



386 W. CENTER, OREM, UTAH 84057

801-356-9600 fax: 801-356-9601 www.first-financial-advisors.com

June, 2016 NewsLetter

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To Our Valued Clients and Friends

THOUGHT FOR THE DAY

"It is impossible to introduce into society a greater ...evil than this: the conversion of the law into an instrument of plunder."

Philosopher Frederic Bastiat

MARKET PERFORMANCE

Anticipation of a Fed rate increase kept markets on edge for most of May, leaving markets to chop around and drift, adding to the uncertainty surrounding weak economic data (see **TRUMPISM**). Market averages struggled to hold their ground but finally rallied into month-end as the world seems to have accepted a ¼% Fed rate increase. Our PRISM hedge fund is back on track, client portfolios perk along nicely, and oil prices have rallied. **YTD: DJI +2.1%; S&P +2.6%; NAS -1.2%; PRISM 0%; Gold +20.0%; WTI OIL +32.0%**

OF CABBAGES AND KINGS

In an industrialized world that runs on fossil fuels, the formula is simple: he who controls the oil, rules the world. That's Saudi Arabia. We know how *fracking* technology unlocked vast amounts of new oil in the US – more expensive to get out of the ground, yes, but nonetheless available to offset the supply monopoly of **OPEC** dominated by Saudi Arabia (how ironic both Bernie and Hillary are advocating making *fracking* illegal, even though declared environmentally safe by the EPA). Still, the Saudis rule by manipulating production levels and price. Thus, when changes take place in the Royal Family of Saud, we pay attention. He is 31 year-old Deputy Crown Prince **Mohammed bin Salam**, next in line to be the King. This Crown Prince is part of a new generation, educated in law, and very aware of modern technology – and not inclined to be so provincial about imposition of *sharia* law in his country, especially as regards women. Changes are in the wind. In an interview with the Economist in 2016, probing questions regarding Saudi Arabia's religious aggression (**Wahhabism** that motivated 15 of the 9/11 hijackers) and war mongering (he is the Minister of Defense who ordered the attack on Yemen) got some interesting answers from the Prince, answers that reflected a keen understanding that falling oil prices has imposed a new political reality on his country (see **WHO OWNS US?**). As chairman of the *Council of Economic and Development Affairs* he is implementing new economic policies called the **National Transformation Programme**, designed to redirect Saudi resources from oil production to domestic consumption, privatization of their economy as in the US (does this sound familiar?), and even imposing new taxes and cutting their fat citizen subsidies and Royal-family allowances to help balance their budget. Idealistic politicians like Bernie Sanders should take note that you can only get away with generous government handouts for so long until the goose stops laying the golden eggs. Then who picks up the tab (did I mention one B-2 stealth bomber costs about \$1 billion?)

WHO OWNS US?

Data on Saudi Arabia's holdings of US treasuries has been released for the first time in 40 years. The report said the Kingdom is holding \$116.8 billion as of March according to the Treasury, which did not break out the data until recently. Due to falling oil prices, that number has been shrinking along with their \$585 billion in foreign reserves, with the International Monetary Fund estimating that up to two-thirds may be held in dollars. The 16% drop in reserves is important because it reflects their growing budget problems related to the plunge in oil prices and war with its neighbors in Yemen. We mention these numbers because of efforts by some to sue Saudi Arabia for being complicit in the 9/11 terrorist attacks (the final 28 page section of the congressional inquiry into the 9/11 attacks has never been made public, on orders from Presidents Bush and Obama). The Saudis, in turn, have hinted that they could retaliate by dumping their holdings of, not only our bonds, but billions in American stocks in their sovereign wealth fund, which could break the stock market overnight if they started to sell (which, of course, would also break them). Such is the game of International chess we play. To keep things in perspective, their \$117 billion in treasuries compares to \$1.3 trillion held in treasuries by China and \$1.1 trillion held by Japan. Of the \$19.2 trillion current US Federal debt, about 33% is owned by foreigners, 15% by domestic private investors, 21% by the Fed, and the rest spread out over Federal Accounts (owed to ourselves like Social Security Trust Fund), and other State and Local governments. We worry that our aggregate debt to GDP ratio is high (about 105%) because of the financial crisis of 2008 when the ratio stood at about 70%, but most of the debt is owed to ourselves - and were not going to foreclose on ourselves. Our highest debt/GDP ratio was in WW II where it reached 122%. With negative interest rates showing up around the globe, it has triggered high demand for the safety of US bonds yielding 1.8% on the 10 year treasury. That low rate may look skimpy to us, but to the rest of the world, the relative yield is irresistible, keeping demand high for US treasuries and our rates low, so that the interest we pay on our debt is only 6% of the Federal budget, the lowest since 1970. Alarmist continue to cry *doomsday* about our debt levels, but in reality 'we are the best house in a bad neighborhood'. In fact, even at barely 2% GDP growth, we are still the envy of much of the world. Better economic policy from a new White House should help to bring overall debt down to more normal levels, spoiling the fun of the doomsayers.

BOORS AND BIGOTS (reprinted: Michael Gerson in The Washington Post)

"The standards and values of reality television – the exaggerated feuds, the personal vilification, and the deleted expletives – have invaded the political realm. And it is a form of social decay. It is good manners that allow citizens to argue without coming to blows, and even to find productive compromise. In most everyday circumstances, manners matter more than laws. Good manners involve an affirmation that we, all of us, are part of the same community, and that everyone is due a certain minimal amount of respect. Poor manners, in contrast, can indicate the dehumanization of individuals and groups. The boor is often the bigot."

TRUMPISM

Economics has been labeled “the dismal science”. Thomas Malthus had published his depressing scenario that the growing world population would soon outstrip our ability to feed them, thus dooming humanity to widespread misery. Today we complain free trade is guilty of killing manufacturing jobs (40% of American manufacturing jobs eliminated by technology and off-shore outsourcing); the assertion that illegal immigrants have taken jobs away from white, blue-collar Americans (in the last Census Bureau report, we learned that ‘white’ children under the age of 5 are now the minority); or the gap between rich and poor is the widest in recent history. The current state of economic affairs in the world is weak enough that the economic data does appear to be *dismal* – declining S&P profits and revenues, consumer sales at traditional department stores evaporating before our eyes (death by Amazon). As we know, the *dismal* data is directly impacting human lives, and is expressing itself in interesting ways – like **Trumpism**, for example. An article in *Harper’s Magazine* talks about ‘Trump’s people’, a group characterized by older, white, blue collar men who have lost the security and relative prosperity of union manufacturing jobs with their paid healthcare, vacations, and generous retirement plans. They sense in a very real way that their whiteness now makes them the disadvantaged minority and they resent it (called ‘*the browning of America*’), not to mention a hate for Muslims triggered by ISIS. There is a sense that they want a man like Trump to revive the ethnic concept of American identity, “*a predictable reaction from a once dominant ethnic-racial group (white) that feels threatened by the rise of other groups,*” as journalist Derek Thompson wrote in *The Atlantic* magazine. “*Economic anxiety and racial resentment are not entirely separate things, but rather like buttresses in an arch, supporting each other in the creation of something larger – Donald Trump.*”

OVERREACH

Andy Johnson owns a small 8-acre horse ranch in Fort Bridger, WY. Mr. Johnson built a stock pond on his property after having obtained all necessary state and local permits. It turns out that Johnson had dammed a creek considered a tributary to larger, navigable rivers which requires a permit from the Environmental Protection Agency (EPA). In 2014, the EPA ordered Johnson to tear out the pond or face fines of \$37,500/day for what the agency described as a violation of the Clean Water Act, even though stock ponds are exempt from the federal law. Mr. Johnson had accumulated \$20 million in fines while fighting the agency’s order, but under a settlement agreement negotiated this year by the Pacific Legal Foundation, the Johnson’s will pay no fine, will keep their property, and will not have to agree to federal jurisdiction or a federal permit. In effect, the government will treat the pond as an exempt stock pond, and Mr. Johnson has agreed to plant some willow trees around the pond as part of the settlement. In 1996, Utah citizens watched in disbelief when, then, President Bill Clinton declared the *Escalante Grand Staircase* in southern Utah a national monument using his authority under the *Antiquities Act*. Just like that, the Federal Government took one of the most popular tourist destinations in the world out of the hands of Utah and turned jurisdiction over to the Bureau of Land Management. *Grand Staircase-Escalante* encompasses the largest land area of all U.S. National Monuments. Here’s the real irony. Under the U.S. Constitution, states were promised that millions of acres of federal lands within their state boundaries would be deeded to them upon achieving statehood. This has never happened in Utah’s case, even though our legislature has repeatedly attempted over the years to have the matter addressed by Congress. In 2012, the Utah state Legislature decided to press the issue by passing the *Transfer of Public Lands Act* demanding the federal government cede title to 30 million acres of national forest and BLM controlled acreage to Utah. Close to 70% of the state is in federal ownership, setting the stage for a host of tensions over land use such as grazing, oil and gas development, and even forest management for wildfires. The state has funded a legal-fee war chest and is prepared to take on the Feds in what should prove to be an interesting case of state’s rights vs Federal overreach and plunder (did I mention the bathroom wars?)

HYBRID SEMI

We’ve wondered for years why the electric motor technology used on freight trains isn’t being used to power our over-the-road truck fleet. The issue was always high conversion cost and resistance to change associated with a major change in the way you power our truck fleet, not unlike industry skepticism when **Tesla** introduced the immensely-popular all-electric Model S to the world. A local Utah company, **Nikola**, recently announced the development of the first CNG (compressed natural gas)/electric hybrid semi-truck aimed at changing the nation’s over-the-road truck fleet. Like other hybrids, the truck will use low-emissions natural gas to power a turbine generator which, in turn, charges a 320-kilowatt-hour battery pack that drives six motors, one for each wheel in the same way as diesel-electric locomotives do. Reengineered from the ground up in collaboration with other prominent engineering firms, the **Nikola** truck promises to be the truck of the future with an 800-1200 mile range, 2000 horsepower, and 80,000-pound pulling capacity. A working prototype will be available by year-end and significant orders are already being placed for the truck even though delivery is still 2-3 years away. The company has been well-funded by a group of ‘very wealthy’ VC investors so their future appears bright. To ensure acceptance and adoption, the company also announced plans to build a nationwide network of refueling stations to support its customers, much like **Tesla** has done for its electric vehicle fleet. This is an example of technological innovation that will benefit all of us.

LOOKING AHEAD

We didn’t sell in May, and our cash cows kept giving their milk. We added to positions in some outstanding REIT’s as they came on sale. We anticipated the Fed would raise rates on June 15 but a bad jobs number for May at the last minute has cast doubt they will raise rates this month. The vote for Britain to exit the European Union (Brexit) is on June 23, adding to the specter of June volatility.

We value your questions or comments so please don’t hesitate to email or call.