It’s an upside-down investment world

An easy-money environment where savers are punished and speculators reap the rewards with help from the Federal Reserve!
Uniquely unusual!
Last Year’s Weiss Wealth Summit

“There is no use trying; one can’t believe impossible things.” Alice

“I daresay you haven’t had much practice. Why, sometimes I’ve believed as many as six impossible things before breakfast.” The Queen
What makes an investor successful in this environment?

Photo: Raymond Bryson
Not Chicken Little ...
Not Pollyanna ...
“Hope is not a strategy.”
~ Billy Beane, Oakland A’s General Manager

Photo: Rafael Amando Deras
To be a successful investor, be a realist

"The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails."

~ William Arthur Ward
<table>
<thead>
<tr>
<th>Index/Metric</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dow Jones Industrial Average</td>
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Data Source: Bloomberg
A continuation of the Great Recovery?

Dow Jones Industrial Average

Data Source: Bloomberg

All-time high: 16072.54
How can this be when the economy is not growing?
And the consumer is struggling?

U.S. Household Median Income (Real Chained 2011 Dollars)

Data Source: Bloomberg

Lowest rate since 1995
Follow the money.
Always follow the money.

Fed Balance Sheet

Data Source: Bloomberg
Why did this happen?

Photo: Eleaf
Remember subprime, CLOs and CDOs?
Which caused the Great Collapse in March 2009?

March 6, 2009 Dow low 6,443.27
The debt didn’t go away

**Chart 1: Domestic Credit Market Debt (As a % of GDP)**

Source – Federal Reserve
Debt can only be retired in three ways ...

1. Pay it off
2. Default
3. Devaluation, which leads to inflation
Default is painful
Ben Bernanke to the rescue
Bernanke’s plan

Provide liquidity and hope it doesn’t set off run-away inflation or a collapse of the currency.
Bernanke’s plan:
A small-town holiday story
Bernanke visits small town USA with $500 from the Federal Reserve
Bernanke’s $500 cycles through town to pay off everyone’s debts
Bernanke takes his $500 deposit and leaves
... And everyone in town is out of debt and filled with joy

Photo: Steven Depolo
In the real economy, the Fed raises the bank reserve requirement

Photo: Tim Evanson
Bernanke’s plan is not working. Growth is anemic.
The money is going to Wall Street instead of Main Street

Photo: Manu H

Photo: Gerry Dincher
The money multiplier plummets

Data Source: Bloomberg

M2 Money Multiplier
Monetary Base
The harder Bernanke steps on the gas, the slower the car goes
The money multiplier is at an all-time low

**M2 Money Multiplier**

Avg. = 8.2

Data Source: Bloomberg
Which means the big banks are investing in the stock market, not lending it!
Easy money combined with low velocity pushes the market higher

Dow Jones Industrial Average

March 6, 2009 Dow low 6,443.27
All-time high 16,072.54
What does this mean for investors?

Photo: Marco Bellucci
The Fed is the only game in town

Photo: Tim Evanson
Valuations are stretched

Shiller PE Ratio
(Yearly)

Data: multpl.com/shiller-pe/

Black Tuesday
Avg. = 16.5

Internet Bubble
Sub-Prime Bubble
Current 25.38
Profit margins are high
Growth is anemic

Nominal GDP
Quarterly YoY Change

Data Source: Bloomberg
The consumer is struggling

U.S. Household Median Income
(Real Chained 2011 Dollars)

Lowest rate since 1995
Margin debt is peaking
But it’s hard to fight the Fed
Market timing is tricky business

- Stretched valuations
- Anemic growth
- Struggling consumer
- High margin debt

**Growing Balance Sheets**
(U.S., U.K., ECB, Japan, China, and Switzerland Combined)

Data Source: Bloomberg
What does this mean for ME and MY MONEY?

Photo: Raymond Bryson
At January’s Weiss Wealth Summit, I said: “One more liquidity-driven rally remains …”
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<th>YTD Return</th>
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Data Source: Bloomberg
But valuations are really stretched

Shiller PE Ratio
(Yearly)

Black Tuesday
Avg. = 16.5

Internet Bubble
Sub-Prime Bubble
Current 25.38

Data: multpl.com/shiller-pe/
On unsustainable profit margins
Dangerous valuations: Earnings x multiple = price

Corporate profitability (high)

Multiples (high)

Valuations (excessive)

Projected future stock market returns over the next decade are about 1% annually using the Shiller model
Valuations are unreliable timing indicators

Shiller PE Ratio (Yearly)

 Avg. = 16.5

Black Tuesday

Internet Bubble

Sub-Prime Bubble

Current 25.38
2014 investment plan

1. Review portfolio and eliminate all speculative investments

2. Maintain significant cash reserve for future buying opportunities

3. Sell all bond funds and own only short-duration bonds

4. Focus on high-quality dividend-paying stocks

5. Guard your capital
<table>
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<td>3M</td>
<td>1.9%</td>
</tr>
<tr>
<td>United Technologies</td>
<td>2.1%</td>
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<tr>
<td>PepsiCo</td>
<td>2.6%</td>
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<td>Colgate Palmolive</td>
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</tr>
<tr>
<td>Procter &amp; Gamble</td>
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</tr>
<tr>
<td>Praxair</td>
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<tr>
<td>United Parcel Service</td>
<td>2.4%</td>
</tr>
<tr>
<td>Microsoft</td>
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TCP Capital (TCPC)  
Dividend Yield  8.3% 

TCP Capital is a closed-end investment company focused on middle-market lending.
Be careful – this market could go either way
What I am watching
“What a strange world we live in…”

Said Alice to the Queen of Hearts

But you can profit in this mad-as-a-hatter market if you are a realist!
Startling Forecasts for 2014 and Beyond

Forecast #13
Two major factors will continue to push the stock market higher:

- Easy money from the Fed that does NOT flow into the real economy

- Major banks investing big in the stock market instead of making big loans