

December 20, 2018

CAZ Investments

**Special Market Update**

Why is this market selling off? Could it be trade wars, government shut downs, Federal Reserve rate hikes, changing power structures in Washington D.C., a slowing Chinese economy, dropping oil prices, etc.? In a word, yes. All those reasons are valid, but what has actually been the catalyst is always hard to state with confidence. What we can say for sure is that there are more sellers than buyers, and the psychology of the market is now officially very different for the first time in a long time. Greed has been replaced with fear and stock prices are reflecting the imbalance of supply.

We have said it so many times that people may get tired of hearing it, but times like this truly do remind us that stocks go down much faster than they go up.... It doesn't take long for "Mr. Market" to get the attention of investors, and we think it is safe to say, he has now gotten most everyone's attention. With the move today, we are now experiencing the second worst December in the history of the U.S. stock market, only surpassed by December of 1931, which occurred in the midst of the Great Depression.

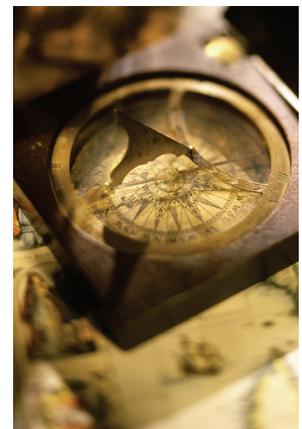
In less than 90 days, we have seen significant carnage in the stock market. Small cap stocks have fallen by 23%, the NASDAQ composite has dropped by 19%, and the S&P 500 has declined by more than 15%. Many high-quality companies have been cut in half, including businesses like Nvidia and Michael Kors, with countless others that have declined by more than 30%, such as Facebook, Apple, Amazon, Netflix, etc.

What the market appears to be telling us is that we are either going to have a significant economic slowdown/recession in the near term, leading to a sharp decline in earnings, or that stock valuations had simply gotten way ahead of company profits and needed to come down dramatically.

We have stated in every recent quarterly letter that we have been concerned about valuations and so we believe that this correction was long overdue. Now that we have seen such a sharp drop in stock prices, what does this mean for investors? Quite simple, stocks are now cheaper than they have been in quite a while. Therefore, the risk/reward is improving, which means the rating on the CAZ Scale should change. As a result of the improving risk profile for stocks, we are officially raising our rating to a "2" on the CAZ Scale.

For those that are not as familiar with our scale, we rate the risk/reward environment from 1 – 5, with 1 indicating the least favorable risk profile, and a 5 indicating the most favorable risk profile. Does that mean that investors should rush out to buy stocks today? Not necessarily, but certain stocks, in certain areas, are definitely getting interesting and we would be comfortable with investors taking positions in our more market sensitive vehicles, like Equity Income. Adding to those positions gradually would be a wise strategy, as this sell off may very well continue.

What is unquestionably a fact from this sell off is that we have seen volatility skyrocket, and that creates opportunity. We alluded to this in our late October update and we will reiterate it today. The chart below illustrates how dramatically the Volatility Index ("VIX") has increased in the last 90 days. We want to sell that volatility and profit from the panic rippling through the stock market.



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Does this chart mean that volatility cannot go even higher? Of course not, but what it means is that we have an opportunity to benefit from an extreme move, as volatility returns to a more normal level.

We continue to focus on our major themes, such as the growth of Private Equity as an asset class, and from generating returns from uncorrelated assets. This market volatility continues to feed into our thesis and we believe that institutional investors, particularly pension assets, are going to be severely challenged to find returns that will allow them to meet their return requirements. That is a trend that we plan to continue to profit from.

Please make it a priority to join us on January 8th for our “Themes for 2019” event. We have three well-known experts participating in our discussion about the Themes we see impacting the world in 2019.

Let us know if you have any questions or would like to discuss any of this in more detail. We wish you and your family a wonderful holiday and look forward to seeing you very soon.

The team at CAZ Investments

