

Is Everything Overvalued

March 14, 2005

Over the past three or four years, we have been taking to task sell side Wall Street in general, and pension consultants in particular, concerning the plight of U.S. defined benefit pensions funds. Overall, the unfunded liabilities of such continue to climb as common stock returns have not been fulfilling their rule of returning double digit returns. To top it off, bonds no longer do the job as coupon returns likewise leave the fund short of obtaining what is necessary to fund future costs.

Of course, one must admit that the shortfall in investment returns is not the only problem. People are living longer, managements have been bowled over by the unions in the past and amounts “earned” in the heady days of the late 1990’s flowed into “operating” earnings and spent in some manner by corporate managements. But all along, pension consultants have maintained their formula driven magical black boxes, which steadfastly cling to common stocks as the want all and be all of long-term investing.

A recent article by Mark Gilbert in London for Bloomberg date 3/14/05 details another investing happening, which the financial community has not seen for near 100 years: the issuance of 50-year bonds. It’s been done by the government of France since the first of the year, as well as just recently Telecom Italia SpA. By the way, if there was ever an indication of an “overvalued” bond market, this is it. If you had approached any decent underwriter five years ago about issuing 50-year bonds, he would have laughed you out of his office. The world is starved for income!

The last unfunded dollar amount we have seen in the United States was something like \$70 billion. In the U.K. it is \$85 billion. In both instances it is growing. We understand that governments in Europe are forcing pension funds to invest more in bonds. There is a similar move going on here in the U.S. as our Pension Benefit Guarantee Corp. is going broke as it takes over more and more near defunct pension plans. We have no faith at all in governments to call the right tune – on the other hand, those who consult the pension funds have certainly had a less than stellar performance. Year to date (see chart below), none of the financial asset have done very well. But of course, the year still has a long way to go.

	Friday	Thursday	This Week	Year-to-Date
Dow	10,776	10,852	-165	-0.1%
S&P	1,200	1,209	-22	-1.0%
NASDAQ	2,042	2,060	-29	-6.2%
10-Year Treasury	4.55%	4.47%	0.24	0.33
30-Year Treasury	4.82%	4.76%	0.17	0.00
Russell 2000	627	627	-18	-3.8%

Mark Gilbert, in his article, said the following when commenting on this rare issuance of 50-year bonds. “When investors are lining up to lend more than \$1 billion for 50 years to a former typewriter maker (in Italy), you’re not in Kansas anymore, Toto.” As a final thought on this matter, wouldn’t it seem sensible for the U.S. Government, which quit issuing 30-year bonds in 2001 to fire up the cannons again? Hey! How about 50-years? Surely if France can do 50, maybe we could even do 100 years. It’s been done before, you know!