January 8, 2016

The year began with a sudden sharp price decline in Chinese stock markets which set off worldwide ripples. The train of events began a few months ago when the Yuan was accepted as one of the world's top currencies along with the Dollar, Yen and Sterling. Shortly thereafter, Chinese leaders adopted a strategy of cheapening their currency in order to encourage exports. Their motivation was to stimulate the economy which had fallen into a slump. It is still not clear whether it is a temporary adjustment or the leading edge of a big financial problem. With respect to the contagion, our export business with China in 2015 was about 4% of worldwide US exports. That is not a worrisome proportion. Nevertheless, the investment world is very sensitive about China's economic importance. The rise and subsequent fall of commodity prices in recent years is another example of China's economic impact. The full significance of the latest volatility is still to be learned.

Here is our take on three impediments to future peace, prosperity, and positive investment returns.

First, Iran and Russia appear to be taking control of Middle East oilfields and perhaps the domination of Sunni populations, especially those in Saudi Arabia.

Just days ago, the Saudis executed 47 people including a Shiite leader, an act which is bringing Shiite crowds into the streets. Next, the Saudis cut diplomatic ties to Iran. Meanwhile, Russia is bombing ISIS jihadists in Syria in defense of the Alawite Shiites headed by Bashar al-Assad, while also bombing US supported fighters who oppose both ISIS and Assad.

Probable outcome: The Russia-Iran partnership takes control of the whole Middle East while the US and Europe stand by, unwilling to intervene. Twenty years ago the US would move troops in to secure the oilfields but things are different now: 1) We are no longer insecure about oil supplies because we have recently become energy self sufficient, and 2) President Obama has succeeded in creating a new world power structure over which America does not preside.

We are still a year away from seating the next US president which should be enough time to allow things to settle down. As the scene unfolds there will be few, we think, who will call for US military action and the US probably will allow events to proceed. The stock market would show some upset under these conditions but if international oil flows are not disturbed, a state of calm should be achievable under the new management. Sooner or later, with control of nearly a third of the world's oil, they will maneuver to raise prices, and if they are not too aggressive about it perhaps other oil producing regions will cooperate.

A second element which will influence market conditions is the US political landscape: Obama's influence on events is diminishing in this lame duck year and that is positive. News media have taken to noting the frequency of personal references in his speeches; the last one clocked 3.5 references to "me", "my", etc. per minute of speech, about once every 17 seconds. The behavior may be a symptom of mental stress. He cried recently during a speech. He may be losing it. Count that as another risk factor.

700 East Ocean Boulevard, Suite 2703 Long Beach, California 90802
Phone 562 435 5650 Facsimile 562 495 0462 alcap.management@verizon.net

There will be plenty of political drama in 2016 with so many interesting and capable contenders. The pertinent question is whether the power of government, in the hands of the next set of decision makers will lead toward less government intrusion at less cost. If so, the future will be seen as bright, and, therefore, conducive to success with new ventures. That energy source is what causes an economy to grow.

The third impediment to future financial health is our unwillingness to confront the probability that the USA will fail to make good on government obligations on bond debt and promised social benefits. Our guess is that society will prefer to reduce the obligations through inflation.

That is not a comfortable picture, but the history books are replete with conflict, change and periods of instability. The appropriate course of action is to understand the ebbs and flows as best we can and manage to cope.

Sincerely,

John May