

## ***VIX AND MORE***

Below is the full 2010 *Bespoke Roundtable* Q&A with Bill Luby of [Vix and More](#).

### **1) What has surprised you the most and least about financial markets in 2009?**

*I was most surprised by the intensity of the 'adverse feedback effects' and the resulting depth of the March lows in stocks. Once the rally began, I was surprised by the absence of a substantial pullback.*

*The one thing that surprised me the least was the persistent decline in implied volatility as measured by indicators like the VIX.*

### **2) What do you believe are the most important lessons to be learned from the 08/09 financial crisis?**

*1. Always know your exits (especially where to take losses) in advance and do not deviate from the plan.*

*2. In a fat tails environment, the feedback effects will trump the underlying economics for an extended period.*

*3. Disasters almost always happen in stages.*

### **3) How has the 08/09 bear market impacted your view on asset allocation and investing as a whole?**

*Asset allocations are of limited value when most assets become highly correlated.*

### **4) What are the various indicators that you follow closely telling you right now about where the stock market is headed? Which indicator is the most significant in what it is forecasting?**

*In aggregate, my proprietary indicators are suggesting that 2010 will be a return to the normalized 8-10% long-term returns in stocks.*

### **5) Starting with 100% cash, how would you allocate it to various asset classes to start the new year?**

*My 2010 allocation is overweight in all types of commodities and emerging market equities, as well as underweight in U.S. Treasuries and cash.*

**6) What do you believe will be the dominant investing themes of 2010? What will be the biggest surprises of 2010?**

*The top story will likely be the interplay between the U.S. deficit, interest rates, the demand for U.S. debt and the impact on all of these on the dollar. Other important flash points will be the potential for sovereign defaults (starting with the Ukraine and Argentina), the solvency of state and local governments, commercial real estate, and pension fund shortfalls. In the U.S., the big economic issues will continue to be jobs and the housing market, with the specter of a revival in the manufacturing sector looming in the background. A big wild card will be whether economic growth in emerging markets can help drive the recovery in developed markets.*

*In terms of surprises, most pundits are underestimating how quickly the U.S. economy will begin to create jobs. This will start to happen in the first quarter, but job growth will be irregular and difficult to anticipate. Finally, the U.S. consumer will turn out to be more resilient than expected and the 'new normal' will look a lot like the old normal, but with less leverage.*

**7) What is your current view on Buy & Hold as an investment strategy?**

*A buy and hold approach has always been somewhat suspect. Ironically 2009 was a good year for buy and hold and 2010 will likely be as well. The real enemies of buy and hold are Schumpeterian creative destruction and high volatility - and while 2010 will probably have more of the former, it will also have less of the latter.*

**8) What do you believe is the contrarian call on equities right now? The economy? Is investor sentiment currently misplaced?**

*One of the more unusual features of the current investment environment is the preponderance of extreme viewpoints - both bearish and bullish. Normally investor expectations fall into a familiar bell-shaped (Gaussian) distribution. At the moment, however, investor sentiment looks more like a barbell distribution, with a high percentage of extreme perspectives relative to middle-of-the-road perspectives.*

*Contrary to current expectations, emerging markets will help drive global growth in 2010, the global economy will heal faster than anticipated, and the stock market will start to look like business as usual again. Both bear and bull extremes will be proven wrong.*

**9) Which sectors should investors be overweight/underweight heading into 2010?**

*Overweight: emerging Asia; emerging Latin America; crude oil exploration and production; industrial metals; silver; lumber; consumer discretionary/retail; semiconductors; homebuilders. Also, alternative energy and nanotechnology will get a second wind.*

*Underweight: U.S. Treasuries (long end of the yield curve); commercial real estate; regional banks.*



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## **10) What is in store for the US economy in 2010 (V-shaped, double dip, U-shaped)?**

*2010 will see a slow and steady recovery, with jobs coming back earlier than expected. The growth trajectory will be erratic, but by the end of the year, the story will surpass the estimates of most pundits.*

## **11) Will we see a jobs recovery in 2010?**

*This will not be a jobless recovery. Instead, there will be slow but lumpy job growth, starting as soon as the end of the first quarter.*

## **12) The real estate market has seemingly taken a back seat in terms of media coverage at the moment. What's in store for real estate in 2010, and how will it impact your investment decisions?**

*Residential real estate will begin to show solid growth in the third quarter, but commercial real estate will take a long time to bottom and turn up. The industrial and office segments will be the last to turn around. The retail segment will turn up slightly earlier.*

## **13) When will the Fed begin to raise rates, and will this be too early, late, or just about right?**

*The Fed will be wary of raising rates too soon and will act conservatively with respect to any inflationary signs. I do not expect to see any rate hikes before the third quarter at the earliest, with the first hike most likely to come in Q4, but perhaps not until 2011.*

## **14) How worried are you about inflation?**

*Inflation is not a major concern in 2010. It becomes a much larger issue in 2011 and a critical issue in 2012.*

## **15) How worried are you about the decline of the dollar, and do you see the greenback making a comeback in 2010?**

*Here I think the Goldilocks scenario is fairly likely: the dollar will be under pressure for all of 2010, but will begin a sustained rally in the second half of the year*

## **16) What are your current thoughts on gold - bubble, just the beginning, or just about fair valued?**

*While there are some elements of a gold bubble, continued strong central bank and investor demand will mean sustained higher prices. Silver should be an even better investment in 2010.*



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**17) Oil has largely been forgotten given the current focus on gold and the dollar. Will the price of oil have a major impact on stocks and the economy in 2010?**

*At \$90-95 per barrel by the end of 2010, crude oil will exert some pressure on consumers and businesses in the coming year. Next year is just the beginning of this trend, however, as oil will exert a larger drag on the economy in 2011 and the years that follow.*

**18) We've just gone through a decade where emerging markets largely outperformed the G-7 countries. Do you foresee this trend continuing in the coming years, or will developed countries begin to make a comeback?**

*Emerging markets are one of my top picks in 2010. While the ride will be bumpy at times, emerging markets - particularly in Asia and Latin America - should outperform developing markets for the next few years.*

**19) Which emerging markets are you most/least excited about heading into the next decade?**

*Most excited about Indonesia, Vietnam, Singapore, Brazil, Chile, Turkey and South Africa*

**20) At the peak of the crisis, the prevailing theory was that Wall Street was dead as we knew it. After the rebound we've seen, many people think it's now back to business as usual. What are your thoughts on this?**

*So far, Wall Street has operated in a manner that is closer to 'business as usual' than I had expected. The big questions are around the changes in the regulatory environment going forward. With the Democrats losing their power and the mid-term elections nearing, I suspect reforms will be rather limited in scope.*

**21) What will be the biggest impact Washington has on Wall Street in 2010?**

*The biggest political issue will be the political maneuvering (i.e., lack of will) leading up to the mid-term elections and the gridlock that comes out of the voting. I expect the Republicans to pick up 20-25 seats in the house and perhaps 2-3 seats in the Senate. Investors will see this as a positive. On the other hand, Congress will be much less likely to pass a second sweeping stimulus bill, which means that the Obama Administration, the Fed, and others will be forced to work more with existing tools.*

**22) What do you think are currently the biggest disconnects between Wall Street and Main Street? Wall Street and Washington? Washington and Main Street? How can we correct this?**

*The disconnect is large and is growing. As long as the class warfare elements of the differences between Wall Street and Main Street are played up, there will be no easy solutions.*



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**23) Will the following be up or down (positive or negative) in 2010? Where noted, what are your 2010 year-end target prices?**

*-S&P 500: Up, 1225*

*-Long-Term US Treasuries: Prices down and yields up. EOY target yield: 4.20%*

*-Corporate Bonds: Flat to up slightly*

*-High Yield (Junk) Bonds: Up slightly*

*-Gold: Up, \$1275/oz*

*-Oil: Up, \$92/bbl*

*-Dollar: Down slightly to DXY 74.00*

*-Average US Home Prices: Up (as foreclosures become a smaller percentage of overall sales)*

*-China's stock market: Up*

**24) Please provide readers with any stock ideas that you really like right now and for 2010 and beyond (and why).**

*See questions 9 and 19.*

**25) Do you have any other advice that you would like to share with readers heading into next year?**

*I expect implied volatility to decline over the course of the year and end 2010 in the low 18s.*