

Premise Capital 4th Quarter 2015 Summary

Premise Investors

We apologize for being a little behind on our 4th quarter update, but it seemed ignoring what is being called “the worst start of a year in recorded history” and only speaking of last year would lead to a hollow update. For that reason, we are going to break the 2015 year end update into two parts. First, we will look at the performance over the 4th quarter and year end numbers as we would normally do but we will also briefly touch upon the market movement in the opening days of 2016 as we feel that tying it all together may give a better understanding of our decision making process.

2015

At the end of the 3rd quarter, our model returns were near their respective risk tolerance benchmarks in the Frontier Advantage Models, with outperformance in the higher equity exposed models. Those numbers were mainly attributable to our first level tactical shifts that shift classes relative to each other, but leave the overall equity-to-fixed income ratio relatively the same.

The 4th quarter is the first time in the last three years we have seen the effects of a “risk off move”* on our models and unfortunately, it was not in our favor. As the following chart shows, the dramatic selloff that started in August and ended in

	Q4 2015		2015	
	Return	Std Dev	Return	Std Dev
Barclays US Agg Bond TR USD	0.65	4.35	0.55	4.52
Barclays US Treasury US TIPS TR USD	-1.78	5.76	-1.44	6.59
Barclays US Treasury 20+ Yr TR USD	3.87	17.97	-1.59	18.93
Barclays US Corporate High Yield TR USD	-6.82	6.22	-4.47	4.92
S&P 500 TR USD	0.15	21.87	1.38	18.65
S&P MidCap 400 TR	-6.11	20.69	-2.18	17.95
MSCI EAFE NR USD	-6.01	18.86	-0.81	17.17
MSCI EM NR USD	-17.36	23.09	-14.92	19.44
FTSE NAREIT All Equity REITs TR	8.74	20.79	2.83	19.96

October was followed by an equally dramatic up move that recovered losses by the beginning of November. When looking at this chart, we were happy to reduce equity exposure at the end of August (especially in September when the trend was in our favor) but could not ignore the strength of the markets as they dramatically returned to just below all-time highs at the beginning of November.

The “cost” of exiting the market is what we consider the missed opportunity from being underweight equities in October. In a general sense, we were “risk off” for roughly a 5% up-move in the SP 500 but fortunately our model returns at year end underperformed by much less than that amount (roughly 1% to 2.5%) depending on both equity exposure and the amount of the tactical shift employed by each model.

An important point is our models did not experience the full effect of this “wobble” because they were diversified into other classes while being risk off. This goes to the point of why employing a cohesive system that focuses on true comprehensive portfolio construction and not just market timing is so critical. If we can reduce the pain caused by incorrect timing decisions with the positives associated with our portfolio creation process, we can provide a diversified portfolio to our clients that attempts to protect them in prolonged significant down moves without taking the full brunt of each incorrect decision.

So our conclusion on 2015 performance is that models performed as expected given the environment. After fees and despite a negative timing decision, we were able to achieve returns just below the representative fee free, un-investable buy and hold benchmarks. However, it is important to remember that our risk-tolerance based benchmarks are not hurdles. When looking over time, we expect to track the benchmarks in generally up trending markets, with periods of some over or under performance. We believe that any net under performance is an acceptable cost in managing a portfolio that attempts to reduce the effects of the extreme down moves we have seen in the last 15 years.



Premise Capital 4th Quarter Continued

2016

It seems like as soon as the calendar year changed, no one wanted to hold equities any longer. Dramatic drops in commodity prices, especially oil, have rippled through emerging markets and investors are worried about a contagion. The markets have quickly broken through support and caused us to reestablish the risk off position we were in last year. When looking at the longer term chart, we see this market action as a continuation of the downtrend identified in the end of last year that unfortunately simply had a strong rally and consolidation period in the middle of it last November.



We think the longer term chart gives investors an idea of what we see as a trend, and what would be deemed “noise.” You don’t have to be a market technician to see that something is different since August of 2015. The trend that had been in place for years has turned into the volatile consolidation phase that becomes a difficult market for tactical management. Investors need to remember that the down moves that happened during the longer term uptrend (January 2012 to May 2015), were also very painful, with various domestic and international news events seeming to point to extended market drops. Looking back, the market really did climb “a wall of worry” and while our models remained invested, many investors did not participate because of the fear.

In closing, we are not trying to time these types of ups and downs, but are trying to position our models for the longer term trends. So while we may occasionally get wiggled in the noise, remember that we are exiting when we think there is the potential for a prolonged down move. Our portfolio construction process acknowledges that while tactical moves will potentially underperform the buy and hold portfolio during some market environments, it can provide a value over time in an effort to reduce the max drawdowns associated with that common approach. We think skill is seen in the ability to minimize this cost over time by not getting shaken out of every down move, while still managing money in a way that may be able to sidestep the longer, more extreme selloffs.

As always, we are closely monitoring these changes, and thank you again for your continued confidence in Premise Capital.

Jason Rolence

*Risk Off in a Premise Capital Frontier Advantaged Model means each model is at or near its lowest acceptable level of equity exposure

