MAULDIN ECONOMICS

YIELD SHARK

Issue 2.2 / February 2013

# State of the Union? Grim! Making Risk Management a Top Priority

### In This Issue



> *"Deficit reduction alone is not an economic plan. Why is it that deficit reduction is a big emergency, justifying making cuts in Social Security benefits, but not closing some loopholes? Nothing I'm proposing tonight should increase our deficit by a single dime."*
>
> *–President Obama, 2013 State of the Union address*

Did you watch President Obama's State of the Union (SOTU) address? Don't feel bad if you didn't, because a near-record number of Americans tuned it out, too.

According to A.C. Nielsen, 33.5 million Americans watched the SOTU, the lowest number since Bill Clinton made his final State of the Union address in 2000 and the second lowest since 1993 when Nielsen started tracking viewership.

I don't profess to know the reasons behind the drop in viewership, but stock market investors would have done well to pay attention – both to what the president said and what he didn't.

The Dow Jones Industrial Average had just pushed past the 14,000 milestone, and the Nasdaq was trading near its 2007 highs.

Obama touched on the 6.1 million new private-sector jobs, a rebounding housing market, rising automobile sales, and a decreased reliance on foreign oil.

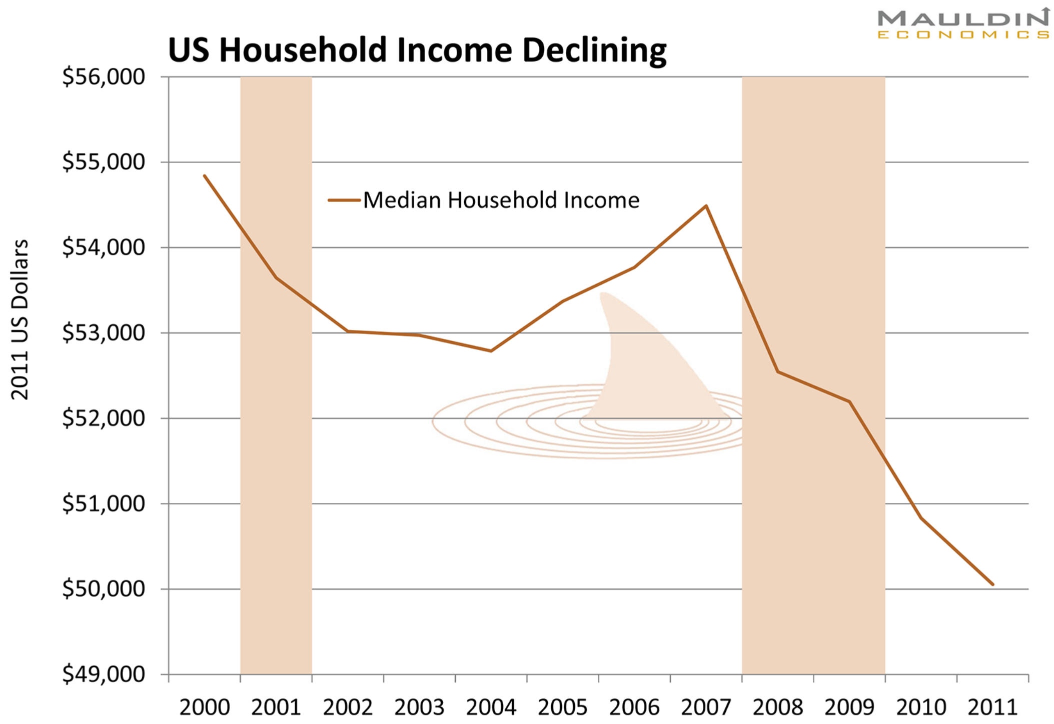
He described the state of the union as "strong." However, he also made brief but surprisingly frank comments about our still-struggling economy.

> *"We gather here knowing that there are millions of Americans whose hard work and dedication have not yet been rewarded. Our economy is adding jobs, but too many people still can't find full-time employment. Corporate profits have skyrocketed to all-time highs, but for more than a decade, wages and incomes have barely budged."*

That's a vague but telling admission of some serious underlying economic problems. In fact, our economy is much weaker than the mainstream media and popular financial press would have you believe.

Here are some statistics about how the economy has performed over the last four years.

**Falling Incomes:** According to US Census Bureau data, American incomes have shrunk by more than \$4,000 over the last four years. In January of 2008, the median household income was \$54,489 (inflation-adjusted), but it has dropped to \$50,054. That 8% drop is the biggest four-year decline since the Census Bureau has been keeping track.




*© Mauldin Economics 2013*

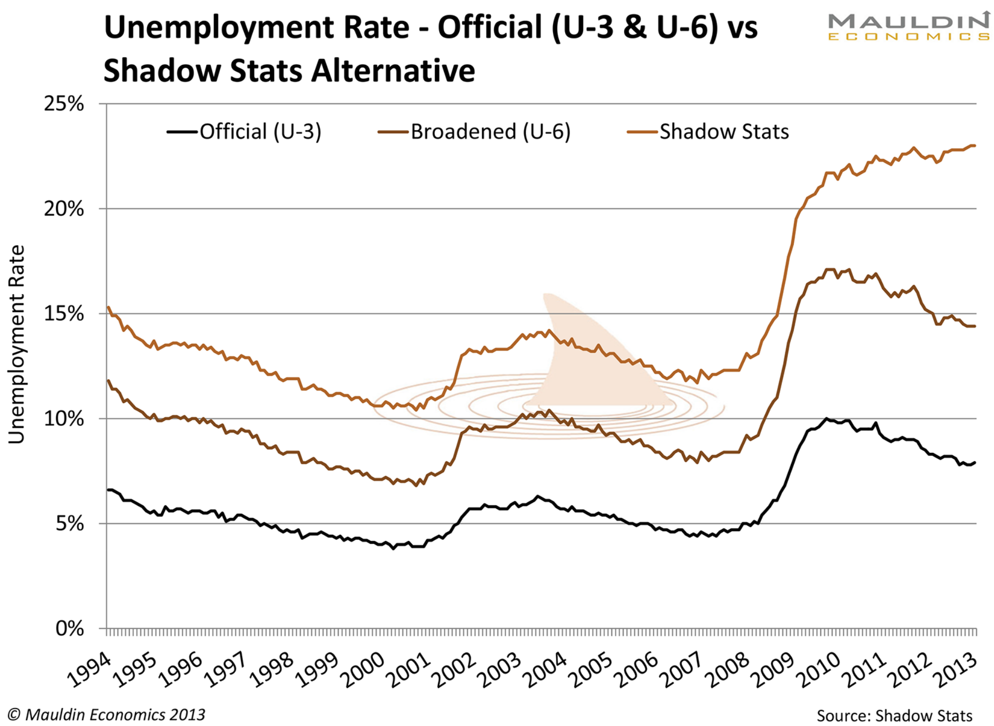
Source: US Census Bureau

If you're the primary grocery shopper for your household, I don't need to tell you how prices have continued to rise in spite of those falling incomes. The Commodity Price Index – a basket of food, fuel, metals, and other essential commodities – jumped 20% during the same time. Ouch!

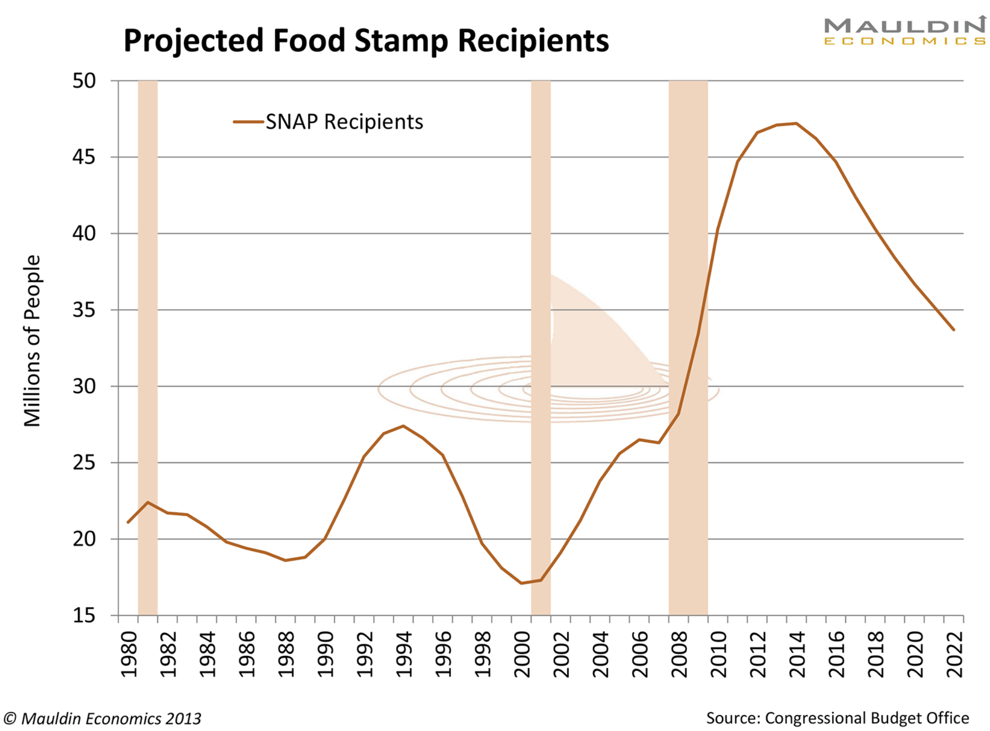
**Unemployment Is Worse. Much Worse:** There are 3 million fewer Americans working today, which is bad enough, but that doesn't accurately reflect how bad the employment situation really is.

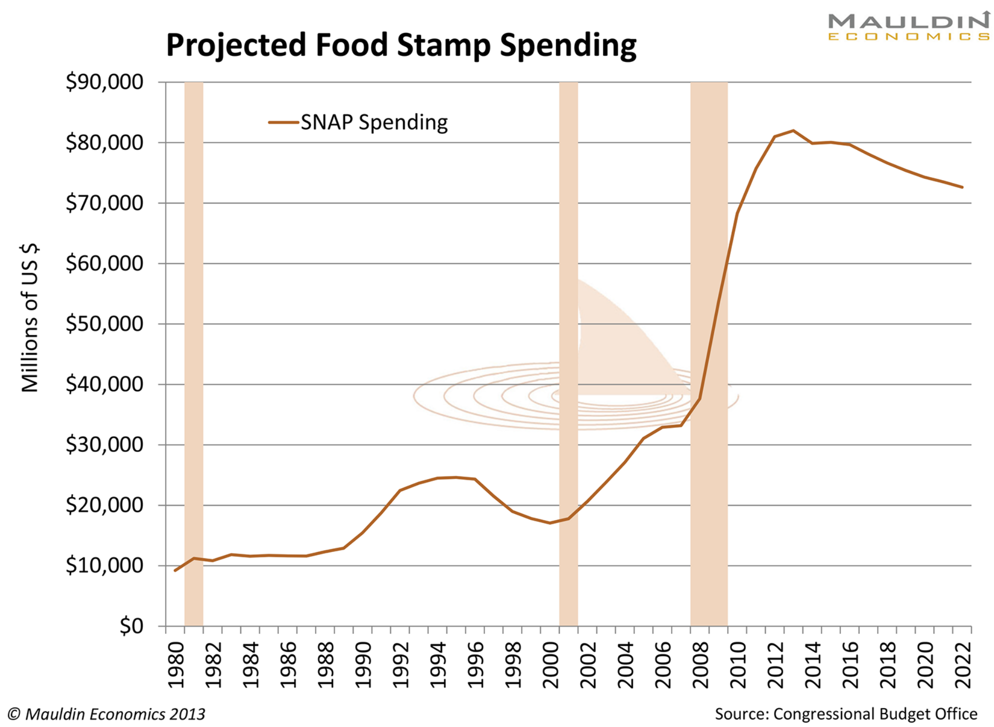
In January of 2008 there were 146.3 million Americans employed, but that number had dropped to 143.3 million by January of 2013. However, the number of Americans aged 18 to 65 grew by 11.7 million during the same period, which means 14.7 million fewer Americans are working today than four years ago. When adjusted for the labor participation rate, the real unemployment rate today is 11.0%.

The broadest measure of unemployment (U6), which factors in people who work multiple part-time jobs, the underemployed, and people who have stopped looking for work, was at 14.9% in January, its highest level ever. And according to ShadowStats, which uses the statistical methods that were in place until the feds started fudging the numbers in the early '90s, U6 was actually 23% in January. Either way, U6 is nearly twice as high today as it was when the Great Recession hit in 2008.

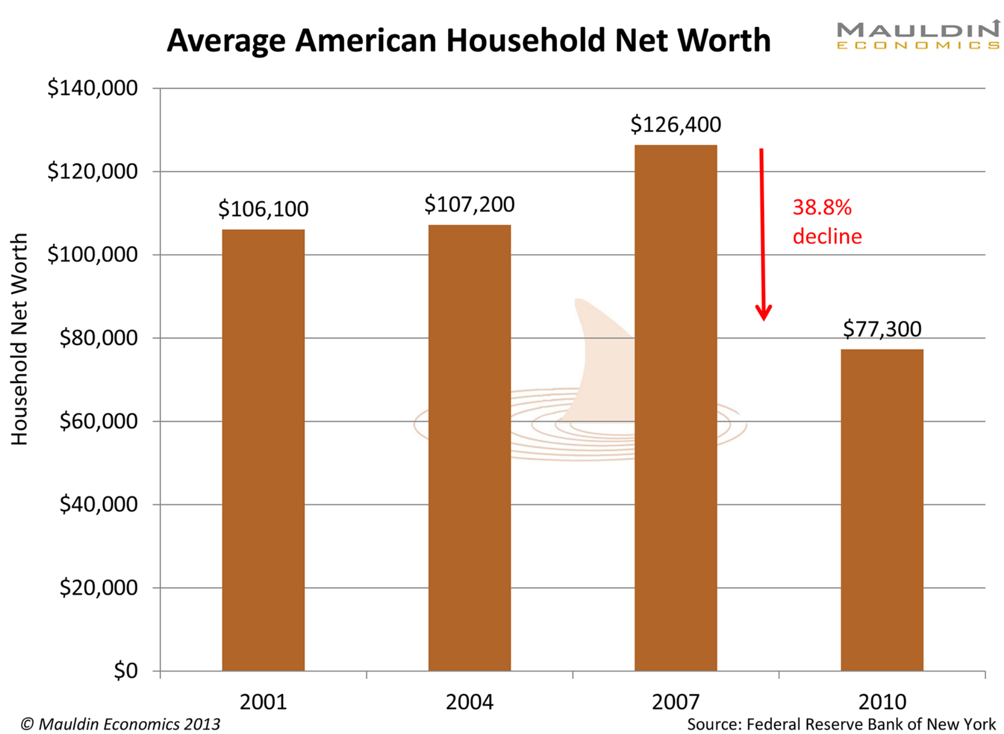



No wonder 47.7 million Americans are currently receiving food stamps, at a cost of $80 billion a year. That is up from 26.5 million people at a cost of $30 billion in January of 2008.






**Falling Net Worth:** The Dow Jones may be at 14,000, but average Americans' net worth hasn't kept pace. According to the Federal Reserve Bank, in June 2012 (most recent data) the average net worth of American households plunged a painful 40% since 2008, from $126,400 to $77,300.



Most of that decline, roughly three-fourths, was due to falling home prices. The median home price fell from $248,000 in 2007 to $173,000 in 2012.

**The Big National Picture:** As individuals, Americans aren't doing so hot, but what about the big picture?

Our economy, as defined by Gross Domestic Product, has seen its slowest growth since the Great Depression years. GDP (adjusted for inflation) in 2007 was $15.5 trillion and is expected to come in at $16.0 trillion for 2012. That $500 billion increase is a paltry 0.6% a year over the last five years.

Against that stagnant backdrop, government spending has skyrocketed. All of us know that our national debt has grown from $9.2 trillion to $16 trillion over the last four years, but Washington DC is only part of the spending problem.

Total annual government spending – federal, state, and local – has increased by 26%, rising from $4.9 trillion in 2007 to $6.2 trillion in 2012.

If you're an Obama fan, your blood may be boiling by now, but the reason I point to these dour numbers is not to bash President Obama but instead to show you the disconnect between the economy and the stock market.

Investors have recently been oblivious to the troubling numbers mentioned above.

The stock market started 2013 off with a bang. The Dow Jones gained 5% just in the month of January and revitalized interest in what is called the January Indicator. The premise behind the January Indicator is that a positive January is the precursor of even-higher stock prices for the rest of the year.

There is some strong historical data to support the January Indicator theory. The S&P 500 index has been tracked since 1950 and has been up 39 times and down 24 times in January.

Following those 39 positive Januaries, the S&P 500 went even higher for the rest of the year 34 times, which is an impressive 87% success rate. That's one of the strongest stock market correlations you can find, but I want to tap the brakes on that enthusiasm.

I am not a market timer and I don't play one on TV, but I know that a lot of people who are timers and who are pretty darned good at their craft now see a growing number of warning signs.

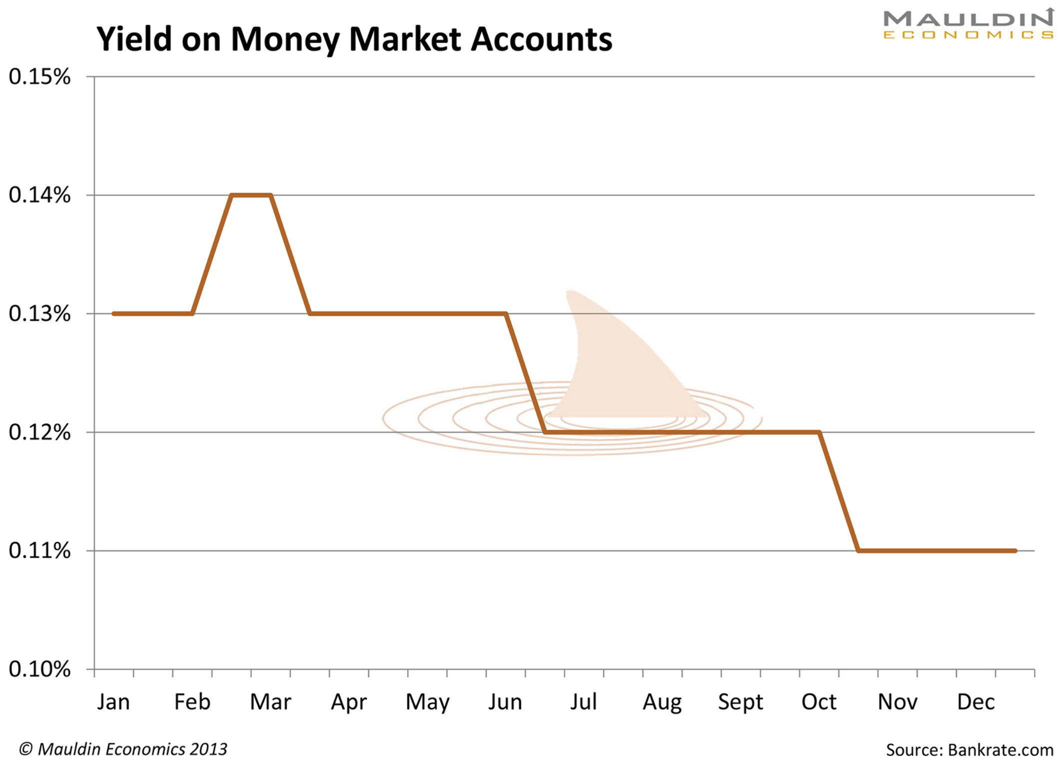
I'm not suggesting that you run for the hills, but I am suggesting you reevaluate your protective stops, consider some hedges, and keep a good stash of cash in a safe place.

Now, let's hear what my Mauldin Economics team has come up with. While I am not involved in the specific selection process, I do trust my team at Mauldin Economics to give us timely, carefully researched recommendations. This month they'll introduce you to a no-load fund that has demonstrated its value as a conservative parking spot.

## Currency Hide and Seek, Merk Hard Currency Fund

Cash has always been boring, but thanks to the Federal Reserve Bank's stubborn determination to keep interest rates artificially low, cash is also a very unproductive place to hide your safe money.

According to the Bank Rate Monitor, the national average money market yield is a pathetic 0.12%.




Over the course of a full year, every $100,000 you stashed in a money market fund would deliver a $120 return, which is little more than you would earn (nothing) by stuffing your money under a mattress.

There has got to be a better, more productive alternative for your safe money. There is, and it is called the Merk Hard Currency Fund (MERKX).

Never heard of it? Don't feel bad, because few people have.

The fund is managed by Axel Merk, who holds a B.A. in Economics (magna cum laude) and MSc in Computer Science from Brown University, which awarded him the Prize for Excellence in Economics in 1991.

Merk then went on to found Merk Investments AG in Switzerland in 1994 and relocated to the US in 2001, where he opened Merk Investments LLC, an SEC-registered investment adviser.

Merk is so highly thought of that presidential candidate Ron Paul asked him to become a member of his monetary and economic campaign panels.

The Merk Hard Currency Fund is a no-load, open-ended mutual fund that is similar to a money market fund in two ways: (1) the fund keeps the average maturity on the very short end of the yield curve and (2) invests in top-quality government debt.

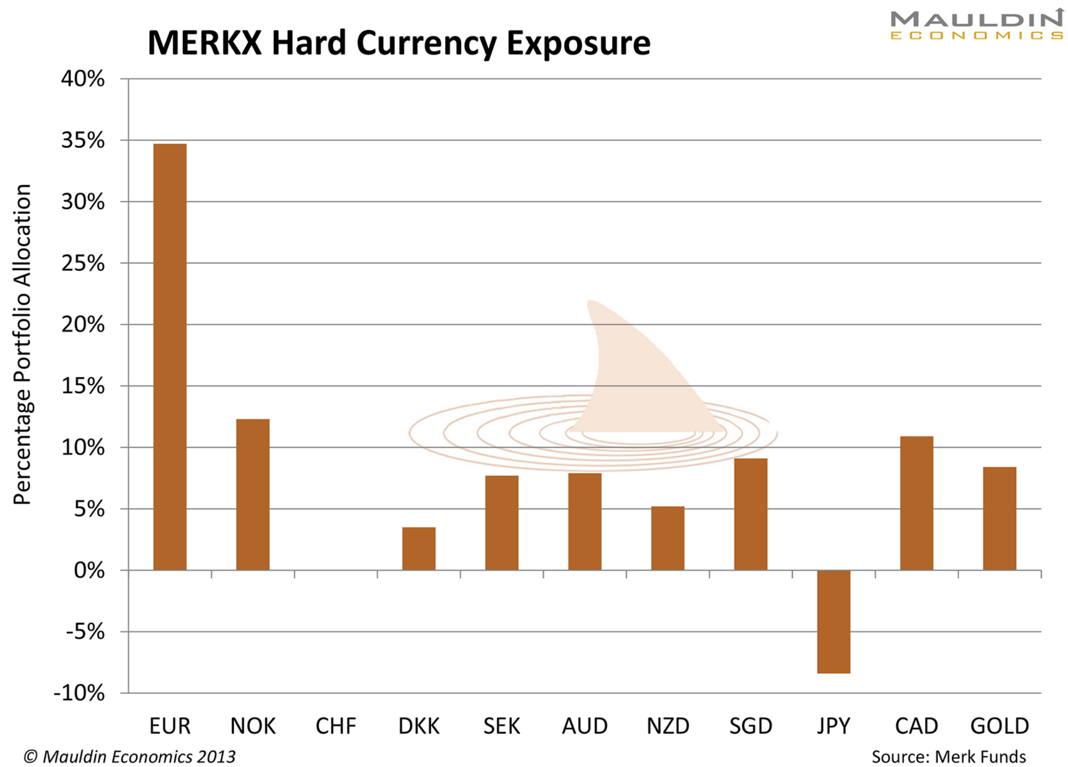
Its similarities with money funds end there, though.

- Money market funds are required to keep their average maturity below 90 days while MERKX keeps its average maturity to less than 180 days and therefore minimizes interest rate risk. In that sense, MERKX could more accurately be described as an ultra-short-term bond fund.
- Instead of investing in US government debt, MERKX invests in the debt of foreign countries and provides diversification out of the US dollar.

MERKX does not invest in just any government bonds, but only those of stable countries that follow a sound economic, fiscal, and monetary policy, such as Switzerland and Norway.

MERKX does not, by the way, invest in any emerging-market debt.

The result is a liquid portfolio of short-duration, high-credit-quality, non-US government debt of countries that pursue sound monetary policies or what Merk calls "hard currencies."




## A Little Bit of Yellow Metal

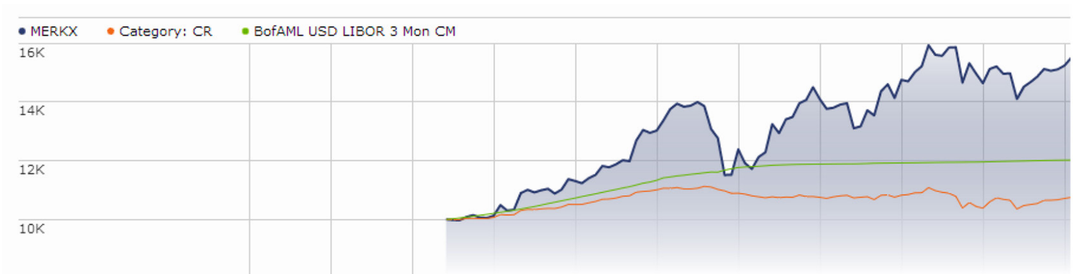
Merk has an unconventional view on gold, which he considers to be the only currency with intrinsic value. As such, gold qualifies as a hard currency to Merk, and the fund includes a small allocation to gold.

| Region | Currency | MERKX | USDX |
|---|---|---|---|
| Europe | Euro | 34.7% | 57.6% |
| | Danish Krone | 3.5% | - |
| | Norwegian Krone | 12.3% | - |
| | Swiss Franc | 0.0% | 3.6% |
| | British Pound | 0.0% | 11.9% |
| | Swedish Krona | 7.7% | 4.2% |
| Australasia ex Japan | Australian Dollar | 7.9% | - |
| | New Zealand Dollar | 5.2% | - |
| | Singapore | 9.1% | - |
| Japan2 | Japanese Yen | -8.4% | 13.6% |
| North America3 | Canadian Dollar | 10.9% | 9.1% |
| Gold4 | Gold | 8.4% | - |

The fund currently has about 8% of its assets invested in gold.

## How Has This Strategy Worked?

Since its inception in 2006, MERKX has only had two down years: 2008, when it lost 4.9%, and 2011, when it dropped a painless 0.7%.




| History (01/31/2013) | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| MERKX | — | — | — | 11.67 | 15.18 | -4.94 | 13.84 | 4.63 | -0.76 | 4.11 |

As you can see, MERKX has had several great years: 11.6% in 2006, 15.1% in 2007, and 13.8% in 2009.

Over the last five years, MERKX has delivered an annual compounded return of 3.2%.

If you're not impressed... you should be, because that is an extremely attractive return for a fund with a 0.4 beta and is the next step up the risk scale from a money market fund.

## Dividends? Better Than a Money Market Account

Since its inception in 2005, MERKX has paid out dividends, but like any short-term parking place, the dividend yield is modest. In 2012, MERKX paid out an 11-cent-per-share dividend, which works out to just a hair under 1%.

| | |
|---|---|
| Dec 13, 2012 | 0.113 Dividend |
| Dec 29, 2011 | 0.096 Dividend |
| Dec 13, 2011 | 0.174 Dividend |
| Jun 29, 2011 | 0.053 Dividend |
| Mar 30, 2011 | 0.047 Dividend |
| Dec 09, 2010 | 0.133 Dividend |
| Jun 29, 2010 | 0.075 Dividend |
| Mar 30, 2010 | 0.071 Dividend |
| Dec 30, 2009 | 0.067 Dividend |
| Dec 10, 2009 | 0.066 Dividend |
| Dec 10, 2008 | 0.027 Dividend |
| Jun 27, 2008 | 0.15 Dividend |
| Mar 28, 2008 | 0.201 Dividend |
| Dec 31, 2007 | 0.418 Dividend |
| Dec 12, 2007 | 0.033 Dividend |
| Sep 28, 2007 | 0.052 Dividend |
| Jun 29, 2007 | 0.063 Dividend |
| Mar 30, 2007 | 0.086 Dividend |
| Dec 29, 2006 | 0.207 Dividend |
| Dec 12, 2006 | 0.002 Dividend |
| Sep 29, 2006 | 0.043 Dividend |
| Jun 30, 2006 | 0.024 Dividend |
| Dec 13, 2005 | 0.01 Dividend |

Those modest dividends are not the reason you should buy the Merk Hard Currency Fund. The reason is that the Fed, as well as our political leaders, wants to drive the US dollar lower… and they're doing a pretty good job.

The Fed didn't reduce its target for the fed funds rate to 0% – 0.25% because it is worried about inflation. The Fed is doing everything it can to spur domestic consumption, goose the economy, and help US exporters.

Furthermore, foreign governments now need to keep their dollars at home to fund their own stimulus programs.

The result will be a secular decline of the dollar for many years to come. That doesn't mean the US dollar won't rally from time to time, but the long-term path is downward.

If you're looking for a place to park some cash, we believe that the Merk Hard Currency fund is one of the best options.

The minimum investment is $2,500 or $1,000 for retirement accounts, such as IRAs.

The fund is no-load and doesn't have any redemption fees or minimum holding periods; it is available through most mutual fund transaction platforms. If you prefer to invest directly through the fund, call 866-637-5386 or go to www.merkfunds.com.

Assuming a $100,000 model portfolio, we normally suggest approximately $5,000 per recommendation. We are, however, doubling that allocation for MERKX to 10% of the model portfolio. Here's what to do:

**Assuming a $100,000 portfolio, buy $10,000 of Merck Hard Currency fund, symbol MERKX, at the market.**

## 15% Profit in the Bank,
## Linn Energy Hits Protective Stop
## Plus, Portfolio Review

We love taking profits! Your Cheniere Energy Partners (CQP) shares were stopped out at $23.50 for a total return of 15.4%, based upon an entry price of $20.73 and a $0.42 dividend.

Hopefully Cheniere shares will go on sale and give us a chance to buy back in at a lower price.

Linn Energy hit our $35 protective stop and should have automatically been liquidated from your account.

BARRON'S

FEATURE | SATURDAY, FEBRUARY 16, 2013

Drilling Into the Numbers

By ANDREW BARY | MORE ARTICLES BY AUTHOR

*Savvy hedging has helped Linn Energy plump its payout and attract investors. But the MLP's accounting for derivatives is starting to raise some questions. A black-and-blue Friday.*

> "Linn may be overstating the cash flow available for distribution, by not deducting the cost of financial derivatives – mainly put options – from its realized gains on hedging activities in its quarterly results."

The good news is that your account should have recently been credited with a 73 cents per share dividend for shareholders of record on February 5. SELL ALL your shares of Linn Energy, symbol LINE, at the market.

Assuming an entry price of $38.83 and $2.19 of dividends collected, the result will be a small loss of less than 2%.

Lastly, we suggest you raise the stop on Plum Creek Timber from $37 to $45.

**Update: Sun Communities, GasLog, Kohlberg Kravis Roberts**

A trio of our recommendations – Sun Communities (SUI), GasLog Ltd. (GLOG), and Kohlberg Kravis Roberts (KKR) – have yet to hit our buy targets.

In fact, they've moved even higher, but you should NOT buy at these prices.

There is a huge difference between good stocks and stocks that are priced right. We believe these are great companies, but it is important to buy them at the right prices.

Here's what to do:

> **Assuming a $100,000 portfolio, BUY 150 shares of Sun Communities, symbol SUI, at $38 or lower. This order is good until canceled.**
>
> **Assuming a $100,000 portfolio, BUY 400 shares of GasLog Ltd, symbol GLOG, at $11.90 or lower. This order is good until canceled.**
>
> **Assuming a $100,000 portfolio, BUY 400 shares of Kohlberg Kravis Roberts & Co., symbol KKR, at $15.50 or lower. This order is good until canceled.**

Will all of these three stocks come down to our buy targets? We believe they will the next time the stock market hits a bumpy patch, so we recommend patience.

As for the rest of our portfolio...

## Portfolio Review

### Aberdeen Asia-Pacific Income Fund (FAX):

FAX has thrown off a reliable stream of income for more than a decade. Most recently, shareholders of record as of January 31 received a 3.5- cent dividend.

Some of that dividend income receives favorable tax treatment. 17% of the above dividend is considered a tax-free return of principal, which is a nice boost to your after-tax income.

| | Estimated Amounts of Current Month Distribution per share ($) | Estimated Amounts of Current Month Distribution per share (%) |
|---|---|---|
| Net Investment Income | $0.0234 | 67% |
| Net Realized Short-Term Capital Gains* | $0.0056 | 16% |
| Net Realized Long-Term Capital Gains | - | - |
| Return of Capital | $0.0060 | 17% |
| Total (per common share) | $0.0350 | 100% |

As always, make sure you consult your tax advisor, but don't overlook the tax-advantaged dividends that FAX throws off.

New subscribers: BUY 600 shares of Aberdeen Asia-Pacific Income Fund, symbol FAX, at $7.50 or lower. Place a protective stop at $7.20.

**Aircastle Ltd. (AYR):**

Although we've owned Aircastle for a very short time, it is off to a great start.

There are some tax nuances (mostly advantageous) for Passive Foreign Investment Companies or PFICs, which Aircastle is, that you need to be aware of.

A PFIC is a non-US company with (1) passive income of 75% or more of its gross income for a taxable year or (2) at least 50% of its assets producing or being held for the production of passive income. The business of leasing/financing aircrafts is considered to be passive income by the IRS.

Under PFIC rules, you need to file an additional IRS form (Form 8621) and make a declaration to treat the PFIC as a "Qualified Electing Fund" (QEF). As a QEF, the company is generally subject to the same tax rules and rates as a US company, except that dividends are not considered qualified dividends and are taxed as ordinary income.

The bottom line is that you must file IRS Form 8621 for the first year that you own a PFIC. As always, you should consult with your tax advisor, but we believe Aircastle's prospects and generous dividend are worth the one-time paperwork.

Aircastle has a very thorough explanation of PFICs on its website.

New Subscribers: BUY 400 shares of Aircastle Ltd., symbol AYR, at $13.50 or lower.

**American Railcar Industries (ARII):**

New Subscribers: BUY 150 shares of American Railcar Industries, symbol ARII, at $39 or lower.

**JPMorgan Chase (JPM):**

JPM reported a fantastic fourth quarter with year-over-year profits jumping by 54% to $5.7 billion.

**The Street**

**JPMorgan Chase Ends Whale of a Year With Record $21.3 Billion in Profit**

"The firm's results reflected strong underlying performance across virtually all our businesses for the fourth quarter and the full year, with strong lending and deposit growth,"said CEO Jamie Dimon.

Indeed, all parts of JPM's business were flourishing. Over the last 12 months:

- Credit Card sales were up 9%
- Commercial Banking grew for the 10th straight quarter by 14%

- Banking revenue increased 33%
- Mortgage Banking originations increased 33%
- Provision for credit losses dropped 70%

Lastly, board director Patrick Flynn nearly doubled his ownership stake when he purchased 6,750 shares at $46.93 on January 29. While that isn't a huge dollar amount, it is a comforting vote of confidence.

New Subscribers: BUY 100 shares of JPMorgan Chase, symbol JPM, at the market.

### PowerShares Build America Bond Portfolio ETF (BAB)

Boring can be beautiful. Since we recommended BAB in September, it has traded in a narrow band between $29.81 and $30.72.

During that time, BAB has paid out dividends of 58.3 cents per share; the most recent payment was 11.7 cents to shareholders on February 15.

Current dividend yield is just below 5%, and it's one of the most attractive investment-grade bond offerings available.

New Subscribers: BUY 150 shares of PowerShares Build America Bond Portfolio ETF, symbol BAB, at the market. Place a protective stop to sell ALL your shares at $28.50.

### Plum Creek Timber (PCL)

You know you're on to something good when a stock you own hits a new 52-week high.

Thanks to an improving real estate market and rising lumber prices, Plum Creek reported fourth-quarter earnings of $79 million, or $0.49 per share, on revenues of $354 million.

Also, shareholders of record as of February 15 will receive a 42-cents-per-share dividend. Plum Creek characterized this dividend as a long-term capital gain that, as such, is expected to be taxed at a maximum rate of 15% (20% for households with incomes over $450,000).

Don't forget to raise your protective stop from $37 to $45!

New Subscribers: Do not buy. Wait for a new signal.

**YIELD SHARK PORTFOLIO[1]**

| INVESTMENT | Ref. Date[2] | Symbol | Current Rec | Entry Price | Latest Closing Price | Gain / (Loss) %[3] | Dividend Paid | Yield Return | Total Return |
|---|---|---|---|---|---|---|---|---|---|
| **HIGH CURRENT INCOME** | | | | | | | | | |
| Linn Energy | 7/24/2012 | LINE | Sell | $38.83 | $35.00 | -9.86% | $2.18 | 7.79% | -4.26% |
| Build America Bond | 9/25/2012 | BAB | Buy | $30.10 | $30.44 | 1.13% | $0.58 | 4.87% | 3.07% |
| **INTERNATIONAL INCOME** | | | | | | | | | |
| Aberdeen Asia-Pacific Income Fund | 6/5/2012 | FAX | Buy | $7.68 | $7.79 | 1.43% | $2.80 | 5.39% | 5.07% |
| **BEST OF BOTH WORLDS** | | | | | | | | | |
| Plum Creek Timber | 6/5/2012 | PCL | Buy | $36.68 | $47.27 | 28.87% | $1.26 | 3.55% | 32.31% |
| **BONUS STOCKS** | | | | | | | | | |
| JP Morgan Chase | 1/29/2013 | JPM | Buy | $47.13 | $47.70 | 1.21% | $0.00 | 2.52% | 1.21% |
| American Railcar Industries, Inc | 1/29/2013 | ARII | Buy | $37.90 | $42.82 | 12.98% | $0.00 | 0.58% | 12.98% |
| Aircastle Ltd. | 1/29/2013 | AYR | Buy | $13.35 | $13.28 | -0.52% | $0.00 | 4.63% | -0.52% |

[1] This sheet represents our current portfolio recommendations and is not a comprehensive track record.

[2] Reference date is the release date of the publication when the recommendation was originally made in Yield Shark.

[3] Includes dividends

| YIELD SHARK PORTFOLIO | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| INVESTMENT | Ref. Date | Symbol | Current Rec | Entry Price | Selling Price | Gain / (Loss) % | Dividends Paid | Total Return |
| **CLOSED POSITIONS** | | | | | | | | |
| Annaly Capital Management | 6/5/2012 | NLY | Sell | $16.23 | $17.00 | 4.74% | $0.55 | 8.13% |
| Yara International | 6/27/2012 | YARIY | Sell | $42.17 | $49.00 | 16.20% | $0.00 | 16.20% |
| Philip Morris International | 6/26/2012 | PM | Sell | $84.90 | $86.00 | 1.30% | $0.85 | 2.30% |
| Female Health Company | 8/28/2012 | FHCO | Sell | $6.44 | $7.00 | 8.70% | $0.00 | 8.70% |
| Poseidon Concepts | 10/24/2012 | POOSF | Sell | $15.33 | $13.10 | -14.54% | $0.00 | -14.54% |
| United Online | 6/5/2012 | UNTD | Sell | $4.03 | $5.05* | 25.31% | $0.10 | 27.79% |
| United Online | 6/5/2012 | UNTD | Sell | $4.03 | $5.60 | 38.95% | $0.20 | 43.91% |
| Cheniere Energy Partners LP | 11/24/2012 | CQP | Sell | $20.73 | $23.50 | 13.36% | $0.425 | 15.41% |

* Partial sale on 8/16/2012

## Questions & Answers

Question: I am fairly new to the publication but notice that almost all the shares recommended are in US dollars, and I think dollars is not something that I want to be in currently. Is it your intention to diversify into investments in other currencies such as the Australian dollar, please? Roger

Answer: You are wise to be worried about the US dollar given the massive budget and trade deficits our country is running, not to speak of the $16 trillion (and growing) national debt.

Like you, we are watching the US dollar and will make swift and substantial changes if necessary. For the time being, we are comfortable with the current portfolio.

Question: I get an email that says the current Yield Shark is now available for January. It is the January edition, but I get the email on January 29. A stock is recommended, and it says it's currently trading in the low $30s. I check online, and it is now $38 and has not been in the low $30s since the start of year. I miss out on this buy? Did this edition come out in early January and I just got the email now? Am I supposed to check some area for new recommendations? Seems like I am seeing these items way too late.

Answer: No, you didn't miss an issue. Yield Shark is always delivered on the fourth Tuesday of each month, and it was an editing error to use the term "low $30s." What we should have said was "mid-$30s."

Question: Why doesn't Yield Shark indicate on which exchange to trade each non-United States stock? I see that both Bull's Eye Investor and World Money Analyst do. I don't know how to determine the native exchange of those foreign stocks recommended on Yield Shark. I realize I could trade them OTC on US exchanges, but I know you also don't recommend trading OTC due to potential liquidity and pricing problems. C.M.

Answer: There are thousands of quality foreign-listed stocks, but Yield Shark will stick to stocks/securities that are traded on a US exchange: the New York Stock Exchange, the American Stock Exchange, the Nasdaq, or the over-the-counter (OTC) market.

You are 100% right about liquidity issues for OTC stocks; that is why we always use limit orders when buying/selling over-the-counter stocks.

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