INVESTMENT NOTES - May 8th, 2019

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It looks like the 'sell in May and stay away' adage is winning over FOMO (Fear of Missing Out- of a bull market) courtesy of President Trump's China tweets. We doubled our short in the Russell 2000 last Thursday and sold half our China ETF. We attended the Berkshire Hathaway meeting in Omaha and walked away with the resolve to sell the holding slowly.

The BRK decision was not based on losing confidence in Warren and Charlie, but on the proliferation of private equity funds at the meeting (saving whole rows of seats- have they no morals?). These funds are based on the idea of buying whole companies and holding them long term (ala BRK). Unfortunately, their source is the same as BRK's – family owned companies. Although Warren might be the first call, he now has competition on price. He also has (as he admits) the problem of size- a $1B family owned business is not going to move the dial for him and there are not that many very large family owned businesses up for sale. It wasn't only the Private equity firms but also the proliferation of Asians – also with tons of cash- to entice any family at the meeting thinking about selling. The third noticeable group were Germans- which should be an attractive hunting ground for Warren with the Mittelstand- however, different tax treatment makes the proposition of a family selling – not so attractive. Therefore BRK, must find a new way, or in VC/private equity speak- pivot. We are not convinced they have found the way to do this.

The China decision had the following reasoning: China ETFs had their largest outflows last week (while VIX ETFs had their 5th straight week of inflows). Trump's tweets had the intention of jump starting the trade negotiations however the result has been investors losing their patience. Investors are also looking at the following: 1. Two US navy destroyers (the USS Preble and the USS Chung-Hoon) sailed within the Spratly Chain in the South China Sea Monday morning. 2. Trump's tweets are being censored and deleted across multiple Chinese social media platforms along with minimal press coverage of the trade talks in China. 3. The PBoC announced a reserve requirement ratio cut which was focused on rural commercial banks on Monday morning (very unusual). 4. Chinese banks lowered the limit for US dollar withdrawals from $5000 to $3000. 5. The IPO of a Tencent backed Chinese video-game live-streaming platform is now delayed. 6. Foxcomm Chairman Terry Gou who is running for President of Taiwan is talking about Taiwanese peace with China but is including the US in his statements- meaning the US is involved. 7. Chinese approvals for foreign investment in the first four months of the year already outweighed the total approvals for 2018.

China might receive some trade benefit from unresolved talks as the trade- weighted Yuan has traded higher in 2019 will probably trade lower increasing their competitiveness. Also despite trade talks, China is coming into the Bloomberg Barclays Global Aggregate Index which should mean about 150B inflow. FTSE Russell is also monitoring China for inclusion in their bond fund (if so, that means another $100B). JP Morgan is also making a decision at the end of summer about including China in their index but at a lower allocation of maybe 10%.

Senator Chuck Schumer (Democrat) is telling President Trump to 'hang tough' on China- showing bipartisan support for standing up to China. However, perhaps we should all be more concerned with Russia. At the beginning of the trade talks, the US needed China's cooperation to handle the North Korea situation and China needed the US to help with the Taiwan situation. North Korea is now turning to Russia (Kim Jong-un visited Putin in Vladivostok) and China is claiming to be a near-Arctic state, and looking for Russian backing, to which Pompeo stated that being 900 miles away entitles China to nothing. The Arctic is important for the Chinese silk road but they aren't the only ones cognizant of the long game.

Which is to say, the breakdown in China trade talks symbolizes a shifting trend and is more geo-politically oriented than economically oriented. Although it looks like children throwing their toys out of the pram, it might be more akin to The Game of Thrones.

We have our buy limits ready and will continue our conservative allocation for the moment.