# Investment Policy

January 2025

BOREAL
CAPITAL MANAGEMENT

# Our market view in a nutshell – January 2025

- **Presidential Transition and Global Tensions**: The return of President Trump introduces heightened policy uncertainty against a backdrop of significant geopolitical shifts. U.S.-China relations are strained, with tensions over Taiwan and China's alignment with Russia during the war in Ukraine deepening divides. Proposed tariffs and "friendshoring" policies could disrupt global trade, pressure supply chains, and fuel inflation. Non-aligned countries face growing pressure to abandon neutrality as the U.S. pursues an "America-first" agenda, underscoring the interconnectedness of global economies despite domestic policy priorities.

- **Economic Challenges and Fiscal Constraints**: Unlike 2017, today's U.S. economy faces elevated debt (130% of GDP), a 6.5% fiscal deficit, and higher interest rates than during Trump's first term. Resilient consumer spending and low unemployment have helped avoid a recession, but inflationary pressures and fiscal imbalances remain critical risks. The Fed continues to normalize monetary policy, but potential tensions arise with the administration's pro-growth agenda, including tax cuts and tariffs. Poorly sequenced policies could destabilize financial markets and exacerbate inflation.

- **Technological Disruption from AI**: AI is reshaping industries, driving both revenue growth and cost savings. Unlike past technological revolutions, its benefits are concentrated among innovative firms, creating disparities across sectors. For investors, distinguishing winners from laggards is crucial, as AI-driven disruptions challenge traditional business models. While optimism about AI's transformative potential is warranted, it must be balanced with caution to avoid speculative bubbles.

- **Investment Landscape and Risks**: After two years of extraordinary returns, markets in 2025 begin with high valuations, reflected in a negative equity risk premium and very tight credit spreads, leaving little margin for error. High valuations require robust earnings growth to sustain prices, increasing the risk of corrections. Geopolitical shocks or disappointing corporate results could disrupt markets, even if the Fed provides support.

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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 | + | Interest rate cuts, controlled inflation, and resilient consumption have reduced the likelihood of a recession. While credit spreads have narrowed, investment-grade bonds remain attractive, as the default rate is expected to stay low |
| | EU Investment Grade | + | The economy is showing greater signs of weakness, and inflation has fallen faster within the target range, providing the ECB with ample room for cutting rates. We prefer government bonds and high-quality corporates |
| | 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 | + | Valuations have kept worsening since stock prices have been rising faster than earnings. With interest rates expected to remain higher for longer, we renew our preference for stocks that can reliably grow their earnings. |
| | Europe | = | The European economy is showing an unexpected resilience despite the slump in manufacturing. With the core economies barely growing and the risk that tariffs pose to the important export sector, we see less upside |
| | Asia | = | We recommend investing selectively in the region. Despite low valuations, China remains an area of concern |
| | Emerging Markets | – | Emerging market stocks tend to be more cyclical, and there are fewer high-quality stocks. The risk of tariffs and a stronger US dollar diminish their appeal in the short term |
| | 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 |

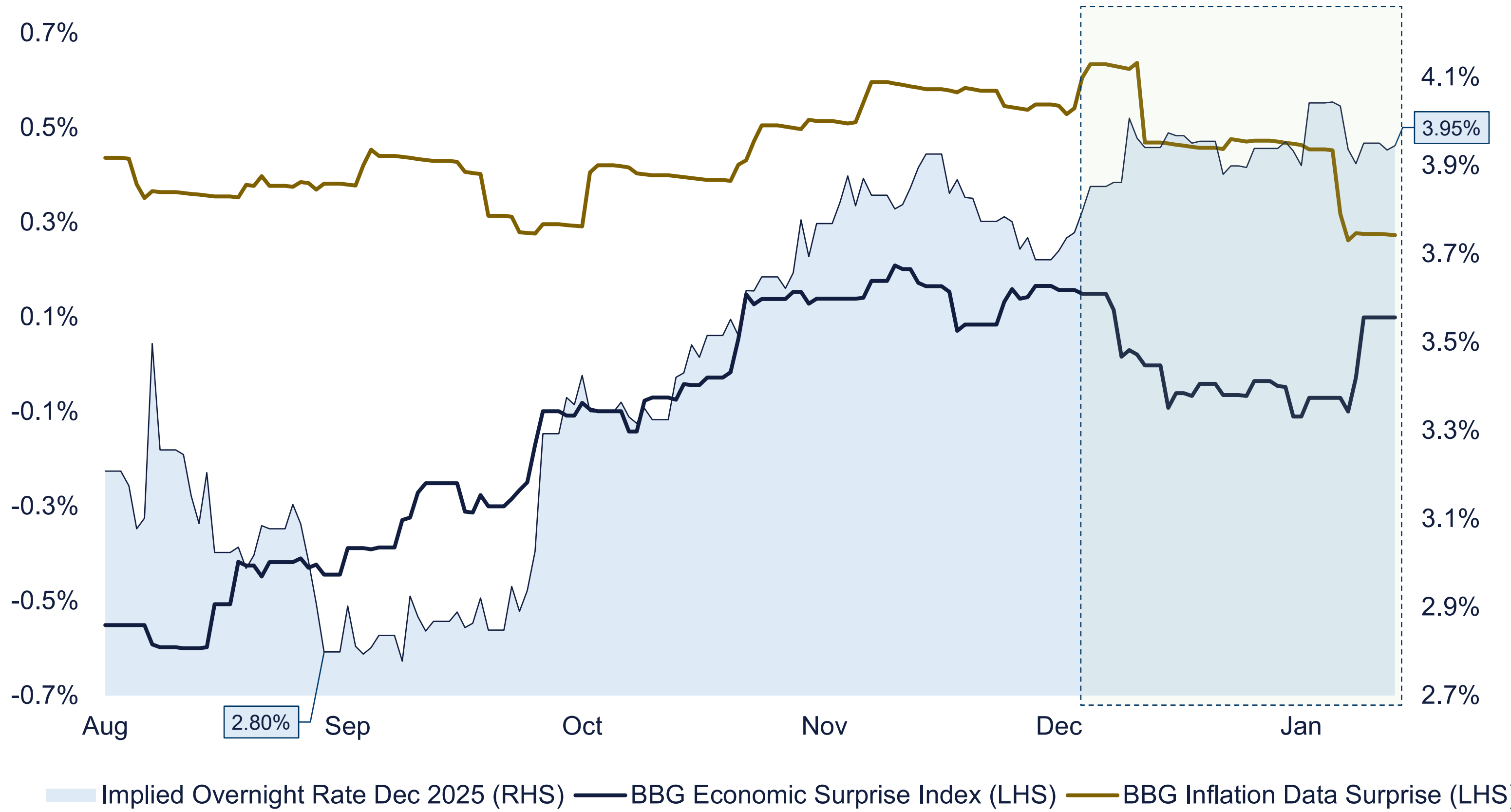
+ Overweight – Underweight = Neutral

# Policy reset


- Over the past months, anticipation has built ahead of President Trump's inauguration. The proposed changes to both domestic and foreign policies are so significant that **markets have been holding their breath**.
- The **starting conditions in 2025 are markedly different** from those in 2017. Interest rates are considerably higher, and inflation sensitivity is far greater than it was during Trump's first term. As a result, despite the administration's bold rhetoric, it must carefully calibrate its policy decisions to navigate these new economic realities.

Source: Bloomberg

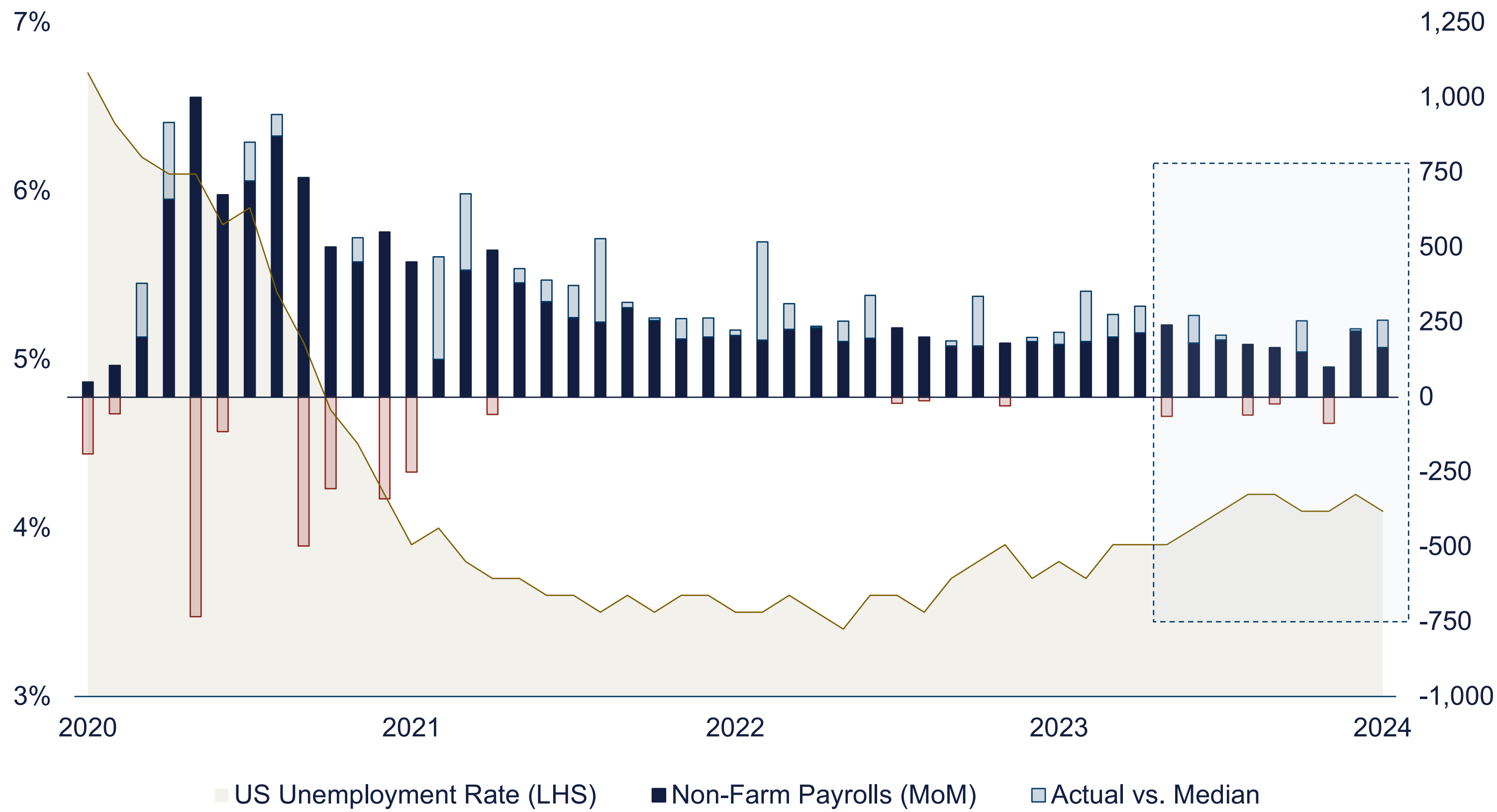
# Don’t fight the Fed




- The Fed is unlikely to preemptively react to specific new policies from the administration. However, a **pro-growth agenda** inherently reduces the perceived risks of an economic slowdown while **heightening the FOMC’s sensitivity to inflation**.
- This dynamic is already evident in markets, where **expectations for rate cuts have been scaled back**, even as inflation and economic activity moderate more than anticipated.

Source: Bloomberg

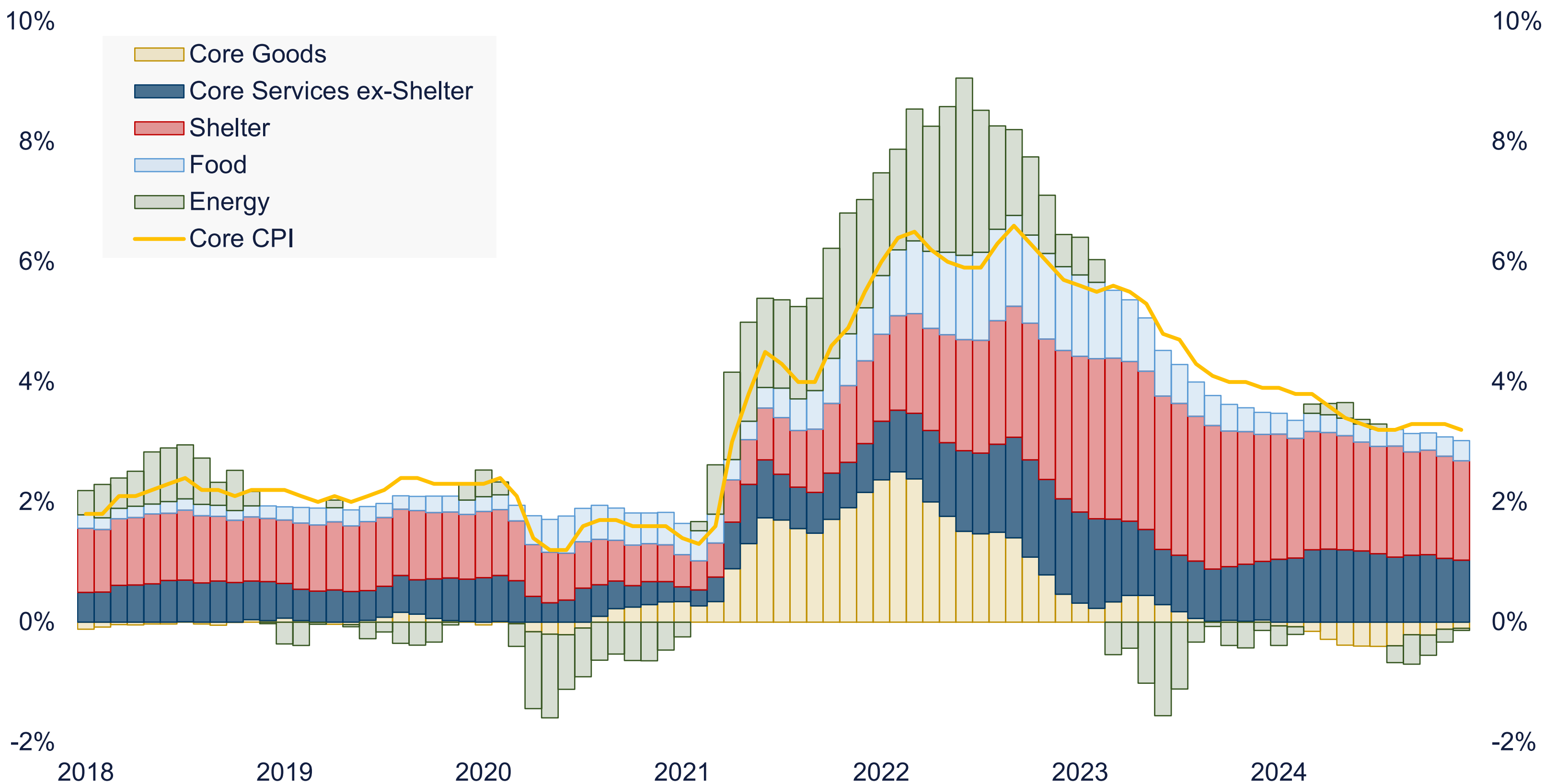
# Lower risk of cooling




- The labor market has shown signs of cooling, but the summer scare—when **unemployment appeared to be rising toward the critical inflection point** indicated by the Sahm Rule—has subsided.
- Since then, **job creation has remained robust, and the unemployment rate has begun to decline**. With pro-growth policies on the horizon, the likelihood of a significant labor market deterioration has diminished further.

Source: Bloomberg

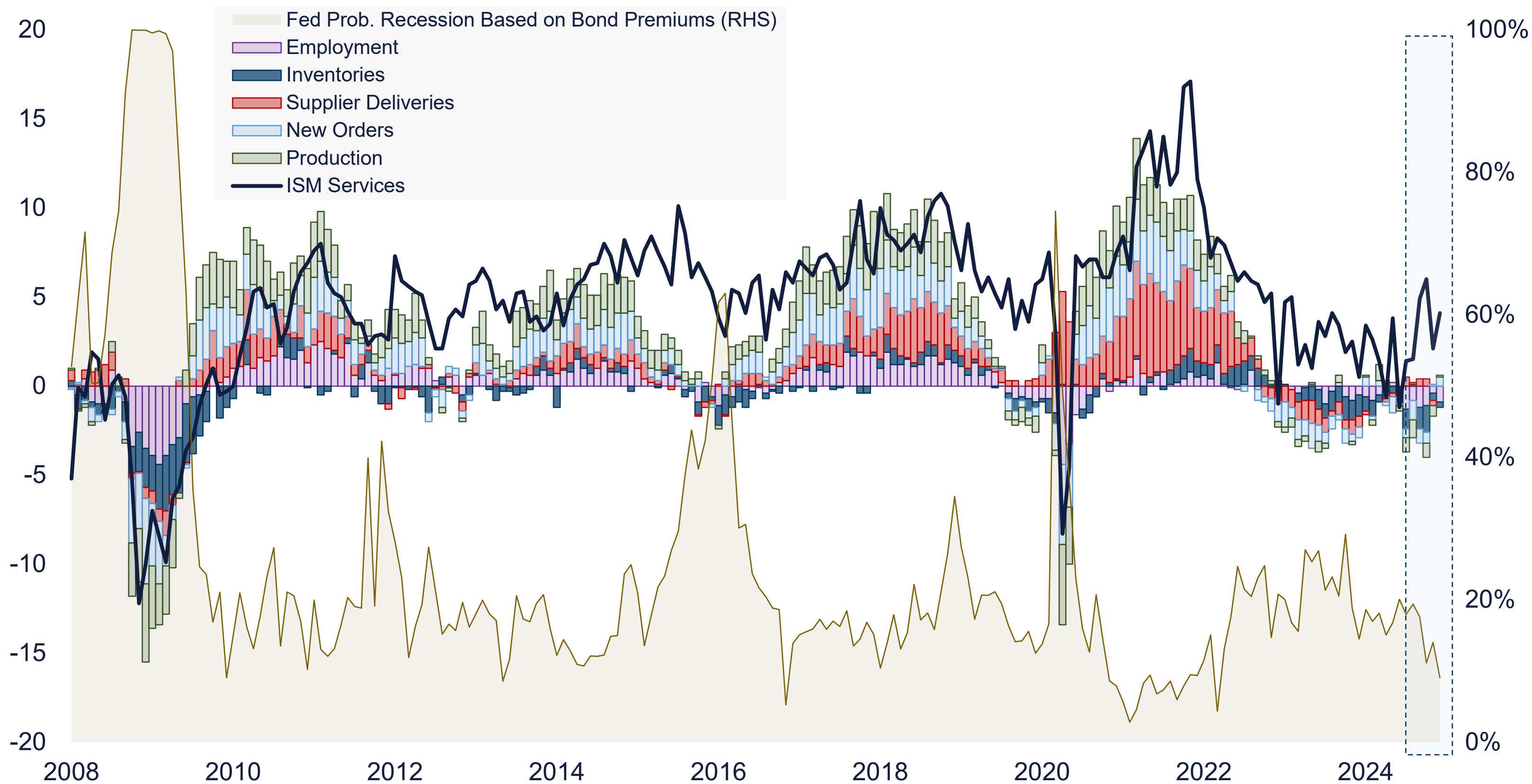
# But higher risk of overheating




- An improved growth outlook brings with it the risk of inflation reaccelerating. While the major inflationary pressures have subsided, **lingering "hot ashes" remain, particularly in the service sector and housing market**.
- Additionally, **tariffs and immigration restrictions could further fuel price pressures**. As a result, inflation is likely to remain a **central focus for markets throughout 2025**.

Source: Bloomberg

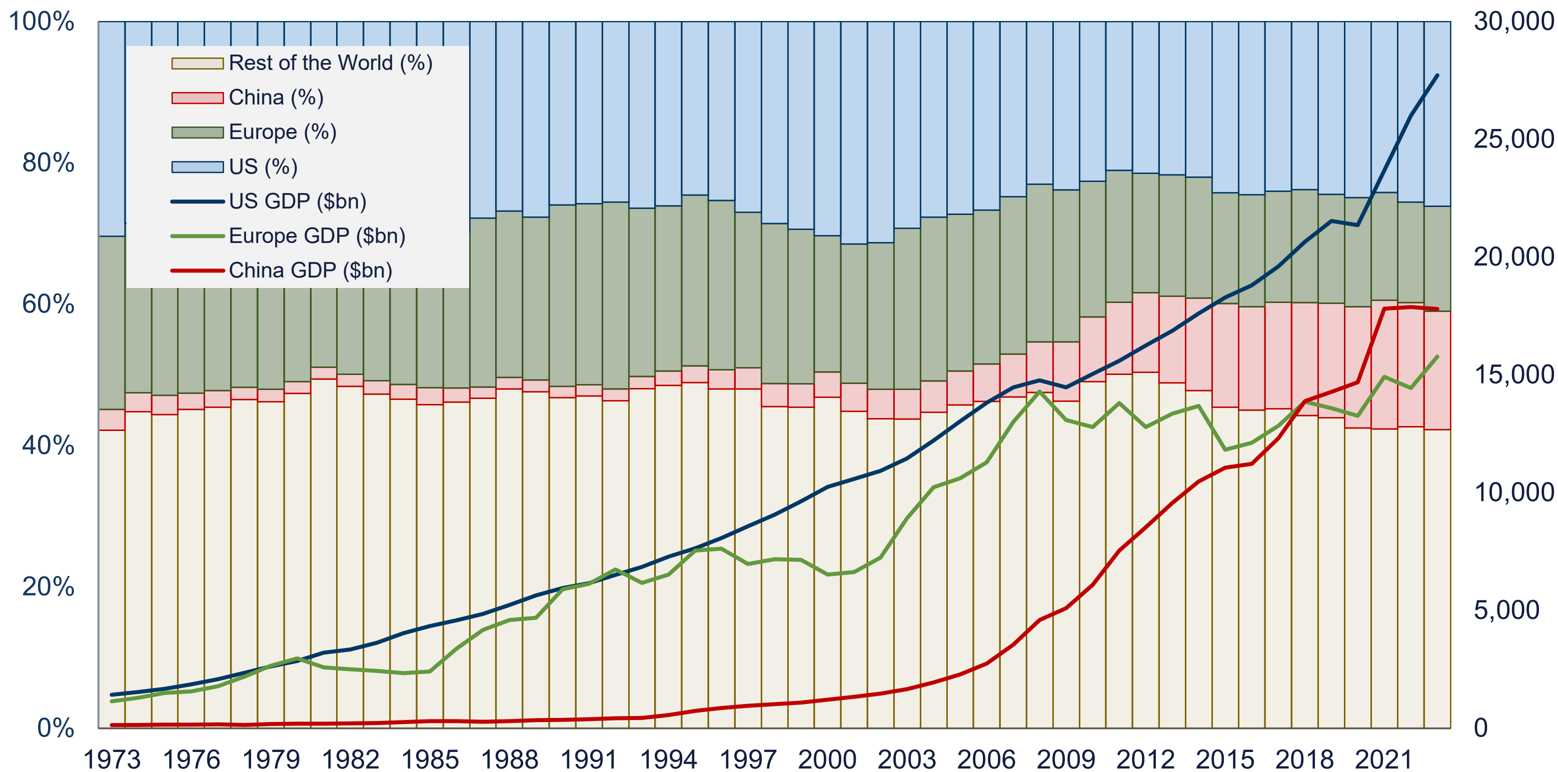
# A new cycle starts




- Economic activity is showing signs of reacceleration. **Manufacturing is nearing expansion territory** after over two years of contraction, while the **services sector remains firmly in growth mode**.
- This **cycle has defied most recession indicators**—such as the yield curve inversion and the Sahm Rule—highlighting the challenges of accurately forecasting recessions. Among the indicators, only credit spreads, which falsely predicted a recession in 2015, have emerged victorious this time.

Source: Bloomberg

# America First




- **US economic outperformance is driven by the inherent strengths of its economy**, including innovation-led growth, a highly competitive corporate sector, and a dynamic labor market.
- These factors, rather than any specific policies, have fueled the superior performance of US stocks over time and form the basis of our **overweight position in US equities**.

Source: World Bank

# Earnings and the Fed Put as counterweights to valuations

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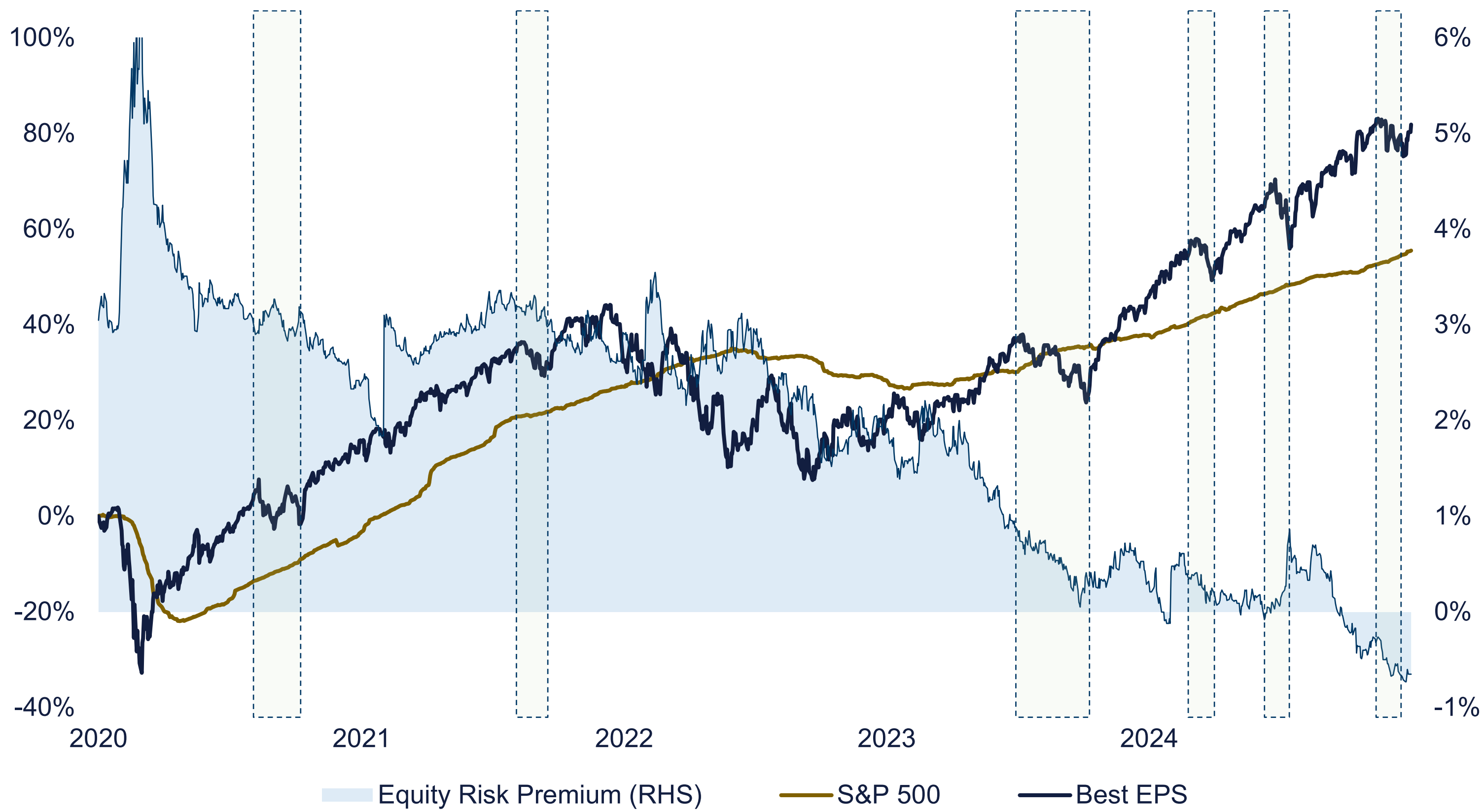


- **At first glance, valuations appear expensive**, with the risk premium at levels not seen since 2002, following the dotcom bubble burst.
- However, **earnings growth** continues to support equities, and the **Fed's ample capacity to cut interest rates** provides a safety net in the event of market turmoil.

Source: Bloomberg

# Investment scenarios

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| | Scenario 1<br>Monetary policy mistake | Scenario 2<br>Outgrowing the problems | Scenario 3<br>Economic policy mistake |
|---|---|---|---|
| **Drivers** | • Inflation remains persistently high, driven by a seemingly strong labor market and resilient housing prices. Tariffs and immigration restrictions further exacerbate price pressures.<br>• The Fed overestimates the economy's strength, keeping rates too high for too long or even raising them further, pushing the economy close to recession. It later reverses course with aggressive monetary easing. | • Pro-growth policies, resilient consumption, and corporate dynamism extend the economic cycle.<br>• Inflation normalizes further, prompting the Fed to ease gradually toward a neutral stance.<br>• Robust economic growth narrows the fiscal deficit, while the yield curve steepens slightly, credit spreads stay tight, and corporate earnings grow steadily. | • Tax cuts are not fully offset by new tariffs and decreased government spending, leading to a significant widening of the fiscal deficit.<br>• Tariffs imposed on key trading partners (such as Europe and China) trigger retaliatory measures, negatively impacting global economic growth.<br>• Debt sustainability concerns pressure long-term rates, steepening the yield curve. |
| **Market impact** | • Equities decline, but the “Fed Put” limits the extent of the correction as lower interest rates support valuations.<br>• Credit underperforms as spreads widen from historic lows.<br>• Sovereign debt rallies on "flight to quality" and falling rates. Commodity prices drop.<br>• The US dollar depreciates if the Fed cuts rates ahead of others or if the slowdown is U.S.-centric; otherwise, "flight to quality" supports the US dollar. | • Equities gain support from earnings growth and the “Fed Put,” even with high valuation multiples.<br>• Credit performs well as default rates stay low and spreads remain stable.<br>• High-quality and sovereign debt deliver solid returns, with potential upside if long-term rates fall.<br>• Commodity prices rise on economic strength. The USD stays strong, driven by growth and real interest rate differentials. | • Equity markets sell off on valuation and growth concerns.<br>• Credit spreads widen sharply as the prospect of corporate defaults looms.<br>• Turmoil in the Treasury market may force the Fed to intervene, putting the US dollar’s role as a reserve currency at risk.<br>• With US Treasuries in question, the 'flight to quality' will take a new form, with safe-haven currencies like the Swiss Franc and Yen, as well as gold, appreciating. |
| **Probability** | 30% | 50% | 20% |

**Short-term catalyzers**

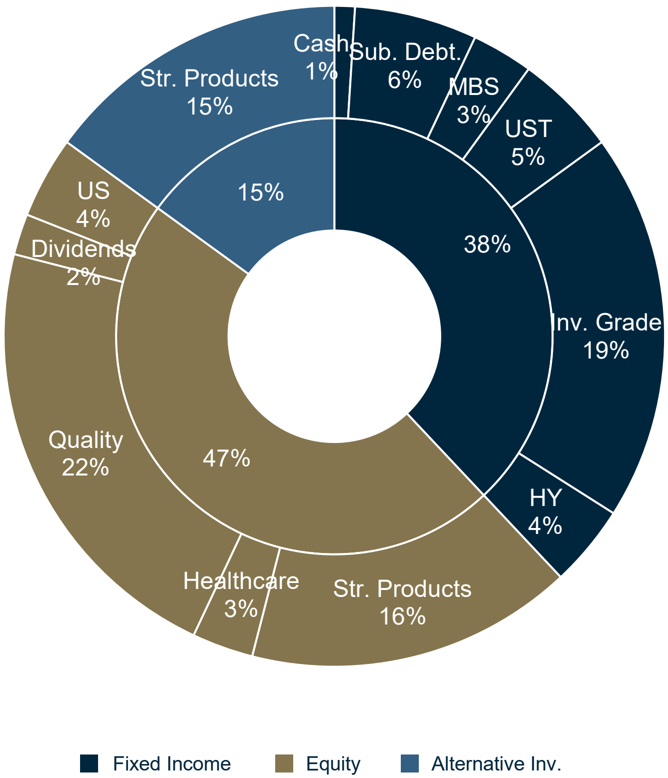
AI-driven productivity boost, De-escalation in Ukraine/Middle East conflicts drives down energy prices, Further slowdown in core inflation

**Other risks**

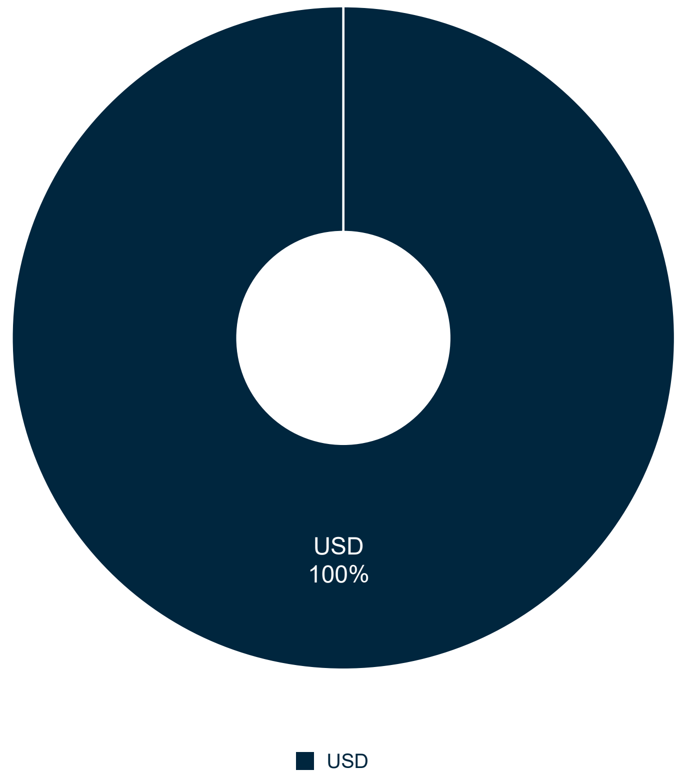
Crypto bubble, Cybersecurity, Debt ceiling, (Geo)Political risks, China/Europe slowdown, Housing market correction

# Boreal Balanced Portfolio USD

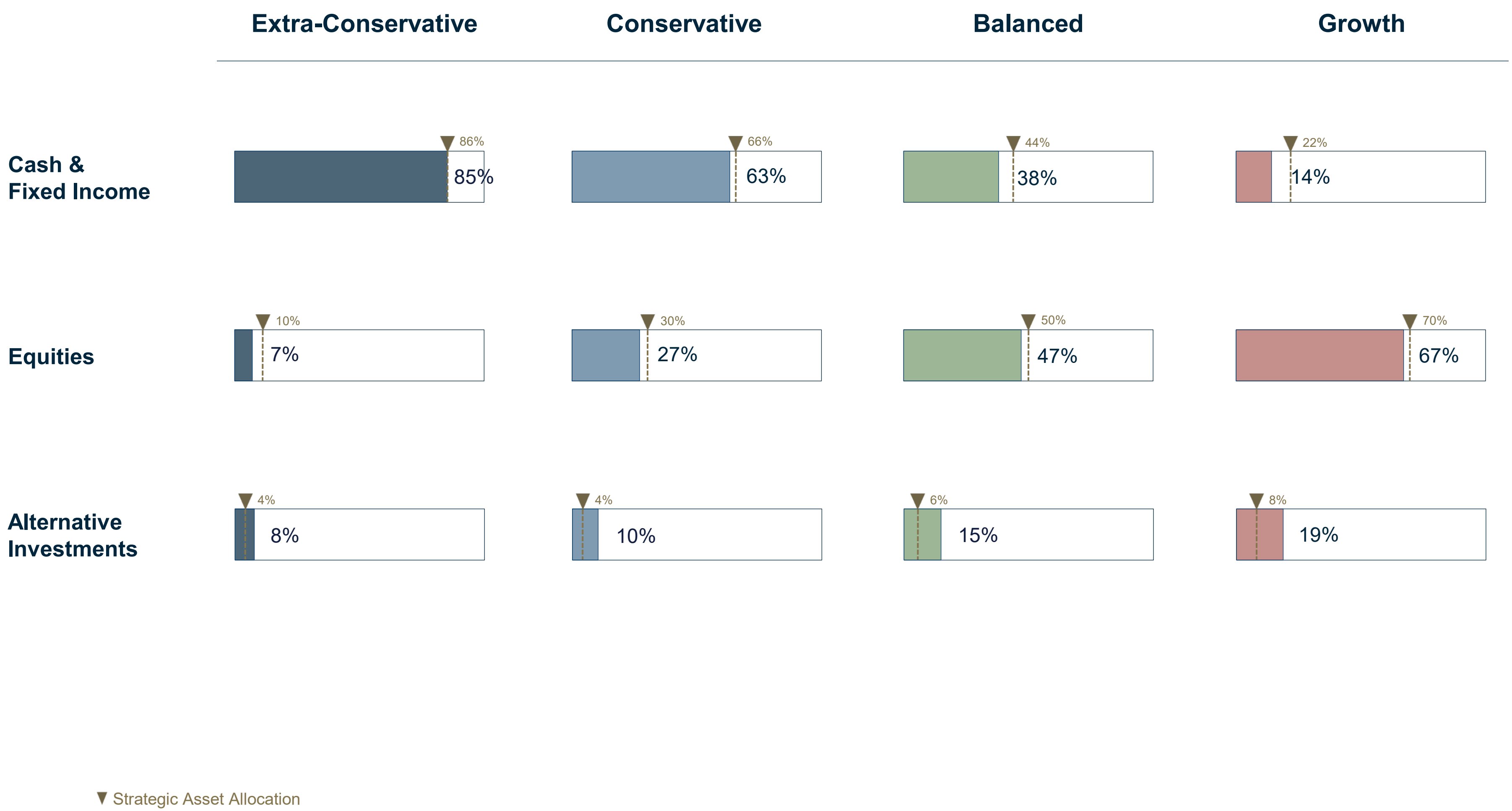
### Asset Allocation



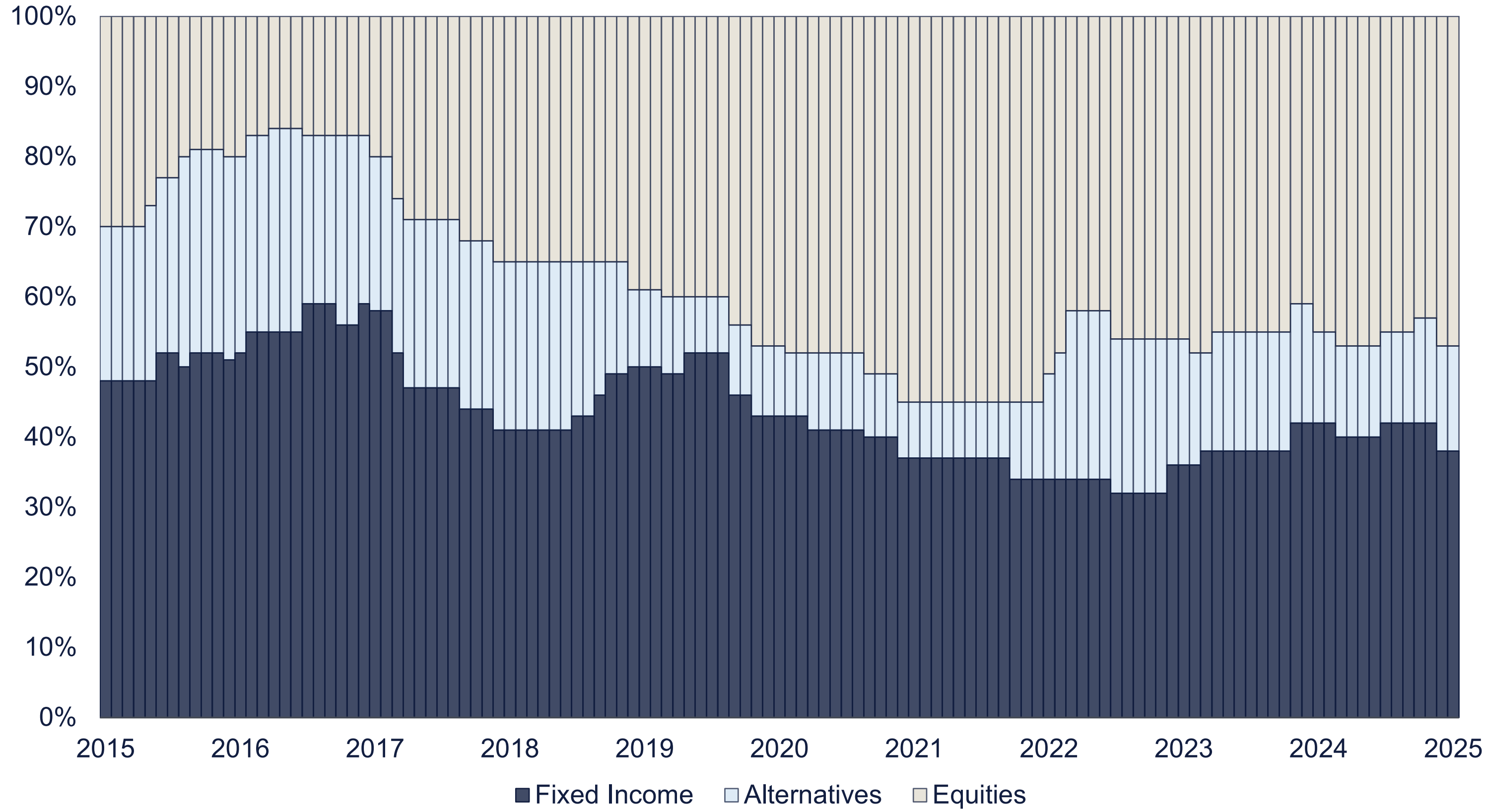

### Currency Allocation



# Boreal Investment Profiles



# Boreal Balanced Portfolio – Asset Allocation evolution



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