

THE GLOBAL TOTAL RETURN PORTFOLIO

Background:

As a result of the volatility of the various global financial markets since the year 2000 peak, a heightened sense of public awareness to volatility and stock market risk has emerged. Further analysis suggests that even though substantial stock market price corrections have recently occurred, further erosion of domestic and global economic conditions remain a possibility, although not a certainty. Although the proven attributes of Modern Portfolio Theory exist, there remain weaknesses in that model (even by admission of its creator, Dr. Harry Markowitz). There are indeed weaknesses, both known and unknown, in all business and investment models. Detailed research from many sources scouring data over several centuries have revealed that the last century alone may not provide sufficient data to accurately assess and implement a successful, long-term investment strategy. The investment model contained herein has been prepared using generally accepted principles from Modern Portfolio Theory and expanded to include ten additional previous centuries of economic activity.

Objectives:

The objective of this proposal is to expand the scope of Modern Portfolio Theory and acknowledge, anticipate and profitably navigate economic, social, and geopolitical forces that influence global financial markets and have repeated themselves many times over many centuries and which have had a direct impact on the values of various asset classes over that time frame.

Methodology:

Various studies have been conducted by both contemporary and historic economic and financial market observers over several centuries. The generally accepted principles of Modern Portfolio Theory concern themselves with both time in the market and diversification. Their limitations may include (although certainly not limited to) a specific, historically documented time frame during which stock market data is readily achieved (i.e. most of the twentieth century).

The formal stock market we know today has its roots in the late 19th century. Therefore, data is not available beyond nearly 120 years of history since it simply doesn't exist prior to that time. As a result, investment models that are based upon such data may be subject to an unknown set of convergences that may or may not have occurred during the approximate 120 years that data is known.

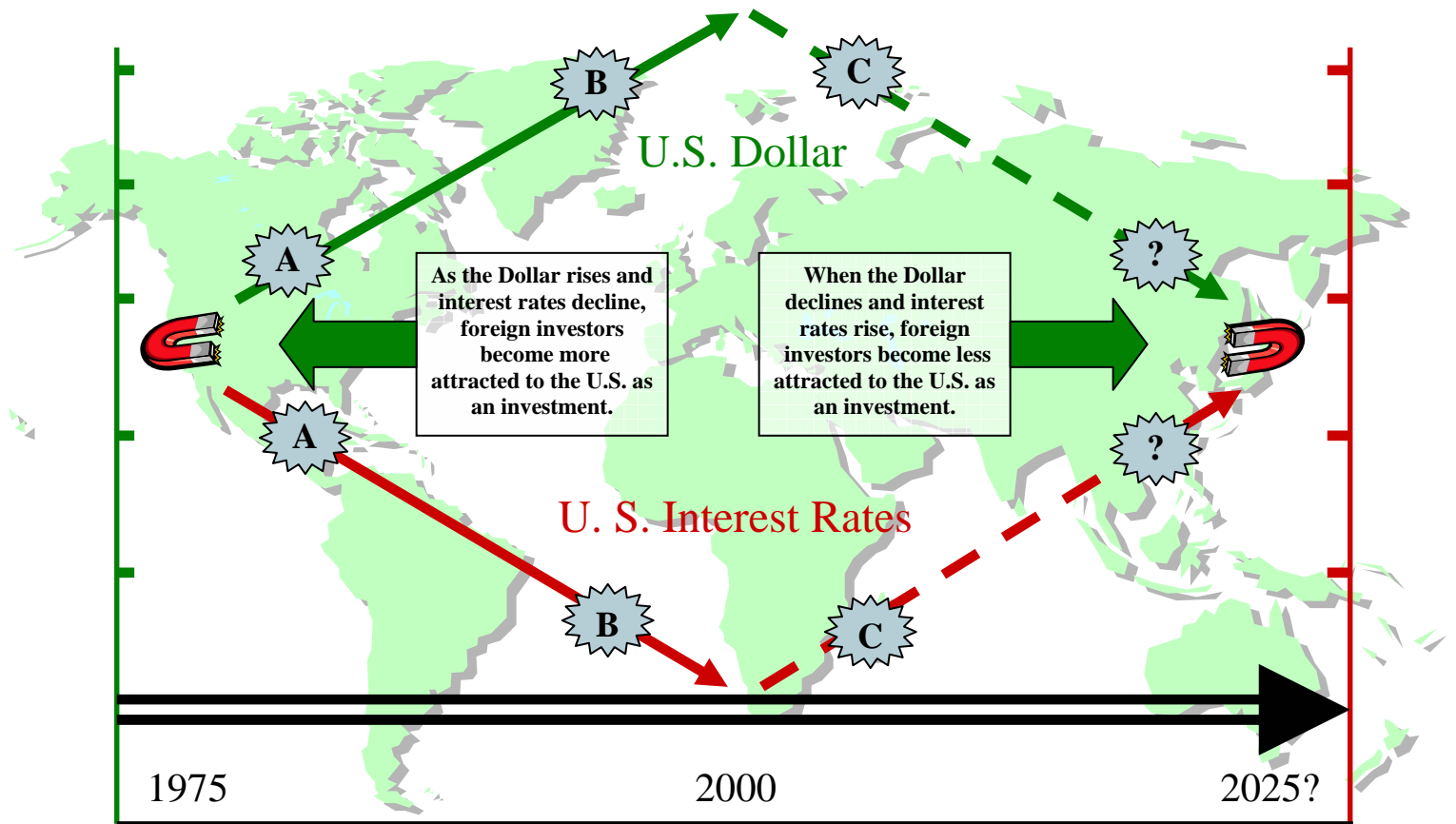
Although stock market records are not readily available prior to the 1880 time frame, various economic, socio-economic, geopolitical, and otherwise patterned human behavior (notably generational in nature) does exist. It is well documented that economic dominance and wealth transfer has constantly been in motion over the centuries from one nation/state to another. Currency values and trends have been both long-term in nature (in many cases lasting several decades) and reflective of such wealth transfer.

This proposed investment model begins with the proven strengths of Modern Portfolio Theory and expands this foundation to identify historic timeframes where similar convergences of economic activity have previously occurred. This not only requires diversification into the traditional asset classes of domestic equity and debt instruments, but also includes equity and debt instruments of various established economies, as well as diversification into 'hard assets' such as oil, iron ore, copper, gold, and various other commodities. Much like the findings of Modern Portfolio Theory, further diversification in this manner also reduces overall portfolio risk while providing discernable enhancement to performance over time.

Executive Summary

Between the late 1970s through the early 2000's, the United States was an international investment magnet for two reasons:

At points A in the late 1970's and early 1980's, when foreign investors chose to deposit their investment dollars into the United States, they did so at an exchange rate that was a mere fraction of the subsequent future exchange rate as the U.S. Dollar rose to point B and beyond. As the U.S. Dollar rose, the value of their investment rose (all other considerations not withstanding). This compounded their returns even more! Currency trends are historically multi-decade trends. Today U.S. investors have the opportunity to capitalize on a declining U.S Dollar (at points C) by investing overseas in much the same manner that foreigners had during the past 25 to 30 years by investing here!



At points A in the late 1970's and early 1980's interest rates were uncommonly high in the U.S. A foreign investor had the opportunity to purchase high quality bonds that carried high coupons. As interest rates declined during the subsequent years to points B (while the U.S. Dollar rose), those investors experienced capital appreciation of the face value of their bonds while continuing to receive high cash flows. The rising Dollar compounded their returns even more!

Executive Summary

As the chart on the previous page shows, from the late 1970's to the 2001 time frame, the US Dollar had experienced general strength versus other currencies. As well, beginning in the early 1980's and up to the present, interest rates in the U.S. have experienced a general decline. This environment attracted substantial foreign money. If, for instance, in the early 1980's a foreign investor had the inclination to invest into US Government bonds, three economic forces have had a positive influence on that money.

- ✿ Investing in bonds paying high coupons created very attractive cash flows.
- ✿ As interest rates experienced an overall decline during subsequent years, the face value of the bonds experienced an overall increase, providing additional total return.
- ✿ As the US Dollar experienced a general rise in value versus a foreign depositor's own currency (point A to point B on the chart on next page), the investment return was even further enhanced due to the more favorable exchange rate upon the return of that money to its homeland.

Today, the shoe is essentially on the other foot. US investors (at point C) have the ability to capitalize on the declining US Dollar by investing in high quality foreign government debt instruments whose current coupons are more attractive than our own and further enhance their return as that foreign country's own currency becomes more valuable than the US Dollar. Today's American investors may recall conversations or personal experiences during the 1980's and 1990's when foreign investing may not have been a productive experience at that time. This was due primarily to the strengthening US Dollar inhibiting productive returns during that time frame. Today, foreigners investing here in the US are experiencing those same inhibited returns that US investors experienced during the 1980's and 1990's.

There are also several economic activities occurring today that research shows have converged at various points in time over the past several centuries. Those activities include large trade deficits and current account deficits, high levels of consumer, corporate and government debt, low consumer savings rates, low and steady interest rates, a declining domestic currency, and increasing commodity values.

The Global Total Return model is offered as an answer to an ever changing world and, likely more challenging investment environment. It has been forward tested and back tested using both Morningstar and Lipper analytical tools and is described in more detail within. These tests have shown both a decline in volatility on a 3, 5 and 10 year basis to less than 6% standard deviation (volatility). This represents less than 1/3 of the standard deviation for the S&P 500's 17+%, while providing comparable or even better returns than the S&P 500 over those various time frames. This is the reason for the expanded collection of investment alternatives offered in this proposal.

Limitations:

Traditionally, investing into a global portfolio has been a more daunting task than it is today. The advent of technology, not only in its use of building and testing portfolios but in the use of measuring relative currency movement, feasible management of transactions into and out of foreign countries, and management of geopolitical risks on a day to day basis may be a primary reason it can be done in today's environment.

For a single manager to be adept at assessing and monitoring a global portfolio even today would require extensive capabilities in all of the above mentioned concentrations: the movement of dozens of various currencies and their impact on those countries bond and stock issuers should prove stressful enough if it weren't for the addition of geopolitical risks. Using several money managers that specialize in those areas is required.