

CAZ Investments

Quarterly Letter

Thunder in the Storm Clouds

We talked for several quarters about how we saw storm clouds on the horizon. Those clouds are now closer, and we are beginning to hear the rumbling of thunder. As a result, the third quarter was the first time, in a very long time, that we have seen fear enter the psychology of market participants in a significant way. We experienced a 10% correction in most major market indices and many international markets declined by much more. Some industries, and individual stocks, dropped by more than 50% during the quarter. As expected in such a selloff volatility spiked dramatically, and investors had a serious “gut check.” After years of complacency, investors had to pay closer attention and determine how much risk they were really comfortable taking.

Interestingly, markets have bounced back quite sharply at the start of the 4th quarter, and investors now have an ability to make modifications to their portfolio without feeling like they are selling into panic. We would strongly recommend that investors who were unsettled by the volatility last quarter take advantage of the bounce to lighten stock market exposure. Do not wait for another selloff to get your portfolio allocation where it needs to be. As we have stated many times, “Sell when you can, not when you have to.”

We continue to focus as an organization on assets that are uncorrelated to the stock and bond markets and that will provide excellent returns even if the market indices enter a period of sideways consolidation. We are in the process of closing our Illiquid Growth and Halcyon Special Opportunities vehicles. If you have not taken the time to truly evaluate where these investments fit in your portfolio we cannot stress enough the importance of doing so. These will be the largest two vehicles in our firm’s history, and the reason they have seen so much demand is because of the unique access that they provide.

Our outlook has not materially changed since our last letter. We remain cautious, and that is demonstrated by our “2” rating on the CAZ scale. There is a time for aggressive, market correlated, positions, but this is not that time. We are continuing our due diligence to attempt to find the best way to profit from the valuation dislocations that the market has experienced in several sectors, most notably in Energy. So far, we have felt it premature to aggressively allocate assets to those sectors, but we are getting closer. We will let you know if we choose to create a thematic vehicle for those opportunities.

The greatest concern we have about the macro-economic picture is definitively revenue and earnings. We will not know for a couple of weeks, but it is very likely we are in an “earnings and revenue recession.” This is where there are two quarters in a row of declining revenues and earnings. While the overall economy



is still growing in the U.S., companies as a whole are not. Let that sink in for a minute. The stock market is within a stone's throw of all-time highs yet companies, as a whole, are seeing declining revenue and earnings. There are pockets of strength, and so far we have seen good results from certain market segments, but the group of companies that are growing is narrowing, and the market needs broad based growth to sustain very expensive market valuations. Where will that growth come from? Think intuitively about where we have seen the greatest growth for the last several years, and then remove Energy from that equation. If you do this it becomes very hard to identify an engine for growth in the near term. Thus, expectations for the next several years must be tempered, and investors are going to need to look beyond traditional stock and bond portfolios to have a strong probability for solid risk adjusted returns.

Patience is always a virtue, and that is especially true today. We emphasize the need for diligence. We are creating several investments that are exciting to us, but we will wait until we identify attractive entry points before we will invest our personal capital. We will notify you when those opportunities present themselves. Thank you for partnering with us, and please let us know if there is anything we can do for you. Enjoy the holiday season with family and friends, and we look forward to seeing you very soon.

The CAZ Investments Team

