Bell Investment Advisors, Inc.

TheOpeningBell

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Emerging Markets and Conservative Portfolios—Two Peas in a Pod?

by Matthew P. King, CFA, Managing Director, Chief Investment Officer

My wife and I enjoy watching the Travel Channel. With two young kids, there is only so much traveling we can do, and when we do travel we can only go so far, so instead of touring the world ourselves we live vicariously through the hosts on TV. One of our favorite shows is *Bizarre Foods*. If you are not familiar with it, the host, Andrew Zimmern, travels the world in search of the strangest foods he can find and then, of course, consumes them. This guy has eaten everything from insects to the least appetizing organs of any mammal, reptile, bird, or fish you can imagine. Given his ironclad stomach and unwavering resolve, it was funny to learn on a recent episode that there is one food Andrew won't touch, and it's not cobra heart or tuna eyeballs. It's walnuts.

As with most of us, Andrew has that one food from childhood that we absolutely detested and still won't touch to this day. The one that we couldn't eat even if it cost us dessert privileges. The one that, despite our palate expanding exponentially since we were eight, still causes us to recoil in abject horror. For me, it's peas. For my wife, mayonnaise. I'm certain you have one too. Once something is deemed your "Least Favorite Food," it is hard to undo that opinion.

If I don't eat another pea for the rest of my life (if only I could be so lucky), there is not much harm that will result. After all, I can always get my Vitamin K from other sources. But sometimes, we adopt steadfast opinions that prove detrimental. Take nuclear power for example. After the incident at Three Mile Island in 1979, the collective opinion developed that nuclear power was unsafe, and as result, we stopped constructing nuclear power plants for the next 28 years. As a consequence, coal-burning plants now generate about 50% of our domestic electricity, which seems like a mistake knowing what we know now about green house gases. Given the present disaster in the Gulf of Mexico, one has to wonder if offshore oil drilling will suffer a similar fate as nuclear power.

For equity investors, emerging markets have always been labeled as high risk investments, and it's easy to understand why. Just in the past twenty years, there have been numerous crises in emerging market countries that led to dramatic declines for foreign investors as a result of declining stocks and devalued currencies. From October 1994 to March 1995, the MSCI Latin America Index lost 42% of its value due to the Mexican Peso Crisis. From August 1997 to August 1998, the MSCI All Country Asia Free ex-Japan Index fell 64% as a result of the Asian Financial Crisis. From September 1997 to September 1998, the MSCI Russia Index plummeted 92% after the country defaulted on its debt. I could go on with more examples, but you certainly get the idea.

However, investors' perception of emerging markets as being high-risk has everything to do with the past and very little to do with the present or future for that matter. While over-indebtedness often played a key role in emerging market crises in the past, today we find ourselves in a unique position in regard to the finances of developed and emerging economies. According to Ramin Toloui, emerging markets portfolio manager at PIMCO, "Public debt in industrialized countries is over 90% of GDP, and it is projected to increase dramatically to almost 110% of GDP in the next five years, according to the International Monetary Fund (IMF). By contrast, in emerging markets, public debt is substantially lower at 38% of GDP and is projected to decrease to 34% over the same period of time." So from the perspective of debt levels, emerging markets appear to be in much better shape than their "safer" developed country counterparts.

Along with financial crises triggered by excessive debt, two other commonly perceived risk factors in emerging markets are political and regulatory risk. To accurately gauge these types of risk, The Heritage Foundation, a public policy research institute, produces an annual Index of Economic Freedom that ranks 183 countries based on ten factors: business freedom, trade freedom, monetary freedom, government size, fiscal freedom, property rights, investment freedom, financial freedom, freedom from corruption, and labor freedom. What is least surprising is that countries like North Korea, Cuba, and Venezuela stand at the bottom of the rankings. What is most surprising is the composition of the top quintile, of which 39% of the countries ranked are considered to be emerging markets by either the IMF or MSCI. These select emerging market countries even manage to rank higher than "safer" developed countries like Norway, Israel, France, and Italy.

According to a report from Vanguard, *How America Saves 2009*, just 18% of the retirement plans that they administer offer emerging market funds and only 11% of participants who are offered these funds actually use them. While this initially may seem like the result of the home bias—the established tendency of investors to overallocate to their home country—the report shows that 98% of the same retirement plans offer developed market funds while 31% of participants use them. So there certainly seems to be a greater comfort level with the "safer" developed markets among those who set the menu of fund choices (the plan trustees) and those who choose the individual funds (the participants).

If investors continue to keep emerging markets out of their portfolios because they are too high risk, it will likely come at the cost of future returns. Emerging markets have historically produced higher economic growth rates and market returns than their developed market counterparts. And under present conditions, you can add to that fact the high debt levels among the "safer" developed countries that are likely to produce a headwind against their economic growth rates going forward.

What resonates most with me about Andrew Zimmern and his show, *Bizarre Foods*, is how he approaches every new food, no matter how strange, as if he were a blank slate. Through his attitude and his closing line, "If it looks good, eat it!" he continually reminds us that preconceived notions often prevent us from trying, and possibly enjoying, new things. But, our thinking isn't always preconceived. Sometimes, it is based on previous experience or events, but because the world changes and evolves, that evidence continually needs to be reevaluated to verify the validity of our opinions and beliefs. Successful investing requires it. ■

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Account Performance Report through June 30, 2010

Since 1999 we have calculated the average and median returns of our clients' accounts. These performance figures are derived from actual accounts managed by Bell Investment Advisors. Here is a quick look at the latest results:

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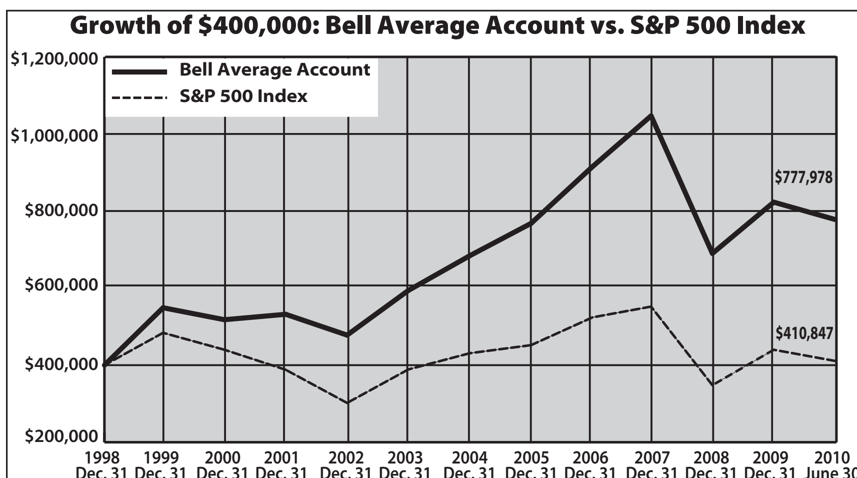
This table compares our average and median account performance compared to five of the major market indices. While you cannot invest directly in any of the indices listed above, it is interesting to note that the most popular index, the S&P 500—with approximately $915 billion indexed to it—is almost flat since the start of 1999.

	2010	January 1999 to June 2010	
Index	Year-to-Date	Total Return	Annualized Return
Bell Average Account (1)	–5.5%	94.5%	6.0%
Bell Median Account (1)	–5.5%	92.8%	5.9%
Dow Jones Industrial Average (2)	–5.0%	37.5%	2.8%
S&P 500 Index (2)	–6.7%	2.7%	0.2%
Nasdaq Composite (2)	–7.1%	–3.8%	–0.3%
Russell 2000 Small Cap Index (2)	–2.0%	67.9%	4.6%
MSCI EAFE Index (2)	–12.9%	29.6%	2.3%

Meanwhile, our Active Portfolio Enhancement® methodology has nearly doubled our clients' assets since 1999. Our advantage lies in our proactive, momentum-based approach versus the passive strategy of tracking a particular market index.

When you compare performance results, it is important to make note of what is, and is not, included in the stated returns. Our returns are reported net of all management fees, mutual fund expenses, and trading costs. Here, the bottom line is the bottom line.



You have seen our performance in terms of percentage return. Here is how our average account performance since 1999 compares to the S&P 500 Index in dollars and cents. The graph above shows the growth of a hypothetical $400,000 investment made in January 1999. ■

Notes: (1) These accounts include the effects of Bell's management fee, mutual fund expenses, Schwab transaction fees, short-term redemption fees, and cash holdings. (2) These returns do not include the effects of the items described in Note 1.

Disclosures:

Past performance is no guarantee of future results. Future returns may differ significantly due to materially different economic and market conditions. Returns assume the reinvestment of dividends and capital gain distributions. These investments involve risk and the possibility of loss—including principal. Mention of a security in this newsletter should not be taken as advice to buy or sell that security.

In regard to the Bell Average Account, the term "average" is defined as a simple average—not a weighted average. Only fee-paying clients who fully employ our Active Portfolio Enhancement strategy are included in the return calculation. Client accounts that hold individual securities or funds not recommended by Bell; employ fixed income, hedging, cash reserve, market timing, socially responsible, or any other strategy not representative of Active Portfolio Enhancement; or maintain cash allocations greater than ten percent of the portfolio are not included in the calculation. We believe that removing these accounts improves the stated results as Active Portfolio Enhancement has traditionally been our most successful strategy. Additionally, only client accounts that were managed for the full calendar year are included in that year's return calculation. Accounts opened mid-year are not included in that specific year's reported results. We do not believe this policy has any material effect on the stated results.

The "Growth of $400,000" graph represents a hypothetical investment of $400,000 made at the end of trading on December 31, 1998, and is based on the returns produced by the average Bell account and the S&P 500 Index, neither of which can be invested in directly.

The S&P 500 Index is an unmanaged, market-cap weighted index of large-cap stocks commonly used to represent the U.S. stock market. More information can be found at www.standardandpoors.com. The Dow Jones Industrial Average is an unmanaged, price-weighted index of 30 large-cap stocks. More information can be found at www.dowjones.com. The Nasdaq Composite is an unmanaged, market-cap weighted index of all-cap stocks listed on the Nasdaq Stock Market. More information can be found at www.nasdaq.com. The Russell 2000 Index is an unmanaged, market-cap weighted index of small-cap stocks. More information can be found at www.russell.com. The MSCI EAFE Index is an unmanaged, unhedged, market-cap weighted index of foreign stocks commonly used to represent developed stock markets outside the United States. More information can be found at www.mscibarra.com. None of these indices can be invested in directly. The composition and volatility of Bell's client accounts vary and may significantly deviate from these indices over time. ■

The Risk of Impatience by Jim Bell, CFP® President and Founder

In the April 2010 issue of *The Opening Bell*, I wrote about my meetings with college students asking me about my career. At some point in each meeting, they look around my office and ask, "How did you get here?" In reflecting on this question, I realize that the skill of patience has served me very well in the development of my career.

All of my life, my parents and relatives have told me that I was a remarkable little boy because I was so quiet and so patient. I was happy coloring or building things or cutting out paper figures for much longer periods than most kids. Today I know other professionals who I am sure are more intelligent than I, but who have struggled with their careers and finances because they have not practiced the skill of patience. They get bored easily and keep moving from one job to another. Patience and longevity in a professional field are crucial to career identity and eventual success.

The Marshmallow Test

My son Forrest—also a financial planner and investment advisor at Bell—is an avid reader of *The New Yorker.* (This alone is a sign that he has developed the skill of patience!). Forrest is a great resource for me because he keeps me up-to-date on the most insightful articles that he reads. He told me about the May 18, 2009 issue of *The New Yorker* which included an article, **DON'T! The Secret of Self-Control,** by Jonah Lehrer. This article summarizes the research performed by Stanford University psychology professor Walter Mischel who, in the late 1960's, designed a simple test for four-year-old children to measure their capacity to demonstrate patience.

In this experiment, known as The Marshmallow Test, children could choose one treat from a tray of marshmallows, pretzel sticks, and cookies. Most children chose a marshmallow. They were told that they could either eat the one marshmallow right away, or they could wait while the adult stepped out of the room, and when the adult returned they could have two marshmallows—as long as they waited and did not eat the first one. The adult would then leave for fifteen minutes, which is a lifetime to most four year olds. Only 30% of the children could wait for the adult to return before they ate the first marshmallow.

Patience Trumps Intelligence

Once the children in Dr. Mischel's experiment reached high school, he was able to observe a link between their academic achievement and their ability to wait for the second marshmallow when they took the Marshmallow Test at the age of four. On average, those who could wait for the second marshmallow had S.A.T. scores 210 points (13%) higher than those who could not. For many years, psychologists have emphasized intelligence as the most important predictor of success; Dr. Mischel argues that intelligence is largely at the mercy of patience.

Patience Can Be Learned

Based on hundreds of hours of observation, Dr. Mischel concluded that the crucial skill of patience was the "strategic allocation of attention." Instead of obsessing about the marshmallow, the patient children distracted themselves by covering their eyes, hiding under the desk, or singing songs. According to Mischel, if you can deal with such "hot emotions" as the temptation of a marshmallow, "then later you might be able to study for the S.A.T. instead of watching television." "And," he concludes, in a statement with particular relevance to our line of work, "maybe you can save more money for retirement. It's not just about marshmallows."

Mischel resists the idea that patience has a genetic origin. When he taught children some mental tricks, like pretending the marshmallow is a cloud, he dramatically improved their patience. According to Mischel, "Once you realize that willpower is just a matter of learning how to control your attention and thoughts, you can really begin to increase it."

Patient Sofia

Forrest and his wife, Rose Lynn, began teaching our granddaughter, Sofia, about patience even before she began to talk, while they were teaching her sign language in the months prior to verbal language development. She began learning the concept of patience by learning the sign for it, which is the arm, palm down, stiffly outstretched ahead, as if pointing to the future, moving up and down a few times as you might gesture, "Down Boy," to a dog. Sometimes when she was particularly impatient, that up and down gesture would become a fierce pumping motion.

Between two and three, a recurring incidence of impatience takes place at the dinner table. Just about everyone knows how difficult it can be to keep a toddler at the dinner table while the adults finish their meal and conversation. When Sofia, who has just turned three, starts getting restless at dinner, Forrest asks her how much longer she is willing to eat with the adults: Five minutes? Ten minutes? She watches him as he sets the alarm on his watch, and she begins to distract herself until the alarm sounds and she is finally free to leave: permission granted.

As Sofia anticipated Christmas last year, about which she was extremely excited, she would first say that Christmas was coming soon, and then, would give the gesture for patience and say, "But I have to wait. I have to be patient." She now has the concept, the sign and the words. I feel good that at three years old, Sofia is already acquiring a skill that will serve her well as she begins to find her own path in life.

Patience and Investment Performance in 2010

The Account Performance Report on page two of this newsletter shows that our average account has grown by 94.5% since January 1999 for an annualized return net of fees and expenses of 6.0%. But it was not an easy road getting there. This is the account performance for our most *patient* clients—those who were able to stay with our strategy through the dotcom collapse that started in 2000 and through the Great Recession which began in 2007. Being patient throughout was certainly not easy to do.

Over the past 11.5 years, our momentum investment strategy (when combined with the skill of patience on the part of our clients), has turned a $400,000 investment into $777,978. Short-term results are a lot like the marshmallow sitting on the tray; the true benefit of long-term investment strategies requires the high-level skill of patience. ■

James F. Bell, CFP®

Momentum for Life

by Bonnie Bell, MA, M.Div Principal, Career & Life Coach

Bonnie Bell, MA, M.Div.

If you have consulted our website over the past few months (www.bellinvest.com), you are probably aware that our new, improved, state-of-the-art website has been under construction since the beginning of the year. We are pleased to announce that we will go live with the site in the Fall—so stay tuned.

Prior to embarking on the website project, since the bear market of 2007–2009, we have been very busy reflecting on and clarifying who we are, what we do, and what we care about. We have also been reevaluating how we do what we do by communicating with you and responding to your feedback. In addition, we have been redesigning and reorganizing our internal processes, systems, and workflow to better serve your needs.

Some of the changes we have already implemented and that you may have already noticed include:

- monthly webinars featuring Bell team experts;
- many of these webinars posted on our website following the presentation date to make them available and accessible on an ongoing basis;
- monthly in-office Lunch & Learn events for clients and/or prospects interested in meeting us in person and learning more about what we do and how we do it;
- quarterly, in-depth, white papers by staff experts on a variety of relevant financial topics;
- quarterly in-office networking lunches featuring presentations by Jim and me on the firm's philosophy, *Making a Good Life Happen™;*
- email blasts to our clients, when appropriate, in response to breaking news or significant activities in the financial markets; and
- more proactive telephone and email communication with you individually.

With a clarified underlying **philosophy** (Making a Good Life Happen™), a **shared intent** (to enrich the lives of our clients), an **overriding momentum-based strategy** applied to all of our offers, and a **clear purpose** (to help our clients plan for and build Momentum for Life™), our closely-knit team of specialists at Bell Investment Advisors is moving forward with renewed energy into a future we collectively embrace.

In a couple of months you will observe changes in our logo, stationery suite, website, email format, and newsletter design, all of which will have a new look and feel, but you will find that that we are the same business and the same high-quality team of professionals you have come to know and trust. We also hope you will agree that with these changes we will have arrived fully into the 21st century.

In the relatively near future we will have the capacity to communicate more easily via our interactive website, but meanwhile, feel free to email me (bbell@bellinvest.com) or contact me on my direct line at Bell Investment Advisors (510.763.5671) with any questions or comments. ■

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