Pecaut & Company

Our Mission: To Be Our Clients' Most Trusted Financial Advisor

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EXECUTIVE SUMMARY

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Market Update

"Be fearful when others are greedy and greedy when others are fearful."

- *Warren Buffett*

This, in a nutshell, is the essence of the value approach. As is apparent upon sober reflection, value becomes abundant when fear determines the pricing of assets. Value becomes scarce when greed is driving the bus. How could it be otherwise? After a six year bull market, fear is returning to the market. Markets worldwide have taken a double digit haircut - the Dow Jones Global Index is down 12%. The bear market we believe started last year has accelerated. Factors include a slowdown in China, a debt default cycle now underway in the energy industry, and, of course, fear where there was once greed and speculation.

The deterioration of the general market last year was masked by what Corey called the F.A.N.G. market (Facebook, Amazon, Netflix, Google/Alphabet). That group of four rose 87%, dragging the S&P 500 to a slightly positive close. Now that fear has reappeared, Amazon is down a third and Netflix has fallen over 40%. The *Wall Street Journal* reports that 31% of the stocks in the S&P 500 are down 30% or more from their 52-week highs, close to the levels seen in the market sell-offs of 2011 and 2012. It could be that correction is already over. It could be that we have a ways yet to go.

Our primary concern is that the Central Bankers have gone all in to solve a problem of too much debt by *creating even more debt.* Essentially the problems of the 2008-09 subprime mortgage crisis were not solved but shifted - shifted from the balance sheets of the general public to those of governments. Years of zero based interest rates worldwide have created a world of elevated asset prices and an expansion of credit creation (without all that much growth to show for the trouble). Both are now in correction. Asset prices have fallen and bankruptcies are on the rise. For the long term value investor, this is good. Greed is giving way to fear. The pricing of assets is becoming less rational. The opportunity set for shrewd allocators of capital is expanding significantly.

It's hard to know how the Great Unwinding of this massive experiment by the Central Bankers will unfold. However, one oddity that their work has spawned is an era of negative interest rates. What was once an anomaly has become commonplace. This just in from Grant's Interest Rate Observer:

Bloomberg reports that 29% of the world's rich-nation sovereign debt yields less than nothing. The grand total of sub-zero-yielding government debt foots to $7 trillion.

Paying to have someone hold your money has become widespread. You can't make this stuff up.

So we encourage proceeding with caution. To expect some dislocations, such as what we're experiencing now, seems reasonable. Plan for volatility and you won't be disappointed.

Good businesses will continue to grow and gain market share. In fact, economic distress can accelerate the growth in intrinsic business for some of our favorites. For example, Warren Buffett was criticized heavily for having Berkshire Hathaway hold so much cash for much of the early 2000s. Then during the 2008-09 subprime mortgage crash, Buffett went on a $100 billion buying spree, capped by the purchase of the Burlington Northern Santa Fe Railroad. Buffett walked his talk. He got greedy when others were fearful. It was the crisis that afforded the opportunities.

In sum, our age old advice seems to us as true as ever. Pay off your debts. Have plenty of cash for emergencies. For retirees, have a good three to five years of needed cash flows for living expenses in cash and cash equivalents. Invest the balance for the best long term total return consistent with a rational, value-oriented approach.

The Book

Thanks to all who have been helping to promote our podcasts (at danielpecaut.com) and our new book, Save, Spend, Invest, Give. The podcasts are approaching 4500 downloads! Folks in 52 countries and 48 states have listened in. A special shout out to Canada for jumping up the board to the #2 country for downloads, passing Finland and Australia. Clearly those Canadians are not only friendly and good-looking, they're intelligent as well.

As for the book, we received our first royalty check last week. It's official, Dan is a professional author! We love your feedback and stories you have sent our way on the book. Above all, we wanted to make understanding money seem simple and approachable, and you are confirming that the book delivers on this score. Our mission is to improve financial literacy in America. Thanks for helping us to launch the effort.

Saving

The opening premise of our book is that saving is a function of attitude not a matter of circumstance. A cast of mind that promotes optimism, hope, and vision for a better future. We've reprinted our "handful of rice" story that so poignantly brings this premise home (see below).

Now our beloved assistant, Shelby Pierce, has her own story to tell. She has been on a disciplined program to save and get out of debt. Recently she had a major win. We are so proud of her. In her own words:

Our Last Car Payment

Last week was an exciting one. My husband and I paid off our car, a black 2005 Honda Element. We also moved out of our apartment of seven years into our first home.

Like so many of our peers, we are heavy-laden with school debt (a debt greater than the cost of our modest first home). When we were high school seniors we each made the choice to attend private liberal-arts colleges simply because it appealed to our interests, regardless of the cost.

The model that had been laid out for us, at the time, was borrowing money.

- If you need to go to college: borrow.
- If you need to buy a car: borrow.
- If you want to buy a house or start a business: borrow!

Oh, not to mention, you need good credit to do these things so be sure to get a credit card to increase your ability to borrow.

We think about money differently now.

Roughly two and a half years ago, while engaged to be married, we sought out sound advice and best practices for how to better run our finances. We took a financial course that challenged us to become debt-free, and stay debt-free. It was a significant shift in our approach to money. Before this, believe-it-or-not, neither of us had ever considered we could someday be debt free.

To say the least, it was a rather mind-blowing proposition, when our course guided us toward paying cash for large items (like a car).

The particular debt pay-off model we follow is the "debt snowball." We order our debts from largest to smallest. We pay the minimum on all of them except for the lowest one where we throw everything we have left at the bottom of our budget.

The significance of paying off our car is that we are getting our first real grip of traction. We will now take the amount we put towards the car, $300 per month, and use that to hammer at our next lowest loan. With this additional $300 per month, that debt will disappear within *three months*.

We are in the midst of our own great American debt-dig-out. And we're making progress.

Wow, that feels good.

- Shelby Pierce

A Handful of Rice

(excerpted from Save, Spend, Invest, Give)

At first, I bought the idea that not everyone could save. Making ends meet is tough. Maybe "buy now, pay later" was the only way to go for some people. After reflecting on this issue, though, I've realized that saving has little to do with money. It has far more to do with attitude, discipline, and a willingness to rewire the circuits.

A former Peace Corps volunteer proved this to me when he told me this story:

Some years ago, a family in India lived in conditions that, while destitute by our standards, were average for their neighborhood. They had a one-room shack that housed grandparents, parents, and five children.

This Peace Corps volunteer noticed that the mother, as a mealtime tradition, would throw an extra handful of rice into the pot in case company came by for dinner. This was a beautiful gesture of hospitality and generosity. But company hardly ever came. The volunteer gently suggested that the mother save this extra handful of rice by throwing it into a bucket.

Slowly, the bucket filled, and when it reached the brim, he took her to the marketplace and helped her sell the rice.

This empowered mother decided she could get by with less if it meant a better future. With this discipline came empowerment. It offered her family hope and opportunity.

When he visited a few years later, not only was this family continuing to save, they had taught their neighbors to save. They had founded a food cooperative. Each month, a member of the cooperative went to the big city and bought bulk quantities at wholesale prices for the group.

Saving has little to do with money. It has far more to do with attitude, discipline, and a willingness to change. Never have I found this point more eloquently put than in that story.

So saving isn't about the money. It's about building a future.

Dan Pecaut Corey Wrenn