HIGH DESERT INVESTMENT ADVISORS
ANNUAL MEETING, November 17, 2016
PORTFOLIO ANALYSIS AND MARKET ANALYSIS

PORTFOLIO MANAGEMENT - SUMMARY OVERVIEW

- Create dependable interest and dividend income.
- Carefully manage the fixed income investment selections in order to avoid losses due to bankruptcy of one or more of our investments.
- With interest rates rapidly rising, there is considerable volatility in the fixed income market. This has particularly affected the longer maturity bonds and the preferred stock assets. Preferred stock investments are the most volatile under these conditions. In this kind of environment, it is necessary to focus on the strength of the generated cash flows and to allow for some losses in market value of the total portfolio.
- Maintain current yields, in today's markets, at an average yield of 5.5% or greater (5% net of fees).
- Diversify all investment names so that if there is a problem specific to a particular company, any losses that occur will not materially affect the total investment portfolio.
- Continue to grow the total amount of cash flow generated from interest and dividend income.
- Generate growth in the total portfolio value by investing in the stock market.
- Use our investment models to determine the timing of our upset sale of stocks, should the market quickly turn ugly. There will be times when it is appropriate to hold "zero" investment in stocks and 100% in fixed income and cash.
- Manage portfolio volatility (Risk) very carefully.

  Risk/Volatility is defined by the change in total portfolio value, compared to the S&P 500 Index, and defined as the "beta" of volatility.

  beta =(The percent change in S&P Index) divided by (The percent change in the value of the total portfolio)

Equities vs. Fixed income Portfolio Investment Allocation

70:30 allocation mix - beta = 0.675 (est.)
50:50 allocation mix - beta = 0.450 (est.)

A GENERAL OVERVIEW OF THE STOCK MARKET AND THE U.S. ECONOMY

1. It appears that there will be a market downturn beginning at year end and into the 1st quarter 2017
2. A rally is projected to begin 11/10/16 and should continue until the end of year 2016
3. The adjusted Monetary Base has shrunk continuously since January, 2016, and recently has begun to fall sharply faster - since late September.
   - The **Adjusted Monetary Base** is the sum of currency (including coin) in circulation outside Federal Reserve Banks and the U.S. Treasury, plus deposits held by depository institutions at Federal Reserve Banks.
   - The adjusted monetary base equals the sum of the monetary source base and an appropriate RAM (The reserve adjustment magnitude) adjustment

- Statutory reserve requirement ratios within a given structure of reserve requirements (where the structure defines the types of deposits that are reserves, perhaps by class or type of depository institution), are conditional on an assumed model of depository institutions' demand for base money.

4. M-1 and M-2 are showing interestingly positive growth curves (even as the Federal Reserve reduces the Monetary Base).
5. Commercial paper borrowing has fallen pretty consistently during all of 2016, except for a brief period between August and September 1.
6. Going back to year 2010, Commercial paper grew rapidly as we came out of the Great Recession.
7. Since the start of year 2015, Commercial Paper has remained flat. That says that there is a lesser need for outside operating capital in business. Operating capital is being generated out of cash flows.
8. Commercial and Industrial Loans grew steadily from 2005 until 2009.
9. Since mid-year 2011, Commercial and Industrial Loans have begun to grow again, at a pretty good rate of growth, indicating that companies are investing in the future, despite all of the difficulties. The growth rate is relatively slow, but seems to be increasing within the past 12 months.
10. Increasing the Adjusted Monetary Base has clearly not worked to expand the economy, during the period from late 2008 to 2016. This is probably more or less true, and interestingly, we are getting better results now that the Monetary Base is shrinking and is returning to a somewhat normal Federal Reserve management style.

LOOKING INTO THE FUTURE

1. The future is very clouded today because of the political consequences that may occur from the Presidential election. This suggests that now is a time when it is appropriate to reduce volatility.
2. Risk is a function of volatility. Volatility can be reduced by increasing the proportion of fixed income investments versus equities.
3. Virtually all of our accounts have a minimum of 50% fixed income, with quite a few at 100% fixed income.
4. By the year end, most of our accounts will have between a 5% and 10% growth for the year.
5. The real issue as you go into retirement is to build a lifetime stream of income: pensions, social security, annuity income, income from taxable and retirement accounts, earned income.
6. Interest rates will likely increase during the coming 3-5 years. This year, the 10 year Treasury generally provided about 1.5% interest rate. Within the past 2 weeks, that interest rate has risen from about 1.7% to about 2.14%. This is quite a large move in such a short period of time - about 25%. (* today the rate is over 2.30%)
7. Expect the value of your fixed income account to fall as interest rates rise. As an estimate, assume that for a 1% change in rates, the value of your fixed income portfolio will be reduced by 1/2%.
8. It is not the value of your fixed income portfolio that is important. What is important is the interest and dividend income that is generated by your portfolio. Equities are designed to create growth and fixed income assets provide your cash flow - from interest and dividends (bonds, mortgage backed bonds, preferred stock, REITs, etc.)
9. What are you able to get in the way of yield today? 0%, 1/2%, 1%, 3%? (Treasuries, banks, insurance companies)
10. Retirees need a minimum net of 4% yield on their investment portfolio to allow it to survive in retirement.
11. At age 65, there is a 25% probability that you or your spouse will live to be age 100.
12. The bottom line is that, in retirement, it is most important to have a stable and continuous money flow to the end of your life. This means that stability - low volatility - in your investment portfolio is more important than trying to get higher risk growth from equity investments.

WHAT DO OUR MODELS SAY ABOUT THE FUTURE OF THE STOCK MARKET?

1. The primary technical model is telling us that we should continue to be invested in equities, even after this long period of virtually no growth in the stock market - since October, 2014.
2. The expectation is that we should get a significant downside move in the stock market sooner rather than later.
3. This expectation is modified by the fundamentals of the market place, the US economy, and the Global economy. The fundamentals suggest that the US economy is growing internally, and is building momentum in its growth.
4. The problem with the fundamentals is, of course, the Presidential Election.
5. Historically, we would have sold out of equities in late August, 2015, and again in early January, 2016. Then we would have bought equities in early December, 2015, and again in mid April, 2016. This is all based on our technical model. During those periods, the fundamental model told us that we should not be selling.

NORMALCY.....

1. If these were normal times, we could expect a good long term stock market rally, not with a lot of strength, but a slow and steady growth curve that would provide another 5-8 years of growth and continuing improvement in the US and Global economies. The Fed is moving back to a policy of normalcy; interest rates are rising slowly; interest rates are low; the monetary system is beginning to look familiar once again - the charts; businesses are seeing creative opportunities, and finding ways to expand, in spite of government interference and oversight; and technology, including medical research, is leading us into a much better and longer life span.
2. That being said, since the Presidential Election, the predicted variables are no longer predictable. We are entering into a period where the "unknown unknowns" are the stress of the day!
3. My guess is that it will be 6 months to a year before we will have any real sense as to what the future holds in store for us.
4. We are going to have to wait for the future to unfold itself and make it clear as to what it holds for us. In the meantime, we must be patient.
5. For our investment strategy, what all of this means is that we must do just what we have been doing for quite some time.
    - Create dependable interest and dividend income.
    - Carefully manage the fixed income investment selections in order to avoid losses due to bankruptcy of one or more of our investments.
    - Maintain current yields, in today's markets, at an average yield of 5.5% or greater.
    - With interest rates rapidly rising, there is considerable volatility in the fixed income market. This has particularly affected the longer maturity bonds and the preferred stock assets. Preferred stock investments are the most volatile under these conditions. In this kind of environment, it is necessary to focus on the strength of the generated cash flows and to allow for some losses in market value of the total portfolio.
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