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MANAGEMENT

"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

IS IT TIME TO GIVE UP ON A BUY-AND-HOLD INVESTMENT STRATEGY?

The current bear market is making many investors question their allegiance to a buy-and-hold strategy. Why sit in a portfolio that is taking such a hit? Why not practice a market timing strategy, selling out of stocks when the market appears "high" and buying back in when it appears "low?"

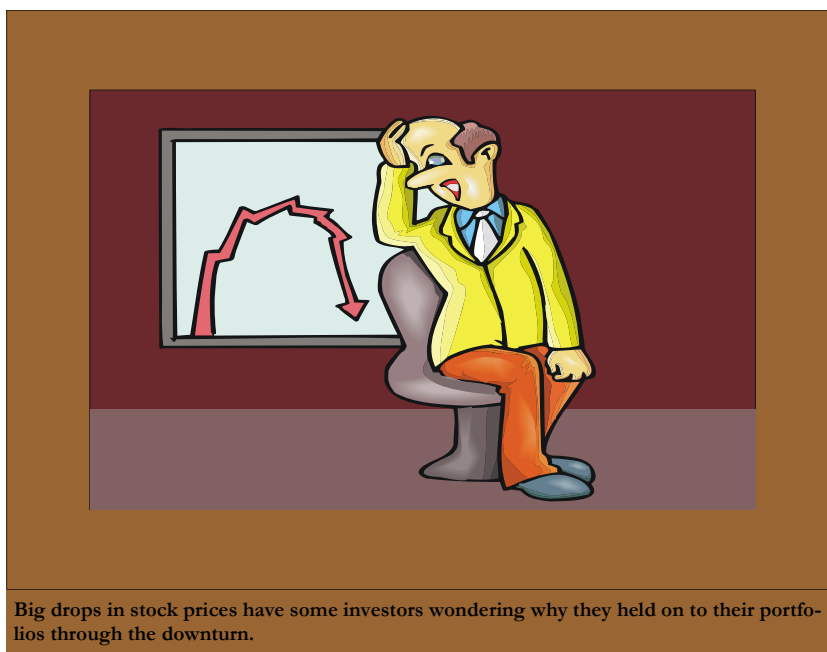
After all, these investors ask, if we had sold when the market was at its recent peak in October 2007 we would have missed the current downturn. Then we can buy back in before it starts to go up again and end up with more money than if we had simply held our portfolios.

It sounds good, so good that it has always been the Holy Grail of investment management, much sought after but never found. Why? Because no one has been able to do it effectively.

It doesn't work

"The overwhelming evidence shows that market timing is not an effective way to increase returns for one harsh but compelling reason: on average and over time, *it does not work*," writes Charles Ellis, author of "Winning the Loser's Game" and former chair of the investment committee at Yale.

John Bogle, founder of the



Big drops in stock prices have some investors wondering why they held on to their portfolios through the downturn.

Vanguard Group, one of the largest mutual fund companies, agrees: "In 30 years in this business, I do not know anybody who has done it successfully and consistently, nor anybody who knows anybody who has done it successfully and consistently."

Market timing requires investors to make two difficult predictions: you must correctly identify the market's peak and its trough. As you can see from any day's financial

headlines, hundreds of the investment world's leading minds argue about this point every day without reaching a correct consensus.

Burton Malkiel of Princeton University, notes in his classic book "A Random Walk Down Wall Street" how hard it is for the experts to identify these key turning points.

Mutual fund mistakes

"Mutual-fund managers have

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- ◆ Stock market has done better under democratic presidents.
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- ◆ Pensions beat 401ks, Millionaires worry & more.

INVESTOR SENTIMENT OFTEN HAS THEM SELLING AT THE WRONG TIMES

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been incorrect in their allocation of assets into cash in essentially every recent market cycle,” he wrote.

For instance, they seem to become cautious just about the time the market has already hit bottom, he notes. Cash holdings of mutual funds hit their peaks at the end of bear markets in 1970, 1974, 1982, and after the stock market crash in 1987, as well as just before rallies in 1991, 1994, and again in 2002. If the managers had been timing things correctly, they would have had little in cash at those points.

Another problem with trying to time the market is that you have to be extremely accurate. You can't

wait to get back into stocks until a few months after they have gone up, because most of the stock market's gains come in very short periods of time. “Most of the ‘positive action’ is compressed into just a few periods, which (perversely but understandably) tend to follow particularly adverse times for stocks,” found Robert H. Jeffrey in a study published in the *Harvard Business Review*.

Sound like today?

And that may be the most salient point. Why would investors be thinking about selling stocks now after the market has fallen by 50 percent? We won't know until after the fact but per-



Market timing success is elusive.

haps today we are at the market bottom and should be buying. If you had been practicing a market timing strategy, would you be comfortable throwing all of your cash into the market today? That's why it is easier to stick with your portfolio through thick and thin.

EVERY PAST MARKET DOWNTURN HAS ENDED IN A BIG RECOVERY

In times like these it pays to listen to the “old hands” - successful investors who have weathered many previous downturns and who have spent their lifetimes studying the investment markets.

Their advice is pretty similar: sit tight, maintain a diversified portfolio, and, if you have cash to spare, invest more for future gains.



Market timers are often caught short.

John Bogle

“The probabilities for stock market investing right now are very compelling,” John Bogle, the founder of the mutual fund company Vanguard, told *The New York Times* recently.

Bogle, 79, helped to invent the first retail stock index mutual fund, now the Vanguard 500 Fund.

He believes that stock valuations are reasonable and that returns over the next decade may average 9 percent annually.

He cautions against trying to time the market and move in and out of stocks, calling it a fool's errand.

He counsels holding a portfolio of stocks and bonds, and keeping it to a fixed balance. Most of all, he says investors should avoid looking at the markets and their portfolios daily.

“If you were to put your money away and not look at it for many years, until you were ready for retirement, when you finally looked at it, you'd probably faint with amazement at how much money is in there,” he said.

Warren Buffett

At last count investor Warren Buffett was America's richest man. He built his fortunes by investing widely and cannily in stocks and companies for over 50 years.

Buffett wrote an editorial in the *Times* on Oct. 17. The headline was simple: “Buy American. I Am.”

Buffett said he was moving all of his personal wealth not already invested in his flagship Berkshire

Hathaway from bonds to U.S. stocks.

“Equities will almost certainly outperform cash over the next decade, probably by a substantial degree,” he said.

He criticized those who have moved to cash with the idea of getting back into stocks at an appropriate time. “In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: ‘I skate to where the puck is going to be, not to where it has been,’” he wrote.

Burton Malkiel

Burton Malkiel, economics professor at Princeton whose theories led to the creation of index funds, says “a century of investment experience” shows that investors who sell stocks now “are almost always making the wrong decision.”

In a recent *Wall Street Journal* editorial he wrote that his research shows that investors who moved money in an out of stocks from 1995-2007 sharply underperformed the market.

“No one has consistently made money by selling America short, and I am confident the same lesson is true today,” he wrote.

STOCK MARKET HAS DONE BETTER UNDER DEMOCRATIC PRESIDENTS

Regardless of an investor's political affiliation, the U.S. stock market has done better under Democratic presidents than under Republicans since 1929.

During this period, each party has controlled the White House for 40 years.

The stock market rose under all six Democratic presidents, and fell under three of the seven Republicans.

An investor who put \$10,000 into the market and only invested under Republican presidents would have ended up with \$11,733. If the administration of Herbert Hoover is excluded (he presided over the Crash or 1929 and the start of the Great Depression), then the Republican investor would see his \$10,000 grow to \$51,211.



However, the investor who chose to have his \$10,000 in the markets only under Democrats would have seen his wealth grow to \$300,671, an annualized growth rate of 8.9 percent.

Aside from Hoover, the worst presidents to invest under were Richard Nixon and the current President Bush. Both saw the mar-

kets decline during their tenures.

The best Republican administration for investors was that of George H.W. Bush, who presided over an 11 percent annualized gain from 1989 through 1993.

Bill Clinton led the charge for the Democrats, with a 15.2 percent annualized stock market return during his eight years in office.

The worst Democrat for stocks was John F. Kennedy, whose three years in office saw stocks gain by 6.5 percent per year.

There are various explanations for the differences, none proven or entirely convincing. Some economists argue that Democrats pursue expansionist fiscal policies that stimulate the economy. Others argue that Democrats benefit from the fiscal policies of their Republican predecessors.

ACTIVELY-MANAGED MUTUAL FUNDS FAIL TO BEAT THE INDEXES

What is the price of active stock management? In general, it means not doing as well as the stock market.

Academic experts have long argued that it is not worth the price to own actively-managed mutual funds, meaning those funds whose managers make daily judgments on which stocks to buy and sell.

Many studies have shown that passively-managed index and asset class funds have outperformed active funds over the years.

Another confirmation of that phenomenon comes this year. *Investment News*, an industry publication, recently reported that 71 of the top 100 U.S. stock funds fell behind the Standard & Poor's 500 Index in the year through Oct. 28. All of those funds measure their performance against the S&P, which gauges the fortunes of the 500 largest publicly-held U.S. companies.

Fidelity Investments saw 14 of its large stock

funds beaten by the index during the 12-month period, the magazine reported.

Popular funds such as Contrafund and Magellan lost out to the S&P 500. Magellan was particularly hard hit, losing 14.8 percent more than the index.

Three funds owned by American Funds also lost the race, including Growth Fund of America, Fundamental Investors, and the Amcap fund. Amcap was one of the better performers, trailing the index by only one percentage point.

One of the worst losers overall was the T. Rowe Price New Era Fund, which fell behind the S&P 500 by more than 16 percentage points.

Many academic studies have concluded that on average active funds will underperform indexes by at least the margin of the fund's management fees, usually in the 1 to 2 percent range. This year many funds made bad judgments that put them even further behind.

COPING WITH MARKET VOLATILITY: TELL YOURSELF THIS TOO SHALL PASS

The stock market is historically cyclical. Though past performance is no guarantee of future results, there have been six other bear markets—declines of 20% or more—during the last 40 years, * and the market has recovered eventually every time. Even if you wish you had sold at what turned out to be a market peak, or regret having sat out a buying opportunity, you may well get another chance at some point.

Neither the ups nor the downs last forever, even though at the times they may feel as though they will. Even in the midst of the Great Depression, there were short-term rallies and trading opportunities. And in some cases, people built fortunes over time by investing carefully just when things seemed bleakest.

If you're not a trader but nevertheless are reconsidering your current strategy, a volatile market is probably the worst time to turn your portfolio completely inside out. Dramatic price swings can magnify the impact of a wholesale restructuring if the timing of that move is a little off. A well-thought-out asset allocation is still the basis of good investment planning. Even if you feel you need to make changes in your portfolio, they don't necessarily need to happen all at once. Try not to let either fear or greed derail your long-term goals.

PENSIONS BEAT 401KS, MILLIONAIRES WORRY, & MORE

Pensions beat 401ks

The average pension plan outperformed the average 401k plan by one percentage point per year from 1995 through 2006, says Watson Wyatt Worldwide, a pension consulting firm.

It attributed the performance advantage to professional management of pension plan assets, which may have added discipline and investment tools not available to workers making their own decisions about their 401k account investments.

Millionaires worry

Millionaires are becoming more pessimistic about their financial futures, a national survey found. Only 54 percent felt wealthier last year.

Forty percent worry that they won't be able to live comfortably in retirement, while 50 percent said they worry inflation will reduce the value of their income, said the Phoenix Cos. a life insurance group.



Optimistic Advisors

A majority of professional advisors think the stock market will be higher in 12 months and that interest rates will remain low, says Naples Asset Management Co., which surveyed investment managers, CPAs, and attorneys in the southeast.

It found that 65 percent of professionals predicted the Dow Jones Industrial Average would gain over 12 months.

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 ...**
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