CAZ Investments

Quarterly Letter

“What Slowdown?”

Markets in the U.S. continued their march higher in the face of concerns related to a slowing economy and increasing geo-political tensions. As we have stated for several quarters, the strength is impressive, and we are pleased to participate in a rising market. The rise of prices, without a commensurate increase in cash flows at the company level, continues to make stocks more and more expensive. We are now more convinced than ever that this could lead to very mediocre returns for stocks for the next 3 – 5 years.

There are clearly some positive signs to point to on the economic front. Growth is undoubtedly better today than it was two years ago, and corporate profits have benefited from this. The disconcerting fact is that it has taken an unprecedented amount of government stimulus to get what could be best described as a moderate recovery. We need the economy to begin to grow based on its own momentum, without artificial stimuli from central banks around the world. Only then will we feel that there is a truly sustainable recovery.

At this point in the economic cycle we remain very concerned about the level of valuations in some of the major asset classes. Therefore, we are strongly encouraging clients to reduce the amount of correlation they have in their portfolio to the major stock market averages. This means that we would like to have significantly less exposure to the general market and more exposure to assets that tend to move either independently, or even in the opposite direction, from those expensive asset classes. The good news is that there are several assets that we have identified that have the ability to serve our portfolios in this capacity, and they have the ability to potentially provide significant profit opportunities.

Is that a typo?

In order to illustrate how we feel market participants seem to have lost their sense of logic we only have to look at the pricing between some assets that tend to have predictable relationships. A prime example of this would be to look at the relationship between U.S. Treasury notes and the debt of some other countries. Now, to be clear, we are critical of some of the fiscal and monetary policies of the U.S. government, but we are still the most powerful economy in the world. We believe the U.S. government will find a way to service its debt. In contrast there are several countries around the world whose economies are improving but that we would not be so favorably inclined to lend money to. By way of illustration you can look at the table below to see exactly how illogical market participants have become. The challenges facing the government of Spain are well documented. Facing total unemployment of 30%+, with youth unemployment approaching 50%, and no clear growth

prospects for their country, we were hearing about the strong possibility of government defaults just a short time ago. Yet now investors around the world are willing to lend money to the Spanish government for LESS interest than to the U.S. government. There are a host of rational hypothesis as to why this is the case, but if one just steps back and thinks logically this picture is quite disturbing. To provide some perspective, as recently as two years ago Spanish Treasury 10 Year Bonds were yielding 5.30% MORE than a U.S. Treasury 10 Year Bond!

Investment	Yield
U.S. Treasury 10 Year Bond	2.65%
Spanish Treasury 10 Year Bond	2.64%

Date As Of: 6/20/14 Source: Bloomberg, Tradestation

These types of discrepancies are more prevalent than we are comfortable with, as it shows that risk has lost much of its respect, and that is disconcerting. Therefore, we strongly recommend that clients evaluate how much exposure they want to have to the traditional market averages. We remain a "**2**" on the CAZ Scale and we are tilted closer to a 1 at this time than we have been in a very long while. Please consider that as you evaluate your portfolio positions and, know that we are working diligently to identify themes that we believe will profit from the environment we expect over the next several years. We are consistently the largest investors in our own vehicles, and so you can rest assured that we are striving to find excellent places to invest our own capital. We will notify you as we identify those opportunities.

On June 1 we opened the Metals Opportunity Series to specifically take advantage of the significant dislocation that has occurred in metals prices. When we see real assets decline by more than 60% we become very interested. We believe there is an opportunity to deliver sizeable capital appreciation from this dislocation, while minimizing the downside risk. Equally as important we believe this vehicle will not only have little correlation to the stock and bond markets, but that it will potentially act as a hedge against possible market risks. Similar to our short sub-prime mortgage position in 2006. If you have not taken the opportunity to learn more about what we are doing in this area, we encourage you to do so.

Our firm continues to grow, and we are excited to introduce you to our new team members who joined us in the 2nd Quarter. Space does not permit a great deal of specifics so please visit www.cazinvestments.com to read more about each person.

Here they are, along with their roles at CAZ:

- Matt Lindholm – Vice President and Portfolio Analyst
- Isaiah Massey – Chief Financial Officer
- Tyler Pratt – Assistant to the Chairman
- Shelby Wells – Client Services Assistant

We hope that everyone is enjoying the last few weeks of summer, and we look forward to an exciting fall. We hope to see each of you very soon, and we wish all the very best to you and your family.