



KAVAR Canvas

The science of investing. The art of integration.

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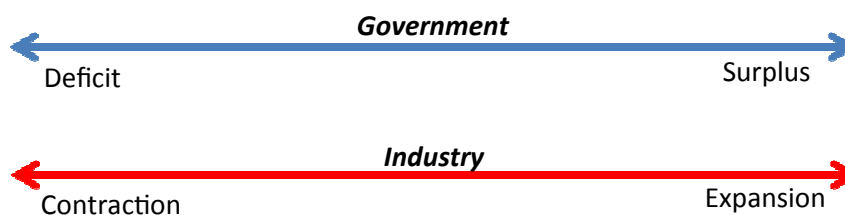
The Hybrid Economy

Written By: Douglas Ciocca

I visited a client earlier this week who was breathless in anticipation of taking delivery of a new Chevy Volt that he ordered last month. A highly-lauded feat of automotive engineering, the Volt is General Motor's (GM) entry in the plug-in hybrid electric vehicle sweepstakes that has captivated eco-conscious car consumers. According to information on GM's website, the Volt can travel 25-50 miles on a fully charged 16 kilowatt hour lithium-ion battery¹. The vehicle is also equipped with a gasoline powered, 4-cylinder, combustion engine that assumes duties of primary propulsion after a 65% drain in the battery². The Environmental Protection Agency rates the Volt as the most fuel-efficient vehicle with an internal combustion engine sold in the United States, with an overall full-economy rating of 60 miles per gallon (combining electric and gas contributions)³. And there is an economic jolt that bolts to the Volt: certain Federal tax credits accrue to the buyer⁴. One might be tempted to suggest that Volt owners can *get* some green for *going* green.

The corollaries of this coming-of-age-from-a-concept car to the current state of the US economy are compelling. Re-aligning our domestic drive train from a tremendous tail-spin has been challenging. Our stock markets have certainly accelerated while our economic engine has produced more puttering than prosperity. And as we navigate through the course of recovery, I ponder the extent of additional government gas we'll infuse to goose our electric economic endeavors.

Government and industry have always co-existed along a continuum of codependency. Government has periodically provided the largest source of industrial demand (domestic defense, infrastructure improvement, the internet) and industry has unfailingly augmented government's fiscal functioning (taxes, intellectual capital loans). Depending upon the prevailing economic conditions, the perceived point along the continuum varies greatly, with a resultant private market characterized by expansion or contraction coincident with a public sector deficit or surplus (see below).



For illustrative purposes only.

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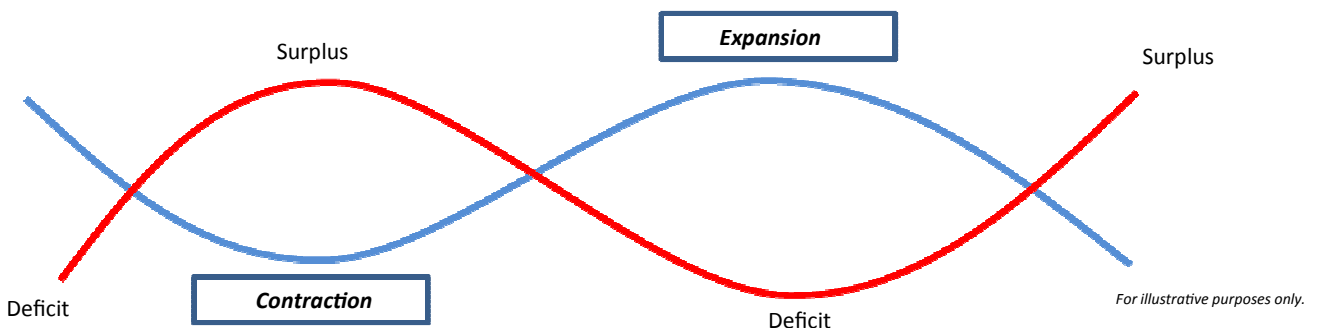
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It is not uncommon, yet entirely unproductive, to contemplate blame, accountability and consequence at the negative extremities of either continuum. Similar to a Volt, with no gasoline in the reserve tank, blaming the driver for failure to fill despite speeding past several service stations, neglecting cyclical inflection points in the economy heightens the prospects for stalling.

I wrote last year about the transition from synthetic (government infused) to organic (industry infused) growth, arguing that easy monetary policy (low interest rates) and accommodative fiscal policy (low taxes) were necessary pump primers for establishing better economic aerodynamics. Thankfully we've seen evidence of success in this transition: GDP has risen

from -4.9% in Q1 2009 to +3.1% in Q1 2010. Industrial production has gone from -2.1% in January of 2009 to +2.4 in December of 2010. Unemployment has dropped from 9.9% in December 2009 to 8.8% last month⁵.

And so it is now that our economic Volt contemplates leaving the test track to explore the open road. Is it ready? What is the proper power proportion between electric and fuel-based propulsion? The capital markets certainly want to know, and, by virtue of their strong move higher since March of 2009, embed considerable optimism in the outcome. Has the electric battery life been extended to a point that gas reliance is solely secondary? To answer that question, consider for a second a veritable of cross-pollination of continuums (see below):



In the spirit of fortuitous fuel transfer, governments often go into a deficit to fund economic expansions, leveraging their unique ability to extend fuel availability until economic battery life becomes adequately recharged. Sources of fuel are not limitless and need to be replenished with their regenerative capability directly proportional to the time derived from the deftness of their dousing. The cyclicity of both entities is pronounced and perpetual, which speaks to the inability to avoid mistakes and distractions (hey, no one ever said hybrid cars were safer – just more efficient!). As well, obstacles remain on the highway back to total health – unemployment, inflation prospects, consumer confidence and the clearing of excessive housing inventory – just to name a few. But I do believe we've seen adequate involvement from the synthetic side and despite some bumps in the road and the occasional idling, I'm almost as optimistic on the growth of our economy as the bubbling buyer pool for GM's Volt – they sold out the entire 2011 US production volume before the end of last year!⁶



IMPORTANT DISCLOSURES:

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¹ www.gm.com

² Norman Mayersohn (2010-10-15). *"Sorting Myth From Fact as Volt Makes Its Debut"*. *New York Times*.

³ <http://www.miamiherald.com/2010/11/24/1942214/2011-chevrolet-volt-rated-at-93.html>

⁴ <http://www.mychevroletvolt.com/chevy-volt-federal-tax-credit-form-8936>

⁵ Source: www.bls.gov

⁶ www.smartplanet.com/business/blog/smart-takes/gms-volt-sales-no-need-to-panicyet/14702/ (2011-3-4)