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What Should Intelligent Investors Do Now ?

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This is my 30th year giving investment advice. Those years have taught me a lot about markets, and pricing. As importantly, however, they confirmed what Ben Graham, Warren Buffett and others counsel, that the biggest problem most investors have is themselves. As important as their portfolios are to their future, many get paralyzed and don't take the steps necessary to be successful. In many ways that's where advisors like us can help - lead investors down a more successful path.

As my associates articles herein clearly demonstrate, this office believes the actions by our Federal Reserve Bank and Government have focused too much on the short-term, thereby creating significant risks to investors over the long-term. We are comforted that many of the world's successful investors agree.

It is at these inflection points, where everything seems okay: the economy is doing better, unemployment is down, asset prices are up, etc., that successful investors look for the dark clouds and are pro-active in their portfolios. In particular they liquidate investments that have run-up and are now over-priced. Over my career, however, many or most investors get complacent. They're not sure how to analyze their holdings, or wonder if the naysayers are just the new chicken-littles. So they do nothing and often get hurt by the market which is always searching to price investments at their true value.

So to follow through with what our firm has worked hard to do over the last 3 decades, we're offering to educate and / or help you. Two ways: 1. Attend a Workshop where we'll discuss our thoughts on analyzing investments and portfolios in light of the current economic and market conditions. Or 2. Contact any of us for a one-on-one review of your holdings. These are more personalized as we also learn about your situation: age, working status, goals, etc. We'll provide you a Value-Oriented opinion of your portfolio and some prudent ideas about what you might do now.

So what should Intelligent Investors do now ? Don't be complacent. Even though it may take effort, implement some time-tested ideas to your holdings. Don't just ride into the future expecting it to look like the near term past. That's often a recipe for a poor outcome.

WORKSHOP

What to buy, sell or hold
Fall of 2015

Don't be complacent. You may be holding over-priced investments. We'll discuss time-tested methods to analyze your portfolio. Will include stocks, bonds, real estate, mutual funds & annuities.

No cost or obligation. You must have a reservation.
Wednesday, August 19, 2015 1:00 pm—3:00
Call (303) 770-3030

A Tale Of Two Bubbles: China vs Nasdaq

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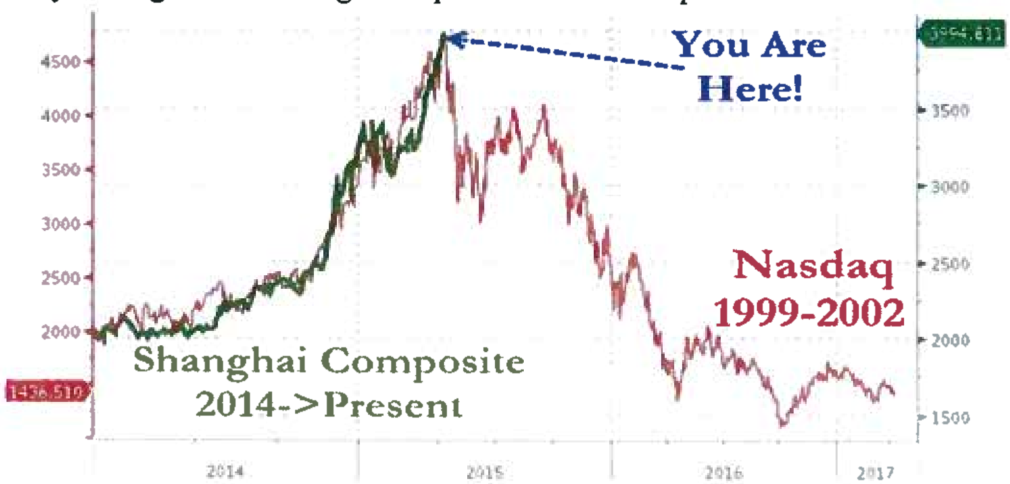
This chart was produced around June 1st, just before China's main domestic stock index peaked. As of this writing, it's down by 1/3 in less than a month. The parallels with our own dot-com boom and bust 15 years ago are amazing. Millions of neophyte investors, trading online in rapid-fire fashion using heavy margin (borrowed money). Price momentum is the only metric, with no regard for underlying value or fundamental research. Numerous IPOs issued and continuous sales of current positions to buy the next hot new stock. Daily trading volume that grew rapidly to world-record levels as the newbies piled in. To paraphrase Prince – the Chinese were partying like it was 1999!

Predictably, this latest investment mania ran out of steam with no particular catalyst, and those who arrived late to the party have been badly hurt. Many who were investing with up to 80% borrowed funds are being wiped out by margin calls. Bursting bubbles always end in tears, as anyone who will admit to being a dot-com day trader will attest.

The big difference between these two bubbles is that the Chinese version was blatantly promoted by the central govt. as the latest wealth creation scheme to maintain the illusion of high GDP growth. Communist party controlled media extolled the virtues of equity investing while expanding the venues for companies to issue shares and Mom & Pop investors to buy them. It became possible for just about anyone to leverage their portfolio with margin debt. Despite being unable to control the rapid rise in markets, China's leadership is now desperately attempting to stop this ensuing crash. Trading has been suspended for half of listed cos. A $20 billion "stabilization fund" has been created to buy stock. Directors and executives have been forbidden to sell. None of these measures have done much to staunch the losses, so don't be surprised if all domestic Chinese exchanges are closed as a last resort. President Xi Jinping's aura of invincibility and absolute control over the govt. is in tatters.



It's perhaps no coincidence that Greece's financial endgame is occurring at the same time. The common theme is that too much debt and government/central bank manipulation of asset markets – stocks, bonds & RE – to spur growth can't be maintained forever. If China's command-and-control system can't do it, nobody can. 7 years after the global financial crisis, we're approaching the point when all the shell games quit working. Holding cash, short-term high quality bonds and precious metal hedges still makes sense to us until markets, not bureaucrats and PhD economists, once again set prices.

Rewards ... and Risk (yes this still exists)

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Despite the performance of the S&P 500 over the last 6 years, I want to remind investors that all investments have a risk/reward aspect. Often, the higher the risk, the higher the reward if the investor's bet turns out to be right. But when years go by of unnatural growth spurred by Fed policy, accompanied by no real correction in stock prices, many investors begin to assume their accounts will only continue to grow, ignoring the risks to their portfolios and long term success.

For almost 7 years the FED has rescued the market from any sort of significant correction. They have kept interest rates near zero in hopes of sparking immediate spending which would generate economic growth. One problem though, the U.S. post-recession economy has grown slower than any on record, and much slower than the Fed's models predicted. Consequently, their plan has forced them to keep rates low much longer than expected.

The first half of 2015 opened some investor's eyes to the reality that risk does exist in the market again. With many statements showing flat or possibly negative returns for index investors for the first time in years, perhaps the facade of a strong and stable economy is becoming more obvious. With the daily news being the number one driver of short term market movements, investors show little confidence with the long term outlook and are relying on 'market timing' and 'buying the dips' to make a profit. This sort of behavior is not new, neither is the history lesson that it usually turns out badly.

In my opinion, the downside risk of a market correction dramatically outweighs the reward of staying fully invested. The FED may continue to support the market, but their policies have already shown they do not work as well as hoped. And the markets response will continue to be less excited if the FED needs to get involved again. Our economy is holding on by a thread called low interest rates, and so many investors are holding onto that same thread. One of the idioms that Value Investing relies on is that in the long-term, prices seek a correct economic level. If prices are higher than the real underlying value, they WILL correct. This, by the way, is not market - timing, it is market - pricing. And my reading of history is it ALWAYS prevails. The potential return from an overpriced investment is minimal upside and large downside. That's not a risk and reward scenario that makes sense. Successful investing requires the upside potential to exceed the downside.

My advice: If you're holding onto investments that are overpriced, sell them now. You may have done well with them over the last few years, but that is not a good predictor of the future. Remember the axiom, ' buy low, sell high ' ? To make this work you need to ' sell high ', but most investors don't and, instead, tend to ride their gains right into the next significant decline. The way to tell if an investment is over-priced is simple on paper, and not so simple in practice. It just takes some time and research coupled with experience. P/E ratios are a good place to start with stocks (Btw. U.S. markets are near all-time record highs) with similar metrics for bonds, real estate, mutual funds, variable annuities, etc.

Now is the time to take a sober view of your holdings and liquidate ones that are over-priced. I am happy to take a look at your portfolio and, with the help of our Investment Committee, give you a no-cost opinion of its underlying Value. This is a time-tested tactic used by many of the world's most successful long-term investors. Please call me @ (303) 770-3030 if I can be of help.

"By almost any measure, US equity valuations look expensive."

Goldman Sachs, June 1, 2015

William Mason CFA

It is easy for me to say that stock prices are sky high and interest rates are rock bottom. That does not make for a good investment environment. This year the P/E ratio of the market is higher than the market in 2007, 1987, 1972, 1965 and 1929. The P/E of the market has only been higher once in history and that was in 2000. All of those periods preceded stock market crashes. I'm not going to predict an imminent crash. The danger is real and present. Making matters worse, the revenues for the S&P 500 are expected to decline for the second quarter in a row.

The bubble warnings are coming from some of the greatest investors in history such as Bob Rodriguez, Bill Gross, Stanley Druckenmiller, Carl Icahn and Jim Rogers. The bubble warnings have also been coming from former Fed officials such as former Fed governors Kevin Warsh, Richard Fisher; and Lawrence Lindsey.

Also noteworthy:

No deleveraging. According to McKinsey & Co. global debt since 2007 has grown by $57 trillion. As they stated: "That poses new risks to financial stability and may undermine global economic growth."

The Fed is keeping interest rates too low for too long. As Carl Icahn stated on June 1: "By keeping interest rates this low you are creating bubbles that you don't even know about. And I do think that sooner or later the Fed can't just keep this market up by itself. I say that it's just not a question of could it be the beginning? I think it's not will it happen. It's when it will happen."

The low rates are forcing investors into higher risk investments. On April 15, Stanley Druckenmiller, one of the most successful investors in history stated the following: "And if you look to me at the real root cause behind the financial crisis, we're doubling down. Our monetary policy is so much more reckless and so much more aggressively pushing the people in this room and everybody else out the risk curve that we're doubling down on the same policy that really put us there."

This is the worst economic recovery since WWII. The economy has only been growing at about 2% per year.

Revenue growth basically nonexistent. Since the end of 2008, revenues for the S&P 500 were only up 11.6% and this year they are declining. According to a July 13, ***Reuters*** article: "Second-quarter S&P 500 revenue is expected to have fallen 3.9% from a year ago, according to Thomson Reuters data. That follows a 3.1 percent slide in first quarter sales."

Cash

I do believe that this investment environment warrants being conservative. For that reason I hold large amounts of FPA New Income.

Oil

I do expect the price of oil to increase in the foreseeable future although I would avoid the shale drillers. The FPA Capital, Letter to Shareholders dated April 13 summed up the situation well: "In short, the bar has closed but we still need to wait for patrons to finish their drinks. Billions of dollars of reduced spending and a significant decline in rig count can only mean one thing: less supply. Less supply, barring a decline in demand (the IEA expects oil demand to increase 1 million barrels per day in 2015), can only mean one thing: higher prices."

Gold

The famous value investor Jean Marie Eveillard summed up gold on June 10: "The late Peter Bernstein talked about gold as protection against extreme outcomes. And to the extent that the current situation is extreme, which I think it is... In a sense gold should do well either in deflationary or inflationary times. I think it's an asset which is of interest today as an attempt to protect against the unintended negative consequences of the policies that are currently in place."

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