A Rocky Mountain Humane Investing, Corp. Company

Optimized Partners

Investing with Experience and Heart in Mind

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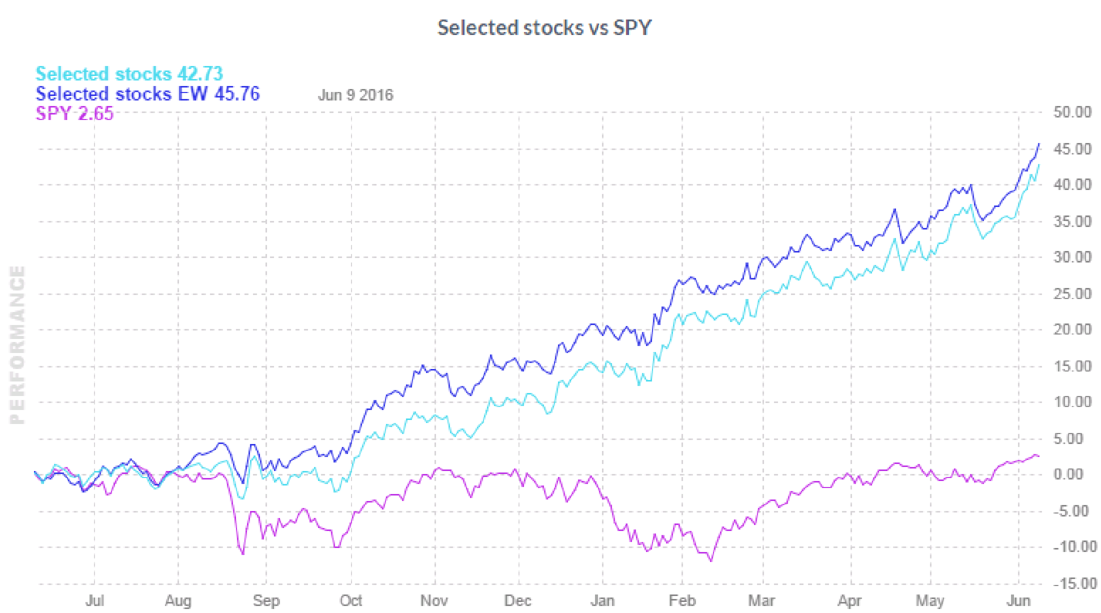
June 10, 2016 client letter

Quick Summary: So far the shift away from dollar driven investments (primarily Emerging Markets) has validated itself as accounts have gained traction unlike any time since the market peak in 2014. EM's will likely validate themselves eventually but the fits, starts and volatility are too much.

Hocky great Wayne Gretzky once said: "I don't skate to where the puck is, I skate to where it will be." This is the essence of our interest rate strategy. Typically short sighted investors don't realize the type of investments they need until its too late and too obvious. A recession is likely by 2017 and at some point the stock market will begin to truly break down, interest rates will plummit as stocks are sold and moved into bonds and interest rate driven securities.

The chart below is a 12-mos back test of the interest rate strategy with applied technical trends (holdings must be above 200 and 50 day moving averages, etc). We always use EW (equal weightings) for holding. Naturally this chart shows an extreme return which we should not expect to continue at the same rate. Its not very scientific at all since it only looks back one year, doesn't include fees or expenses but it does mean my thought process is in the right direction. Had the strategy failed in the past 12 months it would not have been considered.



Please note: Performance chart does not include delisted stocks. Selected stocks line is based on market cap weighted averages and includes only stocks that have available data on Shares Outstanding. Selected stocks EW line is based on equally weighted averages.

The holdings list (from 6/9/16) does change from day to day and you'll find many of these names in your accounts. If you own a REIT that doesn't appear it means it was on the last a while ago. Notice the concentration of REIT's and utilities – both very conservative industries.

I've provided a extensive buy and hold test at the end of this letter.

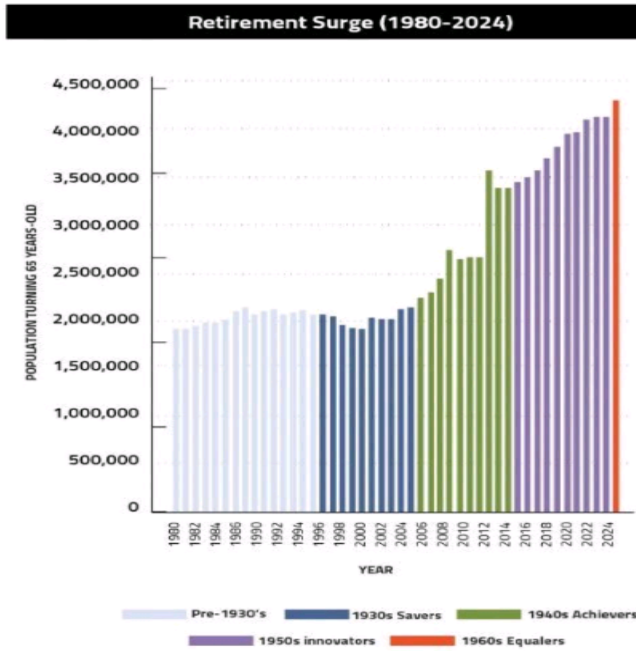
No.	▲ Ticker	Company	Sector	Industry	Country
1	AWK	American Water Works Company, Inc.	Utilities	Water Utilities	USA
2	CLGX	CoreLogic, Inc.	Technology	Processing Systems & Products	USA
3	DLR	Digital Realty Trust Inc.	Financial	REIT - Office	USA
4	DLTR	Dollar Tree, Inc.	Services	Discount, Variety Stores	USA
5	GAS	AGL Resources Inc.	Utilities	Gas Utilities	USA
6	GGAL	Grupo Financiero Galicia S.A.	Financial	Foreign Regional Banks	Argentina
7	HR	Healthcare Realty Trust Incorporated	Financial	REIT - Healthcare Facilities	USA
8	HTA	Healthcare Trust of America, Inc.	Financial	REIT - Healthcare Facilities	USA
9	MEG	Media General, Inc.	Services	Broadcasting - TV	USA
10	POR	Portland General Electric Company	Utilities	Electric Utilities	USA
11	SJM	The J. M. Smucker Company	Consumer Goods	Processed & Packaged Goods	USA
12	TLK	PT Telekomunikasi Indonesia Tbk	Technology	Diversified Communication Services	Indonesia

Over a month ago, based on the erratic statements coming from the Fed (the only person who changes their tune so often is a particular orange Republican candidate) I shifted away from focusing on the weak dollar to focus on the unrelenting march of lower interest rates. Since last month, based on public statements for a rate hike they are now backed into a corner as employment data has become uncomfortably weaker.

I haven't a clue as to what they'll do later this month and it really doesn't matter that much. Should the Fed hike rates again we'll see a surge in asset prices of interest related securities like REIT's, Tbonds, and the $USD and a steep fall in Emerging Market investments. Should they not hike, existent worries about the recent erosion in employment data will continue to offer support to interest sensitive securities. Either way the Macro case for lower interest rates remains in effect for the forseeable future.

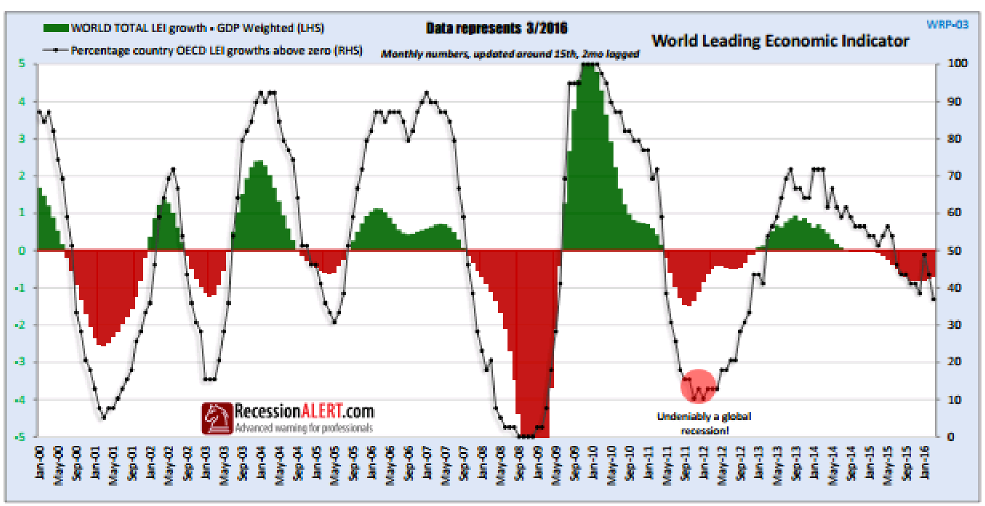
Declining interest rates has been a huge macro trend since 1981 with an endpoint unseen on the horizon. In my judgement focusing on lower interest rates and an inevitable recession is the best positon for an investor to be in this year and possibly to the end of the decade. What makes this strategy so effective is that there are multiple reasons for rates to move lower:

Demographics: The Fed's use of QE has a policy tool has driven short term interest rates to zero at just the time baby boomers are retiring. Thus they're forced to look elsewhere for yield.



The Carry-Trade: This is a strategy where an investor borrows money in one country (Japan for example which has 0% rates) and invests the funds in another country with positive interest rates (the United States).

Weakening worldwide growth: World total LEI's (leading economic indicators) have moved into the impending recession zone.



Central bankers use of 0% or negative rates as a policy tool: No one really knows how this will eventually turn out. Actually, we have a sense of what will happen and it isn't good.   0% rates mean banks just can't sit on their hands and earn a modest rate for doing nothing. Even a loan at 1% is better than 0%. Human beings being what they are forget the lessons of the past and are creating a mountain of debt.   At this point I'd rather not go on since I'd sound like a Ron Paul gold-hawker ad on Fox.

The result of the shift to focusing on interest rates after just a month appears to be a solid success as accounts have gained significant daily traction regardless of daily stock market moves. While the time period is short we've seen absolute and relative performance unlike any period in the last 12 months.

Worldwide decline in 10-year sovereign yields (lower yields mean rising prices)

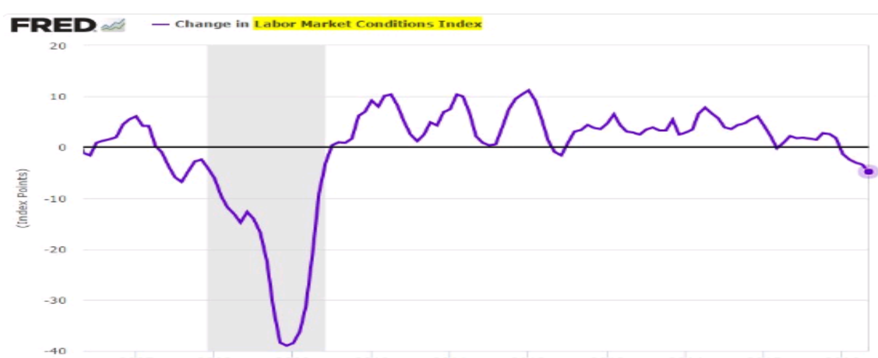
We continue to avoid non-interest rate sensitive US stocks. Despite the recent rally in US equities I'm adamant in avoiding which could be a huge suckers rally not unlike seen in 2000 and 2007. While I believe the bond market is acting properly according to the state of the economy, stocks IMO appear to be disconnected from reality. We've had 5 straight quarters of earnings decline yet the SP500 has moved sideways. Note: there has never been an instance of 5 straight declines in quarterly earnings without a recession.

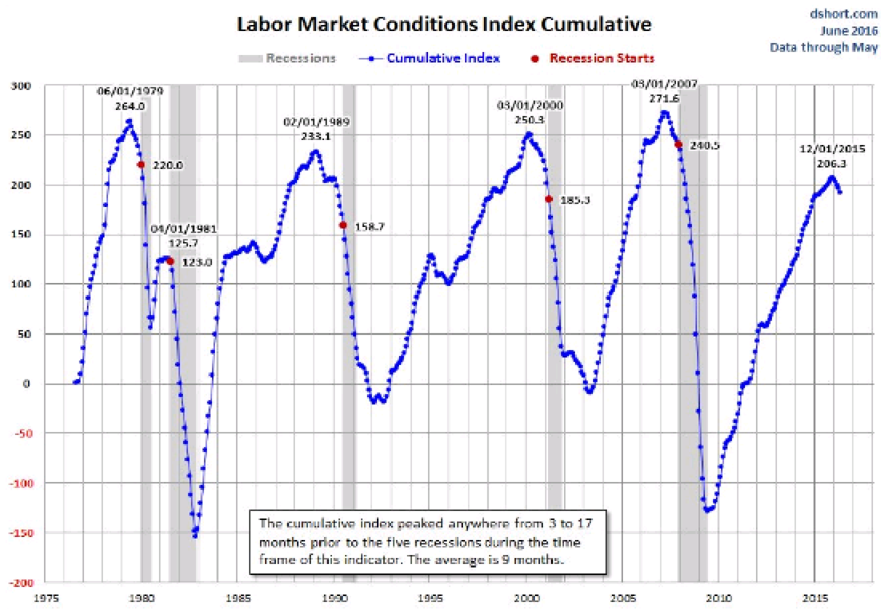
I've just realized I've never spoken of Labor before. Well, now is the time because labor trends are rolling over. When it comes to data that matters for markets and economies the actual number matters less than the trend. The trend is what's really important as that implies direction and velocity.

Last week we saw an awful Non-Farm Payroll number come forth that represented the fourth straight decline in payroll employment.

February +233,000
March +186,000
April +123,000
May (ahem…) +38,000

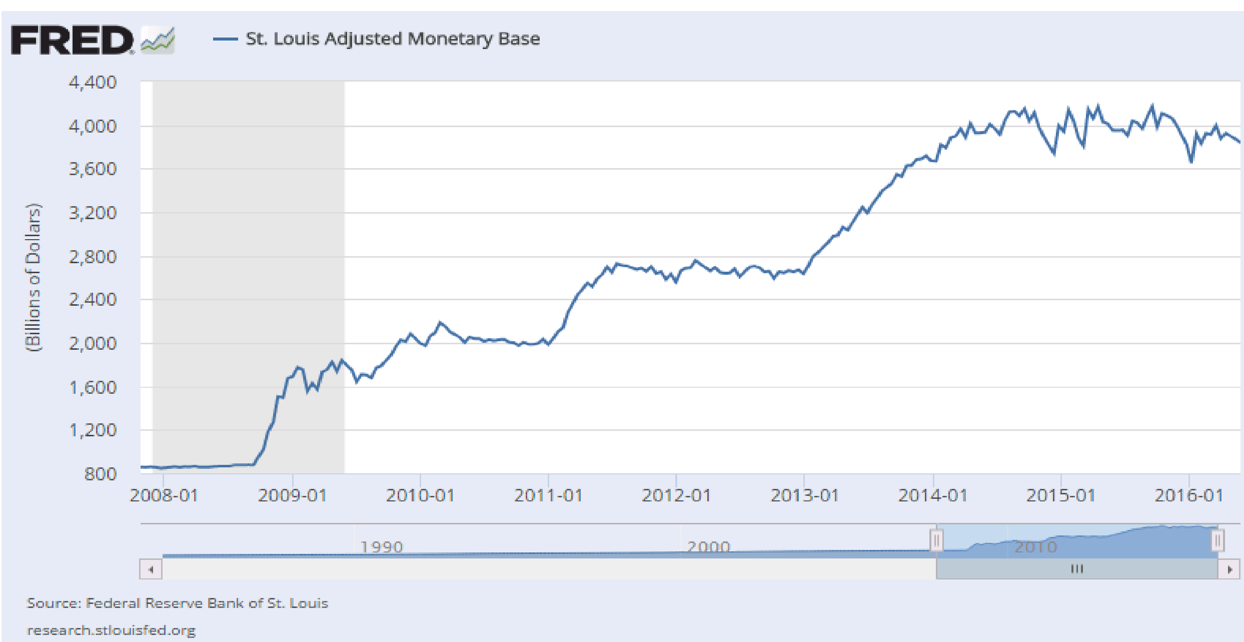
FRED (Federal Reserve Economic Data) shows labor rolling over which always precedes recessions.





Investors should have a clear understanding of what the most important driver to US asset prices. It's not earnings nor is it fiscal policy. The primary driver of assets prices is the Federal Reserve's control of liquidity or cash. If you increase the monetary base you can expect asset prices (especially stocks) to rise. If you contract the money supply there's a good chance of recession or a bear market.

Please see this chart below: Notice the increases in the monetary base in 2008, 2011 and especially 2013. There were QE I, II and III respectively with QE III the primary reason for our bumper return in 2013. Notice as well that once QE III ended in 2014 U.S. stocks haven't made any upward progress. Finally, it appears now that the US monetary base is on a downtrend. Care to guess what that means?



My guess is that the next time we see a surge in the monetary base "QE IV" we'll be in a full blown recession.

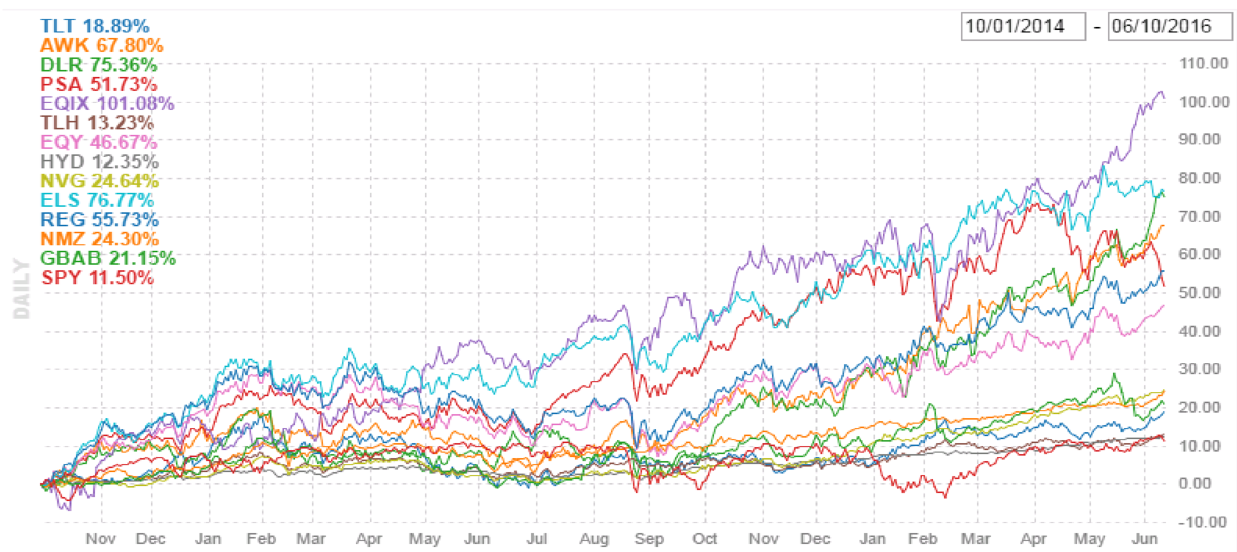
<u>Back-test from November 2014 S&P 500 marking the end of QE III</u>

This simulation below is based on our largest interest rate sensitive holdings for the last two years from November 1, 2014 to June 10, 2016. This is a purely buy and hold simulation where the holdings were purchased November 1, 2014 and held till June 10, 2016.

I chose November 1, 2014 since QE III ended the month before and the broad based S&P 500 has labored ever since.

Transaction cost and management fees are not factored in the returns. However *dividends and interest payments are not factored in either and these payments are significant (the limitations of the software used).* In addition there is data mining involved as well since we're testing performance from holdings primarily selected this year and not 2014. This simulation is only to demonstrate that there is a trend present in interest rate investments and in my judgment the trend will likely persist due to a weakening worldwide economy.

Unless there is a substantial positive change in economic growth these trends should continue but not without hiccups. Of the 20 months of the test there were 4 months of negative returns and 16 months of positive returns. Negative months tended to correlate with monthly negative returns for Treasuries. The sickening decline we witnessed this past January was a strong month for Treasuries and accordingly the interest rate stocks did well. Many of the securities listed were highlighted in last month's letter "Live to fight another day".



Monthly performance from Nov 14 ▼ to Jun 16 ▼

	Nov 14	Dec 14	Jan 15	Feb 15	Mar 15	Apr 15	May 15	Jun 15	Jul 15	Aug 15	Sep 15	Oct 15
AWK	-0.01%	+0.47%	+5.33%	-3.13%	+0.24%	+0.57%	-2.40%	-8.02%	+6.74%	+0.72%	+6.05%	+4.14%
DLR	+1.85%	-4.50%	+10.02%	-8.99%	+0.69%	-3.87%	+4.15%	+2.31%	-3.61%	-1.48%	+4.60%	+13.23%
PSA	+1.78%	-0.73%	+8.65%	-1.80%	+0.72%	-4.68%	+3.00%	-3.87%	+11.29%	-1.91%	+6.05%	+8.43%
EQIX	+8.75%	-0.19%	-4.35%	+3.38%	+4.62%	+9.91%	+5.41%	-5.25%	+9.81%	-2.67%	+1.35%	+12.88%
TLH	+1.21%	+1.42%	+4.95%	-2.88%	+0.91%	-1.10%	-0.51%	-1.99%	+2.50%	-0.54%	+1.83%	-0.78%
EQY	+0.96%	+5.60%	+7.41%	-1.69%	+0.49%	-7.72%	+0.61%	-4.96%	+9.98%	-8.41%	+4.51%	+9.20%
HYD	+0.94%	+0.34%	+2.36%	-0.51%	+0.56%	-0.33%	-0.36%	-2.75%	+1.72%	-0.53%	+2.36%	+1.42%
NVG	-0.27%	+1.72%	+5.05%	-1.82%	+0.98%	-0.54%	-2.92%	-1.93%	+2.98%	-0.85%	+2.00%	+1.31%
ELS	+1.04%	+4.57%	+6.17%	-1.57%	+2.69%	-3.87%	+3.73%	-3.35%	+10.08%	-3.66%	+5.73%	+3.26%
REG	+2.08%	+3.74%	+7.50%	-3.58%	+3.67%	-7.73%	+1.32%	-6.59%	+8.46%	-6.58%	+4.79%	+9.35%
NMZ	-0.12%	+2.78%	+5.67%	-1.73%	+1.13%	+0.26%	-2.06%	-2.25%	+2.80%	+0.64%	+0.04%	+4.12%
GBAB	+2.52%	+1.73%	+7.20%	-1.48%	-2.56%	+0.43%	-2.64%	-4.39%	+6.26%	-0.06%	+0.14%	+4.82%
SPY	+2.75%	-0.25%	-2.96%	+5.62%	-1.57%	+0.98%	+1.29%	-2.03%	+2.26%	-6.10%	-2.55%	+8.51%
TLT	+2.97%	+3.25%	+9.82%	-6.14%	+1.09%	-3.42%	-2.37%	-4.07%	+4.55%	-0.69%	+1.97%	-0.41%

	Nov 15	Dec 15	Jan 16	Feb 16	Mar 16	Apr 16	May 16	Jun 16	Total
AWK	+1.29%	+3.45%	+8.64%	+0.38%	+6.34%	+5.56%	+2.36%	+4.59%	+51.23%
DLR	-2.50%	+6.15%	+5.90%	-1.26%	+13.08%	-0.58%	+8.49%	+7.20%	+59.86%
PSA	+4.62%	+3.18%	+2.37%	-1.61%	+11.29%	-11.25%	+3.64%	-4.70%	+36.44%
EQIX	-0.06%	+2.57%	+2.70%	-2.22%	+9.52%	-0.11%	+10.14%	+2.29%	+91.17%
TLH	-0.40%	-0.36%	+3.70%	+1.86%	+0.13%	-0.38%	+0.29%	+2.28%	+12.50%
EQY	+2.44%	+0.56%	+2.10%	-1.12%	+5.38%	-1.26%	+4.10%	+2.75%	+32.86%
HYD	0.00%	+1.13%	+0.75%	+0.37%	+1.10%	+1.43%	+0.94%	+0.36%	+11.80%
NVG	+0.10%	+4.22%	+2.11%	+0.77%	+3.16%	+2.47%	+1.91%	+1.66%	+24.11%
ELS	+3.14%	+7.49%	-1.12%	+6.43%	+4.28%	-5.83%	+7.02%	-0.75%	+53.94%
REG	-0.11%	+1.10%	+6.27%	-1.81%	+6.05%	-1.54%	+4.61%	+3.92%	+38.00%
NMZ	-0.24%	+1.87%	+0.91%	+0.76%	+1.13%	+1.69%	-0.03%	+3.13%	+22.18%
GBAB	-1.11%	-2.18%	+6.72%	-0.67%	+4.13%	+2.33%	-4.64%	+3.77%	+20.95%
SPY	+0.37%	-1.73%	-4.98%	-0.08%	+6.73%	+0.39%	+1.70%	+0.11%	+7.46%
TLT	-0.87%	-0.30%	+5.57%	+3.09%	-0.09%	-0.74%	+0.81%	+3.76%	+17.87%

A happy summer to all,

Brad Pappas

Disclosures

Long all securities mentioned.

International investments are subject to additional risks such as currency fluctuations, political instability and the potential for illiquid markets. Investing in emerging markets can accentuate these risks.

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