ADVISOR PERSPECTIVES

Letter to the Editor – Challenging Dave Rosenberg

May 31, 2011

The following is in response to the article, [My Breakfast with Dave], by Robert Huebscher, which appeared on May 3, 2011.

Dear Editor:

Predictions will always turn out to be correct – the question is when?

Predictions are usually unambiguous and are made with great conviction. Very few come with time constraints and thus, as time passes, they eventually become true, even if it takes years.

Predictions without time limits are useless. Yet, investors do not seem to be perturbed by this.

A recent article, My Breakfast with Dave, related David Rosenberg's views on inflation and the bond market. There was an audience of 500 advisors and investors who listened to this.

Rosenberg's views on the bond market have not changed from a year ago. "For now, bonds are a very good place to be," he is reported as saying at the conference. Apparently he made no mention of his poor advice given during July and August of 2010 to buy long-term bonds then.

Below is his previous investment advice to buy long-term bonds, extracted from some of his daily commentaries made last summer. This advice, given without a stipulated investment period, has to date (5/23/2011) resulted in a loss for anybody following it. (The return shown is for an investment in the Vanguard long-term Treasury bond fund VUSTX with dividends reinvested, made at the date of his advice.)

> *July 30, 2010* (return to date -0.9%)
>
> *Buy bonds now!*
>
> *The case for more bond buying is actually pretty strong.*
> *If we do end up going to 2.5% on the long bond with the help of Helicopter Ben, that would imply a total return of well over 30%. It has taken the stock market nearly 13 years to achieve that!*
>
> *August 11, 2010* (return to date -2.4%)

And, if the Fed is committed to keeping the funds rate near the floor, and you take a good look at the historical record at how flat the Treasury curve gets at the end of a bull market, we could well see the 10-year note yield down to 1.5% and the long bond sitting at 2% when all is said and done.

August 19, 2010 (return to date -5.7%)

As we invoke Bob Farrell's Rule 1, which is about reversion to the mean, we should see the long bond yield approach or even possibly test the 2% threshold before its final resting stop is reached.

August 23, 2010 (return to date -5.4%)

Indeed, look at the long, long-term chart of the long bond and see what it did after the last depression endured in the 1930s. Indeed, it touched the 2% threshold, which is exactly where it should be on a 'normal' yield curve basis if the Fed does in fact, as we expect, hold the funds rate near zero for the next several years.

Eventually the long-bond yield could end up at 2% and Rosenberg's predictions will prove to be correct. Nobody knows if and when this will happen.

In contrast in my own article, Go for the Long Bond: Technical Indicators are Positive, published on January 25, 2011, I made specific recommendations to buy long-term bond funds and hold them for not longer than four months (82 trading days). Based on historic precedence I expected an average gain for the funds of about 10% over this period, as mentioned in the article.

As it is now exactly 82 trading days since I made this recommendation, let's see the actual returns for the funds which were used in my article:

Buy date	sell date (82 trading days later)	VWESX	VUSTX	BTTRX	EDV	average return for all funds
1/26/11	5/23/11	+6.77%	+6.13%	+7.88%	+11.09%	+7.97%

The average return of the four funds was 7.97%. This is less than the expected value of 10%, but better than the stock market's return. The Vanguard S&P 500 Index Fund VFINX with dividends reinvested gained only 2.21% over this period.

Sincerely,

Georg Vrba, P.E.

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