CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 6, 2011

The Spread of the Jasmine Revolts…
...and Risks from Rising Oil Prices

Revolution and civil war in North Africa and the nascent revolts on the Arabian peninsula have introduced a new force into world economies and financial markets. The Libyan war has cut its oil production already.
What cannot be known is whether these revolts will spread and cause still more havoc.

This letter outlines Core's investment approach to these problems. To date, war and rising oil prices have not hurt financial markets gravely. It is not sensible, however, to assume that the relaxed atmosphere in financial markets will continue.

For the first time in nearly a decade, the geopolitical situation has an enormous influence on investment markets. The uprisings across northern Africa and the Arabian peninsula, focused now on the savage fighting in Libya, have roiled global oil markets. It is impossible to know what comes next and what will be the shape of things in the region in a year. Because the region provides 40 percent of the world's oil production and 57 percent of its reserves, the spreading of these 'Jasmine' revolts to other countries may disrupt oil production and cause further sharp price increases. It goes without saying that higher oil prices and disruptions in supply can be very damaging for the world's economy and for financial markets. Already, since uprisings began in Tunisia in January, crude oil prices have risen by about 20 percent.

Analyses of potential problems arising from damage to oil fields in Libya or their shut down are somewhat encouraging. It appears that there is sufficient excess capacity to make up for lost Libyan oil and that the Saudis are willing to pump more and supply the needed oil. Well and good. However, what we do not know and what we cannot know is whether other oil production, in Algeria or Saudi Arabia, for example, may be cut as and if the uprisings continue to spread. We cannot know whether oil shipments from the Persian Gulf through the Strait of Hormuz, through which 20 percent of the world's oil shipments flow, may be blocked.

We can be quite sure, however, that if oil production and/or oil shipments are cut in a meaningful way, oil prices will rise sharply. How to protect investment capital in this situation is a question Core faces. Here is our approach: If oil prices rise sharply--and it is worth thinking about oil prices above $150 per barrel, from the present $104--some investments assets will probably rise in price, others will fall. Our approach is to reduce the vulnerable positions and to increase investment the others.

Since the Tunisian revolt began, we have cut our investments in equity markets of various emerging economies (e.g., Malaysia, Indonesia and Brazil) and in some sectors of the US and European stock markets, while adding to investments in oil-related, infrastructure and industrial equities. Our investments in gold, silver, agricultural commodities and the Swiss franc all have appreciated, some dramatically, so far this year. We expect that these investments will rise further if the revolts become more intense in the Arabian peninsula and elsewhere in North Africa.

By

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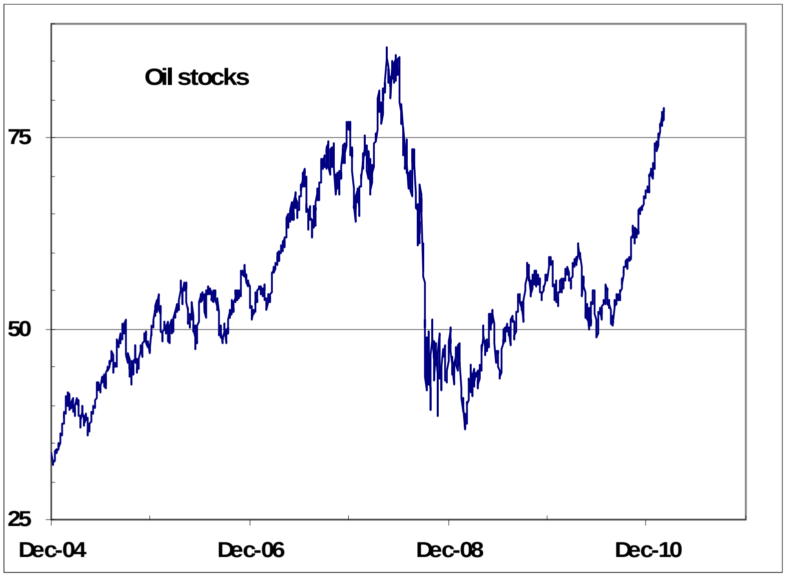
The investment environment now may be seen as one supported by very favorable economic and monetary policy influences, but under the dark cloud of revolution and civil war in a terribly important part of the world. About 20 percent of Core's portfolios are comprised of investments that are fairly direct hedges against a sharp rise in oil prices. These positions should strengthen with oil prices at these levels and go higher still if oil rises further. In addition, we hold large bond investments, largely immune to these Middle Eastern disturbances. We maintain investments in assets that should continue to appreciate in this favorable monetary and economic environment. On Friday, we had a more favorable report on US employment, especially welcome after the months of very week job reports. The report does not prove that strong hiring and wage growth are now underway in the United States, but it is consistent with the other moderately strong economic reports.



The chart above shows the prices of our investment in oil-related stocks. Recall that crude oil ran all the way up to $140 per barrel in 2008, even as the recession was beginning and the financial crisis was exploding. Demand for oil, its price, and the prices of oil stocks then collapsed--as did almost everything. As economies have recovered and oil demand from the developing Asian economies soared, oil prices and oil company stocks have risen. Add war and fear to this rising demand, and we have a volatile situation.

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Tax reports. Remember that we can provide useful information to you and your tax preparer about capital gains, dividends and interest income. Get in touch with us and we will send relevant information to you promptly. As you know, Schwab, as custodian for your investment accounts, is required to provide to you and to the IRS the various reports relating to investment income. Among these this year is a form K-1 for our investment in the exchange-traded fund ("ETF") through which we invest in agricultural commodities, the PowerShares DB Agriculture fund, symbol dba. This ETF is taxed as a partnership; hence, we shareholders of DBA receive a K-1 from the fund. The K-1 includes instructions about how to report this information on a federal tax return. (Of course, all the tax reports, including this one, are irrelevant to IRAs, 401Ks and other qualified retirement plans.) Your tax preparer is likely to be quite familiar with K-1s, although our investment activity is rarely in funds that are formed as partnerships. Contact us, if you have questions.

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