January, 2020

Dear Client

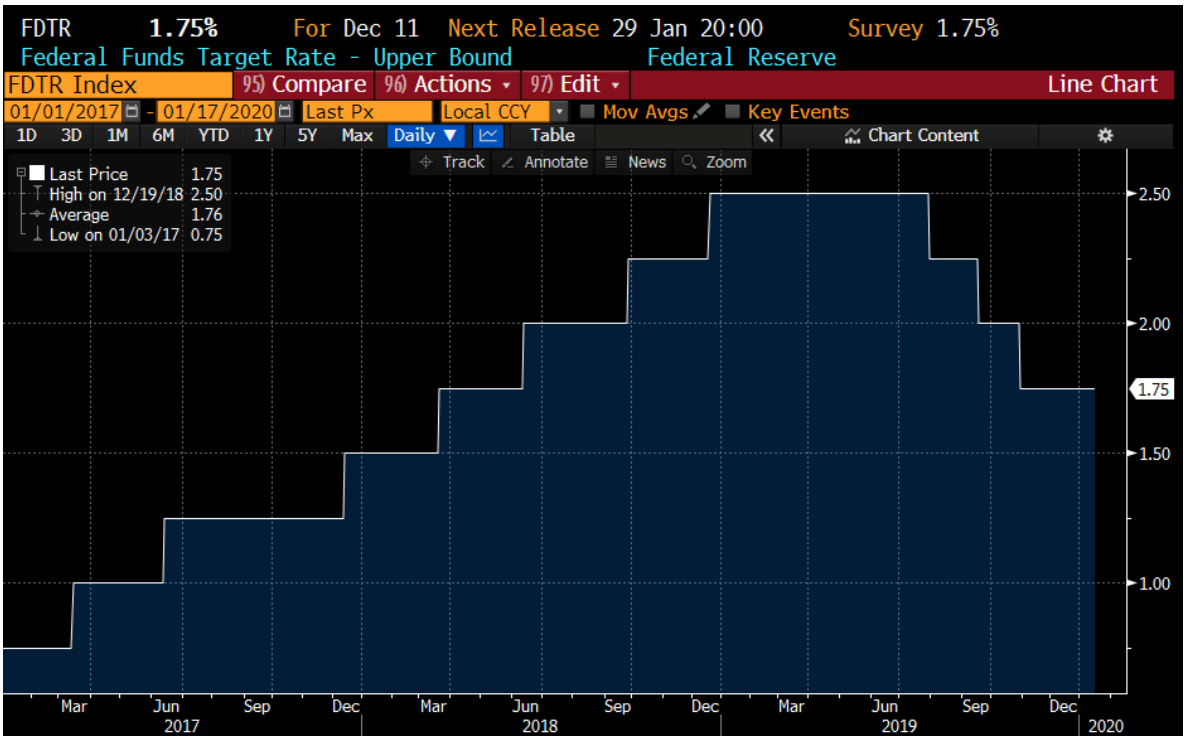
We are pleased to enclose your end-of-year portfolio statement, accompanied with a brief commentary on the key events of the year 2019 and the expectations for the new year 2020.

Economic and financial summary of the year 2019

In 2019, the global economic growth fell to the lowest level since the last financial crisis, due to the slowdown of the US, EU and Chinese economies and doubts about an ordered Brexit in Europe.

Although the global labor market and consumption remained relatively strong, manufacturing activity, fixed investments and trade growth weakened, as the US-China trade conflict took his toll from the business confidence around the world. Problems in the German auto sector further exacerbated this weakness.

After a 2018 where the FED raised the rates in the USA, it changed course in 2019, moving to policy easing. This move, accompanied by further easing policy measures from other central banks (ECB and BoJ) lead to an increase in the monetary support around the world.



Federal Funds Target Rate – Upper Band
Source: Bloomberg

Some of the key events of the year:

- Increased tensions in the Persian Gulf (Strait of Hormuz, Yemen, Saudi Arabia)

- The Amazon rainforest burns while there is mounting evidence the planet is warming up
- Protestors take the streets (Hong Kong, Algeria, Chile, Bolivia, Iran)
- Central American migrant exodus crisis
- North Korea-US Nuclear talks stall
- The US house impeaches president Donald Trump
- Brexit saga upends British politics

A look at the main asset classes in 2019

The year 2019 turned out to be better for most investors than expected, considering the geopolitical uncertainty and the weakening global economic momentum seen at the beginning of the year.

Equity markets

In 2019, all major equity markets rebounded strongly after their setback in late 2018, fueled by the FED's shift to policy easing, delivering high double-digit returns for the year (USA = 30%, Europe = 26%, Switzerland = 28%, Japan = 20%, Emerging Markets = 19%, World = 26%)[1]. The revaluation was driven almost exclusively by higher valuation multiples (while earnings remained fairly constant).

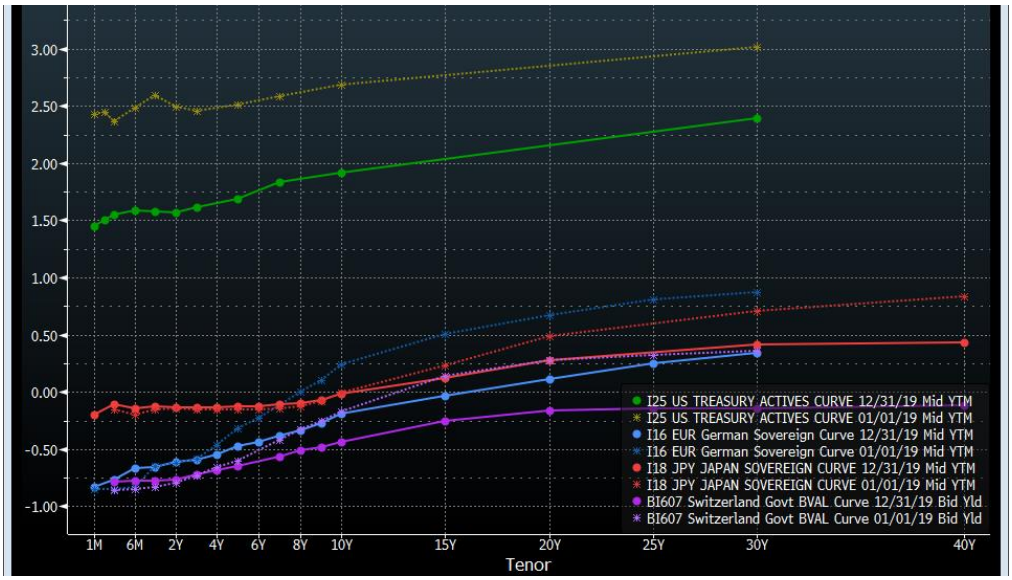
Security	Currency	Price Change	Total Return	Difference	Annual Eq
1) SPX Index	USD	27.23%	29.75%	--	30.22%
2) SXXP Index	EUR	21.20%	25.71%	-4.04%	26.11%
3) SPI Index	CHF	27.95%	27.95%	-1.80%	28.39%
4) MXEF Index	USD	15.90%	19.13%	-10.62%	19.42%
5) TPX Index	JPY	17.01%	19.95%	-9.80%	20.25%
6) MXWD Index	USD	22.71%	25.90%	-3.85%	26.30%

SPX (S&P 500 Index), SXXP (Eurostoxx 600 Index), SPI (Swiss Perf. Index), MXEF (MSCI Emerg. Mkt. Index), TPX (Topix Index), MXWO (MSCI World Index)
Source: Bloomberg

[1] Measured in local currency (for emerging markets measured in USD), including dividends.

Bond markets

US treasury yields declined sharply during the first half of 2019 due to fears of a global downturn, while yields in Germany, Switzerland and Japan reached historic (negative) lows. During the second half of the year the US yields stabilized, after the global recession fears subsided.



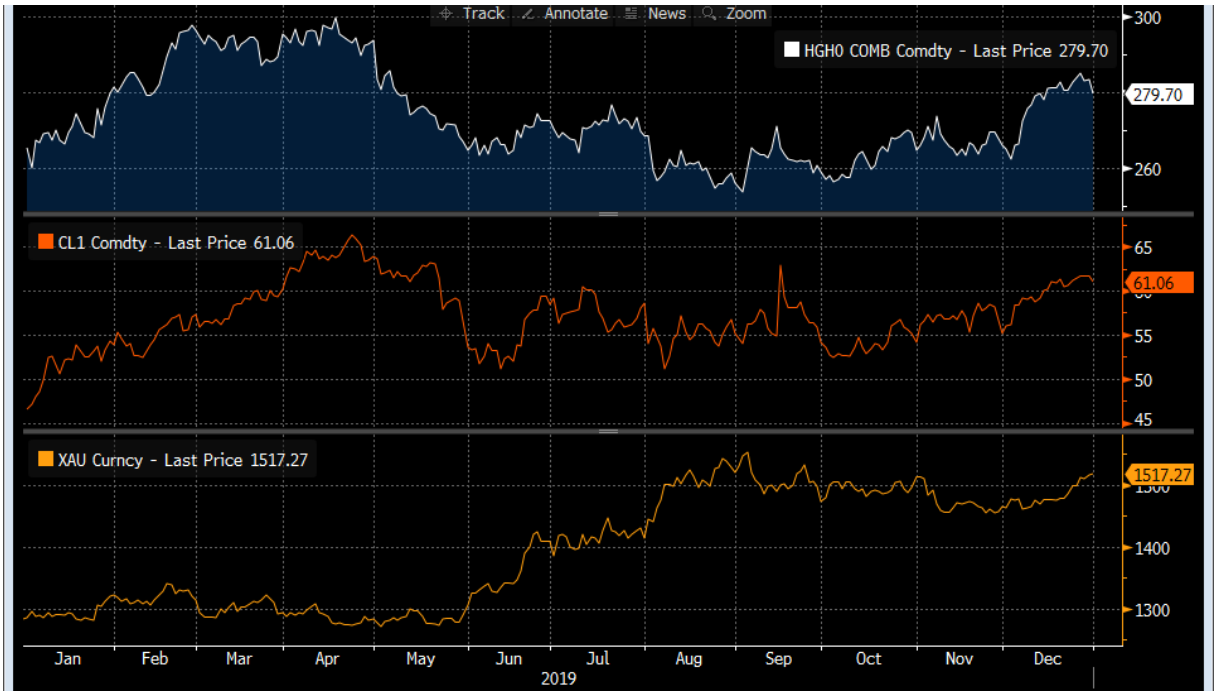
Benchmark rates: GREEN (USA); BLUE (Germany); RED (Japan), VIOLET (Switzerland)
Source: Bloomberg

After reaching a peak end of 2018, the margins of all credit categories fell, closing 2019 at compressed levels. This effect, combined with the decline of the benchmark rates, granted investors with credit risk exposure above average returns during 2019.

Spreads: GREEN = USD Investment Grade; WHITE = USD Emerg. Markets; YELLOW = USD High-yield
Source: Bloomberg

Commodities

US tariffs on China and the slowdown in global manufacturing weighted on industrial metals such as copper and iron. Oil saw prices recover early 2019, as the OPEC sought to restrain supply and tensions raised in the Persian gulf, but prices softened again during the second half of the year as demand softened. Gold price rallied on the back of lower (real) interest rates.



Commodity prices: WHITE (Copper, in USD/MT); ORANGE (Oil, in USD/bb), YELLOW (Gold, in USD/oz.); Source: Bloomberg

Foreign exchange markets

After 2018 gains, the USD maintained his strength against almost all major currencies, supported by better US economic growth and the interest rate advantage. China allowed the CNY to devalue to offset some of the tariff-related pressure, weighing on other EM currencies. Only the MXN held up, as the country reached a new trade agreement with USA and Canada.

Currencies: WHITE (USD Index); YELLOW (EURUSD); BLUE (CHFUSD); GREEN (CNYUSD); RED (MXNUSD)
Source: Bloomberg

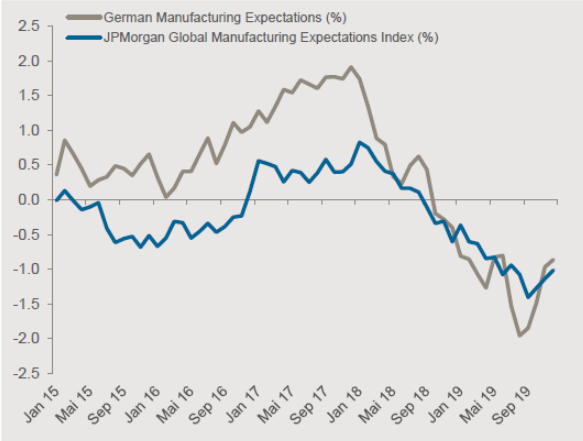
Market outlook for the year 2020

The global economy starts its 10th consecutive year of 3%+ growth and bond yields are close to multi-year lows. In a late-cycle, low-yield world, investors should avoid their "yield" anxiety, and tilt their portfolios towards quality, while considering some kind of downside protection. Investors targeting a given level of return need to increase their holdings of equities (and accept higher risks) or reduce their return expectations.

Our base case for 2020 is for a year with positive but lower returns vs. 2019 for most asset classes, as policy, economic and political dilemmas interact with each other and valuations denote overvaluation:

- Geopolitics: We expect a de-escalation of the US-China conflict, as the US presidential election campaign gains traction. The increase of the polarization in the US may affect investor sentiment, while EU political risk should abate as Brexit subsides.
- Economic growth: We expect the global economic growth to stabilize but to remain muted, showing very little recovery in industrial production, capex and trade. A global economic recession continues to be unlikely, as unemployment remains low (respectively consumption remains strong) and the monetary policy remains supportive.

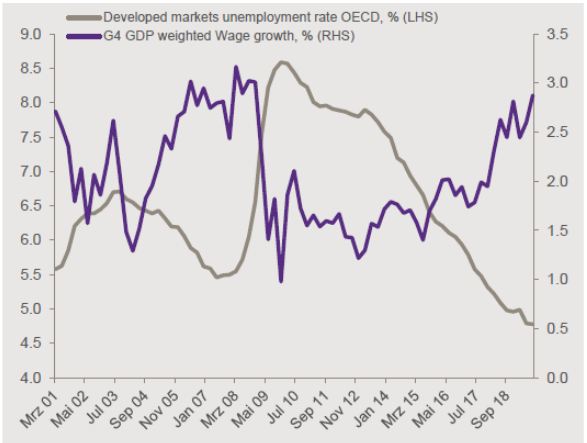
Manufacturing expectations have started to improve



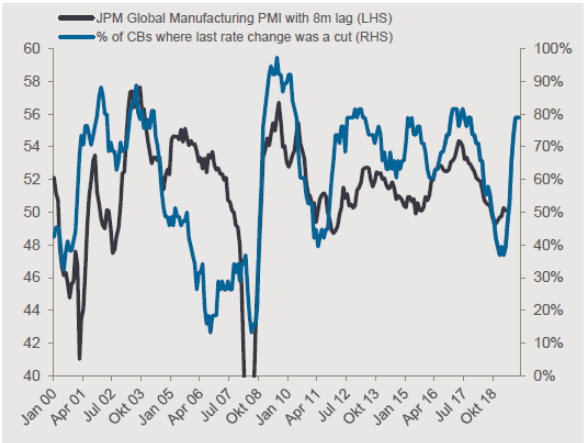
Chinese data is starting to recover

Source: J.P. Morgan Asset Management, Bloomberg, as at January 2020. LHS chart: JPMorgan Global Manufacturing Index shows the standard deviation (s.d.) since 2013, and the source is JPMorgan Corporate & Investment Bank, Global Economic Research. German Manufacturing Expectations series is calculated as a simple average of the standard deviation vs. December 2014 for the Markit German Manufacturing PMI Future Output and IFO Manufacturing, Trade and Construction Business Expectations. PPI = Producer Price Index. Opinions, estimates, forecasts, projections and statements of financial market trends are based on market conditions at the date of the publication, constitute our judgment and are subject to change without notice. There can be no guarantee they will be met.

Unemployment remains at historically low levels

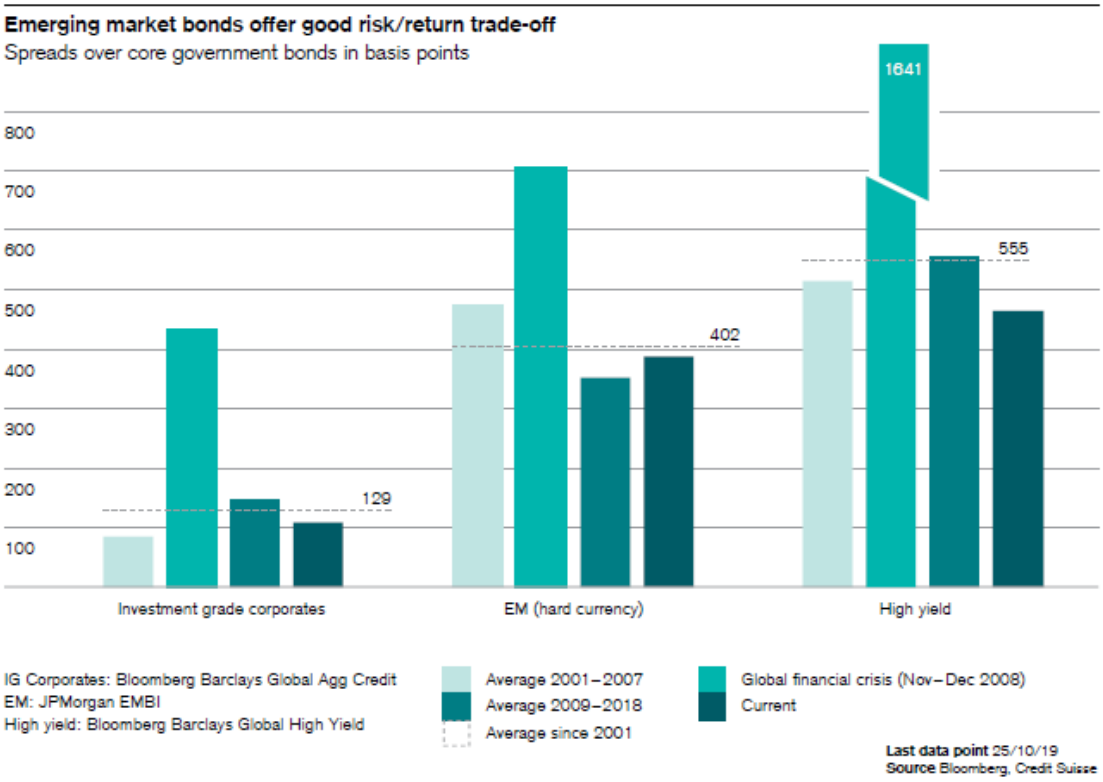


Global monetary policy remains supportive

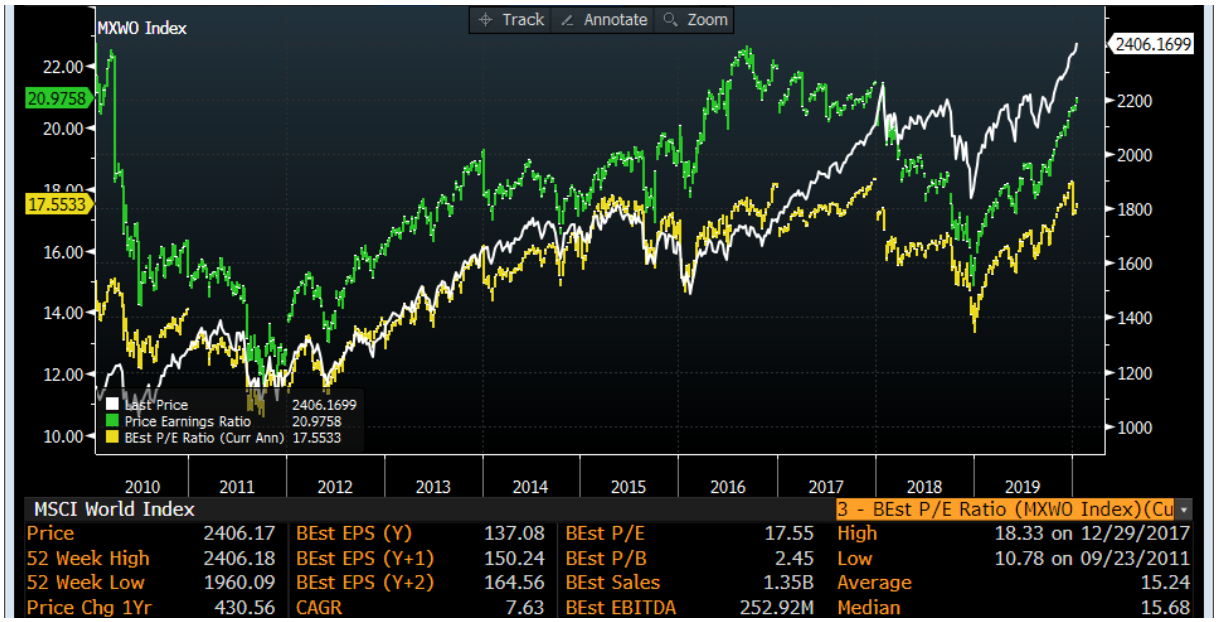


Source: J.P. Morgan Asset Management, Bloomberg, as at January 2020. OECD = Organisation for Economic Co-operation and Development. CBs = Central Banks. Opinions, estimates, forecasts, projections and statements of financial market trends are based on market conditions at the date of the publication, constitute our judgment and are subject to change without notice. There can be no guarantee they will be met.

- Fixed income: Nominal returns on most core government bonds are likely to be negative, except in the USA. Tight spreads imply anemic expected returns in investment grade. Solid returns are expected in Emerging Markets hard currency debt, particularly in Asian markets, where worries over the impact of the US-China trade conflict have triggered the rise in spreads. Compressed high-yield margins do not compensate for risk (particularly in the B segment, due to high level of corporate leverage and increasing default risks). Subordinated financial debt in developed markets remains attractive.



- Equities: Against the backdrop of limited earnings growth (as the margin pressure is intensifying due to increasing wages) and flat to higher bond yields, returns in key equity markets are likely to be in the single-digit range. Equity markets in developed countries are trading currently at around 17.5x forward earnings, significantly above their 10-year average (15.2x).

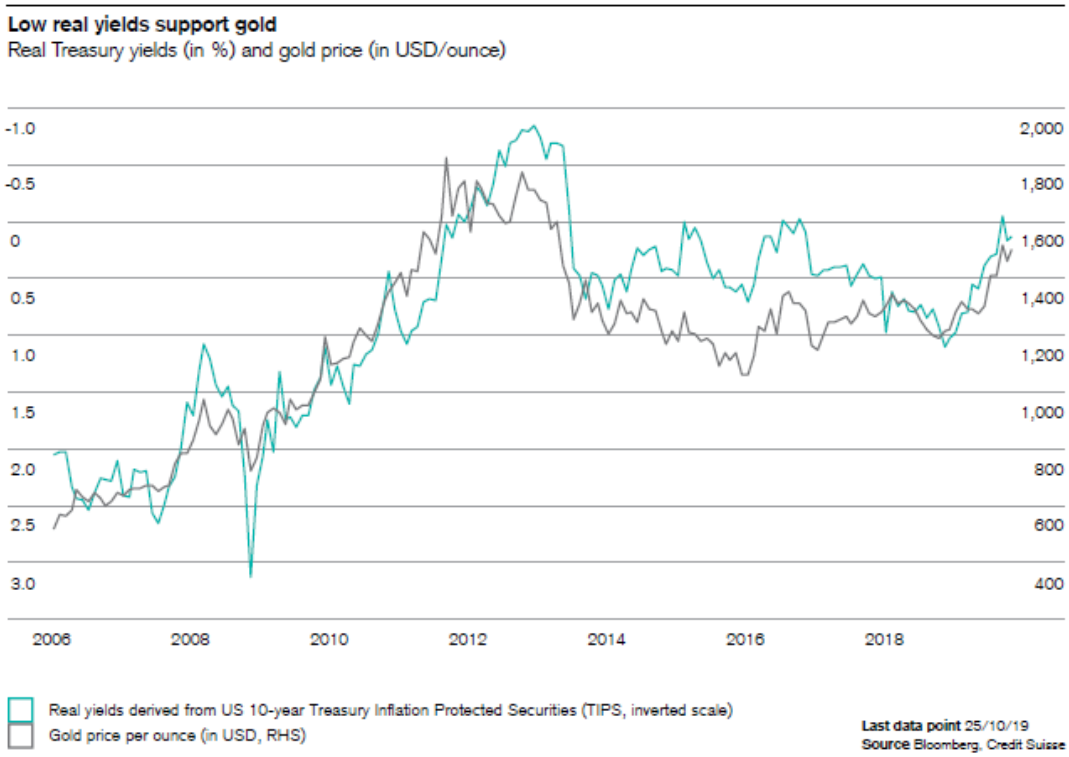


Emerging Markets equites may appear undervalued and attractive, but they may recover only if the trade conflict abates.

Sectors we like in equities:

- Technology: Driven by secular growth drivers such as innovation (5G, Internet of Things, AI, digitalization) and software as productivity enabler.
- Financials: Central bank "tiering" to boost profitability of EU banks. Valuations attractive and fundamentals improving.
- Consumer discretionary: Solid labor markets, wage growth, strong household balance sheet and low interest rates support consumer demand and spending.

- Forex: The USD should retain its strength early in the year, but the EUR is expected to recover terrain during the 2nd half of the year, as the Eurozone economic recovery takes hold and the USD carry loses its clout. The GBP would gain strongly on the back of a Brexit resolution. The CHF seems for us overvalued against the EUR, and if the EU economy picks up, it could lose some ground.
- Commodities: Barring a major escalation between Iran and the USA, oil prices are likely to continue to stay subdued. Gold set to outperform, supported by very low (real) rates.



As in previous years, we will continue to monitor the markets closely for any sign of deterioration of the global economy to be able to react accordingly.

We wish you a happy holiday season and a good start of 2020!

Your Triaxis Team.