

Tactical managers are back.

In the 1970s, pension committees looked to overlay strategies to add alpha and to control portfolio drift. These managers used options and futures to participate in market advances and protect against losses. Then risk went on a 20 year holiday and tactical managers fell out of favor. In the 1980s, investment decisions were transferred from pension committees to employees. Rising stock prices masked poor plan utilization. Legislators and regulators, aware of the demographics, introduced QDIAs to improve asset allocations, savings, and participation.

And then the system broke down.

In 2008, all funds, all categories, and all international markets zigged and zagged together. This exposed mean reversion models to a "Black Swan" event (see "Black Swan" and "Fooled by Randomness" by N.N. Taleb). Whatever trust that was re-established after the dot.com, Enron, and fund scandals is being tested as investors, including active legislators and class action lawyers, opened their year end statements.

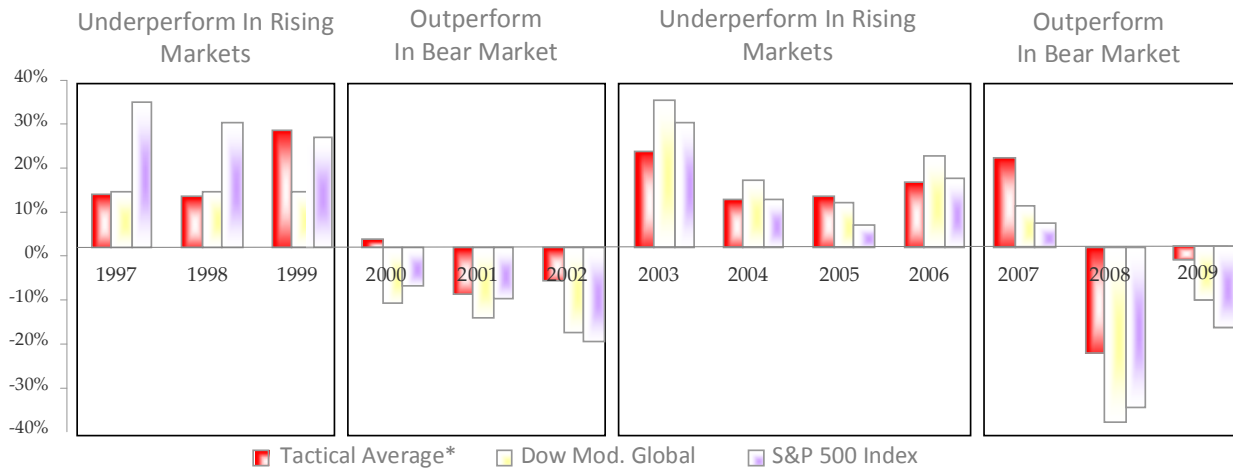
This section of the Center for Due Diligence tracks the re-emergence of tactical managers. We define tactical managers here as those who follow prudent, identifiable methodologies, not 'finger in the wind' market timing. As the CFDD is retirement focused, we will only (1) track money managers with no ERISA conflicts who (2) comply with PPA Section 624 prohibitions against 100% stocks to 100% cash, swings.

Category Update

During the 'pre-credit crisis' years of abnormally high returns at low risk, tactical managers tended to exit markets too early and stay out too long. Poor results pushed most of the original 1970s group to retirement or to manage hedge funds. As we return to a 1970s-type environment of moderate gains at high volatility levels, surviving tactical allocators are returning to favor, as their strategies were designed to work best in these markets.

	YTD	1 year	3 years	5 years	7 years	10 years
Long Term Tactical	-2.21%	-22.03%	-1.93%	3.40%	4.32%	4.19%
Dow Jones Moderate Global	-6.27%	-26.09%	-6.44%	-0.16%	2.73%	3.17%
S&P 500 Index	-11.01%	-38.09%	-13.06%	-4.76%	-3.20%	-3.00%

Tactical Managers Through Market Cycles



* Equal weighting of GE Strategic, Blackrock Global, Morgan Stanley Strategic, Waddell & Reed Asset Strategy, GMO Global, Shepherd Fund, State Street Balanced, Ivy Asset Strategy, Avatar G&I . Source: Zephyr 3/31/09

Avatar Update Avatar has submitted an Advisory Opinion request to the United States Department of Labor seeking to clarify the fiduciary status of proprietary fund of funds in qualified plans. Fiduciaries are responsible for removing all real and potential conflicts of interest. In light of market losses, Congressional, and media scrutiny, conflicts justified by technicalities will not be accepted. Our industry must raise the bar on prudence and plan safety or the privilege of helping Americans retire with dignity will be taken away.

Positions to Consider Data as of 3/31/09

Domestic Equities: Over	<u>Sector Ranking to Consider</u>	
International Equities: Neutral	1 Tech	6 Discretionary
Bonds: Neutral	2 Utilities	7 Industrials
Cash Equivalents: Neutral	3 Cons Staples	8 Materials
	4 Telecom	9 Financials
	5 Healthcare	10 Energy

Our Research

For well over a year, many analysts have contended that the U.S. equity market and, especially, the financial stocks were cheap. Our perspective on valuations is quite different than consensus. While traditional tools such as applying price/earnings ratios to expected earnings has its place, we find it to be very crude. Similarly, more formal disciplines like estimating dividends far into the future and then discounting them back at a rate related to bond yields give only a very rough sense of value. Rather, our own approach is to supplement those disciplines with what we refer to as "Practical Valuation." Our focus is on discerning what certain investor groups are doing and saying. We know that corporate insiders tend to buy low and sell high. We also know that mutual fund investors tend to redeem their shares, unfortunately, near low points but add substantial new inflows near high points. Additionally, we monitor opinion surveys where the consensus of investors is very reliably incorrect at crucial moments: the majority are bearish at bottoms and bullish at tops. Thus, by carefully assembling this type of data we can infer what value really is. Based on these tools, we have only recently seen enough evidence that value is being created in the stock market to warrant a more favorable attitude.

Our **Economic Liquidity** model continues at its very high and bullish levels. The Federal Reserve is making history with its very aggressive grants of credit and outright distribution of funds. This should be no surprise given Chairman Ben Bernanke's academic background. He is one of the country's leading scholars on combating serious economic recessions and, even, depressions. Our bullishness would be tempered if any material weakness begins to show in the dollar.

Our **Investor Liquidity** model is bullish. As we discussed above, many of the metrics we use to create the mosaic of valuation have become positive. If the market continues to respond in like manner, there will be many who think any let up in the overwhelming sense of bearishness would hurt the market. On the contrary, our experience is that this early stage of reversal in thinking typically is associated with stronger markets.

Our **Momentum model** has bullish elements. Most importantly, however, we do not yet see enough evidence that growing buyer enthusiasm is being met by diminished selling. In a sense, the sentiments we refer to in the comments above have not become widespread enough. Again, rather than worrying about enthusiasm, we welcome it -- at this low level of equity prices.

Our **Bond model**. For the first time in more than two years, we are seeing some evidence which would permit us to raise our exposure in lesser-rated corporate credits. On the other hand, this evidence is not conclusive and can be too easily reversed if the economy suffers another shock like it did in the fall. If we move farther out on the credit spectrum, the funds will largely come from Treasuries, which have the least risk

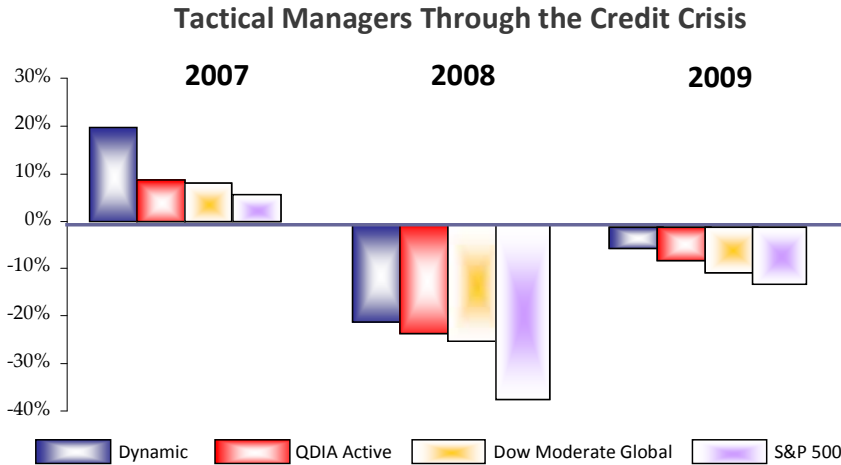
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Tactical Management Notes

It is useful, then, to divide tactical managers into two groups. First are the fully dynamic managers which have no benchmark mandates and may swing from 100% cash to 100% equities, adding leverage, and derivatives.

Next are traditional tactical allocators who begin from a benchmark and allocate “out” rather than from all cash/all equities and allocate “in”. Tactical shifts are typically only 10-20% around a fixed baseline; e.g., a 60/40 stocks/bonds

As the chart below shows, Dynamic Managers, those with the dexterity to go to cash, performed well in the declining markets of 2007-2009. Traditional tactical allocators (called QDIA Allocators here, as they qualify as default alternatives under the Pension Protection Act)) also performed well, but because they were tethered to their equity baselines, may not have been as defensive as they would have liked.



	YTD	2008	2007
Dynamic Tactical	-2.83%	-24.50%	15.54%
QDIA Tactical	-5.18%	-22.97%	8.72%
Dow Mod. Global	-6.27%	-24.74%	8.02%
S&P 500 Index	-11.01%	-37.00%	5.49%

Dynamic Managers: *GMO Benchmark Free, PIMCO All Asset All Authority, UBS Dynamic Alpha, Morgan Stanley Strategist, Ivy Asset Strategy*

QDIA Active Allocators: *Blackrock Global Allocation, Northern Trust Global Tactical, State Street Balanced, Avatar Income & Growth, GMO Global Balanced*

Source: Zephyr 3/31/09; Equal weighting

We welcome your comments and questions:

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About Avatar

Pension funds and individuals have looked to Avatar for tactical overlay and global risk rotation investment strategies since 1970. The firm is now extending its proven techniques to 401(k) and other retirement savings plans. Since senior management includes both the architects of the Pension Protection Act’s business processes and respected tactical portfolio managers, Avatar QDIAs are designed to reduce both market and fiduciary risks. Unlike most lifecycle, balanced, and managed accounts, Avatar allocations are actively managed, deliver consistently strong returns, have no conflicts of interest, and are priced at institutional fee levels.

Active allocation, low fee, transparent, no conflicts



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