

Often, conversations and queries we have with and receive from clients and advisors become the inspiration for our *folios* and *Perspectives*. The thinking being that if a clutch of folks have taken the time to reach out to us with a similar question or concern, others are likely wondering or having reservations about the same thing. Recently, we've received several emails and calls regarding the use of historical data with which to base future expectations on and the wisdom in buying hard assets. In hopes of making OCM's philosophy on these matters clearer, we've paraphrased two such inquiries, along with our response, below.

*I don't think our world today should be compared with "historical data." I am not sure there has been a time in recent history that has all the negative factors that we have today. I hope your firm is taking this into account when working on my portfolio.*

*Are any of your clients buying gold, or other hard assets?*

The comparison to historical data is based on the pure foundation of capitalism. Simply put, investors supply capital and are compensated with return for that capital. Markets are the mechanism with which capital is supplied to companies and from which investors are rewarded for taking risk. Furthermore, companies from around the world are competing for investor capital and investors compete with each other for investment returns. This competition drives prices to fair value, ensuring that no investor can expect greater returns without bearing greater risk.

If this weren't true, capitalism would have failed long ago.

Any reference to historical data is more a reference to this underlying principle. The long-term historical returns on different asset classes of different risk are still fundamentally intact. However, from time to time, investors can irrationally drive expected returns to extremes at the high end of euphoria or the low end of despair. (This is not to say that, every now and then, there are no fundamental reasons that short-term expected returns can temporarily deviate from the long-term historical or future expected returns.)

Yes, currently, the world faces many economic challenges, perhaps as many as at any other time, but not more. Unless we are convinced that capitalism is failing – that is, returns for risk are now completely gone -- then the opposite remains, and there will be return for taking risk.

Our work is to take measured risk, for which we believe our clients will be rewarded. Our task is to control that risk as much as possible through diversification – investing in different asset classes, with different expected returns (and of course, different and varying exposure, safety, security). We take this into account for each and every client.

At this time, we do not own hard assets (commodities) directly. Commodities are not a return-producing asset. Commodities do not produce profits in and of themselves. In capitalism, it is profits that drive value – or the return on capital to an investor.

Commodities, as an asset class, are simply a speculative allocation of capital. So, one purchasing a commodity in hopes of selling it to someone else at a future date for more than one paid is merely speculation. This involves a higher assumption of risk.

To put this in context, to purchase gold at today's price of nearly \$1,625 per ounce (down from \$1,800 when the most recent inquiries came), one must assume that someone will come along at a future date and pay more for that ounce of gold. The question that purchaser should be asking is why? Is there an obvious or pressing use for gold? Is it disappearing at such a rapid pace that supply is truly limited in our lifetime? It's difficult to make a sound argument, rooted in fundamentals, as to why gold will appreciate significantly at this point.

On the other hand, there are many companies that we can make sound judgments about in terms of future growth of profits. (Many of these companies share those profits with the investors that supplied the capital in the form of dividends; others choose to reinvest in the growth of the enterprise for increasing the future profits.) For example, companies that produce commodities mine or refine them for consumption. This is how we choose to have exposure to commodities. We have investments for clients in companies that produce coal, oil, copper, zinc, natural gas, energy and related products.