ZPR Investment Report

June 2016 Volume 22, Issue 6

A NEWSLETTER FOR ZPR CLIENTS

June Contents:

US Commentary

By Mark Zavanelli

US stocks rose in May as economic data began to improve from the very weak levels of the first quarter. A lot of this is just seasonal noise in the data and not representative of any real changes, but after the fear of collapse stability is good. US stocks can continue to rise if we have economic growth of two percent and corporate earnings start increasing again. These are not very exciting targets, but they will be enough. With emerging markets getting a boost from the bounce in commodity prices, overall world growth will also be a little better than it looked a few months ago. This may be a major turning point for emerging markets since sentiment and capital flight had become so extreme. China still remains a risk and a major drag on growth, although this stabilization helps them too.

Into this moment of relative optimism the Fed is going to try to shoehorn in one rate increase before we get too close to the election. Since these initial increases off of zero help to normalize the working of the financial system and credit markets they might just as easily help credit growth as opposed to restraining it. It also brings them one step closer to extricating themselves from the mess they have created with unnecessary and damaging stimulus. How the market reacts to this in the short term doesn't really matter too

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Asian Results

By Vaidas Petrauskas

It was a calm month. The Japanese Nikkei 225 index was up 3.41% in May as Japanese stocks recovered, mainly due to a weaker Yen. The Thai SET index was up 1.71% and Thai Small Caps were up 0.15%. The Singapore FTSE ST All Share index closed down 1.17%. Our Asian stocks held their ground and were up in May in local currency, but it was the month of the Dollar. The Dollar appreciated against most world currencies. The Yen lost 3.62% against the Dollar, almost exactly offsetting the gain on Japanese stocks. The Thai Baht lost 2.20% and the Singaporean dollar lost 2.66%. The Dollar strength hurt our Asian results when converted to U.S. dollars and pushed them into negative territory for the month.

Most of our Asian companies reported quarterly results in May. The Thai reports were good, as expected. Especially our real estate developers, which make up about a half of our Thai holdings, reported strong earnings. The market shrugged this off. That's fine with us. We are happy to add to our positions at low prices. After watching the Thai stock market daily for a decade, it is obvious that it has become subdued this year. The volume is down dramatically. While before it was not unusual to see stocks go up or down 30% after announcing earnings (that is the limit on the daily price change on the Bangkok Stock Exchange), this year Thai stocks barely move. We attribute this to a lack of foreign investors as they all exited last

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Improved Quantitative Strategies

By Vaidas Petrauskas

We recently spent a lot of time researching the Volatility phenomenon. We looked at historical returns of highly volatile stocks versus the less volatile ones and we also looked at combinations of Volatility with other factors and how they interact. We found that a stock's volatility by itself is a very powerful predictor of future returns for that stock. The most volatile stocks underperform significantly regardless of company size. In fact, according to our study, if all you did was buy the most volatile Micro Caps over the past 15 years, you would have lost 22% of your money over the entire 15-year period while the average Micro Cap stock advanced 241% over that time. The most volatile stocks should be avoided at all costs.

On the opposite end, the least volatile stocks beat the averages by a wide margin. One product from this research is our new Low Volatility strategy. We combine low volatility with other factors to pick truly neglected Small Caps which in the study produced the best of both worlds – market-beating returns minus the roller-coaster ride. The strategy works on companies of all sizes, even Large Caps. We plan to build a live track record with this strategy and offer it in the future.

We also studied how our existing quantitative strategies might be improved by removing the most volatile stocks. By excluding them from our quant strategies we hope to achieve two objectives – improve returns and reduce the standard deviation of returns.

We found that removing the most volatile stocks would have improved our successful Volume Value strategy in the backtest. Since it turns out that low volume stocks also tend to be less volatile on average, only 3% of stocks were affected. Still, the returns improve significantly enough and the volatility of returns drops, so we will make this adjustment. The Volume Winners strategy has too few volatile stocks to make a difference, and will remain unchanged. Volume Momentum is significantly improved because this strategy is half Volume Winners and half SuperMo. The SuperMo strategy is not for the faint of heart. It uses our proprietary Momentum Confirmation model to buy the Micro Caps with the highest earnings momentum. In the study and also in our live experience we have seen that this strategy is subject to huge swings. By eliminating the most volatile stocks we both improve returns and reduce the big swings in the backtest. The SuperMo strategy did have a lot of volatile stocks in it (a fifth of companies), so the improvement could be significant. Finally, we also believe we have improved our GRAPES quantitative strategies. We will switch to the improved strategy formulations when we do the next rebalancing at the end of June.

US Commentary (Continued)

much in the grand scheme of things. We need slow growth along with contained inflation, and there really is no other option that leads to successful continuation of the cycle. Thankfully, this is the status quo and the most likely path forward.

One thing that almost everyone can agree on is that there has been a lot of uncertainty and doubt so far this year about where the economy and markets will go. All the jockeying for position has created some large divergences in performance and how assets are valued. At ZPR we have been both on the right side of this (in our US Small Cap Value strategy) and the wrong side of it (in Asia, primarily with our Japanese stocks). While we always want to be "right", and bad performance is frustrating, perhaps the larger message is that these divergences are actually part of a longer process that provides the fuel that a value manager like ZPR can thrive on. Value managers usually make poor timers and the schedule for being rewarded for owning out of favor stocks is usually when it is most surprising. We do see from experience that good periods and poor periods seem to come in bunches, but also that it's hard to predict when those start and stop. In this picture of the world our current good SCV returns are the payoff for sticking with the strategy during times where it was uncomfortable to do so, and they represent a rotation of the environment more than better decisions. In the same way our poor Asia returns are hopefully just earlier in the cyclical process and are setting the stage for a better environment to come. We'd like to avoid periods of underperformance, but it's actually the willingness to take this very sort of risk which is the key to the whole process working. So we'll grit our teeth and try to remind ourselves that these cycles are unfortunately a necessary part of generating better than average long term returns.

Asian Results (Continued)

year. When they return, they will return in droves, and push stock prices up. This lack of interest is somewhat disappointing because before we would see Thai stocks go up strongly on a good earnings report. In the U.S. market it is all a game of beating forecasts and the market players rush in to dump a very good earnings comparison and report because they missed a consensus forecast for the quarter by a penny or so. In Thailand, we only need to be right on the earnings of the company and how well they are doing. Of course, with one eye and fingers crossed that the military will not do anything crazy.

Things are looking good with the Thai economy and corporate earnings. The Deputy Prime Minister of Thailand Somkid Jatusripitak is targeting a 20% private investment rate from 10% currently. This was the rate which set off a long period of 6% a year GDP growth when he left office more than 10 years ago as Finance Minister. He plans to accomplish the private investment rate by many incentives and inviting Corporate Japan to expand in the industrial parks where they already have a major presence. Thailand has the only land route to Myanmar which is the big emerging market story where wages are $1 a day. Everyone is clamoring to set up shop there.

Somkid understands exactly what businesses need and want - Stability. He took a huge step by making the corporate tax cuts he started years ago permanent and in law. A 20% corporate tax rate, no tax on capital gains and a 10% dividend withholding tax (no other income tax) makes this country very successful and appealing to investors. There will be no increase in the VAT. Calls to weaken the currency to improve exports will fall on deaf ears.

That is why we have greatly increased our allocation to Thailand versus Japan where they are doing all the wrong things - increasing the VAT, increasing taxes on capital gains, trashing their currency, rolling out more stimulus and negative interest rates. You will not see any of that in Thailand.

Actually, it seems that Japanese Prime Minister Shinzo Abe has come to his senses and is backtracking on the VAT increase. That news came at the end of May. Until then he was adamant that the VAT increase would go through in 2017. Now Abe wants to postpone the increase from April 2017 to October 2019. The VAT increase was a terrible idea which would only hurt the Japanese economy more. The last two VAT increases, separated by 17 years, both tipped an economy that looked to be recovering back into recession. So we are happy to see it will not be implemented in the near future or hopefully ever.

Meanwhile our Japanese companies reported good results. With the Japanese economy stalling we expected low or flat growth, but we had many good reports and bought more of the best stocks. The Japanese stocks are incredibly cheap - warts and all.

I read an interesting fact in the Financial Times which shows how the negative rate policies are creating great distortions in global debt markets. Anyone interested in “centennial” bonds? There were recently 100-year bonds issued by Ireland, Belgium, and Mexico trying to lock in a low interest rate for 100 years. The Irish and Belgian bonds have a coupon of 2.3% a year until 2116. That is amazing considering that Ireland was practically bankrupt eight years ago. France took advantage of falling borrowing rates to issue 50-year debt with a yield of just 1.9%! That is good news for France and a terrible investment for the buyers of that debt. The sale of Irish and Belgian centennial bonds has been hailed as proof that investors expect global inflation to stay in the doldrums for decades, but no one can predict what inflation will be next decade, let alone in 2116. There is no shortage of buyers either. This shows how desperate investors are for yield these days.

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Just the Numbers

	Period Ending 5/31/16			Period Ending 3/31/16				
ZPR Composites Names in Bold *Benchmarks in italics*	Month	Quarter To Date	YTD	1 Year	3 Year Annualized	5 Year Annualized	Inception (if < 5 yrs)	Incep. Date
ZPR Fundamental Small Cap Value	2.17%	8.06%	11.86%	-4.55%	11.75%	8.59%		
Volume Winners	1.99%	5.67%	6.68%	14.40%	13.92%	10.04%		
Volume Value	-1.82%	4.02%	2.94%	6.41%	14.87%	15.06%		
Volume Momentum	1.60%	2.96%	-0.87%	-9.21%	6.64%	10.08%		
Russell 2000	2.12%	3.66%	2.15%	-9.76%	6.84%	7.20%		
S&P 500	1.53%	1.93%	3.30%	1.79%	11.83%	11.58%		
ZPR Global Equity	0.02%	1.64%	0.09%	-9.37%	1.73%	7.18%		
MSCI ACWI	0.21%	1.75%	2.14%	-3.80%	6.10%	5.80%		
ZPR All Asian	-1.37%	-2.44%	-7.56%	-10.87%	-3.61%	6.97%		
MSCI EAFE	-0.78%	2.20%	-0.75%	-7.87%	2.67%	2.79%		
ZPR All Thai Equity	-3.12%	-3.46%	5.73%	-3.48%	-0.80%		16.81%	1/1/12
Thai Set Index	1.71%	2.31%	12.93%	-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.

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.