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Current Investing Synopsis, Why, When & How

"**Why** has the market gone up so much"?

My best guess is because the Federal Reserve (Fed) is buying $85 billion a month in Treasuries, and has not said when it plans on stopping. Also, because of low interest rates and low inflation, companies are posting decent earnings and a recent pick-up in M&A. (Mergers & Acquisitions)

"**When** will the rally stop"?

It will stop when it does! Many pundits have been wrong for the last few years, yet the market just broke new heights. Although there are tons of reasons to be pessimistic, the market keeps rising. (See answer to first question, Why.)

"**How** will the market change"?

Low rates can't stay low forever. Rates are artificially low because of the Fed (see answer to first question, Why) plus other countries' problems have many foreign investors viewing the United States as a safe place to invest. For example, Cyprus Bank holders wake up one morning to find their bank accounts have been held hostage by a new tax, and they are looking for a safe place for their savings. As of this writing on 4/5/2013 the USA 10yr Treasury yields 1.69%, which is absurdly low and creates its own series of problems and opportunities.

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Now the big question remains, what are we doing about this market?

That answer depends on each client's needs; however, if we were to answer this question broadly, we would say that our clients should have diversity between bonds and equities. They should place an emphasis on yield or value-oriented equities. Also, keep an extremely close eye on fixed income (bonds) and position for a turn in rates. The fixed income or Yield component has been extremely challenging as the market lacks what we look for in AA-AAA rated names. We have not been buyers of municipal bonds (Muni's) for quite some time, and we don't expect that to change. If anything, we are looking to sell what remains of our clients long-term Muni's. We are just waiting to see a return in rates, just as we like to see the locked rates we have on our older Muni's. There is an inverse relationship between rates and returns, which can be explained through a seesaw analogy, if we have rates on one side of the seesaw and return on the other. When interest rates go up, the value of the holding bonds goes down, and when rates go down, those locked into a higher coupon have increased returns. One way to address this seesaw is to invest in bonds, which have yields that increase as rates rise. This is what we are positioning for when we buy senior bank loans with floating adjustable rates. We like the senior loan space because the debt is usually senior and secured by assets in the event of default; plus, the adjustable rate feature means the borrower must pay more if rates go up.

Also, it has been tough for us to monitor downside positions, as we have witnessed volatility extremes, with some positions swinging wildly within a single trading day. We just have to monitor positions closely and constantly search for reasons why certain stocks move. Oftentimes we can't ascertain any news associated with volatility. We have watched companies positively blow past earnings estimates and experience a sell-off, then experience a positive comeback that same day or short-time later. In my opinion, computer programs exasperate the situation as they simply get triggered based on volumes and price levels.

As we have spoken about many times before, this market is also being significantly affected by political decisions, which are one of the worst things for investing fundamentals. One of the oldest expressions on Wall Street is, "Don't fight the Fed", so with low rates you should refinance your home or take on new debt at these levels, that is what corporate America is doing. Another example of not fighting the Fed; bank CD's pay ultra-low rates so we look at the same banks common stock with dividends. CD's are always safer than stocks for default, with less volatility, but under current tax laws the rate is typically less on the stock dividends than it is on ordinary income of CD. So common stock dividends look attractive based on current Fed tax regulations and current rates manipulated by the Fed.

For the near-term we are investing on a cautionary note with liquidity and flexibility to change.

All the Best,

Ian Goldey

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