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A Brave New Decade

There is danger in reckless change, but greater danger in blind conservatism – Henry George

I'll leave it to the news media to grind on about all the events of the last decade. I'm far more interested in what can be learned from these events than simply voyeuristically replaying the past. The media, it seems, has become the electronic equivalent of a driver at a gapers block, it slows down long enough so that we all can get a good look at the gruesome scene, be thankful it isn't us, and then speeds us onward toward the next collision.

In reviewing the events of the recent past, here are some of my humble observations about human behavior

Patience is a virtue most no longer possess. According to Morningstar research, the average holding period for stocks has dropped from 6.3 years in 1950 to 9 months today. Apparently long term investing means to the next quarterly earnings report.

Information does not equal wisdom. Access to information has increased both in speed and volume. Access, however, does not seem to have improved our decisions. With access to all kinds of data, the Federal Reserve maintained artificially low interest rates for an extended period, spurring on an already overheated Real Estate market that turned out to be the leading domino in the financial tumble.

Emotion trumps logic every time. A year ago we were all talking about the demise of the global financial system. People panicked and markets tanked. Since that time markets have done an about face, climbing on news that is much less favorable now than it was eighteen months ago.

We fix problems that are already fixed. We need to believe that we have more control over events than we actually do. Congress has already and will continue to enact ever more regulation in the wake of the financial "crisis" that will do nothing to prevent the next great train wreck.

We are compelled to meddle in affairs that are not our own. Our representatives in Washington actually held hearings on steroid abuse in baseball, and have now focused their collective attention on the undeniably important fact that college football does not have a playoff system (are we really paying these guys?).

Greed and avarice are part of the human condition. No amount of legislation or prayer will wrest this from any economic system. Our founding fathers' recognized this putting in place a system of checks and balances that attempt to keep these vices controlled in our government. Capitalism, while a flawed economic system, operates in the arena of ultimate checks and balances – the open market. Unlike Totalitarian regimes, in Capitalistic systems the crooks eventually are found out and thrown out.

What follows is my take on past and current events and how they will shape our investing future.

The continued low interest policy of the Federal Reserve and the Government's spewing of money into the US economy will inevitably lead to inflation. It is unlikely that the Federal Reserve will willingly raise interest rates fearing that the act will choke off a potential recovery. However, the US Treasury is having greater difficulty selling our mountainous debt, in the form of US Government bonds, to our largest benefactor the Chinese. This is setting up a tug of war of interests. The Fed desires low interest rates and the Treasury, dictated by Chinese demand, will be forced to raise rates in order to sell our bonds. I think I know how this game will end - higher inflation (loose money) and higher interest rates (China). In addition, our government appears hell bent on the continued devaluation of our currency vis-a-vis foreign currencies. This has the short term beneficial effect of cheapening our exports and making imports more expensive. The problem in the long run, however, is what happens when the US dollar is no longer the currency of choice in the world. How then do we sell our bonds?

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I used to say (at the time, tongue planted firmly in cheek) that until we managed to kill Capitalism in this country that I would continue to enthusiastically invest here. Between the bailouts of the banks (good idea, bad execution), the bailout of Detroit (bad idea, worse execution) and Healthcare “Reform” (too early to tell on both counts, but I’m not optimistic on either score), we have injected Socialism deep into Capitalism’s vein. Don’t mistake this for a political statement. There is plenty of blame to go around to both parties. Although the current administration stuck the needle in, the previous administration filled the syringe.

As we move forward we must acknowledge that any system designed by humans (that would be all systems) is inherently flawed. Our job is to minimize the exposure to any one system. As such we will be pursuing the following themes:

Increased foreign exposure for both equities and bonds. We have raised our international exposure to approximately one third of our investments in both stocks and bonds. Both will benefit from a continued weak dollar and will afford us additional investment opportunities off of our shores.

Increased exposure to emerging markets. As markets like China, Brazil and Taiwan continue to discover and encourage Capitalism, exciting opportunities will present themselves.

Increased focus on inflation protection. Our bond exposure will include inflation protected securities whose interest rises with inflation. We will continue our focus on hard assets like Real Estate, energy and commodities which have historically benefitted from increased inflation.

Increased attention to active, defensive investment strategies. Recognizing the impatient nature of investors today we will be looking to employ managers that are more active in attempting to get out of the way of plummeting markets.

These changes are much more evolutionary than revolutionary in their execution. We have been moving down this path for some time, and will continue to monitor events and adjust our investment thesis accordingly. As we bravely head down the path of this new decade, I want to thank you again for allowing us to accompany you. May God bless you and your family in the coming years.