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by Greg Gann

Buyer/Holder: Beware

One of the investment managers with whom I work is Absolute Investment Advisors, LLC. I wish to share the factual data on the market that they compiled and which screams for us to pay close attention.

1. The Nobel Prize winner in economics and Yale professor, Robert Shiller, is the creator of the Shiller P/E ratio. The current level of this index for the S&P 500 is 26. This level has only been met 3 other times in over 130 years of data. Those times were 1929, 2000, and 2007. And, each previous peak was followed by a decline in the S&P 500 of at least 50%.
2. S&P 500 operating earnings grew a cumulative total of 10% from 2011-2013. Expectations were for 36% growth. Nonetheless, the index gained 55% over that time.
3. Russell 2000 operating earnings from 2011-2013 fell 20% (expectations were for 100% growth), yet the index gained 60% over that time.
4. Except for the 2000 peak, the Price/Sales ratio and Price/EBITDA (earnings before interest, taxes, depreciation, and amortization) for the S&P 500 are the highest in history. In fact, they are double the historical averages despite low growth for revenue and earnings.
5. China's banking assets represent 33% of all global GDP. Of the $30 trillion in worldwide credit growth since 2008, half or about $15 trillion has come from China. To put this in perspective, the US subprime totaled just $1.2 trillion.
6. Over the past seven months, 74% of companies issuing IPOs have no earnings. This is the highest level since March 2000.
7. The fact that the stock prices of companies with weak balance sheets have outperformed those with strong companies by a wide margin over the last 2+ years is further evidence of the disconnect between prices and earnings.

The list could easily go on, but I think it's clear, "enough said". Buyer/holder beware. Loose monetary policies may have prevented a depression, but there is no free lunch. They have made investors' hunger for yield push them into risky assets without realizing the inherent risks. They have made it easy for companies to borrow with exceptionally cheap money to increase dividends and stock buybacks, both of which lead to higher stock prices. However, this financial maneuvering is camouflaging the underlying flaws, which is to say anemic, if any, real growth.

When the majority is thinking the same way and all chasing the same things, demand heightens. Heightened demand inflates prices. Eventually prices go up so far and distort beyond fundamentals that the last guy in has no one left with whom to sell. Therein begins the inevitable unwind. It's basically a legal Ponzi scheme. And, you don't want to be one of the later entrants in a Ponzi. Within this context, and hoping to help you think independently and

Also, in these times of tremendous distortions where sentiments of the herd have shifted from extreme fear in 2008 to excessive greed today, I urge you to heed Warren Buffett's sage advice to be greedy when others are fearful, but fearful now that so many others are greedy. And remember, managing investments should be approached from the standpoint of enduring a marathon rather than expiring after the sprint. Unusual times call for uncommon investment strategies, a fresh approach, and an unbiased second opinion, particularly with a financial professional who is not transaction-oriented.

Best wishes,

Greg