5 Issues & 5 Answers looking ahead to 2017

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Issue 1: The main risks for 2017

Risks, both expected and unexpected, could impact markets in 2017. We have identified more than twenty probable risks that should concern markets during 2017. We shall outline the Top 8.

1. Fast Paced US interest rate increases.
2. US recession.
3. Unfunded Pension Liabilities, a $20.4 trillion problem.
4. Escalating Middle East Conflict.
5. Increased Migration Crisis.
6. Eurozone Political Shifts: Changes in Italy, Germany & France.
7. Chinese Economy Hard landing.
8. Compromised market liquidity.

Effective planning will be the key to managing risks that could affect your portfolio, diversifying effectively, and hedging against unforeseen risks.

Most of the risks are region or country-specific, so investors who avoid excessive concentration in any one country or monetary policy can reduce their vulnerability. This is a key discussion that most local investors need to have in order to prepare the portfolios for a new beginning.

The FED raised interest rate on 12/14/16 from 0.25% to 0.50% with three more increases expected during 2017, combined with the Unfunded Pension Liability facing the fifty (50) states and territories will be a large focus of discussion and impact during the year. The combined effect of the Escalating Middle East crisis and the increased migration will add pressure to the whole world. With the election of Donald Trump, we should expect a mayor policy change for the region from the US.

Even when global risks arise, they do not impact all assets equally. For instance, higher inflation might be bad for cash but good for real assets and equities. Or higher interest rates might hurt high quality bonds.

Issue 2: What does the Trump Presidency mean for the Global markets

Donald Trump's surprise election as the 45th President of the United States will evolve into an abrupt shift in most policies of the US, we have seen several key designations that clearly outline a focus changing the status quo and developing new rules of engagement in issues ranging from economics, job creation, diplomatic policy, trade deals, and defense among other issues. We have seen the markets react positively to President Elect Trump as evidenced by the Dow Jones Industrial Average surpassing the 19,900 mark.

The promise of large tax cuts and higher public spending were key issues of the Trump Platform that will be looked at closely. As President Elect, Trump pledged more than $1 Trillion in US infrastructure spending over the course of the next decade. The large economic push driven by lower taxes and increased federal spending will have broad macroeconomic and investment implications.

Issue 3: Will the markets be impacted by the rate increases

Global markets should struggle without access to low rates, however this does not necessarily mean that access to low rates will be over, even with the Federal Reserve increasing its rates and the European Central bank reducing its quantitative easing program during 2017.

Most indicators point that inflation is increasing, most notably we have seen consumer prices climb both in Europe and the US at their fastest pace in close to three (3) years. As expected the Federal Reserve officials, amid signs that the U.S. economy soon could shed its long period of stagnation, approved the first interest rate hike in a year Wednesday and said it foresees three more increases next year. The stock market reacted calmly, while bond yields and the dollar rose. The yield on 2-year Treasurys hit its highest level in since August 2009. The Federal Open Market Committee raised its target range from a range of 0.25 percent to 0.5 percent to 0.5 percent to 0.75 percent. The overnight funds rate currently sits at 0.41 percent. The committee also approved a quarter-point increase in the discount, or primary credit, rate, from 1 percent to 1.25 percent.

Although it's too early to predict how big of an increase the FED will ultimately impose we have seen the treasury 10-year yields climb above 2.5 percent for the first time since October 2014 as surging oil added momentum to a global rout in bonds. An interesting fact that should be noted is the fact that Fed Chair Janet Yellen has said that she is comfortable with inflation that runs above target in order to encourage greater labor market participation. We should remain watchful for other developments.

Issue 4: How to address Brexit and European instability

With national elections set for France, Germany and the Netherlands in 2017, each of which feature a far right candidate, there is potential for economically damaging protectionist policies in the Eurozone.

However, these merely form the backdrop for the most significant geopolitical event to occur in 2017, Britain's triggering of Article 50 and the commencement of its slow exit from the European Union.

While Britain's influence in the global economy has diminished in recent decades, the impact of the June Brexit vote was felt

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in markets and currencies across the globe. The fact that markets are still rattled was shown recently by the British pound's fall to 186-year-lows in the wake of British Prime Minister Theresa May's announcement that Brexit would commence by next March.

The longer the saga continues, the longer the associated uncertainty will be priced into equities and currencies, dampening corporate investment and damaging the European economy as a whole.

Italy suffers from political instability, economic stagnation and lack of structural reforms. Prior to the 2008 financial crisis, the country was already idling in low gear. In fact, Italy grew an average of 1.2% between 2001 and 2007. The global crisis had a deteriorating effect on the already fragile Italian economy. With the defining victory of the "No" in the Italian referendum and the resignation of reformist Matteo Renzi investors will be watching developments in Italy closely as they assess the risks of an anti-euro shift and weight the chances of contagion. Events in Italy could also influence decisions by the European Central Bank on how long it sticks with its easy-money policies. Capital has flowed out of Italy steadily for much of this year. In recent weeks, concerns have sent the gap between Italian and German 10-year government bonds to their highest level since 2014, while Italy's stock market has been among Europe's worst performers this year.

Issue 5: What happens to Puerto Rico Economy and Bonds with the actions of the Puerto Rico Fiscal Oversight Board

Now that the Fiscal Supervision Board has begun its work we have seen a small increase in the prices of the bonds tied to the actions of the board and the recent election of Governor Elect Ricardo Rossello Nevarez. Governor Elect Rossello had stated through his campaign that Puerto Rico must honor its debt commitment and should restructure the terms of its debt in order to achieve this goal, he has presented specific plans to reduce the size and scope of the government, it has included in his plan the use of Public, Private Partnerships with Participation and has named one of his most trusted advisors, Attorney Elias Sanchez, to represent him in the Fiscal Oversight Board. The challenges facing both the Governor Elect and the Fiscal Oversight Board are hard, complex and many, we must attempt to propose, advice and counsel both in order to seek the best outcome for Puerto Rico.

Puerto Rico has been suffering economic contraction for more than a decade and even though the country has made several efforts to revamp our economy, these efforts have not worked. Now, after two decades of fiscal imprudence, excessive spending, salary and benefit increases to all public employees without metrics to justify them, we are faced with a liquidity crisis and no access to the capital markets. Puerto Rico has been and continues to face a crisis of a magnitude no other US State or territory has faced.

A recurrent topic in the analysis of Puerto Rico's Economy has been its weak performance for the past three decades during which our economy grew at the paltry pace of 2%. A rate well below that of our peer group.

Joseph Schumpeter, the famous Austrian economist, used the term "creative destruction" to describe the market forces that promote constant innovation. We must accept these forces when our economic reality changes and re-adjust our focus towards new industries and initiatives that reactivate the economic engine.

In 2017, more than any time in history investors need to focus on seeking trusted advisors and creating parallel processes to implement and supervise any investment strategy, this applies from small mid-sized entrepreneurs to large complex corporations. At Birling Capital, we provide the transformational tools to bridge the gap between nominal performance to outstanding performance that marry investment returns with their goals, strategies, vision and aspirations.

We are committed to providing best in class advice combined with a made for measure approach for your needs.

This concludes our update; we look forward to your calls, visits or emails to discuss further.

FIRM OVERVIEW

Birling Capital is a boutique corporate advisory & consulting firm that offers broad corporate finance & advisory services to institutional, government, corporate, middle-market companies, family corporations and their owners, in identifying and resolving corporate finance related issues as part of a holistic approach both assets and liabilities sides with integrated business, personal, family needs and objectives.

FRANCISCO RODRIGUEZ-CASTRO, PRESIDENT & CEO

Mr. Rodriguez-Castro is President & CEO of Birling Capital since its creation and manages all aspects of its practice. Mr. Rodriguez-Castro with over 25 years of experience has been a key executive in government, global, multinational and public companies as well as a key corporate advisor to multiple entities in a diverse array of market segments. He has participated in structuring over $10 billion in Municipal Finance, Corporate, Commercial, Asset Based, AFICA and Mergers and Acquisitions transactions.

Mr. Rodríguez Castro has been Managing Director at UBS, President & CEO of the Economic Development Bank and held senior lending positions in the corporate banking sector. He is also a key leader in promoting the private sectors participation in the formulation of public policy of the country supporting the governments in its efforts to achieve and maintain sustained economic development for Puerto Rico. In addition to his management roles he was the founder of the Private Sector Coalition a not for profit association

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