"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 2017 Market Commentary

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

2016 Review and 2017 Forecasts

A quick review of 2016:

Stocks - The Dow Jones Industrial Average was up 13.4%
- The S&P 500 was up 9.5%
- The Russell 2000 was up 19.5%
- The Dow Transports were up 20.5%

- High Yield Taxable Bonds ("JNK") rose by 7.5%
- High Yield Municipal Bonds ("HYD") dropped by 3.9%

Bonds - The U.S. Treasury 30 Year Yield went up 5 basis points to 3.07%
(with a big drop into July and big rebound in yields to the end of the year)
- The U.S. Treasury 10 Year Yield rose by 17.5 basis points to 2.44%

Commodities
- The CRB index rose by 9.3%
- Oil was rose by 21.8%
- Gold rose by 8.2%
- Silver rose by 14.6%

Real Estate – Of course, real estate is regional but some generalities can be made.
It moved up for the year by 5.6% (according to Case Shiller through 10-2016)

That look just above at the most recent annual action really only gives a glimpse into what has been happening in the investment markets. Below we will dig deeper.

One of the biggest event was the all-time record low in yields of the bond market which we chronicled, in detail, in our Monthly Updates in our Weblog The Contraction Resumes. More important, to us, than the record low was the dramatic rebound rise in yields from that record low.

The Yield of the U.S. 30 year Long Bond started at 3% at the beginning of 2016 and dropped down to about 2.10% on July 18, 2016 and then rose rather dramatically up to 3.07% at the end of the year. The U.S. 10 year performed similarly. We expect that that rise is the kickoff

to the bond bear market. Unfortunately, we believe it has a long way to go (up in yields) going forward.

It is interesting that we saw no reasonable explanations in the financial press about why our domestic yields rose – they said it was from inflation, but you really cannot see much inflation (except for areas like healthcare where the government is heavily involved – also, see our discussion of commodity prices below). Our research has led us to believe it was from lack of purchasing of U.S. Bonds by the Chinese. We believe the Chinese were simply using that money for other things (due to their slowing economy) rather than buying bonds, even from other nations. Thus, our forecast for rising rates due to reasons other than a pick up in the U.S. Economy or inflation in the U.S. seems to be correct.

Importantly for our forecasting, the record U.S. Long Bond low of 2.10% in July 2016 only took out a similar spike low of January 2015 by 12 basis points, which only took out another spike low of 2012 by 23 basis points. Thus, you can visualize a huge market low (in yields, top in prices) in a huge rounding process (which we have talked about over the years). Importantly, the tops in prices (lows in yields) are much more difficult to forecast or "call" than price bottoms (lows in yields).

Similar to the all-time low in U.S. Treasury yields is the situation in municipal bonds (measured by ETF "MUB"). The market put in double price tops (yield lows) in 2012 just a few basis points each higher than its all-time price high (yield bottom) in mid 2016, which was a spike (without the spike it was essentially the same top as the previous two in 2012). Thus, this market has also experienced a long drawn out topping process (top in prices, low in yields) that we have talked about numerous times.

In equities stocks rose to a record high. The way we describe it is that equities went through a consolidation from late 2014 to just before the night of the election in 2016. Then, well, at first, the market (Dow Jones Industrial Average) dropped 800 points overnight (a drop of 5% that showed the volatile nature of these markets) before rebounding (first retracing the 800 point drop, also overnight) and breaking upwards out of the consolidation – shooting up about 12% for the rest of 2016 (+17% from the bottom of the overnight 800 point drop – of course, no mere mortals were able to buy that drop low).

Very important to us, in terms of forecasting the equity markets, is that the junk bond taxable market, which is often a leading indicator of equities, came nowhere near a new high – it did not follow along with the equity markets. In fact, junk bonds (as measured by "JNK" exchange traded fund) is still down 12.6% from its early 2013 high (and essentially its almost-identical but slightly lower mid 2014 high). The key for us is that it had a strong 16.5% rebound from its February 2016 spike low but it is still far below the double top and its long term trend looks to still be down. This divergence versus the equity markets could be telling for the stock prices.

The situation in the high yield municipal market (measured by ETF "HYD") is somewhat similar to junk taxable bonds. It had a significant (all time high) market price peaking process from November 2012 through May 2013 before experiencing a huge drop of 17%

down to a September 2013 low. That drop correlated mostly with problems of municipal bonds of Puerto Rico. From there it rebounded in price by 17% retracing about 75% of the 2013 drop into mid 2016. Importantly, it has fallen again by about 11% from the consolidation in mid-2016 down towards the end of the year (2016). So, it is in a price downtrend (yield uptrend).

As for commodities, yes they had a rebound of 9% in 2016 as measured by the CRB index; however, they are still down 47.6% from their early 2011 top even after that rise! Oil prices are in a similar configuration – still down 42% from their 2012 high and down 40% from their 2014 high, even after their 22% rebound during 2016. Thus, the trend in industrial commodities is still downward. (We want to point out that the junk taxable bond market has trended along with the industrial commodities markets because a large portion of its issuers are in oil and gas.)

Precious metals are in a similar downtrend. Gold peaked in 2011 at around $1800 per ounce. It dropped about 45% to a low in late 2015 before rebounding by 8% in 2016. Importantly, it is still about 36% below that 2011 top. Silver typically is more volatile than gold & it is in this case. Its drop from its 2011 peak to its late 2015 low is 72%! Even with its 15% for 2016, it is still 67% below its 2011 price peak.

Risk and Uncertainty - We saw the 800 point over-night drop and 800 point same over-night rebound the night after the 2016 Presidential Election. This 5% drop and 100% retracement in less than a few hours highlights, to us, the potentially volatile nature of these markets. Our other point in regards to risk and uncertainty is that the new Administration is taking control after marked rebound in equities from the 2009 Financial Crash low – this after, the Federal debt was doubled by $10 trillion to its current $20 trillion dollars. In addition, we have numerous other problem situations that we have reviewed several times in our Blogs and our Annual Forecasts over the years. Social Security has big problems as does Medicare. In the next few years some restructuring of these programs will have to be undertaken. We have similar problems that we have documented with respect to public pensions. The way we explain it is that promises that were made are only about half funded & this is based on prices of a stock market high, and very near a U.S. Treasury bond market high (low in yields). The perceived pie is about half as large as people are expecting. It can or will be resolved by cuts in benefits and/or increases in contributions from someone; however, formal recognition of the problem and/or its restructure will be contractionary as reality is realized, unfortunately. Our point is that even if the Administration were to do everything perfectly, we would likely have short term and probably intermediate term financial pain. The likelihood of perfection is small, I'm sure you will agree.

The Administration is posturing in ways that it thinks will help American workers, bring jobs back from abroad, etc. Now, whether putting on or raising tariffs on the goods from other nations is wise or not, it would most likely result in a contraction. Trade restrictions are generally coming off/down during a boom and being put on during a contraction. It does seem that we will be heading towards contractionary policies (good or bad for our long term). In addition, the somewhat dramatic changes in policy are being taken divisively – people are

taking sides, including boycotting people/businesses who promote certain ideas/policy – our point on this is that it will likely result in less financial activity – which is contractionary.

So, we are priced at perfection (record high in stocks and near record high in Treasury Bonds) but have huge problems that have to be addressed fairly soon. In addition, we have documented several indications that interest rates are heading up (and not because of a strong economy). To us, this does not seem a like a good environment to be aggressively invested in bullish assets.

Forcasts

From the above presentation you will agree with us that the U.S. has many cross currents. We believe we have been experiencing major market tops (in price, bottoms in yields) similar to the tops we forecasted in 2005 to 2007 before the "Financial Crash." These tops, if we are correct, have been widely spread out in time without a huge divergence in price. Well, that has been true for Treasury bonds, junk bonds and high yield municipal bonds. For commodities, we are still down significantly from spike highs. What we draw from this analysis is that in this cycle, the bond market has had a drawn out peak but the commodities markets have had more of a spike high. Not topping (yet) are the equity markets, which look to us to most likely have a more concentrated high than in past cycles. If you look at past, large equity market tops, they typically are rounded with certain categories topping months before others – This might not happen at this equity cycle top. We will see.

During 2015, we thought that the NASDAQ was topping first – We will see. We have been watching Amazon ("AMZN") in our monthly updates. It put in a good drop but has now rebounded just below its all-time high of October 5th, 2016. It is so close we think it will likely exceed that high and give the NASDAQ the momentum for new highs over the next several months. Still, it looks to us like the NASDAQ will be one of the first equity indices to top.

Another index that we think could very well top ahead of the majority of equities are the Dow Jones Transports. The previous top in the Transports occurred just a few months before the downturn in the prices in oil in the last half of 2014 – with oil topping in June 2014 and the Transports topping in late November 2014. The Transports then dropped by 28% to a spike low on 1-20-2016. From there it has more than retraced the drop, rising by 42% to where it is currently. We expect another, and maybe two more, "down, up" sequences in this index with it likely topping somewhat before other equity markets (see below).

Other equity markets (Dow Jones Industrials, S&P 500, and even the Russell 2000 small caps) are more in sync. Importantly, we think it is highly likely that we have passed the maximum momentum of their current rise (from the 2016 Election lows), which, given how the other markets (Treasury bonds, municipal bonds, junk taxable bonds, high yield municipal bonds, industrial commodities) are behaving (in price downtrends), will likely end in their final highs. Maximum momentum would be from the bottom of the 800 over-night, post-election drop through the end of 2016 (– with slower stair-stepped rises thereafter). That pace seems far to fast to be sustainable, especially given the fundamentals we have

reviewed and the likelihood of a mistake or mistakes rather than the perfection equities seem to be priced to. Thus, while we expect the equity markets to continue to rise in a step-wise fashion, we expect the rate of the rises to be smaller. It may be we have couple "down up" movements with the final top later this year. We will see. However, as we see it, the upside potential is small but the downside probability is large for prices of stocks (and other risky asset classes).

As for bonds, we expect the all-time lows in yields to hold. We expect we will see a stair-stepped rise in yields to significantly higher levels (bond prices lower). Again, we do not expect the rise to happen as a result of a stronger economy or from inflation but from international issues, including deflation abroad (and likely domestically) that we detailed in last years Annual Forecast.

Last year we detailed the parabolic rise in prices of the Utility market into the 1-29-2015 top. From there utility prices dropped 17% to a low on 9-10-15. However, that parabolic rise was not to be "The Top." From the low on 9-10-15 the Utility Index has risen again in yet another parabolic rise (inside a much larger parabolic rise beginning at 2009 Financial Crash lows). This most recent parabolic rise of 33% from 9-10-15 topped on 7-6-2016 and has since fallen about 9%. Importantly, the Utility top was very close to the U.S. Treasury all-time top of 7-18-2016. In fact, it topped just a couple of weeks earlier. When we used the parabolic rise and drop in Utilities to correctly forecast the Treasury and Municipal bond tops in 1994 (see our Press Clippings for 1994), Utilities topped many months earlier as compared to a couple of weeks in 2016. Still, it seems likely that we have seen the all-time top in utility prices (low in yields) in conjunction with all the other factors we have reviewed here.

As for commodities, we expect that industrial commodities like oil will soon resume their downtrends. However, we would not be surprised to see financial commodities like gold rebound more before resuming their price downtrends. If prices of industrial commodities resume their drops, we will likely see more of the negative price ripples in the financial markets that we forecasted (and occurred) for their previous drops. Price drops in oil and gas resulted in the drop in the prices of junk bond and high yield municipal bond funds, for example. We believe there will be lots of ripples as more markets peel off from their market highs and those that already peaked resume their drops.

As for Real Estate. The rise in U.S. Treasury rates and other rates have pushed up mortgage rates somewhat but have not yet resulted in a broad decline in the prices of real estate. (In the Monthly Updates in our Weblog The Contraction Resumes, we have documented weakness in certain areas of real estate that has already begun.) If interest rates continue to rise, we expect that assets heavily financed with debt will see their prices fall, including real estate which is very heavily financed. We expect that those areas which have seen the largest increases in real estate prices, will, in general, see the largest declines (once they get going).

Deflation – We touched on deflation briefly above (and considerably over the years). Financial and Industrial commodities have been in significant downtrends over the last several years. We have seen some ripples from declines in oil, etc. causing junk bonds and high yield municipal bonds to top and decline and the closure of many hedge funds that were

heavily leveraged in those assets. Also, what we said last year still holds: " One area where the negative effects could be noticeable is in the finances of **municipal entities**. Plummeting taxes and revenues could put short term strains on municipal finances – plummeting investment values could further expose the longer term problem of unfunded pension liabilities. Further, the more baby boomers that retire, the more the burden will be on the remaining workers – it is an accounting pyramid time bomb that is waiting to explode, unfortunately. Why the rating and accounting agencies did not & will not step up and expose this situation while there was/is still time to fix it is a mystery but it would likely cause the prices of general municipal bonds, which people believe are bullet proof, to fall in price." Also from last year, "The current problem is that deflation is sweeping the rest of the world. Many countries are now in recession (or depression), are experiencing negative interest rates, and/or are experiencing outright deflation of credit/debt and prices of goods and services." – We have already seen ripples from these situations and from the price drops we have discussed; however, they are far from being resolved - and now, we are further along in those unfortunate trends, abroad and here in the U.S. In addition, if the bond market tops (U.S. Treasuries, junk taxable bonds, municipal bonds, mortgage rates, utilities) that we outlined above hold, and their prices resume there drops (yields go up), heavily financed assets will most likely see their prices drop. For example, this would be the case for real estate, with rents likely following (and we have already recently seen it in certain high end markets). The likely price drops we have discussed would ripple through the economy and decrease demand for goods and services and result in other price drops. It seems to us that we are just a few market declines from outright price deflation in the U.S.

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In summary, we believe it is incredible that there is so much risk in the system yet equity prices are still going up from all-time market highs. I guess you would call it a bubble. On the other hand several markets topped over the past few years but this fact seems to go unnoticed. With equity prices priced for perfection in the face of the problems and issues we have highlighted, we believe the upside potential of riskier assets is minimal while their downside is probable.

We believe that prices that have already topped (as reviewed above) will continue to drop in step-wise fashion.

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As mentioned previously, please review our previous Annual Forecasts and Blogs if you want to get considerable background 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 our watchword again, until we get to the final bottom,

which we believe is still much lower.

(Posted January 29, 2017)

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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