alpha+ capital management

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Dear client,

Uneasiness was palpable in the second quarter and was expressed by a strong desire for the stability of cash, so that cash levels held by investors and corporations are now quite high by historic norms. Stock prices went down by ten percent in the second quarter, and 6.5 percent in the first half of the year. Money also came out of commodities and into assets useful as havens of safety, mainly US Treasury bonds, money market deposits and gold. Investment grade corporate bonds were steady.

May and June were an unwelcome reminder of the stresses of 2008 when crises came one a month, each as complex as the last. Now, in quick succession, we have had a mysterious spasm in stock market function on May 6, with no evidence yet to rule out evil intent; a military brass shakeup that exposed disagreement with self imposed tactical restraints; massive legislative push in medical care, energy taxation and financial system regulations, thousands of pages at a time. When that much legislation is rushed into print by staffers, lobbyists and influential entities, handing unknown authority to government bureaucrats while a majority of voters express opposition, the effect on business decision makers is to postpone everything possible and wait to see what happens.

Next, Europe went wobbly when we learned of the financial debilitation of Greece and some other EU nations which had far exceeded prescribed deficit limits and may be unable to honor debts. The EU now must consider whether to unite financially and honor debts of all member states, or let Greece fail and remove it from the group, or have the IMF and World Bank make bridge loans under the supposition that they will be repaid, thereby postponing and preserving the weakness. Similar concerns apply to our own country.

Europeans are finding out that they are mired in unkeepable promises. One might theorize that governments become insolvent after its role changes from servant of the people to nurturer. The phenomenon has been demonstrated frequently enough to have become folk wisdom.

Elsewhere, belligerence was in the headlines with warlike behavior by Iran, Venezuela, Turkey, Russia and North Korea. Power wielders in these countries are responding logically to the US pullback from established relationships and strategic positions. A case in point is that our historical support of Israel chilled as the probability of Israel striking Iran rose. Also in a fluid state is the projection of American power and influence in the world. Perhaps the administration hopes the Middle East will be dominated by relatively benign Turkey instead of belligerent Iran, so that the US can leave without seeming to have been driven out. Such uncertainties dampen economic activity.

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Meanwhile, the economy coped with the termination of a quarter of a million temporary census workers and a slowing of the flow of cash transfers to the public. Corporate profits and margins being reported for the second quarter are looking good. A slow economic growth rate would be appropriate for a few years as the nation saves its way back to economic health, and attempts should not be made to force growth.

We shouldn't be building many new houses for awhile. Restoration of economic health would be best served by settling onto a level of public and private consumption that we can afford. That implies a savings rate of around 4% and does not leave much room for government subsidized demand.

Polling data show that a twenty percent shift in voting attitudes has happened and a decisive change in legislative seats is months away. The probability is high that at least enough House and Senate seats will shift to effect a containment by stalemate, which by itself would be an improvement, shrinking the uncertainty along with its depressant effects. Of similar importance, though difficult to measure, is the relative spirit of the opposing camps: one pumped and the other demoralized. The thrill running down my leg says a rout is in the making. If that is what we are in for, uncertainty would diminish sharply and the market would rise.

The swelling political scene seems to be an element contributing to recent bursts of buoyancy in the stock market. There is a lot of money out there temporarily being held as cash, too much of it still devoted to financial game playing, but serious long term investment money as well, looking for placement. The near future will be one of policy reversals in taxation, social spending and confinement of government power. And if, as we expect, economic output continues in a mild recovery path and when corporate profits and dividends are evaluated reasonably, then cash will flow to stocks.

Three of the four fear provoking elements: world instability, the national economy and US politics, are likely to be less negative than now. When it comes to the rush to cash, shrinkage of the total negativity is a positive. The fourth fearful element, that a small but dangerous group of terrorists who profess to love death, is still working diligently to shock the modern world by killing other humans on as large a scale as they can. A successful democracy in Iraq and a student led revolution in Iran would work wonders. The possibility of strategic preemption to interrupt Iran's nuclear weapon project whether by Israel or the US, will have to await those who are up to that responsibility.

All things considered we are favorably disposed toward stocks, gold, inflation protected bonds and short maturity corporate bonds. We don't like long bonds and think it is still early for REITS.

Sincerely,

John May