CAZ INVESTMENTS

A Wealth Management Firm

Risk On

1st Quarter - 2012

Anyone who grew up reading the Fantastic Four comic books will recognize the command of "flame on" by the Human Torch. When the command was given by the Torch he would burst into flames from head to toe and his supernatural powers would emerge to allow him to save the day. Whenever the market's animal spirits decide that the flood of liquidity and "the Bernanke Put" is enough of a reason to put capital to work, we get the "risk on" cry from the markets and risk assets explode higher. That was definitely the case in the first quarter, and we were rewarded handsomely by rising stock markets around the world. The riskier the asset, the better it did in Q1. This is always fun but concerning at the same time.

There was a lot to like in the first three months of 2012. Earnings reports were pretty good, employment numbers showed some modest signs of improvement, Greece completed its' debt restructuring and the general mood in the economy felt a little bit better. As would be expected, the world chose to ignore some of the longer term concerns, and the market rallied. Any potential negative news has been overwhelmed by the consensus view that if the markets were to sell-off in a material way that the Federal Reserve, and central banks around the world, would come to the rescue with QE3 or some other liquidity measure (this is the Bernanke Put). If you have a Put below you, there is no reason not to be aggressive, right?

In the last few weeks the markets have sold off as concerns in Europe and the Far East have reemerged. It is really a bit comical to see how quickly the psychology of the market can change, and we know that it frustrates investors to see the ups and downs in a somewhat schizophrenic fashion. But it is what it is: a market that is driven much more by emotion than by near term business fundamentals. One of the things we have discussed recently in our internal meetings is how the market was going up because of a "seller's strike". This is when the number of buyers stays the same, but the sellers just go to the sidelines for awhile. The result is a steadily rising market but on very light volume. At some point the sellers return, and the market drops to a level of equilibrium. That is what the last two months have felt like, and only time will tell if the sellers will return in force.

Sell in May …?

There is an old Wall Street adage that says, "Sell in May, and go away until Labor Day". The saying comes from the propensity of the markets to have a summer correction. The reasons for the sell-offs vary, but there is enough historical precedent to make the saying more than just an interesting bit of investment lore. Will this summer work the same way? Quite possibly. There are several hurdles the market is going to have to surmount in order to maintain the climb higher. The first is the strength of the quarterly earnings reports which are starting to be announced. Companies are going to have had a solid first quarter, that much is a given. The question is whether or not the actual numbers will match the higher expectations that the market has created with the rally. If the reported numbers don't meet the expectations, a pullback will most likely ensue. Secondly, the debt crisis is not gone it just went into hibernation for the first few months of the year.

The last few weeks have illustrated that there are still lots of concerns about Spain, Italy and Greece (Greece was just given a reprieve; it is not fixed). As yields have risen in Spain, the markets have grown more nervous, and after large rallies nervous investors tend to take profits. Thirdly, the worldwide economy has shown some improvement but there is concern about how rapidly the improvement can be and how much of a slowdown may come about in the Far East. Clearly the main growth engine for worldwide demand growth is China, and any signs of a slowdown there have an immediate ripple effect on the rest of the world.

Companies and markets continue to be moderately expensive. They are not obscenely overvalued, but they are certainly not undervalued either. The key for investors' comfort level is going to be the forecasted growth in cash flow from companies over the next year, and that is very hard to predict. As we indicated last quarter, we can build a very good scenario where the "spring uncoils" and a very bad scenario where economies are held hostage by debt levels around the world and macro risks from N. Korea, Iran and Europe.
We certainly are cheering for the spring to uncoil!

In the meantime, we are going to continue to be positioned somewhat defensively. We maintain a reluctant "**2**" rating on our scale. We like so much of what we see, but we feel the downside risk, in the event of a bad scenario playing out, is much greater than the upside in the market. If that is the case then we need to be cautious in our outlook and focus on the preservation of capital more than stretching for returns.

Make no mistake, we are positioned to benefit if the spring uncoils and we make very attractive returns in the first quarter, but we are going to be willing to give up some of the upside in order to maintain our risk controls.

The next few months will bring an increasing focus on politics. Between the Supreme Court ruling on healthcare and the elections growing ever closer, the bantering in the media and on the streets will be a feverish pace. Markets tend to get nervous when they are trying to predict political outcomes. So expect volatility to increase as the steady climb we saw in the first quarter gives way to much larger gyrations, both up and down.

There are some very exciting things on the horizon for our clients, and we look forward to sharing those details with you in the near future. In the meantime, please don't hesitate to let us know if there is anything that we can do for you. We appreciate the confidence you have in us, and we take our role as your financial steward very seriously. We hope your year is off to a great start, and we look forward to seeing you very soon.