THALASSA
CAPITAL LLC

Quarterly Letter March 2013

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THALASSA CAPITAL LLC

Macro outlook

2013 was ushered in three months ago amidst clouds of fiscal uncertainty in the US, economic slowdowns in Emerging Markets and misplaced austerity in most of Europe. As a result, most investors kept looking for safety in the coziness of Uncle Sam debt and other fixed income instruments. As it often happens, equities, especially in the United States, bucked the expectations and delivered a strong first Quarter performance. The upside surprise was a direct consequence of good absolute valuations, excellent relative valuation (to bonds) and a series of domestic economic numbers that have mostly surprised to the upside.

The economic recovery that we are witnessing after the 2008-2009 financial debacle has often been belittled for its lack of vigor and for its dependence on the Federal Reserve miracle drugs. However, it may be possible that we are finally reaching what Bill Gross termed "escape velocity" " or that rate of growth that would assure improving economic performance unassisted by the generous handouts of the Federal Reserve and the government in general.

The housing market seems to be stabilizing, as the affordability index combined with rising rents is making residential real estate more attractive. It should be noted that some areas in the country may still be subject to a renewed flood of inventory as banks and other sellers may be induced to release properties at prices that may finally be moving higher. A turn around in prices was underscored by the most recent data showed by the S&P/Case-Shiller index which climbed 8.1 percent in January from the same month in 2012 after rising 6.8 percent in the year ended in December 2012.

What is possibly going to help sparking an economic virtuous circle is the energy renaissance occurring in the United States. The large discoveries of oil and natural gas in the fields primarily of Bakken (North Dakota), Eagle Ford (Texas) and Marcellus (stretching across New York, Pennsylvania, West Virginia, Ohio and Maryland) should help in different ways. They will help keep manufacturing costs low in the US, they will create new jobs and eventually help address the current account deficit as less oil will be imported and some LNG will be exported.

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This energy theme continues to be a favorite of ours and we still see opportunities in energy infrastructures, energy transportation and energy related services such as, for instance, water purification in the fracking process. Master Limited Partnerships engaged in energy logistics have been star performers year to date and while we believe such intensity cannot continue, the sector's outlook remains positive. In terms of infrastructures, we now see opportunities not only in the United States but globally and specifically Brazil and Mexico.

In the US we do have one potential headwind represented by a deteriorating fiscal position and a broken political system unable to find long term working compromises. If our political system seems unable to find solutions, governments on the other side of the Atlantic seem even more confused. The stabilization process of the European debt problem and the correspondent issue of the common currency continue to move in "mysterious ways" amidst comforting decisions (mostly from the ECB), grand statements of unity from some Heads of States and a series of inconsistent actions by all involved. The recent botched rescue of tiny Cyprus underscores the lack of a grand plan; this situation increases the possibility of unintended consequences like a possible run on the banks of other peripheral but largely more significant countries. Ultimately, we still view Europe as an opportunity rather than a volcano about to erupt but we are conscious that the road to stabilization and prosperity will be long and winding like the road to Tipperary.

As far as Emerging Markets, we view the ongoing (and yes very slow) transition to economies less tilted toward exports and capex investments and more balanced in terms of internal demand as a long term positive. In this light, we continue to prefer opportunities in stocks that play to that constituency. A research report from Pimco has recently indicated a preference for Asian gaming stocks as a play on the transition we mentioned above. The Chinese stock market seems to agree with this thesis; indeed, the CSI 300 consumer discretionary index has returned 116% since the local markets hit bottom in October 2008 practically doubling the performance of the index as a whole and almost quadrupling the returns of the industrial subsector (source: Financial Times).

With the exception of Europe, it would seem stronger economic growth may be the surprise for the second half of the year, especially if the new government in Japan will follow pro-growth political manifestos with real actions. From an investor's perspective this may be good news but we all know that financial markets are supposed to be discounting mechanisms and therefore supposedly able to price future events in advance. Equities have certainly bought into this idea and produced a good rally so far; commodities on the other hand have remained subdued. In the case of an upside surprise, commodities may respond more vigorously than stocks. Bonds, especially US Treasuries, still show an unattractive risk/reward ratio. Overall, as far as fixed income,

we would like to reduce exposure as we think the probabilities of a reversal of fortunes for this asset class are rising.

In between equities and fixed income, the investment spectrum offers the alternative vehicle of REITs. REITs offer broad or specific real estate exposure in liquid vehicles. The nature of the assets held and the structure of their cash flows make REITs a classic of income portfolios, however, their liquid nature and instant pricing makes them more volatile than their counterpart: direct real estate investments. REITs performance this year has been very positive globally and such price appreciation has been compressing yields significantly. We like the space and the vehicle but at the moment we see only a few opportunities in specific segments of the market while the majors seem a little pricey in absolute terms.

Endowments allocations

In this first trimester of 2013, we had the chance to view the newly updated global asset allocations for the two most successful endowments in the country, Yale and Harvard which released their yearly reports. Their approach to investing has been the center of interest, envy and much debate for over a decade. Both schools have produced annualized rates of returns largely superior to their benchmarks and other institutional players; for this reason, they are often scrutinized for new ideas or shifting strategies.

What transpires from their allocation for 2013 is a continued overweight in alternative assets. Yale especially cast its dice in a significant manner in the Private Equity space with an allocation over 35%. Both endowments have a similar exposure to Alternative Strategies at approximately 15%. The allocations of these two successful institutional investors highlight the importance of combining uncorrelated strategies to a traditional portfolio.

We have just posted on the client section of our website a new study on the Endowment Model; please contact our office for log in formation to access this proprietary research.

Yale Endowment Allocation

Asset Class	% Allocated
Absolute Return	14.5%
Domestic Equity	5.8%

Foreign Equity	7.8%
Fixed Income	3.9%
Natural Resources	8.3%
Private Equity	35.3%
Real Estate	21.7%
Cash	2.7%

Harvard Endowment Allocation

Asset Class	% Allocated
Domestic Equities	11%
Foreign Equities	11%
Emerging Markets	11%
Private Equity	16%
Absolute Return	15%
Real Estate	10%
Natural Resources	12%
Publicly Traded Commodities	2%

Domestic Bonds	4%
Foreign Bonds	2%
High Yield	2%
Inflation Indexed Bonds	3%
Cash	0%