Premise Capital

2016 Year End Update

Year end 2016 Update

So how did we get here?

December 31st 2015, the S&P 500 closed at 2043.94. By January 20th, it was trading below 1813, with no end in sight. This price action caused us to move to a more conservative position in all models. At 2016 year end it is easy to forget, that at the time, this decision had us ahead of benchmarks with the "ability to sleep at night" ratio at a premium. However, this drop of over 11% in such a short period was followed by an equally volatile move back upward as the market was back above 2043 by March 17th.

Remember that it is a tradeoff. While exiting before or during a market downturn may protect downside, there is a risk that there is a rally that you do not participate in. Our approach doesn't attempt to "predict" but rather "confirm". As such, we identified this "strength", and by mid-April, we are back to market-like positioning and returns for the rest of the year.

That is not to say the rest of the year was a cake walk. Anxiety was back in the summer as the Brexit vote had the S&P down over 6% from it highs, and again in November as pre-election jitters saw another 5% drop. Despite the volatility and uncertainty, we avoided getting wiggled out during these two pullbacks and remained close to each model's target equity/fixed income ratio.

The post election run has turned what looked to be a lackluster year into one with positive returns across all asset classes we hold in our diversified portfolios. While all indices are positive, the strongest classes were domestic equities, with smallcap and midcap providing the best results. On the equity side, while we closed the year underweight non-domestic equities and real estate, we quickly changed to normal weights in both **Developed International** and **Emerging Markets** after the new year began in response to the strength in last few months of 2016.

On the fixed income side, the increases in rates and accompanying sell off in the bond markets has portfolios positioned with underweights in all classes except for **Short Term** fixed income and **High Yield**. These adjustments reflect the current environment, which may be signaling the long forecasted end of the thirty-year bond bull market, as well as reflecting that **High Yield** is more highly correlated to the equity markets than the rest of the fixed income asset classes.

Looking forward, the interest rate question seems to be holding the real estate index from participating in the the equity run and that is keeping us slightly below maximum equity to fixed income ratio in all models. On the the fixed income side, while the increase in rates initially brings bond prices down, it also increases interest income which acts to counter the decline in prices. This "total return" view of fixed income may have us back in bond classes earlier than expected.

Looking forward to 2017, it seems to come down to two concepts. Does this "Trump Rally" continue and will interest rates continue to rise? On the equity side, since we are 'trend following', we are positioned for a continuation of the current market strength. With the exception of Real Estate which has been negatively impacted due to its relationship with interest rates, we have a positive view on the other equity classes and are positioned near our target equity-to-fixed-income ratios across all models.

As always, we will continue to keep a watchful eye on the markets and make adjustments to our portfolios as necessary.

Best regards,

The Premise Team

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Perspective

I would like to address the issue of perspective when looking at the annual returns. When looking at the return bug below, the calendar year (left table) shows the returns of the classes we use in our portfolios. Remember that these represent only the commonly used, large and diverse asset classes that we include in our core diversified models. Our goal is to allocate among those classes in a way that reflects their position relative to a diversified portfolio as inexpensively as possible with the philosophy that the "alpha" has been commoditized and that exposure to the class is the most important tool.

This highlights the difference in how we define tactical vs. the rest of the industry. The risk controls we have in place limit us to these core classes and prevent concentration in any one class. This is the opposite of the go anywhere, do anything style employed by most tactical managers. For some, the words 'tactical', 'trading' and 'algorithmic' imply an aggressive risk seeking portfolio, yet we use those tools in an attempt to reduce risk.

Thinking about the "Satellite" - There are numerous other classes and subclasses that can and should be utilized by investors, and these classes ARE included in our benchmarks. However, we consider them alternative or more concentrated in scope and thus not in our purview. These classes play a part in a diversified portfolio at the investor level, but are purposely excluded by Premise as they are most often utilized by advisors in an individually tailored manner independent of the core portfolio. Beyond the usual difference due to the benchmark being index based with no fees or trading costs, this misfit must also be understood when looking at relative performance.

Performance

Time Period: 1/1/2016 to 12/31/2016

	Return	Std Dev
BBgBarc US Agg Bond TR USD	2.65	3.84
BBgBarc US Treasury US TIPS TR USD	4.68	5.31
BBgBarc US Treasury 20+ Yr TR USD	1.43	15.39
BBgBarc US Corporate High Yield TR USD	17.13	6.25
S&P 500 TR USD	11.96	15.77
S&P MidCap 400 TR	20.74	18.91
MSCI EAFE NR USD	1.00	20.54
MSCI EM NR USD	11.19	20.71
FTSE NAREIT All Equity REITs TR USD	8.63	20.06

Performance

Time Period: 5/19/2015 to 12/31/2016

	Return	Std Dev
BBgBarc US Agg Bond TR USD	1.66	4.14
BBgBarc US Treasury US TIPS TR USD	1.59	5.62
BBgBarc US Treasury 20+ Yr TR USD	2.55	16.82
BBgBarc US Corporate High Yield TR USD	4.68	6.14
S&P 500 TR USD	5.41	17.69
S&P MidCap 400 TR	6.38	19.12
MSCI EAFE NR USD	-6.23	19.84
MSCI EM NR USD	-8.59	21.12
FTSE NAREIT All Equity REITs TR USD	6.67	19.96

Now that we have identified the classes that we use, and why the portfolio is constrained to this set, I would like you to see a second return bug (right side) that shows the returns of those classes since back in June of 2015. As you can see when comparing the two tables, the returns for the calendar year 2016 are far better than the longer return since the spring of 2015. This is a function of the year starting after a dip, but investors may be framing performance since the high point of their accounts. This return table shows the return of classes since the highs of the previous consolidation and is a much better comparison for the return expectations of an account than the constant bombardment of market highs being reported each day. The annual results do not accurately reflect the expectations an investor over the 19-month period.

Here is a quick example to make this point. Create a 3 asset, balanced portfolio of the following classes from the table.

50% US Aggregate Bond (1.66%)
30% S&P 500 (5.41%),
20% MSCI EAFE (-6.23%).

For the 19-month time period of the return bug, that portfolio would be up only **1.21%.** That is portfolio with no fees, no transaction costs, no tactical moves, and no expense ratios. Premise models should be looked at as more of a core allocation piece that takes what the market gives in most time frames, and tries to protect if the general market is in a prolonged downtrend. One thing is clear by looking at the 1.21% number from the analysis above. In the 19 months prior to year-end, the general markets didn't give much.

I hope this gives you a better understanding of what the Premise models are trying to achieve. They are diversified, risk tolerance based allocation models that attempt to protect against long term downtrends in any component classes. By design, our models are different from models that employ alternative classes or concentrate risk, and thus have different return expectations. We do this because we feel it is the best way to invest the 'core' portfolio and leave the 'satellite' investments to the discretion of the advisor.

Thank you again for your continued confidence in Premise.