Adult Swim Only

"Give me six hours to chop down a tree and I will spend the first four sharpening the axe."
- Abraham Lincoln

"I don't care if your mother did insist you wear it to swimming lessons, go and take it off!"

Over many years of watching, I've developed a love-hate relationship with the business news network CNBC. On the one hand, many of the money managers I respect and follow make on-air appearances, give interviews and provide excellent insight into their way of thinking. On the other hand, I find the vast majority of their content worthless – geared purely for entertainment purposes that appeal mainly to mass psychology.

Often times, the hosts invite guests on to debate opposing market views. The guests usually have strong opinions and argue fiercely in defense of their respective positions. I am convinced many of these on-air guests ultimately care more about saving face or being perceived as smart by the hosts and less about the economic outcome of their investment decisions.

Sounding smart is not the same thing as making money. In my experience, the smartest sounding person in the room may look or sound pretty good, but probably should be nowhere near client money. It is not a coincidence the most polished roles within investment banks and investment management firms are usually occupied by sales, strategists and economists – all client facing positions focused on marketing products – whereas the internal risk takers (traders and portfolio managers) who make a lesser impression are kept within the confines of their offices. The skills valued for raising capital or gathering assets are different from those required for investing success. As the saying goes, "it's the sizzle that sells, not the steak."

Investing is rarely black or white. Investors believe, perceive and ultimately make judgement calls. A good company does not necessarily make a good stock. This is just another way of saying valuations matter. Sometimes investors are willing to pay a high price for growth where-as at other times investors are more comfortable paying a high price for safety. As an investment manager and adviser, the difficult part for me is figuring out where we are likely to be in the economic/investment cycle and what that means for asset allocation and future returns.

Alex Gurevich is the CIO on HonTe Investments, a hedge fund focused on macro strategies based out of Sausalito, California. I have never met Mr. Gurevich but follow his insight and analysis over the investing website Real Vision Television, as well as over Twitter. Prior to running his hedge fund, Mr. Gurevich worked as a trader on both the interest rate derivatives and macro strategies proprietary trading desk at JP Morgan. In a recent interview with Real Vision Television, Mr. Gurevich makes a strong case we are in the late cycle period of an expansion (which I agree with) and highlights the below indicators currently on his radar.

- Significant increase in the price of oil.
- Increased stock market volatility.
- Divergent performance between equity indexes. In 2000 it was NASDAQ and Dow Industrials. Today there is a divergence between large capitalization technology names and much of the rest of the equity market.
- Arrival of both strong corporate earnings and economic statistics.
- Arrival of inflation concerns which in turn lead to concerns of higher bond yields.
- Arrival of funding stress (for professional and technical readers, the recent widening of the LIBOR-OIS basis signifies US Dollar funding – ability to borrow - is tightening).

Mr. Gurevich makes clear the above indicators do not necessarily mean a recession is coming 6-18 months out, only that the presence of the above conditions is consistent with a late cycle environment.

He goes on to highlight the historic pattern observed in both bond yields and the yield curve occurring at the beginning of a monetary tightening cycle will likely lead to a decrease in bond yields over the coming months. I've cleaned up the sentence structure from his video interview, but the meaning is still the same. "Short-term interest rates rise, and the yield curve flattens. Initially long-term interest rates don't budge for a while, but then they make their move to higher yields. This is what we're seeing now. The curve is obviously flattening, but the rise in short-end interest rates leads and has actually managed to drag along long-term interest rates with them. And that is actually, again, paradoxically the sign of a late cycle environment. Every time that happened, we were close to the end of the cycle."

Trying to predict the future usually turns out to be a mugs game. From an investing perspective this is okay, as it is a rare for the prudent investor to be either all-in, seeking maximum risk exposure, or completely out of the market. Both higher and lower price trends have a way of continuing along for far longer than anyone can fathom. I believe we are in a late cycle environment, where thoughtful asset allocation strategies will prove to have made all the difference over time. Invest accordingly.

Sincerely,

Justin Kobe, CFA
Founder, Portfolio Manager & Adviser
