Monthly Market Perspective

December 9, 2014

Performa is an independent, employee-owned investment management firm, founded in 1992. We combine over 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 Squeaky Wheel Gets the Grease, While U.S. Rates Move Lower

Whether it is a child throwing a tantrum at the grocery store or a disgruntled customer yelling at the service staff; the offenders usually manage to garner an unwarranted amount of extra attention. It always seems easier for the rest of us to grease the squeaky wheel rather than bear the continuation of uncomfortable or shameful behavior. Forget about trying to use an episode as one of those teachable moments – just make it stop!

Throughout 2014, the financial markets have seen no shortage of squeaky wheels – struggling economies in Europe and Asia; ongoing geopolitical tensions; crazy intraday price movements in some markets and a five-month collapse of commodity prices. “Squeaky” might not cover it, maybe “finger-nails on a blackboard” is more appropriate. No matter the description, the distraction has simply and completely overshadowed the significant economic progress made in the United States this year, and coopted the U.S. Treasury bond market.

The most pervasive story in 2014 has been the performance of long-term U.S. interest rates. 2014 was supposed to be the year that, finally, interest rates moved higher, breaking out of the range that has been intact for the past five years. So what happened? Why are 10-year Treasury yields 0.75% lower than at year-end? In short, a bond market that is usually fixated on domestic data has turned its attention to the squeaky wheel, and handed the keys over to the international crowd.

A cold winter started the decline in interest rates as economic growth took a quick respite, but the spring rebound should’ve worked to reverse the move. Unfortunately, no good deed goes unpunished and the U.S. Dollar’s value

Performa Preliminary Intermediate Fixed Income Composite Performance *

	Nov	YTD
Performa Gross	0.45%	3.05%
Performa Net *	0.42%	2.78%
BarCap US Int. Gov't/Credit	0.50%	3.46%

Market Retuns

Equities	Nov	YTD
S&P 500	2.69%	13.97%
FTSE World	1.79%	6.72%
Fixed Income		
BarCap Treasury	0.81%	4.91%
ML High Yield Cash	-0.71%	3.99%
BarCap Aggregate	0.71%	5.87%

* The investment management fee for the Performa Intermediate Fixed Income Composite is 0.30% per annum. Please see the last page for important performance disclosures.

against numerous currencies began to rise in earnest at the same time geopolitical tensions surfaced. As a result, the global markets looked for cover, and another safe haven bid for U.S. Treasuries ensued, sending yields lower. On top of everything, anemic growth in the Eurozone, Japan and China began to mount, extending the rally in U.S. bonds. All of a sudden, the U.S. Federal Reserve looks like a parent of out of control quintuplets on the loose at the local Piggly Wiggly. It is time to bring in the reinforcements.

Heading into 2015, the world's central banks have turned grease monkey and taken over for the Fed. The European Central Bank (ECB) is buying asset backed securities and looking to expand its bond-buying program to sovereign debt if necessary. The Bank of Japan (BOJ) expanded their huge bond program as well, and will likely delay another sales tax hike. The People's Bank of China (PBOC) provided a little unexpected financial lubrication with a rate cut after Q3 growth dipped slightly under the target of 7.5%. The gaggle of central bankers is trying to add honey to the growth pot and combat deflation.

The typical market response to all of these activities is to "buy on the rumor and sell on the fact." Investors have seen how this cycle plays out in the U.S. and the rest of the world has always been on a lagging timetable. When the markets feel confident enough to see a world where the stimulus has little shelf life left, there will be some cleanup to do in aisle 5 and interest rates will be at levels that are both more fundamentally correct and higher than the current range we have grown accustomed to.

THE MACRO VIEW

Any lingering doubts about the health of the U.S. labor market were dashed by the November employment report. Job growth surged in November - the addition of 321,000 jobs all but solidifies the fact the 2014 will be strongest year of job creation since 1999. Other key indicators of economic activity, such as manufacturing and service sector surveys continue to indicate further expansion. Not to mention vehicle sales popped back above 17 million, suggesting that consumers are feeling fairly confident heading into the holiday shopping season.

Risks for the Eurozone economy are still skewed toward the downside. Third quarter growth was confirmed at a puny (but positive) 0.2%, while unemployment sits at 11.5%, indicating almost no progress has been made in labor markets. In the U.K., third quarter growth was confirmed at 0.7%, marking the seventh consecutive quarter of expansion. Growth was supported by stronger than expected consumer demand, while business investment missed market expectations.

With third quarter growth falling below the government's stated target of

7.5%, the PBOC decided to reduce interest rates to try to support business investment and private demand. Further accommodation in 2015 will be an attempt to sooth investors' nerves and mitigate financial risks.

GLOBAL MONETARY POLICY

The easy money party rolled on in November. In a surprise move, the BOJ expanded its bond purchase program, while the ECB is reluctantly inching closer to expanding its own purchase program. The PBOC caught the markets off guard with an unexpected rate cut, with the potential for more to come next year. Meanwhile, the Bank of England and the Federal Reserve are closely tracking incoming data, as they consider the timing of 2015 interest rate hikes.

FIXED INCOME MARKETS

After last month's spike in volatility, November was a rather uneventful month for fixed income markets. The yield on U.S. 10-year Treasuries spent the first three weeks of the month in a narrow 10 basis point range, before illiquidity brought about by the Thanksgiving holiday sent yields lower into month-end. For the month, the Barclays Capital Aggregate Index, a measure of the broad investment-grade bond market, returned 0.71% increasing year-to-date returns to 5.87%.

Credit

Despite stronger domestic economic data and a solid 3rd quarter earnings season, investment grade corporate credit underperformed by 43 basis points for the month. At month-end the credit index yield relative to U.S. Treasuries was 6 basis points wider at +118 bps. After November's underperformance the sector's year-to-date excess return is now a positive 0.26%.

- With 3rd quarter earnings season behind us, the trend of weakening fundamental remains in place, albeit at a slower pace. Going forward we expect the leveraging trend to continue, largely due to equity friendly behavior and a robust M&A market. That said we are not yet concerned because underlying revenue and EBITDA trends reflect signs of an improving economy.
- The primary market continued to be active in November as we began to see, in earnest, a wave of new issuance associated with the very active M&A market seen over the past 12 months. In addition, issuers continued to take advantage of the accommodative rate environment. The most notable deal was an inaugural $8 billion debt offering from Chinese based e-commerce entity, Alibaba. Overall, supply for November totaled over $110 billion, roughly $30 billion more than was originated last year. Year-to-date gross new supply now exceeds $1 trillion, which already surpasses most full year estimates for the primary issuance.

Structured Products

The Structured Product market largely held the line in November. The sector posted a positive total return for the month, but underperformed U.S. Treasuries by a scant 8 basis points according to the Barclays Aggregate Index. Most of this underperformance came from U.S. Agency Mortgages, specifically the 30 year GNMA subsector

ABS - Asset Backed Securities were more or less flat for November. Supply was steady but manageable in the new issue and secondary markets. Investors continued to use ABS as a short duration high quality area to park cash. While the auto loan sector provides a decent yield option, supply feels heavy and we could see a slight pullback if broker/dealer balance sheets become bloated heading into year end. We still favor short high quality ABS bonds as a cash alternative and find pockets of relative value in certain (higher quality) portions of the esoteric market.

CMBS - Commercial Real Estate was the best performing subsector in the Structured Product universe, outperforming U.S. Treasuries in November. New issue supply became heavy as the month wore on and yields were forced higher to compensate investors for this increased supply as well as the declining collateral standards seen in recent deals. CMBS still provides solid risk adjusted returns versus other sectors, and we feel comfortable investing in various portions of the subsector though we favor higher quality, shorter duration securities. We like floating rate securities as a medium to long range hedge for interest rate risk, but have been reluctant to invest in the most recent issues.

MBS - Agency Mortgage securities were a mixed bag in November. While conventional mortgage product was flat to slightly negative on the month, the Ginnie Mae program bonds significantly underperformed dragging the subsector down as a whole. We continue to stay underweight in mortgages due to an abundance of volatility and continued government involvement.

High Yield

The High Yield market struggled as OPEC left production targets unchanged and oil prices fell below $66 per barrel by month-end. For the month, the Merrill Lynch High Yield Cash Pay index was down close to 0.75%, with a majority of the decline concentrated in the energy sector, which fell 3.38%.

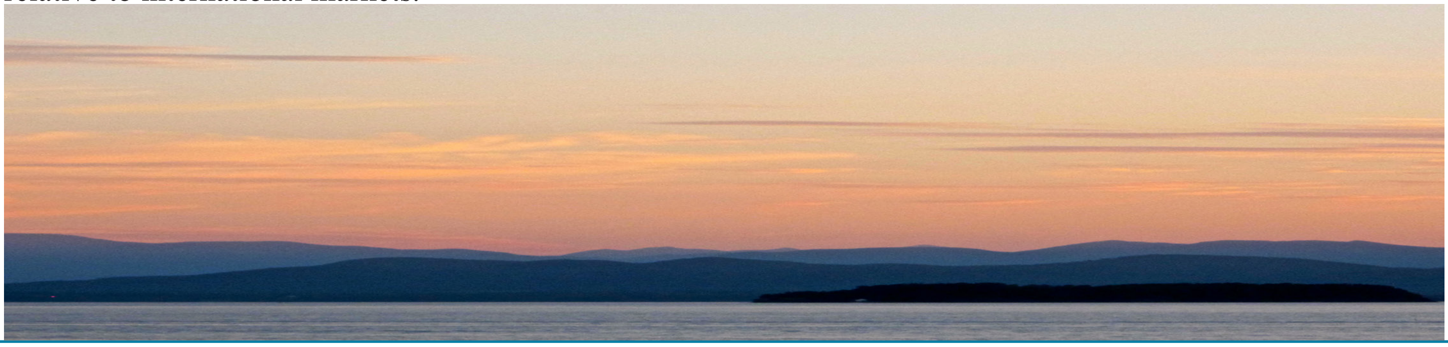
The Performa High Yield Composite marginally underperformed the index for the month, but has outpaced the index by more than 0.50% year-to-date. Partially offsetting negative performance from security selec-tion in the energy, environmental and finance sectors was a large cash position and positive security selection in the telecommunications sector.

EQUITIES

Most major equity indices marched higher throughout November aided by low global interest rates, subdued inflation, declining volatility and continued support from central bankers. The S&P 500 reached new all-time highs intra-month, up more than 11% since the October lows. While the factors supporting domestic equity prices are still in place (for now), the prospect of Federal Reserve interest rates hikes and further divergence in central bank policy has us looking internationally for better risk adjusted returns.

ASSET ALLOCATION

Most asset prices moved higher in November on continued central bank stimulus. As we move into year-end we remained committed to our current asset allocation strategy. Client interest rate exposure is being managed in two ways, by underweighting investment grade bonding holdings as well as maintaining a shorter than index duration in our bond strategies. We continue to believe, at current valuations, domestic equities offer little value relative to international markets.



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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 over $2 billion in assets worldwide. Our Investment Philosophy is value driven and long-term in nature. Whether approaching asset allocation or fixed income, our ability to be nimble, contrarian and decisive sets us apart from our peers and promotes capital preservation.

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