July 29, 2014

The Securities and Exchange Commission is investigating how Cynk Technology Corp., a social network that reports no assets, no revenue and one employee, soared to a $6 billion valuation, according to people close to the probe.

--*The Wall Street Journal,* July 9, 2014

Dear Fellow Investor:

Things are getting a little frothy out there!

Perusal of the *Wall Street Journal* article reveals that Cynk Technology is a classic pump-and-dump stock promoted by characters straight out of the recent Martin Scorsese film, *The Wolf of Wall Street.* The surprise is the magnitude--$6 billion!—of the pump. That there are shysters operating in the stock market is certainly nothing new—I am told (for I have not seen) *The Wolf of Wall Street* takes place in the 1980s. That there are suckers—one is born every day, according to P.T. Barnum -- eager to participate in shysters' schemes is equally not new. But that these kinds of shenanigans begin to pop up these days as the market sets new high after new high, as market volatility diminishes to its lowest level since 2006, and as we approach three years without as much as a ten percent correction, should serve as a warning signal to conservative investors.

In a similar vein, yesterday's *Institutional Investor,* a kind of trade journal for the investment management business, reports that Lone Pine Capital, run by Stephen Mandel, Jr., a highly successful disciple of renowned investor Julian Robertson, saw the value of its portfolio *decline* by between one and three percent in the first half of 2014. Mandel explains to his clients in a letter that Lone Pine's mistakes this year "have largely been ones of omission, not commission." Lone Pine's largest investments have performed about as expected, the letter contends, but the funds' portfolios lack five types of stocks that the market has rewarded well, first and foremost among them, "'blue-sky stories'…These are companies that have meager earnings but are able to 'dream big' and are therefore easily forgiven by investors. They include Tesla Motors and Zillow," *Institutional Investor* reports.

Fancier versions of Cynk Technology?

We at Weybosset Research and Management hear and heed the warning, but we are by no means circling the wagons. For years I have written to you highlighting how unloved common stocks have become, which, in the bad-is-good-and-good-is-bad way of Wall Street, is bullish. Though this situation is beginning to change, it still has a long way to go. Richard Bernstein, of Richard Bernstein Advisors, cites, "Credit Suisse data indicat[ing] U.S. pension funds have among the lowest equity allocations in more than 30 years and remain focused on alternatives rather than conventional equities." Speaking of alternatives, Bernstein goes on to point out that, "International Strategy and Investment's hedge fund survey shows hedge funds are neutrally positioned. ICI data show net outflows from U.S. equity funds for seven straight weeks." And finally, Rich Bernstein's Wall Street Sentiment Indicator, now owned by Bank of America Merrill Lynch and which I have brought to your attention in past epistles, remains solidly bullish, which is to say, Wall Street strategists remain solidly unready to recommend overweighting common stocks.

Big players in the market have taken their advice. "The average U.S. college endowment had only 18% of its investments in U.S. stocks as of 6/30/13, according to a poll of 835 schools by Commonfund. This compares with 23% in 2008 and 32% in 2003," my old friend and mentor Gerry Curtis writes in *Views from the Sidelines #141.* "Defined benefit corporate pension funds have been more traditional with 43% of assets in U.S. stocks as of 12/31/13 but down from 61% as of 12/31/03." And, back in the neighborhood, an annual Gallup poll shows 54% of Americans owning common stocks today, down from 65% in 2007.

The problem with an aversion to equities by investors large and small is that we are in what Jason Trennert of Strategas Research Partners calls "a TINA market—There Is No Alternative." When interest rates if not invisible are microscopic, when emerging markets groan under the weight of inflation, corruption and heavy debt, when bubbles in commodities, gold and other "hard" assets have deflated, and when highly expensive "alternatives" such as hedge funds have, for the most part, proven disappointing, where do you go if you need to fund an institution or a retirement, or just preserve the purchasing power of your capital? How about the large, transparent, highly liquid and on average reasonably priced U.S. stock market?

My point is that, given the positioning of most investors, this market could go MUCH higher before the effects of gravity are felt in a meaningful way.

How to reconcile the warning signals I cited at the beginning of my letter with the likelihood that the current bull market is far from finished? In a word, caution. We need to keep in control the part of human nature that impels us to take more risks as markets rise. We need to be sure our investments are in solid businesses, and above all, to be careful what we pay. This could well cost us *relative* performance—it already has—but, after all, around seventy per cent of successful investing is just staying out of trouble. This is an approach that has served us well over the long haul, and I see no reason why that should not continue to be the case.

I hope your summer is progressing pleasantly, Fellow Investor. We thank you for the confidence you have placed in us and, as ever, welcome any and all comments, complaints or questions.

Yours very truly,

Fla Lewis III
Principal