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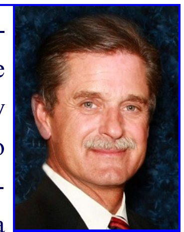
INSIDE:

Scott's Thoughts —



Scott Husband

A member of the Federal Open market committee recently said that while income assets are paying nearly nothing, lower interest rates are a positive because the stock market continues higher. The prudence of paying top dollar for equity ownership in corporate America when all one really wants is your savings to earn something is hard for me to put my arms around. TINA (there is no alternative) is today's "this time is different" statement. When I am told that to obtain a nominal return on my savings (which was delayed consumption) I must risk my principal, the hair on the back of my head stands up. Really? We are supposed to believe that it is normal to earn nothing on your savings, it is normal to be forced into risky assets like stocks and 2% 20 year bonds. Yes we are supposed to believe today's investment world is going to be this way for a long time. Why?....because "there is no alternative".

There may be some good times ahead, but the end will surely be ugly. Morgan Stanley said today that the stock and bond markets are a "bubble". Frankly, nearly everyone who has studied the markets for even a short while knows that. Bill Gross called the financial markets a "Vegas casino". Stephen Roach, former Morgan Stanley chief economist stated "Central bankers desperately want the public to believe that they know what they are doing. Nothing could be further from the truth." We have experienced five consecutive quarters of earning declines, with stocks near their highs! The IMF has for the third time this year, lowered world growth expectations. Bonds trading below zero return exceed $10,000,000,000,000 (10 trillion); a lot of money owning a guaranteed loss. A simple 1% rise in bond yields across the curve, could cause investors in the 20 year treasury bond to lose roughly 20% of their investment value. "Michael Lebowitz shared a chart today showing the utilities sector, one of the most popular yield-focused segments of the equity market, trading at 3 standard deviations, also called "sigma," above its long-term average. Jeremy Grantham defines a bubble as a 2 sigma event, which should occur every 44 years or so. This 3 sigma event in *utilities is statistically the very same degree of overvaluation we witnessed in residential real estate at the height of its recent bubble*....according to Grantham". S&P companies are paying out more in buybacks and dividends than they are earning, no R&D funds available. Switzerland's central bank now owns more publicly-traded shares in Facebook than Mark Zuckerberg, part of a mushrooming stock portfolio that is likely to grow yet further, the Swiss Central Bank holds $129 Billion in Equities. The Bank of Japan owns substantial Japanese and American equities. U.S. Fed Chairman Yellen hinted there is consideration that the Fed may buy stocks too. A simple question; when governments, who can print the paper we work for, buy stock and bonds, who is left? And who are they going to sell to?

From Gavekal Research (9/12/16) ….. "There is no law that says you always have to be fully invested. In fact, just the opposite. I like to have as much cash as possible at any point in time. *Cash is an option to buy something cheaper in the future*…In my mind, there is nothing worse than being fully invested… on the highs. It's always good to have cash. Lots of cash. Many people don't see it that way. They look at cash as a drag on your returns. Maybe if you are a large cap growth manager trying to closet index the S&P 500. But as an individual investor, you have no benchmark you're trying to outperform. You're an absolute return investor. Same as a hedge fund." The research report continues with:

"1) Private sector GDP: The 12-month rate of change stands at 1.3% YoY, a level which since 1968 has *always coincided with a recession*.

2) Industrial production: The six-month moving average of the 12-month rate of change has been negative for a good while, *which since the 1930s has never occurred outside of recession conditions*.

3) Non-financial profits (national accounts): *Since the 1950s these have not been lower than three years ago without a recession* (save 1986-87).

4) Capital spending: The two-year rate of change is negative and (save for 1987) this *situation has always coincided with a recession.*

Scott's Thoughts (continued)

5) New home building permits: The 12-month *rate of change has swung negative, which has often been a recession signal.*

6) Exports: The six-month moving average of the 12-month rate of change has *gone negative, which has almost always coincided with a recession* (there have been recessions with export growth).

7) Industrial sales: The YoY change is in negative territory, which has *usually been associated with a recession.*

8) Tax receipts: The six-month moving average of two year variations *is negative, which has never happened outside of a recession……"*

As investors, we have experienced a sub-par recovery, for a very long while. Complacency is everywhere, which is not good. Investors should be as frightened (an emotion) of this market as they typically are near the climax selling of a bear market. History suggests normal valuation levels are about 50% lower than today; and inexpensive is nearly 2/3rds lower. As simple as it sounds, owning a lot of cash when things are expensive is an effective investment strategy. There is little worse than being fully invested when a correction becomes a full blown bear market. Losses are emotional and drive investors to panic sell just at the moment they should be buying. Having cash around in a decline makes one much more objective, rational and profitable. Having cash as markets appreciate makes one under-perform the stock index (relative performance). Greed is a strong emotion fraught with risk. Rothchild said, buy when there is blood in the streets, and Warren Buffet has said, "The stock market is a no-called-strike game. You don't have to swing at everything — you can wait for your pitch. The problem when you're a money manager is that your fans keep yelling, 'Swing, you bum!'".

If you own stocks and long bonds, I see it as a bet that the Fed will buy equities and you will sell prior to the Fed ending its' stock and bond purchases. My preferred allocation is light stocks and short duration quality bonds. This strategy has under-performed because the markets have not declined yet. I am comfortable because markets always return to normal and absolutely nothing lasts forever; though early to the cash party I am.

"Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria." - Sir John Templeton

Denali Capital attended the Gala for a worthwhile cause, BCDC.

Senator Lisa Murkowski pictured on the right with the DCM family.