Turkey and S. Korea - Your Top Dogs of the World

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POITOU, FRANCE – The Dow rose another 100 points yesterday. Can anything stop this bull market?

At least we know the answer to that question: Yes.

When?

Longtime *Diary* sufferers know better than to trust our market timing advice. So rather than rely on our instincts, the Bor
Partners research department has developed a Doom Index to guide us.

What is it saying now?

—

Mixed Bag

For an update, we turn to our ace analyst in the back room, Joe Withrow.

But first, a bit of background…

The Doom Index is made up of 11 indicators:

1. Bank loan growth
2. Credit downgrades
3. Junk bond prices
4. Stock market valuations
5. Margin debt
6. Investor sentiment (contrarian indicator)
7. Manufacturing sentiment
8. Railcar traffic
9. Nonfarm payrolls
10. Household debt to disposable income
11. Quarterly building permits

Joe and his team update these on a quarterly basis. And each quarter, they award Doom Points based on what these i are saying.

When the index hits six or seven Doom Points, it's time to be cautious. When it hits eight or nine Doom Points, it's time
tattered "Crash Alert" flag.

Anything over a nine means stocks – and the economy – are in deep trouble.

So what's the latest? Joe:

> Most second-quarter data has come in. But we are still waiting for railcar use and building permit numbers. The ISM
> Manufacturing Index came back with another relatively strong reading. I expect we won't see much of a drop-off wit
> yet.
>
> The Doom Index stands at six now, which is our "soft warning" level.
>
> Here are the highlights from the second quarter: The Fed reported credit growth at 0.8%. This number is down from
> first-quarter report of 1.5%.
>
> We also saw an uptick in corporate bond downgrades this month. You can almost feel the tension in the credit mark
> junk bond prices are still holding up strong.
>
> Stock valuations remain high relative to historic levels. But our bullish investor sentiment indicator is coming back re
> low. The euphoria that precedes a major crash is not there.
>
> Household debt-to-income numbers are still at moderate levels as well. On the other hand, auto loans and student l
> through the roof.
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> So, all in all, the data coming in for the second quarter is a mixed bag.

Permanent Loss

We're no better than anyone else – and perhaps worse – at telling you when the next crash will come. Or even how. Bu
happen… we have no doubt.

And when it does, the loss – judging by similar events in the past – is likely to be more than 50%.

Worse, the loss could be almost permanent – as it has been in Japan.

The Japanese central bank has used every trick in the book to try to get its stock market back in the black – ZIRP
(zero-interest-rate policy), NIRP (negative-interest-rate policy), QE (quantitative easing), and the biggest government de
in the world.

But stock market prices are still less than half of what they were in 1989… 28 years ago.

As an investor, your goal is to try to get a decent return on your money without giving it up in a downturn. U.S. stocks c big risk. You want to avoid it.

This week, companies with a total of $3 trillion in market value will announce their results. Unless there are some surpri
will show modest increases in earnings.

But wait; there's something fishy here. Since 2009, earnings per share for U.S. companies have increased a spectacula
Sales, however, have gone up only 32%.

How is that possible? Another miracle?

Easy Money

When the cost of borrowing is low, companies prefer to get financing from debt. When it is high, they switch to equity –
stock.

Debt financing costs are as low as they have ever been; naturally, shrewd CFOs have borrowed heavily, increasing cor
by more than $1 trillion – a 50% rise – since the bottom of the last crisis.

What do they do with the money?

The economy is barely expanding. The typical American has no more real buying power than he had 35 years ago. It's
justify investments in extra goods and services when your customers have no more money to buy your output.

So what do you do?

You buy back your own shares and cancel them. This removes shares from the market, increasing earnings per share f
remaining shares. (Each remaining share then represents a higher portion of the company's earnings.)

Since 2009, the open market share count has gone down as earnings have gone up. According to Real Investment Adv
has added $1.60 per share to the earnings of the average company.

Instead of investing its money to produce more at a lower cost, corporate America has used debt financing to buy back
the highest prices in history.

Corporate chiefs get stock option bonuses (because share prices go up). But now the company is deeper in debt and fl
tide of easy money.

Tides go in and go out. This one will be no exception. And when this one goes out, corporate buyers will disappear – al
everyone else.

Dogs of the World

So what's an investor to do?

Again, we are incapable of giving investment advice. But we can tell you what we do.

For our own family account, we have money in stocks, gold, cash… and real estate.

Since we think we are nearing a financial catastrophe – this post-1971 credit bubble must pop sometime – we keep nearly half our liquid wealth in cash and gold, more than we would normally want.

As for stocks, we are never "in the market," merely hoping that it will go up. Instead, we have two main strategies.

First, we rely on colleague Chris Mayer to find "special situations," companies we want to own regardless of the up and down trends on Wall Street.

[**Editor's Note:** Bill recently committed $5 million from his family trust to following Chris Mayer's recommendations. Bill explains why right here.]

Second, we also follow a strategy based on Michael O'Higgins' "Dogs of the Dow" approach.

O'Higgins found that simply buying the cheapest stocks can pay off.

The problem is stocks are often cheap for good reason. Companies go broke. Their stocks go to zero and never come back. That almost never happens with entire stock markets.

Which is why we've modified O'Higgins' approach. Instead of buying the cheapest stocks on the Dow, we buy the cheapest country stock markets around the world.

This is our "Dogs of the World" portfolio.

Pampered Pooch

Last week, we reported that the U.S. stock market is now the world's most expensive, judged by a range of different tried-and-tested valuation metrics.

That makes the U.S. the least-attractive country market right now.

In our Dogs of the World portfolio, we look for the world's cheapest country stock markets and update it annually. One choice. Once a year. Easy-peasy.

Of course, this is not for people who check their portfolios daily… or even monthly.

Among the world's cheapest now, for example, are Turkey and South Korea.

Turkey is cheap because its government just narrowly survived a *coup d'état* in which military jets tried to shoot down the president's plane.

South Korea is cheap because North Korea aims its missiles in that direction.

Maybe these dogs will turn out to be good investments. Maybe not. But by our reckoning, they are safer bets than the pampered pooches of North America.

Regards,

Bill