# ZPR Investment Report

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A NEWSLETTER FOR ZPR CLIENTS


*April Contents:*



## US Commentary

*By Mark Zavanelli*

March saw a strong rebound in equity prices as confidence returned. It's always good to see that prices can go up as well as down. This first quarter has been another reminder that in today's market you can't forecast what comes next by looking at what's happening today. The talking heads make a living by finding reasons to try and explain things, but if you keep score you will quickly discover how short a life span these explanations have. The truth about price changes is that the market participants who are the marginal price setters today are tied to the short term, and this leads to volatility as they reposition in front of every wiggle of the data, and do so as a herd. In times of high uncertainty like today, there are a lot of wiggles. However, all of this means that long term investors can profit from taking the other side of the trade – by buying when the short term sentiment is blowing cold and selling when it is blowing hot. With the strong move back up in the US market we have taken some profits and will look to redeploy cash as opportunities present themselves. Of course we also have to keep our eyes on the longer term developments as these will help inform our views on individual

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## Asian Results

*By Vaidas Petrauskas*

March was a good month for world stock markets. The participants were in "risk on" mode and all of the problems from January and February were forgotten. The markets erased most of the losses from the first two months of the year, and some markets (U.S.) fully recovered from the terrible start to the year. Quite incredibly the S&P 500 index is now positive for 2016 (as of March 30th) when on February 11th it was down almost 11% since the beginning of the year. These wild swings are impossible to predict. The worst thing to do is to sell during a panic. We have to treat these bursts of volatility as an opportunity to load up on shares of great companies that are on sale. We now had two big market scares, one in August '15 and another in the beginning of 2016, and the market recovered both times.

There wasn't a lot of action from central banks in March, but what news there was moved the markets. The Bank of England held the policy rate steady at 0.50%. The Bank of Japan also stayed put. Additional stimulus was expected but the BoJ was in wait and see mode. The BoJ is still evaluating the impact of their previous actions. But Mario Draghi brought his bazooka. The ECB delivered what the market wanted to hear on March 10th. They lowered the benchmark interest rate from 0.05% to zero and the deposit rate from -0.3% to -0.4%. The ECB also raised the QE size from EUR 60bn/month to EUR 80bn/month and included corporate bonds in their purchases for the first time. Perversely, the Euro jumped on the news after initially falling and never looked back. The Euro gained 4.8% against the U.S. dollar in March. Janet Yellen, not to be outdone, gave a big

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# The Dollar and the Fed

*By Mark Zavanelli*

For the past two years international investments (including ours) have struggled against a rising dollar. There is the obvious effect of currency translation, but also an indirect effect on investment flows. The expectation of future currency moves causes money to move into the currencies and markets that are expected to be stronger.

An important shift in this trend may have occurred this quarter. For all this time that the dollar was rising the logic had been that the path of the economy and of interest rates in the US was starkly different from the rest of the world. Short term rates in the US were set to rise with a Fed tightening cycle while the rest of the world was taking them down. The currencies of commodity producing nations were in free fall as investment flows were reversed. The major currencies of the Yen and Euro were set to see increased central bank stimulus while ours was reduced. Indeed, all of these pro-dollar events actually occurred. Some were natural market actions, and some were artificial attempts to weaken other currencies vs. the dollar to support trade balances. As we pointed out last month, perversely, the dollar failed to rise and instead declined. It was buy the rumor (which had been occurring since mid-2014) and sell the news. Especially with currencies, trees don't grow to the sky.

At the end of March, the market got what it did not expect from Fed Chair Janet Yellen. Up until now the Fed had gone along with the dollar strength, seeing it as a byproduct but not really as a determinant of growth. In her speech she basically entered the "currency wars" by emphasizing that dollar appreciation was hurting US growth and needed to be addressed. So now the dollar itself becomes part of the Fed's calculus on raising rates. This acts as a brake on dollar appreciation since increases can change the path of rates. Another effect is that the Fed seems more likely to let inflation run hotter than what the market expected without raising rates. This is also a clear negative for the dollar as all other things being equal short term real rates would be lower.

Of course it's too early to call the dollar's run over and the negative interest rate policies in Europe and Japan are recent and would logically weaken those currencies. But the Fed has fired its salvo and the market has taken notice. When the dollar finally stabilizes or reverses, international stocks will likely return to outperforming US equities since their valuation is depressed. Once again, don't invest with a rear-view mirror! Just like with driving, it doesn't help much going in a forward direction.

## Asian Results (Continued)

boost to stocks on March 29th by remarking that the Fed will be in no hurry to raise rates. The Russell 2000 index jumped 2.67% that day. The dollar was hit hard.

It was a bad month for the US dollar. It lost ground against all of its 31 major counterparts with the biggest declines against the currencies of the commodity producing nations. The Thai Baht gained 1.4% against the Dollar in March, the Singapore Dollar had a big gain of 4.50% against the greenback, and the Yen gained 0.50%. This softness in the Dollar added to our local currency returns when converted to U.S. dollars.

Our All Asian portfolios were up 4.30% for the month in U.S. dollars and recovered a lot of their losses for the year. The Singapore stocks finally rebounded and had a great month. The indices were up close to 5%. Our Singapore holdings recovered more than 6%.

Thai stocks continue to perform well. The Thai Large Cap SET index was up 5.65% in March and the Small Cap FTSE SET Small Cap index was up 2.93%. Our Thai stocks took a breather after a great run in the beginning of the year. They were up, but less than the Thai SET index. We are having a great year so far in Thailand. The Thai government continues with the right steps to accelerate economic growth. They announced a new package to spur sales in the low-income housing market. They also launched a tax break for individuals to deduct up to 15,000 baht on purchases (dining, hotels, and travel) made during the Thai New Year holiday (in April) to spur spending. Isn't that nice?

Japanese stocks recovered some of their losses in March, although they continue to drag down our performance so far this year. The Nikkei 225 index was up 4.57%. The Japanese economy is stagnating and inflation is nowhere to be found. There were some rumors recently that Shinzo Abe will not raise the sales tax from 8% to 10% which was planned for next April. But he came out and said that the sales tax raise is still planned. That will be another blow to the Japanese economy. However, he also hinted that a new economic stimulus package is in the preparation. We recently reduced our exposure to Japanese stocks and increased Thailand.

# US Commentary (Continued)

stocks and how to position our portfolios.

What remains key is the continuation of the economic cycle. It's still our base case that we get past this economic soft patch and continue muddling along. It's definitely still a disjointed economy, with some areas quite strong and others quite weak. One positive this month has been the action in the bond market. High yield bond spreads fell back, and it no longer looks like the weakness in energy debt will take the whole system down with it and damage credit availability. China is still a serious concern, but it was positive to see their currency stabilize this month and to see them at least give lip service to reforming state owned enterprises along with stimulus. China will continue to drag on world growth for some time. That's already in market expectations so the big issue will be whether more downside shocks arrive.

One new worry emerges from corporate profit reports. Despite the media bemoaning low wage gains, companies are actually being squeezed by costs. Corporate profits declined in the fourth quarter, driven by energy, but underneath we see a general trend of increasing costs. Wal-Mart (a stock that we don't own, and the largest private employer in the world), is interesting to look at because in theory they should be in the "strong" part of the economy, benefitting from lower energy prices and increased personal consumption. In their just released annual report, they report that total sales did increase in their US stores at a rate of +3.1% in the year ending January 2016, which was better than the prior year increase of +1.8%. Unfortunately for them costs increased faster than sales, so operating income in the US actually decreased versus the prior year by -2.1%. The company blamed this mostly on healthcare cost increases (although in the prior year the 1.8% sales growth had been fast enough to overcome the healthcare cost increases). What's more, the company has a major initiative to increase worker compensation this coming year, and is also facing the possibility of steep minimum wage increases at the local level. They have already guided that costs will eat up a greater share of revenues in 2016. With so many low paid workers they may be an extreme case, but clearly labor costs are on the march. So the profit weakness is not just coming from energy and the dollar, and it's not a big surprise that business investment is suffering as cost control has to come from somewhere. This year is going to see slow profit growth.

With all the downside economic risks and a tough corporate environment it can be difficult to see the positive side of the case. For us, as small cap value managers, it starts with the idea that we can find investment opportunities that represent a better value proposition than the overall market. That's especially true in an environment like today's where there is a wide spread between expensive and cheap stocks. When fundamentals differ, results tend to differ as well. While stock price movements are correlated, that doesn't mean that the returns have to be the same. After prolonged underperformance by small cap value there are plenty of cheap stocks to be found. As active managers we are not tied to the industry weights of the indexes and can seek out the areas of the economy that our discipline guides us to. This may be one of those periods where individual stock selection matters more than usual, and returns by style might vary substantially. If we do get even a small economic growth reacceleration, which is likely at some point later this year, small cap value stocks should see a better environment for generating returns.

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# Just the Numbers

| | Period Ending 3/31/16 | | Period Ending 12/31/15 | | | | |
|---|---|---|---|---|---|---|---|
| **ZPR Composites Names in Bold** *Benchmarks in italics* | **Month** | **YTD** | **1 Year** | **3 Year Annualized** | **5 Year Annualized** | **Inception (if under 5 yrs)** | **Incep. Date** |
| **ZPR Fundamental Small Cap Value** | 5.37% | 3.52% | 1.15% | 14.43% | 9.60% | | |
| **Volume Winners** | 2.99% | 0.96% | 10.87% | 16.75% | 10.82% | | |
| **Volume Value** | 7.11% | -1.04% | 5.61% | 19.42% | 17.34% | | |
| **Volume Momentum** | 1.70% | -3.72% | -7.66% | 15.18% | 11.30% | | |
| *Russell 2000* | 7.75% | -1.73% | -4.42% | 11.65% | 9.18% | | |
| | | | | | | | |
| *S&P 500* | 6.60% | 1.17% | 1.40% | 15.14% | 12.57% | | |
| | | | | | | | |
| **ZPR Global Equity** | 4.81% | -1.52% | -2.69% | 8.28% | 8.58% | | |
| *MSCI ACWI* | 7.48% | 0.38% | -1.83% | 8.26% | 6.66% | | |
| | | | | | | | |
| **ZPR All Asian** | 4.30% | -5.25% | -4.21% | 5.12% | 8.56% | | |
| *MSCI EAFE* | 6.59% | -2.88% | -0.40% | 5.46% | 4.10% | | |
| | | | | | | | |
| **ZPR All Thai Equity** | 3.65% | 9.53% | -9.20% | 3.57% | | 15.29% | 1/1/12 |
| *Thai Set Index* | 5.65% | 9.29% | -11.23% | 0.65% | | 9.56% | 1/1/12 |

Composite returns are presented net of management fees and trading expenses, and include the reinvestment of dividends and other income. All returns are in US dollars except for the Thai Set Index, which is presented in Thai Baht.

**Past performance does not guarantee future results.** The table above reflects (1) performance of the ZPR Investment Management, Inc. ("ZPR"), composites named in bold in the first column, (2) performance of the benchmark which reflects the composite's investment mandate, objective, or strategy, and (3) performance of the S&P 500 Index, which is provided for overall comparison and informational purposes. Please see the reverse for important information about composite and benchmark descriptions, how to receive more complete information about the composites, and disclosures regarding the calculation of performance, among other matters. Subsequent markets may perform better or worse than for the periods shown, which will cause the actual results of a portfolio to be better or worse than shown. ZPR does not guarantee or offer any assurance that any portfolio or account will be profitable, meet a client's stated objectives, or prevent or reduce losses. **A client may lose money by investing in a portfolio.**

ZPR Investment Management, Inc. ("ZPR") is an SEC registered investment adviser managing separate accounts that are fully discretionary. SEC registration does not constitute an endorsement of the firm by the Commission nor does it indicate that the adviser has attained a particular level of skill or ability. ZPR claims compliance with the Global Investment Performance Standards (GIPS™). To receive a complete description of the policies and procedures for any composite, a list and description of all ZPR composites, and a presentation that complies with the GIPS standards, please contact us at 386-775-1177 or zprim@mpinet.net.

All composites include fully discretionary, management fee-paying and, beginning on January 1, 2011, non-management fee-paying accounts, including those accounts no longer with the firm. The U.S. Dollar is the currency used to express performance, except for the ZPR All Thai Equity Strategy, for which performance is expressed in the Thai Baht. Returns are presented net of management fees and include all trading expenses and the reinvestment of all income. Net of fee performance was calculated using actual management fees, except in the case of non-fee paying accounts where model fees have been imputed. Actual advisory fees and transaction fees will vary depending on, among other things, the portfolio, account size, and activity. Fees are described in ZPR's ADV Part 2A.

The benchmark and other data provided was obtained from publicly available reports, including internally derived databases and other resources available to ZPR. ZPR believes such data to be reliable but does not audit, verify, or guarantee its accuracy or completeness. When comparing the performance results to a benchmark, clients should keep in mind that: 1) Indexes are unmanaged and unavailable for direct investment. 2) Benchmark returns include reinvestment of income, but do not reflect taxes, or investment advisory or other fees that would reduce performance. 3) Performance information of benchmark indexes is included for comparison purposes only.

**Composite and Benchmark Descriptions:**

The S&P 500 and Russell 2000 are market cap weighted indices of large company and small company US stocks, respectively.

The Fundamental Small Cap Value Composite consists of accounts that hold U.S. small cap stocks selected by using ZPR Fundamental Analysis. This analysis identifies undervalued companies using ZPR's GRAPES valuation model and also applies other selection criteria relating to a company's business prospects, management quality, and capital structure. The benchmark for the composite is the Russell 2000 Index, presented in U.S. Dollars. In the past the composite has displayed higher volatility than its benchmark.

The Volume Winners Composite consists of accounts that hold U.S. micro cap stocks selected by using ZPR Volume Winners Analysis. This analysis is a quantitative evaluation system incorporating volume, momentum and valuation measures. The benchmark for the composite is the Russell 2000 Index, presented in U.S. Dollars. In the past the composite has displayed lower sensitivity to market returns than its benchmark, which would cause it to underperform in a strongly rising market.

The Volume Value Composite consists of accounts that hold U.S. micro cap stocks selected by using ZPR Volume Value Analysis. This analysis is a quantitative evaluation system incorporating volume and valuation measures. The benchmark for the composite is the Russell 2000 Index, presented in U.S. Dollars.

The Volume Momentum Composite consists of accounts that hold U.S. micro cap stocks selected by using ZPR Volume Momentum Analysis. This analysis combines two quantitative evaluation techniques; ZPR's price and earnings momentum measure SuperMo, and ZPR's volume, momentum and value system Volume Winners. The benchmark for the composite is the Russell 2000 Index presented in U.S. Dollars.

The Global Equity Composite consists of accounts that hold both U.S. and International stocks selected by using ZPR Fundamental Analysis. This analysis identifies undervalued companies using ZPR's GRAPES valuation model and also applies other selection criteria relating to a company's business prospects, management quality, and capital structure. The benchmark for the composite is the MSCI All Country World (Gross) Index, presented in US Dollars. MSCI ACWI is a market capitalization weighted index comprised of equities from developed and emerging markets, including the US. The composite has historically held small cap stocks from a limited set of countries while the benchmark weighting is primarily composed of larger companies spread across many countries. This is likely to cause the composite to have greater volatility than its benchmark. The composite includes the performance of accounts that may occasionally use margin; however, the use of margin is not part of the overall strategy of the composite.

ZPR All Asian Composite consists of accounts that hold Asian stocks selected by using ZPR Fundamental Analysis. This analysis identifies undervalued companies using ZPR's GRAPES valuation model and also applies other selection criteria relating to a company's business prospects, management quality, and capital structure. The benchmark for the composite is the MSCI EAFE Index, which is comprised of equities from developed markets around the world, excluding the US and Canada. MSCI EAFE is presented in U.S. Dollars. The composite has historically held small cap stocks from a limited set of countries, including emerging markets, while the benchmark weighting is primarily composed of larger companies from developed countries. This is likely to cause the composite to have greater sensitivity to the returns of countries where it invests, and overall greater volatility than its benchmark.

The ZPR All Thai Equity Strategy consists of accounts that hold Thai stocks selected using ZPR's Fundamental Analysis. This analysis identifies undervalued companies using ZPR's GRAPES valuation model and also applies other selection criteria relating to a company's business prospects, management quality, and capital structure. The benchmark for the composite is the Thai Set (TRI) Index, a market capitalization weighted index of securities listed on the Stock Exchange of Thailand and presented in Thai Baht. The composite has historically held small cap stocks while the benchmark weighting is primarily composed of large companies. This is likely to cause the composite to have greater volatility than its benchmark.