DENALI CAPITAL MANAGEMENT, LLC

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Scott's Thoughts — "2015, the Year Nothing Worked"

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Courtesy of the Fairbanks Daily Newsminer

"2015, the Year Nothing Worked" - CNBC correspondent 12/31/2015

Scott Husband

In rounded numbers,

5, 10, and 20 year Treasury bond prices declined

Barclays 20 year bond ETF (TLT) declined 4.6%

High Yield bonds declined nearly 10%

Utilities declined 6%

Oil declined 30%

Gold stocks (GDX) declined 25%

Russell 2000 (smaller stocks) declined 4%

S&P500 declined but the income took the return to a positive 1.8%

An Equally weighted S&P500 lost 3.5%

Emerging markets declined 17%

EAFA (Europe) declined nearly 1%

Dow Jones Industrials lost 2.3%

Dow Jones Transportation Average declined 17%

(definitive and accepted returns should occur by mid-January)

And, investors saw losses in:

8 of 9 domestic equity categories, excluding large growth

17 of 17 asset allocation categories, from retirement income to tactical allocation

8 of 15 international stock categories

14 of 15 taxable bond categories and

6 of 6 alternative or hedged fund categories

There was no place to hide though shorter term quality bonds generally had a positive return. A few very large hi-tech corporations like Google, Facebook, Netflix, and Amazon did well. Their respective price earnings ratios (P/E) are 31, 100, 292, and 912. Historic P/E norms for the broad market are 10-20. There is no denying these growth companies demand a premium to the broader market, but 100+ times earnings is a large premium. These stocks, because of their large market capitalizations, held up the broader indexes.

Scott's Thoughts (continued)

The market's capitalization compared to Gross Domestic Product is 2nd only to just before the Dot.com bust. As is the median Price Earnings ratio, the Schiller Price earnings ratio, median price to sales and the Tobin Q ratio (price relative to replacement cost). All this simply suggests that the stock market is expensive, even more so than a year ago in-spite of this year's weakness. Why, because both earnings and revenues declined in 2015, which is not normal in bull markets.

The market does not have to do anything. Just because it is expensive does not assure that 2016 will be a bad year. It may be a very old bull market and it may be expensive, but there is a lot of cash in the economy, and that is the primary reason for this bull market and perhaps a move higher.

Janet Yellen, the Federal Reserve chief, recently said "Moreover, holding the federal funds rate at its current level for too long could also encourage excessive risk-taking and thus undermine financial stability."

An article in Seeking Alpha responded: "So after nearly seven years of zero interest rates and massive inflation in the size of the Fed balance sheet, the last five of which were in place after the end of the Financial Crisis induced recession, the Fed is now concerned about encouraging excessive risk-taking? Really? **REALLY?** That may be the most disingenuous statement ever made by a Fed Chair. Remember, the entire thesis of QE was that it would help encourage economic growth through the 'portfolio rebalancing channel', which was a fancy way of saying that if the Fed bought up all the available Treasuries and drove yields to historic lows, then other investors would be forced to buy either equities or lower rated debt thus enhancing capital flow toward business, and theoretically impelling growth higher. Of course, what we observed was a massive rally in the equity market that was based largely, if not entirely, on the financial engineering by companies issuing cheap debt and buying back their own shares. Capex and R&D spending have both lagged, and top-line growth at many companies remains hugely constrained. And the Fed has been the driver of this entire outcome. And now, suddenly, Yellen is concerned that there might be excessive risk-taking. Sheesh!"

Bill Gross, the "Bond King" stated in his December Investment Outlook: *"The faster and faster central bankers press the monetary button, the greater and greater the relative risk of owning financial assets*, I would gradually de-risk portfolios as we move into 2016. Less credit risk, reduced equity exposure, placing more emphasis on the return of your money than a double digit return on your money…... They print money as if they were manufacturing endless numbers of chips that they'll never have to redeem. Actually a casino is an apt description for today's global monetary policy."

Printing vast amounts of money did cause inflation, in bonds and stocks. The only asset group that is not historically expensive is natural resources. Copper, aluminum, lead, nickel, zinc, and lumber, are all down about half. Even the grains are cut in half. Oil and natural gas are down even more. Gold is down 40% and silver 70%.

The best time to lighten an exposure is in a mature bull market, which means selling when everyone is happy, a difficult task. And the best time to increase exposure is in a mature bear market when investors are most concerned. We will see what the markets bring us in the coming year, but we wish a great 2016.

ANNUAL REMINDERS

You may request Denali Capital Management's Firm Brochure and the brochure supplement at any time. If you would like to go paperless and receive Charles Schwab statements, the Denali View and DCM quarterly reports via e-mail, please contact Heather. If you do not file an extension, April 15, 2016 is the deadline to contribute to your IRA for 2015. Please contact Heather if you need deposit envelopes. Also, this is a reminder to check your credit report at: www.annualcreditreport.com.

Olive Sez…

Squirrel dreamin'...

It is time to apply for your Alaska Permanent Fund Dividend (PFD) for 2016. The deadline to apply is March 31, 2016. Filing can be done online at:

https://www.pfd.state.ak.us