The Conservative Strategist

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Fed Chairman: Not a popularity contest

In difficult times (like this), everyone blames the Chairman of the Federal Reserve. *He's too dovish, and will spark inflation. He's too hawkish, and will risk recession.* A given remark or two in a press conference can ignite a firestorm, sending markets down by trillions, as shortly after the December 19 performance.

Current Chair Jay Powell is getting pressure from investors, from Jim Cramer and the financial media, and of course from President Trump. The refrain: Ease up on the rate hikes (two planned for 2019) and the $50 billion in monthly bond sales. The argument: Since markets are reacting adversely to Powell's plans, he must be doing the wrong thing.

Fed should not be slave to the markets

Its critics have lost sight of one of the Fed's chief values: Independence from the pressures of the marketplace. Its task is to aid the smooth functioning of the business cycle, and thereby to minimize the incidence of manias and crashes. In doing so, ignoring the vested interests is part of its mandate.

It could be argued that Fed Chairmen Greenspan and Bernanke, by lowering rates too far and then keeping them ultra-low for too long, and by ignoring growing market excesses, paid too high a regard to short-term market interests versus long-term economic interests, helping spark successive bubbles (Tech and Real Estate-inspired) and crashes. We're now risking a third bubble in the past 20 years, an Everything Bubble fed by universally cheap credit.

The legacy of Greenspan and Bernanke's market focused policies, inherited by Fed Chairs Yellen and now Powell, is a level of interest rates too low to enable the Fed to lower them effectively in response to a future crisis. After all, easing monetary policy is the way the Fed helped lead us out of every recession for the past century.

Toughest job

Having come into office at a precarious time, Powell now faces the delicate task of raising rates enough to once again give the Fed the crisis-fighting ammunition to lower them in response to a recession, but not raise them in a manner so speedy or untimely as to spark that very downturn. That takes discretion, moderation, gradualism, and the willingness to listen to the data, not the crowd — all characteristics that Powell seems to exhibit.

The most successful Fed Chairman in memory, Paul Volcker, fought the high inflation of the late 70s and early 80s with a kind of shock treatment. His remedy was the opposite of the Greenspan/Bernanke way — he kept interest rates deliberately high so as to starve the inflation beast. It worked, and led to the most extended period of prosperity in our country's history. Volcker took a lot of flack from all sides, just as Powell is today.

Guiding markets lower?

As noted last quarter, US equity markets had lurched into bubble territory. We were setting up for yet a third chapter in our two-decade boom/bust pathology. But the fever broke this quarter, and it may not be a bad thing, if markets settle down to more reasonable valuation levels, then waffle for a year or three while corporate earnings catch up. As in the 2011 correction, it may make for a more enduring bull market. If Chairman Powell's rate normalization leads to such a scenario, he should be lauded, not faulted. The alternative may be a much more severe bear market, and a hard landing for which we're unprepared. ■

The Markets December 31, 2018	Price/Yield	Gain, Qtr	Gain, 2018
US Stocks (S&P 500/Vanguard Index)	2506.85	-13.55%	-4.52%
International Stocks (Vanguard Index)	15.17	-11.70%	-14.44%
Emerging Markets Stocks (Vanguard Index)	24.19	-6.33%	-14.71%
Real Estate Stocks (Vanguard REIT Index)	24.78	-6.49%	-6.11%
Bonds (30 year US Treasury/Vanguard Index)	3.02%	4.11%	-2.14%
Dollar (US Dollar Index)	96.17	1.03%	4.40%
Gold (London Afternoon Fix)	$1279.00	7.73%	-0.93%
Money Market Funds (Vanguard Prime – SEC yield)	2.42%	+0.29%	+1.06%*

*change in yield

A solid closed-end fund amidst the wreckage

This has been the worst quarter for closed-end bond funds since the financial crisis. A combination of widening credit spreads, widening discounts, and severe tax-loss selling have sent closed-end bond funds down as much as their equity fund counterparts this December. Some bargains are hiding in plain sight. One such fund is the *RiverNorth/Doubleline Strategic Opportunity Fund* (symbol: OPP). It has several things going for it that puts it on our WatchList.

World-class managers

At least two-thirds of OPP is managed by *DoubleLine,* headed by Jeffrey Gundlach, a bond savant who has established the best track record among all bond fund managers over the past ten years.

Gundlach is especially adept at managing mortgage-backed securities, which is OPP's concentration. As of 11/30/2018, the Fund's Net Asset Value has outperformed the Barclays US Aggregate Bond Index by an average 4.45 percentage points per year since its 9/27/2016 inception.

For the other up-to-one-third of the portfolio, *RiverNorth* is an accomplished manager of closed-end funds, with a deep bench.

A deep discount, and a double discount

As of tonight's close 12/21, OPP trades at a discount to Net Asset Value (NAV) of more than 13%. That means you're buying a dollar's worth of its portfolio for less than 87 cents. Since a current 25%+ of the portfolio is invested in closed-end funds trading at discounts (our estimate is an average 12% discount), on that part of the portfolio an OPP investor is effectively getting a double discount — a discount of 13% on OPP, and another 12% discount on the CEFs it holds. That's about a 23% combined discount. This enhances yield and can boost appreciation potential.

A chunk of your money back at NAV each year, which covers fees

OPP pays distributions monthly, and recently enacted a policy to pay 12.5% of NAV each year in distributions (roughly five percentage points of that is return of capital, the rest income). On the current 13% discount, that comes to a payment of roughly 14.4% of your purchase price. On that 14.4% of your purchase price, you're receiving an automatic profit of 13% of that distribution (since you paid 87 cents on the dollar and you're getting back a full dollar). This comes to a bonus of roughly 1.87% per year — which is more than the 1.80% management fee and other expenses (net of leverage costs) of the fund. So you're effectively getting paid a few basis points to hire some of the best managers in the business, and an innovative fund. (You're still bearing the costs of the underlying CEFs in that portion of the portfolio.)

A possible open-ending in three years

In a shareholder-friendly move, OPP allows for holders to vote in 2021 on whether to open-end the fund. If the majority vote is Yes, then shareholders will be able to sell at NAV just three years from now. That's a 14%+ appreciation from the closing of the discount, added to whatever was earned by the fund. ■

Investment strategies

RIVERNORTH®

Key Parameters

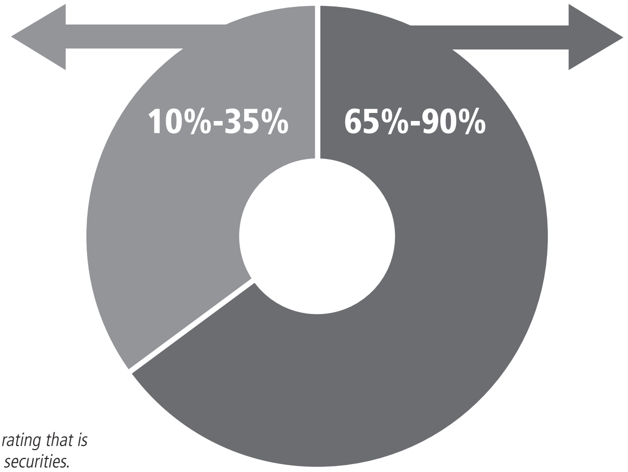
Seeks to generate returns through investments in income producing securities

Seeks to derive value from the discount and premium spreads associated with closed-end funds

Typically invests in closed-end funds (CEFs), business development companies (BDCs) and exchange traded funds (ETFs)

Tactical CEF Income*
Managed by RiverNorth

Opportunistic Income*
Managed by DoubleLine



DoubleLine®

Key Parameters

Seeks to generate risk-adjusted returns through investments in fixed income instruments

Primarily invests in agency and non-agency residential mortgage-backed securities, asset-backed securities, and commercial mortgage-backed securities

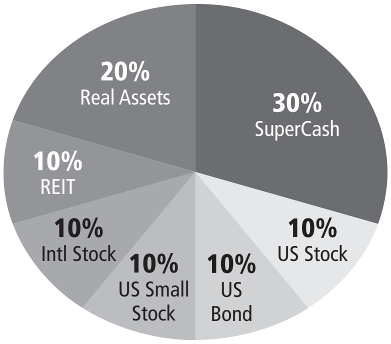
Seeks to derive value from inefficiencies within the subsectors of the fixed income market while maintaining active risk constraints

**Investments may include securities that have a rating that is below investment grade, including "high yield" securities.*

SuperDiversified Portfolios (SDPs)

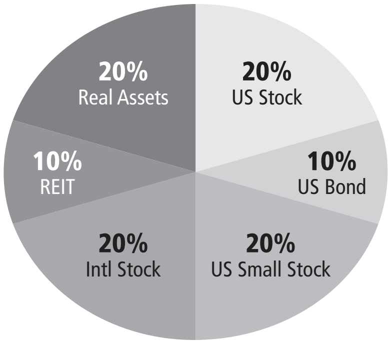
(Almost) nowhere to hide in 2018

SDP1 ***Conservative***



4th Quarter	*2018*
-7.04%	***-6.07%***

SDP2 ***Moderate***



4th Quarter	*2018*
-11.38%	***-9.79%***

This was the worst year for diversified portfolios since 2008. Of course, 2008 was much worse than 2018 in terms of the sheer negative return of a typical portfolio. US large-cap equities, for instance, were down 38% in 2008, versus less than 5% in 2018.

But in one respect, 2018 was worse than 2008, and as bad as any year since 1972. That's in the sheer number of asset class categories and sub-categories that were down. In 2008, investors could at least hide in Treasury bonds. Not this year.

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors Performed

Merger arbitrage a champ in Q4 & 2018

Asset Class	Mutual Fund	Performance 4th Quarter '18	Performance 2018	
SuperCash	PIMCO Instl Low Duration	0.23%	0.23%	Best
	Merger	1.92%	7.68%	Worst
	Calamos Market Neutral	-2.40%	0.96%	
US Stock	Vanguard Index Trust 500	-13.55%	-4.52%	
US Bond	Vanguard Long-Treasury	4.11%	-2.14%	
US Small Stock	Vanguard Small-Cap Index	-18.36%	-9.43%	
Intl Stock	Vanguard Intl Index	-11.70%	-14.44%	
REIT	Vanguard REIT Index	-6.49%	-6.11%	
Real Assets	PIMCO Commodity Real Return	-12.09%	-14.23%	

Our highlight of merger arbitrage last issue was a timely one. While most asset classes saw deep selling across the board in the fourth quarter, merger arbitrage actually gained ground. We spotlighted two funds in the Q3 issue, *Merger* (MERFX) and *BlackRock Event-Driven Institutional* (BILPX).

Both gained 1%+ in Q4 while the S&P lost 13.5%. For the year, they finished up mid-single digits, while the S&P lost ground. And the ride was much smoother. While the S&P Index has a standard deviation of more than 10 over the past five years, MERFX's score is 3.01, and BILPX clocks in at 6.43.

Bitcoin and Gold

I was taught that there are three features of money: (1) medium of exchange, (2) standard of value, and (3) store of value. Let's test Bitcoin and Gold.

Is Bitcoin a *medium of exchange?* The typical transaction takes 78 minutes, costs $28, and involves converting Bitcoin into a conventional currency. Only a tiny fraction of one percent of vendors worldwide accept Bitcoin directly.

Is Bitcoin a *standard of value? Ripple, Ethereum, Tether,* etc. Bitcoin has spawned more than 1600 imitators, and it is easy for anyone to create a new cryptocurrency.

Is Bitcoin a *store of value?* That implies a semblance of long-term stability versus some sort of standard, like inflation. When Bitcoin began in 2010, 5000 BTC could buy two takeout pizzas (the very first Bitcoin transaction). By the end of 2017, they could buy 400 median-priced single family homes. Perhaps by 2024, they'll again buy two takeout pizzas.

By contrast, gold has been a medium of exchange, and a standard and store of value, for thousands of years. And it has maintained its purchasing power over that time, albeit with fluctuations. More than can be said of Bitcoin, or any fiat currency for that matter. The US Dollar could buy 30 postage stamps in the 1960s. Today? Just two.

The bubble bursts

Bitcoin 2017/18, as of 12/14/18

In 2018, Bitcoin erased nearly all of 2017's meteoric rise. As of mid-December, it was down 85% from its highs.

Source: The Daily Shot

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Robert J. Gavrich
CA-Licensed Investment Adviser
President, Seasonal Strategy
1517 Fountain Street • Alameda, CA 94501
©2019 Seasonal Strategy

Phone 415.956.1721
Fax 415.956.1722
Email bob@seasonalstrategy.com

seasonalstrategy.com

The active/negative President

Government major that I was, I learned much about American Presidents from James David Barber's groundbreaking 1972 work, *Presidential Character.*

Predicting presidents

Barber claimed he could predict presidential performance based on a four-quadrant psychological evaluation system. And he did so. Though he finished his manuscript before five men were arrested for a break-in at a Washington DC complex called the Watergate, he made the bold call that Richard Nixon would not serve out his second term.

To Barber, presidents entered office either *active* or *passive* in their management style, and either positive or negative in their view of the presidency, geopolitics, and human nature. Overwhelmingly, these traits and their combinations determine the path of the presidency.

Active-positive presidents (Jefferson, Lincoln, both Roosevelts, Obama) suffused with optimism and talent, faced down crises and emerged triumphant. Active-negative presidents (Wilson, Hoover, Nixon, George W. Bush), secretive, mistrustful, and seeing politics as a zero-sum game, turned prosperity and calm into chaos and conflict.

Where Trump falls

Trump? Read Barber's description of the active-negative character type, and judge for yourself (the excerpts are courtesy of John Dean, who knew a thing or two about an active-negative presidency):

The active/negative type is, in the first place, much taken up with self-concern. His attention keeps returning to himself, his problems, how is he doing, as if he were forever watching himself. The character of that attention is primarily evaluative with respect to power. Am I winning or losing, gaining or falling.

The active/negative lives in a dangerous world — a world not only threatening in a definite way but also highly uncertain, a world one can cope with only by maintaining a tense, wary readiness for danger. The prime threat is other people; he tends to divide humanity into the weak and the grasping, although he may also, with no feeling of inconsistency, idealize "the people" in a romantic way.

In struggling to understand social causality, he restricts the explanations to conspiracy or chaos, fluctuating between images of tight, secret control and images of utter disorder. He strives to resolve decisional conflicts by invoking abstract principles in order to render manageable a too complex reality.

This might be an accurate biographical description of Trump's approach to the Presidency, if it wasn't written 45 years ago. ■

Personality shapes performance

American presidents and John David Barber's personality types

	POSITIVE	NEGATIVE
ACTIVE	***Active-Positive*** Thomas Jefferson Abraham Lincoln Franklin D. Roosevelt John F. Kennedy Bill Clinton Barack Obama	***Active-Negative*** John Adams Woodrow Wilson Herbert Hoover Richard Nixon George W. Bush **Donald Trump**
PASSIVE	***Passive-Positive*** James Madison William Howard Taft Warren G. Harding Ronald Reagan	***Passive-Negative*** George Washington Calvin Coolidge Dwight D. Eisenhower George H. W. Bush