

CAZ Investments

Quarterly Letter

“What a Mess”

We have waited to draft this letter until the resolution of the deadlock regarding the debt ceiling and government shutdown. Surprise.... the “can” has officially been kicked down the road again. We will wait all of four months to see the fight take center stage once more. None of this is good for business or consumer confidence, and it will be a drag on spending at all levels over the next few months.

All we can say is that our disappointment with the folks in Washington grows and grows. It is really quite nauseating if one stops to think about it. This is a prime reason why we need to do something about career politicians who are more concerned about getting elected than doing what is best for our country. That is a topic for another day.

Back to reality. Our economy is doing alright, corporate profits are doing pretty well and the consumer is hanging in there. Imagine what things would be like if we did not have all the uncertainty caused by Washington. What if we had total certainty as to our tax policy and healthcare system? What if we had complete confidence in our country’s financial position, with a balanced budget and a falling level of debt? What if we had energy independence? What would corporate profits look like? Where would unemployment be?

That would be a wonderful picture, wouldn’t it? It is nothing but a dream right now, but it is startling to think how strong the economy could be if the right environment was created to allow capital to flow freely and investments in people and equipment were rewarded. For now, we have to muddle through the chaos and look at the reality of where we are which is more malaise, bureaucracy and manufactured liquidity. The Fed is keeping both feet on the pedal of monetary stimulus, and that is probably going to continue until the 1st quarter when Janet Yellen most likely takes over as the next Fed chair. So risk assets continue to be bid up with a belief that this Fed stimulus will continue unabated for a bit longer.

We are continuing to benefit from the rising prices and are thankful that we are seeing an increase in the value of our clients’ assets. We are not being complacent, though. Quite the contrary. We are ramping up our attempts to find ways to protect client capital in an increasingly risky stage in the history of financial markets. Some of these steps have already been taken and others are being developed behind the scenes to be used at some point in the future.

An important message that all who read this letter should receive is that it is imperative to monitor and adjust asset allocations after the move that we have seen. In a typical portfolio, the allocation to stocks has now increased dramatically



compared to other asset classes. This has accelerated in the last few months as stock prices have gone up, and bond prices have gone down. Quite simply, study your 3rd quarter reports, and see if you are comfortable with the amount of risk in the asset allocation. If you are not sure, reduce risk. One of our favorite sayings that has stood the test of numerous bull and bear markets is, "Sell when you can, not when you have to."

There are some anomalies that we feel compelled to point out. There have only been three times in history that the value of our stock market has traded at more than the Gross Domestic Product ("GDP") of the United States. In the late 1990's during the technology bubble we traded as high as 148% of GDP, and in 2007 we traded as high as 118% of GDP. Today we are approximately 110% of GDP. Of course, there is the possibility that we move a little higher, but history has shown us that serious corrections usually occur when valuations reach these levels. At this point the only bullish case one can make for stocks must be based on the belief that the valuation multiples will continue to expand, similar to the bubble of the 90's, or that the economy is poised to grow GDP at a historic rate. If one of these events does not occur, stocks will trade lower from current levels.

For this reason we are growing even more concerned. We like it when stock prices go up, and we are hopeful that we will see a catch up in corporate profits and economic growth so that we can become more comfortable with valuations. "Hope" is not an investment strategy, though, and we will continue to pare back our risk exposure if the markets continue to outpace cash flow growth and valuations continue to stretch. We remain a reluctant "2" on the CAZ Scale and we are beginning to lean even more negatively.

Our firm continues to grow, and we are excited to introduce you to our new team members who joined us in the 3rd Quarter. Space does not permit a great deal of specifics so please visit our website to read more about each person. Here they are, along with their roles at CAZ:

- Lucia Hwang – Vice President
- Katy Kavanagh – Office Assistant
- Hilary Munding – Client Services Assistant
- Marc Sharpe - Executive Vice President – Director of Private Equity
- Sandra Shaw – Controller

We hope that you have an opportunity soon to interact with our new team members. Over the next few months you will see some outstanding changes in the manner that we report results, provide access to information and communicate with our clients. We are excited to share these innovations with you so please pay special attention to the emails and letters that you receive from our offices and from Fleming and Associates, our third party administrator. Please do not hesitate to let us know if there is anything we can do for you. Have a great fall!

