

THE RETIREMENT INCOME COMPASS

BECAUSE THERE ARE BIG RISKS ON THE ROAD AHEAD

Investing Challenge/Compass Advantage

Why Diversification Matters: Past Performance is Poor Predictor

Best-Performing Asset-Class Index (at top) to Worst-Performing (at bottom) from 1990-2009

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Asset-Class Index Color
9.0%	51.2%	29.1%	32.6%	7.8%	40.0%	25.6%	35.5%	45.1%	43.1%	22.8%	14.0%	10.3%	48.5%	22.3%	13.7%	26.5%	12.2%	5.2%	37.4%	S&P 400 Mid-Cap
1.4%	50.1%	18.4%	23.8%	4.9%	38.7%	23.0%	33.7%	28.6%	29.7%	17.5%	8.4%	-11.4%	47.3%	20.7%	12.6%	23.5%	11.3%	-28.9%	37.2%	Russell Large Growth
-3.1%	46.1%	11.9%	19.8%	1.3%	37.6%	22.3%	33.4%	21.2%	27.0%	11.6%	2.5%	-14.5%	46.0%	18.3%	4.9%	23.0%	7.9%	-33.8%	34.5%	Russell Small Growth
-3.7%	41.7%	9.1%	18.9%	-1.5%	31.0%	21.4%	32.3%	20.0%	21.3%	2.3%	-0.6%	-15.8%	38.8%	16.5%	4.7%	18.4%	7.1%	-36.1%	31.8%	MSCI EAFE International
-5.1%	39.4%	7.8%	14.0%	-1.8%	31.0%	19.2%	31.8%	19.1%	21.0%	-3.0%	-8.8%	-18.0%	35.6%	14.3%	4.6%	15.8%	7.0%	-36.1%	27.2%	Russell Small
-17.4%	30.5%	7.6%	13.4%	-1.9%	28.4%	16.5%	22.4%	8.7%	14.7%	-9.1%	-9.2%	-20.5%	28.7%	13.3%	4.6%	13.4%	5.5%	-36.2%	26.5%	S&P 500 Large
-19.5%	18.2%	7.4%	10.1%	-2.4%	25.8%	11.3%	13.0%	1.2%	11.0%	-13.5%	-11.9%	-22.1%	26.8%	10.9%	4.2%	10.3%	0.3%	-37.0%	20.6%	Russell Small Value
-21.8%	16.0%	3.9%	9.8%	-2.9%	18.5%	6.1%	9.7%	-2.6%	-0.8%	-22.4%	-20.5%	-28.0%	26.6%	4.3%	2.9%	8.6%	-1.6%	-38.5%	19.7%	Russell Large Value
-23.5%	12.1%	-12.2%	-0.1%	-3.6%	11.2%	3.6%	1.8%	-6.5%	-1.5%	-24.5%	-21.3%	-30.3%	4.1%	3.7%	2.4%	4.3%	-9.8%	-43.3%	5.9%	U.S. Bond Aggregate

Source: Fidelity Investments. Past performance is no guarantee of future results. You cannot invest directly in an index. Diversification does not insure a profit or guarantee against a loss.

The Investing Challenge

The table represents the 20-year performance of nine different asset-class indexes (used to build mutual funds or create a fund benchmark). Shown below are the 20-year cumulative results for two investing strategies, starting with \$100,000:

- **Switch to Best Performing Index:** At the start of each year the investor switches the portfolio into the previous year's best performer. **Ending value \$449,970.**
- **Maintain a Diversified Portfolio:** This strategy maintains an equal investment into each of the indexes by rebalancing the portfolio to an equal allocation at the start of each year. **Ending value \$507,840, \$57,870 more than the Switch strategy.**

A review of the jaw-dropping returns for each year's winner makes it easy to see why investors try to chase 'hot' performers based on the outperformance for a year or some other cycle. It's a futile exercise!

The Compass Advantage

Madden's managed portfolios are built with the Diversified Portfolio strategy. By maintaining investments over the nine asset classes, the strategy accrued \$57,870 more than the Switch strategy. The strategy has these extra advantages:

- **Less Variability**—each year's portfolio performance would be in the mid range of the table since the portfolio's return is a composite of all nine asset classes, and
- **Greater Tax Efficiency**—taxable accounts using the Switch strategy would have a capital gains tax liability each year. The Diversified Portfolio strategy will have much smaller tax liability since only a portion of gains would be recognized in rebalancing of the portfolio's asset classes.

While there are no guarantees, it's reasonable to assume that a Diversified Portfolio strategy can be expected to provide a superior return with less volatility and greater tax efficiency over the long run.

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What to know...
and how to go

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