

Praetorian Guard

QUARTERLY NEWSLETTER • 3RD QUARTER 2016



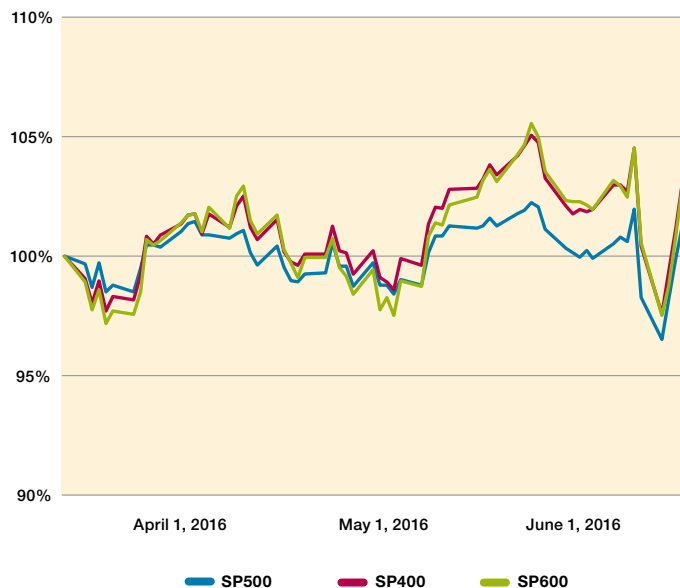
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SECOND QUARTER 2016 MARKET REVIEW AND DISCUSSION

Volatility was slightly less throughout the quarter (compared to the start of the year), but it was definitely not a period for the weak of heart. The side by side graphs below reflect the volatility of the second quarter (left) and 2016 year to date (right) for the U.S. equity markets. These graphs show that in a broader six-month context, the BREXIT vote was a relatively small blip compared to the first six weeks of the year. Both sell-offs recovered as investors and markets digested the news and realized each pullback represented an opportunity to buy at a “discount.”

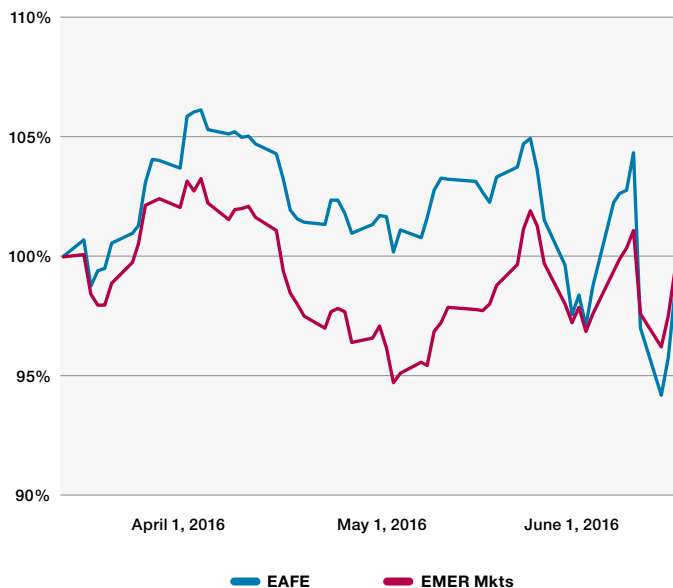
Last quarter we discussed oil in particular and energy in general. Our belief was that oil at \$29 per barrel was too low. This past quarter saw a return towards \$45 to \$50 per barrel. The invisible hand of Adam Smith worked as U.S. rig counts have seen a significant decline from over 2,000 rigs in January 2012 to 440 this week (Source: Baker Hughes). Domestic oil output has decreased from a high of 9.6 million barrels per day to 8.6 million barrels per day at the end of June 2016. This has helped to move oil prices up without causing *(continued on pg. 2)*

US Equity Market Performance Q2 2016



Source: The Financials.com

International Equity Market Performance Q2 2016



Source: The Financials.com

In This Issue

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Lowering the price of fuel increases spending power for consumers.

(continued from page 1) a significant decrease in consumer spending as energy prices have remained low. Gas at \$2.50 to \$3.00 per gallon is still relatively cheap. We do not see a strong rise beyond \$50 per barrel. Even a small increase will bring a positive response from U.S. shale production. Fields which have been temporarily shuttered will quickly be brought back online. Iran will continue to add crude oil to the world market as production in April 2016 reached 3.5 million barrels per day.

The overall economic impact of this is positive. Lowering the price of fuel increases spending power for consumers. In addition, it further provides benefits to large fuel consumers in industries from manufacturing to transportation. It helps to keep inflation low and low fuel costs will slow the Federal Reserve's rate hike timing as

inflation at 2% is one of their goals. Based on this analysis, we will continue to hold our positions in Energy for the foreseeable future.

Additional thoughts on an economic sector: Financials. The end of June saw the "stress test" results for 33 major U.S. banks—all having acceptable capital return plans. Thirty-one of them were cleared to raise dividends and execute share buybacks with the benefit of returning capital to shareholders. Virtually all announced increases in dividends and authorization for share buybacks.

We moved into Financials last fall after minimizing the sector for several years and believe this will continue to be a holding in many of our portfolios over the next 12-18 months. 📌



FACT: The June 23rd referendum initiated a sequence of events that will unfold over the next two to two-and-a-half years.

Britain has named Theresa May as their new Prime Minister. Following the organization of the cabinet, she will decide *when* to formally notify the European Union that Great Britain is invoking Article 50 of the treaty.

The notification begins the *two year process* to complete Britain's exit from the EU. Two years is several lifetimes in economic and political terms. Some critical points to keep at the forefront of any story on this include:



A. Great Britain currently has the 5th largest economy in the world measured in nominal GDP.

B. The UK is the 9th largest exporter and 5th largest importer in the world (2014 data). They will be in a similar position *after* their exit from the EU.

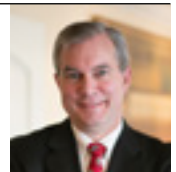
C. The UK will remain a member of the following international organizations and bodies: G7, G20, IMF, OECD, NATO, UN, WTO and the World Bank. 🇬🇧

WHAT CAN WE EXPECT OVER THE NEXT 18-30 MONTHS?

Trade treaties will be negotiated/adjusted. The European continent needs Great Britain's financial markets, exports and military capabilities. These "realpolitik" realities will temper any short-term desire to punish England for leaving or send a signal to other EU members to steer clear of their own referendums. A trade treaty that allows for the relatively free flow of goods and services between the EU and Britain should be the new British government's top priority.

Great Britain will also execute a trade treaty with the United States (regardless of the winner of the Presidential Election) that leverages the special relationship between our countries. It will give either Clinton or Trump the opportunity to demonstrate their self-proclaimed skills and knowledge of either deal making or world affairs. Both will have enormous pressure to get it done effectively and quickly. 🇬🇧

PRESIDENT'S COMMENTARY



"Financial myopia" seems to surround us. The tendency to see clearly what is right in front of us but lose sight of the more distant truth hinders our ability to implement and refine/improve our financial plans.

The application of this observation to the recent British BREXIT vote is only the latest example of focusing on the immediate to the detriment of the long-term. More details below, but pause to consider the sheer lunacy of trying to adjust a multi-year (if not decades long) financial plan in light of a non-binding referendum that is two-plus years from implementation. It's no way to manage a portfolio and harmful to focus on things you cannot control (but that can paralyze your ability to make logical decisions).

Is there any insight for the United States? I believe yes. Great Britain has been around for 800+ years and the United States just celebrated its 240th Birthday. Both nations will be around after (a) the U.S. Presidential election and (b) Great Britain's orderly exit from the European Union. 🇬🇧

THE CHALLENGE AHEAD

By the time you read this, the political conventions will be over and we head into the fall election full steam. Since I see no Thomas Jefferson on the horizon we are going to have to dance with one of our dates come November and live with the impacts—the good, the bad and the ugly.

My sense is there is an undercurrent in the United States and to some extent elsewhere in the Western World. It is growing in frustration, disgust and anger. No single event will tip us over but there are growing portions of our citizens (on both sides of the political spectrum) who no longer accept our political class as elected representatives of us but rather as self-serving overlords bent on getting as much for themselves in as short a time as possible while sticking it to the rest of the citizenry.

Governments are instituted among Men, deriving their just powers from the consent of the governed... That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government.

— *The Declaration of Independence, July 4, 1776*

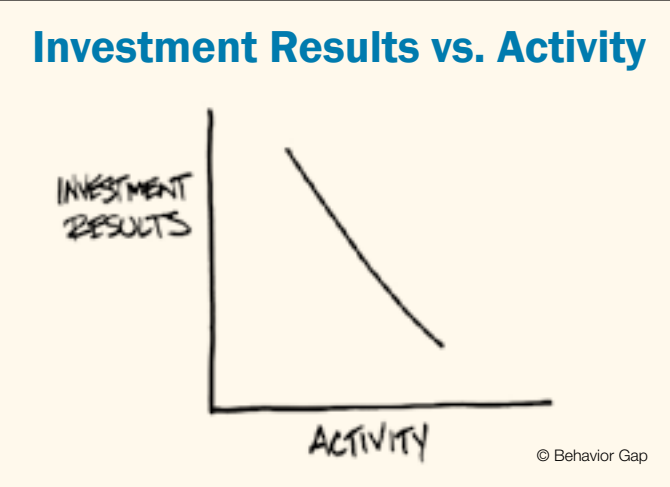
The challenge ahead for us as a nation is to return to first principles: secure the country, defend our people and grow the economy. When we can begin to show progress there, we can then focus on other things that currently take up so much time in Washington but have little impact on the day to day lives of our people.

My hope as we head into the fall debates (and all the normal election commotion) is we recognize that “We The People” are the masters and the elected officials are the servants. They work for us, not the other way around. We have witnessed enough “strange” things this primary season (and in international events) to acknowledge that polls have been more wrong than right for the last 18 months. The talking heads are in uncharted territory so the mute button is more important than ever.

I'm Dick Hewitt and I approved this message...

CLOSING THOUGHT

Seek revenge and you should dig two graves, one for yourself.
—Carl Richards



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