BARRACK YARD ADVISORS

Current Anchors

April 2011

Current View:

Equities: 64%, Bonds: 0%, Cash: 36%

We are living in the continued aftermath of a serious financial crisis and "balance sheet" recession.

Historically, this is a rare economic environment and investors must grapple with some unique issues:

- Price of money is phony and the world is being flooded with dollars
- V.L. p/e = 17.3; yield = 1.9%; appreciation potential = 50% is within 10% of 2007 high
- Cheap money means stocks, bonds and commodities are not cheap

We believe current valuations (negative real interest rates, doubling of stock prices in 2 years, and most commodities at all-time highs) are at levels that warrant a cautious approach:

- Expect extended period of economic challenges
- Avoid interest rate-sensitive investments

Our favorite ideas still include selective high-quality dividend-paying companies – but these are at the upper end of our buying range.

Barrack Yard Advisors will hold most of our other positions for now, but will become net sellers if prices continue to rise.

The Financial Crisis & Its Causes

Most opinions about the causes of the Financial Crisis and its handmaiden, the Great Recession, reflect the political agenda of the opinion-giver as much as any attempt to explain what really happened.

In other words, political biases drive viewpoint.

To caricature the argument: people on the Right blame Jimmy Carter and the millions of poor people 'gaming' the system who had no business taking on mortgages they couldn't afford. To them, bankers are victims of the Community Reinvestment Act.

Those on the Left say the working poor were exploited and hoodwinked into buying incomprehensible loans that greedy 'banksters,' unleashed by the GOP's laissez-faire policies, jammed down their throats.

My favorite narrative goes something like this: Market fundamentalists had taken over the country in the past decade or so and saw scant reason for subjecting bankers to the inconvenience of proper adult supervision.

Left pretty much to their own devices, and goaded on by artificially low interest rates, these banksters borrowed massive amounts of cash to engage in speculative investments they didn't fully understand, using other people's money as collateral.

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The catalyst for the Crisis was when it became apparent banks had morphed into these out-of-control "black box" hedge funds; and greed and incompetence had gotten the better of them.

Then "We-The-People" had to save these clowns from ruin because the banks were too big and too interconnected to fail. We conveniently overlooked the fact that none of the activities that wrecked the bankers actually benefited customers or society, because the whole system would have collapsed with a 1930s-style implosion had we done nothing.

But before running out to burn a banker in effigy, consider that it's in the nature of banks to behave as they did, to help facilitate blow ups in the system from time to time. Remember the S&L Crisis of the late '80s and the bank recession of 1990?

After all, the great John Maynard Keynes wrote 80 years ago: "A sound banker, alas, is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional way along with his fellows, so that no one can really blame him."

Given that bankers don't operate within a vacuum, they will always be at the center of financial panics that reflect society-wide issues. They may facilitate the problem but they don't really cause them.

So who caused the Financial Crisis and Great Recession that became evident in 2008?

The real cause was the prickling of a credit bubble 25 years in the making, and, if you're looking for one, the villain is everyone involved in building up that credit bubble. In other words, the villain is us: individual consumers, poor and rich, speculators, governments, banks of all sorts, real estate people, business owners, investors, politicians and so on.
We all participated and benefited from the credit super-cycle. We borrowed like never before and benefited from asset values climbing to unprecedentedly high levels.

Debt accumulation, asset value increases and tax reduction fueled much of our prosperity, particularly in the Bush/Cheney years. So what lies on the other side of the debt bubble, now that it's been pricked?

It will take many years for the answer to play out.

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