MJB Asset Management

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"If they can get you asking the wrong questions, they don't have to worry about answers."
— Novelist Thomas Pynchon, *Gravity's Rainbow*

Dear Clients and Friends:

How is it that scientists can accurately predict exactly where the Earth and our neighbors in the solar system will be in their orbits around the sun six months from now, yet Wall Street cannot reliably predict the price of corn, oil or Apple common stock tomorrow?

Most investors understand from a rational standpoint that it is impossible to accurately and consistently predict the markets; nevertheless, from an emotional standpoint, they continue to ask the investment world's favorite question—"how will the markets perform this year?"—and the mainstream investment community continues to offer nothing more than dressed-up guesses as "answers."

That is because much of Wall Street buys into the notion advanced by academic economists that economics is not a *social* science but rather a *natural* science akin to mathematics or physics.[1] However, economic issues are always related to human choices and behavior; natural science issues are not. The paths of the planets' orbits are determined by mathematical equations applied to the laws of physics; by contrast, the prices of corn, oil and Apple are determined by market forces, i.e., by constantly changing *human-driven* supply and demand. In the quest to transform economics into a natural science, economists conveniently "assume away" the critical fact that markets are driven by human emotions and reactions and thus are incapable of prediction via equations. Prices can be estimated, they can be implied, they can be guessed, but they cannot be predicted with certainty or, in many cases, even closely.

Of course, most people would prefer certainty to uncertainty when investing, a preference that is not lost on Wall Street when selling its wares. It should thus come as no surprise that Wall Street and the media choose to ignore the uncertainty of the human factor in markets and instead offer soothing

[1] Brendan Moynihan's book, *Next Time Will Be Different* (Infrared Press, 2013, Ch. 4), contains an enlightening discussion of this point.

"spokespersons" presenting scientific-sounding predictions based on comforting "rear view mirror" observations of past market movements.

In effect, investors have been conditioned to ask the wrong question, and the investment media continues to provide answers about which they don't have to worry. For example, I do not recall anyone a year ago predicting the U.S. stock market would rise 30% in 2013 in the face of (remember these?): the fiscal cliff; potential government shutdowns; implementation of ObamaCare; the Syrian civil war; and the uncertainty of whether the Federal Reserve would begin to unwind its accommodative monetary policies. The overwhelming majority of predictions were inaccurate, yet no one holds the predictors accountable for their inaccuracies. The answers to market-related questions (and others) have less merit when they are in response to the wrong questions.

At MJB Asset Management, we prefer to focus on the present moment, rather than get stuck in the past or lost in the future. It is in each moment of every day that the human element in investing takes place and shapes the future. Thus we would advise that the investment world's aforementioned favorite question be rephrased as, "Where do you see current market valuations and how are you positioning your portfolios right now to most effectively maximize the opportunities presented in the current investment environment?" That question demands an answer grounded not in best guesses but in information pertaining to present strategies—which, of course, will create future results.

Perhaps the most significant "human element" we are watching in the economic arena is the transition of the Federal Reserve Chairmanship from Ben Bernanke to Janet Yellen. Wall Street has generally assumed that Ms. Yellen will continue Mr. Bernanke's easy money policies, which had brought interest rates down to historic lows until January of this year, when Mr. Bernanke began to tighten the reins and mid- and longer-term interest rates began to rise again. We don't assume; we prefer to observe, and will closely watch the Fed's actions under Chairwoman Yellen. Until we see a change in policy, we are continuing to position our portfolios to benefit from the opportunities afforded by rising mid- and longer-term interest rates. That means avoiding the most interest rate sensitive bonds, such as U.S. government bonds and high quality corporate bonds—both of which in our view remain overvalued in this environment—and choosing to invest in higher yielding bonds that generate higher interest payments, offer the opportunity for capital increases and are less likely to suffer drops in value should interest rates continue to rise.

With respect to stocks, keep in mind that although interest rates have been slowly rising, they remain at comparatively low levels. Against the backdrop of still low – albeit rising –rates and continued signs of economic growth in the U.S. and other developed economies, we believe that stocks are generally fairly valued and in some cases, e.g., certain developed European countries, attractively valued. As such, we have slightly increased our holdings in the equity markets, including positions in European equities. And because of the ever-present uncertainty of market forces (i.e., because the science of markets is a social science and not a natural science), we are maintaining a variety of protections in place designed to soften the blow of any significant downdraft in the stock markets.

Back to predictions and guesses. Our answer to the wrong question is, quite simply, we do not know what the markets will do and thus do not make predictions; next year's rear view mirror will let us know. Right now, we are reasonably certain, pursuant to the laws of mathematics and physics, that the sun will rise tomorrow; we are infinitely less certain about the direction of the markets. However, rather than spend time wondering whether the markets will repeat last year's performance, we are monitoring the current investing environment and positioning your portfolios to fully take advantage of the most compelling values as they arrive.

Thank you for investing with MJB Asset Management—our door is always open and we look forward to being in touch with you soon.

Sincerely,

Richard Bregman