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Patience is a Virtue

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My study of history indicates that investors who buy high quality, at a low price, and remain patient are the ones who make – 'and keep' – the most money. Those who try to time markets, or invest with market momentum regardless of the price, may sometimes be in the lead, temporarily. Eventually, however, gravity and / or physics takes over and they give back much or most of their illusory gains.

It's not been that long since the dot.com / high tech mania of the late 90's. Local Janus Funds were the envy of investors everywhere. The problem was they were the largest shareholders of many stocks trading at enormous multiples of earnings (or had no profits at all). Our prediction then was that most of those companies would not survive, and investors should get their money out yesterday (you can read our dot.com letter at our website: valuefinancialadvisers.com., or the one just before the 2008 meltdown).

I could go on and on about episodes in the past where investors chased price and ignored fundamentals. If you're interested in more, read 'Extraordinary Popular Delusions and the Madness Of Crowds '.

One of our investing premises is this: new eras fail, fundamentals prevail.

How does this apply to 2013 ? In spite of $ Trillions of printed money and stimulus, the U.S. Economy is barely growing; the worst post-recession GDP ever, in spite of the largest stimulus ever. Yet the U.S. Stock and Real Estate Markets are doing well. Why is that ? Because the Fed has driven interest rates to historically low levels hoping people will borrow to spend, or become so frustrated with the low yield that they take their safe cash out of the bank and invest it. The Fed's plan is that stock and real estate prices will rise, people will feel richer, and spend more money. And then the economy will grow, and happy days will be here again.

This is like a short-term deal with the devil. Keeping interest rates artificially low for this long a period will create significant market distortions, and will end badly for those who blindly believe the Fed knows what it is doing.

As you listen to Ben Bernanke (or Janet Yellen et al) speak, remember two facts. First, for two decades the Fed has exerted way-above-average influence on the U.S. Economy and Financial Markets. Second, during that period the S&P 500 fell 40% over one three year period (2000 through 2003) and 37% in 2008. Both declines occurred right after we were assured 'all was well'.

Our advice: be very cautious as you invest today. Don't 'chase' the returns of yesterday. Only own things of high quality priced at reasonable levels. Don't be fully invested. We see increasing solicitations from firms touting their recent returns. Before you abandon a fundamentally based portfolio that is cognizant of today's risks, be skeptical. Ask these solicitors how they did in the late 90's, or in 2008. Avoid being impatient if you wish to protect your hard earned money. As Warren Buffett said, " The line separating investment and speculation becomes blurred further when market participants have recently enjoyed triumphs ". Fundamental investors are the long-term winners.

Note: thanks to all of you who voted me again as a 5 Star Wealth Manager. I've been fortunate to receive this award every year since it's inception in 2009 by 5280 Magazine. I appreciate your support as we work hard to offer sober, time-tested advice in an ever-complex world.

The PhD Standard

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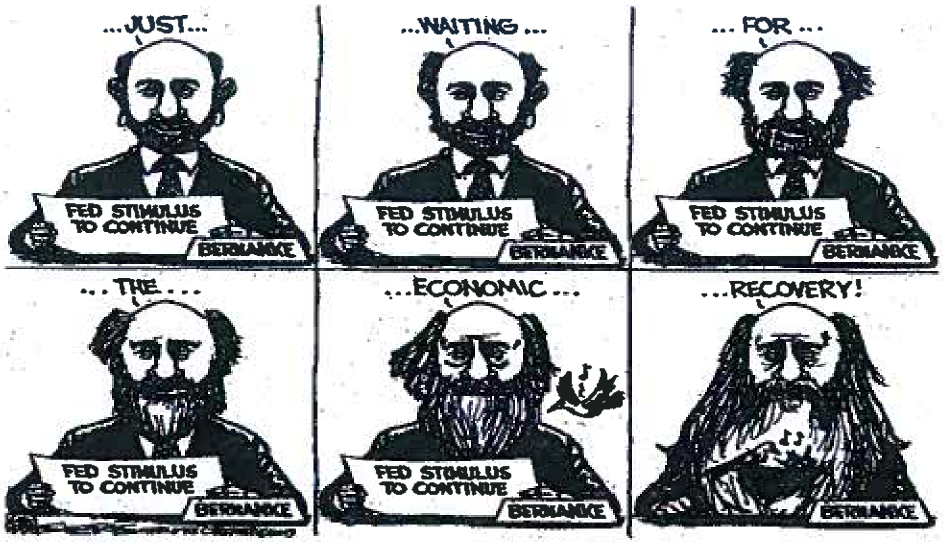

It is said that economists have physics envy. They yearn for precise formulas and tools that produce predictable outcomes every time. But unlike the physical sciences, economics is the study of myriad interactions of flawed, emotional human beings seeking income & profit in a constantly shifting landscape of incentives – both carrots and sticks. It's a very messy business indeed. Our greatest physicist, Albert Einstein, is often attributed with the quote, "Insanity is doing the same thing over & over and expecting different results." The cartoon above pokes fun at Federal Reserve Chairman Ben Bernanke for doing exactly that.

Bernanke & his Fed cohorts are mostly Ivy League PhDs – think Harvard, Princeton & MIT – whose entire careers outside of govt. have been spent in academia, teaching and researching economic theory rather than living in the world most of us inhabit of economic reality. Their computer models make many assumptions about what should happen to outputs as various inputs change. These inputs come from statistical analyses that also assume accuracy in the data sets upon which they're based. Our most powerful economic decision makers are using tools that give them the delusion of control in a world that is increasingly chaotic & hard to measure in our interconnected, global economy. Yet Fed economists continue to pursue policies they're convinced will work eventually, as long as they just keep at it.

I have no problem with the century-old Fed's original purpose of ensuring price stability and the smooth functioning of the money supply and banking system. Being the "lender of last resort" was necessary during the most acute phase of the '08-'09 financial crisis when lending between institutions simply locked up. Bernanke was instrumental and creative in the use of Fed powers to restore liquidity to the overall system, including unregulated "shadow banking" sectors such as money market funds. Much of what was done 5 years ago was unprecedented and experimental – the result of studies by this generation of economists of Federal Reserve "mistakes" during the Great Depression. Our PhD policy makers know one thing if they know nothing else. There will be no deflationary depression on our watch! The result is that inflation will always be considered the lesser evil, and the sure way to slowly reduce the enormous debt burden that led us to this mess in the first place. So the price stability mandate now only seems to apply to declining prices. Inflation up to 2.5% is now seen as positive and is official policy.

Continued on page 3

Workshop

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These days, many working investors find themselves in a bit of a predicament. Most of us have employer sponsored retirement plans (401 k, 403 b, etc.), and often these accounts are the biggest ones we have for retirement. However, employees are usually left to make the investment decisions inside these accounts themselves as they are often self- directed; meaning we are responsible for deciding how our largest accounts should be invested.

I have worked with these types of plans since entering the business with T. Rowe Price in 2008. I am very familiar with their set-up, investment options, and how to make a suitable investment strategy based on the options the plan provides. It is very important that we capitalize on these accounts in order to set ourselves up for retirement, yet few people understand what that entails.

Please join me for our free workshop to delve into this matter. We will discuss these types of accounts in detail; looking at everything from how much to diversify asset classes, short term versus long term goals, and what to do with employer plans after we leave. The workshop will be good conversation and useful information (along with coffee and bagels). No expertise needed, just a desire to better understand your plan, which likely will be a very large portion of your retirement.

As Warren Buffet would say, 'risk comes from not knowing what you are doing.'

Phillip Connors

Saturday, Nov. 16, 10 AM—Noon

There is no cost, but seating is limited.
Reservations are REQUIRED.
Feel free to invite family and friends
We'll add more sessions if needed.
Call us at 303-770-3030 to reserve your seats.

The PhD Standard continued

Where this leads us today is continuing ZIRP (zero int. rate policy) & QE (quantitative easing aka money printing), with no end in sight. Financial repression and massive liquidity have initially created asset inflation (stocks, RE, private equity), which greatly helps the "haves" who dominate these markets. But as the cartoon alludes, not so much for broader non-financial economy, which has grown at an agonizingly slow pace since the Great Recession ended. We appear to be entering a new era of "stagflation", with low growth & rising prices, much like the 70s. If you're too young to remember that decade, it did not end well.

The lesson of history is that money printing and other forms of currency debasement never ends well. Inflation always spirals out of control despite the best intentions of those in charge. Excessive debt always tempts politicians to inflate it away, while claiming their statistics show everything's under control. Mark Twain once said, "There are three kinds of lies: lies, damned lies, and statistics." I'm pretty sure he wasn't a PhD of anything.

"The Decline Curve Never Sleeps and the Decline Curve Always Wins."

William Mason CFA

This message is on oil and gas. I believe that everyone should have something oil related in their portfolio. The title of this message is a quote from the CEO of Core Laboratories. Core is one of the main providers of the new technologies that help companies extract oil from places that were once prohibitive.

His message is simple and direct; oil fields decline. That oil is not being replenished. There is no underground factory turning out more oil. In the ***2008 World Energy Outlook*** of the International Energy Association they produced their findings of the most comprehensive study done to date: "Based on data for 580 of the world's largest fields that have passed their production peak, the observed decline rate — averaged across all fields and weighted by their production over their whole lives — is 5.1%." That is about 3.8 million barrels of oil per day that needs to be found ***just to stay even.***

It is neither easy nor cheap

The following is from the August 1, ***Wall Street Journal***: "The oil giants are spending unprecedented billions of dollars to find and extract petroleum, hunting in harder rocks, deeper underground and farther offshore. Last year alone, Exxon's oil and gas production fell 6% from 2011, to 4.2 million barrels a day. Chevron's production fell 2.4%, to 2.6 million barrels a day. Chevron's costs to produce a barrel of oil and its equivalent in natural gas have jumped 41% since 2010, while Exxon's have climbed 23.5% over that period."

The message from Charlie Munger

Charlie Munger is the partner of Warren Buffett at Berkshire Hathaway. In May he had this to say: "Oil is absolutely certain, oil and gas, of becoming incredibly short (in supply) and very high priced. And, of course, the United States has a problem and China has a worse problem… The imported oil is not your enemy it is your friend."

China

In China 16 million vehicles were sold in the first nine months of this year, up 12% on a year-over-year basis. That is a run rate of over 20 million cars in the year. China crossed the one million car sales mark in 2001.

Shale

Jim Rogers had this to say in June: "As for oil shale, typical wells deplete at 38 per cent the first year. Thus you need a lot of drilling, money, and a high price to keep up production rates. All you have to do is go out in the oil patch. I believe the investment world will be disappointed with the notion that supply is so great that oil will collapse."

Shale oil from the Bakken and Eagle Ford is great but it is not enough. Texas is the largest oil producing state in the country by far. In June, production from the Eagle Ford was up 60% year-over-year. Production in the entire state of Texas was up just 6%.

It is not from lack of trying

The following is from the ***Financial Times*** earlier this year: "Yet one of the most alarming elements of the increase in cost and complexity is that the majors have been getting much less of a bang for their buck. According to Schlumberger, the oil services group, annual capital spending for the industry has more than tripled in the past 10 years, reaching $550 billion in 2011."

Own some oil

Global oil production is up only about 2% since 2005 despite heroic efforts to produce from the depths of the ocean, tar sands in Canada and massive fracking efforts in the U.S. The costs are tremendous. Protect yourself.

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