

# Au Revoir and Auf Wiedersehen 2011

## 2011 Q4 Quarterly Commentary



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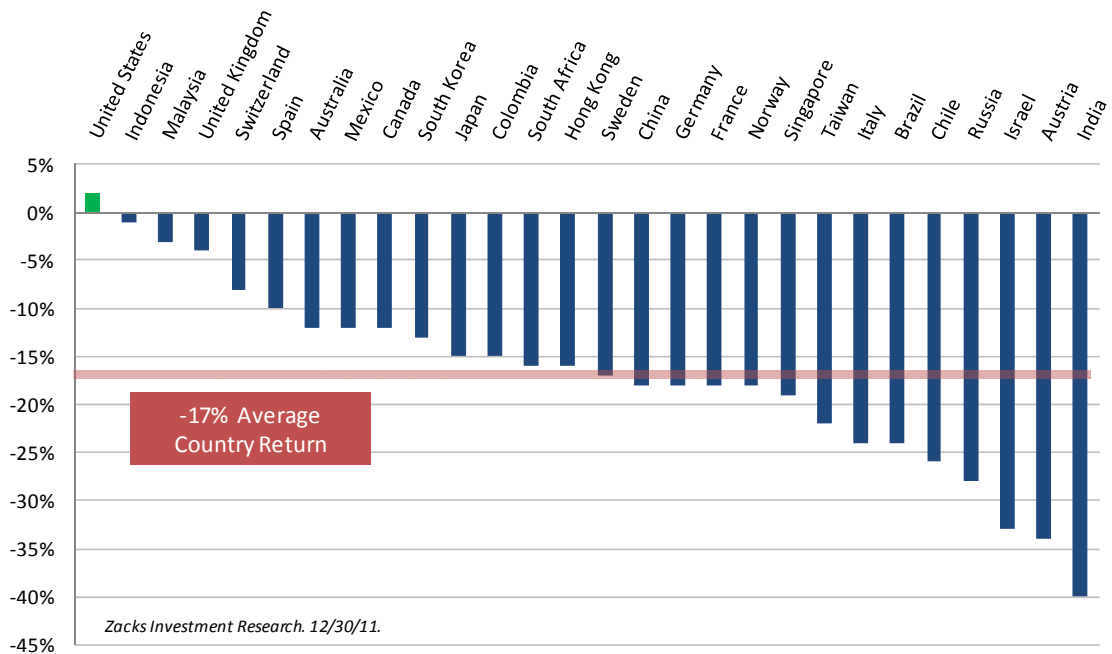
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## Au Revoir and Auf Wiedersehen 2011

We are happy to bid farewell to 2011 and its associated pain. Considering the S&P 500 was up 2% in 2011, a casual observer might ask, “How bad could it have been?” “Pretty bad” is the answer when one considers the breadth of damage inflicted on global stock markets last year.

2011 Country Returns: There’s No Place Like Home



Global headwinds challenged internationally diversified portfolios, and ours was no exception. Countries around the world were down 17% on average and, as the chart above shows, only the U.S. finished the year in positive territory. Clearly, an internationally diversified portfolio of stocks and bonds, which have historically outperformed a 60% stocks/40% bonds U.S. centric strategy, gave less than a lukewarm performance in 2011.

If broad international diversification didn’t work, how about the strategy of separating winning countries from losing countries, the bread and butter of hedge funds? Many of these “smart money” investors expected faster growing economies like India and Brazil to outperform seriously fiscally-challenged economies like Spain – slam dunk, right? Nope, it was the exact opposite, with Spain ranked #6 in returns, right behind Switzerland, while India finished dead last.

So how did the smart money do? How did the hedge fund industry fair? On the year they lost an average of 7.4% <sup>(1)</sup>, which begs the question, “What exactly did

they hedge against?" Global balanced funds, the closest comparison to Weyland, performed better than hedge funds, finishing the year down 4.7% <sup>(2)</sup>. Weyland did better than both, finishing the year modestly better than global balanced funds. But all in all, it was the year the Wall Street Journal lamented "when the smart money looked dumb."

### Follow the Bouncing Ball

Investors were further challenged by high volatility in 2011. Although we started and ended the year with average levels of volatility, the summer saw jaw-dropping historic daily swings in the stock market similar to 2008. The S&P 500 lost just shy of 20% of its value in a brief eleven trading days (between July 22<sup>nd</sup> and August 8<sup>th</sup>). Up and down 3%, 4%, or 5% day after day does not make for restful sleep. And remember, just for perspective, that the U.S. was the **best** performer in the world.

Well-diversified, passively-invested portfolios have historically dampened volatility. But as in 2008, this didn't work well, with most asset classes moving up and down together. It seemed all that mattered last year was Merkel and Sarkozy: when they smiled, markets went up; when they grimaced, markets went down.

The only way to dampen volatility in this type of environment is to reduce market exposure, which we did, and it served us well. From the peak in July to the trough in October, global balanced funds <sup>(2)</sup> dropped an average 14.2%, demonstrating how diversification did not do much to mitigate risk. Weyland portfolios avoided a bit less than half of this downside by being overweight cash.

While that cash in our portfolios helped us greatly reduce our downside losses during Q3 and the beginning of Q4, it likewise reduced corresponding gains in November and December when markets were experiencing upside volatility – which is reflected in this quarterly report. But overall, that was our choice for the year: same or better returns than our benchmark with much less volatility. What is never reflected in statistics like this is the insurance aspect to our positioning, or how well our clients would have been protected had markets truly melted down – a scenario we are grateful did not occur. Moreover, such protection is paramount when one considers that we invest the bulk or all of our clients liquid net worth.

### Going Forth Into the Haze

At the time of this writing, January 24<sup>th</sup>, the coordinated action of global central banks (detailed in our email of November 30<sup>th</sup> titled "Crawling to the Endgame"), together with the further ECB liquidity measure (LTRO) of December 21<sup>st</sup>, have unfrozen the interbank loan market in Europe. While this hasn't solved the underlying problem, it has created enough liquidity that markets are beginning to consider futures that do not include the meltdown of global financial markets.

We recently added to our position in U.S. large growth stocks as these stocks continue to reward us. Over the past year they have been the world's best performing country and style equity choice.

After historic volatility, trends are currently improving in emerging market equities (VWO), global bonds (TGBAX), as well as corporate debt (LSBDX). If this continues, and we can probabilistically confirm the trend, we will reestablish positions. Gold's trend (GLD) is slowly repairing itself as well. Finally, we recently initiated a position in short-term bonds in order to generate some income while these trends mature.

Some may ask, "Even when we were fully invested in mid 2011, why do we own so few positions?" The answer is related to heightened correlations described above. It simply doesn't make sense to increase the number of positions if one isn't getting any non-correlation or return benefit. All it does is increase transaction costs. And in a concealed and harmful way, it also increases exposure to capital gains taxes. However, when correlations return to lower, pre-crisis levels, we will expand the number of positions and reap those benefits.

In the meantime, we look forward to getting away from this headline-driven market. As we pointed out in the 2012 Outlook and Strategy, this year will be a pivotal year for the global political and economic order. If Europe and the U.S. can move toward solutions to their fiscal woes, global prosperity and positive investment returns should soon follow - and follow in a big way.

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(1) Source: Dow Jones Credit Suisse Core Hedge Fund Index.

(2) Source: Lipper Global Flexible Fund Index.