YOSEMITE CAPITAL MANAGEMENT

First Quarter 2014 – COMMENTARY

If you don't know where you are going, any road will get you there. – Lewis Carroll

The financial markets seemed to have had a fair amount of headline risk in 2013 and continuing into 2014, meaning numerous events occurred that could have caused dramatic plunges in the stock and/or bond market if even one of them had a different outcome. This must have been the case since the headlines, the pundits, the talk shows, the political agitators, and the so-called (but not really) experts told us so. Naturally there was no shortage of advice to investors concerning what to worry about, what to focus on, what to do NOW, what to sell, and what to buy.

The country and the world had to deal with running up against the debt ceiling, the partial shutdown of the federal government, the Fed taper, the lack of Fed taper, a military coup in Egypt, atrocities in Syria, and the annexation of Crimea by Russia from Ukraine.

Looking ahead, among many possibilities for market-moving events are the following:

> More turmoil in the Middle East (we can't know this one for sure, but when hasn't there been turmoil in this part of the world?)
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> Slowing growth in China, perhaps accompanied by a financial debacle of some sort arising from excessive debt
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> Another flare-up in Europe related to their inadequately structured Euro-zone
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> A rise in domestic inflation
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> The mid-term elections in November (with heightened cacophony and analysis ad nauseum starting in the summer)
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> The realization that at some point the Fed will raise the Fed Funds interest rate
>
> Fed officials talk about raising the Fed Funds interest rate
>
> The Fed actually raises the Fed Funds interest rate

Maybe it's no coincidence that prescription drugs for depression and anxiety are among the highest-selling pharmaceutical products in the United States.

So what is causing this rash of seemingly market-moving situations? Is this part of the new normal? Will we ever get back to the normalcy we had prior to this set of years so the markets can behave normally?

Though people should always learn from the past and prepare for the future, it is human nature to focus on the present and forget how scary things may have felt during their particular moment. The fact is ***there is always something occurring that has the potential to be disruptive to the economy or the markets***. There is no such thing as "the good old days" because we selectively remember what turned out positively, with a few exceptions for the truly horrific. And as far as the financial markets behaving "normally", the fact is that markets fluctuate – they always have and they always will.

We wonder how so many of those purveying doom and gloom today would have fared during times that really were difficult or even terrible for society as a whole to live through. We wonder whether at least some in our political class would have any true leadership capability during a genuine crisis that legitimately tests the very existence of civilization or society or way of life. Too many seem to have no perspective about the present compared to the past, which may be why so many relatively minor or even artificial events get exaggerated into calamities.

> The Cuban Missile Crisis in 1962 may very well have pushed the world to the brink of nuclear war and global annihilation
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> World War II challenged the existence of western civilization because, especially in the early years, the outcome was by no means certain (historians ponder how very different the world might be if Hitler in June 1941 accepted the advice of his generals to not invade the Soviet Union and instead to focus on defeating a very weak and vulnerable England)
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> The Great Depression in the 1930's challenged the very notion of capitalism and individual freedom as a way of life as the combination of 25% unemployment and deflation caused multi-year struggles just to put food on the table for a large part of the American population; the environmental catastrophe of the dustbowl in 1933 to 1935 further added to the nation's misery
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> The Civil War was about preserving the very existence of the United States and the concepts upon which the country was founded ("that government of the people, by the people, for the people, shall not perish from the earth", as Abraham Lincoln said at Gettysburg in November 1863), with a staggering loss of life and destruction that resulted from years of bitter divisiveness over the moral and philosophical issues of slavery and legal rights of the states

Our problems today are real and must be addressed, but in many aspects they pale in comparison to what prior generations faced.

> The Clash of Civilizations that was brought to the fore with the terrorist attacks on the World Trade Center buildings on September 11, 2001 must be fought, but the world in 2014 is apparently not on the verge of extinction as it was in 1962
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> Our military forays are ostensibly meant to safeguard our interests as a society, but other than those who have family members involved and the tremendous sacrifices they make, those actions do not cause great hardship to the general standard living as did World War II; instead of a home front and rationing of gasoline, sugar, meat and other items, we actually have the luxury of being able to debate the necessity of using and funding our armed forces, something that was unimaginable during the 1940's
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> Compared to the Great Depression of 1929-41, the Great Recession of 2007-09 was a picnic with "only" 10% unemployment and a reasonably quick albeit sluggish recovery (this is not at all meant to downplay the plight of many fellow citizens who were and are experiencing genuine hardship)
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> The political bickering and polarization of today is nowhere near that of the 1840's through the early 1860's in the prelude to the Civil War, let alone during the war when more than 600,000 soldiers were

killed (about 2% of the population which compares to about 0.3% for the United States in World War II and would be equivalent to more than 6.1 million soldiers today)

Thus, it is important that investors maintain proper ***perspective*** about events and situations.

For example, one must understand the perspective of ***probabilities***, especially in contrast to ***possibilities***. While acknowledging that anything is *possible*, we believe it is *probable* that our society is not on the verge of collapse, calamity, hyper-inflation, or any number of other catastrophes. Put another way, if a society-wrecking event were to occur in spite of extremely low odds, then money, investments, and gold are not going to do anyone any good when foraging for food and shelter. Therefore wasting time worrying about certain events is useless to living a good productive life.

A proper perspective of ***time*** is invaluable, especially when the financial markets decline. Short term temporary events are different from permanent long term results. We are fortunate to live in a time and place where market declines are only temporary. If one will not be taking withdrawals from their investments for another 30 years, what happens to the financial markets over the course of a couple of years will not really matter, and this is even more so if one is making contributions to their investment portfolios. If one is taking withdrawals in retirement, having a healthy and proper blend of asset classes will greatly mitigate any drawdowns and sustain a portfolio, as a review of history can attest. For those in between, a blend at the appropriate place in the spectrum will address the problem.

Successful investors have a perspective on ***market history***. We wrote about this in our First Quarter 2013 Commentary: "Since 1900, according to Ned Davis Research, stock market declines of 5% or more (called a "dip") occur about 3.4 times per year on average, which translates to about every three to four months. Declines of 10% or more (referred to as "corrections") take place about once a year on average. The stock market declines of 20% or more (commonly known as a "bear market") happen about once every 3.5 years on average." Understanding the stock market in the context of its history allows investors to take dips and corrections and even bear markets in stride.

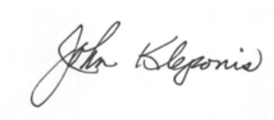
Investors are better served when they have the perspective of ***understanding how someone gets paid***. The news media, authors selling books, and other pundits have vested interests in stoking fears about various current events because fear causes more people to tune in (which raises advertising revenues) or buy the product they are selling. Too many in the financial services industry push inappropriate products or transactions onto people simply because they get paid a hefty commission for making the sale and not because it is the right solution to a given problem.

> And yes, the concept of understanding how people get paid is applicable to us at YCM. We expect our clients and prospects to understand how we get paid in order for them to properly assess how our interests are aligned with theirs.

Another important perspective is that of ***credibility***, especially regarding predictions and forecasts. Some are all about pedigree and credentials, but these are important only to a point if at all and are certainly not the be all and end all. For example, a holder of a Prize in Economic Sciences (officially "Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel") often has no credibility when it comes to areas beyond his or her particular expertise, yet people excessively fawn over such individuals and anything they utter as if they matter. Others are about position in industry, government, academia, etc., as if being a CEO or the president or a senator or a head of an academic department automatically confers legitimacy about various topics, which is simply not true. Related to that is the size of one's net worth, as if possessing more money than most suggests they are superior at all things. Then there are the outrageous predictions that are featured in the "news" simply because they are outrageous. Being a subject in the news media seems to automatically confer some sort of authority, yet sometimes these people are nothing but charlatans if not outright scoundrels.

For anyone making any prediction, whether outrageous or not, we would want to know their past record of all their predictions, yet this is rarely if ever done satisfactorily. Sorry, but one in a row does not count because more than a few is necessary to separate forecasting skill from dumb luck. As far as we know, ***there is no one who can consistently predict the future of the economy or the financial markets***, no matter where they went to school, what degrees they earned, what prizes they won, what positions they hold, how much money they have, what books they wrote, or how many times they appeared on television. And without a record of consistently accurate results, there is no reason to believe their opinion is better than anyone else's (including your own). Aside from all that, making predictions and forecasts is simply not necessary for long term investing success. Making or following predictions and forecasts is more often than not a recipe for disaster instead of success.

With the proper perspective, successful investors will be able to focus on what is truly important to achieve their long term goals and avoid the huge amounts of noise and distractions.



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