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## Not October 2008

**The stock market peaked on April 30 of this year and has steadily declined since, with the move to the downside accelerating in the first few days of August. The 500 point decline on Thursday had all the look and feel of the collapse in 2008.**

In our view, we are not going to see a repeat of those calamitous days.

In 2008 we witnessed the end of an unprecedented run up in the price of real estate. The prodigious leveraging that had taken place, and the failure of Lehman Brothers, put the entire financial system at risk. While the debt built by governments around the world is, and should be, of great concern, we do not believe it represents an immediate threat to the financial system that warrants the level of market contraction that has already taken place. Corporate profits remain strong, world economic growth is anemic but positive, and many of the headwinds that proved troublesome in the spring are abating, particularly oil, gas, and other commodity prices.

Markets such as the one we now find ourselves in are characterized by rapidly changing preferences on the part of investors, and rapidly rising correlations across the stock market. What drove stock prices early in the year, earnings and sales growth, is quickly abandoned in favor of stocks with low valuations, high dividends, and high quality balance sheets. As panic sets in, less and less discrimination on the part of investors takes place as “sell the market” becomes a battle cry. All stocks tend to move together, creating an environment where adding value is increasingly difficult.

We, however, have found alpha in two areas. As the market peaked in April, relative valuations and market preferences had shifted to larger capitalization, lower valuation stocks. The market cap of our Core Plus strategy moved up from \$20 billion to \$80 billion, materially lowering the volatility inherent in the portfolio. At the same time, the relative over-valuation of small and mid cap stocks was evident in our short portfolio. The market cap of the short actually declined to \$3.5 billion. In a falling market small cap stocks generally underperform large cap stocks. Our portfolio was set up to cushion some of the fall. Finally, with investor

preferences shifting to defense, our dynamic model placed more emphasis on valuation. At the end of July, the Core Plus Strategy had an average price to earnings ratio of just 12.3 versus the Russell 3000 at 17.6, and at the same time moved into companies that were twice as profitable. Our portfolio had a return on equity of 40.8% versus the Russell 3000 at 20.46%.

March 9, 2009 will go down in history as one of the best buying opportunities in history. While it is impossible to “pick a bottom” we believe patient investors are once again going to be rewarded. Painful as that approach may sound.