



ISSUE  
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A FORUM  
FOR OPINIONS  
COMMENTS  
AND NEWS

SAN ANTONIO TEXAS  
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INTERCONTINENTAL

# COMMUNIQUE

We are pleased to present the second issue of Intercontinental's Communiqué.

As with our previous issue, you will find articles describing Intercontinental's unique approaches to investment challenges. In the first of these we describe what we, and you, saw happen in 2008 and 2009. It lays out those events and, importantly, lessons we draw from them.

Next we go back to our origin as a provider of investment guidance to clients in Mexico and Latin America. We describe how we took our success in various international markets and applied the principles and techniques to domestic accounts with striking results. (As always, we note that such success is never guaranteed.)

And finally there is our unique approach to a technique that is steadily growing in its significance and use. That is "Socially Responsible Investing." There are many

people and organizations who strongly feel that their investment portfolios must reflect certain fervent beliefs which they hold.

A prime example of this is a prohibition of the ownership of securities issued by companies that produce cigarettes or certain drugs. As you will read, it is a simple fact that many of these types of businesses, such as tobacco and alcohol, are both profitable and recession proof. This creates a challenge to investment performance, and you will see we have developed a unique approach that goes a long way in mitigating such challenges.

We heard from many of you about how you enjoyed our first edition and we shall strive to carry on with this one and all that follow.



SOCIALLY RESPONSIBLE INVESTING; THREE EMOTIONALLY CHARGED WORDS THAT REPRESENT AN IDEA WHICH HAS GROWN TO BECOME A SIGNIFICANT FACTOR IN FINANCIAL MARKETS. THIS IDEA SPRANG UP MANY YEARS AGO AS SOME INVESTORS BEGAN TO REALIZE THAT THEIR INVESTMENT PORTFOLIOS COULD BE USED TO MAKE A STATEMENT; ESPECIALLY IF THEY WERE ABLE TO FIND OTHER, LIKE-MINDED INVESTORS.

## NO GAMBLING, TOBACCO, OR GUNS... BUT MAYBE ALCOHOL IS OKAY.

These people could publicly promote the fact, for instance, that they were opposed to war and therefore they would not invest in any public company which produced and sold lethal weapons. There turned out to be a very wide variety of emotionally charged causes, such as tobacco products, alcohol, gambling, pollution, low-wage labor, birth control and so many more.

The individuals and organizations that pursued this idea found that, while their actions were a strong statement in favor of strong beliefs, the investment outcome for their portfolios often suffered. The reason for that had to do with the nature of markets and human behavior. As an example, in tough economic times, the demand for tobacco and alcohol tends to hold up well. When people are worried about their economic situation, they tend to smoke and to drink. For that matter, when things are going well they will celebrate by smoking and drinking. What this boils down to is the pure economic fact

that cigarette and liquor producers have historically been good investments because they tend to produce good earnings year in and year out.

It would do absolutely no good to try to convince investors who want to make a social statement by refusing to buy stock in such companies that they should consider the economic factors of their decision. The most important thing for these investors is to stick to their principles and to make their statement by doing so.

Several years ago our firm received a Request for Proposal from a foundation on behalf of one of its major participants. That participant was looking for a Socially Responsible Investment Manager who could adhere to their social requirements and produce excellent investment results. Typically, such RFPs are sent to managers who call themselves "Socially Responsible." Such a manager usually will detail the industries and companies that

they exclude from their portfolios due to their definition of what is and is not “Socially Responsible.” As we perused this situation, a light went on.

The foundation’s participant had detailed its social concerns. It did not want any investments in companies involved with tobacco, gambling,

our portfolio. This manager also uses stocks of companies that produce alcoholic beverages, and these remain in our portfolio. The other objectionable areas, gambling, birth control and weapons, do not appear in this manager’s portfolio.

**WE SUM THIS UP IN ONE STATEMENT: TELL US WHAT “SOCIALLY RESPONSIBLE” MEANS TO YOU AND THAT IS WHAT WE EXECUTE.**

birth control or weapons of war. But, they did not mention alcohol. And this is what caused the light to go on.

Our clearing broker, the firm which serves as custodian for all of our investment holdings, offers all of our clients the opportunity to identify any companies whose securities they do not wish to own. This means that we can employ the finest equity managers that we can find and, in each “Socially Responsible” account we run, we are able to produce a list of companies whose securities are not to be purchased by those managers. We sum this up in one statement: Tell us what “Socially Responsible” means to you and that is what we execute. The result has been twofold:

- The manager whom we chose to run the large cap value portion of this portfolio normally includes a tobacco company in its portfolio. We have blocked the inclusion of that stock in

- Because we are choosing equity managers for their demonstrated skill and not because of their social beliefs, we retain very much of the excellence of their portfolio management while adhering perfectly to our clients concerns.<sup>1</sup>

The result of this unique approach to Socially Responsible Investing has been increased contributions from existing clients and new clients for the foundation.



<sup>1</sup> Historical returns for this strategy cannot and should not be used to assume future returns. Investors can lose principal value.



## WHAT THE HECK IS GOING ON AND WHAT CAN I DO?

Investing and finance have become downright scary. We have just completed an entire decade during which most people who buy stocks had a negative return. The decade's defining moment was a sickening market drop from October, 2008 through early March, 2009. Then we had a wonderful reprise only to be followed in the month of May, 2010 by what seemed at times like a global meltdown. In the past, at such times, investors could retreat into treasury bills; the classic riskfree investment. But today, for a three-month bill, you would receive an annual rate of .16%. (Do look carefully. There's a decimal point in front of 16!). The fair questions are, what the heck is going on and what can I do? The first question can be answered with two words; behavior and betrayal. We have seen both before, but seldom to this extent.

The current examples of detrimental behavior are centered around mortgages. After WWII this business began a breathtaking expansion which was fueled by an excellent governmental policy. That was the GI Bill. An entire generation of our young people had been drawn into military service which could have been a massive detriment to our nation. Millions of our best and brightest were fighting a war at a time when they normally would have been educating themselves for lifetime careers. The Congress faced up to that with the GI Bill which helped them finance their education and their first homes. It was a rare example of good policy that created an outcome which paid for itself by turning that generation into people who improved themselves and who became a source of tax revenues.

The post-war boost to our mortgage industry created a vibrant business which grew massively for almost 25 years. The model, used mostly by Savings and Loan associations, was to pay four or five percent for deposits, make mortgage loans for about seven percent and profit from the spread. Then in the early '80s it broke. Deposits paid 18% and no one could

## STUNNING RESULTS IN A DIFFICULT DECADE.

afford a mortgage that could provide a profit. That's why the S&Ls disappeared; replaced by banks who put mortgages into securities which they sold. The spread business became a fee business and, unfortunately for all of us, the regulators of that industry were not capable of controlling it any more.

And, on top of that, our rating agencies, Standard & Poor's, Moody's and others, absolutely betrayed the trust of investors by failing to perform their simple, straightforward duty; actually their reason for being. They failed to look at the composition of securities to which they gave their highest two ratings. That fueled massive buying of mortgage securities by individuals, institutions and even nations. These buyers have hopefully learned two lessons:

- UNDERSTAND WHAT YOUR INVESTMENT IS.
- NEVER RELY SOLELY UPON ITS RATING.

We have all been taught a lesson by these events. Our clients were not exposed to securities comprised of sub-prime mortgages, but they were caught up in the overall market reaction. That's because we do believe that over time a portfolio comprised of stocks and bonds of good companies will provide a return that is handsome and not terribly risky. This requires the basic financial analysis which our rating agencies failed recently to perform. Such analysis, and the resulting asset allocation, we believe are the key to intelligent and prudent investing. It creates portfolios that can weather a storm.<sup>1</sup>

<sup>1</sup> Historical returns for this strategy cannot and should not be used to assume future returns. Investors can lose principal value.

<sup>2</sup> Intercontinental Consultants L.L.C. is an investment advisor. Intercontinental Asset Management Group LTD. is a registered broker/dealer, member of FINRA and SIPC. It executes trades on behalf of Intercontinental Consultants L.L.C. Intercontinental Insurance Agency L.L.C. provides insurance services. Clients should carefully review all account documentation.

The Intercontinental Companies<sup>2</sup> began business in 1982 when Isidoro Korngold, a native of Peru educated at Wharton and Yale and an émigré to the United States, teamed up with John Kauth, a recent graduate of Texas A&M and son of a U.S. Navy aviator. The two had met at the First National Bank of San Antonio where both were employed. Isidoro was involved with the International area of FNBSA, which meant Latin America; predominantly Mexico. That explains why Intercontinental began with a near total focus on clientele from south of the border.

Isidoro brought a deep understanding of that culture along with rigorous experience in both governmental and private finance. John brought a quick and disciplined mind which formed an excellent bond with Isidoro. Together they launched Intercontinental which 29 years later continues to thrive and bring unique ideas to clients. An outstanding example of those is a product we call the "International Account."

In the early 1980s, Isidoro and John had to craft portfolios relevant to their clientele. They drew upon their combined experience to analyze the economic situations of the countries in which their clients lived. Their intention originally was to loan money in those countries. Almost immediately they were facing



a dire situation which was, in fact, a great opportunity.

In 1982, Latin American and other emerging economies were jolted. Money fled and many currencies, including the Mexican peso, plummeted relative to the dollar. Thus, immediately after starting up, Intercontinental faced a severe challenge which it answered by offering foreign clients U.S. certificates of deposit which were trading at extremely high interest rates. At the time this seemed highly unusual but it proved to be a blessing. It taught Isidoro and John to always be ready to think outside of the box.

In a few years those emerging economies calmed down and the high U.S. interest rates dropped. These two economic trends re-established what is the more normal relationship. That is a situation of higher interest rates on Latin-American and other foreign nations' bonds than on U.S. bonds. For their clientele this situation was optimal; bonds issued by countries and companies with whom they were comfortable, and which paid very handsome interest rates.

Isidoro and John learned the benefit of rigorous financial analysis of their population of security issuers. Over the years they were able to effectively trade both bonds and

equities and to produce results that were attractive to their clientele. It must also be noted, as they learned firsthand, that there are significant risks in such portfolios and at times these adversely affect returns. But, over time their clients prospered and grew.

In 2001, Isidoro and John brought Mickey Roth into the company; giving him a specific charge to help grow a domestic (U.S.) part of the Intercontinental clientele. This effort gained momentum in 2005 when Charlie Lutz joined the company.

It happens that the years from Mickey's entrance in 2001 till the present constitute one of the most difficult financial markets in U.S. history. Once again, Intercontinental went outside the box.

John Kauth and Alfredo La Rosa took the step in 2001 of crafting a "traditional" International portfolio, one that was predominantly in Latin-American and other foreign bonds, for foreign bonds, for domestic clients. These particular clients had varied portfolios already, so John offered up something unique.





It did quite well through 2007 and then, taking full advantage of our excellent Trading Staff, we added an allocation of international equities. By the end of 2009 the results were stunning.

There are two points to emphasize here:

First is that such results are not assured and they are subject to risks. They are the result of financial analysis, which can never be considered to produce a certainty.

The second point is, however, just as important. The securities in this account, foreign bonds and equities, are not totally



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correlated with the U.S. market. Thus they have the possibility, as they did in this case, of performing much differently and much better than domestic portfolios.

This is a concept we believe will be of great interest to many affluent investors.



## OUR PRINCIPALS



*The principals of Intercontinental*

*From left to right: Isidoro Korngold, Charles Lutz, Mickey Roth, John Kauth.*

### CHAIRMAN, ISIDORO KORNGOLD

A former high executive of the Central Bank of Peru who played a key role in determining that country's monetary policy, and whose Masters degree from Yale is in Urban Studies.

### PRESIDENT, MICKEY ROTH, CFA

El Paso native, Air Force Academy graduate and former head of USAA Investment Management Company, whose M.S. from U.S.C. was primarily in psychology.

### COO, CHARLES LUTZ

Graduate of Trinity University, with a B.A. in Psychology, longtime San Antonio banker who headed Bank One's entire operation in south and central Texas, and who has provided financial guidance to hundreds of successful San Antonians.

### CEO, JOHN KAUTH, CPA

The son of a naval aviator, graduate of Texas A & M, C.P.A., crafter of unique investment portfolios, and one of the finest golfers in San Antonio.

