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2013 was one of the craziest years in financial history, and also one of the most difficult years for financial advisors. In 18 years as a portfolio manager this year was the hardest I have ever worked. Global politics, economic stimulus and other headline news sure made for an interesting year.

Headlines everywhere show the great returns of 2013 but how many people put 100% of their money into stocks? A better way to ask that question would be; how many people remember the recent financial collapse and then put their entire savings into stocks for 2013? A very large portion of our clients are high-income earners or middle class millionaires who have saved their entire lives to enjoy the second-half of their lives. Additionally, most of our clients had parents that survived the depression and that experience has not left their psyche. 2013 was the year of cautious optimism in a world where money market rates earned close to zero and banks did not want your cash deposits.

Most bonds and anything to do with yield became a taboo in 2013, and some of the methodology defied logic for this advisor. The expression “throwing the baby out with the bath water” certainly applied.

A commentator I have respected for quite some time is Jim Kramer from CNBC who highlighted the euphoria around “Cult Stocks” such as Amazon, Tesla, Netflix, Facebook, Twitter, etc. Some of these cult stocks were newly hatched and already have market capitalizations comparable to well established brands. For example Twitter has a current value of almost $36 billion and CBS’s value is $37.5 billion; Facebook’s value is $135 billion while Disney’s value is $133 billion. I scratch my head and ask, “Doesn’t anybody remember MySpace, AOL or all the other darlings that came before”? Digital trends change so quickly how do we know if these new brands will last?

2013 was also the year of the activist investor, such as Carl Icahn as well as the year of hedge fund managers engaging in retail rhetoric on shorting certain stocks. Certainly not the type of investing the average person engages in their personal retirement accounts. According to multiple articles on the internet the average hedge fund posted only a 6.5% return in 2013, and hedge funds are typically; illiquid, leveraged and have very high costs. Illiquid and leverage was not the approach we used for investing our clients’ money in 2013, and we have not allocated any capital to these types of hedge funds.

With the USA printing money as fast as possible in 2013 it seemed logical that Gold should have rallied as investors would seek out an offset to inflation and a possible devaluation of Fiat Currency such as the US Dollar. Instead Gold had one of the worst performances in 30 years, down 28%. In September 2011 Gold hit $1900 an ounce and ended 2013 at $1,202…ouch that must have hurt all the hoarders of glittering metal. However Bitcoin made its newsworthy debut in 2013 as an alternate currency. I have been personally following Bitcoin for about 6 years and have not invested a dollar into this currency nor do I anticipate that view changing in the foreseeable future. The premise is the same, which is humans want an alternative investment because they are scared of Government collapse. This is another reason why we saw the international wealthy pay record prices for; diamonds, art, real estate, wine & whiskey, collectible cars, etc. A rotation into hard assets regardless of valuation and prices paid.

Bonds – are the stalwart of solid investing. Bonds – are typically the foundation of any good balanced portfolio. Bonds – were the taboo of 2013. As I have written about many times before Bonds dictate the direction of most markets and investing. 2013 was a great time to borrow money for the long-term and based on homeowner refinancing and corporate debt issuance many took advantage of low rates. The 10 year US Treasury started the year at 1.76% and finished with 3.03%, this equates to a 75% change from original yield on this AAA quality investment. If you were a buyer of these types of Treasuries then you are looking at massive paper losses although you will get 100% of your money back if you wait 9 more years (not accounting for inflation or opportunity costs). At Goldey Capital we were not allocators of Treasuries in 2013, other than short-term instruments found in many mutual funds and ETF's.

I was lucky and fortunate enough to sell most of our client's long-term Muni bonds before the collapse in yield occurred but that only preserved their paper appreciation. The remaining muni bonds that were not sold were shorter to intermediate-term maturities (1-15 years) and continued to pay dividends but their paper values fluctuated greatly. High Yield bonds aka Junk Bonds did very well in 2013 as investors were chasing the highest yield and willing to take risks, which made sense as the US Government bought debt and kept interest rates artificially low, while the economy stabilized and improved. Emerging market debt did not fare as well and saw negative returns in 2013. Unless you were willing to bet on Greece which rallied strong, but that was a big gamble for a bankrupt economy being propped up by foreigners.

I was a big buyer of real estate investment trusts (REITS) in 2013 and have been for quite some time. REITS went through a huge roller coaster ride in 2013 and often I could not figure out any logic as to why? One of our firms largest holdings is Starwood (STWD) REIT led by CEO Barry Sternlicht and each quarterly report the company management discussed how they are taking advantage of this disconnected market and making great loans at attractive returns, plus how they have positioned the portfolio against rising rates. STWD did post great returns for 2013, some others did not. Lexington (LXP) is one of our holdings and it has 213 properties in 41 states and a 98% occupancy rate that is triple-net lease, and they finished 2013 in negative territory. There are always detailed reasons for divergence but sometimes logic is hard to find, and then one day the market says your stock in the same sector is a bargain and it rallies. At least that is what holders of undervalued investments hope for.

Deep Value in 2013 was equally volatile and in my opinion seldom rewarded, one exception for us was Amerco (UHAL) in some of our portfolios. UHAL does not have a declared dividend but it has managed to pay several special dividends in recent years, and the stock has rallied nicely based on earnings growth and their story emerging more in the public investment forums. At Goldey Capital we still own some companies trading at 5-10X future earnings (expected PE), and that is OK when I look at the teachings of Warren Buffet, who famously said, "In the short-run the market is a voting machine but in the long-run it is a weighing machine." If a company has earnings and those earnings are not being properly valued then the market will eventually figure it out. How long for this appreciation to emerge is the question? For example, the stock Iridium (IRDM) is held in many of our accounts and this company is profitable but pays no dividend. IRDM has a wide moat as the only telecom that covers the entire globe, plus they have cash on hand and received recent contracts from various sources that exceed their current market capitalization of $475mm, and yet the stock is trading for just 7x estimated 2014 earnings. That makes no analytical sense to this portfolio manager. Amazon is a company we love to use in our personal lives at the Goldey household but not in our investing account where the company is trading at a value of $179 billion and a future PE of 148.

2013, The Correction That Never Came. I was one of millions of investors that thought we would see some type of meaningful pullback at some point in 2013 and that simply did not happen and those with cash were punished with underperformance. The pullback we experienced in 2013 was brief and certainly not the type that would encourage bargain hunters.

So what to expect for 2014 and how do we position our clients investments for this coming year?

- We continue to think rates will rise is 2014 and believe the 10 year treasury will finish with a 3.7% yield and the 30 year Treasury will finish with a 5% yield. This would be a healthy yield curve and still be attractive enough on a historical basis to encourage loans for real estate and business.
- We are still avoiding buying bonds and funds that have an emphasis on longer maturities and will continue to favor; senior bank loans, shorter and intermediate maturity bonds and also foreign bond managers that have proven adroit in this market. I am hopeful that by the end of 2014 we will see some opportunities in muni bonds because I really like owning this asset class for our higher income clients and also for clients in lower income brackets that simply are looking for dependable income.
- We will continue our focus on value investing with total return. That's another way of saying we like dividend paying stocks that trade at good prices.
- We will be consolidating client accounts into fewer managed styles for simplicity, lower costs, and to address the market conditions we see in the coming year.
- We will not be encouraging any clients to use leverage and we still place a large emphasis on maintaining liquidity.
- We do expect some type of correction in 2014, assumed 10-15% range, but then again we expected that last year. We would view this correction as healthy as it would deflate some of the exuberance that currently exists. At Goldey Capital we would prefer a flat market with slight growth as this would allow us to collect our yield with some combined appreciation. With an improving economy in the USA and other markets we think there is potential for another year of positive returns, but nowhere near 2013. With money market rates earning near zero we think a 6-9% total return would be a fantastic goal for 2014.
- Eventually all this printing of money by the American Government will lead to inflation but I don't see that happening in 2014. Deflation is probably a bigger threat to the economy. Deflation simplified means; people have money but don't want to buy anything so prices stagnate based on low demand. Wage income has not increased for the average worker and most costs have remained stable, with notable exceptions in sectors such as education, and health care.
- America will eventually stop buying back so much of its own debt. I have not been a fan of this buyback program at the levels we have witnessed and don't think it is good for our long-term economy. I would like to see this program stop ASAP, but everyone is afraid of the consequences if you take the drug away from

the addict. But my opinion is coming from someone that thinks you should; live below your means, don't spend what you can't afford, have little to no debt, and plan for the possibilities of bad things happening. Our elected officials apparently never took a lesson in household economics, but then again other nations are buying our debt so why not issue at low yields? My greatest fear is what happens when China and other nations stop supporting our dollar, and China has been pushing for this change as they understand completely what is happening. This is another reason why you see Manhattan, San Francisco and other select cities throughout the world have skyrocketing real estate prices as its being bid-up by foreigners who have huge reserves of cheap US Dollars and need a place to invest. Remember Japan in the 1980's when they did the same thing?

- Banks will increase loaning to a more traditional base of their clients such as businesses and this will be good for workers and the chain reaction of a stronger labor market. Most of the major banks have had a huge cloud of uncertainty over their heads in the form of litigation and these variables are being resolved (settled) and should free-up some of their loan capacity. The American economy is stronger than most understand and bank loans are the lubrication that keeps the machines of business turning. Get the banks to start loans and business owners can buy more machines, hire more workers or whatever else to expand or increase capacity.
- Merger & Acquisition (M&A) activity should increase and I was surprised that 2013 was not a bigger year in this department with rates so low. Then again this really illustrates how fearful companies have been. M&A makes sense in this current economy and small to mid-cap size companies should benefit from this trend. We did see something I was very hopeful for which was the Verizon takeover of Vodpahone (VOD) as we were owners of VOD based primarily on their value of Verizon Wireless stake. VOD was another example of an underappreciated asset that just languished until everyone picked up on the low valuation. We also saw silly attempted M&A in 2013 in the form of Facebook (FB) trying to buy privately held Snapchat for a reported $3bb, and yet amazingly being rejected. Who knows how this will play out but I prefer M&A deals such as the Berkshire participation in the takeover of Heinz.
- I see no reason to believe that our elected officials (all three parties) will stop their partisan behavior and I am sure that this will lead to more crisis headlines.

It’s hard to avoid this noise as it affects the financial markets which are another reason we favor yield oriented investments and also value.

Wishing all our clients a prosperous new year in finance, health and appreciation for all that is good.

All the best,

Ian Goldey

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