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Money has been flowing out of bonds and into stocks and real estate. That's as it should be because bonds are still artificially overpriced while stocks are still reasonable, based on historic comparisons of earnings to stock values.

Stock indices rose about 13% in the first six months even though news headlines ranged from bad to awful with scandals in the federal administration, unsettled economic conditions in Europe, a potentially troublesome transition in China's ascent from economic suppression, and intense ferment in the Middle East culminating in the transfer of power in Egypt from the Muslim Brotherhood to the military and perhaps to a more broadly representative body than the religiously motivated Morsi regime.

Normal may be a long way off, but try to imagine a world in which mortgages got done at 5%, long term government bonds yielded 4%, stocks yielded 2% and inflation was 1%. The natural tendency would be toward numbers like that, reflecting a condition of balance and stability which would be achievable if the economy was left to heal itself, assisted by free competitive markets, lower taxes, and insulation from the heavy hands of inept power holders.

Consider the following: Obamacare, a complex, intrusive body of regulation, is poorly understood by the population, and every negative aspect is going to be an unpleasant surprise. Business hiring practices are already responding to the new rules which induce part time employment instead of full time, and avoiding the "50 worker provision," above which a government approved medical plan must be provided or a fine paid of \$2,000 per worker. Another token of what is to come: The Administration has postponed, "administratively," a major provision until 2015, instead of the legislatively required 2014, probably to avoid the effect on the 2014 election results. It has no such authority.

Restoration of normal economic vitality would be encouraged if we had the following: A smaller government; now it makes up 25% of the economy when it ought to be 18%. We need an honest projection of the costs of retirement and medical programs, along with practical plans to finance them, followed by an opportunity for the Nation to decide whether to honor them or change them to some agreeable alternative. And, we need lower corporate and personal income tax rates.

That package would bring the blessing of sanity into the economic outlook along with handsome advances in capital investment, employment, personal consumption and investment returns. Evidence of this potential is the stubborn vitality of our economy despite the suppressive influence of a business unfriendly administration. Fortunately, our political structure enables a small but growing group of free market Congress members to resist the degradation of our national financial health.

As investors, we seek a path which allows participation in future prosperity while protecting our capital from destruction through inflation, or a less likely but not impossible depression. This is being achieved primarily through a selection of stock mutual funds and certain bonds such as inflation protection bonds. We are comfortable with stocks owing to the ability of healthy businesses to cope with the inflationary conditions which we expect in the years ahead. Economic conditions are expected to be less than robust in the next two years but, barring major upsets in the three troubled areas of the world, a subdued level of expansion looks likely.

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Inflation protection bonds don't often produce a feel good effect as their prices rise only with fear of inflation, and when that fear subsides, as it has recently, buying diminishes and prices come down. We regard that as an insurance premium, willingly paid for the protection afforded. Inflation will become tangible when the pace of economic expansion picks up and the accumulated liquidity enables the rise in demand to push prices higher, faster.

Gold prices have fallen from a peak of \$1,800 less than a year ago to around \$1,200 currently, at which level it is believed reasonable to buy as an inflation hedge once again. Please consider, as a matter of course, that there may be 25% downside risk even at these prices.

Looking further ahead, profound changes are underway in two elements of our national reality. One is a dispersal of world military power in which the US will share responsibility and cost with other world power blocs. The other element is potentially more troublesome in that it requires a phase during which our unaffordable social systems are modified to cope with economic reality. There is room for upset along the way, but public understanding is spreading and sanity ultimately should prevail.

Sincerely,

John May