Stamper Capital & Investments, Inc.

"Focusing on Upside Potential and Downside Protection Since 1995."

January 2018 Market Commentary

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

A quick review of 2017:

Stocks - The Dow Jones Industrial Average ("DIA") was up 28.09%
- The S&P 500 was up 21.83%
- The NASDAQ ("QQQ") returned 34.04%
- The Russell 2000 ("IWM") returned 14.02%
- The Dow Transports ("XTN") returned 21.32%

- High Yield Taxable Bonds ("JNK") return was 5.96%
- High Yield Municipal Bonds ("HYD") return was 9.97%

Bonds - The U.S. Treasury 30 Year Yield went down about 27 basis points to 2.74%
- The U.S. Treasury 10 Year Yield went down about 2 basis points to 2.41%
  But
- The U.S. Treasury One Month Bill Yield rose by 78 basis points to a 1.26%
- The U.S. Treasury Two Year Yield rose by 64 basis points to a 1.89%

Commodities
- The Commodities ("DBC") index rose by 6.1%
- Oil ("USO") returned 4.98%
- Gold ("GLD") returned 11.9%
- Silver ("SLV") returned 3.56%

Real Estate – Of course, real estate is regional but some generalities can be made.
It moved up for the year by 6.38% (according to Case Shiller through 10-2017)

Looking backward, the most striking financial events of 2017 were the parabolic rises in the equity indices ("several down, then up moves" as we speculated) into a tight rise at an increasing rate of speed. (Another striking financial event was BitCoin's parabolic rise, which has broken down after a 42% price drop!)

Looking forward, likely the most striking financial event in 2017 is the rapid rise of the short end of the yield curve (rates going up), continuing what started in 2016 and 2015 (and even earlier) depending upon the maturity.

Taken together, these two highlights will likely combine in possibly spectacular fashion as rising interest rates (even just short term rates) will certainly impact the cost of carrying heavily leveraged financial assets, which includes almost all "investments" (or speculations)

these days. Historically, assets with the most downside potential are those with parabolic rises.

2017 Review and 2018 Forecasts

Importantly, as we forecast last year, "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 " has held. "More important, to us, than the record low was the dramatic rebound rise in yields from that record low [1n 2016]"...and the dramatic rise in yields in the short end continued through 2017 as we forecast. Last year we also said:

> 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.

While the U.S. 30 year yield is actually slightly lower now at 2.91% than at the beginning of 2017, its yield at 2.97% is still far above its all-time bottom at 2.12% in mid 2016 – thus, its yield is still in an uptrend.

Probably more important is what happened to the rest of the curve – rates up rather dramatically.

The One Month U.S. T-Bill is at 1.23%, up 78 basis points from January 2017.

A more dramatic example is the U.S. Two Year Treasury which was 0.50% in January 2015 and is now at 2.11% – so the Two Year Yield is now 4 times higher!

The U.S. Treasury Ten Year Yield continued its rise during 2017 from its all-time low of about 1.35% in Mid-2016 up to 2.72% currently – a huge rise, and its highest yield since early 2014.

Last year we said and we still believe:

> 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.

This statement, below, of ours last year also remains intact:

> Similar to the all-time low in U.S. Treasury yields is the situation in **[high grade] 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.

And, those tops remain intact! & the double tops (lows in yield) are spread four years apart. The MUB experienced a lower price high on 8-28-2017 – so its interest rates dropped but not below the previous lows (and are still in a long term uptrend).

In other interest rate categories, **High Yield Muncipal Bonds** (measured by ETF "HYD") and **Junk Taxable bonds** ("JNK") both had their previous price highs hold as we forecasted – thus, they did not put in new yield bottoms and are in longer term yield uptrends.

As for **commodities**, last year we said:

> ...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.)

Even with reasonable price rises in 2017, those previous commodity price highs have held and the tops have been more widely disbursed – industrial commodities are still in price downtrends, as forecasted.

The situation is similar for **financial commodities** like gold and silver. As forecast, even after notable rebounds in 2017, they are still in significant downtrends from their all-time highs. 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 and another 11.9% in 2017. Importantly, it is still below both of those tops. Silver typically is more volatile than gold & it is in this case. Its drop from its 2011 peak to its late 2015 low was 72%! Even with its 15% rebound for 2016, and its 3.6% rebound for 2017, it is still below both of those peaks.

Summary Anaylsis:

The key we take from the above results and analysis is that the bond tops (yield bottoms) we forecasted correctly and, importantly, have "been widely spread out in time without a huge divergence in price (or yield) (yet). Importantly, the trend in interest rates is upward & we are expecting they will have notable large rises for 2018. Thus, to us, the "round top" in prices (round bottom in yields) is over – now we will see much more notable rises in yields.

We have forecasted commodities similarly – multiple tops have held, spread out over time; however, from parabolic tops (more typical of commodities) and their trend is still downward in price.

Stocks has been much more difficult, we think, largely because they are behaving/performing differently than most equity tops. Rather than a large widely dispersed top with different indices topping months or even years apart, they are all topping together. Not only that, while normally, their tops are "rounded," in part, because of their dispersion, this time, they are all in parabolic rises – prices rising at increasing rates – so a tight spike upwards.

We speculated this might happen when last year we said:

> 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. <u>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.</u>** We will see.

So, we did change/update view from our previous forecasts to expect a more concentrated high for equities.

Last year, with respect to equities, we also said,

> 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).

Well, we were correct that the stock market would continue rising in a stepwise fashion but they did not top later in 2017 and, importantly, the stock indexes synched up but rather than passing maximum momentum they accelerated into parabolic rises as we discussed above. Of course, in our view, now, the upside potential is even smaller with the downside probablity of large price drops for equities being even larger.

Forecasts:

We believe interest rates will continue to rise. We expect we will see a continued stair-stepped rise in yields to significantly higher levels (bond prices lower). As previously, we do not expect the rise in rates to happen as a result of a stronger economy or from inflation but from international issues, including deflation abroad (and likely domestically) that we have been detailing in our Annual Forecasts and Blogs. Also, as we have covered previously extra supply from the Federal Reserve selling off part of their balance sheet (rather than purchasing). So, rising interest rates from supply & demand, not from inflation.

We believe commodity prices will resume their price drops, both industrial and financial. We have also covered a lot of this in our our Weblog The Contraction Resumes.

It is cliché but we believe we are at a "tipping point" with respect to stocks. We believe the rise in interest rates, especially the short end of the curve will derail the parabolic rise in the prices of stocks and the prices of other highly financed/leveraged assets. Typically parabolic rises are swiftly retraced so that is what we are expecting (We have correctly forecasted and documented several parabolic price peaks and breaks, in real time, in our Blogs over the many years - most recently BitCoin dropping 42% from its super parabolic peak!) Our minimum downside forecast for equities eventually is the 2009 lows, so considerably lower than currently & a bigger drop than the Financial Crash - prices of other assets would fall similarly. At that point we would sharpen our forecasts for further downside potential/probability. When do we expect this drop to start? At any time & sooner rather than later.

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In summary, we believe it is incredible that there is so much risk in the system (covered for many years in our Blogs) yet equity prices are still going up from all-time market highs. I

guess you would call it a super bubble. On the other hand several markets topped over the past few years but this fact seems to go unnoticed, as does the large rise in short term interest rates about which we have been beating the drum. 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 very probable.

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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.
It was our watchword again from the Housing Bubble to the Financial Crash.
Unfortunately, "Safety" is our watchword yet again, until we get to the final bottom, which we believe is much much lower.

(Posted January 28, 2018)

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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