Grow @ Marinis Group

From: Grow | Marinis Group
Sent: Friday, 10 August 2018 12:20 PM
To: Alex Wiedenmann | Marinis Group
Subject: Groundhog Day?
Attachments: Familiar Voices are Alarmed.pdf; Media Release No 83 _ 2018 07 27_ Armageddon Is Coming.pdf

August eGrow

Dear Friends,

Groundhog Day?

Once again, the usual voices are getting excited about the upcoming economic Armageddon.

Shortly, the hype will ratchet up with the calendar pointing to the 'Scary September' or the 'Awful October' phenomenon, as historically, there have been a significant number of corrections around September and October.

It generates great headlines – but they are irrelevant in a medium to long-term investment scenario.

It is not actually a 'Halloween' effect; it is simply about the Northern hemisphere's investment cycles. The new financial year in America starts on September 1; most people take a summer holiday in July/August, and then investors start to consider their positioning. After a bout of 'exuberance' always comes a bout of 'pessimism' and a significant sell-down occurs.

This correction is a healthy thing – it just always overshoots the mark.

I will however, point out that the same voices were calling out the upcoming crash at this stage last year... eventually, they will be correct... and I love the quote ***"economists have correctly called nine out of the last five market breaks."*** They will get it right, eventually.

But regardless of who made the right call, what should medium to long-term investors do if they wake up to the radio announcer describing a meltdown on Wall Street overnight?

Nothing.

If you have a robust, well-planned strategy, stay in your seats – and many of you will have heard me say that before!

Let the panic merchants sell good assets cheaply. If you have the cash, you might want to buy some extra investments, or if you are in draw-down phase, rely on your 'Marinis Buffer' to protect you from fire sale behaviour.

My job is to do the 'worrying' and the planning; your job is to relax and enjoy the benefits of your lifetime of hard work. It has never happened that there has been a recession without an upside for the patient investor – so I recommend being that investor.

John Maynard Keynes is said to have made the comment ***"The ability of the market to remain irrational is stronger than my ability to remain solvent."*** So, invest conservatively and within your means – I have never advocated borrowing to buy equities.

But remember too, that good businesses continue to sell products and make profit. If we invest rationally, becoming part owners of these businesses, we get a good return over time. The markets have always rewarded the patient and punished the greedy.

The real key to success is the amount of time you expose yourself to the market, not the timing of when you bought in.

And one more thing – well, three really!

I've attached a copy of an article by Roger Montgomery from Professional Planner expressing concern for the near-term future of investments. I don't have a view, preferring to think medium to long-term, but it is always good to have an insight into what others are saying.

Also attached is my recent Media Release which collects many of my favourite quotes to back up my view of investing.

Finally, and pertinent to this month's message, this Media Release also highlights one area of disagreement with my favourite investor Warren Buffett. His famous quote "Get fearful when everybody else is greedy and get greedy when everyone else is fearful" is, in my view, too short-term.

Unlike Buffett we don't have billions to invest – and in the medium to long-term we should just get on with the business of getting rich slowly and conservatively. The alternative is just an attempt at gambling.

As always, if this edition of eGrow stimulates any questions or concerns, please do not hesitate to contact either me, or any of our staff, on (08) 8130 5130.

Kind Regards,

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Media Release No 83 **27th July 2018**

Armageddon IS coming!

(But don't forget, as Paul Samuelson reminds us: 'Economists have successfully predicted nine out of the last five recessions.'

By Theo Marinis

There is a certain smugness about knowing you are right - and when I say 'Armageddon ***IS*** coming', like all my fellow economists, I know this prediction is 100% accurate - but experience tells me two things: I can't know when it will happen and secondly, it won't be the catastrophe the headline writers will predict.

At 55 I have lived through, amongst many other 'disasters', the Cuban Missile crisis, the Vietnam war fiasco, the Whitlam years, the cold war, Chernobyl, the collapse of the USSR, Iraq (twice), Afghanistan, numerous market breaks ... and I am now facing the Trump challenge. And what has the market done over this half century and a bit - increased ***on average by 11.68% pa (Based on the US S& P 500 Index in the period 30/11/1962 to 30/6/2018 as per data supplied by Vanguard Investments Australia Limited)***

So, what have I learned as an economist and financial strategist?

Principally, that panic and impatience lead to poverty.

Benjamin Graham is renowned for saying '***Individuals who cannot master their emotions are ill-suited to profit from the investment process***.' I would argue that when it comes to investing our own money, just about all of us are prone to fall for a 'tip', a 'hunch' or a headline. We get emotional about our money and we are often irrational - and if we get lucky because of our tip, hunch or headline investing, we get arrogant. These are all normal human emotions which usually lead us to failure.

So how do I advise clients to avoid these well-known and proven mistakes?

I preach the Gospel of diversification - and patience.

We all remember ***Warren Buffett's message***: ***'Be fearful when others are greedy - and be greedy when others are fearful.***' Buffett's contrarian approach is great - particularly if you have huge pots of available cash to splash around, and where 'taking a bet' .... and getting it wrong .... won't mean financial disaster. But, for most of us, as 'mum and dad' investors, we can't follow this strategy.

There is another old investment truism, ***'don't try and catch a falling sword,'*** which reminds us we cannot tell where the bottom (or top!) will be and the impact of buying (or selling) too early might lead to significant financial pain.

We need to understand and accept the market gyrations as normal and healthy.

Part of this is understanding, as everybody's economic hero ***John Maynard Keynes*** said, '***The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelope our future.***' In other words, there will, at times, be short-term underperformance. It takes time to rebuild after a market break. This can be very painful for the retiree, in particular.

To deal with this situation, I typically advise clients to maintain a 'Marinis Buffer' equivalent to two years' worth of income when they are in the draw-down phase. This inoculates their investments from the need for a 'fire sale' of good quality assets during a downswing just to fund their daily lifestyle.

As investors, we need to accept that we don't know what will happen in the future

George Soros said, ***'The idea that you can predict what's going to happen contradicts my way of looking at the market.'***

And I am constantly amused by ***John Kenneth Galbraith,*** who had a wonderful take on this when he said (in my absolute personal favourite economist quote) ***'The function of economic forecasting is to make astrology look respectable'.*** Even the "so-called" experts get it wrong - often.

So, we don't know what will happen in the future, except at some stage we are certain it will be 'bad'. During these 'bad' economic times we know for certain that the 'whales' of the investment market will buy good quality assets at very cheap prices.

The skill of the investor is to separate their emotion from their rationality - to recognise that breaks are normal - and that the investment markets are not linear, and therefore don't panic and sell down, or you will lose a fortune.

A successful investor has a medium to long-term strategy, which involves getting rich slowly. Often investing is a two-steps forward, one-step back, process.

We also need to recognise that as investors we are also impacted by the human emotions of fear and greed - and do our best to avoid them.

Therefore, I always recommend appointing a reputable team of advisers; whether accountants, lawyers, stockbrokers or financial advisors, to have an emotionally unengaged personal 'board of advice.'

This is, in my opinion, some of the best money an investing individual will ever spend.

- Thanks to 'The Wisdom of Great Investors' by Perennial Investment Partners for most of the quotes used above.

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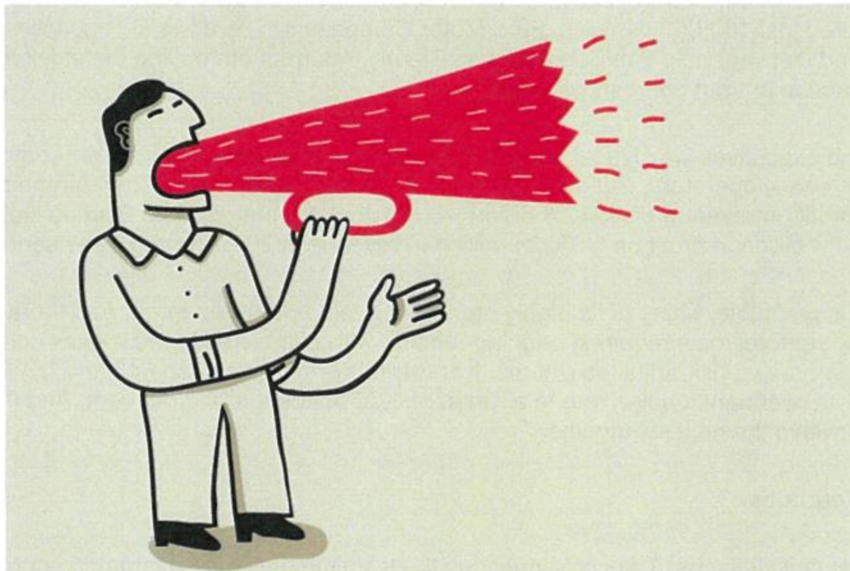
Familiar voices are alarmed

By Roger Montgomery

July 18, 2018



Synchronised advancement across all technology disciplines, and synchronised real-estate appreciation across all geographies, suggest a common fuel source that sits above local and discrete factors. What is this source and what if it is pulled away?

As we are all well aware, central banks have been, through quantitative easing, suppressing interest rates since the GFC. Consequently, monetary policy has fueled unprecedented flows of institutional and private capital into real estate, private equity and stocks.

Now, with quantitative easing turning into quantitative tightening, several observers are rightly warning investors to hold more cash.

Private equity stretch

Stand back and take a look at the technology advancement of the last few years; in every field from artificial intelligence, virtual reality robotics and drones, to telecommunications, autonomous vehicles, electric vehicles, renewable energy, the sharing economy (Airbnb, Uber), digital advertising and 3D printing – the list goes on – technical advancement has accelerated across all fields simultaneously.

Meanwhile, investors have become enamoured with the possibility of profiting from the ability of technology to 'change the world' and disrupt legacy business models.

The multilateral advancement across technical and business fields is not a coincidence. It is simply a function of abundant and cheap money, which has concurrently provided funding to 'blue sky' projects, while fuelling a fear of missing out amongst investors.

Do you believe investors would have chased a private equity 'opportunity' and put US$29.9 billion ($40.8 billion) into a venture that has not turned a dollar of profit since it was founded in 2009 – and continue do so even as regulators clamp down on its aspirations – if interest rates on cash were 7 per cent or 8 per cent? That company, Uber, has a selfascribed 'valuation' of US$60 billion.

One cannot help but conclude that Uber would not exist to disrupt legacy business models and change the world if returns on cash were more attractive. It is simply the punitive returns on cash that have prompted investors to pursue and fuel risky ventures.

Tesla, even after its recent sell-off, sits on a market capitalisation of US$60 billion. In 2017, the company delivered just 100,000 vehicles. Ford Motor Company sits on a market capitalisation of US$47 billion and last year sold 6 million vehicles. Clearly, returns from buying the stock today, even as production ramps, are not going to be great.

I've heard Airbnb executives wax lyrical about various metrics that demonstrate their company's superiority over legacy operators. But the metric that matters is profit, and in 2017 Airbnb reported a US$93 million profit on revenue of US$2.6 billion – a 3.5 per cent margin. The Marriott Hotel Group generated US$1.4 billion in profit on US$22.9 billion in revenue in 2017, for a 6.1 per cent margin.

At least Airbnb is profitable. Many of its highly promoted peers and rivals aren't. And there is little doubt that many ventures now requiring ongoing funding will collapse as interest rates continue to climb and offer improving risk-adjusted returns. It is worth noting that on June 13, the US Federal Reserve raised its overnight lending rate to a range of 1.75 per cent to 2.0 per cent. And it anticipates two more hikes within the next six months.

Bloated listed equities

History holds valuable lessons. The consequences the last time the world attempted economic recovery through the suppression of interest rates are explained in the classic book, Lords of Finance: The Bankers Who Broke the World. Its author, Liaquat Ahamed, offers us the following reminder:

"The quartet of central bankers did in fact succeed in keeping the world economy going but they were only able to do so by holding US interest rates down and by keeping Germany afloat on borrowed money," Ahamed wrote. "It was a system that was bound to come to a crashing end. Indeed, it held the seeds of its own destruction. Eventually, in the last week of October 1929, the bubble burst, plunging the United States into its own recession. The US stock market bubble thus had a double effect. On the way up, it created a squeeze in international credit that drove Germany and other parts of the world into recession. And on the way down, it shook the US economy."

Elsewhere, the world's largest hedge fund, Bridgewater Associates, has stated: "We are bearish on financial assets as the US economy progresses toward the late cycle, liquidity has been removed, and the markets are pricing in a continuation of recent conditions despite the changing backdrop."

I have previously written that the majority of the debt accumulated since 2010 by US non-financial corporations has been used for unproductive purposes, specifically financial engineering such as earnings-per-share-boosting stock buybacks, special dividends and mergers and acquisitions (at inflated prices).

Swapping equity for debt through buybacks has, almost without doubt, inflated the equity market while simultaneously misdirecting capital away from productive purposes. By way of example, US banks collectively returned 99 per cent of net earnings to shareholders via buybacks and dividends. In other words, the jaws between prices and reality have widened.

Bridgewater again: "2019 is setting up to be a dangerous year, as the fiscal stimulus rolls off while the impact of the Fed's tightening will be peaking," and "...since asset markets lead the economy, for investors the danger is already here."

Finally, Warren Buffett's Berkshire Hathaway is now holding US$116 billion in cash, a quarter of the company's market capitalisation. Why? In the latest annual report, Buffett wrote that an attractive price is "a requirement that proved to be a barrier to virtually all deals we reviewed in 2017".

As one commentator noted, Buffett has enough cash on hand to acquire 450 of the S&P 500 companies outright. Yet he did not buy any of them. Nor did he reduce the cash position to expose himself to more shares of any S&P 500 components. He has chosen cash in the form of short-term Treasuries.

History, the world's biggest hedge fund and the portfolio of the world's most successful investor are all telling us something. Stay tuned.

Real estate bubble

Accommodative monetary policy since the GFC has also driven an unprecedented flood of money into real estate, with cross-border flows concentrating in capital cities. But again, the jaws have widened, with property prices divorced from the primary economic fundamentals – namely the spending power of households.

Cities including Auckland, Sydney, Shanghai and London have grown by more than 10 per cent a year, on average, every year since 2013. In Vancouver, prices are up roughly 60 per cent in just the last three years. In Sydney, house prices jumped more than 80 per cent between the end of 2009 and the peak last September. Munich, London, and Hong Kong have all seen house prices rise by 50 per cent on average since 2011.

As with tech companies, the synchronised appreciation of real estate across all geographies hints at influences beyond local factors and it has the International Monetary Fund concerned.

The IMF has noted: "In recent years, the simultaneous growth in house prices in many countries and cities located in advanced and emerging market economies parallels the coordinated run-up seen before the crisis."

When dollars concentrate around particular stocks or technologies, or real estate in particular types of cities, pushing prices to disengage with their economic drivers, and when debt is at record highs, it is time to be cautious. Of course, the IMF, Bridgewater and Warren Buffett could all be wrong. But it's worth paying attention to them.

Roger Montgomery is chairman and chief investment officer of his own investment firm, Montgomery Investment Management.