

# Bianco Research L.L.C.

An Arbor Research & Trading Affiliated Company

Independent • Objective • Original

Volume 14, No. 7

1731 North Marcey, Chicago IL 60614

www.biancoresearch.com

## Total Return Review

Viewing the Markets from a Total Return Perspective

By Gregory M. Blaha (847) 304-1511  
and James A. Bianco, CMT (847) 304-1511  
July 6, 2005

### Is General Motors In Your Portfolio?

On May 26 we released a Market Fact titled [When Giants Fall](#) detailing some of the problems money managers were going to be facing in regards to the General Motors downgrade. One of the main concerns among the money management community using the **Merrill** benchmarks was that General Motors was going to be added to the Merrill High Yield Master II Index at the end of May and removed from the Merrill Investment Grade Corporate Master Index.

Because General Motors was such a large percentage of these benchmarks, a manager's performance over this period could easily be determined by his or her handling of this situation. In fact, General Motors was by far the largest fallen angel ever. To put a perspective on it, the downgrade of GM was larger than the next ten biggest downgrades in history **combined**.

As it turned out, those managers that either held onto or bought GM bonds were handsomely rewarded. Below is a table detailing just how big an impact General Motors could have had on a manager's performance in the month of June.

The Merrill High Yield Master II Index returned 1.90% in the month of June. During this time, GM was a part of this index and contributed 34 basis points of the overall performance of this index. So, even though GM's weighting in this high yield index was only 6.28%, its bonds contributed 18% of the overall performance (34 bps / 190 bps). Obviously those high yield managers who were quick to re-

weight their portfolios to include GM bonds were happy with the results.

On the flip side, investment grade managers who dragged their feet in selling their GM bonds were also rewarded. In the month of June, the Merrill Investment Grade Corporate Master Index returned 0.81%. As of the end of May, GM's weighting in this index was 1.99%. Assuming these weightings remained static, we calculated that an investment grade manager who did not sell any of his or her 1.99% holding of GM bonds could have returned 0.90% during June. While 9 basis points may not seem like a big deal, 9 basis points each month can add up to significant value.

#### Explaining the Rally

The numbers above may help explain part of GM's rally over the past month. Typically money managers are given a grace period to adjust their portfolios once a company is either downgraded or upgraded. Sometimes this grace period can be as long as 90 days. It could be possible that many investment grade managers, seeing that they are making money by holding GM debt, have not yet sold their holding in the automaker. At the same time, high yield managers are trying desperately to buy these bonds for their portfolios, not wanting to miss out on any rally in their benchmark. This increased demand, mixed with less selling, could be exaggerating the rally we have seen over the past month in GM bonds.

Merrill Lynch High Yield Master II Index		
June Total Return	GM Contribution	GM Index Weighting as of June 30
1.90%	0.34%	6.28%
Merrill Lynch Investment Grade Corporate Master Index		
June Total Return Ex-GM	June Total Return With GM	GM Index Weighting as of May 31
0.81%	0.90%	1.99%

## U. S. Fixed-Income Total Returns

	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Treasury Cash:</b>	<b>0.22%</b>	<b>0.73%</b>	<b>1.25%</b>	<b>2.08%</b>	<b>1.47%</b>	<b>2.73%</b>	<b>4.07%</b>
3 Month	0.22%	0.72%	1.21%	2.09%	1.48%	2.60%	3.99%
6 Month	0.21%	0.80%	1.34%	2.10%	1.49%	2.82%	4.05%
<b>Treasury Coupons:</b>	<b>0.42%</b>	<b>2.92%</b>	<b>1.79%</b>	<b>4.42%</b>	<b>4.84%</b>	<b>6.41%</b>	<b>5.94%</b>
2 Year	0.17%	1.42%	0.71%	1.77%	2.66%	4.65%	4.94%
5 Year	0.45%	3.09%	1.55%	3.88%	4.93%	6.74%	5.96%
10 Year	0.81%	5.44%	4.14%	9.93%	7.25%	7.88%	6.65%
30 Year	2.24%	9.45%	11.60%	22.48%	11.75%	10.09%	8.15%
<b>Treasury Strips:</b>	<b>2.01%</b>	<b>9.53%</b>	<b>11.16%</b>	<b>22.24%</b>	<b>12.88%</b>	<b>11.46%</b>	<b>9.90%</b>
5 Year	0.44%	3.62%	2.30%	6.11%	5.70%	7.85%	6.95%
10 Year	1.23%	7.23%	6.62%	15.30%	10.28%	10.79%	9.00%
15 Year	1.92%	10.85%	12.31%	25.90%	14.49%	12.73%	10.53%
20 Year	3.00%	14.13%	18.13%	35.58%	17.40%	13.95%	11.82%
25 Year	4.37%	16.17%	23.72%	45.68%	20.09%	14.92%	12.38%
<b>Broad Indices</b>							
Salomon "BIG"	0.57%	3.12%	2.59%	6.26%	5.64%	7.31%	6.77%
Lehman Aggregate	0.54%	3.01%	2.52%	6.81%	5.76%	7.41%	6.83%
Lehman Government/Credit	0.65%	3.45%	2.75%	7.27%	6.41%	7.71%	6.90%
<b>Government Indices</b>							
Lehman Government	0.57%	3.35%	2.93%	6.65%	5.42%	7.07%	6.63%
Lehman Treasury	0.61%	3.63%	3.19%	7.05%	5.63%	7.03%	6.63%
Lehman Agency	0.39%	2.75%	2.31%	5.70%	4.97%	7.14%	6.63%
<b>Agency Benchmarks</b>							
2 Year	0.19%	1.38%	1.35%	2.68%	3.04%	5.48%	N/A
5 Year	0.43%	3.17%	1.99%	5.80%	5.47%	7.93%	N/A
10 Year	0.77%	5.98%	5.14%	12.18%	8.17%	9.83%	N/A
30 Year	2.07%	9.79%	11.79%	24.34%	13.06%	12.90%	N/A
<b>Other Indices</b>							
Merrill Corporate	0.81%	3.47%	2.52%	8.22%	8.13%	8.79%	7.37%
Lehman Mortgage	0.35%	2.27%	2.13%	6.12%	4.66%	6.82%	6.69%
Lehman Inflation Notes ("TIPS")	0.43%	3.04%	2.70%	9.33%	9.42%	9.99%	N/A
Merrill High Yield	1.90%	2.61%	1.13%	10.62%	14.21%	7.81%	7.28%
Merrill Muncpal	0.67%	3.00%	3.16%	10.00%	6.96%	7.99%	6.99%

Treasury Cash: Equal-weighted total-return avg. of the Treasury yield curve from 3 to 12 month maturities.

Treasury Coupons: Equal-weighted total-return avg. of the Treasury yield curve from 2 to 30 year maturities.

Treasury Strips: Equal-weighted total-return average of Treasury Strips from 1 year to 30 years.

Sources: Bloomberg, Ryan Labs, Lehman Brothers, Merrill Lynch, Salomon Smith Barney and Arbor Research & Trading

## Total Return Comparisons: The "Bullet" versus "Barbells"

Portfolio Type*	As of 6/30/05					
	MTD	Diff.	QTD	Diff.	YTD	Diff.
<b>Bullet (5.04 Duration)</b>	<b>0.44%</b>		<b>3.62%</b>		<b>2.30%</b>	
5 yr and 10 yr	0.51%	0.07%	3.46%	-0.16%	1.96%	-0.35%
5 yr and 30 yr	0.55%	0.11%	3.44%	-0.18%	2.10%	-0.20%
2 yr and 10 yr	0.50%	0.06%	3.48%	-0.14%	2.46%	0.16%
2 yr and 30 yr	0.68%	0.24%	3.41%	-0.21%	3.40%	1.09%
Cash and 10 yr	0.59%	0.15%	3.63%	0.01%	3.01%	0.71%
Cash and 30 yr	0.90%	0.46%	3.64%	0.03%	4.68%	2.38%
Cash and 25 yr Strips	1.04%	0.60%	3.76%	0.14%	5.63%	3.33%

\*This analysis compares the total return of the 5-Year Strip or the "bullet" to cash neutral, duration neutral barbells.

Its purpose is to quantify the effect of the yield curve on total return.

Sources: Bloomberg and Ryan Labs

## World Fixed-Income Total Returns (in U.S. Dollars)

	in U.S. Dollars						
	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>J. P. Morgan Government Bond Indices</b>							
<b>Country</b>							
Canada	3.64%	3.18%	3.34%	22.68%	16.65%	12.14%	9.51%
France	-0.78%	-3.25%	-6.33%	10.36%	15.46%	12.41%	6.41%
Germany	-0.81%	-3.28%	-6.33%	10.26%	15.34%	12.20%	5.30%
Italy	-0.79%	-3.30%	-6.15%	11.54%	15.97%	12.92%	10.29%
Japan	-2.22%	-2.43%	-5.72%	2.71%	4.20%	1.26%	0.41%
United Kingdom	-0.25%	-0.62%	-2.05%	9.84%	12.63%	9.79%	9.78%
United States	0.65%	3.84%	3.38%	7.47%	5.93%	7.23%	6.76%
<b>Region</b>							
Europe	-0.78%	-3.00%	-5.86%	10.51%	15.28%	12.20%	7.31%
Global	-0.76%	-1.14%	-3.55%	7.81%	9.80%	7.98%	5.83%
Global Non-United States	-1.20%	-2.60%	-5.54%	7.87%	11.06%	8.00%	5.10%
<b>J. P. Morgan Emerging Markets Bond Indices</b>							
EMBI Plus	1.78%	6.81%	5.52%	21.37%	19.85%	13.00%	14.64%
<b>Region</b>							
Latin	1.80%	6.76%	4.38%	22.35%	21.94%	9.83%	13.02%
Non-Latin	1.74%	6.88%	7.30%	19.95%	16.99%	20.17%	17.92%

## World Fixed-Income Total Returns (in Local Currency)

	in Local Currency						
	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>J. P. Morgan Government Bond Indices</b>							
<b>Country</b>							
Canada	1.21%	4.45%	5.64%	12.07%	8.53%	7.95%	8.26%
France	1.20%	3.86%	5.17%	10.90%	7.88%	7.28%	7.60%
Germany	1.17%	3.83%	5.16%	10.81%	7.77%	7.08%	6.94%
Italy	1.18%	3.81%	5.37%	12.09%	8.36%	7.77%	10.03%
Japan	0.53%	1.08%	1.95%	4.30%	1.51%	2.20%	3.12%
United Kingdom	1.43%	4.76%	4.91%	11.13%	6.71%	6.14%	8.48%
United States	0.65%	3.84%	3.38%	7.47%	5.93%	7.23%	6.76%
<b>Region</b>							
Europe	1.22%	3.96%	5.21%	11.21%	7.91%	7.27%	8.12%
Global	0.88%	3.09%	3.83%	8.32%	5.64%	5.92%	6.55%
Global Non-United States	0.95%	2.88%	3.97%	8.57%	5.51%	5.38%	N/A

Sources: Bloomberg and J. P. Morgan & Co. Incorporated (<http://www.jpmorgan.com/>)

## U. S. Equity Total Returns

	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Broad Market</b>							
Dow Jones Industrials <sup>2</sup>	-1.69%	-1.62%	-3.65%	0.65%	5.95%	1.73%	10.63%
NASDAQ Composite <sup>1</sup>	-0.48%	3.07%	-5.12%	1.09%	12.62%	-11.75%	7.93%
NASDAQ 100 <sup>2</sup>	-3.18%	0.84%	-7.69%	-1.15%	12.70%	-16.73%	10.92%
NYSE Composite <sup>2</sup>	1.39%	2.17%	1.54%	12.57%	10.77%	3.15%	10.97%
Russell 2000 <sup>4</sup>	3.88%	4.36%	-1.22%	9.54%	12.86%	5.74%	9.93%
S&P 500 (Capitalization Weighted) <sup>3</sup>	0.14%	1.37%	-0.81%	6.32%	8.28%	-2.37%	9.94%
S&P 500 (Equal Weighted) <sup>1</sup>	1.46%	3.08%	0.65%	11.02%	14.50%	9.07%	12.98%
S&P 400 MidCap <sup>3</sup>	2.32%	4.26%	3.85%	14.03%	13.15%	8.49%	14.66%
S&P 600 SmallCap <sup>3</sup>	3.25%	3.94%	1.79%	13.45%	13.95%	10.51%	12.93%
Wilshire 5000 <sup>1</sup>	0.81%	2.32%	0.05%	8.22%	9.95%	-1.27%	9.96%
<b>Interest Rate Sensitive</b>							
PSE Electric Utility Index <sup>2</sup>	5.88%	8.91%	15.35%	39.63%	15.13%	12.75%	10.35%
KBW Bank Stock Index <sup>2</sup>	0.81%	3.46%	-3.26%	5.89%	9.46%	9.27%	14.92%
S&P 500 Financial Index <sup>2</sup>	1.43%	4.32%	-2.31%	5.81%	8.15%	6.88%	14.63%
<b>Other Indices</b>							
Morgan Stanley Consumer Index <sup>2</sup>	-2.38%	-0.98%	-2.67%	0.91%	3.64%	3.27%	10.64%
Morgan Stanley Cyclical Index <sup>2</sup>	-1.11%	-4.27%	-8.39%	3.45%	10.93%	11.75%	10.25%
S&P 500/Barra Growth <sup>3</sup>	-1.24%	0.14%	-1.73%	1.54%	6.43%	-7.87%	9.13%
S&P 500/Barra Value <sup>3</sup>	1.51%	2.58%	0.09%	11.18%	10.09%	3.36%	10.30%
Gold/Silver Stock Index <sup>2</sup>	7.82%	-0.54%	-5.76%	9.10%	11.37%	12.06%	-1.01%

Sources: <sup>1</sup> Wilshire Associates Incorporated (<http://www.wilshire.com>) and Ryan Labs Inc.

<sup>2</sup> Bloomberg L.P. and Ryan Labs Inc.

<sup>3</sup> BARRA, Inc. (<http://www.barra.com>) and Standard & Poors (<http://www.spglobal.com>)

<sup>4</sup> Frank Russell Company (<http://www.russell.com>)

## Commodity Total Returns

	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Commodity Total Return Indices</b>							
Reuters/CRB <sup>1</sup>	1.49%	-2.92%	7.32%	14.41%	14.30%	6.57%	4.39%
Goldman Sachs Commodity <sup>2</sup>	5.81%	-4.50%	16.51%	21.22%	23.82%	10.81%	10.78%
Rogers International Commodities <sup>3</sup>	2.40%	-4.18%	9.63%	19.03%	25.49%	14.63%	13.33%
S&P Commodity <sup>4</sup>	3.57%	-3.83%	13.95%	12.54%	19.65%	8.83%	7.45%

Sources: <sup>1</sup> Reuters/CRB (<http://www.crbindex.com/crbindex/>)

<sup>2</sup> Goldman Sachs (<http://www.gs.com/gsci/>)

<sup>3</sup> Beeland Management Co., L.L.C.

<sup>4</sup> Standard & Poor's ([http://www.spglobal.com/indexmaincommodity\\_data.html](http://www.spglobal.com/indexmaincommodity_data.html))

## World Equity Total Returns (in U.S. Dollars)

	in U.S. Dollars						
	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Morgan Stanley Capital International Indices</b>							
<b>Country</b>							
Canada	6.12%	2.61%	6.40%	29.37%	22.02%	3.91%	12.90%
France	1.19%	-0.83%	1.00%	16.15%	11.97%	-1.09%	9.90%
Germany	0.94%	-1.39%	-3.57%	13.04%	9.35%	-2.37%	6.67%
Italy	1.06%	-3.92%	-3.44%	21.65%	18.10%	3.44%	11.69%
Japan	-0.10%	-3.55%	-5.80%	-1.40%	7.28%	-6.41%	-1.93%
United Kingdom	1.59%	-0.43%	0.92%	16.80%	12.74%	3.08%	8.82%
United States	0.25%	1.64%	-0.41%	6.95%	8.57%	-2.89%	9.95%
<b>Region</b>							
World Index	0.91%	0.60%	-0.40%	10.59%	10.56%	-1.65%	7.51%
EAFE	1.37%	-0.75%	-0.85%	14.13%	12.51%	-0.17%	5.57%
Emerging Markets (Free)	3.45%	4.24%	6.26%	34.89%	24.42%	7.68%	4.28%

## World Equity Total Returns (in Local Currency)

	in Local Currency						
	As of 6/30/05			Annualized Ending 6/30/05			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Morgan Stanley Capital International Indices</b>							
<b>Country</b>							
Canada	3.63%	3.88%	8.76%	18.18%	13.53%	0.02%	11.61%
France	3.20%	6.46%	13.40%	16.72%	4.62%	-5.60%	11.13%
Germany	2.95%	5.86%	8.26%	13.60%	2.17%	-6.83%	8.34%
Italy	3.08%	3.14%	8.42%	22.25%	10.35%	-1.28%	11.43%
Japan	2.72%	-0.08%	1.87%	0.13%	4.51%	-5.54%	0.72%
United Kingdom	3.30%	4.97%	8.09%	18.17%	6.81%	-0.35%	7.53%
United States	0.25%	1.64%	-0.41%	6.95%	8.57%	-2.89%	9.95%
<b>Region</b>							
World Index	1.73%	3.07%	3.66%	10.63%	7.99%	-2.84%	8.44%
EAFE	3.45%	4.82%	8.42%	14.74%	6.60%	-3.11%	6.86%
Emerging Markets (Free)	3.82%	4.54%	7.85%	27.12%	19.03%	7.86%	9.31%

Sources: Bloomberg and Morgan Stanley Capital International (<http://www.msdata.com/>)

## Bianco Research L.L.C.

1731 North Marcey, Suite 510  
Chicago IL 60614

Phone: (847) 304-1511 Fax (847) 304-1749  
e-mail: [research@biancoresearch.com](mailto:research@biancoresearch.com)  
<http://www.biancoresearch.com>

### **For more information about the contents/ opinions contained in these reports:**

**President** (847) 756-3599  
James A. Bianco [jbianco@biancoresearch.com](mailto:jbianco@biancoresearch.com)

**Strategist/Analysts** (847) 304-1511  
Howard L. Simons [hsimons@biancoresearch.com](mailto:hsimons@biancoresearch.com)  
Greg Blaha [gblaha@biancoresearch.com](mailto:gblaha@biancoresearch.com)  
Neil Bouhan [nbouhan@biancoresearch.com](mailto:nbouhan@biancoresearch.com)

### **For subscription/service Information:**

**Arbor Research & Trading, Inc.**  
**Director of Sales & Marketing** (800) 625-1860  
Fritz Handler [fritz.handler@arborresearch.com](mailto:fritz.handler@arborresearch.com)  
Peter Forbes [peter.forbes@arborresearch.com](mailto:peter.forbes@arborresearch.com)

## Arbor Research & Trading, Inc.

1000 Hart Road, Suite 260  
Barrington IL 60010

Phone (847) 304-1560 Fax (847) 304-1595  
e-mail [inforequest@arborresearch.com](mailto:inforequest@arborresearch.com)  
<http://www.arborresearch.com>

### **For more information about Arbor Research & Trading and its services:**

**Director of Fixed-Income Sales** (800) 625-1855  
Daniel Lustig [dan.lustig@arborresearch.com](mailto:dan.lustig@arborresearch.com)

**Chicago Sales Office**  
1 N. LaSalle Street, 40<sup>th</sup> Floor  
Chicago IL 60606  
Bob Youstra [bob.youstra@arborresearch.com](mailto:bob.youstra@arborresearch.com)  
Phone (312) 379-3767

**New York Sales Office**  
230 Park Avenue, Suite 2425  
New York, NY 10169  
Edward T. McElwreath [ed.mcelwreath@arborresearch.com](mailto:ed.mcelwreath@arborresearch.com)  
Phone (212) 867-5326 Fax (212) 370-1218

### **For more information about Arbor Research & Trading and its services:**

**Director of International Sales** (847) 756-3510  
James L. Perry [james.perry@arborresearch.com](mailto:james.perry@arborresearch.com)

**London Sales Office**  
75 Cannon Street London England EC4N 5BN  
Phone 44-207-556-7309 Fax 44-207-556-7468

### **For more information:**

**Director of Arbor (UK)** 44-207-556-7309  
Neil Tritton [neil.tritton@arborresearch.com](mailto:neil.tritton@arborresearch.com)  
Ben Gibson [ben.gibson@arborresearch.com](mailto:ben.gibson@arborresearch.com)