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At the end of the 1990's, I wrote an article entitled "The Fiduciary's Dilemma," forecasting the likely demise of the then nearly two-decade-old equity bull market. Individual investors and fiduciaries for institutions had reaped substantial rewards from almost twenty years of powerful advances in both stocks and bonds. In fact, there had never before been as profitable a period for the stock/bond combination as that from the early 1980's to the end of the 1990's. One didn't need to be a particularly astute investor; one only had to be invested to make significant profits.

In numerous written commentaries and speaking engagements at the end of the 90's, I flagged the primary dangerous conditions of excessive debt and extreme stock market valuations. Based on historic precedent, there was good reason to anticipate a long corrective phase, potentially lasting as long as two decades. Prior long weak cycles lasted until the excesses of the previous long strong cycle had been expunged.

From the bull market peak in the early months of 2000, stocks have experienced two devastating 50+% declines followed by two powerful rallies, netting an annualized century-to-date common stock return in the low single digits. For a variety of reasons, most investors have earned even less than this meager amount, despite powerful government stock market support since 2009. We are pleased that Mission clients with us for the entire century-to-date have earned more than the S&P 500 while assuming far less risk than the index.

A decade and a half later, we are faced with conditions very similar to those that characterized the late 1990's. Stocks have been in a powerful bull market since 2009. Investors who have exercised caution have sacrificed performance. Equity valuations are near historic highs, although below the dot.com highs seen at the 2000 peak. On the other hand, debt burdens are considerably more severe today than they were at the peak in 2000.

Just as at the end of the 1990's, investors hate to give up on the golden goose, which has been so generous for years. At the near collapse of the financial system in 2008, the Treasury and Federal Reserve Board stepped up with unprecedented amounts of rescue money. With the economy never recovering to "escape velocity", the Fed has continued to pump a previously unimaginable amount of money into the banking system. That flood of money has still not been able to kick-start the economy out of the slowest recovery from recession in the past half century. It has, however, kept stocks climbing, with the Fed stepping up its efforts whenever stocks began to demonstrate even marginal weakness. As a result, investors have developed overwhelming confidence that the Fed has their back and will not allow significant market declines. Near historically low interest rates have made the choice of equities easier. Many believe there is no alternative to equity ownership. As was the case in the late 1990's, the longer the equity rally continues, the stronger the belief that stock prices will continue to climb, notwithstanding the lengthening list of geopolitical and economic concerns.

The perfect scenario, of course, would be to remain heavily invested in equities to the ultimate market peak, whenever that is, then to get out or go short. History shows, however, that even the most successful investors rarely pull off such a feat--very few even try. Both diversification into various asset classes and

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remaining relatively permanently invested are concessions to the industry's inability to identify peaks and troughs with any degree of certainty.

Ours is a business of probabilities, not of certainties. What often gets ignored, however, is investors' need to weigh not just the probability of an event occurring but the relative consequences of a good or bad outcome.

In 2009, Carmen Reinhart and Ken Rogoff wrote *This Time is Different*, contributing greatly to the industry's knowledge about economic and market behavior in the wake of financial crises, such as the world experienced in 2008. They analyzed more than 300 such crisis events worldwide over the course of eight centuries. While circumstances inevitably differed from event to event, there were a great many commonalities.

Reinhart and Rogoff have recently stated that the US and Europe are betting against overwhelming historic odds that they will be successful in guiding their respective economies back to normal primarily through austerity and growth. The authors contend that history argues convincingly that regaining economic normalcy will involve some lengthy combination of restructurings (defaults), financial repression and significant inflation. Clearly, restructurings are a last resort. In this country, the Federal Reserve has been exercising financial repression for years by reducing short-term interest rates essentially to zero, seriously penalizing retirees and other risk-averse investors who prefer to rely upon investment income. The Fed has simultaneously been attempting to erase the sting of our country's unparalleled debt by raising inflation. So far their actions have penalized those in need of income, but have failed to raise inflation even to their minimal 2% target. Far more significant inflation will be needed to appreciably reduce the negative impact of our overwhelming debt load. What the Fed's historic economic stimulus program has accomplished is to have boosted the country's relative debt burden to a level that has created multi-decade economic slumps elsewhere in the world over the centuries. Those actions make restructurings an increasingly likely part of our future. Most of the developed world has become debt dependent to a degree that makes major economic collapse likely if current experimental monetary policies fail.

Even members of the Federal Reserve itself have voiced serious concerns about the course of monetary policy. Richard Fisher, President of the Federal Reserve Bank of Dallas stated: "[N]o central bank anywhere on the planet…has the experience of successfully navigating a return home from the place in which we now find ourselves. No central bank…has ever been on this cruise before." Earlier this month, former Fed Chairman Alan Greenspan said: "This is an unprecedented period in monetary history. We've never been through this. We really cannot tell how it will work out." More than a year ago, former St. Louis Fed President Bill Poole pointed out that when you look at the numbers, the US is only a few years behind Greece.

We are clearly not in a business as usual environment. Various governments and central banks rescued the economic system from collapse in 2008. They gave banks enough money to lift them from apparent insolvency six years ago. They have not been able, however, to promote normal economic growth, despite historic levels of stimulus. The Eurozone is now perilously close to its third recession in recent years, and most emerging nations – China most importantly – are experiencing economic slowdowns, while the world strains under the most extreme debt burdens ever. It is instructive to recollect that excessive debt has played an integral role in virtually all of history's great economic crises.

Investors should not alter traditional risk-assumption patterns if the only fear would merely be occasional weak years in which stocks might lose ten or fifteen percent. So far in this still young century the S&P 500 has declined by 50% and 57%. Those bear markets respectively erased seven and thirteen years of price progress. Having already bet the house on the current rescue effort, world central banks would be ill-equipped to rescue markets and the economy if once again needed. If history repeats its typical pattern, we can expect at least one more major stock market decline before the current long weak cycle ends as debt and valuation excesses are extinguished.

While stock prices around the world are still not far below recent highs, there have been quite a few recent indicators of slowing momentum. Although the S&P 500 was up slightly in the third quarter, the average stock in the US and around the world was down. In fact, before last week's rally, most major domestic and international indexes were down for the year-to-date.

Clearly, fear levels have also risen. Quite remarkably, despite obvious intentions of the world's central bankers to support equity prices, vast quantities of world investment assets are being held in instruments offering essentially no yield. In fact, concern about dangers in the economy and markets have led investors to pay for the privilege of lending money to seven European countries. Instead of receiving a positive yield, these investors are willing to pay these governments for the guarantee of receiving their money back in one, two or three years. These are giant investors not worried about small consequences, but trying to guard against a mega-collapse. The yields in Europe are at 300-to 500-year lows. Another illustration that this is not business as usual.

Regardless of long-term concerns, stock prices could continue higher. The determination of central bankers to support stock prices was glaringly apparent when markets plunged two weeks ago. Within hours, we heard dovish, supportive comments from officials of the Federal Reserve, European Central Bank, Bank of England, Bank of Japan and People's Bank of China. The ensuing rally quickly recovered more than half the losses from the September highs. Such government-supported rallies could continue so long as investors remain confident that central bankers retain the will and ability to support markets. On the other hand, given the long list of economic and geopolitical concerns, prices could collapse suddenly if central bankers are ultimately seen to resemble the wizard behind the curtain.

Central bank support has proved to be a powerful stimulus for securities prices since the near collapse of the economy in 2008. At the same time, it's a fair question to ask what these central bankers see and fear that keeps them actively pursuing history's largest ever rescue program fully five years since the alleged recovery began.

In such a highly uncertain environment, we have warned that traditionally diversified, relatively permanently invested portfolios could be in considerable danger. Unfortunately, with the future uncertain, there is no clear right answer. Mission has chosen for the equity portion of client portfolios to employ a quantified equity allocation process that carefully weighs dozens of economic and market conditions. The process promotes equity ownership when historical probabilities are favorable and removes equity risk when historical probabilities are questionable or negative. The process is not designed to anticipate news stories or sudden policy changes, but rather to respond to them by measuring their effects on the economy and markets. By measuring those effects well over the past third of a century, the process's criteria have been able to identify major trends after markets have finished vacillating in the transition period from up to down or vice versa. Successfully identifying major trends has led to participating in (not beating) strongly rising markets and defending against--even profiting from--significantly declining markets. Over full market cycles, the process's results have outperformed the S&P 500 with fewer and smaller losses.

While Mission has been highly risk-averse since the end of the 1990's, Mission's portfolio results since the turn of the century have outperformed the S&P 500, not by matching the strong markets but by avoiding the worst consequences of the weak markets. We expect that protective approach to lead again to significant outperformance over the next few years.

We look forward to the next long strong stock market cycle in which accepting significant equity risk will be prudent, but not until current excesses are expunged. The environment will remain very dangerous until then.

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