

Inside This Edition:

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Important Reminders:

NYSE Closed - No Checks, Deposits or Settlement on:

- **1.15.18 - MLK Day**
- **2.19.18 - President's Day**
- **3.30.18 - Good Friday**
- **Expect 1099 Forms Mid February**
- **Form 1099R Late January**
- **Schedule K-1 Various**

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Greetings from the Northwest.

The essence of these reports from Cairn to you, our investors, should be primarily focused on you, the investment results and some sort of a gaze into the future, and thinking about how that future might affect the way we handle our investments. This time I'm going to start with a more personal note. Lara and I had a chance to meet up with our son, Tygh, who is an exchange student from OSU Forestry Engineering Program to the École Supérieure Du Bois in Nantes, France, focusing on International Timber Trade. Well, that's a tongue twister of a sentence. We had a wonderful opportunity to spend Christmas and the New Year abroad. It was an unusual time to be out of the office as we went from one year to the next. Especially when there was so much news about potential, and eventually real, tax law changes. Patrick is going to pick up most of the load, describing some of these changes for us. Tim is going to update us on the phenomenon known as Bitcoin. And in general we're going to be focusing on some of the things that we find particularly important at Cairn to keep all of our investment energy going in the correct direction.

Our trip involved mostly France, although we had a wonderful few days in Iceland on the way over, and a few days in Amsterdam on the way back. We focused on a couple of locations with longer stays on the Brittany Coast and in Paris, renting an apartment in both places and doing most of the meal prep and grocery shopping ourselves. We had an opportunity to sort of sink into and enjoy France. The overarching condition that must be communicated to our investors is that there is a tremendous amount of economic horsepower happening in Europe. It is busy. Even in the winter there are lots of people spending lots of money.



Timothy Lake

Photo by: Nathalie C.

Loads of construction plus many products being invented and manufactured. They are absolutely determined to create new and interesting results in the way of transportation, education, banking, and healthcare. Over the last couple of years our investments have shifted to more exposure in European companies than in the past. I am extremely pleased to be in that situation, especially since it helps us move toward companies that are comparatively less expensive than some of their counterparts in the USA. Thank you for putting up with the anecdotal research that we carried out whilst being consumers in a foreign land. It is the place to be and we should look forward to enjoying international investing results.

Patrick's Part

As 2017 began, the big legislative topics discussed across the economy and markets were:

- What is a big infrastructure plan going to look like?

- How will the health care bill be rolled back?
- Will corporate tax reform take place?

Only one of these tasks was accomplished (barely), yet the equity markets marched to all-time highs. US stocks, measured by the S&P 500, returned 21.83% with international markets faring a bit better. We feel two acronyms can describe why investor euphoria continued in 2017 despite high valuations and continued geopolitical concerns: FOMO - “Fear of Missing Out” and TINA - “There is No Alternative.” Record low bond yields and paltry interest rates on safe haven investments have caused investors to reach for yield, raising already high risky assets, due to their fear of missing out and lack of an alternative to earn a satisfactory return. TINA can explain the most recent American Association of Individual Investors (AAII) poll where household allocation to stocks reached over 68%. This high allocation to stocks has not occurred since the late ‘90s, so clearly investors are feeling the need to reach for risk as fixed income and cash rates remain low. In our view, FOMO is the reason that many companies with little to no profits and high cash burns (Tesla and Netflix come to mind) trade at current prices.

Other reasons given by financial pundits and talking heads on TV for the continued rise in equity prices are mostly noise and do not hold much water when analyzing the data. Ignoring the noise, FOMO and TINA, while sticking to our disciplined process, allow us to find ideas and investments that still offer attractive risk/reward traits. The silver lining is that not all companies are treated equally by investor euphoria, so we are still able to sift through the investment landscape and find bargains that the investment public has ignored. As an example, throughout the year we were focused on companies that had effective high tax rates that could benefit from tax reform. Many of these companies meeting that criteria are being cast aside over what we believe are excessive worries of competition and market share erosion.

We are pleased with how our portfolios have done in spite of our conservative bias, as we continue to view the US market as expensive. We will continue to be vigilant in finding opportunities without losing sight of the fact that risks are higher than normal and preservation of capital is of equal importance while this nine year bull market matures.

During the last week of December a new tax law was signed by the President. While there are many changes that are still being analyzed by tax experts, we want to touch on a few that we find meaningful.

- The Estate (Death) Tax exemption amount was raised to \$11.2 million (indexed to inflation), per individual, starting in 2018.
- For filers using the standard deduction, charitable donations will not be tax deductible.
- 529 education plans became more flexible. Funds can now be used for K-12 expenses, up to \$10k per child annually.
- Unearned income by a minor (Kiddie Tax) was previously taxed at the parents’ tax rate. The tax rates starting 2018 for unearned income by a minor will be the same rates used by estates and trusts.
- 2% miscellaneous itemized deductions were eliminated, doing away with the deductibility of tax preparation and investment management fees.
- The state and local tax (SALT) deduction is now capped at \$10k per year.

Again, these are just some of the changes that were signed into law. For any detailed questions on how the new tax law affects you, your professional tax preparer will have the answers. I’m going to pass it over to Tim so he can talk about something much more exciting: BITCOIN! Enjoy. —Patrick Mason

Tim’s Part

Bitcoin?

Lately we’ve had a number of our investors ask about Bitcoin (big sigh). It seems to be in the news daily, whether it’s up, down or both. While there are many sources that can provide a deeper plunge into the inner workings of Crypto-currencies and Block Chain Technology, we’ll take a moment and give our perspective on this phenomenon.

Bitcoin as a currency – not so much

The *reason* it was created was to provide a secure and cheaply transferred currency useful to people and businesses worldwide. Despite its promise as a medium of exchange free from central banks and banking industry controls, it is not currently viable as currency for the ordinary human. Some reasons for this: Bitcoin is treated as

property by the US and others, not as currency. This means that for any transaction that involves Bitcoin a tax may be due. Just as selling appreciated stock to buy a car will result in a 1099 for the capital gains, a “sale” of Bitcoin occurs during the conversion to dollars to facilitate the purchase of goods or services, which could result in a taxable event. Imagine getting a 1099 for the purchase of a sandwich! This is of course not happening, but it’s one of the novel effects that will need to be dealt with.

In relation to the US dollar and other currencies, the value of Bitcoin is extremely volatile. Until prices of goods and services are quoted in Bitcoin across the globe, a conversion to traditional currency (i.e., US\$, Euro, etc.) must happen in order to finalize transactions. This makes it unlikely that Bitcoin will be appropriate for widespread public use any time soon.

Another issue for Bitcoin is that “depository” accounts used to hold it have been frequent targets for cyber theft; in some cases entire brokerage firms have been emptied of their Bitcoin. Normal monetary controls, developed over decades of experience, do not yet exist with Bitcoin; a fundamental benefit to some is a fundamental risk to others (think bearer bonds).

VISA just cancelled a pilot program of Crypto-currency payment cards for some of these very reasons.

Bitcoin as an investment - Hmmm

In the sense that one can pay dollars for Bitcoin, and have more or fewer dollars at a future point in time, Bitcoin can be considered an investment, or at least has some features of investing. There is no way of measuring the value or potential value of Bitcoin in relation to the dollars one might invest, except by the market price at any given moment. There’s no productive enterprise being owned that may pay a dividend or rent, and otherwise have a widely agreed upon intrinsic value, as an investment in real estate, stocks or bonds would have. While Bitcoin holds promise for a future with a universal currency, it is unlike gold or other precious metals, which have held value to humans and governments for thousands of years and are unlikely to see this erode. Bitcoin and other Crypto-currencies are very new and it’s possible that they are but a transient experiment leading to something more permanent and useful in the future, in

which case they will be worthless. We’ll see.

If you decide to jump in

Buy only what you can afford to lose! Enjoy the experience and learn from it. Don’t use the kids’ college fund! —*Tim Mosier*

As we go forward, and I have an opportunity to speak with you on the phone or in person, I’d be excited to give you a little more information on the places we explored abroad. Two adventures stick out as really remarkable: One was a fantastic storm on the Brittany Coast of France and then several days following, hiking the rocky, craggy, storm-ravaged coast line. Very, very beautiful and quite stimulating. Second, and without any particular planning, somehow we ended up at the top of the Eiffel Tower on Christmas Eve. That was a blast, absolutely gorgeous wonderful experience, chilly, people packed, fun. I look forward to seeing you throughout 2018, and until then. . .

Happy Trails,



Jim Parr, Principal
Cairn Investment Group, Inc.

