

Some perspective on current events

August 2011

Monday the 8th of August was a historic day on many counts, as volatility in government bonds was extreme (yields on Spanish & Italian bonds declined by almost a full % !) and stock markets around the world continued their precipitous decline. Somehow one could feel the panic selling and also most probably the forced selling.

So, our clients ask, what do we make of this very worrisome situation?

Yes the situation is worrisome but certainly not surprising neither for CapitalatWork Foyer Group nor its clients as for the last 4 years we have relentlessly been talking about worldwide deleveraging, which was going to last for years, by banks, by some overleveraged consumers (US, UK, Spain, ...) and most of all by overgenerous and overleveraged governments.

We have been stressing that the process would be painful, because of sluggish and uneven growth and because of an environment which would be disinflationary at best, deflationary at worst.

This would lead to low, potentially very low interest rates, creating problems for those who need to live from fixed income from their capital.

This is certainly not a rosy environment, but paradoxically not one derived of opportunities and, unless you are very wealthy and/or very very old, certainly not one to sit on your hands and not put your capital to work.

S&P's downgrade of the USA's debt rating does not worry us as much as last week's potential default did, as the critical problem of deficit reduction basically stays the same and there seems to be a framework of negotiations in place and necessary market pressure to significantly raise the chances of success. The USA have, without a doubt, the means to get their fiscal house in order.

The situation in Europe is significantly more complicated, although on average the debt levels are also manageable and the decisions that need to be taken seem to be crystallizing (reduction of the welfare state, creation of a European Treasury, etc ...). Needed now is political will.

Our Tactical Asset Allocation is therefore conservative.

On the fixed income front, we own bonds of the strongest countries (Germany, Netherlands, Finland, Norway, Canada, and Australia) and of companies with a substantial margin of safety when it comes to servicing their debts.

On the corporate equities front, as usual (always was and always will be) the most volatile component of an investment portfolio, one always should worry about all sorts of different risks, general economic growth, industry or company specifics like volume growth, profit margins, profit growth and valuations. It is safe to say that as of this writing (9th of Aug morning with markets again 2/3% down), equity markets are currently discounting a lot of bad news on all of the above.

As an illustration our American Equities at Work, based on conservative earnings estimates (which may turn out to be too optimistic of course) trades at a 40% discount to our estimate of intrinsic value and at an implied growth rate of -1,25% ! Beyond the discounting of negative or very negative expectations, some market participants are forced to sell, dumping prices in the cellar.

So ... our fixed income allocation partly does its work of counterbalancing a very volatile equity component but unfortunately not completely.

Let's stick to our knitting of disciplined valuations, conservative allocations and cool heads, however difficult this can be at times like these

Sincerely Yours,

Ivan Nyssen
Chief Investment Officer

CapitalatWork Foyer Group, the 8th of August 2011.

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