PERFORMA

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Monthly Market Perspective

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Performa is an independent, employee-owned investment management firm, founded in 1992. We combine more than 20 years of experience in the captive industry with the institutional expertise of our investment team to provide our clients with tailored investment solutions.

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The Macro View

Perhaps the new normal for the U.S. economy is a weak winter followed by an upbeat spring. The first half of 2015 stuck to the script as a first quarter swoon brought a second quarter rebound. U.S. economic activity expanded by 2.3%, according to preliminary estimates released in July. Car and truck sales led growth in consumer spending with an additional push from the service sector. Gas prices remain lower than a year ago, putting a few extra dollars in consumers' pockets; however, the glass is only half full as many businesses continue to hold back on capital expenditure plans due to uncertainties in the oil patch. While we expect the 2.3% GDP growth number to be revised higher in subsequent releases, there are still signs that the U.S. economy is not firing on all cylinders. That being said, the labor market continues to do well, giving the Federal Reserve almost all they need for a potential first rate hike in September.

The United Kingdom remains Europe's bright spot after posting another quarter of positive growth (+0.7%). This marks the 10th consecutive quarter of expansion. As in the U.S., British exports have struggled lately due to a stronger currency.

In the Eurozone, Greece was front and center as the government buckled and succumbed to almost all of the creditor demands. Greece is by no means out of the woods and a complete implementation of the latest bailout package may cause a mini flare-up or two. Regardless, the union successfully kicked the can down the road, again. In the meantime, hopefully investors will refocus on signs of life in Eurozone economic fundamentals.

China remains a source of anxiety amongst investors. While second quarter growth came in above market expectations at 7%, many questioned the validity of the data as the last two quarterly numbers have exactly matched Chinese government growth targets. With the significant price moves in local market stocks (mostly down) and ongoing questionable government equity market intervention, Chinese officials have their hands full trying to calm investor nerves and provide support to a faltering economy.

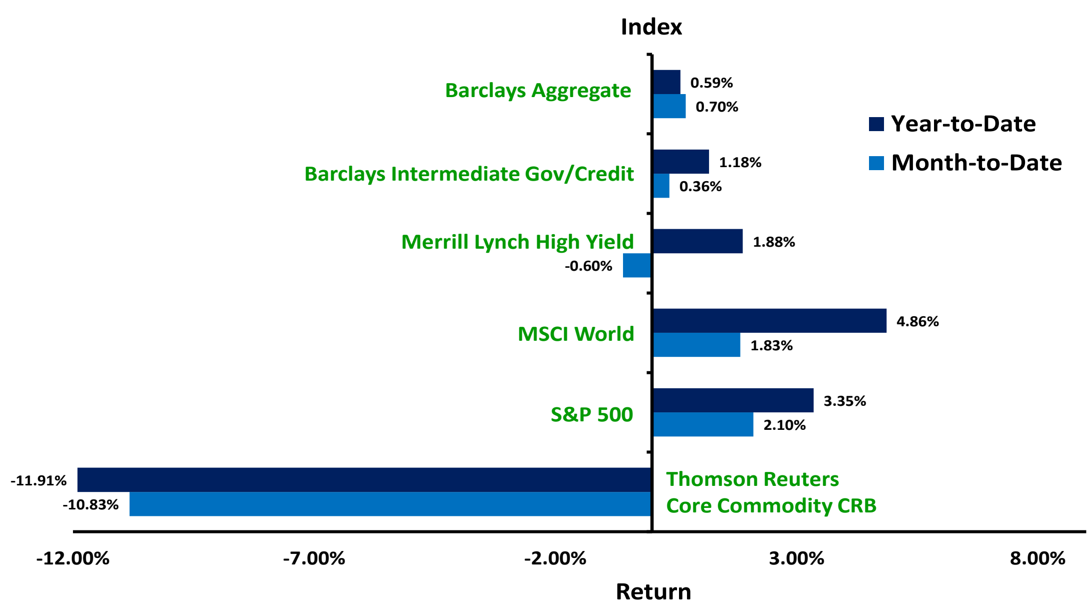
Global Monetary Policy

Global monetary policy remains accommodative, but the tide is slowly shifting. As expected, the Federal Reserve made no changes during their July meeting, but further set the stage for one or more rate increases later this year. In the absence of an unexpected shock, two more solid employment reports and flat to rising price data will be enough for the Fed to increase interest rates at their September meeting.

Similar to the Fed, after seeing 2 ½ years of growth, the Bank of England has begun the same deliberations. Meanwhile, the European Central Bank remains committed to accommodative policy saying it will respond to any unwelcomed monetary tightening.

Asset Class Overview

After watching European officials cobble together a third bailout package for Greece, investors' attention shifted, as the concerns mentioned above stoked market volatility and a dramatic selloff in global commodity markets. In addition to the fireworks in China, Puerto Rico - like Greece - is facing a funding crisis of its own. Even in the face of such obstacles, equity markets managed to post solid July gains with U.S. equity markets outpacing their global counterparts. Investment grade fixed income markets were up as well, with the bellwether Barclays Aggregate Index returning 0.7% (+0.59% YTD). The high yield bond market came under pressure in July as the commodity sensitive sectors continue to influence overall market direction. The lack of liquidity in oil related bonds led to sympathetic price declines elsewhere, and income was not enough to offset the price action. For the month, the Merrill Lynch U.S. High Yield Cash Pay Index fell by -0.60%, but returns still stand at an attractive +1.88% for the year.



Source: Barclays, Bloomberg, Performa Limited U.S., Gross Index Returns

The Markets

Credit

Corporate bonds continued to trade slightly weaker in July due to macro factors (commodities, China, and Greece) as well as the continued torrid pace of new supply. Corporate spreads widened 9 basis points for the month, underperforming their U.S. Treasury counterparts by 0.53% (slightly over 1% for the year).

- Buyers were weary of this summer's new issue onslaught and pricing concessions have been necessary to accommodate supply. For context, this July's $125 Billion was double the amount of new transactions seen in July of last year.
- By July 31st, half of the S&P 500 reported second quarter earnings and results are in line with expectations. As a whole, companies continue to beat reduced earnings expectations, but are lagging their revenue targets. With another 250 firms left to report, we continue to keep an eye on struggling topline growth, new mergers & acquisition announcements, and potentially aggressive financial policies.
- We still find corporate bonds attractive relative to Treasuries. At this point in the cycle, our focus is on identifying individual issuers with appealing fundamental stories that will provide sustainable, additional yield to portfolios. Ultimately, an improving economic backdrop in a higher yielding environment supports corporate bond spreads.

Structured Products

The Structured Product sector had a mixed July as the aforementioned market factors and a general lack of liquidity weighed on prices. However, absent a negative month for mortgages, the remaining sectors performed admirably. Secondary market trading activity took its usual summer break, but the new issue pipeline was robust, particularly in the CMBS sector.

ABS - Asset Backed Securities turned in positive total returns for the month as well as outperforming equivalent Treasury bonds. Buyers appeared after slight weakness, targeting shorter and higher quality offerings. New bond issuance picked up meaningfully towards month-end and demand was enthusiastic.

The student loan market continues to underperform (Performa funds have no exposure). Government programs implemented recently allow student loan repayment rates to match borrower's actual earnings stream, resulting in lower payments and a longer time horizon. The relief provided to previously overburdened borrowers comes at a cost to bond investors, as student loan back pools risk having their own final maturity dates extended. As most of these bond deals have credit ratings tied to a specific maturity date, any extension beyond that brings into question whether the transaction suffers a ratings downgrade. Even though student loan ABS securities typically have a 97% U.S. government guarantee, rating agencies are looking to act and sellers have appeared in an attempt to get in front of the negative news. Without a natural buyer, prices continue to weaken. If downgrades do materialize, we expect some potential forced liquidations to cause further price decreases.

CMBS - The Commercial Real Estate Backed Security sector also enjoyed a positive July. This seems somewhat tenuous however, as yield spreads versus equivalent benchmarks are at the wider end for 2015. We saw a consistent flow of easily digested, secondary supply during the month and view it as a positive for the sector as a whole. Still, we would rather focus on higher quality, mature bonds that hold positive collateral stories and floating rate coupon bonds from single asset/single borrower transactions that offer attractive yields without the usual interest rate risk.

MBS - U.S. Agency single-family mortgage bonds performed poorly in July. While the sector experienced a positive absolute return, it lagged equivalent Treasury bonds. New issuance continues to rise in the previously moribund Non-Agency market as well. Despite heavier supply, we would like to see prolonged strength in underlying fundamentals before participating in this revived area of the mortgage market. Overall, residential mortgages should remain volatile. While we have sat largely on the sidelines, we are taking a more active approach in evaluating tactical opportunities.

High Yield

July was a tough month for the high yield bond market as commodity sensitive sectors weighed on the broader market. The Merrill Lynch U.S. High Yield Cash Pay Index was down 0.60% for the month, while the year-to-date return remains positive at 1.88%.

For the year, performance of the high yield market has not been uniform. Energy related bonds as well as the lowest-rated portion of the high yield market (CCC's) have dramatically underperformed every other industry, sector, and credit segment of the market. We continue to favor the higher quality areas of the high yield market and, if the right opportunities arise, have ample cash on hand to take advantage of mispriced valuations.

Equities

July was another volatile ride for equities, but global markets managed to post modest gains for the month. Macro themes seemed to limit upside moves and second quarter earnings have not, so far, provided the stimulus necessary for another leg higher. As stated previously, second quarter company earnings growth is slowing while revenue expansion is even slower. Overall, U.S. index valuations and related analytical metrics look more expensive, as do some individual stocks that dominate the market. Without a definitive domestic catalyst to break the trend, equity markets will have to rely on better news out of Europe and Asia to be able to break through to the upside.

Contrary to the headline argument that the market is expensive, the amount of winners is particularly small. Within the S&P 500 Index, these names have managed to pull returns higher, while leaving a large swath of stocks treading water or at 52-week lows. In our view, this bifurcated environment leaves a target rich universe from a value perspective, even with headlines and market commentators screaming about how expensive things are. We remain able to identify companies and sectors that are genuinely attractive and exhibit sustainable growth trends. Both characteristics are a good basis for potential future stock appreciation.

In all, a steady improvement in global economic growth, and a stabilized or slightly lower U.S. Dollar will provide some equity market tailwinds. Unfortunately, given that the dog days of summer are upon us and some macro factors are still in play, it looks like the markets may have to wait until later this year for a positive catalyst.

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ABOUT PERFORMA

Combining our extensive knowledge of the insurance industry with the institutional expertise of our investment team, Performa has been managing assets on behalf of captive and other insurance clients for over 20 years.

Our capabilities include asset allocation and active fixed income management through diversified mutual funds or separate account portfolios. With offices in the world's largest captive domiciles, including Bermuda, Vermont and South Carolina, we are focused on delivering customized solutions to meet the unique investment objectives and liquidity requirements of our investors.

We are 100% employee-owned and currently manage $2.8 billion in assets worldwide. Our Investment Philosophy is value driven and long-term in nature. Whether approaching asset allocation, fixed income or equities, our ability to be nimble, contrarian and decisive sets us apart from our peers and promotes capital preservation.

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