Capital Drain

Rick's investment opinion newsletter April, 2016 v.12 no.1

Before printing, think about the environment

Hi Readers,

I really do intend for these letters to be monthly, but sometimes I get so caught up in trying to figure out what to say that time flies by. If I'd had an idea that required action, I'd have shared it. Instead, I'm still comfortable with investment inaction.

I'm contemplating a way to set up the letters so that the "nothin' happenin' " ones go out more smoothly. You should see it in just a few weeks.

In my opinion:

Executive Summary:

- New-year stock volatility- back to normal.
- Our economy continues to grow slowly. Stick with it.
- China- the debt boom is over. Will it bust?
- Oil, too, boomed and collapsed.
- Why oil is different
- It's credit check time: Experian

The recovery continues, and many US 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:

January saw the US stock markets drop sharply, and end-of-the-recovery stories abounded, **and then-- the recovery wasn't ending, and stocks came back up to new records.** These little market stampedes are an easy way to lose money, if you join in them. If you could get ahead of them, that would be different, but that is impossible to do consistently.

Instead, my current summary of the economy, and of the markets, remains the same as last December. The economy is growing, slowly but steadily. Inflation is very low. The stock markets are near their highest levels of the past two years, and far above the levels of two years ago or the interim lows.

Note, though, that the markets are becoming impatient with some of the super-highly-valued tech stocks. Sanity is beginning to return to the internet-related markets, and some companies that have disappointed have seen their stock prices chopped fast.

New jobs are being added at a good clip, unemployment is going down, and many people who'd dropped out of the labor force during the recession are coming back and finding jobs. Both the Federal Reserve and the Conference Board indices of **leading economic indicators are positive**, if only modestly. Some oil prospecting companies and some regions that had recent oil booms are facing hard times, but the rest of the country is doing much better.

Around the world, Europe is not getting sicker, but failing to do all that it needs to do to get healthier, either. I assume that eventually they will, and will recover. Brazil is in a dreadful mess politically, and not good economically. A Brazilian friend was upbeat, saying that the political crisis is getting some long-standing problems out in the open where they'll be addressed, clearing the way for a better future. *Boa sorte*. **China** is a little trickier: their internal debts are huge and some may never be repaid. However, their government can pull strings and make rules, so they may avoid anything worse than slow growth.

In the unlikely event of a new US or European slowdown, even though monetary policy (central bank easing and low interest rates) is at the limit, they could return to the more tried-and-true remedy of fiscal stimulus (government borrowing and spending on infrastructure, education, health care, and other valuable social investments.) Borrowing right now is phenomenally cheap. This kind of spending could quickly pay for itself by goosing the economy back into vigorous growth.

Have you ever wondered how the price of oil can be so volatile? Most commodities can't drop by 75% in less than a year, or double in a month. In the oil (and broadly, fossil fuel) markets there are many competing suppliers. There are very many independent consumers. Ordinarily, you would expect that to create a fairly orderly surprise-free market. **What makes oil different?**

In a nutshell: high flow, low storage. We use an enormous amount of it every day. The flow is so enormous, that the worldwide capacity for storage is small by comparison (compared to storage of grain or copper, for example.) Meanwhile, the adjustment of supply and demand is very slow. People don't stop driving to work or cooking or otherwise using energy, and companies that own producing oil fields are not able to just close a valve and stop production for a while. (Oilfields can be shut down quickly by violence of course, but the process is obviously destructive and produces a big environmental mess.)

The flow of oil from producers to consumers is continuous. If producers' estimates of demand are too high (or estimates of other producer production are too low) the excess can go into storage. Likewise, if the demand at the moment exceeds supply the stored oil can be drawn down.

Remember, though, that the storage is small compared to the flow. If consumers start to see the storage levels drop, they quickly bid the price up, because no one wants to be the user that doesn't get enough. Conversely, if storage gets too full, producers will let the prices drop fast, because no one wants to produce oil that just pours out onto the ground.

It's the relatively small volume of storage that can create the big price swings even though the overall market is so much bigger.

It's **Credit Check** time again.

Why? Identity theft has become a big big business, with professional thieves adapting daily. Your best hope for protecting yourself is to keep an eye on all your financial accounts, watching for suspicious activity.

How? Once per year per Credit Agency, you're allowed to get a free copy of your Credit Report. If you've been following along with my every-four-months pace, you're ready to revisit Experian.

It's easy. I've taken notes from my own recent visit, so you can follow the instructions at www.longspliceinvest.com/CapDrain/Experian.pdf .

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