Big Picture Report

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"Quantitative approach for asymmetric results"

2014 Investment Outlook

Country Stock Market YTD Performance

Country	YTD % Chg	Country	YTD % Chg
Dubai UAE	107.69	Australia	15.13
Argentina	88.87	Israel	15.12
Abu Dhabi (UAE)	63.08	Malta	14.75
Japan	56.72	Britain	14.43
Pakistan	49.43	Taiwan	11.85
Nigeria	47.19	Estonia	11.38
Bulgaria	42.28	Malaysia	10.54
Ireland	33.64	Bermuda	10.11
United States	29.60	Serbia	9.88
Greece	28.06	Canada	9.55
Iceland	27.54	Ecuador	9.28
Kuwait	27.22	India	8.98
Finland	26.47	Sri Lanka	4.78
Romania	26.10	Austria	4.24
Saudi Arabia	25.50	Croatia	3.10
Germany	25.48	Slovakia	2.89
Qatar	24.17	Hong Kong	2.87
Denmark	24.05	Hungary	2.15
Norway	22.73	Philippines	1.33
Vietnam	21.97	Namibia	1.32
Spain	21.42	South Korea	0.72
Mauritius	21.24	Singapore	0.01
Sweden	20.66	Indonesia	-0.98
Botswana	20.55	Lebanon	-1.63
Switzerland	20.24	Mexico	-2.24
Kenya	19.21	Morocco	-2.57
Lithuania	18.73	Czech Republic	-4.78
Oman	18.64	Russia	-5.55
Belgium	18.10	Thailand	-6.70
France	17.99	China	-6.75
South Africa	17.85	Poland	-7.05
Netherlands	17.24	Ukraine	-8.57
Bahrain	17.20	Colombia	-11.18
Italy	16.56	Jamaica	-12.59
New Zealand	16.49	Turkey	-13.31
Luxembourg	16.26	Chile	-14.00
Latvia	16.22	Brazil	-15.50
Portugal	15.60	Peru	-23.63

G7 Country

BRICs

Fund	Net assets ($M)	YTD return
iShares Global ex USD High Yield Corp Bond ETF (HYXU)	$51.40	11.63%
Peritus High Yield ETF (HYLD)	$452.60	10.66%
Market Vectors International High Yield Bond ETF (IHY)	$124.80	6.71%
Guggenheim Invest BulletShares 2018 HY Corp Bond ETF (BSJI)	$142.80	7.97%
Pimco 0-5 Year High Yield Corporate Bond Index ETF (HYS)	$3,508.40	7.87%
iShares Global High Yield Corporate Bond ETF (GHYG)	$80.20	7.22%
Guggenheim Invest BulletShares 2016 HY Corp Bd ETF (BSJG)	$351.00	6.92%
iShares B - Ca Rated Corporate Bond ETF (QLTC)	$10.50	6.79%
Guggenheim Invest BulletShares 2017 HY Corp Bd ETF (BSJH)	$140.80	6.95%
SPDR Barclays Short Term High Yield Bond ETF (SJNK)	$2,881.60	6.57%
SPDR Barclays International Corporate Bond ETF (IBND)	$222.20	4.65%
Market Vectors Fallen Angel High Yield Bond ETF (ANGL)	$16.20	6.39%
Guggenheim Invest BulletShares 2015 HY Corp Bond ETF (BSJF)	$690.30	5.92%
PowerShares Chinese Yuan Dim Sum Bond Portfolio (DSUM)	$129.90	6.06%
iShares iBoxx $ High Yield Corporate Bond ETF (HYG)	$16,071.90	5.54%
SPDR Barclays High Yield Bond ETF (JNK)	$9,962.90	5.49%
Pimco Germany Bond Index Exchange-Traded Fund (BUND)	$3.10	3.81%
Guggenheim CurrencyShares Euro Trust (FXE)	$222.20	3.67%
WisdomTree Euro Debt Fund (EU)	$4.60	3.38%
Highland/iBoxx Senior Loan ETF (SNLN)	$121.90	4.91%
Market Vectors Renminbi Bond ETF (CHLC)	$5.30	5.20%
Guggenheim Invest BulletShares 2014 HY Corp Bond ETF (BSJE)	$505.70	4.71%
Global X SuperIncome Preferred ETF (SPFF)	$63.70	4.33%
PowerShares Fundamental High Yield Corp Bond Port (PHB)	$632.80	4.04%
PowerShares Senior Loan Portfolio (BKLN)	$6,242.80	3.98%
Guggenheim CurrencyShares Swiss Franc Trust (FXF)	$282.00	2.26%
WisdomTree Chinese Yuan Fund (CYB)	$222.00	3.81%
ProShares German Sovereign/Sub-Sovereign ETF (GGOV)	$4.30	1.54%
PowerShares Internaticnal Corporate Bond Portfolio (PICB)	$162.10	1.87%
Guggenheim CurrencyShares Swedish Krona Trust (FXS)	$60.90	-0.26%
Guggenheim CurrencyShares Chinese Renminbi Trust (FXCH)	$8.20	2.33%
Guggenheim Invest BulletShares 2016 Corp Bond ETF (BSCG)	$468.30	2.00%
Guggenheim CurrencyShares British Pound Strlng Tr (FXB)	$56.50	0.49%
Guggenheim Invest BulletShares 2013 HY Corp Bond ETF (BSJD)	$204.70	1.69%
Guggenheim Invest BulletShares 2015 Corp Bond ETF (BSCF)	$474.90	1.54%
Market Vectors-Investment Grade Floating Rate ETF (FLTR)	$97.30	1.49%
Vanguard Short-Term Corporate Bond Index Fund ETF (VCSH)	$7,272.00	1.50%
SPDR Barclays Short Term Corporate Bond ETF (SCPB)	$2,924.60	1.36%
Guggenheim Enhanced Short Duration ETF (GSY)	$462.30	1.32%
Market Vectors Emg Mkts High Yield Bond ETF (HYEM)	$237.60	-0.54%
Guggenheim Invest BulletShares 2017 Corp Bd ETF (BSCH)	$405.90	1.14%
iShares 1-3 Year Credit Bond ETF (CSJ)	$11,590.10	1.09%
iShares Floating Rate Bond ETF (FLOT)	$3,768.80	1.04%
SPDR Barclays Invest Grade Floating Rate ETF (FLRN)	$360.70	1.03%
SPDR BofA Merrill Lynch Crossover Corp Bond ETF (XOVR)	$28.30	0.78%
Guggenheim Invest BulletShares 2014 Corp Bond ETF (BSCE)	$417.10	0.93%
Guggenheim BulletShares 2018 Corporate Bond ETF (BSCI)	$173.40	0.85%
FlexShares Ready Access Variable Income Fund (RAVI)	$41.40	0.85%
iShares 2016 AMT-Free Muni Term ETF (MUAE)	$96.30	1.15%
PIMCO Enhanced Short Maturity Exchange-Traded Fund (MINT)	$3,719.80	0.71%

Figure 1: Tables showing the 2013 performance of world stock indexes and US Bonds ETFs

The 2013 has been one of the most bullish year ever recorded in western societes. Above you can see the astonishingly results just compared with the dogs which notably have been emerging markets.

Next to it, you see a table showing the highest returns for US bonds ETFs. Here the highest returns have been High Yield ETFs. The red box separates the highest returns with the rest and you can see that the difference is quite substantial. The threshold is almost a 2% differential between the two groups, while the biggest deviation is as much as 11% sharp.

However the Bond ETFs space is crowded with very small funds, which are therefore illiquid. If we take a cut-off at 500 million USD AUM, there are truly only five ETFs available in the red box and eight in the second tier box. So the overall space has only thirteen truly investable indexes.

I know I am speaking to a very well informed crowd, so I won't waste time talking about how markets ended up where they are today, we all know that.

Of course it is much more interesting and challenging to elaborate on what can, could or should happen in 2014 and how to invest accordingly.

What is important to remember is that in Western Countries there is a strong interference in markets by Central Banks and portfolios should have been now long adjusted to it.

However the Fed has already taken the decision to start reducing the monthly purchase from an 85 bill. USD to a 75 bill. USD level. Is it going ot have an effect on markets? I would say minimal at this point.

Here is what I currently see in each investible asset:

BONDS:

Central Banks are keeping or trying to keep interest rates at lowest historical level but there is a limit to what they can actually achieve, and that is shown in the chart below which compares the US 2yr govt. and the US 10 yr. govt. yield curve. The actual contribution to the recent spike from the 10 yr. is 100%.

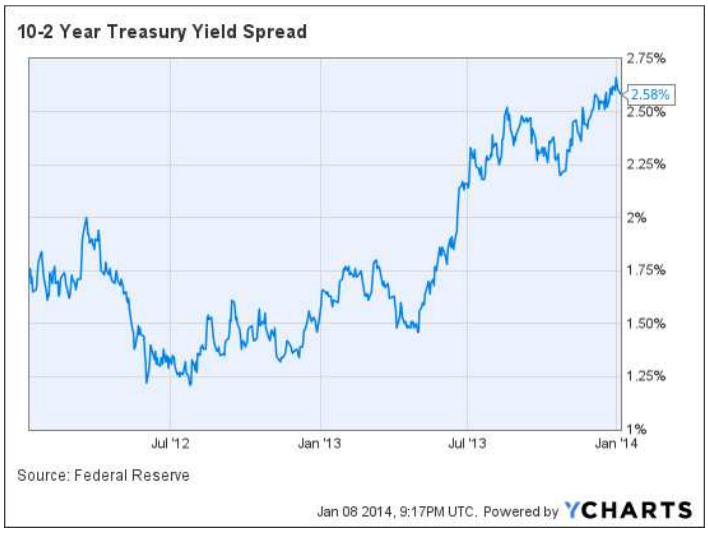


Figure 2: Chart showing the US 10 and 2yrs. yield spread

While the longer end of the curve from 10-30 years ratcheted up last year in response to the Federal Reserve's initial musing about easing up on its bond buying, the short end basically didn't move much.

There are hints that suggest we are approaching a new bear market in bonds, therefore in the next 5 -10 years bonds could be one of the worst investment to have, if at least is not approached in the correct way.

It could be possible to also see the US 2yr. govt bond start moving higher if the Fed will continue its tapering process.

The best strategy to tackle the current situation (and the possible coming bear market) is to be **exposed to bonds with the shortest duration possible**. Just for those who are not familiar with the term duration, please note that such term has nothing to do with expiration per se of the bonds. **Duration shows by how much a yield of a singular bond or of a bond portoflio (using a weighted average of all bonds) will move subsequently to a 100 basis point move of the interest rate.**

Just to give you an idea, the PIMCO Total Return Fund has a duration of 5.37 yrs. (source: https://investments.pimco.com/products/pages/346.aspx). Please note that the TRF is the biggest fund with Assets in excess of 200 bill. USD and therefore they are forced to be diversified, which jeopardize efficiency: in our less crowded world, a better duration is very possible still without jeopardizing efficiency or diversification.

In a bond bear market which translates into an environment of raising interest rates it is therefore important to have the shortest duration possible: it means that bonds and bond portfolios will be impacted the least by each 100 basis points increase.

There are few variables (risks) to keep in mind when investing in bonds and among those there are: **1. Interest rate, 2. Currency, 3. Issuer.**

We have already discussed the 1., let me say few words on the remaing two and which implications those two have in a bond allocation.

Interest rates moves are also dictacted by how strong the internal economy is. In periods of recession the preferred investment is the bond one as companies are less profitable and therefore stocks tend to go lower. To some extent that is where we have been in the last five years, belive it or not. But at the end of a recession, the allocation should shift from overweighting bonds to overweighting equities because companies balance sheets are improving and they are becoming more and more profitable.

Shifting the allocation is also another way to have raising interest rates because it comes due to a massive sell off of bonds (which drives the prices of bonds down, and consequently yields up).

If the above is correct and comes together with the general idea of approaching a raising interest rate environment, then the subsequent thought should be that the stronger the economy, the stronger the currency will become.

Therefore the ideal currency target today is the US Dollar. Not only the above is correct but also the US Dollar is also at a recent high versus the EUR and justify therefore an overweight. In

addition to this, if we will enter in a new crisis as some say, still, today, the one and only world reserve currency is the US Dollar as there are simply no others.

Look at some facts here (reference year is 2012):

World GDP is 85 trillion dollars (in PPP, source Wikipedia);

US GDP is 18,6 trillion dollars;

China GDP is 3,7 trillion dollars;

Brazil Russia and India combined are at 3,2 trillion dollars;

Europe GDP is 13 trillion dollars.

If a crisis will surface again, do we really expect the remimbi or the yen to become the new reserve currency? That is simply impossible because there are not enough banknotes out there as US Dollars. I am afraid that those who believe that the US dollar has lost its power will be disappointed.

To sum up the bond allocation should be overweighted in US dollars versus the EUR to profit from an appreciation of the main currency.

Concerning a possible allocation on Emerging Market Debt, I personally see it as a marginal allocation, in spite also of last summer reaction that those markets had when a first discussion on the US Tapering was released to the public.

For what concerns the issuer the majority of the allocation for the US side should be equally split between Government and Mortgage, with a smaller allocation on Credit.

Why such big allocation in Mortgage? I believe we haven't seen the overall effect of the Quantitatvie Easing, yet. One of the big surprise we will probably be witnessing in the coming weeks and months will be a surprise in the US housing market. It has almost recouped all the losses from the 2009 crisis and what will happen now, is to see news of a total recoup of those losses.

In addition the Fed won't start tapering hard just about the same time, but will most likely wait few quarters in order to be assured that the effects are long term and not driven by some outside factors. Therefore expect markets to be in an overdrive / overshooting mode.

That explains my strong commitment to the Mortgage sector.

In Europe the allocation should favour Government Bonds of peripheral Europe, with a preference for Italy as among those countries it is still the strongest thanks to its widespread production system which is second only to Germany. **Very few also know that Italy has also the third biggest gold reserves in the world** (Source: http://en.wikipedia.org/wiki/Gold_reserve); ok, without taking into consideration the IMF, which is not a country anyway.

The remaining should be invested in German Government Bonds which do not seem to be going anywhere for the time being, in terms of yields.

Allocation to corporates bonds in general are welcome, but I would look for allocation to mega caps, which are very similar in their behavior to government bonds.

EQUITIES:

This side of the investment universe should not see a change in the allocation from 2013, similar to the bonds one.

There are no signs of inversion so positions opened should remain intact. My asset allocation is in fact the same since July 2013 which sees an overweight for Consumer Discrectionary and Financials for both US and Europe (source: http://www.francescomaggioni.com/asset.php).

However it is important to keep an eye to the sectors that did poorly last year, namely most defensive ones such as Telecom and Consumer Staples.

If those sectors would start trending higher, it would make sense to change the allocation selling the overweighted ones into the strength and buy the laggards.

That basically without major change in the environment is simply called: Sector Rotation.

Since those are defensive sectors it will be important to truly understand the reasons behind the coming (possible) sector rotation. It is simply to take advantage of new opportunities or market participants are protecting themselves from a new crisis?

THE UNKNOWN UNKNOWNS

The above analysis is a way to see at an asset allocation mainly divided into the two financial currencies, namely the USD and EUR. That also could be not the best allocation, but I believe it gives enough information for many people to see it either as a benchmark for their allocation or an idea generetor to where put any cash left for the time being.

However nobody knows the future, and we live in an era of chaos, despite what central bankers want us to belive.

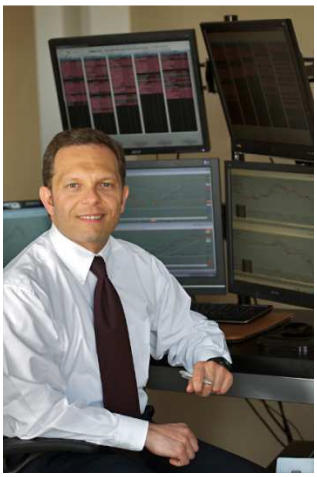
Volatility is at historical low levels, US markets are the historical high levels, so do the high yield bonds sector (performance wise) which is the lowest grade and riskiest one.

Those levels will not continue forever, so investors should be anyway worried and plan for possible multiple worst case scenarios. Western economies have not solved any of their problems that surfaced in 2009 so things are not as great as we may see them.

Personally I would like to add to the above analysis that the first requirement of any investment: liquidity. Do not take position of any illiquid investment, or at least make it no bigger than 5% of your allocation. You should be able to exit any position in one day at the maxiumum, or have an hedging strategy in place otherwise. As Buffet said, it is only when the tide leaves that we discover who is swimming naked.

Allocate part of your portfolio for hedging purposes, either through outright options or via Inverse ETFs.

And as Mohammed El-Erian said two of the most important characteristics an investor must have today are: agility and absortion.



Mr. Maggioni has been working in the financial markets for the last 13 years covering different roles and working in tier 1 consulting companies and banks worldwide.

In recent years his studies have been focused on the psycho-emotional aspects of trading and how those aspects have an impact on traders' behavior.
Before starting this venture, he was head of a hedge fund desk at HSBC Private Bank in Monaco and before that he was employed at Credit Suisse Asset Management (CSAM) in Zurich covering the in-house single manager hedge funds.

Most of his experience in hedge funds was gained while working in a Swiss family office where he was in charge of the research and analysis as well as due diligence for US and European hedge funds. He also performed quantitative analysis and portfolio construction for several funds advised by the family office.

Prior to that he worked as an external consultant for KPMG Financial Services in the Milan office. In 2002 he has been hired by Ernst & Young LLP, San Francisco as auditor for hedge funds, auditing large single funds and fund of funds. In 2000 he joined Ernst & Young in Milan as an auditor for mid-sized companies.

Mr. Maggioni holds an MBA from IUM and a Portfolio Management degree from the University of Chicago GSB.

Useful Links:

European Central Bank:	www.ecb.int
Bank for International Settlements:	www.bis.org
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US CFTC	www.cftc.gov