

## Chasing returns: Does it work?

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2008 has proven to be one of the worst market downturns since the great depression. Since the market bottom in March of 2009, the Standard & Poor's (S&P) 500 Index gained back about 50% through the end of August. In this volatile economic environment, investors are intrigued to transfer their money to specific asset classes that have recently performed well. Studies have shown the majority of people who attempt to time their equity or fixed income allocation strategies end up with less money than if they had left their allocation the same. When investors try to chase returns within specific equity asset classes that have seen recent momentum, the same conclusion can be reached.

### Investor return

In order to understand the impact of market timing and chasing returns as actual gain and loss amounts, Morningstar, a leading investment research company, calculates what is known as its "Investor Return." In this calculation, Morningstar measures how the average investor performed over a given time period, by taking into account all inflows and outflows from a specific fund. This differs from the typical "Total Return" that mutual funds are usually measured by. "Investor Return" measures the compounded growth rate in the value of all dollars invested in the fund over the time period being considered.

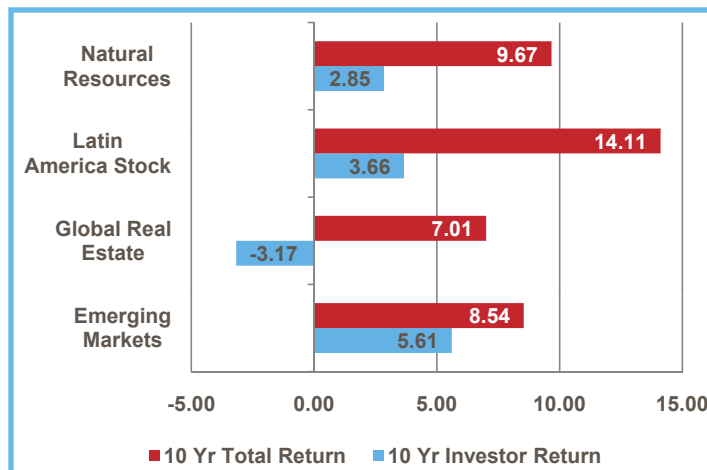
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	1/1/2008	Return for 1/1/2008 to 7/1/2008	7/1/2008	Return for 7/1/2008 to 1/1/2009	1/1/2009	2008 Actual Return	2008 Investor Return
<b>ABC Fund Performance</b>		<b>+ 50%</b>		<b>- 25%</b>		<b>+ 12.5%</b>	<b>-6.25%</b>
<b>Investor A</b>	Contributes \$100		\$150		\$112.50	<b>+ 12.5%</b>	} <b>-6.25%</b>
<b>Investor B</b>			Contributes \$100		\$75	<b>- 25%</b>	

For example, assume Investor A makes a \$100 investment in ABC Fund. The investment increases to \$150 by a 50% return during the first half of the year. Investor B sees the performance potential of ABC Fund and invests \$100. During the latter half of the year, ABC Fund decreases 25%. Investor A's account decreases to \$112.50, giving him and the "Total Return" for ABC Fund a 12.5% return for the year. Investor B's account decreases to \$75, giving him a 25% loss for the year. If you simply average these two investors' accounts together, the "Investor Return" would be around -6.25%, when the fund was actually up over 12% for the year. While this example over-simplifies the actual calculations, it does show the dramatic effects an investor may experience when trying to chase returns.



Certain asset classes have experienced significant inflows and outflows when they are under performing or outperforming the market. The previous chart shows the actual effects over the rolling ten-year time period of a select group of those asset classes. As you can see, investors tend to under perform the actual returns of the asset classes shown, due in large part to buying and selling at the wrong time. The goal of investing is to buy low and sell high. However, as emotion comes into play, the exact opposite may actually occur.

## Investment cash flows

The chart below displays asset classes' inflows and outflows for the past ten years as of June 30, 2009.

### International / Global Equity

Total assets increased over 80% during the four year time period of 2004 – 2007. During that same time period, MSCI EAFE Index outperformed the S&P 500 Index by an annualized 8.5%.

### Emerging Markets

During the years of 2005 – 2007, dollars in the emerging market asset class increased over 65%. The MSCI EAFE Emerging Markets Index was up just under 150% during this same time period. There has also been an 8% jump in emerging markets assets in 2009, all of which came during the second quarter. As expected, the MSCI EAFE EM Index was up almost 35% during the respective quarter.

### Money Market Funds

Over the course of the past two and a half years, we have seen investors jump into and out of money market funds. Dollars flowed heavily into money market holdings as fear plagued the economic environment in 2008. As investors begin to regain their risk appetite in 2009, money market assets have dropped.

History has shown chasing returns and market timing, as strategies, do not pay off in the long run. The equity and fixed income markets will come in and out of favor over the long-term. It is imperative that investors work with their investment advisor to come up with an allocation strategy that is suitable for their end goals. At Baker Tilly Investment Advisors, we strive to educate investors about the importance of proper asset allocation.

Billions, USD	AUM	Fund Flows									
		YTD2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
<b>Fixed Income</b>	1,709	102	30	100	65	16	(17)	29	137	63	(51)
<b>U.S. Equity</b>	2,664	(55)	(9)	43	53	42	145	140	42	78	99
<b>Int'l/Global Equity</b>	1,060	(17)	(71)	153	157	122	86	37	6	(17)	35
<b>Allocation &amp; Age-based</b>	870	0	(5)	116	89	101	104	70	25	13	(30)
<b>Large Cap</b>	1,212	(50)	1	(15)	(32)	(36)	19	24	0	21	7
<b>Multi Cap</b>	669	(6)	(7)	56	69	42	55	46	12	20	41
<b>Mid Cap</b>	281	1	(17)	5	4	22	29	33	15	15	31
<b>Small Cap</b>	263	2	(0)	(13)	8	6	28	27	18	26	15
<b>Core</b>	1,227	(31)	37	37	32	8	88	63	45	62	22
<b>Growth</b>	735	(15)	(29)	8	(2)	(6)	(15)	27	(23)	(11)	112
<b>Value</b>	463	(7)	(29)	(12)	19	31	59	40	24	31	(40)
<b>Emerging Markets</b>	220	17	(8)	38	26	20	4	8	1	(1)	0
<b>Real Estate</b>	45	(0)	3	(1)	10	1	8	6	3	1	0
<b>Commodities</b>	133	14	5	13	11	21	12	4	1	(0)	0
<b>Money Market Funds</b>	3,921	(77)	776	608	229	66	(136)	(222)	(51)	329	100

Source: Lipper, J.P. Morgan Asset Management