alpha+ capital management

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Rising stock prices in the first quarter reflected progress in two areas: the US economy and the US political horizon.

Economic news was better. Employment is rising, auto sales are brisk, and corporate profitability stayed high. This appears to be the middle stage of recovery in this economic expansion, coming after an initial period of getting lean by reducing labor forces and cutting expenses. The natural course of events would include very good increases in future sales and profits. These conditions make stocks the most favored asset for serious long term investment. Stock prices are neither very low nor high at 13 times estimated earnings.

Fear is easing that Europe's weakness will stifle our recovery. The financially stronger European nations will, out of necessity, reduce their financial support of the weaker southern tier, thereby forcing the reduction of social programs that have become overwhelming. Europe will continue to decline in relative size and importance not only because of its socio-political attitudes, but also because of demographics. A substantial decline in birth rate and increased longevity extended over a few generations undermines social programs through the power of arithmetic. Fortunately, Europe will be able, if it wishes, to offset some of the decline in population by attracting larger inflows of immigrants from the nearby Middle East and Africa.

But as Europe fades, American goods and services are finding customers in new growth markets. The world now has seven billion people and four populous countries have three of the seven: China, India, Brazil and Indonesia. Each is experiencing economic acceleration, intensified by the enthusiasm that accompanies their emergence into a modern world of clothes, cars and hand held information devices.

We can't prove it, but we think the stock market also is pricing in expectations of a positive change in the nation's political thrust. America has gotten acquainted with the president for whom it voted. And logic suggests that about one out of three of us has changed his mind or will soon. For one thing, a succession of animosities is being created: Among Catholics, by demands that their religious organizations must include medical coverage for applications proscribed by Catholic morality; Among non-racists, who disagreed with the President's implication that the killing of a youth in Florida had special significance because of personal racial similarity; and among American constitutionalists, aghast at the public chiding of the Supreme Court and its attempted intimidation by the President while the court is deliberating on the principle of separation of government powers. He referred to the court as a group of "unelected people," as if that was relevant, and suggesting that somehow the court's decision making power should be diminished. That, from a former professor of constitutional law.

Those three forces: a better informed analysis of the President's competence and hard core beliefs, animosities incited by the White House in return for no discernible political gain, and the declining vitality of the political left versus an energized opposition led by a broadly acceptable candidate in Mitt Romney should make telling differences in financial support and voting turnout.

Investment risk factors remain on the horizon: The potential for war in Iran and Syria, more potential

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bank failures in Europe, student loan default worries in the US and an upsurge in domestic inflation, which should become more evident as business picks up.

Logic tells us that the current low interest rates are an aberration, being resorted to in desperation by those presently in charge because they think it is the only tool they have and don't know what else to do. The immensity of the cash being flushed through the system is being financed by a surge in the nation’s debt. Such an artificiality tends to be brief and endurable, partly because it compels the sensible into taking control.

Incidentally, a temporary real estate opportunity has opened for the stably employed who rent. An annualized rent of $1000 a month can support a mortgage loan of 20 times that, or $240,000. Then, with a down payment of say, 20%, and interest rates at 4%, a house worth $290,000 could be financed. Interest and real estate taxes are covered by the $1,000 a month payment, and there are some tax deductions. It happens three or four times a lifetime. This is one of them.

Conversely, perhaps the worst investment would be a high grade, long term, fixed interest rate bond or mortgage, now, before market based interest rates resume and an anticipated bulge in inflation rates becomes visible. Prospective losses would be on the order of 30%. For this reason, we have minimized investments in intermediate and long term bonds. In their stead, inflation protection bonds are useful (unless they become overpriced in response to a sudden scare on the inflation front).

Gold is about one third higher than its long term inflation adjusted price of around $1100 an ounce. If inflation accelerates, the gold price would probably run up again, but that may be cutting too fine a point. Our inclination is to look for a subsequent slow decline in gold prices during a hopefully boring decade of government shrinkage. However, if these political expectations prove wrong, gold would be a good buy.

I propose we get into every political argument we can, because we have all the winning arguments.

Sincerely,

John May