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A sense of unease persists for three good reasons: Near term, the Russian expansion; longer term, the looming wave of US citizens maturing into their promised pensions and medical benefits; and medium term, the possible effects of upcoming elections.

The predictable US response to Russia will be to complain loudly and arrange meetings giving rise to proclamations. Our take is that Putin sets a high value on the restoration of Soviet glory to be achieved by renewed domination of the Ukraine and other nearby nations. He knows that the US and Europe are timid adversaries. There is nothing to prevent him from carrying it out this year.

Also take note of his supportive relationships with power holders in Iran, Iraq, Syria and Egypt, then imagine an alliance of these Shi'ite dominated oil nations, led by Russia, and how their interests might be served by using their oil and gas resources to exploit Europe which gets a third of its energy by pipeline from Russia. One lever being applied currently is to raise gas prices aggressively. A natural response would be for a closing of ranks among the Sunni oil nations, such as the Saudis, the Emirates and others who traditionally have been friendly to us. Keep in mind that any rescue by shipping liquefied natural gas from the US or elsewhere would require two years of preparation.

Russia thereby would graduate from a regional power to a world power by deploying into nearby countries thousands of masked men in unmarked uniforms followed up by thousands of occupation troops. Shooting kept to a minimum.

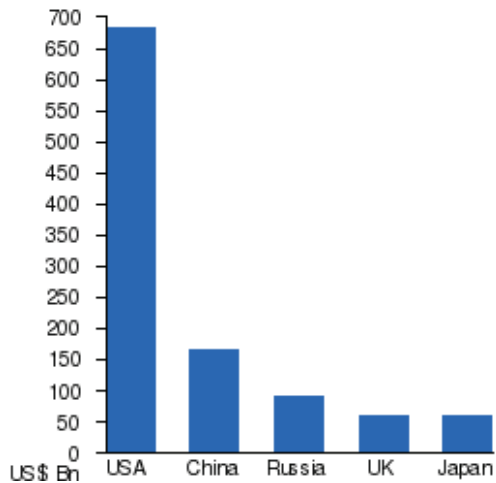
In modern America, the willingness to think about going to war has shrunk. After the WWII victory against fascism, we fought communism with success in Korea and brought about the demise of the USSR. After that, we retreated from Vietnam, endured random attacks by jihadists in the Middle East and Europe, then suffered 9/11, and then fought wars in Iraq and Afghanistan which seemed for awhile to have been worthwhile but are turning out to be less than that.

Further, consider the economics of world peacekeeping: Europe spends less than 2% of GDP on military. Japan spends 1%. Prosperous South Korea, constantly threatened by the bizarre insanity of North Korea, spends 2.5% while we spend 4.4%. Should we not expect that China and other powers in Asia and South America will decide to build military capacity including naval fleets? They will if they think it worthwhile. The obvious path for us is to whip up a joint effort among the friendlies of the world, but the free ride is coming to a tapering off.

With respect to investment implications, a sudden Russian invasion might scare us enough to unsettle the stock market and then, when the threat of fighting evolves into conferring and speech making, the fear will subside and the market will go about its business. We are unlikely to go to war unless we are suddenly badly hurt and fear turns to anger.

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The Top Five Military Spenders, 2012



Stockholm International Peace Research Institute

The financial significance is that it might be time for the US to pressure others to spend more in their own defense. Should we maintain massive US troop deployments in Europe and Korea, so many decades after the wars? Logic suggests we should let the beneficiaries pay the insurance premium.

With respect to Social Security, Medicare and Medicaid, these programs alone promise to destroy the financial structure unless future reforms convert them to privately funded accounts, with the helpless supported by private charities. The most plausible way to deal with the certainty of financial collapse, is to eliminate inflation adjustments for pensions and allow the ensuing inflation to reduce the size of the burden. Unkeepable promises, whether made through unethical vote buying or simple ignorance, must not be allowed to ruin everything. It would be good to have an administration with the competence and integrity to face the inevitable and sort it out in public discourse.

The political scene is characterized by enthusiasm among Constitutionlists and free market Libertarians, contrasted with a defensive attitude among traditionalists and Liberals. The midterm elections are likely change the power balance in the Senate and then we will all focus on the emergence of national candidates on both sides.

If interest rates are allowed to resume normal levels, existing pools of medium and long term bonds will erode in value, while stock values and corporate earnings should not be much affected. The most predictable element for the next decade would be inflation, which so far has been expressing itself primarily in real estate, stocks and restaurant menus.

Sincerely,

John May