Lark Research, Inc.

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INCOME BUILDER

2016 First Half Portfolio Performance

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MAJOR POINTS:

- Summary: The total return on the overall portfolio was 7.2%, with stocks up 13.3% and fixed income up 3.5%. (p.1,6)
- Stocks. The equity portfolio's 13.3% total return outperformed the benchmark S&P 1500 by 910 bp. The strong relative performance was due to the rebound in oil & gas and gold mining stocks, as well as the portfolio's exposure to utilities, telecom and select individual stocks that outperformed. (p.1,2,4,5)

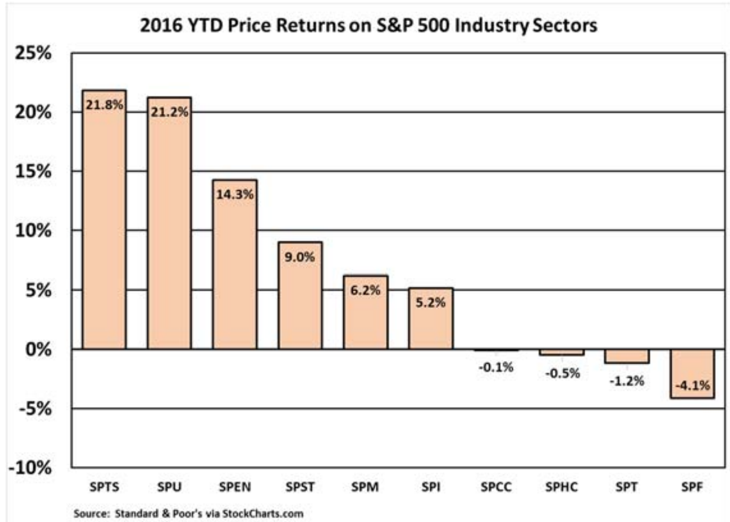
  Bonds. The 3.5% total return underperformed both high grade and high yield, due to a premature sale of preferred stocks and a high weighting of low yielding floating-rate notes. (p.3,5)
- Other investments American Eagle gold coins rebounded sharply. Cash continued to produce a return near zero. (p.3,4)
- Risk profile. The portfolio's market exposure has been cut significantly in both equity and fixed income. Its allocation to equity dropped from 51.4% to 30.5%. Fixed income declined from 12.4% to 8.9%. Cash increased from 30.7% to 54.4% of total assets. Although I am concerned about near-term risks, I will look to rebuild market exposure over time, mostly by taking fewer but larger positions.

The Income Builder model portfolio generated a total return of 7.2% and so achieved its primary objective of exceeding the rate of inflation. The portfolio beat equity benchmarks, but lagged in fixed income. It gained from the strong rebound in specific stocks and sectors that had dragged down its performance in 2015, most notably in oil & gas and gold.

STOCKS. The IB equity portfolio performed well, more than making up for losses suffered during 2015. Over the past 18 months, the portfolio has delivered a total return of 9.3%, compared with the S&P Composite 1500's return of 5.25%.

In the 2016 first half, the portfolio generated a total return of 13.3%, ahead of the the S&P Composite 1500's total return of 4.2%. (The S&P 1500 is an "all-cap" index, made up of the S&P 500, the S&P 400 Mid-Cap and the S&P 600 Small Cap indices. Thus, it more closely matches the structure of the IB equity portfolio.)

The large cap portion of the portfolio, which now accounts for 52.7% of the total equity portfolio, posted a total return of



7.6%, better than the S&P 500's 3.8% return. That sub-portfolio benefited from its positions in Barrick Gold (ABX), AT&T (T), Campbell Soup (CPB), Lockheed Martin (LMT), Merck (MRK), Public Service Enterprise Group (PEG), United Parcel Service (UPS), Verizon (VZ) and Waste Management (WM). Those gainers more than offset double-digit losses in American Express (AXP) and American International Group (AIG).

The Mid-Cap portfolio rebounded sharply after last year's double-digit losses. with a total return of 24.2% in the 2016 first half. The Mid-Cap portfolio's return exceeded the S&P Mid-Cap 400's total return of 7.9%. Big gainers in this group included American Water Works (AWK), Atwood Oceanics (ATW), Cimarex Energy (XEC), Denbury Resources (DNR), Diamond Offshore (DO), Iron Mountain (IRM), New Jersey Resources (NJR), Senior Housing Properties Trust (SNH) and South Jersey Industries (SJI). Many of the energy companies in this group posted big double-digit gains coming off of depressed end-of-year levels. Losers in this group included New York Times (NYT), Sears Holding (SHLD) and Toll Brothers (TOL)

The IB small cap sub-portfolio outperformed the S&P 600 Small Cap index again in 2016, gaining 13.8% compared with the

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Income Builder 2016 H1 Equity Model Portfolio Performance

	31-Dec-15 Beginning Value	Changes During Period Realized Gain/(Loss)	Unrealized Gain/(Loss)	Net (Sales) Purchases	Dividends/ Interest	Commissions/ Fees	30-Jun-16 Ending Value
Large Cap	293,665	3,558	10,329	(142,853)	3,115	(180)	167,634
Mid-Cap	148,938	13,448	12,522	(72,270)	1,405	(105)	103,937
Small Cap	58,659	(958)	6,985	(18,724)	850	(60)	46,751
Total	501,261	16,047	29,836	(233,846)	5,370	(345)	318,322

IB Equity Portfolio	Year-to-date Total Return	Year-to-date Tot. Ret. exc. Div./Int.
Large Cap	7.57%	6.12%
Mid-Cap	24.17%	22.79%
Small Cap	13.83%	12.00%
Total	13.25%	11.77%

Stock Benchmarks

S&P 500	3.84%	2.69%
S&P Mid-Cap 400	7.93%	7.00%
S&P SmallCap 600	6.23%	5.45%
S&P Composite 1500	4.20%	3.08%
Blended Benchmark	5.41%	4.37%

S&P 600's 6.2% gain. Here, the big gainers included Artesian Resources (ARTNA), KB Home (KBH) and Meritage Homes (MTH).

The composition of the portfolio has changed markedly since the beginning of the year. I have undertaken a portfolio restructuring, designed to reduce the number of investments in the portfolio (to make it more manageable) and also to reduce equity exposure out of concern about what I perceive as increasing downside risk. So far, I have sold part or all of 22 positions and reduced the number of equity positions in the portfolio from 46 to 32 (see Bulletin 1442). Similarly, the dollar value of the equity portfolio has declined from $501,261 to $318,322 since the beginning of the year, even though the equity portfolio produced $47,883 of realized and unrealized gains.

Ideally, I would like to carry about 20 equity positions. That would imply the potential sale of another 12 positions. However, I have not decided upon the timing of these additional potential sales.

Market 2016 Performance and Outlook. After a terrible start to the year, the market bottomed on February 9 and rebounded sharply. The rally took the S&P 500 to new highs for the year to 2111.05 on April 20 and then to 2120.55 on June 8. Still, the S&P has been unable to top its previous, all-time high of 2134.72, set nearly 14 months ago on May 20, 2015.

Energy-related stocks helped to lead this year's rebound, due to a recovery in the price of oil. Several of our positions in the energy sector rallied 20%-80% from their starting year levels.

Despite an improvement in market sentiment, there is still considerable uncertainty about the prospects for the global economy and financial markets. No primary theme emerges from the stock market rebound. Consequently, it is difficult to explain the rally.

The top performing S&P 500 sectors in the first half were utilities and telecommunications with gains of 20.2% and 20.8%, respectively. These are typically sought by investors seeking income and reduced risk. Those sectors rarely generate such high returns in a six month period.

After utilities and telecom, most of the next best performers were "risk-on" sectors, including energy, industrials and materials. This is not so surprising, since a stock market rebound is generally associated with an improvement in the economic outlook. In some cases, a rebound in commodity prices also helped to propel the recovery in stock prices.

S&P 500 laggards for the first half included technology, down 1.2%, and financials, down 4.1%. Technology has traditionally assumed a leadership roll, so its relatively weak performance is telling. Meanwhile, the decline in financials is very disappointing and so adds to concerns about the market's prospects.

I previously noted (Risk/Reward Market Commentary—March 27, 2016, on the website) that the lack of participation from financials would likely cause the stock market to remain range-bound. Financials did participate in the mid-February rally, but they have faded since then and took a steep plunge in June after the U.K. voted to leave the E.U. Poor performance by financials is a warning sign that should not be ignored.

Despite the recovery off of the February lows, I am now less optimistic about the global economy's ability to achieve lift-off. As I saw it, an economic recovery in Europe was the key to the "thread-the-needle" scenario which would lead to an easing in the value of the dollar and an acceleration in economic growth in the U.S. and

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other parts of the world. This would provide sufficient cover to allow the Federal Reserve (and eventually other central banks) to back away from their unprecedented monetary accommodation policies and begin the process of deleveraging their balance sheets.

Although "Brexit" may not have an immediate impact, it creates more uncertainty that will dampen economic recovery prospects in the E.U. That, along with the exceedingly slow pace of economic recovery there makes it more likely that the global economy will not recover sufficiently to allow the world's central banks to "reload." Although all hope is not yet lost, I now believe that it is just a matter of time before the financial markets suffer a more consequential setback.

This sentiment can be seen in the stock charts as a long and drawn out topping process. The mixed performance between risk-on and risk-off sectors highlights the market's lack of direction. Under the surface, many risk-off sectors are now trading at or near historically high multiples, making them more vulnerable in a general market sell-off. Risk-on sectors are cheaper, but are more exposed to the global economy, making them still vulnerable in a sell-off.

FIXED INCOME. The Income Builder model bond portfolio's total return was 3.5%. This was worse than the 7.7% total return on Barclays U.S. Corporate Index and also worse than the 9.3% return on Merrill Lynch's High Yield (Constrained) Index.

In the 2016 first half (Bulletin 1441), I sold all of the preferred stock holdings, including the DuPont Class A Preferred, Post Properties Series A, UMH Properties Series A and Zions Bancorp Series G. In light of the continued decline in interest rates, this move cost the portfolio roughly 3.3% in performance.

I also added the Amgen senior floating rate notes and the Weyerhauser 7 3/8% notes due 2019. As expected, the Amgen floaters were a modest drag on portfolio performance because their yield is only about 1.25%. However, the Weyerhauser bonds have performed roughly in line with other short-term investment grade-rated corporate bonds.

The portfolio did benefit from a modest snapback in coal bond prices; but at current low levels, the impact on the portfolio was only slight.

Other mostly high yield corporate bonds produced positive returns, but less than the index averages. Some of the underperformance is due to their shorter maturities, but the lagging performance also bears watching since these are for the most part riskier bonds.

One bond matured in the 2016 first half, the Apple Floating Rate Notes on May 3.

Attention to the fixed income portfolio remains a priority, but I am reluctant to load up now, given very low yields. I believe that attractive shorter-term corporate bonds can still be found, but finding them takes time.

I still hope to invest in distressed energy bonds, but I missed the recent rally. Hopefully, there will be another opportunity before too long to buy bonds at attractive prices.

OTHER INVESTMENTS. The model portfolio is now significantly overweight cash. With the sales of positions in both the equity and fixed income portfolios during the first half, the cash position nearly doubled from about $300,000 to more than $568,000. As a percent of the total portfolio, cash increased from 30.7% to 54.4%.

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Income Builder Fixed Income Portfolio

Closing Positions at June 30, 2016

	Securities Held	Adjusted Cost/Bond	Total Basis	Market Price	YTD Total Return	Safety Rating	Perf. Rating
Amgen Senior Flt. Rate Notes due 5/22/19	10	998.27	9,983	1,002.00	0.2%	A-	3
Arch Coal 7% Senior Notes due 6/15/19	10	785.83	7,858	18.80	50.4%	E	1
Blackrock Global Floating-Rate Income Trust (BGT)	500	14.40	7,200	13.07	6.9%	C-	3
Cloud Peak Energy 6,375% Sen Nts due 12/15/24	10	1,033.00	10,330	330.79	21.2%	E	3
Coca-Cola Co. Floating Rate Notes due 11/1/16	20	1,001.43	20,029	1,001.61	0.4%	A-	3
Donnelly (R.R.) & Sons 8.25% Notes due 3/15/19	10	1,015.92	10,159	1,114.26	4.2%	D+	4
Horton (D.R.) 4% Senior Notes due 2/15/20	10	1,010.00	10,100	1,051.00	4.5%	C-	3
Monsanto Floating Rate Notes due 11/4/16	10	1,003.50	10,035	1,000.70	0.7%	B-	3
Sears Holding 6.325% Sr. Sec. Notes due 10/15/18	10	981.79	9,818	943.18	4.4%	D	4
Weyerhauser 7.375% Notes due 10/1/19	10	1,154.62	11,546	1,213.23	5.1%	B+	3

Income Builder Equity Portfolio

Closing Position at June 30, 2016

STOCK	NO. OF SHARES	ADJ. BASIS	6/30/16 PRICE	EPS 2016E	PE RATIO	EPS 2017E	PE RATIO	DIV. YIELD	YTD RETURN	SAFETY RATING	PERF. RATING
Large Cap Stocks (54.1%)											
AT&T (T)	200	26.49	43.47	2.86	15	3.02	14	4.4%	26.3%	C-	3
American Express (AXP)	100	90.40	60.69	5.56	11	5.60	11	1.9%	-12.7%	C	4
American Int'l Group (AIG)	500	31.06	52.87	4.00	13	5.59	9	2.4%	-14.7%	C-	3
Baker Hughes (BHI)	200	44.77	45.83	(1.93)	NM	(0.07)	NM	1.5%	-0.7%	C-	3
Barrick Gold Corp. (ABX)	400	19.28	22.21	0.59	38	0.70	32	0.4%	200.9%	D+	3
Campbell Soup (CPB)	300	27.19	66.06	2.98	22	3.16	21	1.9%	25.7%	C	4
General Electric (GE)	300	19.17	31.49	1.50	21	1.74	18	2.9%	1.1%	C+	3
General Motors (GM)	300	29.63	28.89	5.64	5	5.83	5	5.3%	-2.5%	C-	2
Imperial Oil Ltd. (IMO)	550	40.21	31.74	0.58	55	1.98	16	1.4%	-2.2%	B	2
Merck & Co. (MRK)	200	32.14	57.94	3.72	16	3.76	15	3.2%	9.7%	B-	4
Microsoft (MSFT)	200	27.45	51.16	2.67	19	2.89	18	2.8%	-7.8%	B-	4
Public Serv. Ent. Grp. (PEG)	200	31.80	46.50	2.87	16	2.89	16	3.5%	20.2%	C+	4
United Parcel Service (UPS)	150	66.16	108.36	5.81	19	6.23	17	2.9%	12.6%	B-	3
Verizon Comm. (VZ)	100	46.79	56.23	3.91	14	4.04	14	4.0%	21.7%	C-	3
Mid-Cap Stocks (30.8%)											
Amer. Water Works (AWK)	100	17.28	84.10	2.83	30	3.04	28	1.7%	40.8%	C+	5
Atwood Oceanics (ATW)	200	28.11	13.66	4.51	3	(0.33)	NM	0.0%	33.5%	C-	3
Booz Allen Hamilton (BAH)	300	15.48	29.35	1.72	17	1.85	16	2.0%	-4.9%	C-	3
Cimarex Energy (XEC)	100	52.01	119.62	(0.12)	NM	1.94	62	0.3%	33.8%	C-	3
Diamond Offshore (DO)	200	26.79	25.42	1.18	22	0.91	28	0.0%	20.5%	C	3
MDC Holdings (MDC)	100	26.63	24.65	2.08	12	2.50	10	4.1%	-3.4%	D+	3
New Jersey Resources (NJR)	400	26.12	38.25	1.62	24	1.77	22	2.5%	16.0%	C-	4
New York Times Co. (NYT)	600	24.26	12.09	0.58	21	0.64	19	1.3%	-9.9%	D+	3
PayPal (PYPL)	200	31.04	36.35	1.49	24	1.77	21	0.0%	0.4%	C-	2
Sears Holding (SHLD)	200	40.34	13.89	(12.45)	NM	(11.73)	NM	0.0%	-10.5%	D	4
Sen. Hous. Prop. Trust (SNH)	500	16.81	21.19	1.89	11	1.90	11	7.4%	42.8%	C-	3
South Jersey Industries (SJI)	500	24.35	31.74	1.30	24	1.36	23	3.3%	34.9%	C	4
Toll Brothers (TOL)	200	21.34	27.06	2.59	10	2.97	9	0.0%	-18.7%	C-	3
Small Cap Stocks (15.1%)											
Arlington Asset Inv. (AI)	250	21.71	12.93	3.22	4	2.90	4	19.3%	-2.3%	D	3
Artesian Resources (ARTNA)	750	20.47	34.09	1.33	26	1.45	24	2.6%	23.1%	C-	5
Consolidated Water (CWCO)	500	13.26	12.86	0.61	21	0.69	19	2.3%	5.1%	D+	5
KB Home Corp. (KBH)	500	13.14	15.46	1.35	11	1.64	9	0.6%	25.4%	D	3
Meritage Homes (MTH)	100	39.67	37.91	3.59	11	4.18	9	0.0%	11.5%	D+	3

Although I am not uncomfortable holding that much cash in the current environment, such a large cash position will be an increasing drag on portfolio performance over time. Consequently, I intend to put that cash to work before too long.

I sold the portfolio's only ETF investment, the Global X MSCI Greece ETF (GREK) in April, along with the other equity sales.

However, I continue to hold the ASA Gold and Precious Metals closed-end fund (ASA), which more than doubled over the past six months.

Similarly, the American Eagle gold coins posted a gain of 24.2% in the first half, their first gain in more than three years. I will continue to hold on to this position.

TTM P/E Multiples for S&P 500 Sectors	5 Yr Avg '11-'15	Current '16
Consumer Discretionary	18.8	18.1
Consumer Staples	18.4	22.3
Energy	3.8	NM
Financials	13.5	14.0
Health Care	18.2	16.8
Industrials	16.3	16.9
Information Technology	16.5	17.5
Materials	20.3	20.6
Telecom Services	21.7	15.4
Utilities	16.6	18.9
S&P 500	16.7	18.4

FINAL COMMENTS. If, by chance, the financial markets do suffer another major setback, it is difficult at this time to determine how a crisis will unfold. The greatest fear, which is what in large measure I have been trying to protect the portfolio against, is that an economic downturn will be accompanied by a rise in interest rates. Yet, in the developed world, fears of an economic slowdown have been accompanied by declining interest rates, even into negative territory.

As long as the financial markets have confidence in the ability and wherewithal of developed countries to manage through a crisis, interest rates will stay low or could possibly even go lower. Most economies can manage negative interest rates for some time, but an extended period of negative interest rates risks damage to both consumer and investor sentiment. For example, negative interest rates discourage savings and promote asset bubbles.

In the event that rates continue to go lower, even in a new financial crisis, many of the portfolio moves that I have made could turn out to be wrong and potentially costly. Examples include holding large amounts of cash, selling the preferred stock positions, focusing fixed income investments on shorter-term maturities and investing in floating-rate investments.

Yet, the ability of developed countries to sustain low (or negative) interest rates depends, in my mind at least, upon their ability to maintain their creditworthiness and especially, the ability of their central banks to sustain or increase exceptionally accommodative monetary policies, including the various forms of quantitative easing. If confidence is ever lost in that regard, many of these countries can still turn to the printing presses to pay their bills, but such practices are usually associated with high levels of interest rates and inflation.

Most economic and financial regulators in the U.S. and elsewhere seem to be assuming that inflation will never return. For example, the stress tests that they impose upon systemically important banks assume worst case scenarios that are characterized by lower or slightly negative interest rates. But this year's rally in gold suggests that there are some investors who still believe that higher inflation and interest rates are possible.

Income Builder Other Investments Portfolio

Closing Position at June 30, 2016

	Securities Held	Adjusted Cost	06/30/16 Price	06/30/16 Mkt Value	YTD Total Return	Safety Rating	Perf. Rating
ASA Gold and Prec. Metals Fund (ASA)	400	13.70	15.66	6,264	118.4%	D+	2
U.S. T-Bills	N/A	N/A		568,342	0.2%	A	4
American Eagle Gold Coins	42	382.57	1,384.16	58,135	24.2%	A	2

Income Builder 2016 H1 Model Portfolio Total Performance

	31-Dec-14 Beginning Value	Changes During Period: Realized Gain/(Loss)	Unrealized Gain/(Loss)	Net (Sales) Purchases	Dividends/ Interest	Commissions/ Fees	30-Jun-16 Ending Value
Common stocks	501,261	16,047	29,836	(233,846)	5,370	(345)	318,322
Fixed Income	120,408	(180)	1,783	(30,641)	2,140	(110)	93,401
Mutual Funds	6,848	80	3,396	(4,114)	69	(15)	6,264
Cash (T-Bills)	299,433			268,601	309		568,342
Gold	46,799	0	11,336	0			58,135
Total	974,749	15,947	46,351	0	7,887	(470)	1,044,463

Income Builder Portfolio	Year-to-date Total Return	Year-to-date Tot. Ret. exc. Div./Int.		Beginning Portfolio Composition	Ending Portfolio Composition
Common stocks	13.25%	11.77%		51.4%	30.5%
Fixed Income	3.46%	1.41%		12.4%	8.9%
Mutual Funds	73.67%	71.72%		0.7%	0.6%
Cash (T-Bills)	0.07%	0.00%		30.7%	54.4%
Gold	24.22%	24.22%		4.8%	5.6%
Total	7.15%	6.32%		100.0%	100.0%

Stock Benchmarks		
S&P 500	3.84%	2.69%
S&P Mid-Cap 400	7.93%	7.00%
S&P SmallCap 600	6.23%	5.45%
S&P Composite 1500	4.20%	3.08%
Blended Benchmark	5.41%	4.37%
Bond Benchmarks		
Barclays Aggregate	5.31%	
Barclays Treas. Composite	4.83%	1.68%
Barclays U.S. Corporate	7.68%	
Mer. Lynch Hi Yield Constr.	9.32%	

Transaction costs assumed at $15 per trade, which reduced returns by 8 bp for stocks and 1 bp for bonds. Blended Benchmark is calculated by applying the weightings for large, mid– and small cap stocks in the portfolio to the returns on the S&P 500, S&P Mid-Cap 400 and S&P SmallCap 600. An alternative benchmark is the S&P Composite 1500 index. Portfolio returns calculated using the Dietz method.

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