



Eurozone's Reintroduction Of Country-Specific Risk And The 'Flash Crash' Of 5/6/10 Reemphasizes Risk Management Over Asset Allocation. Portfolio Derisking Will Be The Key To Maximizing Returns In An 'Unusually Uncertain' World, As Characterized By Chairman Bernanke.

As of November 30, 2010

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There is a failure to recognize the strength and severity of the current global deflationary forces. Liquidity and income are crucial in deflation. This past decade, especially the last three years, has seen solid positive quality fixed income performance and even stronger gold performance versus negative equity returns. Marginalized equity contribution now date back to 1969, and no efficient frontier exists out to 15 years. Derivatives, leverage, naked short-selling, stock lending, and liquidity loss with gated hedge funds found in most alternatives by plan sponsors has certainly challenged the role of equities. Diversification with a high equity orientation is not really diversification when the improbable occurs more frequently.

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## Table of Contents

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1. Country Risk Reintroduced As Eurozone Sovereign Credits Try To Avoid Default
2. The Challenge to US and UK Pension Actuarial Assumptions
3. Benchmark Returns
4. Market Trends: Risks vs. Returns
5. Efficient vs. Inefficient Frontiers
6. Significance of Fixed Income in Asset Allocation
7. Correlation between S&P 500 and Major Market Indices

# COUNTRY RISK REINTRODUCED AS EUROZONE SOVEREIGN CREDITS TRY TO AVOID DEFAULT

- **Risk management must replace asset allocation strategies to reflect the binary world of ‘risk on/risk off’ leveraged alternative investors. Stock picking and sector allocation do not reflect deflation, real rates of return, and the loss of diversification in 2008-9.**

Greater diversification (inverse correlation) is required when one uses leverage, shorting, and derivatives to offset low returns and high volatility. Deflation demands absolute returns, preservation of capital, and income. Asset-price collapses are deep and protracted affairs. Market cycles are now being extended from 3-5 years to 15-20 years to justify return assumptions. No efficient frontiers currently exist out to 20 years. **Gold is inversely correlated to both the equity market and inflation, making it a good diversifier as well as an insurer against financial and geopolitical risk.**

- **The rediscovery of real rates assures a significant increase in quality fixed income allocations to stabilize positive portfolio returns**

Most pension plan fixed income assets are chronically short of their liability duration. **As a monetary policy tool, quantitative ease guarantees a lower discount rate to quantify the present value of liabilities and doubles the reason for more fixed income.**

- **Unwarranted optimism over return assumptions of traditional asset sectors must be corrected in a deflation paradigm**

Pension return assumptions and liability discount factor assumptions are too high. Current 10-year Treasury yields of 2.82% compare favorably to the S&P 500, which yields just 1.98% on the indicated dividend rate, with 5.0+% annual growth in earnings needed to provide a 7% total return. Producing that 7% relies on the S&P 500 maintaining its current P/E multiple, which based on the December 2010 estimated “reported” four-quarter

earnings of \$74.21 is 15.90, above the historical average of 15. Even at a price level of 1180, the current 12-month 2011 forward “reported” earnings projection of \$86.30 makes the forward P/E multiple of 13.67 formidable with all of today’s additional accounting unknowns after FASB 157e.

- **Refusal to reverse ambitious ROA assumptions stimulated the rise in leverage-driven alternative investing and absolute return strategies. Leverage has magnified risk and negative returns and a need for macro managers who understand the financial system. The global credit crunch of 2007-10 has created a huge rise in the under-funded levels of benefit plans and a refocusing on balance-sheet risk.**

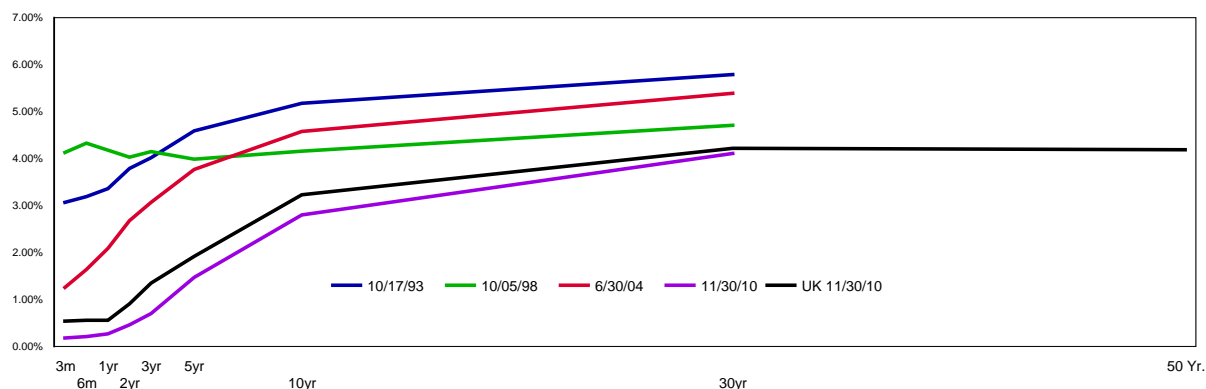
Absolute return strategies with promised bond-like volatility placed a premium on coupon while ignoring duration, credit, refinancing, leverage, illiquidity, valuation, convergence, and event risks in order to continue to try and meet high ROA assumptions. Most are now conceptually bankrupt. Buy-and-hold does not play, or be prepared to accept zero or negative returns as it happened over the last decade.

- **The tightening grip of higher fiduciary standards, disclosure standards, and demographics**

The Pension Protection Act (PPA) of 2006, the FASB 158 Employee’s Accounting for Defined Benefit Pension and Other Post-Retirement Plans, and increased SEC scrutiny all require much more balance-sheet transparency. Demographics will bring dramatic shifts in payout to contribution ratios as “aging” forces the required level of payouts to increase relative to assets as members increasingly retire. Risk is seen as the ability to fund liabilities as the average number of years to retirement for plans are now measured in single digits.

## THE CHALLENGE TO US AND UK PENSION ACTUARIAL ASSUMPTIONS as of 11/30/10

- Over 17 years with long rates at 6% or lower
- Close to 12 years with 10-year rates at 4.25% or less
- Liabilities that are discounted to present value mushroom with lower rates
- Impact of monetary policy 6/30/04 through 11/30/10 (425 bps up, then 500+ bps down)
- Prevailing ROAs and liability discount rates too high; serious pension/OPEB under-funding; FASB/IASB convergence postponed until 2013 but will eventually happen



	3 Mos.	6 Mos.	1 Yr.	2 Yr.	3 Yr.	5 Yr.	10 Yr.	30 Yr.	50 Yr.
10/17/93	3.07	3.19	3.36	3.79	4.02	4.59	5.18	5.79	-
10/05/98	4.13	4.33	4.18	4.03	4.15	3.99	4.16	4.71	-
6/30/04	1.26	1.64	2.09	2.68	3.07	3.77	4.58	5.29	-
11/30/10	0.18	0.21	0.27	0.46	0.70	1.47	2.80	4.11	-
UK 11/30/10	0.54	0.56	0.56	0.91	1.35	1.92	3.23	4.22	4.19

\*Source: Bloomberg Financial Data

# BENCHMARK RETURNS

As of 11/30/10 - Unadjusted for Risk and Taxes

## EQUITY MARKET RETURNS

	3 month	1 year	2 years	3 years	5 years	7 years	8 years	10 years
<b>S&amp;P with Income</b>	13.08	9.94	17.32	-5.18	0.97	3.63	5.00	0.80
<b>DOW JONES</b>	9.89	6.38	11.70	-6.26	0.49	1.78	2.77	0.61
<b>DOW JONES with Income</b>	10.63	9.35	15.13	-3.45	3.17	4.38	5.34	3.01
<b>NASDAQ</b>	18.55	17.68	28.76	-1.17	3.83	4.66	7.79	0.37
<b>WILSHIRE 5000</b>	14.59	13.50	19.67	-4.99	0.57	3.66	6.14	2.02
<b>RUSSELL 2000</b>	21.11	26.99	25.74	-5.44	-2.00	1.95	5.72	3.87
<b>S&amp;P MID-CAP</b>	18.56	26.31	30.82	5.49	7.06	9.30	11.46	8.55
<b>MSCI EAFE</b>	8.38	1.76	18.49	-9.67	1.47	5.40	7.26	1.82
<b>HUI-AMEX GOLD</b>	12.91	16.58	49.97	11.31	18.56	12.87	22.39	30.06
<b>SPOT GOLD</b>	11.11	17.49	30.15	20.92	22.96	19.50	20.19	17.75
<b>WILSHIRE REIT INDEX</b>	7.37	31.18	36.33	-3.45	1.31	7.72	10.78	10.49

## FIXED INCOME MARKET RETURNS

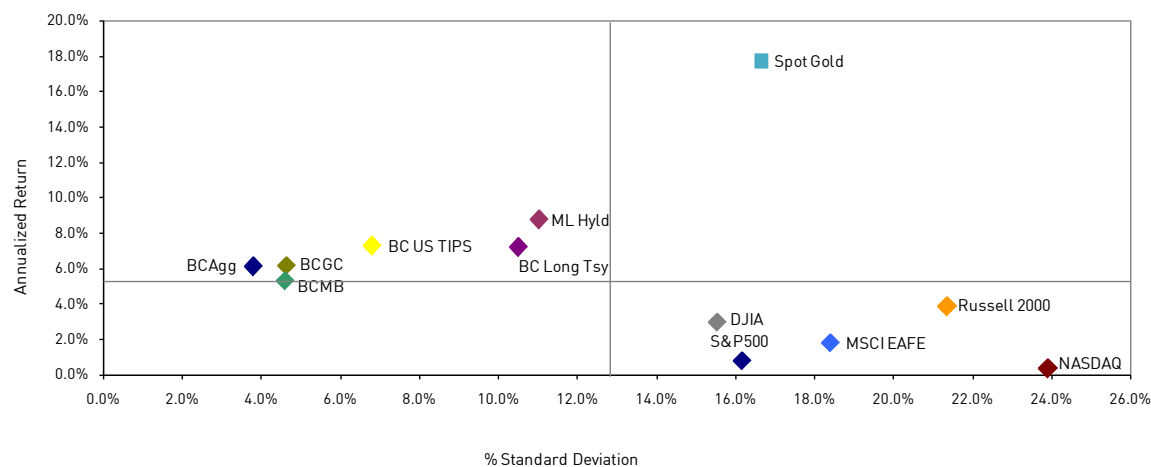
<b>BC GOV/CREDIT</b>	-0.51	6.19	8.68	6.17	6.06	5.26	5.40	6.19
<b>BC AGG BOND</b>	-0.10	6.04	8.80	6.39	6.23	5.42	5.39	6.15
<b>BC 3 MONTH BILL</b>	0.04	0.13	0.18	0.95	2.55	2.41	2.26	2.47
<b>BC 1-3 YR.GOV</b>	0.22	1.85	2.53	3.63	4.43	3.58	3.43	4.22
<b>BC INTERM GOV</b>	0.06	4.44	4.14	5.52	5.82	4.74	4.64	5.49
<b>BC LONG TSY</b>	-6.09	7.22	3.95	6.91	7.03	6.87	6.69	7.23
<b>BC US TIPS</b>	1.52	5.60	12.36	5.45	5.91	5.80	6.42	7.30
<b>BC BROAD MUNICIPAL</b>	-2.43	4.75	9.36	4.86	4.68	4.48	4.75	5.30
<b>ML HIGH YIELD</b>	4.21	16.69	38.01	9.49	8.54	8.23	10.33	8.79
<b>ML GLOBAL ex US</b>	-0.87	0.69	8.62	7.69	8.22	6.25	7.58	7.18
<b>BC EMERGING MKTS</b>	1.03	13.63	28.62	9.31	8.96	9.86	11.86	10.86

\*Source: Bloomberg Financial Data

## MARKET TRENDS: 10-Year Wakeup Call

	Annualized Return	% Std Dev
Barclays Capital Aggregate	6.15%	3.79%
Barclays Capital Gov/Credit	6.19%	4.63%
Barclays Capital Municipal Bond	5.30%	4.61%
Barclays Capital Long Treasury	7.23%	10.51%
Barclays Capital US TIPS	7.30%	6.80%
S&P 500	0.80%	16.17%
Merrill Lynch High Yield	8.79%	11.02%
NASDAQ	0.37%	23.90%
DJIA	3.01%	15.53%
Russell 2000	3.87%	21.35%
MSCI EAFE	1.82%	18.40%
Spot Gold	17.75%	16.66%

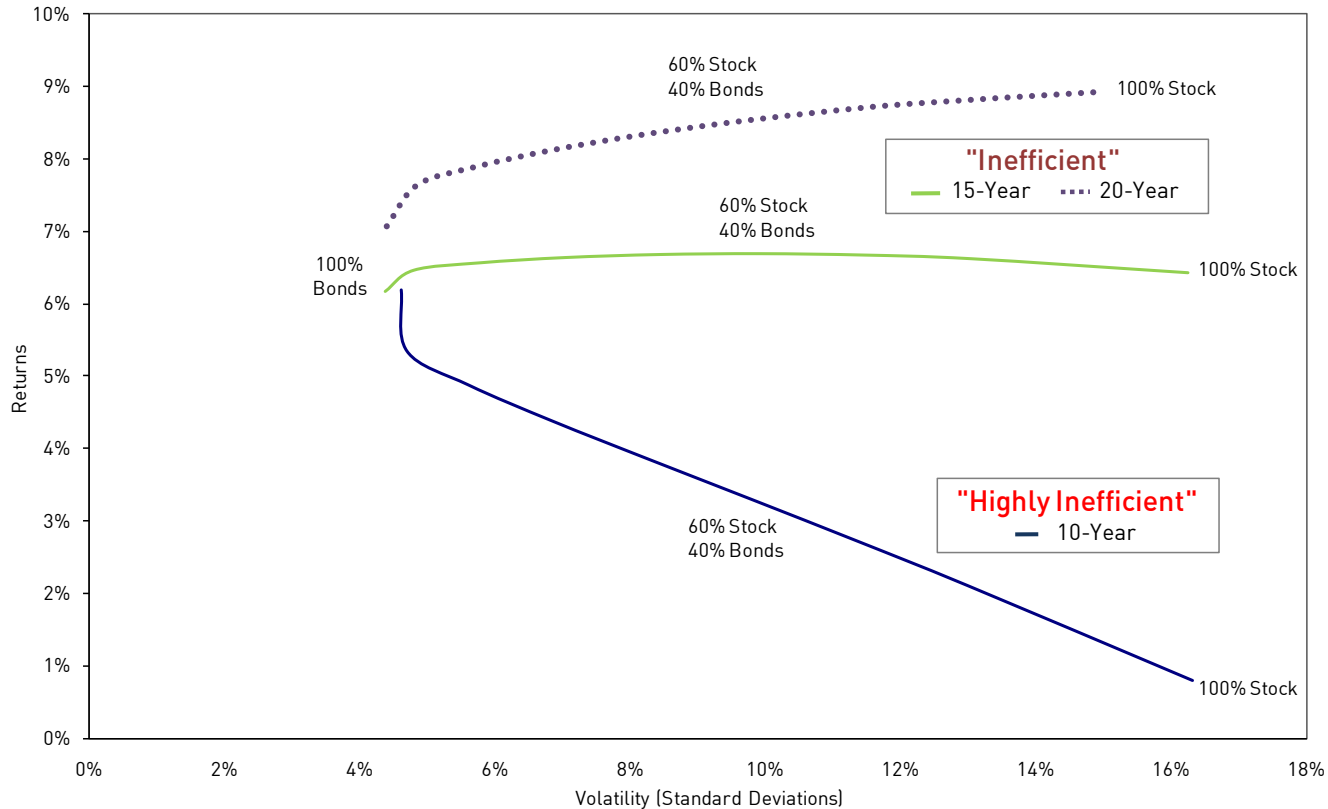
### RISK VS. RETURN: 10 Years thru 11/30/10



\*Source: Bloomberg Financial Data

# EFFICIENT vs. INEFFICIENT FRONTIERS: No Efficient Frontiers Exist For the Past 20 Years

As of 11/30/10




Source: Bloomberg Financial Data

Avg. Annual Total Return (%)	S&P 500	BCGC	Gold <sup>1</sup>
10 yrs	0.80	6.19	17.75
15 yrs	6.43	6.17	8.86
20 yrs	8.93	7.07	6.61
40 yrs	10.12	7.96	9.44

<sup>1</sup>Spot Gold price return. <sup>2</sup>BCGC initiated 1/1/72; we have combined this with the Ryan Labs Treasury Composite from 11/30/70 – 1/1/72.

# SIGNIFICANCE OF FIXED INCOME IN ASSET ALLOCATION – Adjusted for Risk

10 Years Ending 11/30/10



If You Owned	Average Annual Return	Risk (Standard Deviation)	Risk-Adjusted Returns (Upside)	Risk-Adjusted Returns (Downside)
100% Stocks 0% Bonds	0.80%	16.17%	16.97%	-15.38%
80% Stocks 20% Bonds	2.10%	12.99%	15.10%	-10.89%
70% Stocks 30% Bonds	2.71%	11.37%	14.09%	-8.66%
60% Stocks 40% Bonds	3.30%	9.79%	13.09%	-6.49%
50% Stocks 50% Bonds	3.85%	8.27%	12.13%	-4.42%
40% Stocks 60% Bonds	4.38%	6.86%	11.23%	-2.48%
30% Stocks 70% Bonds	4.88%	5.62%	10.49%	-0.74%
20% Stocks 80% Bonds	5.34%	4.71%	10.05%	0.64%
0% Stocks 100% Bonds	6.19%	4.63%	10.82%	1.57%

Stocks: S&P 500 (w/ income)

Bonds: Barclays Capital Government/Credit

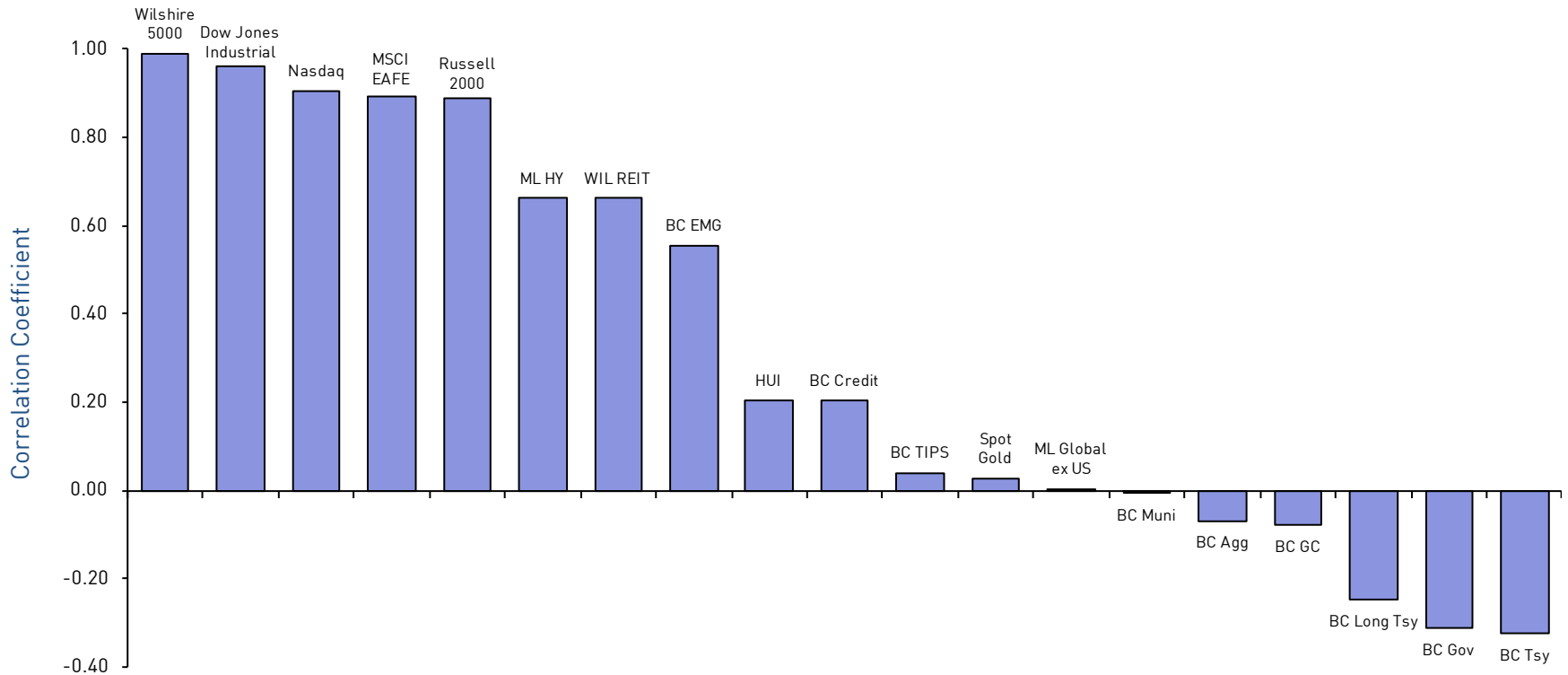
\*Source: Bloomberg Financial Data

Can “mission control” be maintained with these returns for three consecutive down years; i.e., 2000-2002?

# CORRELATION BETWEEN S&P 500 AND MAJOR MARKET INDICES

10 Years Ending 11/30/10

## MOST NEGATIVE CORRELATION = BEST DIVERSIFICATION



\*Source: Bloomberg Financial Data

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