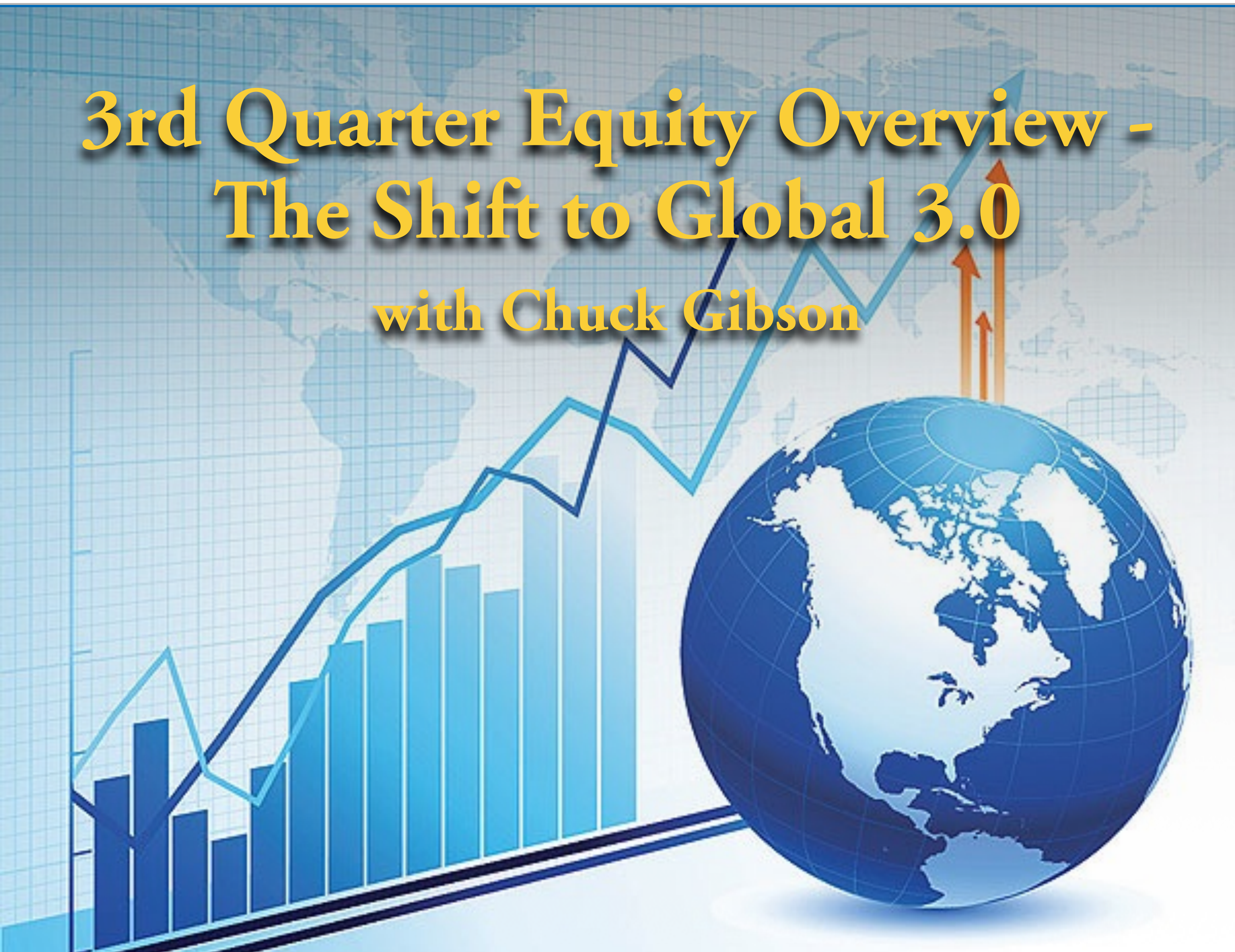
BUILDING WEALTH IN CHANGING TIMES

The Solari Report

NOVEMBER 13, 2014

3rd Quarter Equity Overview - The Shift to Global 3.0

with Chuck Gibson



3rd Quarter Equity Overview - The Shift to Global 3.0

November 13, 2014

Table of Contents

C. AUSTIN FITTS: Ladies and Gentlemen, it's my pleasure to welcome you to The Solari Report for our 3rd Quarter Equity Overview. We are recording this on November 6th, a week before we publish November 3rd, so we're going to be talking about the market as of today. Our topic is 'The Investor's Perspective, the Shift to Global 3.0'.

I did an annual report and talked about this idea of moving into a very different kind of economy, and we talked about it on the annual wrap-ups. We've talked about it on the quarterly wrap-up, and Chuck Gibson sat down with me and he said, "We've gotten a lot of questions. Let's sit down and look at this. What does this mean? If you're an investor, what does it mean to your strategy? How do you see these changes in the equity markets?"

So we decided we would do something called 'The Shift to Global 3.0' and then when the outline got too long, I agreed that in the 3rd Quarter Wrap-Up, which is already in your resource center, I would go through all the different trends that Chuck and I wanted to talk about.

We kind of pre-engineered the trends into the wrap-up, and we'll be using the link to the comic book for the wrap-up to talk about the trends portion today.

So this is going to be a very meaty one. Chuck, as usual, prepared a lot of great slides and a lot of great material. I'm really looking forward to this conversation.

Chuck Gibson, you are fresh back from holiday. I'm so jealous! So you are rearing to go, right?

CHUCK GIBSON: I am rearing to go, but I'm a little bit calmer than I am normally. If the listeners have any question on there being something wrong with me, they will understand why.

C. AUSTIN FITTS: It was: You were on the beach.

CHUCK GIBSON: Let's just say that I was on the beach and relaxing.

C. AUSTIN FITTS: Let me just quickly go through the outline. We're first going to talk about an update on the markets for the last quarter since our last equity overview. Then we're going to talk through the trends. Then we're going to talk a little bit about risks and bring it all down in the fourth section to strategies and what this means to your investment strategy.

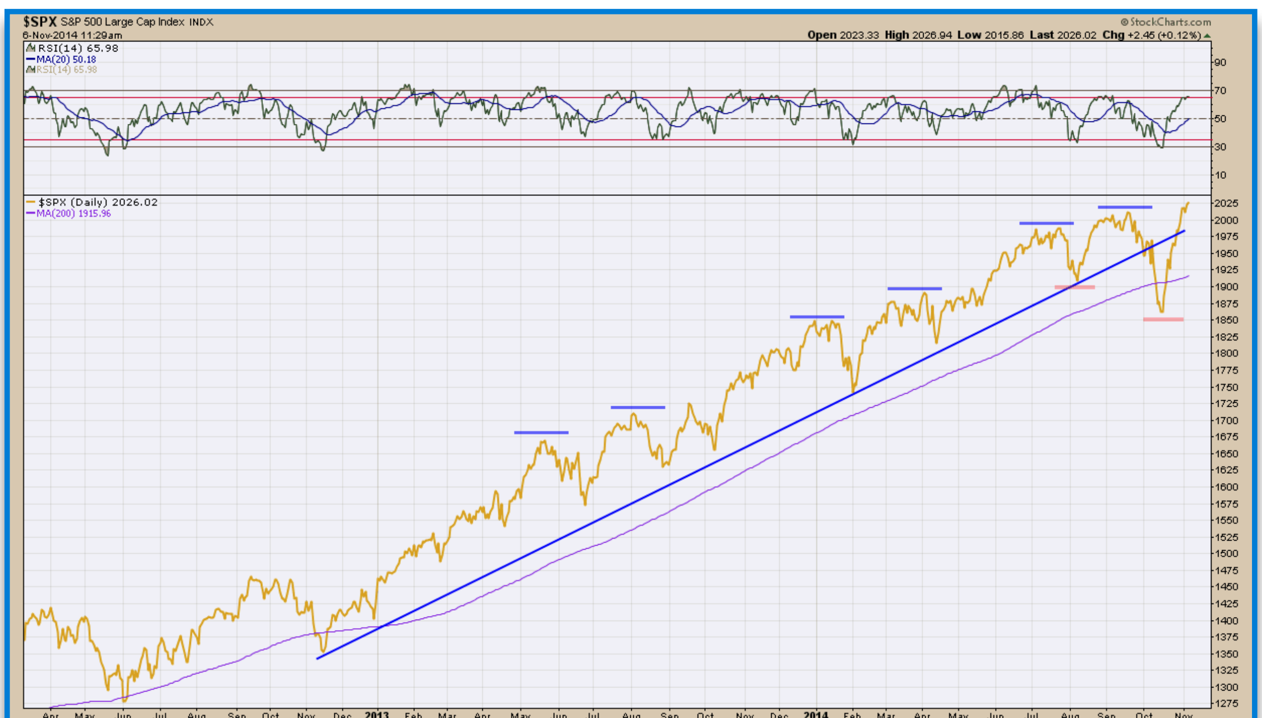
Let's dive in. Update us on the equity market since the last equity overview. What has been going on for the last three months?

CHUCK GIBSON: Before we jump in I just want to say – just to make sure that everybody understands – the charts that we're presenting today are as of today; they don't include just through the 3rd quarter.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: We've had some major movements that have happened from the 3rd quarter until now, and I think that what I have to say would be different if we were talking just at the end of the 3rd quarter.

C. AUSTIN FITTS: Right.



CHUCK GIBSON: So let's jump into the first chart which is the S&P 500. The one thing that happened that was a major shot across the bow for technicians who are really monitoring and following the market was that we had a major break in some technical indicators that presented a warning flag. I'm a cautious individual in general, but these were major technical damage that we really couldn't ignore.

Let's look at the S&P chart and I'll see if I can illustrate what happened. One thing is you can see that this is approximately a two and a half year chart. What you have is higher highs and lower lows. The higher highs are defined by those little blue bars. You can see that each successive peak on the S&P has been higher than the past one.

In addition, you can see that there is a blue upper trend line that the higher lows that have been created have been able to stay within that trend line. So we've had a very, very nice trend of stocks that has followed for approximately two and a half years. As you can see, what happened at the end of September was we had one breach of the trend line. In addition, within a week or two later, we had created a new lower low. On top of that, we crossed over the 200-day moving average. There's nothing significant about a 200-day moving average other than that's what technicians use as a broad-base look across a one year's worth of movement in the S&P. So when you break that, that is a warning flag.

We had three things that happened. We created a lower low, we breached an upper trend line, and we crossed the 200-day moving average. What concerned me the most was the potential. We didn't know it, and we've just not gotten confirmation this week. We didn't know it, but this was a potential in change in direction. That's what we're looking for.

As trend followers, you want to be in a trend as long as a trend is in your favor. When the trend changes, you want to get out.

This was the warning flag that the trend might be over, and lo and behold, we didn't have this data at the end of the quarter. Lo and behold, as of this last week, we've made all-time new highs. It was just a warning flag that is no longer valid and we have to start all over again.

C. Austin Fitts: Now let me ask you, though. A lot of times when you get a correction, someone will talk about the legs down.

Chuck Gibson: Yes.

C. Austin Fitts: You and I were recently talking about if we were going to get two or three legs down. Now that we've made a new high, could we still get that third leg down?

Chuck Gibson: Oh, sure. It will be the start of a new downward leg.

C. Austin Fitts: Right.

Chuck Gibson: Since we've gotten a new high, that last movement down has been basically wiped out; you can ignore it.

C. Austin Fitts: Okay. So my looking for a sale – and you know me; I'm always looking for a sale.

Chuck Gibson: The one thing I do want to point out is that – and I don't have it really well-illustrated. I was trying to find a way to do it so that I could reflect it, but look at the distance between each successive peak. Look at the distance from the peak to the upper blue trend line. If it isn't obvious, what you should see is that that distance keeps getting smaller and smaller and smaller.

C. Austin Fitts: Right.

Chuck Gibson: That shows you that what you have is waning momentum. That's another warning flag that we have to be worried about.

Now this could all be obliterated if we break out to all-time highs. Actually, we have broken out to all-time highs, but if we keep going and the strength continues, then we start all over again and we look for a new lower low.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: So let's move on to the institutional index. There is really nothing surprising here. This is exactly the same thing that happened to the S&P. Again, the breach of a trend line. We had a new lower low created. While I don't have it, it did also breach the 200-day moving average.

Both of these indexes are the ones that we follow very closely. We're concerned, and as of this last week we've breached to all-time highs and the trend continues.

C. AUSTIN FITTS: Right.

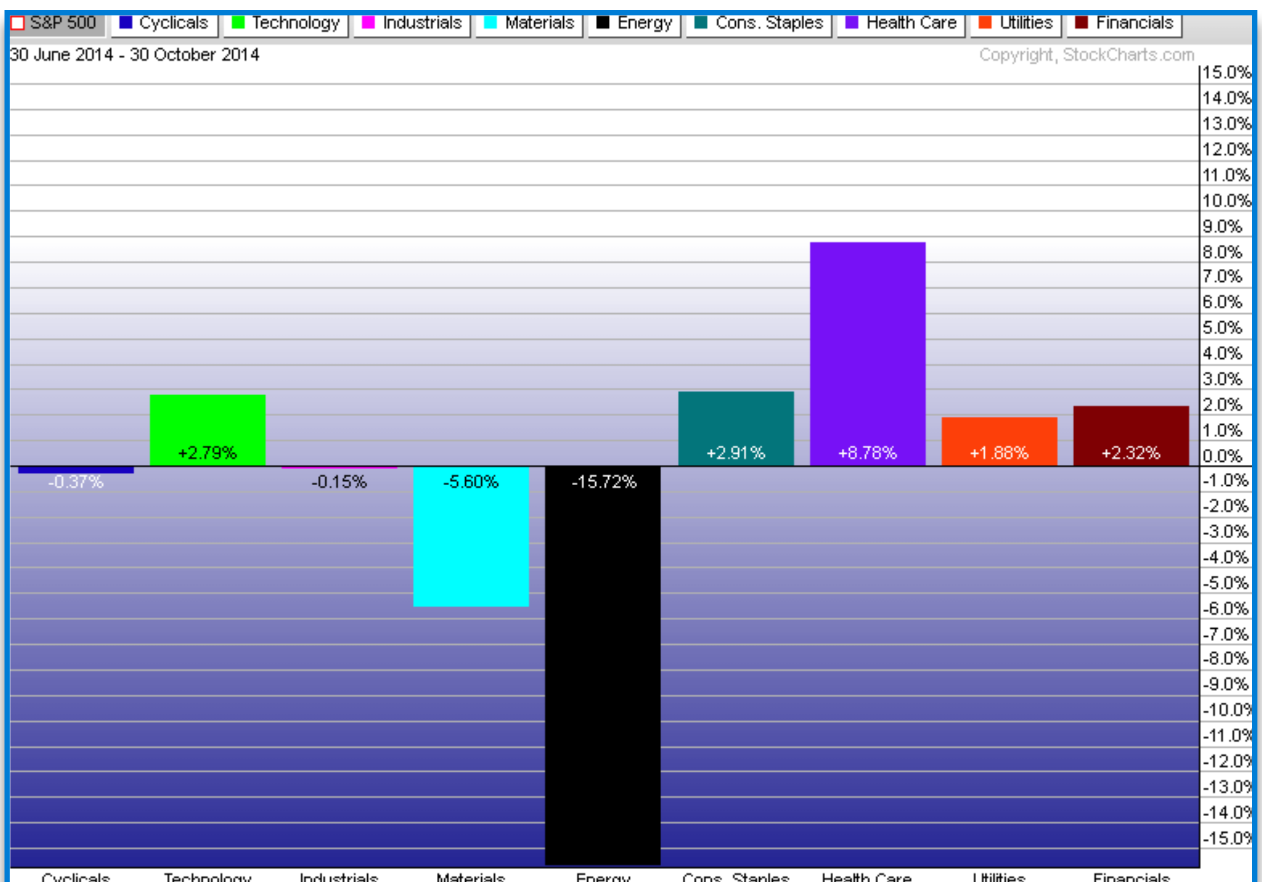
CHUCK GIBSON: The one thing I will illustrate, though, is that the correction that we had on both the S&P and the institutional index during that period of time was almost double digits. I think it was somewhere between nine and ten percent. And you tend to go down very, very fast and then you tend to go up much slower.

What happened was we went up just as fast as we went down.

C. AUSTIN FITTS: Which is very unusual.

CHUCK GIBSON: Yes. That is an anomaly. I'm not sure how to interpret it. Usually you tend to go up slower because you don't have that much strength. I'm not sure I'm going to draw any conclusion to that other than I just wanted to point it out because the strength of the market continues. Even though everybody is saying that the stocks are too high, something is pushing them higher.

C. AUSTIN FITTS: Right.



CHUCK GIBSON: Alright. Let's take a look at a little bit closer refinement of the S&P and look at what sectors did well for the quarter. Again, this is not just the quarter. This actually includes through October.

What we saw was strength in healthcare and financials, consumer staples, and technology all had gains along with utilities. The things that got pummeled the hardest were materials and energy.

I'm not saying that this is deflationary, but what you see in a deflationary environment first is when you start to see commodities take a much bigger hit than stocks and when you start to see a rush into the dollar.

This seems like an early potential start of a deflationary event. When I say 'event' I mean correction. I'm just raising the flag. I'm not saying that's what it is, but I am saying that this is what you look for in an early part of a deflationary move.

C. AUSTIN FITTS: Right.

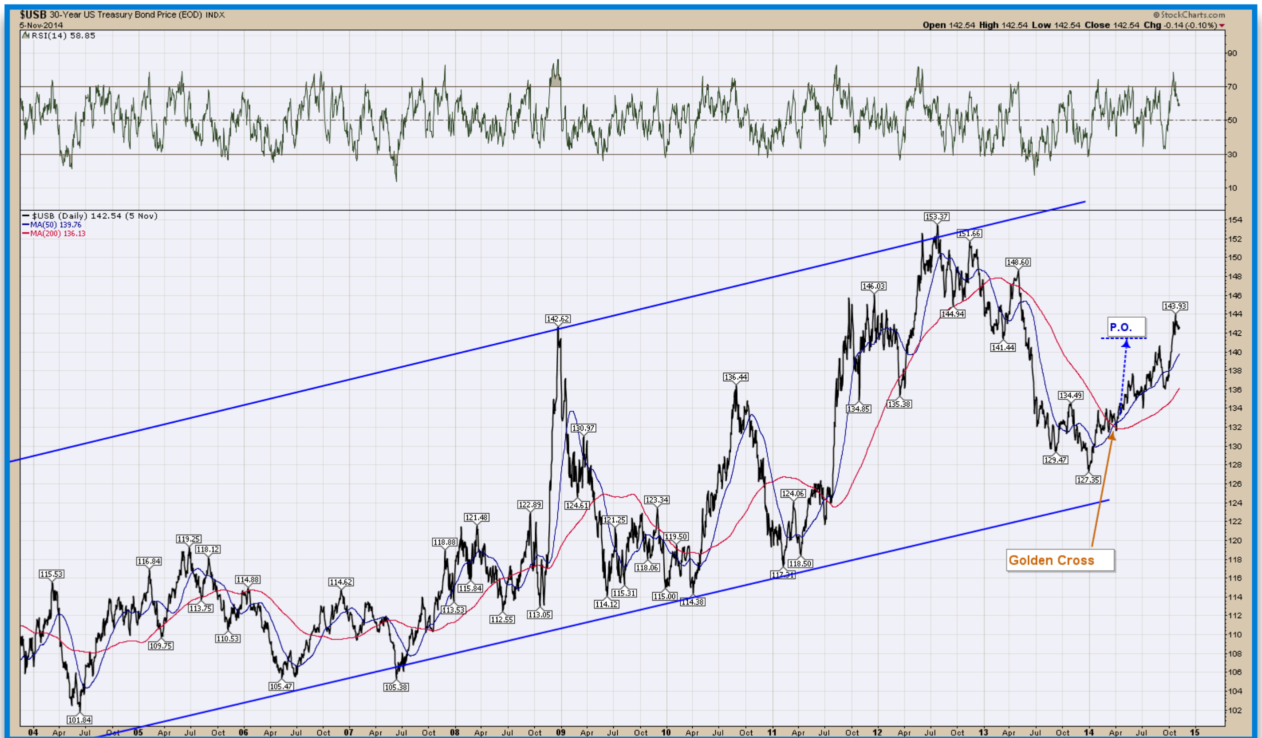
CHUCK GIBSON: Let's take a look at U.S. treasuries.

C. AUSTIN FITTS: The surprise of the year.

CHUCK GIBSON: Exactly. This is an interesting chart because we all heard 'the death of the dollar' and 'the death of interest rates' and 'interest rates can only go higher'. As of January we saw this pattern set up and we had a price objective for this move to higher bond prices and lower interest rates. Everybody said it wasn't going to happen, and it did. Not only has it met our price objective, but it has actually gone higher. Frankly, it's not showing any weakness at this point in time.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: This, to me, is not only as you said a very interesting chart, but it's telling us something else. I think that we have to respect the trend in this one. I expect bond prices to continue to move higher.



C. Austin Fitts: Right. Now we should underscore that this is the long thought.

Chuck Gibson: Yes.

C. Austin Fitts: So the numbers are far less spectacular at the short end, but as you said – and I want to talk about this when we talk further about the U.S. dollar – the possibilities are very real that this could go much higher.

Chuck Gibson: Absolutely. And speaking of the U.S. dollar – which is two more charts away – let's go beyond this bond chart and head on to commodities, Chart #5.

This is interesting because we had this down trend where commodities broke out in January, about the same time that the bonds broke out. We had a nice rally up. You can see it had about a 10-15% rise from that breakout, and then all of a sudden it started to curl and reverse. It's not

only gone past the point at which it started in the breakout, but it's gone even further.

This just helps illustrate my concern that I brought up about deflation. This index, unfortunately, is mostly weighted by oil and energy so it's going to look like this, but if I pulled up the components of this which includes agriculturals and other non-energy related commodities, they have all been in a severe downtrend.

C. Austin Fitts: It's amazing because we got to the end of 2011 and thought, "This year we're going to get an opportunity in commodities because look at how far they've come down." Then we went all through 2012 and we got to the end of the year and we thought, "Well, this year we ought to get an opportunity in commodities because look at how far they've come down." Then 2013, again, falling, falling, falling.

You and I started this year and we thought, "You know, we ought to get an opportunity in commodities!"

You know, they started to perk up and then – boom! So you almost wonder. I don't know when the bear is over, but I am loathe, Chuck, to say that we are looking forward to an opportunity over the next year in commodities!

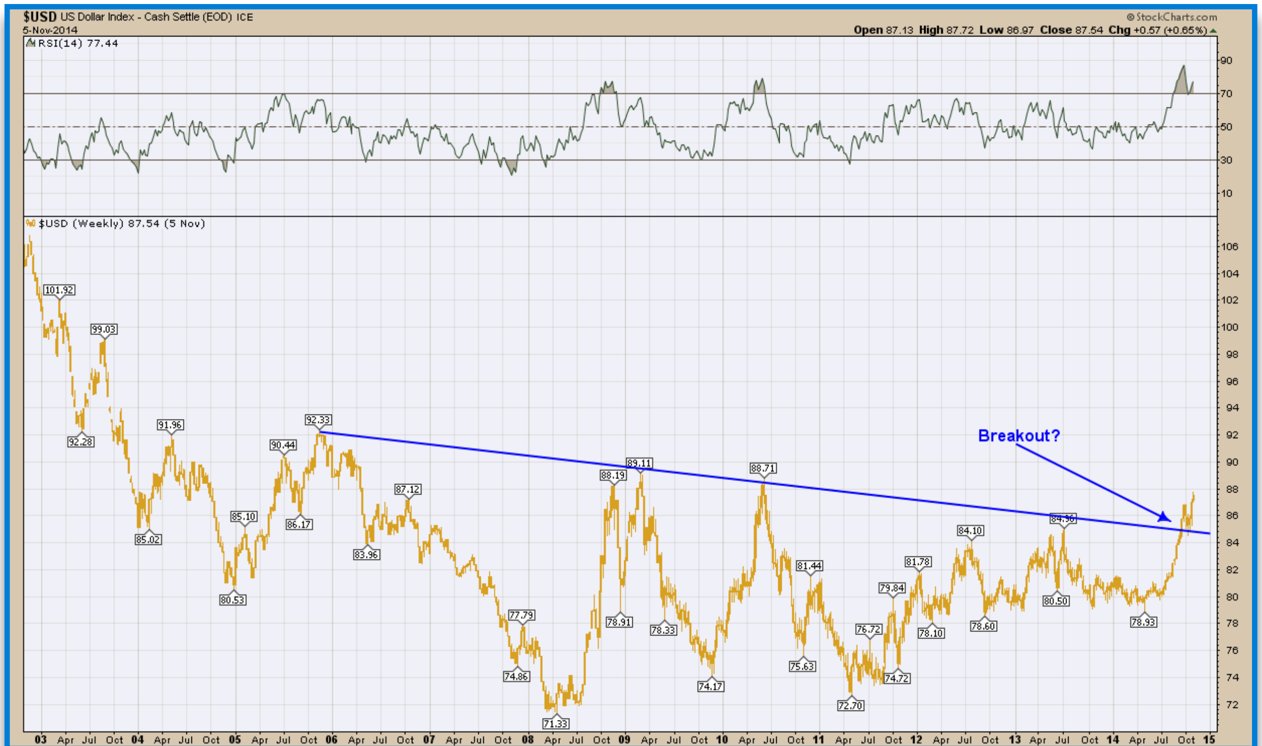
CHUCK GIBSON: We are consistent. The interesting thing for me is that commodities move inversely to the bond prices. We're all thinking that they printed so much money, even though they say they're going to stop this thing, they have so much liquidity sloshing in the system. At some point in time we're going to start to see a rise in interest rates. When those interest rates rise, that's going to present an opportunity for commodities.

And what did we see? Just the exact opposite thing happen where interest rates started to fall, and commodities started to rally at the same time interest rates started to fall. That was something we were scratching our heads with. We were saying, "Something isn't right here." Lo and behold, interest rates continue to fall and commodities said, "Oh, the bottom market is right this time. We're going to reverse and go back down below where we started."

C. AUSTIN FITTS: Right. So this is just another sign flashing 'deflation', and it's also something else that is supporting corporate earnings in many different areas because as the price of coffee, sugar, and milk goes down, Starbucks is in a better position.

CHUCK GIBSON: Yes. Absolutely. The question for me is: Why did we see this? Let's go to Chart #6. This is, to me, the cause of so much of the movement in the price of other instruments. That was the breakout of the U.S. dollar.

This chart goes back since 2003, and we've had this downtrend line of the dollar. We broke out in June or July, and we had a backtest. It broke out of the backtest and then it moved higher. I have to say that I was skeptical when it started, but if you look at the strength of this move and you look at the pattern from which it has come from, from a technician's standpoint I don't like to predict the future – and I'm not – but I'm



telling you that this pattern says that it could go a lot higher.

C. Austin Fitts: Right. This is a point of great concern to me because I do think that it's possible over the next year to year and a half that we see the dollar much, much higher. I think that's a reasonable scenario.

You've got companies and countries all around the world who have borrowed in the dollar, and now we're going into a deflationary period. It's literally a bear trap and could drive the dollar higher.

I don't mean to predict that that is going to happen because there are a lot of different scenarios that could happen, but that is certainly one of them. For some reason, the more the dollar rises and the stronger it looks, the more you start to see all sorts of commentators from a variety of different worlds pushing the idea that the global currency system is about to collapse, the dollar is about to be reset to a gold standard, the end of the world is nearing. There are various variations of the same theme, but the more the dollar rises the more you see these kind of hucksters out there pushing these lines.

I'm really worried that our readers and subscribers are going to fall prey to some of this stuff when, in fact, prices are going in the opposite direction.

CHUCK GIBSON: Well, you know me. My response to that is always going to be, "All you've got to do is look at price." If price is telling you that it is going to continue to go higher, how can you fight that?

What you have to do is look at what reality is. The fact of the matter is that while we may have concerns about our currency and what is being done to it, we're in a heck of a lot better shape than most other currencies – in fact, all other currencies. As such, it is a safe haven. In any other country or any other currency, people who hold those are looking for opportunities to be able to secure their future.

If you look at Europe, Europe's stock market has been terrible. What you have if you're a European investor and you've got money, 1) you have to diversify yourself out of the Euro, and 2) where are you going to go? You're going to go to strength. That's what good investors do. They follow strength. Strength has been in the U.S. stock market and the U.S. dollar.

So all that does is the strength begets more strength because it pulls in outside money that is going to potentially drive this much higher.

C. AUSTIN FITTS: Right. Part of it is you have many countries around the world who are trying to protect their export market. They are well-served to have their currencies fall. A little bit of this is a race to the bottom.

There is no doubt about it that fiat currencies are being debased all around the world, but it's far from just the dollar. There was a great piece the other day that pointed out what the global debt ratio was for all governments before 2008 and what it is now. The reality is that the way that everybody can handle paying their debts is to debase the currency some more. So here we are.

I just think we all need to be prepared for the possibility of a much stronger dollar over the next year to year and a half because it could absolutely happen. Certainly the last couple of months have shown what that feels like.

CHUCK GIBSON: Yes. I would be really cautious about fighting that trend because that trend, again, if you are an investor, you want to follow a trend. The trend is clearly up. If there are any doubts, just take a look at the price of the U.S. dollar and how it compares to the other currencies. That will tell you right away.

C. AUSTIN FITTS: Right. Okay. We didn't look at the charts of the emerging markets. It's funny because I'm teasing you about the commodities. I keep saying, "When can we buy emerging markets?" and it's the same problem because the PEs are so much more attractive in the emerging markets. The problem is with commodities down and the dollar rising, now is not the time. It's the same struggle.

CHUCK GIBSON: We've tried that. We saw a breakout in the emerging markets earlier this year, and here we were jumping on the bandwagon saying that this was a potential new trend. The trend started and it quickly reversed. The dollar took hold and the dollar strength took hold and drove not only the emerging markets but it helped drive Europe and commodities down two levels.

As long as the dollar is continuing to move higher, I think investors need to be really, really cautious about buying anything that is non-dollar denominated.

C. AUSTIN FITTS: Right. That is clearly the case.

So let's turn to the trends: The Shift to 3.0. What we did, ladies and gentlemen, is Chuck and I sat down and tried to break the 'Shift to Global 3.0' down into different areas. As I said before, I decided to make life easier and go through the trends and describe them in the 3rd Quarter Wrap-Up and post a comic book with different pictures and descriptions to make it easy.

What I want to do today is go through those trends and talk about them – not in the context so much of what is happening, which we've already done – but let's look at how that looks from the point of view of investors and equity.

I want you to be able to see these trends as they evidence themselves in the equity markets. So, of course, the first is my old favorite, the rebalancing of the global economy. I've spent a lot of time on this in the last year because we had Stephen Roach on with his wonderful book on *Unbalanced: the Codependency of America and China* about the next phase in the relationship and integration of the Chinese and American economy.

Let's talk about rebalancing the global economy. Chuck, how do you see this in terms of if you look at the stock market? How does this show up from your point of view?

CHUCK GIBSON: I think that this rebalancing, it is going to take a while. I think people need to understand that what we're going to see is transpiring, but it's going to take a whole lot of effort and time to be able to get there. My biggest concern is that while we identify potential trends going forward, they are not going to happen overnight.

C. AUSTIN FITTS: This is a long because in my mind, even though it started decades ago, it got going with the creation of the World Trade Organization and big shifts of capital out in the 1990's and the development of the emerging markets. To me this is a 50-year process. This is a very long-term process.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: The second trend we have is transforming a 3.0 finance and investment. Part of this process is really the creation of stock markets and equity markets around the world.

One of the things I pointed out was that in the beginning of the 1990's there was $9 trillion of global equity market capitalization traded on world exchanges. As of June this year, it was $69 trillion. That's a big increase because we are literally going through a process and this will only happen once where the global economy is coming into the equity markets. You are beginning to see access to all sorts of investments that didn't exist five, ten, or fifteen years ago.

This is very new and very big and, as you said, very long lived.

CHUCK GIBSON: Catherine, I have a question I've always wondered. How long do you think this can go on? I mean, that is a huge expansion as you said – from $9 trillion to $69 trillion. Could this be $100 trillion? If so, how long do you think it would take? That's a huge rate increase.

C. AUSTIN FITTS: I think it's only begun, so I think $69 trillion is tiny compared to where it's going to go.

Here's the thing. The process takes generations because you're talking about people learning. It's an educational process. How long does it take for a society like China – I'll never forget when I was in China in the 1990's. They didn't have a managerial infrastructure. If you look at what they're grappling with now, they are really grappling with how to create corporations that can compete on the international markets, and they don't have the accounting, they don't have the standards, and they don't have the managerial infrastructure in technology. You need that deep inside the culture. You need that deep inside the education, etc.

You need two or three generations of law firms and accounting firms and all these kinds of technologies, but it needs to be embedded deep in the culture.

"You need two or three generations of law firms and accounting firms and all these kinds of technologies, but it needs to be embedded deep in the culture."

To me, it's going to take about four generations at a minimum where a society or an economy or a country is really committed to doing this. If you look at the total amount of corporate assets and business assets or real estate outstanding, it's many, many multiples of what is reflected on the equity markets.

I think this is tiny. As you know, one of the things I'm very interested in is: What are the governmental policies going to be in terms of investing in bonds versus equity? As we've had governments issue more and more debt, you've watched the governmentally controlled or influenced pension funds and sovereign wealth funds and various governmental institutions buy bonds. Now we're seeing a shift where it appears that they are pushing into equity.

Chuck, if they decide to shift into equity as we're securitizing more and more, then we're talking about the $69 trillion being many multiples, but that is two or three generations from now.

Remember the young investors coming up are the first investors who can literally click open their mobile phone and decide to invest in any stock market around the world.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: That's new, and to them they don't know anything different. So how many generations do you need of global generations who think in those terms?

CHUCK GIBSON: I think the internet has really changed that, and I think it is going to rapidly increase the pace at which we've gone up to this point in time. Let me ask you a question because you alluded to it.

You talked about China. You didn't say much about the emerging markets. I'm guessing that you think that the majority of this – or I won't guess. Do you think the majority of this new expansion, this new securitization, will come outside of the United States?

C. AUSTIN FITTS: Yes, I do. Although here is what is very interesting. The opportunity in the United States is if you decide to create place-based ways of securitizing places. So if you do place-based reads there is tremendous opportunity to securitize a lot more in the United States, but you're going to have to have a major conceptual breakthrough on sort-of trading places, and I don't see any move to do that.

I mean, it is theoretically possible, but for now I think the easy securitization is going to come globally around the world – both real estate and corporation securitizing.

CHUCK GIBSON: Okay.

C. AUSTIN FITTS: And it's going to be the frontier markets, too. We didn't mention it, but one of the markets that has held up very well – the emerging markets haven't been strong, but the frontier markets have been very strong.

CHUCK GIBSON: Yes, and unfortunately the liquidity isn't quite there as much as you'd like it to. As you said, at some point in time with the ability of the internet, investors can just get on their mobile phone and invest anywhere across the world. You know that that is coming, and you know that we're going to be talking about Mongolia and other countries that we wouldn't normally be talking about, such as China and maybe the other emerging markets.

C. AUSTIN FITTS: Well, what is amazing is even though liquidity is not where we want it to be – particularly for the institutions – the liquidity now in country ETFs and the ability to invest in a broad index of the market in Singapore or Hong Kong or Thailand or any of these places, it has provided tremendous access that five years ago the fees and commissions of reaching into those markets was enormous.

The liquidity has improved enormously. It's got a great way to go, but I see the improvement.

There was one thing that I wanted to mention, and that is when you looked at the commodities chart, one thing I would point out is when you started to see commodities fall in 2011, I'm not saying that is the only thing that is going on, but the drops very much parallel the institution of literally getting everyone online.

One of the themes we are going to talk about is commodities versus technology because we know there are many forces that should be pushing up the price of commodity, but then there are many forces that are reengineering that pressure down, technology being one of them. I always find it interesting to see the explosion of smart phones at the same times that commodities are crashing. I wonder if there is any connection or not.

So part of it is the securitization. Another part, of course, is the currency. What is the impact going to be of mobile payment systems and online systems? I don't know if you noticed in the trench chart, we were watching bitcoin literally surpass PayPal in volume, believe it or not. I kind of struggle with that one.

CHUCK GIBSON: I didn't realize that.

C. AUSTIN FITTS: Well, who knows if you can trust the statistics, but it's clear to see that we have a shift of transactions online and that is absolutely part of this process. I think the big question on everybody's mind is: What is going to happen as everybody gets online and starts using mobile payment systems? How is currency and how are payment systems going to work?

One of the things I saw when I looked at this for the wrap-up was I was in the middle of looking at Alibaba's IPO and how Alipay operated relative to PayPal or this new Apple Pay. One of the things that was clear to me is that all of the mobile payment systems are competing for market share now in a global market with seven billion people, and those seven billion people can't afford the spreads of the developed world.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: There is a real sort-of slapback tsunami coming when an Alibaba shows up and they are catering to people who can't afford the spreads that PayPal is getting here and how that is going to sort-of turn the market.

I noticed that the week that Alibaba did their IPO, PayPal notified Solari on their online store of a pretty significant break in fees.

CHUCK GIBSON: I didn't know that.

C. AUSTIN FITTS: Yes, and I said, "Okay, that's the emerging market slapback. Thank you."

Anyway, so because of the mobile platform and the 'getting everybody connected' is a part of this, the third trend we had was building out the global network. That is one where I think your background in the information technology and being an engineer has really helped me see this in the equity market.

"Your background in the information technology and being an engineer has really helped me see this in the equity market."

Maybe you could talk about how that shows up and what is happening in the stock market.

CHUCK GIBSON: It's interesting because back when I was in the corporate world we had a guy who was covering AT&T, and that was one of my accounts. I managed a major account section for a large semiconductor company. He came in saying, "The world is changing. It's a convergence and we're going to converge the computer and the telephone, and we're going to converge all of these things. It is all going to go to a handheld device."

We were just laughing at the guy. The phones, if you remember back to Get Smart where Maxwell Smart would pull his shoe off and talk on his shoe, which was the size of the phones back then. What we have seen is he was absolutely right. Whether or not AT&T was the driver of this, I don't want to give them that much credit, but it was really interesting to see how that has come to fruition and it is being accepted.

I think that we've got a long, long way to go to see what the technology is going to bring to handheld devices. I think our world is changing. We are in the middle of this thing.

As somebody who is involved in it day to day, I think this is the direction we are in and we have to accept it. We might as well get on board. Don't fight it.

C. Austin Fitts: One of the things I've seen is if you look at the U.S. market in the sectors that have been strong, what we've seen is the device companies: Apple and Samsung and an explosion of companies that are making the various devices, whether it is the tablets or the phones. But then we also have seen an explosion in the cloud services as much more of a commodity service.

Chuck Gibson: Yes.

C. Austin Fitts: But you see Amazon, Google, and others backing into this and a critical part of their strategic position is having people in the cloud and having the analytics that make that interesting. Then the one that has fascinated me the most is the explosion of social media and realizing, "Oh, the arbitrator of all this internet of things is the social media platform, whether it's people connecting within a place or within a network or communicating with each other."

If you watch the statistics of advertising that is now shifting out of print and TV onto social media, it's quite explosive. I wouldn't have believed it if I hadn't been watching the stocks and the explosive stock market capitalizations that said to me, "Okay, I have to take this seriously."

I didn't want to, but I have to take this seriously because the market is seeing something. That is when I realized that this is really going to be the switching station for the internet of things.

Chuck Gibson: You know, I have to admit, being in the middle of this thing and priding myself on being a part of that technological change, I didn't see it coming either. I thought, "This is the biggest waste of time that I can imagine. What is this going to be for?"

All of a sudden you see Twitter being used for the riots and getting information out and people contacting and things with the uses of it. As you've always commented, it is also a great database for the CIA and other government institutions that want to know and track everybody else. Everybody seems to want to give everybody their information.

C. Austin Fitts: The one I found fascinating was the report of Weibo. I have one wonderful client who is over in China. This idea that the Chinese suddenly can contact everybody around them on Weibo.

If you look at the statistics – I don't know if you noticed the chart I put in under the finance section – you now have a higher percentage of the population in China using these technologies than in the United States.

Chuck Gibson: No, I didn't know that.

C. Austin Fitts: They are quite online.

The last thing I pointed out in this section of the internet of things was your point, Chuck, about the very dramatic developments going on in the interface and making interfaces much more accessible to humans. Instead of us having to talk to the computer in its language, it will talk to us in our language.

Chuck Gibson: Yes.

C. Austin Fitts: We're seeing a little bit in the software technology when we look at companies, but I also think that that is an area that is just going to explode this whole sector as it happens.

Okay. Reengineering delivery. This is one I'm very interested in. The impact on the distribution of these different technologies and how goods and services get delivered – how does that show up in the market?

Chuck Gibson: What I found interesting, for me, was when you buy something online or you do something online you still have to have it delivered to you. The FedEx's of the world, this is an old, stodgy company. Who would have thought that they would have done what they've done in the stock market and how well they have done and benefitted from Amazon and everybody wanting to not have to go and fight the crowds?

C. Austin Fitts: Right.

CHUCK GIBSON: I think from an old school standpoint looking at the companies that have been around for a while, not the new innovations, I think that they are going to be a benefactor of what we're seeing.

C. AUSTIN FITTS: One of the most fascinating things I find in investing in equities is looking at the companies who are making the shift and the others who aren't. For example, this week on the blog they are not publicly traded – they are privately held – I did a little blogpost on my favorite catalog which is the Lehman's Hardware catalog.

Lehman's Hardware is a store in Ohio who has traditionally served the Amish. They sell non-electrical goods. So it's very old-timey stuff. The founder's son got them online and they exploded with everybody interested in gardening or sustainable living.

Now they are unbelievably having an explosive business – all through the internet. That is a very old-timey company that has made the switch to 3.0. They are doing better in 3.0 than they were in 2.0.

We see companies that are very traditional like Corning, who I think has done a great job in developing new products and innovating. You and I can come up with a lot of them.

You don't have to be Amazon to do well in 3.0 at all, but for some companies it's almost like they went to sleep and didn't notice. They never used the internet. You look at companies like Sears and you think, "What happened?"

CHUCK GIBSON: The other thing is that if you use Sears as an example – because I think that is a really good one – because of the pace, and me being in the midst of things for as long as I have, the pace is so fast. It's faster than anything I've ever been involved with. All it takes is one misstep by management to miss that, and then all of a sudden it's too late. You get run over by everybody else and you cannot catch up. In Sears' case, it's because of the size of themselves.

C. AUSTIN FITTS: Right. Well, in every part of the market and in every sector you are seeing companies that are smoothly jumping the curve from 2.0 to 3.0 and others that are just getting left flat-footed.

I think one of the things as an investor that you have to be aware of is that you are going to see a lot of different shakeouts. Part of that shakeout is deflationary, to get back to the deflationary.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Next, as I said, I am interested in this concept of commodities versus technology because you know technology can be unbelievably deflationary. Unbelievably. One of the things I love about the internet is it is when you improve the information technology, then all different sectors improve their communication – not only within the sector but across sectors.

"I am interested in this concept of commodities versus technology because you know technology can be unbelievably deflationary."

The story I put up for that section is one I love about three sixteen-year-old Irish girls who figured out with a completely low-tech process how to improve crop yields by 74%. Now I'm not saying that you could translate that around the world, but imagine if you came up with an innovation that improved crop yields by 74% on a significant scale. That is very deflationary.

CHUCK GIBSON: Oh, absolutely, and the fact that the internet allowed somebody to actually get that out. Before, in the past, how would it get from Ireland over to here other than world of mouth or something? It's just that the internet provides you with that vehicle to be able to get it out and have people recognize and actually capitalize on it.

C. AUSTIN FITTS: Well, in that section I put up a chart of Apple and Amazon versus gold, corn, oil, and copper. You know, you can see that you had much rather be in Apple than any of the commodities.

Okay, let's jump to energy. Energy, to me, is a fascinating area because we've had such a significant increase in domestic production since 2005. It's quite extraordinary. As we've seen, we've just seen prices come down a lot.

We are also seeing the improvement in one of the things that you taught me about, and that is improvement in the economics of renewables and efforts to adopt renewables, for example, in Europe, in a way that have whacked the utility prices over there.

Maybe you could talk a little bit about what is going on in energy and how we see that in the market.

CHUCK GIBSON: You know what I thought was interesting was that if you looked at the economic cycle – and I didn't bring this up in the first section although I was going to – and where we are in this business cycle, you would expect energy to be a leader not a lagger. If you remember, energy was the big loser for the quarter.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: Was that because it got over-extended, or was that because we have growing output in the United States which is driving oil prices down and we are having an oversupply, and that oversupply is actually going to benefit more people because of the lower prices.

Now, it's not necessarily going to benefit the energy sector, but what it will do is it will provide you and I the ability to spend less money and have more money to buy healthcare – because that is going to cost us more.

The other thing is the one disrupter it has is that because the other sectors within the energy sector – hydro or wind or solar or geothermal or any of those renewables – they become cost-ineffective or less cost-effective. Before as oil continued to go higher, what we would see is that they would become more cost-effective so therefore you would have a much broader mix of energy sources. But as oil and energy – if you use oil as the baseline – continue to drop and they stay where we are at now, these other things become a lot less attractive.

If you are an investor, these people are going to have a much more difficult time making profits on the cost per energy basis on these other non-oil based solutions.

C. Austin Fitts: Well, historically we have seen that a lot. As prices rise, there is tremendous interest in renewables. Then as people start to invest in renewables, wow! It flies down again. It's quite remarkable how that happens.

Chuck Gibson: We talked about solar. Again, that was one of the things that I love to follow. As oil got up into the $90 or $100 per barrel cost, with the increase in technology that we're seeing in solar, there is a crossover that is expected to happen.

Now that was more towards the second half of this decade, but because of the improvements that we've seen in technology, it is more like a year or two away. Of course, that price was when we were at $90 a barrel, but there was a crossover in which solar became as competitive.

I think that this is something you can't discount. In your graph there, if you look at how little is being used in solar, the potential – if the governments don't get involved because, as you said, it's been a real disrupter for the utilities – that could be a game changer. It really could.

C. Austin Fitts: Well, what I see is over the next ten years there is tremendous potential for disruption in the energy world. I think you just have to be ready to rock-n-roll. There is no way to know what is going to happen, and it could be pretty wild.

Chuck Gibson: Yes. I think what you are saying is that you don't want to buy and hold necessarily.

C. Austin Fitts: I think you want to buy and monitor. But, you know, it is very hard to monitor. This is one where I tend to want experts following it for me. I don't want to have to monitor myself.

For example, when the Russians came out and said they had a new hybrid fusion and 24 hours later Lockheed Martin comes out and says that they'll have something in ten years. So what do I do? I call you and I say, "Chuck, what does this really mean?" because I don't know.

What does this really mean? It's hard to tell.

Okay. Education. Education is one that I wasn't used to having turn up in the equity markets until we started to look at some of the education stock companies in the emerging markets, although we have a few publicly traded here. I noted in the trend that the second largest download category for apps at the Apple store was education.

CHUCK GIBSON: I didn't know that.

C. AUSTIN FITTS: Yes. It was pretty interesting. What is your take on education and how it turns up in the equity markets?

CHUCK GIBSON: You know, because of the credentials that I have I am forced to do a lot of additional education. I am in favor of it, and there wasn't much of it before – in favor of doing it online. If I wanted to study at 12:00 at night, I don't want to have to be forced to drive to a classroom.

I find that this potential, I don't think I'm in line with the younger generations, but I find that the younger generations would much rather do it online than they necessarily would in a classroom.

I think that there is huge potential as a disrupter for online education, and I don't know where it is going to go. What we saw was a number of online companies, like Corinthian Colleges comes to mind and a couple of others, that just went crazy in the equity market and then they flamed out.

Maybe this is a purge of the system. Maybe you start off with a whole bunch of people and then you get it down to a manageable few, but I think this is going to be a huge growth area personally.

C. Austin Fitts: Well, my take on it is I've been trying to figure out what can explain common core. I think there is a tremendous desire coming top-down to make this a corporate endeavor. I basically think the whole plan is nuts because education is a much more bottom-up pretty yeasty thing. So I'm very nervous and hesitant about most publicly traded education things, but what fascinated me when I looked at this – because to me education is the most important factor in regional or a country's competitiveness. I just think you can't put too much stress on education.

What really struck me, Chuck, when I went through this is if you look at the online opportunities in education – so great universities putting their curriculum online or the Conn Academy or different entrepreneurs doing educational websites or people doing apps and software things that are easily downloaded – what I finally realized was: Wait a minute! You can have a group of kids in a remote village in Outer Mongolia, and if they have a teacher who cares about them and they have internet access, they have access to the most fantastic resources around the world at a very low price, and they can learn as fast as they want.

"You can have a group of kids in a remote village in Outer Mongolia, and if they have a teacher who cares about them and they have internet access, they have access to the most fantastic resources around the world at a very low price, and they can learn as fast as they want."

I am always recommending a DVD on a school in Russia where kids get an incredible education. But globally, everybody can have access to this. In the meantime, American kids have a handicap of about 25,000 hours of wasteful requirements, whether it's their curriculum or student loans.

If you look at the market economics of those kids being free to just learn what they need to be unbelievably competitive versus kids loaded down without handicaps, I think the slapback from the emerging and the frontier markets in education is going to be incredible. I don't even know how to imagine what it might be. But I can't imagine some kids having access to all the greatest curriculum in the world and being free to do whatever they want versus some kids loaded down with these wasteful handicaps.

I think this is going to be wild.

CHUCK GIBSON: I will say this. I know somebody is going to get it right, and I don't know who it is. It may be too early. But when somebody does get it right, the rewards are going to be really limitless.

C. AUSTIN FITTS: Right. If Alibaba figures this out, Amazon is really in trouble.

CHUCK GIBSON: Absolutely.

C. AUSTIN FITTS: Okay. So the next one is war – the biggest business. I just have to laugh. I don't know if you ever read Richard Mayberry, but Richard Mayberry just says, "Take half your money and put it in Lockheed Martin. Take your other half and put it in long treasuries and you'll be great."

I hate to say it, but he's been right so far.

CHUCK GIBSON: Yes, unfortunately – or fortunately, however you want to look at those companies that provide those services to support the war machine. They are pretty much a lock-in possibility. That's how they work. You're not going to kill it and you're not going to hit home runs, but you're definitely not going to lose a whole lot either.

C. AUSTIN FITTS: I want nothing to do with them, but it's going to work until it doesn't, so there you go.

CHUCK GIBSON: I will say this. I don't know if you remember – because I was in the middle of it – but when Clinton was elected and we started to back off on the amount of money that we were putting into these companies and the war effort, it was amazing what happened to those stocks during that period of time.

While we haven't seen that since Clinton, it is possible somebody else could eventually get elected who may have the same impact.

C. AUSTIN FITTS: If you look at the comic book, I show the Lockheed Martin versus S&P. (I'm picking on Lockheed. So my apologies to the guys at Lockheed. They are just the largest one.) If you look at Lockheed versus S&P, they are way outperforming. Then in 2000 they come back down. Then 2001 happens and we're off to the races, and they have outperformed ever since.

Okay. Space: The Final Frontier. Great hoopla and interest in space. I put up some of the different articles. We saw one of the Japanese semiconductors coming out and saying, "Well, this market is mature. We are going to focus on space."

Certainly there is a lot of hoopla, but I put up this story that I love that Warren Buffet always tells. Investors from the beginning of the Wright Brothers flight have net loss money. So my question on space is: Is this is an opportunity to just lose more money, or are we finally going to turn a profit?

CHUCK GIBSON: You know, personally I know this is what you really love. I don't know if the readers/listeners know this, but my prior job before I started as an investment advisor I was the director of a space division in a semiconductor company. The amount of people who can afford it that they are going to address is going to be really small, but I don't think that this driving movement towards space is going to change.

If you are going to make money, my point is that you look for companies that provide the services or the components that people need to go into space. That is what we did as a semiconductor company. Really briefly, what it was is when you are in space you have a lot of radiation that you have to protect against. Any time you have electronics, those are affected by that radiation. It's just a normal part of the atmosphere.

What we did was we made radiation-hardened semiconductors.

Regardless of whether or not this was military-based or commercial or anything else, you still need to have those services. So if you are going to make money in that environment, that is where I would be focusing because whether space grows or not, we still know that there is going to be the demand for those kinds of components.

C. Austin Fitts: Here is what I think. I think space is becoming more important for a couple of reasons. One is that as you move more and more the financial system onto the mobile platform and the internet of things, the satellite systems become that much more important.

Chuck Gibson: Yes.

C. Austin Fitts: What you are really looking at is not so much trips to Mars; you are talking about satellites that are basically communication networks for what is going on down here on earth.

Chuck Gibson: The spy network.

C. Austin Fitts: Well, it's not all a spy network, but you are basically running a big portion of the internet through space. To me, that is part of it. The other thing I find very interesting, and one of my theories is that if you look at what is happening to develop the manufacturing domestically – in North American and the developed world – I think a lot of what is being organized to be done in space, they want the manufacturing closer to home. It's part of rebuilding the industrial base in the developed world. If we are getting a manufacturing renaissance, space is a piece of helping that happen.

Chuck Gibson: This is a really quick side note. The interesting thing about manufacturing is that some of the things that you can do in space, from a manufacturing standpoint, you cannot do on earth because certain components don't combine. Those types of reactions, you can get unbelievable yields. You can do some things that you cannot do here on Earth. That can give you a huge competitive advantage if they can get the space program up and running. You would have a manufacturing lab up in space.

C. AUSTIN FITTS: Right. I think that call that suborbital platform manufacturing.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: So anyway, I am really encouraged about what can happen in space, but I think it is going to be a government-funded and defense contractor area. You are right. Where the investor is going to see it is investing in the industrial platforms that get volume from that.

"I am really encouraged about what can happen in space, but I think it is going to be a government-funded and defense contractor area."

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Okay. Transportation and infrastructure. The IMF came out and said, "We need a massive increase of global infrastructure spending," and I said, "Yes! What a good idea." That doesn't mean it is going to happen, though.

Let's talk about infrastructure and transportation. Where have we been seeing this in the equity markets?

CHUCK GIBSON: You know, there is no question. I don't know if I want to recommend some companies. I guess it's not really recommending.

We see a lot of companies that are just focusing on this. You know the few that I am talking about. There are the Tesla's of the world. Human transportation is not going to get away from the automobile any time soon. It's kind of like moving away from oil. So what they are trying to do is make them a lot smarter and a lot safer. That is all done through electronics.

Again, I was involved in electronics in the automotive world, and the amount of computers that are on a car today is unbelievable.

C. AUSTIN FITTS: Yes, it is.

CHUCK GIBSON: Before they were just computing and giving you information about a car. Now it has gone way beyond that and it's talking about giving information about the people next to you, the car, and how far away the police are. The abilities for transportation to be able to do things that they haven't in the past is just going to blow people away – what changes we're seeing.

C. AUSTIN FITTS: Somebody called me today. They were in their brand new Honda. They were saying, "The car does this and that and talks to me."

I put up the Popular Science cover to the article they did on the future of the car. The competition among car makers to integrate technology – and I think part of it is if you look at the studies that show how many cities in the world are going to be megacities, which is 10 million people or more, we are watching as the emerging markets develop. You are watching the development of the middle class.

As the middle class grows of people who can afford cars, there is nothing worse than 10 million people in one place, all who just bought a car. That is a nightmare.

I think the planning board in the sky is saying, "Okay, we can't possibly have 10 million people in all these different megacities buying cars and doing it the way we are doing it now. How do we do it?"

The idea is lighter, smaller, smarter, and we are seeing all these different ideas about how to share cars and do other things to make this a much more environmentally pleasant experience.

What I want to know, though, is are we going to have cars that run on water? That's what I want to know.

CHUCK GIBSON: Well, we have those engines that run on air right now, so you can expect to see it someday.

I'll just tell you a quick side story. A friend of mine who is very, very intelligent, he is the Director of Design for semiconductors. He bought a new car – and I won't name the kind of car. He had to take a one-day class on how to manage the car. When I say 'manage', I'm not talking about keeping it up to date. I'm talking about being able to communicate with the electronics within his cockpit.

C. AUSTIN FITTS: I can believe it because I got a new car in 2012, which is a luddite compared to what is available now, and I just said that I have to take a day and read this manual. It is unbelievably complicated. There are still functions, I confess to you, that I do not know how to use.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: And, of course, my favorite: Railroads. I just have to bring it up.

CHUCK GIBSON: I will let you go into this because when you originally brought it up to me, I'm thinking, "Is this beta or VHS?"

We're talking about 1980's technology here, and sure enough, this is the Warren Buffet way. The railways are providing the transportation to get stuff to manufacturing.

C. AUSTIN FITTS: I think trains are going to be the workhorses of 3.0.

CHUCK GIBSON: Yes!

C. AUSTIN FITTS: We have certainly seen the trends in transportation do well on the markets. Another thing I wanted to mention is I took a pretty serious look about a year ago at air transportation. What we are seeing is as the middle class grows – and it's really business travel that is driving it – there is a pretty significant increase in air traffic, particularly in the business and upper end areas. That is happening as well.

CHUCK GIBSON: Technology is driving a lot of that because if you look at the improvements that they are making in the aircrafts themselves, the costs to transport somebody from, let's say Brazil to the United States, has come down dramatically not just because of the efficiencies of the engines but because of the size and the amount of people that they can carry in a plane comfortably.

That will continue to improve, and I think that is going to enhance and is not going to go away any time soon. With the population growing like it is, you would expect to see this be a benefactor from that.

C. Austin Fitts: Right. That is why I would love to see some of the new materials they are working with really come down in terms of economics because if you can get those much lighter materials to be very economical, then you are talking planes, trains, cars, and everything. It will be a real explosion in what is feasible.

Okay. Manufacturing Renaissance. I've talked a lot about this on The Solari Report so we don't need to dwell on it, but between the drops in the cost of energy and improvements in robotics and fabrication technology, it does look like we are seeing an improvement in the economics of doing manufacturing in the developed world versus the emerging markets, and - of course – bringing that technology to a smaller footprint so smaller businesses can be much more effective.

Is there anything you wanted to say? You and I have certainly watched the 3D printers bob around in the markets.

Chuck Gibson: No, I really have nothing to input, but I think those have been the wonder kin for me for that renaissance. They are still in their infancy, and who knows where it is going to go. That is one good example of what we are talking about.

C. Austin Fitts: And we would have seen robotics companies do IPOs except that Google bought them all.

That is one thing. Between the private equity guys sort-of scarfing things up or the big guys buying them, the IPO market with the new technology has been much thinner than I had expected. That has been a bit of a disappointment.

CHUCK GIBSON: Yes, you are right.

C. AUSTIN FITTS: Okay. Last section I talked about the 'life technologies'. It is fair to say that the one thing I wanted to mention was that biotech has just been the darling of the markets. There is no doubt about it.

CHUCK GIBSON: Yes, and back in the 1980's it was computers and semiconductors. This decade it is going to be biotechnology. We are in our infancy or our early stages. If it's a ten-step process, we are somewhere between steps two and four I would think, and this is a long, long way to go.

C. AUSTIN FITTS: It's funny because I will dive in and look at what these companies are doing. I will dive in and say, "Oh my God! Isn't this wonderful! This is just so wonderful." Then I will dive in further and say, "Oh my God! This is the most frightening thing I've ever seen!"

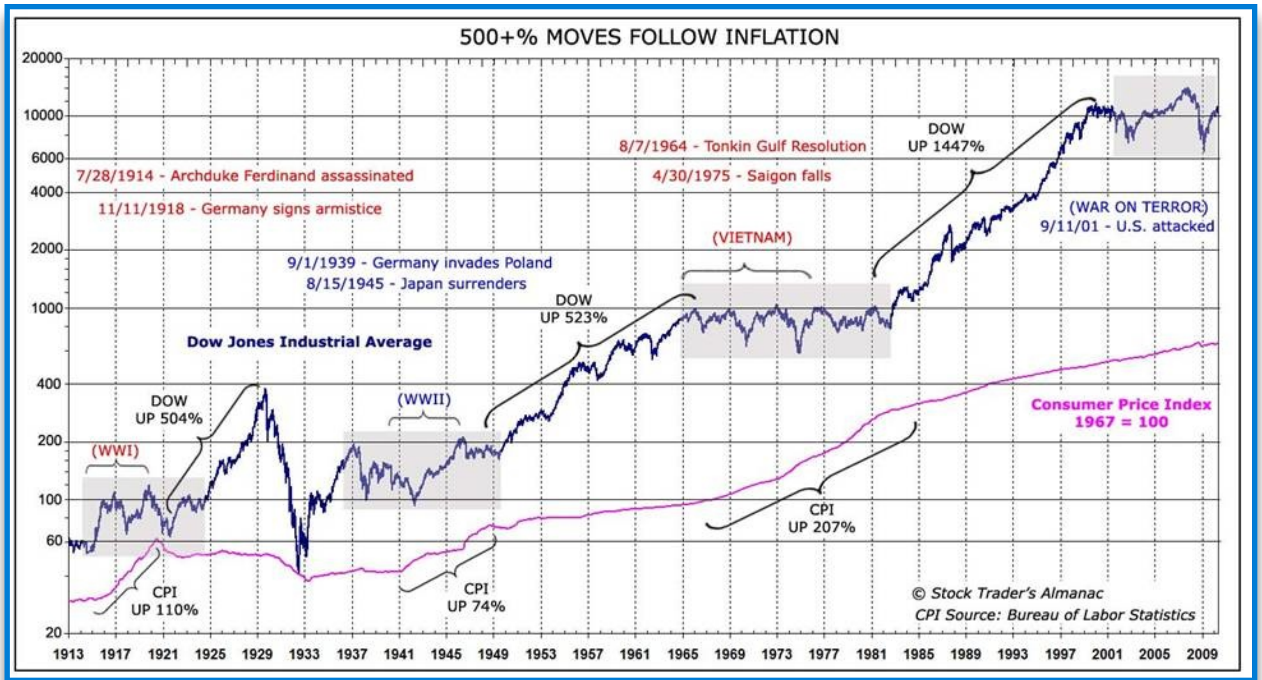
CHUCK GIBSON: Exactly. Not only that, but you look at the number of companies that are out there doing something and the number of companies that could actually just blow up and go to nothing. This is one of those places where you want to tread very carefully and make sure that your exposure is more broad-based than trying to hit a home run picking an individual company.

C. AUSTIN FITTS: Right. So this is another place to hide behind the experts. That's what I think.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Okay. That is it for trends. So hopefully that helps you see a little bit more of the shift as it is going on within the equity markets just by seeing some of the examples.

Let's turn now and talk about risks. I have to laugh. I was on the Council of Foreign Relations website and reading what the establishment had to say about the shift to 3.0. They had a book they recommended on risks. It's a professor who studies risks and he has made a collection of all of the risks in the world, etc.



I fell for it. I went and got his book, and it covered all the risks, Chuck, in the 20th Century. I realized after this unbelievably academic, statistical, drilling, etc. is that it is the same risks in the 21st century. Nothing has changed.

Anyway, I identified five big risks. As it was in the 20th century it is in the 21st century. So let's talk about war. What does war mean to the equity markets?

CHUCK GIBSON: Well, we have Chart #7 here that is a good reference point. Typically what you see – and, again, who knows where it is going to be in the future – when you look past wars is you have a fear that is created when a war breaks out. You tend to see the equity markets take a big hit. At the same time normally you also tend to see the gold market take off at that point in time. Then, not even necessarily once the war is over, the equity markets tend to pick back up and risk is back on again.

It's more of a fear as to where it is going to go and what it is going to turn into, and then the markets tend to accept that and get adjusted to it. Then you start to see a correction.

From an equity standpoint, I would expect to see a decline in prices and then a flattening out – unless it's a World War, of course – and then a rise again.

You always laugh when we talk about this, but it does create jobs and it does create demands.

C. Austin Fitts: Right. It's interesting. If you look at this chart, the war periods look very much like the chart we showed under the 'Dividends Matter' discussion.

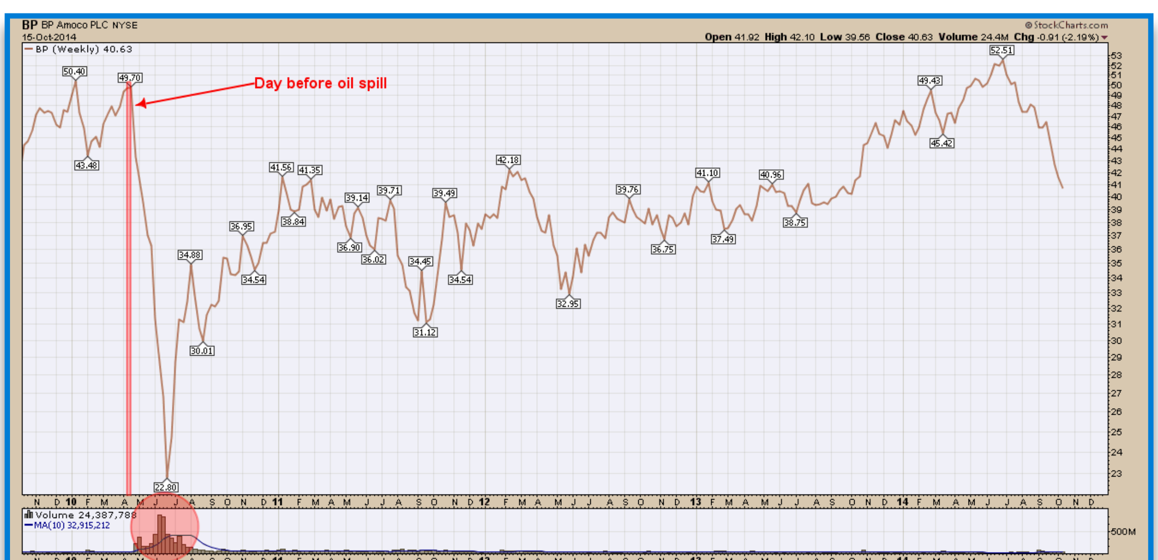
Chuck Gibson: Right.

C. Austin Fitts: Market is going sideways, and this is when you want to be buying dividends.

Chuck Gibson: Yes.

C. Austin Fitts: That is what it looks like. Okay. Nuclear and other environmental disasters.

Chuck Gibson: I don't have a nuclear disaster here, although I could have gotten one maybe from the Russians. Let's take a look at what happened



with the BP oil spill. What you'll notice on this, Chart #8, is BP prior to the oil spill was at almost $50. Within a couple of months it was down to $22.

C. Austin Fitts: Right. That was a very painful dive.

Chuck Gibson: It was, and I remember at that point in time I didn't like BP, but I'm always looking for opportunities. It's kind of like our discussion on the commodities or on the emerging markets. I can just remember so vividly that BP was done. That's it. That's the end of it. They are not going to survive. Then lo and behold, they were back up to higher prices than before the spill.

C. Austin Fitts: Right, although I will say this. I don't know what the politics were behind the scenes, but this was a time when you thought, "Okay, this is dangerous. This company really could go lower, or even be bought."

My fear was not that they would go under; my fear was that somebody would pick them up for a song in a politically arranged marriage and the shareholders lose. That was my big concern, but this is exactly the moment that value investors look for if you are in a position to take that kind of risk. Obviously that was a perfect example of how if you have a concentration in one stock, the unexpected can happen. You never know.

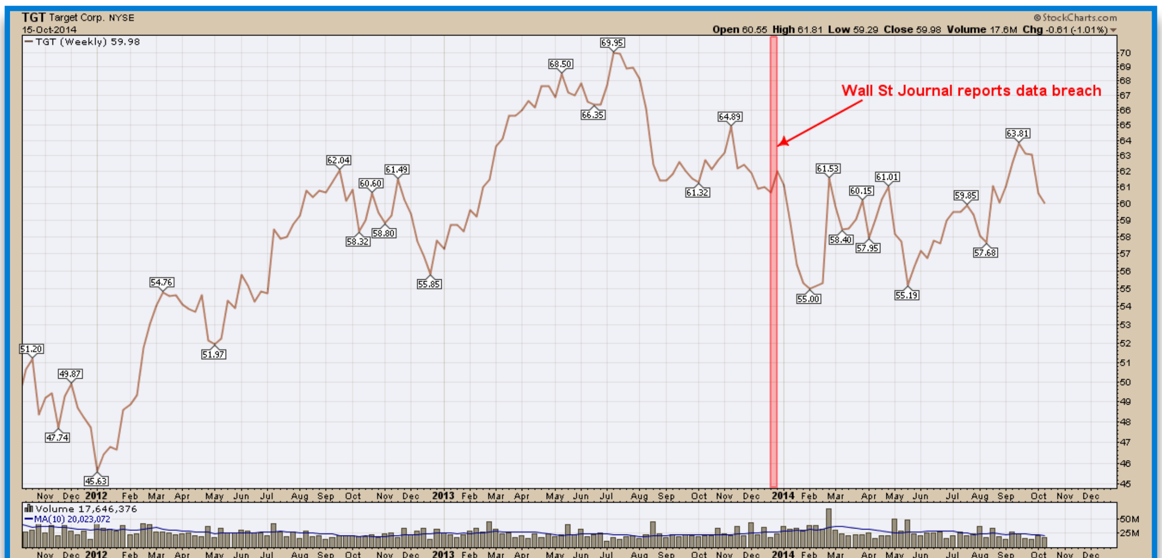
Chuck Gibson: That's right. Unfortunately, during that decline if you look at whatever that three-month period was there, human emotion messes with people. We can step back and say, "Well, hindsight is 20/20. If we would have just hung on," but emotion drives you. Here three months earlier you were at $50 and now you're at $22 and you've lost 60% of your value.

People have a tendency where that is the time that they panic and they get out. Again, I'm not professing this, but if you are an emotional person, emotions are about 70% of investing. If you can't deal with those emotions you really should be looking for a little help there.

C. Austin Fitts: But here's the thing. If you know somebody – because I faced this situation at the time – who has too much in that one stock and they've taken that much of a loss, they could take more. You can't afford to bet the ranch on anything. That's my feeling.

Chuck Gibson: Absolutely.

C. Austin Fitts: Integrity of digital systems. We're certainly seeing this come up more and more these days.



Chuck Gibson: What I did was I tried to find a recent example of what happened to a stock that got hit by one of these break-ins. The first one that came to mind was Target. Here is a chart of Target that we can see, Chart #9. You can see that really the market yawned. It went from 62 down to 55-ish, and the market just almost said, "Big deal."

This was a complete surprise to me. Look at what happened to Home Depot. I don't have the chart here, but the market only lost two to three percent. I don't know if that's because investors don't look at that as a risk to the company or because, really, the company isn't so much at risk; it's really the people whose data was stolen – you and I.

C. Austin Fitts: I think the market knows that these things happen and it can happen to anybody. This is really an assessment of the management's ability to deal effectively with it.

CHUCK GIBSON: That's true.

C. AUSTIN FITTS: What they're saying is that Target is going to figure it out.

CHUCK GIBSON: My immediate thought was that maybe they've become so complacent and acceptant of the fact that nobody's data in reality is safe anymore anyway, so big deal. Next!

C. AUSTIN FITTS: The other possibility is that the guys who engineered it were busy buying.

CHUCK GIBSON: That could be!

C. AUSTIN FITTS: Natural disasters. Fukushima is our example.

CHUCK GIBSON: If we take a look at the Fukushima chart, what I did was I grabbed the global uranium ETF. This was a basket of uranium stocks. You could see what happened. This was in March of 2011. At that point in time it was hovering around $60 a share. On the day that it happened and within a week it had almost been cut in half. Since then you can see the decline.

Is that decline reflective of the fact of the world's distaste and desire for nuclear energy, or is this –

C. AUSTIN FITTS: Commodities and energy coming down.

CHUCK GIBSON: – commodities and energy coming down. Exactly. Which is that? Here's another example of making sure that you are not overly concentrated in any one thing.

C. AUSTIN FITTS: Right. Think about it. You are going from 65 down to 12.5. That's a pretty big drop. That's a pretty big drop.

I think when you look at these examples, what you realize is that anything can happen.

CHUCK GIBSON: Yes. You have to be prepared for that, and if you are an investor you have to have your portfolio or your investment set up such that if that happens I can't get wiped out. I am going to take a hit, but it's not going to affect me.

You can't hide. That's just a part in parcel to investing. Things happen and you have to be able to deal with them. The best way to do that is to manage risk by making sure your position size is correct.

C. AUSTIN FITTS: Right. The last risk I had was what I called 'Creative Destruction', including unemployment. That is when new technology comes in, it actually may not be new technology. You do a very good job, Chuck, of pointing out that sometimes it is simply technology we've had for many decades getting economic and more people are learning how to use it like CAD software, or it's the integration of a new technology with lots of old technologies which are getting cheaper, easier, and they sort of hit a tipping point together, and boom! You're off and running.

I think we are seeing a lot of creative destruction going on, and the mobile smart phone integration is really driving a lot of it.

I've been astonished talking to people who manage advertising. The shift from print to mobile phones and social media has been very fast. So there is a lot of creative destruction going on, and that can be very bad for the equity market if you're not watching.

CHUCK GIBSON: It's not even just that. It's also you might be watching it, but what I found out through many, many years of getting the wrong side of the market, I found things that while you see it happening, you think the market is going to do one thing and it does just the opposite.

C. AUSTIN FITTS: Right. Well, one thing that I would say is I find the equity markets to be unbelievably information. If I try to understand what is happening in the economy without watching the markets, for example, I would never have understood what is happening with social media without watching the equity markets. And watching it from the equity markets' point of view – not just the social media companies and those stocks – but the different stocks that were interacting with the phenomena, I think it just sends a different message.

If you want to see what's going on, it is one of the messages that you need to keep an eye on. I think the equity markets are an early place to watch that creative destruction, and it is important to watch them.

As you would say, price matters.

CHUCK GIBSON: It does. That is all that matters.

C. AUSTIN FITTS: I don't think it is all that matters, but it matters a lot.

Okay. Strategies. So we've talked about what the trends are and we've given some different examples to make sure you see how they show up in the equity markets. We've talked about the risks and all the things that can go wrong. So let's now talk about the strategies. What are the things you need to do in approaching this kind of world? I think the first one that we really need to talk about is this question of buy and hold.

For many years people like me first were trained that you get on the internet or you get the books and everybody says that you buy and you hold. You don't move around; you just stick with it.

Here is the question, Chuck. In a world that is this uncertain and where it is so hard to know and understand what is going on, do we want to buy and hold, or do we want to do something else?

CHUCK GIBSON: I come at this from a real biased standpoint. I was like you. I was trained that buy and hold was the way, and I was trained by Wall Street. That's really what Wall Street wants. They want you to buy and hold. They don't want you to sell. This is how they make their money. If you sell and you move out of their investments, they are not making money.

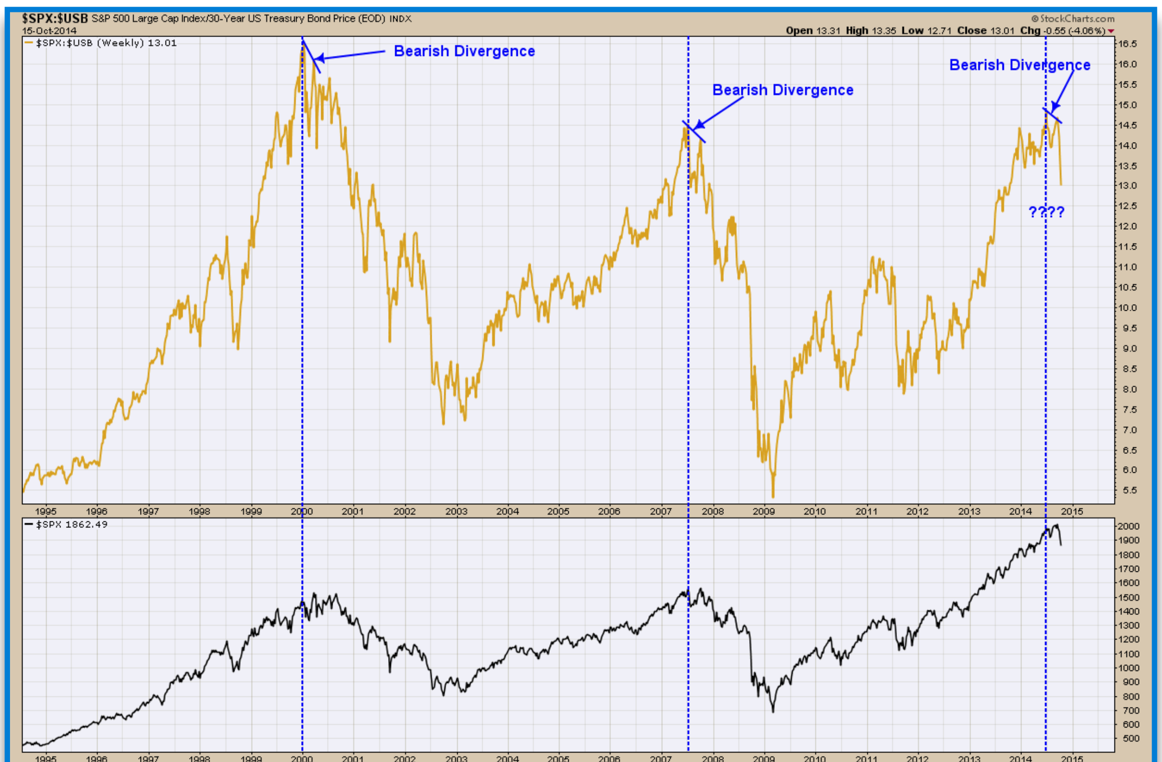
That being said, that is not really the motivation. The fact is that we are in a situation where the world has changed. If we were left to have real markets that were allowed to correct and do what real markets are allowed to do and not have intervention or assistance by government entities, then I would say that maybe buy and hold is okay. I don't know.

All I know is that we are going through cycles. As we start in the year 2000, we go through boom/bust cycles. You can't as an investor – and maybe you can if you are 20 years old – go through many boom/bust cycles because you don't know when the next bust cycle is going to be.

If you happen to be ready for retirement and you go through a bust cycle, then your retirement is blown out of the water. I am just a firm believer that with buy and hold, am I smarter than the market? No, I'm not. But what I can do is I can say that there are times when you want to take less risk. What methodology do you use to determine that? That really is left up to the individual investor. I do know that you can be smarter than the market from a standpoint of watching yourself and making sure you aren't participating in those huge bust cycles.

I'm not advocating that anybody can time the market, but what I am advocating is that you can miss major corrections, and that is what you should be looking to do.

I think on the last Solari Report I presented a way to be able to avoid those boom/bust cycles by a simple methodology on moving average costovers. I don't have it here, but this is another one. This is just a ratio chart of the S&P 500 against the 30-year Treasury bond.



If you had a really confined world and you could only invest in two things, you could either invest in stocks or you could invest in bonds. What you want to do is you want to be invested in stocks when that ratio trend is moving upward. When it is moving downward, you want to be invested in bonds. If you look at what we have right here, we went through boom/bust cycles, and while you are never going to be able to pick the tops or the bottoms, what you can do is avoid those major declines.

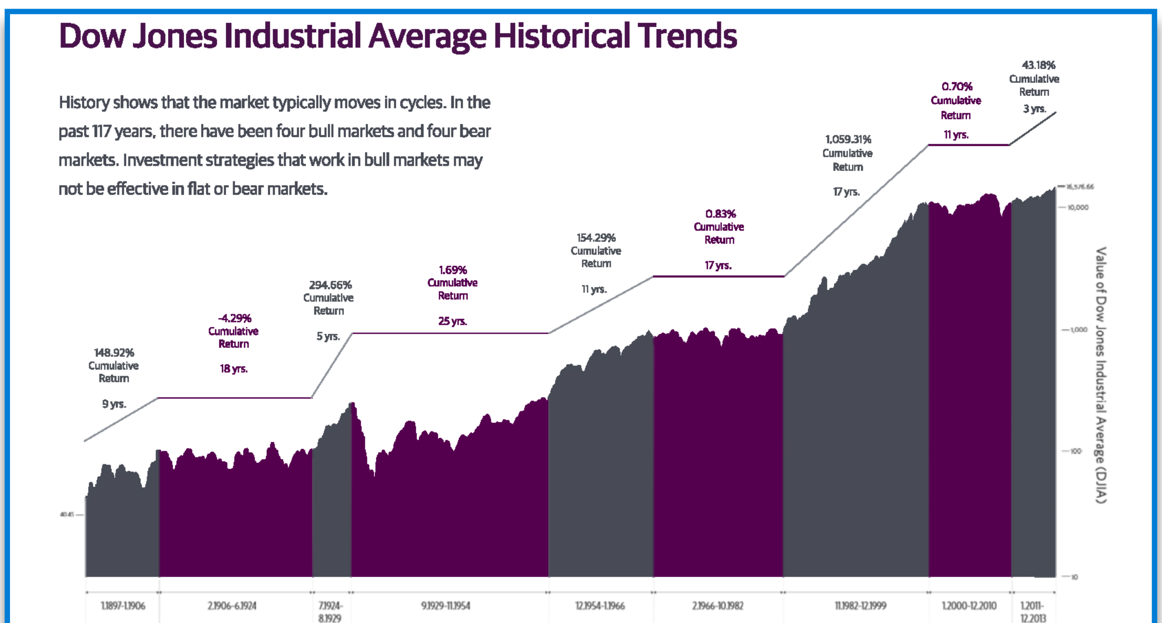
This is a really good starting point that I would recommend that investors be looking at if they are concerned about going forward. They need to have as much growth as they can, but they want to be able to sidestep a potential really bear market. This is one methodology you can look at along with the moving average that we talked about on the last Solari Report.

C. Austin Fitts: Right. Well, time makes a big difference. I said to somebody the other day, "If I was going to Mars for 20 years, I would put all my money into the emerging and frontier markets because I could get the best P/E and I would come back in 20 years."

But since I'm not going to Mars, I need to wait before I do that. Timing is everything.

Chuck Gibson: Absolutely. So let's talk about buy and hold.

C. Austin Fitts: Okay.



Chuck Gibson: For the first chart, Chart #12, this is a long-term historical chart of the Dow Jones Industrial. What you can see real simply is it goes through periods of consolidations, which are your sideways trends, and then it goes through periods of growth. Those sideways trends are when you start to see the potential for those major corrections. If you look at the 68-81 period of time, if you had invested in 1968 you would have made no gains through the entire period if you had held it through 1981. So the stock market wasn't the best place to be.

Buy and hold is one of those times where if you are going to buy and gold, can you withstand those major drawdowns which you are going to see in a consolidated market? And if you do – and this is our mantra which we have talked about since day one – is you are going to want to own dividend paying stock because while the stocks may go up and down, at least you are getting paid to hold onto them.

C. Austin Fitts: That's what I feel, and that is one of my biases. I would much rather get a three or four percent dividend in a stock that is going up and down than sit around and be debased in short-term treasuries. But I don't mind the up and down.

Chuck Gibson: I would, too. Investors, as much as we can try to point them in that direction, a lot of investors can't stand the ups and downs part of it. That is the real problem.

C. Austin Fitts: Right. Okay. Buy and Hold #2.

Chuck Gibson: Let's go onto the final one. This is just an example of what you have to experience if you are going to be a buy and holder. It really matters on where you buy and what you have to live through.

If you look at the period of the first blue bar there, the Dow Jones dropped 34% in 2000 to the 2003 bottom. That was a major bear market. The Feds stepped in and started not only lowering interest rates but they printed money and did whatever fiscal and monetary policies they needed to do to get the economy going again. That was not really that quick of a decline because it took almost three years to complete that.

Look at what happened subsequent to that in 2008. It dropped 50% and that happened, depending on where you picked the top and the bottom, a little bit over a year and half. So we lost 50% in a year and a half. Those are the things that investors have to look at and say, "Do I want to live through that?"

Ultimately you would have been fine if you had just held on, but how many people needed that money from the time it took to hit the bottom to where it came back up to where they were even again?

C. Austin Fitts: I think a lot of people just don't want to live through that. They just don't.

Chuck Gibson: Buy and hold is, to me, one of those things that is a personal choice. You can buy and you can hold and you can get opportunities. If you live through them and if you are patient, most likely you are going to be whole again at some point and time again in the future. But if you don't want to live through that, you need to come up with an alternative strategy.

C. Austin Fitts: Right. Part of this is personal taste.

Chuck Gibson: Absolutely. There is not one right answer here for anybody.

C. Austin Fitts: Right, but I think before you start to invest or as you are investing, you need to be very clear about what your strategy is in terms of buying a home versus trying to modify it if you are going to modify it.

CHUCK GIBSON: You know, Catherine, I don't want to take up too much more time, but I wanted to just make one additional point there. What I've found is where it really runs into a problem is if investors think they can live through it and then what happens is when they are in the middle of it, their emotions grab a hold of them and they say, "I've changed my mind."

Normally the way that works out is it's close to a bottom at that point in time. So you need to make that determination before you invest, not while you are in the middle of it. Emotions will drive you to make the worst investment decisions.

You are absolutely right. That should be determined and it should be thought of ahead of time, and you actually have a plan before you put your dollar to work.

C. AUSTIN FITTS: Right, and it's very interesting. We saw that when precious metals came down. We saw that as really having to say, "Look. Here is my line in the sand. I'm out."

One of the things that it was very important for me to be able to do was persuade somebody, "Look, we can always buy back in. If it turns up, we can always buy back in."

As one of my favorite preachers says, "My elevator only goes to the first floor. If you want to get to the basement, I'm getting off. You can go down to the basement without me."

Anyway, let's talk about what matters. The first thing I want to talk about – and this is my big bias – is I think the future is built by the people who build it. Investment, first and foremost, is about what you're for. I think the history of investment says that the people who are in it are the ones who benefit from it. They are the ones who build the future, and I think there will be a future.

We've been through a period of very dramatic change, and in some ways very off-putting developments from the leadership. There are more than a few investors, Chuck, who are shell shocked, but that is the nature of change. It is very important to sit down, take a deep breath, and say, "Okay, what am I for? What do I think is going to do well in the future that I want to be for?" That is where wealth gets created. Wealth doesn't get created by being against things; it gets created by being for things.

To me, there is a tremendous amount going on in this world that is worthy of being for. I think that is really what investment is about. It's about: What am I going to bet on, and what is the future I want to see happen? What is the future I believe in?

Ultimately, especially as more and more happens through privatized vehicles, the vote that we have that counts is where we get up and bet with our time and our money every day. I think the future is going to happen whether you are there or not, but if you want to be part of it, this is part of getting in and being part of it.

I just want to make a pitch to be part of the future, and I think the potential for the equity markets to grow in terms of what is represented in the equity markets and the importance of the equity markets to determining what happens on this planet is just going to grow.

My attitude is: The water is choppy. Come on in.

CHUCK GIBSON: The other thing that you do a really good job of, and it always makes me smile when you say it so I hope you say it again because it is really relevant here, is say what you say when about seven billion people get up every morning.

C. AUSTIN FITTS: Chuck Lorre is coming on the slow burn. Seven billion people get up, and the way they pay their rent and the way they eat is doing something of value to somebody else and being of service. That's the great, powerful urge that is going on around this planet.

As we securitize more and more assets and more and more companies' end of the markets, that momentum of seven billion people trying to make it work is what is going to be reflected in the market to a certain extent. That's why I found it so fascinating to look at the Alibaba IPO because Jack Ma has found a way to get millions of little businesses online and doing business on the internet. It's a very fascinating model of that urge of hundreds of thousands of entrepreneurs trying to figure out a way to make a living. It's kind of a remarkable thing to watch.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Okay. Custodian. I have to beat the drum. I'll never forget when one commentator was complaining that he lost money because his securities were custodian at a firm run by a former Goldman Sachs chairman. My comment was, "Why in the world was he leaving his securities there? What did he expect?"

To me, it is very, very important where your securities are custodian. I think the Madoff's of this world happen, and there are companies that don't make it and go down. You want to be very, very careful about where your securities really are and who has got the custodian on it.

This is one where you don't want to be creative; you want to be pretty conservative about this. I think that is something a lot of investors don't think about, and it is important to pay attention to.

CHUCK GIBSON: That is exactly true. That is another thing that is in line with trying to look for yields. You go out and take additional risk that you are going to get some incremental small amount of yield greater than what you get, but the risk that you take is really not worth it. I find that same story is true for custodians.

"You go out and take additional risk that you are going to get some incremental small amount of yield greater than what you get, but the risk that you take is really not worth it."

C. AUSTIN FITTS: I was laughing my head off today. I sent this to you, but I don't know if you've had a chance to see it. There was a new survey of millennials, asking them where they liked to bank. Seventy-one percent said their preference was community banks. The next preference was local credit unions. Down at the very bottom, at 41% was online banks.

They've figured the custodian part out, at least with respect to their bank deposits. I thought that was pretty funny.

CHUCK GIBSON: Good for them!

C. AUSTIN FITTS: Price matters. Now I'm going to invite you to talk about this because this is one that you feel strongly about.

CHUCK GIBSON: The thing is, Catherine, I can relate back to the story that when I first started really looking at price I was getting coached by somebody. They kept saying that, and I was so frustrated. I said, "Quit saying that stupid statement! What does it mean?"

Ultimately the sledgehammer finally hit me over the head and I finally got it. I'm going to keep preaching it because at some point in time – hopefully people are a lot smarter than I am and they will get it sooner – what 'price matters' means is that you may have a bias. You may think you know what is going to happen next. I mean, "I know gold is going to go to $2,000 an ounce." Well, it might, but if it's going down to $1,100 first, do you want to still own it?

The fact of the matter is that if you follow price, that is really the most important thing. The rest of the news is really nothing but noise. There are very few people in this world – and there is a website that will back up what I'm saying here – that are good at predicting the future, and most people are worse than the flipping of a coin.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: So if you are trying to get ahead of the crowd, you are not going to be able to do it. Just accept the fact that the best you are going to do is to follow price because price will tell you. If gold is going to go higher, then price should go higher. If it's going down, don't fight it. Go with the trend.

For me, its trend following. Follow the things that are going up, and get out of the way of the things that are going down.

C. Austin Fitts: Or certainly pay attention. I'm somebody who really believes in aligning with the primary trend, but price tells me if I'm wrong. If I think the primary trend is up but the price is going down, that is a very important signal I need to pay attention to.

Leadership. I'll take this one because this is one I care very much about. I think it is unbelievably important the quality of the people who are governing or managing whatever the thing is that you're investing in, whether it's a company or a fund or an ETF. As you know, I pay a lot of attention to looking at the leadership.

It's interesting. We looked at BP and Target and different companies that had events happen – unexpected and terrible things. That is where the quality of the leadership that you have on the board or the lead investors or the quality of the management really matters.

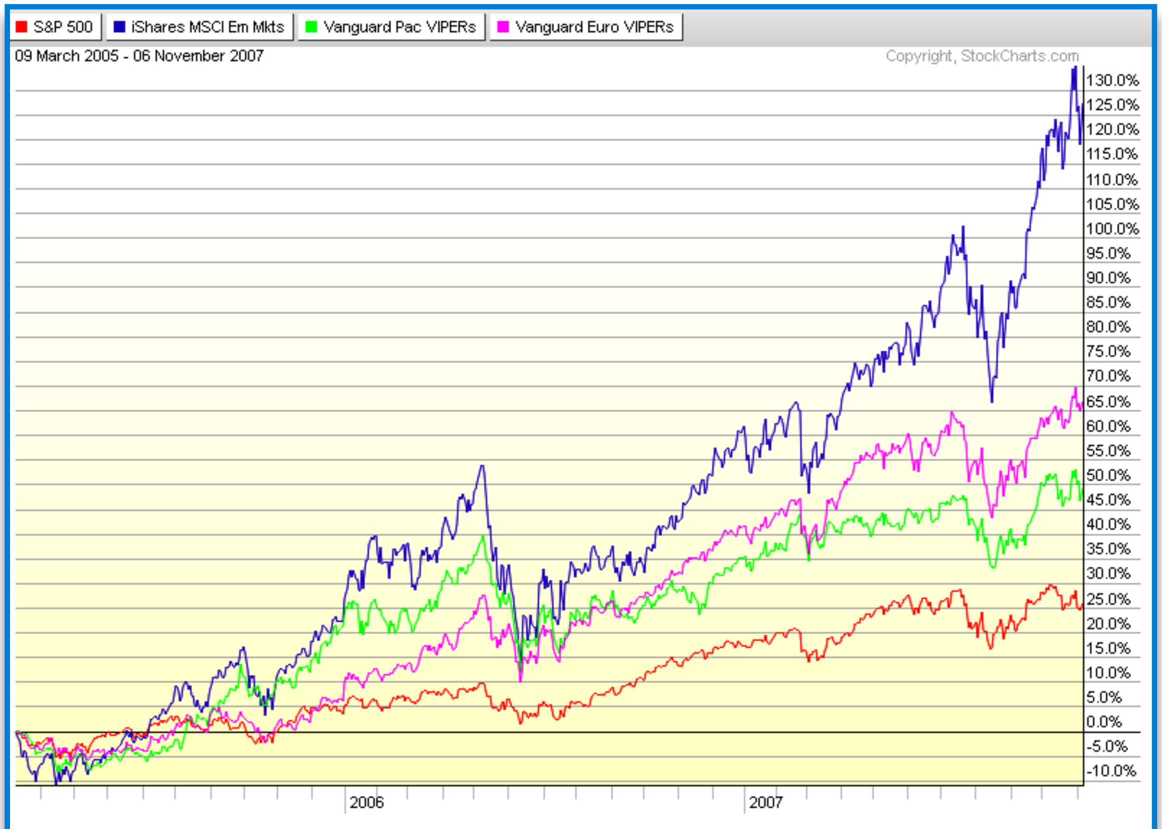
Leadership really matters particularly when you get into the tight situations, or just simply as we said, you are going through a remarkable shift in the marketplace and things can change overnight. Do you have leadership that can spin on a dime and change lead and do what has to be done?

To me, I weigh the importance of leadership. I look at leadership, and it really counts when the former chairman of Goldman Sachs suddenly takes over the firm as your custodian. You've got to be nuts!

Before when the economy was good and you could trust the government to watch out for everything and to enforce checks, nobody thought about this. Nobody cared. Their attitude was, "It's insured. I'm okay. It's not a problem." Now it matters. We're back to old-timey rules here, so leadership really counts.

Diversification. You have two charts on diversification which I thought were fascinating. Why don't you describe this to us?

Chuck Gibson: I'm going to weave in this discussion on diversification but also talk about price really quick. If you look at pre-2008, before the

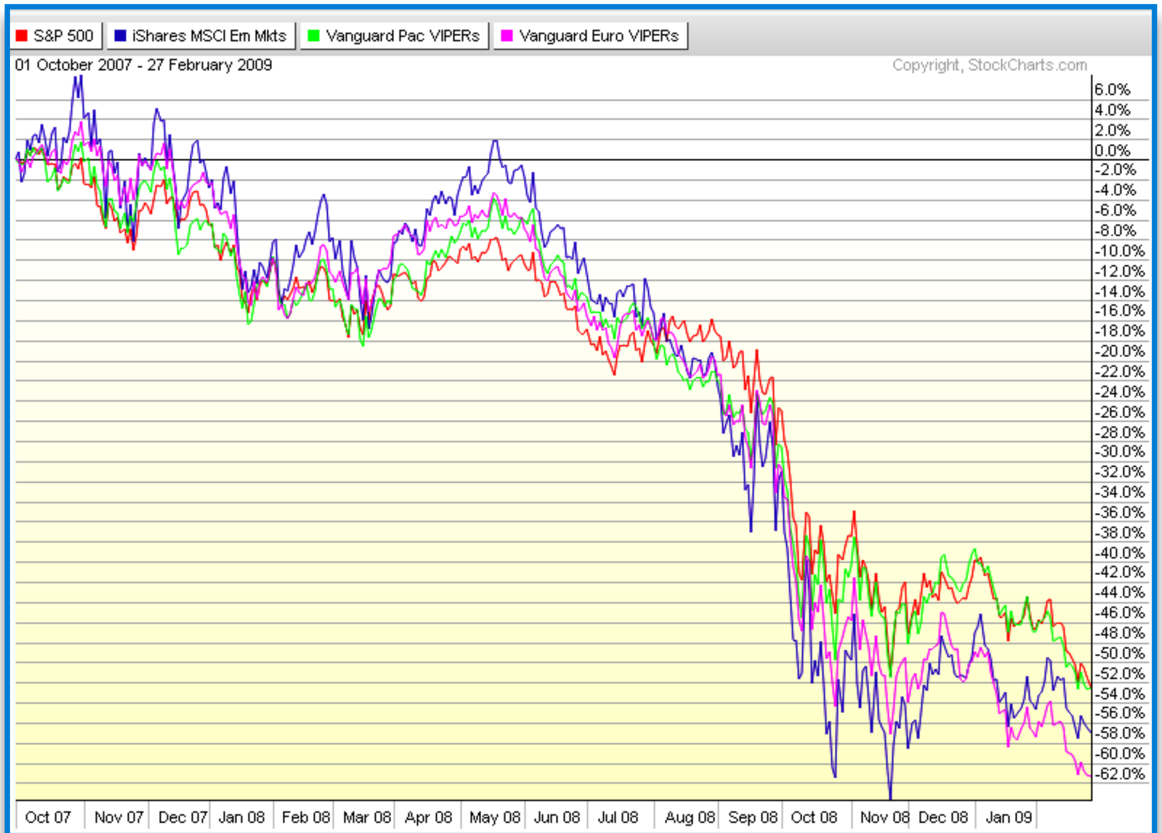


market took its correction in 2008, here is a chart of the S&P 500, which is in red. You have the Euro-Pacific-Asia in green. You have the European stocks in pink, and then you have the emerging markets in blue.

In an upward market, diversification matters a lot because if you would have just stuck all your money in the S&P 500 in this case, you would have done okay. You would have been fine, but you would have done much better by a factor of almost five times if you would have had your money in the emerging market – at least some exposure.

Again, this is where following price matters. If you would have just focused on saying, "I'm going to be in the S&P and price is going up," that is great, but you missed out on a massive amount of gains.

So price matters, but diversification matters just as much in an upward market.



Let's take a look at a downward market, which is the next chart. It's the post-2008. What you should take away from this is that diversification doesn't matter in a downward market. When things go down, everything goes down together.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: So all these assets in 2008 went down together and you got very little variability from any kind of difference from how much was lost because most of them lost 50%, plus or minus a little bit.

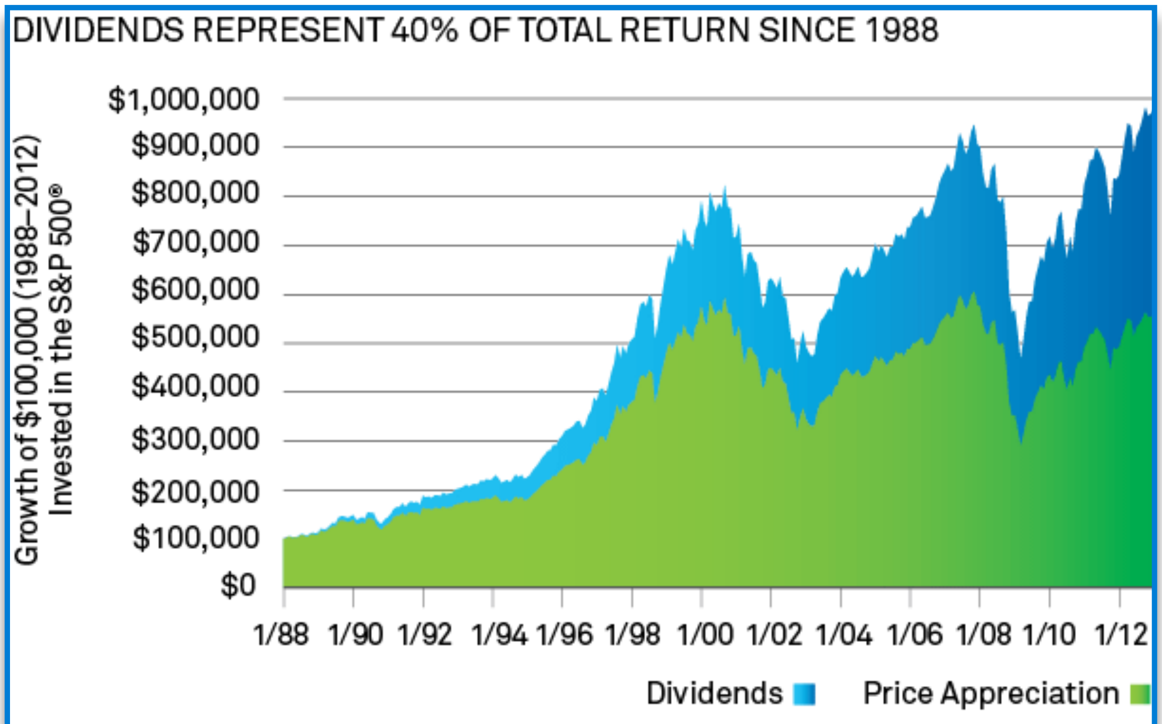
C. AUSTIN FITTS: Right.

CHUCK GIBSON: What you should take away from this is that diversification matters in an up market, and diversification does not matter in a down market. You can diversify away a lot of risks if you are going to be a buy and holder, but in a severe down market you can't.

C. Austin Fitts: Right.

Chuck Gibson: Now I want to go back to dividends because I know that is one of those things that you just absolutely are in favor of.

C. Austin Fitts: Yes. Dividends matter.



Chuck Gibson: They do. Let's take a look at Chart #16 which I think is my last chart. This is a chart of the S&P since 1988. The green area is what you would have gotten from price appreciation, and the blue area is the part that you get from dividends. What you can see is from 1988 dividends have represented 40% of your total returns. Forty percent!

C. Austin Fitts: That's tremendous!

Chuck Gibson: That's a huge amount! Over the long haul, dividends really do matter. They especially matter, as we pointed out in some of the other areas, when you are going through a sideways consolidative period.

C. Austin Fitts: Right. I should point out that Chuck did a really great equity overview on dividends. You can find it in the equity library, and it's really worth listening to.

Okay. Let's just talk briefly about value strategy, Chuck. Can you explain what a value strategy is and why it's important to consider having that as part of your strategy?

Chuck Gibson: Sure. You know, there have been numerous studies that value is a long-term outperformer than any other type of strategy, whether it's growth or momentum. There are all kinds of various and sundry types of investment strategies, but value over time is the most beneficial from a return standpoint.

So what you're looking for – whether it be sectors or regions or individual companies – you really want to find those companies that are undervalued. Now there is not one methodology that defines what undervalued is, but a lot of people might use price to book ratio – finding a company that is lower priced to book against their peers or a country that has a P/E ratio that is at 15 while the United States is at 25.

We know that you get reversions of mean, and what good, smart investors do is they put money in things that are undervalued and they eventually catch on and then they grow and they become overvalued. They take that money out of an overvalued area and put it into undervalued. It's kind of the concept of buying low and selling high.

C. Austin Fitts: I kind of call it 'putting money in cool companies' because you watch the pricing. We've certainly seen this on a company like Tesla. Sometimes I think people are just angry that innovation has been slow in certain ways so they said, "I don't care what the price earning is. I'm just going to buy Tesla as a protest vote."

It's my way of turning to Detroit and saying, "Go jump in a lake! I've had it with you guys! So I don't care what the price is; I'm just voting for this because it's a protest vote."

You get this situation where a company is considered to be very cool, and you look at the prices and it's hard to make economic sense out of the whole thing, but you look at the corollary – something that everybody thinks is uncool. It's buggy whips, it's uncool, and it's way underpriced relative to the cash flows and what the real opportunities are. It's sort-of buying it when it's uncool and selling it when it starts to get cool again. That's the way I think of it.

CHUCK GIBSON: One thing about the value strategy that investors have to consider is that for value investing you have to be patient.

C. AUSTIN FITTS: Very.

CHUCK GIBSON: In the emerging markets we know there are some very undervalued – maybe half the value of the United States – so it makes them very, very attractive, but frankly over the last three years they have been really terrible investments.

At some point in time that is going to change. So either you have to have a way to identify when they come out of their uncool state and be able to jump on board, or you have to buy in and be very patient.

C. AUSTIN FITTS: I put a link on the blogpost to the article at www.GuruFocus.com: Global Stock Market Valuations and Expected Future Returns, which I think does a really good job of explaining that phenomena as it is now, although I will say you and I were talking about that one study where they recommended after a year if it hasn't moved up at all.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Maybe it's not a value stock; maybe it's just a dog.

CHUCK GIBSON: Exactly.

C. AUSTIN FITTS: Okay, the last thing I wanted to mention. We've talked about buy and hold. We've talked about some of the things that matter.

I think a very important part of your strategy is what I would call a 'lifelong learning'.

I really encourage the subscribers to put something in their time budget to regularly go about educating themselves on investing and working on their financial matters steadily because I think the discipline of investing in that education and in that intention really pays off. I know it's something you do a lot of, Chuck. Maybe you could say just a few words about it.

CHUCK GIBSON: Well, part of it for me was because I was forced to. When you have certain credentials they force you to keep them up to date. I don't want to say that I'm trying to make myself better because it was really out of an obligation to maintain my credentials.

But what I found was that the investment world is changing unbelievably fast. Just to see what has happened since the year 2000 to where we are today, we have gone through two boom/bust cycles and are potentially going into a third one here. What has changed is that all the corollaries and all the things that we thought should happen that we were trained from a historical perspective to happen may not be relevant anymore.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: The only way that you can keep up with that if you are trying to stay abreast of the market and manage money is you have got to be able to recognize those and keep up with the market. Like technology, if you don't keep up, it's going to pass you by. That's not normally healthy for a portfolio.

C. AUSTIN FITTS: Well, there is something else. It's like gardening. What you pay attention to grows. So not only are you helping to grow your financial wealth, but I think it's a window on the world. I do think that with this process of securitization we are going through a process that is only going to happen once, and it is going to be a very, very big shift.

This really is a window on the world to a whole world economy that is changing in ways that we don't even begin to understand. You want to have a window onto that process because it's going to be – in some respects – that we are going from many little psychic storms to one big psychic storm, and who knows what is going to happen.

CHUCK GIBSON: Absolutely.

C. AUSTIN FITTS: So I want a window on that world, and the way to do it is to sit down once a week and open the window and peer out and see what you see.

CHUCK GIBSON: Then close it right away because a storm could be coming. You never know.

C. AUSTIN FITTS: Okay. Well, Chuck, this has been unbelievably informative. I thank you for all the work you've done on these slides. We look forward to checking in with you when we see how the year ends.

Until our big Annual Equity Overview, you have a great quarter.

CHUCK GIBSON: Thank you. You do the same. It was great talking with you.