BEDELL FRAZIER
INVESTMENT COUNSELLING, LLC

2016 SUMMER
NEWSLETTER
JULY 2016

# GLOBAL TURMOIL PRESENTS CHALLENGES TO INVESTORS

After a wild ride, the DOW and S&P 500 enter the second half of 2016 higher than when they started the year. Concerns of a US recession dwindled, but choppy price action has infected the US Stock and Bond Markets as global turmoil presents challenges to investors. The correction, which began last summer, continues. **The current Bull Market is the 2nd longest in history and is still very much alive in our minds. Because of its maturing age, its corrections are expected to take longer too.**

There is a bridge of uncertainty which spans choppy waters for global markets. We see volatile price action continuing over the summer and into fall. We believe clarity on Europe and Washington will lead to the next stage of this Bull Market. The current Bull has absorbed a lot in its 7-year life, but kept charging ahead. We see it continuing. We are long-term investors that know how to deal with short-term issues.

## BRIDGE OF UNCERTAINTY

**There's a bridge of uncertainty from now to November.** The lack of clarity in where things are headed in Europe and Washington will likely keep the rally in check and keep us strategically defensive. We prepared for a messy summer, with the correction expected to come to an end in autumn, leading to new highs for the DOW and S&P in 2017. Our thesis always gets tested. So far it's playing out. We have a way to go. It's a stock picker's market. We're stock pickers.

## BREXIT

There is so much uncertainty now that the British voted to leave the European Union. The EU has changed forever. **The British exit raises far more questions than answers at this point.** The risk of a domino effect is real. Voices are getting louder throughout Europe to follow the UK out of the EU. A combined Europe makes up 20% of the global economy. Europe hasn't been a growth engine for years, but has been a source of stability and resilience. This is now being challenged. The UK is a large component of the European economy. The European Union is an economic arrangement. Importantly, trading between the UK and the EU will not halt. The Brexit debate was so heated because a large segment of the British population feels left behind economically and lost faith in government. Sound familiar? There are strong similarities with our Presidential election.

## FED TO THE RESCUE?

Central Banks have been active for years trying to stimulate sluggish economies. This has certainly been the case in the US as well as Europe, China and Japan. The recent events will keep them busy and aggressive. The global economy is still struggling. Heading into the New Year, the big question was how many times our Fed would raise interest rates. **Today, the question is no longer about raising, but rather if they'll actually cut rates again.** It's been a complete 180-degree change. The problem is, the Fed doesn't have as much ammunition anymore. The term lower for longer still applies to the global market. We don't see a rate hike this year. Central Banks have provided substantial support to global markets. Bonds love it. Real Estate loves it. Stocks will love it again too.

## US ECONOMY

The US economy is still growing, albeit at a slow pace. 2% growth still looks doable, dominated by consumer spending domestically. Low interest rates, strong housing and demographics should support this sustainable growth rate. **Exports account for just 13% of US GDP.** It is much healthier than most economies overseas. If the election leads to tax reform or perhaps viable infrastructure plans, the US economy could see some acceleration ahead.

## INNOVATION

Innovation is the lifeblood of the American way. Bigger, faster, stronger has long been the focus. That was the case for decades in computing, manufacturing, transportation and retail. Today, speed is still the theme, but smaller often beats out bigger and strength always wins. Faster networks have led to greater communication and availability of content. Silicon Valley is the nucleus. **Smart devices keep getting smarter and more available.** Automobiles have become luxury mobile computers.

The web is always open for business as the information superhighway. Online purchases are delivered 7-days a week by multiple couriers. Pretty soon, they'll be arriving by drone or driverless cars. Artificial intelligence is real and it's growing. One of the biggest victims of innovation has been jobs. The new economy is so dynamic, it's imperative that humans develop and maintain high skill levels to succeed. Those that fail to keep up, get left behind.

## ENERGY

Oil was a material negative in the beginning of the year, which has turned into a positive. The rise in oil prices was the only medicine to heal the credit markets. It worked. **$50 oil is the fair price in our work, which properly balances supply and demand.** It's high enough to keep companies and countries from defaulting, but still low enough to allow consumers to keep spending elsewhere. $50 oil works for the global economy. Oil has been one of the biggest drivers of the stock market in 2016. Stocks fell when oil fell. Stocks rallied when oil rallied. Renewable energy sources like solar are working too. Renewable energy is no doubt the future. It's already become the present. It's a theme that's investable for years to come.

## DIVIDENDS

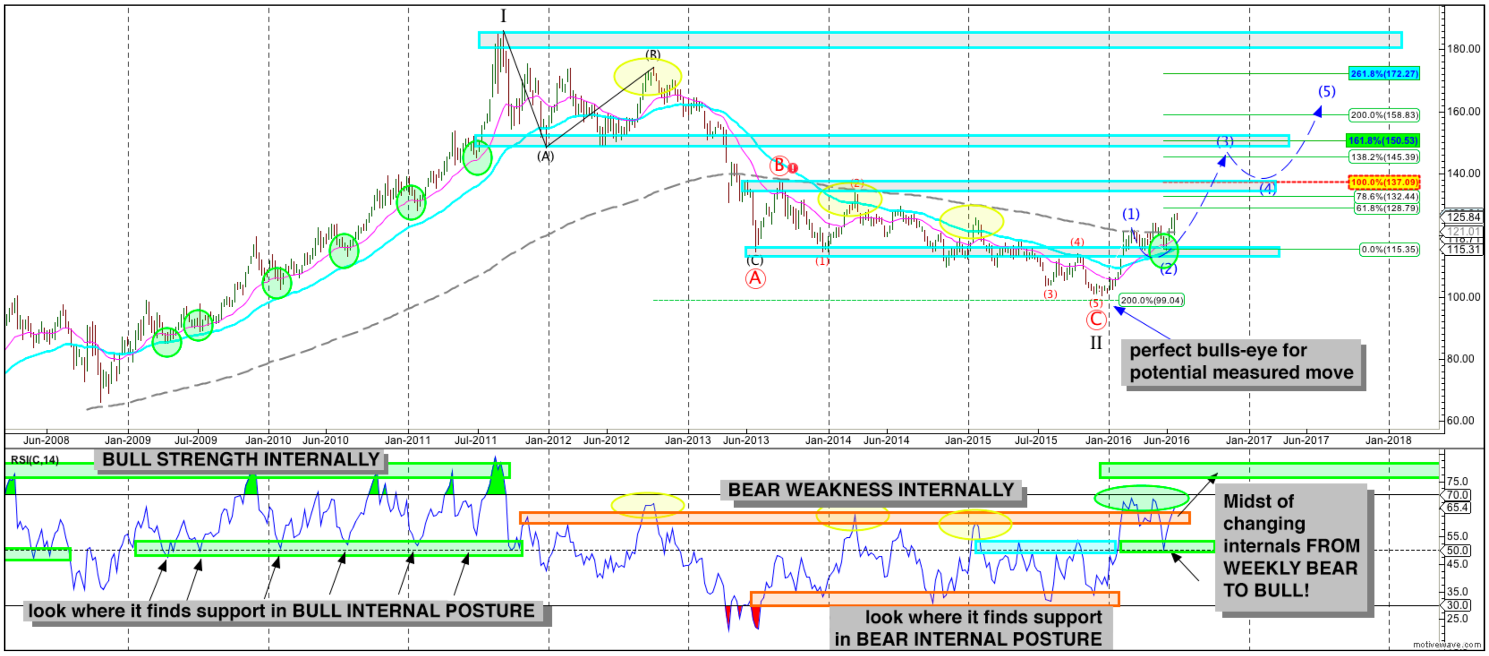
We love dividend paying stocks because they reduce the volatility in a portfolio. For this reason, investors holding dividend producing stocks are often shielded during times the overall markets are displaying angst.

Think of dividend investors as being protected like a Teflon shield from the vagaries of stock performance. Yes dividends tend to offset stock price falls. Not only do they enjoy the comforts of their portfolio's lower volatility, but by focusing on their dividends the cash flow they engender prevents some price deterioration. Also, dividend stockowners are generally long-term focused. Dividend investors have cash flowing into their portfolio by the very nature of their investments, and ready cash is a distinct advantage in a downturn. Dividend stocks tend to be more mature and stable companies. Yes, dividends are a cornerstone of a diversified investment portfolio. We love dividends and always will.

## DOLLAR & EARNINGS

The US Dollar has strengthened against foreign currencies in response to the uncertainty in Europe. Demand for US assets is still strong. This comes with a cost. The stronger Dollar makes US exports less attractive. Nearly half of the S&P 500 company revenues come from outside the US. Just 2% come from Great Britain. **It's a global world, but the US does have some insulation from issues overseas.** The strong currency will be a bit of a headwind for corporate earnings. We see the Dollar staying strong for a bit. Earnings drive stock prices. Until earnings accelerate, we see the stock market staying in this defined range.

## CHARTING THE PRICE OF GOLD




The price of Gold soared over 20% this year and continues to look quite strong for a new Bull Market trend. If you recall, Gold peaked back in 2011, amidst the last fear of a European crisis. It has now staged an incredible rally off quite similar news. There's a reason. Gold certainly has fundamental characteristics. It is primarily used for jewelry. Historically, Gold has earned the safe-haven labels for fear and uncertainty, an "inflation hedge" and is even considered an alternative global currency. That's certainly been the case around the Brexit issue. But that role broke down from 2011 to 2015. Despite plenty of periods of uncertainty the last 5 years, the precious metal fell 40%.

Gold is very difficult to analyze fundamentally, because it doesn't have industrial use and doesn't pay a dividend. Gold beats to its own drum. It can be very cyclical. We find that technical analysis has had better success of forecasting the price of Gold. We study the chart.

We started to get optimistic about Gold at the end of 2015. It was hitting some longer term technical targets for the 40% decline. In our estimation, it represented a major turning point for the Metals market for years to come. We thought the 5-year Bear Market for Gold was coming to an end, and a new multi-year Bull was in the making. We initiated a longer term position in November. That bottoming formation we saw towards the end of last year and subsequent rally into January had major characteristics of confirming the technical trend change. Gold continues to check off many boxes in our work making us confident this is a new cyclical Bull, which should last for quite some time.

There are no guarantees in our business, which is why we will continue to follow Gold dynamically to make sure it continues the foundation it has started. So far so good.

The Chart above shows an historical price action for Gold, and what we believe is the most likely path for the precious metal going forward. If the facts change our positioning will too. For now, we remain very positive on the future prospects of Gold.