“Our Clients’ Past Successes are Not Necessarily Indicative of Future Successes.”

Stamper Capital & Investments, Inc.

“Focusing on Upside Potential and Downside Protection Since 1995.”

January 2014 Market Commentary

(Note: Please see our previous Annual Forecasts and our Blogs
for considerable background on our forecasts)

2013 Review and 2014 Forecasts

I am going to keep the review short and sweet:

Stocks - The Dow Jones Industrial was up 29.7% to an all time high!
as were most U.S. stock indices

Bonds - The U.S. Treasury 30 Year Yield shot up to a record high (prices down)
since its all-time-record-low in June 2012.
Similarly with the yield on the U.S. 10 Year Treasury (prices down)

Municipal bonds also had a negative year (prices down, yields up)
The Barclays Municipal Index had a negative total return of -2.55%

Commodities - The CRB index was down 6.3% for the year
The CRB index is still down 43% from its 2008 top
` The CRB index is still down 27% from its 2011 top
Prices of most commodities have performed similarly

Real Estate – Of course, real estate is regional but some generalities can be made.
The market is “bubbly” at the lower end in many markets
The higher end is still soft and has not rebounded much

This situation with interest rates rising from all-time-record lows (June 2012) on overall record-high-levels of debt (dramatically more than before the meltdown that ended in 2009) but with stocks rising to record highs and a bubbly real estate market (at least at the lower end) is quite remarkable and we think will likely be quite notable a year or two from now – similarly to how people viewed the real estate market of 2005/2006 from the 2009 bottom.

In a similar vein is the giddiness in the local press regarding still grossly-indebted municipalities, school districts, etc. making plans for new spending programs, new bond deals, new parcel taxes, etc. soda taxes, etc. and giving raises and increased pension benefits.

It is amazing because the long term situation with record high levels of debt and increasing debt service is worse now than before the meltdown that ended in 2009 and yet this giddiness.

Discussion and Forecasts

Negative forces - Drags - on the Economy and Prices of More Speculative Assets

With the huge dichotomy between record stock prices and falling commodity prices and rising interest rates, I am going to concentrate mostly on possible effects on the prices of high priced assets.

The Rollover - Of course, well, we have somewhat mixed signals. We have interest rates rising (as highlighted above) and people are attributing that to an improvement in the economy and a demand for capital for new projects. However, commodity prices are in a definite downtrend as also outlined above. We think, rather than demand from an improving economy, it is more likely that interest rates are rising from demand for refinancing debt that is maturing – rolling over old debt - and for paying for increased debt service.

Record Debt – If everything is so great – great enough for record high stock prices - why is the Fed continuing to purchase $75 billion of bonds per month (down from $85 billion per month during 2013)? The Fed has dramatically increased its balance sheet since 2008, and, it consists no longer of just U.S. Treasuries but includes mortgage debt and it is still growing at $75 billion per month. The debt can be sold, paid off or monetized. Selling it will push prices down and raise interest rates more. Paying it down will be a drag on the economy. If it is monetized, we would likely have a large inflation; however, commodity prices continue to drop so, at this time, we believe a substantial inflation to be unlikely. Of course, we have to mention that States, Counties, Cities, and municipalities, etc. continue to have huge municipal bond debt and promised pension benefits.

New Taxes - The Affordable Care Act – We note the impact of this Act is highly speculative – whether positive or negative. The Act has been being implemented over the past several years; during that time we already saw a notable increase in our premiums. Then in 2013 we saw more direct increases as many were forced to switch policies including paying higher prices for the new policies. Next, people started to notice that – oops – their annual deductibles rose rather dramatically; for example from $2,000 per year up to $5,000 per year. While most of these increases in prices and deductibles has been noticed in the private sector, we’ve read and believe that those in the public sector will likely be noting similar changes to their policies during 2014 (we believe that if the public workers don’t make up the increases in costs directly, the governments and municipalities (and/or taxpayers) will have to make up the costs themselves). Importantly, the results of higher deductibles on the average family will likely be showing negative results in 2014 as, unfortunately, many do not have available cash to meet those deductibles if they have numerous medical problems. The Supreme Court has stated that the Affordable Care Act is a tax – so taxes have risen and taxes are most often a negative stimulus/drag on the economy. So, this new tax is a negative stimulus to watch out for especially over the next year or two. It is interesting to us that while the government is trying to stimulate the economy on the one hand, on the other hand it has implemented a new tax which could turn out to be a huge drag on the economy.

Baby Boomers Retiring – To us this is the "lynch pin." It has been reported that debt levels have been far to high to ultimately service for decades – we are talking Social Security and Medicare and State and local government pensions, etc. However, as long as the number of new hires was more than those retiring the ultimate problem was far out into the Future. The large amount of baby boomers that will be retiring is the fuse on this ticking time bomb. Of course, a solution that is raised most often, is to change the benefits promised (for Social Security and Medicare). We believe that changes are very likely – higher retirement ages, lower benefits, possibly income-adjusted benefits. However, although the pie is already much smaller than the population as a whole realizes, it will be when those benefits are cut that the realization of the vastly smaller pie will occur. We do not know when this realization will occur but it gets closer and closer every time another person retires, unfortunately. Unfortunately, what has been happening in Japan is a good model for our situation. The Japanese Nikkei – 225 Stock Average is:

Still down 58% from its 1989 top (when everyone thought they were going to buy the world)
Still down 11% from its 2007 top (while the U.S. is at record highs)

Municipal Finance – The big events of the year besides the muni market putting in negative total returns are the bankruptcy of Detroit and financial problems of Puerto Rico. The bankruptcy of Detroit is the most notable because of its size (the largest ever) and because the court-appointed city manager made an opening salvo offer of 16 cents on the dollar for both pensions and General Obligation debt. Whoa - that got everyone's attention (well, not everyone – it was a non-event in the major media), as the G.O. debt holders assumed they were money good and the pensioners assumed they would also get paid 100 cents on the promised benefit dollar. Of course, most of the city's $18 billion in debt is municipal bonds and promised pension benefits, so similarly to the points I raised about the Baby Boomers retiring, views of the size of the pie are beginning to shrink. Unless there is a Federal bailout, mathematically, someone is going get a lot less than they were expecting previously. Unfortunately, this situation is possible and even very likely in municipalities across the nation. It is really a matter of "can they kick the can down the road yet again."

Forecasts

We believe interest rates will continue to rise.

We believe commodity prices will continue to fall.

We believe yields of municipal bonds, in general, will continue to rise (prices down).

We believe stocks, if they didn't put in their record highs on 12-31-2013, they will shortly.

We believe the downside possibility for risky assets is huge.

We are still looking for dramatic lows of prices of risky assets a few of years hence
with dramatic downs and ups on the way to the bottom.

As mentioned previously, please review our previous Annual Forecasts and Blogs if you want to get considerable back ground information why we are making these forecasts.

As always, we at Stamper Capital will continue to focus on the upside potential and downside protection of the assets we manage.

Thank you for your patronage,
Stamper Capital & Investments, Inc.

Since 2001, "Safety" was our watchword for the 2000-2009 decade. Unfortunately, "Safety" is still our watchword until we get to the final bottom, which we believe is still much lower.

(Posted January 11, 2014)

FOOTNOTES:

Stamper Capital Composite Return Calculation Footnote:
Returns are presented in United States Dollars. Composite returns are calculated monthly using a Monthly Discounting Model. No cash carve outs are made. Quarterly returns are time-weighted rates of return calculated by geometrically linking the composite's monthly returns. Annual returns are time-weighted rates of return calculated by geometrically linking the composite's quarterly returns. Gross Returns are after transaction costs but are before management fees; Net Returns are after Stamper Capital management fees. Investment advisory fees will reduce client's returns. Fees are hypothetically taken out of non-fee paying accounts when reporting net-of-fee returns. Other costs reducing returns are custody account fees and possibly ticket charges, which can vary depending upon the custodian used. Also, see Disclaimer, below.

Morningstar & Lipper Total Returns Calculation Footnote:
Returns - Figures quoted are total returns calculated for the share class and time periods shown. Performance includes the reinvestment of income dividends and capital gains distributions. Performance does not reflect the deduction of taxes that a shareholder would pay on a fund distribution or the redemption of fund shares. Please go to Morningstar's and/or Lipper's website for more information.

Calculation of Risk-Adjusted Performance Returns Footnote:
Statistical Standard Deviation is the measure typically used, and we are using, as a proxy for risk. Standard Deviation is measured versus a composite's or competitor's own returns. Importantly, Standard Deviation is an attempt to measure risk that has been experienced; however, there may or may not be other risks that were taken on (by our clients or our competitor's clients, etc.) that were not experienced and/or that were not measured by Standard Deviation. Importantly, those risks will likely ultimately, at some time, be realized as we saw

in the financial collapse of 2008. Stamper Capital's Upside Potential/Downside Protection Analysis and Implementation attempts to consider these risks and we believe is, in a large part, responsible for our historical outperformance during more unusually volatile periods. Of course, past performance is not necessarily and indication of future success.

Morningstar Risk-Adjusted Star Rating Footnote:
For each fund with at least a 3-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (includeing the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category reveive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. Please go to Morningstar's website for more information.

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