MRP CAPITAL INVESTMENTS, LLC

2nd Quarter 2014 Client Newsletter

Capital Market Update

Inside this report:

This market reminds me of an old Aerosmith song I used to listen to; "Train kept a rollin' all night long. Train kept a rollin' all night long. I'm in heat, I'm in love…but I just couldn't tell her so."

Why? Well, obviously this market keeps rolling along. It's been running since 2009 and so far this year, it is up another 6.05% on a total return basis. And we all like making money, so you could say we are in love with this market. But with all the pockets of uncertainty, we just can't bring ourselves to formally admit our love.

S&P 500 YTD Chart Supplied by BigCharts.com

But, regardless, this train keeps on rolling!

Of course, there are many things we need to keep our eyes on. Most importantly, the economic data needs to be tracked. A slip from growth to recession has historically been bad news for the market. But many believe the 1st quarter GDP pullback was purely weather related. Whatever the case may be, I'll be watching vigilantly.

Consumer Sentiment

You all know, as I talk about it all the time, that my approach is a Top-Down meets Bottom-Up investment process. In the Top-Down portion of the analysis, I combine economic analysis with Behavior Finance observations. One of those observations deals with the mood of the market participants and I use the University of Michigan Consumer Sentiment Index to gauge their mood. This Index is a survey run by the University of Michigan to understand how consumers are feeling about the economy. I use this in combination with the current level of earnings versus a rational level of normalized earnings, market valuation, and the level of complacency in the market to get a sense of what phase of the market cycle we are in.

My work shows that we have been in the Boom Phase of the market cycle since 2009. Since this Boom began fear has been falling among market participants and earnings have been rising, along with valuations. Consumer Sentiment is well off the lows it saw earlier in the cycle, but it is still below the average reading of the Index since its inception in the 1950s. **It is my belief that when the reading on Consumer Sentiment breaks above average, the market will blast even higher.**

But before we get into that, I want to take a look at some economic data to try to get a handle on why the Consumer Sentiment Index is where it is.

To get a sense of the Index and its history, I've posted a chart of it.

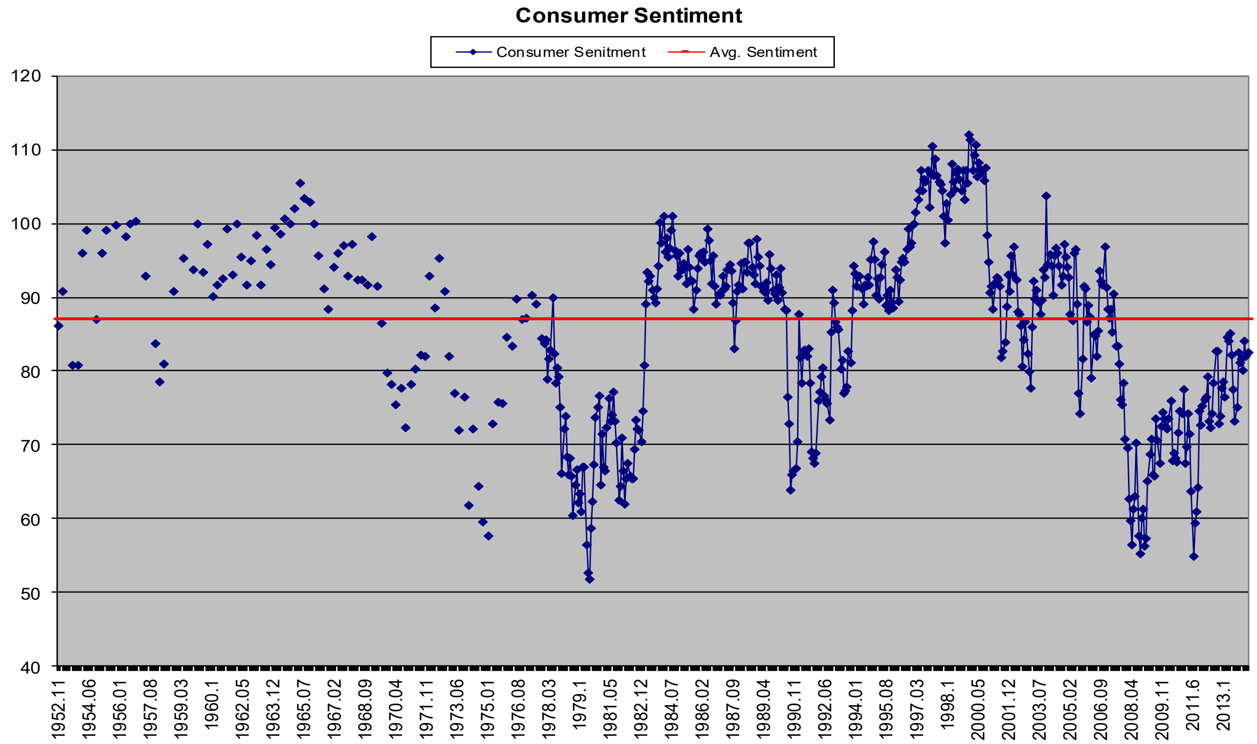

Chart provided by the MRPCI Database

You can see that in the 2008 timeframe, Sentiment was REALLY low! Let's see why that could have been.

For starters, U.S. GDP declined from the 3rd quarter of 2008 through the 2nd quarter of 2009 on a NOMINAL basis. This type of nominal GDP decline was not something we had seen in the U.S. economy for many, many years. So, I think it is safe to say that the economy was in bad shape.

To cut expenses in that terrible economic environment, businesses laid off workers at a very rapid pace. In October of 2007, the U.S. Unemployment rate was 4.7%. In December of 2008, it was 7.3%. In October of 2009, it reached 10%. There can be no question about the fact that people losing their jobs at such a rapid clip had a very dramatic impact on their overall sentiment about the economy.

And furthermore, the S&P 500 experienced a dramatic decline during that timeframe as well.

Given what I've just laid out, I think it is fairly easy to see why the University of Michigan Consumer Sentiment Index was registering such a low reading. However, since then we've had a lot of positive developments. Unemployment is falling, the market is rising, and, as you'd expect, the Sentiment Index is rising as well. But it hasn't broken above an average reading yet. Why?

Again I think if we look at some economic data, we can get a pretty good idea as to why the Consumer feels better than he/she did in 2008 but isn't feeling "good" yet.

As mentioned previously, the unemployment rate peaked at 10% in October of 2009. And now it stands at 6.3%.; a dramatic improvement. But it was as low as 4.4% in 2007. So, we are making improvements concerning the Labor Market but we are not all the way back.

Furthermore, we are seeing some purchasing power issues. Average hours worked and average hourly pay is back to the level is was before the Financial Crisis hit in 2008. BUT, prices of goods and services have climbed nearly 15% since then. So even though people might be making what they were before, they can't live the same lifestyle they had previously. This undoubtedly is keeping a damper on their overall mood.

Additionally, even though the stock market has fully recovered its losses since the 2008 debacle, only 1/2 of Americans are invested in the stock market. So a lot of people missed out on this rally. And finally, the housing market has not fully recovered yet. And with people's houses being a major asset in their overall portfolio, this can keep their optimism in check.

To be quite frank, looking at all the trends in the employment related data, I see a continued drop in the unemployment rate as inevitable. I don't believe you can have a sustained rise in hours worked and hourly wages without employers hiring more people, as people can only work so much. This should inevitably lead to a rise in Consumer Sentiment.

If we buy into the fact that in due time the mood of the Consumer should rise, what does that mean for the market. Well, I've looked into that. But for reference, I want to post the chart of the Consumer Sentiment Index again.

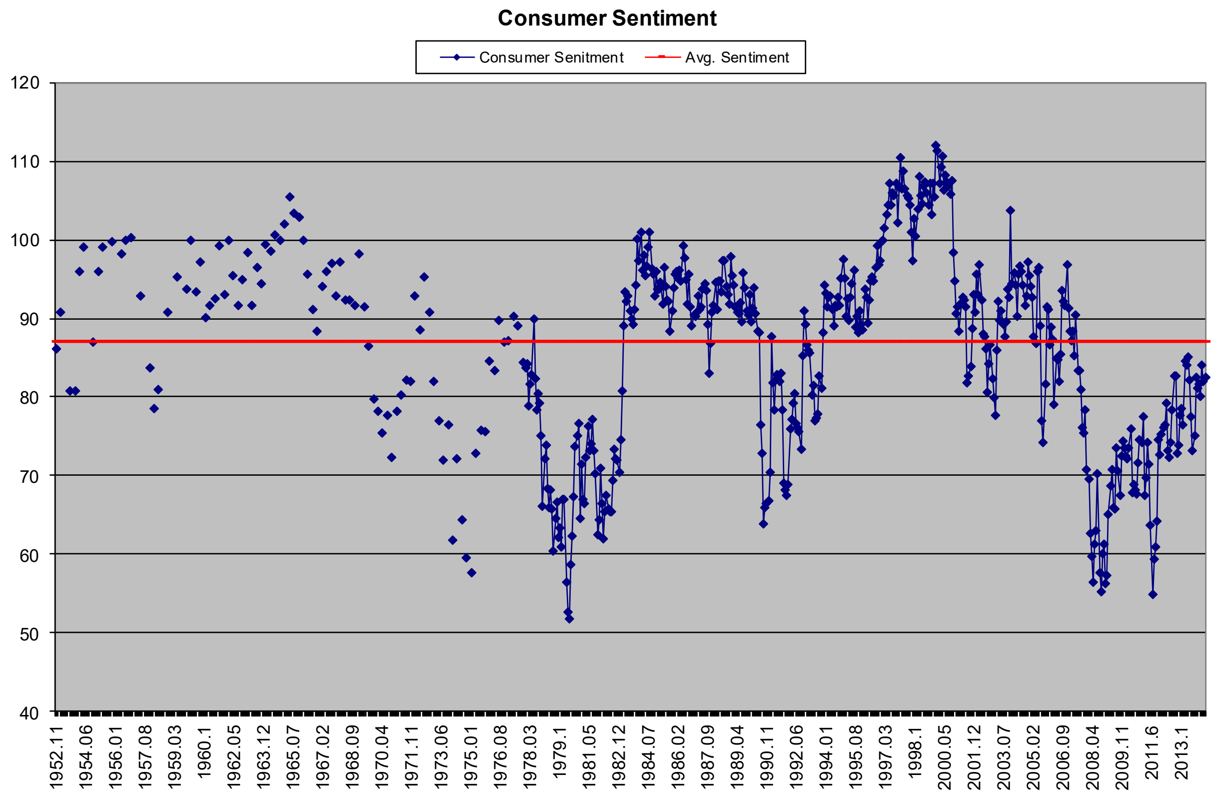

Chart provided by the MRPCI Database

You can see a number of times where the index was below average and made a run to an above average reading. For this analysis, I looked at every time this occurred since the 1980s and took a peak at what the S&P 500 did during that time frame.

During this time frame, I noted 4 times the Consumer Sentiment Index jumped from a below average reading to an above average reading. **The average gain in the S&P 500 was 71.4% during those times.** This tells me, without hesitation, that this change in Consumer's mood is important to the market and it will be something I'll be watching very keenly over the next several months.

Non-Financial Events occurring this quarter

Michelle Wie wins her first professional major championship

276 girls abducted in Nigeria

Islamic State in Iraq and Levant stir more unrest in Iraq

The World Cup begins

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