

## Quant Coalescence

### **February, 2016: “You just crossed over into....the Twilight Zone”**

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Just when you think that the central banks of the world are “out of bullets”, they begin to get very creative and go where they just recently said they would never go...NIRP. What is NIRP? NIRP is Negative Interest Rate Policy, which appears to slowly be replacing ZIRP (Zero Interest Rate Policy) as the next big idea to encourage continued speculation, keep asset prices inflated and motivate consumers to consume.

The Bank of Japan stated in mid-January, 2016 that they would not consider NIRP. On January 29<sup>th</sup>, 2016 they surprised global markets by implementing negative interest rate policy. The Nikkei rallied for **one** day on that news. For 7 years now, such radical central bank announcements have resulted in rallies; albeit the rallies have been for shorter and shorter timeframes, as QE has lost its luster. But....one day....seriously? After digesting the news over the last weekend of January, investors in the Nikkei must have decided that the central banks are getting desperate, the repercussions of their policies have failed, and they are now “experimenting” with the world economy.

During the next (which were the first) 10 trading days of February, the Nikkei was down every single day until the selling took a pause. By this time, the Nikkei was down 17% for the month and the U.S. equity markets were down 6.5% during the same period. The markets did not start to rebound until the major oil exporters (ex the U.S.) declared they would “freeze” oil production. To be clear, they are not going to *reduce* oil production, but planned to work together to *not increase* oil production. Iran and others have since increased oil production. As one can see, we have central bank policies that are entering uncharted waters, news that appears to be intended to impact markets short term vs. being trustworthy policy decisions *and* evidence emerging that central banks have not only failed, but have created bubbles in multiple asset classes. It is clear why some of us that have been professionally trading and following these markets for 30 years may feel like we have crossed over into the “Twilight Zone.” By the way, Janet Yellen has recently suggested that the Federal Reserve will not rule out NIRP for the U.S. Interestingly, before the Fed can *definitively* say that they will consider it; they have to confirm that the systems in place can facilitate such a move AND that it is even “legal” per the Fed’s scope, objectives and mandates for monetary policy.

As for the February 2016 allocations, PCM models are long gold, spread off between long and inverse equities, long U.S. Treasuries and long preferred equities. This allocation has resulted in almost all of the strategies being up all month, whether the market was hitting 2 year lows or rebounding to break even, as it has done in the last week. The volatility that we are seeing in the global markets across all asset classes is exactly when our models have historically outperformed. We expect this volatility to continue for at least 18-24 months. When the time comes and we again enter a constructive, more positive outlook in the market, we will be prepared to advise on which of our models we feel will do very well in that environment. In the interim, we expect to continue to get the type of recognition for performance that we saw in the 3<sup>rd</sup> quarter of 2015 when volatility began to spike.

As previously communicated, PCM has (again) been recognized as a “Top Gun” for our performance during the 3<sup>rd</sup> 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: 3<sup>rd</sup> Quarter, 2015**

#### **Informa Investment Solutions’ (PSN) Ranks PCM “Top Gun” Products**

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- **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*)

### **PCM Strategies: 02.2016 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<sup>SM</sup>: Inverse high yield bonds and long U.S. Treasuries across the yield curve.
2. PCM Absolute Bond Index<sup>SM</sup>: Long U.S. and International Treasury bonds.
3. PCM Absolute U.S. Sector Index<sup>SM</sup> : Long consumer staples and utilities, inverse DJIA equities
4. PCM U.S. Industries Total Return Index<sup>SM</sup>: Long consumer staples, utilities, and cash equivalent; inverse DJIA equities
5. PCM Absolute Equity Income Index<sup>SM</sup> : Long dividend paying equities, utilities and cash equivalent
6. PCM Emerging Market Total Return Equity Index<sup>SM</sup>: Inverse emerging markets and cash equivalent.
7. PCM Total Return Portfolio Index<sup>SM</sup> and PCM Stable Growth Plus+ Portfolio Index<sup>SM</sup>: Long consumer staples and utilities, inverse DJIA equities, long U.S. Treasuries; both Indexes also hold the U.S. dollar and are long gold and other precious metals.
8. PCM Global Tactical Index<sup>SM</sup>: Long gold, U.S. and international government bonds, the Euro and the Yen
9. Global Macro Index<sup>SM</sup>: Exposure to the U.S. dollar, inverse U.S. and Asian equities and long U.S. Treasuries
10. PCM Alpha 1 Index<sup>SM</sup>: Precious metals
11. PCM Absolute Commodities Index<sup>SM</sup>: Gold and silver

\*\*\*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 Composite<sup>SM</sup> 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 2<sup>nd</sup> quarter 2014, the PCM Absolute Bond Composite<sup>SM</sup> and the PCM Absolute Commodities Composite<sup>SM</sup> both won a "Top Gun" award for performance in their respective category for the 1-year trailing performance period, with the PCM Absolute Bond Composite<sup>SM</sup> also winning

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the “Top Gun” award for 3-year trailing performance. The PCM Alpha 1 Composite<sup>SM</sup> 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 Strategy<sup>SM</sup> and PCM Alpha 1 Strategy<sup>SM</sup> 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 [www.pcminvestment.com](http://www.pcminvestment.com) under the “PCM multi-directional Strategies” tab.**

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### About "PCM Quant Coalescence"

Welcome to Provident's bi monthly "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.