

Money Manager Newsletter

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Investment Consulting Group, Inc

Everyone is your teacher and the lessons are free—Socrates

Housing Affordability for 2006

The fed is watching the housing market closely and I think housing is beginning to weaken. If so, the fed will stop raising rates. Some suggest there is a chance fed funds (4.75 currently, 03/28/06) might see 5.00 or 5.25. I don't believe this unless we have higher inflation and a strong economy. One of the most important factors in a slowdown in the economy is that housing gains have contributed significantly to US growth via wealth effects on consumers (i.e., cash out refinance, home equity loan, and job growth in real estate related industries.) The other significant cause of the slowdown is the higher mortgage rates over recent months. The continued pressure on real wage and income will crimp housing affordability in 2006.

Bill Gross, Pimco

Berkshire Hathaway 2005 Annual Report

Too often, executive compensation in the U.S. is ridiculously out of line with performance. That won't change, moreover, because the deck is stacked against investors when it comes to the CEO's pay. The upshot is that a mediocre, or worse, CEO aided by his handpicked VP of human relations and a consultant from the ever accommodating firm of Ratchet, Ratchet, and Bingo all too often receives gobs of money from an ill-designed compensation arrangement.

CEO's understand this math and know that every dime paid out in dividends reduces the value of all outstanding options. I've never, however, seen this manager-owner conflict referenced in proxy materials that request approval of a fixed-priced option plan.

It doesn't have to be this way. It's child's play for a board to design options that give effect to the automatic build-up in value that occurs when earnings are retained. But—surprise, surprise—options of that kind are almost never issued.

Getting fired can produce a particularly bountiful payday for a CEO. Indeed, he can "earn" more in that single day, while cleaning out his desk, than an American worker earns in a lifetime of cleaning toilets. Forget the old maxim about nothing succeeding like success. Today, in the executive suite, the all too prevalent rule is that nothing succeeds like failure.

In criticizing comp committee behavior, I don't speak as a true insider. Though I have served as a director of twenty public companies, only one CEO has put me on his comp committee.

Hmmmm

Warren Buffet, Berkshire Hathaway

Latest from China: Is the bloom slowly fading?

The real estate market has collapsed in Shanghai and is spreading elsewhere. China has over-built in order to put their best foot forward for the 2008 Olympics. It is mind boggling to see American corporations throwing money into China in hopes of cashing in on the huge potential consumer market. However, the vast majority of the Chinese people have no funds with which to buy these products.

Michael Dana, Dana Investment Advisors

Active Portfolio Rebalancing

A study in 1986 by Brinson and Beebower concluded that 90% of a portfolio's variability in returns was determined from the asset allocation decisions. Active rebalancing, by definition requires the reduction of portfolio sectors that are overweighted due to positive volatility and the increasing of portfolio sectors underweighted in less positive or negative volatility.

Does rebalancing protect gains and enhance performance of a portfolio?

As I have mentioned to clients many times, an academic, Rex Singfield, once said in response to the question of how often a portfolio should be rebalanced—"sloppily at best." There are many studies that have calculated the benefit of rebalancing. The conclusions can be inconsistent, but logic would conclude that as an outperforming asset class becomes a larger portion of a portfolio, risk increases. Also time periods of above average returns in one asset class are followed by below average returns. Therefore, rebalancing can improve portfolio returns and reduce negative volatility. (See Table 2)

	STATIC	REBALANCED	DIFFERENCE	BONUS
ENDING VALUE	\$8,874,742	\$9,324,229	\$449,487	5.1%
STANDARD DEVIATION	13.6%	11.0%	-2.6%	-19.2%

Donald R. Stanforth, CIMA
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