BCA First Quarter 2007 Market Review ©
Asset Rebalancing vs. Market Timing

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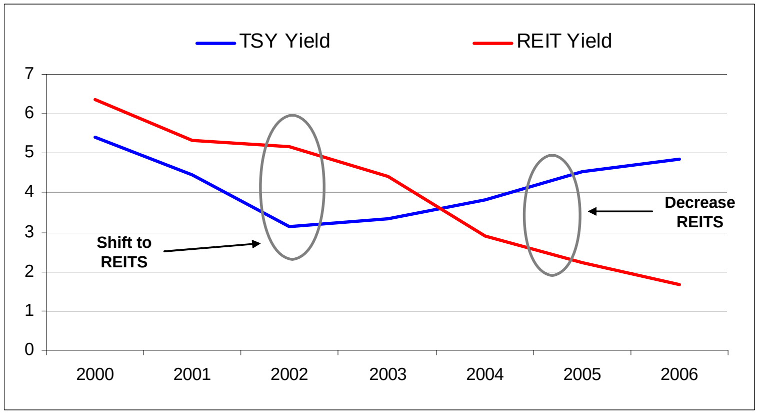
Market timing is an attempt to precisely predict the expected returns of asset classes and sectors. William Sharpe evaluated the potential of market timing in his 1975 publication "Likely Gains From Market Timing." Potential gains from market timing were modeled assuming an investor switches between 100% equity and 100% cash. For example, following a 15% rise in the market value of an asset class, an investor sells the position and raises cash in an attempt to get back in later at a lower price. Sharpe determined that the market timer had to be correct 74% of the time in order to perform better than a passive portfolio of the same risk (volatility).

Asset allocation models are designed to achieve an expected return and risk. The relative valuation of each asset class within the model changes over time, as do the correlations. For example, as domestic bonds became increasing more expensive relative to stocks during the 2002 period, BCA reduced the bond allocation from 45% to 30% and increased equities to 70%. The equity of choice were the REITS, which paid a 5.0% yield; well above the 3.0% bond yield. Since REITS were much cheaper than bonds and had upside potential, where bonds could only decline in value (which they did), it was logical to recommend this substitution to all clients. Recently, BCA has reduced REIT allocations by one-half, as bond yields are now much higher.

Yield Comparison
REIT vs. Treasuries



Rebalancing asset allocations is a risk management process and not market timing. All asset classes experience cycles. The average of their returns is associated with high, low and negative experience. Each asset class within the model may be ranked in terms of relative valuation. Each asset class will be repositioned in this ranking over time. The lowest will move upwards and the highest will revert back towards the bottom. This rotation never ceases. Portfolio rebalancing is governed by the relative value ranking of each asset class and changing correlations.