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Celestial
WEALTH MANAGEMENT

IN THIS ISSUE

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I. Startling Changes in store over the next decade

Over the past ten years, our culture has changed in a myriad of ways because of the internet. Businesses have thrived or failed based on either seeing or failure to see the change around them. Typically, change happens slowly at first and then rapidly. That is what many call the "S Curve" effect that has driven adoption of everything from computers to mobile phones. At first, early adopters venture in to say they were first. Often, they get stuck as the kinks get worked out, but they often have early appreciation for what the new product can do to enhance their lives. Then as more and more people begin to adopt the change, the product typically cheapens.

I recently read an article on the driverless car being pioneered by Google. I had seen videos of this car online so I know it exists but it may be further along than many of you can imagine. **Google's test vehicles have cumulatively driven almost 1 million miles WITHOUT A SINGLE ACCIDENT.** Did you know these cars are currently legal for street use in five states? They are also already permitted on every major highway in the United Kingdom.

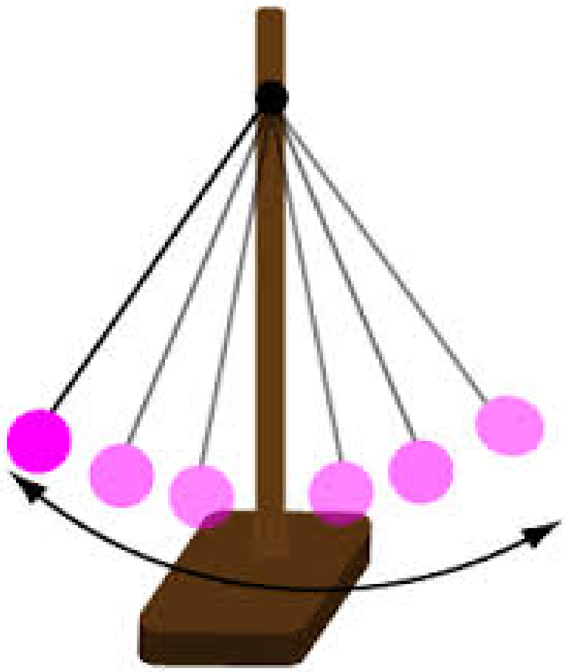
The technology has arrived and is most likely coming to a road near you. The RAND corporation issues statistics on the auto industry. They state that self-driving cars will basically eliminate the 5.3 million auto crashes that occur in the U.S. each year. Those crashes cause 2.2 million injuries and 32, 000 fatalities every year. Further, car accidents are the numero uno killer of adults aged 15-29 and the number two killer of children ages 5-14. If driverless cars are the way of the future, what are the implications for society and what are the implications for the investment world?

Once you begin to think deeper, I think there may be some distrubing conclusions. First, what happens to taxi drivers or my favorite service Uber? These cars could cause the elimination of millions of jobs as a car driver. Thinking deeper, why would we need truck drivers? Why would we need truck stops for those drivers that don't exist? You can already see in a parking garage near you the lack of parking attendants. These jobs are being replaced by automatic card readers. But, without drivers we wouldn't need garage attendents, tollbooth operators, parking meter maids, and valet services.

Further, if the crash rate really is zero or close to it, why would we need auto insurance? Visits to the hospital would be greatly reduced, as would the need for auto parts due to car crashes. Municipalities would lose millions in revenue from speeding tickets and parking violations that no longer occur. According to the National Highway Safety Administration, speeding tickets generate $6.2 billion of revenue for local governments. All of that would vanish. The driverless car has the ability to completely change the auto industry, the American economy and the employment situation of millions of Americans. If this comes to pass there will be opportunity and there will be societal costs. It will be interesting to see how this plays out.

II. Lessons from Mr. George, Mr. Marks and Mr. Templeton

I constantly try to better my self as an investor and as an advisor. One of the best ways to do this is to read. I often read missives, letters and books from some of the best investors in the world. Early in my career I was quite impressed with Mr. George Soros, his track record and they way he thought about the markets. I have tried to implement a lot of what he believed into my practice. Recently I read a piece by Morgan Creek Capital Management and its CEO, Mark Yusko. Mark previously ran the endowment for the University of North Carolina before founding his own firm. He is one of the brightest minds I know and I have learned a lot from him. His recent market review and outlook letter is loaded with information and has many quotes from George Soros. One of his beliefs and my own, was that it was impossible to know what others knows or don't know. Everyone participating in the financial markets does so for their own reasons but we all impact the markets in aggregate. In my opinion, the actions we take in the markets are largely the byproduct of how we perceive the environment in which we live.



There are many out there who believe that market participants are rational and that prices are always the fair value for an asset. The asset always represents a fair value based on all available information. I completely disagree with this notion. In my opinion, as well as Mr. Soros', the markets tend to move towards disequillibrium because the actions of market participants, aided by their emotions, biases or misconceptions exaggerate market moves further than they should go. Outside of a textbook, I believe the concept of equilibrium has no place in the real world. I would argue that financial markets are quite the opposite from being efficient pricing mechanisms. As Howard Marks states, the financial markets spend the majority of their time swinging like a pendulum from overvalued to undervalued and back again. They rarely stop on fairly valued. The current market price of a security is not a reflection of the "fair value" but rather a temporary "unfair" value driven by the actions of market participants. It is up to the investor to decide if that price is undervalued or overvalued. A perfect example of this would be the go-go internet stocks that peaked in March of 2000. Investors placing new money in many of these stocks would be sorely disappointed as the market collapsed. Today, many of those same companies (those who survived) are only worth a fraction of their prices in 2000. The reality is that no one ever has complete information. The best we can hope to do is make an educated guess. Human beings constantly act on their misconceptions and those actions often distort financial markets.

For those who believe in efficient markets, bubbles cannot exist. I believe in bubbles. Every bubble consists of a trend, backed by rational analysis that can be observed in the real world. Then humans pile on that trend driving it to a point that doesn't make sense anymore. Was the 2005-2008 housing market a bubble? When interest rates are low, conditions are set for bubbles to potentially develop. They rarely happen when debt is costly. When money is free or close to it, the rational lender would keep on lending until there is no one else to lend to. It seems that is exactly what happened in the housing bubble. When banks started making loans to people with no assets, no job and no income (NINJA loans) one had to realize the music was about to stop….but few wanted to believe it. What was the herd doing at that time? The majority were loading up on index funds that were full of banks, financials and housing stocks that had already run up, just in time for those banks to crumble. Once again, like the tech bubble, investors found out that price can be a liar about value. John Hussman says, "You can either look like an idiot before it pops or you can look like an idiot after, which do you choose?"

Sir John Templeton, one of the most famous investors said that investors would often ask him where is the best place to invest and he would respond that this was the wrong question to ask and that they should ask where is it most miserable? Investing capital where it feels comfortable will often yield mediocre returns; not bad, just not great. In my experience, when I invest in something that feels ok, I get an ok return, when I feel really good about it I will most likely lose money and when I feel a little nautious about investing, I will likely make money. Soros says, "the worse a situation becomes, the less it takes to turn it around, and the bigger the upside."

III. Gold and Mining Stocks

A February 12 CNN Money article quoting an executive from metals retailer Kitco basically stated that owning gold (at $1200 oz.) as a hedge against inflation or government miscues is crazy. That in itself isn't that important because I have heard that for over a year. What is interesting is that same executive stated "As long as people are terrified that their purchasing power is going to be eroded, gold goes to $3,000 an ounce." **That quote was from August 17, 2011** when gold was trading around $1900 oz. One person, two viewpoints at distinctly different price points of gold. In 2011, article after article talked about gold without any negative potential. Here's a chart of the five wave advance of gold from 1999 to 2011.

- "Deutsche Bank Eyes $2,000 Gold." (Reuters)
- "Five Reasons Gold's Headed for $3,000." (MSN Money)
- $5,0000 gold later this decade?" (Gold Alert)

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I bring this up not as a reminder of what once was, but because of the human condition of linear extrapolation. **We tend to assume whatever happened in the recent past will continue.** It is called "recency bias". As you might imagine, at the moment there aren't many in the United States who see a reason to own gold. This negative sentiment that seems to have crested back in November coincides with a five wave move down from the 2011 high.

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There is little inflation to be seen, the economy is supposedly on the mend, and supposedly the Federal Reserve has it all under control. My insurance agent once told me it does no good to buy insurance after the flood. I take that to heart, because in my opinion, when the time comes that gold will again be a great diversifier, an inflation hedge and a store of wealth, it will be hard to find it at a reasonable price. It is best to have an allocation before that happens. **From a price, volume and sentiment perspective, it is quite possible that after a three year bear market, gold bottomed back in November.** Only time will tell but sentiment and price action seems to confirm that thought. If I were to make a prediction, my guess is that gold heads toward $1400-$1434 at some point in 2015. That price point would match the summer 2013 bounce high and seems like a logical point that a rally would need to consolidate. If gold were to move to that level, it would represent an obvious point to reevaluate the position. A decline below the November low would change that opinion.

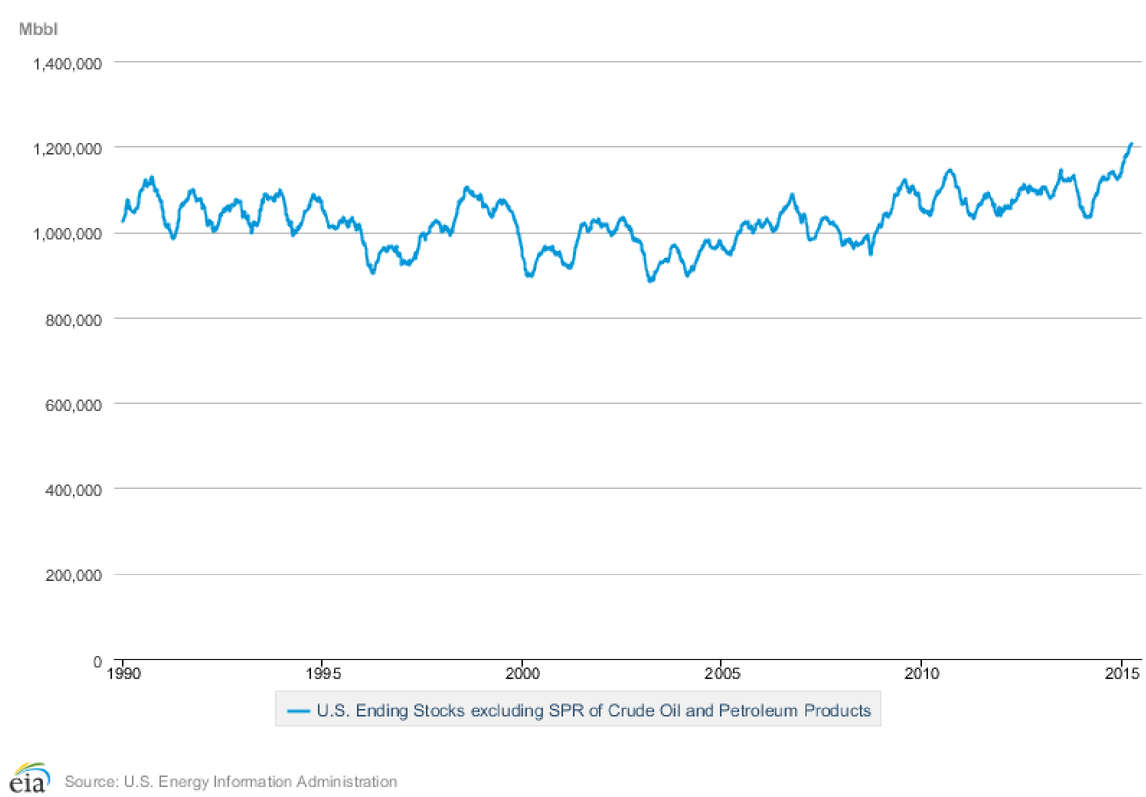
There are many who think that if the US dollar strengthens, gold will not be able to head higher. In the 1976-1980 gold bull market both the dollar and gold were going to record highs, but you also had inflation going up on a monthly basis. Additionally, interest rates were rising, which is counterintuitive to what you would expect to see**. If the dollar continues its rise, it DOES NOT mean that gold cannot rise as well.** It has happened in the past. Regardless of what the price of gold does, in my opinion the mining companies are just screaming significant value for the patient, long term investor. High quality mining companies with low debt levels, quality assets and solid cash flow could do very well in this environment. There are many mining companies trading at prices below the value of their assets (book value). The drop in oil prices is a major tailwind for the mining companies. As you might imagine, a large expense of the mining companies' costs is fuel related to heavy machinery operation. With oil, gas and diesel fuel down 50% from last June, that is a major tailwind. Just be prepared for volatility. All this space needs is a change in sentiment from bad to less bad.

IV. OIL

As you know, the exploration, transportation and procurement of energy has been a primary investment theme of mine for over three years and I don't see that stopping anytime soon. Energy is the heartbeat of the global economy and oil is the primary source of worldwide fuel at this point. Therefore, it is important to have an idea of the situation and price action in what I believe is the most important energy commodity in the world.

As pundits and investors alike attempt to catch the falling knife that is oil, savvy private equity firms such as Blackstone and Carlyle are currently raising billions right now to take advantage of a potential buying opportunity that may arise later this year. While it is possible that West Texas Intermediate oil (WTI) bottomed out just above $40 in mid-March, the fundamentals of supply and demand make me think this is a dead cat bounce.

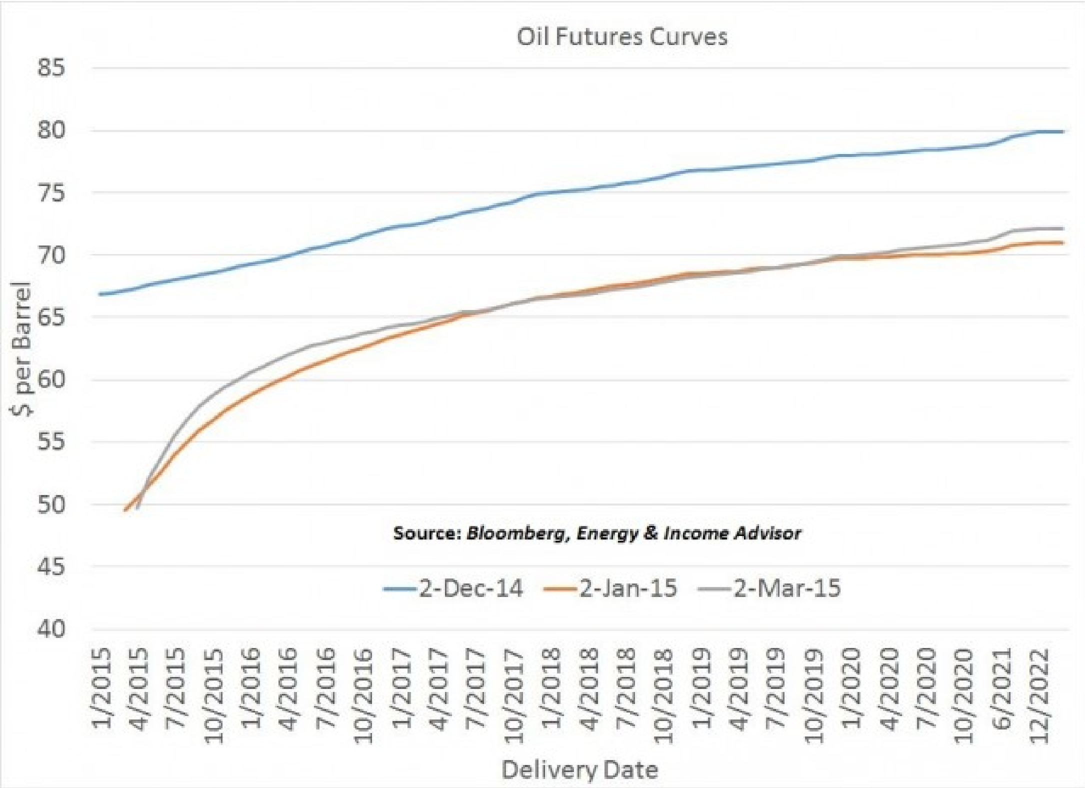
Total Stocks



- First, many of the smart drilling, exploration and production companies hedged at least a portion of their oil production in the futures market at north of $80 a barrel. Meaning that current production is not being sold at the spot price around $50 but instead at much higher levels. According to Fortune magazine, this smart hedging has allowed production levels to reach a 32 year high of 9.4 mbd (million barrels a day). The U.S. is producing 14.5% more oil than this time last year, which means supply is continuing to grow. This chart shows existing inventories.
- Second, it is possible that U.S. government statistics are underestimating the already elevated levels of oil building in inventory. There are a number of wells that have already been drilled and fracked and are ready to flow…..but they have been capped off for the time being. As soon as prices begin a sustainable rise, this oil will most likely be brought to market.

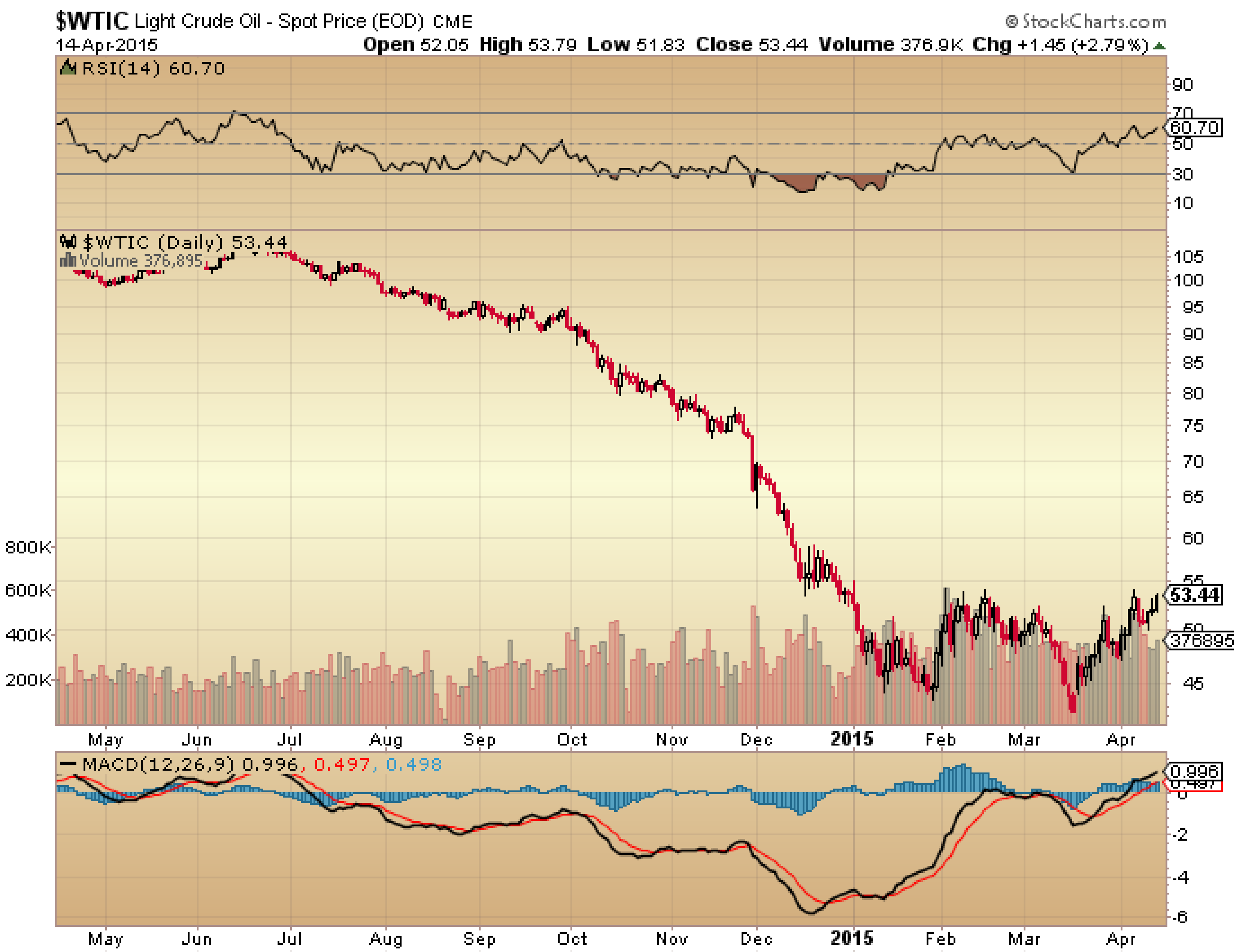
- Third, it appears oil demand is roughly flat and perhaps even falling. One would think with lower prices that demand would increase. So far, that doesn't seem to be the case.

So, you have supply exceeding demand and overrunning the storage facilities in Cushing, OK. Now, oil tanker ships like this Suezmax ship from Nordic American Tanker, are being procured by investments funds, corporations and other speculators to hold oil to sell in the future. Why would these entities engage in this sophisticated trade? You see the futures market shows the key to where the large money (investment funds and corporations) see oil prices out in the future. This chart is a from early March, but it shows at that point the spot or current price of oil at $50 and the price one year out at about $60. So, theoretically, you could buy a barrel of oil today at $50, store it somewhere (Cushing or on a tanker, or your backyard) and buy the contract to sell it at $60 and lock in a risk free $10 per barrel profit (before subtracting storage costs). My feeling is that the curve needs to look more like the blue one from December than the one from Jan/Feb in order to alleviate the supply problem. If the spread between current and future prices narrowed enough that it didn't provide incentive to store oil; that could push more supply into the market and push down oil prices. In my opinion, this has to occur before the price of oil can bottom out. My guess is that this happens prior to the 4th of July.



In closing, this is a chart of WTI crude oil over the past year. Typically when a decline of a commodity is this swift, a countertrend rally often called a (suckers rally) occurs. This acts to suck more investors in before the commodity heads lower toward its ultimate bottom. Longer term I am a firm believer that the second phase of the U.S. energy revolution will occur. But, first we must get through the shakeout period that follows phase one. There are too many companies that took on too much debt to explore for oil, didn't hedge themselves and are now bleeding money. These companies need to be acquired or fail. The key, I think, is to focus investment on the best positioned players with high quality assets, solid cash flows and lower debt levels. These companies will most likely acquire the assets of many struggling companies in the coming months, thereby creating even stronger enterprises for future growth.

I believe as does Blackstone and Carlyle that opportunity is coming in the back half of this year. At that point, one would invest in high quality companies with juicy yields and just wait for oil prices to rise.



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V. Investment Ideas

- **Rather than trying to "beat the market", focus on beating the rate on cash. Plan for lower volatility and liquidity while seeking positive returns.**
- Equity valuations are very rich but masked due to the distortion of the Treasury curve. I believe volatility will return to the markets and think long/short managers are best positioned to capture this volatility by owning companies with strong businesses, barriers to entry, and good valuations and selling short weaker companies with high debt loads that have risen sharply with the broad market rally. I think this strategy of hedged equity may have the potential to produce attractive risk-adjusted returns if and when investors begin to question the valuations of companies. Stock investing involves risk including loss of principal. No strategy ensures success or protects against a loss. Long positions may decline as short positions rise, thereby accelerating potential losses to the investor.

- In 2013, the Affordable Care Act began implementation. There will be many winners and losers in the healthcare industry as a result of the biggest change in the healthcare industry's history. With the largest portion of the U.S. population entering their golden years, healthcare needs will become even more important. Long/short Healthcare seems to be a very attractive way to invest in a sector with lots of potential and lots of potential pitfalls. Investing in a specific sector involves additional risk and will be subject to greater volatility than investing more broadly.

- While there isn't a current shortage of energy on the planet, it is taking more and more energy to discover, drill, transport and refine it. Long term demand should continue to grow globally, particularly in China, India, and other developing countries.

- Potential food shortages due to inclement weather and higher demand from the emerging Asian middle class could result in a boon to agricultural land and potash fertilizer companies. International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

- Tight supply and a depressed single family home market are combining to keep apartment buildings full while driving rents higher. The number of potential renters continues to expand as a large cohort or echo boomers enters the workforce. Rents have been increasing as the desire to remain mobile and inability to secure home financing keeps renting attractive. In addition, low supply of new rental units should allow this space to flourish. Apartment REITS typically offer dividends and potential appreciation opportunities. Investing in Real Estate Investment Trusts (REITs) involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

- Precious metals mining companies have been extremely beaten down over the past two years. Mining is an industry that spans hundreds of years. These companies have been through good times and bad. Companies that mine for commodities are often highly cyclical, meaning they have sustained moves both up and down. When investing in the mining space it is important to be a contrarian. Ideally, I believe you would want to accumulate miners when sentiment is poor around them and sell them when sentiment is positive. Historically this has been a good strategy.

No strategy ensures success or protects against a loss.

Regards,

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