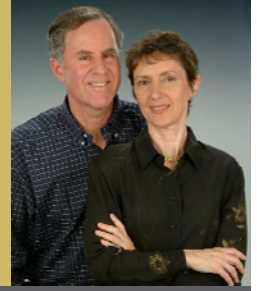


BONDS

Scarsdale Investment Group, Ltd. The All Bond Newsletter



October 2009

Lessons Learned from Ivy League Investing

Summary:

Liquidity Matters: How easily can I exit this investment?

Transparency Matters: Do I really know what I am investing in?

Risk is real: After reading the risk section of the prospectus, and understanding that the negative outcomes are possible, am I willing to proceed with this investment?

Predictability Matters: Can I ascertain with any certainty what the future outcome of this investment might be?

Bonds Matter: Can your financial and life objectives be satisfied with an investment in high quality bonds?

Everyone wants to invest like the Harvard Endowment and the other Ivy League schools so that they can achieve 15 percent or more yearly returns. After the worst financial crisis since the great depression and reported one-year losses of 25 to 30 percent, what lessons have the Ivy League endowments learned?

Here is how the Ivy League endowments were positioned. The Harvard Endowment's approach to investing, calls for broad diversification across all asset classes. That includes placing funds in equities (domestic and foreign), fixed income and real assets such as commodities and real estate. In addition, to pick up the opportu-



nity for big gains, there was also a heavy allocation to nontraditional asset categories that included hedge funds and private equity as well as emerging-market equities and debt, energy and commodities.

Individual investors who tried to mimic the Harvard Endowment

generally suffered losses around 30 percent in the 2008-2009 fiscal year. The University of Pennsylvania's Endowment did better than Harvard's because the University of Pennsylvania had 15 percent of its funds invested in Treasury bonds, which appreciated and provided liquidity.

Take-Aways from the Ivy League Playbook

Liquidity matters. To gain exposure to higher yielding assets, the Ivy League Endowments invested in illiquid hedge funds and private equity. However, when the Endowments needed cash and wanted to sell these investments, they couldn't. In addition, many of their private equity funds made cash calls when the Endowments were short of cash. In order to raise cash, Endowments had to sell their most liquid assets - Treasury bonds and municipal bonds - and borrow cash in the capital markets.

Transparency matters. It is important to know - really know - how your funds are invested. When you purchase mutual funds or Exchange Traded Funds it is important to look under the hood of the investment vehicle and understand what you are buying. Though you might not want to be bothered reading the 'Risk' section of the prospectus and the semi-

annual reports, that is the only way you will know what risks the investment vehicle is taking with your money. The use of leverage, variable rate bonds, swaps and derivatives create unknowns. It would appear that even the most sophisticated investors do not really understand how these very complex instruments work in exceptional markets.

Risk is real. Since you are not Harvard or a university, you cannot go to your donors and alumni to ask for unrestricted gifts to make up your shortfall from your failed bets. It is important to be aware of what you are willing and able to lose, and when a loss may be too painful. If you don't have a trust fund, a parent or a friend who will bail you out, then you might want to have some safe money invested in bonds.

Predictability matters. Bonds enable you to foresee a stream of income and return of principal. Having high quality individual bonds in your portfolio provides liquidity in times of turmoil. Bonds provide growth if you reinvest the income. In fact, if you just invested in high quality individual bonds between June 2008 and June 2009, instead of facing losses of 30 to 40 percent you would have gains. Our municipal bond portfolios invested in very conservative bonds provided aggregate average returns of about 50% in the last 7.5 years. In

To learn more
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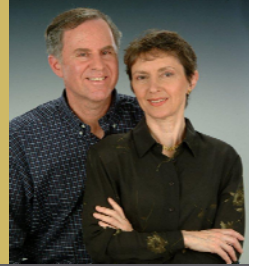
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Summary:

Read the poem, "Joe Heller," yourself:

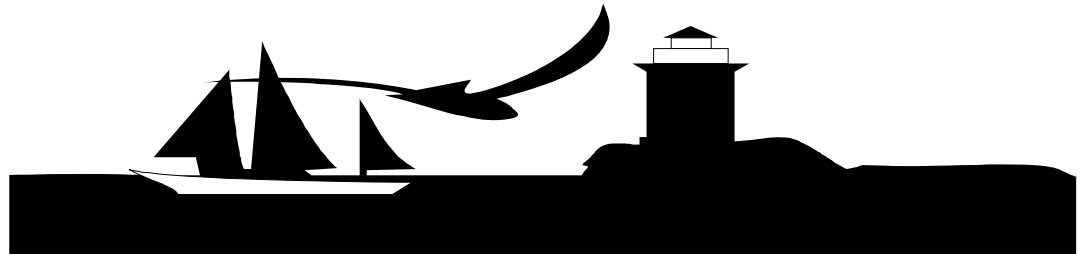
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kurt_vonnegut_a.html](http://bobsutton.typepad.com/my_weblog/2007/02/kurt_vonnegut_a.html)

case you think that is spectacular, it was only compounded interest at 4.5 percent. Disclaimer: Past performance may not be repeated in the future.

What to do now?

We live in an "I need more," economy. The media encourages us to consume more to support the economy, yet we are told to save money to help the economy.

This is a Catch-22, as Joseph Heller might have said in his novel by the same name. In his book Enough, John Bogle



describes the following story. Kurt Vonnegut, in a poem entitled, "Joe Heller" told of the time when he and Joe were at a party at a billionaire's house. Vonnegut described how he asked Joe how it felt to know that the host might make more money in one day than Joe made from his famous novel. He replied that he had something the billionaire would never have – enough!

If you want to get off the treadmill, consider what 'enough' might mean to you. Can you achieve that by investing in bonds? Will having a re-investable cash flow during your working years that can cushion unexpected life events give you comfort? Can you envision the outcome if the bond income compounds over your lifetime? Would you miss the stock market gyrations if your survival no longer depended upon the market rising? Are you playing the same old tape, or are you ready for something new? What is enough?

Important Disclosure Information

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