alpha+ capital management

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The stock market seems eager to run but scared to leave the barn, which is a pretty sensible reflection of reality. Consider the relevant factors:

The health of the foreign economies
The US economy and its state of health
The potential for accidental war stemming from world jihad
The financial policy of the US government after the 2016 election

When America relinquished its role as protector of the world's largest concentration of oil deposits, it enabled Russia and Iran to dominate the Shiite territories and, if they feel up to it militarily, perhaps the Saudi oil fields as well. Iran is shipping arms to the Shia Houthi clan who are attempting to seize control of Yemen on the Saudi southern border, and the Saudis are in fierce opposition. The combined production capacity subject to their control would then be about 29 million barrels a day, double that of the US and 31% of total world output. The implication is that any group with that much money and power will be capable of serious mischief if they wanted to, and there is no doubt about that. Our natural response should be to encourage oil field development everywhere else, especially in North America.

Risk of accidental war seems to be minimal, as Putin appears to understand Obama's motivations and probable responses. He has been given a green light and will continue to advance until something stops him, eventual internal opposition, pressure from other nations and perhaps the mellowing that accompanies success.

With respect to the shift in the world power structure, America has pulled back from the role of singular world power. The new reality is that we are one of several nations that represent big concentrations of people and economic activity. The majors are: China, the rest of Asia taken together (India, Japan, Korea, Indonesia and Australia), Europe and the Middle East…to be followed later by South America and Africa. We cannot be in charge of all of that.

As points of reference, world GDP is around $75 trillion and world population is 7.3 billion (not the 9 billion printed in the previous Alpha letter). America, with a GDP of $18 trillion and population of 322 million produces 24% of world GDP and has 3% of the people. That's what happens when free market capitalism and ambitious people interact.

Some of the investment implications are unsettled because of things to come such as: Will the next US Administration will be as complacent about foreign aggression as Obama? And, as a consequence, will military spending continue to abate or will it surge, in hope of restoring American preeminence? And will taxation rise to pay for it?

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The world economic background is certainly mixed in that China has come through a multi decade spurt of growth by using low cost labor and free wheeling capitalism to become a highly competitive producer of goods for export to the world. That phase has given way. As labor costs advanced and demand pressures abated, the Chinese growth rate slowed and financial pressures have surfaced. New strategies for a resurrection of growth are being sought, but real estate construction already may have been overdone, and another round of infrastructure takes a long time to bring gains. The ideal would be new technologies based on invention, but that delicate flower does not blossom on command. Building consumer demand is another possibility.

Europe is tiring under the weight of social welfare programs and government debt, and America is following a similar path, running up debt loads to be dealt with by citizens of the future. The solution would be to cut spending and taxes to encourage expansion. Unfortunately, many voters are motivated by fear of the uncertain future and desire for government support than are able to grasp the reality that government tends to expand until it sickens the structure. On a positive note, an observation made in the past (about government size being supportable up to around 18% of GDP, but destructive at the level of 24% reached a couple of years ago), more recent measures show an improvement by around two percentage points in the past two years.

Time is ticking on the national debt and social spending collision and we need decision makers who can grasp the difference between a disciplined return to solvency and the ruin that would accompany continued growth of government. The next big opportunity to restore national vitality and build an upbeat attitude is the next election.

No change in portfolio allocations are on the horizon.

Best regards,

John May