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Cause & Effect

Yet again we are talking about the market anticipating a rate hike, the "Will They or Wont They" question. The reply should be - who cares if and when they raise rates, it's going to happen. The real underlying fear is whether Fed will continue to raise rates. There will be a **Cause and Effect** to anticipating rate changes plus the reaction to actual rate changes.

As I have written about in previous newsletters the math of servicing the U.S. debt with an increase in rates can be crippling to the US economy. Therefore, I don't expect rates to dramatically rise based on current debt obligations. This has less to do with Economics 101 but everything to do with advanced politics and global stability.

Additionally the US dollar has rallied in a way that has caught most professionals by surprise. This makes foreign goods and travelling look more affordable to Americans but makes our exports more expensive. Everything in economics has a cause and effect whereas currency is one area where this relationship quickly reveals its implications. The debt market is bigger than the stock market by large sums and implications move faster throughout the world.

Another example of one thing affecting another has been the collapse of oil along with many other commodities, but for this discussion - oil. Yes, it's great that our gasoline per gallon cost less but low prices at the pump have ripple effects on a global basis. In America this means jobs in the oil industry have been cut, suppliers of steel and other infrastructure have witnessed declines, and it slows the migration to solar and other renewable energy sources. Traditionally Americans have shrugged off all warnings about the oil crisis or foreign dependency and only when absolutely pressured do we support more efficient cars or other methods of thinking long-term. This is where the Chinese dominate above all other countries as they plan in terms of the next 50 years, whereas many others think in terms of the next few months.

Another example of collapsing oil prices effect is nations that rely heavily on the income have been subject to sever budget reviews. Russia is not alone in their budget crisis due to oil price collapse because many Latin American countries and Canada have witnessed similar hardships. The main difference is Russia's global stability is partially based on world trade sanctions for their aggressions in neighboring Crimea. So the political world experiences tension over Russia and how it might try to strong-arm other situations to make up for their huge financial losses. Saudi Arabia is greatly affected by budget constraints from lower oil revenue and this can cause panic amongst its people. However the leadership is keenly aware of the

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"Arab Spring", and other political movements in the region and thus they committed to pumping oil at current production levels. This is a global game of chess because if Saudi has the lowest cost to produce oil then their profit margins are the greatest as compared to fracking, offshore, drilling, tar sands and other difficult methods of extraction. Re-starting a well is very difficult and costly which is why most are capped if they stop production. The effect is the investment in exploration and development is reduced or eliminated and when (if) pricing returns to higher levels then the competition will be less and Saudi Arabia keeps pumping without missing a beat and the profits pour in (pun intended).

Another cause and effect relationship is the commodity of water highlighted by the drought in California. California represents roughly 11% of the U.S. GDP and supplies a large portion of our nation's agriculture and specialty crops, as well as global markets (almonds are one example). Many people only look at the effect on food prices which is certainly true but what about the larger issues such as jobs and housing. If the drought continues it might affect jobs and then housing prices and liquidity. One of the things I try to stress in financial advice is the benefits of diversity and liquidity. I know some investors purchase all their real estate in California via rentals or buying trust deeds. This localized weather problem is another reason I prefer a diversified REIT vs. a concentration of housing of one type in one in one state.

Some of these economic trends do influence my buying and selling decisions but fundamentals are always what I rely on in determining what to buy, sell or hold. I made many new purchases at the end of 2014 and beginning of 2015 and I asked myself if interest rates or oil prices will alter my opinion of what I am buying and why.

I am very pleased with the portfolios right now and everyone's mix is slightly different based on their individual situation but there are many common elements to construction or similar positions and percentage ownership. I am still surprised after almost two decades experience as a portfolio manager how some bargains seem to be in full public view with no media attention or analyst coverage. I am still a selective buyer and I like recent acquisitions and am looking to add more. When rates do rise I expect the media and market will overreact in the short-term, and this will affect REIT, Utilities, Bonds and other yield-oriented investments. Unless the Fed throws a big curve and include language about further aggressive rates then I think the selloff will be short-lived. I will have my finger ready to buy some bargains, if, in my opinion, those opportunities present themselves.

All the best,

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