

High Desert Investment Advisory

Monday, February 15, 2016

INVESTMENT ADVISORY

THE COLLAPSING ENERGY MARKET AND ITS IMPACT UPON SOME OF OUR BOND INVESTMENTS.

Over the past 12-18 months, there has been a sharp fall in the price per barrel of oil. This decline in oil prices affects more than just the oil and gas industry in the US. It is a global destruction of economic value that will have lasting effects in unexpected segments of the US economy. This destruction of the value of assets will not be uniform across our country, and therefore, it will have varying impact depending upon the area of the country being considered. In terms of the US Gross Domestic Product (GDP), there is a significant impact when smoothed throughout all areas of the Country. Those areas that produce oil, gas, and coal will suffer the most. For the remainder of the Country, large benefits will accrue from lower costs of energy. However, unexpected results may well occur due to the destruction of wealth across the world. This wealth destruction will impact the US economy directly. If you would like to read a particularly good analysis of this subject, I suggest that you read John Mauldin's article titled " Thoughts from the Frontline - \$100 Trillion Up in Smoke" (http://ggc-mauldin-images.s3.amazonaws.com/uploads/pdf/160206_TFTF.pdf).

It is too easy to succumb to the fear of the unknown unknowns that are lurking on the horizon just waiting for the time when the unexpected happens. It is necessary for us to see a bigger picture, while at the same time, preparing for such a "black swan" event to occur. That preparation must include diversification of investments, anticipation of long term changes and trends, a predictive model, an upset model, and the courage to make decisions and choices. (Sounds easy, doesn't it.....?)

This is one of those times when decisions are more difficult, and the choices are less clear.

As investment advisors, we have made these recommendations:

- We have recommended continuing to add money to equities investments, as the stock market retraces some of the gains of the past few years.
- We have also chosen to invest in fixed income bonds which have higher yields than generally available in the market place (4% to 6% interest income yields). Higher yields mean greater risk.
- Diversification of ownership in fixed income bond assets by corporate name is the recommended strategy, investing a maximum of 2% of the total portfolio value in any single investment and no more than 5% in any single company name.

- Diversification and balance in our risk profile of fixed income assets - as well as in the allocation of equities asset investments.

In the coming few days, we will recommend - to many you - the sale of some of your bond investments, in order to upgrade the diversification of bond assets. Analysis of our various investment portfolios indicates that there is an increasing focus on financial investments, and a current higher concentration in energy investments than is desirable.

In Summary of our new recommendations:

1. There are four energy companies - whose bonds we own - that are likely to fail. For these bonds, there is no option but to wait for the companies to resolve their issues. In all likelihood we will lose our investment in them.

ENERGY XXI GULF COAST INC SENIOR NOTE CALLABLE M/W, RATE: 7.75

SWIFT ENERGY CO *IN DEFAULT* SR NOTE CLBL M/W, RATE: 7.875

COMSTOCK RESOURCES INC SENIOR NOTE CALLABLE, RATE: 7.75

PENN VIRGINIA CORP SENIOR NOTE CALLABLE M/W, RATE: 7.25

2. There are two companies we have in our portfolios that have a high probably of failure; however, they appear to be dealing with their financial issues in such a way as to indicate that they will survive and eventually repay our investment.

PEABODY ENERGY CORP SENIOR NOTE M/W, RATE: 6.25

CLIFFS NATURAL RESOURCES INC SENIOR NOTE M/W, RATE: 5.9

3. There are five additional companies, all energy related, which have very high levels of debt, and are suffering from greatly reduced revenues. I recommend that we attempt to sell these bonds to other buyers who have greater risk tolerance than I wish to accept.

ATWOOD OCEANICS INC SENIOR NOTE CALLABLE M/W, RATE: 6.5

CHESAPEAKE ENERGY CORP SENIOR NOTE CALLABLE M/W, RATE: 5.375

CLAYTON WILLIAMS ENERGY INC SENIOR NOTE CALLABLE M/W, RATE: 7.75

CONSOL ENERGY INC SENIOR NOTE CALLABLE M/W, RATE: 8.25

TRANSOCEAN INC SENIOR NOTE M/W, RATE: 6.0

Percent of High Desert Investment assets held (est.):

Percent in energy related assets:	2% of total High Desert portfolio
Percent in financial assets:	5% of total High Desert portfolio
Percent in govt. gt'd & whole loan assets:	30% of total High Desert portfolio