ASPERA REVIEW

Intelligent, Independent Investment Management

3Q 2012 Quarterly Review: One-Trick Ponies

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

Every client portfolio is separately managed.

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"If a central bank can potentially create unlimited money from nothing, how can it ensure that money is sufficiently scarce to retain its value?"
Jens Weidmann (President of Germany's Central Bank)

I can tell that some of you have been reading my writing. Well, I can tell that some of you are at least skimming for cartoons and family pictures. Although I haven't received many content-related questions of late, I have been receiving an increasing number of inquiries as to why I haven't included a picture of Aspera's heir apparent in some time.

Whether you read or you skim, your request has been heard. Rather than just throw in a gratuitous head shot of my S.V.P. (Senior Vice Princess), I thought I'd use the photo shoot as a teaching opportunity. After all, she's now four-years old, and that seems plenty old enough to start learning a little about economics and finance. Kids are growing up faster these days.

So, I invited my S.V.P. into my office and snapped this first picture of her. It was the day before her birthday, and she was in her typical happy and carefree mood.

Then, I sat my S.V.P. down for a heart-to-heart. I explained the global debt situation to her, and we talked about the deficit as well as the destructive inflationary policies of the developed world's central banks. I could tell that I was losing her. I tried to personalize it. Since her career aspiration is to be a ballerina, I tried explaining to her that she would have to perform professionally well into her 80s. She didn't see a problem with that. I was left with no choice but to explain that her future allowance wouldn't keep up with the increasing cost of princess dolls and new additions to her "My Little Pony" collection. At this point, I snapped the second picture of her.

She now develops a rash and a nervous twitch every time she overhears me mention the name Bernanke or Draghi. Unfortunately, she heard me mumble them many times while writing this Review.

Believe Me, It Will Be Enough

My first job after finishing up my MBA was at a mid-sized asset management firm in Chicago where I was hired to research and recommend stocks. I was fortunate to have had a number of enticing job opportunities to choose from around the country, including a couple at large, well-known, and currently vilified New York investment banks. I chose the smaller Chicago firm for two primary reasons. First, I could never stand to be in New York City for more than about three days without breaking out in a sweat, clawing at my eyes, and experiencing an exponentially-increasing crushing of my soul with each passing day. Aside from that, the city was fine. I also chose the smaller Chicago firm because I genuinely liked and respected the guy (Terry) who owned the firm, and we had a similar investment philosophy.

To this day, there is one thing that stands out to me about my lunch interview with Terry. In describing some of the problems with our asset management industry, Terry stated that because portfolio managers are paid well, they feel a constant pressure to look busy with their portfolios. There is pressure to trade in order to prove that they're actively "managing" their portfolios, but the vast majority of the time, portfolio managers should come into the office, ignore their quote machines, and just play solitaire. No, I didn't accept his job offer with dreams of becoming a world-champion solitaire player. He was exaggerating for effect since there is always more research, learning, and thinking to do than time permits. Still, his philosophy about long-term investing resonated with me.

I've thought back on those "solitaire" comments often during my career. It's a problem which still plagues most of my industry, but I also see it at work with our politicians and central bankers. As an unabashed fan of free markets, I have never felt any warmth towards the mission or even existence of central banks. Still, I have no delusions that the Fed or any other large central bank will be abolished in my lifetime. The most I can hope is that the central banks will inflict as little damage as possible. Central bankers, however, are meddlers, constantly tinkering with money supply, interest rates, reserve requirements, and asset purchases in some comic effort to manipulate the will, desires, and actions of millions of buyers, sellers, investors, lenders, and business owners.

It is dangerously arrogant for a small group of imperfect human beings with expensive college degrees and little or no real-world business experience to believe that they know better than the entire market just what the proper money supply and level of interest rates should be. Even when central banks are able to achieve their short-term goals, their actions often create longer-term negative unintended consequences. If they must exist, I would be more than content to pay them to come in to the office, take out a deck of cards, and spend their days mastering the game of solitaire.

Of course, that's just wishful thinking. Central bankers are tinkerers, and there was much meddling to be done in recent months! No one meddled more than the head of the European Central Bank (ECB), Mario Draghi. On July 26th, he gave a speech at an investment conference in London during which he stated, "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

Mario followed this with an editorial in the German weekly Die Zeit that was titled "The Future of the Euro: Stability Through Change." In his editorial, he wrote, "…fulfilling our mandate sometimes requires us to go beyond standard monetary policy tools. When markets are fragmented or influenced by irrational fears, our monetary policy signals do not reach citizens evenly across the euro area. We have to fix such blockages to ensure a single monetary policy and therefore price stability for all euro area citizens. This may at times require exceptional measures."

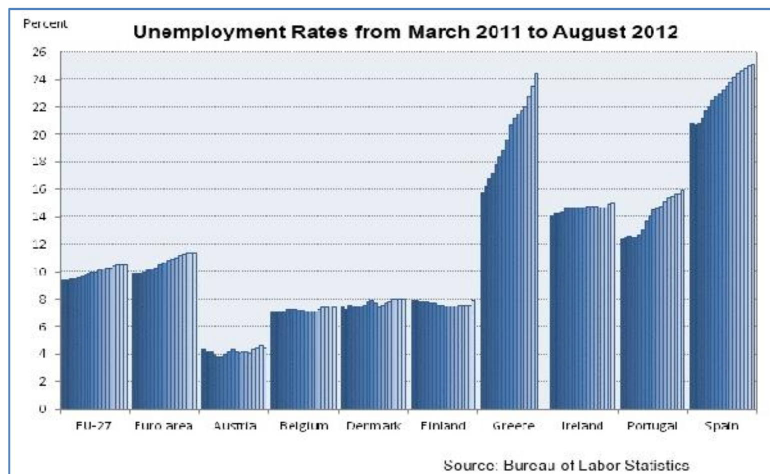
We know now that these utterances were simply laying the groundwork for the September 6th ECB meeting at which Super Mario announced to the world his newest wizardry, termed Outright Monetary Transactions (OMT). There were a number of features embedded in this new scheme, but investors quickly zeroed in on the sentence which read, "No ex ante quantitative limits are set on the size of Outright Monetary Transactions." Ignoring the rest of the press release, this suggested that the ECB would soon begin buying an unlimited amount of Spanish and Italian debt in order to keep those yields down and save the Euro. Once again, equities rallied and bond yields dropped.

However, we can't just ignore the rest of what Mario said. What Draghi clearly stated was that the ECB would be willing to buy an unspecified amount of a country's debt (he's really referring to Spain) which matures within three years as long as that country formally requests a bailout from the EU and agrees to abide by the austerity measures demanded. This means a country must effectively give up sovereign control over its budget to a team of Eurocrats and perhaps IMF officials. That's a very different reality than "we're going to start buying your debt very soon with no strings attached."

There are, of course, other issues that the market was quick to overlook. For instance, all bailout roads go through Germany, but Germany's central bank came out against this plan. Further, the ECB claims that any bond purchases would be offset by measures to ensure that euro zone money supply remains stable. If adhered to, this isn't exactly outright money printing, though it's still most certainly a form of manipulation. Let's not ignore the fact that this plan would incent Spain to refinance its debt with short-term borrowings since these rates will be artificially held down by ECB buying. Too much short-term debt, however, increases refinance risk in the future as the country would have to return to the market more frequently. And what happens when the ECB steps away and interest rates go higher?

Another issue involves a little game theory. Once the ECB has bought a significant amount of Spanish debt, what is to stop Spain from backing away from austerity? The ECB can threaten to end its purchases and even sell its holdings, but this would create a huge spike in bond yields and result in huge losses for the ECB itself.

This plan is similar to all of its predecessors in that it is seriously flawed and bound to fail. <u>It continues to rely on austerity with no promise of any real and imminent economic improvement</u>. It simply inflicts further pain on the people of southern Europe in order to benefit the banks of northern Europe. Unemployment is at 24.4% in Greece and 25.1% in Spain while Germany's unemployment rate is 5.5%. Greeks under the age of 25 are experiencing 55.4% unemployment, and that comparable number is 52.9% in Spain.



The social fabric in southern Europe is fraying. The right-wing Neo-Nazi group, Golden Dawn, rose from obscurity just a few years ago to become the third most popular political party in Greece. Spain is barely holding itself together as Catalonia, Spain's wealthiest region, is threatening to hold a referendum at the end of November on whether Catalonia should secede from Spain. <u>So, the neo-Nazis are gaining popularity in Greece and Spain is struggling to remain whole, and we are supposed to believe that the diverse nations of Europe will come together and agree to a unified and central fiscal governing body and a pooling of debt?</u> I continue to maintain that the Euro, if it survives at all, will not ultimately retain all of its current members.

Race To The Bottom

Bernanke and his lap dogs must have been afraid of relinquishing the spotlight to Draghi, for merely one week after Draghi's OMT announcement, the Fed fired back with its latest acronym. The long-speculated birth of QE3 was formally announced on September 13th, and Ben was clearly proud of his new baby.

With this latest form of monetary magic, the Fed will create $40 billion out of thin air every month and use it to buy mortgage-backed securities (MBS). The twist with this latest action is that Ben didn't preannounce a total amount of money that would be created and spent. Instead, this program is open-ended. The Fed will print $40 billion each month and buy an equivalent amount of MBS until the labor market improves "substantially". Ben offered no benchmark by which to determine what constitutes a substantial employment improvement. It's conveniently subjective.

Ben also announced that the Fed, if necessary, stands ready to purchase additional assets and "employ other policy tools." In other words, the seeds for QE4 have just been sown with the announcement and future failure of QE3! Ben will be busy with MBS for some time, but I imagine that at some future date, once he's bought up most of the available MBS and long-term Treasury markets, he'll have to choose another asset class to manipulate. Finally, Ben announced that short term rates would be held at essentially 0% until at least mid-2015 and that he would not stop easing until well after the economy had regained its strength. I've been warning that, as their ability to reduce interest rates further eroded, we'd see increasing creativity on the part of our Fed, and they haven't let me down.

Exit Strategy?

Adding stimulus is easy. The government can borrow money to spend on pet projects and favored programs. The central bank can lower interest rates, reduce required reserves for banks to induce more lending, or just print money to spend as it wishes. There's a reason policy makers like to borrow, lower interest rates, and print money. It's easy, it makes them popular, it tends to goose the economy and markets at least for a short while, and it often leads to a cushy future job on a high floor at Goldman Sachs. Everyone likes the guy who throws the party and supplies free booze. Partygoers don't care much for the cops who show up, take away the booze, turn the music down, and kick the women out of the hot tub.

This is a very dangerous game that the Fed is playing. It will inject a further $500 billion a year into the system at a time when oil and crop prices are still elevated, the economy is supposedly doing fine, the employment numbers are slowly improving, real estate is no longer crashing, and the stock market is near its highs. This is not a policy being enacted due to an economic meltdown or the seizing up of the banking sector. The Fed is once again instituting another massive intervention in a non-crisis environment. This is a cause for concern rather than celebration.

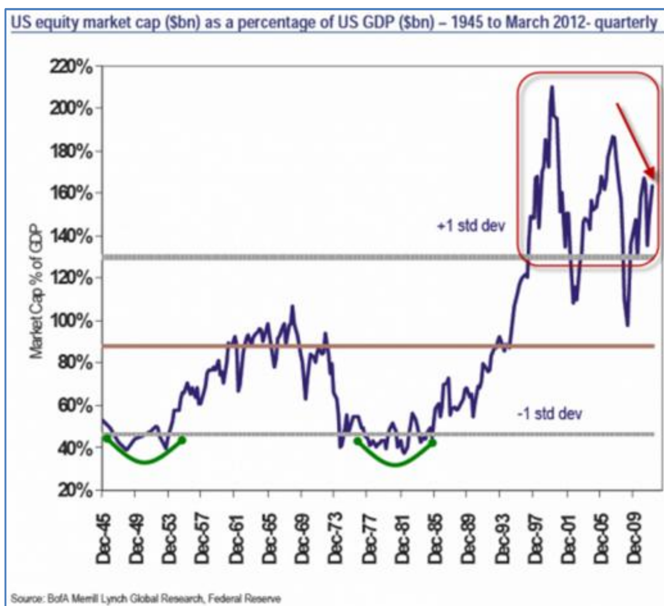
So, why did Ben push this through? Only he knows. Perhaps he genuinely believes it will help the economy and that he'll be able to seamlessly unwind all of the stimulus at some point. Maybe he wants to give Obama a boost since Romney has said he wouldn't reappoint Ben. Maybe he saw the same problems we've long been discussing, and he acted out of fear. Perhaps he was afraid of not acting because the market was expecting QE3 and would take a dive if he didn't follow through. Or, he may just be trying to help the banks again by buying junk securities from them at full price. He might have wanted a weaker dollar to help short-term exports. It was likely some or all of these reasons.

Whatever the motivation, it's hard to imagine QE3 having any meaningful direct impact on the economy. Can you picture a businessman reading about QE3 and thinking, "Thank goodness! Now that the Fed is going to indefinitely print money out of thin air and artificially prop up mortgage-backed securities, I can finally hire a few new people and expand my facility!" More likely, astute business leaders will be alarmed by what the Fed is doing. It actually increases uncertainty about the future. It may be nice to borrow at a lower interest rate, but if you're increasingly unsure of what demand and input costs will look like a few years down the road, do you really want to borrow significantly more? In financial terms, although your cost of capital may be a bit more favorable, your future growth and cash flows are more uncertain. There

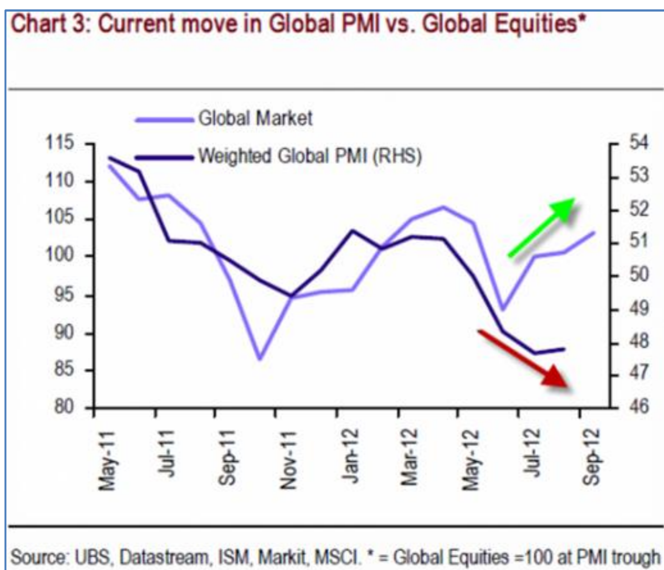
may be some added benefit from some companies and individuals being able to refinance their existing debt at the expense of lenders and savers, but much of this has already occurred over the past two years.

It's probably safe to say that Bernanke realizes that any direct impact on the economy and employment will be muted at best. Instead, in his Q&A session, Ben made it quite clear that he's anticipating/hoping/praying that a wealth effect will help the economy. He was quite explicit in discussing the benefit that could come from rising house and equity prices. He expects people to consume more if they see the value of their homes and stock portfolio going up. This is simply astounding. We're largely through the brunt of the biggest housing credit bust in our lifetime which was in large part due to the easy money policies of the Federal Reserve, and the next great idea out of the Federal Reserve is to try and lower mortgage rates, encourage home buying, and boost home prices?! It just boggles the mind. Can memories be that poor?

If the Fed feels it must manipulate the housing market higher again, at least that market has already rolled over pretty hard. What about equities? Ben has repeatedly mentioned the stock market and the supposed wealth effect from higher stock prices. It's clear that Ben's policies are in part geared toward goosing the market. Unlike housing, though, the stock market is currently near its highs and valuation is hardly compelling.

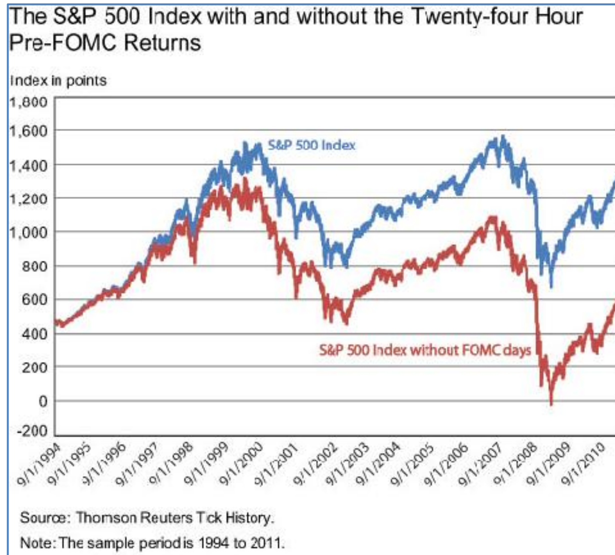


The chart to the left shows the market value of the U.S. equity market relative to U.S. GDP. Beginning in the mid-1990s this valuation metric soared to a higher range than in the preceding 50 years. The tech and housing bubble peaks are easy to spot. Of note, however, is the fact that the current value of this measure remains extremely elevated. Compare today's level to where the measure stood in 1982 at the beginning of the last great secular bull market.

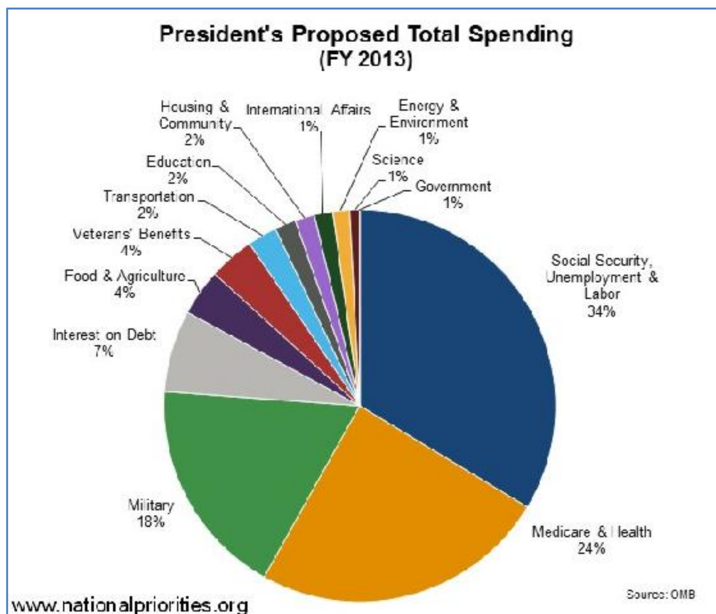


The next chart shows the recent divergence of global equities and the global economy. You can see a substantial divergence between the two, which began this past summer. I suspect this is largely owed to the expectation of additional easing from the ECB and the Fed. Investors chose to ignore fundamentals and buy global equities in anticipation of the easing to come. For the time being, investors are choosing to ignore valuation and fundamentals and focus instead on the easy money pump coming from many central banks. If this sounds similar to the Greenspan Put, it should. Central banks are encouraging investors to borrow and gamble with the implicit promise that central banks will keep rates low and add more juice any time the markets falter. It sounds wonderful, but recall how the Greenspan Put ended. This time, the numbers are larger and the phenomenon is global. The potential for a tremendous bust grows with each new policy action.

If you had any doubt about what has been driving the stock market, the following chart should help clear it up. The blue line shows the actual performance of the S&P 500 back to 1994. The red line removes the performance of the index for the 24-hour period prior to each Federal Open Market Committee meeting. These are the meetings in which Fed members discuss whether and how to meddle. At the conclusion of the meeting, a press release is issued. If we ignore the days prior to Fed action, we see that the S&P would be right about where it was back in 1994. Putting it all together, we see that the stock market has become more and more dependent on Fed easing for its gas. At the same time, the market remains overvalued on virtually every valuation metric that I follow. This is the backdrop with which Bernanke is attempting to bribe us to keep buying stocks. No thank you. When fundamentals and valuation are ignored, there is no limit as to how high the market could climb, but reality can only be postponed, not perpetually circumvented. Perhaps Ben can rekindle animal spirits, but there is no credible exit strategy from all of his easing short of miraculous and strong renewed growth.



Fiscal policy is equally intractable. I watched the first Presidential debate, and while the pundits spent the following hours and days debating who won, there was little discussion of how little difference there was between Romney and Obama on anything of substance. Their comments about the deficit and debt were of particular interest to me. As with every politician, they each claimed to be take the issue very seriously and promised to firmly address it.



Rather than critique the few specifics that were offered, I'll instead ask you to take a look at the chart on the left. When you hear the two candidates or any politician discuss their plan to tackle the deficit, think of this chart. Note how Social Security, Medicare/Medicaid, Defense, and Interest on the Debt add up to 83% of the 2013 budget. Did you hear about any cuts to these areas? Keep in mind that interest costs are only 7% of the budget despite our massive debt load because Bernanke has helped drive interest rates so low. What happens if interest rates return to historical norms? Now look at the remaining 17% of the budget. How much cutting do you think will or even can come from those categories?

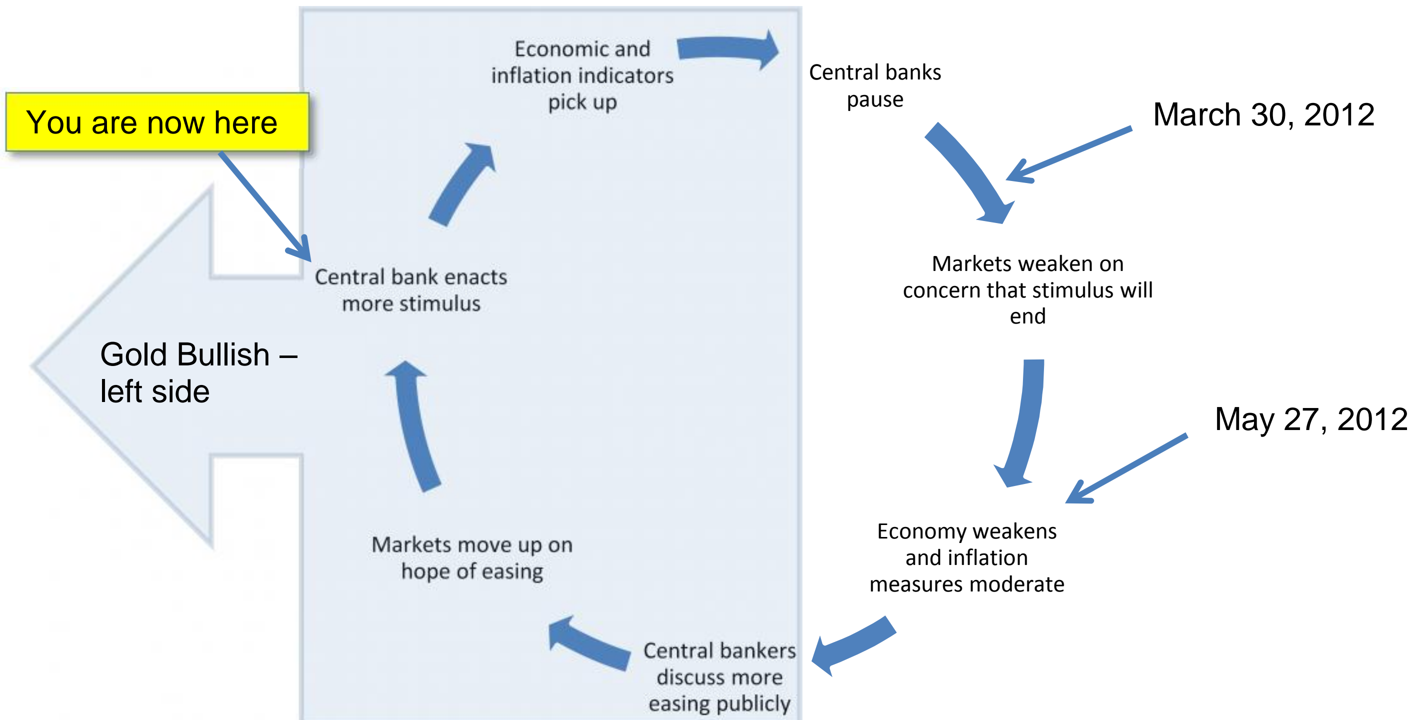
I don't believe for a second that either candidate or party will seriously address the deficit. If you're not going to tackle Social Security, Medicare, and Defense, you're just wasting your breath and our time. The debt and deficit will be addressed one day, but it isn't likely to be done proactively. It will be as a result of a serious crisis brought about at least in part by higher interest rates as confidence in the Fed and our government fades and the bond market starts puking (technical term for demanding higher yields). There is no exit plan in Washington. Both the Fed, our President (Romney too), and our Congress are simply hoping that rapid economic growth magically returns.

I've been stressing for years that we're in uncharted territory. It's refreshing to see that not everyone associated with the Federal Reserve is clueless. Dallas Fed President, Richard Fisher recently gave a speech in which he stated:

> "It will come as no surprise to those who know me that I did not argue in favor of additional monetary accommodation during our meetings last week. I have repeatedly made it clear, in internal FOMC deliberations and in public speeches, that I believe that with each program we undertake to venture further in that direction, we are sailing deeper into uncharted waters. We are blessed at the Fed with sophisticated econometric models and superb analysts. We can easily conjure up plausible theories as to what we will do when it comes to our next tack or eventually reversing course. The truth, however, is that nobody on the committee, nor on our staffs at the Board of Governors and the 12 Banks, really knows what is holding back the economy. Nobody really knows what will work to get the economy back on course. And nobody – in fact, no central bank anywhere on the planet – has the experience of successfully navigating a return home from the place in which we now find ourselves. No central bank – not, at least, the Federal Reserve – has ever been on this cruise before."

There is no viable exit strategy. As Milton Friedman famously stated, "Only a crisis – actual or perceived – produces real change.

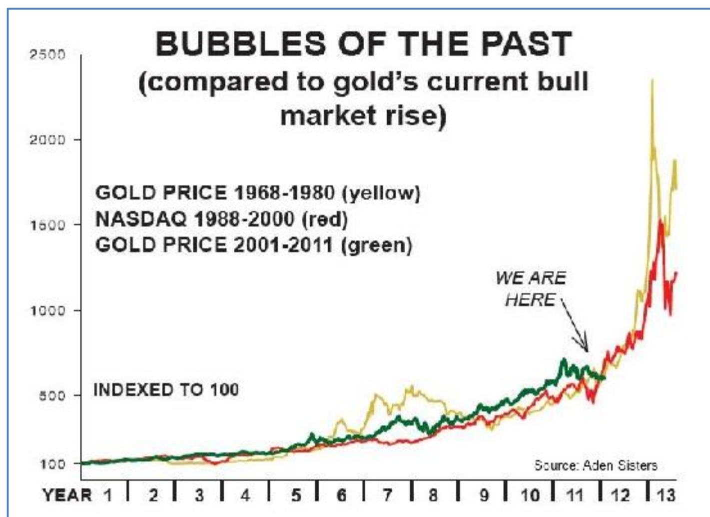
Precious Metals Update



I first presented the diagram above in this year's first quarter Review. At that time (March 30), the central banks were in a holding pattern. The official economic numbers were showing improvement (though we could see that the reality was much weaker), and most asset markets were enjoying a solid rally. I updated this diagram in the May 27th Update piece, "A Mine Is A Terrible Thing To Waste". At that time, most markets had stumbled badly as concerns over Europe were flaring once again.

We've come a long way in the past four months. Concerns over Europe and a weakening U.S. economy brought out more tough talk from the major central banks. As always, they tried their best to talk up the markets without having to actually act. Once their hot air was exhausted, the action followed. As we've already discussed, we've seen plenty of talk and action this past quarter. Right on cue, gold, silver, and the gold/silver miners all bottomed out once the central bank rhetoric started heating up. <u>You would be hard-pressed to find an asset class that performed better than the precious metals over the past two months</u>. The above diagram has played out perfectly. I expect this diagram to hold true as long as the markets still have some confidence in the central banks. At some point, I do expect that confidence to evaporate and that could be the point at which the precious metals enter a bubble phase.

Speaking of bubbles, every time we see the price of gold have a strong move in a fairly short period of time, the bears come out of the woodwork and call it a bubble. This has happened repeatedly over the last 5-6 years, and I'm sure we haven't seen the last of it. You already know that I don't view gold as being in a bubble. I think there's a better case to be made that gold remains undervalued given the quantity of fiat currency currently in circulation and being added every year. I've addressed this issue a couple of times in the last two years, so I won't beat it to death. Instead, I'll offer up just one new chart to help put the bubble argument in perspective. The chart to the left shows the current gold bull market relative to the tech/internet bubble and the gold bubble that peaked in 1980. <u>The current gold bull market looks quaint relative to where the other two peaked</u>.



The next chart helps make another point I've pounded on for years. <u>Gold benefits from an expansion of central bank balance sheets</u>. It is no coincidence that the price of gold has tracked the balance sheet expansion of the Fed and ECB. The central banks have compromised the quality of assets on their balance sheets as they have bought and continue to buy securities of questionable credit quality from the private sector. In addition, the act of conjuring money out of thin air devalues each dollar and euro in existence. <u>It's only logical that gold demand will increase as more investors (and other central banks) seek to protect their wealth from this unprecedented currency debasement and monstrous monetary experiment</u>.

Gold, silver, and the miners have had a big move up in a short period of time. They're still very attractive longer-term, but big moves often attract some profit taking. At some point, there is a good chance that this space takes off and doesn't look back, but this probably isn't that time. Do not be surprised if these names pause or pull back a bit before the next move higher.

Performance

A heavy dose of loose central bank talk and action throughout the developed world brought out the buyers last quarter. Whether investors bought because they thought the easing was good for risk assets or because they thought other investors would think the easing was good for risk assets, I can't say. As long as you weren't a Chinese equity, the U.S. dollar, or a long-term Treasury bond, you enjoyed a bit of levitation during the third quarter.

Index/Market	3Q12	Y-T-D
S&P 500	5.76%	14.56%
DJIA	4.32%	9.98%
Nasdaq	6.17%	19.62%
Vanguard Total Stock Market (VTI)	5.67%	14.54%
Vanguard International Stock Index (VGTSX)	5.17%	8.96%
Europe - Euro STOXX 50 Price EUR	13.75%	5.94%
China - Shanghai SE A Shares	-6.26%	-5.18%
India - BSE India Sensex 30 Index	7.65%	21.40%
Emerging Markets (VWO)	4.56%	9.26%
iShares Aggregate Bond (AGG)	1.03%	2.00%
iShares 20+ Yr Treasury Bond ETF (TLT)	-0.78%	2.45%
Dow Jones Commodity Index (DJP)	10.03%	4.66%
Gold (SPDR Gold Trust - GLD)	10.84%	13.18%
Silver (iShares Silver Trust - SLV)	25.63%	24.28%
Gold Miners (HUI Gold BUGS Index)	20.11%	3.02%
Oil (Cushing WTI spot)	8.41%	-6.72%
U.S. Dollar (UUP)	-2.45%	-2.45%

It's informative to look at third quarter equity returns from various geographies. Europe had a great quarter, thanks to Draghi and the hope for massive bond buying that he generated. Europe had a terrible Q2, so it didn't take much to generate some bottom fishing. This is despite the fact that the economic numbers coming out of Europe continue to be somewhere between weak and horrible.

The U.S. stock market also had a solid quarter. As with Europe, we can largely thank the central banks for this as our economic numbers and corporate earnings have been lackluster at best. Investors were happy to put their blinders on and play Bernanke Roulette once again.

China, however, had another poor quarter. Similar to the U.S. and Europe, the economic numbers coming out of China have been poor. Europe and the U.S. had weak economies but strong stock markets. China also had a weak economy, but its stock market fell. The difference? There was no large-scale stimulus program enacted or proposed in China. There is a lesson here, and it's been borne out over the past few years. Much of the return that has been generated from risky assets is directly owed to the massive amount of stimulus which has been created. This stimulus will eventually end, or it will continue to be injected until the monetary system collapses.

Aspera Performance

We had a very good quarter. Our Aggressive and Moderately Aggressive accounts were up 7-11% for the quarter while our Conservative and Moderate accounts were generally up 6-8%. The driver of our performance has long been the precious metals sector, and these names came roaring back from the dead in August and September. Gold was up nearly 11%, silver climbed 25%, and the gold miners put in a terrific showing. GDX, the mature gold miner ETF, rose 20% in the quarter. GDXJ, the junior gold and

silver miner ETF, climbed 28%. SIL, our silver miner ETF soared 34% in the quarter. A few of our more speculative precious metals positions posted even higher gains in the quarter.

It was a reversal quarter during which many of our names which had been beaten up in the prior few quarters staged an impressive rally. This was not surprising. Where the precious metals space goes in the fourth quarter is anyone's guess. It strikes me as equally plausible that these positions could continue to rally (since they remain attractively valued) or they could pull back due to some short-term profit taking. A pause and shaking out of some weak hands wouldn't be a terrible thing and should be expected.

Trading Activity – Closed or Reduced Positions

My investment strategy doesn't involve heavy trading, as our time horizon is measured in years rather than nano-seconds. Still, I must admit to being a little surprised at how little trading we've done this year. It seems that every time a number of securities on my watch list get close to buy levels, the central bankers goose the markets higher, and every time we get close to reducing our exposure, the market rolls over.

You should expect to see more activity in the fourth quarter, particularly in taxable accounts. If the Bush tax cuts are allowed to expire, the tax rate on capital gains and investment income will increase, substantially in some cases. Whereas in past years, my fourth quarter focus has been on harvesting tax losses for future use, we may well reduce or eliminate some positions with gains this year in order to minimize taxes.

Extorre Gold Mines (XG)

XG was highlighted last quarter after Yamana (AUY), another one of our holdings, made an offer to buy the company. Once I felt confident that a higher offer wasn't coming, we went ahead and sold our position.

Trading Activity – New or Increased Positions

Proshares Ultrashort MSCI Europe ETF (EPV)

European shares rallied strongly following Draghi's OMT announcement. We held off for a few days but then added to our EPV position. This is a hedge position, and we essentially rebalanced it following the rally in European shares. This is an inverse ETF and moves higher when European stocks fall.

Proshares Short Russell 2000 ETF (RWM)

The U.S. stock market also had a nice move prior to and following the recent action by the ECB and the Fed. We took advantage of the pop in the stock market to rebalance this hedge position as needed.

Portfolio Positioning and Outlook

One of my concluding comments last quarter was, "As you know, I'm not about to get lured into any short-term market rally or enthusiasm given the risks that I see ahead and the general lack of compelling valuation." Well, we've seen a short-term market rally and renewed enthusiasm with absolutely no improvement in the fundamental outlook and a worsening of valuation. No one will be surprised to hear that I have no interest in chasing this market.

The Shiller P/E (normalized long-term) is about 50% higher than its long-term average. A move back to just the average would drop the S&P 500 below 950. Insiders are massive sellers of their own stock, and sentiment indicators are at or near levels that signal at least a reversal. The equity market may run further in the near-term, but I suspect it's on fumes. The stock market is hardly healthy if the best reasons for owning stocks are (1) they're not as bad as bonds and (2) Bernanke wants us to. We'll likely greet any meaningful rally from here as an opportunity to reduce our risk further.

Bonds are also generally unappealing. We retain some TIPS exposure, some emerging market local currency exposure, a few individual corporate bond positions, and a high-quality low-duration debt ETF. It's becoming increasingly harder to find fixed income opportunities where the yield compensates us for the risk. Bonds traditionally were bought for the income they generated over their lifetime. Today, they're being increasingly used as trading vehicles with a focus on short-term capital appreciation. Once again – uncharted territory.

It's critical to understand that safe returns today yield zero percent. In a few northern European countries, safe yields will provide you a guaranteed negative yield. When you are shooting for even modest low-single digit returns in this type of world, you are incurring much more risk than you had to in the past. Markets will be volatile, but no one should be expecting consistently big returns with assets valued as they are today. This will change some day, but it's the hand we've been dealt. Expectations must be reasonable as should a comprehension of the risks we face.

The various forms of easing by central banks around the world has created a flood of speculative "hot" money. This money flows like a raging river, and the central banks can't control where it flows. When it flows into an asset class, you can see big returns in a short time frame. Unfortunately, it also works in reverse. These are speculative flows – not long-term investments. To the degree we benefit from it, it will likely be due to buying opportunities which surface when this hot money leaves a space that we're long-term bullish on. Short of that, we will not be chasing this money or trying to predict where it goes next.

We remain confident, however, that the precious metals space should continue to respond favorably over time to the increasing amount of liquidity being supplied throughout the world. Some hot money will flow in and out of the space, but we expect a growing number of investors and institutions to increasingly turn to the precious metals as a long-term store of value in a world of depreciating fiat currencies. We also want to remain focused on hard assets versus financial assets. Owning or having direct exposure to the precious metals and other select commodities remains a priority for us when it comes to deploying capital.

More people are becoming aware of and beginning to understand the risks of the current debt bubble and the danger of unintended consequences that may result from the global monetary pump. My S.V.P. is now one of those people. After proofing this Review for me, she has decided to start hoarding My Little Pony collectibles and Disney princess dolls. We both expect them to outperform the U.S. stock and bond market over the next decade. At least if I'm wrong, I'll have something to play with when I retire.

Have a great quarter!

Best,

Ken Bell, CFA, CFP
President
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