Swiss Enhanced Dividend Strategy (SEDS)

Yearly Review 2021

This document is intended for marketing purposes.

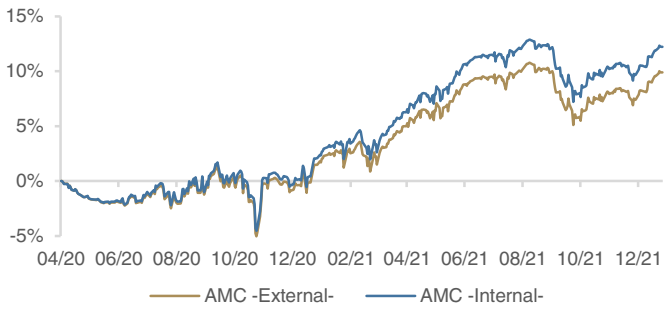
St. Gotthard
Fund Management

Market Review

2021 will be remembered as the second year of the global pandemic, as the rise of new variants, coupled with rising vaccination rates had an important influence on market developments and turns, respectively. Through the year, however, it became clear that some return to normalcy will one day be reached, which we estimate to come somewhere in 2022.

Equity markets in industrialized countries had a strong year, particularly US markets, but also the Swiss equity market was able to gain more than 20%. A major driver of the run into equities was their still relative cheapness against bonds, considering the continued deeply negative real yield environment. Also, somewhat surprisingly, companies were able to regain margins of pre-pandemic times, in some cases even exceeding them. This has led to a continued growth in earnings estimates, for which 2022 may prove a more difficult environment, particularly due to an inflation environment that is unseen in 40 years.

PERFORMANCE SINCE INCEPTION



Source: STGFM

Strategy Review

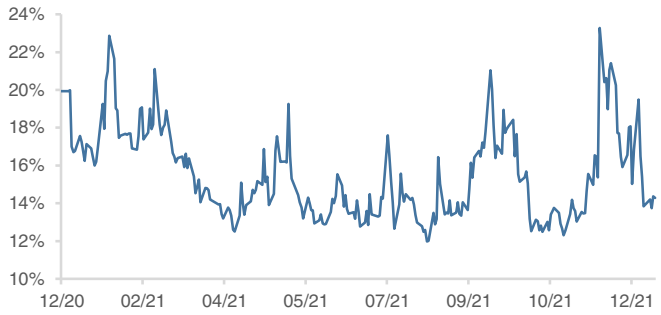
The past year proved favorable for our SEDS strategy, although the significant v-shaped corrections have acted as a head wind to its advantages of steadily collecting a premium 1-2% away from spot prices on covered call options (and covered put options, respectively). With four very strong months with a performance of between 4% and 6.5% each during 2021, the environment proved difficult, but our annual total return of 9.97% and 8.29%, respectively may be considered proof of concept, especially considering the fact that at some points during 2021, cautionary measures were taken in terms of tail risk hedging which cost a certain amount of premia.

The first two months of 2021, the Swiss equity market was going sideways, however with rather severe swings: towards the end of January, the market was up almost 3%, only to see those gains melt away into month end. February also saw some intra-month swings in the order of 4% and ended the month in the red as well. With these headwinds, the certificate was able to hold its ground, but could not profit from the still elevated implied levels volatility in options markets.

The months of March and April were positive for both the Swiss equity market and our strategy as we had changed our cautious stance and took on a bit more exposure (writing calls somewhat more out-of-the-money), resulting in a total return of close to 6% over two months. After such a good run, we reduced our equity exposure, as a number of indicators hinted at investor exuberance, especially considering evidence that a new strain of SARS-CoV-2 that was called "delta" in late May. Markets shrugged off the negative pandemic news, and the Swiss market continued to storm forward. Despite our cautious approach and thanks to a clear focus on dividends, our certificate also gained more than 2%.

The month of June showed two distinct developments: first, as a consequence of rising infections in countries with high vaccination rates (read: Israel, UK), a growing awareness that the pandemic may drag on longer than many had hoped – leading to a re-rating of pharmaceutical companies (40% of the Swiss equity market); second a distinct flattening of the yield curve as inflation fears that had sparked in the previous months subsided, again due to the rise in the delta variant.

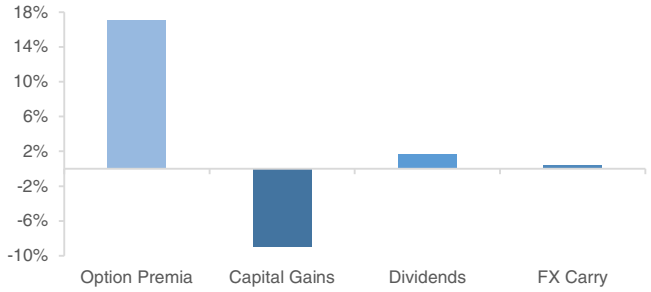
SMI IMPLIED VOLATILITY INDEX (VSMI)



Source: Bloomberg

The month of July proved difficult, as more and more signs of an impending correction induced us to keep exposure on the lower end, in order to protect the year-to-date gains. We still managed to achieve a positive performance, despite a high dispersion among single stock performance (which reduces the strategy's benefits) as well as some premium spent on protective puts.

GROSS P/L CONTRIBUTION FOR 2021



Source: STGFM

August had a strong resemblance to July, while a significant correction followed in the first days of September, dragging Swiss equities down by 6% during the month. After three weeks of decisively falling stock prices, the direction turned swiftly and five weeks of a countermove followed, bringing market averages back to pre-correction levels. Our strategy suffered in such an environment of a v-shaped correction, which led to a somewhat disappointing month of October in relative terms.

November, a sideways month, led to a final month of the year in which the market gained again over 5%, in another euphoric move that led to sentiment levels displaying excessive optimism. We kept our cautious stance throughout the month, with the portfolio delta significantly below average levels of 2021. From a risk-return perspective, the 260-day volatility of 6% lies within our target (also relative to the broad equity market volatility which was about double this level), as does the 10% total return for 2021.

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