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Sandpiper Capital

Gleanings

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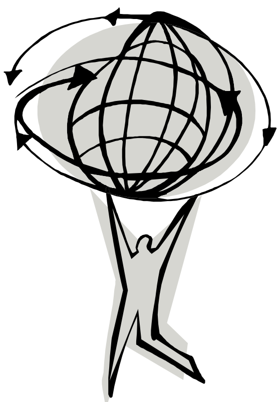

Market Returns Annually and Ten Years Ending 03/31/2016

Index	2014	2015	YTD	10 Yrs
S&P 500	13.7	1.4	1.4	**6.9%**
ML 1-5 yr Gov't/Corp	1.5	1.1	1.1	**2.0%**
EAFE (Dev Fgn Mkts)	-4.9	-.8	-.8	**1.6%**
Emerging Markets	-2.1	-14.8	-1.8	**3.0%**

An Extraordinary Year

Earnings are down. This much we know. Low oil prices reduced the profits of energy producers. The strong dollar hurt exporters and global oversupply depressed profits for manufacturers. We may have seen the biggest earnings drop since 2008. "May have seen", because, if you look at public data bases for S&P earnings, you'll see different numbers. Search Factset or Thomson Reuters for S&P 500 earnings and you'll see a number that they will refer to as "operating earnings" where they add back or subtract some "extraordinary" or "one-time" charges or credits. Refer to Bloomberg or McGraw Hill (the owner of the S&P 500 trademark and dataset) and you can find the "reported earnings" number. Which is just that. It is the number that, according to generally accepted accounting principles, reflects the actual financial results. The financial community tends to gloss over the reported earnings numbers, arguing that the focus on continuing operations is more instructive. Extraordinary charges are essentially ignored. So, if your company abandons a line of business because it has become unprofitable and writes off the assets of that business, that isn't counted as "ongoing operations". We have found, however, that one time charges do convey some important information. In the chart below we compare the ratio of reported earnings to operating earnings in the red line. The line drops as extraordinary charges increase. The black line below that is the one year change in the S&P price. In the past, when reported income become less than 82% of operating earnings, the market has run into trouble, spending a couple of years getting back to even. It may well be the case that a weakening dollar, stabilized oil prices and less deflation will help 2016 earnings. The current reality is that such an optimistic view is not yet warranted by the facts.

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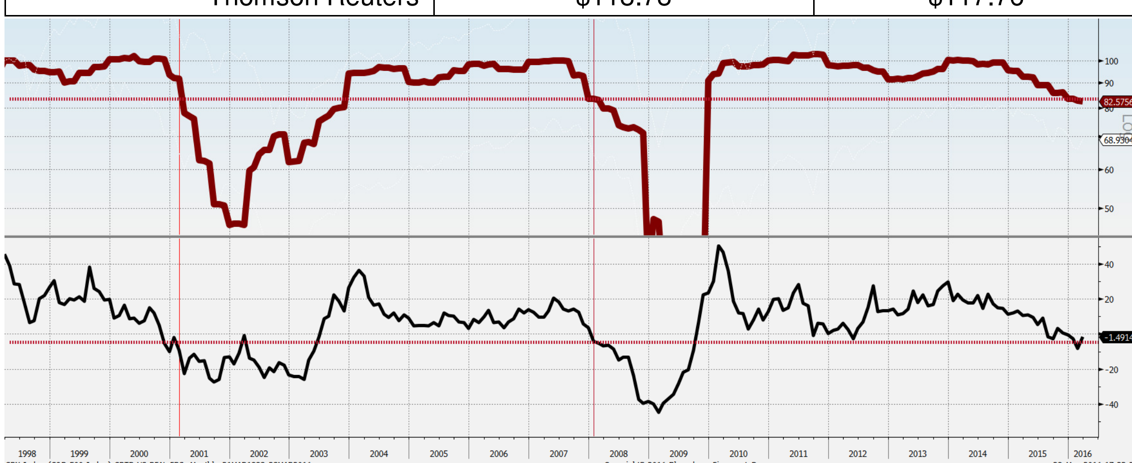
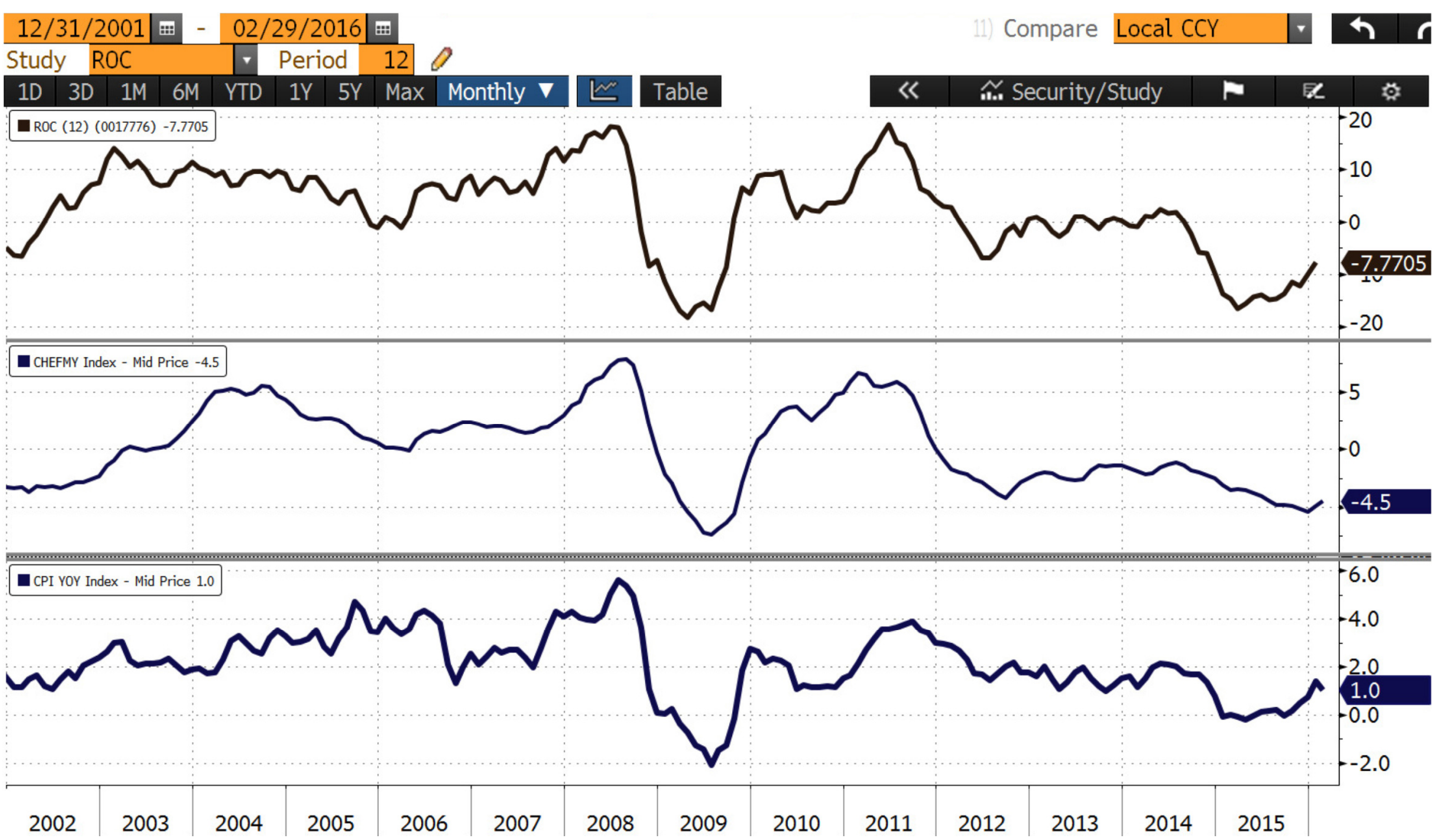
Source for S&P 500 earnings	2014 EPS	2015 EPS
Bloomberg	$103.09	$88.31
McGraw Hill Financial	$102.31	$86.48
Factset	$116.77	$117.36
Thomson Reuters	$118.78	$117.76



Deflation Pushes Global Rates Lower

Of the eighteen developed countries that issue thirty year government bonds, only Israel and Portugal offer higher yields than the 2.6% current US Treasury Bond yield. *The five lowest thirty year bond yields are all under 1%. The ten lowest five year government bond yields are all negative.* That is, bond buyers *pay* those governments to hold onto their money for five years. Falling goods prices (deflation) has affected monetary policy to such an extent that Central Banks see restoring demand as their primary function. If deflation is too many goods chasing too little money, then printing currency, or encouraging the borrowing of money, is perceived to be a solution. Credit growth carries its own risks however, as US corporate debt to equity ratios (even excluding energy and materials companies) as well as emerging economies' sovereign debt to GDP ratios have both doubled in the last ten years. At some point, all this debt becomes unserviceable, propelling bankruptcies as the most likely solution to the too much goods problem. In the meantime, China, from whom we import a lot of our own deflation, is attempting to increase demand for their goods by cheapening the Yuan. They have seen some improvement in export prices, (the top panel below), as a result. The improved demand has lifted their input prices (the manufacturing producer's price index) as reflected by the uptick shown in the line in the second panel. Our domestic inflation has picked up a little also, (third panel), from 0% to 1% at the same time. Somehow, though, more debt and more price cuts don't seem to be anything more than a temporary fix to these global imbalances. It will take a combination of less factory building and wider distribution of wealth and income for some type of equilibrium to be found. Failing that, the next stop for the thirty year bond will be under 2%.



Tom Lukic