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Dear Clients,

We have recently seen a combination of citizen uprisings in north Africa and the Japanese earthquake creating uncertainty and fear. That uncertainty and fear has impacted the general investment markets across the globe and the events in north Africa and the Middle-East have caused a spike in oil and gasoline prices.

North Africa
The changes in governments in Tunisia and Egypt first caused the spike in oil prices, even given a backdrop of weakening demand in China. Add Mommar Gadhafi in Libya to the mix, and oil had nowhere to go but up. The increase in oil prices has provided a reason for the financial markets to take their first significant dip in 2011. While we don't invest in north Africa, we can't escape the impact of rising oil prices unless we own the oil or own shares of companies that produce the oil (which we do to a limited extent).

Unlike some in the media, I believe that the changes in Egypt, Tunisia, and hopefully Libya will yield positive long term results. Those countries rely on oil exporting for a vast majority of their revenues and those revenues will provide the incentives necessary for a more stable and predictable government. Most purchasers of oil prefer to do so from countries with stable governments. Democratic governments are positively correlated with government stability. The people of Egypt, Tunisia, Libya, and other oil-producing nations know this and it is just one of many reasons that they do not want another dictatorship. Just follow the money, and in this case, the money follows the oil.

Structural changes like these are difficult and messy in the short-term but should yield positive long-term financial impacts.

Japan
A significant earthquake that devastates the world's third largest economy situated on a very small island will certainly create some economic turmoil. At this early stage of the disaster, the problem is likely to get worse until the nuclear reactors have been cooled. Economically, this will be a short-term setback for the earnings of Japanese companies who have shut down production to help conserve electricity. However, this event will likely end up as a zero-sum-game economically. The rebuilding effort will provide an economic boost once Japan enters that phase and the insurance companies will foot a large portion of the bill, for which they have previously collected insurance premiums. The wildcard in the mix is what happens to the land where the nuclear plants reside. Land in Japan is scarce to begin with, and if these events render some land as unusable, Japanese citizens who have to relocate may end up causing some home price inflation. A reduction of the supply of land, combined with constant demand (same number of people who need a house) should equal a rise in the equilibrium price. The scenario of rising house prices may be welcomed in Japan, where deflation has been an issue ever since the Japanese real estate bubble burst in 1990.

Our Investments
Economically speaking, the move to more democratic societies will bode well in the long run. The transition is certainly troublesome, but short-term in nature and the players have a great deal of incentives to put a stable, democratic government in place. Additionally, the situation in Japan should not cause long-term concern for financial markets. While we will certainly experience some "monkey-see-monkey-do" drops in our investments as the Japanese stock market has dropped by almost 20%, I believe that these event-driven drops will be short-lived.

Thankfully, our portfolios have very little direct exposure to these events. In our portfolio, most of us own just a very small amount of Honda and Toyota, but that is pretty much the extent of it. Within that particular mutual fund, Honda represents 0.73% of the funds assets and Toyota represents about 0.23% of that fund. Additionally, we hold other mutual funds with no Japanese stocks, which further mutes the effect.

For many portfolios, we were fortunate to add some investments in oil prior to the spike in price. Namely, we have added Petrobras (Brazilian oil company) to the mix. I am looking for buying opportunities presented by the recent turmoil. If the stock markets have a more severe, negative, knee-jerk reaction, it could lead to some interesting investment opportunies.

Lastly, the global shift away from the US dollar continues to gain traction and even though short-term turmoil has a tendency to strengthen the US dollar, I continue to see evidence that the long-term fate of the dollar is devaluation versus other world currencies. The Fed reasserted it's "easy money" policy today after their meeting, which certainly doesn't make me feel better about the US and reiterates the case for continuing to search for international investments.

Best Regards,

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