Capital Drain

Rick's investment opinion newsletter June, 2015 v.11 no.3

Before printing, think about the environment

Hi Readers,

Here's a quick note before the Independence Day long weekend. Relax.

In my opinion:

Executive Summary:

- We don't need to worry about Greece.
- Some worries: China, Russia
- Otherwise, the economy is doing well enough.
- Expect more of the same.

The recovery continues, and many US companies are doing well, but some prices reflect high continued growth expectations. Parts of the tech sector, particularly the profitless highly speculative social media companies, have been climbing fast-- too fast. 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. That applies worldwide, as well. The US is only 25% of the world economy; it makes sense to invest in other economically promising regions.

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 (if you don't avoid it completely), 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:

It is summertime, when markets are usually sleepy-- if left to their own devices. Throw in a crisis or two, though, and you can see some activity. The big long-term picture still favors us, as holders of a diversified portfolio of conservative US and European stocks. The recovery continues and gains strength in the US and most other places.

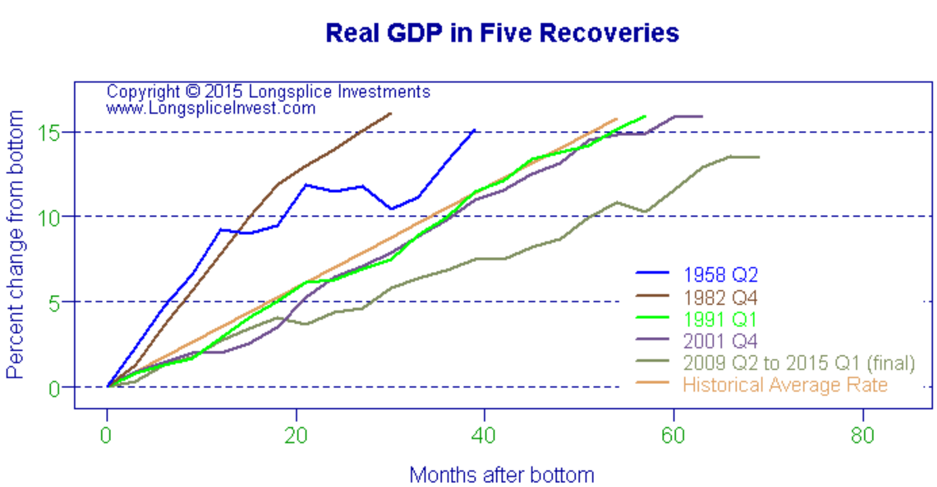
We really don't need to worry personally about the debt problem in **Greece**. It will occasionally roil the stock markets in Europe and here, as it did yesterday, but the markets will bounce back, as they did today. If you're interested in the economics and policy debate within Europe over this, I posted a link to a nice seven-page summary on the blog.

As I write this, China is having a stock market decline. Their market limits the maximum drop to 10% per day, so we won't see a single plunge like we've seen here on a few historic occasions. Prices for the shares were very high, so a big decline is actually a helpful sign. Prices had to fall, best to get it done and put it behind us.

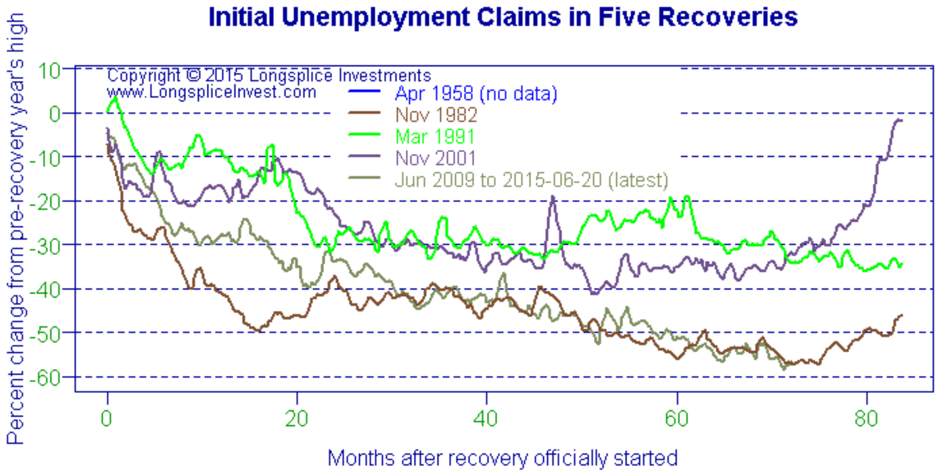
Anyway, we're not invested in China. They're also having an economic slowdown, which could affect us more. They're a big customer for us and a primary crucial customer for some other Asian countries. To the extent that China and its neighbors slow down, we lose some exports. We like to export, but it's not as critical for our economy as it is for some others.

Russia, or more specifically Putin, continues to be an international trouble-maker, so the West will continue to impose sanctions and Russia will continue to retaliate with counter-sanctions. This mess affects Russia most (after poor Ukraine, obviously) then Germany and some of the eastern European countries, then eventually trickles to us as a minor drag on exports.

As an aside, in both the Greek problem and the Ukraine/Russia problem, Germany under Angela Merkel is being unhelpfully focused on doing what's best for Germany, and less concerned about the effects on the rest of Europe. As the biggest economic power in the European Union, one could hope for a more inclusive set of policies. Germany can prosper at least as well in a prosperous Europe as in a troubled one, but they must chose to throw their weight behind the prosperity from time to time. Now would be good.

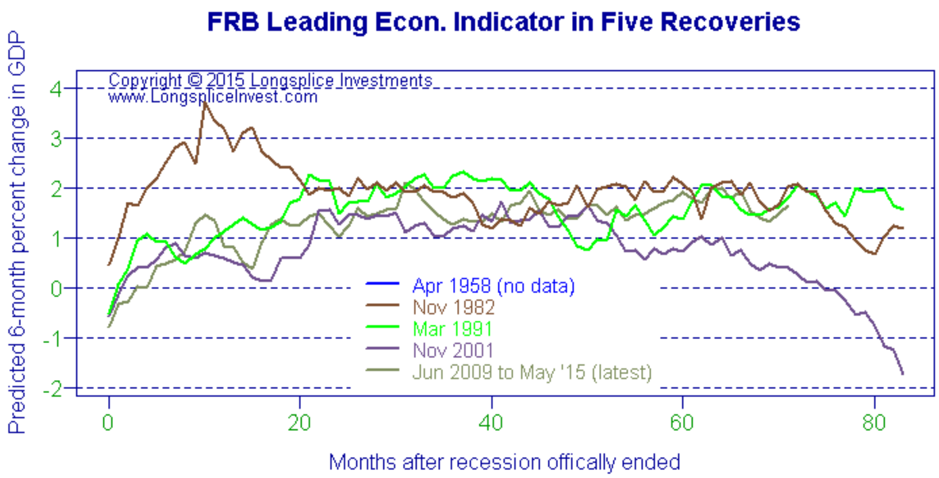


As I said at the start, aside from distant troubles, the US economy continues its tortoise-like advance. This has been a much slower recovery than from other post-1950 recessions, partly due to the recession's depth and partly due to wimpy fiscal stimulus (government spending) compared to prior episodes. The GDP growth comparison shows this most acutely: we've been growing at only half the rate that we did after the 1982 recession, when Ronald Reagan was able to get fiscal conservatives to go along with the stimulus programs we needed. It's too bad that this time around some party leaders were so intent on making Obama look bad at any cost. One of the costs has been a sub-par recovery.



Because the recovery has been so slow, I've extended my comparison charts from six to seven years. That shows that we're still making progress, for example in employment. The rate of new unemployment claims has dropped to a most encouraging level.

Extending the charts also gave the unintended consequence of showing the anemic recovery from the 2001 recession falling apart as the current recession began.



Both the Conference Board's Index of Leading Indicators (which I'm not allowed to reproduce) and the Federal Reserve's similar index show our recovery is fully expected to continue recovering at the rate it has been for the past several years.

Again, you can see that the Fed's indicators were clearly showing the deteriorating prospects as the previous recovery decayed into the most recent recession. That is what leading indicators are designed to do: look at economic variables that tend to start moving before the overall economy starts to show the changes.

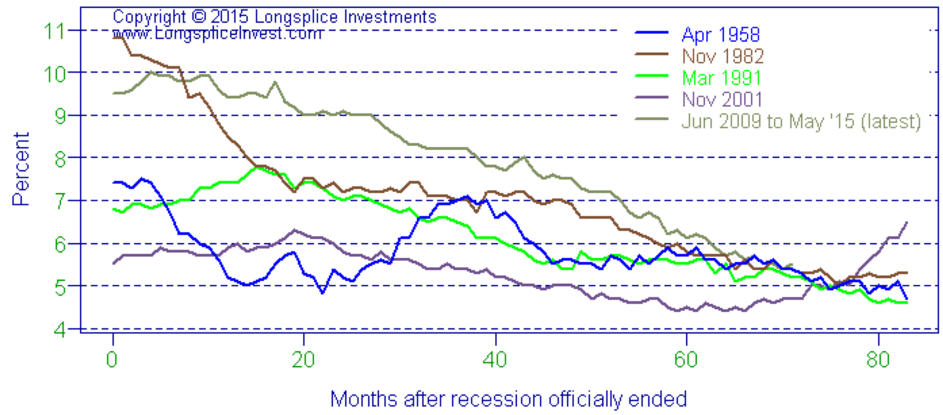
For us, for now, what it shows is more good growth.

The self-reinforcing trickle-up benefit of more workers having more money thus creating demand for more jobs is continuing to work just fine. Our official (headline) U-3 unemployment rate is at a six-year low.

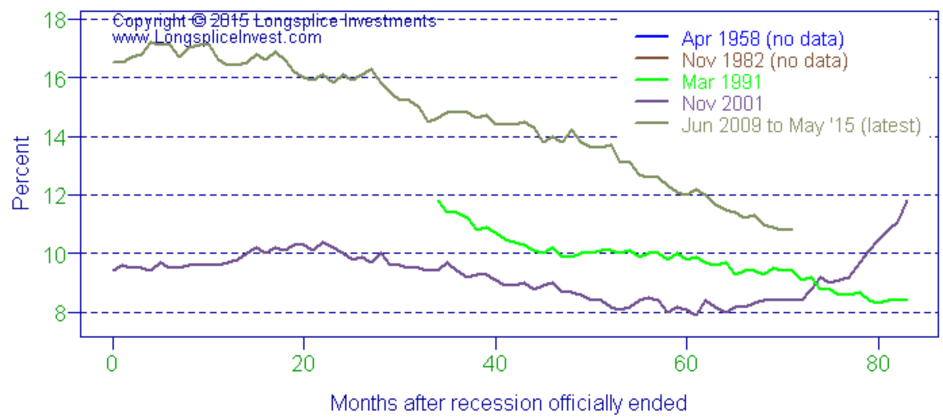
Because inflation(not shown) is still not rising, we can expect job growth to continue, and unemployment to continue to fall, for quite a while.

The broader measure of unemployment, U-6, is less often reported in the media. This counts all the unemployed people in the headline U-3 tally, plus those who are working part time but would prefer to be working full time, plus those who "have become discouraged", i.e., those who can see that there's no work there to make a job search worth the trouble. This is the broadest measure of unemployment, and it is quite a bit higher than the headline number.

Official (U-3) Unemployment in Five Recoveries



U-6 (All types) Unemployment in Five Recoveries

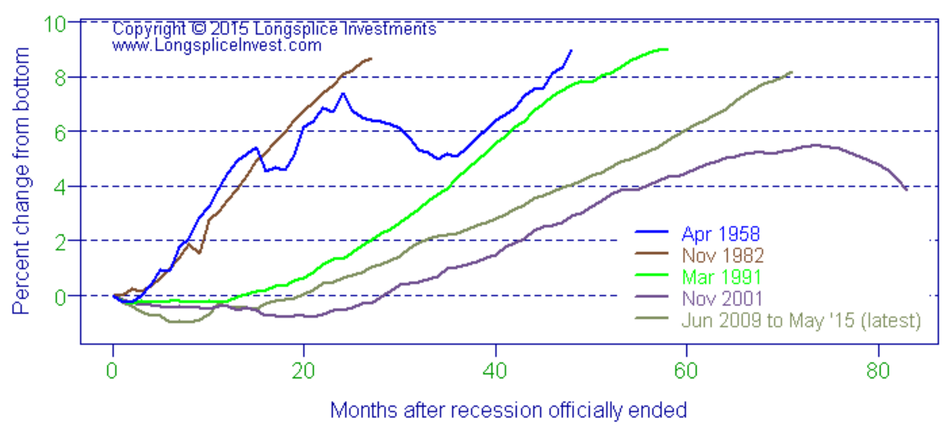


U-6 arguably gives the best picture of the potential workers who don't have earnings to spend, and are thus a part of aggregate consumer demand (purchasing power) which is missing now compared to the last period of full employment.

It's falling close to 10% now, which means it's no longer horrible.

The link in the reinforcing feedback is money, earned and spent and creating more and better jobs for more people. While payroll growth has

Non-Farm Payroll Employment in Five Recoveries



been slow, it has also been steady. We can expect the next half year at least to provide more of the same.

We can all be grateful for that this weekend as we relax and celebrate our Independence Day. Have fun!

It's time to set this on its merry way 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..

Please forward this to any and all friends who are interested. Thanks! If you got this as a forwarded copy, you can get on the list to get your own future copies directly by sending me your email address.

You can subscribe online here to get email notification of both new blog posts and new newsletters.

Take care,

Rick

Rick Drain
1815 Clement Ave SPC 16
Alameda CA 94501-1373

CapitalDrain@LongspliceInvest.com
www.LongspliceInvest.com

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

A collection of fine industrial Boilerplate, but true: