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### The Old New Normal

This quarter was one of recovery. Many capital market indices overcame first quarter declines and ended in positive territory for the year, though fixed income indices fell slightly. As one symptom of financial volatility in global markets, oil prices reflected the 1970s' energy crisis rocketing up 41%. In our prior commentary, we noted that since early March the market's reaction to news good and bad has reflected a more understandable pattern. A more normally functioning capital market rewarded core diversified global risk-targeted investing and reminded investors that chasing performance and trying to time markets may often be hazardous to financial health.

Is the glass half empty or half full? The quarter ended with nearly equal measures of positive and negative news. Economically we remain in the most severe recession since the Depression. Unemployment is approaching 10% and may continue to rise well into 2010. Job losses continue with little foreseeable let up for some time to come. A severe decline in consumer spending, continued home foreclosures, bankruptcies and bank failures with many states experiencing large budget deficits and cutting even essential services continue to darken the economic outlook. The deleveraging era, or the "new normal", and the necessary restructuring of corporate America does not provide much reason to hope for sustainable economic growth anytime soon. Stocks are highly unlikely to return to previous highs for some time to come. While the Obama administration's many initiatives have been greeted positively by most working economists, the severity of the downturn may have been underestimated. Many initiatives are incomplete, including regulatory reform. Concerns about overhangs of credit-default-swaps (CDS) and exit strategies persist.

Yet there are "green shoots" to consider. Deleveraging of financial firms and capital markets is necessary for a return to normal economic functioning and a resumption of economic growth. Many banks have passed the Treasury's stress tests, raised private capital, and returned to profitability. Credit markets have largely returned to a semblance of normal functioning. The stimulus package and other initiatives can take some credit that the talk of depression at the turn of the year has segued to year-end recession end estimates. If employment remains higher than anticipated, it is worth noting that the stimulus program has spent only 10% of funds available and was designed to be most effective beyond the second quarter. In another positive sign, the VIX has returned to more normal volatility levels.

The causative factors of the great 2008 recession were mostly financial rather than economic. A "Madoff syndrome" permeated a wide spectrum of the investment community. While outright fraud was the exception, a pervasive mentality encouraged ignoring the basic rules of prudent financial practice. Excessive leverage, misaligned incentives, irresponsible lending practices, lax regulation – all rationalized by the media, consultants, and academics – that led to financial meltdown and severe recession. The fundamental connection between economic value and sound financial practice was too often ignored. Many had forgotten or chose to

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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.

More information is available at [www.newfrontieradvisors.com](http://www.newfrontieradvisors.com).

ignore the fundamental economic and financial laws that govern risk and return.

Our global strategic fixed stock/bond ratio ETF strategies are designed as optimal core accumulation investments suitable for many long-term objectives. Choice of an appropriate risk profile is one of the most important investment decisions an investor can make. An NFA 60/40 or balanced fund is a useful representative of a "market neutral" accumulation investment. This is because, in aggregate, investors hold claims to the economic productivity of the economy. Mathematically, the average investor's portfolio is roughly equal to a 60/40 fixed risk-targeted portfolio of capitalization-weighted index funds. Deviating from this portfolio represents under-weighting of one segment of the economy and over-weighting of another. Different target risk profiles are available for customized investment objectives. Given recent market volatility, investors may want to carefully adjust their risk profile in light of the current investing environment.

What should investors be thinking today? Deleveraging and restructuring will continue for some time. There are many concerns that the upturn is not sustainable, and a holding pattern seems to be taking place waiting for more evidence on the recovery. As a symptom of continued concern on managing the recession, a number of economists have recently raised the possibility of the need for second round of the stimulus program at the turn of the year. A slow painful recovery is a most likely scenario. Patience and effective risk-controlled global diversification remain the long-term investor's most reliable friends.

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