Sound Investments Inc.

First Quarter, 2016

DJIA 17885 S&P 500 2059 NASDAQ 4920

Summary

Earnings have declined for 3 straight quarters and this trend is expected to continue for the first half of 2016. Then, earnings are expected to grow again: 5% in the third quarter and 18% in the fourth quarter. When I first read this, I thought this didn't make a lot of sense. However, when I read a few annual financial reports from energy and mining companies it was obvious they were one time charges or writing off assets to create as large of losses as possible. Although some of these losses were real, a lot were artificial. The result was weak earnings in the third and fourth quarters of 2015. Comparisons for 2016 will be easier. Another problem, is that most companies either export or derive a lot of their sales from overseas and have been hurt by the high dollar exchange rate. During 2015, the dollar rose 22%, hurting profits but has since declined approximately 5%. The prediction that earnings will recover in the 2nd half of 2016 makes sense. (See chart on page 4)

This investment letter is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research.

Perseverance Pays

Markets recovered in March after a bruising start to the year, and U.S. Stocks ended the quarter with slight gains. International markets did not fare as well posting losses of 9.2%. It was the worst January on record and by February, the markets were off approximately 13%. As a student of the market, I was wondering what happened. News reports indicated a recession was on the horizon, but the real reason was simply this ..... With oil prices declining and dipping below $30 a barrel, many oil producing nations and their sovereign funds found themselves strapped for cash flow. They had to reach into their reserve funds. What was the most liquid asset to sell to raise cash? It was the U.S equity holdings in their portfolios. This rapid decline in equities caused investors to seek defensive areas of the market like utilities and dividend paying stocks, to surge. As I write this on Apr 20th, we think the market has overcome over this tussle and it appears to be ready to make some for forward progress.

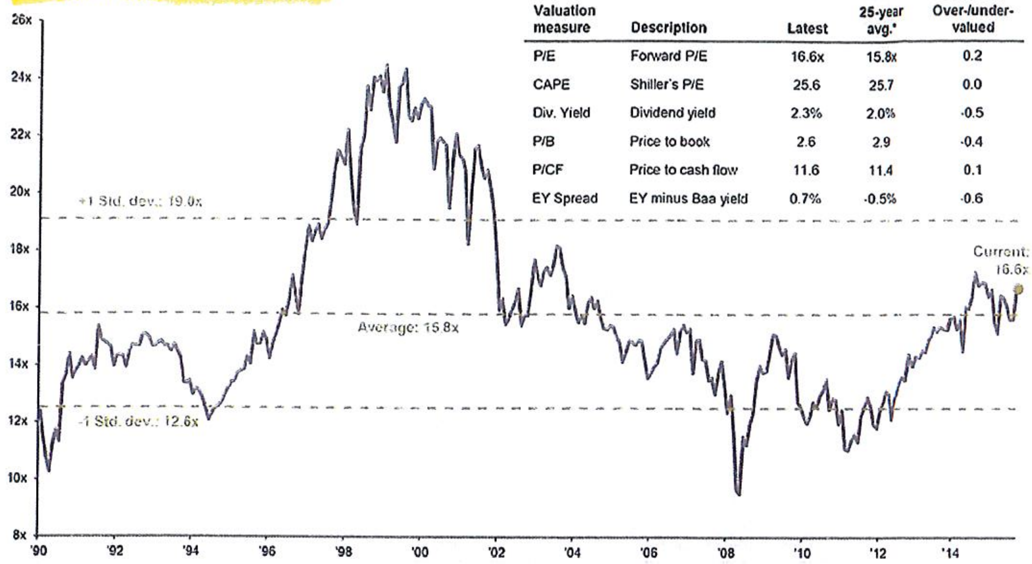
What are the Chances of a Recession and Bear Market?

There are 5 primary causes of bear markets, which are outlined as follows: 1.) Tight Money. Janet Yellow has gone out her way to indicate the Federal Reserve Board will be accommodative. 2.)Rising Rates. Interest rates are very low, but we do not see an inverted yield curve, which preceded every recession for the past 50 years. 3.) High Inflation. Inflation continues to remain tame with the core rate at 1.7% 4.) Rapid Growth. The average growth rate over the last several years is slightly above 2%, which is significantly below the post world -war growth rate of 3.24%. 5.) Overvaluation. The average S&P 500 price / earning ratio over the last 50 years has been 16 to 16.5 and that's about where we are now. (more on this later). Based on the above , at this point, we don't expect a recession or bear market but continue to monitor the situation.

page - 2 -

Equities

S&P 500 Index: Forward P/E ratio



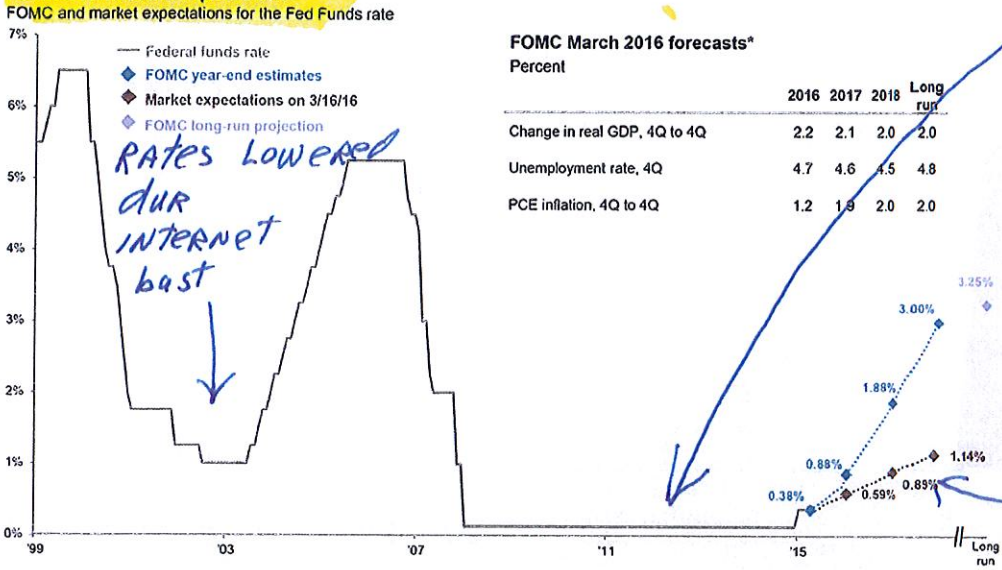
Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	16.6x	15.8x	0.2
CAPE	Shiller's P/E	25.6	25.7	0.0
Div. Yield	Dividend yield	2.3%	2.0%	-0.5
P/B	Price to book	2.6	2.9	-0.4
P/CF	Price to cash flow	11.6	11.4	0.1
EY Spread	EY minus Baa yield	0.7%	-0.5%	-0.6

This chart shows stocks are fairly valued according to historical Ratios

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months. Shiller's P/E uses trailing 10-years of

Fixed income

Federal funds rate expectations
FOMC and market expectations for the Fed Funds rate



FOMC March 2016 forecasts*
Percent

	2016	2017	2018	Long run
Change in real GDP, 4Q to 4Q	2.2	2.1	2.0	2.0
Unemployment rate, 4Q	4.7	4.6	4.5	4.8
PCE inflation, 4Q to 4Q	1.2	1.9	2.0	2.0

Rates lowered dur internet bust

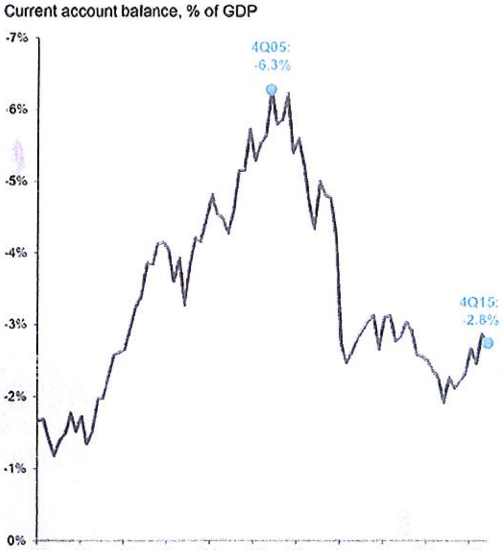
Interest Rates Lowered to Almost zero during Great Recession

The more Likely course on increasing interest Rates

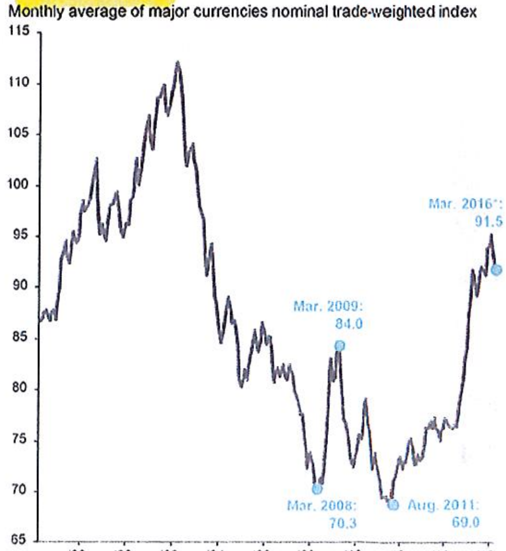
Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.

Economy

Trade balance
Current account balance, % of GDP



U.S. Dollar Index
Monthly average of major currencies nominal trade-weighted index



Big increase in dollar hurt companies who derive sales overseas. It has since moderate.

page - 2. -

Latest Economic News

Favorable economic news includes the following: 1.) Over the last two years, the economy has created approximately 5.8 million jobs, 2.) Job growth in the near term remains robust, 3.) The work week has increased;, 4.) Wages are going up at the fastest pace since the great recession, 5.) Home prices are going up and 6.) The federal government agreed to spend $80 billion more than last year. Again, none of these trends suggest that we are on the brink of a recession. The states that are dependent on oil/natural gas for a vibrant economy may have trouble, but not the whole country. We are not suggesting that there isn't plenty to worry about, (China, Britain leaving the European Common Market, Negative Interest Rates, Terrorism etc.). What we are suggesting is that things would have to change drastically to drag the U.S. into a recession.

Major Concerns Going Forward

Basically, what drives equity markets, are earnings, interest rates and lately, oil prices. Let's look at earnings first.

I. Earnings have declined for 3 straight quarters and this trend is expected to continue for the first half of 2016. Then, earnings are expected to grow again: 5% in the third quarter and 18% in the fourth quarter. When I first read this, I thought this didn't make a lot of sense. However, when I read a few annual financial reports from energy and mining companies it was obvious they were one time charges or writing off assets to create as large of losses as possible. Although some of these losses were real, a lot were artificial. The result was weak earnings in the third and fourth quarters of 2015. Comparisons for 2016 will be easier. Another problem, is that most companies either export or derive a lot of their sales from overseas and have been hurt by the high dollar exchange rate. During 2015, the dollar rose 22%, hurting profits but has since declined approximately 5%. The prediction that earnings will recover in the 2nd half of 2016 makes sense. (See chart on page 4)

II. Rising Interest rates have a big impact on the equity market because bonds or CD's paying a higher rate provides an alternative to stocks. Also higher rates increase interest expense cost which reduces profits and may make some projects uneconomical. In Dec the Fed raised rates by 1/4 of 1% and promised 4 more increases. Since then the Fed has back down to two increases and given that rates are extraordinary low the net affect is to normalize interest rates and should not hurt equities.

III. Oil has found a trading range of $38-40 per barrel and at this level, earnings from energy companies should improve and at the same time consumers will save at the gas pump.

Conclusion

When the stocks are fairly valued, like they are today, there is always a continued testing. This testing often takes the form of reacting to the latest housing data or earnings reports as it seeks conformation that investments are fairly valued. We feel that as long as the Fed stays the course, earnings hold up and the economy handles the myriad challenges in its way equities should maintain their edge over most investments. In some ways it's like threading a needle and this is normal. I welcome your phone calls.

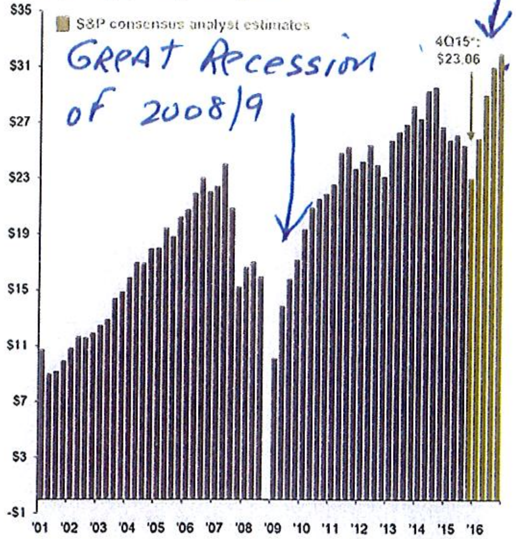
Corporate profits

— 4. —

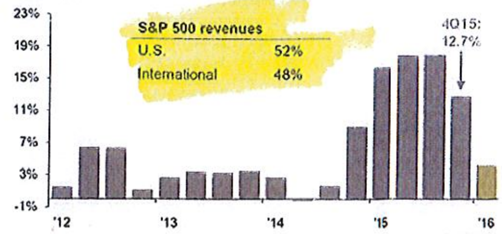
Earnings expected to Recover in 2nd half of 2016

S&P 500 earnings per share
Index quarterly operating earnings

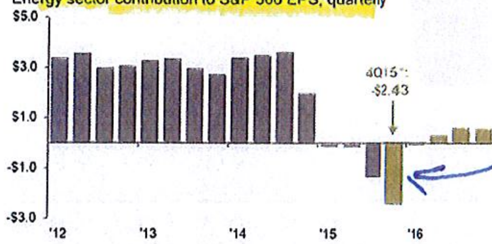
Great Recession of 2008/9



U.S. dollar
Year-over-year % change**, quarterly, USD major currencies index



Energy sector earnings
Energy sector contribution to S&P 500 EPS, quarterly



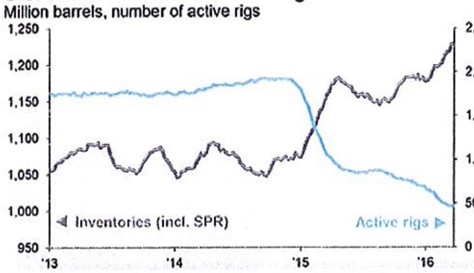
Energy Companies wrote down Assets

Oil markets

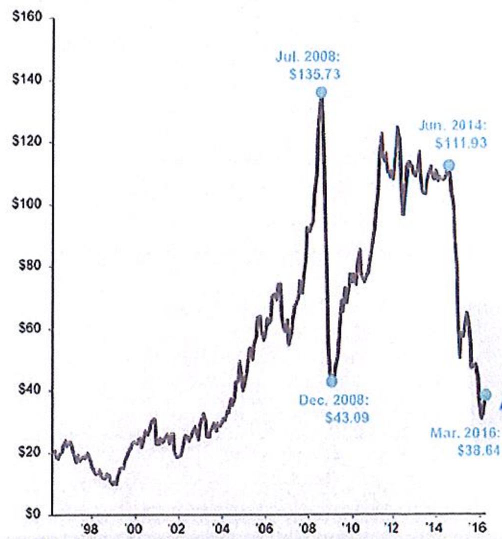
Change in production and consumption of oil
Production, consumption and inventories, millions of barrels per day

	2013	2014	2015	2016*	Growth since 2013
Production					
U.S.	12.4	14.1	15.0	14.5	17.4%
OPEC	37.3	37.2	38.2	39.3	5.1%
Global	90.9	93.3	95.7	96.4	6.0%
Consumption					
U.S.	19.0	19.1	19.4	19.5	2.7%
China	10.5	10.9	11.2	11.5	9.7%
Global	91.4	92.4	93.7	94.9	3.8%
Inventory Change	-0.4	0.9	2.0	1.6	

U.S. crude oil inventories and rig count**
Million barrels, number of active rigs



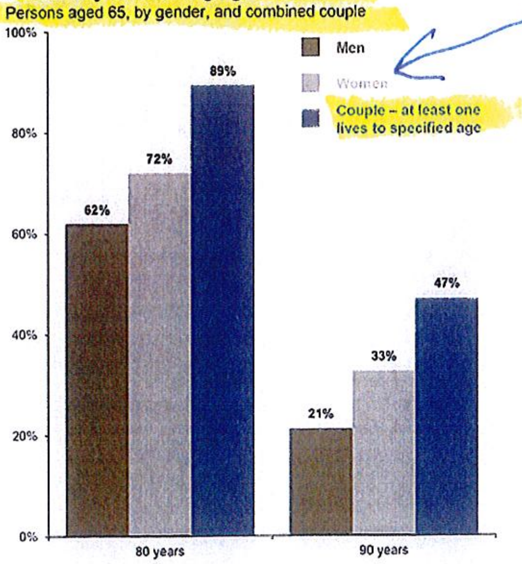
Price of oil
Brent crude, nominal prices, USD/barrel



We may have seen The Lows in Oil

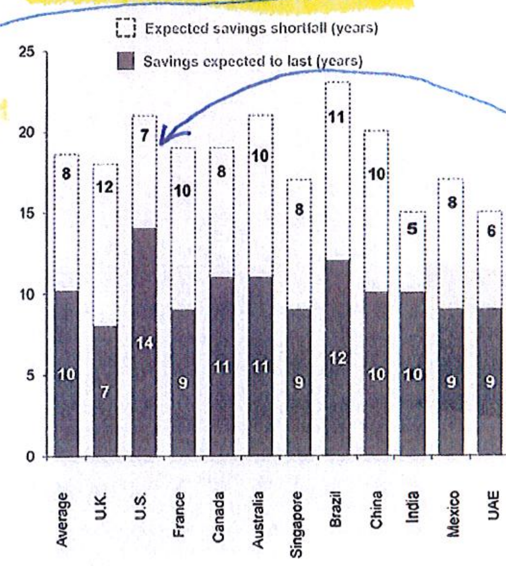
Life expectancy and pension shortfall

Probability of reaching ages 80 and 90
Persons aged 65, by gender, and combined couple



Perceived retirement shortfall by country

How Long Are you going to Live?



Short Fall in Savings in U.S.

page 4.