

Gundlach: Markets Aren't Cheap Enough Yet

By Robert Huebscher

October 18, 2011



Prices for risky assets are straddling the extremes of two potential outcomes. A “hurricane” may hit, in the form of a blow-up in Europe or a move to put the US federal government on an austerity program, driving prices lower. Or world economies will plod along, in which case optimistic pricing makes sense. But prices should be “truly cheap” against those parallel problems, according to Jeffrey Gundlach, and that is not yet the case.

The euro, for example, is now trading at 135, but could rise to 200 if the Eurozone breaks up and the euro is retained only by the core countries. Or, if the peripheral countries’ struggles are dragged out with ongoing bailouts, it could sink to par.

“My view is that the hurricane ultimately has to hit,” Gundlach said. “We will be seeing a cheapening of risk assets, but right now, for the short term, it makes sense to be priced at this middling level.”

Gundlach, the founder and CEO of Doubleline Capital, spoke in a conference call last week to discuss the positioning of its Multi-Asset Growth Fund (DMLAX).

I’ll look at which assets Gundlach favors for the near term and then turn to his views on the political landscape – in particular, his thoughts on “Occupy Wall Street,” a movement which he previously predicted would emerge.

An ultra-safe position

Gundlach said he has greatly reduced his risk exposure in the multi-asset growth fund. “Sharp increases of volatility tend to precede very large market moves and reversals,” he said, adding that recent market volatility indicates dangerous investor unease. “If anything, we’d be inclined to short risk assets at the now-high prices.”

Across virtually all risky asset classes, Gundlach has taken a defensive position.

The only equities in the fund are “Dow Jones Industrial-types” of stocks, according to Gundlach, who said he is avoiding soft goods and discretionary items. He has no exposure to non-US equities.

Junk bonds are priced in “no man’s land,” he said. Although they are a lot cheaper than they were six months ago, he said yields on high-yield bonds, even at today’s 1,000 basis



point spread over Treasury bonds, do not reflect the risk of a recession and accompanying defaults and bankruptcies.

Although he owns some gold in the fund to gain long-term exposure outside the financial system, Gundlach said he has started to accumulate gold-mining stocks, because they have underperformed “pretty substantially.” He said gold prices could decline to \$1,500 as part of a selloff of commodities and “inflationary risk generally.” But there would be “support” at that level, he said, and would add to his position if prices were to decline to \$1,500.

Copper is a reliable indicator of global economic conditions, Gundlach said, and he is short that commodity, as well as other industrial metals. The weakness in copper prices “shows that the global recession story has got some teeth to it,” he said.

Gundlach said he wants to own some commodities – specifically in the energy and agriculture sectors – because of his long-term forecast of increased demand. Until recently, however, the prices in those markets were “completely unacceptable,” he said. One exception he identified has been natural gas, which he said he has been gradually accumulating, and which he will continue to buy slowly.

“Risky assets are definitely not cheap enough,” he said, given the “twin towers” of risk in the US and in Europe, and given the overvaluation in emerging markets. A rally back to market highs is unlikely, he said. “More likely is another leg down that resembles what happened in the July-August timeframe, at which point we would want to reassess and determine how much risk we want to take.”

“Quite frankly I doubt we will ever again be in quite so drilled down a risk position as we have been, starting in about June/July of this year,” Gundlach said.

A premonition comes true

For at least the last year, Gundlach has warned that income inequality will be a divisive issue in the upcoming election. In conference calls with investors, he has pointed to the rising proportion of income that accrues to the top one percent of Americans, which he said would catalyze social unrest and political instability.

The Occupy Wall Street movement proved him right.

Worsening economic conditions – high unemployment, cutbacks in public services, and streets lined with potholes – are responsible for the movement, Gundlach said. Bull markets, in his view, are about cooperation and bear markets are driven by a lack thereof – hence the perceived divide between haves and have-nots that has fueled these protests.



“Occupy Wall Street is another signpost in this journey towards a reaction against income polarization and policies that support it,” he said. Class warfare rhetoric, he said, is coming from Europe as well as the US.

Gundlach said whatever party takes a “taxes are too darn low” stance is likely to prevail in the 2012 election, although he did not say which party (or if a third party) this would be. But raising taxes on higher incomes is certain – “just about a slam dunk,” he said.

We are seeing evidence of a “general feeling that corporate greed is what owns Washington DC,” Gundlach said. “So watch that space, because it’s a very interesting development.”

www.advisorperspectives.com

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

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