

Gundlach – Avoid Riskier Assets

By Robert Huebscher

July 17, 2012



A copy of Jeffrey Gundlach's presentation is available [here](#).

Since early this year, Jeffrey Gundlach has warned investors to avoid exposure to riskier assets, among them equities, non-dollar-denominated securities and sovereign debt. Still reluctant to move to a more aggressive position, Gundlach said on Thursday that “substantial opportunities await” – but they may be as much as a year away.

“We are ready to shake the world up with some decisions in the Eurozone that have to be made in the next year,” he said, “and in the US regarding its debt problems.”

Those decisions will be sufficiently disruptive to the markets to create buying opportunities. Until then, Gundlach advised investors to “not try to press it.”

Gundlach spoke in a conference call with investors. He is the founder and chief investment officer of Doubleline Capital. Summaries of his previous two conference calls – during which he made similar warnings about riskier assets – are available [here](#) and [here](#).

Gundlach discussed how he has reduced exposure to certain assets in Doubleline's multi-asset growth fund. Let's review his outlook across the capital markets – and how he proved that Facebook's stock was a better investment than five-year Treasury bonds.

US bonds and equities

Low-yielding US Treasury securities are unattractive across the maturity spectrum, offering “reward-free risk,” Gundlach said. His funds hold cash instead of short-duration high-quality fixed income, such as Treasury bonds. Holding cash, he said, keeps him aware that he has “dry powder” to deploy, should opportunities arise.

Gundlach said the return on Treasury bonds, even if yields fall a bit further from today's levels, is unappealing in comparison to other vehicles – including Doubleline's total return fund, which yields 5%.

It's not only Fed policy that is keeping rates low, he said. Flight-to-quality is having a profound effect, and fearful investors in distressed European countries are choosing securities such as the 10-year Treasury as a safe haven.



Don't expect another round of quantitative easing, either. Gundlach said that the Fed is "starting to realize that QE III is really not going to be effective" and will be reluctant to implement it.

That may mean value of the dollar is poised to decline, he said, which would in turn imply that the US Treasury market "may be near some sort of a peak in price."

The recent bankruptcy filings by San Bernardino and Stockton have heightened awareness of the perilous state of city and state finances, Gundlach said. On the day he spoke, he said that the price of NMUNI, a benchmark municipal bond fund, had declined by about 50 basis points. Gundlach reiterated a warning he has made in previous conference calls: The tax advantage of municipal bonds may be legislated away, as part of an overall plan to raise taxes on the wealthiest individuals.

Corporate profits at an all-time high as a percentage of GDP – with wages at an all-time low – will stoke public support for taxes on the wealthy, Gundlach said. He predicted that Obama will be reelected, and he said that Obama's side comment in March to Russian President Medvedev that he would have "more flexibility" after the elections should be viewed as one indication of the likelihood of tax increases.

Gundlach said he has taken his fixed income allocation down "a bit," and reduced the duration of his bond holdings to boot. He has reduced his cash position slightly in order to deploy money in commodities.

Commodities, gold and emerging markets

Indeed, Gundlach said he is "taking risk exposure more in commodities than in equities."

Real assets now comprise approximately 25% of Doubleline's multi-asset growth fund. Gundlach said he has increased natural gas holdings to about 6% of the portfolio. He has been bullish on natural gas in the past, and he plans to build his position up to 15% of the portfolio gradually, as part of a long-term strategy.

"I've been liking gold whenever it is below \$1,600 per ounce," Gundlach said. He has increased his gold allocation to 12% of the portfolio, he said.

Since late in 2010, Gundlach has been advocating for investors to eliminate all non-dollar-denominated risk. Last week, however, he softened his position.

"I am no longer unwilling – almost – to listen to the idea of buying other currencies," he said.

Although he hasn't yet bought any emerging market equities, he said that part of his long-term strategy is to build that position. Wealth will be growing in the stronger emerging



markets at the expense of the developed world, he said, and “we do believe that the opportunities are likely to get cheaper in that area.”

Gundlach said he is “waiting for an opportunity to deploy significant capital” into some emerging market sectors.

He won’t be buying the sovereign debt of the weaker European countries. Gundlach expects Spanish yields, which are now approximately 7%, and Italian yields, which are between 5% and 6%, to go higher. “I think you are out of your mind if you owned Spanish bonds,” he said, “and maybe Portugal’s as well.”

Housing and eminent domain

One area Gundlach sees improving is housing. He said that half of the cities in the Case-Shiller index are increasing on a year-over-year basis, and nearly as many went up in the most recent monthly data.

But he is highly skeptical of the eminent domain strategy currently under consideration.

He described the effort as “some ex-Wall Street guys” who plan to lobby financially strapped counties and cities, to get them to use eminent domain to seize mortgages that are currently performing, but which are underwater.

Gundlach said those individuals claim that will buy mortgages at fair value. “The problem of course is that these are ex-Wall Streeters and therefore, what they mean by fair value is probably below fair value, because this is a for-profit enterprise,” he said.

He expects that they will “pocket the profit or perhaps share the profit with sort-of corrupt politicians, and thereby have this great seizure of wealth.”

Support for the idea comes from claims – by its proponents – that it will help out financially strapped cities and counties, at least in the short term. Gundlach doesn’t believe that, although he didn’t say specifically why – only that the plan itself is illogical. He also said it would not withstand a constitutional challenge.

One of the problems Gundlach noted was that the pools that would be seized would not be eligible for Fannie Mae good delivery.

If it were to succeed, he said that it would set a bold and pernicious precedent. The core precept of the plan, Gundlach said, is that it is “immoral” for people to have to pay back debt that is underwater. But, he said, paying back such debt occurs with virtually every credit card transaction. When one buys, for example, a pair of jeans and charges the purchase, the merchandise will be worth less when they walk out of the store. When you charge a meal at a restaurant, he said, it is worth nothing once it is consumed.



“If we are going to start getting people to be forgiven down to market value on all their underwater debt,” he said, “we will be forgiving all credit card debt.”

Facebook, five-year Treasury bonds, and desperate investors

Gundlach was asked about a comment he made, at some point in the past, to the effect that Facebook was a better investment than five-year Treasury bonds. Rather than earn nearly zero on those bonds, he said he proved he could do much better with Facebook stock. He did so by purchasing some with his own money. Because of the volatility of the stock, he was able to sell it in less than 15 minutes at a 4% profit, proving his contention.

But that story was one bit of positive market news amid Gundlach’s bleaker outlook for riskier assets.

Gundlach has said in the past that it is neither fear nor greed that causes investors to lose money; the need for return does that. “Need-based investing is the most deadly,” he said, “because all types of shaky valuations and shaky investments get justified with the fact that at least they have a chance to provide some sort of return.”

“It seems to me, investors right now are downright desperate,” he said.

Investors are underestimating the degree of risk in the markets, according to Gundlach, who said that the fiscal crises in the US and Europe are far from over.

Gundlach said that typically expects to make 80% of his money over 20% of the time. This year has not been one that fell into that 20% category.

He acknowledged that the returns for the multi-asset growth fund have been modest (it is down 0.14% year-to-date), reflecting the conservative positioning of the portfolio. But, he said, “I think that is appropriate.”

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:

<http://www.advisorperspectives.com/subscribers/subscribe.php>