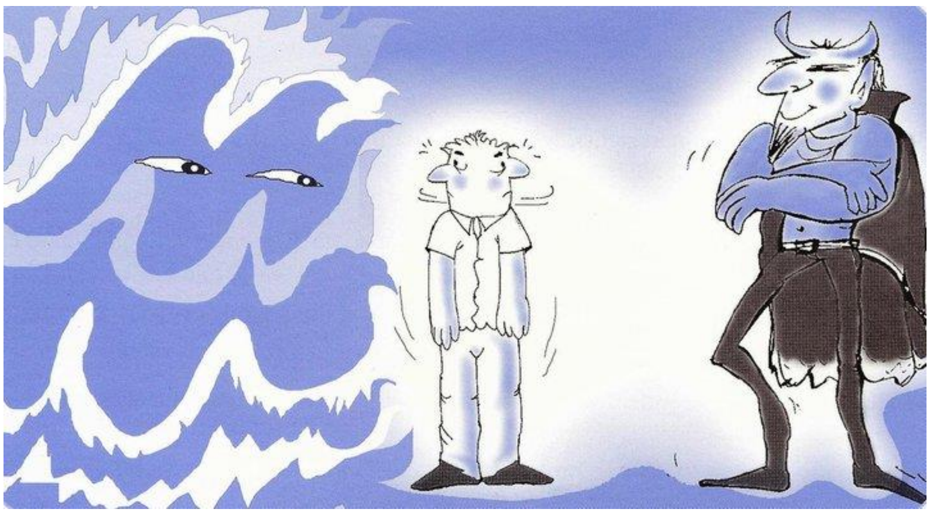
Between the Devil and the Deep Blue Sea
By Alan Snyder



Investing is never easy and now it is harder than ever. Our Hobson's choice between equity and fixed income may be two equally unpleasant alternatives for where to deploy capital. That durable investment shibboleth of a 60%/40% equity/fixed income mix compounds the challenge. The ebullient equity markets reach new highs almost daily, uncoupled from GDP results this year or maybe even next. Interest rates are at record lows with the Fed opining, no negative rates. *Ergo,* there is limited, if not non-existent, upside for fixed rate bonds, with untoward, sword of Damocles, downside in the event of any rate rise. For Nervous Nellies like ourselves, let's focus on the debt side of the equity/debt mix, whether 60/40 or some other percentage mix.

No doubt we can agree that if interest rates climb, a fixed rate instrument is highly likely to decline. (*viz. Investor Bulletin:* Interest Rate Risk -- When interest rates go up, prices of fixed rate bonds fall, SEC Office of Investor Education and Advocacy). We would assert that bonds offer a terrible risk profile. Has inflation been kicked to the side of the road never to appear again and thus interest rates will be forever low? This outcome is a "bet the ranch" approach for the debt portion of a portfolio which, lest we forget, is supposed to be a stabilizer against equity volatility.

Traditional inflation triggers have been:

1. Excess demand, not in evidence today.
2. Money printing and expansive fiscal policies, a double whammy from the Fed, government election year pandering and COVID fears. Moreover, the Fed has repeatedly proclaimed that they are relaxing their 2% inflation target and willing to run “hot.”
3. Accelerating velocity of money, a hard to measure criterion, but worth watching.
4. Economic dysfunction and supply chain replication, much in evidence with global trade declining and “onshoring” the word of the day.

The evidence is substantive and would indicate that inflation increases are certainly possible (take a peek at gold price escalation and future forecasts). What bondholder or other fixed rate debt owner wants to be gobsmacked from this possibility for the privilege of earning paltry yields?

Okie dokie. Should we be slaves to 60/40 or contemplate a higher ratio of equities? TINA and FOMO split the baby with substantive caveats.

TINA, “There Is No Alternative,” is overly confining but should stimulate consideration. Companies can hold real assets, whether hard to replace plant and equipment or natural resource claims and may not be over-levered yet pay consistent and rising dividends. Such companies can fit in a broader conceptualization of the 40% mix. The 40% is configured to cover the possible downside volatility risk from high growth, asset light, young, and/or high beta equity holdings, at least up to some “comfortable” level.

FOMO, “Fear Of Missing Out,” borders on simply foolish. Our diversification schemas best not be shaped by inchoate crowd pop-psychology. So there!

If our equity mix can be carefully increased but fixed rate bonds cannot comfortably fulfill the historic role, should the entire equity/debt benefit be eschewed as hopeless? We answer “no way” but, as usual, this demands more investor work, sadly. There are reasonable alternatives:

1. Floating rate debt, while often having a lower yield than long duration fixed coupons, merits consideration as an anchor to windward.
2. All real assets qualify whether natural resources, select commodities, hard assets such as gold, or royalties.
3. Real estate investments of many flavors. Our caveat during these times is that secular shifts from COVID sheltering, state and federal government action on rent abatements, eviction limits, and bank forced forbearance make careful analysis paramount here.

4. Non-U.S. assets may provide some protection from lower correlations to U.S. markets.
5. Niche-y debt with lower correlation and short duration, our favorite. We know you are shocked: specialty finance and lending against hard assets such as museum-quality fine art are worth considering.

Whether damnation or drowning in deciding how to implement your own optimal debt/equity mix, we hope our writing has stimulated your thinking by this quick exploration of asset mixes. With even more luck and hard work, the scientific community will create a viable vaccine and stop-gap therapeutics. Please stay safe, keep sending your reactions and introducing us to other investors smarter than us.

Lighter Fare

Since COVID-19 tests are sooo hard to get…

Take a glass and pour a decent dram of your favorite whisky into it, then see if you can smell it. If you can, then you are halfway there.

Now drink it. If you can taste it, it is reasonable to assume you are currently free of the virus because the loss of the sense of smell and taste are common symptoms.

I tested myself seven times last night and was virus free every time, thank goodness.

I will have to test myself again today because I have developed a throbbing headache, which can also be one of the symptoms.

I'll report my results later.