LEAR

INVESTMENT MANAGEMENT

2015: The ~~Year~~ Fear in Review **2016: Unwrapping the Present**

"Intelligence is the ability to react to change." Stephen Hawking

The US Stock market ended 2015 nearly where it began (S&P 500 +1.4%, Dow -2.23%). We believe assessing the year by this information is vastly understating the volatility and global complexities which defined much of the year and the challenges and opportunities that have been created in 2015. Below we focus on the year that was, the present and the future.

Understanding the Index - If the purpose of an index is to gauge broad performance, we must dissect the return to make sure we get meaningful information. It is estimated that the top 10 stocks in the S&P index returned an average of 20% while the other 490 returned an average of -5%. This deep divide between the performance of the few and the reality of the vast majority of securities has presented an interesting dynamic. The total returns *feel* worse as positive performance was so narrowly shared.

In addition to the divergence of returns, the S&P's journey to flat took two 10% dips along the way. An investor's reaction to these jarring events was pivotal to performance. Not adding exposure at peak valuations and remaining steadfast when the market repeatedly fell over 10% was essential.

Fear in Review - Stronger dollar, China slowing, The Fed and lower oil prices.

"Never let your fear decide your fate"

In 2015, we witnessed inflated levels of investor fear, frustration, short-term thinking and irrational behavior. The ability to receive news, stock quotes and "expert" opinions at any hour on our iPhones has given us an expectation of immediacy that is antithetical to sound investing.

Adding to the frustration, there were few investments positive in the year. The safe haven gold was down 10%, oil was down 30% and corporate bonds even posted negative returns.

Frustration was not reserved only for the novice investor. As testament to the difficulty of 2015, some of the most seasoned and successful investors posted double digit declines this year. So why was it that many of the smartest and most sophisticated were down double digits in 2015? Fear triumphed over the fundamentals.

Our Firm - Lear Investment Management began operations in the middle of January; our performance is for a partial year. We estimate the net of fee performance of our composite* since inception was -3.6%. The first six months were exceptional for our strategy. Later in the year, the losses stemmed from declines in our international holdings and light exposure to energy. We are never happy with a down year, but stand proud of our decisions, research process and discipline.

US Stocks - We maintained the view at the start of 2015 that US markets were fairly valued and trimmed positions throughout the year. Earnings of the S&P 500 posted negative growth in 2015 with the energy sector and the strong dollar as the main culprits.

Lower for Longer (Oil) - As the year came to a close, it became apparent US producers and OPEC were far slower to curb production than anticipated. The reality set in that lower oil prices are here for longer and those investors looking for generational buys in energy at low prices must be *patient into 2016-17*.

"Grexit" Stage Left - In the summer, the fear of financial contagion resulting from a Greece default on debt punished stocks. In the end, there was little risk of financial contagion.

China - As markets showed relief from EU political strife, the world began to worry about China. Excessive governmental controls were a source of mass confusion and Chinese markets took drastic twists and turns, which left many investors disenchanted. In a surprising policy shift, the Chinese devalued their currency. And, the shock, rather than the substance of the move, further rattled investors.

China continues to evolve into a more mature economy with a lower dependence on manufacturing and a shift to a service-based economy. In 2015, the Chinese consumer continues to grow- driving sales in several US companies including Apple and Nike. We believe there is a healthy shift occurring in China and remain committed to finding investments that can benefit from the demographics of China while minimizing our exposure to the inner working of their less than ideal securities marketplace.

Emerging Markets (Ex India and China) - The China fear spread to other emerging markets as concern of a currency and debt crisis was the fear du jour. This fear calmed with China stabilization, but the recovery of share prices has yet to occur.

The Federal Reserve - Fed Fear was a constant headline in 2015 as the world watched for the Federal Reserve to raise interest rates for the first time since the financial crisis. This move came and went and it appears the slow and steady normalization of policy did not cause a sharp rise in the dollar, emerging market sell-off or any of the Doom's Day effects that were feared. This did not keep markets from having rate hike tantrums in anticipation of Fed meetings on a normal course basis. It is incredibly important to stay focused that an increase in rates is emblematic of an improving US economy.

Miscellaneous Fear - Throw in a large corporate conspiracy with Volkswagen's emission fraud, unthinkable terrorist attacks in Paris, high yield bond liquidation in the US, the sheer destruction of the MLP investment model and there you have it - 2015.

Unwrapping the Present - Opportunity created by fear is exceptional for the *patient* investor.

"The most reliable way to forecast the future is to try to understand the present."- John Naisbitt

2016 - Investments are a mix of cash, fixed income, stocks, real estate and commodities. How we allocate to each asset class is the foundation of success.

Cash - We believe there will be continued volatility in 2016. The election year, China, global politics, energy prices, rate hikes and currency fluctuations will create uncertainty and further confusion. *We believe having cash available to meet living expenses and to take advantage of price dislocations is critical.*

Fixed Income - The Fed has begun the normalization of interest rates and are forecasted by many to continue in 2016. If rates rise, the price of traditional bonds should decline. We continue to favor floating rate senior secured bank loans which take advantage of rising rates, short-to-medium term maturities and good credit quality. This is a greatly misunderstood portion of the market and one where we have an informational advantage. The fear has created many interesting opportunities in corporate fixed income.

The Fed - Four rate hikes are forecasted for 2016. We do not believe there will be this many rate hikes. In fact, there is a possibility the Fed lowers rates if economic conditions deteriorate.

US Stocks - Fundamental analysis is the key to long term success. We will continue to look for investments with value - meaning a reasonable price for future earnings growth. The fear in 2015 (and early 2016) has created many interesting opportunities. If you are an investor looking for growth over a long period of time, we believe stocks present a favorable opportunity - especially compared to other asset classes.

It would be difficult to pen a letter without mentioning the exciting world of technology. Self-driving cars, artificial intelligence, "Big Data", cloud computing, genetic manipulation and social networking are the norm in 2016 and no longer sci fi fantasies. However, the valuations of many technology companies have reached lofty levels. We will maintain a modest weighting to technology and look to add if there is a dramatic sell-off.

We believe there will be a shift from growth stocks to value stocks in 2016 as investors look for solid balance sheets, dividends and low valuations. We will add to value equities on dips as we forecast several moves down.

Economy - Jobs, Cars and Houses - Three key pillars of the US economy are jobs, automobiles and housing. The unemployment rate is at 5% - a sign of health for the economy and often leads to more spending by the consumer. However, layoffs are accelerating and causing some pause. We will monitor closely as a sign of a more meaningful slowdown in US economy. Today, we still believe the economy will grow in 2016.

While car sales in the US reached an all-time high in 2015, housing has been a disappointment throughout this recovery. Credit has been the challenge for many homebuyers. The effects of the foreclosures of 2007 could ease credit conditions as it takes seven years to qualify for a mortgage after a foreclosure. Easing credit could be a tailwind and a key element to spark the next stage of the recovery.

Modest growth in select areas is the name of the game and consistent performance, dividend income and avoiding hype stocks should provide solid returns and insulate from losses. We forecast earnings to grow modestly in the US with continued volatility in short-term news cycles.

Energy - As previously stated, we believe energy will be lower for a longer period of time creating difficulty for many energy companies planning their operating budgets on $35-40/ barrel oil prices. We will remain patient and look for opportunities to invest once reality of the lower prices sets-in. One of the most important factors in 2016 will be not investing in beaten down oil stocks too early – especially MLPs.

Also, please remember - Lower oil prices is good for the consumer in US, Europe and India.

Europe - European monetary policy continues to be expansionary and economic data points to a recovery in progress. European markets continue to have attractive valuations compared to the US and lower oil should benefit the region. We are cognizant of the currency fluctuations with the Euro and have implemented a hedged strategy that will mitigate our exposure.

In contrast to the favorable economic backdrop, Europe has complicated political challenges. We will closely monitor, but continue to be optimistic for the region's continued recovery.

Namaste - India presents the most interesting opportunity in 2016 and beyond. India has emerged as the fastest growing economy in the world at +7%. India posted disappointing returns in 2015. Expectations for the Modi administration were sky high and the markets were clearly disappointed with the lack of reform. While we have trimmed exposure, we believe enthusiasm has been curbed and 2016 is a pivotal year to see improvements. If not, we will look to exit as we have most all other emerging markets.

In Conclusion - Investors who stick to their discipline of lowering risk by investing around the world with value as their basis; should be rewarded for their patience in 2016 as the world grows modestly. This is our time to remain steadfast and take advantage of situations where fear has created the prices.

We are in a new world – this is the first "bear" market in this global information age. The market fluctuations will be delivered to investors real-time in the palm of their hand.

We do not know all of the events 2016 has in store. This is the reason we believe in a dynamic and diversified portfolio with a mix of cash, fixed income and stocks of different sized companies in different areas of the world. The most important factors are:

- understanding the data
- not getting emotional
- not reacting to short-term market moves
- sticking to your disciplined strategy
- having cash and patience to take advantage of opportunities created

We wish you peace, health and happiness in 2016. We will continue to work tirelessly to navigate the global markets and help you, our investors, achieve your goals and realize your purpose.

The Lear Global Vigilance Composite is a collection of separate accounts managed by Lear Investment Management. Currently the composite holds approximately **25% in cash and fixed income. The inception of the index was February 2, 2015. The composite is tracked by Black Diamond (an Advent company). The composite is $72 million dollars of total assets and made up of 55 accounts. These are actual clients of the firm and are all managed by the Lear Investment Management portfolio management team. The strategy is global (US and abroad) equities, fixed income, and cash - depending on market conditions. The composite reinvests dividends. Individual account performance will differ. Past performance is not a guarantee for future performance.*

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