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Third Quarter Letter
October 27, 2016

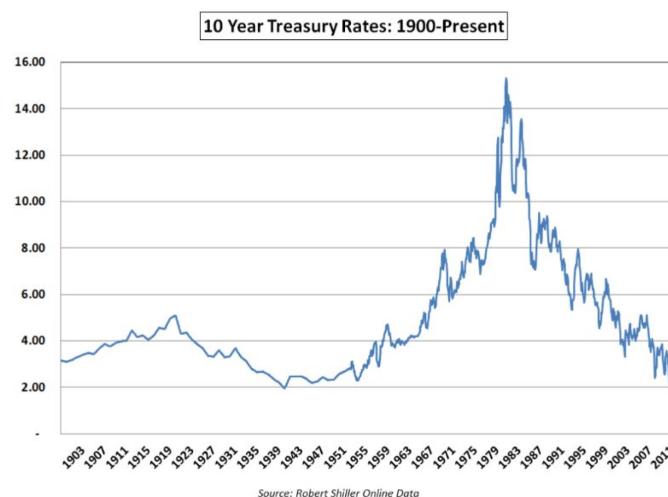
Dear Clients and Friends,

I try to use this medium to look at a big picture issue or, at minimum, something other than parroting the quarter's performance figures for a few asset classes (you can do that yourself!). This quarter, I just have a simple question:

**Could we be experiencing a "bubble of safety"?**

Please note: it's not my style to be a "bubbler-caller" so I don't want to be seen as taking some cemented stand, as many prognosticators have done for centuries, and as many have done since the financial crisis of 2008-09. Calling a bubble usually brings with it an ugly step-sibling: the doom-and-gloom warning about the wreckage surely to appear once the exuberance recedes (and hopefully the press coverage for calling it). This is not a "white paper" nor a thesis justifying personal or professional investment action or policy changes. It's a question.

**Safety of Government Bonds**




The stunning collapse of the prevailing rate of return provided by US Treasury notes (pictured above) can be described simply in one sentence: there is massive demand for "risk-free" US government fixed-income securities in a major flight to safety. Say what you want about central bank intervention, low inflation, whatever - investors are willingly receiving returns not seen since Depression-era trading. Speaking of investors…

**Safety of Cash**

**Playing It Safe**

Percentage of those surveyed within each generation who feel investing is too risky

| MILLENNIALS | GENERATION X | BABY BOOMERS | SILENT GENERATION |
|---|---|---|---|

**Bolder With Age**

Millennials hold more investments in cash and less in stocks than older generations.

| | MILLENNIALS | GENERATION X | BABY BOOMERS | SILENT GENERATION |
|---|---|---|---|---|
| **Cash** | **70%** | **68%** | **60%** | **53%** |
| Equities | 14 | 17 | 20 | 22 |
| Bonds | 7 | 5 | 5 | 9 |
| Real estate | 4 | 3 | 3 | 4 |
| Alternatives | 2 | 1 | 1 | 1 |
| Other | 1 | 3 | 8 | 8 |

Note: Silent generation, boomer and Gen X respondents with at least $100,000 in household assets and millennial respondents with at least $50,000 in household assets.

Source: BlackRock Global Investor Pulse THE WALL STREET JOURNAL.

This is a chart that should make any investment advisor cringe, and requires no explanation why. Cash levels of this size (and the fears of investing), across all generations, are shocking and are a major indication of safety-seeking among the survey's respondents; people with money to invest.

**Safety of Living in a Fantasy**

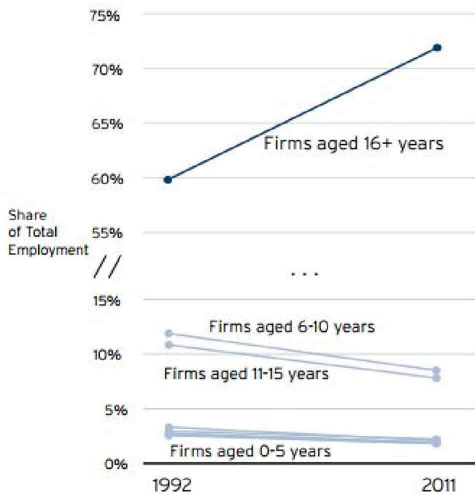
**Self-made millionaire: Don't put money in your 401(k)**

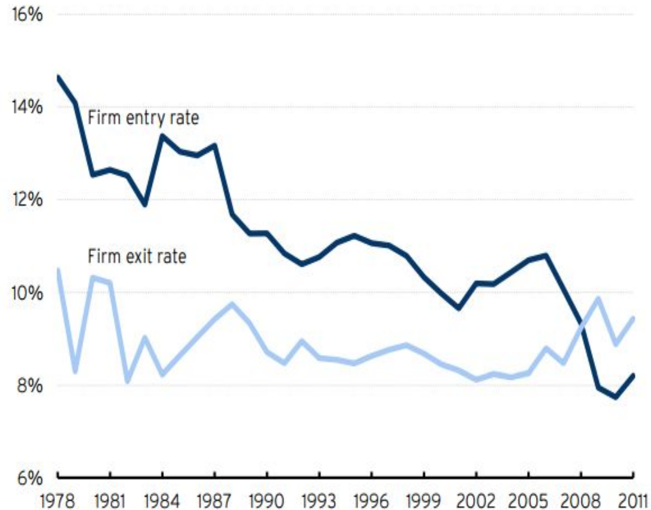
October 26, 2016

A maddening display of the "guru fallacy" (my term) is on display in this CNBC article. Too often we see one person's major success as a simple formula to be copied, but in this case it's especially awful because of his advice to young people. "You can't save your way to millionaire status," says our Guru, in a completely false, misleading and egotistical piece which advises young people to *just work a little harder to reach the financial promised land,* as if our bootstraps are all connected to hidden millions and all we need to do is pull on them hard enough.

Truth: you can save and invest your way to millionaire status. It's not complicated. The power of compound interest is the most powerful thing any young investor can ever harness. Like you needed another reason to stop paying attention to CNBC?

**Safety of Working for The Man**

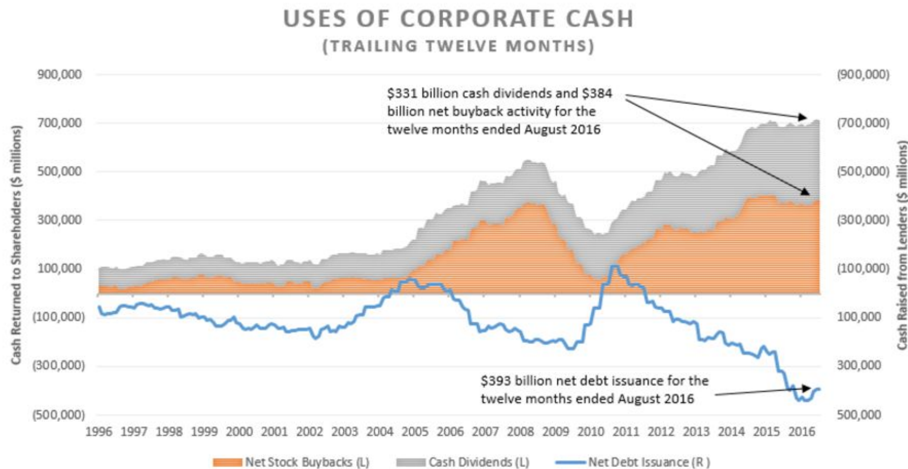



Source: Brookings' "The Other Aging of America: The Increasing Dominance of Older Firms"

This one's pretty simple: less new companies are being created, while jobs increasingly lie with larger, older firms. We could go down a rabbit hole and speculate why this might be but the takeaway should be that NOT starting a new company is the safe play and people are increasingly going this route. The trend of portraying Americans as startup-crazed risk-takers might be a bit fudged, don't you think? The TV commercials with pre-teen startup founders wearing suits in their parents' garages are pretty cute, though.

**The Safety of Lining Your Pockets**




Source: factorinvest.com

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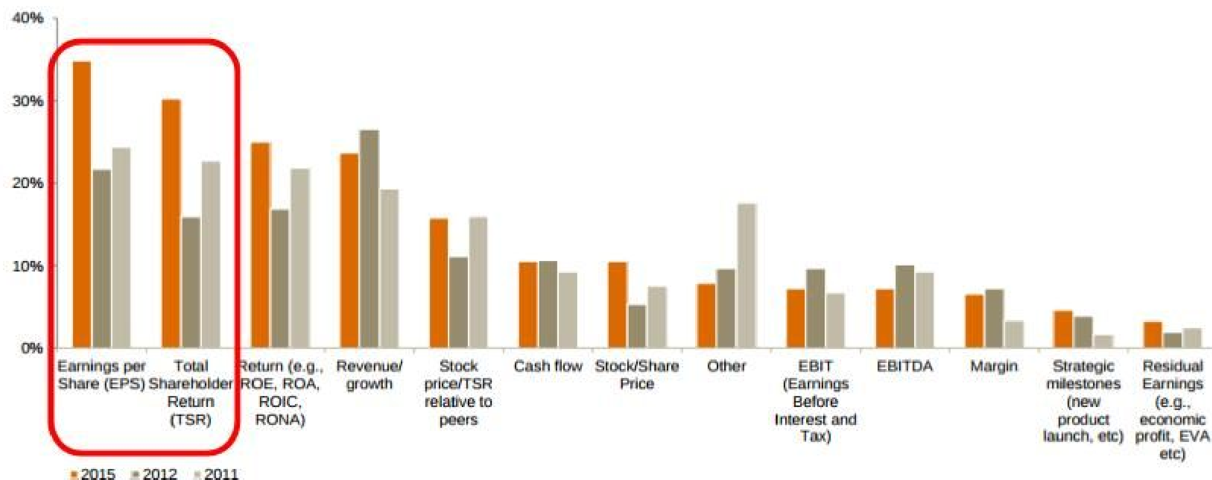


Source: PWC's Global Equity Incentives Survey

What could be safer than paying yourself with somebody else's money? It is increasingly the norm to have executive equity compensation tied to short-term metrics *the executives can directly manipulate*, like EPS and Total Shareholder Return. Corporate executives are incentivized to shun thoughtful uses of retained earnings and are instead - you guessed it - playing it safe via buybacks and dividends, simply because they're allowed to by shareholders and directors who aren't taking the long view. Why take a risk looking out decades when you can earn huge sums today? (Hopefully your sarcasm detector was on)

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We can play this game all day, but my point is simple: there's a seemingly larger than normal demand for safety right now. It shows in interest rates. It shows in cash holdings. It shows in false beliefs about saving and investment. It shows in declining entrepreneurship rates. It shows in executive compensation and corporate distributions.

What if much of our current economic stagnation was actually derived from a lack of risk-taking, instead of excesses? I don't know the answer to the question, but I do think about it a lot. Could I be totally off-base here? Are *you* seeing it out there? Have you noticed a trend of clinging to what's safe and secure in your world? Let me know - I'm genuinely curious to hear other viewpoints from those of you in other industries, cities and states.

As always, thank you for your trust.

Sincerely,

Tyler

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