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Reset

The Dow rose 15% this quarter, its best performance since 1998, up nearly 50% from the lows of March. Nearly all assets rose this quarter and for the year. Recent stock market performance confounded many. A number of strategists announced that diversification was dead; bonds would outperform stocks, and fixed risk long-term strategies were ineffective. But diversification's demise seems to have been greatly exaggerated. Global diversification was a positive for our strategies for the quarter and year; stocks did not underperform bonds and disciplined rebalancing paid off. Gold reached the technical \$1000 milestone, while the dollar declined relative to the euro and yen. In our commentary last quarter, our view was that long-term investing sentiment had begun to return to basic financial values including liquidity, transparency, and diversification. The new quarter ends with little reason to revise our views.

Strategy Positioning

Investors are still hurting. Global economies and capital markets are still in the Intensive Care Unit. A 50% increase in equity values in the last seven months does not provide great relief to those who lost nearly a third of their investments since last year's peaks. But the prognosis is promising. While much remains to be done, the Fed has been resourceful and effective in managing lending and monetary policies. Many signs indicate that the economy is slowly returning to more normal functioning. A wide consensus exists among working economists and institutional investors alike, that the Fed's and the administration's policies have avoided an historic financial crisis that could have resulted in a second great depression.

But money is moving slowly. Individuals have been in shock for over a year. Investor behavior is changing at the institutional and individual level. The leveraged market bubble spawned much investment ephemeral exotica. Fundamentals were often ignored or trivialized. Institutional investors are now avoiding illiquid and high volatility assets, previously fashionable leveraged equity funds and derivatives. The strategies finding increasing favor are liquid, transparent, and plain vanilla strategies. Individuals who initially moved into stable value and money market funds have headed toward well-diversified core funds.

No investor should expect the market to provide the returns experienced in the heady days of the ill-managed, irresponsible, highly leveraged, conflicts of interest era that ended in early 2008. The current success of government programs comes at the price of large deficits that must be paid back one way or another. A return to more sustainable consumer spending and investor confidence, as well as purging toxic assets and a reduction in foreclosures, is

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About New Frontier

New Frontier is a Boston-based institutional research and investment advisory firm with an extensive background in quantitative research, consulting, and management. Founded in 1998 by the inventors of the world's first broad spectrum, patented, provably effective portfolio optimization process, the firm continues to pioneer new developments in asset allocation and portfolio selection. Based on cutting-edge practical economic theory, New Frontier's services help institutional investors, across the globe, to select and maintain more effective portfolios.

New Frontier develops and manages a broad range of ETF-based asset allocation portfolios for advisors and their clients, and currently oversees over \$1 billion in global ETF asset allocation portfolios.

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essential for more normal functioning markets and economies.

Look Ahead

Will Americans return to their leveraged spending ways as before? Will America remain the primary consumer in the global economy? Bruised consumers are unlikely to be spending as they were. The setbacks may be long lasting. Americans are saving at a far higher rate. Consumers know that they were overleveraged. The fear and reality of unemployment is very real and pervasive. Such behavioral patterns, with their impact on the global economy, imply that the recovery may be slow though more sustainable.

The inventory cycle has turned around. The business cycle is positive, though nothing like past recessions. Whatever the case for economic growth, unemployment will likely remain near 10% for the near future. One continuous fear is the possible corrosive effect of long-term unemployment on the growth of the economy. The additional fear is when the Fed will tighten policy, but it is unlikely to be anytime soon. There is little reason to fear inflation for some time to come. The Fed has been very effective at managing the crisis and there are several mechanisms to remove money from the economy. In addition, a higher savings rate may result in a decrease of the need to sell debt to foreigners.

The March low reflected real fear and great uncertainty. The rise of equities can be seen as a correction of the excessive fear at the time relative to what we now know. While investors are unlikely to get rich in the next few months, the prognosis for risky assets in well diversified portfolios seems positive for the next two years and perhaps beyond. We continue to believe that well-diversified risk-targeted long-term funds are important components of many well-defined investment programs.

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