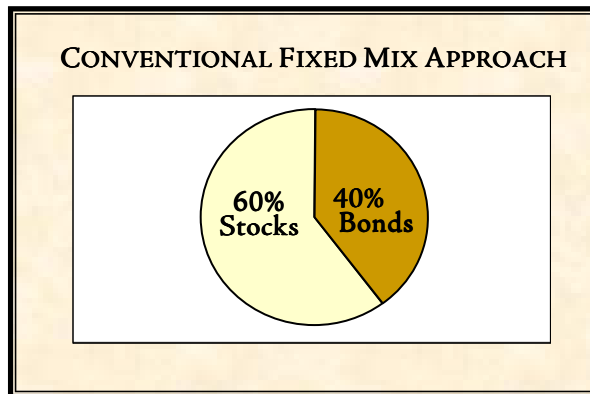


Target return investing is surprisingly simple and yet profoundly different from the more conventional approach to portfolio management. The two approaches offer important and complementary potential benefits to the investor. Conventional portfolio management strategies tend to focus on "wants" – getting the most return we can from the markets, subject to an acceptable level of risk. Most investment counselors adopt this approach. In contrast, target return investing focuses on "needs" – achieving a specified level of return that meets our future consumption requirements. In order to understand the differences between the two strategies, we can use the concept of the cruise control.

First let's review the conventional approach. This approach to portfolio management is to adopt a fixed, or approximately fixed, percentage allocation across two or more asset classes, the simplest case being the 60% stocks, 40% bonds mix in the chart above. Expected returns of asset classes vary through time and, therefore, a fixed-allocation portfolio will, by definition, also have a variable expected return through time. Assuming that actual realized returns roughly equal expected returns over time – a reasonable assumption – then a fixed-allocation portfolio should not be expected to achieve any particular absolute level of return.



The variable expected returns of a fixed-allocation portfolio will, in fact, lead to highly variable actual returns, even over lengthy timeframes. You can think of this as similar to the way a "lead foot" driver will vary speeds, speeding up going downhill and slowing down going uphill, as shown in Figure 1.

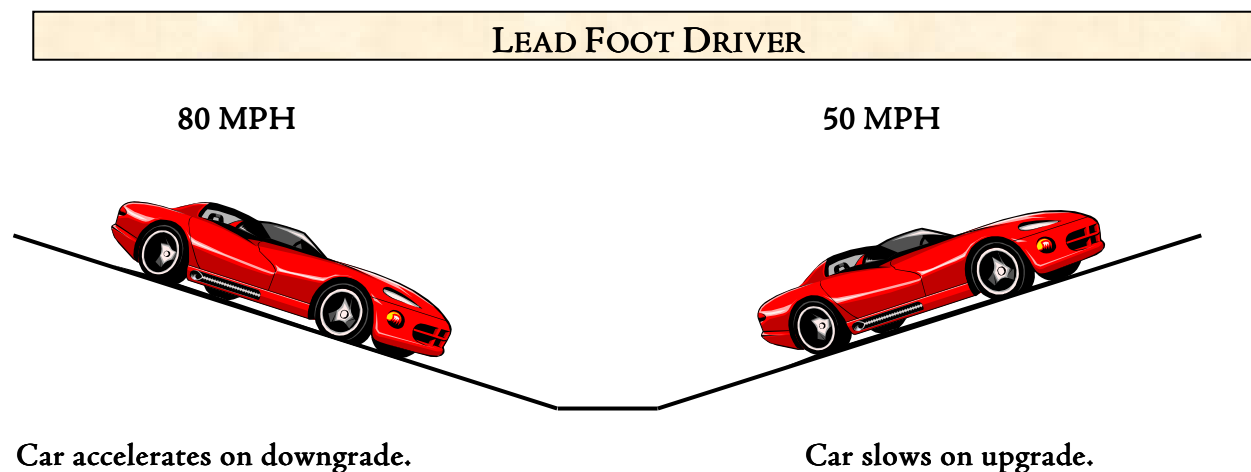


FIGURE 1

In contrast, investing for an absolute target return such as 7% is very different from the conventional target allocation approach to portfolio management. This strategy recognizes the reality that expected returns of individual asset classes are ever-changing through time. Therefore, it is necessary to make periodic adjustments in asset allocation in order to keep the portfolio's estimated expected return constant and equal to the selected long-term absolute target return. In the same way, cruise control varies the amount of gas to keep the car at a constant speed (see Figure 2

below), target return investing changes the portfolio mix periodically in response to changing expected returns on individual asset classes to keep the portfolio's estimated expected return constant over time.

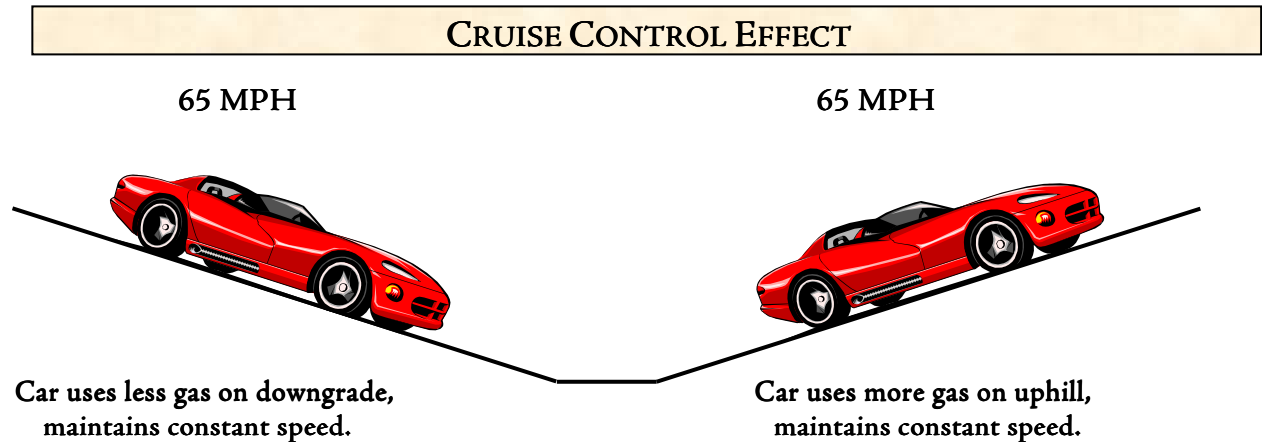


FIGURE 2

One should not expect the short-term returns arising from this process necessarily to be close to the long-term target. However, over time, short-term returns should be roughly evenly divided between periods of outperformance and underperformance relative to the target. Thus, as the time commitment to the strategy extends, we can expect the average realized annual return to converge toward the target return. This idea is illustrated below in Figure 3.

CONVERGENCE TOWARD TARGET OVER TIME

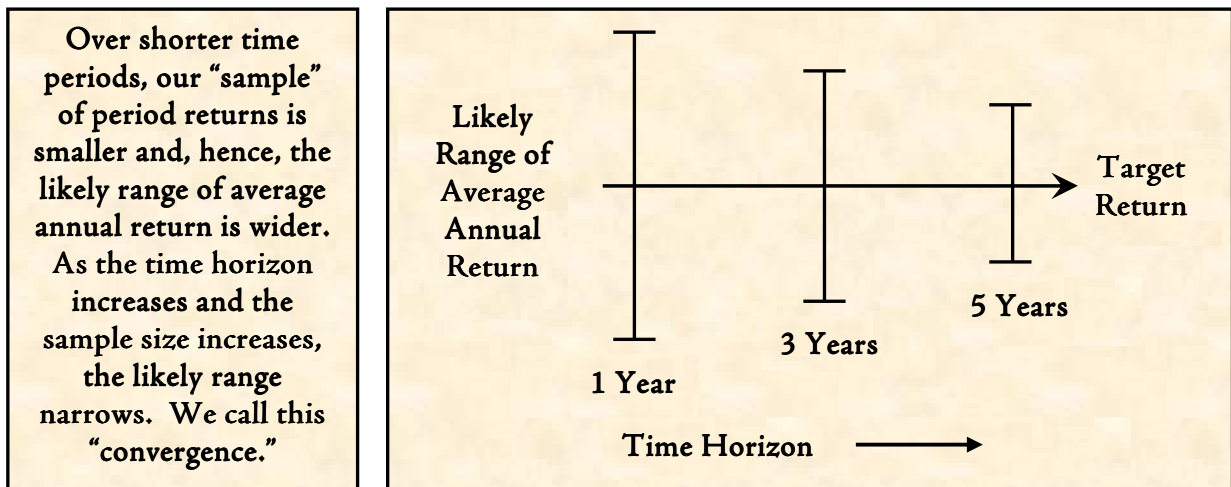


FIGURE 3

In summary, the target return strategy seeks to deliver a rate of return that will be acceptably close to a pre-specified target return, over a reasonable and relevant timeframe (e.g., 5 years), with reliability.

In other words, the target return approach seeks to deliver the reliability of absolute return that the more conventional fixed-allocation portfolio should not be expected to accomplish. Conversely, the target return strategy does not attempt to capture the supercharged returns of equities in a bull market or deliver any particular level of relative return, as might be expected of the conventional fixed-allocation approach.

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