

Sub-Advisor Insights

October - December 2011

Emphasis by Madison

Managers of the Tweedy, Browne Global Value Fund

- ~ “There seems to be a pervasive sense of gloom, relentless media coverage of the problems, and suggestions of new problems to come. In a disheartening way, it is somewhat reminiscent of the famous 1979 Business Week article on the “death of equities.” Markets, in our opinion, are dealing with a confluence of factors that create enormous uncertainty and are clearly unnerving investors who, like everyone else in the world, are not hardwired to be rational and objective.”
- ~ **“While we are not starry-eyed optimists, we don’t see the world in some state of terminal economic decline.** Moreover, we own businesses; they are adaptive, competitive organizations with enormous financial and human resources that are able to constantly adjust to changing circumstances and markets. So, through all this we stay very focused on the progress of the businesses we own while constantly looking for better opportunities.”
- ~ “We constantly remind ourselves that behind every stock is a company, and if the company does well, the stock should in time do well if we are disciplined enough to wait for an attractive entry price in the public market. As our partner, John Spears, often says, **“If you own a stock in a good business, it will do most of the work for you.”** On the other hand, when we believe the variables affecting a business are too hard to evaluate and the consequences of being wrong too difficult to quantify, we take a pass, which in a simplistic way, explains why we have not invested in European banks.”

Bill Nygren, Co-Manager, Oakmark Fund

- ~ “How should individual investors deal with high volatility? I’d say they should pretty much ignore it. The financial media have business reasons to make investors believe they need to follow every zig and zag of the market and of their portfolio, but I don’t believe one needs to. And for some investors, the more often they look at their portfolios, the more nervous they get, which can be counterproductive.”
- ~ **“We believe today’s investors have a once-in-a-generation opportunity to use asset allocation to add to their investment returns.** It would be a shame to let anxiety about volatility get in the way of capitalizing on this opportunity. Stocks appear to us to be significantly undervalued relative to bonds. A skeptical shareholder might ask, “Didn’t you say almost the same thing a year ago? And didn’t bonds blow stocks out of the water in 2011?” Yes and yes. We did think stocks were cheap a year ago. But companies now have higher earnings than they did a year ago, have fewer shares outstanding (meaning EPS grew even more than earnings), pay higher dividends and have even more cash on their balance sheets. We believe the average stock is worth more today than it was worth a year ago, yet it sells at about the same price. Bonds, on the other hand, had a yield a year ago that we believed offered insufficient reward for exposure to the risk of future inflation. Bonds today have a lower yield than they did a year ago – the yield is less than 2% on a 10-year Treasury. We believe bonds are even more overvalued than they were a year ago.”

John P. Calamos – Chairman, CEO & Co-CIO, Calamos Investments

- ~ “The major economies are at different stages of dealing with their debt crises. Historically, debt nationalization has often been the first strategy for dealing with the aftermath of banking/real estate-leveraged implosions. The U.S. and Japan have accomplished this to a large degree. The eurozone is trying to figure out what nationalizing the debt of varied countries means and who pays. On the whole, Europe’s debt picture is similar to that of the U.S., but without a true fiscal union, Europe faces a much more difficult resolution process.”

Rob Lovelace – Portfolio Counselor, American Funds

- ~ “For many investors, maintaining a consistent investment plan can prove difficult. DALBAR, a research firm, provides evidence every year of the gap between investor returns and investment returns. The latest study shows that from 1991 through 2010, the “average equity fund investor” realized an average annual total return of 3.8%, while the Standard & Poor’s 500 Index provided an average annual total return of 9.1%. The goal is to close the gap between investor and investment returns. The difference in returns is largely attributable to investors getting in when times are good – essentially buying high and selling low. Some have dubbed this the “behavior gap,” and it seems clear that investors need a consistent approach that can help them overcome the tendency to respond emotionally to market volatility and to stay on track with long-term goals. The volatility in markets obviously scares investors. The biggest risk is that volatility causes investors to get out of the market. **A point-to-point return doesn’t matter if the investor isn’t there at the end point.**”

Niels Jensen – Founder, Absolute Return Partners LLP

- ~ “Life in the fund management industry is not what it used to be like. Life is tough even for the supremely skilled. Markets are changing, fund managers are struggling to adapt and clients are growing restless as a result. So what can you do? Identify an investment strategy you are comfortable with. Whether you believe in value, growth or something entirely different is less important. All active managers have their ups and downs, and it is when the going gets tough that it becomes critical that you are entirely onboard with the manager’s investment approach. Do not disregard sound advice. Those of us who have worked in the industry for decades know where many of the pitfalls are and can help investors stay clear of most of them. **Just make sure your interests are aligned with those of your adviser.**”

Thomas Howard - Professor Emeritus, Daniels College of Business, University of Denver

- ~ “The Volatility Trap is the empirical observation that, even though investors have recently suffered increased volatility and lower or even negative returns, future volatility will most likely lessen and market returns will often be above average. As strong as is the urge to bolt the market, the rational decision is to stay the course or even increase equity holdings. The Volatility Trap provides no relief for the investor over time. Let’s say that you have just suffered through four weeks of high market volatility and negative returns, and you are ready to run for the hills. To avoid the Volatility Trap, you stay the course in hopes of seeing the predicted lower volatility and high returns. Instead, volatility worsens and your losses mount. At 13 weeks, you are thinking “enough is enough” and prepare to exit the market. Again the evidence reveals that, even though the pain has continued, the empirical facts have not changed: the data still show that future volatility should decline and returns should rise. With great trepidation, you relent and stay the course. You continue to take a pounding, and after 26 weeks you are at wits’ end. **Still the Volatility Trap provides no solace – the evidence still says that most likely things will get better.** There is no time limit to the Volatility Trap. No matter how long recent volatility lasts, the best decision for most investors going forward is to stay the course.
- ~ “The relationship between low recent returns, high future returns and recent volatility is driven by investor behavior. The low recent returns are the result of emotional investors leaving the market as volatility rose, which drives down prices and returns. The higher future returns result when these same emotional investors quit selling or begin to move back into the market. To take advantage of these swings, an investor must be more rational than his or her counterparts in the marketplace. Such self-control is essential to earning the best long-term returns. **Once we put the initial, instinctive anxiety in perspective, we can see rising volatility for what it is: an opportunity, not something to be feared.**”