



Bermuda



South Carolina



Vermont

Monthly Market Perspective

June 30, 2016

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.

The Referendum That Caught Everybody Off Sides

After the dust settled last Thursday, over 30 million British citizens (more than the recent general election) turned out to vote in a referendum that asked whether the U.K. should remain or leave the European Union (EU). With the majority favoring a divorce from their perceived overbearing partner, the results stunned the world. Prior to the June 23rd referendum, the “remain” camp had regained the upper hand in the polls and markets had certainly reacted positively to the status quo. In an instant, all was undone.

The vote to leave the EU has raised more questions than provided answers, but two things are understood: Pandora’s box has been opened and the ultimate outcome is perfectly unclear.

Be Careful What You Wish For – Cameron Style

U.K. Prime Minister Cameron placed a major wager when he supplicated the Scots during their Independence Vote in September of 2014. He promised the Scottish Conservative Party that in return for their help in keeping Scotland part of the U.K. assuming they were in power afterwards, then the U.K. would hold an EU membership referendum (“Brexit Vote”) by the end of 2017.

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What may have seemed to be a party bag give-away a year and a half ago just became the noose around Cameron's political neck. He immediately resigned last Friday and left his unknown successor holding the bag. Compounding the current angst, mass resignations and firings within the current government and the main British opposition party give the impression that no adults are in charge. There has been little organized response to the increasingly exacerbated EU governing bodies as well as European political leaders.

Germany and France have taken a hardline stance since the Brexit vote and EU Parliamentary leaders have thrown decorum out the window when interacting with their British counterparts. The show of verbal force is obviously designed to keep the EU intact while trying to repair a tremendous crack in the wall.

Market Response

From the market perspective, the week prior to the vote saw a rebound of confidence as risk assets rallied along with the polls and global bond yields moved higher. 10-year U.S. Treasury rates increased 17 basis points leading up to the referendum (6 basis points coming the day of the vote). Markets quickly reversed course pre-dawn Friday in Europe (late Thursday evening in the U.S.), once it became clear that the "leave" camp was pulling off an upset. As one would suspect, stocks fell hard, the British Pound was hammered and global bond yields fell in a classic flight to quality.

After a couple of high volume, negative days for stocks, commodities and other affected currencies, the markets have tried to find their footing heading into month-end. Even though global

interest rates have remained around historic lows, risk assets have managed to claw back losses, staging decent rallies despite heightened uncertainty.

What stands out to us is the difference in investor activity and psychology today versus the previous 10 months. While some investors were caught off sides after buying equities the week prior to the referendum, the post vote selling was high volume, but orderly – a targeted risk reduction. In the past year, the two major sell-offs (August 2015 and January 2016) were different and marked by panic and indiscriminate risk shedding.

Known vs. Unknown Unknowns

While the Brexiting process will be long and arduous, there still is a possibility that it is reversed or not enacted. The referendum was non-binding and there is no obligation to begin Britain's split from the EU. That said, if the divorce proceedings continue, it will take years to reach a conclusion. No one knows for certain the global economic ramifications of a politically less stable Europe. The Brexit vote was a shock to confidence, but accurately estimating its long-run impact on global economic growth is an impossible exercise today. For now, uncertainty rules and we believe that markets will stabilize and then become reactive to events and data as opposed to proactive.

Lost in the shuffle is the U.S. Federal Reserve's current tightening trend. If ever a legitimate non-data factor allowed the Fed to stop raising interest rates this may be it. Brexit seems a more realistic reason to pause rate hikes than last year's Chinese currency devaluation or a bunch of over leveraged oil wildcatters succumbing to bankruptcy. Alas, this leaves bond investors with the potential for yet another "lower for longer" scenario instead of monetary policy normalization.

Our Response

While we had shed some risk leading up to the Brexit vote, we still maintained a shorter than benchmark duration stance within our fixed income portfolios. After closing the gap some in early June, we feel that the uncertainty around the Brexit vote compels us to look for spots to get closer to home should rates stabilize and the flight-to-quality rally subside. The path towards higher rates along the U.S. yield curve remains hostage to their relationship to substantially lower global yields.

For equity portfolios, the market immediately threw fundamentals out the window – the typical response we have seen over the past seven years. Investors moved risk into already expensive, defensive stocks, in turn making them even more expensive on a relative basis. At this point, companies with any neutral to negative news immediately come under selling pressure. We continue to sift through the rubble looking for new bargains as well as to adding to our high conviction holdings. As has been the case with these mini-cycles since 2008, the tug of war between growth/momentum vs. value/fundamental investing styles has flipped from the latter after February to the former for the time being.

In the meantime, the market likes high yield bonds as the sweet spot between I.G. bond yields that are too low and equities that have elevated volatility. Flows into the sector have been larger than most expected post the Brexit vote.

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ABOUT PERFORMA

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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 over \$3 billion in assets worldwide representing more than 65 captive client relationships as of May 31, 2016. 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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