Twelve Points Perspectives – Q4 2015

A Tale of Divergence

*"**It was the best of times, it was the worst of times**, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way – in short, the period was so far like the present period…"   Charles Dickens, A Tale of Two Cities*

Written in 1859, and taking place in late 18th century, this quote seems remarkably fitting for today's economic, geopolitical, and market environment.   Set in Paris and London, the book covers the period around the time of the French Revolution.

Today's setting is highlighted by the diverging policies of major central banks *(U.S. tightening, while most others are easing)*, the strengthening dollar and the weakening foreign currencies, the larger *(but slowing)* emerging economic growth and the slower *(but stable)* developing economies' growth, the positive effect of cheap oil on some markets and the negative effect on others, the globalization of world economies due to open borders and the social unrests due to these open borders, the diplomats and the dictators, the bulls and the bears both being "right", the rise to prominence of Liquid Alternatives, and the descent of Traditional asset classes as the only necessary ingredients in a diversified portfolio.

The Markets – More Red than Green

- While Global stocks staged a small Q4 comeback, the performance of bonds was mixed-to-negative. Commodities extended their sizable losses. Alternatives, true to form, had varied results with a lot of dispersion between the top and bottom sub-asset-classes, sub-strategies, and performers.

- **Global stocks** rebounded 5.1% in Q4, but finished the year down 2.4%. The **S&P 500** headlined the rebound, returning 7% in Q4, and 1.4% for the year. However, this slightly positive return is misleading, as the market lacked breadth, illustrated by the fact that 7 out of the 9 Morningstar style boxes experienced negative 2015 returns. The so called "FANG" stocks (Facebook, Amazon, Netflix, and Google) attributed for most of S&P's positive 2015 performance. **Developed International** markets returned 3.6% in Q4, but were down 0.4% in 2015. **Emerging markets** were slightly up in Q4, returning 0.7%, but down a disappointing 14.6% for the year.

- **U.S. Taxable Core Bonds** were down 0.6% in the quarter, as the market reacted to the anticipated December Fed rate hike, and up 0.6% for the year. **Municipal bonds,** the best performing bond category, gained 1.5% in Q4, and were up 3.3% for the year. **U.S. High Yield** declined another 1.3% in Q4, as credit spreads continued to widen, due to Energy/Commodity default concerns and Third Avenue shutting down its Focused Credit fund while restricting redemptions, finishing the year down 4.5%. **Emerging Market Debt**, denominated in local currency, experienced its worst loss in over a decade, down 14.9% in 2015, mostly due to local currencies depreciating against the dollar.

- **Commodities**, facing headwinds from **lower energy prices**, extended their losing streak, finishing the year down 24.7%. **Gold** also continued its decline, down 11% in 2015.

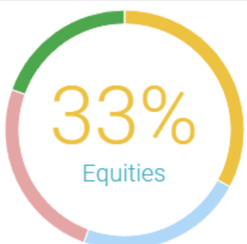
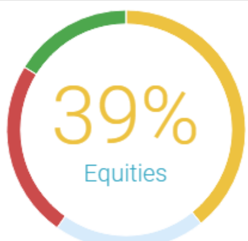
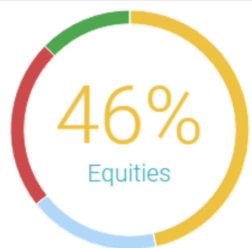
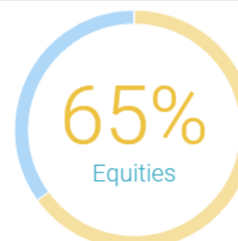
- The average **Multialternative** manager was **flat** in **Q4**, and down 2.6% for the year – a similar return to what most traditional stock and bond investors would have experienced, but with a better imbedded "expected" downside protection.

Source: Morningstar

Your Portfolios – What Was, and What We Tried to Prevent…

Your 2015 portfolio returns were similar to those of traditional stock and bond portfolios. More importantly, **last year's returns did not have a significant effect on the expected likelihood of you reaching your stated financial goals**. *

While 2015 marked the return of market volatility, most traditional asset classes (with the exception of Emerging Markets) ended the year close to flat. Our **overweight Developed International and Emerging Markets stock allocation was a headwind**. While what is cheap can certainly get cheaper, given last year's drawdown, we continue to like the International/Emerging markets stock overweight (vs. U.S. stocks). **Our outsized Alternatives allocation aided returns, and as importantly, provided an expectation of improved capital protection in case of sizable and prolonged market drawdowns**.

	Model - Conservative Balanced	Model - Conservative Growth	Model - Aggressive Growth	Benchmark - 65% Global Stocks, 35% U.S. Bonds
Asset Allocation	 33% Equities; 23% Fixed Income; 25% Alternative; 20% Cash	 39% Equities; 21% Fixed Income; 24% Alternative; 16% Cash	 46% Equities; 18% Fixed Income; 23% Alternative; 13% Cash	 65% Equities; 35% Fixed Income
Risk Stats				
Stress Test Risk	-14%	-17%	-21%	-40%
Correlation Risk	0.31	0.33	0.35	0.44
S&P 500 Beta	0.27	0.32	0.38	0.68

Selected risk statistics of TPWM Model portfolios are compared to a 65% Global Stocks, 35% U.S. Bonds benchmark. "Stress Test Risk" shows the worst expected drawdown out of the approximately 60 HiddenLevers scenarios tested; "Correlation Risk" shows the portfolio correlation to the direction of the S&P 500 movements; "S&P 500 Beta" shows the magnitude of portfolio returns in relation to S&P 500 returns.

Source: HiddenLevers. Stress tested returns do not guarantee actual future returns. HiddenLevers Stress Testing Model Performance (Accuracy) Review

** Some portfolio returns may vary*

Tomatoes, Tomaahtos – and Kale Shakes

We love to travel! *(and if you do too, ask us about our partnership with the G2G Collection).* One of the things we love most about travel is enjoying local delicacies. Have you ever tried to find that local delicacy you enjoyed so much stateside, and it was just not as good? Are our chefs not as talented? Can they not follow the same recipes? The difference is the quality of the ingredients! A *pomodoro* grown in Italy or a *ntomata* grown in Greece is likely going to taste better than the one grown here. Furthermore, most countries tend to eat seasonally, whereas U.S. consumers are used to finding most ingredients year-round.

Just as a chef can't make an amazing meal without quality ingredients, a portfolio allocator can't put together a portfolio providing outsized returns when almost no ingredients *(asset classes)* are "in season." In fact, according to Societe Generale, as reported by CNBC, "2015 was the worst year for finding returns since 1937, when the cash-like 3-month Treasury bill beat out other major asset classes with a return of 0.3%."

With this backdrop, instead of building portfolios stretching for outsized returns, we continue to concentrate on constructing portfolios with a low expected downside capture (but also, a low expected upside capture). While most investors' portfolios are too stock heavy (typically 60-80%), our clients' portfolios typically allocate a lower 30-50% to stocks. While most investors' portfolios hold no Alternatives, our clients' portfolios typically allocate 35-50% to diversifying and risk-reducing Alternatives.

Put another way, instead of making a Caprese salad with out-of-season tomatoes, we're opting for the healthy and seasonal Kale Shakes.

Harvard & Yale like Kale too

Comparing Select Ivy League Endowment Allocations to TPWM's			
	Harvard [1]	Yale [2]	TPWM [3]
U.S. Equity & Preferreds	6 - 16%	4%	4.5 - 8%
Long/Short U.S. Equity			4 - 6%
Foreign Equity	6 - 11%	14.50%	14.5 - 22.5% [4]
Emerging Market Equity	4 - 17%		5 - 8.5%
Private Equity & Venture Capital	13 - 23%	30%	
Absolute Return	11 - 21%	21.5%	5 - 10%
Managed Futures & Global Macro			17.5 - 23%
High Yield & Convertibles	0 - 3%		2.5 - 3.5%
Natural Resources & Commodities	6 - 16%	8.5%	1 - 2.5%
Real Estate	10 - 17%	13%	11.5%
Domestic Bonds & Cash	5 - 9%	8.5%	15 - 24%
Foreign Bonds	0 - 4%		
Inflation-Linked Bonds	0 - 6%		

1. Fiscal Year 2016 Asset Class Ranges, as of September 2015
2. Fiscal Year 2016 Asset Allocation Targets, as of September 2015
3. "Conservative Balanced" through "Aggressive Growth" portfolio ranges, as of January 2016
4. Includes Managers who allocate a portion of the portfolio to Emerging Markets Equity

How would you invest billions of dollars if given a chance? The Harvard and Yale endowments, the two largest in U.S., total to $60+ billion. To manage these massive pools of assets, they can (and do) hire some of the most respected investment minds in the world. While we don't strive to build "endowment-like" portfolios, our current views on the market risks and opportunities seem to align with many notable endowment portfolio managers. The biggest differences are the endowments' allocations to Private Equity, vs. our allocations to Managed Futures & Global Macro, and the endowments' higher allocation to (fixed income) Absolute Return, vs. our larger allocation to traditional Bonds & Cash.

Sources: Harvard, Yale, US News

Board of Review – An Annual Self-Assessment

"After a Scout has completed the requirements for any rank or Eagle Palm, he appears before a board of review. Its purpose is to determine the quality of his experience and decide whether he has fulfilled the requirements for the rank. If so, the board not only approves his advancement or Palm but also encourages him to continue the quest for the next rank or Palm." – Boy Scouts of America

Every year, we will conduct a self-assessment - to review our decisions on which asset classes we chose to over/underweight, what themes we wanted to get exposure to and which we chose to stay away from, and the quality of investment manager selection.

Since our clients are long-term investors, most of these decisions are long-term in nature. Frankly, a year is not long enough of a time frame to properly evaluate the quality of many of these decisions. Many of them may take a full market cycle (the period which includes both a bull and a bear market) to play out. For example, an active fund manager should be evaluated over a full market cycle. Yet, others, in the "Opportunistic" sleeve, may be short-term in nature – and may play out in less than a year. Nonetheless, an annual self-assessment is a great practice to reflect on where we are in the journey, and evaluate whether any course adjustments are necessary vs. staying on course.

Highlights of this self assessment can be seen on the following pages.

It's a "Risk-Off" Environment
Let's Underweight Stocks

Most long-term investor portfolios allocate 60-80% to traditional long-only stocks. As we found the U.S. stock market expensive, and thought that International markets (while more attractive than U.S.) carry significant risks, we chose to underweight stock exposure across most client accounts.

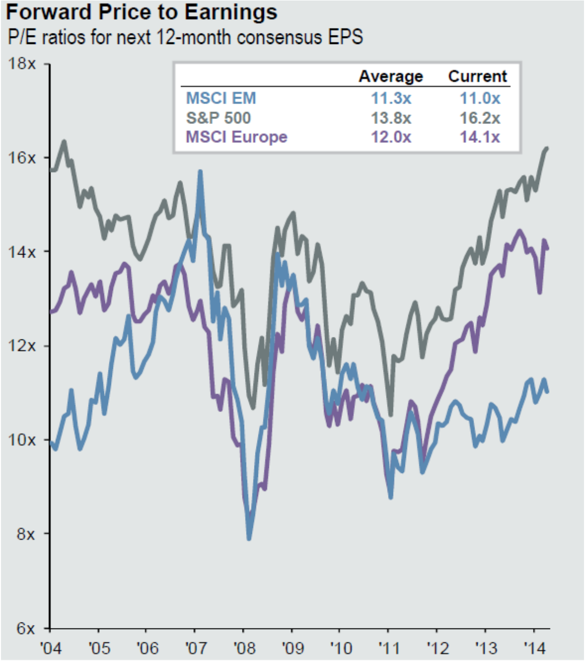
While our "fully invested" model portfolios called for 35-50% in stocks, most of our clients' portfolios had 30-45% in stocks throughout 2015.

Global Stocks had a volatile 2015, ending the year in the red.

Source: HiddenLevers – iShares MSCI ACWI ETF

International/EM Stocks - Let's Buy More of What's Cheap
But Let's Currency Hedge Our Euro and Yen Exposure

Among many other factors, at the start of 2015, in deciding to overweight International & EM stocks, we considered the higher *(vs. International & EM markets, but also – vs. its own history)* Projected Price to Earnings Ratio of the S&P 500. Source: JPMorgan Guide to the Markets, **2015 Q1**.



While many Developed International Markets had positive returns in local currency, due to most currencies weakening vs. the dollar, the dollar denominated returns were mostly negative. *Of note - 2/3 of the Emerging Markets 2015 loss came from currency depreciation.* Source: JPMorgan Guide to the Markets, **2016 Q1**

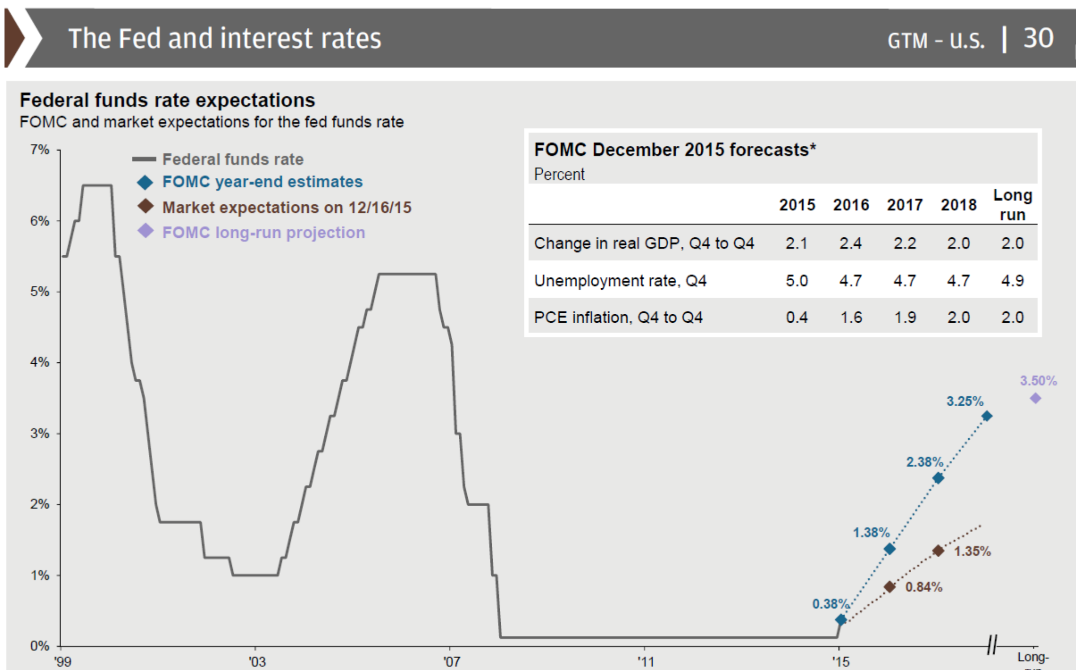
Global equity markets

	2015	
Country / Region	**Local**	**USD**
Regions / Broad Indexes		
All Country World	1.8	-1.8
U.S. (S&P 500)	-	1.4
EAFE	5.8	-0.4
Europe ex-U.K.	9.1	0.1
Pacific ex-Japan	-0.8	-8.4
Emerging Markets	-5.4	-14.6

Sources: JPMorgan, FactSet, MSCI, Standard & Poor's

Yields are Low, and (likely) Rising – Let's Underweight Bonds
But, within Core Bonds – Let's Overweight Munis

- Most long-term investors' portfolios allocate 20-40% to Core bonds. Throughout 2015, we allocated approximately 10-15% to Core Bonds. Taxable Core bonds were only up approximately 0.6% for the year.
- The Municipal Bond Market makes up approximately 10% of the U.S. Bond market. Within our Core Bond allocation, we allocated 45% to Municipal Bonds – a significant overweight. We even allocated to Municipal Bonds in select IRA accounts. Municipal Bonds were up approximately 3.3% for the year.
- For the first time since June of 2006, the Federal Reserve increased its key interest rate by 0.25%. Along with the market, we anticipated the December rate hike. Going forward, the market expects the pace of the future hikes to be slower than FOMC's forecasts, as do we.



	2015	2016	2017	2018	Long run
Change in real GDP, Q4 to Q4	2.1	2.4	2.2	2.0	2.0
Unemployment rate, Q4	5.0	4.7	4.7	4.7	4.9
PCE inflation, Q4 to Q4	0.4	1.6	1.9	2.0	2.0

Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are the federal funds rates priced into the fed futures market as of the date of the December 2015 Federal Open Market Committee (FOMC) meeting. *Forecasts of 17 FOMC participants, midpoints of central tendency except for federal funds rate, which is a median estimate.
Guide to the Markets – U.S. Data are as of December 31, 2015.

J.P.Morgan Asset Management

Sources: JPMorgan, FactSet, Federal Reserve

Alternatives Should Provide a Ballast in Volatile Year

- Most long-term investors do not allocate to Alternatives. Many of those that do, only allocate 5-10%. An allocation of this size does not provide enough diversification to “move the needle,” in case of market drawdowns.
- Throughout 2015, we allocated approximately 40% to Alternative investments. While the 2015 returns for Alternatives were “nothing to write home about,” they were still generally positive. And more importantly, they provided the expectation of a portfolio ballast – in case of stormy markets.

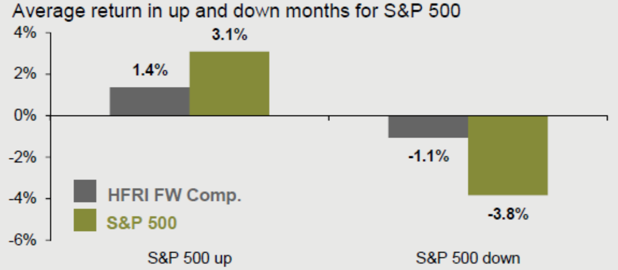
Hedge funds

GTM – U.S. | 54

																2000 - 2015	
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Ann.	Vol.
Equity L/S 17.3%	Event Driven 13.2%	Macro 5.5%	Large Cap 28.7%	Event Driven 14.2%	Equity L/S 10.0%	Large Cap 15.8%	Macro 11.4%	Macro 4.7%	Large Cap 26.5%	Large Cap 15.1%	Large Cap 2.1%	Large Cap 16.0%	Large Cap 32.4%	Large Cap 13.7%	Market Neutral 4.5%	Event Driven 6.8%	Large Cap 16.9%
Relative Value 14.4%	Macro 10.1%	Relative Value 5.3%	Event Driven 23.0%	Large Cap 10.9%	Event Driven 8.6%	Event Driven 15.2%	Equity L/S 11.4%	Market Neutral -3.0%	Relative Value 23.0%	Relative Value 12.5%	Relative Value 0.8%	Relative Value 9.7%	Equity L/S 14.5%	Macro 5.8%	Large Cap 1.4%	Relative Value 6.7%	Equity L/S 11.4%
Market Neutral 14.3%	Relative Value 9.0%	Market Neutral 0.9%	Macro 21.5%	Equity L/S 7.9%	Market Neutral 6.1%	Equity L/S 12.8%	Relative Value 10.0%	Relative Value -17.3%	Equity L/S 22.3%	Event Driven 11.5%	Event Driven -0.5%	Event Driven 6.5%	Event Driven 13.4%	Relative Value 5.3%	Macro 0.7%	Macro 5.7%	Event Driven 8.5%
Event Driven 7.8%	Market Neutral 9.0%	Equity L/S -1.7%	Equity L/S 16.9%	Macro 7.5%	Macro 6.1%	Relative Value 12.2%	Event Driven 8.7%	Event Driven -20.8%	Event Driven 20.3%	Equity L/S 8.9%	Macro -0.7%	Equity L/S 4.7%	Relative Value 7.5%	Equity L/S 3.6%	Relative Value 0.2%	Equity L/S 5.6%	Macro 6.1%
Macro 4.1%	Equity L/S 1.6%	Event Driven -3.1%	Relative Value 9.1%	Relative Value 6.1%	Relative Value 5.3%	Macro 8.2%	Market Neutral 5.7%	Equity L/S -26.4%	Macro 6.9%	Macro 3.2%	Market Neutral -1.5%	Market Neutral 3.1%	Market Neutral 6.4%	Market Neutral 3.2%	Equity L/S 0.0%	Large Cap 4.1%	Relative Value 5.9%
Large Cap -9.1%	Large Cap -11.9%	Large Cap -22.1%	Market Neutral 3.3%	Market Neutral 3.4%	Large Cap 4.9%	Market Neutral 7.0%	Large Cap 5.5%	Large Cap -37.0%	Market Neutral -1.7%	Market Neutral 2.5%	Equity L/S -4.3%	Macro -1.3%	Macro 0.1%	Event Driven 2.6%	Event Driven -2.6%	Market Neutral 3.9%	Market Neutral 3.0%

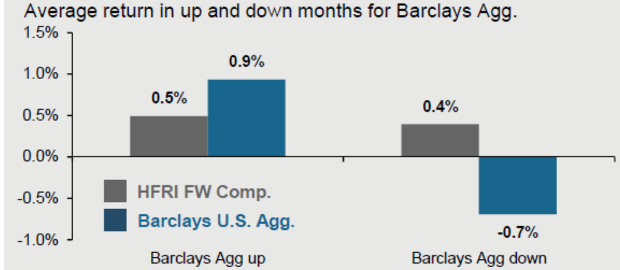
Hedge fund returns in different market environments

Average return in up and down months for S&P 500



Hedge fund returns in different market environments

Average return in up and down months for Barclays Agg.



Source: Barclays, FactSet, HFRI, Standard & Poor’s, J.P. Morgan Asset Management.
Hedge fund returns in different market environments are based on monthly returns over the past 15 years.
Guide to the Markets – U.S. Data are as of December 31, 2015.

J.P.Morgan
Asset Management

Sources: JPMorgan, Barclays, FactSet, HFRI, Standard & Poor’s

Manager Selection Aided Returns

- Our **U.S. stock** ETF finished up 0.28% for the year, ranking in the top 17% of its Morningstar category (Large Cap Value). However, due to performance of "FANG" stocks, it trailed the S&P 500 ETF by approximately 1%.

- While all 3 of the **International Developed** Mutual funds were down in 2015, 2/3 outperformed their category, ranking in the top 24% and 39% of their respective peer groups. The International Developed Small Cap fund finished in the bottom 20% of its peer group, due to its larger than category average allocation to Emerging Markets.

- The **Emerging Markets** fund finished in the top 3% of its peer group.

- The **Frontier Markets** fund, one of our smallest allocations, underperformed its benchmark.

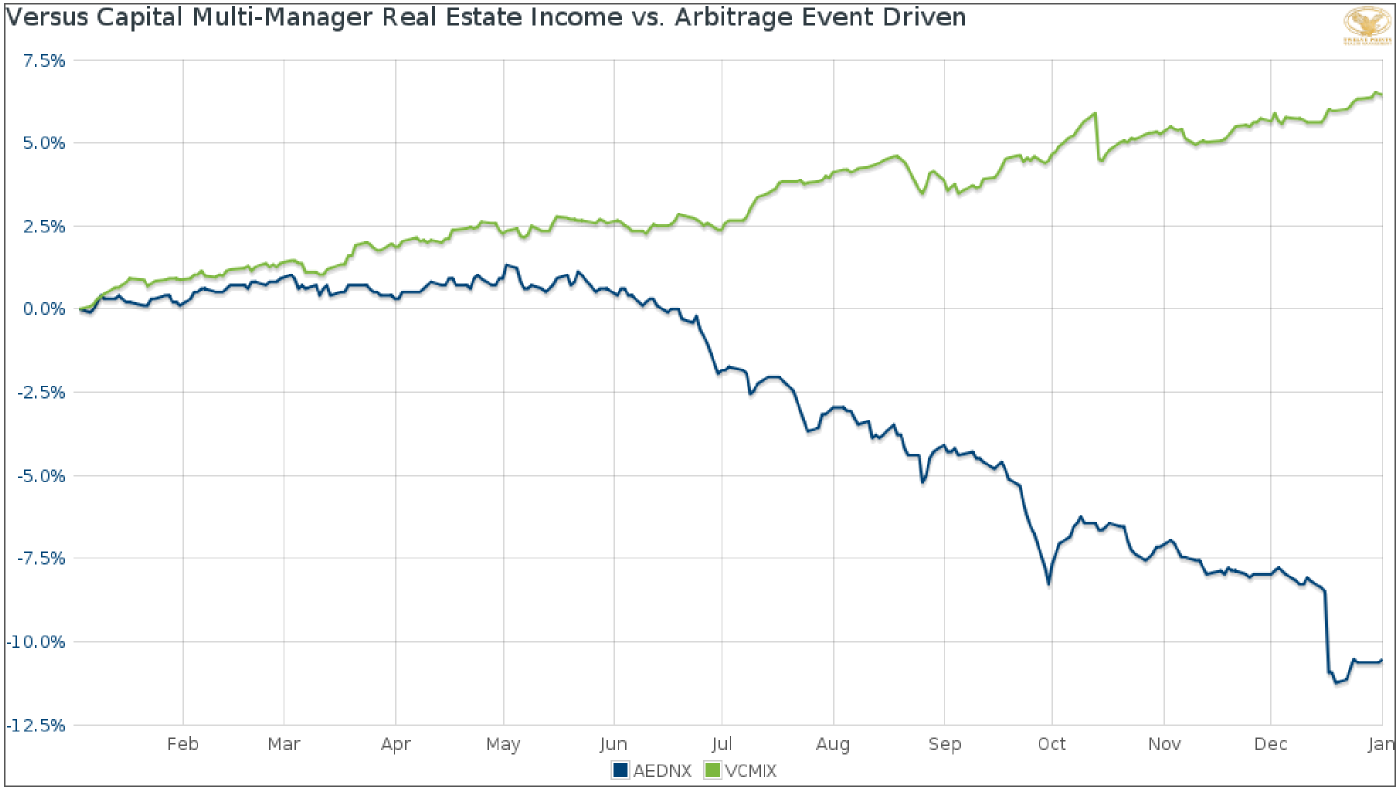
- Both of the **Core Bond** funds we used for most of the year were up in 2015. The Municipal fund finished in the top 3% of its Morningstar category, while the Taxable fund, despite Closed End Funds' discounts widening, finished in the top 26% of its category.

- Half (3/6) of the **Alternatives** funds we used for most of the year were up in 2015. The 2 largest Alternative fund allocations *(Managed Futures and Private Real Estate)* were up.

- The Preferred Stock Closed End Fund's NAV growth outperformed its peer group, ranking in the top 14%. However, as its discount widened in 2015, its price slightly underperformed the category.

Source: Morningstar

A Tale of Two Managers



- **Versus Capital Multi-Manager Real Estate Income** fund was our **2015 MVP.** In one of the most difficult years for "finding returns," it delivered solid positive returns, monthly income, with low volatility. Private Commercial Real Estate remains our favorite way to get exposure to the relatively healthy U.S. economy, and the fund remains one of the two largest holdings.
- The **Arbitrage Event-Driven** fund was our **most disappointing holding of 2015**. The disappointment didn't come from the 2015 drawdown, as market volatility is normal, and many managers experience drawdowns. We were disappointed because of the unexpected fund strategy change that took place soon after our early 2015 investment. We put the fund on our watch-list by August, and "relegated it to the minors" in November.

Source: HiddenLevers