

# Bianco Research L.L.C.

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1731 North Marcey, Chicago IL 60614

www.biancoresearch.com

## Total Return Review

Viewing the Markets from a Total Return Perspective

By Greg Blus and Greg Blaha (847) 304-1511

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### Sharpe Ratios Suggest Too Much Risk for the Reward

Sharpe Ratios measure the amount of an investment return that is in excess of the risk-free rate, adjusted by the standard deviation of that return. Convention uses the yield of the 90-day T-bill as the risk-free rate. In other words, did the investment adequately compensate the investor for taking the risk? The answer, based on the following table of risk-adjusted returns, appears to be - "Gee, I guess not."

For the past several years, the main investment mantra has been "spread is good – more spread is better." However, a look at the Sharpe ratios of various benchmark indices shows that spread wasn't as good as we thought. Over the past year, the risk-adjusted return of the Lehman Credit Index has been -0.34 and that of the Lehman MBS Index has been -0.31. In contrast, the Sharpe ratio of the Treasury Index has been +0.18. The trailing three-year period tells a similar story: Credit at -0.20, MBS at -0.23 and Treasury at -0.15. Even though all of the returns were negative (cash was king), the risky sectors did **worse** than Treasuries.

To further highlight the problems in the credit sector, the lower panel in the sector examines the risk-adjusted returns by rating. All rating classes have generated negative Sharpe ratios over the one-year and three-year periods. Interestingly, the AA and A sectors have done worse than the lower-rated BAA sector. So much for it being "safer" paper!

Sharpe ratios can be a useful tool, but they are, by definition, backward-looking. The lesson that we might take away from the current readings is that, yes, spread **can** be good, but it is not **universally** good. At some spreads, the reward of higher yield does **not** compensate investors for the higher risk in the instrument.

#### Comparing Returns

(Through Q3 2007)

Sharpe Ratio					
Index	1 year	3 years	5 years	7 years	10 years
<b>Treasury Yield Curve</b>					
3-mo T-Bill	0.00	0.00	0.00	0.00	0.00
6-month	1.52	0.43	0.32	0.49	0.35
2-year	-0.07	-0.86	-0.09	0.59	0.37
5-year	0.15	-0.47	0.05	0.46	0.32
10-year	0.20	-0.15	0.12	0.34	0.25
30-year	0.10	0.02	0.14	0.26	0.25
<b>Lehman Broad Indices</b>					
Aggregate	-0.08	-0.14	0.37	0.74	0.59
Gov't/Credit	-0.03	-0.18	0.34	0.64	0.51
Int Gov't/Credit	0.18	0.52	0.50	0.25	0.23
Government	0.16	-0.15	0.21	0.55	0.47
Treasury	0.18	-0.15	0.19	0.49	0.44
Agency	0.09	-0.17	0.25	0.69	0.56
Credit	-0.34	-0.20	0.43	0.73	0.52
MBS	-0.31	-0.23	0.22	0.78	0.70
Municipal	-1.55	-0.23	0.32	0.54	0.37
TIPS	-0.38	-0.11	0.43	0.77	0.61
<b>Lehman Credit Indices</b>					
AAA	-0.15	-0.25	0.18	0.75	0.54
AA	-0.59	-0.29	0.22	0.75	0.57
A	-0.66	-0.27	0.31	0.67	0.47
BAA	-0.36	-0.22	0.59	0.66	0.47
<b>Stock Market Indices</b>					
S&P 500	0.00	1.26	1.33	-0.13	0.28
NASDAQ	2.17	0.51	0.92	-0.31	0.11

**Sharpe Ratio:** The return in excess of the risk-free rate, adjusted by the standard deviation of that return.  
The 90-day T-Bill rate is considered the risk-free rate.

Data Source: Ryan Labs

Concept Courtesy of Mitch Stapley, Fifth Third Funds

**Greg Blus is a Vice-President of Arbor Research & Trading**

## U.S. Fixed Income Total Returns

	As of 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Treasury Cash:</b>	<b>0.36%</b>	<b>0.36%</b>	<b>4.48%</b>	<b>5.39%</b>	<b>4.30%</b>	<b>3.05%</b>	<b>3.98%</b>
3 Month	0.36%	0.36%	4.43%	5.33%	4.27%	3.04%	3.93%
6 Month	0.40%	0.40%	4.89%	5.86%	4.51%	3.22%	4.15%
<b>Treasury Coupons:</b>	<b>2.07%</b>	<b>2.07%</b>	<b>6.10%</b>	<b>6.17%</b>	<b>3.59%</b>	<b>3.81%</b>	<b>5.49%</b>
2 Year	0.39%	0.39%	4.96%	5.46%	3.19%	2.75%	4.53%
5 Year	0.59%	0.59%	5.42%	5.54%	2.61%	2.87%	5.23%
10 Year	1.18%	1.18%	5.54%	5.49%	3.03%	3.52%	5.39%
30 Year	4.25%	4.25%	6.94%	6.26%	5.05%	5.66%	6.58%
<b>Treasury Strips:</b>	<b>1.89%</b>	<b>1.89%</b>	<b>4.86%</b>	<b>4.49%</b>	<b>5.65%</b>	<b>6.68%</b>	<b>8.19%</b>
5 Year	0.62%	0.62%	6.00%	6.32%	3.21%	3.45%	6.11%
10 Year	1.63%	1.63%	5.81%	5.77%	4.10%	5.25%	7.52%
15 Year	2.20%	2.20%	5.24%	4.78%	5.00%	6.70%	8.24%
20 Year	2.44%	2.44%	4.13%	3.54%	5.91%	7.91%	8.67%
25 Year	2.78%	2.78%	4.30%	3.43%	6.27%	8.05%	8.81%
<b>Broad Indices</b>							
Salomon "BIG"	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Lehman Aggregate	0.90%	0.90%	4.77%	5.37%	3.88%	4.42%	5.91%
Lehman Government/Credit	0.91%	0.91%	4.97%	5.40%	3.68%	4.55%	5.95%
<b>Government Indices</b>							
Lehman Government	0.73%	0.73%	5.51%	5.84%	3.77%	3.81%	5.78%
Lehman Treasury	0.79%	0.79%	5.70%	5.91%	3.72%	3.79%	5.75%
Lehman Agency	0.64%	0.64%	5.21%	5.79%	3.90%	3.86%	5.80%
<b>Agency Benchmarks</b>							
2 Year	0.48%	0.48%	5.36%	5.96%	3.76%	3.26%	N/A
5 Year	0.44%	0.44%	5.55%	6.03%	3.45%	3.70%	N/A
10 Year	1.00%	1.00%	5.09%	5.53%	4.35%	4.94%	N/A
30 Year	1.06%	1.06%	3.87%	3.62%	5.61%	6.62%	N/A
<b>Other Indices</b>							
Merrill Corporate	1.09%	1.09%	3.79%	4.31%	3.50%	5.68%	6.14%
Lehman Mortgage	1.01%	1.01%	4.77%	5.67%	4.35%	4.26%	5.82%
Lehman Inflation Notes ("TIPS")	1.12%	1.12%	7.54%	6.32%	4.07%	6.16%	7.30%
Merrill High Yield	0.61%	0.61%	4.02%	6.85%	7.00%	12.84%	6.19%
Merrill Muncipal	0.40%	0.40%	2.41%	2.95%	4.03%	4.99%	5.72%

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 10/31/07					
	MTD	Diff.	QTD	Diff.	YTD	Diff.
<b>Bullet (4.45 Duration)</b>	<b>0.62%</b>		<b>0.62%</b>		<b>6.00%</b>	
5 yr and 10 yr	0.58%	-0.04%	0.58%	-0.04%	5.42%	-0.58%
5 yr and 30 yr	0.57%	-0.05%	0.57%	-0.05%	5.41%	-0.58%
2 yr and 10 yr	0.73%	0.12%	0.73%	0.12%	5.21%	-0.79%
2 yr and 30 yr	1.12%	0.50%	1.12%	0.50%	5.33%	-0.67%
Cash and 10 yr	0.82%	0.21%	0.82%	0.21%	5.06%	-0.94%
Cash and 30 yr	1.45%	0.83%	1.45%	0.83%	5.13%	-0.87%
Cash and 25 yr Strips	0.79%	0.17%	0.79%	0.17%	4.40%	-1.60%

\*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 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>J. P. Morgan Government Bond Indices</b>							
<b>Country</b>							
Canada	5.31%	5.31%	24.80%	20.46%	14.00%	16.70%	10.24%
France	2.55%	2.55%	11.12%	13.99%	7.16%	12.18%	7.63%
Germany	2.46%	2.46%	11.47%	14.37%	7.27%	12.21%	7.55%
Italy	2.53%	2.53%	11.07%	13.83%	7.42%	12.53%	8.02%
Japan	0.25%	0.25%	5.16%	3.86%	-1.59%	1.97%	2.24%
United Kingdom	2.86%	2.86%	8.12%	9.13%	8.36%	10.08%	8.27%
United States	0.81%	0.81%	5.73%	5.96%	3.79%	3.93%	5.86%
<b>Region</b>							
Europe	2.56%	2.56%	10.76%	13.41%	7.40%	12.07%	7.87%
Global	1.55%	1.55%	8.24%	9.02%	4.07%	7.24%	5.87%
Global Non-United States	1.76%	1.76%	8.99%	9.94%	4.13%	8.33%	5.65%
<b>J. P. Morgan Emerging Markets Bond Indices</b>							
EMBI Plus	2.56%	2.56%	6.33%	8.56%	10.75%	15.02%	11.23%
<b>Region</b>							
Latin	2.97%	2.97%	6.41%	8.53%	11.42%	17.15%	10.11%
Non-Latin	2.03%	2.03%	6.28%	8.66%	9.81%	12.10%	13.34%

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

	in Local Currency						
	As of 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>J. P. Morgan Government Bond Indices</b>							
<b>Country</b>							
Canada	0.66%	0.66%	1.86%	2.11%	4.88%	5.60%	5.98%
France	0.81%	0.81%	1.28%	0.56%	2.66%	3.99%	5.10%
Germany	0.71%	0.71%	1.60%	0.89%	2.77%	4.02%	4.98%
Italy	0.79%	0.79%	1.24%	0.43%	2.91%	4.31%	5.53%
Japan	0.48%	0.48%	1.74%	2.20%	1.15%	0.74%	1.80%
United Kingdom	0.88%	0.88%	1.86%	0.19%	3.92%	4.01%	5.97%
United States	0.81%	0.81%	5.73%	5.96%	3.79%	3.93%	5.86%
<b>Region</b>							
Europe	0.78%	0.78%	1.46%	0.61%	2.93%	4.13%	5.35%
Global	0.70%	0.70%	2.55%	2.35%	2.67%	3.15%	4.62%
Global Non-United States	0.66%	0.66%	1.59%	1.26%	2.32%	2.91%	4.16%

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

## U. S. Equity Total Returns

	As of 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Broad Market</b>							
Dow Jones Industrials <sup>2</sup>	0.38%	0.38%	13.73%	17.92%	14.13%	13.18%	8.62%
NASDAQ Composite <sup>1</sup>	5.88%	5.88%	19.09%	21.74%	13.98%	17.30%	5.83%
NASDAQ 100 <sup>2</sup>	7.08%	7.08%	27.88%	29.85%	15.13%	18.16%	8.41%
NYSE Composite <sup>2</sup>	2.82%	2.82%	14.64%	19.88%	17.94%	17.73%	9.27%
Russell 2000 <sup>4</sup>	2.87%	2.87%	6.12%	9.29%	13.75%	18.72%	8.03%
S&P 500 (Capitalization Weighted) <sup>3</sup>	1.59%	1.59%	10.86%	14.55%	13.15%	13.88%	7.10%
S&P 500 (Equal Weighted) <sup>1</sup>	1.28%	1.28%	8.30%	11.83%	14.22%	18.82%	10.60%
S&P 400 MidCap <sup>3</sup>	2.63%	2.63%	13.92%	17.01%	16.01%	17.78%	12.38%
S&P 600 SmallCap <sup>3</sup>	1.86%	1.86%	8.56%	11.55%	14.29%	18.42%	10.10%
Wilshire 5000 <sup>1</sup>	1.91%	1.91%	11.21%	15.06%	14.10%	15.23%	7.41%
<b>Interest Rate Sensitive</b>							
PSE Electric Utility Index <sup>2</sup>	6.40%	6.40%	17.76%	21.44%	21.35%	22.72%	12.21%
KBW Bank Stock Index <sup>2</sup>	-2.20%	-2.20%	-9.41%	-5.94%	4.77%	9.77%	6.94%
S&P 500 Financial Index <sup>2</sup>	-1.80%	-1.80%	-6.63%	-2.40%	8.37%	11.15%	7.85%
<b>Other Indices</b>							
Morgan Stanley Consumer Index <sup>2</sup>	0.77%	0.77%	9.78%	14.35%	13.75%	11.00%	8.50%
Morgan Stanley Cyclical Index <sup>2</sup>	0.43%	0.43%	21.44%	27.36%	17.95%	22.27%	10.68%
S&P 500/Barra Growth <sup>3</sup>	2.13%	2.13%	12.95%	15.67%	11.70%	11.27%	5.81%
S&P 500/Barra Value <sup>3</sup>	1.05%	1.05%	8.93%	13.58%	14.68%	16.60%	8.00%
Gold/Silver Stock Index <sup>2</sup>	11.54%	11.54%	33.23%	38.51%	23.50%	26.24%	9.66%

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 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Commodity Total Return Indices</b>							
Reuters/CRB <sup>1</sup>	5.58%	5.58%	18.86%	20.36%	11.27%	11.98%	4.21%
Goldman Sachs Commodity <sup>2</sup>	9.61%	9.61%	30.26%	27.67%	6.02%	16.31%	7.25%
Dow Jones-AIG Commodity	3.33%	3.33%	14.68%	15.40%	10.10%	15.12%	7.94%
Rogers International Commodities <sup>3</sup>	3.36%	3.36%	24.38%	25.77%	12.74%	20.83%	11.97%
Brookshire International Raw Materials	6.04%	6.04%	26.16%	27.61%	16.11%	24.00%	N/A
S&P Commodity <sup>4</sup>	5.42%	5.42%	21.05%	19.54%	4.93%	12.52%	4.28%

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 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Morgan Stanley Capital International Indices</b>							
<b>Country</b>							
Canada	9.39%	9.39%	42.52%	45.70%	32.11%	34.22%	16.03%
France	3.83%	3.83%	17.49%	26.49%	24.77%	24.56%	13.06%
Germany	4.65%	4.65%	35.37%	47.44%	32.89%	30.87%	11.41%
Italy	3.79%	3.79%	10.51%	19.09%	21.21%	25.08%	12.67%
Japan	-0.38%	-0.38%	1.66%	4.93%	14.39%	16.80%	3.98%
United Kingdom	6.02%	6.02%	17.72%	23.66%	22.00%	21.32%	8.79%
United States	1.69%	1.69%	11.34%	14.92%	13.52%	14.09%	6.99%
<b>Region</b>							
World Index	3.09%	3.09%	15.64%	20.97%	18.84%	18.88%	8.35%
EAFE	3.94%	3.94%	18.05%	25.43%	23.96%	23.71%	9.64%
Emerging Markets (Free)	11.16%	11.16%	49.90%	68.33%	45.22%	40.31%	15.18%

## World Equity Total Returns (in Local Currency)

	in Local Currency						
	As of 10/31/07			Annualized Ending 10/31/07			
	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
<b>Morgan Stanley Capital International Indices</b>							
<b>Country</b>							
Canada	4.56%	4.56%	16.32%	23.51%	21.55%	21.45%	11.54%
France	2.06%	2.06%	7.09%	11.59%	19.53%	15.47%	10.39%
Germany	2.87%	2.87%	23.38%	30.08%	27.31%	21.31%	8.75%
Italy	2.03%	2.03%	0.72%	5.06%	16.12%	15.95%	10.08%
Japan	-0.15%	-0.15%	-1.64%	3.26%	17.56%	15.39%	3.54%
United Kingdom	3.98%	3.98%	10.91%	13.53%	17.00%	14.63%	6.49%
United States	1.69%	1.69%	11.34%	14.92%	13.52%	14.09%	6.99%
<b>Region</b>							
World Index	2.16%	2.16%	10.73%	15.03%	16.93%	15.68%	7.39%
EAFE	2.43%	2.43%	9.69%	14.47%	20.75%	17.08%	7.59%
Emerging Markets (Free)	8.96%	8.96%	41.42%	56.65%	38.99%	33.53%	16.73%

Sources: Bloomberg and Morgan Stanley Capital International ([http://www.ms\\_cidata.com/](http://www.ms_cidata.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/Analyst** (847) 304-1511

Howard L. Simons [hsimons@biancoresearch.com](mailto:hsimons@biancoresearch.com)

Greg Blaha [gblaha@biancoresearch.com](mailto:gblaha@biancoresearch.com)

Ryan Malo [rmalo@biancoresearch.com](mailto:rmalo@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)

## 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>

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

#### Chicago Sales Office

1 North LaSalle Street, 40th Floor  
Chicago IL 60602

Daniel Lustig [dan.lustig@arborresearch.com](mailto:dan.lustig@arborresearch.com)

Phone (866) 877-0266 Fax (312) 269-1681

#### New York Sales Office

The Chrysler Building, 405 Lexington Ave  
New York, NY 10174

Edward T. McElwreath [ed.mcelwreath@arborresearch.com](mailto:ed.mcelwreath@arborresearch.com)

Phone (212) 867-5326 Fax (212) 370-1218

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

#### London Sales Office

4 Broadgate, 2nd Floor, Room 57

London England EC2M 2QY

Phone 44-207-965-4784 Fax 44-207-965-4787

Neil Tritton [neil.tritton@arborresearch.com](mailto:neil.tritton@arborresearch.com)

Ben Gibson [ben.gibson@arborresearch.com](mailto:ben.gibson@arborresearch.com)

#### European Sales

James L. Perry [james.perry@arborresearch.com](mailto:james.perry@arborresearch.com)

Phone (847) 756-3510 Fax (847) 304-1595

Rich Kleinbauer [rich.kleinbauer@arborresearch.com](mailto:rich.kleinbauer@arborresearch.com)

Phone (41) 22 363-9229

#### Far East Sales

Robert Reynolds [robert.reynolds@arborresearch.com](mailto:robert.reynolds@arborresearch.com)

Phone (847) 756-3680 Fax (435) 647-3073