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## OUTLOOK

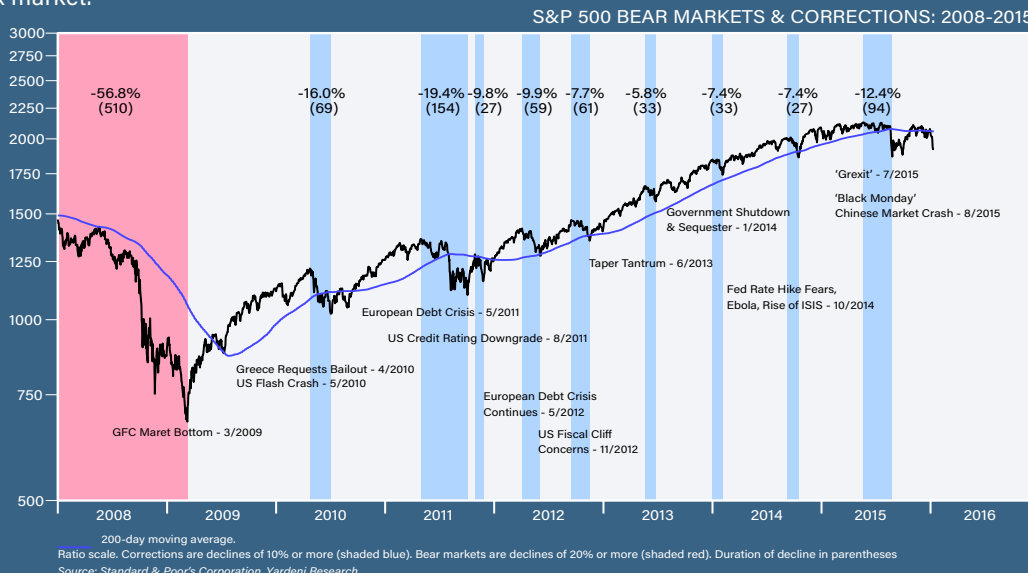
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We've Been Here Before

## A Note From Our CEO

### We've Been Here Before:

Before we begin to discuss our outlook for the upcoming year, we feel it's appropriate to take a step back and evaluate where we are, where we've come from, and where we are going. It has been over 7 years since Lehman brothers collapsed. While the S&P 500 has appreciated 97% (or 9.8% annualized) since that day, the market has experienced fits and starts. Looking back over this time period there have been many reasons not to be invested in the stock market.



The Global Financial Crisis we experienced in 2007-2009 was not the first market disruption which had a protracted impact on investor sentiment. There were two market events in the 20th century which also had repercussions well after the worst was over: the Great Depression and the Great Inflation of the 1970s-1980s. Though the effects of the Great Depression lasted through the 1930s, gross domestic product bottomed in 1933. The S&P 500 would experience six corrections of over 25% before the onset of WWII, which paradoxically had the effect of calming the stock market. After the war, fears of sliding back into another depression lingered until 1950. During the following decade, the S&P would return 481.5% (or 19.3% annualized). Beginning 1973, the US experienced a 10-year period of high inflation and high unemployment, known in economics as stagflation. During this period, inflation peaked at 14% and unemployment rose to 10%. At the onset of the Great Inflation, in 1973 and 1974 the S&P 500 experienced a 48.2% drawdown. Over the following 10-years, the S&P would experience 8 corrections of 10% or more. During this period, investors left the stock market in droves to pile into bonds, which at the time offered high yields to protect against high inflation. Those investors would miss the beginning of the strongest bull market in stock market history. From 1980 until 2000, the S&P 500 would return 2,575.3% (or 17.9% annualized). In both of these periods, investors who took a longer term view benefited. As we begin to consider the current market conditions, it's important to be mindful of the fact that true panics set in when something happens the market did not expect. The Great Depression, the Great Inflation, and the Global Financial Crisis were true panics. In the first trading week of January, the S&P 500 was down 5.9%, making it the worst start to the year in market history. While it can be painful, volatility is part of the reason investors can expect a risk premium in equities over the long-term. The existing downside risks to the global economy create the potential for muted GDP growth and flat or declining market activity in coming years. Past experience has shown that focusing on value over growth equities during similar market environments has led to greater returns over the long run. Excessive multiple expansion and shrinking margins have reduced the prospects for growth oriented investing, but the current economic landscape and market activity enhances the future prospects for value investing. Looking forward, we see little prospect for volatility to subside, however as history has taught us, investors who are able to withstand the turbulence should be rewarded. Trying to time the market will never work, but proactive adjustments to asset allocation allow investors to take advantage of alpha generating opportunities. The best course of action is to stay the course and remain invested at all times.

*John Chatman*

CEO - Waterloo Capital Management

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## Outlook 2016: We've Been Here Before

### 2015 Review

The dramatic bull market charge over the last six years slowed to a crawl in 2015. As you know, every year we take a look back at our prior year themes and drivers across all markets and asset classes. Heading into 2015, our primary theme was that divergent trends globally would drive market direction and increase overall volatility was correct. Economically, the year was highlighted by divergence in central bank policies, the prolonged rout in commodity prices, and a resurgence in global market volatility stemming from fears of a slowdown in global markets. On the macro front, geopolitical factors included the rise of ISIS, the migrant crisis in Europe and the Middle East, Greece threatening to leave the euro zone, and the Chinese government struggling to implement sweeping economic reforms. Overseas, China's stock market climbed into the stratosphere for nearly half of the year before crashing in an extreme fashion following the removal of the Yuan vs. dollar peg and reports that GDP growth would not hit its projected target for the first time in nearly two decades. In Europe, Greece's debt problems dominated the headlines once again, and uncertainty surrounding the potential "Grexit" spurred volatility and threatened to derail the already fragile euro zone recovery. The European Central Bank (ECB) was commendable in containing the fallout of the Greek situation and promoting inflation and sustainable economic growth through implementing quantitative easing (QE) measures. Domestically, the US Federal Reserve finally raised its benchmark interest rate after nearly a year of murky economic measures and hazy forward guidance. The lack of action and guidance spurred bouts of volatility while keeping trading ranges for many indexes relatively tight.

<b>Domestic Equities</b>	
DJ Industrial Average	-2.23%
S&P 500	-0.73%
NASDAQ	5.73%
Russell 3000	-1.47%
Russell 1000 Growth	4.03%
Russell 1000 Value	-6.19%
Russell Mid Cap Growth	-1.27%
Russell Mid Cap Value	-6.87%
Russell Small Cap Complete	-4.75%
Russell Small Cap Value	-7.88%
<b>Foreign Equities</b>	
MSCI World ex USA	-5.44%
MSCI EMU	-3.34%
MSCI EAFE	-3.30%
MSCI EM	-16.96%
FTSE China 50	-13.68%
<b>Fixed Income</b>	
Barclays US A g g Bond	0.55%
Markit iBoxx Liquid IG	-4.74%
Barclays US Treasury 7-10 Yr	1.63%
Barclays US Treasury US TIPS	-1.44%
S&P National AMT Free Muni	3.26%
Barclays US MBS	1.51%
<b>Real Assets</b>	
S&P GSCI	-32.86%
FTSE NAREIT All Equity REITs	2.83%
DJ US Real Estate	2.14%
LBMA Gold Price PM	-12.11%
Oil Price Brent Crude	-34.97%

Source: Morningstar Direct

### 2016 Outlook

Without question, the market volatility in 2015 was unsettling for investors. The global economy is still trying to find firm footing and we expect many of the themes from our 2015 Outlook to carry over into this year. The global investment landscape has several headwinds facing it for the upcoming year. US stocks are at best fairly valued and corporate profit margins seem to be peaking. China's depreciation of the Yuan was a significant event, which will likely continue to create uncertainty in global markets for some time. Incongruities in the global economic recovery will continue propelling the divergence of central bank policies. Possibly even more so than last year, markets will be fueled or quashed by these policies and the underlying strengths and weaknesses of individual economies. The delay of the Federal Reserve's first interest rate hike caused other central banks to delay implementing their own policies. Now that the Fed has made its move, other central banks will surely make their own. Underlying data indicates that many economies are headed in the right direction, but the resurgence of the global economy remains extremely delicate and multiple downside risks remain prevalent. Headwinds such as the continuing collapse in commodity prices, weakness in China and other emerging markets, and geopolitical tensions are still strong. These headwinds will put downward pressure on many markets and will likely fuel bouts of volatility throughout the year. What these issues spell out is a flatter efficient frontier, meaning that investors should not expect to be rewarded for taking additional risk in portfolios. This has caused us to reduce the overall risk in our portfolios. However, this is not to say there are no opportunities in the current market environment.

We believe that the early year selloff is more indicative of a reactionary trade resulting from investors' fear rather than a collapse in the global economy. The markets are moving away from the "easy" trading days that many investors have become accustomed to since the depths of the Global Financial Crisis in March of 2009. The investment landscape going forward will be much more difficult to navigate. Returns over the next several years are likely to be muted, and in several sectors, it is quite possible that investors should be more worried about the return of their capital rather than the return on their capital. Though it may appear that the negatives outweigh the positives in 2016, we believe that developed economies will be able to sustain their economic recoveries and generate positive investment growth this year.

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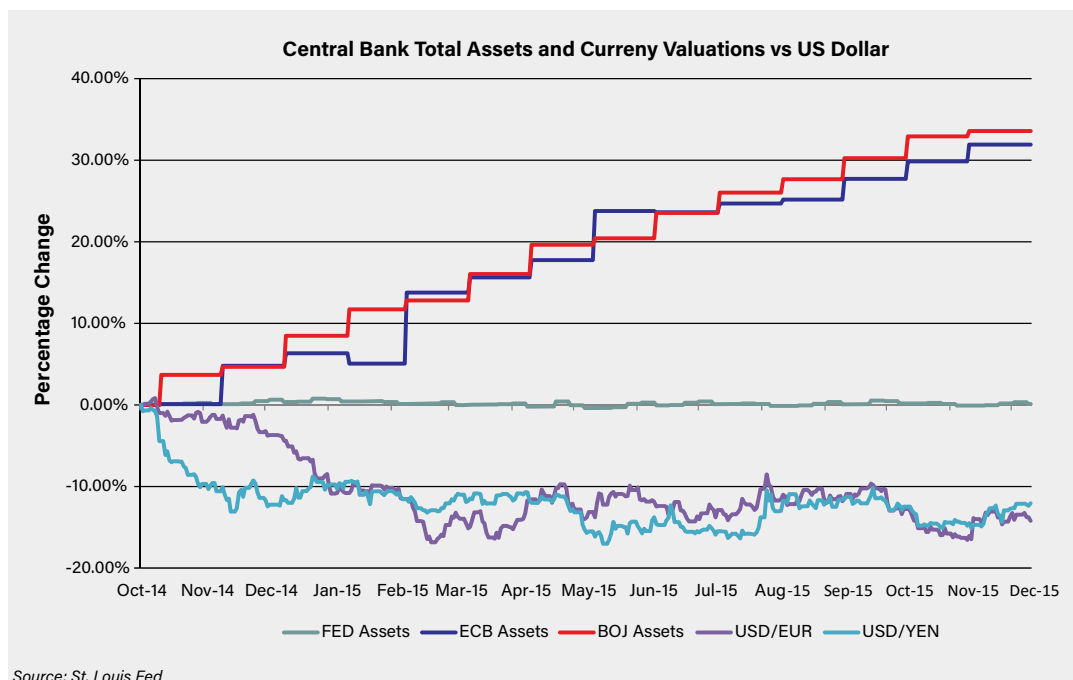
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## Investment Themes 2016

### Divergent Central Bank Policies Will Drive Global Markets

Last year we pointed to divergent monetary policies as a potential source of increased volatility in the markets as one of our core investment themes. In the past year: the US Federal Reserve embarked upon the first rate hike cycle in nearly a decade, the European Central Bank (ECB) began large-scale quantitative easing, the Bank of Japan (BOJ) pushed forward with easy money policies and furthered structural reforms, and the People's Bank of China (PBOC) removed the peg to the US dollar effectively devaluing their currency.

The effects of these policies will manifest themselves in several areas of the global market. We continue to believe the quantitative easing in Europe and Japan will be a tailwind for rising equity valuations. Rising rates in the US should lead to a continued appreciation of the US dollar. This will likely continue to depress US exports, weighing on multi-national corporate earnings. Additionally, emerging market nations will continue to be negatively impacted by the strong US dollar. China will continue to be in focus, as they attempt to shift their export-driven economy to one that is fueled by domestic consumption.



## Foreign Developed Markets Poised to Outperform

Looking across the pond, the UK and Eurozone economies appear to be gaining traction. Both areas have struggled to keep inflation moving toward policy levels given the fears emanating from China and the pressure of lower oil prices on average inflation measures. In the Eurozone, the European Central Bank (ECB) has remained steadfast in its effort to utilize quantitative easing to boost investment and inflation. ECB President Mario Draghi has said on multiple occasions that the bank is dedicated to doing whatever it takes to meet its goals before the program is scheduled to end in 2017. The tailwind from the ECB's easy money policy, along with the relatively attractive valuations observed in the European markets, lead us to project that European equities will outperform US equities in 2016. Additional tailwinds for the region include lower currency prices, the trickle down savings from lower oil prices, and the continuation of low interest rate policies, all of which should help foster domestic consumption. European markets are still at attractive valuations after experiencing pullbacks last year due to the Greek debt crisis, tensions created by the migrant crisis, and fears of contagion sparked by China.

The Bank of Japan (BOJ) has shown that it has no problem with increasing its unprecedented monetary stimulus measures to keep the Japanese economy afloat. Prime Minister Shinzo Abe's "Abenomics" plan has resulted in some signs of economic improvement, but the short-term parts of the plan have run their course and any positive tailwinds from the most recent measures are not likely to be seen in 2016. Many economic headwinds still exist. The government has had to cope with poor demographics, high savings rates, sluggish wage growth, and a lack of consumer demand. Despite these obstacles, the BOJ has shown that it is capable of quickly implementing government policies to assist the country's somewhat fragile recovery. We expect the BOJ and Prime Minister Abe to continue pursuing easy money and business friendly policies this year, with the ultimate effects of these policies resulting in a net positive for the economy. The Japanese stock market has held relatively steady through troublesome times, and Japanese markets may have garnered a "safe trade" label for investors. As volatility continues to surge in 2016 we expect the demand for "safe" holdings to increase which will be a potential tailwind for Japan's markets. Additionally, businesses have been incentivized to drive wage growth and spend excess capital on building shareholder wealth through capital expenditures, buybacks, and dividend payments.

Attractive valuations, rebounding investor sentiment, accommodative monetary policy, and improving economic fundamentals for businesses and the workforce make European and Japanese markets attractive plays this year. Both markets have the potential to outperform US equities this year, but the lack of sustainable economic growth will create more volatile swings in the markets. Further, as we have seen multiple times before, when market prices are supported by central bank policies sell offs and short-term runs can be exacerbated by disappointing forward guidance. These spikes in volatility can spark reversals in investor confidence and potentially derail market momentum. The attractive valuation levels and the potential for outperformance make us keen to maintain a substantial allocation to Europe and Japan. The divergence of monetary policies this year will lead to further currency fluctuations. The US dollar will likely appreciate this year, and accommodative policies in both Japan and the Eurozone will put downward pressure on the yen and euro. The potential decline in foreign currencies relative to the US dollar suggests that currency hedged positions may outperform US dollar denominated foreign investments in 2016. We will continue to monitor the exchange rates of currencies against the US dollar and will shift our foreign exposure to currency hedged positions as we see fit.

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“The effects of these [divergent] policies will manifest themselves in several areas of the global market.”

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## Investment Themes 2016

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### New Credit Cycle Generates Opportunities

The U.S. credit cycle has lasted for the last seven years. Credit cycles are economically important because they indicate the ease of access to borrowed capital. As interest rates decline and lending requirements are lowered it becomes easier for borrowers to access capital. Conversely, when interest rates rise and lending requirements become more stringent, it becomes harder for borrowers to access capital. The Federal Reserve's decision to raise benchmark interest rates should push interest rates higher this year and into the future. Additionally, new banking regulations have made it harder for borrowers to raise capital through traditional means.

For these reasons as well as others we believe that the current credit cycle is coming to a close and we are entering the early stages of a new cycle. The energy sector will struggle to cope with the end of this credit cycle, but it should not have as significant of an effect on other sectors. We are seeing a bifurcation in the metrics of the energy industry relative to the rest of the economy. While credit has essentially dried up in the energy sector and defaults are likely, credit capacity is increasing in many areas and this should continue given the underlying strengths of the economy. Additionally, following the Fed's rate hike, banks have a better understanding of where future interest rates are likely to head and should become more comfortable lending money during a rising rate environment. The increase in lending also signals that consumers are becoming more comfortable increasing their spending habits. An increase in spending would be welcomed considering that personal consumption in the US has expanded at 3.7% on a nominal basis compared to an average of 7.1% during recovery cycles since 1950.

Raising interest rates has historically been used to cool down a surging economy, but based on the projected pace of future rate hikes and the mixed signals of the underlying economy we feel that the economic recovery will continue to plod along despite hawkish Fed actions. The current recovery is unique in its both its length and amplitude. The bull market has exceeded all but two in length, and the recovery has been the slowest economic rebound since WWII. The pace of the recovery has been significantly slowed by deleveraging activity. The memories of the GFC and the recent volatility in the markets have perpetuated the idea that households need to increase savings, and US households and businesses have been deleveraging since the GFC. The increase in the household savings rate has been a drag on domestic consumption. Additionally, uncertainty regarding the future path of interest rates and access to capital has delayed business investment decisions and capital expenditures.

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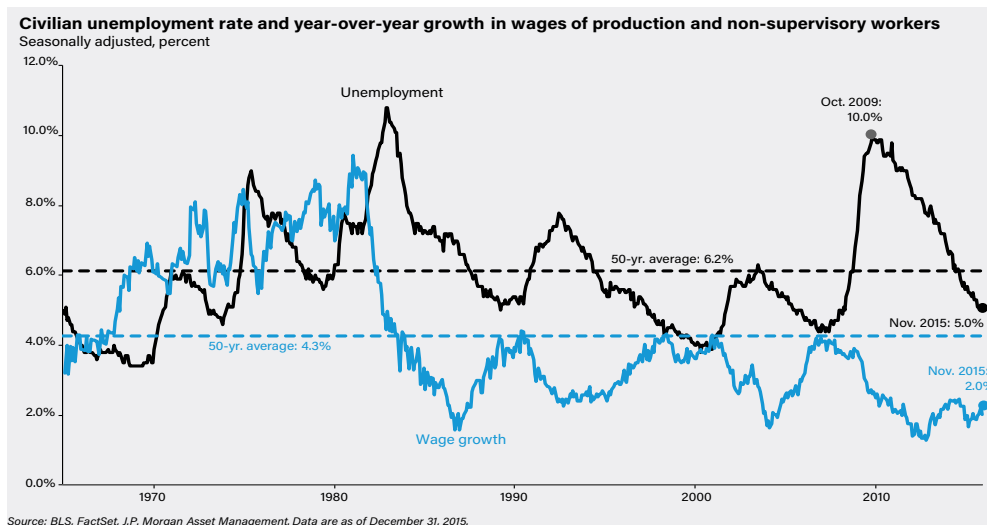
“The current credit cycle is coming to a close and we are entering the early stages of a new cycle.”

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## U.S. Momentum Slowing but Recession Unlikely

Although the path of the economic recovery has been slow, the stock market has climbed to lofty valuation territory since the end of the GFC. Low interest rates have perpetuated a search for yield which has increased the demand for riskier assets like stocks. As more participants have entered the market, multiples have expanded and driven valuations to historically elevated points. It now appears that multiple expansion alone will be unable to drive the market higher and that fundamentals and earnings growth will need to support price appreciation. Unfortunately, profit margins have been narrowing, and earnings have been dragged down by a lack of consumer demand, the effects of a stronger dollar, and lower energy prices. We feel that the negative effects of a stronger dollar and lower commodity prices are transitory. We have not yet seen a significant increase in spending by consumers and businesses resulting from energy cost savings, but a reversal in deleveraging trends indicates that spending should increase this year. Low unemployment, wage growth momentum, rising housing prices, and a strong services side of the economy all signal that the US has a stable economic foundation. Headwinds to market and economic growth still exist and may cause setbacks over the short-term, but the likelihood of a recession is minimal. Our belief is that the US economy will continue pushing ahead supported by the expectation that wages will begin to rise, main street has begun to stabilize, and companies have reinforced their capital structures. Wage growth has been relatively stagnant as unemployment has been declining, but unemployment data shows that we are now nearing maximum employment. As the labor gap has narrowed, the population of those out of work and seeking employment as well as temporary workers has begun to decline in favor of more structural employment. The shift of hiring toward full-time skilled employees should continue to put upward pressure on wages in 2016.



At the household level, bank lending, and credit card debt have begun to show upward trends. An increase in leverage from current levels suggests that a US recession is unlikely this year. Sustainable levels of leverage at both the household and corporate level help boost economic growth. The increase in these leading indicators signals that US consumers are more confident about spending money, businesses are more confident borrowing money, and banks are more confident lending money. All of this indicates strength in the future economy.

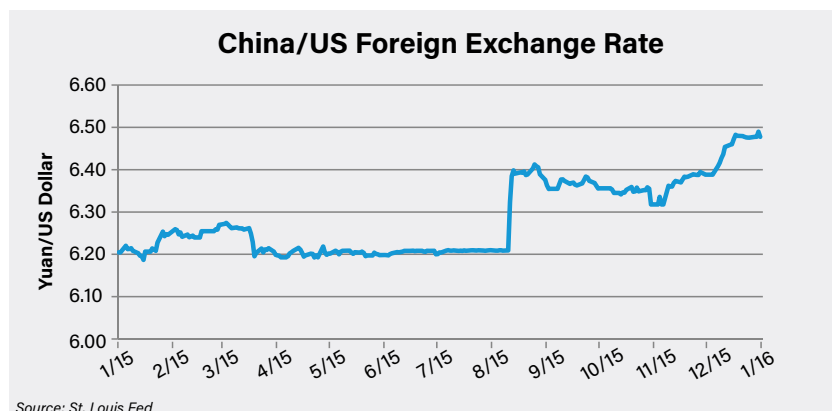
That being said, many downside risks to the recovery are still present. The precipitous decline in energy prices have compressed inflation and slowed capital spending in many areas of the nation. Multinational companies will have to continue facing headwinds from a stronger dollar and weak global demand. A disruption in the Chinese economy could ignite a wave of fear and weigh on consumers' sentiment and economic optimism. While the downside risks are significant, we believe that the US remains the bellwether of the global economic recovery. The underlying economic fundamentals remain strong and the domestic economy should continue to build on this solid foundation.

## Investment Themes 2016

### The Continuing Slowdown in China

China has been at the forefront of nearly all financial and economic conversations over the past year. The country that spurred global growth in the years following the global financial crisis has made it clear that it is determined to transition its economy from one driven by manufacturing and exports to one that is driven by domestic consumption supported by its massive burgeoning middle class. The country's leaders have had a difficult time soothing both its own population and the rest of the world as it has started to implement reforms to meet its lofty goals. Global markets sold off in breathtaking fashion after the surprise devaluation of the yuan last year, and uncertainty surrounding the validity of economic data and the free market nature of the Chinese stock market has fueled global market speculation throughout the early days of 2016. President Xi has made it clear that China will continue to let the yuan float in a more free market fashion as it attempts to sure up its economy. While the free market nature of the currency has been welcomed by many, it will make it difficult for China to succeed. The country experienced nearly \$1 trillion in annualized outflows since the loose US dollar and yuan peg was removed, and further weakness in the currency will likely push out more capital and further devalue the Yuan.

Substantial devaluation of China's currency could have a massive impact on the future of the economy. Chinese businesses have borrowed nearly \$10 trillion since the global financial crisis and, at least \$1 trillion of that debt is held in US dollars. Further devaluation of the yuan will likely lead to companies failing or becoming "zombie" corporations as they are supported by the government. The debt picture is anything but clear. Easy lending policies have caused government and private debt to balloon to 240% of GDP over the past 8 years. Any massive failures of state-owned enterprises will surely fuel doubts that China's government will be able to support a fragile economy during an unprecedented shift in growth drivers and policies. The Catch-22 is that China could be forced to continue devaluing its currency in order to generate sustainable growth as it implements new economic policies.



China's economy has been unarguably slowing down. GDP growth in 2015 was the lowest that it has been in the last 25 years. That being said, China's growth still outpaces the rest of the world and it is likely that 6.0% to 6.5% GDP growth is achievable for the time being. While 6.5% growth is commendable, China will need its growth to meet at least that level in order for massive amounts of borrowing to be paid off in the future. The industrial side of the economy has long been the boon to China's economic growth. The transition to a domestically focused consumption based economy has brought the services sector to the forefront. China's services sector has now overtaken the industrial sector in contributions to GDP. A strengthening services sector is proof that the rotation in economic growth is happening and is beginning to gain traction.

### Negative on Fixed Income, However Benefits Remain

Though credit notably underperformed equities in 2015, we maintain a negative outlook on the return prospects of US fixed income during 2016. We expect marginally higher interest rates over the next year. The Federal Reserve has embarked upon its first rate hike cycle in nearly a decade, which creates a negative environment for fixed income investing given that bond prices decline as interest rates rise.

Although it is likely that the Fed will tighten monetary policy at a slower pace than they have in the past, rates should increase and in a rising rate environment, we expect high quality US fixed income to post negative to low single digit returns for 2016. That being said, we will maintain a portfolio position in fixed income as a diversifier and hedge against outsized drawdowns in the equity markets. The early stages of a rising rate environment have reinforced the negative correlation between bonds and stocks. While equity markets roiled during the first weeks of 2016 and entered correction territory, the Barclays US Agg Bond index generated positive returns.

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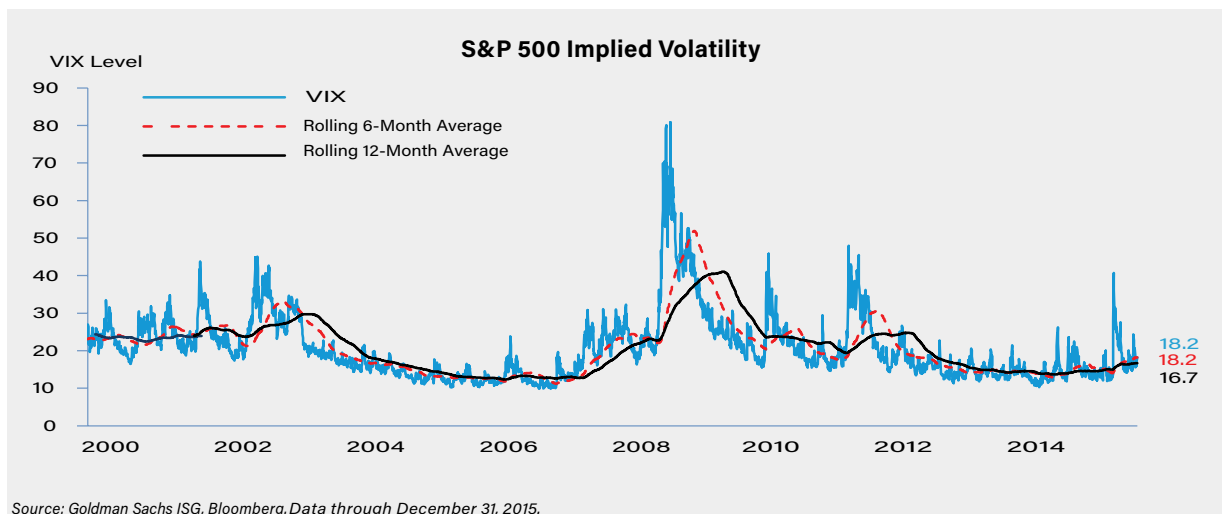
“We will maintain a portfolio position in fixed income as a diversifier and hedge against outsized drawdowns in the equity markets.”

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## Investment Themes 2016

### Volatility is Here to Stay

The markets are going to remain highly volatile during 2016. The market action for the coming year can best be described as “fat and flat”, meaning investors can expect high volatility with little prospect of strong returns. The rout of commodity prices, the slowdown in China, the divergence of monetary policies, and slow global growth will all drive volatility this year. Although we expect this volatility to weigh on investor sentiment and create a challenging investment environment we want to emphasize that as investors, not traders, we will remain confident in our asset allocation and refrain from attempts to time short-term moves in the markets.



“The market action for the coming year can best be described as “fat and flat”...”

Asset Class	2016 Target	% Change	2015 Target
<b>Domestic Equities</b>	15.0%		19.0%
Large Cap	8.0%	-1.0%	9.0%
Mid Cap	4.0%	-1.5%	5.5%
Small Cap	3.0%	-1.5%	4.5%
<b>Foreign Equities</b>	13.0%		14.0%
Foreign Developed	11.0%	1.0%	10.0%
Emerging Markets	2.0%	-2.0%	4.0%
<b>Fixed Income</b>	14.0%		10.5%
Global Bond	5.0%	---	5.0%
Unconstrained Bond	0.0%	-3.0%	3.0%
High Yield	4.0%	4.0%	0.0%
Municipal Bond	0.0%	-0.5%	0.5%
Private Debt	5.0%	3.0%	2.0%
<b>Absolute Return</b>	19.0%		22.0%
L/S Strategy	2.0%	-2.0%	4.0%
Global Macro	1.0%	-3.0%	4.0%
Distressed Securities	3.0%	---	3.0%
Relative Value Arbitrage	2.5%	---	2.5%
Managed Futures	3.5%	---	3.5%
Equity Market Neutral	3.0%	0.5%	2.5%
Multi-Strategy	4.0%	1.5%	2.5%
<b>Real Assets</b>	11.0%		9.5%
Domestic REIT	3.0%	1.5%	1.5%
Foreign REIT	2.0%	-1.0%	3.0%
Commodities	0.0%	---	0.0%
MLPs	6.0%	1.0%	5.0%
<b>Private Equity</b>	19.0%		20.0%
PE Partnerships	17.0%	-1.0%	18.0%
Listed Private Equity	2.0%	---	2.0%
<b>Cash</b>	9.0%		5.0%

## Domestic Equity Outlook

US equity markets have historically experienced drawdowns following the first rate increase in a rising rate cycle. The drawdowns tend to be short-lived though, with markets recovering to pre-rate hike levels six to twelve months after the first interest rate move. US markets generally respond well to rate hikes over the medium term because rising interest rates indicate that the underlying economy is strong and supportive of earnings growth. We think that this trend will continue in 2016 although market volatility will increase the number and amplitude of market pull backs this year. An increase in the strength of corporate balance sheets and access to cheap capital have been conducive to M&A activity, share buybacks, as well as promoting capital expenditures. We believe that companies will be forced to continue utilizing diverse management strategies to improve returns as profitability measures near historical highs. Stock market data shows time and time again that over the short-term, the markets are driven by investors' emotion and sentiments, but over the long-term markets are driven by company level and economic fundamentals.

Current P/E vs. 20-year avg. P/E				Current P/E as % of 20-year avg. P/E			
	Value	Blend	Growth	Value	Blend	Growth	
Large	15.1 / 14.2	16.1 / 17.2	18.2 / 21.1	105.8%	93.8%	86.4%	
Mid	16.1 / 14.5	17.6 / 16.8	19.2 / 22.1	111.2%	104.8%	87.1%	
Small	16.0 / 14.7	17.4 / 17.5	19.1 / 21.6	109.0%	99.6%	88.3%	

Source: FactSet, Russell Investment Group, Standard & Poor's, J.P. Morgan

We will focus on allocating to specific sectors of the market that will benefit from the current economic trajectory. Growth equities have outperformed value since the global financial crisis, but we believe that this trend will begin to reverse as growth companies struggle to maintain high margins and multiples begin to compress. Historically, value equities have outperformed growth over the long term. Growth equities tend to appreciate rapidly over times of exorbitant economic expansion, but have lagged value equities during times of subpar economic growth. Uncertainty has dragged on investor sentiment, and with higher volatility expected during the year as a result of Fed rate hikes, swings in oil prices, and fears of a Chinese collapse, it is unlikely that we will see a reversal over the near-term. The early year market correction pulled valuations into more attractive territory, which should accommodate a value tilt. We expect the economy to continue growing at a sluggish pace for much of 2016; therefore, we will overweight value equities relative to growth within the domestic equity portion of our portfolio.

“Stock market data shows time and time again that over the short-term, the markets are driven by investors’ emotions and sentiments...”

## Domestic Equity Outlook

Our research indicates that the highest upside potential lies in the technology, financial, and consumer discretionary sectors. After experiencing a precipitous decline year-to-date, we feel that technology stocks have the potential to advance for the remainder of 2016. Tech companies should demand high multiples as investors seek out growth opportunities during lukewarm economic expansion and a rising interest rate environment. Additionally, tech companies should benefit from an increase in consumer activity as discretionary spending rebounds. E-commerce should continue to flourish and online marketing and advertising have become the primary revenue drivers of many large tech companies. The tech sector has been one of the fastest growing and most innovative niches of the economy for some time and we expect that trend to continue and drive profitability in 2016.

The financial sector has been hit especially hard since the global financial crisis. Banks have had to deal with government imposed fines, operation tightening legislation, a surge of deleveraging, and declining interest rates. Now that many of the new rules and regulations have been imposed and both deleveraging trends and interest rates have started to reverse, we expect the financial sector to rise from the ashes. We believe that the financial sector will outperform due to its positive correlation with rising interest rates and an expected increase in consumer debt and spending. Higher interest rates allow banks to charge higher rates on loans, and an increase in consumer debt and credit card usage should have a direct effect on financial companies' bottom lines. Consumer discretionary companies will likely benefit as consumer spending increases. A slowdown in household deleveraging, cash savings stemming from lower energy prices, and higher wages should support an increase in consumer spending.

We will maintain a substantial allocation to large cap equities. We expect that large cap companies will continue to show resilience and successfully navigate through this choppy economic environment. The detrimental effects of an appreciating US dollar should begin to roll off as companies actively manage currency exposures and a stabilization in rates and oil prices should entice companies to increase capital spending. Additionally, large cap companies have benefited from access to cheap capital as interest rates have been falling. Many companies have locked in lower borrowing costs and have raised sufficient capital to increase investment, M&A activity, or other actions that benefit shareholders.

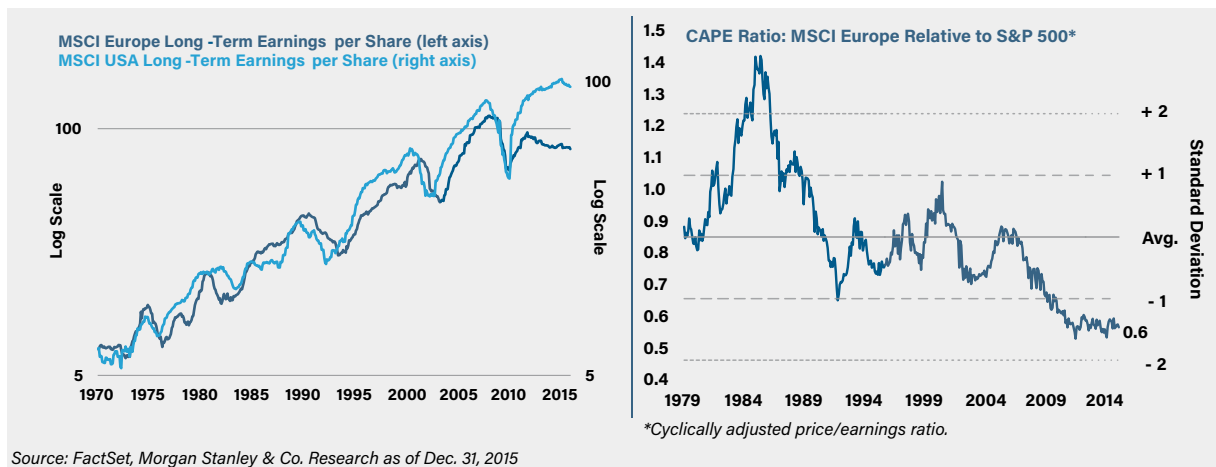
EPS Y/Y	S&P 500 PRICE RETURN AT VARIOUS P/E AND EPS Y/Y LEVELS					
	P/E MULTIPLE					
	15.0	15.5	16.0	16.5	17.0	17.5
-4.2%	-14.4%	-11.6%	-8.8%	-6.0%	-3.2%	-0.4%
-2.5%	-12.9%	-10.1%	-7.3%	-4.4%	-1.6%	1.3%
-0.8%	-11.5%	-8.6%	-5.7%	-2.8%	0.1%	3.0%
0.8%	-10.0%	-7.1%	-4.1%	-1.2%	1.8%	4.7%
2.5%	-8.5%	-5.5%	-2.6%	0.4%	3.4%	6.4%
4.2%	-7.1%	-4.0%	-1.0%	2.0%	5.1%	8.1%
5.9%	-5.6%	-2.5%	0.6%	3.7%	6.7%	9.8%
7.6%	-4.1%	-1.0%	2.1%	5.3%	8.4%	11.5%
9.2%	-2.7%	0.5%	3.7%	6.9%	10.1%	13.3%
10.9%	-1.2%	2.0%	5.3%	8.5%	11.7%	15.0%
12.6%	0.3%	3.6%	6.8%	10.1%	13.4%	16.7%
14.3%	1.8%	5.1%	8.4%	11.7%	15.1%	18.4%
16.0%	3.2%	6.6%	10.0%	13.4%	16.7%	20.1%
17.6%	4.7%	8.1%	11.5%	15.0%	18.4%	21.8%

Data as at December 31, 2015. Source: KKR Global Macro & Asset Allocation Analysis

# Foreign Equity Outlook

## Eurozone

Draghi and the ECB have been adamant about maintaining easy money policies in order to nudge inflation higher, increase liquidity, and boost asset prices. These easy money policies will lead to further depreciation of the euro versus the dollar and create tailwinds for the economy. Although the recovery of the European economy has been slow, we believe that 2016 will not yield as many setbacks and that the recovery will gain significant traction this year. The banking system has been cleaned up, the Greece situation is under control, exposure to China is minimal, and QE is in full swing. We expect that the aforementioned tailwinds will generate positive earnings growth for European equities. European earnings growth has significantly trailed that of the US since the end of the global financial crisis, but over the long-term earnings in both markets have been approximately the same. When looking at relative valuations, European equities are trading at a significant discount to the US on a cyclically adjusted basis which has created enticing value opportunities in the region. Additionally, real interest rates in Europe are in negative territory or trading at historical lows. We will likely see an increase in equity demand from European investors as they increase their allocation to risk assets in order to generate meaningful yields. With the expectation that European growth has the potential to surprise on the upside, the stabilization of the European economy, and the proverbial economic backstop from ECB monetary policy, the risk-reward metrics of this region remain attractive. We will be increasing our allocation to Europe for these reasons as well as others.



Source: FactSet, Morgan Stanley & Co. Research as of Dec. 31, 2015



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“We recommend a tactical overweight to European equities. The current valuation levels and potential tailwinds from the European Central Bank’s quantitative easing program create a fertile landscape for asset appreciation.”

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## Foreign Equity Outlook

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### U.K.

In the UK, the Bank of England (BOE) has maintained historically low interest rates and easy money policies. While the BOE will likely follow in the US's footsteps and raise rates this year, policy makers' comments imply that any rate hikes will be small and ramping up will be gradual. Of particular consideration is the potential EU referendum. Prime Minister David Cameron has said that he expects to finish negotiating EU reforms by the end of February, which could set up a vote by the end of the year. The vote will have important implications given the fact that it could complicate the UK's relationship with EU nations. EU nations currently represent around 50% of UK export volume. Current polls do not show a clear consensus, and things such as the ECB's policy plans and the migrant crisis could affect the outcome of the vote. The UK has not had a referendum vote since 1975. During the last referendum vote, Britain was struggling and needed the support of EU nations. In the current landscape, the EU looks somewhat a mess to as it struggles to cope with Greece and other peripheral countries and the migrant crisis. Because of the uncertainty shrouding the future of EU countries, the UK may feel that voting to leave the EU may keep things more status quo than staying. While the pending referendum vote will have important implications, we still believe that the UK is the closest to the US in terms of economic recovery and stability. The BOE's easy money policies could be maintained until the second half of the year which should continue to spur investment before liquidity begins to dry up. Additionally, the economic prospects of the Eurozone should serve to catalyze further recovery in the UK.

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“The pending [European Union] referendum vote will have important implications...”

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### Japan

Shinzo Abe and the Bank of Japan (BOJ) will continue implementing their own easy money policies. The BOJ has said that it has multiple ways to maintain easy monetary policies, and the BOJ's dedication to its cause was witnessed in January when the Bank implemented a negative interest rate policy. The move to charge banks to hold reserves is the most forthright signal that the BOJ is willing to pull out all the stops in order to keep the economy headed in the right direction. The short-term effects of "Abenomics" have nearly run their course, and the verdict is still open for debate. Japan's leaders have now been turning their attention to improving business structure in an attempt to generate wage growth and increase shareholder wealth. These structural changes will take time to filter through the economy, but an increase in wages and hiring should help the economy overcome some of its demographical demand drag and boost consumer spending. The seemingly perpetual influx of capital into the Japanese economy has caused the yen to depreciate significantly against the dollar. We expect this trend to continue in 2016 as the dollar strengthens alongside rising US interest rates and Japan continues its efforts to increase capital velocity and support domestic investment. The aforementioned details increase our confidence in Japan's prospects and we expect to increase our allocation to the Japanese market in 2016.

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“[Japan] will continue implementing their own easy money policies... an increase in wages and hiring should help the economy overcome some of its demographical demand drag and boost consumer spending.”

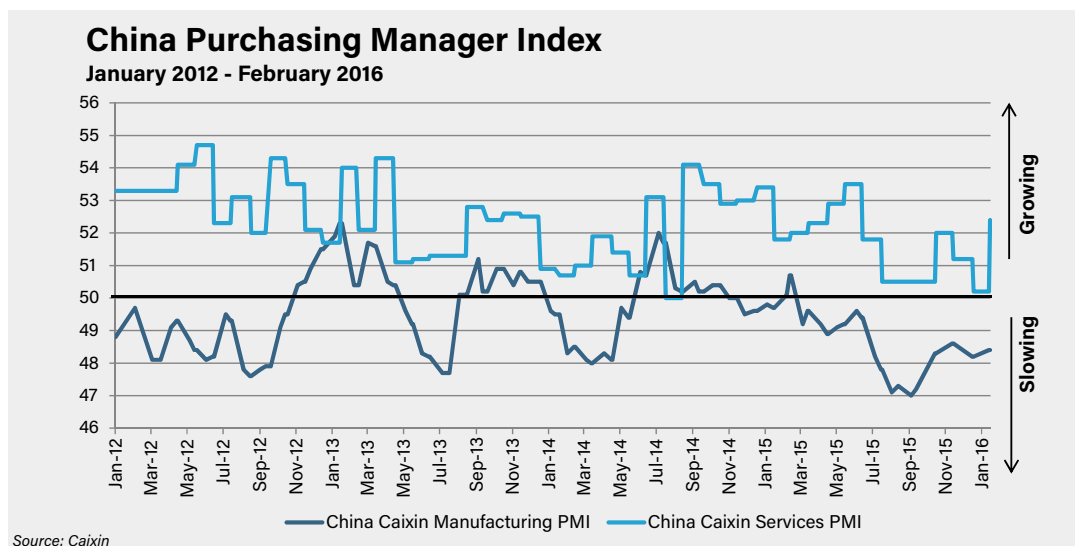
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## Foreign Equity Outlook

### China

China will be the most important country to watch in 2016. As the driver of peripheral global growth over the last few decades, the economy set an example for other emerging market countries, but none have been able to catch up to its breakneck growth rates. A significant slowdown in the Chinese economy will be detrimental to many emerging markets, but large-scale negative effects are unlikely to spread to the global markets. The economy is indisputably slowing, as shown by China's manufacturing PMI which has been tracking below expansionary levels since early 2014. Although the manufacturing sector is slowing, China's services sector has remained in expansionary territory. The services sector will likely be a more telling gauge of the government's successful or failed economic reform given that services are more responsive to domestic spending. China's leaders have shown fortitude in pursuing their goal to shift economic growth from export driven to free-market consumption driven. The government has the tools and the financial support to keep the country's growth trajectory relatively stable during this transition, and an economic collapse in the short-term is unlikely.

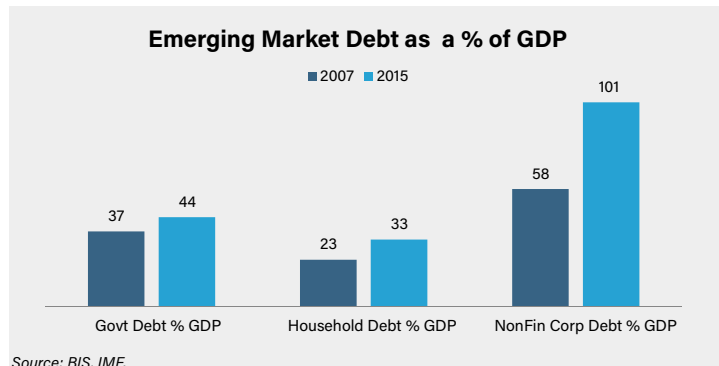
When looking at China from a distance, it is important to remember the influence that the government has over much of the economy and especially the stock market. The Chinese stock market is a poor measure of underlying economic strength. Only a small percentage of the population participate in the stock market, and the government has actively intervened by injecting capital, halting trading, and forcing company executives to hold or buy stock when prices were declining. While the "talking heads" may focus on the sporadic movement of China's market, we feel that it is more important to look at the underlying data which suggests that the economy is not headed for a hard landing. The government has the power to keep the economy afloat and push reforms through the system, and the likelihood of an economic collapse and widespread contagion to the global economy are very slim. China will continue to be in the spotlight as market volatility increases, but signs of additional economic stabilization should suppress global fears and give a boost to global markets.



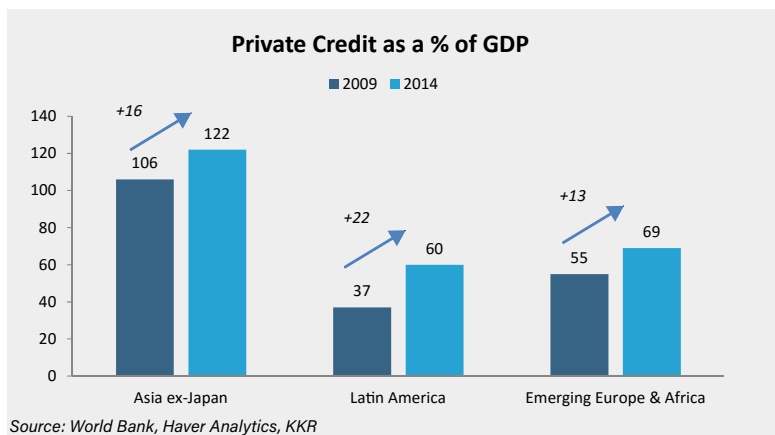
“China will be the most important country to watch in 2016”

## Emerging Markets

Emerging markets have struggled amid the slowdown in China and a lack of supportive growth from developed market economies. Fears that China has ceased to support emerging market growth has led to the outflow of a record amount of capital from emerging markets. The lack of demand from developed economies and the prolonged rout in commodity prices has caused investor sentiment regarding the asset class to sour. These capital outflows and lack of confidence in the asset class have pushed many emerging markets into bear market territory. Another important aspect of note is the recent slowdown in global trade. Emerging markets have generally relied on strong global trade and exports to grow GDP. With the potential for more economies to focus on growing domestic demand, much like China is attempting to do, emerging markets could experience ongoing struggles.

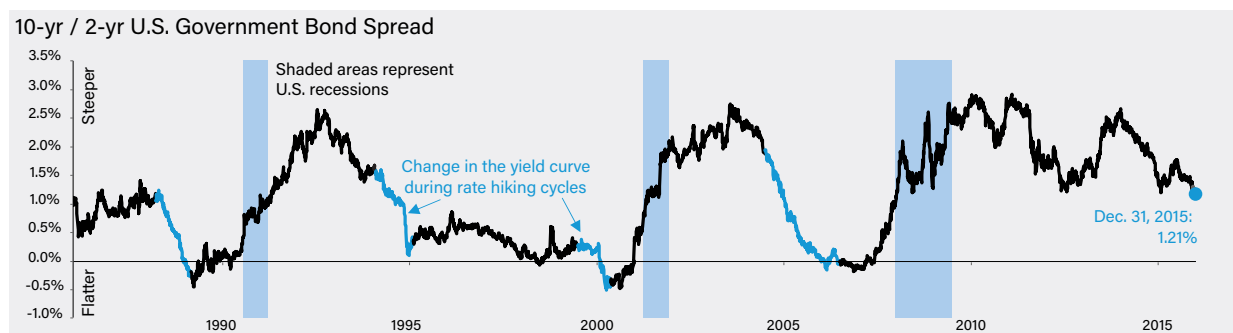
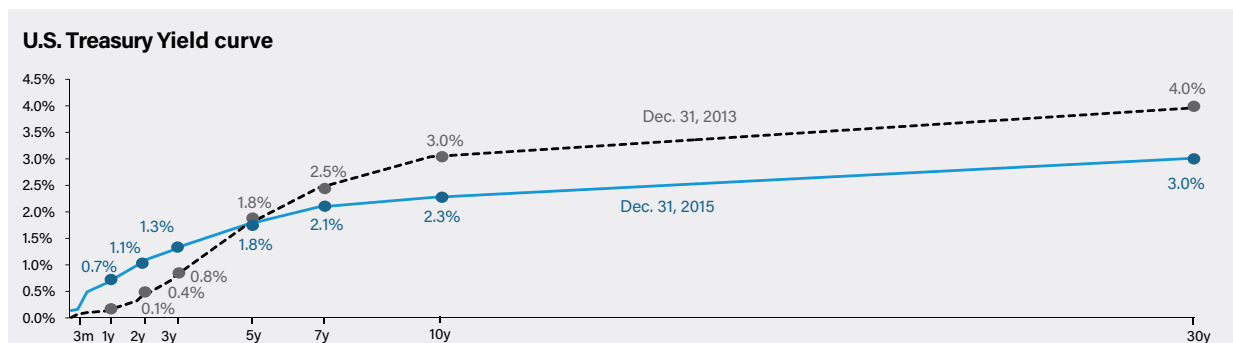


Many emerging market countries have pushed to devalue their currencies in an effort to boost exports. Unfortunately, competition has kept exports relatively stagnant while cheaper currencies have driven up the price of imports. Currency devaluation creates additional implications when looking at the current debt situation in which emerging markets have found themselves. In the years following the GFC, emerging markets eagerly borrowed as interest rates fell. Now, it is becoming clear that at current GDP growth rates, many countries, corporations, and individuals may have taken a bigger bite than they can chew. The massive debt overhang in China and other emerging markets is unlikely to collapse all at once, but with global trade slowing and growth rates expected to remain depressed, vetting and holding emerging market assets will be difficult. While we believe that 2016 will be a poor year for emerging and frontier economies overall, we will maintain a small position in the asset class as a means of diversification. Over the long-term, emerging markets have shown a propensity for outperforming developed markets during periods of global recovery, and tend to take a "V" shaped rather than a "U" shaped path. We feel that maintaining a position in the asset class enables our portfolios to capitalize on rapid shifts in the recovery of emerging market equities. When looking at risk-reward, the flattening of the efficient frontier makes this asset class less attractive until we see a significant shift in investor sentiment. Despite this, we feel that the potential upside is too great to warrant a complete reallocation away from the asset class.



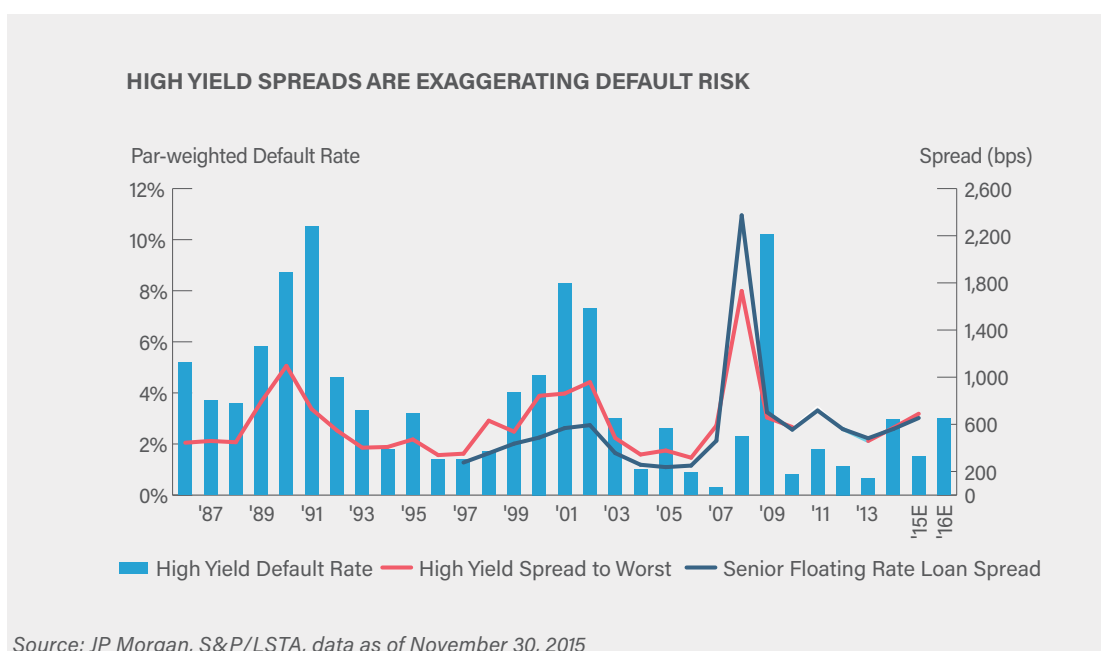
## U.S. Fixed Income

In December, the US Federal Reserve announced the first rate hike in nearly a decade. Though the move was widely expected, and size of the increase was small, the move marks a turning point in the outlook for US bonds. Due to the divergent policies that many other global central banks are undertaking, the uncertain economic outlook, and a fretful geopolitical climate, we expect interest rates to be volatile this year. Given these uncertainties, we expect the Fed to raise rates at most 3 to 4 more times in 2016 and that the 10-year Treasury to remain below 3.0%. As the Fed slowly raises short-term rates, we expect rates on the longer end of the yield curve to only slightly move higher, leading to a flattening of the yield curve. Credit spreads for corporate bonds have been widening since mid-2014 and at this point, these issues seem attractively priced. We will take advantage of these opportunities by allocating to managers who take an active approach and target investment-grade corporate bonds, high-yield, and US bank senior debt. The onset of a global divergence in interest rates should finally create intriguing opportunities for unconstrained bond funds. Funds that have the ability to actively manage duration and take short positions on interest rates are in the best position to outperform in the fixed income market this year.



Source: Bloomberg, FactSet, J.P. Morgan Asset Management. Data are as of December 31, 2015.

Despite the volatility experienced in the past 18 months, we have a favorable view of high yield bonds. The energy sector constitutes for roughly 20% of the high yield market. Falling oil prices increased investor concerns last year that there would be a high degree of defaults in over-levered energy-related companies. The fall in the pricing of high yield issues has resulted in elevated yields, however fundamentals for non-energy related issues remain intact. At year end, the market pricing for high yield bonds implied defaults of 6.6% of the high yield issuers in the market. If you exclude the energy sector, the implied default rate was 5.5%, still well above the long-term average of 4% and above the current default rate of 3%. To access this space, we see opportunities in high yield closed end funds. Closed-end funds issue a limited number of shares which are traded daily on major stock exchanges. Due this fact, the shares can trade at a discount or premium to the actual price of the securities held in the portfolio. Many high yield closed end funds are currently trading at 15-20% discount to the net asset value of the bonds in the portfolio. Many of these funds are trading at significant discounts to their NAVs despite marginal exposure to the energy sector. Our view is that these assets have been oversold as investors have sold all high yield exposure, regardless of their underlying exposure to energy, over fears that low oil prices would push companies into default. The built-in appreciation factor related to the steep NAV discounts and dislocation of asset pricing and fundamental data make this an attractive asset class for generating alpha this year.



## Global Fixed Income

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International fixed income will likely remain challenged in 2016. Global bonds denominated in foreign currencies were hurt as the US dollar strengthened for the majority of 2015. While we do not expect the dollar to strengthen to the degree that it did last year, rising rates domestically and falling rates globally will likely attract foreign capital to US dollar denominated yields and put upward pressure on the dollar. While we are generally constructive on the economic prospects for both Europe and Japan, monetary policy combined with weakening currency will likely weigh on returns for bonds in those areas. Both the European Central Bank and the Bank of Japan are likely to continue their bond-purchasing program in 2016, putting further downward pressure on yields. We are currently negative on emerging market debt, however it may be an opportunity later in 2016. Any allocation to this area will require active management. Countries that have been able to implement reforms and build up foreign reserves should be able to weather additional US dollar appreciation. For many countries, lower commodity prices will lead to lower revenues and consequently, an increase in defaults. Stabilization in commodities and a slowdown in the appreciation of the US dollar may mark a turning point for the sector.

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“Given the likelihood of an appreciating U.S. dollar, we recommend avoiding the [emerging market debt].”

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“International developed fixed income has a bleak outlook, as globally-suppressed yield levels will make it difficult to find opportunities in this sector.”

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We have an overall neutral view on real estate this year. While REITs are generally categorized as bond proxies, we feel that it is important to maintain an allocation to real estate. REITs as a whole may experience a pullback as rates continue to rise we see specific opportunities in the space. Domestic real estate remains attractive because construction trends have failed to keep up with increases in demand. We see the most attractive opportunities in multi-family, office, and retail construction. The strengthening economic backdrop of low unemployment, higher wages, and increased consumer spending should be a tailwind to real estate values. We will focus on allocating capital to real estate sub-sectors, such as multi-family housing, which has experienced a demand increase and should benefit from wage growth momentum and a rising rate environment. It could be argued that raising interest rates will cause yields to decline, but we do not think that a gradual uptick in rates will have a significantly detrimental effect on property yields this year.

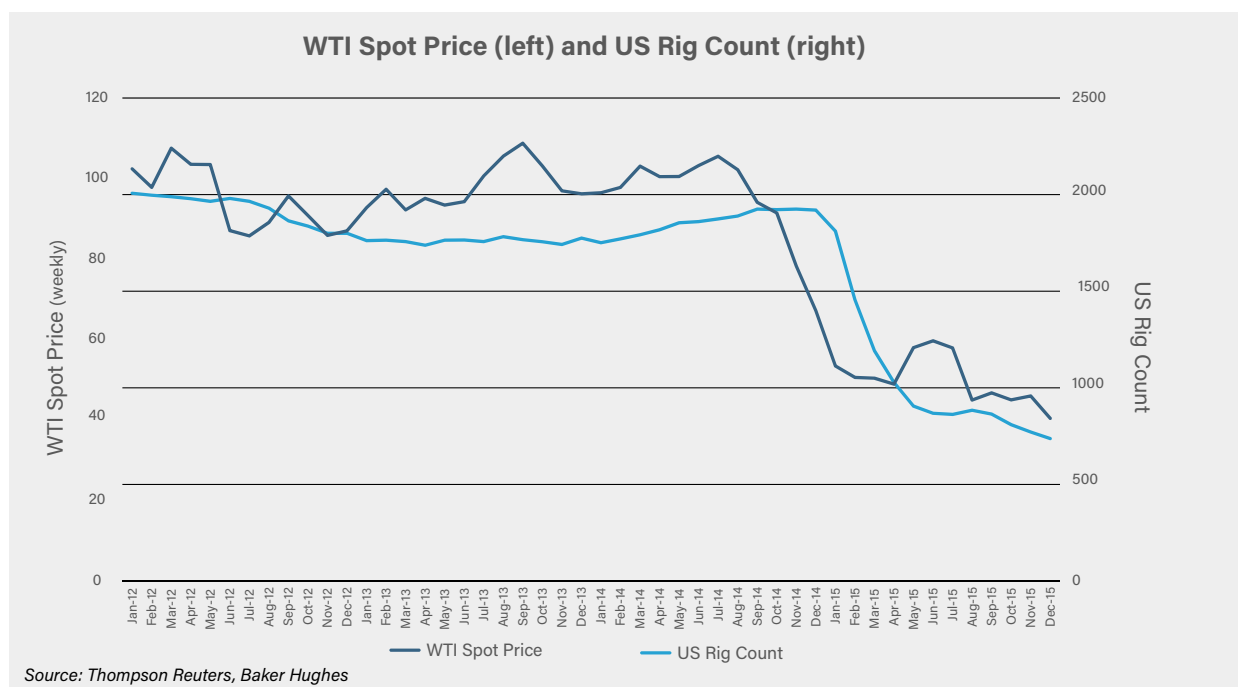
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“A rising interest rate environment could prove detrimental to real estate demand, but we think that this headwind can be overcome.”

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## Real Assets

Although the timing surrounding a turn in the price of commodities will be difficult to foresee, we believe that opportunities are present in the US oil and gas sector. Numerous companies have struggled to survive the precipitous decline in oil prices, but those companies that have healthy enough balance sheets to ride out the storm are valued at steep discounts. History has shown us that oil prices tend to revert to their long-run mean over time. The current supply and demand dislocation in the oil industry should begin to correct itself as operating well productions decline, upstream investment is depleted, and drilling activity slows. We think that MLP's and a handful of healthily capitalized companies offer attractive entry prices with limited downside risk at current crude spot prices. The horizon for this investment will likely extend beyond 2016, though we feel that it will be to our benefit add to this position early in order to take advantage of our longer term outlook for the oil industry.



“The supplies of nearly all major commodities have grown at a faster rate than demand and as a result, prices have fallen drastically in the commodity markets.”

The heightened volatility in the market creates an enticing investment landscape for hedge fund strategies. The divergence of global central banks' monetary policies and the widening disparity between the goals of these policies have created tensions in global markets, manifesting in currency pricing and interest rates. As these tensions become more pronounced, we expect trends to develop in global markets, benefiting a variety of hedge fund strategies. Over the past 25 years, rising interest rate periods have been very good for fundamental long/short hedge fund managers. Rising rate environments tend to exacerbate disparities between companies with varying capital structures, profit margins, and business models, creating dispersion in the performance of these companies. This environment allows long/short managers the ability to generate alpha by buying companies with stable capital structures and shorting companies who will struggle.

With increased clarity in monetary policy, we expect systematic strategies (e.g. managed futures and quantitative strategies) and global macro managers to take advantage of trends in currency pricing and interest rates. We also expect to see an increased opportunity set for these strategies in emerging markets, US interest rate trades, and in the structural devaluation of certain Asian currencies. While 2015 was characterized by strong consensus trades (such as the strong US dollar trade), we expect to see increased dispersion in terms of positioning as traders take advantage of idiosyncratic opportunities. Distressed credit strategies struggled in 2015. Credit spreads widened throughout the year as a result of falling oil prices, but the systematic decline has created opportunities. The decline in distressed debt pricing was broad based, affecting pricing across the asset class regardless of the fundamentals. This has created a larger opportunity set and entry point for distressed investors. We expect managers to capitalize on very high yields relative to expected default losses and the increased frequency of actionable events (e.g., debt exchanges and restructurings).



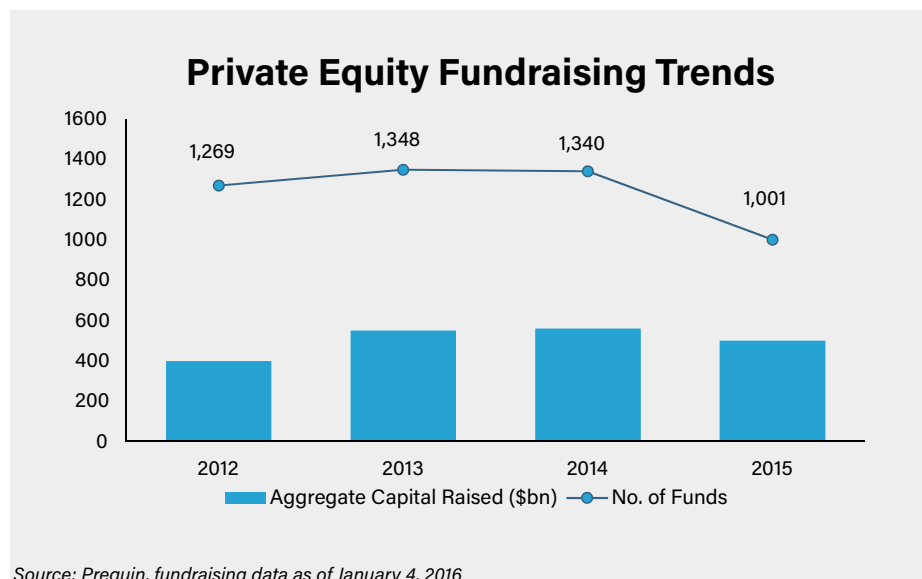
“The divergence of monetary policies and reforms creates an enticing investment landscape for many hedge fund strategies.”

## Private Equity

High asset prices remain the major issue facing private equity as we enter 2016. Easy financing and large amounts of dry powder at private equity firms have contributed to driving acquisition multiples higher. However, the renewed appetite of strategic buyers has also bid up private company valuations, making it more difficult to acquire targets at attractive valuations. The coming year will be relatively more attractive for realizations, rather than for new private investments. Merger & acquisition activity and buyouts have helped fuel positive market activity, and with many companies maintaining large cash balances. We expect this trend to continue as companies look for additional ways to generate value for stakeholders. We are less optimistic toward new private equity vehicles currently being raised. It will be difficult for new funds to generate positive returns without a significant increase in multiples. We do not think that multiples will extend much further beyond current levels during the average life cycle of most funds.

Market pricing aside, we do see several opportunities to deploy capital into private strategies. Middle market buyouts have generally transacted at lower multiples and assets flowing into the space still remain below 2007 levels. In the middle market, technology companies focusing on the capture and use of big data will likely be an opportunity moving forward as Fortune 500 companies will be investing heavily in these initiatives over the next several years. Information technology companies focused on under-served consumer segments, creating efficiencies through service-as-a-software (SaaS) should fare well as companies will continue to look to cost cutting measures to increase profit margins. Firms deploying assets into energy private equity should perform well given the precipitous drop in energy prices. Energy infrastructure and high-quality energy exploration and production assets are attractive, as the price of oil has pushed many over-levered energy companies to the edge of default, forcing distressed sales into the market. We expect the opportunity set to broaden as defaults in the energy sector accelerate.

We believe that funds with available liquidity will have the ability to purchase assets at extremely attractive prices. A rising sense of investor uncertainty has created opportunities in the secondary markets. As the near-term global growth outlook has become murkier, investors have placed a higher premium on liquidity. After rising for three years, pricing in the secondary market fell in the third quarter of last year. While pricing will continue to be asset and vintage year specific, investors have the ability to buy high quality, seasoned assets for a discount of net asset value.



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“I think that the first thing is you should have a strategic asset allocation mix that assumes that you don’t know what the future is going to hold.”

– Ray Dalio

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