2015: Resetting Expectations
7th Annual Investment Forum

Canterbury Consulting would like to thank everyone who took the time to attend our 2015 Annual Investment Forum. Each year, we endeavor to produce an event showcasing investment experts that can speak competently on macroeconomic forces and provide investors with an informed perspective heading into the coming year.

Below you will find comprehensive notes taken during each of our speaker's presentations, but first we would like to highlight some of the most compelling content:

- Jim Paulsen, feeling deflation fears were overdone, presented a bullish argument that included the potential for the U.S. to swing to a trade surplus and the current economic recovery to be the longest one in history
- Frank Brosens highlighted the disappearance of bank proprietary trading desks as an opportunity for hedge funds to provide transitional capital in stressed environments. He went on to highlight the explosion of high yield bond issuance as a fundamental risk and the rise in populist anger over austerity programs creating the potential for civil unrest that could impact markets
- Contrary to Mr. Paulsen, Francis Scotland was very concerned about global deflation and specifically mentioned that China and Emerging Market governments would need to cut interest rates. Two days after our conference, India's central bank cut interest rates ahead of its regularly scheduled meeting citing "sharper than expected decline" in prices of things like fruits, grains, crude oil and other commodities
- A.J. Agarwal shared that the Blackstone Group is focused on the European real estate opportunity set as it has the potential for a decline in cap rates. Domestically, Blackstone is finding opportunities in retail centers and single family homes
- Betsy Doyle taught the audience how to meet their giving objectives through strategic philanthropy

EQUITY MARKETS: JAMES "JIM" PAULSEN, WELLS CAPITAL MANAGEMENT

Introduction
We are in the midst of what is expected to be the longest recovery in U.S. history (10+ years). 2015 will be a great year for Main Street as global growth surprises on the upside. Given that, deflation scares will subside, inflation will become a concern, interest rates will rise, and the stock market will be volatile and flat.

Current Environment
Slow growth in the U.S. is not new; it has been happening for the past three decades. The working population is aging and growing much more slowly. Job creation is rising at 2% with the working age population growing at 0.5%. This means future economic recoveries will likely not exceed 4% real GDP growth maybe ever again. On the positive side, slower recoveries can lead to longer recoveries. Longer recoveries, in general, allow the market to put higher valuations on financial assets.

The U.S. economy is now self-stimulating; there is no longer a need for government intervention and stimulus. The driving forces behind that are:

1. New credit creation
2. Better household world
    a. Job gains up
    b. Unemployment low
    c. Unemployment claims down
    d. Wages increasing
    e. Low inflation
    f. Low yields
    g. Low gas prices
    h. Restored median household balance sheets (20% above pre crisis peaks)
    i. Improved confidence
3. Capital spending cycle
    a. Tons of “dry powder” on corporate balance sheets
4. Increased housing starts (housing remains very affordable)
5. U.S. Trade Improvement (possible trade surplus country by the time this recovery ends)
    a. Low real exchange rate
    b. Slow growth
6. Confidence revival (financial market will continue to be re-priced away from an “Armageddon situation”)
7. Oil and interest rates are low

2015 Financial Market Outlook

— Good News Becomes Bad News: An improving economic environment will cause the Fed to raise rates. Stock market typically does poorly when rates are first raised

— FED Perceived as Behind the Curve: Fair value in 10-Yr Treasury rate is closer to 3%+

— Interest Rate Structure Reconnected to the Economic Cycle: Rates rise as the economy improves

— Stock Market Turbulent and “Flattish”: Sentiment is higher than any other time in this recovery. Strong sentiment, being a contra-indicator, may leave the market vulnerable to a drawdown. Additionally, the valuation environment is much different than it was 3 years ago. The median U.S. stock price is trading at its highest P/E multiple in the post-WWII era. Lastly, the Fed needs to raise rates. Historically, initial rate hikes have been met with increased volatility and lackluster equity returns

The biggest risk to this recovery is a premature end caused by high inflation. This will cause the Fed to raise rates, independent of fundamentals, and ultimately depress stock prices.

Bond Themes for 2015

— 10 year Treasury yield needs to re-price to 4-5%

— Bullet now and barbell after the Fed gets in the game

— Stay underweight duration and overweight lower quality

Stock Themes for 2015

— Stay overweight stocks. There may be a near-term correction, but the long-term outlook remains good

- Diversify out of the U.S. and into resource-based economies, economies with accommodative monetary policy, and emerging markets
- In the U.S., investors should overweight staples, energy, materials, and small cap stocks

CREDIT MARKETS: FRANK BROSENS, TACONIC CAPITAL

Introduction

The current recovery is unprecedented given the unconventional monetary stimulus the Fed has undertaken. High yield issuance has doubled from 2011 to 2014, European high yield markets have grown extraordinarily fast over the past couple years, and the leveraged loan market is back where it was pre-crisis.

High yield spreads have widened which has created some opportunity but, as a whole, high yield is still not attractive. A reach for yield has led to credit valuations becoming stretched over the past few years. All of this has caused Taconic to move towards less risky opportunities like senior secured debt and merger-arbitrage.

2015 Investment Outlook

- QE Abatement: Should cause more market dislocations and a resurgence in volatility in the U.S. QE re-priced all financial assets in the U.S. Europe and Japan are attempting to devalue their currencies with their own bouts of QE. QE outside of the U.S. could be an anchor on U.S. rates
- Proprietary Capital Market Retreat: Hedge funds have become market makers as prop desks have disappeared from banks
- M&A and Distressed: M&A in the U.S. is coinciding with distressed opportunities in the U.S. and Europe
- Equity Market Discipline: Maintaining pricing discipline is even more important now that valuations are higher. Investors need to avoid crowded trades. There will be more frequent periods of market volatility

Credit Outlook

- Populist anger against German fiscal austerity (particularly in Greece and France) is becoming apparent. This has created some political risk in the region that should not go unnoticed
- M&A activity is picking up and creating investment opportunities
- Distress in Europe has caused opportunities for investors to provide capital to the market. Mini dislocations in the market have caused asset owners to be forced sellers, creating opportunities for investors to step in and acquire those assets

Q&A

- Today's return potential is mainly dependent on the risk of the asset. Taconic is currently more focused on the senior part of the capital structure where it can generate 8-10% expected returns. They would rather add leverage to those assets than move out the risk spectrum in the current environment
- Why invest in hedge funds? They can generate returns of 5-6% over the risk free rate with very little correlation and beta to equity markets. Additionally, Taconic aims to have nearly zero interest rate exposure, which is especially attractive in this environment

EUROZONE DYNAMICS: FRANCIS SCOTLAND, BRANDYWINE GLOBAL INVESTMENT MANAGEMENT

Introduction

Rates in the U.S. are well below where they should be based on domestic fundamentals because of what is happening globally:

- Deflationary pressures in Europe are keeping global rates low. These self-inflicted pressures were brought on when the Eurozone raised rates in 2011. This coincided with U.S. unemployment falling while Eurozone unemployment increased. Further evidence of deflation in the region can be seen in Germany's breakeven inflation rates which have plummeted recently. Russia's undeclared war on Ukraine has also added to deflationary pressures
- China is another source of deflation in the global economy. China was forced to add an unprecedented amount of debt to their balance sheet coming out of the financial crisis. Ever since then, they have tried to unwind this debt which has led to deflationary pressures
- Fiscal and monetary policy in emerging markets is also driving deflation. The "Taper Tantrum" of 2013 must have been like déjà vu to emerging market countries. It was reminiscent of the Tequila Crisis and Asian Crisis experienced in the 1990s where emerging market countries faced with rising rates found it difficult to repay their debts. Since the Taper Tantrum, central banks in the region have tried to slow inflation, improve balance sheets, and reform monetary policy causing deflationary pressures on the global economy. Additionally, commodity price pressures have also caused major deflation in several emerging market countries.

To reverse this trend, the Eurozone will need to provide QE, the Chinese government will need to spend more, and emerging market countries will need to cut rates.

Market Outlook

The culprit behind the drop in oil prices was a break in global demand. However, this is a self-correcting phenomenon; oil prices at these levels will aid economic growth and eventually increase demand for oil, especially in the emerging world.

Yields in the U.S. are fairly priced at 2% given the deflationary pressures globally and current global interest rates. Brandywine believes German Bunds are expensive and their spread to U.S. Treasurys needs to compress. They are not sure if that means Bund yields will increase or Treasury yields will fall. Chinese re-inflation would be very good for equity markets. Brandywine believes Chinese equity markets are one the cheapest in the world. If rates get cut in emerging markets, it would be positive for bonds and equities, but the impact on currency is less clear. In India, they think the currency can increase even with a rate decline.

2008 to 2012 was a bull market in fear. The market was worried about a U.S. fiscal crisis, Chinese hard landing, double dip, etc. In 2014, Brandywine's theme was the "Big Shift", where they thought the global economy would finally gain traction. The price of gold is too high given the fact that global economic health is improving. If emerging markets reflate, it would also put a bid back into commodities.

Q&A

The sell-off in oil will impact oil producers like Russia and Venezuela in a muted fashion because China will likely bail out both. The issue in Russia is the private sector, in which debt denominated in foreign currency was issued. If Russia's currency depreciates further, it will be very difficult for these companies to meet their debt obligations.

What do we do with the explosion in government debt that came out of the financial crisis? In Europe, they are making the debtors pay and in the U.S. it is the creditor that is paying (with Japan in the same position as the U.S.). It will likely be the way of U.S. policy that leads the global economy out of debt (i.e., depress currency and risk future inflation).

REAL ESTATE: A.J. AGARWAL, BLACKSTONE GROUP

Introduction

There are two drivers of real estate returns:

1. Cap rates (Cap Rates = Net Operating Income / Market Value): As cap rates go up, prices go down
2. Cash flows on the asset: As cash flows go up, prices go up

Real estate values bottomed in late 2009 in the U.S. Blackstone believes cap rates will stay stable or go up in the U.S., which is not good for real estate values. However, they see improvement in real estate fundamentals with GDP improving, employment improving, and a small increase in population growth. These factors, coupled with limited new supply of real estate, should help drive future real estate returns.

Market Outlook

Europe is the number one place Blackstone is deploying capital. They believe interest rates will continue to decline, causing cap rates to fall. However, unlike the U.S., there is very anemic demand in Europe. Cash flow growth is low but supply is nonexistent, which is a net positive for fundamentals (0-5% GDP and 0% new supply in Europe).

In Asia, there are significant dislocations in the market. Developers are having difficulty accessing capital, and buildings are trading below NAV. Blackstone thinks interest rates will continue to fall, led by Japan and their QE (lower cap rates). Demand is also strong in the region and there is less new supply than previously (increase in cash flow).

The biggest risk to real estate investors is new supply, particularly in the U.S. Occupancy rates for many sub-sectors are near all-time highs, which should allow for increases in rents (which are below 2006-2007 peak levels) and eventually new supply to come to market.

The one area that has shown improvement in supply is U.S. multi-family; however, total new housing supply is well below historical pacing. Single family residential housing is far below historical averages. Multi-family cap rates are at an all-time low. Investors should be cautious about this sector of the real estate market.

In the last 4 years, cap rates have gone down, and cash flows have gone up. It has been a perfect storm for real estate prices. Going forward, however, it will be more important than ever to focus on real estate selection. This is because cap rates will not continue to fall forever, making it imperative that investors select properties with increasing cash flows.

The spreads that real estate lenders are charging today are 4x what they were in 2007. Blackstone expects spread compression as rates move up. This should help cushion real estate debt investments in a rising interest rate environment.

Investors can buy retail and office assets at a 6% yield. This is very attractive to domestic and foreign investors that have to buy government bonds at less than 2% in the U.S. and less than 1% in parts of Europe and Asia. This should cause capital to continue to flow into real estate.

Opportunities

— **Retail Centers:** High single digits cash-on-cash returns with leverage and NOI growth leads to high teens returns for investors

— **Select Service Hotels** (generate income from room fees): 8% yield with an 11x EV/EBITDA multiple. This is a better valuation than full service hotels, plus select service hotels have better margins

— **Single Family Houses:** There are opportunities to buy houses for less than the cost to build (the land is free)

— **Offices:** There are opportunities to buy offices in prime areas that are significantly below the cost of replacement. They can also find office assets that are leasing well below current market rates, which is a tailwind as they mark those rents to market

EFFECTIVE PHILANTHROPY: BETSY DOYLE, THE BRIDGESPAN GROUP

Introduction

Philanthropy is a personal journey. You want your dollars to make a real and lasting impact. Most think philanthropy's natural state is underperformance. Success in philanthropy is much more difficult to measure. Common traps for funders are:

— Getting results is not a requirement

— There is no checks or balances to the funder

— Everyone is busy which causes most to underinvest

— Good enough giving is sufficient

What Should I be Asking?

Knowing the right questions to ask is the most important thing:

— What are my values and beliefs? There is no right answer; it is a personal decision

— What is success – and how will it be achieved? This is about setting achievable goals and *implementing strategy that will ensure those goals are met*

— What am I accountable for?

— How do I get the job done? Do you set up a foundation, work with foundations, raise funds, and/or write checks? Smaller organizations can maximize giving by focusing on fewer, bigger philanthropic endeavors. If you are a philanthropist and do not have the ability to do the service work, you need to find a great organization that can help you maximize your efforts

- How do I work with grantees?
- Am I getting better? This is about seeking feedback from grantees, surrounding yourself with critical advisors, and be open to improvement

Q&A

As a non-profit, how do you raise funds from the younger generations? It is important not only to have a program strategy, but also a funding strategy. These are a very different set of customers. It is important to get your messaging right and tailor it for your audience.

U.S. philanthropy vs. the rest of the world: Services/philanthropy in the rest of the world is expected to be performed by the public sector, whereas in the U.S. they have taken a more private sector approach to providing service/philanthropy.

Tips for those interested in giving: make sure you are clear on your values and beliefs, expectations of what that means after the funder is gone, and understand who else shares those beliefs. Decide if you are going to be strategic in your giving or not. Decide if you want a professional staff or if you want to involve family members.
