BARRACK YARD ADVISORS

Current Anchors

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Review of 2011:

"An opportunity-of-a-lifetime comes around in the stock market about every 6 months."

That's a jesting remark I used to say as a young stockbroker years ago. Yet it reflected a truth about the capital markets back then: stock and bonds were extremely volatile, even by today's standards.

How volatile? Anecdotally if you missed out on buying something because it moved sharply higher, chances were pretty good you'd get a second chance to buy it again at an even lower price—often within a few months.

Stocks would make a "round-turn" in price.

Most market participants were wary of buy-and-hold strategies. The legacy of the long Bear Market that ran from 1965 to 1982 was investors trying to avoid round-turn situations, mostly by playing short-term trends.

Stock market technicians, allegedly adept at identifying price movements, were the financial rock stars of the day. Later, during the Great Bull Market, most of them would be seen as charlatans.

Round-turn describes the stock market price action of quality companies during the later years of a long Bear Market. But it's no longer in the stock market lexicon.

...continued on page 2

IN THIS ISSUE

HAPPY ALMOST 30TH BIRTHDAY MR. BULL MARKET in BONDS

Pessimism isn't as prevalent in the bond market. Buy-and-hold rules! That's because bonds have been in a Bull Market for the entire working careers of most investment managers.

Few under the age of 60 know what it feels like to have the value of their bond portfolio drop by 40% in a matter of weeks—as was the case in the autumn of 1979—simply because the Fed decided to get serious about fighting the inflation it had arguably caused...

Consequently, just as round-turn investing has exited the stock market lexicon, interest rate risk seems to have disappeared from the bond market lexicon.

...continued on page 3

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…continued from page 1 | Review of 2011

The Great Bull Market in stocks that ran for 18 years starting in 1982 made the term redundant.

Buy-and-hold became the prevalent belief: ride out the storms because price dips will eventually be followed by new highs. When the trend is your friend, to use a cliché, higher prices will eventually bail you out.

Now, after a "lost decade" in stock returns, and in the face of what seems to be an increasingly volatile stock market, the wisdom of buy-and-hold is under scrutiny.

People are thinking maybe stocks don't always go up? Perhaps a perpetual Bear Market is the "new normal" (to steal a phrase)?

So my question is: as 'buy-and-hold' leaves the stock market lexicon, will "round-turn" enter it once again?

If the answer is yes, paying close attention to the price you pay for stocks will be ever more important; **dividends could be the primary source of return for most stocks**, and being nimble will be a key component of investment success.

What reminded me of the quip about an opportunity of a lifetime—which is really code for trying to exploit volatile times—was looking at the performance numbers of the S&P 500 in 2011.

For all practical purposes, stocks ended the year pretty much where they started.

Lest you think Zen-like calm reigned, however, remember **the market fell by some 20% between April and October**.

Downward volatility created some pretty scary moments for participants in August and again in October; and reminded one to perhaps think of volatility as an asset class.

On the plus side: dividend income in the US increased by over 11% last year.

Most foreign markets experienced even greater volatility and performed badly.

"…after a 'lost decade' in stock returns, and in the face of what seems to be an increasingly volatile stock market, the wisdom of buy-and-hold is under scrutiny."

According to the FT, **over $6,300 billion was erased from global stock markets last year**. Emerging markets in aggregate and Hong Kong stocks specifically dropped by some 20%. European blue chips ended the year 11% lower.

Last year was a tough, volatile year, for most risk-assets. **Whipsawed stock markets were the norm**.

The Reuters-Jeffries CRB Index, a basket tracking the price of raw materials from oil to wheat, fell by 8.3%.

Naturally, domestic bonds fared much better: US Treasuries returned about 15% last year, according to Goldman Sachs.

Buy-and-hold indeed!

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OUTLOOK 2012:

"The future is foggy…" "…uncertainty is the new normal…" "…it is clouded by…"

Our Outlook for 2012 does not disagree with any of the above clichés taken from various publications of prestigious investment banks.

We have always believed the future is foggy, just as **we believe it's a fallacy to think the future is ever anything but unknowable.**

As investors, we can potentially profit from this fallacy. **When the future is perceived to be stable and secure**, as was the case in the late '90s, **stocks are expensive**: the earnings yield on US stocks was something like 3% back in those days.

Now there's a perception that the future is more uncertain than usual and the earnings yield is over 8%. **The earnings yield for many European and Asian companies is in the double digits.**

…continued from page 1 | Happy Almost 30th Birthday

Given rates are so low, the following hypothetical should give one pause:

If long-dated Treasury yields were to rise to 7% at some point in the next 5 or 6 years, bond prices would fall roughly 40% from current levels.

Such a hypothetical event would also have a devastating impact on commercial real estate prices, utility stocks, REITs, etc.

Will this happen? Truth is, only God knows and He's not telling. But it's worth pondering…

Strategy to Tame the Turbulent Teens:

Talk about clichés! Our base assumption is 3: 2: 1. There are three big risks, two vast opportunities, and one great challenge. The **three big risks** are:

Slow growth rates: Excessive debt burdens and developed world demographics imply slow or no growth. This is a shift from the pattern since World War II. We therefore assume free cash flow will be sole driver of equity returns.

Debasement of paper money: Central Banks are printing unprecedented amounts of money to avoid severe deflation. We believe you should own stuff: farm assets, infrastructure assets, strong currencies, fungible commodities in the ground, etc. to anticipate this risk.

Interest rates: The cost of money remains phony and creates distortions. Ours will not remain a zero-interest-rate world forever.

…continued on page 4

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Focus on strong balance sheets; seek to avoid assets that are particularly sensitive to the cost of money changing.

The **two vast opportunities** are an aspiring world yearning for the **staples of a better** life: better food, clothing, education, luxuries, travel, etc. and the infrastructure to support it. Plus,

The **need for security**, both public and private—a common national defense, a crime-free cyber space, secure access to energy supplies, safe water, a clean ecology, assured retirement income, and a place to keep assets that won't be expropriated.

The one **challenge** is to find Stores-of-Value in the current Age of Uncertainty & Manipulation.

The Barrack Yard approach is to embrace opportunity through investing in companies that meet our definition of the three constructs known as perpetual annuities; toll-takers; and rarities.

Equally, we seek to mitigate risk by adhering to our 3-pronged investment philosophy; the 5-enduring principles; and an investment process toolset developed over many years.

Our view of the current situation is best described by something the Yale economist Irving Fisher wrote back in 1925. If nothing, it proves the old adage that if history doesn't repeat itself, it certainly rhymes:

"It seems, then, that the market overrates the safety of "safe" securities and pays too much for them, that it underrates the risk of risky securities and pays too little for them, that it pays too much for immediate and too little for remote returns, and finally, that it mistakes the steadiness of money income from a bond for a steadiness of real income which it does not possess. In steadiness of real income, or purchasing power, a list of diversified common stocks surpasses bonds."

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