

Memo to: Oaktree Clients
From: Howard Marks
Re: There They Go Again . . . Again

Some of the memos I'm happiest about having written came at times when bullish trends went too far, risk aversion disappeared and bubbles inflated. The first and best example is probably "[bubble.com](#)," which raised questions about Internet and e-commerce stocks on the first business day of 2000. As I tell it, after ten years without a single response, that one made my memo writing an overnight success.

Another was "[The Race to the Bottom](#)" (February 2007), which talked about the mindless shouldering of risk that takes place when investors are eager to put money to work. Both of those memos raised doubts about investment trends that soon turned out to have been big mistakes.

Those are only two of the many cautionary memos I've written over the years. In the last cycle, they started coming two years before "[The Race to the Bottom](#)" and included "[There They Go Again](#)" (the inspiration for this memo's title), "[Hindsight First, Please](#)," "[Everyone Knows](#)" and "[It's All Good](#)." When I wrote them, they appeared to be wrong for a while. It took time before they were shown to have been right, and just too early.

The memos that have raised yellow flags in the current up-cycle, starting with "[How Quickly They Forget](#)" in 2011 and including "[On Uncertain Ground](#)," "[Ditto](#)," and "[The Race Is On](#)," also clearly were early, but so far they're not right (and in fact, when you're early by six or more years, it's not clear you can ever be described as having been right). **Since I've written so many cautionary memos, you might conclude that I'm just a born worrier who eventually is made to be right by the operation of the cycle, as is inevitable given enough time. I absolutely cannot disprove that interpretation.** But my response would be that it's essential to take note when sentiment (and thus market behavior) crosses into too-bullish territory, even though we know rising trends may well roll on for some time, and thus that such warnings are often premature. **I think it's better to turn cautious too soon (and thus perhaps underperform for a while) rather than too late, after the downslide has begun, making it hard to trim risk, achieve exits and cut losses.**

Since I'm convinced "they" are at it again – engaging in willing risk-taking, funding risky deals and creating risky market conditions – it's time for yet another cautionary memo. **Too soon? I hope so;** we'd rather make money for our clients in the next year or two than see the kind of bust that gives rise to bargains. (We all want there to be bargains, but no one's eager to endure the price declines that create them.) Since we never know when risky behavior will bring on a market correction, I'm going to issue a warning today rather than wait until one is upon us.

I'm in the process of writing another book, going into great depth regarding one of the most important things discussed in my book *The Most Important Thing*: cycles, their causes, and what to do about them. It will be out next year, but this memo will give you a preview regarding one of the most important cyclical phenomena.

Before starting in, I want to apologize for the length of this memo, almost double the norm. First, the topic is wide-ranging – so much so that when I sat down to write, I found the task daunting. Second, my recent vacation gave me the luxury of time for writing. Believe it or not, I’ve cut what I could. I think what remains is essential.

Today’s Investment Environment

Because I don’t intend this to be a “macro memo,” incorporating a thorough review of the economic and market environment, I’ll merely reference what I think are the four most noteworthy components of current conditions:

- **The uncertainties are unusual in terms of number, scale and insolubility** in areas including secular economic growth; the impact of central banks; interest rates and inflation; political dysfunction; geopolitical trouble spots; and the long-term impact of technology.
- In the vast majority of asset classes, **prospective returns are just about the lowest they’ve ever been.**
- **Asset prices are high across the board.** Almost nothing can be bought below its intrinsic value, and there are few bargains. In general the best we can do is look for things that are less over-priced than others.
- **Pro-risk behavior is commonplace,** as the majority of investors embrace increased risk as the route to the returns they want or need.

Ditto

In January 2013, I wrote a memo entitled “[Ditto](#).” Its thrust was that (a) history tends to repeat, (b) thus my memos often return to the same topics and (c) if I’ve handled them well in the past, rather than re-invent the wheel, I might as well borrow from what I’ve written before. Ergo, “ditto.”

Few topics are more susceptible to this treatment than the process through which (a) investment fundamentals fluctuate cyclically; (b) investors overreact to the fluctuations; (c) the level of risk aversion incorporated in investor behavior fluctuates between excessive and inadequate; and thus (d) market conditions swing from depressed to elevated and treacherous. Here’s how I summed up on this topic in “[There They Go Again](#)” (May 2005):

Given today’s paucity of prospective return at the low-risk end of the spectrum and the solutions being ballyhooed at the high-risk end, many investors are moving capital to riskier (or at least less traditional) investments. But (a) they’re making those riskier investments just when the prospective returns on those investments are the lowest they’ve ever been; (b) they’re accepting return increments for stepping up in risk that are as slim as they’ve ever been; and (c) they’re signing up today for things they turned down (or did less of) in the past, when the prospective returns were much higher. This may be exactly the wrong time to add to risk in pursuit of more

return. You want to take risk when others are fleeing from it, not when they're competing with you to do so.

Do you see any differences between then and now? Is there any need to redo this description? Not for me; I think "ditto" will suffice. I'll simply go on to borrow the conclusion from "[The Race to the Bottom](#)" (February 2007):

Today's financial market conditions are easily summed up: There's a global glut of liquidity, minimal interest in traditional investments, little apparent concern about risk, and skimpy prospective returns everywhere. Thus, as the price for accessing returns that are potentially adequate (but lower than those promised in the past), investors are readily accepting significant risk in the form of heightened leverage, untested derivatives and weak deal structures. The current cycle isn't unusual in its form, only its extent. There's little mystery about the ultimate outcome, in my opinion, but at this point in the cycle it's the optimists who look best.

The Seeds for a Boom

My son Andrew worked extensively with me in preparing this memo. We particularly enjoyed making a list of the elements that typically form the foundation for a bull market, boom or bubble. We concluded that some or all of the following are necessary conditions. A few will give us a bull market. All of them together will deliver a boom or bubble:

- **A benign environment** – good results lull investors into complacency, as they get used to having their positive expectations rewarded. Gains in the recent past encourage the heated pursuit of further gains in the future (rather than suggest that past gains might have borrowed from future gains).
- **A grain of truth** – the story supporting a boom isn't created out of whole cloth; it generally coalesces around something real. The seed usually isn't imaginary, just eventually overblown.
- **Early success** – the gains enjoyed by the "wise man in the beginning" – the first to seize upon the grain of truth – tends to attract "the fool in the end" who jumps in too late.
- **More money than ideas** – when capital is in oversupply, it is inevitable that risk aversion dries up, gullibility expands, and investment standards are relaxed.
- **Willing suspension of disbelief** – the quest for gain overcomes prudence and deference to history. Everyone concludes "this time it's different." No story is too good to be true.
- **Rejection of valuation norms** – all we hear is, "the asset is so great: there's no price too high." Buying into a fad regardless of price is the absolute hallmark of a bubble.
- **The pursuit of the new** – old timers fare worst in a boom, with the gains going disproportionately to those who are untrammelled by knowledge of the past and thus able to buy into an entirely new future.
- **The virtuous circle** – no one can see any end to the potential of the underlying truth or how high it can push the prices of related assets. It's broadly accepted that trees can grow to the sky: "It can only go up. Nothing can stop it." Certainly no one can picture things taking a turn for the worse.

- **Fear of missing out** – when all the above becomes widespread, optimism prevails and no one can imagine a glitch. That causes most people to conclude that the greatest potential error lies in failing to participate in the current market darling.

Certainly many of the things listed above are in play today. Performance has been good – with minor exceptions, quickly rectified – since the beginning of 2009 (that’s more than eight years). There’s certainly more money around these days than high-return possibilities. “New ideas” are readily accepted, and some things are viewed as representing virtuous circles.

On the other hand, some of the usual ingredients are missing. **Most people (a) are conscious of the uncertainties listed above, (b) recognize that prospective returns are quite skimpy, and (c) accept that things are unlikely to go well forever.** That’s all healthy.

But on the third hand, most people can’t think of what might cause trouble anytime soon. But it’s precisely when people can’t see what it is that could make things turn down that risk is highest, since they tend not to price in risks they can’t see. **With the negative catalyst so elusive and the return on cash at punitive levels, people worry more about being underinvested or bearing too little risk (and thus earning too low a return in good markets) than they do about losing money.**

This combination of elements presents today’s investors with a highly challenging environment. The result is a world in which assets have appreciated significantly, risk aversion is low, and propositions are accepted that would be questioned if investors were more wary.

Most of what remains for the meat of this memo will consist of descriptions of things afoot in the markets today. They are intended – as usual with my memos – to be anecdotal and thought-provoking, not complete and scientific. Think about how many of the things listed above you see in the examples that follow.

U.S. Equities

The good news is that the U.S. economy is the envy of the world, with the highest growth rate among developed nations and a slowdown unlikely in the near term. The bad news is that this status generates demand for U.S. equities that has raised their prices to lofty levels.

- The S&P 500 is selling at 25 times trailing-twelve-month earnings, compared to a long-term median of 15.
- The Shiller Cyclically Adjusted PE Ratio stands at almost 30 versus a historic median of 16. This multiple was exceeded only in 1929 and 2000 – both clearly bubbles.
- While the “p” in p/e ratios is high today, the “e” has probably been inflated by cost cutting, stock buybacks, and merger and acquisition activity. Thus today’s reported valuations, while high, may actually be understated relative to underlying profits.
- The “Buffett Yardstick” – total U.S. stock market capitalization as a percentage of GDP – is immune to company-level accounting issues (although it isn’t perfect either). It hit a new all-time high last month of around 145, as opposed to a 1970-95 norm of about 60 and a 1995-2017 median of about 100.

- Finally, it can be argued that even the normal historic valuations aren't merited, since economic growth may be slower in the coming years than it was in the post-World War II period when those norms were established.

The thing that is clearest is that the low Fed-mandated short-term interest rates make high valuations seem reasonable. When yields are low on fixed income instruments, low earnings yields on equities (that is, low e/p ratios, which equate to high p/e ratios) seem justified. As Buffett said in February, "Measured against interest rates, stocks actually are on the cheap side compared to historic valuations."

But he went on to say, ". . . the risk always is that interest rates go up a lot, and that brings stocks down." **Are you happy counting on continued low interest rates for your investment security, especially at a time when the Fed has embarked upon a series of rate increases?** And if interest rates do remain low for several more years, isn't it likely to be as a result of a lack of vigor in the economy, which would likely cause earnings growth to be sluggish?

VIX

The value of an option contract is largely a function of the volatility of the asset under option. For example, the owner of a "call" has the right – but not the obligation – to buy something at a fixed "strike price." Thus he should hope the asset will be volatile; if its price rises a lot, he can buy at the strike price and sell at the new, higher price, locking in a profit. And what if it goes down a lot? No matter; he isn't obligated to buy.

Thus the expected volatility of the underlying asset is a key ingredient in determining the proper price for an option. For example, everything else being equal, the more volatile an asset is expected to be, the more the buyer of a call should be willing to pay for it (since he participates in the gains but not the losses) and the more the seller of a call should charge for it (since he is forgoing upside potential but retaining downside risk). This is reflected through option-pricing formulas such as the Black-Scholes Model.

The formulas can also be used backwards. Starting with the option price, you can figure out what level of volatility the buyers and sellers are anticipating. Thus, ever since 1990, the Chicago Board Options Exchange has published the CBOE Volatility Index, or "VIX," showing how volatile investors in options on the S&P 500 expect it to be over the next 30 days. The attention paid to the VIX has increased in recent years, and it has come to be called the "complacency index" or the "investor fear gauge." When the VIX is low, investors are pricing in stable, tranquil markets, and when it's high they're anticipating major ups and downs.

The bottom line is that last week's VIX was the lowest in its 27-year history – matching a level seen only once before. The index was last this low when Bill Clinton took office in 1993, at a time when there was peace in the world, faster economic growth and a much smaller deficit. Should people really be as complacent now as they were then?

What's the significance of the VIX, anyway? **Most importantly, it doesn't say what volatility will be, only what investors think volatility will be.** Thus it's primarily an indicator of investor sentiment. In "[Expert Opinion](#)" I quoted Warren Buffett as having said, "Forecasts usually tell us

more of the forecaster than of the future.” In a similar way, the VIX tells us more about people’s mood today than it does about volatility tomorrow.

All we really know is that implied volatility expectations are low today. As with most things in investing, the VIX can be subject to multiple interpretations. As *Business Insider* wrote on July 18:

While alarmists may view this [low level of VIX] as a negative — a signal that complacency has made traders vulnerable to an unforeseen shock — many investors simply see it as a byproduct of conditions ideal for stocks to continue edging higher.

I would add one last thing: people extrapolate. So when volatility **has been** low, they tend to assume it **will be** low and build that assumption into the prices for options and assets. **The two are not the same.**

Super-Stocks

Bull markets are often marked by the anointment of a single group of stocks as “the greatest,” and the attractive legend surrounding this group is among the factors that support the bull move. When taken to the extreme – as it invariably is – this phenomenon satisfies some of the elements in a boom listed on page four, including:

- trust in a virtuous circle incapable of being interrupted;
- conviction that, given the companies’ fundamental merit, there’s no price too high for their stocks; and
- the willing suspension of disbelief that allows investors to extrapolate these positive views to infinity.

In the current iteration, these attributes are being applied to a small group of tech-based companies, which are typified by “the FAANGs”: Facebook, Amazon, Apple, Netflix and Google (now renamed Alphabet). They all sport great business models and unchallenged leadership in their markets. Most importantly, they’re viewed as having captured the future and thus as sure to be winners in the years to come.

True as far as it goes . . . just as it appeared to be true of the Nifty-Fifty in the 1960s, oil stocks in the ’70s, disk drive companies in the ’80s, and tech/media/telecom in the late ’90s. But in each of those cases:

- the environment changed in unforeseen ways,
- it turned out that the newness of the business model had hidden its flaws,
- competition arose,
- excellence in the concept gave rise to weaknesses in execution, and/or
- it was shown that even great fundamentals can become overpriced and thus give way to massive losses.

The FAANGs are truly great companies, growing rapidly and trouncing the competition (where it exists). But some are doing so without much profitability, and for others profits are growing slower

than revenues. Some of them doubtless will be the great companies of tomorrow. But will they all? Are they invincible, and is their success truly inevitable?

The prices investors are paying for these stocks generally represent 30 or more years of the companies' current earnings. There are clear reasons to be excited about their growth in the near term, but what about the durability of earnings over the long term, where much of the value in a high-multiple stock necessarily lies? Andrew points out that the iPhone is just ten years old, and twenty years ago the Internet wasn't in widespread use. That raises the question of whether investors in technology can really see the future, and thus how happy they should be paying prices that incorporate optimistic assumptions regarding long-term earnings power. Of course, this may just mean the best is yet to come for these fairly young companies.

Here's a passage from one company's 1997 letter to shareholders:

We established long-term relationships with many important strategic partners, including America Online, Yahoo!, Excite, Netscape, GeoCities, AltaVista, @Home, and Prodigy.

How many of these "important strategic partners" still exist in a meaningful way today (leaving aside the question of whether they're important or strategic)? The answer is zero (unless you believe Yahoo! satisfies the criteria, in which case the answer is one). The source of the citation is Amazon's 1997 annual report, and the bottom line is that the future is unpredictable, and nothing and no company is immune to glitches.

The super-stocks that lead a bull market inevitably become priced for perfection. And in many cases the companies' perfection turns out eventually to be either illusory or ephemeral. Some of the "can't lose" companies of the Nifty-Fifty were ultimately crippled by massive changes in their markets, including Kodak, Polaroid, Xerox, Sears and Simplicity Pattern (do you see many people sewing their own clothes these days?). Not only did the perfection that investors had paid for evaporate, but even the successful companies' stock prices reverted to more-normal valuation multiples, resulting in sub-par equity returns.

The powerful multiple expansion that makes a small number of stocks the leaders in a bull market is often reversed in the correction that follows, saddling them with the biggest losses. But when the mood is positive and things are going well, the likelihood of such a development is easily overlooked.

Finally, a rationale often arises to the effect that, thanks to market technicals, investors' powerful buying of the leading stocks is sure to continue non-stop, meaning they can't help but remain the best performers. In the tech bubble of the late 1990's, for example, investors concluded that:

- stocks were doing so well that they would continue to attract capital,
- since tech companies and tech stocks were the best performers, they were sure to continue attracting a disproportionate share of the new buying,
- the superior performance of the tech stocks would cause more of them to be added to the stock indices,
- this would require index funds and closet indexers to direct a rising share of their buying to tech stocks,

- in order to keep up with the returns on the indices, benchmark-conscious active managers would have to respond by increasing their tech stock holdings, and,
- thus tech stocks couldn't fail to attract an ever-rising share of buying, and were sure to keep outperforming.

You can call this a virtuous circle or a perpetual motion machine. It's the kind of thing that fires investors' imaginations in a bull market. But the logic that says it will work forever always collapses, sometimes just under its own weight, as was the case in 2000.

Many of the most important considerations in investing are counterintuitive. One of those is the ability to understand that no market, niche or group is likely to outperform the others forever. Given human nature, "the best" will always come eventually to be overpriced, even for their stellar fundamentals. Thus even if the fundamentals hold up, the stocks' performance from those too-high prices will become ordinary. And if they turn out not really to have been the best – or if their business falters – the combination of fundamental decline and multiple contraction can be really painful.

I'm not saying the FAANGs aren't great, or that they'll suffer such a fate. Just that their elevated status today is a sign of the kind of investor optimism for which we must be on the lookout.

Passive Investing/ETFs

Fifty years ago, shortly after arriving at the University of Chicago for graduate school, I was taught that thanks to market efficiency, (a) assets are priced to provide fair risk-adjusted returns and (b) no one can consistently find the exceptions. In other words, "you can't beat the market." Our professors even advanced the idea of buying a little bit of each stock as a can't-fail, low-cost way to outperform the stock-pickers.

John Bogle put that suggestion into practice. Having founded Vanguard a year earlier, he launched the First Index Investment Trust in 1975, the first index fund to reach commercial scale. As a vehicle designed to emulate the S&P 500, it was later renamed the Vanguard 500 Index Fund.

The concept of indexation, or passive investing, grew gradually over the next four decades, until it accounted for 20% of equity mutual fund assets in 2014. Given the generally lagging performance of active managers over the last dozen or so years, as well as the creation of ETFs, or exchange-traded funds, which make transacting simpler, the shift from active to passive investing has accelerated. Today it's a powerful movement that has expanded to cover 37% of equity fund assets. In the last ten years, \$1.4 trillion has flowed into index mutual funds and ETFs (and \$1.2 trillion out of actively managed mutual funds).

Like all investment fashions, passive investing is being warmly embraced for its positives:

- Passive portfolios have outperformed active investing over the last decade or so.
- With passive investing you're guaranteed not to underperform the index.
- Finally, the much lower fees and expenses on passive vehicles are certain to constitute a permanent advantage relative to active management.

Does that mean passive investing, index funds and ETFs are a no-lose proposition? Certainly not:

- While passive investors protect against the risk of underperforming, they also surrender the possibility of outperforming.
- The recent underperformance on the part of active investors may well prove to be cyclical rather than permanent.
- As a product of the last several years, ETFs' promise of liquidity has yet to be tested in a major bear market, particularly in less-liquid fields like high yield bonds.

Here are a few more things worth thinking about:

Remember, the wisdom of passive investing stems from the belief that the efforts of active investors cause assets to be fairly priced – that's why there are no bargains to find. But what happens when the majority of equity investment comes to be managed passively? Then prices will be freer to diverge from "fair," and bargains (and over-pricings) should become more commonplace. This won't assure success for active managers, but certainly it will satisfy a necessary condition for their efforts to be effective.

One of my clients, the chief investment officer of a pension fund, told me the treasurer had proposed dumping all active managers and putting the whole fund into index funds and ETFs. My response was simple: ask him how much of the fund he's comfortable having in assets no one is analyzing.

As Steven Bregman of Horizon Kinetics puts it, "basket-based mechanistic investing" is blindly moving trillions of dollars. ETFs don't have fundamental analysts, and because they don't question valuations, they don't contribute to price discovery. **Not only is the number of active managers' analysts likely to decline if more money is shifted to passive investing, but people should also wonder about who's setting the rules that govern passive funds' portfolio construction.**

The low fees and expenses that make passive investments attractive mean their organizers have to emphasize scale. To earn higher fees than index funds and achieve profitable scale, ETF sponsors have been turning to "smarter," not-exactly-passive vehicles. Thus ETFs have been organized to meet (or create) demand for funds in specialized areas such as various stock categories (value or growth), stock characteristics (low volatility or high quality), types of companies, or geographies. There are passive ETFs for people who want growth, value, high quality, low volatility and momentum. Going to the extreme, investors now can choose from funds that invest passively in companies that have gender-diverse senior management, practice "biblically responsible investing," or focus on medical marijuana, solutions to obesity, serving millennials, and whiskey and spirits.

But what does "passive" mean when a vehicle's focus is so narrowly defined? **Each deviation from the broad indices introduces definitional issues and non-passive, discretionary decisions.** Passive funds that emphasize stocks reflecting specific factors are called "smart-beta funds," but who can say the people setting their selection rules are any smarter than the active managers who are so disrespected these days? Bregman calls this "semantic investing," meaning stocks are chosen on the basis of labels, not quantitative analysis. There are no absolute standards for which stocks represent many of the characteristics listed above.

Importantly, organizers wanting their “smart” products to reach commercial scale are likely to rely heavily on the largest-capitalization, most-liquid stocks. For example, having Apple in your ETF allows it to get really big. Thus Apple is included today in ETFs emphasizing tech, growth, value, momentum, large-caps, high quality, low volatility, dividends, and leverage.

Here’s what Barron’s had to say earlier this month:

With cap-weighted indexes, index buyers have no discretion but to load up on stocks that are already overweight (and often pricey) and neglect those already underweight. That’s the opposite of buy low, sell high.

The large positions occupied by the top recent performers – with their swollen market caps – mean that as ETFs attract capital, they have to buy large amounts of these stocks, further fueling their rise. **Thus, in the current up-cycle, over-weighted, liquid, large-cap stocks have benefitted from forced buying on the part of passive vehicles, which don’t have the option to refrain from buying a stock just because its overpriced.**

Like the tech stocks in 2000, this seeming perpetual motion machine is unlikely to work forever. If funds ever flow out of equities and thus ETFs, what has been disproportionately bought will have to be disproportionately sold. **It’s not clear where index funds and ETFs will find buyers for their over-weighted, highly appreciated holdings if they have to sell in a crunch. In this way, appreciation that was driven by passive buying is likely to eventually turn out to be rotational, not perpetual.**

Finally, the systemic risks to the stock market have to be considered. Bregman calls “the index universe a big, crowded momentum trade.” A handful of stocks – the FAANGs and a few more – are responsible for a rising percentage of the S&P’s gains, meaning the stock market’s health may be overstated.

All the above factors raise questions about the likely effectiveness of passive vehicles – and especially smart-beta ETFs.

- Is Apple a safe stock or a stock that has performed well of late? Is anyone thinking about the difference?
- Are investors who invest in a number of passive vehicles described in different ways likely to achieve the diversification, liquidity and safety they expect?
- **And what should we think about the willingness of investors to turn over their capital to a process in which neither individual holdings nor portfolio construction is the subject of thoughtful analysis and decision-making, and in which buying takes place regardless of price?**

Credit

Corporate debt instruments are good candidates for spotting bull-market behavior given that (unlike equities, for example), we can readily determine their prospective returns. We know that, as described in “[The Race to the Bottom](#),” in overpopulated markets providers of credit compete to make loans and investments that embody low returns, weak structures and slender margins of safety.

Whatever the level of fundamental risk, sometimes the reward for bearing it is demonstrably inadequate, and sometimes it is highly excessive. **It's an over-simplification, but sometimes I think we could base our strategic decisions almost exclusively on the relationship between risk in the market and investors' willingness to bear it.**

It's very helpful to know – and a lot of my new book will be about – where we stand in that swing. In that regard, I'll remind you that “[The Race to the Bottom](#)” was prompted by a *Financial Times* article about U.K. banks' willingness to compete for mortgage business by increasing the multiple of annual income they would lend. Earlier this month, ironically, I read the following in another London newspaper, the *Daily Mail*:

In a chilling echo of the sub-prime mortgage crisis of 2007, car finance firms packaged and sold £5.5 billion of risky loan debt to investors last year – twice as much as the year before.

Such eagerness to finance low-quality loans will always be a sign of elevated, over-financed, risk-oblivious credit markets. At the late-2008 trough of the financial crisis, high yield bonds and leveraged loans yielded almost 2,000 basis points more than comparable Treasuries, meaning anyone who bought and held couldn't really lose. Then, as investors recovered their equilibrium and bought, prices rose and the yield spread contracted. Now the spread is merely average relative to history – a few hundred basis points. The net yields on these securities are still highly likely to be well in excess of those on Treasuries, but any capital appreciation would have to come from further spread contraction, and that certainly can't be counted upon.

The credit investors of today clearly aren't gun-shy, leaving investment opportunities to languish at excessive yields and yield spreads. At best these investments are fairly priced today in relative terms and fully priced – offering low returns like everything else – in absolute terms.

I'll use an example to illustrate the acceptance being accorded low-grade credit instruments. In early May, Netflix issued €1.3 billion of Eurobonds, the lowest-cost debt it ever issued. The interest rate was 3.625%, the covenants were few, and the rating was single-B. Netflix's GAAP earnings run about \$200 million per quarter, but according to *Grant's Interest Rate Observer*, in the year that ended March 31, Netflix burned through \$1.8 billion of free cash flow. It's an exciting company, but as *Grant's* reminded its readers, bondholders can't participate in gains, just losses. **Given this asymmetrical proposition, any bond issue should be characterized by solidity and a meaningful promised return, not the sex appeal of its issuer.**

Is it prudent to lend money to a company that goes through it at such a prodigious rate? Will Amazon or Google be able to loosen Netflix's hold on its customers? Is it wise to buy bonds based on a technology position that could be overtaken? Positive investor sentiment has taken the company's equity value to \$70 billion; what would happen to the bond price if worries about rising competition took a bite out of that one day? **Should you take these risks to make less than 4% per year? In Oaktree's view, this isn't a solid debt investment; it's an equity-linked digital content investment totally lacking in upside potential, and it's not for us. The fact that deals like this can get done easily should tell you something about today's market climate.**

Finally, let's consider whether risk tolerance and carefree behavior are isolated or widespread in today's credit market. Here are some quotes from a July 14 article by Lisa Abramowicz of *Bloomberg Gadfly* (emphasis added):

Over the last eight years, junk-rated corporate debt has been transformed from a fringe asset to a staple for many fixed-income investors. As they've become more popular, these risky bonds and loans have increasingly lost a feature that made them so attractive (and lucrative) – the investor protections known as covenants written into the documents that govern the debt. These are aimed at ensuring investors can recover their money if the company fails.

Last month, the \$26.9 billion of junk bonds sold had the highest proportion of deals on record with weak investor protections, Moody's Investor Service reported this week. About 60 percent of the risky U.S. corporate bonds sold had few protections written into their deal documents, Moody's said. In the leveraged-loan market, nearly three quarters of the debt is "covenant lite" after three years of record issuance . . .

Investors have grown so confident about the seemingly interminable corporate-debt rally that many are dismissing the likelihood of large swaths of risky companies going bankrupt. After all, these covenants usually don't matter until there's a problem.

It's a standard cycle: cautious investing produces good performance in a salutary environment . . . which leads to a reduction of caution . . . which leads to bad performance when the environment turns less favorable. This is part of the race to the bottom I wrote about in 2008.

Emerging Market Debt

The emerging markets are another place where investor opinion fluctuates wildly and visibly. "Everyone knows" the emerging markets have more growth potential than the developed world, but attitudes regarding the realizability of that potential – and thus the price one should pay for it – gyrate wildly over time.

I described the phenomenon in "[The Role of Confidence](#)" (August 2013). When confidence is running high, the emerging markets are viewed as being just like developed markets, only faster-growing, meaning it's reasonable for their securities to sell at yields and p/e ratios like those in the developed world. But when confidence declines, it becomes clear that there are risks that don't exist in the developed world – like coups, institutionalized corruption, maxi-devaluation and debt repudiation – and thus significant valuation discounts are in order. Again, as with corporate credit, which is this? **Are investors appropriately sensitive to the risks and imposing reasonable discounts, or are they ignoring the risks and happily paying up?** That's a lot of what you have to know.

To answer the question, I'll make reference to \$2.75 billion of bonds that were issued by Argentina in mid-June. The maturity was 100 years – "century bonds" – and the interest rate was 8%.

You might have thought this would be a hard thing to sell. After all, Argentina had defaulted on its debts eight times in its 200-year history, with no fewer than five defaults in the past century alone, most recently in 2014 amid a legal dispute with the Elliott hedge fund. . . .

But investors do not seem to care: there were \$9.75bn of bids. And Argentina is not the only peculiar event in bond markets this month. Take a look, for example, at Ivory Coast. In recent weeks, this West African nation underwent yet another military uprising. But this month it sold 16-year bonds with a 6.25 per cent yield – and these were also heavily oversubscribed. Places such as Senegal and Egypt have also seen hot demand for their debt. (*Financial Times*, June 27)

To conclude on this subject, I can't resist citing (but am too polite to name) the head of research and strategy for a likewise-unnamed broker/investment bank:

"It's just shocking that they exit default and their bond issue is a century bond," said [Ms. X]. . . Nevertheless, she is advising her clients to buy the bonds as at least a short term trade.

Let me get this straight: it's incredible that Argentina is able to issue this thing, but it's a good buy for a moment. **It's a sign of the times: "something may go wrong, but probably not soon."** I much prefer Warren Buffett's view: "If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes."

For only the third time in history, emerging market debt is selling at yields below those on U.S. high yield bonds. Is Argentina, a country that defaulted five times in the last hundred years (and once in the last five), likely to get through the next hundred without a rerun?

The essential bottom line in all investing is simple: is the risk premium at least adequate? Can we answer in the affirmative with regard to emerging market debt today?

Private Equity

In today's low-return world, it's clear that institutional investors needing 7-8% a year aren't likely to get it from Treasuries yielding 1-2%, high grades at 3-4%, or mainstream stocks that most people expect to return 5-6%. *Heck, you can't even get it from Ivory Coast bonds!* Where is one to turn?

The good news for firms like Oaktree is that the answer is felt to most likely lie in what have come to be called "alternative investments" (there was no collective term for them when my partners and I started off 30 years ago). Since essentially no public "beta" markets offer the returns institutions need, many have turned instead to so-called "alpha strategies," where skillful, active management has the potential to augment market returns, producing what's needed.

But one of the biggest alternatives categories – hedge funds – has been largely discredited as a result of the meager average return over the last dozen years. And some of the others, like venture capital, are hard to access and too small to absorb much capital. That brings investors mainly to real estate, distressed debt and, especially, private equity.

Private equity firms market double-digit return track records, and even their top-of-the-cycle 2005-07 funds now sport respectable gains. As a result, they're attracting capital at all-time-high rates:

Private equity is experiencing the best fundraising climate in years – perhaps ever. In the first half of the year, 224 North America-focused funds closed, raising \$133 billion, while globally there have been 412 private equity funds closed, which raised a combined \$221.4 billion, surpassing slightly the record \$220.8 billion raised in 2008, according to Preqin. (*Mergers & Acquisitions* newsletter)

Private equity funds have been raising total capital in the hundreds of billions for the last few years, and even before the latest spate of mega-funds, they already had several hundred billion of “dry powder.” Importantly, since private equity managers mostly engage in leveraged buyouts, these amounts have to be viewed in terms of the levered-up total capital they'll produce. Thus the PE firms will probably add more than a trillion dollars to their buying power this year. Where will it be invested at a time when few assets can be bought at bargain prices? Sellers of private companies, too, tend to set asking prices for their firms based on what cash flows are worth in this low-return world.

I'm not saying private equity isn't a solution, or even that it's not the best solution. It's just that **its record fund-raising is yet one more sign of the willingness of investors to trust in the future.**

SoftBank Vision Fund

Perhaps the ultimate demonstration of faith in fund managers is SoftBank's recent raising of \$93 billion for its Vision Fund for technology investments – presumably on the way to \$100 billion. SoftBank is a Japanese telecom company showing an 18-year annual return of 44% on investments that have included chipmakers, ride-hailing and telecom. But I see issues with the fund:

First, SoftBank's record of investment success has relied heavily on one phenomenal investment. The \$20 million Softbank invested in Alibaba in 2000 has grown in value to more than \$50 billion. **Skill or luck? And extrapolatable?**

Second, size matters. In 1999/2000, the venture capital industry got into trouble because it followed massively successful mid-1990s funds of hundreds of millions, with funds of \$1-2 billion. The Vision Fund isn't for startups, but still, can you wisely invest \$100 billion in technology?

Third, here's an organization that has never managed money for third parties, starting the biggest fund in history to do just that. Is their experience transferrable? **In all these regards I think the fund indicates a high level of enthusiasm and a low level of skepticism.**

Fourth, and perhaps more importantly for my purposes here, I want to spend some time on the fund's structure. For each 38 cents they put into the fund's equity, outside investors are required to put 62 cents into preferred units of the fund. On the other hand, SoftBank itself invested \$28 billion in equity but nothing in preferred.

- That means when the fund reaches \$100 billion, SoftBank will have put up only 28% of the capital but will own 50% of the equity. Adding in management fees and carried interest, its 28% of the capital may give it 60-70% of the gains.
- Even the private equity industry – with its willingness to take risk – has traditionally shied away from piling debt on technology companies (although less so lately). SoftBank doesn't hesitate to lever its tech investments.
- The preferred units will pay a 7% annual coupon. Lending money to a tech fund at that modest rate apparently is part of the price demanded of the LPs for an opportunity to invest in the fund's equity. I can imagine the sales pitch about how lucky the LPs are to get a chance to provide leverage for their own investment, but I doubt I'd be convinced.
- Finally, as the *Financial Times* wrote on June 11:

While the preferred unit holders will eventually receive their principal back [plus 7% per year], they will only receive [an equity] return for the equity portion of their investment in the fund.

All outside backers of the fund are receiving 62 per cent in preferred units and the rest in equity, allowing them to reduce their downside risk, while still generating a good return.

Sounds good on the surface. But how much does this diversion of the investors' capital into preferred units really reduce their downside risk? **The FT says investors in the preferred units “will eventually receive their principal back.” Should that really be “will,” or perhaps “may” or “hopefully will”?** Does a \$100 million investment in the fund put only the \$38 million of equity at risk, or is there risk associated with the preferred, too? I guess I don't consider the preferred units as rock-solid as the *FT* suggests. Aren't they more like the Netflix bonds: tech-linked downside with no upside? Would an arm's-length lender give an LP money at 7% to lever his equity in this fund 1.6 times?

The willingness of investors to invest in a shockingly large fund for levered tech investing with a questionable structure is a further indication of an exuberant, unquestioning market.

Digital Currencies

The discussion of innovative investments brings me to Bitcoin, Ether and other digital currencies. I'd guess these things have arisen from the intersection of (a) doubts about financial security – including the value of national currencies – that grew out of the financial crisis and (b) the comfort felt by millennials regarding all things virtual. But they're not real.

Some businesses accept Bitcoin as payment. Some buyers want to own Ether because it can be used to pay for computing power on the Ethereum network. Some people are eager to speculate on digital currency for profit. Others want to put a little money into these to-date-profitable phenomena rather than run the risk of missing out. But they're not real!

People tell me these currencies are solid, because (a) they're secure against hacking and counterfeiting and (b) the software used to generate them strictly limits the amount that can be

created. **But they're not real!!!!** Nobody has been able to make sense to me of these currencies. Here are a few paragraphs on Ether from *The New York Times* of June 19:

The sudden rise of Ethereum highlights how volatile the bewildering world of virtual currency remains, where lines of code can be spun into billions of dollars in a matter of months. . . .

Ethereum was launched in the middle of 2015 by a 21-year-old college dropout, Vitalik Buterin . . . Mr. Buterin was inspired by Bitcoin, and the software he built shares some of the same basic qualities. Both are hosted and maintained by the computers of volunteers around the world, who are rewarded for their participation with new digital tokens that are released into the network every day.

Because the virtual currencies are tracked and maintained by a network of computers, no government or company is in charge. The prices of both Bitcoin and Ether are established on private exchanges, where people can sell the tokens they own at the going market price. . . .

Many [new currency] applications being built on Ethereum are also raising money using the Ether currency, in what are known as initial coin offerings, a play on initial public offerings.

Start-ups that have followed this path have generally collected Ether from investors and exchanged them for units of their own specialized virtual currency, leaving the entrepreneurs with the Ether to convert into dollars and spend on operational expenses.

These coin offerings, which have proliferated in recent months, have created a surge of demand for the Ether currency. Just last week, investors sent \$150 million worth of Ether to a start-up, Bancor, that wants to make it easier to launch virtual currencies.

Bottom line: you can use the imaginary currency Ether to buy other new imaginary currencies, or to invest in new companies that will create other new currencies. In "bubble.com," I highlighted some illogical aspects of e-commerce by including some of my father's old jokes regarding how to make money. Here's another that seems 100% appropriate for the digital currency movement:

Two guys meet in the street. Joe tells Bob about the hamster he has for sale: pedigreed and highly intelligent. Bob says he'd like to buy a hamster for his kid: "How much is it?" Joe answers, "half a million," and Bob tells him he's crazy.

They meet again the next day. "How'd you do with that hamster?" Bob asks. "Sold it," says Joe. "Did you get \$500,000?" Bob asks. "Sure," says Joe. "Cash?" "No," Joe answers, "I took two \$250,000 canaries."

One of my very favorite quotes concerning the market's foibles, from John Kenneth Galbraith, says that in euphoric times, **"past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present."**

Maybe I'm just a dinosaur, too technologically backward to appreciate the greatness of digital currency. But it is my firm view that **the ability of these things to gain acceptance is just one more proof of the prevalence today of financial naiveté, willing risk-taking and wishful thinking.**

In my view, digital currencies are nothing but an unfounded fad (or perhaps even a pyramid scheme), based on a willingness to ascribe value to something that has little or none beyond what people will pay for it. But this isn't the first time. The same description can be applied to the Tulip mania that peaked in 1637, the South Sea Bubble (1720) and the Internet Bubble (1999-2000).

Serious investing consists of buying things because the price is attractive relative to intrinsic value. Speculation, on the other hand, occurs when people buy something without any consideration of its underlying value or the appropriateness of its price, solely because they think others will pay more for it in the future.

It isn't unreasonable for someone to use Bitcoin to pay for something – or for a seller to accept Bitcoin in payment – based on an agreement between the parties: barter takes place all the time. But does that make it “currency”?

The price of Bitcoin has more than doubled since the start of the year. Can something that does that seriously be considered a “medium of exchange” or “store of value,” rather than the subject of a speculative mania? Maybe not, but Bitcoin looks staid in comparison to Ether, which has appreciated 4,500% so far this year. The outstanding Ether is now worth 82% as much as all the Bitcoin in the world, up from 5% at the beginning of the year.

The New York Times notes that together, the outstanding Bitcoin and Ether are worth more than Paypal and almost as much as Goldman Sachs. Would you rather own all of the two digital currencies or one of those companies? In other words, are these currencies' values real? They're likely to keep working as long as optimism is present, but their performance in bad times is far from dependable. **What will happen to Bitcoin's price and liquidity in a crisis if people decide they'd rather hold dollars (or gold)?**

We Agree, But . . .

Andrew told me about a conversation he had recently with some fund managers, in which he went over a lot of what I'm discussing here. Given today's conditions, their response started predictably: “We agree, but . . .”

We hear a lot of that these days:

- We agree, but the things we're doing offer higher returns than the rest.
- We agree, but cash isn't an option when it returns nearly nothing.
- We agree, but we can't take the risk of being out of the market.
- We agree, but there's no alternative.

Investors should choose their risk posture based on an assessment of what's being offered in terms of absolute return, absolute risk, and thus absolute risk-adjusted return. But today – on that famous other hand – investors generally don't have the luxury of holding out for absolute returns and safety like they enjoyed in the past.

Many of the things I've highlighted above offer good returns and risk premiums relative to the returns on Treasuries and high grade debt. But (a) low rates may be – generally are expected to be – a temporary condition and (b) it might be wiser to gauge reward in absolute terms. **The bottom line is that while the prices and prospective returns on many things are justifiable today relative to other things, you can't eat (or spend) relative returns.**

Everyone's investing on the basis of relatives these days; they see no alternative. But that reminds me of former Citigroup CEO Chuck Prince, who gained fame in the months leading up to the Global Financial Crisis for saying of the bank's leveraged lending practices, "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." **Today I think most investors know the good times will end someday, as Prince did, but for now they feel they, too, have no choice but to dance.**

And there's one other thing we hear a lot these days:

- We agree things can't go well forever – we agree the cycle is extended, prices are elevated and uncertainty is high – but we don't see anything that's likely to bring the bull market to a close anytime soon.

In other words, there'll be a time for caution, just not today. In that connection, Andrew reminds me about Saint Augustine, who said: "Give me chastity and continence, but not yet." **Is there something other than the punitive returns on safe assets that keeps this from being a time for caution?**

Observations and Implications

As I said, most of the phenomena described above seem reasonable given the rest of what's going on in today's economic and financial world. But step back for perspective and put them together, and what do we see?

- Some of the highest equity valuations in history.
- The so-called VIX index of fear at an all-time low.
- The elevation of a can't-lose group of stocks.
- The movement of more than a trillion dollars into value-agnostic investing.
- The lowest yields in history on low-rated bonds and loans.
- Yields on emerging market debt that are lower still.
- The most fundraising in history for private equity.
- The biggest fund of all time raised for levered tech investing.
- Billions in digital currencies whose value has multiplied dramatically.

I absolutely am not saying stocks are too high, the FAANGs will falter, credit investing is risky, digital currencies are sure to end up worthless, or private equity commitments won't pay off.

All I'm saying is that for all the things listed above to simultaneously be gaining in popularity and attracting so much capital, credulousness has to be high and risk aversion has to be low. It's not that these things are doomed, just that their returns may not fully justify their risk. And, more importantly, that they show the temperature of today's market to be elevated. Not a nonsensical bubble – just high and therefore risky.

Try to think of the things that could knock today's market off kilter, like a surprising spike in inflation, a significant slowdown in growth, central banks losing control, or the big tech stocks running into trouble. The good news is that they all seem unlikely. The bad news is that their unlikelihood causes all these concerns to be dismissed, leaving the markets susceptible should any of them actually occur. **That means this is a market in which riskiness is being tolerated and perhaps ignored, and one in which most investors are happy to bear risk. Thus it's not one in which we should do so.**

What else:

- My observations are always indicative, not predictive. **The usual consequences of the conditions I describe – like an eventual increase in risk aversion – should happen, but they don't have to happen.**
- **And they certainly don't have to happen soon.** No one knows anything about timing. Certain consequences are implied, but even if they're going to happen, we have no way of knowing when. It feels like we're in the eighth inning, but I have no idea how long the game will go on.
- **I'm never sure of my market observations.** As you'll see in my new book, I believe strongly that where we are in a cycle says a lot about the market's likely tendencies, but I never state opinions on this subject with high confidence.
- **As a natural worrier, I tend to be early with warnings,** as described on page one. 'Nuff said.
- **Finally, while my observations are uncertain and should be taken with a grain of salt, what I am sure of is that valuations and markets are elevated, and the easy money in this cycle has been made.**

What to Do

To me, the four components of the current environment listed on pages 2 and 3 – high uncertainty, low prospective returns, high prices and pro-risk behavior – are indisputable. The question is whether you agree. If so, I trust you'll grant that they make for a troubling combination. Markets normally respond to elevated uncertainty with lower asset prices and compensatorily higher returns. But not today. Thus we're living in a low-return, high-risk world. Period.

For that reason, this might seem like an attractive time to refrain from investing, or at least from bearing risk. However, organizations for which investing is an essential part of the business model – like pension funds, insurance companies, endowments and sovereign wealth funds – generally don't have the option to not invest. That's especially true when the return on cash is as low as it is today.

Further, the case for cash that can be built today from all the above could have been made years ago, and doing so would have resulted in huge penalties. Oaktree's investment philosophy

generally causes us to eschew the raising and lowering of cash. We might make an exception in extraordinary circumstances, but today doesn't seem to warrant doing so. **Instead, Oaktree will continue to follow its 2012 mantra: “move forward, but with caution” – and, given today’s conditions, with even more caution than in the recent past. If one is going to invest at times like this, investment professionalism – knowing how to bear risk intelligently, striving for return while keeping an eagle-eye on the potential adverse consequences – is the absolute *sine qua non*.**

Environments like today’s call to mind the applicability of something I was told more than 40 years ago by Sid Cottle, editor of the later editions of Graham and Dodd’s *Security Analysis*: **“Investment is the discipline of relative selection.”** I interpret that to mean we have no alternative but to choose from among the available options based on their relative merit.

[“There They Go Again”](#) was written in May 2005, at the front end of a string of cautionary memos leading up to the last cyclical peak. It was the first time I explicitly raised the question – too early as usual – of how one should invest in a low-return world. I went on to list a few possibilities, none of which was sure to work, but I concluded with the one thing I was convinced of:

... there’s no easy answer for investors faced with skimpy prospective returns and risk premiums. But there is one course of action – one classic mistake – that I most strongly feel is wrong: **reaching for return.**

The events of 2007 and 2008 showed this observation to have been prudent and appropriate. And given today’s similarities to the last cycle, I think it’s applicable again.

Here’s a great observation on the subject from Berkshire-Hathaway’s 2010 letter to shareholders:

We agree with investment writer Ray DeVoe’s observation, “More money has been lost reaching for yield than at the point of a gun.”

Or as Peter Bernstein put it, “The market is not an accommodating machine; it won’t give you high returns just because you need them.”

The key strategic decision for anyone shaping investment strategy is whether to apply aggressiveness or defensiveness at a given point in time. In other words, should we worry more today about losing money or about missing opportunity? The answer at all times depends on what’s available in the investment environment.

- I have no doubt that the ascent to the apex from which the Global Financial Crisis took place was powered by the willing acceptance of risk in the low-return world of 2004-07. **In other words, excessive risk tolerance and the resulting incautious behavior provided the foundation for the vast losses experienced in the move from peak to trough.**
- And in the trough of late 2008/early '09, I likewise have no doubt that most investors were saying, “I don’t care if I ever make another penny in the market; I just don’t want to lose any more. Get me out!” **Their excessive risk aversion created the opportunity for the huge returns enjoyed in the recovery.**

Where are we today? As I said earlier, risk is high and prospective return is low, and the low prospective returns on safe investments are pushing people into taking risk – which they're willing to do – at a time when the reward for doing so is low.

Given my view of the environment, the only reason to be aggressive today is because defensive investing implies low prospective returns. But the question is whether pursuing high expected returns through aggressiveness can be counted on to be rewarded. If the answer is no, as I believe, then this is a time for caution.

That doesn't mean you have to be content with a low-return portfolio. If you need returns higher than those available in the beta markets at the low-risk end of the spectrum, it is reasonable to move into riskier asset classes. **But for every asset class, there are high-risk and low-risk approaches. When the market is rational, low-risk investments will always appear to offer prospective returns lower than those on high-risk ones. But in tough times, the former are less likely to bring losses than the latter. In my opinion that makes them right for today.**

* * *

Perhaps the best way to understand investment cycles is through that great statement attributed to Mark Twain: "History doesn't repeat, but it does rhyme." The duration, pace, amplitude and details of each investment cycle are different from those of its predecessors, but the basic themes and essential ingredients are usually vaguely familiar. What Twain calls rhyming history I describe as "common threads."

The themes or threads that repeatedly characterize too-bullish markets are the ones listed on page 4. **While they don't all have to be present for a top, bull market or boom to form, (a) usually many are present when one does and (b) it's hard for a full-throated bubble to come into existence without them. They truly are the raw materials for market excesses on the upside.**

On the other hand, the keys to avoiding the classic mistakes also recur, and I listed them in "[There They Go Again](#)":

- awareness of history,
- belief in cycles rather than unabated, unidirectional trends,
- skepticism regarding the free lunch, and
- insistence on low purchase prices that provide lots of room for error.

Adherence to these things – all parts of the canon of defensive investing – invariably will cause you to miss the most exciting part of bull markets, when trends reach irrational extremes and prices go from fair to excessive. **But they'll also make you a long-term survivor. I can't help thinking that's a prerequisite for investment success.**

The checklist for market sanity and safety is simple, and the answers will tell you what to do:

- Are prospective returns adequate?
- Are investors appropriately risk-averse?
- Are they applying skepticism and discipline?
- Are they demanding sufficient risk premiums?
- Are valuations reasonable relative to historic standards?
- Are deal structures fair to investors?
- Are investors declining any of the new deals?
- Are there limits on faith in the future?

The basic proposition is simple: Investors make the most and the safest money when they do things other people don't want to do. But when investors are unworried and glad to make risky investments (or worried but investing anyway, because the low-risk alternatives are unappealing), asset prices will be high, risk premiums will be low, and markets will be risky. That's what happens when there's too much money and too little fear.

I'll close with a final "ditto," from "[The Race to the Bottom](#)" of just over ten years ago:

If you refuse to fall into line in carefree markets like today's, it's likely that, for a while, you'll (a) lag in terms of return and (b) look like an old fogey. But neither of those is much of a price to pay if it means keeping your head (and capital) when others eventually lose theirs. In my experience, times of laxness have always been followed eventually by corrections in which penalties are imposed. It may not happen this time, but I'll take that risk. In the meantime, Oaktree and its people will continue to apply the standards that have served us so well over the last [thirty] years.

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