

WEALTH

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MANAGEMENT

"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

WORRIED ABOUT THE FUTURE OF THE UNITED STATES? INVEST OVERSEAS

Many investors are worried about the declining position of the United States in the global economy.

The dollar has been on a long-term downtrend, federal budget deficits and international trade deficits keep going up, and the country has lost many of its basic industries to overseas competitors.

While disconcerting, these trends offer plenty of opportunity to an investor because their ability to invest outside of the domestic market has increased greatly over the last 30 years.

Plus, foreign investing offers diversification that can smooth out returns: 97 percent of the world's population and 75 percent of economic production are outside the United States.

The globalization of finance has opened up dozens of foreign stock and bond markets, from big and established to small and emerging, to outside investment. There are now thousands of international stock and bond mutual funds offering investors a low cost and efficient instrument for international investing.

Weak dollar profits

Domestic investors can profit off of the weak dollar just by purchasing foreign stocks or bonds. If foreign currencies rise in value vis-à-vis the dollar, then the domestic investor's foreign holdings become more valuable in U.S. dollars.

The U.S. domestic investor makes money on the deal, and the money is denominated in the currency he will use to buy goods and services, that is, the dollar.

But that's not the only reason to invest abroad. Growth prospects are different country to country and many economists predict that a number of emerging economies will continue to grow at a faster pace than



Although the United States remains an economic powerhouse, it now shares the global economy with dozens of other

a mature economy like ours.

The Brazilian stock market, for instance, gained almost 83% during 2009. U.S. investors who put money into Brazil did even better because the U.S. dollar declined in value against the Brazilian real. A U.S. investor who owned the Brazilian Bovespa index last year gained 145 percent in U.S. dollar terms.

Commodities or growth

Successful investing in foreign markets often hinges on two factors: commodities and economic growth.

A commodity-poor country like China or India that is rapidly industrializing can offer plenty of growth potential. Meanwhile, commodity-rich countries like Brazil and Russia offer investors the chance to profit from rising

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FOREIGN MARKETS ALSO OFFER BOND AND RATE DIVERSIFICATION

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prices on oil, minerals, and even agricultural products.

Also, other opportunities exist, even in mature economies in Europe or Asia. Europe got a boost 10 years ago when the euro was adopted and the region's economies were more tightly linked.

Japan's economy, which has been in a slump since the late 1980s, is finally showing signs of life and may be growing again.

Stocks are not the only foreign investment opportunity: all governments issue bonds and many foreign companies do as well. Investors can benefit from the difference in interest rates from country to country. Investing directly in foreign securities can be expensive due to higher fees and taxes. The best way to approach foreign markets is through large pooled investment funds such as open-end mutual funds or electronically-traded funds, also known as ETFs. They provide



diversification and handle all the details involved in dealing with different markets. This is why we suggest that you be invested across the various domestic and international asset classes.

AN EXCERPT FROM: THE PROGRESS PERSPECTIVE

At any given moment, progress always appears to us linear, when it is in fact always exponential. Thus, there may very well be as much progress in the hard sciences, in information technology and in medicine in the next ten years as took place in all of human history to this point. It is just this progress—and its profound implications for economic growth and returns on equity capital—that the pessimists miss. But they would have to, because otherwise they could not persist in their pessimism.

Innovation compounds apace. Equities may have provided no net return for the ten years through 2009; this is grist for the pessimists' mill. They conveniently ignore the fact that this decade followed the greatest ten years in the history of equities. They even more studiously ignore the fact that, even as equity prices did less than nothing in the most recent decade, the dividend of the S&P 500 doubled. But even this is beside the point, which is that Moore's Law rolled over five times during this allegedly "lost" decade, such that computing power which cost a dollar at the beginning of 2000 costs three cents today.

And thereby hangs yet another tale—of flight, of technology, and of the unquenchable human spirit.

On April 13, those of us who reverence the event will celebrate—and heaven knows, that's the right verb—the fortieth anniversary of the night Apollo 13 spacecraft, with three astronauts on board, blew up. On that night this year, I suggest we gather our families and friends, and watch Ron Howard's magisterial film **Apollo 13**.

Aside from the drama itself, look for the moment—about halfway through the film—when the world's foremost space scientists and technologists begin working the problem of how to get those three

heroes home alive **using slide rules**. Because at that point, NASA's mainframe computer is essentially fried; they have asked it for so many calculations that it can no longer respond in time to save the astronauts.

As you watch these scenes, take out your BlackBerry, iPhone, or similar device. And know that the computer embedded in it is a million times smaller, a million times cheaper, and a thousand times more powerful than all the computing power that was available to NASA the night Apollo 13 blew up.

Over the next quarter century or so—well within the life expectancies of today's retiring baby boomer couple—this billion fold increase in computing power per dollar will happen again. As it does, information technology will solve all our most vexing problems, including but certainly not limited to energy, the environment, poverty and disease.

We realists—a term I prefer to "optimists," though they are in fact synonymous—will invest patiently and persistently in this progress. By doing so, we may enjoy long retirements full of dignity and independence, even as we endow legacies to those we love and must leave behind in the world.

Pessimists will miss it, increasing the chances that they may run out of money in retirement and die destitute and dependent upon their children—all in the illusory quest for "safety."

Welcome to 2010. Just one man's opinion, of course, and no one else is responsible for it. But: I think it's at least possible that this is the first year of the worst decade to be a pessimist in all of human history.

GOLD IS ALL THE RAGE, BUT IT MAY NOT BE A GOOD INFLATION HEDGE

Gold has been on a roll this year, hitting an all-time high of over \$1,200 an ounce early in December. Investor demand has been so great that the U.S. Mint had to stop producing some popular gold coins due to supply difficulties.

Investors are buying gold as a hedge against inflation and against another financial disaster. But how good is gold's record in protecting an investor's portfolio in the long term? Not very good, it turns out.

Despite gold's 25 percent climb in 2009, an investor who bought gold the last time it hit a high, almost 30 years ago in 1980, could have done better putting her money in an interest bearing checking account.

That's right: the gold investor earned a total of only 44 percent over that long period, while the average interest-earning checking account grew by 92 percent, according to figures compiled by Bankrate.com.

No inflation hedge

What's worse, gold failed to protect an investor from inflation over the last 30 years. After adjusting for inflation, the 1980 gold buyer is still 79 percent below where he started, reported Bloomberg.com recently. Meanwhile, U.S. stocks went up 22-fold over that same period: the Standard & Poor's 500 Index increased by 2,182 percent between gold's last high in 1980 and December 2009.

Even super-safe U.S. Treasury securities did much better than gold over this period, gaining 1,089 percent vs. gold's gain of just 44 percent.

Non-productive asset

Gold is a non-productive asset, which makes holding it over a long period costly. Bonds and other interest bearing investments make regular income payments. Stocks pay dividends and offer a share in a company's profit growth through capital appreciation. Neither investment has any carrying cost, while gold is costly to store and protect. Also, gold has had some very violent swings over the years, making it quite volatile.

From 1971, when President Nixon abandoned the gold standard, through January 1980 its price went from \$35 an ounce to a high of \$850. It fell in subsequent years, hitting a low of \$252 an ounce in August 1999.

The recent run-up in gold seems to have a lot to do with the public's fears that the U.S. government's huge borrowing during the recent financial crisis will either cause the currency to collapse or inflation to soar.

Better hedges

Using gold as a hedge against a collapse of the dollar fails the reductio ad absurdum test: if the currency fails what would an investor translate his gold holdings into in order to spend it? Would he hide hundreds of pounds of gold coins under his bed or in a hole in the backyard?

Gold also fails as a long-term inflation hedge. "The history of gold in regard to inflation shows that it's not a great hedge," Maxwell Bublitz, chief strategist for SCM Advisors, a \$3.5 billion investment firm, recently told Bloomberg news service.

Instead, stocks, especially stocks of small companies, tend to do well in inflationary periods. Also recommended for diversification are broad-based holdings in commodities or stocks of companies which produce those commodities, including commodities that have use and scarcity value like oil, grains, coffee, and industrial metals.

WHAT ARE THE REAL RISKS IN INVESTING?

Investors often get hung up on the wrong phenomena when they think about the risks of investing.

Many investors think daily market fluctuations are the main risk: you buy into the market today and next week it may fall 10 percent, resulting in a 10 percent "loss," under this definition of risk. But those fluctuations really don't quantify or capture the real risks faced by investors (after all, no one seems to mind market fluctuations when they are upward fluctuations).

Business risk

One real risk to worry about concerns the future of a business in which you are investing. You face the risk that it could go out of business altogether, or that its position in the business world will be so damaged—say by bad management or competition—that it will decline and never recover. This type of risk is called "business risk." It is fundamental to any investment in the business world. The easiest way to obviate this risk is to own a widely diversified group of businesses. The owner of a mutual fund that invests in hundreds of companies has little to fear from one company going broke.

Financial risk

Financial risk is another fundamental problem. It is the danger that the excessive use of borrowing will turn into a catastrophe. Someone with a long time horizon can ride out even steep declines in markets. But the investor who has borrowed in order to make his investments may have to find large amounts of cash to cover his loans at a time when the value of the assets backing up those loans has deteriorated. The obvious way to avoid this risk is to avoid investing with borrowed money.



Real investment risks have little to do with day to day market fluctuation. Valuation, financial, and business risks are the real worries.

Valuation risk

This may be the most important risk of all. You take it on when you buy a stock that is overvalued in relation to its potential earnings and prospects. This is typical of a "growth" stock that investors are enthusiastic about and have bid up the stock's price far above its capacity to reward them. The best way to avoid this risk is to tilt your portfolio toward value stocks, in other words, stocks whose price is cheap in comparison to the true value of their underlying businesses. These stocks provide a margin of safety when things go wrong and more growth potential when positive surprises occur.

DID THE LAST TEN YEARS INVALIDATE A BUY AND HOLD INVESTING STRATEGY?

Does two major bear markets in 10 years, and the recent whipsaw when stocks fell sharply in 2008 and rose sharply in 2009, mean that “buy and hold” investing is dead? A lot of pundits are saying so. Investors who held stock portfolios over the last 10 years made very little money, they argue. Those who sold when things turned sour and bought back in on the recovery did better, protecting their capital while enjoying some nice gains.

These arguments pop up periodically during bad times for the financial markets. The last long period of doubt corresponded with the high inflation years and successive bear markets that lasted from the early 1970s through mid-1982.

No successful timers

Some of the most successful academics and investment managers recently told the *Journal of Indexes* that buy and hold investing remains valid, recent history notwithstanding.

“I almost have to laugh when I get a question like that,” said Larry Swedroe of BAM Advisor Services in reaction to the “is buy and hold dead” question. “Whenever we get some kind of crisis, all those who believe in active management come out of

the woodwork with this nonsense. All that shows is that they don’t know the basics of investing.”

Burton Malkiel of Princeton University and author of “A Random Walk Down Wall Street” said it is natural for people to say they should have sold in late 2007 and bought back in at the bottom this past March. “We all have 20/20 vision in retrospect. The problem with it is that nobody, and I repeat, *nobody* can time the market,” he said.

Jeremy Siegel of the Wharton School and author of “Stocks for the Long Run” noted that the recent bear market reaffirmed that stocks pay high long-term returns because they can be very risky in the short term. But still beat other assets over the long haul, he said.

Error protection

Buy and hold also prevents investors from making errors when the going gets tough, says Gus Sauter of the Vanguard Group. “A buy and hold strategy helps prevent us from acting in a knee-jerk fashion and under-performing by making bad decisions when the market soars or falls,” he said.

BEAR MARKET RECOVERY IS QUICKER WITH SMALL AND VALUE STOCKS

Stock market downturns—from average bear markets to deep downturns like in 1929 and 2008—are a way of life for investors. Since 1926 there have been 23 separate bull and bear markets (bear markets are bad, bulls are good). The average bear market lasted for 11 months and the average bull market lasted for 32 months.

“But the great bear markets were worse in all respects—they lasted longer and more money was lost, with a minimum decline of 40 percent for the Standard & Poor’s 500 Stocks Index,” says Scott A. Leonard, an investment manager in California who published his research on bear markets in *The Journal of Financial Planning*.

Time for recovery

Leonard studied the three great bear markets that have occurred since the end of the Great Depression: the final Depression bear market that ended in April 1938; the crash around the oil embargo of 1973-74; and the dotcom stock bust of 2000-2002. (The credit crunch bear of 2008 is the latest big bear). He found that a diversified portfolio had fully recovered to its pre-crash value within three to five years. The fastest recovery occurred in portfolios that held more small stocks, because they reaped outsized returns after each crash.

The last bear market for the 1939 aftermath Great Depression resulted in a 50 percent decline in stock prices over 13 months ending in April 1938. Within five years, three of the four classes of stock studied by Leonard had recovered: small stocks, small value stocks, and large value stocks had fully recovered, while the large stocks in the S&P 500 index trailed slightly behind.

The stock market lost 43 percent during the bear of 1973-74, a period of high inflation, an oil crisis, and the end of the Vietnam War. Within three years everything but the S&P had recovered. Small value stocks increased by almost 230 percent in that period.

The dotcom bust lasted for 25 months, ended in September 2002—taking stocks down by 45 percent. All four classes of stock had fully recovered five years after the bear ended.

Leonard recommends owning small and value stocks during and after major bear markets in order to speed portfolio recovery.

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors’ returns within their tolerance for risk. Here is what sets us apart:

- ◆ Fee-only investment management
- ◆ A disciplined investment strategy
- ◆ Access to institutional no-load passive asset class funds
- ◆ An academic Nobel Prize-winning investment approach

- ◆ Continued access to academic research
- ◆ A tax-efficient focus with valuable tax- and estate-planning ideas
- ◆ Risk tolerance assessment
- ◆ Periodic portfolio rebalancing
- ◆ Regular communications and state-of-the-art reporting
- ◆ No front-end loads, no back-end loads, no surrender fees, not locked in
- ◆ **MOST IMPORTANT ...
A TRUSTED ADVISOR RELATIONSHIP**



INTRODUCTIONS—REFERRALS ARE ALWAYS APPRECIATED.