Monthly Market Perspective

October 17, 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.

IN THIS ISSUE

"It's incredibly difficult to prove one's worth as an investment professional at a time of sky-high valuations, more efficient markets and endless cheap money. An increasing number of respected money managers are realizing that and just getting out of the game."

- Lisa Abramowicz, "Hedge Funds Get Timed Out", Bloomberg, September 27, 2016

Monthly Spotlight

The game looks unfamiliar, the rules have changed, and for some, it's just not worth competing anymore. Over the last decade, global central bankers have transformed the world's financial system, and we find ourselves writing yet another monthly on global monetary policy as the great policy experiment continued last month.

September was the month of the central banker, with all four major developed market central banks holding meetings to set, evaluate, adjust, and/or tweak monetary policy. Despite the fact that global monetary policy has been exceedingly accommodative for years, we have yet to reach a turning point globally.

During September, global central bankers continued with their dovish rhetoric, begging the question: What more can global central bankers do? Take rates even further into negative territory? Buy even more bonds for longer periods of time? And most importantly, what does the unwinding of years and years of easy money policies look like?

September: A Month in Review

Last month the Bank of England (BOE) and European Central Bank (ECB) both resisted the urge to ease policy further, electing to take a wait and see approach while flashing their dovish feathers. This position makes sense as the economic outlook in the medium run continues to be clouded by the Brexit vote and the U.K.'s ultimate trading relationship with the EU (and the rest of the world, for that matter).

A week later, the Bank of Japan (BOJ) underwhelmed expectations, leaving rates and the size of their asset purchase program unchanged. The market had been looking for a rate cut and an increase in the size of their asset purchase program. Interestingly, while the market was somewhat disappointed, the BOJ did adjust policy, electing to target specific yield levels (yield curve control) while signaling to markets that they plan to let inflation overshoot their target. This shift in BOJ policy is curious, and we are left to question if the new policy stance will, in fact, have the desired outcome, namely reflating a struggling economy.

Last, but certainly not least, was the Federal Reserve. The Fed voted to leave policy unchanged as the number of dissenters grew from one to three, suggesting a growing divide within the committee. Those members who wanted to see a rate hike in September cited ample economic progress and potential risks to continued easy money policies. In its policy statement, the Fed painted a slightly more optimistic picture of the U.S. economy which, in theory, set the table for a rate hike later this year.

Monetary Policy: With or Without?

Monetary policy has been the unrivaled, indisputable workhorse during the current expansion. Accommodative policies worked to dampen negative shocks and support an ailing global economy while fiscal policy stood on the sidelines. As the current credit cycle ages, many have begun to question the ability of monetary policy to further buffer potential headwinds to economic activity.

Today, with monetary policy experiencing diminishing returns and the call for help on the fiscal side of the equation growing louder, we remind our readers that not all spending is created equal. Spending for the sake of spending would be detrimental. Federal debt levels are already poised to swell to worrisome levels in the coming years, thanks to deteriorating global demographics; blindly adding to that mountain of debt is not a good idea.

With that being said, structural reforms and the strategic allocation of dollars to infrastructure projects with long-run benefits would surely boost economic activity (central bankers have been calling for it for years) and would relieve some of the pressure currently on monetary policy. Unfortunately, such reforms are highly contested and hard to pass, so we are not holding our breath.

To be sure, the global economy is certainly better off today than it would have been without the help of simulative monetary policy. However, as we have argued on multiple occasions, the normalization of monetary policy should have begun long ago. Now, as we begin to enter the later stages of the business cycle, we are left to ponder the potential unintended consequences of the last eight years of extraordinarily easy monetary policy.

In particular, we highlight that monetary policy during this cycle seems to have a dampening effect on market volatility. Decreased volatility is great while it lasts, but then without announcement, volatility pops, sparking outsized market moves with little to no change in the fundamental landscape. We've said it before, but we feel compelled to say it again: negative interest rates as a policy does not make sense. Paying someone for the right to finance their debt is not only irrational behavior, it is flat-out careless. Negative rates are not a new, clever policy tool that will help stimulate sustainable growth. Instead, negative rates are a signal that something is horribly wrong and the system is failing to allocate capital appropriately.

While the end of the current expansion may not be imminent (as the current slow growth environment looks poised to continue in the near term), existing stimulative monetary policies are experiencing diminishing marginal returns. As the effectiveness of current easy money policies comes under further questionings, the fiscal side of the equation (as messy as it is) will feel more pressure to act. It's been a surprising, unprecedented, and uncertain expansionary cycle thus far, and we're expecting more of the same as we move through the U.S. presidential election, the last round of 2016 central bank meetings, and onward to 2017.

CONTRIBUTORS

Editor: **Scott Mildrum, MS, Economic & Macro Strategist**

Contributors: **Spotlight & Asset Class Overview:** David Kilborn, CFA, CIO, Scott Mildrum, MS

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 over $3.46 billion in assets worldwide representing more than 65 captive client relationships as of September 30, 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.

CONTACT US

Relationship Management
Hugh Barit
Chairman & CEO
(441) 295-6754
hbarit@performa.bm
25 Church Street, 2nd Floor
Hamilton HM12, Bermuda

Portfolio Management
David T. Kilborn, CFA
CIO & President
(843) 297-4130
dkilborn@performausa.com
14 North Adgers Wharf
Charleston, SC 29401

Relationship Management
John James
Captive and Consultant Relations Mngr.
(802) 540-1752
jjames@performausa.com
3 Main Street Suite 215
Burlington, VT 05401