EDGE

Q1 2014 Outlook

Winter / Spring 2014

CONFIDENTIAL

ONE OF THESE THINGS IS NOT LIKE THE OTHERS

In the investment world, differences are where value is created. We are not talking about that dangerous phrase "This time it is different." No, we are talking about finding those little disconnects that others have not quite picked up on or perhaps don't fully believe quite yet. Identifying those opportunities is what creates differences in our returns versus market comparisons.

Differences come in many types. There may be a difference in trend from one period to the next. For example, the Fed has clearly demonstrated that they are ramping down support in contrast to the past five years. There may be a difference in how two parties act in the same period. For example, other global central banks have been talking up more support in contrast to the Fed.

In this world, change is the only constant, which means that differences are always coming and going. We must keep a vigilant eye and an open mind to understand the ramifications of what we see.

Be willing to be different as an investor, but only if the facts support it. Be willing to pick your spots; you do not have to own all types of assets at one time or one type of asset all the time.

The song "One of These Things Is Not Like the Others" is played during an educational segment on Sesame Street, a popular and long-running American children's television series. The song was written by Joe Raposo.

Source: Wikipedia

RECOMMENDATIONS

Fixed Income

For investors with the time horizon and risk appetite, allocate away from fixed income toward higher returning opportunities.

For investors seeking to hold some capital as "dry powder," maintain a short-duration portfolio focused on high-quality corporate bonds.

For investors seeking relative return within fixed income, focus on select credit exposure including floating rate securities and long/short credit.

For investors able to accept illiquidity, private debt opportunities offer higher current cashflow and mid-teens return expectations while staying higher on the corporate capital structure.

Equities

Stay invested in equities. US equity continues to offer reasonable risk-adjusted returns.

Specifically in US equity, we continue to favor the revenue and dividend growers. High-quality, mega-cap equities offer a reasonable valuation with strong balance sheets and growth potential as the economic recovery strengthens.

We continue to recommend investment in the technology sector; we believe technology is positioned to benefit from improving capital expenditures and a longer-term cycle of innovation.

Relative to our investment recommendation last year, valuation in the healthcare sector rose sharply. While there remains relative value, it should be used as a source of capital for higher-returning investment ideas.

Investors should increase exposure to European equities.

We believe Europe is still in the early innings of a recovery and presents a higher-return outlook than the US, due to the potential for multiple expansion and higher dividend yield albeit with higher incremental risk.

Exposure to Asia ex-Japan should be maintained despite near-term headwinds.

Improving developed market growth, attractive valuations, increased stability in China, and active reform present a compelling investment backdrop in Asia.

Within Asia, in 2013 active management added material value relative to local indices and we believe this trend will continue in 2014. In this context, we maintain our specific recommendation on China.

Real Assets

We continue to recommend MLPs as an investment in the US energy renaissance story.

Valuations are inline with historical averages; however, the combination of yield, distribution growth, and overall conditions for top-line growth remains attractive.

Take advantage of the US energy renaissance using active management in a broader context.

Aside from MLPs, investors should explore other areas within the energy supply chain that are positioned to benefit from increased production growth.

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OUTLOOK

Realize MORE

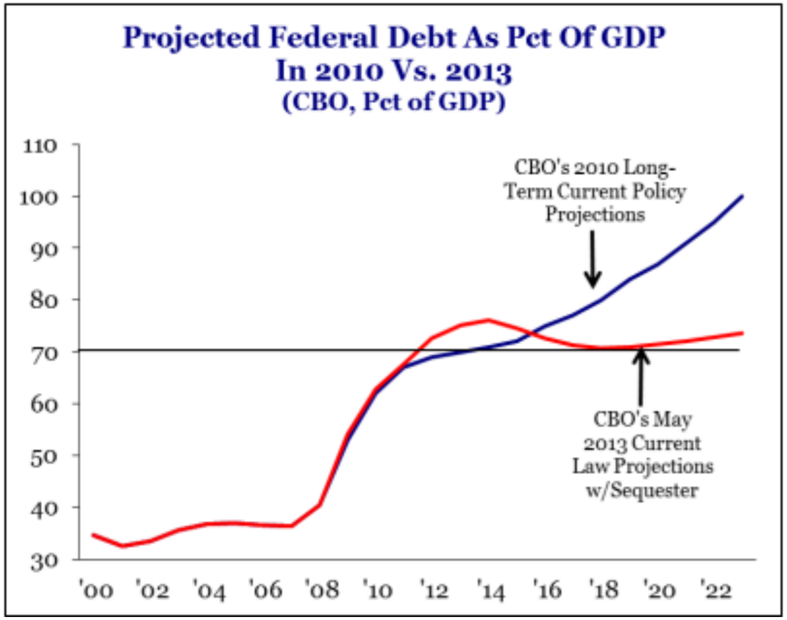
US GOVERNMENT CONCERNS TAKING A BACKSEAT

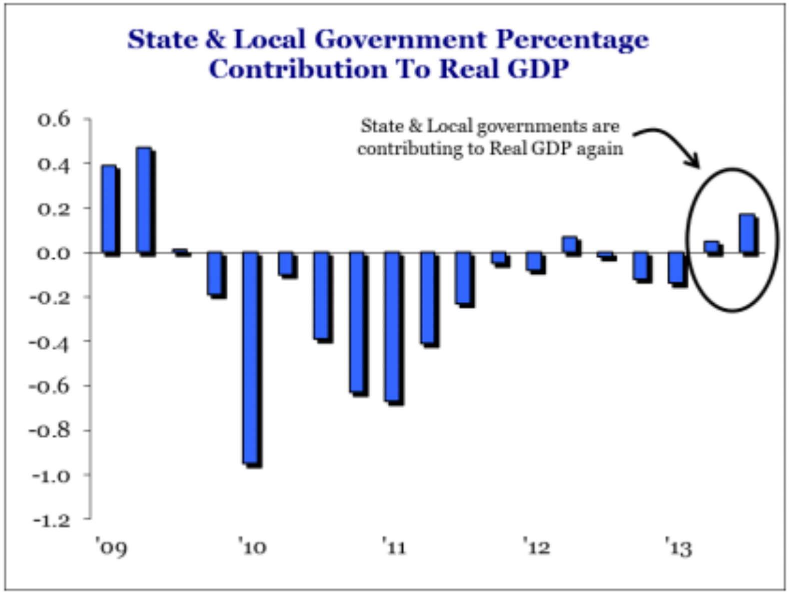
"Markets like to climb a wall of worry" as the saying goes. 2013 proved to be a perfect example as US equity multiples expanded and stocks rallied 32% despite "sequestration" budget cuts, a banking crisis in Cyprus that threatened to revive euro worries, a spike in US interest rates related to fears around change in Fed policy, sluggish 1H profit growth, and continued US government dysfunction (shutdown, ACA rollout, debt ceiling).

By the close of 2013, many of the government-related concerns were subsiding. Sequestration was replaced with a two-year budget deal to keep the government open, preventing a repeat of the 2013 closure. Federal government fiscal drag, which was 1.3% in 2013, will slow to just 0.4% in 2014. State government contributions of 0.2% will turn this to a rounding error. Improving tax receipts combined with spending cuts have stabilized US debt/GDP near 70%.

Government has played an outsized role in the economy and financial markets since 2008. While some of this involvement was required given the dire circumstances following the financial crisis, the overall impact has been to constrain consumer and corporate confidence as well as investment spending - dampening already lackluster economic growth and likely delaying recovery.

A move toward normalization of public policy and government influence in private enterprise is a positive development for the US economy and investors. **<u>We believe that stable public policy in the near term will support a better environment for corporate decision making, investment, and risk taking, leading to stronger GDP - and ultimately stronger corporate profit growth. Investors, in turn, can pay more attention to business fundamentals when making their investment decisions.</u>**





Source: Strategas

IMPROVING TRENDS IN THE "REAL" ECONOMY

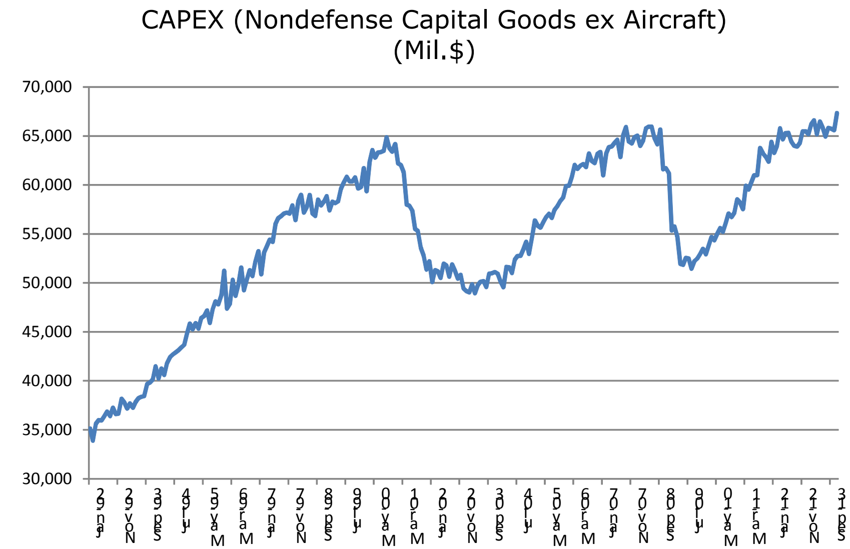
Recent economic trends are reason for optimism for 2014. Both GDP and jobs data in the US have improved and surprised to the upside. While GDP and jobs do not directly translate into corporate profit growth, they are important indicators.

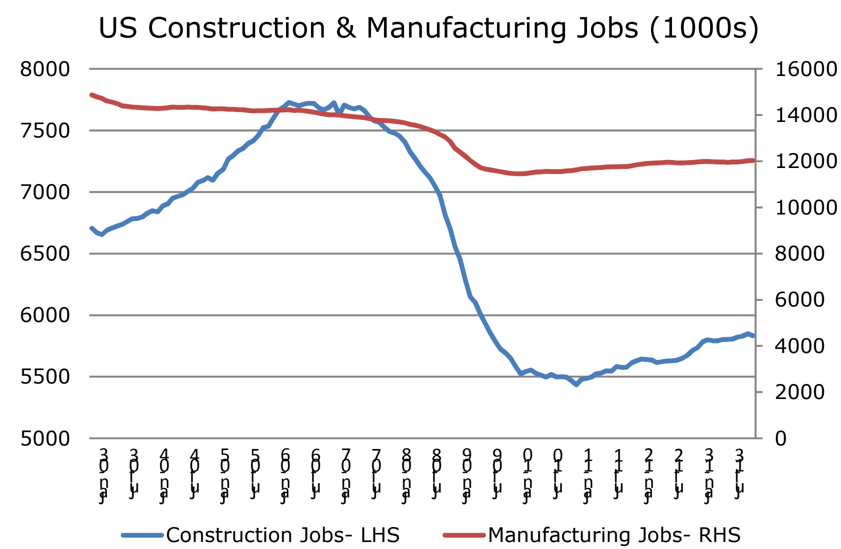
According to Bloomberg, S&P 500 companies are sitting on $3.4 trillion in cash. Although US profits have returned to record levels, much of the growth has been driven by cost-cutting and share re-purchases as recent revenue growth has been sluggish.

There are signs that companies are starting to shift to a more growth-oriented strategy. Pressure from activist investors and a desire to protect market share are two meaningful catalysts for higher capital expenditure (capex) spending. Spending in 2014 is set to accelerate from 2013's $2 trillion pace - a positive sign for long-term corporate growth.

At the same time, there is strength in two important sectors of the US economy: construction and manufacturing. Construction jobs have not yet returned to prerecession levels, but in 2013 US housing did begin to contribute to GDP growth. Construction employment peaked in January 2007 and currently stands nearly 1,900,000 jobs lower. Returning to peak levels over the next two years (nine years after the prior peak) would imply monthly job gains of 78,800 jobs from construction alone. Manufacturing job growth has two primary drivers: return of jobs from "offshoring" as labor costs have converged and the revival of the US energy industry and derivative industries such as petrochemicals.

All the above trends are long-term positive developments for US growth. Increased capex spending is a sign of CEO confidence and a driver of organic corporate profit growth. Hiring from manufacturing and construction could be an important contributor to middle-class income growth, boosting consumption and confidence. **The boost to the US economy from increased corporate investment and continued job growth sets the stage for improved income and profit growth and supports current equity valuations. We particularly favor companies that are able to drive revenue growth that supports EPS.**





Sources: Census Bureau, BLS, Strategas

FINDING VALUE IN A "MORE" EXPENSIVE NEIGHBORHOOD

A natural question for investors in US equity after a year when the S&P 500 returned 32% is whether now is still a good time to put capital to work in the region. The quick answer is that equities are still the best investment opportunity today as compared to other asset classes, and US equity in particular offers attractive returns relative to the risks elsewhere in the world for a USD-based investor.

A host of catalysts exist for years to come, including the US energy renaissance that offers margin improvement for all types of industries due to lower input costs, pent-up demand for capital expenditures, and companies flush with cash to continue buybacks, dividends, and merger and acquisition activity.

That said, valuations in US equity are as high as they have been post-crisis and have reached long-term averages in an environment where the strengthening recovery is still underpinned by meaningful support. It is important that investors remain selective in how they implement exposure to find value in a market where prices have generally risen.

In the actively managed dividend equity portfolio we manage for clients, large-cap US equities and particularly mega caps show reasonable valuations, strong balance sheets flush with cash, and above-average dividend yields with room for growth. The emphasis on growth of revenue and dividend is key for the stocks that we favor. Companies in the technology sector in particular have balance sheets, growth prospects, and valuations that are more attractive than the broader market and relative to themselves historically. We recommend maintaining this exposure. Our overweight shift to the health care sector last year worked favorably, but earnings multiples for this sector have rebounded from 13x to 16x; this is in line with the market but no longer offers the margin of safety opportunity it once had. We recommend using this exposure as a source of capital for other ideas with higher return potential.

Estimating Drivers of Return in 2014

2013	Actual TTM P/E Expansion	Est. EPS Growth	Avg. Dividend Yield	Actual 2013 Total Return
Return Driver ->	14.5x -> 17.4x			
Return Contribution	19.6%	10.7%	2.1%	32.4%
2014	**Est. TTM P/E Expansion**	**Est. EPS Growth**	**Est. Dividend Yield**	**Est. 2014 Total Return**
	17x -> 17x			
Est. Return Contribution	0.0%	6.0%	2.0%	8.0%

Sources: Edge, Bloomberg and Standard and Poors

Mega-Cap US Equity Better Value

Characteristics	S&P 50 Median	S&P 450 Median (Excludes Top 50 Names in S&P 500)
Dividend Yield (%)	2.5	1.9
Dividend Payout Ratio	28.5	29.0
TTM Margins	21.3	15.4
5yr Avg ROE (%)	18.2	12.4
Est Long Term Growth	9.9	10.8
Current Yr PE	16.9	18.3
Forward PE	15.0	16.3

Sources: Edge and Bloomberg

KEEPING EXPOSURE IN EUROPEAN EQUITY

Looking back on Europe in 2013, there was a noticeable absence. Where was the seemingly annual flare-up of sovereign crisis concerns? Even when the ill-conceived and worse-communicated strategy in Cyprus to "bail in" bad banks occurred, the financial markets hardly skipped a beat. Investors' confidence in the willingness and ability of the European Central Bank (ECB) to eventually "get it right" seems to have grown. The euro-area exiting recession (again), economic activity seemingly on the upturn, an improvement in the primary balances of troubled nations (i.e. fiscal balance before debt service), and the growing chorus of politicians swapping austerity talk for growth policies even in Germany all inspired investors to believe in a tomorrow that is in recovery.

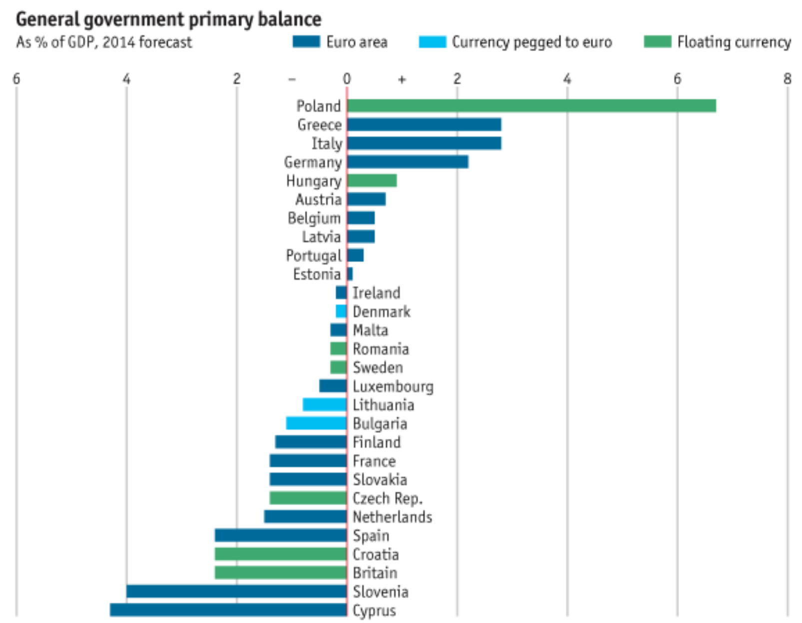
That is not to say that the euro-area problems have been solved, but progress has been made. It is likely that ECB President Mario Draghi will continue to demonstrate that they remain inclined to ease policy further in contrast to their US counterparts. Unemployment remains stubbornly high for the moment (north of 12%), access to credit especially for small and medium-sized businesses remains a concern, and there is still the distribution and amount of sovereign debt to be resolved.

In 2014, regulatory review of European bank sheets is in store. The ECB is set to take over EU bank supervision in 2014 after an Asset Quality Review (AQR). Since the last (highly criticized) stress test of banks in 2011 by the nascent European Banking Authority (EBA), continental financial institutions have raised around 80Bn EUR while also reducing their balance sheet size at the margin. The result has been an increase in the measure of their financial resilience (Core Tier 1 capital ratio) to around 11%. There is more work to be done before banks can once again help facilitate the much needed credit creation in the region, but the progress is positive.

In equities, it is important to note that earnings on the MSCI Europe index remain approximately 27% below 2007 levels and even 3% lower than the last 2011 peak before the double-dip. European earnings have historically exhibited more volatility than US earnings. In the context of our view of an economically stabilizing region with increasingly supportive fiscal and monetary policy, we see earnings growth potential over the next few years as higher than that of the US as profitability reverts toward trend.

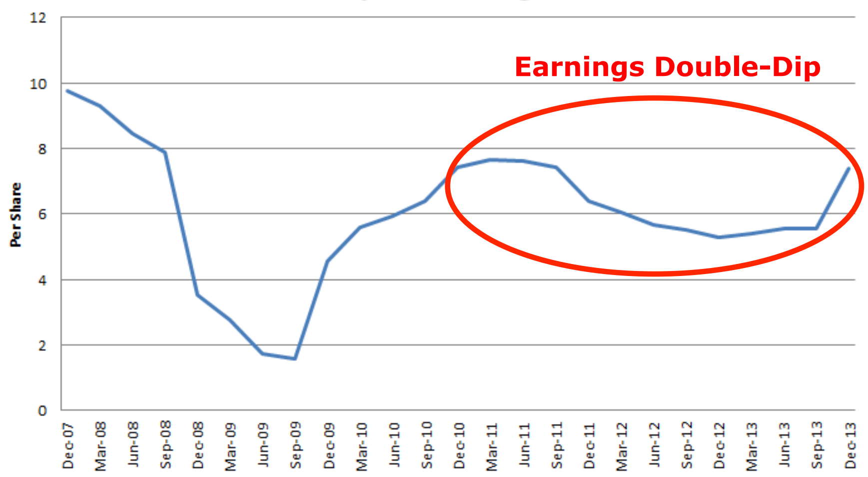
Over the next three years, the combination of low valuation and a decent dividend yield presents a higher total return in Europe than in the US. The higher return expectation is balanced by a higher risk and the potential that currency translation back to the US dollar can be a detractor, but we recommend reducing an overweight US allocation toward the European valuation opportunity.

European Sovereign Fiscal Balance Improved



Sources: European Commission, Economist

MSCI Europe Earnings 2007 to current



Source: Bloomberg

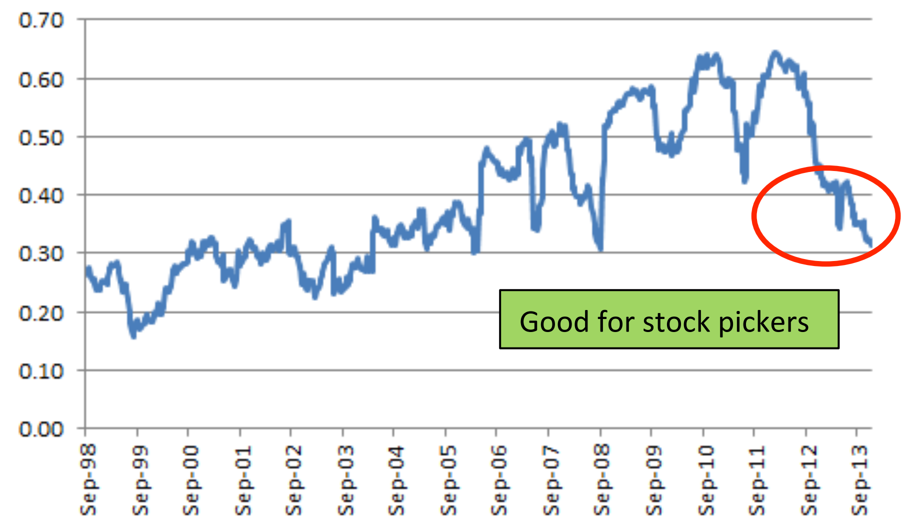
IMPROVING FUNDAMENTALS IN ASIA; MACRO HEADWINDS PERSIST

Ten percent is the answer. The question? How much have developed markets (MSCI World) outperformed emerging Asia (MSCI Asia ex-Japan) annualized over the three years ending 2013? Aside from a strong 2012 showing, emerging markets (including Asia) have investors questioning their allocation decisions and their long-term views on the region. We caution investors not to form their opinion on index-based returns. Poor index construction, including lumpy sector allocations and stock weightings, continue to blur the better opportunity sets across emerging markets. For those reasons, we have been strong advocates of active management in Asia (and Latam) and specifically China. To provide an example of the magnitude of outperformance offered by active managers in China, two of our preferred implementation options generated positive, mid-teens returns in 2013, which compares to the local Shanghai index return of -4%. **We continue to believe that Asia offers one of the best opportunity sets for active managers to add value relative to their respective benchmarks and deliver strong absolute returns in the long term.**

We upgraded our view on emerging markets (driven by Asia) in our Q1 2013 quarterly outlook, and our upgrade was based on increasing evidence that the Chinese economy was strengthening and the odds of a hard economic landing were diminishing. In hindsight the conclusion was sound - China GDP bottomed during the second quarter and appears to have stabilized within a range of 7.5% to 8% for the year (2014 estimates are for 7.6% growth). We also believed that new leadership in China would announce the much needed reforms capable of transitioning the world's second largest economy into its next phase. This assumption also appears to be valid as indicated by announced policy decisions from the Third Plenum (a meeting of China's Central Committee) held in November. We admit to a strong difference between policy announcement and implementation, but it appears, at a minimum, that the intentions are strong.

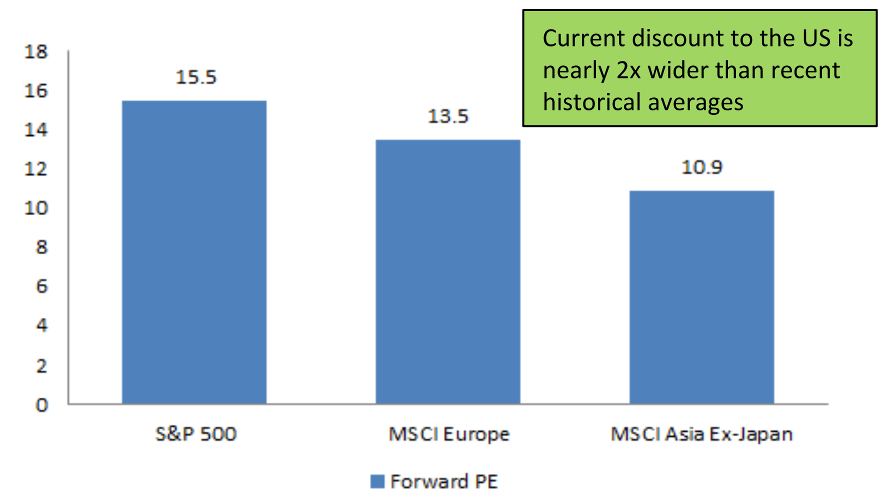
A stable China is also good for the broader Asia region, as is a rebound in developed country economic growth, mainly the US and Europe. In recent quarters, earnings growth has begun to accelerate in Asia (using the MSCI Asia ex-Japan Index as a proxy), which, given the attractiveness of valuations, should bode well for future returns. Although we expect macro headwinds to persist in the near term, **we find it difficult to dismiss Asia at a time when developed market GDP growth is accelerating, local valuations are attractive, earnings growth is beginning to improve, and China's leadership is in the early innings of critical reform. For these reasons, we recommend investors maintain their exposure to select emerging markets.**

Emerging market correlations continue to move lower



Source: Strategas

Asia trades at a steep discount to developed markets



Source: Bloomberg, as of January 2014

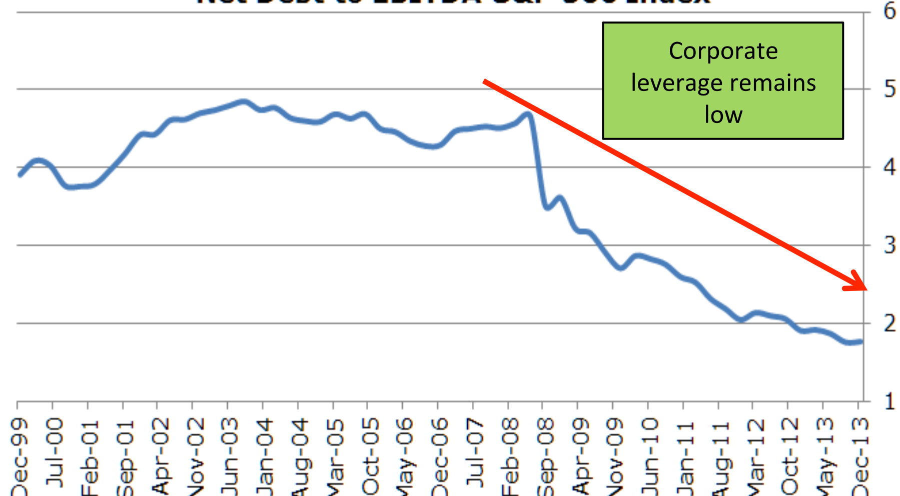
THINGS ARE LOOKING UP FOR INTEREST RATES

With the Fed deciding to commence tapering of Treasuries and Agency mortgages in December, it seems likely that the long-term trend in interest rates is upward. While we cannot forecast with certainty the rate at which they will increase, we do know that it is probably a bad idea to be invested in long-duration bonds over this period. The Fed has made clear their intention to anchor the short end of the yield curve, providing some certainty for investors in fixed income securities for the near term. There are no magic bullets for investors in a rising rate environment, but the one silver lining is that higher yields can provide a better environment to invest in fixed income securities in the future. **Expectations need to be tempered for investors in fixed income. Returns in the low-to-mid single digits, absent any extenuating circumstances, will be the normal for the next few years.**

With the Fed buying fewer and fewer Treasuries and Agency mortgages, we believe that investors need to be leaning more toward the corporate credit side of the market. Corporate fundamentals continue to be very strong, as corporate executives have not forgotten the bitter taste of the financial crisis. Companies continue to have healthy balance sheets with large amounts of cash on the sidelines. Also, the improving growth potential for the US economy helps increase top-line growth for corporate profits. **We continue to recommend selective corporate debt until leverage ratios exceed recent averages or until higher rates hamper the ability of companies to refinance debt.**

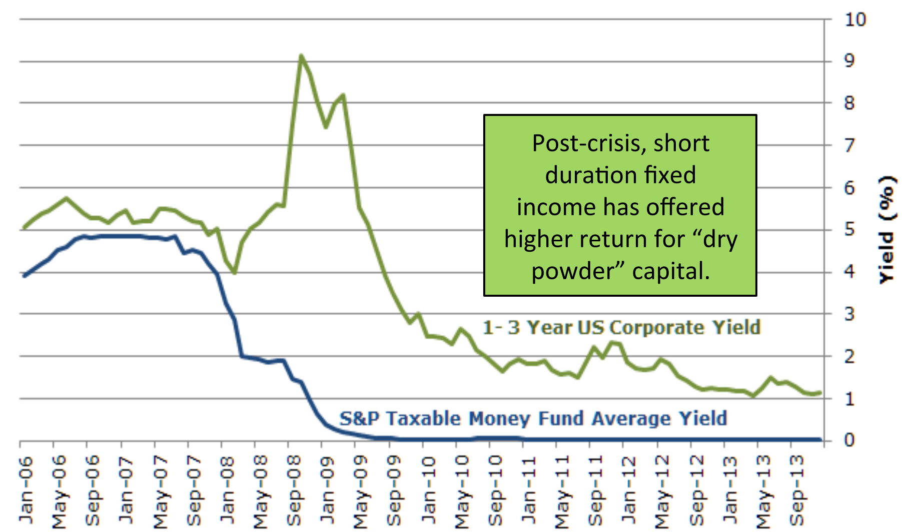
When assessing the tool kit for fixed income securities, we look for investments that have some of the following characteristics: short duration (providing fast reinvestment opportunities), floating rate (providing less rate sensitivity), lower credit quality (providing a greater spread buffer), and credits providing an illiquidity premium. It is always important to remind yourself of the role fixed income plays in your portfolio. **For investors who have the ability to take on more equity risk, it might be the proper time to increase allocations to equities. Money market reform has made holding cash a difficult investment choice. For investors who see fixed income as a store of dry powder, we recommend staying in short-term corporate debt. Investors who do not want full equity risk but seek a higher relative return can allocate money to lower credit quality, private debt, or even long-short fixed income.** Despite the headline coverage municipals have been receiving lately, separately managed municipal portfolios can provide customized investment solutions and added tax benefits for investors willing to forgo some liquidity.

Net Debt to EBITDA S&P 500 Index



Source: Bloomberg

Cash Can Be Costly



Sources: Bloomberg and BofAML Indices

ENERGY OPPORTUNITY SET IS INTACT, BUT REMAIN NIMBLE

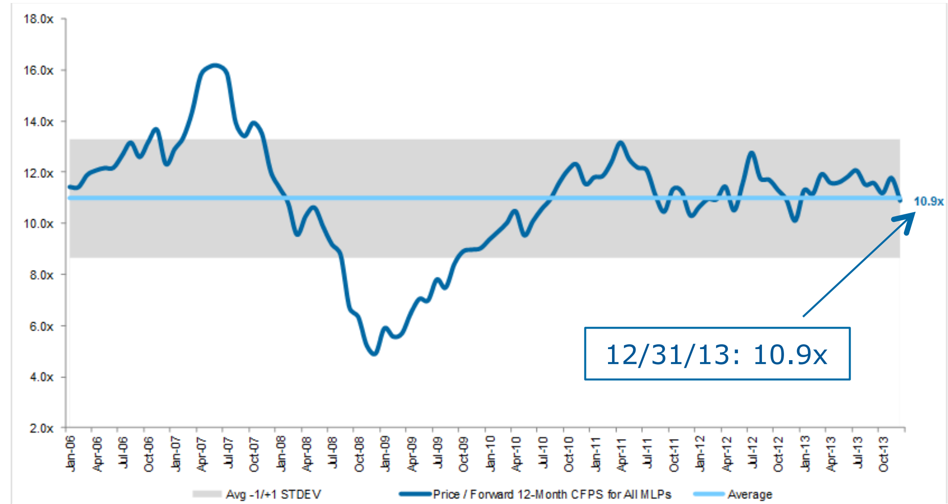
Unlike REITs as another high-yielding real asset sector, 2013 was a strong performance year for Master Limited Partnerships (Alerian Index +27.6%). Similar to equities, multiple expansion largely accounted for the move. The valuation of the MLP universe is fair to slightly above long-term averages, depending on the metric used. Index-wide MLP price/discounted cash flow has pulled back just below longer-term averages while valuation on an Enterprise Value/EBITDA basis is more expensive and slightly above long-term averages. The drop in distribution yield to approximately 6% on the Alerian is nearly 100 BPS below the long-term average and the rate spread compared to US Treasuries is below longer-term averages of 3.7%.

While the margin of safety has been reduced over the past year, there are still a number of reasons to hold targeted exposure and to expect equity-like returns in MLPs, including record setting debt and equity capital raises in excess of $70B to fund future investment, record setting capital deployed in projects exceeding $30B in 2013, capital flow from investors topping historical flows due to MLP relative distribution yield, cost of capital for capex at historically low levels averaging just over 7.7%, and dividend coverage remaining strong with future distribution growth expected at 6-8% in 2014.

Performance divergence in the MLP sector was significant in 2013 with the median performance of top 10 MLPs up 88% while the bottom 10 were down 32%. **In 2013, active managers hired by Edge saw significant outperformance compared to the Alerian Index. Company and sector selectively, volume differential across shales suggest more tailored portfolio construction, and geographical exposures become increasingly important as logistical alternatives such as rail and shipping become more established.**

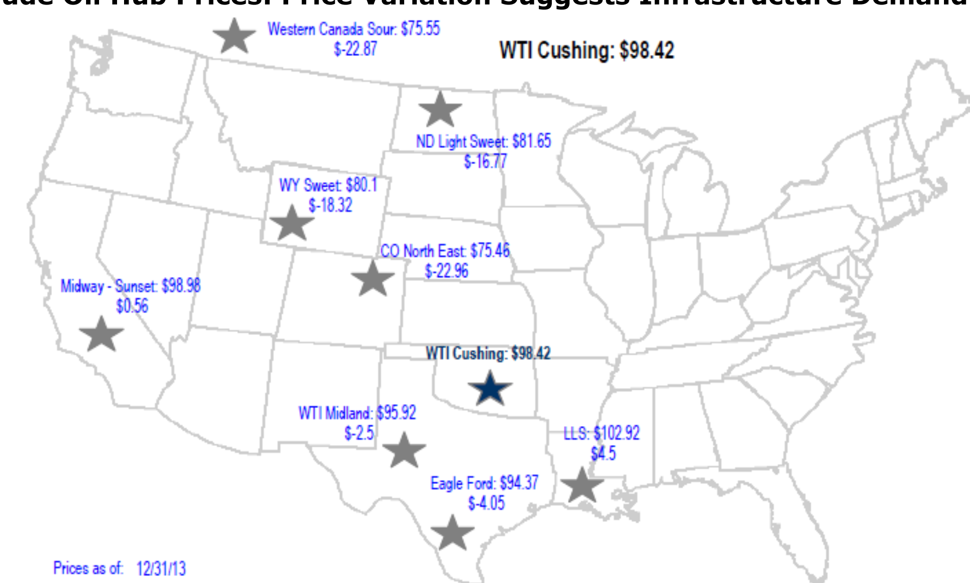
Where appropriate, we suggest diversifying some exposure toward equity alternatives to energy infrastructure. With the S&P Energy sector trading at a 14% discount to the 2014 forward P/E of the broader market and the prospect of US energy independence by the end of this decade, **we identified an active manager whose portfolio will potentially benefit from the increase in US oil and gas production in conjunction with the broader value chain impact on petrochemical, transportation, storage, and manufacturing sectors that are set to benefit from lower sustained energy input costs.**

MLP Valuation Fair over Longer Time Frame: Price / Forward Cash Flow for All Master Limited Partnerships



Source: Swank Capital

Crude Oil Hub Prices: Price Variation Suggests Infrastructure Demand



Source: Credit Suisse Research

APPENDIX

Market Performance

Index	October	November	December	Total Return Q4-13	2013	2012	2011	2010	Trailing (annualized) 3yr	5yr	10yr
DOMESTIC EQUITY											
S&P 500	4.6%	3.0%	2.5%	5.2%	32.4%	16.0%	2.1%	15.1%	16.2%	17.9%	7.4%
DOW JONES INDUSTRIAL	2.9%	3.8%	3.2%	2.1%	29.7%	10.2%	8.4%	14.1%	15.7%	16.7%	7.4%
NASDAQ	4.0%	3.8%	3.0%	11.2%	40.2%	17.7%	-0.8%	18.1%	17.8%	23.0%	8.8%
S&P 400 Midcap	3.7%	1.3%	3.1%	7.5%	33.5%	17.8%	-1.7%	26.6%	15.6%	21.8%	10.3%
RUSSELL 2000 INDEX	2.5%	4.0%	2.0%	10.2%	38.8%	16.4%	-4.2%	26.8%	15.7%	20.1%	9.0%
RUSSELL 3000 INDEX	4.2%	2.9%	2.6%	6.3%	33.6%	16.4%	1.0%	16.9%	16.2%	18.7%	7.9%
ALERIAN INDEX	2.7%	0.9%	1.6%	-0.7%	27.6%	4.8%	13.9%	35.6%	15.0%	29.4%	14.9%
INTERNATIONAL EQUITY											
MSCI AC World (ACWI)	4.0%	1.5%	1.8%	8.1%	23.5%	17.0%	-6.8%	13.4%	10.4%	15.7%	7.9%
MSCI EAFE	3.4%	0.8%	1.5%	11.7%	23.6%	18.1%	-11.6%	8.4%	8.9%	13.2%	7.7%
MSCI EM	4.9%	-1.5%	-1.4%	5.9%	-2.4%	18.7%	-18.2%	19.4%	-1.8%	15.1%	11.5%
MSCI EMEA	5.2%	-3.8%	-1.0%	9.5%	-4.7%	22.4%	-20.2%	23.8%	-2.4%	14.1%	10.4%
DJ Stoxx 50	6.7%	0.7%	2.4%	16.1%	28.2%	21.8%	-15.7%	-8.4%	9.6%	9.5%	6.3%
FTSE 100 INDEX	3.5%	1.1%	2.9%	11.9%	21.6%	15.8%	-2.1%	9.1%	11.3%	16.3%	7.8%
NIKKEI 225	-1.0%	4.9%	1.5%	7.6%	30.5%	12.4%	-10.4%	11.5%	9.5%	11.7%	6.1%
HANG SENG INDEX	1.7%	3.0%	-2.4%	10.7%	6.5%	27.7%	-17.3%	8.3%	4.0%	13.8%	10.0%
SHANGHAI SE COMPOSITE	-1.1%	3.7%	-4.1%	11.4%	-1.0%	6.9%	-16.5%	-9.7%	-4.0%	7.8%	8.8%
BRAZIL BOVESPA INDEX	3.2%	-7.4%	-3.0%	10.1%	-26.8%	-2.0%	-27.1%	5.9%	-19.4%	6.3%	11.0%
MSCI BRAZIL SMALLCAP	-0.5%	-7.5%	-1.8%	2.6%	-26.0%	29.5%	-24.0%	43.1%	-10.0%	29.5%	NA
S&P SECTOR BREAKDOWN											
S&P 500 ENERGY INDEX	4.2%	0.9%	3.1%	5.2%	25.0%	4.6%	4.7%	20.4%	11.0%	13.4%	13.5%
S&P 500 MATERIALS INDEX	4.2%	1.3%	4.8%	10.3%	25.6%	15.0%	-9.8%	22.2%	9.2%	18.8%	8.2%
S&P 500 INDUSTRIALS IDX	5.1%	3.6%	4.2%	8.9%	40.6%	15.3%	-0.6%	26.7%	17.2%	19.8%	8.5%
S&P 500 CONS DISCRET IDX	4.7%	3.5%	2.3%	7.8%	43.1%	23.9%	6.1%	27.7%	23.4%	27.7%	9.4%
S&P 500 CONS STAPLES IDX	6.4%	1.6%	0.6%	0.8%	26.1%	10.8%	14.0%	14.1%	16.8%	15.9%	9.9%
S&P 500 FINANCIALS INDEX	3.3%	4.6%	2.1%	2.9%	35.6%	28.7%	-17.1%	12.1%	13.1%	13.7%	-0.3%
S&P 500 HEALTH CARE IDX	4.3%	4.7%	0.8%	6.8%	41.5%	17.9%	12.7%	2.9%	23.4%	18.3%	8.3%
S&P 500 INFO TECH INDEX	4.6%	4.0%	4.1%	6.6%	28.4%	14.8%	2.4%	10.2%	14.7%	21.9%	7.2%
S&P 500 TELECOMM SVCS IX	8.5%	-2.5%	-0.3%	-4.4%	11.5%	18.3%	6.3%	19.0%	11.9%	12.7%	8.1%
S&P 500 UTILITIES INDEX	3.8%	-1.9%	0.9%	0.2%	13.2%	1.3%	19.9%	5.5%	11.2%	10.2%	9.2%
FIXED INCOME											
US TREASURY BILLS	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.2%			
US TREASURY MASTER	0.5%	-0.4%	-1.0%	-0.9%	-3.4%	2.2%	9.8%	5.9%			
US MUNICIPAL 3-5 YEAR	0.9%	0.1%	-0.2%	0.8%	1.4%	2.4%	5.4%	2.5%			
US BROAD CORPORATE	1.5%	-0.3%	-0.2%	1.0%	-1.5%	10.4%	7.5%	9.5%			
GLOBAL BROAD MKT CORP	1.4%	-0.1%	-0.3%	0.9%	0.1%	11.0%	4.5%	6.0%			
US HIGH YIELD	2.5%	0.5%	0.5%	3.5%	7.4%	15.6%	4.4%	15.2%			

All performance data quoted in USD and includes dividends

Source: Bloomberg

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