BigSur's Ivestment Committee 2015 Outlook

As we launch into the New Year and have some data from the month of January, our BigSur Investment Committee has put together our outlook for 2015 and our broad recommendations for positioning our clients' portfolios in this market environment. Our views since the "2014 October flash crash" (expressed in the last few Thinking Man publications) remain intact and can be synthesized in five key points:

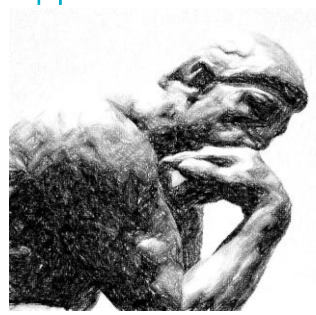
- Keep a healthy allocation to cash due to the increasing volatility across markets and our prediction that 2015 will see several "credit events" (pockets of pain but not conditions for a widespread contagion that creates a global crisis or a global recession)
- Cautious stance on government fixed income markets from developed countries (where over one third of the market has 10 year nominal yields of less than 0.5%; and 5 year nominal rates in Germany and Japan are negative!)
- Equities should outperform fixed income in 2015, though the return of a traditional balanced portfolio is estimated to be meek 4-5%
- We maintain our investment thesis held for over 5 years that the US is the "best neighborhood to be in" and offers better risk-adjusted returns than Japan and Europe (both of which are marred in deflation) as well as Emerging Markets
- We continue to believe our clients should hold more non-traditional asset classes where the illiquidity premium more than compensates for the extra risk

Key Point #1: 2015 will not see a major global crisis but there will be pockets of pain and volatility spikes

In 2015 we do not see conditions for a global financial crisis or a global recession. This is considering that:

- While we embark in a post-Quantitative Easing (QE) world for the Fed, global monetary policies will continue to be accommodative (in Europe, Japan and China)
- Banks' balance sheets have strengthened (especially in the US) or are being stress-tested (in Europe), creating stronger buffers in the global financial system

The Thinking Man's Approach



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Ignacio Pakciarz | CEO
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The "Risk-on/ Risk-Off" market dynamic is here to stay, but with expected increasing frequency of spikes in volatility for 2015. But, why?

- Given the lack of clarity around the first Fed rate hike in USA and divergent monetary policies and economic forecasts;
- Due to lower bond inventory at market-makers, it now takes seven times as long to liquidate a bond portfolio as in 2008. Thus, the exits for trades are crowded. If investors suddenly sell "en masse", prices could gap down.

Based on our recent meetings in New York with top managers, our research sources and our own analysis of market behavior, we determine 5 Key Investment Implications in today's world.

For more on how we are positioning our portfolios, please contact your investment advisor or email:

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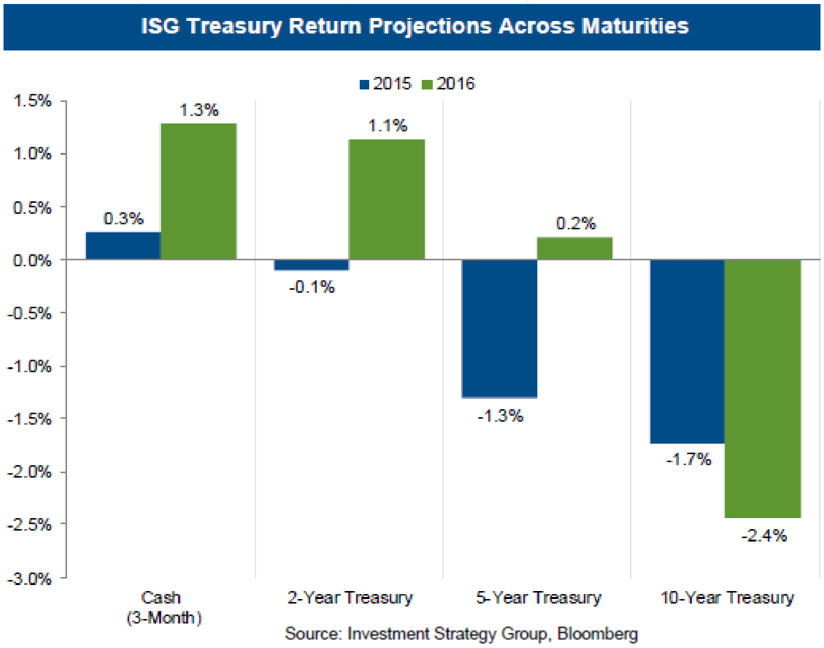
- The oil "crisis" we are currently experiencing will ultimately show a net positive impact on the global economy. While the 55% correction in oil prices was abrupt (signaling not only excess supply but weakening global demand), the overall effect will be positive, in particular for the US consumer (who saves on average $10 per week). The short term negative effect in employment and financial conditions will prove to be sector specific and will longer term help the rest of the economy. This is good news for countries that are high consumers and importers of oil, like India
- Historically, equity bull markets peak towards the end (not the beginning) of a rate hike
  - Latest inflation data shows the Fed will probably delay the 1st rate hike;
  - Fed will most probably be very gradual and timid in the size of the rate hikes, such the peak in rates might be lower and the duration longer than in previous cycles
- However, we see 2015 a year of specific credit events in certain pockets – such as in high yield oil and energy issuers, some oil producing countries (like Russia or Venezuela) or some particular issuers. Credit research is key in this environment.
- Cash is "king"
  - As we said in our Thinking Man #23 and #24, we expect the low levels of volatility of these recent years to be a thing of the past. We have already seen two great signals: the 2014 October crash and the Swiss National Bank surprising removal of the Euro/Franc cap. We see volatility picking up across all asset classes and as such, think there will be opportunities for tactical trades. An example is doing "BUY-WRITE" strategies to generate income (with stock indices, ETFs, individual names or currencies).

Key Point #2: Cautious stance on the largest sector of the fixed income universe: government bonds from developed countries

- Clients may arguably view cash having an "opportunity cost." In our view, the other "low risk" asset- investment grade fixed income- offers limited value. 10 year government yields in developed countries at these low levels have a potential for negative returns for 2015. As value investors, rather than invest a large allocation to investment grade fixed income, we prefer cash to have the portfolio flexibility to take advantage of the opportunities as they present themselves (especially to buy high quality assets at a good entry point for the long-term).

Chart 1: Expectations of Negative Treasury Returns



- We put high grade investment bonds at an underweight as 10 year yields in developed countries are extremely low: US at 1.8%, UK at 1.5%, Germany at 0.4% and Japan at 0.2%. Over 1/3 a of the government bond markets have 10 year nominal yields of less 0.5% while 5 year nominal rates in Germany and Japan are negative!

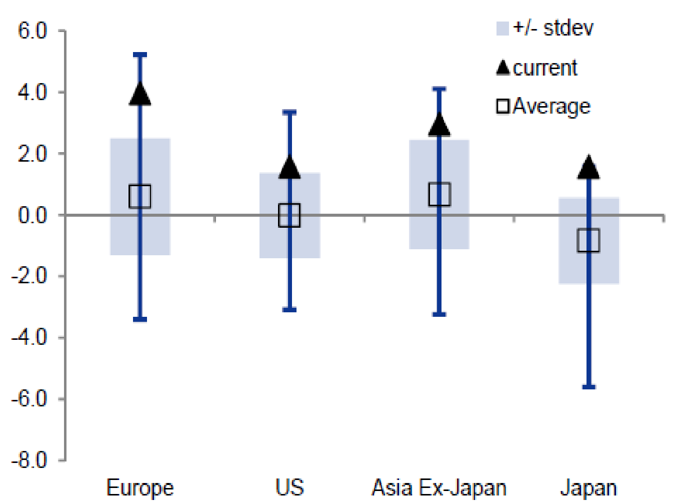
- Chart 1 on the previous page demonstrates these views by the Goldman Sach's Investment Strategy Group's projections for return across Treasury maturities in 2015 and 2016 vs. cash

Key Point #3: Equities should outperform fixed income in 2015, even though the performance of a traditional balanced portfolio will be modest, around 4-5%.

- While we expect the equity markets to have a lower returns for 2015 than average returns since 2009 (which have been around 20% annually), we still see stocks as attractive relative to bonds.
- Dividend yields remain high relative to bond yields, as demonstrated by Chart 2. The black arrows represent the current premium dividend yields offer to real government bond yields, ranging from 2-4%. In all cases, this premium is at the high end of the range and above the averages of the last few years.
- Dividend pay-outs and share repurchase programs have increased steadily in the last 5 years and will continue to do so in 2015.
- While popular measures of stock-market valuations like the P/E ratios or the cyclically adjusted P/E ratios are above the historical average, they are far below the all-time peaks; but relative valuations when we compare them with bond yields are still attractive
- The technical factors of investor and regulator complacency are not present – the market still continues to climb a "wall of worry"

Chart 2: Dividend Yields of Stocks Higher Than Real Bond Yields

Exhibit 23: Dividend yields are high vs. real bond yields
Dividend yields minus 10-year real government bond yields. We use 5-year average inflation as a proxy for inflation expectations. The distribution uses data from 1990 except for Asia ex-Japan where it is from 1995



Source: Datastream, Haver, Goldman Sachs Global Investment Research.

- The last 6 times the S&P500 produced negative annual returns (including dividends) the US economy was in or near recession. Low gasoline prices, strong auto sales and potential for more housing construction should keep the US economy afloat.

Key Point #4: We maintain our investment thesis held for over 5 years that the US is the best neighborhood and offers better risk-adjusted returns than Japan and Europe (both of which are marred in deflation) as well as Emerging Markets.

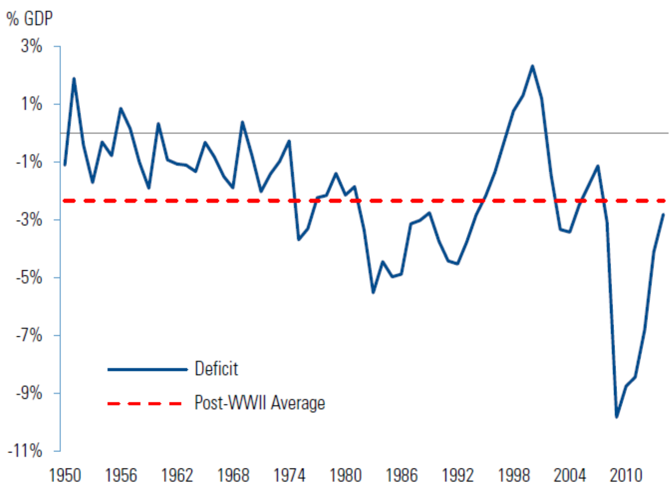
Within our equity allocation, we continue our long standing position of a US overweight, as the US boasts a stronger economy, better profit outlook, less fiscal drag and falling bond yields.

- An accelerating US economy is a notable exception in a world where growth is expected to be below the long term trend for most countries: many analysts predict the US to be a leader in GDP growth in 2015 with expectations between 2-3% growth.

- The health of US economy is stronger: the federal budget deficit which plagued the economic a couple years ago have been meaningfully reduced, and is now at the average level since World War II (as demonstrated by Chart 3). Leverage at both the consumer and corporate level have been sharply reduced in the US versus other parts of the world.

Chart 3: US Federal Budget

The US federal deficit has narrowed to a post-crisis low in fiscal year 2014.



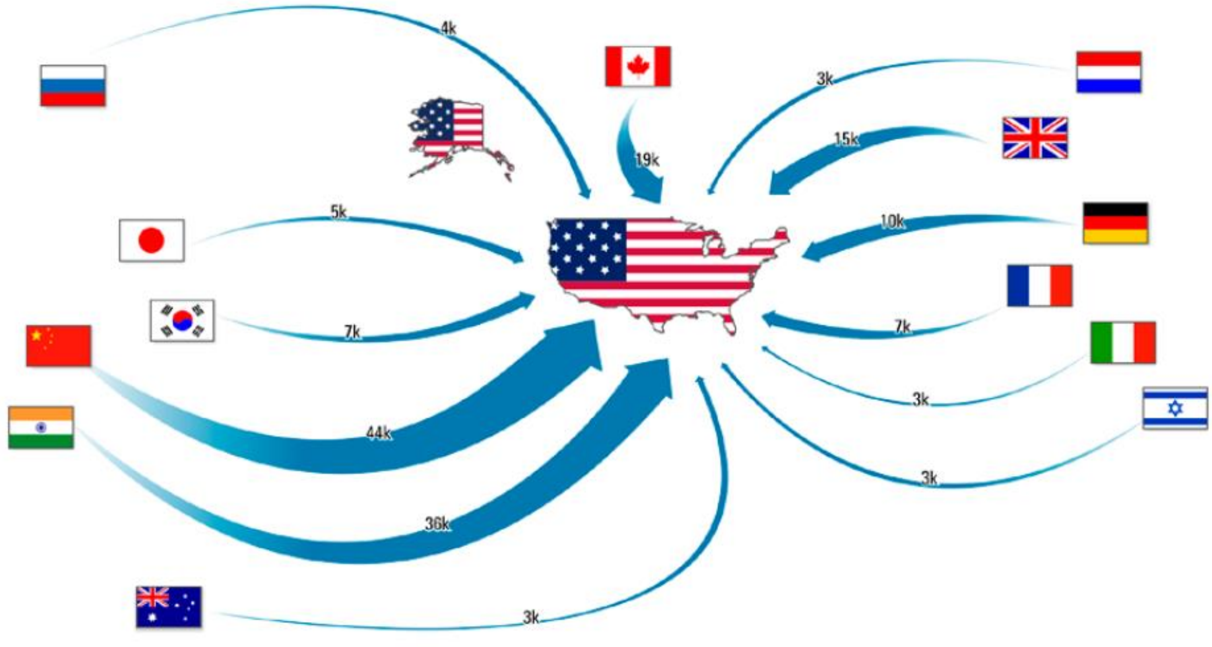
Data through FY 2014.
Source: Investment Strategy Group, Datastream.

- The US continues to show it is the winner in the "brain game." It remains the country which is able to attract the top talent from around the world. This is a key differentiator for the US in a world which increasingly puts values on human capital resources, intellectual property and innovation and puts less value on natural resources such as commodities. Goldman Sachs used data from the World Intellectual Property Organization to create an interesting chart showing the flow of highly skilled "inventor' immigration (Chart 4 below). The US was able to increase the inflow of this key demographic by 51% in the period of 2006-2010 (from the period 2001-2005). This is a way that the US can continue to keep its edge.

Key Point #5: We continue to believe our clients should hold more non-traditional asset classes where the illiquidity premium overly compensates for the extra risk.

- As discussed in previous Thinking Man notes, we are focused on finding non-traditional revenue producing assets that offer lower levels of liquidity and have an expected INTRINSIC return that well compensates the risk. Given our cautious views on fixed income, and lowered expectations of equity returns, we think investors must seriously consider allocating to non-traditional assets to position their portfolios for multigenerational wealth.
- We are looking for assets which offer intrinsic value with nominal returns of 8-11%. Some examples include: revenue producing core commercial real estate; opportunistic hard money lending (against high quality assets); private debt; infrastructure and other niche asset types. It is important to distinguish that we are not simply talking about any "alternative" product which is not an equity, bond or cash, (i.e. we are not looking to hold hedge funds which are liquid positions into illiquid funds). For more details on the type of non-traditional assets we are investing in, please see Thinking Man #22 published at the end of September.

Chart 4: Migration Flow of Inventors to the US



Data through 2010.
Note: Showing the number of inventors migrating to the United States between 2001 and 2010.
Source: Investment Strategy Group, Goldman Sachs Global Investment Research, World Intellectual Property Organization.

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Conclusions:

- 2015 will be the first post QE year and will see volatility across markets go back to more normal levels from depressed levels. This spikes in volatility should be taken advantage of by our clients. We continue to look closely monitor the markets for opportunities to deploy cash when there are spikes in volatility and sudden market corrections. We believe some strategies like "covered call writing" can be a defensive way to gain exposure to US equity markets.

- The goal is to strike a balance between growth and safety that allows our clients to "sleep well at night" during a potentially tumultuous 2015 without being tempted to act impulsively, while we aim to detect good entry points for long-term opportunities.

- 2015 will see a surge in "credit events": Credits with low fundamentals are being punished by the market. As one manager told us, the market may have "finally entered a phase of credit risk differentiation." The price breakdown in lower quality high yield signifies a shift in the fixed income markets, and many managers believe that if there is another fall in fixed income markets, these lower quality credits can continue to gap down.

- One of our focuses this year continues to be finding top tier, high quality non-traditional investments. We're identifying attractive themes and looking for the most efficient and appropriate vehicles to invest with. Some new ideas that we've been working on include diversified real estate in the US and Europe for distressed and value added opportunities; private companies in Asia; private and mezzanine debt in the US and Europe.

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