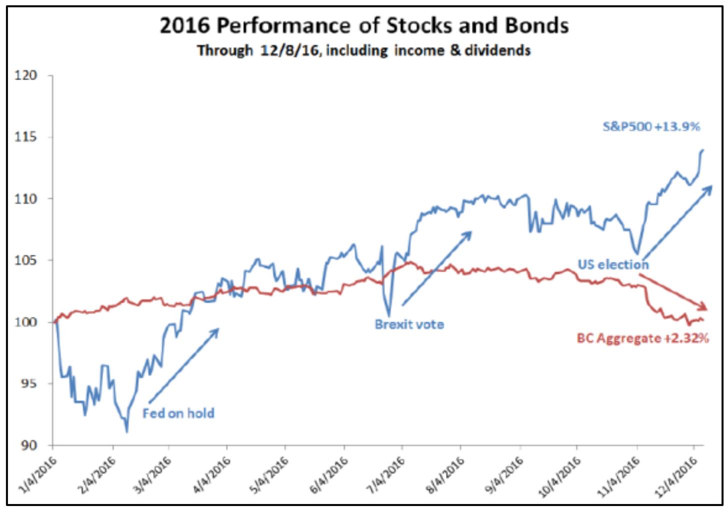
2016 Winter Investment Advisory Board Summit

The Windrose Investment Summit is a full day of investment dialogue, including members of the investment team and the Investment Advisory Board. The Board consists of leading investors from well-known groups such as Boston Children's Hospital, Boston College, Bowdoin College, D.E. Shaw and Union Park Capital. The day of meetings is followed by a keynote speaker at dinner and includes Windrose clients.

Windrose Advisors hosted a one-day Investment Advisory Board Summit in December 2016. The event provided a venue for sharing investment ideas, discussing market opportunities and important context for the current economic environment. The discussion focused on a number of current topics, including the impact of the presidential election, tactical investment ideas and emerging hedge fund managers. We believe the cross-pollination of investment ideas and market opinions between the WA Investment Team and Advisory Board will continue to enhance portfolio positioning and manager selection for WA clients through changing market environments.

Following are some of the key takeaways from the Advisory Board discussion:

- The U.S. presidential election outcome was a surprise and global capital markets are repositioning in response. Equity markets have rallied on the expectation of additional stimulus while bond markets have fallen in anticipation of inflation. Policy proposals from the president-elect seem supportive of growth and inflation, but will impact asset classes and industries differently. Tax reform may benefit cyclical stocks from higher earnings, while hurting municipal debt as tax advantages become less appealing. Trade protectionism could buoy small cap domestic stocks while disadvantaging US exporters, such as the tech sector. Infrastructure spending would favor materials, industrials and capital equipment, but potentially adversely affect U.S. Treasuries depending on how infrastructure spending is financed.



Source: Bloomberg

- The market is pricing in a 'reflation trade' based on the president elect's policy proposals, but longer term, the risk is that growth disappoints and inflation persists, with stagflation as a worst case scenario. From an asset allocation standpoint, 'reflation' alongside decreased regulation, will benefit financial and industrial equities and energy assets such that tend to outperform in periods of rising inflation. To protect against longer term stagflation, hedges such as gold and inflation-protected municipal bonds can offer protection when most other assets underperform.

- Alignment of interest, transparency, concentrated portfolios and focused skill sets are just a few of the traits that may indicate a likelihood of future outperformance for hedge fund managers. We continually look for characteristics that set managers apart, and over the past year we have focused our due diligence on smaller managers; those with less than $500M in assets under management and a track record under three years. A select group of emerging managers that we monitor are building their firms in ways we consider investor friendly – alignment with LPs, innovative fee structures, limits on asset growth, transparency across the portfolio and a focus on less-trafficked opportunities. Some of the best hedge fund investment opportunities are with smaller/newer managers and those managers who build their business with LPs in mind stand the best chance of success. Newer managers have different business risks than more established managers, but we expect to be compensated for the risk with superior performance.

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As part of our Investment Advisory Board Summit Windrose clients and Advisory Board members heard Harold Kotler of Gannett, Welsh & Kotler (GW&K) share his thoughts and experience on building a strong bond portfolio and investing in today's fixed income market.

Harold is the CEO of GW&K, as well as the firm's CIO. In addition, he chairs the Investment Committee and is a member of the Management Committee. Since joining GW&K in 1975, Harold has successfully managed fixed income trades through periods of stagflation[1], recession[2] and expansion[3] in the United States. Today, his firm manages $33 billion in client assets.

Following are some of the takeaways from Harold's presentation:

The GW&K Philosophy:

- Harold stated the whole point of active management is to take advantage of opportunities in the current market to exploit higher yields and cheaper valuations. In a market where interest rates are expected to increase, many individual investors opt to purchase short-term bonds and sell long-term bonds. To the contrary, Harold believes this presents an opportunity for GW&K to purchase longer duration bonds at a cheap price and sell shorter duration bonds at an attractive price when rates increase. In November, GW&K was extremely active, selling bonds with effective maturity dates of 4 to 5 years in order to purchase maturities in the 10 to 15 year range. Harold emphasized the importance of having a dynamic active management approach in order to effectively manage and trade fixed income securities. His advice in this market is to "keep buying." Eventually your fixed income portfolio will feature much more attractive yield and income levels.

The Current Investing Environment:

- The municipal fixed income market suffered tough losses during November as investors feared aggressive fiscal stimulus plans under the Trump administration would increase inflation and interest rates substantially. The municipal bond market, by some measures, posted its worst monthly performance since July 2003. Harold believes current fixed income volatility provides opportunities for active managers such as GW&K. In the current fixed income environment, GW&K rebalanced its portfolio toward longer duration bonds while selling out of shorter term securities to pick up increased yield.

- There has been speculation as to whether the recent decline in municipal bonds is overdone. The fundamentals for state and local governments have not changed, and Treasuries have not sold off as much as municipal bonds. Even though tax reform under Trump's administration could make municipal bonds marginally less appealing on an after-tax basis, they will remain a key component in high net worth investors' portfolios.

- Finally, Harold reminded us that we are fortunate to live in a country where democracy works and noted few, if any countries, could have managed through our last election cycle without bloodshed. He remains optimistic about growth prospects for the coming year.

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[1] 1970s
[2] 1980; 1981-1982; 1990-1991; 2001; 2007-2009
[3] 1985-1980; 1982-1990; 1991-2001; 2001-2007; 2009-Present

The perspectives and opinions disclosed reflect those of Harold Kotler and do not represent recommendations by Windrose Advisors.