ASPERA REVIEW

Intelligent, Independent Investment Management

1Q 2013 Quarterly Review: I See Debt People

Aspera Financial, LLC is an independent registered investment advisor.

Aspera offers independent fee-only investment management and advisory services throughout the Triangle area and nationwide.

Every client portfolio is separately managed.

The securities and strategies discussed in this Review may not apply to every client portfolio.

919-622-2076
Cary, North Carolina
ken@asperafinancial.com

"It is always amazing to observe how people become less risk averse after risk has markedly increased and more risk averse after it has markedly decreased."

Pater Tenebrarum

The results are in, and the evidence points to a strong and resurgent global economy! The U.S. economy is humming along, the Cyprus flare-up hasn't spread, Europe is fixed, the Japanese have realized the danger of deflation and have pumped up their printing presses, Chinese real estate prices are rising again, interest rates are near record lows, home prices are rising, and the U.S. stock market has reached new highs! Clearly, the unprecedented fiscal and monetary stimulus that flooded the global economy was timely, justified and inspired.

Importantly, significant economic adjustments have been made globally as a direct result of the Great Financial Crisis (GFC). Greece offers a good example. The country, long an energy importer, is rapidly becoming energy self-sufficient. As reported by Ekathimerini,

> The remaining parts of an olive tree under which the ancient Greek philosopher Plato is said to have sat to teach and debate with his pupils were found on Thursday to have been forcibly removed, possibly for firewood.
>
> …There have been reports of numerous trees in Athens being chopped down illegally as residents try to obtain firewood. Many Athenians have turned to wood-burning stoves and fireplaces to keep warm due to a rise in the tax on heating oil.

In addition, countries in southern Europe have effectively tackled important social and health issues since the GFC. Governments have addressed obesity and social morale by sponsoring recurring, large-scale, outdoor, calisthenics gatherings, replete with walking, rock throwing, banner-writing, and chanting clinics. These same progressive countries are encouraging more family-time by staging random unofficial "vacation days" for various industries and labor groups. Europe remains at the vanguard of progressive politics.

In the U.S., the recovery is so strong that we've been able to provide food stamps and disability checks to a record number of households. Prosperity has spread so broadly that tens of thousands of Americans are able to leave the labor force every month, no longer needing to be bothered by the burden of employment. Global leaders have indeed engineered an economic miracle!

The Great Deleveraging

Hopefully, it's obvious that I'm in a particularly sarcastic mood. It's hard to stifle the sarcasm, given the revelry associated with new nominal (not adjusted for inflation or the price of gold) highs in the U.S. stock market and the associated proclamations that a new bull market has commenced. In addition, we continue to hear that the worst of the crisis is behind us thanks to the bold and innovative steps taken by leading politicians and central bankers.

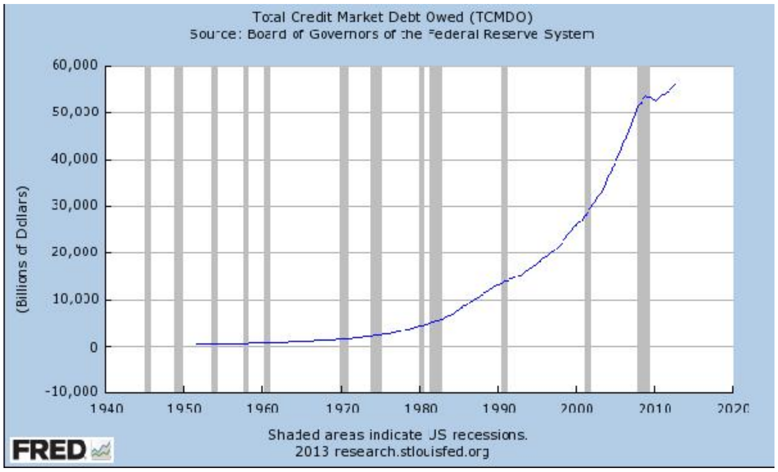
It's easy to understand why the bulls are all aglow. The simple fact that the world hasn't convulsed and spiraled back down over the last few years has left them feeling increasingly confident that the patient has left the ICU for good. Unfortunately, we remain mired in the same destructive cycle now for the past 15 years.

BANK
QUICK! GIMME THE CASH!

1. A crisis erupts
2. Financial markets sell off
3. Central banks and governments provide stimulus
4. The crisis subsides
5. Markets climb

Of critical importance, however, is the fact that each crisis has grown in terms of its reach and severity. Each crisis has required ever-larger stimulus. Equally important, the measures taken to address each crisis have contributed directly to a greater misallocation of capital and a larger subsequent crisis. This time is no different.

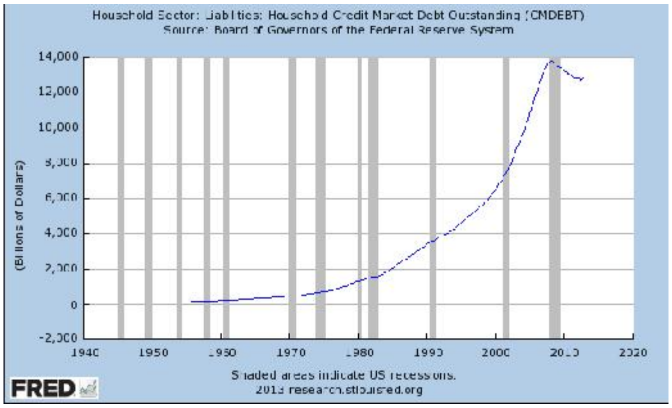
Let's put things in perspective. In the U.S. alone, the Federal Reserve is printing $1 trillion in 2013. In addition, our government is borrowing about another $1 trillion to fund its budget deficit. $2 trillion is being created and borrowed this year alone in an effort to boost an economy which is supposedly in recovery and which produces $16 trillion in goods and services annually. The size of this stimulus is staggering on an absolute and relative basis, but most people have grown numb to it. Despite this unprecedented stimulus, this economic recovery has been anemic compared to past recoveries, and economic growth is barely positive now. What exactly are policymakers going to do when their massive meddling eventually blows up and the next crisis or severe recession erupts? Print and borrow $4 trillion? Distract us with a war on Liechtenstein? Promote and subsidize a national diet of cat food?



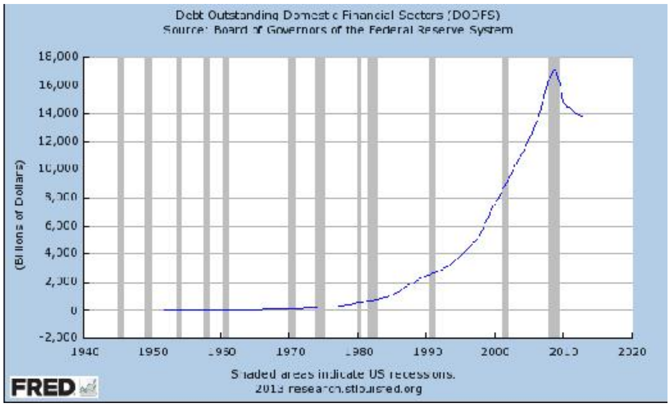
There was a tremendous credit bubble in 2008-09. I've said countless times that you don't solve a debt problem by borrowing more, but this is what our leaders have tried to do. The chart to the left shows the total amount of debt in the economy. Note the small dip from 2008-09. This was the "great credit retrenchment" you may have heard of! Debt contracted by an insignificant amount and only for a few quarters before once again plowing higher. With each passing day, we continue to borrow more as a nation.

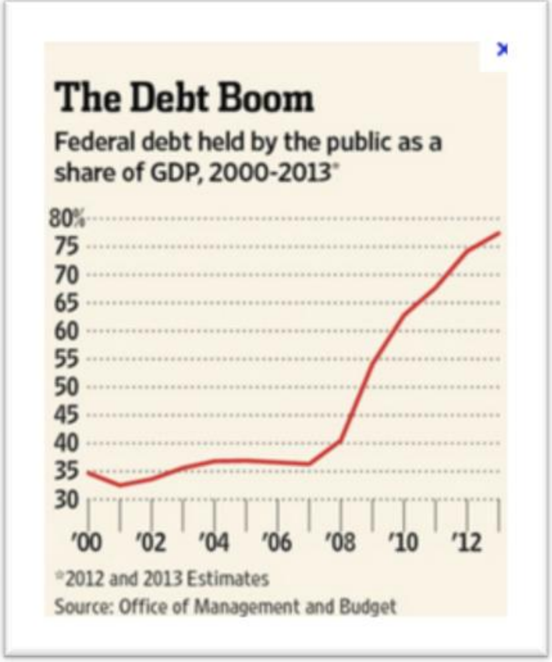
Total debt is growing again, but the composition of that debt has shifted since the GFC. The following three charts illustrate that financial institutions and consumers have modestly reduced their debt while the federal government has hit the accelerator.

Household Debt



Financial Sector Debt





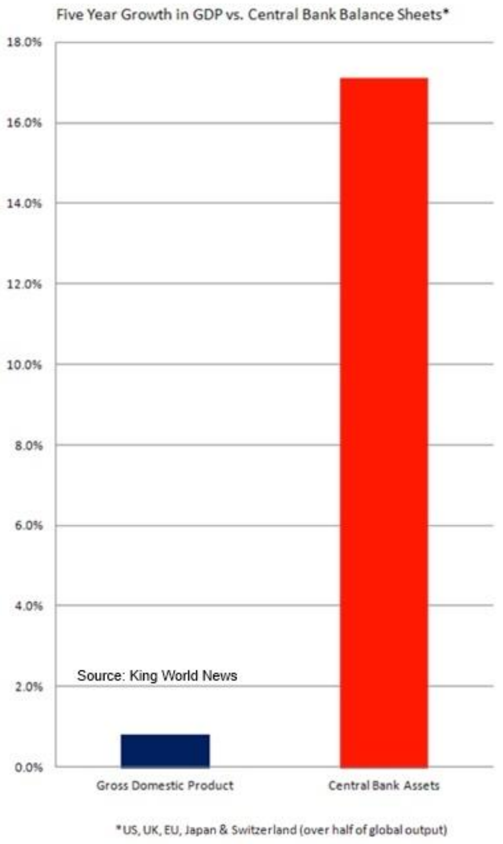
In a sense, debt has moved up the food chain, from consumers and banks to the federal government. Arguably, this will allow banks, businesses, and consumers to re-lever (borrow more) and fuel another bout of consumption and speculation. Most mainstream economists view this debt-financed spending as positive since it adds to GDP. It isn't quite that simple. Consumptive spending via borrowing simply steals from future growth. Importantly, we're not seeing strong increases in productive spending – on assets that will produce future income. Building a factory which earns more than its cost of capital is intelligent and builds wealth. Buying a new TV, car, leisure suit or 6-foot tall Rick Perry chia head might feel good in the moment, but they don't increase national wealth. GDP may be currently growing, but that doesn't mean that national wealth is following suit.

Speaking of buying cars and debt, subprime auto loans are back. With safe returns pretty much at zero, Wall Street is once again packaging crappy loans together to pass along to "investors" with the promise of a higher yield. When I warn about investors chasing yield, this is precisely the type of activity I'm referring to. Reuters ran an article on this earlier this month. The highlight was the following:

> Thanks largely to the U.S. Federal Reserve, Jeffrey Nelson was able to put up a shotgun as down payment on a car.
>
> Money was tight last year for the school-bus driver and neighborhood constable in Jasper, Alabama, a beaten-down town of 14,000 people. One car had already been repossessed. Medical bills were piling up.
>
> And still, though Nelson's credit history was an unhappy one, local car dealer Maloy Chrysler Dodge Jeep had no problem arranging a $10,294 loan from Wall Street-backed subprime lender Exeter Finance Corp so Nelson and his wife could buy a charcoal gray 2007 Suzuki Grand Vitara.

> All the Nelsons had to do was cover the $1,000 down payment. For most of that amount, Maloy accepted Jeffrey's 12-gauge Mossberg & Sons shotgun, valued at about $700 online.

A subprime loan is defined as a loan given to someone with a credit score below 660. The most recent data I could find showed that sub-prime loans accounted for a quarter of all new car loans in Q2 of 2012 and 56% of used car loans. As if sub-prime wasn't bad enough, a new category has been created for those with credit scores below the horrific level of 600 – "deep subprime". I'm sure this will end well! Fortunately, this is a small part of the overall debt market, so it isn't going to have widespread ramifications. It's more indicative of the return to madness we're experiencing as central banks "force" investors to buy increasingly risky securities in hopes of generating a return.



The $64,000 question is just how big a credit bubble can be blown before the financial system implodes? No one knows the answer, but we've seen in Japan that it can continue longer and further than most think. The timing may be uncertain, but the ultimate resolution is likely to be a bigger crisis than what we had in 2008-09. The problems this time are global, and the balance sheets of governments and central banks have already been stretched thin.

The chart to the left shows the 5-year growth in GDP and central bank balance sheets for the bulk of the developed world. A large 17% expansion in combined central bank balance sheets (think money printing) resulted in a mere 1% increase in GDP across these 5 countries over the past 5 years. This is ignoring the debt that these countries borrowed to further boost GDP. Ever-larger stimulus is having ever-smaller impacts on the real economy. The fact that so much stimulus is being supplied during a time of supposed recovery is not a sign of strength. This is a sign of weakness.

But, But, But…What About The Stock Market?

Yeah, yeah, yeah. It's all fine and good that I believe that our problems have simply been papered over and that the stage is being set eventually for an historic crisis, but what about the stock market?! How can the stock market be rising and reaching new nominal highs if things are really so bad and unstable? I see it's time for two of my favorite investment quotes.

"The stock market has called nine of the last five recessions." Paul Samuelson

"In the short run the market is a voting machine, but in the long run it is a weighing machine. Ben Graham

There are a few reasons that the U.S. stock market has had a tail wind.

1. With no safe returns available for the past few years, investors continue to chase yield, including dividend yields.

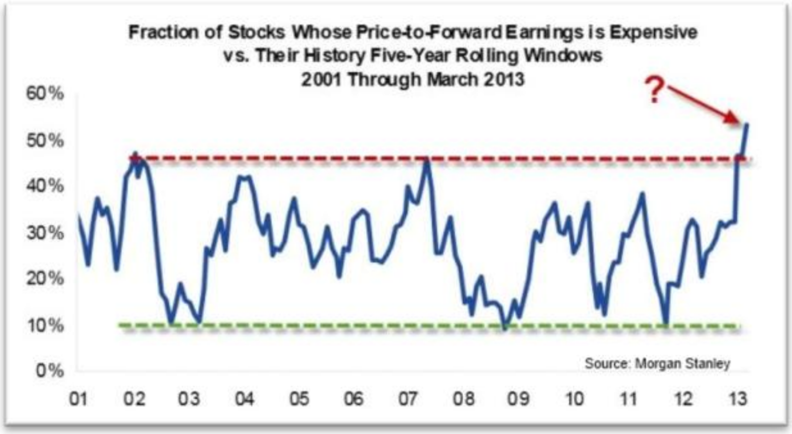
2. Investors believe in the "Bernanke Put". We know that Ben watches stocks and that he believes in the wealth effect (higher stock prices makes people feel wealthier and spend more). Investors believe Ben can and will prevent any substantial decline in the stock market.

3. Trillions in new money (hot money) is being printed globally, and this money is going to go somewhere. Given the problems in the rest of the world, the U.S. continues to look relatively better at the moment.

4. Momentum. Buying begets buying in the short-term as investment professionals fear being left behind.

5. Valuation. We've spent the last 15 years at a higher plateau of valuation than in the previous 85 years. Investors are able to justify today's valuation by comparing it to the peaks of 2000 and 2007.

Let's take a closer look at valuation. The chart below helps to put things in perspective. It shows the percentage of stocks that are trading at a premium valuation relative to their expected earnings. It's a little disconcerting to see more stocks trading at a premium than right before the 2007 market peak. Company earnings have been boosted by trimming payrolls and by the massive stimulus created in recent years. This is a huge crutch for stocks and the entirety of global finance. Should deficit spending stop, interest rates rise, inflation pick up, and quantitative easing be halted, it's hard to imagine earnings not taking a substantial hit.



Fraction of Stocks Whose Price-to-Forward Earnings is Expensive vs. Their History Five-Year Rolling Windows 2001 Through March 2013

Source: Morgan Stanley

The current U.S. stock market may not be in outrageous bubble territory yet, but valuation is stretched, and there's an air of speculation about it, as hedge funds seem confident that Bernanke won't let the stock market fall. We've been through this before with Greenspan, and that didn't end well. At some point, confidence in Bernanke and other policymakers will abruptly end. The higher risk markets climb before then, the harder they'll fall. In the meantime, overvalued markets can always get overvalued.

Precious Metals Update – Let's Start With A Couple Big Picture Items

There were two significant news items this quarter that have a bearing on gold, one in Europe and one in Asia. The first involved Germany and the announcement that Germany would be repatriating some of its gold that is held abroad. Germany's central bank announced that it wanted to have 50% of its gold holdings held within Germany by 2020. This involves moving 374 tons from France and 300 tons from our New York Federal Reserve back to Germany. This move was primarily politically motivated and was instigated after federal auditors raised questions as to the whether the Bundesbank (Germany's central bank) had actually verified the existence of their gold holdings abroad.

Clearly, this raises questions as to the shift in trust between central banks, but the most interesting aspect of this to me is that it's taking 7 years to effect this transfer. A Forbes article stated that "the gold coming from the U.S. will probably have to be flown in. This will probably have to be done in 3 to 5 ton shipments, the maximum insurance companies will cover, meaning it will take between 60 and 100 flights." Why will it take 7 years to arrange for 60-100 flights? Venezuela was able to transfer 160 tons of gold from New York in 2011. If Venezuela could move half the tonnage in one year, why will it take the Germans, the kings of efficiency and logistics, 7 years to move their gold?

The conspiracy theory crowd believes it will take 7 years because the Fed doesn't actually have the gold. The belief is that the Fed has leased the gold and will have to buy it back before the shipments to Germany can take place. They want to do this over time so as not to spike the price of gold higher. I don't know if this is true. What I do know is that countries are becoming much more interested in keeping their gold closer to home. I also know that there is no logistical reason Germany couldn't ship all of its 300 tons of gold back home this year. There has yet to be an explanation for why this must take seven years. It smells fishy.

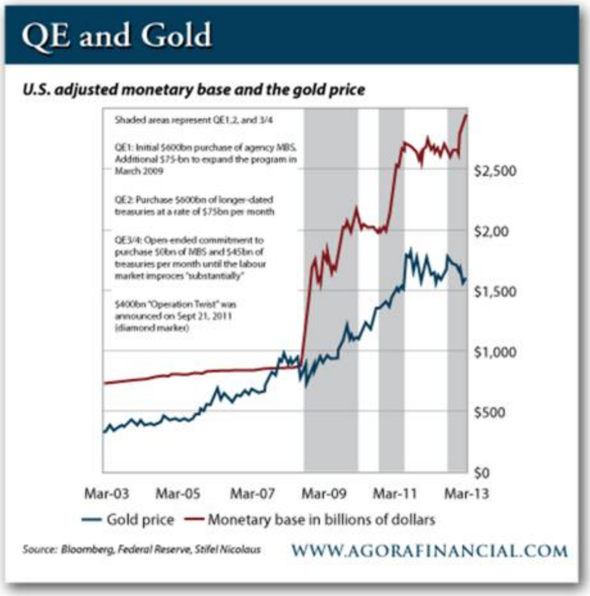
The other international news is something I discussed last quarter -- the latest attack on deflation and a strong yen by the Japanese. I wrote last quarter:

> Abe [Japan's new Prime Minister] has made it clear that he wants a cheaper yen and that he expects the Bank of Japan to play ball and monetize ever more financial assets, including Japanese sovereign debt.
>
> Japan has the largest national debt relative to the size of its economy of any country in the world. They have borrowed hundreds of trillions of yen to "stimulate" their economy over the years, and all they have to show for it is a still weak economy now saddled with unpayable debt. Their solution? More of the same. This is sheer madness. This, my friends, is a prime example of why we own gold. It is a hedge against monetary and fiscal incompetence.

During the quarter, we learned the details of Japan's latest monetary stimulus gambit. Japan has promised to print enough money to double the yen in circulation in just two years. They will be printing the equivalent of $81 billion each month, and they promise to achieve 2% inflation in two years. They've effectively said that (like Bernanke in the U.S. and Draghi in Europe) they will do whatever it takes.

So, between just the U.S. and Japan, about $165 billion will be created out of thin air each month, and this new "money" will be used to buy all sorts of government bonds and other financial assets. With trust between the central banks waning, countries repatriating their gold, and a new big player in the money printing game, the precious metals must be racing higher, right?

If Everything Is So Bullish For The Metals, Why Are They Falling?



Source: Bloomberg, Federal Reserve, Stifel Nicolaus WWW.AGORAFINANCIAL.COM

Interestingly and disappointingly, gold and silver remain in a funk, despite this latest bullish news out of Japan and Germany. The chart to the left shows how gold has even disconnected from the Federal Reserve's policy of quantitative easing (QE). Gold moved higher in lock-step with the earlier quantitative easing programs (money printing) but has failed to follow suit more recently. Even the latest details of Japan's plan sparked a very short gold rally, only to be followed by further selling.

Not only is gold not moving higher, a panic is currently underway and the price of gold is falling hard as I update this Review (mid-April). There are a number of factors which are driving gold lower at this moment.

1. A number of sell-side investment firms have put out very bearish calls on gold over the last two months. Goldman has been particularly aggressive recently, with its latest attack coming just as the March employment data was being released (a report which was leaked to them and

others ahead of time and which clearly showed a weak employment picture – a key data point which will keep the Fed printing money). The attack on gold has been widespread and relentless, with a number of big firms claiming the gold bull market is over. Even the New York Times came out with an article on April 10th entitled "Gold, Long a Secure Investment, Loses Its Luster".

2. We've seen huge futures selling recently. The large speculator futures and options short positions are about 40% higher than the 2008 gold price bottom. The risk of a big short covering rally was substantial and would have caused big damage to these big players. In addition, the inventory of gold at the COMEX (futures exchange) had recently hit its lowest level since September 2009, potentially a sign of more buyers taking physical delivery. Speculators certainly had an interest in driving gold lower in order to exit their trades profitably. I always hesitate to assert manipulation, but this does smell fishy in light of the bullish news for gold (Japanese money printing and weak U.S. economic data). More on this below.

3. The size of the Cyprus bailout has grown (don't they always?), and there is talk that Cyprus may have to sell some of its gold holdings to fund the shortfall. Cyprus owns just under 14 tons of gold, so this alone is unlikely to move the needle significantly. The bigger fear is that the other weak European countries may now be "invited" to sell their gold as well in order to fund their own bailouts. Italy holds 2,452 tons of gold, Portugal holds 382 tons of gold, and Spain has 282 tons. This fear is probably overblown. Regardless, any sales will probably not actually hit the market as China (and perhaps Russia) would likely stand ready to facilitate a private trade.

4. Just as buying can beget buying in the short term, selling begets selling. There are many traders who focus on chart patterns and technical indicators. These have clearly broken down for the metals in the last two days, leading to sell signals for these traders. In addition, there are margin calls going out that will require selling. We could see a few ugly days until this washes out.

5. The fact that gold failed to rally following the latest QE here in the U.S. may have led some investors/owners to question whether gold will protect them from future money printing. This may have made some gold traders/investors more susceptible to selling during this latest panic. Not everyone is as confident in the thesis or as patient as I am.

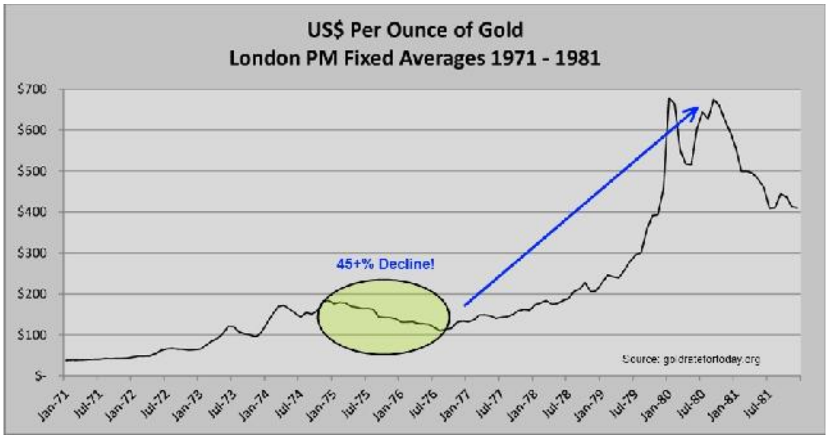
The declines in gold and silver have translated into large share drops in the miners. The miners have been simply pummeled, with many of them trading at or near 52-week lows. I regularly caution that these names are very volatile and can move 30% or more in short order. Still, I must admit to being a little surprised to see these stocks so incredibly out of favor. Insiders at these companies appear equally surprised but are taking advantage of these prices. According to INK Research:

> ...there are now seven precious metals stocks on the TSX with insider buying for every one with selling. That's a near doubling of the ratio since mid-January – and represents a level of lopsided transactions that is usually only seen during major market peaks or valleys.
>
> "That is the type of insider buying we saw in the broad market during the height of the great financial crisis in late 2008 and early 2009," points out Ted Dixon, CEO of INK Research. "A similar situation now seems to be in place among gold and silver miners."

Parallels With The Mid-1970s

I've cautioned for years that gold and silver could suffer a serious pullback and still be in a bull market. I've often drawn parallels with the last great gold bull market and mania, which occurred throughout the 1970's and peaked in 1980. The miners didn't really take off until the tail end of the cycle that time, and they seem to be acting similarly so far.

There's another parallel with the 1970s cycle. Look at the chart below. About midway through the last bull market, the price of gold fell about 45% over the course of nearly two years. It's getting a little easier for us to imagine how the gold bulls must have felt during those two years. In 1976, you would have heard the same extreme negativity towards gold that we're hearing today. The good news is that we have a precedent for what we've been experiencing since the fall of 2011, and the ultimate outcome last time was extraordinarily profitable. The bad news is that we haven't fallen as far as we did in the mid-1970s. However, we're now in a world when large buyers (like China, Russia and India) have been strategically adding to their gold reserves.



Ok. Now What?

As you know, I've been invested in the precious metals for over a decade now. As with every key investment I've made over the years, my focus remains firmly on the rationale behind my investment as well as the "value" of that investment. Attempting to time multiple entry and exits during secular bull or bear markets is much easier said than done and not something I claim to be particularly skilled at (nor is anyone else that I'm familiar with). Ignoring the "experts" and being little moved by what others are doing/saying has been crucial to my investing. The rationale for owning precious metals remains very compelling. What follows is primarily a hand-holding exercise.

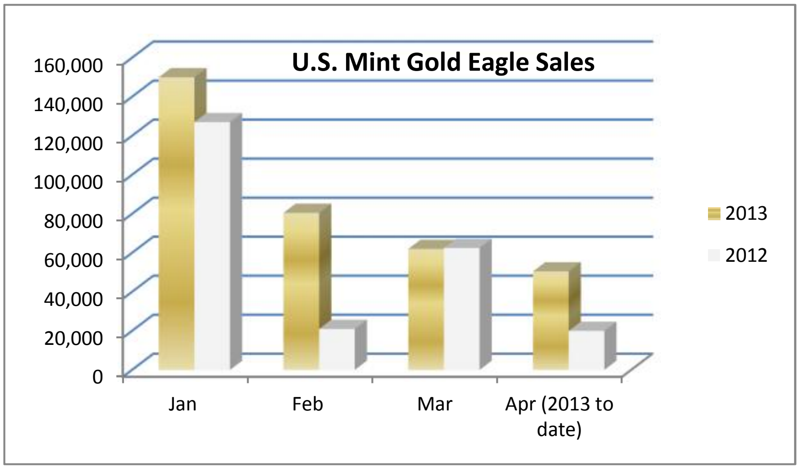
1. More and more fiat money (backed by nothing) is being printed each day. Japan is the latest to jump on the currency devaluation bandwagon in a huge way. This is bullish for the metals and for all real assets. It isn't bullish every day, month, quarter, or year, but this is a huge tailwind for real assets.

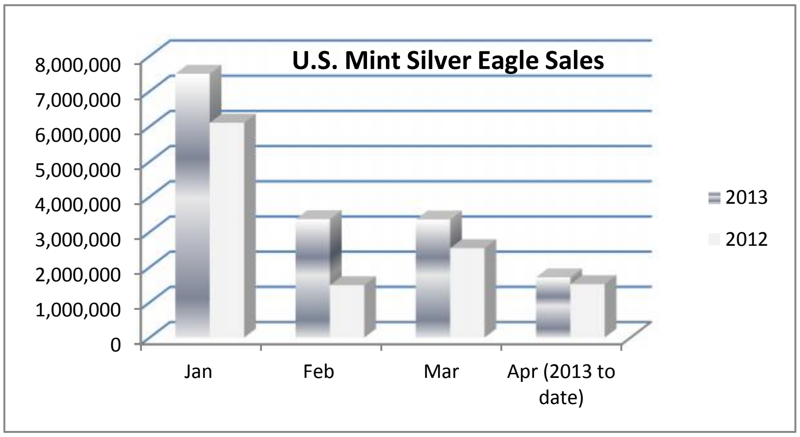
2. Central banks that are printing money are effectively monetizing the debt of their country. Our Treasury is issuing $1 trillion(ish) in debt each year, which is just about exactly what the Federal Reserve is printing and buying. I don't see large deficits going away any time soon, so the need for this printing will continue. If it doesn't, the free market will likely demand higher interest rates to buy this debt. This will result in more budget revenue going toward interest expense and necessitate more borrowing. Do you really believe that the Fed can stop printing money? I suspect we'll see even more printing and extreme measures in the years to come.

3. Global growth is anemic and slowing. You'll be hard-pressed to find a significant country (size wise) that doesn't want a weaker currency in order to boost exports. Japan's current assault is largely geared toward weakening the yen in order to sell more goods abroad. You'll be hearing more from Japan's upset neighbors in the coming quarters as their goods become relatively more expensive. This race to devalue has been underway for a few years, and it's showing no signs of abating.

4. I do not sell investments I believe in simply because the short-term chart isn't pretty or because Goldman Sachs says so or because other investors may be selling. Goldman, Merrill, CIBC, Societe Generale, Credit Suisse, and CitiGroup have been abysmal at predicting the price of gold over the last 12 years. I can't think of anyone I'd rather listen to less when it comes to understanding gold or silver. I wouldn't be at all surprised if some of these firms were taking advantage of this decline to buy gold/silver for their own internal accounts.

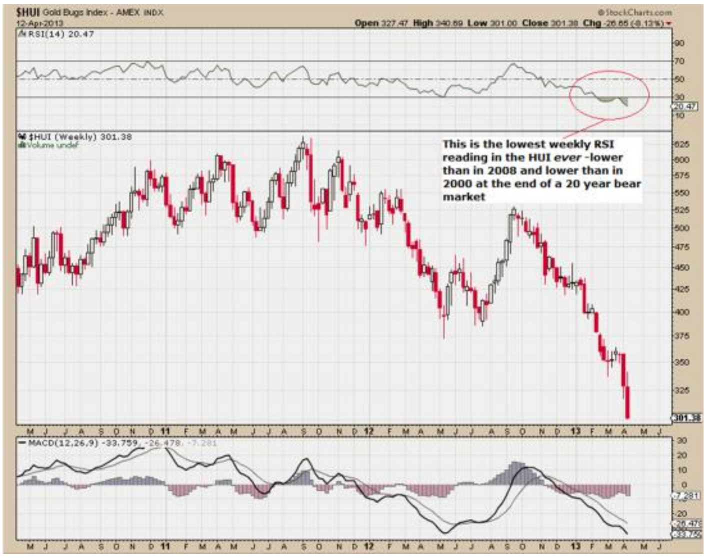
5. There is a difference between what is happening in the paper market (futures) and the physical market. This is a very important point. 400 tons of gold were sold in the futures market on Friday alone. This equates to 15% of annual gold mine production. 400 tons of gold equates to a value of $20 billion, but futures traders trade on margin and only have to put up about 5% of the value of their position. In other words, 400 tons of gold were traded, but only $1 billion stood behind that. The price of gold can be pushed around in the paper market through the use of futures contracts. There is no limit as to how many futures contracts can be sold, and the volume of futures trading is far in excess of the actual trading of the physical metal on any day. What we need to understand is that 400 tons of actual physical gold did not change hands on Friday. These are paper gains and losses that are settled in dollars but have a huge impact on the price of the metals.





All indications are that demand for physical metal remains robust. Games can be played in the paper market only so long. The metals are moving into stronger hands – owners who won't be interested in selling at $2,000 or $3,000 per ounce. Eventually, we're going to reach a point where physical demand dwarfs physical supply. It will be like a light switch was flipped. This is the point that the metals will climb to new highs and not look back. The two charts to the left show that purchases of gold and silver bullion coins from the U.S. Mint are running nicely above last year's levels. Note that the April figures for 2013 are partial-month numbers and have already surpassed last April's levels. I'd be surprised if there isn't a spike in coin sales after this latest beat down. When the price of gold and silver get hit, buyers of the physical metal come out in droves. You can be fairly sure that the Chinese, Russians, Indians, Turks, and Brazilians are busy buying the actual metal and storing it away safely.

6. Sentiment is often a terrific contrary indicator (sell when sentiment is very bullish and buy when it's extremely bearish). Well, sentiment in the precious metals is incredibly bearish. Gold, on a relative strength basis, hasn't been this oversold since 1999, right before the beginning of its bull market. The mining stocks (chart below) are also plumbing the depths, registering a relative strength reading below that of the 2008 low and even the 2000 low. This extreme bearishness is a bullish signal as those who were going to sell have probably done so, or are at least just about done. The fact that the gold panic is now headline news is also a strong contrary indicator.



This is the lowest weekly RSI reading in the HUI *ever* -lower than in 2008 and lower than in 2000 at the end of a 20 year bear market

7. Emotions are dangerous when it comes to investing. I’ve had conversations with all of you about the tremendous underlying problems in the world and the rationale behind our holding precious metals positions. You agree with me. Actually, some of you have even greater concerns than I do (which is hard to believe). So, if you believe those problems are real and if you still believe that owning gold and silver make sense in such a world, take a deep breath, have a glass of wine, don’t look at the price of gold or silver or the miners until next Spring, and rest easy knowing that we own something real in this mad world.

8. I have absolutely no intention of selling my own personal holdings so long as we’re in a world of rising debt and unprecedented fiat money creation, so I certainly won’t be selling yours. I’ve seen this all before. It isn’t fun. It’s testing. This is simply how markets work, and these shake-outs are part of the “game”. With Japan now also aggressively printing money and with clear signs of global economic weakening (which will support continued money printing), my gold and silver will have to be pried from my cold dead hands.

9. I’ve held off on adding a tactical (shorter-term) position in this space. Gold peaked in the fall of 2011 after getting ahead of itself. At the peak, the buying and bullishness was getting a bit frenzied. This isn’t unusual near short-term tops. Frenzied selling is what we see near bottoms as well. This is the type of activity I’ve been waiting for to put on a tactical position. Stay tuned.

Performance

Index/Market	1Q13%	1-Yr
S&P 500	10.03%	11.41%
DJIA	11.25%	10.34%
Nasdaq	8.21%	5.69%
Vanguard Total Stock Market (VTI)	10.48%	12.04%
Vanguard International Stock Index (VGTSX)	2.74%	5.27%
Europe - Euro STOXX 50 Price EUR	-0.45%	5.10%
China - Shanghai SE A Shares	-1.98%	-1.73%
India - BSE India Sensex 30 Index	-3.04%	8.23%
Emerging Markets (VWO)	-3.67%	-1.32%
iShares Aggregate Bond (AGG)	-0.32%	0.80%
iShares 20+ Yr Treasury Bond ETF (TLT)	-2.82%	4.96%
Dow Jones Commodity Index (DJP)	-1.77%	-4.02%
Gold (SPDR Gold Trust - GLD)	-4.66%	-4.72%
Silver (iShares Silver Trust - SLV)	-6.61%	-12.59%
Gold Miners (HUI Gold BUGS Index)	-19.61%	-24.48%
Oil (Cushing WTI spot)	5.89%	-9.39%
U.S. Dollar (UUP)	3.62%	3.15%

The big winner in the quarter was the U.S. stock market. Other equity markets were subdued. Europe was flat and the emerging market space was down a few percent. The domestic bond market also took a breather in the quarter, posting modest losses. Commodities, including gold and silver, lost more ground in the quarter after a weak fourth quarter, but it was the gold/silver miners that performed worst.

Aspera Performance

With gold, silver, and the miners continuing to be treated like lepers, it's no surprise that we were negatively impacted. These names remain a core position and will be a significant (but not the only) factor when it comes to our returns. They certainly haven't been helping us recently or for the past couple of years. I certainly expect this to change dramatically but can't say when.

Trading Activity – Closed or Reduced Positions

We had a very quiet quarter trading-wise. A few names approached our sell level, and we crept closer to adding a tactical position in the precious metals space, but we remain stingy when it comes to putting cash to work in this environment.

Hillshire Brands (HSH)

HSH was sold in January after reaching our sell target. Recall that HSH was part of the former Sara Lee. Sara Lee split into two business last year, a coffee and tea business (DEMBF) and a food products and foodservice operation (HSH). Sara Lee also paid a $3.00 per share dividend to us. Sara Lee was purchased as a cash alternative – a relatively safe place to park some cash. The investment paid off nicely with a healthy dividend and capital appreciation of the two separate equity chunks.

As you may have noticed on April 1, we sold the other “chunk” at a nice gain. German consumer products conglomerate, Joh. A. Benckiser, offered to buy DEMBF at a 33% premium. This provided a nice opportunity to exit our position with a solid gain.

Trading Activity – New or Increased Positions

Apple Inc. (AAPL)

As I wrote last quarter, we would likely add modestly to Apple below $500. It didn't take long for the market to provide this opportunity. Apple provides a good example of how a company can go from infallible to mortal in no time at all. As I discussed last quarter, I avoided the name as it ran to $700 as the mortality of the company was clearly being ignored. At current levels, the stock strikes me as rather attractive. The company provides a nice yield, they have a terrific balance sheet, and many of the risks are at least somewhat discounted. I remain very interested in how the company's large cash balance is resolved. Should they choose to make a large company-changing acquisition, we will likely bid farewell (and probably at a lower price as the market would probably frown on such a move). I would much rather see the company increase its regular dividend or issue a “one-time” special dividend to shareholders.

Portfolio Positioning and Outlook

I continue to sleep well with how we're positioned. The thesis for our precious metals position remains fully intact and isn't impacted by the price volatility. To me, the thesis is ultimately far more important than what the price of gold or silver is doing at any moment. I expect to see new highs with both metals and a huge move in the miners in due time. The rest of our portfolio remains conservatively positioned with a healthy dose of cash and cash-substitutes as well as a number of securities providing a nice and safe yield.

It won't surprise you that I have no intention of chasing the U.S. equity market. There is a ton of hot money sloshing around the world, especially with the Japanese joining the money-printing party. Little of the money being printed is finding its way into the productive economy. Instead, it's being used to support increased speculation. This won't end well. Should risk assets continue to ramp higher, which is certainly possible, we will continue to lag. I simply won't buy assets I deem overvalued in the hopes that I'll sell them to a greater fool at some point.

I continue to struggle to find attractive equity markets to own globally. Europe is a mess and although some countries have cheap stock markets, they're only cheap if they remain in the Euro community. As you know, I expect some type of membership change to occur or a complete failure of the European Monetary Union. It's structurally flawed, and I see no mutually-satisfactory way forward for the North and South. Some of the southern European countries have stock markets that look fairly cheap, but you don't want to own equities in a country that leaves the Euro, readopts a national currency and then devalues. You may want to invest afterward, but not before.

So we remain in a world where global imbalances continue to grow. Debt is climbing from already unsustainable levels and we remain mired in untested waters when it comes to monetary policy. A false sense of security is pervasive in the markets. Interest rates are low at least in part because central banks are buying government debt. This isn't a free market rate of interest. It's a centrally-planned rate. But corporate, mortgage, education, car and every other type of debt is priced off of these manipulated "risk-free" Treasuries. If Treasury yields are artificial, so are the yields on all of the other debt. Furthermore, equities are valued based on discounted cash flow, and the risk-free (Treasury) rate is a critical component. The lower this rate, the higher the value of equities. Almost every asset is at risk of being mis-priced on the high side in this crazy world. When this charade comes to a close, voluntarily or involuntarily, there's going to be a big catch-down to reality!

So much of what I see occurring in the world and in financial markets reminds me of a house with black mold. The mold slowly and quietly spreads while the home owners keep slapping up new layers of tacky wallpaper to mask it. Everything appears fine until the homeowners die in their sleep one night. With that, let me wish you a happy and healthy Spring!

Have a great quarter!

Best,

Ken Bell, CFA, CFP
President
Aspera Financial, LLC

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