2Q 2016

Market Outlook

ICM ASSET MANAGEMENT

ECONOMIC TRENDS

U.S. Economy	We have been somewhat ambivalent about the outlook for the U.S. economy for several quarters now. During the first six weeks of this year, U.S. markets moved down sharply on fears of an economic slowdown. We have been witnessing an expected slowdown in corporate earnings for nearly four quarters now and continue to get mixed data from the U.S. economy. Although the Federal Reserve would prefer to raise interest rates, the path is not clear because of international problems mainly in China and most recently Europe. While these concerns may be weighing on the minds of the Federal Reserve, they may be actually hiding the real reason that the Fed cannot raise short term rates—the U.S. economy is just not that strong. Artificially low interest rates have been unable to spur any additional economic growth in part because U.S. productivity growth rates are at historically low levels. While the markets may have grown accustomed to bits of positive and negative news on the U.S. economy, at what point does this begin to matter? Growth is simply exceedingly difficult to come by and although we do not anticipate an immediate recession in the U.S. we want to be mindful of these potentials as there are some worrying signs. According to a recent article by David Rosenberg, the national income data released with the first quarter Fed flow-of-funds report was telling. Nominal growth at an annual rate slowed to 1.7% from 2.5% in Q4 and Q3 of 2015, and the nearby peak of 4.9% in last year's second quarter. The annual trend has softened from 4.3% YoY a year ago to 2.9% currently, and is actually running at the same pace or lower than five of the past six official recessions. As a positive, household debt growth slowed to a mere 2.7% annual rate in the first quarter of 2016 from 3.7% in Q4. This is much different from commentary we provided years ago referring to consumers tapping their "household ATM" at what were 12% annual expansions in credit in 2004, 2005, and 2006 as the housing bubble formed. Despite the best efforts of our Federal Reserve and other global central banks to ignite a self-sustaining expansion of growth with lower rates, the savings rate in the U.S. continues to climb. It appears that we have really seen a secular change towards credit, savings, discretionary spending and home ownership. This is not too surprising as the older demographic profile of U.S. consumers is evolving. We are seeing the first of the post WWII baby boomers turning 70 this year with the median age now just over 60. With low interest rates on traditional safe havens such as U.S. treasuries, people are being forced to set aside an even greater share of their paychecks late in their careers as they prepare for retirement. Furthermore, it will be difficult for global economies to rise by borrowing still more because U.S. nonfinancial sector debt relative to U.S. GDP just hit a record high of 250%...at its peak in the last cycle in 2009 it topped at 240%. While many older consumer balance sheets are in much better shape than during the last financial crisis, the newly created debt has simply been transferred to government balance sheets. Younger U.S. consumers are taking on larger debts using things like student loans and longer maturity car loans rather than second mortgage debt to finance their lifestyles. The future burdens of servicing this debt will soak up monies that used to be spent on other areas of the economy.
U.S. Dollar	Following the surprising results of the U.K.'s decision to leave the European Union, the U.S. dollar has continued strengthening because of its perceived safety among global investors and the resultant flows into the dollar to invest in both our fixed income and equity markets from these global macro investors. As we have discussed in past quarters, a strong dollar hurts global companies that compete with foreign companies by making U.S. products more expensive. At this point, however, there is very little the Federal Reserve can do or is willing to do in order to weaken the U.S. dollar versus other currencies. The potential for erratic strength or weakness of

global currencies, however, remains one of the biggest concerns we have for the U.S. and global economies in the interim. Since U.S. corporate earnings have been mediocre at best in this environment, a strong dollar will only make matters worse. We are still coping with the dramatic increase of the dollar in late 2014 and early 2015, so any further rise will only make the burden worse.

Additionally, we do not know the extent that global central banks will go to in order to compete with one another. Last summer and early fall, China lowered the value of their currency significantly and that was immediately followed by devaluations from Korea, Japan, Taiwan and others who are China's primary competitors. We anticipate that the strength of the U.S. dollar won't subside anytime soon as the entire world tries to figure out what the global economies will look like in a post BREXIT world. While the implications of a stronger U.S. dollar have their damaging aspects, it is still somewhat comforting that our currency remains the preferred global currency as it remains the significant safe haven for global trade. The strong dollar will also have its continued downward impact on global commodity prices including oil and gold.

ASSET CLASS

U.S. Equity

Climbing the wall of worry? Best house in a bad neighborhood? High correlation with the S&P 500 Index and oil! These are all terms used by market theorists to justify why stocks move up even though the fundamental backdrop to support such a move has deteriorated. Like most opinions, they have some merit but shouldn't receive too much credit. We have opined here in the past that stocks will occasionally move on more than just fundamentals—over the short-run, stocks move on emotion, either good or bad; domestically and globally.

During the quarter, the Fed remained extremely dovish and the odds of them being able to "normalize" (raise) rates in the short run have all but evaporated. At the time of this writing the odds makers are indicating all the way out to late 2017 that the U.S. Federal Reserve is unlikely to act. This fact helps relax those investors who think that raising rates may be detrimental to stock prices as cheap rates have helped propel this market from its dramatic lows in March of 2009. This reminds us, however that we are still over 7 years into a bull market with only a couple of pullbacks. We expect to see more volatility in the coming months as we deal with the BREXIT fallout, struggling Asian economies, continued chatter from various Federal Reserve governors and a controversial U.S. presidential election.

At this time, the economic picture also appears to be somewhat murky, but this confusion has been supportive of equity prices as global central bankers appear inclined to stay accommodative for the foreseeable future. We will, however, continue to seek pockets of value and invest capital in an opportunistic manner using the volatility which creates new bargains in the selloffs. We buy individual companies, not market indexes. The sector rotation is significant in today's market and we will continue to use the rotational loser sectors as our best source of new candidates.

As discussed in past communications and at our presentations, we have shifted the portfolios to a more domestic focus. We are doing everything we can to minimize unpredictable global volatility coming from things such as BREXIT and Asian economic weakness. While the final outcome of a full BREXIT is difficult to model, the fact remains that global markets are going to remain volatile. Emotions outweigh fundamentals in financial markets in the short run.

The second quarter showed a market that had the inclination to want to move higher although it was quickly disrupted during the last week with the election results coming from the United Kingdom and their populist vote

	to withdraw from the European Union. Some cited the move in stocks as one of the most "hated" rallies in a while, as stock prices moved up without improving fundamentals and in the face of some very high profile global calling for equity market pullbacks in the second half of 2016. Looking at the whole quarter, however, ICM investment portfolios continued to be rewarded for being invested in the value stocks that persisted in leading growth through most of the quarter.
Fixed Income Markets	The second quarter of 2016 proved to be a much more stable environment for fixed income investing. We didn't have disruptions like those that occurred during the fourth quarter of 2015 with various fixed income funds going out of business, forcing liquidation of portfolios which also spilled over into the beginning of the first quarter. As oil prices continued to recover during much of the quarter, the fear of a slew of energy companies facing financial difficulties and ultimately going bankrupt subsided. The U.S. dollar as measured by the Dollar Spot Index (DXY) didn't rise materially until the last week or so of the quarter, which helped stabilize other commodity prices. This provided some additional stability for the corporate fixed income environment. The large fear of financial defaults that we experienced during the first quarter simply did not materialize. In fact, with the weakness abroad and the negative yields that are being experienced by several of the developed economies, we saw a strong bid for U.S. treasuries, which saw the yield of the U.S. 10-year treasury fall from 1.77% at the beginning of the quarter to 1.47% at the end of the quarter. The insatiable demand for yield by investors was evident in the dramatic drop in yields in the U.S. treasury market and also by the demand for high yield debt, and is pushing investors further out on the quality curve. For now this scramble for yield seems like a predictable move, but it needs to be monitored as this may quickly reverse if we see any substantial distress in the quality of business of the underlying high yield companies.
Commodities	As promised, the commodity markets were not boring during the second quarter. We continued to see wild swings in the metals and energy markets especially as a result of tighter supply and demand balances for several commodities and as a result of the fluctuating value of the U.S. dollar versus other currencies. We cannot, however ignore some human caused volatility here, either. We saw investors in China who have a propensity for speculation push iron ore prices back up again. In early May, we read an article where we saw that speculative activity continues to be cited as a driving force behind the surge in Chinese commodity futures. Dalian iron ore has risen 46% since the start of 2016, while approximately $330 billion worth of contracts were traded in April. This amount is equivalent to roughly four times the amount spent internationally for trading physical iron ore in a year. Analysts have attributed part of the interest in futures to the ability to watch them in real-time (minute to minute), as opposed to the spot price, which is published once daily. These disruptive forces cause extreme volatility in the valuation of resource companies operating in this global economy and do very little for the overall investing environment. As we have shown here in the past, the strength or weakness of the U.S. dollar relative to other developed economies is a significant cause for commodity volatility in the short run. With the U.S. Federal Reserve on hold for both of the Federal Open Market Committee (FOMC) second quarter meetings and electing not to raise U.S. interest rates, this moderated somewhat the strength of the U.S. dollar and in turn help boost those commodities for the short term. The volatility of commodities can provide occasional unique opportunities, however. Specifically, we are focused on a new special situation during the quarter and that is due to the significant reduction in the industry stockpiles and active mining of zinc. While this is a somewhat obscure market that isn't often discussed by the talking heads on TV, it is a very important market to industrial applications globally. Our chosen candidate is a Canadian

company mining assorted minerals but with a significant piece of its business in the global mining of zinc.

Regarding another commodity that we have discussed here for years, we got a much clearer picture of what some refer to as Texas tea, more commonly known as crude oil and professionally West Texas Intermediate crude oil. The global oil markets have been struggling to find a balance between supply and demand domestically while balancing the production levels of OPEC and non-OPEC members around the globe. We leave the quarter with the feeling that it will be difficult for new production to come online in the U.S. until the price of the commodity gets above $55 for a meaningful period of time. This price level is going to be closely watched by the largest global producer, Saudi Arabia, who reportedly has additional production capacity to bring on if necessary in order to maintain their dominant market share globally. The $55 level roughly approximates the level at which new supplies could be tapped and the Saudis have little interest in seeing these competitors emerge.

It's interesting to see how the U.S. with all of its production has actually increased its oil imports from foreign sources during the first half of 2016. This is a result of other oil rich financially poor countries selling tanker loads of oil for what they can which can often be cheaper on a per barrel price than areas of our country can deliver to refineries in the Gulf Coast. According to an article read in late March, the four-week average of imports was running at 7.9 million barrels a day, which is 9.8% higher than a year prior. This has occurred as U.S. production fell and the number of rigs drilling for oil continued its decline, ending the quarter at *421* after hitting a low of 404 in mid-May, but that is down from a whopping *2026* in 2011 and then 859 at the end of the second quarter in 2015.

WHAT TO WATCH

Geopolitics

What can we say here that hasn't already been discussed? First of all, we will not be making any projections on what happens with the relationship between the U.K. and the European Union which is most currently on our minds because of the impact it has had on global markets here at the end of the quarter. We will suggest however, that at the time of this writing, there are still several potential outcomes as to how this may turn out. But the new Prime Minister, Theresa May, has said "Brexit is Brexit" and intends to negotiate the departure, even though she doesn't appear to be in a hurry. Several possibilities have been discussed, but we ought not forget about Scotland. The House of Lords said in an April 2016 report that any decision to exit the European Union would have to be approved by the Parliaments of Scotland, Northern Ireland and Wales. Scotland overwhelmingly voted to stay in the European Union during the "Brexit" vote. There had been a lot of talk of a "do-over" although that seems unlikely now as the Conservative Party quickly elected a new leader to begin negotiations with the EU.

The other side of the BREXIT question is what do the other members of the European Union do? Is this the beginning of the end to the European Union if several unhappy countries try to go the way of the Brits, or does the European Union moderate some of their oppressive bureaucracy and give more of a voice to the individual members of the union? Immediately after BREXIT the markets started to price in a lot of fears, taking the global markets down across the board just as the quarter came to an end. This was quickly reversed as it was apparent that global central banks were prepared to be accommodative for a long time. The E.U. has been a mess for decades. The U.K. vote didn't change that, it only sped up the rate of change.

China—we know you are tired of hearing about this from us—but it isn't any better. The levels of debt in this country are unsustainably high given their decelerating economic growth rate and aspiring shift from an export economy to a consumption economy. Their total debt to GDP ratio is the second highest on the globe, second only to Japan. We saw an early sample of the implications of the risk in the high level of China's debt in early April as we witnessed a fresh wave of defaults at state owned enterprises in China when part of their $3 trillion corporate bond market was forced to cancel some bond offerings followed by further cuts in the rating of the Chinese bond market by Standard & Poor's. This issue needs to be contained and so far has largely been contained in the Asian markets. The U.S. has very little exposure to the Chinese corporate bond market, but as we have seen in the past, the worries and volatility in the second largest economy in the world will be felt in the U.S. and other global economies if circumstances turn seriously worse.

India is still managing to grow nicely even with the high levels of corruption there. With a population close to that of China, Prime Minister Modi is making some progress in helping his country accelerate its growth. The keys will be to reduce corruption and open the Indian economy to more outside investment. Lower global energy prices are also very helpful to this population in trying to grow their middle class because India is not energy self-sufficient.

Mr. Putin has recently been relatively quiet in the global theater compared to quarters past when his actions were incredibly disruptive. Part of this is likely because of the fact that their economy is still incredibly weak due to the post-Crimea global sanctions and weaker than normal energy prices. But Russia has remained more irritatingly confrontational than in recent history with the reports of the Russian military's aggressive harassment of U.S. aircraft and warships operating in the Baltic Sea. Additionally, there have been reports of an increased level of harassment and surveillance of our diplomatic personnel in Moscow by security personnel and traffic police. These harassments have increased so much that it has prompted Secretary of State John Kerry to reach out to Vladimir Putin directly asking him to stop. However, the true economic stresses being felt by the Russian government can be seen by their recent decision to sell parts of Gazprom and Alrosa, their state owned oil and diamond companies, respectively.

Finally, a brief mention of the Middle East. Syria remains a potential flashpoint, Yemen and Iraq continue to be battlegrounds, and Iran remains a confrontational question mark, but barring a dramatic and different outbreak of hostilities, the Middle East still seems likely to muddle along without any resolution to its numerous and seemingly perpetual problems. The essential thing for investors to remember is that as a result of the U.S.'s reduced dependence on imported energy, the Middle East is not the high impact threat to our economy that it once was.

MOVING FORWARD

U.S. Fixed Income Markets

It will be interesting to see how U.S. fixed income markets act the rest of the year. The corporate market will depend largely on earnings of the underlying companies. Many companies have had the opportunity to refinance debt over the last several years at much lower levels due to artificially low interest rates. We did see a trend beginning in the first quarter and into the second quarter on companies whose stocks moved up aggressively, such as select names in the energy sector. Individual companies did secondary equity offerings and then either began aggressively buying back their own corporate bonds or tendering for them at specific prices. This has been a popular strategy and something that our fixed income strategies have benefited from as we did our homework to identify investments where we felt comfortable that bond prices were too low relative to the company's ability to service its debt. This is a positive step for corporate balance sheets as it reduces companies overall indebtedness and saves them money moving forward paying coupons. It also illustrates how the U.S. corporate bond market can overreact in the short run causing companies to step in and buy their own debt at less than par.

It is hard to imagine that demand for the U.S. Treasury securities will not see continued demand. The U.S.10-year

	treasury yield relative to other global currencies is considered attractive. The U.S. 10-year treasury yield closed at 1.47% at the end of the quarter after beginning the quarter at 1.77%, which is significant when you compare that to other yields in developed markets such as Germany at -0.13%, or Japan at -0.22%. According to Bloomberg, global bonds with negative yields have reached $9.8 Trillion, a level never seen before. Demand for return *of* your money versus return *on* your money becomes the mindset in the short run with stresses affecting markets globally. This will likely continue to prevent U.S. Treasury yields from moving up in the foreseeable future. It is hard to imagine what could happen in the short run to reverse this trend. The fear of interest rates moving higher is not a concern of ours as the yields in the U.S. are much higher than that of other developed economies.
U.S. Equity Markets	The U.S. equity markets have been climbing a wall of worry. The yield on the S&P 500 Index stands at 2.19%, a full 72 basis points ahead of the yield on the U.S. Treasury at the end of the quarter. Overall earnings quality in the U.S. has deteriorated consistently for the last year. As we prepare for the second quarter earnings season, the bar for companies to hit has been lowered significantly. Therefore company guidance will be critical in determining whether or not markets can move higher, and more importantly what sectors will lead us there. Sector rotation has caused markets to churn. This creates an environment where stocks don't break out to new levels, making the market look "toppy". The demand for sectors with yield has pushed the valuation of these sectors to relative highs. The strongest sectors of the market this year were Telecom and Utility indexes which were also among the strongest sectors for the second quarter. This uneasy investing environment is creating significant bargains in individual names within those sectors that are not being bought for things like yield. This is an extremely exciting period for us as we continue to do our fundamental work. While this choppy investing environment creates extreme moves, these are the very environments we enjoy as significant value is created over time. The trend we suggested in the last couple of letters continues to develop from growth to value investing. For the year, to the end of the second quarter, the Russell 2000® Value Index is up 6.07% while the Russell 2000® Growth Index is actually -1.60%. We expect to continue to see this trend evolve and for the market to reward patient fundamental based investment advisors. Investors who choose to own index funds in an environment like this may become much more frustrated with a lack of meaningful returns relative to those invested in fundamental based investment advisors owning companies for their own stories vs. buying a market of stocks.
PORTFOLIO PERFORMANCE & ATTRIBUTION	
Small Cap Intrinsic Value	ICM's Small Cap Value Strategy portfolios underperformed the benchmarks for the second quarter, but maintained a lead for the year. The volatility around the FOMC minutes in the middle of May pushed the materials sector lower which hurt the performance of our strategy. This sector quickly returned at the end of the quarter and we continue to believe that after doing a significant amount of research in this sector there is still a lot of value here. Additionally, as in other strategies we added to our exposure to the specialty finance sector of the market for its dividend yield and business model which focuses more on the domestic economy vs. uncertain global economies. We ended the quarter with just over 15% cash and as we begin the third quarter and as we readjust the portfolios to the BREXIT news, this could increase further as we get into earnings season. This is an investing environment where managers have to be actively pursuing new ideas and trimming portfolio holdings as they reach price targets or as domestic and global conditions change. As a value manager, we are eager to see the results of many companies in the portfolio and on our watch list for additional investments. We

	expect to continue to focus on domestic based companies as we move forward but as usual we will opportunistically look for value created by what we expect to continue to be a volatile environment moving forward.
Large Cap Globally Dominant	ICM's Large Cap Globally Dominant portfolios underperformed the benchmarks for the quarter. While we are still down for the year, we were able to overcome some of the underperformance felt during the first quarter. We finished the quarter with higher levels of cash than where we started mostly due to the incredible volatility experienced in global markets as a result of the BREXIT news affecting global markets. We will begin to redeploy this cash as we get into earnings season and as we see how things begin to unfold for the status of the European Union, China and the U.S. presidential election. The global nature of companies in this portfolio makes them much more susceptible to U.S. Dollar volatility relative to other currencies. This is why we will continue to be very focused on value in this environment to find companies that can continue to grow earnings despite the negative effects of a stronger dollar. The dollar was relatively flat for a majority of the quarter and only really began a stronger rally near the end of the quarter as a result of the uncertainty surrounding BREXIT. We saw nice performance coming from the technology and energy sectors, and while we see significant value in several sectors, many lack a catalyst. As we continue to monitor global economies and other geopolitical developments we will again be able to deploy some of the cash that has been created during the quarter.
All Cap Value	Portfolios in ICM's All Cap Strategy finished the quarter relatively flat vs. the benchmarks. While the strategy did not perform as we had anticipated, we have done a deeper dive into the companies we own in this portfolio and are very comfortable with them, so we look at this as more of an issue of timing vs. bad fundamental work. We did, however finished the quarter in a much more defensive position with more cash than we began with at just over 25% cash as we did not feel the risk/return dynamics were there. As the new quarter progresses and we identify new opportunities, this will change. We took profits in the energy sector of the portfolio as we felt in the short run that oil prices are not as cheap as they were from where they started the quarter. The oil supply/demand ratio is closer to being in balance with the number of adjustments globally that have been made over the last 18 months. Inverse ETFs were utilized during the quarter to help protect for downside risks in overall markets due to much uncertainty; and although we did not have a position at the end of the quarter we anticipate using them again going forward. The increased volatility has created very attractive pockets of value and we will redeploy cash as we see continued fundamental improvement of the companies within these sectors. We continued to focus on individual companies in the portfolio with a more domestic focus as we see significant geopolitical pressures on international markets and as we have done with other strategies, we have increased our holdings of specialty finance companies such as REITS.
Enhanced Income	ICM's Enhanced Income portfolios finished the quarter, on average, up about 2%. Adding this to the first quarter's performance, most portfolios in the strategy are up just over 5% for the year and ended the quarter with a 4.8% current yield. As the market shifts its focus to yield in this unsure investing environment, this helped the enhanced income strategy with its various investments in the REIT and specialty finance sectors. This was mainly driven by the continued rally in oil prices as they attempt to normalize and with our shift in quality of names in this sector as they progress with their business plans and the rest of the market begins to recognize it. We also continued to find significant value in the corporate bond market, increasing our weighting in the lower tiers of the

	investment grade and high tiers of the non-investment grade markets. We finished the second quarter more fully invested than at the end of the first quarter and added value in the financial services sector while trimming our holdings in other sectors as they achieved our price targets. The enhanced income strategy ended the quarter less hedged with equity options than we had during most of the quarter. We ended up with just 16% of the names in the portfolio with covered calls vs. just over 64% at the end of the first quarter. This does not suggest a shift in bullishness; rather it had to do with the incredible volatility experienced in the markets just before the end of the quarter where we covered many of our positions, locking in gains. As we begin the new quarter we are opportunistically adding back in our hedges as we identify opportunities.
Micro Cap Value	ICM's Micro Cap Value Strategy materially outperformed in the 2nd quarter of 2016, driven by positive strategic management decisions, a premium tender offer and an overweight position in gold and silver mining companies. Our portfolio positioning continues to be predicated on a weak global economy propped up by accelerating global money printing. As mentioned in previous commentary letters, global money printing has inflated most assets (stocks, bonds, and now commodities) creating additional friction in a slow global economy. Ironically, the more the global economy slows, the more asset prices are propped up. Additionally, as central banks around the world create excess liquidity piled upon previous excess liquidity, asset price appreciation is becoming indiscriminant. In 2015, both commodities and small companies justifiably underperformed as they were disproportionately affected by the slow global economy. So far in 2016 global growth forecasts have declined, yet both commodities and small cap stocks have rallied. The only thing that's changed is global liquidity. This situation is not likely to change because the leaders of our global financial system (e.g. U.S. Federal Reserve, ECB, BOJ, etc.) remain the same. In this complex environment, company fundamentals will remain weak and inherently slow as further asset price appreciation clogs money velocity. This challenging business environment will create individual buying opportunities as the excess liquidity in the system quickly flows to undervalued investment opportunities. As we look forward, we are encouraged that global liquidity is seeping out to the smaller equity capitalizations and if it continues it is likely to shorten the typical holding period required to create consistent capital appreciation with this investment strategy.
Fixed Income	Our ICM Fixed Income Core Bond Strategy portfolios continued to achieve the positive performance that began in the middle of the first quarter. Our allocation to the energy and materials sectors and to the individual companies within this sector accounted for a majority of the gains in this strategy. The portfolio ended with cash very near where it began, close to fully invested for the seasoned portfolio. Seasoned accounts in this strategy ended the quarter with a current yield of approximately 5.2%. We are continuing to see value in some sectors of this market, but the volatility and negative fears that affected this asset class from the fourth quarter of last year has largely been wrung out and the extreme values we saw at that time are now gone. We are tending to stay relatively short in duration in the fixed income strategies, but we do not see an environment where 10-year treasury yields will be able to rise in a meaningful fashion at all. There has again been a tremendous amount of money flowing into High Yield ETFs, which tends to move bonds as there is an overall lack of liquidity in the fixed income markets. We will remain patient in adding more names to these portfolios which has proven to be advantageous for portfolios in this strategy for the last year or so.

We request that clients advise ICM in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at 800.488.4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.