Update and MCS Q2 2015 Outlook

<u>"Turn, Turn, Turn"</u>

"Turn! Turn! Turn!"
To everything - turn, turn, turn
There is a season - turn, turn, turn
And a time to every purpose under heaven
A time to gain, a time to lose
A time to rend, a time to sew
A time for love, a time for hate
A time for peace, I swear it's not too late.

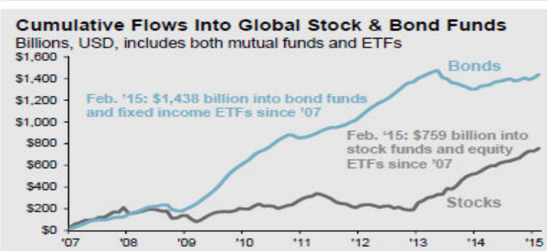
The American rock band called the Byrd's stated the obvious in 1965 the year this song was released. The times were turning then, just as they are now. The focus of this Outlook is on "the time to gain and time to lose" part of the song which we will apply to investing- and we will allow the poets, social activists and dreamers to decipher the rest of the song. The song was written by Pete Seeger in the late 1950's, adapted from Chapter 3 of the Book of Ecclesiastes in the King James Version of the Christian Bible. The concept is clearly ageless and simplifies cycle theory. A transition or a turn does not take place in a moment, but occurs over a period of time as it did during the Vietnam War era when the song became an international hit. To summarize our Outlook:

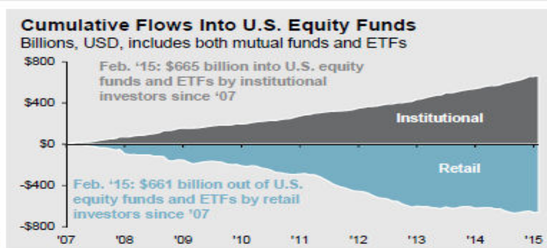
- The MCS strategy differs from traditional stock and bond trading as it seeks to reduce volatility for investors while achieving positive absolute returns during the full investment cycle.
- The methodology: tactical trading, investment flexibility and being asset class agnostic are key to the strategy which has allowed our almost 10 year track record to beat the S&P 500 by 70% during this timeframe with a much smoother ride.
- Update on the Central Banks
- The latest data on the US economy and the fundamentals of US Companies
- Briefing on other Asset Classes
- When can investors expect the next investment from MCS and what are the most likely areas for investment?

By nature, Americans are impatient and want changes to happen immediately. The somewhat recent additions of email, voicemail, social media and mainstream news assaulting us 24/7 have most likely accelerated this predilection. Americans receive our news on the go- via snippets such as WTOP in Washington, DC and CNBC scrolls on the bottom of the screen each day, and investors often interpret these messages as the entire story. The MCS investment strategy combines short, mid and long term goals in investing, since we assume investing is for the rest of our life (or the entities life in the case of a foundation, endowment or pension fund). There is a time to be born and a time to die after all. There are times in an investing cycle that test the mettle of any strategy- it was 1987, 2000-02 and 2008-09 for long only strategies suffering severe downturns in bear markets. Absolute Return and Tactical strategies have suffered of late; some of our competitors have had large downturns, even 12-20% just last year, compared to our slightly positive return. The benefit of the MCS strategy through combining principal protection and asset appreciation is that the protection of principal piece allows our firm to keep principal intact evidenced by no negative years. This allows the portfolio to compound but does not discount our focus on profits which will be covered in this Outlook. Performance for Tactical Growth (0.54% gross) and the Hedge Fund (1.50% net) were positive in Q12015, and Tactical Moderate portfolios were flat. MCS Tactical Growth long term annualized performance of 8.4% (gross) over 9 ½ years compares with a 5.2% annualized return for the S&P500 during the same time period. Investors focusing on just the last few years will have to find another story during the next phase of this investing cycle.

The Federal Reserve stopped printing money in October of 2014 and investors perhaps assumed the markets would move accordingly and quickly. Transitions typically take time, and when the US markets experienced a quick 'V' shaped downturn in October just after the Fed announcement, many investors were worried. The October downturn occurred in a timeframe of positive fundamentals for the sectors MCS made investments into and ultimately the bulk of the downturn was attributed to the Ebola scare. This downturn contributed to the demise of approximately 1000 Hedge Funds and many individual traders. Despite this downturn, the US markets have since consolidated into a sideways channel. Many entities in the US stock market such as mutual funds, ETF's, institutions and others cannot 'go to cash" and have to be almost fully invested. If the chart below from JPM highlights the flight from the US equity markets during the last decade, one must ask themselves- who is buying stocks and why have the US markets lately struggled to go up if the Fed is out of the game? The chart below shows $60B in outflows from domestic equities while inflows in global equites have been positive since 2008. The bottom right of the chart shows retail investors have been out of the market since 2007, while institutions are in.

		Mutual Fund Flows																	
Billions, USD	AUM	YTD 2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Domestic Equity	6,441	8	(60)	18	(159)	(133)	(81)	(28)	(149)	(68)	(3)	17	100	120	(25)	57	258	176
World Equity	2,200	13	85	141	7	4	57	26	(80)	142	151	107	72	24	(4)	(23)	58	11
Taxable Bond	2,951	20	16	(13)	256	129	221	301	22	100	44	21	0	40	125	76	(36)	7
Tax-exempt Bond	577	7	28	(58)	50	(12)	12	70	8	11	15	5	(15)	(7)	17	12	(14)	(12)
Hybrid	1,392	6	27	71	45	40	35	20	(26)	40	20	43	53	39	8	7	(37)	(13)
Money Market	2,678	(48)	6	32	4	(85)	(455)	(444)	624	570	220	41	(175)	(273)	(62)	354	133	183

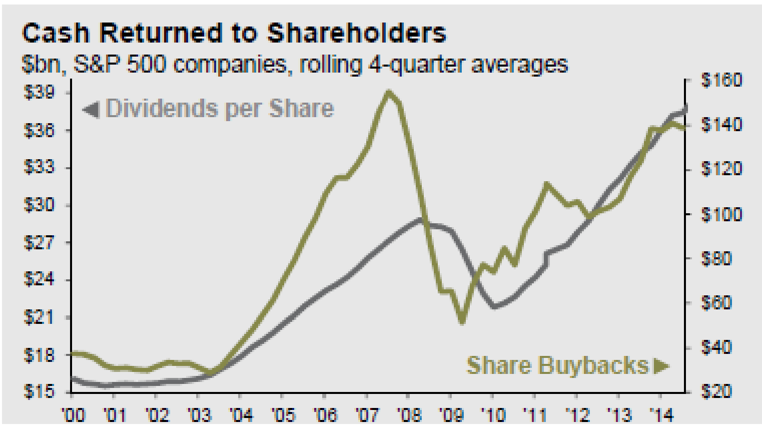




Source: Investment Company Institute, J.P. Morgan Asset Management.
TOP: Data includes flows through February 2014 and excludes ETFs. BOTTOM: Data includes flows through February 2015 and includes ETFs. ICI data are subject to periodic revisions. World equity flows are inclusive of emerging market, global equity and regional equity flows. Hybrid flows include asset allocation, balanced fund, flexible portfolio and mixed income flows.
Data are as of March 31, 2015.

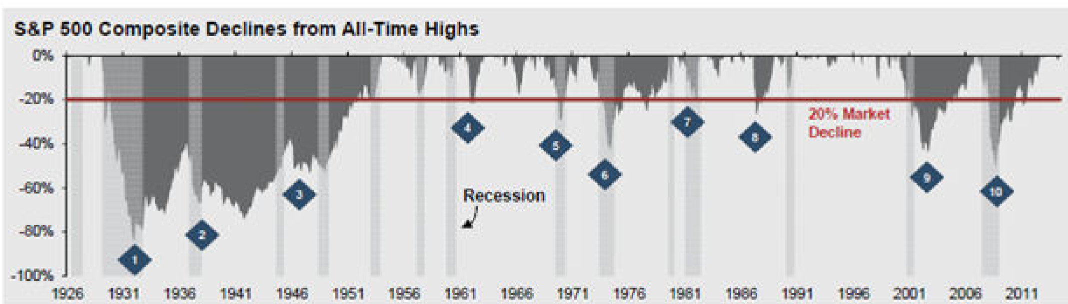
J.P.Morgan
Asset Management

The in-depth MCS analysis has highlighted that corporate stock buy-backs are one of the main reasons the US Markets are elevated. Our Q42014 Outlook discussed this in depth and our blogs have illuminated some of the newer players in the stock buy-back game such as General Electric. The MCS strategy is predicated on certainty and yes- it has been difficult to invest with certainty since the meltdown of 2008-2009 for professionals that are not just asset allocating. However, we are only concerned with investing today and in the future. A useful chart from JPM shows what occurred the last time stock buy-backs hit such a massive level-to put it in perspective, once the buy-backs slowed the market did as well.



MCS has committed equity capital on four different occasions since 2009 which ended each year positive. It may be beneficial to review those trades, especially for those investors that don't fully understand the Fed distortion. For investors that may not know, MCS management has invested their own funds in this strategy since the early 1980's. The US had a Federal Reserve then, just as we do now and they have been active the entire time engaging in such activities such as: raising rates, operating Permanent Open Market Operations (a small version of QE) and engaging in full blown QE all along the way. Despite this, MCS has also identified eight low risk time frames to invest successfully since our official track record began in 2005. It is not uncommon for investors to forget about the downturns and take relatively high risk bets on the market. We have personally seen this happen in 1987, 2000 and 2008 and we see the same phenomenon now. Today, MCS has plenty of 'dry powder' available to exploit the markets. If other managers are fully invested, they must sell something to buy another investment. The money management industry is the only industry we know of where people clamor to buy something right after they sell something else. Imagine investing in commercial real estate, selling and making a profit- then having to find another good investment immediately- whether it is available or not? Most investors should wait until the next low risk investment came along, but in our world this is a novel concept. It is also important to state that a ten year track record is rare for an investment company on Wall Street. While they do exist for some asset classes like US Large Cap Managers, the Morningstar database, (which tracks thousands of managers) reports that fewer than 50% of all managers have a 10 year track record and for those managers not in a very basic strategy the numbers are much smaller than that. We will also explore where these low risk profitable investments in the market will come from- especially since the Feds have quit easing, at least for now.

Distortion is a word MCS is fond of because the unprecedented money printing by the US Central bank has caused severe distortions. Another term could be mal-investment. During the entire history of the markets there has never been a time that the Federal Reserve pumped $3.4T into the markets. The next closest time period would be the Great Depression when they pumped the maximum allowed by law at the time, and on a relative basis did not come close to today's unprecedented dollar amount. The $3.4T is not as important as the ratio of debt to GDP. Debt needs to be paid back and if the ratio gets over a certain percentage it becomes almost impossible to do so without disrupting asset markets, especially credit markets.   In a high conviction strategy, one would be guessing that this printing would have worked alone, while the fundamentals and economic numbers were subpar. Since October of 2015, the market has been transitioning from the Fed easing and has basically been flat. Markets that are not distorted go up and down based on fundamentals and economic numbers; this is very positive signal for MCS to participate in the marketplace.   Historically, it is normal to have a 10% correction approximately every 2 years, a 20% correction every four years and a 25-40% correction every four to seven years. We can see through the chart below during the economic winter cycle of 1929-1950 that these corrections occurred more frequently, just as one should expect today based on where we are in the cycle.



Characteristics of Past Bear Markets

◆	Market Corrections	Cycle Peak	Bull Market Duration (Months)	Decline from All-time High	Recession	Commodity Shock	Fed Tightening	Extreme Valuations	Commentary
1	Crash of 1929	Aug 1929	37	-84%	◆			◆	Excessive leverage, irrational exuberance
2	1937 Fed Tightening	Feb 1937	22	-74%	◆		◆		Premature monetary tightening
3	Post WWII Crash	May 1946	48	-54%	◆			◆	Post-war demobilization, recession fears
4	Flash Crash of 1962	Dec 1961	14	-22%				◆	Flash crash, Cuban Missile Crisis
5	Tech Crash of 1970	Dec 1968	73	-29%	◆	◆	◆		Economic overheating, civil unrest
6	Stagflation	Dec 1972	29	-43%	◆	◆			OPEC oil embargo
7	Volcker Tightening	Nov 1980	31	-19%	◆	◆	◆		Extremely high rates to reign in inflation
8	1987 Crash	Aug 1987	59	-27%					Program trading, overheated market
9	Tech Bubble	Aug 2000	118	-42%	◆			◆	Extreme valuations, mostly in tech stocks
10	Global Financial Crisis	Oct 2007	55	-51%	◆	◆	◆		Leverage, housing, Lehman collapse

Source: Standard & Poor's, NBER, FactSet, Robert Shiller, J.P. Morgan Asset Management.
*A bear market represents a 20% or more decline from the previous market high.
Data are as of March 31, 2015.

J.P.Morgan
Asset Management

MCS can/will and has invested in bounces in the US equity market, when our risk criteria are met- while other strategies that are fully invested cannot take full advantage of these bounces. That being said, it is highly likely the next investment will probably not be in the US equity markets if a correction, then a bounce does not ensue. Should markets correct in the short term, (which is very likely), healthcare and technology are the sectors still most likely to outperform. The downturn in the Energy sector may not be fully complete, but when it is, a low risk bounce is also expected in this asset class. Emerging markets, an inverse bond move, and a precious metal move are all under consideration for our next move into the marketplace.   A synopsis is included in the separate sections below on for more detail.

Investors may also like to know how long they can expect between trades. During the MCS official track record, the strategy averaged 1.5 equity trades per year. Over the full history of the strategy, an average of 2 equity trades a year has occurred over the past 30 plus years. There is a time for trading and yes, recently, there have been fewer trades.   We can expect to have some years of 2 or more trades as markets regress to the mean. It is highly likely we will trade each and every year because of basic fundamentals returning to the marketplace. This concept may seem strange to some, so let's clarify further. Markets are returning to a normal environment which reacts to economic and fundamental factors. We also now have historical data on what actually occurs when the Feds interfere and distort the market to such a large degree. That means if QE4 should take place, we would enter the market, but if it doesn't- we will enter during the bounces in the best performing sectors in the US equity market. Plays on other asset classes in the market (previously mentioned) will also materialize since the distortion is dissipating thus there will be times of outperformance in these asset classes.

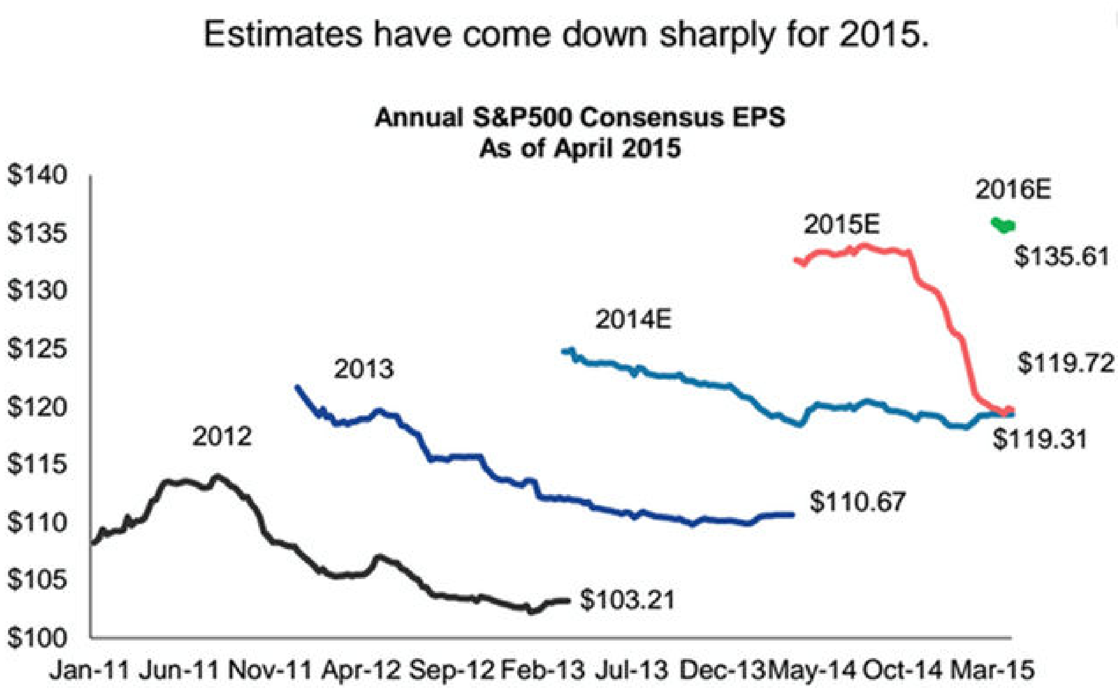
ECONOMIC INDICATORS-

While the numbers appeared to be improving into Q42014, they have again regressed with a lowered GDP outlook for 2015, low non-farm payroll number, and wage growth stagnating and stale housing numbers. Here is the table for all 25 economic indicators updated at the end of Q12015. As one can observe from comparing what are healthy numbers and the current numbers, the US economy continues at a subpar pace.

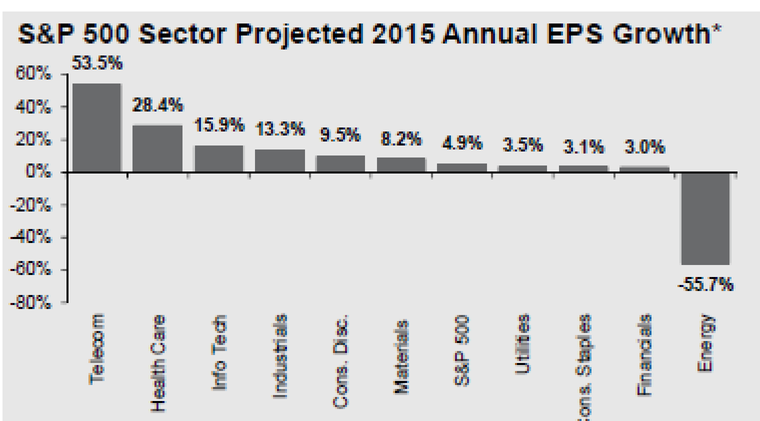
Economic Indicators April 17 2015			
	TARGET	LAST	CURRENT
Automotive Sales	19M	16.7M	17.2M
Consumer Credit	5-6B YoY	14.8	15.5
CPI	2.2-2.6%	0.7%	0.2%
Jobless Claims (Initial Claims)	290-350K	304K	294K
Retail Sales	2.5-2.7%	-0.8%	0.9%
Michigan Consumer Sentiment	90+	98.1	93
Personal Income and Consumption	1.0-1.5%	0.3%	0.4%
Balance of Trade	0	-46.56	-35.4
GDP	3.3-3.7%	2.6%	2.20%
Foreign Exchange Rate	1	0.95	99.6
Productivity and Cost Target	1.5-3.0%	-1.8%	-2.20%
Employment Cost Index (Yearly)	3.0-3.4%	0.6%	2.20%
Hourly Earnings	2.0-3.0%	0.5%	0.30%
Non Farm Payroll	250-300K	257K	126K
PMI	50-59	54.2	59.2
Business Inventories	0.4-0.6%	54.0%	0.30%
Capacity Utilization	80-83%	79.7%	78.4%
Durable Goods	1.2-1.5	0.3	-1.4
Industrial Production	1.0-1.4%	-0.1%	-0.60%
Existing Home Sales	6M	5.04M	4.88M
New Home Permits	1.4-1.6M	1.032M	1.039M
New Home Sales	600K	481K	539K
New Home Starts	1.4-1.6M	1.089M	926K
Wholesale Inventory	1.0-1.5%	0.2%	0.30%
PPI	2.3-2.9%	1.1%	-0.80%
*LAST - MCS last update 2/12/13			

FUNDAMENTALS-

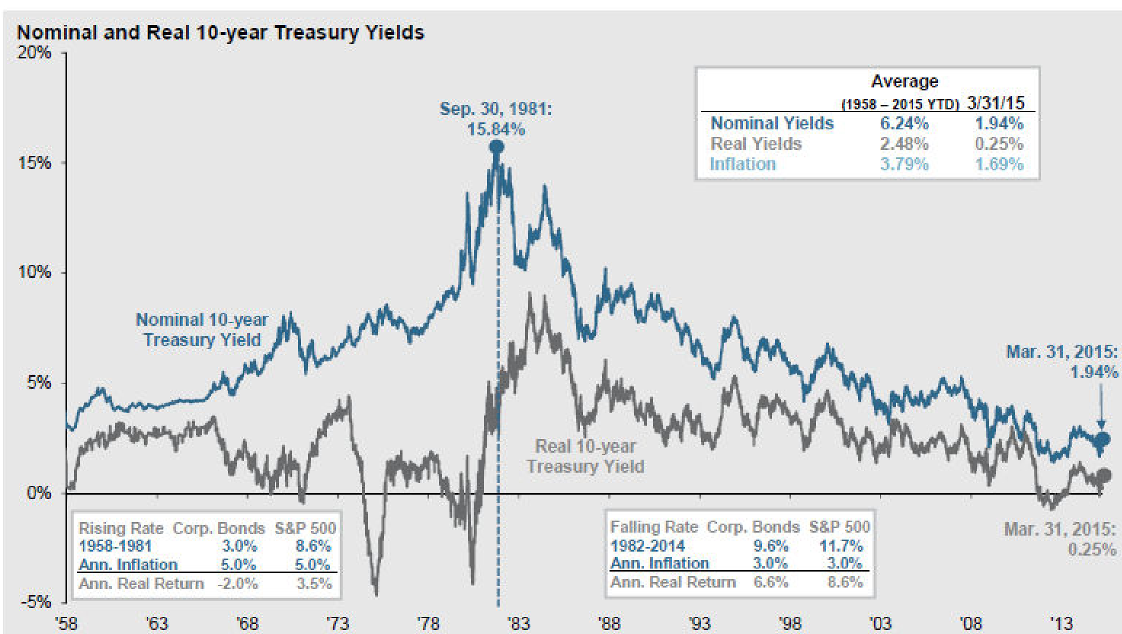
The fundamentals of US Companies in many cases are declining. The chart below illustrates one of the major reasons for a US short term correction. Earnings are being taken down faster than we have ever seen them in our entire careers and even JPMorgan noticed the steep decline.



The price earnings multiple today is sitting at 17.4 but should be more in the 14.8 range. We are repeating the same information from our Q1 2015 Outlook verbatim, "Times of anomaly in the markets occur during periods of transition such as we have experienced the past few years via massive Fed intervention and gargantuan buyback programs which circumvent normal investing. Should economic and fundamental conditions fail to improve and the P/E multiple drop to a proper valuation of about 14, investors could expect to see at least a 20% drop in the S&P based on earning expectations for 2015. Should fundamental and economic conditions actually deteriorate; the drop could be much greater." The chart on the left confirms our outlook for relative positive earnings growth in technology and healthcare during much of 2015.

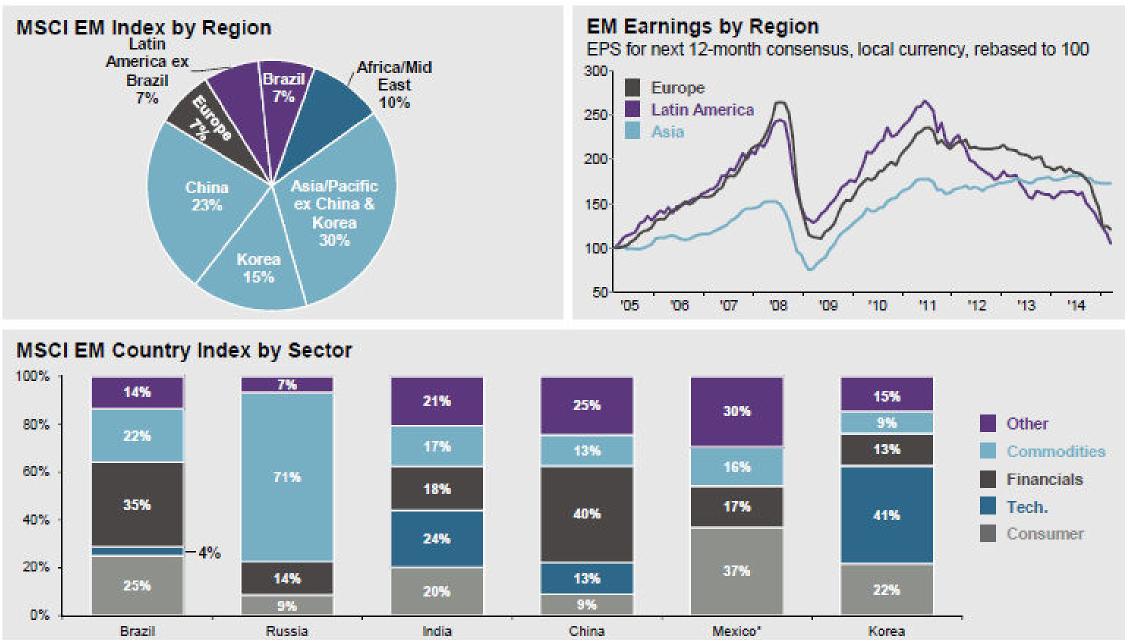


THE BOND MARKET- The twelve Federal Reserve Presidents from across the country have been on major speaking campaigns. Interestingly, it does not matter when the Fed's raise rate because they have covered their bets on the timeframe for raising rates from the meeting at the end of April to the middle of 2016. Basically, one of the Presidents has discussed all of those dates during a presentation or prepared speech. Today, the US 10 yr. yield is sitting at 1.94% and the 30 yr. yield is 2.58%. This pales in comparison to the 25% of sovereign debt issued today which carry negative yields. In addition, two first times ever events happened last week in the Bond market: Mexico issued a 100 year bond priced in Euro's at a yield of only 4.2% and the Swiss issued a negative 10 year bond! Should you be recently retired, you can only bemoan the 1980's- not for the disco scene- but for the low risk high yields of 10 year Treasuries, over 15.8%. The risk being taken on by investors recently is amazing, so we have included a chart we have used many times- Fixed Income Yields and the price impact of a 1% move in interest rates. MCS fully expects the inverse Bond play to be one of the most lucrative in terms of profit terms for our portfolios. The charts below explain why-but the TIME has not yet arrived. We will analyze and monitor the situation until the Turn in the bond market but will not try and front run it as many have tried unsuccessfully to do in the recent past to the detriment of their portfolios.



Source: Federal Reserve, BLS, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for March 2015, where real yields are calculated by subtracting out February 2015 year-over-year core inflation. All returns above reflect annualized total returns, which include reinvestment of dividends. Corporate bond returns are based on a composite index of investment grade bond performance.
Data are as of March 31, 2015.

EMERGING MARKETS- The P/E multiple for Emerging Markets is approximately 6 compared to 17.4 for US Markets. This is an asset class we had used successfully a few years ago and will use again as earnings outperform and multiples increase.



Source: MSCI, FactSet, J.P. Morgan Asset Management. "Other" is comprised of Health Care, Industrials, Telecom, and Utilities sectors. *Mexico Telecom. sector accounts for 20% of the country's market capitalization. Values may not sum to 100% due to rounding.
Data are as of March 31, 2015.

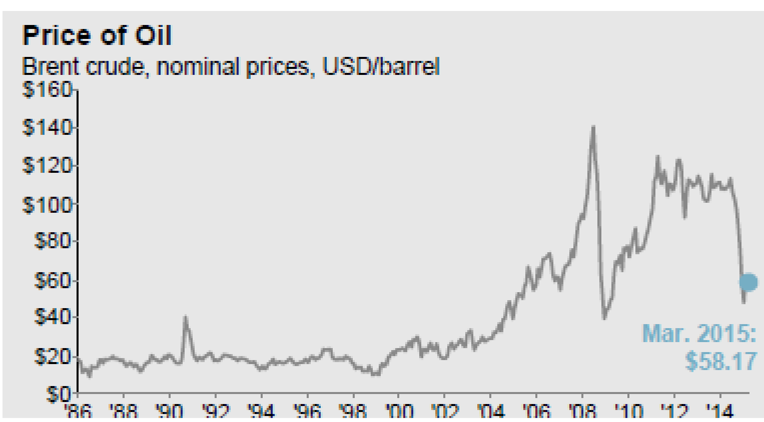
J.P.Morgan
Asset Management

DEVELOPED MARKETS- are specifically those countries that have a relatively high GDP, wealth and quality- depth and breadth of markets. Currently the Dow Jones and FTSE group list 26 qualifying countries. These countries rely heavily on the services sector to boost GPD and to allow for a higher standard of living than most other countries. Many of these countries,; Japan, Eurozone (specifically Germany, Italy and Spain) among others are currently wagering a currency war with each other in order to maintain or boost their global market share for their goods and services because the demand for these foods and services are not expanding. Hence some companies from these countries are going to greatly benefit from the currency war, however, at the expense of other companies and countries. This scenario sets the stage for stock market expansion and contraction one of the backbones of successful investing.

PRECIOUS METALS- Gold is the universal monetary unit since the beginning of civilization. This metal carries inherent value globally and is influenced by certain specific factors or a combination thereof: inflation, deflation, interest rates, currency valuation and global uncertainty. Gold is currently consolidating with a channel and as the factors listed above take center stage, sudden and swift moves will occur that will propel gold outside of the channel and allow for an investment that will produce positive returns in a very short period of time. As an example, a swift increase/decrease in global inflation or the sudden appearance of a 'black swan' better known as uncertainty will cause a knee jerk reaction in the price of gold. Those looking for and expecting such an occurrence will benefit greatly.

THE US DOLLAR- The US Dollar is recognized almost everywhere in the world as one of the most secure and safe monetary instruments due to its historical record. However, since late last year it has been both a blessing and a curse. As many countries are in a race to weaken their currencies so their goods and services are cheaper for the consumer, the US Dollar has subsequently strengthened against these other currencies and therefore, US goods and services are increasing in price on a relative basis. One of the other major impacts for corporations doing business aboard is the impact of converting foreign dollars into US dollars when the profits are transferred to the US. Profits are significantly reduced by this foreign exchange transaction. Also, since most commodities are denominated in US dollars, prices are lowered for those countries producing the commodity and US denominated debt for those countries become more burdensome to handle since it takes more dollars to pay the interest and ultimately the debt for those countries. Usually a stronger dollar implies the underlying economy is doing very well, however in this case it is a direct result of the weakening of other currencies which results in the remaining currencies strengthening. A stronger US Dollar usually indicates US consumers will buy more goods and services which helps fuel US GDP. Unfortunately, most US consumers are struggling to reduce their debt, expenditures and save for the future. So instead of boosting spending, the strengthening US Dollar has had little or no positive impact on the US economy. Regrettably, this is only the tip of the iceberg.

OIL- Oil is poised for a bounce in the latter half of 2015. Just as many investors did not see the sharp downturn based on slowing global growth and increasing production, they will most likely miss the bounce. The key price point of about $52/barrel for WTI is crucial. Should the price break strongly through this threshold, a bounce would be further out. The chart below is a good example of an asset class, (oil in this case) attempting to retest prior lows.



RECAP OF MCS OPPORTUNITIES- History has provided a slightly different opportunity for investors in each turn of the cycle; timing is always the key. Most investors get this timing wrong, as some have more recently by holding stocks such as JPMorgan, Citigroup, Bank of America, BB&T, McDonalds and others far too long into this cycle.   MCS excels when markets are not distorted but rather when they react normally to fundamental and economic data, as they have for centuries. In the grand scheme of most of our investing lives, this current period of time will seem insignificant. Once the cycle is complete, investors will be focusing on the full impact of the entire cycle with respect to their portfolios and lives.   Then, in the future, our children and grandchildren will read about this full time period as it is presented in financial textbooks. (The textbook term for this full cycle will be noted with a name similar to the Great Depression.) Despite this, multiple moves into different asset classes mentioned in this Outlook are expected in our portfolios in the near-term, when they present themselves. Investor behavior may not change, and many will get burned for the third time in less than two decades. MCS expects US markets to dip and increase one final time before falling off the cliff between now and 2016. We define falling off a cliff as a loss of 25% to 80% of the S&P500. This is typical market behavior because historically it has always happened in the cycle.

* Source - All charts are from Guide to the Markets, JPM Q22015