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OBSERVATIONS ON THE MARKET

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If you happen to run into Tina Fomo, keep walking. If she calls you on the phone, just hang up. If you are an investor, it's already too late. You have heard her seductive voice, probably already done something you regret, or will regret sometime soon.

Barron's begins an article last week with: Mister Market has a Mistress: Tina Fomo. They go on to explain what Tina Fomo stands for: There IS No Alternative, and Fear of Missing Out. This is most likely the simplest explanation of what is going on in the market today. Some investments are doing things that you would expect, others are not. The connection is not always obvious. To begin with, European interest rates are most likely the source of a lot of distortion in the search for income. Five-year interest rates in Belgium, France, Germany, and Japan are all negative. You pay them to hold their bonds. No coupon clipping here. Even Spain and Italy only pay about .30%. With U.S. five-year interest rates at 1.38%, it is pretty easy to understand why the market is not normal. If you consider that inflation is picking up somewhat - the latest March to April number shows an annual rate of over 4%, funds are flowing to the U.S. seeking higher yields - in spite of not getting paid for inflation. It gets worse.

In the last few weeks Spain sold 50 year bonds at a yield of 3.45%. France also sold some 50 year bonds at an interest rate of 1.75%. This is exactly what they should be doing, but who is buying these things? The theory goes that big pension funds and insurance companies are matching liabilities with income. This is otherwise known as immunization. If the future liability payment is funded with a matching bond payment, there is no risk. So the theory goes. You can bet that in 10 or 20 years and Spanish interest rates are back up to 7% or more, and their bonds are trading at a value of 50 cents on the dollar, they won't feel so immunized. Not to mention, there will probably be another massive bailout, but we digress.

This phenomenon has spread to the stock market. When you start paying more than 20 times $1 of earnings, you are not getting any value, especially if it is a mature, slow growing company - regardless of the dividend that it pays. Tina Fomo is seducing you. Companies that are taking on more debt to increase their dividend, are another risk. Or worse, companies who are borrowing short-term to take advantage of the current very low interest rate environment to then buy longer-term, higher yield bonds. This works great until it doesn't. So what to do?

Anybody who watches much television has seen a rerun of Julia Roberts in *Pretty Woman*. It was one of her big movies. The problem is that the character she plays would never fly off in a private jet to see the opera in San Francisco. The real life character has an average life span of 23. Tina Fomo is another movie, don't expect the rich guy to show up and bail you out. Buy dividends and earnings that are sustainable through economic cycles, and buy them at reasonable prices. A 6% to 8% earnings yield is reasonable. When you start dropping below 5%, the risk of having an underperforming asset starts going up. The real problem is that nobody knows how long this movie is going to play. But just like the 2008 recession, we will recover, and well managed companies will be worth more after it is over. Just like they always are. And you can be guaranteed that with the exception of luck, none of the talking heads on the business channels, nor you or I will know when it starts or ends. (Note to self when I am ready to jump out the 16th floor window in the next recession)