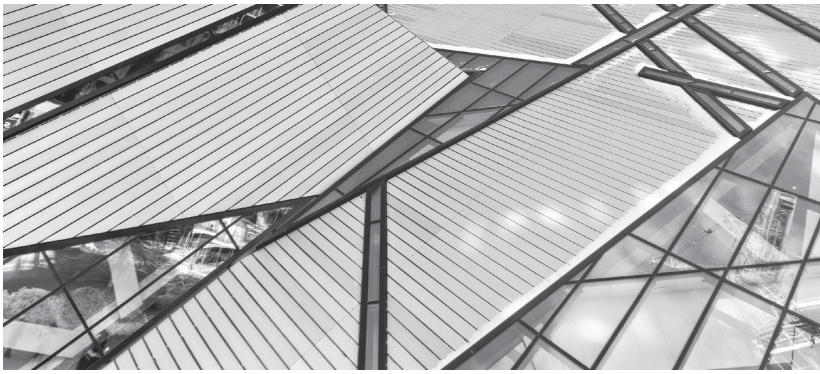
INVESTING IN A LOW-RATE ENVIRONMENT



"WE STANDS FOR WEALTH ENTERPRISE"

Santiago Ulloa. Managing Partner and CIO

May 2021

Over the past 18 months, we have experienced the greatest health and economic crisis since the Second World War. Governments in nearly all countries, with varying degrees of success, have made massive investments in their economies. After the big crash in financial markets in March 2020, the markets have recovered strongly and we have entered, since November of last year, a new cycle of global growth. In our opinion, these expansive monetary policies, coupled with central bank actions to keep rates low, have resulted in historically low interest rates.

And recently, with expectations of future inflation increasing, we have seen the public bond markets adjust to reflect the higher probability of sustained inflation above central bank targets. Bond prices fell in the first quarter of 2021. At the benchmark level, the ten-year US Treasury bond has gone from yielding 0.90% per year to 1.60% in just four months (source: Bloomberg), generating a paper loss of value of more than 3.5% to the holders of these securities in a short period of time.

Beyond the capital loss, we are also concerned about investing to generate positive real returns. Bonds, which typically played an important part in portfolio construction, both for diversification and income generation, can no longer be relied on to accomplish these objectives.

As a reference, and based on an analysis done by the Callan Institute, in 1989 you could get an average annual return of 7.5% with a portfolio composed of 25% in US high-quality bonds and the rest in cash, with a volatility (risk) of 3%. Fifteen years later, in 2004, to obtain the same return, it was necessary to include 50% in shares and exclude cash, multiplying the risk by three. After fifteen years, in 2019, to get that same 7.5% return, it was necessary to double the risk and include new types of assets (Private Equity, real estate, etc.), while reducing cash and fixed income to minimal levels. The current situation is even more complex. Interest rates are significantly lower than two years ago, and the stock markets are valued at historically high levels.

We are in a complex moment, with positive tailwinds due to the expected GDP expansion globally post pandemic in 2021 and beyond. While stock markets may continue to rise, despite expensive valuations, we believe the best opportunities will likely be in less traditional markets, where competition is lower, and access is limited.

We are re-looking at hedge funds, selectively focusing on sectors with significant valuation distortions, such as distressed markets, high-yield bonds and strategic hedging operations, and in both North American and Asian markets.

Another of the sectors where we see the potential for cash yield is private lending to small and medium-sized companies in the United States. This is a space that traditional banks have largely exited and can provide additional return above the coupon through warrants and options. The private REIT space can also serve as a source of income, but, in our opinion, investors should focus primarily on high-quality multi-family, industrial and logistics-

oriented vehicles. These investments, as well as in infrastructure and raw materials, can also serve as a protection against inflation. We also see the private markets as an important source of return going forward.
While these areas provide an opportunity to diversify sources of return, protect against inflation and generate income, they are unfortunately also more complex and have less liquidity than traditional public market stocks and bonds.

While the profile and needs for each family may not change, this does not mean that the investments or "ingredients" can remain the same. In order to achieve the same objectives and maintain appropriate diversification, in the near future, investors will likely need to include investments that may be different than what they have done in the past (private investments, hedge funds, real assets, etc.) in a custom-tailored way to fit their cash flow needs, risk tolerance and overall objectives.

For more information, please reach to WE Family Office at 305.825.2225 or send as an email to info@wefamilyoffices.com

WE
FAMILY OFFICES®