CONSUELO MACK | WEALTHTRACK

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On this week's show an exclusive interview with a contrarian who has been correct on interest rates and the value of U.S. Treasury bonds for years, Kessler Investment Advisors' Robert Kessler.

Robert Kessler
Founder & CEO
Kessler Investment Advisors

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CONSUELO MACK: This week on WEALTHTRACK, U.S. Treasury specialist Robert Kessler has been right about the strong performance of treasuries for nearly two decades. Why he is even more adamant about owning them now is next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack. One of the most popular acronyms on Wall Street in recent years is TINA, standing for There Is No Alternative, in this case the theory is there is no alternative to investing in stocks and other asset classes traditionally thought of as being risky because you can lose money in them.

With so called risk free assets such as Treasury bills yielding close to nothing the TINA approach to investing has become ever more popular. As investors around the world search for income dividend paying stocks in particular are being touted as a desirable alternative and many companies are helping out.

According to *The Wall Street Journal* "Payouts at S&P 500 companies for the past 12 months amounted to almost 38% of net income" the most since February of 2009, in the throes of the financial crisis. Some companies such as Pfizer, Alcoa, Kellogg and Kraft Heinz have actually paid out more than they have earned in the past 12 months.

Standard and Poors reports that dividends have increased at double-digit rates for each of the past five years. They are forecasting low-to-mid single digit growth this year but predict dividend payouts will still reach a quarterly record of $100 billion in the third quarter alone.

Heaven forbid you should hold treasury securities with their near historic low yields.

Not so says this week's guest. He is Robert Kessler, Founder and CEO of Kessler Investment advisors, a manager of fixed income portfolios specializing in U.S. Treasuries, for institutions and high net worth individuals globally. He has been extolling the virtues of U.S. Treasury bills, notes and bonds in portfolios for as long as I have known him which is nearly two decades. And so far they have not disappointed.

Over the past twenty years the benchmark 10-year Treasury note has delivered an average annualized return of 6.2%, the 30-year Treasury bond an 8.1% return and one of Kessler's favorite treasury securities, the 30-year U.S. Treasury strip 14.2%, all competitive with the S&P 500's 8.3% return, with a lot less volatility, and at maturity you get your principal back.

I started the interview asking Kessler about his passionate objection to TINA.

ROBERT KESSLER: TINA is about us believing there is no alternative to something else, or that this time is different which is another acronym which TTID, This Time Is Different, but the fact of the matter is it never is different. We can go back to 1999 because most people remember the dot com period of time.

CONSUELO MACK: Where they did think things were different, the new paradigm.

ROBERT KESSLER: Where they thought something was a new paradigm. So we used the word "paradigm," and oddly enough we even had central bankers at the very end in 1999 that actually began to talk about the new paradigm. Now the new paradigm at that time was that companies could earn no money, and they could sell at astronomical prices because the future was unlimited. So we kind of made that up, So let's move forward quickly to 2005, 2006 because we're trying to talk about what really looks the same. That bubble, the dot com bubble was created out of kind of thin air, but someone had to pay for it. So someone was funding with easy credit, easy money, not interest rates because interest rates were around five or six percent in those days, so it was easy credit. Someone had to give you money to create a company like this. Then if you look at 2006 ...

CONSUELO MACK: Investment bankers were willing to step into the breach and fund dot com companies.

ROBERT KESSLER: Absolutely.

CONSUELO MACK: Private equity, investment bankers.

ROBERT KESSLER: Investment bankers are always there. There's no question about that. In 2006, 2007, the same investment bankers were creating easy credit for housing, not interest rates. Interest rates once again were at five or six percent, and we had something at that point like the new paradigm which was housing prices never come down.

CONSUELO MACK: Exactly. Alan Greenspan said that.

ROBERT KESSLER: Alan Greenspan. Ben Bernanke actually began to say that too. So as you get to the end of a period of time that was a seven-year period of time, and we seemed to be running in seven, eight-year cycles, we start getting this kind of craziness. So now let's move up to right now, and now we have something that we started by talking about TINA. Now we never heard that number, that name before, that acronym before, there is no alternative, and what is there no alternative for? It's the assets that I'm going to choose to talk about, and those assets start off with equities, and the reason it starts off with equities, because equities pay a dividend, and even though over the last four quarters earnings have been down and we have something called a price/earnings multiple, price and earnings, we don't care about the earnings too much now. We're only going to look at price. The reason we don't care about the earnings too much is because most of these companies pay dividends.

CONSUELO MACK: We, again, this is the royal "we" you're speaking about. This is what Wall Street is saying. This is not you…

ROBERT KESSLER: We're talking about Wall Street, those people who advise you to do something. So if I want to advise you to buy equities, even though they're not earning any more money than they were earning before, even though their dividends are not that excessive, I have to now convince you of doing it. So here's the convincing way we do it. We tell you that a Treasury which is totally risk free, a Treasury will only pay you one and a half percent. You can't afford not to own something else that pays you something more because over the long term you're going to retire and you need that income.

CONSUELO MACK: That's the ten-year Treasury, one and a half percent.

ROBERT KESSLER: So you don't want that one and a half percent which has no risk. You need to buy something else, so we're going to buy that dividend group which is the equity market. Because it starts off at four percent, you really shouldn't get four. Three is a good number or two. So we're going to have to expand the multiple or the price, and as we get the price higher, the dividend will come down, but you're still making a lot of money. Now this is completely illogical. This is nonsensical. It makes absolutely no sense because what you're saying is the company is not earning as much money. It's an equity. There's no maturity on it. There's no guarantee you're going to keep getting this, but someone's going to convince you that the price/earnings multiple should expand, and you'll make plenty of money. Now if you fall for that, which is what we hear all the time, I give you something better than that. TINA also refers to bonds. You should buy high-yield bonds here. Why? Because look, high-yield in the past you could say it's expensive, but now compared to a Treasury you should own some of that stuff.

CONSUELO MACK: Again "they" are speaking. This is Wall Street. There is no alternative. Right.

ROBERT KESSLER: Wall Street. So what's important about the paradigm, the housing market and what's currently happening, as I say to most people, when someone tells you There Is No Alternative, you should run right away.

CONSUELO MACK: Away.

ROBERT KESSLER: Away from anything like that. Now I started mentioning earlier that the interest rates at the time, 1999, was five or six percent. The interest rates in 2006, 2007 were five or six percent. When they came down each time, they came down because there was kind of this malaise, this decline in the economy, and when they came down, stocks came down, and they should because stocks are based on earnings.

CONSUELO MACK: Absolutely, and earnings are based on the economy doing well.

ROBERT KESSLER: So if I want to convince you to buy something now, I have to completely turn that on its head. This time is not like the others, because if you actually listen to this, no, it is exactly like the others. It is not different than the others. It's just another way of talking about credit. I want to get back to this question of credit. What we've done is made all of that credit that was available to people in the housing market or people in that dot com market, we've now made that credit available, of all things, to all of these corporations. They can all go out and borrow money easily.

CONSUELO MACK: And to Wall Street and exactly to investment firms and to companies.

ROBERT KESSLER: What do they do with the money? That's so important because in the United States we are finding out we have very low productivity which is a terrible thing. That's why wages aren't going higher. Productivity would mean that wages could go higher after we improve the productivity. How do we do that? You invest in the future. Corporations need to take that money, those earnings, and invest it and so what are they doing with it? They're taking all that money and they're paying it back to shareholders in the form of those dividends and buying back their own stock. Now what's intriguing about that ...

CONSUELO MACK: They're not reinvesting, so capital expenditures are down, flat.

ROBERT KESSLER: Very low.

CONSUELO MACK: Very low.

ROBERT KESSLER: In a sense what they're actually doing is liquidating their own company because you're paying them money to invest your money in a better way than you can. You didn't give them the money just to give it back to you at a multiple, because you give it to them and you get it back at 20 times that number which is what you paid. So when you look at this process of credit, okay, we're not doing the credit for the housing. We're doing the credit for the corporations, and they're misusing it just like we've misused it for the dot coms and misused it for the housing market.

CONSUELO MACK: Robert, the reason interest rates are so low you think is because the economy is very weak.

ROBERT KESSLER: Last year we had a discussion I think in June or July, and one of the things we talked about were, are things getting better? If you look at Europe – and I'm going to skip the Brexit for a moment which is a serious enough problem – Europe continues as Italy does, as Portugal recently, all of these countries are having serious problems, and they're not going away. They're what we would call structural. China continues to have the same kinds of problems, and all of this stems from over capacity throughout the world and lack of demand. Those are simple.

CONSUELO MACK: And a lot of debt.

ROBERT KESSLER: And a lot of debt, so you create debt by extending credit.

Coincidentally if it was expensive and the demand was very high, interest rates would be substantially higher, but somehow interest rates keep dropping, and it's not just short-term interest rates which are controlled by central bankers. It's long-term interest rates, and long-term interest rates are based on inflation and based on the future. So they're telling you there's something wrong structurally in the global market. That being the case, it's very important to understand rates are down because of demand in the marketplace.

CONSUELO MACK: Because of fundamentals.

ROBERT KESSLER: Fundamentals in the marketplace.

CONSUELO MACK: It's the old-fashioned story that the global economy is slow and, therefore, of course interest rates are low because there isn't that much demand.

ROBERT KESSLER: That's right.

CONSUELO MACK: For credit.

ROBERT KESSLER: That's right. So let me relate this for a moment because we will get to Treasuries which we inevitably get to Treasuries or cash or things that I think are…

CONSUELO MACK: Those are the risk-free assets that everyone else is saying reject.

ROBERT KESSLER: So when you look at this retail marketplace where people could actually get hurt here, one of the things that people worry about is the bond market bubble because you hear this all the time. It's the bond market bubble.

CONSUELO MACK: Well, they're talking about the fact that interest rates were at record lows, that Treasuries have had a 30-year plus bull market run, and they're saying that bond prices, Treasuries especially, are very expensive.

ROBERT KESSLER: So let's talk about ...

CONSUELO MACK: So that's the argument.

ROBERT KESSLER: Let's talk about what's wrong with that argument to begin with. We were talking about dividends before for instance, and people like to sit back and say, "Well, wait a second. Treasuries are so much lower than dividends of equities. You've got to buy the equities."

CONSUELO MACK: Yields are so much lower.

ROBERT KESSLER: Yields. The reason for that is, well, we never saw this before, and so we have to adjust all these prices to what we never saw before. But the fact of the matter is it's completely untrue. From 1930 to 1960 dividends were always higher than Treasuries.

CONSUELO MACK: Dividend yields were always higher.

ROBERT KESSLER: Dividend yields were always higher than Treasuries and substantially higher, and the reason ...

CONSUELO MACK: That's 30 years.

ROBERT KESSLER: That's for a 30-year period that no one seems to tell you about. What's important about that, it was coming out of the Depression. We of course are coming out of the Great Recession, and people coming out of the Depression realized that you had to pay a premium for risk, and there was risk in equities. They all knew that.

CONSUELO MACK: Right. They had all gotten killed.

ROBERT KESSLER: One wonders why we don't know that now, since every seven or eight years our markets have been dropping 30 to 50 percent. This is eight years, so it's an iffy kind of a thing. So when you look at that period of time, why were they buying those Treasuries? Treasuries yielded for almost that whole average of that 30-year period of time two and a half percent. Dividends were five and they stayed there. You didn't make ...

CONSUELO MACK: Because in order to attract investors, companies had to pay high dividends because no one in their right mind after the crash would get back into equities again.

ROBERT KESSLER: There wasn't that much growth. There wasn't that much growth.
I'm going to talk about cash for a moment. If you went to sleep tonight with a bunch of cash, no one says you're going to keep that cash under your pillow or in that bank for the next 30 years. The implication of cash is always the same. Well, if you have cash for the next 30 years, you won't make any money. You can't retire. No, no. I'm going to keep the cash until the stock market drops 30 percent, and then I'm going to buy 30 percent more with my cash. Well, how do you know that's going to happen? I don't know. It's eight years. I just gave you an argument on dividends which are so ridiculous about they have to grow the P/E. The point I'm making is that people make this assumption about things they don't think you should have, for instance the ten-year Treasury. It pays you one and a half percent which is not so terrible, one and a half percent in a marketplace where things all over the world seem to be collapsing.

CONSUELO MACK: So this is the point, that you really feel that the macro environment is very negative, and it in fact is riskier now than it was last year or the year before. Right?

ROBERT KESSLER: My point is at one and a half percent, if you stop and think about it, at one and a half percent I'm only making one assumption, that there's a lot of risk out there, and to get five to lose 30 ...

CONSUELO MACK: In a year or whatever.

ROBERT KESSLER: ... there isn't a period of time I can give you that goes much more than seven or eight or nine years that the stock market doesn't drop 20, 30, 40, 50 percent. So what you're saying to me is someone is suggesting to me seven or eight years giving you all this TINA craziness, that I should go ahead and invest for the long term.

CONSUELO MACK: What about the theory that as kind of a bedrock of long-term investing, most people who invest for their retirement for instance, they're investing for 30 or 40-year periods of time, and if you look at all the tables starting in 1929 or 1880, whatever, there are a lot of different ones, that if you stay invested in the stock market that market timers are, number one, are notoriously wrong, that if you stay invested in the stock market and keep reinvesting your dividends in a tax-free vehicle like a 401(k) that eventually you'll have more money when you need to withdraw it for retirement? That's the theory. Are you saying that basically that broad diversification, just this is not the time to be broadly diversified? This is the time in fact to get out of the stock market? This time is different?

ROBERT KESSLER: That argument makes absolutely no sense, and the reason it makes no sense is because no one is around for that period of time that everyone's talking about. I don't know anyone who ever did that. I don't know anyone who invested in IBM in 1960 and stayed with IBM ever since then.

CONSUELO MACK: I know a couple but it's very rare. Very few.

ROBERT KESSLER: Well, but very few, and believe me I'm not one of them, but the fact of the matter is most people who are listening are being told this is for your retirement, and I'm sitting here and saying be very serious. You cannot afford to lose 30 or 40 percent to make five, and that is the argument.

CONSUELO MACK: You are more adamant now about owning Treasuries and having cash than you have been in a number of years. Why?

ROBERT KESSLER: First of all, I think cash is worth a lot. People are so worried about how much they're going to make, what the yield is. I'm going to go back again in time because it's always good to do this. When I started in business, we all were in the payroll savings plan. Eighty-seven bucks. You got $100 some distant time in the future.

CONSUELO MACK: It's like a savings bond.

ROBERT KESSLER: That's what we all did. They took it out of our salary. That was known as savings. It wasn't known as an investment savings. So when we talk about dollars right now, it is important to distinguish between savings and investments. Now I just want to take this current stock market because, yeah, I think it's important. It's up 185 percent from 2009. Now it's convenient for me to say, 'Was I smart? I started in 2009," but everyone knows we didn't. We all started before that. So now it's up 185 percent. It's eight years later. The economies around the world structurally are not changing and governments look as wacky as they've looked in ages, and someone's telling me I'm a long-term player in the equity market? This is a little bit ridiculous. So you say, why am I a little bit more adamant today? First of all, Treasuries at one and a half percent, 160 or whatever they closed at today, are interesting because in so many places in the world right now, they're substantially lower than our Treasury market and we are the best.

CONSUELO MACK: Thirteen trillion or something worth interest rates.

ROBERT KESSLER: Are negative. South Korea is 135, South Korea. All of Europe is below one in most respects, so now you've got a Treasury, and now the question is, well, it doesn't pay you enough. Well, if I tell you it's going from 150 which is what I did a year ago when it was 250, now it's 150. Everyone made plenty of money in the Treasury market. We were making 13, 14 percent last year. If the Treasury goes from 150 to a half of one percent, nine or ten percent, well, what happens if it doesn't? It's a Treasury.

CONSUELO MACK: Right, so you'll get your money back.

ROBERT KESSLER: Well, you're sitting with a piece of paper that's better than every other piece of paper.

CONSUELO MACK: So let me ask you, though, just because investors can lose money in Treasuries, and obviously they can if interest rates go up. So the Kessler Cornerstone Absolute Fund, your hedge fund, last year it was down seven percent, and in 2013 – I just looked at the figures – it was down 11 percent. I mean aside from those two years, you've had very positive returns in. So there is risk in ... that's a strategy as opposed to buying a straight Treasury.

ROBERT KESSLER: But that's exactly like saying I sold all my stocks when it was down 40 percent. What about that risk? The answer is generally speaking you own Treasuries for different purposes. We have a fund that is an investment fund. I get back to the discussion of investing versus savings.

CONSUELO MACK: Investing versus savings.

ROBERT KESSLER: I'm not suggesting that people necessarily do what we do with Treasuries, but I am suggesting the reason you own Treasuries, there's a specific reason. Number one, they're the safest instrument you can own, but more important than that it is the only instrument that will act positively in a very negative marketplace, meaning that if stocks come down and various other things come down, Treasuries will in fact go up.

CONSUELO MACK: It's a non-correlated asset.

ROBERT KESSLER: If you don't want a ten-year Treasury because you ... the assumption always is when people say, "Well, you could lose money in Treasuries," no one says you have to sell the ten-year Treasury, but you don't get that with an equity because there's no maturity on an equity, and there's no guarantee that that yield you talked about is going to be paid in the future.

CONSUELO MACK: All right, two more questions. One is one investment for a long-term diversified portfolio. What should we all own some of?

ROBERT KESSLER: I answer this every single year the same way. If you ask me about a pension portfolio, every single time I say every year buy zero-coupon, long-term Treasuries. There is nothing you can tell me sitting here nor is anyone else going to be able to do it that has performed better over the last 30 years. This argument, "Oh, it's the end of the bull market in Treasuries," all of this is completely ridiculous. First of all, everyone doesn't know that, and they've all been wrong steadily, but zero coupon bonds if you do it every year, because that's what we always talk about with IRAs and retirement plans that we invest every year. Look, maybe it's paying two and three quarters for a long term this year. Maybe next year it'll be paying four. I don't know. Maybe it'll be paying six, so you'll get six. The object of doing that is legitimately a real pension fund idea, and if they all did that, the trouble is it doesn't really require a manager.

CONSUELO MACK: Right. There's going to be a fee. You can do it right through the ...

ROBERT KESSLER: You can do it right through ...

CONSUELO MACK: The U.S. Treasury Department.

ROBERT KESSLER: I once did a program in Great Britain and the United Kingdom, and someone said, "Well, for what you do, you could just go to the post office and buy it. Right?" The answer is, kind of yeah.

CONSUELO MACK: Yes. Last question is you just sold a house in California. What are you doing with the proceeds?

ROBERT KESSLER: We put that into bills.

CONSUELO MACK: Treasury bills.

ROBERT KESSLER: That would be very, very short-term Treasury. It's like cash, and some of it in the fund.

CONSUELO MACK: The reason that you're buying Treasury bills? Is it just a place to park to wait for a better opportunity or ... ?

ROBERT KESSLER: I bring this out about cash. It is nice to go to sleep, for your whole audience. You may all be invested in the stock market, but I'm going to tell you for a couple weeks try having the cash in the bank. It is a great feeling.

Robert Kessler, Kessler Investment Advisors, thank you so much for joining us.

ROBERT KESSLER: Thank you for having me.

CONSUELO MACK: At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term.
This week's Action Point is: Keep some cash in the bank, separate from your investment account.
Kessler is right. There are benefits to having a stash of cash in the bank. You have immediate access to it, 24/7, in case of an emergency. It's free of investment management fees, and psychologically, it is very reassuring. Fairholme Fund's Bruce Berkowitz refers to it as "financial valium" for a reason.

Next week we are discussing workable solutions to solving the retirement crisis with two pros who have devoted their careers to the cause: State Street Global Advisors Fredrik Axsater and Kennedy School of Government's Brigitte Madrian. It is a critical, must hear discussion.
You also might be interested in hearing why Rober Kessler and his wife collect Japanese ceramics. Both are in the EXTRA feature on our website.

For all of you who reach out to us on Facebook and Twitter, keep doing so. We learn from your comments.

Thanks for watching. Have a great weekend and make the week ahead a profitable and a productive one.