

EMERSON LETTER™

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The Return of Cash Flow & Value Investing:

Recent comments from a very bright colleague in the financial markets, have inspired me to write this latest Emerson Letter. He most insightfully stated that cheaper and cheaper corporate debt prices will diminish the appeal of equities. This will prove to be a time of opportunity for credit investors. Financial markets will also increasingly mirror markets of the late 1970s and early 1980s, where Graham and Dodd value and cash flow driven investing proved to be profitable. Those investors who know how to invest in negative trending markets will thrive.

Central Bank QE, ZIRP and NIRP have created massive multi-asset bubbles. These debt-financed bubbles across many industries, most specifically the energy industry, are and will continue to pop, and the subsequent re-pricing of these credit markets will be very bullish for credit opportunity funds. Old fashioned credit work, combined with a shrewd understanding of potential outcomes, will reward those patient investors with new cash to invest. Due to cheaper and cheaper credit markets, equity markets will simply become an unattractive and an unpredictable place to invest.

As my astute colleague commented, the page is turning and the only way out is through the "flaming door" of rising interest rates. The Fed and other Central Banks led the world into this easy money environment, they will have to try and gently lead the world away from low interest rate policy. Jim Read from Deutsche Bank has described their unconventional actions in the past 9 years as "Plate Spinning." Each year, as these unconventional policies prove more and more fruitless, the Central Planners have simply added more "Spinning Plates" from their newfound policy toolboxes. Will they be able to slow down the spinning of the plates before they all coming crashing down, or are current dislocations and re-pricing in various credit markets including energy and materials a forewarning of a deeper credit adjustment to come?

Respectfully yours,

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