'Inside Cenacle'

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Dear Clients and Friends,

It's hard to believe that summer is nearly over. Labor Day is a few short weeks away and mid-term elections are just around the corner in November. Evidence suggests the "Lost decade" in stocks ended in May 2012, and the US is in the early stages of a new bull market until proven otherwise.

The market could use a correction of 10-15% just to keep things healthy. As of this writing, there is no evidence whatsoever of "bear market price action". Even a decline from the current S&P value of 1936 down to 1580 would not surprise market technicians.

Tensions in the Middle East, Ukraine, Russia, ObamaCare, high frequency trading, LIBOR rate manipulations, elections, rioting in St. Louis, continue to frighten investors.
First it's something; then it's nothing.

On the other hand, we believe the bond market is in the second year of a long term bear market. Did you know that bonds produced 34 years of a negative real rate of return from 1946 until about 1980? Then we entered a period of rising bond prices and lower interest rates for 32 years. The bond rally ended during the summer of 2012. With monthly reductions in QE bond purchases and the expectation of higher rates in 2015, isn't the Fed quietly telling investors to "GET OUT"?

Efforts in fiscal accommodation (easy money) will firmly kick in providing us with "normal" interest rates in the near future giving us lower bond prices.

(US Treasury chart going back to 1790, courtesy of www.businessinsider.com)

Where Do Market Returns Come From?

The researchers at Morningstar/ Ibbotson Associates found that the Consumer Price Index, that is, the cost of

living compounded 3% annually from 1926 to 2013. They determined the following net returns, adjusted for inflation, between large, small stocks and bonds:

Large company common stocks.................... 7.1%
Small company common stocks.................... 9.3%
Long-term, high quality corporate bonds........ 3.0%

In general it can be said, that stocks "return" between two and three times more than a broad portfolio of high quality bonds. Stocks may offer more ***volatility***, - that is a temporary decline in prices which is overcome within a relatively few years; but fixed income returns can't compare to stocks by any stretch of the imagination.

Lastly, a quick study of 4,264 US bond funds in April 2014, showed that using a 3% inflation rate, 78.8% of the funds used in the study were "inverted". In other words, an investor owing bonds funds has a very high probability of having an annual negative cash flow, because (inflation rate + annual fund expense) minus the (annual income) is negative.

Does that seem to be a high price to pay for the safety of owning bonds? Isn't that exactly the same place real estate investors were in 2006-2007, when you had to bet on higher prices in order to make a profit, instead of relying on a positive cash flow?

Who will be the some of the victims of rising rates?

- Retirees with a majority of assets in fixed income bond funds
- Investors who rushed into guaranteed fixed rate annuities
- Apathetic employees with too much allocated to Target Dated Retirement Funds

How Will This Effect Retirement?
A classic diversified portfolio is 60% stocks and 40% bonds. If bonds are indeed in a bear market, this type of "old school" allocation will likely produce anemic returns as bonds become a drag on performance. The security of owning bonds will only be a psychological comfort.

Fine Tuning As We Go
During the five-year period 2009 through 2013, the Standard & Poor 500 stock index produced an average annual compound rate of total return of 17.91%. For the same time frame, NASDAQ returned an annualized 22.95%. Harvard University's endowment fund is rumored to have earned 1.3% per year**.** Can you imagine?

"Temperament is more important than IQ. You need reasonable intelligence, but you absolutely have to have the right temperament. Otherwise, something will snap you."
Warren Buffett

What To Expect
The twelve-month forward earnings estimate is approaching $125, and with the S&P 500 trading at 1,950 (a 6.4% annual earnings "yield") it continues to trade just a touch above its long-term earnings multiple. With interest rates are far below their average, a dollar of equity earnings (not to mention earnings growth) should, if anything, command a higher valuation than normal.

Equities prices will continue to benefit from the easy money policies from the Fed,

below-average borrowing costs which may allow companies selectively to lever up their earnings, and hold a higher than normal cash position which permits mergers, acquisitions, increased dividends, stock repurchases, more hiring and capital expenditures.

Bull markets do not end amid today's nervousness and the slightest rumor of bad news. The "bear" comes out of his den when everyone is having the time of their life, and all the money chips are sitting on the table unattended**.**

Conclusion

We still believe the best is yet to come for equity prices. Cenacle Capital is proud to announce our latest long term investment strategy called the **"SMART 4" Sector Rotation Strategy**. In my humble opinion, it's one of the best models I have ever seen. For more information, call 847.686.4800 and request a copy of our "Tear Sheet".

How Can I Do Better?
For our relationship to be more genuinely satisfying to you, what is the one thing I am not currently doing for you that you most wish I would do? And is there one thing I do-that I seem to take as a matter of course-which you would prefer I not do?

Please know that I ask these things for one reason only: to serve you better, as you would wish to be served. In just that sense, please be as candid as you can possibly be in an email to info@cenaclecapital.com or call 847.686.4800 and leave a message. If it makes you feel better, send an anonymous letter to our mailing address below.

If these questions miss the point, please tell me what you wish I had asked you. Thank you for taking the time to consider these questions, and to respond as you think best.

We really appreciate your business and value you as a client or subscriber.

Sincerely,

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