

MARTIN TRUAX *and* RON MILLER

The
EVERGREEN
Portfolio

TIMELESS STRATEGIES
to SURVIVE and PROSPER from
INVESTING PROS



The Evergreen Portfolio

**TIMELESS STRATEGIES TO SURVIVE AND
PROSPER FROM INVESTING PROS**

**Martin Truax
Ron Miller**



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Preface

For the past 20-plus years, a group of individual investors, advisors, and writers has been gathering together in the spring for a tradition of exchange of investment outlooks and ideas. Starting in Atlanta, the meeting moved midway to the North Georgia Mountains to a private estate known as Chota Falls. Thus, what started as the Atlanta Investment Conference began to transition into the Chota Forum, where the number of speakers stayed about the same but the size of the audience became more limited. One of the advantages of this revised forum size was the greater ease of one-on-one exchange and interaction.

Over the years, the “elves” from Louis Rukeyser’s *Wall Street Week*, national political representatives including the former Speaker of the House, Hon. Newt Gingrich, major brokerage firm analysts, investment newsletter writers, and business executives (future billionaires included)—have participated as speakers and presenters. Although not everyone saw the future the same, they gave our attendees a heads-up about what was happening in our country and the world, and an opportunity to perhaps *position their investments more advantageously*.

At the Chota Forum in the spring of 2009, the speakers were individually interviewed by the Master of Ceremonies after their specific presentations. In each taped interview, Gary Alexander asked them five specific questions:

1. How did we get in this mess?
2. What will the recovery cycle be like?
3. What is your suggested solution to the problems?
4. What is your longer term outlook?
5. How should one invest in this environment?

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As you will read in Chapter 2, those speakers participating in that year's personal interviews were:

- Bob Barr, former Congressman and Libertarian Party presidential candidate
- Robert Bishop, longtime editor of *Gold Mining Stock Report*
- Roger Conrad, editor, *Utility Forecaster* and *Canadian Edge*
- Adrian Day, CEO, Adrian Day Asset Management
- Neil George, former editor, *Personal Finance*
- Elliott Gue, editor, *Personal Finance* and associate editor, *Energy Strategist*
- Dr. Alan Keyes, former Republican presidential candidate
- Ian McAvity, editor, *Deliberations*
- Rick Rule, CEO, Global Resources Investments Inc.
- Ben Sheperd, editor, *Louis Rukeyser's Mutual Funds*
- Mark Skousen, editor, *Forecasts & Strategies*
- Frank Trotter, president, Everbank.

Soon after the 2009 Conference, we were contacted by publisher John Wiley & Sons about putting these thoughts into book form. Many of the presenters agreed to put more extensive thought and advice into a single chapter for this combined contribution project.

When informed of it, other financial experts agreed to join this project. Robert Prechter and Alexander Green, editor of the Oxford Club, quickly agreed to add their thoughts. In addition, *U.S. & World Early Warning Report's* editor, Richard Maybury, gold guru Duane Poliquin, rare-coin experts Van Simmons and David Hall, and estate planning attorney Gary Kashdan agreed to contribute.

The Friends for Autism Foundation, Inc., has been the organizer and beneficiary of the 20-year conference event.* It will also be the recipient of the royalties of this book. Over the years, all of the speakers have contributed their time, and in most cases, their expenses of being at the conference, in order to help the cause of autism. When the event was first organized in 1987, it was estimated that 1 in 10,000 were affected by this condition. Now the Centers

* For information on the Friends for Autism Foundation and its partner, Childhood Autism Foundation (CADEF), you can go online to CADEF.org. For information on the Atlanta Investment Conference/Chota Forum, please e-mail: atlinvestconf@mindspring.com.

for Disease Control and Prevention (CDC) estimate this number at *1 in 105* (1 in 70 for boys). The Friends for Autism Foundation appreciates the generosity of all the forum speakers and attendees over the years. The Atlanta Investment Conference/Chota Forum has raised substantial sums for the cause. These funds have contributed to an autism center at Emory University Medical School in Atlanta, and toward model schools and training programs. Again, we thank all those who have made this and other efforts benefiting this cause both meaningful and worthwhile.

What you are about to read contains the condensed wisdom of more than 15 seasoned investment pros in a very unique gathering of contributions never before brought together in written form. We believe you will find it a most valuable and useful guide in helping you build the tools necessary to successfully invest and profit even in the most tumultuous times. In compiling these selections, our goal is to help you meet your financial challenges with more of your assets intact and with an appreciation and a better understanding of what is happening, and most importantly, of how to prepare and adjust accordingly.

With our best wishes and expectations,
Martin Truax, Conference Co-Chairman

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CHAPTER 1

The Evergreen Portfolio

THE BIG PICTURE

Martin Truax

Our planet had a close call with financial fate in the fall of 2008. The dominoes began to fall as nontransparent hedge funds rejected redemption requests and aggressively yielding money funds were about to do the same. As investors' emotions switched from greed to fear, a classic run on the alternative and shadow banking system began. Some of the most savvy were transferring bank balances to Treasuries only. Complacency had suddenly become concern, and capitulation soon followed. We had a financial panic, the worst in 70-some years. The banking system froze and deleveraging ensued, bringing on a deflationary adjustment in almost all classes of global assets, with the exception of the highest quality of liquidity.

Government financial intervention became the most aggressive in modern times. Liquidity, low interest rates, purchases of doubtful debt, cash to consumers, incentives to buy cars and homes, anything that might slow the speed of the falling dominoes was attempted. *Less bad* was soon seen as *better* than *more bad*. Liquidity went mostly into the financial markets, into stocks and all levels of bonds, from the government's short-term debt to corporate junk paper. With direct correlation, most of the global financial markets

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had a significant rebound. The intervention appeared to be successful for the time being.

Now we have what many are describing as a *new normal*. It's become a different world with higher unemployment, excess manufacturing and housing capacity, and difficult-to-obtain credit. Consumers hesitate to buy beyond the necessities. Their hopeful expectations for the prime collateral of the world, real estate, are forced to be adjusted. Buyers look for bargains and wait until prices are actually further reduced. It's a classic deflationary scenario that ushers in a *self-feeding deflationary trend*.

The Long Cycle

Extending over the life expectation of the average adult, the long-term economic/financial cycle repeats about every 70 to 80 years. Our human errors are revisited as memories formed by experience fade away. The financial lessons of history are forgotten. Beginning the long cycle, from a conservative mindset of debt *avoidance*, debt steadily is sought and extended until it becomes unmanageable. In the first decade of the new millennium, we arrived at the unmanageable level again. We have employed debt instruments created by financial engineers that are so convoluted that even the engineers aren't sure what, where, or how much exists. Rules put in place some 70 years ago to prevent recurrences of past mistakes were changed and abandoned. Gone were the Glass-Steagall Act, which separated commercial banking from investment banking; the stock lending rule for shorting; and the uptick rule. Gone, too, were the more conservative bank leverage caps, and the regulation on the largest financial markets—derivatives. These safeguards were all abandoned or ignored to allow *greed* to once again overwhelm the system. And the system broke. Can it be put back together once again?

For the U.K., the U.S., and most of the developed countries, it will probably take a long time for the deleveraging side of the long-term cycle to unwind—perhaps a decade *or more*. And depending on who's in charge, our social structures could be significantly altered during this transition. Americans' expectations are high. Y2K proved to be beatable and a nonevent. We continually want and expect quick financial fixes. But Americans have promised themselves *what cannot possibly* be delivered in their future. As I heard the late John Templeton (1929–2008) say simply in one of

his final presentations, “American industry and government have overextended themselves in retirement and health benefit promises.” It has become our expectation to be taken care of in our senior years. Historically, the family took care of the family. Elections and labor negotiations were won with promises that someone besides our family might provide for us instead. The means are just not there. Any further deflation and destruction of the value of what remains (of our nest eggs) will further extend the time for potential financial recovery. We’ve arrived at that point in the cycle where the ammo for quick fixes is getting low and the incoming opposing forces loom overwhelmingly.

Our Future

In our personal battle for financial survival, plans for our retirement or legacy may need to be adjusted. Certainly our investment strategy will need to be different when we’re in the deleveraging/deflationary back end of the long-term cycle than when we’re in the early inflationary/leveraging expansionary stages of the cycle. In round one of the deleveraging process from 2000 to 2009, the average global investor lost about a quarter of his overall asset values in stocks, bonds, and real estate—probably more if leverage (debt) was employed. Round two, a carryover of the unfinished first round, could be even more destructive. We can expect the governments of the world to attempt to further delay the natural cycle. They’ve done so already, but only by expanding debt even more. This increasing debt will have to be dealt with again at a future time.

As Ludwig von Mises said: “There are no means of avoiding the final collapse of a boom brought on by credit expansion. The alternative is only whether the crisis should come sooner as a result of voluntary abandonment of further credit expansion, or later as final and total catastrophe of the currency system involved.” The writer of possibly the longest-published investment newsletter in the United States, Richard Russell, observes: “There have been other debt bubbles in history, but this one is by far the greatest ever and definitely more international in scope. The outcome when previous bubbles have fallen apart has always been a deflationary depression.” My own thought is that eventually renewed inflation will be the alternative of choice, whether we experience a depression or somehow manage to avoid that potential social changing event.

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From the book *This Time It's Different*, authors Carmen M. Reinhart and Kenneth Rogoff say:

Perhaps more than anything else, failure to recognize the precariousness and fickleness of confidence—especially in cases in which large short term debts need to be rolled over continuously—is the key factor that gives rise to the “this-time-it’s-different” syndrome. *Highly indebted governments, banks, or corporations can seem to be merrily rolling along for an extended period, when bang!—confidence collapses, lenders disappear, and a crisis hits.* [Italics added for emphasis.]

Economic theory tells us that it is precisely the fickle nature of confidence, including its dependence on the public’s expectation of future events, that makes it so difficult to predict the timing of debt crises. High debt levels lead, in many mathematical economics models, to “multiple equilibria” in which the debt level might be sustained—or might not be. Economists do not have a terribly good idea of what kinds of events shift confidence or how to concretely assess confidence vulnerability. What one does see, again and again, in the history of financial crisis is that when an accident is waiting to happen, it eventually does. When countries become too deeply indebted, they are headed for trouble. When debt-fueled asset price explosions seem too good to be true, they probably are. But the exact timing can be very difficult to guess, and a crisis that seems imminent can sometimes take years to ignite.

Just as the economists, politicians, and majority of investors didn’t anticipate round one, or at least its timing, we can probably expect that round two’s long-term impact will be at least equally surprising, and probably at least as destructive. I might expect it could be even more so, as much of the means to defend or counterattack have been depleted. Interest rates can’t go below zero for too long—or can they? To what asset categories will be the next flight to safety?

Is there a round three out there as well? Probably so. It might well be the “unintended consequence” of rounds one and two. What will rounds two and three look like? Biblically speaking, we’re not given to know our fate, but that doesn’t mean that we do nothing in preparation for the possibilities. Some of our colleagues have addressed potential

preparations in the following chapters of this book. Personally, I feel that we need to respond as the events occur. But we need to have in place a plan that we can quickly implement as the future unfolds. The best investors will seize the opportunities as the present affords them. As the late financial manager Peter Bernstein remarked, “Look at your wealth as a loan. It can be called at any time.” By employing a diverse strategy, we’ll hope to survive and maybe even prosper. By all things we can consider, we’ll certainly plan on it.

Asset Placement

The average investor has accumulated real estate (30%), business interests, cash reserves (12%), bonds (7%), and stocks (25%), as well as life insurance policies and pension plans.* Most investors use some kind of management for these more liquid assets, be it commingled funds or separately managed accounts. And most have also bought into both the *efficient market theory* and the *modern portfolio theory*. The first theory states that it’s tough to beat the market indexes over time. The second states that you diversify through different styles of management. Different styles can include big cap, small cap, mid-cap, international cap, value, and growth (*cap* is short for the *capitalization* size of the companies).

My response to this is:

Rule #1. If you want to survive and hopefully prosper during the back side (the deleveraging) of the long cycle, forget both of those theories.

Rule #2. Remember Rule #1.

If you have so much big cap, small cap, mid-cap, and international cap and the market declines, it means that, overall, you’re going to have *so much less cap*. I’ve never had an investor tell me that’s what he wants and expects from his assets—less cap. But most investors have bought into these themes when they were presented to them. It’s what the financial industry teaches its people in training and through continuing education programs. It’s repeated over and over again. Financial advisors and management have no doubt believed it and have certainly bought into it.

*Barron’s 9/14/09—David Rosenberg.

There are certain periods when these theories can work: when the market goes up over a decade or two, such as the two periods of 1949 through 1966, and again from 1982 to 1999. Both were approximately 17-year periods of continually higher markets with periodic corrections (declines). But the three periods of 1966 through 1982, 1929 through 1949, and 1999 through whenever, were not periods of upward-trending markets with periodic corrections. Rather, these were periods when we experienced extended declines with periodic upward corrections. These periods, too, can last 17 to 20 years. The only way for your equity assets to survive and possibly prosper in such a period is for you to become a tactical asset allocator. *Tactical* means: There's a time to increase equity asset exposure, and a time to decrease equity asset exposure. Yes, there should be a timing to be fully invested. There should also be a timing to cause us to be less so. In my opinion, we are in a period for the latter. To think and act otherwise could be destructive to your capital—like a loan, callable at any time.

Most financial advisors will tell you that it's just time in the market. But for the first decade of the new millennium, 2000–2010, the Dow Jones Industrial Average crossed 10,000 approaching 30 times. The index investors didn't make a dime, even with their dividends, for their time in the market. That's 10 years of negative return, with the S&P (including dividends) down approximately 10 percent. In addition to the actual losses, there is also the opportunity loss of the income that could have been received from Treasuries or money market funds had one stayed on the sidelines. Even at the end of that decade, the market was still at a historically expensive multiple to earnings.

We can also look at the results of some of the timing of tactical investors, individuals who used a successful method of adjusting equity exposure during this past decade. Some more than tripled their equity assets during that same 10-year period. We have to choose which drummer we want to march with. Do we go with those who say, "You can't time the market; you can't beat the market"? Or do we march with those who have been successful at doing just that? According to investment manager Ron Arnott, a study shows that annually rolling over 20-year Treasury bonds since 1966 has beaten the S&P during that same period. That's right: For 42 years through December 2008, government-guaranteed bonds have beaten the stock market indexes.

Bonds

Bonds also need management and adjustment. We can just choose to roll over varied laddered maturities. For example, we can invest in 2-, 4-, 6-, 8-, 10+-year bonds and, when each matures, we just roll to the 10-year period. In 8 years you'll have all the money at more favorable 10-year rates. You'll also have liquidity every 2 years. You could also create a similar ladder going out as far as 20 years. And maybe that's okay for the *first* 70 years of the long-term cycle. But remember, the current cycle was artificially stretched to avoid the pains of recessions. It started when Federal Reserve Chairman Greenspan reacted after the crash in 1987 with, "not on my watch." Presidents learned that *it was the economy* that most impacted their ability to stay in office. Whatever it took to keep the economy growing and the markets hitting new highs became the priority of the past 25 years.

Each economic slowdown of the past quarter-century has been met with lower interest rates and monetary stimulation (called *quantitative easing*). We became accustomed to the "Greenspan Put." The Maestro could turn it around. He could defy the unpleasant deleveraging/deflationary part of the inevitable long-term cycle. We postponed the unpleasant, just as we can postpone a trip to the dentist. Regular trips will keep us healthier. Extended avoidance will eventually allow a small cavity to rot the tooth to the core. At some point, through postponement, it will give way and be lost.

Quantitative easing (money printing or computerized expansion of available cash or bonds) by a government with immunity from writing checks without sufficient funds can be useful in emergency situations. Most of us have overdraft protection on our personal accounts for such occurrences. But when debt is not paid back, how much and how long can it go unaddressed? We'll find out, for sure. Most would agree that we're past the point of being able to repay. We can't raise taxes high enough. We can't cut expenditures low enough (much of the expenditure is interest on the debt). So what can be done? The answer is that eventually we'll probably have to deflate the relative value of debt. Remember your first mortgage or auto loan? If you had to borrow, it probably seemed big at the time. But now most of us look back at that debt as small in comparison to some potential asset financing today. That's a lot of creeping inflation. Just accelerate that inflation of the assets and the current fixed debt, too, can look smaller and more manageable.

We must remember, however, should inflation reappear as a solution to excessive government debt, that interest rates would likely adjust upward. Investors expect to get the inflation rate plus 2 or 3 percent of earnings on their money. If rates go up, previously issued longer term bonds adjust downward to compensate for the new higher rates. So, longer term bonds could leave us with less purchasing power when they mature after inflation, and less principal if we cashed them in early to get the new higher rate. Meanwhile, the short-term rates during ZIRP (zero interest rate policy) leave us little or no return after taxes.

By law, states, counties, and municipal governments cannot run deficits. These governments are not able to write checks against insufficient funds. So, greater care must be exercised in selection of which regional entities will have the sufficient funds in times of state and local government financial shortfalls. Some state budgets are already short almost 50 percent in their tax receipts to their budgeted expenditures. Taxes can't be raised enough to offset these deficits. Budgets can't be easily cut in half without social consequences. Something has to give. How much of it will be from the repayment of bond principal?

Fixed Returns

All this is to say that a guaranteed rate of return might be nice for planning retirement and legacy purposes during the first 60 or 70 expansionary or milder asset-inflating years of the cycle. It might be just as nice in a normal, longer-term backside or deflating side of the cycle as well. But our current cycle was not allowed to be normal on the Maestro's watch. Election considerations were prioritized. So, rolling a large portion of our assets to a guaranteed return during a period of artificially low rates could be devastating if inflation becomes the ultimate answer to debt excess. Since lowering expenditures and raising taxes don't win elections, what do you think the other solutions might possibly be? Investors need to plan accordingly and not get overly fixated on a guaranteed return at this time. And remember, in round one, many of the guarantors had to get guaranteed themselves. That was just in round one. Unfortunately, most individual investors were choosing to place their investable assets into fixed returns (cash and bonds) as this first decade, or round one, was closing out.

Stocks

Most investors expect history to repeat in terms of long-term performance of equities. Over the long term, 10 percent has been the average. As discussed earlier, there are cycles of approximately 17 years when the returns have substantially exceeded 10 percent, and periods of approximately 17 to 20 years when they have substantially fallen short of the average and actually been negative. The years 2000 through 2009 are an example of an entire decade with negative returns. Over the long term as well, about one third to a half of the 10 percent return has come from dividends.* With the 80 million or so Baby Boomers wanting to retire soon, or having already done so, they will need income. Total return investing (a combination of dividends and appreciation) yielded unsatisfactory results for the past decade. The biggest problems that caused the financial crisis, panic and a negative performance (overextension of debt and use of derivatives), have only gotten more unmanageable. My expectation for the remainder of this current potential (minimum) 17-year period, which began in 2000, is for more of the same.

I feel that high-dividend stocks will be in strong demand. Combined with hedging techniques that follow the market direction, these “cash cows” can help preserve principal while providing spendable income. As the collection of Social Security and Medicare premiums (taxes) from the working generation falls short of promised distributions to the retired or semiretired Boomers, something has got to give. Will it be “means testing” that lowers our benefit payments, or will it be higher premiums or taxes? Those with “other means” (other income, assets, or both) might even see both a higher tax and a lower benefit payment. To maintain the lifestyle to which we have become accustomed, and want, and expect, Boomers will need to become more self-sufficient—as in having spendable (bird-in-the-hand) income from our investable assets. I feel any time can be a good time to be accumulating high-dividend stocks, but only when combined with a defensive, disciplined, hedged approach to investing.

The *hedged approach* should be transparent (with no secrecy of what you’re investing in), liquid (to be able to get your money on a day’s notice) with no “lockups,” without leverage (with no margin), and guaranteed against theft by government-sponsored

* One-third since 1926 for the S&P 500; half since 1919 for the Dow Jones Industrial Average.