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"Debtutante"

A débutante (from the French *débutante*, "female beginner") is a young lady from an aristocratic or upper-class family who has reached the age of maturity, and as a new adult, is introduced to society at a formal "début" presentation.

The title of this article is my segway into discussing the beauty contest of debt. Currently the beauty contest of world economies is between strong balance sheets and weak ones. Strong balance sheets are the attractive suitors, and others are taking what they can get.

A constant theme of mine is: "Bonds are more important than stocks, and without understanding debt structures you should not invest in equities (stocks)". Recently, Greece, a relatively small nation (Greece's GDP was $305 billion in 2010, California's was $1.85 trillion), has occupied headlines around the world with a financial crisis that has the potential to create a ripple effect similar to the Bear Stearns or Lehman collapse. This possible meltdown is due to the ever-present globalization of a world in which we are all inter-connected. Within this "small world" strong nations often look to invest their excess capital, and increase their wealth, through attractive yielding bonds issued by nations looking to increase capital. Greece can hardly be called the young debutante, as their financial history supersedes almost everyone. But Greece and their Euro union are young having recently debuted.

Greece was temporarily bailed out by some of their more economically stable European brethren. Without severe adjustments to principle or terms, I think it is almost impossible for Greece to pay off their massive debt, causing the issue to be delayed. This "Pretend and Extend" solution is a Band-Aid not a remedy. As this is being written American politicians are still debating raising the debt ceiling. How will America address our debt situation? Will America start to address our debt problems or just kick the can down the road once again?.

I have been carefully monitoring some of the most respected money managers in the world as they have been very vocal on their observations and opinions of debt. Bill Gross from Pimco has stated they are no longer buying long US Treasury bonds and famed Hedge Fund manager Jim Rogers has publicly declared he is shorting US Treasuries. The ultimate irony is when big scary events (real or imagined) come about on the world economic stage the US Treasury market rallies. Why? Because ultimately the USA is still looked upon as the world's most stable place for safety of principle.

China is raising their rates to fight inflation and the USA is keeping them as low as they can. Why? China is producing and America is not, it's almost that simple. Rates will eventually rise,

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which is why we have to be very careful in the types of bonds or bond managers we use for our portfolios at Goldey Capital.   In client reviews I address what we are buying and why.

America is no longer buying back its Treasuries, but they are still buying mortgages in the form of support for Fannie Mae and Freddie Mac. This cannot continue and must be dealt with, because that snowball is compounding as it rolls down a very steep hill. It's estimated by the National Mortgage Association that over 90% of all mortgages are purchased by government agencies. Ask yourself, would you lend money to your neighbor for 30 years at 5% interest taxable? Wait before you answer… Also factor this is a non-recourse loan so they could simply walk away and not pay you the 5% interest and principle, and there is nothing you can do about that. I would guess most investors would not loan their hard earned money under these terms, but this is exactly what we are doing as taxpayers! Our country will be broken until we fix the underlying mortgage situation in America through privatization and removal of debt from taxpayer balance sheets. Yes we have other economic concerns such as: Social Security, Medicare, Debt Ceilings and State Budget Shortfalls. Ultimately though, the mortgage industry is a keystone because it touches so many lives and interconnects our society on so many levels. With that said, based on current rates for LIBOR, a 30-year mortgage for a potential homeowner placing 20% down should yield a marketplace yield of somewhere between 6.5-7.5%. Corporations with better balance sheets than most homeowners, pay this rate or higher, for similar maturities.

Increasingly I have been a buyer of select California Municipal bonds as they seem to be one of the best overall values relative to the fixed income market. I am always available to discuss this debt issue with clients of Goldey Capital and my justifications for the purchase of particular individual bonds.   Additionally, I have placed an emphasis on taxable bond managers that have proven themselves adept and tactical in changing markets, such as; Pimco , Doubleline, Templeton, and others.

From 1996 until 2008 I was a core buyer of bank stocks for my portfolios, but thankfully, through diligent market analysis, I was able to sell off my holdings in large banks before the collapse of the industry. That brings us to today. I just bought back my first bank stock in three years in the form of Bank of America (BAC). Why now and why BAC? I think this stock has troughed on the low side, it currently sells for less than their book value, trading for about six times its 2012 earnings estimate, not to mention BAC is one of the largest financial institutes in the world and its highly unlikely it could ever collapse (too big to fail!). Hopefully, I am right and they stabilize their balance sheets and start paying a dividend of significance. I don't expect BAC to be out of the woods anytime soon, or a declare an immediate dividend, but I think it is an interesting time to enter at a price of $10-12, based on the metrics I just reviewed.   I feel the industries of financial banking and insurance are strong plays, and as my confidence increases I will continue to invest back into industry leaders.

Cash is a terrible investment at these rates but is relatively safe if you don't factor in erosion based on inflation. For many clients over the last nine months I have been holding too much cash. My reasoning behind this strategy has been to maintain flexibility and limit principal loss. My job as a financial advisor is not for the general public, but rather advice to individuals under my Fiduciary care. Of course every client is different which is why the advice is never a blanket statement. Even for those clients fully invested, their portfolios are filled with tactical investments like the aforementioned bond managers, as well as investments in currency and commodities via ETF's/mutual funds, or tactical equity managers such as Blackrock Global Allocation Fund.

On July 7th ADP job report looked good saying with jobless claims dropping by 11,000 and private sector added 1570,000. That same day, Warren Buffet on a CNBC interview said the the 265,000 employees of Berkshire Hathaway have a job and they will probably increase head count over the next year. July 7th the S&P 500 was up by 1.05%. Today, July 8th the Government official numbers came in and they contradict ADP finding severely with an estimate of only 18,000 jobs created by the U.S. economy. This article is being sent to Goldey Capital clients mid-day on July 8th and the S&P 500 is currently down 1.1%

Like the debutante filled with excitement about the future, I too am optimistic. However, I have decades of experience and wisdom which is why my optimism is shielded with caution.

Sincerely,

Ian Goldey

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Portfolio Manager

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