Better Off with Bonds?
The 40-Year Story

A *Journal of Indexes* and *Financial Advisor* Webinar
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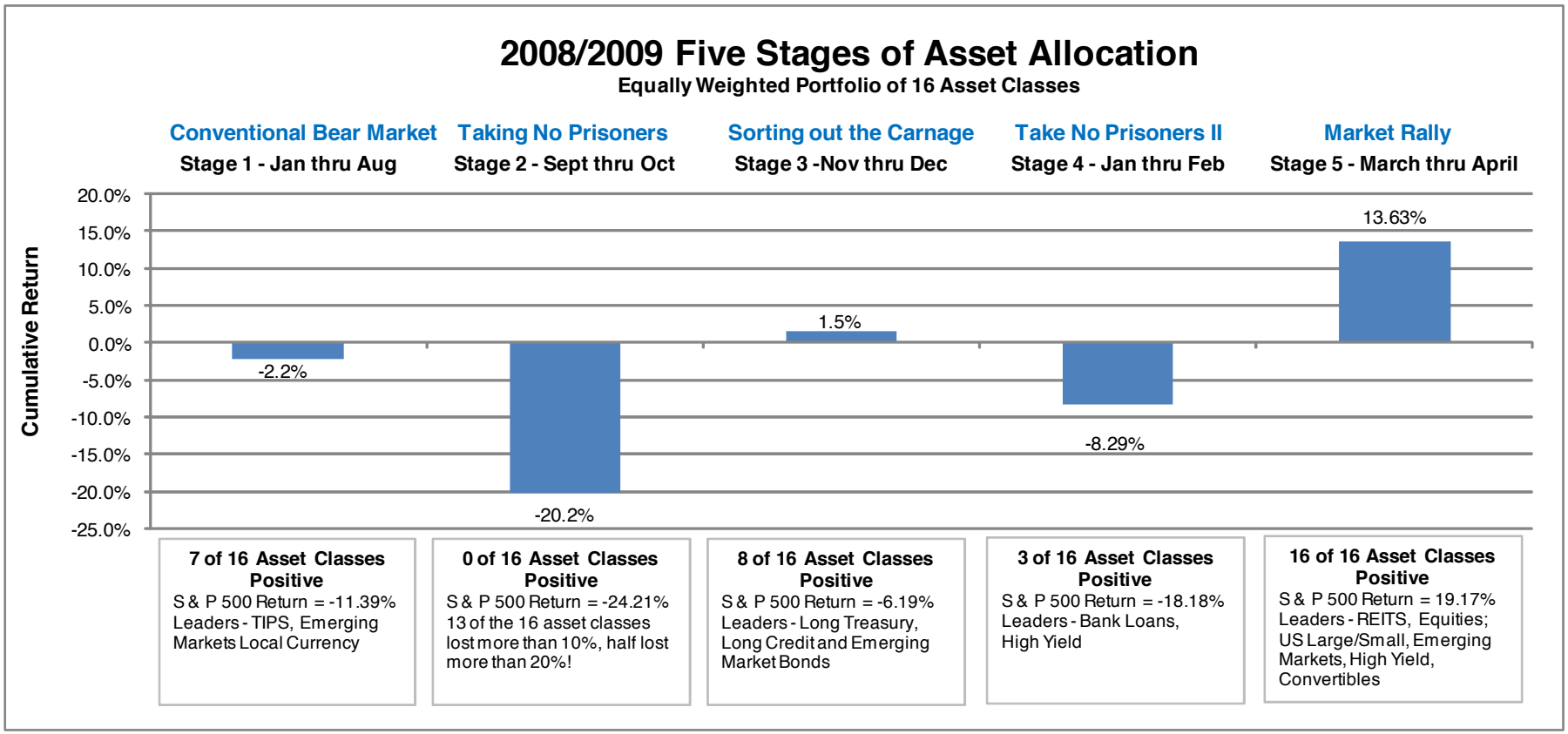
2008/09 in Review



The Equally –weighted portfolio is comprised of the following indexes, rebalanced monthly. ML US Corporate & Government 1-3 Year; LB US Aggregate Bond TR; LB US Treasury Long TR; LB US Long Credit TR; LB US Corporate High Yield TR; Credit Suisse Leveraged Loan; JPM EMBI + Composite TR; JPM ELMI + Composite; ML Convertible Bonds All Qualities; LB Global Infl ation Linked US TIPS TR; FTSE NAREIT All REITs TR; DJ AIG Commodity TR; S&P 500 TR; MSCI Emerging Markets TR; MSCI EAFE TR; Russell 2000 TR.

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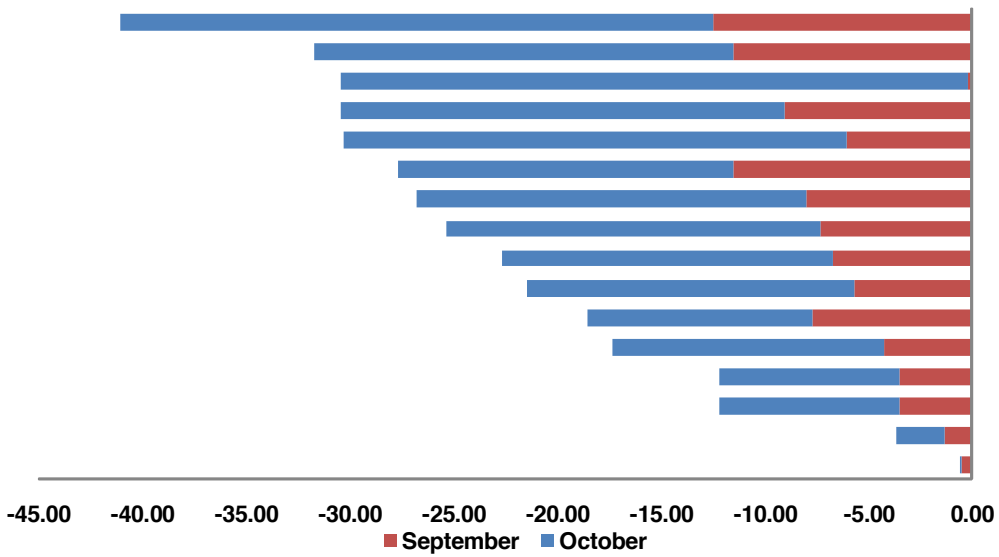
There Was No Place to Hide in Stage 2

Asset Category	October Monthly Rank Since 1988*	2-Month Return
MSCI Emerging Equity TR Index	2nd Worst	-41.02%
MSCI EAFE Equity TR Index	Worst	-31.68%
FTSE NAREIT All REITs TR Index	Worst	-30.46%
DJAIG Commodities TR Index	Worst	-30.41%
Russell 2000 Equity TR Index	Worst	-30.29%
S&P/TSX 60 TR Index	Worst	-27.69%
ML Convertible Bond Index	Worst	-26.78%
S&P 500 TR Index	Worst	-25.35%
Lehman US High Yield Index	Worst	-22.62%
JP Morgan Emerging Market Bond Index	2nd Worst	-21.45%
Lehman Long Credit Index	Worst	-18.57%
Credit Suisse Leveraged Loans Index	Worst	-17.32%
JP Morgan Emerging Local Markets Index	Worst	-12.21%
Lehman US TIPS Index	Worst	-12.19%
Lehman Aggregate Bond Index	4th Worst	-3.67%
ML 1-3 yr Government/Credit Index	29th Worst	-0.60%



*Monthly Rank Information is for the month of October 2008. Lehman US TIPS Index as of 11/1997. Credit Suisse Leverage Loan Index as of 2/1992; JPMorgan Emerging Market Bond Index as of 1/1994; DJAIG Commodities TR Index as of 1/1991. S&P/TSX 60 TR Index as of 4/30/1999

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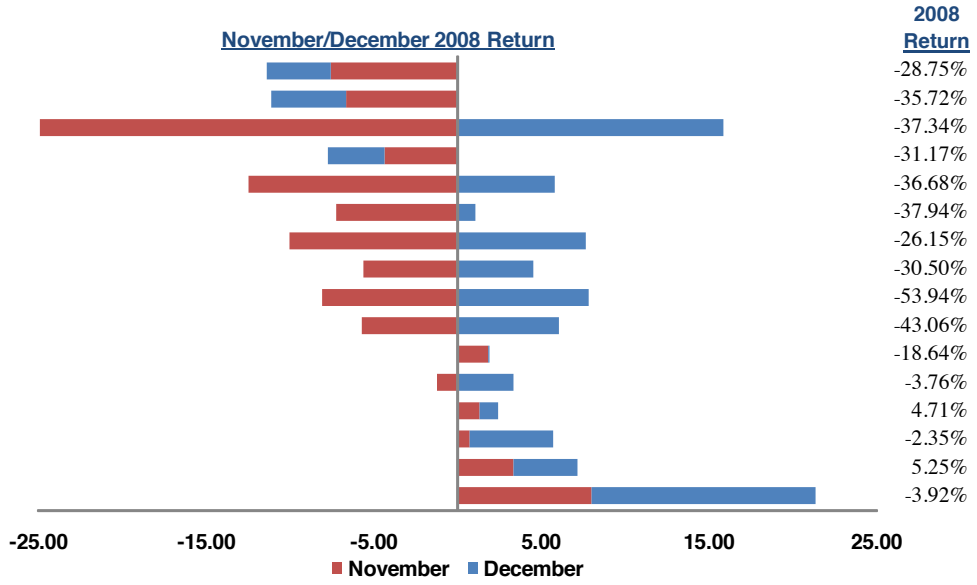
Modest Improvement in Stage 3

Asset Category	December Monthly Rank Since 1988*	2 Month Return	2008 Return
Credit Suisse Leveraged Loans Index	4th Worst	-11.37%	-28.75%
DJ AIG Commodities TR Index	24th Worst	-11.16%	-35.72%
FTSE NAREIT All REITs TR Index	Best	-9.06%	-37.34%
S&P/TSX 60 TR Index	20th Worst	-7.78%	-31.17%
Russell 2000 Equity TR Index	38th Best	-6.71%	-36.68%
S&P 500 TR Index	118th Worst	-6.19%	-37.94%
Lehman US High Yield Index	2nd Best	-2.34%	-26.15%
ML Convertible Bond Index	14th Best	-1.11%	-30.50%
MSCI Emerging Equity TR Index	39th Best	-0.31%	-53.94%
MSCI EAFE Equity TR Index	27th Best	0.34%	-43.06%
JP Morgan Emerging Market Bond Index	64th Worst	1.87%	-18.64%
JP Morgan Emerging Local Markets Index	10th Best	2.08%	-3.76%
ML 1-3 yr Government/Credit Index	25th Best	2.44%	4.71%
Lehman US TIPS Index	Best	5.70%	-2.35%
Lehman Aggregate Bond Index	2nd Best	7.11%	5.25%
Lehman Long Credit Index	Best	21.38%	-3.92%



*Monthly Rank Information is for the month of December 2008. Lehman US TIPS Index as of 11/1997. Credit Suisse Leverage Loan Index as of 2/1992; JPMorgan Emerging Market Bond Index as of 1/1994; DJAIG Commodities TR Index as of 1/1991.

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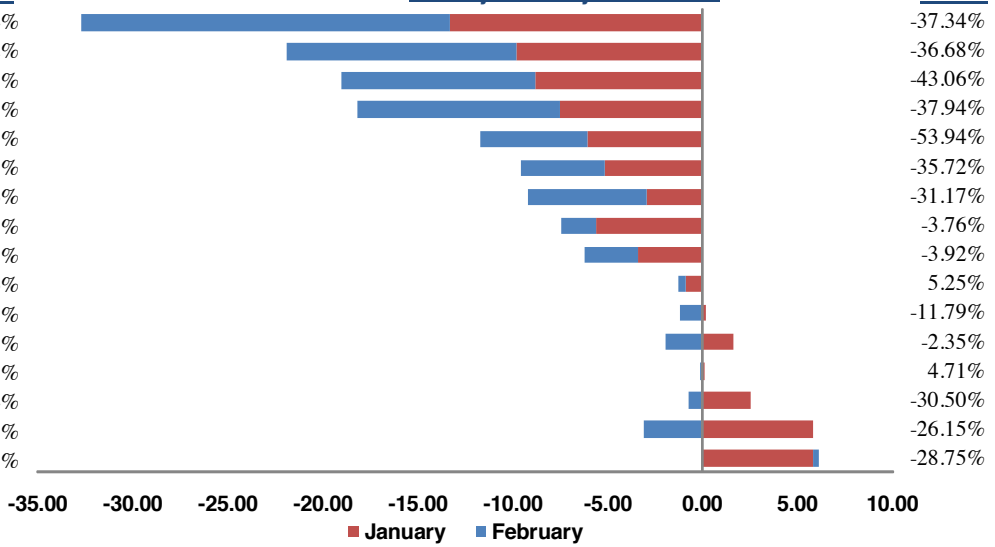
Back to the Crash in Stage 4

Asset Category	February Monthly Rank Since 1988*	2 Month Return	2008 Return
FTSE NAREIT All REITs TR Index	3rd Worst	-32.74%	-37.34%
Russell 2000 Equity TR Index	6th Worst	-21.92%	-36.68%
MSCI EAFE Equity TR Index	7th Worst	-19.03%	-43.06%
S&P 500 TR Index	4th Worst	-18.18%	-37.94%
MSCI Emerging Equity TR Index	39th Worst	-11.68%	-53.94%
DJ AIG Commodities TR Index	26th Worst	-9.57%	-35.72%
S&P/TSX 60 TR Index	11th Worst	-9.16%	-31.17%
JP Morgan Emerging Local Markets Index	17th Worst	-7.43%	-3.76%
BarCap Long Credit Index	13th Worst	-6.19%	-3.92%
BarCap Aggregate Bond Index	52nd Worst	-1.26%	5.25%
JP Morgan Emerging Market Bond Index	45th Worst	-1.00%	-11.79%
BarCap US TIPS Index	11th Worst	-0.30%	-2.35%
ML 1-3 yr Government/Credit Index	26th Worst	-0.07%	4.71%
ML Convertible Bond Index	69th Worst	1.74%	-30.50%
BarCap US Corportate High Yield Index	15th Wrost	2.70%	-26.15%
Credit Suisse Leveraged Loans Index	60th Worst	6.15%	-28.75%



*Monthly Rank Information is for the month of February 2009. Lehman US TIPS Index as of 11/1997. Credit Suisse Leverage Loan Index as of 2/1992; JPMorgan Emerging Market Bond Index as of 1/1994; DJAIG Commodities TR Index as of 1/1991.

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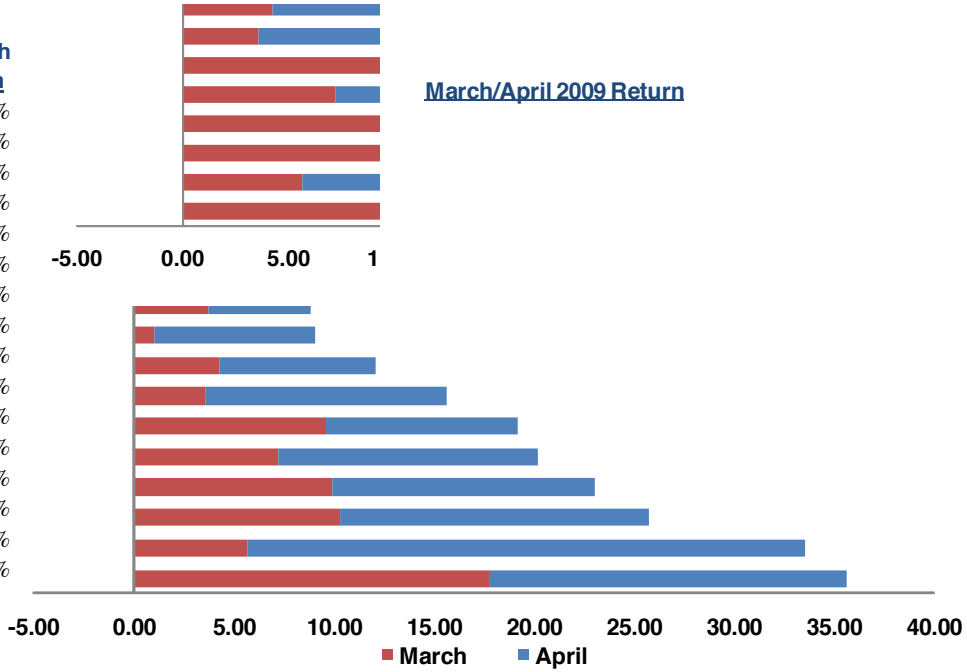
The Mother of All Market Recoveries

Asset Category	April Monthly Rank Since 1988*	2 Month Return
ML 1-3 yr Government/Credit Index	107th Best	1.02%
JP Morgan Emerging Local Markets Index	82nd Worst	1.44%
BarCap Aggregate Bond Index	111th Worst	1.88%
BarCap Long Credit Index	15th Best	2.41%
BarCap US TIPS Index	12th Worst	3.86%
DJ AIG Commodities TR Index	109th Best	4.36%
JP Morgan Emerging Market Bond Index	21st Best	8.87%
Credit Suisse Leveraged Loans Index	Best	9.05%
ML Convertible Bond Index	4th Best	12.05%
BarCap US Corportate High Yield Index	Best	15.68%
S&P 500 TR Index	4th Best	19.17%
MSCI EAFE Equity TR Index	2nd Best	20.18%
S&P/TSX 60 TR Index	Best	23.06%
Russell 2000 Equity TR Index	2nd Best	25.77%
FTSE NAREIT All REITs TR Index	Best	33.62%
MSCI Emerging Equity TR Index	2nd Best	35.66%



*Monthly Rank Information is for the month of April 2009. Lehman US TIPS Index as of 11/1997. Credit Suisse Leverage Loan Index as of 2/1992; JPMorgan Emerging Market Bond Index as of 1/1994; DJAIG Commodities TR Index as of 1/1991.

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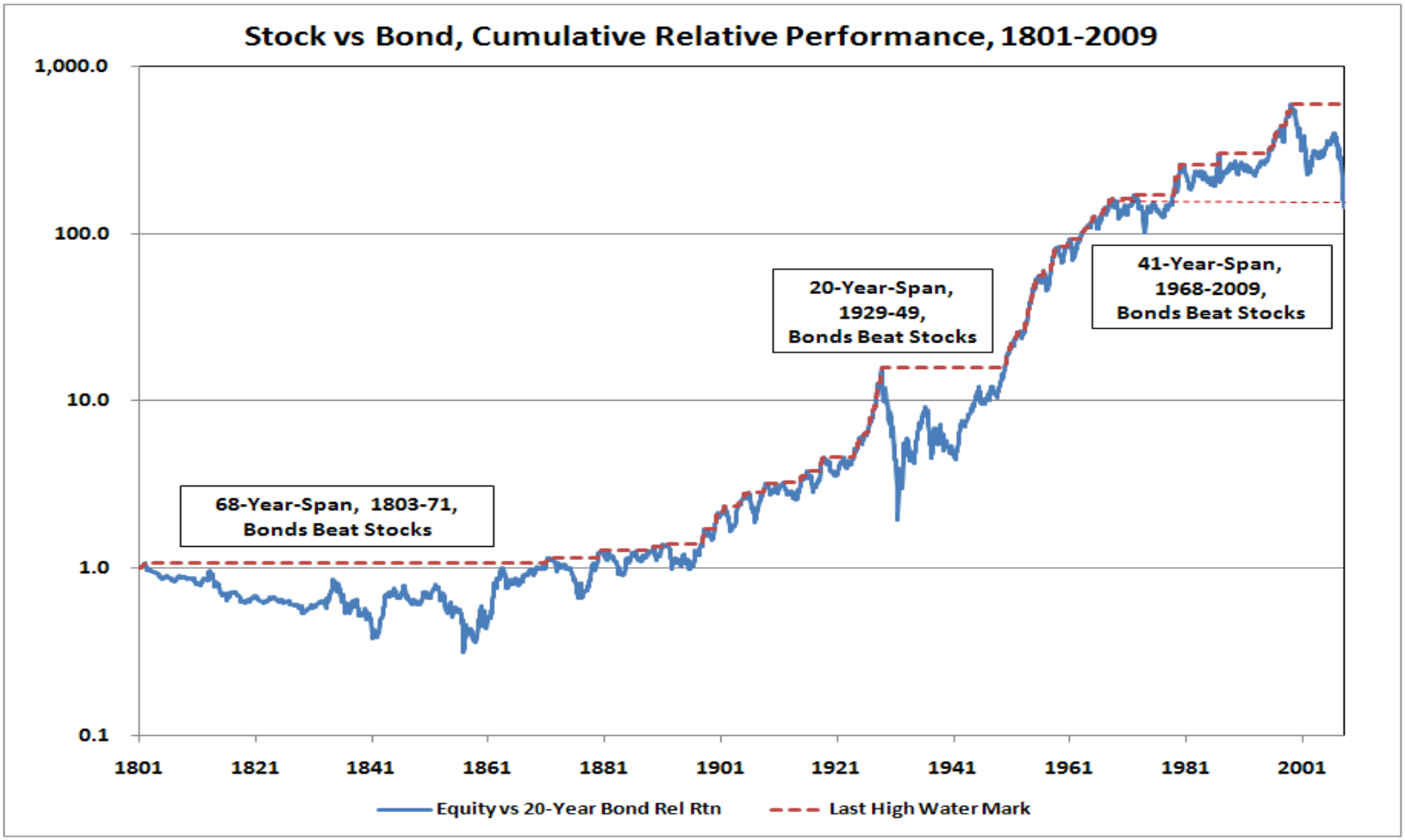
Stocks for the Long Run?
(How Long, Exactly, Do We Mean?)



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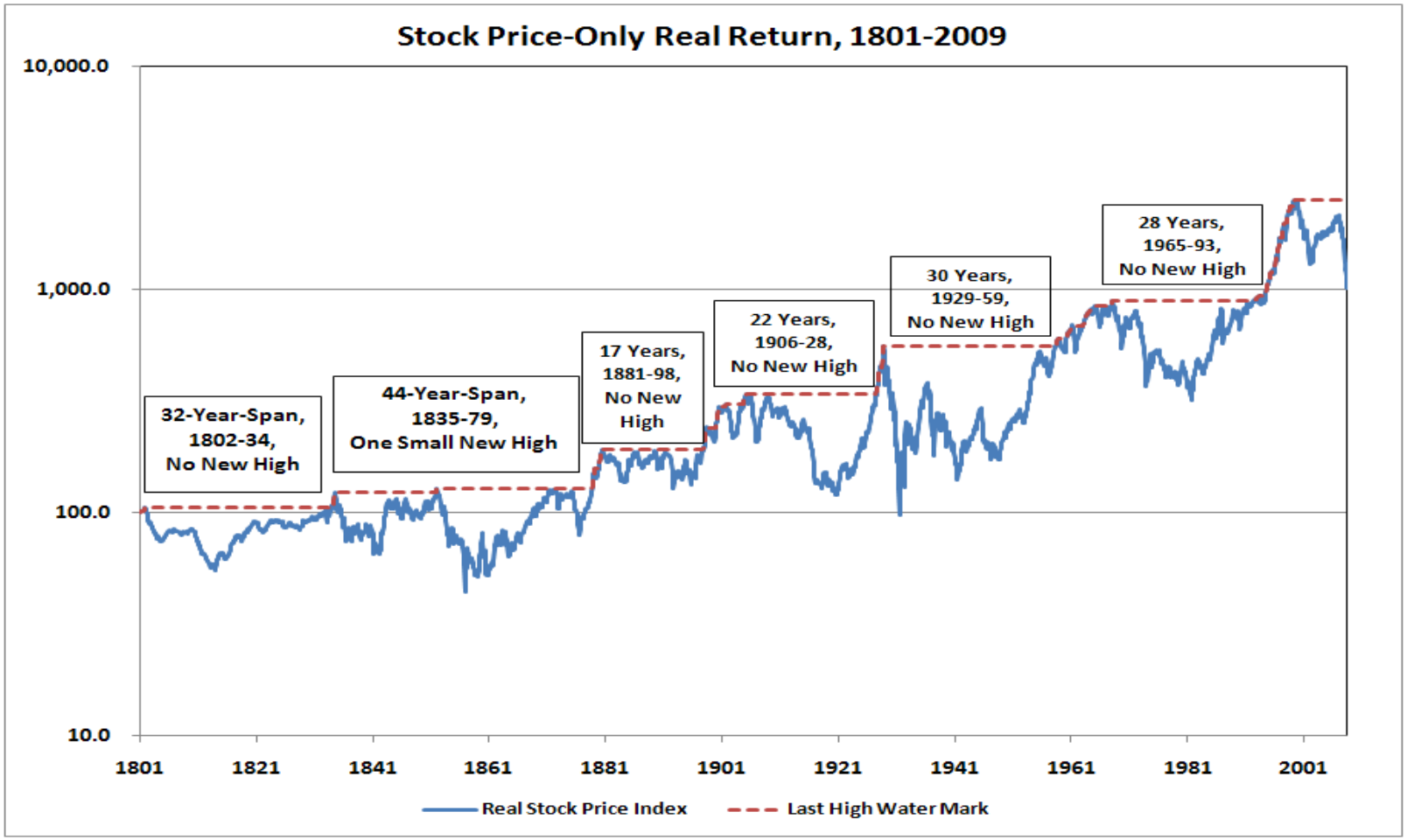
Over Past 207 Years, Droughts Over Ten Years Span 173 Years … over 80% of Two Centuries



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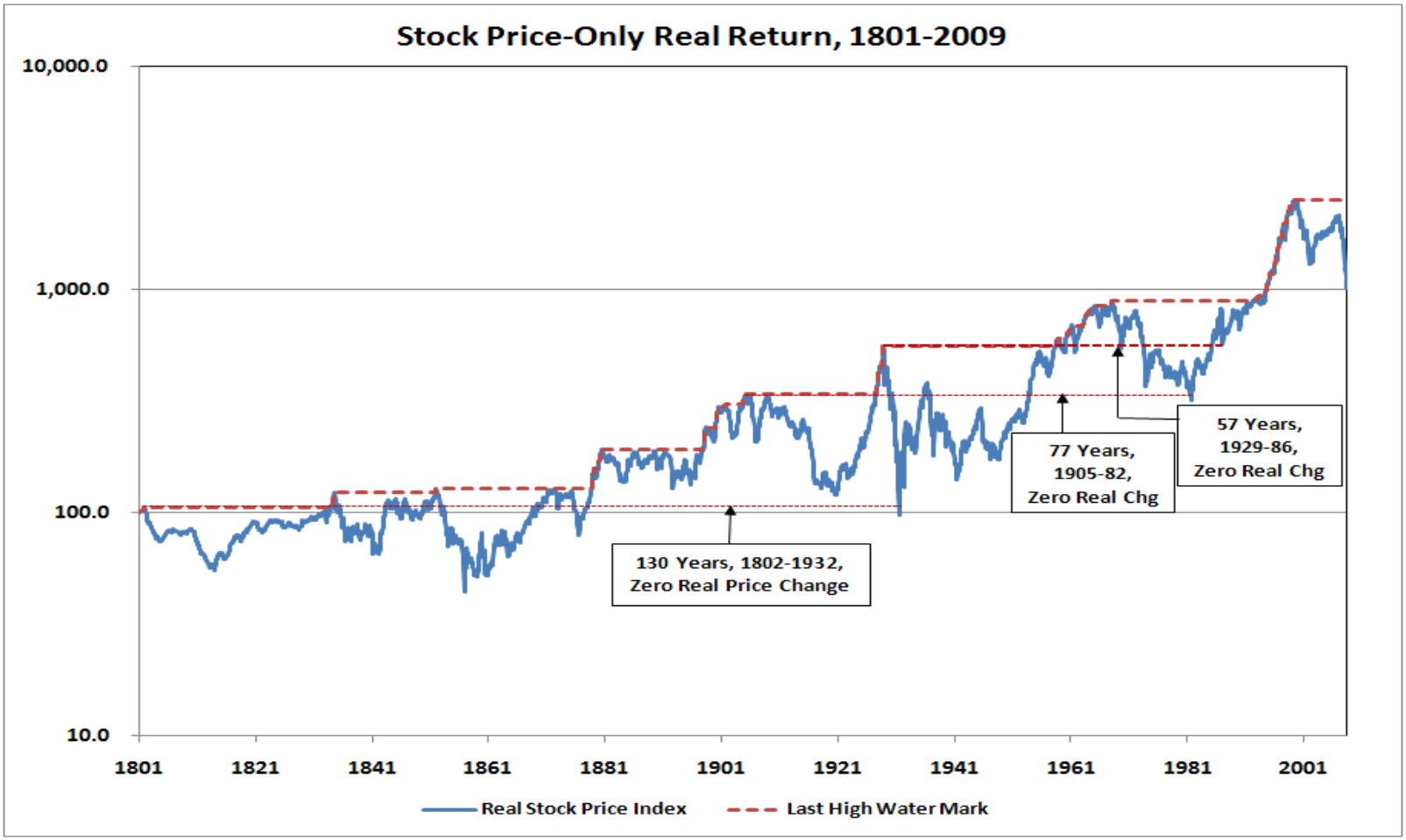
And Old Peaks May be Tested For Decades More



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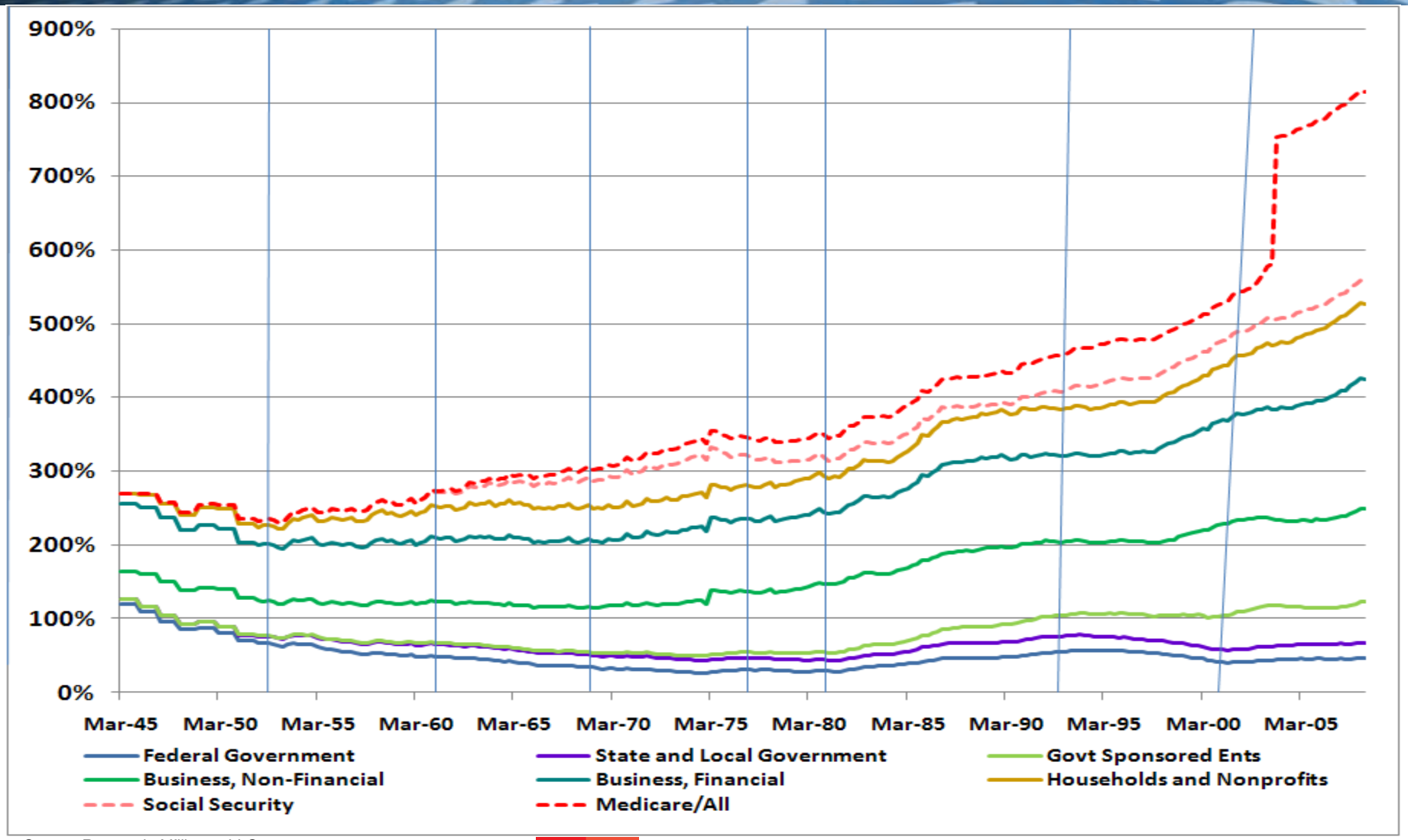
Total US Debt is Skyrocketing 800% of GDP, up 300% in ten years



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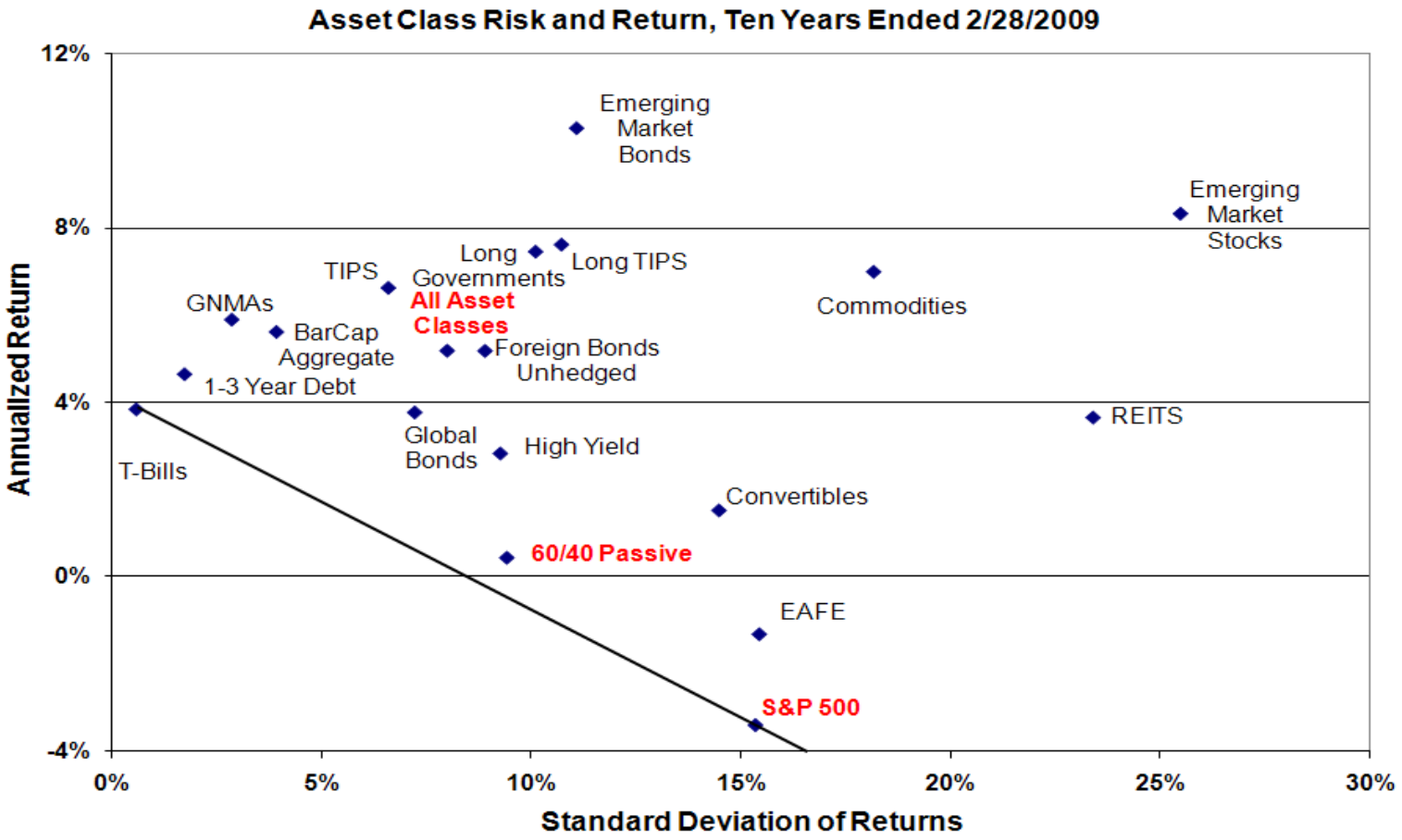
A Capital Market Line Inversion
(Why, Exactly, Do We Seek Equity-Like Returns at Bond-Like Risk?)



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Where Are the Opportunities Today?

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Three Paths to Improved Prospective Returns

Consider Other Asset Classes

- Stocks and bonds are not the only choices
- Unconventional assets can be priced to offer better returns

Seek Alpha

- Conservatively, focusing on avoiding negative alpha, or
- Aggressively, if you have confidence in the opportunities

Actively Manage the Asset Mix

- *Include* alternative markets in these decisions
- Seek assets which are out of favor, priced for better returns

All Three Paths Can Be Pursued in Parallel!

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Looking Forward

- **Painful declines across asset classes leave a target rich environment**
  - Anything with credit or liquidity risk, even unfamiliarity, has been savaged
  - Opportunistic, tactical investors face best opportunity set in decades

- **Opportunities abound**
  - TIPS: Priced to reflect inflation of less than 1%/year through 2028
  - IG Corporate Debt: Yielding 5% more than Treasuries
  - Convertible Bonds and High Yield Debt: Widest spreads in history
  - Emerging Market Bonds: Double digit yields
  - Value Stocks: Best valuation multiples relative to growth since 2000

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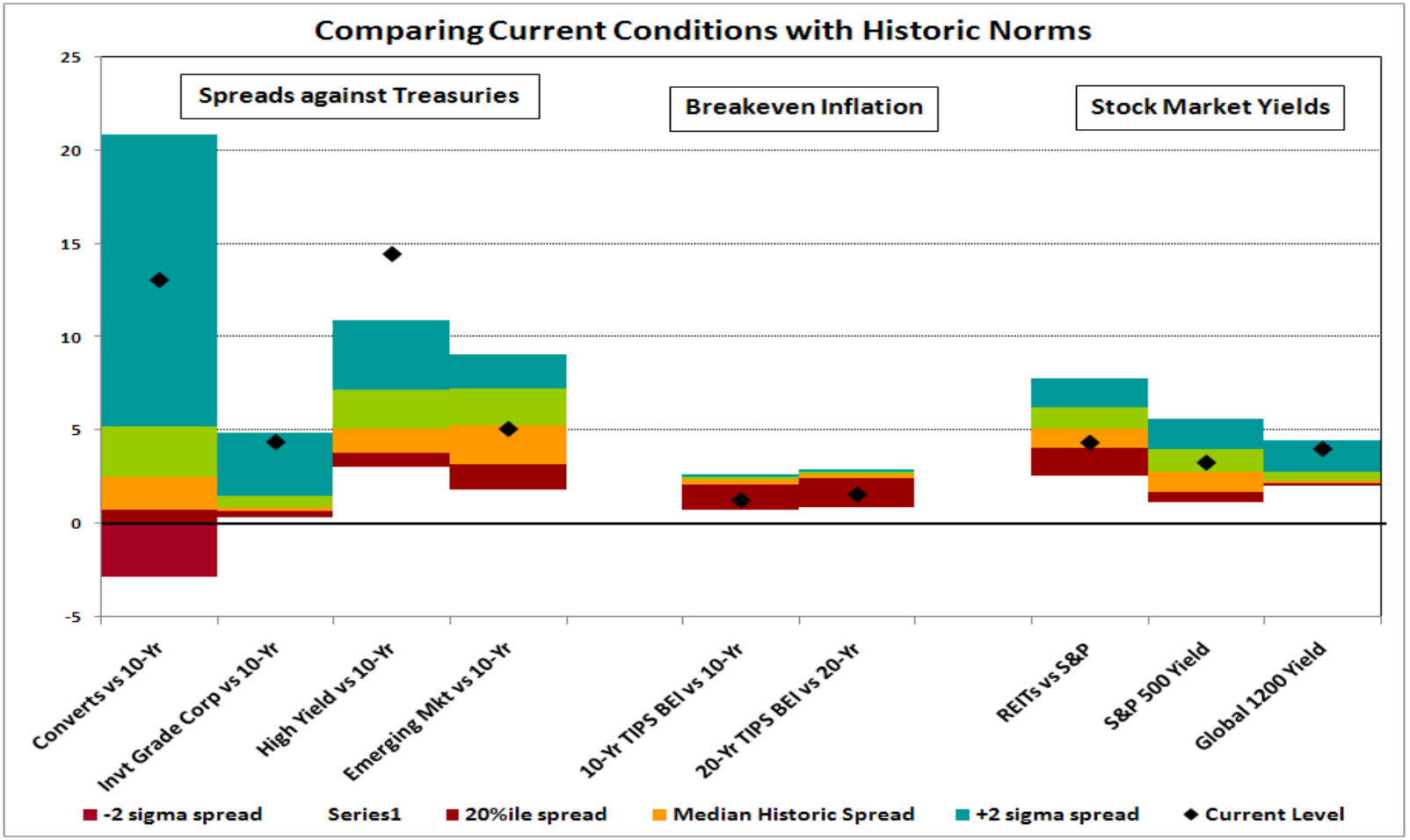
Yields and Spreads, April 15, 2009
A Spectrum of Opportunity



Source: Research Affiliates, LLC, Bloomberg, Merrill Lynch, Lehman Brothers *

Study from Morningstar and Ibbotson

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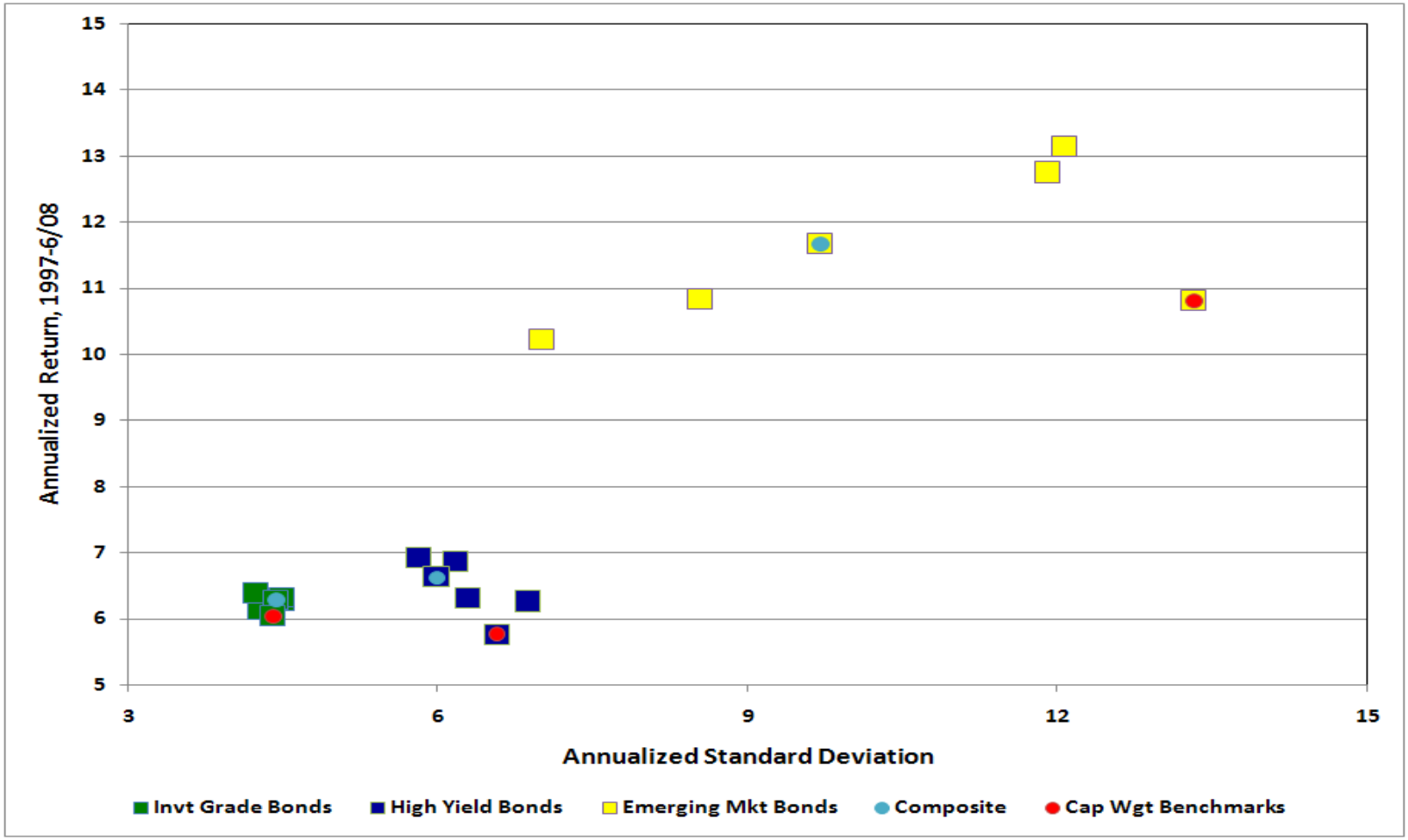
Not Your Grandpa's Bonds Any More!



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Fundamental Index Strategies
Attractive Relative Equity Valuations

3/31/2008	Price / Sales	Price / Book	Div Yield	Weighted Avg Market Cap
FTSE RAFI US 1000	0.22	0.88	2.9%	$45.5 billion
Russell 1000	0.74	1.57	2.7%	$61.2 billion
RAFI Discount	-70%	-44%	-5%	
FTSE RAFI US MS 1500	0.14	0.61	2.2%	$0.7 billion
Russell 2000 Index	0.55	1.11	1.9%	$0.8 billion
RAFI Discount	-75%	-45%	-12%	
FTSE RAFI Developed ex US 1000	0.27	0.73	5.6%	$28.4 billion
FTSE AW Developed ex US 1000	0.55	1.12	4.4%	$34.6 billion
RAFI Discount	-51%	-35%	-20%	
FTSE RAFI Developed ex US MS 1500	0.23	0.63	5.1%	$1.1 billion
FTSE AW Developed ex US 1500	0.39	0.89	4%	$1.2 billion
RAFI Discount	-41%	-29%	-25%	
FTE RAFI All World 3000	0.25	0.80	4.3%	$32.5 billion
FTSE All World Index	0.64	1.33	3.6%	$46.7 billion
RAFI Discount	-61%	-40%	-17%	
FTSE RAFI Emerging Markets	0.32	1.08	3.5%	$15.1 billion
FTSE AW All Emerging	0.65	1.46	3.5%	$17.9 billion
RAFI Discount	-51%	-27%	-2%	

Note: The index version of the RAFI methodology, or the FTSE RAFI Indexes, is licensed globally by our partner the FTSE Group.

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When Valuation Dispersion is wide, the Cap-Weighted Market is Severely Overpaying for Growth

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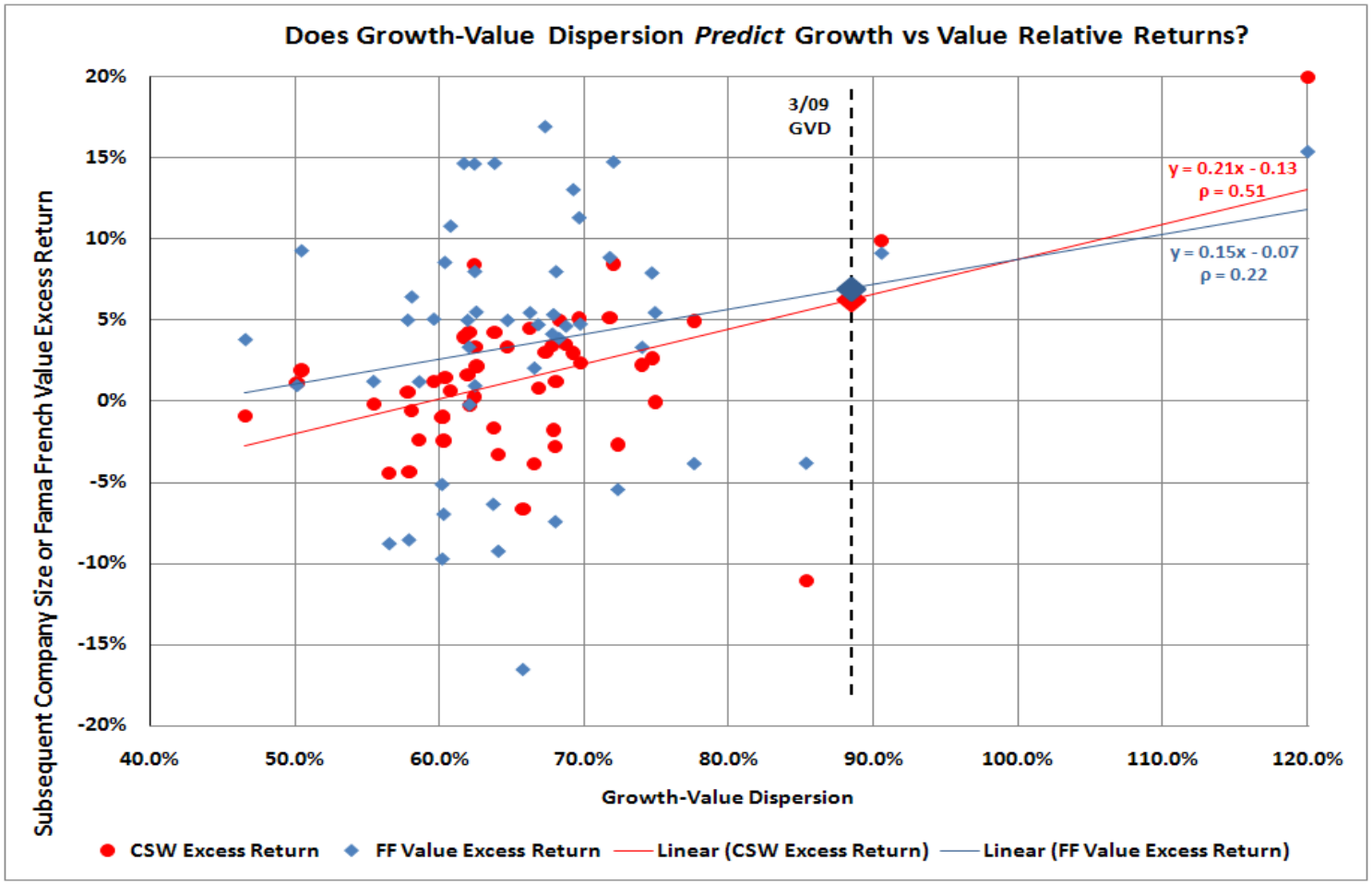
The Dispersion of Valuation Multiples is Highly Predictive of the Growth-Value Cycle



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Where Do We Go From Here?

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A Spectrum of Returns
Where Were You Invested in These Periods?

	5-Years Returns (Cumulative)				15-Year Characteristics*	
Asset Class	2008	2003-2007	1998-2002	1993-1997	Standard Deviation	Correlation with 60-40
Emerging Markets	-53	391	-21	44	26	0.54
MSCI EAFE	-43	171	-12	74	16	0.75
REITS	-39	131	23	118	15	0.34
S&P 500 Equal-Weighted	-40	109	12	136	16	0.89
Commodities	-36	95	21	58	12	-0.21
S&P 500	-37	83	-3	152	15	0.98
Emerging Market Bonds	-11	82	44	---	12	0.58
High-Yield Bonds	-26	67	3	75	7	0.66
Convertible Bonds	-36	66	20	92	13	0.85
Unhedged Foreign Bonds	10	44	28	45	9	-0.01
TIPS	-2	36	51	---	5	-0.43
Long-Term Gov't Bonds	23	32	52	62	9	-0.04
Mortgage Bonds	8	25	43	42	3	0.04
Lehman Aggregate Bond	5	24	44	43	4	0.01
Money Markets	2	16	23	26	1	0.14

Red = worst three (excl. SPEW) Blue = bext three (excl. SPEW)

The 2002 bear market was only difficult for those who were wedded to an equity-centric "normal portfolio"

The 2008 bear market has been a Take No Prisoners market

*Emerging markets and TIPS standard deviations and correlations are for the ten years ended 12-07.

Past performance is no guarantee of future results. 60-40 represents a composite of the S&P 500 (60%) and Lehman Brothers Government/Credit Bond Index (40%). Standard deviation is an absolute measure of volatility measuring dispersion about an average which, for an index, depicts how widely the returns varied over a certain period of time. The greater the degree of dispersion, the greater the risk. Correl w/60-40 measures the correlation, or tendency to move in tandem, of the performance of the listed asset class with the 60/40 portfolio for the 15-year period ended 12/31/07. A higher number indicates a greater correlation. Emerging Markets Stocks represented by MSCI Emerging Markets Index. Commodities represented by Dow Jones AIG Commodity Index. REITS represented by Wilshire REIT Index. Emerging Markets Bonds represented by JP Morgan Emerging Markets Bond Index Global. TIPS represented by Lehman U.S. TIPS Index. High Yield Bonds represented by Merrill Lynch High Yield Master II Index. Long Term Govt Bonds represented by Lehman Brothers Long-Term Treasury Index. Mortgage Bonds represented by Lehman Brothers Mortgage. Convertible Bonds represented by Merrill Lynch ALL US Convertible Securities Index. Unhedged Foreign Bonds represented by Citigroup World ex-U.S. Government Bond Index. Money Markets represented by Citigroup 3-Month T-Bill Index. Intl Stocks represented by MSCI EAFE Index. S&P 500 Equal Weighted (SPEW) reflects the performance of the S&P 500 Index with component stocks equally weighted rather than capitalization weighted. The Standard & Poor's 500 Stock Index (S&P 500) is an unmanaged, capitalization-weighted index of U.S. companies generally representative of the U.S. Stock Market. The Lehman Aggregate Bond Index is generally considered to be representative of the domestic, investment-grade, fixed-rate, taxable bond market. Returns are not indicative of the past or future performance of any investment product.

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Thank you for Attending!

Better Off with Bonds?
The 40-Year Story

A *Journal of Indexes* and *Financial Advisor* Webinar
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