Playing Ball in the Later Innings

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Since 1945, there have been 11 economic cycles

• The average recession has been 11.1 months

• The average expansion has been 58.4 months

Source: National Bureau of Economic Research
Since 1945, there have been 11 economic cycles

• The average recession has been 11.1 months

• The average expansion has been 58.4 months.

• As of January, the current expansion is 79 months.

Source: National Bureau of Economic Research
Since 1945
Longest U.S. Economic Expansions

- Mar 1991 to Mar 2001: 120 months
- Feb 1961 to Dec 1969: 106 months
- Nov 1982 to Jul 1990: 92 months
- Jun 1938 to Feb 1945: 80 months
- Nov 2001 to Dec 2007: 73 months
Mythical Chimera

- Something that exists only in the imagination and is not possible in reality.
Mark Dotzour’s Chimera: Winning the Masters with an 18 Handicap
Japan’s Chimera: Quantitative Easing in a “New Dimension”

On Apr 4, 2013 BOJ will buy 50 trillion in JGB and 10 trillion in Nikkei ETFs.

Plan to double the monetary base from 135 trillion yen to 270 in two years.

Government Pension Investment Fund will cut holdings of government bonds from 60% to 35% to increase demand for stocks.

“This is taking monetary easing into an entirely new dimension.”

H. Kuroda, Governor BOJ
Japan Opens the Floodgates

The BOJ is purchasing ETFs linked to the Nikkei 225 and the TOPIX index and owns roughly half of the market for ETFs in Japan. -Bloomberg 12/21/15

Promised not to sell stocks they have already purchased until March, 2026.

The BOJ will purchase $656 billion in assets every year “as long as needed.” Bloomberg 12/18/15

Kuroda also increased the maximum amount the BOJ can own of each JREIT from 5% to 10%. Bloomberg 12/21/15
Chinese Chimera: The Shanghai Stock Exchange

Plunged 30% in three weeks in June.

• You can buy, but you can’t sell.
• Please borrow money to buy stocks.
• Half of all shares are suspended from trading.
• Declared war on “foreign puppet masters” and vicious short sellers.
European Chimera:

I can help countries that are heavily in debt by loaning them even more money.

“The Governing Council is willing and able to act by using all the instruments available within its mandate if warranted in order to maintain an appropriate degree of monetary accommodation. “

Draghi, November 3, 2015
Stock Buybacks Proliferating

The 449 companies listed in the SP500 from 2003 through 2012:

Used 54% of their earnings to buy back stock
Used 37% of their earnings to pay dividends

Leaves 9% to re-investment in growth for the future and increase wages.

In 2012, the 500 highest-paid executives in US public companies received on average $30.3 million each; 42% of their compensation came from stock options and 41% from stock awards.

Stock Buybacks Proliferating

Buybacks to Net Income: Trailing Twelve Months

Source: FACTSET Buyback Quarterly  December, 2015
Stock Buybacks Proliferating

Number of Companies with TTM Buybacks Exceeding Net Income

Source: FactSet

Source: FACTSET Buyback Quarterly December, 2015
Stock Buybacks Proliferating

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Company</th>
<th>Sector</th>
<th>TTM Buybacks ($M)</th>
<th>YoY% Chg in Shares Out</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAPL</td>
<td>Apple Inc.</td>
<td>Information Technology</td>
<td>$39,852</td>
<td>(4.9%)</td>
</tr>
<tr>
<td>MSFT</td>
<td>Microsoft Corporation</td>
<td>Information Technology</td>
<td>$15,209</td>
<td>(3.3%)</td>
</tr>
<tr>
<td>QCOM</td>
<td>QUALCOMM Incorporated</td>
<td>Information Technology</td>
<td>$11,245</td>
<td>(8.7%)</td>
</tr>
<tr>
<td>WFC</td>
<td>Wells Fargo &amp; Company</td>
<td>Financials</td>
<td>$10,669</td>
<td>(2.0%)</td>
</tr>
<tr>
<td>GILD</td>
<td>Gilead Sciences, Inc.</td>
<td>Health Care</td>
<td>$9,287</td>
<td>(4.3%)</td>
</tr>
<tr>
<td>AIG</td>
<td>American International Group</td>
<td>Financials</td>
<td>$9,184</td>
<td>(11.2%)</td>
</tr>
<tr>
<td>ORCL</td>
<td>Oracle Corporation</td>
<td>Information Technology</td>
<td>$9,121</td>
<td>(3.5%)</td>
</tr>
<tr>
<td>BA</td>
<td>Boeing Company</td>
<td>Industrials</td>
<td>$7,098</td>
<td>(6.0%)</td>
</tr>
<tr>
<td>PFE</td>
<td>Pfizer Inc.</td>
<td>Health Care</td>
<td>$6,974</td>
<td>(2.6%)</td>
</tr>
<tr>
<td>INTC</td>
<td>Intel Corporation</td>
<td>Information Technology</td>
<td>$6,918</td>
<td>(2.6%)</td>
</tr>
</tbody>
</table>

Source: FACTSET Buyback Quarterly  December, 2015
Margin Debt
Debit Balances at Broker/Dealers

Debit Balances in Margin Accounts at Broker/Dealers

- Jul 2007 Dow 14,021
- Jul 2008 Dow 10,827
- Jul 2009 Dow 8,087

- Mar 2000 Dow 11,234
- Mar 2001 Dow 9,106
- Mar 2002 Dow 7,415

Source: Standard and Poor’s
The Investment World Today: Globally

• Europe, Japan and China barely hanging on, even with massive printing of money.

• Commodity prices in a four-year free fall is hammering countries all over the world
  Canada, Mexico, Brazil
  Russia, Iran, Saudi Arabia
  Australia
  African oil exporting countries

• Hence, bonds from these countries are considered more risky.
The Investment World Today: United States of America

• The US economy could be in the 7th or 8th inning of this economic expansion.
• Car sales and retail sales are current drivers.
• Single-family home construction will contribute to growth in 2016.
The Challenge for the FED

• They need to normalize rates before we have the next recession.

• Declining 10-year treasury rate is signaling global economic weakness ahead.

• Higher rates mean a stronger dollar.
  
  Less manufacturing
  Less foreign investment in the US
  More US investment in foreign countries
  Trouble for emerging market countries
Our Fed is Not Out of Bullets

• Drop the Fed Funds rate to below zero
• Print money and purchase long bonds to drive the mortgage rates down to 3%
• Set an artificial cap on Treasury rates to drive mortgage rates down to 3%
• Print money and buy REITs to juice the CRE market
• Print money and buy ETFs to elevate the stock market
<table>
<thead>
<tr>
<th>Year</th>
<th>Initial</th>
<th>Final</th>
<th>Change</th>
<th>BPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1956</td>
<td>2.50</td>
<td>3.00</td>
<td>up</td>
<td>50</td>
</tr>
<tr>
<td>1960</td>
<td>4.00</td>
<td>1.98</td>
<td>down</td>
<td>202</td>
</tr>
<tr>
<td>1964</td>
<td>3.50</td>
<td>3.85</td>
<td>up</td>
<td>35</td>
</tr>
<tr>
<td>1968</td>
<td>4.61</td>
<td>6.02</td>
<td>up</td>
<td>141</td>
</tr>
<tr>
<td>1972</td>
<td>3.51</td>
<td>5.33</td>
<td>up</td>
<td>182</td>
</tr>
<tr>
<td>1976</td>
<td>4.87</td>
<td>4.65</td>
<td>down</td>
<td>22</td>
</tr>
<tr>
<td>1980</td>
<td>13.8</td>
<td>18.9</td>
<td>up</td>
<td>508</td>
</tr>
<tr>
<td>1984</td>
<td>9.56</td>
<td>8.38</td>
<td>down</td>
<td>118</td>
</tr>
<tr>
<td>1988</td>
<td>6.83</td>
<td>8.76</td>
<td>up</td>
<td>193</td>
</tr>
<tr>
<td>1992</td>
<td>4.03</td>
<td>2.92</td>
<td>down</td>
<td>111</td>
</tr>
<tr>
<td>1996</td>
<td>5.56</td>
<td>5.29</td>
<td>down</td>
<td>27</td>
</tr>
<tr>
<td>2000</td>
<td>5.45</td>
<td>6.40</td>
<td>up</td>
<td>95</td>
</tr>
<tr>
<td>2004</td>
<td>1.00</td>
<td>2.16</td>
<td>up</td>
<td>116</td>
</tr>
<tr>
<td>2008</td>
<td>3.94</td>
<td>0.16</td>
<td>down</td>
<td>378</td>
</tr>
<tr>
<td>2012</td>
<td>0.08</td>
<td>0.16</td>
<td>up</td>
<td>8</td>
</tr>
</tbody>
</table>
Black Monday
October 19, 1987
### Rate Hikes Prior to Black Monday: October 19, 1987

<table>
<thead>
<tr>
<th>Date</th>
<th>Rate Change</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>September 1984</strong></td>
<td>11.500 %</td>
<td>Lowering rates for two years</td>
</tr>
<tr>
<td><strong>December 1986</strong></td>
<td>5.875 %</td>
<td></td>
</tr>
<tr>
<td><strong>Jan 5, 1987</strong></td>
<td>tiny increase to 6.00%</td>
<td></td>
</tr>
<tr>
<td><strong>Apr 30, 1987</strong></td>
<td>half percent increase to 6.50%</td>
<td></td>
</tr>
<tr>
<td><strong>May 22, 1987</strong></td>
<td>quarter percent increase to 6.75%</td>
<td></td>
</tr>
<tr>
<td><strong>Sept 4, 1987</strong></td>
<td>half percent increase to 7.25%</td>
<td></td>
</tr>
<tr>
<td><strong>Sept 24, 1987</strong></td>
<td>tiny increase to 7.3125%</td>
<td></td>
</tr>
<tr>
<td><strong>Oct 19, 1987</strong></td>
<td>Black Monday: Dow falls</td>
<td>22.6% in one day</td>
</tr>
</tbody>
</table>
Black Monday   October 19, 1987

Rate hike regime lasted eight months. Rate was increased five times. Rate increased by a total of 1.50%

Then the stock market collapsed.
### Rate Cuts After Black Monday  October 19, 1987

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct 19, 1987</td>
<td>Black Monday: Dow falls 22.6% in one day</td>
</tr>
<tr>
<td>Oct 20, 1987</td>
<td>Fed rate was still 7.3%</td>
</tr>
<tr>
<td>Nov 4, 1987</td>
<td>half percent decrease to 6.8%</td>
</tr>
<tr>
<td>Jan 28, 1988</td>
<td>small decrease to 6.6%</td>
</tr>
<tr>
<td>Feb 11, 1988</td>
<td>small decrease to 6.5%</td>
</tr>
<tr>
<td>Mar 30, 1988</td>
<td>quarter percent increase to 6.7%</td>
</tr>
<tr>
<td>Dec 31, 1988</td>
<td>nine more rate hikes to 8.7%</td>
</tr>
</tbody>
</table>
Black Monday  October 19, 1987

Rate cut regime lasted four months.  
Rate was cut four times.  
Rate was cut by a total of .80%

Rate increases resumed 
four months after the crash.
Impact of Black Monday on the Economy
The Energy War Escalates
The Energy War Escalates
OPEC Breakeven Prices
to Balance Their Budgets

$107  Bahrain
$ 96  Saudi Arabia
$ 93  Algeria
$ 76  Iraq
$ 70  Iran
$ 58  Qatar
$ 52  Kuwait

Source: IMF and WSJ 1/20/16
Energy War Impact in America

• State and county budgets in CA, AK, ND, OK, LA, TX, OH

• Texas sale tax revenue dropped 3% in November from a year earlier. -Bloomberg 12/30/15

• Oklahoma expecting $900 million budget deficit in Fiscal 2017. -Bloomberg 12/30/15

• Alaska bond rating downgraded from AAA to AA+ due to declining tax revenue and budget gap.
State of Texas Tax Revenues
Sept – Dec, 2015

• Total tax collections down 6.06% from year earlier
• Oil production/regulation taxes down 48%
• Cigarette/tobacco taxes down 14%
• Natural gas production taxes down 48%
• Sales taxes down 2%

Source: Texas Comptroller of Public Accounts
<table>
<thead>
<tr>
<th>Tax Type</th>
<th>FY2015</th>
<th>9/15 through 12/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax</td>
<td>5.57%</td>
<td>-2.12%</td>
</tr>
<tr>
<td>Motor Vehicle Sales</td>
<td>7.23%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Motor Fuel</td>
<td>3.93%</td>
<td>.94%</td>
</tr>
<tr>
<td>Franchise</td>
<td>- 1.61%</td>
<td>-58.23%</td>
</tr>
<tr>
<td>Natural Gas Production</td>
<td>- 32.60%</td>
<td>-48.14%</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>14.15%</td>
<td>-14.02%</td>
</tr>
<tr>
<td>Alcoholic Beverages</td>
<td>8.12%</td>
<td>3.62%</td>
</tr>
<tr>
<td>Oil Production</td>
<td>-25.68%</td>
<td>-48.91%</td>
</tr>
<tr>
<td>Hotel Occupancy</td>
<td>8.33%</td>
<td>1.61%</td>
</tr>
<tr>
<td>Total Tax Collected</td>
<td>1.35%</td>
<td>-6.06%</td>
</tr>
</tbody>
</table>

Source: Texas Comptroller of Public Accounts
Energy War Impact in America

• Upstream and downstream energy companies
• Railroads
• Trucking companies
• Steel companies
• Law firms
• State and local government budgets
• Junk bond market
Iran

Currently exports 1.1 million barrels per day, but aims to double production within six months after sanctions lifted

In December, they put up $30 billion of oil and gas contracts on the market

Iran has been raising taxes to raise revenue as sanctions limited oil sales.

Claims Saudi Arabia bombed its embassy in Yemen
Saudi Arabia has announced it will raise domestic petrol prices by more than 50 per cent for some products.

Prices will increase for electricity, water, diesel and kerosene, after the country posted a deficit of $135 billion in 2015.

The 2015 deficit is the highest in the history of Saudi Arabia, which relies on oil for 90 per cent of public revenues. Contemplating selling a portion of ARAMCO to raise money.

The IMF has warned Riyadh that failure to cut spending and implement reforms will eat up the country's fiscal reserves in just five years.
Nationally
the Bullish Outlook Continues
The Present Situation Index was unchanged at 116.4, while the Expectations Index increased from 83.0 to 85.9 in January.
Household Net Worth Recovering After Stock Market Rally

Source: Board of Governors of the Federal Reserve System

Households and Nonprofit Organizations; Net Worth, Level

Billions of Dollars

Oct-45  Jan-55  Apr-64  Jul-73  Oct-82  Jan-92  Apr-01  Jul-10
Household Net Worth Recovering After Stock Market Rally

Source: Board of Governors of the Federal Reserve System
The Business Sector
Corporate Profits
(With Inventory Valuation Adjustment & Capital Consumption Adjustment)

Corporate Profits After Tax with Inventory Valuation Adjustment (IVA) and Capital Consumption Adjustment

Source: U.S. Dept. of Commerce: Bureau of Economic Analysis
Small Business Outlook
“Planning To Hire People In The Next Three Months”

Planning to Hire People in the Next Three Months

Source: National Federation of Independent Business
Corporate Hiring Plans:
Next 6 Months

<table>
<thead>
<tr>
<th>Quarter</th>
<th>More Jobs</th>
<th>Less Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q4-15</td>
<td>35%</td>
<td>34%</td>
</tr>
<tr>
<td>Q3-15</td>
<td>33%</td>
<td>32%</td>
</tr>
<tr>
<td>Q2-15</td>
<td>34%</td>
<td>26%</td>
</tr>
<tr>
<td>Q1-15</td>
<td>40%</td>
<td>23%</td>
</tr>
</tbody>
</table>

Source: Business Roundtable
Job Openings in America
Looking for Workers

<table>
<thead>
<tr>
<th>Category</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Job Openings</td>
<td>5,431,000</td>
</tr>
<tr>
<td>Construction</td>
<td>135,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>294,000</td>
</tr>
<tr>
<td>Trade, Transportation, Utilities</td>
<td>907,000</td>
</tr>
<tr>
<td>Professional &amp; Business Services</td>
<td>1,108,000</td>
</tr>
<tr>
<td>Education &amp; Health Care</td>
<td>1,113,000</td>
</tr>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>764,000</td>
</tr>
<tr>
<td>Government</td>
<td>506,000</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics
BLS release on January 12, 2016
Outlook for Inflation and Interest Rates
The Consumer Price Index

Consumer Price Index for All Urban Consumers: All Items

US Treasury Bond Rates

• Central banks in China, Russia, Brazil and Taiwan are selling US government bonds at the fastest pace on record.

• Foreign net treasury sales hit $123 billion in the 12 months ended in July.

Source: WSJ 10/8/15
Investment Themes for 2016

• Europe, China and Japan printing money with little result
• Emerging market countries experience inflation & recession
• No American inflation until year after oil price bottoms
• A couple of meaningless rate hikes by the Federal Reserve
• GDP ambles along at a tepid 2% growth rate
Investment Themes for 2016

• Mortgage rates unlikely to increase above 4.5 percent
• Home price appreciation to continue in most markets
• Currency declines will reduce foreign purchases of US real estate from Russian, Canada and Mexico.
• Anti-corruption policy in China could reduce Chinese purchases of US real estate
• New federal transparency rules on cash purchases will reduce foreign buying demand in the US
• Foreign pension funds have strong appetite for US CRE
• Japanese REITS have strong appetite for US CRE
Investment Themes for 2016

• US stock market could fall like October 1987, due to excess margin debt
• Big stock market decline could reduce spending in the US
• Lack of liquidity in the bond market
  • Third Avenue Focused Credit Fund blocked redemption and began liquidating $789 million in assets in December.
  • Stone Lion Capital Partners suspended redemption in one of its funds in December

THE BLACK SWAN
Putin gets tired of $36 oil and blows up oil production in Iraq and Libya
• In 2015, hedge funds lost more than 3% on average.
• The S&P500 returned 1.4%, including dividends in 2015.
• The Dow was down 2.2% and the S&P was down .7% for 2015.
• Some hedge funds are restricting investor redemptions
• Increasing selling pressure in the US junk bond market.
• China selling US Treasury bonds and still our yields continue to fall.
• Forget the BRIC countries.
• Changes to FIRPTA will increase foreign demand for CRE.
• Higher US$ could restrain Canadian and Mexican investors.
• Anti-corruption campaign in China could reduce Chinese demand.
• Increased JREIT purchases as part of BOJ QE campaign.
• “We are in an environment where very few of the classic, liquid, safe
  assets have provided much protection whatsoever. “  WSJ 1/8/16
FIRPTA Reform
Foreign Investment in Real Property Tax Act 1980

Goal to increase foreign investment in the US real estate market.

Increases the amount that a foreigner can own in a US REIT from 5% to 10% and still be exempt from FIRPTA taxes.

Will allow foreign pension funds to fully own US real estate without paying FIRPTA taxes when they sell.