STOLPER ASSET MANAGEMENT
1924 S. UTICA, SUITE 805
TULSA, OK 74104-6516

www.stolperassetmanagement.com

918.745.6060
866.692.3066 Toll Free
918.745.6583 Fax

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Portfolio Comments
For the Quarter Ending June 30, 2015

The Greek philosopher Euripides noted more than 2,000 years ago: "Long-term planning works best in the short term." His advice may be especially relevant in today's investment climate which is suspended in a wait-and-see environment as participants attempt to anticipate the ramifications of the Greek fiscal crisis as well as the fallout from a potential equities bubble in China, and how to navigate the continued uncertainty surrounding the Federal Reserve debates on raising interest rates. At such times we do well to remember that future results depend, more often than not, on having a plan combined with a disciplined approach to execution even through times when the rate of short term progress is frustrating.

One area that did not make much progress for the quarter was the U.S. equities market. The S&P 500 closed on June 30th at 2,058, representing a return of 0.28% for the second quarter, and 1.24% for the first six months of 2015. The Dow Jones Industrial Average (DJIA) ended June at 17,596 for a return of -0.29% in the past three months and 0.03% for the year to date.

Although both of these major indices closed the quarter within a few percentage points from their record highs in May, and have traded within relatively narrow ranges, the headline numbers mask a somewhat uneven first half of the year. As the adage goes, it is a market of stocks rather than a stock market, and there has been some recent sector winners, other industries that started the year strong and have faltered, and a number that are experiencing a downward trend. Among the current winners are the banking sector, which has benefited from a rising interest rate environment and confidence in an improved economy, alongside the healthcare and pharmaceuticals industries buoyed up by the Supreme Court ruling on Obamacare. Not faring so well have been the energy, utility, REIT and transport sectors. Utilities were hit by income-seeking investors lured by rising bond yields and, while energy enjoyed a rally earlier in the year, with oil supply continuing unabated and the U.S. shale industry still suffering, the earnings outlook for the sector is still depressed compared to recent years.

The U.S. economic growth story for the first half of the year looks a lot like that of last year, when a harsh winter contributed to a contraction in the first quarter followed by a strong rebound in the second. The Commerce department reported a contraction in GDP of 0.2% for the first three months of the year, a significant deceleration from the last quarter in 2014 when real GDP grew 2.2%. However, strong home sales, improved wage growth and hiring, as well as a pickup in consumer spending, has led to forecasts for an increase in GDP of 2.7% for the second quarter on a seasonally adjusted annual rate basis, with growth expected to average around 3% for the second half of the year, provided the upturn in consumer consumption is sustained.

One factor driving spending forecasts is the continued low oil prices, which remain around half the recent peak levels achieved in 2014. On the back of this downturn, many expected a decline in oil-related capital spending and a strong upturn in consumer spending. The first has materialized while the second – the "tax-cut" component – appears so far to have mainly translated into cash constrained individuals increasing savings and lowering debt. A barometer of this is evidenced by **Wal-Mart Stores Inc. (WMT-NYSE)**, the world's largest retailer, highlighting the soft retail environment in its latest investor conference call. Still, the expectation is that higher consumer spending will materialize.

The domestic unemployment rate has essentially reached the Federal Reserve's target, turning attention towards inflation figures and the timing of the much anticipated move away from the zero interest environment that has been in effect since December 2008. The June UCLA Andersen Forecast predicts that the quarterly run rate for inflation will be above 2% by the third quarter of this year, thereby fulfilling the Fed's dual mandate. Expectations were that rates may have risen as early as June of this year, but soft economic data has pushed back the likely date of the event until September or beyond. Consequently, the Fed's June meeting failed to live up to its billing as the most exciting one of the year.

As Fed Vice-Chairman Stanley Fischer stated recently: "we are going to be changing monetary policy from the most extremely expansionary we've been able to do in all of history to an extremely expansionary monetary policy." While it would be hard to fathom that an imminent, gradual and carefully-monitored rate rise is not already reflected in the prices of assets, it would also be a mistake to assume that Fed chairperson Janet Yellen considers it her primary duty to implement measures specifically designed to propel stock prices higher. Moreover, beyond the first hike, which is pretty much a near-term given, Ms. Yellen pointed out: "We absolutely do not expect to follow any mechanical 25 basis points a meeting, 25 basis points every other meeting [plan]." Another reminder that predictions of Fed action are, well, just predictions.

Helping keeping domestic rates low will be unusually low interest rates in Europe. The yield on 10-year German Bunds approached zero in April, but have since "normalized" to around 75 basis points. At home the U.S. ten-year Treasury yield has climbed sharply, rising from 1.7% at the beginning of February, to 2.4% by the end of the quarter.

Dominating the headline concerns on an international scale recently, and contributing to the uncertainty that has kept stocks range-bound, has been the saga in Greece, which is balancing on the verge of a Greek tragedy, at least from the point of view of those who view a 'Grexit' (an exit from the euro by Greece) as undesirable. On June 30th, Greece requested a third bailout from the Eurozone in a last-minute effort to secure a debt deal before the country's bailout expired and it defaulted on a $1.7 billion loan from the International Monetary Fund (IMF), one of its three international creditors (the other two being the European Union and the European Central Bank). Greece's plea was rejected and it became the first developed country to default to the IMF, an organization of 188 nations charged with the challenging mandate of trying to keep the world economy stable.

Days earlier, Alexis Tsipras, the prime minister of Greece and leader of the radical-left Syriza party, made the surprising decision to call a referendum on the proposals made by the country's creditors, urging voters to reject them. The reaction of the finance ministers of the other 18 euro-zone states was swift and punitive; together with the IMF, they withdrew the deal on the table that Greece was required to agree to in order to receive further bailout funds. A day later, the European Central Bank (ECB) capped the amount of money Greek banks can borrow from the Bank of Greece under the Emergency Liquid Assistance (ELA) facility. The result was that Greek banks, which had been relying on central bank funding to offset the wave of withdrawals by skittish depositors, were forced to close to avert a total hemorrhaging of their balance sheets. The Greek stock market was also temporarily shut down.

While not trivializing the current crisis for Greece, its citizens and the country's creditors, the larger lesson in retrospect may be centered on the theory that the euro is a single currency in the same sense that the dollar is the single currency in the U.S. The ideal, and perhaps necessary, conditions for a single currency is one backed by a single central bank and monetary policy as well as single fiscal, political and legal authorities. The euro fails to enjoy this confluence of integrated support and instead has been imposed upon nations though laws and treaties. The system works only so long as the constituents – and not just the governing bodies – believe in it. As the deposit flight in Greece illustrates, the contagious fear that euros in Greek banks may suddenly be devalued by conversion into a "new drachma" is enough to bring the economic system to a near halt, even absent a definitive outcome. The reality is that Greece only produces 2% of European gross domestic product, and a default, currency exit, or a departure of the current government is unlikely to engender a global stock or bond market meltdown. The greater underlying fear that has contributed to an environment of muted investor optimism is the more existential question of whether the European monetary union is reversible. The saga continues.

Another international market story garnering worldwide attention is that of Chinese stocks entering correction territory as they lost a fifth of their value on the back of having more than doubled over the past year. Trillions of dollars were wiped out in the last few weeks of the quarter amid dramatic daily swings. In an attempt to engineer a "soft landing" for stocks, The People's Bank of China cut both its one-year lending and deposit rates by 0.25% towards the end of June, in addition to lowering the amount of cash that large banks must keep on reserve by 0.50%. Despite recent losses, the Shanghai Composite has surged over 30% this year, the rise appearing to be driven by puzzling investor exuberance and government stimulus, rather than an improvement in economic or corporate fundamentals.

On a final note, while we resisted the temptation to print our newsletter on rainbow colored paper, a domestic piece of news that reverberated worldwide was the Supreme Court ruling in June to legalize same-sex marriage throughout the country. In doing so, it could be said that the Court significantly improved

Republican presidential prospects in 2016 by removing a losing issue for the Republicans from the agenda. Their prospects may be further improved if some clarity can be reached as to who the party will choose as their candidate for the White House. On the last day of the quarter, straight-talking New Jersey Governor Chris Christie became the fourteenth major contender seeking the GOP nomination. He faces a tough opponent in current frontrunner Florida Governor Jeb Bush. On the Democrat side, Hillary Clinton remains clearly in the lead in the race to clinch her party's nomination, although polls currently show Bernie Sanders, a 73-year-old lawmaker, closing the gap.

Meanwhile, as always, we continue to carefully monitor events and opportunities, with a continued focus on sector and company fundamentals, which continue to be the catalyst for long-term individual stock performances even in a prolonged environment of subdued overall market movements. Weakened global demand and a strong dollar have continued to put constraints on growth opportunities for certain industries, fueling record levels of stock buyback and M&A activity as a means to augment earnings before a return to more organic growth. Against such a backdrop, we believe it is even more advantageous to embrace our strategy of seeking to identify and hold high quality value investments at prices that are reasonable or below our perceived intrinsic value. We wish you and your families a summer that is both restful and more exciting (in a good way!) than recent market performance and look forward to a productive second half of the year. We sincerely thank you for your continued confidence and trust.