

Interim Market Update

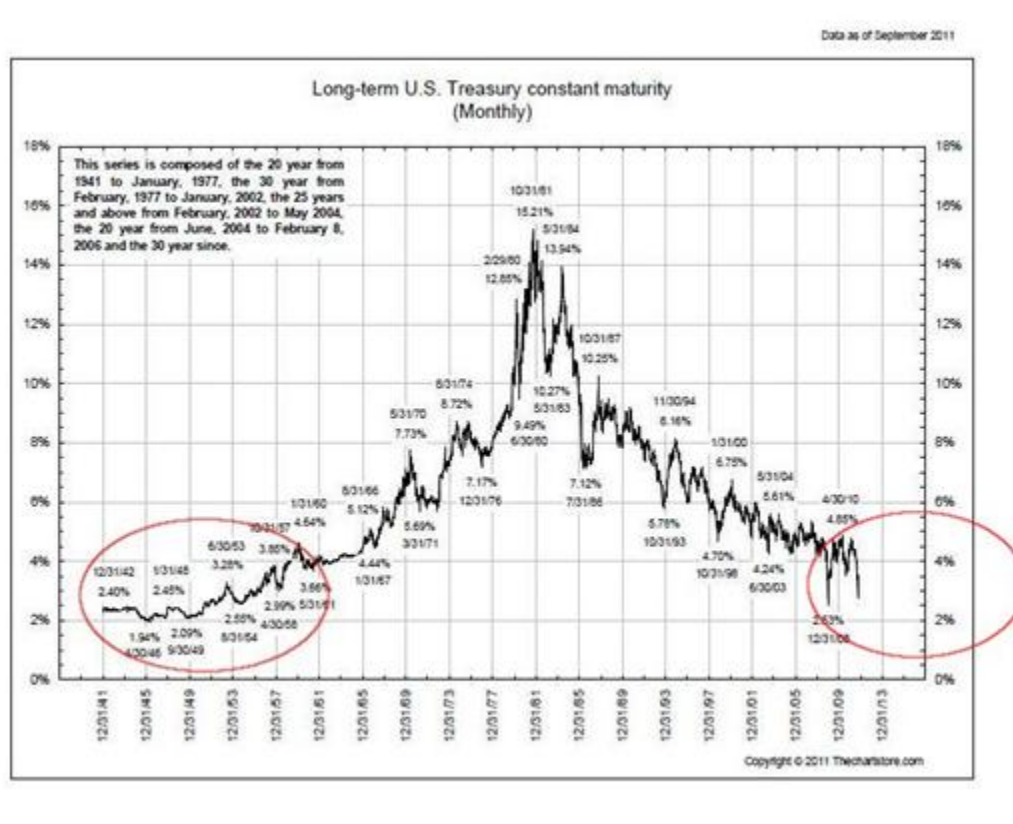


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October 27, 2011

CHANGE IS IN THE AIR

At the October 18th seminar we explained during our portion of the program the reason we believe the long 30-year bull market in bonds is about over. Much to our surprise, we found the same story on the webpage of Pragmatic Capitalism a piece quoting David Rosenberg (Rosie) from his October 25th newsletter. The only difference being that he says it much better than we do. Please note the enclosed chart depicting the trend in long government yields (remember – yields down = prices up) as well as his comments.



Adapted from Thechartstore.com



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“The bond market remains in a full fledged secular bull market, though it is probably safe to say after this year’s downleg in yields to new lows out to the 10 year part of the curve at least we are in the very mature phase. With that in mind, it may pay to reassess what the backdrop may look like when the Great Bull Market in Bonds, which began in 1981 with 30 year Treasury Bonds yielding 15.25%, finally comes to its glorious end.

For starters, I think it’s safe to say that the bull market in bonds will end reasonably close to the point in time that inflation (or deflation) bottoms. This is because we have determined that the only economic factor that correlates workably with interest rates, at least for long term Treasury bonds, is core CPI inflation.

...what about the end of the Great Bull Market in Bonds? It could come pretty soon. You heard right. Long term Treasury bond yields could reach a secular bottom in the next couple of years. And what will it look like? Well, rates will likely be much lower than anyone expects and, as occurs at most secular market peaks, the public will probably swear by them. In order for the public to love 2% 30 year Treasury bonds, they will first have to believe in stable or modestly deflating core CPI as a long term forecast. After all, what other safe investment has delivered inflation plus 2% or better, guaranteed, in the past 30 years? They will also need to be fed up with risk and, judging by the extreme volatility of the stocks and weakness in real estate, who could blame them? We can see that boomers are already voting with their feet, as the mutual fund flows clearly indicate.

Finally, the investing public will probably need to be afraid to be out of the bond market. That will most likely be due to a “flight to quality” as we continue to suffer bear market in stocks and real estate and suffer the economic setbacks of renewed recession.

Pull this all together, as I said at the outset, bonds are not better or worse than equities. They are different. It goes without saying that the best time to allocate to equities is at the point of maximum pessimism. We know that historically, that moment has coincided with valuations below 10X trailing



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12 months reported earnings and dividend yields above 5% as measured by the S&P 500 index. We also know that conventional wisdom is erroneously linear at inflection points, so not only is the market “cheap” at these secular lows, but the future is much brighter than generally perceived. Pulling the trigger at that magic moment when bonds have peaked and stocks can’t hurt you anymore and dividend yields are more than secure at twice the Treasury rate would be nice. But you never know for sure at the right time or you think you know for sure too early. For now, we are not even close.”

Adapted from Gluskin Sheff & Pragcap.com

The founders of Central Plains Advisors have been on this ride since early 1982 – at a time when everyone thought, and many still think, we were crazy to own government bonds. Our continuing admonition to you is – don’t let the recent backup in yields (decline in price) dent your resolve as we finish out this mission. We have not seen the low in yields as yet. The third quarter real GDP number of 2.5% may be the last positive quarter we see for some time. Historically, lows in yields come nine months after a recession starts.

As Rosie said in his piece, the time to sell is approaching and it will likely come when everyone believes we are crazy to sell. No one, of course, will ring a bell, but rest assured we will be there to act. It would be naïve to think we can pick the exact right time to sell. However, if you have been with us for any length of time at all you will know that the ride has been wonderful, and we have set up a new place for you to go if it fits.

Thanks for your trust.



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