

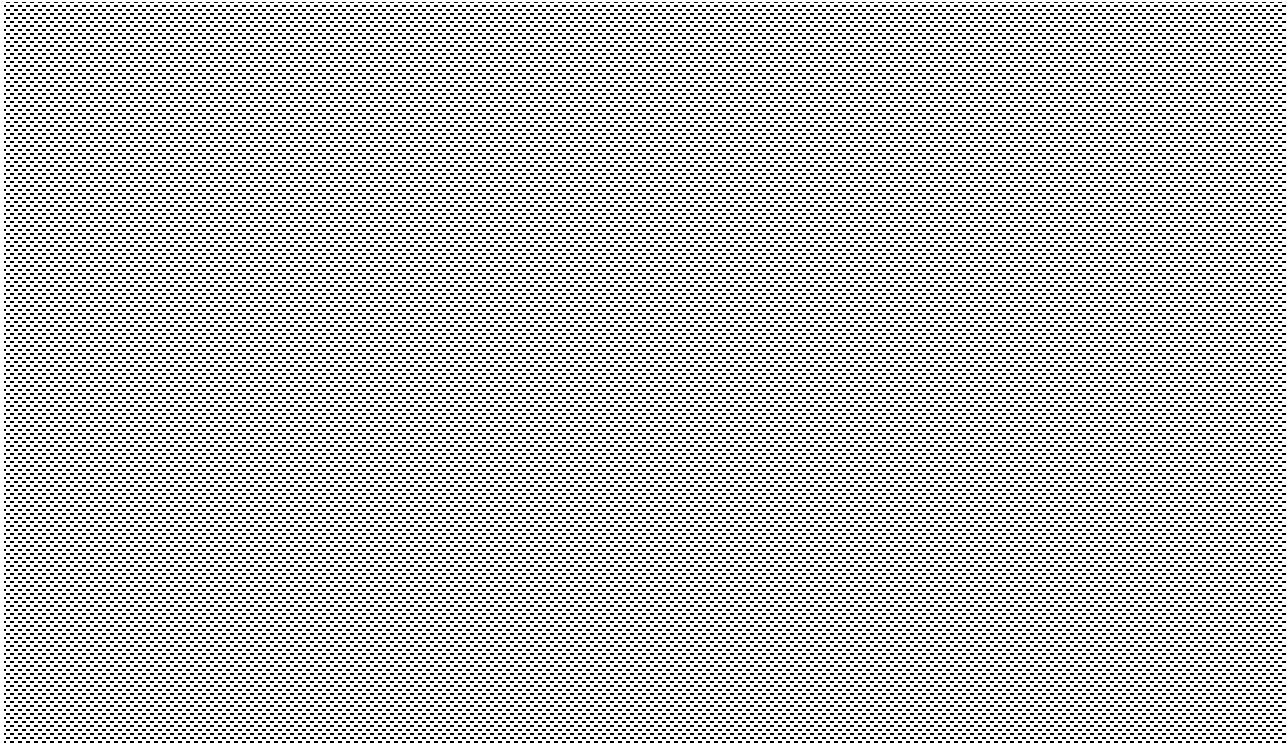
Re: 2014 Full Year

January 28, 2015

Dear Friends,

For the full year 2014, GLOBAL RETURN generated [REDACTED]

Impressively, GLOBAL RETURN accomplished this while maintaining, on average, over 10% in Cash [REDACTED] RN sold 13 positions that generated [REDACTED]



Below I discuss equity valuations and everything Mom taught me about “the value a dollar.” Please contact me if you have any questions or would like to discuss my investment strategy or philosophy.

Respectfully,

A handwritten signature in blue ink that reads "Elliot Trexler".

Elliot Trexler
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¹ Actual results. Non-levered. Net of management fee and expenses. See Appendix A and Appendix B for additional information. Past performance does not guarantee future performance.

² See Appendix C for additional information.

³ As-of December 31, 2014.

⁴ Includes preferred stock, convertible warrants, options and ETFs.

⁵ Cash Balance throughout all of 2014 averaged 10.30%.



Current Valuations

From October 1, 2014 to January 16, 2015, the S&P 500 earnings projections for Full Year 2015 were revised downward by 10%; meanwhile, the S&P 500 index price increased 6%.⁶

How does it make sense to buy stocks at higher prices when earnings projections have decreased? Imagine you're buying a home that's 2,000 square feet for \$300,000 (the house is in the Midwest where you can actually do this). At the closing, the title company says, "Oops, the house is actually only 1,800 square feet or 10% smaller than originally thought." What does the buyer do? If he were like many of today's investors, he'd increase the purchase price 6% and buy the house for \$318,000 dollars.

Here's where the S&P 500 market stands:⁷

U.S. Equity Valuations		Historic Averages			
Valuation Metric	Most Recent ⁸	1-Year Ago	5-Year Avg.	10-Year Avg.	25-Year Avg.
Price-to-Earnings	16.8x	15.4x	13.5x	13.8x	15.6x
Shiller CAPE Ratio	26.8x	25.5x	22.5x	22.9x	25.3x
Dividend Yield	2.05%	1.9%	2.0%	2.0%	2.1%
Earnings Yield	3.7%	3.7%	4.3%	3.3%	2.3%
Price-to-Cash Flow	12.0	10.8	9.3	9.7	11.3

True GDP increased in Q3 2014. However, since I purchase stock in companies, and benefit from their increased profits, a more helpful perspective can be found near the bottom of the press release issued by the U.S. Bureau of Economic Analysis proclaiming GDP rose 5%: Corporate profits increased \$64.5 billion in the third quarter, compared with an increase of \$164.1 billion in the second.⁹ That's a 61% decline in corporate America's profits. GDP does *not* reflect corporate income, so while the value of production of goods and services increased, corporate profits significantly decreased. Considering this data, the question I ask myself is, "Do today's stock prices offer me value in the future?"

⁶ S&P Dow Jones Indices. In my last quarterly letter I stated that the S&P Dow Jones estimate of future earnings was delusional. I suspect this earnings revision was the first of several more.

⁷ Sources: S&P Dow Jones Indices, Robert Shiller Data. Price-to-Earnings uses 2015 projected earnings; Earnings Yield is (TTM Earnings/S&P Price) – CPI Inflation; Price-to-Cash Flow is Price/2015 projected Cash Flow

⁸ Based on January 22, 2015 prices. Except Shiller CAPE Ratio is January 7, 2015.

⁹ Bureau of Economic Analysis. GDP News Release, Page 2. December 23, 2014.



Price versus Value: Everything Mom Taught Me about the Value of a Dollar

It won't surprise many readers that I'm devoting a section of this letter to what Mom taught me about the value of a dollar. Mom's lessons directly impact how I view money, how I spend money and how I invest money. Those who knew Mom would agree she was, in her own words, "cheap." Mom didn't like to pay-up for anything; however, it was this thriftiness that allowed her to retire and enjoy the life she wanted. I suspect my value-oriented mentality is a credit to Mom and her thriftiness; she always said, "The apple doesn't fall far from the tree."

My first two lessons in understanding the value of a dollar are also the most influential, and they're actually some of my first childhood memories. The first lesson was quantitative in nature and occurred at our local grocery store. Mom and I were walking through the aisles grabbing food to put in our cart. I naively grabbed a box of cereal to which Mom quipped, "Wait, let's check the price." This baffled me because anyone could plainly see the large dollar figures listed on the price-tags in front of each brand of cereal. Mom proceeded to point to a tiny figure on the bottom of the price-tag; she told me this was the "per-unit-price." For the rest of our shopping trip Mom explained to me what the figure meant in relation to the number of units received for each dollar spent. I've come to realize what Mom elucidated was the difference between *Price* and *Value*, something often overlooked within our industry.¹⁰

The second lesson was qualitative and occurred while sitting in the back seat of my parents' car. We were at a stoplight when I saw a billboard advertising the price of a hotel room, the price included ".99" cents after the whole dollar figure. I asked why the hotel didn't just round-up the price to the whole figure. Mom explained that this tactic is called marketing psychology. She then lectured on how external influences alter our perceptions, and it is these perceptions that lead us to make spending decisions.

We all know that you're supposed to buy the product you deem most valuable at the least per-unit-price available. Doing this is crucial because marketing experts have conditioned consumers to purchase the most expensive items and simultaneously altered our perception so that we "feel" like we've selected the best value for our money (this is Marketing 101). Yet, countless experiments consistently show that emotions override rational logic nearly every time.

Below are a few examples of how this happens:

- Feedback loops. Robert Shiller contends that the feedback loop, which is similar to the self-fulfilling prophecy theory, occurs when investors see rising stock prices so they buy stocks (they don't want to feel like they're missing out). This additional buying increases stock prices, which then encourages more investors to buy more stocks and the loop continues until the bubble pops.

¹⁰ Price is what you pay. Value is what you receive.



- **Implicit Memory.** Have you ever thought to yourself, “Okay, now is the time to have an emotion.” Of course not. This is because our brain (specifically, the amygdala) has an automatic firing mechanism whereby when a certain event occurs our brain fires-off an appropriate (ideally, it’s appropriate) emotion and we respond with an appropriate (ideally, it’s appropriate) reaction (the reaction we take is governed by the prefrontal cortex which manages goal-directed behavior).¹¹ For example, if you see a car speed through a red-lighted intersection, fear is triggered and you slam the brake pedal, this is an automatic response; no driver thinks, “Oh, I should develop fear. Once I’m fearful, then I’ll quickly lift my foot off of the gas pedal, place it on the brake pedal and push it down firmly.” This is one example of when emotions work to our advantage. Unfortunately, investing is very different from driving a car and investors have implicit memories – stock prices increase, the amygdala fires-off an emotion of excitement and the investor buys more stock. All the meanwhile, just like the drivers, investors aren’t consciously thinking of what’s occurring.
- **Social Reinforcement and Peer Pressure.** Very few people are comfortable operating without social reinforcement and most people make decisions based on peer pressure. As adults, peer pressure looks very different than it did when we were kids on the playground, but in our pursuit of social reinforcement we’ll inadvertently succumb to unrecognized peer pressures. Like the car driver above, seldom are we consciously aware of what’s happening as we’re actually taking action.

Recognizing what influences our behaviors is challenging. For investors, the risk of not identifying these influences is costly because we’ll distort our perception of the reality that exists between price and value. I know of no one who consciously makes a decision to pay more for a product than what they deem its value is, yet it happens all the time. Below is a wonderful, and absurd, example of how external influences altered perceptions, which then created a schism between price and value.

In 1996, Tyco Toys introduced the world to a stuffed-doll named Tickle Me Elmo. This fictitious cartoon had been aired on Sesame Street since 1979 and was now available on store shelves. Tyco Toys thought a reasonable “per-unit-price” was \$28.99, but they were run by smart executives who understood that price and value are different. So how did Tyco Toys alter consumers’ perception to change their behavior in an effort to increase the *value* of the product?

Tyco Toys used economics most basic principle: supply and demand. Tyco Toys heavily marketed the stuffed-doll (creating demand among children, which is merely a perception) and intentionally under-manufactured it (limiting supply). The ensuing demand-supply tension altered parents’ perception of the doll’s “value”.¹² During the Tickle Me Elmo craze parents were wrestling in toy stores, several people were even arrested, to get the “final” doll off the shelf. Reports state that the highest price paid for the stuffed-doll was \$7,100. Many adults think they aren’t subject to peer pressure...the only thing that would drive an adult to act like this is the wrath they would face if they returned home empty-handed!

¹¹ Interestingly, the prefrontal cortex can be trained through behavior modification to take or not take certain actions based upon the individual’s goals; this is irrespective of the emotion produced by the amygdala.

¹² In the process Tyco Toys also created one of corporate America’s greatest marketing schemes to-date.



The buyer who paid a per-unit-price of \$7,100 for this stuffed-doll is the same type of buyer who raised their purchase price on the fictitious house described earlier. I'll wager this buyer believed they were making a rational decision based on their perception of Tickle Me Elmo's value. After all, who intentionally decides to make an irrational decision? (As a side note, \$7,100 invested into the S&P 500 in 1996 would be worth approximately \$33,000 today; this is a 365% return, or 8.5% annually. I don't know what the *value* of that Tickle Me Elmo doll is today but it's not \$33,000.)

Turning back to stocks, I'm not finding enough value that justifies paying current prices. Conversely, I do have holdings with prices that far exceed their values; let's look at Target (TGT), which I recently sold, as an example.

Target: Price versus Value

Valuation Metric	TTM ¹³	3-Year Avg.	5-Year Avg.	10-Year Avg.
% Change in EPS Growth	-22%	-16%	-4%	-2%
% Change in EBITDA	-18%	-8%	-2%	2%
% Change in Cash Flow/Share	-41%	-1%	5%	8%
% Change in Profit Margins	2.8%	3.7%	3.9%	4.4%
Purchase Price per Share	\$57.29			
Sale Price per Share	\$75.41			
% Return	32%			

I look at a plethora of data points when considering buying or selling a security, so the above metrics are far from a complete list. Irrespective, the average percent change in these metrics clearly points to a downward trend (even when excluding Target's Canadian blunder). I would gladly buy this stock at a much lower price-per-share because it would then possess *value*, but at the current price, given its prospects, the stock contains no future value.

At \$75.50, the stock is trading at 23 times 2015 earnings per share. When using 2016 operating earnings per share, the stock is trading at 20 times earnings. These guestimates imply Target is going to increase earnings per share by 13-18% year-over-year (or 91% adjusted for Canadian operations). Unfortunately, earnings projections have already been downgraded by 12% and are subject to further revisions. Plus topline revenue growth has decreased 63% over the last 10 years. Finally, the *price* I pay today must support next year's *value* and Target lacks sufficient opportunity to defend the current price; in other words, throughout all of 2015 and 2016 (for the next 24 months!) the market must believe Target is owed a multiples premium to maintain its current price. I'm not willing to take that bet.

Selling a stock is a difficult decision because I have a high required rate of return. Now I'll need to find a replacement for this capital which is tough to do in this market. My yield-on-cost for Target was 3.63%, and compounding by the quarter, but I suspect there's more downside to Target than 3.63%, so I'll take my profit now.

¹³ Trailing Twelve Months.



Marketing and Benchmarking

As a value investor, I'll look at any security in the U.S. or Europe; these include common and preferred stocks, options, warrants, convertible debt and ETFs. However, I acknowledge this does not allow for easy and consistent benchmarking or marketing. Therefore, in the coming quarters, I anticipate selecting one or two major indices that I'll use as benchmarks.

2015 Prognosis

Many people have asked what my thoughts are on 2015. In my Q1 2014 letter, I stated two opposing views are required to fully understand security valuations. One perspective is a broad market view and the other is an individual security view. A rising tide will lift all boats; so a great company destined to go higher might exceed a rational price due to broad market conditions. Unfortunately, lousy companies will also benefit from broad market increases. I reiterate a quote from Benjamin Graham, "Observation over many years has taught us that chief losses to investors come from the purchase of low-quality securities at times of favorable business conditions."¹⁴ Some characteristics I would use to describe "favorable business conditions" that benefit my investment returns are: significant price declines, depressed price-to-earning ratios, high cash flow per share, etc. *Nothing* about earnings reductions and price increases seems favorable to me. So for the time being, I'll rely on my required rate of return to determine whether or not to buy a security and keep an eye on the broad market.

Conclusion

As stock prices decline, my list of potential investments will grow longer and the sentiment of my letters will change to bullishness. I yearn for declining prices because this is when my cash is most productive – I can buy more stock with less money – my per-unit-price declines. It should not be ironic that declining prices offer reduced risk and increased returns, which, after all, is what every investor wants.

Please contact me if you would like to discuss my investment strategy or philosophy.

Respectfully,

Elliot Trexler

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¹⁴ The Intelligent Investor. Page 516.



Appendix A

All Data as of December 31, 2014

2014 Net Return¹⁵ = 12.20%

Top 5 Positions by Return ¹⁶	
Symbol	% Gain
LOW	157.88
BDX	83.09
WBA	80.34
SYK	77.80
MDT	73.93

Bottom 5 Positions by Return ¹⁶	
Symbol	% Gain
MCD	2.95
PSK	2.48
PFF	2.02
CALM	-8.24
EDIV	-15.84

Cumulative losses equal 0.44% of total portfolio value.

Top 5 Positions by Size	
Symbol	% Portfolio
MCD	3.6
WBA	3.5
WFC	2.8
PEP	2.8
LOW	2.8

Portfolio Composition	
Domestic Stocks	74%
Foreign Stocks	7%
Other ¹⁷	5%
Cash	14%

PAST PERFORMANCE DOES NOT GUARANTEE FUTURE PERFORMANCE

¹⁵ Actual results. Non-levered. Net of management fee, which is 1.5% of assets under management, and expenses.

1) End of Month Balance – Beginning of Month Balance – Deposits – Management fee and expenses = Monthly Income

2) Monthly Income/Beginning Month Balance = Monthly Return

¹⁶ % Gain = (Closing Price – Purchase Price) / Purchase Price. Purchase price includes dividends.

¹⁷ Includes preferred stock, convertible warrants, options and ETFs.



Appendix B

Unaudited Monthly Returns

2013 Net Return	22.70%¹⁸
2014 Net Return	12.20%¹⁸

2014 Monthly Returns	% Gain or (Loss)¹⁹	% Cash Balance²⁰
January	(3.49)	9
February	3.96	5
March	1.95	5
April	0.28	8
May	1.84	8
June	1.67	8
July	(1.80)	12
August	2.31	11
September	(0.43)	17
October	1.94	15
November	3.64	12
December	(0.40)	14

PAST PERFORMANCE DOES NOT GUARANTEE FUTURE PERFORMANCE

¹⁸ Actual results. Non-levered. Net of management fee, which is 1.5% of assets under management, and expenses.

¹⁹ Actual results. Non-levered. Net of management fee, which is 1.5% of assets under management, and expenses.

²⁰ Figures are rounded.



Appendix C

Benchmarks

HFRX EH Fundamental Growth Index: Employs analytical techniques in which the investment thesis is based on the valuation of the underlying company, which is expected to have earnings growth and capital appreciation exceeding the broader equity market. Investment theses are focused on characteristics of the firm's financial statements in both an absolute and relative sense to other similar securities and market indicators. Strategies employ investment processes designed to identify attractive opportunities in securities of companies which are experiencing or expected to have abnormally high levels of growth compared with relevant benchmarks in earnings, profitability, sales or market share.²¹

HFRX EH Fundamental Value Index: Employs investment processes designed to identify attractive opportunities in securities of companies which trade at valuation metrics the manager determines to be inexpensive and undervalued when compared with relevant benchmarks. Investment theses are focused on characteristics of the firm's financial statements in both an absolute and relative sense to other similar securities and more broadly, market indicators. Strategies typically focus on equities which generate high cash flow, but trade at discounted valuation multiples, possibly as a result of limited anticipated growth prospects or generally out of favor conditions.¹⁸

The Barclay Equity Long Bias Index: Equity Long/Short managers are typically considered long-biased when the average net long exposure of their portfolio is greater than 30%. Only funds that provide us with net returns are included in the index calculation. Please note that the calculation for the number of funds is time-stamped and that the number of funds will continue to increase until all funds categorized within the sector have reported monthly returns.²²

GLOBAL RETURN Large-Cap Domestic: Companies that are member to the S&P 500 Index or are domicile in the U.S. and have a market capitalization greater than \$2 billion.

GLOBAL RETURN Large-Cap Foreign: Companies that are member to the MSCI Euro Index.

²¹ Hedge Fund Research. www.hedgefundresearch.com

²² BarclayHedge. www.barclayhedge.com



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