INVESTMENT PERSPECTIVES

JANUARY 2020

JAPANIFICATION OF THE WESTERN WORLD

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INTRODUCTION: THE COMPLEXITY OF LOWER VOLATILITY

There are not many things that keep me up at night except for my grandchildren when they come to spend the night at our home. This is because I am not a central banker. Not so long ago, the threat of a currency crisis or a recession kept policymakers awake, but now it is 'Japanification'. The prospect of Europe or the US following Japan into years of weak growth, deflation and low interest rates gives them sleepless nights precisely because they lack the tools to fight it effectively.

For now, Europe and North America have sidestepped the worst of that fate thanks to the unprecedented resources injected into financial markets by central banks. However, prolonged monetary easing has implications for productivity. It props up businesses with cheap credit that would otherwise struggle to survive and inflates asset prices.

As investors, the threat of this new paradigm has profound implications for us all. It changes the cost of cash and the nature of risk. But even more profoundly, it changes the fortunes of our real economies, stunting investment in the underlying real assets and testing the abilities of entrepreneurs to build and to make a difference.

After the experience of 2019, when markets eventually recovered from their late 2018 losses, the greatest lessons should be that all investors need to be reactive, and above all, stay invested. We expect that Japanification will mean we have to adjust to shorter, and less extreme, economic cycles. We also see better returns in equities, carry opportunities in fixed income as well as investment grade credit and subordinated bonds. In addition, we continue to work on opportunities in private markets and a number of liquid alternative themes. As we try to anticipate the challenges for investors ahead, we believe that these strategies will help identify paths to profitable portfolios in 2020.

Happy reading.

Eric **Syz**
CEO AND CO-FOUNDER OF SYZ GROUP

THE MACRO VIEW: THE COMPRESSED ECONOMIC CYCLE

2019 was all about a never-quite-arriving recession. We saw an about-turn from the Federal Reserve that triggered renewed accommodation from other central banks, including in emerging markets. As 2020 nears, this trend seems to be on the verge of turning around and giving way to a more positive growth dynamic. We think these developments illustrate a wider and profound change that has important implications for all investors.

'Japanification' refers to the persistent economic situation of low growth, low inflation and low interest rates that Japan has endured for almost three decades. This now fairly describes western economies too. While a useful shorthand, the term misses an important implication for investors.

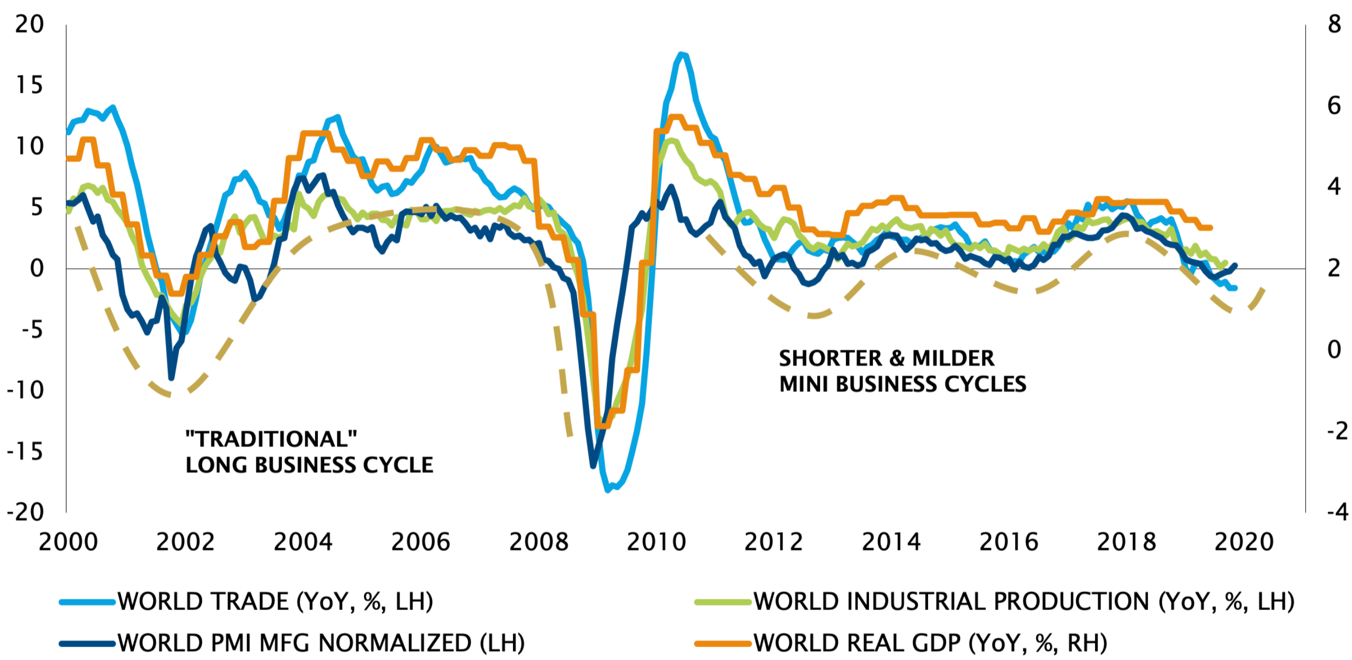
We have been conditioned to expect relatively long business cycles of alternating strong recoveries and sharp declines, painting a v-shape picture of relatively long economic boom and sudden bust. In this framework, as economies grew, central banks gradually tightened credit conditions to prevent inflationary pressures, finally pitching us into recessions before the whole round restarted. 'Japanification' marks a departure from this familiar, multi-decade model.

We believe that this new model also implies shorter and milder business cycles, of a few quarters or years at most. This shortening of cycles and their smaller magnitude means that investors will have to adapt to weaker or confused signals from traditional indicators. Just think of the recent manufacturing recession that we have seen in the US, or the short-lived inverse yield curve.

In addition, in the short term, interest rates may be less efficient in managing the ups and downs. The large volumes of debt already held by individuals and corporations inevitably limits their capacity and appetite for more, making each successive central bank rate cut less effective.

From a positive perspective, inflationary pressures remain minimal, and interest rates low, but stable. Central banks will not, we believe, become much more accommodative. But they can maintain their current stance at the very least through 2020 as they continue to undershoot their inflation targets. That implies a durable low-rate environment and a need for investors to look further afield for yield, as well as more tactical investment thinking over mini cycles that may be measured in months rather than years.

Turning to specific risks for next year, markets will follow US/Chinese relations closely. The tensions are mostly about political willingness complicated by domestic politics. Any serious deterioration in the relationship would cut into US growth and possibly trigger further reaction from the Fed to prevent the dollar from rising. This said, we see only one of two extremes - a worldwide recession or a sudden surge in US growth - prompting the Fed to adjust interest rates again in 2020. While we cannot exclude such dramatic developments, neither of these scenarios seem likely to us for the year ahead.



SOURCE: SYZ AM, FACTSET

THE MACRO VIEW: THE COMPRESSED ECONOMIC CYCLE

All of this implies that normalised monetary policy will not be with us any time soon, even in the case that global growth rises. Neither the European Central Bank nor Fed are likely to raise rates. That implies that real cash rates will remain negative, including in US dollars. As a result, looking to 2020, gold is likely to retain some value, if not for attractive returns, at least as a useful diversifier in portfolios, especially if we see more use of fiscal policies.

Turning to currencies, it may be easier to say what we do not expect to happen: there is no reason to expect the dollar to appreciate much further. Since 2014, it has been supported by a growing rate differential with the rest of the world, that we now expect to stabilize. So while there is no reason to strongly favour the euro or Swiss franc, we believe that investors should no longer expect to benefit from further gains in the USD. This also means that emerging assets will no longer face the headwind of a strong dollar in 2020.

We believe that this new model also implies shorter and milder business cycles, of a few quarters or years at most. This shortening of cycles and their smaller magnitude means that investors will have to adapt to weaker or confused signals from traditional indicators.

PORTFOLIO CONSTRUCTION: STAYING INVESTED

One lesson from 2019 should be 'remain invested despite the swings in market sentiment'. While returns in many asset classes this year were solid on paper, unfortunately for many investors they remained just that, on paper. In contrast, our portfolios were invested throughout the year and their performances have been strong.

As we live in a 'Japanified' environment, where rates are low or negative, investors feel pressure to invest their cash, with the possible exception of holdings in US dollars, into riskier assets. This means that we may see underinvested investors chasing returns as we move into 2020.

In this kind of environment, we suggest using derivatives as a tool for cushioning any downside, especially from any hiccups in equity markets. These derivatives build a basis for efficient positions in order to smooth the "performance journey" of portfolios.

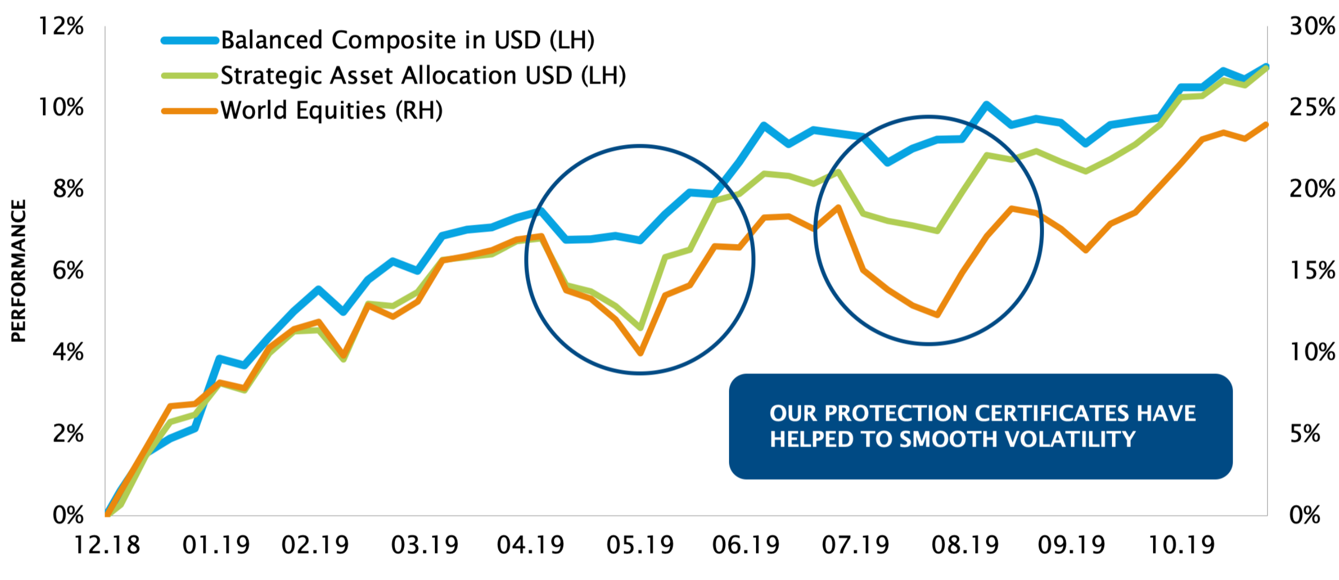
Our equity positioning can be broadly summarised as underweight Europe and Japan, neutral emerging markets and overweight the US, where earnings growth remains sound. We believe that equity investors should focus on quality names and low corporate debt, picking market leaders with strong balance sheets. Beyond this generalisation, we are convinced that large cap, quality stocks remain attractive in the present late-cycle environment.

In addition to equities, the lower-for-longer rates environment means our portfolios are invested in bonds using a selective, laddered approach: at the short end of the yield curve we think that emerging market and high yield credit should offer reasonable returns to both euro and dollar denominated investors. High yield credit remains of course an interesting source of returns since default rates won't go up sharply because macro conditions are no longer deteriorating. For durations between five and ten years, we favour investment grade credit in Europe and the US. Finally, at the longer end of the curve, it makes sense to have US dollar and euro-denominated sovereign bonds in ten-year plus maturities in order to keep a hedge against a macroeconomic deterioration.

Plenty of uncertainties remain. The US China trade war, November's US elections and the evolution of the UK's Brexit policy. But overall, consumer spending in the most developed countries remains robust. As long as that is the case and the main central banks (US Federal Reserve and European Central Bank) keep their commitment to accommodative policies in order to extend the economic cycle, markets should be able to look past any temporary volatility.

In this foreseeable future of persistently negative cash and bond yields, the most important precondition for investment success in 2020 will be to stay invested while maintaining some portfolio hedges.

USD BALANCED COMPOSITE PERFORMANCE



SOURCE: SYZ PRIVATE BANKING. DATA AS OF NOVEMBER 24, 2019.

EQUITIES: IDENTIFYING QUALITY AND DIVIDENDS

As discussed in the previous section, we expect the macro environment in the next decade to be characterized by low inflation, low economic growth and thus very low interest rates. This 'Japanification' scenario will have profound implications for equities. It will certainly prove a risky environment, but if history is any guide, it should also offer excellent opportunities.

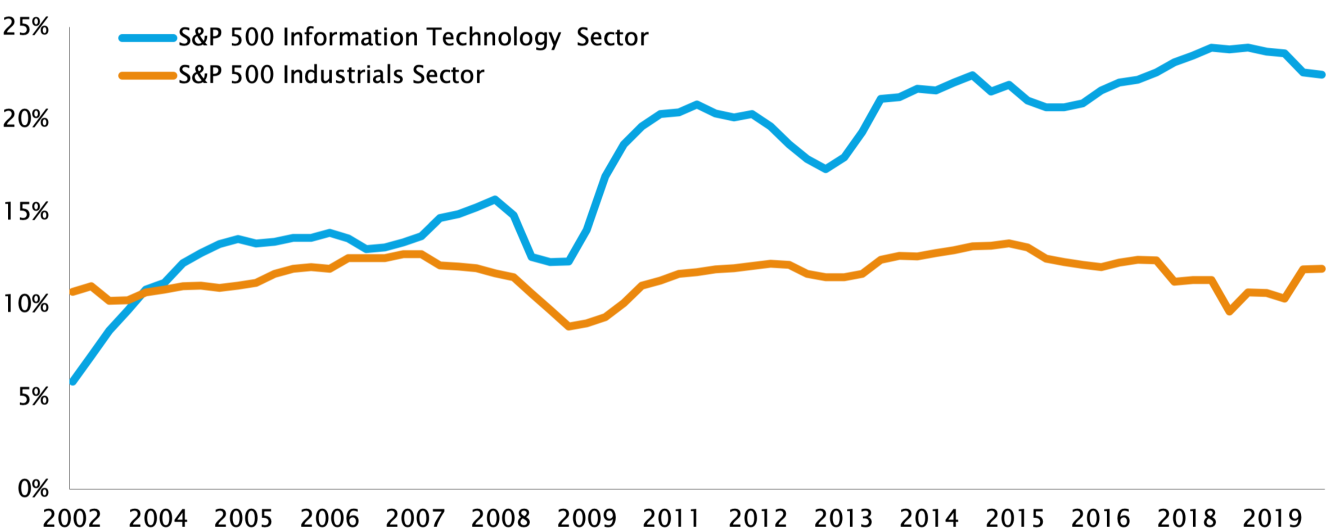
In such a scenario, two investment styles should particularly thrive. The first is quality growth, as companies that are able to grow, irrespective of the economic environment, should experience a rise in the price-to-earnings ratio due to their scarcity. The other is equity income, not only because of their superior dividend yield but also because those companies tend to offer superior risk rewards in difficult market environments.

'Japanification' does not mean that economic cycles will disappear, only that they should become more muted than in the past. That is precisely our scenario for 2020, where we expect a small uptick in growth. This in turn implies better performance from economically sensitive sectors, after years of underperformance. It therefore appears reasonable to include some opportunistic cyclical exposure to portfolios. This could be achieved in particular through some well-run industrials and consumer discretionary companies, whose depressed historical valuations leave ample room for a re-rating if economic sentiment improves in 2020.

Nevertheless, the core of all portfolios should remain centered around high quality companies that can grow regardless of the macroeconomic environment. We try to identify stocks that enjoy pricing power in industries with high barriers to entry to reduce the risk of disruption. This is of paramount importance, as technology, globalization and easy access to capital have dramatically increased the challenge that companies face. Every industry is potentially impacted, from healthcare to consumer brands and financial services. Investors need to scrutinize their portfolios more than ever to avoid losses.

We continue to favor technology companies as they are amongst the main beneficiaries of this transforming competitive landscape. Some of these companies are structural winners and we intend to remain invested in the long term. These firms are natural compounders that should be kept as core equities in the portfolio. As they happen to be mainly located in the US, we are also overweight that region.

OPERATING MARGINS OF US IT SECTOR VERSUS US INDUSTRIALS ... A PREMIUM IS JUSTIFIED



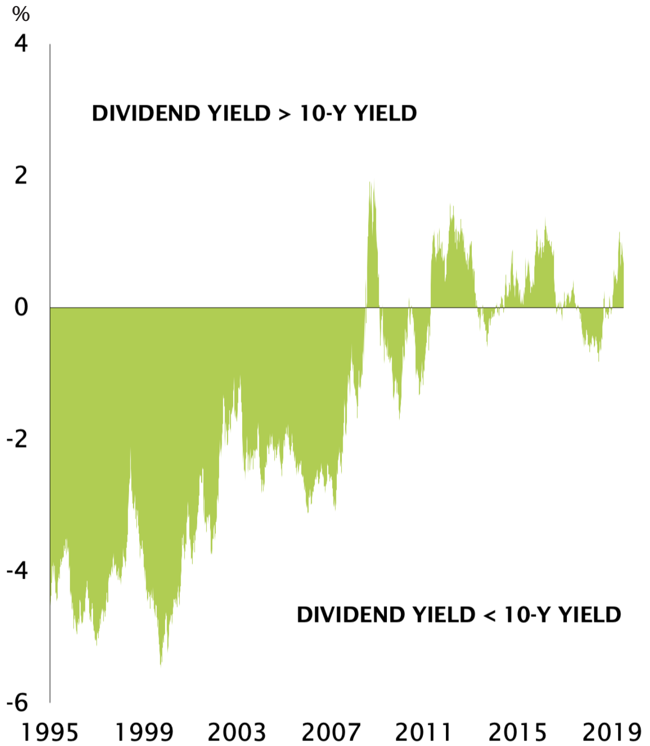
SOURCE: SYZ, BLOOMBERG

We also like dividend payers, as long as they do not sacrifice their growth and investments to pay excessive yields. Those companies tend to be more disciplined than their non-paying peers, which translates into better risk return characteristics in the long term. In a world of ultra low rates, they also provide a valuable source of income.

EQUITIES: IDENTIFYING QUALITY AND DIVIDENDS

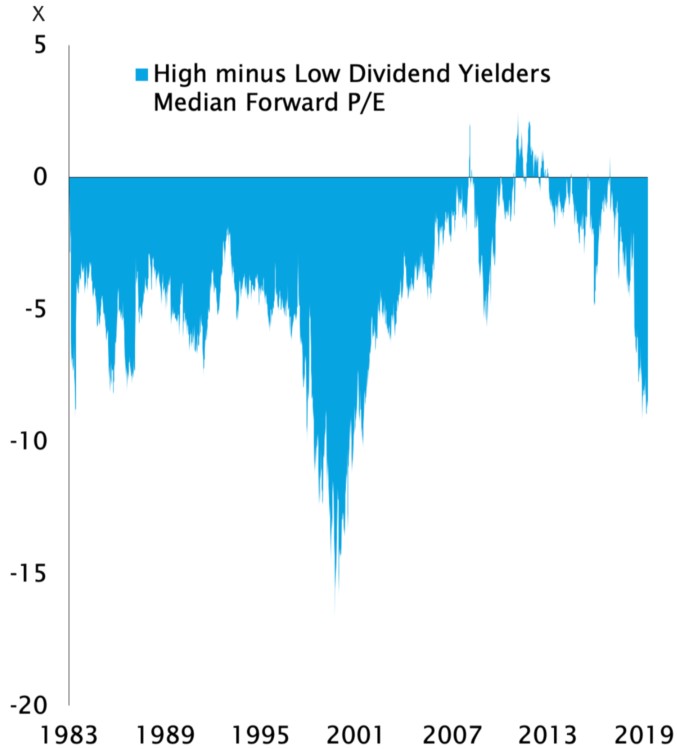
DIVIDEND EQUITIES ARE CHEAP ...

VS. BONDS
MSCI ACWI DIVIDEND YIELD
LESS 10-YEAR US GOVT BOND YIELD



SOURCE: SYZ AM, BLOOMBERG.
DATA AS OF END OF OCTOBER 2019.

VS. EQUITIES
S&P 500



SOURCE: NED DAVIS.
DATA AS OF END OF OCTOBER 2019.

2020 will be paved with geopolitical risks: US elections, Hong Kong unrest and Brexit uncertainty to name a few. But thanks to a more benign economic environment, reaccelerating earnings and still accommodative central banks, we expect equity markets to provide another year of positive performances.

FIXED INCOME: CARRY OPPORTUNITIES

Today's fixed income investor, compared with just a decade ago, needs a far broader approach to earn yield. Investors need to look at more geographies and more deeply into the yield curve. The threat of 'Japanification', and one quarter of the asset class in negative territory, has pushed investors to look beyond home markets for positive returns and reassess the risks.

In 2020 investors will need to have to focus on carry yields and adjust their short-term outlook, selecting names that still offer relative returns with lower volatility. A more active approach, identifying positive carry returns without exposing portfolios to undue risk through carefully selected names. That should be capable of providing portfolios with lower volatility and relatively sound incomes.

Contrary to first impressions, the era of fixed income is not over. In an environment of positive growth, we believe that high yielding credit and hard currency emerging market bonds can both contribute to a portfolio's returns. There are good carry opportunities. Thanks to a combination of growth, supportive central banks and the lack of inflation expectations, policy makers will be able to maintain their current courses.

Of course, the hunt for yield will remain the main allocation driver. While 2019 offered strong returns, this was mostly thanks to the fall in interest rates, rather than tightening spreads. There is still value and space for compression, since spreads are somewhere between fair and slightly expensive.

Investment grade credit offers opportunities further toward the five to ten year part of the yield curve where spreads are wider. This is especially true for the eurozone where the European Central Bank is still purchasing assets. In the circumstances, these look like good substitutes for sovereign debt.

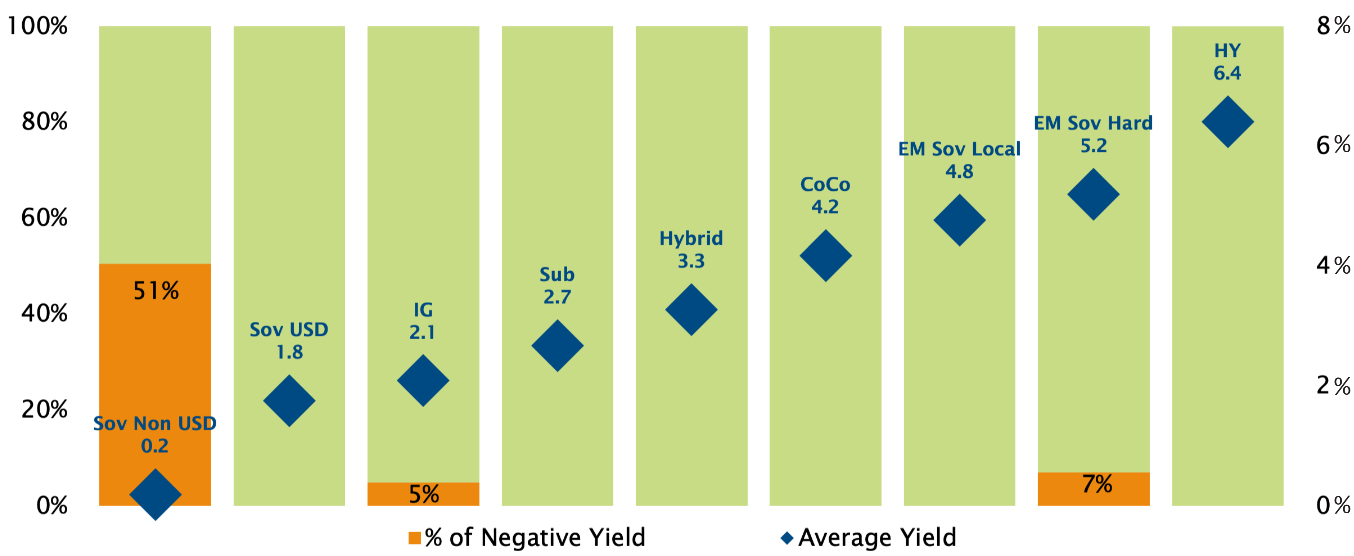
Subordinated bonds, which have not yet recovered from the beating taken in the wake of the financial crisis, continue to be considered risky. We think this risk is exaggerated and that their valuations will begin to catch up as investors reevaluate their investment grade issuers.

In the emerging markets, Brazilian sovereign bonds in hard currency offer high carry and a good probability of successful political reforms that would support bond prices. There are also interesting carry opportunities in Indonesian and Russian debt, where credit fundamentals remain solid. Finally, South African debt has attractive valuations and potential for spread compression if macroeconomic conditions improve.

Finally, on the government debt front, we prefer US Treasuries to European sovereigns. If we are wrong on the growth side, Treasuries offer a more attractive carry and a better ten-year hedge than non-US peers. The greatest unknown for such a scenario would be a Democrat presidential victory next year in the US, which, on the strength of campaigning so far, may raise wages and create more inflation: index-linked Treasuries would provide investors with a better hedge for such a political outcome.

OVERVIEW OF THE GLOBAL FIXED INCOME MARKET

YIELD ARE EXPRESSED IN THE BOND CURRENCY



SOURCE: SYZ AM, ICE INDICES. DATA AS OF END OF NOVEMBER 2019.

PRIVATE MARKETS: INVESTING IN A LATE-STAGE ENVIRONMENT

Building a private market allocation in a well-diversified portfolio has several diversification and return benefits. It requires allocation discipline over the years to spread vintage risk and cash flows. We believe it also requires tactical allocation flexibility to navigate an evolving valuation landscape. Taking a long-term view, pursuing a rational investment process, and using secondary markets are important considerations.

Given their strong historical performance, private market strategies have been high on the satisfaction list of investors. However, after a sustained period of central bank easing and low interest rates, the inflation of asset prices is naturally leading to investors' concerns on valuations. We think it is important to take an active approach to asset allocation and be very selective when it comes to individual opportunities, especially in a late-stage economic environment.

Against this backdrop, we do not want to rely on financial leverage or expansions in multiples to generate performance. Instead, we position our portfolio for operational value creation, targeting structural growth stories. The quality of a business' management team is, and remains, a key criterion in our decision making.

In order to achieve our objectives, we are constantly looking to co-invest with specialist teams who have demonstrated a strong track record in their niche areas of expertise. Their ability to navigate structural complexity and secure information advantages lead to lower entry multiples. The capacity to create long-term value and position an asset for an attractive exit, complements the sources of returns. For these reasons, we see better equity risk rewards in the small and mid-market corporate buy-and-build space, as well as in turnaround situations in Europe in particular.

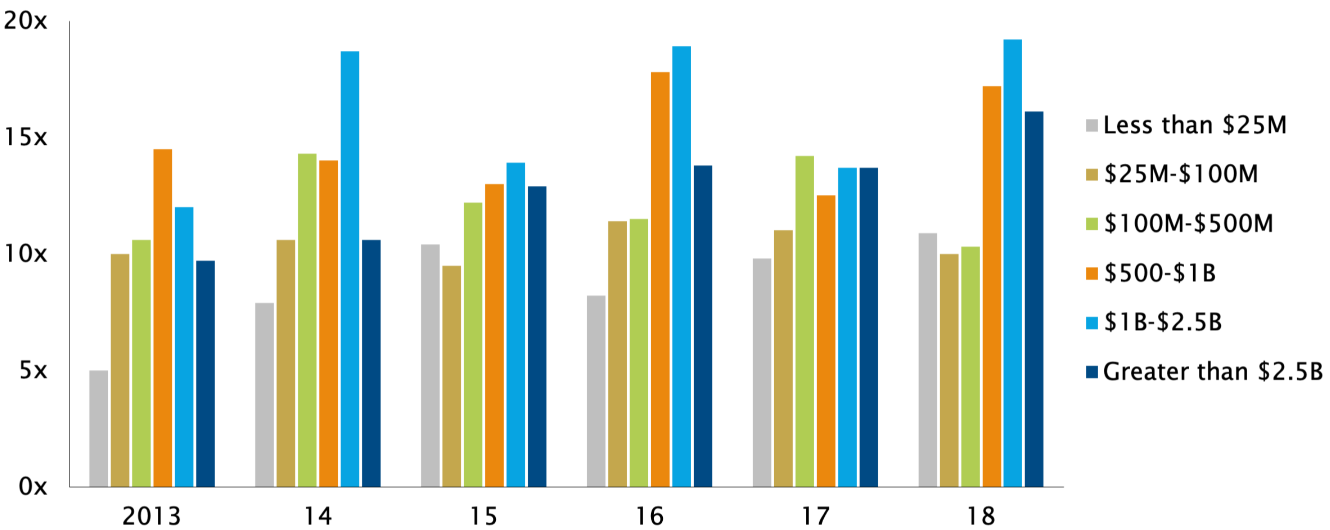
These attributes are most often found in smaller opportunities where information is less transparent, processes are less intermediated, and competition is more limited. We are fortunate in being able to take advantage of lucrative opportunities overlooked by traditional allocators because of their size, complexity, or difficult market access.

In a late cycle environment, fuelled by record amounts of leverage and debt issuances, we also choose to build ourselves some downside protection and diversification by including 'special situations' and uncorrelated strategies into our portfolio mix. We look, for example, at opportunities that we believe are more resilient to a macro downturn, such as litigation financing, royalties or distressed strategies.

One of the keys to private market investing is not to fall into the trap of inertia. Just because a strategy has performed in the past, does not mean that it is well adapted to the next decade. It is all too easy to forget the lessons of a previous cycle, especially in an environment where we believe a lack of liquidity will create volatility, as banks no longer act as market-makers.

With many assets fairly priced, high debt levels, shallow liquidity and the increasing dominance of passive strategies, market conditions are not without risks. Nonetheless, they also create a very attractive opportunity set for the strategies we are pursuing.

MEDIAN EBITDA PURCHASE PRICE MULTIPLE FOR GLOBAL BUYOUT TRANSACTIONS, BY DEAL SIZE



SOURCE: PITCHBOOK DATA, INC.

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LIQUID ALTERNATIVES: THREE THEMES TO DIVERSIFY RETURNS

In the search for a balance of risk and reward in a portfolio, liquid alternatives can play an important role in identifying alpha (the excess return compared with a benchmark). The challenge is that true alpha only exists where there are market inefficiencies. Once too many investors are attracted to a strategy, those inefficiencies are simply eroded back into beta.

In this constant search for alpha, we believe that three themes will stand out over the 12 months ahead.

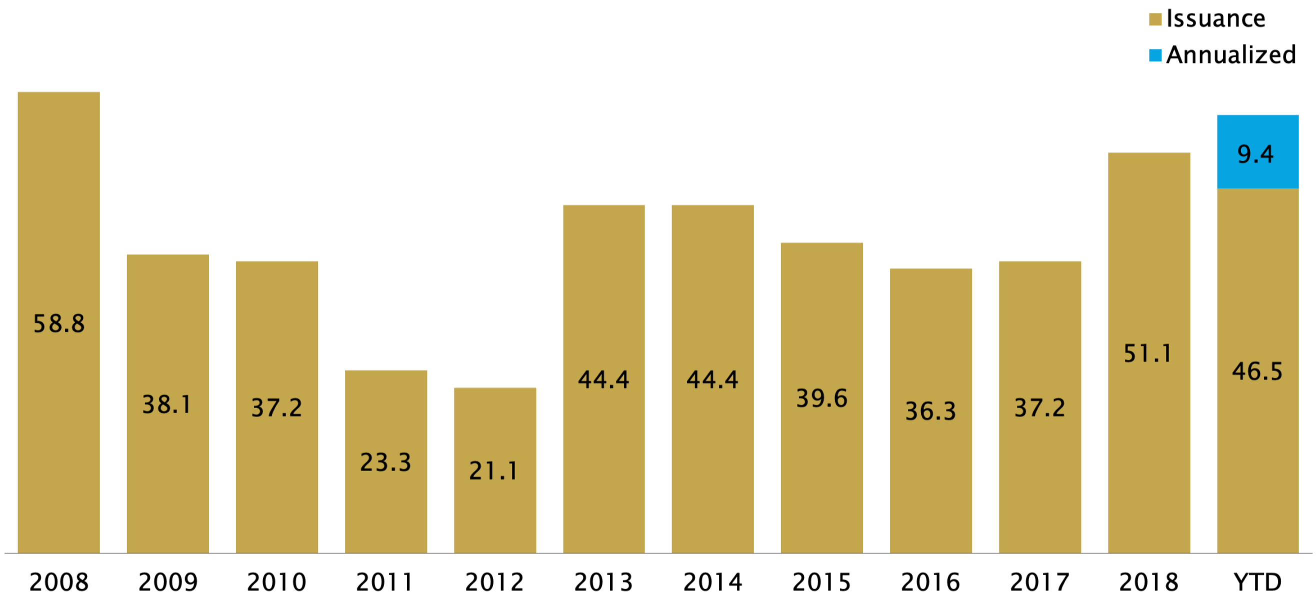
The first is convertible bond arbitrage (or capturing value in the difference between a convertible bond and its underlying stock). The outlook for this strategy has not changed significantly over the last year. It can take advantage of a more volatile environment and at the same time maintains a position in the equity market. This strategy is also backed by a favourable corporate action pipeline and improved US new issuances, thanks to a new tax law.

Secondly, we think there is value to be found in Japan, perhaps ironically given our conviction that the world's developed economies are threatened with 'Japanification'. Yet, thanks to recent reforms under Prime Minister Shinzo Abe, Japan's corporate sector is undergoing profound changes. By making cash more expensive for businesses to hold, Japanese companies are being encouraged to engage in more corporate activities such as merger and share buybacks. This is working. Activity is picking up, creating opportunities with more value for shareholders.

Finally, our third investment theme for the year ahead is 'Machine Learning.' This is a revolutionary technology that is profoundly altering our experience of the world as computers develop their own algorithms, creating new applications to address new and existing problems. We are at a stage where machines are data mining to build models and make discoveries in a range of fields that are independent of human hypotheses. This has created a race for data, and among investors, a search for alpha in the market. These are investable technologies, through highly specialized managers, working to optimise portfolios and create investment and forecasting models.

Each of these themes, we believe, will play out over 2020 and each has the potential to add usefully diverse sources of return to investors' portfolios.

ISSUANCE IN US CONVERTIBLE MARKET
DOLLARS IN BILIONS



SOURCE: BOFA MERRILL LYNCH GLOBAL RESEARCH, ICE DATA INDICES, LLC.
DATA AS OF END OF OCTOBER 2019.

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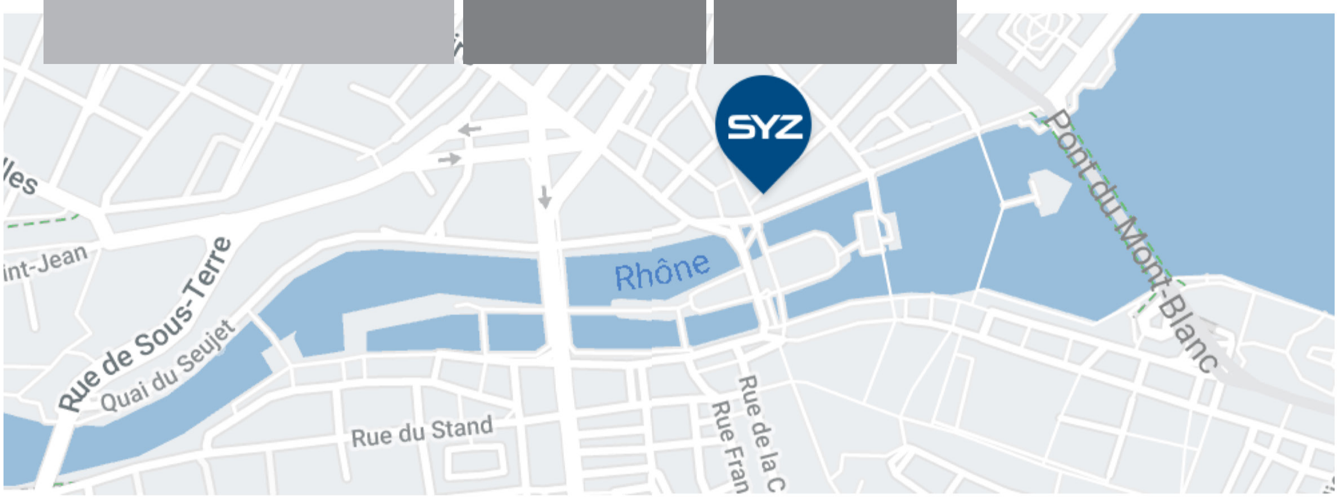

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