



ZPR Investment Report

September 2017

Volume 23, Issue 9

A NEWSLETTER FOR ZPR CLIENTS

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US Commentary

By Mark Zavanelli

US small cap stocks fell in August while large caps were roughly flat. During the month, the market became afraid that the US economy was slowing down. Data on big ticket items such as autos and housing were weaker than expected. Market indicators such as the 10-year bond yield, and the US Dollar, were also interpreted as signaling economic weakness. Value stocks, which are typically more sensitive to the economy, declined as a result.

I view this as a typical market gyration, which we've seen many times before. As

prices were falling we were putting cash to work and rebalancing in order to take advantage of opportunities. The economy is doing fine, and even temporarily weak areas will bounce back over time. Instead of a late cycle slowdown that the market fears, I think the US economy is actually about to get stronger. A boost from trade is on the way, with the weaker dollar combining with stronger international economies. The recent decline in interest rates is going to help rate sensitive areas like autos and housing that the market is worrying about. With inflation in check

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Asian and UK Results

By Vaidas Petrauskas

Our Asian portfolios extended gains in August. Country diversification worked very well – while US stocks sold off in the middle of the month, Asian stocks, and especially Japanese stocks, advanced. Our All Asian accounts rose 2.13% in August and are up 19.54% year-to-date.

Japanese stocks are entirely responsible for our good August result. Our Japanese stocks rose around 3.60% in Yen versus a -1.40% loss for the Nikkei 225 index. We had very good quarterly operating results from many of our companies and we added a few new stocks to the portfolio. Japan is one market where we have no trouble finding good and cheap companies to buy that meet our criteria. We currently have 25 stocks in Japan and feel great about the stocks we own.

The US Dollar continues to be very weak, especially against the Euro. But against our Asian currencies the Dollar finished the month flat. Only the Thai Baht appreciated against the Dollar in August – by 0.30%. The strength of the Thai Baht is already making Thai exporters and Thai officials nervous. The Baht is the best performing Asian currency this year, gaining 7.8% against the US Dollar. Capital is flowing into Thailand, which is considered a safe haven among emerging markets, due to its enormous current account surplus derived from robust growth in exports and tourism income.

The political prospects in Thailand are improving. The big news on the political front this month was the trial of the former Prime Minister Yingluck Shinawatra. It

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The Growth-Value Cycle

By Mark Zavanelli

As we've commented in several recent newsletters, we are currently in the midst of some extreme factor swings. From 2010 to 2014 there was a period of relatively even performance between growth and value stocks (at least according to the Russell Index measurements). Then 2015 saw the emergence of the current crop of market darlings, and strong outperformance by growth. By mid-2016 we had reached an extreme where those stocks were going up and everything else was going down. The valuation spread between the price of growth stocks and value stocks had spiked up past two standard deviations, to levels not seen since the Tech Bubble. Then value came back powerfully, and 2016 as a whole turned out to be an outperforming year for value. Now in 2017 we're back to severe outperformance by growth again. It is a topsy-turvy environment. It's a foolish task to try and call a momentum peak, but I think we're far enough along that any money made in the darling stocks will be given back in a future decline. So I think that owning them is speculating (which is a perfectly reasonable activity, if approached correctly) and not investing. These performance swings historically have not been kind to investors on average, since the tendency to move money towards better looking investments is particularly dangerous in such periods. Here are three general points to help in navigating this environment:

1. Keep a Balanced Asset Allocation.

This is the type of environment where people get excited about very large returns in a few successful companies. They tend to think about returns instead of about risk, and their tolerance for lower risk or out of favor assets becomes lower. When stock market returns have been high, future risk is higher not lower. Often to keep balanced you will have to take money out of good performing investments to put it into something more boring (like cash).

2. Understand the Power of Reversal.

Extremes create their own reversals. When we see those big historical returns our reaction is to think that we would be happy with even half of that, which at the time seems a reasonable assumption. It is not. These are binary outcomes. Either the excitement continues (justified by real events or not) and the returns go with it, or it doesn't and those returns become negative. The reason is a behavioral one relating to attention. I was thinking of this in relation to the recent record Lottery. Whatever the reason for the extreme attention to the big jackpot (humans are complicated creatures!), the pattern is that a lot of lottery tickets are sold for this one event. Then it's over, and very few tickets are sold after that (ok, they also have spent their allotted or available Lottery money). The key insight is that the attention creates a wave pattern. The more intense it is, the bigger the other side is when it happens.

3. Keep in Mind the Long Term Power of Valuation.

Today's valuation is a good predictor of long term (10 years or more) future returns. It's difficult to appreciate this in the moment, but overall market valuation told you that forward returns were likely to be terrible in 1999-2000 (during the market rise) and terrific in 2008 (after the market fell). Today we do not have such extremes, but it works across the distribution of valuation levels. The reason we say it predicts long term returns is that it is not a good predictor of short term returns (if it did that would be easier). What I like about this analysis is that it frames the question. If valuation has a significant message, then it becomes a question of when and not if or what. Today, for example, we can predict with confidence that the next 10 years of returns for the S&P 500 will be below the long term average, probably significantly so, because valuation is so high. For my investment analysis, this means thinking more about risk, and being cautious about having too much market beta. The business cycle also becomes more important in my thinking, because it makes sense that the timing of a re-valuation of stocks would have something to do with unexpected economic events.

US Results (Continued)

and the Fed on hold, good economic data will be viewed positively by the market and stocks can move higher. It's a Goldilocks scenario for the moment, and the economic expansion continues. The terrible destruction from Hurricane Harvey will throw some monkey wrenches into the near term data, but the rebuilding effort will lead to increased economic activity once the money starts flowing.

The decoupling we have seen between different types of stocks (small vs large, growth vs. value, domestic vs. foreign) continued in full force this month. With these groups all acting independently, diversification is working especially well. While the US market overall is expensive, this may not matter all that much for the cheaper categories of stocks which are already going in their own direction.

Asian and UK Results (Continued)

was a political farce. She faced 10 years in prison over her government's rice subsidy program. The fear was that Thais loyal to Thaksin Shinawatra (Yingluck's older brother who is in exile) would launch violent protests and disrupt business activities. But she skipped the court and fled the country to join her brother in Dubai. Thailand still is split between pro- and anti-Thaksin forces with violent and bloody history between the two camps. The country has been under military rule since the May 2014 coup, which occurred after months of political crisis following protests against Yingluck's government. Her fleeing the country removed an element of political instability. There was no violence. Thai stocks rose as a result. The general election is scheduled to be held in a year, but the junta will still control political life in Thailand for many years to come.

The Thai economic recovery is gaining speed. GDP is expected to grow 3.5% this year, and exports are very strong despite the stronger Baht. We have added new Thai stocks this month (we now own 15 stocks) and we feel the prospects for Thai companies are great with a long runway ahead. One of the nice things about investing in Thailand, and there are many, is that Thai stocks are very loosely correlated with the other stock markets. So there is a big diversification benefit. The Thai stock market is dominated by local investors.

We underperformed the Thai SET index in August partially due to one of our bigger positions losing over 11% on poor quarterly results. Our official All Thai return, which is expressed in U.S. dollars, was 0.32% in August. The Thai Baht appreciated by 0.30% against the US Dollar, so in local currency we were unchanged. The Thai SET Total Return index (in Thai Baht) posted a strong gain of 3.32% as foreign investors bought large stocks. Small companies were left behind.

Year-to-date our All Thai accounts are up 17.42% in US Dollar terms. A stronger Thai Baht is responsible for 7.86% of that gain. The Thai SET Total Return index (in Thai Baht) rose 7.67% since the start of the year.

Our UK stock performance was disappointing in August. First, we had one big loser which dropped 20% after a surprise announcement that they will likely lose two customers which in aggregate account for 10% of sales. The stock was incredibly cheap before the drop and is even cheaper now. Second, we also got badly hurt on the currency front as the Pound lost 2% against the US Dollar. The Brexit drama is still unfolding and getting more heated with British and EU negotiators both playing hard ball, so the Pound will continue to swing widely based on the developments in Brexit negotiations.

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Just the Numbers

ZPR Composites Names in Bold <i>Benchmarks in italics</i>	Period Ending 8/31/17			Period Ending 6/30/17			
	Month	Quarter To Date	YTD	1 Year	3 Year Annualized	5 Year Annualized	10 Year Annualized
ZPR Fundamental Small Cap Value	-1.21%	1.34%	9.74%	20.35%	10.03%	16.54%	7.50%
Volume Winners	-1.85%	-2.32%	8.59%	37.21%	18.27%	18.56%	NA
Volume Value	-2.20%	-2.78%	8.15%	53.26%	22.57%	22.99%	NA
Volume Momentum	-0.66%	-1.51%	11.65%	41.07%	8.84%	17.32%	NA
<i>Russell 2000</i>	-1.39%	-0.66%	4.30%	24.61%	7.36%	13.70%	6.92%
<i>S&P 500</i>	0.05%	2.12%	11.66%	17.91%	9.63%	14.64%	7.18%
ZPR Global Equity	0.59%	3.13%	15.44%	22.67%	5.16%	12.47%	10.11%
<i>MSCI ACWI</i>	0.43%	3.27%	15.48%	19.45%	5.40%	11.15%	4.27%
ZPR All Asian	2.13%	5.00%	19.54%	24.66%	2.25%	10.52%	13.39%
<i>MSCI EAFE</i>	-0.02%	2.87%	17.50%	20.84%	1.61%	9.21%	1.51%
ZPR All Thai Equity	0.32%	-1.34%	17.42%	26.34%	7.29%	15.17%	NA
<i>Thai Set Index</i>	3.32%	3.42%	7.67%	12.54%	5.27%	9.74%	NA

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 compliance@zprim.com.

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.