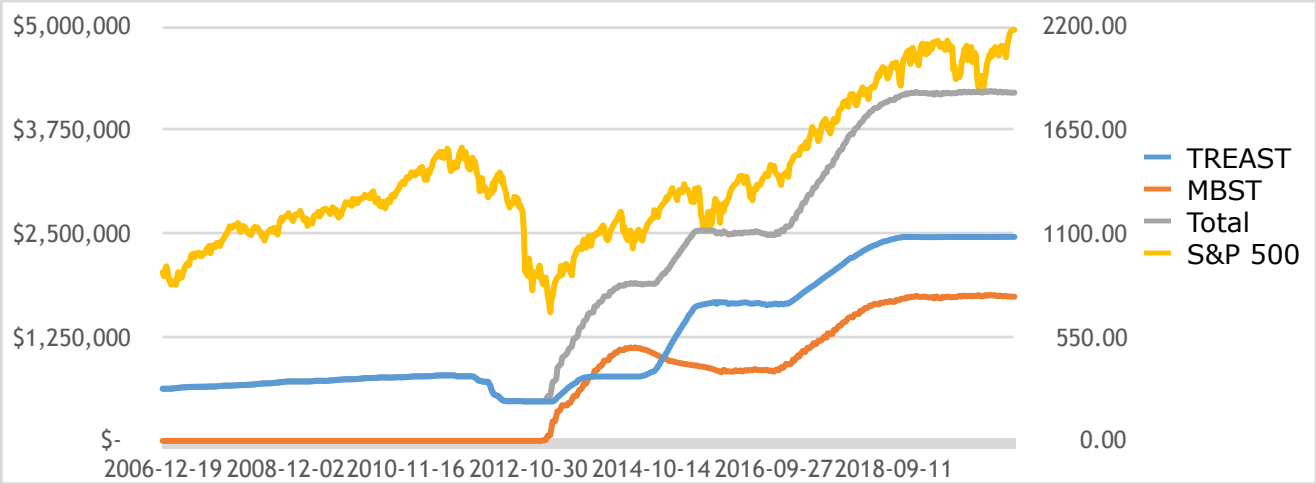
Camelot Portfolios
Talking Points
August 23, 2016

How effective is the Fed on the Economy?

As we enter our 7th bull market year, people are wondering when this run will end. This has been one of the longest sustained growth period in the United States as measured by the S&P500 (see graph below), but unlike the post war switch in the late 40's/ early 50's and the growth in tech in the 90's, the growth does not appear to be organic. Since 2008, the Federal Reserve has bought $1.97 trillion of US Treasuries and $1.741 trillion of mortgage backed securities. This is well known as quantitative easing ("QE"), and this seems to have strong correlation to the growth in the US economy. Dating back from December of 2002 to today, the correlation between the balance sheet and the S&P 500 is .88. Although this is only one variable to consider, it seems to be statistically significant, and shows the power the Fed has on the American economy.



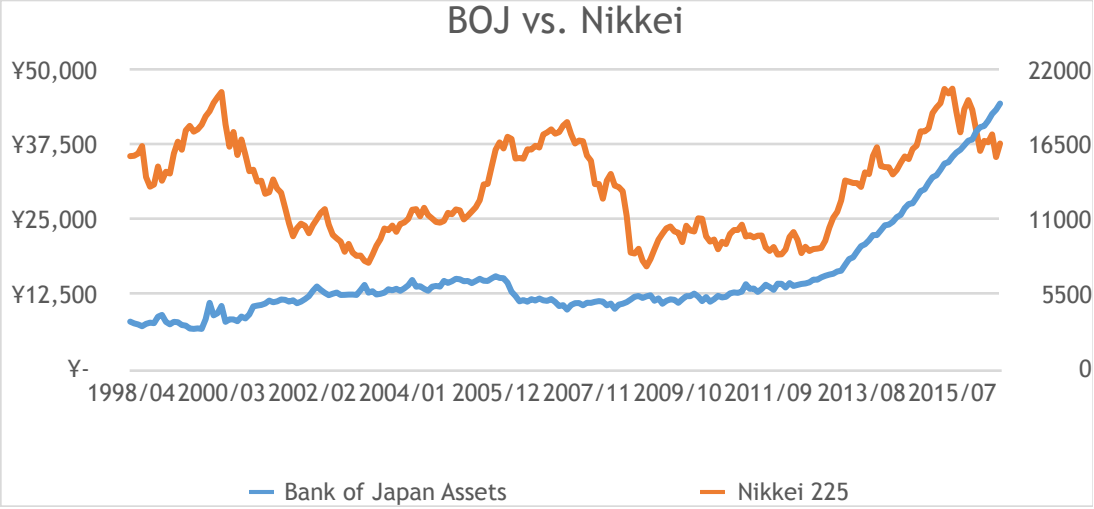
Source: FRED, S&P

Quantitative easing may have worked in the United States, but other major developed nations have not had the same economic effects. From the 1970 to 1990, Japan was the envy of the modern economic world. They had the highest productivity and their real-GDP was growing over 5%/year, but there was a slowdown in Japan's economy in the early 90's. Fast forward to today, Japan is a highly developed nation, but it has seen stagnating growth with substantial amounts of debt. Japan refers to quantitative easing as Abenomics - named after the Prime Minister Shinzō Abe. Abenomics has had a similar effect for the economy, yet the success is not as strong as the United States.

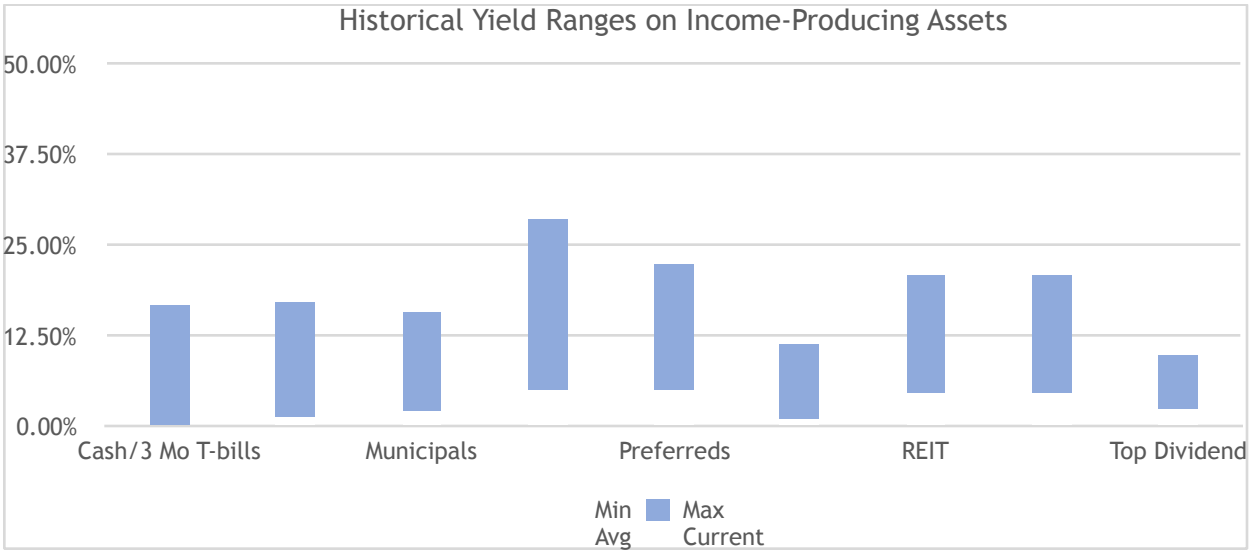
Sources: Bloomberg, Bank of Japan

There are a multitude of other variables to check on a macroeconomic level, but it is interesting to look at a country's monetary policy.

Current Distribution Yield Update



It has been a couple of years since we have updated income yield based on asset classes. Most of the major asset classes are near their historical lows. This is due in part to the low interest rate environment. Also, dividend yields have been pushed down because of inflated market prices on common/preferred stock. One exception to distribution yields is MLP's. This asset class has had a significant pull back in market prices, yet distributions have stayed constant even after a pullback in oil. Each asset class poses different levels of risk, and our investment team is diligently keeping our eyes on opportunities within each asset class.



Sources: FRED, Morningstar Direct

The Bubble Wrapped in Dragon Skin

There is no denying China has seen exceptional economic growth. Their economy has changed from a centrally planned nightmare, which killed over 50 million of its own citizens*, to the second largest economy. Their government has meticulously balanced between private enterprise and state owned, and the closer we look at the monumental infrastructure growth, the greater the concern our team has in investing.

* Source: http://www.heritage.org/research/commentary/2010/02/the-legacy-of-mao-zedong-is-mass-murder

In the past, real estate/infrastructure bubbles have significantly impacted economies worldwide negatively time and time again. Examples of this are widespread - Southeast Asia 1996-97, Europe 2007-08, and United States 2006-08. China uses a similar approach to Thailand in the 90's for fixing their currency, but the difference is the size of the war chest. Thailand had foreign reserves close to $37.2 billion in 1996, and this dwindled to below their debt obligations in 1997 (Moreno). The central bank was forced to float the currency and the value of the currency plummeted by 40.2% (Economics).

How this relates to the Chinese central bank is their foreign currency reserves were close to $4 trillion, but have fallen 20% in 15 months (Economics). China does have a formidable war chest with less debt obligations overall, but the middle kingdom may not be able to support its currency forever.

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Disclosure