Bond King Moved His Throne

We ended Q3 with an industry shaking bit of news as Pimco founder and Chief Investment Officer Bill Gross left his own firm to join Janus Funds. For many years we have owned Pimco funds and as of this writing we continue to hold a select few positions.

At Goldey Capital we have reviewed Pimco funds twice in the last year as the firm went through recent turmoil when Bill Gross's heir apparent Mohamed El-Erian resigned. I've had the good fortune of being at the economics conference when Mr. El-Erian announced to the world his observations of "A New Normal". His thoughts and observations have helped shape the way I have looked at the markets and our client's investments. Mr. El-Erian's resignation and the reasons surrounding the event were strongly felt. For 2013-14 we have been reducing or eliminating our positions in Pimco funds managed directly by Bill Gross on a selective basis of client's holdings and account needs. As of end of Q3 2014 our exposure to Pimco fund was primarily the institutional share class of Pimco All Asset Authority Fund (PAUIX) led by Robert Arnott and we also own a few remaining shares of the ETF version of the Pimco Total Return Fund (BOND).

We have been increasing our bond manager allocation for the last four years to manager Jeffrey Gundlach at Double Line (DBLTX) which is now Goldey Capitals largest mutual fund holding and also Templeton Global Bond fund (TGBAX) managed by Dr. Michael Hasenstab which is a close second to position size within Goldey Capital.

In general we have been lowering our bond positions over the last year as we have written about numerous times. On October 2nd Warren Buffet announced that the pension funds for Berkshire portfolio companies – with the exception of a few of his utility companies – are 100% in stocks. Mr. Buffet has owned bonds in the past and many of his deals have often had a fixed income component. Quoting from that Oct 2nd Interview on CNBC On the stock market broadly, he said "everything is a function of interest rates ... interest rates are like gravity." "If interest rates were 10%, all of our stocks would be worth less." Buffett said then that with interest rates near 0%, all assets were worth more. "Every asset, at present value, is worth the cash it will return before its termination date."

What is the magic investment benchmark for me during my almost two decades as a financial advisor and portfolio manager? It wasn't some tech company IPO or other newsworthy headline, it was the ability to find a good selection of AA rated Muni Bonds with a 5% tax-free yield. Today that search for quality tax-free yield with decent maturities is rarer than an albino unicorn.

In my opinion rates will not skyrocket and it will be quite some time before I might see the return of 5%+ yields on quality Muni's. I am already surprised that the 10 year rate has not crossed 3% as I thought we would end the year above this level, as did most money managers. Quite interestingly Doubleline's Jeffrey Gundlach has been saying the opposite and has accurately predicted the malaise in US Treasury yields.

In this authors personal opinion if US interest rates went higher to historical norms based on current global economics we would potentially have a global disruption of significant magnitude. Here's why:

According to the website www.nationaldebtclocks.org the US has currently $17.7 trillion in debt and growing at almost one million dollars a minute. Can you imagine what that would happen to the US Budget if the rate on Treasury debt increased by 1.5%? The interest payment alone would rise by $260 billion which is more than the **combined** budgets of The Dept. of Health and Human Services including Medicare and Medicaid, Dept. of Education, Dept. of Veterans Affairs and the Dept. of Housing and Urban Development. Talk about fixing America's bridges and infrastructure the 2014 budget for Army Corps of Engineers was only $4.7 billion. If rates were to rise 1/100th of a percent (also known a 1 basis point) that would equal almost 3x the entire annual budget of the Army Corps of Engineers. (Source Office of Management and Budget)

As a follow-up to previous newsletters where we discussed the difficulties individual and commercial borrowers are having in getting loans. Former Fed Chairman Ben Bernanke just publicly stated that he was unsuccessful in refinancing his mortgage. Remember low rates are meaningless if the banks don't loan.

Besides low yields another effect of foreigners supporting our currency is a strong dollar. This strength has caused troubles for exporters and foreign companies based on the US Dollar.

Since our financial practice is built on individual care, many clients' portfolios look different based on individualized needs and goals. We always welcome the opportunity to have a conversation on any topic discussed as the noise from television and other media may be overwhelming for the average investor. It's our honor to serve our clients and we will continue to be steadfast in guiding our clients through these volatile markets.

decisions that may or may not have worked as expected are not to be construed as trading errors but rather honest opinions articulated to the reader.