

CAPITAL INVESTMENT MANAGEMENT

Registered Investment Advisor

BOSTON • DENVER • SAN FRANCISCO

Market Update: My Own Worst Enemy?

"The four most expensive words in the English language are, 'This time it's different.'" - Sir John Templeton (1912-2008)

Sir John Templeton, the legendary investor turned philanthropist, died last month in the Bahamas at the age of 95. Counted among the all-time investing heavyweights (he did, after all, retire to the Bahamas), Sir John was a contrarian investor, casually defined as one who buys while the market sells.

As you may have read, Templeton began investing at the onset of WWII by borrowing \$10,000 and purchasing roughly 100 different stocks, over a third which was in bankruptcy at the time¹. While the rest of the world population was fearful, having barely recovered from the Great World War, John went against the grain and crafted his own makeshift "mutual fund". His personal philosophy, one he would retain throughout his investing life, was to buy stocks at a "point of maximum pessimism", when the vast preponderance of investors had already cut and run. (He would eventually sell those stocks at the end of the war, and use the proceeds to found his own investment fund company.)

Although Sir John did, it is not necessary to pioneer your own mutual fund to be financially independent in America. There are a large number of individuals who believe that, in order to be financially successful, you need to complicate your financial picture by putting dollars in some byzantine, overly complicated investment, invent and sell a dot-com, or just flat-out win the lottery.

Alternatively, there is also the approach of such financial gurus as Warren Buffet, Bill Miller, and Sir John Templeton: Invest your money for the long-term, in the unstoppable force that is the U.S. economy. The stock market is not a bingo parlor, a racetrack nor a casino; it is where the companies of the United States (which are becoming increasingly global) come to raise capital for new facilities, projects and products, by allowing you and me to become investors (read: co-owners) of said companies.

How is it then that the Templeton's, Bill Millers and Buffets of the world seem to be so rare? Why is it that the historic average mutual fund investor makes only 3% on their investments while, historically, mutual funds have earned somewhere in the neighborhood of 10%²? If you examine them closely, you will find that nearly every successful financial guru had the benefit of professional management (either their own or someone else's) coupled with a patient, long-term view on the market.

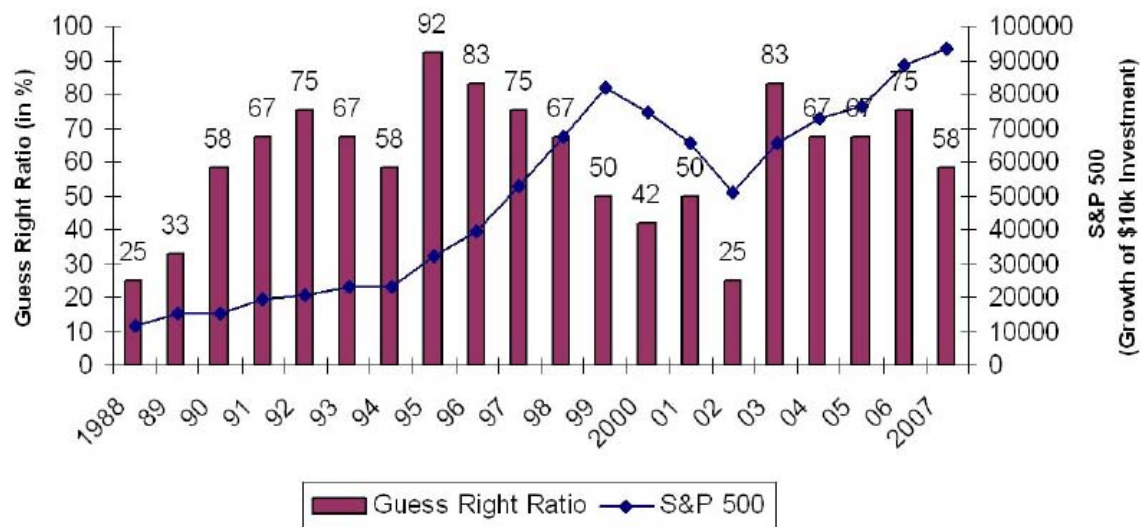
We believe that we are your fiduciaries, your financial guardians, not only charged with keeping an eye on the investment process that we employ on your behalf, but also obligated to put your interests first and keep you focused on your goals and invested for the long-term. It is our legal duty for us to put clients-first, similar to that of an attorney or accountant.

MY OWN WORST ENEMY

When the markets swing one way or another, the natural human reaction is to either cash in on the trend, or run from it. In financial parlance, they say the market is alternatively driven by “Fear” or “Greed”. But how successful are people, in cashing in on their emotions as opposed to a planned long term strategy?

In order to track the performance of people who attempt to time the market, Dalbar, a financial services research firm, established a measurement known as the “Guess Right” ratio. The Guess Right Ratio checks mutual fund net inflows and outflows versus market performance to see how they stack up. In plain English, if you invested in the market and it went up, you scored a point; likewise, if you pulled money from the market, and the market went down, you scored a point. In both cases, your decision to act affected your portfolio positively, by making yourself money or preventing yourself from losing money.

If the ratio of correct guesses is over 50 percent, then more investors timed the market correctly than not and if the number is below 50 percent, they blew it and lost themselves money. So how did the market timers fare?



Dalbar, Inc., (2008). Extract of *Quantitative Analysis of Investor Behavior 2008*, from www.dalbar.com

The answer is: depends. In periods of rising markets, investors guessed correctly. As the market was going up, they felt good about the US equity markets and rode the wave of momentum. In down markets (1988-89, 2002), they guessed incorrectly; 3 out of 4 of investors, reacting to the markets, guessed wrong in 1988 & 2002! Once they began to lose principal, fear took hold as they fell into the mistaken belief that “this time is different” and lost confidence (and money) in almost equal amounts.

The blue line? That’s what a hypothetical \$10,000 investment into the S&P 500 index would look like if you got hit by a bus, slipped into a coma, and woke up nineteen years later in 2007. Without reading a newspaper or watching a single news program, you would have almost \$95,000, nearly ten times what you started with by making exactly zero market timing decisions

in the first place, and certainly more than the average mutual fund investor, over the same timeframe.

Year to date (as of 8/07/08), the S&P (blue line) is down over 13% and there is every indication that, once again, people are panicking and making the wrong moves each and every day.

THOSE WHO DO NOT LEARN THEIR HISTORY

The most recent “crisis” to hit the US economy has been the popping of the Real Estate Bubble, followed up by the credit/liquidity crunch that occurred once lenders realized the people writing the loans, had virtually zero interest in seeing those loans paid back. Once housing prices started to decline, and interest rates were reset to higher rates than normal, people began to default on their homes and the proverbial “house of cards” came tumbling down with disastrous financial consequences. (Exhibit A: Bear Stearns, which went from \$50/share to \$2/share in the span of two weeks.)

At this point, banks did what they typically do: violently overcompensate. Even corporations suddenly found themselves without access to capital, which they need to fund expansion and growth. Without that expansion and growth, companies experienced flat to negative earnings which affected equity markets. Thankfully, the Fed intervened restoring some liquidity (and sanity) to the fixed income markets, and this pretty much brings us to where we are today.

Here’s the best part: none of that should matter to you, because this time is *not* different. If you put a list of disasters from your lifetime in a row, it ends up reading like a Billy Joel song: Asian Flu, Enron, 9/11, Dot-com, Housing Bubble, Gulf War, the S&L’s went bust. Black Monday, Stagflation, Oil crisis, Communism, Vietnam, North Korea, even World War II. In the moment, each seemed like a crisis of insurmountable proportions and we were told “this time is different”, the end of the world was nigh. Each and every time, the broad equity market rebounded with vigor and rose higher than it had been before the crisis, proving that notion completely false.

We may have lost Sir John Templeton, but that doesn’t mean we have to lose one of the lessons he taught us: your personal behavior in the financial markets is a key component to your success. If you have a well diversified portfolio that matches your risk tolerance and objectives, which is continually being monitored and rebalanced along the way, then why would you tinker with it? Why not embrace the one investment strategy, patience and courage that time and time again, have proven its worth.

Market cycles, like the rising and setting of the sun, will happen no matter what we, the government, or anyone tries to do to prevent them. However, in the dozen or so bear markets since WWII, when the market recovered, it was the investor who was rewarded, not the panicked seller. It’s trying times like now, where more people are guessing; thereby moving more towards wrong than right, that you need to stick to your plan, listen to your advisor, tune out the “noise” generated by the media and ask yourself: Are you more like the herd or more like Sir John?

SO, WHAT SHOULD WE BE DOING?

We believe that we have constructed your portfolios based on your life goals and while the journey may be extremely bumpy, we hold true to the principles around the why and the when. If you continue to have questions, please call us.

The CIMCO Team

1. *McFadden, Robert D. (2008, July 9). Sir John M. Templeton, Philanthropist, Dies at 95. The New York Times, Retrieved August 7, 2008, from <http://www.nytimes.com/2008/07/09/business/09templeton-cnd.html>*
2. *Dalbar QAIB 2007. Institutional investor performance is based on a consistent 60% allocation to equities (S+P 500) and 40% allocation to the fixed income (Long-term Government Bond Index) markets. Average investor performance is based on a comparable 60% equity/ 40% fixed income allocation. The average investor refers to the universe of all mutual fund investors whose actions and financial results are restated to represent a single investor. This approach allows the entire universe of mutual fund investors to be used as the statistical sample, ensuring ultimate reliability.*

To determine if the fund(s) are an appropriate investment for you, carefully consider the fund's investment objectives, risk factors and charges and expenses before investing. This and other information can be found in the Fund's prospectus, which may be obtained by calling 1-800-DIAL-SEI. Please read it carefully before investing.

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice. This information is for educational purposes only.

Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

There are risks involved with investing, including loss of principal.

SEI Investments Management Corporation is the adviser to the SEI funds, which are distributed by SEI Investments Distribution Co (SIDCo). SIMC and SIDCo are wholly owned subsidiaries of SEI Investments Company.

Ryan Carlin

Internal Account Executive, SEI Advisor Network – Midwest Region

Based in Oaks, PA, Ryan is an Internal Account Executive who, in tandem with Regional Director Andrew Silver, works exclusively with Financial Advisors based in Ohio, Indiana & Kentucky. In this role Ryan is responsible for assisting advisors develop investment strategies and portfolios for goals-based investors.

Ryan graduated with a B.S. in Finance from Penn State University and currently holds his Series 66 license.