CHARLES FISH INVESTMENTS, INC.
2010 Main Street • Suite 320 • Irvine • California 92614 • 949-296-3970 • *fax* 949-296-3974 • charlesfishinvestments.com

Charles W. Fish
CEO/Chief Investment Officer

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Letter from the Chairman…

" I need to listen well so that I hear what is not said." - Thuli Madonsela

The Federal Reserve, along with other central banks, have dug themselves quite a hole. They now own over one third of all outstanding negotiable debt. They are resolved to unwind most of this and use their control of the short end of the yield curve to raise interest rates, sighting moderately rising economic activity and job gains. It is what they don't say that gives us concern. We are troubled by high debt, low productivity and capacity utilization. The surge in demand from our last recession seems to have been satiated and our now eight year-old economic recovery is running out of steam. We are even more troubled by the rise in delinquencies on credit cards and auto loans. But we are most troubled by continuing declines in loan demand; particularly the commercial and industrial loans used by the smaller enterprises that actually fuel our economy. If the Fed continues on its present course, which seems almost certain, while bond investors demand for longer duration bonds strengthens, the yield curve could become inverted (if short term rates are higher than long term rates). Seven out of the last seven times this happened a recession followed.

Yields are rising for now, but they could turn around swiftly if the U.S. economy shows further weakness. If that occurs, the current administration's protectionist tendencies will no doubt emerge and history tells us how counterproductive those tactics are.

The June 26 issue of *Bloomberg Businessweek* carried an astonishing article. While President Trump describes America's steel industry as a great source of well-paying blue-collar jobs, a new mill opened in the village of Donawitz in Austria. According to this article, the plant can produce half a million tons of steel wire a year. What takes your breath away is that while a plant of similar capacity built in the 60's employed up to 1,000 workers, the new mill in Austria requires just 14 employees. This is the 21st century's version of the 19th century's industrial revolution destroying countless cottage industries.

We are "…the parent of the future."* We must embrace this role and not look backward for growth in industries whose time has passed. Surely America, of all nations, with its geography and railroading history, should have been the world leader in high speed rail. We shouldn't have to import wind turbines and our children shouldn't have to go deep into debt to obtain the knowledge and skills required for tomorrow's jobs.

While we hope our politicians get their priorities in proper order, we need to balance risks and opportunities and see to it our clients' bond portfolios are properly positioned for the future. Subtleties aside, CFI favors acquiring short cash substitutes sufficient to take advantage of any sell-off in the bond market which we expect would be of short duration. Laddering about half the portfolio through 10 to 12 years is recommended. This, however, needs to be energized by acquiring callable bonds with large coupons and short calls whose characteristics make them unlikely to be called and will generate far superior yields to maturity. We always support the use of non-rated bonds when their credit evaluations pass thorough scrutiny and they can be acquired at compelling spreads above their rated counterparts.

The benefits of municipal bonds, capital preservation, liquidity and tax-free income, can be enhanced with superior performance on a consistent basis, but only when actively managed by skilled portfolio managers equipped with all the best tools for the job. Forgive the blatant plug for CFI, but we have these capabilities with a modest number of employees and you don't have to travel to Donawitz Austria to see it for yourself.

*"The wise man must remember that while he is a descendent of the past, he is the parent of the future." Herbert Spencer (1820 – 1903) - English Philosopher and author of the phrase, "Survival of the fittest."