Capital Drain

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Before printing, think about the environment

Hi Readers,

I don't have much new to say, but given the significant events going on in the world, I'd like to reassure you that you can just sit tight. I'm sticking with my existing portfolio, and will do so even if one of our world hot-spots boils over.

What I wrote last month is still what I think. You could re-read that if you care to.

Thus, in my opinion:

Executive Summary:

- Stay Calm and Carry On
- The dollar is rising strongly
- Russia and China, too unpredictable to invest in.
- Europe seems headed for a renewed recession, of their own making.
- India and Brazil have hope from new leadership.
- ISIS and Ebola: two serious outbreaks, but each can be contained.

The US recovery continues, and many companies are doing well, but the prices reflect high continued growth expectations. If you're holding shares of any of the conspicuous high-fliers, especially the “hot” new tech IPOs, you might consider selling into this enthusiasm. Better to risk a little less gain rather than a lot more loss.

As confidence in the economy spreads, investing in all-market index funds becomes more attractive. We are likely reaching the phase where a rising tide will lift (almost) all boats.

If you're inclined to pick among individual stocks, be conservative and be in the best of securities: stick to value, to safety, to short maturities (for debt), and call me to chat if you’re concerned about anything you’re holding.

Above all, avoid the investments that are at all-time extreme valuations: junk bonds, developing-country bonds, and headline-grabbing stocks with high P/E ratios.

The Details:

The world is a tumultuous place, this past month more than usual. Still, the tumult isn't anything we have to respond to as investors-- yet.

We have continued good news on the economy. In the US, the only problem with the recovery is that it is achingly slow. We are still recovering, and every month that recovery will reach more people.

The recovery is likely to be smooth, but the stock markets are likely to be more variable. There will be unpredictable ups and downs based on current events and changes in sentiment. The big picture, though, is predictable: recovery. I'm sticking with that, and sticking with the portfolio I've had these past few years. I believe it's a good balance between reward and the current risks.

Partly because of that world tumult, the **dollar has been rising** strongly lately. In most times of crisis, world investors will move to the dollar, for stability and safety. That's especially true right now with the EU, China, and Russia each causing investors concern. Ordinarily such a strong rise in the dollar would raise concerns of increased US inflation, because of higher prices for imports, but in our slow recovery inflation is still very low and likely to stay that way.

In different ways, **Russia and China** are now out on limbs in relations with neighbors.

An important aspect of investing is to know the risks you're taking, and make sure your potential rewards are sufficient to cover the risk. When the risks aren't knowable, or even easy to estimate the magnitude, then the rewards aren't sufficient. Just say no. “Hoping for the best” is not a rational investment strategy.

Russia's Putin has given up all pretense of wanting to join Europe as a comfortable neighbor and trading partner. He's gone back to the historic idea of needing to keep control of eastern European states as a buffer against invasion from the west. His transparent “covert” attack on Ukraine has eliminated any trust or forbearance among western governments or investors. He'll certainly hurt Russia more than anyone else. For us as US investors, it's sufficient that we not invest in Russia in any way.

China has been less overtly hostile, but they're also becoming riskier in unpredictable ways. The Chinese Communist Party is determined to stay in power. There's no longer anything communist about them. They're just an autocratic party, trying to keep absolute political control of an enormous, varied, and dynamic country.

I've mentioned before that the government is getting more heavy-handed about favoring local companies over foreign ones. That continues, and grows worse.[1] Some

1 “Unequal before the law?,” The Economist, 23 Aug 2014, The Economist Newspaper Limited, 30 Sep 2014 <http://www.economist.com/news/business/21613348-chinas-antitrust-crackdown-turns-ugly-foreign-carmakers-forefront-unequal>.

foreign firms are scaling back and exiting. That alone is reason enough for me to not want to invest in business in China, directly or indirectly.

Very recently that same investor concern has been extended to Hong Kong. China's leader Xi Jinping has taken a hard line against the promised increased democracy in Hong Kong, and a hard line against the protests among Hong Kong's citizens. The outcome is unpredictable and thus un-investable.

Europe continues to falter, and may re-enter recession if they haven't already. Their insistence on fiscal austerity rather than stimulus is certainly not creating good results. They're so attached to the austerity theory that they just won't allow themselves to admit that they're failing, and continuing to damage their economies as a result. For the purposes of this newsletter, it's enough to say that I will certainly not be investing there until something changes for the better.

Their continued poor performance also makes it less likely that the US economy could overheat anytime soon.

India's new Prime Minister Narendra Modi is likely to bring fresh ideas and energy to modernizing and re-invigorating their economy. We won't know for a while if he'll be able to get his ideas implemented, or whether they'll be good ones, but it's a hopeful situation. India has enormous potential for growth, once they get over some of their own internal obstacles.

Brazil is holding elections, including potentially a new President. This Sunday October 5 will be the first round, expected to be close and require a runoff on October 26. The incumbent Dilma Rousseff has disappointed many. Brazil's economy has been flat at best, which is disappointing after the fast growth under the previous President, Luiz Inácio “Lula” da Silva. Rousseff was Lula's chosen successor. Marina Silva (no relation) is the other strong candidate, and investors appear to favor her, despite her relative lack of national political executive experience. She was a federal Senator and a member of Lula's cabinet. Whoever wins, it would be nice to see Brazil's economy growing again, and a change (or even cabinet shuffle) of leaders could help.

Rounding out our list of world tumults, we have the explosive appearance of **ISIS** (aka ISIL and now just IS) in the Middle East, and **Ebola** in West Africa. Neither threat is trivial; either could yet become a serious problem for the world economy. For now, though, they are only potential problems. They are containable, the international community is responding strongly (if belatedly), and neither is a clear reason to change our investments. For now.

It’s time to check the spelling and ship this to you.

If you have any questions, please write or phone. If you want to read more, the company web site has archived editions of this letter, lots of charts, and links to other interesting sites. There's also a web log where I discuss the process and progress of starting the mutual fund, along with occasional economic or investing thoughts..

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Take care,

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"Our doubts are traitors,
And make us lose the good that we oft might win,
By fearing to attempt."
--W. Shakespeare