The Lam Group
Investment Management

Was This Time Different?

After a successful 2009, some would say that the most expensive investment advice given during the global credit crisis was:

This Time Is Different

The last 20 months are an example of how volatile markets can be and the importance of a long-term strategy and investment discipline. Markets are unpredictable and the severe downturn that began in September 2008 was as unexpected as the worldwide rally that began in March 2009.

Table 1: Asset Class Returns for The Crisis, The Recovery and The Aggregate

EQUITY ASSET CLASSES	The Crisis (6 mo) 8/31/08-2/28/09	The Recovery (14 mo) 2/28/09-04/30/10	*This Time is Different? (20 mo) 8/31/08-04/30/10*
S&P 500 Index - Domestic Large Cap	-41.82%	+ 65.46%	*- 3.74%*
Russell 2000 Index - Domestic Small Cap	-46.91%	+ 87.33%	*- 0.55%*
MSCI EAFE Index - International Large Cap	-44.58%	+ 61.26%	*-10.64%*
MSCI EAFE SC Index - International Small Cap	-45.16%	+ 84.97%	*+ 1.44%*
MSCI EM Index - Emerging Markets	-47.21%	+110.23%	*+10.98%*
DJ Wilshire REIT Index - Domestic Real Estate	-61.72%	+135.50 %	*- 9.84 %*
FIXED INCOME ASSET CLASSES	**The Crisis (6 mo) 8/31/08-2/28/09**	**The Recovery (14 mo) 2/28/09-04/30/10**	***This Time is Different? (20 mo) 8/31/08-04/30/10***
BarCap Aggregate Bond Index - US High-Grade	+ 1.88%	+10.33%	*+12.40%*
BarCap High-Yield Index	-22.39%	+64.92%	*+27.99%*
BarCap TIPS Index - US TIPS	- 7.47%	+15.05%	*+ 6.46%*
DJ UBS Commodities Index - Commodities	-44.03%	+27.29%	*-28.76%*
Citigroup Non-$ World Bond Index - Non-$	- 1.62%	+10.30%	*+ 8.51%*
JPM EMBI Global Bond Index - Emerging Markets	-12.74%	+35.02%	*+17.82%*

Source: Morningstar, JP Morgan, PIMCO and DFA.

As illustrated in Table 1, despite the 6 month crisis in all asset classes, the cumulative performance of these asset classes over the last 20 months, ***while disappointing, was not the end of the world.***

At the apex of the crisis in February 2009, many of those who predicted that "this time is different", also boldly proclaimed that:

Commercial Real Estate is: a) the next shoe to drop, b) the next nail in the coffin, c) both a & b

It is worth noting the DJ Wilshire REIT Index is up over 135% over the last 14 months.

What the data in Table 1 shows us is that trying to predict market direction, especially with a short-term time horizon is a loser's game. <u>Global diversification, portfolio balance and discipline, combined with low investment expenses and tax-efficiency, are the keys to long-term investment success.</u>

Over the long-term, if you take more risk, your expected return should be higher

While greater risk does not necessarily translate into higher return in the short-run, over longer periods of time, if greater risk did not result in higher return, why would anyone take greater risk? Conversely, if you are not taking very much risk, why do you deserve to make a higher return?

The last 10 years of equity asset class returns support this assertion. In late 1999, the US economy was soaring. Unemployment was at record lows, our currency was strong, inflation was low, and our budget was in surplus. With regard to the US stock market, the economy was "new" and it was often heard in the financial media that:

the risk was NOT being in US growth (internet) stocks.

At the same time, the circumstances in the emerging markets countries were dire. In the late 1990s, there had been an Asian currency crisis (the Asian Contagion), the Russian bond market had defaulted, and the political unrest in many emerging markets countries was constantly in the news. Common problems that many emerging markets countries shared were high unemployment, weak currencies, rampant inflation, and weak sovereign balance sheets.

In 1999-2000, emerging markets looked like a risky investment while the US looked like a sure thing. However, history has shown us that investors who took risk in the new millennium (2000) were rewarded over the next 10 years and the investors who watched too much CNBC television were not.

Table 2: US vs Emerging Market Equity 10 yr Returns thru 12/31/09 (annualized and cumulative)

	10 Years	
EQUITY ASSET CLASSES	**Annualized**	**Total Return**
S&P 500 Index - Domestic Large Cap	**- 0.95%**	**- 9.10%**
MSCI EM Index - Emerging Markets	**+10.11%**	**+161.96%**

Source: Morningstar, JP Morgan, PIMCO and DFA.

Today, rare is the pundit who believes the US economy, federal government and corporate America are in anything but trouble, and at the same time it is often heard in the financial media that:

the risk is NOT being in emerging market stocks.

It is fair to say that the US economy is on unstable footing; unemployment is high, our currency is weak, inflation is pending and our political direction is anything but certain. At the same time, circumstances in the emerging markets have never been better; employment is robust resulting in a growing middle class, currencies are strengthening, and they enjoy large budget and trade surpluses.

Is it possible that emerging markets equities are the next new thing?

Or is it possible that being up over 160% over the last 10 years (vs. US equities being down over 9%) the markets have already recognized the promise of the emerging markets and compensated the investors who took the risk when they were risky?

*If the US is more risky than it was 10 years ago, and the emerging markets are less risky than they were 10 year ago, where should the **future** expected return be higher?*

Table 3: Asset Class Returns for 10 years thru 12/31/09

EQUITY ASSET CLASSES	10 Years Annualized	10 Years Total Return
S&P 500 Index - Domestic Large Cap	- 0.95%	- 9.10%
Russell 2000 Index - Domestic Small Cap	+ 3.51%	+ 41.23%
MSCI EAFE Index - International Large Cap	+ 1.17%	+ 12.38%
MSCI EAFE SC Index - International Small Cap	+ 6.87%	+ 94.29%
MSCI EM Index - Emerging Markets	+10.11%	+161.96%
DJ Wilshire REIT Index - Domestic Real Estate	+10.67%	+175.59%
FIXED INCOME ASSET CLASSES	**10 Years Annualized**	**10 Years Total Return**
BarCap Aggregate Bond Index - US High-Grade	+ 6.33%	+ 84.75%
BarCap High-Yield Index	+ 6.72%	+ 91.57%
BarCap TIPS Index - US TIPS	+ 7.70%	+110.02%
DJ UBS Commodities Index - Commodities	+ 7.13%	+ 99.15%
Citigroup Non-$ World Bond Index - Non-$	+ 6.62%	+ 89.88%
JPM EMBI Global Bond Index - Emerging Markets	+10.52%	+171.98%

Source: Morningstar, JP Morgan, PIMCO and DFA.

This question is not meant to suggest that the prospects of the US are better or worse than the emerging markets or that one asset class should be eliminated in favor of another. As markets are unpredictable, both asset classes are important contributors to a diversified portfolio strategy.

In practice, buying low and selling high is never easy or obvious; as a consequence, the framework of a disciplined multi-asset class investment strategy has never been more important.

In retrospect, the asset class results for the past 20 months and the last 10 years were unexpected, surprising and in many ways shocking. What will the next decade bring?

We are sure of only one thing:

The future will continue to be unpredictable

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