The Lam Group
Investment Management

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The Big Picture: The New Normal?

In the aftermath of the global financial meltdown many pundits, most notably Bill Gross of PIMCO, the world's largest fixed income manager, stated that the economic impact resulting from the crisis would permanently inhibit future global growth and require investors to rethink their future return expectations. The argument was for stock and bond markets worldwide to experience a "New Normal" of lower expected long-term returns. This "New Normal" was marketed as the cornerstone of PIMCO's May 2009 Economic Outlook and they, along with many other pundits and salesmen began marketing new and often expensive "alternative" and "tactical" investment products to give investors seeking new (abnormal?) ways to outperform the "Normal", be it new or old.

Table 1: The New Normal – Cumulative Asset Class Returns from 3/31/09 to 3/31/11

EQUITY ASSET CLASSES	The New Normal? 3/31/09-3/31/2011	Last 12 Months	Last 10 Years
S&P 500 Index - Domestic Large Cap Stocks	+ 73.20%	+15.65%	+ 38.28%
Russell 2000 Index - Domestic Small Cap Stocks	+104.75%	+25.79%	+113.29%
MSCI EAFE Index - International Large Cap Stocks	+ 70.53%	+10.42%	+ 68.99%
MSCI EAFE SC Index - International Small Cap Stocks	+103.92%	+19.94%	+172.49%
MSCI EM Index - Emerging Markets Stocks	+114.51%	+18.46%	+371.93%
DJ US Select REIT Index - Domestic Real Estate	+165.64%	+24.44%	+190.36%
FIXED INCOME ASSET CLASSES	**The New Normal? 3/31/09-3/31/2011**	**Last 12 Months**	**Last 10 Years**
BarCap Aggregate Bond Index - US High-Grade Bonds	+13.21%	+ 5.12%	+ 71.87%
BarCap High-Yield Index	+78.49%	+14.31%	+128.74%
BarCap TIPS Index - US TIPS	+14.58%	+ 7.91%	+ 92.16%
DJ UBS Commodities Index - Commodities	+54.87%	+28.49%	+ 97.96%
Citigroup Non-$ World Bond Index - Non-$ Bonds	+17.62%	+ 8.51%	+117.70%
JPM EMBI Global Bond Index - Emerging Markets Debt	+41.56%	+ 8.58%	+173.86%

Source: Morningstar, JP Morgan, PIMCO and DFA.

As we can see from Table 1, the timing of the proclamations in early 2009 for lower return expectations and a "New Normal" investment climate could not have been more precisely mistimed.

What does normal have to do with risk?

In our view, there is nothing old or new about the relationship between risk and reward. Positive return can only exist in the presence of risk and in today's world, there is plenty of risk to go around. In some areas there is more risk than before, in other areas there is less.

Ten years ago, many felt US large cap growth stocks were a "sure thing" (a new normal?) and these investors could not be bothered with more risky emerging markets stocks. History has shown us which asset class has been more rewarding over the last decade. In many ways, the investors who rely on the safety and comfort of buying what others are buying are not really investing, but rather they are reacting to and consuming emotionally-based stimulus, often from overbearing media outlets. Unfortunately, the counter-intuitive nature of the risk/reward relationship is difficult to see with an emotionally-based decision-making mindset.

Two years ago, during what many felt was the most volatile and uncertain period in our lifetimes, where the entire financial system was teetering on the brink, those investors who eschewed the safety of cash and made riskier (but diversified) investments were handsomely rewarded.

Return finds investors who take risk

Over the long run, higher risk and higher-expected return have often converged.

Today, the US has many of the negative economic characteristics (growing budget/trade imbalances, high unemployment, weak currency, impending inflation etc.) of many risky emerging markets countries, while many emerging markets countries (e.g. China, India, etc.) over the last 10 years have become more stable and less risky by most economic measures.

In the next 10 years, where will return find investors?

Academic studies[1] have shown that GDP growth and equity returns have little correlation with each other and that **risk** is the primary determinate of return. Without some level of risk, it is unrealistic to expect meaningful return.

While there are few who currently believe economic growth in the US will match countries like China and India over the next 10 years, the markets have already recognized the promise of economic growth in the emerging markets over the last 10 years (Table 1). It is worth noting that as countries like China and India lose their advantage of lower-cost labor due to their strengthening currencies, these countries may choose to allocate their resources differently and extend the scope of their US investments beyond the traditional purchases of US government bonds, much like Japan did in the 1980s.

In a weakened economic state, the US could actually become a better investment. As the US dollar loses value, US assets will become increasing inexpensive to foreign investors and the countries with the strongest currencies may increase their acquisitions of US companies, real estate, and resources. Germany's EuroNext acquisition of the New York Stock Exchange is a recent example of what might become a trend. It is possible that US equity markets will rise merely as a consequence of global bargain hunting. *Return will find investors*. While growing foreign ownership of traditionally US-owned assets may not necessarily be good for our country, it could be beneficial for the domestic equity markets.

[1] Marlena Lee. Deficits, Debt, and Markets. December 2010

Is the concept of the New Normal wrong? We will let the performance of all asset classes since this concept was introduced speak for itself. However effective, marketing, especially when presented in the luxurious wrapping of well-known, yet conflicted pundits, is still just marketing.

1Q 2011

In our managed portfolios, 2011 began strongly, but the quarter ended with a month marred by unpredictable and exogenous shocks to the global capital markets. On one side of the world, turmoil and bloodied political unrest in the MENA (Middle East and Northern Africa) region caused oil prices to rise, while on the other side of the world, Japan was rocked by the most powerful earthquake in its history, bringing tsunamis and a nuclear crisis to the forefront of investor consciousness. Unrelated to the crises in MENA and Japan, fears of further debt problems in Europe were also renewed.

With all these unexpected events and the consequential spikes in volatility and market uncertainty, our investments were well served by our globally-diversified and balanced investment strategy.

Despite the worldwide increase in volatility, the global equity markets continued their rebound this year. But much like last year, the rise was anything but gradual or deliberate. While the quarter started off favorably for the US and other developed-country equity markets, emerging markets had negative returns during the first two months of the year; yet by quarter-end, even the emerging markets had positive results. Domestically, the S&P 500 rose 5.92%, international developed markets, as measured by MSCI EAFE (net) was up 3.36% and emerging markets, as measured by MSCI EM (net) rose 2.05% for 1Q 2011.

Once again, ***patience***, even in the presence of unpredictable and unexpected events, rewards the long-term investor who adheres to a disciplined asset allocation plan.

It is worth noting that events like the Japanese earthquake and the unrest in the Middle East (much like the volcanic eruption in Iceland, the oil spill in the Gulf of Mexico, Hurricane Katrina, and the terrorist attacks of 9/11), while unpredictable and unexpected, seem to happen with such regularity on the global stage that exogenous shocks must be anticipated.

While these types of events are impossible to foresee, a globally-diversified and balanced investment strategy is a sound and time-tested approach for those of us who cannot successfully see into the future with any degree of accuracy or consistency.

"A goal without a plan is just a wish"
Antoine de Saint-Exupery, a French writer

We continue to believe the most important investment decision an investor makes is the initial portfolio asset allocation configuration articulated in a written Investment Policy Statement (IPS) and prepared with the guidance of an unconflicted investment advisor. An unconflicted advisor is one who acts in a fiduciary capacity and puts its client's interests ahead of its own.

Consideration of an investor's time horizon, risk tolerance, current income needs, tax position, and estate plans must be made in the context of a wide range of possible market conditions. The asset allocation configuration *must not* be driven by then prevailing market conditions, the accompanying emotions, or the media that often plays into those emotions. Similarly, portfolio rebalancing decisions should only be made with the goal of buying low and selling high in the context of long-term investment policy guidelines.

The Lam Group: Invisible and Unconflicted
An unconflicted, independent investment manager is only visible to those who are looking for one.

As our clients and friends know, we started The Lam Group almost 10 years ago because Tina and I could not find a suitable investment management firm to manage our own personal assets. Armed with a strong capital markets framework borne out of our combined 20 years of professional experience in institutional markets on Wall Street, we knew what we wanted but were unable to find it. The most important elements we were looking for was an independent firm with a business model that was unconflicted with the interests of their clients. Why was an experienced and knowledgeable investment advisor with a transparent and academically-tested investment strategy so hard to find?

As we could not find one, we decided to become one.

Over the last 10 years, we have grown organically and have over $200MM AUM with fewer than 40 clients. We have never done any advertising and have generally met new clients as referrals from existing clients, as well as through leading tax advisors and estate attorneys. We were fortunate to be the subject of a full page article in the Wall Street Journal on February 7, 2011 (page R5 of the physical paper). The article (written by WSJ reporter Shefali Anand) was based on the Randomness of Asset Class Returns research we had published earlier this year and really captured the essence of our globally-diversified and balanced portfolio strategy.

The reaction to the article was been overwhelming and indicates that many others are looking for what Tina and I could not find 10 years ago. The Lam Group is currently accepting a limited number of new clients who believe in our diversified, multiple-asset class investment management approach and embrace our use of passive investment strategies.

The Lam Group

Investment Management

The Lam Group focuses on designing and managing balanced and globally-diversified investment portfolios. Our asset allocation approach employs a highly-analytical process to determine the appropriate combination of asset classes to build investment portfolios and strategies that realistically and optimally reflect the needs, risk tolerances, and investment horizons of our clients.

Our Firm has been structured to provide our clients with an investment management relationship that enjoys the highest degree of transparency and avoids conflicts-of-interest. This transparency, combined with the intellectual honesty of using passively-managed asset classes in our asset allocation strategy, is the foundation of our overall investment philosophy and approach.

The Lam Group is an independent, fee-only, SEC-registered investment advisory firm with clients in Oregon, Washington State, California, Texas, Maryland, Florida, Pennsylvania, Connecticut, New York, and New Jersey. We offer both investment management and portfolio consulting services for taxable investors, family offices, endowments and foundations.

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Asset Class Investment Results:
All portfolios constructed and managed by The Lam Group are designed for an individual client's specific risk tolerances, income requirements and investment horizon. Our investment management approach includes the design of a customized asset allocation plan, the research and selection of the most appropriate and cost-effective asset class investments for the client's specific investment policy, and the on-going monitoring and disciplined rebalancing of the aggregate portfolio to optimize return, manage risk and minimize taxes.

As different clients have different goals, risk profiles and investment horizons, it is not useful to publish a track record of specifically-managed portfolios. The investment performance data below illustrate the returns of some of the actual mutual funds utilized by The Lam Group for specific asset class allocations in the construction of investment portfolios we manage.

All data is as of 3/31/11

Equity Asset Class Category	**1Q2011**	**12Mo**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Total Equity Market				
-Wilshire 5000 Index (Total US Eq. Market)	***+6.00%***	***+17.57%***	***+3.88%***	***+1.00***
Domestic All Cap Fund	+7.21%	+20.10%	+5.32%	+0.99
Domestic Large Cap Stocks				
-S&P 500 Index	***+5.92%***	***+15.65%***	***+2.62%***	***+1.00***
Domestic Large Cap Value Fund	+9.29%	+19.59%	+3.12%	+0.98
Domestic Small Cap Stocks				
-Russell 2000 Index	***+7.94%***	***+25.79%***	***+8.57%***	***+0.93***
Domestic Small Cap Value Fund	+8.80%	+27.26%	+8.53%	+0.92
Real Estate Investment Trusts (REITs)				
-DJ US Select REIT Index	***+6.70%***	***+24.44%***	***+1.48%***	***+0.80***
Domestic REIT Fund	+6.59%	+24.49%	+2.48%	+0.80
-S&P Global REIT (ex-US)	***+4.28%***	***+22.24%***	***-4.93%***	***+0.87***
International Real Estate	+4.78%	+23.74%	-5.20%	N/A
International Large Cap Stocks				
-MSCI EAFE Index	***+3.37%***	***+10.42%***	***-3.02%***	***+0.92***
International Large Cap Value Fund	+4.70%	+13.48%	-1.91%	+0.93
International Small Cap Stocks				
-MSCI Small Cap EAFE Index	***+2.96%***	***+19.94%***	***+1.39%***	***+0.86***
International Small Cap Value Fund	+5.58%	+18.71%	+1.74%	+0.89
Emerging Markets Equity				
-MSCI Emerging Markets Index	***+2.05%***	***+18.46%***	***+4.32%***	***+0.83***
Emerging Markets Value Fund	+0.72%	+18.89%	+6.36%	+0.85

Source: Morningstar, JP Morgan, PIMCO and DFA. * 5 yr correlation using monthly data

All data is as of 3/31/11

Fixed Income Asset Class Category	**1Q2011**	**12Mo**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Investment Grade Bonds				
-Barclays 1-3 year Govt Bond Index	***+0.06%***	***+ 1.73%***	***+ 2.48%***	***-0.31***
Short Duration Domestic Inv. Gr. Bond Fund	+0.65%	+ 3.90%	+ 4.47%	+0.46
Short Duration Domestic Muni Bond Fund	+0.56%	+ 1.63%	+ 2.52%	-0.01
-Barclays Aggregate Bond Index	***+0.42%***	***+ 5.12%***	***+ 5.30%***	***+0.16***
Domestic Investment Grade Bond Fund	+1.11%	+ 6.86%	+ 8.31%	+0.26
Domestic High Yield Bonds				
-Barclays High Yield Bond Index	***+3.88%***	***+14.31%***	***+12.94%***	***+0.74***
High Yield Bond Fund	+5.11%	+17.23%	+14.71%	+0.82
Inflation-Linked Bonds				
-Barclays TIPS Index	***+2.08%***	***+ 7.91%***	***+ 3.93%***	***+0.26***
TIPS Fund	+2.07%	+ 8.48%	+ 3.92%	+0.26
-Dow Jones UBS Commodities Index	***+4.45%***	***+28.49%***	***- 5.20%***	***+0.54***
Commodities-Linked Fund	+7.16%	+37.43%	- 2.67%	+0.55
International (non-US $) Bonds				
-Citigroup Non-$ World Govt Index	***+0.97%***	***+ 8.51%***	***+ 3.25%***	***+0.26***
Non-$ Bond Fund	+1.55%	+ 5.85%	+ 1.64%	N/A
Emerging Markets Debt				
-JP Morgan EMBI Global Diversified Index	***+0.87%***	***+ 8.58%***	***+ 8.72%***	***+0.63***
Emerging Markets Debt Fund	+1.27%	+ 9.68%	+ 8.19%	+0.66

Source: Morningstar, JP Morgan, PIMCO and DFA.

* 5 yr correlation using monthly data

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