Friday, August 5, 2011, at 4 p.m. EDT

Financial Advisor Webinar Series

Andrew D. Martin
President of 7Twelve Advisors, LLC

Long-Term Bond Fund Investors Perform Better Than Expected In A Period Of Rising Rates

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Andrew Gluck, Moderator
Editor, Advisors4Advisors.com

Upcoming Webinars

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Fritz Meyer	August 2011 Economy Update	Tuesday, August 9
Tammy Emsick	The Switch Is On Again For RIAs	Friday, August 12
Bob Keebler	Introduction To Tax-Aware Investing	Friday, Sept. 9
Doug Carter	Letting Prospects Sell Themselves	Friday, Sept. 16

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"A4A cut my research time in half"

Kathleen Iola
Iola Financial Group

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Top Stories

IAA Identifies Top Compliance Concerns For Advisors This Year
Compliance, Registered Investment Advisors, Scott Martin
Social networking made the list of advisors' biggest compliance headaches this year. So did pay-to-play political contributions, data security, custody, and advertising issues.

2 Credit Rating Agencies Affirm AAA Rating For Now But Say More Action Is Needed On Deficit
Investing, Strategies, Steve Higgins
Both Moody's Investors Service and Fitch Ratings reacted to Tuesday's Senate passage of the debt ceiling agreement by affirming the United States' top credit rating. But both...

When Targeting Clients, Be Specific
Marketing, Client Communications, Stephen Wershing
Successful referral marketing begins with client segmentation. But, according to a recent study by Cerulli Associates, most financial advisors do not embrace formal segmentation.

Oops! The "30 Days Before" Wash Sales Rule
Investing, Strategies, Sheryl Rowling
In my recent posting, I gave an example of the "30 days before" aspect of the wash sale rules as follows:

Debt Deal May Not Cut Spending Enough To Avoid Downgrade Of U.S. Credit Rating
Investing, Strategies, Steve Higgins
While the major credit agencies declined to comment on the debt deal passed by the House Monday, some economists are saying a downgrade remains likely.

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Should iNvestOrs fear rising interest rates?

Andrew D. Martin, President | 7Twelve Advisors, LLC

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Bubble? You mean from all the money we've made on bonds lately?

Webcast: Preparing for the Burst of the Bond Bubble

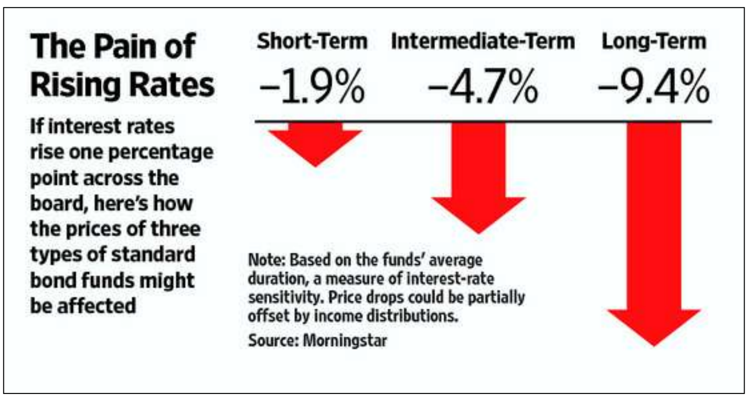
Tuesday, April 26th, 1pm EST, Please Register .

Thirty years of declining interest rates that pumped up bond returns have hit rock bottom. Higher rates and inflation are academic. Rates will rise, bond prices will fall. It may not happen tomorrow or next week, but it's coming. There are ways to protect portfolios in a rising interest rate environment.

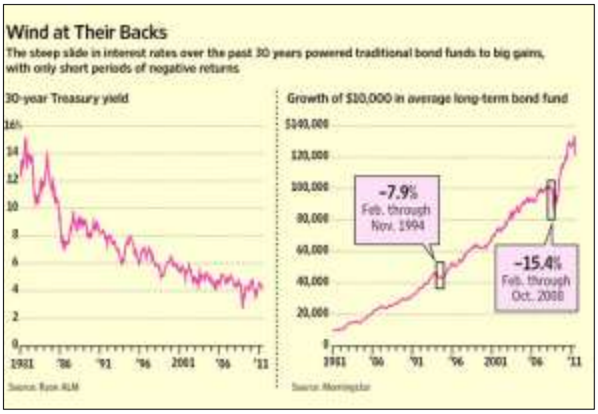
Join **Tom Lydon** , Editor of **ETF Trends** ; Joe Leary, US Treasury Rates Strategist at **CitiGroup Global Markets, Inc.** ; and Dan O'Neill, President of **Direxion Shares** , for this Webcast as they discuss how to:

- Protecting ideas for fixed income holdings
- Understanding the importance of hedging strategies
- Evaluate the right types of products to use for your strategy

Register here to attend our Webcast , **Tuesday, April 26th, 1pm EST** .



Happy landing!



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(Source: Merrill Lynch)

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Basic Price / Interest relationship

$10,000 bond face value, 10% coupon

Interest rate direction	Yearly interest	÷	Market interest rate	=	Bond value
⇔	$1,000	÷	10%	=	$10,000
⇧	$1,000	÷	12%	=	$8,333
⇩	$1,000	÷	9%	=	$11,111

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Malkiel’s Theorems

1. Theorem One: Bond Prices and Yields Move in Opposite Directions
2. Theorem Two: Long-Term Bonds Have More Interest Rate Risk than Short-Term Bonds
3. Theorem Three: Higher Coupon Bonds Have Less Interest Rate Risk
4. Theorem Four: A Bond's Sensitivity to Interest Rate Changes Increases at a Diminishing Rate as its Maturity Grows
5. Theorem Five: Capital Gains from an Interest Rate Decline Exceed the Capital Loss from an Equivalent Interest Rate Increase

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Theorem 5

Differentiating (2) with respect to i we obtain:

$$\frac{\partial P}{\partial i} = \frac{-C(1+i)^{N+1} + C(1+i+Ni) - FNi^2}{i^2(1+i)^{N+1}}.$$

Multiplying through by i/P (where we use expression (2) for P) and simplifying we obtain

$$(9) \qquad \frac{\partial P}{\partial i}\cdot\frac{i}{P} = \frac{-C(1+i)^{N+1} + C(1+i+Ni) - FNi^2}{C(1+i)^{N+1} - C(1+i) + Fi(1+i)}.$$

Let us write $\Delta(N) = (1+i)[C(1+i)^N - C + Fi]^2$ so that

$$(10) \qquad \frac{Fi}{(1+i)[C(1+i)^N - C + Fi]^2} = \frac{Fi}{\Delta(N)} > 0 \text{ for all finite } N.$$

Differentiating (9) with respect to C we obtain:

$$(11) \qquad \frac{\partial\left[\frac{\partial P}{\partial i}\cdot\frac{i}{P}\right]}{\partial C} = \frac{Fi}{\Delta(N)}\,[1 + i + (1+i)^N(Ni - 1 - i)].$$

When $N = 1$, (11) $= 0$. (11) is positive for all finite $N \geqq 2$ as will now be shown by induction. Write

$$\emptyset(N) = 1 + i + (1+i)^N(Ni - 1 - i).$$

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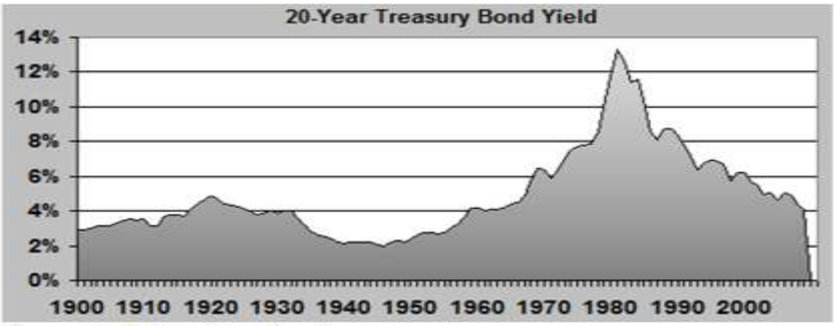
110 year history of interest rates



(Source: www.Crestmontresearch.com)

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The entire taxable bond fund universe, pre 1960 to present

Total Mutual Funds			26325	
Taxable Bond Mutual Funds			4227	16%
Incept < 1960			5	0.118%
Fund	Symbol	Incept	Morningstar Category	Type
DWS Core Plus Income S	SCSBX	4/24/1928	Int Term Bd	Corporate
Nicholas High Income I	NCINX	5/1/1930	High Yld Bd	Corporate
Northeast Investors	NTHEX	8/1/1950	High Yld Bd	Corporate
Putnam Income A	PINCX	11/1/1954	Int Term Bd	Corporate
Wells Fargo Advantage High Yld Bo	EKHBX	9/11/1935	High Yld Bd	Corporate

Predecessor funds may have had a different name.

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↑ 116%

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Higher rates? Lower rates? Does it really matter?

Market	Period	Interest rates	Annual returns
Bear	1963-1981	↑	4.15%
Bull	1982-2010	↓	7.85%

Comparison of average annual returns for an equally weighted portfolio of all taxable bond funds with inception dates before 1960 that are still in existence.

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The index case—

Interest rates rose 300 bps from 1976-1985

$ 10,000.00	1976-1985	Compounded Return
1976	15.60%	$11,560.00
1977	3.00%	$11,906.80
1978	1.40%	$12,073.50
1979	1.90%	$12,301.89
1980	2.70%	$12,635.07
1981	6.30%	$13,431.08
1982	32.60%	$17,809.61
1983	8.40%	$19,305.62
1984	15.15%	$22,230.42
1985	22.11%	$27,145.57
	109.16%	Cum. 10 yrs, non compounded
	171%	Compounded

Barclays Capital US Aggregate Bond Index

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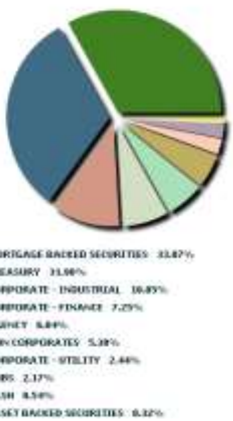
Have I mentioned diversification?

As of 07/29/2011



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1963-1981

20-Year Treasury Bonds compounded returns:

+27.4%

10-Year Treasury Bonds compounded returns:

+87.7%

Source returns data: James Keys, Ibbotson, Federal Reserve Bank, Aswath Damodaran, PhD

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Indexing may be enough

IT'S HARD TO BEAT THE MARKET—PARTICULARLY AFTER TAXES

Percent of active managers underperforming the index
(10-year return from 6/30/99 to 6/30/09)

MORNINGSTAR CATEGORY	BEFORE TAX (%)	AFTER TAX (%)
Large-Cap Blend	34%	53%
Small-Cap Blend	47%	71%
Intermediate-Term Bonds	88%	100%
International Blend	53%	77%
Emerging Markets	52%	71%

Sources: Morningstar, BCI, as of 6/30/09

Per the SEC's guidance, Morningstar uses the highest federal tax rate prevailing for each type of distribution. These results simulate the tax effects for an individual in the highest tax bracket. Actual tax costs depend on the investor's tax situation and may differ. **Past performance does not guarantee future results.**

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T Bills and Bonds 1950-1980

	Annual Returns on Investments		Compounded Value of $100*	
Year	*T.Bills*	*T.Bonds*	T.Bills	T.Bonds
1950	1.17%	0.43%	$124.34	$199.27
1951	1.48%	-0.30%	$126.18	$198.68
1952	1.67%	2.27%	$128.29	$203.19
1953	1.89%	4.14%	$130.72	$211.61
1954	0.96%	3.29%	$131.98	$218.57
1955	1.66%	-1.34%	$134.17	$215.65
1956	2.56%	-2.26%	$137.60	$210.79
1957	3.23%	6.80%	$142.04	$225.11
1958	1.78%	-2.10%	$144.57	$220.39
1959	3.26%	-2.65%	$149.27	$214.56
1960	3.05%	11.64%	$153.82	$239.53
1961	2.27%	2.06%	$157.30	$244.46
1962	2.78%	5.69%	$161.67	$258.38
1963	3.11%	1.68%	$166.70	$262.74
1964	3.51%	3.73%	$172.54	$272.53
1965	3.90%	0.72%	$179.28	$274.49
1966	4.84%	2.91%	$187.95	$282.47
1967	4.33%	-1.58%	$196.10	$278.01
1968	5.26%	3.27%	$206.41	$287.11
1969	6.56%	-5.01%	$219.96	$272.71
1970	6.69%	16.75%	$234.66	$318.41
1971	4.54%	9.79%	$245.32	$349.57
1972	3.95%	2.82%	$255.01	$359.42
1973	6.73%	3.66%	$272.16	$372.57
1974	7.78%	1.99%	$293.33	$379.98
1975	5.99%	3.61%	$310.90	$393.68
1976	4.97%	15.98%	$326.35	$456.61
1977	5.13%	1.29%	$343.09	$462.50
1978	6.93%	-0.78%	$366.87	$458.90
1979	9.94%	0.67%	$403.33	$461.98
1980	11.22%	-2.99%	$448.58	$448.17

*Base Year 1928
Source: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.htn[1]
The raw data for T Bond and Bill returns is obtained from the Federal Reserve database in St. Louis.
The T Bill rate is a 3-month rate and the T Bond is the constant maturity 10-year bond,
the T Bond return includes coupon and price appreciation.

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Why might this be true?

Best answer: *I don't know*

Next best answers: 3 P's

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3 P's

- Pragmatic
- Paradox
- Productivity

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Rising rates means rising income

Year	Nominal Rate	% Increase from year before
1963	4	
1964	4.19	4.75%
1965	4.28	2.15%
1966	4.93	15.19%
1967	5.07	2.84%
1968	5.64	11.24%
1969	6.67	18.26%
1970	7.35	10.19%
1971	6.16	-16.19%
1972	6.21	0.81%
1973	6.85	10.31%
1974	7.56	10.36%
1975	7.99	5.69%
1976	7.61	-4.76%
1977	7.42	-2.50%
1978	8.41	13.34%
1979	9.43	12.13%
1980	11.43	21.21%
1981	13.92	21.78%

Market yield on U.S. Treasury securities at 10-year constant maturity, quoted on investment basis

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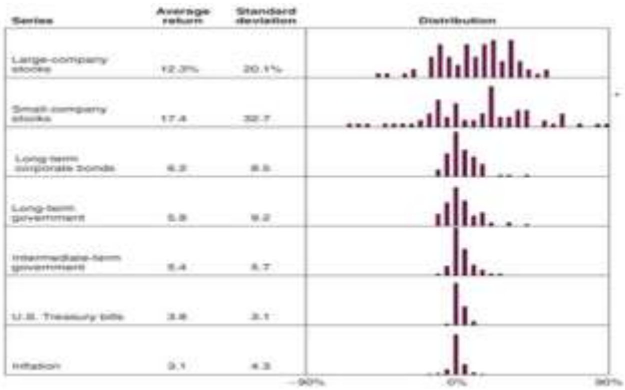
Higher historical size of returns = higher variable returns



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Blinded by science

Yield comparisons of 10 year Govt Bonds

Country	Rating	Yield
Australia	AAA	4.9%
Japan	AA-	1.1%

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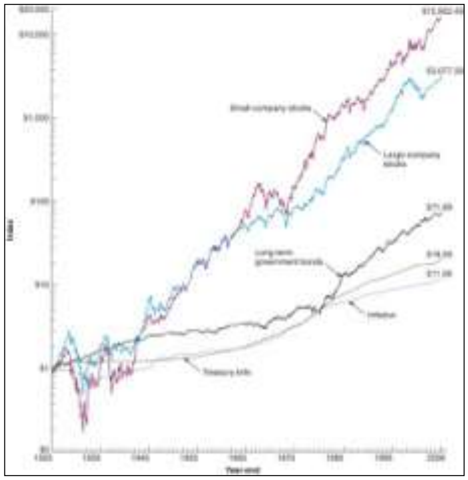
See anything bursting down there?



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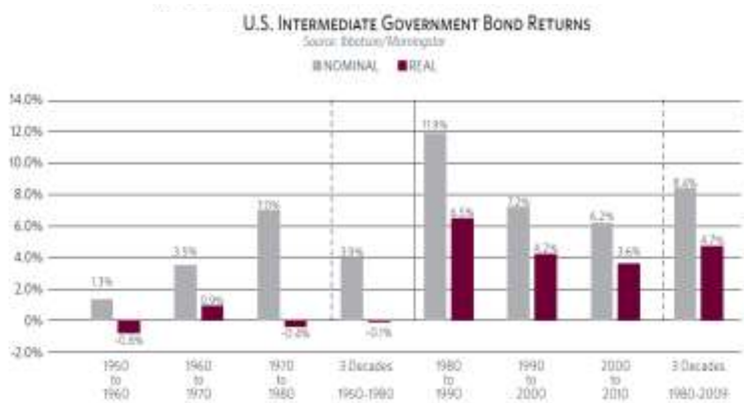
1950-2009



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Jevons Paradox

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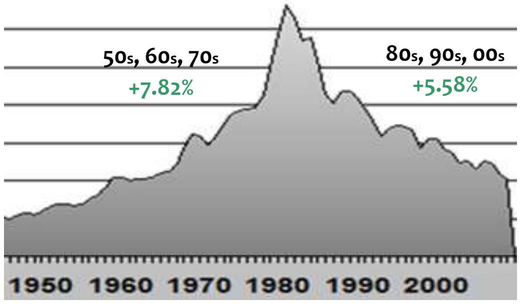

Source: http://www.data360.org/dataset.aspx?Data_Set_Id=508

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Starting to make sense?


THE WALL STREET JOURNAL.
WSJ.com

FUND TRACK | JULY 15, 2011

Money-Market Fund Assets Rise

By JOHN KELL

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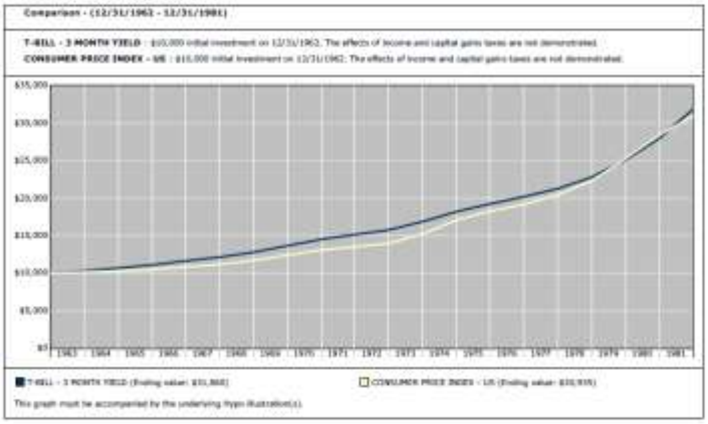
Bonds beat inflation too



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Thank you!

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