Out of Bondage
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Dear Fellow Investors:

In the Bible's books of Genesis and Exodus we are told that as Prime Minister of Egypt, Joseph was wise enough to store up massive amounts of grain in a seven–year prosperity period. When the seven-year famine followed, his family came to Egypt to buy food. After revealing himself as their brother, Joseph's family, the Hebrew people, moved to Egypt to live. They successfully got relief from the famine, but chose to stay and live in Egypt long after the famine had ended.

This is a perfect picture of what has happened to US institutional and individual investors over the last eleven years. A seven-year prosperity period, led by a boom in everything technology oriented, ended in 2000. Stocks, as represented by the S & P 500 Index, were the most over-priced that they had been since 1929 and 1972. Beginning with institutional investors who had the resources to do so, the money was moved to Egypt in the form of a variety of other asset classes. Bonds, emerging stock markets, gold, commodity indexes, oil, small cap stocks and a wide list of illiquid "alternative investments" all became populated with the money which fled the large-cap US stock market famine. Soon, all the major financial advisor, registered investment advisor and institutional consulting firms created strong systems to move institutional and individual investors to Egypt. For individual investors, the most popular destination for the money has been bonds, CDs and money market funds.

Long after benevolent leaders like Joseph had died, Egypt eventually was led by people who enslaved the Hebrews and put them to work building monstrous orifices like the pyramids. These gigantic undertakings were heavy on the manual labor and unbelievably time consuming due to the limited technology of that era. The more the Hebrews complained, the more burdensome the Pharaohs of Egypt made their work. The Hebrew people screamed for a savior to lead them out of bondage. Unfortunately, the time to get out of Egypt was long before the people had become enslaved. It was as soon as the end of the famine allowed them to prosper in Israel, the "land of milk and honey". The land promised them by God.

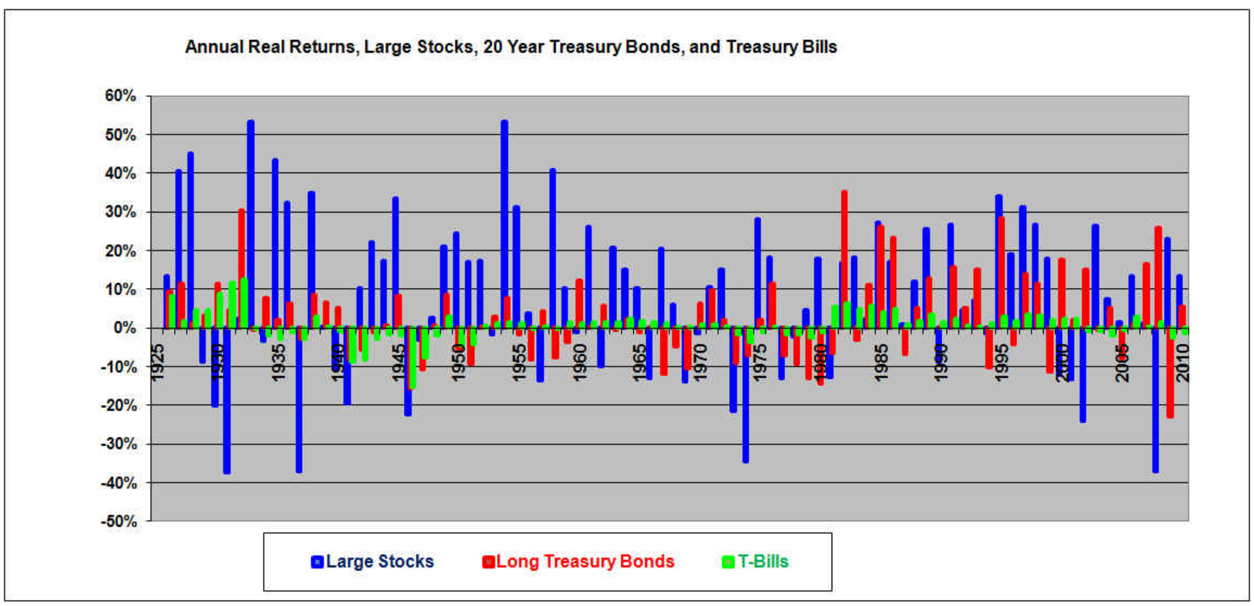
Ten-year Treasury bonds have paid 2% or less for much of the last year. Since the stock market famine's peak consternation in late 2008 and early 2009, every stock market decline in 2009-2012 has been met by a mad dash to the bond market. This is only a good idea if there isn't money to be made where they started out in the first place. Stocks, as measured by the S&P 500 Index, trade at 13 times consensus estimated earnings. This puts them below the historical average of 15. Secondly, stocks have performed quite well in the last three years and have represented the fact that prosperity has returned to the asset class that people came from originally. Thirdly, stocks pay a higher dividend than the ten-year Treasury bond and all other secure bond investments like CDs.

All hell had to break loose in Egypt to get Pharaoh to release the Hebrews from bondage. God brought ten plagues onto Egypt. The Egyptians were abused by everything from bloody rivers to insects/pestilence, to the death of their firstborn sons. The Hebrews had to walk across a peeled back Red Sea and wander in the desert for 40 years to get back to the "promised" land.

The last time that ten-year Treasury bonds hung around 2% was in 1950. Stock investors had suffered the plague of the "great depression" and the plague of World War Two. First, the entire financial system was challenged and then folks had to wonder if they were going to have to learn to speak German or Japanese. From 1951 to 1981, those who stayed in bonds (bondage) were punished by multiple losing years in the bond market. This all culminated in 11% inflation and five consecutive years of losses from 1977 to 1981. Ten-year rates peaked at 15% in 1981. Bonds had done so poorly that nobody wanted anything to do with long-term bonds.

The last indignation for the Hebrews during their time in Egypt was being asked to create bricks without straw. Pharaoh doubled the labor and the misery. This is exactly what the bond market is asking institutional and individual investors to do. Bond investors are seeking "fixed income" with no interest. Their financial advisors and consultants are being asked to create something out of nothing.

The chart below shows 20-year Treasury bond performance annually since 1925. From 1951-1981, there were 17 years that investors lost money in long-term Treasury bonds. The plagues on bond investors during those years were especially vicious from 1955-59, 1967-69, 1973-74 and the aforementioned 1977-81. Are today's institutional and individual investors going to invite similar plagues over the next 30 years or will they get out of bondage?



Source: InvestorsFriend.com, Stocks Riskier than Bonds, February 14, 2011

Best Wishes,

William Smead

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