# Built on Trust

July 2011

## Results Through June 30, 2011

For the quarter, the balanced portfolio gained 1.0% after expenses compared to a gain of 0.7% for the Wall Street Index.[1] So far in 2011 the balanced portfolio has gained 3.2% versus 4.3% for the Wall Street Index.

Almost all of this year's return has come from the equity sector of the portfolio which has gained 6.6% versus 6.3% for U.S. stocks and 3.7% for international stocks. This outperformance is the result of our focus on global blue chip stocks.

## Major Tenets of the TCI Investment Philosophy

Occasionally we find it helpful to review the principles that form our investment policy and the basis for the asset allocation decisions. We have found our approach is similar to author and investor, Howard Marks, whose beliefs are articulated below.[2]

**TCI is a defensive investor.** We worry about things that can go wrong and about losing money. Because we are worried we build in a margin for error. We may make less when everything goes right, but we tend to lose less when things return to earth. We believe long-term investment success can be built more reliably on avoidance of significant losses than on the quest for outsized gains.

**TCI is a contrarian investor.** Basically this means *leaning away* from the direction chosen by most others. Sell when investors are euphoric and buy when they are afraid. Sell what they love and buy what they hate.

**TCI is a value investor.** Investment success doesn't come primarily from "buying good things" but rather from "buying things well". For example, most people can tell the difference between a good company and a bad one, but it is much more difficult for them to tell the difference between a low stock price and a high one. We evaluate asset classes using reversion-to-the-mean, considered by many to be the most powerful force in finance.

**TCI is a member of the "I don't know" school of investing.** The majority of investors falls into the "I know" school and they believe they can discern what the future holds. We believe it is impossible for anyone to know much about a vast number of factors and how they will interact. Instead, we work to understand all we can about asset allocation, risk management, and manager selection, and we continually monitor each, adjusting as necessary. We also track the secular economic headwinds and tailwinds that influence long-term investment trends.

## How Is TCI Invested Today?

The government's zero interest rate policy and quantitative easing programs (QE1 and QE2) have acted to reduce expected returns of all asset categories to below normal. In the case of small-cap stocks and most bond categories, expected returns are at or near all time lows. Only quality and emerging markets stocks show potential. As a result these categories are our predominant equity holdings.

We are limiting our bond exposure to defensive investments. The rates paid on government bonds have been cut so low that bondholders are no longer being rewarded for their investment—instead, the only party benefiting is the government. Our taxable fixed income manager, PIMCo, avoids government bonds and instead focuses on corporate bonds, floating rate bonds, non-agency mortgage bonds and emerging market bonds. These shorter-term, cheap bonds deliver a reasonable spread relative to inflation—something government bonds cannot provide.

Alternative investments provide a different source of defense. TCI has selected three "manager of managers" to fund this asset category. PIMCo All Asset All Authority actively selects from a wide variety of PIMCo mutual funds to meet its goal of CPI (a measure of inflation) plus 6.5% over a full business cycle. Absolute Investment Advisers uses a diverse group of strategies (i.e. long/short credit) normally associated with hedge funds to provide lower volatility and lower sensitivity to traditional market risks. Lastly, Altegris Investments chooses managers who use proprietary trading systems to take long and short future positions to follow either bullish or bearish trends in a wide range of global markets and asset classes. Top managers using this strategy have historically produced excellent returns that are uncorrelated to stocks over a business cycle. We are currently over-weighted in alternative investments due to poor valuations in the equity and stable sectors.

## What Will TCI Do If the Market Declines Significantly?

We would expect our current defensive portfolio to limit losses during a decline, therefore we are already allocated appropriately should such an event occur. Our strategy would be to wait until market valuations return to an undervalued level and once again provide the "margin of safety" we are looking for to make additional long-term investments.

## Recent Portfolio Changes

Caldwell & Orkin Market Opportunity Fund is in the process of being eliminated from the alternative sector of TCI portfolios. The proceeds are being divided among the remaining investments in this category. The long/short strategy employed by the fund showed great promise when purchased two years ago, however manager Michael Orkin seemed to abandon the investment process we had originally discussed, leading to our decision to sell.

## Conclusion

The investment objective of most clients is to earn 4–5% more than the rate of inflation over the long-term. To succeed, you must have a clear idea of your tolerance for risk, exercise discipline and stick to your plan. Please contact your relationship manager should you have any questions or concerns.

[1] 50% U.S. stocks, 10% international stocks, 30% U.S. taxable bonds and 10% Treasury bills
[2] Howard Marks, "The Investment Realist's Creed," *Trusts & Estates,* Vol. 141, No. 4, April 2002, pp. 26–34

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## Returns to 06/30/11

| Symbol | Name | 3-Months | YTD | 1 Yr | 3 Yrs | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|---|
| | **Stable Investment Sector** | | | | | | |
| | **Taxable Bonds** | | | | | | |
| PTLDX | PIMCo Low Duration Fund | 1.1% | 2.2% | 4.4% | 5.9% | 6.0% | 4.8% |
| PRRIX | PIMCo Real Return Fund | 3.3% | 5.2% | 7.9% | 6.5% | 7.5% | 7.4% |
| PTSHX | PIMCo Short Term Fund | 0.4% | 1.0% | 2.1% | 3.2% | 3.6% | 3.2% |
| PTTRX | PIMCo Total Return Fund | 1.9% | 3.0% | 5.9% | 9.5% | 8.9% | 7.4% |
| PFIUX | PIMCo Unconstrained Bond Fund | –0.1% | 1.1% | 2.7% | 7.2% | — | — |
| | **Tax Free Bonds** | | | | | | |
| VWIUX | Vanguard Admiral Intermediate Tax Exempt | 3.5% | 4.1% | 3.6% | 5.3% | 4.8% | 4.4% |
| | **Money Market Investments** | | | | | | |
| FPOXX | Financial Square Prime Obligations | 0.0% | 0.1% | 0.1% | 0.5% | 2.2% | 2.2% |
| | **Alternative Investment Sector** | | | | | | |
| | **Long/Short Stock Funds** | | | | | | |
| COAGX | Caldwell Orkin Market Opportunity | –1.3% | –2.5% | –2.0% | –3.8% | 5.0% | 2.0% |
| HSGFX | Hussman Strategic Growth | 2.7% | –0.1% | –8.5% | –3.2% | –0.8% | 5.2% |
| | **Alternative Funds** | | | | | | |
| ASFIX | Absolute Strategies I | 1.0% | 0.6% | 4.2% | 3.1% | 3.1% | — |
| AOFOX | Absolute Opportunities I | –2.4% | –2.6% | 2.8% | — | — | — |
| PAUIX | PIMCo All Asset All Authority Fund | 1.6% | 4.5% | 8.4% | 7.6% | 8.3% | — |
| | **Commodity/Managed Future Funds** | | | | | | |
| MFTIX | Altegris Managed Futures Strategy I | –5.3% | –8.0% | — | — | — | — |
| | **Equity Investment Sector** | | | | | | |
| | **US Stocks** | | | | | | |
| FINSX | Fidelity Advisor New Insights | –0.5% | 4.2% | 27.6% | 2.0% | 4.8% | — |
| MSSGX | Morgan Stanley Instl Small Company | –3.7% | 2.2% | 39.0% | 8.8% | 4.6% | 6.3% |
| VDIGX | Vanguard Dividend Growth | 3.2% | 8.2% | 29.5% | 5.6% | 6.0% | 3.6% |
| VPMAX | Vanguard Primecap Admiral | 0.3% | 5.5% | 33.1% | 3.9% | 5.6% | 5.5% |
| | **International Stocks** | | | | | | |
| ACINX | Columbia Acorn International | 1.7% | 3.0% | 32.3% | 4.2% | 7.4% | 11.3% |
| GMCEX | GMO Emerging Countries III | –1.3% | 3.3% | 35.0% | 2.1% | 9.5% | 17.4% |
| MSFAX | Morgan Stanley Instl Global Franchise | 7.9% | 12.2% | 32.1% | 11.1% | 7.8% | — |
| TFEQX | Templeton Instl Foreign | 0.8% | 6.1% | 28.7% | 0.8% | 4.4% | 7.8% |
| | **Real Estate** | | | | | | |
| GRSIX | Cohen & Steers Instl Global Realty | 2.4% | 4.8% | 31.4% | 3.7% | — | — |
| | **Asset Allocation Portfolios** | | | | | | |
| | Capital Preservation | 1.0% | 2.1% | 7.3% | — | — | — |
| | Conservative | 0.8% | 2.6% | 11.1% | 3.1% | 4.2% | 5.0% |
| | Balanced | 1.0% | 3.2% | 14.4% | 3.2% | 4.5% | 6.5% |
| | Growth | 0.7% | 3.3% | 16.3% | 1.0% | 2.7% | 5.1% |
| | **Indices for Comparison** | | | | | | |
| | BarCap US Aggregate Bonds | 2.3% | 2.7% | 3.9% | 6.5% | 6.5% | 5.7% |
| | MSCI EAFE International Stocks | 1.6% | 5.0% | 30.4% | –1.8% | 1.5% | 5.7% |
| | Russell 2000 Small Cap Stocks | –1.6% | 6.2% | 37.4% | 7.8% | 4.1% | 6.3% |
| | S&P 500 Large Cap Stocks | 0.1% | 6.0% | 30.7% | 3.3% | 2.9% | 2.7% |
| | Wall Street Index | 0.7% | 4.3% | 19.3% | 3.7% | 4.0% | 4.3% |

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