2017 Summer 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 M.I.T., 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 June 2017. 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 U.S. market valuations, Japan, Financials and Energy. 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:

- Despite high valuations the S&P 500 has continued to rise over the first two quarters of 2017 pushing the bull market in U.S. stocks to over eight years, the second longest bull market in U.S. history. Based on a common valuation metric, the Shiller PE ratio, U.S. equities have only been more expensive twice in history (see Figure 1). On the other hand, foreign equities, in both developed and emerging markets are cheaper than their U.S. counterparts and have positive earnings growth momentum as a recovery takes hold, specifically in Europe and Japan. Within long-only equity portfolios, Windrose is underweight U.S. equities in favor of Japanese, European and Emerging Market equities.

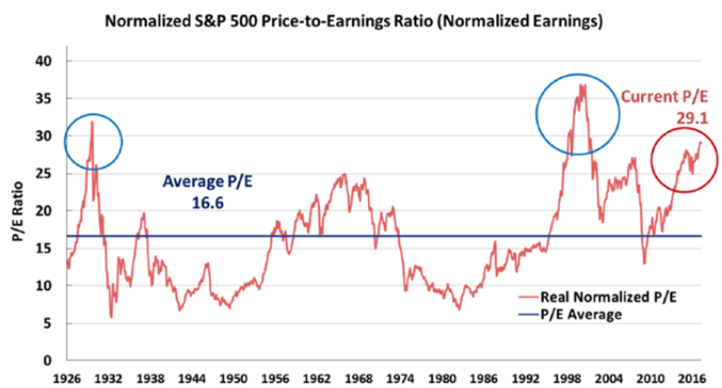

Figure 1 —Source: ACR Alpine Capital Research, S&P Indicies, Robert Shiller

- Japan, historically considered a value trap, is undergoing significant corporate reform that promises to better align the interests of investors and management teams to unlock value. Over the past two decades, persistent deflation has left corporate balance sheets vastly inefficient, with excess cash and unprofitable subsidiaries. Approximately half of publicly listed companies in Japan still trade below book value. To counter these trends the Abe administration has initiated a series of reforms, which include:
    - Stewardship Code that encourages monitoring of corporate events and active voting from shareholders
    - Corporate Governance Code that promotes dialogue with shareholders, Return on Equity (ROE) targets and independent directors on boards
    - Restricted stock compensation to incentivize management teams to increase shareholder value
    - Regulation to allow wholly owned subsidiaries to be spun off tax free to shareholders

  The rise of management incentives should make corporations more focused on ROE and responsive to activist investors.

- Financials, from a strategic standpoint, are likely to be the beneficiary of rising interest rates. Financials are the only sector that benefits directly through the income statement from higher interest rates. With strong historic negative correlation to rates, financials provide a hedge against rising rates and inflation. Further, financials remain under-owned as a sector and valuations remain historically low, especially compared to the broader equity markets. Banks in the U.S., Europe and Japan have strengthened their balance sheets and are likely to see higher pay-out ratios on higher earnings as rates move higher. In addition, after six years of deleveraging, U.K. and U.S. banks are entering a new lending cycle, underpinned by a recovering housing market, policy support and/or potential for consumers to start re-leveraging. The combination of attractive valuations, improving fundamentals and strategic exposure to reflation provide strong arguments in favor of higher exposure to financials.

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As part of our Investment Advisory Board Summit Windrose clients and Advisory Board members heard David Goel of Matrix Capital share his thoughts and experience investing in growth industries, specifically innovative health care technologies.

David is the Co-founder and Managing Member of Matrix Capital Management. Prior to Matrix, David was a Technology Research Analyst at Tiger Management. David is a Director of Univision Communications; the leading American Spanish broadcasting media company based in New York, a Director of Popular, Inc., a bank with operations in New York, Florida and Puerto Rico, and is also a Trustee of Phillips Exeter Academy and a Trustee of the Museum of Fine Arts. David received a Bachelor of Arts from Harvard University and is a graduate of Phillips Exeter Academy.

Following are some of the takeaways from David's discussion:

The Matrix Investment Approach:

- David focuses on driving performance through a highly concentrated, long/short equity strategy, focused on high growth sectors. Matrix has established sector expertise and domain knowledge in a number of industries, including Technology, the Internet, and the convergence of technology within Life Sciences. As part of the philosophy at Matrix, the investment team takes a long-term view of growth companies and is willing to hold high conviction positions through volatile markets and periods of underperformance, with a focus on disassociating stock price from company value. As part of the portfolio construction process, David and his team look for companies that have strong management teams in place, particularly companies with executives who are material shareholders of their companies. This insures that the companies' interests are aligned with their investors and management is motivated to maximize returns.

Investing in Life Sciences:

- Matrix's investment team has deployed significant resources toward developing a sophisticated understanding of the dynamic intersection between technology and biology: next-generation genomic sequencing. They believe this space has the potential to deliver significant growth over time, and they have invested in several companies they believe will be outsized winners and leaders in this space.
- Matrix is focused on two key subgroups within the oncology sector: genetically-targeted therapies and immuno-oncology assets. The first group profiles cancerous tumors with enormous specificity, which allows researchers to precisely profile genes that are either over- or under-expressed in these cancers. The second category is predicated on the seminal work pioneered by Adaptive Biotechnologies, which has led oncologists to understand cancer as a disease of the immune system. Both of these subgroups exist thanks to the increasing improvements in engineering and computational power.
- Matrix has cultivated both a deep set of relationships and the industry expertise necessary to identify the most attractive investments. Specifically, Matrix has developed the Matrix Institute, a residency research group that evaluates and supports the manager's idea generation and diligence, as well as provides Matrix with key connections. Part of this residency research group is comprised of 62 scientists from around the world who are leaders within the gene sequencing field.

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