Interviewee: **Michael Aronstein**

Company: **Marketfield Asset Management, LLC**

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**Ken Pruitt**

Michael Aronstein of Markefield Asset Management, good morning.

**Michael Aronstein**

Good morning.

**Ken Pruitt**

Thanks for coming in. Are we getting to the point where higher gasoline prices start to choke off consumer spending and therefore the whole economy?

**Carol Massar**

He's shaking his head no.

**Ken Pruitt**

He says no.

**Michael Aronstein**

No. Actually if you do the arithmetic it's, I'd say, for most people the increment is $20 to $30 a month between where prices are now and where they were, say, a year and a half ago. When you sit down and think about how much driving you actually do and the mileage, you know, most people I would say on average use, say, 600, 800 gallons a year, maybe a thousand, 1200, assuming you're not driving for commercial reasons. So you're adding maybe a dollar a gallon spread out over 12 months. So the actual impact, I think, in the aggregate is not that great. The psychological impact is a lot every time you fill it up if you're shelling $50 or $75 that hits. But I think in practical terms, it's not a big effect. And in fact, it's really a redistribution within the economy, not an actual extinguishing of purchasing power or wealth.

**Carol Massar**

I'm going to break in, because you say ‘most people’, Mike. Most people in New York, or most people all across the country? Because I think there's some folks in middle America who are saying, ‘hey, this is really impacting my pocketbook’ at this point. No?

**Michael Aronstein**

Well it's certainly going to have an effect on some people, but it's not a gigantic effect. I mean, the declining mortgage rates over the past 12 months, it's probably five times more impactful in terms of people's cash flow statements than the rise in gasoline prices.

**Ken Pruitt**

Well, it depends on where you are, too. I mean, Congress was debating a 50% increase in the gas tax back in the '90s. And at the time, I was on a fishing trip in Montana where people drive long distances to jobs that don't pay that well by coastal standards. Plus, you got to have a pretty solid vehicle to get you through the winter out there. People drive 50 miles to work, 60 miles to dinner and a movie.

**Michael Aronstein**

That probably will be cut back in Montana. Although, I think in parts of the West and upper Midwest, you have better paying jobs now searching for hydrocarbons.

**Ken Pruitt**

Of course, the proportion of the family budget goes for energy. Back when we had gas lines in the '70s, I think it was something like 12%, and now it's about 8%. That's all energy including heat, electricity and gasoline, and all that.

**Michael Aronstein**

Right. And the proportion that goes for shelter is still by far the biggest item in the family budget, and that's come down 50 or 60%.

**Carol Massar**

If you still have your house.

**Michael Aronstein**

Well, even if you don't.

**Carol Massar**

How’s that?

**Michael Aronstein**

Assuming you're living indoors, yeah, and renting, even if you formerly were paying a mortgage of a place you own, the cost to shelter yourself and your family is down dramatically. It's the biggest single budget item, and it's basically collapsed over the past five years. So that's why the consumer discretionary sector in the stock market has been the best performing sector for almost four years now.

**Ken Pruitt**

Does it continue to be?

**Michael Aronstein**

Until people figure it out. I think people are slowly figuring this out. But at the end of 2008, it was almost unanimously reviled. We started buying consumer discretionary stocks around Christmas of 2008, and it's really been the best part of our portfolio, almost non-stop since then.

**Carol Massar**

What in particular? I'm curious. Names like?

**Michael Aronstein**

Retailers, the restaurant chains-- sort of widely diversified across the discretionary sector. In the last two years we've moved a little more toward the growthy types of stocks, the more high-multiple type things. No, it's been a sector in general that has really surprised people, continued to surprise people in the face of, there's a lot of economic mythology out there saying, well the U.S. consumer is dead. They're in the midst of a huge delevering cycle. But all of the deleveraging had to do almost strictly with real estate. It didn't have to do with the rest of the consumer's budget. I think, if you look yesterday, I think Moody's reported that credit card delinquencies and charge offs reached an all time low, all time last month. February is usually not a great month because people are suffering from the post-Christmas hangover. February turned out to be a great month for credit metrics having to do with credit cards. So the facts kind of believe the general sentiment, I think.

**Carol Massar**

So we know corporate America has gotten its balance sheets in your order. And you're now saying households? You feel confident that they really have cleaned up their act?

**Michael Aronstein**

Well, they're kind of five years into the mission and they're doing better with it. Corporate sector really began restructuring after the big decline in the emerging market economies in '97, '98, and the collapse in commodity prices, which put tremendous pressures on the U.S. industrial sector to either relocate or cut that cost to nothing, rationalize the balance sheets. And they've been doing for a decade, and you see the results. That's the other big surprise, is that year in and year out since the '08 collapse, corporate profits keep surprising people in the upside. They keep doing it. And people feel like it's kind of an irrational development or there's some statistical quirk to it. But it's actually a reflection of a very, very big change in the fundamental nature of the corporate structure.

**Ken Pruitt**

We're talking with Michael Aronstein of Marketfield Asset Management. How does the overall economy look to you this year?

**Michael Aronstein**

It's pretty good other than the public sector. They haven't gone through the restructuring yet, and they're going to.

**Ken Pruitt**

They are?

**Michael Aronstein**

The markets are going to force them to.

**Ken Pruitt**

The public sector is going to?

**Michael Aronstein**

Yeah and it's not going to be pretty. You just have to hope that people who are on the receiving end of the government's largesse are more graceful in terms of their response than the people in Greece or, Heaven forbid, the ruling class in Syria.

**Ken Pruitt**

Well you know, we didn't pay much attention to things like public pensions and public salaries until recently. So if the economy picks up, will that sort of recede into the background again?

**Michael Aronstein**

No, because the arithmetic is untenable at this point. You get to a point where the compounding of certain obligations just doesn't work under any realistic scenario. I think we've passed that point already. Sort of like the auto industry. You could see it coming over the horizon 20 years ago that this industry wasn't going to make it, but it takes a long time. Unfortunately, people in general only respond when smacked in the face with a two-by-four, particularly in the public sector where the political imperative is to kind of behave like Santa Claus. I think most people who are professional politicians don't find it attractive to go out with a message of austerity that some of the gifts that we've given, and some of our generosity has to be cut back. So they tend not to do it until it's absolutely necessary, and that usually is caused by some sort of emergency. You've seen it all over Europe. There was no question 15 years ago that Greece was kind of a problem economy, and five years ago, it was clear that their borrowing was completely beyond reason, and that the lines between the income and the obligation lines were just departing. It looked like an F-15 taking off.

**Ken Pruitt**

Are we going to be seeing more stock in California's and Harrisburg, Pennsylvania's?

**Michael Aronstein**

Yeah, absolutely. At some point people will connect the dots and say, this is a general problem. We've had irresponsible acquisition of obligations by state, local and federal entities, and these now, after the compound interest table has worked its magic, they're not sustainable. But compound interest is inexorable, but it takes time. It's like smoking. The first five or ten packs of cigarettes won't kill you, but if you do it long enough and don't get run over by a bus it's going to have a really bad effect on your overall health.

**Ken Pruitt**

What's your single best idea, Mike?

**Carol Massar**

Pressure.

**Michael Aronstein**

I wish I had one.

**Ken Pruitt**

Give us five best ideas then.

**Michael Aronstein**

I look at the fund as a totality. We have the latitude to use shorts as well as long positions. We're pretty unconstrained. So I view the world through the lens of our portfolio, which has a lot of, I would say, diversified themes running through it. And I really hesitate to give one specifically because out of the context of our whole kind of investment array they're different.

**Ken Pruitt**

What are some of the themes?

**Michael Aronstein**

Well we've had a theme for the last 14 months or so that the U.S. was going to surprise on the upside and that the emerging markets were going to surprise in the opposite direction. That really to the extent that you got an extension of the global recovery, it was more likely led by U.S. and subsequently Western Europe or northern Western Europe, and not at all by the places people are looking toward for a reacceleration.

**Carol Massar**

So wait. I know in your note at the end of the year: financials, housing, construction-related were areas you like. So can I assume that you're still in those positions?

**Michael Aronstein**

Yes.

**Carol Massar**

Are you adding something at all?

**Michael Aronstein**

No, no. We've been fortunate with the building materials and the home builders, and those things.

**Carol Massar**

Finally.

**Michael Aronstein**

Yeah. It's taken, we really added a lot to those positions in the Fall, last year.

**Carol Massar**

And holding on to them. You're not paring back at all.

**Michael Aronstein**

No, we haven't. We've added a little bit to the shorts and the developing markets recently. And of course, that was a very, very painful position to hold January and February, because everything went up like a rocket ship. But it's one of the advantages that we have a two-sided portfolio. It was painful, but not fatal.

**Ken Pruitt**

Well some of those building material stocks, I mean, you just called up a USG here, makes dry wall, up 80% this year. I mean, how much could possibly be left?

**Michael Aronstein**

I don't know. I ask myself that everyday. We do own the stock and it's obviously been our best performing stock this year. A lot of these businesses have gotten to the point where they are the last person standing. If we ever get halfway back to normalcy in terms of construction you're going to need drywall, and it's not like that's a widely distributed activity at this point.

**Ken Pruitt**

How would feel if you weren't already in it? I mean, just judging as a non-owner and you look at something that's gone up almost $9 this year, and it's at 19.

**Carol Massar**

Would still buy it if you didn't own it?

**Ken Pruitt**

Would you still buy it?

**Michael Aronstein**

I don't know. That's a tough question. I don't like to buy things because they've gone up. You really have to be disciplined about looking at something. It's very easy after stocks double to say, oh yeah, I understand the fundamental story. It's compelling. So we really try to have a process by which we are looking at things that are not derived from momentum. But that said, I certainly don't think that there's a theme about construction that's really prominent in a lot of people's portfolios among professional money managers. And you look at where some of these stocks were five, seven, eight years ago and what they're earning power is now, over time, they could really, really surprise people.

**Carol Massar**

Ken brings up USG, and I'm looking back at April 2008 when it was $40 and change. I mean, does it go to that level? I mean, you hope it does.

**Michael Aronstein**

It would be fine with me. I don't know.

**Carol Massar**

It's under $19 now, so it's less than half that. I mean, is $40 a realistic number to start looking at? Is that why you continue to hold it?

**Michael Aronstein**

Well you know, in a bull market people tend to get scared by things going up until the end. Then they like things going up a lot. So I think you've had a lot of people who have been very hesitant to commit to this market because, not only stocks specifically, but the market in general, which has gone up a lot since the beginning of the year and pretty relentlessly, and that scares people early in bull markets.

**Carol Massar**

Which is why we have a low volume, right?

**Michael Aronstein**

Yeah.

**Carol Massar**

People aren't really aggressively out there buying.

**Michael Aronstein**

No. People are made nervous by the fact that things have gone up a lot. Sometimes you have to really, you have to calibrate as to where the overall market is and whether or not you're early, midway or late, and how popular things are. And that's a difficulty. You have to find the intersection between the fundamentals and the market's expectation, and see whether or not there's a big divergence. You can describe the fundamentals accurately. But if they're embedded in the market's level of expectations surrounding something, it doesn't matter. Being right in this business is beside the point, if you're right in a way that is expected and already embedded in prices. So that's the difference between being a commentator and actually doing it. The commentary part in terms of people on the street who are professional, what I call television economists, have it a lot easier because you're not held to account by a scorecard at the end. And some of these trends, you could say today, yesterday or last week what's going on.

**Ken Pruitt:**

Michael Aronstein, Marketfield Asset Management.

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