These are the Good Old Days
PART 1

We can never know about the days to come
But we think about them anyway

It's what the lyrics say. Of course Carly Simon wasn't talking about investing. In fact she had a whole different subject matter in mind. Anticipation keeps us all waiting. Patience is indeed a valuable virtue. It works so well for so many things.

As a group I think value investors are a whole different breed. Contrarian in nature, analytical, conservative, willing to adhere to basic principles many of which are ignored by the investing public. Sometimes its a difficult and lonely journey.

Patience is one thing the investing public just doesn't have anymore. A recent study by my friends at Columbia Business School showed that the average holding period for a stock in these robust times was 7 months. Since ours is 5-7 years it would seem we have a competitive advantage already.

The advent of indexing is another trend that appears to have "juiced" the market. In the last 3 years investors have sank $823 Billion into Vanguard funds. This creates a cycle where money pours into Vanguard indexes, which have to go out and buy the stocks in the index driving the prices higher and higher. This causes active managers who own smaller stocks to underperform, causing investors to redeem, forcing active managers to sell their stocks, driving them down, furthering widening the gap between the performance, leading more people to embrace indexing. Wash, rinse, repeat...

The byproduct of all this for a Value Investor such as myself is that valuations for stocks outside of the indexes are much cheaper and you can still find pretty good values. Although the opportunity set has gotten smaller over time.

One legendary investor, Seth Klarman stated in his annual letter the perversity of index investing. "There are several ways indexing distorts valuations" he says. "Index funds invest money in companies totally regardless of whether they are attractively valued." Klarman was saying that its really kind of mindless. He's had only 3 down years in 30 folks the man knows what he is talking about.

One wonders if valuations would go down as fast as they went up when the mindless public decided they couldn't take the headlines anymore.

Of course the "index" bubble is not the one that concerns me the most. The bond demons have been lurking for quite some time. The reality is that much of the gains attributed today in the markets were built upon mountains of debt. Let's call it the credit bubble. Credit in student loans, credit in auto loans etc. Auto finance delinquencies are at the highest levels in a decade. Highest since the pre2008 credit crunch. Except now there are more of them. It's only a matter of time before delinquencies turn into defaults. Who is really that attached to a 10 year old Honda Civic??

Take an agricultural bellweather like John Deere Co. John Deere Credit, the financing arm of the parent company provides nearly half of operating income today. As recently as first quarter 2013 this was only 15%. Credit losses are also widening here. Loans past due 60 days marked to unperforming have increased to 1.6% from 1.0% last year. A 60% increase. This is the highest level since 1993. Deere knows this of course and has made some provisions. But the markdowns seem paltry when compared with prior downturns. And lets face it it's simply a much bigger deal to the total picture today.

What about corporate bonds?
I started talking about excesses in the bond market over 2 years ago. We even exited all intermediate and open ended bond positions. I've gotten tired of talking about it. I just stopped writing, because the silliness just seems to go on and on.

In that time the bubble our "Credit Bubble" has gotten thinner and thinner. You can read quite clearly through it. Its just floating around the room looking for anything sharp.

Of course we've been planning for all this. I think one of the greatest buying opportunities of our lifetime lies ahead. Like the peaks of Colorado viewed from Western Kansas. I can see it and its getting closer all the time. Anticipation....Anticipayay tion is making me wait....It's keeping me waiting...

A client asked me the other day "Do you think we will have a crash?" It seems he had watched one of the financial shows that masquerade as investment research. Mainstream financial media likes to bring up the crash stuff. If they happen to be luck out and be even close to right they can milk that for a decade. Remember Elaine Garzarelli? Of course you don't. She "predicted" the crash of 1999 stating correctly I might add that the market was 40% overvalued in 1998. She was a media a star and even started her own fund. You don't hear much about here these days but she made a fortune even though her fund has had paltry returns.

So to answer that Yes even if I thought so would be bordering on irresponsible. I can tell you that valuations are distorted is in my view provable but does not necessarily culminate in an abrupt ending. It could.. But one focusing on such hyperbole really misses the point.

And the point is dear reader that for the umpteenth time valuations in the bond and credit markets are unsustainable and distorted. The stock market as well but in my opinion to a lesser degree. This will be sorted out over time.

Another noted value investor recently stated that he believes the US stock market as measured by the S&P 500 Index (There's that index again) will yield negative returns over the next decade. I DO NOT disagree. Most investors these days have not lived through a long and brutal bear market. I think it's quite possible they will have to endure one. How that negative return manifests itself is anybody's guess. It's folly to think you can.

I think our investors will do quite nicely. We invest in a radically different way. Emphasizing not losing money first. Balance sheets first, not anticipated sales or gains that may or may not materialize. Quality of assets is important. How much you pay for them. Patience.

The investing public doesn't seem to care about valuations anymore. We do. It's not different this time. It never is. The laws of mathematics have not been repealed. Unfortunately if I am correct for most investors these are the good old days.