Where Can I Invest Today
and by the way
What's Really is Going on Anyway?
(May 2015)

As participants or observers, we can pragmatically affirm that our U.S. stock and equities markets have exhibited outsized investment returns since 2009. The Federal Reserve's decision to "permanently" jump-start the economy at the time served to power stock market growth as if it were on steroids.

This unique event was created mainly as a direct consequence of their lowering interest rates earmarked to lessen corporate borrowing costs, thus increase private sector investment, corporate earnings, and ultimately the stock market valuations. However, this Federal Reserve strategy also served to lower investor returns on corporate debt U.S. bonds, and fixed income investments. For most investors to maximize their portfolio returns, there was no other alternative sector to invest their money but the stock market as the risks elsewhere were substantial verses their perceived rewards that were minimal. Nonetheless, the continuing search for safe, secure and higher yields that have since left world bond markets still continue today.

The above Federal Reserve induced stimulus design was previously brought to the U.S. national economic stage by English economist John Maynard Keynes in 1935. Its intended design was to be a short to medium term, national financial stabilization plan to boost corporate liquidity, new hiring, and sequential private sector consumer spending. Makes sense so far, doesn't it? The results of this monetary strategy accomplished to significantly boost wealth for some via higher stock market valuations however inversely caused a dilution in the relative currency value of our U.S. dollar within the world's international monetary regime.

Fast forward from 2009 to 2015. Our U.S. equity markets are still growing in price (not necessarily value as I will explain later) and the Federal Reserve's quantitative stimulus scheme and policy over the past 5 years has now come to an end. So what really was the financial result of this Keynesian inspired monetary strategy and what kind of economy do we now actually have?

The evident result today as of May 2015 from this past policy has been an ongoing continuance of anemic to slow growing U.S. national economic output plus 4.5 Trillion Dollars of

added national debt to pay off, refinance, or try to dissipate in an effort to re-stabilize our monetary base liquidity at some time in the future. On a positive note, what we do have is a low 5.4% nominal unemployment rate today verses 8.9% in 2008, (9% - 14% respectively in "real" terms).

Without the Federal Reserve printing any more money to push interest rates lower and generate further dollar value dilution, we must ask; is this torpid and sluggish economic growth our new norm? Is a more robust economic growth rate average of 3.7% as we have seen on average over the past 10 years ever attainable again within the next 2 to 3 years? And while we wait, where are investors going to seek investment safely and maximum yield? To build an answer to these closing questions, let's see what others in the world financial arena are doing as it does matter a lot in today's capricious environment.

In the furtherance of current U.S. Keynesian doctrine and by demonstrating not to be outdone by America, the European Financial Community has now had their own financial re-juvination epiphany by their also electing to employ a demand based, quantitative stimulus program of their own. Remember the Euro Commissioner's statement in 2014? "Whatever it takes". That is to say, he is also recommending to create more Euros, dilute its monetary value and thereby expand their own currency base within the world's financial system which will then serve to weaken their currency, just like ours did.

Their strategy does tend to be a very self serving one, wherein by their current expansion of money supply and our not doing so in kind, our dollar has gone up in price (by 24%) and their Euro Dollar cost has alternatively gone down in price. How does that effect us? Their exports to us now cost less when purchased with our higher valued U.S. Dollars. This directly helps them boost the volume of their own manufacturing output and thereby employment when selling their goods and services to us here in the U.S. This is important because we represent 29% of their worldwide export revenue so this is a huge potential economic boost for them assuming we continue to buy their goods and services as we have. U.S. imports from them however will alternatively continue to remain a liability on our national balance sheet and unfortunately must be subtracted from our Gross Domestic Product output volume, thereby increasing our budget deficit.

Comparing our current financial status highlights with the European economy will give you a little better perspective of our mutual positions.

	Nominal Interest Rates	*Real* Economic Growth
United States	+1.5% to +1.8%	0% to +.5%
Europe	- .3% - -.5%	-1%

Currently, there is a financial movement and tactical economic shift between the world's sovereign countries as to their own respective stimulus and growth policies. The rest of the world, much like Europe, is currently stimulating their own economics by their governments' lending from their treasuries to their own respective banking systems or alternatively, printing more of their currency while we are not.

As a result, our U.S. international corporate earnings and net profits garnered in sovereign currency from our overseas operations are minimized once translated back into U.S. Dollars through repatriation. Result: U.S. corporate overseas profits remain stagnant in that country not to be brought home and invested here.

However, our current dollar price is now very high and perceptually strong and safe to the international community. The result is that the rest of the world is racing to purchase U.S. Treasury bonds to *hedge and safeguard* their own respective currency and its declining value. In 2014 alone, foreign investors purchased over 374 Billion dollars in U.S. Bonds from their own foreign reserves. Their bond investments now represent 31% of our total U.S. Treasury debt!

Our domestic non-government corporate earnings are currently flat only rising zero to 2% year to date depending on the company being scrutinized. Flat earnings along with low productivity are making per share stock market valuations today as volatile as TNT.

U.S. domestic and world economic conditions such as these do not make for a stable-rising market going forward in 2015. Meanwhile, the European stock market is up 15% since January of this year due to their recent stimulus programs. From a forensic historical view, these European financial events mirror our stock and equity markets dating back to 2010.

To further assess our equity investment market stability under the continuance of these conditions, consider these facts: The two (2) underpinnings of stock market share valuation sustainability are corporate *earnings and interest rate* costs (i.e. higher debt cost reduces free cash flow). Another fact is that short and medium term U.S. interest rates are poised for a graduated increase for reasons stated below according to the Federal Reserve and irrespective of flat stock earnings and worker productivity growth.

There are three driving explanations that underlay the facts outlined above as to why this all will evolve into a 10% to 15% or higher stock market correction in 2015:

First: Interest rates are currently being governed by monetaristic policies and not budget driven *fiscal discipline*. As stated earlier monetarism, as a stimulus form, is an effective financial policy strategy that allows for short to medium term growth within our U.S. consumer driven economy. It is an economic policy that is primarily *demand* driven and predicated upon renewed consumer and business spending (after all, 68% of our entire 18 Trillion Dollar U.S. annual Gross Domestic Product Production (GDP) is derived from the consumer services sector – not manufacturing). However the *Consumer Price Index "CPI"* (i.e. an indices modeled to measure consumer spending activity) is only up .5% per year in 2015. No reason to raise short term rates here is there? You can't slow it down much more.

Nonetheless, there is also a co measuring device - the *Producer Price Index –PCE* (modeled to measure spending for Health Care costs, Manufacturing, Wholesale Businesses and Consumers alike). It has, and is rising plus 2% per year over the same term under the same economic conditions. This is a reason to raise short term rates when coupled with a 94.5% employment rate. This jobs number represents almost full employment give or take .5%. To mitigate this high employment statistic, we can counter argue with debate over the record low worker participation rate of 61.2% verses 66% of the past. However, the Federal Reserve nevertheless scrutinizes the Producer Price and not the consumer price index to determine and initiate Economic Policy. So, we have to keep our eyes on the proper and most prescient bellwether for us to anticipate financial policy prospects in the future.

Second: Corporate earnings levels from 2013 into 2015 have been *dubiously bolstered* by corporate management's excessive dividend payouts to stockholders which are designed to retain their stockholders loyalty and sustain new share sales. This enables companies to maintain maximum corporate stock valuation thresholds.

Per share earnings indices are thereby falsely lifted through these recurrent corporate stock buy backs which serve to directly dilute the actual stock capitalization available to the public. Earnings are calculated as a percentage of capital which deceptively raises the appearance of real "earnings" (net income divided by share value "outstanding"). These corporate buy backs shrink the shareholder base of corporate stock inventory outstanding which then serves to exaggerate corporate "nominal" earnings and its bellwether valuation multiplier (price to earnings). It's a false bottom within the corporate vault.

Meanwhile, Wall Street money raisers who sell stocks claim that the commonly used stock valuation model – "The Price/Earnings Multiplier" that is historically 14 – 15 x earnings is now only 20 – 21 x earnings according to the money raisers and Wall Street, when in reality –economists, such as Robert Schiller's Price Earnings Index that he adjusts for inflation over the prior ten years is 27x – 28x earnings! Same earnings, same stock, same time of measurement.

Ratios of earnings to stock price over an entire sector diverse index of 26x – 30x is not sustainable for any extended period of time.

False exaggeration of earnings impacted by corporate stock buy-backs, high dividend payouts, and higher leveraged corporate debt refinances which are subjected to variable interest rate fluxuations foretell a real warning signal. Worse yet, are the under-funded corporate pension plan obligations liened and secured against this same corporate liquidity. These unfunded and lawful obligations are over a trillion dollars. (a subject that will warrants a study of its own)

Dubious corporate conditions and financial activities like the four referenced above - stock buy backs, excessive dividend payouts, excessive debt refinances and underfunded pension obligations are a recipe for financial disruption in a flat productivity-earnings environment. This is Kryptonite for a sustainable stock market.

Third: The U.S. economy is rising at an annual rate of .5% (not 5%) based on the recent CPI economic measure and rising 2% per year based on the PCE. The U.S. and World Economies are still unstable and weak. All combined, these are not strong and sustainable growth trends as I see it.

To further, support this concern *China, Indo China, Southeast Asia and East Asia's* growth histories were the underlying drivers of the World's economy over the past ten (10) years. Not only were they a major part of our own national economic sustenance, they were the main drivers of growth benefiting the commodity producing "frontier" countries as well (Vietnam, Nigeria, Chile, Peru, Indonesia etc. and yes – even 2nd World Russia).

To look forward as to our future we need to ingest one additional and a major economic factor into our thinking process. Whether we accept it or not, *the maturing intellectual technology (IT), internet* and *wireless communication systems* have served to conflate the world's financial, social and manufacturing communities together as one. Social trends and living standards that are already very common to us here or in Europe are now emerging in the consciousness within third world countries' mainstream populations like never before and currently changing how they live all thanks to the cell phone. Consider that low tech manufacturing (clothing, shoes, toys) have now

almost entirely gravitated to be produced for us in these frontier, 2nd and 3rd world countries. (25% of all U.S. import products come from China alone and these domestic U.S. imports product made just by China alone subtract 16% (2.9 Trillion) off of our 18 Trillion Dollar economic production that we ourselves did previously).

I think you get the point. Our economic (and social) world as we know it is changing and changing fast. We best be prepared to change with it and seek to adjust our investment and business models accordingly. Referring to the prescient writings of the late economist John Makin, and I paraphrase: "globalization not only exerts downward pricing pressure on U.S. low-tech manufacturing labor wages and their products, it is alternatively holding down worldwide inflationary costs as we have and will continue to witness". This explains the world's desire to search for liquidity so as to gain more jobs, and pay higher wages which are all aimed to raise our respective standards of living.

You can't blame robotics on this one. The entire U.S. and worldwide economies are currently going through this major transformation of economic integration. The internet and intellectual technology are here, not leaving anytime soon and it will continue to materially influence our world societies and economies, good and bad.

I hope these prior three (3) intellections above along with the I.T. observation will serve as a guiding economic channel to where we, as an investor collective, should seek and uncover what and where to invest next. Stay with me on these observations going forward:

Currently, many private investors, mutual, and ETF funds are turning their yield-seeking eyes to Europe. It's easy and tempting to do ... after all, Europe is where *we were* economically back in 2010 but they are without our federalistic advantages that bring a 50 state collective mechanism for national enforcement of financial and political controls. They have 19 country's political and economic systems to deal with. Europe's stock market has hit bottom and is now rising quickly; their Quantitative Easing programs are now in full effect and Euro currency printing abounds. Except for Germany, England and some Scandinavian communities, fiscal discipline in each country is mostly absent and excessive work rules idiosyncratic to each other abound in all of the Euro dollar based countries. Therefore, expansionistic monetarism is their only perceived way out of their economic conundrum as they see it. I don't see it that way. The German fiscal discipline model has proven best to follow. The same undergoing monetization programs we just discussed for Europe and the frontier countries also apply to Australia and Japan. Investing in Communist China along with Mr. Xi's leadership can be the subject of another paper. However,

you should note here that mainland China's real growth is more like 3.9% and not 7.5% per year as they prefer to represent.

The bottom line; Europe is not going to have any different economic outcome than we had or currently have. That is ... a slow growing anemic low productivity economy that is also going to be unstable 2 to 3 years out just like ours. Their current corporate profit margins are as thin as ours and sovereign work rule reforms remain unaddressed. They, like us, also have underfunded corporate pensions and yet continue doing corporate stock buybacks and over-leveraging of debt. England will now vote to even stay in the union. Yikes!

Nonetheless there will always be straight line thinkers as our Keynesanites have demonstrated by believing in central government rule and controls to be our economic emancipation and further believing in policies of: "one size fits all". They will continue be convinced that money printing liquidity programs will entice banks to lend, but they haven't; make businesses grow, but they haven't; and, providing everyone work while these same workers anticipate big upcoming salary increases in which to spend in Hawaii and/or to buy a Bentley. (A Gatsby Mirage)

What is important to note here is that the 1935 Keynesian Doctrine of Quantitative Easing has an application but as only a *temporary* not *permanent* economic systemic fix. It must be converted into fiscal discipline thereafter paying off accumulated government debt and letting the markets (not unnecessary regulation) take over the healing and upcoming growth process. The current and future outcomes of U.S. and European past stimulus actions will now serve to formulate our new "Standard of Living". It's result will be *Exhibit A* in 2020 as the monetary horse is out of the economic barn now. We'll just have to wait and see.

Only U.S. led fiscal discipline (like Germany), U.S. Federal and State income tax reforms and liberalized international trade legislation will provide us, and the world outsized and exponential sovereign growth success.

Okay, if this is all true then where do investors invest now while we are waiting for this reformation to happen if it will not be Europe, Indo-China, China itself or Australia. Evil Knievel would say Russia. Some would say China. But in those cases, you have their country's economic and legal opacities to rely on along with their idiosyncratic societal issues. You also have to depend in their autocratic and capricious communist or dictatorial governments, their socialistic centrist policies and antiquated rules of law. A loose cannon indeed. Where is the low hanging fruit? Is there even any left?

Today, May 2015, two areas are the best in the world in which to invest. For low risk, it is right under your nose – The United States of America. Our policy reforms could come in 2017it is For higher risk and high growth – India within a mutual or Electronically Traded country fund. (Currency hedging depends on your investment term horizon).

For interim 2015 – 2017 – Large U.S. Capitalized internationals who will be repatriating much of their 2.3 Trillion that is currently dormant in their overseas cash accounts. These funds will alternatively be put to work in new capital spending and expanded research and development back home. Real earnings and productivity will follow. Well managed foreign international companies are also a horse to watch. However, they must be focused on research and development and not stock buy backs and dividends. Toyota comes to mind.

Additionally, select manufacturing sectors will come back into play as energy costs dwindle at $55 - $65 per barrel verses $140 in 2014. The current and ongoing U.S. gas energy abundance will allow high energy users such as chemicals, autos, and metals to come back into our U.S. Manufacturing Base. This includes Japanese and Scandinavian manufacturers as well.

Also, contrarian hedge funds that specialize in purchasing oversold corporate debt as I warned about earlier is another investment target for higher risk diversity in the intermediate term.

Real Estate Investment Trusts (REITS) and real estate focused private equity groups (The Blackrocks and Blackstones are solid) plus those that specialize in U.S. office and multi-family properties within world class U.S. cities. They are an attractive alternative strategy as well.

We're going though some tough growing pains and economic learning curves right now. Be patient, be very alert and on your financial toes. Now is when opportunities lay open at your feet.

That's how I see it as of now and welcome your thoughts.

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