BILLEAUD CAPITAL MANAGEMENT

Established 1986

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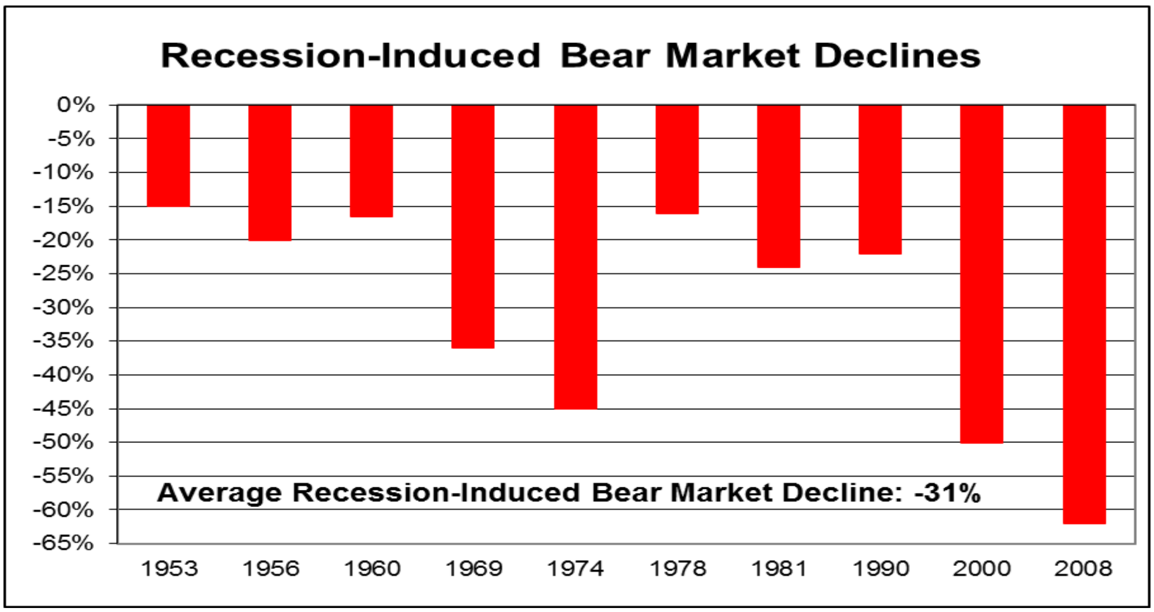
An Investment Primer

The Intersection of Expensive Markets and Recessions

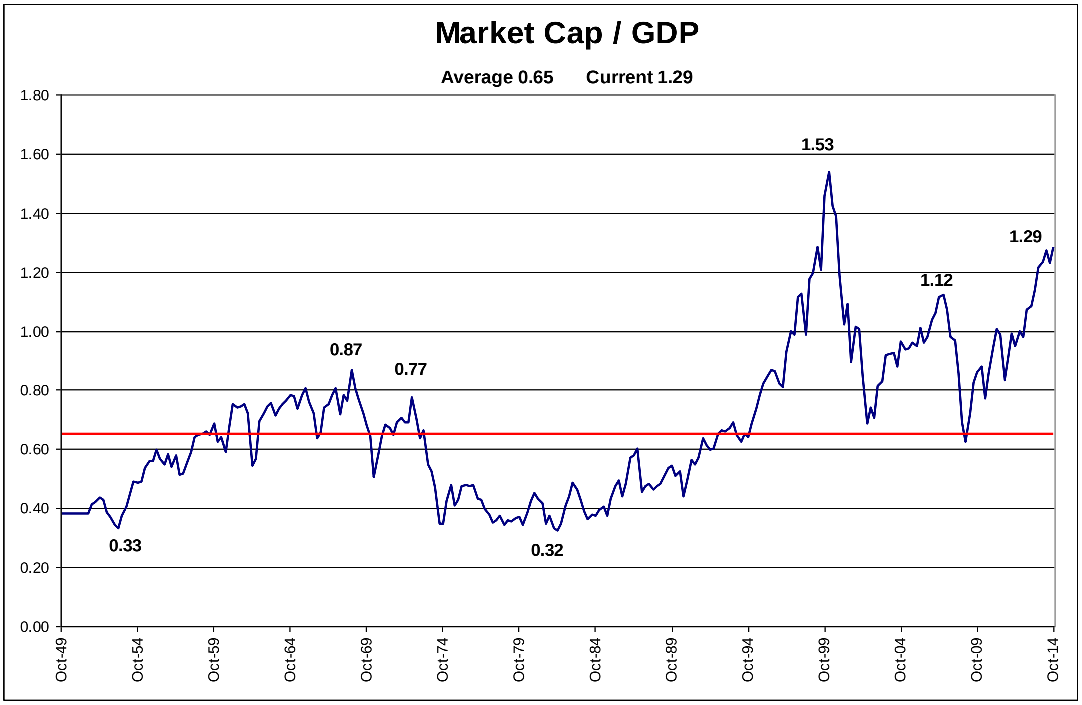
There have been 10 recession-induced bear markets since WWII. While each recession-induced downturn has been rough on stock prices, four have been particularly nasty: **1969 (down 36%), 1974 (down 45%), 2000 (down 50%) and 2008 (down 64%).**

1st Qtr. 2015 Returns	
Stocks	0.90%
Real Estate	4.02%
Long-Term Govt Bonds	4.00%
Interm-Term Mortgage Bonds	1.03%
Short-Term Govt Bonds	0.78%
Inflation-Protected Bonds	1.81%
Gold	0.07%



The chart on the following page shows a valuation measure which compares the total value of all listed stocks traded (Market Cap) to the size of the U.S. economy (GDP). This measure of market valuation is completely objective and overcomes the accounting discrepancies that tend to cloud many of the other commonly used measures of value. This valuation measure has many fans within the investment industry, including Warren Buffet who has described it as "probably the best single measure of where valuations stand at any given moment."

The long-term average value of this measure is 0.65 (denoted by the red horizontal line in the chart). So - by definition - anything above that represents a market that is valued above the long-term average, anything below that represents a market valued below that average. *The higher (or lower) the current value is from the 0.65 average, the more highly valued (or undervalued) the stock market is, as measured against that historical level.*



A quick glance will reveal that just before the downturns of 1969, 1974, 2000 and 2008 – the market cap to GDP measure was well above the 0.65 line. In fact, you could say that during those periods, not only did the market sport an above-average valuation, in some cases it was extreme. So when the recessions of those eras hit, the adjustments in stock prices were severe. It's a long fall from the top step.

What about today? Where does this measure now stand? Well, look at the chart - the market is once again significantly above the red line. In fact, it is now priced to reflect the second-highest level of overvaluation of the last 65 years, surpassed only by the grand dot.com, technology blow-off that characterized the late 1990's.

Ok, the Market is Expensive. So What. Can't An Expensive Market Just Get More Expensive?

Sure it can. An overvalued market, in and of itself, means nothing. Prices can certainly continue to climb, and often have. The late 1990's into the 2000 market peak is a textbook example. Where you can run into trouble however is when an overvalued market runs headlong into a recession. That event has the potential to be *material.*

While we generally avoid forecasts (*they violate BCM Investment Principle #3*), the lessons of history are worth noting. When the next recession does occur, we are going to go out on a limb here and guess that market participants will once again be schooled on the lessons of *risk* as well as reward. Remember the wisdom of Mike Tyson - "Everybody has a plan, until they get punched in the face".

We here at BCM have a plan, and rest assured, we will follow it. So long as our Market Risk Model remains in the low-risk environment (as it is now), we will hold and maintain our fully invested, diversified investment positions. If/when our risk model downgrades to a more high-risk outlook for the financial markets, we will take that change seriously and adjust our portfolios accordingly. We will do our best to try and stay ahead of the risk curve. This is our discipline, our philosophy, and represents the core of what we do.

Thank you again for your ongoing trust and confidence.