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THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

Announcer: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks Over 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. And now, here's your host, Mike Alkin.

Mike Alkin: Hello, welcome to the podcast. It is Tuesday, August 28th, 2018. We're doing it a day later today. I had to wait, I wanted to wait a day so I can get a guest that I really thought you would enjoy on the podcast and being the summer and travel and stuff, yesterday couldn't happen. I hope you had a good weekend. My weekend was great, I painted all weekend. Yep, I spent two days paining my daughter's bedroom. My wife told me ... we built a house a few years ago when my daughter was younger and it was more childlike so she's going into high school now and my wife said she could redecorate her room. So, I pay no attention to that stuff just like when we built the house, I paid no attention to what wound up in the house, I just said to my wife, you handle it and she loves to do it.

So, around the house I typically will see people come and go and workers sometimes for whatever and, "Hi, how are you?" Nice to talk, I always sit and talk to them and hang out with them, but I don't typically get involved in this, my wife does all that but, on this particular occasion I noticed that there was somebody in the house I didn't recognize, and my wife had somebody helping her and my daughter decorate and I'm like, come on, it's a bedroom but anyway, I didn't say anything.

So my wife was talking and we were talking one night and then it came up with, of course, typically the question I don't normally ask but I've learned over the years now I do ask is, "How much is this going to cost?" And she told me and I was like, "Really?" But I've learned also not to argue but I knew something was up when she said to me, "Hey honey, I've had three painters in and I don't know but I think it seems a little expensive." I said, "Well, for what?" "For painting our daughter's bedroom." She said, "Okay,"

she said, "They all want around $2,500." I said, "For a bedroom? What are you, lining it with gold? I don't understand." She said, "No, it just seems expensive." So is it $2,500 to paint a, I don't know, 15 by 15 bedroom, 15 by 12, I don't even know. Four walls, a lot of trim, woodwork and the ceiling and so she said, "Yeah." So she shows me the quotes and it was appalling, it was just ridiculous.

As I've gotten older and I have a family, I'm sure, like many of you, you weigh what's worth my time and what's not worth my time and you weigh it verse what it's going to cost. So there are things, and if you've been listening to the podcast, you know I'm severely limited in that decision because I can't do anything. Anything mechanical, I'm an utter train-wreck, I'm a deer in the headlights. I used to try, I always rolled up my sleeves and said I could do everything and Lord knows I proved I can't, so my wife knows just go get it done.

Stuff that I can do, I'm out there with my snow blower and I'm out shoveling the sidewalk because I can. So if I can, why shouldn't I? It's good exercise, I enjoy it, it's fine and it's easy. Not easy, but it's enjoyable. But in the painting normally she brings someone in. But this was ... I think it was egregious. We live in a nice neighborhood, it's a regular ... it's probably a little upscale, it's an upscale town but $2,500? That room somewhere else, it's 500, 600, 700 and there are a few towns around where I live on Long Island when the trades people come in, they just come in a PFA, they pull it from their ass what number they're going to charge and they figure, "Well, okay, well one or two of the spouses are working. One spouse is working the other's home, the other's busy, they're not paying attention and we're going to just jam them." And screw that. I'm not going to get jammed by anybody. I don't mind paying but not when somebody's trying to hose you.

So I said, "I'm going to paint," and that's what I did. So I spent Saturday, all of Saturday afternoon, all of Sunday taping. The walls were a mess, I don't know how, it's a relatively new house but with all the stuff on the wall, there are patches everywhere, so my daughter was freaking out. She's like, "Dad, you don't know how to do anything. You can't ... " She's like, "Yeah, stock stuff, yeah and all that, you can snow blow, but you don't know how to do this." Let me tell you something, I crushed it. I nailed it. I patched, spackled, everything trimmed out it all, did it, dark blue on the ceiling, I know, don't even ask but dove white walls, oil on the baseboard, got it.

I could barely move today, it's so ... I work out, in the winter I put

on the 15 pounds but I took it off already, I'm in okay shape. I have muscles I didn't even remember I had. How is that possible? Just painting three coats on the ceiling, that dark color drove me nuts but my traps, literally I feel like somebody's sticking needles in me the whole time. My fingers, just from painting baseboards. I know, it sounds ridiculous right? But I just can't even get my head around it as to these little things. Feels great though, I love it, it's like a whole new workout so I think I'm going to find new projects to do on a regular basis.

But anyway, so that was my weekend and we're back at it and I was thinking about the markets and I was thinking about ... I was seeing that the markets were up hitting new highs yesterday because Trump dented hopes for a China deal after agreement with ... everyone was excited about Mexico and then people thought, "That's good for Canada because he's agreed with them, he's going to ultimately come to agreement with Canada." The fact the whole ... China is going tit for tat with us and there's a lot of stuff going on and a lot of macro stuff.

We see the conference calls that are taking place, we're seeing companies starting to talk about their ability to raise prices and they're feeling good because it's been a decade since company's could really have any pricing power so some manufacturers, 3M was one that I can think of that called out, "Hey, we're taking prices." Some packaging companies were saying that, you haven't see that. If you've heard me on the podcast when I brought you through the anatomy of post-global financial crisis, it was no top-line growth, companies would cut costs like crazy to try and make their earnings growth and then when they cut to the bone then what did they do? They levered up the balance sheet and then the balance sheets then, they levered up, meaning they borrowed money, they put that on the balance sheets and with that money a lot of them went out and bought back their stock. When you buy back stock you reduce the share count, it's an artificial boost in earnings.

What you hadn't really seen was top-line growth. Then Trump gets elected, you've got the tax cuts, you've got a lot of money being repaid, patriated and you've seen a lot of stuff take place and you've seen really good earnings growth. You've seen, I think, last quarter, this quarter mid 20s earnings growth. So really strong earnings growth but again, what's really driving it? You like to see prices and I love to see price increases because as an analyst, a price increase, if I can take one percentage point increase in sales that comes from pricing, it flows down more to the bottom line

and especially in the manufacturing company than does a point in volume. If I sell one percentage point more of the widgets I'm making, I've got to go buy the raw materials, I've got to produce it, I've got some waste, I've got labor that goes into it, I've got to put it on a pallet, I've got to ship it, there's a lot of stuff that goes on versus a point of price.

"Hey Mr. Customer, your price has gone up a point." What do you think matters more to profits? Exactly, price. But you've seen companies reluctant to do it, now you're starting to see them dip their toe in the water, but rising prices could lead to inflation and we haven't seen real inflation in a while, it's peeking its head up a little bit, two percentage points growth there. So it's something to keep an eye on but also, coming off the heels of 20 plus, 25% earnings growth. So here's what I'm thinking and working through in my head. So markets hitting new highs, 25% earnings growth, hey Goldilocks is here, right? We have low unemployment, of course it's record lows and we're seeing record earnings and prices going up.

You've heard me talk before though about some of the consumer stuff that we're seeing, some car loans aren't so great, the subprime sector. We've got student loan debt, you've got a lot of stuff, some banks are reserving more for credit cards. Again, not near crisis levels except the subprime auto, but just at a point in time though where you're starting ... a lot of good stuff is priced into the market and I wanted to bring a guest on today that was going to help us think this through because I'm really not sure exactly where it goes. Obviously, if you've been listening to the podcast, I'm cautious, I think the market's had a massive move, you've had so much good stuff priced in and I think the risk is much more to the downside. I'm not calling for a global financial crisis, I'm not calling for a crash but a major correction could be in store.

So we're going to bring on a guest today to talk about that. I've had him on before, he's a former prop trader, he worked for Goldman Sachs for years, writes his own newsletter, just a really smart guy. He also owns farm land and he runs a private real estate investment trust, so has a great insight, very good geopolitical thinker and we're going to talk through some of these issues. So, without further ado, I will bring on Steve Koomar, editor of the Vigilante Investor. Steve Koomar, welcome to the podcast.

Steve Koomar: Oh thanks, it's my pleasure to join you, thank you.

Mike Alkin: No, you're welcome. Did you have a nice summer?

Steve Koomar: Very good summer, very busy, very active and so now it's time to ... got one more week before fall begins. Really it's not really fall but after Labor Day, then things get pretty active again so it'll be fun.

Mike Alkin: Yeah, I was excited the other night, I took my dog for a walk and I walked outside in shorts and T-shirt. I said, "Whoa, I could do with a sweatshirt." So I love that, the fall was in the air here in New York but it was fleeting because the next day it was 90 again with high humidity but we'll take what we can get.

Steve Koomar: Yeah exactly, take that little reprieve.

Mike Alkin: Exactly. So Steve, let's talk ... when I had you on last time, I got some really nice feedback from listeners and it was great. You have an interesting background and I'd like to just refresh listeners. Maybe those who heard the last podcast and maybe for new listeners, your background is somewhat atypical in the sense that you have a lot of international investing experience and you spent time in Japan you were on a prop desk. So just take listeners through if you can, your background in investing.

Steve Koomar: Sure, I started with Goldman Sachs in the late 1980s in fixed income derivatives and our focus was very much on providing a quantitative, analytical product to institutional investors. I did that for a few years in New York and Goldman asked me to move to Japan and run a business for them in Japan, which I did that. After about a year I was at a crossroads. I either had to come back to New York and continue to do the same thing on the career path or stay in Japan and start prop trading and manage a prop book for fixed income business in Japan. I took the latter, it was a very interesting change, it was a huge step for me to really operate on a prop desk in a market that was really very foreign to me just a year earlier, but it was a great-

Mike Alkin: So, you had a foreign market and a new total skillset you had to develop essentially?

Steve Koomar: Yes, that's what I had to do, and it was-

Mike Alkin: Can you just tell people who may not be familiar what a prop desk is?

Steve Koomar: In this case, Goldman had a big business in trading bonds and all

the whole complex of fixed income products in Japan and a prop desk ... I worked with that desk but what I had the ability to do was just take positions for the firm. I wasn't trading with clients, I was just trading for the firm's book, for the firm's profit and loss. They gave me license to trade all of the fixed income complex in Japan but I could also trade equities, currencies, other markets around the world. They allowed me to try to trade one market against another to the extent that I could. A lot of what I did was relative value trading within the Japanese market, but I did a lot of international trading as well and it was basically to take advantage of the special knowledge and perspective that I gained from sitting in that seat, to earn a profit for Goldman Sachs.

Mike Alkin: You got a quite a view on all that's going on in the different financial markets and you're handling their P and L and so people in prop desks have changed over the years so let's talk about an investing framework. So here you are, you're starting out trading different markets than you're familiar with and you're sitting on a prop desk and you're trading fixed income, you could take currencies, pretty much you could do whatever you wanted to do, where you thought you could generate a profit for the firm. So how did you structure an investing framework for yourself? Then if you can talk about the framework and how that morphed into how you think about the world of investing today? Because one of the things that has surprised me, Steve, for the first time in my 20 plus years career, is I have exposure now to retail investors, a lot of folks who listen to this podcast, and I have really nice interactions with them and with the subscribers that I have to the newsletter and it's a lot of back and forth on emails and direct message on Twitter and it's really ... it's great.

One of the things that I realize in talking with them or communicating with them via email and direct messages, if I would say one thing that has surprised me is not necessarily having an investing framework. It's hearing an idea and it might make sense or not. When I started in the business a long time ago, I had to develop an investing framework which kind of came from the firms that I was at. Over time, you morph and develop and establish your own framework. Can you share with listeners how you've developed your investing framework and where it's led to today?

Steve Koomar: Sure, you always have a core that you lean on. Everybody has a core framework that they lean on and my core was always value. I could quantitatively analyze securities to figure out where the value is and I could trade something that I thought was ... I could

buy assets that I thought were very, very cheap and offset some of the risk by hedging it, either by selling other investment products that were expensive or just fairly valued, and try to capture that value. Then we would lever that up, that's what I did at Goldman, is we levered up those positions that we thought we had the greatest value in. That was the core of what I did, is I found relationships in the markets where I thought that the odds were very strongly in my favor that if I could sit on this position long enough, I would make a really good profit.

Mike Alkin: You're looking for asymmetry?

Steve Koomar: So that was ... I'm sorry?

Mike Alkin: You were looking for asymmetry in the risk reward?

Steve Koomar: Absolutely, that's right. Asymmetry was exactly what it was. So that was the core of what I did but you couldn't rely on one thing alone and particularly doing that in Japan was difficult to do because sometimes what made something fall out of alignment in terms of its market relationship might be at the very beginning and it could get a lot worse before it gets better. If you had a lot of leverage in that position, you could get pushed out of position very easily. So I had to have other types of things that I did where there was asymmetry and sometimes it was just outright market bets. It could be a volatility position because maybe volatility in currencies was very low and I could trade volatility there. Or I might trade volatility and currency versus the Nikkei because there might be a relationship there that was off. So I would get into other markets, or other places where I could find asymmetric bets and build a diversity of positions in my book.

That's a lot of what I do today. I do that in a lot of ways. I don't offset my risk and lever up my book by putting hedges on, and that's what a hedge fund would do, but I do look for ... I look for value positions but I also add to that, I look for growth and I modify what a normal growth investor does and then I really look for growth that is not expensive to buy, because anytime you buy in growth in the market, you're going to pay up for it in terms of price earnings, multiple or however you want to measure the pricing variability.

But I look to buy growth at the cheapest price possible and so I have a mix of growth and value positions in my book and I also try to structure it where the most volatile positions I will ... the things that I think have the highest risk associated with them, I'll

size them in a smaller position size than the things that I think are the least risky and the least volatile. Those I will size in larger quantities but still never having really significant imbalances in the portfolio. So I try to have a lot of different investment bets out there so that ... because you're never right 100% of the time. You always can do something wrong.

Mike Alkin: Well that's point number two that has surprised me over the last year is position sizing, which is just so critical. Like you, in a portfolio I might have a ... there could be a wide range for me between my highest conviction idea and my lowest conviction idea and it could be based on a few things. It could be based on just the inherent volatility of that position, it could be where they are in their cycle, something can be deep in a bear market where I see catalysts evolving but I don't think it's time yet but I want a little exposure to the position and I'll start small and scale into it as I continue to do my work and have more conviction. So that's one thing that it might be.

Then I look at the risk reward. What's my upside versus downside? So I do size positions differently and that has been surprising for me with people saying, "Okay, all things equal." I think it is so important for investors to really understand the upside potential versus the downside loss and then size accordingly. What's that, rule number one? Don't lose money, rule number two, live to fight another day-

Steve Koomar: That's right.

Mike Alkin: ... because like you say ... Right?

Steve Koomar: Yeah.

Mike Alkin: You're not going to be right all the time and so it's interesting. So because I interrupted you while you were taking us through your Goldman Sachs and then your Japan prop desk days, how'd it morph from there? What did you do after that?

Steve Koomar: Well I went to work for Prudential for a while, managing a global fixed income book for them and it was here I was investing for pension fund clients of Prudential and mutual fund clients of Prudential and for the insurance company's general account. Here I had a book of international bond positions and currency positions-

Steve Koomar: ... international bond positions and currency positions and had to manage ... they would manage around an index and your goal was to beat the index.

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: Said a lot of ... really had exposure to all the markets, all the developed and emerging markets. And, that was a great experience. I did that for a while. And then, Prudential kind of went through some changes, in terms of what they wanted to do in international markets and, I moved on to a fixed income fund of Hedge Funds. A

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: And, developed a business, there, related to basically putting together a portfolio of different Hedge Fund strategies, within one bigger Portfolio for large institutions.

Mike Alkin: That's interesting because, you get to see all global basis, you get to see all the different Hedge Funds and meet and interview the Managers. And, it's not only understanding their investment strategy but, doing the Due Diligence on their business. Right? Understanding if it's a viable business. Or, understanding the processes they have in place. So.

But, you also get to see some really great minds and some not-so-great minds. But, really it ... that must be a fascinating position because, as a manager I've always been on the other side of that. I've always been the one fielding the questions from the fund of Hedge Fund Managers.

And, you can tell ... I can tell, pretty much quickly, whether somebody really understands what they're doing. And, it's not a coincidence, when you walk out of a meeting and the guy on the other side ... or the woman on the other side of the table, whose really put you through the grinder ... it tends to be ... you tend to see they're ones great performance. So, it's pretty consistent there.

What was your experience like, in the fund of Hedge Fund world?

Steve Koomar: You know, it was interesting, I ... many of these strategies were very complicated. Obviously.

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: And, they required incredible amounts of analytics. But-

Mike Alkin: Right.

Steve Koomar: ... the best, most consistent performers, could explain their strategy in one or two sentences. And-

Mike Alkin: Yep.

Steve Koomar: … it basically … the people who had very, very logical grasps of what they were doing, and they could distill it down to something relatively simple, those are the ones who were the most consistent performers.

And, the thing that gets everybody is, you know, you go through a process … and it got fixed income really badly around the financial crisis … is that, you know, leverage is always … can be dangerous.

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: And, you get too much confidence-

Mike Alkin: Yeah.

Steve Koomar: … around your ability to Hedge and it can be fatal. And, that was a lot of what was behind the financial crisis, really, was just too much leverage built up around relationship that people thought … had been working for the last twenty years and would continue to go on forever and there was a dislocation-

Mike Alkin: Yeah.

Steve Koomar: … and, it was the end of so many of those managers.

Mike Alkin: Yeah.

Steve Koomar: But, yeah, I think, generally, I think that simple logic prevails. That's what I learned from that, more than anything else.

Mike Alkin: It's interesting, I … throughout my career, we've had investors from all over. We've had domestic investors, who invest in the Hedge Funds of European and Asians. I do a lot in the Uranium space, right now. And, it's interesting how … I was just over in Asia and I was there visiting some people and I also met with some Fund of Funds, some allocators of capital, somebody Uranium strategies that I have and I've spoken with US investors on Nuclear Power and Uranium and many European investors.

And then, the Asian investors. And, for the Asian investors, the growth in Nuclear Power is taking place in Asia. That's where all the growth is coming from. So, when I would sit across the table from a capital allocator, I didn't have to explain the case, for them, for Nuclear Power.

And, when I would speak to some … when I do speak to European investors, I quasi have to speak about the case for Nuclear Power. But, when I speak to American investors, they say to me … well, Nuclear is a dying business. And, now, the Asians know completely that's not true.

They know it's a growth business. So, it's fascinating to see people's own experiences, even though we live in a global, 24/7, always connected world … you know, it's great to get out there. When I get out there and talk to these different people, I really get to see people's own personal daily experiences.

And, what they see and read, locally, that shapes their views. And, it's so interesting to me because, I think, as an investor, sometimes, I have to … for any category I'm looking at … I always have to ask myself … I see the thesis. I see the drivers, the catalysts. But, what am I missing?

It's a big market. Who's the marginal buyer of this security that's going to take these prices higher? And, what's going to get them interested in it? And, it helps me, by meeting people from around the world, really take my blinders off and not be myopic in my view.

And, not just myopic in my view, based on fundamentals. But, based on the overall picture and who the investor base is. And, so, for me, and for many, many years I've invested internationally, and that's helped. By going all over the place and visiting with people. But, from your experience, in Japan, and working abroad, how has that shaped your view as an investor, today. And, what experiences do you think you could bring with it … do you bring to it?

And, maybe for listeners, who are saying … well, how did Steve know? He was trading currencies; he was trading bonds? Where do you even begin to look? And, people ask me … they say, how do you get your ideas? It doesn't come out of a screen, a computer screen.

I mean, yeah, you [crosstalk 00:29:41][inaudible 00:29:41]-

Steve Koomar: Right.

Mike Alkin: … on my Bloomberg I have them and I can pop them in, once in a while. And, I go, okay. Yeah. The same companies are coming up. But, for me, it comes from just being a voracious reader of stuff. Whether it's geo-politics or whether it's history. Or, whether it's current events, in other parts of the world. It's just stuff. And, I

just ... you stumble upon things that kind of make sense.

How do you ... and, how does your international experience ... and, how does that shape who you are today?

Steve Koomar: Yeah, that's a great question, Mike. I mean, I think that a lot of this started before I went to Japan, but, I've always been very interested in history and geo-politics.

But-

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: ... Japan ... my experience in Japan really ignited ... sparked a real flame towards really trying to learn as much as I could, and just devouring information and analysis related to geo-politics. And, what I saw there, the effect, while I was there, of geo-politics, on markets, was enormous.

I mean, there was a trade dispute, that was going on between the Clinton administration and the Japanese government, in the early and mid 90s, when I was there. And, the volatility of that place, in the stock market, in the currency markets, especially and ... but, also in the bond market there ... was enormous.

And, it really drove these enormous, very well developed markets, the geo-politics of that trade dispute drove the Japanese, at market, and, perceptions of where the economy was going.

And, I could see how critical that was. And, over time, I've just studied and learned more and more about geo-politics. And, when I talk about geo-politics, it's just not ... policy is really important. But, so much of policy and so much of who we are, is formed by the geography of our people. Our cultures are really, really a product of the geographic advantages and obstacles, that we face.

And, this is true of every society, in the world. And, as policies change, in one country, they affect other countries. Or, as power differentials change, you know ... the awakening of China has had such an impact on Asia and on the world. And, the effect of just the US Military, in that area ... what that did, to allow China to develop, was just incredible.

And, so you see things, like this and you ... and, it really has some big ramifications as you learn about geo-politics, you can see how it just never ... the impact on the markets, never changes.

What actually it's doing ... what geo-politics is actually doing to markets ... always changing ... but, the fact is, there's always impact on the economy and on the markets. And, right now, probably more so, than many times in the past. Because, you have an American President and Administration that is bent on changing the ... kind of the ... the economic order that's existed for the last 70 years-

Mike Alkin: Yeah.

Steve Koomar: ... and, this is going to take a long time to play out and it's going to have enormous impact on all these markets, going forward.

Mike Alkin: It's so interesting. I'm a geo-political junkie and, no formal training in it. But, just like you, for years and years and years, in my whole adult life, I've taken a keen interest in it. And, you know, with my Uranium investing, it's one of the big ... the number one supplier of Uranium to the world is Kazakhstan. And ... they have 40 ... the country is 41% market share, the state owned entity has in the mid 20s in market share. And, they're the 800 pound gorilla.

And, you know, it's a state owned entity and they have lower costs. And, it's interesting to ... they've ... one can always make the argument, when ... in commodities, or in anything, that the state owned enterprises have less economic discipline because, you don't know what their motivations are for producing what they produce and, oftentimes, it's to feed civil programs. And, they just got to keep selling ... producing and selling and, when ...

Years ago, when I started really wrapping my head around the Uranium space in Kazakhstan ... I'd always had a fascination with the Soviet Union and obviously, Kazakhstan being a former state of the Soviet Union, I had remembered a book I read. Back ... it was primarily in the 90s and it was written in the late 80s, and it was called PERESTROIKA, THE NEW THINKING FOR OUR COUNTRY AND THE WORLD. And it was written by Gorbachev.

And-

Steve Koomar: Mm-hmm (affirmative).

Mike Alkin: ... and it was, at the time, it was a fascinating book. But, I recalled ... I wanted to get ... years ago, when I was getting ... really familiarizing myself with the Kazak environment, with the economy, with the political situation ... I recalled back and being

a former state of the Soviet Union, I went back and I read that book and it gave me ... it gave me the insights into what they were thinking.

The guys running this country, now ... or, the guy running the country and the state owned entities, where they came from because, they were being ... they were still being run ... even though the Cold War had long ended ... even though the Soviet Union had long disbanded, it was being run by people who grew up in that Soviet Era and were trained in those schools.

And so, having read something twenty-some-odd years ago, it was able ... I was able to go back and revisit it and read it again and it kind of puts you in the mindset of where we are today. And, I think, sometimes ... often, when I speak to investors, sometimes, they'll say ... ah, Kazakhstan, they're just going to produce whatever they produce and, that's it. Right? And, it's a throw-away line. And, that's the thought process that goes into it.

But, I think, having an understanding of geo-politics and why things happen and the moving parts, and how they connect, is really so important. And, it's never too late to start. If you're not a fan of it ... But, you are an investing fan, I think, and you want to be an investor. I think it's so important to really have a sense of for what's going on around the world.

And, I know, I read your stuff, and you do such a great job at it. You really put the pieces together. So, I love reading your stuff, on that.

Speaking of that, let's talk, if we can ... you know, I mentioned that I was just over in Asia. But, let's talk ... what's going on with China. And, I know you've had some views on the trade wars and I have been surprised by the Chinese really digging in. And, I know you have some interesting views on that.

What we've seen is, they're going tit for tat with us. The more we put tariffs on, they're matching it. And, on the surface, you wouldn't think that was something they could actually win. So, why don't you talk about what's going on, on the Chinese Trade side. And, I bring that up especially, in light of the agreement that was signed with Mexico, I think, just a couple of days ago, where now the Chinese want to come to the table and Trump is kind of saying ... yeah, yeah I don't have time for you, right now. I'm focused on other stuff.

So, talk about, if you can, what you see going on in the part of the world and what's going on with the Chinese and the US and all this Trade War stuff.

Steve Koomar: Sure. I think that's the biggest factor out there, in the Global economy, right now, is what's going on with China and trade with the US. I think ... you know, I really expected, when this whole discussion about changing the terms of trade ... when Trump first introduced it, I thought China would seek an agreement with the US, quickly, which would ... they would see the handwriting on the wall.

I mean, their economy is so dependent on exports to the US, and they don't really import, that much, from the US. They have some agricultural products and intermediate goods, some services. But, it's really not that much that they import, from the US.

But, they really need access to the giant US economy, to keep their economy running. They have to keep selling goods to the US. So, I just figured that they would play ball. They would understand that they would have to make an agreement that would ... come to terms with an agreement that would maybe give them a little less than an advantage than they've had in the past.

And, their advantages are significant. It's not just in terms of dollars and cents, which they are big on, in terms of dollars and cents. They have bigger tariffs on strategic goods, than the US has. Or, other countries, really, for that matter.

And, they also have a value added tax, which the US does not have. And, that value added tax of 17%, acts as a 17% tariff, basically, at the border for all imported goods.

Mike Alkin: Right.

Steve Koomar: So, there's ... it gives ... they have a pretty significant advantage, in terms of the total tax structure that they have. And, in addition to that, they have a lot of non-tariff barriers, in terms of how they deal with inspections. They also require, you know, joint ventures, for many businesses, that want to do business there. And, giving up intellectual property. And, they also engage in a lot of cyber espionage.

So, there's a lot of ways in which they gain technology, that wouldn't be considered, very fair. In a Western economy. But, to them, it's ... I think ... it's quite fair.

And, so they've really developed some significant trade advantages, in the past, and they're ... I thought that they would just be willing to give up some of that, in order to get an agreement and keep things going. And, maybe accept the slightly lower growth rate, going forward ... but, they have decided to dig in.

And, you know, they have tried to go tit for tat with the US. And, they have to the extent that could. But, they just don't have that many goods to tax, in terms of imports.

Mike Alkin: Right.

Steve Koomar: They have so many more exports. And, so what they've resorted to, is a pretty clever strategy of trying to influence the up-coming US mid-term election. So, they have really pressed their bet, in terms of hitting the agriculture states, that are really important part of Trump's support base.

There are a lot of important Senate elections. There's also a lot of important House elections, in those states and, if the pain from a trade war, in those states can cause a significant swing, to the Democrat party, in the mid-term election, Trump will, really, probably lose a significant amount of his ability to, kind of, push his agenda going forward. Both in terms of not having the Congressional support, but also, you know, it was just ... he would just be, you know, have to back track and find a new strategy and a way to govern, going forward.

And, I think, that's really what China is banking on. They would like to damage Trump, enough, so that he doesn't have the strong negotiating position that he appears to have, now.

Mike Alkin: Well, you point out that the majority, I think you said, 34 billion of Chinese tariffs hit the agricultural sector and 14 billion of that goes to soybeans, which is like a third of the US soybean production, you had pointed out.

And, you have personal experience with soybean production. I mean, you own farmland.

Steve Koomar: I do. I do.

Mike Alkin: So, right?

Steve Koomar: I'm a soy ... I own farmland and I sharecrop it.

Mike Alkin: And you ... yeah.

Steve Koomar: So, I'm literally a soybean producer, myself.

Mike Alkin: So, it's ... so, talk about ... what are you seeing out there? What are your farmers, who are renting your land ... what's going on, on the ground?

Steve Koomar: You know, it's a bad year, in terms of price. And, many farmers hedge their bets going into the year and sold some soybeans production, in advance. So, it's not like they're going to bear the full brunt of the pain of this. But, a 20% drop in your price, is a lot, when you're already operating on a low margin.

Mike Alkin: Wow.

Steve Koomar: So, it really does mean some losses for many soybean farmers. And, that will offset a little bit, by really great production. It's going to be pretty much a record year, in terms of crop yield, this year. And, that will offset some of the pain.

Mike Alkin: Mm-hmm (affirmative).

Steve Koomar: But, right now, really, for the most part, there's a lot of dissatisfaction and grumbling. But, not anybody that's really willing to, you know, make significant changes. People are still kind of moving along with the status quo.

I don't see any signs of, you know, this affecting people's votes. But, it may affect whether or not they actually go vote. And, so, I think that it's really a little bit up in the air, how this is going to play out, in these key states.

And-

Mike Alkin: So, how do you think about ... so, let's say they do have ... and, China is playing the long-game. Right? They're ... they have time. They think in terms of 50 and 100 years. They're not worried about tomorrow. And, you know, when you think about informational warfare, if you will, the ... right now, obviously, the Russians have a target on their back, from Congress. You can't find anyone on any ... whether you're watching a Liberal talk shows or, the Conservative talk shows ... excuse me ... right? Russia is the target for everyone, in terms of what's going on, that Americans are suspicious of.

But, you know, the Chinese are going at it. Right? And, the thing

with the Russians, where they were influencing the vote, is what they allegedly did in the November elections, for the Presidential elections. This is just a different tack, where they're trying to influence the hearts and minds of people.

So, if you think about what's going on and you think about the potential for change to occur, and like you said, policies could change ... how do you translate that into market risk?

Steve Koomar: Well, you know, I think that the markets have done very well, under President Trump. There's been a significant amount of de-regulation. You've had a big corporate tax cut. I think that has changed the ... combination of those two policy initiatives has put the US on a somewhat higher growth trajectory, going forward.

And, I think, that is being priced, at least to some extent, in the Stock Market. If you-

Steve Koomar: ... Stock market. If you start to take away the deregulation initiative or if you think there's a risk that that goes away and if you think there's a risk that there's a reversal on some of these tax cuts it will cause stock prices to decline. So there is a risk factor out there. If there is a significant change in government policy related to this election, it would severely damage stock prices. Just the threat of it could cause a correction. So I think about this and I go I think the market is had a nice run. It's a pretty high evaluations. I wouldn't say it's crazy rich, but it's not cheap. So to the extent that I have stocks that are pretty fully valued or have had a really nice run and there's a lot of good news priced in I'm starting to take risk off the table and add to my [inaudible 00:47:08] of cash.

So that if we do get a correction, whether it be because of risk factor which being something related to election fears and the change of government or with being a Fed or could just be there's a lot of good news price in the market and it could go down when enough good news is already been priced in. Whatever it is I think it's good to start raise cash incrementally. I'm not like selling everything. I'm just selling the things that I think are pretty fully valued. That maybe I wouldn't buy at these prices today, but I've been holding because they've been doing well and on a nice path.

Mike Alkin: So, I want to stop you there for a second and maybe we can help investors who are either new to it or they're caught up in the, they've been doing it awhile, but they've seen nine years of rising stock prices. And it's something that gets talked about a lot, but

I want to drill down if we can. You said, what you said was, "If I think they're fairly priced or fully priced right now." And we all use the terminology and I know what that means in my head how I'm thinking about valuation and you know what that means, but regular, ordinary investors who have other jobs and other lives may have a nice portfolio of stocks that have done well. Help them think about how you think about valuation.

For me, I think about it on a, depending on the industry and the company, I might look at the price to earnings ratio and the growth rate and the expected growth rate of that earning stream. I may, if it's a capital intensive industry, I may look at it on an enterprise valued EBDA basis. I may look at it on a free cash flow basis. I look at it at different things and different valuation measures and I'm always looking at what the expectations are for that, whatever stream, I'm looking at. Whether it's at earnings or cashflow. And how that squares with where its been in the past. How do you think, when you're saying somethings fairly priced, help our listener sitting at home who is coming home he's worked a full-day or she's worked a full-day and now it's eight o'clock at night they're sitting down looking at their portfolio saying, "Okay how do I know if it's fully priced?" How do you think about that?

Steve Koomar: Well I look, for instance, I look at a lot of growth stocks. It's exactly the way you describe it. I look at the price earnings ratio and I look and I compare to the expected growth rate going forward. And if you have a stock with a, say a ten price earnings ratio, but it's got an expected growth rate of 15% I think that's an exceptional value. I'm gonna want to own that stock. And that would be kind of about as cheap as you're gonna find in this particular market. And I've bought some stocks with that kind of a profile and they've done well. I think I did something very similar to that with Best Buy and with, one stock was Williams Sonoma which had at the time, something like an APE or eight or ten APE and projected growth rate of double digits and, but now Williams Sonoma has just had some fairly good earnings reports and has triggered a lot of shortcoming and was a lot of short interest in the stock.

It still has over 20% short interest. And it got the prices where the price earnings ratio got to be above 17 and at that price I said, "You know what with the earnings growth rate of maybe 8 to 10% this isn't nearly as attractive as when I first bought it. I think maybe it's a good place to exit the trade. And I exited the trade.

Mike Alkin: So here it is trading at two times it's growth rate which you're

saying, "Okay this is probably pretty stretched here."

Steve Koomar: Yes. Exactly. Exactly. And so that would be an example of a situation that I was, of a recent case where I've exited at the [inaudible 00:51:49] because I thought it had a reasonable valuation on it. I wouldn't say that it's expensive. A 15 or 17 APE is kind of where the market is.

Mike Alkin: Yep.

Steve Koomar: But I could also look at that and I go where's the rest of the market in terms of growth? I don't know. Something around 10% probably right now going forward. I mean it's been 25 the last year, but that's not gonna be sustainable after tax cut rolls off. So it's somewhere around market growth expectation. Maybe a little below market growth expectation now, but it's got a market PE. This isn't that exciting to me anymore. It's a great business. It's gonna be a sustainable business, but I think maybe if we get a correction I might be able to buy it back cheaper. And in any event I got that cash available to deploy on the best possible opportunity out there in whatever industry it happens to be.

Mike Alkin: Well so you just mentioned growth. I mean we've seen earnings growth of mid 20's% which is pretty stunning. And some things I'm wrestling with right now is we see economy 4% plus. Unemployment is at decades lows. Interest rates are low, they're climbing a little bit, but we're not seeing the wage increases that you might expect, but the thing that I'm noticing and, I've talked about this before on the podcast, is prices are going up and when you listen to the conference calls I think this quarter, some of the packaging companies 3M came out and said we're taking pricing up and it seems it's easier now for companies to pass on raw material increases in the form of price increases. And they have been quite reluctant over the last decade, companies have been afraid to move pricing higher for fear of losing customers to competition. Who blinks first. If I raise prices will the others follow?

Now some of the retailers aren't. I think Wal-Mart has kept prices and even dropped prices, but I'm seeing it in some of the manufacturer and I think Pampers, P&G, they had a big price increase. I think it was 5% on Pampers. So if they're taking pricing it's going to the retailer and the retailer can either choose to pass that on to the consumer or to eat it themselves. And on the manufacturing side, on industrial manufacturing, I'm seeing more and more companies talk about what we're more comfortable

taking pricing. Rising prices leads to inflation. Now inflation has been non-existent basically, but it's creeping up a little bit. One of the things I always and I like is an analyst you like to see pricing because it has more of an impact on your operating margin than volume does. Because if I have to make one percentage point more of something I've got to order the raw materials, pay people to make it, palletize it, ship it. There's a lot of stuff involved.

If I take a point of price I'd send my salesman into the corporate headquarters of my customers say price has gone up 1%. That's a lot more flowing down to the margin line. So now the companies are getting comfortable it seems, starting to take pricing. Have you given that much thought and if so do you think that the end markets can absorb price increases or do you think that it's something that companies will try in and dip their toes in and see where it goes? What's your thought on that?

Steve Koomar: I think that's an interesting perspective. Indeed there are industries where pricing power is starting to return. And those industries should perform pretty well if their pricing power is sustained going forward. You know at least until a point where the cost goes up more than they can recoup in terms of their price increases, but I think we're at a stage in terms of tightness of the labor market and economic growth where it's inevitable where you'll see pockets of pricing power and it might expand and become broader across the economy overall in time. I think one of the checks on pricing power for a long long time has been the global economy and the increasing globalization and the ability to outsource to emerging markets where labor costs are extraordinarily low and still ship goods very safely across the oceans. Things that you could have never done on 80 or 100 years ago.

And that has, as that has proliferated and companies have gotten better and better that has put downward pressure on prices. It's increase competition above and beyond what we were accustomed to in prior decades. But even, and I think some of the changes in trade though that we're going to see where you just saw an agreement completed between the U.S. and Mexico and bi-lateral agreements will continue to get done most likely. To be negotiated between the U.S. and Europe. Between the U.S. and Britain. Between the U.S. and China hopefully at some point down the road. And that points to probably every one of those bi-lateral agreements that is negotiated is probably going to reduce competition in U.S. a small bit on the margin.

And so I think what you're looking at in terms of more price and power is something that will pick up steam in the years ahead. And initially that will be good for the companies that are involved and I guess one of those places is steel. Right?

Mike Alkin: Yeah. Yeah.

Steve Koomar: And even without the tariff the pricing power had already started to come back. But with the tariff in the U.S. it solidifies it. I think you're going to get more and more of that and I think in the near term it's very good for those companies. In the long term it's gonna create an interesting dynamic in terms of monetary policy and trying to figure out how to find [inaudible 00:58:57] interest rate policy to keep a lid on inflation and we'll see how that goes. That's something that we're gonna have to watch and learn from. I can't really predict how it'll go.

Mike Alkin: Right. So what do you like right now if I were to ask you Steve is there a stock that or a sector or something that you would think that is, by your criteria, mispriced and is interesting to you? You want to share anything with the listeners?

Steve Koomar: Yeah, I really like investing in 5G. And 5G is the next generation of mobile communications technology that's gonna start coming out in 2019. It's going to, when it's fully operational, which will take a few years to get it fully operational, it's gonna increase capacity of the system by 1000 times. It will increase speeds by between 10 and 100 times. It's going to create so much more usage of the mobile technology infrastructure. Whether it be automation all the way across industry from factories, to automation in cars, to automation in homes, automation of smart cities. All this automation, every one of these different whether it be a streetlight or a traffic signal, that monitors things that are going on in a city. Or devices that you have in your home. Or automated driving functions. All of these things will have communication devices attached to them and so the growth of that is big and the company that has really the best, the lock really on the patents for mobile communication devices is Qualcomm.

And you've seen it it's really started to perform in the last couple of months really since its merger with NXP was dissolved by Chinese authorities basically refusing to approve of the merger. Qualcomm ever since that event, Qualcomm has started to really take off and I think that it's growth rate just based on the growth of 5G as more and more devices other than just mobile phones start to get equipped with communications devices, mobile

communication devices. I think it's going to really play well to Qualcomm growth going down the road.

Mike Alkin: And Qualcomm is a chip maker with an intellectual property portfolio that's probably pretty staggering.

Steve Koomar: It is and yeah, they have, they basically have four high quality mobile communications chips. They have the patents that really, you want to have the best quality product you really have to do business with Qualcomm.

Mike Alkin: Right. Right.

Steve Koomar: They don't make all the chips, but they license. Either license or make most of the chips that are used in high quality devices.

Mike Alkin: I have to tell you I got a direct message from someone on Twitter and he interned with you over the summer and he, I speak to him on Uranium once in a while on Twitter. And he told me that working for you over the summer was just one of the greatest experiences he's had in his young life. So not only are you a great wealth of knowledge on the markets and really good investor, but you apparently are a very good teacher as well. So kudos to that.

Steve Koomar: Well thank you I really enjoyed that experience as well. It was great to have somebody to do some research alongside me. That was fun.

Mike Alkin: That's great. I find for me the, I get a lot of people reach out and say, "Can I have ten minutes of your time." And you know I don't always have the time, but when I do I'm always happy to share 'cause it's really enjoyable to see people who are excited and young and really want to work and learn so it's fun. I can't thank you enough for your time. So tell us about the Vigilante Investor. I love reading it. I think it's one of my must reads so I would suggest it to other people as well. So that they read it as well. So talk to us about how they get a hold of you and what it is and give them a synopsis of it.

Steve Koomar: Yeah. Vigilante Investor newsletter it's almost three years old. At this point two and a half years old and been producing analysis, in-depth analysis on geopolitics and the effect, the critical effect that it has or is having on markets and investment opportunities. And I've been putting out stock selections that go along with that analysis ever since I started two and a half years ago. If you want to learn more about it go to vigilanteinvestor.com. And you can

follow me, you can write to me if you have questions, and you can also follow me on Twitter @viinvestor.

Mike Alkin: It's always a delight speaking with you and I always come away smarter and I really appreciate your time.

Steve Koomar: Mike it's my pleasure. I mean chance to have a conversation with a guru like you I could never pass that up.

Mike Alkin: All right great. We'll have you on in a few months in the Interim. We'll be in touch and it was great speaking Steve.

Steve Koomar: You bet. Thanks Mike.

Mike Alkin: Well I hope you enjoyed the conversation with Steve. I love talking to him. We talk offline and a really fascinating guy and so I always, this second time now he's on the podcast. I'm going to endeavor to have him back a lot more. He's what I like in a newsletter writer. He's low-key. He's not promotional. He's not bombastic. He doesn't make outlandish predictions that have very little chance of coming to the light of day. He's just a good, good thinker and analyst. So a really really smart guy and I enjoyed the conversation. I hope you did too. I just want to let you know that I am the co-founder and chief investment officer at Sachem Cove Partners LLC. And due to industry regulations, I don't discuss any of Sachem Cove's funds on this podcast and all the opinions expressed by the podcast participants are solely their own opinions and do not necessarily reflect the opinion of Sachem Cove or its affiliates.

And this podcast is for informational purposes only and it should not be relied upon as the basis for investment decisions. Clients and or affiliates of Sachem Cove Partners may maintain positions in securities discussed on this podcast. We'll be back next week and I haven't decided yet who we're gonna have on, but hopefully we'll get a good guest for you and in the interim. Hope you have a great week and last week of summer. I know my kids aren't that excited about it, but hey you know that's life. Right? All good. Have a great week and we'll talk next week. Thanks.

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