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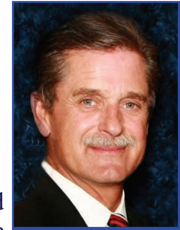
Scott's Thoughts —



Scott Husband

"Those classes of investments considered "best" change from period to period. The pathetic fallacy is what are thought to be the best are in truth only the most popular-the most active, the most talked of, the most boosted, and consequently, the highest in price at that time".

Fred Schwed, Where are the Customers Yachts?

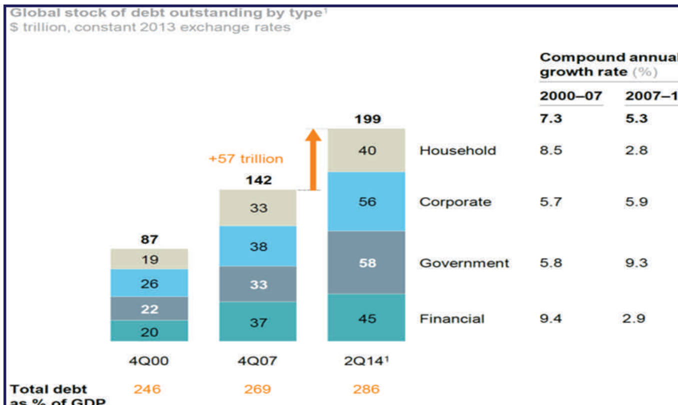
Remember the Dotcom craze? Stocks were the most expensive in history, and after the fact we all knew it was a bubble. The housing market five years into the new century was appreciating 30% a year and everyone was bragging about their profits. After the fact, we knew it was a bubble. Bonds, the income producing asset class, are the most expensive in history; to the point where you pay, not earn, but you pay to own. I think that's a bubble. Stocks have nearly tripled in the last 6 years and are now the third most expensive in US history, just behind 1929 and the dotcom markets. Historically, stocks offer little value at this level.

I wanted to give you a look at what has driven me to be cautious. Some of the following is deep in the weeds, but the idea is that we live in interesting, and I think troubled, times. Zero interest rates, expensive stocks, and tumbling natural resource prices will not last forever. Nearly every central bank wants inflation and when enough money has been printed, they will get their wish.

"'Price is what you pay; value is what you get.' Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down." ***Warren Buffett***

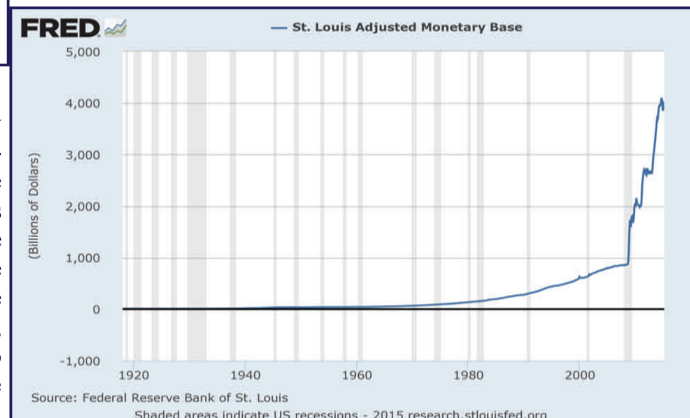
Interest rates are **negative** in some parts of the world. Goldman Sachs estimates that nearly $4 Trillion of the world's debt trades for negative returns. Imagine willingly buying an investment that guarantees a loss. With negative interest rates, you give someone your money and make them swear to give you less in five years. That is like having the bank pay you to borrow money! It makes no investment sense and reminds me of the saying, "Something that cannot last forever, doesn't".

The chart below shows that in spite of the appearance of deleveraging that has occurred since the beginning of the Great Recession, world debt is nearly 40% higher compared to world GDP.



Bonds are the most expensive they have ever been, not every bond and not everywhere, but in their entirety, bonds are trading for record high prices-- this is the same as saying interest rates are at their lowest.

Now, old timers will tell you that if you print more money than your economy's growth, you will create inflation. There are many examples throughout the 20th century of governments excessively printing new money in an effort to meet (pay for) their promises. The chart below shows the growth of the US monetary base since 1918; some might call the recent move, "parabolic".



But there is little (stated) inflation. The Fed desires a 2% yearly increase in the CPI, but we are not even close to that. Yes, everything I buy costs more, it takes as much today to feed my wife and I as it did 15 years ago to feed our family of 5. Beef prices are at record levels, it is easy to spend $65,000 on a truck, and the phone on the kitchen wall is gone as is the $8.00 a month phone bill. These new dollars did make some things more expensive though, primarily bonds. Once again, bonds are so expensive, that the dollar in your pocket is worth less than the promise to return it (in some countries on a nominal basis, and in many more on an inflation adjusted basis).

Scott's Thoughts (continued)

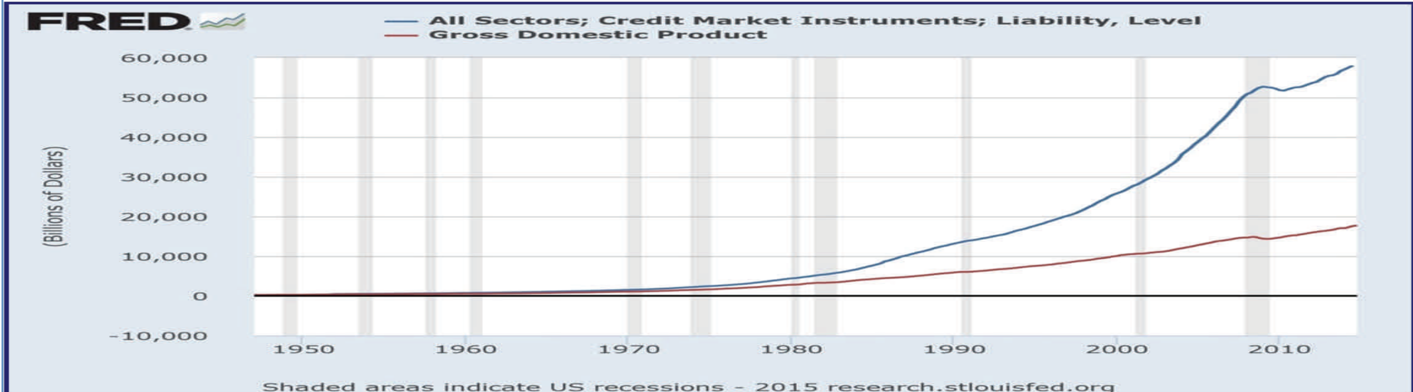
"There are no new eras-excesses are never permanent", Bob Farrell.

All these new dollars have brought us not only an expensive bond market but also joy to the stock indexes. Most managers underperformed the stock indexes last year, but the indexes did go to new highs. The Schiller PE ratio has been higher on only two occasions, 1929 and 2000. Just recently the stock market went higher than the ratio achieved in the 2007 bull market, just before the Great Recession began. The NYSE stock market capitalization is at record highs of nearly $20 trillion which is about 50% higher than it was at the end of the dot.com craze and about 10 times more than 30 years ago. The printing of money did create inflation, financial asset inflation.

"The four most dangerous words in investing are 'This time is different.'", John Templeton.

We ended our QE venture and are now watching Europe begin their Trillion dollar bond purchases (printing). Everyone is aware that Greece can never meet its' obligations, Portugal, Spain and Italy are close behind. Japan is borrowing their entire budget and owes more than twice their GDP. Their intent is to devalue their currency in an attempt to provoke consumers to spend more money, thus creating more demand, resulting in a faster growing economy. Some argue it has worked, others say it has not, but the current recovery from our last recession is the weakest on record. And Europe is doing worse than we are.

The chart below demonstrates the growing spread between US GDP and US Credit. Basically, a lot of money has been borrowed to acquire less growth. In the 1970's the ratio was 1.5:1, in 2000 the ratio of debt to GDP was 2.5 to 1, and at year end 2014, the ratio is 3.25:1---The growth of credit has ballooned way beyond the economy's growth rate.



But what I find most fascinating is the public's belief that today is normal, that interest rates might go even lower because of the deflation perception (I find it very difficult to believe consumer prices are declining), that stocks offer great value at this level (record high stock prices), and the 50%-75% decline in natural resource prices is only the beginning of a larger trend lower.

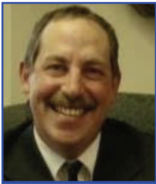
Being early in this business is a close cousin to being wrong. Bond prices can go higher and interest rates can go lower. I think it is more likely that stocks will move higher, from expensive to more expensive. I am perplexed with a lot of the natural resources trading below the cost of production; one would think this can't last because no one stays in business for very long selling products for less than their cost. But then again, in a world of negative interest rates, perhaps losing just a little is the new norm.

One of the rules of investing (assuming there are still rules) is that as markets become more expensive, you lighten your investment exposure. As markets decline you increase your investment exposure. Basically you want the least of something as it peaks and the most as it bottoms. I've kept bond exposures shorter than the indexes because there is simply too little upside and so much risk. A ten year treasury returning to an historically normal rate will decline about 35% in value. That is simply too much risk for the little bit more in income earned. I have been light in stocks thinking there would be a correction. The equity market has simply moved higher with caution being a cost rather than a benefit. My like for the third asset group, the hard assets, has been hurtful. Not only are many in the group selling for less than cost, but the companies producing the items are trading at levels approaching 10%-15% of their old highs! If we turn the saying around, "Those classes of investments considered 'worst' change from period to period. The pathetic fallacy is what are thought to be the worst are in truth are only the least popular-the least active, the least spoken of, the least boosted, and consequently, the lowest in price at that time".

I have a history of being early that has served me well. Historically I was able to out-perform the averages with a lot less volatility. I sold expensive and bought value. Occasionally I tripped. I never saw negative interest rates coming. A stock market trading a third higher than average with the world's economies in a low to no growth environment amazes me. In the long run everything returns to the mean, which is another way of saying that the next big move will be unlike today.

Thank you

Visiting Europe—for Fun and Profit



Mark Simpson

First, a quick flashback.

Six years ago last month, the US Federal Reserve began its process of Quantitative Easing (i.e. creating new dollars to inject into the financial system) and kicked off what has been called "the most hated bull market in history". It was thus named because it was fueled by the influx of new dollars, it suffered little competition for those dollars from the lowest interest rates on record, it eschewed such mundane concepts as company fundamentals or durable profitability, and its unmanaged indexes continued to leave the majority of active portfolio managers to explain their underperformance. Even company directors, with the task of allocating profits toward the most promising directions of new corporate growth, could find few avenues more attractive than the repurchase of their own shares. Over the past several years, some companies have directed more than half of their operational cash flow for this purpose.

Across the pond, the European Central Bank, having only their interest rate tools, and a series of agonizingly-arranged bailout pools for those countries most deeply affected by the crisis, was unable to engage in the same style of monetary expansion as the US employed. Signs of economic growth appeared only to fade away in later periods, and the afflicted countries (Greece, Italy, Spain, Portugal) traded off feature roles as the problem of the month.

Fast forward to today, and the long-suffering ECB has found a way around those dastardly constitutional controls and is beginning to print new Euros at a rate that makes our Fed look like pikers. Our miserly reserve bankers topped out at the rate of $45 Billion of new dollars a month – the ECB is going to generate $60B, and has promised to continue that rate through the end of next year!

At the same time, though not uniformly rosy, US economic figures have been showing improvement, and look downright enviable when compared with other developed nations. The Fed ended new money printing last fall, and have been warning that they may raise interest rates for almost a year now.

The primary result from these two changes in monetary posture has been most immediately and dramatically manifested in the relative value of the two currencies. One year ago, purchasing a Euro would have cost you $1.35 US. Today, you can pick up that same Euro (or maybe one of the new ones!) for $1.07. And that's up a nickel from last week. Most financial observers think that "parity" (i.e. $1.00 = €1.00) is already cooked in, and the debate is on where the Eurobottom might be. The relative strengthening of our dollar is also seen in most other developed market comparisons, including Australia and Japan.

Here at Denali Capital, we are proud to work with many sophisticated, cosmopolitan, world-traveling clients, and knowing that you too, dear reader, are among that select group, I point out an interesting feature of this currency move. For those who have any desire to go across to The Continent for a visit, things just got a lot cheaper than they've been in a long while. Food, lodging, souvenirs and local transport should all cost about 25% less than it would have in 2014. Please note that I am stating this as a point of interest only – it is not an offer of travel advice, nor is it a solicitation for the purchase of travel advice. We provide investment advice.

Speaking of which, in the likelihood that Euro-area investors, banks, and brokerages react to the new liquidity as their US counterparts did in 2009, many financial sages are calling for European stocks to outperform our markets over the medium term. Money flows suggest that US institutions are listening. According to Bloomberg, in the first quarter alone, ETF holders pulled $14 Billion from US stock funds, while adding $29 Billion to international funds. Denali Capital clients could expect to see allocation shifts in that direction as well.

So you could visit Europe yourself, or simply let part of your portfolio visit it for you. You could stroll the halls of the Louvre, and explore castles along the Rhine, or stay right at home while we look to pick up shares of Unilever or Volkswagen. Europe is on sale right now, and we hope this is to your benefit.

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REFERRALS

A successful business grows through personal recommendations from satisfied clients. If you have a friend or associate who may benefit from our services, please ask them to give us a call. Thank you to those of you who have already referred clients.

The Fish Sez…

"Here's lookin' at you, kid…"

Rules for Retirement Plan Contributions

Traditional and Roth IRAs
You can make a contribution to a traditional individual retirement arrangement, or IRA, anytime up to and including the due date for your tax return. That means you have until April 15, 2015 to put money in your IRA and still count it as a contribution for 2014. This IRA rule holds true whether your contributions are deductible or nondeductible.

For Roth IRAs, the deadline is also April 15, 2015 for 2014 contributions.

If you file a tax extension, you don't get any extra time to make your traditional or Roth IRA contribution.

SEP IRAs
You can set up a simplified employee plan, or SEP, and make matching and nonelective contributions until the deadline of your business income tax return, *including* extensions. This is true for self-employed SEPs and employee SEPs.

SIMPLE IRAs
You must set up a savings incentive match plan for employees, or SIMPLE IRA, by Oct. 1 of the year to which a contribution applies. For example, to make a contribution for 2014, you must have set up the plan set up by Oct. 1 of that year.

However, you have until your business income tax return due date, including extensions, to fund a SIMPLE IRA.

Source: www.fool.com

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