LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"All economic movements, by their very nature, are motivated by crowd psychology"
—Bernard Baruch

Both the stock and bond markets have come a long way over the last four or five years. Long-term government bond yields are now one half their peak level reached in 1981. Common stocks, as measured by the Dow Jones Industrial Average, have risen by approximately 140% since their 1982 low. Such dramatic changes in valuation over such a short time are relatively rare. This rise in the stock market, for example, is rivaled in the past 100 years only by the 1942-46 rise, the recovery after 1932, and the 1920's.

The primary underpinning for this significant change in the valuation of financial assets has been the decline in the rate of inflation from double digit levels in the late 1970's to a rate of about 1.5% for the past 12 months. Moreover, the financial markets have been buoyed by an unprecedented conjunction of favorable money flows. Fearing a deflationary collapse as a result of too much debt and too little growth or income to support that debt, the central banks of the industrialized world, through vigorous monetary policies, lowered interest rates. Lower interest rates caused investors to shun short-term instruments in favor of stocks and bonds causing their prices to rise. At the same time, corporations, not requiring additional plant and equipment, invested in stocks through repurchases and buyouts, and foreign investors, awash in dollars by virtue of their trade surpluses with the U. S., invested in our markets.

There are those who suggest that the above forces will continue and drive the financial markets to higher levels. That very well may be the case. So long as expanding purchasing power is created in the form of credit and not utilized for productive purposes because of declining consumption, it will continue to be funneled into the financial markets. Furthermore, it does not appear that crowd psychology has reached the level that characterized the major market peaks of the past. Whenever an asset generates superior returns over a lengthy period it attracts more and more investors who feel pressured to follow success and shift increasing funds into those assets which recently have demonstrated the greatest returns. A self-feeding process develops which eventually leads to a major overvaluation. The end comes only after a whole new set of excesses has been created, which at the time do not seem like excesses.

While the securities markets may work higher over the next several years, we remain cautious. The fundamental nature of our approach to investing suggests that in and of themselves and especially relative to bonds, stocks are not cheap. Therefore, we continue a selective approach to equity purchases with a bias toward yield and quality. Given relative valuation levels and our sense that inflation is unlikely to be troublesome in the near future, we are willing to allow investment reserves to build for lack of attractive opportunities and have a slight preference for bonds over most stocks.

Year End 1986

450 Regency Parkway, Suite 410 | Omaha, Nebraska 68114-3701 | *tel* 402.392.2606 | *fax* 402.392.2597 | www.lawsonkroeker.com