

observations

INVESTMENT

As Nick Murray says...

Just as we were preparing to go to press with our third-quarter *Investment Observations* newsletter, dramatic events unfolded in headlines and on news broadcasts across the country and the world as Wall Street reeled from the credit bubble pop. That made the articles we planned irrelevant, so we went back to the huddle and called a new play.

Moneta Group Family CFOs have been in touch with clients over the past few weeks, providing answers to many questions—some of them fraught with anxiety. It is unreasonable to expect anyone with access to the news not to be scared. These have been stressful days, but we are confident in our strategy, which takes advantage of market swings and hopefully provides some peace of mind.

As always, it would be nice to have a crystal ball and be able to tell you what lies ahead, but that is not possible. Instead, I'm going to borrow the no-nonsense perspective of Nick Murray, a renowned and



Joseph A. Sheehan CFP, CFA
MANAGING PRINCIPAL

respected writer in the financial industry. Nick says:

"First, let me foreswear any attempt to be timely in this essay, which of necessity is being written about 10 days before you see it. In the interim, things being as they are, the market may go up and/or down 4 percent in a day several times; a number of banks and/or insurers may tank, merge and/or get bailed out—eventualities that the mob will greet with euphoria and/or terror on succeeding days; and the federal government will elect to rescue them all and/or let them all burn from a Friday to a Monday. I know not/I care

not; it matters not. And it's all too boring for words."

I couldn't have said it better. Murray concludes his essay with a personal musing. "Joan and I had been planning, and saving assiduously for, some major renovation work in our brownstone...this winter... suffice it to say that this was a very solid six-figure project. This week, we advised the contractor...that we are going to wait 'til next year, whereupon we put every plugged nickel in the equity market. We did so out of one overriding conviction: *that when this is over—whenever and wherever that is—these prices will never be seen again.*"

I conclude with words of encouragement: Yes, these last few weeks have been difficult ones and we can't be certain what's in store in the near future, but be assured that our commitment to our clients and our promise to act in your best interest does not waiver—no matter how choppy the financial seas. Remember the Life Boat Drill!! ❖

FALL 2008

INSIDE THIS ISSUE:

As Nick Murray says...

Remember the Lifeboat Drill

Great Idea or Great Investment?

Negotiating Savings

*Writing, editing and preparing our newsletters is not an overnight process, and our goal is to offer insights and information that are as up-to-date as possible. The third-quarter **Investment Observations** newsletter arrives a bit later than planned, but we hope represents a more timely reflection of what occurred in the markets in recent weeks.*

*We are very pleased that we are now able to communicate with clients much more rapidly through the "For Our Clients" area of our Web site, www.monetagroup.com. Here you will find weekly postings, as well as ongoing additions of articles on a variety of topics. If you have not received your User ID and Password, please contact your principal team or Nancy Powers at npowers@monetagroup.com. As always, we welcome your feedback and ideas for future **Observations** newsletters.*

Remember the Lifeboat Drill



Timothy J. Halls
CFP®, CFA, AWMA

It is a confusing and challenging time for investors. While history is littered with instances of financial turmoil, it is difficult to shake the feeling that ‘this time, it’s different.’ That reaction isn’t helped by a news media that seems to be challenged to provide balanced coverage.

During the times it occurred, past turmoil was viewed with similar levels of fear.

- On Black Monday (Oct. 1987), the Dow Jones lost nearly 23 percent of its value in *one day*, and a total of more than 31 percent for the week.
- Over a very short time period in the late 1980s, America’s Savings and Loan industry essentially disappeared.
- At its height in the mid-’80s, Drexel Burnham was the fifth largest investment bank in the world. By 1990, it was bankrupt and the high yield bond market was severely scarred.

- In 1998, Long Term Capital Management, a hedge fund with more than \$125 billion in assets, collapsed—and nearly brought the world’s financial markets down with it.
- Beginning in March 2000, the tech bubble collapsed—wiping out trillions of dollars of stock market value.

Yet somehow, after each of these cataclysmic events, the markets bounced back.

Now we have the collapse of the credit bubble, and with it, the repeated use of the word ‘unprecedented.’ That’s a word not to be tossed around lightly. While by any measure the planned government bailout is huge, saying it is *truly* unprecedented ignores the market interventions of years past, just as saying, ‘this time, it really is different,’ ignores historical reality.

Moneta’s philosophy neither changes with market variances nor is it passive. We create portfolios with a level of downside risk a client feels comfortable taking. We allocate the assets across lowly-correlated asset classes, and then, through rebalancing, we stay with the plan as the markets inevitably go up and down.

Unfortunately, when markets correct, the normal human response is to make an ad hoc reappraisal of one’s level of risk-tolerance. That’s quite understandable, because when threatened, it’s natural to become more defensive. But that normal human response is contrary to one’s best interest and contrary to successful investing.

At the beginning of your relationship with your Moneta Family CFO, and frequently discussed during ongoing review meetings, you and your principal went over the Lifeboat Drills, illustrating the loss potential for your specific portfolio allocation in a down year. Still, with all that has occurred in the past weeks, it is human nature to feel uncomfortable in today’s markets.

What to do? Accept that there has always been volatility in the markets. During those times, it is natural to feel uncomfortable. But a sound investment strategy dictates rebalancing your portfolio to your previously agreed-upon allocations. That is one thing that, historically, has worked to take advantage of the inevitable upswings in the markets. No one knows where the markets will be in the short-term. But by rebalancing—based on

historical precedent—you’ll accomplish several things:

- You’ll be ‘buying low.’
- When the markets recover, it will take less time to return to your previous level.
- You’ll avoid the cataclysmic mistake of exiting the market at the bottom and missing out on the recovery.
- You will take the guesswork out of your investment strategy.

At Moneta Group, we can’t predict where the market is headed in the short term. We are, however, confident in the long-term. Remaining disciplined in times of market peaks and troughs, and actively rebalancing into depressed asset classes, are two components that separate successful investors from unsuccessful ones. Now is one of the critical times when sticking to the plan and agreed upon asset class exposure is of vital importance. ❖

Great Idea or Great Investment? What's More Important?



Luke Ferraro

As I write this article, oil is trading at around \$120 per barrel (\$86 a barrel as of October 10, 2008). Although this price is close to being 20 percent lower than it was in early July, it is still considerably higher than where it was trading last year. Let us also keep in mind that last year, at \$80 per barrel, we were already wishing for some relief.

Regardless of the exact price of crude oil, prices for oil in general are high, and this has generated an enormous amount of interest in alternative energy sources. Even T. Boone Pickens, the legendary oil trader, has developed his own alternative energy plan.

So the question becomes, "Is a great idea for the country a great investment opportunity?"

Every decision we make for your portfolio looks at both future upside potential and future risks. Risk is something that often gets overlooked by investors.

"The individual investor should act consistently as an investor and not as a speculator. This means...that he should be able to justify every purchase he makes and each price he pays by impersonal, objective reasoning that satisfies him that he is getting more than his money's worth for his purchase." — Benjamin Graham

Investors are attracted to the potential payout, but they often forget to consider the opportunity for losses. Just look at Las Vegas: The city would not exist if people really took a hard look at their odds for success.

This brings us to the classic question of gambling vs. investing. Gambling is wagering a sum of money with the expectation of outsized returns. Those oversized returns are there because the odds of success are not in our favor. Investing, on the other hand, is wagering a sum of money with the expectations of a reasonable return because the odds of success are in our favor.

I could write 300 pages on how to buy the right stocks at the right time, or you could go to your local bookstore and pick up a book on investing (one or two may have been written). But to summarize: We want to buy companies that have the potential for future earnings growth, and we want to pay a reasonable price for these companies. I do not doubt

that many alternative energy companies have the potential for fantastic future earnings growth, but the problem lies with the price we have to pay.

Currently, many alternative energy companies trade above 70 times earnings (PE of 70)—if they have earnings at all—and companies that have no earnings (and there are many of them) are even harder to value. That is not to imply that there are no good investment opportunities currently in the space. Our active managers are always looking at whether or not it makes sense for your portfolio to invest in these companies.

I am guessing that right now many of you are thinking, "Yes, but this is the next great theme for the next 10 years." This could very well be the case, and if I had to guess, I would say that the alternative energy bandwagon is here to stay. However, if you pay too much, you can lose a great deal of money even though you might have been correct on the idea. The dot-com bubble

of the late '90s is an instructive example: No one would maintain that the Internet is less prevalent today than it was 10 years ago. It has grown by leaps and bounds since 1999, just like alternative energy may grow from now until 2019. But it is important to look at how the majority of the tech stocks performed in the past 10 years. The NASDAQ is still roughly half its value from the peak in March 2000. This scenario is what we are trying to avoid.

I am not advocating that all alternative energy companies are overpriced and should be avoided. I am simply pointing out that having a static allocation of alternative energy stocks in a portfolio is not prudent based on what we currently know.

Our active managers work to identify good investment opportunities based on individual risk/reward relationships. It is always our goal to identify these opportunities and to make appropriate investments that will affect your portfolio in a positive manner. ❖

Bear Markets:

Traditional Definition:

"A bear market is a period of time during which common stocks are returned to their rightful owners."

Bear Markets:

The Murray Corollary:

"A bear market is a period of time during which people who think this is different sell their common stocks—at prices that will never be seen again—to people who know that this time is never different."

The Four Essential Characteristics of All Bear Markets, According to Nick Murray

1. Bear markets are an organic, natural, constant element of a never-ending cycle.
2. Bear markets are as common as dirt.
3. A bear market is always—repeat, always—the temporary interruption of a permanent uptrend.
4. Equities' great volatility is the reason for, and the driver of, their premium returns.

You can read more of Nick Murray's opinion on the subject of bear markets in the "For Our Clients" area of the Web site, www.monetagroup.com

Negotiating Savings

One of the Core Values we hold dear at Moneta Group is to do only what is in our clients' best interests. To that end, we take no compensation from the investment vehicles we use. This makes us unusual in the investment community. It also allows us to help you achieve your goals and objectives because the investments we utilize, such as mutual funds, separate accounts and individual bonds, do not add expenses that are later shared with the investment adviser.

As we have grown, in large part due to your advocacy for Moneta, we have increased the pressure on the investment vehicles we use to lower their expenses for our clients. This is accomplished in mutual funds by creating a different 'share class.' Moving to a share class with .25 percent lower expense increases the return of the fund by .25 percent. Reducing the expense ratio from, say, 1 percent to .75 percent is significant over time, providing a substantial benefit to those investing in these funds.

There is only one reason an investment company would do this: They stand to lose a significant amount of money if the investment dollars were to be moved by a large RIA, like Moneta. For some companies, like Vanguard, lower fees are part of their culture and differentiation. Other investment companies reduce expenses only after hard negotiations and effort. We have these conversations with all the investments we use, and over time, we have successes.

In the past year we have had success with Vanguard, Royce Low-Priced Stock and Turner Midcap funds, all resulting in a benefit of approximately \$450,000 to those Moneta clients who have invested in these funds. And that is in just the first year. We also have an agreement in principal and are working through the operational issues with another fund family that, when complete, will add another \$550,000 of savings for our clients in the first year—a total of nearly \$1 million!

I share this with you because in years when the equity markets are not behaving the way we would like, we want you to know that we are taking advantage of this situation by engaging in hard negotiations that will accrue a benefit to you for years to come.

Keep in mind that although the savings are important, if these funds do not perform according to our selection criteria, we will discontinue using them. Our allegiance is first, foremost and always to you. With that in mind, we continue to act in your best interests. ❖

"I buy when blood is running in the streets of Paris."

— an early Rothschild