
Index

A

- Active and passive investing. *See also*
Mutual Funds
analysis of asset class efficiency,
192–198
characteristics of inefficient markets,
190–192
overview, 189–190, 198–201
- Adaptation or extinction
dividend revolution.
See Dividend revolution
earnings growth.
See Earnings growth
historical comparisons.
See Historical comparisons
overview, 1–4
return and volatility forecasts.
See Return and volatility
forecasts
valuation stabilization.
See Valuation stabilization
- Agency securities, 81
- Alternative investments
event driven
distressed securities, 172
overview, 171
risk (merger) arbitrage, 171–172
global macro (tactical trading)
discretionary, 174
overview, 174
systematic, 174
- hedge fund performance
characteristics, 175–177
- infrastructure, 164–167
- investing in alternatives,
150–153
- long/short equity
global, 173
overview, 172–173
sector based, 173
short selling, 173
U.S., 173
- natural resources, 163–164
- overview, 149–150
- private equity, 153–161
- private real estate, 161–163
- relative value
convertible arbitrage, 170
fixed-income arbitrage, 171
market neutral, 170–171
overview, 170
volatility and hedge funds,
167–170
- Asset allocation examples, 91–93
- Asset allocation, balanced, 93–94
- Asset classes
criteria for, 95–97
efficiency of, 192–198

Asset classes, *continued*

- equity asset classes
 - size, 100–101
 - style, 97–100
 - geography, 101–104
 - fixed-income asset classes
 - credit quality, 105–106
 - duration, 106
 - overview, 105
 - overview, 95
 - weightings, 112–115
 - which groups of investments
 - are not, 96
- Asset turnover, 37–42

B

- Baby Boom, 64–65
- Bernanke, Ben S., 108
- Bond valuations, 16–17
- Bureau of Economic Analysis, 140, 144–145
- Bureau of Labor Statistics, 141
- Business cycle data sources
 - Bureau of Economic Analysis, 140
 - National Bureau of Economic Research, 140
 - Organization for Economic Cooperation and Development, 140–141
 - overview, 139–140

C

- Capital calls, 155
- Cash, return and volatility forecast, 86
- Congressional Budget Office, 146
- Convertible arbitrage, 170
- Corporate bonds, 81
 - See also* Fixed income asset classes
- Credit quality, 134–135
 - data sources
 - Congressional Budget Office, 146
 - Moody's Investors Service, 145–146
 - overview, 145
- Credit-default swap market, 63–64
- Cuban missile crisis, 54–56

Cyclicality

- adapting style, 185–188
- conflicts in cyclicality and valuation, 184–185
- overview, 179
- style cyclicality, 179–180
- style evolution, 181–183

D

- Darwin, Charles, 1
- Data sources
 - business cycle
 - Bureau of Economic Analysis, 140
 - National Bureau of Economic Research, 140
 - Organization for Economic Cooperation and Development, 140–141
 - overview, 139–140
 - credit quality and interest rates
 - Congressional Budget Office, 146
 - Moody's Investors Service, 145–146
 - overview, 145
 - earnings growth
 - Bureau of Economic Analysis, 144–145
 - Federal Reserve, 143–144
 - Institute for Supply Management, 142–143
 - overview, 142
 - inflation
 - Bureau of Labor Statistics, 141
 - Federal Reserve, 142
 - overview, 141
 - University of Michigan, 141
 - overview, 139
- Deregulation, 31–32
- Derivatives, 63–64
- Distressed securities, 172
- Dividend revolution
 - DPS versus EPS, 47–50
 - overview, 43–47, 51
 - valuing dividends, 51–52
- Dividends, valuing, 51–52
- DPS versus EPS, 47–50
- Duration, 135–136

E

Earnings growth
asset turnover, 37–42
data sources on
 Bureau of Economic Analysis, 144–145
 Federal Reserve, 143–144
 Institute for Supply Management, 142–143
 overview, 142
financial leverage, 36–37
interest expenses, 26–27
long-term earnings growth of seven percent, 22–24
more conservative management, 28–31
overview, 21–22, 42
productivity and labor costs, 32–33
profit margin, 34–35
re-regulation, 31–32
retention ratio, 35–36
saw-tooth pattern, 24–26
source of earnings, 33–34
tax expenses, 27–28
valuation and earnings, 42
Employee Retirement Income Security Act (ERISA), 75
Energy prices, 14–15, 59–63
EPS versus DPS, 47–50
Equity asset classes, 97
 weightings, 109–112
Equity tactical risk management
 geography, 131–133
 size, 126–128
 style, 128–131
ERISA (Employee Retirement Income Security Act), 75
Event-driven alternative investments
 distressed securities, 172
 overview, 171
 risk (merger) arbitrage, 171–172
Exchange traded fund (ETF), 189–190
Extinction. *See* Adaptation or extinction

F

Federal Reserve, 14, 19, 56, 108, 142–144
Financial leverage, 36–37
Fixed-income arbitrage, 171
Fixed-income asset classes, 115
 credit quality, 105–106
 duration, 106
 overview, 105
Fixed-income tactical risk control
 credit quality, 134–135
 duration, 135–136
 geography, 136–137
 overview, 133

G

Geography, 131–133, 136–137
Global long/short equity, 173
Global macro (tactical trading)
 discretionary, 174
 overview, 174
 systematic, 174
Government bond supply, 12
Greenspan, Alan,
 on oil reserves, 60
 on tactical risk control, 108
Growth and value indexes, 180, 186–187

H

Hedge funds, 150, 167–170
 market neutral, 170–171
 performance characteristics, 175–177
High energy prices, 14–15, 59–63
High-yield bonds, return and volatility forecast, 82–84
Historical comparisons
 1960s, 53–58
 demographics, 64–66
 derivatives, 63–64
 high energy prices, 59–63
 overview, 53, 66
 severe weather activity, 58–59
Homeland Security, Office of, 32
Hurricane Camille, 58
Hurricane Katrina, 58–59

I

- Inefficient markets, characteristics of, 190–192
- Inflation, 7–8
 - earnings quality and, 207
 - sources of data on
 - Bureau of Labor Statistics, 141
 - Federal Reserve, 142
 - overview, 141
 - University of Michigan, 141
- Infrastructure investments, 150, 164–167
- Institute for Supply Management, 142–143
- Interest expenses, 26–27
- Interest rates, 7–16
 - data sources
 - Congressional Budget Office, 146
 - Moody's Investors Service, 145–146
 - overview, 145
 - end of long decline in, 11–14
 - no repeat of 1970s, 14–15
- International bonds, return and volatility forecast, 84–85
- International investments, 101–104, 112–115, 131–133, 136–137, 193, 195, 199
 - international stocks, return and volatility forecast, 76–78
- Investing in the new era
 - active and passive investing. *See* Active and passive investing
 - alternative investments. *See* Alternative investments
 - cyclicality as new style. *See* Cyclicity
 - overview, 147–148
- Investment plan
 - balanced asset allocation, 93–94
 - overview, 89–90
 - six strategic asset allocations, 91–93
- Iraq invasion, 54–56

J

Japanese stock market, 104

K

Keynes, John Maynard, 53–54

L

- Large-cap U.S. stocks, return and volatility forecast, 69–73
- Long-term bonds, return and volatility forecast, 82
- Long/short equity
 - global, 173
 - overview, 172–173
 - sector based, 173
 - short selling, 173
 - U.S., 173

M

- Market neutral hedge funds, 170–171
- Market-based portfolio
 - asset classes. *See* Asset classes
 - data, finding. *See* Data sources
 - investment plan. *See* Investment plan
 - managing risk through adaptation. *See* Risk, managing
 - overview, 87–88
 - strategic asset allocation. *See* Strategic asset allocation
- Mean-variance optimization, 109
- Merger and acquisition (M&A) deals, 38–40
- Mid-cap and small-cap U.S. stocks, return and volatility forecast, 73–76
- Moody's Investors Service, 145–146
- Mortgage-backed securities, 80
- Municipal bonds, return and volatility forecast, 85
- Mutual Funds. *See* Active and Passive Investing, 189–202

N

- National Bureau of Economic Research, 140
- Natural resources, 150, 163–164
- Nifty Fifty, 97–98

O

- Oil, 59–63, 163–164
- Ongoing risk management, 137–138
- Operating earnings, 203–207

- Organization for Economic
Cooperation and Development,
140–141
- Outsourcing, 14
- P**
- Passive investing. *See* Active and
passive investing
- Private equity, 149–150, 153–161
- Private real estate, 150, 161–163
- Productivity and labor costs, 32–33
- Productivity gains, 14
- Productivity growth, rate of, 11
- Profit margin, 34–35
- Q**
- Quality of earnings
inflation and earnings quality, 207
operating earnings track economics,
204–207
operating versus reported earnings,
203–204
overview, 203
- R**
- Radio frequency identification (RFID),
40–41
- Real estate, *See* Private real estate
- Re-regulation, 31–32
- Real estate investment trusts (REITs),
162
- Rebalancing, 120–122
- Relative value
convertible arbitrage, 170
fixed-income arbitrage, 171
market neutral, 170–171
overview, 170
- Reported versus operating earnings,
203–204
- Retention ratio, 35–36
- Return and volatility forecasts
cash, 86
forecast volatility, 68–69
high-yield bonds, 82–84
international bonds, 84–85
international stocks, 76–78
large-cap U.S. stocks, 69–73
long-term bonds, 82
mid-cap and small-cap U.S. stocks,
73–76
municipal bonds, 85
overview, 67
range rather than point estimate,
67–68
short-term bonds, 82
taxable core bonds, 79–81
- RFID (radio frequency identification),
40–41
- Risk (merger) arbitrage, 171–172
- Risk tolerance, 7
- Risk, managing
equity tactical risk management
geography, 131–133
size, 126–128
style, 128–131
fixed-income tactical risk control
credit quality, 134–135
duration, 135–136
geography, 136–137
overview, 133
ongoing risk management,
137–138
overview, 117–120
rebalancing, 120–122
stock/bond/cash tactical risk
management, 124–126
tactical risk management, 122–124
volatility and diversification, 119
- Russell 2000, 73–74
- Russia, 12–13
- S**
- S&P 500, 6, 22, 44–45, 47, 70–72,
205–207
- Saw-tooth pattern, 24–26
- Sector-based long/short equity, 173
- Severe weather activity, 58–59
- Short selling, 173
- Short-term bonds, return and volatility
forecast, 82
- Size, 100–101, 126–128
- Small-cap and mid-cap U.S. stocks,
See also Size
return and volatility forecast, 73–76
- Stock/bond/cash tactical risk
management, 124–126

- Strategic asset allocation
 - asset class relative weighting
 - consistent across profiles, 114
 - asset class weightings by geography, 112–115
 - equity asset class weightings by capitalization, 110–112
- Strategic asset allocation, *continued*
 - equity asset class weightings by style, 109–110
 - fixed-income asset classes, 115
 - mean-variance optimization, 109
 - overview, 107–109
- Style, 97–100, 128–131
 - adapting, 185–188
 - cyclicality, 179–180
 - evolution, 181–183
- T**
- Tactical risk management, 122–124
- Tactical trading (global macro)
 - discretionary, 174
 - overview, 174
 - systematic, 174
- Tax expenses, 27–28
- Taxable core bonds, return and volatility forecast, 79–81
- Telecommunications Act of 1996, 31
- Terrorist attacks, 56
- Tort costs, rise in, 29–30
- Trade imbalance, 12
- Twain, Mark, 53
- U**
- U.S. long/short equity, 173
- U.S. Treasury securities, 80–81
- University of Michigan, 141
- V**
- Valuation and cyclicality, 184–185
- Valuation and earnings, 42
- Valuation stabilization
 - bond valuations, 16–17
 - drivers of valuation, 6–8
 - interest rates, 8–16
 - end of long decline in, 11–14
 - no repeat of 1970s, 14–15
 - overview, 5–6, 19
 - stocks and bonds together, 17–19
- Venture capital, 156
- Volatility and diversification, 119
- Volatility and hedge funds, 150, 167–170
- Volatility forecasts. *See* Return and volatility forecasts
- Volatility Index (VIX), 117, 167
- W**
- Websites, 139–146