

Weighty Decisions

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The term “Lost Decade” was first coined as a reference to the time after the Japanese asset price bubble's collapse within the Japanese economy. The term originally referred to the years 1991 to 2000. Many investment professionals now also refer to the past ten years in US history as a “Lost Decade”. The average annualized return on US equities was -1% between 2000 and 2009, as measured by the S & P 500 index. If an individual had invested \$10,000 in the S & P 500 on January 1, 2000, that portfolio would have then been worth \$9,089 as of December 31, 2009.

Our strategy at Tri Pillar Investments would have avoided this outcome completely. While we recognize that systemic risk cannot be diversified away, we are confident that investors can actually benefit from volatility in the capital markets over time. This can be done by maintaining a basket of diversified instruments. Our portfolio construction begins with an examination of the domestic US equity markets. We recommend that this portion of the portfolio consist of funds having exposure to large-, mid- and small-cap stocks so that they do not miss the rally in any one category. Market capitalization is a simple mathematical calculation. The current price of the stock is multiplied by the number of common shares outstanding.

Large capitalization stocks tend to fall into the mature, stable, and less risky category of companies. They include the more recognized companies, such as GE, IBM and Microsoft. Their average capitalization is greater than \$5 billion. These companies are often the performance leaders coming out of recessions, because they truly are the safest, most liquid investment vehicles available. Large capitalization companies are more likely to pay dividends, representing a major component of return over time. They are also more likely to have international operations, and hence will be responsive to global economic trends and currency risk. This can be an advantage. As of December 7, 2010, large capitalization stocks have returned 11.83% to date this year.

Historically, mid-cap companies are perceived as being riskier than their larger counterparts, especially when markets correct. During the bear phase, mid-cap stocks get crushed much more than large-caps. Their market capitalization ranges from \$1 to \$5 billion. As of December 7, 2010, mid capitalization stocks have returned 23.79% to date this year.

Small cap stocks are generally less than \$1 billion in size. They are often considered less financially stable. They have less trading liquidity, greater risk, more volatility and less access to capital than their larger cap brethren.

Both mid cap and small cap stocks often outperform the markets, as economic recoveries progress and stock market rallies mature. Over the long term, small cap stocks have had the best rate of return of any equity asset class. As of December 7, 2010, they have returned 23.39% to date this year.

How does this relate to the concept of correlation among asset classes? While all domestic equities are highly correlated over time, this correlation varies. In times of uncertainty, it is tempting to try to time the market, predict bottoms and tops, and react emotionally to economic events. However, returns will be optimized and risk reduced By maintaining a clearly reasoned asset allocation, harmonious with an investor's risk tolerance.