KLCM Advisors, Inc.

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Point of View

Perspective is sometimes defined as the faculty of seeing all relevant data in a meaningful relationship. Today we live in a world where in most aspects of our lives, perspective is no longer valued. The relevance of history and a deeper understanding of issues has given way to the desire to procure current data. We appear to be consumed by the most recent data point, the next poll, tweet, e-mail, economic report, fed statement, earnings report, etc. This obsession with timely data and "instant analysis" has become the predominant driver of short term pricing in financial markets.

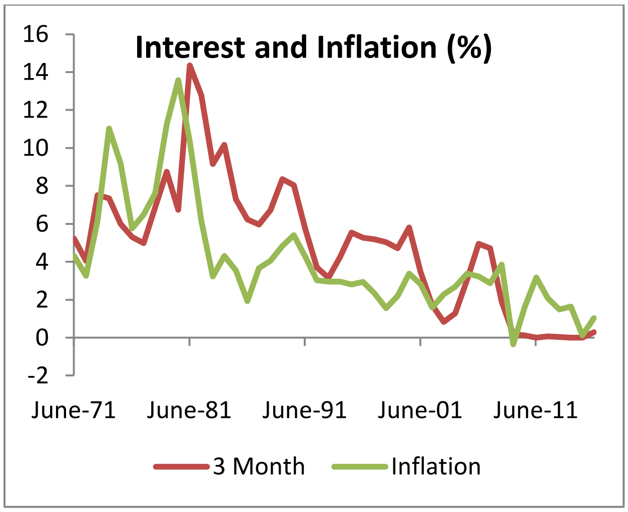
Our investment and business life has spanned 35 years; the scope of change and, more importantly, the pace of change have made the investment landscape almost unrecognizable from 1981. In the past, inflation, high interest rates, and low stock valuations were the norm. Today, we ponder negative returns on sovereign debt across the world. Until 2008, low risk assets provided small, but real returns for savers and investors; that changed as central banks around the world flooded markets with liquidity to stem the financial crisis and jump start economic growth. The persistence of these policies, eight years after the crisis, has profound effects on return structures in all asset classes around the world.

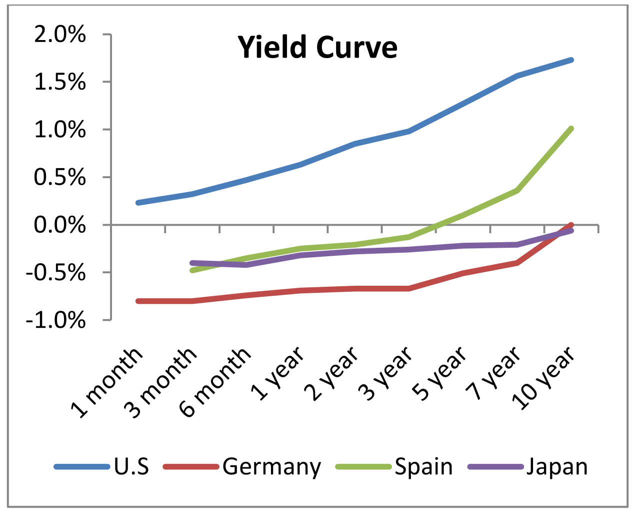
What appears to be missing in today's discussion and decision making is the perspective that informs longer-term judgment. Why? Perhaps it is the inability to easily measure these thoughts in a quantitative model that has relegated perspective and judgment to the back burner. Maybe it is a function of long economic cycles that are being "managed" through fiscal and monetary policy. It may simply be the recent relative underperformance of active managers versus passive investments that has made perspective irrelevant. Or is it that many are unwilling to confront the long term issues and challenges that these post crisis policies are creating? Regardless, policymakers must regain our focus on the long term issues that drive economic growth.

An example of the investment conundrum we are now experiencing is the relationship between interest rates and inflation. Historically, short term treasury rates traded above inflation rates. That relationship, which is key to asset pricing across all financial assets has been disconnected since 2009. This is not how economic theory and, more importantly, how financial relationships in the real world are supposed to work. If this basic building block is no longer a core tenet of investing capital, many of the relationships we use to value securities are being built on sand.

Another dislocation is the global interest rate structure. While we are perplexed by low U.S. rates, the ambiguity of rates around the world is stunning. Countries with greater economic uncertainty have historically paid higher rates to attract capital. As we write, Spain's current 10 year rate is 1.00% and the U.S. government 10 year note yields 1.75%. This makes no sense when U.S. unemployment is 5% and debt to GDP is 73%, while Spain's numbers are 19% and 101% respectively.

It is this type of unnatural and artificial pricing of assets that give us pause, not whether the Fed will raise rates in November or December.





We have listened to and consulted with experts on all of these topics, hosted robust conversations with professionals and our peers, but have achieved limited satisfaction with the answers posited. It is this endless cascade of uncertain answers to the key fundamental issues of investing that keeps us asking: what don't we see or understand; what can go wrong; how do I limit my risk? While there is no consensus view or answers to these questions, there is near unanimity in that these are the key variables to solve if one is to win the investment challenge posed today. It is also universally noted that most investors are not asking these questions; instead, they are focused on the data point dujour in making investment decisions. We live in a market and world where perspective is lacking.

It is with this backdrop and the humility that comes with the scars of a long investment career that informs our judgment today. When we ask what is wrong with these pictures, and cannot get any confidence that we and others we respect can accurately answer these questions, we will error on the side of caution. This caution is manifested in our portfolio construction; keeping fixed income portfolios relatively short, buying large cap, higher quality, dividend yielding equities, and also holding some cash. Investing capital for others, with the viewpoint of a fiduciary is not undertaken lightly and at times it must focus on capital preservation.

Perhaps it is this perspective, and knowledge of one's own limitations on predicting the future in a complex and unsettled world that guides our judgement and our current cautious viewpoint!