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Quant Coalescence

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December, 2015: "It's beginning to look a lot like……."

Christmas? Time for the first rate hike in 9 years? The last leg of this bull market? Time for some performance awards? All of the latter? We now know the Fed hiked a quarter point. We also know that PCM has (again) been recognized as a "Top Gun" for our performance during the 3rd quarter of 2015 by Informa Investment Solutions. Four of our models were in the top 10 performers out of hundreds of products and money managers.

PERFORMANCE RECOGNITION: 3rd Quarter, 2015
Informa Investment Solutions' (PSN) Ranks PCM "Top Gun" Products

- **PCM Protective Equity** - (Top 10/#5) All Cap Universe *(543 products in the All Cap universe)*
- **PCM Diamond** - (Top 10) US Balanced Universe *(314 products in the US Balanced universe)*
- **PCM Global Macro** - (Top 10/#2) Global/Intl Balanced Universe
- **PCM Global Tactical** - (Top 10/#8) Global/Intl Balanced Universe *(297 products in the Global/Intl balanced universe)*

I don't think anywhere in the US is looking a lot like Christmas this year, with even Buffalo, New York setting a record for no snow this late in the season. As far as the Fed, the speculation will soon enough turn to "What next? When? How many?" And is this bull market on its last leg? The following are some interesting statistics to consider:

- Corporate debt is *over 50% higher* than it was at the beginning of the financial crisis in 2008. As interest rates rise, the corporate buybacks of stock that have been a major driver of this bull market will begin to dry up. The debt that has been taken on will become more expensive to service, profit margins will contract and credit defaults will increase. This will further increase the yield that investors expect and so the vicious cycle begins. (Remember that the first signs of trouble in 2008 were in the credit markets)

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- This bull market is the third longest in history. By the spring of next year, it will be the second longest in history and we are already at almost twice the average time of bull markets historically.
- Margin debt as a percentage of nominal GDP hit an all-time high earlier this year and appears to have peaked. The last two times margin debt peaked were right before the 2000 and 2007 bear markets.
- Even though the S&P 500 and Nasdaq have been at times on the positive side in 2015, the majority of equities in the S&P 500 are down for the year. This is possible due to a handful of very large cap stocks being up substantially. In other words, there is very broad based weakness in equities, despite where the broad based indexes are trading.
- The trailing P/E of the S&P 500 is 23. One year ago it was under 19. The average over the last 140 years has been 16.6. The S&P 500 is close to unchanged from this time last year. The reason the P/E has gone up is therefore not because the market has gone higher, but because earnings have been negative year over year for the last 2 quarters. This is the first time this has happened since the financial crisis ended in 2009. Falling earnings, rising interest rates and valuations at almost 40% higher than the historical average make for a tough uphill climb for equities.

The December allocations theme is equities with a bias towards dividend payers, technology, financials, emerging market bonds, and inverse high yield bonds, which is very similar to what we saw in November. Most of the models and portfolios also have a fair portion in cash equivalents.

PCM Strategies: 11.01.2015 Allocations*

*(Please note that performance numbers on the website for indexes do not include dividends and are appropriately calculated sequentially.)

1. PCM US Bond Total Return Index sm: Inverse high yield bonds and cash equivalent.
2. PCM Absolute Bond Index sm: 1-3 month U.S. Treasury bills.
3. PCM Absolute U.S. Sector Index sm : Technology, financials and industrials.
4. PCM U.S. Industries Total Return Indexsm: Technology, insurance, industrials and media.

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5. PCM Absolute Equity Income Indexsm : Dividend paying equities and cash equivalent
6. PCM Emerging Market Total Return Equity Indexsm: Emerging Asia and cash equivalent.
7. PCM Total Return Portfolio Indexsm and PCM Stable Growth Plus+ Portfolio Indexsm: Technology, financials, and industrials are also a common theme, both Indexes also hold the U.S. dollar and gold inverse.
8. PCM Global Tactical Indexsm: Equities in New Zealand, inverse gold, consumer staples, and cash equivalent.
9. Global Macro Indexsm: Exposure to the U.S. dollar, broad based U.S. equities, emerging market bonds and cash equivalent.
10. PCM Alpha 1 Indexsm: Cash equivalent
11. PCM Absolute Commodities Indexsm: Cocoa and cash equivalent.

***We have enhanced our website AGAIN at http://www.pcminvestment.com. You can now see performance of our indexes (previous day and month to date) on our streaming ticker. We include performance for both our indexes and our composites, as applicable. You will be asked to enter your email address to get into the website. There will be no password required, so you won't have to worry about forgetting it. This is partly due to helping us stay in compliance with requirements in our industry that we know who has reviewed our website content. Please use the website link above to see all of our indexes and composites.

In addition to the above mentioned "Top Gun" performance awards from Informa Investment Solutions, PCM composites have been previously recognized for performance by Informa Investment Solutions; the PCM Absolute Bond Compositesm for the three year performance ending the 4th quarter of 2014, as well as previous awards for 1-year trailing performance and 3-year trailing performance. As of 2nd quarter 2014, the PCM Absolute Bond Compositesm and the PCM Absolute Commodities Compositesm both won a "Top Gun" award for performance in their respective category for the 1-year trailing performance period, with the PCM Absolute Bond Compositesm also winning the "Top Gun" award for 3-year trailing performance. The PCM Alpha 1 Compositesm was awarded the "Top Gun" performance award for the 1st quarter of 2014. We are very pleased to see these particular multi directional strategies being recognized, as the PCM Absolute Bond Strategysm and PCM Alpha 1 Strategysm are particularly timely for where we are in the current market cycle.

To view Morningstar Fact sheets of all of our index models, please visit our website at ww.pcminvestment.com under the "PCM multi-directional Strategies" tab.

The views and strategies described herein are for illustrative purposes only and may not be suitable for all investors. The information is not based

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About "PCM Quant Coalescence"

Welcome to Provident's "Quant Coalescence" communication. We suspect that many of you are no different than us. That is to say that when our quantitative models rebalance every 2 weeks for some indexes or once a month for other indexes, you sometimes find yourselves asking "What is behind a rotation into that ETF?" This communication is our opportunity to "unite for a common end" with our clients and partners; keeping you updated on our thoughts and perspectives. As you know, our indexes are based on an absolute approach: we strive to make money in up markets or down markets, while trying to greatly minimize loss in any market environment.

Our indexes are also quantitative, reflective of our systematic, unbiased and technical approach. Since our indexes are unbiased, the quantitative models would obviously at times rotate into positions that cause us to scratch our heads. Nevertheless, being so close to the analysis as it unfolds, allows us to quickly begin to validate the fundamental reasons behind the quantitative "following of the money." At other times, the trades are not validated right away; the story unfolds as the days pass. We have been very excited about many of these "validations" and "ah ha" moments. We had another "ah ha" moment when we decided that these insights would also be interesting to those who have entrusted us with their financial peace of mind. Our goal is to be short and to the point, specific to what is happening in our indexes rather than a lengthy macroeconomic perspective.

For further disclaimers and disclosures, see our website for index disclosures and composite disclosures.

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