CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

November 29, 2020

The Election, the Virus, the Vaccine

Momentous weeks. We have a new president elect and a president who will not concede that he lost the election. Last week—some three weeks after the election—the administration agreed to permit the transition phase of the post-election period to begin. Coronavirus infections rise in a terrible third wave in America and at alarming rates in Europe, where the virus had been seen to be well-contained. Hospitalizations increase at a rate that threatens to overwhelm hospitals in many American communities; deaths are again rising, recently at the rate of 2000 per day. Against this are announcements from Pfizer, Moderna and AstraZeneca about the efficacies of the vaccines being developed, from which it appears likely that effective vaccines will be available in 2021. The light at the end of the Covid tunnel is closer than we thought a month ago.

The Fed's monetary support and its vast injections of money into the system have been more important to financial markets than the weakness or strength of the economy and, indeed, more important than the health or illness of Americans.

So far, Mr. Trump's intransigence and prevarications have not adversely affected financial markets, however harmful they are to our democracy and to the process by which the new administration prepares to take office on January 20th. The many legal challenges brought by the Trump campaign and its allies are being withdrawn by the Trump team or dismissed one after another by the courts adjudicating them. Although Mr. Trump has not conceded that he lost the election and although his efforts to overturn the election results continue, a peaceful hand over of executive power seems likely.

As for the virus and the vaccines, problems are considerable. Before one or more vaccines is approved, manufactured, delivered around the world and administered, time will pass, probably many months. During this time, and given the uncontrolled spreading of the virus in America, economic activity falters once again. It is notable that, before the election, there was no new round of federal fiscal support for the economy. Whether even a relatively modest package will be enacted in December or early January is unknown. If the Republicans retain control of the Senate--as will happen unless the two Georgia Senate run-off elections go to the Democrats--the prospects for further support for the economy from the federal government following January 20th are uncertain. Mitch McConnell has consistently asserted his unwillingness for another round of big federal support.

By

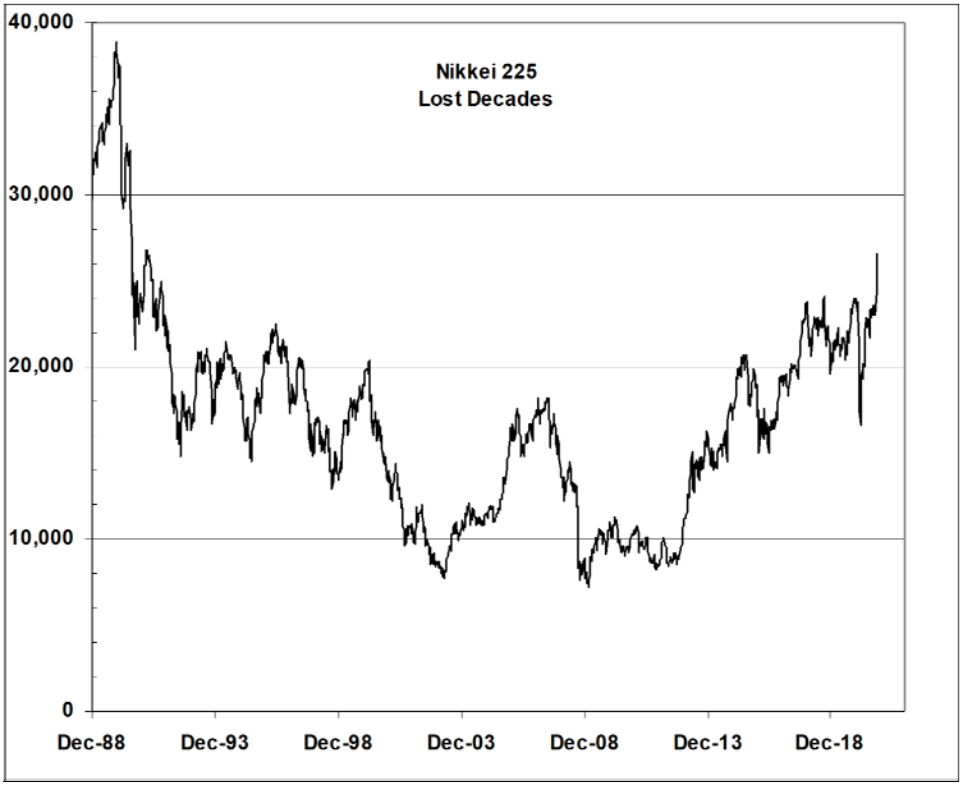
Jack Mayberry

The health or weakness of the real economy is of secondary consideration to financial markets. Odd as this seems, the experience of the last six months has shown us what matters now. The first round fiscal support provided by the CARES act that became law in late March and the immense and ongoing monetary support provided by the Federal Reserve since then demonstrate what really matters to markets. The absolutely enormous liquidity provided by the Fed has been far greater than needed to sustain economic activity. This excess

liquidity has flowed to stock and bond markets and to housing. The prices of these assets have risen sharply. The Fed will certainly keep the monetary spigots open wide. With that in mind and with the risk of a contested election seemingly behind us, Core is making new investments.

The chart below shows the principal stock index for Japanese stocks. Note that the index has just reached levels last seen in 1991. It is worth pointing out that, since the early 1990s, Japan has generally had interest rates near zero, periodic bouts of deflation and very little real economic growth. In recent years, the same obtains in Europe and America. Are we becoming 'Japanified?'

As mentioned in previous letters, Core's focus is on the equity markets in East Asia and, to a lesser degree, in Germany. Although I have in mind some investments in US equities, I expect to continue to invest more in Asia and Europe than in America. (As relates to my comments above about the Fed's excess liquidity support for stocks and bonds, note that the liquidity flows to non-US investments as readily as to American ones.) China, Korea, Japan, Taiwan and others have been far more effective in dealing with this Coronavirus than have been the US and Europe. In previous experiences with MERS and other Coronavirus epidemics, those countries became accustomed to actions that have helped with this one, including the wearing of masks. And of course, in the case of China, the authoritarian state does not just make recommendations about behavior, it commands them. It appears that Koreans, Japanese and Taiwanese have far greater trust in government and a far greater willingness to follow the recommendations than do many in America. Because these countries have been able to suppress the incidence of Covid infections, their economies have been able sustain growth to the good of their stock markets.



Moreover, the Asian stock markets offer far greater value than does the American market. Asian markets are markedly less expensive than the US market, no matter how one measures: The ratios of stock prices to the underlying earnings of companies, of stock prices to underlying value of assets, of stock prices to sales of companies all favor Asian markets over American. The chart in my last letter shows how Asian markets have under performed US markets in recent years.

To fund these new investments, Core has reduced our long-standing investments in gold and long-term Treasury bonds. These investments served us very well, particularly in the first months of the plague. We retain positions in both and may reduce them further in the months ahead.

This very strange year draws nearer to its close. We will learn in coming weeks how the health of Americans was sustained or worsened as a result of visits—for those who made them—during this Thanksgiving weekend. Then come the year-end holidays that many of us will celebrate in hitherto unexpected ways. As 2021 unfolds, we should be able once again to travel and congregate without the risk of shortening our lives. Let us hope.

CORE Comments

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 15, 2020

As the Year Ends and the Election Approaches

Core made modest equity investments in the last quarter, but we retain large holdings in cash and short-term bonds against post-election risks.

We are in the final weeks before the election and the final calendar quarter of the year. The election, if contested, presents risk—more on this below. Before that, a review of our investments and the various markets in the quarter just ended. Our accounts earned modest gains in the third quarter and, as you know, very strong gains for the year to date. Our principal investments--long-term US Treasury bonds, short-term, high-grade US corporate bonds, and gold --were all positive in the last quarter, although their appreciation was less robust than in the first half of the year. During the last quarter, we made some new investments, including in German stocks, in large East Asian companies and in a gold mining company. As noted in an earlier *Core Comments*, German stocks have, in recent years, gained far less than American stocks. Similarly, the Asian companies in the exchange-traded fund we purchased have also underperformed US companies, as shown on the graph on the next page. Because of this, they offer less risk than their American counterparts and the likelihood of gains that will exceed those of the American companies in the years ahead. As for the gold miner, Barrick Gold, it is very profitable with gold at the present high prices and will quite likely appreciate more than gold itself if and as the latter rises further in price.

In the aggregate, these new investments comprise just 18 percent of the portfolios Core manages. By contrast, our conservative and very safe positions in short-term bonds and cash comprise more than 25 percent of the assets we manage. Thus, as we approach the election in this period when, once again, Coronavirus infections and hospitalizations rise, and while the labored recovery from the economic devastation of the first half of the year falters, we have chosen to maintain a low-risk strategy.

The election and investments. Election day is less than three weeks away, but already millions of voters have cast their ballots by mail. Many millions more will do so before November 3rd; many voters have well-founded fears for their health if they go to their regular polling place to vote in person. Because mail-in ballots will not be counted before November 3rd, it is unlikely that the winner of the presidential election will be known on election day. Under 'normal' circumstances, the delay might merely be inconvenient. This election, however, does not present 'normal' circumstances.

By

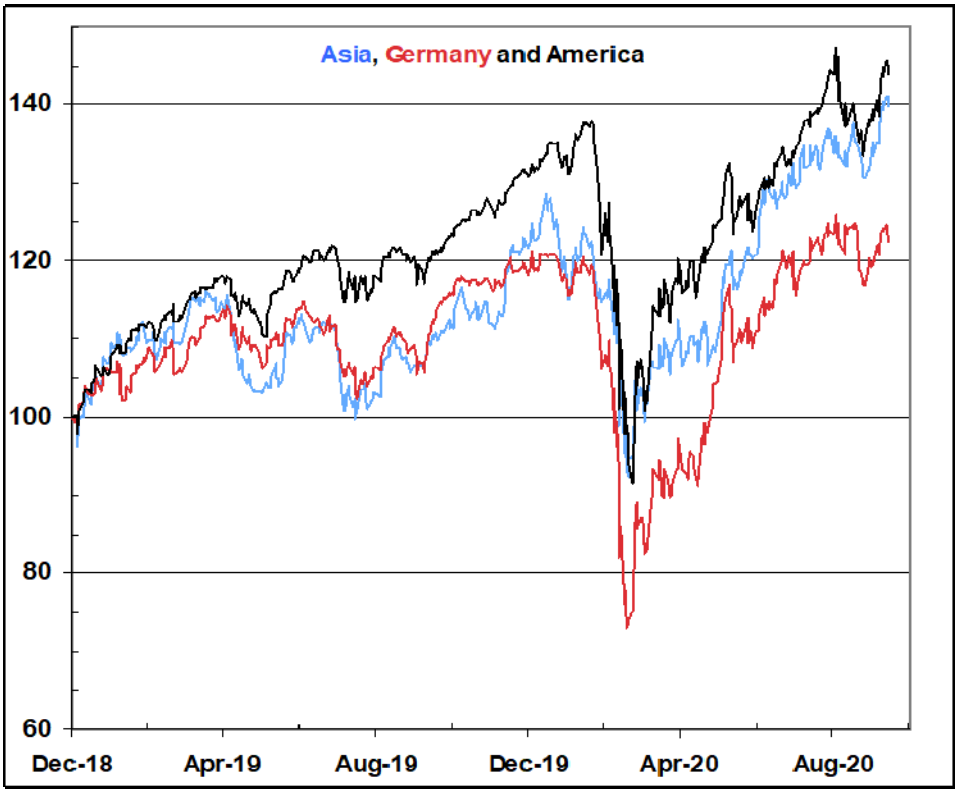
Jack Mayberry

Our president has repeatedly claimed that mail-in voting is rife with fraud--an assertion not grounded in historical experience. He declares often that the election will be 'rigged.' More alarmingly, he refuses to say that he will accept the result of the election if he loses it. We know that many lawyers are at work preparing litigation to contest or defend election results in states with significant

mail-in balloting. Given the calls by Mr. Trump for his supporters to go to polling places and to be on the lookout for voting fraud, we may expect some of Mr. Trump's violence-prone followers to seek to disrupt Americans' exercise of their voting rights.

America has deep and long-standing democratic institutions; will these prevail against Mr. Trump's attacks on them? I believe they will, but they will be tested. There have been several contested elections for president in our history; we all remember the most recent in 2000 when, five weeks after election day, the Supreme Court stopped Florida's vote recount and handed the victory to George W. Bush. It was an unsettling period until the Supreme Court ruled. However, Mr. Gore promptly and without cavil accepted the Court's decision and Mr. Bush became the president. The 2000 election and its aftermath may well be seen as a cake-walk compared to what lies ahead.

The graph below shows our recent investments in Germany and Asia compared to American stocks, all rebased to 100 as of the end of 2018. Asian stocks are in blue, German in red and the S&P 500 in black.



The uncertainties posed by this election season are reflected in the volatility (i.e., price changes) in various markets. Since mid August, the standard measure of stock price volatility, the so-called VIX, has risen back to levels consistent with a fearful stock market. (Of course, the VIX is far below its exceptional levels that prevailed from late February through April when it appeared that a second Black Death was upon us.) But if Mr. Trump acts on his various threats, we are in store for a much more troubled stock market than prevailed in the aftermath of the 2000 election. Note that during November and December of that year, stocks fell by 12 percent from election day to just after the Supreme Court decision, while gold and Treasury bonds rose in price. I make no prediction about the outcome of the election nor how Mr. Trump might act in the event he losses, but I think it prudent to be careful with investment capital for the time being.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

August 30, 2020

New Highs in the S&P 500…
...Mean What?

The S&P 500 has recently set a new all time high. Its valuation is utterly divorced from the weak economic conditions around the world and from depressed profits of the companies that comprise the index.

Core's investments have well exceeded returns from stocks.

Contrary to my expectations, put forth several times in *Core Comments* this year, the stock market, as measured by the S&P 500 index, has recovered fully from its February and March losses and gone on to set new all-time highs. The utter collapse in the economy through the second quarter of this year appears to have mattered little. The epic fall in corporate earnings has caused little consternation. As it happens, the four titanic tech companies, Apple, Amazon, Microsoft and Google (properly known as Alphabet), have benefitted enormously from the work-from-home and shop-from-home life that the Coronavirus brought. Each of these companies has a capitalization of more than one trillion dollars--Apple just reached two trillion--and a disproportionate amount of the S&P's gain is a result of the growth of these four.

The S&P 500 is a capitalization-weighted index, meaning that the value of the S&P is determined by the capitalization--the product of a company's total shares outstanding times the price of each share--of its components. Thus, the biggest companies count the most. Other stock indices are constructed differently or comprised differently. These others tell a different story: whereas the S&P 500 has exceeded its previous, pre-Coronavirus February high by about 3%, the so-called 'equal-weighted S&P 500,' by which all companies, big and small, have the same weight, is down by 5% from that February high. The Russell 2000, the best-known index of small US companies, is down by about 7% from that high.

Where do stocks go from here after the enormous advance from the late March lows? Impossible to say. But, by any number of analyses, tech stocks and the market as a whole are more overvalued now than at the peak before the dot.com bubble burst in 2000. We will continue to look elsewhere to invest the capital we oversee.

The investments we hold have served us very well for the last year and more. Whereas the S&P is up by 8.6% this year, Core's accounts in the aggregate have gained 18.5% net of fees paid to Core and have avoided the wild rides down and up. (Variation in returns exists among different accounts.) Recently, I have made a couple of changes in our investments: I have reduced our positions in our very profitable investment in long-term US Treasury bonds by a quarter. (Recall that in March, I first made a reduction in this large investment.) I have become more doubtful that the yield on long Treasuries will fall further and that prices will rise further. (Prices and yields on bonds move inversely.) Prices and yields have been largely stagnant since late March; it is a precaution to reduce this still large position against the possibility of adverse price moves.

By

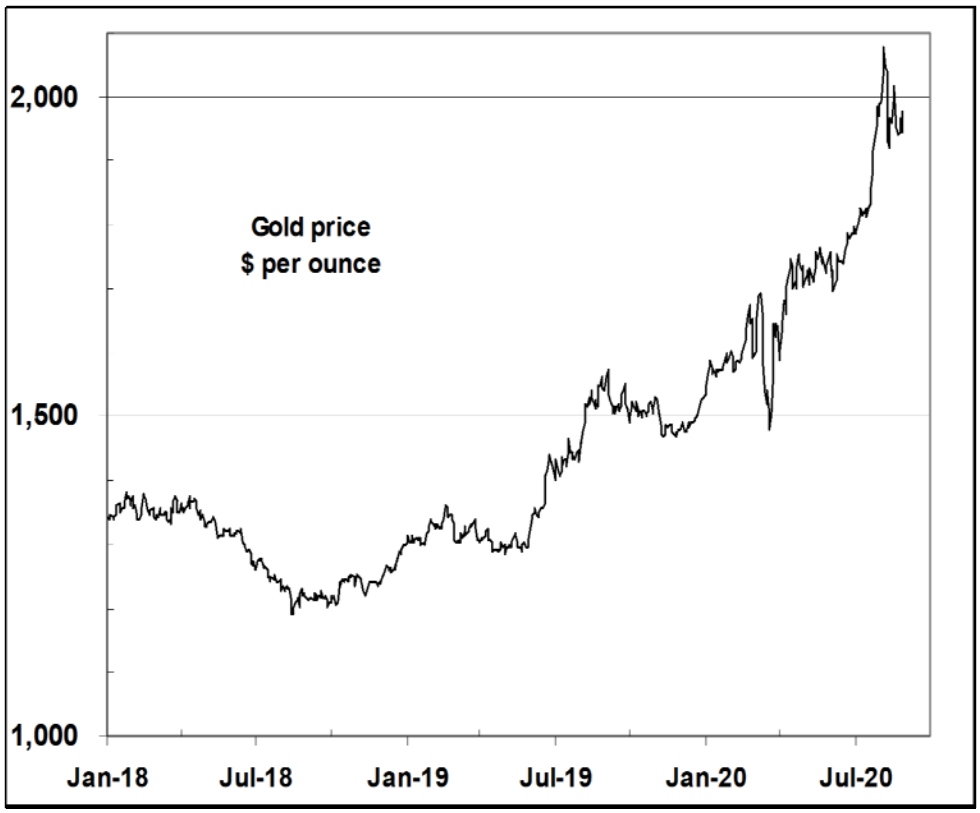
Jack Mayberry

The Coronavirus has caused a collapse in demand and a concomitant slowing of the economy. Tax revenues have fallen while spending by the federal government to support people and businesses has soared.

The United States has become increasingly indebted. One result has been an increase in gold's price.

Our other large investment in the last year and more has been gold, the price of which has continued to move higher. In early August, gold set a new all-time high at more than $2000 per ounce. (The nearby chart shows its gains since the beginning of 2018.) My assessment is that gold prices move higher from here. Hence, with some of the proceeds of the sale of long-term Treasuries, I purchased a position for us in a large gold mining company, Barrick Gold Corporation. Its cost of production of the gold it mines is about $1100 per ounce; as gold prices rise, its profits rise faster.

There are two important reasons to expect higher gold prices: The first is that the response by the world's rich countries to the pandemic has been to increase government spending to support unemployed and underemployed workers and to help businesses at risk of failure from the collapse in demand. This response--and there is probably more to come--has increased government borrowing significantly and has weakened the fiscal position of these governments. Apart from the 2017 tax cut, tax revenues in America have fallen again this year while spending has increased. Because currencies--the US dollar and the others--are all calls on the financial strength of their governments, weakening fiscal positions undercut the value of their currencies. Gold is no country's liability; its gains partly reflect weaknesses of currencies.



If you give a farmer a dollar bill to buy a bunch of carrots, you get a bunch of carrots and the farmer gets a promise from the United States. From a logical point of view, that promise becomes less secure as the United States becomes more indebted. Unlike the explosion of US federal indebtedness, there is no discernable increase in the amount of gold being mined.

The second reason to expect higher gold prices has to do with the carrying cost of gold. Gold pays neither interest nor dividends, while it imposes storage costs upon it owner. By contrast, bonds and money market funds (usually) pay interest. One has to pay to own gold, but one (usually) receives payments as an owner of bonds. These days, however, some $15 trillion of bonds have a negative yield: one has to pay Germany for the privilege of lending money to it. Although the United States does not have negative yields now and probably will not in the foreseeable future, US money market funds pay essentially nothing. The Fed promises to keep short-term rates at or near zero for at least a few years to come. In these market conditions, gold's modest carrying costs do not loom too large. Gold prices are going higher; gold mining stock prices are going higher.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

August 2, 2020

Progress in July...
...And a New Investment

Still the Coronavirus infections and deaths in the United States worsen, while Congress and the administration delay a fiscal response to ameliorate economic damage that has befallen households, municipalities, states, and businesses small and large. Because of continued strong performance of our two principal investments, long-term US Treasury bonds and gold, Core's accounts increased by another 4 percent in July. (As always, there is variation among individual accounts.)

Core's principal investments—long-term US Treasury bonds and gold—have done very well this year, indeed very well for the last two years. Further appreciation lies before us.

Early last week, gold achieved an all-time high exceeding the previous high from 2011. As I write, gold is up by about 30 percent for the year to date, while our long-term Treasuries are up by 26 percent. By contrast, the American stock market, as measured by the S&P 500, is up by all of 1 percent. A few points about gold: it has a 90 percent inverse relationship to real (that is, inflation-adjusted) 10-year Treasury yields, which have been declining sharply, and a 90 percent positive relationship to the size of the Fed's balance sheet. Thus as interest rates fall, gold appreciates; as the Fed balance sheet increases (as it has this year from $4 trillion to $7 trillion), so does the gold price. The Fed's balance sheet is almost certain to rise further as it tries to overcome the huge collapse in demand occasioned by the disease. Gold prices have a 67 percent positive correlation with the federal government's budget deficit to GDP ratio. With the weak economy and the unprecedented federal borrowing, this ratio will continue to rise and gold will follow it higher.

The 30-year US Treasury now yields 1.2 percent, a surpassingly low level. (Yields and prices move inversely; as yields on bonds fall, prices rise.) How much further can these yields fall and the corresponding bond prices rise? As of this week just passed, $15 trillion of bonds in developed countries trade with negative yields. The Federal Reserve has been clear that it will not let yields for US Treasury bills, notes and bonds fall below zero. But, as inflation continues to fall with the collapse in demand occasioned by the disease, it seems likely to me that the yields on long-term Treasuries will continue towards zero and the prices of these Treasuries will keep rising. We are sticking with this investment.

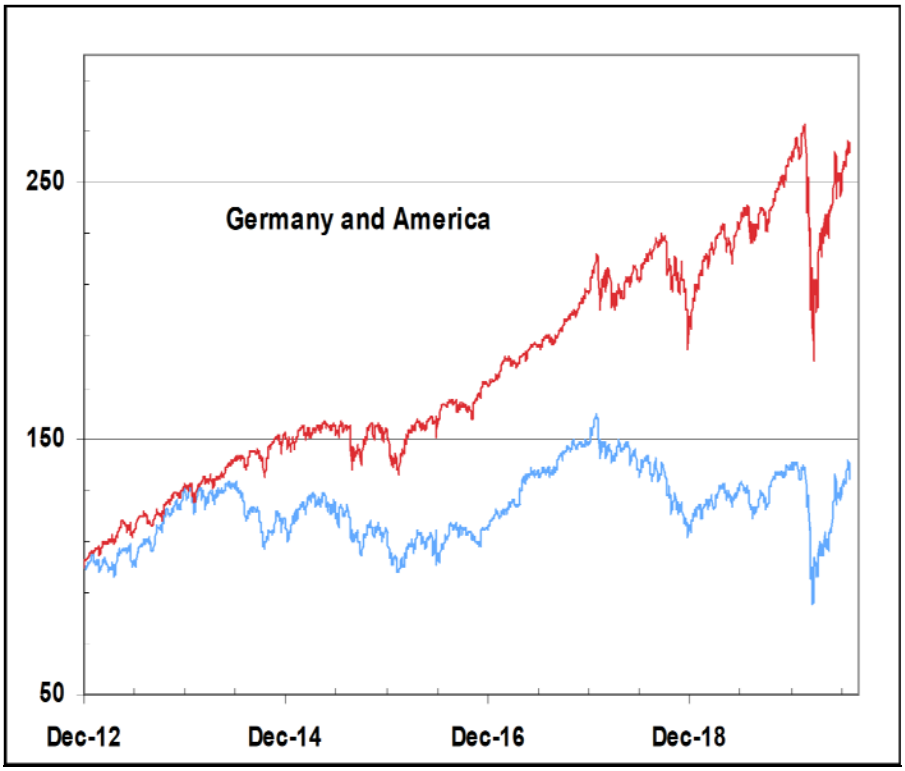
By

Jack Mayberry

Core made a new investment recently by purchasing German stocks via an exchange-traded fund. A number of factors persuaded us to make the investment. One is the effectiveness of Germany's actions in the pandemic. The haphazard American approach to the Coronavirus causes infections to spread across much of the country and deaths to rise. By contrast, Germany began public information campaigns on January 24th, prior to the first infection in

Germany has handled the pandemic in far better fashion than has America. This will speed Germany's economic recovery. Moreover, German stocks are far cheaper than American stocks.

Germany. An effective lockdown and careful reopening beginning in May have kept cases in Germany very low and permitted a so-far well-controlled resumption of economic activity. In America, new infections per million people have doubled to 200 from the worst of the levels in March and April when New York and New Jersey were suffering so greatly. In Germany, the rate of new infections per million is about 10. Deaths are averaging about 5 per day in Germany, as against more than 1000 in America. I am mindful that cases are beginning to rise anew in Germany and that this weekend featured an angry demonstration in Berlin against the virus-control regime. The Coronavirus is an opportunistic and effective spreader, but the means of slowing its spread are well known and generally observed by Germans.



Germany is, of course, an export power-house and might be seen likely to suffer as the globalization of trade wanes. However, some two thirds of Germany's exports go to other European markets, likely shielding it from the rising nationalistic trends that restrain trade. Additionally German stocks have lagged the appreciation that American stocks have enjoyed for several years, making the relative valuation of German stocks far superior to American. The nearby chart shows the S&P 500 in red font and Germany's index in blue, both rebased to 100 as of December 31, 2012. Any number of other comparisons besides stock prices would show that German stocks offer far better values than do American. German stocks are cheaper by any measure than US stocks and, as a result, are less risky.

It might be remarked that there is no German Apple, Google, Amazon or Microsoft, the companies that have taken US stocks so high. True. But if one strips technology stocks out of the S&P, one still sees a huge outperformance by the other American stocks as against German ones. American outperformance was not always so: From the end of the dot.com bear market in 2002 and until 2008, German stocks very sharply outperformed US stocks.

The desperately awful US approach to the Coronavirus will continue to depress economic activity here while the numbers of the newly-infected and of deaths rises as they have in the last six weeks. Under these circumstances, it is likely that Europe generally and Germany especially will see a faster recovery from the economic detonation that was occasioned by the Coronavirus and the lockdowns. Dr. Fauci has given us encouraging words about the likelihood of a vaccine late this year or early next. If and when this happens, it likely that stock markets will present real opportunity. Until then, gold and long-term Treasuries will continue to buoy our portfolios.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

July 3, 2020

A Review of the Year so far...
...And a Look Ahead

The first half of this year was really extraordinary, in the real world and in financial markets. In the real world, so to call it, the Coronavirus, the once-in-a-century pandemic, governs our lives now and will probably do so for some time to come. Then came the murder of George Floyd in Minneapolis and the crystallization, at long last, of the recognition of racism and its deleterious effects in our society. We can hope that this recognition will persist longer than the pandemic and that American racism will be ameliorated.

Half way through a year with little precedent. What comes next?

Despite Coronavirus and an intense stock market panic in February and March, Core's portfolios have earned solid gains.

The first six months. As the National Bureau of Economic Research told us in June, the recession began in February, prior to the Coronavirus lockdowns. The stock market made a positive start to the year, including setting a new high in mid February before the epic and swift decline by more than one third to the last week of March. In the last week of March, the stock market and bond markets--including the US Treasury bond market, the world's deepest and most liquid market--also went berserk, indicating that, even in the Treasury market, one could not be sure one could buy or sell in a rational way. The Federal Reserve jumped into action to restore liquidity and to provide support, through massive purchases of bonds and other measures, for the entire bond market. Congress and the administration swiftly enacted legislation to transfer trillions of dollars from the Treasury to businesses and individuals to make up for income lost as the economy shut down.

These monetary and fiscal actions sparked a rebound in the stock market and steadied the bond market. Now, at the end of this remarkable first half of the year, where do things stand? Core's accounts, in the aggregate and net of the fees paid to Core, have appreciated by more than 14.5% in these six months. (There is variation among individual accounts for various reasons.) The stock market, as measured by the S&P 500, was down by 3.8%, after its dizzying decline and rebound. The broadest measure of the US bond market was up by 4.9%. Core accomplished its good results by avoiding the stock market and by investments in long-term US Treasury bonds and gold. The securities through which we make these investments appreciated in the first six months by 20.4% and 16.8% respectively. Core's accounts also held a good deal of money market funds and, in recent months, high-grade short-term US corporate bonds. These latter investments did not earn much for us, but provide safety and 'dry powder' for the investments we expect to make as things grind forward.

By

Jack Mayberry

What lies ahead. As I see it, activities of all kinds--social and economic and more--are unlikely return to pre-Coronavirus times until there is an effective and widely-administered vaccine, or at least until there is effective and widely-

Until a vaccine or at least an effective treatment, activities of every kind will be constrained.

One needs to invest carefully and slowly.

available treatment. Neither is at hand. Accordingly and in light of the recent vast increase in US new infections, I think that economic weakness will persist. Some think that the recession ended in May and that we are on the way to a V-shaped recovery. I doubt that. Things improved in May and June from the catastrophic declines in economic activity of March and April, but we are still very far from attaining pre-recession levels. Another lockdown seems unlikely, but the surge in infection across the South, the Southwest and into California put 're-openings' into reverse. Note that the rather good employment report announced yesterday is based on surveys from mid-June, before infection surges began. We shall see about the V-shaped recovery.

As for the stock and bond markets, it would be a very rare event indeed if the sharp February to March sell off was not 'tested' by a decline toward those lows. We have not had this 'test' yet, but we have had a real slow down in the advance of the S&P. In early June, the S&P moved to within 5% of its February all-time high and then fell back. It ended June 9% below the February high. It may not happen, but it would be the usual thing for the stock market to head back down to or near the March lows. Meanwhile, from the mid-March chaos in bond markets, long-term Treasuries and gold, our principal investments, continued to appreciate. At the end of June, gold prices reached their highest levels since 2012.

Given our large positions in very safe short-term corporate bonds and money market funds we hold, we have what I characterized above as 'dry powder.' I have a set of equity investments that make sense in our new Coronavirus, work-from-home lives. Of course, our long-term Treasuries represent a big source of funds to invest in stocks when times are safer and when prospects for continued low interest rates ebb.

The Fed's analysis. Last week the Fed released a significant report in connection with its 'stress tests' of the capitalization of banks in light of the Coronavirus and the recession. The Fed puts forward three scenarios from the present economic situation, characterizing these 'V-shaped,' 'U-shaped,' and 'W-shaped' recoveries. The 'V-shaped' is, as discussed above, the optimistic idea that, after the sharp recent decline in the economy, we have a sharp recovery that restores economic activity to pre-Coronavirus levels. The 'U-shaped' contemplates a longer period in which the economy crawls along at low levels before recovering. The 'W-shaped' characterizes the economy with a recovery now, then another decline as Coronavirus matters worsen again, until there comes a more lasting recovery. In each of these scenarios, the Fed expects long-term Treasury rates to stay near the lows seen in the first quarter of this year, for corporate bond yields to rise in relation to Treasuries, and for stocks to fall by 50% from June 1st levels! I don't think we will hear Jerome Powell or other Fed governors saying this aloud, for fear that their predictions become self-fulfilling prophecies, but so the Fed has written. (If you wish to read this report, not a long one, you will find it at https://www.federalreserve.gov/publications/files/2020-sensitivity-analysis-20200625.pdf).

The history of recessions and bear markets, as well as the Fed's analysis, suggest that caution should guide our investing at this remarkable time. It would have been a fruitful thing to dive into the stock market at the March lows, particularly after successfully avoiding it, as we did, during the sell off. Unfortunately, market timing is really an impossibility; it wreaks havoc on the portfolios of those who attempt it. I will continue to be guided by a longer view and will deploy capital back into stocks when things play out further in this 2020 drama.

CORE Comments

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

June 14, 2020

Who Could Have Imagined?

Six months ago, we were heading toward year-end holidays, ignorant of what the immediate future had in store for us. Then the Coronavirus, the lockdowns and self-quarantining, the deaths of more than one hundred fifteen thousand Americans, the collapse of economic activity, the loss of some twenty million jobs in America and the swift and deep decline in stock markets. And then the murder of George Floyd and the rise in protests across the country (and around the world) against America's terrible history and its terrible present of racial discrimination and violence against African-Americans. The year is not quite half over. In the next half, we will have more Coronavirus, more economic hardship, more reverberations from the George Floyd murder and a presidential election. Buckle up.

I remember 1968 well, punctuated as it was by the assassinations of Martin Luther King and Robert Kennedy, the rioting about racial matters combined with anti-war demonstrations, and the near conflagration at the Democratic National Convention in Chicago. I remember the assassinations of John Kennedy and Malcolm X in 1963 and 1965, but I also remember the hope engendered by mid-sixties civil rights legislation. I was inspired by Tommie Smith and John Carlos at 1968 Olympics in Mexico City. I remember feeling optimism about the future in that black year. My optimism appears to have been somewhat misguided; the Viet Nam war did not end until 1975, even though Lyndon Johnson withdrew from the 1968 presidential race. The civil rights legislation and the riots in 1968 did not notably improve the circumstances of blacks in America. Richard Nixon, perhaps foreshadowing Donald Trump, created a constitutional crisis with the Watergate break-in and its aftermath. And, turning to investment matters, 1968 marked end of a twenty-year bull market of nearly uninterrupted advances and ushered in a fourteen-year period of bear markets and stasis. In June of 1949, a month after my birth, the S&P 500 stood at 14. By December 1968, it had advanced more than seven-fold to 107. By August of 1982, it advanced by only two more points to 109. As Mark Twain may--or may not--have said, history does not repeat itself, but it does rhyme.

The chart on the next page shows some history, from which rhyming patterns may be emerging. It shows the S&P in the bear market that began the Depression. From its peak in 1929 until its bottom in 1932, the S&P fell by 86 percent. (Yikes!) During that period, the market put on five rallies of 20 percent or more, including the first such when the S&P rose by 44 percent. That 44 percent rise in from November 1929 to April 1930 rhymes pretty closely with the S&P's recovery from the late March lows this year to the highs last week, also 44 percent. The 1929 to 1932 bear market was desperately awful, but I could have illustrated the same point of big counter-trend rallies within all the recent

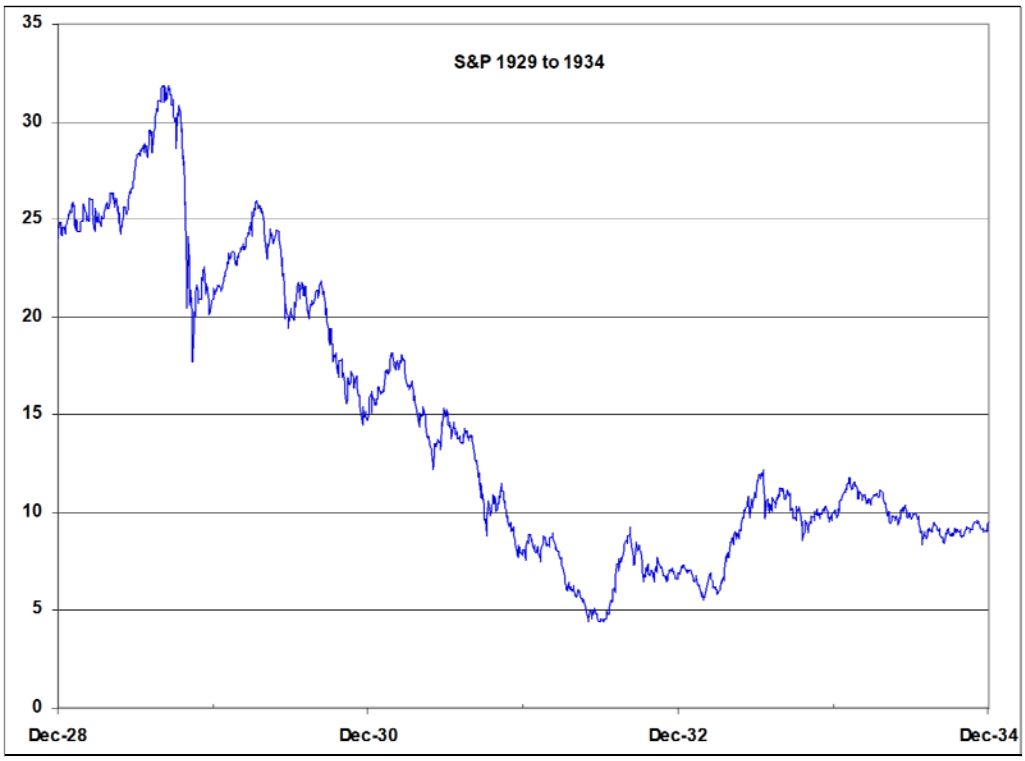
By

Jack Mayberry

bear markets. (To make matters worse, the stock market did not recover its 1929 peak until 1954, fully 25 years later.)

The National Bureau of Economic Research (NBER) announces the beginnings and endings of economic recessions. Last week, the NBER declared that this recession (or will we ultimately characterize this as a depression?) began in February, the month before the lockdowns began, showing what has been evident from the economic reports, namely that the economy began to contract before the Coronavirus lockdowns. Some optimists now offer the argument that the recession ended in May! Doubtful. If the recession ended in May, why are jobless claims still rising at a rate well above 1.5 million per week? In the recent four recessions, weekly jobless claims never were as high as 700,000.

Perhaps we should not dwell upon the economy, because the Federal Reserve Board, with its remarkable policies, has driven the US stock market rapidly upward since it began its latest rounds of support in late March. Among other things, it has added another $3 trillion to its balance sheet and has increased M2, the main measure of money in circulation, by $2.5 trillion since early March. Both are by far the largest ever. Guess what: from the March bottom to the recent June top, the increased value of American publicly traded securities is just about $2.5 trillion. (The money had to go somewhere, I suppose.)



At last Wednesday's press conference following the two-day meeting of the Fed's Open Market Committee, Jerome Powell, the Fed chairman, noted the parlous state of the American economy and, once again, promised to take action as needed. Every one I know takes Mr. Powell at his word now--despite his famous course reversal in January 2019 from monetary tightening to monetary easing, now known as the Powell pivot. But history has demonstrated often that, while the Fed can mitigate the effects of recessions and bear markets, it is powerless to eliminate them. We are in early stages of a very severe recession and in early stages of what is likely to be a memorably awful bear market. Bly eschewing stock investments, this year, we avoided the losses in February and March. Core's investments in long-term Treasuries and in gold, very successful over this last year, will, in my judgment, continue to anchor our portfolios and continue to lift them in value.

CORE Comments

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

May 23, 2020

Don't Fight the Fed
...Really?

The hoary rule in investing is not to fight the Federal Reserve, meaning one should follow the direction its actions point and avoid investing against the Fed's policies. The Fed has, as discussed in recent letters, initiated unprecedented and powerful efforts to mitigate the damage from the Coronavirus-induced bear market and recession (or depression--too early to tell which). As we have observed, after the initial plummet in stock prices from February 19th to March 23rd, the stock market has delivered a significant rally and made up a good deal of lost ground. The flow of economic reports in the last month has shown a collapse in economies without precedent since the Great Depression, but stock investors appear to be looking across the canyon of economic desolation to the return to pre-Coronavirus economic growth and corporate profits.

Terrible economic collapse but a rising stock market. What gives?

The correlation between economic activity and stock prices has been essentially zero in the last two months. Typically there is a fairly strong positive correlation between the two. That correlation will return.

A significant explanation for the stock market's partial recovery is the prompt action of the Fed and the expectation of future Fed responses. Over the weekend of May 16 and 17, for example, Jerome Powell, the Fed's chairman, told us that the Fed has more ammunition if needed to fight the problems. Alas, the Fed can deal with liquidity matters, but not solvency. That is, it can enhance the flow of money through the system, but it cannot provide capital to companies threatened with insolvency caused by the collapse in demand for companies' products or services. (It must be said, however, that the Fed is trying to overcome its inability to provide capital by buying a broad array of assets, including, indirectly, junk bonds. Its purchases lift prices in commercial debt markets, enabling companies that are otherwise uncreditworthy to raise capital in debt markets. This is a close cousin to providing capital to weak companies.)

Economic fundamentals are simply dreadful, but the stock market ignores them. (Try reading economic reports from around the world every morning, if you want to become depressed early each day.) Corporations announce lower profits from the first quarter, but the stock market considers this yesterday's news. It is said that the Fed and the Congress will tide us over until things are back to normal. In this letter, I make two points, firstly, that the Fed does not always win in fighting bear markets, secondly, that a resumption of what was normal activity in pre-Coronavirus days will not come soon.

By

Jack Mayberry

The simple point first: in each of the bear markets and recessions of 1981 to 1982, 2001 to 2002, and 2008 to 2009, the Fed cut the short-term rates it directly controls quite dramatically. In the 1981 to 1982 period, while the Fed cut rates by 45%, the S&P fell by 28%. In the dot.com problem in 2001 to 2002, the S&P fell by 50% while the Fed was cutting rates from 6.5% to 1.75%.

Then, in the financial crisis and deep recession in 2008 and 2009, the Fed cut rates from 5% to 0.5%, while the S&P fell by 58%. One can fight the Fed.

How soon will things return to pre-Coronavirus normal? The stock market ignores this, but the return to normal will be a long time coming. America and Europe are ending locks-downs in different ways in different places, but the ability and willingness of folks to resume former activities will be absent. Many workers have been 'furloughed' or temporarily put out of work; will their former jobs and former incomes be restored? Certainly not for all of them. Income has been lost; the dangers of closeness to others with whom we are not in quarantine are foremost in the minds of everyone. Many will not be able to spend and even more will be unwilling to spend in the way they had before Coronavirus. Already the savings rate has reached multi-year highs; companies and individuals now understand the need to put money aside against the risks that Coronavirus shows us. This will dampen economic activity; the recent bankruptcy filings of JC Penney, J Crew, Neiman Marcus and Hertz are only a start; more are to come. China provides a bit of a road map for this, in that it suffered first, locked things down first, then began reopening first. Although industrial production and the like in China have approached pre-Coronavirus levels, spending by consumers has lagged significantly. Supply has resumed much faster than demand.

Long-term Treasuries and gold have out-performed the stock market by miles in the last year. Further out-performance lies ahead as the bear market continues.

Core's Investments. The strong rally since March 23rd is impressive--and so have been other bear-market rallies in past. It is disconcerting for an investment manager--myself--to watch from the sidelines as this rally unfolds. It requires patience and resolve about one's views, while one recognizes that one's judgment may be wrong, to resist jumping into the stock market game. One is helped in two ways: firstly, that our investments in Treasuries and gold have continued to appreciate since the stock market's lows in March, such that a typical Core account has earned another 4% since the March low and that Core's accounts have risen by more than 22% in the last twelve months. The second reason to avoid stocks is to review once again the way that bear markets in the past have unfolded. There are always big counter-trend rallies in bear markets, such as we now experience. These are followed by longer and deeper declines. Bear markets persist and disappoint the hopeful. They end when optimism about the future is entirely supplanted by despair. We are nowhere near that point: sharp rallies on the hopes of treatments--Remdesivir on April 17--now on hopes of vaccines--Moderna this week--are indices of optimism not the expression of despair.

Given the views expressed above, how should we evaluate our investments in long-term US Treasury bonds and in gold? These both have provided very good returns for us since we first took these positions well over a year ago; the question is what lies ahead. Deflationary forces arising from the weakness in demand for stuff, as discussed above, will cause Treasury bond prices to continue to rise Not forever, but for now. As for gold, our other large investment, it must surely continue to rise and probably for a longer time than our Treasuries, because of the long-term peril that the fiscal and monetary expansion cause. In the medium term—a year or so, until Coronavirus matters are in hand—the deflationary forces will be the larger ones. After that, the huge increase in the money supply that the Fed has provided—never before seen at this scale—creates the significant risk that currencies, including the US dollar, will weaken sharply against the price of gold.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

May 3, 2020

What Do We Know Now?

As lockdowns are lifted, we will enter a new and uncertain coronavirus era. Its contours are unclear, but the political support for stopping economies and sequestering citizens is ending fast.

By

Jack Mayberry

Things in the asset markets have calmed down since the extraordinary turmoil that characterized March. The quiet, such as it is, is largely the result of the Fed's actions of which I wrote in my last notes. As for the coronavirus, lock-downs remain in place in most states in America and are slowly being lifted in Europe and elsewhere. It appears that in all developed countries the mortality of this coronavirus is 0.1% or lower for healthy young people. Had this been known eight weeks ago, the world might not have begun this medically-induced economic coma. But, there it is. This was not known and most countries--Sweden excepted--shut things down to save lives. We shall see what happens as things reopen, whether, as there has been in Singapore, for example, a second wave of illness and what will emerge from a second wave. The recrudescence of illness aside, what will the economy look like? There has been hope for a V-shaped recovery, whereby, after the detonation of coronavirus-shutdown, comes a swift and sharp recovery to where things were before. Hopes for a swift economic recovery have, along with the Fed, impelled stocks higher in recent weeks.

How likely is a V-shaped recovery? As I see it, a low probability. Although healthy young folks don't die from this, how willing will the young and healthy and the compromised oldsters be to return to crowded cinemas and opera houses, to ride subways, to go to ballparks, to go back to favorite restaurants? And will the 30 million Americans who have applied for unemployment benefits in recent weeks soon be re-employed and drawing their accustomed paychecks? To the extent they do receive their former levels of income, how much more will they save and how much less will they spend? A lot, I think. Saving more and spending less is a good thing for lots of folks and lots of companies, but not so good for economic growth.

The investment questions are these: did we enter another bear market for stocks on February 19th? Was the 35% decline to March 23rd the first leg down? Has the S&P's 35% recovery to April 29th been the first counter-trend bear market rally? (That counter-trend rally, as I characterize it, still leaves us, if you do the arithmetic, 13% from the Feb 19 high.) The answers are not to be known for a while, but the very high probability is that we began a new bear market in February and we began a new recession (or worse) then or in March when lock-downs began. I have been looking closely at the history of bear markets of the last century, of recessions, and of the depression of the 1930s. The lessons are clear: Bear markets persist for a long time; during them come significant rallies; then come deeper declines. There is an unhappy interplay of hope against fear that persists for years; when optimism and hope finally disappear, then comes the recovery. As I see it, the stock market and the hopes for the V-

shaped economic recovery make it clear that optimism is high; until despair is the prevailing view, we are not at the end of this bear market. The swiftness and the depth of the decline in economic activity in these recent weeks are unprecedented, at least in the 20th and the 21st centuries. It is somewhat alarming to note that regaining the level of the high in the stock market in 1929, before the that terrible bear market and the depression, was not accomplished until 1954, a bit more than 35 years from the 1929 high. Oops.

The depression of the 1930s and the accompanying bear market are not the templates for this economy and this stock market, although the economic contraction now is likely to surpass all the recessions since that time. Economists (think John Maynard Keynes), our government and the Federal Reserve learned some things from the 1930s: As we have observed in recent weeks, Congress and the Fed have delivered some swift and impressive actions. (Thus the optimism for a V-shaped recovery.)

Despite forceful and swift actions by Congress and the Federal Reserve, economic activity has fallen off a cliff. Restoring reasonable growth and providing income again to citizens will take a very long time.

There will be no V-shaped recovery and the bear market will worsen and persist.

Core's investments. The rally in the S&P from the March lows recovered much recently lost ground, but Core did not attempt to join that party. We retained our investments in long-term Treasury bonds and in gold. Note that long-term Treasuries always rise in price and fall in yield in recessions. As it happens, since 1980 or so, the total return from long-term Treasuries has exceeded that of the S&P. Results are similar for shorter periods and more recent intervals. Note also that investments in US Treasuries do not involve any risk of default or return of capital, whereas stocks.... If the total return is greater with Treasuries without the attendant risks of stocks, what's the problem? Particularly when, as was the case when the S&P reached its peak in February, corporate profits had fallen for a year and economic growth was already slowing.

The argument made against long-term Treasuries now is that prices are very near all-time highs and yields near all-time lows. As of this writing, the yield on the 'long bond,' the thirty-year Treasury, is 1.278%. How can it possibly go lower? It goes lower because the supply of Treasuries is less than the demand for them. The US will run vast deficits and need to sell many bonds. The demand for these bonds is far greater than what the Treasury will issue. We all will be saving more.

All that said, if this is a real bear market--and it is--there will come a time when we will want to put aside Treasuries and gold and pile into stocks at what are likely to be quite attractive prices. We are not there yet, but when folks take into account how severe an economic decline we have entered, then will come lower stock prices (and higher prices for our Treasuries and gold) and we will put some chips on the table. For now, we will wait and watch.

* * *

A word about a couple of investments. We had a brief investment in high grade corporate bonds (via a security with the symbol lqd). I wrote about buying this in my last letter, but shortly afterwards, I decided again that the risk, though not a big one, was not worth it and I sold the position. We all made a bit of money on the trade. Since then and because most portfolios held large cash positions that earn nothing, I decided to invest in short-term high-grade corporate bonds with maturities up to five years. Some portfolios now hold this; others will soon. We will not get rich on this investment, the symbol for which is slqd, but we will earn a respectable rate of interest while we wait and watch.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

April 10, 2020

The Fed Backstops Everything

In these increasingly frequent letters, I have tried to explain what appears to be unfolding in our new world. In this *Core Comments*, since we are now in the Paschal season, let me wish everyone a good Easter and Passover. Passover Seders, in the midst of this plague, have redoubled meaning.

My aim is to explain what the Federal Reserve is doing and the effects its amazing actions have on every asset class under the sun. So far, we have not seen the benign effects of the huge $2 trillion legislation recently enacted. One hopes we will soon. On April 9th, the Fed announced another heretofore unimagined policy, the effect is to extend the credit of the Fed to almost all credit markets in America. Given the Fed's US dollar actions, discussed below, one realizes that the Fed's actions are global in scope. If we ever doubted that the Fed is the central bank for the world and that the US dollar is the world's currency, its actions dispel those doubts.

The Fed's actions in this crisis have been swift, radical and, in important ways, very effective. Liquidity has been restored to markets that ceased to function for a period in mid March. It provided dollars around the world to meet the unmet demand. It is acted in a series of moves to bolster credit of almost every kind.

One suspects we will see more from the Fed in the weeks ahead.

March witnessed extraordinary disruptions in bond markets, including the market for US Treasury bonds, the deepest and most liquid market in the world. At the same time, the US dollar sustained a period of extraordinary volatility, first falling by about 5%, then surging higher by 17% in the space of nine days, before again falling back to where the roller coaster ride began. The dollar is the world's reserve currency; much more than half of all the world's trade is denominated in dollars. Its gyrations were exceptional and indicated the extreme need that foreign banks, foreign countries and foreign businesses had for dollars and the difficulties of obtaining those dollars. In a five-day period beginning on Sunday, March 15, the Fed announced three huge programs to increase access to dollars around the world, entering into dollar swap agreements at very low rates with its six long-standing swap partner central banks--those for the Euro, the Swiss Franc, the Japanese Yen, the Canadian Dollar, the Pound Sterling and the Swedish Krone. Four days later, it extended similar terms to the central banks of Australia, Brazil, Korea, Mexico, Singapore, Denmark, Norway and New Zealand. On the next day, it increased the frequency of its dollar-funding operations. To date, nearly $550 billion have been drawn by these central banks. In their turn, those central banks offer dollar facilities to their domestic banks, which then lend the dollars on to domestic business. The Fed ended the dollar-funding crisis.

By

Jack Mayberry

In its blizzard of policy undertakings in March, the Fed also sought to end the disruption of the high-grade US corporate debt market. In the *Core Comments* of February 27, I noted in passing that I had sold our high-grade corporate bonds, remarking that there was no reason to hold those bonds, which had very little credit risk, while we held our Treasuries that present no credit risk. Little did I know then that credit markets would fall shortly thereafter, along with the volatility in the dollar. The fund through which we held our corporate bonds (symbol LQD) fell by 22%--an unheard of amount—in the dreadful mid-March period. The Fed, along with its many other efforts, promised liquidity to high-grade bonds and it worked. Bond prices began to recover; this week, we purchased a new position in LQD, now yielding a

rather handsome 3.8% and on its way back in price to the levels of early March.

Then yesterday came what is the most radical policy yet. The Fed will support--with $2.5 trillion--a huge range of personal, small business, municipal and state credits, as well as commercial mortgages, leveraged loans, equipment loans and leases, and corporate bonds (even including some 'junk bonds'). This has been never ventured before. Prior to the financial crisis of 2008 - 2009, the Fed only held US Treasuries. In its 'quantitative easing' in response to that crisis, it expanded its balance sheet five fold, but only added more Treasuries and US government-backed mortgage securities. Now the Fed underpins essentially every aspect of credit markets except for distressed debt. (How long will it be before the Fed buys distressed debt and US stocks? Just a rhetorical question.)

The Fed guarantees liquidity in credit markets. I take this to mean that we may invest in credit markets--bonds and other fixed income securities--based upon our views of what the future holds. We need not concern ourselves that the credit markets will turn upside down and become utterly incomprehensible, as they were for two weeks in mid March. If I am right in drawing this conclusion then, for me, it points the way for Core's investments in the period just ahead. That is, we can analyze the credit markets in terms that we understand, e.g., what will the economy do in the months ahead? What are the inflationary or deflationary pressures? We need not concern ourselves with the question of liquidity in these markets; the Fed provides the lubricants to ensure their functioning.

By avoiding stock investments this year and with our large investments in long-term US Treasury bonds and in gold, we have earned good returns, while the stock market crashed around us.

Core's investments. As mentioned above, we took a position this week in US high-grade corporate bonds. We had sold our similar position in late February; with the benefit of hindsight, this looks to have been shrewd trade. It was not that I foresaw the huge decline that lay ahead; I simply acted to further reduce risk in our portfolios. I had been concerned since the autumn of 2018 that things would unravel. Economic growth was weakening; the strong stock market in 2019 was not sustained by growing corporate earnings. Corporate profits fell all through 2019. Stocks were boosted higher by a series of Fed actions. First, in response to the sharp sell off of stocks in November and December 2018, the Fed stopped raising the Fed funds rate and stopped reducing the assets on it balance sheet. (This is now known as the 'Powell pivot.') Then, as 2019 rolled on, the Fed cut the Fed funds rate, after a failed experiment to 'normalize' short-term rates. Finally, early last autumn, the so-called repo market went haywire. The repo market (short for 'repurchase market') refers to overnight lending between banks to meet their demands for credit. Suddenly repo rates increased enormously. (This was something of a mystery then; now it seems to have been the canary in the coal mine foreshadowing last month's amazing disruptions in fixed-income markets.) In response to repo ructions, the Fed took hundreds of billions of new short-term Treasury bills on to its balance sheet, pointedly declaring that this was not quantitative easing. Nevertheless the stock market took it as the 2019 version of QE and moved higher in price, despite declining profits. Don't fight the Fed, as they say.

As with the Treasury market and many others, the stock market has rallied from the fierce mid-March selling. Stocks clearly like the news of the latest Fed actions, putting some $2.5 trillion into more or less everything in the credit markets. Although this bear market in stocks was the fastest ever, in that it declined by 35% from intra-day high in mid February to intra-day low in late March, it will still, in my view, follow the long-established patterns of bear markets. After this initial decline, it has rallied back quite strongly making up some half of what it lost just recently. Reflexive bear market rallies are often sharp and strong, as is this one. What follows usually is a long period of further declines, further rallies, and deeper lows than in the first round of selling. Thus I think it will be this time, as well. Because we have all made a good return so far this year with our Treasuries and gold while stocks crumbled, we have the luxury to wait, to observe, and to pick our point to buy stocks again.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 25, 2020

Further Comments

Coronavirus has afflicted America badly in the last weeks. Worsening conditions wreak havoc on all financial markets. The stock market has continued to fall sharply, with intermittent (and probably unsustainable) short-covering rallies. Unsurprisingly. On Monday, the market made another new low for this bear market; the S&P has now fallen by 35 percent from its high fewer than five weeks ago! This is the swiftest decline ever in stocks. More strikingly, the Treasury bond market also became disrupted; with prompt action by the Fed, Treasury market weirdness has resolved itself (for now). The Treasury bond market is the deepest and most liquid market in the world and Treasuries are without credit risk. That is, the United States will not default on its interest payments and principal repayments. Despite this, suddenly on March 10th, Treasury bond prices started to fall. The Fed stepped in and restored liquidity to Treasuries. Long-term Treasury bond prices have resumed their upward trajectory and their yields have again fallen.

The spread of Coronavirus worsens by the day. We cannot know how things will unfold in the coming weeks and months, but it is not hard to imagine that our new ways of life--staying at home while life in our cities is shuttered--will be with us for some time. The numbers of people infected, the numbers hospitalized, the numbers dying will increase in coming days and weeks. It is a new age.

As an investment matter, Core's accounts remain solidly higher for the year; the accounts Core manages are up by 11% year to date (with variations among accounts for various reasons). It was our good fortune to have avoided the stock market as we entered this year. We continue to avoid it. Our investments are in long-term Treasury bonds, gold and cash. With cash we earn nothing, but we lose nothing. We retain cash to make stock investments when this bear market ends, as, inevitably, it will. As we fall into a deep recession with both demand and supply shrinking sharply, Treasury bonds increase in price. In the extremity of uncertainty that we face, gold offers its historical role as a haven in unsettled times.

Recently the disruption of financial markets turned Treasuries and gold upside down for a brief period. To the astonishment of many including this writer, on March 10th both gold and long-term Treasuries began a swift, short-lived, but steep decline. On March 9th, long-term Treasuries, as measured by the investment we hold, were up by 26% for the year to date and gold by 11%. In the view of many, myself included, the exceptional advances of Treasuries and gold made sense. Utter panic had broken out in the stock market; it had already fallen by more than 14% for the year to date.

By

Jack Mayberry

The sudden decline in Treasuries and gold, beginning on March 10th, brought gold down by 13% and long-term Treasuries by 16%. We may read more in the days ahead about what happened in that period; we can surmise that a good deal of the selling of these assets was so-called forced selling by investors whose stock positions were falling relentlessly. Some investors who had borrowed in order to buy stocks were required to sell. Quite probably some of these investors were selling their winners--gold and Treasury bonds--because they could not sell their losing stock positions at reasonable prices. The disruptions were extremely disturbing to the Fed, not so much the lower prices, but the inability of the Treasury market to function smoothly. Extraordinary actions by the Fed in recent days appear to have dealt with the liquidity problem in the Treasury market; both Treasuries and gold have rallied considerably in this last week. Gold is close to its March 9th highs and long-term Treasuries are not far behind.

In the context of this disruption in the Treasury market, I reduced our positions in TLT, the Treasury fund we hold, by about one third. (I accomplished the sale at a price of 162, far above the 139 level that TLT reached at its nadir last week.) We still have a large position in Treasuries and I expect further gains in their prices. However, the sharp, sudden and disconcerting decline in gold and Treasuries showed that, in these extraordinary markets, even safe investments can be risky. I have increased our positions in money market funds and cash to 33%. The Treasury market is now acting rationally again, but it is foolhardy to believe that there will not be more significant market disruptions in coming weeks.

The Shape of Bear Markets. As noted above, the decline from the mid-February highs in stocks to the 35% decline as of Monday's low is the swiftest ever. The old saying is that 'they slide faster than they glide,' but this is altogether new. A typical bear market makes its way from top to bottom in over a period of more than a year and the process of forming the bottom of the bear market and beginning the recovery and advance is measured in many months. Given the extraordinary shut down of business activity and the normal lives of all of us, we must expect a deep economic slowdown, far surpassing what we refer to as the Great Recession of 2007 to 2009. If so, the decline in the stock market--and its duration--both have much further to go

Of course, things may unfold differently. If, as of Easter, as our president would like, things were to go back to normal, at least in parts of the country not terribly afflicted, then there could be swift recovery of economic activity. Epidemiologists consider it unlikely that Easter represents the date when life in America can resume former patterns. The proposed legislation just passed in the Senate is huge. More than $2 trillion will be provided by the federal government and it will be backed up by perhaps as much as $4 trillion of support from the Federal Reserve. (These numbers have never been bandied about before; I remember Everett Dirksen, the minority leader of the Senate in the sixties, making the comment 'a billion here and a billion there, pretty soon, you're talking real money.' Those were the days.)

At present, a rational long-term investor will wait patiently and will be alert. There will certainly be enormous investment opportunity when the Coronavirus crisis and the bear market in stocks come to an end. We cannot know when that will be. The best approach is to continue with the productive and relatively safe investments we now hold.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 11, 2020

On the Right Side

From phone calls and emails I have received from clients in the last week, it seems useful to write another letter. My views on all this change day to day as the things develop. In my recent letter, I characterized coronavirus as a 'black swan' event; it certainly is. Then, beginning last Friday, we have new unexpected event, namely the refusal by Russia to agree to further cuts in oil production as proposed by Saudi Arabia, the *de facto* leader of OPEC. The Saudis sought an agreement to cut oil production further as demand for oil fell with the general weakening of global economies, weakening that has only intensified with the coronavirus. In the side bar, see a bit about how the Saudi/Russia matter causes problems in America.

There has been no good news about coronavirus, except that the Chinese seem to have contained it.

Italy tries a similar approach.

Other countries try other things. We shall see what Mr. Trump's stopping flights from Europe to America accomplishes.

When oil prices fell sharply in the past, it was said that America realized a benefit in that we paid a bit less at the gas pump.
But as shale oil production has increased to make America (for awhile recently) the biggest oil producing country in the world, we now face many lost jobs in the highly leveraged shale oil sector and reduced spending on plant and equipment.
America derives essentially no benefit form the Saudi price war.

Some of the uncertainties when I wrote a couple of weeks ago have been resolved: we know now that coronavirus extends itself very widely and that in more than one hundred countries it manifests itself. The ability for scientists to identify the 'Patient Zero' in a place in which there are suddenly many infected people is clearly quite limited. We realize that the numbers of infected people is probably widely underestimated or undercounted. We see this in America now, where we do not have the means to test many people. We saw this a couple of weeks ago in Iran when reported numbers of deaths from coronavirus was far, far higher than expected given the numbers reported to be infected.

Today the World Health Organization declared this to be a pandemic, not just an epidemic. Today, Angela Merkel, Germany's Chancellor, told us that two thirds of Germans are likely to become infected by coronavirus. China imposed extreme restrictions on travel and quarantined scores of millions in Wuhan and neighboring cities in Hubei to slow the transmission of the infection. Then, in the space of little more than a week, Italy became a 'hot spot.' In the first instance, it closed off cities near Milan and in the Veneto. More recently, it has essentially put the entire country in quarantine. In Westchester County, just north of New York City, the National Guard has been brought in to a community in which a number of people in a temple fell victim to the infection. Schools, colleges, universities are closing. A Core client with one child at Columbia and another at Bard College, a bit up the Hudson, told me that Columbia had closed and sent it students home (as have Harvard and others) whereas Bard 'strongly recommended' that its students stay on campus during the spring break and not go home!

By

Jack Mayberry

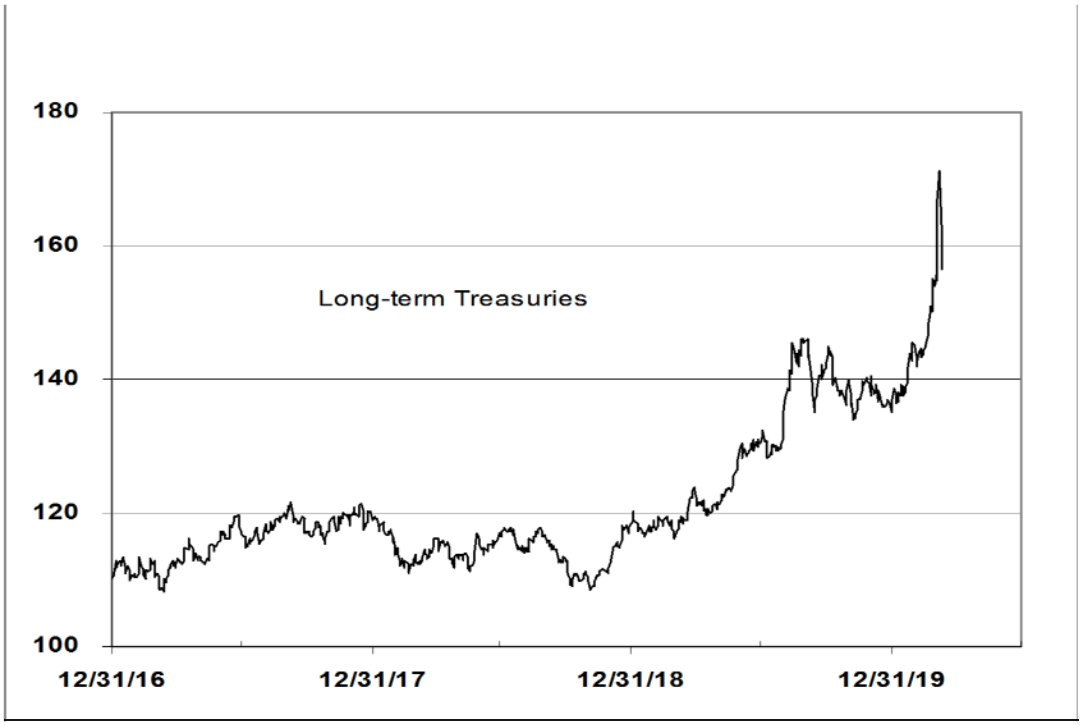
Each reader of this letter will have her or his reports on this same subject. As it relates to my investment work for you, all this means is that there is an unfold-

ing disaster spreading around the world, the seriousness of which is still unknown. The financial markets reflect the seriousness and the uncertainty. The uncertainty by the quite exceptional price volatility we see in many markets, especially in stock markets. There is a statistical measure of this called the VIX, meaning stock price volatility index. As of this week, the VIX has exceeded every previous reading except for those in October and November 2008 immediately after the collapse of Lehman Brothers, the epicenter of that financial catastrophe.

The chart below shows the price action in US Treasury bonds maturing in twenty years or more. This is Core's largest investment.

Treasury prices have risen; Treasury prices always rise in a recession. Despite short-term price movements, there is no reason to sell these.

The seriousness of the coronavirus pandemic is still unknown, but many serious things are known: Supply chains for global manufacturing have been upset. Closing of schools, unwillingness to board planes and travel, closing of factories, sending workers out of offices to have them work from home, and restrictions on travel are serious impediments to economic activity and to life. The odds that we will have a recession are much higher than they were only a month ago. And, given recent sharp and deep declines in the stock market, it seems clear to me that we are in early stages of a bear market. Bear markets are infrequent: the last one ended in March 2009. But they are not brief and they do damage. We can expect a year's worth, if not more, of some nasty stock market action. This nasty action can quite readily bring prices down by twenty to forty percent from their highs in February. In the financial crisis and recession from October 2007 to March 2009, the S&P 500 fell by more than 55 percent. This one may not be nearly so bad, but it is unlikely to be much fun for stock market investors.



Happily, Core's investments have been on the right side of things. In the last month, the S&P 500 index has fallen by more than 18 percent, while our long-term US Treasuries are up by more than 8 percent. For the year to date, Core's portfolios have advanced by more than 10 percent. (There are, of course, variations in individual accounts for lots of reasons.) Because bear markets persist and because, in bear markets, Treasury bond prices and gold prices rise, I am in no hurry to look about for what to buy in the stock market. For now, our 'safe haven' investments in Treasuries, gold and cash preserve our capital and cause it to grow.

As I wrote at the beginning of this note, I have been hearing from clients as things have become exciting in financial markets. Please do not hesitate to call or to email me. There's lots to talk about.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

February 27, 2020

The Black Swan Event

Many investors were quite sanguine about the effect that coronavirus would have on economies and markets.

So much so that as recently as last week, the S&P 500 made a new all-time high. Then, oops, coronavirus spread to more than 40 countries.

The black swan appeared. Stock investors raced for the exit.

Coronavirus is the black swan event for the financial markets and the global economy. So strong has been the prevailing view that the stock market can only go up and that the Federal Reserve will prop the stock market no matter what is going on in the economy, that stocks blithely set new all-time highs only a week ago, weeks after the extent of the epidemic in China became known. In the last week in January stocks fell a bit, then resumed their upward march until February 20th. In the past six sessions, the S&P 500 has fallen by something more than 12 percent and is now down 8 percent for the year to date. Interestingly, however, throughout January and February, long-term US Treasury bonds, Core's largest investment for its clients, have continued to rise in price as their yields have fallen to all-time lows. Similarly, gold, our second largest investment, has moved smoothly and steadily higher, seen as a safe haven in this now more dangerous world. Long-term Treasuries are up by 9 percent this year and gold is ahead by 6 percent. As a result, Core's clients' accounts are markedly higher now, as the pandemic spreads, than before it emerged. Typical client accounts are up about 8 percent so far this year, although there is, of course, some variation in returns among accounts.

Given the very rapid selling in stocks in the last six sessions, they are quite 'oversold' on a short-term basis. And, unsurprisingly, long-term Treasuries and gold are 'overbought,' although to a lesser degree than stocks are oversold. It is quite reasonable to expect that in the short-term, the markets will reverse and that stocks will recover some of their losses, while bonds and gold give back some gains. However, unless, by some miracle, the coronavirus goes away suddenly, it is likely that bonds and gold will be selling at higher prices some months from now and that stocks will be lower than where they stand now.

We have made a couple of investment changes in the last month. First, we bought a small position in utilities stocks, our first investment in stocks in over a year. This is still based upon my thesis that the economy is weakening--and probably more rapidly because of coronavirus--and that investment capital will continue to flow to the safe and somewhat stodgy utilities. Folks do still need to turn the lights on, even if they are not spending and travelling as much. More recently, I sold our position in high-grade US corporate bonds. Our investment in these bonds, via an ETF with the symbol lqd, has been a good one, but I am concerned that, if the economy continues to weaken, especially with the uncertain path of coronavirus, corporate earnings may continue to weaken, even to the extent of not being able to meet their interest payments on their bonds. The risk is not a huge one, but, given that we can invest in US Treasuries with no repayment risk, it seems imprudent to hang on to the corporate bonds.

By

Jack Mayberry

One cannot know how coronavirus will develop and spread. One cannot know how it will affect economies. Caution is the best approach.

The trajectory of coronavirus is unknowable. It seems to spread easily, but the death rate for those who contract it appears to be somewhat low. Optimists acknowledge that the global economy is slowing because of its effects, but they hope for a 'V-shaped' recovery, implying that once coronavirus is 'under control,' the affected economies will rebound rapidly. Maybe. However, travel has certainly slowed, manufacturing, particularly in the affected parts of China, has stalled. Japan has closed schools; presumably parents will stay at home to look after their kids, instead of continuing work at their offices, shops, and factories. Such things will happen in country after country as the disease spreads.

Investment commentators expect the Fed and other central banks to come to the rescue, but short of developing an effective vaccine, it is hard to know what help central banks can offer. (Developing vaccines is not part of the central bank tool kit, at least as I understand it.) Coronavirus affects both supply-side economic issues and demand. Keeping people from work, disruption of just-in-time supply chains, uncertainties about the scope and extent of the disease, and impairment of companies' capacities to meet credit obligations all suppress the supply of goods and services. These in turn lessen demand for employment, cut disposable income, and lessen wealth and confidence. These matters are not readily correctable by central banks.

Core's plans. Our investments have not been adversely affected by coronavirus. Investors have turned to the safe havens of US Treasury bonds and gold in this crisis. Thus one could say that, to a degree, coronavirus has helped our investments. We cannot know how the epidemic will develop and spread; we cannot what will be its short-term and long-term economic effects; we cannot know what will be the financial market impacts of coronavirus. Thus, we will be cautious and watchful.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

February 1, 2020

Priced for Perfection...
...in an Imperfect World

In the last several days, the ever-spreading Coronavirus dominates the news and the activity in financial markets. In the news, we learn of its day-to-day increasing infections and deaths. We learn of the attempts to contain it and to find the means to cure its victims or, at least, to slow its spread. Major US airlines have stopped flights into and out of China; other nations acted sooner than the US. We read of the isolation of those who may have been exposed to it. Only epidemiologists have anything useful to say on these matters and one reads that some of them declare that it is too early to make meaningful predictions.

The sudden emergence of Coronavirus is very disruptive to China's economy. Long-term consequences are impossible to assess at this time.

The investment response so far has been to sell stocks and flock to 'safe-haven' investments like Treasury bonds and gold. This response is entirely rational and very beneficial to Core's portfolios.

Despite not really knowing what may happen next with all this, economists and investment firms have begun to estimate the likely effects on global and US economic activity. The isolation of large cities in China, the cancellation of travel to and from China is certain to restrain China's economic activity; this just after we learn that China's economic growth was slower in the year just ended than in any year in the last twenty-nine. Goldman Sachs, the American investment bank, on Friday projected that the effect on the US economy would be to decrease (already weak) economic growth by 0.4 percent in the first quarter of this new year.

The reaction in financial markets has been utterly reasonable. Stocks have fallen fairly sharply while the safe-haven assets like US Treasury bonds, gold, the Japanese yen and the Swiss franc, have all risen markedly. As we have written in previous letters, Core's investments for its clients have been limited to bonds (mostly long-term US Treasuries), gold and money market funds. We have avoided stock investments on the notion that prices for stocks were too high when measured by the risk they present. Thus, as things have unfolded recently, the accounts of Core's clients have appreciated: long-term US Treasuries, our largest investment, have gained some 7.7% this month, while gold has appreciated by 4.5% and achieved its highest price since 2013.

Priced for perfection. The stock market rose by a more than 25% in 2019 and, until news of the Coronavirus emerged, it had risen by another 3% in the first weeks of January. As discussed in previous letters, the rather remarkable rally has taken place while corporate profits have fallen in each of the four quarters of 2019. And, as also discussed, the price appreciation has gone on while the US economy has been weakening.

By

Jack Mayberry

The rally in the last quarter of 2019 was powered by the Federal Reserve, which had cut Fed funds rates three times in 2019 and, more importantly, had commenced, in early October, another huge round of buying securities. This was undertaken, as we are told, to put right the repo market, by which banks lend to

Stock markets, particularly in the United States, have been priced for perfection.

Unfortunately, the world is an imperfect place.

each other overnight. Buying of Treasury bills has exceeded $300 billion so far and continues at the rate of $60 billion per month. The Fed is at pains to say that this is not a further round of Quantitative Easing--the securities buying that it and other major central banks undertook in the aftermath of the financial crisis. However, the flood of new money into the system, at a time when private credit demand from companies and households is weak, finds it way into asset markets.

Whether the rally in stocks was induced by the Fed or not, the effect has been to increase valuations to remarkably high--one might say dangerous--levels. The ratio of stock prices to underlying corporate earnings--the price to earnings ratio--has risen markedly. Ditto the ratio of price to corporate net assets--the price to book value ratio. Such measures have approached those that occurred just prior to the bursting of the so-called dot.com bubble in 2000 and 2001. Given that there is no obvious likelihood that economic activity in the US and in other developed countries will rise from today's somnambulant levels, it is hard to justify such high valuations.

Thus, one can say that the stock market has been priced for perfection. The disturbances early in January when the US assassinated Iran's General Soleimani gave a brief foretaste of how stock markets could be disturbed by external events. The Coronavirus matter is showing us in a more pronounced way how our imperfect world can throw up obstacles to a stock market priced for perfection.

What about highly priced bonds and gold? May similar points be made in arguing that Treasury bonds and gold, having themselves appreciated so much, are priced for perfection? Of course, and one can read these arguments every day. The difference is that the increase in Treasury bond prices (and the concomitant decrease in their yields) is grounded in economic realities. These include slowing economic growth, persistently low inflation with increasing deflationary pressure, and the excess of savings over the demand for credit. As for gold, how can one measure its value? The decline in interest rates on sovereign debt in these recent years means much. Gold pays no interest and costs money to store safely. The carrying costs and absence of interest payments become less significant when we note that the ten-year German *bund*, the safest security issued in Europe, offers a yield today of -0.438%. In August of 2019, more than $15 trillion bonds traded with a negative yield. We are approaching that level again in this new year.

If one wants security, that is, a safe investment that will assure you of the return of your capital, you may look to German *bunds*. But, if you buy them, you are assured to lose money because of the negative yield. In this world, the carrying costs of gold do not loom terribly large. As prickly situations arise, *e.g.*, a nasty, rapidly spreading virus; a belligerent, missile-testing autocrat in North Korea; or an angry developing nuclear power in Tehran, gold and long-term US Treasury bonds look quite appealing.

At present the world dicey enough to incline me to invest for safety and to realize the gains that will continue to arise in Treasures. The slowing economy and the world of excess savings is one that enhances the value of long-term US Treasuries. Declining corporate profits present a situation too parlous to dump money in the 'priced-for-perfection' US stock market. When the stock market does, in time, return to more attractive levels, Core will be buyer of stocks for its clients. The time may come soon or it may come late, but it will come. The economic cycle has not been repealed and stock valuations--as with many things--do revert to the mean. Let us be patient and sell our Treasuries when they become too expensive. Let us buy stocks when they become attractive in price.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 5, 2020

On to 2020....Buckle Up

Although the killing of General Soleimani is at the forefront of everyone's thinking, and although the immediate impact on financial markets is sharp, we take a look first at the ways by which the actions of the Federal Reserve have pushed stocks higher and lowered expectations that a recession is at hand.

The repo market is complex, but the salient point is that the Fed, since September, has pumped more than $300 billion into the financial system. Because the appetite by companies for borrowing is very low, the money appears to have flowed into financial assets.

By

Jack Mayberry

The repercussions that may follow the assassination of General Soleimani are of paramount importance to peace in the Middle East and in the world. The killing had a very sharp impact on many investment assets on Friday and, as the Monday markets in Asia open, one observes a continuation of these. I discuss this below, but first, a review of recent months.

The Fed and the repo market. As discussed in previous *Core Comments*, the actions of the Federal Reserve Board, both its three cuts in the short-term rates it controls directly and its vast and unexpected buying of short-term Treasuries beginning in the autumn, caused the stock market to rally quite strongly in the last quarter of 2019. As to the unexpected Treasury purchases, malfunction of the so-called repo market, by which banks lend to each other overnight, caused rates for such loans to spike to 10 percent in September. This part of the financial system is opaque but important. Rather than explaining it here, I point to a mid-December article in The Economist that addresses the matter. As for the year end, things functioned as they should, so, in the short term, the Fed has been successful in smoothing a suddenly unruly corner of our financial system: https://www.economist.com/finance-and-economics/2019/12/18/despite-the-feds-efforts-the-repo-market-risks-more-turbulence

In its rescue of the repo market, the Fed put some $300 billion of new money into the system. Although the Fed is at pains to say this is not a renewal of Quantitative Easing, market participants recognized this as yet another gigantic infusion of liquidity into a system in which demand for borrowing to fund corporate activity has been weakening. (In the autumn, while the Fed was increasing the money supply at the rate of ten percent annualized, commercial and industrial lending contracted by one percent.) So where does the money go? Into financial assets. Thus the strong stock market in the last three months.

Recession fears, at their peak in August and September, have subsided. This is more a hoped-for event than one likely to be realized. Corporate profits have continued to weaken; manufacturing activity in the US and other developed countries have continued to weaken; job openings have declined for six months. One could go on. There is little evidence that economies are improving. Although the US has appeared to avoid falling into a recession in 2019, the best one can say is that it is flying at stall speed.

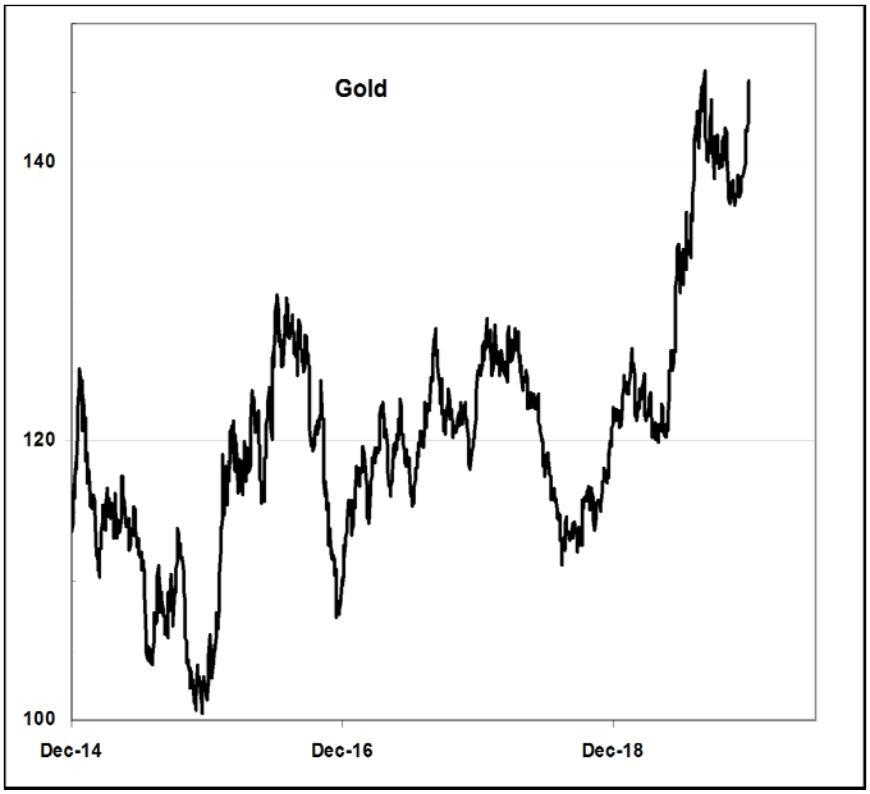
2020 begins. Although the fourth quarter of 2019 was a strong one for stocks, 2020 has not begun well. The assassination of Iranian General Soleimani by the United States on Friday morning New York time caused an immediate sharp sell off in stock markets around the world and sent investors toward safe-

The sharp increase in 'safe-haven' assets, including gold and long-term Treasuries, has given a significant boost to Core's investments. We have avoided stock investments for more than a year, keeping us out of harm's way in the aftermath of the Soleimani killing.

haven assets, notably including gold and long-term US treasuries in both of which Core has substantial investments. Iran promises retaliation and, given that General Soleimani was, by most accounts, the second most important Iranian leader, we can probably take the retaliation threats seriously.

The US stock market rallied more than 25 percent during 2019 while profits of firms in the S&P 500 declined each quarter. This suggests that stocks trade at precariously high levels. The killing heightens already elevated geo-political risk. Let us remember the six-month long riots in Hong Kong, the sharp disagreements between China and America and the nuclear threat from North Korea.

We cannot know how Iran will respond and, unfortunately, we cannot be sure that the next moves by the United States will be calibrated to foster peace. Iran has engaged in provocative actions since Mr. Trump repudiated the nuclear arms treaty negotiated by the Obama administration. Then, in response to the December 27 rocket attack on an Iraqi military base near Kirkut and the raid on the US embassy in Baghdad, comes the sudden attack on General Soleimani, with the bare explanation that further threats to US personnel were planned.



Unless something dramatically awful unfolds from this killing--and we can certainly hope that the dramatically awful will not come to pass--it is likely that effects on the markets in which we invest will be muted. But, when comes the retaliation and when comes the further slowing of the US economy, stocks will give up their high-wire act. This will provide the opportunity to invest in stocks at lower prices than now prevail. After a year in which Core invested cautiously for you and produced solid investment returns in Treasuries and gold, we anticipate an investment environment that will offer opportunity for further relatively low risk and productive investing.

A word about gold. In the last year, Core's second largest investment, after long-term US Treasury Bonds, has been gold. When we made the investment, gold was rousing itself from a significant decline and, with the view that geopolitical disturbances were rising, the case for owning gold seemed strong. As the nearby chart shows, gold enjoyed strong gains in 2019. It stuttered a bit in the autumn as recession fears faded and the Fed pumped vast new sums of money into the system. But well before Iran's havoc and Soleimani's assassination, gold resumed its upward march and, as of early Monday trading in Asia, it has exceeded its late summer highs. Another element in gold's rise is the desire of many countries, China, Russia and others, to withdraw support from the US dollar, the world's reserve currency. Gold purchases by major foreign central banks have been remarkably high in the last year. For better or worse, part of gold's strength represents anti-American sentiment. Gold's ascent will not be a smooth path, but the rather fraught geo-political environment reminds us of gold's safe-haven value.

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