ASPIRIANT

Market Viewpoint

Aspiriant's Current Views on Capital Markets

May 2010

The Picture Brightens

- Aspiriant establishes longer-term (20 year) capital market expectations (CMEs) at least every two years. Throughout the year, we combine our own research with views from international governmental and non-governmental organizations, academia, and investment managers to develop whatever short-term view of the markets may be reliably helpful to our clients.

- As of this writing, the Aspiriant view over the next year revolves around two core themes. First, we expect differentiated levels of economic growth around the world as the result of different pre-crisis conditions and responses. Second, innovation in telecommunications and business models are increasing productivity of knowledge workers, bringing more talent into the global labor pool (*The World Is Flat*), and more effectively addressing smaller markets.

- In general, we are not persuaded by PIMCO's now fashionable idea of a "new normal," with durably lower returns to risk assets. Though our central expectations are in line with the consensus views of the economists and strategists we evaluated, we place a higher probability on above consensus economic growth and returns.

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Aspiriant establishes longer-term (20 year) capital market expectations (CMEs) at least every two years. The purpose of the CMEs is to (1) provide expected returns for portfolio mixes to be used in our wealth planning process; and (2) to help guide our portfolio construction and investment manager evaluation process. Still, on an ongoing basis, we combine our own research with views from international governmental and non-governmental organizations, academia, and investment managers to develop whatever short-term view of the markets may be reliably helpful to our clients. Unlike the CMEs, our short-term view is not a point estimate of returns, but rather a general sense of opportunity and risk in various markets.

The combination of our long-term and tactical views underpins the macro investment decisions employed across all client portfolios. While tactical decisions are typically limited to the "opportunistic" portion of Aspiriant portfolios, we will make tactical moves we feel are sufficiently compelling – e.g., our overweight to corporate credit in early 2009. Whether or not we make any investment changes, this market viewpoint allows us to evaluate the near-term prospects of our long-term CMEs and compare our expectations to industry consensus views.

In addition to developing *expected* economic and market scenarios, we conduct "stress tests" to explore the impact of various *unexpected* or unlikely scenarios on client portfolios. Through this process, we seek to identify warning signs that negative scenarios are becoming more likely.

THEMES

The Aspiriant view over the next year revolves around two core themes. First, we expect differentiated levels of economic growth around the world as the result of different pre-crisis conditions and responses. In general, emerging economies have more opportunity for productivity growth and room for fiscal expansion (due to their lower leverage) and are likely to grow much faster than their counterparts in the developed world. Despite some positive trends, developed economies such as the US are likely to face headwinds such as high levels of government and consumer debt and excess capacity in labor and product markets.

Second, innovation in telecommunications and business models are increasing productivity of knowledge workers, bringing more talent into the global labor pool (*The World Is Flat*), and more effectively addressing smaller markets. Successful innovation typically increases economic growth and eases inflationary pressure.

OVERVIEW

The US recovery has evolved. First, the economy was propped up by fiscal and monetary stimulus. Next came the current stage of inventory building. The final stage involves job creation and the emergence of self-sustaining final demand. The Federal Reserve is unlikely to raise interest rates until this stage begins to emerge, probably in 2011. Europe faces deflationary headwinds of greater magnitude than the US. Severe austerity measures expected on the periphery of the Eurozone (Greece, Spain, Ireland) are not likely to be counterbalanced by expansion in the core. Problems in the periphery introduce fiscal uncertainty, but will probably be felt in exchange rates rather than interest rates outside of the affected economies. Prospects in China and most emerging economies are brighter.

Among the most interesting questions will be the impact of the global champions from the emerging markets on growth in their home countries relative to the developed economies on which their revenues depend. Some of the world's biggest and best companies are from emerging markets: South Korea's Samsung is the largest (by revenue) and one of the world's best known electronics companies; Mexico's CEMEX is the largest cement company in America and the third largest in the world; Brazil's Aracruz is the world's largest and most profitable producer of pulp for paper and tissues; and Russia's Gazprom controls more gas reserves than all the big oil firms from developed markets combined. Will these companies invest in their home markets, driving local growth and enhanced productivity, or will their investment continue to be focused in developed markets, in order to avoid tariffs and get closer to their largest customers?

Economic growth

Consensus[1]: Consensus is for a de-synchronized global recovery, with lower levels of growth and inflation in developed markets (especially Europe, 0.5% real growth; the UK, 1%; and Japan, 0.5%). The US is expected to grow about 3-3.5% with 1.5% core inflation, for a nominal growth rate of 4.5% (similar to the average over the last 25 years). China is expected to grow about 10%, with other high-growth emerging markets growing around 6%. PIMCO is notably more pessimistic (1-2%) than consensus while Goldman Sachs is significantly more optimistic (4% global growth with low inflation), especially about growth in the US.

1 "Consensus" refers to our qualitative evaluation of the central beliefs of the economists and strategists whose research we reviewed. It is not based on an exhaustive review of all possible sources of information and is not meant to indicate a quantitative average or suggest that all of the research was in agreement. Rather, it is for illustrative purposes only, intended to give a general sense of the expectations of market participants.

Aspiriant's view: Our view is in line with consensus, though we think the likelihood of an upside surprise is higher due to the impact of low-cost, mobile, productivity-enhancing technology.

Interest Rates and Inflation

Consensus: Consensus is for central banks in developed markets to keep interest rates low in the face of deflationary trends while rates in emerging economies increase to head off inflation (which has already started in food and energy prices, but is starting to spread to wages and other goods).

As of 3/31/10, the forward yield curve in the US bond market implied that the market expects the yield on the 10 year Treasury bond will be 5.2% in 10 years, which was higher than the (then) current (3.9%) and average since 2000 (4.5%), but lower than the average since 1970 (7.3%). The dramatic steepness of the yield curve (10y – 3 month) suggests that the bond market expects the yield curve to flatten significantly in the years ahead, with the majority of the increase in short rates, not long rates. For example, over the next five years, the 2y is expected to go from 0.8% to 5.3% while the 20 year would go from 4.4% to 5.6%. The 10-year TIPS yield suggests that the market expects about 2.2% inflation.

Aspiriant's view: There are significant cross-currents with some factors suggesting low rates (disinflation in developed markets, productivity-enhancing innovation, savings glut in emerging and petro-dollar economies) and others suggesting higher rates (concern about deficit spending). On balance, we expect rates to remain lower than the historical average for several years.

ASSET CLASSES

Fixed Income

Consensus: In the municipal bond space, retail investors have become very concerned about municipal budget crises and higher interest rates. This is evidenced in the flow of funds into short-duration municipal bond funds, record low yields in the short-duration/high quality portion of the municipal bond space and a very steep yield curve. Duration and credit spreads remain elevated relative to historical averages.

On the contrary, corporate bond prices have rallied with AAA and high yield spreads back to 2007 levels despite much higher (though falling) default rates.

Aspiriant's view: We think the concern about repayment of municipal debt misses the reality: repayment of state and local general obligation debt has very high priority and coverage ratios are much higher than in the corporate sector. Further, in the next few weeks, the bond rating agencies will be harmonizing the municipal bond and corporate bond ratings, which will result in an upgrading of the entire municipal bond sector (since BBB municipal bonds have had about the same historical default rates as AAA corporate bonds).

The overall valuation of corporate debt (i.e., spreads) does not leave much room for error. Though the economy is improving and the public debt markets have been surprisingly accommodating, there is disappointingly little reward for taking credit risk at this stage in the economic cycle.

Implications: We have a more neutral view of credit risk, which we view as fairly priced as opposed to a year ago when we took the unusual step of adding a significant overweight to credit (in the Aspiriant portfolio allocations, in addition to the decisions of the underlying investment managers). Over the next few quarters, we will eliminate the overweight to corporate credit) in taxable fixed income and retain the overweight to municipal credit (which we expect to be durable).

Real Estate

Consensus: With very few transactions taking place, it's hard to define a consensus regarding real estate. Judging from the behavior of the markets, however, the concern about public real estate has subsided. In particular, concern over the huge amount of commercial debt coming due in the next few years has disappeared from the headlines.

Aspiriant's view: We believe that the improving economy will help the real estate market in the intermediate term, but real estate (which lags the economy) will face continued headwinds in the near-term. Sectors which have already undergone more adjustment (e.g., single family for sale) will perform better than sectors which started adjusting later (e.g., office). We continue to like non-US sectors with some protection (e.g., emerging markets multi-family residential) and single family residential in the US.

Implications: We have maintained the significant allocations to real estate across client portfolios. We continue to evaluate active investment managers and various benchmarks to gauge our performance.

Public Equity

Consensus: Consensus is for a continued strong rebound in global equity markets, corporate profits and equity share values. Goldman Sachs is even more optimistic, expecting 15% total return to global public equity over the next 12 months. PIMCO, who is arguing for a "new normal," expects equity market returns in the low single digits over the next five years.

Aspiriant's view: Despite the Great Recession and continuing pain in many parts of the world, there is no indication that near-term global economic growth will be significantly different from what we have experienced in the past. The combination of reasonable economic growth, low inflation and low interest rates should be supportive of equity market returns. The initial "hope" phase that propelled equities sharply higher through much of last year is likely to make way for a more moderate period of returns, consistent with previous growth phases of the equity cycle where equity markets are driven by recovering profitability.

Implications: We are maintaining allocations to global equity markets, including overweights to value, small cap, and emerging markets. We are exploring ways to increase tax efficiency and to add greater risk management to our equity portfolios.

Private Equity/Opportunistic

Consensus: Private equity/opportunistic is a very broad asset class, including traditional private equity and a range of investment strategies most often employed using hedge funds. Private equity funds have been inactive for the last several years, though a number of very large deals have recently been announced and the valuation multiples are rising rapidly. While financing is not as readily available as it was before the financial crisis, the complete freeze appears to have ended. The general rise in the markets and especially illiquid segments has helped hedge fund returns, which are benefitting from the lack of competition from the proprietary desks of banks and investment banks.

Aspiriant's view: The reduced volatility lowers the ability for hedge funds to add value, but the global macroeconomic uncertainty remains high and the number of corporate events (M&A, IPOs, divestitures) is rising and providing catalysts for trading strategies. Appropriate opportunistic strategies and exposure to streams of private economic activity are important complements to public markets.

Implications: We continue to advocate meaningful allocations to PE/

Opp where appropriate. Though the high yield corporate bond market has recovered to 2007 valuation levels (as measured by yield spreads), the protracted distress cycle provides substantial opportunity for additional gains.

Commodities

Consensus: With 24 commodities in the S&P Goldman Sachs Commodity Index, ranging from oil to pork bellies, commodities are a very broad asset class with disparate relationships to the economic cycle. As far as we can tell, the consensus is for low to moderate returns to commodities, due to relatively weak economic growth and an easing of supply concerns.

Aspiriant's view: Commodity returns are likely to be supported by strong global growth. We are most positive on oil, as we expect improving fundamentals and further inventory drawdown to drive higher prices. However, upward sloping oil futures curve (contango) presents a headwind in the form of negative roll yield (mitigated by our dynamic oil trading strategy). Precious metals are attractive as long as short-term interest rates are near zero, but we fear a vicious reversal once rates rise, as investors flee precious metals in favor of higher yielding Treasury bills and other risk assets.

Implications: Aspiriant client portfolios have significant commodities exposure, with higher commodity allocations for portfolios with higher equity allocations (and therefore higher exposure to commodity price risk). We are maintaining our broad diversification (similar to the GSCI) and tactical trading strategies, which have added significant value over the past two years.