

**Our prediction for 2011:
Wisely allocated investors will sleep well.**

The economy will remain weak this year, barely mustering 2.7% GDP growth. No, forget that. GDP will soar to 4.0% – the best performance in a decade. No, no it won't. The economy will grind to a virtual halt: somewhere between absolute zero and 2.0%.

These are not off-the-cuff comments by analysts throwing darts in a bar. They are intensely-researched predictions – all made within a month of each other at the end of last year – by respected economists. The best and brightest of Wall Street, government and academia all looked at more or less the same data and came to different, highly subjective conclusions.

It's the same story in the equities market. One panel of experts predicts an 11% rise in the S & P index this year – easy. Others “sense” a painful 10% correction. Still another panel bravely anticipates an increase “between 7% and 17%.” Most are bullish (as always), some worry the worst isn't over (as always). So-called “hot sectors” for this year range anywhere from energy to Indonesian agriculture... small cap healthcare to big technology.

What should all this contradictory wisdom portend for your investment strategy?

In a word: nothing.

The fact is, nobody knows what the economy – or stocks – will do this year. No one. Your investment strategy should neither anticipate, nor depend upon, what the Fed does... whether Congress gets anything of value done this year... whether the housing market rebounds... or what sectors get hot. Over the long term, a correctly-diversified portfolio trumps any and all short-term phenomena. This has been true for many decades and – barring an alien takeover of Earth – will remain so.



By far the most refreshing statement of the Prognostication Season was made by analyst Paul Goodwin. After forecasting a global economy that is “gathering strength,” but warning of a U. S. market correction and continued sluggish business spending, Goodwin finished his piece thusly:

“I personally would not invest a dime based on my predictions, *nor those of any other fearless prognosticator*. I prefer the nice, grounded feel of reality under my feet when I follow the market... rather than trying to get ahead of it.”

That’s a view we strongly endorse.

The only proven-successful investment approach for this year is the same as it was for last year... and should be for every year going forward. Do not predict: *plan*. Allocate scientifically; rebalance regularly. Stay disciplined. Chase no fads, capitulate to no fear. Never own enough of one thing to make a killing, *or be killed by it*.

These are a few of the precepts that guide Holland Portfolios.

Basically, we believe in capitalism. And the science of capital markets. It is patently obvious – and never more painfully clear than in recent years – that active management or stock picking cannot systematically “beat the markets” to achieve excessive returns. There is no El Dorado, no Lost City of Gold. Most investors instinctively know this. But they find it hard to resist the siren calls of 24/7 talking-head analysts – who get handsomely paid either way their advice turns out.

One of the strangest and most disheartening stories of late last year was a survey in which “two-thirds of active investors” said they expect to beat the S & P 500 index this year. What’s wrong with this picture? First of all, the survey itself implies that one-third of active investors already accept they’ll underperform. Go figure. But worse, only 25% of active managers beat their own benchmarks last year. What is the basis to believe they’ll do three times better next time around?



“Wait till next year” is a fine slogan for disappointed baseball fans. But the market is not a ballpark. Investing is not about adding sluggers (who hit .300) to your lineup. It’s about *manufacturing* your future – building and sustaining the means to live long and live well, in all types of weather. Active investors’ addiction to swinging for the fences is a source of dismay to many seasoned professionals. Said one:

“I don’t know if the market will go up or down,
but I do know many individual investors and their advisors will
continue doing the wrong thing at the wrong time.
Human nature is the only thing you
can really predict.”

In an investment context, “human nature” is usually portrayed as a bipolar disorder – fear versus greed. But there’s another far more important quality that humans (uniquely) possess. Discipline. It’s not glamorous. But what made us successful as a species is the same trait that marks the successful long-term investor – finding what works, and sticking with it.

Holland investors know short-term economic performance doesn’t matter. Interest rate fluctuations are irrelevant to the process. Asset allocation is dictated not by numbers at the closing bell on any given day, but by the investment plan itself. In short, markets work efficiently. They incorporate all known information. And the only stock worth owning is... the world.

By “the world” we mean the widest possible range of asset classes, globally diversified.



Three myths: the safe haven, the sure thing and the stock picker

One of the least talked-about but most worrying indicators is continued low volume in the equities market. Institutional investors are back. But individual investors remain wary – if not terrified – of stocks. The perceived “safety” of bonds has meant an unprecedented potential transfer of wealth: over the last two years, once sleepy bond funds have taken in nearly \$600 billion.

As one safe-haven seeker said, “It’s not about return on principal anymore, it’s about return OF principal.”

But investment advisors – even bond traders themselves – know this is a dangerous fallacy. For one thing, bonds can be equally as volatile as stocks. Second, overly-conservative investing poses unacceptably high risk. This so-called “dead money,” earning historic low returns, can defeat an investment plan as quickly as the proverbial “sure thing.” The goal is to have your money outlive you. By themselves, bonds (known in the trade as fixed income) are not adequate to this task.

Risk and return are related. Depending on your time horizon, bonds and cash belong in the right mix with equities in a diversified *working* portfolio. They help reduce volatility. But bonds can never replace the superior returns of equities over time.

Wariness of the market is understandable, but it’s justified only in terms of aggressively-managed portfolios. As we know, active managers (and their clients) were pummeled in 2008. At a time when investors depended on stock pickers to steer them clear of the carnage, panicky active managers actually lost *more* than the S & P 500 index: well over 40%. And that’s before you add the higher fees – up to another 10% for hedge funds and so-called “alternative” investments.

But despite the worst financial crisis in 80 years, long-term index investors, by definition, lost the absolute minimum. And they’ve participated fully in the inevitable (and historically rapid) recovery. It’s a lesson we would rather not repeat, but the Great Recession was a case study of what we mean by allocating wisely for risk-adjusted returns.

Finally, we need hardly mention the gut-wrenching images of (active) investors ruined by dreams of consistently astronomic returns that turned out to be scams. Transparency has never looked better. We are reminded of a classic statement in a pilot’s manual: “Visibility is important in avoidance of terrain.” Knowing what’s in your portfolio, how it is being allocated, and *why*, is key to superior risk-adjusted long-term performance... and sleeping well. Ask any Holland investor.



Holland Portfolios

Four exceptionally diversified, non-speculative portfolios.
Each custom-indexed portfolio designed to achieve superior returns
with reduced investment risk.

All funds kept in a segregated account, in the investor's name, at Fidelity Investments. Online access to this account at all times. All transactions made within the investor's account. All investments SEC-regulated instruments (institutional mutual funds; Exchange Traded Funds). Investor receives monthly or quarterly statements from Fidelity.

Disciplined, long-term approach. Research based on Efficient Market Hypothesis.
Strategy guided by proven Fama/French Multifactor Models.

Implementation: portfolio structure determines performance.
Asset allocation explains most of the variation in returns. Stocks should
be the risk portion of a portfolio. Diversification and
regular rebalancing are essential.

Manufacture income (to rise with increasing costs of living)
by owning the great companies of world: dividends have risen 5.9%,
on average, every year since 1935.

