



Richard W. Greene
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To: Interested Parties

Date: January 20, 2011

From: Richard W. Greene

Re: *Intelligent Index* 4th Quarter Review

Fourth Quarter Review

Global markets staged a second year of recovery despite the mid-year debt crisis that engulfed many European Union countries. Low interest rates and improving corporate profits created a hospitable environment for U.S. equities. Against this backdrop, the Intelligent Index Model Portfolio gained 23.19% (gross of fees) compared to a return of 15.06% for the Standard and Poor's 500 Index. The outperformance of 8.03% is the widest margin of outperformance over the S&P 500 Index since 2001, when the Intelligent Index Model Portfolio returned 1.73% versus a -11.89% loss for the S&P 500 Index.

Below is a breakdown on the relevant indices along with 3-Year, 5-Year, and 10-Year annualized returns.

Quarterly and Annualized Returns for Intelligent Index Model Portfolio and Indices as of 12/31/2010

	<u>Q4 2010</u>	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>	<u>10-Year</u>
Intelligent Index (Gross)**	13.49%	23.19%	2.84%	5.19%	6.35%
Intelligent Index (Net)**	13.14%	21.66%	1.56%	3.88%	5.03%
S&P 500 Index*	10.76%	15.06%	-2.85%	2.30%	1.41%
DJ Wilshire 5000*	11.59%	17.16%	-1.92%	2.90%	2.50%
S&P Citi Large-Cap Value*	10.51%	15.10%	-5.36%	0.87%	1.65%
S&P Citi Large-Cap Growth*	11.02%	15.05%	-0.50%	3.60%	0.99%
S&P Citi Mid-Cap Value*	12.38%	22.78%	2.26%	4.70%	8.46%
S&P Citi Mid-Cap Growth*	14.55%	30.57%	4.75%	6.66%	5.70%
S&P Citi Small-Cap Value*	15.97%	24.72%	2.60%	4.06%	8.02%
S&P Citi Small-Cap Growth*	16.52%	27.99%	3.28%	5.16%	7.00%

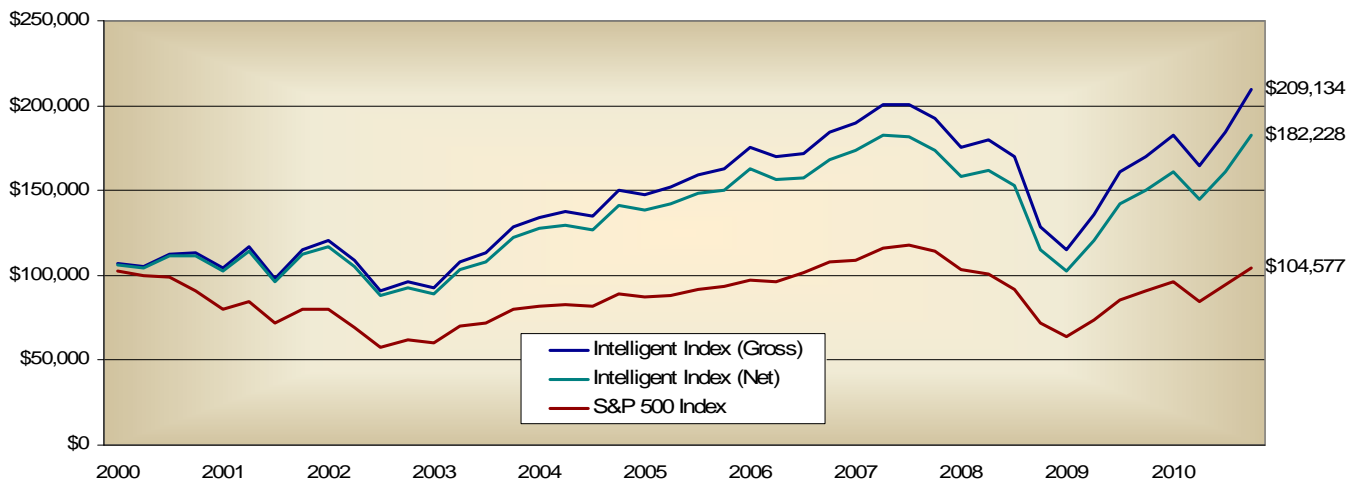
Source: Bloomberg, wilshire.com, iShares.com.

As a result of all the underlying indices and the S&P 500 Index being positive, no shifts were made for this quarter and the portfolio remains equally weighted between growth and value styles.

Of its 11-year history, 2010 marks the 9th year that the Intelligent Index Model Portfolio has outperformed the benchmark S&P 500 Index. Not inclusive of fees, the cumulative outperformance of the Intelligent Index Model Portfolio vs. the S&P 500 Index since inception in 2000 stands at 104.56%, averaging 6.53% annually. During what is considered a lost decade of returns, the Intelligent Index Model Portfolio generated an annualized return of 6.94% gross of fees, versus 0.41% which the S&P 500 Index earned on an annualized basis since 2000. While the S&P 500 Index and the Dow Jones Industrial Average are still -19.65% and -18.26% below their all-time highs of October 9, 2007¹, respectively, the Intelligent Index Model Portfolio is 4.09% above its all time high quarterly watermark established in June 30, 2007.

Below is a comparative chart illustrating the growth of \$100,000 in the Intelligent Index Model Portfolio and its benchmark S&P 500 Index since inception in 2000.

Growth of \$100,000
Inception 2000 – 2010



Looking Back

2010 also personified the proverbial wall of worry to which investors often refer. The jobless recovery that began in 2009 persevered with the help of Federal Reserve’s policy of keeping rates low and gradual improvements in many economies. The biggest drivers however were the decision to expand the Fed’s policy of quantitative easing combined with the end of year \$800 billion tax and incentive compromise legislation. While investors were thrilled to see their portfolios post additional recoveries, many were suspect of the perceived improvement in the economy that the markets implied. As a result, up until the fourth quarter of 2010, money flows reflected net redemptions of equity mutual funds in favor of what is historically the less risky bond market.

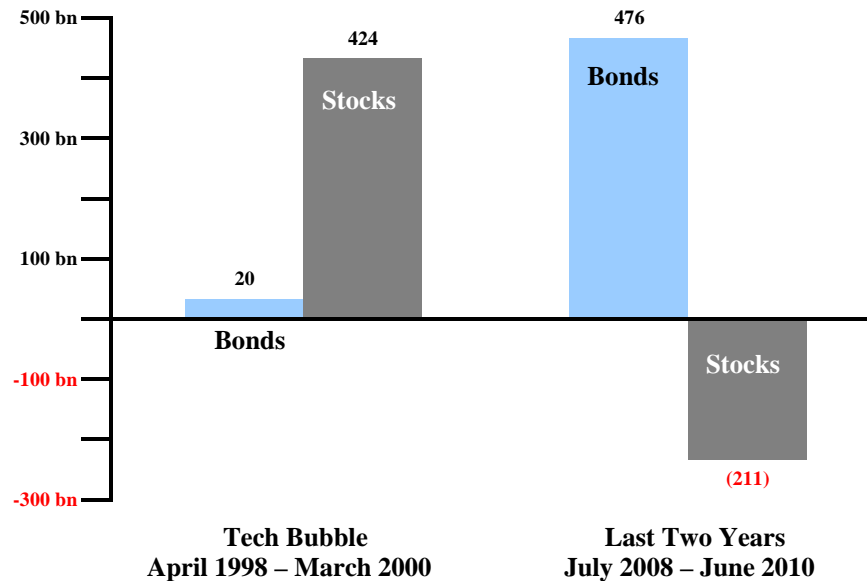
Over the last several years, investors’ “love affair” with stocks was severely strained and in many cases irreparably damaged as the implosion of the credit bubble and Wall Street’s culpability in the fiasco proved to be the last straw for many. The mortgage meltdown served as the salt to the wound, and combined with the dot com bubble, was responsible for a decade of 1.41% annualized returns from 2001 through 2010 in the bell weather S&P 500 Index. The last decade in which equity returns were so dismal was 1970-1979 when the S&P 500 Index returned an inflation-adjusted -1.34%.² The key difference is that at the start of 1970, investors had just \$48 billion dollars³ invested in stock mutual funds. By the end of 2000 however, holdings in stock mutual funds stood at \$7 trillion³. Consequently, despite the market’s recovery since March of 2009, net redemptions out of stocks and into bonds was historic as the chart below illustrates.

¹ S&P 500 Index: www.businessweek.com/news/2011-01-04/s-p-500-pattern-echoing-2004-is-bullish-sign-technical-analysis.html; <http://finance.yahoo.com>.
Dow Jones Industrial Average: www.the-privateer.com/chart/dow-long/html; <http://finance.yahoo.com>.

² “A Decade-by-Decade Look at the S&P 500 Index and Inflation. February 24, 2010. <http://allfinancialmatters.com/2010/02/24/a-decade-by-decade-look-at-the-sp-500-index-and-inflation/>

³ Waggoner, John. “Investors Look Back on a Decade of Grim Stock Returns.” USA Today. December 30, 2010. www.usatoday.com/money/perfi/stocks/2010-12-30-worstdecadeever30_CV_N.htm

Going With the “Flows” – Tech Bubble vs. Today
Net flows into stock and bond funds



Source: <http://blogs.marketwatch.com/fundmastery/2010/08/09/bond-bubble-vs-tech-stock-bubble/>

Along with a loss of faith in the market investors have had difficulty with the “disconnect” between the market’s recovery and the general state of the economy. The 1.53 million people that filed for personal bankruptcy in 2010¹ certainly didn’t feel like there was much of a “recovery.” Despite the market being a leading indicator, it requires a considerable leap of faith to believe that a meaningful recovery in the economy is forthcoming considering the persistence of high unemployment, ongoing weakness in residential real estate, and now the additional focus on the balance sheets of public entities, which continue to deteriorate while states’ unfunded liabilities expand exponentially. Only after 18 upward months in the market did investors begin to return to the equity side of the markets, adding \$22 billion¹ to equity mutual funds during the first three weeks of December, which is the first such net inflow in almost 3 years.

Looking Forward

The Federal Reserve’s efforts to inflate financial assets by maintaining lower rates have, at least in the short term, succeeded. Most GDP forecasts for 2011 have been raised and are now in the 3% growth range which suggests ongoing gradual economic improvement. Of concern perhaps is the increase in bullishness across the investment community. As one observer put it, it’s easy to be “bullish until the bills come due.”⁵ Buoyed by the market’s large 4th quarter rally, 12-month price target forecasts have been raised for the S&P 500 Index, ranging from 1400 by Citigroup⁴ to 1450 by Goldman Sachs⁵. Anecdotally, dating back to 1994 when research on the Intelligent Index began, the broad markets experienced positive annual returns in 10 of the 12 years following those years that experienced a positive fourth quarter. Many market observers have also anecdotally pointed out that the third years of presidential terms have a tendency to be good years for stocks with no negative third years since 1939 and 17 presidential cycles.⁶ While this data provides no guarantee of future results, it does carry some credibility as more often than not the strongest economic growth has coincided with the third and fourth years of a presidential cycle.

While state and municipal balance sheets have deteriorated, corporate balance sheets continue to strengthen due to improved earnings and the low interest rate environment, which has enabled corporations to issue lower coupon debt, save substantially on debt payments, and reflect healthier balance sheets. Furthermore, many of these funds raised by companies from the bond market are and will be increasingly used for share buybacks, dividend increases and acquisitions. All are constructive factors for equities.

⁴ Ossinger, Joanna, and Kisling, Whitney. “Citigroup Raises 2011 S&P 500 Estimate 7.7% to 1,400.” January 3, 2011. www.bloomberg.com/news/2011-01-03/citigroup-raises-its-2011-s-p-500-estimate-to-1-400-from-1-300.html

⁵ Phillips, Matt. “In 2010, Growth Topped Gloom.” The Wall Street Journal. January 3, 2011. <http://online.wsj.com/article/SB10001424052748703859204576053832923195222.html>

⁶ Hogelucht, Frank. “The Third Year of the Presidential Cycle.” December 20, 2010. www.safehaven.com/article/19400/the-third-year-of-the-presidential-cycle

The political backdrop adds some additional positives for the market as the new Congress seems poised to address the deficits and government spending. One's political opinion aside, all can agree the scale of our national deficit and the percentage of tax revenues needed to pay just the interest on it are accidents waiting to happen. Entitlements, bailouts, and the like all need to be re-assessed and more financial discipline employed.

A final potentially bullish indicator may lie in the mutual fund flows chart referenced above. Investors as a whole have unfortunately had a dismal track record for allocating assets. History consistently shows how investor psychology undermines their investment returns, as it rests largely on emotion and investing via the rear view mirror. For many professional investors, the massive flow of funds away from stocks over the past few years represents significant upside opportunities as, in their minds, some of these assets will inevitably find their way back into the market given unacceptably low interest rates.

Strategy

“Investors do better when risk management is a conscious part of the process. Survival is the only road to riches and one should only try to “maximize” returns if losses would not threaten your survival and you have a compelling need for the gains you might earn.”

Peter Bernstein, Renowned Economist & Financial Historian⁷

The exodus from stocks and into bonds was driven as it usually is partially by fear, but equally by a heightened risk aversion to the market, after bubbles, scandals, and incompetence at so many levels evaporated investors' investment returns and at worst, entire portfolios. It's not the paltry yields the bond market has offered over the last couple of years that investors are clamoring for; it is for some semblance of safety of their assets. With the equity market improving and some of the clouds clearing, investors are faced with difficult decisions as to how to manage risk. Continue to earn minimal returns in the bond market or join the parade back into the equity market?

As most of you are aware, the allocation decisions with which we try to assist clients are rarely driven by what is the asset “du jour.” We are not influenced to any meaningful degree by forecasts, prognostications, or popularity contests between asset classes. The Intelligent Index provides us with sufficient diversification across most asset classes and sectors to be a suitable core holding for most investors, which precludes us from having to play guessing games. With the semblance of a party starting on Wall Street we would encourage investors to consider the following:

- Is the reallocation of assets from bonds into stocks only driven by a search for higher yields or returns? In other words, are those assets being put back at risk because of a change in financial circumstances, time horizon, and renewed long term confidence in equities or only because “it looks like the market is doing better or may go up this year”?

While no one ever knows the optimal allocation in advance, we strive to create “all weather” allocations that can be viable in both bull and bear markets in reaching one's financial objectives, based on each client's time-horizon, risk tolerance, and investment objectives.

Bottom Line

- Review allocations and time horizons, and determine if any rebalancing of assets is required.
- Review any additional liquidity needs for upcoming expenses, and adjust equity allocation accordingly.
- To the extent possible, build hedges into your portfolios by blending the more volatile equity investments with lower beta equity-type investments.
- If you own fixed income instruments, be very cognizant of where your portfolio is located on the yield curve. With the chances of a double dip recession fading, the deflation scenario becomes more unlikely. At the same time, commodity prices have risen significantly, impacting food, energy, and many raw material prices to the upside. Add healthcare costs to the mix and the fact that there will be a limit to government easing, and you have a scenario that inflation is in the cards. We continue to advocate staying on the shorter end of the yield curve.

⁷ Bernstein, Peter. “Peter Bernstein on the market, short-selling and hedging.” October 20, 2004. <http://seekingalpha.com/article/2963-peter-bernstein-on-the-market-short-selling-and-hedging>

- Remember that unlike the New Year's parties some of us may have attended recently, the parties on Wall Street generally do not end well. Moderation tends to lessen the severity of hangovers.

In closing, we want to once again extend our best wishes for the New Year and express our satisfaction in being able to provide investors in our Intelligent Index Model Portfolio with another good year.

Additional thanks to the many of you who over the years have graciously referred friends, relatives and associates to Centerpoint for financial advisory services. Referrals from loyal friends and clients have always been a great contributor to our growth, and we strive to maintain your utmost trust and confidence in the future as well. We welcome the opportunity to meet with and assist any additional referrals you may have, and we look forward to updating you again after the 1st quarter as well as sharing exciting new developments as the year progresses. Please do not hesitate to contact us with any questions or thoughts in the meantime.

Sincerely,

Richard W. Greene
Managing Principal

Jennifer M. Wolfsberg
Principal

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All quantitative analysis illustrated herein is done using market composites which best represent the overall investment strategy of the Intelligent Index. All annualized return figures consist of both capital appreciation and dividends reinvested. Risk: The Intelligent Index Strategy allocates its investments among Barclays iShares ETF indexes invested in growth and value style equities of small, mid, and large capitalizations. The Intelligent Index Strategy systematically rebalances its allocations in these assets to maintain their target weightings. There can be no guarantee that rebalancing will achieve its intended result. The risks, both systematic and unsystematic, associated with an investment in the Intelligent Index Strategy specifically and equities in general may not be suitable for all investors. The performance figures contained herein do not guarantee future results. The opinions expressed herein are subject to change without notice. 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