AXIOMA
Wealth Management AG

2020 investment strategy

(19.12.2019)

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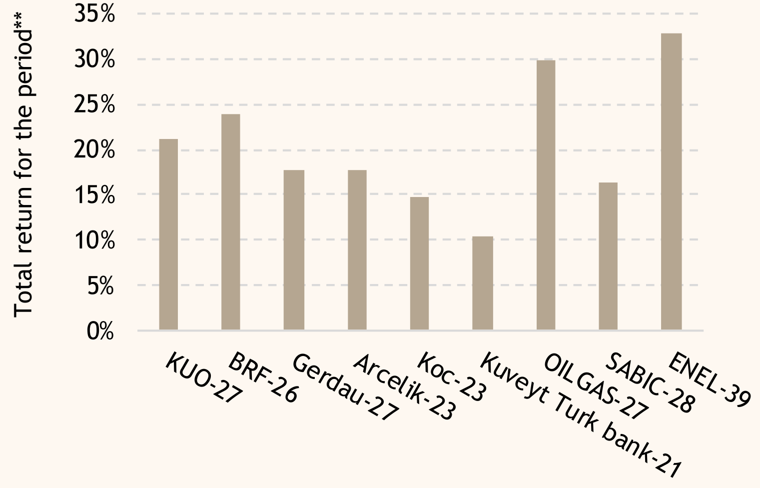
2019 results

In 2019, events unfolded better than our optimistic scenario and our investment strategy performance was 13.6% (AXIOMA Leveraged Bond Fund) from the beginning of the year to the end of November *.

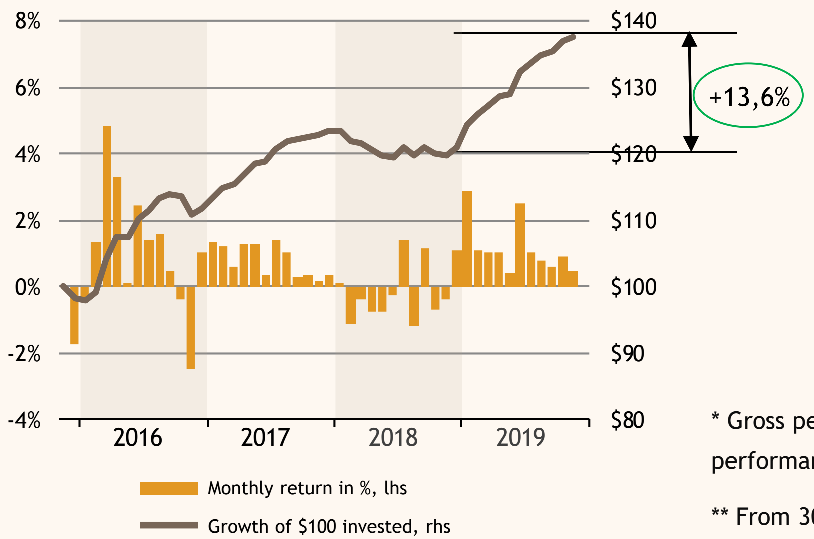
The Fed cut interest rates 3 times by 25 bps down to 1.75%, which no one had expected at the end of 2018, and US Treasuries' yields fell to lows by the end of August over fears of a slowdown in global economic growth due to the US-China trade war. By the end of November, we witnessed a parallel downward shift along the entire UST yield curve by about 90 bps.

Risk appetite remained elevated for the most part of the year, which led to significant inflows to EM bond markets. According to end-of-November data, the maximum narrowing of credit spreads was shown by our top picks from Western Europe (about 150 bps). Credit spreads of bonds from Eastern Europe and North America in our portfolio narrowed by an average of 100 bps, from Latin America by an average of 60 bps, while issues from Asia and Australia showed a narrowing of only 30 bps, which nevertheless exceeded our expectations.

Our 2019 investment ideas met our expectations by delivering 10-30% total return



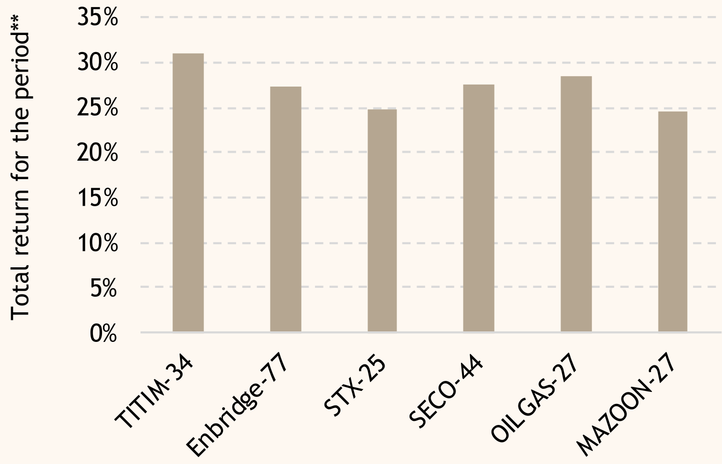
Strategy (AXIOMA Leveraged Bond Fund) historical performance*



* Gross performance before management and performance fees, as of 29.11.2019

** From 30.12.2018 to 19.12.2019

Return on the most successful transactions ranged from 25% to 30%



Source: Bloomberg, AXIOMA (19.12.2019)

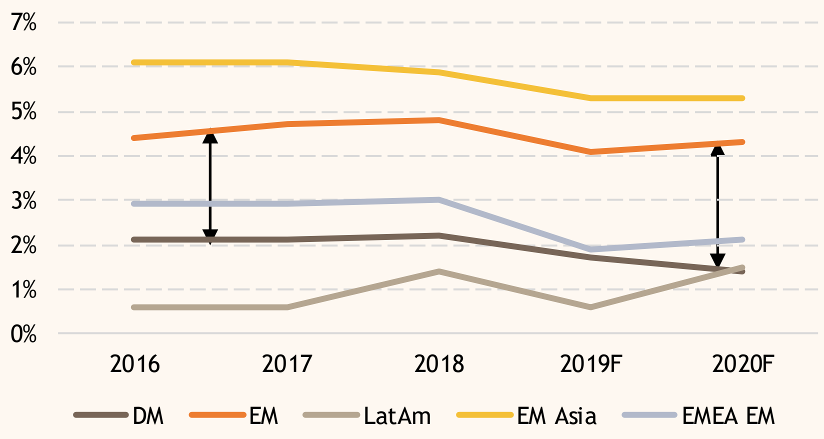
2020 investment strategy

Unlike in 2019, the main component of performance in 2020 will be the coupon return, while a further decrease in the yields of US government securities may add a couple percentage points to the performance of our portfolio. In our base case scenario, we assume a slight narrowing of credit spreads in Eastern Europe, the Middle East and Latin America, while we expect the spreads to remain unchanged or even grow slightly in the other regions. The credit spreads narrowing will occur on the back of credit quality improvement, assuming that other types of risk remain unchanged (country risk, geopolitical risk, etc.). At the same time, the focus on the credit quality of individual issuers will remain a decisive criterion for inclusion in the portfolio.

In general, unlike countries with developed economies, where a further slowdown in economic growth is expected, EM countries should accelerate slightly their GDP growth after the government/head of state changed in many of them, which allows the implementation of the necessary reforms. Stable oil prices should also support EM economies, as many of them export commodities.

The risks of correction in the financial markets will remain in 2020, however, the monetary easing by the main central banks may postpone it for some time. Among the main risks remaining are the trade dispute between the United States and China, a drop in stock prices due to profitability decrease amid global economic slowdown, U.S. elections in November 2020, growing populist sentiments around the world, as well as geopolitical tensions. In light of these factors, we maintain the average duration of our portfolio at 4.5 years, keep the proportion of securities with an investment rating at 50-60% and maintain broad diversification. At the same time, we are ready to use local price imbalances to build positions and capitalize on these opportunities. We do not plan to use leverage at current or higher price levels. However, we can use it in case of price dropdown.

EM countries maintain higher GDP growth rates relative to developed countries



Source: Bloomberg, AXIOMA (19.12.2019)

The main source of income - the coupon, a decrease in UST yields can add 1-2%. Focus - on EM, due to the comeback of economic growth and current yield premium. As correction risk remains, duration is not higher than 5 years with broad diversification.

Performance forecast under 2020 strategy

We believe that the main component of performance in 2020 will be the coupon return, while bonds from Latin America, namely Mexico and Brazil, Eastern Europe and the Middle East, can increase in value due to the credit spreads narrowing. The rest of Latin America, Russia, North America and Asia will serve as defensive assets, diversifying country risks. Thus, our target portfolio allocation by region is as follows:

Target geographical allocation for 2020

Russia & CIS	16.3%
Latin America	22.7%
North America	8.0%
Asia	9.1%
Middle East	10.4%
Western Europe	10.7%
Eastern Europe	11.5%
Africa	9.5%
Australia	1.8%
	100.0%

Expected total return under the strategy for 2020 by scenario

		5 years UST yield to maturity								
		0.48%	0.73%	1.0%	1.2%	**1.5%**	1.7%	2.0%	2.2%	2.5%
Spread (bps)	-100	14.2%	13.1%	12.0%	11.0%	**9.9%**	8.8%	7.7%	6.6%	5.5%
	-75	13.1%	12.0%	11.0%	9.9%	**8.8%**	7.7%	6.6%	5.5%	4.4%
	-50	12.0%	11.0%	9.9%	8.8%	**7.7%**	6.6%	5.5%	4.4%	3.3%
	-25	11.0%	9.9%	8.8%	7.7%	**6.6%**	5.5%	4.4%	3.3%	2.2%
	base case	9.9%	8.8%	7.7%	6.6%	**5.5%**	4.4%	3.3%	2.2%	1.2%
	+25	8.8%	7.7%	6.6%	5.5%	**4.4%**	3.3%	2.2%	1.2%	0.1%
	+50	7.7%	6.6%	5.5%	4.4%	**3.3%**	2.2%	1.2%	0.1%	-1.0%
	+75	6.6%	5.5%	4.4%	3.3%	**2.2%**	1.2%	0.1%	-1.0%	-2.1%
	+100	5.5%	4.4%	3.3%	2.2%	**1.2%**	0.1%	-1.0%	-2.1%	-3.2%

Strategy return	**Optimistic scenario**	**Base case scenario**	**Negative scenario**
Coupon component	4.4%	4.4%	4.4%
Price change due to change in UST yields	2.1% — 3.2%	1.1%	-2.1% — -3.2%
Price change due to spread narrowing or widening	1.2% — 2.3%	0.0%	-3.3% — -4.4%
Total:	7.7% — 9.9%	5.5%	-1.0% — -3.2%

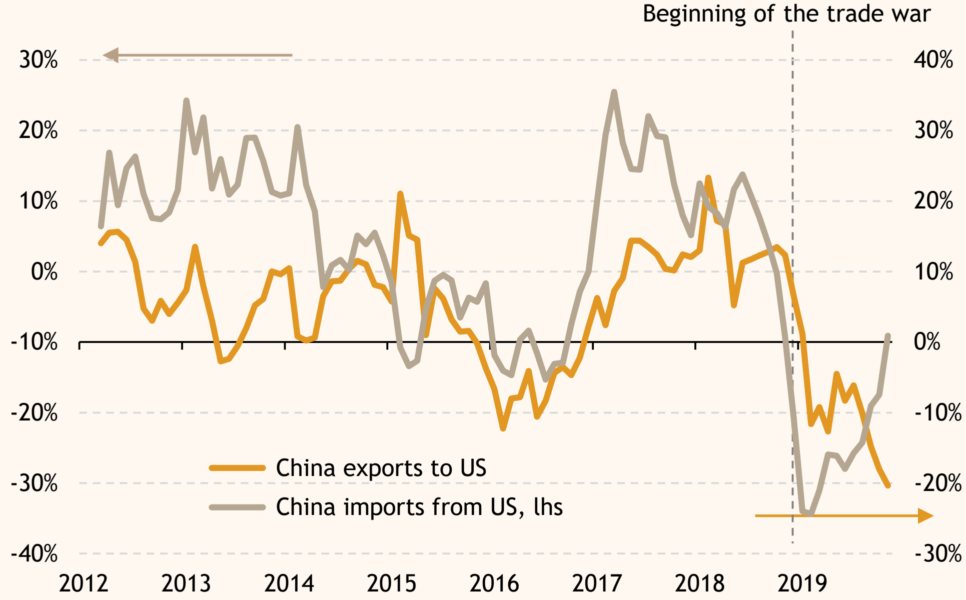
Main risks in 2020

We believe that the pricing of many financial assets is based on a rather favorable scenario, as of the end of 2019. Accordingly, the realization of at least one of the risks may trigger the rest, increasing the likelihood of an extremely negative scenario.

Among the main risks, we consider:

- Continuing trade tensions between the US and China
- Rise in trade tariffs worldwide
- Sharper US economic slowdown
- Falling oil prices due to global economic growth slowdown
- Political instability in the USA due to the upcoming presidential elections in November 2020
- Surge of defaults in China resulting in fund outflows from the EM bond markets
- Wave of credit rating downgrades due to populists coming to power and debt profiles worsening
- Geopolitical instability always remains on the radar

A sharp decline in trade between the US and China after the beginning of the trade war



Source: Bloomberg, AXIOMA (15.12.2019)

Thus, the probability of a deep correction is higher than in 2019 in case of negative scenario realization

US Treasury yield curve scenarios

Base case scenario

In our base case scenario, we proceed from the assumption that the Fed will reduce the rate once by 25 bps closer to mid-year or even by the end of 2020, when the 2019 monetary stimulus will no longer be effective. According to this scenario, the refinancing rate will be 1.5% at the end of 2020. We assume that inflation expectations will remain restrained, leading to a parallel shift of the curve. Thus, 5-year US Treasury yields will reach 1.4%, and 30-year UST yields will be at 2.0%.

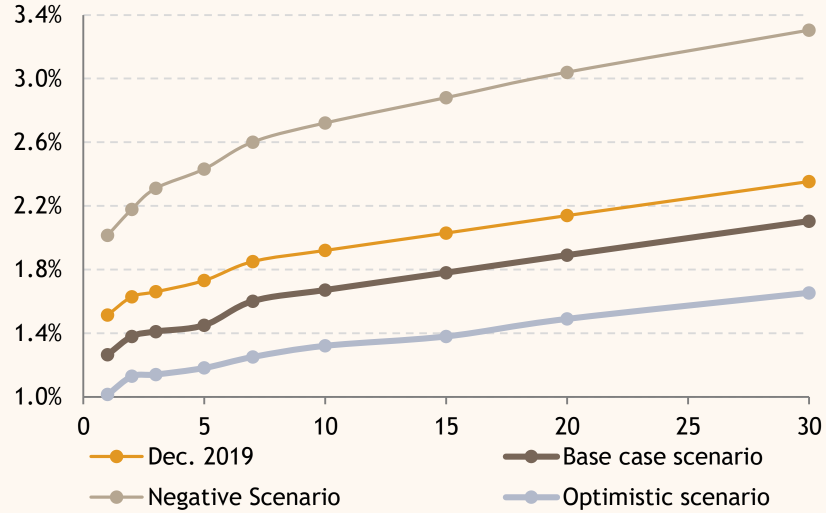
Optimistic scenario

We do not exclude the possibility that the United States and China will not be able to achieve a trade deal before the US presidential election. In this case, a fall in trade volume will put serious pressure on the US economy, which will lead to more aggressive actions by the Fed. Nevertheless, we do not expect interest rates to decrease by more than 0.5%, given their already low levels. At the same time, a simultaneous decrease in inflation expectations and the launch of a bond buyback program to improve the liquidity situation in the market can also push yields down. In this case, the yield on 5-year-old US treasury bonds could drop to 0.9-1.2%, and 30-year UST yields could fall to 1.5%, so the yield curve will become almost flat.

Negative scenario

We do not expect the Fed to raise interest rates by more than 50 bps during 2020. Nevertheless, in the event of an unfavorable developments, including higher inflation rates or a partial sale of US Treasury holdings by China could result in a much stronger upward movement of the yields. Under this scenario, the yield of 5-year US Treasuries may exceed our expectations and hit as high as 2.2-2.4%, and 30-year UST yields going up to 3.2%, increasing the slope of the curve.

Current US Treasury yield curve versus various scenarios for the end of 2020



Source: Bloomberg, AXIOMA (19.12.2019)

2020 investment themes

Emerging markets (EM)

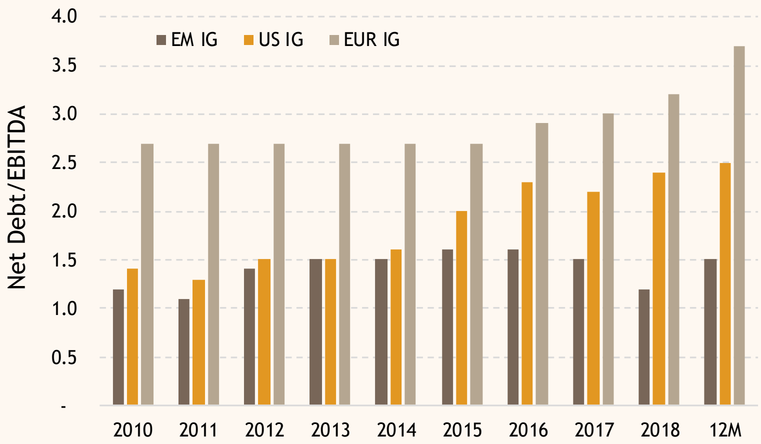
EM countries remain our favorite, both due to the expected improvement in macroeconomic indicators and the existing yield premium for bonds of issuers of the same credit rating compared to their developed countries' peers.

The local currencies depreciation created more favorable positions for the growth of export-oriented production.

Low interest rates around the world and a growing share of bonds with negative yields will stimulate the search for new investment opportunities, which should support investment inflows into EM.

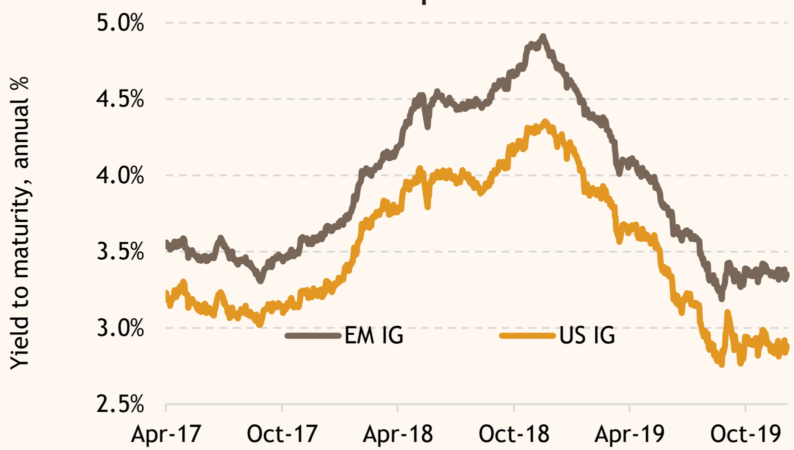
The increase in bonds' amortization is positive for both companies (as it allows more flexibility in managing the volume of annual repayments) and for investors (as incoming funds need to be reinvested).

The credit profiles of EM issuers with an investment grade rating (IG) are much better than those of issuers with similar rating from the US and Europe



Source: JP Morgan (25.11.2019)

Yields on EM issuers with an investment grade rating are higher than their developed countries' peers



Source: Bloomberg, AXIOMA (19.12.2019)

The reforms launched by many EM countries in 2019 after the presidential and parliamentary elections should begin to bear fruits in 2020, which will lead to improved macroeconomic indicators.

2020 investment themes

Diversification and thorough credit analysis are the key to success in 2020.

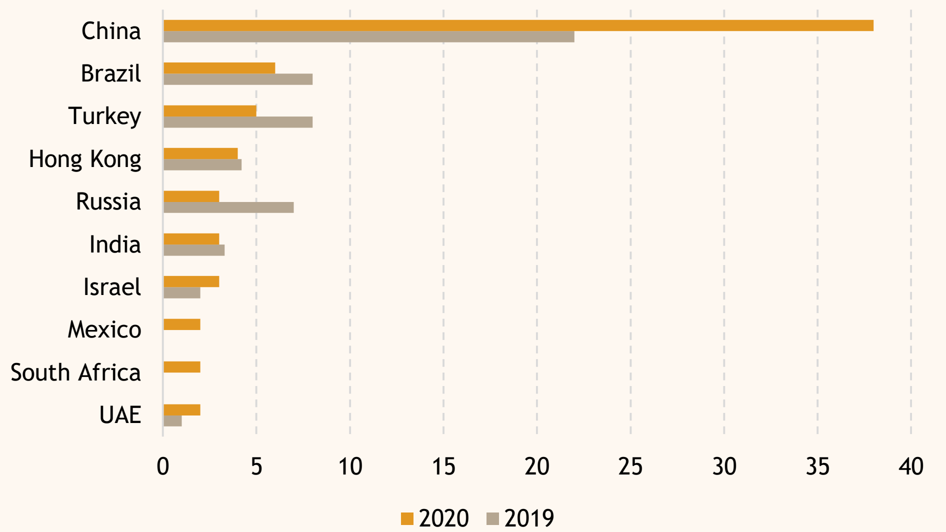
We continue to maintain the share of developed countries at the level of 15-20%, in order to diversify the EM risks. At the same time, or top picks for the European and US segments do not only show low sensitivity to events that are important for EM, but also have the potential for further price growth due to improving credit metrics.

Prices on Russian bonds are also quite stable. Here, first of all, a noticeably reduced supply volume and increased activity of Russian investors play the main role. For example, for banks, investing in Eurobonds of Russian issuers represents a unique opportunity to profit from USD-denominated deposits. Nevertheless, it is worth mentioning that the debt profile of many Russian issuers corresponds to higher credit ratings.

We believe that the portfolio management success in 2020 will largely depend on the number of distressed bonds in the portfolio. We continue to avoid investing in bonds of Chinese issuers, the main risks of which, in our opinion, are the opacity of corporate decision-making, as well as the complexity of legal structures, often combining businesses from different sectors.

Bonds of Chinese issuers already make up a large part of the market and offer a premium to similar issues from other EMs. Nevertheless, we would like to emphasize that in 2019 the number of defaults on the domestic market of China set a new record ($ 17.6 billion), while only 6 issuers with a total debt of $ 1.97 billion defaulted the Eurobond market so far. We expect the bad debt problem of Chinese issuers to worsen.

Maturity of companies with junk ratings in 2020, in billion US dollars



Source: JP Morgan, 25.11.2019

We will maintain broad diversification with a focus on the credit analysis of each issuer to reduce the impact of default risks in portfolios.

2020 investment ideas

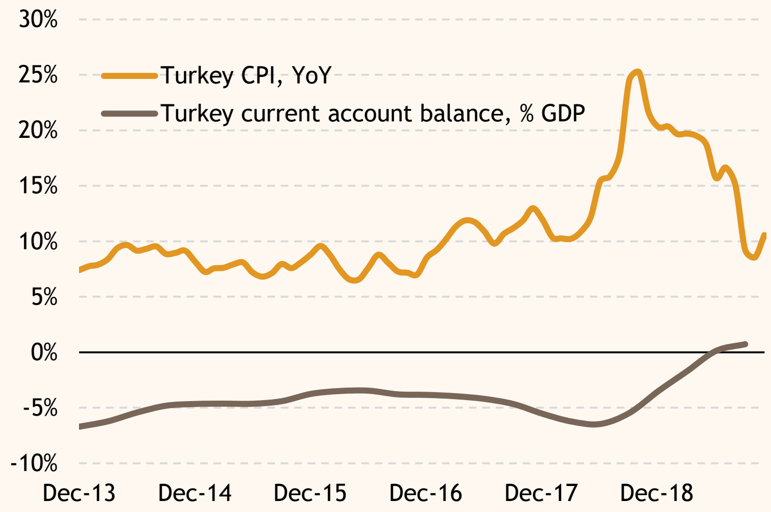
Emerging markets: Turkey

In 2019, after the 2018 economic crisis, Turkey delivered a decrease in inflation, an improvement in the country's balance of payments, and demonstrated stability of the financial system. Corporations and banks survived turbulent times, not allowing a single default or restructuring of external debt. For 2019, credit spreads on Turkish bonds decreased significantly. However, according to our opinion, current yields are still attractive, considering the country and credit risks of these issuers. We continue to give preference to senior issues of the largest banks and bonds of large companies denominated in hard currency.

Arcelik (BB+) produces household appliances under the brand names of Beko, Grundig, Arcelik, etc. Arcelik is a leading Turkish manufacturer and is the third largest after Electrolux and Indesit in Europe. Its revenue in 2018 amounted to USD 5.7 bn, with EBITDA reaching USD 582 m and net debt leverage coming in at 3.2x. The company is a part of Koc Holding. We find beneficial the company's diversified end market, as well as active currency risk management resulted in full hedging its FX position. We continue favouring the company's bonds maturing in 2023, which are currently being traded at yield-to-maturity of 4.2%.

QNB Finansbank (B+) is a medium-sized Turkish bank with total assets of USD 31 bn (as of September 30, 2019). The bank is 99.88% owned by Qatar National Bank (Aa3/A/A+). Finansbank offers all types of loans. The share of loans to corporations and SME (small and medium-sized businesses) represents 68%, while the loans to individuals are at 32% as of September 30, 2019. The bank demonstrates stable profitability (net interest margin of 4.4%, return on assets of 1.6%), good quality of assets (share of overdue loans represents 6.3%) and strong capitalization positions (Tier 1 capital is 13.2%). We believe that the rating of the bank does not fully reflect the support of shareholders, as well as the stability of the financial sector in a country where people are accustomed to holding savings in gold and, accordingly, the likelihood of a serious outflow of deposits is small.

Significant improvement in credit metrics of Turkey in 2019



Source: Bloomberg, AXIOMA (19.12.2019)

2020 investment ideas

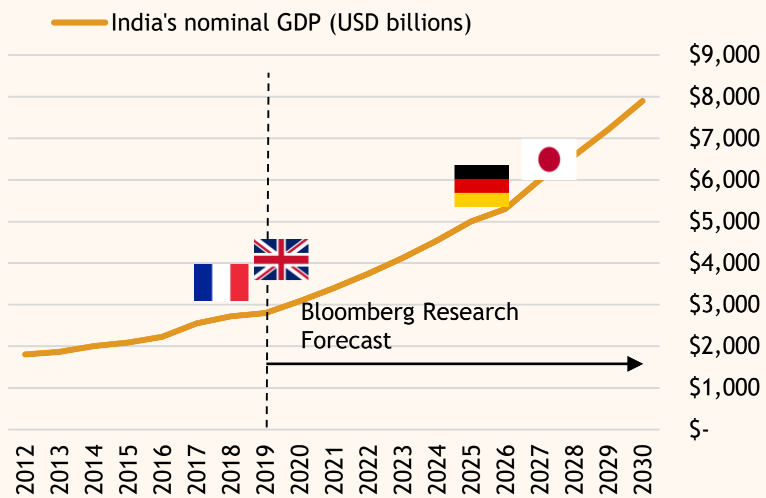
Emerging markets: India

India is quite a typical representative of the group of emerging economies. On the one hand, high population and GDP growth rates make this country attractive compared to other developing countries, on the other hand, protectionist policies, complex labor laws, weak infrastructure and widespread bureaucracy prevent it from realizing its potential. We are conservative about the country's prospects, which are more dependent on the success of ongoing and planned reforms. Therefore, we focus on individual names that are of interest to us on a stand-alone basis.

Bharti Airtel (Ba1/BBB-) - Indian telecommunications company, the second largest mobile operator in the world with operations in Asia and Africa. This is one of the oldest companies in the Indian telecommunications market, with a 52% share owned by its founder Sunil Bharti Mittal and his family, and 48% by Singtel (A+), Singapore's largest mobile operator. The company's bonds underwent sales after the Supreme Court of India decided in favor of the state, which insisted that royalties should be calculated from the total profit, rather than from the mobile segment, as previously calculated by all telecom companies. Payment of debt must be made before January 2024 and rating agencies put the company's credit rating on a negative watch. We believe that the risk of losing the investment grade rating is already reflected in the company's bond prices, and the latest news on capital injection by Singtel may help the company to maintain its investment rating.

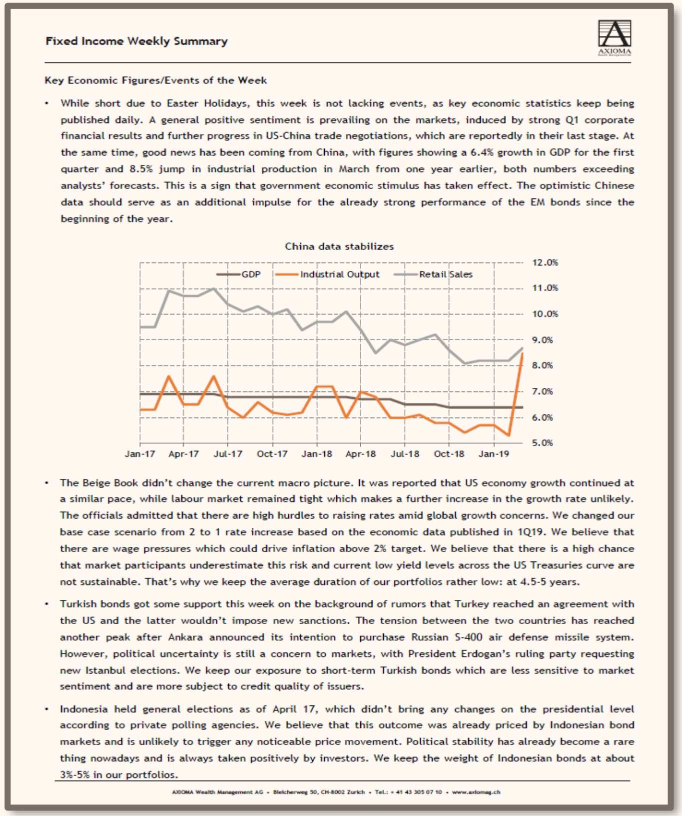
Adani Transmission (BBB-/Baa3/BBB-) – India's largest private power grid company. The company's bonds are guaranteed by cash receipts under contracts. The company has a rather high debt burden and big plans for further business development. Therefore, the news that the Qatari sovereign fund is buying a stake in one of the company's assets was positively received by bondholders. We believe Adani Transmission bonds have upside potential.

By 2027, India could become the 3rd largest economy in the world after the US and China



Source: Bloomberg BI Research (13.12.2019)

Stay informed about AXIOMA’s investment strategy



Fixed Income Weekly Summary

Key Economic Figures/Events of the Week

- While short due to Easter Holidays, this week is not lacking events, as key economic statistics keep being published daily. A general positive sentiment is prevailing on the markets, induced by strong Q1 corporate financial results and further progress in US-China trade negotiations, which are reportedly in their last stage. At the same time, good news has been coming from China, with figures showing a 6.4% growth in GDP for the first quarter and 8.5% jump in industrial production in March from one year earlier, both numbers exceeding analysts’ forecasts. This is a sign that government economic stimulus has taken effect. The optimistic Chinese data should serve as an additional impulse for the already strong performance of the EM bonds since the beginning of the year.

- The Beige Book didn’t change the current macro picture. It was reported that US economy growth continued at a similar pace, while labour market remained tight which makes a further increase in the growth rate unlikely. The officials admitted that there are high hurdles to raising rates amid global growth concerns. We changed our base case scenario from 2 to 1 rate increase based on the economic data published in 1Q19. We believe that there are wage pressures which could drive inflation above 2% target. We believe that there is a high chance that market participants underestimate this risk and current low yield levels across the US Treasuries curve are not sustainable. That’s why we keep the average duration of our portfolios rather low: at 4.5-5 years.
- Turkish bonds got some support this week on the background of rumors that Turkey reached an agreement with the US and the latter wouldn’t impose new sanctions. The tension between the two countries has reached another peak after Ankara announced its intention to purchase Russian S-400 air defense missile system. However, political uncertainty is still a concern to markets, with President Erdogan’s ruling party requesting new Istanbul elections. We keep our exposure to short-term Turkish bonds which are less sensitive to market sentiment and are more subject to credit quality of issuers.
- Indonesia held general elections as of April 17, which didn’t bring any changes on the presidential level according to private polling agencies. We believe that this outcome was already priced by Indonesian bond markets and is unlikely to trigger any noticeable price movement. Political stability has already become a rare thing nowadays and is always taken positively by investors. We keep the weight of Indonesian bonds at about 3%-5% in our portfolios.

AXIOMA Wealth Management AG • Bleicherweg 50, CH-8002 Zurich • Tel.: + 41 43 305 07 10 • www.axiomag.ch

- Every week, our in-house team of financial experts and analysts take an in-depth look at how global events are affecting the financial markets and present their forecasts

  Please visit axiomag.ch/insights

- Every month, AXIOMA’s fund managers provide an update on AXIOMA Leveraged Bond Fund

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Your team

AXIOMA's staff are always available to answer your questions and create a tailor-made solution for your specific requirements. Email or call us with any questions, or to make an appointment for a face-to-face meeting at our office in Zurich.

Josef Meyer, Partner, Co-owner, Chairman of the Board

Svitlana Altherr, CEO

Maria Kotlyarchuk, CFA, Head of Investments

Ilya Karmilov, PHD, FRM, Head of Operations

Nina Midrigan, Analyst

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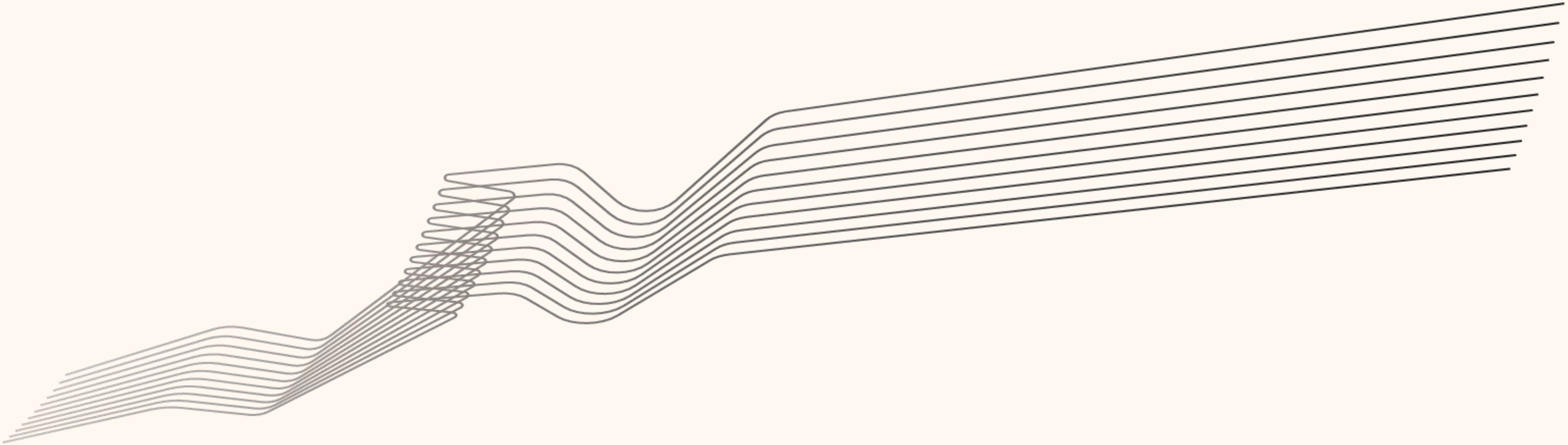

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