CAZ Investments
Quarterly Letter

More Animal Spirits

The market euphoria that started in the 4th quarter continued in the first three months of 2018, with stock prices continuing the rally that began on election day. Business optimism has continued to strengthen, and there is hope that we are going to begin a new period of economic growth. That hope is based on four primary expectations:

1. Regulatory reform
2. Health care reform
3. Tax reform
4. Infrastructure spending

In our view, stock prices have priced in the vast majority of the benefits from each of these areas, but it is impossible to predict how much of the President's agenda will make it through Congress. As a result, we remain very bearish on valuations while being optimistic about the business climate. When we consider our overall stance, we believe that investors should remain skeptical, make decisions based on things that are irrefutable and make investments that are not totally reliant on the political process to be successful. Thereby we remain a **"1"** on the CAZ Scale and encourage investors to maintain the lowest level of stock market exposure at which they are comfortable.

How will the Political Winds Blow?

To unpack each of the policy areas mentioned above would take several books and is far beyond the scope of this letter. That said, here is what we believe will occur in each of these areas based on our research and feedback from relationships that are deeply involved in the political process.

1. Regulatory reform – Because the powers in this area rest with the executive branch and are "stroke of the pen" actions, we are hearing that there is extremely positive momentum. The impact of most of the executive orders that occurred between February and April have yet to be fully felt. What we are hearing is that there are expectations in nearly every sector that improvements are on their way. Some of the effects are already trickling into the system, and the removal of overbearing regulations could well become a steady flow of benefits as we move into the second half of the year. We will be watching to see how this change in business-owner outlook impacts hiring patterns, and we are hopeful that these reforms will lead to a surge in job growth.

2. Health care reform – It is a mess. We don't expect this to surprise anyone, and it is every bit as challenging as it appears. This area of our government is one of the most complicated, most emotional and most

difficult to fix. We believe the administration jumped the gun and should have had more buy-in from multiple parties before launching efforts to repeal and replace. Quite frankly, we will be surprised if anything gets accomplished during 2017. Investors who were hoping for an economic boost from reforms in health care are likely to be disappointed.

3. Tax reform – There is a good chance that tax reform, with significant bi-partisan support, can be passed this fall. The President's plan is likely going to change significantly, but if any of the core proposals are enacted it will be a positive for the economic environment. The tax savings from the plan is certainly one factor, but it is the simplification included in the proposal that has the potential to save business owners incredible amounts of time and compliance costs. The result should be more jobs as owners will be able to focus more on growing their businesses, and they will have additional resources to do so.

4. Infrastructure spending – While much of this area is "stroke of the pen," it will take Congressional approval to significantly change spending patterns. We are very skeptical that large deficit spending, on top of major tax cuts, is going to be politically feasible in this calendar year. There is likely to be some progress, and certain sectors should benefit, but we do not believe there will be across the board seismic shifts that will have a major impact on job growth.

The Ever-Present Wildcard

The world is unlikely to ever get to a place where the geo-political landscape is not a constant thought in the minds of business and government leaders. The result is consistent uncertainty, which leads to persistent discomfort, which translates to less confidence in the allocation of capital resources. Whether we think about North Korea, instability in the Middle East or terror attacks in London, not a week goes by where the geo-political climate is not present in our thoughts. This is a new paradigm for many countries, and people, who have grown accustomed to consistent stability. Although, one would never know this reality exists by looking at the level of stock prices or the generational lows in the pricing of volatility in the options markets. On the one hand, this is to be admired as it shows the resiliency of man and markets, and on the other hand it should frighten us that the markets have become so complacent and overconfident.

Plan for the Second Half of 2017

We are most comfortable making decisions based on known, predictable factors. Stock valuations are near the top of that list, and that is why we are so cautious now. Stocks are simply expensive on every metric. This means the margin of error is very small and any catalyst, whatever it may be, has the potential to cause a stampede, and we do not want to get run over. To reiterate, we can build a case for stock prices to move higher on the back of major reforms and a resurgent economic cycle, but all of that is conjecture. Investing based on hope is dangerous. We prefer to invest our personal capital in situations where we feel

we have a high level of persistence and predictability. At this time, it is very hard to find this in traditional public markets and much easier to find in non-correlated assets that have idiosyncratic factors that determine success. Until the macro environment changes, we are going to concentrate our efforts in the less traditional segments, and we will continue to keep you posted on where we choose to invest our personal money.

Please stay tuned for announcements from us throughout the summer as we expect several investment opportunities to cross the finish line. If these do come to fruition they will most likely have a small window of opportunity, so our time frames may be short.

We appreciate your willingness to invest alongside us, and we would welcome the opportunity to introduce ourselves to other investors with whom you frequently discuss investments with. We hope you have a tremendous summer, and we look forward to seeing you very soon.

All our very best,

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