



Seeking Beta in the Bond Market: Update December 31, 2010

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I have updated the model described in my article, [Seeking Beta in the Bond Market: A Math-driven Investment Strategy for Higher Returns](#), which appeared on November 23, 2010.

Figure 7 from the article, included below, shows the upper and lower switch points for the Bond Value Ratio obtained from the model from 2006 through 2010. **A lower switch point was generated on 12/17/2010.** This indicates the beginning of an up-market for bonds, according to the model.

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Figure 7: Bond Value Ratio (BVR) from 2006 to 2010



According to my models, both the stock market and the bond market are now in an up-market mode and the question arises how one should apportion one's funds for investing in each market.

In table 1 below, mix 3 and mix 4 show the returns for investments in the bond market using high beta bond funds (VUSTX or BTTRX) in combination with the Vanguard S&P 500 Index fund VFINX. All fund values were indexed to a value of 100.00 as of 1/12/1990 to facilitate comparison of returns. The results for mix 3 and mix 4 are based on 100% invested in the bond funds during up-markets and then switching to the stock market during down bond markets. Table 2 shows the average annual returns achieved.



Table 1
Returns for investments in bond market funds in combination with a stock market fund

Bond market	Bond market	switch point date	months btw. switch points	value VFINX	value VUSTX	value BTTRX	%-return for each month VFINX	%-return for each month VUSTX	%-return for each month BTTRX	value mix3 = VFINX + VUSTX	value mix4 = VFINX + BTTRX		
down		1/12/90		100.00	100.00	100.00				100.00	100.00	sell bonds, buy stock	
	up	5/4/90	3.68	102.17	96.25	96.25	0.58%	-1.03%	-1.03%	102.17	102.17	sell stock, buy bonds	
down		3/12/93	34.29	158.83	144.15	144.15	1.30%	1.18%	1.18%	153.01	153.01	sell bonds, buy stock	
	up	7/14/94	16.07	165.77	147.02	147.02	0.27%	0.12%	0.12%	159.70	159.70	sell stock, buy bonds	
down		10/23/95	15.32	220.96	180.23	180.23	1.89%	1.34%	1.34%	195.77	195.77	sell bonds, buy stock	
	up	9/12/96	10.68	258.70	176.78	162.29	1.49%	-0.18%	-0.98%	229.21	229.21	sell stock, buy bonds	
down		12/30/97	15.58	382.83	213.46	238.88	2.55%	1.22%	2.51%	276.77	337.40	sell bonds, buy stock	
	up	1/24/00	24.82	568.65	221.54	229.97	1.61%	0.15%	-0.15%	411.10	501.16	sell stock, buy bonds	
down		11/14/01	21.70	635.74	292.75	336.70	0.52%	1.29%	1.77%	543.25	733.77	sell bonds, buy stock	
	up	3/26/02	4.34	639.89	274.54	294.43	0.15%	-1.47%	-3.04%	546.79	738.55	sell stock, buy bonds	
down		5/28/03	14.07	763.03	346.92	414.34	1.26%	1.68%	2.46%	690.95	1039.35	sell bonds, buy stock	
	up	8/7/03	2.33	782.00	321.40	347.51	1.06%	-3.22%	-7.26%	708.14	1065.20	sell stock, buy bonds	
down		2/11/05	18.21	991.57	369.59	471.97	1.31%	0.77%	1.70%	814.31	1446.70	sell bonds, buy stock	
	up	5/18/06	15.15	1061.10	360.05	439.27	0.45%	-0.17%	-0.47%	871.42	1548.15	sell stock, buy bonds	
down		12/31/08	31.49	1372.19	518.30	676.06	0.82%	1.16%	1.38%	1254.42	2382.69	sell bonds, buy stock	
	up	12/30/09	11.97	1930.52	455.87	537.57	2.89%	-1.07%	-1.90%	1764.83	3352.18	sell stock, buy bonds	
down		8/27/10	7.89	2021.38	534.38	680.71	0.58%	2.03%	3.04%	2068.79	4244.75	sell bonds, buy stock	
	up	12/17/10	3.68	2128.61	487.65	608.92	1.41%	-2.45%	-2.98%	2178.53	4469.93	sell stock, buy bonds	



Table 2

Average annual returns for investments in bond market funds in combination with the stock market fund VFINX and for an investment in S&P500 index fund VFINX alone.

Investment period			average annual return for VFINX alone	average annual return for mix3 = VFINX + VUSTX	average annual return for mix4 = VFINX + BTTRX
5/4/90	-	12/17/10	15.85%	15.98%	20.09%
7/14/94	-	12/17/10	16.80%	17.23%	22.47%
9/12/96	-	12/17/10	15.91%	17.09%	23.14%
1/24/00	-	12/17/10	12.87%	16.52%	22.22%
3/26/02	-	12/17/10	14.75%	17.15%	22.89%
8/7/03	-	12/17/10	14.56%	16.48%	21.49%
5/18/06	-	12/17/10	16.39%	22.11%	26.01%
12/30/09	-	12/17/10	10.66%	24.41%	34.77%

- Investment in bond market funds VUSTX and BTTRX is according to the signals from "Seeking Beta in the Bond Market".
- For mix 3 and mix 4: only when down bond markets occur is an investment made in S&P500 index fund VFINX (with dividends re-invested).
- Investment in S&P500 index fund is according to signals from "Improving on Buy and Hold".

The historic values shown in table 2 demonstrate that an investment using the combination represented by mix 3 achieved the highest returns. The returns are significantly better than an investment in the stock market index fund alone.

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