PORTAL

ASSET MANAGEMENT

INVESTMENT OUTLOOK 2020

Our inaugural Investment Outlook for 2020 will attempt to address three key challenges:

1. Where we are in the global business cycle given the macroeconomic data and how this will affect the various traditional asset classes given current securities valuations.
2. What are the major themes driving the Cryptocurrency market overall, and?
3. Our investment hypothesis underpinning this as an uncorrelated asset class and attractive source of returns.

Key Macroeconomic Takeaways:

- Emerging Markets (EM's) look to drive global growth in 2020 as trade tensions ease.
- Global trade and PMI data have reached an inflection point and we are seeing business and consumer confidence return globally.
- Equity markets in particular have been impacted by perversely low interest rates resulting in excessive cost cutting and share buybacks, resulting in valuations that have disconnected from the underlying corporate outlook.

Key Cryptocurrency Takeaways:

- The outlook for the cryptocurrency markets are overwhelmingly positive as institutional interest grows and exchanges are regulated.
- Facebook's Libra is a game-changer and will drag governments into the Cryptocurrency space as they risk being completely bypassed by business.
- Tokenised fiat currency's will be driven by business's providing consumers what they want as we move towards a cashless society.
- Regulation remains opaque and difficult to forecast, but moving in the right direction.
- Our strategy has proven itself as able to generate attractive risk-adjusted returns independent of, and uncorrelated with, the traditional securities markets and their drivers.

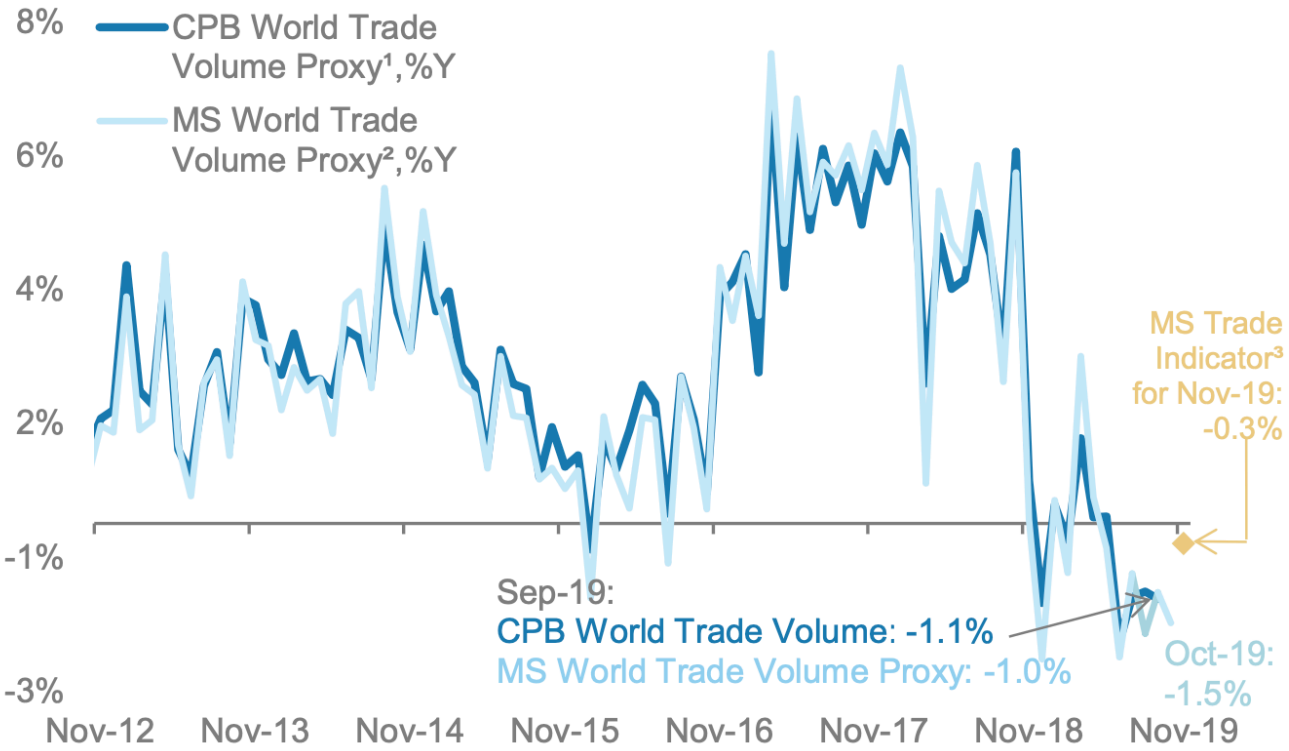
1. GLOBAL MACROECONOMIC OUTLOOK

We believe that a coordinated global economic recovery in 2020 is likely as we end an almost two-year downtrend in business confidence and global growth expectations driven by the US-China trade war and tightening monetary policy. For the first time since the beginning of 2018 we see both trade tensions and global monetary policy easing simultaneously. This, combined with the expectation of sustained easy monetary policy, leads us to believe that we will see a return in business confidence and further hiring, making the policy stimulus overall more effective.

In this environment of reduced uncertainty and 'lower-for-longer' interest rates, coupled with moderate wage growth, we should see a recovery in consumer spending. This will further drive investment activity as corporate confidence improves as consumer demand picks up. Throughout 2018, tighter policy and escalating trade tensions both weighed on growth, and even though monetary policy began to ease from the beginning of 2019, it was offset by rising trade tensions and geopolitical risks such as Brexit. Today, these two forces are both moderating and reinforcing each other in supporting the global economy.

From my perspective, the most important global growth indicators – Global Trade data and PMI's (Purchasing Managers Indices), provide an early signal of a turnaround in global growth. As things stand, the October and November data show both trade and the new orders component of the manufacturing PMI stabilising as per the chart below:

Trade Activity is Stabilising



Source: Morgan Stanley, Global Economics, Global Macro Chart Board, 4 December 2019.

Finally, we expect that the recovery in global growth will be driven by the Emerging Markets (EM's). In China, we believe an easing of trade tensions will lift corporate sentiment and continued PBoC policy support will help to drive a recovery in growth.

In EM's outside China, macroeconomic stability has given central banks the space to ease monetary policy, which helps to support a recovery in growth.

- In India, the improvement in the health of the financial sector will help to reduce risk-aversion and, coupled with continued policy reforms, should drive an improvement in domestic demand.
- Similarly, in Brazil, greater transparency and political accountability coupled with lower rates will help to boost consumer demand and the passage of pension reform will help to support corporate sector sentiment.
- In Russia, acceleration in infrastructure spending, supported by both fiscal and quasi-fiscal easing, lifts growth higher in 2020.
- South Africa is also showing nascent signs of renewed growth and optimism as corruption is rooted out and economic policy has stabilised.

In the Developed Markets, we see stabilisation but very sluggish growth.

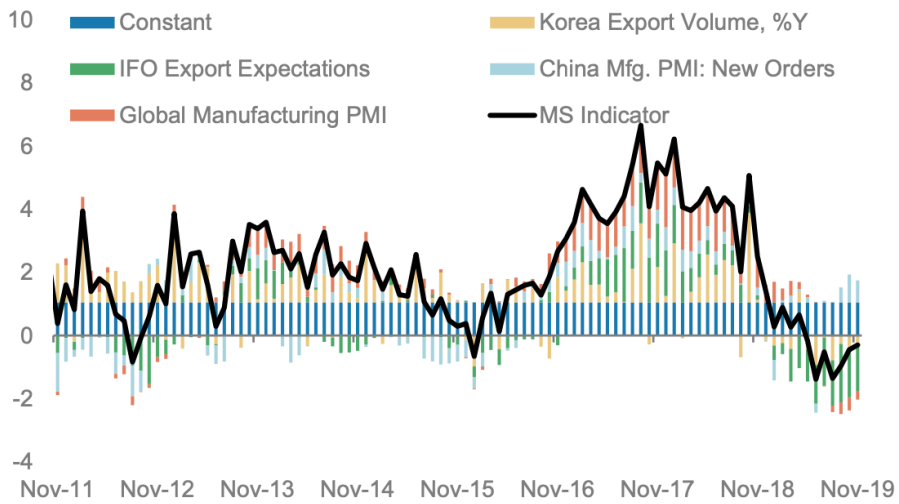
- The USA has lowered rates to offset the fiscal support and doesn't have much room to cut further.
- The Eurozone is still battling with the effectiveness of its monetary policy easing being constrained and an ageing population demographic with unsustainably high unemployment amongst the youth.
- Japan's consumption tax will weigh on growth and consumer demand.
- As always, the UK is still not inspiring confidence with its forced Brexit plans.

Overall, we believe that global growth has reached an inflection point and will recover if the US-China trade talks continue in a positive manner. There are definitely risks to the outlook, especially lingering uncertainty around trade talks that have shown progress but not a comprehensive deal as of yet. A new potentially negative development is the impending impeachment of President Trump, and what this will mean for US Foreign and Trade policy in the new year.

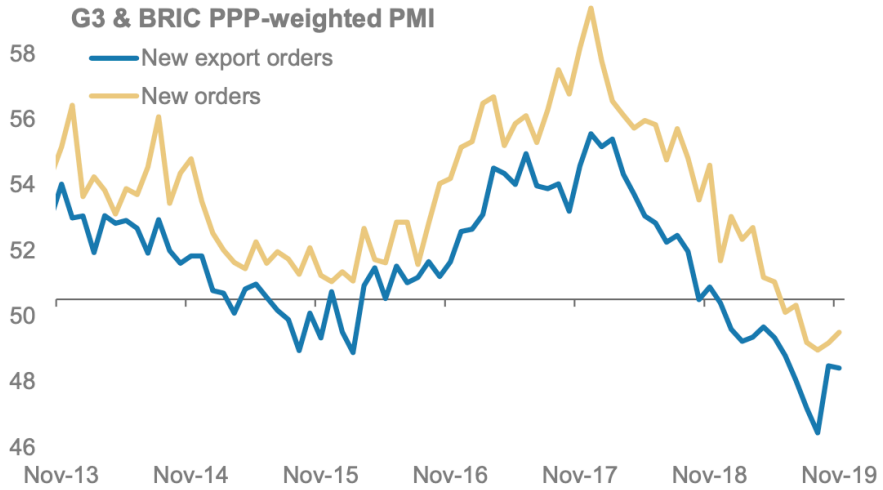
Global Trade, New Orders and PMI's

Global trade growth contracting by a narrower margin

Components of trade indicator still mixed directionally



PMI new orders rose for 2nd month, export orders stable



New orders/inventory ratio improved again in November

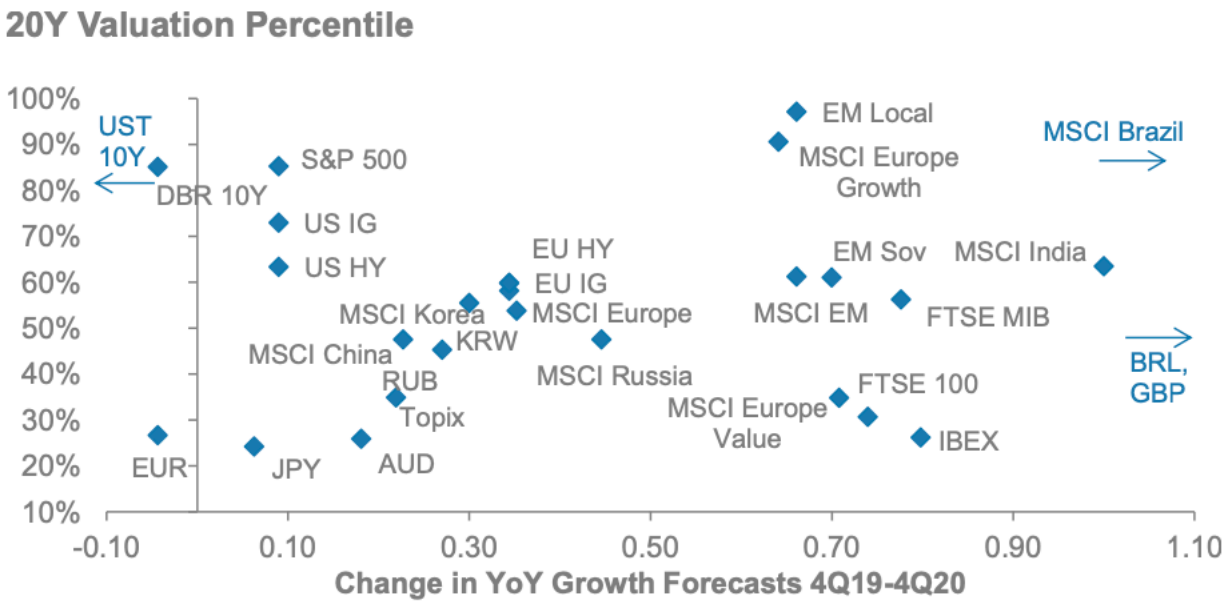
Source: Bloomberg, CPB, CEIC, Markit, Haver Analytics, IMF, national sources, Morgan Stanley Research estimates; Notes: (1) CPB world trade volume is an aggregate measure of global trade published by the CPB Netherlands Bureau for Economic Policy Analysis, (2) The MS World Trade Volume Proxy is based on global trade data for economies which are the earlier reporters of trade data. For details, please refer to page 7, (3) The MS Trade indicator is a regression model based on relevant soft and hard data to forecast the most recent global trade growth data. See page 8 of January Trade Flow Monitor for more information. CPB data available until Sep, MS trade proxy available until Oct and trade indicator available until Nov.

2. CAPITAL MARKLETS OUTLOOK

We must remember that the global securities markets are essentially a forward predictor of future expected interest rates, inflation and corporate earnings. Due to the collective interpretation and intelligence of millions of participants they tend to reflect expectations pretty accurately, especially in the long run.

If we ignore our positive view on the global economy above and instead start thinking about 2020 in terms of what current valuations say about future returns, the outlook is not very encouraging. As per the chart below, courtesy of Morgan Stanley, valuations are extremely high for the S&P 500, US 10 Year Treasury and even MSCI Europe given their extremely subdued growth outlooks. We expect much lower long-run return estimates for US stocks than we do based on cyclically adjusted equity valuations.

What's cheap and has the best growth momentum? EM over DM!



Source: Bloomberg, Datastream, Morgan Stanley Research Global Exposure Guide 2019, Morgan Stanley Research forecasts; Note: we use 20 years of data where available. We show the average percentile of P/B and forward P/E for equities, REER for FX, real yields for DM rates, loss-adjusted spread level for DM credit and spread level for EM rates and credit. For equity and credit we weight the change in GDP growth by the revenue breakdown of the equity market in that region. For rates and FX we show the change in GDP growth of the region.

In addition, there remains an underappreciated problem with corporate profits, especially in the US, where S&P 500 earnings have generally not grown for the past year despite growth in revenue, an obvious and alarming sign of negative operating leverage. Staying in the US but looking instead at small- or mid-cap companies, profits are down close to 10% from the highs, again despite growth in revenue. Globally, profit trends have been even worse outside the FAANG's and BAT's stocks.

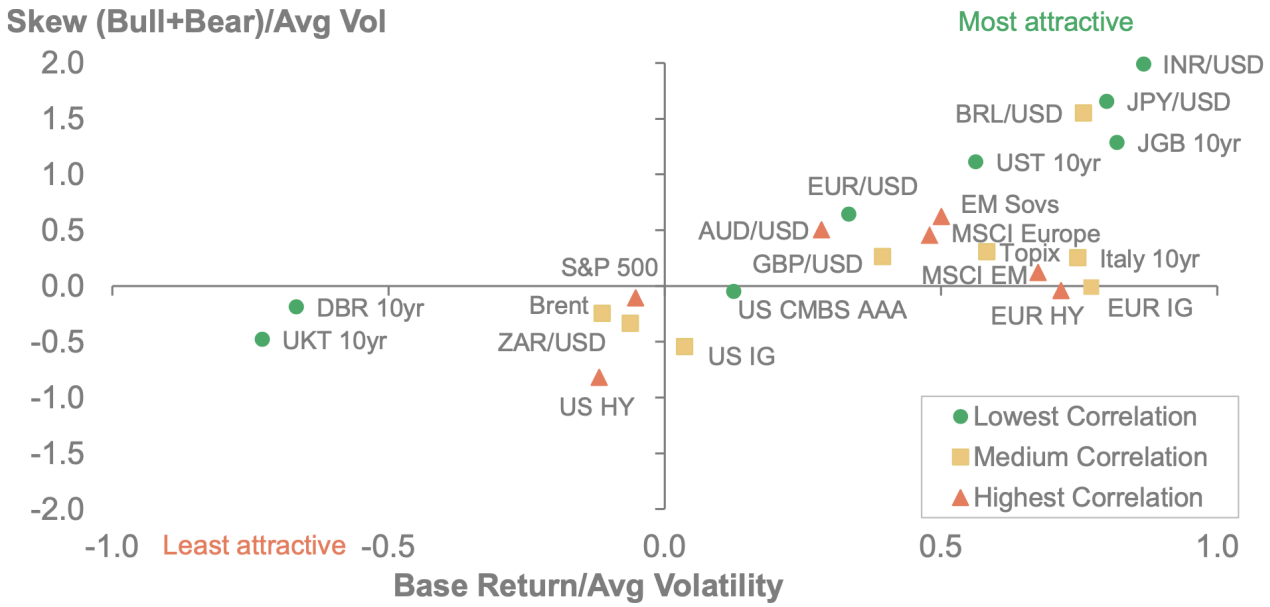
Our interpretation of slowing US growth but tightening labour markets suggests a weaker top line and higher cost pressures for DM companies. Meanwhile, the power of share repurchases looks unsustainable, with the total payout ratio for the S&P 500 above 100% in 2019.

Our outlook for the major asset classes is as follows:

- **Global equities:** Long Emerging Market (EM) equities over the DM (US, EU and Japan.)
- **Government bonds:** Long EM (currency hedged) debt over US, UK and Germany.
- **Global credit:** Remain very defensive. We see this as a bubble brewing with flat and increasingly negative rates. Again, EM over the US. Curve and would be long investment grade over high yield corporate debt. Stay well away from Europe!
- **Commodities:** Short oil, gas and coal. Neutral iron ore and base metals. We remain cautious due to an oversupply in most commodities with Copper being an exception.

Expected Returns vs Risk.

Global asset classes – expected 12-month return vs. risk



Source: Morgan Stanley Research. Note: 'Expected returns' based on MS Strategy 12m forecasts and current market prices. Correlation is 10Y relative to global equities (MSCI ACWI). Credit returns are excess returns. Low correlations include negative correlations. Volatility is the average of long-term average and option implied where available.

In conclusion we expect a relatively benign global economic growth outlook driven by an unwinding of trade tensions between the US and China, and further driven by EM's recovery. Concerningly, valuations are relatively high and as such we expect range-bound equity performance at best in a flat rate environment. If inflation rears its head and interest rate expectations kick-up, then a rerating of multiples by as much as 25% is very likely. This favour's quality and defensive value factors; however, investors would be best suited at searching for quality and growth at a reasonable price.

The Outlook for Cryptocurrency's

To date, cryptocurrencies have always been seen as an addition, rather than substitutes, to the traditional asset class of cash / currency. They have not yet managed to gain institutional, and more importantly sovereign acceptance, as a means of payment despite their increased security and relevance in the digital era.

On the supply side, governments, banks and payment processors such as PayPal and credit card providers Visa and Mastercard are moving us towards a cashless society. This is evidenced with governments moving to eliminate larger notes in circulation to clamp down on the black economy. Banks and card providers meanwhile are being forced to find ways to foster many multiples of smaller payments with cards through technological innovations, such as contactless and mobile payments. This all bodes well for digital currency's.

In our view, China and the USA are key to the outlook for Cryptocurrency's. Until now, China has banned the purchase and the sale of cryptocurrencies, but in late October, Chinese President Xi Jinping endorsed blockchain as "an important breakthrough for independent innovation of core technologies". More importantly, he repeated the PBoC's intention to have cash replaced by a central bank-issued digital currency. The aim is to "support the yuan's circulation and internationalisation."

In line with these initial thoughts above, we will be following these three major themes in 2020:

1. Libra

In the USA, when Facebook announced Libra, its new cryptocurrency payment system earlier this year, it was quickly blocked by Congress. However, Facebook with Libra is a game changer as they have a prospective user base of over 2bn. This has the potential to seriously disrupt the payment industry send the use of cryptocurrencies into the mainstream. It seems their abuse of users privacy in the past has stymied their efforts in the short-term to get this done.

Libra is the most important development in the Blockchain industry for a long time. A privately issued international fiat-backed currency with a ready market of 2.7 billion Facebook, Instagram and WhatsApp users and the combined clout of 27 other large companies and institutions, poses a formidable challenger to government-run fiat money.

To be clear, Libra is not seen as a major threat to the networks such as Visa, Mastercard, but their participation in the Libra Association as per the graphic below increases the political and regulatory risk for both companies. Therefore, Libra is seen as less of a true Blockchain-based currency, and more of a secured intermediary between traditional currencies and certain marketplaces, or "stablecoin." This is because Libra is clearly designed to hold a relatively stable value and is going to start at least with permissioned validation and backing from select partners as per the chart below.

Breaking It Down: The Libra Association

What is the Libra Association?
An independent, not-for-profit membership **organization which will oversee the development of the token**.

- Each founding member paid a minimum of $10mn to join
- Each founding member gained one vote in the Libra Association council
- Each founding member may be entitled to **share part of the dividends from interest earned on the Libra reserve** (proportionate to their investment)

At creation, there are 28 founding members (right).

Source: Facebook, Techcrunch, Morgan Stanley Research

2. Tokenised Fiat

This rapidly evolving landscape for "tokenized fiat" will drive a regulatory debate and lawmaking process worldwide but, just as importantly, it will set off a new round of open-source development of Blockchain-based applications. A relatively stable form of digital payment enables more fluid functionality for existing blockchain projects in finance and supply chain management.

Also, the new offerings will become developer platforms in their own right, with Libra actively promoting (and funding) such development. Independent Libra-based wallets are already being built by start-ups outside of the Libra Association. We can expect a flood of other services and Dapps to come. They will present potentially new investment prospects for our target funds, which have the opportunity to invest alongside Facebook and its deep-pocketed partners.

Assuming governments back cryptocurrencies, adoption rates will drive the timeline for mainstream use. We believe consumers want them as its much more convenient than cash and retailers prefer digital payments and so it will become mainstream. As global internet usage and mobile computing power grows and becomes cheaper, digital wallets will become a defacto way of storing cash and transacting globally. They must also allow for global reach in the payment market. To do this, alliances must be forged with key stakeholders – mobile apps such as Apple Pay, Google Pay, card providers such as Visa and Mastercard, and retailers, such as Amazon and Alibaba need to facilitate this adoption.

3. Regulation

Regulation continues to be the elephant in the room for Cryptocurrencies. The big theme, as we see it, is that different jurisdictions around the world are going to come into conflict with each other. How that plays out, how it is reconciled at the geopolitical level will have far-reaching consequences, not only for Crypto but for the future of the financial system.

One way to look at it is through the lens of Libra, which has suddenly stirred regulators out of their slumber. Now they feel threatened – particularly in the U.S., which has taken umbrage with the fact that Libra, despite being founded by an American corporation, Facebook, is setting up shop in Switzerland to take advantage of that country's more lenient crypto rules. U.S. officials are truly worried that this new, private form of money, regulated by a foreign power, will threaten the dollar's dominance.

But with China also pushing into digital currency solutions that could threaten USD hegemony, and a host of new stablecoins threatening to bypass dollar intermediation, Washington may have much more to worry about than just Libra. Something has to give: either international harmonization of crypto policies, in recognition from each state that they can't afford to drive innovation offshore, or a more confrontational situation in which large states resort to heavy-handed tactics to get their way. Watch deliberations at the Bank of International Settlements, the IMF, and the anti-money laundering-focused Financial Action Task Force to see how his pans out.

With regards to securities laws, it's noteworthy that the SEC has accelerated a previously slow approach to enforcement actions against ICO issuers. Those actions are widely expected to grow from here. It is also hoped that more clarity can be given to the STO process, since the path to approvals is taking a very long time. Meanwhile, there's a glimmer of hope that with Bakkt seeing regulatory approval for its bitcoin futures and new providers of ETFs seeking SEC approval that mainstream, exchange-traded instruments for buying exposure to bitcoin and other crypto assets could finally be upon us soon.

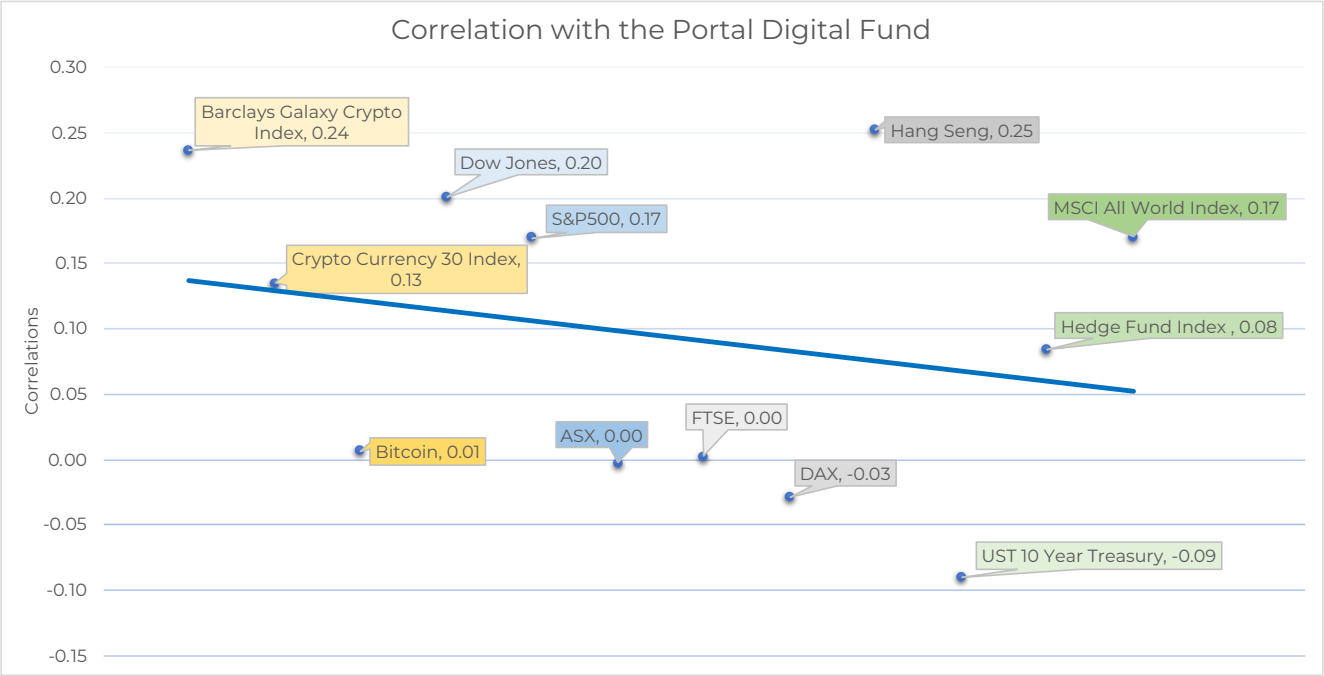
The Case for Cryptocurrency as an Alternative Asset Class

One of the main attractions to the Cryptocurrency space, and in particular our strategy of investing in hedge funds that are trading quantitively driven "hedged" strategies across Cryptocurrencies, exchanges and geographies, is the complete lack of correlation and outsized returns that can be achieved.

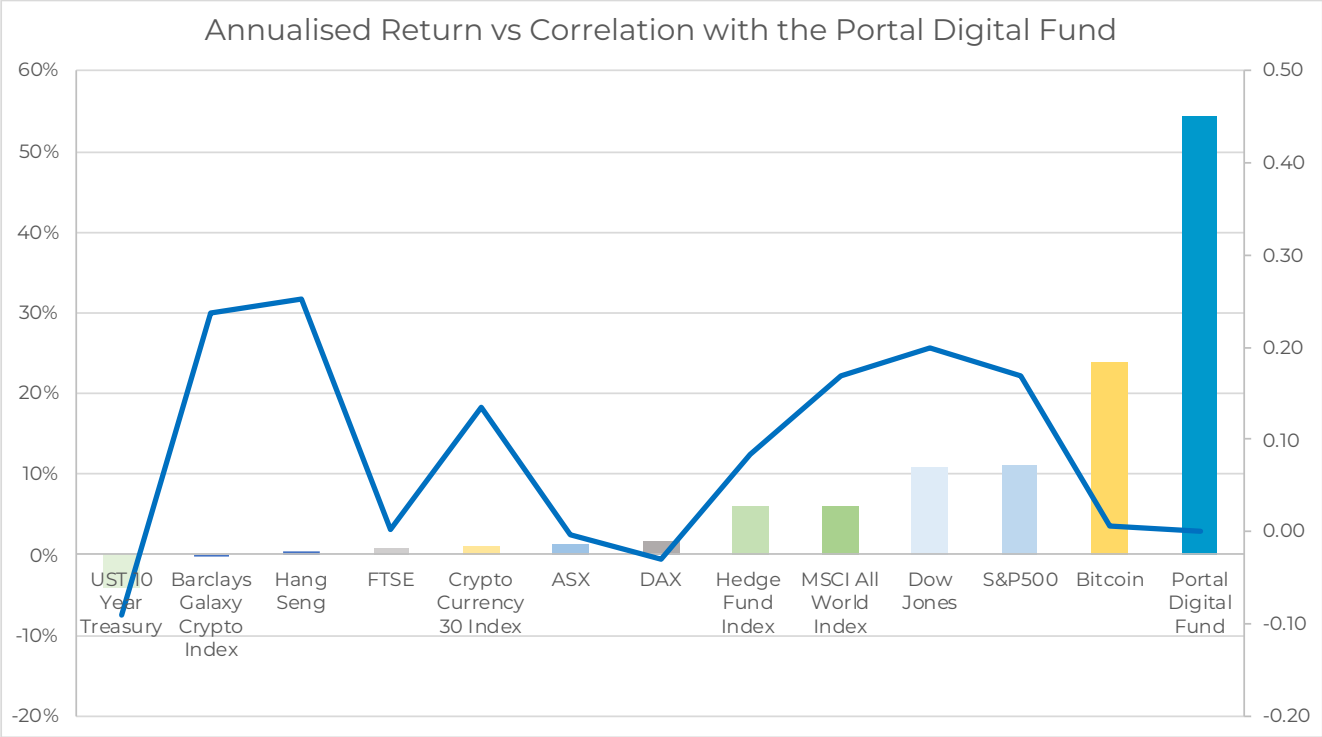
As per the correlation matrix below we examined the returns of the Portal Digital Fund (PDF) versus the two main Cryptocurrency Indices (Bloomberg Galaxy Cryptocurrency Index and CCI 30), various global equity indices, (DJIA, SPX, ASX, FTSE, DAX, HSI) the 10-year US Treasury, the HFR Global Hedge Fund Index and the MSCI All World Index.

Correlation Since Inception (Sept 2017)	Annualised Return	Portal Digital Fund	Barclays Galaxy Crypto Index	Crypto Currency 30 Index	Bitcoin	Dow Jones	S&P500	ASX	FTSE	DAX	Hang Seng	UST 10 Year Treasury	Hedge Fund Index	MSCI All World Index
Portal Digital Fund	54.3%	1.00												
Barclays Galaxy Crypto Index	-0.3%	0.24	1.00											
Crypto Currency 30 Index	1.1%	0.13	0.13	1.00										
Bitcoin	23.8%	0.01	0.78	0.09	1.00									
Dow Jones	10.9%	0.20	0.07	0.41	0.08	1.00								
S&P500	11.1%	0.17	-0.01	0.39	-0.01	0.97	1.00							
ASX	1.3%	0.00	0.35	0.32	0.28	0.52	0.55	1.00						
FTSE	0.8%	0.00	0.37	0.35	0.30	0.47	0.48	0.99	1.00					
DAX	1.6%	-0.03	0.07	0.18	0.10	0.69	0.72	0.66	0.58	1.00				
Hang Seng	0.5%	0.25	0.12	0.43	0.03	0.67	0.72	0.50	0.45	0.57	1.00			
UST 10 Year Treasury	-4.1%	-0.09	0.01	0.08	0.11	-0.17	-0.22	-0.22	-0.20	-0.23	-0.29	1.00		
Hedge Fund Index	6.0%	0.08	-0.04	0.03	0.07	-0.15	-0.17	-0.20	-0.18	-0.17	-0.18	0.44	1.00	
MSCI All World Index	6.1%	0.17	0.15	-0.01	0.18	-0.18	-0.18	-0.09	-0.09	-0.09	-0.14	0.29	0.69	1.00

As per the chart below, the highest correlation of the PDF is 0.25 with the Hang Seng Index, which we believe is due to the fact that its heavily technology weighted and also more subject to geopolitical risk due to Chinese sentiment. As per the trendline fitted below, the majority of correlations are between 0.15 and 0.05 for all asset classes, including Bitcoin and the other Cryptocurrency Indices. This is significant in that demonstrates the uncorrelated and protective ability of PDF as a real alternative investment as part of a balanced portfolio.



In addition to being completely uncorrelated, PDF has also managed to achieve a much higher risk-adjusted return with a Sharpe ratio of 2 and volatility of 17% on average versus these other asset classes. As per the chart below, although we position ourselves as a moderate-risk investment, our returns and low correlation ensure we sit at the far end of the risk-return spectrum. i.e. a higher return for lower risk than an investment in pure Cryptocurrency and / or any Cryptocurrency indices.



This is because price visibility is still very limited in many currencies due to the lack of participants and liquidity in the Cryptocurrency space, enabling very profitable trading opportunities. Although some of our underlying Fund Managers have expressed concern that arbitrage opportunities between some Cryptocurrencies and exchanges are now seeing reduced margins, other innovative quantitative strategies continue to see margins generated from nascent and inefficient markets.

Furthermore, we expect many more trading opportunities are expected with the inevitable arrival of new sovereign and corporate Cryptocurrencies, as well as new and innovative products such as commodity-based Cryptocurrency's, derivatives and soon we expect, credit.

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Although we expect that the real institutional interest in the Cryptocurrency slace is expected to be between 18 months to 3 years away, there are many positive developments

in instruments such as BTC futures now being traded on traditional exchanges such as Bakt and CME opening up institutional opportunities.

Looking forward to 2020, we believe that our strategy will continue to generate outsized returns relative to the more traditional equity and fixed income markets, and more importantly will remain completely uncorrelated with those asset classes as well as the physical Bitcoin and various Cryptocurrency Indices.

Conclusion

In conclusion, cryptocurrencies need to become legitimate in the eyes of governments and regulators, especially with regards to exchanges and custodians, before institutional investors will embrace them as an asset class. This will bring stability to cryptocurrency inflows and allow for proper price discovery and liquidity facilitated by increased depth in the cryptocurrency markets.

As we look to the decade ahead, it would not be surprising if a few new cryptocurrency's were to unexpectedly emerge and become mainstream. Some countries with historically strong banking industries such as Switzerland are trialling cryptocurrencies, and pushing for the world's first fully regulated exchange. The question is which country will take advantage of being the first to obtain licenses and build global alliances. As that occurs, the line between cryptocurrencies, financial institutions, and public & private sectors may become blurred.

Either way, this all bodes well for the outlook for the cryptocurrency market and in particular our strategy. .

We wish all our readers a wonderful festive season and all the best for the new year.