ASHDON
Investment Management

Market volatility has been felt by all investors year-to-date. Through January and February every asset market worldwide was affected by downward price volatility. The S&P 500 Index traded down -10.5% in the depths of this sell-off, and indices of smaller-cap and international companies traded even lower. The S&P 500 Index ended the first quarter up 1% - creating a one quarter trough to recovery price action not similarly felt since the Great Depression. The S&P 500 Index has continued to trade higher as we write this letter, and is standing near its all-time highs. Even with this strong rally and the possible momentum-style breakout that could follow, bonds continue to outperform stocks year-to-date (the S&P 500 Index has returned +2.83% YTD, while the Barclays US Aggregate Bond Index has returned +2.96% YTD). This is not a particularly bullish signal. Continued market volatility is likely and we could be in the midst of a bear market for stocks.

The "profits recession" we discussed last quarter has intensified. As of this reporting, several of 2015's favorite companies (AAPL, NFLX, for example) have been affected by the growing global economic weakness. Neither the selloff nor rally during the quarter surprised us. In our view, the world economy is held back by the threat of a deflationary trap caused by over leveraged households, companies and governments. The EU and Japanese economies are at the center of the struggle – Japanese banks are struggling and destabilized while the economy is in outright deflation. Analysis from our partner-managers points to an industrial recession in the Chinese economy, leaving the consumption economy teetering. Emerging markets continue to weaken in the wake of steep declines in commodity prices and large capital outflows. Rebalancing capital allocations and debt levels will take many quarters, even years, and the imbalances will likely weigh on global growth rates for some time to come.

The complexity of the current environment is not an excuse for us to fall short of investors goals. Investors need exposure to stocks to *grow* purchasing power or exposure to bonds to *preserve* purchasing power. Most investors need both. How much of each is the question. We reduced our exposure to stocks by 10% in early Q4 2014, investing in a short-duration Treasury ladder. Looking back, that decision was a good one: bonds outperform stocks in 2015. After observing market action over that period and having continued dialogue with partner-managers, we concluded that another 10% reduction in equities is prudent for the near-to mid-term.

Our view of changes in stock valuations through 2016 combined with our ongoing dialogue with partner-managers led us to the conclusion that a further 10% reduction in stock exposure was prudent for the near-to mid-term. We sold positions during the last week of April. Our investment thesis is similar to that in 2014: we are seeking to reduce portfolio volatility, but more importantly we are preparing to benefit from volatility – and the lower prices it brings.

We work with skilled investment managers (our partner-managers) who invest in high quality companies, so we are confident in the long-term prospects. However, we recognize that the long term is made from a series of short terms. We believe that the investment environment we are now working in is such that investors need to be more nimble. The Ashdon team meets with its partner-managers around the globe on a regular basis. We also meet internally two or three times each week to hammer out the details from these exchanges with the goal of bringing the best overall thinking to our client portfolios. Ashdon is a team with a passion for finding the best balance of *real* risk and *real* return – as opposed to volatility and index-relative return - for each of our clients. Our meetings keep us nimble and aware, but "bring us back from the edge", and we seem to always reaffirm the long-tested principle: stocks of high quality companies will be trading higher 10 years from now.

We use our quarterly letter to share a boiled-down view of the results of our hours of work. There are many details behind these paragraphs above. Rather than asking you to read a longer letter, this brief presentation will hopefully answer most of your questions. As always, if you would like a deeper dive, feel free to reach out to us.

Thank you for your confidence.

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