

Richard
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Is buy-and-hold dead?

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July 2012

If one searches in Google for “Does buy-and-hold work?”, more than 191 million results will appear. If one searches for “Is buy-and-hold dead?”, more than 81 million results will appear. However, if one searches for “Successful buy-and-hold strategies”, only about 9 million results will appear. It’s pretty clear that the investing world believes that buy-and-hold strategies are basically dead and gone.

Is the consensus correct, and are buy-and-hold strategies truly dead? The answer, if you ask us, is a definitive no. Buy-and-hold is very much alive and well.

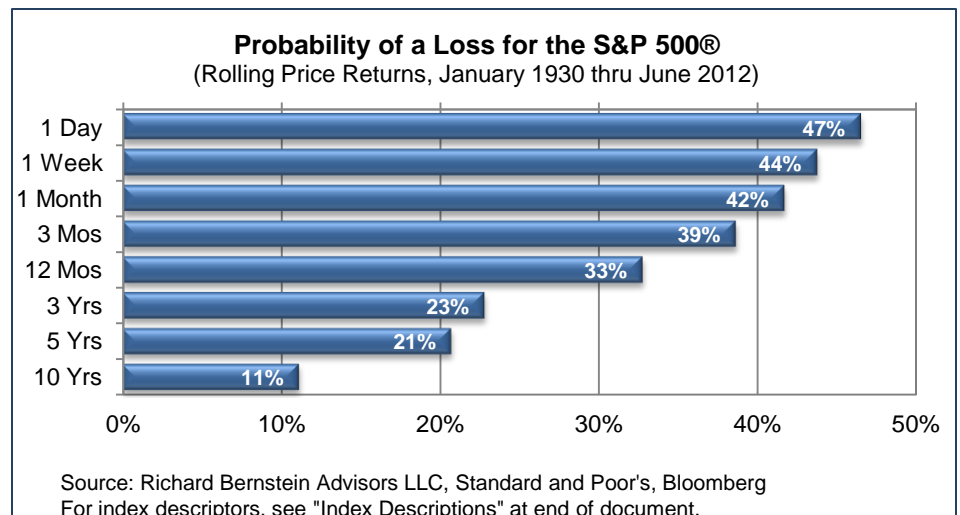
Navigate the Noise

In *Navigate the Noise – Investing in the New Age of Media and Hype* (Wiley: 2001), I pointed out that investment returns can be significantly hurt by strategies based on short-term, noise-driven strategies. The data clearly and consistently showed that extending one’s investment time horizon was a simple method for improving investment returns. Eleven years later, those conclusions remain very much intact.

There are sound economic reasons why extending one’s time horizon can benefit investment returns. Changes within the economy tend to be very gradual, and significant adjustments rarely happen within a short period of time. Certainly, there is plenty of daily news, but how much of that news is actually important and worth acting on? The data suggest very little of that information is meaningful and valuable. Most of it is simply noise.

Chart 1 shows the probability of losing money in the S&P 500 based on varying time horizons. As one extends one’s investment time horizon, and increasingly focuses on the fundamentals of the slow-moving economy, the probability of losing money decreases. In fact, short-term trading is like flipping a coin; it is virtually a 50/50 proposition.

Chart 1:



Is buy-and-hold dead?



Using longer investment time horizons to improve investment returns seems to work for a broad range of financial assets, but does not seem to work particularly well for real assets such as gold and commodities. (See the charts at the end of this report).

Buy-and-hold isn't dead, but one has to buy-and-hold the correct assets

Buy-and-hold strategies typically do perform well, but their success is predicated on buying and holding the correct assets. Having exposures to the correct market segments is called beta management, and investors tend to be very poor beta managers.

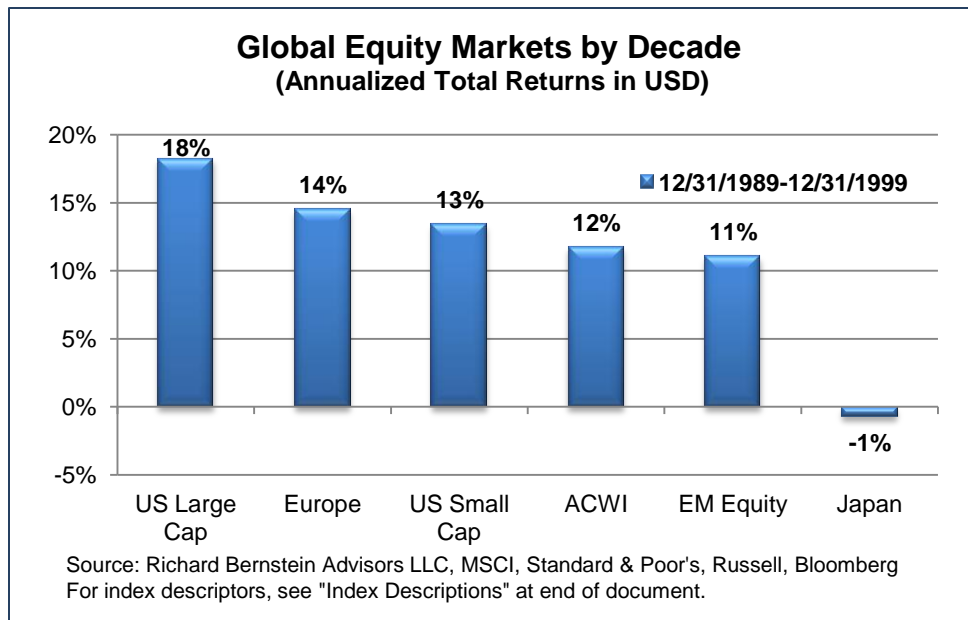
"Stocks for the long run" was the theme of the late 1990s and early-2000s, and investors were encouraged to buy-and-hold S&P 500 index funds. That seemed to make sense to them at the time because the US stock market had just finished one of its most successful performance decades in history. As a result, investors preferred US stocks. Unfortunately, US stocks subsequently underperformed.

Chart 2 shows why investors wanted to accentuate US stocks in their portfolios at the beginning of the 2000s. Chart 3 shows what actually happened in the subsequent ten years, and why investors perceive that there was a "lost decade in stocks" and that "buy-and-hold is dead".

However, if one had bought and held emerging market stocks in 2000 rather than US stocks, one would be very happy today. If one had bought and held BRICs, one would be very happy today. Buy-and-hold has continued to be a viable investment strategy, so long as investors bought and held the correct stocks!

Ironically, many investors today seem to be following the same formula they followed last decade, and are again buying and holding the prior decade's winners. In our opinion, these investors are positioning their portfolios for another "lost decade in equities".

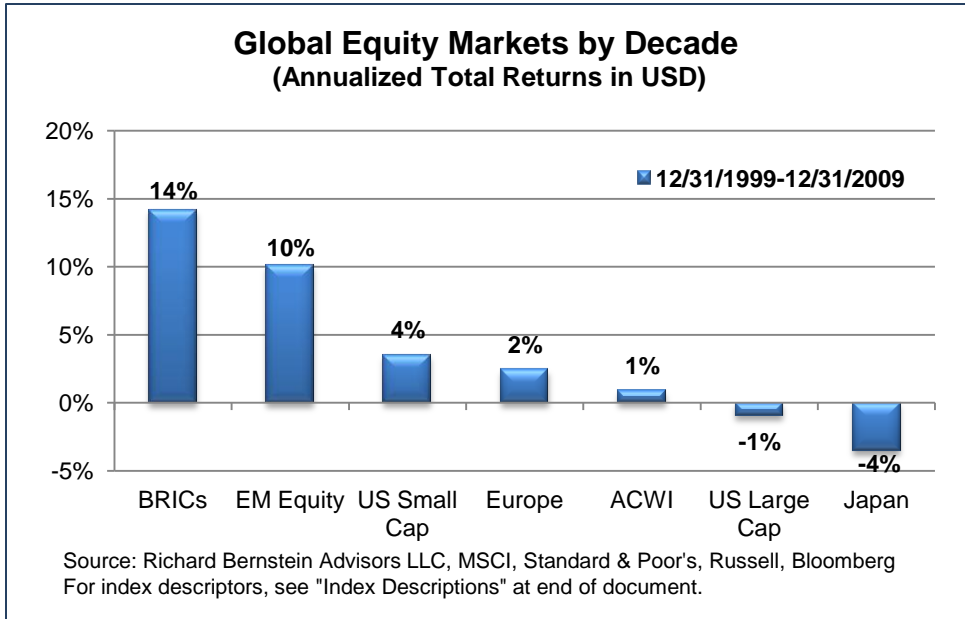
Chart 2:



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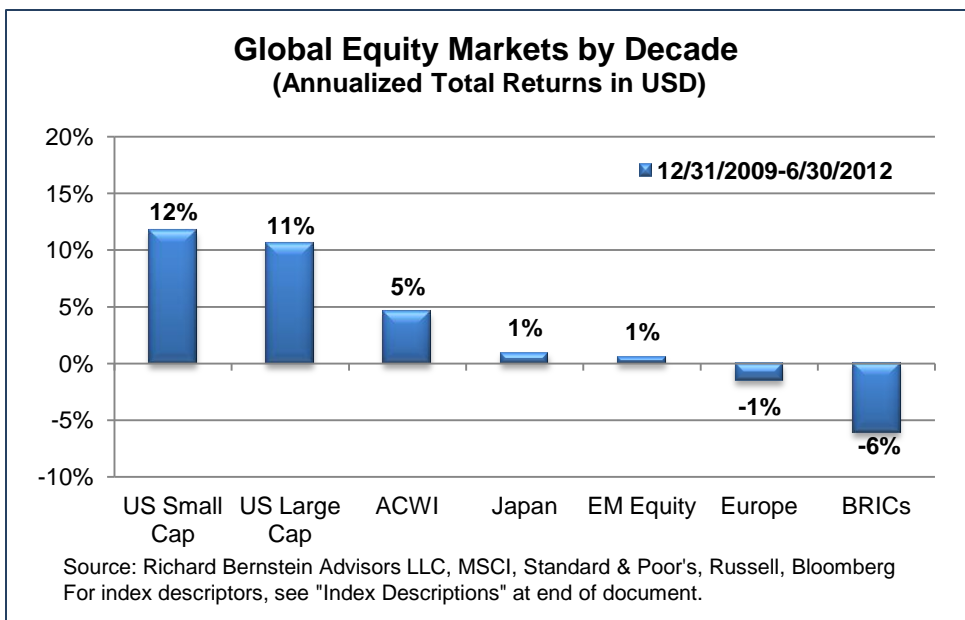
Chart 3:



A "lost decade" in emerging markets?

This decade has so far been another decade of change. Chart 4 shows the performance of equity segments since December 31, 2009. Note that the prior decade's winners are so far not fairing very well. Might there be a "lost decade" in the emerging markets?

Chart 4:





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Buy-and-hold isn't dead

Buy-and-hold seems alive and well. The Sirens' song of daily economic and financial noise lures investors away from investing with longer time horizons. In addition, investors need to be careful not to chase past performance, and carefully manage the beta-exposures of their portfolios.

Our strategies continue to be highly disciplined to limit the detrimental portfolio effects of short-term noise, we continue to maintain longer-term investment time horizons, and we continue to combine that discipline and time horizon to try to get more effective beta exposures within our portfolios.

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PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS

Appendix



Chart 5:

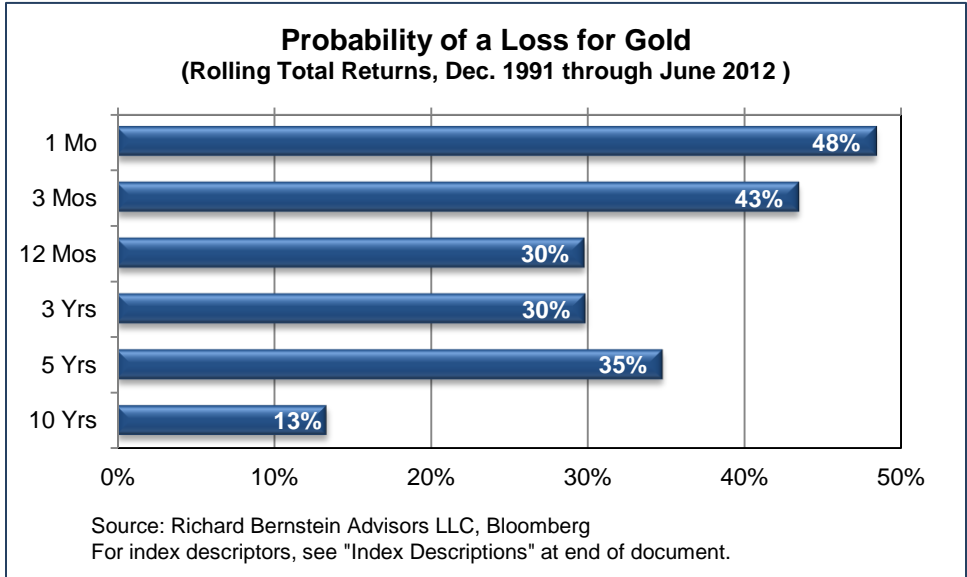
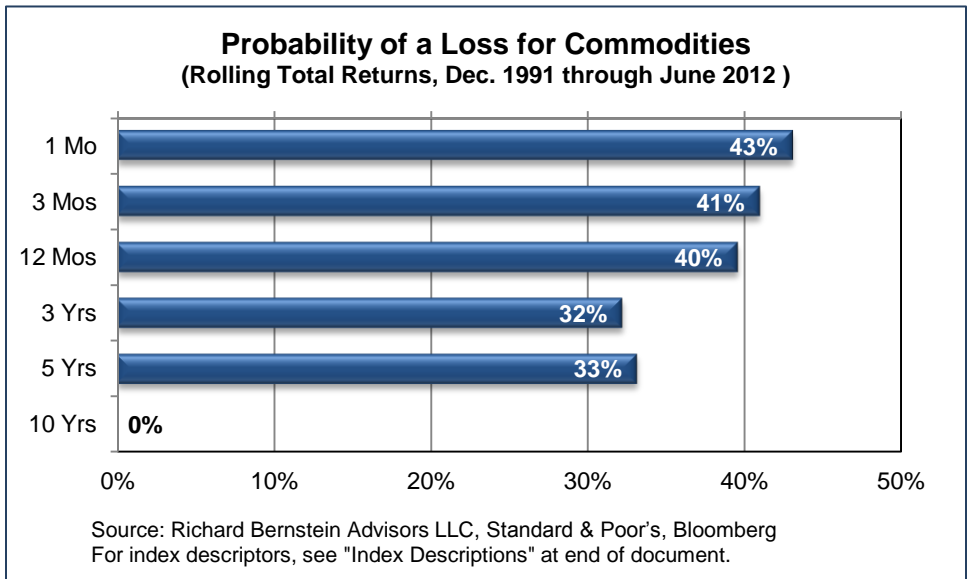


Chart 6:



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Chart 7:

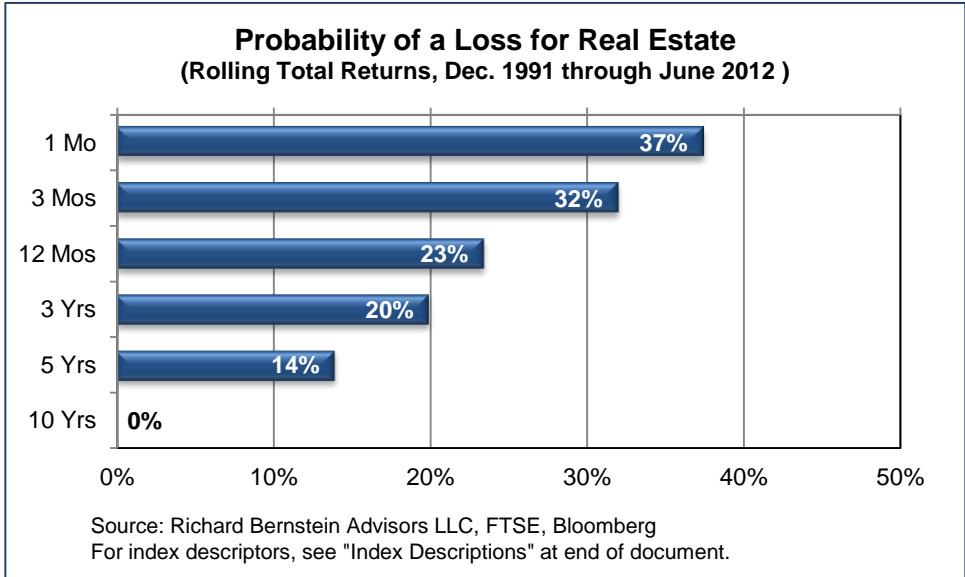
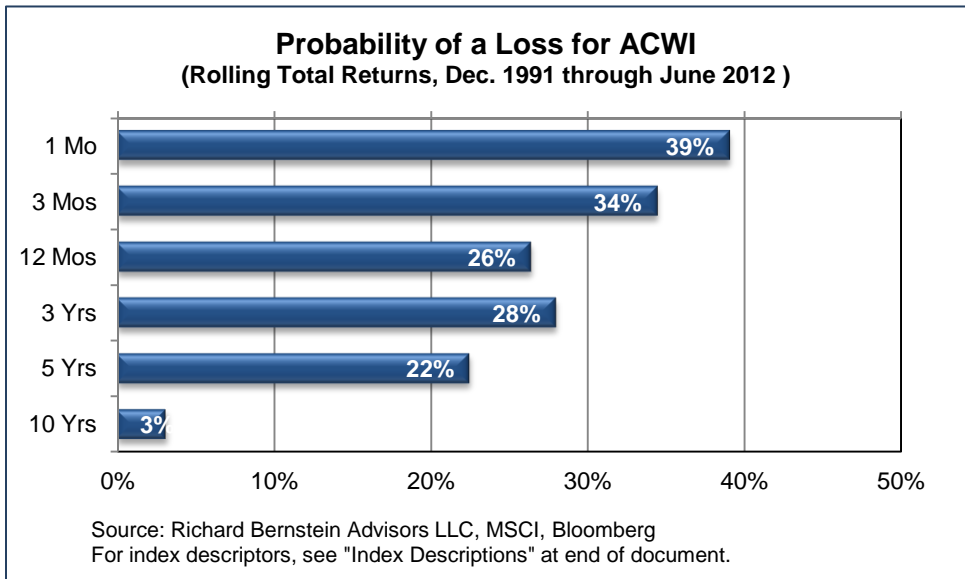


Chart 8:



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Chart 9:

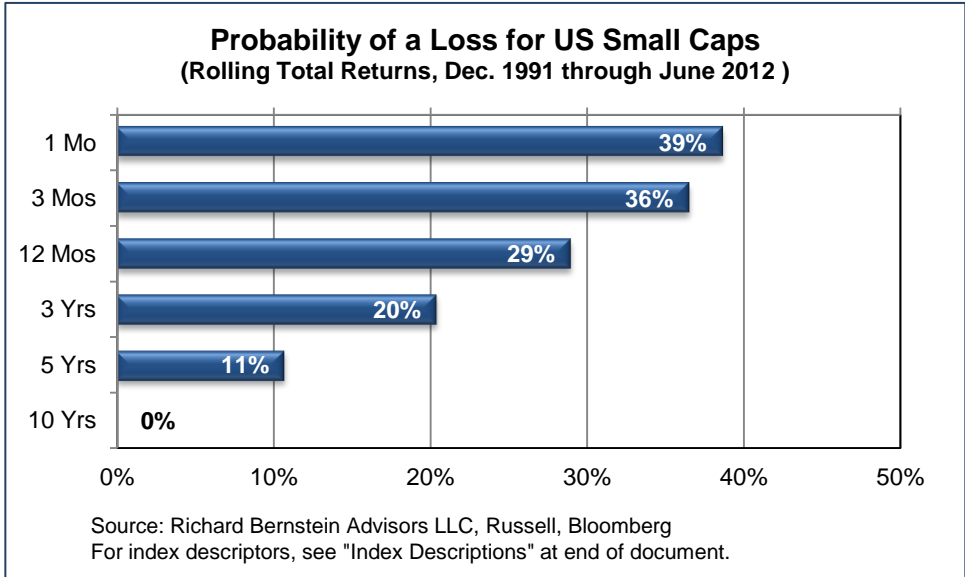
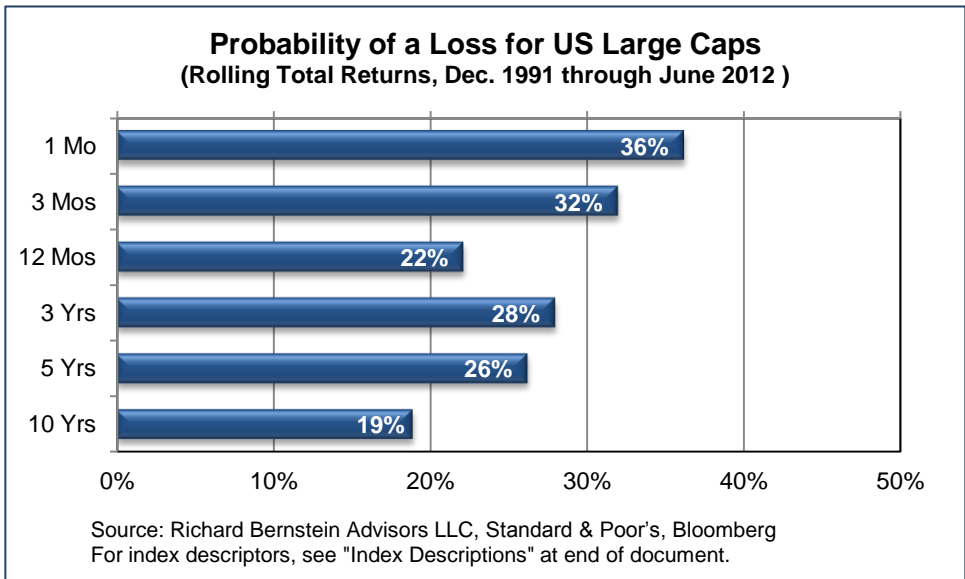


Chart 10:



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Chart 11:

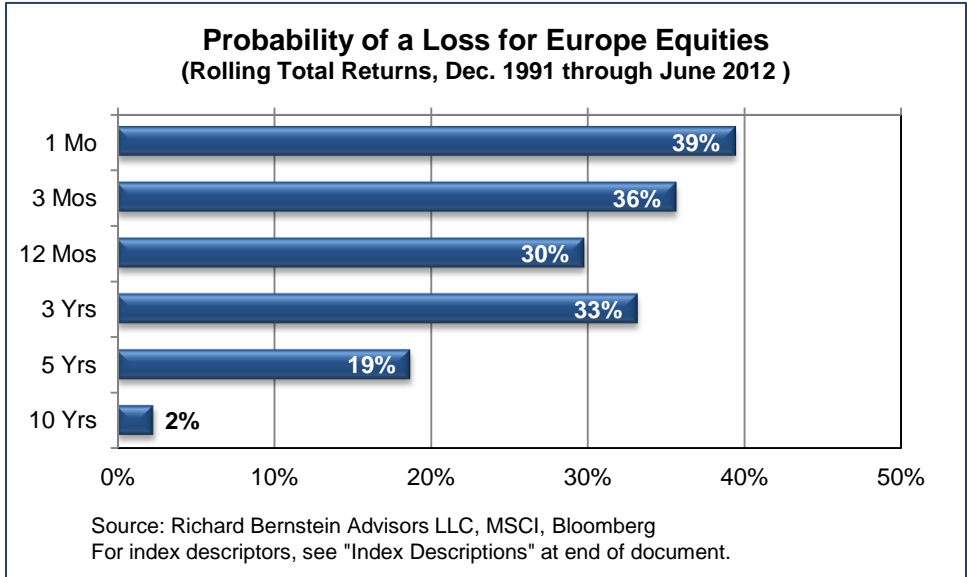
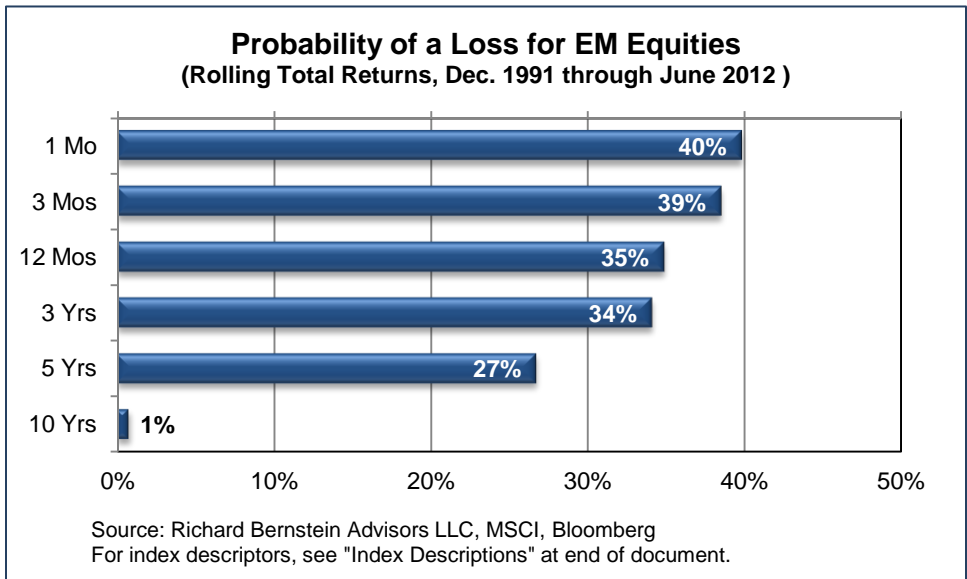


Chart 12:



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Chart 13:

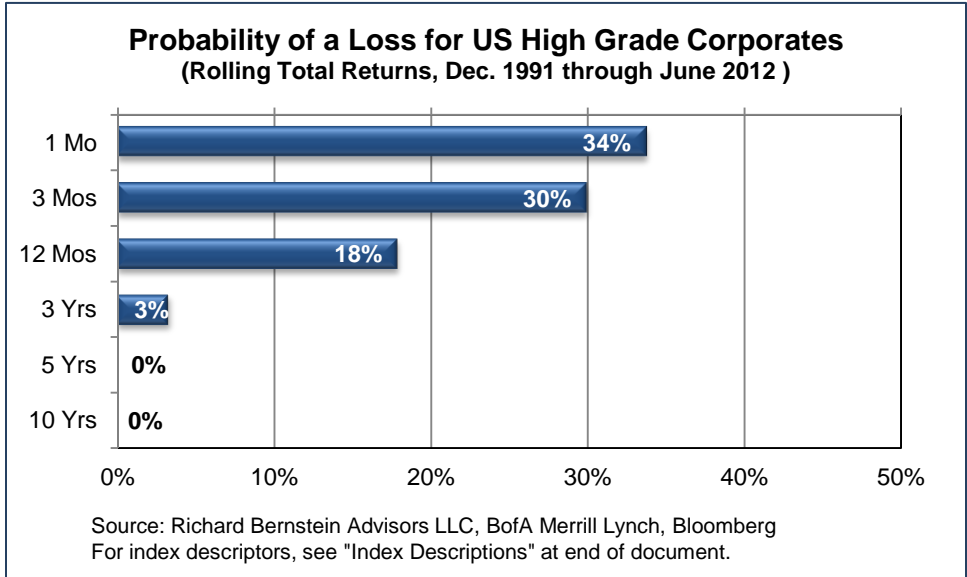
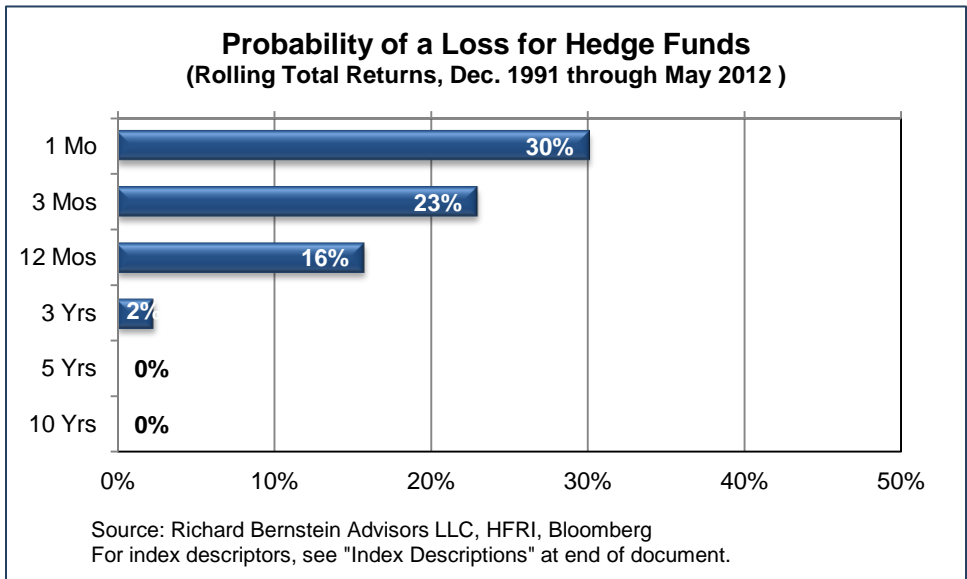


Chart 14:



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Chart 15:

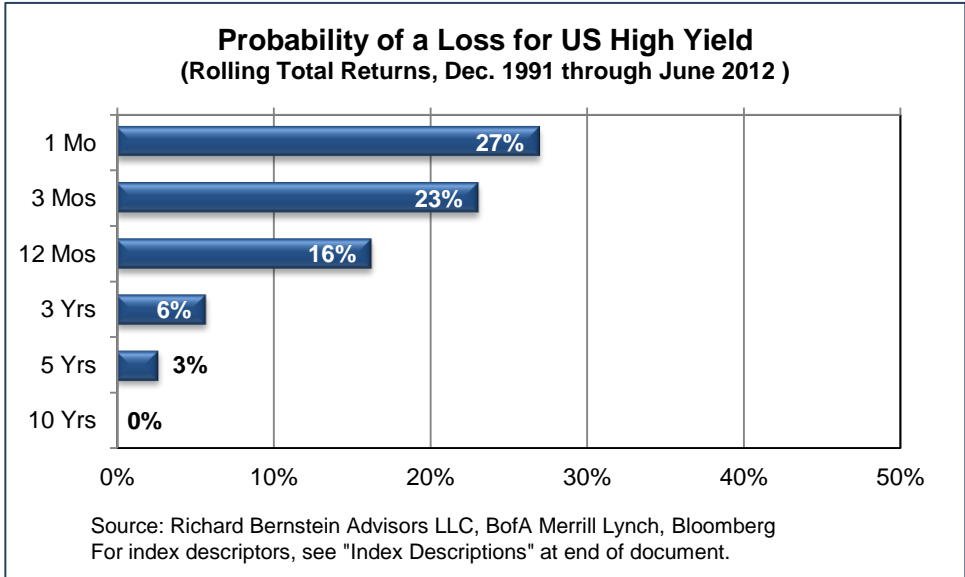
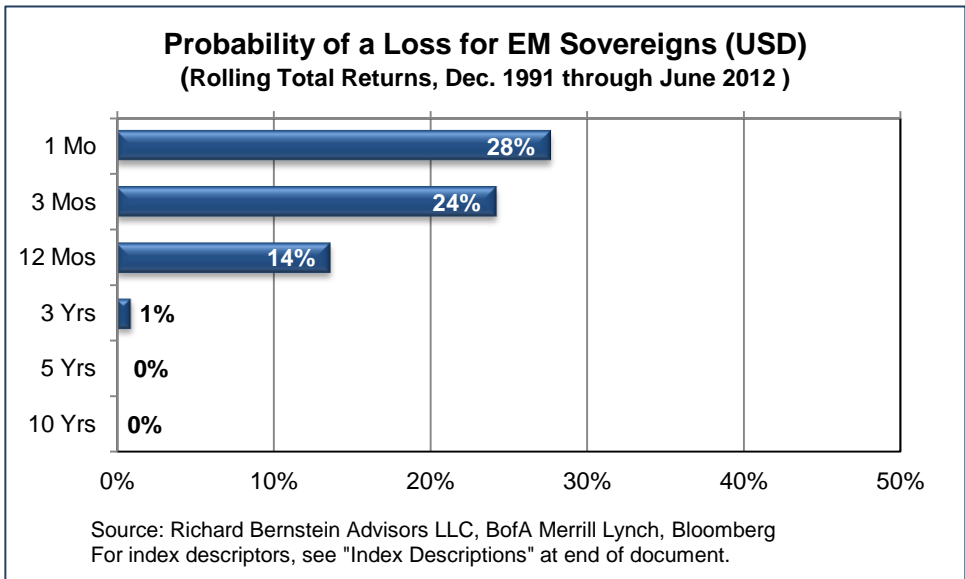


Chart 16:





INDEX DESCRIPTIONS:

The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website.

The past performance of an index is not a guarantee of future results.

Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. **Indices are not actively managed and investors cannot invest directly in the indices.**

MSCI All Country World Index (ACWI®): The MSCI ACWI® Index is a widely recognized, free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of developed markets.

US Large Caps: Standard & Poor's (S&P) 500® Index. The S&P 500® Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries.

Europe Equity: MSCI Europe Index. The MSCI Europe Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of the developed markets in Europe. The MSCI Europe Index consists of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom

BRICs: MSCI BRIC Index. The MSCI BRIC Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of the following four emerging-market country indices: Brazil, Russia, India and China.

EM Equity: MSCI Emerging Markets (EM) Index. The MSCI EM Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of emerging markets.

Japan: MSCI Japan Index. The MSCI Japan Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of Japan.

U.S. Small Caps: Russell 2000 Index. The Russell 2000 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index.

Gold: Gold Spot USD/oz Bloomberg GOLDS Commodity. The Gold Spot price is quoted as US Dollars per Troy Ounce.

Commodities: S&P GSCI® Index. The S&P GSCI® seeks to provide investors with a reliable and publicly available benchmark for investment performance in the commodity markets, and is designed to be a "tradable" index. The index is calculated primarily on a world production-weighted basis and is comprised of the principal physical commodities that are the subject of active, liquid futures markets.

Real Estate: THE FTSE NAREIT Composite Index. The FTSE NAREIT Composite Index is a free-float-adjusted, market-capitalization-weighted index that includes all tax qualified REITs listed in the NYSE, AMEX, and NASDAQ National Market.



INDEX DESCRIPTIONS: cont'd

Hedge Fund Index: HFRI Fund Weighted Composite Index. The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager funds that report to the HFR (Hedge Fund Research) database. Constituent funds report monthly net-of-all-fees performance in USD and have a minimum of \$50 million under management or a twelve (12)-month track record of active performance. The Index includes both domestic (US) and offshore funds, and does not include any funds of funds.

3-Mo T-Bills: BofA Merrill Lynch 3-Month US Treasury Bill Index. The BofA Merrill Lynch 3-Month US Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. The Index is rebalanced monthly and the issue selected is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date.

Long-Term Treasuries: BofA Merrill Lynch 15+ Year US Treasury Index. The BofA Merrill Lynch 15+ Year US Treasury Index is an unmanaged index comprised of US Treasury securities, other than inflation-protected securities and STRIPS, with at least \$1 billion in outstanding face value and a remaining term to final maturity of at least 15 years.

US High Grade Corporates: BofA Merrill Lynch 15+ Year AAA-AA US Corporate Index. The BofA Merrill Lynch 15+ Year AAA-AA US Corporate Index is a subset of the BofA Merrill Lynch US Corporate Index (an unmanaged index comprised of USD-denominated, investment-grade, fixed-rate corporate debt securities publicly issued in the US domestic market with at least one year remaining term to final maturity and at least \$250 million outstanding) including all securities with a remaining term to final maturity of at least 15 years and rated AAA through AA3, inclusive.

U.S. High Yield: BofA Merrill Lynch US Cash Pay High Yield Index. The BofA Merrill Lynch US Cash Pay High Yield Index tracks the performance of USD-denominated, below-investment-grade-rated corporate debt, currently in a coupon-paying period, that is publicly issued in the US domestic market. Qualifying securities must have a below-investment-grade rating (based on an average of Moody's, S&P and Fitch) and an investment-grade-rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long-term sovereign debt ratings), at least one year remaining term to final maturity, a fixed coupon schedule, and a minimum amount outstanding of \$100 million.

EM Sovereign: The BofA Merrill Lynch US Dollar Emerging Markets Sovereign Plus Index
The BofA Merrill Lynch US Dollar Emerging Markets Sovereign Plus Index tracks the performance of US dollar denominated emerging market and cross-over sovereign debt publicly issued in the eurobond or US domestic market. Qualifying countries must have a BBB1 or lower foreign currency long-term sovereign debt rating (based on an average of Moody's, S&P and Fitch). Countries that are not rated, or that are rated "D" or "SD" by one or several rating agencies qualify for inclusion in the index but individual non-performing securities are removed. Qualifying securities must have at least one year remaining term to final maturity, a fixed or floating coupon and a minimum amount outstanding of \$250 million. Local currency debt is excluded from the Index.



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