



MARKET OUTLOOK

A publication of Strategis Financial Group and MarketOwl.com

Bear markets reveal true value of active management

In my weekly market commentaries, I refer regularly to active investment management. This active management could also accurately be called active risk management or active asset allocation.

Very simply, each describes an ongoing investment strategy where the investment advisor or the investor employs a hands-on approach in an attempt to control risk or to improve returns.

This differs substantially from the traditional myth perpetuated by Wall Street that the best way for investors to make money in the stock market is to passively buy and hold.

Major Wall Street firms and most independent brokers have colorful charts that show that over time, major stock indices like the Dow or the S&P 500 will outperform virtually every other investment. Unfortunately, those Wall Street firms fail to mention that stocks have a history of producing little or no gains over extended periods.

Let me explain the differences in the two approaches by comparing each to fishing.

In the passive approach, we take our boat out into the open water and drop anchor. One spot is just as good as another because we

believe at some point the fish will swim past our position. We bait our lines and toss them into the water. Then we wait for as long as it takes for a hungry fish to come along and bite. According to Wall Street, we don't need to ever change our bait or our location because eventually we will be in the right spot at the right time.

If we want to increase our chance of catching fish, Wall Street says we can diversify by changing to a new random location every hour whether we are catching fish or not.

As an avid angler, I see many people who follow that approach to fishing in spite of having very limited success. Here are some of the

Experienced advisor joins Strategis team

Jeff Goettsche recently joined Strategis as a financial advisor. He has worked in the investment industry for nearly 20 years.

Mr. Goettsche was most recently affiliated with Wachovia Securities where he operated an independent office. He also spent several years working for Merrill Lynch.

A graduate of Brigham Young University, Mr. Goettsche has a degree in business finance.

Jeff lives in the picturesque community of Alpine, Utah, at the base of the Wasatch Mountains. He and his wife, Denise, have three daughters.

In his spare time Jeff enjoys golf and he was a member of the BYU golf team in his younger days.

President/CEO Mark Sumsion



said he is thrilled to have Jeff as a member of the Strategis Financial Group team. "It is a rare opportunity for a firm like ours to be able to attract someone with the expertise and talent of Mr. Goettsche. We are delighted to add his enthusiasm and experience to our team of experts."

reasons people use this fishing method:

- They got lucky using this technique in the past so they see no reason to change
- They have limited angling experience
- They don't know much about the habits of the fish they are trying to catch
- It takes very little effort
- They have never had anyone show them a better way.

In contrast, an angler using an active approach will steer his boat to a spot on the water that provides likely habitat for the specific type of fish he seeks.

He understands that 90% of the water is devoid of fish at any given time, so he might even employ a sophisticated electronic fish finder to make certain there are fish below him. He will use a bait specific to the fish and to the outside conditions.

If he doesn't have immediate success, he will change baits in an attempt to get the fish to bite. If that doesn't produce results, he will quickly move to another location. He will repeat this process until he catches fish.

All commercial anglers and professional sport anglers use the active angling system. Their livelihood depends on catching fish, so

they cannot afford to passively wait for the fish to eventually come to them. Similarly, Wall Street professionals do not follow the approach they espouse for ordinary investors. To understand why, let's go back to our fishing example.

Imagine that you are a fishing guide. For years you have studied specific locations and learned the habits of the fish. You have spent an enormous sum on boats, tackle and other equipment. People pay you well to have you help them catch fish. But you understand that how much money you make depends on your clients' successes. If they don't catch fish, you will soon be unemployed.

Now imagine that you are standing next to your boat on the dock one morning. An expensive SUV pulls up and a well dressed man and his family climb out. The man announces that they have come to enjoy a few days of fishing and would like some tips about the best spots and methods.

You tell him that you would love to help them out and you quote him your normal daily rate of \$500. He responds that \$500 seems much too expensive for something he is sure he is capable of doing on his own. He repeats his request for information and offers you a \$40 tip.

“Over the past nine years, the S&P 500 is the worst-performing of nine different investment vehicles tracked by Morningstar...”

Obviously, for \$40 you cannot afford to give him the information he needs to be successful. You have invested huge amounts of time and money to learn how to help people catch fish. If you sell that information cheaply, you will soon be out of business. On the other hand, money is money. You take the \$40 and tell the man to take his family down to an overhanging tree, to bait his hook with a worm and to wait for a bite.

A few minutes later another vehicle pulls up and another family gets out. They gladly agree to your \$500 rate and in minutes, they are in your boat zooming to a spot that virtually always produces lots of fish. It is far across the lake from where the city sewage pipe empties into the lake under the overhanging tree.

You never give a second thought to the other family you sent to that spot. Perhaps they will catch some fish and perhaps they won't. It doesn't really matter because you've got the money you need for the day, plus an extra \$40 that you can use to take your spouse to dinner that night.

Small-time investors who do their own investing and have online

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accounts with discount firms are like the first man in this example. The big Wall Street firms and independent brokers have no incentive to help them be successful.

So is the fishing guide worth the \$500 a day he is charging? Only the customer and the marketplace can tell us whether or not his service is fairly valued. The same is true when it comes to paying someone to manage your investments.

A March 26, 2008 *Wall Street Journal* article noted that over the past decade, stock market gains have been minimal.

"The stock market is trading right where it was nine years ago. Stocks, long touted as the best investment for the long term, have been one of the worst investments over the nine-year period, trounced even by lowly Treasury bonds.

"The Standard & Poor's 500-stock index, the basis for about half of the \$1 trillion invested in U.S. index funds, finished at 1352.99 on Tuesday, below the 1362.80 it hit in April 1999. When dividends and inflation are factored into returns, the S&P 500 has risen an average of just 1.3% a year over the past 10 years, well below the historical norm, according to Morningstar Inc. For the past nine years, it has fallen 0.37% a year, and for the past eight, it is off 1.4% a year. In light of the current wobbly market, some economists and market analysts worry that the era of disappointing returns may not be over.

"Conventional stock-market wisdom holds that if investors buy a broad range of stocks and hold them, they will do better than they would in other investments. But that rule hasn't held up for stocks bought in the late 1990s or 2000.

"Over the past nine years, the S&P 500 is the worst-performing of nine different investment vehicles tracked by Morningstar..."

Fortunately, investors do not



have to sit passively and watch their portfolio assets decline month after month during a bear market. Since October 2007, the stock market has seen a significant decline. Under a buy-and-hold philosophy, investors who have participated fully in the downturn have seen their account values drop as much as 20%. That is exactly the type of situation active managers attempt to avoid.

Above is a chart that illustrates what active management attempts to accomplish. The gold line is the S&P 500. The black line is iShares Lehman 20+ Year Treasury Bond (TLT).

Look at the downward path of the S&P 500 since October 2007 accentuated by the blue arrow. If an investment advisor practicing active risk management had switched your account from being invested in the S&P 500 to a money market fund in October, what is the value of avoiding the ensuing 17% loss?

Unfortunately, even the best investment managers usually don't have that kind of perfect timing. Look at the point marked by the red circle. What if an advisor at about this point advised moving client assets to TLT because his indicators showed that bonds were gaining

strength when compared to other investment alternatives? We at Strategis Financial found ourselves in that exact position in the summer of 2007.

For a few weeks, the decision to switch assets to long-term government bonds seemed to be questionable because equity markets advanced strongly for eight weeks while bonds foundered. In hindsight, it was brilliant.

While the S&P 500 is only about 5% below that mid-August level, bonds (TLT) have gained

Investment Company Act, Rule 3a-4

As your investment advisor, we are required by the Investment Company Act, Rule 3a-4, to make recommendations in accordance with your individual needs and financial circumstances. We must also periodically check to ensure that these needs and circumstances have not changed. So if there have been changes in your financial circumstances, please contact your advisor at **1-800-279-3377**. We will be happy to make any necessary adjustments in your portfolio selection.

about 10%. In the process, clients also avoided much of the volatility they would have experienced had they been invested in the S&P 500 Index during that time. So can we quantify the value of active investment management?

In this case the value is about 15% or \$15,000 for a \$100,000 account. For that period of time, a \$100,000 account would have been charged fees of about 1.5% or \$1,500. So one could argue that in this case, the value of the active management was a gain of \$13,500.

The real strength of active management is seen during bear market periods. There are numerous studies that show active management does not improve portfolio returns during powerful bull mar-

kets. But when it comes to actual account values, avoiding major losses has a greater statistical impact than similar gains. After all, it takes a 100% gain to erase a 50% loss.

—Flint Stephens

Mr. Stephens is marketing director and a financial advisor for Strategis Financial Group. He has been a writer and editor for numerous investment publications. He has a masters degree in communications from Brigham Young University.

New strategy focuses on global currencies

Strategis Financial Group has

introduced a new investment strategy designed to take advantage of the price variations in international currency.

The creator of the strategy, Rod Jackson, is the consultant and creator of many of the firm's other management strategies including Focus Growth and Retirement Freedom.

Mr. Jackson's methodology uses a system of differential equations to determine which currencies have the strongest momentum at any given time.

It is kind of like when you visit an optometrist and the doctor checks your vision by having you compare one lens against another.

The objective is to allocate client assets to the currency that is showing the strongest momentum at any given time.

Accounts are set up at FolioFN and the investment vehicles are exchange traded funds (ETFs).

Mr. Jackson has more than 25 years experience as a market research analyst. Through the years, he developed trading strategies still in use by some of the country's largest trading organizations. These include widely recognized multinational banks.

For a dozen years, he worked as a management consultant for commodities. Clients included the Mars Corporation, Hershey, General Foods, Hunt Wesson, Nabisco Brands, Mitsubishi Bank, and others. He created econometric models of price movements to forecast commodity price trends.

Mr. Jackson has a degree in computer science from Brigham Young University. While at BYU, Mr. Jackson supervised the School of Management's transition from mainframe computers to PCs. He also has an associate's degree in music.



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During the past 20 years, the author, Flint Stephens, wrote and edited publications for nationally known experts like Howard Ruff, Kenneth Trester, Dennis Slothower, and others. Annual subscription rates for these publications ranged from \$69 to \$495.

Mr. Stephens' experience covers everything from mutual funds, to stock and commodity options, to precious metals, to international business. While

MarketOwl.com focuses primarily on Exchange-Traded Funds (ETFs), the information encompasses a wide range of industry sectors and has application to almost all types of investing.

With a master's degree in communications, Mr. Stephens is skilled at taking complex concepts and explaining them in easy-to-understand language. The information he presents is valuable for novice investors as well as for those with many years of trading experience.

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