ZPR Investment Report

March 2019 Volume 25, Issue 3

A NEWSLETTER FOR ZPR CLIENTS

Contents:

US Commentary

By Mark Zavanelli

US and international stocks continued to rise in February. It's more than just a bounce. Chinese stocks, after taking a beating last year, have led the way back up. This is significant because China is the epicenter of the global economic slowdown. The Chinese currency, the yuan, has also rallied so far this year versus the dollar. This is another indicator that the most negative scenarios around China's economy are not coming to pass, at least not right now. From the price of copper to high yield spreads, market prices are telling us that the world economy is not falling off a cliff. Reported GDP for Q4 in the US also showed that businesses and consumers were surprisingly resilient in the face of falling stock prices. Business capital spending, which I thought could be very weak, was actually better than expected.

It looks to me like the market drop late last year was yet another market scare and not a harbinger of something worse. We've had a number of these over the years since the financial crisis. The modern structure of the market seems to be prone to these sorts of declines, and their predictive power about what's happening in the economy may be less than what it was in the past. It's also worth noting that in general, market drops are a lot more frequent than bad economic events.

Looking forward, 2018's major headwinds of Fed tightening and trade tensions are

(Continued on page 3)

Asian and UK Results

By Vaidas Petrauskas

Foreign markets did not rise as much as the US stock market did in February, but our Asian stocks had a good month. The good performance of Asian investments is masked by a strong dollar. All Asia portfolios, when expressed in US dollars, rose slightly more than 1%.

The Japanese Yen lost almost 2% against the US dollar in February. The Thai Baht lost 0.80%. The Singapore dollar lost 0.20%. The British Pound, which is driven primarily by Brexit news, gained 1.3%.

In local currency, our Japanese stocks rose more than 2% and Thai stocks rose more than 1%. We had a very good month in Singapore. We hold only two Singapore companies, but between both of them we had a 6.8% gain for the month.

Thai earnings season ended on the 1st of March. It was an underwhelming earnings season. The statistics show that on aggregate there was a 36% earnings decrease for Thai companies in the 4th quarter. This seems extreme. From my observation it wasn't that bad, although there were certainly many Thai companies reporting big drops in earnings. There are several reasons for this. A slowdown in China led to a drop in exports in the last 3 months, so companies which depend on exports to China suffered from fewer orders. The tourism sector also contracted

(Continued on page 3)

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

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

E-mail: info@zprim.com
Web: www.zprim.com

The Sky Didn't Fall

By Mark Zavanelli

With hindsight, we can tell the story of the world economy and stock markets over the past year or so. I think this is useful for setting the stage for what comes next. We know that 1) The global economy began to slow in late 2017 due to weakness outside the US, 2) Policy changes in the US around taxes, spending, and tariffs distorted the normal pattern of the economy, causing a mini boom-bust, and 3) that non-US stock markets peaked in the market melt up of January 2018 while the US market had increased volatility for the first three quarters trying to discount the risks from trade and central bank tightening. Value stocks had horrible relative performance since late 2017, not because of technological disruption or some other made up reason, but more simply because their earnings peaked first. In the 4th quarter the US market had its fear moment about the economic cycle, and the "last man standing" of high growth US stocks fell hard.

To me, this story is a typical lead in to a recession that could have started in September 2018 after the tariffs went into effect and likely would have lasted through 2019. Only that's not what happened. Here we are at the end of February and data is unequivocally ok. While China, Europe, and Japan did have negative growth (or close enough to it) in the 4th quarter due to a decline in manufacturing, US consumers and corporations kept spending.

In reaction to the plunge in stocks, the policy driven headwinds to the economy (both trade and central banks) reversed direction. We're left with the after effects of the previous slowdown, but that's already reflected in stock prices. The key question is whether we are at the beginning, middle, or end of that process. Economic prediction is hard, but that can be to our advantage as investors. The market and conventional wisdom have discounted a continued slowdown possibly culminating in a 2020 recession. This is a guess driven by the Treasury yield curve (which has a partial inversion) and a slowing LEI (Leading Economic Indicators). This is why our value stocks are so cheap as the market thinks their earnings are going away in a downturn.

Going back to the difficulty of forecasting, I think the consensus is a little too sure that we are on this path, and it seems fishy to me. If the bears are right and we are collapsing under an over investment boom fueled by cheap QE debt, then we should be looking at a fast and vicious financial liquidity pullback with bond spreads soaring and an obvious risk of defaults somewhere. That is just not what we are seeing in the data today, either from market measures, surveys, or economic statistics. Instead, I think there's at least an equal possibility that the market's forecast is dead wrong, and we are close to the end of the slowdown and not the beginning. All of the long-term issues and problems are still there, and certainly matter, but without a spark there's no fire. What would surprise everybody the most is if international economies, which were the first to slow, rebounded from the weakness and started to pick up again. This would be natural after the reaction to the trade scare.

The US is going to have a weak and messy Q1, but that's well known. Q1 economic data has the shutdown and also seems to have bad seasonal adjustments every year anyway. If signs of an upturn appear, the market and especially value stocks will react strongly. We are not there yet. The liquidity flowing back into the US market has gone into growth stocks, following the consensus forecast and acting as though the 2018 playbook is still in effect. After the events of the last few months I think continuation of last year's trends is the least likely scenario.

US Commentary (Continued)

largely behind us. Interest rates have been stable since the Fed went on hold and aren't high enough to restrict the economy in a major way. I think the expectation of higher rates and their impact on growth was a problem, and that is fading. A trade resolution would provide a significant boost to corporate confidence, but the current truce and tariff level is good enough to allow business as usual.

The market has gone straight up, and volatility has not been abolished. Value stocks are still vulnerable to short term fears as the economy and corporate earnings growth slows down this quarter. We have cash to take advantage of opportunities in a pullback, because I think the next shift will be a reacceleration of growth expectations that brings better returns to both foreign and value stocks.

Asian and UK Results (Continued)

because of fewer Chinese tourists. The biggest contraction occurred in energy and petrochemical sectors. Any business dependent on local consumption (commerce, banking) is doing fine.

Quarterly results of our holdings were good. We always try to avoid any company which has significant business in China. We are buying two new Thai stocks and also increased some of our current holdings.

The Thai government has implemented stricter lending rules for second home purchases to cool speculation in the real estate market. We have been gradually exiting our property developers' stocks in anticipation of weaker results in 2019. The government has now also started looking into the auto loan market. They also want to regulate the pricing of private hospitals. So, there are many pitfalls to be avoided in Thailand.

We have been successful trading Thai stocks in this environment. Because many of them trade in a range, we have been buying low and selling high.

The long-awaited general election will be held in Thailand this month. The economy is still expected to grow close to 4% in 2019. But much depends on exports, particularly to China.

The Japanese earnings season ended in the middle of February and I was genuinely surprised how strong the results of Japanese companies were in the calendar 4th quarter (in Japan, fiscal year ends in March, so it is less confusing to talk in calendar quarters). I believe the reason for a strong 4th quarter was the fact that there were many natural disasters in Japan in the 3rd quarter (floods, typhoons, and an earthquake), which led to a big slow-down as companies halted production. I believe the strength in the 4th quarter was because of the pent-up demand coming back and also because of the reconstruction efforts. So, it is possible that growth has slowed down again in the current 1st quarter. Japan's exports in January fell at the fastest pace (8.4%) in more than two years because of weak demand from China. The Japanese government is still planning to increase the VAT rate from 8% to 10% in October. That will negatively impact consumption. It's a mistake.

The resolution of US-China trade dispute would be very welcome for all Asian economies which are heavily reliant on exports to China. However, if there are structural problems with China's economy, exports may not fully recover. That is why we have been looking for companies which depend on local consumption, which is still strong, and not exports.

This Page Intentionally Left Blank

Just the Numbers

ZPR Composites **Names in Bold** *Benchmarks in italics*	Period Ending 2/28/19			Period Ending 12/31/18			
	Month	Quarter To Date	YTD	1 Year	3 Year Annualized	5 Year Annualized	10 Year Annualized
ZPR Fundamental Small Cap Value	3.60%	13.43%	13.43%	-29.95%	4.58%	3.78%	12.09%
Volume Winners	3.80%	10.28%	10.28%	-4.09%	12.82%	11.95%	NA
Volume Value	6.26%	16.12%	16.12%	-10.55%	13.97%	12.19%	NA
Volume Momentum	6.01%	13.88%	13.88%	-18.84%	5.99%	3.14%	NA
Russell 2000	5.08%	16.90%	16.90%	-11.03%	7.36%	4.41%	11.97%
S&P 500	2.97%	11.22%	11.22%	-4.38%	9.27%	8.50%	13.12%
ZPR Global Equity	2.00%	9.57%	9.57%	-26.40%	2.31%	1.93%	15.56%
MSCI ACWI	2.72%	10.87%	10.87%	-8.92%	7.19%	4.83%	10.05%
ZPR All Asian	1.06%	7.73%	7.73%	-25.00%	0.55%	0.79%	19.38%
MSCI EAFE	2.56%	9.32%	9.32%	-13.35%	3.38%	1.00%	6.83%
ZPR All Thai Equity	0.25%	9.18%	9.18%	-20.27%	3.41%	4.80%	NA
Thai Set Index	0.97%	6.02%	6.02%	-8.08%	10.12%	7.14%	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.