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Sound Investments Inc.

Third Quarter 2015

Summary

Recent surveys on retail spending manufacturing activity and the service sector, confirm that the economy is edging forward, but still operating well below capacity. Earnings are starting to come in for the Third Quarter and the early read is mixed, which has been the case for several quarters. In general, companies with a disproportionately large U.S. footprint are doing better than those with a big stake offshore. Such lackluster trends could limit growth to 2.3-2.5%. My wife, Heather, and I often watch movies and this economy reminds me of the show, "***Something Gotta Give" staring Jack Nicholson and Diane Keaton.*** Harry, played by Nicholson, has a number of transformational events that enable him to woo Erica, played by Keaton. The stock market also needs a transformational event, namely **growth** of at least 3%, in order to drive the stock market higher.

Shorter term, the markets may go sideways but longer term things look very positive.

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

DJIA 16284.7 S&P 500 1920.0 NASDAQ 4564.7

Markets Falls

In my last report, I noted that the S&P 500 Index had tripled in value in just 6 years and almost doubled in value since the fall the autumn of 2011. I was looking for a correction or decline in stocks of about 10%. Well, we finally got the correction with last quarter being one of the most volatile for stocks in four years, (See illustration on the back of this page.) The small-cap Russell 2000 index dropped nearly 12% for the quarter. Developed foreign markets fell by 9% while emerging markets fell by 12% and commodities (i.e. oil, minerals, food stuffs) fell by 18%. Biotech and healthcare fell sharply in September after years of persisted leadership, but energy or Oil and Gas companies were the biggest losers and are the primary drivers of a weak earnings trend this year.

As we discussed in our last three client letters, corrections, or pull backs, are a normal part of the market and are fairly routine. Pullbacks are mentally challenging to weather but are part of the stock market. To some extent, we migrated our losses as I sold some investments in early August and don't believe this will lead to major stock market declines like we had in in 2003 and 2008. I want to spend the remainder of this letter discussing the state of the economy.

Meanwhile, the Economy Lumbers Along

Recent surveys on retail spending, manufacturing activity and the service sector, confirm that the economy is edging forward, but still operating well below capacity. Earnings are starting to come in for the Third Quarter and the early read is mixed, which has been the case for several quarters. In general, companies with a disproportionately large U.S. footprint are doing better than those with a big stake offshore. Such lackluster trends could limit growth to 2.3-2.5%. My wife, Heather, and I often watch movies and this economy reminds me of the show, ***"Something Gotta Give"*** *staring Jack Nicholson and Diane Keaton.* Harry, played by Nicholson, has a number of transformational events that enable him to woo Erica, played by Keaton. The stock market also needs a transformational event, namely **growth** of at least 3%in order to drive the stock market higher.

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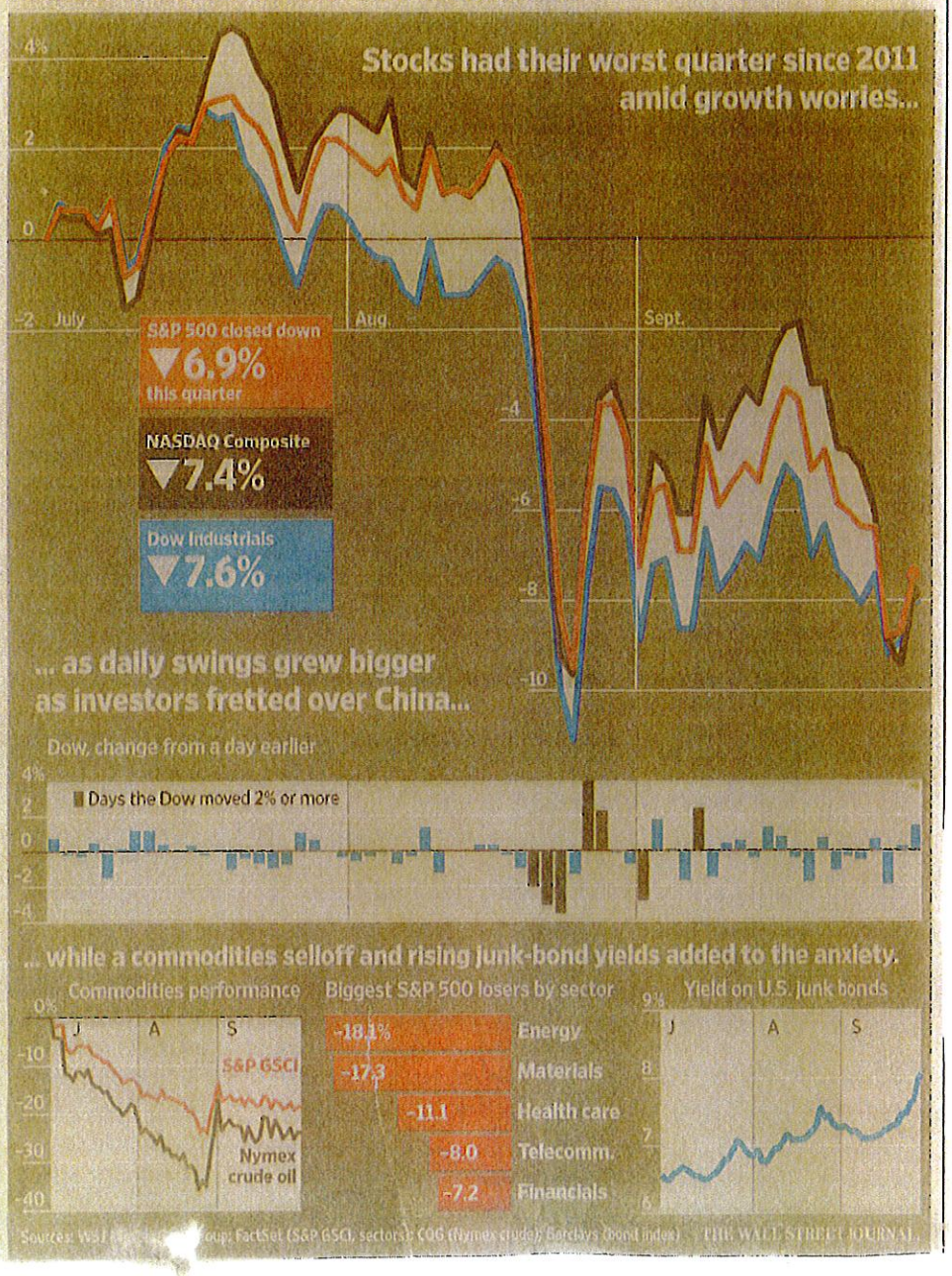
NASDAQ 4620.16 ▲ 2.3% STOXX600 347.77 ▲ 2.5% 10-YR. TREAS. ▼ 3/32, yield 2.061% OIL $45.09

A Painful Quarter for Markets



Sources: WSJ [illegible] Group; FactSet (S&P GSCI, sectors); CME (Nymex crude); Barclays (bond index) THE WALL STREET JOURNAL.

Sept 30th, 2015 MARKS the end of the worst quarter IN 4 YEARS.

The MARKET HAS since Recover, but we need better growth numbers to move ahead.

Where we are Now - The New Normal 2%!

I subscribe to an investor newsletter and wanted to share an article entitled " **The Nagging Question for Investors, Is 2% Enough?"** The writer rhymes off a number of indicators that are stuck at 2% listed as follows:

- The 10 year government bond yield has retreated to 2.02%. This is not a panic level or a predictor of a recession; but a 2% government bond yield doesn't suggest much fear of economic reacceleation any time soon.
- The dividend yield in the S&P 500 index is now in the same zone at 2.15%. Before 1960 stocks yielding more than government bonds were the norm and that phenomenon has been quite rare since then.
- Markets are fixated on 2% as the stated long-term goal for inflation.
- The American economy appears to be growing at roughly a 2% pace through fits and starts. Growth, for the first half was 2.2% and trended lower in the third quarter. So again 2% for the year might be right number.

So, what do we have? We have slow but positive growth, cool inflation readings and low interest rates which are a combination that some call the Goldilocks Environment - neither too hot nor too cold. The problem is that the three bears outnumber Goldilocks in the story which roughly translates to little progress and an economy near stall speed. Our sense is 2% is not enough to drive this market forward it can only keep it treading water or in a trading range.

The Charts

I started my career as a corporate money lender and tend to look at the sales and earning numbers first. However, when in doubt, I look at the charts! As I write this on Oct 18th 2015, a famed technical analyst, Louise Yamada, writes that a longer term top has been been forming over the past year (see charts on the reverse of this page.) She goes on to point out that since Oct 1st, leadership in the market is in a lot of depressed stocks. For example, energy or oil and gas stocks have been the worst performing sector of the year, suddenly emerged as the winners, for the quarter up 13% since Oct 1st. In addition, Louise. advises that even in the rally over the past 2 weeks we're seeing a deterioration in some of the former leaders, which suggest these rallies are not sustainable.

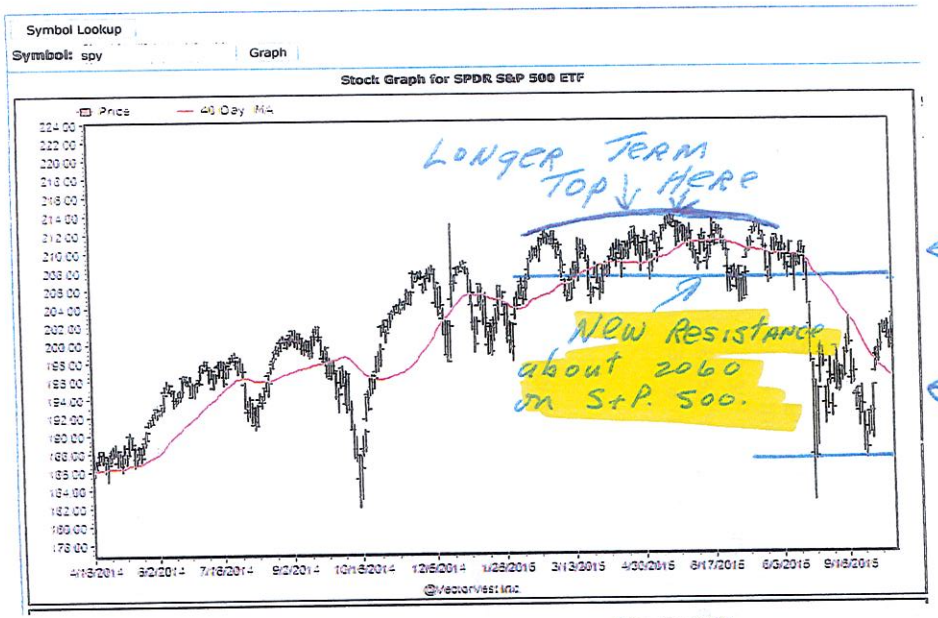
Yamada also mentions that after a big decline, markets tend to rally back or go up to the point where the downtrend started. She identified the next level of resistance to be around 2050 to 2060 on the S&P 500. She does not see a crash or anything like 2002 or 2009, but is advising that forward progress may be muted. It is important to realize the market can go down even if it does not experience a recession or slowdown.

Conclusion

The market's recent gyrations have been unnerving and we have scaled back the portfolios for the first time in 4 years. We still feel this is a correction in a bull market and expect forward progress once again. Investors remain in a forgiven mood and this sideways move could continue for a quarter or two. Shorter term the markets may go sideways but longer term things look very positive. Please feel free to call anytime.

I recently received the Five Star Wealth Manager Award and will be featured in the Kansas City Journal. Thank you all for your loyalty and confidence in working with us throughout the years.

Equities



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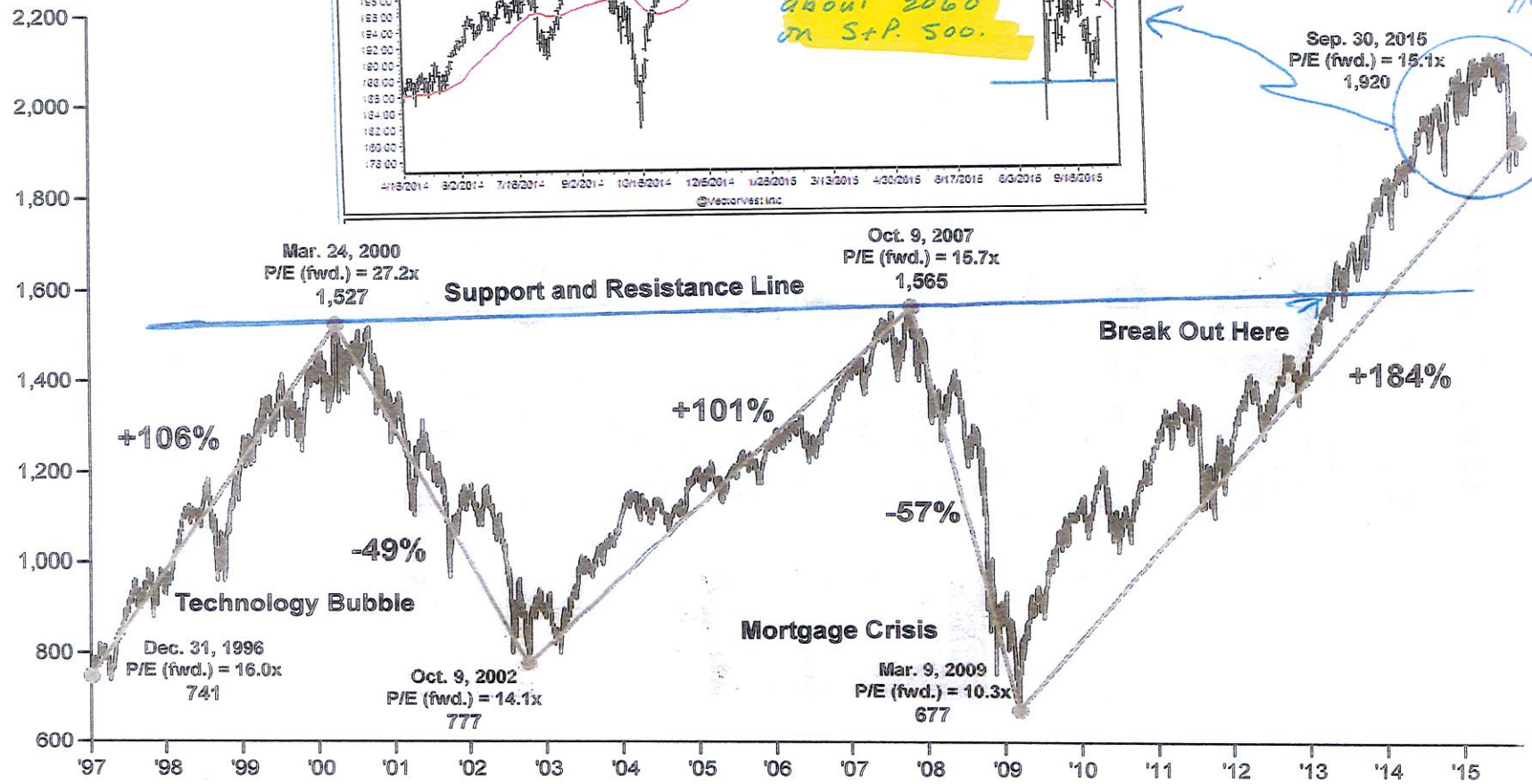

Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.