6.30.11

This is the second in what will be a long running series of Gold Coast Wealth Management's commentary on the financial markets. These commentaries will not have a formal schedule and will be written when events or market related topics strike us as important. Today's commentary concerns what we view as an inflection point for the financial markets.

Obama "Goes to School" on a 4 Year Old Putt

When playing golf, by rule the person furthest from hole shoots first. When you are on the green there are times where this leads to a distinct advantage. That occurs when your fellow golfer has a very similar shot but is just a bit further away. In these circumstances you can watch how the ball rolls and garner much information on how to line up your own putt. In golfer parlance you 'go to school' on their putt. We are horrible putters at Gold Coast, but our percentage increases dramatically on those rare occasions when we are allowed to go to school on our playing partner's putt.

What does this have to do with anything?

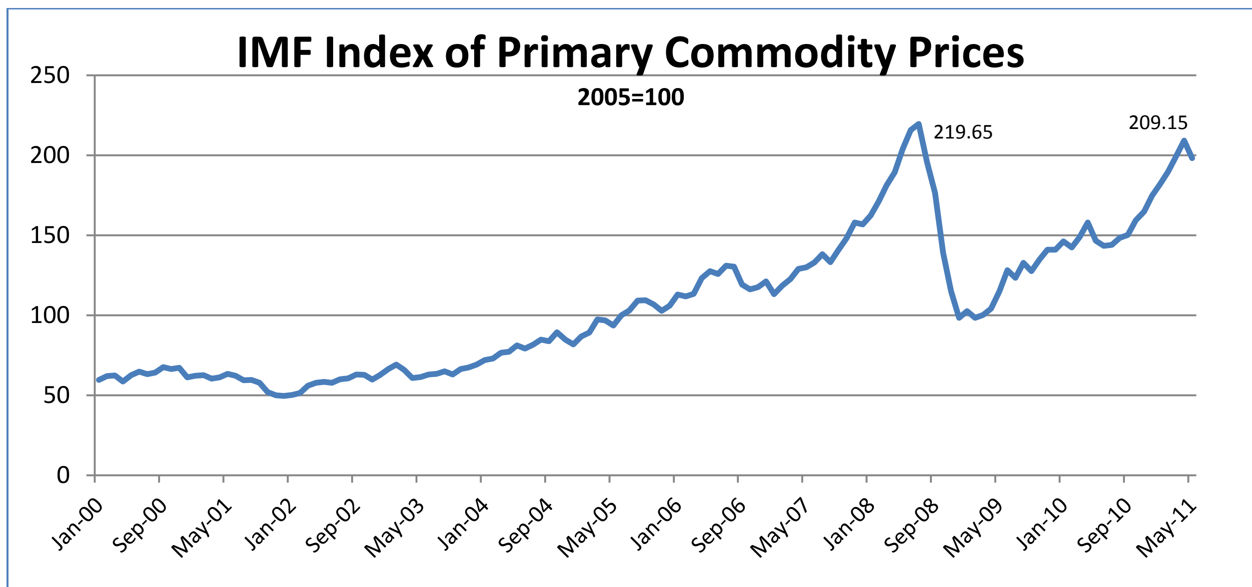
From a purely economic perspective, our 43rd President, George Walker Bush, and his political party were faced with a very difficult putt as they prepared to go on the campaign trail in the second half of 2007 and into the early part of 2008. Different quarters of the financial markets were sending unusual signals and in the process were affecting different demographics in what turned out to be ominous ways. The U.S equity markets, using the S&P 500 as a proxy, had a very good 2006, and were gently climbing into the second half of 2007. There was a 2 month hiccup in June-July of 2007 but then a nice rebound into the fall; and after everything was tallied 2007 went into the books as a positive year for equity markets. For equity market investors a very nice 24 month period. If the correlation between equity market investors and voter demographics was 100%, there is a good chance the GOP remains in control of the White House.

But our financial markets do not consist solely of equities. Unfortunately for the incumbent party there was also a rapidly deteriorating housing market and booming commodity markets. Commodity markets where such essentials as oil, gas, grains, protein, woods, and metals trade. Markets where violent price appreciation from 2006 through mid-2008 affected a different demographic of people in a much different way. Unfortunately for President Bush and his party, the rise in commodity prices sent people to the streets to protest and journalists to their keyboards to type. Using very simple deduction skills, it seems commodity markets trumped

equity markets. In our view, the simple math is that more people buy gas than own stocks. More people buy food than own stocks. Ditto that for owning a house or apartment versus stocks.

As Bush and his party were lining up their putt, they didn't know it at the time, but they had the future 44th President of the United States looking over their shoulder. And now 4 years later, the 44th President has almost the exact same putt. Equity markets have rebounded very smartly over the past 2 years and commodity markets are off and running again. Also similar to 2007-08 the housing market is still suffering. But the cure for housing is out of Obama's control; in our view the cure is and always has been more a function of time than policy. With rates where they are and 2 rounds of housing focused stimulus already in the books, an effort was made and it fell short. But, it seems Obama does think he can affect another market, a market that acutely affects the very demographic that swept Obama into the White House. A demographic that does not feel it has directly benefitted from any of the government or Fed driven largesse of the past 2 years. This demographic represents the middle and lower class voters, people who feel they have not benefitted from the recent efforts to stimulate the economy.

If you look to the chart below, you will see that commodity prices have crept back to the levels of 2008. The media is starting to take notice of citizen responses. On the editorial page of the Wall Street Journal (Of Wealth and Incomes - Why Americans are so unhappy with this economic recovery, 2011) recently, middle class soccer moms and suburban families were mentioned as casualties of a reckless monetary policy that has driven fuel and other commodity prices back to hurtful levels. The WSJ showing empathy for middle class soccer moms? We immediately went out and added to the commodity surge by stocking up on grains, water, and other non-perishables because certainly the world is ending.



1. Data compiled by the Commodities Team in the IMF Research Department, 2011
2. Broad category weightings used to compile index based on 2002-2004 average world export earnings: Non Fuel 36.9% (Edibles 18.5%, Industrial inputs 18.4%) Fuel 63.1%
3. Deflated by U.S. CPI.

Obama Response

On June 23rd, President Obama did something that no other President has done in the past 36 years, he coordinated a release from the US Strategic reserve without it being necessitated by a war or some type of natural (hurricane) or man-made disaster (shipping channel disruption, federal deficit reduction plan in 1996-97). We are politically agnostic at Gold Coast, but we favor government policy that allows our portfolio managers to make informed decisions with minimal regulatory uncertainty. When there is uncertainty, an ability to handicap government policy becomes important. With that in mind, on June 23rd we were given a much needed jolt, or reminder in the form of a blunt stick to the head that the Presidential campaigning season is under way in the United States.

To us at Gold Coast, this is a campaign season where it seems anything and everything is now the table. In our first letter we mentioned our belief that the 3rd year of a Presidential Cycle provides an underlying bid to equity markets. The qualitative reason behind this theory is that the 3rd year starts the campaign season for the sitting President (or his party). In order to stimulate the populace the President (and his political party) will support policies that stimulate equity market growth. The table below shows the S&P 500 returns in the 3rd year of a Presidential cycle going back to 1951.

<u>S&P 500 Returns, 3rd Year in Presidential Cycle</u>

2007	5.49%
2003	28.68%
1999	21.04%
1995	37.58%
1991	30.47%
1987	5.25%
1983	22.56%
1979	18.44%
1975	37.20%
1971	14.31%
1967	23.98%
1963	22.80%
1959	11.96%
1955	31.56%
1951	24.02

Once again, while it is helpful to recap, that's not what we're paid to do. We are paid to look forward and make decisions based on the data that we feel important. And at this point in time there are very few data points as important as the direction of the political winds. More so than any other time in recent history, the government has a firm grip on the financial markets through regulation, direct ownership, and the public's growing distrust of Wall Street. On top of that, we have a President on the ropes, but a President who just threw a haymaker directed at the speculators in the oil and gas markets. If he's willing to intervene in one market to give some relief to his constituents, what other markets will he enter next, and what form will it take?

We fear any positive momentum from the first intervention could be used as a springboard into other industries and markets. As such, we remain cautious in taking our equity exposure. Our thoughts go out to any company or industry that can be perceived as taking advantage of the middle or lower class citizens in this country. In addition to the oil companies that were just affected, banks, credit card companies, and speculators in other consumer commodities should be on watch.

June Market Update

June was a tough month for equity markets but our large account strategy finished slightly positive and our small account strategy was slightly negative as of this writing. With the S&P 500 down 1.67% , the Russell 2000 down 2.4%, middle and long dated Treasuries down from 1% to 3.5% depending on the index, gold down 2.3+%, Dow Jones Europe Index down 2.50%, there were not a lot of places to hide. In the middle of June we were very heartened to see our portfolios' holding up in the midst of a large equity market selloff. It gave us great pleasure to see that our prudent diligence in creating portfolios, designed first to protect capital and then to effectively compound it, produce negligible draw downs during that period.

We still prefer to get exposure in equities through companies with strong capital structures that are supported by a strong and historically increasing dividend, or ones that do not have to rely on a strong underlying economy to generate solid financial performance. We also are closely watching our fixed income managers in the total return space. Treasuries staged a violent sell off to end the month of June, and whether or not this is the making of a new trend becomes very important to our allocation, the economy, and government policy going forward.

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The S&P 500 Index is generally considered to be representative of the U.S. large capitalization stock market as a whole. The Index is a capitalization -weighted index of 500 designated, commonly traded stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of those stocks. The Index is unmanaged, is not available for direct investment, and is not subject to management fees, transaction costs or other types of expenses. The Index is trademarked by a third party index provider, has been licensed for use by Gold Coast [confirm that this is true], and is used solely for comparative purposes herein. The index provider is not affiliated with Gold Coast and does not endorse, sponsor, sell or promote Gold Coast's investment strategies, and makes no representation regarding the

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