BCWM
PROVIDING PEACE OF MIND

Absolutely. Positively. Not.

One of the things we've learned in our business is that when virtually the entire investment world is absolutely, positively sure something is going to occur, not only does it NOT occur but the opposite usually does.

Occasionally these are called "bubbles," like the tech-stock bubble when everyone was convinced tech stocks would only go up forever. In 2000, you could hardly have a conversation with anyone without hearing how much money they made in tech stocks just in the past week. Needless to say, that ended badly, since tech stocks plunged 70%.

Recently, it occurs to us that we don't know *anyone* who *doesn't* think interest rates are going up. ANYBODY! Try it out: Ask the person next to you, and see if we're right. See if you can find someone who doesn't think interest rates are going up.

It's partly because of this that we are all the more convinced that long-term interest rates are not going to increase and are likely going to decrease. It's not easy to be on this side of the equation, just as it wasn't easy to be short tech stocks in 2000. But like we said last month in "The Risk of Looking Wrong," it can be painful to look wrong while you wait for the inevitable to play out.

When you hear people talking about interest rates going up, they're not necessarily wrong. The Federal Reserve Bank has been raising short-term interest rates at almost every meeting and short-term bond yields have followed suit. However, long-term rates are determined by market forces (supply and demand), and we have fundamental reasons to believe that the demand for U.S. treasuries will continue to drive long-term interest rates down in the years ahead.

Extremely low unemployment notwithstanding, we feel that inflation isn't going to accelerate, although we are (again) clearly in the minority. All major economies of the world—and most emerging economies—are far too over-indebted to realize the continued sustainable robust economic growth needed to push inflation higher.

What we saw play out at the end of May illustrates just how easily and quickly interest rates can decline. On May 29th, the day after Memorial Day, we watched interest rates on the 10-year U.S. Treasury bond decline from 2.93% to 2.78%. In the world of bonds, this is an extremely large move for one day.

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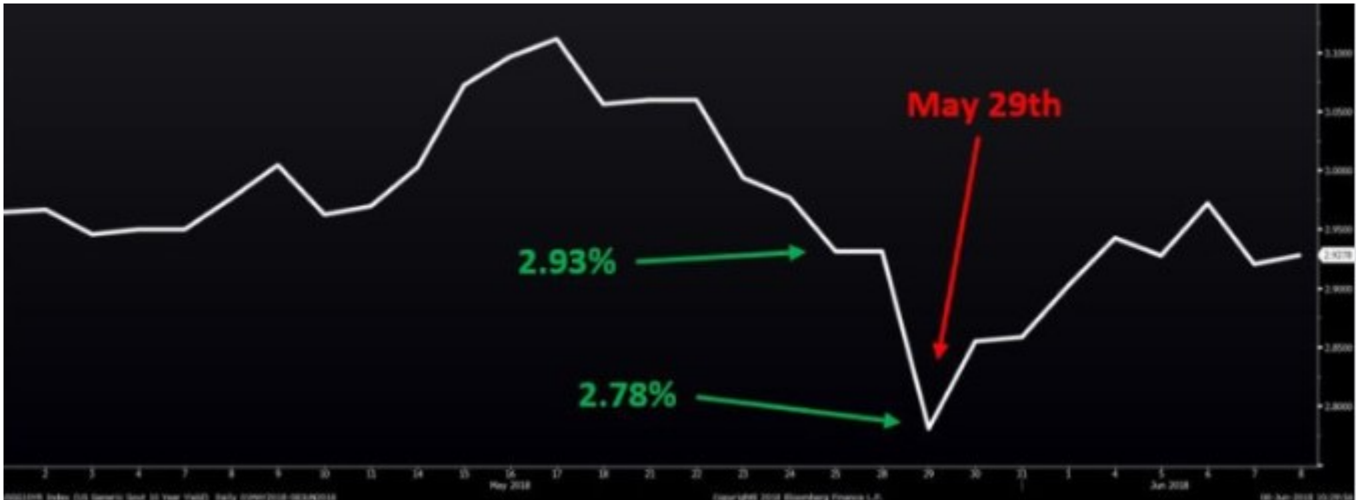

Why the big move? Did Trump tweet that he is going to eliminate the Federal Reserve? Did employment numbers severely disappoint? No, there are actually more job openings now than there are people seeking them. Unemployment is at 3.8%, its lowest level since April 2000. Inevitable inflation should be driving interest rates higher. But on May 29th, rates took a dive.

The downward move in interest rates allegedly occurred because of Italy. More specifically, Italian politics. That's it. The call for a new general election that could turn into a referendum on Italy leaving the Euro, thus weakening European ties (à la Brexit), caused some investors to retreat to "safe haven assets," also known as U.S. treasuries . . . which drove bond prices up and interest rates down.

What is happening in Italy is not insignificant, but, on the radar screen of worldwide calamities, it is not much of a blip. What is noteworthy at this point is how just the *potential* for further chaos within Italian politics could inflict pain on the rest of the Eurozone and therefore create such a stir in the U.S. treasury markets. Bottom line: Interest rates were looking for a reason—any reason—to decline. And Italy was as good a reason as any.

While we're on the subject of markets doing the opposite of what investors expect, it has come to our attention that "growth" stocks are having a much better year than "value" stocks. Growth stocks are younger companies that emphasize growing profits and are not yet paying dividends to shareholders . . . companies such as Facebook, Netflix, Google, and Amazon. Value stocks tend to be more mature companies that typically return profits to shareholders in the form of dividends.

The chart below shows the performance of Value (blue) and Growth (red) stocks over the past two and a half years. Value stocks have underperformed Growth stocks to the tune of about 18%.

After a 9-year bull market, we are focused on owning companies that offer the best risk-adjusted return for the future. Achieving that may require buying a stock that does not appreciate much in price but provides 4–5% a year in dividends alone.

This universe includes companies like AT&T (which we sold earlier this year but will likely take a stake in again) as well as Exxon Mobil (which we purchased earlier this year). Other names likely to show up in our portfolios include Ford, Philip Morris, and IBM.

Every now and then the brain trusts that oversee the Standard & Poor's 500 Index make changes so that it reflects what is currently going on in America. For example, thirty years ago Sears was a big-time retailer and Home Depot didn't exist. Today, Home Depot is big time and Sears barely exists.

This past week, Monsanto, a lightning rod for anti-GMO activists and a long-time member of the S&P 500, was deleted from the index because it was purchased by Bayer, a German conglomerate. What's newsworthy about this is that Standard & Poor's chose to replace Monsanto with Twitter, a company that didn't exist fifteen years ago and just reported its first profitable quarter—and that we made the mistake of selling a year ago.

But when the president of the United States uses your product every day, inclusion in the S&P 500 was probably a foregone conclusion. Let's face it, if President Trump shopped at Sears every day, their business might be picking up as well.

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