BCWM
PROVIDING PEACE OF MIND

The Risk of Looking Wrong

Our business is an interesting one.

Every day we have to decide how to get the best potential return with the least amount of risk. It's a business that requires us to peer into the future and attempt to determine the risks, based upon market levels, historical performance outcomes, and geo-political possibilities.

It's slightly more complicated than "buy low, sell high."

What can make our job really frustrating and sometimes irritating is that we can make an investment decision that is ultimately correct but can appear to be incorrect for a long period of time . . . long enough to test our patience (and possibly yours too).

Case in point: In 2010, conventional wisdom and the media were saying that California (the entire state) was going bankrupt due to the sub-prime mortgage crisis. After extensive research, we determined that bonds issued throughout the state of California offered a unique opportunity. We began investing in some of the most toxic and unloved municipal bonds you could find: zero-coupon bonds issued by municipalities and school districts in the state of California.

These bonds had become dirt cheap because . . . well, because California was going bankrupt. The bond prices were so low, investors could get 6% interest tax free!

A year later, the bonds we had first purchased were down 20%. Oops! Now the bonds were priced to yield over 7% tax free. And we didn't look very smart.

So what did we do? We bought more . . . and more . . . and more. And then eventually we were proven to have been correct all along, and over the next couple of years we looked brilliant. Returns of 50% were common, and many of the bonds appreciated well in excess of 75%.

But going through that first year looking stupid was very difficult. More than one client questioned our sanity and one even took their business elsewhere before getting to enjoy the part where we looked smart.

While we are on the subject of looking stupid for a long time . . .

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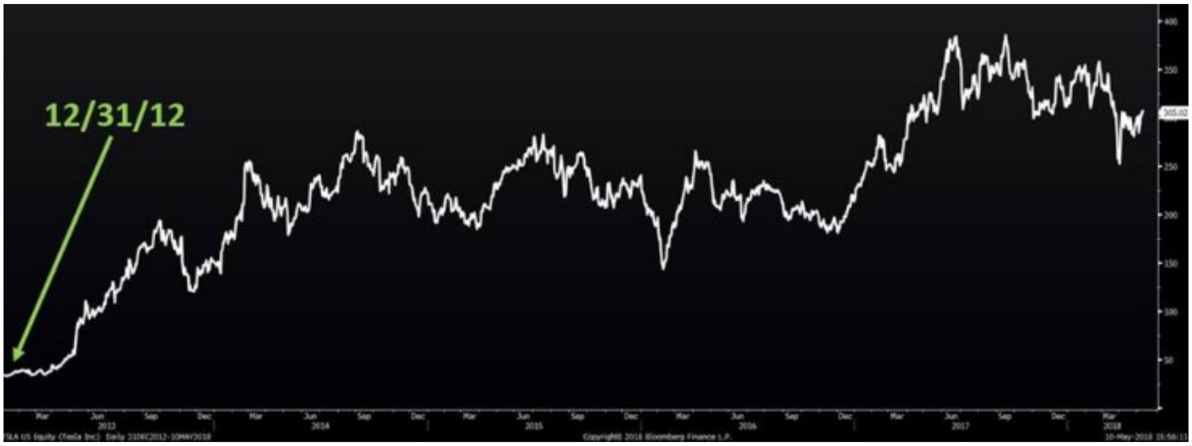
For the past several years, many (savvy) investors have been short Tesla stock, betting the stock price would decline. And since 12/31/12 they have looked really stupid as the stock has appreciated from $32 per share to $385 per share.



We don't short stocks because a stock can appreciate in value longer than you can remain solvent (like Tesla). Nevertheless, you might have thought us foolish for not owning the stock. After all, it did appreciate in value $353 per share in five years. And the cars are great, so how come we don't own it?

We actually researched the company a long time ago, and what we saw was a company burning through cash at an unsustainable rate. Yes, the cars are really cool but Tesla's balance sheet was bleeding.

That didn't seem to matter to investors as they continued to purchase the stock because the cars are so great. If the product is great, the company must be great too, right?

Wrong.

Recently, while on a quarterly earnings call, Elon Musk, the founder & CEO of Tesla, made headlines because he seemed to lose a little patience with analysts asking questions about profitability. He dismissed many questions, calling them "boring," "bone-headed," and "not cool." The stock sold off 7% after the call but is still trading at sky-high valuations.

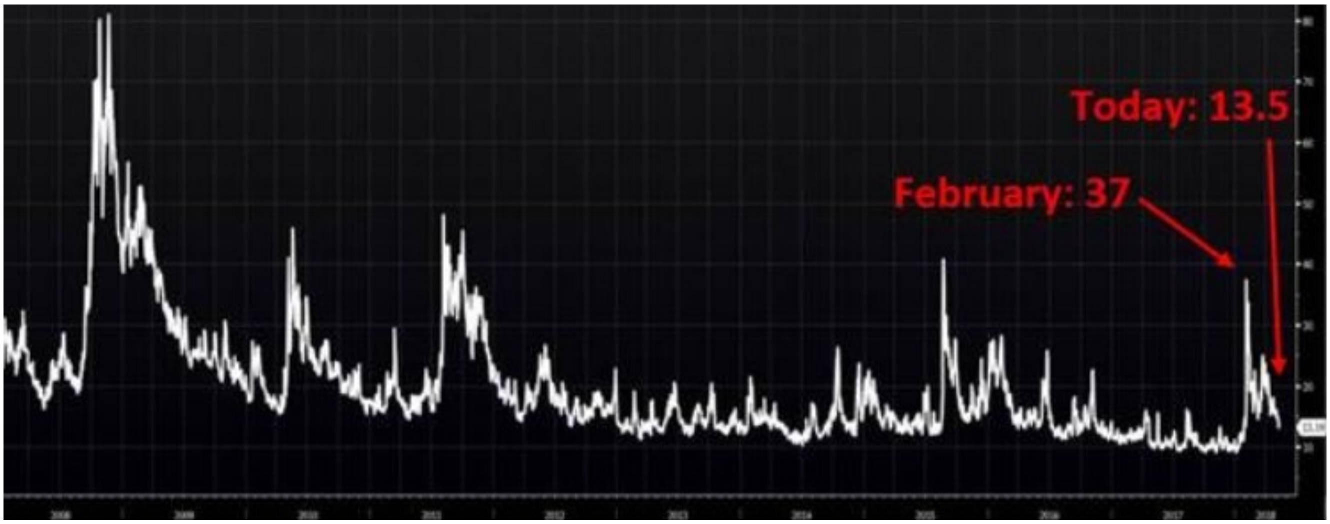
As we pointed out last month, being a genius inventor/creator does not make a person great at running a multi-billion-dollar business.

Like us and our experience with California municipal bonds, short-sellers of Tesla may ultimately be correct (if they don't get wiped out first), but they have certainly looked painfully incorrect for several years.

Speaking of earnings calls, the majority of first-quarter reports have been released and the results are generally good. Revenues grew and profits are up from a year ago in most sectors. The telecom industry was a notable laggard as it faces headwinds and threats of disruption. Fortunately, we made the decision to exit the sector entirely and sold all shares of AT&T in March, not long before the stock dropped dramatically.

Company earnings reports have been good enough to keep market bears contained, and although some of the risks we have discussed in previous commentaries still persist, we are becoming somewhat less cautious.

Why are we becoming somewhat less cautious? Because one of our biggest concerns (volatility) is slowly abating. Although the VIX Index has not returned to its placid levels of the last several years (trading around 9–10 most of the time), it is now trading between 12 and 14, after hitting 37 in February.



And although we are not as worried as we were a month ago, we remain cognizant that 9-year bull markets rarely turn into 10-year bull markets.

One thing keeping the stock market from suffering any major sell-off has been corporate stock "buy-backs." Many corporations are flush with cash from the Trump Tax Act that reduced corporate taxes, and they are using that cash to purchase their own stock. According to the *Wall Street Journal*, buy-backs this quarter are on pace to exceed buy-backs of any quarter since 1998. While this is great for short-run stock appreciation, it is not a sustainable way to create long-term value for shareholders.

At Boyer Corporon Wealth Management, we continue to feel that stock prices are rich and expect long-term interest rates to remain in check . . . at the risk of looking wrong for an uncomfortable period of time.