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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in Highly Predictable Global Patterns

ALEXANDER B. MILES is the Co-Founding Partner and Chief Investment Officer of Kingfisher Capital. He serves as Portfolio Manager for the firm's flagship Kingfisher Global Tactical Series, and he has served as Manager for alternative investment funds with a focus on water, sustainability and the water-energy-agriculture nexus. Kingfisher provides global, multiasset investment management for high net worth individuals, family offices, foundations and bank and adviser platforms, investing primarily in publicly traded equity, debt and commodities markets. Mr. Miles' career has spanned several investment firms including Lehman Brothers and the Myers Limited Partnerships. He was educated at Colgate University and Emory University before receiving his MBA with a concentration in investment management and sustainable enterprise from the University of North Carolina at Chapel Hill. He also serves as a Board Officer and the Water Program Champion for Envision Charlotte, a unique public-private collaboration that provides a global model of urban environmental sustainability for measurable community and economic results.

SECTOR — GENERAL INVESTING

TWST: If you would, start by telling our readers a bit about Kingfisher Capital.

Mr. Miles: Kingfisher Capital is a globally focused investment management boutique headquartered in Charlotte. Our roots go back to 1989, when our legacy companies consisted of a long/short hedge fund and a long-only, primarily value-oriented blue chip stock and municipal bond portfolio strategy. Those two complementary investment offerings were married to deliver solutions to high net worth clients throughout much of the 1990s and into the first part of the last decade.

I was originally recruited to the firm's hedge fund to work with our Chief Investment Officer as an Analyst and also package our fund for the family office market in midtown Manhattan. Towards the end of 2003, I took over as Chief Investment Officer for the Registered Investment Adviser and began implementing a global approach to managing the firm's assets. At that time, we were going through a business transition with a retiring Founding Partner, and we retooled the RIA side of the business to focus on what is now more commonly described as global tactical and multiasset allocation strategies to complement our core stock and bond investments.

At that time, my investment worldview was more attracted to emerging global opportunities. By the late 1990s, I felt that the 50-year post-World War II era — in which Western economies rapidly industrialized while dramatically expanding credit and benefiting from sustained access to very cheap energy and resources — was reaching critical limits. Our untethered ability to expand credit to subsidize consumption was reaching an end, and that was about the same time that we were seeing a demand shift in parts of the developing world, bringing new pockets of Western-style consumerism to the global market, along with a voracious appetite for industrial and energy commodities to feed infrastructure construction. At that time, we were also seeing dramatic innovation in financial markets, making it possible for many more investors to access global markets, international markets and emerging markets. The Internet, electronic trading, research platforms such as Bloomberg created scope and scale for investors. And for U.S. investors, who in most cases had very little exposure to emerging opportunities in the rest of the world, we felt that it was time to develop thought leadership in global, multiasset investing by creating more of a global platform for our investor base.

TWST: Describe further your investment philosophy. You have a term you use, "gravity investing."

Mr. Miles: Gravity investing is essentially a thematic overlay that we employ within our portfolio research that seeks to observe and exploit trends in the global economic and social landscapes which we think are leading to seemingly unavoidable and highly predictable outcomes. We liken the predictability of some of these story arcs to essentially that of dropping a brick out of a two-story window. Unless some outside force really comes out and interrupts or influences in a very dramatic way the trajectory of that brick, that brick is going to hit the ground. And there are a number of story arcs in the global economy that we think are suggesting unavoidable or highly predictable outcomes that will drive capital flows and investment for years to come. Some of these key themes have become more evident today, as the world has evolved. But when we began circulating these ideas in 2004, they were pretty innovative.

One such example is the urban migration trend, where we see people from the rural developing and rural developed world moving into cities where they can engage in commerce and access a broader range of goods and services. We call that "moving to the aqueduct," and we like to refer to the story of ancient Rome to demonstrate its importance. By 100 A.D., when Rome was at its peak, the city was serving over a million people and had over 11 working aqueducts that were delivering water and retrieving waste water. With the fall of Rome and the destruction of the aqueducts, in a very short period of time — less than 10 years — the population of Rome dwindled from a million to under 300,000, and much of the technology was lost for centuries until resurfacing during the Renaissance. So this concept of the aqueduct is a central theme that we think will drive capital flows as people continue migrating to urban centers.

This theme dovetails nicely with another gravitational trend we call "resource lifecycle management." The world is recognizing that the era of cheap and easily accessible energy, water and food is being challenged by resource scarcity, emerging demand trends in parts of the world, including Latin America, Asia and the Pacific Rim, and environmental regulation. And those factors in concert are creating bottlenecks that can only be solved through efficiency technologies, products and services that pull costs out of these high-cost systems. So we look at the key areas — providing health care in the Western world, where you have aging demographics and the costs are rising; securing new energy supplies, delivering food in the emerging world, managing water quality and distribution, managing waste streams effectively. If you can pull costs out of these high-cost systems, if you can create the technologies, services and products that help resolve bottlenecks within the water-energy-food nexus, you are likely to see a lot of growth in an otherwise topline challenged world.

In all, we have identified 12 key themes. Others include climate change leading to greater irregularity of historical weather patterns, increased drought or flooding, reduced snowmelt impacting recharge rates for underground aquifers; what we call the G8 to the G20 world, creating a more balanced global economy where by 2030 60% of global GDP will come from the developing world; water scarcity impacting food prices and availability; wealth disparities creating growing divides between the haves and have-nots. These story arcs create highly predictable long-term outcomes. We try to invest in the things that will alleviate or solve these challenges or benefit from a competitive advantage as a result of the challenges, and avoid areas that may be on the path to obsolescence as a result of their lack of foresight in preparing from these predictable outcomes. So gravity investing is a thematic overlay that we integrate with our traditional top-down macroeconomic and bottom-up security analysis. We view it as an important and differentiated leg of the stool to inform our investment decisions and add value for the client.

Highlights

Alexander B. Miles discusses his investment strategy and portfolio-construction strategy. He follows a "gravity investing" methodology, where he identifies what he says are highly predictable global trends that affect businesses throughout the world, among which are resources lifecycle management, the urbanization of the world, climate change, wealth disparity and water scarcity. He also describes the move toward higher-risk assets. He is currently overweight financials, especially alternative asset managers.

Companies include: Apollo Global Management, LLC (APO); The Blackstone Group L.P. (BX); Kohlberg Kravis Roberts & Co. (KKR); KKR Financial Holdings LLC (KFN).

"Gravity investing is essentially a thematic overlay that we employ within our portfolio research that seeks to observe and exploit trends in the global economic and social landscapes which we think are leading to seemingly unavoidable and highly predictable outcomes."

TWST: For your Global Tactical strategy portfolio, how many holdings do you typically target? What kind of turnover does it typically experience?

Mr. Miles: The Kingfisher Global Tactical Growth strategy is a global multiasset portfolio that is geared toward generating global equity returns with lower risk. It is intended to provide MSCI World-equity-type performance with less volatility and lower downside capture. The portfolios typically hold 25 to 40 securities, a combination of exchange traded funds, closed-end funds and individual securities. The strategy maintains a diversified core component that supports rather low turnover. The tactical component allows us to generate alpha by overweighting regions, sectors, subindustries and individual securities, while also managing risk exposures through volatility, equity and currency hedging. The strategy leverages our gravity investing approach in conjunction with macroeconomic and fundamental security analysis.

With the success of the Global Tactical Growth Strategy we have created what we call the Global Tactical Series, designed for adviser platforms, individual investors and foundations and endowments that would benefit from our global, multiasset portfolio approach but may not have the research and administrative breadth to perform all the work internally. The series offers an investment approach more akin to the university endowment or family office model, in which investors select among four unique entry points along the risk continuum: Global Tactical Conservative, Global Tactical Balanced, Global Tactical Moderate Growth and Global Tactical Growth. Each successive portfolio solution integrates a smaller fixed income allocation overlay, allowing investors to seamlessly move up or down the risk continuum.

TWST: Tell us about a few of your current favorite investment ideas, and what criteria you focus on when you are evaluating those.

Mr. Miles: One of the things that we laid out in our year-end letter is, a lot of folks are talking about risk-on and risk-off in this market. What we try to do is we try to clarify what risk-on and risk-off means, and what we decided was that risk-on essentially means assets that perform well in a greater-than-expected inflationary environment, and risk-off means assets that perform well in a greater-than-anticipated deflationary environment. And what we did was, we drew a normal distribution curve and we ran a continuum from the left to the right along the X axis — left being deflationary investments, right being inflationary investments — and the continuum looked something like this: To the left you had cash, Treasury holdings; as you move more to the left middle, you go into investment-grade corporate bonds; then you move into preferred equities, high-yield corporate bonds, dividend-paying blue chip stocks; as you move further into the middle and toward the right of the curve, you pick up more consumer stocks, real estate, small-cap and emerging market stocks, ultimately resource stocks, more economically sensitive stuff with commodities and gold at the far right. So as you move from left to right, in a normal environment, where the risks to inflation and deflation are somewhat equal, you should have a portfolio that has a component of inflationary protection and deflationary protection. What we realize today is that the large allocators of capital around the world — the large hedge funds, sovereign wealth funds, pension funds — are abnormally skewed to the left side of the curve. They are abnormally weighted to deflationary investments as a result of what we lived through in 2008 and the post-2008 world. So what we would anticipate is that we will see what is commonly referred to as the "Great Rotation." We will continue to see a migration from an abnormal risk aversion or an abnormal acceptance of a deflationary hypothesis transition back to a more normal acceptance of risk, which will push people back to the middle of the distribution curve and even out the far right of the curve toward assets that perform best in inflation.

"The next one to three years should see some kind of a resumption of a more normal environment where investors who are overly weighted to deflationary assets will actually start to potentially lose money in those assets and will have to swing out to the right side of that curve to invest in inflationary protection in order to offset the losses in the deflationary side of their portfolio."

So when we look at our Global Tactical strategy right now, we are anticipating that the next one to three years should see some kind of a resumption of a more normal environment where investors who are overly weighted to deflationary assets will actually start to potentially lose money in those assets and will have to swing out to the right side of that curve to invest in inflationary protection in order to offset the losses in the deflationary side of their portfolio. That rebalancing should create an opportunity for assets that are more economically sensitive to perform very well.

Over the last three years, you have witnessed significant outperformance in what are commonly referred to as blue chip stocks. The valuations now in many blue chip, high-cash-flow generating stocks seem a little bit expensive relative to the growth that can be purchased in parts of the emerging world like Indonesia or Brazil, Vietnam, even Russia, which is extraordinarily cheap. We

also think that sectors in the U.S. markets that are more economically sensitive — even materials, energy, technology. These stocks have lagged some of the more staid blue chip sectors of the market. We expect that over the next one to three years we should see a significant outperformance in that sort of basket of investments, those that have trailed the broader market over the last two to three years as a result of the phenomenon I just described.

TWST: You mentioned having both a core component and a tactical component. Could you give us one or two specific examples of your favorite investment picks from those two components?

Mr. Miles: The core component, which represents approximately 40% to 50% of the Global Tactical strategy, is a diversified equity portfolio globally that is not an exact mirror but reminiscent of the exposures that the broader benchmark index would provide. That component allows us to be tax-efficient, because we rarely trade that area of the portfolio. The tactical component, which is the other 50% of the portfolio, is where we make all of our overweight, underweight, hedging and tactical decisions.

"About the middle of 2012, we made the call to invest in the financial sector again in an overweight capacity. We wanted to be long the banks."

1-Year Daily Chart of Apollo Global Management, LLC

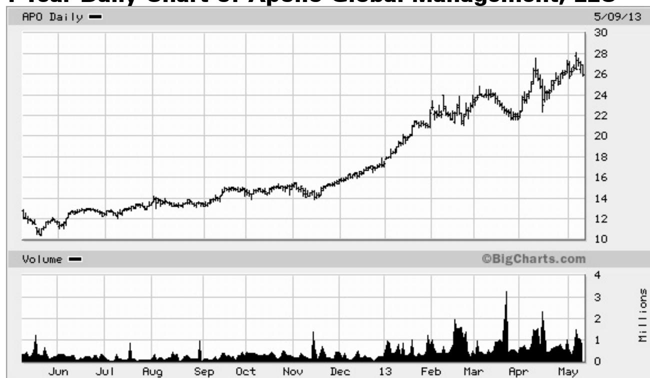

Chart provided by www.BigCharts.com

One of the gravitational themes that has impacted our portfolio is water scarcity. Water scarcity comes in multiple forms. Water is a resource that is very unique based on the locality; the richest parts of the world typically have much easier access than the poorest parts of the world. Water cannot really be transferred; there's not a global marketplace for water as there is for energy and agricultural commodities. Pumping, transporting, filtering and treating it require huge amounts of expensive energy. Water is not typically viewed as an economic good because it has political and social components to it that make it, and probably will make it, a universally and continually subsidized asset. As a result, water investments can struggle to attract necessary capital because investors cannot earn a fair return. We deal with significant and increasing challenges around water availability and water quality, and because water is so interconnected with our food, manufacturing, health care and energy sectors, water challenges can affect other sectors of the economy. So we have identified agricultural commodities, as a derivative, if you will, of the water market. We view agricultural commodity pricing, particularly in the grains, as a proxy for water pricing, partially reflecting its availability, demand and quality. As a result, in late 2011, we took a position in the Dow Jones Grains Index, with a portion of our tactical assets of about 5%, and we held that investment through the summer of 2012 when America suffered an enormous drought. As the scarcity of water reflected in lower crop output, corn stocks shrunk, prices took off and investors chased into the market. Ultimately, we sold our investment into that influx of new capital. Even though our secular view on water and the grains as a proxy for water scarcity suggests that we want to be invested in this theme over a long period of time, as a tactical investor, we only want to be long at the right price. And so we tend to buy into surpluses and sell into shortages, versus the other way around, as volatility around our themes permits. At the end of the day, our gravitational themes inform our investment weightings but do not override other factors such as price and value.

TWST: Is there another example you would share?

Mr. Miles: About the middle of 2012, we made the call to invest in the financial sector again in an overweight capacity. We wanted to be long the banks. The banks had gone through a series of recapitalizations; they were preparing for Basel III requirements; they were seeing their Tier I capital ratios increase. We saw valuations that were attractive in companies preparing to turn the corner on earnings, and the regulatory overhang was at least peaking. We felt like it was time, after four years of underperformance by the financial sector, to see the resumption of its historical leadership. So we took an overweight position through the purchase of a number of the larger money center banks, and specifically with the purchase of several of the alternative asset management companies. The alternative manager were raising new funds and locking up capital for a long period of time. They were benefiting from a renewed resumption of risk taking by investors. And the valuations of the asset managers were extraordinarily cheap. Companies like **Apollo** (APO), **Blackstone** (BX), **KKR** (KKR), **KKR Financial** (KFN) — we took positions in these companies because they have complex business operations largely misunderstood by the ordinary investor. They are MLP structures and force investors to pay K-1s, which can be onerous. So there are a number of factors that led to why these types of investment vehicles were significantly

undervalued relative to the basket of financial securities that you could compare them to, like, for example, a **Legg Mason** (LM) or a **Franklin Resources** (BEN). We felt like we should exploit that opportunity.

The benefit investors get today is that there are just a small number of these companies that really have a sight line on virtually every major deal around the world, and so the amounts of intellectual capital that's within these organizations, along with the deal flow they see, make them compelling opportunities. And with the structures their funds have — investors that are locked up to pay fees for five- to 10-year periods, where they can't walk out the door — these are very predictable cash flow streams with upside. So we remain overweight the financial sector and alternative asset managers in particular.

1-Year Daily Chart of The Blackstone Group L.P.

Chart provided by www.BigCharts.com

I'll give one other example. One of the things that we're seeing is this fight for yield. The Fed has obviously been very involved in trying to push the yield curve down, flatten the yield curve to try to spur investors toward this inflation trade that I outlined earlier. I would say that there is a reasonable chance, despite the fact that we believe that portfolios should take on more exposure to the inflation trade than they currently have, that we could go into a 1930s style deflation — meaning the Fed is unsuccessful in generating the inflationary outcome it is seeking. One of the reasons that the Fed is so active, and that Chairman Bernanke is so active, is because they are desperately trying to avoid what the Chairman believes he understands about what created the post-Depression era in the United States. And so there is a chance that we could revisit new lows in yields on the U.S. 10-year Treasury, and continue to fight the deflationary battle for years to come. However, we think this outcome is less likely to occur and it is more likely that the gears of our economy will eventually catch. Having said that, yields in lower-quality U.S. corporates are getting extremely compressed in our view. What we've seen is a rotation, first from Treasuries to corporate bonds, with investment-grade corporates performing extremely well over the last couple of years, now into the high-yield market. When I look at the universe of available corporate bonds out there, it is shocking how low the yields have gotten for distressed companies with lower credit quality. What we have found is that for investors willing to go outside the U.S., comparable yields are associated with much higher-quality credits. And so we've been adding international, emerging market and even some specific European corporates to our bond mix because we think that the risk/return characteristics have become attractive outside of the U.S. Frankly, we would rather be investing in quality common stocks than distressed U.S. corporates.

1-Year Daily Chart of Kohlberg Kravis Roberts & Co.

Chart provided by www.BigCharts.com

TWST: What are you underweighting or cautious about these days?

Mr. Miles: We're underweight U.S. blue chips and defensive slow-growth, large-cap equities. The Dow Jones Industrial average, blue chip type stocks are expensive relative to growth that can be purchased in faster-growing and sometimes smaller companies both in the United States and around the world. So we are essentially underweight the most defensive portion of the investment spectrum. We are underweight telecom; we're underweight utility stocks; we're underweight investment-grade, high-quality corporate bonds; we're underweight consumer staples stocks. For example, we bought **H.J. Heinz** (HNZ) in 2009, and we sold it about a year ago, before Mr. Buffett bought the company unfortunately. We also bought several of the company's bond issues at a discount to par. Mr. Buffett's bid to buy the company recently valued **Heinz** at about 20 times the current year's earnings estimates for a company growing EPS in the midsingle digits. We think that demonstrates how much investors are willing to pay for cash flow, and we think that they are underappreciating growth.

Areas outside the U.S. that we're underweight include Southern Europe and Japan. While there are specific companies in Europe that we think present unique value, we think as a region, Europe will continue to be constrained by disparate political factions that seek conflicting outcomes. Overall, their economy remains overwhelmed by a slow-growth, high-debt environment. So we're broadly underweight Europe as a region, although we think there are pockets of undervalued opportunity there. Recent monetary policy changes in Japan

have helped push the Nikkei to multiyear highs, but we remain concerned about the sustainability of that move. With gross public debt in Japan as a percentage of GDP moving above 200% this year, we prefer to watch from the sidelines.

TWST: Is there anything you'd like to add in conclusion?

Mr. Miles: Our investment approach is designed to deliver a global investment model, an endowment-type model for high net worth individuals, foundations, endowments and retirement plans, and to provide favorable risk-adjusted returns. Clients may access us directly or through numerous adviser and bank platforms. For those investing long-term capital, we have to recognize that the world has changed, that the world has gone from being a Western-dominated world to being a much more integrated global marketplace, and that the emerging consumers of tomorrow are going to create different kinds of growth trajectories in their economies versus Western economies that are digesting overindebtedness and slow-growth arcs. Markets are becoming more open, more transparent and more regulated, which will attract new capital in the global search for yield. Today, investors should be preparing for that inevitability by investing in globally and tactically diversified investment portfolios positioned to exploit emerging gravitational trends both domestically and abroad.

TWST: Thank you. (MN)

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