// ZPR Investment Report
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ZPR Investment Report

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US Commentary

By Mark Zavanelli

Stocks whipsawed back higher in June. Given where we are in the business cycle, if high tariffs are imposed, they might be enough to push the economy over the edge. Stock prices have good reason to react. This month, the tariff threat against Mexico ended, the Fed took more steps towards rate cuts, and a truce was called in the China trade war. While these are all positive resolutions, they have not brought about any certainty about the direction that the economy and the investing landscape will take. For all economic decision makers, this uncertainty itself matters because time horizons are shortened and larger decisions postponed. Something that we can be more certain about is that two important prior trends have changed, the direction of interest rates and the US dollar. When the landscape changes, it's also a time when the patterns that investors have become used to also typically change. I write about these in a separate piece this month.

At this moment every economic data point is under high scrutiny because uncertainty is so high. Economic data in June showed the slowdown continuing, but not in uniform fashion. The bright spot was the US

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Asian and UK Results

By Vaidas Petrauskas

Our Asian portfolios rose 4.99% in June. Both the rising stock market and a weakening dollar contributed to good performance.

The U.S. Fed was joined by the ECB and the Bank of Japan in indicating a new round of quantitative easing. Stock prices rose around the world as a result. Lower rates mean higher asset prices. The U.S. Fed's hints of a possible rate cut prompted offshore funds to shift towards emerging markets in search of better yields. This boosted the currencies and asset prices of those markets. The Thai Baht appreciated significantly as a lot of foreign funds moved into Thai short-term government bonds. This inflow of foreign funds prompted the Thai government to look for ways to curb the speculation because a strong currency hurts the country's exports.

The Thai Baht gained 3.2% against the US Dollar in June and 5.5% from the beginning of the year to the strongest level in 6 years! The baht has emerged as the best performing Asian currency against the US Dollar this year. The Japanese Yen is second. So we are in the right markets this year at least as far as currency is concerned. Getting the currency right is very important.

Funds flowed into Thai stocks also. The main Thai SET index gained 6.8% for the month. Our small capitalization stocks were left behind, but we still gained around 4% in local currency. Add on top the 3.2% appreciation by the Thai Baht, and our All Thai portfolios rose 7.13% in June.

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Short Term vs Long Term: A Way to Make Sense of This Crazy Environment

By Mark Zavanelli

The dichotomy between short- and long-term investing is huge in today's market. Let's start with bonds. Currently, European government bonds have substantially negative 10 year yields even though inflation is positive. These are negative yields on a real after inflation basis, and lenders are paying borrowers instead of the other way around! I even read that one guy in Denmark actually was able to get a negative rate mortgage. Before Quantitative Easing this had never happened in recorded investment history. Rates have been negative before, but because of deflation real yields were positive. How does this make sense? The answer is that it doesn't and doesn't have to in the short run. Speculators (including giant money managers and hedge funds) are making a short term killing by owning them at the right time. They aren't worrying about small negative yields when the prices of the bonds are going up so much. The bulk of ownership is trapped and can't move substantially elsewhere due to risk concerns (they already own a ton of US Treasuries and there are dollar hedging costs). Thank you ECB! You have the power to make the impossible possible. In the long run, this situation will not last. Even the ECB knows that negative rates are dangerous. They will eventually raise them and the 10-year German Bunds or other European debt will be an awful, money losing investment. But not right now! No way are European short rates going up. So speculators party until their fingers are burned and who cares what the asset is truly worth. Short term vs. long term, a totally opposite picture.

There are similar things going on in the stock market. Defensive investments, following how expensive bonds have become, are in short supply and are priced at levels where long term returns will be poor. It's financial repression for retiring Boomers. Now that rates are going down, however, those prices can continue to go higher in the short term. The market has also tried to "bubble" up. Bitcoin, pot, disruptors, cloud stocks, IPO prices, all tell the same story of a market that simply wants to speculate. This is not the Dot Com boom, because 19 years is too soon for such an event to happen twice. Instead, this is today's more muted version. The results will follow a predictable pattern, so it's silly to be surprised. Speculation can make you money, and is in no way a dishonorable activity. Just don't confuse it with investing.

Turning towards the long term, is everything expensive? Completely the opposite. Foreign developed and emerging markets are actually dirt cheap in absolute terms, forget relative to all the expensive stuff. Foreign developed markets have poor growth and demographic prospects, so that's a partial offsetting factor. But emerging markets are the true growth investments today, and they are priced cheap. In the US, there are lots of companies that are thriving today and yet are priced at extremely cheap absolute levels. I've discussed it before. The problem is that they are actually making too much money and the market is worried that there is only downside as the economic cycle turns down. Plus, in the US there are plenty of growth stocks producing price gains right now, so investors are focused on that. This is actually a beautiful setup for the long-term investor. Not only do you not have to own what's overpriced with poor long term expected returns, you can instead own cheap assets with good expected returns. The only problem is that you have to be willing to swim against the tide of current performance.

What's the difference between short and long term? Just waiting. The moral of the story is to match your actions with what you are trying to do (and this can be a mix, of course). When speculating on short term investments, act with an eye toward the short term. Historically, this is a tough game for small investors to play. The worst thing is to be speculating, owning a bunch of assets with bad long-term prospects, and not even know it. If investing for the long term, stay grounded in a long-term asset allocation strategy and lean away from expensive assets. As a long-term investor today, bond duration and growth equities are expensive. So, in fixed income lean towards short maturities and don't reach for yield because spreads have been pushed down too. In equities, own cheap international and value stocks. When faced with only bad choices (i.e. like in bonds today), choose the least risky, knowing that this way you can hopefully change your positioning later without losing capital.

A Second Big Change Afoot

By Mark Zavanelli

A couple of months ago I wrote about a sea change in interest rates. It's worth making the point again because its impact is so profound for the financial system. Now that the Fed is on its way to cutting rates, we're back to a low rate regime for the foreseeable future. This affects almost everything in the economy, from consumption to corporate planning to asset prices of every sort. While it's true that the Fed can't "push on a string" and halt an economic decline immediately by lowering rates, we have plenty of economic history such that we can predict the likely outcome. Even if a downturn comes, a rate cutting Fed limits downside and promotes recovery. Stocks can of course fall while the Fed is cutting, but they can recover afterwards too. Assets that are typically leveraged, such as real estate, are even more impacted. It's very rare to have a switch from rising to falling rates while the economy is still healthy enough to support new activity. This is a boon to all sorts of construction. The cheap, economically sensitive portions of the stock market will eventually see the benefit here.

The second big change is the direction of the US dollar. When US interest rates were rising, the dollar was too. Now interest rates are falling, and the currency markets are adjusting. This may be a major trend change for the dollar. It's overdue. Since the dollar is both a safe haven and in recent years a higher yielding currency, it attracts a lot of "carry trade" flows when its perceived to be rising and hedging is either cheap or is seen as unnecessary. Once the dollar's rise is in question then more money simply stays in local currency. As the world's major reserve currency, the dollar has the most to lose over the long term as the world economy diversifies. With the rise of cryptocurrencies, there is also the new potential of a digital competitor to the dollar. It also doesn't help that the US effectively abuses its role as the world's currency by running massive deficits. This is now aided by a Fed willing to turn debt into currency through the mechanism of bond buying (QE). All of the potential long-term downside for the dollar is ignored when the trend is rising. But watch for those concerns to come back now. Even the perception of a weaker dollar will likely have major implications for investing in international and especially emerging markets. Whether it's a cause or an effect (in reality its some of both), international investments save most of their outperformance for periods when the dollar is flat or falling. This is odd for export economies which benefit from a weaker currency, but it's true for them too (even Japan, where stocks are negatively correlated with the Yen on a daily basis). Investment flows are too powerful, and have a twin effect on local liquidity conditions and asset prices. Is this the moment when significant underperformance for international assets turns around? A trend change in the dollar will be an important indicator. June's weakness was a start.

US Commentary (Continued)

consumer, who saw continued decent earnings gains and spending. This economic momentum is the status quo and reflects prior strong jobs gains. The overall US economy is hanging in there as a result, and the major question is how much it will deteriorate. Even now the consumer is not all positive, as spending on the volatile categories of autos and housing is relatively flat and consumer confidence is declining. The corporate spending side of things, on the other hand, is showing clear deterioration. Earnings growth is weaker, capital spending is weaker, and manufacturing survey data is indicating clear slowing. Incidentally, spending on Technology is mostly on the corporate side. There is a lot of secular growth in Tech, but a lot of cyclicality too. When the current market favorites start declining investors will be reminded of this fact. I'm paying extra attention to our own Tech stocks, especially those relating to semiconductor demand. Trucking data shows that the overall goods economy is in contraction. This is messy, however, due to strange timing effects relating to tariffs and inventory building. The bottom line is that the economy is slowing. As long as that trajectory is intact, negative economic surprises will matter but positive ones probably won't. With the bond market pricing in three Fed rate cuts, the market's view on the direction of the economy is leaving zero doubt. This is a tough situation for value stocks, but prices certainly reflect it. The next big change is likely up, but how long and what do we have to go through to get there are real questions. The data is going to start looking very late cycle soon, with risk of recession rising. I don't think it actually happens, but that will be answered in the future and doesn't really matter to the market today.

Asian and UK Results (Continued)

June was the opposite of May. In May we saw a relentless sell-off of Thai shares regardless of fundamentals. This is how it usually works – a huge sell-off is followed by a big rebound. It happened in June of last year and it happened again in May of this year as the market tends to overshoot to the downside, then the pendulum swings the other way. We try to act on these swings. We bought new Thai stocks in mid-May.

Our Japanese stocks gained more than 2% and a stronger Yen added another 1%. Japanese stocks have been slowly but steadily rising during June. I feel they are still asleep and undiscovered. Money has been flowing to emerging markets because of the weak dollar, ignoring Japanese stocks. There is tremendous value in the Japanese stock market, and the improving corporate governance picture adds to the attraction of Japanese stocks. I think Japan is the country for value investors to focus on at this time.

Our two Singapore stocks have had an amazing June and an amazing year. They rose 24% between them in June. One of them operates a gold mine, so that is understandable given how the price of gold rose in June. We show a year-to-date gain of 35% in Singapore, and that includes cash, which is around half of the portfolio we allocate to Singapore. We are looking at a third promising Singapore company that we plan to buy.

During the weekend of June 27–30th, an all-important G-20 summit took place in Osaka, Japan, where leaders of the biggest countries met. The most important was the meeting between President Trump and President Xi Jinping of China on Saturday. Markets eagerly awaited news about a potential trade deal with China. The outcome of those talks was much more positive than anyone anticipated, I think. Trade negotiations will resume after a six-week stalemate, with the U.S. agreeing to a temporary freeze on further tariffs on Chinese goods (so no 4th round of tariffs). President Trump also eased restrictions on Huawei. In exchange, China agreed to resume buying soybeans and other agricultural products from the U.S. I believe a trade deal is still far away, but the latest news is clearly very encouraging and world markets started July trading with a big rally.

Just the Numbers

	Period Ending 6/30/19			Period Ending 3/31/19			
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	9.45%	1.96%	12.06%	-18.19%	6.69%	4.42%	14.77%
Volume Winners	3.49%	2.98%	9.02%	0.52%	14.62%	12.09%	NA
Volume Value	7.24%	0.88%	12.16%	0.12%	18.48%	14.45%	NA
Volume Momentum	4.94%	-2.31%	6.57%	-8.68%	10.50%	4.11%	NA
Russell 2000	6.90%	1.93%	16.80%	2.04%	12.92%	7.05%	15.36%
S&P 500	6.89%	4.16%	18.37%	9.49%	13.52%	10.92%	15.92%
ZPR Global Equity	6.26%	0.71%	8.63%	-19.68%	5.46%	2.87%	17.50%
MSCI ACWI	6.59%	3.80%	16.60%	3.18%	11.29%	7.04%	12.59%
ZPR All Asian	4.99%	0.89%	7.58%	-22.00%	4.59%	1.83%	20.34%
MSCI EAFE	5.97%	3.97%	14.49%	-3.21%	7.81%	2.81%	9.48%
ZPR All Thai Equity	7.13%	1.78%	7.27%	-14.54%	2.10%	4.63%	NA
Thai Set Index	6.82%	6.61%	12.78%	-4.78%	8.57%	6.98%	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 Thai Set Index, for which performance is expressed in 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.