

# alpha+ capital management

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Our reelected leadership is on a policy path that is clearly unwholesome, following the same collectivist path that has sickened half the countries of Europe, undid the Soviet Union and suppressed China for 50 years until they turned toward private commerce, enabling consumption to rise from bad twenty years ago to pretty good for a billion people. But, despite comparisons of systems that encourage prosperity with others that deter it, the factual data does not influence those committed to failed ideas.

A pattern is evident in which the discipline of free markets, the guidance of balanced budgets and the maintenance of American financial strength are insufficiently respected. The Obama plan is to increase spending on social programs, raise taxes on those who have high incomes and assets, and borrow the shortfall which has reached 40 cents per dollar spent. Now the Congress has dealt with the debt ceiling by moving the deadline two months further on. The technique of postponing deadlines as practiced famously in Europe and known as “kicking the can down the road”, works just as well for financial management as it does for garbage disposal.

An underemployed American public, made insecure by the collapse of a 20 year, government-induced wave of excessive real estate finance, voted by a margin of 4% to encourage the government to provide food, shelter, education and medical care for those who apply. We would favor that too, if it were possible, but it isn't. Every attempt fails for the same reason: human nature brings more of us to feed at the trough than to fill it.

Apparently, the primary source of general prosperity is the drive of self interest and acceptance of the notion that we are responsible for our personal achievements. However, an uncomfortable observation must be confronted: success and wealth correlates with culture, education and intelligence, as well as luck. That can arouse lower emotions which are called into effect routinely by such presidential utterances as: “That business you built? You didn't build that” and “Fat cat millionaires and billionaires” and “They need to pay their fair share”, are intended to invalidate those who actually pay most of the taxes, and to create animosity against them. It brings out the vote.

The US economy is confronting a high probability of currency debasement, a moderate probability of an impeded expansion and a certainty of higher taxes. Under these conditions, the first task of an investor would be to preserve value as compared to reaching for greater returns. This defensive posture would forgo higher risk bonds and REITs (real estate investment trusts) which have become overpriced by perhaps 30%.

Also to be avoided are US Treasuries with yields pushed down to 2% when normality would demand 4%. These bonds will perform poorly when the Federal Reserve stops spending almost \$100 billion a month buying debt securities to manipulate interest rates.

Currently, the primary test for an investment is its ability to cope with inflation. The favored assets are: real estate financed conservatively at current low interest rates, common stocks, and inflation protected government bonds. Gold is still expensive in our opinion but would be acceptable at \$1300. Buying pressure for gold has cooled a bit, as would seem reasonable with inflation temporarily suppressed during the slow economic growth expected this year.

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Long term investors are concerned about the malaise of Europe, civil upset and resort to confiscation of wealth. Japan also faces a difficult future as the growing proportion of the elderly is weighing heavily on a diminished younger workforce, a condition which also will affect China, owing to its long term one child limit. Elsewhere on the globe the prospects are for forward progress. Consider the previously impoverished people of Asia, South America and Africa, with half of the planet's 7 billion humans, producing and consuming much more of what there is to buy. Then, imagine a pacified Middle East, richly endowed with oil and free to take part in commerce.

The American economy is suppressed by the prospect of greater regulation, taxation and the sense of an adversarial element in government toward business. An indicator of US investment attitudes is that withdrawals from stock mutual funds are estimated at \$80 billion for 2012, while corporate treasuries repurchased around \$400 billion of their own shares. Our reaction is that the corporate people are the better informed, but neither group is enthusiastic about the immediate future. That sluggishness may erode in time, but a change to a business friendly, low tax flavor would work wonders.

Politics are in great ferment because the stakes are so high. Government now absorbs 24% of the nation's total output and its appetite is growing. About 20% is perceived as affordable, with 18% a more friendly burden. Republicans presumably will analyze the political problem and restructure to regain control of policy. An obvious but painful step would require a reduction of traditional religious influence in the design of laws intended to govern everyone, including people of other creeds, or none. The focus on abortion and same gender marriage seems to have turned more than half of young voters away before free markets and prosperity even got a hearing. They can be won back.

A second opportunity exists in racial politics which was displayed by the enlarged majorities in each of the four racial blocs, most of whose participants are comfortable with the concept of a big, benevolent government. The remedy would be to reach out with open arms, and skim off, each year for the next 20 years, the top 2% of the voters in each bloc, as measured by education, intelligence and wealth. If that result cannot be achieved through cogent, ethical argument aimed at those with the greatest ability, it is simply not achievable. A positive majority for the reconfigured party could be encouraged by recruiting everyone who fits in any of three other categories: Libertarians, Constitutionalists, and those who favor minimal government, free competitive markets, and low taxes.

I wouldn't miss this for the world.

Sincerely,

John May