DJ IA	Nasdaq	S & P 500	Russell 2000	MSCI EAFE	Crude Oil	Euro	10 yr Treas.	Fed.Fund Rate	Prime Rate
17042.90	4493.39	1972.29	1101.68	6638.93	91.16	0.7917	2.52	0-0.25	3.25

Money Manager Newsletter

September 30, 2014

Investment Consulting Group, Inc.

"The Greatest Safety Lies In Putting All Your Eggs In One Basket And Watching The Basket"
Gerald Loeb—EF Hutton , The Battle for Investment Survival

How Long Will The Expansion Last?

The recovery remains the weakest since the second world war. The expansion is now five years old, longer than the post-war average of 58 months. The next recession could in theory be around the corner. But unlike people, business expansions don't die of old age: they are killed by an unpredictable shock, says Bob Hall, an economist at Stanford University and chairman of the academic panel that dates American business cycles: "The next recession will come out of the blue, just like all of its predecessors." Recessions have become rarer in recent decades. The three expansions preceding the 2008 crisis lasted on average for 95 months. The late Rudi Dornbusch, an economist, once said, post-war expansions didn't die in their beds; they were murdered by the Federal Reserve. The economy would run out of spare capacity, profits deteriorated, prices and wages rose and the Fed hiked interest rates, precipitation a recession. If that pattern holds, the current expansion should have plenty of life left in it. Inflation is actually lower than the Fed's target of 2%. The current expansion has at least two more years to run; the economy is still operating some 5% below it's potential. The previous three expansions have ended around three years after unemployment fell to it's "natural" rate, likely between 5% and 5.5%. By that yardstick, JPMorgan reckons the expansion could last until 2018, which would make it one of the longest on record. Interest rates have been stuck at zero since the recovery began because of sluggish growth and low inflation. If the Fed starts to tighten, rates will spend most of this expansion closer to zero than at anytime since the 1930's. That leaves the Fed precious little firepower to respond to another stock.
The Economist

How The Rich Outsmart Themselves:

Recently the Wall Street Journal reported that major money institutions, such as the General Motors pension fund and the Harvard University endowment, missed out on the banner stock rally of the past five years — a 76 percent surge in the S&P500 — because they shifted capital from blue chips into hedge funds. General Motors and Harvard would have been better off simply calling the 800 number of Fidelity or T. Rowe Price or any similar "retail" broker that's open to the public and putting their billions into the most basic S&P index fund. Hedge funds are consistently effective at one thing — enriching their own top management. Managers of big pots of money need to pretend they are engaged in super-complex alternative-asset transactions. The pay and overstaffing at endowments and pension administrations are rationalized on the grounds that only highly paid people could possible grasp the world of hedge funds. Tuesday Morning Quarterback

Wooley and Vayanos (2012) argue that academics/practitioners need to develop new theories of markets and asset pricing for market participants: Like regulations, funds have been following procedures based on the discredited theory of perfect markets. They are using our instruction manual predicated on the efficiency of markets to invest in an inefficient world. They should instead be matching like for like by using strategies based on the presumption of inefficiency to invest under inefficient conditions.
Wooley and Vayanos 2012, 58

"Long ago, Ben Graham taught me that 'Price is what you pay; value is what you get.' Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down." Warren Buffett

09/30/2014	Growth Median P/E	Value Median P/E	Historical Growth Avg.	Historical Value Avg.
Royal Blues	23.2x	13.4x	24.6x	11.3x
Large Cap	19.3x	11.6x	19.7x	10.6x
Mid Cap	23.0x	13.1x	23.3x	11.9x
Sm Cap	25.5x	12.7x	27.3x	11.9x

Warren Buffett is offering a refresher course on his approach to investing. The billionaire uses two personal real estate investments he made to demonstrate some of his key principles: focus on what an investment will produce, not its price; stick to what you know; and don't try to predict what the economy or stock market will do. "You don't need to be an expert in order to achieve satisfactory investment returns. You must recognize your limitations and follow a course certain to work reasonably well," "Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick 'no'." The examples Buffett cited were his 1986 purchase of a 400-acre Nebraska farm and his 1993 purchase of a retail property near New York University's campus. Both purchases were made after prices collapsed. Buffett said he didn't know much about farming or retail. He knew the farm would remain productive and the retail center would keep appealing to NYU students. Over the years, Buffett hasn't sought out any price quotes on his farm or retail property, and he isn't inclined to sell. Buffett compared the stock market to having farm investor shout out prices of Buffett's farm every day. "If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm," "If the number he yelled was absurdly high, I could either sell to him or just go on farming." Buffett said he learned the keys to investing by reading. Professor Ben Graham's book "the Intelligent Investor." For investors who don't have the skills or time to estimate the value of investing, Buffett repeated his standard advice: make regular purchases of a low-cost stock index fund. Josh Fund—Associated Press

Webster defines **inversion** as reversal of the usual order of words, as in the placement of the subject after an auxiliary verb in a question. Wall Street has come up with a new meaning: a company re-incorporating in a country outside the US, primarily to avoid paying our high 35% corporate tax rate. This has been going on for some time but at such a slow rated that not much has been written about it. Secretary of the Treasury, Jack Lew, wants to find legal ways to prevent companies from completing inversions. Stay tuned as it promises to be an interesting confrontation. With so much going on here in the USA, plus Russia and the Middle East, China has been somewhat neglected. Analysts know that their growth rate is slowing from double digits to about 7.5% this year. The elephant in the room for China is their commercial residential real estate bubble. They are relatively new at the capitalism game and will soon realize that nothing goes straight up. When the bubble bursts, it will reverberate around the world. After the initial shock worldwide, markets will stabilize and China will somehow sweep the problems under the rug. Many people that came to the cities to seek their fortune will be heading back home to the farm, their dreams shattered. Somewhat like our recent college grads heading home to their parents basement. Very sad.
The Dana Viewpoint

Take a moment to examine how fund managers have fared so far and the circumstances they face for the rest of the year. Only 23% of large-cap mutual fund managers have outperformed the S&P 500 this year, rivaling the worst performance in the past decade. By comparison, about 37% of fund managers have outperformed the benchmark since 2003. Most large-cap fund managers will be drafting very disappointing year-end letters. Stock pickers are struggling in the current environment. Fewer than 20% of large-cap growth and value managers have outperformed their respective Russell 1000 benchmarks. Hedge funds have also woefully underperformed. The average hedge fund is up jus t2% this year, according to industry tracker HFR, compared to about a 10% return, including dividends, for the S&P 500. Choice of shorts and market timing are the clear sources of blame. Amid the bleak returns, there is some good news for the broad market. Based on the underperformance of most types of professional stock pickers. The S&P 500 should keep rallying through the end of the year. That's because many of these funds will feel compelled to chase performance in order to boost returns before the calendar turns. Wall Street Journal

"I've never let my school interfere with my education." Mark Twain

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Treasury Market Yields	09/30/2014	12/31/2013	12/31/2012
2 Year	0.58%	0.38%	0.25%
5 Year	1.78%	1.75%	0.72%
10 Year	2.52%	3.04%	1.78%
30 Year	3.21%	3.96%	2.95%
Commodities			
Oil ($bal)	$91.16	$99.29	$91.82
Gold ($/oz.)	$1210.50	$1203.10	$1674.80
CRB Index	$278.55	$282.57	$295.01

"We bring a private-equity perspective to public-equity investing. By that, I mean we take the very long-term time horizon that private equity firms typically take, and try to anticipate how investors might view a company differently five years from now."
Bill Nygren, Barron's, June 3, 2014

What exactly is an economic moat? And how are these derived? Whilst cultural and economic difference create nuances across geographies, competitive moats tend to be derived from the same general sources. Pat Dorsey's The Little Book that Builds Wealth describes these well as broadly falling within four categories:

1. The Network Effect
2. Intangible Assets
3. Cost Advantages
4. Switching Costs

The first of these, the "Network Effect," revolves around the premise that the value of a company's service increases for both new and existing users as more people use it. "Intangible Assets" involve the benefit of patents, brands, licenses, et al., that may prohibit copycats and build trust, experience or prestige in the minds of consumers. "Cost Advantages" are found in firms that have a structurally lower cost base than peers, enabling them to offer customers a lower price. Lastly, "Switching Costs" involves those situations where a customer changing providers would be too expensive or particularly disruptive.

"*Bankruptcy was designed to forgive stupidity, not reward criminality.*"
William P. Barr—General Counsel Verizon (Calling for US Government Liquidation of MCI World.com)

When Shaquille O'Neal was drafted into the NBA, he spent the first million that he earned within 30 minutes. O'Neal then received a phone call from his banker, who scolded him, and told him that he would end up joining the list of former athletes who ended up broke if the current trend continued. O'Neal decided to sharpen up his education on business and finance. He returned to college, completing his Bachelor's degree, followed by his M.B.A., and lastly, his Ed.D. That's right, he is now Dr. Shaquille O'Neal. As of today, Shaq is the joint owner of 155 Five Guys Burgers restaurants, 17 Auntie Annie's Pretzels restaurants, 150 car washes, 40 24-hour fitness centers, a shopping center, a movie theater, and several Las Vegas nightclubs. In addition to his business holding, O'Neal still earns $22 million per year (roughly $423,000 per week) from his endorsement deals with Arizona Crème soda, Icy Hot, Gold Bond, Buick, Zales, and at least a half dozen additional corporate sponsors. He is also a studio analyst for TNT. In Shaq's own words, "It is not about how much money you make. The question is are you educated enough to KEEP it."
Www.TimeToFocus.com/cmayes

Largest U.S. pension fund, Calpers, to exit hedge funds entirely to reduce complexity, costs. WSJ

"Focus on signal over noise. A lot of companies get confused; they spend money on things that don't actually make the product better."
Elon Musk—Tesla Motors

"Yellen has really mastered the art of central banking. She has a knack for offering really long answers that don't offer much substantive content. It's a particularly useful skill because she can't just say she doesn't want to answer a question. She has to emit words of some kind.*"* *Sudeep Reddy frustrated while blogging the press conference for the Wall Street Journal 9/17/14*
Dissent within the Fed is growing, making it more difficult for the FOMC to meet its goal of clear communication. It is increasingly clear FOMC members are not so much debating policy as they are talking past one other about what they should care about in terms of policy.
The improved outlook for labor utilization is hard to dispute. More jobs accumulate each month and unemployment is falling. But Richard Fisher leaves out how much improvement is necessary to get to full employment, which is not just the Fed's goal; it's the Fed's mandate. FTN's analysis finds plenty of labor slack, at least as much as there was in 2002, for instance.
Unfortunately, Fisher is not the only one to think his forecast is more accurate than reality. Yellen explained the Fed's assessment that inflation is picking up, despite the fact that it is dropping off, as a reflection of their new forecast. The whole committee appears trapped in its own board room when it comes to economic statistics.
As for Charles Plosser, we get it. He really, really hates temporal guidance. But as Yellen sort of explained in the press conference, the considerable time language is actually dependent on the Fed's forecast of sub 2% inflation, so it is not really temporal at all except that the Fed as a group is convinced inflation will remain below 2% for a considerable time, at least through 2015.
Yellen went so far as to say she thinks the unemployment rate is only a "quarter percent to one percent" above the natural rate. That's telling, because it implies she may favor tightening faster than the market thinks she does if the rate keeps falling the way it has so far this year. It's also a little odd if you think about it. After all, didn't the FOMC abandon the unemployment rate as the sole determinate of the health of the labor markets? What about the other 25 labor market variables we have been asked to track in addition to the unemployment rate? It is just a ruse to prevent traders from pricing in a tightening until the time comes?
We suspect the division between some Fed presidents who are strict advocates of the Taylor Rule, the unemployment rates is already low enough to justify a hike, and Governors, who see signs of slack but maybe not a huge amount of slack in the rest of the data. If so, it means the disagreement between voting members may not be as pronounced as we thought. The housing market recovery has been rocky at best so far this year, a trend likely to continue until credit loosens and consumers see more wage growth.
Chris Low, Chief Economist

My retirement is invested for the next 25 years or more. I have little interest in controlling my chosen active managers or if they outperform next year or not. I encourage investors to monitor returns and asset allocation. Expect inconsistent returns, good and bad, are all part of long term performance. Donald Stanforth