



12/29/2009

Year End Market Letter 2009: What's Going On?

Hidden Value Investment Management

Brett Tynes

One of the most important jobs we do that you never see is reading and posting data to our economic "Corkboard". As you know, our lives are awash in a constant flood of information, and even we as professional investment managers sometimes struggle to make sense out of it. To make matters worse, the headlines often don't help us figure out what's going on.

For instance, is there still a threat of deflation, which was in the headlines at this time last year? Since May, the CPI has been +.1% (May), +.7% (June), flat (July), +.4% (August) +.2% (September), +.3% (October) and +.4% (November, the most recent statistic we have). For the most recent 12 months, consumer prices have risen 1.8%. This is in contrast to the 1.4% drop in consumer prices reported by the Bureau of Labor Statistics over the second half of 2008, when a lot of economists were talking nervously about a deflationary spiral. No headlines have declared this, but the deflation threat appears to be over; the question now is whether inflation will remain as mild as it has been or, as the economy recovers, will it take off?

Since you always hope to get more return on your investments than the inflation rate, are there any investments that look especially weak if, indeed, the threat of deflation is over? In an effort to avoid any losses, a lot of investors and institutions have parked their money in short-term investments; by one estimate, there is now about 90% as much money (\$11.7 trillion) in money market accounts and short-term Treasuries, than in the Wilshire 5000 stocks (\$13.1 trillion) currently.

But is this really avoiding losses? 3-month Treasuries are paying about 0.3%; 6-month issues now pay .16% and 12-month T-bonds are yielding .37%, which is well below the inflation rate. Every rise in the CPI means the value of their money is going down-- which is something else we aren't reading about in the headlines. Money market fund yields, meanwhile, are at record lows.

Meanwhile, we've all been reading screaming headlines about debt problems in Dubai, one of the oil-rich countries on the Persian Gulf. But Dubai makes up just 0.1% of the global economy. What hasn't been reported is that, very quietly, the sovereign wealth funds in Qatar and Kuwait have been selling their stakes in U.S. companies, and raising capital. More recently, Saudi Arabia, Kuwait, Bahrain and Qatar are now creating their own petro-currency (<http://www.ritholtz.com/blog/2009/12/persian-gulf-currency-union-and-the-forex-risk-to-nations-everywhere/>), which will be called the "Gulfo," and are in the process of creating a regional central bank along the lines of Europe's monetary union.

Will the Gulf States Union (or whatever it is called) need to pump more oil in order to balance their fiscal ledgers and support their new currency? Does that mean oil prices will drop further--at least temporarily, as all these issues get sorted out?

There's one more subject that's getting a lot of headlines lately: unemployment. Recently, we've heard some rare good news, that fewer jobs are being lost now than a year or six months ago. What isn't being reported is that every month that jobs are lost puts American deeper into a hole that it will need to climb out of eventually.

How big is this hole? Has anybody tried to calculate it? Economist Paul Krugman recently suggested that with eight million jobs lost since the start of the recession, plus 100,000 new Americans moving into the work force every month, the economy would need to create an average of 300,000 new jobs a month in order to get to something close to full employment five years down the road. So if you see any number lower than 300,000 new jobs created, you'll know that this particular hole is getting deeper.

This makes it easier to interpret some of the forecasts that you may be reading, such as the recent study by the Bureau of Labor Statistics, which estimates that the economy will create 15.3 million new jobs in the next ten years. Do the math, and that comes out to about 125,000 a month.

None of this helps us predict the future, of course. But it does show that much of the information that we receive, and the way the information is presented, can be disinforming (at worst) or (more often) take our attention off what's really going on in the world. There's a lot more to know than what the headlines are telling us.

As we continue to position your portfolios to avoid the risks we see developing throughout markets the world over, you will notice our buy and sell orders foreshadowing certain developments we are uncovering in our economic research.

We will continue to hold true to our tenets of: 1) Uncovering Values "Hidden" in the markets, and 2) Protecting your investment assets from detrimental market losses. As the New Year progresses, we expect our risk identification and value management discipline to be the key to protecting your investment assets and growing your wealth.

Please let us know if we can help any of your family, friends or colleagues, as we enter 2010. We deeply appreciate your referrals.

Now, if you'll excuse me, I have to get back to reading and posting...

Regards,

Brett Tynes

About Hidden Value Investment Management (H.V.I.M.):

Hidden Value is an Independent Investment Management firm providing high-level, absolute return driven, investment portfolio management. Together, Hidden Value's managers have over 30 years of experience utilizing flexible value, growth and fixed income strategies. With an approach designed to find positive market returns in all market conditions, Hidden Value's managers are free to use multiple investment disciplines geared toward protecting capital and growing wealth.