MANAGEMENT & TRUST CO.

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Today's investors face extremely problematic decisions. Risk-free options provide essentially no return. Traditional low-risk investments in fixed income securities have produced losses for the past year and a half. Common stocks have surged higher with only minimal interruptions for nearly five years. Ignoring equity risk has not only been the best approach since 2009, it has been spectacularly rewarded. But the risks have not disappeared; they have been successfully papered over. Apparently off most investors' radar, they have risen exponentially.

According to the Federal Reserve, the picture won't be improving soon for those who desire a return on risk-free investments. The Fed's "forward guidance" indicates no intention to raise short-term interest rates for many quarters at the very least.

Notwithstanding the Fed's best efforts, longer-term interest rates have risen substantially, with the ten-year U. S. Treasury yield doubling from July 2012 to present. As a result, long maturity Treasury bonds experienced double-digit losses in 2013. The Fed's policy of financial repression, with an avowed purpose of forcing investors to forego safety and assume risk, led many into bonds or bond funds in the latter years of the past decade. When rates were declining with the Fed buying vast quantities of Treasury and mortgage-backed securities, those bond purchases proved profitable, leading an ever-increasing number of investors to seek such Fed-supported returns. That strategy worked until it stopped working. By the time rates reached historic lows in mid-2012, the number of bond investors reached all-time highs, just in time to participate in the bond losses accrued over the past 17 months, despite continued Fed bond buying. Should interest rates continue to rise over the quarters and years ahead (which is the Fed's forecast), an increasing number of bondholders will be saddled with losses. Following the Fed's suggested paths can sometimes be hazardous to your wealth, especially when the Fed attempts to distort normal interest rate or valuation boundaries.

Fed stimulus efforts continue to support stock prices, however. So far, investors who have trusted in the Fed's support have profited handsomely. To the extent that would-be equity investors have let valuations or sub-par fundamental conditions dampen enthusiasm for stock ownership, they have missed profit opportunities.

The question facing investors today is whether or not to trust the Fed to keep the party rolling. Despite slumping stock prices both domestically and around the world in the early weeks of 2014, historically reliable technical indicators suggest that it's likely this equity rally hasn't breathed its last. The persistence of positive price movement, favorable advance/decline figures, far more volume going into advancing than declining stocks and Lowry's buying power and selling pressure data all point to stock prices likely having at least months to go before finding a ceiling to this already 58 month-long rally. On the other hand, many measures of investor sentiment closely resemble their levels in 2000 and 2007, immediately preceding stocks' losing half or more of their values twice so far in this still young century. Stocks are clearly overbought, overvalued and overbelieved. Speculative margin debt has exceeded even its prior 2000 and 2007 peaks. With money essentially free, stocks are doing what real estate did in the middle of the last decade, and which led to the biggest real estate crash in modern times.

It remains to be seen whether or not stocks are ultimately fated to travel a similar path following misguided Federal Reserve interventions.

It has been almost universally acknowledged--even by Fed supporters--that the elevation of asset prices has occurred with only minimal benefit to the broader economy. Just five years ago, the multiplication of the Fed's balance sheet from $800 billion to today's $4 trillion--with more to come--would have been inconceivable. That increase in debt in the pursuit of higher stock and house prices has prompted surprisingly little outrage. By contrast, I have condemned it repeatedly, and have heard not one credible plan for the ultimate reduction of that debt level. The vast majority of analysts, strategists and commentators simply ignore it.

In a December 2013 International Monetary Fund Working Paper, Carmen Reinhart and Ken Rogoff warned of the potential folly of such complacency. They chastised advanced country central bankers and other policymakers for their apparent belief that first world countries will escape the consequences of massive debt levels that regularly occur in overindebted emerging countries. Reinhart and Rogoff state: "The magnitude of the overall debt problem facing advanced economies today is difficult to overstate… and the current level of central government debt in advanced economies is approaching a two-century high-water mark." They argue from considerable historic precedent that advanced countries are likely to have to resort to some or all of the same approaches to emerge from massive debt levels that emerging countries regularly employ. Those approaches include: debt restructuring or conversions, financial repression and significant inflation (all forms of default), affecting debtors and creditors alike. The authors make the point that history argues strongly that the potential for major countries to simply grow their way out of today's debt levels is minimal. If and when such events occur, the potential consequences to the world economy and markets are severe.

With history arguing strongly that unprecedented debt levels are likely to lead to multiple instances of debt default around the world, holding substantial permanent equity positions is a high-risk proposition. Mission has instead chosen to employ a strategic equity allocation approach based on a time-tested reading of dozens of fundamental and technical data points. Over the past 33 years, this process has provided an average return about 400 basis points above that of the S & P 500 with fewer and smaller losses than that index has experienced. In 2013 this strategy provided a double-digit return with a mere 37% exposure to equity risk. With monumental overhanging debt uncertainty, we strongly believe a proven strategic equity allocation approach to be far more prudent than a sizeable permanent equity position.

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