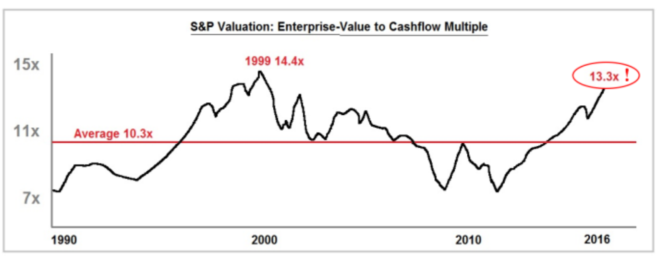
# PRUDENT GROWTH INSIGHTS

Overwhelming evidence supports the fact that the stock market trends upwards over the long term…assuming you live long enough. But there are periods when, after enough losses, investors question the truth in this axiom and look for reasons why it appears not to be a truism. Often these reasons are extrapolated beyond their investment horizon prompting selling by these investors, typically at or around market lows. Unlike any other time though, the Federal Reserve is the gorilla in the room. What could it mean for the market if the Fed spent the next few years selling the over $4 trillion of bonds and stocks they have bought since the crisis?

**Valuation:** As shown in the chart below, the market has once again entered valuation levels that offer high risk and modest returns. Using the S&P 500 Index as our benchmark one can see that, over the past 25 years the average "enterprise value" for the stock market has been 10 times cash-flow within a wide range of 7x and 15x.

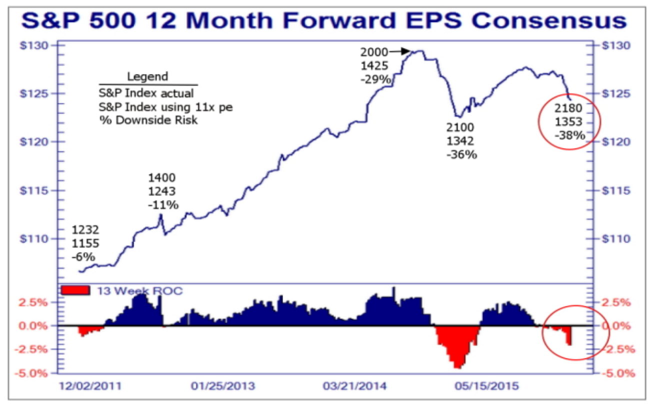



Clearly the best level for superior long-term returns for stocks is well behind us. Other yardsticks we observe, such as market-capitalization to GNP, show similar unattractive valuation levels for stocks.

**Earnings:** At certain times the yardstick above does not provide an accurate measure of return potential. Note for example that in 2003, ahead of a four-year bull market, the yardstick did not give a definitive buy signal. Sometimes measurement tools like these that are ratio based can have a numerator or denominator mask the facts. So let's look at the earnings for the S&P index to see if there is good news that could counterbalance this flawed valuation metric.

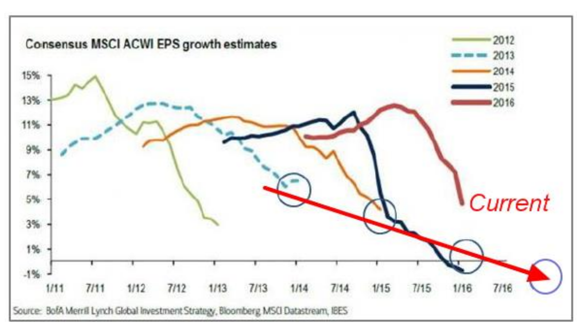
Below is a chart of the S&P's "forward" EPS. Most pundits use trailing and forward EPS and then multiply these numbers by a P/E ratio. Typically they use the historical trailing P/E multiple for the market of 15 times. While that is the historical multiple for trailing EPS, a study of the historical multiple based on "forward" EPS reveals a much lower 11 multiple average (source: AQR).

Using a charting of the forward EPS since 2011 and adding a notation of the market's price at several points in time reveals that the market have been moving further and further away from the historical 11 times average. At the current S&P 500 level of 2180, the market would have to decline 38% to get to the 11 times average.

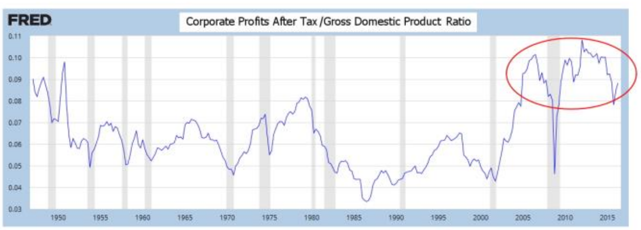



Note also that the forward EPS estimate peaked in mid-2014 at $130, a level not realized to date, and its subsequent recovery peaked lower at $128 from which it is declining.

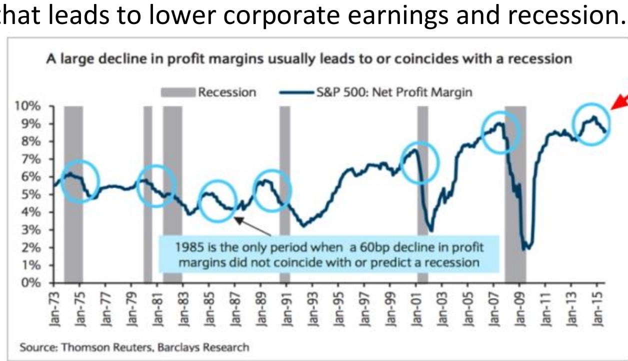
Perhaps the current forward estimate is being understated by analysts and is due for a recovery. The chart below shows the opposite. As one can see every year analysts have started out optimistically for global earnings-growth only to cut their estimates as the evidence of weakness weighed in. Furthermore, each year's growth rate has been lower than the previous and, if 2016 continues the trend, will now be decidedly negative. No good news here.



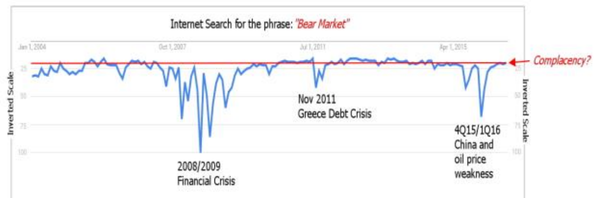
**Corporate Profit Margins:** Perhaps the high valuations and poor earnings growth for the market can be saved by an expansion of profit margins as managements work to improve the bottom line. The chart below shows the success managements have had over the past fifteen years. Out of a dollar of sales they have trimmed personnel and operating expenses. They have reduce capital expenditures thus reducing depreciation expenses. They have benefited from a significant reduction in interest rates thus reducing their debt expense. The huge amount of buybacks have reduced shares outstanding thus increasing EPS beyond the growth in actual earnings. And finally some have moved their corporate designation offshore to avoid taxes altogether. Given all the above there is not much left for management to trim. Note that the 9% to 10% margin level is at the upper extreme for the post-war period. It is unlikely that this metric can be used to bailout the weakening EPS growth or the extreme valuation for the market.



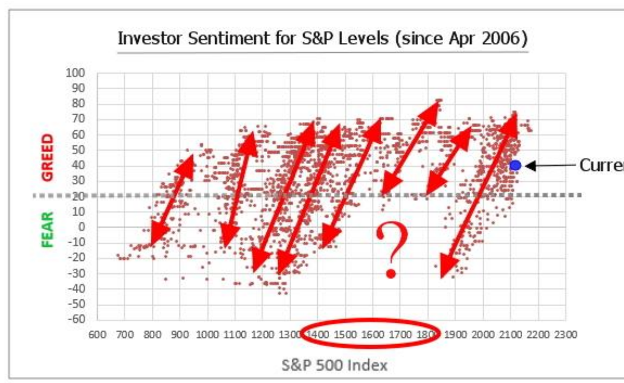

**The Economy:** While we can highlight currently deterioration ISM numbers for the economy, let's stick with the profit margin discussion introduced above. The chart below shows that high margin levels invariable revert to their mean, in this case from 10% down to 6%, and are almost always the result of a recession. The social movements in support of higher minimum wages and price controls for prescription drugs is probably a precursor of the margin decline that leads to lower corporate earnings and recession.




**Investor Sentiment:** Sometimes all of the above are less relevant when investors have already discounted the above concerns by being very bearish. Unfortunately, the chart below is one example of the complacency among investors. The chart plots the internet search of the phrase "bear market" and shows the recent concerns, based on China concerns and the oil price collapse that got investors' attention, have now dissipated. Given China is the 800-pound gorilla for the global economy and higher oil prices are paramount for solvency in the high-yield market, investor sentiment for stocks is far too favorable.

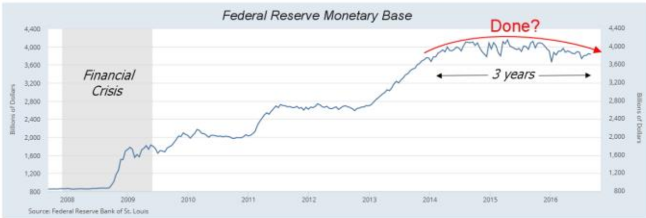



Furthermore, the lengthy uninterrupted rally out of the late 2011 lows fueled by unprecedented amounts of easy money never established regular periods of investor concern to provide long term support for these price levels. Note in the chart how there was no "climbing-the-wall-of-worry" fear established within the S&P 500 range of 1400 and 1800. In a market free fall this range could be full of air pockets as the market looks for new buyers to establish a market low.

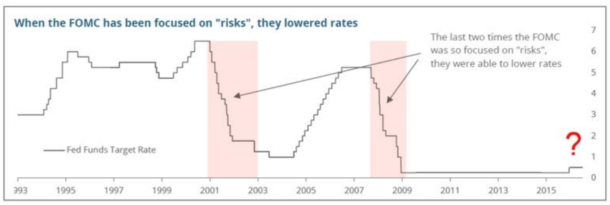



**The Federal Reserve:** This body has been the unique variable that has thrown traditional stock market analysis and investment processes into a quandary. The Fed has printed over $4 trillion dollars and cut interest rates to zero in an effort to combat the after effects of the financial crisis. In conjunction with global central banks, as evidenced by negative yields on sovereign debt, investors have stretched valuations to the extreme to find a home for their money.

But we are now seven years since the crisis and unemployment is now less than 5%. At some point the Fed has to call it quits and let the economy return to market-place influences. The chart below shows, in terms of money printing, the Fed paused/stopped almost three years ago yet the stock and bond markets continued to new highs.




If money supply will no longer be a tool for the Fed to defend the economy against weakness, they are now clearly without their favored tool to combat future risk, lower interest rates.




**Conclusion:** We remain concerned that investors are no longer risk adverse at a time when paltry longer-term stock-market returns and significant drawdowns are likely. With the Federal Reserve having exhausted the market-elevating tools of higher money supply and low interest rates, we believe the drawdown risk has been moved forward dramatically.

# For more info on RAM visit us at [www.ramlp.com](http://www.ramlp.com).

*** DISCLOSURE**

**Past performance is not indicative of future results.**

*A Single Managed Account (SMA) is an actively managed portfolio. There is no guarantee that any investment will achieve its objectives, generate positive returns, or avoid losses. The SMA may purchase ETFs. The risks and volatility of these investments may be magnified as they may include leverage, which magnifies the changes in the value of the ETF or Underlying Fund. The SMA will incur a loss as a result of a short position if the price of the short position instrument increases in value between the date of the short position sale and the date on which the SMA purchases an offsetting position. The SMA's losses are potentially unlimited in a short position transaction. A higher portfolio turnover will result in higher transaction and brokerage costs.*

**Investors should carefully consider the investment objectives, risks, charges and expenses of an SMA account offered by RAM Capital Management LLC. Any performance data quoted here represents past performance. Current and future performance may be lower or higher than that experienced in the past. Investment return and principal value will fluctuate, so that SMA accounts, when closed, may be worth more or less than their original cost. Past performance is no guarantee of future results.**

**The performance shown for RAM in any chart is for a single-managed account (SMA) managed on a fully-discretionary basis by RAM Capital Management LLC (RCM) and that adheres fully to RCM's investment process and portfolio execution. In some cases, due to the modest size of the account or client restrictions placed on the account, an SMA account's performance may vary.**

**RAM Capital Management LLC does not guarantee the accuracy or completeness of information posted on its site or within its reports, nor does it assume any liability for any loss that may result from reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice and are for general information only.**

For the performance of the Prudent-Growth Portfolio the past performance for January 1, 1996 to September 30, 2010 is for the RAM Capital L.P fund. The prior performance is net of management fees (1% per annum), and net of other expenses. Also prior performance does not include the effect of the LP's performance fee, which does not apply to SMA's. On October 1, 2010 the partnership was converted to, and it's performance ported to, a mutual fund adhering to the Investment Companies Act of 1940 and regulated by the SEC. Past performance since the conversion are net of management fees (1%) and expenses (0.25%). The latter does not apply to SMA's although all commission and other charges, fees and expenses are the responsibility of the SMA owner. The LP and the mutual fund were managed in the same style and by the same portfolio manager and advisor, RAM Capital Management LLC, since the fund's inception on January 1, 1996. The past performance is not necessarily an indication of how an SMA will perform in the future.

The S&P 500 Index is an unmanaged composite of 500 large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. You cannot invest directly in an index.



**Investors should carefully consider the investment objectives, risks, charges and expenses of the RAM Capital Management LLC's (RCM) services.. This and other important information about RCM is contained in its Form ADV, and, along with performance current to the most recent month, can be obtained by contacting us**.

The information contained herein, including any attachment(s), is provided by RAM Capital Management, LLC ("RCM") to the intended recipient solely for informational purposes. Any dissemination, re-distribution or other use of this message by any recipient is unauthorized. **Past performance may not necessarily be repeated and is no guarantee or projection of future results.** The information in this document has been obtained from sources believed to be reliable, but RCM does not represent that it is accurate or complete. Data presented is not audited and includes estimates, which may not represent actual results. RCM assumes no obligation to update or correct estimates.

**Under no circumstances should the information contained herein be used or considered as an offer to sell, or a solicitation of an offer to purchase, any security or investment service. The information presented herein is presented in summary form and is, therefore, subject to qualification and further explanation.**