The Lam Group
Investment Management

<u>The Lam Group Newsletter Vol. 12, No. 1</u>
Autumn 2012

- The Big Picture: The 25th Anniversary of Black Monday
- The Lam Group: The Wisdom of Experience
- Asset Class Investment Results

The Big Picture: The 25th Anniversary of Black Monday

Hopefully all our readers are old enough to remember that Monday October 19th 1987 was a difficult day in the global equity markets. The S&P 500, which closed at 282.70 on the previous Friday, declined over 20% on that Monday.

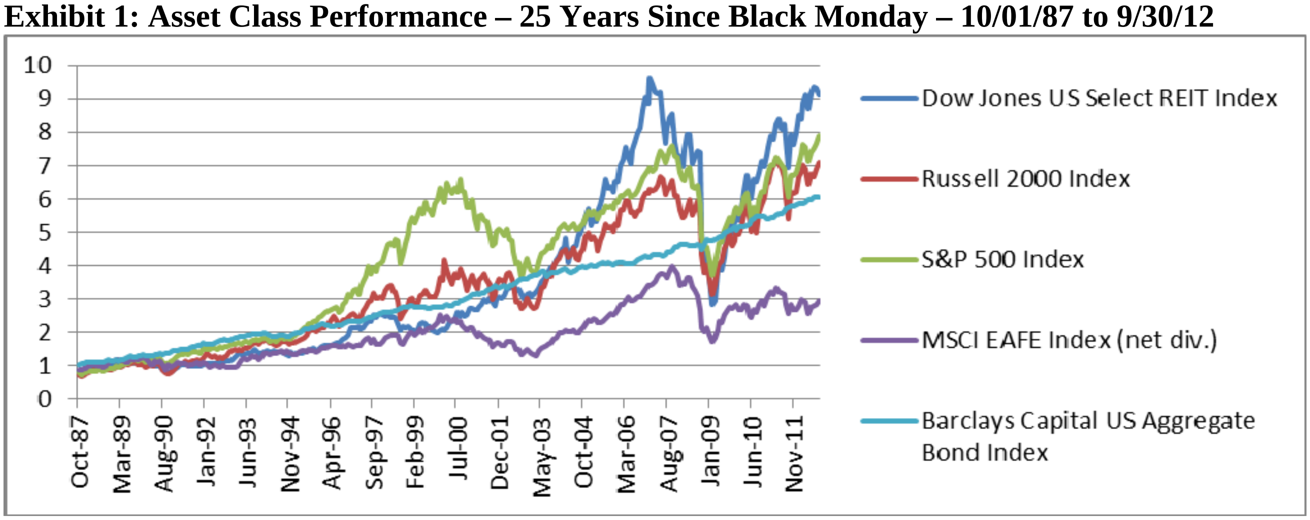
While media pundits were not as prominent or powerful as they are today (CNBC and the internet did not yet exist), by December 1987, a group of 22 preeminent economists from around the world met in Washington DC and collectively predicted:

The next few years could be the most troubled since the 1930s

In the 12 months following the crash, predictions of an impending decade-long global recession due to a worldwide economic slowdown were pervasive.

At that time, the largest one-day decline in the stock market placed investors in uncharted territory and questioning whether there was something fundamentally unusual about the causes of the crash. Program trading, issues of global liquidity and disagreements amongst Central Banks regarding monetary policy were cited as contributing causes to the crash and panicked calls of “this time is different” were widespread. In hindsight the problems over the past 25 years seem so familiar.

Exhibit 1: Asset Class Performance – 25 Years Since Black Monday – 10/01/87 to 9/30/12



Only asset classes illustrated are ones with full data series available for 10/01/87 to 9/30/12 period

The markets have recovered nicely since October 1987 and while it seems like a long time ago, the last 25 years contain many lessons. As Mark Twain once said:

History doesn't repeat itself, but it rhymes

Here are some of the highlights of our most challenging market events over the last 25 years:

Three significant financial meltdowns:
- S&L crisis in 1989/90
- Long Term Capital Management hedge fund crisis in 1998
- Global financial crisis in 2008

Three sovereign defaults/debt restructurings:
- Russia in 1998
- Argentina in 2001
- Greece in 2011/12

Two domestic terrorist attacks:
- World Trade Center bombing in 1993
- 9/11 attack in 2001

The discovery of two (at least) multi-billion dollar investment frauds:
- Enron in 2002
- Madoff in 2008

Adding to global volatility and the ensuing unrest over the last quarter century were the Asian contagion currency crisis in 1997, the repeal of the Glass-Steagall Act in 1999, the bursting of the internet bubble in 2001/02 and the war in Afghanistan/Iraq that began over 10 years ago.

It is worth noting that many good things have happened over the last 25 years. Personal computers, smartphones and easy internet access have become commonplace and the productivity gains these technologies have allowed have made the markets more global, economies more interconnected, and ultimately, the world has become smaller. As Table 1 illustrates, a long-term investment horizon and the mathematics of compounding have been important factors in the growth of wealth despite the occasional crisis.

Table 1: Asset Class Return & Risk Data – 25 Years Since Black Monday – 10/01/87 to 9/30/12

EQUITY ASSET CLASSES	**Annualized Return**	**Total Return**	**Standard Deviation**
S&P 500 Index - Domestic Large Cap Stocks	+ 8.60%	+687.41%	15.60%
Russell 2000 Index - Domestic Small Cap Stocks	+ 8.16%	+610.39%	20.22%
MSCI EAFE Index - International Large Cap Stocks	+ 4.39%	+192.44%	17.87%
DJ US Select REIT Index - Domestic Real Estate	+ 9.25%	+813.83%	19.74%
FIXED INCOME ASSET CLASSES	**Annualized Return**	**Total Return**	**Standard Deviation**
BarCap Aggregate Bond Index - US High-Grade Bonds	+ 7.47%	+505.76%	3.88%

Only asset classes illustrated are ones with full data series available for 10/01/87 to 9/30/12 period. Source: Morningstar.

While every crisis brings cries of "this time is different" and the widespread fear that the financial system will fail, the major meltdowns of the last quarter-century have proven the long-term resiliency of the global markets, and that forays into "uncharted territory" have often been the market's most reliable buy (or at least portfolio rebalancing) signals.

Unfortunately, during times of high market volatility, many investors tend to decrease their exposure to risky investments at precisely the time when all the bad news has been fully reflected in the price of these investments.

To avoid making this kind of mistake, an intelligent investor must have a portfolio asset allocation plan (or Investment Policy Statement) that **truly** reflects that investor's tolerance for risk using a realistic investment horizon. While no investor enjoys the negative emotions that volatile markets can bring, it is often the investor with an inappropriate (or too aggressive) portfolio risk profile who panics during difficult times. The formulation of an investor's initial asset allocation plan is the most important step in the investment management process and must be contemplated unemotionally, with realistic expectations, and with the benefit of a long-term historical perspective.

Seldom does a change in the global markets or world circumstances indicate or require a fundamental change in investment philosophy if a properly-diversified and balanced strategy is already in place.

Being an intelligent investor also requires experience and a belief that there is a fundamental relationship between risk and return and that when prices go down, the expected future return should go up. While an investment in an individual stock or bond can go to zero, investments in broadly-defined asset classes cannot. This is the beauty and benefit of asset-class investing.

Changes in markets, particularly those brought on by crisis, are best handled dispassionately in the context of disciplined portfolio rebalancing towards long-term asset allocation targets. *Having long-term allocation goals makes buying low and selling high a portfolio discipline rather than a trite slogan.*

Does it ever make sense to allow circumstances to change one's investment philosophy?

The answer is: when there is **a change in the investor's personal circumstances** such as a change in employment status, a change in marital status and/or a change in family circumstances.

These sorts of circumstantial changes can bring uncertainty into an investor's life and cloud the investment horizon. From an investment management standpoint, these life changes/events usually require the reassessment (often lowering) of the overall risk in a portfolio's investment policy.

Reducing portfolio risk can include shortening of investment time horizon, increasing allocations to less risky assets, and/or increasing portfolio liquidity and income capabilities.

Of course, positive changes in personal circumstances such as liquidity events (IPO or company sale), getting a more prosperous job, and/or family inheritance can lead to the need for a more aggressive investment policy that allows for a longer investment horizon and a higher overall tolerance for risk.

Changes in personal circumstances can be critical turning points and are important to acknowledge. The resulting changes to an investor's long-term asset allocation plan are best implemented carefully and deliberately, and if possible, during times of market serenity.

The Lam Group: The Wisdom of Experience

In 1987, Japan was the Asian giant that was widely thought be to the next dominant economy. Sony was as ubiquitous as Apple is today. And the purchase of prized American assets (such as Pebble Beach and Rockefeller Center) by Japanese investors in the late 1980s and early 1990s were illustrative of Japan's robust economic strength and growing global influence.

Presently, nobody believes Japan is going to dominate much of anything, and China is now the new Asian giant. It is anyone's guess if China will really be the next Japan.

While new technologies and increased globalization can change and often improve our lives, the fundamental relationship between risk and reward remains intact. This risk/return relationship gives investors the opportunity to take risks that can ultimately lead to return. By the time Japan and China were widely viewed as the next global growth engines, the investment performance of these countries had already peaked.

In the next 25 years, it is possible the next global market leader will not be a country that is widely or currently believed to be strong or safe. Historically the risk/return relationship has rewarded investors who took risk, not those who followed the consensus.

This year, I celebrated my 30th college reunion at Tufts and my 25th business school reunion at Wharton and I feel obviously older and fortunately wiser than I did as a younger man. In the investment management profession, experience matters and the lessons learned over the last 25 to 30 years allow our firm to navigate volatile times with less emotion, a greater appreciation of historical events, and more discipline.

We approach the end of the year with the uncertainty of next month's Presidential Election all but upon us. Hopefully the resolution of this uncertainty will give way to clarity with regard to tax rates and policy changes before year end.

The Lam Group focuses on designing and managing balanced and globally-diversified investment portfolios. Our asset allocation approach employs a highly-analytical process to determine the appropriate combination of asset classes to build investment portfolios and strategies that realistically reflect the needs, risk tolerances, and investment horizons of our clients.

Our Firm has been structured to provide our clients with an investment management relationship that enjoys the highest degree of transparency and avoids conflicts-of-interest. This transparency, combined with the intellectual honesty of using passively-managed asset classes in our asset allocation strategy, is the foundation of our overall investment philosophy and approach.

The Lam Group is an independent, fee-only, SEC-registered investment advisory firm based in Lake Oswego, Oregon. We offer both investment management and portfolio consulting services for taxable investors, family offices, endowments and foundations.

Nelson J. Lam
The Lam Group, Inc.
P.O. Box 850
Lake Oswego, OR 97034
October 19, 2012

Asset Class Investment Results:
All portfolios constructed and managed by The Lam Group are designed for an individual client's specific risk tolerances, income requirements and investment horizon. Our investment management approach includes the design of a customized asset allocation plan, the research and selection of the most appropriate and cost-effective asset class investments for the client's specific investment policy, and the on-going monitoring and disciplined rebalancing of the aggregate portfolio to optimize return, manage risk and minimize taxes.

As different clients have different goals, risk profiles and investment horizons, it is not useful to publish a track record of specifically-managed portfolios. The investment performance data below illustrate the returns of some of the actual mutual funds utilized by The Lam Group for specific asset class allocations in the construction of investment portfolios we manage.

All data is as of 9/30/12

Equity Asset Class Category	**3Q 2012**	**2012 YTD**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Total Equity Market				
-DJ US Total Market Index	***+6.09%***	***+16.12 %***	***+13.29%***	***+1.00***
Domestic All Cap Fund	+6.58%	+15.37%	+13.22%	+0.99
Domestic Large Cap Stocks				
-S&P 500 Index	***+6.35%***	***+16.44%***	***+13.20%***	***+1.00***
Domestic Large Cap Value Fund	+8.79%	+17.88%	+12.52%	+0.98
Domestic Small Cap Stocks				
-Russell 2000 Index	***+5.25%***	***+14.23%***	***+12.99%***	***+0.95***
Domestic Small Cap Value Fund	+7.41 %	+16.18%	+13.10%	+0.94
Real Estate Investment Trusts (REITs)				
-DJ US Select REIT Index	***-0.38%***	***+14.47%***	***+20.52%***	***+0.81***
Domestic REIT Fund	-0.08%	+14.61%	+20.54%	+0.82
-S&P Global REIT (ex-US)	***+9.26%***	***+24.22%***	***+ 9.96%***	***+0.89***
International Real Estate Fund	+8.57%	+24.43%	+10.91%	+0.88
International Large Cap Stocks				
-MSCI EAFE Index	***+6.92%***	***+10.08%***	***+ 2.12%***	***+0.92***
International Large Cap Value Fund	+7.33%	+ 8.08%	- 0.23%	+0.93
International Small Cap Stocks				
-MSCI Small Cap EAFE Index	***+7.89%***	***+13.20%***	***+ 4.75%***	***+0.88***
International Small Cap Value Fund	+8.21%	+12.46%	+ 2.43%	+0.90
Emerging Markets Equity				
-MSCI Emerging Markets Index	***+7.74%***	***+11.98%***	***+ 5.63%***	***+0.86***
Emerging Markets Value Fund	+7.22%	+11.47%	+ 3.23%	+0.86

Source: Morningstar, JP Morgan, PIMCO and DFA.

* 5 yr correlation using monthly data

All data is as of 9/30/12

Fixed Income Asset Class Category	**3Q 2012**	**2012 YTD**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Investment Grade Bonds				
-Barclays 1-3 year Govt Bond Index	***+ 0.26%***	***+ 0.44%***	***+ 1.49 %***	***-0.33***
Short Duration Domestic Inv. Gr. Bond Fund	+ 1.66%	+ 3.95%	+ 4.13%	+0.48
Short Duration Domestic Muni Bond Fund	+ 0.24%	+ 0.82%	+ 1.65 %	-0.04
-Barclays Aggregate Bond Index	***+ 1.58%***	***+ 3.99%***	***+ 6.17%***	***+0.09***
Domestic Investment Grade Bond Fund	+ 3.15%	+ 9.09%	+ 7.69 %	+0.35
Domestic High Yield Bonds				
-Barclays High Yield Bond Index	***+ 4.53 %***	***+12.13%***	***+12.90%***	***+0.76***
High Yield Bond Fund	+ 4.59%	+12.52%	+11.82%	+0.84
Inflation-Linked Bonds				
-Barclays TIPS Index	***+ 2.12%***	***+ 6.25%***	***+ 9.29%***	***+0.26***
TIPS Fund	+ 2.46%	+ 6.79%	+10.10%	+0.26
-Dow Jones UBS Commodities Index	***+ 9.69%***	***+ 5.63%***	***+ 5.26%***	***+0.60***
Commodities-Linked Fund	+12.10%	+11.77%	+12.71%	+0.62
International (non-US $) Bonds				
-Citigroup Non-$ World Govt Bond Index	***+ 3.98%***	***+ 3.96%***	***+ 4.02%***	***+0.31***
Non-$ Bond Fund	+ 2.16%	+ 3.58%	+ 3.28%	N/A
Emerging Markets Debt				
-JP Morgan EMBI Global Diversified Index	***+ 6.64%***	***+14.24%***	***+11.83%***	***+0.66***
Emerging Markets Debt Fund	+ 5.96%	+12.92%	+11.73%	+0.68

Source: Morningstar, JP Morgan, PIMCO and DFA.

* 5 yr correlation using monthly data

Disclaimer:
Opinions and views expressed in this newsletter and on the www.thelamgroup.com website are solely those of the author and are subject to change based on market and other conditions. These materials, including the mention of individual securities and mutual funds, are provided for informational purposes only and should not be used or construed as a recommendation or solicitation to buy or sell any security, fund or sector. Neither The Lam Group, Inc. nor any of its data or content providers (such as Morningstar and Dimensional Fund Advisors) shall be liable for any errors in the content, or for any actions taken in reliance thereon. All data provided by The Lam Group, Inc. is based solely upon research information provided by third parties. The Lam Group, Inc. has not reviewed, and in no way endorses the validity of such data. The Lam Group, Inc. shall not be liable for any actions taken in reliance thereon. Past Performance is no guarantee of future results.