MRP CAPITAL INVESTMENTS, LLC

The Whipsaw!!

Research Report 08/03/2015

Introduction

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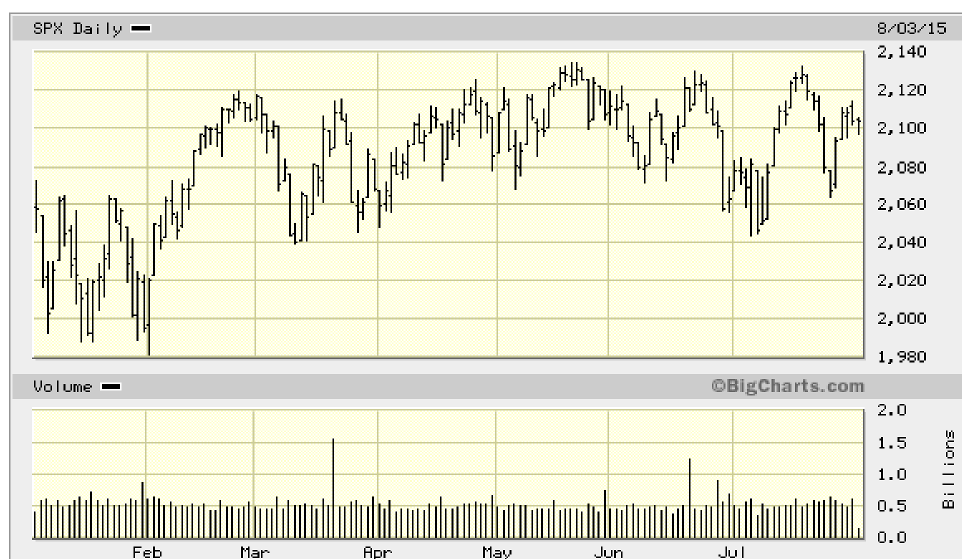
Whew!!! That last few months have seen some crazy market movements...but yet, WE'VE GONE NOWHERE!



YTD 2015 chart supplied by BigCharts.com

To be more specific the S&P 500 has registered miniscule gains, which is what I'm referring to when I say "we've gone nowhere". However, many stocks, indicies, and commodities have shown tremendous amounts of volatility. Enough so that you'd think the stock market would have shown some movement.

Maybe when we dig deeper, we will find that movement and begin to decipher what is going on.

The Markets

Let's first start with questioning the initial statement I made that "we've gone nowhere."

Yes, it would be largely correct to say that the S&P 500 has gone nowhere. In fact, Year to Date through the end of July it is up 2.18% on a price basis. For all the ups and downs we've had and the major news stories that have broken, that is very little change in the index's value.

Looking at the other indices, we see that:

The Shanghai Composite Index is actually up 12% for the year, despite falling 30% in the last few months.

The Nikkei 225, Japan's stock market, is up 17.75% year to date.

The Euronext 100 is up 18.57% for the year, despite all the drama going on in Greece and the Eurozone.

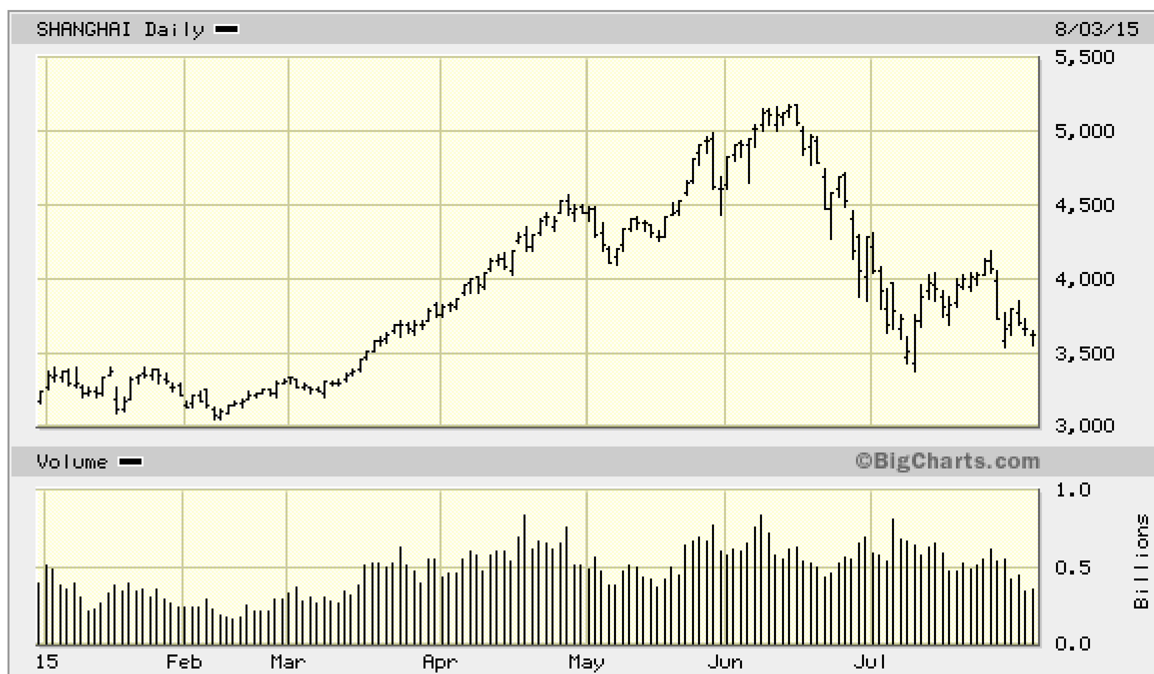
Meanwhile the FTSE, England's market, has been going nowhere like the U.S Market and is up a mere 1.87%.

And looking into the commodity markets, oil has fallen in price about 50% from where it was a year ago.

And gold has fallen about 16% from where it was a year ago.

So, is my initial statement true? Have we, indeed, gone nowhere? Yes, the S&P 500 has gone nowhere. But, some others markets have seen crazy runs...both good and bad. China saw an amazing upside run early in the year and then has collapsed as of late. European markets, despite all the trouble, have shown solid gains. And commodities have been getting creamed.

In the end it depends how you are invested, to determine if you feel the markets have gone nowhere so far this year. If you are in well diversified portfolio, you've probably made a little bit of money. If you are a risk taker and are playing the "hot" trends, you might be getting killed. Fortunately for my clients, we are well diversified.



Shanghai Composite Index 01/01/2015-08/03/2015

Chart provided by BigCharts.com

Causes of the Whipsaw

As we've seen, the U.S. markets are bopping around, sometimes up and sometimes down, and hovering around flat returns so far this year. Meanwhile, the foreign markets, most specifically China, have been getting whipsawed around like crazy; up big for awhile and then crushed. Well, why is this happening?

The first big overhang relative to the markets is the looming interest rate hikes by the Fed. Literally, for years they've been jaw-boning and telling us that rates are going up. But, they haven't yet. HOWEVER, the latest rumor is they are going to hike in September. And if you've read my report "Don't Fight the Fed" you know that once the Fed embarks on a tightening cycle, the market enters a grinding phase where gains are hard to come by.

The second overhang, or more aptly put "shock", that is rattling markets is the price of oil. Seemingly out of the blue, late last year oil prices fell and fell hard. Some people thought initially this was a one-time blip and energy prices would bounce right back. But as it appears now, low energy prices might be with us for quite some time. The impact of low energy prices is still being sorted out in the market right now and is whipsawing the price of some stocks back and forth and is doing the same to the overall market.

Adding these two factors to an already skeptical market place is the cause of this trendless volatility in the market. And these skeptics have been focused on a number of issues, which are the cause for their uneasiness about the markets;

-debt, specifically levels of government debt

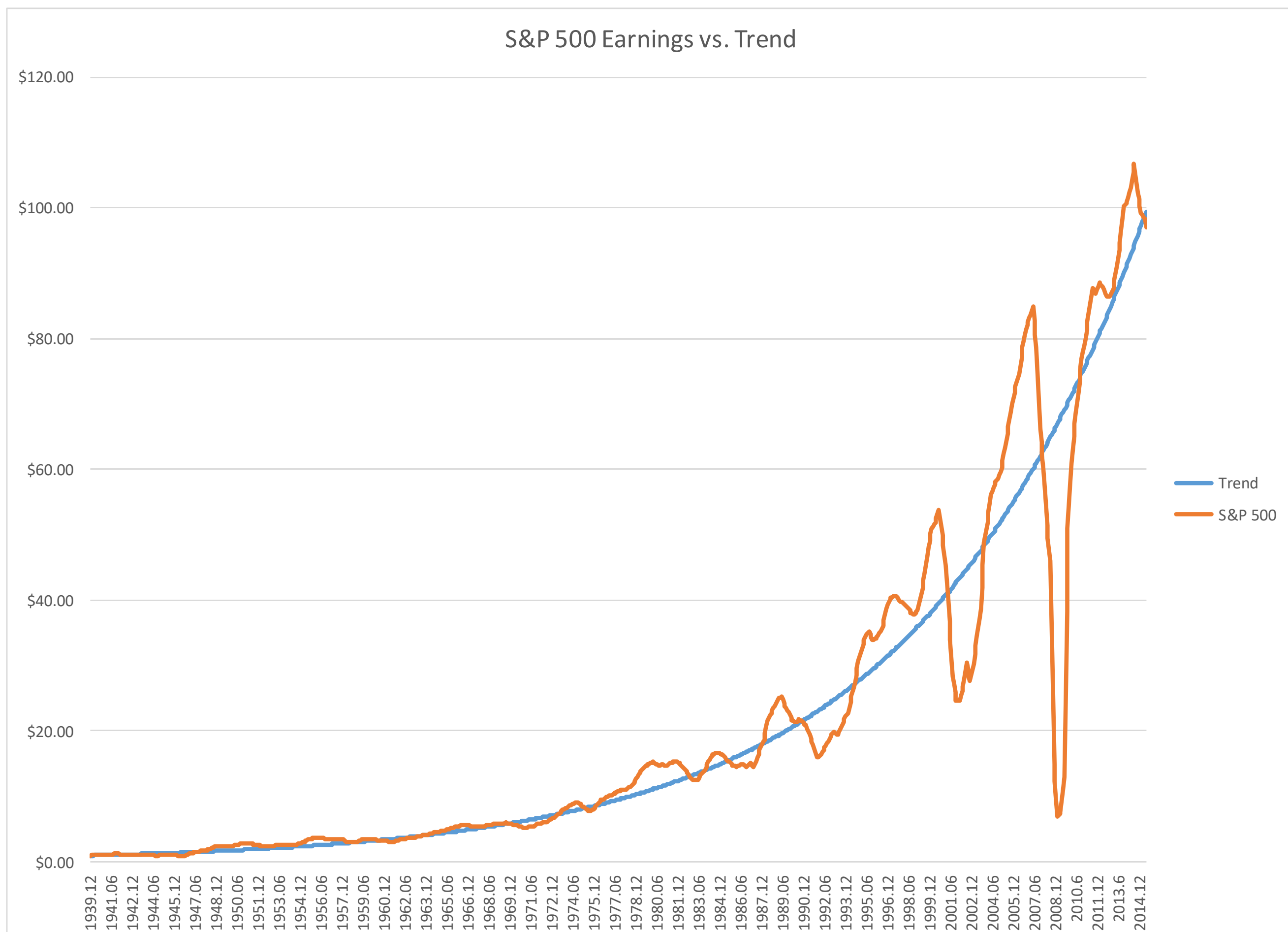
-geo-political issues, focused on the Chinese economy and Middle East relations

-leadership, meaning government officials antics

MRPCI Macro-Model Review

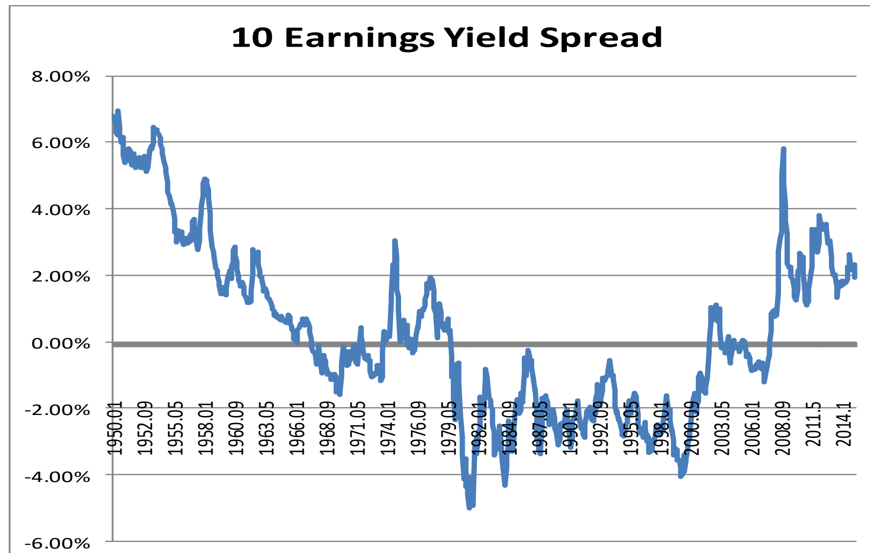
One big thing I've learned over my 18 years of managing money professionally is that there are always "issues" weighing on the market. Many times these issues worry the heck out of the market participants, but in the end they turn out to simply be distracting noise. To help me tune out the noise, I focus on my models. I've talked at length about these models over the years, so I'll spare you all the details and technical mumbo-jumbo related to them. However, I will provide an update on where they stand right now.

1) **Earnings versus Potential**—With the recent fall in earnings, this metric is more attractive than it was a few months ago.



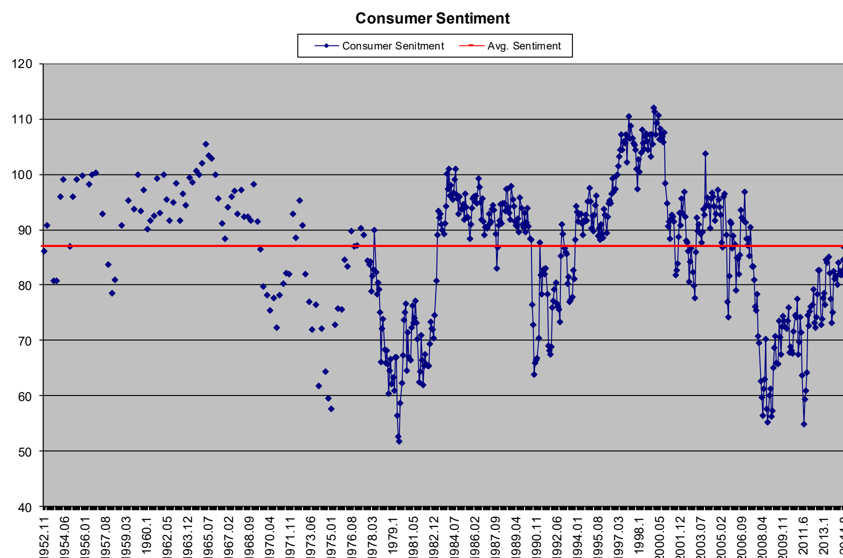
There is still not a ton of upside room for earnings to run, but it isn't clearly all downhill from here.

2) **Valuations**—On a raw basis, the valuation of the market is high on a historical basis. However when compared to bond alternatives, the stock market looks like a great relative value.



I would like to note that this relative value is versus an interest rate environment that is being kept artificially low by the powers that be. But, I don't see this changing radically any time soon.

3) **Consumer Sentiment**—Consumer Sentiment remains high and this usually provides optimistic outlooks and actions related to the market and market moving events.



4) **<u>Level of Complacency in the Market</u>**—One of the biggest dangers to the market is when market participants begin to ignore the risk factors in the market. This can be noted by long periods of low volatility readings on the VIX Index.

As you can see, our current market is reacting to negative news in a healthy way. "Fear" seems to spike during market threatening events and this is a good thing for the long-term viability of our current Bull Market.

To summarize the reading of the MRPCI Macro-Model, all four indicators have at least some form of positive readings. This leads me to believe that the current Bull Market we are in is not over and, in fact, it should have some room to run. The biggest risk factor to the market would be a collapse in Consumer Sentiment, which has provided a buoy to valuations. With this we need to keep a keen eye on any economic events that could negatively influence people's mood. Things like, employment levels, incomes, housing prices are important to monitor.

However, it is vital to understand that historically within these long-term Bull Market runs there are several significant pullbacks. In fact, I've put out research reports detailing pertinent information which is designed to help us be better prepared for these cyclical selloffs.

In my Dec. 31, 2013 report entitled "A Bear Hunt", I highlight the three major reasons for a selloff within a secular Bull Market were:

1) An expanding economy slipping into recession
2) A market whose valuations became unreasonably high
3) Geo-Political events

Another very important report was the one entitled "Don't Fight the Fed", which discussed the findings that markets run to the upside right until the moment the Fed begins to raise rates. Historically, the market does not pull back prior to the Fed hiking rates. Rather it begins a low-return "grinding" type of phase when rates begin to move higher.

Frankly, looking at the findings of these reports higlights the importance of many of the events that have been taking place over the last few weeks.

-On the valuation front, we've seen earnings of S&P 500 companies fall over 7% from their peak but the market has actually risen over that time. That is putting stress on valuations.

-On the Geo-Political front, we've seen a Chinese economy that is showing signs of faltering. And we all know that when your money becomes tight, sometimes people do desperate things.

-And on the interest rate front, there is a lot of talk about the Fed beginning an interest rate hiking cycle. I really am uneasy about this for two reasons:

1) The findings of the "Don't Fight the Fed" paper show that an interest rate hiking cycle makes gains in the market more difficult to come by.

2) The hiking of interest rates has the real chance of throwing our economy into recession. Which, as we know from the "Bear Hunt" report, is the #1 reason for a cyclical Bear Market.

So, yes...it still does look like that longer-term Bull Market trend is still intact. But I am growing more and more uneasy that we are heading for a cyclical pullback. Which is better than all out Bear Market, but still not fun to deal with.

Investment Opportunities

Regardless of the state of the economy at large, we need to find attractive investment opportunities. And when I take a look at my investment valuation models, there are many interesting looking plays.

First and foremost, financial stocks are, and have been, registering very attractive readings within my models. I don't think the investing public has forgotten the 2008 debacle and valuations within that sector have not fully normalized. And, yes, I understand that things are different now then they were...but the readings of my models are still registering extreme undervaluation for many companies in that space.

Also, many technology companies look very good according to my models. Cash flows are booming and balance sheets look really good for many companies in that space.

And finally, the problems in the energy space seem to be pushing valuations on many companies in the sector to very attractive levels. It will be key to get the timing right on making investments in this space, but valuations are getting close to buy levels for some of the operators.

Summary and Conclusion

To review, it appears that there are a number of overhangs troubling the market. First, and foremost, is the concern over when the Federal Reserve will raise interest rates. Secondarily is the shock of low oil prices on the financial landscape. When you add these to the already murky picture which is clouded by high levels of government debt, questions regarding the leadership abilities of our elected officials, and the geo-political issues arising out of China's potentially faltering economy, you get a market with some real worries.

However when you review the long-term prospects, it does not appear that the classic signs of a market breakdown are in place. Earnings are not ahead of trend, complacency has not set into the market, consumers are still optimistic, and some measures of valuation appear attractive. BUT, some of the signs of a cyclical pullback are in place.

To assess the potential impact of a cyclical Bear, we can we can apply technical analysis to the S&P 500. You can see support for the market around the 2000 level. That would NOT measure as a formal pullback per my models, since that is only a 5% pullback from the market's highs. However if 2,000 is not held by the market, then 1850 appears to be the next stop. And that would equal a formal pullback as the drawdown from the S&P's highs to that level would be approximately 12%.

S&P 500 Chart from 01/01/2014—08/03/2015

Chart provided by BigCharts.com

Of course, if China's woes increase, the Middle East continues to flood oil into the market thereby driving the price lower, our Fed does raise rates at their September meeting, and earnings continue to falter, then the 1,850 level might not be the final resting place of the market.

As always, we will hope for the best and prepare for the worst. As mentioned earlier, there are usually some good buying opportunities even in the market selloffs. In fact, broad indiscriminate selling generally yields lots of oversold stocks. Since I've been a net seller in the market for quite some time, I should have everyone with ample firepower to take advantage of this sell off...should it arise.

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