KEATING INVESTMENT COUNSELORS, INC.
REGISTERED INVESTMENT ADVISOR FOR INDIVIDUALS, RETIREMENT PLANS, TRUSTS AND FOUNDATIONS

Portfolio Update
Mid-August 2019

Dear Clients,

We recently completed a series of trades as we strive to reduce risk across client portfolios. As discussed in our recent Investment Strategies, we believe we are nearing the end of the current credit cycle and, therefore, business cycle. At the end of a credit cycle, it becomes difficult to borrow additional funds which pushes risky borrowers into default. These debts are then restructured, and the process starts anew. Typically, there is a drop in economic activity when troubled borrowers become stressed, resulting in an economic recession.

The last credit cycle was centered around the U.S. housing market with devastating results. These debts directly impacted U.S. households as many consumers had their life savings wiped away. Additionally, the losses from these bad debts fell onto the global banking system which was unprepared for the storm. In combination, this triggered the sharpest decline in economic activity since the Great Depression.

The current expansion of credit has gone toward governments and corporations. The restructuring of these debts should be much more orderly and shouldn't trigger significant issues within the <u>U.S. banking system</u>. There will be companies that go out of business and many foreign governments will need to "tighten their belts." Although there are U.S. companies that have overborrowed, the overall economy is not likely to suffer a significant and sustained decline in activity as competitors will quickly replace any troubled businesses. <u>The important difference in the current cycle is where the losses from these bad debts will accumulate. As mentioned above, banks absorbed most of the bad debts from the housing meltdown. This time around, investors extended credit to unworthy borrowers as they struggled to generate income over the past decade</u>. There are many large public pension plans, insurance companies, and retirees who lent money to entities that have little ability to repay their debts. As these investors come to this realization, asset markets are likely to become very volatile. <u>This is what concerns us and is reflected in our increasingly conservative positioning.</u>

While many investors will view this scenario with trepidation, the upcoming volatility will also create the best investment opportunities we have seen in 5+ years. For those investors with cash ready and available, there should be very attractively priced stocks and bonds to seize as others are forced to sell assets. Therefore, we have allocated roughly 20% (+/- 5%) of client portfolios towards cash/treasuries. To further reduce risk, we have also established large positions in gold mining companies because the price of gold is likely to move sharply higher if investors become panicked. Meanwhile, our remaining stock investments are heavily weighted toward financially strong, non-cyclical, U.S. companies that should benefit over the long-term as weaker competitors retrench or disappear.

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The purpose of this letter is to update all clients of our current thinking and the rationale behind recent changes. Additionally, for clients with taxable accounts, we have enclosed updated figures for your realized capital gains thus far in 2019. Please forward these figures to your tax professionals because total gains are likely to be above average this year for most clients. While nobody enjoys paying taxes, we made these changes because we believe they will benefit your long-term wealth. It's also important to step back and realize we have enjoyed one of the greatest bull markets in history over the past decade and most of the positions we have owned during this period have at least doubled in value. As a result, it is nearly impossible for us to reposition portfolios at this point without triggering capital gains taxes.

Thank you for your continued faith in our management and we hope for many prosperous years in the future. Although we believe we are heading into a challenging and emotionally straining period, we've attempted to put clients in a position to take advantage of opportunities as they appear. If you have any questions or would like to review your personal circumstances, please do not hesitate to call. Additionally, many clients may have a spouse or family member with work-based investment accounts that are beyond our view. Now would be a good time to review those investment allocations and we would be happy to provide our guidance.

We should also stress that we are not predicting any immediate downdraft in the market. It is impossible to accurately forecast the timing of any market movements. These changes merely reflect the shifting odds of success. With most investment opportunities available today offering little return, it's only reasonable to reduce risk and wait for better opportunities to reveal themselves. At the same time, if the market manages to continue to churn upwards, we will look forward to trimming additional positions in the future.

Truly yours,

Keating Investment Counselors, Inc.

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