"Price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal."

-- Ben Graham

April 25, 2012

A Look Back

As individual investors continued to withdraw money from the stock market during the first quarter of 2012 in favor of bonds, U.S. equities posted their best first quarter returns in more than a decade.

During 2011, companies that possessed great consumer franchises threw off enormous amounts of free cash flow, and paid large dividends with the capability of increasing them multiple times during the next five years were the "belles of the ball."

During the first quarter of the current year, the leadership has come full circle. Stocks that are more speculative with lofty valuations took center stage. It is as though the fear of last summer abated and risk is once again front and center.

The Dow surged 934 points, or 8.84 percent, to 1312.04 and the S&P 500 soared 150.87 points, or 12.59 percent.

We would be remiss if we didn't mention the NASDAQ composite, the tech laden index advanced by 18.67 percent, outdistancing both the Dow and the S&P 500 and narrowly missing its biggest point gain since 2000.

The financial and tech sectors were the big gainers each surging roughly 21 percent in the quarter. Nine of the ten S&P 500 sectors rose in the quarter. Utilities were the lone loser declining 2.7 percent.

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Bank of America takes the crown as the best performing Dow component surging 72 percent in the first quarter, while J.P. Morgan Chase advanced 38 percent and Microsoft gained 24 percent.

The best performer among the S&P 500 was Sears which jumped a whopping 108 percent during Q-1, while Netflix advanced 66 percent and Apple increased by 48 percent.

The bulls will like this factoid: since 1950, the S&P 500 has always finished a year higher after gaining at least 8 percent in the first quarter, according to S&P's Howard Silverblatt. And more gains could be in the offing; in six of the previous eight instances that the S&P 500 gained more than 10 percent in the first quarter, it has averaged a 3.3 percent advance in the following quarter according to S&P.

Performance

We are generally pleased with how Boyar Asset Management performed during the quarter. Considering our large cash position across most accounts, and having no exposure to Apple (which according to Barclays was responsible for 15 percent of the S&P 500 advance during the first quarter), we did quite well on a risk adjusted basis. Midas, a company that we owned in many of our accounts received an $11.50 per share takeover offer. We disposed of our entire holding a few pennies shy of the offering price. As a result of this and additional sales we made in other positions, in general our cash position is high as we believe a temporarily pullback may be on its way, and we want to have some “dry powder” to take advantage of the situation. A word of caution, if the market continues its upward bias, our large cash position could inhibit our relative performance over the short term. Ideally we would like the market to retreat, so we can pick up some bargains.

A Look Ahead

We believe we are due for a market correction. The S&P 500 for example has advanced almost 26% during the past six months. Furthermore, the gain has been slow and steady, and devoid of a material pullback. So, we think that we are certainly due for a correction; the timing however is anybody's guess.

In our opinion, despite the recent advance common stocks remain quite attractive on a relative basis for long-term patient investors. We can think of no asset class that is nearly as compelling; perhaps single family homes in certain parts of the country could prove equally rewarding for those with a long term time horizon.

There are still plenty of things to worry about, which could negatively impact the stock market during the short term. We listed a number of our biggest fears in our fourth quarter letter.
Let me recite some of them again:

Fears

1) The European debt problem has been pushed down the road, but it s lingers.
2) Iran
3) The Chinese economy experiences a deeper and more protracted decline than economists are currently forecasting. The Chinese housing collapse is a bigger problem than currently imagined.

4) The U.S. doesn't address its ballooning deficit quickly. Don't think that the same thing that happened in Europe can't happen here.
5) Entitlement issues such as Medicare and Social Security have to be tackled.
6) The Bush tax cuts end in December. If they are permitted to expire by year end, it is conceivable it could force the U.S. into recession in 2013.

<u>Reasons to be Bullish</u>

1) There appears to be early signs the housing picture is brightening. Homes in many parts of the country have not been this affordable in decades. A housing pickup could have a profound impact on job creation.
2) There is a distinct possibility we can become energy independent by the end of the decade.
3) Both the Iraq and Afghan conflicts will be drawing to an end. The cost savings should be enormous.
4) Corporate balance sheets are in great shape. U.S companies are in a good competitive position.
5) The U.S. banking system is on the mend. U.S. banks are in far better shape than their counterparts throughout the world.

"Bandwagon Investing" Is Gold a Bubble?

There is a category of investments that involves assets that will never produce anything, but that are purchased in the buyer's hope that someone else- who also knows the assets will be forever unproductive - will pay more for them in the future. Tulips, of all things, briefly became a favorite of such buyers in the 17th century.

This type of investment requires an expanding pool of buyers, who in turn, are enticed because they believe the buying pool will expand still further. Owners are not inspired by what the asset itself can produce - it will remain lifeless forever - but rather by the belief that others will desire it even more avidly in the future.

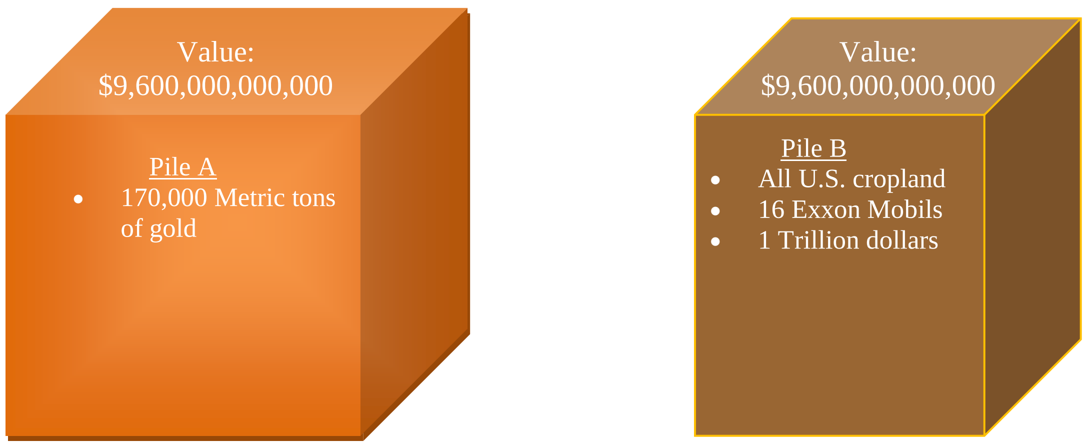
The major asset in this category is gold, currently a huge favorite of investors who fear almost all other assets, especially paper money (rightfully so, considering the paltry returns an investor currently receives). Gold, however, has two significant shortcomings, being neither of much use nor procreative. True gold has some industrial and decorative utility, but, demand for these purposes is both limited and incapable of soaking up new production. Meanwhile, if you own an ounce of gold for an eternity, you will still own one ounce at its end.

What motivates most gold purchasers is their belief that the ranks of the fearful will grow. During the past decade that belief has proved correct. Beyond that, the rising price has on its own generated additional buying enthusiasm, attracting purchasers who see the rise as validating an investment thesis. As "bandwagon" investors join any party, they create their own truth-- for a while.

Over the past 15 years, both Internet stocks and houses have demonstrated the extraordinary excesses that can be created by combining an initially sensible thesis with well-publicized rising prices. In these bubbles, an army of originally skeptical investors succumbed to the "proof" delivered by the market, and the pool of buyers- for a time- expanded sufficiently to keep the bandwagon rolling. But bubbles large enough inevitably pop. And then the old proverb is confirmed once again: “What the wise man does in the beginning, the fool does in the end."

Today the world's gold stock is about 170,000 metric tons. If all this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fittingly comfortably within a baseball infield). At $1,750 per ounce- gold's current price - its value would be $9.6 trillion. Call this cube A.

<u>What would you choose?</u>



Let's now create pile B costing an equal amount. For that, we could buy all U.S. cropland (400 million acres with output of about $200 billion annually, plus 16 Exxon Mobils (the world's most profitable company, one earning more than $40 billion annually). After these purchases we would have about $1 trillion left over for walking-around money. Can you imagine an investor with $9.6 trillion selecting pile A over pile B?

Beyond the staggering valuation given the existing stock of gold, current prices make today's annual production of gold command about $160 billion. Buyers - whether jewelry and industrial users, frightened individuals, or speculators - must continually absorb this additional supply to merely maintain equilibrium at present prices.

A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops - and will continue to produce the valuable bounty, whatever the currency may be. Exxon Mobil will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and remember you get 16 Exxons). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube but it will not respond.

Admittedly, when people a century from now are fearful, it's likely many will rush to gold. I'm confident, however, that the $9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B.

Excerpt from Berkshire Hathaway's 2011 Letter to Shareholders.

Is the Bull Market for U.S. Treasuries Finally Ending?

All things must pass. Treasury bonds regarded as the world's safest assets have been in a bull market (meaning their prices have risen while their yields have fallen) since 1982. Equities have been in a secular bear market (with falling prices) since 2000. Neither can last forever. It is possible in the future, when looking back we will see that both have already ended.

Just recently a number of well respected economists have made such a prognostication. In support of the thesis relating to bonds it is argued The Federal Reserve will not undertake another round of quantitative easing. The U.S. economy shifts to a sustainable recovery, private sector credit in the U.S. expands, China and other major emerging economies rebound after dipping in the first half of 2012 and the eurozone recession doesn't shock the global economy.

If all of these conditions are confirmed, then a bond bear market, with lower prices and higher yields, is inevitable.

Naturally, none of these conditions is yet certain. But let's assume that bonds are indeed in a new bear market; how will this affect equities? It should be good. Money coming out of bonds must go somewhere. Most pension plans and individuals have abandoned the equities markets in droves in favor of bonds. A change in asset allocation could fuel a further advance in stocks.

From a historical perspective bull markets normally commence when equities are very cheap, rather than when the economy is strong. There is no question that stocks are significantly more attractive than bonds. You can still purchase high quality equities where the yields are significantly higher than bonds. Furthermore, in a great many instances the dividends, in all likelihood will be raised multiple times during the next decade.

One can certainly make the argument that equities only look attractive because bonds are overvalued, and their yields are unsustainably low. If bond yields were to rise, so the argument goes, then equities may outperform in relative terms, but wouldn't rise in absolute terms.

In response to the aforementioned position one must remember that the correlation between rising bond yields and equity prices is not constant, but changes according to the levels of the yields. When yields are low, a rising yield does little damage to the economy or companies' borrowing plans. But above a tipping point of 4 to 5 percent, higher bond yields begin to entice investors away from stocks, and begin to negatively impact a company's ability to capture an adequate return from the borrowed money...all potentially damaging to equities.

With yields starting out at historic lows, plainly an initial move would be positive for stocks.

Ten year treasury bonds currently yield 2.2 percent. They could rise quite awhile before troubling the stock market.

So, where does this leave us? A turn in bonds would be initially great for stocks, which theoretically can be a refuge for the displaced funds. This big switch has not as yet occurred, but at some point in the not too distant future there is a good chance both equities and bonds will shift their secular direction - probably at much the same time. The critical driver is the economy.

However, the economic data does not yet prove the secular shift is imminent. And once the shift has happened, equity investors need to be very careful that bond yields do not race upwards raising the cost of money and crimping the valuations they can pay for equities. The vast majority of bond traders working today have known a world in which yields forever come down, so there is a danger, however, remote this could happen, once it becomes clear that bonds' long bull market is over.

Excerpt from The Financial Times, dated March 24, 2012 in an article penned by John Authers.

Cyclical Stocks Look Cheap, but before you Spend your Hard Earned Money on these Gems Read On:

Just as it is easier to draw straight lines than to think in nonlinear terms, it is simpler to buy stocks that have gone up a lot over the previous decade than to remain committed to the ones that have done nothing. However, linearity is for suckers. Success in investing comes from being able to see not what is in front of you but what is lurking just around the corner.

Take heavy- equipment makers Caterpillar and Deere for example. It is very easy to love these deeply cyclical companies, which have benefited mightily from the run-up in commodity prices over the past decade. Their stocks have advanced dramatically over that time frame, and for good reason. Their revenues and profits have tripled and quadrupled during that ten year period.

The story gets better. Earnings for the aforementioned are projected to advance by double digits well into this decade, according to some of the most respected Wall Street analysts. In theory, these American icons should be a value investor's paradise because of their past success and expectations of their future wonderful growth, they are trading at low double-digit P/Es...Cheap!

But before you run out and spend your hard-earned money on these gems, let's examine what might be lurking around the corner. During the past few years the emerging markets in particular experienced rapid economic growth. Part of this was simply a recovery from the 2008 crisis; however a significant portion was spurred by global stimulus.

Let's pause for a second and think about that. The 2008 global recession took place in large part because of substantial borrowing from under reserved financial institutions that allocated the capital to ill conceived fixed asset investments. That put a hurricane like tail wind in the sails of deeply cyclical stocks. For eight years, until 2008, their sales and profits grew as if Google was their middle names. Investors stopped treating them as cyclical stocks.

The global fixed-asset bubble burst painfully in 2008, and the deep cyclical stock story should have concluded. After all, if you build things that will last decades, you don't have to make more for a very long time, and you will need considerably less earth movers from Caterpillar. This would have been a rational expectation- and it would have been wrong. The sales and profitability of Cat and Deere and the like have already surpassed the levels they reached before the 2008 crisis.

Because of massive global stimulus -turbocharged by China's 12 percent of GDP mother of all stimuli which was further amplified by off-the-charts leverage - the asset bubble has been re-inflated over the past couple of years. The stimulus came at a significant cost: the increased leveraging of governments. Last year demonstrated that there is an upper limit to how much a developed country can borrow, unless they are willing to borrow at double or triple their current rates.

We are very likely entering a third leg of global deleveraging. The first two were by consumers and corporations, and to a large degree took place at the expense of the governments that took over their debts. Now we are entering the most painful stage: government deleveraging, which will be de-stimulating to the global economy and cause a massive decline in fixed asset investment.

Today investing in deeply cyclical stocks is not unlike a game of musical chairs. If you own these stocks, you are coining money while the music is playing. We know what happens when the music stops; these stocks will plummet.

Caterpillar, Deere and Joy Global among others benefit from operational leverage. A large portion of their costs is fixed, and as their sales increase, their margins do too. Their profits are high because their margins are at an all-time high, but once China, India and Europe slow down and demand evaporates, sales will decline. Their operational leverage will start working against them because costs will not decline as rapidly as sales, and margins will do what they always have done: they will revert to the mean and in all likelihood collapse. Companies' earnings power will be completely reset and will not resemble anything even close to what they are today. Stocks that looked very inexpensive will suddenly look very pricey.

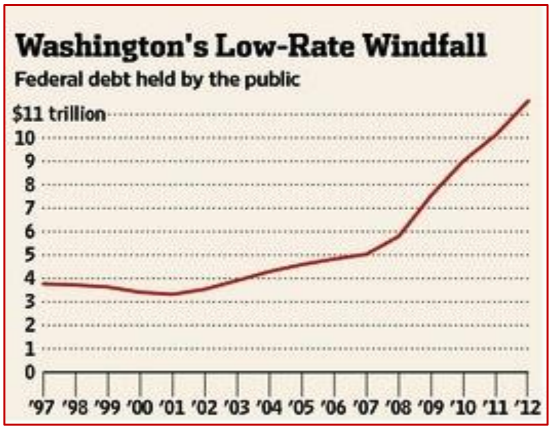
The commodity "super- cycle" is rather long in the tooth. Gold, copper, silver, palladium etc. have had virtually uninterrupted advances for a decade or more. Naturally, it is difficult to predict when the music will stop. If you think you possess perfect pitch and will hear the music stop and be able to grab a chair before everyone else....Good Luck... The vast majority of dot-com investors thought they had perfect pitch, and we know all too well what happened to them. Bubbles don't follow timetables, but the risk- reward of owning these cyclical stocks has clearly shifted into unfavorable territory.

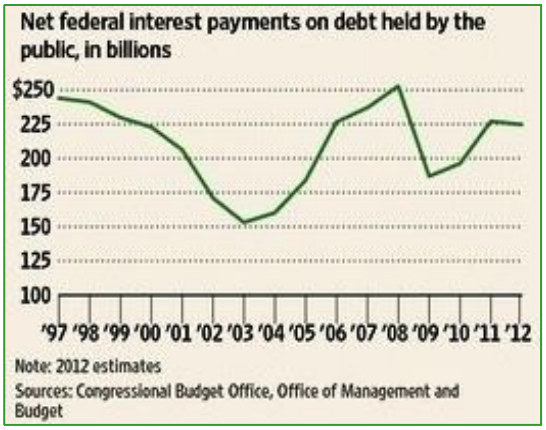
Condensed from an article that appeared in the February 2012 edition of Institutional Investor penned by Vitaliy Katsenelson.

The Federal Debt Bomb

First, a couple of facts: the U.S. Treasury currently has $10.7 trillion in outstanding publicly held debt, and more than $8 trillion of it must be repaid within the next seven years. More than $5 trillion falls due within the next 36 months.

This relatively short-term debt sheet is no accident. Like a subprime borrower opting for a low teaser rate, the government has structured its debt to keep current interest payments low. This is a political temptation for every administration because it means lower budget deficits on its watch.





The Obama Administration has added close to $5 trillion to the U.S. debt. So it much prefers to finance all of this at a rate, say of 0.3 percent in two-year notes than at 2 percent in 10 year notes. The nearby charts show how federal debt has soared during the Obama years, yet net federal interest payments are lower than they were in 2007 and lower than they were in nominal dollars even in 1997 when public debt was a mere $3.8 trillion. This year the debt is expected to reach $11.58 trillion.

The problem is that this disguises the magnitude of the debt threat and stores up trouble for future Presidents and taxpayers: and maybe not so far in the future.

The Congressional Budget Office (CBO), for example, forecasts that in the period 2014-2017 the average rates on three-month Treasuries will rise to 2 percent from less than 0.1 percent today. CBO expects average rates on 10 year Treasury notes to climb to 3.8 percent, from 2.03 percent now. CBO adds that every 100 basis - point rise in government borrowing costs over the next decade will trigger almost $1 trillion in new federal debt.

As of January 2012, taking into account all the various notes and bonds issued by the federal government to the public, Uncle Sam is paying an average interest rate of 2.24 percent. The government expects to spend in the neighborhood of $225 billion this year making interest payments.

That may seem like a large sum, and it is, but consider what happens if rates quickly rise back toward their historical norms. As recently as 2007 the government was paying 5 percent on its debt, which is the average of the last two decades, though of course rates could go higher. During the 1990's, the average was well above 6 percent.

If the government had to pay the 5 percent rate that it was offering before the financial crisis on today's debt, the annual interest payments would soar to $535 billion, twice CBO's projection for total federal spending on Medicaid this year. If Uncle Sam had to pay 6 percent on its debt, the annual interest payments of $642 billion would surpass total federal spending on Medicare, currently $484 billion. Such a radical change in budget math could trigger a political panic and intense pressure for tax increases, perhaps even for a European - style value - added tax.

Should the Treasury be much more aggressive now in seeking to borrow for the long term at today's low rates? This would be a sensible call, especially given that everyone except perhaps the Federal Reserve Board of Governors expects rates to rise.

Of course, the Treasury can't decide entirely on its own to rely on longer-term financing. Investors watching the mounting Obama debt pile probably wouldn't agree to finance most of it for 30 years at a low rate. The risk of future rate increases or inflation are too great.

Not that we can tell how much private demand exists for 30 - year bonds anyway. The Federal Reserve is now among the largest buyers as it implements "Operation Twist" and other monetary adventures.

This is a useful reminder that fiscal authorities aren't the only ones who will have trouble exiting this era of profligate government. Sooner or later the Fed has to manage the withdrawal from its historically accommodative monetary policy. Even now many investors suspect that the Fed is keeping rates so low for so long in part to finance federal debt on easier terms.

If the economy gains steam- say in a new administration that reforms the tax code, cuts spending and reduces regulation - the Fed may have to raise rates to forestall inflation. But if it raises rates, interest payments on the debt will soar, the deficit may not fall from current levels and pressure could build for a tax hike.

President Obama may not mind this outcome but the Republican candidates should, which is why they used to talk about this fiscal nitroglycerin that President Obama and Fed Chairman Ben Bernanke have created. The two leading Republicans might also take a moment to wonder how much they really want this job. The next presidential term may be spent trying to defuse the Obama debt bomb.

Condensed and edited from a Wall Street Journal article dated March 12, 2012.

If you have any questions or comments, please do not hesitate to call.

Best regards,

Mark A. Boyar