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Portfolio Comments
For the Quarter Ending September 30, 2015

Simply put, it has been a turbulent quarter. Economic woes in China cast a pall over worldwide growth prospects, while Europe grappled with an exploding migrant crisis, commodity prices continued to slide, and the Federal Reserve once again held off on raising interest rates, but this time from a position of being cornered by outside factors. The result was that equity markets in the U.S. and abroad took a battering.

We understand that having a long term perspective doesn't render market correction events any more palatable, but during such times solace may be gained from the advice of a sage with many decades of investing experience; the sage of Omaha in this case. In sharing his own approach, Warren Buffett remarked: "I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years." It is a direct echo of our investing philosophy of looking for high quality assets that can be held for long periods of time. We eventually anticipate making gains on the success of the underlying businesses, not the vagaries of outside factors and investor sentiment in the interim. While we'd prefer the markets to stay open, we appreciate your patience during periods they do not go in the desired direction.

The S&P 500 closed on September 30th at 1920 representing a return of -6.43% for the third quarter, and -5.27% for the first nine months of 2015. The Dow Jones Industrial Average (DJIA) ended September at 16,284 for a loss of -6.99% in the past three months and -6.96% for the year to date. In dropping, most precipitously in the latter half of August, both indices entered correction territory, which is generally defined as a negative reverse movement of at least 10% to adjust for overvaluation.

In looking for explanations, the big news was China. In a country not known for its transparency, what news that was coming out of it wasn't positive. Headlines revolved around the 40% plunge in the Shanghai Stock Exchange Composite Index between its 52-week peak in June and the trough at the end of August. The index has since recovered some and, given the precipitous run-up preceding the crash, the market is down less than 3% for the year and still up almost 35% over the past twelve months.

Stolper Asset Management is a Registered Investment Adviser that offers investment advisory services to private and institutional clients.

We utilize a disciplined, fundamental approach, applying rigorous, independent research with the objective of delivering long-term performance that achieves the investment goals of our clients. We offer managed equity programs with a value-oriented focus, in addition to a balanced managed program with a higher current income priority, as well as tailored fixed income advisory services.

The headline numbers aside, what really sent sympathetic tremors around markets abroad was the glaring fragility of the touted global recovery and the dent in the credibility of policy makers and regulators charged with buoying up the system when needed. China is the second biggest economy in the world, after the U.S., and its GDP represents over 15% of the global economy. As the country's economy attempts to shift towards consumption over export-led growth, the rate of this growth has slowed to 7% on the back of three decades averaging 10% a year. While some gripe that this 7% may be significantly overstated, the figure translates into a rate that is almost three times that of the west's star performers; the U.S. and Britain.

China's response to the 2008 crash was to flood the economy with public investment leading to almost 80% growth over the seven years to 2014, during which time the U.S. delivered 8%. The result was a Chinese economy dependent on credit. According to World Bank figures, China's debt-to-GDP ratio currently stands around 228%, the highest of any world economy. While the level is startling, of more concern is the 47% hike in this number over the past five years since a quick rise in leverage is a good indicator of future financial stress. Mitigating this statistic is the fact that the majority of debt is between state-owned institutions, dampening the possibility of a full scale crash.

However, the risk of a credit crunch and capital flight is real. The ineffectiveness of the Chinese government's measures (including a mini-devaluation of the Renminbi) to quell panic selling on the exchanges, and generally restore confidence, has underlined the fact that the powers-that-be in Beijing do not control the economy. A further devaluation may be the ultimate solution but would inflict considerable financial pain given the US$3 trillion of foreign debt racked up by Chinese companies while the Renminbi appreciated.

The China slowdown is a major contributor to the hurt currently felt by commodity producers in the energy, agriculture and metals sectors worldwide. In fact, the end of the 1990's was the last time commodity prices have been so depressed compared to equities. To the bewilderment of some, however, production in many cases is continuing unabated despite the evident over-supply in raw materials. Cost-cutting, inexpensive credit, cheap labor in local currency terms, and the ability of major producers to weather the price storms are driving the supply glut. If prices stay depressed eventually the crunch will come, output will decline and we'll see industry contraction in the number of players through closures and consolidation.

While the label "made in China" had been affixed to worldwide market malaise, the country's economic model may not be so much broken as a victim of stagnation in the rest of the globe. The unrelenting crisis in Europe contributed to a contraction in global trade in the first half of this year that was the largest since 2008. As the reluctant poster child for the strained Eurozone system, Greece is still struggling but continues to swallow the bitter pills of fiscal constraints and austerity that came with the country's €86 billion (US$95 billion) bailout in July. A snap general election in the middle of September led to the re-election of the left-wing Syriza party led by Greek Prime Minister Alexis Tsipras. The victory was a surprise to some and a close call resulting in a slimmer coalition majority. The voter turnout was a somewhat apathetic 55%; understandable after the fifth general election in six years and a large number of abstentions in protest of Mr. Tsipras' about-turn on pledging to end austerity.

A sixth election may be closer on the horizon than anyone wishes.

An international leader that didn't fare so well this quarter was the Australian prime minister, Tony Abbott, who was ousted from his role by his Liberal party and replaced by Malcolm Turnbull. Mr. Turnbull, a straight-talking lawyer with a successful business background, maybe shouldn't get too comfortable, as he is the fourth politician appointed to the post in just over two years. At play is a changing political and demographic climate with an increasing presence of urban professionals whose vote is not tied to any particular party allegiance. The party in power is consequently highly focused on a current leader's prospects in upcoming elections rather than their performance in previous. Mr. Abbott's fate wasn't helped by economic growth limping along at 2%, which despite the hurt inflicted by the current commodity slump and reduced demand from China, is below the country's potential.

Back in Europe, the issues are not just political and economic but very much immediately humanitarian with hundreds of thousands of migrants from disadvantaged and war-torn regions attempting to flood into safer countries with the resources to help. Refugees from Syria, Kosovo, Serbia and other countries are storming the borders of front-line and other states such as Germany, Italy and Hungary and, tragically, sometimes perishing in their attempts. After a previous quota system agreed in July failed to address the scale of the issue, the end of September saw a new, larger system approved. Germany's size and willingness has meant it has shouldered the largest part of the burden, although it has been strict on its acceptance criteria. Understandably the country is keen to share the responsibility. At this time, the crisis has yet to be stabilized, let alone resolved.

The government isn't the only Germanic entity under immediate pressure. In the corporate world Volkswagen's reputation was severely rocked by the revelation that it has falsified pollution tests on diesel cars worldwide, which permitted them to pass America's strict NOx-emission controls. The fabricated results were the result of software installed on the vehicles that was then deactivated outside the lab testing environment, sending the cars out on the streets churning out fumes at up to 40 times permitted levels. VW's CEO, Martin Winterkorn, was quick to resign to be replaced by Matthias Müller, and the company has set aside €6.5 billion (US$7.3 billion) to cover direct costs and fines. While superficial parallels may be drawn to the company and industry impact suffered in the wake of the **B.P p.l.c (BP-NYSE)** gulf disaster, the dumfounding fact here is that the acts were deliberate. Studies show that vehicle exhaust fumes are linked with tens of thousands of deaths a year in the U.S. alone each year, so this crime is far from just monetary. Questions raised for the huge global car industry as whole, and the apparent non-independent nature of testing, should have real ramifications for a long time to come. It appears that a regulation overhaul is necessary in Europe and likely beyond. The scandal may also provide a boost to electric cars.

Back home, economic focus was once again on the Federal Reserve ahead of its rate-setting meeting on September 16th. While market consensus for a while now has been that the central bank would move away from its zero interest rate policy before the end of the year, as the meeting date loomed opinion shifted back towards maintaining the status quo so as not to risk a setback in the American recovery. As it transpired this opinion prevailed, and the benchmark rate remains at zero.

On the face of it, domestic numbers look encouraging; the economy grew at a 3.7% annualized rate in the second quarter of 2015 and in August the unemployment rate fell to 5.1%. While inflation has remained stubbornly below the Fed's 2% target for the past three years, the expectation is that increased employment will boost wages and lead to higher prices. Depressed oil prices and a strong dollar should also eventually reverse, pushing inflation in the desired direction. The problem with theories are that they are just that and there are other interdependent forces at play. A Fed move to tighten while the global economy is faltering is a risky move that could drive the dollar up more and put a further squeeze on American exporters as well as hurt worldwide prospects by drawing foreign capital to the U.S. On balance, the Fed is credited with making the right decision for now in extending the waiting game, but it's one that cannot play out forever. Past is the era when poor economic news came with the silver lining of more rate cuts and quantitative easing. Furthermore, the sentiment that central banks act as some kind of safety net for markets and help to dampen volatility is waning.

With little over a year until the next U.S. Presidential election, the campaigns are gathering steam and front-runners are emerging. Since 1972 (the year that anti-war activist George McGovern won the Democratic nomination, only to be annihilated at the polls by Richard Nixon) every nominee has been a former senator, governor or vice-president. So while Donald Trump has been grabbing the headlines and a level of popular support, endorsements and campaign funds raised tell a different story. With Scott Walker bowing out of the race, the two credible candidates among the fifteen contenders for securing the 2016 Republican nomination are now Jeb Bush and Marco Rubio. Mr. Bush has raised $120 million, well over twice his nearest rival. On the Democratic side, Hillary Clinton remains the frontrunner by a large margin despite the controversies she is facing surrounding questionable choices made in her e-mail communications while Secretary of State. In the meantime, Vice President Joe Biden is making overtures about mounting a challenge, but nothing is official yet.

In conclusion, the macro picture is looking a little shaky at present and the markets are a barometer of this. At such times it is even more important to focus on quality stocks and other investments that can withstand the storm. Not because such assets are immune to a downturn in prices, but because they will eventually emerge strong and the fair value associated with such quality will be recognized. So this is where we continue to concentrate our efforts; on aiming to build and maintain portfolios that are populated with investments that we believe are trading below their intrinsic value and will eventually outperform the market over complete cycles. Circling back to Mr. Buffett, he once advised: "Be fearful when others are greedy and greedy when others are fearful." While we consider ourselves neither greedy nor fearful, we are optimistic and believe we will look back on this period as a time of opportunity. We are, in others words, prepared to be patient and we wholly appreciate that you are also.