

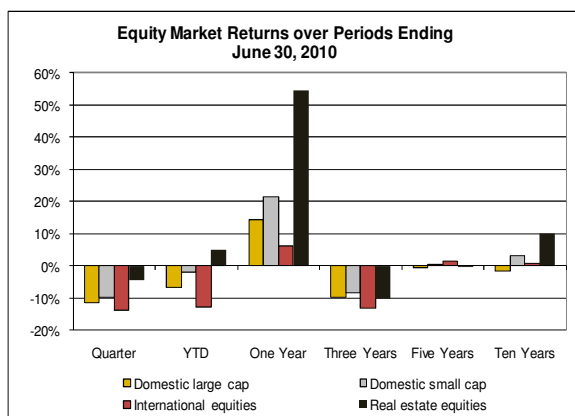
Capital Market Perspectives

JULY 2010

Equity Markets

All equity markets, especially international equities, reported losses in the June quarter. Over the year-to-date period returns in only the real estate market have remained positive, with the domestic large-cap, small-cap and international equity markets back in negative territory. Given the level of uncertainty associated with the oil spill in the Gulf, debt problems in some European countries and the pace of the economic recovery it is not surprising to see these results, especially in international markets.

More significantly, equity market returns have languished over longer time horizons. Returns



are distinctly negative over the three-year period and just about break-even over the five and ten year periods. In fact the S&P 500 is surprisingly negative over the last ten years. Here is some of what the ten-year numbers bring to mind:

- Regardless of all the talk from managements about seeking to add value for shareholders, in the aggregate over the past ten years those in charge of our largest 500 firms have added none.

- All the slicing, dicing and trading of financial assets by our best and brightest has not amounted to much.
- That there has not been a return for bearing risk over the past ten years says little about what to expect for the next ten years.

Bond Markets

Bond returns have been more robust in recent periods. Returns over several periods ending June 30, 2010 for the Citigroup 5-Yr. Treasury Index, which reflects interest rate risk only, and the Barclays Government/Credit Index, which reflects both interest rate risk and credit risk, are shown in the following table:

	Quarter	YTD	1 Year	3 Years	5 Years	10 Years
5-Yr. Treasury Index	4.6%	6.4%	7.9%	8.9%	5.9%	6.3%
Barclays Index	3.9%	5.5%	9.7%	8.5%	6.0%	3.8%
Inflation	0.0%	0.3%	0.5%	1.0%	1.8%	2.1%

Note that bond investments have provided investors positive inflation-adjusted returns over these periods. These results along with the fact that bond returns have not been correlated with equity returns explain why bonds are an important part of any well-diversified portfolio.

Over recent periods with short-term interest rates close to zero and the fluctuating demand for U.S. Treasury securities facing economic uncertainty, the realized return of bond portfolios can be quite different from these indices over short periods. The rapid shifts in the yield curve can produce sizable differences in results depending on the weighted average maturity of a particular portfolio. The longer the maturity the greater a given shift will have on the portfolio's return, and vice versa. ♦

RJR Associates Welcomes Interns

Three very enterprising individuals have joined RJR this summer as interns. We welcome their keen minds, fresh ideas and unique personalities to the RJR team:

Patrick Keegan – A University of Rochester student who will complete a dual major in Economics and Political Science next year, Pat is a quarterback on the school’s varsity football team and team captain. Pat spends most of his free time on the south end of Skaneateles Lake, fishing, skiing and sailing with his parents and 4 younger siblings.

Ruchika Sangani – A Columbia University junior in the fall, Ruchika is pursuing a degree in Engineering Management Systems with a minor in Economics. In her spare time she enjoys eating ice cream and playing tennis.

Atul Singh – Atul just completed his M.B.A. in Finance from Syracuse University. He



L-R: Atul Singh, Patrick Keegan, Ruchika Sangani

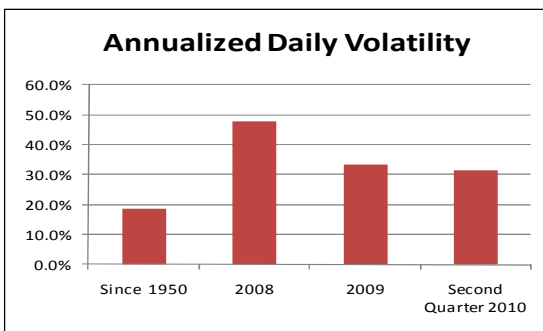
earned a Bachelor of Science in Statistics at Delhi University in India and a Diploma in International Marketing from the Delhi School of Economics. Atul has a passion for driving and as a boy believed he would become a train driver or a NASCAR/MotoGP race driver. He also loves animals and photography and will seriously consider wildlife photography as a post-retirement career. (Editor’s Note: Atul was honored as the best finance student and for exemplary academic achievement!) ♦

Volatility, Intrinsic Value and Random Noise

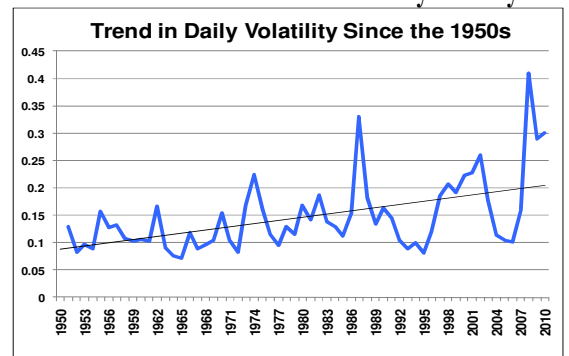
by Bob Ryan

Recent Volatility

Equity markets have been increasingly volatile of late. The chart below confirms this by showing the annualized standard deviation in daily returns of the S&P 500 over various periods, including the sixty years since 1950. Recent periods are almost at the levels we



saw during the financial crisis of 2008. Shown to the right is a chart of the trend in daily volatility since the 1950s. Especially



note the sharp peaks, which generally seem to be present in periods of economic uncertainty. The upward trend in the volatility is consistent with more and more people trading financial assets.

While somewhat distorted by the recent shenanigans of Wall Street institutions and traders, there is an extremely important economic role for capital markets. These markets are crucial in moving capital from

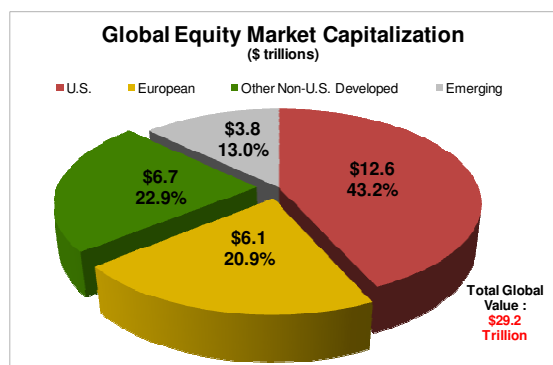
Investing in Europe

by Tom Benner

The debt crisis of Greece and other European countries has led to significant investor anxiety as reflected in the 23.8% MSCI EMU Index drop this year. Prices will stay lower until skepticism concerning the European Union's (EU) ability to bring its large fiscal deficits under control is ameliorated.

However, it makes little sense to abandon commitments to European stocks now. Market participants have already made a judgment about the impact of increased sovereign risk which is reflected in lower equity prices. Selling will lock in short-term losses and leave investors on the sidelines when prices recover, which frequently happens in unpredictable spurts.

Investors should instead spread their equity exposure across all European countries. Greece has less than 1.0% of Europe's total market capitalization while the entire European market comprises not much more than 20% of global stocks, as recapped in the chart below:



Investment results since 1970 have been similar for both domestic and international markets, including those in Europe. But the primary purpose for adding European and other international holdings to a domestic portfolio is for the diversification benefits which have made returns more stable and improved risk/return results

(Sharpe Ratio). Over the last 40 years the ratio increased from 0.22 to 0.24 by adding a 50% international allocation to a well-diversified U.S. portfolio, as seen in the following table:

Stock Markets	Annualized Average Return	Risk / Standard Deviation	Sharpe Ratio
U.S.	9.8%	18.5%	0.22
European	10.9%	24.7%	0.21
Non-U.S. Developed	10.2%	23.1%	0.19
50% U.S. & 50% non-U.S.	10.3%	18.9%	0.24

Correlations from 1970-2009 between movements of domestic and international markets were 0.72 (1.0 means perfectly in tandem), but this relationship has steadily increased to where both broad markets now tend to move almost in lock step (0.89 for the ten years since 2000, 0.94 for the five years since 2005). Although having exposure to both asset classes has not materially lowered portfolio volatility of late, the effect of European and other international currency fluctuations provides additional diversification benefits which helps reduce overall risk. And, it is not certain that correlations will remain this high indefinitely.

Fiscal anxieties can obfuscate the many reasons investors should stay the course in Europe. These include having the world's largest economy (as measured by GDP), a strong legal and regulatory system, liquid markets, and investment returns that provide offsetting stability to a U.S.-concentrated portfolio. EU budget deficits and spending issues will eventually get resolved which will lead once again to investor confidence. But markets will respond well ahead of improving conditions so serious investors should maintain their established allocation commitments to this important market. ♦

Volatility ... cont. from page 2

those who have it to those that want it. This capital has a cost – those who have it (investors) earn this cost (return); those who want it pay it. The role of secondary markets (e.g. the Stock Market) is to reduce this cost by providing liquidity, establishing value and allocating risk.

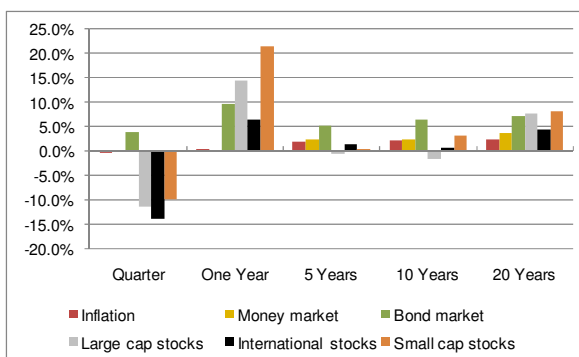
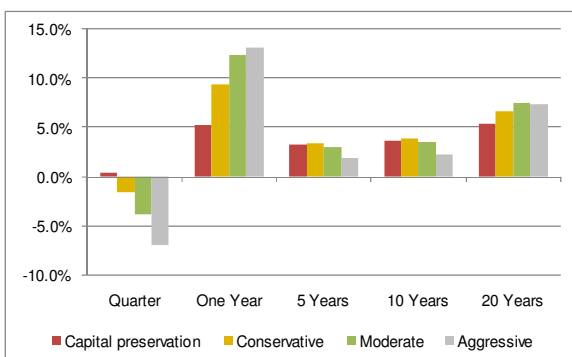
Intrinsic Value and Random Noise

Securities traded in capital markets are claims on real cash flow, not some sort of gambling chips. The intrinsic value of these securities is

the present value of the cash flows due to the holder of these claims. It doesn't seem reasonable that the intrinsic value of securities should fluctuate wildly daily. So what's going on? With all the active traders in the market there is always a wide difference of opinion, much of it whimsical, on the factors that determine value. Keep in mind we are dealing with cash flows long into the future – it doesn't take much of a change in these factors to have a dramatic impact on value. In the short run these changing opinions produce a lot of random noise in market values. Over longer periods this random activity is dampened and market results tend to move towards intrinsic value. ♦

Market Returns

We show returns over several periods ending June 30, 2010 from indices that are oftentimes used as proxies for individual markets as well as from diversified portfolios with differing risk profiles. The accompanying charts for periods ending June 30, 2010 are reasonably consistent with these expectations – long-term results from international markets being the outlier. ♦



We welcome your comments:

Bob Ryan: rryan@rjassociates.net

Tom Benner: tbenner@rjassociates.net

Serving the investment needs of individuals, institutions, foundations and endowments

RJ Associates Inc.
AN INVESTMENT MANAGEMENT FIRM

Syracuse: 315.476.8200 • Rochester: 585.383.5432

www.rjassociates.net

101 S. Salina Street • Suite 750 • Syracuse, NY 13202