



The Value of Diversification Part II & Protecting Your Hard-Earned Assets

OR

Investing 101

Many investors and analysts alike have staunchly felt that, over the past ten years, investing in the stock markets have been a waste of time and effort, not to mention the volatility factor and being fraught with anxiety. To put this in perspective, we have had weeks (September 17) where the S&P sold off some 6% and we have had weeks in October where it has increased 5-7%. Small-company stocks that make up the Russell 2000 Index fell as much as 25% earlier this year. Foreign stocks as measured by the Morgan Stanley EAFE Index (MSCI EAFE) lost as much as 26% and emerging markets (MSCI EM) were down as much as 27%. Yet the broad market after all the yin and yang really isn't much different than we were at the start of the year. But what of the last ten years?

Quite often the phrase "Lost Decade" is used when describing the past ten years of investing in the US stock market. Clearly if gauged by the broadly-based Standard & Poor's (S&P 500) Index or the more narrowly defined Dow Jones Industrial Average (DJIA) that reference feels very real. If you had invested in just the S&P 500 during this period, your annualized return would have been a paltry 1.4% from 2000 through 2010.

Now let's take a look at the "value" of utilizing a diversified portfolio or one that not only contains investments in the broad indices of the US market, but also, foreign markets, emerging markets, commodities, REITS and bonds. The concept is simple: you want to have a portfolio containing certain assets that should go up, while others may go down.* If properly constructed the end result would help to serve a dual purpose; a) spread the risk, and thereby manage it more effectively and by doing so preserve one's assets against systemic failure and; b) eke out a positive return by regularly adjusting your portfolio mix to reflect market conditions.

For example, if you take a typical range of investments utilizing a broad mix of asset classes, a basic diversified portfolio would be comprised of securities in the following indexes: S&P 500 (large stocks), Russell 2000 (small stocks), Real Estate Investment Trusts (NAREIT), International stocks (MSCI EAFE) and emerging markets (MSCI EM). Over the past decade the respective returns would have been: 1.4%, 6.3%, 10.4%, 3.9%, & 16.2% as based upon the indices reflected within. What this exercise helps to illustrate is the impact of diversification. Conversely, as was the case from late 2007 through early 2009, all of the above markets were down, but the impact was minimized due to diversifying across asset classes. While this example seems ideal, it does not **fully** protect against systemic downside risks, which occurred in the recent period from 2007-2009. All of the above markets swooned, which is a classic

systemic breakdown. However, if one **truly** diversifies by incorporating other investment classes such as precious metals, oil and bonds into the portfolio, the ultimate effects of that downturn would have been greatly ameliorated.

So, if we build a portfolio comprised of 60% of the equity classes referred to above and mix in the balance of bonds and commodities, we not only have produced a profit but in a near-fatal recession we have helped to preserve our assets. Ask yourself this question: **How important is the preservation of my assets?** At ANY age this should be of paramount importance, but if you are over the age of 50 and holding onto what you have worked hard to earn over the previous 20-30 years this takes on new meaning. Bottom line, if you are not diversified you are assuming more risk than you most likely should and if this risk is not quantified within your financial plan, you are missing a vital step in planning for your financial future. Diversification is what CIG does well and we are proud that we have never had to tell a single client that they cannot afford to send their children to college or have saved enough to retire comfortably. Never underestimate the value of having a financial plan or diversification within your portfolio. IT IS WHAT WE DO AND WHO WE ARE AND WE ARE PROUD OF OUR TRACK RECORD.

As far as recession talk, the prospect of such is far from certainty, but the picture is about as clear as mud. Economic indicators, while showing modest signs of recovery, are not indicative of a strong recovery. Add to this the bleak outlook on job growth, which not only impacts consumer spending, but also portends dire consequences for the housing market via less 'new home' sales and a continued drop in 'existing home sales,' an increase in foreclosures and in turn, decreased real estate valuations which all contribute to slower economic growth.

For those following the Gold market and wondering what caused the recent fall from just over \$1,900 to a shade below \$1,600 (currently trading at \$1785) it is partially due to the unwinding of trades predicated on projected inflation that has been moved to the back burner. This unwinding in massive amounts has caused excessive volatility and by doing so, spread to other markets and lent itself to the clouded direction of the overall marketplace. This theory took on new meaning with the Federal Reserve's open policy stance maintaining low interest rates "for the foreseeable future." However, many Central Banks have been buying gold on the way up to the \$1900 level and I suspect they will continue to make purchases at these lower levels. A story in the British newspaper, The Telegraph, stated that the Qatari Royal family planned to spend \$10 billion buying gold stocks. All that said, the price of gold sits at barely twice the level of where it traded in 1980. Hardly a solid return on one's investment, particularly if you factor in the adjustment for inflation which roughly places the price of gold at nearly \$2,400.

Additionally 'The Fed' recently announced the re-introduction of "Twist," which is the intervention by the Central Bank of buying longer dated treasuries (10-30 years) thereby removing them from the market, causing a flattening of the yield curve and thus pushes interest rates lower. This move also has the "intended" effect of reducing the national debt by shortening the average maturity of outstanding US Treasury debt which in turn creates more money in the 'system' which in turn motivates spending.

In closing, we would be remiss if we didn't at least acknowledge the (ongoing) troubling situation in Europe and in particular the Greek debt problem and the residual effects among the larger banks in France, Germany, Italy and Spain. While the Greek problem 'may' have been put to bed, Europe still faces looming debt issues with Italy, Spain and Portugal. But all credit-related problems are not the sole enterprise of European banks. In fact, ALL the major US banks hold Euro bank debt as well as Euro Sovereign debt. In fact after the US equity markets dropped by 6% during the week of September 25, they quickly rebounded the following week based on the assumption that the European Financial Stability Facility (EFSF) will have a similar response as did the United States utilizing the 'Troubled Asset Relief Program or TARP as it became known and will be used to breathe life back into European banks. The parameters for implementation of EFSF have not been worked out as yet, but this is not a matter of how or why, but WHEN. We are keeping a very close watch on the Euro situation as its repercussions far outweigh the trough we experienced in 2008-2009. Ergo, like TARP, we do not see a workable alternative to the enactment of EFSF by the European Central Bank. Just when, is anybody's guess.

In addition to providing quality planning and diversification of your risks, CIG is keeping an eye on all of these developing issues and the potential impact they may have on our economy and your portfolio. Our Risk Management Committee meets regularly to monitor these situations and acts accordingly. As your trusted advisor, we are here to analyze these conditions, guide you through these times and help you meet your goals according to your desired time horizon and risk tolerance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Gonzales', written in a cursive style.

Richard Gonzales
Chief Operating Officer
CIG Corp.

*see CIG Letter, December 2010

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