

What You Hear is Not Always What You See

February 20, 2006

For the 18 months ended 12/31/05 the Fed has increased interest rates by 350 basis points (3 ½%). Our clients that have been with us for these entire 18 months have seen there accounts increase in value 20% after deducting our maximum fee of 2% annually.

How can this be? We all know that if interest rates go up bond prices go down. That being the case there should be no way that a client of ours could obtain such a return during that 18 months. We had our clients invested in 20-year government bonds 67% of the time. The remaining 33% of the time we were invested in government money market funds.

The answer is to be found in the following chart courtesy of www.thechartstore.com. The Fed can control *short-term* rates only. Please observe that all notes and bonds with maturities due in 10 years and longer have gone down in yield despite the Fed's action. Down in yield and up in price.

How many bond managers that you know have done this well? Can you remember any bond manager on CNBC telling those who were listening to buy long term bonds? The answer has to be either none or very few. The world had changed and most money managers continue to live in the past.

