GVA Newsletter

May 2017

FOMO

"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well." Warren Buffett

"Exponentially rising or falling markets usually go further than you think, but they do not correct by going sideways." Bob Farrell Rule #4 of investing.

"Learn how to see. Realize that everything connects to everything else." Leonardo da Vinci

The collective psychology of human beings is remarkably consistent over time in that it swings from optimism to pessimism. However, the timing of these changes is unpredictable and can be violent. Markets are a demonstration of that psychology and its oscillations between fear and greed. At the extremes of these emotions it really boils down to fear and fear at some level. On the one end, you have fear of loss, and on the other you have fear of missing out. The acronym FOMO that is used quite often in financial conversations these days, is just that – Fear Of Missing Out. Emotions rise with the intensity of markets – you can feel this happening now and the most difficult aspect of this environment is that no one can tell you when it will end.

This reality is what creates investment opportunity. Chasing a market moving up just on momentum and hope for additional appreciation is not investing – it's speculating. And as Benjamin Graham once said, "The experience of the speculator is one of temporary gain and ultimate loss."

We take a different approach to these markets. Achieving and maintaining financial independence or other important financial goals is not a game, but it seems at times as though the financial industry treats it as such. Conversations about the market have been reduced to entertainment – much like they were in 2000. However, if you retired in 2000 with an expectation that you would enjoy market returns to continue, you were sorely disappointed. A dollar invested in the S&P 500 did not produce returns for roughly 12 years while experiencing two 50% declines along the way. Some suggest that the set up today is worse. That should be sobering.

Why do we keep talking about the stock market and debt? Simple – the reason we do what we do is to give our clients the highest probability of reaching their goals. This is our "Why". We care more that our clients achieve their goals than how they achieve them. There are many path's our clients use to reach their goals: starting and/or running a business, investing in real estate, having a careful savings strategy, or investing in the stock and bond markets to name a few. We just want them to get there. We think it is a good time to have a financial plan and investment strategy that is not dependent on the current environment continuing. What is your plan?

Matt and Tom

Executive Summary

Why When Matters
A favorite saying in the investment industry is "You can't time the market." But people confuse this comment which is meant to say that no one can predict what will happen next, with a non-thinking approach to investing. Timing matters greatly in investing as we will share in this section.

Valuation and Expected Return
Markets are historically rich right now, or dear as Benjamin Graham would say, and expected future returns are subsequently quite low according to value investors like Jeremy Grantham, John Hussman and Nobel Prize Winner Robert Shiller.

Debt Update
We have more debt now than ever before in history. Auto loans and student loan combine to a value of $2.4 trillion. Subprime was roughly $1.3 trillion in 2006 before that bubble burst. Margin debt is at a new high – higher than ever. What could possibly go wrong?

Psychology of a Full Market Cycle and the Possibility of a "Blow off Top"
The last stage of market tops can get crazy. We find it useful to do a little thought experiment as to where we may stand in the cycle of market psychology. It would not be surprising to us to see a surge in markets to new highs that drives even more investors into investments that carry immeasurable risks.

Create your own economy corner – "Start With Why"
Simon Sinek's recent book has become a favorite of corporate leaders, consultants and personal growth leaders. We should be focused on why we are doing what we are doing – what is our purpose or mission. Global Vision Advisors was founded on this principal.

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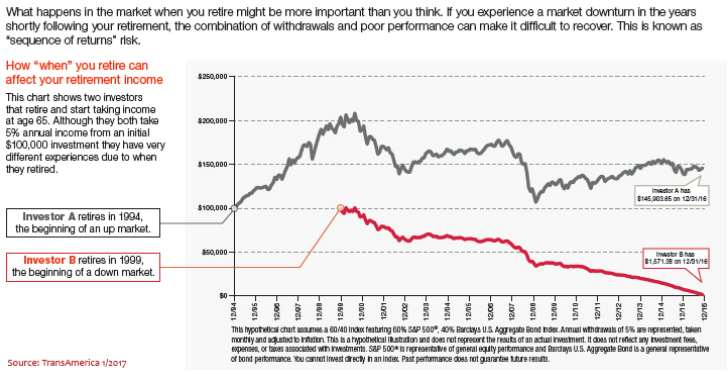
Why When Matters Most

Contrary to the message promoted by Wall St. to retail investors, timing matters. After every market decline we discover that smart investors sold near the top while telling others to stay the course, and then they buy from fearful investors near the bottom. Timing matters most when investors are looking to take distributions from their portfolios to fund their lifestyle goals.

The illustration below comes from Transamerica. It shows two investors who follow a traditional approach to investing with portfolios allocated 60% to the S&P 500 and 40% to the Barclays Aggregate Bond Index. Both take a 5% income distribution from their portfolios monthly that adjust for inflation over time. The only difference between investor A and investor B is that investor A retires in 1994 and investor B retires in 2000.

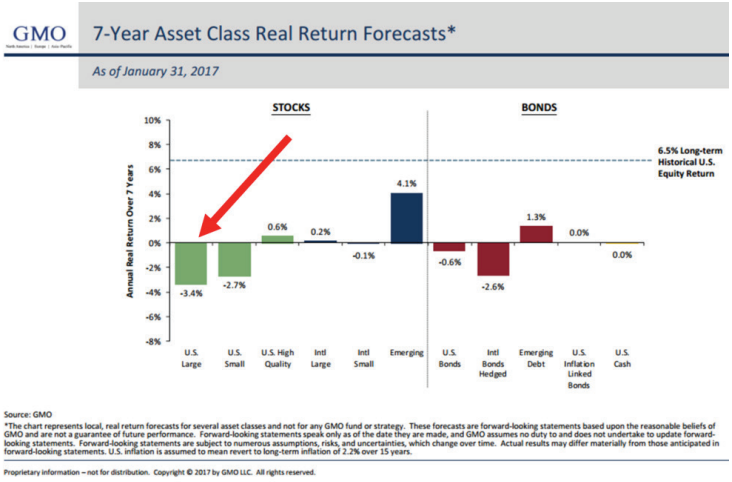
Both investors begin with $100,000. By 12/31/2016 investor A has $145,903 and investor B has $1,571 even though investor B took 6 years less in distributions.



If you are near to or entering retirement, it is critical to consider what a sustainable strategy would be to help your investments outlive you. In the past investors have mitigated this concern by increasing exposure to bonds as they age. However, in today's ultra-low interest rate environment that only makes it harder to achieve desired returns. The simplest answer is that as valuations rise, expectation for returns should diminish, and subsequently planned distributions from portfolios. But that is not how human psychology works. Most people believe that after stocks rise or fall, they will continue in the same direction.

Valuation and Expected Return

Below is GMO's 7-Year Asset Class Real Return Forecast as of January 31, 2017.



GMO is Jeremy Grantham's firm in Boston and they have a long history and strong reputation as value investors. This forecast is worse than the forecast they made at the market top in 2000.

John Hussman's 10-year forecast based on the total value of corporations as a percentage of GDP – which is known as Warren Buffet's favorite measurements of market valuation. In 2000, this model forecast a return of -5% per year for 10 years on the S&P 500. The market did in fact loose roughly 50% from 2000 to 2010. Today, using this method, he is forecasting a negative 1.5% per year for the next 10 years. By looking at the chart you can see where the forecasted returns have been at every point in time going back to 1950. For instance, at the market low in 2009 this indicator forecast a 10-year return expectation of 10% per year. The red line showing what the actual 10-year return was – illustrating just how closely related the ratio of Corporate Value to GDP has been compared to returns in the market. Obviously that does not mean it will perfectly predict the future, it is just a relationship that has been valid over time. Of course, this time could be different:

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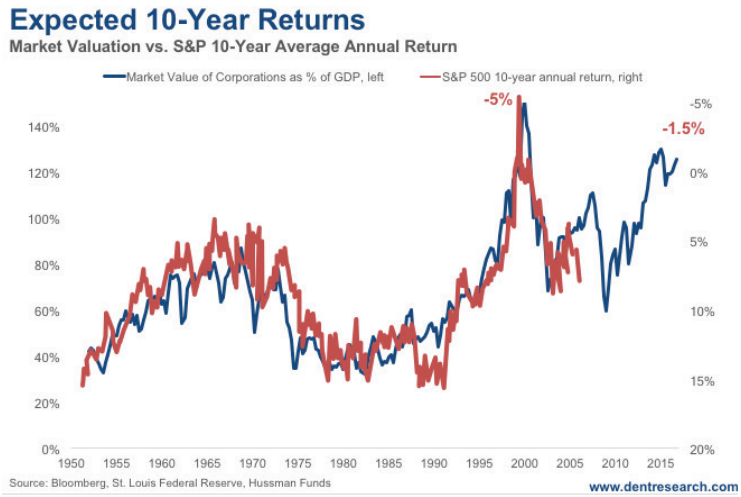
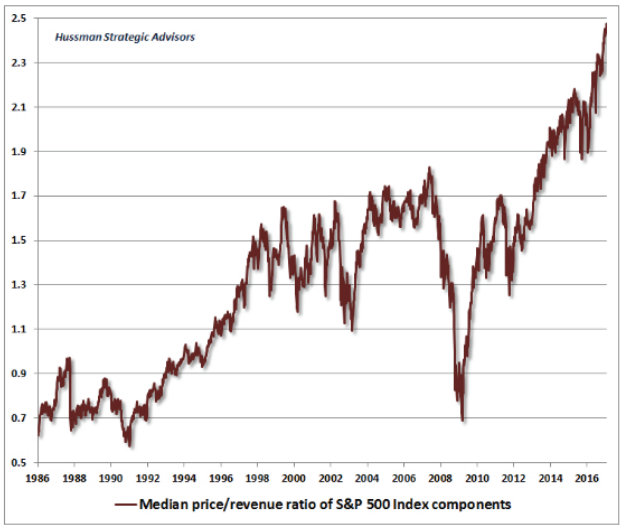


In our last newsletter we cited the 10-year Shiller CAPE (Cyclically Adjusted Price Earnings) to show that there have been only two times in history where stocks were more expensive by this measure: 1929 and 2000. What we failed to point out is that at the market peak in 1929 the CAPE was 18 – today it stands at 29. What caused this number to rise to 32 in 1930 was collapsing earnings. So, before the collapse in 1929 stocks were much cheaper by this measure than they are today – that is remarkable.

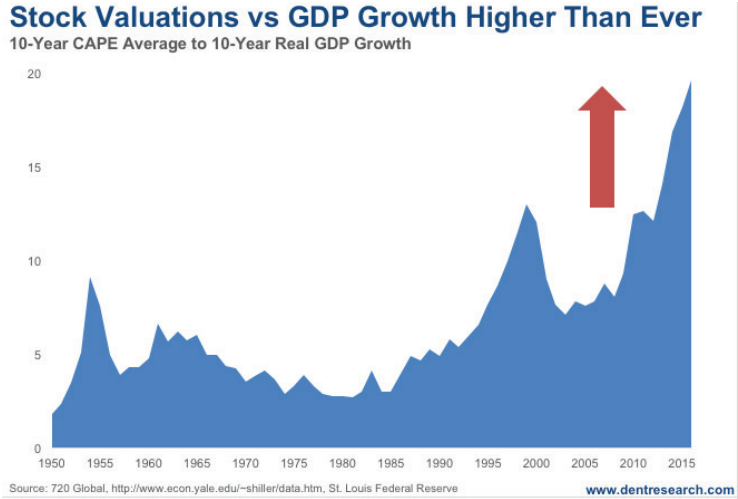
Many pundits on Wall St are comparing today to 2000 saying that we have more room to the upside. However, when we compare the valuations today, relative to the economy's health, today's market looks more overvalued than ever. Consider the following charts:

The first chart comes from Hussman and shows the median price/revenue ratio of S&P components:



When we share this chart with clients we point out that in 2000 the average P/E multiple was higher than today because the average or mean was driven by a relatively small number of tech stocks. Whereas today, the over-all market is more overvalued as measured by the median price/revenue shown above.

This next chart shows Stock Valuations vs. GDP Growth:



If we look deeper, we can see that the economy was actually much healthier in 2000 than it is today.

We Were in Better Shape During the Dot-com Bubble

A Broad Range of Economic Comparisons

Indicator	1995-1999	2012-2016
GDP Growth	4.08%	1.90%
GDP Trend	2.30%	1.80%
Productivity Growth	1.84%	0.49%
Federal Debt (trillions)	$5.36	$17.47
Federal Debt, % of GDP	60.23%	101.40%
Personal/Corporate Debt (trillions)	$15.49	$41.11
Personal/Corporate Debt, % of GDP	156.09%	220.13%
Federal Deficit, % of GDP	-0.33%	-3.29%
10-U.S. Treasury Yield	6.05%	2.13%
Federal Funds Rate	5.38%	0.18%
S&P 500 3-Year Earnings Growth	7.53%	-3.84%
S&P 500 5-Year Earnings Growth	9.50%	0.49%
S&P 500 10-Year Earnings Growth	7.74%	0.89%

Source: 720 Global

www.dentresearch.com

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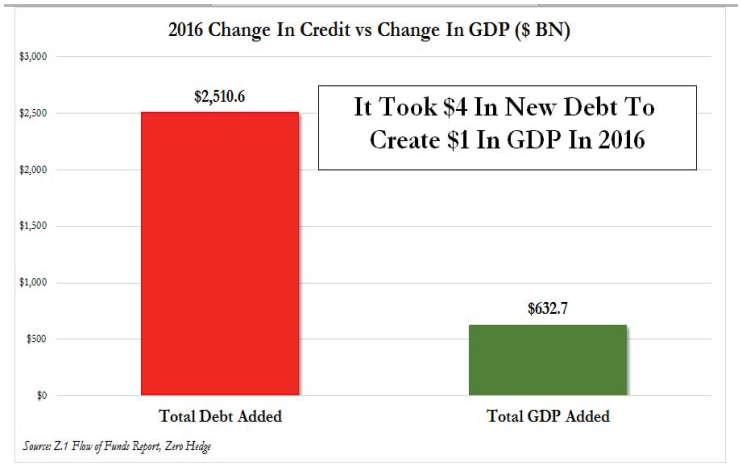
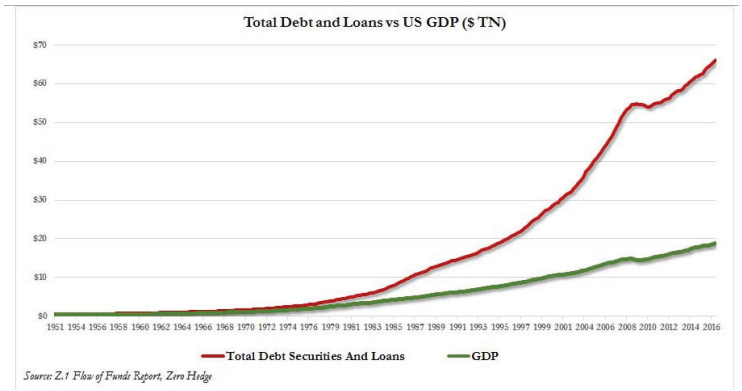
What explains all of this, i.e. record high asset prices with relatively soft economic fundamentals, is the growth of debt. Below are two charts, one showing that we added $4 in new debt in 2016 for every dollar in GDP we created:



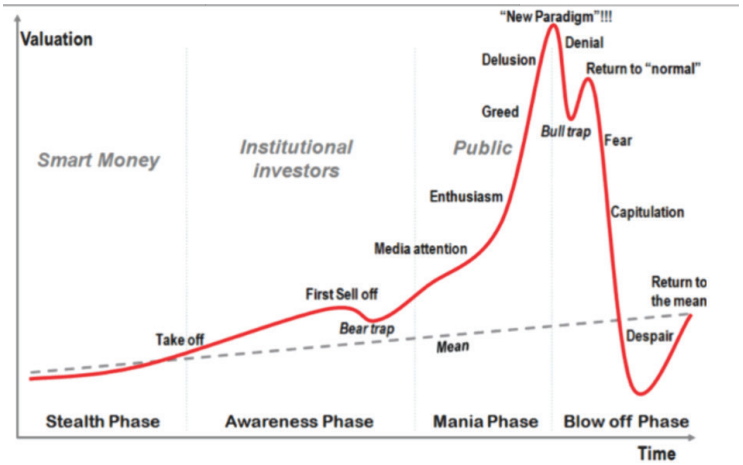
The Next shows the growth of debt and loans compared to the growth of debt going back to 1961:



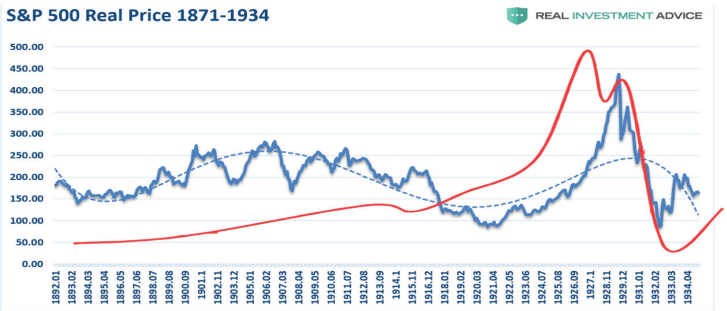
We are in an economic malaise while asset prices are rising. Every public official and politician tries to explain why the economy is not growing and what the solution should be – Democrats, Republicans and Independents. But none of them are speaking clearly about the long-term impacts of the growth of debt in our economy. In our opinion, you cannot understand the economy or markets without understanding the impact of debt. We all want something for nothing and we continue to borrow from the future to fund all the things we want and can't afford today. Debt does not matter, until it does. This is perhaps the most inconvenient truth of our day.

Psychology of a Full Market Cycle and the Possibility of a "Blow off Top"

We found this thought experiment from Lance Robert of RealInvestmentAdvice.com to be very interesting. First, he outlines the psychology of full market cycles. And then he considers whether the bull market that began in 1980 is actually still intact. Let's begin with the psychology of full market cycles:



The chart is self-explanatory and could be used over shorter time frames – like 2002 to 2009 for instance. But below he shows charts that over-lay this psychology with three time frames: 1871-1934, 1935-1980 and 1980-Present.



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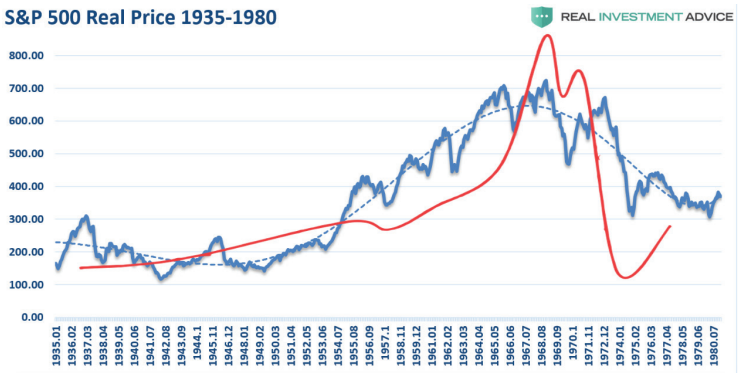
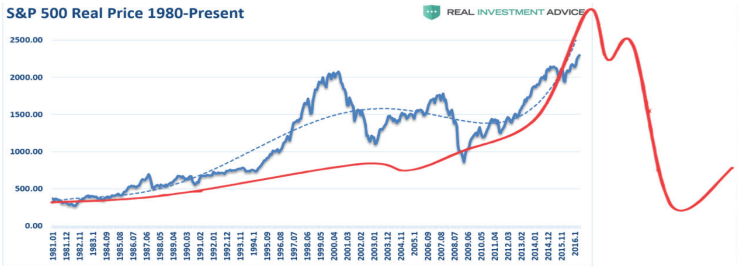
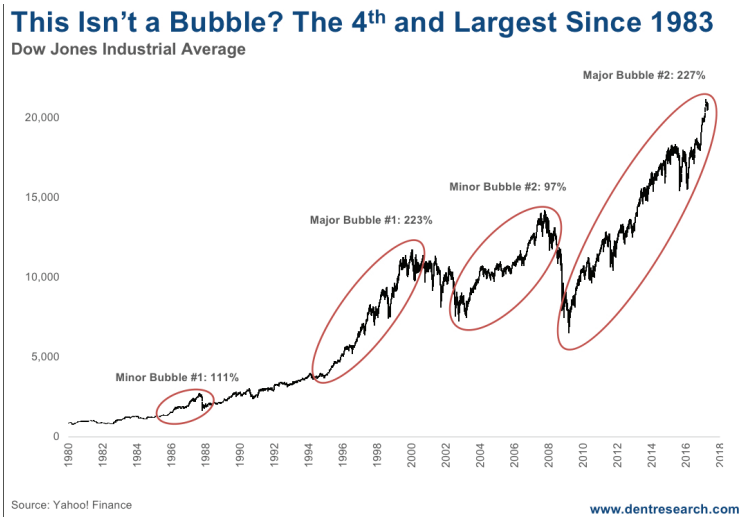




Finally, he shows the potential range of market movement should this be the case. It should be noted that he is not suggesting that this has to be the case. It is just a thought experiment that speaks to the potential level of risk in the market.

Another way of looking at this is that we may be on the largest of four bubbles that have built up during this time. 1987, 2000, 2007 and today. The chart below illustrates that perspective:



The balance of the data we receive continues to suggest that there is significant downside risk in the market. However, it is altogether possible that emotions drive the Dow from 21,000, a level we would have never expected it to achieve in such short order, to 30,000 or even 40,000. This is what the Japanese Nikkei did in the late 1980's before falling 80% and the kind of action the Nasdaq saw in the late 1990's before falling 80%.

Again, predicting or participating in these market moves is the realm of speculators, not investors. We are planners and investors and are looking for the highest probability outcome to support our clients' desire to achieve their personal financial goals.

Create Your Own Economy Corner - "Start With Why"

The first question we ask new clients when we begin to work with them is what is their vision for the future? What do they want to have, do or be? The second, and even more important question we ask is: what is important about that to you? Or put another way, why do you want that?

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It is the reasons that inspire and motivate people to take action. In other words, it is not what you want but why you want it that lights the fire. Famed personal coach and motivational speaker Tony Robbins refers to himself as the "Why Guy". When he was asked recently what he reads for inspiration he listed three books. The first was "Start with Why" by Simon Sinek.

Sinek uses examples from the corporate world to illustrate the difference between organizations like Apple that have a clear sense of why, vs other companies who are more focused on the "what". Companies and individuals with a clear sense of why, he argues, attract and inspire people who are motivated by a sense of purpose. They have a better chance of handling adversity, achieving their objectives and delivering on their promise.

He also says something interesting about the process of discovering your "why":

"The WHY does not come from looking ahead as what you want to achieve and figuring an appropriate strategy to get there. It is not born out of any market research. It does not come from extensive interviews with customers or even employees. It comes from looking in the completely opposite direction from where you are now. Finding WHY is a process of discovery, not invention."

We began Global Vision Advisors in 2007 to help people discover their why so they could create their true vision of a wealthy life. We call our process "Discovery". While we seem at times to be distracted by the conversation around markets and the economy, that is just part of our "what" we do and "how" we do it. Unfortunately, it is part of the times we live in and a reality we find too impactful to ignore. At our core we exist to help people clarify and achieve their goals. This is our WHY.

To see Simon Sinek present his ideas about "WHY" click the link below for his fascinating TED talk:

https://www.ted.com/talks/simon_sinek_how_great_leaders_inspire_action

Please reach out to us to experience the process of discovery and allow us to help you create your future vision.

Have a great summer!

Matt and Tom

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