BIAS Global Navigator

PORTFOLIO MANAGERS SECURITIES ANALYSTS June 2013

Starbucks . . .
TO INFINITY AND BEYOND!

After 40 years of developing one of the most well-known brands in the world, Starbucks continues to expand around the globe. Starbucks, however, has more than just proliferation of stores on their list of goals.

From a small beginning of one store in the state of Washington in 1971, Starbucks now has 11,000 stores in the United States and 6,000 stores in international markets. As a mature company, Starbucks' revenue growth is still outpacing its industry peers by an average 2.7% annually, with their most recently posted sales for the first quarter 2013 up 11.3 percent. In early 2011, the company quietly dropped the "Starbucks Coffee" appendage from their logo as their wider plans are to push beyond just coffee.

That means Starbucks plan to both broaden their product lines and extend their global reach.

In Atlanta and Austin, the company is now experimenting with handcrafted soda made with a carbonation machine. They are looking for ways to drive slow mid-afternoon business by providing a new type of beverage experience for the customer with perhaps a fizzy lemonade, spiced root beer or ginger ale.

In late 2012, the company made two large purchases: La Boulange and Teavana. La Boulange is a San Francisco based bakery/café operator who will roll out new food offerings in Starbucks' stores nationally over the next year. The company's long term goal is to increase food sales from approximately 14% today to 30% of sales.

The cash purchase of Teavana Holdings for $620 million is Starbucks' largest acquisition. The Teavana stores are mainly "mall based" emporiums of bulk and single serve tea. Tea is a $40 billion US category with greater profitability than coffee. It is expected to deliver immediate synergies to the predominantly coffee based stores of today.

The greatest challenges and opportunities are in China where Starbucks cafes are more profitable than in the United States but sales per store lag. The company's two largest challenges are affordability and satisfying a tea drinking culture.

The upper class in China represents one percent of the population or approximately 13 million people, while the urban middle class is close to 330 million, almost the population of the entire United States, but they cannot afford Starbucks products on a regular basis. For example, a cup of green tea latte costs nearly $5 or 15% of daily wages. Starbucks entered China in 1998 but stayed true to their coffee centric business. The company now realizes they must create a business model in China that understands the customer. As such, they plan to leverage the "tea expertise" they acquired through Teavana to better position their business as beverage cafes versus coffee only cafes.

Starbucks operates more than 700 stores across the Southeast Asian markets including Indonesia, Malaysia, the Philippines, Singapore, Thailand and most recently, Vietnam.

Starbucks wants to become one of the world's

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Starbucks (Continued from Page 1)

most respected, admired, and enduring brands. The company claims a core value of investing in their people and the communities they serve. Starbucks believes their success is linked to the success of the farmers and suppliers who grow and produce their products. In 2013, Fortune Magazine recognized them as the fifth most admired company in the world.

We recently bought Starbucks shares in the BIAS Global Equities Fund and the BIAS Global Balanced Fund.

The Fed Model Revisited

We believe stocks remain a better value than bonds and being overweight equities is the right decision. As proof of our view, we decided to revisit the Fed Model to confirm our belief.

In past Quarterly Market Briefings BIAS has shown how cheap equities are valued relative to bonds. Our favoured example is the Fed model that attempts to show relative attractiveness between stocks and bonds. The calculation is:

Ten Year T-Note Yield Minus S&P Earnings Yield

(Earnings Yield is the S&P 500 earnings/S&P 500 Price)

The Fed Model data as of June 28th, 2013 was:	
10 Year US Treasury Yield	2.49%
S&P 500 Earnings	$110.00
S&P 500 Price	1606.28

When this relationship is greater than negative three, stocks are cheap relative to bonds. When greater than positive 3, bonds are cheaper than stocks. Using this measure, stocks remain cheap as shown in the graph below.

Ten Year Treasury Bond Yield Minus S&P 500 Earnings Yield

(June 28th, 3013)

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What Happens After the Fed Tapers?

Mark Twain wrote that "History rarely repeats, but it does rhyme." That statement is certainly appropriate when the current Fed interest rate policy is viewed through the lens of history. While asset purchases, now termed Quantitative Easing (QE), is considered a novel approach to the financial crisis, the US Governement has employed this tool before. Given recent Fed statements regarding the reduction in the amount of planned bond purchases later this year and the resulting sharp rise in Treasury yields, we went in search of historical parallels to frame our analysis about the end of Fed intervention and we found a useful precedent.

Between 1942 and 1951 the Fed embarked on a policy to hold interest rates down. To accomplish this, the Fed purchased Treasuries (Quantitative Easing), increasing the Fed's holdings from two to seven percent of GDP to as much as 11 percent in 1945. Today, the Fed's Treasury holdings are around 12 percent, up from about three percent in 2008, and just like in the 1940s, the Fed's increase in Treasury holdings via QE have pushed yields artificially lower – making the Treasury's financing less expensive.

This is the rest of the story: When the Fed began to reduce asset purchases in 1951, the yield on long-term Treasuries did not spike up. In fact, it held below three percent for more than two years for a number of reasons:

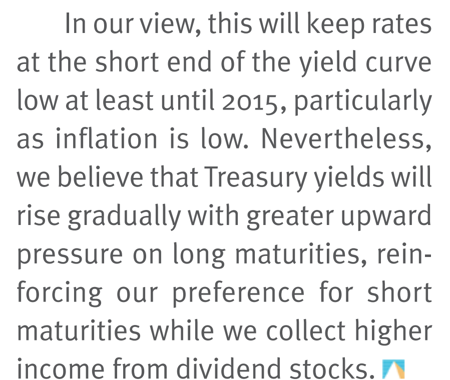
- The Fed did not liquidate its bond holdings, so there was no sudden increase of Treasury supply on the market even as purchases slowed.
- The Fed conducted open market transactions with a view to "maintaining orderly conditions in the Government security market."

The Fed has said it will not abruptly stop purchasing bonds in the market, but will gradually reduce purchases.

- The discount rates of the Federal Reserve Banks were held at 1.75 percent until January 1953 and did not exceed two percent until the fall of 1955.

Given that past is prologue, we believe there are important parallels here regarding today's tapering of QE, specifically:

- The Fed, in order to maintain an orderly market, is unlikely to sell its holdings of Treasuries until several years after it has hiked the Fed Funds Rate.
- The Fed has said it will not abruptly stop purchasing bonds in the market but will gradually reduce purchases.
- Finally, the Fed is unlikely to raise the Fed Funds Rate until unconventional monetary easing (QE) is scaled back.



In our view, this will keep rates at the short end of the yield curve low at least until 2015, particularly as inflation is low. Nevertheless, we believe that Treasury yields will rise gradually with greater upward pressure on long maturities, reinforcing our preference for short maturities while we collect higher income from dividend stocks.

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Performance (as at 30th June 2013)

Short Duration Income Fund
Risk: low ■ □ □ □ □ high

Benchmark: Citigroup 1-3yr Treas Index
Inception Date: December 29, 2006

Performance	Q2/13	1-Year	2-Year (Annualized)	3-Year (Annualized)	Since Incept. (Annualized)
Short Duration Fund	-0.66%	-0.45%	-0.67%	0.22%	1.67%
Benchmark	-0.09%	0.35%	0.56%	0.80%	2.85%

Global Balanced Fund
Risk: low □ ■ □ □ □ high

Benchmark:* Blended Composite†
Inception Date: December 29, 2006

Performance	Q2/13	1-Year	2-Year (Annualized)	3-Year (Annualized)	Since Incept. (Annualized)
Balanced Fund	-2.08%	4.13%	-0.63%	4.86%	1.09%
Benchmark	-0.48%	9.09%	2.92%	7.55%	2.21%

Global Dividend Income Fund
Risk: low □ □ ■ □ □ high

Benchmark: S&P Global 1200 Index
Inception Date: September 28, 2012

Performance	Q2/13	1-Year	2-Year (Annualized)	3-Year (Annualized)	Since Incept. (Annualized)
Dividend Fund	-3.79%	—	—	—	0.33%
GDI Total Return	-2.78%	—	—	—	1.38%
Benchmark	-0.19%	—	—	—	8.79%

Global Equities Fund
Risk: low □ □ □ ■ □ high

Benchmark:* S&P Global 1200 Index
Inception Date: December 29, 2006

Performance	Q2/13	1-Year	2-Year (Annualized)	3-Year (Annualized)	Since Incept. (Annualized)
Equities Fund	-2.24%	6.65%	-1.85%	5.61%	-1.60%
Benchmark	-0.19%	15.47%	3.08%	10.79%	-0.20%

*Prior to April 1, 2012 benchmark was FTSE World Equity Index. † 60% S&P Global 1200 Index/ 20% Citigroup 1-3Yr Treas. Index/ 20% Citigroup 3-7 Yr Treas. Index

Management Commentary

Equities Q2 2013

Global equity markets were on a fast track to impressive year-to-date performance rising more than 13 percent until May 22 when FOMC minutes indicated some Fed Governors were prepared to reduce QE. Investors reacted by selling bonds and stocks. The result was that the S&P 1200 Global index finished the quarter flat. US equities advanced almost three percent as measured by the S&P 500 while Japan's NIKKEI advanced over four percent in US dollar terms. Sectors that led were Consumer Discretionary, Health Care, and Finance.

Currencies Q2 2013

The US dollar advanced against most major currencies after Fed Chairman Bernanke made the case for reducing monetary stimulus as the economy improves, sparking declines in commodity based and emerging market currencies. The Australian dollar weakened over 12 percent against the greenback in the quarter due to Bernanke's comments and an unexpected interest rate cut by the Reserve Bank of Australia. The euro appreciated slightly against the dollar as the troubled peripheral nations' situations stabilized. The yen weakened for another quarter, giving Japan's Prime Minister Abe a symbolic victory for his easy monetary policies.

Fixed Income Q2 2013

The Treasury market had a volatile second quarter as 10-year bond yields rose to 2.4 percent after declining to 1.65 percent earlier. Fears that the Fed would slow asset purchases later in 2013 drove the price declines. Overseas, the ECB cut the benchmark rate to a record low citing weak economic growth, but longer-maturity yields in the region moved higher as a consequence of events in the US. Canadian yields rose in line with US Treasuries despite weak domestic economic data. Corporate bonds underperformed Treasuries as fund outflows overwhelmed parts of the credit market.

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