MRP CAPTIAL INVESTMENTS, LLC

Research Report

written on 3/22/2013

Normalization

This report is an updated version of the report I initially wrote at the end of the 4th quarter of 2012.

Inside this report:

Over the past 8 years, we've seen the market go through many phases and in our newsletters and research reports we've named these cycles and market movements. Recently we've seen the "rebalancing" and the "consolidation" to name a few. Right now, however, we are in the beginning of a new cycle that I'll dub "normalization."

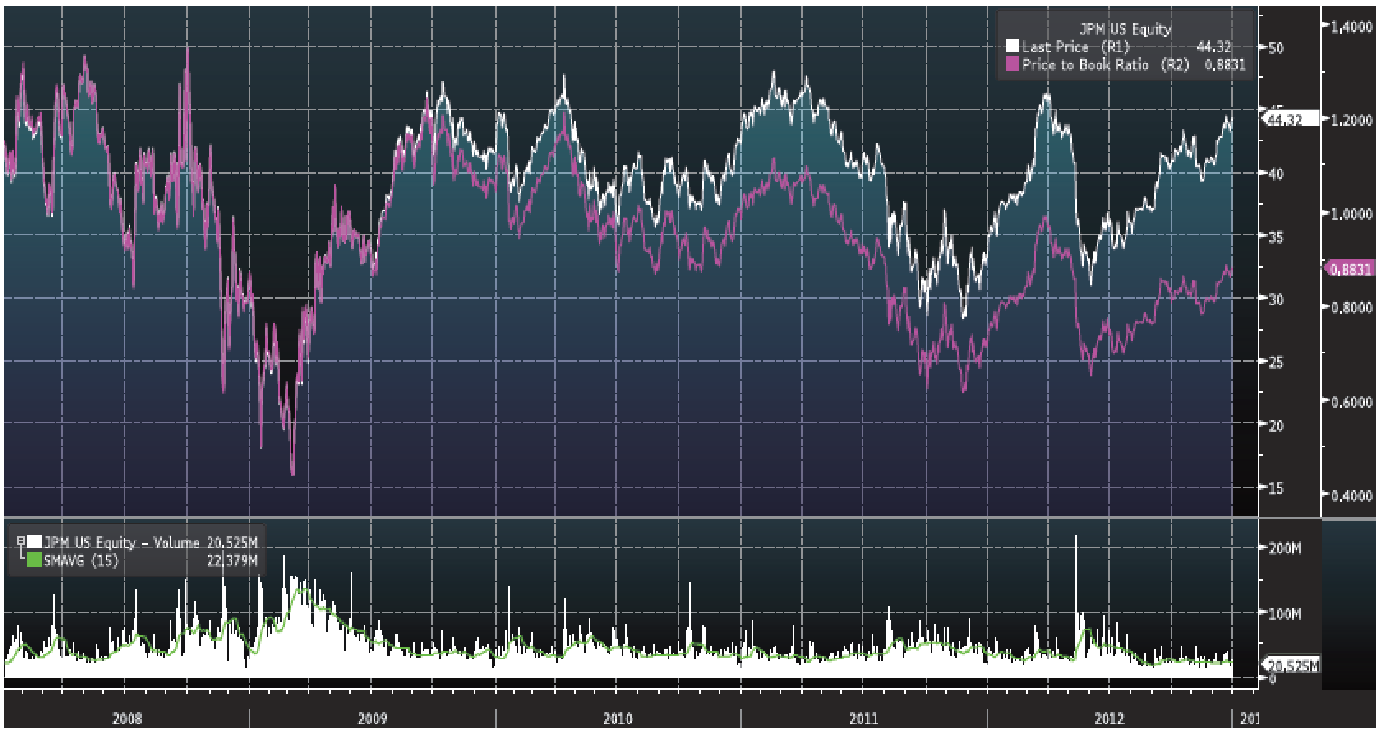
This normalization process is occurring now and will most likely undo the extreme pricing irregularities that have been forced upon the market through efforts to rescue the world's economies from the dire situations they faced as part of the 2008 crisis. Some of these irregularities came about from overt and purposeful efforts, while some arose as unintended consequences relative to those actions.

Like all long-term secular trends, this process of normalization will not be an overnight knee-jerk reaction. Rather, little by little, day by day, quarter by quarter, I expect to see the following irregularities begin to reverse themselves.

Interest Rates: Here's a look at the yield to maturity of generic 10-Year U.S. Treasury, per Bloomberg.

See that incredible drop in the yield in 2008? I wouldn't be shocked to see that thing climb back to the 3-4% range in the next several quarters/few years.

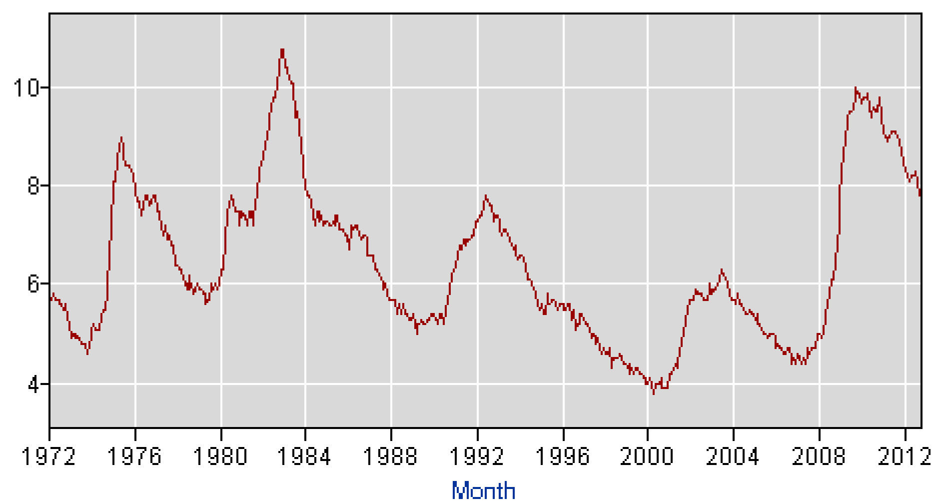
<u>Valuations Metrics (particularly of banks and other financial assets):</u> Here is a price chart of JPMorgan common stock along with its Price to Book Value, courtesy of Bloomberg. Bear in mind, I'm using JPM as a proxy for the financial sector as hole to illustrate this concept.

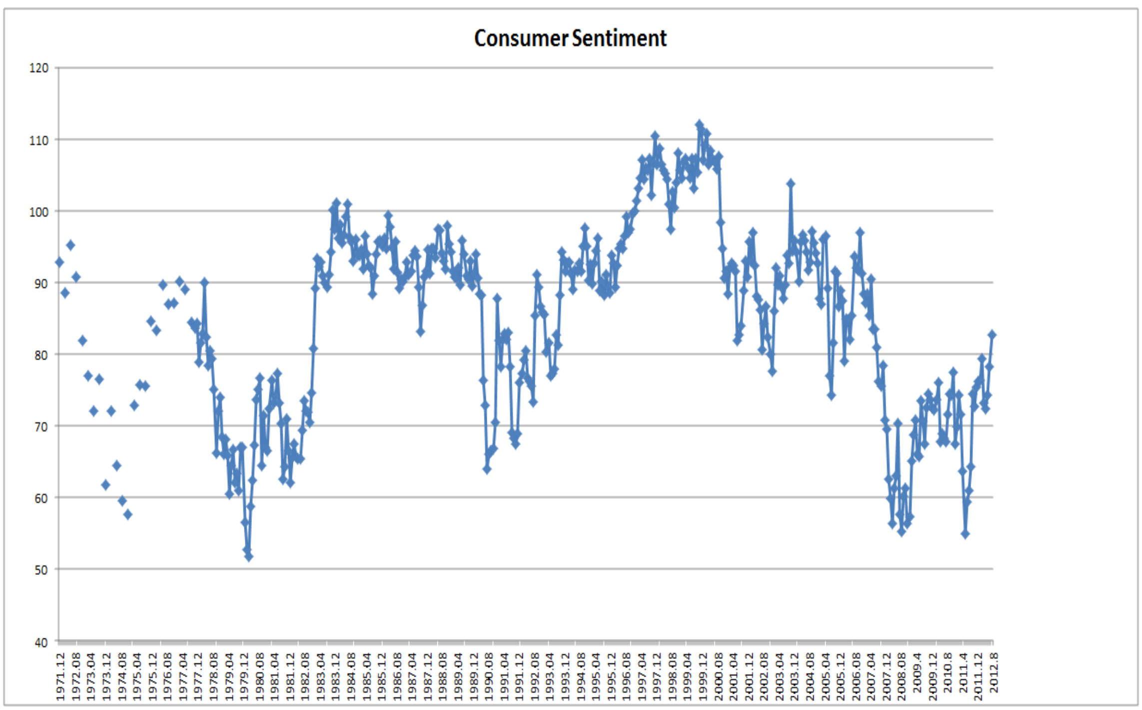


After the 2008 crisis shook the financial world, the stock price of JPMorgan has gone, essentially, nowhere despite book value per share rising over 37%. A return to pre-2008 Price-to-Book valuation levels and a stable Book Value for JPM, implies that this 37% gap will be corrected if this normalization process occurs.

<u>Unemployment and Consumer Sentiment:</u> Given that I feel these are co-related, I wanted to list them together. Businesses, fearing the worst in 2008, had to cut costs quickly. This led to extraordinarily high levels of unemployment, which correspondingly decreased people's outlook on life. Hence, the drop in Consumer Sentiment.

Unemployment Rate since 1972 from the Bureau of Labor



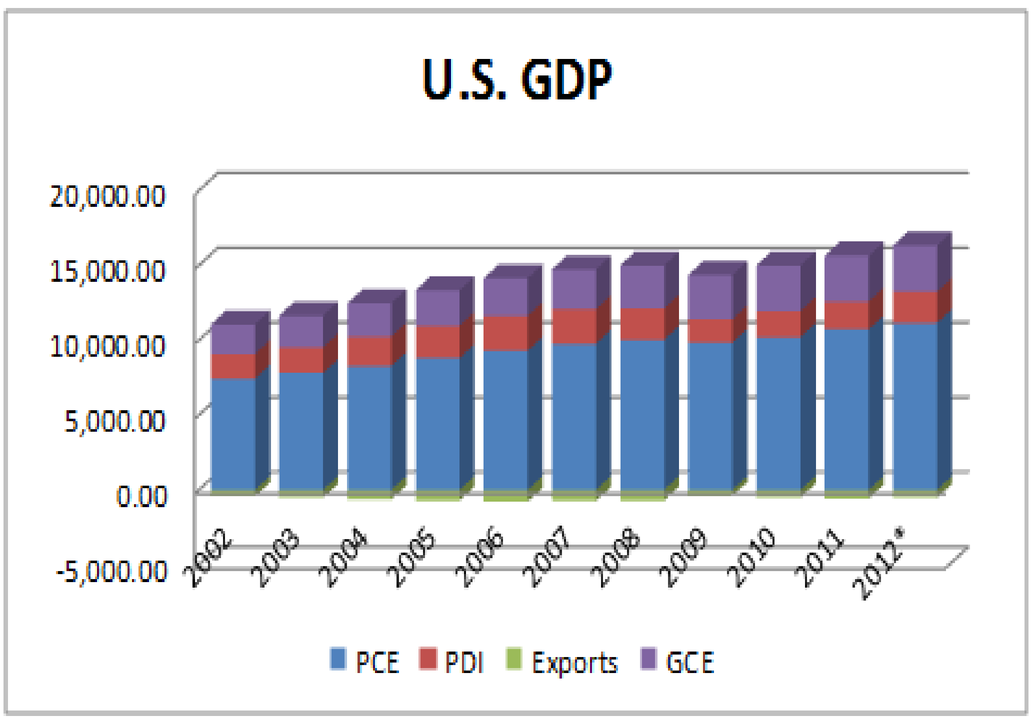


If during this process of normalization, the unemployment level drops, I'd expect sentiment to rise. Then, correspondingly, valuations to rise for the market as a whole with a focus on financials.

And finally, one thing that doesn't need to normalize on a raw basis is U.S. GDP. The latest data shows that on a seasonally adjusted annualized level the GDP of the United States is $15.811 trillion, an all-time high. In fact, U.S. GDP has been registering all-time highs since the 2nd quarter of 2010.

Nevertheless, seeing a change in the composition of that $15.811 trillion figure will be a key sign towards confirmation that this normalization process is moving full steam ahead. Of the four main components of GDP, Personal Consumption and Government Expenditures are at all-time highs, $11.54 trillion and $3.903 trillion respectively. Net Exports is currently hovering n the middle of the range it has been stuck in since 2002, ($516.8) billion. While Gross Domestic Investment remains below its 2nd quarter 2006 high of $2.352 trillion and currently stands at $2.080 trillion.

I believe that seeing an improvement in the Gross Domestic Investment and Government Expenditures ratio just might hold the key to reaching a fully normalized state within the capital markets. Without question, we will be watching as these events unfold.



Data Courtesy of Bureau of Economic Analysis

*2012 is seasonally adjusted data from the most recent (3rd)

Update

I think now is a good time to look back at the ideas put forth when this report was initially written (end of 4th quarter 2012), to see how things are progressing and/or if there has been any changes to the thinking behind the theories.

The four things mentioned to watch in order to gauge how the Normalization process is proceeding were: Interest Rates, Valuations, Unemployment coupled with Sentiment, and GDP.

At the time of the initial writing, the yield on the 10-Year Treasury was 1.78%. As of the close of business yesterday (3/21/2013), the yield on the 10-Year had risen to 1.95%. That is a 9.6% change in the rate and I consider that significant.

Regarding Valuations, the price-to-book ratio of JPM was used as a proxy for financial asset valuations as a whole. At the time of the initial report, JPM's Price-to-Book ratio was quoted at 0.88, now that same ratio is 1.00. That equates to a 13.6% increase in the valuation.

Additionally, Consumer Sentiment stood at 72.9 according to The University of Michigan Survey at the end of 2012. The final February reading of that index stood at 77.6, a 6.4% increase.

And finally, relative to the U.S. GDP the full year 2012 numbers were released. This data showed an increase of U.S. GDP to $15.685 trillion, which represents of 4% increase from the 2011 figures.

In summary, it is fairly clear to see that the Normalization process is occurring. This is something to actively watch and monitor, as the ramifications of it should have an impact on investment portfolios.

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