Quarterly Newsletter - April 2016

April 15, 2016

Dear Client,

We said in our last letter that if the Federal Reserve were to stop threatening to raise rates the bad markets of late last year and early this year would likely reverse and go up. Janet Yellen must have read our letter. They did stop the threats and the markets have reacted very favorably. But we remain concerned. The Fed, like most central banks now, is an ?inflation targeting? central bank. This means they care much more about inflation and much less about unemployment. This makes them deflationist in their basic approach. We worry that the Fed will soon go back to raising rates. In a weak world economy this would not be good.

Then there are other big things to be worried about. Clearly the terrorist threat in Europe is much worse than we had imagined. And a recent column from Martin Wolff of the Financial Times lays out a series of very terrible things that could happen to the world economy if China does not manage their economic rise and increased power in an intelligent way. His column was called China's Future Challenge for the World Economy. We have a pdf if you wish one.

And then we have a sort of rain of mildly depressing things drizzling down all day long. The worldwide tax evasion scandals. The collapse of Brazil. The oddly dreadful state of American politics. And an article in the March 26th Economist detailing the rise in monopoly power in the U.S. economy. We strongly recommend that you Google this article The Problem with Profits and read it. Monopoly power is on the steady rise, both in the U. S. and in the rest of the world. This power has created the wealth of the rich 1%, and it just really difficult to see how it can be defeated. We in fact believe that monopoly power explains many of the depressing (and Trump inducing) aspects of American life ? but these are political questions and have no business in an investment newsletter.

But there are also various things to be quite optimistic about. The main one of these is the fact that the Fed did not in fact raise rates. They reversed course in a very public way, something a large and tradition bound institution such as the Fed is not good at. And in their statement they made explicit mention of the weakness of the world economy and the harm that a continuing strong dollar might do. Janet Yellen has made it quite clear that she remains apprehensive about the high level of long-term employment in the U.S. She seems more willing than Ben Bernanke was to accept somewhat higher levels in inflation in return for a reduction in long term employment. We believe this to be a wise and good monetary policy, and the stock market clearly agrees. And the Chinese monetary authorities have, thus far at least, managed to aim their economy there toward a soft landing rather than the deflationary crash and crisis that had been foretold by the bears last year.

These are not small victories. They are very important.

The stock market itself has been quite optimistic recently. A sharp market decline started in mid-2015 and then suddenly ended in mid-February 2016. Perhaps you will recall the sickening dive in oil prices. It really is stunning when a gigantic commodity like that can lose something like 80% of its value in a year and a half. The fall in oil seemed to be dragging the whole world economy into deflationary hell. Hedge funds made gigantic bets that the fall would continue. In early 2016 things got so bad that the first month of

2016 was the very worst opening month period in all of U.S. market history. The Third Avenue Focused Credit bond fund, a famous and large high-yield bond fund, basically just melted down. Talk of another Lehman debacle was rampant. Everyone was frightened out of their wits.

And then the whole thing reversed, very suddenly, when the Fed said they would not be raising rates immediately. It was off to the races. Oil went from the mid-twenties to over forty. The whole world commodity complex showed real strength. Our rebalancing method worked very well. We almost looked like successful market timers ? though we have absolutely no intention of doing any such thing.

We say all of this not in order to brag, but rather as a cautioning. The bad things we spoke of earlier in this letter are both real and very bad. And they are still very much out there. Periods of extreme market volatility may well lie ahead. Uncertainty creates volatility and volatility creates more uncertainty. Please remember that it is volatility that accounts for the higher long term performance of equities. Volatility creates risk, and equity owners must be compensated for assuming volatility risk with higher expected rates of return. But these higher expected rates of return may be higher losses instead. This is just in the nature of risk. We wish to warn you in advance. When they were falling earlier this year all the big bad bears were out there snorting and growling. The bears are quiet now but, they will be back with the next big down-draft. If these things frightened you then, now would be a time to review the allocation of your portfolio. Call us if you wish to discuss this.

Jim John Richard & Ryan.

Addendum: as required by law we are enclosing with this report our Privacy Policy statement. And as also required by law, we wish to inform you that our SEC disclosure document, form ADV, has been updated and is available at all times upon request. Call us and we will send you a copy. The form is also available on our website.