



**Scannell Wealth Report
September 14, 2009**

The Markets

Rarely do you see a headline in a mainstream newspaper containing the three words, “Yale,” “Harvard,” and “Losers,” but that’s exactly what happened last week in *The Wall Street Journal*.

The *Journal* certainly wasn’t talking about the Universities’ academic prowess or even their athletic exploits; rather, it was the disappointing performance of their once invincible endowment funds. The value of their endowments each dropped by 30 % for the 12 months ending June 30, 2009. By comparison, a typical plain-vanilla endowment allocation of 60 % stocks and 40 % bonds lost only 13 % during that period, according to the *Journal*.

What’s newsworthy about these losses is that Yale had pioneered an unorthodox approach to endowment investing that worked spectacularly for years (and was copied by Harvard), but like many investment ideas, it eventually ran into a brick wall. Under the leadership of David Swensen, Yale’s portfolio mix changed dramatically. For example, the allocation to private equity rose from 3.2 to 20.2 %; real assets – timber, real estate, and the like, rose from 8.5 to 29.3 %; and hedge funds went from zero to 25.1 %. To accomplish this mix, the allocation to domestic stocks and bonds dropped from 71.9 to 14.1 %, according to a March 2009 article from Portfolio.

Essentially, Swensen argued that endowment funds should avoid traditional stocks and bonds and, instead, invest in higher yielding and less liquid assets that more closely match an endowment fund’s long-time horizon. That strategy was a winner for years and despite the 30 % loss last year, both Yale and Harvard’s portfolios are still ahead of where a traditional 60/40 allocation would have put them.

Here’s the point – even the best and the brightest such as Swensen eventually stumble, if only temporarily. Likewise for us, the cost of long-term investment success may be the periodic pain of significant declines.

Data as of 9/11/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	2.6%	15.4%	-	-7.1%	-1.5%	-2.5%
DJ Global ex US (Foreign Stocks)	5.2	34.4	-3.3	-3.0	5.5	1.6
10-year Treasury Note (Yield Only)	3.3	N/A	3.6	4.8	4.2	5.9
Gold (per ounce)	2.0	15.9	36.1	19.7	20.4	14.7
DJ-UBS Commodity Index	0.7	5.6	-28.5	-8.7	-2.9	3.1
DJ Equity All REIT TR Index	6.7	12.7	-31.9	-13.0	0.9	9.0

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron’s, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

WHO’S RIGHT, stock market investors or bond market investors?

The stock market set a new yearly high last week while interest rates on government securities continued to drop. A strong stock market suggests investors are willing to add more risk to their portfolios and that they are more confident in the economy. This could be a bullish sign that the worst is behind us and we’re off to the races.

The reason for the recent drop in interest rates on government securities is more puzzling. Here are several traditional reasons why rates on government securities might drop:

- The government is trying to stimulate economic growth through a low interest rate policy
- The economy is fully functioning and investors perceive risks as low
- Inflation is declining
- Investors are seeking a safe haven

As a good example of the safe haven reason, back in the middle of October 2008, the 10-year Treasury yielded 4.0 %. Over the next two months, as the world financial system almost collapsed, the yield dropped nearly in half to 2.1 % as investors fled the stock market for the perceived safe haven of U.S. government debt. However, as the crisis eased, investors moved back into the stock market, which helped push the yield up to nearly 4.0 % again by early June 2009, according to data from Yahoo! Finance.

Interestingly, as the stock market hit its bear market low on March 9, 2009, the yield on the 10-year Treasury was 2.9 % – significantly above the 2.1 % “fear” low from a few months earlier. This suggests that the stock market hit its price low several months after the bond market hits its fear low. The bond market may have been saying that in early March, things weren’t as bad as the stock market thought they were. Now that we’ve had a greater than 50 % pop in the S&P 500 index since that low, you’d have to score one for the bond market’s predictive ability!

Moving to the present, the yield on the 10-year Treasury dipped back down to 3.3 % last week from its June high of nearly 4.0 %. Is the bond market now foreshadowing another flight to safety? Is it suggesting that the economy is weaker and the recovery will take longer than generally perceived by stock market investors? Is it betting that deflation is a bigger concern than inflation? Or, is it suggesting that the Goldilocks economy is back and economic activity is “just right?”

Right now, there is no definitive answer to what the bond market is telling us because there are several crosscurrents buffeting it. However, suffice it to say, that if the yield on the 10-year Treasury continues to decline, our alarm bells will rise commensurately.

Weekly Focus – Think About It

“The bravest are surely those who have the clearest vision of what is before them, glory and danger alike, and yet notwithstanding go out to meet it.”-- Thucydides

Best regards,
Scannell Wealth Management Group

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this email with their email address and we’ll ask for their permission to be added.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

* The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general*

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Prepared by your Wealth Advisor, **Tim Scannell, CPA, CFP®**

Securities offered through **HighTower Securities, LLC** Member FINRA & SIPC

225 Aberdeen Dr., Valparaiso, IN 46385 (219) 531-4941

This newsletter was prepared by PEAK