THE MIKE ALKIN SHOW
TALKING STOCKS OVER A BEER

Ep. 4: How to Construct a Balanced Portfolio

Speaker 1: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks Over A Beer, hosted by hedge fund veteran and newsletter writer Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors.

Mike sifts through all the noise of mainstream financial media and Wall Street, to help you focus on what really matters in the markets. Now, here's your host Mike Alkin.

Mike Alkin: Welcome to the podcast. I hope you all had a good weekend. I am still recovering. My son had a birthday party for his twelfth birthday, and my wife was a brave soul and okayed 13 of his buddies to have a sleepover at our house. Oh my, 13 12-year-old boys. As I told one of the kids' dad who texted me while the party was going on, to see how we were making out, I told him, "Now I know what it was like living during the time of cavemen." They are just full of energy, off the charts.

So we took them to dinner, we took them to a movie, and my wife, she's smart. We got to the restaurant, she made sure to go around and apologize to all the diners, anyone within seating distance of us. You know, "We apologize. We know you wanted a quiet meal, we're going to our very best to contain the boys and keep them quiet," and for the most part they were.

Then we went to the movie and they were captivated by the movie. They stayed quiet, it was great. Then we got back to the house, it was a little bit late, it was probably about 11 o'clock. My wife said, "You're in charge of policing them." She said, "You stay in the family room. Sleep on the couch so you'll be able to hear them in the basement. You go down around midnight, tell them to go to bed and to give them the curfew." I said, "Okay, great."

So around 12 o'clock I went down. Boys were in the basement playing, it looked under control. I said, "Boys, time to ... Lights out. I'm going to give you a 10 minute warning." They said, "Okay. No problem Mr Alkin. We're good." I said, "Great. Job accomplished."

I thought I heard some moving around about one o'clock. I went down and lights were on. There was absolutely no way these boys were sleeping. They were running around like crazy. So I gave them, "Guys, time to go to bed." Now many of these kids had a playoff basketball game at 1:30 on Saturday, so they needed their sleep, my son included.

Thought I had it under control, I shut the lights off, went upstairs. Went down at 1:30, clearly my voice wasn't being heard, they were still up. I went down at 2:00, still up. Somewhere along the way, about 2:30 I must have fallen asleep. Out like a light on the couch upstairs in our family room.

Next thing I know, I wake up, I feel someone staring at me. It's 8:00 AM in the morning. I look, and there's my wife, standing over me, staring at me. Apparently I'm not a very good security guard. It turns out at about 4:30 in the morning the house alarm went off, and my house is pretty fortified. I have a house alarm that you could hear for a long way. It goes right to the police station. I slept right through it.

The entire house was up. My wife was downstairs and here I am, sleeping like a baby. My daughter was downstairs when the alarm went off. Apparently the kids had also clogged up the toilet. My wife was plunging the toilet at 5:00 AM, I didn't hear a thing.

So, my house alarm goes off, my toilet is a mess, I'm sleeping like a baby. I am told, from what my wife tells me, I am no longer in charge of future birthday party oversight. Now I've got tell you, that might not be such a bad thing, but that's how my weekend started.

So, I hope you had a better weekend. No, but really we had a lot of fun and it was great. Anyway, onto the stock stuff. Last week was a wild ride. The S&P dropped about 2%. The tech heavy Nasdaq did a little bit better, it lost a little over 1%. But the DOW got hammered. It was down about 3%.

It was an odd week because it started off relatively positive. The S&P jumped I think a little over 1% on Monday, but somewhere midday or so on Tuesday, when new fed chairman Jerome Powell testified before the house financial services committee, stocks got hammered.

I always like to say, "Don't confuse a good economy with rising stock prices." Because if the [inaudible] is too good, the fed could raise rates to combat inflation, which you get with a strong economy, and those rate increases could hurt earnings. I think something like, now it's about 40% of debt issued by Russell 2000 companies is floating and tied to LIBOR and susceptible to a rise in the benchmark rate.

During the Q&A session when Powell was speaking he noted that his economic projections, they've increased since the December Federal Open Market Committee meeting, that's where all the fed governors get together. That scared Wall Street due to their concern that the fed may hike rates more than the three that were expected.

I think the CME FedWatch tool places a chance of a fourth rate hike up about 31, 32% now, whereas it was 24% the week before. The chances of a March rate hike are at 83%. The markets don't like uncertainty and that scared the markets.

Then you fast forward to Thursday, and the equity market was really dealt a blow. This time it came from President Trump, who announced that he's going to be imposing tariffs on steel and aluminum imports. 24% for steel and 10% for aluminum. That decision prompted concerns about higher prices, inflation that the consumer will foot the bill for, and retaliation from China and other major trading partners. I'm going to discuss the trade wars in more depth, the potential trade wars that can come from these tariffs in the educational segment.

But so the week, I think during the week last week of 11 S&P sectors finished negative, so they all did. Industrials were down 3%, material is down four. Tech held up okay, it was down a little bit less than 1%. The consumer staple segment was down about 1.3, 1.4%. so it was a sea of red last week.

If you've been listening to me on the podcast, or if you're a subscriber to my newsletter, you know that I think the stocks are in a very tricky territory right now. I've gone, for my subscribers I've gone in depth about concerns, and I'm really urging people to really examine what they own and why they own it, and to be disciplined in their investing program.

One of the things, I think we're nine years in now to a bull market, and that's led to increased risk taking. I think now is the time to be thinking more cautiously. In today's interview I'm bringing on a guest who has made his living with a balanced approach to investing.

He manages a combined fixed income and equity portfolio. I've known him for years, and he does it exceptionally well. He and his partners manage their clients' money with the goal of capital preservation first and foremost. You're going to hear, he's a bit more bullish than I am but I think that's good. I think it's here to hear different views others than just mine.

Now I will tell you, the podcast is new, relatively new. This is our fourth episode. Alex came in-studio this time. I'm learning on the fly on certain things about podcasting. One of the things I didn't realize is that if you share a microphone the sound quality can be different, which my sound engineers down in Maryland told me when we were doing this. So we had one microphone and we were both standing right near it, sitting right near it, so the sound quality might sound a little bit different. I might sound a little bit further away. I just wanted to give you that heads up.

I think you're going to really enjoy listening to Alex. Let's bring him on. Alex Oxenham, partner and co-portfolio manager at Hilton Capital Management. Welcome Alex.

Alex Oxenham: Mike, thanks for having me. It's a pleasure to be here.

Mike Alkin: You bet. We are Talking Stocks Over A Beer. Alex Oxenham and I have known each other almost 10 years. He is what, I think of all the guys I've met over my career, one of the most thoughtful analyst portfolio managers that I've ever met. I have talked stocks and macro with him for, at length, ad nauseum, for a long time.

I'm always really impressed with the different view he brings to things. He's very anti-consensus, but not as a matter of course, but when you talk to him he peels the onion back to layers you might not have thought, or things you might not have thought about.

Alex is a portfolio manager at Hilton Capital Management, which is based in Long Island, New York. The firm was founded in 2001. They manage about a billion foreign assets. They're really a balanced portfolio manager, right Alex?

Alex Oxenham: Yeah, effectively. We get put in a lot of different buckets but that's probably a pretty good one.

Mike Alkin: They manage private accounts and they also have a four star rated mutual fund. What's the name of that fund?

Alex Oxenham: Yeah, our fund is the Hilton Tactical Income fund.

Mike Alkin: Hilton Tactical. So what does a balanced fund manager do?

Alex Oxenham: Traditionally a balanced fund manager is someone who would invest half the portfolio in stocks and half of the portfolio in bonds. But back in 2001 we were founded by Bill Garvey and he had kind of a different principal with that. He was running fixed income money for a large group of private clients and he got the idea of, "Hey, you know, I think your bond portfolios are great, but if I added in a mix of traditional yield investments other than fixed income, things like perhaps MLP's, writs, preferred stocks and a little bit more esoteric fixed income." He said, "I think I can not only get you a better yield, but give you a better attractive total return, and do it in a way that doesn't meaningfully add the level of risk that you're taking." That's kind of the firm was founded.

Mike Alkin: So would you say ... What's your number one priority? Is it capital preservation? Is it yield? How do you think about that?

Alex Oxenham: It's definitely not yield. If you focus on just yield you're likely to blow up. I say that half-jokingly because there's a lot of ways you could construct a portfolio today to have a 6% or 7% yield, but I don't think it's a real sustainable portfolio. You could create a portfolio with a low yield, and a lot of these other balanced funds in the marketplace have that. But what we really try to do is participate in the markets with a focus on generating income for you, but at the same time trying to deliver a competitive total return over a market cycle. So being hyper focused on avoiding large draw-downs.

I think that entire, and this my belief as well as our firm's belief, is that real money is made by letting your money compound. It's not trading in and out, it's letting your growth grow and then continually to grow it. One of the worst things you can do for compounding wealth is to have a large draw-down. You know the law of numbers.

Mike Alkin: Exactly.

Alex Oxenham: If you lose 50% you've got make 100.

Mike Alkin: Exactly.

Alex Oxenham: So you don't have to chase every penny and every bull market, but if you can in the bear markets maybe capture 40%, 30% or only 20% of the downside, there's a lot less work you have to do on the other side.

Mike Alkin: Yeah. So you mentioned Bill Garvey, who I know Bill well. He's a fabulous money manager. You guys have really done a terrific job. And Craig, who's-

Alex Oxenham: Yeah. Craig O'Neill and Tim Reilly, someone who just joined on our portfolio management team. The firm's been growing. I joined almost seven years ago and we were 350 million under management, and we've been growing ever since, as the story gets out and it resonates well.

Mike Alkin: I've had the luxury of seeing the process, how you guys manage the process. 2009 interest were let's say zero effectively.

Alex Oxenham: Yeah, fair enough.

Mike Alkin: Fair enough, right?

Alex Oxenham: [crosstalk 00:13:15] splitting hairs.

Mike Alkin: Yeah, exactly. So, you're running a yield portfolio, and now here we are, nine years into a bull market and rates are starting to go up. Walk listeners through the evolution of how the portfolio has evolved during that time, and what you are looking at to decide what percentage of the portfolio is fixed income and what percentage is equities. How are you think about ... How does a balance manager think about that? Because a lot of our listeners will have a balance, right? One of the things I've been talking about is what I call yield tourism. Which, as rates have been down, they go and reach for maybe yield and things that might be outside their comfort zone. How do you think about that? How do you maintain your discipline? Walk us through the evolution over the last nine years.

Alex Oxenham: Yeah, that's a lot. This is I think probably going to be the most important part of the podcast. One of the things that I think, the reason we've been successful and why I feel that Hilton does a great job is not only do we understand what's happening in equity markets, but we understand what's happening in interest rates and fixed income markets as well.

I think a lot of the knowledge that is going on in the rates world, or say currencies or commodities and the equity market, they're sympathetic to each other. I always wondered how these managers that just run growth stocks run a grow stock portfolio and don't have a position on the US dollar or of point of reference on interest rates. A lot of them are kind of clueless. I always struggled with that.

So what we've done at Hilton, as we really every day, and it's like the ethos of the firm, is to focus on the big picture. What's happening in the world today that could change that would have a meaningful impact? So this is this top-down global macro view that all the marketing people would talk about.

Mike Alkin: So that's how you start. You come at it [crosstalk 00:15:17]

Alex Oxenham: Yeah, every morning. It's not like it's part of our process, but that's what I do. The first ... I got into Bloomberg every morning. I look at interest rates, commodities, economic data and mergers and acquisitions. That's just what I look at.

Mike Alkin: And for listeners who don't know, when you say rates, you're looking at the 10 year, you're looking at corporate bonds. You're looking at all different bonds.

Alex Oxenham: Yeah, so when I look at rates what matters is when it comes to rates I look at the whole term structure of the US. So anything from twos, threes, fives, 10 year and 30 year rates. I look at LIBOR, and then I look at usually [inaudible 00:15:54] or [inaudible 00:15:54] rates, so British or German rates as well. Not necessarily the foreign rates every day, but certainly the US rates every morning, just to get an idea.

I keep an eye on them during the course of the day. If there's a fed announcement, what's the movement like? If there's something else, it's just very important to understand what's happening

in the rates market, as well as what's happening in the equities market.

Mike Alkin: Explain why it's important.

Alex Oxenham: Because as you talked about, we've had low rates for, I don't know, nine years now. The equity markets benefited from a tremendous of debt issuance by corporations, and that debt issuance is interest expense. So the lack of a high rate of interest is improving the corporate earnings of corporations. As interest rates rise, that debt expense theoretically grows for the market.

Mike Alkin: And we've seen companies borrow money, take on debt to buy back stock, which has helped their earnings as well.

Alex Oxenham: Absolutely.

Mike Alkin: Yeah.

Alex Oxenham: Yeah, absolutely. That's not necessarily, and we're diverging a little bit, that's not necessarily a bad thing, but just in the last few weeks, already this year the average interest rate from a LIBOR perspective is 90 basis points higher. So call it 1%-

Mike Alkin: 90 basis points being nine tenth of 1%.

Alex Oxenham: Yeah, so we'll call it 1%. Let's say you're a medium-sized writ and you're levered up like all rates, you have a billion dollars of outstanding-

Mike Alkin: Levered meaning debt.

Alex Oxenham: Yeah, meaning debt. Debt at the property level, debt on the corporate level. You have a billion dollars of debt, if you pay an extra 1% that's $10 million of earnings out the window. A lot of the debt that these companies own or have issued is floating rates, so the rates move up. They have no choice. You're starting to see that impact companies on a daily basis. It does put the buy-back thesis a little bit more at risk broadly. Obviously Apple, it's irrelevant to them.

Mike Alkin: We're going to dive into this further because in a little bit I'm going to ask you how you come up with your view. But let's walk, I think it's interesting for listeners to learn about what your routine is. Talk about that. After rates, what do you then look [inaudible 00:18:14]?

Alex Oxenham: Yeah, I look at commodities as well, what's going on there. Then I look at the dollar. Often those rates, the dollar and commodities are all linked together. It's funny I can go back, and maybe I'm skipping ahead to your questioning, what got me interested in doing this as a profession, and everyone has-

Mike Alkin: I was going to go there, yeah.

Alex Oxenham: Yeah, and everybody has, and it's germane to your question, everyone has a different reason. I can remember three distinct moments. One was, I was maybe a tenth grader in high school, and I had a friend of mine who was really into computers. Mike knows, I'm ... Anyway.

He lived with his dad and I come over. One day he's looking at the stock pages in the San Diego Union Tribune. I say, "What are you doing?" He's like, "My dad said if there's a product that I like I should look at the stock." I'm like, "Oh, well what's what?" It was Hasbro, and he shows me stock chart in the newspaper. I remember going, "Wow, that's pretty neat." Every since then I've been curious. I realized that companies have stocks and that it's something I should be interested in.

So I kind of followed, and then I started going through undergrad and we were learning about the concepts of corporations, the professors always referred to corporations as living breathing entities, like an individual. I wasn't a great student or anything but I was paying attention I guess during that lecture. I'm like, "What do you mean? They're not living breathing. They make stuff and they sell stuff." And then it slowly started to occur to me that, you know what, they are. They're organisms, because of how complex they are, the behaviors that they have. It all ties down into the stock price.

Then later in my career, maybe when I first started, I started to realize how interconnected everything in the world was, and how an interaction in ... This is a bad example because a lot of people won't agree, but I kind of believe it, is that the food riots that started in Tunisia, I don't remember when, maybe 10 years ago. There was a lot of food price inflation and you had riots in Tunisia. It was associated with lowering interest rates and how that had an impact on pushing up the prices of commodities. It was like a eureka moment for me, that I could really understand

how everything is interconnected on what's seemingly seems like useless data. That was like that was it for me.

Mike Alkin: That was the beginning of the formation of you having a top-down view.

Alex Oxenham: Correct, yeah.

Mike Alkin: You're paying attention to commodities. You're paying attention to the dollar. You're paying attention to interest rates.

Alex Oxenham: Yeah.

Mike Alkin: What do you do with that? I know you and I know how well you invest, you're not reacting to what's going on. You are forming an opinion and anticipating. I always say great [inaudible 00:21:24] get to where the puck is going. How do you use those to formulate a thesis on where things are going.

Alex Oxenham: Yeah, I can't ice skate, so I would probably skate to where my face was going to fall into the board. It's funny, this global macro thing, it's very hard to get your hands around. For your listeners, you shouldn't be intimated about it, but what you should do is you should try to understand it, because you'll find every year you'll get better at understanding it. What you'll realize is after you've been doing this for four or five or six years, it's not the understanding of the environment that matters, it's the changes at the margin that are occurring that matters.

Mike Alkin: It's all about the rate of change, right?

Alex Oxenham: Yeah, it's about the rate of change. It's not whether you're in a booming economy or you're in a recession, or you're going into a recession or you're coming out of ... It's not about that, it's about the changes at the margin and how you can position your portfolio to take advantage of that, defensively or opportunistically.

Mike Alkin: I think people a lot of times look at absolutes and not rates of changes-

Alex Oxenham: Yeah, exactly.

Mike Alkin: ... and compare prior periods and say, "Well, it's not nearly as bad or as good as then." But the reality is the market's pricing in the growth or lack of growth, and it's moving based on that.

Alex Oxenham: Yeah. I like anecdotes and I'll give you an example of a good one for this, is that ... And I've also realized this [inaudible 00:22:50] I've realized this lately, is that investing is a lot like other things in your life. Really, any specialty that you do literally can relate anecdotally to top-down macro investing. Fishing is a great example of it. Any one data point is not good, right? Everyone knows that you catch more fish at high tide than you do at low tide, and then you catch even more fish when the tide's coming in, and then it's not quite as good but still good when the tide's going out. Whether it's sunny or cloudy, whether it's windy, what the water temperature is, where the ridges are if it rained, the turbidity of the water.

There's no set time, you need to have a confluence of certain events to decide whether or not you're going to catch a lot of fish or a little. Investing is the exact same way. So whatever it is you do in your professional life, whether it was building houses, or mining for copper, or a textile business, or you're a professional bass fisherman, investing and understanding those core competencies that you had that made you good, apply that same mindset to investing and just figure out what [inaudible 00:23:56]

Mike Alkin: That's a great point. So, interest rates, they're zero, a little bit more than zero nine years ago. As the market's evolving and we're .... How are you shifting the portfolio? Even like right now, the economy is looking really good but that means inflation might be rearing its head. Rates are starting to go up. How do you think about positioning? I think it's germane because a lot of our clients may have shifted money out of fixed income into equities. How do you think about it all?

Alex Oxenham: Yeah, it's a good question. I think I can just go into the view, historically we look for a lot of different key economic indicators to try to figure out at the margin if we should take more or less risk. Last year was a perfect example, we had seen the recovery and the data. You could see it in things like, and this goes back to the fishing analogy, consumer confidence, ISM services and manufacturing data, small business sentiment, leading indicators, credit spreads were declining. I would add, credit spreads are a great kind of tool whatever your process is you definitely need to implement.

Mike Alkin: Can you explain credit spreads to the listeners?

Alex Oxenham: Yeah, so credit spreads are the worthiness of a borrower. Think about it, you have two friends. You have that really rich friend, we all have one of those, and then you have that degenerate friend-

Mike Alkin: We all have one of those.

Alex Oxenham: ... and we all have probably two of those. You're having a barbecue at your house, shrimp on the barbie. Your rich friend says, "Mike, I need to borrow 50 grand." It's a business relationship, and Mike says, "All right, fine. You've got to pay me 5%." Your friend agrees, "Okay, great." The degenerate comes over and he's like, "Mike, I need to borrow five grand." Mike's like, "All right, your interest rate's 15%." Mike's going to charge more for a lower credit-worthy borrower than he would for someone that he knows is going to get the money back. That's a credit spread.

So a solid company like Google let's say would pay 50 basis points, or half a percentage point, over treasuries. Whereas a company that's less attractive, significantly less attractive, like Newell Rubbermaid, might pay 350 basis points over. Now, there are credit-spread benchmarks, so you can look at investment grade credit spreads. That's really a good one to use. Every day they move. As they tighten, the implied credit-worthiness of the borrower is improving because they're lower. As spreads widen, the implied credit-worthiness of that borrower is deteriorating.

So typically, prior to a recession you see spreads widen. You'll see spreads widen. You'll see unemployment rates increase. You'll see declining consumer confidence and you'll see declining manufacturing in service economy data. So you can tie all of those things together, but I would think the one that is the most important, at least for my point of view, right or wrong, is credit spreads. Not every increase in credit spreads does predict a recession, but it's a great tool for someone to use to make these changes in their portfolio. It's one we rely on quite heavily.

Mike Alkin: One of the charts in the presentation that Hilton has is spectacular. It shows how you guys through the downturn took your equity weightings before it cratered way down, and how you've then started moving your equity exposure much higher. I think in 08 you guys went from nearly a 40% weighting in 03-04, and by 08 you were down to 23%. You took it as high during 2012-2013 to close to 60% equities. You're sitting now, I think through the end

of December you were sitting at about 49%. That's showing, and it also goes as low as 23, as high as 60, and now you're about 49. What's driving that decision making?

Alex Oxenham: Yeah. There's a lot of things here. Some of the things, we think it's very difficult to time the market. We'll always have some measure of equity exposure. We may pull it down dramatically, and in very bullish time periods we'll always have some fixed income in the portfolio. While it's virtually impossible to time the market, but what we saw in 06 and 07 as we saw the equity markets going up pretty consistently, and then we saw credit spreads widening, and not only just in bonds but in other types of instruments.

Those two don't go together. When stocks perform well you should see credit spreads narrow, or at least not widen. It's very unusual. So we always have to believe at the firm that the fixed income markets are smarter than the equity markets.

Mike Alkin: I always say that, and people look at me and say, "What do you mean?" I say, "Because the fixed income market knows."

Alex Oxenham: Yeah, they're bigger. They're bigger. We could do a whole nother podcast on if that's actually true today or not.

Mike Alkin: Yeah, yeah.

Alex Oxenham: Right, but that's for probably episode six.

Mike Alkin: Right, exactly.

Alex Oxenham: So that kind of happened, and lo and behold the bond market was right and we had a pretty severe financial crisis, and we had successfully taken down our equity weighting to sub-30%. Clients were happy. We were happy. Our process worked, and then as the fed started to intervene, and the ECB and the Bank of Japan, it became apparent to us that they were putting a floor under asset values, and that was a time to start incrementally adding back to risk. There weren't any key variables for getting back in, it was more subjective.

Mike Alkin: It's the art of what you do.

Alex Oxenham: Yeah, and investment, if you ask any of my partners at the firm,

they would tell you that investing is more of an art than a science. So if anyone tells you that it's a science, you should probably politely excuse yourself from the table.

Mike Alkin: I agree. Yeah.

Alex Oxenham: So we started adding back to risk, and in Hilton fashion we don't do things quickly, very methodical, and sort of took weighting up for the next six years to anywhere between 45% and 60% in equities. Today we sit a little bit more aggressive than neutral in the equity portfolio. That's really a reflection of us seeing the economy accelerate in 2017 pretty dramatically. That one was data driven. You could see that occurring.

Mike Alkin: I want to stop you there. One of the things I say to listeners and I write about in my newsletter is don't confuse an economy with stock prices.

Alex Oxenham: Correct.

Mike Alkin: For me, and I'm more cautious than you, from rising rates, I think inflation, I think other things. But can you expand upon your view? Because people often say to me, "But Mike, how can the economy be doing well, and maybe stock prices potentially not do well? Or vice versa."

Alex Oxenham: Yeah, it's not as simple as the economy. We run a, quote-unquote, "balance tactical portfolio," so we're shifting between fixed income and equities, and by and large if you get the economy right there's a high correlation to what the stock market is going to do. But Mike's right, it's not necessarily a year to year thing.

Interestingly enough when interest rates reach a certain threshold the correlation and equity prices goes negative. Meaning, once rates reach a certain threshold it starts to negatively impact equities. Historically that threshold has been 5%. There are a couple firms that have some good slides to that effect.

Mike Alkin: So here we are with the 10 year approaching 3%, coming off of 1.3 I think it was in 2016. You would say, "We're a little bit aways from the 5%." But it's interesting, I look at some of the banks when they're reporting their earnings, and I see that they're taking their loan loss reserves up for consumer credit across the board. When

I look at subprime auto for instance, which is 20% of the loans in the auto land, those defaults are approaching debt crisis, global financial crisis levels, but main stream credit, good credit is lower.

Is the market focused on the 5%? Or is the market focused from here on the rate of change that's occurring year over year? Because it seems the banks are taking up reserves meaningfully. What is the equity and fixed income market's focused on as we're seeing rates start to rise right now?

Alex Oxenham: Yeah. I appreciate that Mike, that's a good question. I think the natural level of where interest rates are going to begin to impact stock prices is going to be lower than the 5%. The reason I think that is going to matter, it's because we've had low rates for nine years and we're increasing [inaudible 00:33:38] lower base.

We also have tremendous intervention by the fed, which is now unwinding the balance sheet by the way, so that's important consideration. But the ECB and the Bank of Japan are aggressively buying bonds. One of the things, there was a great research report we've read and we had a long meeting about, is that because rates in Europe are broadly negative. I mean, I think [crosstalk 00:34:05]

Mike Alkin: Can you explain that?

Alex Oxenham: Yeah.

Mike Alkin: Real rates and ...

Alex Oxenham: Yeah. The ECB ... As everyone knows during the financial crisis the US government, we bailed out the automakers, the fed increased their balance sheet tremendously, bought mortgage backed securities and other government issued notes. What they did is they pushed down interest rates, which allowed companies and individuals to borrow to buy cars or companies.

Mike Alkin: And just a little bond buying 101, bond prices and yields work inverse to one another. as there's more buying pressure, it's driving prices of bonds up and interest rates down.

Alex Oxenham: Right. What that did, and you can go on NBC or wherever you consume your financial news and that improves asset prices. It worked. The US economy recovered, much less so than it had prior

but that's another podcast. So the ECB followed suit. It worked here, it worked there. But they did it at a magnitude I think of four to five times greater than what the fed did as a percentage of Europe's balance sheet.

Mike Alkin: The ECB being the European Central Bank.

Alex Oxenham: Right, which is the European fed. They bought so many bonds that they actually took interest negative.

Mike Alkin: Stunning.

Alex Oxenham: It's not a unique phenomenon, it's occurred before but it doesn't really make a lot of sense. This gets back to my point today, and this might feed into Mike's thesis a little bit. He's a little bit more bearish than I am. I'm optimistic, but as a result of negative rates in Europe, the Europe investors, they're not unintelligent, they're not interested in negative yielding debt.

What they've done is they've converted to dollars and they've invested in US credit markets. I think today credit spreads are, even with the recent volatility we've had in the equity markets, credit spreads have hung in there pretty well. I mean-

Mike Alkin: Has that surprised you?

Alex Oxenham: Yes, it has actually. A little more than a month ago we were at cycle lows on spreads. We've increased a little bit here. I go back like, "What's the reason for that?" I think the reason for that is there's a lot of buyers in the US credit market that otherwise wouldn't be there. I think that-

Mike Alkin: Are they reaching for something? Or are they-

Alex Oxenham: They're reaching for not negative yields.

Mike Alkin: Negative yields, right. Are they less focused on credit quality when they're reaching? How do they think about that? Do they sacrifice quality for yield?

Alex Oxenham: Absolutely, they do to a certain extent. But this pressure and this downward pressure on US interest rates happens in the triple-A bucket as well as the junk bucket. Anecdotally, someone was

talking the other day about foreign investors buying municipal bonds. Which they don't even get a tax benefit for it, but because they were highly rated and had a 300 or 400 point advantage over an equivalently rated European issue, it was a no-brainer for them. For me to hear that, because I'm not very active in the municipal bond market, is a bit unusual.

Mike Alkin: Not many people are anymore.

Alex Oxenham: Yeah. The reach for yield is true. As I've said before, Hilton is very focused on credit spreads. We're focused on ... I think you could see credit spreads higher, even though the economy remains robust and-

Mike Alkin: What creates that scenario?

Alex Oxenham: The ECB ending the bond buying program and interest rates in Europe starting to increase above zero I think will end that. And then you'll see an unnatural increase in credit spreads in the US. That could potentially put even more pressure, rates pressure on the US markets. I think this year equities are, they're in a tug of war. You have on one side a tax cut that's clearly not going to hurt business, right? It's going to be beneficial for consumers and businesses and the economy. And then on the flip side you have higher borrowing cost.

It's like you're an over-leveraged consumer and the credit card doubles your interest rate. Think of it that way, what does that mean for you? On the flip side, the economy is doing great. You have this tug of war in the markets right now, and as rates move higher and higher I think the edge will eventually move to rates. Keenly aware that I think the US Central Bank is aware of that. I think they'll be more modest in their approach, versus what we saw prior to the dotcom recession and prior to the global financial crisis, which was kind of mindless increases in rates.

Mike Alkin: Why do think ... Inflation is just now nine years into dramatic rate cutting with an increase in money supply. Which, more money chasing fewer goods should lead to inflation. It's been thwarted for all these years, and now we're just starting to see the talk of inflation starting to heat up a little, but heat up is still only 2%. What's been holding it back? What's your outlook for it? Because I know the fed is so focused on that. That's one of their mandates, is keep inflation in check.

Alex Oxenham: Yeah, so I'm in the, "We're going to have rampant inflation," camp. I'm wrong all the time but that's-

Mike Alkin: I thought I was the only one who was wrong.

Alex Oxenham: Yeah. No, no. I'm not in the rampant inflation camp. I'm in a moderate inflation camp. The Austrian kind of school of economics, as your money supply goes up and you get a corresponding increase in inflation, without all the velocity of money. This is a whole nother concept, it has declined precipitously. So even though you've printed money it's not really making its way into the system, because-

Mike Alkin: The banks are [inaudible 00:40:04]

Alex Oxenham: It supported the banks, they used it as collateral. But [inaudible 00:40:09] increased, so theoretically, yeah that's supposed to work, but it really doesn't. I just don't see it in the data. Inflation is another data set we look at, and not just broad like CPI or PCE numbers. PCE came out today, it's at 1.5 year over year, very subdued. By the way, a pretty environment for equities. But in rent of shelter, which is housing and renting and services and goods, those are the three main components, it's not really that high.

Mike Alkin: They keep out healthcare. They keep out energy. When you pay, as an employer you guys pay healthcare.

Alex Oxenham: Yeah.

Mike Alkin: You go to the gas tank, you fill up our gas.

Alex Oxenham: Yeah, yeah.

Mike Alkin: Right? What's your view on that? Because it's really not the real living expenses that we are incurring every day.

Alex Oxenham: Yeah, I agree. I agree. This gets in the little Black Hawk helicopter like conspiracy theory. Energy I can see why they keep out, because oil prices aren't going to ... They're not stocks. They can't go to $1,000 a barrel, it's not going to happen. It's going to be between 20 and 100 for most of the time, so I get keeping that out. Healthcare, a bit of another animal altogether.

Mike Alkin: If the threshold rate is 5%, we're approaching three right now, so there's some room there, but you think it might come down a little bit. How does that affect you as a portfolio manager in allocating

the portfolio between equities and bonds? You're sitting here in the high forties now, how do you think about that?

Alex Oxenham: We run a yield strategy, so we're very in tune to the interest to the interest rate risk on the market. In fact, we pulled our yield down over the last few years and avoided stocks and traditional yield sectors like staples and utilities. We've been overweight financials, they benefit from rising rates. We're going to continue to maintain that course. There's a lot of fluff in some of these sectors.

Mike Alkin: I'm very bearish on the staples. I may short the sector I think for the most part. I think they've bought back so much stock, they have no revenue growth. They've squeezed out all the margins they can. They've levered up their balance sheets, and they have a whole host of people hiding out there trying to get yield. At some point, earnings start to come back because they've levered up so much now it's hard for them to go buy back a lot more stock because they don't have the growth.

Alex Oxenham: Is that why Cheerios bought dog food last week?

Mike Alkin: Yeah, that's right. That's right, with Blue Buffalo. It's paying $8 billion for dog food. They're paying 22 times cash flow. You see these things and you say, "Oh my God." That's what happens near tops of cycles, you see crazy deals get done.

Alex Oxenham: Yeah. I guess if it doesn't work you can say companies are what they eat.

Mike Alkin: That's right. That's right. But you're talking about General Foods, which makes cereal and other stuff. They've announced an $8 billion, 20% of their sales, on Blue Buffalo dog food. Which is good, we use it, but they paid a 22 times cash flow, which is an enormous number to pay. Getting back to thinking about the allocation.

Alex Oxenham: For us, and we're ... The tug of war, right? On one side you're going to have the economy pulling things along, and on the flip side you're going to have rates in a normalizing credit cycle that are going to signal, "Enough's enough." I think for us our plan to still stay away from the yield sectors. Although I have to say with the sell-off that you've had in certain sub-sectors, they're beginning to get a little bit more attractive. But I don't think for me I'm willing to into that yet. We're going to continue to reduce

our credit exposure, and as government yields get higher they become more attractive and they're [inaudible 00:43:55]

Mike Alkin: I was going to say, for somebody who has a portfolio at home and they're normally a treasury investor let's say, now they've gone into corporates.

Alex Oxenham: Right, or even junk bonds.

Mike Alkin: Or even junk bonds with higher yields. When you're saying, "reduce credit exposure," what you're saying is as rates come up on treasuries they're risk-free US treasuries backed by the full faith and credit.

Alex Oxenham: Yeah, exactly.

Mike Alkin: So you're going to rotate a little bit into that.

Alex Oxenham: Yeah, that's exactly right. That's our plan. It's funny because anecdotally I had a conversation with a friend of mine who's a retail broker. He said to me, he's like, "You know, I've had a couple inquiries about fixed annuities and CD rates."

Mike Alkin: When's the last time you had one of those?

Alex Oxenham: He said he hasn't ... It's been about 10 years since people were asking him about it. This gets to my point is that, back to when I talked about why I do what I do and why I like it, the economy is a living breathing organism. Companies are living breathing organisms. The organism is waking up to the fact that there are higher yielding alternatives that take less risk. So at some point, and I'm not sure when that will be, higher interest rates will have an impact on the market. That's exactly why volatility in 2018 has been higher than expected. But I would also had, that's a good thing because we've had muted volatility for nine years because the fed has purchased all these bonds, the ECB. They have encouraged risk-taking and people have embraced it, and the economy has benefited.

Mike Alkin: Do you think there's a financial asset bubble?

Alex Oxenham: I do not.

Mike Alkin: You do not, okay.

Alex Oxenham: I do not.

Mike Alkin: We're on the other side there. Why do you say that? Why do you think the financial prices, asset prices are reasonable?

Alex Oxenham: I mean on a valuation standpoint, equities are 17, 18, 16 times earnings depending on how you measure it, in the context of a really contained inflationary environment, and we're at 1.5 inflation. That's not a very high multiple. Now there's a lot of different stocks in the market and clearly some stocks are trading at uncomfortable valuations, but broadly speaking I don't see a bubble in really any sector of the market that's major.

I don't want to get into crypto or anything like that. But housing seems to be fairly priced. There's not a lot of supply, incomes are up, job creation is high. Millennials are a huge [inaudible 00:46:29] of the population moving into home buying, home buying, building and buying and housing related stocks have a tremendous amount of upside in our opinion because of that. Not really a bubble. That's based on affordability is significantly more affordable than it was during the bubble.

In Canada for instance their statistics look a lot like ours on the home side prior to us blowing up. So, are there global bubbles? No doubt about it. But in the US I think for the most part things are pretty solid.

Mike Alkin: How do you think about the deficits when it factors into your calculus? The budget deficits, you're looking at the debt we have as rates go up. How do you think about it?

Alex Oxenham: I think early on in the broadcast Mike said I was a contrarian, and that I had ideas out of left field that were-

Mike Alkin: Bring it [crosstalk 00:47:27] We want to hear it.

Alex Oxenham: We've entered that part of the program. There's been a lot of talk about, and by the way we're running a fiscal experiment in the US because, let's all agree we're near the late cycle expansion of the economy. It could last six months, it could last five years. I don't pretend to know. I'm going to work hard to figure out, but typically you're not running a bigger deficit when your economy's

running at peak performance.

The Trump budget is going to widen the deficit and they're going to spend money on military, the wall and what else is in the budget. That's very unusual. We've never really done that before. Usually now, when tax receipts are high and the economy is humming along, the deficit narrows. That's actually really bullish for stocks and a lot of people are attributing this rise in rates associated with the US putting itself in a potentially future fiscal problem associated with that. I can understand that point of view, I just simply don't agree with it.

Mike Alkin: What are the touch points that make you disagree with it?

Alex Oxenham: This frame of reference has changed. 10 years ago I would have probably agreed with you that that's a problem, but today it's not. When you're the global reserve currency, like the US dollar, liquid, everyone wants it, and you can control the money supply, I don't think that it's highly inflationary for, and I'll be extreme here, for the US to print money to pay off the deficit. I really don't think it is.

I'll frame this another way, because you'll see that and then you'll think, "Wow, he's a little off his rocker." Mike's looking at me a little crazy right now.

Mike Alkin: We love that.

Alex Oxenham: Right? I'll frame this another way, there was a lot of criticism around like the airport product production in Denver. Do you remember this?

Mike Alkin: Sure, yeah.

Alex Oxenham: It was, my numbers are wrong but let's say it cost $2 billion and they couldn't afford it and Denver wasn't growing and the economy was stagnant. However they got it done, they built this airport. I don't know if it was ... When did they do that? You travel a lot more than I do.

Mike Alkin: It had to be close to 20 years [crosstalk 00:49:48]

Alex Oxenham: 20 years, yeah. Someone did a study that that airport has produced $21 billion of economic output since they built it.

Mike Alkin: Is that right?

Alex Oxenham: Right, and so this gets back to my thinking, is, if you run a deficit and you spend money that you don't have but it can lead to a huge growth and economic output, I don't think that's necessarily a bad thing. I kind of treat the US deficit that way as well.

Mike Alkin: Even in the face of rising interest rates? Where we're borrowing and paying higher interest expense on that debt?

Alex Oxenham: Yeah, because the US government can effectively print money to cover it. Look, that's textbook inflation, but we've been seeing the ECB do it to the tune of trillions. The Swiss Central Bank is printing ... They're literally hitting control-V on their laptop and printing money and then buying US stocks.

Mike Alkin: Buying US stocks. They're one of the many shareholders. It's crazy.

Alex Oxenham: No signs of inflation. If these smaller countries can do it I think the reserve currency could do it as well [crosstalk 00:51:01]

Mike Alkin: So let's talk about the currency. Last year the dollar came off first time in a long time.

Alex Oxenham: Yeah, kind of a surprise actually.

Mike Alkin: Yeah, so it has weakened and it continues to weaken a little bit. What's your view on the dollar? And if you can, explain for listeners the impact, the dollar being the reserve currency, and the impact of the dollar on commodity prices and other things.

Alex Oxenham: Yeah. Commodities are priced in dollars. There's a huge impact in commodity prices linked to the dollar. That's just how it is, whether you like it or not is irrelevant. The quicker you can understand that the better off you'll be.

Mike Alkin: And accept it.

Alex Oxenham: Yeah, and accept it. It's how it is. I don't like it but that's how it is. But the funny thing is, is ... And I was kind of wrong about the dollar admittedly, I thought it would strengthen because we'd have higher rates, better economic growth, a good ... The change of administration would be pro-business, so I thought that would be strong for the dollar, and the dollar weakened.

Where was I wrong? Well, it was really more a function of other currencies. The Euro started strengthening, the Pound started strengthening. What happens with the dollar, even though it's King Dollar and it's the world reserve currency, it doesn't mean it can't be pushed and pulled by other forces.

I think now the bigger impact is if the ECB and the Bank of Japan slow their intervention in the bond markets. Their currencies will keep the dollar from appreciating dramatically. I think that's kind of what's happening. The ECB in their most recent press conferences, they're still committed to it but they're coming to some end date in the future. They're going to reduce the amount. They're going to taper like we are and that will probably keep pressure on the dollar.

Mike Alkin: If the dollar keeps going down, when we think about the treasuries refinancing their debt, issuing more debt, the Chinese and the Japanese are big buyers of our bonds.

Alex Oxenham: Yeah, that's right. Citizens in Europe are now as well because it has a positive yield, a pretty good one too.

Mike Alkin: What's the impact of the dollar on their appetite for buying debt?

Alex Oxenham: Yeah, historically it's always been a ... Because it's expensive to hedge, so if you're a Euro-based insurance company and you're at your board meeting and you can get negative rates in Europe or positive rates in the US, you obviously pick the positive US rates, but you have to hedge out the Dollar-Euro exposure because you don't want to take a currency loss.

The yield differential and the expense to hedge are largely close, but obviously beneficial now because the yield differential's so great. So we have a lot of foreign buyers in the US because of that. I don't know if US rates matter [inaudible 00:53:49] I think it's more the domestic race to those foreign buyers. That's what matters.

As rates go up, they're not going to want to hedge anymore, they're just going to buy their own paper. I think you could see this experiment where, and this is just a guess, where the fed raises rates and rates in the US increase. They already have, but maybe to say, let's say 50 basis points across the board in a year

from now.

Mike Alkin: Half a percent.

Alex Oxenham: Half a percent. That then the ECB begins to taper and they get positive rates, and then the European owners of US assets sell and then rates tick a little higher than they normally would in the US because of that phenomenon. I think that is something to consider.

Mike Alkin: If I was in a corner of the room looking down and eavesdropping on Hilton meetings two years ago, a year ago and today, how has the thinking changed? How are you positioning yourselves?

Alex Oxenham: Two years ago we were relatively negative. We had come from a really bullish position and we started to see the economic performance of the US decline. We had a huge spike in credit spreads associated with the oil price collapse and a lot of the bankruptcies that occurred in the oil patch. It began to impact the US economy. GDP decelerated meaningfully, coupled with a spike in credit spreads. We had to pull back on risk.

And then midway through 16 to the back half, you started to see some slight acceleration in the data. 17 remained better. It improved at the margin but still below potential. And then late, I'd say middle of 17, to beginning of the third quarter, you could really see the data, for whatever reason, [inaudible 00:55:39] higher. As a result of that we became much more bullish. But as a firm we do think we were close to, much closer to a recession in 2016 than people realize. We were close. The [inaudible 00:55:54] had kind of turned, interest rates had increased for unworthy borrowers. There were some fearful consternation there.

Mike Alkin: So if you're 48%, 49% equities now, six months from now we have this conversation. Are you going to be 55%? Are you going to be 40%? What do you think about? What's going into your [inaudible 00:56:16] What are you, Craig and Bill thinking about that's going to drive that decision?

Alex Oxenham: When we manage our portfolio, it's funny you say six months, we really think about it in terms of three months, six months and 18 months, like where we're going. We plan on reducing credit risk. I think I've covered that pretty extensively with you as to why. Our equity weighting-

Mike Alkin: So you're changing the fixed income portfolio. When you have an opportunity to get higher yield from safer fixed income, you do that.

Alex Oxenham: Right, or even a lower yield but a lower yield that is still risk-adjusted better.

Mike Alkin: I mean a lower yield ... That's right, lower yield risk. Exactly.

Alex Oxenham: Yeah, it's fine. We'll do that. I think you have this tug of war with equities and the tax cut and the fiscal stimulus and the growth associated with that, and you have the tug of war with rates. It's rates and performance of the US economy. I don't know who wins that war, I just don't see enough inflation data that would suggest to me that rates will get out of control. I would probably lean more towards the equity side, and that's kind of how we're positioned. You won't see us dramatically increase risk from here. In fact, we're going to de-risk the fixed income portfolio and probably hold course for the next [crosstalk 00:57:38] three to six months on equities.

Mike Alkin: When I look at your numbers, when I look at Hilton's numbers and I go back to 08, and the market was down 37% and you guys were down 14. We talked about the law of math before. You think about, as you said if somebody's down 50 you've got to double that to get back to break even. That was a tremendous job that you guys did. What's even more impressive to me is your preservation of capital in 08 was in 09 the market was up 26% and you guys were up 23. That's a stunning not only capital preservation, but you were able to keep it on the upside. That was really, that was incredibly impressive.

Alex Oxenham: Yeah, thanks. I think conceptually that, like I said we try to avoid the draw-downs. It doesn't mean we're going to, we're going to try hard. In the past we've been fortunate to avoid it. But also, the real opportunities to make money are coming out of the recessions. That's when you get really rewarded for risk-taking, and so if we can capitalize on avoiding the draw-downs as much as possible, and then capitalize on the subsequent recoveries, the real money is made in the turn of the cycle, not squeezing out every drop of lemon juice out of an orange, or the orange juice out of the orange in 2016, 17 and 18.

That's what the financial media and CNBC are all about, market's

in turmoil, tax cut. Don't squeeze every drop out of your fruit. Manage your orchard the way that it deserves to be for the long run. I think it's hard to do because we're emotional animals and everyone goes to cocktails parties where their friend always made more money than you did. But block that out and really focus on what matters, and that's compounding wealth over time.

Mike Alkin: Let's have a free-for-all here a little bit. I want to pick your brain on things that at times have been in your portfolio, but they're not something you guys specialize on but you know a lot about. Bill Garvey is a commodities guy with great experience, so I want to talk oil, oil stocks. You and I happen to visit the Bakken the day the bell rung, where it [crosstalk 00:59:51]

Alex Oxenham: Yeah, it was October 13 maybe?

Mike Alkin: Yeah, 14 I think it was.

Alex Oxenham: Time's flying by the way.

Mike Alkin: Alex and I and a couple of other people visited the Bakken. I tell the story where we paid I think 450 bucks a night for a Hampton Inn hotel room. We went to a steakhouse where there were all the roughnecks buying $300 bottles of [inaudible 01:00:14] and two of them-

Alex Oxenham: Only on Thursday when they got paid, right?

Mike Alkin: Buying F150 pickup trucks, going like crazy.

Alex Oxenham: Like crazy.

Mike Alkin: I think the biggest funniest part of that was when the waitress at the steakhouse told us, "You should go over to the strip club because all the New York strippers are coming in here because they make more money in Williston, North Dakota, than they do in New York City. We didn't go but it was pretty interesting.

Alex Oxenham: But we checked around.

Mike Alkin: Yeah, we sniffed around.

Alex Oxenham: Mike being the analyst that he is had his ways of confirming that.

Mike Alkin: Exactly, so we confirmed it. But no, you guys were very, very active in Master Limited Partnerships, in MLP's, for many years. You've

taken down that exposure dramatically. MLP's are very high yielding for those who don't know. Think oil and gas pipelines. They're very high yielding investments. You guys had done very well with them and smartly pulled down exposure. How are you thinking about the oil complex now, oil and gas complex?

Alex Oxenham: Yeah, we actually have the lowest weighting in firm history in MLP's.

Mike Alkin: Really?

Alex Oxenham: Yeah, we're at about 3% and we have plans to probably reduce that even further. I could spend time talking about MLP's. There's a lot of good research that's available, but the structure of an MLP is flawed. I don't want to pick on anyone in particular but investors wanted yield because interest are low, and they've wanted yield since the beginning of time. So Wall Street and the oil executives, two groups of people that really love to pay themselves, I think that's pretty fair to say-

Mike Alkin: You think?

Alex Oxenham: ... created a structure where they have a limited partnership and is a toll road, and I don't like that word because it's not true, but that's the marketing spin. It pays these dividends and the oil passes through and everybody gets paid. Well really, the people that are getting paid are the general partnership owners of the limited partnership, that were getting effectively override on the income that you were getting. Their incentive was to grow the income, not grow a sustainable living breathing business.

A lot of this imploded when oil prices declined because there were a lot of bad actors in the space. I can remember back in 2011, there were maybe five or six different ETF's you could invest in MLP's. By 2013 I think there were over 100 funds and vehicles, so it exploded in demand and it imploded on itself. Working with you helped us reduce that exposure.

Mike Alkin: You remember when you highlighted to me they were doing secondaries and it was easy and IPO's were coming out, and couple of them failed. There were a few that had a hard time pricing. To you that was a great signal.

Alex Oxenham: Yeah. I mean look, it was a great call for us, but it was actually

relatively easy. This was a lot easier than the call that Hilton made in 07 and 08, because you had a confluence of a lot of events. You had massive supply in crude oil in 2013 or 14, so we were at nine to 10 million barrels a day but yet the price literally increased from $60 a barrel to $80. You're like, "All right, higher prices encourage production, more supply impacts with lower prices." A cure for high prices is high prices. I know it's one of your saying, I agree.

Mike Alkin: A cure for low prices is low prices.

Alex Oxenham: Is low prices, right. At the same time in 2013 [inaudible 01:04:07] he was talking about tapering. So you had an increase in interest rates, you had the dollar strengthening, you had investor appetite for MLP's at its crescendo. Literally everything lined up, and then it was we go out, we see these signals, we've already started to pull down our risk. We go to the Bakken and we realize, I know for me it was like a seminal moment, how technology was impacting everything. We already knew how it was impacting your phone and ride sharing and how you make your reservations for travel, but sitting in a rig and a roughneck tell you six months ago they were doing vertical wells and now they're doing horizontal and spidering and the flow rates are triple and double, and they can do it four times as fast, like-

Mike Alkin: And proud to say they could keep producing.

Alex Oxenham: Yeah, at a lower cost. It's like you have this eureka moment while this supply thing is really. It's funny because I'll fast forward to today Mike, you've had crude oil, goes from 100 and 14 to 35 and 16, back to 61. The US is at peak production as of a couple days ago, 10.2 million barrels a day of production, and prices are stubbornly high. Again, peak production, oil prices are probably going to decline from here.

Mike Alkin: It's interesting because in that ... You want to bring a gas well online, it doesn't take you very long. You want to drill, it's not long. So it's one of the things-

Alex Oxenham: No, it's very easy.

Mike Alkin: ... my uranium interest, but when production shut down it could take years to bring it back on. There's a big difference there.

Alex Oxenham: Yeah. One of the biggest benefits to the MLP thing, it's funny because I kind of trash them a little bit and from an investment

standpoint I like to stick by it. But from an infrastructure standpoint it was very beneficial, because we have a very robust infrastructure now in the us to transport a barrel of oil from the Bakken to Philly. It used to be through trains that were blowing up and killing people, which now it's pipelines, gathering pipelines and water disposal pipelines.

In all of the major basins in the US they're relatively well developed. Which is funny because now our supply, and with the technology, maybe it used to take a month to turn a well on, now they can do it in a matter of days. So the producers can respond to price levels quicker than they ever have been before, and they can offload the gas or the oil through an MLP infrastructure more proficiently than they ever have before. From a US energy infrastructure standpoint, the whole MLP boom was a huge, huge positive for the US.

Mike Alkin: Right. I want to go off talking of oil and gas. I know that you, I don't know, you and I haven't talked about this in a while, preferreds. I know you were doing a lot of investing with preferred stock. Explain them and what your view on them now is.

Alex Oxenham: In the capital structure of a company, this gets kind of boring, you have a priority of payments, who deserves to get what. The most senior position you can have in a company from an investment standpoint is, we call it a bank loan. If the company goes bankrupt it gets paid back first. And then you have secured notes, senior unsecured, common stock. So common stock gets all the profits of the company that are left over, but in the event of a bankruptcy they're the last one to get paid back.

Mike Alkin: They take a lot of more risk.

Alex Oxenham: They take a lot of more risk, but you have all the upsides. A bound holder of Amazon ... I mean, who would rather be, an equity holder of Amazon or a bond holder?

Mike Alkin: Absolutely equity.

Alex Oxenham: Bond holders are getting nothing. That's why you own stocks. But in between stocks and bonds is another layer called preferred equity. The preferred name means you get a preferred income

stream, so you equity in the company but you don't get benefits of the profits, but you get a preferred income stream before the shareholders get a dividend. It's kind of quasi fixed income and quasi equity.

Mike Alkin: You have been a buyer of those I know. If my memory serves, a couple of years ago you were buying quite a bit. What's your view now on them?

Alex Oxenham: They're very interest rate sensitive, because we consider them to be more fixed income than equity. We don't really get involved in distressed preferred investing. We prefer buying anywhere from investment grade to double B-plus type credits. I don't want to wake up and have a credit impairment situation on my preferred equity. And kind of context with how we've been focused from 2013 on about interest rate risks, we've kept a close eye on our preferred exposure. As far as rate risk goes, higher coupon preferreds have less interest rate risk, because they're less sensitive to changes and market rates.

Credit spreads are also important, and preferred spread to a spread as well. We saw unprecedented tightening in 2017, we had started to reduce our preferred exposure. Preferred have sold off a little bit this year. Some, there are starting to become some single issues that are attractive, but we haven't added, nor do we plan on imminently adding to our preferred exposure.

Mike Alkin: How do you handle position sizing depending on where we are and marrying that with your top-down view? Can you talk about what a big position is percentage-wise and what smalls one are? How do you think about that?

Alex Oxenham: Yeah, it depends on what the issue is. Again, the whole Hilton Tactical Income approach is income and risk mitigation. We're different from a lot of other managers. We're not going to take big concentrated swings. It just isn't what we're ever going to do. For us a big single name position would be 3.5%. I get for most hedge funds and long [inaudible] that that would be kind of low. They can call me a chicken, that's fine. I accept that role.

Mike Alkin: Your mandate is to preserve capital.

Alex Oxenham: Yeah, so our smaller position sizes are at 1%. We keep it diversified.

Mike Alkin: When you're pulling up exposure you go from 30% to 60% let's say.

Alex Oxenham: In total exposure, yeah.

Mike Alkin: Total exposure, meaning you're 60% equities from 30. It doesn't mean you're taking those position sizes but you're more stocks.

Alex Oxenham: Yeah, we're adding more names. We're kind of agnostic to types of securities that we'll use. We'll use anything from emerging market equity ... Sorry, emerging market debt, to an ETF or a closed-in fund or individual bond. We're agnostic, so the weightings will shift based on that. We could have a huge 20% weighting in treasuries let's say, and we wouldn't consider that a concentration. But if we took our equity weighting up from let's say 40 to 50, that would probably four 2% names and then add to two existing names.

Mike Alkin: Okay. One or two favorite sectors or stocks.

Alex Oxenham: Favorite sectors. We've been and we remain overweight industrials and financials. Financials are tricky. It's a bit of a battleground. For us, again, Hilton, we have an interesting view on the world. It's not how much money you can make it's how we view things, it's how much money you're going to lose if you're wrong. For us financials, because as interest rates rise their profitability improves and typically the stock prices perform well.

Mike Alkin: When you're saying financials are you talking just banks, or insurance companies, or across the whole financial complex?

Alex Oxenham: When I refer to it I mostly mean banks and exchanges.

Mike Alkin: Okay, yeah.

Alex Oxenham: It's a good question, because they benefit from higher rates and they're a natural offset to the rest of our yield portfolio. We have a nice overweight there and we've had that for one, two, three, four, five, going on six years now. Industrials are benefiting from lower tax rates, accelerated CAPEX depreciation, lower taxes and robust US economy. We've been overweight industrial, so for me-

Mike Alkin: That's it.

Alex Oxenham: ... those, I would stay in those sectors.

Mike Alkin: Sectors to avoid?

Alex Oxenham: Sectors to avoid, yield chasing sectors. I mean there are specific opportunities in writs broadly I would avoid real estate, broadly would avoid staples and broadly would avoid utilities.

Mike Alkin: Okay. [inaudible 01:12:54] other cycle?

Alex Oxenham: We don't. We tend not to own really deep cyclical [crosstalk 01:12:59] so we don't really pay attention to the aerospace cycle or the auto cycle, or really oil and gas outside of our MLP's.

Mike Alkin: So, Hilton Tactical Income fund, it's a four star, and you guys just launched that, what, two years ago? Not even?

Alex Oxenham: We have two fulfillment options at the firm. Most of our business is in separate accounts but we have a mutual fund. You should read the prospectus before investing in the fund.

Mike Alkin: What to qualify for the separate accounts? What does somebody need? How do they do that?

Alex Oxenham: We have a lot of different platform providers and third party brokers that have access to us.

Mike Alkin: Can they just call? Can people call you directly and become a client of Hilton?

Alex Oxenham: Yeah. We could do that. Yeah, we have a number on the website. Feel free to call and someone will reach out to you.

Mike Alkin: What about the mutual fund? How does that ... Different classes?

Alex Oxenham: Yeah, we have to share classed and institutional share class and an A share class. The fund follows the same strategy that the separate accounts do. There may be slight variations in performance but it's the same structure, and that's up on all the major retail platforms, TD, Schwab, Pershing, Fidelity, a lot of the wire houses. The symbols are HCYIX and HCYAX. You can Google the Hilton Tactical Income fund and go to the website and review the perspectives and the tear sheets on that as well. The fees are, expense ratio rather is 98 basis points on the institutional share class.

Mike Alkin: So if you have your money in there it's [crosstalk 01:14:45] percent.

Alex Oxenham: Yeah, less than a percent. Right. I think the minimums are 50,000 for the institutional class and $2,500 for an IRA.

Mike Alkin: Great. I can't thank you enough. It was great. Will you come back?

Alex Oxenham: Absolutely. It's fun. I'm glad. I think I'm ... Are we episode four?

Mike Alkin: Episode four.

Alex Oxenham: It's not bad.

Mike Alkin: Not bad.

Alex Oxenham: Who says the sequels aren't better the original?

Mike Alkin: And we finished a whole beer while we were talking.

Alex Oxenham: We did.

Mike Alkin: It's great.

Alex Oxenham: Hopefully we'll have another one.

Mike Alkin: We will. Thanks man.

Alex Oxenham: Thanks Mike.

Mike Alkin: All right buddy. And now for the educational segment. I mentioned earlier in the podcast how the markets took it on the chin on Thursday when President Trump surprised the global markets, there's a real shock, by announcing his intention to introduce a 25% tariff on imported steel and a 10% tariff on imported aluminum into the US. Those interested are being hurt by cheaper steel and aluminum being sold into the US, while they when they're selling their goods abroad pay duties on those exports.

Now as you would expect, Democrats and trade unions love the announcement, but it also sent shivers up the spine of politicians in President Trump's own Republican party because they worry about the dire political and economic consequences. Now this move by Trump shouldn't be a surprise to his own party though because during his campaign populist and protectionist positions were front and center. He talked about it all the time. Yet, they make the announcement on Thursday, the White House, and the markets got

rattled. So neither his own political party or the market should be surprised, but they were.

The equity markets got hammered. The US dollar took it on the chin. It's all about fears of trade wars that are emerging, and I want to talk about that. Trade wars. Many of our trading partners did not like that announcement coming out of the White House. China, Japan, South Korea, Brazil, Canada, they were upset. They said they were going to retaliate by slapping higher tariffs on our goods.

I think it's important, what I want to talk about is the importance of helping you understand the economic significance of tariffs and how they impact economies. Now obviously for US steel and aluminum industry insiders, their jumping up and down with joy for these tariffs as they've been competing against cheap imports of both aluminum and steel.

So in theory you could argue tariffs are a good thing, as they protect domestic industries. But in practice, history suggests just the opposite. History shows that what it really does is enrich a small segment at the expense of the broader economy. So as is often the case with these protectionist-like tariffs, the prices for the goods using what's protected. Think of what steel and aluminum go into, appliances and cars and a host of things. Those prices of those goods rise, inflation for the entire economy while the benefit falls to those who're directly tied to it, those in the steel and aluminum industries.

So only those in the preferred industries, those with their goods protected benefit from the tariffs. They see their profit margins who are kept intact, or they go higher, but the costs, the retaliatory tariffs from foreign governments or lack of access to cheaper substitute goods, they're shared by all of us, the consumer.

For instance, if the government slaps a tariff on import steel, the US steel industry notices the benefit right away, while the rest of the country is paying more for their goods with steel and aluminum in those processes. So we are feeling that inflation. Appliances, cars, buildings, they're all going to go up. Here, the markets earlier in the week, last week on Tuesday, were fearful of rising interest rates because Chairman Powell had suggested they wanted to keep a lid on inflation, even though it for right now is modest, but they want to get ahead of it. Here, two days later on

Thursday, tariffs get discussed. What does that lead to?

That's going to basically lead to rising prices. Think of it this way, it's basically a tax increase on the US consumer. The US consumer was just told that he or she got a tax cut with Trump's new tax plan. Yet, the unintended consequence of these tariffs will be rising prices, taking away the benefit. We don't know exactly how much because we don't know the details yet of the plan of the tariffs, but it can offset to some degree that tax cut.

It's bad policy on its own, but it gets much worse when unprotected industries then go to Congress for similar favor. From Trump perspective, it could erode his base in rural America and the blue collar workers that Trump says he's trying to help. There's always retaliation and typically a lot of these countries who retaliate are major trading partners. They tend to single out agriculture when they do that, so that's not good for the American farmer.

Now let me give you some history on this to support what I'm saying. If we go back to 1930, there was the Smoot-Hawley Act, which was a precursor to World War II. Now back then, under Hoover, the American embraced a protectionist policy. They levy taxes of up to 50% on imported goods. As history, looking back on it, it was considered to be a huge mistake. It crippled global economic activity and it helped accelerate the decline and the Great Depression.

And really, the global trade freeze only ended when Congress passed the Reciprocal Trade Act of 1934, which gave FDR, who was then president, the power to negotiate these bilateral trade deals with other countries without congressional approval. But by that time the global economy was already broken and it gave rise to all the nationalist populism in Europe and that brought on World War II.

If we look for a more recent example, George W Bush in 2002 initiated a steel tariff. I think that's a useful guide as to where we are today, because then by 2002 the EU was in existence, China was already in the World Trade Organization. At that time, President Bush slapped tariffs on steel coming into the country, which ranged from 8% to 30%.

If you go back and look at some of the studies on what the net negative consequences for US economy were, they were pretty staggering. 200,000 Americans lost their jobs to higher steel prices in 02. Those jobs represented about $4 billion in lost wages from February to November 2002. So more American workers lost their jobs in 2002 due to higher steel prices than the total number employed by the US steel industry itself, which was about 187,000 people in December of 2002.

One out of four, so 50,000 of these job losses occurred in the metal manufacturing, machinery, equipment and transportation equipment, part sectors. Every US state experienced employment losses from higher steel costs. The analysis shows that American steel consumers have borne heavy cost from higher steel prices caused by shortages, tariffs and trade remedy duties, among a host of other factors. The US dollar during that time got slammed. The stock market doesn't like uncertainty. We saw that Tuesday when we thought we were going from three hikes to possibly now four. Stock prices started to sell off. Uncertainty was added to the mix with these tariffs.

We'll learn more this week about the details of those tariffs, but the possibility of trade wars emerging from them add a whole level of uncertainty to the market. Nine years into this bull market, I think one needs to really be cautious in how they're positioning their portfolio, because the uncertainty at this point in the bull market cycle can lead to stock prices for a rough road ahead.

Anyway, that's the podcast for today. I hope you enjoyed listening. I look forward to speaking with you next week. I will be speaking to you from a remote location. I'll fill you in on the details when we speak. Have a good week. Thank you.

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