QUARTERLY PORTFOLIO REVIEW

BFT FINANCIAL GROUP

FOURTH QUARTER 2019

Welcome to a new decade.

Our key theme for 2020 is that we see stronger global growth ahead. Receding trade tensions; diminished risks of a hard Brexit; reduced odds of a victory for Elizabeth Warren in the US presidential elections; liquidity injections by most major central banks; and improved sentiment about the state of the global economy all helped push stocks higher late last year.

Some clouds have formed over the outlook since the start of the year, however. The December US manufacturing index fell to the lowest level since 2009, while the Purchaser Manager Index (PMIs) in the euro area, UK, and Japan gave up some of their November gains. The conflict between the US and Iran also flared up.

Geopolitical risk will be key this year as global trade tensions continue to simmer, while America's military pivot to Asia to counter China's rise could lead to a dangerous vacuum in the Middle East.

Trade tensions subsided sharply after China and the US reached a "Phase One" agreement.

The deal prevented tariffs from rising on December 15th on $160 billion of Chinese imports. It also rolls back the tariff rate from 15% to 7.5% on about $120 billion in imports that have been subject to levies since September.

However, stock market sentiment is quite bullish at the moment, which makes equities more vulnerable to any disappointing news in the short term after the strong rally in the last quarter of 2019. While we are maintaining our positive 12-month view on global equities in anticipation that global growth will rebound convincingly later this year. We continue to see more and more evidence that the global economy is actually strengthening. Our key expectation is that global growth should accelerate in 2020. So, we continue to favour stocks over bonds. A more defensive stance might be appropriate starting in late 2021.

Cyclical stocks, including financials, will outperform defensives. Which indirectly means that it is likely that international stocks will outperform their US peers.

Central banks will stay dovish, but bond yields will nevertheless rise modestly thanks to stronger global growth. We favor emerging market debt over investment grade and government bonds. As the dollar is typically a counter cyclical currency, we think the odds are high that the US dollar will weaken in 2020 against the EUR, GBP, AUD, and most EM currencies. A recovery in demand and therefore in the manufacturing sector will be positive for oil and industrial metals prices. Gold prices could be range-bound next year but could rally again once inflation breaks out.

The Global Economy

There is mounting economic evidence that the global manufacturing cycle is bottoming out. The "official" Chinese PMI produced by the National Bureau of Statistics rose above 50 in November for the first time since May. The private sector Caixin manufacturing PMI has been improving for five consecutive months. The euro area manufacturing PMI increased over the prior month, led by gains in Germany and France. Although the PMI data for the US has been mixed.

The auto sector has been particularly hard hit during this manufacturing downturn. Fortunately, the industry is showing signs of life with the new orders-to-inventory ratio moving back into positive territory for the first time since the autumn of 2018. US banks are also reporting stronger demand for car loans. In China, vehicle production and sales are also improving. Both automobile ownership and vehicle sales in China are still a fraction of what they are in most other economies, suggesting further upside for sales. Which is important as the car makers and its suppliers make up a large part of the global manufacturing chain and that means that it can be supported for many years to come as car ownership in China continues to grow.

Global financial conditions have eased sharply, largely due to the dovish pivot by many central banks last year. Monetary policy normally impacts the economy with a lag of 6 to 9 months, so we should start to see effects soon.

Trade War Uncertainty

The trade war remains the biggest risk to our positive view on global growth. However, for President Trump, the key priority is to get re-elected this year. Trump generally gets poor grades from voters on most issues. The one exception is the economy. Rightly or wrongly, the majority of voters approve of his handling of the economy. An escalation of the trade war would hurt the US economy, especially in a number of Midwestern states that Trump needs to win to remain president. The point of the tariffs was not simply to raise revenue; it was to get China to the negotiating table. For their part, the Chinese would rather grapple with Trump now than face him after the election when he will no longer be constrained by re-election pressures.

Contrary to most media reports, there is a fair amount of overlap between what Trump wants and what the Chinese themselves would like to achieve. For example, as China has moved up the technological ladder, many Chinese companies have begun to complain about intellectual theft by their domestic rivals. Thus, strengthening intellectual property protection has also become a priority for the Chinese government.

In the same vein, China aspires to transform the RMB into a reserve currency. A country cannot have a reserve currency unless it also has an open capital account. Hence, financial market liberalization must be part of China's long-term reform strategy. These mutual interests between the US and China could provide the basis for a long-term trade truce.

In the meantime, the Chinese government is trying to stimulate its economy to counter the negative impact of the trade tariffs. However, this time around the Chinese government is not keen to increase the credit growth. One of the developments that has gone largely unnoticed by investors this year is that China's general government deficit has climbed from around 3% of GDP in mid-2018 to 6.5% of GDP at present. Some of this stimulus has been used to finance tax cuts for households. Some of it has also been used to finance infrastructure spending.

Germany should benefit from stronger global growth and a recovery in automobile production. The recent rebound in the German PMI is encouraging in this regard. The weakness in euro area growth this year has been concentrated in Germany and Italy. France and Spain have actually grown at a trend-like pace. Italy should also benefit from an easing in financial conditions and receding political risks. The Italian 10-year government bond yield has fallen from a high of 3.69% in October 2018 to 1.23% at present.

Fiscal policy across the euro area is also turning more stimulative. The additional fiscal spending in the euro area rose by 0.4% of GDP this year mainly due to a somewhat larger budget deficit in France. The trend should remain positive in 2020 as even in Germany fiscal policy should loosen.

The UK economy should start to recover this year as Brexit uncertainty fades and fiscal policy turns more stimulative. There is not enough appetite within the Conservative party for a no-deal Brexit. As such, Prime Minister Boris Johnson's victory will allow him to push his proposed deal through Parliament. It will also allow him to fulfill his pledge to pass a budget that boosts spending, which will add to the global growth recovery.

Japan has been hard hit by the global growth slowdown, given its close ties to its Asian neighbors, mostly China. Add on an unnecessary consumption tax hike, and it is no wonder the economy has been weakening. Despite this weakness, there have been signs of improvement of late: The manufacturing PMI ticked up in November, while the services PMI rose back above 50. Consumer confidence also moved up to the highest level since June. More importantly, Prime Minister Abe announced a multi-year fiscal package worth approximately 26 trillion yen (USD 230 billion).

Risks

We see two key risks to the global economy this year and those are increased geopolitical risks, which could be in the Middle- East or in Asia. Increased tensions in the Middle East can lead to higher oil prices or less global trade. Both would be detrimental for global economic growth. However, rather than having a big impact on the global economy we think it could add to market volatility as investor sentiment will ebb and flow with the short-term news. That means we favor staying on course with our pro-risk investment strategy and avoid becoming distracted from short-term volatility as volatility is not the same as investment risk.

The second major risk we see is rising inflation. Inflation expectations are low after last year's slow-down but looking beyond the next 12-to-18 months, there is a good chance that inflation will increase materially from current levels. The unemployment rate across the G7 has fallen to a multi-decade low, while wages are rising, governments globally are increasing fiscal spending and central banks will stick to a low interest rate regime for the foreseeable future.

A combination of these factors could very well lead to higher inflation in the next few years. Rising inflation typically affects equity and bond markets in a negative way as it puts pressure on profit margins and the fact that markets will expect higher interest rates going forward.

Equity Markets

Relative valuations favor stocks over bonds. Despite the stock market rally this year, the MSCI All-Country World Index currently trades at a reasonable 15.8-times forward earnings.

This is below the forward PE ratio of 16.7 reached in January 2018 and even below the forward PE ratio of 16.4 hit in May 2015. Non-U.S. stocks are quite a bit cheaper than their U.S. peers.

The forward PE for U.S. equities currently stands at 18.1, well above the forward PE of 13.6 for non-US equities. In our view both European and Asian equities are likely to outperform this year. As cyclical and financial stocks typically do well in an economic climate like the current one, we think value stocks will outperform growth stocks.

Fixed Income

Central banks will remain on the sidelines next year. Inflation is currently still running well below target in most countries. Even in the U.S., where wage growth has risen, core inflation excluding housing has averaged only 1.2% over the past five years. Nevertheless, long-term bond yields could still move higher next year as investors revise up their estimate of the neutral rate in response to faster growth. Consistent with our bullish view on global equities, we expect corporate bonds to outperform sovereign debt in 2020. In the U.S. neither interest coverage nor debt-to-asset ratios are particularly stretched. Admittedly, the picture looks less flattering if we focus on high-yield issuers.

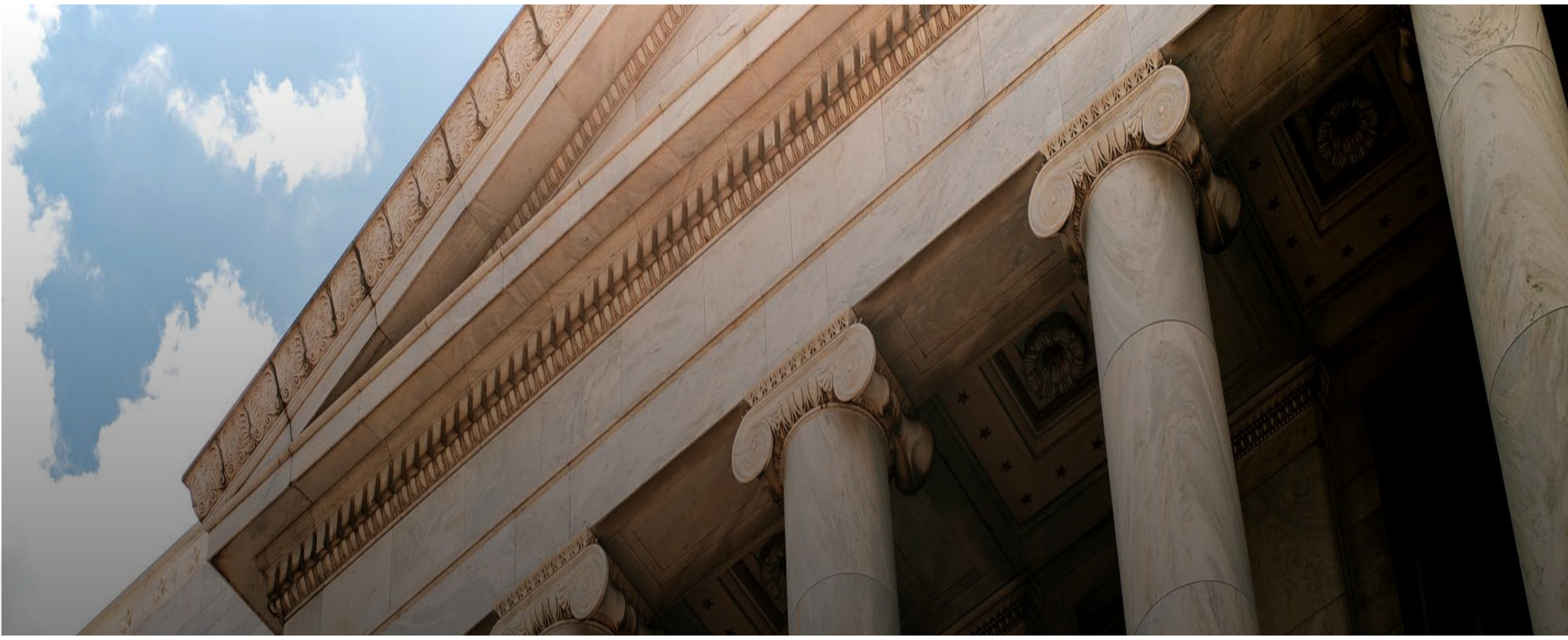
To increase yield on a diversified fixed income portfolio we therefore favor emerging market debt, particularly local currency government bonds, over corporate high yield. Many idiosyncratic risks have now eased (such as in Argentina, Brazil and Turkey), while EM growth is showing signs of stabilization. Real yields remain attractive relative to developed markets given generally low inflation combined with relatively high nominal interest rates. The asset class would likely do well when we see a reacceleration of global growth.

Portfolio Review

The last quarter of 2019 was very positive for equity markets. The ongoing improvements in economic data turned investor sentiment much more positive. Especially small cap and value stocks, which underperformed earlier in the year, performed strongly in the last quarter. As we believe value stocks will continue to perform, we keep a value bias and small cap bias in the portfolio.

Fixed income also performed strongly in 2019 as U.S. bond yields came down as the Fed lowered interest rates. Even inverting at a certain moment. This led to strong price performance of government bonds.

After the sharp rally in bond prices over the summer we have reduced the exposure to U.S. Treasuries and instead added Treasury Inflation Protected bonds (TIPS) as we believe these will perform better in a rising bond yield environment.



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The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is a market value weighted index with each stock's weight in the index proportionate to its market value.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

You cannot invest directly into an index.