

## Horizon Notes

Henry Bragg and his wife, Laurence have added another daughter, Julia, to their growing family, which also includes Julia's big sister, Kathryn. Henry joined the firm full time following the completion of his MBA degree program at Rice University's Jones Graduate School of Business.

Cathy Haymes, our client service administrator, has been with us for five years on a part time basis. She began working on a full time schedule on July 1st.

We're glad to have Henry and Cathy here all the time now to improve client service and meet the needs of our growing business.

**Report on Client Survey.** We recently completed the first round of client surveys as part of our Client Dialogue process. We will continue this process over the balance of this year and into the future so that we can gather opinions from all of our clients, providing us with a better understanding of how we are performing relative to their expectations.

In summary, our first series of interviews indicated a high degree of client satisfaction with our services and that client expectations are being met. As part of the survey process, we also received several helpful comments from clients as to areas where we can improve or provide a more comprehensive service. We will be addressing these individual circumstances over the next few weeks.

Many thanks to those of you who have agreed to help us by participating in these surveys. We intend to pay attention to what we're learning so that we can constantly improve our service quality and client satisfaction with our offerings at Horizon and Maddox Thomson.

## Investment Results and Investor Behavior

Financial journalist and Newsweek contributor, Jane Bryant Quinn, has suggested that, *"The secret to wealth is that a secret doesn't exist. For success, you need only a simple investment, with profits compounded over time."* Indeed, if we look at market (investment) behavior over time, it does look simple. For example, the average return for a portfolio of 100% stocks during the period from 1926 through 2005 has been 10.4%. That sounds pretty good until you look at all of the years that went into creating the average. With rare exceptions none of the individual years were average, with many years nowhere close!

As you can see from the accompanying table, for annual periods during this time, returns ranged from a gains of 162.9% to losses of 67.6% and further, (also on average) there was a loss in one of four years. Still, the average return was 10.4%.

### Rolling Periods Range of Returns (1926—2005)

<u>Periods</u>	<u>Annual</u>	<u>5-Year</u>	<u>10-Year</u>
Highest Return	162.9%	36.1%	21.4%
Lowest Return	-67.6%	-17.4%	-4.9%
Negative Periods	26.1%	12.7%	3.4%

*Source: Ibbotson Associates, Inc.*

So, if a 10.4% average return is good, what's so hard about obtaining it? This is not a secret either. In order to earn the average return from the markets, an investor must be invested throughout the entire period. The problem is that investing is emotional and investors' actions and therefore, returns are influenced by their emotions.

To support this point, author Nick Murray, speaking recently in Dallas, said that for the period from 1985 through 2004, the average return from the average

equity mutual fund was 10.7%, while, during the same time, the average return for the average investor was 3.7%. So, while the market is doing just fine, the average investor is not doing nearly as well.

These findings suggest that investors' behavioral biases influence them to make the wrong moves at the wrong time. Rather than keeping short term market moves in perspective, investors react to these moves impulsively with either exuberance or panic. As you can see from the averages in the table, these short term events, both positive and negative, have a way of balancing out over the long course of time. In fact, if you return to the table you will see that the highest and lowest 10 year returns are much more agreeable and there were losses in only 3% of the periods.

So, the good news is, in spite of the short term emotional roller coaster of market returns, the tried and true tenets of long-term investing continue to make sense and withstand the test of time. Invest for the long term. Diversify your portfolio. Avoid market timing. Expect markets to rise. Expect markets to fall. Don't expect miracles.

At Horizon, we help our clients avoid these behavioral biases and follow a disciplined, methodical process defined by each of our clients' Investment Policy Statements. We have a formal asset allocation, and a formal rebalancing strategy, which we follow faithfully. We follow our procedures because we know that in the long run our process will provide better returns for our client portfolios. This is basic "blocking and tackling" but it gets done on a regular schedule. Portfolios are designed based on your goals and objectives – unless your goals and objectives change, the design of the portfolio shouldn't change.

#### COLLECTED THOUGHTS

*"A person wrapped up in himself makes a small package."*  
– Harry Emerson

#### Market Review

The following table shows market index returns for the 2nd quarter, previous 12-mos, and past 3 years.

Index	2nd Qtr	1-Year	3-Year
S&P 500 (Large Stocks)	-1.91%	6.62%	30.34%
Russell 2000 (Small Stocks)	-5.29%	13.29%	61.62%
EAFE (International Stocks)	-0.26%	23.63%	77.71%
Lehman Bond Aggregate	0.23%	-0.20%	4.91%

After a smooth first quarter, investors held on tight for a very bumpy second quarter. April proved to be a continuation of the good times from the first quarter as the market indexes continued their advance. As the first week passed in May, there seemed to be no reason to doubt that the indexes would finally push past their 2000 highs. Fed Chief Ben Bernanke hinted that the interest rate hikes might pause, and it seemed that we would finally see a market breakout on the upside. Then, on May 10th, the Fed announced another rate hike and changed directions on what they might do to interest rates in subsequent meetings. The following weeks saw every major index cascade from their highs, erasing most if not all gains for the year. If not for a brief rally in the last week of the quarter, the markets losses for the quarter would have been much worse. And, at this writing, the difficulties continue with concern about the middle east.

Recently appointed Fed Chairman Ben Bernanke certainly made his presence felt this quarter as the market appeared to be fixated on his actions. It would be fair to say that investors learned two important lessons about the new Fed chief this quarter. First, Mr. Bernanke has not mastered his ability to communicate with the media, as inadvertent comments resulted in unintended market volatility. Second, the market is still learning how to interpret Mr. Bernanke's comments, whether they are public or off-the-cuff. The wild volatility this quarter came about even though the Federal Reserve made the

very predictable move of raising short-term interest rates another 0.50%. A third lesson which has not yet been learned, should be not to expect a pause in interest rate increases until it occurs.

Interest rate increases are having a tangible impact on CDs, consumer loans, and mortgages. Times are better for savers and lenders, but it is now more expensive for consumers and borrowers. Mortgage rates, in particular, have risen to almost 6.5% and as expected, many real estate markets are beginning to cool.

There is no compelling reason to believe that the recent market volatility will end anytime soon. The Fed will keep raising rates until they feel that inflation is no longer a danger, and inflation will continue to creep into the economy as long as energy prices remain persistently high. On a somewhat positive note, interest rates have returned to historically normal levels. The current Fed Funds Rate of 5.25% is slightly higher than the 20 year average of 4.9% but is still lower than the 50 year average of 5.9%. So, if the Fed chooses, there is still room to raise rates further without severely dampening the economy. We may see two or more rate hikes, but it remains very unlikely that we will see 1980s level interest rates.

As to the equity markets, the major U.S. markets have done little more than move sideways for the last seven years while corporate profits and the economy have continued to grow at a robust pace. This has placed stock valuations on a price-to-earnings basis at their lowest level in years.

We feel that the next quarter or two will remain choppy as market spectators and participants learn to adjust to Ben Bernanke as the new Fed chief, but we remain optimistic about the market in the longer term because of the fundamental strength in the economy and relatively low stock prices.

Thank you very much for your continued confi-

dence in our service and advice. If you have any questions, comments, or would like to schedule some time to come by and review your goals and objectives, or to just visit, please call.

### Manager Spotlight— Meridian Growth Fund

The equity portion of our clients' portfolios comes in many shapes and sizes. The funds we recommend invest in companies that range from extremely large and well-known to extremely small. Smack dab in the middle is an asset class called "Mid Cap." Mid Cap companies are neither the large nor small. They are typically companies that have matured beyond the stage of a start up, but have not yet grown to a level that would make them a household name. We recently completed our regularly scheduled due diligence call with Rick Aster who manages the Meridian Growth Fund and thought we would share our thoughts with you.

Rick Aster, the founder and portfolio manager of the Meridian Growth Fund, received his Masters in Economics from UC Santa Barbara before working for many years as an institutional level securities analyst. In 1977 he went out on his own and founded Aster Investment Management to service a handful of private clients. As his reputation grew, the demand for his services grew. He began the Meridian Growth Fund in 1984 to accommodate interest by smaller investors and has been the portfolio manager ever since. The firm has gradually shifted its focus towards the management of the Meridian Growth Fund and two other mutual funds.

Aster's approach to investing is that of a skilled stock picker. He describes his style as being a mix of both art and science. At the heart of this portfolio is a group of roughly 250 stocks that he follows very closely. He talks regularly with the management of each company and spends a great deal of time analyzing and understanding the dynamics of their respective businesses. When one of the stocks gets to a level that he finds attractive, he buys. When a

stock gets too expensive, he sells. He does not allow himself to get bogged down by committees and narrowly defined investment parameters. His interest is in making well informed investment decisions that make sense on an academic level and that pass the "gut test."

Aster's firm is very small by design. The ten employee firm is fashioned to support Aster in his passion of following and picking stocks for the Growth Fund. Most of the management duties for the fund fall on Aster's shoulders, although he enlists the help of an analyst to do the hard number crunching and also draws upon the expertise of other investment professionals at Meridian from time to time.

We have selected the Meridian Growth Fund for our clients because of Aster's approach, opportunistic style, and long track record of superior returns. As with all of our recommended investment managers, we will continue to monitor the performance and process of this fund to assure it delivers the quality and performance we expect for our clients.

*Disclaimer: This manager (Meridian Growth Fund) is responsible for managing one or more investments recommended in the past by Horizon Advisors. A complete list of all investment recommendations Horizon Advisors has made in the past 12 months is available upon request.*

#### COLLECTED THOUGHTS

*"Desires make good servants – but bad masters." - Anon*

#### Making Cents—Reviewing your Insurance

Once a decision has been made to purchase a life insurance policy, people often put the policy "out of sight and out of mind." In the short run, this is probably an appropriate action. However, in the long run and in many circumstances, a periodic review of your policy may yield great benefits.

The costs and benefits for life insurance policies, in general, change a great deal over the course of time. This occurs as insurance companies adjust their policy provisions to newer mortality tables, administrative expenses and investment results. In particular, as people today are living longer, the cost to the insurance company of providing death benefits can be spread out over a longer period of time. Often times, however, we have discovered that the terms of a client's existing policies may not pass along the benefits of these changes to the policy holder.

Our clients have often found that a review of their policies and coverage may result in opportunities to either save money in premium dollars or purchase a greater amount of coverage for the same premium costs. In either event, it is absolutely worthwhile to dust off your older insurance policies and have them reviewed by a professional.

If you have an agent that you trust and with whom you are comfortable, make arrangements for him to review your costs and coverage. Otherwise, call us and we will be happy to help you with your review.

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