THE BIG PICTURE
THE CRYSTAL BALL FOR 2015
THE GLASS IS HALF FULL/HALF EMPTY

IN 2014, we quoted one Wall Street firm's forecast of S&P growth to be nearly equal to the S&P's earnings growth for the year, interrupted by a 10% decline during the 12 month period. Not bad. But the average stock in the broader Value Line index of 1700 stocks was closer to flat. **FOR 2015**, we could easily stick with that scenario again, but with the possibility of an interruption of twice that 10% magnitude. Looking further out, with price earnings ratios high - but not yet at the historic highs by the more followed measurements - we could continue this outlook for the foreseeable future. *Long term*, the stock market mirrors corporate profit growth, when those earnings are compared to the interest rates being offered or expected. Investor confidence levels can add or subtract from the valuations (price to earnings ratios) as well.

BUT LET'S NOT BET OUR ENTIRE NEST EGG ON THE PREMISE THAT CONTINUED POSITIVE EARNINGS GROWTH AND INCREASING INVESTOR CONFIDENCE WILL BE GIVENS IN 2015. Most Wall Street forecasts are for 5-8 years of more of the same of the last 3 years' profit increases, stable interest rates & increasing investor confidence. Such is the best case, half full scenario. I understand how these forecasts are derived. But, let's look at these assumptions about growth, interest rates & confidence more closely, especially for the next twelve months, OK? Let's get started.

DON'T FIGHT THE FED. The Fed will do "whatever it takes" to keep the economy (appear to be) growing, that inflation will (appear to be) under control, and unemployment (appear to be) declining. Those statistics are produced "by the governors" (and federal government departments) "for the people". *Continued confidence* of consumers, investors, and business managers is key to fighting the headwinds of deleveraging (unwinding the global debt of households and corporations). Maintaining low interest rates is crucial to this equation of reducing *the burden* of deficits & debt at all levels: government, corporate & personal.

CORPORATE STOCK REPURCHASES have been a substantial factor in the earnings improvements we've seen over the last four years. Low interest rate loans available to the big corporations have shrunk the number of outstanding shares. That inexpensive source of funds is creating share demand. When an increase in demand causes a shrinkage of supply, that's economics 101: the price goes up. We expect more of the same: easy money for big corporations with low interest rates & more stock repurchases. We'll also watch for an increase in mergers and acquisitions going forward. Such could provide the easiest way to grow both earnings & revenues.

NOW ADD THE EXCHANGE STABILIZATION FUND (ESF) to the market support (half full) case. Established in 1934 to help manage the market price of gold, the ESF mandate has been expanded to help "stabilize" currencies & most any financial market or exchange. You can read all about it by googling the same. Combine high frequency trading and growing ETF buying and selling, and you have about 75% of daily trading, according to active traders quoted on CNBC. The ESF can easily influence those mechanical (computerized) trades, especially thru "pre-opening" buying when few sellers are around. Such "stabilization" is legal.

IF YOU LIVED IN Russia, China, Europe, the Middle East, Africa, or (most of) Latin America, would you consider transferring a portion, if not the majority of your excess liquid assets not needed for the immediate future, into a more stable country? That move becomes a double benefit if the currency (currently the dollar) is also appreciating against your country's currency. Investments in big U.S. companies can offer good liquidity and higher dividends than the interest rates that most other countries are offering.

SO THE BIG "SMART MONEY" is flowing into New York, Miami, Los Angeles, Vancouver and buying premium properties, collectibles (art, antiques) and the bigger name more liquid equity shares. Cyprus, as a safe harbor for Eastern Europeans, didn't work out so well. So the U.S. remains the "cleaner shirt in the laundry basket" for liquidity. It offers rule by contract law, relatively stable neighbors to the north and south, and large protective motes to the east and west to slow down tanks and armored personnel.

THE U.S. BUDGET DEFICIT has shrunk in half over the last five years. Quantitative easing (printing) is on (temporary) hold. Pension plan underfunding has improved through stock, bond, and real estate appreciation. Banks & corporations are at all time liquidity highs, & the U.S.trade balance improves with the increase in oil and gas production. Manufacturing moves back on shore to tap U.S. cheaper energy. Relatively cheap labor combined with high technology are available in the U.S. What's not to like, when the US is compared to other "safe" alternatives.

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"BULL MARKETS DON'T DIE OF OLD AGE". Rather, they typically do so when the Federal Reserve reverses course. Investors watch for the " inverted yield curve", when short term interest rates become higher than long term interest rates. My partners and I meet almost daily with economists, portfolio managers or their representatives. We have scheduled approximately 200 lunches per year with the likes of these "informed" investors. NONE of them see an *inverted yield curve* system in our near future. So, it's unanimous: "don't worry about *substantially* higher short interest rates any time soon." And the last time the Fed did raise short term rates, from 2004 to 2006, the S&P went from 1000 to 1500 or a 50% advance. Investors see such initial hikes as signs that the economy is doing better.

THE OFFICIAL INFLATION RATE is not a problem, and ongoing market corrections can slow down any speculative bubble. So goes the "professional thinking". *Not one of our lunch speakers foresaw* the lower interest rates that we actually *experienced* in 2014. For 2015, I have not heard a one be bullish on gold, with the possible exception of Raymond James' chief equity strategist, Jeff Saut. Nor have I heard a forecast *bearish* for stocks (*greater than* a 20% correction). More on all this later.

BULL MARKETS HAVE THREE PHASES: first, a recovery from depressed levels (that's *done!*); then an improvement in economic fundamentals or at least are not getting worse, (we're improving now, according to the statistics); and third, speculative phase (we have few signs of it as yet as the small stock performance trails behind the big safer stocks). Today only 53% of investors are back in the market vs. 65% in 2007 at the last market peak[1]…so we're *waiting* for phase III!. We'll watch for signs of higher valuations, especially for junior companies accompanied by investor participation that approaches the 2/3 level.

MOST OF THE GAINS IN THE STOCK MARKET ARE HISTORICALLY MADE IN THE THIRD YEAR of the election cycle. That of course would be 2015. Years three have had only one losing year since 1932, and that was a 1% loss that would have been an up year when dividends were added for the total return[2]. So, the third year is about to start. History is on its side.

WITH 80-90% OF CORPORATE earnings cash flow going into dividends, with stock buybacks along with the accumulated cash levels at low interest rates, and with easy access to bank loans & bond markets, the agenda has been to create a *wealth effect.* When assets increase in value, hopefully more spending is realized. Governments (sovereign wealth funds) have also been active investors, not only as market stimuli (quantitative easing, etc), but through government employee pension investing.

WHEN INTEREST RATES EVENTUALLY DO GO UP, bonds will go down. The government pension funds as well as individual investors could begin to exit fixed income (bonds) and head even more into equity allocations. In total, that's a lot of potential positive flow of funds from both a domestic source seeking returns and from foreign seekers of "flights to safety". For growth investing, it's always good to get ahead of the waves.

EXPECTING THE UNEXPECTED

COUNTERING THIS VERY POWERFUL "POSITIVE FLOW OF FUNDS WITH SHRINKING SUPPLY OF STOCKS" PICTURE, is the potential for "surprise investor confidence shaking events". The global financial markets are closely linked. We have witnessed a past Russian debt default, the Taiwan baut currency collapse, and even a small island of Cyprus bank collapse. As tens of trillions of newly created money looks for safer havens and positive returns in a near zero or negative real interest rate environment, the individual investor and professional traders *react together* in a herd instinct. Volatility created by the highly leveraged speculators of hedge funds and trading operations is further multiplied by the computerized trading of the "high frequency" gang. Rapid moves can be triggered by the pre-opening light volume market support. But the urge to be first through the exit, exacerbated by computers flipping direction, is the same condition we saw in October 1987. Such could happen again.

LOOSE CANNONS

MEANWHILE, PUTIN IS FINDING LITTLE MEANINGFUL RESISTENCE to his troops and trucks. He reminds the world that he has a "nuke" up his sleeve and the ability to put out anybody's lights thru a "grid attack". Add cyber and China to the equation and maybe a dash of Iran and North Korea, and we would have a potential overnight (or day) "who done it" scenario. As Putin is squeezed with sanctions, he and China are side by side in photo ops as they trade arms & military technology for mutual advantage. As the director of the FBI told 60 minutes on October 5, 2014, experienced terrorists with online recruiting and training efforts are reaching "troubled souls who are seeking meaning" in some misguided way. Many are committing their entire lives to

[1] CNBC
[2] Steve Sjuggerud's Tru Wealth

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the internet. They attempt to steal secrets, hurt kids or defraud adults. It's an epidemic.

THERE ARE TWO KINDS OF BIG COMPANIES IN THE U.S. "Those who've been hacked and those who don't know they've been hacked", said James Corney in his first public statement as FBI Director. "On a smaller scale, they can take over personal computers & with it your entire life." And that's the way it is…today, 2015.

THE GOLD AND SILVER BULLION OPEN INTEREST OF THE CONTRACTS ON THE COMEX have never had so much potential demand for delivery of the metals vs. the inventory that can be delivered. So much gold paper (trading certificates) has been sold (surpressing the price), that the contracts outstanding simply dwarf the available metal to deliver (according to Miles Franklyn.com). Congress has begun questioning the big banks about "manipulating the commodities market". As we did with the Libor rate scandal, we'll see how this all shakes out.

WHO MAKES UP THE STATISTICS?

ACCORDING TO JOHN WILLIAMS (SHADOWSTATS.COM), the true unemployment rate in the US is closer to 23%, with the actual inflation rate at 9.3%, when such are calculated the way they were from the 1970's thru 1994. "Adjustments to the data computations" have made the official numbers now in the under 6% and around the 1.79% range respectively. That sounds better and gives us more confidence that "things are getting better". We know how important that is. *But in reality*, real household income is *down* close to 20% over the last 15 years when adjusted for taxes and inflation. With 3 billion workers added to the global workforce over the last 20 years, labor remains very competitive internationally and wages stay suppressed . The rising cost of food, medical care, education, cyber services & most insurance plans keep budget pressures on the average U.S. household.

MONEY CONTINUES TO FLOW INTO U.S. EQUITY MARKETS and the US dollar. Valuations as measured by the lesser followed Nobel Prize winning Schiller's P/E Index, read as high as former market readings in 1929, 1936, 1987 and 2000. Historically, the markets have topped 12-24 months after reaching these, according to Prof. Robert Schiller.

PLAYING DEFENSE

WE HAVE THREE LIQUID ASSET ALTERNATIVES: 1) CASH with zero interest rates. With potential 9% real inflation, that's a for sure "loser"; 2) BONDS with rates expected to rise. These too could be "losers". 3) EQUITIES. Positive flows of funds are expected, until a loss of confidence interrupts such flows. Then these, too, could become a "losers".

THERE ARE THREE EQUITY STRATEGY ALTERNATIVES WE CONSIDER: 1) BUY AND HOLD long term and take what comes from these presently higher valuations; 2) BUY FOR INCOME: (dividends), and *then don't be bothered* by the daily/monthly prices for that income: 3) TACTICALLY ADJUST. Go for total return/capital gains & dividends, but hope to get out before everybody else does, so as to keep any gains before they disappear and become losses.

LET'S CONSIDER ALL THESE ALTERNATIVES. Many investors believe they will push the sell button more rapidly than they did in the last two 50% off stock sell offs of 2000-2002 and 2007-2009 bear markets. It's going to take a very *disciplined approach* to do it. But Remember, the Fed and ESF (Exchange Stabilization Fund) are watching. When a top appears in place, then intervention (i.e. forward guidance) can quickly reverse the free fall. October 2014 was an example of an illiquid "mini panic" stopped in its tracks. What's our #1 rule? Don't fight the Fed? Even many of the "smartest traders" are being whipsawed & are falling behind performance of the big cap buy and hold approach, for now….

SO LET'S PLAY IT SAFER, and consider the following diversified strategy. 1) Have cash, enough to get by for awhile, say 6 months; 2) Buy primarily short term bonds, more for portfolio stability than income, with some longer terms to benefit in the "flight for safety". If you're enough of a contrarian, sprinkle some gold dust on top. Perhaps the legal proceedings now underway in Congress & the courts on the commodities and precious metals markets will answer questions as to what's behind the recent price moves 3) Go for stocks, investing for "total return". Have a *disciplined exit system* for most of the portfolio. Perhaps maintain a few picks for the longer term, not watching the daily/annual fluctuations, if you've got enough assets to hang in thru the upcoming rough spots.

FOR THE BULK OF LIQUID ASSETS NOT NEEDED FOR SHORT TERM SPENDING, let's also consider income as our objective. We can hedge the downside with a disciplined system, & either spend the cash flow or use it to buy more shares. Then we'll try not to get overly concerned if "the market indices" rise more than our income stocks in a given period. It will happen. Likewise, if the market takes a sudden & unexpected deep dive, we can use dividend cash flow to add to more income

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generators. Enclosed is a white paper, "Income Investing", describing this approach more fully.

NOW LET'S TALK ABOUT THE OTHER IMPORTANT STUFF

OUR COSTs OF LIVING HAVE MORE THAN DOUBLED WHILE HEALTH CARE HAS QUADRUPLED over the last 30 years. Only 37% think they'll need long term health care assistance (LTC). But 70% of us actually will. Only 8% have insurance to cover these needs[3].

THERE ARE ESSENTIALLY THREE KINDS OF LTC INSURANCE: 1) "Use it or lose it", where you pay an annual premium that can rise over time. If you never need it (about 1 in 3 chance), that premium money is gone. End of story. 2) Pay an initial lump sum for a certain dollar amount of care that you may need later. There are no further payments. If you don't use it, you or your heirs get the money back. OR, you get 3-5+ times that amount to spend on long term care needs, at your home or in a care facility. 3) You have an LTC rider on your life insurance that can prepay the face amount of the policy for long term care needs. There are only a few companies still willing to do these above type policies. The sooner in life you commit, the better the benefits for the amount paid.

LONGER TERM

ABOUT $1 TRILLION IN ASSETS WILL TRANSFER TO HEIRS EACH YEAR FOR THE NEXT 50 YEARS. According to the Institute for Preparing Heirs, 70% of wealth transfers are *not successful*. This is not to say the paper work was not in order, but that there was a loss of family cohesion because of unresolved issues and disputes over the control of the assets. It can impact the surviving family income, health, spirituality, unity and support of causes and community. Families can experience difficulty in the transfer of wealth, due to the distance factor and/or possible disfunction of kids, heirs' unwillingness to follow advisors, and a host of other potential conflicts. Family harmony can be disrupted, sometimes permanently. Concern for the impact of sudden money upon heirs is a legitimate concern in many cases. It's more the impact than the amount.

THE BENEFICIARIES DO GET THE ASSETS SUCCESSFULLY in most cases. It's often after they receive them that the problems can begin. Professional trust services can help overcome some of these concerns. In particular, I like corporate trustees who are able and willing to work with individual family situations and also willing to follow the investment principles of the grantor. Along with a number of our investment newsletter writer friends, we have co-authored a book, "The Evergreen Portfolio" which contains investment advice meant to endure for the long haul. In particular, I would prefer following the diversification and risk management as outlined in this letter and that book as related to both investment income and tactical asset management (a defensive strategy) program. Our personal buddies, family members or professional managers who we may ask to be co-trustees can also *help to guide the more flexible corporate trustee*.

PRESERVING ACCUMULATED WEALTH FOR WHEN WE NEED IT, AND FOR ULTIMATE TRANSFER

IT'S A LOT TO THINK ABOUT, but time has a way of catching up. The sooner we get on it, the easier it will be and the better the potential outcome. The cobbler who had no shoes is earmarking 2015 for filling the shoe rack, hopefully for all the possible occasions.

OVER THE LAST YEAR, we have put together *an excellent team* at our new home at Raymond James to help make those shoes fit better. We would like to encourage all of our investment clients & friends to join us in the personal effort of getting loose ends tied together in the New Year 2015. This can include thinking about those details we'd rather not think about (right now), but probably should. We can let some professionals go to work for us and do a lot of our heavier lifting. It can be a wonderful gift to those for whom we have concerns, if we can get this right. It will probably take a small time commitment for most of us.

The 43 year Customer's Man getting it into 2nd gear for 2015…, Martin

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[3] Barron's

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