

Choosing Sides

As a money manager, everyday you are required to make decisions. Those decisions are driven by an over-riding strategy predicated on facts, assumptions, experience and gut instinct. So let's take a walk inside my mind to get a better handle as to why our stock portfolio is positioned as it is.

Remember, I'm only talking about the stock portfolio, or as we call it, the growth side. Many of you have large positions in alternative investments non-correlated to the stock market. Although we supervise, manage, and advise on the non-correlated side, our fees are only directed against the growth side.

Currently, there is a clear disagreement as to the direction of the economy and thus the stock market.

The Federal Reserve position (5 ¼ % daily funds rate) suggests:

1. Oil prices are no longer an issue and will continue to move lower.
2. The housing market has bottomed, and after a few months, the uptrend will continue.
3. Geopolitical risks (Iran, Venezuela, China, Russia, Iraq, North Korea, Nigeria, India, and terrorism) have calmed down and will no longer be an issue.
4. Hurricanes like Katrina are once in a lifetime, and therefore, concerns are unfounded.
5. We are awash in oil and gas, thus high prices for gasoline, natural gas, and home heating fuel are a thing of the past.
6. The fact that interest rates are inverted, with long rates lower than short rates, makes no difference, because this time it's different. (See last email.)
7. The consumer will shrug off higher adjustable-rate mortgage increases because they are paying less at the pump, and will continue to spend.
8. Foreigners will continue to buy our debt (dollars), to support our deficit.
9. There will be no recession.
10. The stock market will soar from here.

The Bond Market (4.60% 10-year bond yield) suggests:

1. Oil will continue to be an issue, as our dependency on foreign oil increases. Alternative fuel sources have been talked about since the 1973 Oil Embargo with little success.
2. The housing market will be as severe and problematic as 1989-1991, and could be as bad as the 1930's (see prior emails.) The homebuilders have not bottomed and the downtrend will continue.
3. Geopolitical risks (Iran, etc.) are a fact of life and will continue to be with us for a very long time.

4. The weather, from hurricanes to drought, will have significant impact on all aspects of our economy.
5. The inversion of interest rates, with longer rates lower than short rates, is significant because it's **NOT DIFFERENT THIS TIME**. (See last email.)
6. The consumer will be impacted by higher adjustable-rate mortgages, higher energy costs, and excessive credit card debt.
7. Foreigners will think twice about increasing their U.S. dollar purchases, and that position will impact our deficit.
8. The stock market will move lower from here.
9. There will be a recession.

There you have it. Two diametrically opposed positions. Which side do you think is right? Most people will initially answer "I don't know." I, however, do not have that luxury. I'm paid to make a decision, to use my judgment. I've done my homework, and strongly believe that the bond market is the correct position. Unfortunately, for the last several months, the stock market has disagreed. Because of my position that a recession is looming, geopolitics is significant, oil will move higher, and there will be a significant collapse in the housing market. I've:

1. Raised a lot of cash.
2. Shorted the homebuilders.
3. Shorted the overall market.
4. Kept our positions in oil and gas.

For the last few months, that position has been contrary to the broad market. But given the world we live in, I don't believe it will be contrary for long. Setting the right strategy and sticking with it is sometimes hard, and sometimes difficult, but always worthwhile in the end.

Till next time,

Bill

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