Quarterly Market Outlook & Strategy

Through the Looking-Glass

First Quarter of 2020

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Executive Summary

- The first quarter of 2020 was a "tale of two halves." From January through mid-February, stocks and bonds soared, as investors expressed euphoria about the prospects for technology, Teslas, and…US Treasuries. Then in a sudden reversal, markets collapsed, as investors tried to absorb the potential consequences of the novel coronavirus for the economy and earnings. There's an old adage that says stocks go up by the stairs and down by the elevator, and this was no exception.
- You might say it's also been a "tale of two years" but in reverse order; the stock market's anticipatory weakness in 2018 was followed by a melt-up in 2019, thanks to the Federal Reserve's "liquidity" operations. The government's latest move to bail out investors has helped stocks regain about half of what they lost, bringing valuations back to the lofty levels of mid-February—when allowing for a modest decline in corporate earnings.
- Our cyclical models suggest we are, perhaps, a third of the way through the stock market's re-pricing, although the Federal Reserve's asset-purchase programs make any kind of market forecast hazardous. We feel more confident in saying that this is *not* a liquidity crisis. It is solvency crisis, and not easily remedied.
- We believe there is a significant risk of cascading defaults in the form of a "debtors' strike," as households and businesses seek to retain whatever cash they can get their hands on. This outcome seems more likely than in 2008, which witnessed strategic defaults by some mortgagors. Since then, there has been growing public awareness—and anger—at the disproportionate support given to Wall St vs. Main St.
- Whatever happens in financial markets, it is unlikely that consumer spending will rebound quickly. Americans will undoubtedly realize that they need a larger margin of safety against unexpected shocks. Household savings will continue to rise, which will slow the recovery in the economy. Absent a quick resolution of uncertainty surrounding the coronavirus—which we deem unlikely—businesses will be dealing with complex and difficult choices that inhibit planning and hiring decisions. The interruption of global supply chains and rising geopolitical tensions will certainly not help.
- Central banks have trapped themselves in a Catch-22. By encouraging the buildup of unproductive debt, they have created the very deflation they sought to avoid with easy monetary policies. Inflation cannot be marshalled to reduce debts in a liquidity trap; it will only arrive *once debts have been written down*. Policymakers have been repeating the same policy mistake for twenty years—and now the reckoning has arrived.
- We retain large cash cushions as we await opportunities in real and overseas assets.

Paradigm Lost

At the end of last year, my beloved husband Peter was stricken by something eerily similar to the coronavirus, and it damn near killed him. He has a great sense of humor, fortunately, so in those dark days of winter we fell back on one of his memorable slogans: "Shit happens, does it not?" Pete has a Zen-like brilliance for seeing things honestly and rolling with the punches. This phrase was one of many funny and charming things that made me fall in love with him. Now that he's on the mend, I can share how much I empathize with the disorientation and anxiety many people are feeling now.

Entropy is the natural state of the world, although we humans prefer a more ordered existence. Usually *homeostasis* keeps biological and social systems within equilibrating boundaries, as we oscillate between periods of order (as innovations are standardized and spread) and disorder (shocks to the system that spawn creativity and change). However, we *homo sapiens* are too clever by half, in our attempts to impose order and resist disruptive change. As Alan Watts explained in his 1951 masterpiece, The Wisdom of Insecurity:

> *The more one studies attempted solutions to problems in politics and economics, in art, philosophy and religion, the more one has the impression of extremely gifted people wearing out their ingenuity at the impossible and futile task of trying to get the water of life into neat and permanent packages.*

Our attempts to create order meet the human need for an explanatory narrative, as well as a desire to solidify and share the benefits of innovation across society. Usually the goals are increased efficiency and/or reduced risk. Civilization would not have advanced as far as it has without standardization and scale. Yet it's in our nature to go too far; when it comes to social and natural systems, we often seek to ~~stop change~~ impose order where it doesn't belong. In his marvelous book Antifragile, Nassem Taleb catalogues the perverse results of man's Sisyphean attempts to contain risk. Quite often, the results are akin to squeezing a balloon: reduce risk in one area, and it pops up unexpectedly (and often magnified) in another. When we think we have everything under control, we discard buffers against failure. As Taleb writes:

> *"Mother nature gave us two kidneys when we only need about a portion of a single one. Why? Because of contingency. We do not need to predict specific adverse events to know that a buffer is a must. Which brings us to the buyback problem. Why should we spend taxpayer money to bailout companies who spent their cash (and often even borrowed to generate that cash) to buy their own stock…instead of building a rainy-day buffer? Such bailouts punish those who acted conservatively and harms them in the long run, favoring the fool and the rent-seeker."*

The coronavirus illustrates the tradeoffs between efficiency and resilience that we described in our *Valor Added* letter of last summer. The adverse effects of the disease have been magnified by our having allowed precautions and preparations to dwindle—at the household, corporate and government levels. The only constant in life is change, yet we are shocked when something comes along and disturbs our lives. We forget that shit happens, yes it does.

It Ain't Over 'Til It's Over

The recent peak in newly-diagnosed cases—in this first, acute phase of the pandemic—has analysts writing the beginning of the end of the coronavirus story. Yes, it's a great relief to know that social distancing is effective at curbing the spread of disease. And it's certainly true that antibody testing (available at scale in May) will, by identifying those who have developed immunity to the virus, allow a gradual reopening of the services economy. Immune individuals, most especially health and care workers, will be a lifeline to vulnerable individuals who simply cannot run the risk of getting sick. As will teachers who can help to reopen schools.

Even so, we believe this disease will likely represent an ongoing burden to society. Given the speed with which the shutdowns occurred, it seems unlikely that large swathes of the community have yet developed resistance; experts estimate 2-5% US residents have been exposed to date. I suspect the proportion is higher; samples taken in other countries suggest exposure rates might be as high as 20%. Still, that would leave us well short of the 50-70% that is needed to create "herd immunity." Absent a vaccine or demonstrably safe and effective treatments, the high rate of severe illness creates psychological (and financial, and liability-related) impediments to resuming everyday life.

We don't yet know why such a large number of relatively young and healthy individuals have been hospitalized, or how lasting are their physical scars. Our testing regime is not sufficiently established to deploy early treatment with *Plaquenil* (when it's believed to be most effective). Other promising therapies are either unproven (*Remdesivir*) and/or costly (blood plasma donations). Synthetic antibodies offer great promise, but progress will require accelerated testing, approval, production AND ensuring that these therapies are affordable.

There's no question the country needs to get back to work as soon as possible; the alternatives are catastrophic. We need some kind of 'smart' quarantine system, supported by widespread testing and mask-wearing. A recent report from by German researchers, [Making the Fight Against the Coronavirus Pandemic Sustainable] identifies the conditions that must be met before economies can be reopened safely: "coordinated, large-scale testing to monitor the spread of the virus and immunity of the population"; "comprehensive and unrestricted medical care"; "regional and supra-regional coordination of ventilation capacity;" and an effective communications strategy by political leaders who are "considered credible and of integrity."

Unfortunately, we are not nearly there yet, nor are most other countries. It will take most of 2020 to sort it out, and even that could be optimistic. It looks increasingly likely that the US (or at least parts of it) will use the good news from early April to justify lifting the shutdown, regardless of preparedness. Considering that we don't know how durable are our antibodies, or how great is the risk of mutation (the 1918 flu's second wave was more deadly than the first), such a course risks significant loss of life. Predictably, those with the fewest resources—especially frontline service workers—are being asked to bear the lion's share of the burden.

Which brings me to what I consider the main story here. I am probably more optimistic than most about the availability of medical remedies for this disease. However, its ultimate impact (which we will see in the variation in fatality rates across cities, states and nations) will reflect primarily socioeconomic factors. The United States will not fare well in that analysis, given the unequal distribution of resources (financial and otherwise) that are being deployed to help society cope with this disease. I believe that this first phase of the pandemic represents the end of the beginning—the first chapter, if you will—of a longer and far more challenging tale. Here are some of the outcomes we anticipate as the story unfolds.

Welcome to the United States of Debt

The US Federal Reserve has pledged a virtually unlimited supply of funds to backstop public and private debts. Treasuries, agency mortgage-backed securities, municipal bonds, US dollar swaps, commercial paper, corporate credit and all manner of securitized loans—you name the debt, the Fed has committed itself to ~~printing~~ lending money to allow the government to buy it.

The only things the Treasury can't (transparently, yet) purchase are publicly-traded stocks, although the Fed has said it is willing to backstop those too. In fact, the Fed is already supporting the stock market by guaranteeing the debt—including, now, a lot of junk bonds—that keeps it afloat.

Some claim the Fed had no choice. That's because, over the course of three decades, our monetary policymakers eliminated virtually all incentives for investors—and by extension the firms that rely on their capital—to limit risk in portfolios. The result was as obvious as it was inevitable: massive amounts of leverage have been deployed to boost growth and juice returns. Whether you're talking about individuals, corporations or the government, DEBT is the four-letter word at the heart of an economy that has been "financialized" beyond recognition.

High levels of household debt (mortgages, auto loans, student loans, and credit cards) coming out of the Great Financial Crisis were matched in the recovery by a corporate borrowing binge of epic proportions. US non-financial corporate debt now stands at $16 trillion, a record 74% of GDP. Much of the new borrowing was issued to fund stock buybacks, rather than productive investments (or pension contributions, or rainy-day funds). As noted in our October letter to clients (The Fed's Failure) the IMF estimates that ~40% of the corporate sector would be bankrupted by a "normal" recession—and this one is anything but. Even before the crisis hit, one in six U.S. companies was considered a "zombie," whose interest expense exceeds their earnings before interest and taxes. Among smaller companies, the zombie share was *already* close to 25%. As debt levels rose, cash was "returned" to shareholders as if it would never be needed; in the twelve months to last November, cash balances at S&P 500 companies declined by 11%, the largest drop since 1980.

In addition to secured debts are public and private sector pension obligations that remained underfunded at the end of 2019, *despite the longest stock and bond bull market in history*. The Fed was undoubtedly motivated by concern about what would happen to retirees' nest eggs if asset prices were allowed to return to fair value. Pensions would have to be recapitalized by state and local governments that haven't the money to do so. Mutual fund companies would have experienced a run on their assets. Banks and shadow banks, which financed all manner of leveraged investment strategies (including the king of them all, "risk parity") would have collapsed. Having lured investors out onto the furthest limb of the risk tree, the Fed had no choice but to play its final hand. Financial historian James Grant, as usual, puts it best:

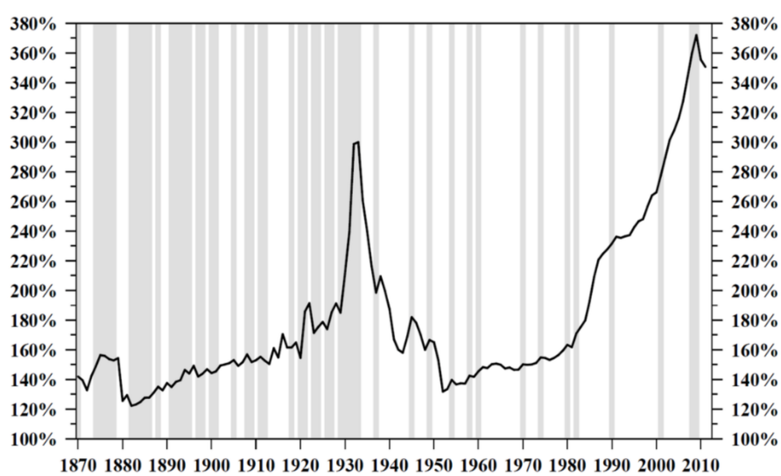
> *"It took a viral invasion to unmask the weakness of American finance. Distortion in the cost of credit is the not-so-remote cause of the raging fires at which the Federal Reserve continues to train its gushing liquidity hoses.* ***But the firemen are also the arsonists****. It was the Fed's suppression of borrowing costs, and its predictable willingness to cut short*

Wall Street's occasional selling squalls, that compromised the U.S. economy's financial integrity…Perhaps never before has corporate America carried more low-grade debt in relation to its earning power than it does today. And rarely have equity valuations topped the ones quoted only weeks ago."

So. The US government has now assumed control over financial markets, tempting investors to act as if we are back to business as usual. Stocks have rebounded to the same lofty valuations (allowing for a modest decline in earnings) that preceded the crisis. There's an implicit assumption that the effects of the coronavirus, however frightening, are temporary.

Leaving aside that we are unlikely to see a rapid recovery in the economy, there's a further assumption that US fundamentals were otherwise sound. At the very least, there's hope that the disruption caused by the virus—which prompted the swiftest market crash since 1929—reflects a *liquidity* crisis that can readily be addressed with emergency credit and budgetary support. This is not a liquidity crisis. It most certainly is a *solvency* crisis.

U.S. Total Credit Market Debt as a % of GDP



Lacy Hunt, Hoisington Investment Management Quarterly Letter, 2015

The inexorable rise in the ratio of US debt to GDP is *prima facie* evidence of the unfortunate fact that most of the funds borrowed over the past few decades—by households, corporations and the government—were not put to productive use. They were not invested in a manner that has generated the necessary increase in income (reflected in faster GDP growth) that would allow these debts to be repaid. In fact, the amount of incremental output generated from each dollar of new borrowing has declined steadily since 2000. Encouraging households and businesses to borrow *even more,* through the inducements of low interest rates and market backstops, hardly solves that problem. Rather, it compounds it.

The US Federal Reserve, like the European Central Bank, and the Bank of Japan before it, has tried to generate inflation through easy monetary policy, with the goal of reducing the real burden of our massive debts. *All attempts have been self-defeating*, because the extra liquidity encouraged ever more unproductive borrowing, and the extension/ recapitalization of debts that can never be repaid. Much of the borrowing was applied (directly or indirectly) to financial assets, which benefited a relatively small number of households with a positive net worth. Meanwhile, interest rates for ordinary borrowers remain far above what can be obtained by large institutions and corporations, driving many households deeper into the hole.

Central banks have trapped themselves in a Catch-22. By encouraging the buildup of unproductive debt, and keeping zombie companies on life support, they have created the very deflation they long feared. Inflation cannot be marshalled to reduce debts in a liquidity trap; it will only arrive *once debts have been reduced*. We have been repeating the same policy mistake for twenty years. As Einstein said, "The significant problems we face cannot be solved at the same level of thinking we were at when we created them."

Wall Street Wins Again

Sadly true to form, most of the relief funds Congress allocated via the CARES Act have been directed toward the financial system. Underwritten by the Fed, leveraged SPVs have been granted *$7 trillion* in financial asset buying power, including support for wealthy investors in high yield (junk) and municipal debt. The real economy, by contrast, will receive ~$1.5 trillion: $500b in loans and grants to small business, $600b to medium-size businesses, payments to households totaling ~$300b, and support for unemployment insurance estimated at $260b.

As large as these sums for Main Street are, they're not nearly enough. The $500b allocated to small business via the Paycheck Protection Program and Economic Disaster Loans represents just 2.5% of US GDP, even though firms with fewer than 500 employees generate just under half of US output and jobs—and two-thirds of all the *new* jobs created each year. If a small business borrower manages to jump through all the hoops, that's just enough to keep the firm in business for 1-2 weeks. Households will receive checks of $1,200-$2,400, with income phase-outs and other conditions attached. Median income in the US is about $60k, or $1,100 per week. So again, we're talking 1-2 weeks of support. Casey Mulligan at the University of Chicago estimates the cost of closing nonessential businesses until July at ~$10,000 per family.

Unemployment benefits are a more significant source of household support; the $600 weekly supplement approved by Congress will raise the average paycheck to $825 (about $20/hour) for a period of four months. However, we are already 1½ months into the corona-crisis and some state unemployment funds are already running out of money. New York, Massachusetts, Texas, California and Ohio will soon have to borrow from the Federal unemployment trust fund to fill the gap, with negative repercussions for state finances. Nor will the support come quickly. There are logistical obstacles to actually getting money into the hands of small business and families, given the paperwork requirements and limited architecture for processing outgoing payments from the government. State unemployment systems are staggering under the weight of so many new applicants. With less than $1,000 in emergency savings, the average American household doesn't have much to fall back on; most of that has probably already been exhausted. It's not surprising that a third of US renters did not make their April rent.

Eventually, the US government will have to do more—much more—in order to prevent an outright collapse in the economy. The Fed has now said that it will backstop small-business loans, given public outcry against the disproportionate support for the financial system. However, *without debt relief* the impact on private consumption will be limited; money from the Fed that goes to pay landlords and mortgage servicers is not essentially different than money from the Fed that goes to purchase rental REITs and mortgage-backed securities. Either way, investors are protected. Households, not so much.

You Break It, You Own It *(Or: Be Careful What You Wish For)*

What are taxpayers getting in exchange for their generosity? A financial system whose risks have once again been socialized, but whose rewards remain in a limited number of private hands. The taxpayer will hold the bag for defaulted loans, but is not guaranteed an equity stake in the companies the government is bailing out. In an *Irreverent Economist* blog post I described the Fed/Treasury move as a "nationalization" of our financial system, given the wide scope of government control. But that's not quite right, since the public does not have ownership rights. It is better described as an organized protection racket run by banks, hedge funds, private equity investors, and large businesses.

> *"When plunder becomes a way of life for a group of men in a society, over the course of time they create for themselves a legal system that authorizes it and a moral code that glorifies it."*
>
> — Frédéric Bastiat

Quoting Bastiat is too generous to our business and government leaders, who have abandoned even the fig leaf of legal authority. The United States spent decades formulating a considered response to the competing claims of creditors via our commercial bankruptcy code. Apparently, we are to abandon those precedents, along with legal restrictions (embodied in the Federal Reserve Act's Section 13(3)) on the central bank's ability to purchase private and municipal securities.

It is hard to imagine a good (i.e., rational, efficient and transparent) mechanism through which the government will pick winners and losers via its asset purchase decisions. Whose debts will be written off, how were those beneficiaries chosen, and what evidence is there that a clean slate will catalyze economic growth? *You cannot revive a consumer-led economy by depriving people who need money to survive while rewarding those who don't need it at all. Even a cynic knows the math doesn't work.*

It's likely that we will see cascading defaults in the small- and medium-size enterprise sector, followed by increased industry concentration as those with favored access to capital buy up former competitors. New business formation has been in decline over the past two decades, and this crisis will pose a fatal blow to many aspiring entrepreneurs. Will large business and private equity investors "roll up" the remnants of formerly competitive markets? What results will their monopolistic business practices produce? We've had a taste of the consequences for brick & mortar retail, the rental home market, nursing facilities, medical device manufacturers and physician practices—most notoriously, Envision Healthcare and Team Health. These firms already had a poor reputation for quality of care and surprise medical billing; they're under renewed fire for salary cuts, layoffs and poor treatment of medical personnel during the crisis.

"Henry, your wife called. She asked you to pick up three extra-large bakeries on your way home."

Over the past three decades, the Fed has short-circuited the rebalancing of wealth that normally results from stock market declines, by printing money to preempt them. In so doing, they have created massive distortions in the allocation of capital, with adverse consequences for growth and the distribution of national income and wealth. During the global financial crisis, aggressive intervention could be justified, at least initially, as an essential stabilizing measure, given the potential risks to the economy from banking system failure. Now we're in a *public health* crisis, whose solution requires a focus on the *public* and on *health*.

Reaping the Whirlwind

Everything that goes around comes around, eventually. By seeking to drive risk in the financial system toward zero, central banks have progressively reduced the potential for real investment returns. Risk can be reassigned, but not eliminated, and there is no return without risk. If the United States follows in the footsteps of Europe and Japan in supporting zombie companies and unproductive investments, the prospects for public market investors are not auspicious: the Japanese stock market topped 30 years ago, while Europe peaked 20 years ago.

There are crucial differences between the Unites States and Japan (or Europe for that matter) that suggest a potentially worse outcome in this country. For one thing, Europe and Japan—not to mention China—are *creditors* to the United States; we rely on them for "vendor financing" so that we can continue to run large trade deficits. If the US prints money in order to prop up failing companies, while suppressing default risk premia, it's just a matter of time before foreign investors look elsewhere for return. The shale industry "miracle" is the poster child for Fed-sponsored capital destruction, and will soon be put out of its misery by Russia and Saudi Arabia. Not only will financing dry up, that source of support for the external accounts will disappear. A weaker dollar will (eventually) have inflationary consequences, especially in a deglobalizing world characterized by rising labor costs and supply chain disruptions.

Japan and Europe are also, on the whole, more egalitarian than the United States, with a greater sense of shared sacrifice in addressing their financial challenges (although the people of Greece would certainly disagree!) That said, when US captains of finance, leading politicians, sports team owners and media personalities start calling bullshit on corporate and hedge fund bailouts, you know we're in the 9th inning of this game. Policies change when no one—not even those who benefit from them—accepts them as fair.

We expect to see a rising number of labor and debt strikes, as households reject the "deadly virus vs. destitution" tradeoff being offered to them as shutdowns are lifted. Already, workers in lower-paid "essential" industries are going on strike, rather than running unprotected risks to their health. Generous unemployment benefits are making it far easier for them to do so. The sense of betrayal among the rank and file toward their employers is palpable. Stories such as this Texas company docking its employees' benefits, and this one about Tesla's layoffs following a strong earnings report (after Elon Musk called coronavirus worries "dumb") are dumbfounding. There are hundreds of such stories, including many about healthcare workers being denied PPE—or not allowed to bring their own. Collective action is far more difficult than it used to be, given segmented labor markets. However, the shabby treatment many workers have been experiencing is galvanizing action.

The coronavirus provides a similar focal point around which large numbers of debtors will likely choose strategic default on their unsecured loans (rental contracts, student loans, medical billings and credit card balances) in an echo of the "walk away" strategy mortgage borrowers pursued back in 2009. Deferral of credit card payments—while double-digit rates of interest continue to compound—can hardly be considered relief. Relief checks don't support households when they can be seized to meet debt payments. It's one thing when a person feels like he or she is the only one struggling financially. But when 30% of the workforce is in the same boat, there is far less stigma associated with saying "I'm done" — especially when wealthy CEOs, investors and hedge fund managers are being bailed out. The greater prevalence of social media as compared with 2008-09 means such trends may snowball. The Fed might be able to underwrite $10, $20 or $30 trillion in private debt, but it cannot absorb the entire US financial system while keeping the Emperor clothed.

All to say that even when the pandemic is behind us,
its consequences for financial markets will reverberate for years

* * *

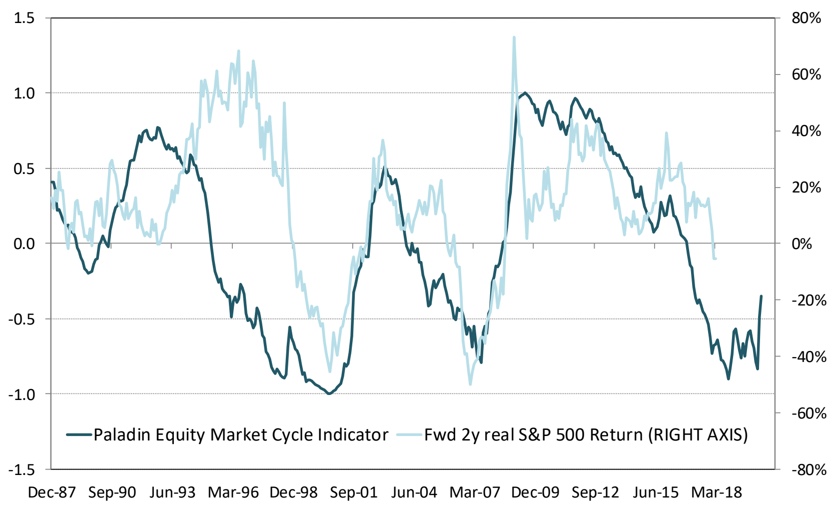
Paladin Strategy

Paladin's structural analysis of our current predicament is paired with an assessment of relevant cyclical factors (sentiment, liquidity and business cycle conditions) to determine whether stock market investors will be adequately compensated for the risks they're taking. Many of these indicators have been signaling a waning economic cycle for the past two+ years. As a result, Paladin clients entered 2020 with equity exposures that were near the low end of their dynamic allocation ranges, as well as a substantial cash position. We took further defensive steps in early February as we watched the epidemic gain tragic force in China.

Predictably, pundits have been quick to describe the stock market's "correction" in the past tense. We, like everyone else, are eager to return to normal. We also know that bear markets lay the groundwork for the next bull run; valuations become depressed (increasing their appeal to long-term investors); sentiment becomes pessimistic (momentum-driven investors are either out of the market or short); business input costs fall (stabilizing corporate profitability); and household and corporate balance sheets get cleaned up (creating "dry powder" for new spending, hiring and investment). With this in mind we refresh our equity market indicators to answer the question: How much has the market's decline improved the outlook for stocks?

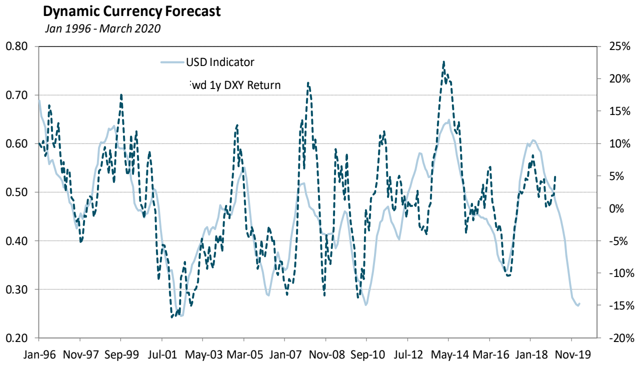
Our 2-year stock vs. bond return model has done a good job of catching major turning points in the equity market cycle. At end-March it had recovered modestly, toward a level commensurate with -20% real US equity returns over the next two years (that's in addition to the 25% decline we saw up to that point). With the markets' retracement, we are still looking at another 30% down. That's not great, admittedly, but better than the -40% to -50% levels recorded earlier.

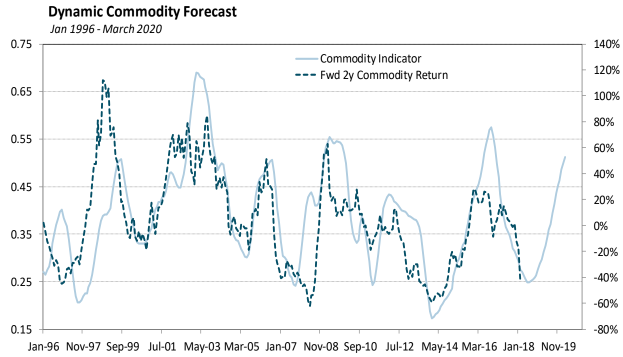
Paladin Equity Market Indicator vs. Subsequent Market Returns
Dec 1987 - Present



Valuations remain at historically high levels, even as earnings contract sharply. Household and corporate balance sheets have weakened significantly, while sentiment toward the market remains mixed. Based on how our equity cycle indicator has mapped to past bear markets, we think we were *roughly halfway through* this downturn at the end of March. That's assuming that Fed liquidity—which is responsible for most of the indicator's rise—is able to neutralize a severe default cycle. If the Fed's ameliorating influence is hamstrung by factors outside its control, such as a chronic public health crisis or debtors' strike, then we're further from a market bottom.

We haven't even addressed the question of what all of this stimulus does to the international perception of US credit quality. The chart below shows our US dollar indicator, which includes as a key input the United States' *twin deficits* – the combination of our escalating trade and budget deficits. We were already among the largest debtor nations in the world before the unprecedented expansion in government spending that's now underway. Our analysis suggests there will be a meaningful decline in the US$ in the year ahead, along with a commensurate rally in commodity prices. The implication is that real assets, including natural resources, real estate, and inflation-protected bonds will offer attractive investment opportunities in the years ahead. Not right away, of course; it is likely that we will first see a deep recession and deflation.





A weaker US dollar, coming amid a disentangling of global supply chains, is likely to result in increased labor and other input costs—and higher inflation over the long run. In this environment, we're retaining our substantial underweight to equity and similar risk assets. We are also overweight cash—which is king once again.

There is no longer a margin of safety in the fixed income markets. Already-precarious state and local finances will be decimated by the cost of the COVID-19 response; we have reduced client municipal bond exposure accordingly, and continue to avoid corporate bonds. Given the broad-based solvency issues discussed in this letter, credit looks to be fundamentally broken for the foreseeable future. Nor is the risk-reward skew on duration attractive with the 10Y US Treasuries yielding 0.8%.

We can only assume that other investors are coming to similar conclusions. As such, the Fed must be prepared to buy an astronomical sum of securities if they are to continue propping up markets. This is money printing on a whole new scale. Opportunities are likely to be better in areas where the hand of global central banks is not quite so heavy. We expect that our clients' portfolios will eventually include a hefty share of non-US dollar assets, including foreign currencies, equity, real estate and other real assets. The key challenge over the next 6-18 months will be balancing the poor outlook for the US dollar against ongoing risk to any asset that has exposure to a deteriorating business cycle – including commodities and foreign stocks. For now, we have a sizable investment in the Japanese yen, a safe-haven currency, and are looking to build exposure to natural resources, renewable energy, global real estate, and foreign equity (with emphasis on Asia).