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Donald G Creech, CFP(r) AIF(r)
Investor Resources, Inc.

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Advisor Edition

Staying On Track

Extract of Quantitative Analysis of Investor Behavior —2005 ©

You will get an understanding of the "Guess Right Ratio" in this report. It shows that investors abandon their plan at the worst possible times —during down markets. By way of contrast, you will see what happened when investors stayed the course.

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Guess Right Ratio

What is the Guess Right Ratio?

The Guess Right Ratio indicates when the average equity investor correctly "guesses" the direction of the market. Net flows into mutual funds are used to determine if investors made short term gains by correctly anticipating the direction of the market. The average investor guesses right when there is either net inflow followed by a market rise or net outflow followed by a down turn.

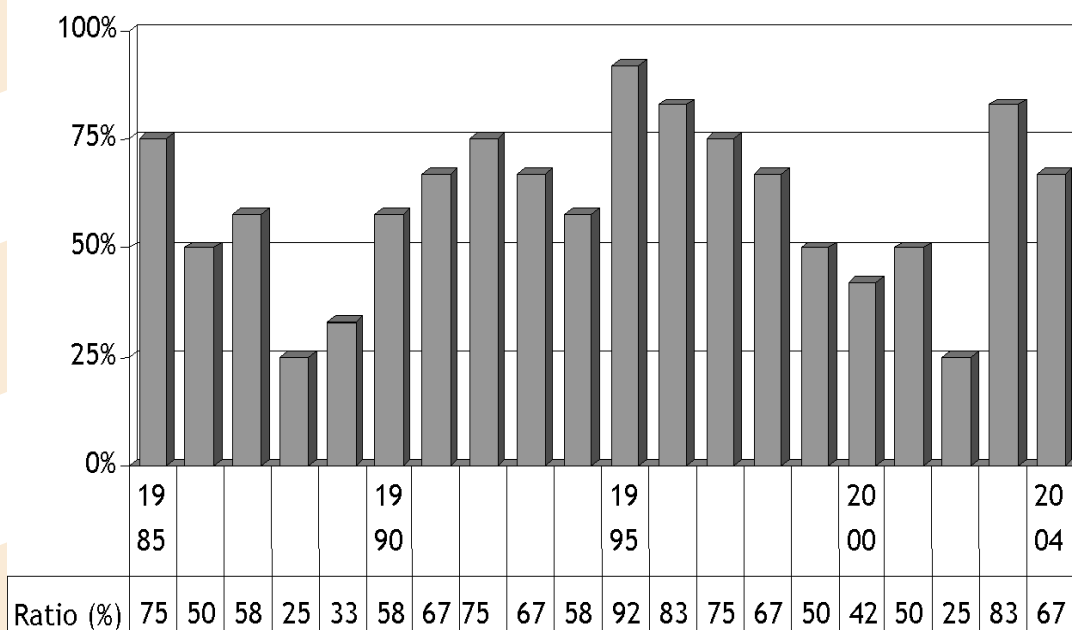
In general, profits are made when the Guess Right Ratio exceeds 50%, indicating that investors must be right at least half the time in order to gain more than is lost.

Note that this statistic is not dollar weighted so it cannot be used to measure returns.

Investors Guess Wrong During Declines

The Guess Right Ratio is strongest during periods of rising markets (1985, 1995, 1996 and 2003) but investors make most mistakes after the down turns (1988, 1989, 2002). These mistakes occur because investors are driven by the fear that the market will not recover, but as broad indices show, the market does recover.

The overall Guess Right Ratio for the 20 year period is 60%.



Commentary

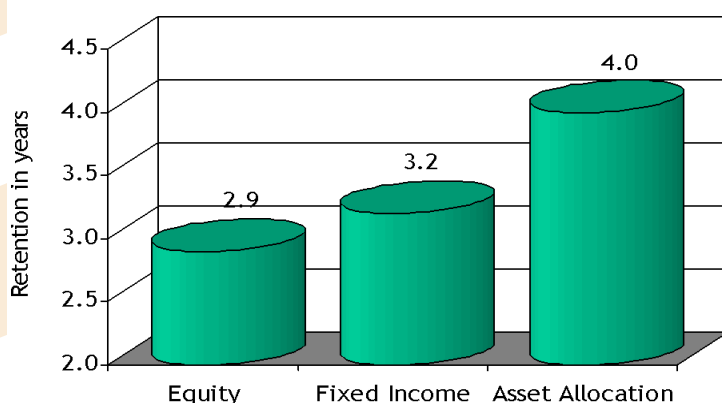
It is easier to make the right decision when markets are rising and the fear of loss is on the back burner. The really smart decision, that most investors get wrong, is to invest when the market is down.

"If you don't know when to get out, it is better to stay in."



Retention Rates Equity, Fixed Income and Asset Allocation

Average Retention Over 20 Years



Asset Allocation Investors Show Discipline

Asset allocation funds handle decisions for investors and this study finds that investors actually hold them for longer.

The 20 year analysis shows that asset allocation funds are held for substantially longer periods than either equity or fixed income funds.

All Classes Show Improved Retention

Asset retention increased for equity, fixed income and asset allocation funds in 2004. These improvements produced substantial gains for the average investor.

Equity funds improved from 3.3 to 4.2 years, fixed income funds from 2.9 to 3.2 years and asset allocation funds increased from 4.8 to 5.3 years.

Commentary

Investors are holding on to their mutual funds for longer and this is a very good indication that previous imprudent behavior is being corrected.

If maintained, the effect of this change will likely be higher investor returns.

"Check your fund every year to avoid a panic."

Average Retention measured over:	1 Year	3 Years	5 Years	10 Years	20 Years
Average Equity Fund Investor	4.2	3.3	3.0	3.0	2.9
Average Fixed Income Investor	3.2	2.9	2.9	3.0	3.2
Average Asset Allocation Investor	5.3	4.8	4.4	4.4	4.0



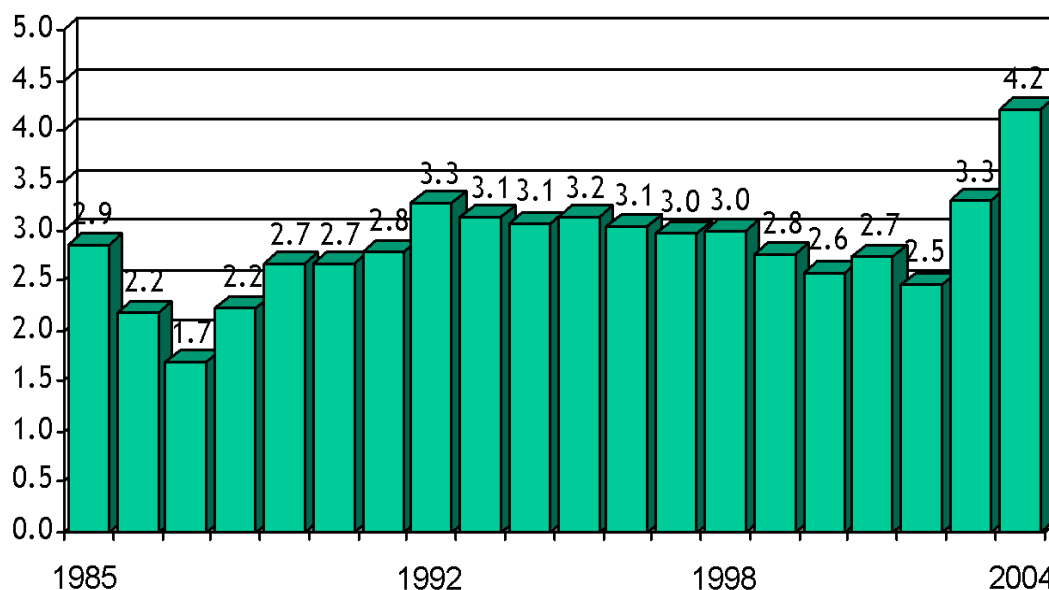
Equity Investors Retention Rates

Increased Retention Pay Big Dividends in 2004

The equity fund retention rates set a new record in 2004. Retention was at the highest level since 1984, when the tracking began. Investors held on to their mutual funds in spite of a weak market during the first three quarters. This contributed greatly to investors actually earning more than the S&P 500. This was not due to outstanding fund performance but to investor behavior. Investors wisely continued to plow money into their funds as the market declined, and kept them there so the post-election rally pushed real returns past the benchmark.

The desirable investment behavior in 2004 followed another year of good behavior (2003) which also set a record for retention. It is too early to speculate whether this improved behavior will continue, but it is encouraging to compare recent actions to the 1987 crash when retention reached record low levels.

Equity Investors Retention (Years)



Commentary

Retention is critical to investment success for the obvious reason that you cannot benefit from the market if you are not in the market. While it is highly profitable to avoid market down turns, very few investors do this successfully. Unless you can predict when down turns will occur and for how long, the strategy of getting out to avoid a loss does not work.

Consider that the market moved up 60% of the time and down only 40% for each month of the last 20 years.

"Remaining invested is betting with the odds."



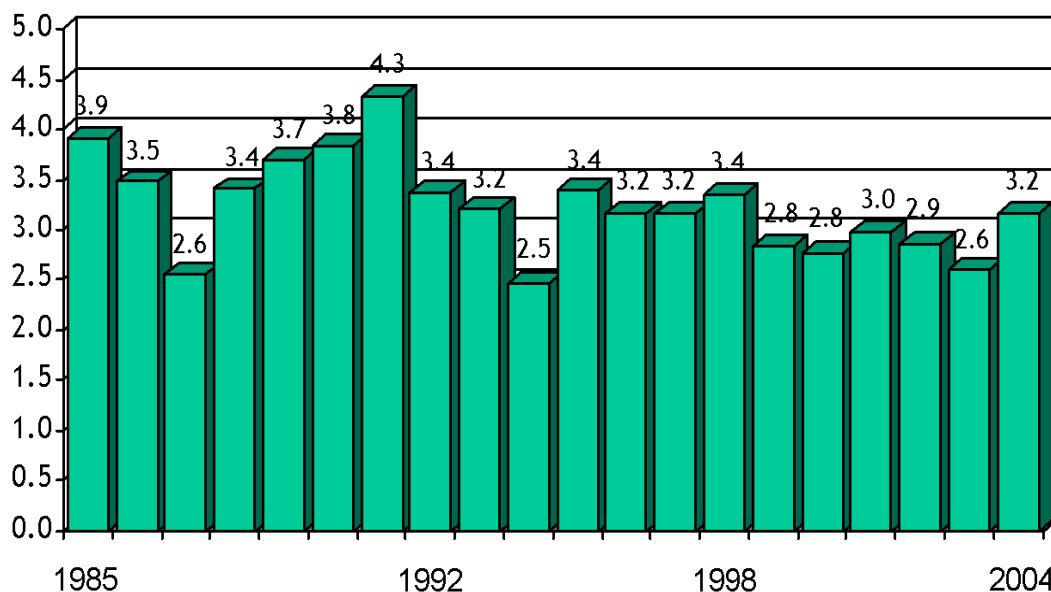
Fixed Income Investors Retention Rates

Bond Investors Held as Long Term Rates Held

The expected increase in long term rates that drove investors out of bond funds in 2003 never materialized. These fixed income investors decided to hold on to their funds and pushed retention rates back over the three year level.

The persistently low long term interest rates have protected bond investors from significant loss of principal that would occur if there was an increase in rates.

Fixed Income Investors Retention (Years)



Commentary

Fixed income fund investors have historically made fewer errors than their equity counterparts. This trend was dramatically reversed in 2004 when equity investors remained invested, driving retention to record levels.

While long term rates have remained low, this is not sustainable and rates are likely to rise to historical norms.

"Bond funds are the cushion for a bumpy stock market."



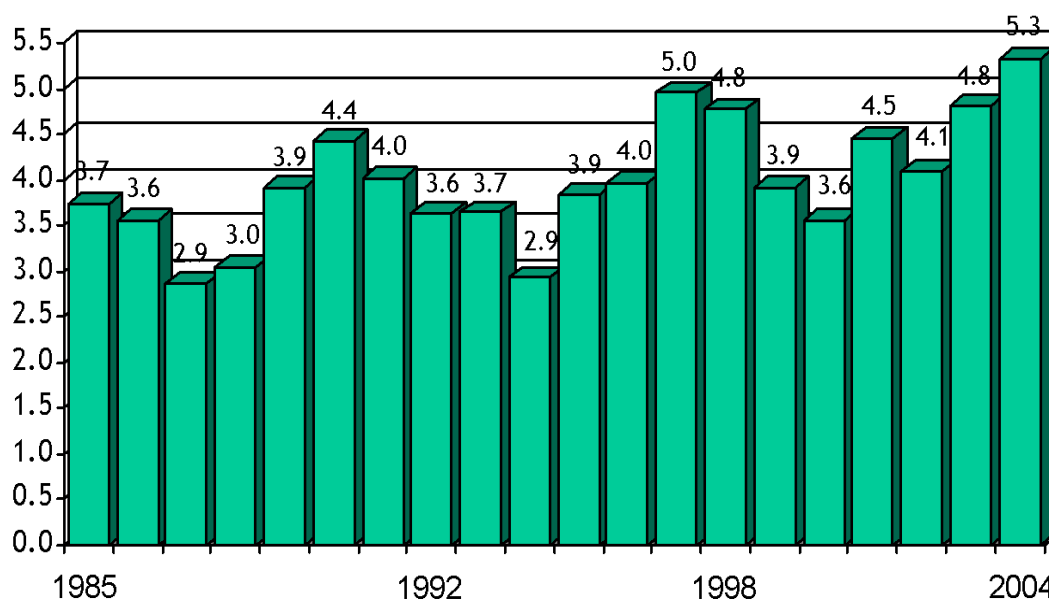
Asset Allocation Investors Retention Rates

Asset Allocation Funds Encourage Good Behavior

Longer retention rates are expected since asset allocation funds handle the rebalancing for investors. Retention rates for these funds give evidence that this does work. The retention rates for asset allocation investors are substantially longer than either equity or fixed income counterparts.

At a retention rate of 5.3 years, asset allocation funds are successful in limiting the investor losses that occur because of fear based selling. Even in the face of the most severe market declines in history (2000 - 2002), retention in these funds remained above 3.6 years. This retention limited investors realized losses and took advantage of the recovery in 2003 and 2004.

Asset Allocation Investors Retention (Years)



Commentary

Asset allocation funds have created a comfort zone for investors that protects them from their own errors.

While traditional performance measures show asset allocation funds severely underperforming equities, the improved investor behavior that they produce has prevented significant losses for investors.

"Asset allocation funds don't perform better, they make investors perform better."



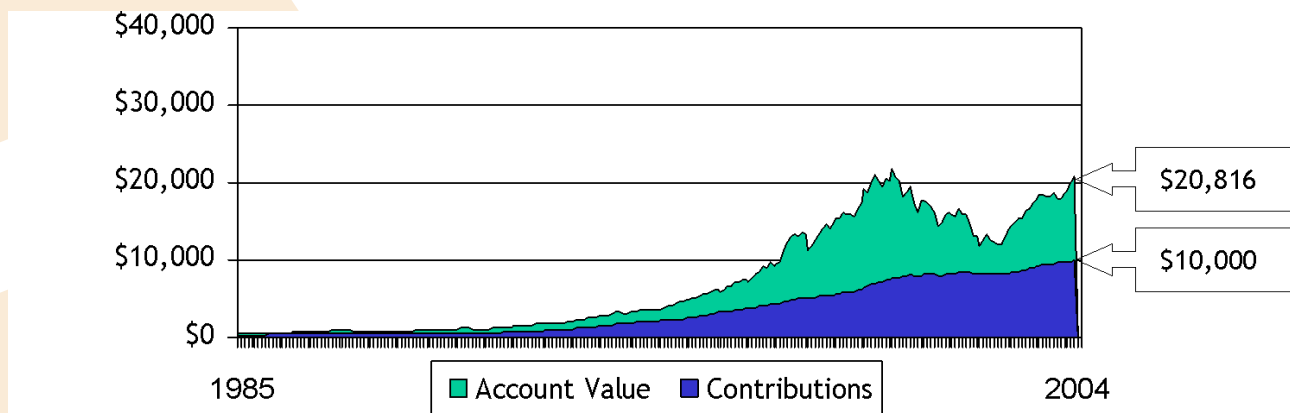
Hypothetical \$10,000 Investments

Comparison of Average Investor Behavior to Systematic Investing

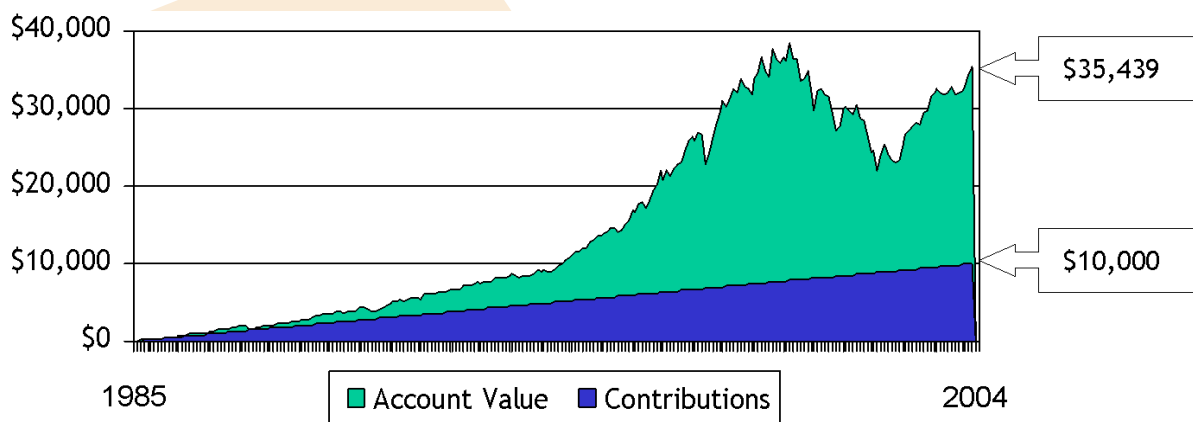
The first illustration depicts the growth of an average equity mutual fund investment when \$10,000 in contributions are made in the same pattern as the average investor. The results are an ending value of \$20,816.

The second illustration depicts the growth of a systematic investor using dollar cost averaging to make \$10,000 in contributions. This systematic investor ending value is \$35,439; representing an advantage of \$14,623 or 70% over the 20 year period.

Average Investor



Systematic Investor



Commentary

The 70% advantage of systematic investing shows the importance of consistency in wealth building. The benefit of dollar cost averaging illustrated here can be dramatically improved by increasing contributions over time.

"Start early, keep contributing and don't panic."

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