MV Capital Management E-Update

Market Timing's Siren Song

April 19, 2007

In Greek mythology the Sirens were sea deities who lived on an island surrounded by rocky shoals and dangerous currents. The Sirens would play enchanting music to lure the crews of passing ships, who would of course perish on the shoals as they approached. In Homer's epic *The Odyssey* the hero Odysseus is curious to hear what this seductive music sounds like but is also disciplined enough to know the peril. So he orders his crew to put wax in their ears so as not to hear, tie him to the mast and sail past the Sirens' island. When he hears the sweet melodies of the harps a crazed Odysseus screams at his crew to untie him from the mast, but of course they don't hear anything and sail on until he is out of danger.

What got us thinking about Greek mythology? Well, we were looking at numbers this week and noticed something that took us back to 1999. On December 31, 1999 the S&P 500 closed at 1469.25. This past Wednesday April 17, for the first time since 2000, it closed above 1470 (1471.48 to be precise). That's right – a capital appreciation of 0.15% for a seven year, three month and 17 day holding period! That got us trading stories about life back when everyone and his little sister was a stock market expert. Ah, the sweet Siren song of day trading, market timing and Internet stocks. We couldn't pass up the opportunity to share it with you!

The history of investing is littered with the debris of market timing and the madding of crowds. And yet history always manages to repeat itself. We call this the Cocktail Party Theory of Investing. Rational value-maximizing may be all well and good, but having a good cocktail party story about your feats of investment brilliance – well, that does untold wonders for our psyches.

Picture New Years Eve, 1999 (yes, this may be embarrassing for some!). Andy, gesturing wildly with a glass of 15 year old Glenmorangie single malt in one hand and Romeo y Julietta cigar in the other, is loudly explaining how he just "got in" to Global Crossing and Juniper and Pets.com. Explosive! To the moon! He turns to Barbara, a rather quiet type nursing a Madeira sherry, and barks: "So what are you in?" Barbara mumbles: "Well, I sat down with my financial advisor the other day and he explained the value of patience and discipline, so I've diversified into large cap value and small cap growth and international and…" by which point Andy is already crowing about his market smarts to someone else (and losing half his Glenmorangie on the carpet) and Barbara realizes she is talking to herself.

Like Odysseus, we sometimes have to figuratively tie ourselves to the mast to resist the Siren call of market timing. How would Andy and Barbara have done had they both gotten into their respective strategies right at the end of 1999? Well, on a total return basis the S&P 500 returned an annual average 1.18% from January 1, 2000 to March 31, 2007. The Nasdaq Composite returned a dismal -6.22% annual average for the same period.

Let's assume Barbara wanted to stay in all equities and her advisor helped her to (yawn) prudently diversify – as a hypothetical example 25% large cap value, 17% large cap growth, 16% small-mid value, 10% small-mid growth, 15% developed international, 5% emerging markets, 5% real estate and 5% commodities (Andy would fall asleep just listening to that boring recitation). Based solely on their respective index benchmarks* this diversification would have produced a 7.43% average annual over the same time period.

Ah, but in hindsight that was a terrible time to come into the markets! What about a more favorable period? Say, January 1, 1995 – December 31, 1999? Well, the results would have been quite different! For that period the S&P 500 returned an average annual 28.55%. Nasdaq blew out a whopping 40.22%. Whoo-hoo! Poor boring Barbara with that same diversified (hypothetical) portfolio would have had to make do with a modest19.93%.

But if Barbara had kept herself tied to the mast during the 1999 Siren song (and the fear-induced panic of 2002) that same hypothetical allocation would have returned an average annual 12.37% from January 1995 to March 31,2007. By comparison the S&P 500 returned 11.57% and the NASDAQ 10.51% for the same period.

And if she gave into the hype and jumped in the hot tub with Andy - switching out of the diversified portfolio into Nasdaq stocks at the height of the frenzy? Well, if you take the returns for the hypothetical allocation from 1995 to December 1999 and then the Nasdaq Composite returns from 2000 – March 2007 the average annual hypothetical return for the full period would be 3.69%. In real life it would be worse on account of transaction costs, taxes, fees and the like.

Market timing is the playground of fear and greed. Diversification is how we stay patient and disciplined. And if we really need to have a good story for cocktail parties? How about this one: "The markets crashed but I didn't do so badly". Surely that counts for something?!

With warm regards,

Masood Vojdani — President

Katrina Lamb, CFA — Senior Investment Analyst

* For all calculations we used returns data from Zephyr StyleAdvisor. As proxies for the asset classes mentioned we used Russell 1000, Midcap and 2000 style-based indices, MSCI EAFE index for international stocks, S&P Emerging Markets (Investable) Composite, Dow AIG Commodities Index, and Dow Wilshire REIT (Full-cap) Index for real estate. Indices are not directly investable. Returns for indices do not include fees, transaction costs, taxes or other expenses. The hypothetical returns shown do not relate in any way to the performance of any actual past or present MVCM portfolio. Past performance is not a reliable measure of future returns.

MVCM 2007 0006
DOFU: April 2007

MV Capital Management, Inc.
4520 East West Highway, Suite 400
Bethesda, MD 20814
www.mvfgroup.com
(301) 656-6545 tel
(301) 656-2722 fax