

observations

INVESTMENT

Time to Recovery



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As of this writing, the S&P 500 is off more than 40 percent in the past year, and the Dow is down nearly 45 percent. Inevitably, corrections such as these lead to conversations about how long it will take for the markets to recover.

A popular statistic, and one that brings waves of gloom to those who hear it, reminds us that the Dow Jones Industrial average didn't get back to its pre-Depression levels until 1953—nearly 24 years later.

But statistics like that one can be very misleading. In the first place, they assume a portfolio is invested 100 percent in the Dow.

This is not how Moneta Group invests clients' money. Even for portfolios allocated 100 percent to stocks, only about one-third would be in Dow stocks. And most Moneta clients do not have 100 percent of their portfolios allocated to stocks, making the Dow an even smaller component.

But more important, this analysis ignores the impact of rebalancing. When stock values correct and a portfolio's allocation to stocks falls below its target, Moneta's philosophy is to rebalance back to the agreed-to levels. In so doing, we are keeping the exposure to stocks constant and 'buying low.'

The net result is that when the market recovers, the portfolio's value usually has returned to its previous level much faster than if rebalancing had not been done.

(continued on page 2)

*Charts are for illustrative purposes only. Performance returns shown are those of various asset classes.

These model returns do not represent actual investment decisions by Adviser and, thus, may not reflect the impact that material economic and market factors might have had on our decision making if Adviser was actually managing the money.

Performance returns were calculated after the periods shown. Performance returns reflect the reinvestment of dividends and are calculated based on total return, including gains or losses plus income, without deducting Adviser's advisory fee.

Mutual funds in which the client's assets may be invested charge their own advisory and other fees as described in each fund's prospectus.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

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Our fourth-quarter **Investment Observations** newsletter addresses concerns voiced by you, our clients, in response to the constant barrage of news related to the current financial situation. Along with our bi-weekly 'Voice of Moneta' e-mails and ongoing communications you have with individual principals, we hope to provide answers to your questions and perhaps serve as a 'voice of reason' in the relentless negative news that has claimed the headlines.

We hope you're enjoying the weekly 'blogs' (written by Moneta Group's Professional Consultants) and posted in the "For Our Clients" area of the Web site, www.monetagroup.com, as well as the 'Voice of Moneta' e-mails. As always, your opinions, suggestions and feedback are valuable in helping us shape the communications we send to you. We welcome your ideas for future **Observations** newsletters. Please send your comments to Nancy Powers: npowers@monetagroup.com

observations

Let's look at this theory in relation to the Great Depression.

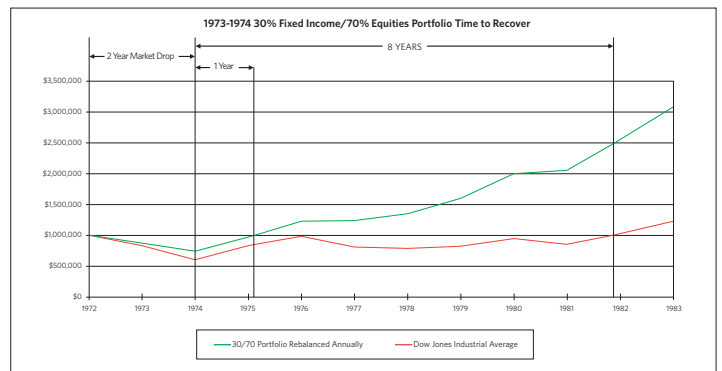
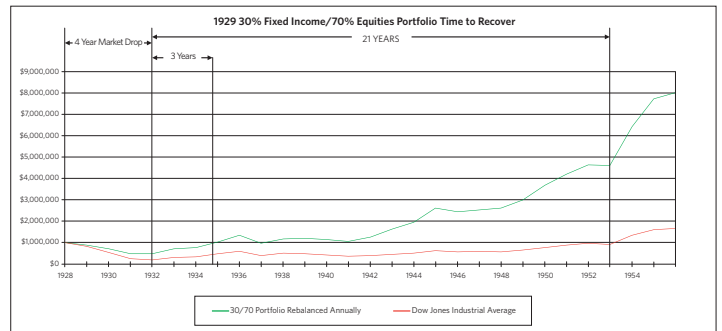
In the chart to the right, the red line illustrates how a \$1,000,000 portfolio, invested 100 percent in the Dow Jones Industrial Average, performed in the years following the market's collapse. It clearly shows that the portfolio did not recover its prior level until the end of 1953.

However, compare these results to the green line, which represents a diversified portfolio of 70 percent U.S. stocks and 30 percent U.S. bonds, one that was rebalanced each year.

That portfolio found its previous level just seven years later!

The same comparison applies during the crash of 1973 to 1974. The Dow Jones took 10 years to achieve its pre-crash high. But the 70/30 portfolio, annually rebalanced, got back to even in just three years.

This analysis shows similar results in the Tech crash and, in fact, all other market corrections. And it explains, in part, Moneta's philosophy on rebalancing. ❖



The Investing Environment in 2008

Based purely on statistics provided by Ibbotson Associates¹, the chance of experiencing what the financial markets returned in 2008 was less than half of 1 percent. In more colorful terms, we'd call 2008 results a 'black swan.'

We have to go back to 1931 to find a year with anything near the broad-based declines of 2008. It was a challenging year by any measure, and Moneta Group clients experienced portfolio losses that exceeded what we reasonably expected.

In light of this outcome, it is right and logical to question our investment strategy and,

perhaps more important, to ask how the results of 2008 might change our approach in the future. We don't have a final answer yet, but we want to share some information that speaks to these important questions.

Review of Current Investment Philosophy

Moneta's current philosophy of investing has its roots in Modern Portfolio Theory, which teaches that to achieve the highest long term returns with the least amount of volatility, it is crucial to diversify holdings across investments that are lowly-correlated with

one another. In other words, we don't want everything in a portfolio going down at the same time. A strategy of broad diversification across many different asset classes is designed to reduce volatility in a portfolio. However, history shows that in times of severe economic decline, this benefit is reduced.

We augment this strategy with a strict rebalancing discipline. Why? Because we believe (as do most) that it is impossible to guess with any accuracy which asset classes will be up or down in any given year. We also note that, historically, yesterday's winners frequently

turn into tomorrow's losers, and vice versa. Allocating a set amount to each asset class, and rebalancing regularly, allows us to capitalize on these factors and reduce the long-term volatility of the portfolio. ❖

Challenging the Status Quo

One principle of Moneta's investment process has always been to challenge our philosophy, and today is no different. There are four primary ways in which we do this:

- Moneta's Investment Department selects and monitors the investment vehicles that Moneta Principals

¹ Ibbotson Associates® provides asset allocation consulting services to institutional clients and is a leading authority on asset allocation with expertise in capital market expectations and portfolio implementation.

recommend for our clients. One of the Investment Department's most important responsibilities is evaluating which asset classes should be included in client portfolios. Should we invest in emerging markets? Hedge funds? Currencies? We accomplish these evaluations through direct research, consulting with other investment firms and industry experts, and continual study of academic and real-world publications.

- The Moneta Investment Selection Committee reviews and evaluates all Investment Department recommendations. This 10-person team includes Moneta Principals, our Chief Investment Officer, and three outside investment experts. It is the committee's responsibility to give final approval to Investment Department recommendations.

- Moneta also has an Investment 'Think Tank,' a group of tenured Principals and outside experts tasked exclusively with challenging the status quo. Meetings of the Think Tank include a great deal of brainstorming and candid conversation, and when the Think Tank identifies a strategy it feels has traction, that strategy goes to the Investment Department to be thoroughly researched.

- Finally, Moneta's 28 Principals are highly involved in the investment community at large,

providing additional balance and perspective that is crucial to the firm's investment process. ❖

How We Fared in 2008

Given the 12-month results of 2008, it would be easy to conclude that Moneta's investment strategies didn't work, and that diversification across different asset classes, along with rebalancing, is ineffective.

We note that Moneta's clients were certainly not alone in absorbing large losses in 2008: The true titans of investing, Warren Buffett, the Harvard and Yale endowments, pension funds, charitable organizations and many others experienced significant downturns. Locally, the Missouri State Retirees Pensions Fund (MOSERs) announced it was down nearly 24 percent in 2008. In fact, only people in cash equivalents were truly spared in 2008.

We also note that with very few exceptions, the investments we selected for our clients in 2008 did well against their respective peer groups. It's not great consolation to say, "You lost a lot, but not as much as most people," yet it is an important perspective in an otherwise disappointing year. ❖

What are the Alternatives?

Despite the historic effectiveness of our investment

strategy, challenging times always call for a closer review of alternative approaches.

- **We could encourage clients to invest only in money markets and CDs.**

Assuming investments stay below FDIC insurance limits, this strategy certainly protects principal. But because of inflation, the 'real' value of portfolios would decline over time. Few of our clients' retirement goals would be achieved with the returns this strategy would provide.

- **We could encourage clients to put all their money in bonds.**

Unfortunately, as we saw in 2008, bonds can have just as many snares as stocks. Even if clients diversified away the default risk by owning a portfolio with many different holdings, most would be constrained by the returns. Historically, bonds have not outpaced inflation sufficiently for most clients to meet their goals.

- **We could encourage clients to stay in cash until they think the market is going to recover.**

However, history clearly shows that by the time investors figure out the market is recovering, they will have missed the upturn, having succeeded in selling assets at near all-time lows, and missing out on much

of the recovery.

- **We could try to guess the asset class that is going to be the next winner.**

But there are two problems with this: 1) History shows it is not possible to consistently pick the winners. 2) Everything is beaten up so badly today that just about any asset class has great upside potential.

Since none of these alternatives are attractive, we remain confident that diversifying across asset classes with a strict rebalancing discipline is the best long-term investment strategy for our clients. That said, we are looking hard at our investment strategy to determine if there are any opportunities to improve the efficiency or effectiveness of any of its many components. ❖

The Benefit of a Diversified Portfolio

We will never stop challenging our process. In years of global economic distress, asset classes are generally linked and decline together. Economies are cyclical, and our strategy is designed to take advantage of those cycles. Fortunately, better times have always emerged. Over time, we continue to believe it is necessary to endure years like 2008 to receive the inflation-busting, wealth-creating, long-term returns a diversified portfolio can provide. ❖

A Worth magazine interview with:

David Swensen, Chief Investment Officer of Yale University's portfolio. (For the complete article, visit 'For Clients Only' at www.monetagroup.com and click on 'Voice of Moneta.')

Q: Have recent events caused you to re-evaluate your investment strategy?

A: No.

Q: Aren't people discouraged when they see their portfolios plummet?

A: People tend to look at the highest number their portfolios ever reached and believe that number is theirs. When it goes down, they feel as if they've lost something. In one sense, it really wasn't theirs.

Q: What if they cashed it out?

A: But that's not what you do. Even if you're 65 or 70 you still have a substantial life expectancy.

Coca-Cola: The Ticking Time Bomb?



Luke Ferraro
INVESTMENT ANALYST

Cola-Cola, the world's largest soft drink producer, must be a ticking time bomb based on how the equity markets are treating its stock. How did I come up with this initial theory? Because during one point this year, the stock had fallen by more than 38 percent!

Some might argue with my theory and propose that the markets are efficient and any drop in stock price is warranted by a perfectly explainable reason.

For example, opponents of my theory might say the drop in the stock price could be because sales of Coke are decreasing and Pepsi is taking market share away. But that can't be an explanation because Pepsi stock price is down about 29 percent this year. Well then, perhaps more and more people are drinking generic

brands of soda to save on cost in the downturn of the economy. Nope. Cott Corporation, the maker of RC Cola, is down close to 85 percent this year.

Efficient-market proponents might say that consumers have moved off soda and into water. Well, the two largest bottled water producers are Dasani and Aquafina, Coca-Cola and Pepsi products respectively. "Not bottled water, tap water!" Aqua America, one of the nation's larger water utilities stocks, is down close to 20 percent through the end of October. So, since the stock price has fallen, and since no stock in the non-alcoholic beverage industry has gone up, Coca-Cola must be a ticking time bomb.

Or maybe this is what's going on: Investors are selling Coca-Cola stock and other stocks of well-managed companies simply to raise cash. Billions and billions of dollars have moved out of mutual funds and hedge funds and into money markets.

These mutual funds and hedge fund managers must do one thing and one thing only in order to raise cash to repay investors: They must sell stocks. Coca-Cola's future earnings, sales, dividends or products are, as a general rule, not even taken into

consideration when managers need to raise cash.

This is not a recommendation to buy Coca-Cola stock. I could have produced the same article using 1,000 different companies as the example. The purpose is to emphasize that, as long-term investors, we should be taking advantage of opportunities in the market to buy great companies at reduced prices.

I believe that the markets eventually will recover from these current prices.

When they do, stocks of great companies will rebound as the very same mutual fund and hedge fund managers who are then receiving money from investors will again begin buying stock to put that money to work.

When they do, the stock price—and the markets—will go up. ❖

"Leaving the game plan is a sign of panic, and panic is not in our game plan."

— Chuck Noll, former coach of the Pittsburgh Steelers