

The Not-So-Lost Decade

By many measures the US economy has stagnated or fallen behind in the first decade of the 21st century. Real Gross Domestic Product (GDP) was the lowest it's been in the last seven decades. Employment growth was essentially zero because the jobs created from 2003 to 2007 weren't sufficient to make up for the two recessions during the decade. Household net worth, when adjusted for inflation, fell. Home prices declined and consumer debt skyrocketed. Indeed, in many ways, this was "The Lost Decade."

The US economy is the largest single economy in the world. When things don't go well here, the effect ripples across the globe.

Despite our dominance, the market capitalization of US companies makes up less than half of the world market capitalization - about 42%. Most US investors have a "home country bias" and they also have a significant company bias, typically investing a majority of their portfolio in some measure of the S&P 500. These are large companies that we are all familiar with and hear a lot about. For the most part, this investment approach worked out well in prior decades, but not from 2000 to 2009.

An investor who bought and held the S&P 500 during that time period experienced an annualized decline of one percent. It was a painful start to the decade with a ...

- ... 9% loss in 2000 (when the Tech Stock bubble burst),
- ... 12% loss in 2001 (after 9/11),
- ... 22% loss in 2002 (Worldcom and Enron).

The U.S. market tried to make up for the losses during the middle of the decade, but couldn't catch up. Then, the global financial crisis hit in late 2007. The S&P suffered a loss of 37% in 2008 followed by the start of a recovery with a gain of 26% in 2009.

[Refer to the two illustrations enclosed: The Lost Decade and World Market Capitalization.]

So just why wasn't this The Lost Decade, you ask? If you were a globally diversified equity investor, you fared comparatively well during this time period. In fact, the globally diversified equity investor beat inflation as well as most short-term fixed income investment returns.⁽¹⁾ A 100% equity portfolio returned 5.4%. A 70% equity/30% fixed income portfolio returned 5.7%. Why? Several reasons.

First, even though the rest of the world was impacted by the US and the global financial crisis, the world wasn't affected by the overall malaise of the decade. For the decade:

- o Foreign Large stocks (the international version of the S&P 500) had an average return of almost 11% per year.
- o Emerging Market stocks returned almost 12%.
- o Real Estate Investment Trusts (REITs) earned 10%.

- US Small Value stocks were up almost 12%.
- Foreign Small Value stocks gained almost 7%.
- Every asset class (except for Foreign Large Value) beat the S&P 500 in a meaningful way for the decade.

Second, rebalancing added some value, especially if you had an allocation to fixed income. In volatile times or bear markets, a portfolio with fixed income is periodically rebalanced to ensure a consistent allocation among asset classes. This rebalancing sells fixed income and purchases additional equity when its expected return is higher. During profitable times and bubbles, an allocation to fixed income forces a disciplined investor to sell when the value is high.

Third, rebalancing among equity asset classes added some value. For the most part, the asset classes rose and fell together during events like 9/11 and the global financial crisis. But not always. During the Tech Stock crash in 2000, REITS and U.S. Small Value stocks soared as most asset classes crashed. During 2007, Emerging Markets rocketed to a return of 40% while REITS plummeted by 18%. These are all opportunities to sell high and buy low.

Squeezing out a percent here and a percent there from low costs, diversification, rebalancing and discipline makes the difference between successful financial independence or a failed market experience.

As Yogi Berra said: "It's tough to make predictions....especially about the future." No one predicted what this decade was going to be like. But, despite national and global crises, politics, corruption and terrorism, markets work. This decade reaffirms the fundamental market philosophies we've adhered to during our 22 years in business.

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⁽¹⁾ *The diversified portfolio did not beat intermediate and long-term bonds. However, this was a unique period for bonds. They greatly exceeded their expected return. The circumstances that created those significant returns are not likely to repeat.*

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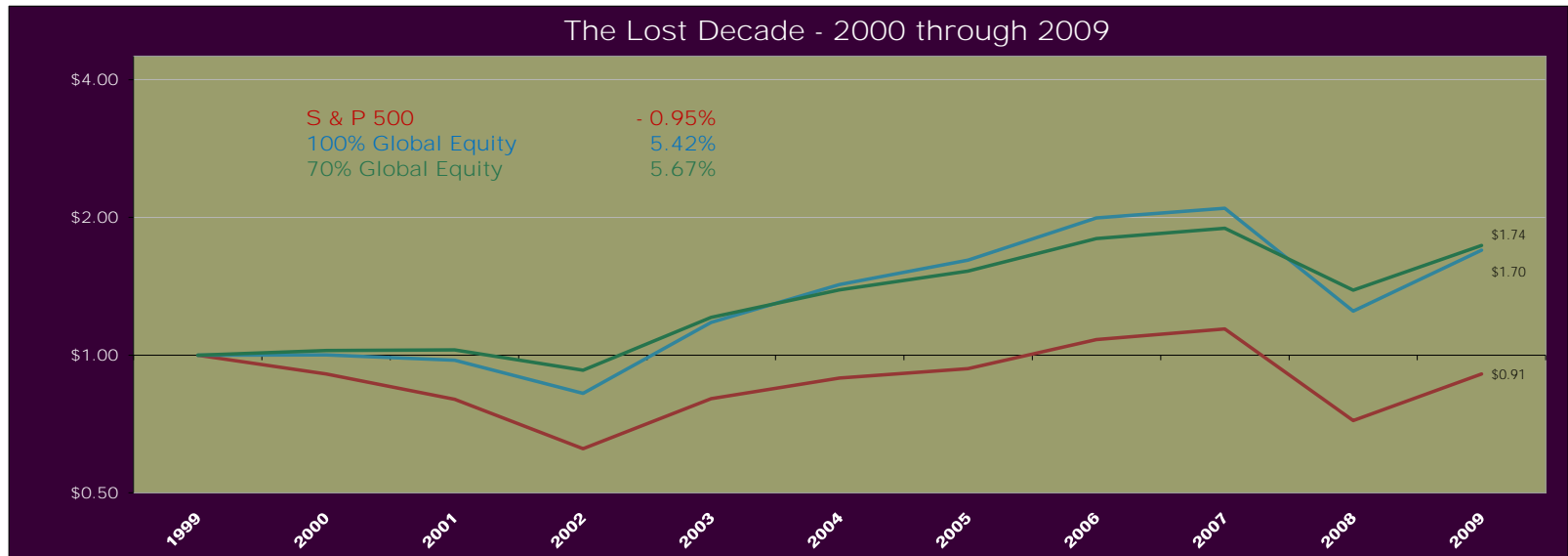


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The Lost Decade - 2000 through 2009 Compared To a Globally Diversified Portfolio

The decade is not completely lost. A globally diversified portfolio out-performed the S&P 500 during this time period.

Year	Fixed Income	Domestic/US					Foreign					Diversified Portfolio	
		S&P 500	Lg Value	Small	Sm Value	REITs	Large	Lg Value	Small	Sm Value	Emerging	100% Equity ¹	70% Equity ²
2000	7.33	-9.10	22.44	-12.26	23.07	31.04	-24.50	-3.15	-12.26	-2.01	-30.60	0.11	2.28
2001	7.28	-11.89	-0.46	18.04	22.90	12.36	-24.57	-18.52	-16.75	-6.48	-2.37	-2.68	0.31
2002	3.39	-22.10	-25.23	-19.87	-9.17	3.60	-16.01	-15.91	-2.85	3.82	-6.00	-15.33	-9.72
2003	1.47	28.69	27.53	57.81	64.52	36.18	31.99	45.30	60.25	66.79	56.26	42.91	30.48
2004	0.83	10.88	20.22	19.15	21.68	33.17	16.12	24.33	32.11	35.14	25.95	20.96	14.92
2005	2.36	4.91	12.13	5.61	9.47	14.00	13.28	13.80	22.63	24.13	34.54	13.03	9.83
2006	4.32	15.80	23.62	17.08	23.37	36.14	22.33	30.38	26.32	27.54	32.59	23.64	17.84
2007	5.95	5.49	2.73	-2.61	-10.76	-17.56	16.45	5.96	8.04	6.24	39.78	5.07	5.34
2008	4.75	-37.00	-39.09	-38.64	-31.93	-39.20	-42.70	-44.09	-47.11	-42.54	-53.18	-40.37	-26.83
2009	0.80	26.46	22.47	47.02	34.58	28.60	29.36	34.23	44.83	47.81	79.02	35.81	25.31
Anualized Return	0.04	-0.95%	4.03%	5.42%	11.75%	10.11%	10.72%	-1.31%	3.53%	6.77%	11.85%	5.42%	5.67%



Sources: Dimensional Fund Advisors, Inc. (DFA). Fixed Income - Merrill Lynch 1 Year Treasury. US Large - Standard & Poor's 500®. US Large Value - Fama-French Large Value Research Index. US Small - Fama-French Small Cap Index. US Small Value - Fama-French Small Value (Small High) Index. REITs - Wishire REIT Index. Foreign Large - MSCI EAFE (net) Growth. Foreign Large Value - MSCI EAFE Value. Foreign Small - DFA International Small Simulated Index. Foreign Small Value - DFA International Small Value Simulated Index. Emerging Markets - MSCI Emerging Markets Index.

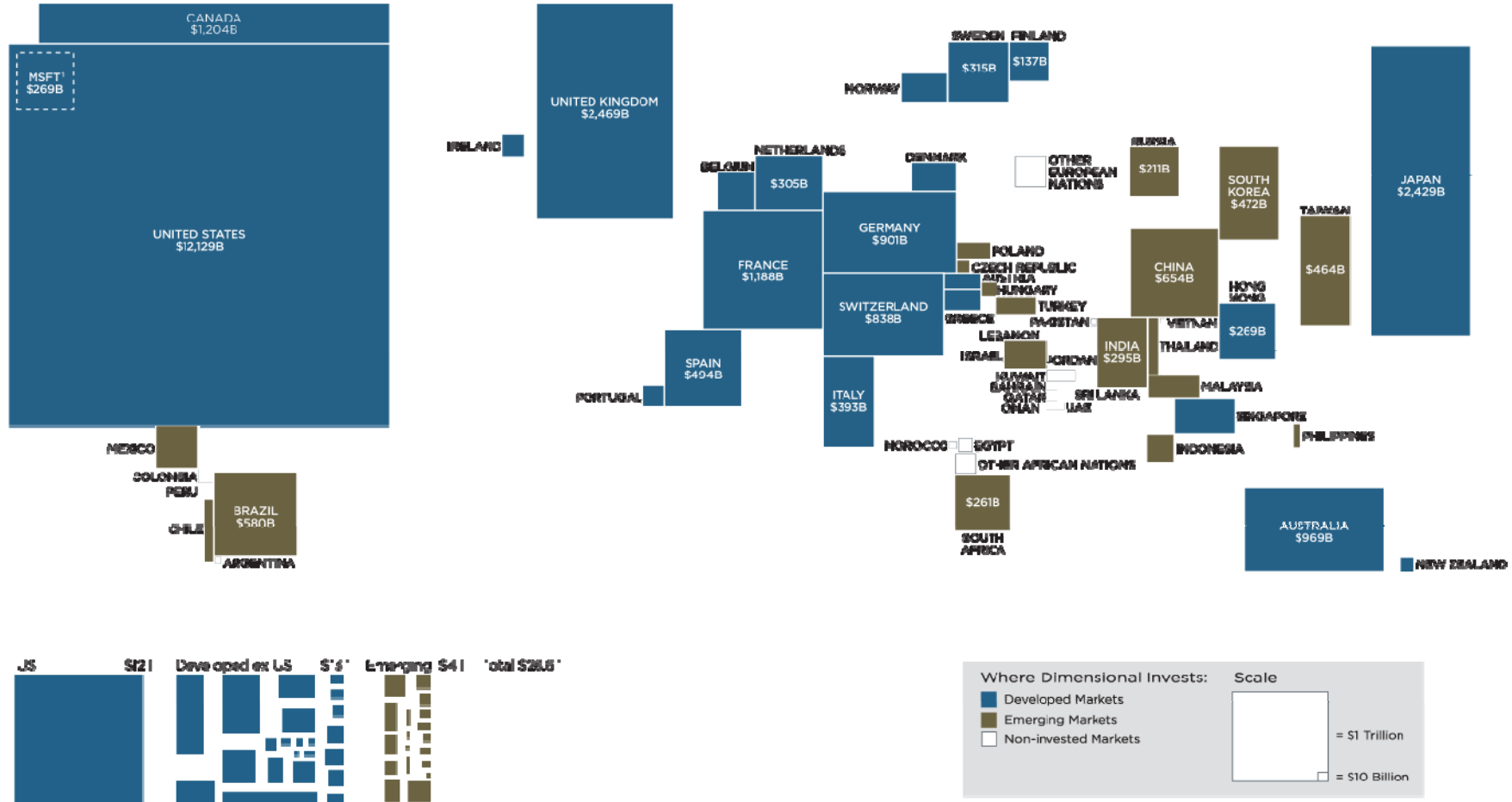
¹ This 100% equity diversified portfolio is a hypothetical portfolio assuming 25% US Large, 20% US Large Value, 10% US Small, 10% US Small Value, 5% REITs, 5% Foreign Large, 10% Foreign Large Value, 5% Foreign Small, 5% Foreign Small Value, and 8% Emerging Markets.

² This 70% equity diversified portfolio is a hypothetical portfolio assuming 30% Fixed Income, 14% US Large, 14% US Large Value, 7% US Small, 7% US Small Value, 3.5% REITs, 4.9% Foreign Large, 7% Foreign Large Value, 3.5% Foreign Small, 3.5% Foreign Small Value, and 5.6% Emerging Markets.

Both of these portfolios are presented for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past Performance is no guarantee of future results.

World Market Capitalization

\$28.6 Trillion as of December 31, 2009



In US dollars. Map reflects countries in the MSCI Provisional All Country World Index, MSCI All Country World Small Cap Index, and MSCI Frontier Markets Index. Market cap data is free-float adjusted. MSCI data copyright MSCI 2009, all rights reserved. Vietnam data provided by MFMI. Many small nations not displayed. Totals may not equal 100% due to rounding. Dimensional makes case-by-case determinations about the suitability of investing in each emerging market, making considerations that include local market accessibility, government stability, and property rights, before making investments. For educational purposes; should not be used as investment advice.