

Memo to: Oaktree Clients

From: Howard Marks

Re: Ditto

Here's how I started *Whad'Ya Know* in March 2003:

I always ask Nancy to read my memos before I send them out. She seems to think being my wife gives her license to be brutally frank. "They're all the same," she says, "like your ties. They all talk about the importance of a high batting average, the need to avoid losers, and how much there is that no one can know."

The truth is, anyone who reads my memos of the last 23 years will see I return often to a few topics. This is due to the frequency with which themes tend to recur in the investment world. Humans often fail to learn. They forget the lessons of history, repeat patterns of behavior and make the same mistakes. As a result, certain themes arise over and over. Mark Twain had it right: "History doesn't repeat itself, but it does rhyme." The details of the events may vary greatly from occurrence to occurrence, but the themes giving rise to the events tend not to change.

What are some of my key repeating themes? Here are a few:

- the importance of risk and risk control
- the repetitiveness of behavior patterns and mistakes
- the role of cycles and pendulums
- the volatility of credit market conditions
- the brevity of financial memory
- the errors of the herd
- the importance of gauging investor psychology
- the desirability of contrarianism and counter-cyclicalities
- the futility of macro forecasting

Most or all of these have to do with behavior that's observed in the markets over and over. When I see it recur and want to comment, I'm often tempted to dust off an old memo, update the details, and just insert the word "ditto." But I don't, because there's usually something worth adding.

Cycles

One of the most important themes in investing – and one I often find worthy of discussion – relates to cycles. What is a cycle? Dictionaries define it as "a series of events that are regularly repeated in the same order" or "any complete round or series of occurrences that repeats or is repeated." And here's the definition of the term "business cycle": "The recurring and fluctuating levels of economic activity that an economy experiences over a long period of time."

As you can see, the common thread is the concept of a series of events that is repeated. Many people think of a cycle as a continuous pattern in which a rise is followed by a fall, followed by another rise and another fall, and so forth.

These definitions are fine as far as they go, but I think they all miss something very important: the sense that each of the events in a cycle not only follows the one preceding it but is a result of the one preceding it. **I think in the economic, investment and credit arenas, a cycle is usually best viewed not merely as a progression through a standard sequence of positive and negative events, but as a chain reaction.**

Before I launch into the discussion of cycles that will follow, I want to make the point that it's hard to know where to start. It's tough to say, "The cycle started with y," since usually y was caused by x, and x by w. But we have to start someplace.

The Real Estate Cycle

I'll use the cycle in real estate as an example. In my view it's usually clear, simple and regularly recurring:

- Bad times cause the level of building activity to be low and the availability of capital for building to be constrained.
- In a while the times become less bad, and eventually even good.
- Better economic times cause the demand for premises to rise.
- With few buildings having been started during the soft period and now coming on stream, this additional demand for space causes the supply/demand picture to tighten and thus prices and rents to rise.
- This improves the economics of real estate ownership, reawakening developers' eagerness to build.
- The better times and improved economics also make lenders and investors more optimistic. Their improved state of mind causes financing to become more readily available.
- Cheaper, easier financing raises the pro forma returns on potential projects, adding to their attractiveness and increasing developers' desire to pursue them.
- Higher projected returns, more optimistic developers and more generous providers of capital combine for a ramp-up in building starts.
- The first completed projects encounter strong pent-up demand. They lease up or sell out quickly, giving their developers good returns.
- Those good returns – plus each day's increasingly positive headlines – cause additional buildings to be planned, financed and green-lighted.
- Cranes fill the sky (and additional cranes are ordered from the factory, but that's a different cycle).
- It takes years for the buildings started later to reach completion. In the interim, the first ones to open eat into the unmet demand.
- The period between the start of planning to the opening of a building is often long enough for the economy to transition from boom to bust. Projects started in good times often open in bad, meaning their space adds to vacancies, putting downward pressure on rents and sale prices. Unfilled space hangs over the market.

- Bad times cause the level of building activity to be low and the availability of capital for building to be constrained. Or, as we said in computer programming in the 1960s, “go to top” and begin again.

This process is highly illustrative of the cyclical chain reaction I’m talking about. Each step in this progression doesn’t merely follow the one that preceded it; it is caused by the one that preceded it.

Cycles and Risk

This memo is devoted to the cycle in attitudes toward risk. Economies rise and fall quite moderately (think about it: a 5% drop in GDP is considered massive). Companies see their profits fluctuate considerably more, because of their operating and financial leverage. But market gyrations make the fluctuations in company profits look mild. **Securities prices rise and fall much more than profits, introducing considerable investment risk. Why is that so? Primarily, I think, because of the dramatic ups and downs in investor psychology.**

The economic cycle is constrained in its fluctuations by the existence of long-term contracts and the fact that people will always eat, pay rent, buy gasoline, and engage in many other activities. The quantities involved will rise and fall, but not without limitation. Likewise for most companies: cost reductions can mitigate the impact of sales declines on earnings, and there’s often some base level below which sales are unlikely to go. In other words, there are limits on these cycles.

But there are no checks on the swings of investor psychology. At times investors get crazily bullish and can imagine no limits on prosperity, growth and appreciation. They assume trees will grow to the sky. Nothing’s too good to be true. And on other occasions, correspondingly, despondent investors can’t think of any limits to how bad things can get. People conclude that the “worst case” scenario they prepared for isn’t negative enough. Highly disastrous outcomes are considered plausible, even likely.

Over the years, I’ve become convinced that fluctuations in investor attitudes toward risk contribute more to major market movements than anything else. I don’t expect this to ever change.

The Source of Investment Risk

Much (perhaps most) of the risk in investing comes not from the companies, institutions or securities involved. It comes from the behavior of investors. Back in the dark ages of investing, people connected investment safety with high-quality assets and risk with low-quality assets. Bonds were assumed to be safer than stocks. Stocks of leading companies were considered safer than stocks of lesser companies. Gilt-edge or investment grade bonds were considered safe and speculative grade bonds were considered risky. I’ll never forget Moody’s definition of a B-rated bond: “fails to possess the characteristics of a desirable investment.”

All of these propositions were accepted at face value. But they often failed to hold up.

- When I joined First National City Bank in the late 1960s, the bank built its investment approach around the “Nifty Fifty.” These were considered to be the fifty best and fastest growing companies in America. Most of them turned out to be great companies . . . just not great investments. In the early 1970s their p/e ratios went from 80 or 90 to 8 or 9, and investors in these top-quality companies lost roughly 90% of their money.
- Then, in 1978, I was asked to start a fund to invest in high yield bonds. They were commonly called “junk bonds,” but a few investors invested nevertheless, lured by their high interest rates. Anyone who put \$1 into the high yield bond index at the end of 1979 would have more than \$23 today, and they were never in the red.

Let’s think about that. You can invest in the best companies in America and have a bad experience, or you can invest in the worst companies in America and have a good experience. **So the lesson is clear: it’s not asset quality that determines investment risk.**

The precariousness of the Nifty Fifty in 1969 – and the safety of high yield bonds in 1978 – stemmed from how they were priced. A too-high price can make something risky, whereas a too-low price can make it safe. Price isn’t the only factor in play, of course. Deterioration of an asset can cause a loss, as can its failure to produce profits as expected. **But, all other things being equal, the price of an asset is the principal determinant of its riskiness.**

The bottom line on this is simple. No asset is so good that it can’t be bid up to the point where it’s overpriced and thus dangerous. And few assets are so bad that they can’t become underpriced and thus safe (not to mention potentially lucrative).

Since participants set security prices, it’s their behavior that creates most of the risk in investing. This is true in many other activities as well, the common thread being the involvement of humans.

- Jill Fredston, an expert on avalanches, has observed that “better safety gear can entice climbers to take more risk – making them in fact less safe.” (*Pensions & Investments*)
- When all traffic controls were removed from the town of Drachten, Holland, traffic flow doubled and fatal accidents fell to zero, presumably because people drove more carefully. (Dylan Grice, Societe Generale)

So improvements in safety equipment can be neutralized by human behavior, and driving can become safer despite the removal of safety equipment. It all depends on how the participants behave.

The Cycle in Attitudes toward Risk

The riskiest thing in the investment world is the belief that there’s no risk. On the other hand, a high level of risk consciousness tends to mitigate risk. I call this the perversity of risk. It’s the reason for Warren Buffett’s dictum that “The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs.” When other people love investments, we should be cautious. But when others hate them, we should turn aggressive.

It is essential to observe that investor attitudes in this regard are far from constant. A memo called *The Happy Medium* (July 21, 2004) said that while it would be good for most investors (the ones not suited to be contrarians) to always hold a moderate position that balances risk aversion and risk tolerance – and thus the fear of losing money and the fear of missing opportunities – this is something very few people can do. Rather, attitudes toward risk cycle up and down, usually counter-productively. **Becoming more and less risk averse at the right time is a great way to enhance investment performance. Doing it at the wrong time – like most people do – can have a terrible effect on results.**

How does the up-cycle in risk taking develop?

- **When economic growth is slow or negative and markets are weak, most people worry about losing money and disregard the risk of missing opportunities. Only a few stout-hearted contrarians are capable of imagining that improvement is possible.**
- Then the economy shows some signs of life, and corporate earnings begin to move up rather than down.
- Sooner or later economic growth takes hold visibly and earnings show surprising gains.
- This excess of reality over expectations causes security prices to start moving up.
- Because of those gains – along with the improving economic and corporate news – **the average investor realizes that improvement is actually underway.** Confidence rises. Investors feel richer and smarter, forget their prior bad experience, and extrapolate the recent progress.
- Skepticism and caution abate; optimism and aggressiveness take their place.
- Anyone who's been sitting out the dance experiences the pain of watching from the sidelines as assets appreciate. The bystanders feel regret and are gradually sucked in.
- The longer this process goes on, the more enthusiasm for investments rises and resistance subsides. **People worry less about losing money and more about missing opportunities.**
- Risk aversion evaporates and investors behave more aggressively. People begin to have difficulty imagining how losses could ever occur.
- Financial institutions, subject to the same influences, become willing to provide increased financing. In the words of Citibank's Chuck Prince, when the music's playing, they see no choice but to dance. Thus they compete for market share by reducing the return they demand and by being willing to finance riskier deals (see *The Race to the Bottom*, February 14, 2007).
- Easier financing – along with the recent gains – encourages investors to make greater use of leverage. Borrowed capital increases their buying power, and they move to put it to work.
- Leveraged investors report the greatest gains, consistent with the old Las Vegas maxim: "the more you bet, the more you win when you win." This causes others to emulate them.
- The market takes on the appearance of a perpetual-motion machine. Appreciation accelerates, possibly leading to a mania or bubble. **Everyone concludes that things can only get better forever. They forget about the risk of losing money and fixate on not missing opportunities.** Leveraged buyers become convinced that the things they buy with borrowed money are certain to appreciate at a rate above their borrowing cost.
- Eventually things get as good as they can get, the last skeptic capitulates, and the last potential buyer buys.

That's the way the cycle of attitudes toward risk ascends. **The skeptic in times of moderation becomes a true believer at the top.**

But as Herb Stein brilliantly observed, “If something cannot go on forever, it will stop.” Applying that thought here, I’d say when things are as good as they can get, they can’t get any better. That suggests eventually they’ll get worse.

It always turns out that – investors’ hopes to the contrary – economies, profits and asset prices can’t rise forever. Or, at a minimum, they can’t keep pace with investors’ ever-rising hopes. And thus the down-cycle begins.

- Once the last potential buyer has bought, there’s nobody left to take prices higher.
- **A few unemotional, disciplined and foresighted investors conclude that things have gone too far and a correction is in the cards.**
- Economic activity and corporate earnings turn down, or they begin to fall short of people’s irrationally expanded expectations.
- The error of those expectations becomes obvious, causing security prices to start declining. Perhaps someone is daring enough to point out publicly that the emperor of limitless growth has no clothes. Sometimes there’s a catalyzing event. Or sometimes (see early 2000) security prices begin to fall of their own accord, simply because they had moved too high.
- The first price declines cause investors to rethink their analysis, conclusions, commitment to the market and risk tolerance. It becomes clear that appreciation will not go on *ad infinitum*. “I’d buy at any price” is replaced by “how can I know what the right price is?”
- Weak economic news takes the place of positive reports.
- **The average investor realizes that things are getting worse.**
- Interest in investing declines. Selling replaces buying.
- Investors who sat out the dance – or who just underweighted the depreciating assets – are lionized for their wisdom, and holders start to feel stupid.
- Giddy enthusiasm is replaced by sober skepticism. Risk tolerance declines and risk aversion is on the upswing. **People switch from worrying about missing opportunity to worrying about losing money.**
- Financial institutions become less willing to extend credit to investors. At the extremes, investors receive margin calls.
- Investors who borrowed to buy are heavily penalized, and the media report on leveraged entities’ spectacular meltdowns. Forced selling in response to margin calls and covenant violations causes price declines to accelerate.
- Eventually we hear some familiar refrains: “I wouldn’t buy at any price,” “There’s no negative case that can’t be exceeded on the downside,” and “I don’t care if I ever make another penny in the market; I just don’t want to lose any more.”
- The last believer loses faith in the market, selling accelerates, and prices reach their nadir. **Everyone concludes that things can only get worse forever.**

Coping with the Risk Cycle

The important conclusions from observing the above pattern are these:

- Over time, conditions in the real world – the economy and business – cycle from better to worse and back again.
- Investor psychology responds to these ups and downs in a highly exaggerated fashion.

- When things are going well, investors swing to excessive euphoria, under the assumption that everything's good and can only get better.
- And when things are bad, they swing toward depression and panic, viewing everything negatively and assuming it can only get worse.
- When the outlook is good and their mood is ebullient, investors take security prices to levels that greatly overstate the positives, from which a correction is inevitable.
- And when the outlook is bad and they're depressed, investors reduce prices to levels that overstate the negatives, from which great gains are possible and the risk of further declines is limited.

The excessive nature of these swings in psychology – and thus security prices – dependably creates opportunities of over- and under-valuation. **In bad times securities can often be bought at prices that understate their merits. And in good times securities can be sold at prices that overstate their potential. And yet, most people are impelled to buy euphorically when the cycle drives prices up and to sell in panic when it drives prices down.**

“Buy and hold” used to be a popular approach among investors, and it performed admirably when the markets rose almost non-stop from 1960 to 1972 and from 1982 to 1999. But thanks to the lackluster results of the last thirteen years, it has nearly disappeared. Nowadays, investors are much more likely to trade in an effort to profit from – or at least avoid losses connected to – economic, corporate and market developments. However, when most investors unite behind a macro trading decision, they're usually wrong in the ways described above. This is the reason why contrarianism often pays off big.

In order to be a successful contrarian, you have to do the opposite of what the herd does. And to do that, you have to diverge from the conventional cycle in attitudes toward risk. Everyone would like to profitably resist this error-prone and thus costly cycle. The fact that most people succumb anyway shows how strong its power is, and that most people are not above average in this regard (of course). Markets move in response to decisions made by the majority of investors. Most investors are guilty of the sin of overreacting (and, even worse, the sin of moving in the wrong direction), demonstrating that the ability to resist the cycle is uncommon.

To be a successful contrarian, you have to be able to:

- see what most people are doing,
- understand what's wrong about most people's behavior,
- possess a strong sense for intrinsic value, which most people ignore at the extremes,
- resist the psychological pressures that make most people err, and thus
- buy when most people are selling and sell when most people are buying.

And one other thing: you have to be willing to look wrong for a while. If the herd is doing the wrong thing, and if you're capable of seeing that and doing the opposite, it's still highly unlikely that the wisdom of what you do will become apparent immediately. Usually the crowd's irrational euphoria will continue to take prices higher for a while – possibly a long while – or its excessive negativism

will continue to take prices lower. The contrarian will appear wrong, and the fact that his error comes in acting differently from most people will make him look like nothing but an oddball loser. **Thus, in addition to the five requirements listed above, successful contrarianism requires the ability to stick with losing positions that, as David Swensen has written, “frequently appear downright imprudent in the eyes of conventional wisdom.”**

If you can't stand living with the embarrassment of being unconventional and wrong, contrarianism may not be for you. Rather than trying to do the difficult opposite of what the crowd is doing, you might have to settle for merely refusing to join in its errors. That would be a very good thing. But even that is not easy.

Risk and Return Today (2004 Version)

The name of this section served as the title of a memo in October 2004. It was one of my first cautionary responses to the vertiginous market ascent that would be exposed by the sub-prime mortgage collapse in 2007 and would culminate in the global financial crisis in 2008.

In the memo I observed that the “capital market line” connecting risk and return had become “lower and flatter.” The lowness meant that the line started off with low returns on low-risk assets (due to the Fed's efforts to stimulate the economy through low interest rates) and, as one moved out the risk curve, even riskier investments offered low potential returns. “Due to the low interest rates,” I said, “the bar for each successively riskier investment has been set lower than at any time in my career.”

The flatness of the line was a result of sanguine attitudes toward risk. Here are excerpts from my explanation (emphasis in the original):

- **First, investors have fallen over themselves in their effort to get away from low-risk, low-return investments. When you're especially eager not to make safe investment A, it takes less compensation than usual (in terms of prospective return) to get you to accept risky investment B. . . .**
- **Second, risky investments have been very rewarding for more than twenty years and did particularly well in 2003. . . . Thus investors are attracted more (or repelled less) by risky investments than perhaps might otherwise be the case and require less risk compensation to move to them.**
- **Third, investors perceive risk as being quite limited today.** Because rising inflation isn't seen as a significant risk, bond investors don't require much of a premium to extend maturity. And because the combination of a recovering economy and an accommodating capital market has brought default rates to record lows, investors are unconcerned about credit risk and thus are willing to accept below-average credit spreads. **Prospective return exists to compensate for perceived risk, and when there isn't much perceived risk, there isn't likely to be much prospective return.**

In summary, to use the words of the “quants,” risk aversion is down. . . .

. . . **would-be buyers are optimistic, unafraid, undemanding in terms of return, and moving *en masse* to small asset classes.** Holders of assets, who play a part in setting market prices by deciding where they'll sell, also are optimistic. The result is an unappetizing, risk-tolerant, high-priced investment landscape. . . .

There are times when the investing errors are of omission: the things you should have done but didn't. Today I think the errors are probably of commission: the things you shouldn't have done but did. **There are times for aggressiveness. I think this is a time for caution.**

In other words, everything seemed positive, attitudes toward risk bearing were on the upswing, and security prices moved higher, bringing down potential returns. That memo may have been too early, but it wasn't wrong. There was a fair bit of money to be made in the next few years, but its pursuit brought investors close to the peril that lay ahead.

Risk and Return Today (2013 version)

For about a year from the middle of 2011 to the middle of 2012, I was thinking and saying that given the many problems and uncertainties afflicting the investment environment, the biggest plus I could find was the near-total lack of optimism on the part of investors. And I thought it was a major plus. There's little that's as helpful for the availability of bargains as widespread low expectations.

Arguably the eight pages of this memo leading up to this point are there for the sole purpose of establishing that when investors are sanguine risk is high, and when investors are afraid risk is low. Today there's no question about it: investors are highly aware of the uncertainties attaching to the sluggish recovery, fiscal imbalance and political dysfunction in the U.S.; the same or worse in Europe; lack of growth in Japan; slowdown in China; resulting problems in the emerging markets; and geopolitical tensions. **If the global crisis was largely the product of obliviousness to risk – as I'm sure it was – it's reassuring that there is little risk obliviousness today.**

Sober attitudes on the part of investors should be a source of comfort, since in normal times we would expect them to bring down asset prices to the point where they're attractive. **The problem, however, is that while few people are thinking bullish today, many are acting bullish. Their pro-risk behavior is having its normal dangerous impact on the markets, even in the absence of pro-risk thinking. I've become increasingly conscious of this inconsistency in recent months, and I think it is the most important issue that today's investors have to confront.**

What's the reason for this seeming inconsistency between thoughts and actions? The answer is simple. **These people aren't buying because they want to, but because they feel they have to.** In the past I've referred to them as "handcuff volunteers."

The normal response of investors to uncertain times is to say, "Because of the risks that are present, I'm going to shy away from risky investments and stick with a very safe portfolio." Such views would tend to depress prices of risky assets. But, thanks to the actions of the world's central banks to keep rates near zero, that very safe portfolio – especially in the credit markets – will produce little if any return today.

Many investors have sought the safety of money market and T-bill funds yielding zero, Treasury notes at +/-1%, and high grade bonds at 3%. But some can't or won't. The retiree living on his

savings may not be able to abide the 90% reduction in short Treasury note returns. I imagine him picking up the phone, calling the 800 number and telling his mutual fund company “get me out of that fund yielding zero and get me into one yielding 6%. I have to replace the income I used to get from intermediate Treasuries.” And thus he becomes a high yield bond investor . . . whether consciously or not.

A similar process can affect a pension fund or endowment that needs a return of 7-8% and doesn't want to bet its future on the ultra-low yields on high grade bonds and Treasuries, or the 6% that the institutional consensus expects stocks to return (especially given how badly stocks performed in 2000-02 and 2008 and their overall lack of gains since 1999).

Take high yield bonds for example. They provide some of the highest contractual returns and greatest current income, they are attracting considerable capital. When capital flows into a market, the resulting buying brings down the prospective returns. And when offered returns go down, investors desirous of maintaining income turn to progressively riskier investments. In the bond world that's called “chasing yield” or “stretching for yield.” **Do it if you want, but do it consciously and with full recognition of the risks involved. And even if you refuse to stretch for yield, be alert to the effect on the markets of those who do.**

Getting Rid of Money

It's relatively easy to make good investments when capital is in short supply relative to the opportunities and investors are reticent. But when there's “too much money chasing too few deals,” investors compete to put it to work in ways that are injurious to everyone's financial health. I've written often about the tendency of people to accept lower returns, higher risk and weaker terms in order to deploy their capital in “hot” times (again as described in *The Race to the Bottom*). The deals they do get worse, and that makes investing riskier and less profitable for everyone.

Because the returns on “safe” investments are so low today, people are moving further out on the risk curve to pursue returns that meet their needs and are close to what they used to get. And the weight of their capital is bringing down prospective returns and making riskier deals doable.

As noted on page 9, I wrote in 2004's *Risk and Return Today* that, “The result is an unappetizing, risk-tolerant, high-priced investment landscape. . . .” At that time it happened because of excessive bullishness and a paucity of risk aversion. This time around it's occurring despite the absence of bullishness, mainly because interest rates have been rendered artificially low by the Fed and other central banks. **Regardless of the reason, things are happening again today – especially in the credit world – that are indicative of an elevated, risk-prone market:**

- Total new issue leveraged-finance volume – loans and high yield bonds – reached a new high of \$812 billion in 2012, according to Standard & Poor's, surpassing by 20% the previous record set in pre-crisis 2007.
- The yields on fixed income securities have declined markedly, and in many cases they're the lowest they've ever been in our nation's history. Yield spreads, or credit risk premiums, are fair to full – meaning the relative returns on riskier securities are attractive – but the absolute returns are minimal.

I find it remarkable that the average high yield bond offers only about 6% today. Daily I see my partner Sheldon Stone selling callable bonds at prices of 110 and 115 because their yields to call or yields to worst start with numbers – “handles” – of 3 or 4 percent. The yields are down to those levels because of strong demand for short paper with prospective returns in that range. I’ve never seen anything like it.

- As was the case in the years leading up to the onset of the crisis, the ability to execute aggressive transactions indicates the presence of risk tolerance in the markets. Triple-C bonds can be issued readily. Companies can borrow money for the purpose of paying dividends to their shareholders. And CLOs are again being formed to buy leveraged loans with heavy leverage.
- The amount of leverage being applied in today’s private equity deals also indicates a return to risk taking. As *The Wall Street Journal* reported on December 17:

Since the beginning of 2008, private-equity firms have paid an average of 42% of the cost of large buyouts with their own money, also known as “equity,” while borrowing the rest. In the past six months, the percentage has fallen to 33%, according to Thomson Reuters, close to the 31% average in 2006 and the 30% average in 2007. . . .

Other measures also suggest that debt loads are hovering around pre-crisis levels. The average debt put on companies acquired in leveraged-buyout deals from July to December amounted to 5.5 times the companies’ annual earnings (defined as earnings before interest, taxes, depreciation and amortization). That is higher than any two consecutive quarters since the beginning of 2008, according to S&P Capital IQ LCD. The average deal leverage was 5.4 times earnings in 2006 and 6.2 times earnings in 2007.

The good news is that today’s investors are painfully aware of the many uncertainties. The bad news is that, regardless, they’re being forced by the low interest rates to bear substantial risk at returns that have been bid down. **Their scramble for return has brought elements of pre-crisis behavior very much back to life.**

Please note that my comments are directed more at fixed income securities than equities. Fixed income is the subject of investors’ ardor today, since it’s there that investors are looking for the income they need. Equities are still being disrespected, and equity allocations reduced. Thus they are not being lifted by comparable income-driven buying.

* * *

In 2004, as cited above, I stated the following conclusion: “There are times for aggressiveness. I think this is a time for caution.” Here as 2013 begins, I have only one word to add: ditto.

The greatest of all investment adages states that “what the wise man does in the beginning, the fool does in the end.” The wise man invested aggressively in late 2008 and early 2009. I believe only the fool is doing so now. Today, in place of aggressiveness, the challenging search for return should incorporate goodly doses of risk control, caution, discipline and selectivity.

January 7, 2013

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