Market Update

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From: Mike Sullivan
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Subject: Unravelling??

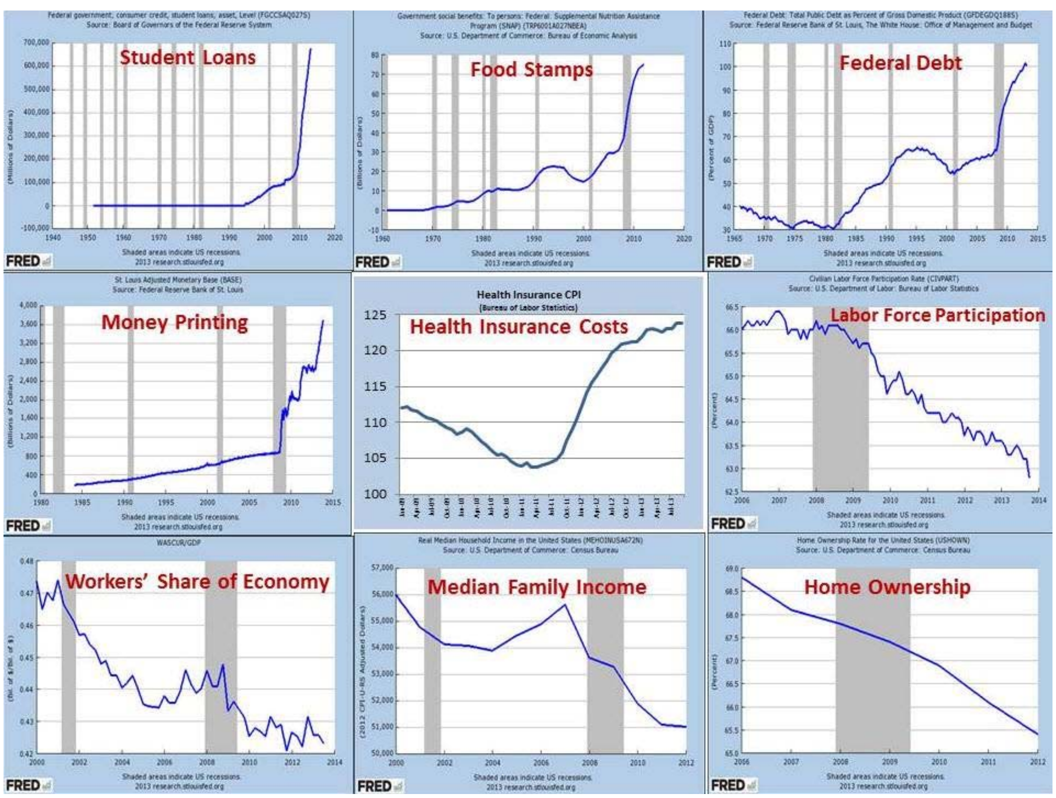
In our last update, we followed up our prior discussion about the major headwinds blowing across the globe with a glimpse of the all-important (then) upcoming meeting of the Federal Reserve.

Of little surprise, the Fed used the market turmoil of late August and early September as an excuse to ***not*** raise interest rates for the first time since June of 2006. Almost ten years have passed since there last was an interest rate hike. Nonetheless, unable to admit that their one-and-only approach to everything – *money printing* - has never in history been a viable, serious solution, the Fed once again chose to forego raising rates by even a paltry ¼%. Regrettably, they have now unleashed even more turmoil as confidence in their policies has been thumped.

After the meeting, Fed Chairwoman Janet Yellen downplayed all ownership of collapsing global economic activity, preferring to overlook the fact that the economic growth rates of the past decade or two had been dramatically accelerated and overdone due to the Fed's relentless debt creation.

Markets have been in utter turmoil since as some participants are finally realizing that central bank policies may not be aligning the real world for long-term success after all. Not to give up too easily, other participants are up to their old tricks, ramping markets higher as the worse and worse economic data causes them to anticipate more money printing coming out of Europe and Japan.

When we step back and look at the big picture we can see the utter desperation of Fed policies in the U.S. as they have so clearly mortgaged the future to achieve another sugar-high bounce. Asset markets seem to be realizing our plight as the Fed seemingly pretends to still be in control …



In our forthcoming Quarterly Letter, we will review the nine charts in more detail but for now we believe the picture sufficiently tells the story. It is at times difficult to see why so many reasonable people might expect this game to succeed long term. If faith in Fed policies is indeed lost, inflated asset prices may be at great risk quickly. We believe that is what the markets are now suggesting.

In the meantime, more and more market participants are joining our chorus about these short-sighted tactics that have mortgaged the future for current day distortions. Renowned billionaire investor Carl Icahn offered his views about the distortions the Fed has created in today's world (not just the markets) just this week. According to Icahn's interview September 29th:

- Low rates and asset bubbles: Fed policy in the wake of the dot com collapse helped fuel the housing bubble and, given what we know about how monetary policy is affecting the financial cycle (creating ever larger booms and busts), the Fed has become the 'bubble blower extraordinaire'.
- Herding behavior: The "quest for yield" is pushing investors into risky assets in a frantic hunt for yield because risk-free assets yield *at best* an inflation-adjusted zero return.
- Financial engineering: myopia is constantly displayed by corporate management teams who are of course issuing massive amounts of debt to fund Earnings-Per-Share-inflating buybacks as well as 'mergers and acquisitions'. (This point is ironic, as Icahn often coerces companies to buy back shares)
- Fake earnings: Companies are being deceptive about their bottom lines.
- Ineffective leadership: Congress has consistently not done what it was elected to do: legislate. (Icahn of course is backing Donald Trump who has recommended Icahn be Treasury Secretary!)
- Corporate taxes are too high: Tax inversions, where companies move overseas, are costing us jobs.

We wholeheartedly agree of course. However, it is an art form for market followers to be able to discern when one of the Wall Street 'movers' like Icahn is stating something because he sincerely believes it, versus stating something to motivate you to do something (ie sell stocks to him)!

Icahn fully admits he has happily benefited from Fed policy on the markets way up. For him to throw the Fed under the bus here suggests he may be positioning towards earning more long-term profits by 'shorting' stocks (selling borrowed stock) as markets begin to work their way down again.

Despite the sell-off through September, another market bounce may still be on the way. It is very possible Icahn and friends may be looking to entice investors to sell shares to them at current levels so that they may profit from another market rally, long-term or not.

If we do indeed get a bounce, we would suggest it will likely be due to yet another round of the stock buy-backs Icahn mentions (a concept we have written about for years). Much of the rally has been built on the back of buy-backs. Stock buy-backs are particularly rewarding to Wall Street and to corporate insiders. Wall Street profits by executing the transactions on behalf of companies, and the corporate insiders profit as their Earnings Per Share increase and their stock price typically follows suit. (Buy-backs are just one Fed-driven reason that wealth-disparity is at record levels.)

However, many of those companies are buying shares back using debt financing which they secure cheaply thanks to the Fed. In the end, insiders who sell stock along the way bank their profits, as does Wall Street. The rest of the investing world just goes along for the typical cyclical ride up then back down again. We see a likelihood that the August / September dip would have been used once more to buy-back shares again. If so, even though corporations may report flat or even declining revenues, EPS may jump again … and the markets may follow along. We pretty much expect it!

We suspect, however, that this may very well be the last dance for a while for that accounting gimmick. Once it is over, many companies will then find themselves loaded with debt, having overpaid for their own stock instead of growing their businesses as a healthy system encourages.

If we do indeed get a market bounce here, be sure to pay attention to warnings from Icahn and friends, and consider using any bounce to your advantage. The charts on the prior page are telling us something. Some investors may wish to use it to lighten up their risk exposure at higher prices. If you are one such investor, and we can be of assistance, please call us at (614) 734-WLTH (9584).