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Monthly Market Perspective

December 7, 2015

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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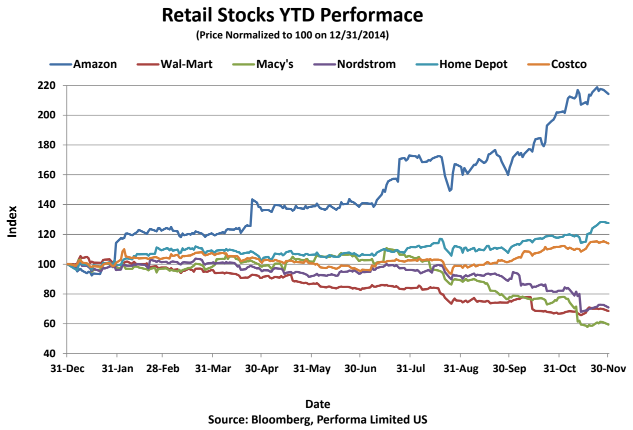
Monthly Spotlight: Not All Retailers Are Created Equal

Bob Dylan released *The Times They Are a-Changin'* back in 1964. However, we are pretty sure he didn't have the retail sector in mind when he wrote the classic. No matter though as today's retail sector is certainly *a-Changin*'. In the midst of the 2015 holiday shopping season, segments of the sector are in total disarray from an equity market perspective. Stocks of traditional brick and mortar department stores have been sold aggressively, and the consensus is that online shopping, now more popular than ever, will be the death knell of many physical companies.

It wasn't all that long ago when Wal-Mart redefined the retail industry with a model of cheap rent and high volume sales. Favorable terms with suppliers allowed Wal-Mart to undercut its competition, as customers flocked to those everyday low prices. Just as Wal-Mart's concept was revolutionary during its time – a category killer – the current disrupter is Amazon. After a decade and a half of plowing cash flow back into distributions centers, free shipping, and building enough heft to pressure suppliers themselves, CEO Jeff Bezos has positioned Amazon as the leading model of online shopping.

Today, traditional brick and mortar retailers not only compete with new concepts in their genre, but also the 21st century reality that consumers are addicted to their screens. Why drive to the nearest retail outlet when shopping on one's smart phone is faster and by all accounts less stressful. Competitive pricing remains a key component in the shopping experience, but drawing consumers into the store takes more resources than in the past. Retailers have to differentiate and create a brand experience that can compete with online both physically and virtually.

As the retail space evolves to satisfy the demands of today's screen happy consumers, established players in certain retail segments continue to prosper, while others have lost their competitiveness (see chart below).



Some department stores, for example, have had a hard time transitioning. Sears and JC Penney are two high profile, mid-priced chains in multi-year declines. Until recently, however, it was thought that those companies, focused on specific regions or either end of the consumer spectrum, could easily survive. Apparently, that is no longer the case. Recent earning reports from bellwethers Macy's and Nordstrom highlight the decline of the department store model, irrespective of customer demographics. Attempting to compete on price by having sales in perpetuity has eroded almost all profitability.

Meanwhile, companies like Costco and Home Depot have navigated the Amazon disruption remarkably well and continue to thrive. Both companies have built tremendous brand loyalty by providing better in-store experiences, while creating a web presence that allows customers to purchase commodity type products without defecting.

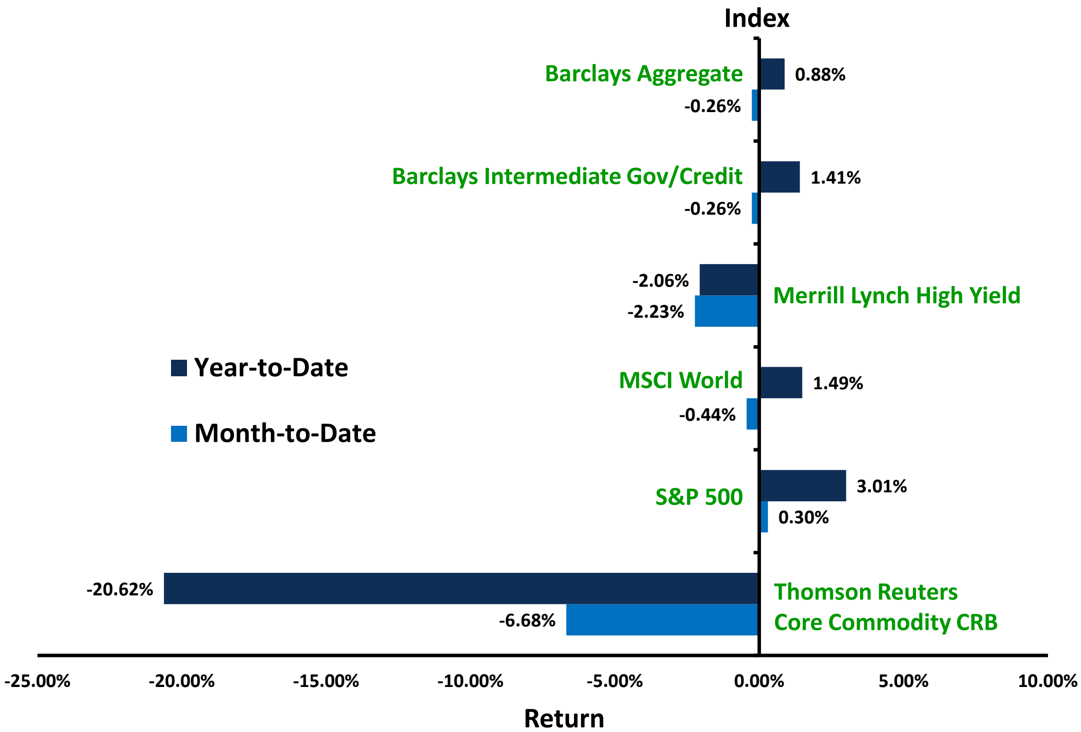
Undoubtedly, over the last several years, Amazon has changed the retail playing field but that doesn't mean the game is over. As has always been the case, companies must adapt to survive. Wal-Mart, for example, seems to understand the need to reinvent itself as a more attractive physical shopping experience. By slowing the pace of new store openings, selling groceries, adding smaller concept stores, and increasing their web presence Wal-Mart should be more competitive down the road.

Like McDonalds and Microsoft before it, Wal-Mart's core customer base is large and dedicated for various reasons. Some companies fall into the trap of straying too far from their core business searching for the next growth catalyst, while viewing the equity markets as the arbiter of success. Taking a page out of the Jeff Bezos book, and waiting to judge the results over an appropriate length of time, may disappoint short-term stock holders. However, if the message, actions, and outcome are consistently positive, value will become apparent.

Despite the Amazon disruption some companies are performing quite well, while others are struggling to keep up with times. In an environment of heavy and indiscriminate selling, we find the fundamental analytical work exciting as we identify those companies we believe will be long term survivors and move past those we do not. Finding value is hard and waiting for it to unfold in terms of price appreciation can be even harder. Microsoft disappointed investors for years even while it continued to pile up cash and profits. That said, those investors that bought at the right levels during those disappointing years are more than happy now.

Asset Class Overview

November was a tough month for financial markets. Persistent macro uncertainty, particularly surrounding the timing of a Federal Reserve interest rate hike, kept investors on the sidelines for much of the month. The MSCI World Index, a measure of developed world equity markets, returned negative 0.44% in November (1.49% year-to-date). Meanwhile, U.S. equity markets managed to post modest gains with the S&P 500 returning 0.30% for the month (3.01% year-to-date). Throughout the month, declining oil prices put additional pressure on the energy sector of high yield bond market. For the month, the Merrill Lynch U.S. Cash Pay High Yield Index returned negative 2.23%, dragging the year-to-date return into negative territory (-2.06%). Lastly, a move higher in rates weighed on high quality fixed income returns. The Barclays Aggregate Index, a measure of the broad investment grade bond universe, returned negative 0.26% for the month (0.88% year-to-date).



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

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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, active fixed income and equity 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 representing more than 50 clients. 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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