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"Diligence is the mother of good fortune."
—Miguel De Cervantes
(Spanish writer/1547-1616)

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Dear Clients:

U.S. stocks experienced further turbulence (which is normal) in the second quarter, but generally posted modest positive returns for the three- and six-month periods ending June 30, 2018. Even so, the S&P 500 remains about 5.4% below its peak reached on January 26, 2018.

"Growth" stocks once again trounced "Value" stocks, as the mega-capitalization technology "FAANG" stocks (i.e. Facebook, Amazon, Apple, Netflix and Google) continued their fundamentals- and gravity-defying ascents. According to Bespoke Investment Group, the ***five FAANG stocks added $523 billion*** to their market caps in the first half of 2018, while the ***other 995 stocks in the Russell 1000 Index (i.e. the largest 1000 market cap stocks in the Russell 3000 Index) added a total of $183 billion.***

We can attest it's made life difficult not owning the FAANG stocks, but just like during the technology bubble of the late 1990s, the valuations just don't make sense to us. Past performance is no guarantee of future results, but after enduring an extended period of pain and doubt, we were eventually vindicated. We'll expand on that later.

While our overall outlook for U.S. stocks and our portfolio remains solidly positive (earnings, employment and economic growth remain strong), there are also significant headwinds.

Trade tensions between the U.S. and China, Canada, Mexico and the European Union remain high with the rhetoric and threats getting hotter. The hypothetical trade war between the U.S. and China became reality just after midnight on July 6 when the U.S. slapped tariffs on $34 billion of targeted Chinese products and China immediately responded in-kind. As Liz Ann Sonders of Charles Schwab said recently, while the "first order" effects of currently-proposed tariffs on growth of gross domestic product (GDP) will be dwarfed by the stimulus from tax cuts and less regulation, "second order" effects on business and consumer confidence must also be considered. The "animal spirits" of capitalism can be fleeting and business and investors hate uncertainty.

As we'll explain further, the third quarter of a midterm election year (MTEY—which we're currently in) has historically been a difficult period for stocks. Fortunately, the 12-months following a midterm election has historically been a strong period for stocks.

So, while we expect turbulence and will not be surprised to see weakness in the third quarter, stocks should be better once we get past Election Day.

Periods ending June 30, 2018
(Total Returns-Annualized*)

	Russell 3000 Index	Russell 3000 Growth Index	Russell 3000 Value Index	S & P 500 Index
Three-Months	3.89%	5.87%	1.71%	3.43%
Six-Months	3.22%	7.44%	-1.16%	2.65%
One-year*	14.78%	22.47%	7.25%	14.37%
Two-years*	16.63%	21.59%	11.64%	16.12%
Three-years*	11.58%	14.63%	8.48%	11.93%
Five-years*	13.29%	16.14%	10.40%	13.42%
Ten-years*	10.23%	11.78%	8.60%	10.17%

Growth Continues to Trounce Value—When Will It End?

As Bespoke said in a recent report, there haven't been many other times in the last twenty years where it has been worse to be a value investor. It certainly feels that way.

The Bespoke graph on the next page shows the relative strength of the S&P 500 Value Index relative to the S&P 500 Growth Index. In the graph, a rising line indicates value stocks are outperforming and vice-versa. "Looking at the chart, the road for value investors has certainly gotten lonely," they wrote. Further, "for more than a decade now, we have seen a steady decline in the relative strength of the S&P 500 Value Index, with barely even any brief periods that bucked the trend."

As the chart also shows, the last time the relative outperformance of growth reached this extreme level was during height of the technology bubble. All bubbles eventually pop, but unfortunately nobody can say when this trend will reverse.

In the cover story of the April 28, 2018 issue ***"Are Value Stocks Ready to Grow Again?"*** Barron's wrote "Value investing *should* work. At its most basic, it's buying stocks that are cheap and holding them until the rest of the market realizes these great companies are selling at a bargain price, and pile in, driving prices up. Endless research has been done on the so-called value factor; the most well-known was published by economists Eugene Fama and Kenneth French. Using decades of data, the duo posited in 1992 that value—buying the cheapest stocks and selling the priciest—was one of three factors contributing to outperformance. Over the long term, that has generally been true. But since 2006, growth stocks—shares of companies whose earnings are growing at an above-average rate—have outpaced value stocks, especially in the U.S. This has caused consternation and speculation: Is value dead?"

As Mark Twain said, we think reports of value investing's death are greatly exaggerated and believe discipline and patience will eventually be rewarded.

Stocks typically struggle during midterm election years

There is a "Presidential Cycle" for stocks, a pattern of performance coinciding with various years of a presidency. In particular, Year 2 of a presidency is a Mid-term Election Year ("MTEY"), with Congressional elections held in November. Historically, stock prices have been weaker in MTEYs than in Years 1, 3 or 4 of a Presidential Cycle.

We are at the halfway point of 2018, a MTEY, so it's instructive to review past performance in similar years. While past performance is no guarantee of future results, studying historical patterns may give clues as to what to expect in the weeks and months ahead.

According to Sam Stovall, Chief Equity Strategist of CFRA, stocks are challenged during MTEYs, possibly due to the uncertainty associated with the change in the presidential party's representation in Congress. Indeed, as shown in the table, the party controlling the White House lost an average of 22 House seats and 4 Senate seats in the 18 MTEYs since 1946. Further, for the six-months leading up to the election, the S&P 500 fell in price in 50% of all observations, declining an average of 1.1% and slipping by double-digits in five of nine times.

For ***first-term*** midterm elections (like 2018), the S&P 500 dropped an average of 3.0% in the same six-months and declined 60% of the time.

Mid-Term Elections Returns & Results

Mid-Term Election Year	S&P 500 % Changes Apr. 30-Oct. 31	Pres. Party Change House	Pres. Party Change Senate
1946	(20.9)	(54)	(12)
1950	8.1	(28)	(5)
1954	12.1	(18)	(1)
1958	18.2	(48)	(12)
1962	(13.4)	(4)	2
1966	(11.9)	(48)	(4)
1970	2.1	(12)	1
1974	(18.2)	(48)	(4)
1978	(3.8)	(15)	(3)
1982	14.8	(26)	2
1986	3.6	(5)	(8)
1990	(8.1)	(8)	(1)
1994	4.8	(54)	(9)
1998	(1.2)	5	0
2002	(17.8)	8	1
2006	5.1	(30)	(6)
2010	(0.3)	(64)	(6)
2014	7.1	46	(9)
2018	???	???	???
All 18	**(1.1)**	**(22)**	**(4)**
First Term	**(3.0)**	**(25)**	**(3)**

Source: CFRA, S&P DJ Indices. Past performance is no guarantee of future results. Data: 4/30/46-10/31/15.

As shown in Stovall's second table, the S&P 500 recorded the worst 6-month stretch of the entire 16-quarter Presidential Cycle during the second and third quarter of Year 2, with average declines of 2.0% and 0.9%, respectively. Fortunately, the two worst quarters of the Presidential Cycle were followed by the three best.

Further, the MTEY price weakness phenomenon was even more pronounced for small-capitalization stocks, with the Russell 2000 index dropping 2.5% and 6.7% in the second and third quarters in MTEYs since 1978 and losing 3.8% for the year.

S&P 500 Returns in the Presidential Cycle
Data: 12/31/44-5/4/18

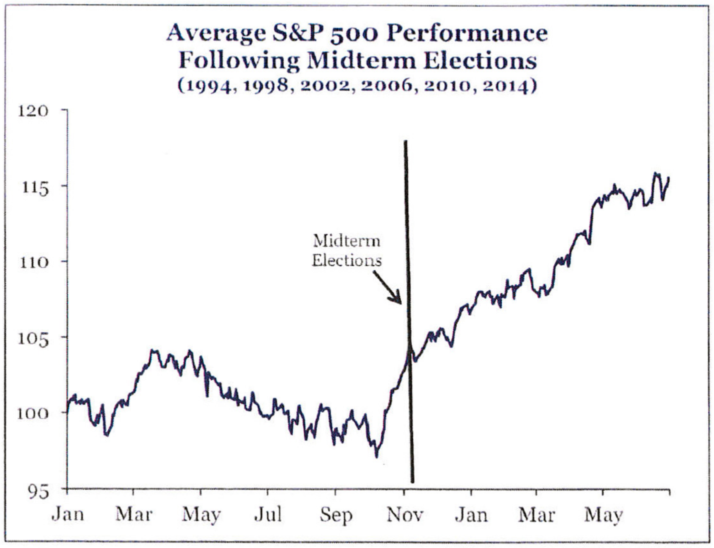
Pres. Cycle	Average Price % Changes Q1	Q2	Q3	Q4	Year	Frequency of Price Gains Q1	Q2	Q3	Q4	Year
Year 1	(0.1)	2.6	1.3	3.8	**8.2**	53%	58%	63%	79%	**63%**
Year 2	1.1	(2.0)	(0.9)	7.5	**5.7**	47%	53%	61%	89%	**61%**
Year 3	6.6	4.6	0.6	3.1	**15.2**	89%	72%	56%	71%	**88%**
Year 4	1.2	2.3	0.6	1.8	**6.3**	61%	67%	56%	78%	**78%**
All Years	**2.2**	**1.8**	**0.4**	**4.1**	**8.8**	**62%**	**62%**	**59%**	**79%**	**72%**

Small Cap Returns in the Presidential Cycle
Data: 12/31/78-5/4/18

Pres. Cycle	Average Price % Changes Q1	Q2	Q3	Q4	Year	Frequency of Price Gains Q1	Q2	Q3	Q4	Year
Year 1	1.2	7.4	3.0	5.6	**17.0**	60%	100%	70%	80%	**90%**
Year 2	3.7	(2.5)	(6.7)	2.4	**(3.8)**	70%	33%	33%	89%	**56%**
Year 3	8.9	7.1	(0.1)	1.4	**17.0**	80%	60%	50%	70%	**60%**
Year 4	2.8	2.2	3.8	1.5	**10.9**	67%	67%	67%	67%	**78%**
All Years	**4.1**	**3.7**	**0.3**	**3.0**	**11.0**	**70%**	**67%**	**56%**	**77%**	**72%**

Source: S&P Capital IQ, Yahoo.com. Russell 2000 from 1979-1994, S&P SmallCap 600 thereafter. Past performance is no guarantee of future results.

Additionally, as shown in the graph from Strategas Research Partners on the next page, the months following a midterm election have typically been positive.



Source: Strategas Research Partners

If historical patterns hold, stocks will tread water ahead of the November 6 midterm election, but better returns should be ahead.

The implications of rising interest rates and a "flattening" yield curve

The primary objective of the Federal Reserve ("the Fed") is to create conditions favorable to maximum employment, stable prices (low inflation) and moderate long-term interest rates.

In response to the global financial crisis, the Fed established a near-zero short-term interest rate policy, making it easier for consumers and businesses to borrow and spend money which would, in turn, stimulate the economy. This period of near-zero interest rates lasted for seven years and led to a pick-up in economic activity and improved consumer and business balance sheets.

Fast forwarding, as unemployment has dropped and inflation picked-up, the Fed has responded with a series of ***seven rate hikes*** from December 2015 to June 2018. This has naturally led to increases in rates paid by borrowers to lenders. The Fed has signaled its intent raise short-term rates two more times before year-end.

While yields on short-term bonds have been moving higher, yields on longer-term bonds (such as 10-and-30-year U.S. Treasury bonds) have remained essentially unchanged, leading to a "flattening" yield curve (the difference in yields from shortest- to longest-maturity bonds—the yield curve is generally upward sloping). This is a much-watched financial indicator, as an "inverted" yield curve (where short-term yields exceed long-term yields) has typically preceded a recession by 13 months on average dating back to 1913.

The yield curve (defined as the difference between 10-year and 2-year U.S. Treasury bonds) currently sits at 0.35%, down from a high of 2.8% in March 2010 and 2.6% in December 2013. We're watching this closely, but it's important to remember 1) the yield curve is flatter than it has been, but is still positive and 2) while every recession has been preceded by an inverted yield curve, a recession has not followed every inverted yield curve (i.e. an inverted yield curve is an imperfect predictor or recession).

Summary

KM celebrated its 43rd Anniversary on May 1, 2018. This is a milestone very few investment management firms reach. We owe it all to you, our clients. We thank you for the trust and confidence you've placed in us and work hard every day to earn it.

Regards,

Kirr, Marbach & Company, LLC

Past performance is not a guarantee of future results.

The Russell 3000 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. stock market. This index cannot be invested in directly.

The Russell 3000 Value Index is an unmanaged, capitalization-weighted index that measures the performance of the value segment of the U.S. equity universe. It includes those Russell 3000 Index companies with lower price-to-book ratios and lower expected growth values. This index cannot be invested in directly.

The Russell 3000 Growth Index is an unmanaged, capitalization-weighted index that measures the performance of the growth segment of the U.S. equity universe. It includes those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. This index cannot be invested in directly.

The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This index cannot be invested in directly.

The S&P 500 Value Index is an unmanaged, capitalization-weighted index that measures the performance of the value segment of the U.S. market for large capitalization stocks. It includes those S&P 500 Index companies with lower price-to-book ratios and lower forecasted growth rates. This index cannot be invested in directly.

The S&P 500 Growth Index is an unmanaged, capitalization-weighted index that measures the performance of the growth segment of the U.S. market for large capitalization stocks. It includes those S&P 500 Index companies with higher price-to-book ratios and higher forecasted growth rates. This index cannot be invested in directly.