Fall
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Spreng Capital
Management Inc.

Spreng Capital Management is an investment advisory firm registered with the State of Ohio. Founded in 1999 by James Spreng, Spreng Capital has grown to encompass the very best in service and support for our clients.

Our client base is quite diverse. With clients in 23 states, we offer structured, customized investment management for individuals, profit sharing plans, Foundations, endowments and businesses. We are fee only investment managers, receiving no commissions nor do we sell any financial products. We are paid only by the investment management fees of our clients. We advise our clients on financial planning and manage their assets, making recommendations based entirely upon our clients' needs and goals. Everyone on the Spreng Capital team has a vested interest in the success of our clients' portfolios. Our team has a unique blend of experience, youth and business credentials.

Our use of high quality stocks and mutual funds along with investment grade bonds, allows us the opportunity to deliver consistent long term returns. We focus on minimizing risk and volatility, striving ultimately to deliver the very best after-tax returns possible, within the constraints you have established.

There is nothing that signals success more than referrals from existing clients. Our success is a result of our clients' continued confidence in us and their willingness to recommend us to their family and friends.

"The hardest thing in life is to know which bridge to cross and which to burn" - David Russell

"I've lived in America most of my life, so I've seen firsthand how not to run a country" - fictional Scotsman Groundskeeper Willie from the cartoon <u>The Simpsons</u>

We begin this quarterly epistle with what we deem to be two appropriate quotes from Scotsmen. While one of the individuals quoted is real and the other is a fictional character from a long running US television show, we think that their comments underscore quite well what has just transpired in the United Kingdom polling stations. To summarize what has occurred, Scots age 16 and older voted on the decision of whether or not to break away from the United Kingdom which is comprised of England, Northern Ireland, Scotland and Wales, to form their own independent country again after 300 plus years of unity with the UK. The very act of voting to disband all of the institutions and traditions after such a prolonged period of time was, by itself, quite unique. What was even more remarkable was the fact that this action, the tearing apart of a coalition that has endured for so long, was not going to be done at the end of the barrel of a gun like Vladimir Putin did with Crimea and the Ukraine. It was actually going to be done by a peaceful vote of the majority. In a vote that was deemed too close to call right up until the very last day, Scotland voted by a 55% to 45% margin to remain part of the United Kingdom. The world's equity markets heaved a huge sigh of relief at the outcome. Splitting up the assets and liabilities of a marriage is a messy process. One can only imagine how nasty it could have become as diplomats tried to negotiate who got the North Sea oil, what percentage of the national debt belonged to each party and the biggest crisis of all..........what would Queen Elizabeth do with Balmoral Castle in Scotland if she was no longer Queen over a newly independent Scotland?

Index	Qtr.	YTD
DJIA	1.29%	2.81%
NASDAQ	1.93%	7.59%
S&P 500	0.62%	6.70%

Fortunately for all of us, the more pragmatic Scots ruled the day and the Kingdom stayed intact, at least for now. The irony for Americans struggling with their own tugs and pulls of emotions over the role of government in everyday lives is that this whole episode was driven by the fact that the Scots wanted <u>***more***</u> money to flow from London to Scotland to support more social services and safety nets. They felt that for the amount of tax dollars that they were sending to London they should be receiving more in the way of funds flowing back to Scotland. It makes us look downright prophetic to look back at our summer of 2014 newsletter where we discussed how much upstate New York feels disenfranchised by the amount of their tax money that flows to New York City and Long Island. Imagine if there was a referendum on the primary ballot next spring to split upstate New York from downstate. It is not so far-fetched when we watch what has just transpired across the Atlantic in the United Kingdom. Scotland and England have a much longer history together and they walked right up to the dissolution line before backing away.

Boundaries can do funny things, especially when they are used to arbitrarily delineate countries and nationalities. Unfortunately, one only has to follow the horrendous bloodshed in the Middle East over the last 100 years to see what happens when boundaries are drawn up for the wrong reasons. The great European powers of the early 20th century, France and England, secretly drew up what was referred to as the Sykes-Picot Treaty of 1916 that essentially established the boundaries of all of the major players in the Middle East today. Unfortunately for all of us, including of course the individuals in their respective countries today, the boundaries were arbitrarily drawn trying to use as many straight lines as possible. Regardless of the fact that the Sunnis, Shiites and Kurds all had long simmering animosities towards each other that had been going on for centuries, the Sykes-Picot Treaty essentially placed all three groups into one country, Iraq. We now see the ultimate folly of forcing such disparate groups into proximity to each other and trying to govern them in a fair and equitable manner! To be blunt, the established countries of the Mid-East, as they are currently configured, are on the verge of pulling apart at the seams, probably forever. Even worse, this disintegration won't happen at the peaceful ballot box. Hundreds of thousands of innocents will probably die in the ensuing fighting and millions will become refugees fleeing the fighting. This will put incredible strains on an area that already has difficulty governing its own populations and lacks the infrastructure to supply a lot of the basic needs to their own people.

The United States most likely will withdraw into more isolationism in its foreign policies in the future for two distinct reasons. Economics classes all refer to this dichotomy as the "guns versus butter" predicament. Eventually we will not be able to fund both "guns" for defense and "butter" for entitlement programs unless we significantly raise taxes and cut entitlements……..or most likely, both. Also, historically the US has refrained from entering into other countries' affairs unless it serves our purpose such as the Panama Canal and Panama's quest for independence from Columbia, or on the basis of humanitarian disasters. At the same time, the world will experience more bad characters like Putin and ISIS that will follow our policies on the evening news and read our polls and know that the US has neither the financial ability nor the will of the public to intervene. As my wife, Valerie, so adeptly puts it, "Why would anyone want to run for President?"

So what does all of this mean for us as investors? Well, it matters a great deal. If individual consumers make up almost 70% of our economy, then the confidence of these consumers in the security of their jobs, the competency of their governing and taxing institutions and elected officials, the safety that they feel when they climb onto an airplane or go shopping at their local store, all matter a great deal to the profitability of the companies that provide goods and services to these consumers. Populations concerned about their future and their safety do not purchase expensive iPhones and pre-ripped blue jeans. Therefore, it is important to invest in companies that provide goods and services that are deemed essential. Companies that generate electricity, provide food, medical assistance and shelter would all fall into this category.

As if Ukraine, Gaza and ISIS were not enough to concern even the most iron-willed investors among us, there is always China to give us pause. With 1.3 billion people, and within that enormous population a middle class of over 300 million consumers, companies and countries around the world are climbing all over each other to try to gain a foothold in this marketplace. The US has 300 million people in total. New York City, our largest city, has 8 million people. To put the size of China's population into perspective, if everyone lived in the cities and no one lived in the countryside, every single state in the United States would have 3 cities the size of New York City within its states boundaries! That begins to give you an idea of what 1.3 billion consumers can look like. China's economic growth has been nothing short of phenomenal since the Communist Party began to loosen the stringent controls on the Chinese economy. For all of his faults, and yes there were plenty, Richard Nixon is the one who opened Communist China to the rest of the world with his "Ping-Pong" diplomacy in the early 1970s. With the introduction of their own hybrid form of capitalism into their economy, Chinese economic growth has skyrocketed to the point that they will eventually pass the United States economy as the largest in the world. However, all is not what it may seem in the Orient.

Sometimes the best measurements of economic productivity are obscure little things like the cost of shipping containers or corrugated boxes. The theory is that trade between nations requires shipping containers and boxes. If rates or prices in these goods are rising then there must be demand for them to be used in transporting goods. We like to follow the price of copper on the worldwide scale. Copper is used in almost all manufacturing and construction so the rising, or falling, of copper prices are indicative of overall economic health. Another obscure measurement of economic health is electricity usage. In a world powered by electricity for running machines, computers and air conditioning, a decline in electricity consumption can be a harbinger of future economic hiccups. China has experienced a decline in electricity consumption for the first time in five years. Money is also flowing out of China at a very high rate. When money flows into a country it is usually because there is a desire to buy or develop industry or housing. When money flows out, it is not a good sign. Realistically, there could be two factors at work for their outflow of funds. There could be a genuine concern that China’s best days are behind it as an economic growth engine. Or, there has been an attempt to crack down on the rampant graft and corruption that are endemic in the Chinese Communist ruling elite. This may be an attempt to slide as much money out of the country as possible before the police come knocking at an elected official’s door in the middle of the night to haul his family and him away for a “show trial” and eventual execution. It is probably a combination of both.

There is no denying the fact that China is experiencing its own growing pains within their economy. It is estimated that for every $1 of credit that is put back into the Chinese economy only 10 cents is returned in economic growth. That is a very dismal payback. The International Monetary Fund recently criticized China, which is in itself, a very rare occurrence. In studying 50 years of data, the IMF found that China’s explosive growth in lending ranks in the top five in the world since World War II. In the four other cases, each country experienced a banking or lending crisis within three years of its lending boom.

All of this discussion of China leads us to the recent IPO of the Chinese internet stock, Alibaba. Alibaba has been dubbed the Amazon of the Chinese consumer. Every American consumer knows who Amazon is and what they provide. I would hate to guess how much Christmas shopping is now done by Amazon and don’t even ask Barnes and Noble how many books Amazon might sell unless you want to be verbally accosted. Alibaba’s initial public offering exploded on the scene last week and immediately soared to an incredible valuation for the new company. Once again, everyone wants a piece of the Chinese middle class. However, everyone also readily admits that 80% of all the goods sold on Alibaba’s web site are counterfeit goods! What this indicates is that Adidas, Coach, Nike or whoever it might be that is setting up their own store online with Alibaba, is willing to accept the fact that only 20% of their total sales is of legitimate product just to get their foot into that market. Alibaba does not deny that there are counterfeits in their marketplace but of course, they are diligently in the process of rooting out these characters from their marketplace. I’ll bet they have some wonderful beachfront property in Nebraska to sell too. There is an old story called ***Ali Baba and the Forty Thieves*** from the Arabian Nights tales. I just can’t help but ponder the 21st Century version of ***Alibaba and the 1.3 Billion Thieves***.

So how are the markets performing through the first three quarters of 2014? For the quarter just completed, the Dow Jones Industrial Average was up 1.29% and year to date is up 2.81%. The NASDAQ Technology Index was up 1.93% for the quarter and is up 7.59% for the year. Finally, The Standard & Poors 500 Index comprised of the 500 largest companies in the US stock market was up 0.62% for the quarter and is up 6.70% for the year. These are good numbers for the quarter and the year to date with the exception of the Dow. The Dow is comprised of 30 large companies that are chosen to represent as broad a spectrum of the US economy as possible. For instance, Johnson & Johnson is there to represent medical; Boeing-air travel; GE-manufacturing; Goldman Sachs-finance. The fact that this particular index is having a mediocre year for performance is not a big deal to this point. It may just reflect that these 30 companies had excessive changes in their stock prices in the past and are now in a time period of reestablishing a more correct price for their stocks. It certainly bears monitoring but no action at this time.

Where do we go from here? We have not even discussed the upcoming mid-term elections or the eternal jockeying for the presidential Primaries in 2016. With all of the commotion over the IRS abuses of power, NSA domestic spying, Edward Snowden and now the revelation that the CIA was spying on the Senate Intelligence Committee that has oversight of the CIA, it is pretty easy to see why there is so much outright fear and trepidation over the roll-out of Obamacare. ***In theory,*** Obamacare is a good thing. One of the issues bubbling to the surface right now is that the IRS has declared that they do not have the legal jurisdiction or manpower to collect the fines for individuals who refuse to carry health insurance. Without the ability to force individuals to comply, and with a Congress that will in no way shape or form, work to correct this issue. The prospects for a smooth implementation of Obamacare continue to drift farther away for the taxpayers. For anyone over 20 years of age, who has had any experience with government bureaucracy, there has to be concern about how this will all play out and the effects it will have on individuals and the overall economy. As we have said many times before, Obamacare is here to stay because there will never be enough votes in the House and Senate to override a filibuster or Presidential veto, but the devil is always in the details and the details of Obamacare are particularly devilish.

Of more immediate concern is the eventual rise in interest rates and how that will affect overall economic performance. Historically, a gentle, slow rise in interest rates has actually been good for stock performance in the first year. The higher cost of borrowing money is offset by the better performance of the economy which promoted the rise in interest rates in the first place. However, with the setting of incredibly low and arbitrary interest rates at 400 year lows, how consumers and investors will react to a rise in rates is very unpredictable due to the circumstances. As someone who remembers 18% per year borrowing costs and 9% a year interest on 30 year mortgages on homes, we have to wonder how young consumers buying their first home will react to more normalized interest rates. Will there be a buyer’s boycott until rates go back down? We have had artificially low interest rates in some form or fashion since 2000. That means that someone graduating from college at the age of 22 in the year 2000 is now 36 years old and has never known anything but low interest costs.

We know that we have talked about the policies and politics of low interest rates for years now and that we always say that ***when*** rates rise, and that even after all of our discussions, rates are still low! It is entirely possible, though not really probable, that we could see these artificially low interest rates for many more years. Always remember that low interest rates favor the most indebted and the largest debtor in the history of the world is the US government, and that the largest debtor is also the one who sets global interest rates! To say that our government has a vested interest in keeping interest rates as low as possible for as long as possible would be an understatement of biblical proportions. None the less, if and when rates do begin to rise, investors need to be prepared for the increased volatility of stock prices that will occur with this return to normalcy. We are certainly aware of this possibility of increased volatility and are planning our actions and investments accordingly. The world is uncertain, from terrorism, to domestic politics, to Russian imperialism, to interest rates to an economic slowdown in China. Everything is intertwined in a world of instant communication. Economic markets respond to this information in an instant as well. Always remember, that we are investors, not stock traders. There will be uncertainty, and opportunity, in the months ahead. As investors we need to be emotionally prepared for the realities of a more volatile market that is likely to occur. If we are patient, we will be fine.

Our Annual Client Event on September 3rd was a huge success again. We had over 230 clients and their friends and family attend a beautiful summer evening of food, music and friendship. Our attendance exploded this year by almost 30% over last year. Please mark your calendar for the first Wednesday after Labor Day next year. If you were unable to attend, we do hope that you will be able to join us next year and for those of you who attended this year, we look forward to seeing you again next year.

We are excited and optimistic about the future both for you and for our firm. We continue to receive large influxes of new funds thanks to you and your many referrals that we receive every month. No one said securing a viable financial future is easy; nor should it be. There are many challenges and headwinds that we will face every day. The markets contain risk and they offer reward. Our task is to balance the two and to deliver good returns with an acceptable amount of risk.

If you have questions about your holdings or about the general condition of the economy, please contact us at once. If we do not have a current email address for you would you please email us and allow us to add you to our regular list of clients with whom we correspond. Our email addresses are jspreng@sprengcapital.com, tbrown@sprengcapital.com and lkunzer@sprengcapital.com Please be assured that we are monitoring market situations at all times.

If there have been any changes in your financial circumstances of which we should be made aware, please notify us at once. If you would like a copy of our most recent Form ADV or our Privacy Policy, please call the office. If you have not visited our website, please do so at www.sprengcapital.com

We appreciate the opportunity to work with you, your families and your businesses. We are very grateful for the many referrals that you have provided to us. We can think of no greater compliment than to have you recommend us to your family and friends. We will continue to do our very best to provide you with healthy, consistent returns with a minimum of risk. Always remember, "Investing is a marathon, not a sprint."

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