THALASSA
CAPITAL LLC

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"The reality is that financial markets are self-destabilizing; occasionally they tend toward disequilibrium, not equilibrium." George Soros

As George Soros correctly pointed out many years ago, at the height of his remarkable investing career, markets often become ruled by disequilibrium forces rather than reaching for balance. The current year, started with such a profile as different asset classes have been in the process of decoupling from the effects of coordinated global monetary policy.

New macro trends are filtering thru the fabric of international financial markets putting in motion a diverse set of investing dynamics. As a result, volatility is on the rise as manifested by the constant large fluctuations of equity indexes, currencies and energy related instruments.

As of this writing, asset returns are mostly positive but within a regime of much higher volatility. Equities in the developed world are up 4.1% outperforming emerging markets by 2.4%; specifically in the developed world, Japan is the best performing market, up 12.2% and Canada, a victim of the energy rout, the worst performing region, down 5.8%. In terms of sector performance, Healthcare leads the pack with a return of 10.5%, followed by Consumer Discretionary at 8.3%. Unsurprisingly, Energy is the worst sector, down 4.1% along with Utilities down by the same percentage. Interestingly enough, Energy and some Utilities (selected water companies and energy pipelines) may now be one of the few areas where opportunities could be found (data source: JP Morgan, Global Equity Research).

Looking forward to the second quarter, we can identify a few drivers that may shape markets performance. Naturally, the turn of the tide in US monetary policy and the speed at which such change will materialize will continue to influence market's volatility. Chairwoman Janet Yellen in her recent Fed meeting seems to have shared a vision of very slow and gradual adjustments for interest rates. This approach should pave the way for a more smooth reaction by equities in the face of rising

rates. Federal Reserve's actions, however, will be very conditioned by possible acceleration of growth in Developed Markets and especially in the US. A recovering housing market and an easing of the fiscal drag could quickly re-ignite the domestic economy and force a faster process of rates normalization.

On the European front, we have a very friendly Central Bank and so far a weakening Euro; these two elements have produced a positive feeling over European equities. While we like the Old Continent's valuations, we would like to spend a word of caution as structural reforms remain the key for sustainable growth and eventually sustainable returns.

As far as sector strategy, as mentioned earlier, we continue to see long term value in the Energy space. Among different metrics of interesting valuation for the sector, we can now add a serious overshooting of earnings downgrades when compared to the move in oil prices. If we are correct in believing that oil prices are bottoming out, the 12 and 24 month forward valuations would seem rather attractive at this juncture. We also note that we are entering a favorable period for the sector; historically the second quarter has a higher probability of market outperformance (source: Datastream, JP Morgan).

Emerging Markets should remain under pressure as the lingering effects of the strong US Dollar and poor pricing for most commodities is still a major factor. Federal Reserve uncertainty also continues to weight on EM and contributes to compress valuation multiples. However, opportunities will eventually arise and we are diligently monitoring classic metrics to spot value in developing markets.

On a strategic note, we would like to reiterate our conviction that going forward, alpha based strategies should produce better risk adjusted returns than beta. The length of the current bull run in equities, an uncertain monetary policy along with a global divergence of monetary decisions may suggest an environment more apt for active approaches such as factor investing, smart beta or pure discretionary strategies.

Staying with the strategic theme, two articles recently caught our attention on the case for long termism. The two pieces were published on the Harvard Business Review and the Rotman International Journal of Pension Management. Our clients know that one of our asset allocation pillars is indeed investing with a long term horizon. One of the studies quoted Morningtar data indicating that the average investment holding period for the largest 25 American equity mutual funds is now down to only 1.4 years. And yet different studies have indicated an advantage in holding periods of three to five years. In the next few weeks, we are planning to

write a comprehensive review of these studies in our never ending effort to provide concrete and applied research for our clients.

In conclusion, we feel the future path of investment returns will probably be lower than in the last five years and within a context of higher volatility. Rather than fearing such a set of contingencies, we would like to embrace it and use the volatility to position our portfolios for the long term by taking advantage of potential significant dislocations.

As always, we would like to thank you for the renewed confidence in our work,

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