Quarterly Investment Outlook

1st Quarter 2016

December 2015

ameliora WEALTH-MANAGEMENT

Fixed Income

We make no changes to our bond allocation

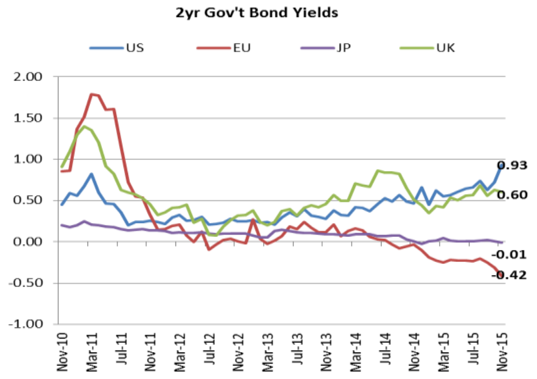
The respective monetary policies of the Federal Reserve and the European Central Bank have been labelled the “Transatlantic Divergence”. The former central bank is about to tighten policy while the latter continues its accommodative stance. The anticipation of an interest rate hike, which has gone on for the entire year, has pushed rates on short term US government bonds meaningfully higher than comparable to European bonds. Consequently, the US dollar has risen close to 15% against the EUR year to date.

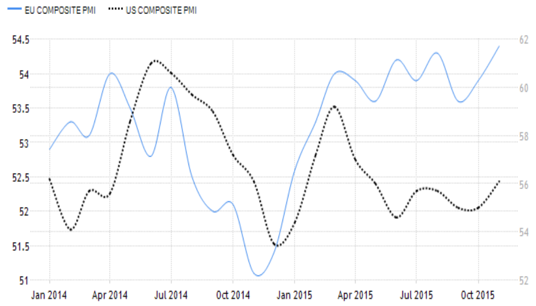
However, divergence works both ways. Improved economic conditions have emerged in the Euro area and the growth trajectory has been stronger than that in the US. Coupled with an accelerated growth in core inflation, developments in Europe seem to improve faster than expected. Falling interest rates and a weakening currency have been supporting growth in the world’s largest trade union.

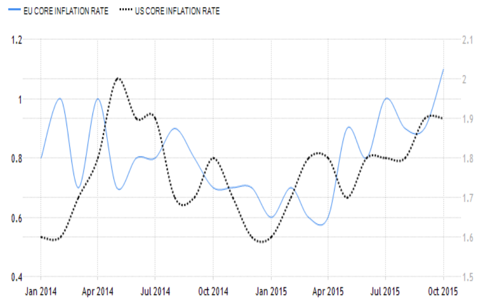
For the US economy the prevailing headwind is the strength of the US dollar. Rather than being the result of higher interest rate differentials and expectations of rate hikes, we think the dollar strength stems from massive currency intervention by the trading partners of the US. Having the status as the world’s reserve currency means that an increase in foreign purchases of dollars is accompanied by an equivalent increase in the US current account deficit, and subsequently an increase in the trade surplus of the foreign buyers. Running current account deficits are indicative of unfavorable trade dynamics and a worsening fiscal standing, both potentially harming domestic employment growth. The United States has not run a balanced budget since the early 1980’s and is currently running a deficit of over $100 billion or 2.4% of GDP. While foreign governments have accumulated assets by managing account surpluses the US have increased its liabilities – to the tune of $17 trillion or 100% of GDP.

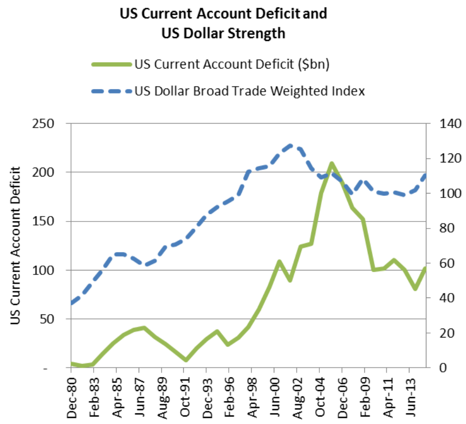
As the US has met foreign demand for bonds with increasing supply of treasuries, interest rates have not declined. Rather, interest differentials have widen to levels not seem in decades. Consistently running account deficits, characterized by high debt burdens and fiscal constraints, translates into an embedded risk premium of holding US treasuries. Countries with balanced trade or surpluses tend to have lower interest rates as observed in the Eurozone and Japan, where current account surpluses stand at $350 billon and $12 billion, respectively.

A depreciating currency is associated with more cross-border lending in that currency as foreign issuers tap into lower funding rates. With net issuance of Eurozone corporate debt this year taken up solely by companies outside the region, we think the current divergence will reverse as even more money flows are directed towards euro denominated assets.









Sources: Bloomberg, LLP, tradingeconomics.com.
Data as of November 30th, 2015. US current account data as of June, 2015

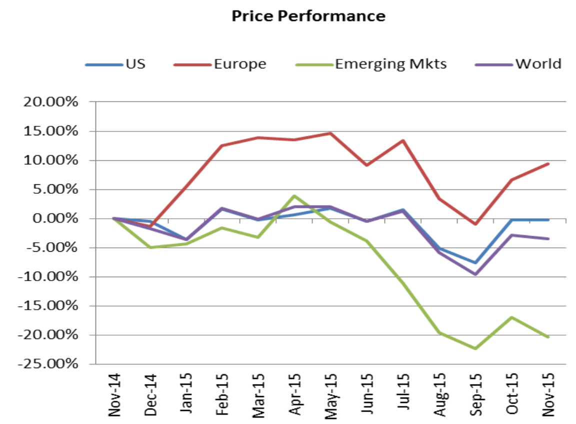
Equities

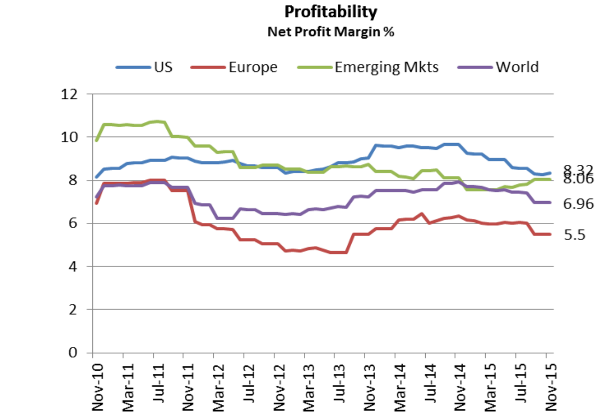
We shift allocations to select sectors

Diverging developments have so far in 2015 also befallen the global equity markets with European stocks rivalling those of the United States and emerging markets. However, global equity volatility converged during the latter part of the year as company profitability was reportedly weakening, especially by US companies with international sales. As a result earnings expectations were revised sharply downwards. Observers of analysts' earnings estimates will note that, empirically, profit projections tend to be overly optimistic at the start of a fiscal year only to be become utterly pessimistic at the end of that year – with the result of companies delivering better results 70% of the time.

Over time, holding global equities have been profitable even adjusting for times of significant volatility. Over the last 50 years equity investors have required a risk premium of about 2-3% above comparable risk free interest rates. This has translated into a historical annualized return of around 7%, implying normalized interest rates of 3-4% during the same period. Factoring in that current global nominal interest rates are roughly 2% and 0% in real terms, and the likelihood that rates will stay low for some years, we think that future asset returns for equities and bonds will likely be lower than their respective historical trends.

Although we prudently suggest lowering return expectations in general, we also acknowledge the different dynamics between business sectors during economic cycles. Over the course of the last cycle that started in late 2007 certain sectors have had significantly differing operating environments. While health care related companies have experienced a noticeable positive development, industries such as banks and financial companies have faced a barrage of obstacles. This is reflected in the respective sectors' valuations. Health care stocks are trading at a 20% premium and financial stocks are trading at a 20% discount to their respective historical valuation. We are of the opinion that evaluating relative sector attractiveness is a viable approach of capturing opportunities going into the next phase of cycle.



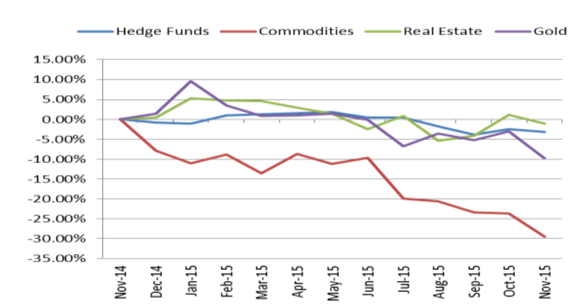


Sector	Price/Earnings	P/E Average	Relative Disc./Prem.
Financials	13.17x	15.73x	-16%
Health Care	23.82x	19.31x	23%
Technology	19.34x	23.69x	-18%
Consumer Discretionary	18.86x	22.86x	-17%
Industrials	18.79x	17.70x	6%
Consumer Staples	23.12x	18.29x	26%
Energy	55.14x	17.12x	222%
Materials	25.81x	29.27x	-12%
Telecom Services	19.12x	20.20x	-5%
Utilities	17.52x	19.18x	-9%
World	**19.11x**	**21.08x**	**-9%**

Alternative Investments

We make no changes to our alternative investment holdings

Including alternative assets in the asset allocation is arguably a method of attaining broader portfolio diversification. This year, some alternative assets such as commodities and gold exhibited profound uncorrelated characteristics measured against global equities and bonds. But few asset allocators would claim that losing up to 30% and 10% in these two alternative asset classes, respectively, is the desired effect of a diversified portfolio. We, however, view risk diversification more as a measure of how sensitive an asset is to a comparative asset class. An example is hedge funds. As an asset class, they exhibit positive correlation to risky assets such as equities, but they tend to have how much lower beta, or sensitivity, cushioning violent price swings. As such, we think hedge funds serve as functional risk diversifiers.

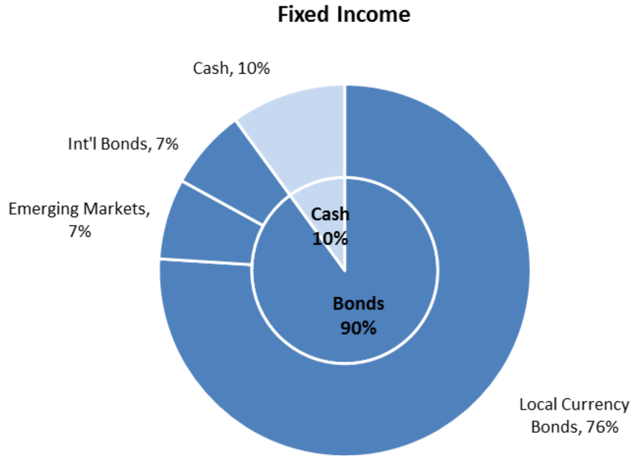


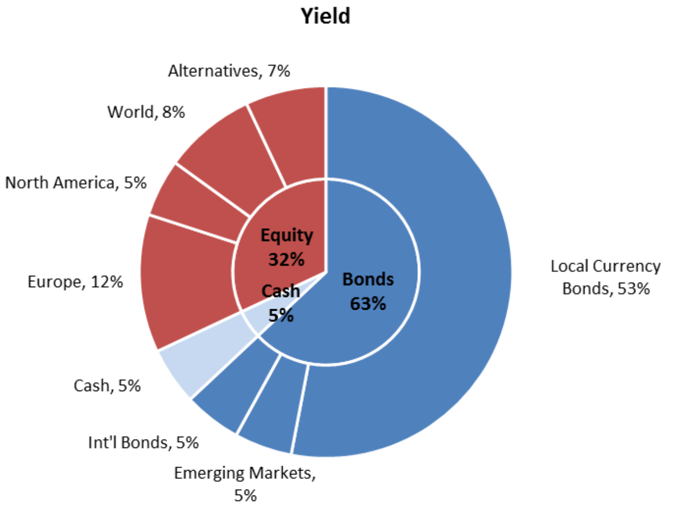
Sources: Bloomberg, LLP, Ameliora Wealth Management
Data as of November 30th, 2015

Indexes: *US=S&P 500 Price Index, Europe= STOXX 600 Price Index, Emerging Markets=MSCI Emerging Markets Price Index, World=MSCI World Price Index. Hedge Funds=HFRX Global Hedge Fund Index Commodities=Bloomberg Commodity Index Total Return, Real Estate =FTSE EPRA NAREIT Developed Total Return Index for, Gold=USD Spot price.* ***Sector indexes****=MSCI Global Sector Price Indexes*

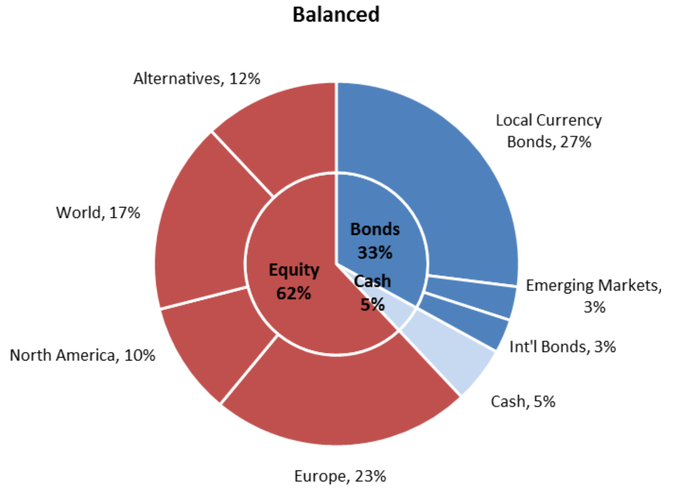
Asset Allocations

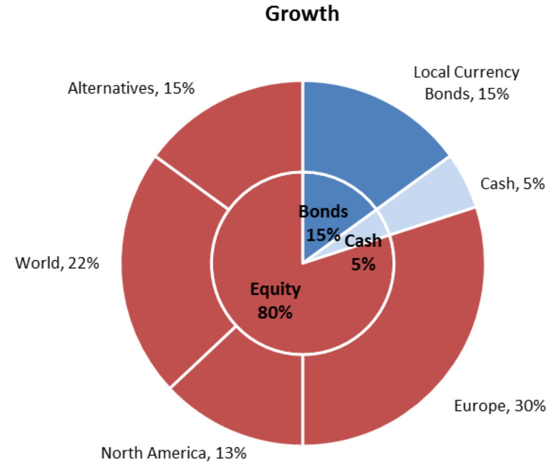
Income Strategies



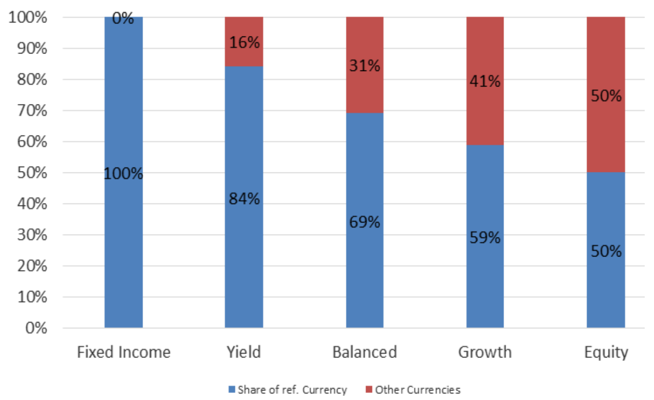


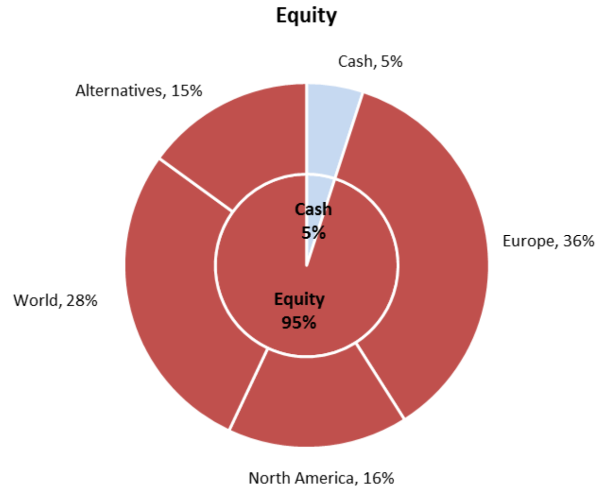
Growth Strategies





Currency Exposure





Source: Ameliora Wealth Management as of November 30th, 2015
Note: Tactical asset allocations are subject to change without notice. The asset allocations represents Ameliora's investment strategy in USD

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