ANALYTICS INVESTMENT ADVISORS, LLC

Risk Return and Risk Management

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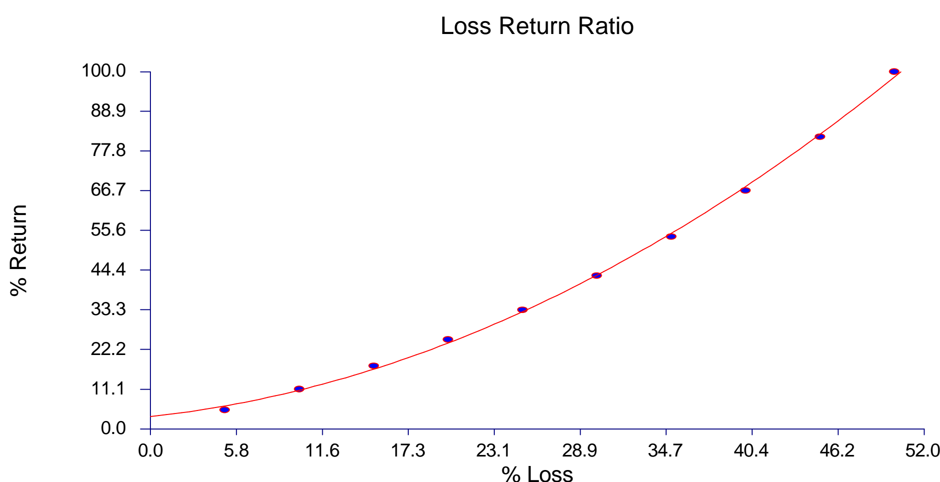
The economic environment will be challenging for many asset classes in 2010. Witness for example the market volatility in January, which resulted in the biggest loss for the Dow (-3.4%) since the final sell off of the bear market last February. This occurred in spite of a robust rebound in GDP of 5.7% in the fourth quarter (4.7% was projected).

Much of the recent volatility appears to have been created by political uncertainty, monetary and fiscal policy inconsistencies, and the delayed confirmation of Ben Bernanke as Chairman of the Federal Reserve System. Of major concern is the growing national (public) debt, which increased from $5.8 trillion in 2008 (41% of GDP) to $8.5 trillion in 2009 (60% of GDP). At this rate, the national debt will reach 85% of GDP by 2018, clearly a cataclysmic level. A recent Wall Street Journal NBC News poll noted that 70% of those surveyed agreed that the government is unhealthy and/or in need of large reform.

Regardless of market conditions, however, it is wise to have a smart defensive strategy, which we believe to be preventing small losses from turning into large losses. Simply put, the larger the loss, the more it takes to get back to break-even. For example, while it requires an approximately 18% return to recover from a 15% loss, a 50% loss necessitates a 100% rebound to break-even.



It is because of this phenomenon that we recommend our clients make consistent use of stop/loss orders. This technique is particularly effective with Exchange Traded Funds (ETF's) due the relatively few number required for adequate asset allocation, and their comparative lower volatility relative to individual issues. While the method of calculating the appropriate level of stop/loss varies (standard deviation or moving averages, for example), a 15% level is common. This subject will be expanded in next month's commentary which will examine the rationale for the ETF sectors deemed to be propitious for investing at this time.