# THE FRIDAY BRIEF

A weekly discussion of events and their impact on your investments

BEACON INVESTMENT MANAGEMENT


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## Much Ado About Little

Economic data reported during this holiday-shortened week was particularly light; perhaps facilitating the market's rebound of 4.5%. Global markets rebounded as well as investors realized the world's economy was not cliff-bound. Europe's credit implosion has dampened growth, but evidence so far indicates it will not stall the recovery.

The IMF predicted yesterday that the global economy would grow 2.6% this year in advanced economies, better than the April estimate of 2.3%. The Fund projected that emerging markets would expand by 6.8%, up from 6.3% in April.

A Bloomberg poll of 52 economists indicates that the US economy will grow by an average of 2.8% through the first half of 2011. That estimate is down .1% from last month. Consumer spending which accounts for nearly 75% of the economy was revised down as well from 2.5% to 2.4% this year. The thirty-year average is 3.1%.

Unemployment is a major factor weighing on the consumer. Last week the Labor Department reported that employment dropped by 125,000 workers as census workers were laid off. However, this week, jobless claims improved significantly. Initial claims fell by 21,000 in the July 3rd week to 454,000 for the lowest level since early May. The four-week average fell 1,250 to 466,000, the best weekly improvement since early May though still slightly higher than a month ago.

No significant housing data has been released since last week's 30% plunge in contracts to buy existing homes. It was the worst drop on record dating to 2001. The Mortgage Bankers' Association's weekly report on mortgage applications for home purchases dropped 2% for the July 2 week. June vs. May purchase applications fell 15% while May vs. April applications fell 30%. Without government stimulus, the housing recession will likely persist for months to come. But a positive sign is that the refinancing index jumped 9.2% in the week and is at its highest level since May of last year (when rates were very low). Thirty-year mortgages averaged 4.68% for the week.

Per-share earnings of S&P 500 companies rose 52% during the first quarter, but estimates are coming down for the second quarter as a result of Europe and slowing growth in China. Forecasts in the second quarter are 34% according analysts polled by Bloomberg. The gauge has fallen 4% in 2010. The S&P 500 now trades at roughly 13 times estimated profits, near the lowest level in 15 months and about 25% cheaper than the long-term average.

Despite the noisy talk of deflation and contraction, most analysts and economists expect the economy to continue to grow, albeit more slowly due to recent disruptions. Given the uncertainty and disruptions of late, active investors seem dazed.

Expensive hedge funds did not protect investors' capital last quarter in the face of an 11.63% drop in the S&P 500. The average hedge fund was down 2.79%. Our passive Risk Averse model was down only .34% for the same period. During the first half of 2010, the index of hedge funds lost 1.2% while our model gained 2.23%.

I have often quoted the study by Brinson, Hood and Beebower which demonstrates that 90% or more of the variance in portfolio returns among large pension plans is explained by the allocation of stocks, bonds and cash. Given this fact, why in the world do investors spend most of their time and money fretting over the remaining 10%; an amount accountants often dismiss as immaterial?

In a recent article entitled *Fake Diversification, Does Asset Allocation Work?* David Loeper demonstrated that during both the latest market drop from the April 23 highs as well as the crash of 2008, the expensive asset allocation and 'diversification' strategies simply did not work.

| *Price Return (excludes dividends/interest)* | **4/23/10 6/29/10** |
|---|---|
| **IShares Barclays 7-10 Year Treasuries (IEF)** | **7.26%** |
| Vanguard Total Domestic Equity (VTI) | -14.52% |
| Vanguard World Equity Ex-US (VEU) | -14.28% |
| IShares Treasury Inflation Protected ETF (TIP) | 2.97% |
| IShares iBoxx $ Investment Grade Corp. Bond Index Fund (LQD) | 2.49% |
| IShares iBoxx High Yield Corp. Bond Index Fund (HYG) | -3.65% |
| IShares S&P/Citigroup Int'l Treasury Bond Index Fund (IGOV) | -3.30% |
| IShares JP Morgan USD Emerging Mkt. Bond Index Fund (EMB) | -0.02% |
| IShares MSCI EAFE Index Fund (EFA) | -17.06% |
| IShares MSCI Emerging Markets Index Fund (EEM) | -12.75% |
| IShares Dow Jones U.S. Real Estate Index Fund (IYR) | -10.41% |
| IShares FTSE EPRA/REIT Developed Real Estate ex U.S. (IFGL) | -12.90% |
| IShares S&P GSCI Commodity-Indexed Trust (GSG) | -13.34% |
| IShares COMEX Gold Trust (IAU) | 7.24% |

| *Price Return (excludes dividends/interest)* | **2008** |
|---|---|
| **IShares Barclays 7-10 Year Treasuries (IEF)** | **15.99%** |
| Vanguard Total Domestic Equity (VTI) | -36.99% |
| Vanguard World Equity Ex-US (VEU) | -43.43% |
| IShares Treasury Inflation Protected ETF (TIP) | -2.05% |
| IShares iBoxx $ Investment Grade Corp. Bond Index Fund (LQD) | 0.11% |
| IShares iBoxx High Yield Corp. Bond Index Fund (HYG) | -17.56% |
| VALIC Company I Intl Govt Bond (VCIFX) | -0.55% |
| IShares JP Morgan USD Emerging Mkt. Bond Index Fund (EMB) | -4.30% |
| IShares MSCI EAFE Index Fund (EFA) | -42.13% |
| IShares MSCI Emerging Markets Index Fund (EEM) | -49.47% |
| IShares Dow Jones U.S. Real Estate Index Fund (IYR) | -40.54% |
| IShares FTSE EPRA/REIT Developed Real Estate ex U.S. (IFGL) | -52.10% |
| IShares S&P GSCI Commodity-Indexed Trust (GSG) | -45.75% |
| IShares COMEX Gold Trust (IAU) | 5.22% |

The iShares Barclay's 7-10 Year Treasury index we use in our passive portfolios handily beat all the other 'diversification' tools with gold as a close second during the most recent drop. But as Loeper points out "gold doesn't pay any interest, costs you money just to hold it and has a 200 year real return of 0%, according to Jeremy Siegel in his book *Stocks for the Long Run."* The 7-10 Year Treasury ETF currently yields 3.3% - state tax free. And the largest annual loss of the 7-10 year US Treasury index in the past 75 years was 10%, which compares very favorably to the list above.

Through Wealthcare we help our clients maintain the best allocation of stocks, bonds and cash needed which represents the 90% of returns necessary to deliver sufficient confidence in meeting their important goals while minimizing risk. Taking greater risk to impact an extra 10% of returns makes no sense. We avoid it.

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