

## **OPINIONS & FACTS...**

**Summer 2010**

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*“Fear has a greater grasp on human action than does the impressive weight of historical evidence.”*

*Jeremy Siegel  
Stocks for the Long Run*

Temperament is a funny thing. No two of us share the same response to our investment results. Some are equal occasionally, but never the same for any length of time.

The outcome of your investment plan will be dictated by your temperament, not by your intellect. The first thing an investor must do is be sure that she has an abiding faith in the future. According to our old friend Nick Murray:

*“Such faith is the belief, in the absence of proof either way, in a secularly rising trend line of human economic achievement, and of the values of great businesses which drive, and are driven by, that achievement.”*

While the moving value of those businesses will periodically rise above and fall below the trend line, they always will, in as much as they are driven by human nature, either be too optimistic or too pessimistic. Remember: historically, when you observe the market's appreciation and your portfolio turns “Too Optimistic”, be prepared. Operating like a pendulum, it will turn back; it's just a matter of when. And if we knew when...we'd all have a Merry Christmas and a Happy Hanukah every year.

**“EVEN BOND GUYS HAVE GOOD IDEAS...SOMETIMES...”**

We've referred in numerous letters to the phrase “New Normal”. While these words sound and seem like the spin of something unusual, it's more than that. Mr. Mohammed El-Erian, CEO and Co-CIO of Pimco Funds, coined this phrase and has added to it ideas we haven't spotted in other writings. His concept is that through a series of transactions, transitions, collisions and trade-offs in the marketplace that we're heading to a world that is re-regulated, de-levered and growing less rapidly in the *industrial countries*. According to Mr. El-Erian, “It's a world in which concerns about the dark side of globalization tempers enthusiasm for its net benefits. One of the problems is the politics which are affecting markets as well as the economy.”

**“So you're in debt. Welcome to the world economy...”**

We are seeing a debt explosion in industrial countries and stringent regulatory initiatives all across the globe. Unlike the last several decades it seems that the industrialized countries are experiencing some headwinds of political problems and the people are thinking “anti-incumbency” around the world. What this has done is to further shift growth and wealth dynamics to *emerging economies*. Industrial economies particularly are operating with reduced tolerance for policy errors and political accommodations. According to Mr. El-Erian, “In a macro way, the time is growing short for private political agendas.” And we might add that sooner or later the industrial countries will run out of lenders.

**“So, what else is askew?”**

I think we see this in our own country, in fact it is so evident that many of us refuse to face it. It's easier to simply look away. With climbing debt, environmental tragedies, wars, global de-leveraging bringing that lower medium term growth there are less public finances in industrial countries. Eventually inflation down the road is a sure bet. Our take on this “New Normal” road to the “New Destination” is that high double digit growth is probably out of the question over the short and intermediate term. **However, we think the New Destination just might be emerging markets.**

Meanwhile, corporate profits have come roaring back helped by tremendous cost resizing especially by US companies along with realized productivity gains. Basically, American industry has learned to do more with fewer personnel this has caused the stuck-in-the-mud unemployment rate to remain between 9% and 10%.

Why hire when your company is profitable with what you have?

**“Hey Joe, the US has been through worse...so stay with us...Isn't capitalism the best idea?”**

Mr. El-Erian maintains in a recent article that the US retains its position as one of the most dynamic and entrepreneurial economies in the world with proven ability to adapt and reinvent itself. He comments, “With lowered

cost structure, increased cash cushions on the balance sheets and controlled debt our country is still a provider of global public goods, including the world's reserve currency." We are certainly in agreement here. Around the Omega world the glass is never half empty – always half full.

Although our friends at Pimco believe things may be different now, there are still basic fundamentals that experienced pros stick with.

We believe that with individual research of selected companies worldwide with the freedom to let well structured money managers make their own decisions, we will be successful in providing you with higher than anticipated returns on your investment.

### **“DON'T TAX ME, DON'T TAX THEE, TAX THAT MAN BEHIND THE TREE.”**

On January 1, 2011, Federal, some state and local tax rates are scheduled to rise quite sharply. The Bush tax cuts expire on that date and this means that the highest Federal personal income tax rate will go to 39.6% from 35%; the highest federal dividend tax rate pops up to 39.6% from 15% while the capital gains tax rate jumps to 20% from 15%. Lots and lots of other changes will occur as a result of the sunset provision of the Bush tax cuts.

### **“The drumbeats from Washington sound ominous...”**

There are many other caveats to the expected, mysterious tax code that is being talked about by the Administration and the Democratic Congress. It appears that this tax bill may be written with no concept that people have the ability to shift tax rates, production and income out of next year (2011) to this year to the extent possible.

Recently you may have read about the governor of New Jersey killing an idea of the excess taxing of millionaires in New Jersey. It was pointed out that probably more than 50% of those very wealthy people could simply move their income to other states that had no state income tax. As we've written before we recall the Reagan **TAX CUTS** gave us great incentive to work longer and harder because we were keeping more of the money we earned.

This will be a history lesson for all of us when we see the effect of the increased sovereign debt during the middle of a hung-on recession with interest rates at record lows and the fed attempting to jump start the economy and at the same time increasing taxes.

### **“Leadership indecision is the enemy of successful government.”**

The mystery continues: increased taxes during a lingering recession; record debt; a nine year war; the stock market going up at the slightest hint of positive news. We search in vain for mature, experienced leadership.

However, there has always appeared politically courageous people who are willing to use proven economic truths that have worked and will work again. So one of the most valued characteristics of the American people is the ability to “know” when things weren't right and become motivated enough to do something about it.

### **WE KNEW THEY WOULD FINALLY WISE UP AND JOIN US!**

For years we have been under the belief that if you owned a “fully managed” mutual fund (where stocks and bonds are actually researched by live human beings these same people doing in-depth studies of companies, rather than computers looking at indexes) that you would have a better opportunity to reach your financial goals than simply choosing a mutual fund that has nothing in it but mid cap stocks, or small cap stocks or any other specialty that concentrates on one tactical asset. Finally the idea of giving fund managers total freedom is now catching on with investors. Our thought is that to accomplish reasonable investment levels you must trust the organization managing your assets to diversify not only in various selected assets, but also globally.

A small category known as Global Tactical – Asset – Allocation funds have finally become popular in the last couple of years. Managing a fund in an unconstrained or tactical manner can, theoretically, provide downside protection and some sort of absolute return during episodes of extreme market volatility. By having “safety valves” (a form of bonds or more conservative stocks) a portfolio could appeal to more conservative or risk-adverse investors.

Needless to say, this gives the managers the freedom to go anywhere to accomplish the goal described in the prospectus. It can allow the managers to become more nimble.

### ***This has been our investment policy for many years.***

According to a recent *Fund Track* article in the *Wall Street Journal*, this flexibility is often absent in other mutual funds, in part because many managers run their funds for institutional clients, whether large investors or financial advisors. What this means is a fund must fit into a particular “style box” that Morningstar has “invented”.

The advisors or investors who use the style box, fit funds typically that allocate their money to a particular manager or fund based on a certain strategy, US Large Cap, for example. If that fund is not performing as expected in order to keep the same allocation (large cap) stock in the portfolio another fully invested large cap fund has to be found. This means the advisor (or investor) must know when to go to small cap, mid cap or cash, based on the economy/market. *Did I hear market timing?*

We have observed (by long experience) that individual investors can suffer under this approach because they don't have the background to know when to be fully invested in specific classes. The typical client at Omega relies on managers both for achieving gains and minimizing losses. These flexible funds have been a favorite of ours for many years. While many advisors use isolated style funds for their asset allocation, we've found that utilizing superior managers with consistent returns is the best bet giving them the freedom to allocate in many types and styles of stock and/or bonds.

## OPINION

The Administration's flagship effort to help people in danger of losing their homes is not working out so well, according to Alan Zibel of the Associated Press, more than a third of the 1.24 million borrowers who have enrolled in the \$75 billion mortgage modification program have dropped out, the article stated. Last month alone, 155,000 borrowers left the program bringing the total to 436,000 who have dropped out since it began in March 2009.

A major trigger, according to the AP, causing so many to have dropped out is the Obama Administration initially pressured banks to sign up borrowers without insisting first on proof of income. "When banks later tried to collect the information many troubled homeowners were disqualified or dropped out", the article stated.

The writer goes on to point out that many borrowers said the banks had lost their documents, the industry said borrowers were not sending back the necessary paperwork and now Treasury officials are requiring the banks to collect two recent pay stubs at the start of the process in order to prove documentation of their income. One of the problems now is that people have to prove their income, unlike in the early heady days of the "almost free money" insisted on by Freddy Mac and Fanny Mae.

(Imagine that. They won't let me "misrepresent" my income on a mortgage loan application!)

There should be a lesson here that maybe, just maybe, many of the people who have below prime loans shouldn't be buying homes, but should be renting until they can

afford a down payment. Where we ask again: does the US Constitution guarantee that every citizen has a constitutional guarantee to own a home?

Another lesson we might learn from this: the "give away" of borrowed money to people who can't afford to own a house is not a "stimulus". Apparently people don't really value "free gifts" from our government who take those gifts from people who earn the money and pay taxes.

That's our take, yours is welcome

*Joseph E. Hawley* *John Dickers*

*Tom Hawley*

*Sammy Bryant*



"IT DOESN'T MATTER WHAT EITHER OF YOU SAY. THIS ADMINISTRATION BELIEVES THE WAY TO PROSPERITY IS TO BORROW MORE MONEY, REDISTRIBUTE IT TO PEOPLE WHO DON'T WORK, AND HOPE THEY BUY TV'S, CARS, BEACH HOUSES AND ELECTIVE PLASTIC SURGERY PROCEDURES."

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