has pushed valuations higher, which will now require strong revenue growth to justify. The Q3 earnings season, which has just begun, will be crucial in evaluating whether these valuations are sustainable.

- **Volatility remains elevated** due to ongoing uncertainties. The upcoming U.S. elections could significantly impact fiscal policy, including corporate tax rates, while geopolitical tensions in the Middle East and Ukraine continue to pose risks. Given the positive economic outlook but high valuations and political/geopolitical uncertainties, we have adopted a **more defensive stance in portfolio positioning**.

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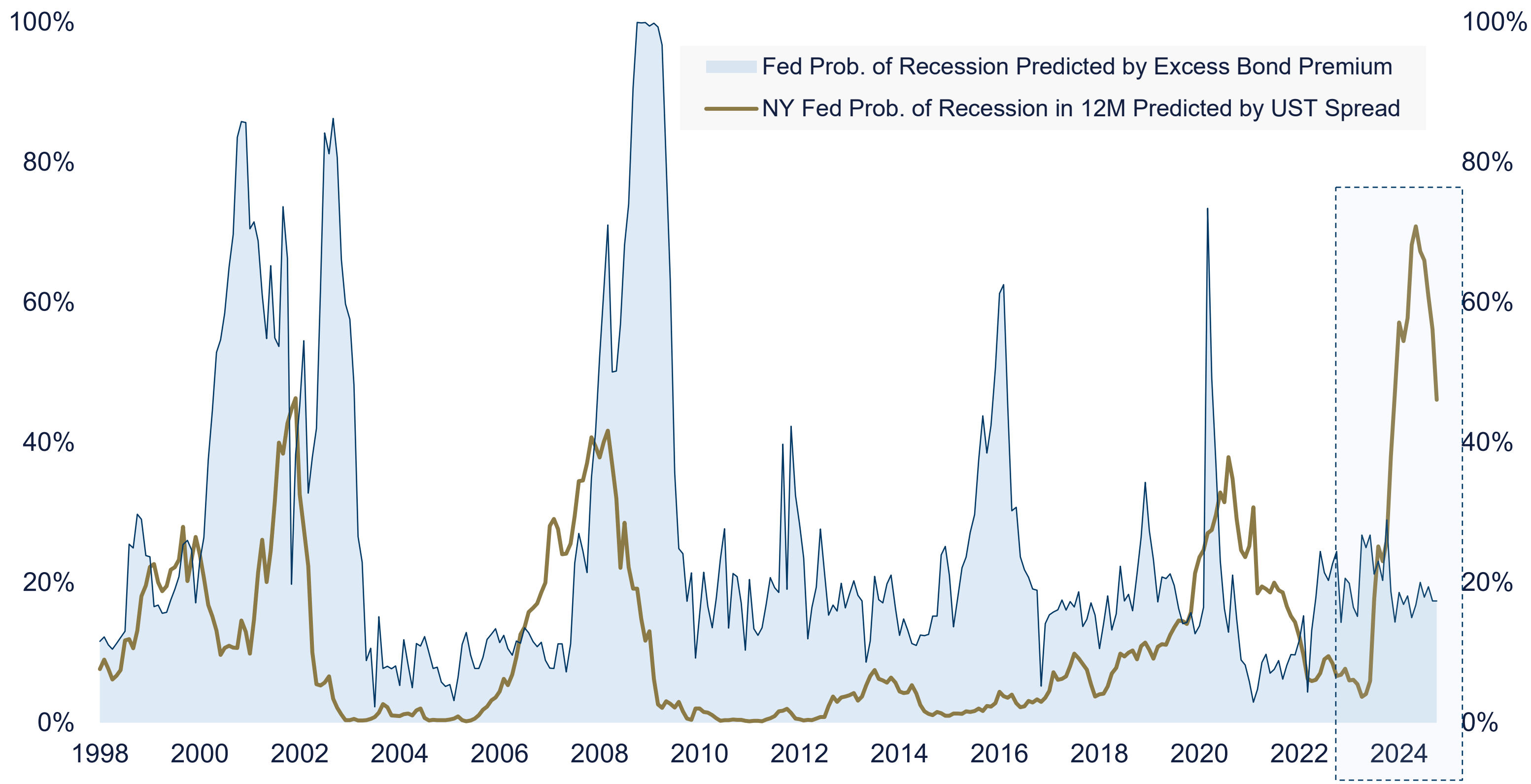
Asset Class		View	Rationale
Fixed Income	US Investment Grade	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. Given the binary macroeconomic risks we are facing (stagflation vs. recession), we favor TIPS and short-duration bonds
	US Credit	+	The Fed's recent shift in policy has reduced the likelihood of a recession. While credit spreads have narrowed, they remain attractive as the default rate is anticipated to stay low
	EU Investment Grade	+	The decisive action of the ECB and the widening of corporate spreads has caused high-quality euro-denominated debt to begin to offer an acceptable risk-adjusted return
	European Credit	=	Prospects for European credit have improved since it is expected that the ECB will follow the Fed in lowering rates. However, the European economy remains more vulnerable to a downturn
	Emerging Markets	=	The prospect of a weaker dollar spurred by the Fed's interest rate cuts has marginally enhanced the appeal of emerging market debt
Equities	US	+	After the 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
	Asia	=	We recommend investing selectively in the region
	Emerging Markets	–	Emerging market 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	+	To complement our core allocation, we favor Healthcare and companies that pay sustainable dividends
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	=	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

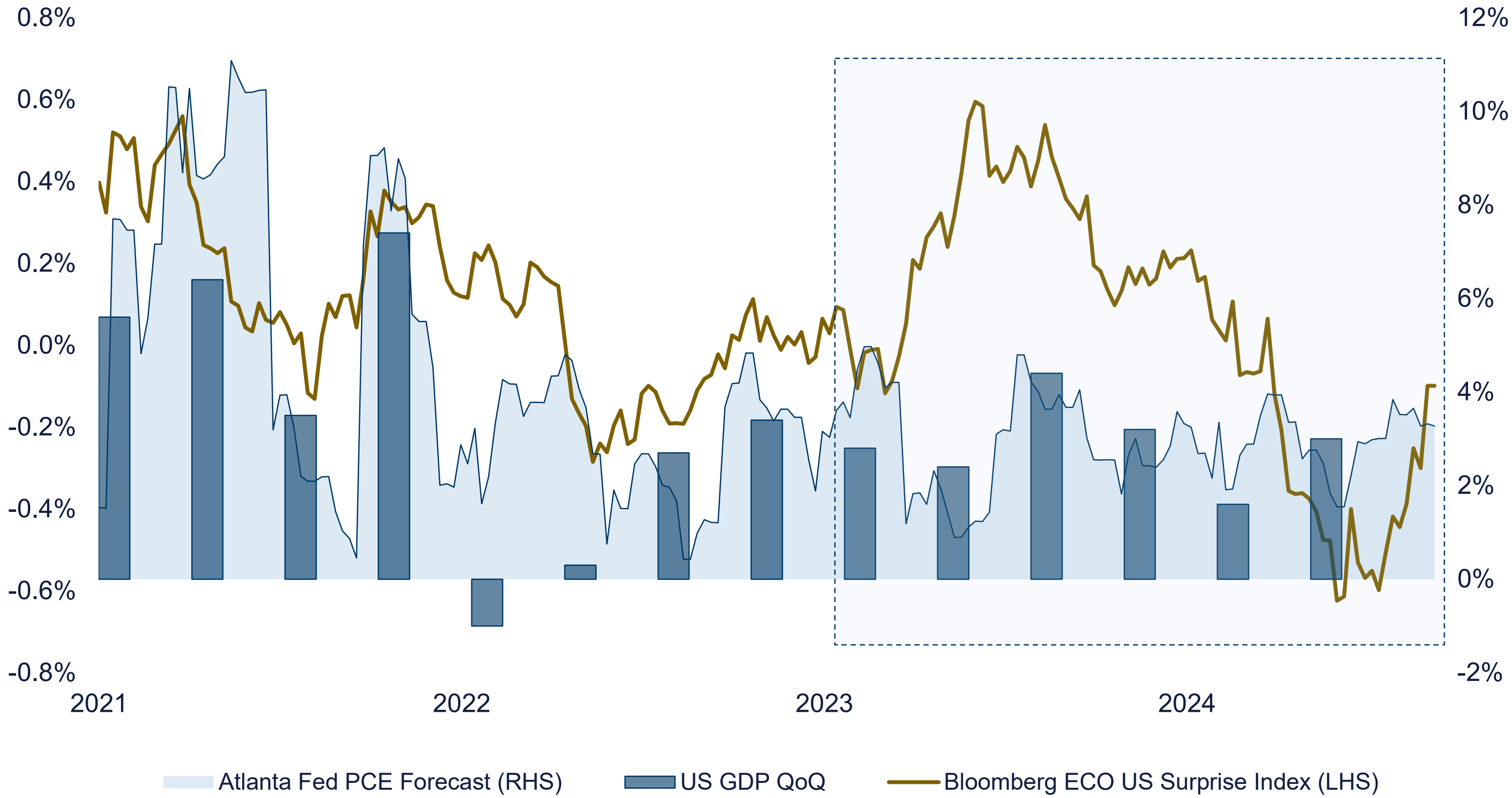
Soft-landed?



- The U.S. economy appears to be **nearing a soft landing** – a scenario first discussed in late 2021 but which seemed elusive as inflation surged and the Fed began raising interest rates.
- Several **leading indicators have signaled a high probability of recession**, highlighting just how unlikely a soft landing once seemed.

Source: Bloomberg

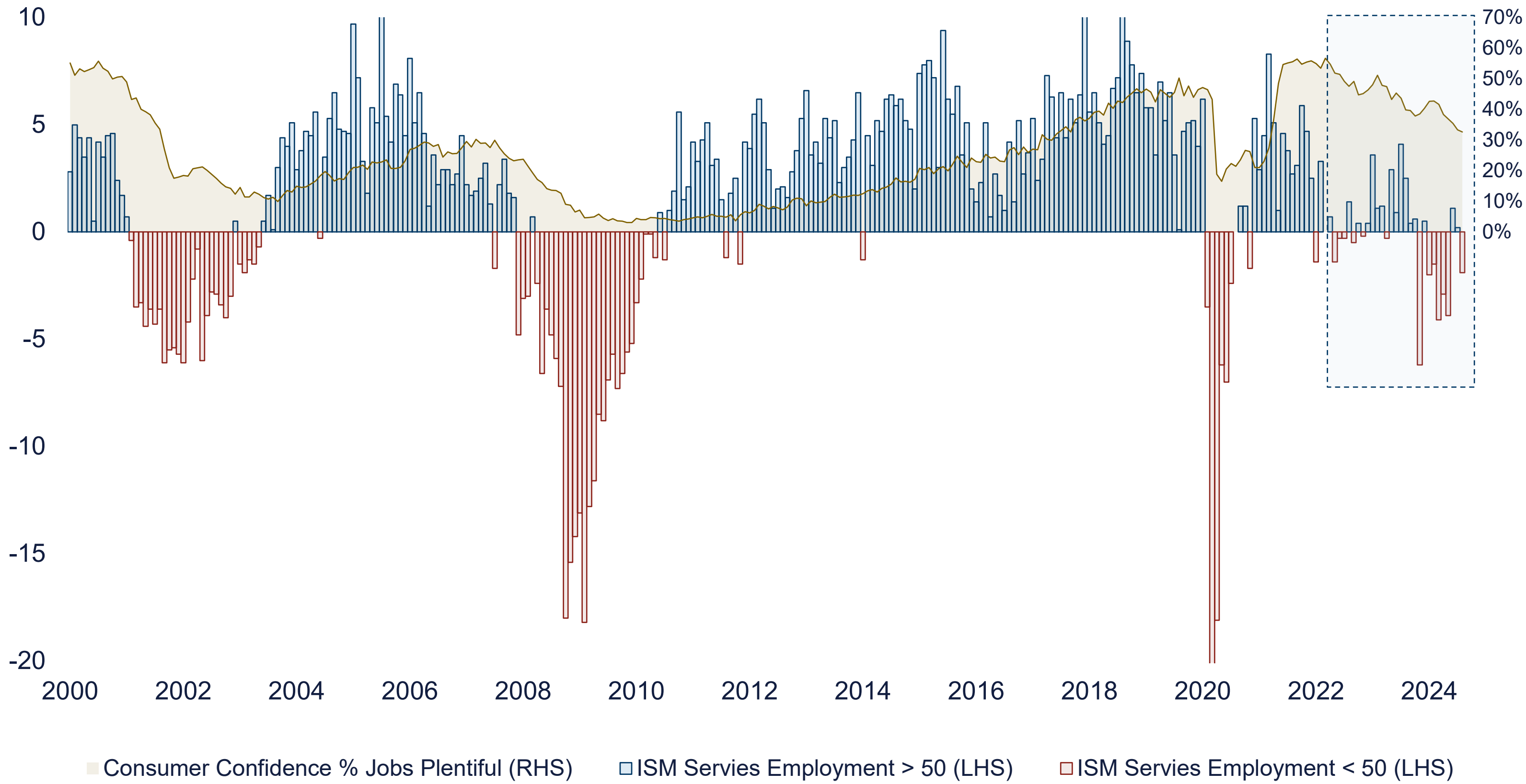
The consumer keeps saving the day



- In the third quarter, **the U.S. economy regained momentum**, with growth projected at a solid 3%. Strong consumer spending continues to offset persistent **weakness in the manufacturing sector**.
- After several months of near contraction, the **Services PMI expanded in September** at its fastest pace since early 2023, **driven by resilient consumer demand**.

Source: Bloomberg

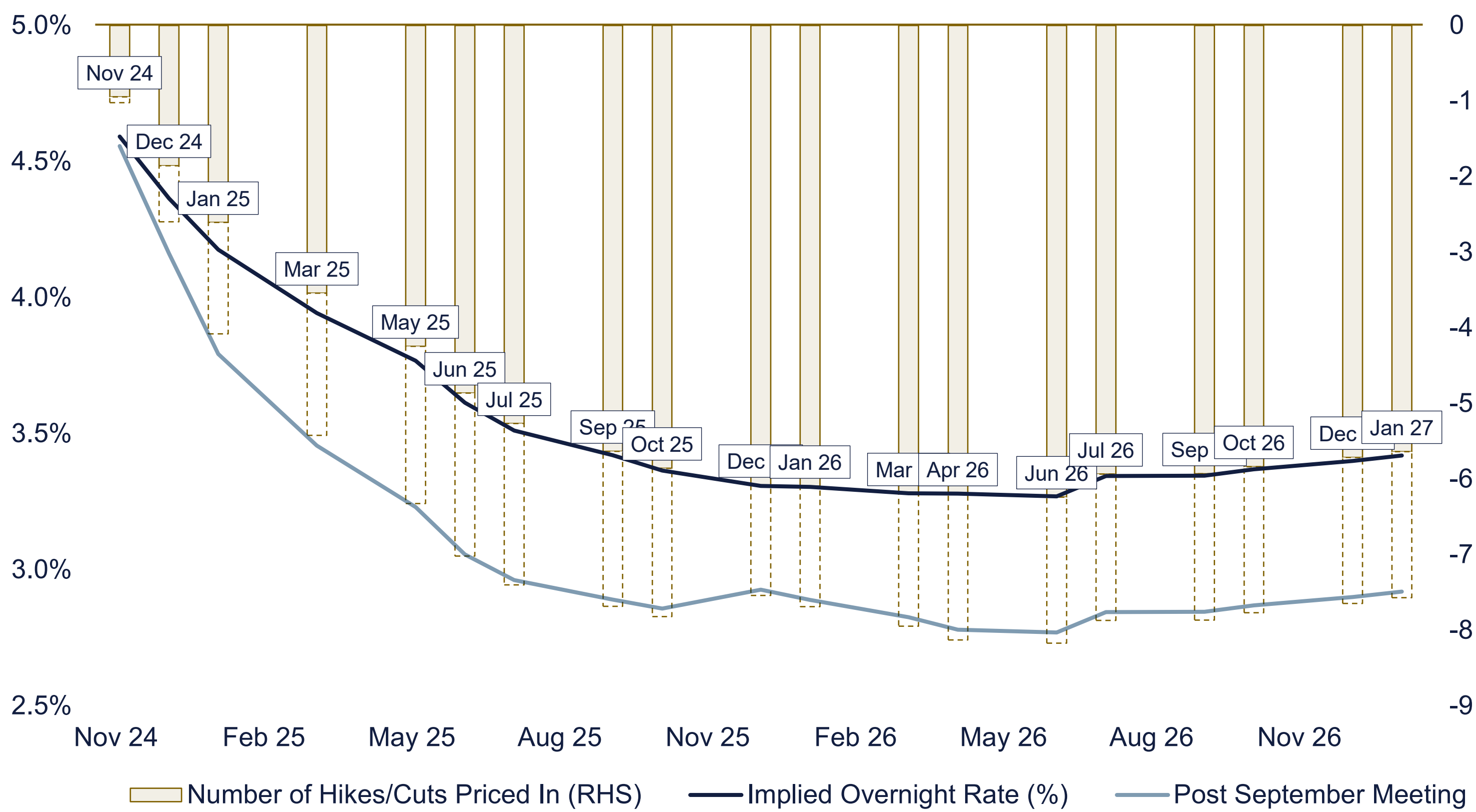
Unemployment bucked the trend, but doubts remain



- In September, unemployment fell from 4.3% in July to 4.1%, with payroll numbers significantly exceeding expectations, **easing concerns about the labor market reaching a tipping point**.
- However, **soft data continues to indicate potential weakness**, including consumer perceptions of job availability and the employment components of both services and manufacturing PMIs.

Source: Bloomberg

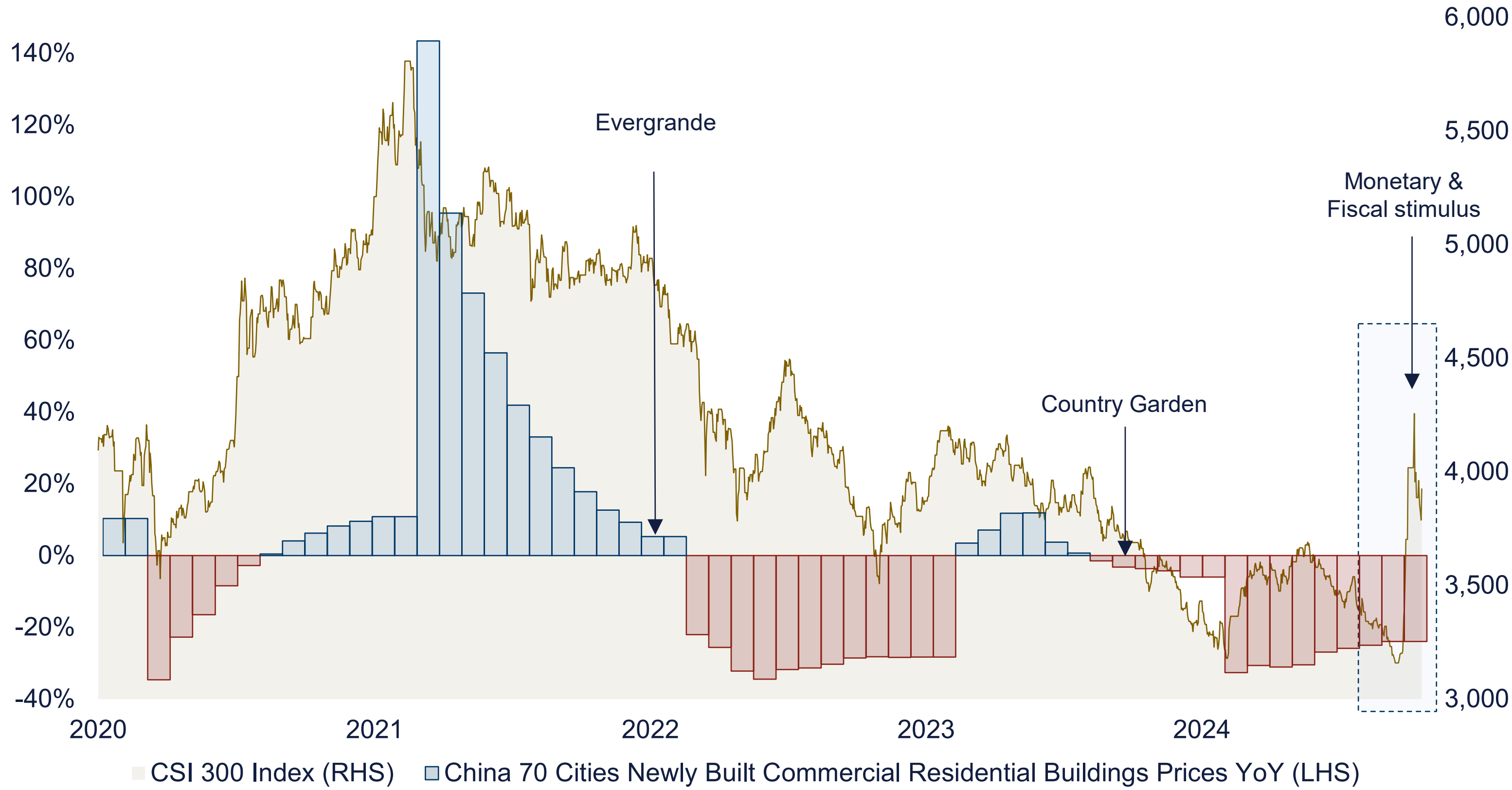
The risk of data-dependency



- With the Fed maintaining a **data-dependent approach**, the strong labor report **suggests less urgency to cut rates**.
- However, as inflation continues to decline, real interest rates are effectively rising. Additionally, the **time lags in monetary policy mean the Fed must consider data 12 to 18 months ahead**, rather than focusing on backward-looking indicators.

Source: Bloomberg

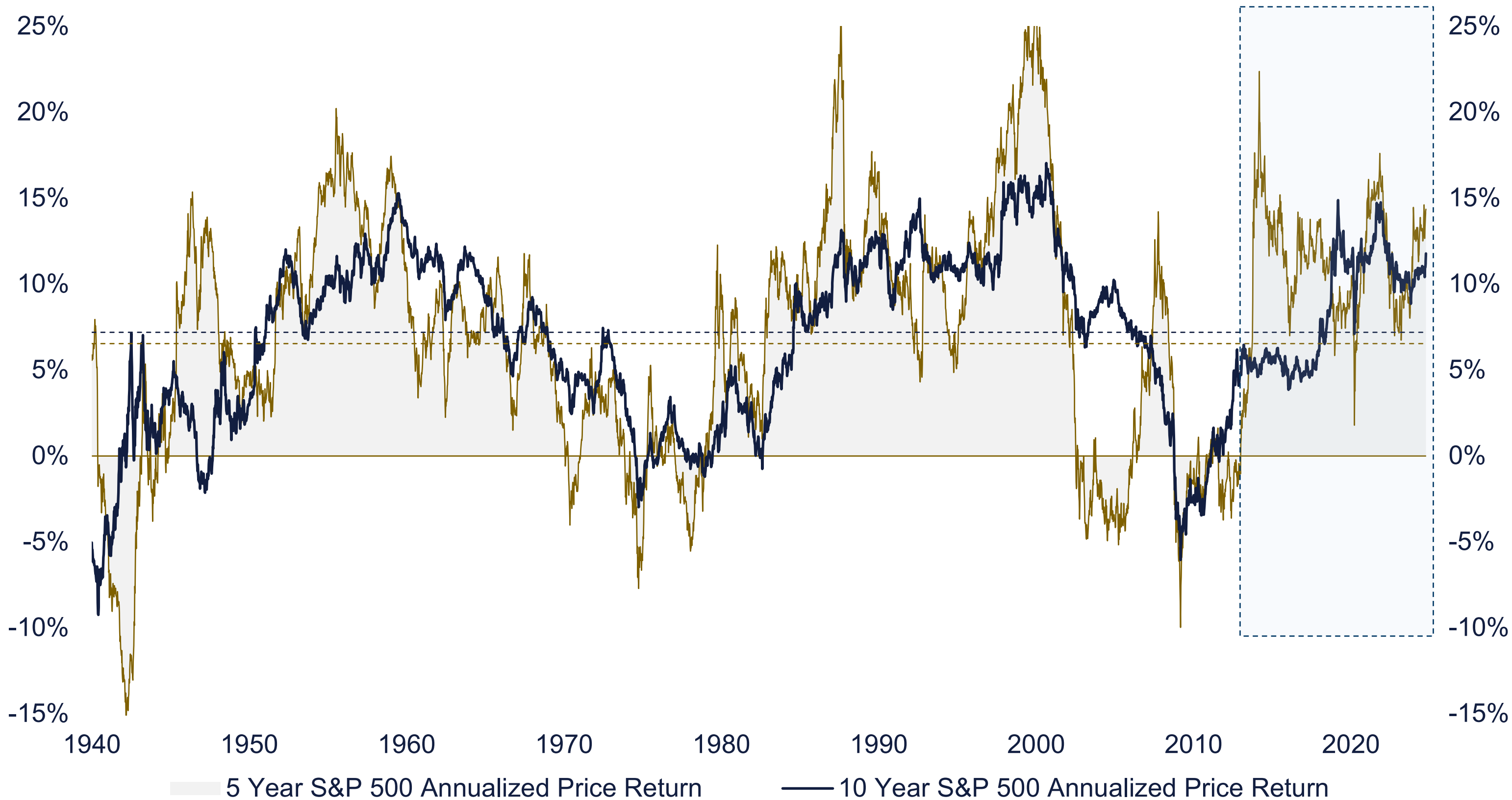
Global context remains weak



- Chinese authorities have introduced a **round of monetary and fiscal stimulus**, primarily aimed at **boosting the struggling stock and housing markets**. However, these measures are far less impactful than previous infrastructure-driven stimulus efforts.
- In **Europe, the manufacturing slump is weighing heavily on Germany and France**, both of which are barely growing. Similar to the U.S., consumer spending continues to support the economy, bolstered by record-low unemployment levels.

Source: Bloomberg

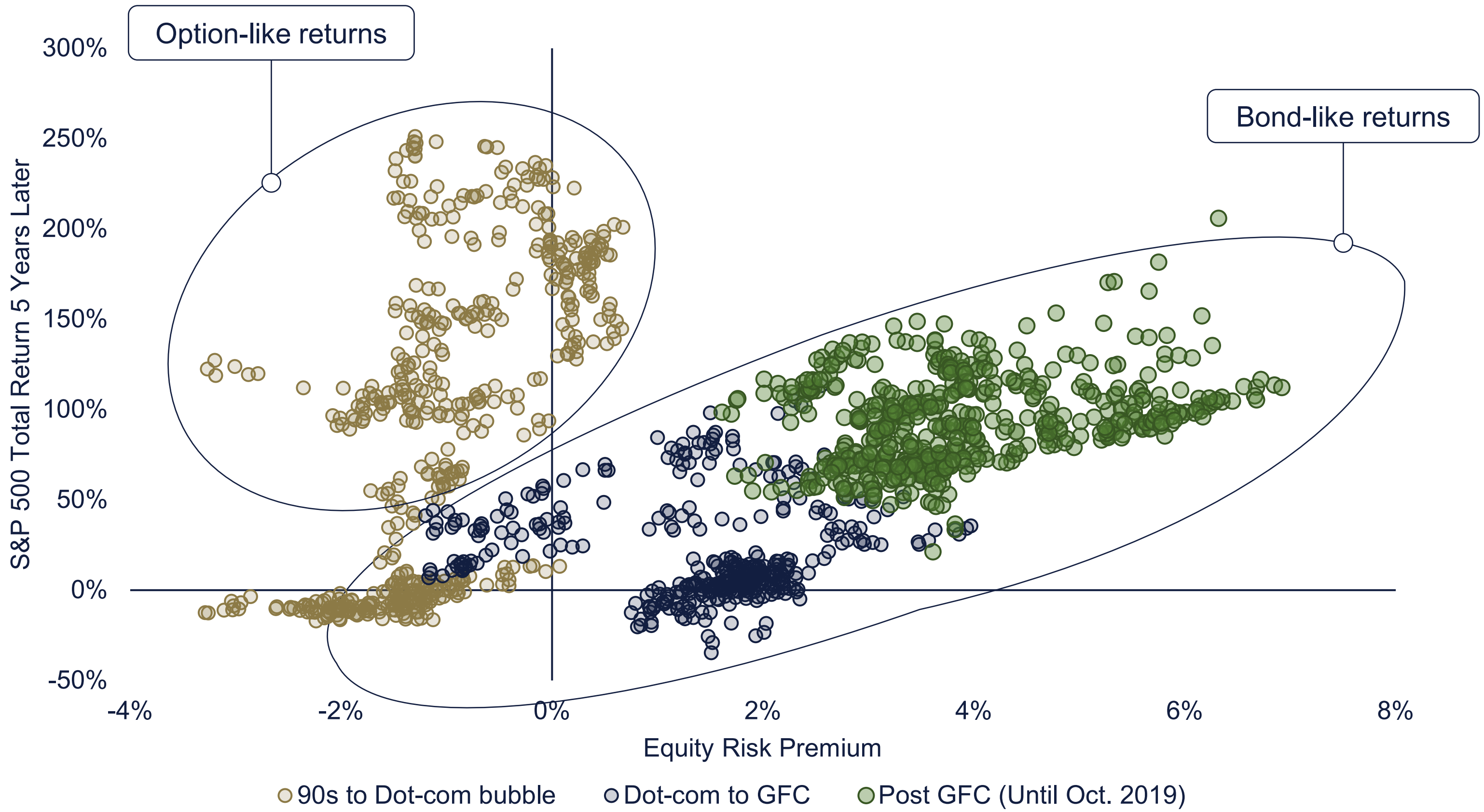
A long winning streak



- Equity markets are delivering **another exceptional year of performance**. Over the past six years, S&P 500 investors have consistently enjoyed above-average returns, and portfolios have avoided losses for the last 12 years.
- While not entirely unprecedented, this trend raises **concerns about whether equity markets are outpacing underlying fundamentals**.

Source: Bloomberg

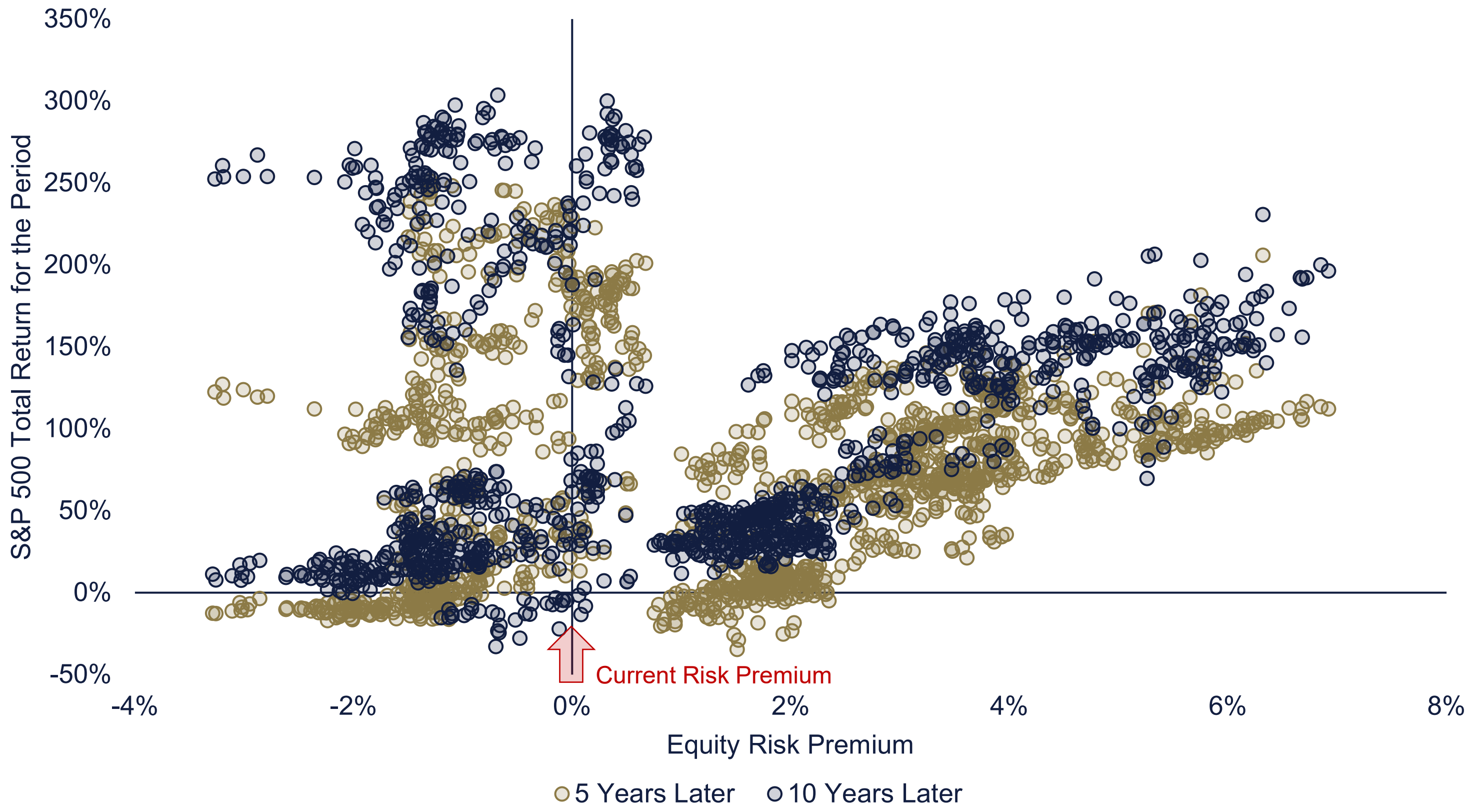
Stocks are not bonds



- **Equity valuations matters to a point**, but they are not the only factor to consider. Unlike regular bonds, the price of a stock reflects a stream of future cash flows that are expected to increase over time.
- The **attractiveness of a stock is determined by its valuation and its growth prospects**. A high valuation can signal strong growth expectations, but it also means the company must deliver significant revenue growth to justify its price.

Source: Bloomberg

How long is long-term?



- Historically, **periods of che equity valuations** have been followed by **positive returns over the subsequent five years**.
- **High valuations may require a longer investment horizon to realize positive returns**, as strong corporate growth is necessary to justify the initial price.

Source: Bloomberg

High (Absolute) Yield

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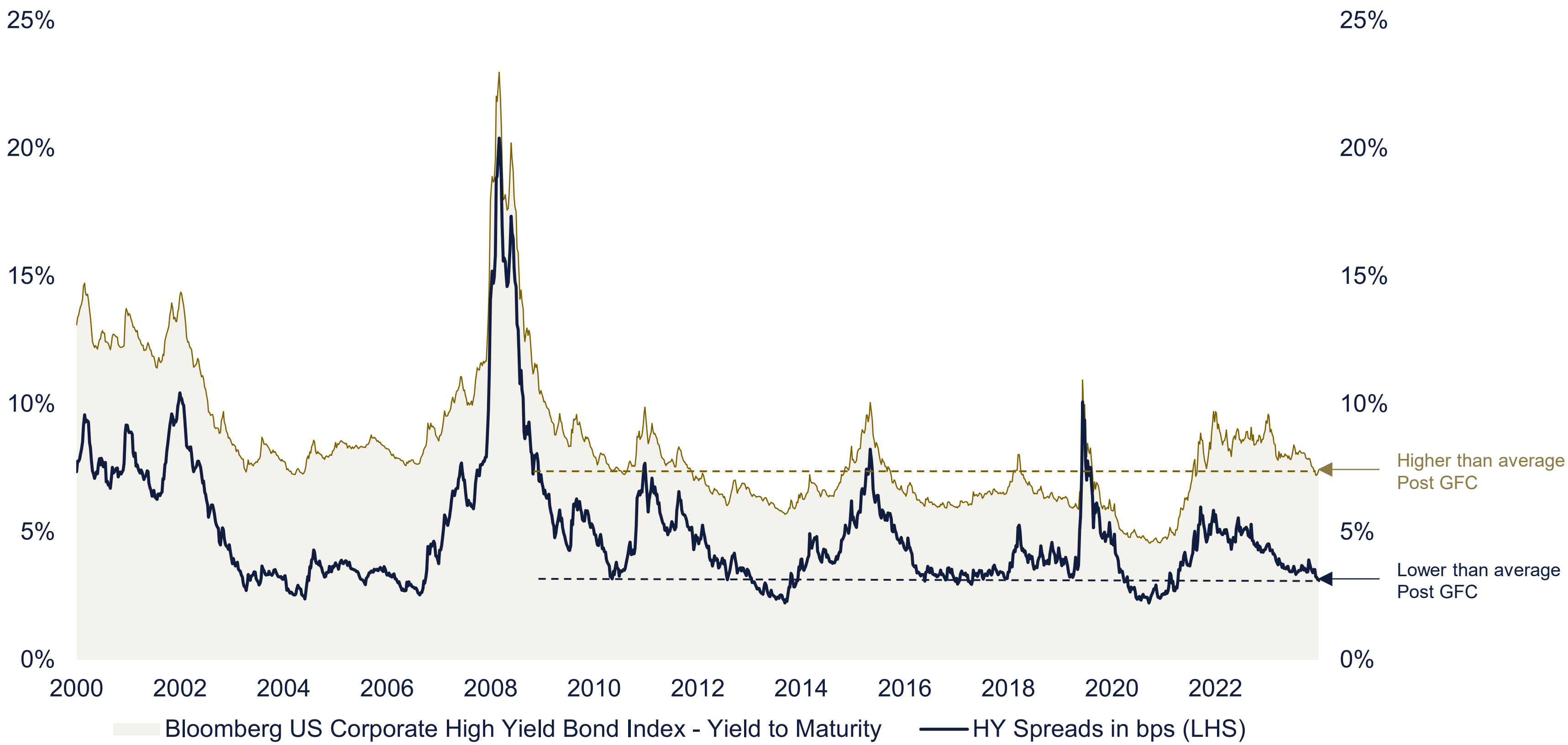
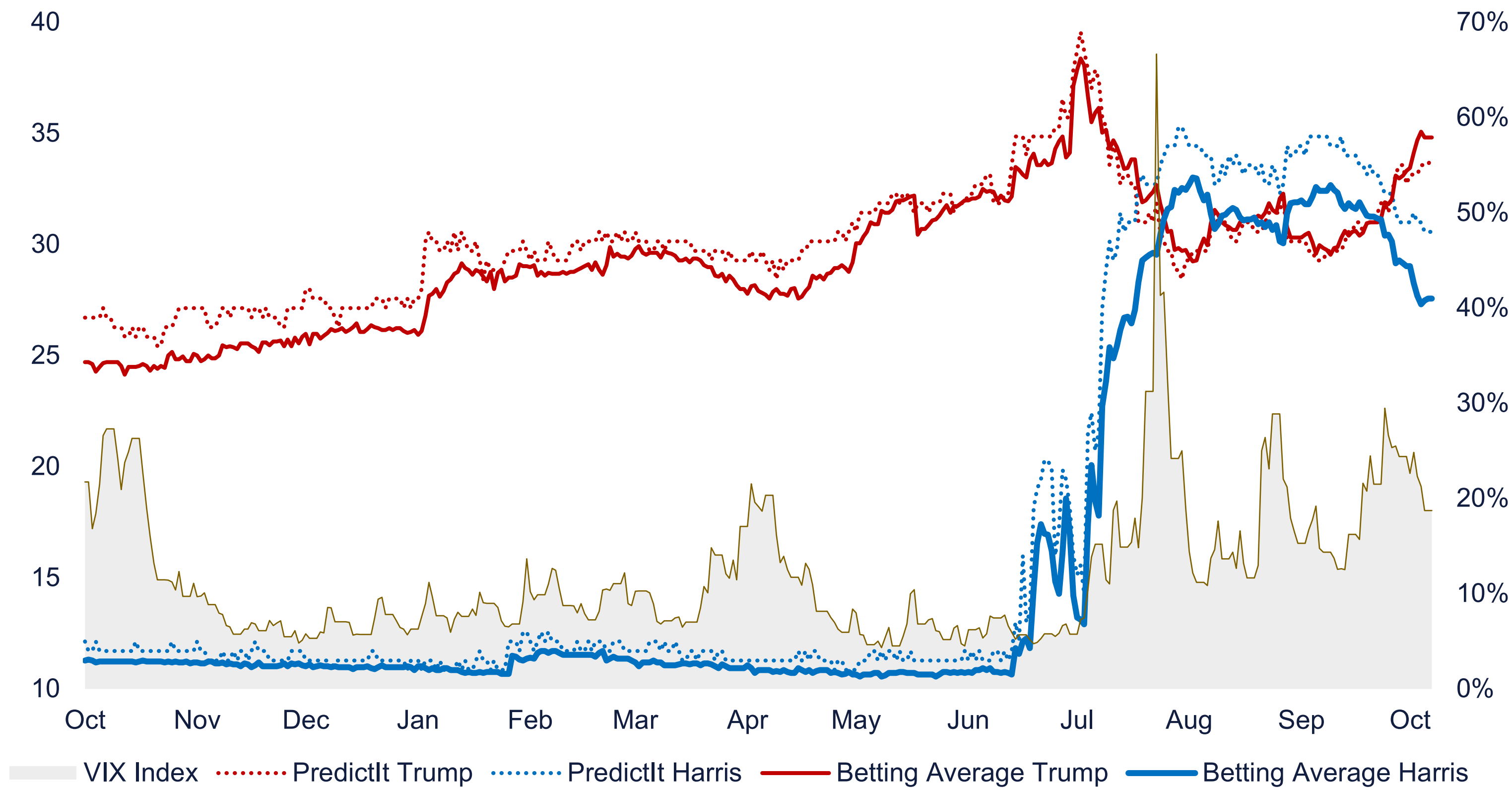


- Current **credit valuations appear quite unattractive**. Credit spreads, which are closely tied to equity markets, are nearing all-time lows. While high equity valuations suggest elevated implicit growth rates, in the credit market, they indicate a low expectation of defaults.
- **However, yields are appealing**, as the Treasury yield curve offers significantly higher rates compared to the previous decade. In the current environment, high-yield bonds have a greater capacity to withstand widening spreads and/or an increase in the default rate.

Source: Bloomberg

Close to the finish line



- The U.S. Presidential Elections are approaching, but **markets have remained relatively calm**. Current **odds favor Donald Trump**, which may suggest that markets are supportive of his fiscal and economic policies. If this is the case, **a victory by Kamala Harris could potentially unsettle markets**.

Source: Bloomberg

Investment scenarios

	Scenario 1 Policy Mistake	Scenario 2 “Boiling Frog”	Scenario 3 “Soft landing”
Drivers	• Sticky inflation persists amid a hot labor market and resilient housing prices, with core services inflation defying the Fed´s 2% target • The Fed must keep interest rates elevated for longer than anticipated • Macroeconomic uncertainty and market volatility increase. Long-term interest rates pick up again along with inflation expectations	• Consumption, which has barely budged despite the sharp increase in borrowing costs, finally adjusts • Firms, which in the face of a tight labor market have been reluctant to lay off workers despite higher costs and sluggish profitability, begin to restructure • In order to help the economy, the Fed is forced to loosen monetary policy aggressively, but it is too late to prevent the economy falling into recession	• Fiscal policy remains accommodative, and the economy continues to grow, avoiding a recession • The Fed pauses rate hikes and eases policy. Inflation continues normalizing without the economy slowing down significantly • The yield curve steepens, credit spreads narrow further, and corporate earnings resume growth. It is the beginning of a new economic cycle
Market impact	• Corporate profits rise if inflation is caused by strong economic growth, 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 appreciates against safe-haven currencies as long as the economy remains strong. Gold gains as inflation expectations get de-anchored	• Equity markets fall, and cyclicals underperform quality and defensive stocks • Credit spreads widen sharply as the prospect of corporate defaults looms • Sovereign debt appreciates due to "flight to quality“ and lower interest rates. Commodity prices will fall. • The US dollar will depreciate if the Fed leads the way cutting interest rates and / or if the economic slowdown is not a global phenomenon. Otherwise, "flight to quality“ will support the US dollar	• Equity markets rally, as the economy returns to the “Goldilocks”, and valuation multiples widen • Credit spreads tighten further as investors chase yield again • High-quality and sovereign debt trade range-bound • Commodity prices stabilize. The fate of the US dollar is determined by growth differentials and real interest rate differentials
Probability	10%	30% (-5%)	60% (+5%)

Short-term catalyzers

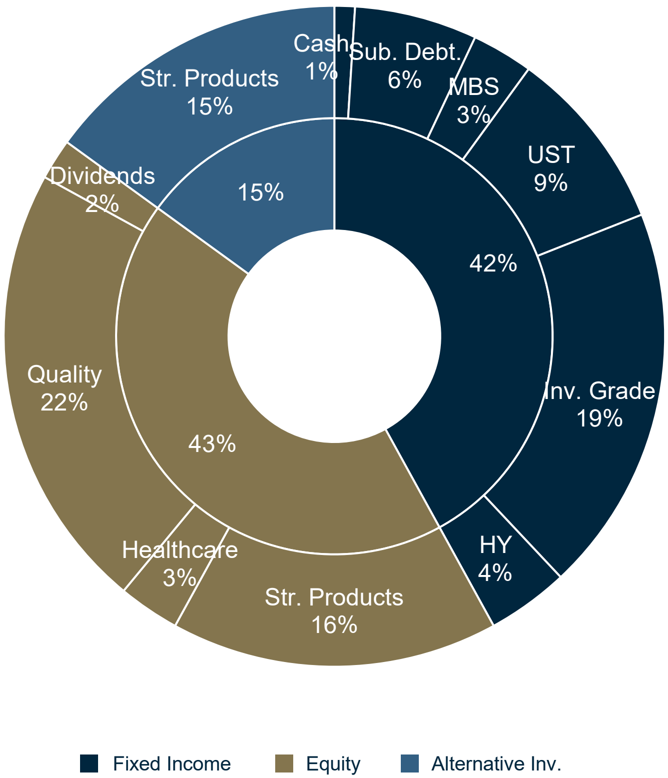
Peace agreement in Ukraine, Slowdown in inflation, Supply chain problems continue to ease

Other risks

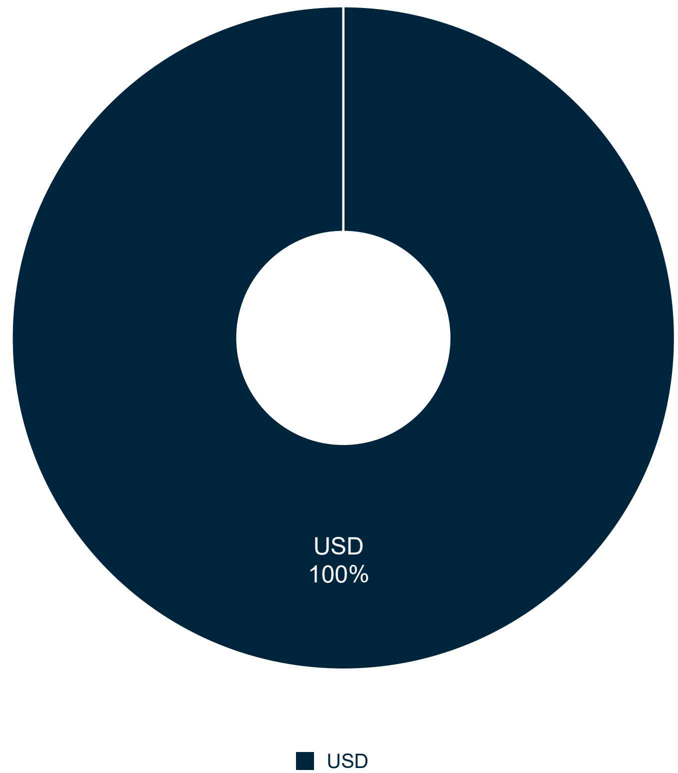
US Presidential Election, Debt ceiling, Escalation of geopolitical tensions, China slowdown, Housing market correction

Boreal Balanced Portfolio USD

Asset Allocation



Currency Allocation



Boreal Investment Profiles

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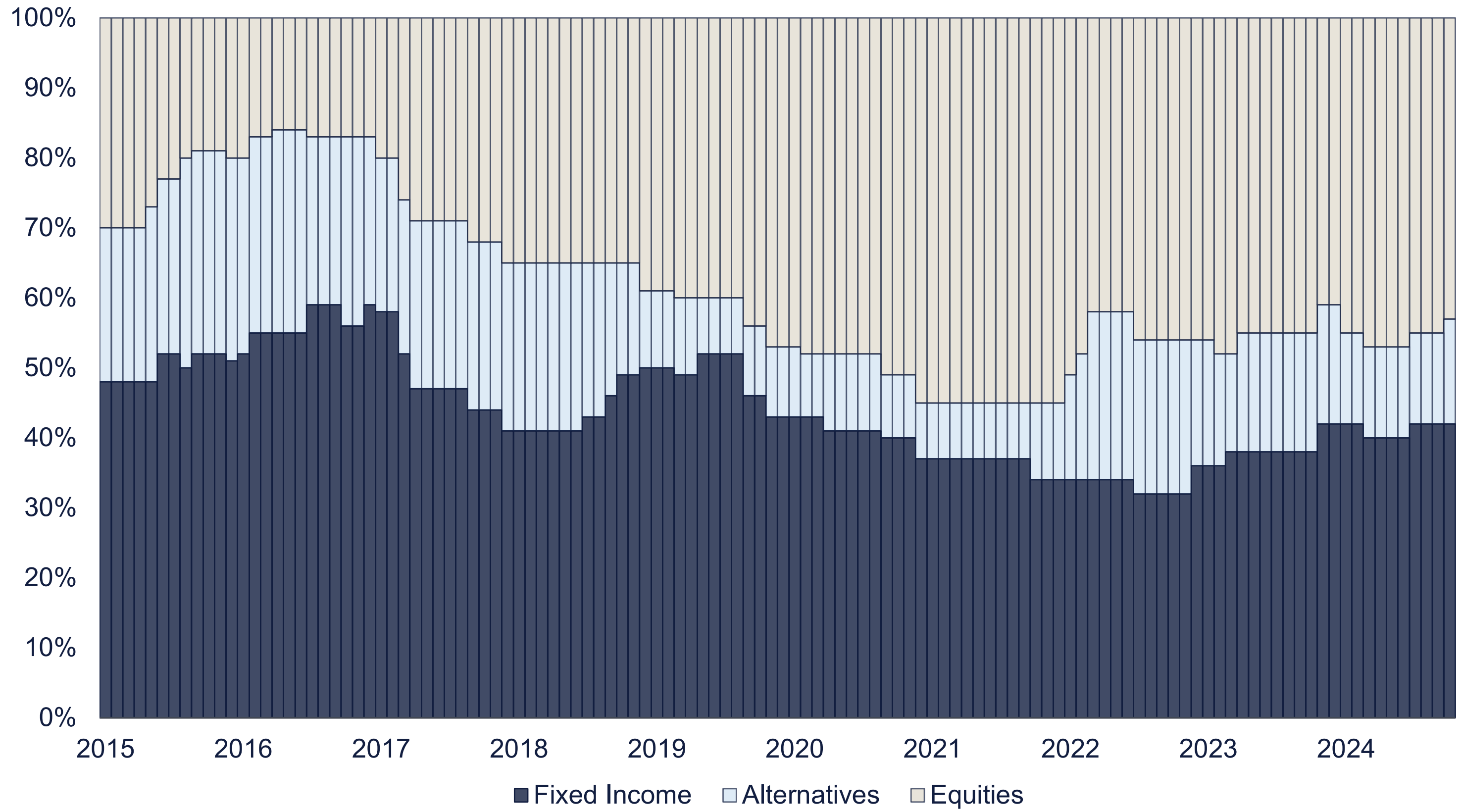
	Extra-Conservative	Conservative	Balanced	Growth
Cash & Fixed Income	▼ 86% 87%	▼ 66% 66%	▼ 44% 42%	▼ 22% 19%
Equities	▼ 10% 5%	▼ 30% 24%	▼ 50% 43%	▼ 70% 62%
Alternative Investments	▼ 4% 8%	▼ 4% 10%	▼ 6% 15%	▼ 8% 19%

▼ Strategic Asset Allocation

Boreal Balanced Portfolio – Asset Allocation evolution



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