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Sung Nam

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Stable Disequilibrium

"Back in 2006, PIMCO rejected the consensus view of a "great moderation" (and "goldilocks") in favor of the concept of a "stable disequilibrium." Specifically, we argued that stability on the surface was accompanied by weakening and increasingly unstable underpinnings.

Our concept of a stable disequilibrium is back. Whether it is due to a lack of timely understanding, an insufficiently agile political system or imperfect policy tools, the collective response to the unusual multi-speed dynamics of the last few years has added this concept to the dynamic characterization of the New Normal. "

From Mohammed El-Erian's recent posting uploaded to PIMCO's website, it seems the skepticism we have had over the market rally (17% S&P YTD) and the strong returns in fixed income bonds is on page with some of the leading voices in the financial market.

Yesterday, I was asked by an individual from State Street what my thoughts were on the market in general. I mentioned the artificial propping of asset prices by the monetary policy in place is concerning. Although corporate profits are stronger than 2006, the premiums found in the fixed income and equity market seem unwarranted.

He then went on to ask about fixed income returns and whether it is a good time to invest in them right now. A lot of retail investors, who aren't familiar with fixed income, are now rushing for these products. I've noticed a strong interest in these products since the beginning of the year, and we know the aged, yet tested quote where the investor should head for the exit when the shoe shine boy is giving stock tips is well suited for times like today. News on Fixed income returns are all over the media and although they will generate a respectable 5-6% return, which is closer to the average weighted coupon rate than the outpaced double digit returns seen over the past 4 years, individual securities may see a loss should the continued support wear thin.

We were never big followers of the market performance except to use as a benchmark for our portfolio. When the market is shaking, we will still be investing in strong cash generating, lately dividend paying, downside risk protected companies with a strong product and growth. In fact, we secretly want a market correction so that we could pick up more of these securities for cheap.

Recently, fixed income yields have been rising as money pulls out of the impending fixed income bubble into the looming equity market bubble. Also, the FED may shift gears on their purchase program, which will pull the rug on the price support for the fixed income securities.