



Optimist or Pessimist ?

Bill Connors

BC@valuefin.com

One of many clever Mark Twain writings I heard when I was much younger: “There is no sadder sight than a young pessimist, except an old optimist”. I think of this periodically as I age and view the many imperfect parts of the world we live in and the humans who inhabit it. And, of course, as Investment Advisers we are always scouting the risks of economies, financial markets and specific assets – looking at the squeaky wheels, trying to avoid problems.

At 66 I have lived long enough to observe that irony and enigma are common phenomena. Is the glass half empty ? Yes, but it is half full too. Was such and such activity a good thing ? Yes, it was good for some, but not for others. In sort of a Newtonian way, most actions produce both positive and negative effects.

Returning to this format, a commentary on financial topics: Some enigmatic answers are clearer looked at with a time-

horizon perspective. Often what is good for finances and economies in the short-run is bad in the longer-term. Example – debt. Borrowing money eases stress initially as the borrower has more money than before with little pain. Over time, however, the re-payment costs crowd out spending on other things. That new car excitement is replaced by years of payments. Sort of like running downhill, then encountering the uphill that follows.

On a bigger picture and philosophical note I find myself pulled between optimism and pessimism. In spite of some ugly news we are often shown, the standard of living of the average human is the highest ever and increasing at the fastest rate in history. Widespread famines that killed millions in the past affect only small populations today, usually for a relatively short time. This trend of improvement is nearly ubiquitous.

As investors our research introduces us to some truly spectacular, innovative advances. These cover a huge range from artificial Intelligence to medical breakthroughs and promise longer lives with improved conditions for most countries, developed and developing.

Regarding this big-picture my pessimism is more short-term. The huge global build up in debt at historically low interest rates, portends a rough patch when those re-payments come due, possibly at more normal, higher rates. This is a pattern of complacency that humans seem to revisit on a cyclical basis. As societies we get smarter in some areas, but repeat elementary mistakes in others.

At the end of the day, overall I am an optimist. This fits my personality. In economics, however, I find myself distressed by today's current conditions. These make me wary in the short-term.

A Market on Fumes

Scott Taylor

Scott@valuefin.com

On March 8th, the current bull market in stocks reached its 8th birthday. From the lows reached during the '08-'09 global financial crisis, the broad indices of U.S. companies have continued to set records during this second longest sustained advance in the history of publicly traded markets. Great news, right?

Not exactly. Unless you simply own an index fund and blindly trust it to accurately reflect the true value of the underlying businesses it represents, it's quite a bit more complex than that. First, you had to suffer through the gut-wrenching 18-month S&P 500 decline of -57% to get to your 3/9/09 starting point during the worst bear market since the 1930s Great Depression. I know that investors chronically have short memories, but I vividly recall trying to cope with what at the time looked like a financial system on the verge of complete collapse. It's very hard to stay fully invested, let alone buy more, after watching an indexed portfolio get cut in half. Other major indices did even worse. Was corporate America really worth so much less than before at the lows? Conversely, is it really worth so much more now, 8 years later?

My (and my VFA associates) answer is an emphatic NO. This bull market is running on fumes. Unprecedented and unsound central bank policies kited both equity and debt markets to price levels completely disconnected from reality, and faith that fiscal policy will somehow take over to stimulate high & sustained growth is now driving these markets.

The Fed just hiked short term rates for the 3rd time in this cycle, which historically creates headwinds for capital markets. ZIRP justified whatever valuation you wanted to use for stocks, bonds & RE; rising rates reverse this.

The new management in Washington DC has done little so far to move toward the key initiatives of broad deregulation, tax reform and infrastructure spending. Given the obvious facts that a) Donald Trump's style & methods have yet to prove effective as a sitting president (the arbitrary First 100 Days test means little) and b) the Republican congressional majorities are not unified on major issues, the Trump rally has stalled out. Failure of the first major legislative initiative (Obamacare repeal) and escalating foreign policy problems (Syria, N. Korea, Russia) only bolster my resolve to hedge our risk. We must ready ourselves for the next bear market (index declines of -20% or more) as misplaced confidence in fiscal miracles to come fades away. The legacy of post-crisis measures (or lack thereof) is simply too large to overcome.

Ample allocations to cash, short term bonds & precious metals are justified means to protect our portfolios. Inverse ETFs allow us to "short" the market & book gains equal to index losses. Stocks paying ample dividends can help offset price declines. All these investment tactics will greatly cushion the blow when the next bear arrives. He's taking his time to get here while hope "trumps" common sense & math, but arrive he will.

What Happens if ???

Phillip Haydn Connors

Phillip@valuefin.com

When I started in the business back in 2008 with T. Rowe Price, my training and focus was based entirely around a diversified portfolio for retirement savings. I didn't really start looking at total financial situations and planning until I joined Value Financial Advisers in 2011. I feel many young investors follow a similar pattern when learning about the investment world. Their first step is to contribute to an employer plan, but there are a lot more elements to a well-designed financial plan.

One of the most common missing pieces I see with younger couples is life insurance. I too was in this boat. But four years ago I became the proud father of an amazing little girl for whom I am entirely financially responsible, and my thinking changed. Almost immediately I started a college-funding account because the rising costs of college are hard to ignore. If my plan works, in 14 years her college will be covered. But what happens if I die before then? I do not have nearly enough saved for her college today, not to mention the ongoing costs of raising children. So I bought a term life insurance policy with a 20 year level-premium. If I unexpectedly die, those closest to me can use the proceeds to support and raise my daughter.

It seems many younger people don't think seriously about life insurance. They are relatively healthy and think it unlikely they'll pass soon. Factually, they are right, younger people are less of a risk. But I have two acquaintances who passed on early and left their families in a dire financial situation. Logon to any crowd

funding site right now and you'll find numerous pages for families of deceased younger people who are asking for help with bills they can't pay.

Fortunately, for healthy young people, this is not difficult to protect against. Term life insurance is very inexpensive. I actually doubled the amount of coverage on me based on the premium being less than I expected.

How much you need is not too difficult to discern. Pay off the mortgage, maybe any other bills, fund college and other child-raising expenses, and consider leaving cash in the bank for unexpected items. Getting quotes is easy and painless - and no cost. If you like the quote you can buy and set up an automatic monthly bank draft. If you win the lottery you can cancel the policy, and lose nothing.

Dealing with one's mortality is not fun, but is a big part of the financial planning process. While hoping for the best, we need to plan for the worst. Your family will thank you forever if you take these steps and something causes your early demise.

As always, if you want to get a general idea of how life insurance works to protect your family, please feel free to give me a call. Even if you have a life policy, we can discuss if the amount is sufficient and whether the premiums are the lowest available. It's never too late to make a good financial plan for the future.

"Truckload of Nitro Glycerin on a Bumpy Road"

Bill Gross

William Mason CFA

I sent an email to **Bob Rodriguez** mentioning some quotes from **David Stockman**. One such quote was: "In sum, the Trump/GOP coalition is in a massive inherited debt trap, and therefore has zero wiggle room to enact the kind of sweeping, deficit-financed Reaganesque tax cuts that Wall Street is peddling to the homegamers in order to herd them to the slaughter one last time." (Note: Stockman was Director of the Office of Management and Budget under Reagan.)

Bob responded with: "Yep. It is all there but why will investors or the public believe this negative scenario when they haven't believed it before? Why will they listen to reason this time when they didn't in 2007, 1999, or the S&L/high-yield mess of 1987? I could go further back but you get the point."

I've known about Bob's valuation screen throughout my career. It classifies stocks based on items such as P/E ratio, Price/Sales ratio and EBITDA multiples. On March 21, Bob wrote the following: "My own value screens hit the lowest number of stocks qualifying at the end of the year at 24 which compares to May 2007 at 35, January 2004, 47, and March 1998, 47. The screen hit an all-time high number of qualifiers in the first week of March 2009 at 465 versus a prior high of 337. Throughout the entire run of the stock market since 2011, the highest number of qualifiers from my value screen was 77, which doesn't get to the average unless this number about doubles. It just helps to demonstrate how much the market has been manipulated by unsound monetary policy as well as by corporate financial engineering throughout this market cycle."

The following was written by **Fred Hickey** in the March 6 edition of *The High Tech Strategist*: "On a GAAP basis – the way that earnings per share was calculated for the vast majority of my four decades as an investor – there hasn't been any earnings growth over the past five years... Over the same period (during the worst economic 'recovery' on record) there's also been net negative revenue growth for the 30 companies in the Dow Jones Industrial Average."

"Margin debt last month hit a record \$513.3 billion, about \$130 billion (35%) more than investors had at the top in 2007 (a record then too)."

Bill Gross wrote the following in his March *Investment Outlook*: "But our highly levered financial system is like a truckload of nitro glycerin on a bumpy road."

"Don't be allured by the Trump mirage of 3-4% growth and the magical benefits of tax cuts and deregulation. The U.S. and indeed the global economy is walking a fine line due to increasing leverage and the potential for too high (or too low) interest rates to wreak havoc on an increasingly stressed financial system."

Laurence Kotlikoff wrote the following for the February 13, *Dallas Morning News*. Kotlikoff is an economics professor at Princeton and was formerly on President Ronald Reagan's Council of Economic Advisers.

"To begin, economic theory is not perfect. Investors often adopt a herd mentality: 'Prices are rising like crazy. Everyone's buying. They must know something I don't. I don't want to miss out.'"

"Princeton Nobel laureate Robert Shiller was the first to call this 'irrational exuberance.' It produces asset price bubbles leading to crazy valuations — asset bubbles that can burst at any moment because they aren't based on fundamentals."

"Indeed, today's price-earnings ratio is higher than in almost every year since 1880."

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VALUE FINANCIAL ADVISERS, INC.

9185 E. Kenyon Ave., Suite 250

Denver, Colorado 80237

303.770.3030 Fax 303.773.9122

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