

Should We Have Made Tactical Changes To Our Asset Allocations?

The collapse in stock prices last year spared no one as share prices fell around the world. All 47 markets tracked by MSCI lost ground, with 23 countries experiencing losses in excess of 50% (total return measured in dollar terms). The US finished 7th, with a total return of -37.6%.

Among the ten largest firms in the S&P 500® Index at year-end 2007, there was a wide range of outcomes for 2008: Bank of America and General Electric significantly underperformed the market, with price declines of -65.9% and -56.3%, respectively; while Johnson & Johnson shares fell only 10.3% and Wal-Mart rose 17.9%. Other prominent firms experiencing dramatic losses included American International Group (-97.3%), Citigroup (-77.2%), Fannie Mae (-98.1%), Merrill Lynch (-77.6%), and Wachovia (-85.4%). Since all these firms are constituents of a market portfolio, the easiest way to outperform the market in 2008 was to avoid or underweight these big losers.

It seems plausible that last year's financial meltdown was so extensive and so well-advertised that investment experts would have found it relatively easy to outperform the broad market – and Beacon – by selecting the right stocks or sectors. But a review of several widely read sources of advice suggests that, in at least one respect, there was nothing unusual about 2008: it was just as hard as ever to outperform the market.

A few samples from the "where to invest now" articles we were reading a year ago:

- For its annual "Where to Invest" issue, *SmartMoney* scoured the globe for appealing opportunities and identified a dozen companies "likely to increase profits in a world filled with trouble spots."

Outcome: From the recommendation date of November 2, 2007 through December 31, 2008, the average share price decline of the twelve named stocks was 52.4%, compared to a drop of 40.2% for the S&P 500® Index and 35.4% for the Dow Jones Industrial Average. Performance varied widely: Wells Fargo (WFC) shares declined 8.8%, while Genworth Financial (GNW) plummeted 88.9%.

Pearlman, Russell. "Where to Invest 2008." *SmartMoney*, January 2008.

- A prominent money manager and self-described "contrarian" investor wrote in a January 2008 *Forbes* column: "You have to choose carefully here, since many financial stocks will not come back for a long time, if ever. . . . The safest plays are among the big banks."

Outcome: Prices for the seven financial stocks mentioned in the column, including Citigroup, Freddie Mac, and Wachovia, declined an average of 74.0% in 2008.

Dreman, David. "Seize the Day." *Forbes*, January 8, 2008.

Wall Street Journal, New York Stock Exchange 2008 Trading Summary, January 2, 2009.

- A money manager who applied detailed quantitative analysis to successfully predict the crash of 1987 was expecting a gain

of 20% for the S&P 500® in 2008: "Our models show the S&P 500 is undervalued by 25%...Our indicators are extremely bullish."

Outcome: Disappointment.

Tergesen, Anne. "What the Pros Are Saying." *Business Week*, December 31, 2007.

- A veteran market analyst favored "pockets of value," including stocks which had been "excessively punished" in the subprime-related meltdown: Nordstrom, Tiffany, J. Crew, and his favorite, American International Group.

Outcome:

Company	Price Change 2008
<i>American International Group (AIG)</i>	-97.3%
<i>J. Crew Group (JCW)</i>	-74.7%
<i>Nordstrom (JWN)</i>	-63.8%
<i>Tiffany & Co. (TIF)</i>	-48.7%

Tergesen, Anne. "What the Pros Are Saying." *Business Week*, December 31, 2007. *Wall Street Journal*, New York Stock Exchange 2008 Trading Summary, January 2, 2009.

- Nvidia was featured in a "Company of the Year" cover story by *Forbes*, which reported that the firm's sophisticated graphics chips, the brains inside popular products such as the Sony PS3 game console, were finding new applications in science and industry.

Outcome: Nvidia shares fell 76.3% in 2008.

Caulfield, Brian. "Shoot to Kill." *Forbes*, January 7, 2008.

Wall Street Journal, New York Stock Exchange 2008 Trading Summary, January 2, 2009.

- A successful former hedge fund manager and globetrotting author argued correctly a year ago that a recession in the US was already underway. He was bullish on commodities ("the commodities bull market still has years to go") and China ("there are gigantic opportunities in China and gigantic changes taking place there.")

Outcome: The Dow Jones-AIG Commodity Index declined 37% in 2008, the worst year since its inception in 1998, and total return for the S&P GSCI® Index was -46.49%. China ranked 26th among 47 world stock markets tracked by MSCI, with a total return of -50.83%. In fairness to the forecaster, he was making a long-term recommendation, not a prediction for the next twelve months. Investors who overweighted their portfolios in 2008 with commodities or Chinese stocks are hoping he's right.

Barclays Global Investors. *Ishares.com*, accessed January 7, 2009.

Cui, Carolyn. "Commodities: Great—Then Ugly." *Wall Street Journal*, January 2, 2009.

O'Keefe, Brian. "Hog Wild for China." *Fortune*, December 24, 2007.

- *Fortune* editors sought to identify the "true artists of today's mutual fund world" and selected six "standout managers" through a careful selection process. *Fortune* was sufficiently confident of their efforts that they believed "having even one of these names in your portfolio would reflect a savvy eye."

Outcome: Compared to a passively managed blend consisting of two-thirds DFA US Large Company Portfolio and one-third DFA Large Cap International Portfolio, total return for the six actively managed selections (four US, two international) was more than 200 basis points lower for the year ended December 31, 2008. Maybe next year.

Morningstar. *Morningstar.com*, accessed January 6 2009.

Rosenburg, Yuval. "Old Masters and New Classics." *Fortune*, December 24, 2007.

- The cover of *Fortune's* Investment Guide 2008 issue offered a teaser: "Five Must-Have Foreign Stocks." With thousands of stocks to choose from throughout the world, imagine how rewarding it could be to identify a handful of the best-positioned companies. After consulting with "top foreign fund managers and analysts," *Fortune* settled on the following picks:
 - Bank of Ireland, IRE ("dirt cheap," 7% dividend yield).
 - The iShares Brazil Index, EWZ ("only Egypt has done better over the past five years").
 - Mobile Telesystems, MBT ("more cell phone subscribers than AT&T").
 - Potash Corp. of Saskatchewan, POT ("earnings to soar more than 50%").
 - GlaxoSmithKline, GSX ("strong cash flow, rich dividend yield").

Outcome: Bank of Ireland eliminated its dividend amid rising loan losses. Brazil finished 36th out of 47 world stock markets tracked by MSCI. Shares of Mobile Telesystems couldn't escape the collapse in Russian stock prices. Potash Corp. shares fall along with fertilizer prices. GlaxoSmithKline performed relatively well. The average price decline in 2008 for the five recommendations was -59.5%, compared to a loss of 45.2% for the MSCI All-Country World Index.

Bank of Ireland. *Bankofireland.com*, accessed January 7, 2009.

MSCI. *Mscibarra.com*, accessed January 5, 2009.

Rosenberg, Yuval. "Harvesting the Top Foreign Stocks." *Fortune*, December 24, 2007.

Wall Street Journal, New York Stock Exchange 2008 Trading Summary, January 2, 2009.

Our take: If making tactical changes to your asset allocation and stock picking didn't work in 2008, when *will* it work?