Aspera Bulletin

Intelligent, Independent Investment Management

Where Are We Now?

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 Bulletin may not apply to every client portfolio.

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I appreciate all of the inquiries as to my disappearance lately. I'd love to report that I've been relaxing on a beach on a remote telecommunications-free island in the Caribbean, but client business, trading, earnings season, and a beautiful, laughing, 4-month old daughter have kept me very busy these past few weeks. As earnings season slows I hope to have a little more time for writing, sleep, and personal grooming.

I certainly haven't avoided writing due to a lack of material! Let me try and catch up with the past few weeks and recap where we stand.

- As we know, the Fed has driven interest rates to ridiculous below-market rates.
- These low rates are devastating for the savings of retirees who have no business moving out on the risk curve in search of higher yield.
- These low rates are also supposed to encourage more borrowing despite the fact that our economy is currently suffering from too much debt.
- Congress is angry that the banks aren't lending their bailout funds to people who already have too much debt in the middle of some type of economic "ession."
- Congress is criticizing bankers for paying themselves too much, over-levering their balance sheets, and maintaining huge off-balance sheet liabilities while Congressfolk continue to pay themselves too much, over-leverage our nation's balance sheet, and maintain huge off-balance sheet liabilities.
- The collective earnings of the S&P 500 companies will register its first decline ever in the fourth quarter of 2008. Ever.
- Congress just passed a $787 billion stimulus plan that will further increase our national debt and displace private investment. The notion that this and future stimulus is only temporary and will be withdrawn once the economy recovers is laughable.
- Over $8 trillion in spending/promises have been incurred in the past year.
- We have a Treasury Secretary in charge of both the financial industry bailout and the IRS who either isn't smart enough or honest enough to do his own taxes properly.

- This same Treasury Secretary just announced an eagerly-awaited financial bailout plan that included no details and no plan aside from somehow spending a lot more money.
- The Obama administration is now working on some scheme to "save" the housing market. Whatever the details of the plan, we can be sure it will entail using the tax dollars of those who were prudent to "rescue" those who made bad choices. It will also impede the housing market finding a bottom.
- This year's Federal budget deficit is creeping towards $1.5 trillion, and is sure to rise further as tax receipts continue to fall.

Debt, Debt, and More Debt

Simply put, this massive increase in debt is an inter-generational transfer of wealth. In other words, we're doing this for our own current "benefit" and will be passing the bill to our children. Where's the discussion of fairness? With every bailout of the past year, our leaders have told us that we must act immediately or the global economy will collapse. That hasn't left much time for educated discussion, nor has it prevented the global collapse that their swift undebated action was supposed to prevent. Last week, I explained to my 4-month old daughter that her share of the national debt is well over $200,000. You should have seen the diaper I had to change after that.

It amazes me how accepted it has become that the the cure for any slowdown of any magnitude is always to throw money at it. This is the policy that we've pursued consistently since the Great Depression, and look where it's gotten us. There's a popular quote that seems rather appropriate. "*If you keep doing what you've been doing you'll keep getting what you've been getting."*

For far too long, our policy makers have increased and encouraged borrowing at every whiff of a slowdown rather than let the market correct the excesses that have built up. Each time, they managed to forestall what would have been a healthy correction at the expense of preordaining a more severe future correction. Ironically, now that it's time to pay the piper, our authorities are laying the blame on the failings of the free market instead of their constant meddling. Unfortunately, their actions will only prolong the length of this downturn.

As I've stated before, the good news is that the market is still doing its job, and many of the excesses (excluding government credit and money supply expansion) are gradually being cleared away. The housing bubble is unwinding, consumers are beginning to save again, global equity markets are back to far more reasonable levels, excess production capacity is starting to dry up, etc. This process will take time, especially with the massive level of government meddling, but it is occurring, and it will *eventually* take us to a healthier level of economic activity -- one not dependent largely on household credit expansion.

Stock Market Rally?

As ugly as the situation is, there is a strong likelihood that the fiscal and monetary stimulus being dumped on the economy will *appear* to have a positive impact. As counterproductive and inefficient as most of this spending will eventually prove, the stimulus will at least help slow the rate of decline, probably beginning in the second half of the year. In anticipation of this or at the earliest sign of this, we may experience a fairly strong rally in the equity market as investors come to believe that the worst is behind us. The expected "Obama rally" earlier this year was doomed from the start as too many people were expecting it and were looking to sell into it. With pessimism growing again and less talk of an impending rally, the odds of a rally have actually increased.

To the extent that the credit bubble has not been allowed to correct sufficiently, it's hard to imagine that any such rally will be the real deal. As discussed in prior posts, bear rallies can be powerful. The Great Depression saw a 50% rally over a 6 month period right in the middle of the first leg down. Barring a dramatic change in policy, any rally unaccompanied by a significant correction in the credit bubble is likely to prove a dead cat bounce.

The ballooning national debt and Fed balance sheet also need to be watched. I just can't see all of this stimulus being removed without collapsing any recovery we do eventually get. Government doesn't have a terrific track record of enacting temporary stimulus. Not surprisingly, it typically manages to morph into permanent funding. New constituents will be created who will create lobbying groups, and they won't take kindly to any future talk of decreased funding. The Fed will also find it difficult to withdraw the massive monetary stimulus it has injected. Once the printing presses are humming, it's very difficult to turn them off. Although much of the talk these days is of deflation, I see significant inflation as a much more serious threat down the road.

Strategy Update

As a result, current long-term Treasury yields strike me as unsustainably low. I had shorted the long end of the curve in mid-December and sold that position near the end of January. I didn't anticipate this being a short-term position, but we were fortunate to buy the position close to its low, and it experienced a 25% gain in just over one month. Hopefully, I'll get another crack at it. The Fed has discussed buying long-dated Treasuries. Should they follow through, I would expect another decline in long yields at which time I'll take a hard look at loading up again. Longer-term, this is a position I want to own.

Gold has typically been viewed as an inflation hedge, but it's been one of the best performers in this current deflationary phase (as it was during the Great Depression) as investors flock to its safety and low interest rates minimize the opportunity cost of owning gold. We've been overweight precious metals throughout the gold bull market and have continued to add on pullbacks. In early January, I bought a few junior mining names that had been driven to ridiculously attractive prices. More recently, I eased back on our GLD/DGP position in those accounts where the position grew just a little too large following this recent rally. We still own a healthy precious metals position and would be quick to add on any significant pullback.

Most of the balance of our aggressive portfolios hasn't changed significantly. Our bias at these levels is towards select emerging markets and commodities. I take a long-term approach with these positions and am quick to point out that I have no expectation for these positions in the short-term (less than one year). The countries I'm focusing on have already declined significantly, have experienced an outflow of hot money, are marked by high savings rates, have at least reasonably solid reserves, and are trading at attractive valuation levels. Five years from now, I expect to be pleased with their performance.

We still hold a decent cash position, and we continue to have just a few short positions as the recent leg down in the market has made it more difficult to find many compelling short opportunities. As usual, at the margin I would anticipate selling some long positions and increasing short exposure if we get a strong rally without signs of a significant positive change in the underlying fundamentals.

I think that catches me up from my relative absence the past few weeks. I now have to go explain to my daughter why she'll be learning Chinese and why her savings account is short the dollar. I'll be putting a second "backup" diaper on first.

Best,

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President
Aspera Financial, LLC

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