MRP CAPTIAL INVESTMENTS, LLC

Transition

Research Report 03/24/2015

Introduction

Inside this report:

During the Financial Debacle of 2008/2009, a client sent me this cartoon. I've kept it ever since and have shared it with all of my clients because I think, as funny as it is, the cartoon accurately depicted what was happening at the time.

The Rescue Plan

In my opinion, "The Powers That Be" took actions to save the banking system. If any other benefits trickled down to the broader economy, including individuals, that was fine...but the banking system had to be saved. And I feel that this modus operandi has continued to dominate the financial landscape; UNTIL NOW!

Right now, I feel that there is a transition underway within the economy itself.

Why Save the Banks?

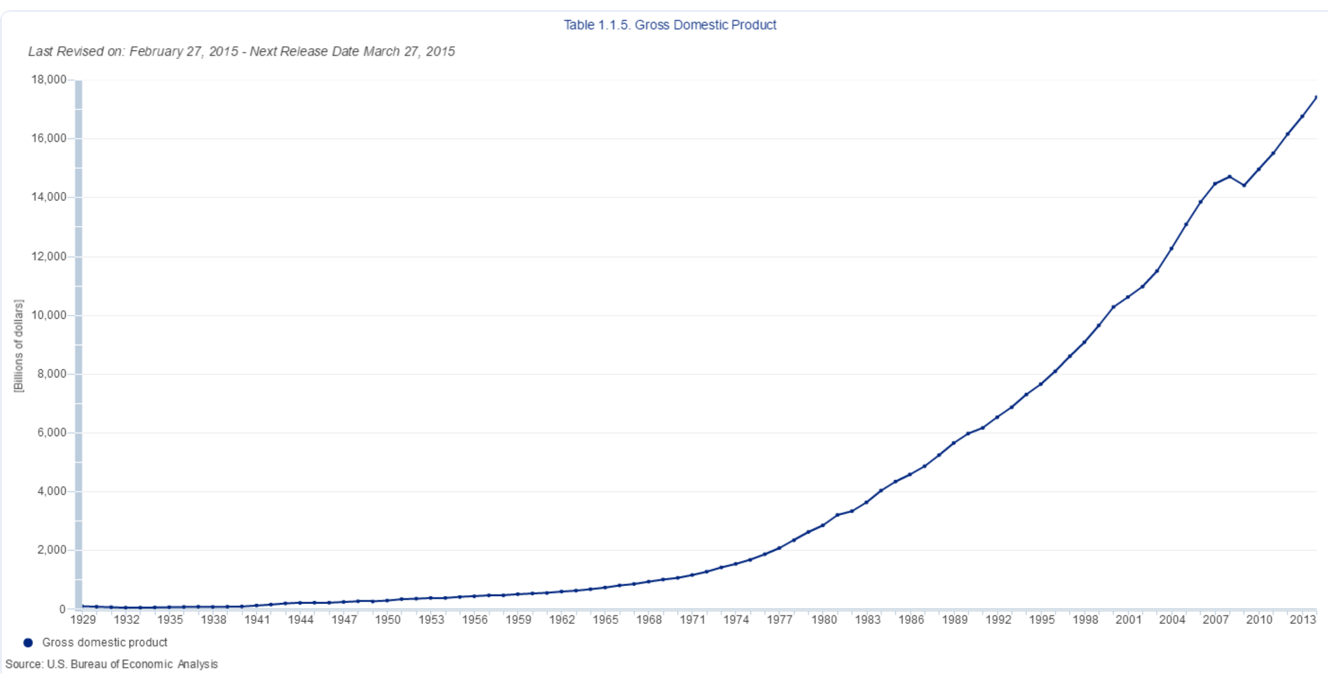
There is, and was, a lot of talk about whether the "bailouts" were the right thing to do. And I want to be crystal clear, I am not arguing for, or against, these actions. I am not saying they were a good thing or a bad thing. You see, as a professional money manager my job is not to make monetary or fiscal policy decisions or even to make political statements. My clients hire me to protect and grow their assets. In order to do this effectively, I must recognize what is occurring and position portfolios appropriately.

For example, if the Fed is making clear signals that it is going to cut rates, then I must position bond portfolios to benefit from this. It doesn't matter if I think the Fed should do that or not. The simple fact is they are giving clear signals they are going to do that. Therefore to fulfill the mandate my clients have charged me with, I must take advantage of that specific opportunity.

With those marching orders in mind, let's take a look at why the banks were saved.

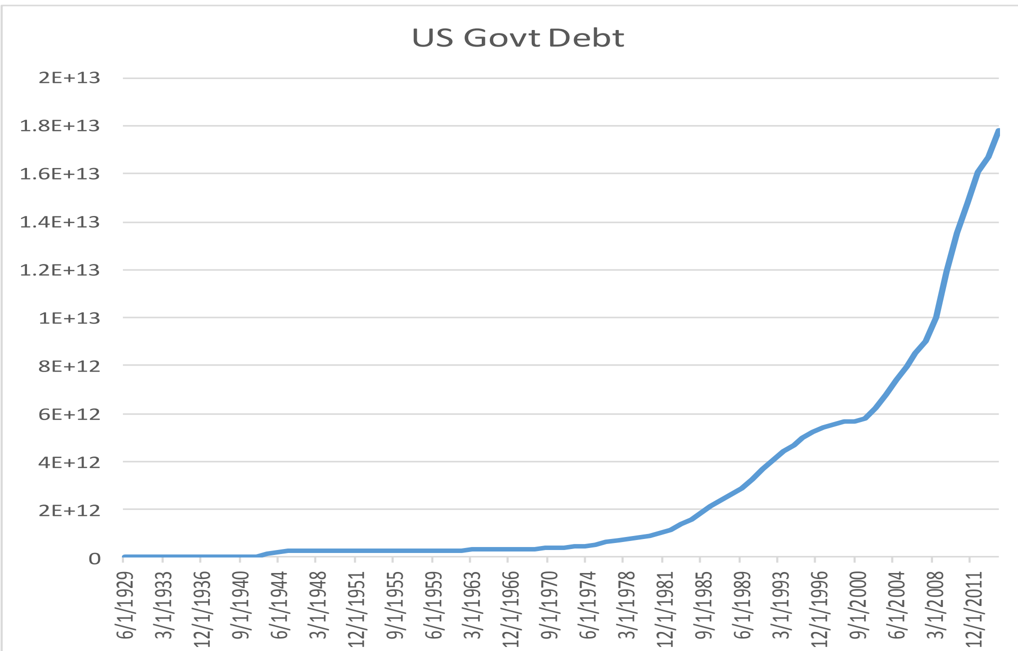
Our economic model is one built on credit, cash flows, and debt financing. To get a sense of just how important these things are to our economy's viability, let's look at some graphs and charts.

For starters, let's look at the Gross Domestic Product of our country. GDP is a measure of all the goods and services produced in a country and it includes all private and public consumption, government outlays, investments, and net exports. I like to think of it as all the stuff our country makes and uses.



Looking at that chart, we can see that the GDP of the United States has increased from $104 billion in 1929 to $17.4 trillion in 2014. Staggering growth, in my mind.

Now, let's take a look at the United States Debt level during that same time.



Data supplied by the U.S. Treasury

Looking at this data we can see that the level of U.S. Government debt went from $16.9 billion in 1929 to $17.9 trillion at the end of 2014.

And if you are thinking the same thing I am; Yes, our GDP and debt are just about equal. So, essentially a years worth of labor and production has been completely financed with borrowed money.

The important piece of information to know with regards to an economy like this is; What happens if that flow of money is cut off? I think this chart of the 37% drop in the S&P 500 for the year of 2008 answers that question.

Chart Supplied by BigCharts.com

You see, one of the main issues with the 2008 crisis was lenders not wanting to lend and the flow of funds being severely reduced...until the lender of last resort stepped in on many occasions to keep liquidity flowing.

And who keeps money flowing, provides funds to businesses, and facilitates the capital transactions? BANKS!!!!!

As you can see, without a robust banking system our current economic system would fail. Therefore, any and all actions necessary to save the banks were undertaken during this crisis.

Did it work?

Again I am not making an endorsement of the actions taken during or after the 2008 crisis, nor am I making a negative statement against them. Rather, I am simply looking at some facts.

Did these actions save the day? That is, did they save our economy from total collapse? Well, let's look at some figures and charts to answer that question.

First off, the stock market; as represented by the S&P 500, has appreciated 209% from the March 2009 lows. So...yes, in terms of stock price appreciation the actions taken worked.

Chart Supplied by BigCharts.com

Another big asset on the bank's and individual citizen's balance sheets is real estate. So, let's look at housing prices.

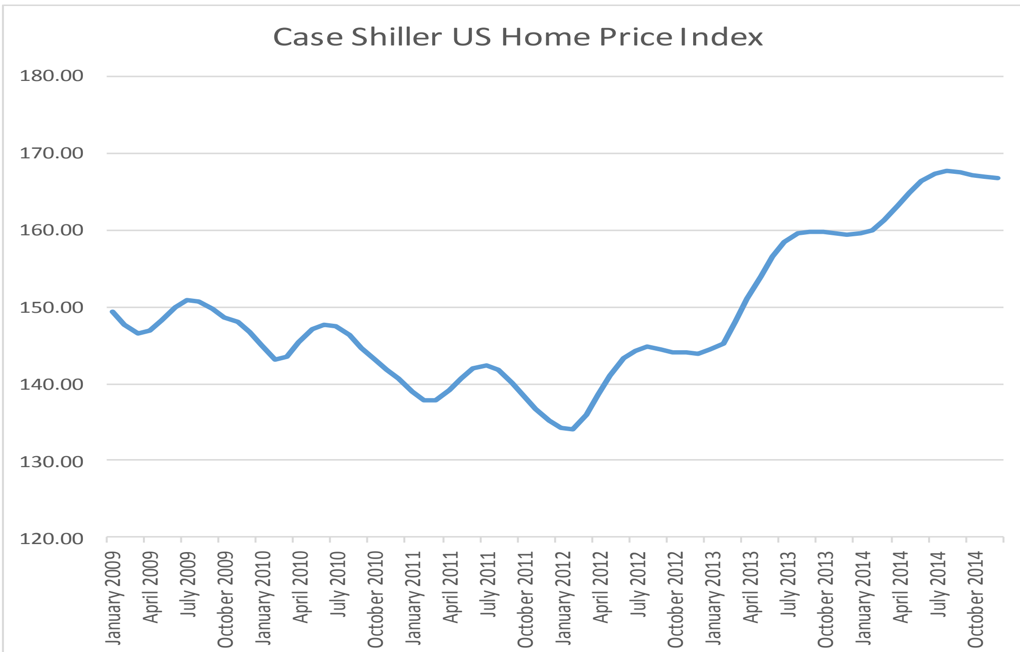
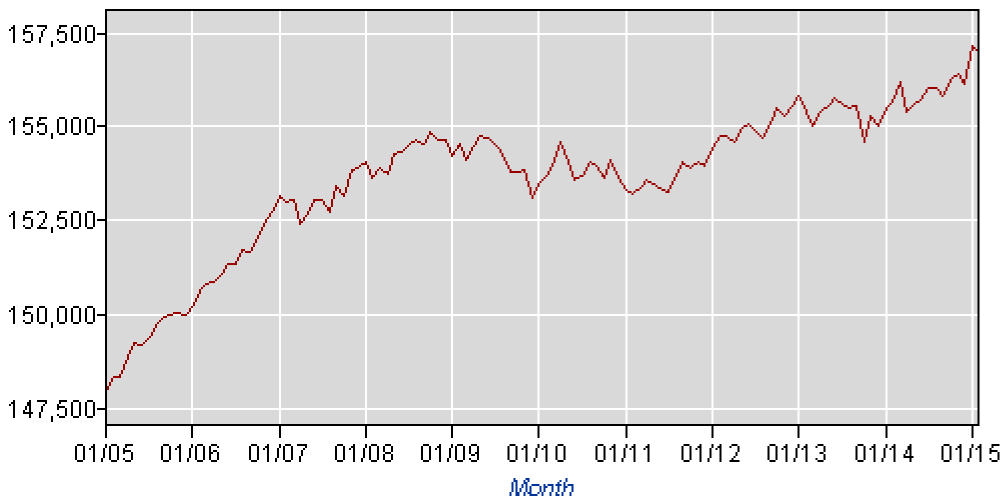


Chart Supplied by Standard and Poors

From the beginning of 2009 until December 2014 (the latest Case-Shiller reading), US home values have appreciated 11.65%. And since the housing market lows in early 2012, home prices have risen 24.4%. Again, looking at this data it appears the actions taken to save the economy have worked and/or are working.

It appears asset prices have risen based on the actions taken by "The Powers that Be." But have the people actually benefitted from these actions? A good place to look to find out this answer is to examine the data on jobs.

A great number to look at is the total number of people working, the Bureau of Labor Statistics calls this the "Civilian Labor Force." And below is a chart they have provided.



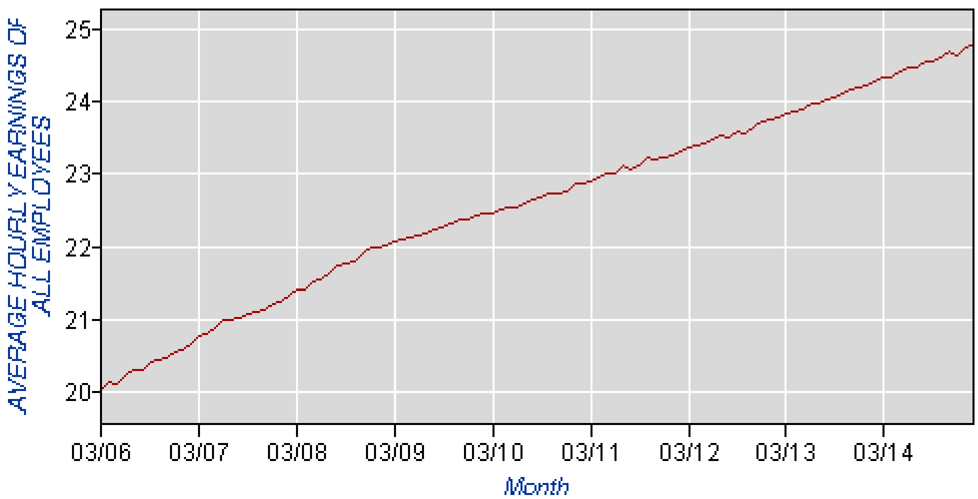
As you can see, there are now more people working in the United States than ever before. In fact, as of February 2015 the Civilian Labor Force totaled 157 million people and in February of 2008 that number was 153 million people. That equates of 4 million more jobs now than there were right before the crisis occurred.

Okay...that is great, right? There are some new jobs out there. But are these people making a good wage?

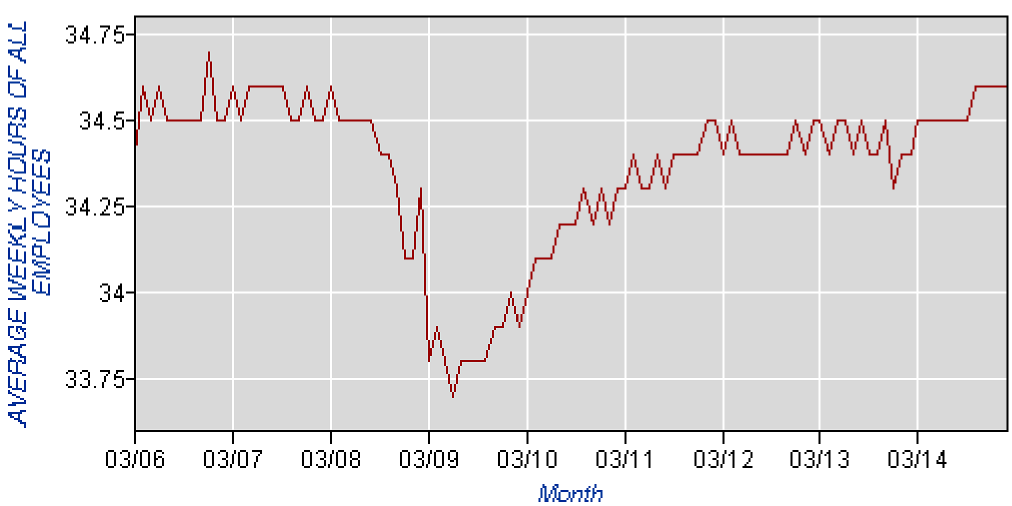
To answer this question, I believe we need to look at two specific data points and then consider a third.

The first two data points are: hourly wages and hours worked. Both of these pieces of data have been provided by the Bureau of Labor Statistics.

Concerning hourly wages, the chart goes straight up. So, wages are fine.



When you look at hours worked, you see what the problem was; a severe dip in hours worked starting in 2008. But you also see that the problem appears to be eradicated as hours worked are back to normal levels.



Looking at hours worked and hourly wages, we can see that the pay for those jobs worked appears to be very robust. But the one thing we need to consider is the cost of living. If we want to get a feel for how close to "normal" life is, we need to get a feel for what it was like before the 2008 crisis and what it is like now. So, let's look at the Consumer Price Index and get a real good idea of what the cost of living has done since 2008.

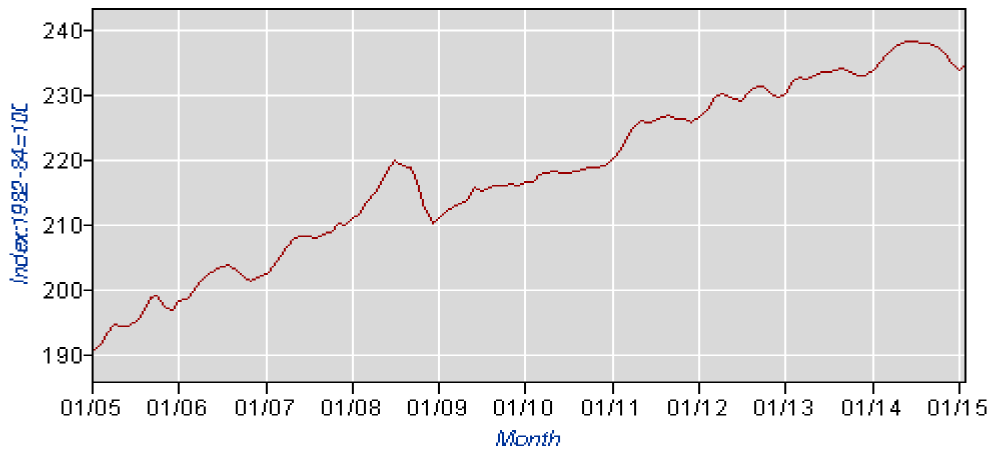


Chart Provided by The Bureau of Labor Statistics

You can see from a quick look that the CPI is way above where it was in 2008. But to get a real sense of how this compares to wages, we need to do some quick math.

January 2008 wages multiplied by hours worked equated to: 732.78.

January 2015 wages multiplied by hours worked equated to: 851.40

This represents a 16.18% rise in money in the average workers pocket over that time frame.

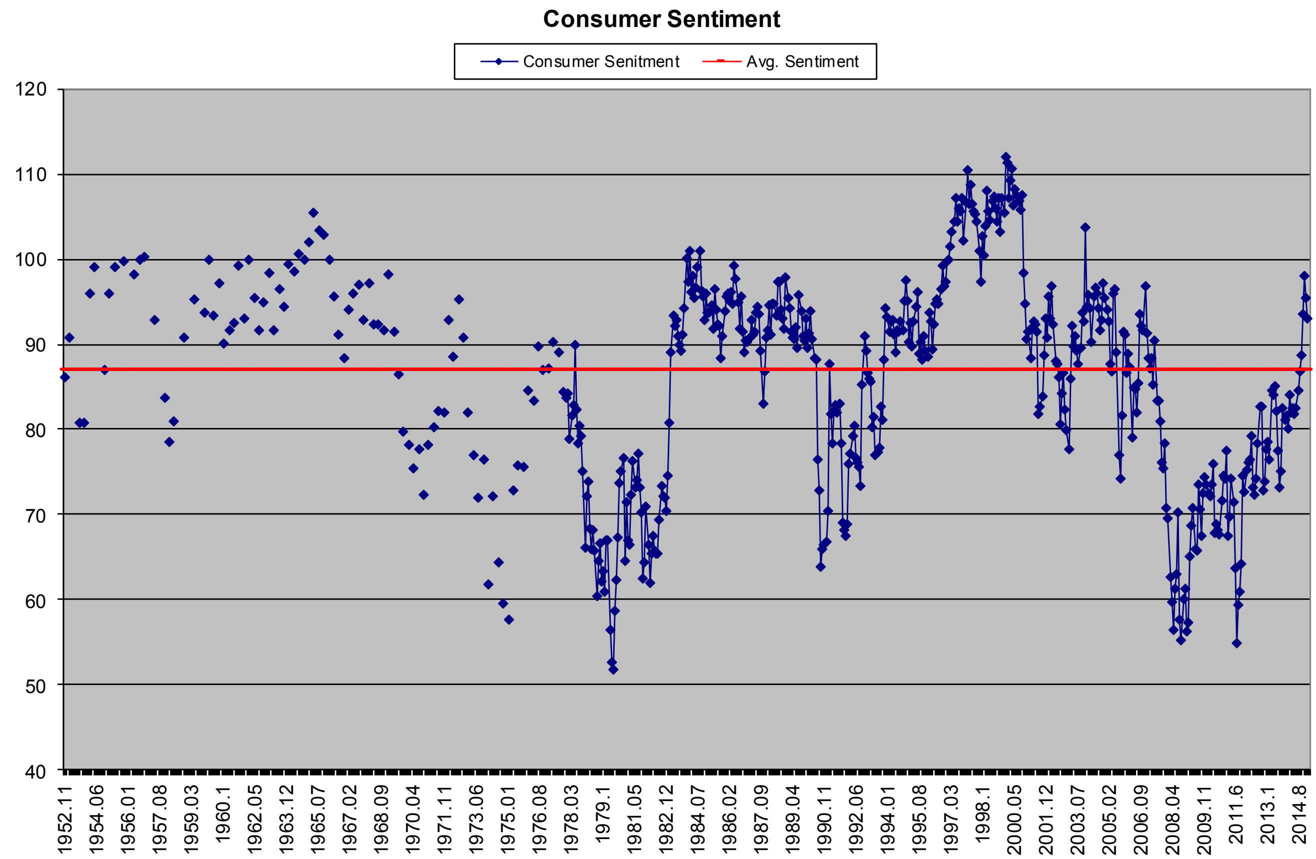
January 2008 CPI level was 211.08

January 2015 CPI level was 233.707

This represents a 10.7% rise in the cost of living during that time frame.

Judging by this, the American worker should feel pretty good about his current economic situation. Not only is the average worker making more money than ever before (on a real and nominal basis), but there are also more people than ever before working.

And in my opinion, this is precisely the reason why the Consumer Sentiment Index has taken such a big move to the upside.



Data Supplied by The University of Michigan Consumer Sentiment Index

Putting all of this data together (rising equity prices, rising home values, great employment changes) leads to a consumer feeling good and optimistic. And that is why I track the University of Michigan Consumer Sentiment Index so closely. It takes all the various pieces of data that could, should, and do have an impact on the Consumer's mood and boils it down into one number.

So, to answer the question posed at the beginning of this section of the report; Yes, it certainly appears that the actions taken by "The Powers that Be" to save the economy have, indeed, worked.

What's Next?

What's next, in my opinion, is a transitional phase. This transitional phase will move us away from a stance that anything and everything must be done to save the banks and into a stance of normalization. An economy with record highs on the stock market, record levels of corporate profits, and with optimistic citizens should not need extraordinary measures in place to "save the economy." In fact, we've already seen some of these extraordinary measures wound down and ended, namely Quantitative Easing. Now, it appears time to begin to take the interest rate levels up a smidge.

What is fascinating to me about this eminent event is the amount of teeth gnashing and ripping of clothes associated with it. Now, I did understand the fear of the unknown associated with the end of Quantitative Easing. And that fear was when the Fed stops buying longer dated bonds, long interest rates will rise. But that didn't happen. In fact, long term rates fell. See the chart of the yield on the 30 year Treasury with the knowledge that the Fed ended quantitative easing in October of 2014.

Chart Supplied by BigCharts.com

In essence, all the fears of sky-rocketing rates associated with the Fed ending its Quantitative Easing program were proven to be unfounded. And this is what gives me the foundation for my belief that the rise in short-term rates will be manageable and controllable.

So with all this in mind, we know that short-term rates will rise. The next question an investor must ask themselves is: What happens WHEN rates go up? Historically, the dollar will strengthen, commodities (in dollar terms) will fall, U.S. buying power will go up, profits from international sales (when reconstituted in dollars) will fall, and U.S. citizens will be able to travel abroad and buy more because of the strength of their currency. Interestingly enough, a lot of that is already happening. Why? Because professional investors already realize that rates are going to be officially raised by our Federal Reserve Bank sometime in the future and they have placed their bets in an effort to get ahead of the curve.

Given the potential for continued dollar strength and where earnings are in relation to "trend", I'd expect profits of U.S. companies to be hurt.

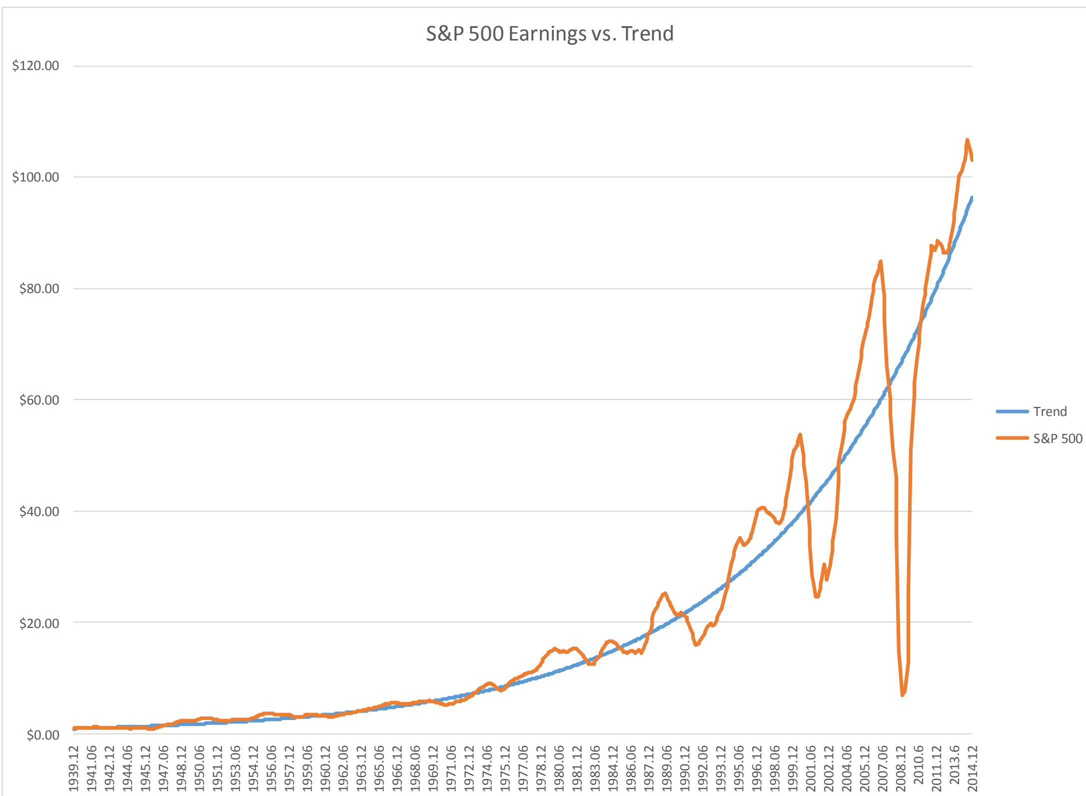


Chart Provided by the MRPCI Database

In general, that is. I believe the pockets of continued profit growth will be in businesses that will do well in the face of a robust U.S. consumer.

And, to me, that will be a key moving forward. In the headwinds of rising rates and all the associated fear of the unknown, we need to find the pockets of profitable investment opportunities. We've seen the data on why the consumer is optimistic. We now need to find stocks that will grow their profitability as the consumer remains confident.

Of course, there are many other areas of potential profitable investment opportunities. Some trends can not be denied, regardless of market technicalities. I think some important ones are: the growth of the population and the growth of technological proliferation within society. Furthermore, there will always be opportunistic trading possibilities; like the ones associated with the current pullback in oil prices.

But aside from these macro-trends and short-term opportunities, I think a driving force behind a continued Bull Market will be the impact on the market of an optimistic U.S. consumer. This confident entity will be armed with a strengthening currency to further enhance its influence on the market.

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