Investment Policy

November 2024

BOREAL
CAPITAL MANAGEMENT

Our market view in a nutshell – November 2024

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- Over the past weeks, **markets have been driven by the outcome of the U.S. elections**. While prediction markets had largely anticipated a Donald Trump victory, the confirmation of his win—coupled with the Republican clean sweep of the Senate and House—exacerbated market reactions. Equity markets surged, the U.S. dollar strengthened, and Treasury bonds declined.

- Trump's economic agenda, focused **on tax cuts and deregulation,** has boosted expectations for accelerated **economic growth and higher corporate earnings**, at least in the near term. However, the **inflationary effects of tariffs and immigration restrictions** could push interest rates higher. Concerns about the **sustainability of government debt** are also likely to intensify, as offsetting tax cuts with tariffs carries significant economic risks.

- A shift to a regime of higher growth, inflation, and interest rates would resemble past economic cycles, which have historically proven less stable. Despite heightened policy uncertainty, **investors should avoid overreacting**. The U.S. economy and its markets remain exceptionally resilient, and, as with previous administrations, the new government will likely prioritize preserving these strengths. Speculative bets against the U.S.—particularly those driven by political preferences—often come with high opportunity costs over the long term. That said, **investors should temper expectations of a repeat of the "Trump trade" from 2016**, when inflation and interest rates were much lower, the fiscal deficit was half its current size, and the equity risk premium stood at 3.5% compared to -0.5% today.

- Amid the election-driven focus, the Fed quietly reduced interest rates by 25 basis points. **Future rate cuts have been scaled back**, not due to political developments, but because of improving economic data. Fed Chair Powell reaffirmed the Fed's **data-dependent approach**, emphasizing that policy responses will wait until proposals become concrete.

- Attention has since returned to corporate earnings, with Q3 results now offering greater clarity. Companies have achieved their **fifth consecutive quarter of earnings growth**, marking a full recovery from the 2022 slump. Nevertheless, earnings growth remains critical as rising equity prices and higher interest rates have continued to worsen valuations.

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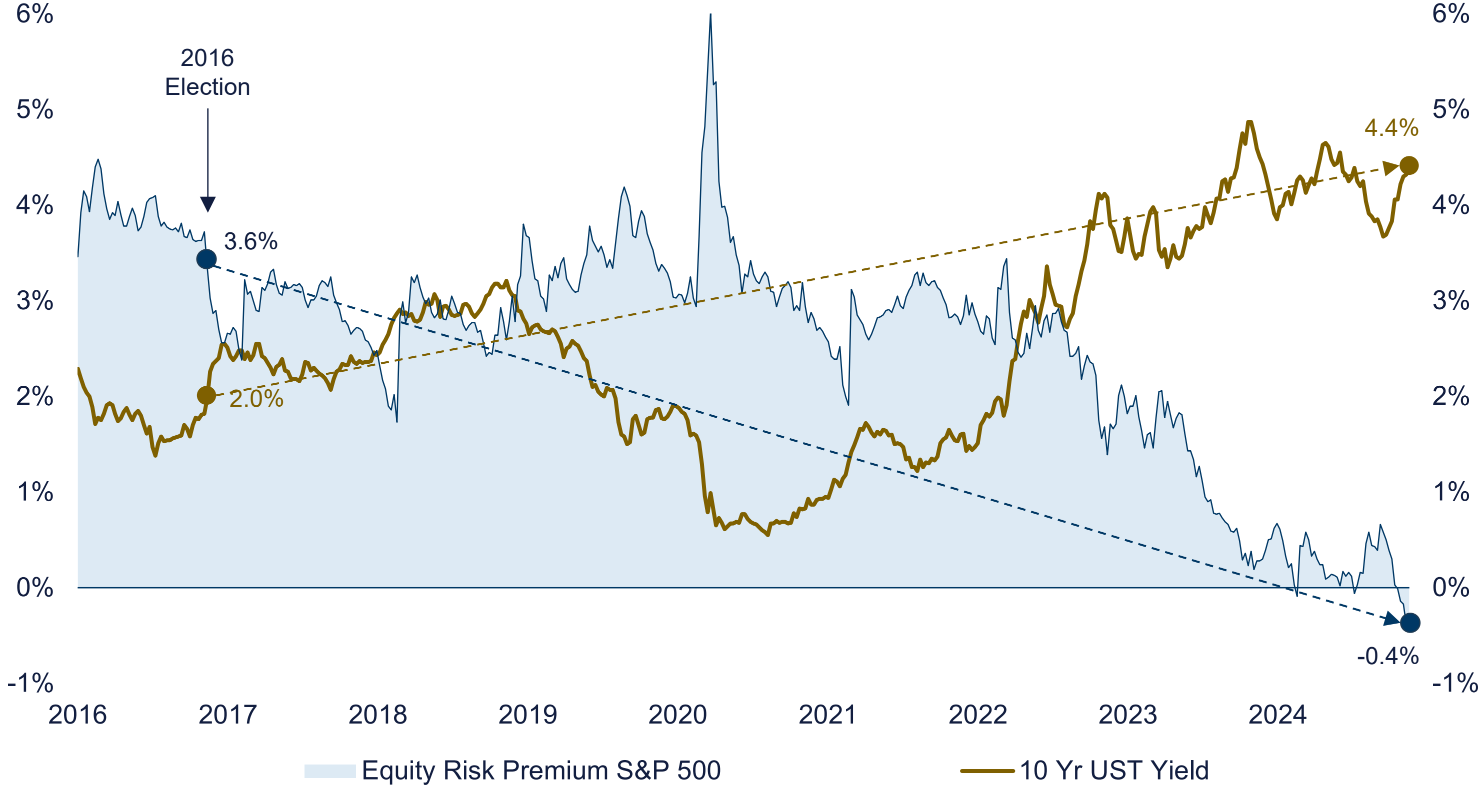
	Asset Class	View	Rationale
Fixed Income	US Investment Grade	+	Treasury bonds offer protection against an economic slowdown and / or increased risk aversion. We favor short to medium maturities
	US Credit	+	The Fed's recent shift in policy has reduced the likelihood of a recession. While credit spreads 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

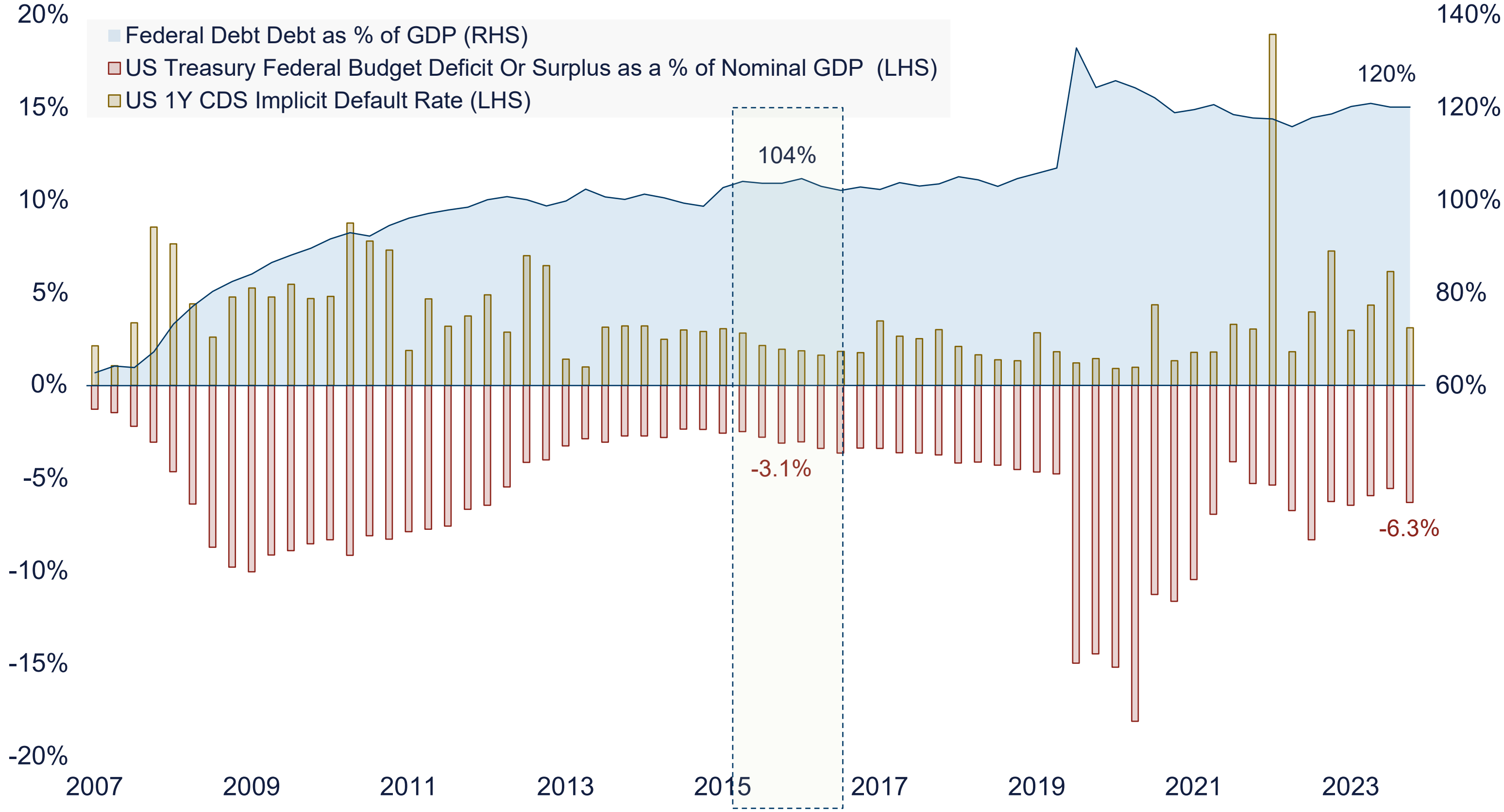
A different starting point



- Sequels often fail to perform at the box office as strongly as the original films. Similarly, **the "Trump trade" from 2016 occurred under very different conditions**: inflation and interest rates were much lower, and the equity risk premium was at 3.5%, compared to -0.5% today.
- Investors should **exercise caution before assuming a repeat of the 2017 market rally**. This time, reviving the "animal spirits" of the markets will likely prove far more challenging.

Source: Bloomberg

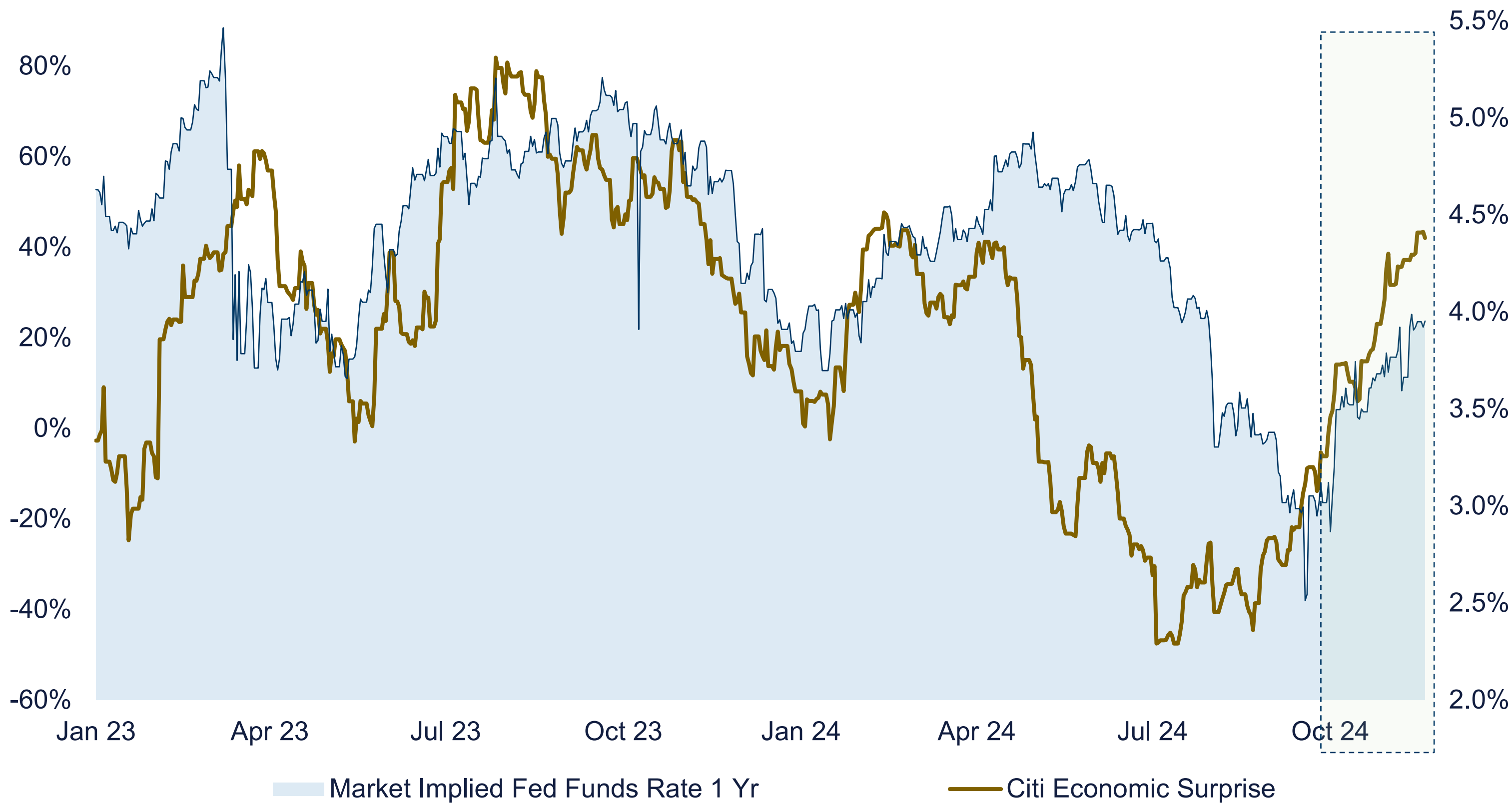
With less room for maneuver



- Additionally, the new administration's **room for maneuver will be significantly constrained by the fiscal deficit**, which is now double its size compared to 2016.
- While tax cuts are likely to widen the deficit further in the short term, **the extent to which tariffs can offset this remains uncertain**. Tariffs represent an untested policy tool in this context and could introduce significant economic and geopolitical risks.

Source: Bloomberg

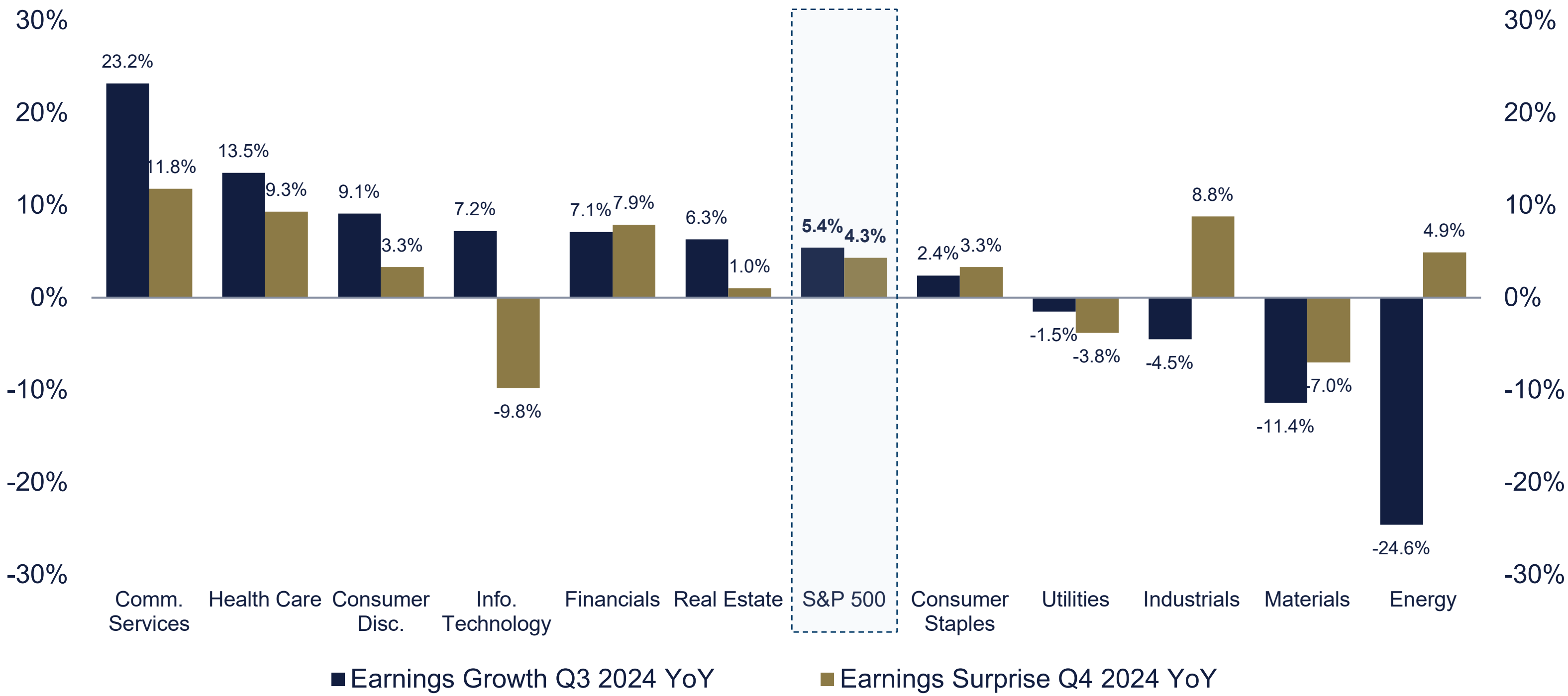
Data, not policy dependency



- The Fed maintained its **data-dependent approach**, prudently setting aside the potential impact of proposed economic policies until they materialize.
- **Macroeconomic data for the month was broadly supportive**, with service and consumption surveys showing continued improvement. Unemployment held steady at 4.1%, and inflation aligned with expectations.

Source: Bloomberg

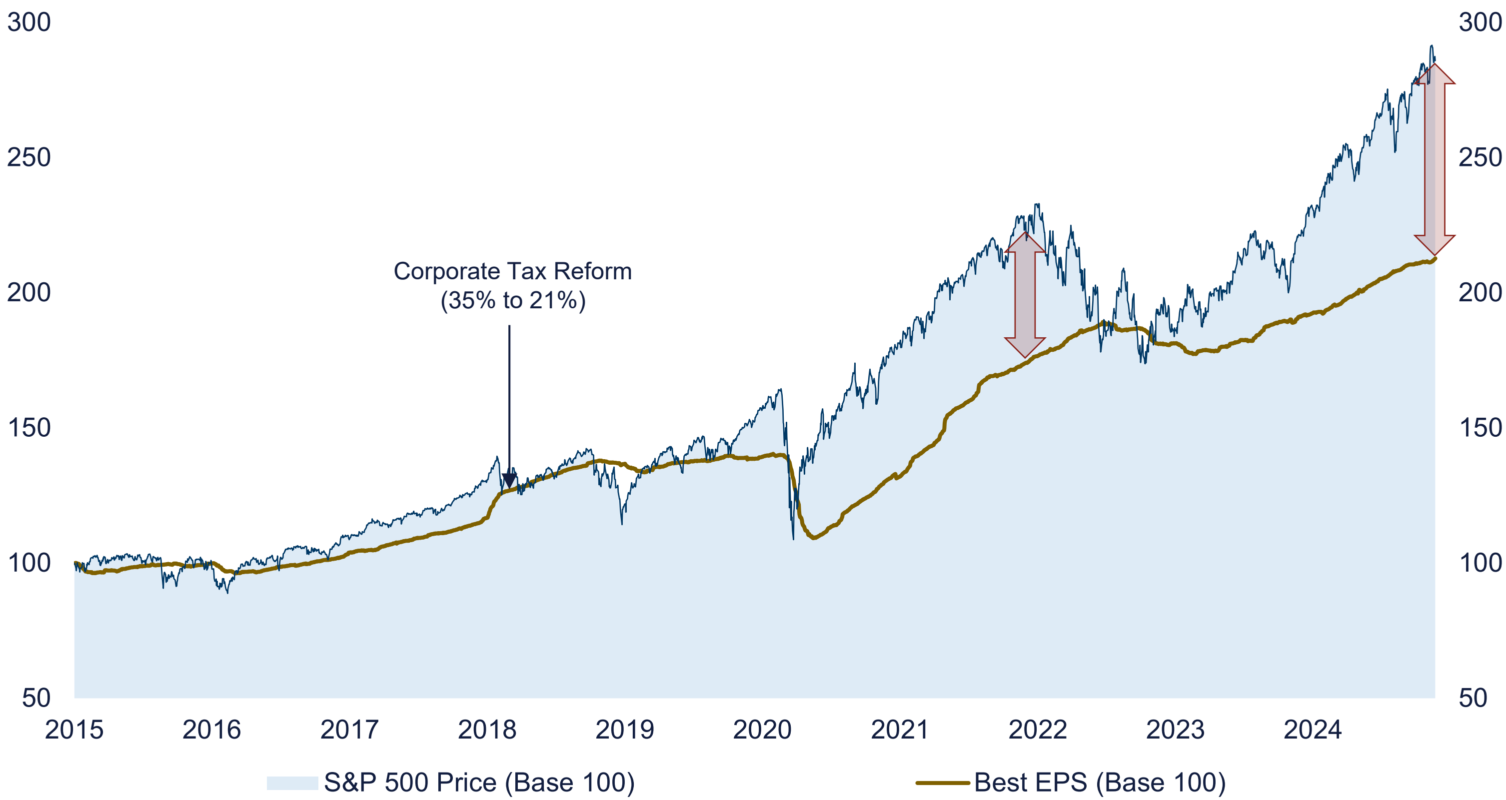
Earnings recession is over



• With the third-quarter earnings season now complete, the outlook for equities remains supportive. Earnings surprises have been below the 10-year average of 8.5%. However, **earnings growth has accelerated compared to Q2,** with companies reporting their **fifth consecutive quarter of earnings growth**, signaling a full recovery from the 2022 slump.

Source: Bloomberg

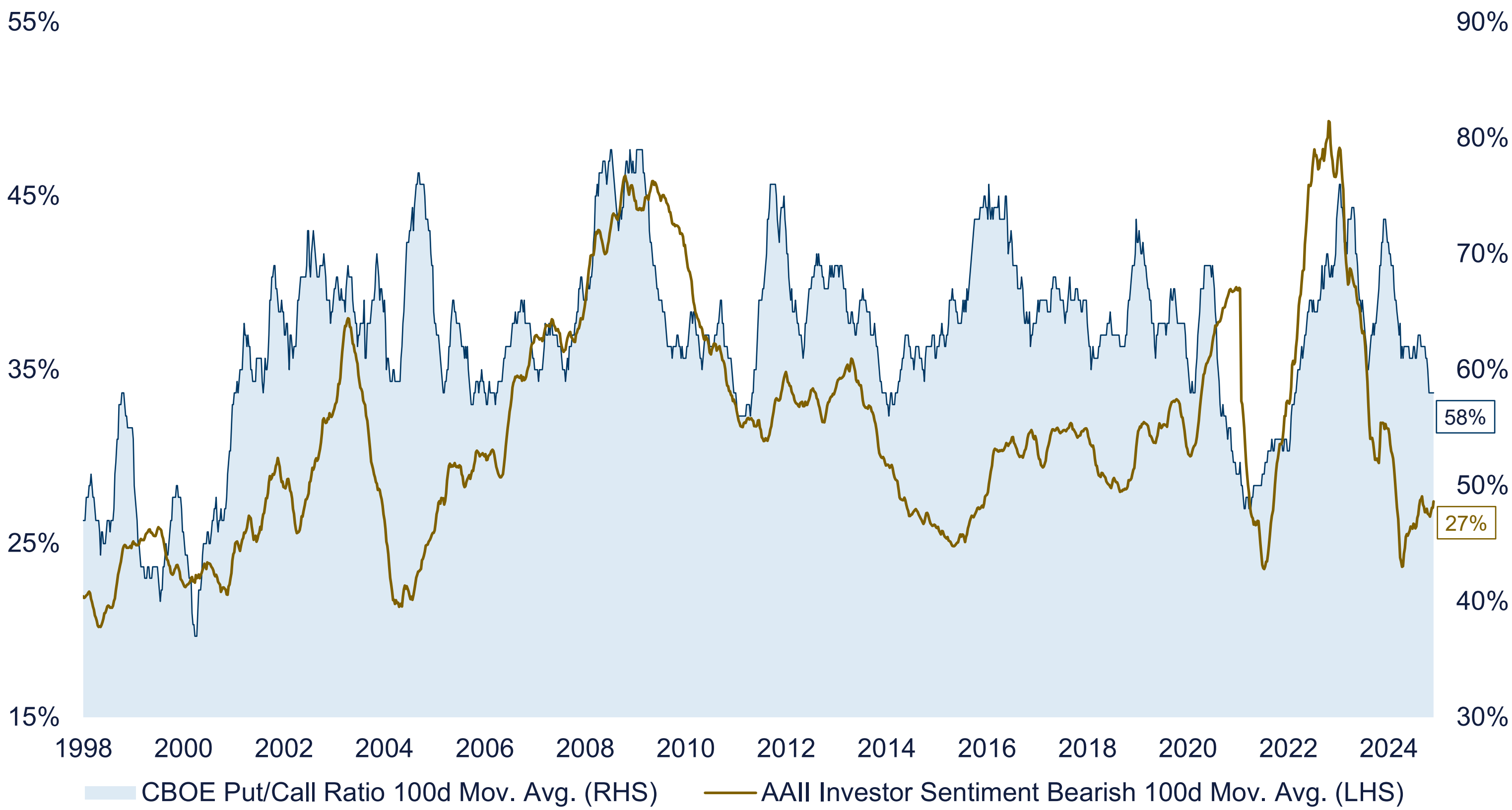
Stock prices are rising faster than earnings



- Despite the **positive trend in earnings, stock prices are rising at a faster pace**.
- While this could reflect investor anticipation of further corporate profit growth, it also raises **concerns of overvaluation**, especially in an environment of higher, rather than lower, interest rates.

Source: Bloomberg

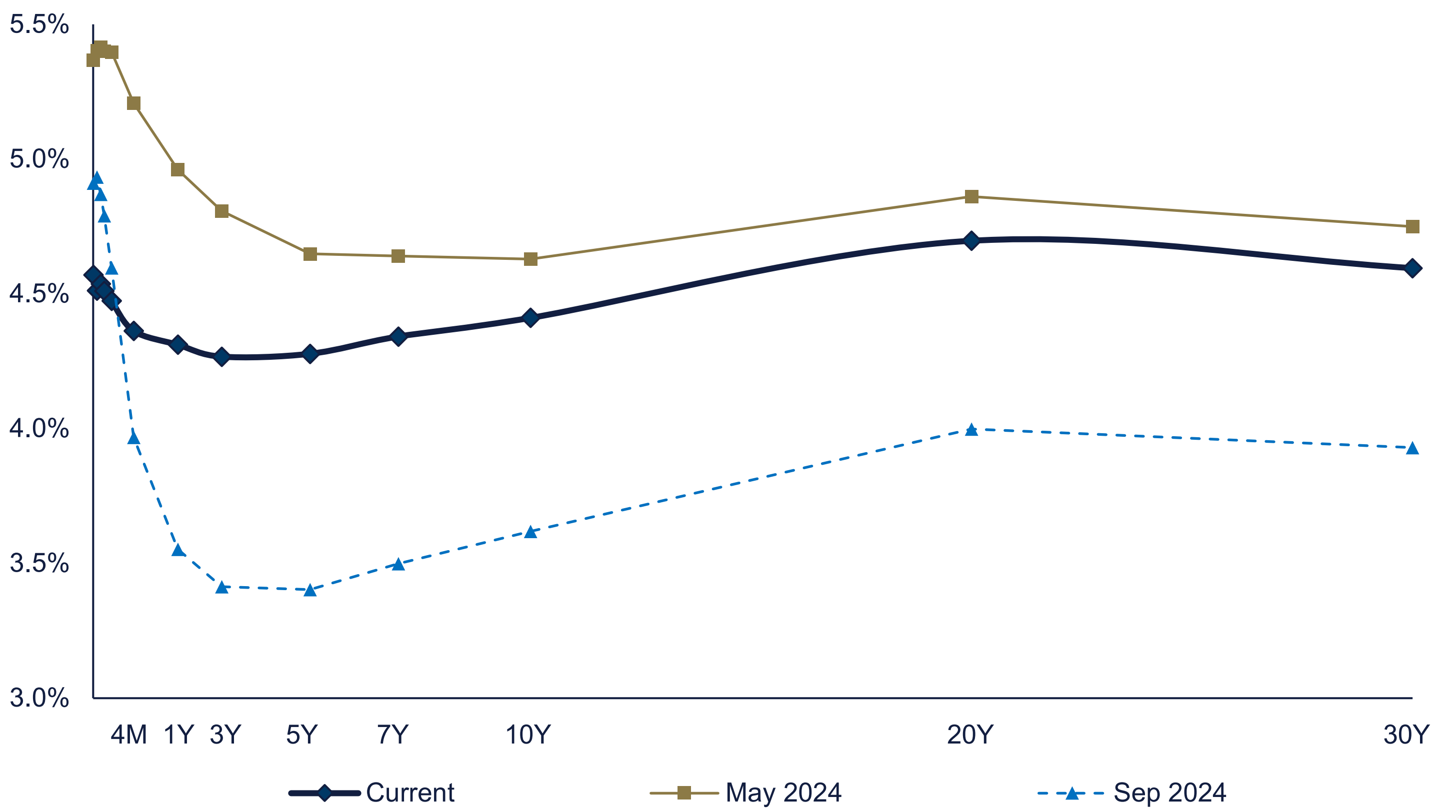
Momentum = Complacency



- Investor **sentiment remains bullish**, providing **another indication of potential overvaluation** in equities.
- Markets appear increasingly complacent, with **performance driven largely by momentum stocks**, which are significantly outperforming other factor styles.

Source: Bloomberg

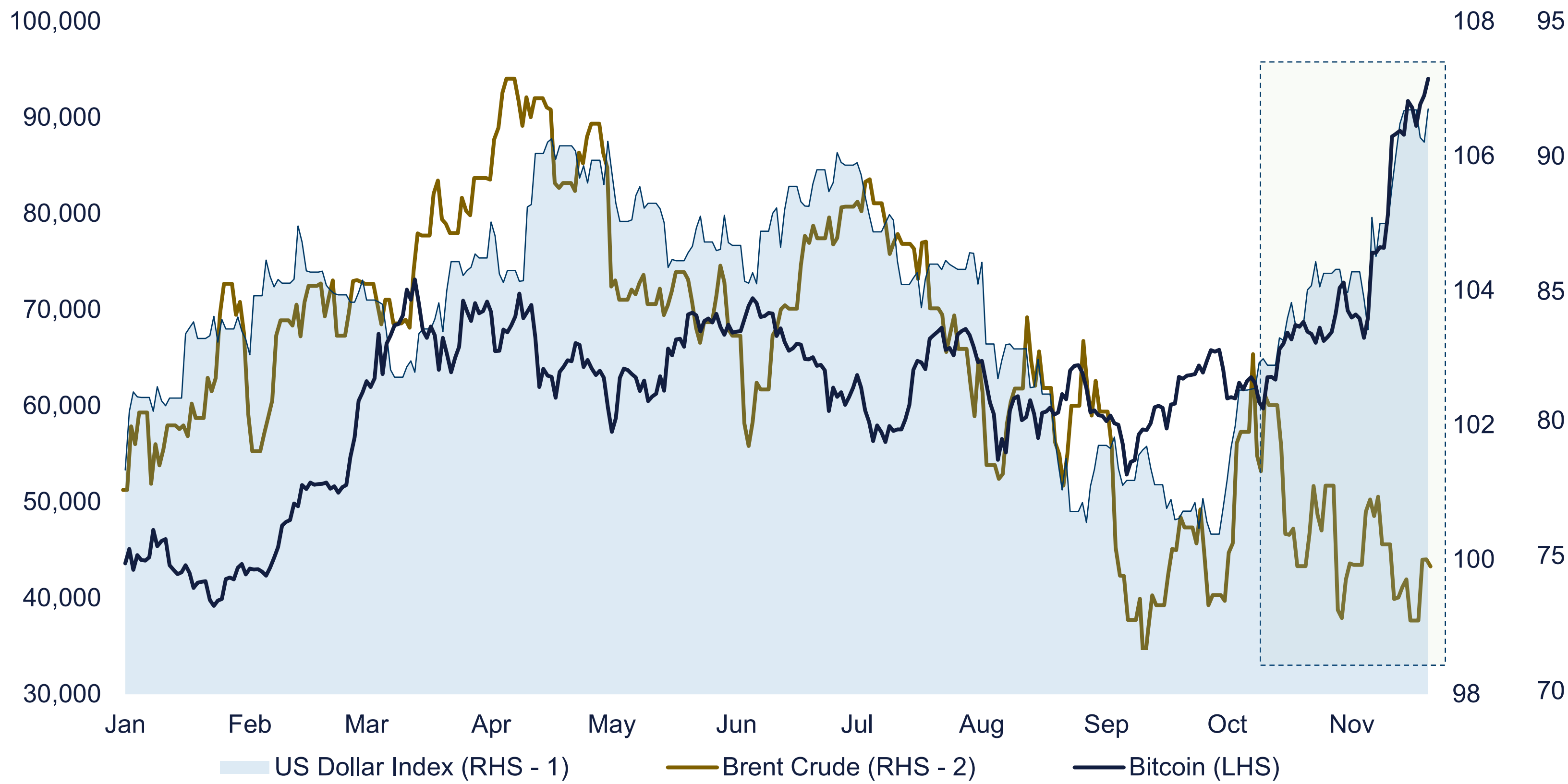
Another big swing



- **Interest rates have rebounded sharply** from the September lows. The 10-year U.S. Treasury yield has risen by 80bps, now at 4.4%, well above the start-of-year level of 3.9% and nearing the April peak of 4.7%. These are significant movements in interest rates.
- With the Fed expected to reduce rates to around 4%, **the yield curve remains very flat**, offering little term premium to investors.

Source: Bloomberg

Fiscal (and Crypto) risks to the dollar



- The U.S. **dollar could appreciate if the economy grows faster, and tariffs reduce the trade deficit**.
- However, **rising fiscal deficits may dampen demand for U.S. Treasuries**. Additionally, **Trump's policies towards cryptocurrencies could undermine the dollar's role** as the global reserve currency. This is an increasing area of concern, as cryptocurrencies become more integrated into global financial markets infrastructure.

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%	25% (-5%)	65% (+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

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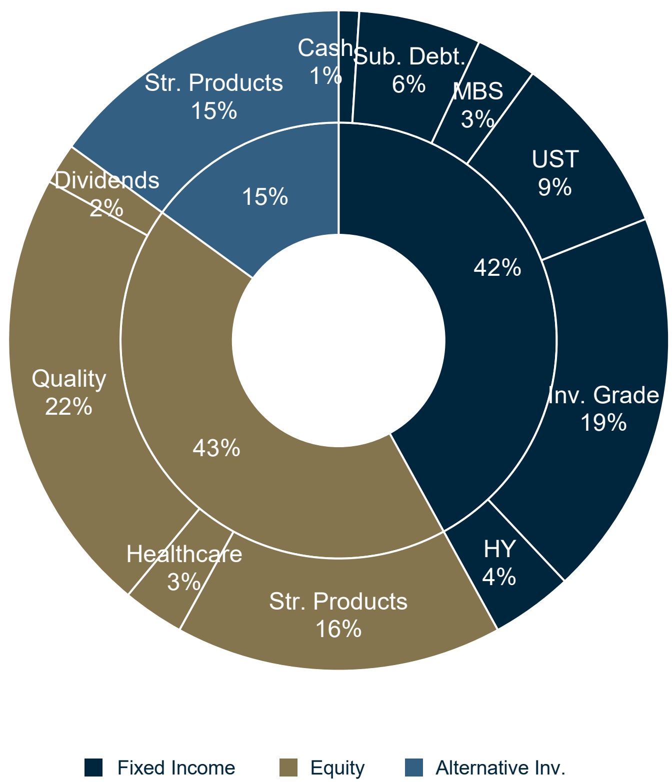
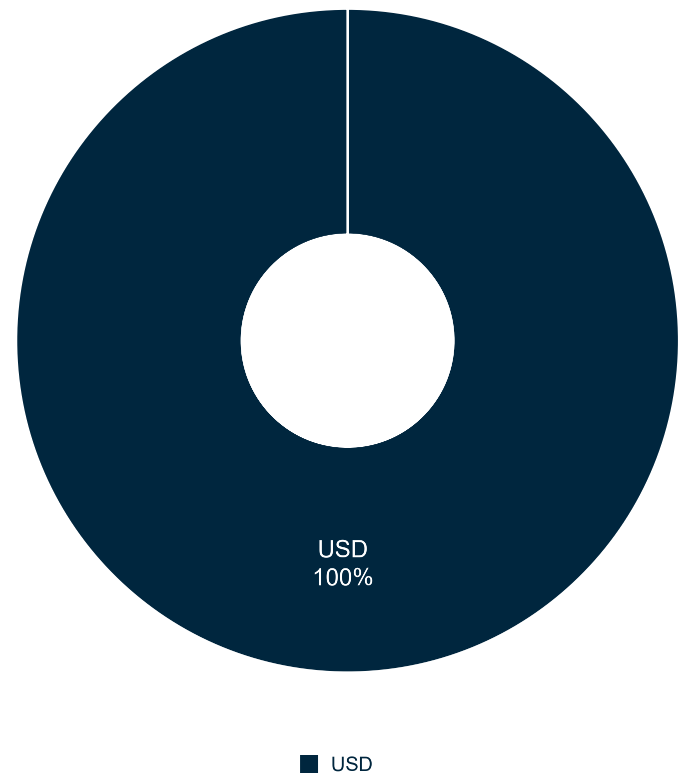
Asset Allocation



Currency Allocation

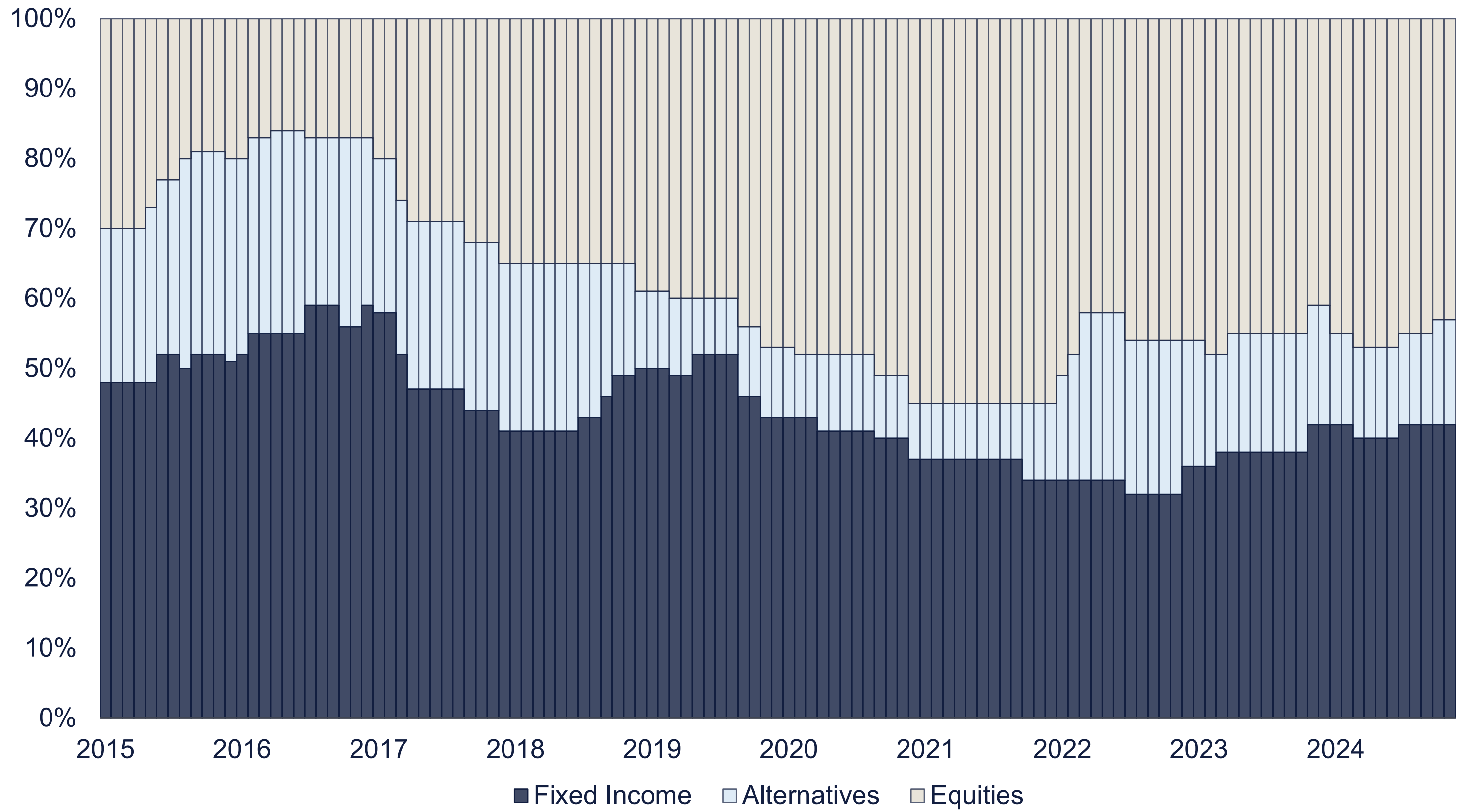


Boreal Investment Profiles

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

▼ Strategic Asset Allocation

Boreal Balanced Portfolio – Asset Allocation evolution



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