



# ZPR Investment Report

July 2016

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A NEWSLETTER FOR ZPR CLIENTS

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## US Commentary

By Mark Zavanelli

Here they go again. Another European crisis grabbing the headlines and sending investors fleeing. It's like the rerun of a bad movie. The ending is still the same, which is that the whole episode can safely be ignored for now. As usual we try to take advantage of the volatility, and we were able to buy a few shares when the market was falling. One near term side effect of the crisis that we are monitoring is a temporarily stronger Dollar (especially against the Euro). This has implications for US corporate profits in the second half of the year, which had been forecasted to see relief from the strong currency effect (and now maybe won't). As it did last year, this will also

have an impact on the Chinese Yuan. China can't handle any currency strength right now coming from its tie to the dollar as they already have falling exports. So they will continue to devalue, slowly. The net of this, if the Dollar stays strong, is negative for US multinational companies. We will monitor and stay flexible. With US growth continuing and emerging markets getting a boost from commodity strength, the cycle looks set to continue.

June was finally a month where we were firing on all cylinders, both in Asia and the US. For our US Small Cap Value strategy, the first half of 2016 saw very strong absolute and relative performance. We've

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## Asian Results

By Vaidas Petrauskas

We had a good month in Asia despite the Brexit sell off (see our Brexit section for your complete guide to the British EU referendum). Our All Asian portfolios were up 3.89% in June.

Our Thai stocks had a very good month. They rose more than 5% versus 1.45% for the Thai SET index. The property developers were the biggest gainers among our Thai holdings. A stronger Thai Baht added another 1.56% to the dollar denominated returns.

The Singapore Large Cap index FTSE ST All Share was up 1.13% and the Small Cap index FTSE ST Small Cap was down -1.63%. Our portfolio return in Singapore was slightly negative in local currency,

but the Singapore Dollar gained 2.5% against the USD, so our USD return was positive.

The Japanese Nikkei 225 stock index went down 9.63% in June. This was mostly due to the strength in the Yen which appreciated by 8.05% against the U.S. Dollar. Our Japanese stocks were "only" down 5% for the month. Including the currency impact we were up.

The suspension of the VAT increase in Japan for several years and the significant selloff of the Japanese stocks again make them a remarkable value. The smaller cap stocks we hope will break free of the games the hedge funds and others are playing. We are counting on our Japanese

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## Brexit

By Vaidas Petrauskas

In June the biggest short-term risk to the markets was the June 23rd Brexit referendum – a vote by the British people on whether to leave the European Union or stay. It was considered to be a long shot. The consensus in the market was that Brits would vote for the status quo. The bookmakers gave an 80% probability for the “Remain” vote. The markets actually rallied before the referendum being certain the UK would stay in the EU. But voters had other ideas. 52% of Brits voted to leave and 48% voted to stay. This came as a shock to everyone, including some of the Brexiteers themselves. Boris Johnson, the former London mayor who led the “Leave” campaign and was the favorite to replace David Cameron as the Prime Minister of Britain, the next day looked like he just saw a ghost. David Cameron announced his resignation the next day after the referendum. Britain is now in a big political mess. The Prime Minister has resigned and the opposition is in complete disarray. There are also questions over the future of the United Kingdom. Both Scotland and Northern Ireland voted by clear majorities to remain in the EU, only to be overruled by the English and Welsh.

The markets have, of course, reacted violently to the referendum outcome, as they always do when events do not happen according to the consensus in the markets and the markets adjust to the new reality. We certainly saw a big adjustment on June 24th. The British Pound tumbled more than 10% against the US dollar to the lowest level in 31 years and British equities lost 5%. It wasn't the worst performing market. Equity indices around Europe were down around 8% for the day with Spain down 12%. The bank stocks were especially hard hit. Both Deutsche Bank and Barclays saw a quarter of their market value erased. The Euro lost 3% against USD. Meanwhile the Yen, which is considered to be a safe haven, strengthened from 106 Yen to the Dollar to below 100. This has hurt Japanese equities. The Nikkei 225 index fell close to 8% for the day. The Japanese outdid themselves as they were the first to wake up to the news and they didn't know what to expect. The Nikkei reversed some of the losses the next day. Not even Thailand escaped the selling. Both Thailand and Singapore equities were down more than 2%. Gold was up as expected. The U.S. markets joined the selloff. Major averages in the U.S. were down more than 3% for

the day. Luckily the selloff was short lived. In the last days of June the markets across Asia and U.S. advanced strongly and almost erased all the losses they suffered after the Brexit vote. The drop in the Asian markets and especially in Japan is silly. These countries should all be celebrating the opportunity to trade directly with the UK without the high tariffs and complex rules. Global trade is greatly enhanced.

No one knows how the British – EU situation will play out in the future. It will take years of negotiations before the UK actually leaves. Freedom to choose. Yes, there is uncertainty and it is messy. But it is all opportunity.

We consider the referendum outcome a very good thing economically, politically, and especially for the future and traditions of Britain in the long run.

The EU is a monstrous regulatory bureaucracy with huge inefficiencies and redundancies. It is anti-business, socialist, anti-growth and has a monetary policy that is ruinous and tax structures that are too complex.

Not to mention the impossible job and labor rules for business. We have the French making Uber executives criminals for not having a taxi business license. You have to have a license to do anything.

It hurts global trade with big tariffs and red tape. Only the EU members benefit with free trade. The EU has currently gone after the American corporations, raiding corporate offices of McDonald's, Google, Apple, etc. The EU Competition Commission has gone after Google with multiple anti-trust charges. This restricts innovation and hurts the EU citizens the most. These are bureaucrats who think all the problems can be solved by more regulation and bigger fines.

The EU is in crisis due to immigration. This is also the main reason that Britain voted to leave. Looking ahead, the huge population growth of Africa and Middle East, India, Pakistan, Bangladesh, and the vast problem of their incompatible cultures, is all unsustainable. The influx of refugees puts a stress on the socialist systems of Europe. The Syrian war forced millions of Syrian refugees into Europe, which caused great divisions in Europe, with Germany accepting many refugees and

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## Brexit (Continued)

other countries refusing to accept any. At some point Germany will no longer foot the bill of the other countries. The grand concept of the EU fails in the face of reality and those who administer it. To the extent that it brings down internal trade barriers, it is still a wonderful economic idea for its members.

The Baltic countries and other Eastern European countries threatened by Russia have no alternative to the EU.

Being in the EU and NATO is a political necessity to have some hope of maintaining their freedom against a very real threat.

The decline in the British pound will be a big trade advantage and it will later recover. The decline of the euro could very well be terminal. The EU bank stocks are toxic waste. It's no wonder why demand for Gold is rising. Because of low interest rates we have a real estate bubble underway as people have nowhere to put their money. The 10-year bond in Germany is negative. The Swiss Central Bank decided to leave rates unchanged at -0.75%! Germany has negative interest rates out to ten years. Japan's are negative out to 15 years and Switzerland's are out to 30 years! This also means stocks are still one of the few remaining games in town.

## US Commentary (Continued)

been able to do this in a difficult, choppy market that didn't have much return. Maybe the extreme dominance of the FANG stocks last year was the final act in the long period of outperformance by Large Growth stocks, and now it's our turn. We'll see. We still have very cheap stocks, despite the overall market valuation. In Asia the first half has been a tough period, but we're encouraged by what we own and this month hopefully is the first step back on the road to positive results. I would argue that the big performance deviations are actually what you want in hiring an active manager like ZPR (of course everyone wants the "good" deviations, but one

doesn't come without the other). In an investment world that has become dominated by shorter term players (in the form of hedge funds) and passive investments like ETFs, the style swings in any one period can be extreme. The money moves in and out and returns see-saw with it. This causes volatility in relative performance, but it also creates opportunities that our strategies can hopefully capitalize on to do even better in the long run. Whether short term results have been good or bad, we just keep executing our strategy because investment success is a marathon and not a sprint.

## Asian Results (Continued)

companies to continue to increase their dividends, buyback their stock, and to do mergers and acquisitions with their hoard of cash. Foreign investors are very pessimistic about Japan and they have sold \$93bn worth of Japanese stocks in the past 12 months. This is great news for us contrarians because most of those that wanted to sell already sold. Yet there are record payouts to shareholders and a steady pick up in domestic M&A.

We also have the Japanese Government Pension Investment Fund and the Central bank on our side. They are dependable buyers of the market as are corporations – via share buybacks. Analysts at Goldman Sachs see that trio collectively buying 23tn yen worth of domestic equities this year. We are finding and buying new stocks in Japan after the recent selloff.

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The information contained in this Newsletter is not investment advice for any person. It is presented only for informational purposes to assist in explaining the portfolios and composites. All expressions of opinion reflect the judgment of the firm on this date and are subject to change. The information has been obtained from sources considered reliable, but we do not guarantee that the foregoing materials are accurate or complete. Clients or prospective clients are directed to ZPR's Form ADV Part 2A and its representatives for individualized information prior to deciding to participate in any portfolio or making any investment decision. ZPR does not provide tax advice. All clients are strongly urged to consult with their tax advisors regarding any potential investment. Past performance does not guarantee future results; there is always a possibility of loss.

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## Just the Numbers

ZPR Composites Names in Bold <i>Benchmarks in italics</i>	Period Ending 6/30/16			Period Ending 3/31/16				
	Month	Quarter To Date	YTD	1 Year	3 Year Annualized	5 Year Annualized	Inception (if < 5 yrs)	Incep. Date
<b>ZPR Fundamental Small Cap Value</b>	4.75%	13.19%	17.17%	-4.55%	11.75%	8.59%		
<b>Volume Winners</b>	0.22%	5.90%	6.91%	14.40%	13.92%	10.04%		
<b>Volume Value</b>	0.38%	4.41%	3.33%	6.41%	14.87%	15.06%		
<b>Volume Momentum</b>	1.13%	4.12%	0.25%	-9.21%	6.64%	10.08%		
<i>Russell 2000</i>	-0.25%	3.60%	2.02%	-9.76%	6.84%	7.20%		
<i>S&amp;P 500</i>	0.09%	2.29%	3.67%	1.79%	11.83%	11.58%		
<b>ZPR Global Equity</b>	4.38%	6.09%	4.47%	-9.37%	1.73%	7.18%		
<i>MSCI ACWI</i>	-0.55%	1.19%	1.58%	-3.80%	6.10%	5.80%		
<b>ZPR All Asian</b>	3.89%	1.36%	-3.96%	-10.87%	-3.61%	6.97%		
<i>MSCI EAFE</i>	-3.32%	-1.20%	-4.04%	-7.87%	2.67%	2.79%		
<b>ZPR All Thai Equity</b>	6.87%	3.17%	13.00%	-3.48%	-0.80%		16.81%	1/1/12
<i>Thai Set Index</i>	1.46%	3.81%	14.57%	-3.51%	-0.18%		11.53%	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](mailto: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.