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Sandpiper Capital

Gleanings

Market Returns Annually and Through Ten Years Ending 6/30/2013

Index	2011	2012	YTD	10 Yrs
S&P 500	2.1	15.9	13.8	**7.3%**
ML 1-5 yr Gov't/Corp	3.1	2.5	-.5	**3.4%**
EAFE (Dev Fgn Mkts)	-12.2	17.2	5.0	**7.7%**
Gold	10.1	7.1	-26.	**13.6%**

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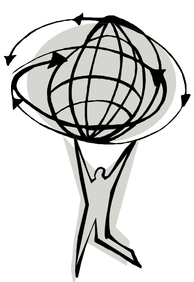


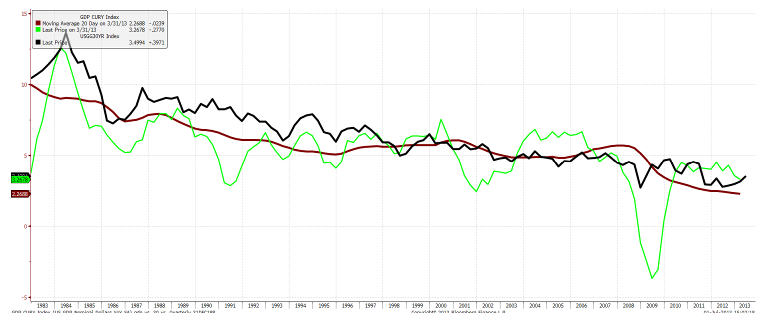
"If we find stocks overpriced and we want to avoid a correction, what can we do? Well, historically, we hedge our bets with other asset classes."

"Hedging…."

The real challenge for a money manager is not just the need to predict the future, it's that you need to predict the future of a bunch of different things. What interest rates will be available on which bond types over what time span directly affects the choice of maturities for the bonds that you buy. What policies Central Banks will pursue to keep their respective governments entrenched has direct implications for the commodity and stock markets by way of the degree to which they decide to intervene. The latitude allowed the trading floors of money center banks has a direct relationship on the volatility of the markets. While the broad themes that allow us to keep a steady hand on the rudder while we survey the investment horizon usually run in trends that last for decades, the short run has had a few anomalies. I'll run through a few that relate to the charts on the right.

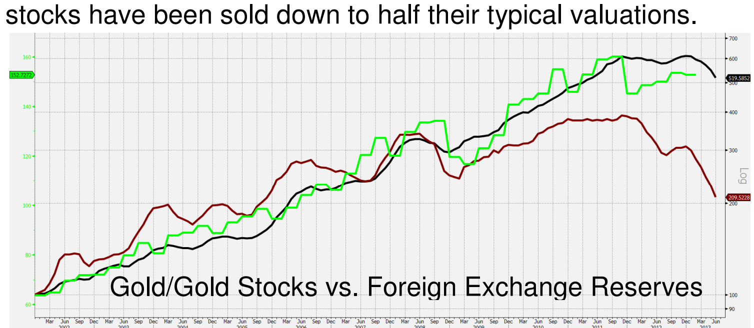
Interest Rates

The black line on the first chart represents the history of long term interest rates. You will see that interest rates tend to follow GDP growth rates, i.e.; if the economy grows at 4%, long term riskless rates tend towards 4%. While trendline GDP growth (red line) continues to fall as the US faces increasing global competition, rates have increased 1% over the last year. While that volatility isn't unexpected, the effect is that the market value of bonds in clients' portfolios have gone down as interest rates have gone up. We do now though, have the ability to reinvest and lock in higher rates with maturing assets.



Gold Stocks

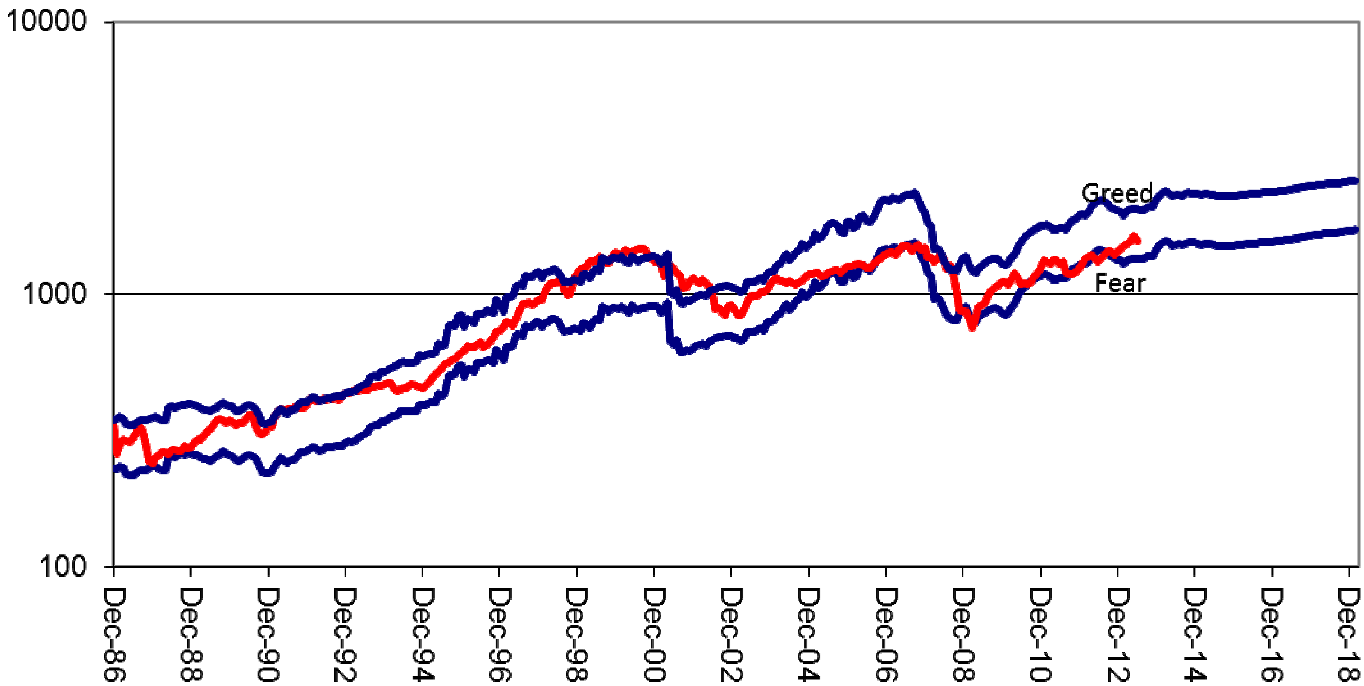
The green line below shows the excess growth of global foreign exchange reserves, (reserve growth less global gdp growth). The demand for gold (the black line) as a hedge against devaluing money has been fairly steady, but again, the recent retracement as monetary inflation has slowed, has been dramatic. Even more drama surrounds the market drop of gold stocks, (red line). The typically tight relationship between the price of gold and that of gold miners has disappeared as the stocks have been sold down to half their typical valuations.



Stock Prices

Our view of the stock market is both informed and handicapped by our view of the economic reality in which we find ourselves. The need to be both objective in terms of the facts, but to also be aware of the subjective sentiments that those facts cause us to feel is a challenging balancing act.

The benefit of the Sandpiper Fair Value Model for the S&P 500 Index is that it does give objective information about whether the market is too high or too low. The blue bands denominate the top and bottom ranges of what we would normally consider fair value. For the past 26 years, actual prices have stayed within the bounds of computed prices most of the time. Our strategy is to proportionally sell stocks as the market moves up within the bands from the bottom of the range: fear, to the top of the range: greed. Our selling this year has been overly aggressive perhaps, as the experience of the last five years has trained us to sell early. Too much global debt and an anemic global economy scares us.



If we find stocks overpriced and we want to avoid a correction, what can we do? Well, historically, we hedge our bets with other asset classes. If perceived monetary inflation hurts stock prices and benefits gold, then gold goes up when stocks go down. If worries about a slow growth economy hurt stock valuations, then the same worries benefit the bond market as people lock in rates to protect themselves from deflation. That hedging behavior can be seen in the graph below. The red line represents the value of a combination of gold and bonds. The black line is the stock market. Generally when you the market gets overpriced, the gold/bond hedge gets underpriced and vice versa. We are most interested in the blue line. That is a history of the combination of stocks, bonds and gold. The protection from big drops that comes from keeping a balance of assets has been enormous. The price to be paid for that protection is that, for some substantial periods of time, you will wish that you had been in just one or the other. The trick has been to buy the one that's down.