MRP CAPTIAL INVESTMENTS, LLC

Where Are We Now?

Research Report 11/19/2013

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Inside this report:

Over the last 5 years, we've seen an incredible rise in the value of stock market assets. Below is a table showing the year by year returns of the S&P 500.

2009.........26.46%

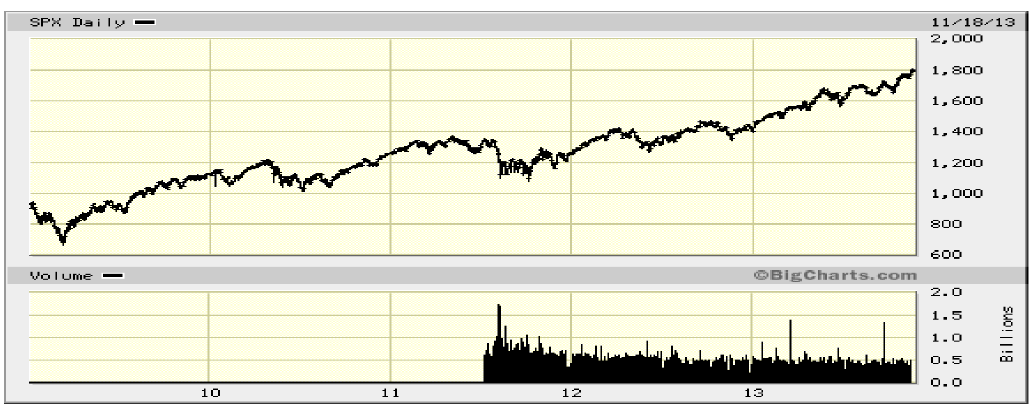
2010.........15.06%

2011..........2.11%

2012.........16.00%

2013.........25.62% (through 11/18/2013)

If you compound the returns listed above, you get a 116.50% return!!!



S&P 500 1/1/2009—11/18/2013 from BigCharts.com

But since we know that past performance is 100% indicative of past performance, we need to turn our eyes towards what is up next for the market. And before we can speculate intelligently on that topic, we first need to fully understand where we are now in the markets.

Current Place and Time

According to my work, we are currently 5 years into a Secular Bull Market run, or a Boom as I call it. Booms, on average, last 18 years. As discussed on the opening page, our current market has appreciated 116.50% since 2009. This equates to an annualized return of 17.59%. Booms, on average, return 14.33% annually and 1,014% from their opening lows. And during the course of this upward move, Bull Markets, on average, experience 5 short-term bear markets (or pullbacks) that average (15.4%) per pullback. We've had 2 pullbacks during our current upward swing.

Using the data from the previous paragraph, it is pretty clear that our current Boom has lots of upside room to run before it even becomes average in nature. In fact, the data on "average Bull Markets" tells us that we've got 13 more years of upside left and 3 cyclical bear markets to deal with.

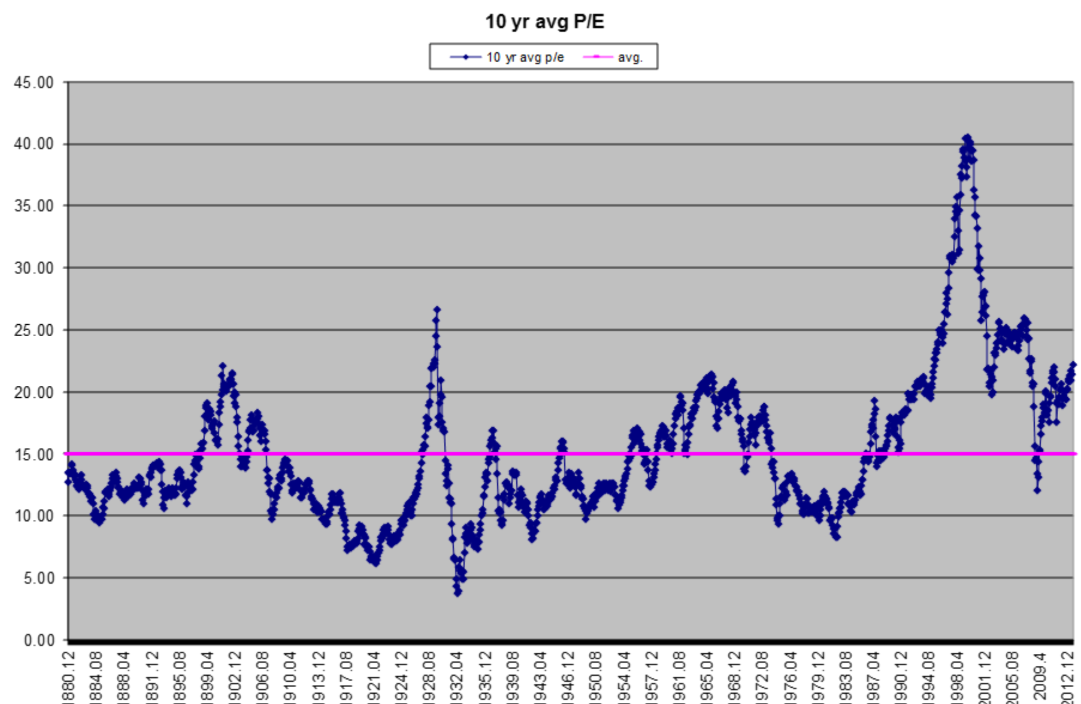
I must admit that 13 more years of market upside is music to my ears, but the fact that we might have to deal with 3 more bear markets, averaging over 15% downside, is the data that is catching my eye.

So I am sharpening my pencil and focusing in on how close we are to the next cyclical bear market.

Bear Hunt

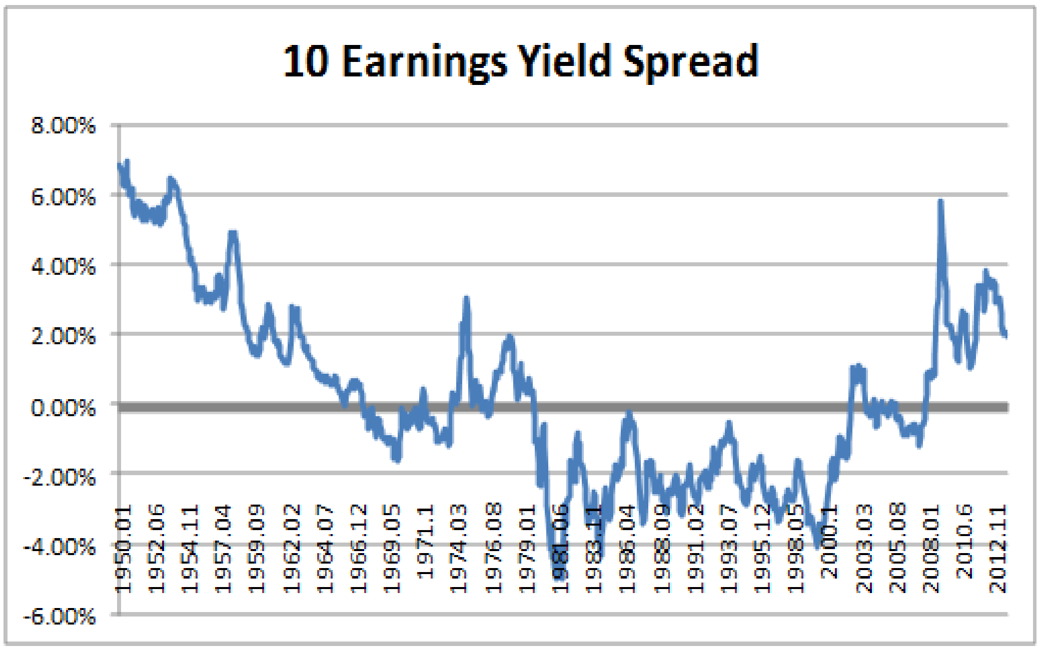
To best assess how close we are to that next 15% down turn, we need to look at some data. As many of you know from my previous writings, I like to look at a few specific indicators to get a sense where the market is within the Behavioral Cycle. To get a very detailed breakdown of the reasoning behind why I use these specific indicators, please re-read "The Holy Grail."

First and foremost, when attempting to gauge the market's place in the cycle an investor must be aware of the market's valuation level; that is how expensive and/or cheap is the market. Rather than the standard trailing 12 month P/E ratio, I like to use the 10 year average P/E ratio. Below is a chart detailing where we are in that valuation continuum.



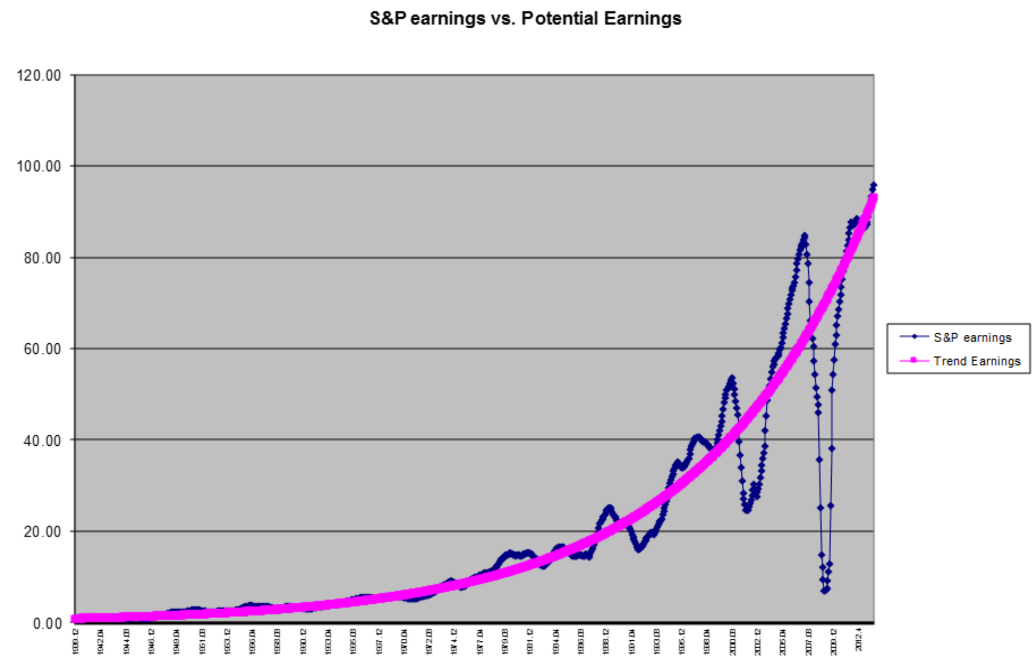
As you can see, the S&P 500 is not cheap. The "easy money" is off the table.

But to just look at equity valuation levels in a vacuum results in a naïve analysis. To get a better grasp on where equity valuations are relative to other investment options, I also look at the Equity Yield (1/(P/E Ratio)) compared to the 10 Year Treasury Yield. This let's us know whether stocks or bonds are the better bet moving forward. The higher the spread the more attractive stocks are, while the lower the spread the more attractive bonds are over the long-term.



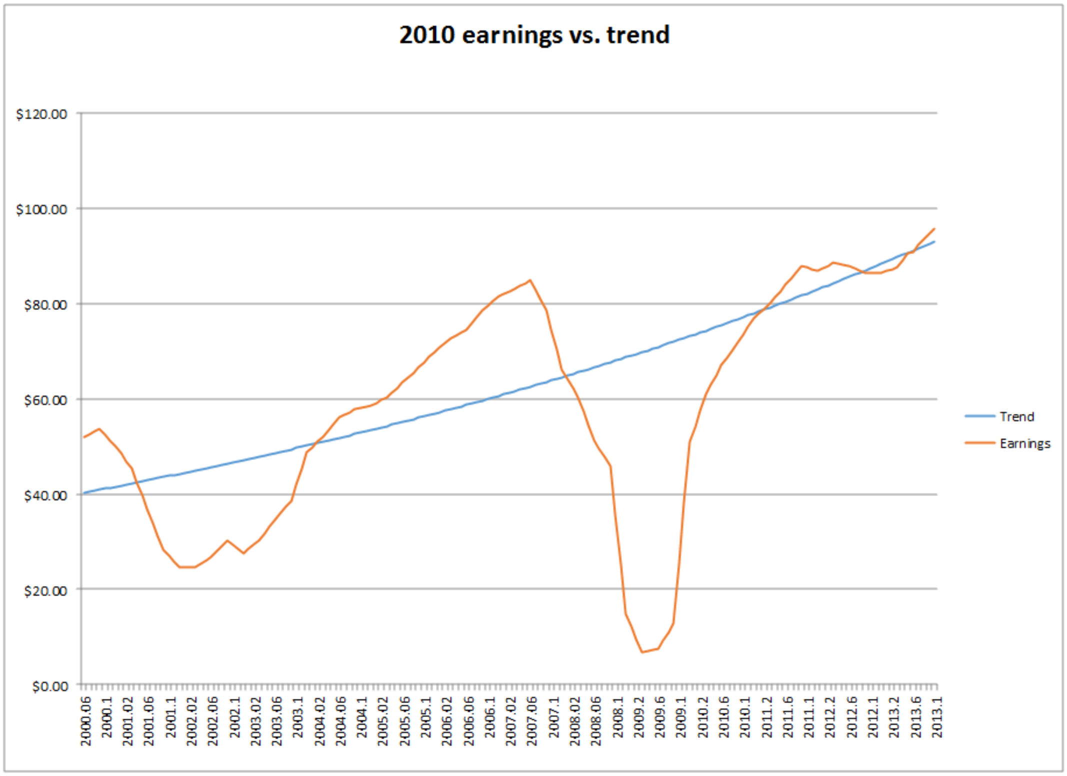
The following chart shows that the risk/return bet favors buying stocks over bonds right now, as either stocks are cheap or bonds are expensive.

The next item to consider is earnings. First, let's look at a long-term chart of earnings versus trend.



As you can see from this chart, actual earning fluctuate around the long-term trend line (a derivation of nominal GDP). And when they become to detached from the trend line, the revert through the mean.

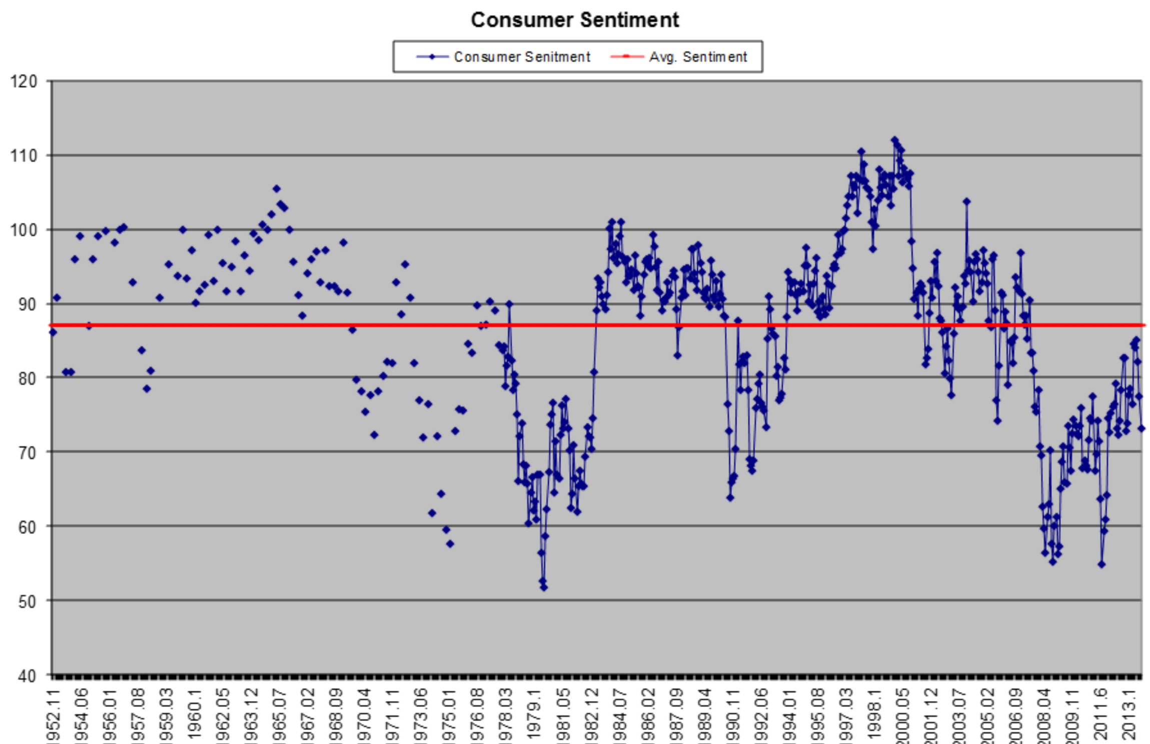
Here is a short-term chart focusing on earnings versus trend from 2000 through the latest 2013 data.



This chart shows that earnings have bounced hard off their lows made in 2008 and they are now hovering right around the trend line.

The concerning thing to me about our current level of earnings is that the Trend line is derived from the historical level of GDP. With our recent GDP growth being well below average, it is likely that the Trend line will move lower over time. This will cause the Current Earnings line to move higher on a relative basis. If this were to occur, it is very possible that earnings are more above trend than the chart is showing. This is certainly a point of concern longer-term.

The last two things that I track are related to the vibe surrounding the markets and they set the table for how the previous two indicators (valuations and earnings) might be impacted moving forward. The first one is the Consumer Sentiment reading.



It is my belief that consumer's drive the markets (again, explained in great detail in my past writings). So, we must track the consumer's mood in order to see what the path of this next trip will be. As you can see, Sentiment is off the lows and trending higher. However, it is still below average and is far from exuberant.

This implies the potential for upward movement in valuations, if sentiment can continue to rise. And that is a great question to have answered; Will Consumer Sentiment continue to rise? To answer it, we need to consider other metrics that could impact the Consumer Sentiment Indicator. Four major influencers of the Consumer Sentiment Indicator are:

-Unemployment levels;

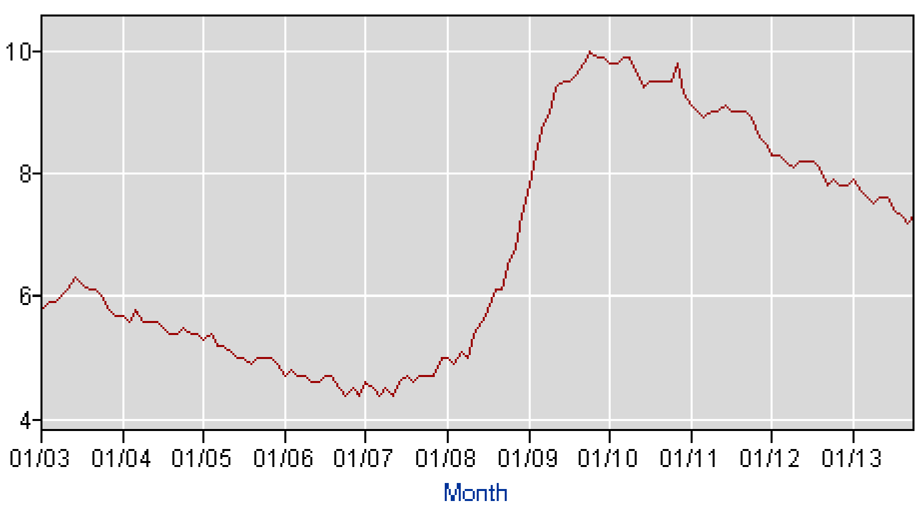
-Income figures;

-Asset Valuations;

-Government Stability.

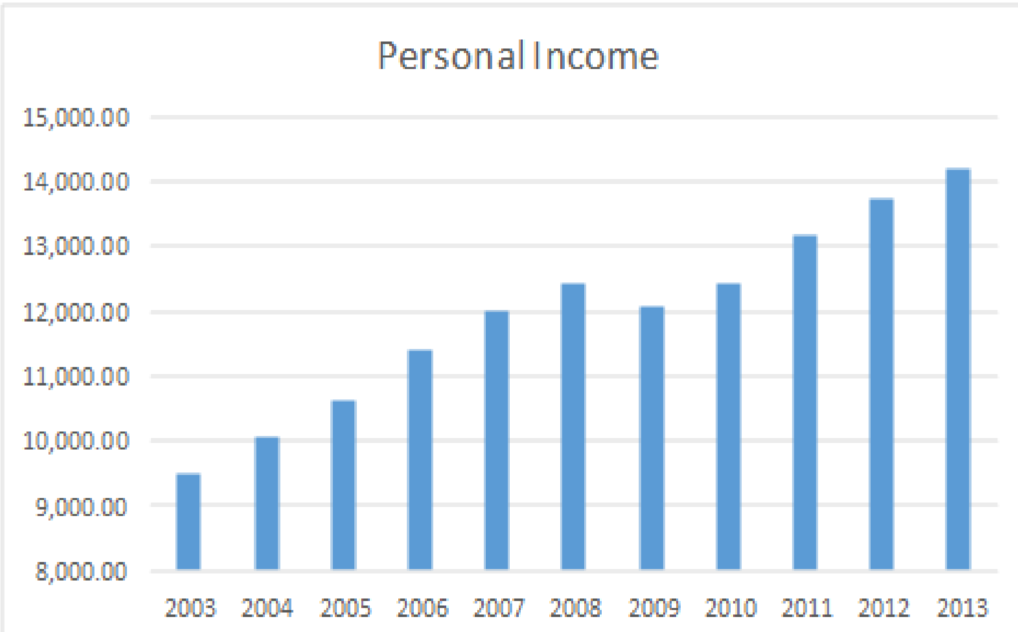
Fortunately, 3 of these 4 influencers have officially released data that we can use to track them with. The fourth, Government Stability will have to be guesstimated.

Concerning Unemployment levels, we certainly have a much better employment picture than we did in a few years ago.



Seasonally adjusted Unemployment rate for 2003-now. Data and chart provided by the Bureau of Labor Statistics.

Using data provided by the Bureau of Economic Analysis, we can see the pretty dramatic rise in Personal Income levels of US Citizens from 2003-now.



And to get a sense of the asset valuation levels for US citizens, I went to the data put out by The Fed. Their work shows the following information, through the 2nd quarter of 2013 (data is in BILLIONS):

	2008	2013	Change
Assets	$71,448	$88,369	$16,921
Liabilities	$14,234	$13,548	($686)
Net Worth	$57,214	$74,820	$17,606

Simply looking at the chart on the preceding page, we can see an increase in assets and a decrease in liabilities of US Households and Nonprofit Organizations to the tune of over $17 trillion.

The final piece of data we will consider when attempting to judge whether Consumer Sentiment will continue its upward path is the stability of the U.S. Government. But, perhaps, "stability" is not the correct term to use. Maybe, "confidence" is a better choice. Are U.S. Citizens, and potential investors, "confident" in the U.S. Government? Again this is a guesstimate, but let's take a peak at a few headlines related to the Government's antics, uh...I mean actions over the last few years. I think you will see that the public's confidence in our Government might not be all that high.

August 6, 2011

S&P Strips U.S. of Top Credit Rating

October 1, 2013

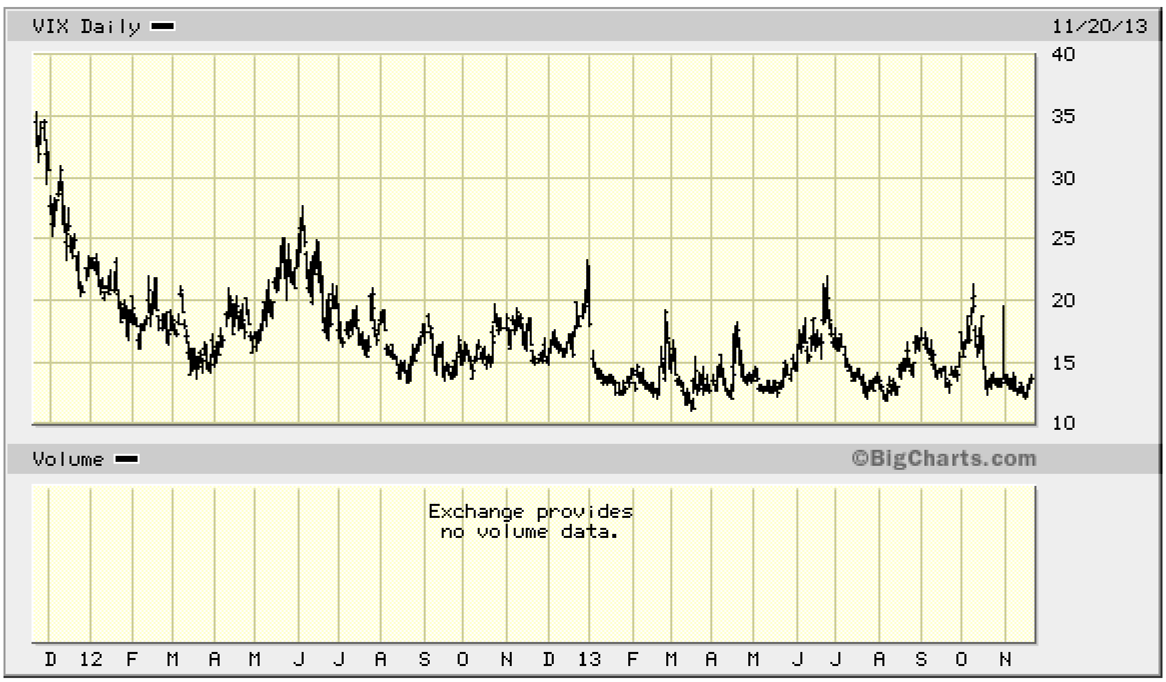
Government shutdown

October 21, 2013

Obama: No 'sugarcoating' problems with health website

In a nutshell, it appears the only thing keeping the Consumer Sentiment from booming is the Government's antics. If they can get their act together, we could be in for a big upside move in the markets.

The fourth and final major metric that I track relative to the market's place and time in the Behavioral Cycle is the level of complacency in the market place. I use the VIX Index to get a sense of this. The major sign I believe I can garner from this indicator is how ripe the market is for downside swings. A warning sign is a prolonged low reading of the VIX. This implies complacency and an over-looking of the risks in the market. Below is a 2 year chart of the VIX Index taken from BigCharts.com.



Looking at this chart, I do not see complacency in the market place. It appears to me that market moving events are accompanied by a spike in the VIX, which is akin to a spike in fear within the market place. This is a normal and positive sign for the market's over all health.

Recap

For a quick recap of what my four main indicators are telling us about the market…

Stock Market Valuations….C

not overly expensive, but not longer wildly cheap.

Corporate Earnings...C-

lurking around record highs for quite some time. This is good, but how much upside is left.

Consumer Sentiment...B+

below average with lots of upside potential.

Market Complacency…B

not lackadaisical, but not in panic mode any longer.

If we aggregate the level of the profit potential within the market using the above grades, we get a C+. What this means is that over the "long-term" we have an above average environment for profit potential. And for a gauge, average market profitability is about 10%.

In light of all this, I do think there is a lot more money to be made in the markets and a lot of time left to make that money. But we need to fully embrace Warren Buffett's Two Rules of Investing:

#1—Don't Lose Money.

#2—Don't forget rule #1.

Now, these are funny rules...but they are mathematically sound. If you play around with numbers, you will note that losing money is mathematically more painful to someone's long-term track record (and an investor's net worth level) than making lots of it during upturns. So, with this in mind we refocus on when is the next Bull Market pullback coming?

The data tells me that, as of right now, a substantial pullback, is not imminent. Related to the data, the two most interesting things to track right now are earnings and Consumer Sentiment. A boost in Sentiment should send the markets higher, while earnings are the biggest downside risk to the markets. Rest assured, these things will be tracked on a day-to-day basis and portfolio management techniques updated as necessary. But for right now, **the Bull Market appears to be very much intact**.

And one closing comment, I am of the mindset that in market that is approaching fair value, stock picking becomes more and more important. Within extremely undervalued markets, you can buy almost anything and make money. Within fairly valued markets (and over-valued markets), investors need to really sharpen up their pencil on individual investments and their risk/return profile. I won't bore you with those details of how I preform bottom-up investment analysis, rather I will point you to the piece I wrote awhile back entitled "Thoughts on Valuation."

With this in mind, I am focused on where the market is...but I'm also drilling down heavily on specific investments.

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