



Yanni Partners
A Division of GBS Investment Consulting, LLC

MEASURING UP

DELIVERING
THE PROMISE

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Looking Beyond the Turmoil

IN THIS
ISSUE

Addressing
questions
about the
current
financial
landscape.

Investors are currently witnessing a seismic shift in the financial landscape. The roughly 20% decline in national home prices since the summer of 2006 has inflicted widespread losses in mortgage-related investments.¹ Many financial services firms held major positions in vulnerable mortgage investments, and stock prices have collapsed during the past year. Since September 2007, over \$1 trillion in market value of financial services firms has evaporated.² The Federal Government took control of the quasi-public mortgage insurers Fannie Mae and Freddie Mac, which collectively guaranteed roughly half of the \$10 trillion of mortgages outstanding. The large investment bank Lehman Brothers declared bankruptcy, and the retail brokerage firm Merrill Lynch was compelled to negotiate a sale to Bank of America. The Government assumed control of the largest insurance company, American International Group. In the largest bank failure in U.S. history, Washington Mutual succumbed under the weight of bad housing loans.

The turmoil in the financial services industry has occurred in the midst of a surge in market volatility and massive losses of risky assets – stocks and non-government bonds. The broad domestic equity market has lost roughly 24% of its value since September 2007. Many mortgage and corporate bonds have plunged in value to pennies on the dollar. Investors have responded to these losses with inevitable questions:

- Are the markets likely to recover?
- Is there a rational basis for projecting long-term equity and fixed-income returns? If so, what are reasonable return projections?

This issue of *Measuring Up* addresses these questions. Yanni Partners, a Division of GBS Investment Consulting, LLC, has devoted significant analytical resources over the years to provide clients with reasonable assessments of markets' long-term risks and returns. We urge investors to look beyond the current turmoil to position the portfolio for long-term growth with adequate stability.

Banks' mortgage-related losses have frozen the credit markets. Congress has responded with a broad rescue plan designed to stimulate the flow of credit to aid the economy. This issue does not address the potential near-term effects of this rescue plan. Rather, we focus on the long-term drivers of capital market returns.

At Yanni Partners, we believe global equity and fixed-income markets are likely to recover. We project long-term annualized returns of 7.8% for domestic equities, 9.1% for international equities and 4.9% for a diversified fixed-income portfolio. We believe capital markets will continue to fluctuate, yet levels of risk will ebb and flow over time, consistent with historical experience.

Structure of Markets

To assess the markets' prospects, it is beneficial to review the basic function of the capital markets, which provide the institutional mechanisms for investors to channel their savings into the economy and allow the economy to transmit the creation of wealth back to investors. Stocks and bonds offer claims on economic growth. The stock of a corporation entitles the holder to a proportionate share of the company's profits. Companies pay out a

¹ Based on Standard and Poor's Case-Shiller Home Price Index Composite 20, July 2006 – July 2008

² Based on Financial sector in S&P 500 Index, September 2007 – September 2008



FIGURE ONE

Annualized Results: December 1961 - August 2008*

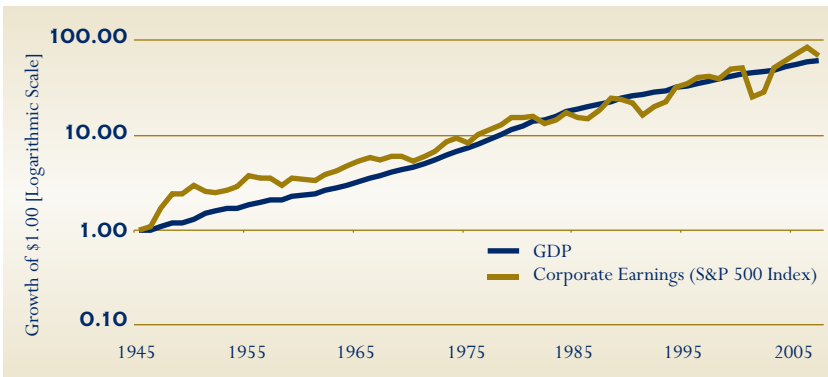
	Equity (S&P 500)	Fixed Income (10-Year UST)	Inflation (CPI)
<i>Nominal Results</i>			
Average Performance	9.8%	7.2%	4.3%
Best 10-Year Period	19.5%	15.7%	2.3%
Worst 10-Year Period	0.5%	2.4%	8.8%
<i>Inflation-Adjusted Results</i>			
Average Performance	5.3%	2.7%	-
Best 10-Year Period	14.5%	10.9%	-
Worst 10-Year Period	-3.7%	-1.8%	-

UST: U.S. Treasury Notes

*At the time of publication, September, 2008 CPI data had not been released

FIGURE TWO

Cumulative Growth of U.S. Economy and Corporate Earnings



portion of annual profits to shareholders, and plow back the remainder of annual profits in the operation of their businesses. A stockholder's investment return, over the holding period, consists of the cumulative dividends collected over time plus any gain (or loss) from the sale of the stock. Companies that succeed generally experience long-term growth in earnings and dividends, giving rise to a long-term growth in the prices of their stocks, albeit with considerable volatility along the way. A well-managed company will likely participate in the long-term growth of the economy. The diversity of world markets allows investors to mitigate individual company risks. Thousands of stocks trade around the world. Investors can buy stocks that trade in numerous countries, across all industries, spanning a broad range of company sizes and level of economic maturity.



A bond provides a method for an investor to loan capital to another entity. Entities issue bonds because they can borrow more economically from the capital markets than from financial intermediaries such as banks. Numerous types of entities issue bonds – corporations, not-for-profit institutions and Governments (national and local). Bonds typically pay a fixed or variable rate of interest. The level of the interest rate depends, in part, on the perceived risk of the borrower. National Governments generally can borrow at a lower rate than a private entity, such as a corporation, due to their superior financial strength. Investors tend to favor government bonds during tumultuous economic times. This so-called “flight to quality” increases the yield premium of non-government bonds to Government bonds, thereby offering a measure of stress in the financial markets. Opportunistic investors increase purchases of non-Government bonds when the yield premium rises. A bond's term also affects its interest rate. Long-term bonds generally bear higher rates than short-term bonds, due to additional uncertainties stemming from a long holding period.

Interest rates fluctuate over time in response to economic conditions. Bond interest rates compensate the investor for deferring immediate consumption. Economists contend that the rate of interest will correspond to the productivity of capital.

The bondholder of a corporation enjoys a superior claim on the company's assets relative to a shareholder. In the event of bankruptcy or the liquidation of the company, the corporation will first pay bond holders up to their principal claims. Remaining assets will revert to equity holders. Bonds bear less risk than stocks due to their senior claim on corporate assets.

Stocks offer the potential for capital growth. Bonds provide the prospects for stability and liquidity, although periods of stress in the markets can impair liquidity. Successful portfolio management requires

the appropriate mix of stocks and bonds to meet the unique needs of the investor.

Yanni Partners believes the markets have the potential to recover because we expect resumption in growth across global economies. Economic growth drives the markets' performance. Most nations around the world have experienced economic growth over the long term, subject to periodic slowdowns and contractions known as "recessions." Yanni Partners therefore believes that the equity and fixed-income markets will likely reward investors over the long term.

Long-Term Performance

Figure One shows performance of domestic equities, fixed income and inflation from December 1961 to August 2008. Annualized performance has averaged 9.8% for equities, 7.2% for fixed-income and 4.3% for inflation. The economy, measured by GDP, has grown at an annual pace of approximately 7.5% during this period. Inflation-adjusted returns have averaged 5.3% for equities and 2.7% for fixed income. Results have diverged from the long-term trend over shorter periods, as shown in the range of the best and worst ten-year periods. Equities have displayed greater risks than fixed income as evidenced by the greater dispersion of returns for the best and worst 10-year periods. This table documents how a long-term investor has been able to participate in the growth of the economy over time.

Successful companies will likely experience growing streams of earnings, as the companies participate in the economy's long-term growth. Figure Two plots the cumulative growth of the economy and corporate earnings from 1945 to 2007. Figure Two depicts a close correlation between growth of the economy and growth of corporate earnings. This steady growth in earnings has fueled the long-term performance of equities. This close historical connection between the economy and corporate earnings prompts us to project a meaningful long-term equity market return.

FIGURE THREE
Annual S&P 500 Dividends Per Share (1946 - 2007)

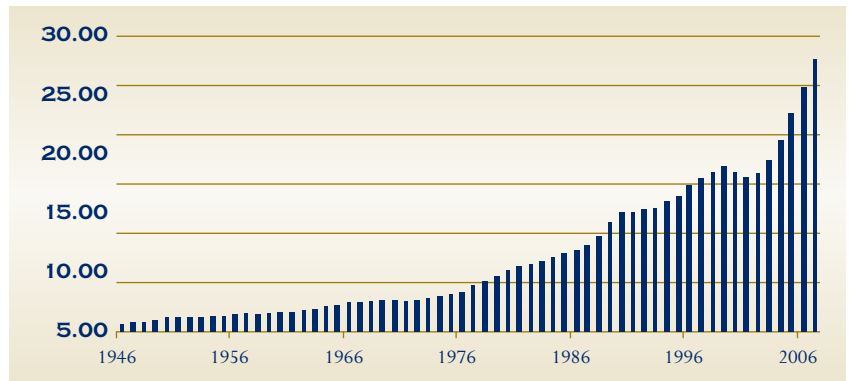
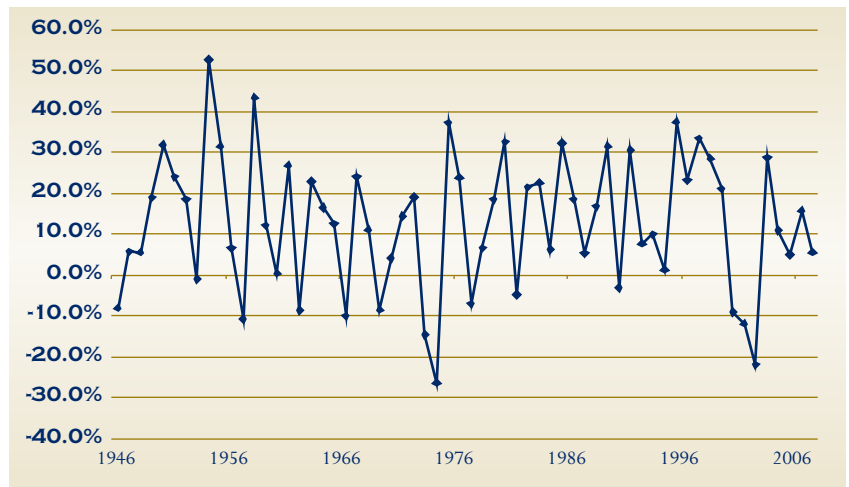


FIGURE FOUR
Annual Total Returns of S&P 500 Index (1946 - 2007)



Figures Three and Four further explain equities' risks and returns. Figure Three plots annual dividend payments for the broad equity market from 1946 to 2007. Figure Four depicts the market's annual returns over the same period. Dividends have displayed relatively steady growth. In contrast, the total return of equities has displayed an erratic pattern. The companies' cash distributions to shareholders have demonstrated far more stability than stock prices. Stock prices exhibit more short-term "noise" than the companies' operating performance. This "noise" inherent in stock prices accentuates the importance of maintaining patience and a long-term perspective when investing in equities.

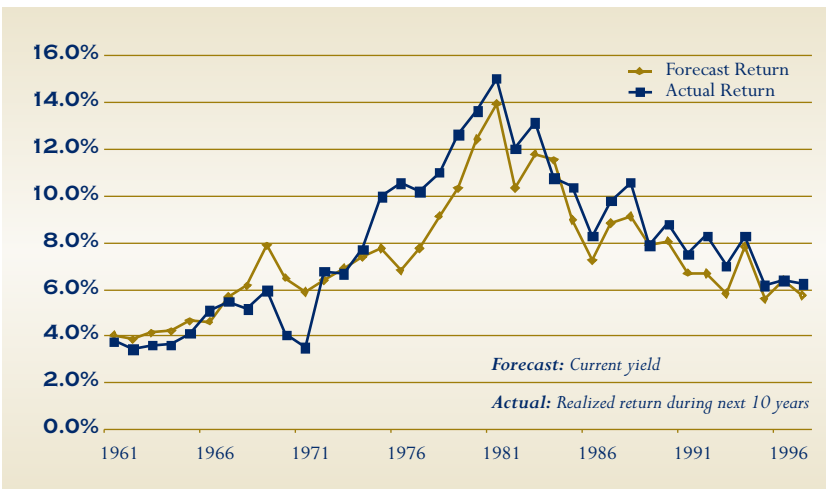


310 Grant Street, Suite 3000
Pittsburgh, PA 15219-2302



FIGURE FIVE

**Forecast and Actual Fixed Income Returns
10-Year US Treasury Notes Dec. 1961 - Dec. 2007**



income yield has forecasted future returns reasonably well.

Setting reasonable risk and return expectations enhances the prospects for a successful investment strategy. Optimistic return projections might prompt the organization to commit to obligations that it cannot support. Pessimistic forecasts might lead to an overly conservative strategy, thereby depriving the

organization of valuable resources.

Long-Term Expectations

Yanni Partners believes that an investor can develop reasonable long-term expectations about the markets' potential returns. Such forecasts stem from the markets' drivers of returns. One can estimate equity returns from the current dividend yield, expected growth in dividends and expected change in the market's valuation level (the price/earnings ratio). In fixed income, the current yield provides a reasonable basis for forecasting the return.

Figure Five plots historical results of the fixed-income forecasting method. The current fixed-

Conclusion

Recent market losses have captivated investors' attention. Yanni Partners trusts that the capital markets will ultimately recover due to the long-term link between economic growth and markets' returns. A good understanding of the markets' return drivers will help an investor to craft a successful investment program. We will continue to apply the requisite analytical tools to develop effective investment solutions for our clients.

Yanni Partners provides a full range of consulting services vital to the management of various portfolios. Our ultimate goal is to offer a basis for improved investment monitoring and performance.

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