LORING WARD
A BETTER WEALTH EXPERIENCE

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PORTFOLIO PERSPECTIVES

Rolling the Dice on Return Premiums

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Test your knowledge of probability: If I'm rolling two standard six-sided dice and you're picking the outcome (the sum of the two dice, any number between 2 and 12), what number do you pick?

If you've taken statistics or played many dice games, your strategy is to pick 7 because 7 is the most likely outcome. There are actually six different ways to roll a 7: 1+6, 2+5, 3+4, 4+3, 5+2, 6+1. That's more than any other number.

Now the wrinkle: Let's assume this is my tenth roll and I have not yet rolled a 7. What number do you pick now? Yes, 7! And what if I have rolled 100 or even 1,000 times without a 7? What number do you pick for the next roll? Yes, again 7!

Seven is the most likely outcome and the logical number to pick, no matter the previous results. Unless you are a fortuneteller, any other number is pure speculation and not grounded in science.

For the last 25 years we've constructed portfolios using science and the knowledge of various return premiums available in the market. We rely heavily on the work of Nobel Laureates and academics to zero in on return premiums that can help us construct better portfolios. We still don't fully understand what drives these premiums, but our expectation is that they will be positive over time.

On the following page are the annual returns for the premiums we recognize when constructing client portfolios. The premiums are ranked from highest to lowest each year. Even though we expect positive premiums every year — just like we expect to roll a 7 when rolling two dice — premiums can be negative. In fact, just like we can have consecutive dice rolls without a 7, we can have consecutive years with negative premiums, as was the case in 2000, 2001 and 2002 for the Market premium.

15 Years of Return Premiums

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
HML 39.2%	SMB 23.8%	MOM 25.7%	MKT 30.8%	MKT 10.7%	MOM 15.0%	HML 14.4%	MOM 21.5%	TERM 23.9%	MKT 28.3%	MKT 17.4%	TERM 28.2%	MKT 16.3%	MKT 35.2%	TERM 23.9%
CMA 32.8%	RMW 20.0%	RMW 20.2%	SMB 25.9%	HML 10.2%	HML 9.2%	MKT 10.6%	TERM 5.0%	RMW 14.7%	CREDIT 19.4%	SMB 13.1%	RMW 11.2%	CMA 9.5%	SMB 8.4%	MKT 11.7%
RMW 23.3%	HML 18.3%	TERM 16.0%	CMA 17.3%	TERM 7.2%	TERM 4.7%	CMA 8.4%	RMW 1.9%	MOM 13.2%	SMB 7.6%	TERM 10.0%	MOM 7.2%	HML 8.0%	MOM 7.9%	MOM 1.4%
MOM 15.0%	CMA 12.0%	CMA 14.4%	HML 5.05%	SMB 7.2%	MKT 3.1%	CREDIT 2.0%	MKT 1.0%	CMA 4.1%	RMW -0.7%	CMA 9.8%	MKT 0.4%	CREDIT 6.8%	CREDIT 4.6%	RMW -0.4%
TERM 14.8%	CREDIT 6.4%	HML 10.5%	CREDIT 3.5%	RMW 6.5%	RMW 1.1%	RMW 1.4%	CREDIT -6.9%	SMB 3.5%	CMA -3.0%	MOM 5.7%	CMA -1.4%	TERM 3.3%	CMA 1.1%	CMA -1.9%
SMB 3.7%	MOM 4.3%	SMB 5.2%	TERM 0.4%	CREDIT 0.2%	SMB -1.0%	SMB 1.4%	CMA -7.9%	HML 0.9%	HML -5.6%	CREDIT 1.5%	SMB -5.8%	MOM 1.6%	HML 0.0%	HML -3.2%
CREDIT -7.3%	TERM -0.1%	CREDIT -1.6%	RMW -18.6%	MOM -0.3%	CREDIT -1.9%	TERM -3.5%	SMB -8.5%	CREDIT -13.7%	TERM -15.0%	RMW -2.8%	HML -6.6%	SMB 0.6%	RMW -1.7%	CREDIT -5.5%
MKT -17.6%	MKT -15.2%	MKT -22.8%	MOM -24.5%	CMA -7.7%	CMA -5.0%	MOM -7.7%	HML -12.3%	MKT -38.3%	MOM -82.9%	HML -3.3%	CREDIT -8.6%	RMW -3.0%	TERM -11.4%	SMB -8.1%

CMA	Investment	HML	Value	MOM	Momentum	SMB	Size
CREDIT	Credit	MKT	Market	RMW	Profitability	TERM	Term

Source: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html and Morningstar Direct December 2015.

Past performance does not guarantee future results.

The premiums undulate from year to year and no premium is consistently ranked at the top or bottom of the chart. This is why it is wise to be invested in many different premiums, since when one is underperforming, another will be near the top. And because there is no way to accurately and consistently pick the winners and losers each year, it's important to stay the course, especially in challenging times.

What we learn about investing from rolling dice: Even though outcomes are likely and expected, they don't always happen. Regardless, we don't abandon our strategy.