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Let's Go Global !

JULY 2012



Executive Summary

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- 2012-2013 should provide investors with good opportunities to buy cheap non-U.S. stocks.
- Diversification is important. It is not the time to sell international/emerging markets stocks.
- The MSCI EAFE index (index representing international stocks) P/E* ratio decreased 50% from 2000 to 2012 (after doubling from 1991 to 1999).
- Less than 20% of the World GDP (Gross Domestic Product) is in the U.S.
- In the next 10 years, international/emerging markets stocks should continue to outperform.

* P/E = Price /Earnings ratio, which is a measure of the price paid for a share relative to the annual Earnings per Share (EPS).



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Introduction

The European crisis created lots of volatility, uncertainty, fear... but also opportunities. Furthermore, the Merkozy alliance is over and Europe may focus more on growth.

Great companies were founded during or shortly after a recession or a market decline (Texas Instruments in 1930, Samsung in 1938, McDonald's in 1948, Walmart in 1962, Microsoft in 1975...).

Government Debt to GDP is much lower in emerging/developing economies, and the age distribution is better.

While the Net Present Value of health care and pension costs grew to more than 200% of GDP for the U.S. (Vs. around 50% for France or Germany), U.S. Stocks have more than doubled since March 2009. In the meantime, middle-class spending continues to grow and is expected to increase six-fold in the Asia-Pacific Region by 2030.

Adding international stocks to a U.S. stock portfolio will decrease the portfolio volatility.

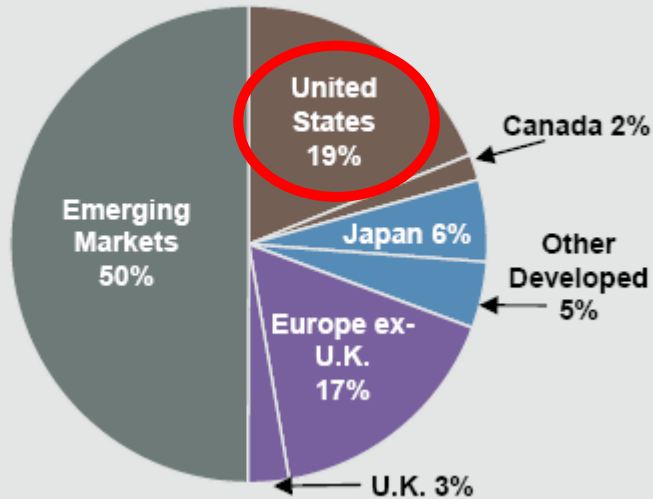


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U.S. GDP is Only 19% of the Global GDP

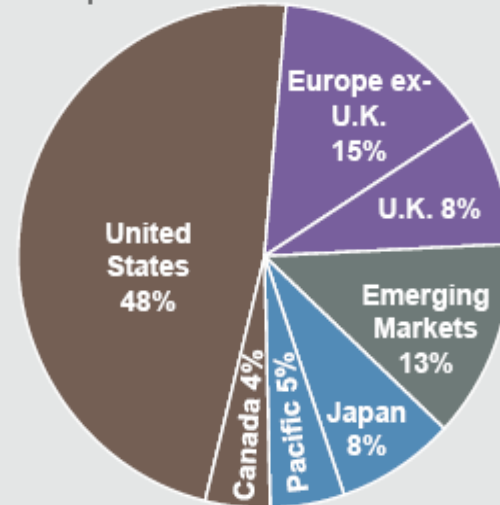
Share of Global GDP

Based on purchasing power parity



Weights in MSCI All Country World Index

% global market capitalization



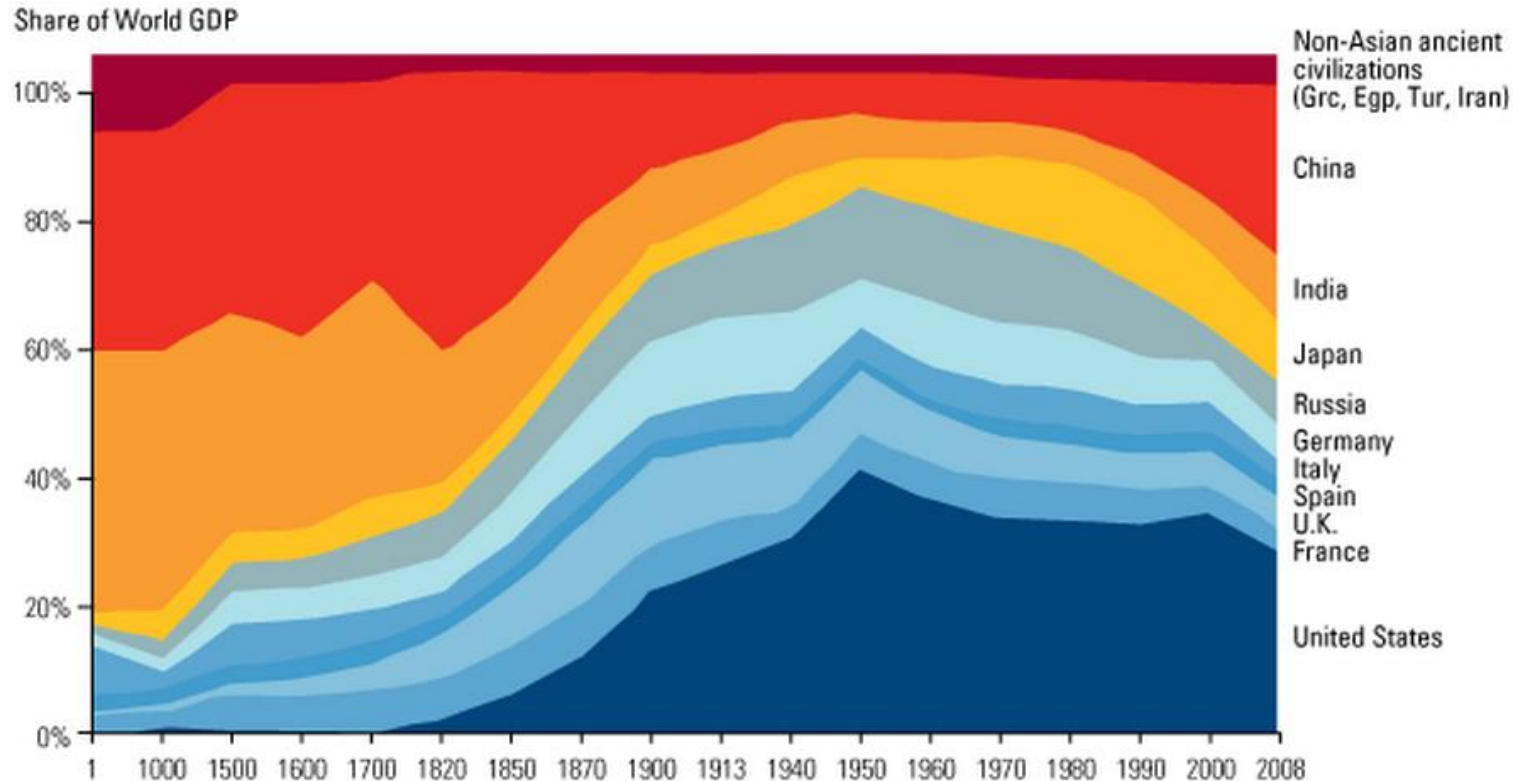
MSCI All Country is an index representing all the stocks in the world

Source: MSCI, S&P, IMF,
FactSet, J.P. Morgan as of
06/30/2012



Economic History of Major Powers: China is Returning to Historical Norms?

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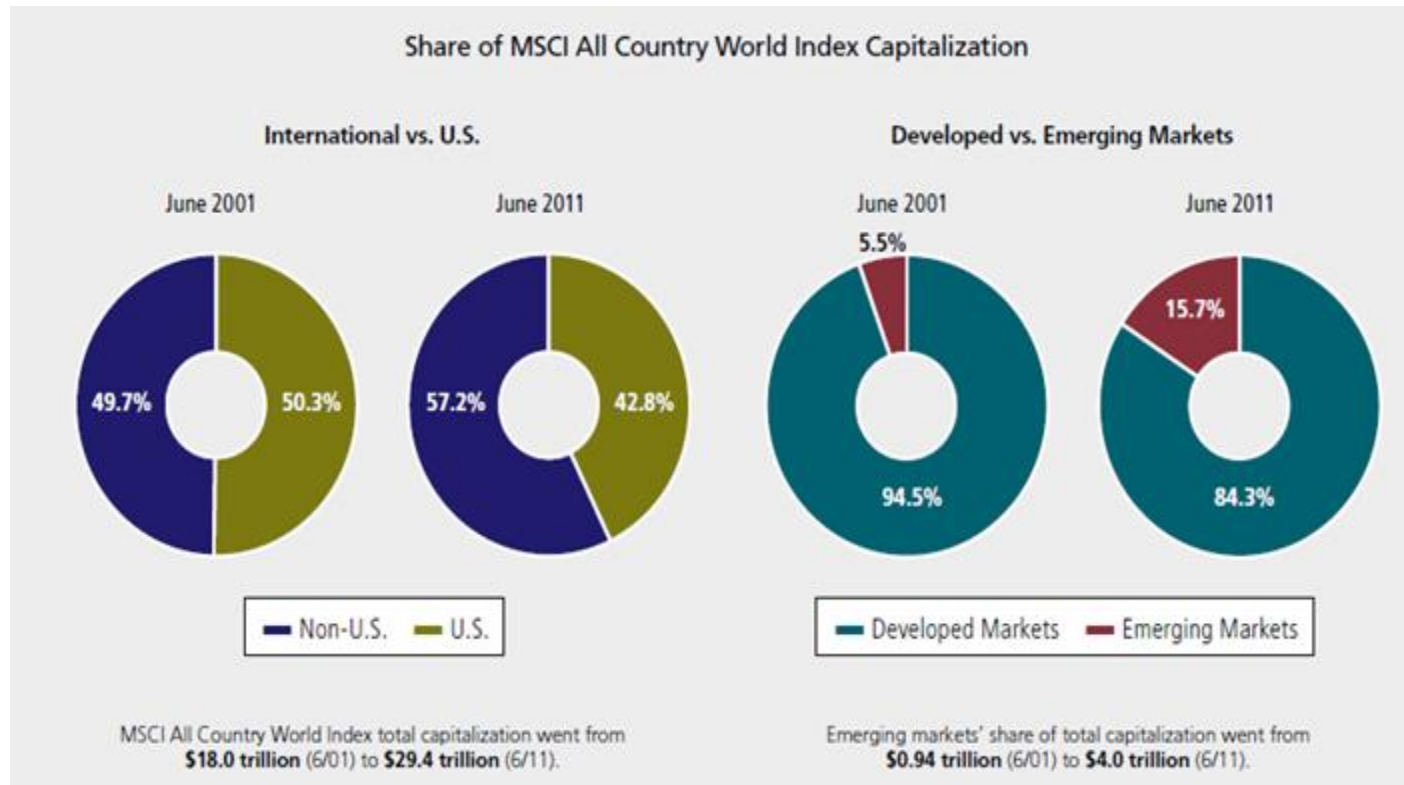


Source: Statistics on World Population, GDP and Per Capita GDP, 1-2008 AD, Angus Maddison, University of Groningen



International and Emerging Markets Stocks Have a Growing Share

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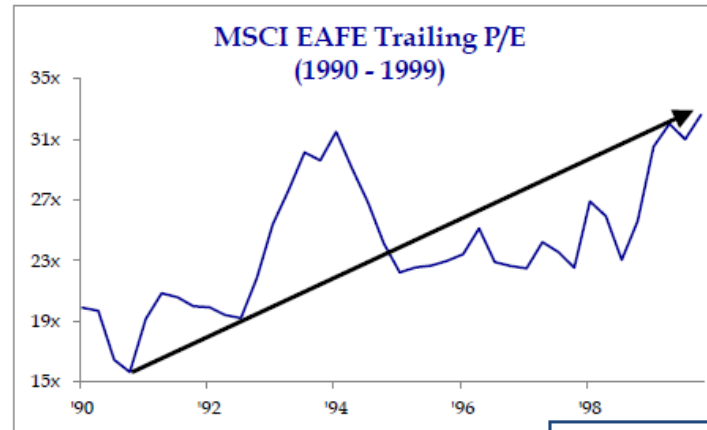


Source: FactSet

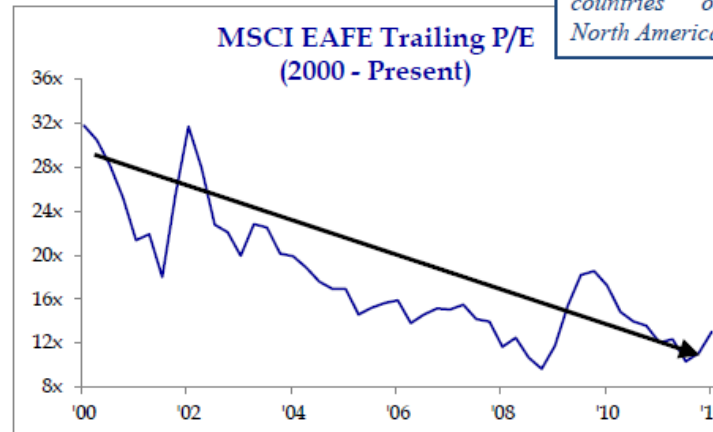


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MSCI EAFE P/E Ratio is Low Implying Low Valuation



The MSCI EAFE index represents developed countries outside of North America.

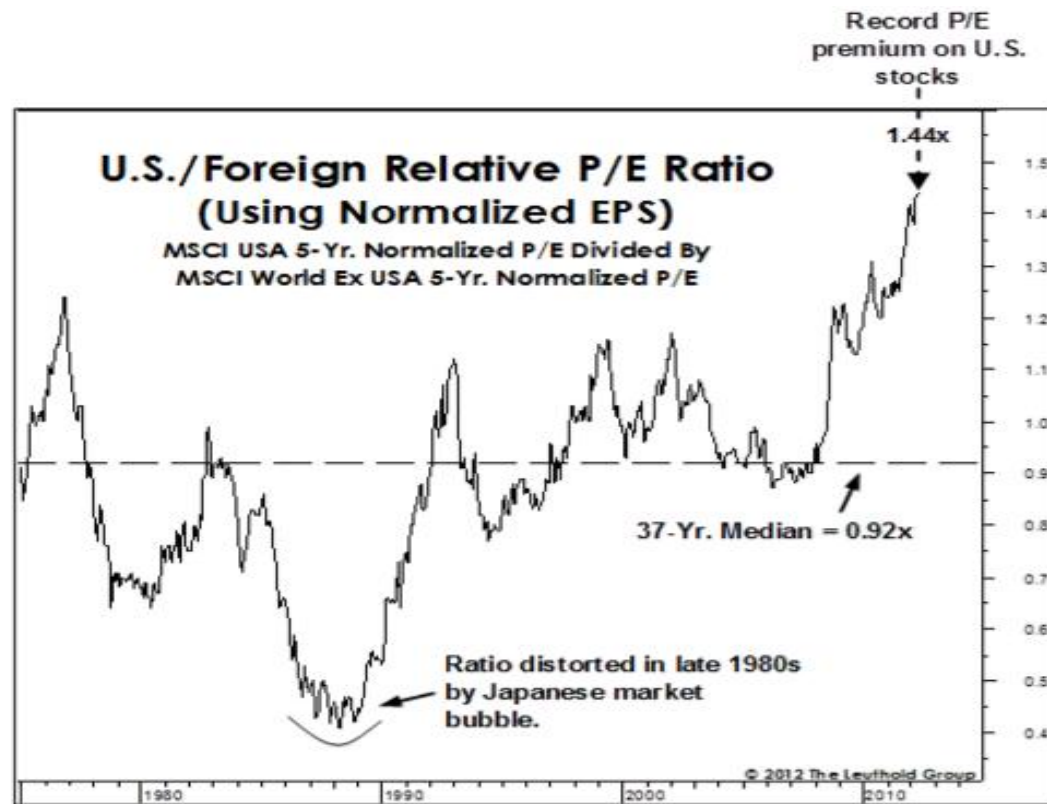


MSCI EAFE index is designed to measure the equity market performance of developed markets (Europe, Australia, and Far East) outside of the U.S. & Canada

Source: Strategas

U.S. P/E Ratio is High Relative to Foreign P/E Ratio

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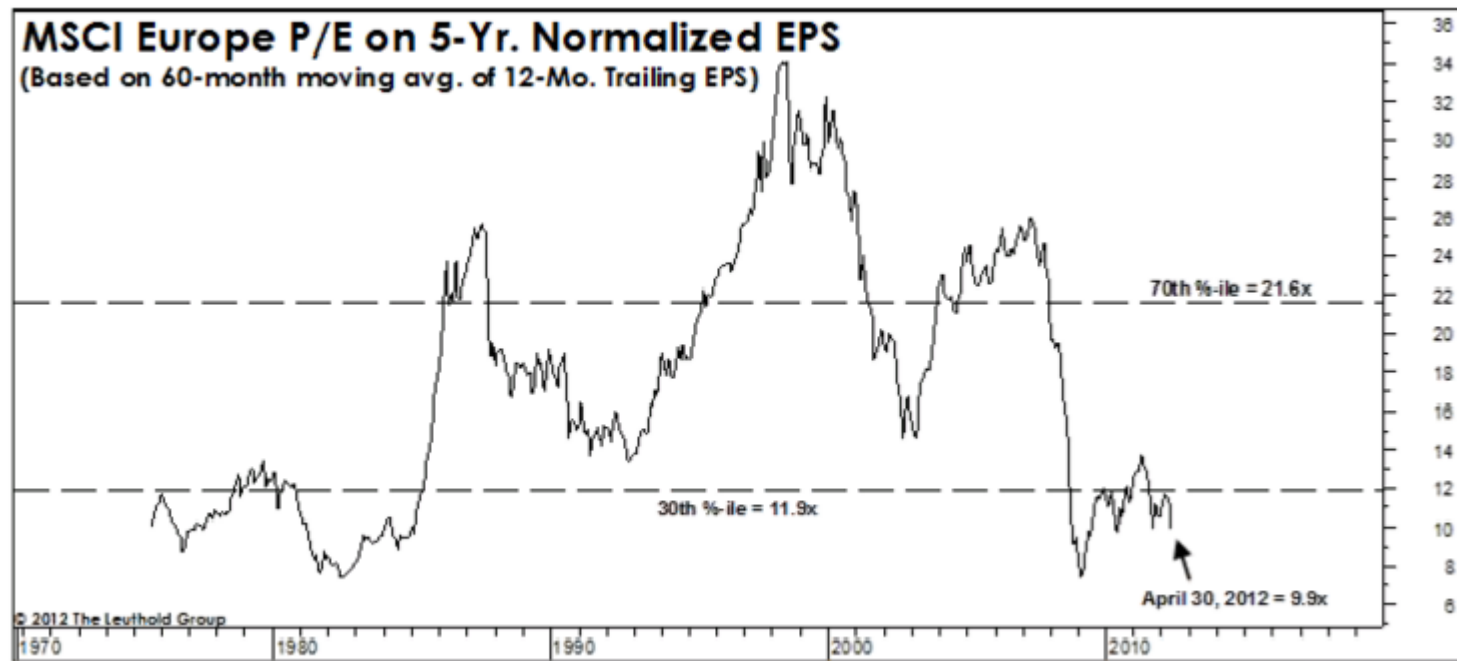


U.S. stocks seem to be expensive compared to International stocks



MSCI Europe P/E Ratio Is Low Compared to its History

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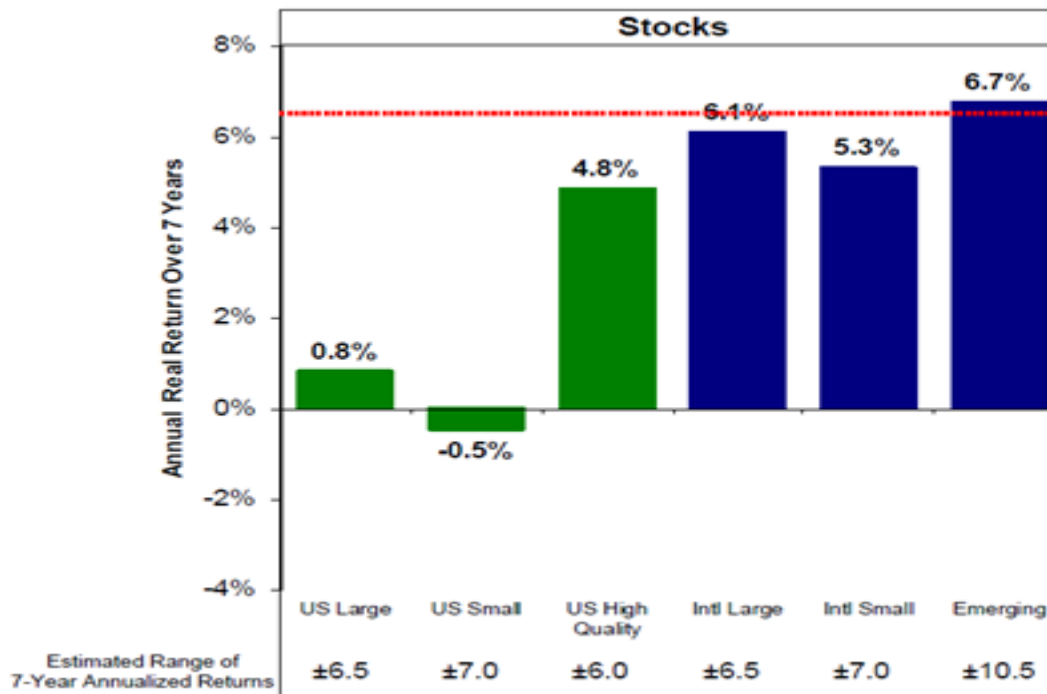


European stocks seem to be inexpensive compared to history and their Earnings



Great Investor Jeremy Grantham (GMO) Also Believes in International Stocks

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Grantham believes that International and Emerging stocks will increase by 5% to 6% per year adjusted by inflation.

Jeremy Grantham is a British investor and Co-founder and Chief Investment Strategist of Grantham Mayo Van Otterloo (GMO). Grantham is regarded as a highly knowledgeable investor in various stock, bond, and commodity markets, and is particularly noted for his prediction of various bubbles.



Historical Stock Markets Returns: Diversification is Important

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	1970s	1980s	1990s	2000s	2002-2011
Canada	11.0	11.7	9.9	9.2	11.7
Europe	8.6	18.5	14.5	2.4	4.9
EAFE (Europe, Australia, Far East)	10.1	22.8	7.3	1.6	5.1
World	7.0	19.9	12.0	0.2	4.2
Pacific	14.8	26.4	0.5	-0.3	5.8
United States	5.9	17.6	18.2	-0.9	2.9

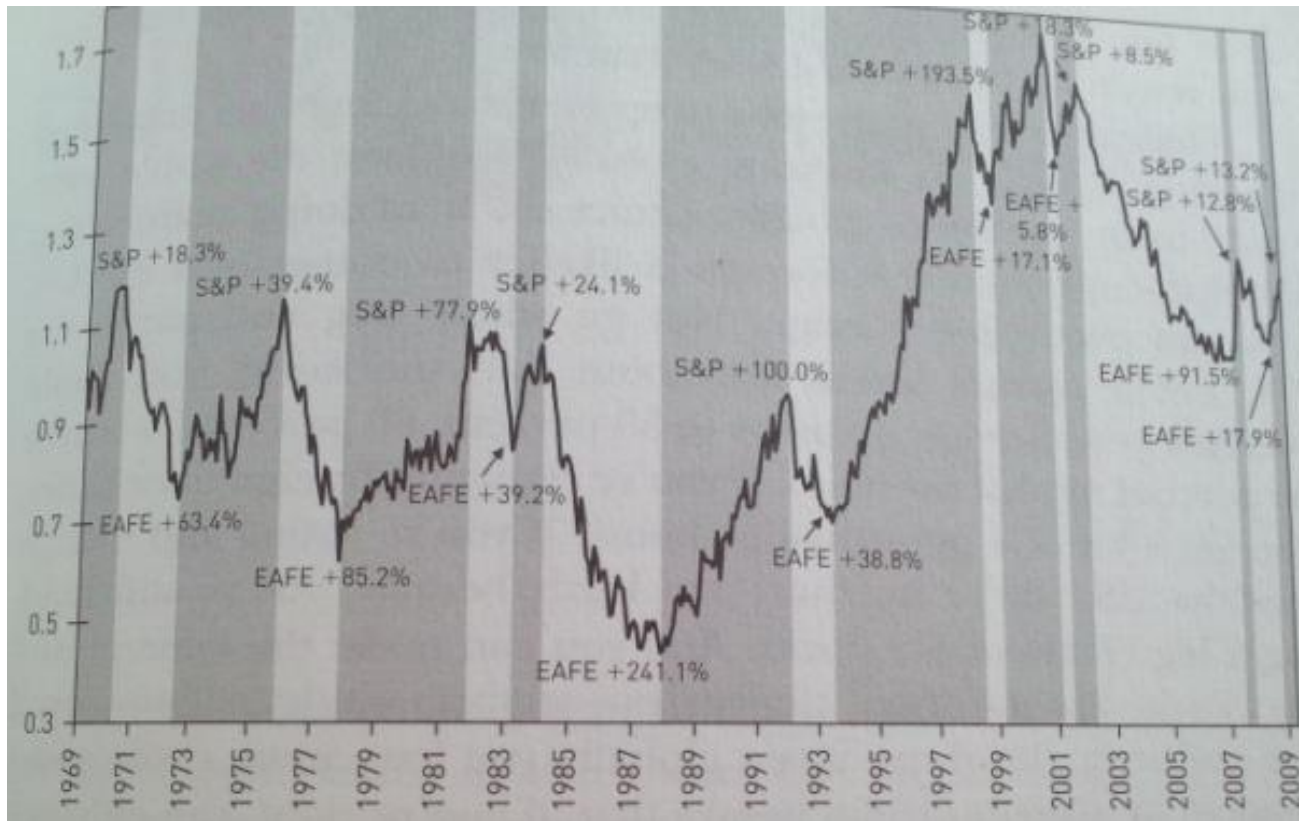
Source: Ibbotson, MSCI, Fama-French



S&P 500 Vs. MSCI EAFE:

Sometimes U.S. Leads, Sometimes U.S. Lags

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When the line is going up, U.S. stocks outperformed International stocks

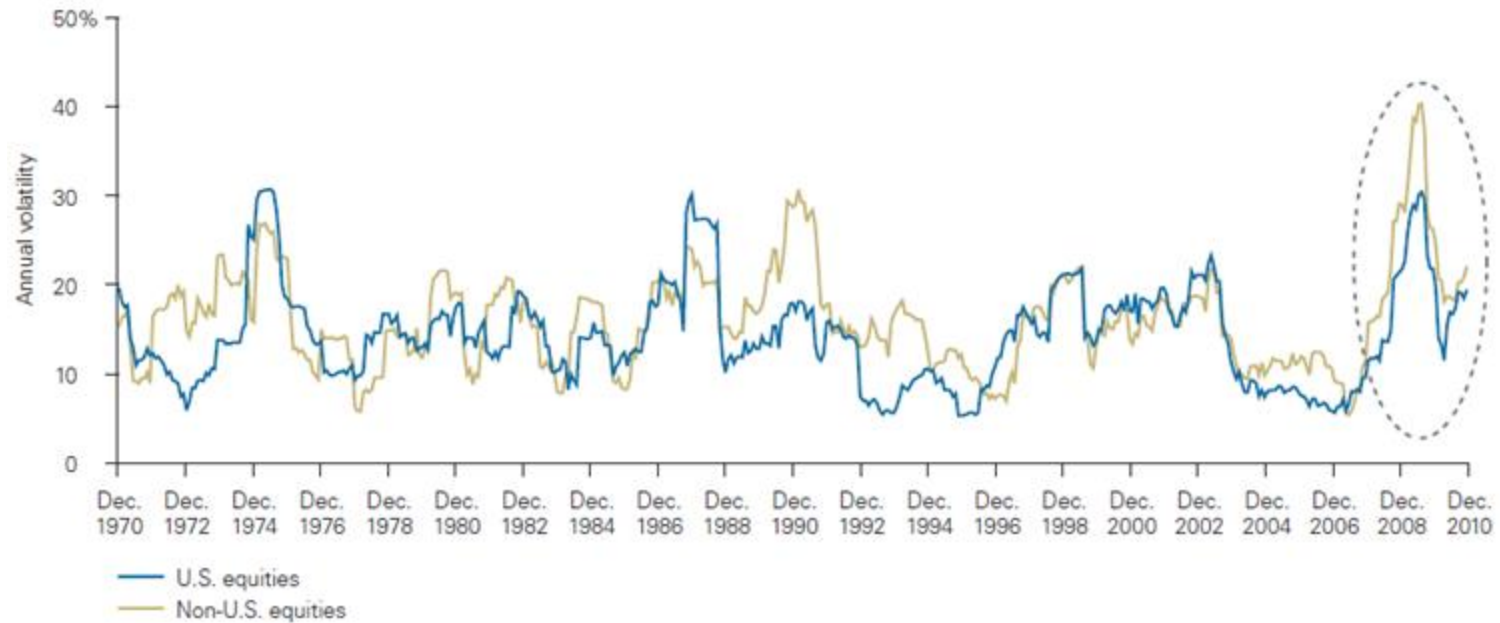
Source: Thomson Reuters



Non-U.S. Stocks Have Similar Volatility as U.S. Stocks

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Rolling 12-month standard deviation of returns

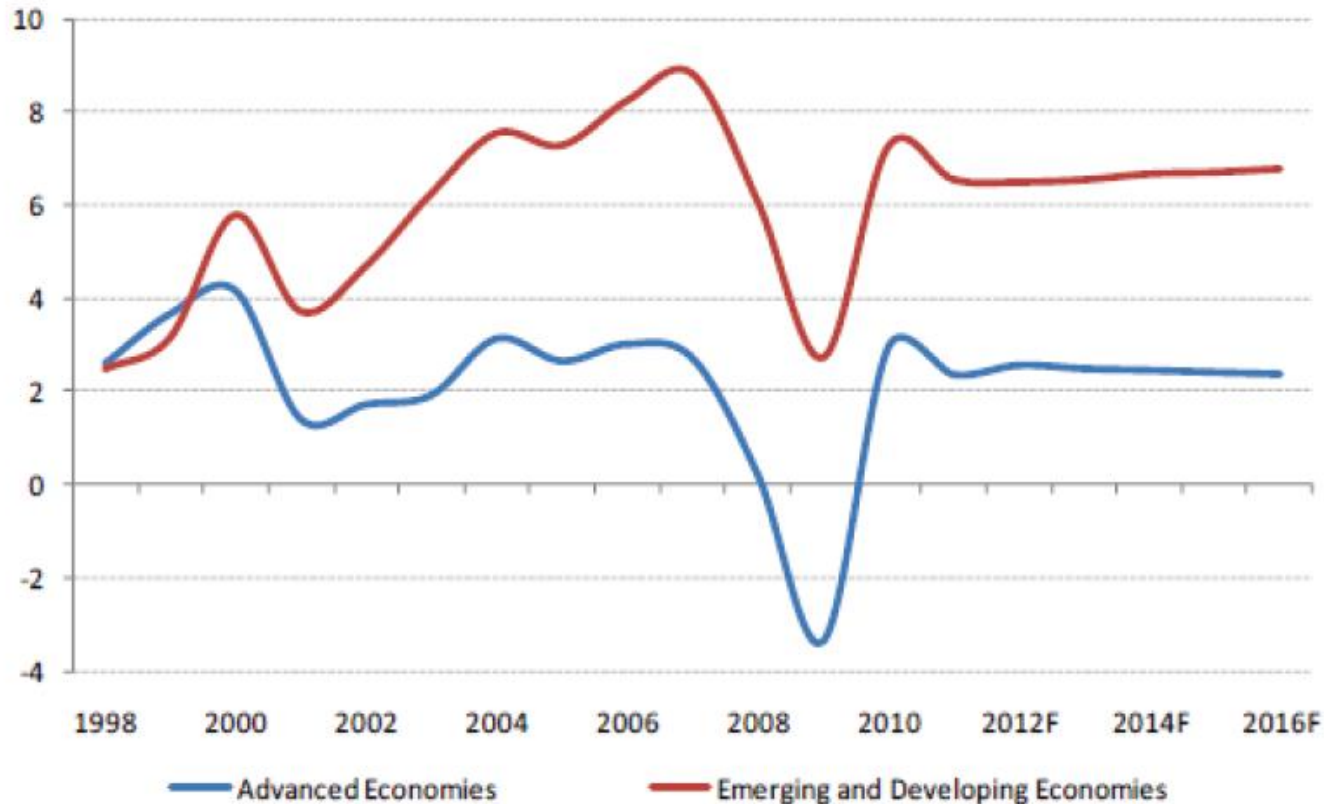


Source: Vanguard, Thomson Reuters, MSCI, J.P. Morgan as of 12/2011



% GDP Growth: Emerging Markets Grows Faster than Developed Markets

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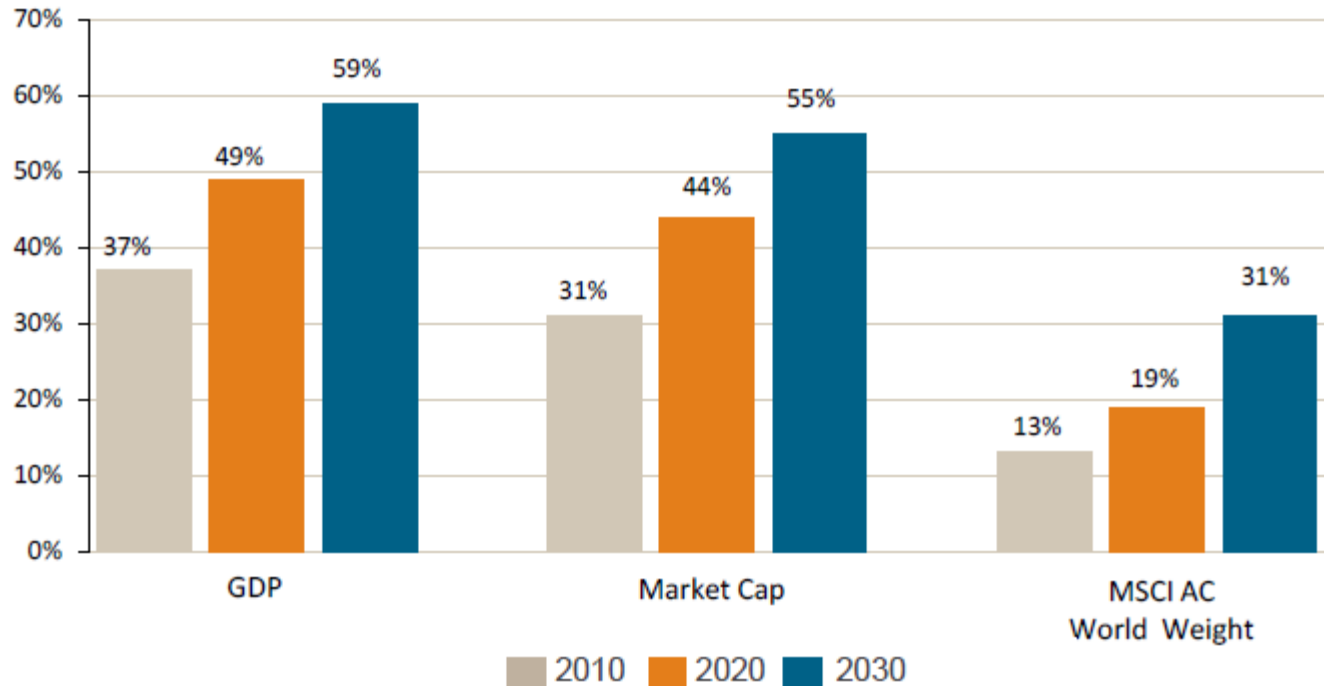


Source: Stone Harbor



The Emerging Markets Share of the World is Increasing

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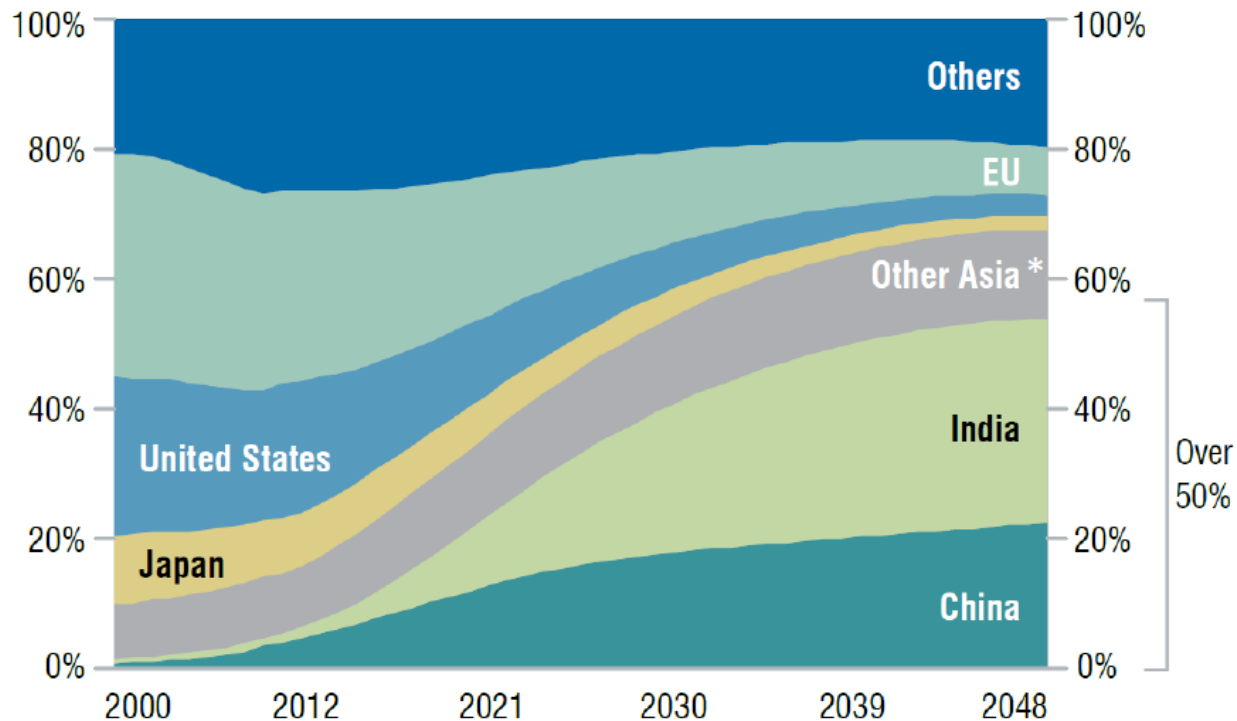


Source: Goldman Sachs, September 2010 – Global Economic Paper No. 204 “EM Equity in Two Decades: A Changing Landscape

The Share of the Global Middle Class Consumption is Increasing

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Projected Shares of Global Middle Class Consumption
2000-2050



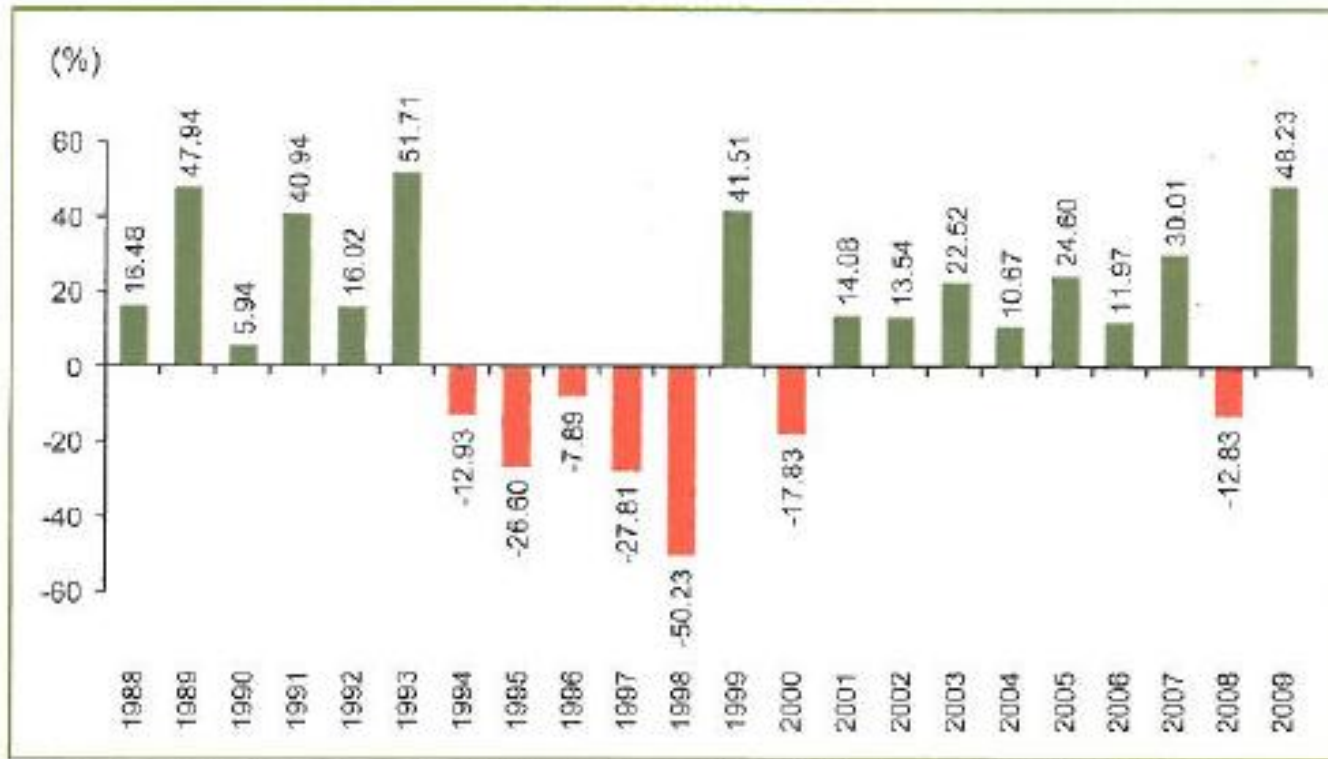
*Other Asia is defined as Asia excluding Japan, India and China. Source: Homi Kharas, "The Emerging Middle Class in Developing Countries." OECD Development Centre. 26 Jan. 2010. Web. Mar. 2011. <http://www.oecd-ilibrary.org>.

Source: OECD



Emerging Markets Outperformed Since 1988

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Source: Factset. 1. Difference in returns between MSCI EM Index and MSCI World Index.

Source: Credit Suisse



The Emerging Markets Population is Larger and Younger

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Economics							Demographics			
	GDP USD (B\$s)	GDP Per Capita	GDP Growth	Unempl. Rate	Inflation (CPI)	C.A. (%GDP)	Population	Population Growth	Median Age	Migration per 1000
Developed										
U.S.	\$15,094	\$48,387	1.9%	8.2%	1.7%	-3.5%	314 mm	0.9%	36.9 yrs	+3.6
Canada	1,737	50,436	2.0	7.3	1.3	-2.4	34	0.8	41.0	+5.7
U.K.	2,418	38,592	-1.3	8.2	3.0	-2.4	63	0.6	40.0	+2.6
Germany	3,577	43,742	0.3	6.8	1.7	5.5	81	-0.2	44.9	+7
France	2,776	44,008	-1.0	10.0	2.0	-1.8	66	0.5	39.9	+1.1
Japan	5,869	45,920	1.6	4.6	0.2	1.5	127	-0.1	44.8	-
Italy	2,199	36,267	-2.5	9.8	3.3	-2.2	61	0.4	43.5	+4.7
Emerging										
Russia	1,850	12,993	-2.0	5.4	3.6	5.4	138	-0.5	38.7	+0.3
Mexico	1,155	10,153	2.1	4.8	3.9	-0.5	115	1.1	27.1	-3.1
Brazil	2,493	12,789	4.1	5.8	5.0	-2.1	206	1.1	29.3	-0.1
China	7,298	5,414	6.6	4.1	3.0	2.8	1,343	0.5	35.5	-0.3
India	1,676	1,389	6.3	9.8	7.6	-2.3	1,205	1.3	26.2	-0.1

Source: FactSet, Eurostat, CIA, J.P. Morgan Securities, J.P. Morgan Asset Management.

GDP levels represent 2011 data and are from the April 2012 World Economic Outlook published by the IMF, except for the U.S. levels, which come directly from the BEA. All GDP Growth data are from J.P. Morgan Economics and expressed as % change versus prior quarter annualized. All GDP growth data are for 2Q12. India unemployment is from CIA estimates and is as of 2011. CPI Inflation is shown as % change versus a year ago and all data are for May 2012, except for India and Japan, which are as of April 2012. Unemployment rate for developed countries comes from FactSet Economics, Eurostat and Statistics Canada and represent the most recently available data. Demographic data provided by CIA World Factbook at CIA.gov.

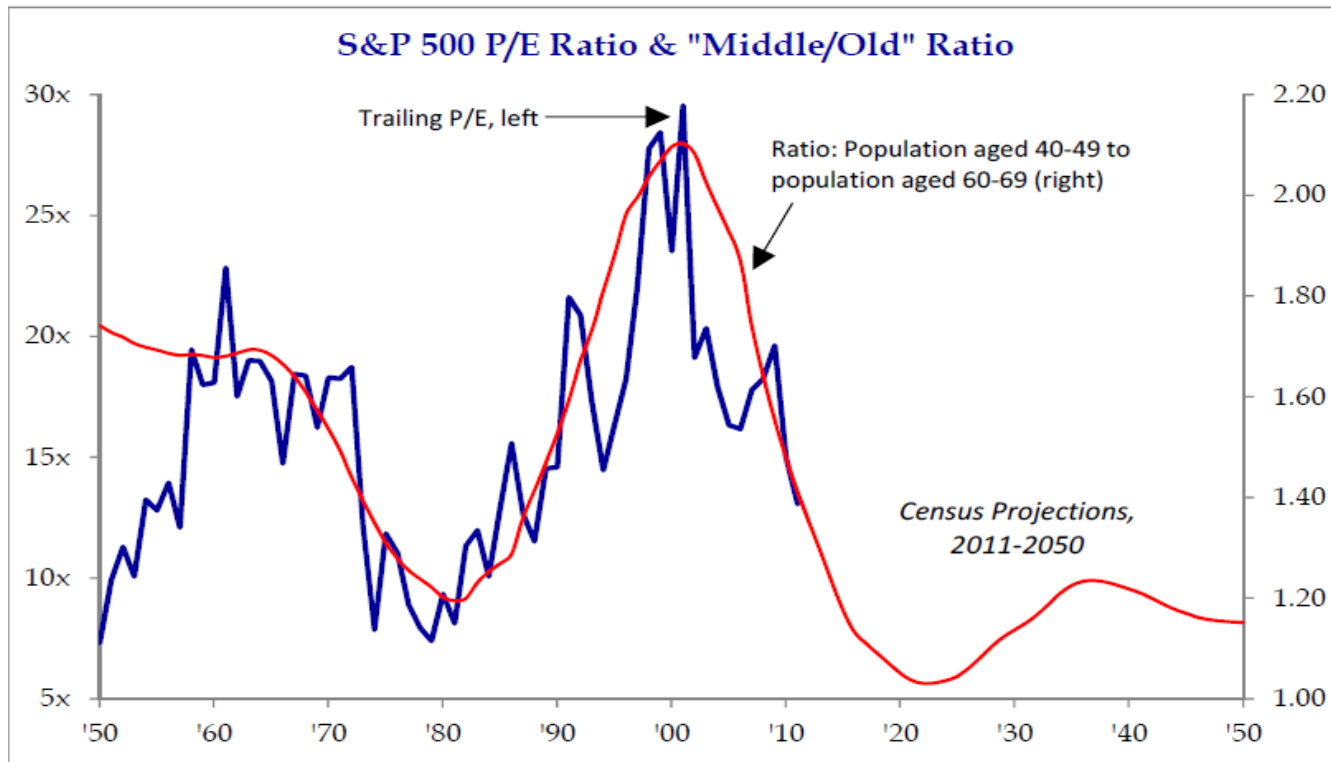
Current Account (C.A.) represents each country's current account balance as of 3/30/12. Russia, China, and Brazil's current accounts are as of 12/31/11.

Data are as of 6/30/12.



Middle/Old Population Ratio May Put Some Downward Pressure on the P/E Ratio

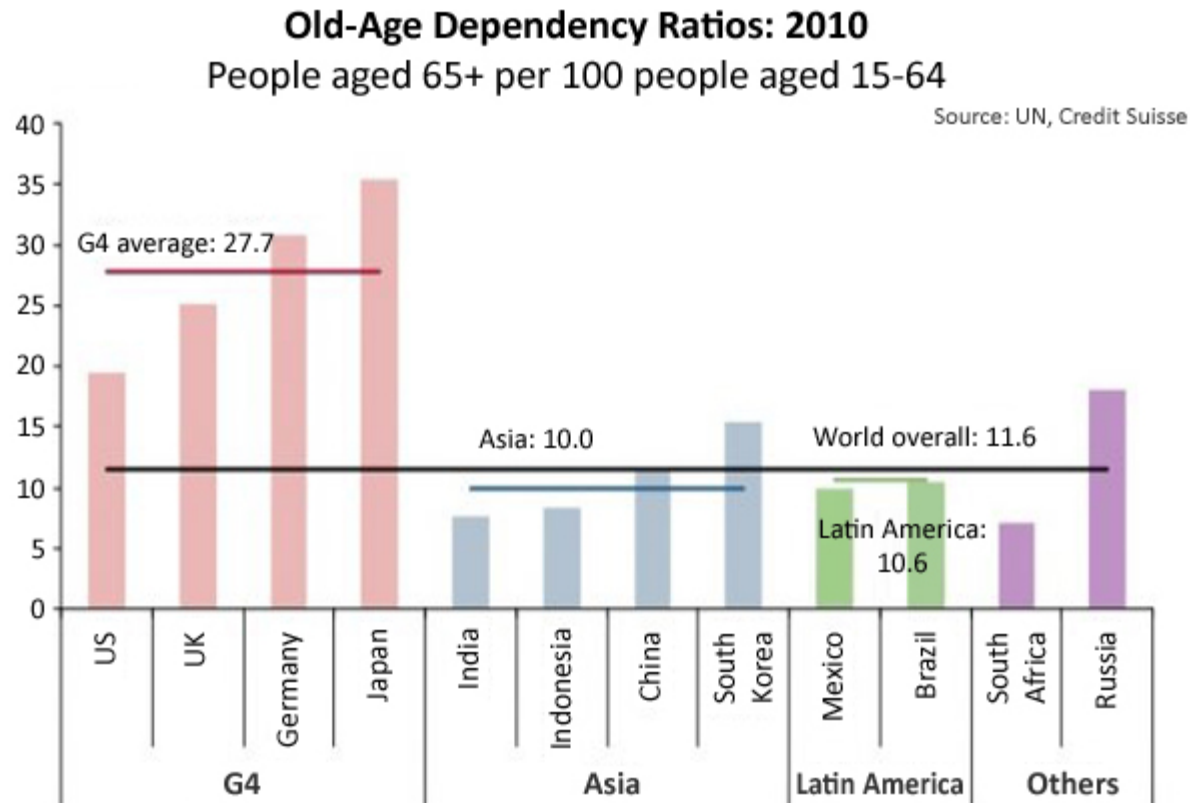
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Based on SF Fed calculations: <http://www.frbsf.org/publications/economics/letter/2011/el2011-26.html>

The number of old people will increase in the next 10 years and may put pressure on U.S. stocks

Source: Credit Suisse



Where are the Millionaires?

Pockets of wealth

		MILLIONAIRE* HOUSEHOLDS (% OF TOTAL HOUSEHOLDS)	SHARE OF WEALTH HELD BY MILLIONAIRE* HOUSEHOLDS (%)
1	Singapore	11.4	52
2	Hong Kong	8.8	74
3	Switzerland	8.4	44
4	Kuwait	8.2	67
5	Qatar	7.4	63
6	UAE	6.2	63
7	United States	4.1	55
8	Belguim	3.5	36
9	Israel	3.3	36
10	Taiwan	3.0	38
	Global average	0.8	38

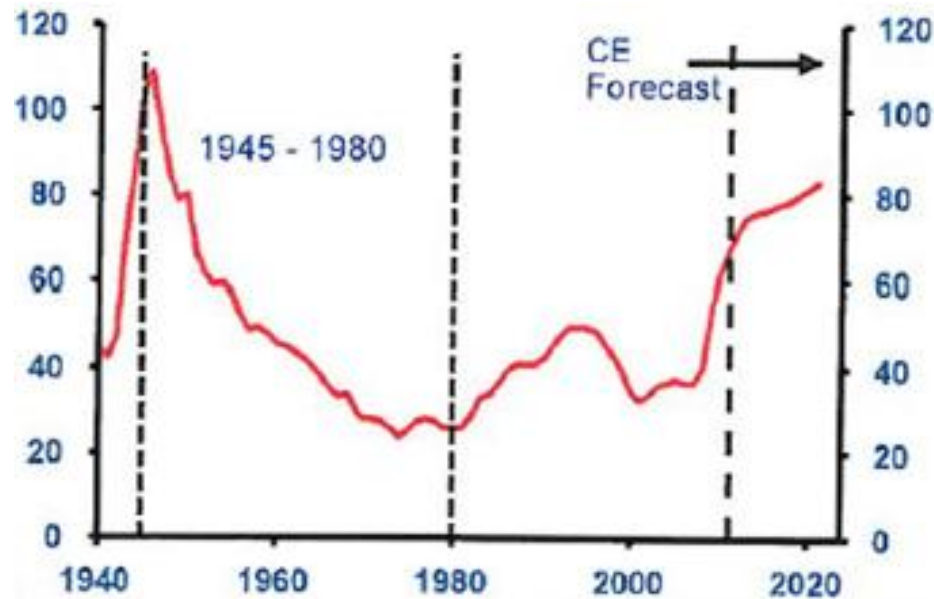
* Millionaire households are those with more than US\$1m in assets under management

Source: BCG



U.S. Government Net Debt Situation (as a % of GDP) is Worrisome

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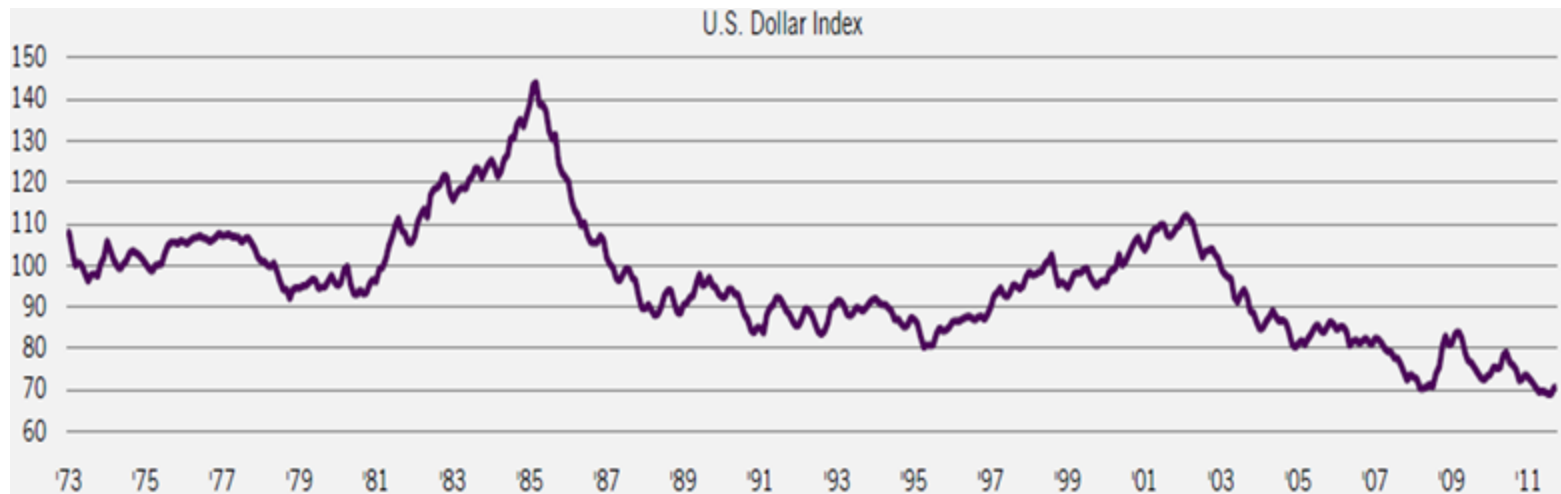


Source: Thomson Datastream,
Capital Economics (CE)



U.S. Dollar Has Been Decreasing Since 1985

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Source: Federal Reserve
as of 10/31/11



International Bonds Have Good Diversification Benefits

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	Lehman Bankruptcy	Enron/ WorldCom	9/11	Russia/ LTCM	1994 Fed Rate Rise	Gulf War	1987 Stock Market Crash	1979/80 Oil Price Rise
	Q4, 2008	Q2, 2002	Q3, 2001	Q3, 1998	Q1, 1994	Q3, 1990	Q4, 1987	Q3, 1980
US Equity	-22.4	-14.4	-14.7	-9.2	-3.8	-13.7	-23.0	9.7
EAFE Equity	-20.0	-2.1	-14.0	-14.2	3.5	-21.2	-10.6	6.2
US Bonds	8.9	4.5	5.5	5.7	-3.0	0.9	5.5	-8.8
Int'l Bonds	8.8	14.0	7.8	9.6	1.9	6.1	24.0	1.9

Unhedged US dollar returns (%)

Source: MSCI/Citigroup

	2005-09	2000-04	1995-99	1990-94	1985-89	Past 25 Years
US Equity	0.0	-3.6	29.0	8.1	18.5	8.6
EAFE Equity	3.5	-1.1	12.8	1.5	36.1	5.4
US Bonds	5.0	7.4	7.4	7.5	12.0	7.0
Int'l Bonds	4.6	8.8	5.9	11.4	19.3	7.7

Annualized unhedged US dollar returns (%)

Source: MSCI/Citigroup

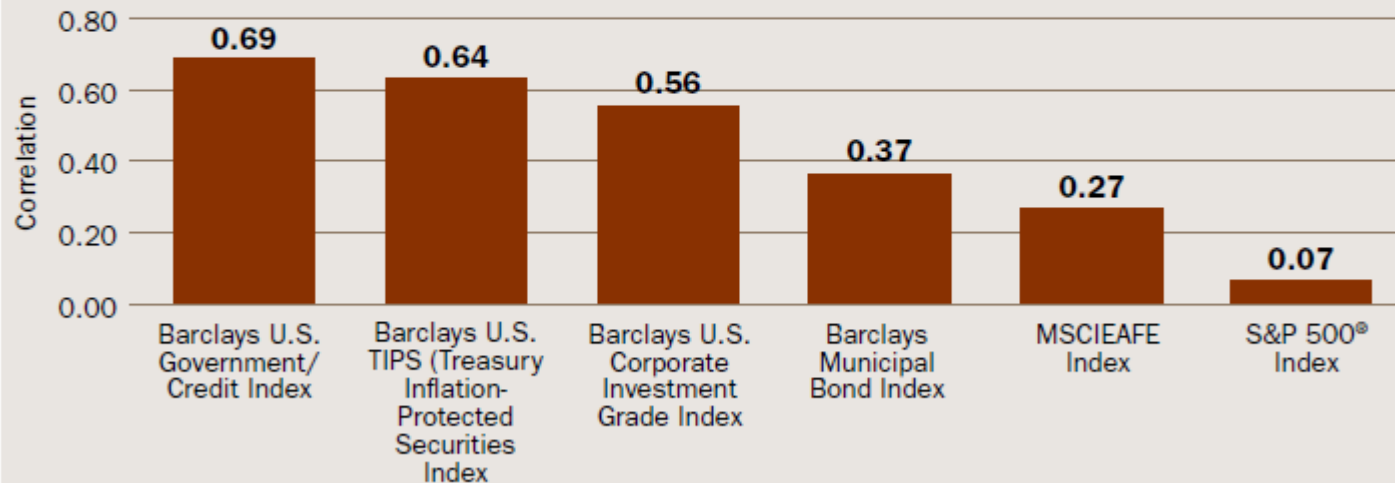


International Bonds Have Good Diversification Benefits

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Historical Low Correlation With Other Asset Classes

For the 10-year period ended March 31, 2012, global bonds, represented by the Citigroup World Government Bond Index, have shown a low correlation to U.S. bonds as well as to international and U.S. equities



Source: Zephyr Style Advisor



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Our core investment belief is that asset allocation (equities, fixed income, cash, real estate...) is the single most important determinant of success in any investment plan. The dominant amount of risk and return comes not from your choice of individual investments but from your asset class mix. Bourbon Financial Management focuses our resources on risk management, asset allocation, and securities selection.

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616 W. Fulton St., Suite 411, Chicago, IL 60661, USA

(+1) 312-909-6539 ~ www.bourbonfm.com



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