ZPR Investment Report

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A NEWSLETTER FOR ZPR CLIENTS

August Contents:

US Commentary

By Mark Zavanelli

Global stock markets were very strong this month. Bond yields were at or near record lows after the Brexit vote which set up a rotation back into stocks as volatility and temporary fears settled down. As in the old market adage, prices have climbed a wall of worry. The money flooding back into stocks since the declines early in the year have especially helped cheaper assets. Value approaches like ours have been gradually coming back into favor as the price of "safe" assets had risen too high relative to everything else over the past year. As we've seen in our US Small Cap Value strategy, when the tide shifts the return differences can be dramatic. This is the benefit of owning unloved assets that get reevaluated by the market. We have also seen historically that these style trends can persist over many years. We always think it's a good time to own value but at the present moment it seems particularly attractive relative to everything else.

Throughout this bull market the pattern has been the same, where concerns about an economic shock coming from Europe or Asia have sent global stock markets into a tailspin, only to have the concerns dissipate and markets move back up. It's not that these risks weren't real, only that the possibility of short term contagion was way overblown in this period of central

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Asian Results

By Vaidas Petrauskas

The momentum of our Asian stocks continued in July and as a result our All Asian portfolios gained 4.88% for the month. This follows a gain of 3.89% in June. Slowly but surely the recovery of our Asian investments continues.

The Japanese stock market was one of the best performing, although all global equity markets rose significantly in July. The Japanese Nikkei 225 stock index was up 6.38% for the month. The Yen "only" lost 53 basis points against the US Dollar. Usually the Yen and the Nikkei 225 almost exactly offset each other, but that wasn't the case this time, which is good for us. Our stocks outperformed the Nikkei 225 index. We estimate our Japanese stocks were up more than 8% in local currency. We had one big winner – our recently discovered construction company with explosive earnings growth rose 38% in July. Japanese stocks are back in favor, at least for now. The earnings season has started in Japan and the quarterly results have been good so far.

The Yen was getting weaker during the month, but appreciated significantly on the last trading day after the Bank of Japan announced additional stimulus measures by expanding its asset purchase program. They keep doing the same thing and hoping for different results. How about lowering the taxes? That will get the economy going. The announced measures fell short of market

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ZPR INVESTMENT MANAGEMENT
1642 N.Volusia Avenue
Orange City, Florida 32763

Phone: (386) 775-1177
Fax: (386) 775-7749

E-mail: zprim@mpinet.net
Web: www.zprim.com

Slow Growth and Low Rates. Tough Times for Investors?

By Mark Zavanelli

It's apparent from the data that we are in an era of low growth and low interest rates in developed world economies. This has been occurring even eight years after the financial crisis where we are in a cyclical expansion. There is a laundry list of possible reasons for the slow growth which differs by country (although demographics is a contributor across the board). It's pretty clear at this point in the recovery that it isn't just some cyclical, temporary phenomenon. Emerging market growth has been cyclically weak due to the commodity bust and is set to recover, but this has had little effect on developed economies. The "normal" rate of growth is slower today than what it was in the past, confusing many about where we stand in the economic cycle.

Slow nominal growth leads to low interest rates through the linkage of inflation, which is included in both numbers. Real growth and real rates are also connected theoretically (the time value of money is less in a slow growth world), but the primary link today is through a triumvirate of central banks, the Fed, the European Central Bank, and the Bank of Japan. Whatever the supposed mandate of these central banks is, in the post crisis period the three have attempted to solve the slow growth problem through extreme interest rate manipulation on both the short and long ends of the curve. Right now, although the Fed has halted asset purchases and is nominally in a policy tightening phase, the ECB and BOJ have gone into overdrive. Government bond yields in Japan and higher quality European countries are negative out to ten years of maturity, which is unprecedented in the history of finance, spanning back thousands of years. No one can argue that this is a natural condition. This is also pulling down US government interest rates as money flees the Euro and Yen in search of positive yields. At 1.47%, the US 10 year Treasury Bond has a much higher yield than those other countries, but is less than current and expected inflation (approximately 2%), so the real yield is negative.

There's a Yin and Yang in this for investors. On the one hand, the central bank actions have had two notable positive effects, at least in the short term. First, they have caused asset prices of all stripes to rise. In fixed income especially there has also been a shrinkage in risk spreads so there has been an amplified impact on riskier assets. This can be thought of as pulling gains from the future into the present, since presumably they can't or won't influence prices forever. Still, we don't know what the future is so we're happy to have those gains today. Second, because of the belief in the power and willingness of central banks to provide unlimited support, there has been no ripple effect from areas of the world with troubled debt. When Italy can borrow more cheaply than the US, they can bail out their banks with impunity. The same goes for China, which has to manage an implosion in large parts of its commodity and export driven economy. Back in the US, financially troubled states and municipalities can push off problems further into the future. It has essentially made every dip in risk assets a buying opportunity. Free money means it's hard to go wrong. You basically have to be Puerto Rico and tell people you won't pay them back for there to be a problem.

The flip side of this story is two-fold. First, as we can see, new money invested today in fixed income is stuck with negative nominal or at least real yields when held to maturity (you can have gains but some greater fool has to buy it at an even more negative yield for that to work). To get more you have to take credit or duration risk, and those spreads are also shrunken so you get less return for accepting those risks than you would normally. This is what the central banks want, to get investors to provide capital to the private economy at lower rates, for longer, and with higher risk. Secondly, to the extent that central banks have manipulated asset prices in the present, there is at least a risk of reversion in the future as those policies are removed. They may not be able to cause a boom where they want it (like in the Japanese economy) but the extra debt created as a result of this manipulation shows up somewhere and causes a problem down the road. One thing central banks have not been able to do is to halt a full fledged economic bust as it is happening.

As an aside, some participants say it will get even more extreme in the near future as the cyclical expansion part cools off and maybe low growth turns out to actually be zero or negative growth, pushing yields even lower. The range of longer term outcomes goes from mild, in a

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Slow Growth and Low Rates (Continued)

scenario where the central banks succeed in promoting real growth without inflation and asset price losses are limited to government bonds; to severe, where there is a destruction of confidence in one or more major currencies. Here are some simple suggestions for coping with this situation:

1. Don't reach for returns (either yield or gains) when prices are high. There's too much potential loss in a reversion scenario and very little extra return. There is neither safety nor return in expensive prices.
2. Treat gains as an "advance payment" on longer term returns. This means selling some things that went up to harvest those gains.
3. Do invest in what is out of favor and that you still believe has long term viability. There is cheap stuff out there.
4. As long as the market sees problems as being met by more stimulus we are in a "buy the dip" market.
5. Check your current and long term asset allocation. If you're like most investors you probably have more money in what's gone up, like US large cap stocks or yield plays like utilities and REITs. Potential diversifiers are hard assets like commodities or gold, or stocks in out of favor countries such as emerging markets.

US Commentary (Continued)

bank activism. This time it seemed like there was a clear transmission mechanism to affect US stocks and the US economy through the strengthening US dollar. Over the past year earnings for the S&P 500, which have a lot of sales outside the US, declined on the back of losses in the energy sector and the headwind from the strong dollar. However, even after Brexit, the dollar has stabilized and energy losses have flattened out as oil prices have partially recovered. Corporate earnings are resuming positive growth this quarter, led by cyclicals and small caps.

All is not rosy, however. The market thinks we are back to a Goldilocks setup where growth is positive enough for earnings to grow but slow enough to keep the Fed on hold from further rate increases. That's not really accurate on either count. The monkey wrench in this is inflation. With low growth even small increases in inflation can have an impact on the economy. For example, right now the cost of an average worker in the US (as measured by the Employment Cost Index, running at about +2.3% per year) is rising faster than the productivity of that worker (rising at about 1% per year). That's not math that leads to new business investment, and instead companies are looking for ways to cut costs to offset the inflation. The market has pegged the Yellen Fed as super dovish after seeing their behavior so far. That might be true, but I also think they are bad at communicating, and that they will react to a further uptick in inflation. This would actually be good for the economy, but the market might not take it that way.

Asian Results (Continued)

expectations and as a result the Yen surged on the last day. The BOJ decided to ramp up its purchase of exchange-traded funds from 3.3 trillion yen to 6 trillion. You can expect more stimulus measures from Shinzo Abe as he consolidated his power after winning a sweeping victory in elections to Japan's upper house in July. Year to date the Yen is up 16.52% against the U.S. dollar. The BOJ's stated policy to weaken the Yen has to be a total embarrassment.

Thai stocks also had a good month. The Thai SET index advanced 5.47% and our stocks lagged that by about 1%. Our property development and construction companies again were the best performing group. A stronger Thai Baht added another 0.92% to the dollar denominated returns.

Singapore stocks continue to be very volatile. That's one reason we have kept our allocation there low. In theory it should be a market full of opportunity as it combines a developed economy and stock exchange with the dynamic growth of the surrounding region. However we have had big disasters as well as successes in Singapore. The corporate governance in Singapore is poor. We have witnessed many times how companies do a stock or rights offering much below the market price, destroying the stock in the process. We had one such example in July, but made the right decision to exit the position right away as the stock sold off by 37% after we exited. We also observed how management can withhold information from shareholders and the regulators about the true state of the company. Again, we observed this first hand in July. Our Singaporean oilfield services company announced a voluntary liquidation on July 28th out of the blue, which shocked everyone. Then reversed the decision on July 29th instead deciding to continue operating under court supervision. As it turns out, while the management was issuing rosy press releases about new big business opportunities in Africa and Vietnam, the company was struggling to raise new capital to pay creditors. After the July 28th decision all top management left "to pursue other opportunities". Best of luck to them. Meanwhile the stock has been suspended since before the announcement and we are stuck with it. We are conservatively valuing it at zero as it is unclear how much, if anything, can be recovered. Thankfully it was a small investment.

The bright spot in Singapore was our new gold stock which we bought in mid-June. It quickly nearly doubled and we managed to take some profits. We had actually wanted to buy more along the way but the stock ran away. After we sold some the stock dropped back and we added to it again. We expect record results from this gold miner as they already preannounced record production and lower production costs.

Just the Numbers

	Period Ending 7/31/16			Period Ending 6/30/16				
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	8.98%	8.98%	27.69%	11.92%	14.81%	11.37%		
Volume Winners	3.70%	3.70%	10.87%	16.48%	14.48%	11.13%		
Volume Value	6.04%	6.04%	9.57%	5.76%	14.36%	16.28%		
Volume Momentum	7.35%	7.35%	7.62%	-3.61%	5.26%	11.26%		
Russell 2000	5.90%	5.90%	8.25%	-6.73%	7.08%	8.35%		
S&P 500	3.56%	3.56%	7.54%	4.02%	11.67%	12.10%		
ZPR Global Equity	6.63%	6.63%	11.39%	-4.49%	5.09%	8.38%		
MSCI ACWI	4.34%	4.34%	5.98%	-3.16%	6.60%	5.96%		
ZPR All Asian	4.88%	4.88%	0.73%	-13.45%	-0.49%	7.05%		
MSCI EAFE	5.08%	5.08%	0.83%	-9.72%	2.51%	2.17%		
ZPR All Thai Equity	5.50%	5.50%	19.22%	0.26%	4.01%		16.61%	1/1/12
Thai Set Index	5.71%	5.71%	20.93%	-0.61%	3.20%		11.78%	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.