ZPR Investment Report

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A NEWSLETTER FOR ZPR CLIENTS

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US Commentary

By Mark Zavanelli

In March, large cap stocks fell as as the rally off the February declines fizzled out. Small cap stocks resisted the declines and rose slightly. It has been a roller coaster ride the last two months. Since the weakness was led by the big Tech stocks in March, we finally saw smaller stocks resist declines. Over the last year we've been pointing out the breakdown of correlation within the market, with momentum stocks seeing all the gains. Now that these stocks are finally reversing, we can see some of the diversification benefits. Our Volume quantitative strategies represent the opposite side of the market (no attention) from the exciting growth stocks, and they did better this month. There is no shortage of cheap stocks in the market.

Interestingly, the catalyst for the initial decline in February receded with additional data points. Inflation fears settled down a little and longer-term interest rates came back down. The Fed did raise rates again as expected and will do so at least twice more this year. Long rates will also need to rise modestly to avoid a completely flat yield curve by year end. I think this is now expected by investors and won't be surprising. Economic growth forecasts for the first quarter are moderating although still solid. This "Goldilocks" environment is a positive one for stocks and won't hurt bonds too badly. Corporate earnings growth is strong, even removing the effect of the tax cut. The drop in stocks so far this year is

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Asian and UK Results

By Vaidas Petrauskas

In March markets continued to experience increased volatility. With earnings reports taken care of in February, market participants focused on political events. There were plenty of things to worry about: Import tariffs announced by the Trump administrations spooked investors and sparked fears of a trade war with China, there was also blocking by the administration of some high-profile mergers, a sudden sell-off in seemingly invincible FAANG (Facebook, Amazon, Apple, Netflix, and Google) stocks, and the always-present worry about rising interest rates.

US stocks led the way in sell-offs and recoveries while foreign markets were playing catch up. Japanese stocks are especially sensitive to big drops in the US, which is not good for diversification. If there is panic selling in the US, I noticed Japanese stocks will drop much more than US stocks did.

Thailand acts as a good refuge from global turmoil. Thai stocks still finished the month down, but they march to their own drummer. The volatility of Thai stocks was much lower than the volatility of US or Japanese stocks this year.

Our Asian markets and the UK finished the month in negative territory. Monthly performance of indices and currencies is shown on page three.

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Meaning of the Market Selloff

By Mark Zavanelli

In last month's newsletter we discussed two factors behind the decline in February: the interest rate scare, and the forced reversal of market bets against volatility. When interest rates stabilized and the market rallied in early March, it seemed like it would be back to business as usual. Instead the market swooned again, with ongoing volatility, leaving the major averages near correction territory (-10% from the highs) by month end. The continued volatility and weakness indicates that this might not be a swiftly passing event, and that the root cause is deeper.

I think that last month's technical event around volatility bets was just an indicator of a larger disease: extreme investor optimism. Essentially, we've had it coming. After a year of moving steadily higher, with enormous gains by the leading stocks, the market went vertical in January. Money flowed out of laggard value stocks only to add to the performance chasing. This was an international phenomenon too, as similar companies were the leaders in many world markets. The signs of a narrow market emerged last year, as correlations within the market broke down. With hindsight, it will probably be noted that the withdrawal of liquidity by central banks, the rise in short term rates and short term credit spreads, and the weakness in the US Dollar all resulted in an end to the rise in leverage that is necessary to support this type of upward market move.

So where does this leave us now? I don't think this is like the Tech Wreck of 2000 where the market will see significant declines. That was a true mania, which is not the case with today's market. Instead, it's likely that the market will go through a period of back and forth volatility as the former leaders find their footing and new stocks begin to outperform. If history is any guide, the gains in those former leaders are finished, however. There will probably be moments of worry as it becomes clearer that the market's short term uptrend has broken, and as we enter the weakest part of the year from a seasonality perspective.

Corrections are normal events within the life of a bull market, and they don't have much predictive power in signaling the end of bull markets. Fed tightening cycles do, but that becomes dependent on the fate of the real economy. At this point, the economic expansion seems very well entrenched on a global basis, and the corporate sector is healthy. Undoubtedly there are long term issues that will have to be reckoned with in the next down cycle, but that is true of every business cycle.

US Commentary (Continued)

actually helping to restrain the "animal spirits" of excessive confidence, and to keep us on a more level economic path.

The headlines this month that hurt the market were around trade. While global trade is indeed critical to economic prosperity, it is very unlikely to be disrupted even to a small degree by these actions. There won't be a trade war, and in fact trade might actually become freer under bilateral deals which are being struck. Trade is a political issue in every country, and everyone wants to protect selected industries that are deemed politically sensitive. Some large multinationals may have to re-do their investment plans (this is the point), but their flexibility means that they are unlikely to be hurt in a lasting way by any changes.

Asian and UK Results (Continued)

Japan	
Nikkei 225 Index	-2.78%
Topix Index	-2.94%
Yen vs. USD	+0.83%
Thailand	
Thai SET Total Return Index	-2.36%
FTSE SET Small Cap Index	-4.37%
Thai Baht vs. USD	+0.69%
Singapore	
FTSE ST All Share Index	-2.37%
Singapore Dollar vs. USD	+0.99%
United Kingdom	
FTSE All Share Index	-2.20%
British Pound vs. USD	+2.11%

There was no place to hide as all markets dropped more than 2%. The S&P 500 index also dropped more than 2% (although the Russell 2000 index finished in positive territory). Our All Asian and All Thai strategies performed similarly, suffering losses of more than 2%. We were helped a little by a weaker dollar.

With the first quarter of 2018 completed, we can also review how global markets performed in the first three months of 2018. In summary, developed market equities headed lower while emerging market assets rallied. The weaker dollar helped boost commodities along with emerging market assets. Brazilian stocks were the best performing assets class in the first quarter. UK stocks were the worst-performing asset class, losing close to 8%, followed by Japanese stocks, which were down over 5% in the first 3 months. But those numbers are in local currency. We should take into account currency exchange rate changes also. In fact, in export oriented markets, the reason stocks are weak is usually because the currency is strong. And that was the case in Japan and the UK this year. The Yen is up 6% in the first quarter, erasing loses on stocks for foreign investors. The British Pound is up 4% in the first quarter, not enough to completely erase loses on British stocks.

UK stocks at the moment are the most unpopular asset class in the world among institutional investors and that partly explains their poor performance so far in 2018. Many big institutions are underweight UK equities. The main worries are Brexit, a struggling economy, inflation, lack of real wage growth, and a weak earnings outlook.

One interesting aspect specific to UK listed companies is that many of them have very large pension fund deficits. From my observation I think the situation with UK corporate pension plans is worse than anywhere else in the world. Almost all UK companies have pension plans for employees and because of multiple reasons most pension funds are greatly underfunded. This means that a substantial proportion of profit that would otherwise be available for dividends or investment is being diverted into the pension fund, and while the company appears to be very profitable, shareholders are not getting all the benefit. So in the UK we pay close attention to a company's pension fund.

I think UK stocks offer a compelling opportunity. The valuations are attractive compared to the rest of the world and there are some great companies in the UK. We have a very small allocation to UK stocks in our Global strategy. I am thinking about increasing that in the future.

It is clear that 2018 will be much more volatile than the last couple of years. This is both bad and good. The good part is that there will be more bargains to be found. But the current market environment is different. While buy-and-hold worked well last year, this year we have to be more active trading stocks. It is likely that increased volatility will persist as trade-related news will drive prices in the near term.

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Just the Numbers

	Period Ending 3/31/18			Period Ending 12/31/17			
ZPR Composites Names in Bold *Benchmarks in italics*	Month	Quarter To Date	YTD	1 Year	3 Year Annualized	5 Year Annualized	10 Year Annualized
ZPR Fundamental Small Cap Value	0.72%	-5.88%	-5.88%	25.38%	18.20%	19.59%	10.35%
Volume Winners	1.03%	1.01%	1.01%	13.45%	18.40%	18.96%	NA
Volume Value	2.63%	-0.66%	-0.66%	16.24%	20.45%	23.02%	NA
Volume Momentum	1.51%	-3.04%	-3.04%	17.61%	10.65%	17.52%	NA
Russell 2000	1.12%	-0.25%	-0.25%	14.65%	9.96%	14.12%	8.71%
S&P 500	-2.69%	-0.91%	-0.91%	21.84%	11.43%	15.80%	8.50%
ZPR Global Equity	-1.18%	-1.15%	-1.15%	27.07%	12.28%	13.05%	12.61%
MSCI ACWI	-2.08%	-0.84%	-0.84%	24.63%	9.90%	11.40%	5.22%
ZPR All Asian	-2.47%	2.53%	2.53%	28.90%	9.10%	9.50%	15.57%
MSCI EAFE	-1.70%	-1.41%	-1.41%	25.63%	8.30%	8.38%	2.43%
ZPR All Thai Equity	-2.31%	-1.67%	-1.67%	15.64%	7.99%	9.03%	NA
Thai Set Index	-2.36%	2.12%	2.12%	17.30%	8.85%	8.18%	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.