

# alpha+ capital management

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Dear client,

The two biggest elements influencing investment markets are positive: national politics and the economy. A year from now, barring imponderables, employment numbers will be swelling comfortably, consumption growing slowly, profits rising smartly, and interest rates trending higher reflecting the then conventional wisdom on inflation, credit risk and fair rent for the money.

Politically, power will have shifted decisively.

By that time the cause and effect of the most recent wave of credit overuse should have revealed important truths about the interaction of man and money: one is that a dose of subsidized credit is an easy and effective medicine for a financial cold, but use is addictive. The other is that subsidized credit enables the opportunistic to invent new financial games that use high leverage to produce large, temporary flows of profit.

Unfortunately, the games leave a lot of financial debris which we, dear reader, have to clean up. The way to do it is to limit leverage, allow market interest rates to prevail and prevent the government from perverting the financial system to become a tool for ideological ends. Fan and Fred are the poster boys for that behavior.

Some observers have begun predicting that a tax raising strategy to pay for expanding social services, subsidies and various federal programs will be in the form of a VAT, a value added tax imposed on goods at each stage of production, eg, from iron ore to steel ingot to steel sheet to truck bumper to pickup truck. The added tax burden would reduce corporate profits and personal incomes and equity values. The tax is popularly applied in Europe, and is believed probable in the US if we fail to shrink the government and continue to expand social services.

Public alarm about finance and economics has matured into a worried search for understanding. Native common sense is leading to conclusions regarding government policy on taxation, spending, public entitlements and the appropriate extent of government intrusiveness. A dramatic power reversal should become visible in the coming winter, along with adjustments in the valuation of US strategic interests and the conduct of sane foreign policy. The shift in sentiment is palpable; the odds feel like between two-to-one and three-to-one.

(Just readying to sign off on this letter and see a breaking news flash that Michigan Democrat Congressman Bart Stupak who was induced to reverse his opposition to the medical bill has now decided not to stand for reelection. Hmmm... maybe he knows something we also know.)

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If we are wrong about this and politics somehow goes the other way, we would follow a more defensive posture with greater emphasis on inflation protection, an increase in foreign Pacific equities, and short maturities on bonds.

This should be a summer to remember.

Sincerely,

John May