INVESTMENT NOTES - December 18th, 2018
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There will be no investment notes next week in observation of the holidays. We wish to take this opportunity to wish everyone 'Happy Holidays' and may 2019 bring you health, happiness and prosperity (which we will do our best to facilitate!).

This week we would like to talk about three topics: 1. How an indictment of President Trump would play out. 2. The threat of passive investment. 3. Our outlook on 2019 and positioning going into the New Year.

How an indictment of President Trump would play out:
To see how an indictment of President Trump would play out we have studied what happened when Vice President Spiro Agnew was indicted. The Vice President was indicted under financial misconduct charges that occurred when he was Governor or Maryland (he supposedly continued to receive payments while in the White House). A deal was struck that if he resigned the office- the charges would be reduced. He received a $10,000.00 fine and lived a nice life in retirement doing the usual speeches, etc. for compensation. In President Trump's case a similar strategy would be pursued. The interesting point is that the statute of limitations on a Federal case such as what is being contemplated for President Trump is 5 years. Therefore charges need to be made before the second term as he would have immunity until the term is complete and by that time the statute of limitations would have taken effect. If charges are brought during the first term and a deal is not struck, the minute the helicopter leaves the White House lawn, the President will be facing charges and probably jail time along with a substantial fine. Charges will probably be brought in 2019. We believe that President Trump will not be the Republican candidate in the next Presidential election.

The Threat of Passive Investments:
On Bloomberg's Odd Lots- Fraser-Jenkins of Bernstein was featured. He is known for stating that, "passive investment is worse for society than Marxism". In the podcast, he states that the rise of passive investing as a dominant strategy has coincided with the success of the 60/40 portfolio. For years it has been a winner to buy stocks and bonds and assume that one will do well if the other is doing badly- making investment very easy. But if the relationship changes, more sophisticated forms of portfolio management will thrive. We have written about the large exposure of the markets to the short volatility strategy and how it is imbedded in most investment strategies. These short volatility strategies have done well during a period of stable stock-bond anti-correlation, but these portfolios will do terribly if the relationship between stocks and bonds changes. This year we have had brief periods where stocks and bonds have gone down together. Questions we are asking: How much of investing is predicated on this relationship? What would cause that relationship to end? How ugly would it be if it would end?

The Outlook for 2019 and our position at the start of 2019:
In contrast to most of the predictions for 2019 that we have read so far, our outlook is negative. We believe there is a threat of stagflation for 2019 and as per the previous paragraph, the market will not react well to the dual bear markets in stocks and bonds. We believe that inflation that is already in the economic system, has been tempered by the drop in oil prices this year. We believe this dampening will not occur again next year, however, we also are not bullish on the oil price but feel it will remain at current levels or slightly above (see our notes of last week). The inflationary forces for next year are twofold: 1. Continuing trade wars with tariffs and duties will increase prices. This will be coupled with the great deflationary force of Chinese exports decreasing. 2. Full or close to full employment in the United States will cause wage inflation. Productivity increases have subsided therefore the full inflationary force of these wage gains will be felt. Companies will not be able to

hesitate to raise prices as profit expectations are high and there will be no reduction in taxes to offset a reduction in margins.

At the beginning of 2019 we are expecting to be conservatively invested with a large exposure to the US treasury market hedged into Euro. We will continue to hold positions in selected stocks whose underlying fundamentals reflect their ability to ‘price make’ not ‘price take’. We will look to invest in emerging markets that benefit from lower oil prices and have room to de-regulate while having healthy sovereign balance sheets. These emerging markets will also be helped by a falling USD. Lastly we will be looking to buy the VIX index and take advantage of shorting opportunities although going into the year we expect not to be net short but have a very low exposure. Sometime in 2019 we do expect to be net short.

Jane Siebels