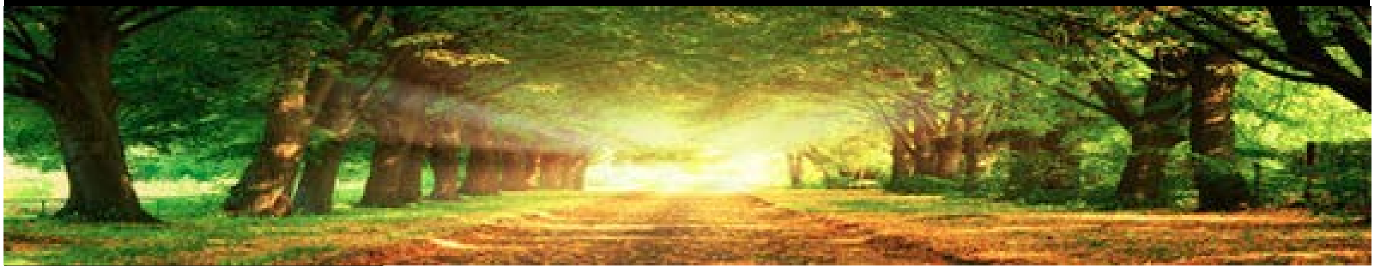

Celestial Wealth Management

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Summary

Are you one of the many who are told what to think about the markets by the media? Do you blindly believe what others tell you about the markets? Do you only read articles that confirm your own personal investment biases? Or, do you question the "groupthink" that is often regurgitated in the financial media? I am sure you have read many opinions about why a Donald Trump presidency would be good or bad for the financial markets. However, how much does it matter? Over time, despite what they may believe, Presidents have little effect on the financial markets. Earnings, valuations, investor sentiment and inflation have a much larger effect on the financial markets than anything done in the oval office. It is important to remember to stick to your strategy, look for value and remove emotions from your investment process. Often the opinion by the majority is wrong and it takes courage to step out from the crowd.

On the sentiment front, the socioeconomic case laid about by Robert Prechter's group makes a lot of sense to me. The latest Gallup polls show that President Barack Obama is enjoying a 57% approval rating, which is the exact same rating former President, Bill Clinton had when he left office in November 2000. **The one common denominator is that the U.S. stock market was within earshot of an all-time high on each occasion.** Of course, this is not 2000. In this very polar election process, you had a candidate representing the bull market establishment taking on a candidate whose rise was tied to the frustration of a large number of voters with that same establishment. This push and pull of growing angst among many (often called populism) could be the Western world's equivalent of an Arab spring.

Following Great Britain's decision to exit the European Union, Mr. Trump and Bernie Sanders' ability to appeal to a large swath of the U.S. is a form of populism as well. These are the sentiments that often accompany a bear market not a bull market. Let's all hope President Elect Trump's "Make America Great Again" slogan takes hold. I prefer to look at each presidency with a glass half full attitude. But, after each election roughly half of Americans will be unhappy with the outcome. I hope he can galvanize our government to work together. With a lackluster economy and a stock market that has not advanced in 24 months, the potential for more downside volatility is there. However, the potential for positive change is there as well. It's important not to get too excited or too fearful of this presidential transition.

Interestingly, since Mr. Trump won the election, the financial markets seem to be focusing on his economic policies and has rallied. The Dow Jones Industrial Average hit a new high but was very narrow in the advance. Infrastructure related stocks, such as engineering and construction firms, basic materials and heavy equipment manufacturers have been rallying. Additionally, healthcare companies have experienced a significant rally. But, both sectors are still below their 2016 highs. On the downside, gold, emerging market stocks, global bonds and U.S. bonds have begun to sell off as well as utilities, consumer staples and REITs. Those "safety stocks" I spoke of last month, have begun to reverse the extreme overvaluation I saw. Many have declined north of 10% so far. There will come a point where these companies will return to a fair value and become attractive again but for now I would have minimal exposure to them.

Jesse Livermore, author of Reminiscences of a Stock Operator once wrote, The *average American is from Missouri everywhere and at all times except when he goes to the brokers' offices and looks at the tape, whether it is stocks or commodities. The one game of all games that really requires study before making a play is the one he goes into without his usual highly intelligent preliminary and precautionary doubts. He will risk half his fortune in the stock market with less reflection than he devotes to the selection of a medium-priced automobile.*

I think this quote is important to keep in mind. Embracing investment strategies with an attitude of "cover my eyes, bury my head and hope for the best" is in my opinion less than reasonable. Investing without sensitivity to price or the value you are getting for your investment is like buying a car, a house or clothing without analyzing the price and the value you are getting. Very few of us would buy a new car without checking prices online, researching multiple dealerships and performing a test drive. Why should investing your life savings be any different?

"Buy low". Easy to say, soooo hard to do. It will always be hard because it is so unclear what "low" actually is. There isn't a bell that someone rings to let you know the bottom is there. Through my research I spend quite a bit of time analyzing asset class valuations in an attempt to assess fair value and then compare it to the current price. That helps me look at current prices and valuations with a historical background. I have no idea if 18,500 is roughly the DJIA market high for this cycle, but I can say that I believe it is not anywhere near the "buy low" area. Valuation analysis can never give you a clear signal but it can serve a role in risk management by telling you areas to emphasize or de-emphasize.

Thoughts from an Investing Legend

One of my investing "heroes" is Seth Klarman of Baupost Group. Interestingly, he grew up in Baltimore near the Pimlico Race Track. His investing prowess has generated a 16.4% compounded annualized return for his investors over a 33 year career. (He compounded $1 to $150, source Morgan Creek Capital Mgmt.) In 1982, Baupost was formed with $27 million. He now runs one of the most successful hedge funds in the world amassing $30 billion in assets. Unfortunately, his minimums are so high that only the largest institutions in the world have access to his fund. But, that doesn't mean we can't learn from him. Klarman started managing money with the basis that the best way to compound wealth was to avoid losing large amounts of money and keep the power of compounding working in his favor. The power of compounding should never be understated. The world of market index based investing has completely missed this mathematical power in my opinion. Routinely sitting through 30-40% index based portfolio losses significantly erodes the power of compounding.

In order to not lose money, Mr. Klarman surmised that he needed differentiated insight. He believed he couldn't overweight his portfolio in the most widely covered (and therefore overanalyzed, over-owned and overvalued) stocks. This is exactly the opposite of index based investing, which blindly funnels ever more capital into the names that recently have performed best. He had to focus on buying those out of favor names that he calls "bargains". Essentially buying cheap assets. His view was that you were buying a big discount and getting a "margin of safety". Interestingly, he wrote a book called that in limited production. It is occasionally available on Ebay for north of $500 for anyone interested.

Another key point to his investing philosophy was that he needed to be patient and wait for the bargains. To use a baseball analogy, there was no need to swing at every pitch like an index that holds everything. He was willing to hold cash or short-term, secure investments while he waited for the "fat pitch" that came right down the middle. He just had to make sure to swing when it came. It is routine for him to hold 30-50% in cash when he feels bargains don't exist. Amazing that his returns over time were so good while holding all that cash. A misconception is that he generated those returns in spite of the cash. He argues that he earned those returns because of that cash. Because he was never fully invested, he was always able to deploy capital when opportunities arose. Cash has protective capabilities that help protect portfolios during market dislocations and provides liquidity to buy bargains after those corrections occur.

What is Value?

Price and value are two different things. In theory, investors should only buy stocks, bonds, real estate and other assets when the price is meaningfully lower than its value. For example, getting $1 in assets for 0.70. Buying assets with a "margin of safety" is potentially a way to help preserve the value of your portfolio from losing money over the long-term. Value investing requires a great deal of hard work to find the bargains, it requires discipline to step outside the herd, and it requires a long-term investment horizon. Simplistically, that means buy low, be different and disregard short term movements. That sounds like exactly what individual investors should pursue. **However, few are willing to devote sufficient time and effort to find the potential bargains, few have patience and even fewer actually adhere to a long-term horizon.** I often hear individuals on the street saying that the market is a casino, or that the market is rigged against the little guy. I respond by saying, in the short term I may agree, however the major advantage that individuals have against professionals is the ability to be a long-term investor. Remember, there is always someone on the other side of the trade.

We can all think of examples of things that are good for us, such as eating healthy, exercising regularly, and getting enough sleep, however many people can't do those things consistently. The wildly successful infomercials for P90x exhibit this perfectly. For those that don't know, P90X is a nutritional and exercise program that is very regimented and has extremely good results **IF** you are able to stick to the program for the full 90 days. Statistics show that the average person loses anywhere from 20-30 pounds in 90 days (source Modica Fitness). With those results, why do 82% of the people who purchase the program, quit? For the same reason that many investor's portfolios languish; it is hard.
People are always looking for the easy way out, the short cut. With investing, there are no short cuts. ***That is why there is opportunity for those who are willing to put in the work and be different.*** Often, the worst thing to do is what has done well in the recent past. Unfortunately, that is what too many people do. When I ask people what their 401(k) investment strategy is, the answer is often one of two responses:

1. I chose my investments based on the best returns over the past 3 or 5 years
2. I put 10% of my capital into each of the 10 best performing investments

I would argue that option 2 is better than option 1 because of the diversification but I would also argue that both strategies are woefully poor and I would have expected people to put more time and thought into their life savings.

George Soros said it best, *"It's not important whether you are right or wrong, what's important is how much money you make when you are right and how much money you lose when you are wrong."* Mr. Klarman has a similar philosophy. He takes a common-sense view of risk; how much he can lose and the probability of losing it. While that approach may seem outdated and simplistic it really helps provide clarity when building a portfolio. In my opinion, risk is not a temporary movement in the price of an asset (its volatility), but the permanent loss of capital.

Another thing to remember is that there is no such thing as a "value" company. Price is all that matters. At some price, a company is a buy, at another it's a hold and another it's a sell. The goal is to buy the first, avoid the second and sell the third. While this sounds simple, value investing is based upon the belief that markets are not efficient. I think the markets will never be efficient because of human nature. Humans are prone to overreactions in both directions which drive assets to undervalued and overvalued prices. I feel as though whether in athletics, or in investments, it's an enormous advantage to have opponents who believe that it is too hard, so why even try. The hard part of a value based strategy is maintaining the psychological ability to stick to your strategy in the short term even when it looks as though the strategy is wrong. The long cited DALBAR study of individual investors shows that they are inherently anti-value. Generally, individual investors repeatedly buy the most expensive assets and sell the cheapest assets which leads their portfolios to underperform over time. **In my opinion, independent thinking is the best way to pursue outstanding returns.**

Mr. Klarman says, the fundamental principles of value investing can allow you to survive and prosper when everyone else is rudderless. What that means to me is that having a disciplined strategy, whatever that is, provides comfort in times of stress. Constantly changing your strategy based on the prevailing winds seems to be a fools errand to me. The logic is difficult to argue against. Buying things with a large margin of safety seems far superior to buying something at a price well above its intrinsic value and hoping to sell it to a "greater fool" at some point in the future. Further, a value strategy is generally of little use to the impatient investor since it usually takes time to pay off. "All an investor can do is follow a consistently disciplined and rigorous approach and over time the returns will hopefully come." When return is the primary goal, there is a tendency to take excessive risk.

As a value investor, your strategy is to buy bargains that financial theory says should not exist. One of the reasons bargains emerge is that investors don't have an adequate strategy for managing through crisis. It is crucial to have a strategy you believe in and the analysis to back it up before a crisis emerges. That gives you the courage to pursue a potential bargain when it arrives. Buying dollars for fifity cents is a good way to make consistent profits.

What about selling? Many investors have great ideas about buying investments but what about selling? I believe this is the hardest part. Tax considerations aside, an investment should be reduced or sold when it reaches a full valuation. The trick of successful investors is to sell when **THEY WANT TO**, not when they have to. Selling around fair value has a number of benefits, including avoiding the potential to be stuck with an asset when a speculative bubble bursts, the greatest number of buyers appear around fair value as the crowd joins the party, and the chance to accumulate cash to rebuy bargains at the next cycle. *Patience and discipline can look foolish, until they make you look prudent and even prescient.*

Short-term performance envy often causes investors to make decisions based on emotion and sentiment and contributes to the mediocrity of many investors' returns. **Investing in what you wished you owned can become a perpetual cycle of underachievement. Emotions tend to dominate short term decisions, but the real culprit I believe is the constant focus by the financial media on short-term performance metrics.**

This is why at Celestial Wealth Management, we are looking for clients with a longer term investment horizon, who are patient, are willing to step apart from the crowd, generally adhere to a value discipline of buying low, and finally, look at crisis as opportunity. If you know of anyone who may fit this description please have them reach out to us.

Investment Ideas

- **Rather than trying to "beat the market", focus on beating inflation and the rate on cash. Plan for safety and liquidity while seeking positive returns.**
- Equity valuations are very rich but masked due to the distortion of the Treasury curve. Volatility is returning to the markets and I 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.

- Monsoon country investments. Attempting to take advantage of demographic, educational and investment possibilities in the countries surrounding the old spice routes of the Indian Ocean. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

- 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.

- A potential U.S. infrastructure upgrade cycle may be around the corner. Moving from our current grade of D+ to B would require an investment of $3.6 trillion by 2020.

- Supply problems remain high across the energy asset class. While there isn't a current shortage of energy on the planet, it is taking more and more energy and capital to discover, drill, transport and refine it. Long term Demand should continue to grow globally, particularly in China, India, and other developing countries.

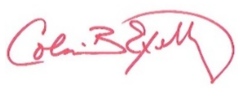
- Potential food shortages due to inclement weather and higher demand from the emerging Asian middle class could result in a boon to agricultural land and potash fertilizer companies. International and emerging market investing involves special risks such as currency fluctuation and political instability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

- The rise of E-Commerce has coincided with an increased desire for efficient warehouse distribution real estate. As e-commerce moves toward even faster delivery, positioning of distribution becomes even more important.

- Precious metals mining companies have been extremely beaten down over the past four years. Mining is an industry that spans hundreds of years. 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, 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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