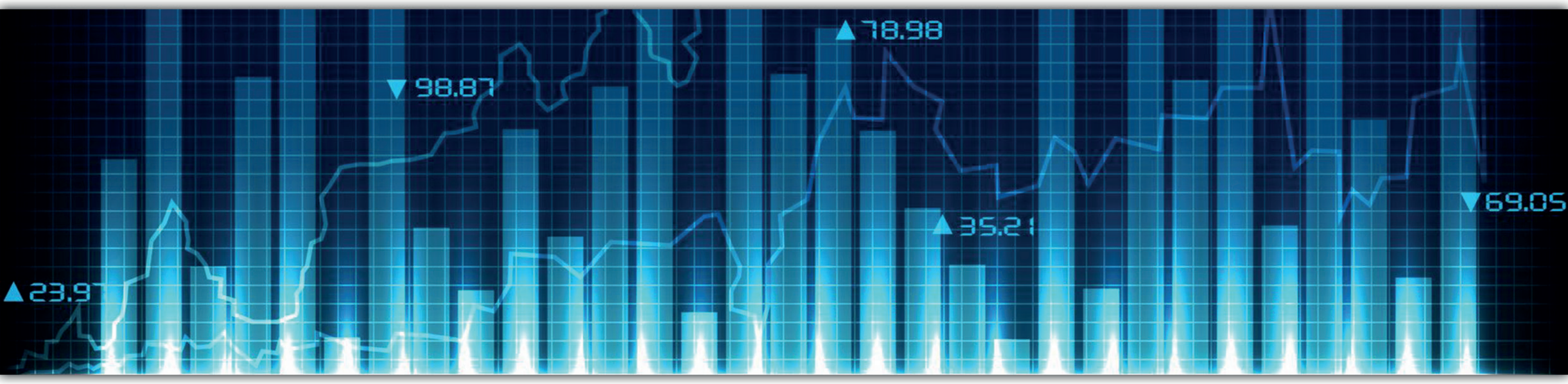

Ben Bernanke: No Tapering! - Just a play for time?

Investors continuously ask themselves where to invest and when is the best time to enter the markets. Risk is always a major consideration and over the last 30 years, investors have become accustomed to the idea that governmental bonds are safe. Governmental bonds were very attractive due to their steady and predictable returns, but does this still hold true in the current environment? Bonds have rallied in the recent years as very low interest rates make bonds attractive assets thereby pushing up bond prices and reducing the actual yield. Figure 1 shows 10 year US treasury yields development over the past 5 years. Figure 2 shows the corresponding price of 10 year US treasuries falling over the same period. This shows the inverse relationship of bond price and yield.

Every investor should think about the following: What will happen when the US Federal Reserve (American central bank), the Bank of England or the Bank of Japan would stop, or just reduces its monetary stimulus? This summer has shown that markets have started to price in an increase in interest rates. **This would mean the beginning of the end of ultra-low interest rates.** This would lead to major losses for investors holding government bonds, but also for pensioners and government workers, as inflation will likely exceed wage increases. However, it also means an increased risk of principal repayment at bond maturity.

Any increase in interest rates is highly likely to put additional pressure on companies, municipalities

Figure1: 10 Year US Treasury Yields Development

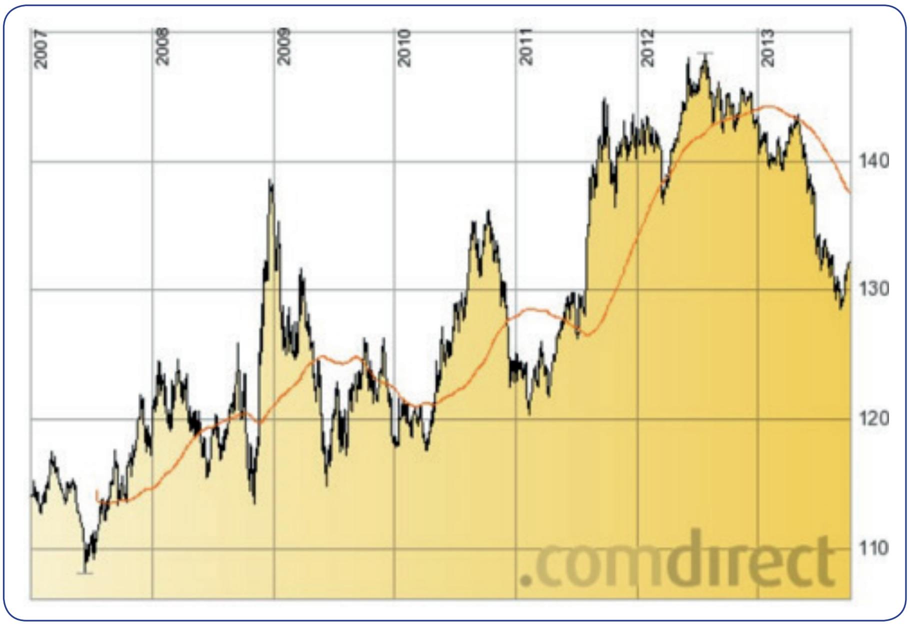

Figure 2: 10 Year US Treasury Price Development

SHORELINE

and states as refinancing costs rise dramatically. Major defaults could result and the bankruptcy case of Detroit might just be the start.

Alarming signs are out there already. Big fund managers like Blackrock and the Norwegian sovereign wealth fund[1] are reducing their investments in US Treasuries and UK Gilts. Other major bond investors like PIMCO are making big losses due to write-downs on bond values.[2]

The Fed funds futures index, an indicator for future interest rate changes[3], are rising steadily and the August 2016 contract is bearing an interest rate above 2%. The current Fed funds rate is slightly below 0.5%, meaning that the Fed could start raising interest rates mid-2014 or latest end 2014.[4]

One can see in the chart that yields on US treasuries have risen quickly since May (Figure 3). Rates of 1.6% in May 2013 rose to 3% by the beginning of September 2013 almost doubling the yield. For US government bonds this is a remarkable move and shows how cautious investors have become about investing in US Treasuries.

Another important event took place on 18th of September. Despite wide-spread market sentiment, the Federal Reserve chairman Ben Bernanke announced a continuation of its US$85bn per month bond-buying program. The immediate reaction was a weaker dollar, a rally on global stock markets and a drop in yields on US treasuries.

We believe that this is a play for time by the Fed. The inevitable reduction in bond buying will have to happen eventually. Therefore we believe that the latest market moves can be seen as a good moment to reallocate assets, away from bonds. Our research suggests rising yields and falling bond prices in the future.

Investors, as well as Financial Advisors, have to address this fundamental change in their portfolio construction and hold positions that are likely to profit from these changes. Shoreline is taking action to prepare clients' portfolios for this major shift and to add value. Our investment management team is researching the market to identify new investment ideas for a changing environment. For further assistance, please do not hesitate to contact us.

Figure3: 10 Year US Treasury Yields Development

---

[1] Norwegian Government Pension Fund Global Annual Report 2012
http://www.nbim.no/Global/Reports/2012/Annual%20report/Annual%20report%2012.pdf

[2] Pimco Total Return Fund Lost 14% of Assets in Four Months
http://www.bloomberg.com/news/2013-09-04/pimco-total-return-fund-lost-14-of-assets-in-four-months.html

[3] Description of Funds Rate
http://www.clevelandfed.org/research/data/fedfunds/faq.cfm

[4] Fed funds futures are back with Bernanke unease
http://www.marketwatch.com/story/fed-funds-futures-are-back-with-bernanke-unease-2013-09-06