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We have emerged from that awful phase of this cycle when we were wondering when the next disaster would hit while hoping the last one was the last one. That and other evidence tells us that the shrinkage of consumption and financial activity has given way to the current phase which may be thought of as the rounding of the bottom of the cycle.

The early indicators are the recent behavior of some asset values, lean inventories and new orders for capital equipment. They point to recovery ahead, probably a drawn out one which will take the time needed for an overheated, over-financed economy to heal and strengthen gradually. That's good news.

The private economy has pulled back to what would seem to be a sustainable spending pattern. In June, the national savings rate rose to 6.9% of disposable income compared with little or no net savings in the past several years. That's good news too, in that a resumption of economic health and full employment is not going to happen unless made possible by sound private sector finances.

In recent months, as fear of financial collapse diminished, investors became less compulsive about holding US Treasury bonds and started reaching for risk-based opportunity. Also, the public is becoming familiar with the immensity of the borrowing and taxation implied by planned federal projects let alone the sudden government ownership or control of several American industries. These are works in progress in a fluid political setting and how they play out will influence interest rates, consumption and asset values.

This public focus on financial and economic matters is bearing fruit. Economists and observers of every stripe are offering their analyses and the increasing public grasp ought to result in a citizenry better able to weigh the validity of economic policy ideas. That lively awareness itself is moderating policy. The President adjusts strategy based on his perception of public pressure and how much bending is politically desirable and possible without costly erosion of support. And, he is smart enough to understand how the size of the federal budget will be reflected in the rising cost of financing it.

World market forces are capable of disciplining profligate borrowers even including the dominant one, us. China's financial people are aware that their hoard of dollar obligations will decline in value with inflation and they and other buyers of world debt will require interest rates which combine money rent plus expected inflation. China has been accumulating gold bullion and is proposing that international balances be represented by a mix of world currencies. They want diversity because they know that the flow of events in the US will accelerate the decline in the value of the currency.

Money flows in the markets for stocks, debt, real estate, and commodities appear to be aligned with the conditions we expect to see unfold: a bottoming followed by a slow return toward economic

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health, accompanied by an increased probability of inflation. We favor stocks, short term investment quality bonds, inflation protected bonds and such commodities as gold and oil/gas.

For those given to optimism, here are some bright spots:

A turn away from the left in European politics.

Iranians in the streets resisting suppression.

Iraq surviving as a democracy.

Coordinated attacks against jihadis by Pakistan, Afghan and US forces. Growing use of weapons systems like armed drones and surveillance technology.

The possibility that Israel will destroy Iran's nuclear capacity.

The possibility that Israel and Palestine will find a path to survival.

Chinese Uighurs resisting Han Chinese in Xinjiang province.

Honduran government preventing a takeover by leftist elements.

In the US, increasing political resistance to government dominance.

Regards,

John May