AUREUS
ASSET MANAGEMENT

January 2015

2015 Global Asset Allocation Review

Introduction

The purpose of the Aureus annual global asset allocation review is to assess the risks and opportunities available in global financial markets and their potential impact on the investment portfolios of our clients. Our views are expressed over two frameworks:

1. **Asset Allocation Policy** expresses a high-level asset allocation framework covering a longer, market cycle view of investing.
2. **Tactical Asset Allocation** represents our position on investment opportunities for the coming year and may be adjusted as market conditions change.

In practice, Aureus develops customized investment policies for clients based on specific goals and objectives. Ranges for each asset class allow us to accommodate client-specific factors including income requirements, return objectives, risk tolerance, tax sensitivities and liquidity needs. In addition, these ranges provide flexibility to make tactical adjustments based on changes in opinion toward an asset class. Current views are summarized in this review and are refreshed as inputs to our model change.

Executive Summary

Aureus is pleased to release its 2015 global asset allocation review. As always, our analysis combines critical interpretations of global market factors and asset classes, with a particular focus on the following:

2015 Analysis			
Market Factors	▪ US Economy ▪ Global Economy ▪ Corporate Profitability ▪ Inflation ▪ Geo-politics	**Asset Classes**	▪ Cash ▪ Fixed Income ▪ US Equities ▪ International Equities ▪ Alternative Assets

The output from our analysis serves as a starting point for the customized asset allocation we design for each Aureus client. Each year we provide a tactical allocation to specific asset classes. A summary of the high-level changes is presented in the chart below with more detail available on page 10.

2015 Tactical Asset Allocation Summary

Asset Class	2015 Tactical Allocation	Δ vs. 2014	2014 Tactical Allocation
Cash	4%	↑	3%
Fixed Income	12%	↓	15%
US Equities	42%	↓	44%
International Equities	16%	↑	14%
Lower Risk Alternative Assets	14%	↑	12%
Higher Risk Alternative Assets	12%	=	12%

This year's asset allocation is remarkably similar to last year with only minor adjustments to specific allocations for 2015.

Fixed Income: Bonds had a strong year because inflation and interest rates moved lower worldwide. Many expect the Federal Reserve to begin to raise rates in 2015, and the bond market, anticipating that action, could provide a low or even negative total return. While reducing our fixed income exposure, we are increasing our allocation to absolute return strategies in the alternatives allocation for 2015, given their projected lower volatility over time.

US Equities: In 2014, we had expected equity returns to be positive but in the single digits, which as late as mid-December looked like a reasonable projection. However, a year-end rally pushed US equity markets to record levels and another double-digit return. We continue to believe that equity returns will moderate from these historically high rates because of valuations at the higher end of historic ranges. Therefore, we are slightly reducing our US equity allocation for 2015. Consistent economic progress and lack of other compelling investment alternatives should keep supply/demand considerations positive for US equities.

International Equities: Valuations favor international equities over US equities, although there should be notable divergence in terms of country specific growth rates. Oil rich nations will struggle and energy importers such as Europe and Japan will benefit. Certain European countries remain saddled with ineffective economic and political policies (such as Greece, France and Italy). However, we have increased our allocation to international equities for 2015 in recognition of the positive relative valuation compared to US equities, and very little competition from interest rates.

Alternative Assets: Overall allocation to alternatives increases slightly, with an emphasis on lower risk absolute return strategies and hedged strategies in response to elevated volatility in the last half of 2014, which we expect to continue into 2015.

Review of 2014

A year ago in our *2014 Global Asset Allocation Review*, we continued our overweight to US equities and said the following, "from a several year time frame, we still believe that a slow but steady improvement in economic growth, together with positive supply demand considerations, should make this the most attractive long-term asset class". To date, this very basic decision has proved to be correct.

2014 Relative Investment Performance

Asset Class	2014 Investment Returns	
	Positive (Relative)	Negative (Relative)
Fixed Income	▪ US Treasuries ▪ Municipal Bonds ▪ European Sovereign Bonds ▪ Japan Sovereign Bonds	▪ High Yield ▪ Short-Term/Cash
Global Equities	▪ US Large Cap ▪ India & China	▪ US Small Cap ▪ Most non-US markets
Alternatives	▪ None	▪ Most hedge funds ▪ Commodities

Investment Return Summary

Asset Class/Index	Asset	% Return 2014	2013	2012	2011	2010	5 Year *
Cash							
BofA Merrill Lynch U.S. Treasury Bills	Treasury Bills	0.1	0.1	0.1	0.1	0.8	0.1
Fixed Income							
Barclays US Aggregate	US Fixed Income	6.0	-2.0	4.2	7.8	6.5	4.5
Barclays US Treasuries - Intermediate	US Fixed Income	2.6	-1.3	1.7	6.6	5.3	2.9
Barclays US Treasuries - Long	US Fixed Income	25.1	-12.6	3.6	29.9	9.4	10.0
BofA Merrill Lynch High Yield	US High Yield Bonds	2.5	7.4	15.6	4.4	15.2	8.9
Global Equities							
S&P 500	US Large Cap	13.7	32.4	16.0	2.1	15.1	15.5
Russell 2000	US Small Cap	4.9	38.8	16.4	-4.2	26.9	15.6
MSCI EAFE	Developed International	-4.5	23.3	17.9	-11.7	8.2	5.8
MSCI EMF	Emerging International	-1.8	-2.3	18.6	-18.2	19.2	2.1
Alternatives							
HFRI Equity Hedge	Equity Hedge Funds	2.3	14.3	7.4	-8.4	10.4	4.9
HFRI Fund of Funds Composite	Hedge Funds	3.2	9.0	4.8	-5.7	5.7	3.3
S&P GSCI	Commodities	-33.1	-1.2	0.1	-1.2	9.0	-6.5
S&P GSCI Gold	Gold	-1.8	-28.7	6.1	9.6	28.7	1.0
Inflation							
CPI-U All Items Less Food And Energy	Inflation	1.8	1.7	1.9	2.2	0.8	1.7

* *Annualized Return*

US Equities have been the clear market leader over the last 5 years as shown in the table. As we expected, valuations favored large caps over small caps last year and they provided a materially higher return. The biggest surprise to us in 2014 was the decline in interest rates, which allowed long bonds (20+ year US Treasuries) to post a 25.1% return for the year, markedly above all other asset classes.

We misjudged US and other high quality sovereign bonds, which we thought a year ago might lag, as we expected higher interest rates. Instead, economic growth in almost all areas outside the US was anemic, and there was limited demand for consumer and corporate borrowing, keeping bond rates at record lows and bond prices at or near record highs. In addition, alternative assets underperformed long only US equities, as was true in 2013.

The plunge in the price of oil was a major surprise in 2014, down over 40% from the mid-2014 peak, reflecting both weak global demand and excess supply. The annual production of energy in the US has nearly doubled over the past decade, making the US the largest producer surpassing Saudi Arabia. A year ago, it seemed unlikely that inflation would sink to close to zero in the Eurozone and remain below 1% in Japan. In both Europe and Japan, governments have moved too slowly to address the economic weakness, relative to the US.

The following sections review prevailing fundamental, valuation and geo-political conditions for 2015 and concludes with a summary of our asset allocation position.

Section A: 2015 Model Factors

Model Factor 1 - Fundamentals

Key considerations include prospects for growth, chances of inflation or deflation, and potential for further earnings gains.

Economic Overview

While the US attacked the 2008-09 financial crisis with relative speed and urgency, the central banks and the governments in Europe and Japan hesitated; it was not until 2013 that Japan attempted decisive action, and the European response is still divided between those countries favoring austerity and those which need a real boost to growth. We may see some modest improvement this year, but the political challenge in Europe is still unresolved. The emerging world can be divided into countries which export commodities (very little growth expected) and those which import commodities and stress domestic consumption (better growth). In all, we should expect no more than a slight improvement in worldwide economic growth in 2015.

Economic Growth

United States:

Factors	Influence
▪ Strong consumer and corporate balance sheets	++
▪ Very low interest rates and inflation	++
▪ Strength of dollar	+
▪ US GDP growth continues to lead the developed world	+
▪ New job growth creation	+
▪ Low commodity prices, stable wage costs	+
▪ Record high profit margins	+
▪ Sharp oil price decline a boon to consumer	+
▪ Federal Reserve policy moves towards less ease	-
▪ Equity valuation levels slightly above historical average	-
▪ Slower expected gains in corporate profits	-
▪ Bond valuations well above average	-

With nominal GDP growth of around 4.2% in 2014 (2.5% real growth) despite the negative effect of bad weather in the first quarter, the US is ahead of the UK, Europe and Japan. We anticipate real growth at 2.5%-3.0% for 2015. Spurring these numbers is the all-important category of job creation; over the past six to eight months, job creation has averaged over 230,000 per month, up from 200,000 at the start of 2014. However, wage growth has stagnated at around a 2% rate with this number falling -0.2% in December. We need to see wage growth to sustain this economic recovery. The collapse in gas prices is a boost to consumer incomes and confidence. Another positive is family finances, which are much stronger than at the time of the Great Recession of 2008-09. Total household debt is much lower as a percent of income and debt service has dropped from 13% of income to just below 10%. With the Fed maintaining near zero short-term rates, the US credit costs are very low and an inducement to borrow. However, many expect the Fed to start to raise short-term rates later this year, in a step toward "normalization" of monetary policy. Because equities had another strong year, valuations are now somewhat above average. The strong dollar will depress demand for US goods and services sold overseas and reduce reported profits due to currency. However, Europeans, unhappy with their own currency, may invest more in the US stock market. The energy industry has been a leader in this economic recovery, decreasing foreign dependence and increasing both capital expenditures and employment. An important factor will be the negative impact on earnings for the energy industry as a result of the collapse in oil prices, however, industries which use substantial amounts of energy will receive a meaningful benefit.

Europe and Japan:

Factors	Influence
▪ Determination of central banks to assist growth	+
▪ Low oil prices	+
▪ Equity markets valuations below average	+
▪ Extremely low bond yields (Greece is an exception)	+
▪ Poor economic growth figures	-
▪ European political struggles reappear	-
▪ Japanese need to reform not sufficiently addressed	-

Both Europe, with the exception of the UK and Norway, and Japan are major importers of oil, so the fall in prices are a strong positive to both consumers and corporations. Couple that with the very easy monetary policies of the European Central Bank and the Bank of Japan, and you have two big pluses for both areas. However, these are currently offset by continual political wrangling in Europe (will Greece fall back into chaos? will France or Italy ever find a way to improve their competitiveness?) and extremely weak economies. Japan is also very sluggish, and actually slipped into recession in the latter part of 2014. We think that the positive results of the recent Japanese election should bolster that country's confidence. There are still tough steps needed in Japan and Europe, to restore global competitiveness. Valuations in these countries' equity markets are below historical averages, making them relatively cheap, especially in contrast to the very low rates offered by their sovereign bonds.

Emerging Markets:

Factors	Influence
▪ Oil importing countries greatly helped by price decline	++
▪ Low inflation, except for a few badly managed economies	+
▪ Low equity valuations	+
▪ Political turmoil remains a major uncertainty	-
▪ Strength of dollar a negative for local currencies	-
▪ China still struggling with debt overhang	-
▪ Oil exporting countries significantly hurt	- -

The fall in price helps all oil-importing economies such as India, China, Philippines, Malaysia, and Thailand. The opposite is true for oil exporters, such as Russia, Brazil, Venezuela, Mexico, and the Gulf countries. The potential for a resulting shift in economic power has implications for investing in these parts of the world. Add to that the strength of the dollar and many emerging countries have to face not only budget but also currency challenges. While China, as the second largest economy in the world, remains in transition, as it moves from dependence on housing and infrastructure construction (financed by too much debt), towards a consumer driven model, its growth may suffer. However, in most of the emerging markets, valuations reflect these uncertainties and stocks look cheap.

Interest Rates and Inflation

Our 2015 outlook for global inflation remains muted, particularly reflecting global oversupply of oil and other commodities. However, there will be divergences between the policies of the Federal Reserve in the US and other central banks around the globe. Here, the Fed should start a program of slow increases in short-term rates later this year, while in Europe and Japan central bank policies will remain very accommodative. Therefore, both short and long-term interest rates may rise in the US but remain low in the rest of the world.

Corporate Earnings

Corporate profit margins in the US remain at record highs, with strong balance sheets. Companies are using excess cash to raise dividends, repurchase shares, or make acquisitions. Capital spending has trailed profit growth, but there are some signs of a pickup in this category. As demand continues to rise and unemployment declines, we anticipate a pickup in capital expenditures. Even in Europe and Japan, earnings for leading companies are rising and they remain in good financial condition. Emerging market corporations, other than commodity producers, seem in good shape with attractive long-term prospects.

Model Factor 2 - Valuation

Key considerations are valuation and yields, viewed historically, in absolute and relative terms.

Equities

In 2011 and 2012, the US market traded below its historic valuation averages; starting in 2013 and continuing in 2014, most US stocks rose more rapidly than earnings, driving valuations to levels higher than average. While there is little competition from bonds, US equities no longer seem cheap.

Valuations in specific European markets and Japan have remained below their long-term averages, and are considerably lower than in the US. In emerging markets, valuations seem inexpensive.

Global Equity Valuation Comparison

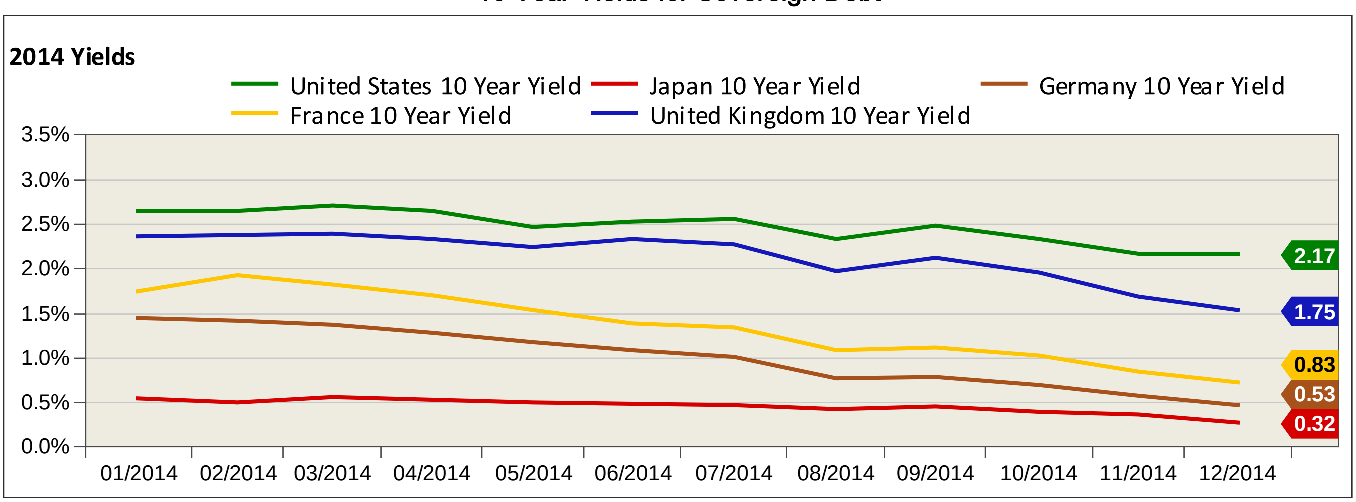
	10 Year P/E Ratio			Jan.	Jan.	10 Year Price/Book Ratio			Jan.	Jan.
Country/Region	High	Low	Avg.	2015	2014	High	Low	Avg.	2015	2014
US	17.0	11.8	14.5	16.4	14.0	2.6	1.6	2.2	2.4	2.1
Europe	13.9	8.8	12.0	13.9	12.0	2.2	1.1	1.6	1.6	1.4
Japan	20.7	11.7	15.9	13.8	14.1	2.0	0.9	1.3	1.2	1.1
Asia ex Japan	17.1	10.0	12.5	10.9	11.7	2.7	1.3	1.8	1.4	1.5
Latin America	13.6	8.8	11.2	11.9	13.5	2.6	1.1	1.7	1.5	1.7
Middle East & Africa	12.3	7.6	11.0	11.9	11.4	2.5	1.3	1.9	1.7	1.8

Source: Factset

Bonds

Sovereign bonds in the developed world are at record low yields and record high valuations. The chart below shows the steady decline in interest rates during 2014. In the US, a change in Fed policy could bring about a gradual rise in rates and decline in bond prices, while in much of the rest of the world low inflation and very easy monetary policies will provide support for top quality government bonds. Spreads between high and low quality bonds in the US widened considerably in 2014, reflecting investor concerns about excess supply. We believe that fixed income investors should consider alternatives such as absolute return funds, where there may be opportunities for experienced managers to provide returns better than fixed income, at very little if any increase in volatility.

10 Year Yields for Sovereign Debt



Model Factor 3 - Geo-political

Key considerations are government and political conditions in specific geographies that may impact economies and investment markets.

United States

A split government, with the Republicans in charge of Congress and the Democrats controlling the executive branch, is not necessarily a negative. Both parties will have a desire to show their constituents that they can accomplish something positive. Any agreement on trade and tax policies could result in better business conditions. The strong dollar may impact foreign policy in the near term.

Europe

The gap between the well-financed north and the distressed south remains wide. This gap is reflected in almost diametrically opposed policies; the north wants strict budget and debt discipline, while the south (including France, for this purpose) wants much more emphasis on economic growth and government spending. With the north insisting on major labor and budget reforms as a precondition for any relaxation of tough standards, and the south fearful of political backlash if reforms are pushed too hard, there is an obvious stalemate. Greece may provide a testing ground later this year as to whether there is room for compromise.

Japan

Prime Minister Abe's LDP party won a key election late in 2014 to remain in full control of both houses of parliament. We expect that this political certainty may result in greater confidence for both consumers and businesses. However, progress on reforms has been, and could remain, very slow.

Emerging Markets

China's dilemma is to walk a very fine line between discouraging too much debt for overbuilt economic sectors, such as housing and infrastructure, and encouraging investment in domestic consumption and social welfare programs. We remain cautious near-term but hopeful that China will accomplish this transition over the next few years. Growth has slowed across much of Asia, although both Indonesia and the Philippines are exceptions. India, under new political leadership, could respond very positively to growth incentives.

South America has been a disappointment. Brazil, Argentina and Venezuela, all natural resource and debt-heavy economies, are all suffering from commodity price collapses, which are also creating political unrest. Corruption and rapid inflation are also challenges throughout the region.

Africa could be a region of major opportunity in years to come, but the extreme political unrest from extremist groups is a major risk today. In addition, some of the most successful countries in recent years, such as Nigeria, are dependent on their oil exports. A similar dilemma, how to respond to tumbling oil prices, faces the Middle East.

Russia, always unpredictable, has the added challenge of lower oil prices and a very weak currency, which threatens a recession in 2015.

Finally, as recent events demonstrate all too well, the threat of militant terrorists is always present. This provides uncertainty and potential volatility for many countries.

Model Factors – Summary Table:

Region	Economic Fundamentals	Valuation & Risk	Geo-political
US	▪ Growth increasing steadily and jobs are more plentiful. ▪ Federal Reserve finally begins to tighten and raise interest rates. ▪ Corporate, financial, and consumer balance sheets remain relatively strong. ▪ Expect that the dollar will remain strong throughout 2015.	▪ Equity valuations now above historic median, but still reasonable relative to current interest rates ▪ Cash yields unattractive, high quality fixed income has little appeal. ▪ Volatility reappeared in late 2014 and could remain a factor in 2015.	▪ A split government between the two political parties promise challenges. ▪ Will both parties see their way towards compromise, in order to get things done? ▪ Obamacare and immigration reform are touchy issues.
Developed Markets	▪ Economic improvement in Europe depends on reaching difficult political compromise between budget discipline, labor and political reform, and incentives for the private sector. ▪ Japan is finally making progress towards better growth and ridding country of deflation. ▪ Many European and Japanese corporations have strong balance sheets and are regaining export competitiveness.	▪ Equity valuations relatively low in Japan and Europe. ▪ European and Japanese bonds appear fully priced,	▪ Challenges from ultra-nationalistic parties in Europe could make it harder for further progress towards economic reforms. ▪ Japanese confidence seems to be slowly improving. Although the long-term budget problems require necessary economic reform.
Emerging Markets	▪ China's economy is too dependent on debt creation. ▪ The commodity exporting nations, such as Brazil, will be hurt by low commodity prices; others with a higher consumer component, such as India, should do well. ▪ Frontier countries growing rapidly.	▪ Equity valuations range from cheap to fair value. ▪ Unpredictable flow of funds from the developed world will remain a source of volatility. ▪ Currencies will most likely fall vs. the dollar, leading to problems in areas where too much debt has been issued in dollars.	▪ Leadership in China needs to change the economic model to focus on domestic demand; but any such transition can take years. ▪ Russia may suffer from economic and social instability due to low oil prices. ▪ Much of South America still emphasizing too much state interference in economic affairs.

Section B: 2015 Global Asset Class Review

1. Cash

Returns on money market funds and Treasury bills remain just over 0.1% providing a negative real rate of return. However, cash provides important protection against market downturns as well as a source of liquid reserves for taking advantage of better price opportunities.

2. Equities

In the US, valuations have moved towards the high end of historical averages but are supported by improving growth and high profit margins. The strength of the dollar will prove a headwind to US multi-nationals. In Europe, valuations are reasonable by historical standards, but growth is uneven, and political challenges may depress investor confidence. Emerging markets trade mostly at the low end of historical averages, with the exception of a few countries such as India.

We favor developed market equities and recommend rebalancing a little more towards international equities vs. the US, primarily for valuation reasons. Emerging markets are a mixed picture but with more positives than negatives.

3. Fixed Income

While we were surprised by the very strong returns from sovereign bonds in 2014, we believe that there is very little further opportunity for lower yields and higher prices this year. We would reduce commitments to high quality fixed income securities.

4. Alternatives

Alternatives include absolute return vehicles, long-short equity funds, and specialized credit. Within alternatives we recommend a higher allocation to absolute return funds as an alternative to fixed income. Also, given that volatility seems to be increasing, long-short equity funds may finally provide satisfactory diversification to long only equities. We remain positive regarding specialized credit, emphasizing distressed debt in both the US and Europe.

Taking all these inputs together, we arrive at a set of conclusions summarized below, as compared to our long-term policy targets:

2015 Asset Class Summary Table

Region	Equities	Fixed Income	Alternatives
US	Overweight	Underweight	Overweight
	▪ Higher valuations balanced by improving growth and more demand.	▪ Negative potential real returns.	▪ Emphasize absolute return and specialized hedge fund managers.
Developed Markets	Equal Weight	Underweight	Equal Weight
	▪ Fair to undervalued.	▪ Overvalued as central banks maintain a low rate environment.	▪ Some attractive opportunities, especially in European credit markets.
Emerging Markets	Overweight	Underweight	Underweight
	▪ Be selective: attractive valuations may be offset by slowing growth.	▪ Equities seem a better bet, especially as currency challenges detract from debt appeal.	▪ High volatility and restricted liquidity.

Section C: 2015 Asset Allocation Model

1. Base Case Asset Allocation

Valuations and economic fundamentals combine to result in a base case asset allocation.

The base case has four principal asset categories: cash, fixed income, global equities and alternatives. In turn, equities are subdivided into US and international (as well as by market cap), while fixed income is subdivided by quality. Alternatives consist of two subcategories.

2015 Asset Allocation Model

Asset Class	Risk Level	2015 Bias	2015 Policy Range	2015 Tactical Allocation	Δ vs. 2014 Tactical
Cash	Low	=	**0% - 10%**	**4%**	↑
Fixed Income		-	**10% - 25%**	**12%**	↓
High Quality Bonds	Moderate		10% - 20%	12%	↓
High Yield Bonds	High		0% - 10%	0%	=
Global Equities		+	**45% - 65%**	**58%**	=
US Equities	High		40% - 50%	42%	↓
International Equities	High		10% - 20%	16%	↑
Alternatives		+	**15% - 30%**	**26%**	↑
Directional Strategies	High		5% - 15%	12%	=
Absolute Return	Lower		5% - 15%	14%	↑
Total				**100%**	

Notable changes from our 2014 model:
We continue to have a bias toward equities and alternatives for 2015 and away from fixed income.

From a tactical perspective, changes to our model were modest, equity exposure remains consistent with 2014 while fixed income is slightly reduced. Offsetting the reduction in fixed income is an increase in the absolute return component of the alternatives allocation. This shift recognizes what we believe will be a more difficult performance environment for bonds, while increasing absolute return adds a lower risk allocation to the portfolio.

2. Expected Returns

2015 Asset Allocation: Expected Returns

Asset Class	Expected Nominal Return	2015 Tactical Allocation	Expected Nominal Return Attribution
Cash	0.0% – 0.5%	4%	0.0% – 0.0%
Fixed Income	2.0% – 3.0%	12%	0.2% – 0.4%
US Equities	6.0% – 9.0%	44%	2.6% – 4.0%
International Equities	6.0% – 10.0%	14%	0.8% – 1.4%
Directional Alternatives	6.0% – 8.0%	12%	0.7% – 1.0%
Absolute Return Alternatives	4.0% – 6.0%	14%	0.6% – 0.8%
Total Portfolio Nominal Return		100%	**5.0% – 7.5%**
Less Expected Inflation			(2.0%)
Total Portfolio Real Return			**3.0% – 5.5%**

Calculating expected returns is mainly a quantitative exercise to establish a range of returns for both asset classes and an overall "average" portfolio. History has shown that rarely will these asset classes deliver these expected returns during any one calendar year given the cyclicality and volatility of individual asset classes. However, using these expected returns allows us to test our assumptions and their application to a client's portfolio.

For 2015, we expect better returns to come from US equities, international equities and alternative assets. When applied to a diversified portfolio, the expected returns are in the 5.0% to 7.5% range with the overweight to US equities providing the bulk of the returns.

As always, we remain diligent in our approach to the financial markets and the management of our clients' investment portfolios. As new information becomes available we update our models and, when market conditions warrant, will make adjustments to our tactical allocations.

We appreciate the opportunity to share our views and welcome your questions and comments.