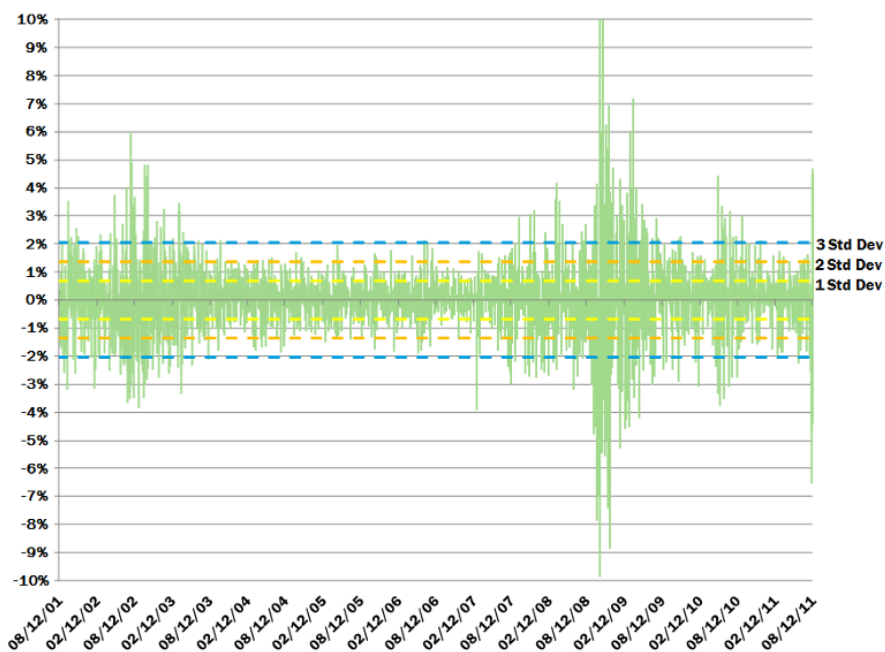




It is impossible to predict the timing, severity and duration of volatility in global markets. Low or declining volatility can persist for various amounts of time, but episodes of high volatility have lasted more than just a few days (Chart 2). Periods of severe volatility as seen in 2002, 2008, and 2010 serve to remind us that it is nearly impossible to accurately and profitably time exit and entry points.

### Daily Price Return of S&P 500



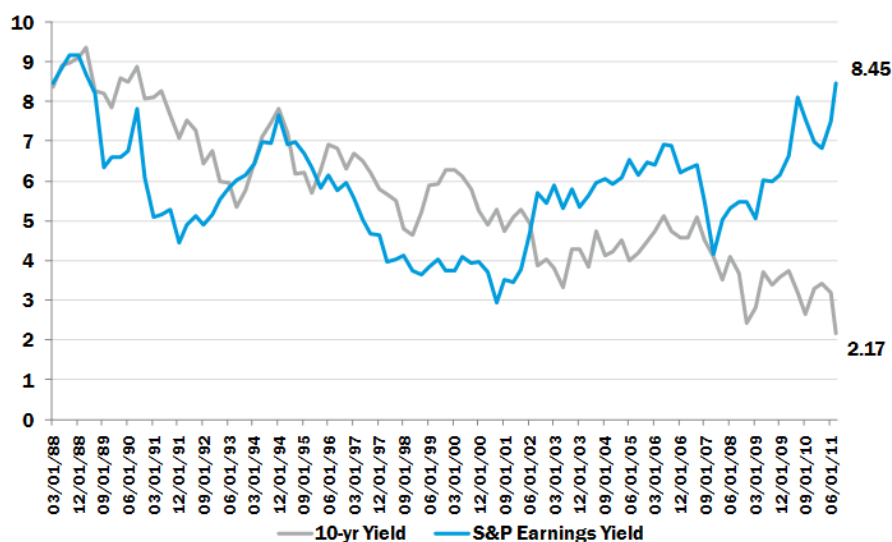
The overwhelming explanation for the recent flight to safety and persistent market volatility is investor uncertainty on a global scale. Concerns about the Eurozone and the slow pace of recovery for the US economy should not be ignored, but a disconnect has formed between the market moves and essential fundamentals. To paraphrase one of our hedge fund managers, valuations are attractive, but irrelevant in this environment. Several fundamental factors that should be considered include:

- *Near-term default risk in the US has been eliminated with debt ceiling agreement.*
- *Corporate earnings have been very strong with growth of 16.5% in Q2 and projected growth of 14% for the year.*
- *Corporate balance sheets are very healthy with record amounts of cash on hand.*
- *The lending environment continues to improve as banks are in better shape today than a few years ago.*
- *The Fed has stated that it will keep interest rates low until at least mid-2013.*

Although these periods are difficult on all of our psyches, these market moves frequently provide an opportunity to revisit the relative valuation of different asset classes.

- *Given the estimated operating earnings of over \$82 on the S&P 500 companies, the S&P earnings yield is close to 8.5%. As the 10-year treasury moves to historically low yield, the spread between S&P 500 earnings yield and the 10-year Treasury yield has widened significantly.*
- *Equity market valuations are relatively attractive even on the basis of dividend yield. Consider that the yield on the 10-year Treasury (2.2%) is in line with the dividend yield on the S&P 500 (2.2%), and the S&P 500 offers opportunity for capital appreciation.*

## S&P Earnings Yield vs 10yr Treasury



Daily conversations with our managers help us remain confident in our strategies. Although every manager is different, we have heard a few general themes about the past week of volatility. They tend to agree that it is difficult and dangerous to try to time markets and trade around these extreme price moves. Instead, many are using price dips to add to high conviction positions. They are paying attention to valuation measures as well as market indicators such as the fact that insider buying is at its highest level since early 2009. Dislocation is difficult, but it frequently provides new investment opportunities. Our managers are diligently and carefully watching for these as they present themselves.

While it is disconcerting to see the large and sudden drop in equity markets, this is not a reflection of the performance of a portfolio that is diversified across multiple asset classes. Bonds provide an anchor to the portfolio in this environment while hedged strategies also help to cushion the impact of the market volatility.

We are hopeful that lessons from the past combined with current evidence encourage investors to stay invested and avoid reducing equity exposure while this rampant uncertainty rules the market. Our experience in previous periods of volatility and equity underperformance, including during the recent downturn in 2008-2009, is that clients that remain invested through these rough periods recover best when markets turn. Conversely, those portfolios in which strategy was altered and discipline was not maintained were not positioned well to capture the market rebounds making it difficult to outperform over a long horizon.

## About Canterbury

As an investment management consulting firm, Canterbury Consulting is dedicated to helping institutional and individual clients think strategically about their investments. We assist clients with asset allocation planning, investment policy development, manager search and evaluation as well as comprehensive performance reporting.